

**AA Submission: Use of public private partnerships to construct the Waterview connection (11 Apr 2008)**

## EXECUTIVE SUMMARY

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- The Automobile Association has no objection in principle to Public Private Partnerships where toll regimes conform to its toll roads policy. In particular the Association believes strongly that toll tariffs must be set to optimise the utilisation of the built asset and surrounding network, not the return on capital of the investor. It also requires that the administration costs of a toll collection system do not constitute a significant proportion of the toll tariff.
- The Automobile Association is concerned that the high level of risk in the New Zealand road construction market, combined with high costs of capital may result in private sector investors seeking a higher rate of return than in similar nations overseas and that these costs will be passed on to motorists. The Association believes that the Government's objective must be to obtain the best value for road users by: seeking to maximise the value of this construction opportunity over a very long time frame; minimising delays to construction; minimising consenting costs; minimising costs of capital; minimising construction costs; minimising administration overhead costs; and minimising on-going maintenance costs.
- The Automobile Association is concerned that Government transport policy objectives to significantly reduce private car mode share create an additional level of risk for those seeking a PPP concession for the Waterview Connection. The AA has requested that Treasury examine the development of transport policy for its effects on economic development.
- The Automobile Association believes the Crown should call-in the Waterview Connection in order to streamline the consenting process. This will reduce the risk to the concessionaire and could significantly reduce the cost of the project.
- The Automobile Association believes the Government must clarify its position on the second Waitemata crossing as a part of the Waterview Connection concession. Current legislation requires at least one free alternate route. That route is State Highway One. Noting that the Auckland Harbour Bridge lane extensions (the clip-ons) will come to the end of their engineering lives within the term of any Waterview Connection concession it is important that there is a clear indication to users of whether the lane capacity of the free alternate route will be reduced within the term of the concession.

## **SUBMISSION BY THE NEW ZEALAND AUTOMOBILE ASSOCIATION ON THE USE OF PUBLIC PRIVATE PARTNERSHIPS TO CONSTRUCT THE WATERVIEW CONNECTION**

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### The New Zealand Automobile Association

1. This submission is presented by the New Zealand Automobile Association, which represents its members in the development of policies, regulations and legislation affecting their interests as motorists and owners and users of motor vehicles. The Association represents over a quarter of a million Members who live in the Auckland region.
2. The New Zealand Automobile Association is an incorporated society. Its policies are determined by its elected National Council.
3. The New Zealand Automobile Association general policy on tolling may be relevant to this submission and is included as an attachment. Part of this policy states that objective of any tolling scheme must be optimal utilisation rather than maximum profit. This condition was met by the Transit Western Ring Route proposal.
4. The New Zealand Automobile Association was a lead agency sponsor of the Allen Consulting/Infometrics study "*Benefits of Investing in New Zealand's Road Infrastructure*". It also carries out quantitative research of its Members opinions including previous submissions on Member opinion of tolling options on Transit's Western Ring Route proposal.

*The consultation document asks a series of specific questions of submitters. The Automobile Association responds as follows:*

#### **What specific benefits or costs do you consider would arise if the Waterview Connection was procured through a Public Private Partnership (PPP)?**

5. The Association would expect the principal benefit of a Public Private Partnership would have to be earlier completion of the project than might otherwise be the case. The *Allen Report* showed this would have a substantial net economic and a fiscal benefit to New Zealand. Were the project not accelerated though a PPP arrangement then the AA would contend that there was no benefit in considering a PPP arrangement.
6. A Public Private Partnership allows the public sector to defray costs and risks to the private sector, in return for an on-going toll revenue streams to for the term of the partnership. The Association is concerned that the private sector could face greater risks and uncertainty than the public sector and seek recompense for this which could ultimately be expressed in increased costs to motorists.
7. The Association is specifically concerned about the risk price of policy uncertainty surrounding transport policy. Draft transport policy released by the

Ministry of Transport<sup>1</sup> proposes significant mode share change targets for urban areas in both short (2015) and long terms (2040) which may result in declining revenues as a result of Government policy. As Dieter Katz<sup>2</sup> has argued a requirement for PPPs is that the objectives should be objectively measurable and durable for the length of the project. Unless there is sufficient scope for revenue protection road toll operators must bid based on the most pessimistic expectations of demand on the assumption that Government will actually legislate to achieve its own targets.

8. The Association is concerned that under current legislation the simplest solution to consenting challenges is simply to expand the project scope thereby unduly increasing the costs of large roading projects. The Ministerial Advisory Group on Roothing Costs investigation into the cost-escalation of the Alpur B2 project found that the escalation in costs on that project (roughly 400% in eight years)<sup>3</sup> were largely caused due to consenting issues related to that project. As there have been no significant changes of legislation and the scope of the Waterview project has escalated in a similar manner in the past five years it is unlikely that this will change. The scale of the escalation also indicates an environment of high consenting risk and hence costs for PPP partners. The Association is concerned that PPPs encourage higher costs because the cost of shouldering these risks under PPP can be passed on to motorists.
9. The differential in the cost of capital between the private and public sectors is significant. The cost of capital in New Zealand (90-day bills) is currently 8.91 percent. Noting that 10-year Government infrastructure bonds are being offered at 6.36 percent and that the historic ten-year average difference between 90-day bills and ten-year Government bonds is 0.25% there is an opportunity cost to the private sector which is motivated by return on capital for investing in infrastructure. Given the higher risk of PPP investment any private investor will seek a higher rate of return than can be achieved at no risk (ie rolling 90-day bills), introducing further costs for motorists. Treasury has sold \$200 million worth of infrastructure bonds at 6.36%. This is almost certainly the lowest possible cost of capital. Under current financial conditions this suggests that private sector finance could add 2.5% p.a to the cost of a PPP project. Over the 35-year concession lifetime of a \$2 billion project this could result in hundreds of millions of dollars in extra cost to motorists.
10. Thus in the short-term the cost drivers are the opportunity cost of capital, in the medium term the consenting risks of design and construction and in the long term the efficacy of the Government's own policies to affect mode share decreases. Therefore it can be expected that private partners will expect a higher risk premium than is the case in other countries where PPP's have been used and this will in turn be passed on to motorists.

**If the Waterview Connection is procured as a PPP, what do you consider would be the best form of PPP to ensure value for money? Please explain the reasons for your answer.**

11. It is difficult to recommend an optimal form of PPP to ensure "value for money" when "value for money" is not a requirement of the New Zealand transport strategy. As PPPs remain subject to the Land Transport

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<sup>1</sup> Sustainable Transport Discussion Paper (November 2007)

<sup>2</sup> Financing Infrastructure Projects: Public Private Partnerships

<sup>3</sup> Ministerial Advisory Group on Roothing Costs Final Report (August 2006) p14

Management Act and fall under the jurisdiction of Regional Land Transport Committees this could be problematic. However the optimal form of PPP will be the one where each party bears the risk over that which they control. The main risks normally addressed by PPPs internationally are: construction cost risks; design risks and financial risks. The Ministerial Advisory Group on Rooding Costs found that while construction costs had played a part in the cost-escalation of the projects it reviewed the largest share was due to consenting (scope change) risks. It is impossible to know whether these would be greater for a private consortium because New Zealand has never experimented with private large scale road construction before. The nearest comparison would be the Transpower Waikato power line which is enjoying the benefit of a Ministerial call-in to progress through the Resource Management Act processes. Thus ideally the cost and risk for design and obtaining design consents should be born by the public sector. Public sector responsibility for consenting the project might inspire a similar call-in for Waterview.

12. The cost and risk for construction should almost certainly be borne by the private sector as international experience has demonstrated that where this occurs projects are delivered earlier and at less cost. This is probably because a public agency cannot effectively become bankrupt. This arrangement is simply an extension of some existing joint venture approaches to projects undertaken by Transit to date. However the main concern is the cost of delayed construction due to consenting processes which creates opportunity costs for Auckland.
13. It is not clear whether there is any benefit from the private sector shouldering the funding risks when the public sector has the capability to do so at significantly less cost. According to Debt Management Office figures the Public Debt is 22% of GDP which is internationally a very low figure. Although the target is currently 20% this is regarded internationally as a minimum and the Government would still be considered prudent with a public debt of 25% of GDP. This potentially could mean an additional \$45 billion available for public infrastructure investment.
14. The issue of tolling is difficult under existing legislation given the need for community support. Since the AA's 2006 Western Ring Route survey AA 2008 surveys have found a marked decline in financial happiness and given the increasing demands of accommodation, food and fuel on constrained household budgets it is unlikely that the appetite for tolls will have increased. While it may be possible to overcome any legal challenges the economic situation may prove more complex. While the Association has no objection in principle to tolling the route (assuming its conditions are met) but the practical issues are complex.
15. The Association is particularly concerned that the administrative overhead of operating a toll are a reasonably small fraction of the tariff. The Association would not support a toll that was essentially in effect to act largely as a demand management measure.
16. Altogether this suggests a build operate transfer (BOT) model. This is the model currently provided for under the Land Transport Management Act although consideration should be given to the competitiveness of New Zealand's tax treatment of large-scale private-sector infrastructure compared to nations where BOOT schemes operate.

**Are there particular advantages you consider would be gained from procuring the Waterview Connection as a PPP that would not be gained through some other form of procurement? Please explain the reasons for your answer.**

17. The principle advantage of private funding is that it frees up public funds for deployment elsewhere on New Zealand's underdeveloped roading network. This could, of course, also be achieved by funding via sovereign debt instruments such as infrastructure bonds.
18. It is possible that the scale of a Waterview PPP may attract the attention of international construction firms able to complete the project at lower cost so that complying bids may be built at less cost than experienced in New Zealand to date.

**What do you consider to be the level of market appetite for PPPs in the New Zealand transport sector? Please explain the reasons for your answer.**

19. The Association is not qualified to discuss the intentions of the finance or construction sectors, however to date there has been little enthusiasm from Auckland consumers for tolling Waterview in Auckland. Despite the fact that under the Transit Western Ring Route proposal nobody was actually worse off (because there was a free alternative route), of the 2,651 respondents to the AA's Western Ring Route survey of Auckland Members in November 2006, 29% were strongly opposed to tolling, 21% were opposed and only 27% supported or strongly supported the Transit tolling proposal. Of particular note was the strong opposition base in Waitakere. This low level of support is significant as community support is a condition for tolling proposals under the Land Transport Management Act.

**Please provide any additional comments you may wish to make about the possible procurement of the Waterview Connection as a PPP?**

20. Roads, by their very nature, tend to be monopolies or near monopolies. Thus the Association's principal concerns about PPPs are those that relate to the protection of consumers interests under monopoly conditions. These are:
  - a) Price (i.e Overcharging)
  - b) Quality (Poor service)
  - c) Quantity (Reduced alternatives)
21. The Association is particularly concerned that transparency is maintained throughout the PPP process so that the extent of operator revenue, costs and profits remain accessible to the public.
22. Overcharging occurs when tolls remain after they are needed, or are set at a profiteering level. Often this is due to a lack of flexibility in the concession agreement that allows one party to exploit an unexpected advantage over a long period. Conditions in the concession agreement to prevent overcharging should be consulted on with users.
23. Poor service quality includes practical issues surrounding the tolling mechanism, such as expensive transponders, lack of a cash-only lane, lack of signage, inadequate access to legitimate payment options combined with profit-maximising penalties for non-payment. There are also issues surrounding user safety standards, emergency services access, maintenance standards and environmental thresholds. Such conditions must be stated covered in any concession agreement.

24. The Association is specifically concerned that the mode transfer obligations placed on regional land transport committees by the Government Policy Statement under the New Zealand transport strategy may be incompatible with the utilisation optimisation objectives of a sensible tolling strategy. This could lead to a profit-maximising tolling strategy or alternately make the concession uneconomic. The AA has called for the Treasury to examine the implications of the proposed transport strategy from an economic development perspective.
25. The principal alternate route to Waterview is State Highway One. The Association has concerns about the timing of the construction of a second Waitemata Crossing. If this is delayed beyond the date at which the Auckland Harbour Bridge Clip-ons reach the end of their safe operating life then a PPP partner will enjoy windfall profits from a significant reduction in capacity on State Highway One. While it is probable that a second harbour crossing will also involve a PPP any Waterview PPP should clearly specify the conditions surrounding the provision of a second Waitemata Crossing. PPP concessions for Waterview should not in any way constrain capacity expansion on other routes.

To conclude the AA welcomes this opportunity to comment on a Waterview Connection PPP and would be happy to assist officials further with this project. Specifically the AA carries out Member research which provides a reasonable proxy of public opinion at relatively low cost.

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**New Zealand Automobile Association Incorporated**