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Mrs Jane Prentice MP
Chair
House of Representatives Standing Committee on Infrastructure and Communications
Canberra ACT 2600

Dear Mrs Prentice

Thank you once again for the opportunity to present to the Committee as part of the Inquiry into Infrastructure Planning and Procurement.

I am writing to provide the additional information requested by the Committee regarding the Inverted Bid Model, specifically:

- International and Australian experience with similar models for delivering infrastructure
- How government can have confidence that the Inverted Bid Model delivers value for money
- How government can be assured that costs will not escalate once an investment partner is appointed

International experience

The international models most comparable to the Inverted Bid Model are the so called Aggregator Model in the United Kingdom and the NPD Model in Scotland. Like the Inverted Bid Model, both models secure finance first through competitive tenders before separate tenders are undertaken for other project partners such as construction and operation and maintenance (O&M). Further information on these models is available at:

http://www.gov.uk/government/publications/psbp-overview/priority-school-building-programme#aggregator-model

http://www.scottishfuturestrust.org.uk/publications/explanatory-note-on-the-npd-model/

Australian experience

In Australia, there are broad similarities between the Inverted Bid Model and the current process for moving forward with unsolicited infrastructure proposals to government. Under both arrangements, private sector partners are appointed first before separate tenders are undertaken for construction and O&M. An example of this is the North Connex Project in Sydney where Transurban locked in the cost of construction (assumed construction risk) before tendering for a construction partner (Lend Lease).

Value for money

The Inverted Bid Model could be described as the "unsolicited bid model but with competition". Under the Model, long-term equity investors like superannuation funds compete to be selected as the preferred project partner by way of an 'open book' and iterative equity funding competition.

Prior to calling for tenders, government releases a project specification sufficient to allow a detailed risk allocation. This starts with a well scoped but flexible project specification so as to enable bidders to submit innovative solutions. It culminates in a fully resolved design to enable costs to be locked in (see below).

Funding competitions have been used widely in the UK and evidence from the UK Audit Office shows such competitions do deliver value for money. HM Treasury now requires all projects over £50 million to use funding competitions. For further information see:

http://www.nao.org.uk/report/innovation-in-pfi-financing-the-treasury-building-project/

Cost certainty

Committee Members asked how government can have confidence that the cost of a project will not escalate between the equity funding competition and the construction tender with the cost borne by taxpayers. Is there, for example, scope for the successful bidder to select a 'gold plated' construction solution?

The short answer is no. During the equity funding competition, potential investors submit the *minimum internal rate of return (IRR)* they are seeking based on design specifications (outputs) and risk sharing arrangements proposed by government for building and operating the asset over its lifetime.

For example, government may propose to build a specified toll road where demand (patronage) risk is transferred to a private partner, or it could propose a "gain share, pain share arrangement" where toll revenue is shared and/or the private partner receives a specified payment to make that road 'available'.

The IRR bid is initially expressed as a percentage, however prior to the selection of the successful bidder or group of bidders at the end of the equity funding competition, this percentage is converted into a *fixed cash flow equivalent* and construction and other costs are locked in. There is no scope to later increase costs.

In other words, during the equity funding competition, each bidder seeks to make an ex ante bid that it believes is competitive both against a government's benchmark and other participants' bids. *Thereafter they must deliver and operate the asset to ensure the actual ex post IRR does not fall below their fixed bid.*

The Inverted Bid Model is also able to provide a mechanism to respond to newly emergent risks which are dealt with through a pre-agreed mechanism as well as new opportunities due to for example changes in technology. In the case of the latter, an option could be included to vary a contract at an agreed price.

The Inverted Bid Model is flexible in terms of how it manages risk but, in our view, offers a more disciplined approach because long-term equity is appointed to manage an asset over its entire life. They earn their returns not through up front fees but through the efficient management of an asset over its lifecycle.

Long term equity investors are therefore fully accountable to members and/or shareholders for the financial success of the project. There is no comparable oversight and accountability under the current bid model.

Please don't hesitate to get in contact if we can provide any further assistance.

Kind regards

Jane McGill
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