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The new world of value transfer PPP's

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Introduction

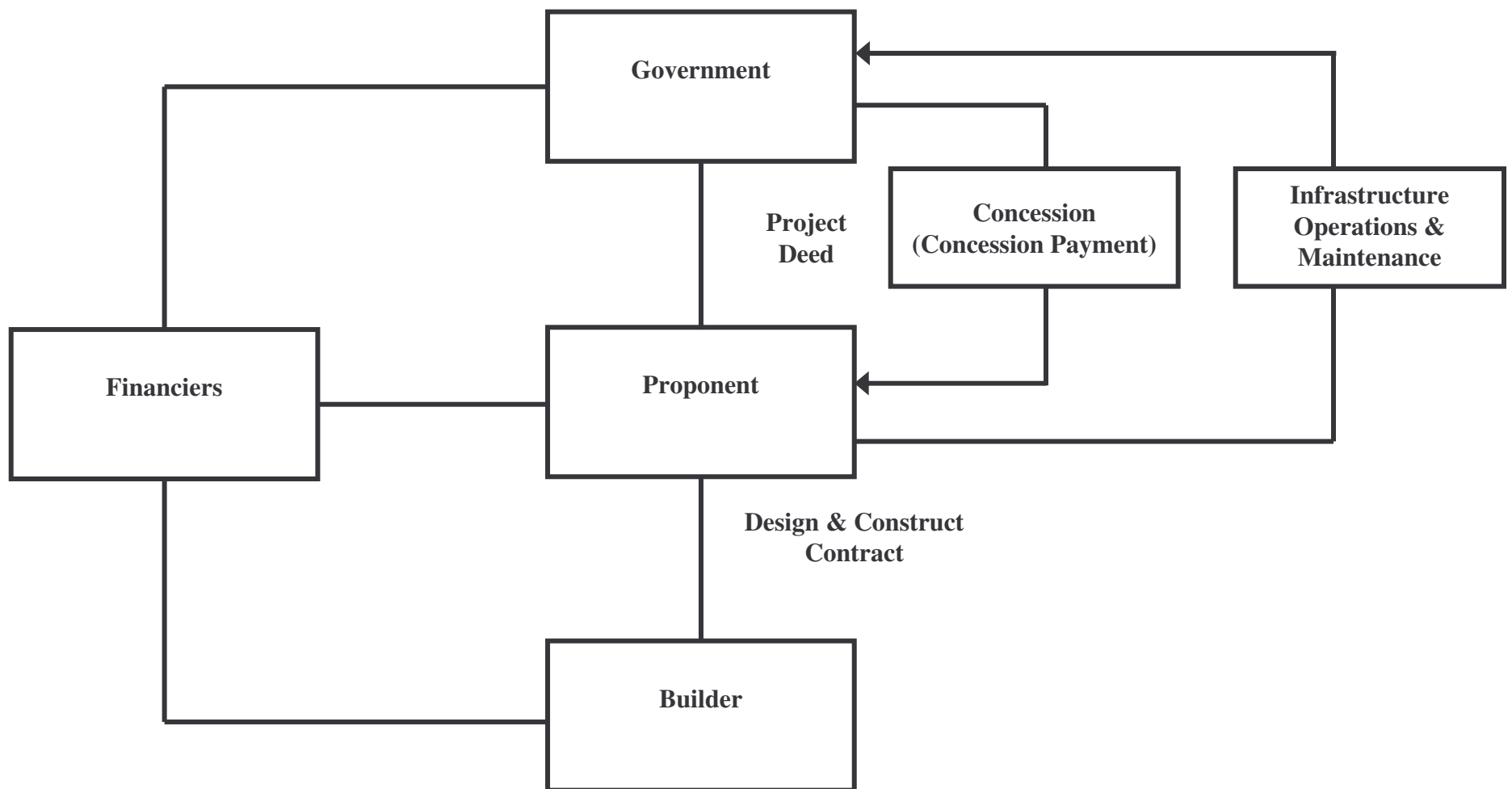
Introduction

- There has been a growth in recent years in large scale property developments in Australia which involve the provision of infrastructure:
 - Chatswood Transport Interchange
 - Spencer Street Station
 - Bonnyrigg Housing
 - Parramatta Legal Precinct
 - Civic Place
 - King Street Wharf

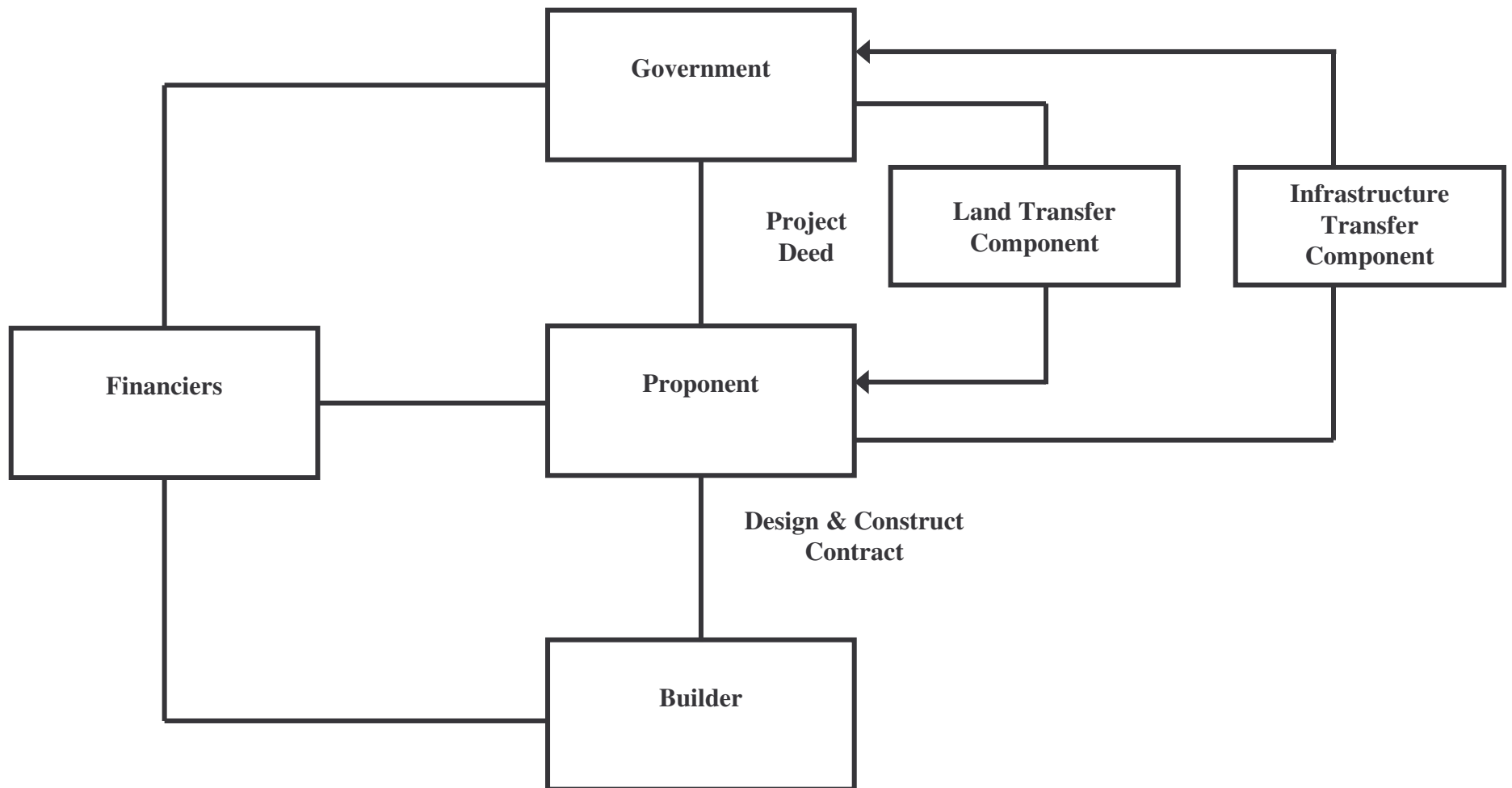
"PPP is a general term covering any contracted relationship between the public and private sectors to produce an asset or deliver a service."

The Working with Government, Guidelines for Privately Financed Projects. December 2006
(Working with Government Guidelines)

Traditional project structure



Value Transfer project structure



- These projects do not look like the textbook Public Private Partnership (PPP).
- There is no concession period or operations and maintenance component
- Yet they clearly involve a transfer of value between the Government and private sector.
- Value is transferred to the private sector through development opportunities and the conversion of brown fields into new residential or commercial buildings.

- The relationship between Government and private sectors in these projects is more tenuous than it is with social infrastructure as there is no clear payment of a concession fee by the Government and public infrastructure is often connected with private development.
 - **Transport interchange projects** – retail precincts are integrated with stations and bus interchanges
 - **Housing projects** – social and private housing stand side by side

Types of risks

Types of risk

- The following broad areas of risk usually arise:
 - Site risks
 - Design, construction and commissioning risks
 - Financial risks
 - Operating risks
 - Market risks
 - Network and interface risks
 - Industrial relations
 - Legislative and government risks
 - Force majeure
 - Stakeholder risks

Stakeholder risks

Stakeholder risks

- It is common for a project to involve consultation or concurrence with 5-10 different Government stakeholders
- Individual Government stakeholders may have little interest in expediting resolution of project issues
- Stakeholders consider these matters to be outside their "core business".

- Example - an energy provider may require:
 - A detailed design approval process in relation to a substation
 - submission of design material for approval
 - Insurance requirements
 - Commissioning requirements
 - Provision of bank guarantee security
- Result:
 - delays in construction or project delivery
 - increase in project costs

Latent condition risks

- The concept of latent conditions is now commonly differentiated into:
 - Contamination
 - Geotechnical
 - Services
- These risks are all very similar – all parties tend to underestimate the impact which latent conditions can have on a project

- Using contamination as an example:
 - The actual extent of site contamination will require investigation
 - The cost of disposal of contaminated material is higher than non-contaminated fill
 - The excavation and disposal of contaminated material takes longer than non-contaminated fill
- Value Transfer PPP's can make these issues more difficult to handle - why

- Adequate testing across the site may be difficult due to existing buildings and infrastructure
- Government owned brown field sites tend to be more contaminated
- Government PPP's involve lengthy and expensive market processes
- The “zero sum” nature of funding means delays are expensive

Mixing property and infrastructure

How much is the land worth?

- Property development projects are usually financed by third party financiers
- Accurate and reliable land valuations are essential to development financing
- Valuation is more difficult when projects involve infrastructure components

An example to demonstrate this.

Construction of a bus interchange near a major Sydney railway station

- 4 levels of public facilities, including:
 - bus parking facilities
 - facilities for passengers
 - a major connection to the railway station
 - Offices for State Transit Authority use

- 3 levels of retail shops
- a large residential tower
- a fixed completion date set by the Government
- a Government contribution - a fixed amount of \$15 million by way of progress payments

When the developer approaches the bank for finance the financier may take into account:

- the contribution by the Government, which will be seen as pseudo-equity;
- the valuation of the retail and residential components which may include:
 - a description of the retail and residential components as future airspace stratum parcels, which only have a value if Stage 1 is completed
 - the integration of the retail areas into the bus interchange areas

Is the project meant to happen?

- In a standard property development the project financier may incorporate a condition precedent whereby 60% of off-the-plan sales must be exchanged before funding commences
- But if the project involves infrastructure and the Government guarantees a contribution, the financier may not impose this requirement
- Is the underlying value tested in the traditional manner?

Differential impacts of delays

- When risks materialise the contractual arrangements may entitle the developer to an extension of time
- Delay costs may also be paid
- However, with infrastructure delivery and Value Transfer PPP's a new set of problems arise if the development is running late

- In the case of the earlier bus interchange project, if the Government determines there is a need for bus refuelling services mid-project the following ramifications could arise:
 - if there is a delay in the conduct of works, the builder will claim an extension of time
 - the developer may be able to claim a comparable extension of time from the Government
 - the Government pays for the cost of variation, together with an amount for preliminaries and margin

However:

The financier is repaid only when the sale of the retail areas and off-the-plan apartments are completed and the money collected.

The developer is exposed to additional interest costs due to the delay in completion of retail and off-the-plan apartments, when funding has been drawn down to its greatest amount.

Actual cost to the proponent of this variation is far greater than the construction cost alone.

Opportunities for Value Transfer

Opportunities include

- Transport corridor projects
- Social housing developments
- Hospitals
- Schools

Transport corridor projects

- Government traditionally leaves land around transport nodes for later/separate development
- Zoning and planning controls are not always linked to the transport project
- Disposal of land is usually conducted by the Government late in the project

Transport corridor projects

- Example – a major underground rail project
- Government acquires larger areas of land on the surface at proposed transport nodes
- Planning and development approvals are created at concept plan stage as part of the Project approval
- The land is “included in the deal”

Social housing

- Opportunities for retail and commercial development are often not included
- Zoning and planning controls
- Disposal of land

Social housing

- Social and private housing can be integrated – this is already being done
- Zoning and planning controls are not always linked to the transport project
- Disposal of land is usually conducted by the Government late in the project

Social housing

- Example – a major social housing project in a green field site
- Planning and development approvals are created at concept plan stage as part of the Project approval
- Concept plan includes pre-approval for retail centre, motel development and commercial precinct
- The land is “included in the deal”

Schools

- Example – a development of 10 schools in Sydney
- Demographics means that schools in “older” areas are no longer required
- As part of the PPP project, the consortium is given the right to brown field school sites
- The proceeds of redevelopment are available to the consortium, with a profit share to Government