

***Developing and
refining the
Public Private
Partnership
model and other
infrastructure
financing tools
in New Zealand***



Infrastructure®
New Zealand

**This paper has been developed
by the Infrastructure New
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Scope and purpose of this paper

This paper presents a private sector perspective on how the Public Private Partnership (PPP) model should be refined and updated to best serve New Zealand's present and future infrastructure needs.

It has been prepared based on feedback from pan-industry engagement conducted by Infrastructure New Zealand and is intended to support parallel work being done on this topic within Government.

The paper proposes that, rather than taking a 'one size fits all' approach, the PPP Model should be tailored to suit different projects, based on risk profile and the Government's objectives, and a streamlined 'Community Partnerships' model should be used for smaller projects. The paper also includes seven recommendations to harness the opportunities enabled by the PPP Model.

This overall approach is supported by detailed options for Government to consider, together with examples and use cases drawn from New Zealand and international best practice.



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Executive summary

Public Private Partnerships offer significant opportunity

New Zealand is a small market that faces significant cost, delay, and uncertainty because of a lack of an agreed long-term pipeline and collective national 'end'. Our spending per capita on infrastructure is high compared to other OECD nations, but the value we get from that investment is in the bottom 10%.

This must be turned around. It is time for a mature conversation on infrastructure, how we finance and fund it, and how we get the most out of the relationship between central government, local government, and the private sector to deliver better infrastructure, faster.

In this context, industry believes there is significant opportunity to harness private sector capability and capacity to support the delivery of New Zealand's infrastructure pipeline.

To realise this opportunity, New Zealand requires a comprehensive 'toolkit' of procurement methods — including standard form construction contracts, collaborative alliances, and privately financed models — that can be selected depending on the risk profile and desired outcomes of the infrastructure project. This approach recognises that there is no 'one size fits all' approach to infrastructure procurement.

Within this toolkit, industry sees strong potential to use Public Private Partnerships (PPPs), and similar partnership models involving private finance, for a selection of suitable vertical and horizontal projects. Well-executed PPPs for suitable projects can help to:

- drive better whole-of-life outcomes by integrating design, delivery, and asset management, and linking payment to successful operating performance,
- provide greater certainty as to project budget and schedule,
- utilise the full breadth of technical and financial delivery capacity of the private sector,
- benefit from the private sector's specialist expertise, efficiency, and capacity for innovation,

- provide opportunity for economic growth generating private sector investment (including iwi and other investors), and
- offer the opportunity to bundle similar scale projects, enabling and encouraging investment in programme scale efficiencies and innovation.

This opportunity relies on PPP models being kept up to date and fit for purpose

The potential benefits of PPPs, and similar partnership models involving private finance, can only be realised if these models are kept up to date, incorporate industry feedback, and are fit for purpose. The Infrastructure Commission has recognised the PPP Model's performance in New Zealand as generally positive, although not without challenges. Industry recognises these challenges and has identified areas for improvement which are set out in this paper.

It is worth noting at the outset that refined partnership models are not a 'silver bullet' for Government or industry. We recognise the foundational importance of a range of complementary initiatives which are beyond the scope of this paper, including:

- increasing construction industry capacity,
- improving consenting and other regulatory settings,
- assessing and prioritising different infrastructure needs within a credible pipeline,
- selecting the appropriate contracting model for each project,
- implementing best practice in risk assessment and project planning and management, including independent oversight where appropriate, and
- empowering experienced Government-side project leads who can provide the necessary direction and navigate potential roadblocks.



We have worked with industry to refine the partnership models

Infrastructure New Zealand (INZ) sees an opportunity to refine the existing PPP Model and consider other models for facilitating partnerships to finance, deliver, and maintain New Zealand's infrastructure.

We believe that any refinement process should be informed by a range of sources, including the lessons learned on New Zealand's eight previous PPPs, recent local market developments, and international best practice.

Therefore, in the development of this paper, led by our Funding & Financing Working Group, INZ has canvassed feedback from a range of our private sector members. This includes equity and debt providers, design and construction contractors, facilities and asset managers, and the advisory community.

We have sought to present a pan-industry view, highlighting points on which there is some consensus from the feedback received, or where appropriate, presenting multiple options which have each attracted a reasonable degree of support amongst participants in the market engagements. However, we acknowledge that it is not practical or realistic to express a unanimous industry position that harmonises all individual viewpoints across the sector. As such, we have included supplementary views in Appendix 2 and Appendix 3 to ensure workshops and discussions are accurately reflected.

While we have undertaken some initial consultation with Government to understand areas of focus and what forms of industry feedback might be most useful, the viewpoints expressed in this paper are intentionally those of industry alone.

We have developed two scale-appropriate models

Industry recognises that large-scale, nationally significant infrastructure should be procured differently to smaller community-scale infrastructure. To ensure that Government can effectively leverage private sector expertise and capital in both cases, and best utilise the capacity of diverse industry participants, we have developed two scale-appropriate models.

Model One: Refined PPP Model for large-scale projects (over ~\$200m)

This model builds on New Zealand's existing PPP Model and documentation, while accommodating industry feedback on how the model can be refined to improve outcomes. It includes a more tailored and flexible approach to risk allocation and risk sharing, a renewed focus on collaboration and partnership, and process improvements designed to maximise return on effort during the request for proposal (RFP) and later phases.

Model Two: Community Partnerships Model for small-scale projects (up to ~\$200m)

This model is designed to enable private financing for smaller scale projects for which the fully developed PPP Model would be too complex. The focus is on a simplified process and commercial terms to enable greater participation from the local contractor market. We have outlined two forms that this model could take:

- **Model 2A:** The 'PPP-Lite' Model for core infrastructure delivery (such as school builds).
- **Model 2B:** The 'Long Term Service Agreement' (or Lease) Model for an even lighter-touch approach for quasi-public assets with some commercial characteristics (such as social and affordable housing and local health hubs).



We have seven recommendations

A summary of key recommendations and reflections from the industry:

1. Use PPPs selectively on projects that have a well-defined scope, set of objectives, and risk profile

The PPP Model can excel in cases where Government's priorities include on-time and on-budget delivery, whole-of-life performance, value-for-money, and innovation. Conversely, where the project is more fluid and less defined, or material risks are unable to be quantified, a collaborative procurement model (for example, alliance or early contractor involvement) may be more appropriate.

For detail supporting this recommendation, refer to page 7 ('Introduction and Context – PPPs are part of a broader toolkit') and page 10 ('Model One – Use cases for the Refined PPP Model').

2. Adopt a menu of PPP approaches that enable flexibility for projects, rather than a 'one size fits all' model

The approach should be adapted to suit large and small projects, horizontal and vertical projects with different risk profiles, and different Government objectives. This more flexible, tailored approach is consistent with recent practice in other markets such as Canada (in particular, Ontario and British Columbia) and Australia (where, for example, Victoria is moving from a single model form to an array of economic, community, and precinct partnerships).

For detail supporting this recommendation, refer to page 8 ('Introduction and Context – The existing PPP Model has the potential to be refined'), page 11 ('Model One – Refinement One: Risk allocation and pricing mechanism'), page 17 ('Model One – Refinement Four: Procurement Process'), and page 22 ('Model Two – Industry recommended approaches for Community Partnership models').

3. Refine the PPP Model for large-scale projects to drive broader industry acceptance

We recommend that Government considers the following points when refining the model:

- There are some 'easier wins' that can be implemented

immediately. These include a renewed focus on ensuring that delivery and operational requirements focus on 'big picture' project outcomes rather than granular details, and process improvements to make deals easier to transact (for example, by allowing bidders to rely on Government reports and maximising the level of meaningful engagement in bidder interactive sessions).

For detail supporting this recommendation, refer to page 15 ('Model One – Refinement Two: Simplification of the operating regime including outcomes-focused KPIs and abatements') and page 17 ('Model One – Refinement Four: Procurement Process').

- There is industry consensus that risk allocation needs to be revisited, but the magnitude of the change will differ from project to project. We have outlined two structures: the first with targeted risk sharing to address project-specific challenges (for example, geotechnical conditions, land ownership, utilities location, and consenting); and the second with more generalised risk sharing based on an Incentivised Target Cost (ITC) model, with a 'painshare/gainshare' regime. Each option has its own benefits and trade-offs. We would encourage Government to consider both options and make an informed decision about which is appropriate for any given project or if the project would be better suited to a non-PPP procurement model due to, for example, a high degree of uncertainty or difficulty in clearly defining the project scope upfront.

For detail supporting this recommendation, refer to page 11 ('Model One – Refinement One: Risk allocation and pricing mechanism').

- Government should be intentional in designing a procurement process to suit the project and the desired outcomes. Beyond some initial 'low hanging fruit' process improvements, there are choices that can be made between, for example, a shorter but less certain process to choose a preferred bidder and a longer but more certain process. Rather than advocating for one standard procurement path, we have identified factors that would favour one format over another and offered suggestions on how to maximise efficiency and value-for-money in either case.

For detail supporting this recommendation, refer to page 17 ('Model One – Refinement Four: Procurement Process').

4. Implement a streamlined Community Partnership Model for smaller projects

Rather than trying to fit smaller projects into the Refined PPP Model for large-scale projects, a more streamlined Community Partnerships Model should be considered. These include (1) the 'PPP-Lite' Model, which could use NZ3916 as the basis for its design and construct (D&C) obligations, and potentially reduce the liquidated damages and security requirements imposed on contractors and (2) the Long Term Service Agreement (or Lease) Model, which is a simpler services contract providing a long term revenue stream to support upfront capital investment by the private partner. In either case, the Government's requirements and evaluation criteria should reward standardised, replicable elements wherever possible. While some project-specific tailoring is often needed, even for smaller projects, this should be done intentionally and kept to the minimum required to achieve the Government's desired project outcomes – that is, the starting point should be 'standard by default' rather than 'bespoke by default'.

For detail supporting this recommendation, refer to page 22 ('Model 2A – PPP-Lite Model') and page 25 ('Model 2B – Long Term Service Agreement (or Lease) Model').

5. Embed features, in and beyond the contract, that foster collaboration and proactive resolution of issues

Consider the use of Key Result Areas (KRAs) to foster collaborative practices under the project agreements, third party agreements, and/or consenting charters to chart out the necessary engagement with local authorities in advance, and a renewed focus on training and personnel continuity. However, recognise that adding superficial 'collaborative' features to a contract will not on its own be sufficient. To convert collaborative intent into lasting success, both Government and the private partner need to dedicate significant resources and incentives to this exercise.

For detail supporting this recommendation, refer to page 15 ('Model One – Refinement Three: Renewed focus on partnership, collaboration, and active SPV management').

6. Consider smart bundling strategies early in procurement and include robust contractual mechanisms to facilitate future expansion/augmentation of projects

These strategies have been used in a few previous cases in New Zealand (for example, on the Schools PPPs), and more frequently and systematically in Australia, to reduce upfront transaction costs, promote standardisation of common elements, and drive economies of scale during operations. If designed correctly, they can also foster a more relationship-based approach without sacrificing commercial rigour or value for money.

For detail supporting this recommendation, refer to page 20 ('Model One – Refinement Six: Augmentation/ expansion mechanisms') and page 22 ('Model 2A: PPP-Lite Model – Simplified Procurement Process').

7. Regularly review the affordability threshold

This was identified in the Infrastructure Commission's Transmission Gully Post-Construction Review in May 2024. The industry would take this further and note that the cost-benefit analysis which helps to determine the affordability threshold needs to be refined to ensure that we place a value on intangibles such as improved resilience and whole-of-government outcomes rather than just focussing on direct monetary and productivity benefits.

For detail supporting this recommendation, refer to page 20 ('Model One – Refinement Five: Affordability Threshold').



Introduction and context

There is significant opportunity to harness private sector capacity to support infrastructure investment for New Zealand's future

New Zealand has a clear choice: continue with the current approach to infrastructure investment, allowing for more drift in how it funds and builds its infrastructure, or implement significant reform to improve efficiency and ensure adequate funding over time to maintain our assets.

New Zealand's spending per capita on infrastructure is high compared to other OECD nations but the value we get from that investment is in the bottom 10%. This must be turned around. It is time for a mature conversation on infrastructure, how we finance and fund it, and a fundamental reset of the relationship between central government, local government, and the private sector.

Pipeline certainty and longer-term thinking are needed

New Zealand is a small market that faces significant cost, delay, and uncertainty because of a lack of an agreed long-term pipeline and collective national 'end'. Longer term thinking and accountability for investment decisions need to be a key feature of any new approach, and projects should fit in as part of that broader vision rather than be viewed in isolation.

In INZ's report, *Estimating the Costs of an Uncertain Infrastructure Pipeline*, it is estimated that greater pipeline certainty could unlock productivity benefits and improvements to enable between \$2.3 to \$4.7 billion more capital investment each year.

Private sector financing and expertise in design, construction, and maintenance need to be at the centre of change

There is an opportunity to leverage third party capital, design, delivery, and maintenance capability to deliver and maintain infrastructure in New Zealand. This has the potential to enhance delivery capability and productivity, and transfer key risks of deliverability and whole-of-life

asset quality to the private sector. PPPs are one way to do this and leverage the strengths of both the public and private sectors.

PPPs are part of a broader toolkit

There is no 'one size fits all' approach to infrastructure procurement. New Zealand requires a comprehensive toolkit of procurement methods — including standard form construction contracts, collaborative alliances, and privately financed models — that can be selected by procuring authorities depending on the risk profile and desired outcomes of the infrastructure project.

Within this toolkit, industry sees strong potential to use refined PPPs, along with other partnership models involving private finance, for a selection of suitable vertical and horizontal projects. PPPs combine the efficiency, expertise, innovation, and capital of the private sector with the public sector's objectives and regulatory oversight to deliver public infrastructure and service.

It is worth noting at the outset that PPPs and similar models are not a 'silver bullet' for Government or industry. We recognise the foundational importance of a range of complementary initiatives which are beyond the scope of this paper, including:

- increasing construction industry capacity,
- improving consenting and other regulatory settings,
- assessing and prioritising different infrastructure needs within a credible pipeline,
- selecting the appropriate contracting model for each project,
- implementing best practice in risk assessment and project planning and management, including independent oversight where appropriate, and
- empowering experienced Government-side project leads who can provide the necessary direction and navigate potential roadblocks.

PPPs are long-term contracts that can improve service delivery outcomes

PPPs are a long-term contract for the delivery of a service, where provision of the service requires the construction of a new asset or enhancement of an existing asset, that is financed from external sources on a non-recourse basis. Full legal ownership of the asset is retained by the Crown.

As outlined by the Infrastructure Commission, the key policy characteristics of the New Zealand PPP Model include:

- a focus on service outcomes,
- the construction of a new infrastructure asset, or substantial enhancement of an existing asset, to facilitate the delivery of service outcomes,
- the delivery of service outcomes by a private sector partner for a defined period (often between 20-30 years),
- the efficient allocation of risk to the party best able to manage that risk,
- the separation of ownership (retained by the public sector) and financing (provided by the private sector partner) to provide meaningful risk transfer and management, and
- the application of a payment for performance regime to incentivise the delivery of specified service outcomes and to penalise non-performance.

When deployed effectively, PPPs can improve the delivery of service outcomes for major public infrastructure assets by helping to:

- drive better whole-of-life outcomes by integrating design, delivery, and asset management, and linking payment to successful operating performance,
- provide greater certainty as to project budget and schedule,
- utilise the full breadth of technical and financial delivery capacity of the private sector,
- benefit from the private sector's specialist expertise, efficiency, and capacity for innovation,
- provide opportunity for economic growth generating private sector investment (including iwi and other investors), and
- offer the opportunity to bundle similar scale projects, enabling and encouraging investment in programme scale efficiencies and innovation.

When assessing the suitability of the PPP Model for any procurement, Government of course needs to weigh up the value of these benefits for that particular project against the anticipated costs of a PPP procurement (including transaction and finance costs).

Lessons can be learned from past challenges

The potential benefits outlined above can only be realised if PPPs, and similar partnership models, are kept up to date, incorporate industry feedback, and are fit for purpose.

In 2021, the Infrastructure Commission published the New Zealand Public Private Partnership Model Review, in which it recognised the PPP Model's performance as generally positive, although not without challenges. Industry recognises these challenges and has identified areas for improvement. These include inflexibility on risk allocation, onerous and time-consuming procedures during various phases of the project, and the model being relatively inaccessible for and not well understood by smaller, local contractors.

While the Infrastructure Commission's Transmission Gully Post-Construction Review, released in May 2024, concluded that the PPP Model was not responsible for the challenges faced on that project, there is an industry-wide desire to work with Government to ensure that lessons learned are disclosed and discussed as openly as possible and are incorporated into the model going forward.

The existing PPP Model has the potential to be refined

Industry is eager to work with Government

The Government is seeking to return to the use of PPPs and other alternative delivery models, and industry wants to work with Government to create enduring models that can be used where appropriate to leverage private sector expertise, capital, and finance. INZ and its private sector members see an opportunity to refine the existing model and consider other models for facilitating external partnerships to finance, deliver, and maintain New Zealand's infrastructure.

We believe that any refinement process should be informed by a range of sources, including the lessons learned on New Zealand's eight previous PPPs, recent local market developments, and international best

practice. It should also form part of a broader, ongoing conversation between industry and Government on procurement model selection and how industry can best support the delivery of Government's infrastructure agenda.

We have developed two scale-appropriate models and a range of detailed recommendations

Industry recognises that large-scale, nationally significant infrastructure should be procured differently to smaller community-scale infrastructure. To ensure that Government can effectively leverage private sector expertise and capital in both cases, we have developed two scale-appropriate models:

- 1. Refined PPP Model for large-scale projects (over ~\$200m)**
- 2. Community Partnerships Model for small-scale projects (up to ~\$200m)**

These models build on the feedback received from the wider sector, particularly the need for a menu of well-defined options rather than a 'one size fits all' approach.

Our proposed refinements are based on wide sector engagement

The Funding & Financing Working Group drafted a working paper

The process was initiated by INZ's Funding & Financing Working Group, which comprises a range of industry experts from advisory, equity, debt, and contractor backgrounds.

The Working Group developed an initial working paper in early 2024 as a basis for broader sector discussion. This initial paper highlighted different options and trade-offs, to show the flexibility of the model and prompt meaningful feedback from INZ's wider membership.

A broad range of industry feedback was gathered

Sector workshops were held in Auckland and Wellington in May and early June 2024, using the working paper to tease out points of sector agreement, as well as areas where there were supplementary views.

Participants ranged across:

- equity and debt providers,
- design and construction contractors and consultants,
- facilities and asset managers, and
- legal and financial advisors and other members of the advisory community.

This final paper aims to present a pan-industry view

In this paper we aim to consolidate the feedback received and present a pan-industry view. We highlight points on which there is broad consensus based on the feedback we received, or where appropriate, present multiple options which have each attracted a significant degree of support.

However, we acknowledge that it is not practical or realistic to express a unanimous industry position that harmonises all individual viewpoints. Where supplementary views have been uncovered during our industry engagement process, we have identified these in the paper. This is to ensure that workshops and discussions are accurately reflected.

There has been initial consultation with Government to understand priorities and relevance

We have undertaken some initial consultation with Government to understand key areas of focus and priorities, and to confirm what forms of industry feedback might be most relevant and useful.

However, the viewpoints expressed in this paper are intentionally those of industry alone. That is, they are independent of Government.

This final paper will be provided to Government (including Treasury, the Infrastructure Commission, and key agencies) and industry is open to engaging further on any of the included ideas and recommendations.



Model One: **Refined PPP Model for Large-Scale Infrastructure Delivery**

The existing PPP Model provides a framework for the delivery of public infrastructure and related services under a 'whole-of life' procurement approach. It is typically used for large individual projects (or bundles of smaller projects) with a total capital cost ranging from approximately \$200 million to over \$5 billion. The model has delivered a number of successful projects in New Zealand and around the world. However, there is room for improvement.

To ensure that PPPs are fit for purpose and respond to current industry conditions, we would encourage Government to consider making a suite of changes to the commercial framework and procurement process, to ensure we can learn from practical lessons from previous PPPs in New Zealand and international best practice. We would suggest considering these changes on a tailored 'best for project' basis rather than adding more features and complexity to every contract 'by default' (noting industry's preference for PPP documentation to be as simple as possible within the bounds of what is achievable for a structured, whole-of-life arrangement).

Our recommended approach reflects industry consensus that there is no 'one size fits all' model for PPPs. The Refined PPP Model must include options that Government can flex to suit individual projects – for example, to reflect the different risk profiles that are typically associated with horizontal and vertical infrastructure projects. This more flexible, tailored approach is consistent with recent practice in other markets such as Canada (in particular, Ontario and British Columbia) and Australia (where, for example, Victoria is moving from a single model form to an array of economic, community, and precinct partnerships).

Use cases for the Refined PPP Model

The Refined PPP Model should be considered for the procurement of large-scale infrastructure projects where most (or all) of the following criteria apply:

- Government can clearly articulate the desired scope and objectives of the project.

- The project would benefit from a whole-of-life focus – for example, a single private partner takes long term responsibility for design, construction, and operations, and operational efficiency and maintainability are key drivers of project design. This factor is particularly relevant for projects with a more complex and/or higher value asset management and maintenance (including lifecycle) profile.
- Government wants upfront certainty on budget and delivery timeframe, with strong contractual incentives to deliver to these metrics.
- The risk profile and capital cost of the project can be assessed with some degree of certainty after taking into account due diligence, reasonable contingencies, and other measures, and Government sees value in transferring this risk to the private sector.
- Government is looking for innovation in a bidder's proposed solutions for one or more elements of the project – for example, design excellence, overcoming regional delivery constraints, optimised maintenance, employee and customer experience, and/or activation of a wider precinct – and is prepared to provide a less prescriptive and more outcomes-focused brief in order to ensure there is sufficient flexibility for such innovation to occur.

Considering New Zealand's infrastructure needs, and the criteria stated above, the Refined PPP Model for large-scale projects could be applied in the following sectors:

- Transport (for example, large-scale public transport and roading).
- Healthcare (for example, major hospital construction and redevelopment).
- Education (for example, bundles of large new school builds with concurrent delivery).
- Defence, justice, and corrections (for example, prisons).
- Water and wastewater (for example, large-scale treatment plants and networks).



However, it is important to emphasise that not all projects in these sub-sectors will be suitable for a PPP. If a project does not satisfy the majority of the criteria stated above, we would encourage Government to consider whether the project may be suited to a more collaborative construction delivery model – for example, alliance or Early Contractor Involvement (ECI) models, which could enable a more collaborative development process with risks to be managed jointly by Government and the contractor, albeit with less certainty and whole-of-life focus.

Our proposed refinements to the PPP Model that are set out below assume that a project is inherently suitable for delivery via the PPP Model.

Industry proposed refinements for the PPP Model

Refinement One: Risk allocation and pricing mechanism

As recognised by the Infrastructure Commission, a key principle of PPPs is the efficient allocation of risk to the party best able to manage and control that risk. While meaningful risk transfer to the private sector is a core benefit of using the PPP Model, there are risks which have proven difficult for the private sector to quantify, price, and manage on previous projects – for example, consenting and geotechnical risks on New Zealand's previous roading PPPs.

Many industry participants, particularly D&C contractors, are of the view that the risk allocation achieved on prior PPPs will be difficult to support in the current market environment. This view is at least partly informed by contractors' increased practical understanding of the applicable risks based on their experiences on prior PPP projects (including but not limited to the Transmission Gully and Pūhoi to Warkworth roading projects). While there are different opinions on the magnitude of change that is necessary, there is broad consensus that projects require more risk sharing and pricing flexibility than

others in order to make them viable and good value for money.

To this end, we present two distinct PPP pricing and risk allocation structures within the Refined PPP Model for consideration:

- **Option A: Existing PPP Model with Targeted Risk Sharing**
- **Option B: Incentivised Target Cost (ITC) PPP Model**

While we acknowledge that these options exist on a spectrum and many other variations are possible (including a combination where some scope items have a fixed D&C price and others have an ITC mechanism), we think it is important to start with a couple of base options that retain flexibility for adaptation to focus the discussion to provide a clearer path to implementation.

Regardless of the selected model, industry was clear that for a risk sharing approach to work in practice, there needs to be certainty over the availability of contingency funds at the Government level without a long approval process (in addition to sufficient contingencies being readily accessible at the SPV level). There also needs to be control over the use and access of those funds when needed, to enable a 'best for project' management of risks and to avoid delays while working through contractual processes. The objective is to enable all parties to proactively focus on emerging issues and have resources and budget to find technical or commercial solutions rather than letting the issues mature into legal disputes.

Within the two options presented, the Funding & Financing Working Group has attempted to present a middle ground and enable a more sustainable risk allocation. However, there remains concern from some parts of the industry that this does not go far enough to ensuring an appropriate risk allocation and incentivising collaboration within the PPP context – refer to Appendix 2 for details of this viewpoint.



Option A – Existing PPP Model with Targeted Risk Sharing

This option is the closest to the existing PPP Model in terms of risk allocation, with a fixed D&C price driving greater cost certainty and greater risk transfer from Government to the private sector. It is appropriate for projects that are well-defined and relatively certain overall but may contain a handful of less certain elements.

The main refinement under Option A is to introduce a targeted risk sharing regime for specific, difficult-to-assess risks that arise during the delivery phase of a project – for example, geotechnical risks. If deployed effectively, this approach would drive better value for money as bidders are not forced to price in excessive contingencies to deal with uncertain risks. It also reduces the risk of disputes and, in a worst-case scenario, contractor insolvencies during delivery.

Under this option, it would be the Government's role, in conjunction with the private sector, to identify which risks are challenging enough to merit a risk sharing approach for a particular project during the feasibility and market sounding phases, and the procurement process. In industry workshops, it was generally acknowledged that the risks under vertical projects were typically more quantifiable than in horizontal projects, although not always, particularly with higher levels of stakeholder engagement that can't be done upfront. In either case, the following key risks would be considered:

- Geotechnical risk – this is particularly relevant for large linear projects where it may be impractical to study the entire corridor in detail in advance.
- Utilities' location risk – similar applicability as above.
- Key commodity price risk – for example, steel, concrete, and bitumen.
- Consenting risk – including territorial authority interface, noting that the need for sensible collaboration and sharing of consenting may be even greater in the short term until proposed reforms to the Resource Management Act and Public Works Act

frameworks have been implemented and reach a steady state. Particular attention is required to managing situations in which the project critical path is in the hands of a party with no financial stake in the project.

- Land ownership – where required land has not yet been purchased or is not accessible.

Risk sharing would typically be achieved by expanding the regime for extension events (and compensation extension events) under the Project Agreement to offer more time and cost relief to the private party on those specific delivery-phase risks. To ensure that the private party remains incentivised to manage the risk as far as possible, and avoid claims for insignificant matters, options could include relief only being available if the impact exceeds an agreed threshold proposed and priced by the private partner as part of the tender process, or a cost-sharing mechanism where the private partner is only entitled to recover a pre-agreed percentage of the excess. **Documentation point (Project Agreement and D&C Sub-contract):** Refer to Appendix 1 for a more detailed outline of how the proposed risk sharing mechanism could be contractually implemented in the PPP Project Agreement and associated D&C Sub-contract. We note that similar risk sharing regimes and thresholds are often used to deal with project-specific risks on Australian PPP projects (in particular, contamination and change in law-related risks) and these may be a good reference point if drafting examples are required.

Other than the delivery-phase risk sharing described above, and the potential for greater requirements around active special purpose vehicle (SPV) management responsible subcontracting and collaboration measures set out later in this paper, the risk allocation under Option A would be largely unchanged from New Zealand's existing PPP Project Agreement.

There was broad agreement across industry workshop participants (although not unanimous agreement – see Appendix 2) that Option A would be the appropriate model for the procurement of most vertical infrastructure projects. However, for horizontal projects, and vertical projects where there are material elements of unquantifiable risk but for which Government still wishes to

use a PPP Model, industry would encourage Government to consider using the Incentivised Target Cost (ITC) PPP Model set out as Option B below and/or procuring the project in multiple packages with an appropriate mix of fixed price, ITC, and/or alliance portions.

Option B – Incentivised Target Cost (ITC) PPP Model

If a more fulsome change in the contracting structure is considered necessary (for example, due to a project having a high degree of cost uncertainty or being very large), an Incentivised Target Cost (ITC) PPP Model, which has some similarities to the pricing methodology of an alliance contract but is closer to a conventional D&C in its other terms, could be considered. The key difference compared to Option A is that Option B takes a generalised approach to risk sharing, rather than a targeted approach. As such, it may be more appropriate to deploy Option B where there are multiple unquantifiable risks, and the impact is difficult to isolate, and/or where long delivery timeframes make it difficult to fix the price upfront for a wide range of market-based inputs.

While there is some precedent for this model (most notably, the A\$11 billion North East Link (NEL) PPP in Melbourne, Australia, which has been commenced but not yet completed), wider market usage has so far been limited. As such, there is no standard model that is ready to adopt, and the Government would need to allow a longer lead time to work up and test the model before launching a transaction. **Documentation point (Project Agreement):** *If Government wishes to produce an ITC version of the PPP Project Agreement, the closest precedent is likely to be the NEL documentation although this has market-specific and project-specific features and would need to be adapted for the New Zealand context. Potential reference points for this adaption (for example, to make sure that terminology is conformed to New Zealand market practice) would be the target outturn cost mechanisms*

included in recent NZTA alliance contracts and under consideration in other sectors. While clause 2.5 of the recently revised NZS3910:2013 contains a similar mechanism, it was noted by participants that this was lacking in detail and therefore is not sufficient for this context.

- At a high level, the ITC PPP Model would incorporate a target outturn cost (TOC) pricing model (similar in some respects to the pricing mechanism under an alliance contract) under which the Crown, the SPV, and the D&C Sub-Contractor each share in the risk of overall cost overruns and the benefit of overall cost savings during the delivery phase. The TOC for design and construction would be based on expected allowable costs (i.e., limb 1) with certain allowances for profit and overhead (i.e., limb 2) and 'painshare /gainshare' amounts (i.e., limb 3). Consistent with the parties' collective commitment to transparency and visibility of cost and time, the Crown would need to work with the SPV and the D&C Sub-Contractor during the procurement phase to understand the build-up of the TOC for the project.
- The 'painshare/gainshare' regime would be designed to expose the parties to an agreed share of cost overruns and savings, noting that the percentages may change once agreed thresholds are reached.
- The private parties' 'painshare' would ultimately need to be subject to an agreed cap for the project to remain 'bankable' for equity investors and lenders, and manageable for the D&C Sub-Contractor. Where ITC pricing mechanisms have been used on non-PPP projects, this cap has typically been linked to the contractor's margin in some way. Whatever the precise mechanism, the Crown will likely need to bear

any residual cost overruns beyond the agreed cap. This is likely to represent better value for money for the Crown, than requiring the private sector to price in large contingencies in an attempt to cover risks that it cannot readily quantify or manage.

The intention of using an ITC-based mechanism is to prioritise a 'best for project' outcome by aligning the parties' interests and promoting some degree of increased collaboration during project delivery. In this respect, it shares some features with an alliancing agreement but without the inclusion of the 'no fault, no blame' principle that characterises the 'fully collaborative' alliance end of the contracting spectrum. Other than the pricing mechanism, however, the ITC PPP Model could retain the core features of a PPP, such as fixed delivery timeframe with a liquidated damages regime, completion requirements, defects liability, and ongoing performance KPIs. These PPP features would need to be tailored specifically to each project noting, for instance, that differing liability caps may need to be incorporated compared to typical PPP projects to give effect to the TOC pricing model and the 'painshare/gainshare' regime.

This model would require a more careful and transparent open-book monitoring of allowable costs incurred, and more generally, a higher level of trust, transparency, and investment in shared cultural norms between the parties as compared to Option A above. Industry participants who have prior experience in ITC-based projects commented that a general ITC approach may be superficially simpler than creating a bespoke regime for each individual risk, however this does not usually equate to less work overall during the procurement and delivery phase, and rather, tends to demand a higher level of resourcing and skill to administer than a less collaborative model. A fulsome risk pricing exercise is also still required to set the TOC.

While the potential time and resourcing implications should not be seen as a barrier to exploring the model, it should be recognised when setting a procurement timeframe and allocating resources (both Government-side and private-side) to support a project. For the model to work effectively, and to ensure the pain/gain incentives

drive meaningful behaviour, a reasonable amount of preparatory work is required to ensure alignment on the TOC value itself, as well as the allocation of risk which may, or may not, cause the TOC to increase if the risk materialises.

If this model were adopted in New Zealand, the Crown and industry would need to work through the balance between the greater flexibility inherent in the ITC structure and the need to maintain sufficient structural certainty to enable whole-of-life pricing, as noted by facilities management (FM) and operations and maintenance (O&M) industry participants. Implications for private financing due to reduced certainty will also need to be managed to mitigate any resulting pricing or gearing impacts, as noted by equity and debt industry participants, if the value proposition from the PPP procurement is to be maintained, including with reference to the costs of private finance compared to the benefits of the PPP Model. There may be alternative approaches, including government contributions/grants to the project as utilised in Australia, which can assist to mitigate these impacts.

While the limited existing precedents (for example, the ongoing NEL project in Melbourne) may provide some guidance on how to strike the required balance, some time and effort would be required to get project participants comfortable with how to manage this in the New Zealand context. Where an appropriate balance cannot be struck which maintains the underlying value proposition of a PPP procurement due to a specific project's risk profile, then alternative contracting models utilising multiple packages and/or a more collaborative approach may be more appropriate.

Refinement Two: Simplification of the operating regime including outcomes-focused KPIs and abatements

As recognised by the Infrastructure Commission, a defining characteristic of New Zealand's PPP Model is its focus on service outcomes. It is important that key performance indicators (KPIs), performance standards, and abatements/deductions for not meeting them, are designed with this in mind.

Industry's general perception is that this outcomes-focused approach was well reflected on some of New Zealand's early PPPs – for example, Wiri Prison, which included a reward for reducing recidivism and focused on major issues. However, on later PPPs, there has been a tendency towards adding more complex requirements. Workshop participants identified cases where this tendency has been unhelpful including KPIs which do not clearly translate into a better user experience or tangible community benefit, and/or which are not resilient to changes in neighbouring infrastructure (for example, a roading KPI system that is so sensitive that it could be triggered by changes in a traffic light phasing system).

In this context, industry has the following suggestions:

- There is a strong consensus that specific KPIs should be limited to the core requirements and outcomes expected during operations. This simplifies operational risk assessment and enables easier contract management, while continuing to incentivise the right behaviours. By focusing on overall outcomes rather than granular tasks or methods, it also gives the private partner more latitude to propose innovative ways to achieve the same outcome more efficiently.
- Where possible, design led performance should be tested via works completion tests/close-out tests to confirm compliance with the minimum contract requirements rather than being added as separate ongoing KPIs to be met during the operational phase of the project. This aligns with, for example, the process in energy projects where works completion tests are run to show ability to perform under different conditions and enables the operational KPIs to be outcomes focussed.
- There should be clear training for all sides (Government, SPV, and Sub-contractors) on how the performance regime operates. Industry is interested in exploring whether this would be done as a jointly attended training session, so that there is a common understanding from the outset about all key aspects.

This suggestion is complementary to our suggestions in relation to continuity of personnel below.

Refinement Three: Renewed focus on partnership, collaboration, and active SPV management

Partnership and collaboration are key to any project being a success. These are particularly important values on a whole-of-life contract such as a PPP, which requires the procuring authority and the private partner to maintain a decades-long relationship. There is broad agreement across the industry that more needs to be done to foster true partnership and collaboration, both between Government clients and the private consortium, and within the consortium itself (including between the lead parties and subcontractors). This would support issues to be identified early and dealt with on a 'best for project' basis. Industry also recognises the value of the project SPV (i.e., equity) taking a more active approach to managing risk and solving problems.

Subject to the caveats mentioned below, industry is eager to explore the potential to include Key Result Areas (KRAs) to contractually incentivise collaboration under the PPP Project Agreement. KRAs have been used in New Zealand within alliance contracts in the transportation sector, typically linked to payments under limb 3 of the TOC pricing, and internationally (for example, on the Sydney Metro Western Sydney Airport PPP) to reward suitable collaborative behaviours, such as:

- early notification of delays and other communication protocols,
- risk and cost management, including contingency,
- communication effectiveness and an assessment of 'best for project' management of issues/risks as they arise,
- strong sub-contractor collaboration and management, including assessments around 'positive and equal partnership' and undertaking health-checks on the design and construction consortium to ensure it continues to function efficiently,
- environment, health, and safety compliance, and
- project management (including no 'vexatious' claims).

The adoption of KRAs into the PPP Project Agreement is an example of how New Zealand can borrow from other procurement models (such as alliancing) and other jurisdictions to ensure that its PPP Model is up to date and reflects current priorities. However, participants generally acknowledged that inclusion of KRAs alone

will not be sufficient to mitigate an inappropriate risk allocation or create a meaningful culture of collaboration (and some expressed doubts that this could be fully achieved under a fault-based contract model – see Appendix 2 for more details of this view). While under the ITC PPP Model, the behaviours can be linked to payments under limb 3 of the pricing structure to incentivise parties, further thought needs to be given to how the underlying PPP contracts, including subcontracting structures, can be amended to achieve this objective. **Documentation point (Project Agreement):** *If Government wishes to include KRAs in the PPP Project Agreement, drafting examples can be found on several Australian PPP project deeds (some of which are publicly available) and in alliance contracts for transportation projects in New Zealand (for example, Waterview Alliance and City Rail Link).*

Another example of international best practice (seen on recent Australian projects) is the use of ‘third party agreements’ between the Government procuring authority and key local government stakeholders (for example, those responsible for granting local consents). These agreements are entered into in advance to clearly set out the parties’ respective responsibilities for the consenting workflow and the level of collaboration required. In a similar vein, locally ‘consenting charters’ were used with Auckland Council for both the Waterview Alliance and the City Rail Link projects. While not contractually binding for those projects, the charters nevertheless promoted a governance approach that allowed statutory approval risks to be more effectively managed. **Documentation point:** *While the content will need to be drafted to reflect the specific subject matter on which cooperation is required, general precedents for third party agreements can be found on recent Australian projects (such as the Sydney Metro Western Sydney Airport PPP) and examples of consenting charters can be found on the Auckland-based projects referred to above.*

That said, it is important to acknowledge that contractual incentives will only be successful if combined with other non-contractual drivers of collaboration including cultural factors, good project management, and recruitment and retention of high-quality personnel. To this end, industry is supportive of intensifying the focus on the following ‘Partnership Enabling Principles’ during procurement, delivery, and operations:

- **Training:** Government and the private consortium should each take responsibility for providing clear guidance and training to their respective personnel, including subcontractors who may have limited PPP experience, to ensure that the PPP contract is well understood.

- **Resourcing and contingencies to allow for active management:** Government and the private consortium each need to (1) appropriately resource the contract management function with sufficient personnel, and (2) allocate a sufficient delivery-phase budget including contingencies to enable proactive and collaborative engagement at all levels to resolve issues as they arise. Procuring agencies may also wish to consider including express evaluation criteria in relation to active equity and SPV management (which bidding consortia must address in their RFP response), as is now common practice on PPP procurements in New South Wales and other Australian jurisdictions.
- **Continuity of personnel:** Government and the private consortium – including the SPV as an active manager, and the D&C and FM/O&M Sub-contractors – should each maintain adequate continuity of personnel (or failing this, fulsome handover processes) between the procurement period and delivery period. This ensures that institutional knowledge of the project and contracts is carried forward and reduces the risk of future disputes, misunderstandings, and oversights.
- **Maintaining a strong sub-contractor market:** Many industry participants voiced this concern during engagement workshops; there is a recognition that, despite international contractors entering the market to bid and deliver large projects, there is a reliance on local contractors and supply chains, including many small and medium enterprises, to deliver the work. To support the sustainability of the subcontractor market, some have suggested that PPP and other procurements should include ‘health checks’ or other forms of visibility and accountability for sub-contracting activities to ensure that the risk pass-through remains appropriate (i.e., held where it is best able to be managed) and sustainable, and that the behaviour of head contractors around their risk pass-down and honouring of contracts is being managed. There is also interest in exploring how contractor market sustainability can be better incorporated into bid evaluation criteria and/or KRAs in the Project Agreement as ensuring the ongoing sustainability of the construction sector needs to be a core consideration of any contracting model.

Given the importance of partnership, collaboration, and market sustainability, a number of local contractors and consultants have provided a supplementary paper (refer Appendix 3) to provide further detail regarding their expectations of a refreshed PPP Model.



Refinement Four: Procurement process

In contrast to some of the collaborative procurement models which focus solely on contracting the initial delivery of infrastructure, PPP procurement processes traditionally retain competitive tension for a longer period, resulting in a more fixed and certain whole-of-life solution before appointment of preferred bidder. To get the level of certainty required, the existing PPP bid process has typically consisted of a 5–6-month RFP process where 2–3 shortlisted parties develop and submit priced bids with committed financing. This has been followed by a short, preferred bidder phase which is primarily focussed

on documentation finalisation and meeting conditions precedent rather than further bid development.

The certainty and competitive tension which results from this process has been beneficial for Government procuring agencies. However, the time, cost, and market resources associated with the RFP period has been a topic of discussion for industry. While it is acknowledged that there are no shortcuts to good procurement for successful delivery of an infrastructure project, we believe there are ways to address some of industry's concerns while still meeting the Government's objectives, as outlined below.

General improvements identified with broad industry support

There is broad industry support for the following to be adopted for PPP procurement, noting many of these suggestions are already part of other contracting approaches in New Zealand:

- **Provide bid cost compensation in order to compete with international markets (for example, Australia) and properly reward bidder effort.** Consistent with some recent examples in New Zealand, the industry strongly supports the practice of stipends (ideally a fixed sum equal to 65–75% of anticipated bid costs) being paid to reimburse unsuccessful, shortlisted bidders for their efforts in the RFP stage of procurement. While intellectual property from the losing bidders is retained by Government with the payment of the stipend, the true value of the stipend is maintaining a competitive and functioning market in which bidders can invest in high-quality responses.
- **Allow bids to be based on Government reports for pricing purposes (for example, ground condition and utility location), rather than requiring each bidder to perform its own duplicative due diligence.** This is recommended to streamline the procurement process, although its application to any given process depends on the approach to risk sharing. If the risk allocation is sensible from the outset, this will naturally take pressure off the due diligence process by reducing the need to perform impractical amounts of due diligence or technical studies during the RFP phase to try to quantify risks which are highly uncertain (for example, detailed geotechnical investigations along an entire motorway alignment).
- **Limit required documentation deliverables to the Project Agreement mark-up, term sheets, and binding commitment letters.** The provision of full documentation should not be looked on more favourably (for example, fully drafted D&C and FM contracts and debt facility agreements, and fully developed delivery and operational phase management plans).
- **Provide clear evaluation criteria so that bidders can understand where to focus their efforts during the bid process.** For example, Government should provide clear guidance on which elements should be the focus of innovation and design development, and which are standard elements to be adopted without material change.
- **Balance probity with ability to provide specific feedback during the bidder interactive sessions to enable improved solutions to be bid.** In New Zealand and overseas, we have seen more responsive, competitive, and innovative bids submitted in cases where Government project teams are empowered to give direct, specific feedback through interactive sessions, rather than being overly focused on probity constraints. This also reduces the need for time-consuming 'Best and Final Offer' (BAFO) processes.

Alternative approach to consider: Shorter RFP phase followed by longer preferred bidder phase

While there can be no overall shortcuts in the procurement timeframes if objectives are to be met, there was some industry support for reallocating time so that there is a shorter and less costly RFP phase, and a longer preferred bidder phase for certain projects. Industry discussions identified that this reallocation of time might be suitable in some instances where the project scope is complex and less well-defined upfront, and the Government procuring agency is looking for a more collaborative project definition and design process to ensure project objectives are able to be met.

Under this alternative approach, the expected RFP deliverables and evaluation criteria would need to be adjusted (i.e., to be less developed and firm) and further bid development would be required during the preferred bidder phase to achieve the level of certainty required for financial close.

A benefit of this approach could be to expand market capacity when there are multiple large horizontal or vertical projects being bid at once – that is, select a preferred bidder earlier so that other teams can be freed up for other projects. Under this variation, the design would be progressed further during the preferred bidder phase in a collaborative, rather than competitive, environment. This approach would also reduce the stipends payable to unsuccessful bidders given the lesser deliverables prior to preferred bidder selection (although this would need to be offset by the potential need to pay a material pre-development or off-ramp amount to the preferred bidder to compensate for work performed if the process is discontinued for any reason).

While there was some support for this alternative process, other industry parties expressed concerns about potential timing and process risk (noting that previous experiences of elongated bilateral processes on either side of the Tasman have not always been positive – for example, in relation to Christchurch Convention Centre, and the Circular Quay Renewal, Inland Rail, and the first attempt at Canberra Light Rail 2 in Australia).

It was acknowledged that trade-offs would need to be considered by procuring agencies if a shorter RFP phase were enacted:

- Government will have less certainty on the solution and whether it represents whole-of-life value for money at the point of preferred bidder selection. This could have an unintended consequence of further ‘time creep’ during the preferred bidder phase if it takes longer than anticipated to finalise the solution and documentation. However, it may also enable the delivery solution to be further developed, reducing the likelihood of disputes during the delivery phase.
- Competitive tension between bidders will be lost earlier in the process before firm pricing is provided. Government will have less bargaining power during the preferred bidder phase than it did during the RFP phase, noting that it is highly unlikely that Government will be able to keep a ‘reserve bidder’ in play during an extended preferred bidder period. In this scenario, Government would need to consider whether it can deploy other controls to retain a degree of ‘market’ price tension during the preferred bidder phase (for example, some form of benchmarking or later tendering of subcontract packages on a transparent basis, noting that these methods are not uncommon within other procurement models).
- The process is likely to favour incumbents over new market entrants (for example, international sponsors and contractors), due to a more subjective RFP process and the need to navigate an extended, bilateral preferred bidder phase during which, familiarity with the Government procuring agency and how they operate will be a great asset.

While consensus was not reached on all aspects of an alternative process or the scenarios in which it may be appropriate, there was considerable agreement that it would be reliant on a steady stream of projects so that parties can bid on the basis of ‘win some, lose some’ and Government can equally take a portfolio view of the risk and value positions achieved.

A few industry participants suggested an even earlier selection of the preferred bidder based

primarily on capability statements (see Appendix 2 for details). There have also been further ideas suggested post the industry workshops, these have not been tested with the broader industry group however are included for completeness (see Appendix 2 for details).

Alternative approach to consider: Run lender process during preferred bidder phase

While lenders add a further level of rigour to projects, there was some industry support for running the debt financing competition during the preferred bidder phase rather than requiring full debt commitments as part of each bidder's RFP submission. While this disaggregation of the debt financing element would further streamline the RFP process, the trade-offs would include reduced certainty of RFP submissions (given that debt sizing and pricing impacts the overall cost of the project) and a risk that key structuring and risk positions bid at RFP may need to be reopened in the preferred bidder phase if they are found to be unbankable at that point.

As the pipeline of privately financed projects increases, a deferred debt process may become more readily achievable, especially on simpler projects, due to greater familiarity and standardisation of documentation and risk allocation, and less risk of the 'downside surprises' referred to above. If this alternative is adopted, the debt financing competition should be run as early as possible in the preferred bidder period, to improve the ability for lender comments on the proposed solution and the documentation to be addressed other than via more conservative debt sizing or pricing.

While there was some support for a deferred finance competition, there was a general reluctance to consider further disaggregation of elements of the PPP (including delaying FM involvement or equity selection) given the implications this could have on the whole-of-life focus and broader outcomes sought by the procuring agency.



Refinement Five: Affordability threshold

Time delays during the business case and procurement process can lead to sub-optimal outcomes for projects as inflation and other cost increases aren't always fed into the affordability threshold. As recognised in the Infrastructure Commission's Transmission Gully Post-Construction Review, an unrealistically low affordability threshold can result in bidders value-managing design and timelines to a point where unnecessary risk is introduced into the construction phase of the project. We suggest:

- appropriate setting at the initial business case phase, taking into account whether innovation or standard specifications are the desired outcome for the project,
- affordability threshold resets for inflation, etc. post business case to be undertaken pre-bid phase and, if appropriate for the process, pre-financial close with potential for independent review if a more complex analysis is required, and
- allowance for key commodity price indexing in specific circumstances, particularly with large-scale multi-year project delivery (i.e., diesel, steel, bitumen, or other significant pricing elements could be clearly assumed in the affordability threshold with movement dealt with on an open book basis).

The overall funding envelope for the project should also include sufficient project management resources and budget for Government to proactively and collaboratively engage where needed during the delivery phase.

Additionally, when undertaking the cost-benefit analysis to justify the stated affordability threshold or cost estimate for business cases, intangible resilience benefits need to be taken into account.

While the affordability threshold provides a guide for procurement and business case approvals, it needs to be understood that it shouldn't reflect a 'maximum price', noting that the competitive bid process in itself is setting the 'market price' for the project. In fact, during industry engagements some participants queried whether the affordability threshold was required at all (refer to Appendix 2 for further detail on this view).

Refinement Six: Augmentation/expansion mechanisms

While this feature was not initially tabled for discussion in INZ's working paper, it was raised in various industry forums and Government consultations. We believe the interest in PPP augmentation/expansion mechanisms is driven by a combination of (1) the desire across industry to find ways to make procurement processes more efficient, and (2) the recognition from industry and Government that it is more practical to deliver certain projects in multiple phases due to budget, market capacity, and/or operational constraints. The desire for efficiency however needs to be managed to ensure that competition can be maintained, particularly when the pipeline is limited.

There is a significant track record of PPP augmentations in Australia, including on multi-phase projects such as Sydney Metro, Gold Coast Light Rail, and Canberra Light Rail in the horizontal space and the Melbourne Convention and Exhibition Centre and Casey Hospital in the vertical space. In New Zealand, a similar expansion mechanism has been included in the documentation for the Schools 3 PPP project, and multi-stage delivery is also under consideration for other existing and proposed projects.

A well-designed augmentation/expansion mechanism has the potential to maximise integration across a multi-phase project without sacrificing value for money or flexibility. On Australian project augmentations, it is typical for key elements of later phases, such as the D&C works (subject to some degree of design novation) and the debt financing package, to be let via a competitive tender process, in order to maintain pricing tension and reduce the risk of a limited pipeline or supply chain being monopolised as noted above.

Government should consider including these mechanisms in the Project Agreement for multi-stage PPPs, and potentially for all PPPs for future-proofing reasons, to reduce overall procurement costs, promote standardisation of common elements, and drive economies of scale during operations. **Documentation point (Project Agreement):** *Drafting examples of augmentation/expansion mechanisms can be found in the documentation for the Schools 3 PPP project and there are several publicly available Australian reference points – for example, Schedule 23 (Augmentation Process Schedule) of Partnerships Victoria's standard Project Deed and equivalent schedules in the project deeds for the Sydney Metro projects.*

Model Two

Community Partnership Models for Smaller Scale Infrastructure Delivery

While there are multiple projects which would fit well into the large-scale PPP Model, New Zealand also has a need for more efficient delivery of smaller scale projects (in the \$25 million to \$200 million range) in a manner which supports and develops our local contractor market. This includes the following sectors and use cases:

- Education – for example, bundles of smaller scale, relatively standardised school upgrade projects.
- Health – for example, smaller regional clinics and hospital buildings, and mixed or ‘health hub’ developments with commercial elements.
- Justice – for example, smaller courthouse upgrades or rebuilds, especially in regional areas or involving a standardised design.
- Housing – for example, social housing, affordable and key worker housing, off-base defence housing with potential synergies with urban transit and precinct revitalisation under city deals and regional deals.

Allocating more public sector money, while following the established direct procurement mechanisms, is not necessarily the optimal path to addressing the country’s smaller infrastructure deficits due to a range of factors including limitations on the bandwidth of Government procuring agencies. At the same time, there is broad industry consensus that the large-scale PPP Model (and/or scaled down versions of other traditional ‘top down’ procurement methods such as BOT or BOOT) are either too complex or insufficiently community-focused and flexible for smaller assets.

In view of this, there is an opportunity to explore how private sector expertise and financing can support a more efficient roll out of community-scale infrastructure assets through ‘Community Partnership’ models.

In exploring this idea, our objective is to balance the following priorities:

- Creating more opportunities for smaller and mid-sized contractors.

- Establishing a shorter, simpler tender process for prospective developers, and their contractors and suppliers (that is commensurate to the value of the assets being delivered).
- Retaining, as far as possible, the key advantages that Government procurers receive from large-scale PPPs, including using the private sector as an effective delivery agent, benefitting from the large, flexible private sector resource base, and maximising public value through a competitive tender process.
- Ensuring sufficient flexibility to enable community partnerships to be shaped to meet the needs of different line agencies and local government (for example, as part of city deals or regional deals).
- Allowing for complementary commercial functions and revenue sources that can drive greater value from the public dollar and enhance the user experience, where appropriate.

Industry proposed approaches for the Community Partnerships Model

Based on initial working group discussions and industry feedback, we have identified and refined two potential structures for the Community Partnerships Model:

- **Model 2A:** The ‘PPP-Lite’ Model for core infrastructure delivery (such as smaller, consecutive school upgrades).
- **Model 2B:** The ‘Long Term Service Agreement’ (or Lease) Model that has a more mixed, commercial character and is suitable for local ‘health hub’ developments, social and affordable housing, and other quasi-public or mixed precinct projects.

These models are intended to be starting points which can be considered and adapted by procuring agencies to meet their needs. As with the Refined PPP Model for large-scale projects, we acknowledge that there are many

possible variations on these models. However, we believe that nominating some tangible, detailed starting points will set a clearer path to implementation than if we were to describe a broader array of possibilities in less detail.

Model 2A: PPP-Lite Model

Industry sees benefits in developing a separate PPP-Lite model for smaller, less complex projects, which retains the whole-of-life procurement methodology and private sector delivery rigour of the PPP while simplifying the construction contracting approach to enable broader market participation. While this model will not be suitable for all small-scale projects, it would be a useful complement to existing, traditional delivery methods.

The PPP-Lite Model retains the basic structure of the PPP Model; with Government retaining full ownership of the asset with a concession to be provided to the private sector for the development, maintenance and, in some cases, operation of the asset during the concession term, in exchange for a unitary charge or service payment. However, once developed it should be simpler and quicker to implement, in line with the smaller scale of the assets being procured.

The key differences of the PPP-Lite Model, compared to the large-scale PPP Model, are summarised below.

Simplified Risk Allocation

Industry recommends that D&C aspects of PPP Project Agreement are amended and simplified to reflect a 'passed up' D&C Sub-contract based on NZS3916, subject to adding back a few key PPP features including the following:

- Pass-through and linked claims and disputes and DC/FM interface principles.
- Enhanced performance security and delay liquidated damages sized to cover SPV management and debt service costs, although it is acknowledged that this needs to be sized with consideration to the size of the smaller contractors and workarounds considered as to how the project structure can support a lesser quantum of performance security.
- Liability caps based on a replacement contractor analysis, unless risk borne by Government through support for terminated D&C Sub-contractor for the delta between the market standard liability cap that might be expected to apply (for a similar job) under a NZS3916-based contract and the market standard

liability cap that you would expect to find in the D&C subcontract for a PPP.

- Enhanced termination events, including reaching or exceeding a liability cap.

It is recommended that FM/O&M aspects of PPP Project Agreement remain substantially the same as the current model, but with a simplified KPI regime to focus on the core deliverables to simplify the project management need, and cost, for smaller scale projects, with generic and easy to understand KPIs.

***Documentation point (Project Agreement):** While the Project Agreement would require material amendment to allow for the pass-up of the 3916 contract, initial thinking as to how to accommodate smaller scale contractors has already been undertaken with the school PPP expansions. The majority of the provisions relating to the SPV and FM could be adopted unchanged from previous School PPPs.*

***Documentation point (Construction Contract):** The Ministry of Education is a frequent procurer, and we understand that there are existing 3910/3916 contracts in place which have a standard form of special conditions. This base can be adopted for easier adaptation to, and market acceptance for, a PPP-Lite Model. While further work would be required to adapt to a 3916 'pass-up' drafting examples which consider different approaches to performance security, LDs and liability caps can be found in expansion documentation for the Schools 2 PPP (Rolleston and Wakatipu expansions).*

Simplified Procurement Process

Industry recommends (1) a condensed procurement process relative to large-scale PPPs or (2) a sole sourcing process with appropriate market benchmarking or other value-for-money checks. This is justified on the basis that PPP-Lite projects will be smaller and have more standardised construction requirements. While a process could be run for a single asset (such as a new school build), a clear pipeline of similar projects will maximise efficiency, provide pipeline stability for D&C contractors, and attract more interest from equity, asset management and facilities management providers who require economies of scale.

Option 1 – Condensed procurement process considerations with similar follow-on projects

There are a number of approaches that can be taken to condense the procurement process with similar similar follow-on projects such as:

- Using a single stage RFP process rather than a two stage ROI and RFP process or keeping a two-stage process but adopting a simple pre-screening or panel selection process in place of a full ROI.
- Limiting design and build requirements to basebuild, which is to be standardised where possible, to leverage lessons learned and efficiencies for subsequent projects to be delivered.
- Including an in-built expansion mechanism in the Project Agreement, which enables further sites to be sequentially added once the first site is complete, provided performance KPIs are met, and/or subject to running a mini pricing competition or benchmarking process between the agency's pool of pre-qualified contractors. This streamlines the procurement method for subsequent projects and incentivises the private sector to deliver, while ensuring that the procuring agency is not locked into hiring an underperforming partner to deliver future projects in the sequence.

Option 2 – Sole sourcing process considerations

The Government could consider sole sourcing for some projects as an alternative to a competitive bid process, particularly if the agency has a pre-qualified list of partners.

Sole sourcing involves either an unsolicited proposal or another direct negotiation with a chosen contractor. This approach might be adopted where it has the potential to encourage innovation, particularly for an unsolicited proposal, or where it might be the most efficient procurement method both in terms of time and cost, noting that this is a particular focus for smaller projects.

There are some obvious challenges to sole sourcing, including the risk that Government does not benefit from competitive tension (both in terms of price and design options) and the risk that the process lacks openness. As such, Government would need to be confident that it was able to negotiate the best outcome through this method and that benefits such as an efficient roll out of multiple small projects outweighed any

downsides. More generally, sole sourcing would need to remain consistent with Government's procurement principles.

Cabinet documents released in June 2024 indicate that Government's guidance for unsolicited proposals is currently under review and will be revised by the end of 2024. Industry would encourage Government to take the proposed partnership models into account when conducting this review, to ensure that the revised guidance can accommodate a range of partnering models.

Use cases for the PPP-Lite Model

Industry recommends that Government consider the PPP-Lite Model for assets that support the delivery of core public services of a smaller scale (less than \$200 million), which do not require the same degree of innovation that a larger scale project may have and would lend itself to delivery by a smaller local contractor.

While the current PPP Model has previously been used for smaller scale procurements via the three Schools PPPs, this necessitated a bundling of schools, delivered concurrently and with a D&C Contractor 'wrap', to enable sufficient scale to attract the market. It is however acknowledged that bundling of this nature is not always practical, something which the scalable nature of the PPP-Lite Model seeks to address with two key options for procurement:

- Bundling of projects to be delivered consecutively, enabling alignment of the timeframes with the procuring agencies delivery schedule. This would also increase accessibility to smaller local contractors who may not have the workforce, or balance sheet, to deliver projects concurrently.
- Procurement of a single small project, where a strong forward pipeline exists, with the ability to add additional projects, identified or not, into the same overarching Project Agreement when appropriate funding commitments are held.

Without limiting the use cases of this model, we consider it particularly relevant for the following sectors:

- Education – delivery of a pipeline of smaller, similar school upgrade projects to be delivered consecutively (subject to performance) while still incorporating a whole-of-life approach. Use of this model would enable the Ministry of Education to continue to use local delivery partners for the construction of schools, while incorporating a whole-of-life procurement approach. Pipeline dependent, it would also be feasible to have multiple 'active' PPP-Lite partnerships in place at one time under which new school procurements can be added. This approach would enable ongoing competition to ensure value for money, while streamlining the contracting process by using existing arrangements.
- Health – delivery of a pipeline of smaller regional clinics or hospital buildings. Depending on Government priorities, either (1) the private partner could deliver a standardised base build and ongoing hard FM services, with final fit-out and operations to be managed by

Government, or (2) the private partner could also include the fit-out and service delivery within its scope.

- Justice – delivery of a pipeline of smaller court upgrades or rebuilds, particularly in regional areas and/or where a standardised design is acceptable.

In each of the use cases above, the PPP-Lite Model would be complementary to the Refined PPP Model for large-scale projects (which could be used for larger single builds or large bundles of works that need to be delivered concurrently).

Model 2B: Long Term Service Agreement (or Lease) Model

Industry recommends that Government consider using a Long Term Service Agreement (or Lease) Model (in this paper, collectively referred to as an 'LTSA') in circumstances where Government requires an asset and associated services but (1) does not need to own or exercise granular day-to-day control over the asset, and/or (2) is open to the private sector generating complementary commercial revenues from the asset and/or developing the asset as part of a mixed use precinct.

Where the factors stated above are present and the PPP-Lite Model is therefore less suitable, the LTSA offers an efficient, outcomes-based alternative that gives the private sector the certainty it needs to deliver and finance the asset.

While there are already examples of LTSAs being used to deliver publicly oriented assets in New Zealand (for example, in the delivery of social housing under Income-Related Rent Subsidies (IRRS) contracts and student accommodation under long term concession or lease agreements), we think it is worth highlighting, and more deliberately revisiting, their potential uses for smaller scale infrastructure in the current political and economic environment.

Industry views the model detailed below as a starting point that can be adapted depending on the context rather than a 'one size fits all' formula.

Documentation point (LTSA): *Unlike for a PPP, there is no existing 'standard form' for an infrastructure LTSA. However, the drafting task should not be overly onerous (since it is a simpler and less prescriptive contractual form) and many procuring agencies will have existing service agreement and/or lease templates that could be adapted to meet the procurement objectives.*

Aspects of an Infrastructure LTSA

Land and asset ownership

Assets are developed, and may be owned, by the private partner. This typically occurs on private land, although Government could consider providing the land under a medium term (for example, 30 years) or long term (for example, 99 years) lease if it needs the asset to be located on a particular site or wishes to make a non-cash contribution to project viability.

Delivery requirements

The private sector is responsible for delivering the asset and commencing operations by a designated long-stop date. Depending on the asset, the LTSA may contain some input on design and delivery requirements, however this is significantly less prescriptive than under a PPP or even a PPP-Lite Model. This reduces bid time and costs and gives the private partner more flexibility on how it structures and tenders out the delivery-phase contracts. For example:

- There does not need to be a single turnkey D&C contract with a full pass-down of the relevant terms of the LTSA and instead, the private partner may elect to take more development risk.
- If the LTSA covers multiple sites, the private partner is free to appoint a different contractor for each site. This facilitates more local participation and spreading contractor solvency risk while also ensuring critical mass for private sector capital investment.

Operational requirements

The private partner provides the nominated services over a contractual term of at least 20 years. While certain minimum service standards may be imposed, these should be 'light touch', outcomes-based measures that do not require extensive monitoring by Government. The intention is that the private partner retains primary control over 'how' it provides the services.

Revenue profile

Government commits to purchasing all, or a significant portion of the services being provided for a term of at least 20 years, which underpins the viability of the development. For example:

- For a core public building, Government may purchase 100% of the services being provided, such that Government's service payment will be the sole revenue stream that will be used to cover capital and operating costs.
- For a mixed-use building or precinct, Government may only purchase, for example, 70% of the services being provided and the private partner will provide the remaining 30% of the services on an at-risk commercial basis. As an example, in a health hub context, the Government revenue stream may consist of a public health clinic and the complementary commercial revenue stream may consist of rent from private pathology and pharmacy tenants within the building, or the Government can contract for a 'minimum volume' of services from a private health clinic which can underpin the new development. This approach can potentially help Government get a higher quality and more holistic community facility for a lower outlay of public funds.

End of term position

At the end of the LTSA term and subject to any Government option to renew, the assets typically revert to the private sector in their entirety (for example, social housing may be sold or tenanted privately). We note that the approach to residual value and ownership will likely differ if the asset is developed on public land rather than private land.

Smart bundling

As with other models described in this paper, the LTSA is amenable to bundling of multiple similar assets as separable portions, with their own timelines and lease payments, within the one 'umbrella' LTSA.



Use cases for an Infrastructure LTSA

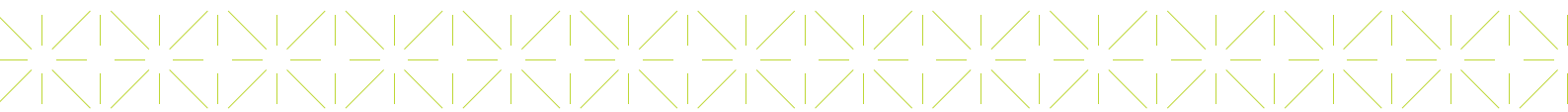
As noted above, industry recommends that Government consider using the LTSA model to deliver a quasi-public service where there is less need for day-to-day Government control and there are upside opportunities for complementary commercial development. Potential use cases include the following:

Health

- Delivery of urban and regional 'Health Hub' developments which are built and owned by the private sector and underpinned by LTSAs but are also capable of attracting material commercial revenue streams that can support the delivery of a larger and higher quality health precinct than Government would be prepared to fund directly. In Australia, similar models are being adopted in connection with hospital redevelopments and co-located research facilities, complementary commercial tenancies, and onsite key health worker accommodation.
- Underpinning delivery of new health services by entering into government contracts for the provision of minimum volumes of services (for example, radiology services or cancer care from a private operator). These services contracts can underpin the viability of the private sector development and reduce pressure on existing public sector infrastructure, leading to improved health outcomes for both private and public patients with limited or no upfront capital investment from the Ministry of Health or Health New Zealand.

Housing

- Delivery of social, key worker affordable and off-base defence housing. Under this model, the private sector would build and maintain housing stock for use by a designated tenant group, with an appropriate level of long-term service payment or subsidy from Government (at least 20-25 years) in order to make the project economically viable. The service contracts can be adapted to fit the requirements of the housing. For example, for social housing there would be a higher focus on tenant care and the management of vacancies. This form of housing delivery could also be aligned with urban transit and precinct revitalisation under City Deals and Regional Deals. Documentation points (LTSA for housing): Industry participants noted that the long-term social housing contracts (following the basic principles articulated above) already exist in New Zealand. However, their potential is underutilised. Industry is eager to engage with Government to rework the existing documentation to enable it to support private financing and housing delivery at scale.
- Government should also consider emerging Australian models. For example, Housing Australia's 'HAFF Funding Agreement', which is being rolled out to facilitate availability-style subsidy payments for new social and affordable housing, and includes basic delivery and operational requirements but is materially less complex than a PPP Project Agreement.



Appendix One: Detailed mechanism for Refined PPP Model (Option A) – Targeted Risk Sharing

INZ's Funding & Financing Working Group has developed the following mechanism that could be used to implement 'Option A – Targeted Risk Sharing' model within New Zealand's model form of PPP Project Agreement.

This is intended as a consultation draft for Government and broader industry (outside of the Funding & Financing Working Group) to consider. We note that, while it includes examples of risks that may need to be addressed, not all of these risks will be relevant to every project. While providing some initial thoughts as to how the targeted risk sharing may be incorporated, the below does not purport to address all of the documentary amendments or considerations which will need to be taken into account to implement this approach.

Note that the terms used in this Appendix align with the defined terms used in the PPP Project Agreement – for example, 'Contractor' means the Project SPV, and 'D&C Sub-contractor' means the primary D&C Contractor responsible for design and construction works.

Compensation extension events (entitlement to extension of time and full cost impact) may be expanded to cover any project-specific risk factors that are unable to be priced, controlled, and managed by the private partner, for example:

- geotechnical conditions (to the extent not shown on survey),
- location of utilities (to the extent not shown on survey),
- inflation of key commodities (for example, bitumen for a roading project),
- inflation of build cost components subject to a materiality threshold (for example, an agreed percentage above pricing as of the bid date) which could be bid back and linked to the D&C Sub-contractor's margin or another contractor financial health metric, and

- anything else identified by Government based on pre-bid market sounding or agreed as such during the bid period (i.e., in Project Agreement departures proposed by bidders).

Extension events (traditionally, entitlement to extension of time but no cost impact)

- The scope of extension events may be expanded (beyond the usual categories, for example, force majeure events) to cover project-specific risk factors that are unable to be priced by the private partner and are beyond its reasonable control. For example, prolonged consenting delay (subject to an agreed materiality threshold) and anything else identified by Government based on pre-bid market sounding or agreed as such during the bid period (i.e., in Project Agreement departures proposed by bidders).
- For the project-specific extension events (such as those described above), time relief could be accompanied by cost sharing where determined as part of the risk sharing mechanism. The contractual mechanism could operate as follows:
 - The Contractor is entitled to an Extension of Time under the Project Agreement (and the D&C Sub-contractor is entitled to the same extension under the D&C Sub-contract).
 - Cost relief to be determined based on the risk sharing approach agreed. This may contain a 'first loss' provision if bid back by the Contractor and the D&C Contractor with the Government to bear any excess).
 - Limited equity liquidated damages would be payable in relation to any uninsured extension events, and savings from delays in drawdown would also be taken into account as part of the compensation calculation process. Equity would therefore take some risk alongside the Government and the D&C Contractor but would be protected by a cap on its share of additional costs.

- The compensation would be determined on an open book basis and would cover any additional, allowable costs suffered or incurred as a direct result of extension events (where not insured). Allowable costs would be based on the equivalent to 'limb 1' direct costs in a full Target Outturn Cost model and would also include (1) liquidated damages for the benefit of the SPV/debt, and (2) all insurance deductibles (including any liquidated damages during an Advance Loss of Profit (ALOP) deductible period).



YMCA Christchurch
Credit: Crown Infrastructure Partners

Appendix Two: Supplementary Views

The main body of the paper attempts to cover off views which gained material levels of support from participants involved in the various industry engagements. It is important to note that while every effort was made to involve a broad range of industry participants who have a part to play in the establishment, delivery, and operation of PPPs, the engagements did not necessarily constitute a systematic or proportionately weighted survey of the people and organisations expected to be involved in a PPP delivery. Recognising this, we wanted to ensure that supplementary views which were raised in the initial working group or wider industry workshops, and views and ideas that were presented to INZ by members after the wider industry workshops, were also recorded and these are included in this appendix.

Refined PPP Model – Risk allocation

The industry is not fully aligned on ‘Option A – Existing PPP Model with Targeted Risk Sharing’ and ‘Option B – ITC PPP Model’ proposed in relation to the Refined PPP Model. We have recorded two supplementary viewpoints below.

Broader uses cases for ITC PPP Model

While industry participants made a general distinction between vertical infrastructure projects (which typically have less uncertain or difficult to quantify elements) and horizontal infrastructure projects (which typically have more uncertain or difficult to quantify elements), it was suggested by some that the ITC PPP Model should not be limited to horizontal projects but should also be used for large, complex vertical infrastructure projects. This is not inconsistent with the overall industry consensus that the PPP Model should be thoughtfully tailored on a project-specific basis rather than imposing a ‘one size fits all’ model on either the whole industry or particular sub-sectors.

Alliance within a PPP

Not all industry participants believe that the Targeted Risk Sharing and ITC PPP options go far enough to

address issues with the existing PPP Model – particularly as it relates to risk sharing during the delivery phase, predominantly (but not exclusively) in the context of large horizontal infrastructure projects, but also in enablement of collaboration within projects. One idea that has been advocated for in this context is the adoption of a new model which uses a full alliance contract for the delivery phase, within the overlay of a PPP. The new model would involve typical alliancing features during the delivery phase (such as a ‘no blame, no sue’ premise and full sharing of cost overruns or savings as between Government and the private consortium members). A key challenge would be working out how to integrate this more fluid and collaborative delivery approach with PPP-style financing and whole-of-life maintenance arrangements.

In response to this suggestion, other industry participants have raised concerns that an alliance delivery model is not sufficiently certain on project scope, pricing, or allocation of liability between participants to (1) allow FM/O&M to properly scope and price its whole-of-life maintenance task, or (2) support a private financing package without excessive pricing, contingencies, and gearing restrictions. There is also concern that the ‘no fault’ feature of the alliance model is not compatible with the lender protections usually required on a greenfield project financing (such as a PPP), including a robust contractor security package and direct agreements, which rely on fault-based provisions to enable lenders to step in and remedy issues on a troubled project. Put simply – the process of trying to fit a pure alliance into a PPP would likely dilute the features and benefits of a PPP to a point where it is not worth involving private finance in the first place (and/or the project is not capable of being project financed on a limited recourse basis by typical infrastructure financiers such as banks and superannuation funds).

To industry’s knowledge, a full alliance-based PPP has not been implemented before in other jurisdictions and this has at least partly been due to the incompatibility concerns raised above. Therefore, if there was a desire to consider this option further, it would require material amendment to the existing PPP framework and significant

consultation with private partners in order to assess its feasibility as an option.

If not possible to implement under the PPP framework, this does not preclude alliancing from forming part of the wider infrastructure delivery toolbox (and indeed it has been used successfully in New Zealand on projects which would not have been suited to a PPP) or use as part of a multi-package procurement. There has been successful implementation of a 'multi-package' approach for mega-transport projects in Australia, whereby the project was divided into multiple packages with some being delivered through a PPP and others being delivered through a different model (such as an alliance).

Refined PPP Model – Renewed focus on partnership, collaboration, and active SPV management

While the use of Key Result Areas (KRAs) in the Project Agreement was generally viewed as a positive idea to explore further, some participants' experience has been that the introduction of KRAs into non-alliance contracts has not driven the expected collaboration (because the core contract still requires individual parties to deliver their contractual obligations for payment rather than having a collective 'best for project' and 'no-sue' basis).

Participants holding this view were concerned that: (1) KRAs do not change the overall financial structure of the contract, which allocates risk to individual parties rather than sharing it on a 'no fault' basis, and (2) KRAs would apply between the Crown and the head contractor(s) and might not be flowed down to subcontractors. While this view is not necessarily inconsistent with the general consensus that encouraging better collaboration and engagement requires a portfolio of strategies inside and outside the contractual terms, it advocates for more fundamental changes to the PPP Model as noted elsewhere in this Appendix.

Refined PPP Model – Procurement process

While procurement was discussed at length in the industry engagements, there continue to be a range of views across the industry on the 'best' process to achieve optimal results. In the preceding paper we have tabled principles of approaches which gained more support, however the below also details three supplementary views

which were either discussed in industry engagements but did not receive majority support or were detailed to INZ through post engagement feedback from members.

Early preferred bidder selection, akin to an alliance contractor selection, to enable a collaborative design process with the procuring agency

In discussion on a shorter RFP period, some industry participants suggested this concept should be taken further with the preferred bidder selected based primarily on an assessment of the consortia members' capability for the project due to be delivered. The potential benefit of early selection would be a higher level of involvement from the procurement agency in the design process, noting that probity requirements would be reduced. In this way, collaborative design elements of the alliance model could be adopted prior to parties reaching contractual and financial close. This approach received limited support as part of the industry engagements with some participants cautioning that the approach could limit competition and innovation.

Earlier selection of preferred bidder could also seek to allay concerns raised regarding the transparency of risk processes and pricing during tender stages, noting that a regime of tender box price tension can result in significant pressure to win and the underestimation of risk pricing. This, in turn, can create a poor contracting environment for the winning consortium, including the sub-contracting entities who were not involved in the initial head contractor pricing/ risk allocation decisions. This concern reflects the importance of ensuring appropriate risk allocations and sub-contractor pass down, regardless of the procurement method.

Early Contractor Involvement approach to enable certainty

This procurement option has been raised in the context of projects which have a higher degree of uncertainty or initial risk. It would involve the RFP process commencing at an early stage, before the procuring agency undertakes too much pre-design work but when there is a strong degree of certainty that the project can proceed. In line with the above, preferred bidder selection would occur following a very short RFP process with the evaluation largely based on capability. The preferred bidder phase would involve the initial design work and scoping of both an early contractor involvement (ECI) package and the full form PPP contractual documentation. Post contractual close, the ECI package would commence with the intent that this package covers the completion

of the early higher risk elements of the project, following which the fixed price for the remainder of the works would be determined and inserted into the contractual documentation ahead of financial close. It is important to note that this option has not been discussed at length by industry, however based on discussion which did take place we can infer that there may be concerns about the early-stage selection (as with the above) and while the ECI phase would assist with the risk allocation, this would result in less certainty for the procuring agency upfront.

Equity-led staged PPP Procurement & Delivery Process

A further specialised procurement process was recommended in post-workshop feedback received which could enable accelerated delivery of certain projects, typically those with more known service and scope requirements, in situations where market constraints mean that usual procurement methods would lead to a delay in delivery, and therefore realisation of the project benefits for the procuring agency. Key aspects of this approach would include the following:

- Appointment of a preferred equity partner following a short 'EOI' style process.
- Engagement with the selected equity partner to agree and develop a construction and operational procurement strategy to support key elements of the business case, and the outcomes sought by the agency.
- Equity partner then tenders for the design team and commences the initial design work to enable further procurement.
- Equity-led procurement of the FM provider and D&C provider (via competitive tenders) with these processes running in parallel with the design development. The D&C tender would be run on a P&G and margin basis (with trades to be tendered later on an open book basis to work up a fixed price).
- The FM and D&C processes would be closely followed by a competitive process for debt and third party consultants and development of the full project documentation.

Given the equity-led process, it is envisaged that there would be various 'checkpoints' between the equity partner and the procuring agency which would enable the workstreams to be paused or stopped (subject to agreed cost reimbursement and fees) if affordability, value for money, or other requirements were not being met.

As this option was not discussed at the industry workshops, the breadth of support for the model is uncertain. However, as noted in the paper, there was a general caution from many industry participants about disaggregation of the procurement process (and associated impacts on innovation, whole-of-life, and value for money considerations) which would apply here. The option would also raise conflict of interest issues for some segments of the market – that is, for prospective equity partners who are affiliated with a D&C and/or FM provider.

Refined PPP Model – Affordability threshold

The applicability of an affordability threshold (i.e., whether it is needed at all) was also raised as part of the industry discussions. In some jurisdictions (for example, Canada), there is no affordability threshold with reliance placed on the competitive process itself to provide justification for the cost.

It was however noted that should the affordability threshold be removed, there would need to be certainty that the approved funding levels would be sufficient to cover the market determined price. If not, the risk that the project may be cancelled, if the market price was higher than expected, may deter some bidders and provisions used overseas, such as a double stipend payment, may need to be put in place to protect tenderers from cancelled procurements.

Sub-contracting market concerns

As outlined in this document, while international contractors are anticipated to participate in PPP procurement in New Zealand going forward, there will continue to be a strong reliance on the domestic contractor and consultant market for the delivery of infrastructure projects. In addition to points already covered (refer comments under 'Refinement Three' relating to collaborative KRAs and maintaining a strong sub-contractor market), some concerns were raised during industry engagements regarding the current lack of transparency over the contracting arrangements between the head contractor and sub-contractors. The concerns raised relate not only to risk and financial aspects within those contracts, but also to broader health, safety, and wellbeing. Improvement suggestions could include utilisation of a standardised contract suite (like NEC) where standard risk profiles are

assigned at varying levels of sub-contracting which are appropriate for industry and ensuring efficient dispute resolution processes to avoid lengthy and expensive litigations. Improved transparency and focus on sub-contractor arrangements, including by standardisation of documentation, could remove barriers to entry by removing the need for smaller sub-contracting entities to have significant legal and commercial representation.

Refer also to Appendix 3, a supplementary paper drafted by a number of local contractors and consultants to provide further detail regarding their expectations of a refreshed PPP Model.



Appendix Three: **Response from Horizontal Infrastructure Delivery Organisations to draft paper Model 1 – Refined PPP Model for Large Scale Infrastructure Delivery**

Infrastructure New Zealand Funding & Financing Working Group – an asset delivery industry response to draft paper “Model 1 – Refined PPP Model for Large Scale Infrastructure Delivery”

Context

This paper is presented in response to the above document draft and has been written to match the format of, and to append to, the final paper.

The content includes recommendations from a number of larger New Zealand based contractors and consultants involved in the design and construction of of largely horizontal infrastructure in New Zealand. These organisations are not involved in, nor have expertise in, infrastructure financing.

For large infrastructure PPPs the design and construction of the asset represents the majority of the work done and money spent in a PPP. In the example of NZ’s two large roading PPPs to date, Transmission Gully and Puhoi to Warkworth, this can involve more than 500 constructors and designers on any day, typically over a 5+ year contract.

Our government plans to use private financing to accelerate the delivery of NZ’s infrastructure and we believe this is a great opportunity to develop a PPP model that works for NZ, as part of a suite of delivery mechanisms. Adding a modernized PPP model to our toolkit can help bring infrastructure on-line faster, provide opportunity for economic growth generating private sector investment (including iwi and other investors),

spread the cost of infrastructure intergenerationally across users, and provide a mechanism to assist in capturing value uplift. If the model is successful and a pipeline of PPP opportunities can be developed, this will allow our financial and construction markets to plan and invest in people and assets to help create a healthy sector and opportunity for productivity gains.

A successful PPP model should be seen as one that delivers to objectives, allows consortium members to make a reasonable profit, fosters innovation and collaboration and supports a healthy construction sector.

Objectives - for developing a workable PPP model for NZ, should include:

- Bankability (can be financed)
- Appropriate risk-reward sharing
- Honouring the third “P” in PPP - “Partnership” - this should come with an acknowledgement that NZ contractors and suppliers want to build NZ’s infrastructure, and be responsible for their performance, but not put their businesses at risk to pay for NZ’s infrastructure. This is not partnership or a successful outcome
- Attractiveness for both international and local markets for private businesses to bid for client work
- A platform for a safe, healthy, sustainable and increasingly capable construction sector in NZ
- Efficient use of our industry resources

We do not believe that “Minor tweaks to the existing PPP model” will go far enough to address these objectives, and that more substantial changes are required.



To meet the above objectives, avoid inappropriate or unmanageable risk allocation resulting in pricing being fixed on incomplete/inaccurate information, and genuinely seeking to avoid poor outcomes - our views on the following elements of a new PPP model are:

Procurement Processes – should be designed with/to:

- A focus on comprehensive pre-tender activities to provide the necessary and reliable information for tendering consortia and to de-risk asset delivery (e.g. geotechnical report, topographical survey, design information).
- Sound risk - reward balance, to avoid gambling.
- Value for Money (VfM) objectives in mind - this should not be confused with tender box price tension at any cost.
- Maximise the use of, an already constrained, senior industry resource by running a compact, initial competitive phase to select a preferred consortium, who will then develop the design and price. Where VfM objectives necessitate, and again not for tender box price tension reasons, in some cases two consortia may be need to be taken through this phase and be compensated by way of a stipend.
- Not require commitment to pricing until the design has been developed to an appropriate stage of sufficient detail and risks are well understood between all parties.
- Acknowledge that appropriate investment during tender phases (i.e. 2% of CAPEX stipend payments) is paying to get better certainty and represents good value for money. Under-investing in stipends is counter-intuitive.

Risk Management and Allocation – should be designed with:

- Sound risk - reward balance.
- Assigning risk ownership to those best able to control and manage the respective key risks.
- An acknowledgment that large infrastructure projects in NZ are often complex and high risk, How risk is allocated is important especially across key risks such as consenting and consultation, land acquisition, geotechnical, pandemic, cost fluctuations, third parties, etc.
- Recognition that balance sheet size is not risk management (or “is only one element”).

- A mechanism that allows partnership in risk management, and can drive collaborative risk mitigation across multiple parties. This would be useful and could include for example the client and SPV having money and resources for risk mitigation.
- For a PPP delivery consortium, protecting programme and having mechanisms for relief is of the utmost importance.

Asset Delivery Contracting Models – should be designed with:

- A recognition that outside of New Zealand, western countries that have traditionally used PPPs have mostly moved on from adversarial, full risk transfer models. For example in UK, Canada and Australia, PPP models are being reformed moving to more collaborative styles. Countries such as the USA and do not use PPPs as they haven’t been able to generate construction industry interest.
- A mature approach to contracting acknowledging:
 - D+C and other adversarial contract models tend to be more suited for well-defined, low risk, projects or scopes. These can come with a long tail of claims and disputes, taking valuable senior resource out of our already constrained market.
 - Complex projects, for example Waterview and CRL, tend to be more suited to collaborative contracting where consortium parties’ objectives are aligned to manage risk and deliver the objectives. Collaborative contracting aligns behaviours around a common purpose and outcome, bringing a diversity of expertise incentivised to resolve complexity and manage risk.
 - Adversarial contracting models like D+C cannot be made collaborative through the addition of KRAs/KPIs or incentives.
- Awareness that in a model where single “D+C Wrap” contracts are awarded to a large/ international management contractors - checks and balances will need to be made on how sub-contracting to local contractors and suppliers is being managed to manage any potential commercial imbalances. These imbalances can exist because local sub-contracting organisations often do not have large commercial and legal teams (nor does our industry want this cost inefficiency) or contract negotiation leverage (its often a take it or leave it situation), nor do many have balance sheets of an even remotely similar scale.



The following improvements would further help optimise the PPP model for its NZ setting maximizing its chance of success:

- sub-contractors should feel stretched but not scared about working under a PPP model, benefit from upskilling and productivity increasing opportunities around work methods and good documentation, and without having onerous PPP clauses flowing down to them. Some might not be capable.
- A standard contract suite, like NEC, could be developed to manage/ standardise this to make sure risk appropriately stays with the head contractor and avoiding it just being passed down to smaller contractors and suppliers, and doubling up on risk allocation.
- Consortium wide dispute resolution processes should be developed to allow effective and low-cost resolution of disputes and allow sub-contractors and suppliers reliance on their contract terms without costly arbitration. We need all available resources actively contributing positively to our construction market, not tied up in disputes that add no value to our economy.
- A mechanism should be developed for checking the health and wellbeing within a construction consortium where there are overlapping PCBUs. This should include the management of psycho-social hazards given the stresses that can occur in management of significant and often one-sided risk allocation.

If the above cannot be achieved then collaborative contracting models should be used.

We would be happy to engage with government in developing a PPP contracting approach that will address these points, whilst also ensuring that PPP investment can be secured to support with closing the infrastructure deficit.

Organisations that have contributed to and support this paper*

Downer
Beca

McConnell Dowell
Fulton Hogan

Heb
Tonkin+Taylor

*Note: we consider there will potentially be other contractors, consultants and their industry bodies that may be interested in supporting this paper but we have not been able to contact them to confirm their support to date given time available.





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