How to lose $118 million by not borrowing $653 million

Jon Stanford[1]

The former Newman government had severe debt phobia which alleged that governments should not borrow to build infrastructure but should enter into Public Private Partnerships, PPP, to reduce public debt. This was followed by an arrangement build the office tower at 1 William Street, Brisbane. A contract was let with a private builder to construct the tower block for $653 million[2] and, on completion, the government would pay the builder $1.14 billion[3] over 15 years to acquire the building. Under the accounting for PPP an 'economic PPP' i.e. one under which the private sector purchase the services of the project the amount owed by the government is not included in the public debt.[4] Originally the classification of 1 William Street as an 'economic PPP' may have had some validity as some six floors of the total 43 were to be leased by the private sector, it must be said, didn't bother to confirm this by signing a lease or any other binding contract. In June 2015 the current government found that it was not possible to lease any office space at current rentals and, as it was not willing to subsidise rents for 15 years, found that it would be obliged to shoulder the entire burden of the $1.14 billion. If, on the other hand, 1 William Street was classified as a 'social PPP'[5] the full cost of the building on completion would be included in the public debt.

The table below gives the outcome of two financing schemes. The first is to borrow the cost of the project, $653 million, by a government loan carrying an interest rate of 3.5 per cent for the life of the project. The table assumes that the construction period is three years and the cost of the project is evenly spread over these years. The second financing is the actual scheme. The private sector construction firm builds the tower over three years and receives the agreed financing on completion in equal

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[2] http://www.couriermail.com.au/news/queensland/state-government-announces-successful-bid-for-development-of-high-rise-administrative-complex-at-1-william-street/story-e6freoof-1226541774944

[3] The operating lease commitment is for $1.144 billion commencing on completion of construction. The lease period is over 15 years. *Report 7: 2014–15*, Queensland Audit Office, 14.

[4] Typically, economic PPPs do not result in an asset in the state's books as the state does not control the asset *Report 7: 2014–15*, Queensland Audit Office, 13.

[5] Typically social PPPs affect the state's balance sheet as they meet the definition of a finance lease, where the state bears the risks and rewards of ownership but does not have legal control over the asset. Finance leases increase the liability of the state and, while the state may avoid increasing external borrowings through QTC by entering PPPs, the liabilities of the state will increase. *Report 7: 2014–15*, Queensland Audit Office, 14.

annual instalments for the next 15 years. The table shows that the PPP saves funds in the construction period but loses substantial amounts in the next 15 years. If the project had been financed by borrowing, the cost of the PPP would have been sufficient to repay the borrowing and leave $118 million for something else. A simple calculation shows the loss from the PPP exceeds the $771 million. This is intuitively obvious; would you like to be paid $1.14 billion over 15 years to spend $653 over three years? The short answer is Yes. On the other hand, any rational government, not in the grip of debt phobia, would prefer to borrow $653 million through a public loan.

I know that there are some fine points having to do with the time value of money that have been skipped in the foregoing analysis but, I can confidently assert, taking them into consideration will not change the principle which is that paying more instead of borrowing does not reduce the amount you owe. There is a lot more not known about the PPP deal because the previous government kept it a secret – it was 'commercial in confidence'.

In conclusion, it must be admitted that losing $118 million by not borrowing $653 million takes unusual and, hopefully, rare skills in finance and public administration.

Year	Interest on Loan	PPP Payment	Amount PPP saved (+) lost (-)
1	8	0	8
2	8	0	8
3	8	0	8
4	23	76	-53
5	23	76	-53
6	23	76	-53
7	23	76	-53
8	23	76	-53
9	23	76	-53
10	23	76	-53
11	23	76	-53
12	23	76	-53
13	23	76	-53
14	23	76	-53
15	23	76	-53
16	23	76	-53
17	23	76	-53
18	23	76	-53
		Amount Lost	-771
		Repay Loan	653
		Net Loss from PPP	-118