PPPs and Traditional Delivery Compared

Traditional Infrastructure Delivery

In the traditional procurement approach, Government engages an engineer or architect to design a facility based on input requirements. Government then engages a contractor for construction. Often government will also separately procure specialised equipment, such as medical equipment for a hospital.

Unless government has a substantial operating surplus, it will need to borrow to meet the cost of designing, constructing and procuring equipment for the facility.

Following construction, government repays its borrowings over time, with interest, meets the cost of maintenance, and operates the facility. In some projects, operations and maintenance are outsourced to a contractor.

The following figure sets out the typical contractual relationships that exist when government uses traditional infrastructure delivery.

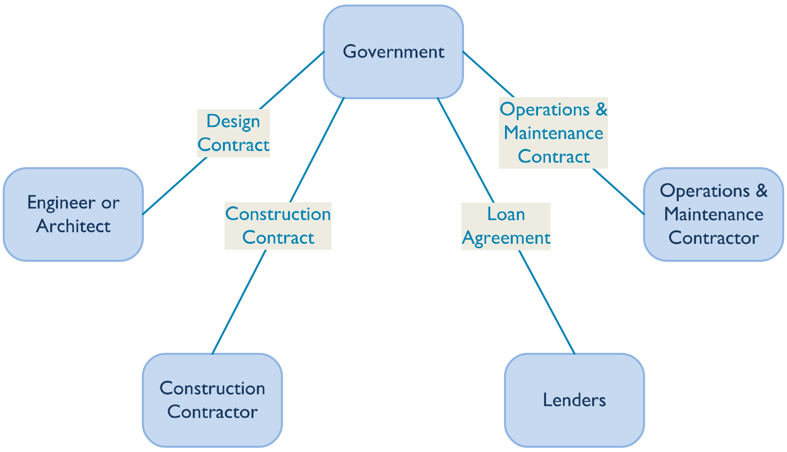


Figure 1: Traditional Delivery (Click figure to enlarge). Source: Foster Infrastructure.

PPP Delivery

Under a PPP approach, government engages one private sector party to design, build and operate the facility to deliver specified outputs and services. Payment is based on the services delivered once the facility is operational, and conditional on meeting key performance indicators that are specified in the contract.

In a PPP, it is the private party that raises the finance necessary to pay for design, construction and (in whole or part, depending upon the nature of the project) equipment procurement. However PPPs are not just about finance, the focus is on long-term delivery of services and a "fit for purpose" infrastructure solution.

A PPP does not necessarily require government to leave everything up to the private sector. In many PPPs, the private sector designs, builds, finances and maintains the infrastructure while the government uses the infrastructure to provide services to the public.

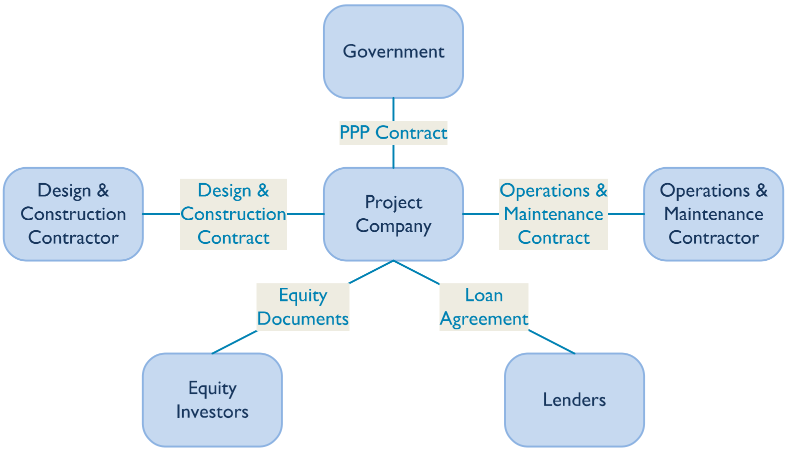


Figure 2: PPP Delivery (Click figure to enlarge).
Source: Foster Infrastructure.

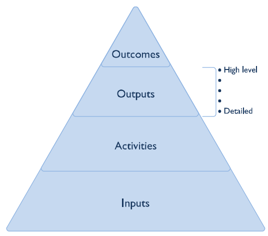
Of course, this form of delivery is not suitable for all projects. On average, only about 10% of infrastructure spending by Australian governments is through PPPs.

Use of Output Specifications in PPPs

The project specification is a key foundation upon which the project team can build performance indicators for the private sector.

Specifications can be viewed as a hierarchy. To deliver the project, a set of inputs are required (for example, labour and materials). These inputs are applied, through appropriate processes, to deliver a set of outputs. Delivery of the outputs is expected to result in achievement of a set of outcomes. It is the outcomes that are of most interest to government.

In traditional delivery, specifications are typically focussed on inputs.



The specification hierarchy. (Click to enlarge.) Source: *Foster Infrastructure*.

In a PPP, the specification typically focuses on a set of outputs. Specifying outputs transfers the risk in relation to inputs and processes to the private sector, and encourages innovation in these areas. In some cases, the outputs are expressed in high level terms. In other cases, the specification is detailed, but nevertheless remains output focused.

In some PPPs, the specification is focussed in part on outcomes, not outputs. However, in most projects, the outcomes are difficult to measure or are influenced by complex factors outside the control of the parties, and consequently it is generally not value for money to ask the private sector to take the risk of achievement of the outcomes.

Cash Flows for Government under different Delivery Methods

Traditional Delivery and PPPs require very different cash flows from government (or users).

In traditional delivery, government faces large up front costs for construction of infrastructure. It then has to meet ongoing maintenance costs, and periodic refurbishment or lifecycle costs.

In a PPP, government pays nothing up front.

In a "government pays" PPP, government then makes service payments over the operational term of the contract. The payments are reduced if the availability of the infrastructure or quality of services provided by the private sector does not meet the contractual KPIs.

In a PPP with user charges, the pattern is similar, with user charges (such as tolls on a toll road) replacing the service payments. The total revenue will generally increase from year to year, reflecting both the adjustment of the tolls in line with inflation, and the increasing usage of the infrastructure.