

1 PROCESS CHALLENGES

The successful procurement of major government infrastructure typically relies on two to three high quality bidding consortia with a clear focus on competing strongly to deliver the best bids to government. In turn, government will undertake a robust evaluation process to determine a preferred bidder with whom to close the deal within government's required timeframes.

Both these centrepieces of a successful procurement process can be impacted by incorporating value capture into a project. Careful procurement process design is required to achieve the highest quality outcomes in respect of both the infrastructure element and the value capture element of the project.

1.1 Limiting competition

If delivery of value capture is seen as critical to success in a bidding process, the incorporation of value capture in a project will limit the range of bidders who will put themselves forward to bid for the project.

Delivery of core government infrastructure and the commercial developments involved in value capture components of a project are two distinct markets and involve quite different sets of expertise and relationships. Contractors and financiers who are adept at infrastructure projects, through many years of working on these projects, will often not have the in-house expertise and relationships to undertake commercial developments. Invariably, they will need to partner with developers, contractors and financiers which specialise in the commercial development market.

If alignment between an infrastructure party and a strong commercial developer is critical to a bid's success, the infrastructure team are unlikely to invest the significant time and cost

resources a bid requires unless they are confident a strong partner will be secured.

At the outset, government will want to consider whether it wishes to engage with consortium with an overall level of expertise in both the infrastructure and commercial development markets (a combined offering). It may after all attract stronger bidders in individual sectors if it were to procure infrastructure and commercial development separately.

There is also the special case of organisations which do have both in-house infrastructure and commercial development expertise. Such organisations may have an inherent advantage such as the ability to co-ordinate between two companies in the same group versus the co-ordination challenges between unrelated companies dealing at arm's length. The integrated organisation may also be able to cross subsidise. This, in turn, can limit the appetite of the non-integrated consortium to bid.

1.2 Certainty and transaction execution

One of the major challenges in integrating significant commercial opportunities with government infrastructure is the different approaches each market sector takes to bid processes. This may seem surprising but it's a real impediment to government receiving sufficiently detailed bids to evaluate and close out the transaction with the preferred bidder.

Infrastructure providers and commercial developers have very different cultures. This manifests itself in different approaches to bidding - the level of resources each is prepared to deploy, the level of certainty they are prepared to commit to and their different approaches to managing risk. Each has their pluses and minuses. But, critically for government, they often do not speak well to each other.

Infrastructure providers are used to working to a detailed and certain scope and risk allocation. This, in turn,

permits them to commit to deliver infrastructure by a fixed date for a fixed cost. If the project is a PPP and is financed, this in turn enables them to deliver highly geared and aggressively priced capital, with little or no working capital and fixed funding profiles which allow precise interest rate hedging. This is made possible because key risks such as certainty of revenue and the procuring of key approvals are addressed by government.

By contrast, developers are exposed to both market revenue risk and regulatory uncertainty as to the timing and conditions of key approvals. To manage these risks they need flexibility as to when to commence, and therefore complete, construction and even the flexibility to vary the very nature of the commercial developments to adapt to market demands. They also have a tradition of minimising costs in developing a bid and deferring a range of matters to be addressed once they are in a preferred bidder position.

Time and again, when the different groups come together for the purposes of bid, there is a process of discovery and multiplication of challenges. Sometimes the infrastructure provider comes to the realisation that the developer cannot provide the certainty it needs. Alternatively, the developer may not be permitted the flexibility it seeks. A disproportionate amount of senior management time is consumed with the task of bridging the gap between the two approaches - management time which may be more productively spent refining the design and price of the core infrastructure.

Despite the effort, and competitive imperative both groups fully understand, time runs out and these aspects of bids often end up submitted to government with many outstanding issues unresolved. It generally takes significant further work once a particular consortium is named preferred to close out the commercial opportunities aspects of the project. In the end, government may achieve a great overall outcome despite these bidding issues but it pays to anticipate them when developing a procurement plan at the outset of a project.

1.3 Evaluation challenges – the tail that wags the dog

Government will need to grapple with the important question of how to evaluate the commercial development.

Should government be evaluating the commercial development component and the infrastructure component together and awarding the project to the bidder with the best overall bid? What if another bidder has a superior core infrastructure proposal but with a less impressive commercial development?

Government is called on to exercise judgement when designing the procurement process and match it to the particular requirements of the project. For city-shaping infrastructure with legacy impacts, while any associated commercial development may be significant in absolute dollar terms, it will only be a small component of the project relative to the core infrastructure. For such projects, the government would not want to see the commercial development 'tail' wagging the infrastructure 'dog'. This suggests the commercial development could best be procured separately.

But contrast this with a more balanced project such as a convention centre development. In such projects, the associated hotel and retail complex may be of the same order of importance as the public infrastructure and be integral to the success of the public infrastructure. For such a project, an integrated approach to evaluation and project award would be indicated.

For other projects such as a carpark associated with a new hospital, the focus of the commercial development is primarily to drive revenue and reduce the overall net present cost of the project to government. In such projects, the commercial development is really just a component of the price part of the evaluation task.

Maybe government wants the best of both worlds. It may prefer an integrated solution combining the infrastructure with the commercial development and so seeks bids on that basis. But if it wants to avoid being locked in to going with the second best infrastructure solution, government may make it clear that it reserves the right to evaluate the commercial development separately and, if it chooses, to sever the commercial development from the winning proposal. If it exercises its severance option then government may subsequently run a further process to separately procure the commercial development. The approach leaves government with flexibility but query the impact on the commercial developer. What would be the effect on the commercial developer's motivation? Why develop a compelling bid if there remains a reasonable chance that government may not even proceed with the commercial development?