Using Relationship-based Procurement for the Provision of Infrastructure

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Abstract

The last two decades have seen the evolution of Relational Contracting methods, such as Public Private Partnerships (PPPs), as alternative procurement approaches to traditional methods of delivering public infrastructure. Competing demands for public sector investment for new infrastructure has prompted Australian governments to increasingly turn to the private sector to form partnerships in the finance, design, construction, ownership and operation of infrastructure assets. This has become a major challenge but the emergence of PPPs provides an alternate means for developing infrastructure using private sector expertise. There is considerable growth potential for PPPs given that the New South Wales Government has developed policies to expand the application of PPPs to include social infrastructure, such as healthcare and schools. A key argument for all levels of Government (Federal, State and Local) to procure projects using PPPs is that the process would deliver better overall value for all the stakeholders. The aim of this paper is to investigate current approaches to successful risk management of infrastructure using the Top Ryde mixed-use PPP project as a case study. Top Ryde was one of the first and largest PPPs in NSW where the main public sector entity was Local Government (i.e. Council) as opposed to State Government). This involves an analysis of project documentation and a semi-structured interview process with key project stakeholders from both the public and private sectors. The results of this research centres around an effective tri-partite contract agreement, innovative relationship management and a very successful risk management approach with a particular focus on legal, financial and community factors.

Keywords: Case Study; Local Government; PPP; Relationships; Risk.

Introduction

There is a strong body of opinion to support the concerns of the private sector that current social infrastructure projects in Australia are not true partnerships (Curnow, et al, 2005; Jefferies and McGeorge, 2009; Jefferies and Lau, 2010).

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The public sector needs to make PPPs more attractive to the private sector and clarify the risk identification in order to transfer more responsibility to the Private Sector. This issue is supported by recent industry criticism of PPPs concerning the ‘narrowness’ of the scope of work that is offered to the private sector (Jefferies and McGeorge, 2009). Stakeholders from the private sector are frustrated with the high transaction costs of PPPs, which offer only a marginal increase in scope of business opportunity. This is in stark contrast to opportunities that are available in the much lower cost-to-bid ratio of more traditional procurement models (Jefferies et al, 2010). This has led to the decision by a number of major construction contractors to withdraw from the PPP process.

Additionally Shepherd (1999) and Jefferies and McGeorge (2008) argue that there are fundamental reasons for the need to review the PPP process, these reasons include:

- Lack of flexibility in the evolution of the project where the host authority must juggle competing bidders and keep them on the same baseline;
- Current PPP arrangements lack flexibility in operation;
- High transaction/tender costs in taking at least two fully developed and underwritten bids to the finishing line (e.g. Melbourne City Link incurred external tender costs of $24Million at financial close); and
- PPPs need to allow the private sector to utilise its expertise and gain a broader scope of work and an increased transfer of risk and responsibility.

There is general acceptance that PPPs are part of the procurement landscape in Australia. Accordingly the specific aim of this paper is to map the current approaches to successful risk management of Public-Private Partnerships (PPPs) via a current case study project. Therefore, a critique of the Top Ryde PPP project is performed and the findings are presented as a case study example of best practice.

Public-Private Partnerships (PPPs)

A lack of consensus defining PPP causes some confusion, for example they are typically driven by perspective and, range from the very general to the quite particular. Akintoye et al (2003), describe Public Private Partnerships (PPPs) as long-term contractual arrangements between a public sector agency and a private sector concern where resources and risk are shared for the purpose of developing a public facility. According to Chueng et al (2005), PPPs are a form of Relationship Contracting, which includes partnering, alliancing, joint venturing, PPPs, and other collaborative working arrangements. They are based on mutual benefits, win-win scenarios and provide better risk sharing mechanisms. Relationship contracts are usually long-term, develop and change over time, and involve substantial relations between the parties.
Within the context of Local Government in New South Wales (NSW), the working definition of PPPs for this research project is:

“An arrangement between a council and a private person for the purposes of providing public infrastructure or facilities and/or delivering services in accordance with the arrangement” (NSW Department of Local Government, 2005).

Characteristics of PPP Projects

In outlining the nature of social PPP projects, Jefferies and McGeorge (2009) provide comparisons to economic infrastructure projects. Key features and differences are identified in Table 1.

**Table 1: Key Features and Differentials Between Social Infrastructure Projects and Economic Infrastructure Projects**

<table>
<thead>
<tr>
<th>Key Features</th>
<th>Social infrastructure projects, e.g. schools and hospitals</th>
<th>Economic infrastructure projects, e.g. motorways, tunnels and bridges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scale of project</td>
<td>Smaller</td>
<td>Larger</td>
</tr>
<tr>
<td>Examples</td>
<td>Schools and hospitals</td>
<td>Motorways, tunnels and bridges</td>
</tr>
<tr>
<td>Complexity</td>
<td>More complex – especially ongoing involvement with community</td>
<td>Less complex</td>
</tr>
<tr>
<td>Risks</td>
<td>Associated with performance of the facility, e.g., major failure in air-conditioning systems</td>
<td>High construction risk engineering projects (e.g. collapse of Lane Cove Tunnel during tunnelling phase). Financial risks can also be high.</td>
</tr>
<tr>
<td>Revenue generation</td>
<td>Rental streams via the Government. Value-adds are sought, e.g. rental space, service contracts and other additional means</td>
<td>Direct payments for example from tolls</td>
</tr>
</tbody>
</table>

The Top Ryde PPP delivery model

The original Top Ryde Shopping Centre was built in 1957, being New South Wales’ first regional shopping centre. The role of Top Ryde as an important retail and social centre declined over the
1980’s and 1990’s as its infrastructure became outdated with insufficient parking and a limited choice of food and retail outlets. The City of Ryde (CoR) recognised that the redevelopment was required in order to reduce lost expenditure outside the suburb, increase employment and restore the Town Centre as a social and civic hub.

The Beville Group (the private sector contractual partner with CoR) purchased the Centre in 2000. The proposed expansion of the Town Centre was of such a significant size that an Integrated Traffic Solution (ITS) was required. Defined Developments (DD), a subsidiary of the Beville Group, was established as developer to deliver Top Ryde shopping centre and they signed a 49 by 50 year lease for a ‘peppercorn’ rent of $1. Under the terms of the lease, DD wouldn’t pay any significant rent for the land providing they successfully linked CoR Civic Precinct land to the ITS in the form of bridges and underpasses. Under the Local Government Amendment (Public Private Partnerships) Act 2004, the NSW State Government subsequently deemed the project as a ‘PPP’ as the developer was providing free infrastructure to the City of Ryde in the form of rights of way through the underpasses and over the bridges linking CoR land from West to East and enhancing the access solution for CoR ultimately allowing for future redevelopment to be undertaken by CoR.

In March 2005, Bevillesta entered into a management services agreement with Bovis Lend Lease (BLL), requiring them to provide design master planning services that combined their in-house architectural expertise together with their cost planning programming and resources. In 2006, the LEP Number 143 was gazetted, which allowed for future growth of Top Ryde City and the surrounding suburbs. BLL was appointed on a guaranteed maximum price contract to undertake the design and construction of the project. Construction on the Centre commenced in September 2007 with Stage 1 of the Centre officially opened towards the end of 2009.

Over the course of the research two main themes emerged: the tripartite agreement and the risk management process.

Tripartite Agreement

Under the Tripartite Agreement, the City of Ryde is the roads authority and the owner of Devlin Street and Blaxland Roads. As owner, the City of Ryde agreed to lease a portion of these roads, comprising the site for Top Ryde, to the Developer under the Agreement. The Developer undertook the works on the site and agreed to own and operate the works (finance, design, construct and operate). Under section 138 of the Act, the consent of Council, as roads authority, with concurrence of the RTA, was required. A condition of the DA consent was that the three parties enter in a Tripartite Deed of Agreement. The Tripartite Deed served to clarify the roles and responsibilities of the three key players, i.e. City of Ryde, RTA and Bevillesta, at the beginning of the project. The Tripartite Deed was not adversarial. The roles and responsibilities of each party were discussed, agreed and formalised at the start of the project.

A three-layer communication model was established and embraced by all the parties to manage the PPP work. The three levels consisted of:
1. **PPP Communication Meeting** - Hosted weekly by the Main Contractor (Bovis Lend Lease) and attended by CoR, and often RTA, with stakeholders such as State Transit Authority and the Project Verifier as necessary. This meeting served to advise and discuss detailed works progress, certification issues, focus points for co-operation, feedback from the local community and communications required with local residents about future work. Weekly communication meetings were structured to review the works programme and the community's interest together to manage expectations and minimise inconvenience.

2. **PCG (Project Control Group) Meeting** - Initiated and hosted by CoR weekly as appropriate, this brings together the project managers operating on behalf of the CoR, the Developer, Main Contractor and RTA to overview general progress, identify and mitigate risks and issues, ensure information flow is timely, agree points of collaboration, resolve contentious issues, defuse potential problems and agree action points for all participants to ensure the project proceeds as smoothly as possible. Weekly PCG meetings have enhanced communication and collaboration between the three PPP stakeholders’ representatives, the effectiveness of which has been reinforced by the inclusion of the Main Contractor in this forum.

3. **High Level PCG Meeting** - This was held every two three months according to need and, as specified in the Tripartite Deed is chaired by an independent person. Given RTA's concurrent role in the PPP, the principal attendees had been the CoR and the Developer. These meetings provided a platform of supervision, negotiation and control of the direction of the PPP works and design intent of the overall project. This forum was principally concerned with policy, direction and the progress of the project at a strategic level. Collaboration at quarterly High Level meetings between the Heads of the CoR and Bevillesta organisations provided a strategic control upon the relationship between the PPP Agreement and the DA (Development Application) process. The nominated project managers for the CoR, RTA, Bevillesta and BLL operated as consistent principal contacts for their organisations facilitating resources as required and ensuring that communication was not weakened or diluted. The Tripartite parties and BLL each have large organisations with many ‘interested’ members.

The Tripartite Agreement brought together the owner (CoR) and regulatory body (RTA) together with the private sector developer (in the form of Defined Developments). In removing key risks such as design and maintenance, CoR were able to supply infrastructure to the community at an ‘administration cost’. The PPP model used for Top Ryde supplied a very low risk solution for local government (CoR) and also provided benefits to the RTA in the form of upgraded infrastructure, enhanced signal arrangements and reduced maintenance costs on a major section of the State road network.

There were a number of legal and administration costs identified as part of the Top Ryde project, and indeed unique to PPPs. These include:

- Legal advice regarding the establishment of the PPP;
- The legalities of setting up the PPP and also arrangements with the contractor(s);
• Liaising with project stakeholders to work through the contract and assessing the risk in the contract;
• Costs incurred as part of the Independent Verifier process stipulated by the Department of Local Government (NSW State Government requirement of PPP projects);
• The lack of standardised contract documentation from projects of this nature; and
• Efficiency and effectiveness on the focus on the ‘finer points’, given the economics of long-term legal obligations contained in many PPPs, particularly in contracts of over 20 years, and in this case the 49 by 50 year lease arrangement.

Risk Management

Compliance, Due Diligence and the Tripartite Agreement

The basis of the model used for the delivery of Top Ryde involved the establishment of: the risk profile; internal and consultant reports; deeds; marketing plans; statutory compliance; and Project Control Groups as the foundations for successful project structure. This process was authorised with subsequent project approval to proceed by the State Department of Local Government. In order to manage this process, and particularly the process of engaging consultants, commissioning external reports and studies, especially where in-house expertise was lacking, the GM put together a cash surplus of $9m to support and fund these issues for the duration of the project.

At the pre-delivery stage BLL were engaged under a consultancy agreement in order to mitigate risk in the ground (sub-soil). A detailed geotechnical and structural analysis was carried out by BLL under contract with DD and WT Partnership (cost consultant) provided reviews of all BLL costs. These tests enabled a ‘no latent conditions’ clause under the contract and BLL did all necessary research to price and deliver the contract. This level of Geotechnical research enabled BLL to price work more accurately.

The Tripartite Agreement succeeded in bringing the owner (CoR) and regulatory body (RTA) together with the developer (DD). CoR and RTA mitigated some of their risk by having input into the design by ensuring compliance with design standards. CoR were allowed to enforce their rights under the design standards and DD, as developer, had to deliver this under the contract. CoR also mitigated some of their risk by putting bonds into place under Tripartite Agreement that were linked to significant stages of project delivery. Further risk was mitigated by not issuing occupancy until the Integrated Traffic Solution (ITS) was complete and approved in accordance with the DA, i.e. in accordance with Local Government planning law and State Law (LEP) which meant that the centre could not expand until the ITS was developed. Maintenance risk was managed by using an on-going clause in the centre’s lease agreement that DD maintain and certify annually.

Major Design and Construction risk, which was enhanced by the complicated underpass system to allow traffic from RTA network into top Ryde site, was mitigated with the engagement of BLL as D&C contractor. The management framework was developed by Defined Developments and implemented via various levels of the PCG meetings. CoR via RTA had a requirement to engage the Verifier before the RTA would grant approval. The Verifier approving the design mitigated risk.
Defined Developments contributed towards the cost of the Verifier and therefore had risk mitigation as they had input into design.

Financial Risk

The Developer mitigated financial risk by establishing funding arrangements with a syndicate of 6 lending institutions. Finance could be effected if one or more of the banks pulled out of the deal but this in turn was mitigated by a ‘no reason’ clause, e.g. there had to be an significant event such as a dispute or extensions of time for them to do so and therefore allow financiers to enforce step-in rights.

The risk of ensuring centre occupancy (tenants) was managed by DD as the financiers would only fund the project if budgets were correct. This involved a significant projection and feasibility study of project finance costs, leasing plans and agreed revenue from centre. The financiers also undertook their own finance checks, assessed by an independent cost consultant, WT Partnership, who checked costs, valued variations etc. The banks also engaged independent retail experts every month who sat on a agreed leasing panel to assess that DD were meeting budgets and adhering to the project’s program. Checks were also carried out on demographic studies to ensure demand was there for a centre of this size and nature and DD had to sign up major tenants before finance was approved.

Community Risk

Community support for the development of Top Ryde was significant. This risk was initially managed at approval stage by going out to a full public review and debate. One frequent topic was the issue of pedestrian access to the Centre. Access was proposed to change via pedestrian bridges and the community raised questions, for example “why do we have to cross the bridge, why can’t we cross the road like we used to?” These issues changed overtime, as did community members, so referring them back to a public consultancy process years earlier did not always lead to a positive outcome for the public. These risks should be managed via an upfront agreement and continuously response to public questions. A community interface, that included newsletters, meetings, consultation provided a successful method for problem solving and served to keep the community in a positive frame of mind about the project. BLL had very good people on the project but often strategic repositioning meant they were moved to other projects and a failure to inform their current partners such as CoR and DD was an example of communication failure. It was suggested that BLL Engineers were good technical people but, CoR had to take the lead when dealing with community.

The maintenance of the lifts that connected to the pedestrian bridges was a significant community and technical risk. There was community backlash to the first bridge when the lifts were not operational due to system failure. In hindsight, both bridges should have been operational at the same time in order to manage on-going pedestrian access to the centre. Greater security measures were also introduced to prevent on-going vandalism. This helped to enforce that the biggest risk was managing the change for people (community). Change can be perceived as simple to some, yet
significant to other members of the community. The simple fact that they can no longer walk across the road and must now use a bridge, or that a bus stop is moving 50m down the road can lead to community backlash. In a project of this nature constant assessment of the impact on community is important to long-term project success. The issue of the pedestrian bridges were a significant contractual issue, the RTA made it a condition that pedestrian crossing on Devlin Street, a main arterial route with over 90,000 daily traffic movements, be removed to improve traffic flow.

Conclusion

A PPP consortium is a temporary organisation with a complex network of players with competing goals and objectives, many of whom never observe the complete picture. Inevitably the group operates under pressure, particularly the members of the SPV (Special Project Vehicle) who are the drivers of the project. Social, as opposed to economic, infrastructure PPPs are complex. Much of the negativity and adversarial environment, which surrounds PPPs outlined in the introduction is due to a lack of transparency, not just in terms of the bidding process, but also with regards to the identification of risks and opportunity for the broader community and stakeholders. PPPs currently act as an essential but relatively minor part of Governments’ asset acquisition program. However, as they tend to be large, complex projects that can affect people’s lives for a very long time, PPPs instil a great deal of interest and passion.

The results of this research were developed from project documentation and semi-structured interviews with Senior Management participants representing the various project stakeholders from both the public and private sectors. Three features appear crucial issues in the success of this project: the delivery model; risk management; and communication. Over-arching these three themes appears to be the adoption and integration of successful relationship management. Overall, Top Ryde is an excellent example of how PPPs can be successful, rewarding and provide value for money to all stakeholders including the broader community.

References


