www.pwc.com.au

West Gate Tunnel Project Transurban Final Offer

Summary Value for Money Assessment Report

10 December 2017

Disclaimer

This report has been prepared by PwC at the request of the Department of Treasury and Finance (**DTF**) in order to provide a summary of the value for money assessment of the West Gate Tunnel Project (**Project**).

This report has been prepared by PwC from material provided by, and discussions with, DTF and third parties including:

- Transurban
- Advisian
- Collaborative ITS Consulting Australia (**CICA**)
- Veitch Lister Consulting Pty Ltd (**VLC**)
- Smedley Technical & Strategic (**SmedTech**)
- Macquarie Capital
- VicRoads
- Western Distributor Authority (**WDA**)
- Department of Economic Development, Transport, Jobs and Resources (**DEDTJR**)

(together, the Information).

No verification of the Information has been carried out by PwC or any of its respective agents, directors, officers, contractors or employees, and in particular PwC has not undertaken any review of the financial information supplied or made available during the course of the engagement. This report does not purport to contain all the information that DTF may require in considering the Project or its form of delivery.

PwC has based this report on Information received or obtained, on the basis that such Information is accurate and, where it is represented, complete. PwC and its respective agents, directors, officers, contractors and employees make no express or implied representation or warranty as to the accuracy, reliability or completeness of the Information.

PwC will not provide any express or implied opinion (and assumes no responsibility) as to whether actual results will be consistent with, or reflect results of, any financial model outputs.

PwC may in its absolute discretion, but without being under any obligation to do so, update, amend or supplement the Information.

This report is for the sole use of DTF in considering the Project and its delivery. We accept no responsibility, duty or liability to anyone other than DTF in connection with this report, or to DTF for the consequences of using or relying on it for a purpose other than that referred to above. We make no representation concerning the appropriateness of this report for anyone other than DTF. If anyone other than DTF chooses to use or rely on it they do so at their own risk.

This disclaimer applies to the maximum extent permitted by law and, without limitation, to liability arising in negligence or under statute.

Contents

1 Introduction

1.1 Purpose

This report summarises the value for money (**VfM**) assessment of the Final Offer for Transurban's Market-led Proposal (**Transurban's Proposal**) for the West Gate Tunnel Project (**Project**).

The VfM assessment has been undertaken in accordance with the Victorian Government's Market-led Proposal Guideline (**Guideline**), which requires Transurban's Proposal to progress through four separate stages of assessment in order to reach Stage Five. If the proposal progresses to Stage Five, this will involve the State and Transurban entering into the proposed contractual documents under which Transurban will design, construct, operate and maintain the upgraded West Gate Freeway (**WGF**) from the M80 to Williamstown Road and the new West Gate Tunnel (**WGT**) which connects the WGF to CityLink near Footscray Road, over a 28 year period.

The VfM assessment at Stage Four has formed part of the State's overall assessment of Transurban's Proposal and its decision to progress the proposal to Stage Five. This report includes:

- background on the development of Transurban's Proposal for the Project
- details of the VfM assessment methodology
- summary findings of the quantitative VfM assessment undertaken in accordance with the Guideline.

1.2 Background

In March 2015 Transurban submitted its Market-led Proposal for the Project. The Department of Treasury and Finance (**DTF**) undertook an assessment of the Stage Two proposal in accordance with Stage Two of the Guideline. In April 2015, the State endorsed a recommendation to progress the proposal to Stage Three of the Guideline and requested Transurban to prepare a revised proposal (**Revised Proposal**).

The Revised Proposal was submitted to the State in October 2015 and was assessed by DTF and its advisers in accordance with the Stage Three Guideline requirements. One of the findings of this assessment was that the Revised Proposal was capable of delivering superior value, exceeding the State's VfM benchmarks of a next best alternative via a competitive process.

In December 2015, the State decided to progress Transurban's Proposal to Stage Four of the Guideline and commence exclusive negotiations with Transurban. During the course of Stage Four, the following key activities have been undertaken:

- further community consultation on and development of the Project's scope in order to define key requirements of the competitive tender of the design and construct (**D&C**) delivery of the Project works
- joint conduct by the State and Transurban of the competitive tender process for the D&C delivery of the Project on a fixed price, fixed time, turnkey basis. This process resulted in the announcement of a joint venture between CPB Contractors and John Holland (**CPBJH JV**) as the preferred bidder in April 2017
- execution of a D&C Commitment Deed between the State, Transurban and CPBJH JV in April 2017, in order to preserve the outcome of the D&C tender process pending the

State's completion of the statutory approval process for the Project. This D&C Commitment Deed sets out both the agreed form of the D&C contract and the associated fixed D&C price

- following execution of the D&C Commitment Deed, the State has:
  - conducted and concluded an Environment Effects Statement (**EES**) and the Minister for Planning has issued his Assessment Report, including the final Environmental Performance Standards for the Project
  - made a number of announcements that affect Project scope and cost (such as the announcement of additional truck bans in Melbourne's inner west)
- the State has developed and endorsed a preferred toll price structure for the Project (in relation to both WGT and CityLink toll price adjustments). This structure was informed by the following principles:
  - improving transport outcomes by optimising asset utilisation and managing traffic flows across the network
  - ensuring that toll levels reflect the benefits obtained by users and minimise distortionary impacts on the network, while protecting the long term interests of the State including the State's ability to fund future network augmentations
- the parties have negotiated the detailed commercial terms for the suite of Project documents which are proposed to be entered into by the State and Transurban.

Based on the above, Transurban submitted a Final Offer for assessment by the State in accordance with the Guideline requirements. The VfM assessment as summarised in this report forms a part of this overall Stage Four assessment.

1.3 Transurban's Proposal

1.3.1 Commercial proposal

Transurban's Proposal for the Project includes the following key features:

- Transurban will design, construct, operate and maintain the upgraded WGF from the M80 to Williamstown Road and the new WGT from the WGF to CityLink near Footscray Road
- as outlined above, delivery of the Project works has been subject to a separate D&C tender, meaning that 70% of total project costs reflects the outcome of this competitive process
- Transurban's operation, maintenance and toll collection functions will be delivered via a 'centralised' operating model, supporting both the Project and CityLink
- the total Project cost is expected to be funded through a combination of:
  - tolls imposed on users of the WGF and WGT (including heavy commercial vehicle tolls on the WGF and car, light commercial vehicle and motorcycle tolls on the WGT)
  - adjustments to various CityLink tolls during the remaining term of Transurban's existing CityLink Concession (to 2035) - most notably the application of a fixed 4.25% toll escalation rate for 10 years from 1 July 2019
  - a 10 year extension of the CityLink Concession (from 2035 to 2045)
  - a State funding contribution
- the concession term will align with the expiry date of the extended CityLink Concession (in January 2045). With the intended Financial Close date in December 2017, this results in an approximate 28 year term.

- to access the above funding sources, the Project contract documents include not only the suite of documents relating to the design, construction, financing, operation and maintenance of the Project, but also a suite of documents related to the associated amendments to the CityLink Concession Deed. These amendments to the CityLink Concession Deed effect the CityLink funding sources and have been integrated with other negotiated improvements in the State's commercial position under the CityLink Concession Deed to better align it with more contemporary Public Private Partnership (**PPP**) arrangements.

DTF has advised that it is Government's policy to implement the necessary legislative support for the WGT and CityLink toll revenues streams in the required form and timeframe (**Policy Assumptions**).

This legislative support can be implemented at any time prior to the toll revenue streams commencing (essentially up to the end of the 5 year construction phase). The Project documents include contingent State funding support for any toll revenue streams for which legislative support is not in place in the required form and timeframe.

On this basis, the principal VfM assessment reflects these Policy Assumptions. The VfM implications should these Policy Assumptions not eventuate is commented on separately below.

1.3.2 Financial proposal

The Project includes the following features from a financial perspective:

- whole of life Project costs (including D&C, operation and maintenance (**O&M**), lifecycle and toll collection costs) forecast to be incurred in order to meet the ongoing performance requirements for WGT / WGF under the Project documents and also to be incurred in relation to CityLink during the 10 year concession extension (from 2035 to 2045)
- toll revenues based on the State's preferred toll pricing regime forecast for each of (i) WGT/WGF, (ii) changed CityLink tolls during Transurban's existing CityLink Concession (to 2035) and (iii) all CityLink tolls during the 10 year concession extension (from 2035 to 2045)
- the State contribution (during the D&C phase)
- the rate of return on the capital invested by Transurban.

In essence, Transurban has forecast whole of life Project costs and toll revenues and has discounted both back to the expected Contract Close date (December 2017), to assess whether in Net Present Value (NPV) terms Project revenues are sufficient to cover Project costs and provide the required return on capital (after taking the State contribution into account). On this basis the Project is fully funded as the present value of Project revenues and the State contribution, equals the present value of Project costs.

2 Approach to VfM assessment

2.1 Introduction

A VfM Assessment Framework was developed and approved by the State in October 2015, prior to Transurban's submission of its Revised Proposal in Stage Three. The VfM Assessment Framework sets out the principles for the quantitative and qualitative assessment of Transurban's Proposal, and was developed to take into account the specific cost and toll revenue elements of Transurban's Proposal and the requirements in the Guideline.

The focus of the VfM assessment summarised in this report is the quantitative VfM assessment.

In order to facilitate the quantitative VfM assessment, a quantitative State Benchmark has been developed against which to compare Transurban's Proposal.

2.2 State Benchmark

The Guideline allows two alternative approaches to developing a benchmark for a Market-led-Proposal:

- a traditional State funded procurement, or
- a realistic alternative.

Given the nature of the Project, the State's Business Case (publicly released in 2015) identified the alternative form of procurement as being a State Owned Toll Company (**SOE**), with availability PPP delivery of the Project's physical infrastructure. This model has been adopted as the most realistic alternative and underpins the forecast Project costs, revenues and return on capital included in the State Benchmark.

As this model reflects the financial outcomes under hypothetical efficient private sector delivery of the Project, it represents a more challenging benchmark for Transurban's Proposal than the traditional State funded procurement alternative.

The State Benchmark includes State estimates for the key financial features included in the Transurban Proposal (identified in section 1.3.2). That is, the State has developed independent forecasts of whole of life Project costs and toll revenues, together with a market based measure of a reasonable return on capital given the Project's risk profile. Project costs and revenues are discounted back to the forecast Contract Close date (December 2017) to determine whether the Project revenues are expected to be sufficient to fund Project costs and to calculate an NPV that can be compared to the NPV of Transurban's Proposal.

Where the State Benchmark results in a negative NPV, this means the State's forecasts suggest that Project revenues are not sufficient to fund Project costs and provide the required return on capital. This would mean that additional Project funding is needed (for instance in the form of a higher State contribution). Where the State Benchmark results in a positive NPV, this means the State's forecasts suggest that Project revenues are more than is required to cover costs and provide the required return on capital.

To develop the State Benchmark:

- for those elements of the Project which have been subject to separate competitive tender processes conducted jointly by the State and Transurban, this has been assessed as securing value. To ensure a like for like comparison, the outcomes of those processes have been adopted in both the Transurban Proposal and the State Benchmark

- for those elements of the Project which have not been subject to competitive tender processes, the State engaged a range of specialist advisers to assist in developing robust independent State forecasts.

Based on this approach the key elements of the State Benchmark are described further below:

- common assumptions have been adopted with the Transurban Proposal in relation to the competitively tendered:
  - D&C costs
  - Independent Reviewer & Environment Assessor costs
  - Independent Payment Certifier costs
  - Insurances
- State estimates for the non-contestable D&C period, O&M, lifecycle and toll collection costs for the Project which are consistent with the performance requirements under the Project documents have been forecast by:
  - Advisian in relation to incremental CityLink O&M and lifecycle costs
  - Collaborative ITS Consulting Australia (**CICA**) in relation to WGT O&M and lifecycle costs and toll collection costs
- toll revenues based on the State's preferred toll pricing regime have been independently forecast for each of (i) WGT/WGF, (ii) changed CityLink tolls during Transurban's existing CityLink Concession (to 2035) and (iii) all CityLink tolls during the 10 year concession extension (from 2035 to 2045). These estimates have been based:
  - on independent traffic modelling by the State's traffic adviser, Veitch Lister Consulting (**VLC**), using their Zenith traffic model, the outputs of which have been reviewed by Smedley Technical & Strategic (**SmedTech**)
  - other relevant assumptions provided by Department of Economic Development, Jobs, Transport and Resources (**DEDJTR**)
- benchmark rates of return on capital for the Project determined by Macquarie Capital. These rates of return have assumed that the State would require a commercial rate of return for the commercial risk position assumed by it under the SOE model (i.e. the benchmark rates of return reflect market rates).

As the benchmark rates of return have been expressed in terms of ranges, this results in the overall State Benchmark also being expressed in terms of a range (as illustrated in Figure 1 below).

The net Project funding in Transurban's Proposal is then compared to the net Project funding range for the State Benchmark. Where the Transurban Proposal sits in the top half of the range, prima facie this suggests it represents VfM.

3 Summary VfM assessment

3.1 Introduction

In accordance with the approach outlined in the previous section, the summary assessment of Transurban's Proposal against the State Benchmark is shown below. This assessment reflects the Government's Policy Assumptions. The VfM implications should the Policy Assumptions not hold true are addressed in the section which follows.

3.2 VfM conclusion based on Policy Assumptions

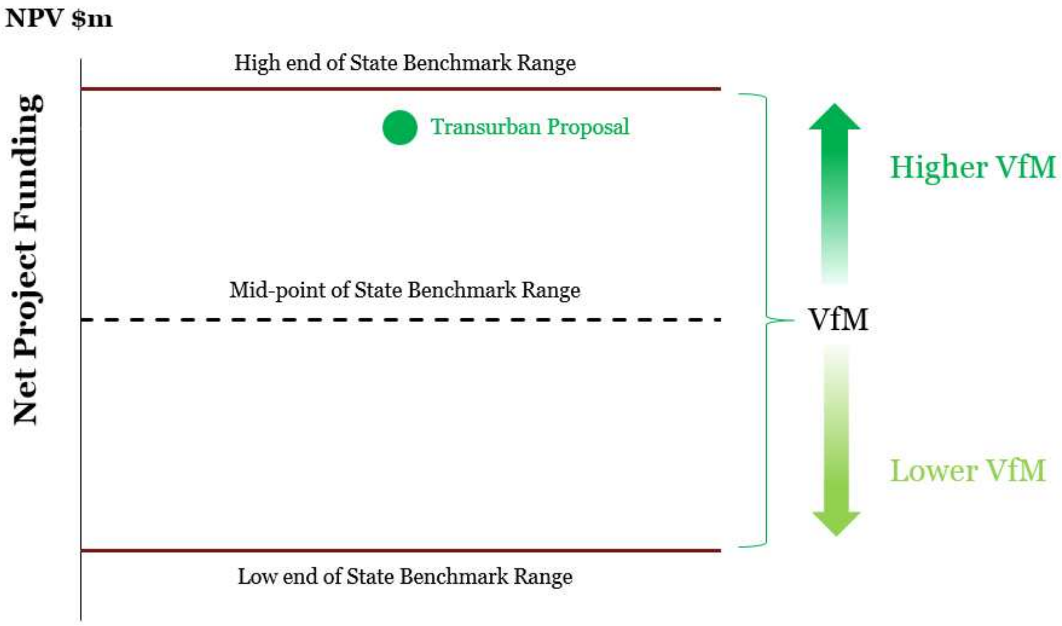
Based on the Policy Assumptions, the Transurban Proposal has been assessed as offering a VfM outcome for the State. This is demonstrated in the table below, which shows the comparison of the net Project funding in Transurban's Proposal to the net Project funding range for the State Benchmark.

Table 1 – VfM comparison

NPV $m	Transurban Proposal	State Benchmark	
		Low	High
Project NPV	**0**	**(600)**	**55**

This comparison shows that Transurban's Proposal is able to fully fund the Project. In contrast, the State Benchmark forecasts Project revenues being insufficient to fund the Project at the low end of the range (by $600m NPV) and producing a marginal surplus over Project costs (of $55m NPV) at the top end of the range. This places Transurban near the top of the State Benchmark range and hence it has been assessed as providing VfM.

Figure 1 – Illustration of VfM comparison (NPV)



The table below provides summary comments on how each element of Transurban's Proposal compares to the corresponding element of the State Benchmark.

Table 2 - Quantitative assessment

	Quantitative assessment
Toll revenue	Based on the State's preferred toll pricing regime, which is common to both the Transurban Proposal and the State Benchmark, the toll revenues in Transurban's Proposal sit at the top (favourable) end of the State's Benchmark range for these amounts. Toll revenues fund approximately 65% of the total Project costs.
Contestable D&C costs	A competitive tender process for each of the contestable costs provides comfort to the State that a competitive price has been realised and that the resulting amounts represent VfM. The State Benchmark and the Transurban Proposal costs use common assumptions in relation to the timing of cash flows and the nominal amounts. Contestable D&C costs represent approximately 70% of total Project costs.
Non contestable D&C costs	Transurban's non-contestable D&C costs slightly exceed the State's Benchmark range for these amounts. These amounts represent only 6% of total Project costs.
State costs	Common assumptions for the timing and nominal amounts of State costs are adopted in both the Transurban Proposal and the State Benchmark.
Non contestable O&M costs	The non-contestable O&M costs in Transurban's Proposal are below the State's Benchmark range for these amounts. These amounts represent approximately 10% of total Project costs.
State contribution	Common assumptions for the timing and nominal amounts of State contribution are adopted in both the Transurban Proposal and the State Benchmark.

3.3 VfM implications should Policy Assumptions not eventuate

Should the Policy Assumptions not eventuate, this will trigger the relevant contingent State funding support under the Project documents. If this occurs this is a State risk. As such it is appropriate for Transurban's debt and equity to be kept whole, and for Transurban to be compensated for the reinvestment risk which crystallises in respect of part of its investment in the Project.

The VfM assessment has shown that where the contingent State funding support is triggered the State's risk position in relation to the Project increases and the VfM of Transurban's Proposal is impacted.

In this context the outcomes under the Transurban Proposal where the Policy Assumptions do not hold, have been compared to the estimated cost of the State's next best option at this time (as advised to us), of reverting to State delivery of the tendered D&C contract. Estimates of the additional costs and risks borne by the State in these circumstances have found that the cost of reverting to State delivery is greater than the diminution in the VfM of Transurban's Proposal where the Policy Assumptions do not eventuate.

In order to form an overall view, Government needs to consider this comparison in the context of Government's assessment of the risk that the Policy Assumptions may not eventuate and the State's increased risk position under Transurban Proposal where the contingent State funding support is triggered.

www.pwc.com.au

© 2017 PricewaterhouseCoopers. All rights reserved.
PwC refers to the Australian member firm, and may sometimes refer to the PwC network.
Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details.

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

Liability limited by a scheme approved under Professional Standards Legislation