



Llywodraeth Cymru
Welsh Government

**WELSH GOVERNMENT
A465 HEADS OF THE VALLEYS DUALLING – ABERGAVENNY TO HIRWAUN
SECTIONS 5 & 6 – DOWLAIS TO HIRWAUN**

Mutual Investment Model (MIM) Soft Market Testing Report

1. Summary

The Welsh Government undertook a market engagement exercise in October 2017 to inform the scoping, approach to and content of the procurement for the A465 Project. Sixteen companies completed and returned a questionnaire and eleven respondents (“Respondents”) were invited to attend separate clarification sessions which took place in Cardiff on the 10th and 12th October 2017.

Welsh Government found a high level of consistency across the market consultation Respondents on the six topics explored.

Extent of O&M Network - the Respondents strongly agreed that the inclusion of sections 1 to 4 in the O&M network would make the project more attractive to the market, and that it could provide better Value for Money for Welsh Government through economies of scale. All Respondents said exclusion of sections 1-4 would not likely deter them from bidding on the Project.

Third Party Equity Competitions - there was a strong consensus that a third party equity competition (TPEC), for 35% of the equity stake in the Project, would be viewed negatively by the market. Over half of Respondents said this would deter them from bidding for the Project; their reasons included: not being able to choose their project partners; the inability get a TPEC through internal governance processes; and the equity being diminished to a proportion that would no longer be attractive.

Procurement Down-Selection - the market favoured a 3-1 procurement process. The rationale for this was that a full interim submission would be required within the 3-2-1 approach to comply with the 2015 Procurement Regulations, and therefore the majority of bid costs would be incurred in order to produce a bid at the down-selection stage in any event. Every respondent preferred the shortest and most cost efficient process possible.

Community Benefits - all participants realised the importance of community benefits to the Welsh Government and the significance of the opportunity that the A465 provides in the regeneration of the local area. Many innovative ideas were suggested, including those which would have a long lasting impact on the local communities.

Market Resources - there is a potential resource challenge with the M4 and Hinkley Point competing for resources, but the Respondents felt optimistic about meeting those challenges, in particular by leveraging the local supply chain. No Respondents had any concerns around the capacity of the debt and equity markets to finance the Project alongside competing projects.

Concession Length - no preference was expressed on whether the concession length of the project should be 30 or 35 years plus construction. Almost all Respondents did not see any material difference without knowing the lifecycle of the road.

2. Introduction

The Prior Information Notice (“PIN”) for the A465 Sections 5&6 scheme (“Project”) was issued on 7th September 2017. The PIN described the Project and also provided information on the market engagement exercise that would take place in October 2017 to inform the scoping, approach to and content of the procurement for the Project.

The published PIN referred to a questionnaire which Respondents were asked to complete and submit to Welsh Government. Following receipt of the questionnaires, the Transport Division reserved the right to ask Respondents to attend a meeting and/or respond to any clarification in writing in respect of any submitted questionnaire.

The Respondents were invited to attend separate sessions, which took place in Cardiff on the 10th and 12th October 2017. For the purposes of this exercise the Welsh Government was interested in views from equity providers, tier 1 construction and O&M contractors and consortia thereof. Section 9 of this report covers the views of the wider market, who the Welsh Government has consulted with across several informal sessions such as the MIM Technical Event held in Cardiff on 11th October 2017.

The purpose of the sessions was to clarify and better understand the market’s view on issues which the Welsh Government included in the questionnaire and that will inform its approach to the development of the business case and procurement documents for the Project. The Project will be procured using the Mutual Investment Model¹.

The responses were not marked and will not form part of any formal assessment, nor will they affect any economic operator’s future participation in the competitive dialogue process for the Project.

The following sections of this report collate the results of the soft market testing. Each section starts by explaining the topics that were discussed with Respondents.

The decisions made by the Welsh Government following this exercise are outlined in Annex A: Summary of Decisions. These decisions took into account the results of the soft market testing exercise as well as further analysis and a range of other considerations.

¹ <https://gov.wales/funding/wales-infrastructure-investment-plan/mutual-investment-model/?lang=en>

3. Inclusions of sections 1- 4 in the Project O&M

Respondents were asked for their preferences on the opportunity for the contract to include the operation and maintenance of sections 1 to 4, as well as the O&M responsibilities of sections 5&6. This would mean that the total O&M responsibilities would be 41.1km, as opposed to solely the 17.7km to be constructed. It was asked whether the exclusion of sections 1 to 4 would deter any Respondents bidding. Respondents were also asked for their approach(es) to the treatment of latent defects risk and condition risk on sections 1 to 4 and for which information/surveys they would expect to be made available for review in respect of existing assets/infrastructure on sections 1 to 4. Further to this, Respondents were asked to discuss whether they believe it to be feasible for sections 1 to 4 to be maintained to the same performance standard as sections 5&6.

Response

Ten of the eleven Respondents made it clear that the inclusions of sections 1 to 4 would create economies of scale which could deliver better Value for Money; achieved through the sharing of materials and resources across the whole O&M network. Therefore, the strong preference of ten of the Respondents was for the Project to include O&M for sections 1 to 6.

Whilst all eleven Respondents acknowledged that the inclusion of sections 1 to 6 in the O&M would make the Project more attractive, the exclusion of sections 1 to 4 would not likely deter any of the potential parties from bidding. However, it was commented that if only sections 5&6 were included, it may impact the scale of the contractors interested in taking on the O&M which could in turn cause concerns for funders.

Several Respondents were also able to give examples of previous successful projects where they had taken on the O&M of existing road whilst simultaneously being responsible for constructing a new section. No significant issues or lessons learnt were raised.

All eleven Respondents were very clear that a significant risk assessment of the historic assets (structures and pavement) would be required prior to agreeing any O&M contract and taking on latent defect risk. In order for it to be possible to take on the O&M of sections 1 to 4, the risk must be measured and accepted following conclusive analysis.

Data requested from the Welsh Government included: as-built drawings; Principal Inspection reports for structures; condition surveys and maintenance records. The extent of warranties available from either Welsh Government or original contractors was also queried by a couple of Respondents to guarantee the validity and reliability of the information supplied and work performed. Although others did not indicate that a warranty would be required, they did express that they were less comfortable taking responsibility for the reliability and accuracy for the data provided by the

Welsh Government. Most emphasised the benefit of having access to this information as soon as possible.

Concern was raised about issues which were not identifiable, in particular geotechnical issues which are difficult to predict. Two of the eleven parties thought that it would create better Value for Money if the Welsh Government held the risk of latent defects, as any risk taken on by contractors would be priced. The majority indicated that providing full data was available, they would be comfortable to take on latent defect risk.

It was queried whether section two of the A465 dualling (Gilwern to Brynamwr), which is currently under construction, would be subject to a different arrangement as there will not be the same availability of data as on the remainder of the existing road to assess the risk and performance. It was questioned whether the latent risk for this section would sit with the current contractor constructing the road, or the successful bidder.

If sections 1-6 were to be included in the O&M contract; 75% of Respondents, in principle, had no issues with adhering to the same standard of performance across all sections of the road. Comfort was taken by these Respondents in the fact that the A465 is a relatively new road, with the oldest sections being no more than 15 years old. However, a number caveated that if the sections were not currently at the same standard a grace period would be necessary in order to allow time to bring the existing road up to standard. It was emphasised that the capacity to understand, analyse and come to a conclusion on the risk was of paramount importance.

4. Third Party Equity Competitions

Respondents were asked to provide their view on Third Party Equity Competitions (“TPEC”), in particular whether they believe that they provide better Value for Money. Respondents were also asked whether the inclusion of a Third Party Equity Competition would deter them from bidding on the A465 Project.

Response

Ten of the eleven interviewed parties preferred that Welsh Government did not run a third party equity competition on the Project and the majority said that a decision from Welsh Government to use a TPEC would be likely to deter them from bidding for the project. Although one party did not see it as negative for them, they struggled to identify the benefit of the approach.

One of the most common reasons given against TPEC was that Respondents value the freedom to choose who they work with, forming trusted, strategic partnerships. Respondents were concerned about being partnered with a body that they do not know, or worse, have a poor relationship with. It was suggested that senior debt providers may look unfavourably upon TPECs for the same reason. Senior debt providers want to know who their borrower is when they take proposals to their credit committees and uncertainty on this issue is unwelcome. It was noted that the senior debt solution could collapse at a critical point if the senior debt provider is asked to provide finance to a company with whom they feel unable to work.

Respondents also expressed that the circa £400m cost of the Project did not create a ticket size sufficiently large enough for a TPEC. Particularly once the 50% share for the SPV is split amongst consortium partners. Five Respondents expressed the view that despite incurring all the bid costs and taking on the risk a successful bidder could become a minority equity holder in comparison to the third party equity provider who will hold a 35% stake. Furthermore a TPEC would make it more difficult to attract investors and other consortium partners to the Project, particularly at a time where there are a number of competing Projects occurring in the UK which may become comparably more attractive.

Half of Respondents made it clear that a TPEC would hinder their internal approvals process to bid for the Project. Many Respondents argued for Welsh Government to instead take 20% (rather than 15%) equity in the Project, rather than a TPEC as this would assist with providing comfort to internal investment boards.

The majority of Respondents stated the Project will already have access to the best value equity as it is secured through a competitive procurement process, in a market with an abundance of available equity, and therefore there would be no upside to running a TPEC on the Project. Instead, a TPEC may attract those who are looking for more liquid, short term assets and will not be long term active investors in long term infrastructure projects.

5. Procurement Process

Respondents were asked to express their preference regarding either a 3-2-1 bidding process, where one bidder is eliminated in an interim stage, or 3-1 process where all bidders remain in the competition until the winner is announced. Respondents were informed that due to both the preferred MIM approach and procurement regulations which Welsh Government must comply with, a full interim bid submission would be required and a purely technical solution would not suffice.

Response

The vast majority of the eleven Respondents preferred a bidding process which went straight from 3-1 bidders if a full interim submission is required under the 3>2>1 option in order to comply with the 2015 Procurement Regulations. Although all parties were eager to reduce their bid costs, they recognised that given the amount of resources required to complete a full interim bid, it would be beneficial to have a longer period of time to submit a one-time only full bid. Several indicated they would welcome regular and detailed dialogue with Welsh Government with clear expectations and rules set. Bidders wish to be informed if it is clear their bid is not of the same standard of the other two bidders to allow them to decide whether to withdraw from the competition.

Concern was raised by two Respondents over the six weeks allocated time to complete the PQQ. Reasons given included the complexity of the Project and the number of documents required for the PQQ, some of which may also require translation. In some cases, internal governance structures may also make it challenging to complete and submit the PQQ to a desired standard in six weeks. The Welsh Government reminded all Respondents that the standard form PQQ documentation is already on the website. Several indicated that the PQQ should be specific enough to provide opportunity to differentiate themselves from other competing bidders, whilst not too specific to rule out bidders on an irrelevant basis. A couple of parties also queried the price: quality split at ITPD stage.

A number of Respondents were clear that upfront timetable clarity and certainty was a critical factor in their decision process on which projects to bid and therefore continued transparency is welcomed from Welsh Government.

The topic of reimbursed bid costs was raised by a couple of Respondents who queried whether this was something Welsh Government were considering. The Welsh Government indicated they were not anticipating paying bid costs.

6. Community Benefits

Respondents were asked what targets they would plan to set and for examples of what they believed would be achievable on the Project to benefit the community.

Response

All participants realised the importance of community benefits to the Welsh Government and the significance of the A465 in the regeneration of the local area. Furthermore, all parties were able to demonstrate previous projects, both in the UK and abroad, where significant efforts were made to enhance the local community, including utilising the local supply chain wherever possible.

However, it was recognised by a number of parties that the local supply chain must price competitively in order to be viable suppliers. If prices vary significantly, suppliers suggested their commitment to securing a large proportion of the supply chain from Wales would need to be balanced with delivering Value for Money.

In addition to this, when setting community benefit baselines Welsh Government were urged to recognise the need for contractors to employ deep subject-matter expertise, especially when significant complex structures are being constructed such as large arches and where local expertise may need to be complemented with resources from elsewhere.

Comments were made that some suppliers already have a large, local workforce and although not creating new jobs the Project would allow them to retain an existing local workforce.

7. Market Resources

Respondents asked whether they foresaw skills or resources to be at risk, due to other projects, Brexit or other factors. They were also asked whether they believed that any particular market factors would have an impact on the raising of finance, debt and/or equity, for the Project.

Response

Nine of the eleven Respondents were optimistic about meeting the resource challenge despite a number of competing infrastructure projects in the UK and felt that it could be overcome, in particular, by leveraging the local supply chain. Some multinational consortia were confident they could bring their international supply chain if it was required and therefore there was no reason to be concerned.

A number of parties suggested that the M4 project and Hinkley Point were the competing projects of the most concern, in particular because of their geographical proximity to the A465.

It was noted that the availability and inflationary pressures on cost of labour and materials was a potential concern, particularly as a potential result of Brexit, however clarity on the timetable would help to plan ahead and secure the required resources.

No concerns were raised around the capacity of the debt and equity markets to finance the Project alongside competing projects. Most commented that they believe there to be enough liquidity in the market to provide competitive financing and Value for Money.

8. Concession Length

Respondents were asked for their views with regards to the concession length in the context of financing the Project. In particular whether they believe that there would be any difference in the financing solutions available to a 30 year concession in contrast to a 35 year concession.

Response

Ten of the eleven Respondents did not see any material difference in the two proposed concession lengths without looking in more detail at the lifecycle requirements of the road. The commonly agreed position was that both a 30 and 35 year concession period after construction would attract competitive financing options.

It was commented that by having the concession period at 30 years, it would attract both banks and institutional investors and therefore a more competitive financing solution, providing better Value for Money.

Several Respondents gave examples of contracts they had been involved in which were longer than 35 years and therefore demonstrated that they were comfortable with a concession period of a longer length if required.

9. Wider Market Engagement

Engagement with the wider market has taken place on a similar basis to the soft market testing events. Views of the wider market mirrored the more detailed views from the soft market testing outlined above.

There was a strong agreement that the inclusion of sections 1 to 4 in the O&M would make the Project more attractive for bidders. It was also acknowledged that the wider O&M network could expand the opportunity to deliver long term community benefits through the project. Most were comfortable about maintaining the entire network to a consistent standard; particularly as even the oldest sections were only completed in 2004. Several indicated that it may provide better Value for Money if the latent defect risk of a limited number of structures sat with Welsh Government, although they were comfortable with taking on at least the majority of the latent defect risk.

There was a general consensus that the wider market does not wish the Project to use a TPEC. Respondents want to ensure that the equity provider is aligned with the long term goals of the Project; an outcome less likely with a TPEC. It was asked whether the SPV's "core" shareholders would be eligible to compete for the third party equity share.

The importance of community benefits was clearly understood by the market, and many innovative and creative ideas were suggested to Welsh Government. There was a particular focus on the legacy benefits which will outlast the short term construction phase.

Competing projects were not seen as a challenge and many were clear that they would not be engaging with the Project if they believed it to be in jeopardy due to resource constraints. Partnerships were being formed with this consideration in mind to give full confidence that any constraints driven by competing projects could be overcome.

The market was agnostic on the concession length of the road being either 30 or 35 years from construction, seeing neither as diverting from normal practice in the industry.

Annex A: Summary of Decisions

In considering the findings of the Soft Market Testing alongside a range of other considerations, the Welsh Government has made the following decisions for the project to be taken forward:

Extent of O&M Network The O&M will include Sections 5&6 only.
Third Party Equity Competitions The Project will not have a TPEC.
Procurement Down-Selection & PQQ Timescales There will be a single stage tender process (3>1 process), whereby all 3 shortlisted bidders are invited, following a period of detailed dialogue, to submit a final tender only, from which the Successful Participant will be selected. The minimum 6 week period to complete and submit a PQQ will be extended.
Concession Length The concession length of the project will be 30 years plus construction.