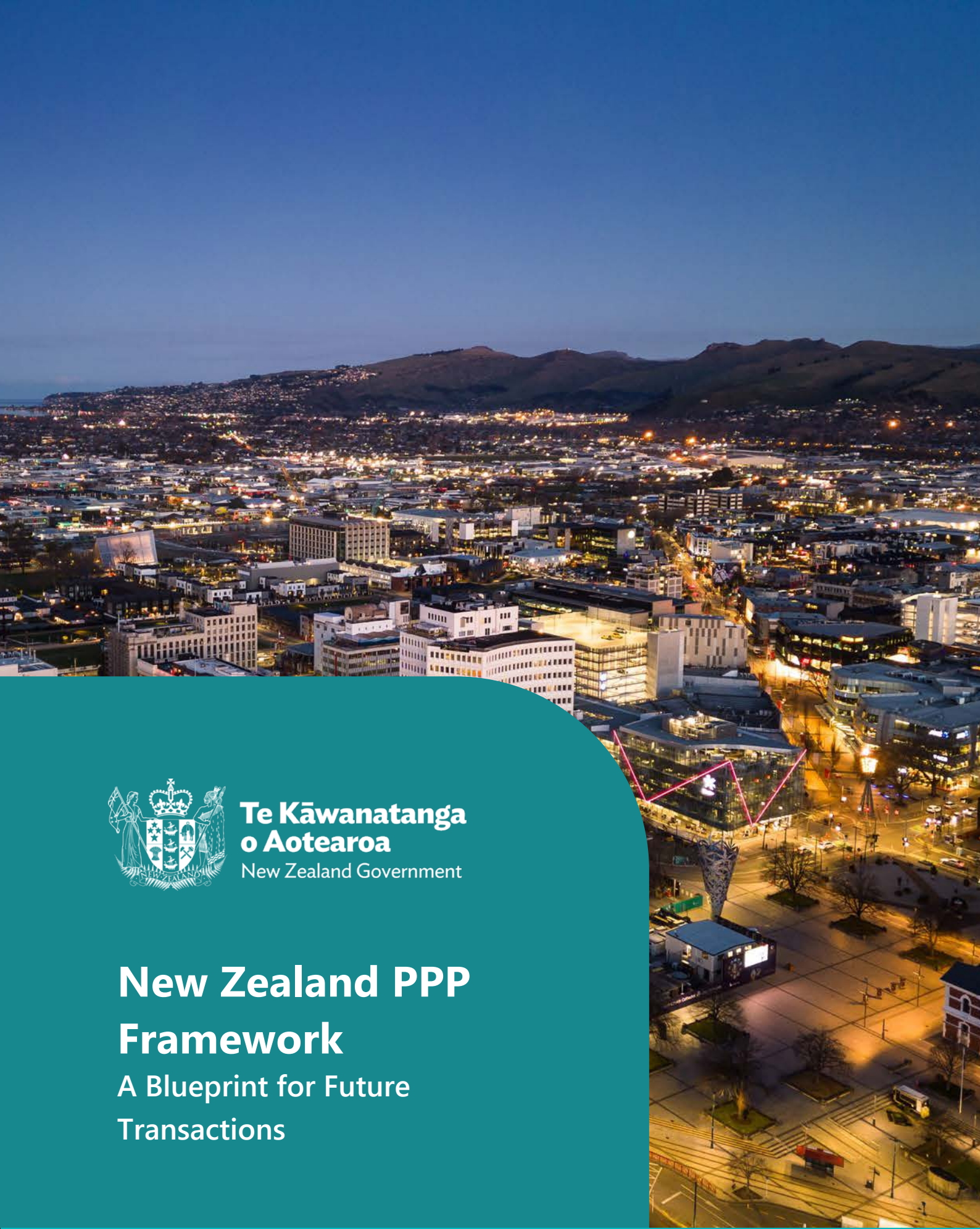


Te Kāwanatanga o Aotearoa
New Zealand Government

New Zealand PPP Framework

A Blueprint for Future Transactions

November 2024

Foreword

Rt Hon Christopher Luxon, Prime Minister

New Zealand is an outstanding place to do business – but my Government knows it can be even better.

Whether it's attracting more investment, unleashing entrepreneurs to bring fresh thinking and new ideas to solve tough problems, or delivering the modern, reliable infrastructure our country needs to thrive, we are working hard to make the most of New Zealand's future.

And we can't do it alone. New Zealand needs private sector expertise to achieve those ambitions. Infrastructure represents a big opportunity to leverage that expertise – and to do that, we need the right tools for the job.

Public Private Partnerships (PPPs) can help close the infrastructure gap by bringing forward investment and ensuring there is a greater focus on whole-of life infrastructure outcomes across planning, delivery, and maintenance.

With PPPs, the Crown can take advantage of private finance and expertise, fund assets over time, and retain ultimate ownership.

That is not a new approach – New Zealand and other countries have successfully used PPPs for decades. But with massive infrastructure investment required in the coming years, we know there's potential for PPPs to play an even bigger role in the New Zealand economy.

It's all part of our plan to deliver the growth, innovation, and investment we need to lift incomes and create opportunity for all New Zealanders.

Hon Chris Bishop, Minister for Infrastructure

Refreshing New Zealand's Public Private Partnership (PPP) model is a key part of the Government's plan to be smarter about how we deliver, fund, finance, and maintain infrastructure. Bringing new PPP opportunities to market will help us attract the international expertise and capability we need to deliver our significant pipeline of infrastructure projects.

When done well, PPPs can drive better performance than traditional approaches because PPPs have strong contractual incentives for on-time, on-budget delivery, as well as long-term maintenance and service-level obligations. Investment discipline is a key ingredient that our system is currently missing. However, I am confident that lessons learned from PPPs will be applied across many projects.

New Zealand's approach to PPPs has always been, "greater outcomes for the same cost". To continue this focus, Government will only use PPPs when they outperform the counterfactual procurement model. PPPs will be most suitable for large, complex projects where objectives and outputs can be clearly specified. These are the types of projects that will benefit most from innovation, risk transfer, and whole-of-life project optimisation.

Simon Court MP, Parliamentary Under-Secretary to the Minister for Infrastructure

Overseeing the Public Private Partnership (PPP) policy reform has been a priority for me as Under-Secretary to the Minister for Infrastructure. The rigour of the PPP procurement process, contractual incentives, and performance requirements provide investment decision makers with greater confidence that under a PPP contract, New Zealanders will get what they pay for.

I am encouraged by the feedback and engagement from the sector to date and I expect this updated PPP framework will give the market confidence that New Zealand will have a sensible, stable, and enduring approach to PPPs.

Together, we can fully realise the potential for private sector discipline and innovation to deliver reliable and resilient public infrastructure.

Hon Barbara Edmonds, Labour Party spokesperson for Infrastructure

Swings in priorities each election cycle don't help New Zealand's infrastructure deficit.

We need to be smarter about the way we plan and deliver infrastructure if we are going to deliver the infrastructure New Zealanders need now and into the future. Having an agreed framework for how all governments manage PPPs is vital for providing the sector with confidence. This PPP Framework outlines clearly how governments of all stripes should think about PPPs as a procurement method.

We support PPPs when they maintain some form of public ownership/control of critical infrastructure and align with Labour values of fairness and cooperation. A robust analysis that demonstrates long-term cost effectiveness and better value for public money must guide consideration of PPPs.

Although we might disagree on specific projects, Labour welcomes this framework to help guide future decisions.

Te Kāwanatanga o Aotearoa
New Zealand Government

Table of Contents

Foreword **2**

Rt Hon Christopher Luxon, Prime Minister 2

Hon Chris Bishop, Minister for Infrastructure 2

Simon Court MP, Parliamentary Under-Secretary to the Minister for Infrastructure 3

Hon Barbara Edmonds, Labour Party spokesperson for Infrastructure 3

Table of Contents **4**

The New Zealand PPP Framework **6**

Why and when we will consider PPP for project delivery 6

Our Enhanced Approach to PPP **8**

Policy updates 8

Availability and Economic PPPs 8

The role of project finance and Crown borrowing 8

Crown capital contributions 9

Delivery of public services 9

Determining whether a PPP offers 'Value for Money' 9

Model and contract updates 10

Optimal risk allocation and targeted risk sharing 10

Incentivising and allowing innovation 11

Design Development 11

Performance Regime v Evaluation Incentives 12

Consequences of construction delay and risk allocation for late delivery 12

Completion regime 13

Major expansions and augmentations 13

The role of SPVs and Equity 14

Dispute resolution procedures 14

Extension and Compensation Events 15

Process updates 15

Affordability Threshold validation 15

Greater collaboration through progressive procurement 15

Client resourcing and preparation 16

Interactive Tender Processes 16

Bid cost reimbursement 16
Benefits of other models 17
Alliance 17
Strategic Leasing 18
DBM or 'PPP-lite' 18
Long-term Strategic Asset Management Partnerships 18
Next Steps 19

The New Zealand PPP Framework

The New Zealand PPP Programme commenced in 2009 and developed an international reputation for being outcomes and service oriented – that is, it has not been used simply to deliver infrastructure assets. Instead, it has focused on the enhanced delivery of public services, with the intent that this would challenge, or shift, how we deliver infrastructure to New Zealanders across wider asset networks.

Eight PPP projects have been developed since 2011, including three corrections facilities, two state highways and three bundles of primary and secondary schools. Service delivery outcomes achieved through these projects to date have been positive, in many cases outperforming similar projects delivered using other methods. Standardised or modular designs from PPP projects and asset management lessons have also begun to be implemented elsewhere.

However, there have also been some commercial challenges faced by those delivering the contracted outcomes, which is not sustainable. As we prepare for future PPP projects, we are committed to learning from the shared experience of PPP delivery agencies and contractors alike, to ensure the New Zealand PPP framework is an attractive and successful delivery model.

No two significant and complex infrastructure projects are alike, and as the scale of individual and aggregate investment in the New Zealand infrastructure pipeline grows, we consider it essential that public sector agencies have access to a range of tools – including a PPP Framework that retains the key objective of providing unrivalled incentive on whole of life performance and service outcomes, but is flexible in accommodating unique project characteristics and market conditions.

This document outlines some of the model, policy and process enhancements we believe will contribute to making future PPP transactions as successful as possible for all parties.

The development of this approach to future PPP transactions has been led by the New Zealand Infrastructure Commission, working closely with the Treasury and relevant public sector agencies. It incorporates a range of feedback and insights from private sector stakeholders, experienced public sector PPP practitioners, and consideration of international best practices.

We will continue to engage with the sector on the principles set out in the document and refine the New Zealand PPP Framework to ensure that it serves the procurement needs and objectives of government while remaining attractive to market participants.

Why and when we will consider PPP for project delivery

One of the features that has distinguished the New Zealand PPP approach from other jurisdictions is the focus on greater outcomes rather than lower cost. This is achieved through the strict use of a 'willingness to pay' Affordability Threshold, based on the modelled net present cost of delivering the same service outcomes using non-PPP delivery methods.

This means that any PPP proposal must be expected and able to outperform the counterfactual of non-PPP infrastructure delivery for a commensurate net present cost. This approach focuses tender evaluation exclusively on non-price attributes, provided the Affordability Threshold is met.

This will remain the key objective of the New Zealand PPP programme, with other more appropriate levers used to deliver infrastructure cost savings (including sophisticated investment options analysis at the business case phase – such as greater investigation of non-built solutions and demand management).

The key benefits that can be achieved through PPP project delivery include:

- ✓ increased focus on the specification and performance of service outcomes required from infrastructure investment (rather than asset input specification)
- ✓ integrated service and asset design solutions focused on 'whole of life' optimisation and performance
- ✓ better risk management through appropriate allocation of risk to parties able and incentivised to manage them well
- ✓ a long-term contract that provides greater time and cost certainty to decision makers than leaving public sector asset owners to manage risks to budget, timetable, performance and asset condition over the same period
- ✓ strong availability and performance incentives, based on payment for good performance and abatement for poor performance, which provides greater certainty that assets will deliver the desired service levels over their useful life, and
- ✓ wider benefits to New Zealand's infrastructure sector as a result of leveraging private sector expertise, including the potential to attract new entrants who bring new skills and increase competition.

PPP procurement should not be categorised as a financing tool. While the PPP model utilises private finance in support of achieving these enhanced outcomes, spreading infrastructure related cash flows through project finance arrangements is not the purpose of PPP procurement (if it were, this outcome could be achieved more efficiently through general Crown borrowing to finance infrastructure needs).

Having private capital at risk for delivery performance offers significant benefits by creating stronger commercial incentives. This approach requires greater discipline and due diligence during the procurement phase, while also ensuring that private consortium maintain accountability throughout the entire lifecycle. With "skin in the game," they are motivated to prevent performance or availability failures, ultimately enhancing overall accountability and reliability. Realising these benefits may require some recalibration of the amount of project finance deployed in future PPP transactions and in the intra-consortium allocation of risk.

PPP will not be appropriate for all projects. It should be considered alongside a suite of other procurement and delivery options, all of which will have pros and cons depending on unique project characteristics.

Delivering a project as a PPP is more likely to be successful where:

- ✓ the project is of sufficient scale or complexity that it would benefit from increased contractual incentives to manage risk and performance, and that innovative design, construction and service delivery approaches may be employed,
- ✓ the nature of the asset required is specific and can only be applied to the purpose intended (ruling out other long-term infrastructure delivery approaches, such as strategic leasing, where the Crown does not need to own the asset),
- ✓ desired outcomes or outputs can be well-specified, enabling clear articulation and monitoring of performance requirements and standards,
- ✓ there is a durable long-term service need, and it is unlikely that the service requirements will vary unpredictably over the contract term,
- ✓ there is sufficient market appetite and depth to ensure a competitive procurement process,
- ✓ there is a reasonable expectation that the PPP provider will be able to realise risk management and cost optimisation efficiencies, such that they can outperform the most likely counterfactual for non-PPP delivery within the Affordability Threshold, and
- ✓ the public sector client is, or will be, sufficiently resourced with the requisite skills and capacity to procure and manage the project well, including the behavioural/cultural shift required to realise the benefits of an outcomes focused partnership which may require significant departures from business-as-usual input specification.

Our Enhanced Approach to PPP

The NZ Government has listened to market, agency and end-user feedback and has a desire to attract more private sector capital, expertise and innovation to deliver even better outcomes from future PPPs. The updates we propose to make to the model can be considered under three headings:

Policy updates – intended changes to the policy settings, frameworks and nature of the consideration of PPP procurement in New Zealand, and how this integrates with overall fiscal strategy and national infrastructure priorities.

Model and contract suite updates – intended changes to the New Zealand PPP model and Standard Form PPP Project Agreement. This will ultimately result in a revised suite of standard form contractual documentation, updated to cater for an increased range of project circumstances, including sector specific considerations and greater interrogation (or in limited cases, specification) of downstream documentation and risk allocation.

Process updates – proposed changes to the process by which procuring agencies undertake PPP procurement, primarily focused on the EOI and RFP phases and designed to enhance collaboration and de-risk project outcomes for all parties.

Unless stated, the New Zealand approach to PPPs will otherwise remain consistent with past practice and guidance, including the use of and strict adherence to an Affordability Threshold and an Interactive Tender Process.

Policy updates

Availability and Economic PPPs

New Zealand PPPs will remain primarily focused on transferring availability and performance risk, not revenue generation risk. In the short term, we expect that most projects proposed for PPP procurement will be unlikely to derive sufficient third-party revenue streams to support the full cost of delivering, operating and maintaining the required infrastructure. On this basis, the majority of New Zealand projects will continue to be availability-based PPPs.

However, through the business case process, all projects proposed to be procured by way of a PPP will consider the potential applicability of third-party revenue streams and how these might contribute to meeting the delivery cost of the project. Agencies may also choose to invite the proposition of alternative revenue generation opportunities as variant bids, which either offset project costs or provide for additional scope and operational outcomes.

The role of project finance and Crown borrowing

The existing PPP projects in New Zealand have been fully project financed. This may not be the case for future transactions.

Using long-term debt to finance long lived infrastructure assets that provide intergenerational service and benefits is an equitable and appropriate use of Crown borrowing capacity. This principle holds whether investments are financed using limited-recourse project finance or general Crown borrowing. Of course, limited-recourse project finance comes with a higher cost of capital as it specifically prices for unique project risks. These are project risks that the Crown is exposed to irrespective of how the project is delivered, they are just not readily recognised and valued in portfolio level discount rates or average costs of capital.

Whether project finance or general Crown borrowing is deployed, all debt is recognised on the Crown balance sheet. The purpose of PPPs is not to provide a financing tool – they are a project delivery model which utilises private capital for the incentives this provides, rather than cash flow spreading benefits or to move project obligations off balance sheet.

For this reason, various forms of Crown capital contributions could be available to procuring agencies,

Crown capital contributions

The government is focused on ensuring efficient application of capital to infrastructure projects and the different ways that both public and private sector capital might be best deployed.

The government will carefully consider how and when it might contribute capital to PPPs. This could potentially occur:

- Through construction, by way of milestone or progress payments.
- At construction completion as a "bullet payment".
- Through the operating phase of a project, through mechanisms such as conditional debt paydowns.

The application of capital contributions will be made on a project specific basis. In determining any capital contribution, consideration will be given to the need to retain sufficiently material levels of private debt and equity capital in the project to achieve the desired performance incentives, and the impact that any reduction has on market interest.

Also relevant to the consideration of the optimal level of private capital is the impact of financing related liquidated damages resulting from delays to service commencement, which are exacerbated if larger and larger projects are fully project financed.

Delivery of public services

PPP models are often described by reference to which of the following services they bundle together: Design, Build, Finance, Maintain and Operate (i.e. DBFM or DBFMO). The distinction between DBFM and DBFMO is less obvious for linear infrastructure such as a state highway, but is clearly illustrated in the difference between the Auckland South Corrections Facility (a DBFMO with the custodial services provided by the private sector) and Auckland Prison (a DBFM where custodial services are provided by the Department of Corrections).

Generally speaking, DBFMO models create much greater opportunities for innovation and efficiency. Transferring responsibility for operations of the facilities supports an outcomes-based procurement approach to service delivery models which, in turn, unlocks increased innovation in design solutions. By contrast, DBFM approaches mean that the client is likely to provide greater specification of the parameters necessary to support their selected operating models.

Determining whether a PPP offers 'Value for Money'

In this context, 'value for money' refers to whether an investment can deliver better outcomes if delivered as a PPP, when compared to the same project delivered under the most effective non-PPP method, for commensurate cost (on a net present basis). It informs the delivery model decision, not the investment decision, and must not be confused with the cost-benefit and other analysis that informs the strategic and economic case for the investment.

To offer value for money, a PPP proposal must be expected and able to outperform non-PPP infrastructure delivery for a commensurate net present cost.

This assessment is inherently subjective but is more likely to be true where the favourable project characteristics and potential benefits identified on page 5 are present.

Making a PPP 'value for money' assessment therefore requires:

- An estimate of the project costs, including construction and ~25 years of operations and maintenance, if delivered under the most likely non-PPP counterfactual (e.g. a Design & Construct contract, with in-house asset management delivery). This is the Public Sector Comparator.
- An assessment of whether the bundling of services under a long-term availability and performance-based PPP arrangement will result in design innovations, construction and operating cost optimisation,

improved risk management, and overall performance efficiencies.

- An assessment of whether this optimisation and efficiency will be sufficient to overcome the additional costs associated with PPP delivery, including SPV resourcing, upfront procurement and transaction costs, contract management, and incremental costs of project finance relative to Crown borrowing at a portfolio level.

The previously prescribed methodology for this assessment was described as quantitative analysis, and required the comparison of two sets of cashflows, those which make up the Public Sector Comparator, and those represented by a Proxy Bid Model, representing the subjective assessment of modelled PPP efficiencies described above. The two sets of cash flows are discounted to a net present cost point estimate for comparison, using a project specific discount rate which reflects the risks borne by investors in the project (which are constant whether those risks are retained by the Crown or transferred to a PPP provider).

This quantitative analysis may still be appropriate for some projects where it is considered to add a compelling and defensible illustration of how a PPP can deliver value for money (for example, where observable qualitative evidence of PPPs delivering efficiencies in that sector is not readily available). However, in those cases an increased emphasis will be placed on the qualitative assessment which underpins the quantitative modelling.

Model and contract updates

Optimal risk allocation and targeted risk sharing

Large complex public infrastructure projects are risky endeavours. These risks exist for the asset owner irrespective of how the project is delivered, but the delivery method can either provide more or less effective risk management. The proposition of PPP is that it enables and incentivises risks to be better allocated and more cost-effectively managed in the long term.

Project risk should be borne by the party best able to manage or mitigate it at least cost, and the risk should be priced appropriately by that party. Further, achieving the performance incentives fundamental to a PPP requires the clear allocation of risk between parties. We expect our delivery partners to be highly incentivised to deliver timely and high-quality infrastructure assets within budget for New Zealanders.

We acknowledge that the scale, complexity, type and location of infrastructure projects has a significant impact on the level of risk inherent in an individual project. This means that a "one-size-fits-all" approach to risk allocation is not appropriate.

Procuring agencies must undertake an appropriate level of work to understand the unique risks and attributes of a project prior to the release of an RFP. It is expected that any project specific risk attributes will be clearly identified, tested and discussed through the market sounding process, with market feedback on potential risk mitigations or allocations taken on board.

Where certain risks genuinely cannot be efficiently priced within a bidding process, a solution should be developed to share or cap the private sector partner's exposure to that risk at an appropriate level. Such risks may include significant departures from understood geotechnical baselines, or volatile commodity pricing.

The approach to risk allocation for each project will be clearly set out in the procurement documents and identified as a specific topic for engagement through the Interactive Tender Process.

The proposed allocation of risk will also have a bearing on the nature, and level of specificity, of elements of the Performance Regime. Where the client agency retains a share of a particular risk, it will necessarily require appropriate oversight of aspects of design and

delivery which may affect its exposure. Where it is determined that significant risks must be retained by the client, this may be an indicator that PPP is not the optimal delivery model for the project.

Incentivising and allowing innovation

There are three important ways in which PPP promotes innovation:

- Bundling long-term service level requirements together with design and construction responsibilities, combined with relative long-term revenue certainty (subject to performance only, not reconsideration of the investment decision and commitment to funding levels) allows for more efficient whole of life planning and asset management, and trade-offs that the public sector does not traditionally have the ability or short-term incentive to make.
- Specifications that are focused on the service outcomes required from the relevant infrastructure, with the bare minimum prescription or constraints necessary to ensure the client agency can effectively integrate the asset into their existing networks and operating model.
- The competitive procurement process which rewards the most innovative and efficient solution, because proposals are assessed on their ability to deliver outcomes within a set cost envelope.

However, these factors incentivise innovation early in the project's life only – and once the deal is signed the strong risk allocation of the contract can drive commercial or client behaviours which tend to stifle innovation in later stages. One such example is in the attribution of cost-savings resulting from Changes being 100% in the client's favour, which provides little to no incentive to the private sector partner to identify and propose genuine opportunities for innovations which make the project more deliverable or efficient. This will be reconsidered on a 'best for project' basis.

To increase the opportunities and incentive for innovation throughout the project lifecycle, client agencies must be able to trust the performance incentives and intra-consortium risk allocation to drive desirable whole of life focused decision making. This requires the asset and facilities management or operations and maintenance subcontractor to have a strong voice within the consortium decision making during the tender development, design and construction phases, and procuring agencies will be looking for evidence that this is the case. Care must also be taken to ensure that the discount rate specified for the base case financial model does not disincentivise otherwise sensible short-term v long-term trade-offs.

Design Development

Entering into a contract with strong time and cost risk allocation, and which contractually binds parties to the design developed during the tender phase, presents obvious risks but is also an intended feature of the PPP model to focus all parties on developing designs which allow them to manage those risks and ensure that the procuring agency receives what was bargained for during the tender phase. However, before entering into a fixed price performance based contract, the design should be sufficiently certain that the contractual obligations can be priced, and the design development process should still allow for appropriate revision to take account of site specific factors or other positive opportunities identified later during project delivery.

PPP design is intended to respond to the outcome or output specification which allows for, and encourages, solutions that outperform 'business as usual'. This may come in the form of international best-practice, repeatable scale efficiencies, or new innovation that responds to the unique project and New Zealand context. Comments from client-side subject matter experts during design development should be provided in the spirit of enabling such approaches (including novel or innovative solutions), not as a means to trend back to more familiar methodologies that the client uses elsewhere. Having the right team and

tools in place will be essential to the success of this approach.

Design development and programme are often on the critical path during early stages of project delivery. Material submitted for review must be of a high quality and client-side teams must be appropriately resourced to meet required response times.

High quality design is a critical component of successful PPP projects (and includes both innovation and effectiveness of the design in meeting service outcomes, and its deliverability and efficiency during construction). We expect to see evidence that subcontractors responsible for design are appropriately enabled and incentivised to meet these sometimes-competing objectives. This may require new approaches to how these services are contracted for, including appropriate remuneration and liability structures that provide both accountability and incentive for delivering the desired outcomes.

Performance Regime v Evaluation Incentives

PPP procurement provides incentives in both the short term (succeeding in the competitive tender phase) and long term (the contractual performance regime). Using each of these incentives appropriately is an important, and potentially overlooked consideration.

The contractual performance regime and payment mechanism are key drivers of performance incentives. These incentives apply not only to how services are delivered during the operating period but, importantly, in the design of the built solution and operating and maintenance model developed during the competitive tender phase (i.e. the incentive to develop a solution that minimises performance abatements).

However, another equally important driver, and arguably more proximate and powerful incentive, is the evaluation criteria against which the solutions developed during the competitive tender phase are assessed (i.e. the incentive to win the competitive process by developing the best solution).

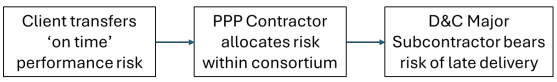
Care will be taken to ensure that certain operating period performance requirements are not better served through clear evaluation criteria that reward innovative solutions during the tender phase. For example, where these performance criteria are better influenced through innovation in design choices during the tender phase rather than operating period service provision.

Whether and how bids are numerically scored and weighted also requires careful consideration.

Consequences of construction delay and risk allocation for late delivery

PPP project delivery provides greater incentive for 'on time' performance than other procurement models. This is because no revenue is received by the private sector partner until the asset is constructed to the agreed standard and available for use. However, because debt has been drawn down by the private partner during the construction phase to finance construction payments, there are material debt service costs that still need to be met.

In the absence of the availability-based revenue to service debt that has accrued, this cost is typically borne by the Design & Construction Major Sub-Contractor as part of the Liquidated Damages imposed by the private sector partner SPV.



We consider this risk allocation is generally providing the right incentive on the party best able to manage the risk. Managing the construction programme so that the asset is delivered to the quality standard and specifications required before the planned service commencement date is one of the primary risks best managed by the Design & Construction Major Sub-Contractor and where they can add value.

However, as the scale of projects has increased (and therefore the level of debt required to finance their construction) the costs imposed

by debt service Liquidated Damages may represent risk that is disproportionate to the associated reward. The risk to projects is that this may provide a perverse incentive on construction delivery decisions and behaviours, or significantly reduce the number of construction parties willing to participate in New Zealand PPP projects.

The public sector client agency can influence how 'risky' the on-time delivery risk is by carefully considering when it needs the asset completed. It should also be wary of unnecessary pressure on the construction programme proposed by bidders. Creating an alignment of incentives is a core tenet of PPP procurement and the application of private finance through the construction phase is a key aspect of ensuring on time and on budget delivery.

Options to mitigate this potentially disproportionate impact have been considered and, where appropriate, this may be achieved through reducing the level of private finance included within the project (as discussed under Crown capital contributions above).

Completion regime

The works completion testing regime is of critical importance to the whole of life performance risk transfer of PPP. The level of quality assurance necessary for investors and long-term maintenance and operations contractors to take whole of life performance risk on the design and construction partners' work (decades after defect and liability periods expire) is a significant step-change from business-as-usual.

This focus on quality at works completion is a deliberate and intended feature of the PPP model. However, past experience has shown that rigid adherence to works completion requirements is not always practical or in the best interests of public service delivery.

Horizontal infrastructure projects are likely to require more pragmatism in relation to minor divergences or defects that would otherwise prevent the issuing of a Works Completion Certificate.

Future projects will consider whether the Independent Reviewer should have greater scope to use professional judgement in determining whether the works completion requirements have been met, and a pre-agreed approach to accepting temporary or permanent divergences. This will require a framework for the construction sub-contractor to retain the risk of future performance failures associated with any concessions made to completion requirements, so that these divergences do not impose additional risk on the operations and maintenance sub-contractor without recompense.

Major expansions and augmentations

The long-term and contractual nature of PPP procurement can make the model less suited to projects which require a high degree of flexibility.

There have been several instances where the procuring agency has sought changes to the asset or service provision relatively early in the project's life. This will be discouraged and mitigated through better strategic investment planning which recognises and funds near term infrastructure needs, rather than by amendment to the PPP model.

The PPP model will be updated to allow for major expansion or augmentation of projects. The objective of these augmentations will be to leverage the efficiency of contracting directly with the existing PPP provider and wrapping the operating period services together seamlessly post-augmentation, while retaining appropriate mechanisms to benchmark or compete components of the augmentation to ensure value for money.

Augmentation frameworks will require detailed consideration in the initial Project Agreement and procurement process. For example, an augmentation equity IRR cap should be bid through the initial competitive procurement process.

The intent is that this will more easily facilitate the delivery of expansion or additional infrastructure utilising existing successful partnership arrangements, potentially through

an additional long-term partnering agreement which delivers separate PPP Project Agreements for subsequent stages or augmentations. We will include enhanced augmentation process provisions and options for umbrella partnership agreements in an updated Standard Form PPP Contract Suite.

The role of SPVs and Equity

A fundamental principle of the PPP model is that if the private capital invested in the project is at risk for project availability and performance, those investors will actively manage the project to ensure that it is delivered on time, available for the delivery of services, and performs to the standard required. The Special Purpose Vehicle (SPV), which enters into the PPP Project Agreement with the client agency is expected to actively manage this performance on behalf of its owners/investors.

Industrial equity (i.e. investors with a corporate relationship with one of the major-subcontractors) can provide some useful influence and add additional long-term incentive for the related entities, but must not be able to influence SPV decision making on matters where it is conflicted. Strong, independent equity plays a valuable role in balancing intra-consortium influence and is generally more likely to be incentivised by stable long-term performance returns than getting through the construction phase and recycling their capital for other projects (which is not to say an emphasis on de-risking construction and early operations is unhelpful, it is essential, but a balance is also beneficial).

A majority of independent equity will also be particularly helpful for projects that anticipate major expansions or augmentations, which may require competing major sub-contractor roles for future stages if clear public value cannot be demonstrated by continuing with the existing consortium.

Decisions made during the competitive bidding process can constrain modelled SPV financial resources. Limited resources mean the SPV may only become actively involved when its equity is at risk, which is typically when issues have reached such a serious level that the project may be at risk of failing. The procuring agency must therefore emphasise its performance expectations of the SPV in its procurement documentation and evaluation criteria.

Procuring agencies will assess whether the SPV is appropriately resourced and incentivised to actively manage its risk, including review of the agreements between the SPV and the major sub-contractors.

Many of the contractual obligations that the SPV owes to the client agency will be transferred down to the SPV's major sub-contractors. This is an inherent and necessary part of managing risk under the PPP model. Afterall, the major sub-contractors have the expertise and resources to understand and manage delivery issues that the SPV and its investors do not. However, this has led to a tendency to rely on the major sub-contractors for day-to-day management and interaction with the client agency rather than the SPV setting aside necessary resources and owning this relationship for itself.

The role of the SPV and risks that it manages directly should be distinguished from the risks that its debt and equity financiers are taking as investors. Our expectation is that, in order to realise the performance and incentive benefits of the PPP model, investment returns should be exposed to project performance, not entirely insulated by the downstream risk allocation.

Dispute resolution procedures

There have been a range of disputes across PPP projects in New Zealand, ranging from 'business as usual' disputes expected on significant infrastructure projects regarding scope, design or neighbouring landowner issues, through to more substantive commercial claims regarding performance of contract obligations and/or entitlement to relief.

The broader enhancements to the New Zealand PPP model and process outlined in this document, such as periodic validation of

the Affordability Threshold and de-risking the project through greater planning and collaboration throughout the procurement process, are expected to reduce the incidence of disputes (including in relation to claims that may be incentivised by poor commercial outcomes, rather than clear contractual entitlement to relief).

However, disputes will still arise and having a robust framework for their resolution benefits all parties by reducing the time and cost burden of managing disputes, and helps create confidence in the PPP model, particularly for new entrants.

The existing disputes resolution framework includes a Disputes Resolution Panel, where senior representatives of each contract party first seek to resolve disputes in good faith. The Accelerated Disputes Resolution Provisions (ADRP), by contrast, lead to a determination by an independent expert selected from a panel.

Opportunities for improvement include making ADRP determinations binding for a greater range of disputes (by increasing the current $1million cap) and creating a standing panel of highly regarded and capable experts across the PPP programme rather than on a project by project basis. The use of Dispute Avoidance Boards such as those provided for per the FIDIC suite of contracts will also be considered as a form of early warning system that allows potential issues to be de-escalated.

Extension and Compensation Events

The Events regime deals with extensions of time (Extension Events and Intervening Events) and claims for both time and cost relief (Compensation Extension Events and Compensation Intervening Events). Extension Events apply during the construction phase and Intervening Events during the operating phase.

The question of entitlement in projects to date has typically been a matter of contractual interpretation rather than disagreement on the contextual factual circumstances. Enhancements to the Events regime may include using a legal expert from the panel to determine entitlement to contested Events claims (rather than the Independent Reviewer, who is unlikely to be best placed to make determinations on legal matters), with the Independent Reviewer to then determine the time or quantum of relief.

Determining delay entitlement requires a comparison against programme and how the event has impacted the critical path. A robust and recently updated programme is therefore an essential component for efficient dispute resolution, as well as general project management hygiene.

Process updates

Affordability Threshold validation

If the Affordability Threshold is set too low (because of optimistic or inaccurate business case estimates, or because costs escalate during the procurement phase due to factors unknown at the time the Affordability Threshold was set), delivery of the project outcomes will be placed at risk.

Significant time can elapse between cost estimates being developed to inform the Affordability Threshold during the business case phase and the submission of a complying fixed price proposal at the conclusion of the RFP. The deliverability of the project outcomes within the estimated Public Sector Comparator should be monitored during the procurement process and periodically validated and, where necessary, updated at pre-determined milestones (i.e. not on an ad hoc basis, and not too late in the procurement process for tenderers to react to the updated price envelope).

Greater collaboration through progressive procurement

A collaborative PPP strategy fosters greater partnership between the procuring agencies and the consortia, with both working together to define requirements, design, pricing and risk before reaching agreement on the contractual terms.

Many of these benefits can be achieved through approaching the Interactive Tender Process fundamental to the existing NZ PPP model as intended, through open dialogue, targeted questions and constructive feedback.

The existing PPP framework can be flexed to allow for sequential or progressive procurement of individual consortium members that ultimately enter into the Project Agreement, with precedent for separately competing debt financing and the asset and facilities management major-subcontractor for example.

A more formalised spectrum of PPP process amendments will be available for situations where the desired benefits of a PPP could potentially be achieved, but unique project attributes challenge the use of the traditional New Zealand PPP model and process requiring fully formed consortia with committed finance. This includes long-term partnering agreements for Staged PPP procurements or anticipated major augmentations.

Client resourcing and preparation

A key lesson to emerge from previous PPP projects is the need for client agencies to build teams with the capability and capacity to effectively manage a PPP project throughout its life cycle.

While the procurement phase has generally been well resourced and supported, PPP procurement places some unique demands on procuring agency teams through the planning and delivery phases. As such, agencies and investment decision makers need to ensure that project budgets allow for the resourcing required to meet these demands, which may require interim funding above baseline following Cabinet consideration of an early Strategic Assessment for the project.

Emphasis will be placed on the pre-procurement phase of future projects, to ensure that the project is de-risked to the maximum extent practicable through activities such as geotechnical and other investigative studies, market engagement and advanced land acquisition and planning approvals.

Ensuring continuity of personnel between phases of the PPP project is also as important for client agencies as it is for the private partners.

Interactive Tender Processes

The objective of the Interactive Tender Process is to improve the quality of submitted proposals through allowing:

- the procuring agency to observe the progress of the development of technical and commercial elements of bids and identify specific topics for discussion.
- the bidding consortia to ask questions on the RFP documentation and test their developing proposal with the procuring agency.

Not all parties have felt that the Interactive Tender Process has facilitated the desired level of interaction, and there are differing levels of understanding and application of the process across both client agencies and bidders.

To address this concern, guidance and briefings will be provided for both procuring agencies, probity auditors and private sector parties on the intended structure, engagement protocols and process for ITP sessions.

The principles of probity and fairness will continue to govern all interactions between procuring agencies and bidding consortia. We will work with procuring agencies and probity advisors / auditors to ensure a balance is struck between these principles and the desire to maximise the quality of submitted proposals.

Bid cost reimbursement

The government acknowledges the significant time and monetary investment made by private sector parties when bidding for PPP projects.

We recognise that the costs associated with preparing a proposal for a PPP project are often higher than other forms of procurement and have a bearing on parties' willingness to participate in PPP procurement.

To encourage participation, the government is considering three primary options to mitigate the cost of bidding for PPP projects including:

- The level of technical investigations which may be carried out in advance of the procurement process and shared with bidders (with potential reliance for bidders).
- The level of specified "at risk" activities, including design, required to be undertaken as part of preparing a proposal.
- The reimbursement of a portion of verifiable bid preparation costs for unsuccessful parties.

Where reimbursement of a portion of verifiable bid costs for unsuccessful bidders is considered for a project, the proposed approach will be clearly communicated to the market early in the process.

It is important to note that any reimbursement of bid costs is a real incremental cost to the project and therefore forms part of the value for money assessment when considering whether PPP procurement is an appropriate procurement option.

Where bid cost reimbursement is utilised, it is expected to be a material contribution to verifiable third-party costs, to a maximum predetermined cap.

Benefits of other models

The intent of this document is to signal the areas where we will enhance the PPP model in ways that contribute to its objectives, not to attempt to reflect features or objectives of other procurement and delivery models.

Agencies can calibrate a PPP to reflect project characteristics but should not attempt to force a PPP delivery model to fit a given project; the project's characteristics will determine the most suitable model.

For example, if project risks and interfaces are so complex and uncertain that a PPP must consider utilising global incentivised target cost pricing mechanisms, that is probably an indicator that PPP is not the right model for the project and an alternative should be deployed. If there are specific risks that are exceptionally difficult to manage or efficiently price, then sharing or capping certain parties' exposure to those risks could be accommodated within a PPP.

Alliance

The alliance contracting model is well understood, and frequently used for large New Zealand infrastructure projects.

In engaging with the sector on potential evolution of the PPP risk allocation, many have suggested increased risk sharing between client and contractor, including incentivised target cost and other alliance-like features to encourage greater collaboration and reduce the focus on fixed risk pricing to incentivise performance.

When agencies consider whether an alliance or PPP would best deliver the project outcomes and appropriately incentivise performance, this will include detailed analysis of project specific risks. In some cases, a fixed price PPP will provide the greatest focus on de-risking the project through up-front planning and due diligence, including scrutiny of the agency's own cost estimates and whether the project can be delivered within the Affordability Threshold. In other cases, this analysis may reveal that the project cannot be delivered as a fixed price PPP without the client taking back significant elements of cost and performance risk.

Without the strong performance incentives provided by a typical PPP risk allocation, the justification for having private capital at risk for contractor performance is reduced, and an alliance contract structure may be more appropriate.

Strategic Leasing

Infrastructure contracts with a long-term operating period and performance regime can be achieved outside of PPP.

Where the asset required is relatively generic and could have a range of applications, it is unlikely that there will be a strong imperative for the Crown to retain ownership of the asset. In such a case the best value for money option may be private provision such as through a lease arrangement.

Where the required asset is highly specific to the proposed public sector use (such as a prison), it is expected that public ownership will be more economically efficient than private ownership, as the private owner will likely seek to recover/amortise the full cost of the asset during the lease term, while retaining residual ownership and opportunities for further revenues thereafter.

In the public sector, leasing is common for office accommodation, public interface areas, and equipment. In some circumstances the public sector also utilises leasing for more strategic assets such as housing, healthcare, and education related facilities.

Leasing can improve the delivery, utilisation, and performance of physical assets used in the provision of public services. This is generally achieved through right sizing of the footprint and tenure of asset usage and capturing best practice from the private sector.

Leasing is more likely to provide value for money in certain project and policy circumstances. The durability of the public service requirements, speciality of the assets required, degree of service delivery and asset integration, and requirement for private sector delivery of services are key issues for a public sector entity to assess when considering their approach to acquiring the use of physical assets.

The Treasury will provide agencies with guidance on the project and policy circumstances where it may be appropriate to consider leasing for their proposal's physical asset requirements.

DBM or 'PPP-lite'

Design, Build, Maintain or DBM is often touted as a form of PPP-lite that removes significant transaction cost and complexity by not requiring private sector financing (debt or capital). These models are often used for the procurement of specialised equipment (e.g., rolling stock) where specific maintenance requirements apply. The model might have a place for smaller infrastructure projects, but does not provide the long-term performance incentive and procurement process discipline that can be achieved where material private capital is at risk for availability and performance failures, and hand-back condition decades after construction completion.

Long-term Strategic Asset Management Partnerships

The vast majority of the infrastructure that will be used by the current and next generation of New Zealanders already exists. Short-termism can no longer be allowed to incentivise decision making that 'kicks the can down the road' as poor asset management creates risk to the effective delivery of public services as well as shortening the economic useful life of our infrastructure. Stewardship of this existing asset base must improve.

The long-term benefits of PPP-style commercial structures can be applied to projects with significant 'brownfield' asset management requirements. We are interested in exploring how such partnerships could be tailored for projects where the whole of life services are greater than the upfront capital investment.

Next Steps

The New Zealand government is pursuing an ambitious pipeline of infrastructure investment. In addition to procuring agencies approaching the market in relation to prospective PPP projects in a range of sectors, the government is implementing multiple initiatives to provide a more certain and stable delivery environment.

- National Infrastructure Plan
- Infrastructure Priorities Programme
- National Infrastructure Pipeline
- National Infrastructure Agency

We look forward to delivering world-class infrastructure outcomes together, for the benefit of current and future generations of New Zealanders.