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Budgeting & Accounting for PPP's

Danny Graham

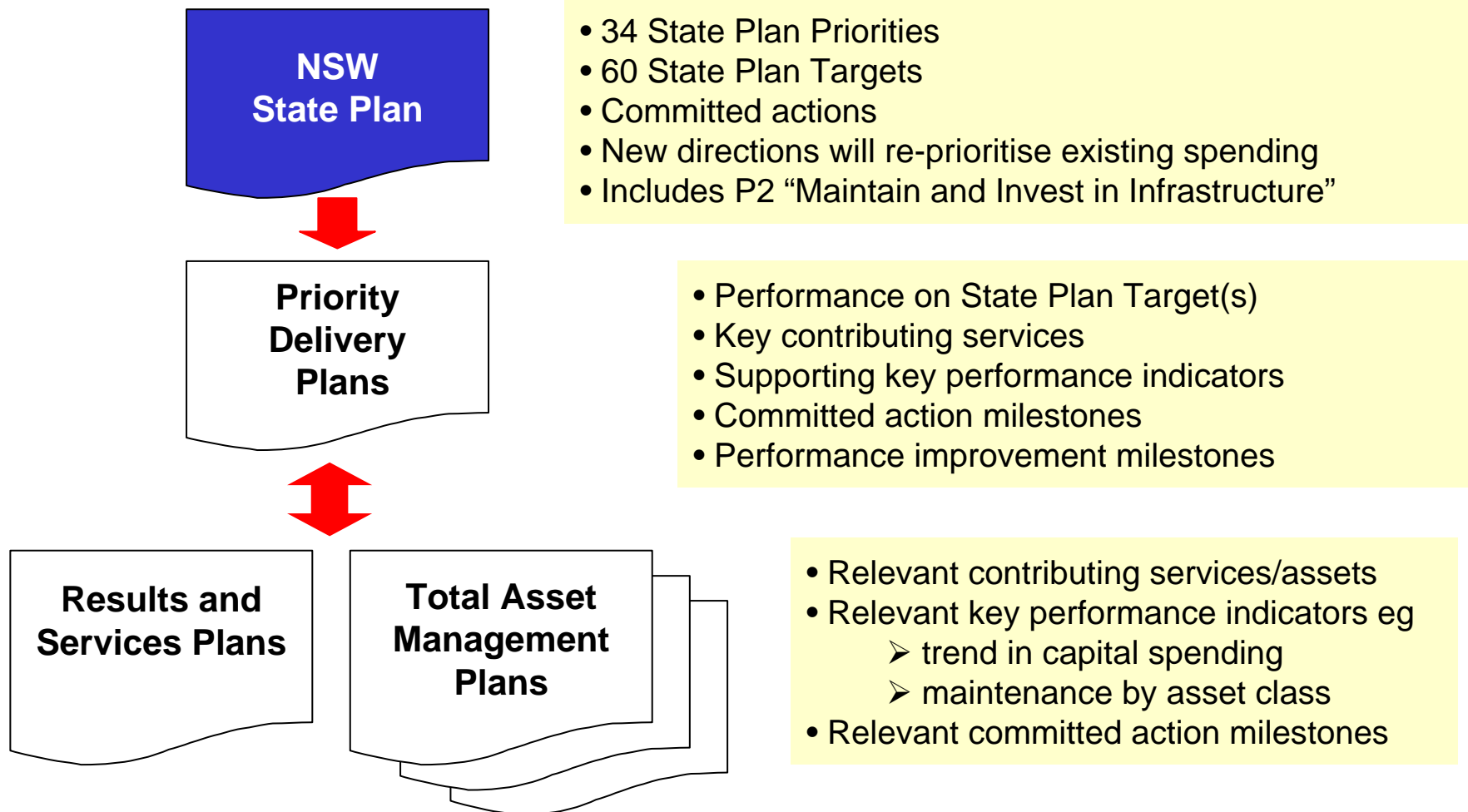
Director Private Projects NSW Treasury

- Government's Fiscal Strategy & Capital program
- PPP Policy Principles
- Economic and Social Infrastructure projects
- Private Financing and NSW's Fiscal Strategy
- Characteristics between procurement options
- Budget Rule for PPP's
- Accounting Treatment and Budget Impact of PPP's

NSW Fiscal Strategy & Capital Program

- The aim is to provide approved and affordable services to the public.
- State Plan indicates service priorities.
- Capital requirements should be determined by Results & Services Plan/ Statement of Business Intent.
- Capital requirements are not driven by the method of procurement.

Line of Sight – Priority Delivery Plans, RSPs and TAM plans



Procurement Framework/Context



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**RESULTS AND
SERVICES PLAN**



“This is what we want to achieve.”



**TOTAL ASSET
MANAGEMENT PLANS**



**“This is how we are going to manage
our assets to support what we want to
achieve.”**



**BUSINESS CASES
AND OTHER
PROJECT
DOCUMENTATION**



**“These are the projects that we need
in order to implement our asset
strategies.”**

Investment vs Financing Decision



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Government's budgeting process maintains the distinction between:

- Decision to ***invest*** (is the project worth pursuing?)
 - ❑ Cost benefit analysis/Business Case
 - ❑ Prioritisation
- Method of ***financing*** (procurement decision)
 - ❑ Value for money
 - ❑ Public interest

PPP Policy Principles



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- “Value for Money” is the objective
 - Public Sector Comparator: the “value-for-money” test
 - Departments retain efficiency gains
- Risk transfer
- PPP is a procurement option – **not** an off-balance sheet financing arrangement



Objectives from major PPP transactions

- **Obtain best value-for-money**
- Minimise transaction costs for both sides
- Minimise legal risk
- Accountability
- Contain scope
- Manage the “politics”
 - Inter-agency issues
 - Ministerial expectations
 - Other stakeholders (media, special interest groups, unions etc.)

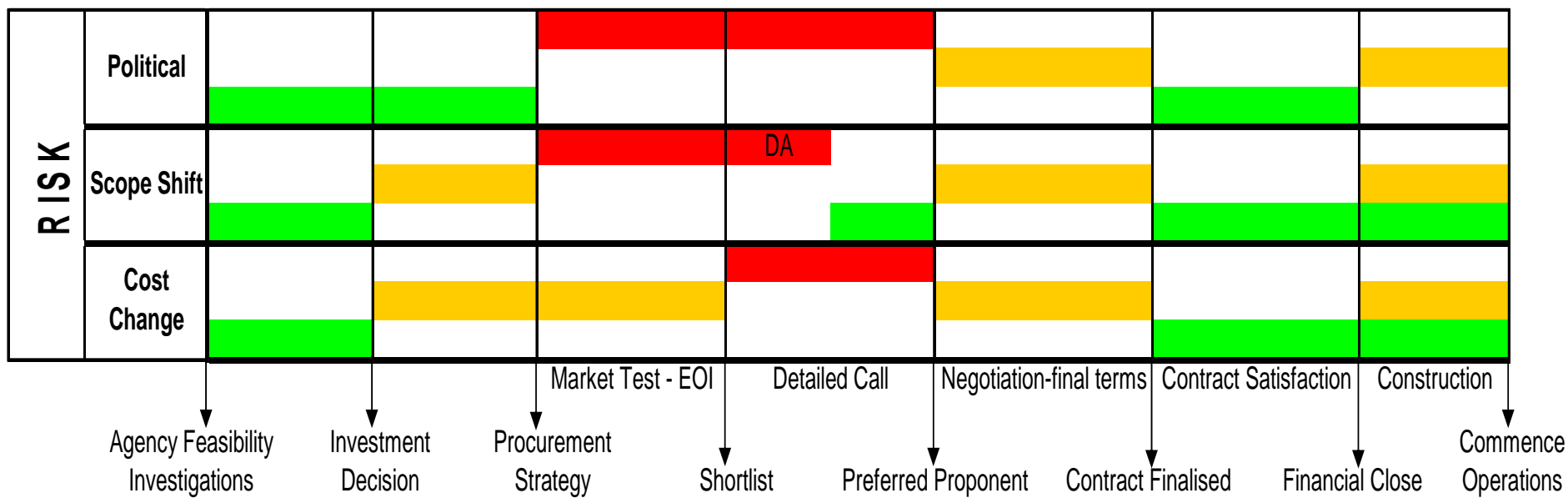


What is value-for-money?

- Getting the best possible outcome at the lowest possible price
- ➔ Importance of **competitive tension** can't be understated
- For privately financed projects:
 - Separation of investment decision from procurement and financing decision
 - Tested via a Public Sector Comparator



Project Delivery – Process and Key Risks



High
Medium
Low

DA - Development Approval

Scope of PPP Policy



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- Both General Government and Government Trading Enterprise (PTE) sectors
- PPP's defined in Working With Government (WWG)
 - Service normally provided to the public by Government
 - Service requires an asset involving private sector financing
 - Contribution by Government and/or any upfront payments
- Joint Financing Arrangement (Public Authorities Financial Arrangements Act 1987 "PAFA")
 - Treasurer's approval required
 - Private sector constructs assets and uses them for the exercise of a function of an authority

Economic vs. Social Infrastructure



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“Economic” Infrastructure	“Social” Infrastructure
Most (if not all) revenues from third parties – subject of market-based resource allocation.	Usually paid for out of tax revenue – subject of Government resource allocation decisions.
Infrastructure provider faces genuine “market risk”.	No “market risk” to provider of infrastructure – payment streams usually subject to long-term contract or budget allocation.
Traditionally delivered through a Government Business Enterprise or State-owned Corporation.	Traditionally delivered through a General Government agency.
Revenue risks are a key driver of (financial) outcomes.	Cost risks are a key driver of (financial) outcomes.

- Due to the different characteristics Economic and Social Infrastructure projects have different budget impacts
 - For Economic Infrastructure projects, where market and price risk is fully transferred (with confidence), can create the ability to expand the capital works and bring projects forward
- Whereas, with Social Infrastructure Projects:
 - Government ultimately funds through on-going payments; and
 - PPPs do have a budget impact

When things go wrong



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- For economic infrastructure projects:
 - Concession holder faces full market risk;
 - If revenue is not meeting costs, then the banks hold first right over the asset and step-in rights;
 - Equity holders lose their Investment;
 - Banks can choose to continue operations or on-sell the concession right to another investor (eg Cross City Tunnel)
- Importantly, the contract requires the service to continue being provided to the public

When things go wrong



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- For social infrastructure projects:
 - Government retains the right to step-in and deliver the public services without taking over the liability obligations

PPP Accounting Policy – Accepted Australia Wide



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- The Australian Governments Heads Of Treasury (HOTs) forum has adopted a consistent financial reporting framework for PPPs
- We have adopted a standard based on the principles of the UK PPP accounting Standard FRS 5 in determining the owner of the asset
- This has been adopted and applies to both social and economic infrastructure projects

PPP “Budget Rule”



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- For Social Infrastructure Projects:
 - “PFPs must undergo standard investment appraisals and be approved and funded for conventional procurement before a decision is taken to pursue PFP procurement on value for money grounds.”
- For Economic Infrastructure Projects:
 - Projects must undergo standard investment appraisals

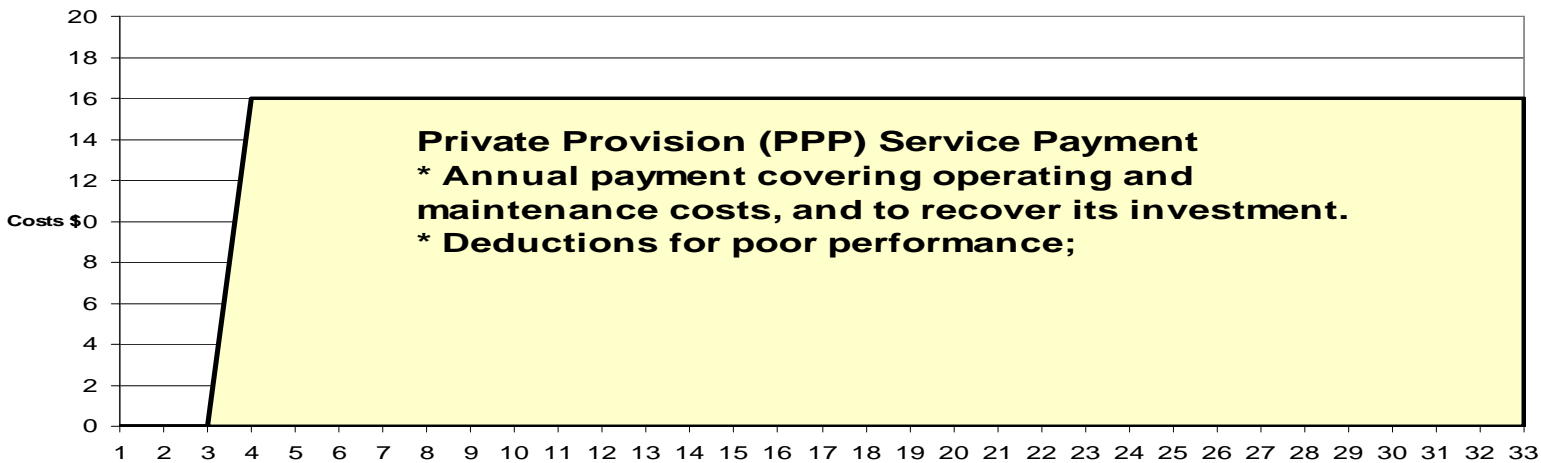
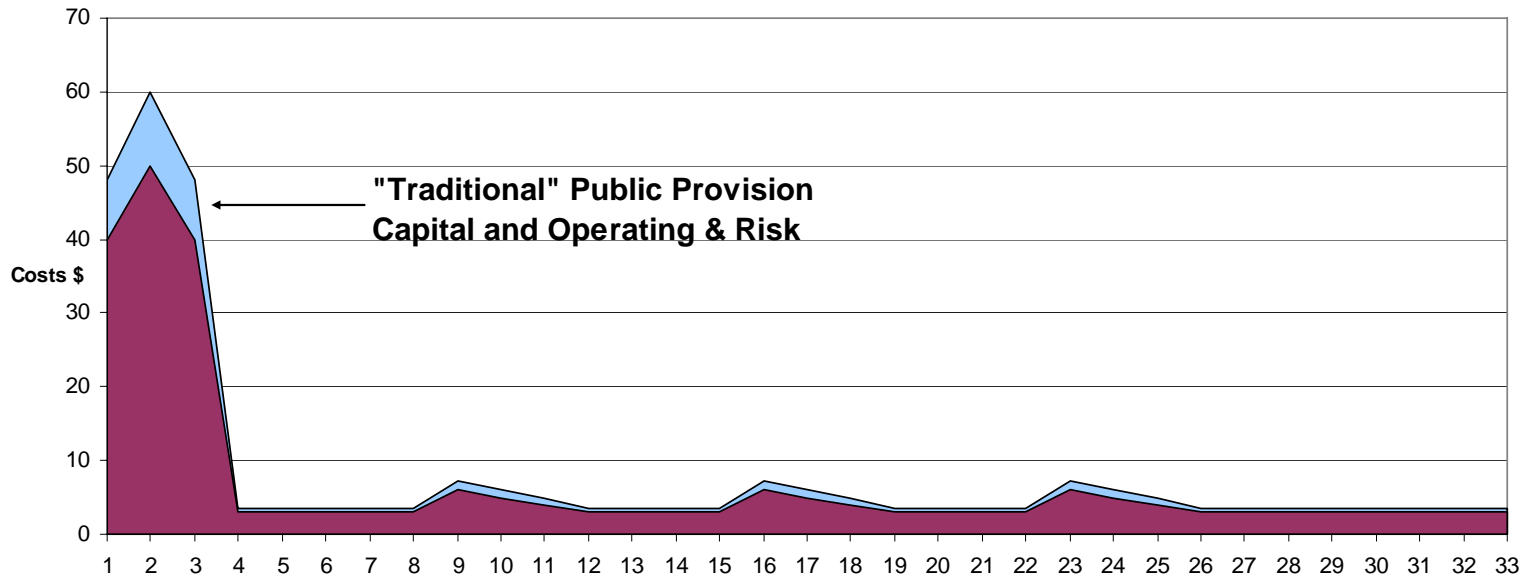
Implementation of Budget Rule



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1. **Commencement of PPP procurement** - included in Asset Acquisition Program (Infrastructure Statement) based on conventional procurement.
2. **During procurement** - funding approval required for scope changes or escalation changes.
3. **End of the procurement** - Funding removed for conventional capital project. Funding provided for financing component of the PPP annual service charge. Agencies receive any capital savings, after allowing for procurement costs.
4. **After procurement** - PPP Budget Rule will continue to be applied to the project for budget decision-making purposes.

Traditional Procurement vs. Social PPP



Impacts of Procurement Options



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Transaction	Government Operating Statement	Balance Sheet	PPP Budget Rule
Traditional (budget funded expenditure)	Capital expense Operating expense	Increase in assets	Not Applicable
Economic Infrastructure (eg: toll roads)	Income from profit sharing arrangement	Right to receive asset at end of term acknowledged by a progressive increase in assets.	Not Applicable
Social Infrastructure (Finance Lease)	Repayment of borrowings, split into an interest and principal component	Asset and liability from commissioning. Principal reduces liability	Debt obligation assumed by Treasury
Social Infrastructure (Operating Lease)	Annual lease funded from recurrent allocation	Lease expenditure. No asset or liability.	As per conventional procurement

Budget impact of different procurement options for a social infrastructure project

- Procurement of a \$100M schools package (An example)
 - Assuming a construction profile of \$20M, \$50M, and \$30M over the first 3 years;
 - Recurrent annual maintenance expenditure of \$5M; and
 - PPP Finance option amortised over 10 years
- The impact on the State's balance sheet under different procurement options can be shown as:

Social Infrastructure Example (Net Lending Result)



CONVENTIONAL	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6	Yr 7	Yr 8	Yr 9	Yr 10
<i>Balance Sheet</i>										
Asset @ 30 June	20.00	70.00	100.00							
<i>Operating Statement</i>										
Capex	20.00	50.00	30.00							
Operating expenditure				5.00	5.00	5.00	5.00	5.00	8.00	5.00
Notional Loan repayment	1.10	3.85	5.50	17.60	17.60	17.60	17.60	17.60	17.60	16.68
TOTAL	1.10	3.85	5.50	22.60	22.60	22.60	22.60	22.60	25.60	21.68
NPV	119.86									
FINANCE LEASE										
<i>Balance Sheet</i>										
Finance lease asset @ 1 July				100.00						
Finance lease liability @ 1 July				-100.00						
Finance lease liability @ 30 June				-88.27	-75.77	-62.46	-48.29	-33.20	-17.12	-0.00
<i>Operating Statement</i>										
Operating expenditure	0.00	0.00	0.00	5.00	5.00	5.00	5.00	5.00	8.00	5.00
Interest payment	0.00	0.00	0.00	6.50	5.74	4.93	4.06	3.14	2.16	1.11
Principal payment	0.00	0.00	0.00	11.73	12.50	13.31	14.17	15.09	16.08	17.12
TOTAL	0.00	0.00	0.00	23.23	23.23	23.23	23.23	23.23	23.23	23.23
NPV	107.19									

Benefits of PPPs



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- Integration of design, construction, operation, and maintenance through whole-of-life costing
- Efficient transfer of risks to private sector
- More efficient use of infrastructure

Benefits of PPPs in NSW



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	% Whole of Life Savings vs PSC
Bathurst, Orange & Associated Health Services PPP Project	11.7%
Bonnyrigg Living Communities Project (Social Housing PPP)	6.3%
Replacement of RailCorp's Electric Passenger Rollingstock	29.9%
Long Bay Prison and Forensic Hospitals	0.4%
New Schools Project 2	24.6%
Newcastle Mater Hospital Redevelopment	2.1%
New Schools Project 1	7.3%
Cross City Tunnel	30%
Westlink M7 (Western Sydney Orbital)	23%
Lane Cove Tunnel	24.8%

- PPP transactions are about the delivery of services
- PPPs should not be driven by Off Balance Sheet motives but rather obtaining a Value for Money outcome
- Social Infrastructure PPP's should be approved and funded for as per conventional projects
- Social Infrastructure PPP's impact on a State's balance Sheet
- Government agencies need to appropriately fund the recurrent expenditure to avoid any affordability issues.