PUBLIC-PRIVATE PARTNERSHIPS IN THE COMMONWEALTH OF AUSTRALIA

WHICH PUBLIC & HOW PRIVATE?

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Australia is a federation of six sovereign States and two self-governing Territories.

The States were established as independent British colonies and joined together to form the Commonwealth of Australia in 1901.

Within the federation, the Commonwealth was given most of the direct taxation powers and is thus the major source of funding for State activities; it has responsibilities for matters of national significance: Defence, Trade and works of national significance such as the national highway and railway networks.

The Federal Government then provides an annual allocation to the State Governments through an arcane formula determined by the Commonwealth Grants Commission. The larger States cross subsidise the smaller States as a generally agreed principle of development within the federation. The net result is that all the States cry poor.

At the same time, the State and Federal Governments (in common with most governments in the developed world) have a natural reluctance to either introduce new taxes or to raise levels of debt to fund infrastructure or service development. PPPs in Australia have developed in response to this federal funding model to meet the demands of the community for new infrastructure and services.

The States have some indirect taxing powers (such as land taxes and have primary responsibility for service delivery: Health, Education, Police, Roads and Public Transport. The only significant public transport is in the capital cities and, with one exception, is run by the State, not the city.

The exception is Brisbane where the city council operates the bus and ferry network (but with funding from the State Government under a purchaser - provider agreement).

This is made possible because Brisbane has just one local government entity for the whole of its metropolitan area (it is one of the largest city councils in the world in terms of area, though quite small in terms of population).

Elsewhere in Australia, local government in the major cities is fragmented and most metropolitan areas have a multiplicity of local councils. In Sydney, a city of some 4.5 million people, we have 40 local councils some with as few as 50,000 residents. The City of Sydney (which is the core CBD municipality) accounts for just 1% of residents, though, because of its commercial activities, it's clearly a significant proportion of the economy.

What this structure means for urban transport is that capacity for planning, infrastructure provision and service delivery lies overwhelmingly with the State and local government is but a minor player. Where local government has an influence is in the built environment - as the administrator of local urban planning and development, councils are key stakeholders in transport network design; their decisions about urban consolidation affect travel demand and those on local urban form define the network in commercial centres.

We also rely on local government to provide low level infrastructure such as bus shelters.

The national government, on the other hand, whilst having no current direct involvement in the delivery of urban transport, recognises a responsibility for connecting the cities with interstate highways and rail infrastructure and, by a series of agreements, has a strong role in co-ordination of the States.

Through the Australian Transport Council (of State and Federal Ministers) common standards are defined for vehicle design, road user standards and the like. The Commonwealth also recognises an obligation to fund urban highways if they can be shown to be part of the national grid; the most notable example is an orbital motorway (under construction) in Sydney which will enable interstate traffic to bypass the congested urban roads.

Some years ago, the national government of the day decided that urban life was a matter of national importance (after all, 90% of Australians live in the 5 major cities) and put in place a "Building Better Cities" (BBC) program under which it undertook to fund urban infrastructure programs. Building Better Cities funding contributed to the introduction of Sydney's light rail line, a PPP which involved Federal, State and Private Sector funding and also relied on the participation of the Sydney City Council in terms of traffic plans to accommodate the on-street tracks and for the contribution of some small parcels of land.

Within our environment then, it can be seen that the scope for public private partnerships has been largely between business and State Governments. Rather than seek private sector assistance to develop its facilities, such as airports and interstate rail services, the Commonwealth's preference has been to privatize them.

Without doubt, the success story for PPPs has been in the provision of roads. For more than a decade the NSW Roads and Traffic Authority has been working with private sector companies to provide a significant proportion of our urban motorway system. This has given us four major motorways plus a second Sydney Harbour crossing - vital initiatives which we were able to bring forward because of private sector investment in an automobile-dependent city even though some of us would have preferred to see the investment go into enhanced transit.

Typically, motorway PPPs are build-own-operate-transfer schemes where the builder receives tolls and ownership transfers to the Government after 30 years. With their predictable, steady cash flows, in a city which is predominantly motorised, (over 80% of journeys to work are by car) these projects have become highly-attractive to financial institutions and superannuation funds and most have moved from an initial provider-owned status to being part of a listed infrastructure trust.

It seems to some of us that the tolls involved are so high that they should inhibit use of the motorways, but automobile operating cost appears to be highly elastic and traffic continues to grow.

Interestingly, the possibility has now emerged of a federal-state PPP in the roads area. The Commonwealth Government has recently announced a new national transport strategy called Auslink; it aims to enhance and expand the interstate road and rail networks and, in the roads area, contemplates sections of the interstate grid built by the private sector, under supervision of State Authorities and funded by ‘shadow tolls’.

Of more interest in the context of sustainable transport systems, however, is the scope for partnerships in urban transit activities. Here, our experience has been a little more chequered.

Let me firstly outline the range of projects that has been attempted and then I would like to look at some case studies in more detail.

From our perspective, urban transit PPPs can involve either infrastructure projects and service delivery (or both); for instance, at the present, my organisation is also considering the prospect of having our fleet supplied and maintained by a private sector provider.

So, in recent years, we have seen:

- Construction of Airport-City rail links in Sydney and Brisbane
- Construction of a light rail line in Sydney
- Outsourcing of all public sector transit services (rail, bus and tram) in

Melbourne

- The commencement of development of smart-card ticketing systems in most capital cities
- Outsourcing of public sector bus services in Adelaide and Perth

And, in Sydney, at the moment, we are commencing what some might view as a reverse form of PPP where long-standing private sector bus monopolies are being opened up to competition as is my organisation, the public sector State Transit.

I think it can be said that all of these projects have contributed to service improvement, but, commercially, the results have been patchy.

Sydney Airport RailLink.

Sydney Airport is conveniently located just 5 km from the Sydney CBD, yet its transit connections have been poor. There was no rail connection and travellers primarily relied on taxis and airport shuttle buses.

An addition to the suburban rail network was proposed in the early 1990's as an unsolicited private sector project; it was researched and negotiated at some length and it was eventually agreed that the underground line would be funded by the State Government and the four stations by the proponent who would be responsible for all construction.

The proponent would then recover costs by means of a station user fee; this was estimated in 1993 at $A7.00, a hefty sum for a railway where the train fare was of the order of $A2.00 (the user fee is now $A10.00).

The Government was advised that it could offset its costs by “value capture” from land taxes and property transfer duties above and around the rail link. (The area between the CBD and the Airport was a “brownfield” industrial area which was due for redevelopment; there has since been significant commercial and residential redevelopment but I haven’t been able to ascertain whether the land taxes, transfer taxes and developer contributions have made a significant contribution to cost recovery)

The rail link works were brought in on budget and ahead of time but the line has not been a commercial success. Indeed, ultimately the Airport Link Company defaulted on a $200M loan and had to be wound up and the assets were taken over by the project’s financier. The line is currently being operated by an appointed manager but the long term outcome is, as yet, unclear. Although one objective of public-private projects is to move risk to the proponent, somehow or other, project was ultimately underwritten by the NSW government. If the line cannot be brought up to cost-recovery after write-down of asset values, the bank is entitled to claim its losses from the government - ultimately this could mean a payment of $200M.

If all parties did their homework and the construction phase was so successful, why did this project fail?

- X Patronage did not meet estimates probably because of the high station fee (which meant that if two people were travelling together, a taxi was cheaper).
- X The line was taken through the airport and connected to the suburban network. This meant that, in peak hours the trains were full and there was no room for travellers and their luggage.
- X Unlike rail connections that terminate at the airport (eg Hong Kong's Airport Express), the trains are normal commercial rollingstock, which means commuter standard accommodation and no provision for luggage; nor is there any provision for check-in at a city rail station.
- X It's possible, also, that many air travellers consider suburban rail travel to be 'down market'.

As a public transport professional, I use this service fairly regularly, and, as part of the suburban network, it functions well; moreover, the airport rail stations are the very best in town. However, I can't say that it is value for money and it's clear that very few airline passengers make use of it, the main users being airport workers who can get concessional weekly travelpasses.

Brisbane had a similar experience with its airport rail link which opened in May 2001 (in this case, a spurline ending at the airport). Once again, the cost recovery imperative resulted in a high fare ($10 last time I travelled) and, again, the taxi fare is competitive if two or three people are travelling. Forecasts for this service projected 50,000 passengers per week but in its first year it was estimated to be carrying only 6,000. Nonetheless, this is an excellent train connection with 'special' trains to suit airport users which should have done better business.

Sydney Light Rail.

As in many cities, there is a section of the Sydney community that considers the future of urban transport to lie with light rail. Clearly, LRT performs well on high density corridors, however, this is unlikely to be the case in a sprawling, suburbanised city unless segregated permanent ways are constructed. Given that such corridors are chiefly only available by sequestering currently used road space, this presents a significant problem.

However, pressure for light rail continues unabated and, with keen interest being expressed by a private enterprise consortium to build and operate a system, a decision was taken in the early 90s to build an inner-city light rail along the alignment of a former heavy rail freight line. This connected the Sydney CBD to an urban regeneration district which was formerly an industrial and port area. The concept was not unlike London's Docklands Light Rail, albeit on a smaller scale and mostly using ground level tracks.

A contribution of $A22.5M to infrastructure was made by the Commonwealth Government via the BBC funding program; the State gave the necessary leases of the rail corridor and arranged the necessary consents from affected landowners; the consortium funded the rollingstock, stations, catenary, etc at a cost of $43.5M. The City Council was also a major player in assigning on-street corridors and re-designing the traffic layout in the area.

The State Government also negotiated an arrangement with my organisation that; fixed bus services at 1994 levels in the area of light rail operation; there was to be no competition for the market.

In this particular case, it was a pre-condition that there would be no operating subsidies paid to the consortium. Accordingly, the system went into operation in 1997 with a fare that was robust, but not totally unaffordable. (Current fares are of the order of $....... for a .... km trip). The original system operated successfully on this basis for three years and, in 2000 was expanded into the inner western suburbs at a cost of $20M (of which $16M was contributed by the State Government). The 7 km track now carries some 3.5M passengers each year and a North-South intra-CBD extension is now proposed.

This latter plan will be interesting as it relies on buses being removed from the CBD streets on which it will run; this, if it goes ahead, will mean that people coming to the CBD by bus will have to disembark at the CBD fringe and change modes to get to the city centre. Many of us are unconvinced that this will be saleable to commuters, moreover we don't see it being possible to provide the bus-tram trip for the same cost as a direct bus, so the CBD extension will almost certainly require an operating subsidy in addition to a government contribution for infrastructure. (We understand that the total projected cost of this 2 km line will be $A160M for that track and rollingstock, plus up to $A100M for supporting infrastructure and interchange facilities). This project relies heavily on support from the City Council which must provide on-street access as well as significantly changing its urban plan.

Melbourne's Trams and Trains.

The city of Melbourne (3.5M population) has one of the world's oldest continually-operating tram system and it is also one of the largest. There are some 240 km of track, most of which is on roads shared with other traffic and, in 1999, there were 520 vehicles on the system.

Melbourne also had 350 km of suburban heavy rail with 200 stations and 150 carsets.

This system, by the 1990s was becoming run-down and was fraught with inefficiency. There was tension between the labor movement and the State government of the day.
Faced with the need to upgrade the system and reduce costs, the Victoria State Government decided to offer franchises for the operation of the tram and train networks (also offered was the regional rail and coach network, but I shall confine this paper to the urban transport system).

Tenderers were expected to take full control of the system and to progressively upgrade rolling stock and infrastructure; they were to be remunerated by an operating subsidy, payments to cover the leases for new rolling stock and capital grants for infrastructure and other capital programs. There were also reimbursements for concession fares and some performance based payments.

As part of the process, the Government indicated that it expected annual patronage growth of 3.6% p.a. over a 15 year period; this compound 70% increase was adopted in the funding model and relied upon by the tenderers.

(It's unfortunate that similar growth estimates were simultaneously being put forward in support of a PPP tender for a new urban motorway system. In hindsight we realised that you couldn't have had both).

There was keen interest in the call for tenderers and, perhaps, some considerable over-enthusiasm. The winning franchisees projected the elimination of operating subsidies within 10 years and, within 15 years, all payments were proposed to be either performance or investment based. All committed to major rollingstock replacement and refurbishment programs.

Insofar as this process was intended to transfer risk to private sector partners, it succeeded our wildest expectations. Unfortunately, the tenders proved to be financially unsustainable and, faced with a political embarrassment, the government still had to inject cash into the system.

In 1999/2000, the first year of outsourced operations, payments to franchisees were some $A300M (10% below forecast). The following year they were more than 20% below forecast but much of this was mainly because of delays in the capital program; performance payments also were below target. However, by 2001/2, it was clear that the franchisees were struggling. In February 2002 the State Government had to commit an additional $A105M to the franchisees but even this was not enough and later that year, the biggest of the three franchisees ceased operation forfeiting a performance bond of $A135M and owing some $A70M to its creditors.

The franchises have been subsequently re-allocated between the two remaining operators; the funding model has been modified and is moving away from an incentive basis to traditional management style contracts. In money terms, the government's forward estimates suggest that an additional $A1B is required over the next five years, an increase of over 50% on original projections. It now seems unlikely that there will be any long-term savings from the franchise process.

What went wrong? At the core of this issue is that tenderers were just too optimistic in their bids. Either they didn't do their homework (which seems unlikely for these major international operators) or perhaps they took the view that, given the government's strong wish to outsource, they would ultimately be able to transfer the risk back to the government - if so, they were right!

It's true that they weren't helped by an ineffective integrated fare collection system in which evasion was rife, but this alone would not have caused the collapse (indeed, this is one area where a clear case could have been formulated for compensation).

Or was it that the government agencies responsible for managing the contracts missed something? Again in hindsight, the bids were demonstrably unsustainable; possibly the officials were carried along on the wave of enthusiasm for outsourcing that originated with the government of the day.

The impartial observer is compelled to the view that there was too much emotion on both sides and not enough rational evaluation.

Nonetheless, the private partnership yielded some good results in terms of performance: on-time running and reliability improved generally by up to 35%; service cancellations fell by 20-30%; fleet quality improved significantly; there was a 5% increase in service kilometres; train patronage increased by 5% in two years and trams by 6%. Importantly, user satisfaction ratings are steadily increasing.

The current model provides for the franchisees to take control of all staff and assets to maintain and improve assets for a term of five years (extendable by 18 months) after which they can be transferred to a new operator or back to the State.

For a fuller outline of the Melbourne experience, I refer readers to Stanley and Hensher, "Melbourne's Public Transport Franchising: lessons for PPPs", a paper prepared for the 8th International Conference on Competition and Ownership in Land Passenger Transport, Rio de Janeiro, 2003.

Integrated Ticketing.

Readers will be aware that Smart card transit ticketing systems are the flavour of the month in cities around the world, and Australia is no exception. At present, integrated ticketing projects are underway in every major city.

Since ticketing projects involve operators who are either regulated by, or owned

by State Governments, there is no federal or local government involvement and the main challenges involve balancing the interests of the operators and ensuring the optimum allocation of risk.
In Sydney, we have opted for a turn-key, build-operate contract in which a private-sector company, for a fixed price, will design and build the ticketing system and instal it. Subsequently it will operate it, recovering its costs by a change on each transaction. Capital for the project is being provided by the State Government (because it can access funds at lowest costs). When established in 2005/6, the contract will be managed by a commercially structured State-owned Corporation, which will receive all revenues, pay costs of operation to the ticketing provider and remit the balance to the transport operators according to the travel provided by each.

The initial contract will be for a period of 15 years, following which there is the option to offer the operating contract for tender. However, it is likely that further advances in technology will mean a new generation charging system will be available by then. For instance, we expect to see convergence of transit ticketing, road tolls and other ‘e-purse’ commercial transactions.

Total cost of this project is $A160M, funded by debt. The system currently provides some 1.75M transit trips each working day (of which 30% is cash) and patronage is growing at 1-2% p.a. We expect the proportion of cash transactions to reduce as the advantages of the smartcard system are recognised.

What is interesting about this PPP is that ultimate financial risk resides with the Government (subject, of course to strong performance bonds posted by the provider). However performance risk sits with the provider, whose very existence depends on the system meeting specification. In the long-run, the provider will be paid for delivery of a working system, but will depend on that system working reliably for its future sustainability.

For transit operators (public and private) themselves, there is no risk - they make no contribution until the system is in place, then simply “rent” the system through a charge per passenger trip.

For State Transit, this also means the eventual dismantling of a revenue collection function involving in-house administration and a network of ticket agents at .... corner stores and newsagencies. We expect a nett saving of the order of $A10M p.a.

The State Government has also reserved the right to a share of any “blue sky” income that might be derived from expanding the use of the ticket’s ‘e-purse’ capability into non-transit areas of commerce such as small retail purchases or event entry.

Interest is now emerging in linking the various city-based ticketing systems;

however, this involves some complexity due to differing ticketing system providers, some of whom are fierce competitors, and the actual market for interstate use is probably quite small. Perhaps, the States should have consulted with each other more closely before embarking on their individual projects.

Bus Outsourcing.

Probably the most successful PPPs outside of highway construction is in the outsourcing of bus services in Australia's west - the Western Australia capital of Perth and the South Australia capital, Adelaide.

In both cases, existing services where State Government owned and operated, rollingstock was dated and there were major labor inefficiencies. Decisions were taken to offer the services for tender but with the Governments retaining ownership of the respective fleets.

The service contracts involve a modified form of "gross cost" contract, in which the operator receives a mix of cost-based and incentive payments and fares are notionally returned to the government.

This model tends to attract service-provider organisations and, in Adelaide, one of the operators is an international contracting organisation which specialises in facilities management such as hospitals and prisons. In Perth, the contractors are both organisations with extensive transit experience as owner operators.

These models are a good example of public-private arrangements with both partners bringing to the partnership the skills and resources which they best manage. Government, in essence, takes the core patronage risk, recognising that there is little that can be done by the operator to grow it significantly. Government also takes the key planning decisions about the network design and level of service.

The operator, on the other hand, relieves government of significant labor management risk (Governments are rarely able to resist the demands of unionised public-sector workforces) and are also able to focus strongly on operating efficiency and customer service without having to worry too much about political issues. In both cities, there have been significant improvements in reliability, on-time running and customer service with the comfort to Government that the system is running at efficient costs.

Significantly, in both cities, the incumbent public-sector operators were permitted to bid for their businesses, but both ultimately failed (actually TransAdelaide managed to retain a small part of its previous business).

A form of this western model now looks like moving to Sydney but, here, the environment is rather more complicated. Sydney has had a very long-standing mix of public and private bus services with 1750 State Transit buses in the denser East, and about 2000 privately owned buses in the suburbanised west, operated by some 20 different companies.

Neither public nor private operators are considered by the Government to be operating optimally and it has commenced a major reform program which will eventually reduce 55 contract areas to 10. Private sector operators will have to co-operate through joint ventures, or to merge and there will be one gross-cost-plus-incentive contract for each region. There will be an initial term of seven years, renewable if performance meets benchmarks but the intention is that all contracts will then be open to competition.

This is a bold experiment in that, elsewhere, the main objective has been to contract out the government's own agency. In this case, government is intervening to re-direct the use of privately-owned assets and workforces. The end result relies on a level of trust being developed between the stakeholders and on there being some assurance that those who exit the industry (voluntarily or otherwise) will receive full value for their working assets.

Ultimately, we can expect the major industry players to prevail and I think State Transit will be one of them because we know our bus business can be financially self-sufficient on the proposed contract terms. As in the west, the New South Wales Government will carry the risk on patronage and service levels; the operators will carry the risk on cost and performance targets.

In Conclusion - What does all this mean?

In this paper we have looked at some variations on the PPP theme in a federal structure. What do we find ?

Firstly, there is nothing special about federalism unless the different levels of government want to get involved. In Australia, the current federal government has little interest in urban infrastructure and service delivery, and has left it to the States; it has been resistant to federal tax concessions for urban public transport even as it has introduced tax policies for company-owned cars that make it cheaper per kilometre the further you drive.

However, previous governments on the other side of politics have perceived a strong commitment to improving urban life and have invested strongly in urban transport projects.

Secondly, in our system at least, fragmented local or city government has neither the power nor the resources to significantly influence transport policy; it is a customer of the State, rather than a key player. However, when the whole of the metropolis is governed by one Council, the situation changes markedly.

The interesting thing about PPPs in Australia is that the roads projects have been so spectacularly successful that the financial markets have not shown much enthusiasm for public transport infrastructure PPPs unless Governments hold most of the risk. For Governments the reluctance of the markets has eroded much of the attraction for public transport PPPs.

Importantly though, in a federation the different administrations have the opportunity to converse with each other, to learn from each other, to benchmark against each other, and to set common standards.

How does a federal structure impact on the PPP environment? Are opportunities easier or more difficult to find? This is hard to answer in the Australian environment since almost all are developed at the State level. Perhaps the answer is that the logical level at which to structure partnerships is between private sector proponents and the level of government responsible for service delivery. For example, while not involved in transport projects, the Sydney City Council has developed several public-private relationships in respect of the services for which it is responsible.

And, federal or not, what are the key points for developing a successful PPP? The Australian experience shows that what necessary is good data, good planning skills, a sound understanding of the relevant industry. What is absolutely essential is a sound commercial attitude. What is surprising in many Australian PPPs is the lack of hard-nosed business skills, indeed the naivety, in large commercial and financial institutions. It seems to me that, if we want successful outcomes, it's not sufficient to rely on the proponents undertaking due diligence; the sponsoring agency has to recognise that it knows things about the business opportunity that are invisible to proponents - agencies perhaps need to step beyond the limits of normal disclosure.

And agency staff have to also resist over-enthusiasm - in several of the above cases, proponents could rightly claim to have been swayed by officials desperately keen to realise their own pet projects.

Finally, in a mixed economy, there's opportunity and a role for all players public and private - but at all times, the emphasis has to be on partnership.