

Cabinet Secretariat Reference	
Submission No.	BERC 161
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Submission to: Budget Expenditure Review Committee

Submission Title: East West Link – Public Sector Comparator

Portfolio/s: Roads, Public Transport

SUBMISSION PROPOSAL

Recommendation:

That the Budget and Expenditure Review Committee (**BERC**):

1. **Note** the Public Sector Comparator (**PSC**) for the Public Private Partnership (**PPP**) component of the East West Link Stage One (**Project**).
2. **Note** the PSC (plus State costs and risks) is able to be delivered within the existing approved budget for East West Link Stage One.
3. **Note** that the PSC will be presented to BERC for final approval together with the detailed payment mechanism and abatement regime in November 2013.

Objectives:

1. To note the PSC for the Project prior to release of the East West Link Stage One Request for Proposal (**RFP**).
2. To update the Committee on the budget impacts for the Project.

Key Issues:

Background

1. Details of the PSC will be tabled at the BERC meeting, including a detailed PSC report and an overview presentation. The presentation will include a reconciliation against the project budget. A redacted version of the presentation is attached (**Attachment 1**).
2. The PSC for the Project has been prepared consistent with Infrastructure Australia's National PPP Guidelines (Volume 4: Public Sector Comparator Guidance) and comprises four elements:
 - a. Raw PSC – including forecasts for all capital and operating costs associated with designing, constructing, operating and maintaining the Project and delivering the services over the same period as the term specified in the RFP Documentation and to the performance parameters required under the Outline Scope and Requirements (**OSR**).
 - b. Competitive neutrality – adjustments to remove any net competitive

advantages or disadvantages that accrue to government by virtue of its public ownership.

- c. Transferable risk – the value of risks expected to be transferred to the private sector.
 - d. Retained risk – the value of risks expected to be retained by the State.
3. Each of the above components (and the overall PSC) is expressed in terms of the Net Present Cost (**NPC**) of projected risk adjusted whole of life cash flows based on the risk free discount rate (determined in accordance with Infrastructure Australia's National PPP Guidelines) over the proposed term of the PPP arrangement for the Project.
 4. The PSC is required to be presented as a single point estimate (with risk adjustments expressed in terms of a range around that estimate).
 5. The PSC is based on the Reference Design prepared for the Comprehensive Impact Statement (**CIS**) (as part of the planning and approvals process which is currently being conducted under the *Major Transport Projects Facilitation Act*). This Reference Design includes the reference design enhancements which were submitted to the Major and State Significant Projects Committee (**MSSPC**) on 26 September 2013 and subsequently approved by the Minister for Roads, the Acting Treasurer and the Premier. The CIS will be placed on public exhibition from 31 October 2013.

Process for developing the PSC

6. The PSC is substantially based on the comprehensive and detailed cost and risk estimating work completed to March 2013 as part of the development of the East West Link Business Case (**EWL Business Case**).
7. It has subsequently been adjusted to:
 - a. Exclude items included in the EWL Business Case financial analysis which are not relevant to the PSC (as they relate to elements of the East West Link Stage One which are being developed and procured separately to the PPP to which the PSC relates).
 - b. Make a limited number of updates to the EWL Business Case analysis for changes in project scope and risk which have occurred in the last 5 months.

Overview of EWL Business Case cost and risk analysis

8. Given the significance of the East West Link Stage One, the financial analysis completed as part of the EWL Business Case included a rigorous process for the initial development of risk adjusted cost estimates supported by a comprehensive range of independent peer reviews. Those relevant to the PSC included:
 - a. Appointment of a construction contractor (the John Holland Leighton Dragados Joint Venture (**JHLD-JV**)) to develop a risk adjusted design and construct cost estimate (on a fixed price, fixed time, turnkey contract price basis). This effectively estimated the price that a design and construct contractor would bid to deliver the project (and hence addressed transferred risks under a PSC). The JHLD-JV also provided risk adjusted cost estimates for operating, maintenance and lifecycle costs.

- i. The use of a construction contractor to prepare the underlying risk adjusted cost estimates represented a more rigorous approach than that typically adopted for the purposes of developing a PSC, which usually involves appointing a quantity surveyor for this role.
 - ii. As the JHLD-JV estimate reflected the price which a construction contractor would charge as a design and construct contractor in a PPP setting (with effectively no opportunity for claims and other variations during the delivery phase) it provided a much more fulsome risk adjusted cost estimate than would typically be developed for either business case or PSC purposes.
 - b. Completion of the usual risk identification and quantification workshop process to identify all project risks and quantify those which had not been priced by JHLD-JV in their underlying estimate.
 - c. Completion of an extensive peer review process, including the following:
 - i. Department of Treasury and Finance (**DTF**) appointed APP to independently peer review the risk adjusted cost estimates prepared by JHLD-JV. APP noted the JHLD-JV estimate was ‘conservative’.
 - ii. LMA subsequently appointed Aquenta to prepare an independent, fully risk adjusted cost estimate. As quantity surveyors their approach reflected the approach more commonly adopted in preparing the PSC for a social infrastructure project. This estimate was the lowest of all estimates, being 30% lower than JHLD-JV’s estimates.
 - iii. APP completed a final peer review of the risk adjusted JHLD-JV and Aquenta estimates and developed an approximate \$500 million range for risk adjusted design and construct (and operating and maintenance) costs. The low end of this range represented an estimate which was expressed as being consistent with a competitive market for the project. The upper end of this range represented a more conservative estimate (which was still less than the JHLD-JV estimate).
 - d. Subsequent agreement with DTF regarding the risk adjusted cost estimates to be included in the EWL Business Case. This sat within the APP range for risk adjusted costs.
9. The EWL Business Case was submitted to BERC on 2 April 2013 and subsequently approved by BERC on 8 April 2013.
10. The total project cost identified in the EWL Business Case approved by BERC was \$6,843 million (nominal) and this included \$200m for various transport and urban renewal initiatives. At the same time, BERC approved a further \$200 million (nominal) for Eastern Freeway upgrades, bringing the total funding approval for the EWL Stage One to \$7,043 million (nominal).
11. In September 2013, an Updated EWL Business Case (as at June 2013) was submitted to MSSPC for noting. This document retained the same risk adjusted cost estimates for financial and budget analysis purposes, but presented the economic appraisal of the project based on the low end of the APP range (i.e. the ‘competitive market estimate’).

Adjustments to exclude items from EWL Business Case financial analysis not relevant to the PSC

12. The EWL Business Case financial analysis focussed on assessing the 'funding gap' between the EWL Stage One whole of life, risk adjusted project costs and toll revenues.
13. As such, it included project scope elements which are outside the scope of the PPP Project to which the PSC relates. In order to provide a like for like comparison with PPP bids, the following items have been excluded from the costings for the PSC:
 - a. forecast toll revenues
 - b. toll collection costs (to be separately procured)
 - c. Hoddle Street Interchange works costs (currently expected to be separately procured)
 - d. public transport upgrade costs (being separately developed and subsequently procured)
 - e. Eastern Freeway upgrade costs (being separately developed and subsequently procured)
 - f. Other State costs (such as land acquisition, independent reviewer costs, contract management and the like)
 - g. Categorisation of the total risk adjustments included in the EWL Business Case into transferred and retained risk adjustments in the PSC.
14. Note, where these are costs, they remain relevant to the reconciliation between the PSC and the approved EWL Stage One budget.
15. The PSC is required to reflect the proposed term of the PPP arrangement (which under the RFP includes a 25 year operating term). The EWL Business Case also analysed the project over a 40 year operating term.

Updates for changes in project scope and risk over the last 5 months

16. The PSC then includes a limited number of updates for post EWL Business Case changes:
 - a. Adoption of the 'APP competitive market estimate' (being the low end of the cost range identified by APP) as the basis of the risk adjusted design and construct cost estimates for the PSC. This estimate has been adopted in response to the prevailing conditions in the Victorian construction market and the very strong competitive field evidenced by the PPP Project's Expressions of Interest process. It will also provide a more rigorous value for money benchmark for PPP Proposals (as it is now closer to the level of risk adjusted design and construct costs which have consistently been indicated via informal market feedback).
 - b. The inclusion of additional risk allowances for scope uncertainty and potential additional land acquisition costs (given the CIS process will not be completed until June/July 2014, and discussions with Transurban regarding the Project's CityLink connection are not finalised: either of which may result in further scope changes).
 - c. Inclusion of the cost of a number of Reference Design enhancements (relative to the design which existed at the time of preparation of the EWL Business

Case) which were submitted to MSSPC and subsequently approved by the Minister for Roads, the Acting Treasurer and the Premier in October 2013.

- d. Adoption of the 'APP high' estimate for operating, maintenance and lifecycle costs.
 - e. Inclusion (as a 'below the line' State cost) of the allowance for land acquisition and compensation costs for the Evo apartment building and adjacent properties which was approved by MSSPC in August 2013 (but not budget funded at the time).
17. The combined effect of these changes is that the PSC and 'below the line' State costs and risks are able to be delivered within the existing approved budget for EWL Stage One.

Revised role of the PSC

18. For the Project, the PSC will be used as a benchmark rather than its previous 'pass / fail' function. There is no longer an assumption that the State will revert to traditional design and construct delivery if PSC cost expectations are not met.
19. The fully risk-adjusted PSC will not be disclosed to shortlisted respondents, although a number of detailed costing reports and information that were inputs to the EWL Business Case, and have informed the development of the PSC, will be made available to shortlisted respondents.
20. There are concerns that disclosure of the PSC may undermine competitive tension in the tender process. This issue will be actively monitored throughout the interactive tender process.

Priced options in the RFP

21. In the RFP, Shortlisted Respondents are requested to separately price the following works:
- a. Delivery of the southbound Port Connection stub over CityLink, terminating south of Mt Alexander Rd (as a potential reduction in Project scope);
 - b. Delivery of the longer southbound Port Connection stub, terminating at Racecourse Rd (as a potential addition to Project scope);
 - c. Delivery of an additional northbound lane on CityLink, from Racecourse Rd through to Moreland Rd (and additional ramp metering locations); and
 - d. Delivery and maintenance of a communication sub-system for the sole use of VicTrack.
22. The last two options have not yet been costed. If adopted, the CityLink works will be funded via Project Zebra and the VicTrack works will be funded by VicTrack (i.e. they will not be funded via the EWL Stage One budget).
23. The first two options have been included as a result of the approval of the Reference Design enhancements referred to above and are estimated to cost \$48 million (nominal) and \$43 million (nominal) respectively.
24. The first option represents an element of Project scope which may be available as a potential scope reduction in the event that PPP proposals do not deliver savings

relative to the PSC.

Accounting treatment

25. LMA's commercial and financial adviser, PwC has reviewed the key terms of the RFP and has confirmed there is no change to the accounting treatment advice for the Project which was provided as part of the EWL Business Case.
26. The accounting treatment for the PPP will include:
 - a. Treatment of the PPP as a finance lease, with recognition of the finance lease asset and finance lease liability when the road opens (currently expected in 2018/19). The finance lease liability will be recognised as a note to the accounts from financial close to completion (from 2014/15 to 2018/19).
 - b. Drawdown of the State contribution during the design and construct period will be recognised as a reduction in cash holdings or increase in borrowings (depending on how it is funded) and a prepayment of the finance lease. This will be applied as a reduction in the finance lease liability as soon as the finance lease liability is recognised (i.e. on opening).

Budget impacts

27. Budget impacts for PSC delivery will be tabled at the BERC meeting (as part of the PSC).
28. Budget impacts for PPP delivery (based on the underlying risk adjusted cost estimates for the PSC, combined with estimates of the adjustments required to determine the value of the finance lease liability under PPP delivery and details of the State contribution payable during the design and construct phase) will be presented in a separate submission from DTF.

Risks:

1. The timeframes associated with the procurement process are very tight. Any delay in noting the PSC and approving it in November introduces an additional risk to contract close and meeting the State's preferred procurement timelines for the Project.

Support/Criticism:

1. The East West Link Project has received both support and criticism from stakeholders, particularly in relation to the potential for direct access to the central city, potential surface impacts and investment opportunities in alternate priority projects.
2. The new Commonwealth Government has indicated its public support for the Project.

Terry Mulder MP
Minister for Roads
Minister for Public Transport

Date:

FUNDING

Financial Implication Tables

DTF and the Department have agreed the financial implications and costings in this submission:

Yes No

IMPACT ASSESSMENTS

Social Impacts:

1. Enhanced transport networks, for both private vehicles and public transport, will facilitate improved mobility and access for all.
2. Potential negative impacts from construction activity, changed traffic conditions and changed urban form and will be considered and mitigated as part of the project.

Family Impacts:

1. The Project will create benefits for families through improved access to jobs and services.
2. The project will impact families whose properties are required for acquisition. Impacts are mitigated under the terms of the Land Acquisition and Compensation Act (1986).

Regional and Rural Victorian Impacts:

1. The Project will provide more transport options and improved access to the Port of Melbourne in support of rural and regional economies.

Economic Impacts:

1. Enhancing the transport network will assist supply chain efficiency, business to business interaction and improve the competitiveness of the Victorian economy.
2. Improved freight network capacity and efficiency will contribute to State productivity..
3. Significant construction activity will support the Victorian economy during project delivery.

Regulatory burden, offsetting reductions and evaluation strategy:

Does the submission propose an increase in regulatory burden on the business or not-for-profit sectors that is likely to be 'material' as defined in the Victorian Regulatory Change Measurement (RCM) Manual?

Yes No

Environmental Impacts:

1. The Project will achieve a number of outcomes, such as smoother traffic flow, improved access to employment and housing and more efficient public transport that will create a positive environmental outcome.
2. The project will be developed in a manner that seeks to minimise any potential negative environmental impacts of construction, operation and traffic use.

Charter of Human Rights and Responsibilities Act 2006 Impacts:

1. The process will be managed to take account of relevant obligations and ensure that any recommendations to government are consistent with relevant responsibilities.