TE TAI ŌHANGA
THE TREASURY

GUIDANCE

# Strategic leasing

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Te Kāwanatanga o Aotearoa
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# Contents

# About this document

The Treasury has developed the Strategic Leasing Guidance (the Guidance) in consultation with the Infrastructure Commission, public sector entities and industry stakeholders.

This Guidance does not provide a new procurement model – the leasing activity contemplated in this document is no different to the leasing activities that already occur in the public and private sector. Rather, this Guidance provides the policy and project circumstances for which leasing could provide improved outcomes and be a viable option for public sector entities to consider for their physical asset requirements.

Also provided is guidance on best practice technical and commercial considerations the Treasury expects public sector entities to evaluate and incorporate into their strategic leasing arrangements.

Public sector entities (referred to as procuring entities throughout this guidance document) should consider this Guidance at the strategic stage of their decision-making process.

Consideration of this Guidance or choosing a strategic leasing approach to asset requirements does not exclude public sector entities from following Government Procurement Rules[1] and guidance published by the Functional Lead for Property for office accommodation and public interface area requirements,[2] where applicable.

For the avoidance of doubt, leasing proposals for office accommodation, public interface area and equipment is not within the scope of this Guidance. Procuring entities should continue to follow existing leasing guidance published by the Functional Lead for Property (Chief Executive of MBIE) for office accommodation and public interface area requirements.

1 https://www.procurement.govt.nz/procurement/principles-charter-and-rules/government-procurement-rules/

2 https://www.gpg.govt.nz/guidance/leases/

# Overview

## Introduction

The objective of the Strategic Leasing Guidance is to:

- assist procuring entities' consideration of whether leasing is an appropriate approach to acquire the use of physical assets required for the delivery of their public services, and
- provide procuring entities with best practice technical and commercial considerations for their leasing arrangements.

In the public sector, leasing is common for office accommodation, public interface areas, and equipment. In some circumstances the public sector also utilises leasing for more strategic assets such as housing, healthcare, and education related facilities. This Guidance has been developed to provide procuring entities with confidence to consider leasing to a greater extent and for a wider range of assets.

Leasing is more likely to provide value for money in certain project and policy circumstances. The durability of the public service requirements, speciality of the assets required, degree of service delivery and asset integration, and requirement for private sector delivery of services are key issues for a public sector entity to assess when considering their approach to acquiring the use of physical assets.

Leasing can improve the delivery, utilisation, and performance of physical assets used in the provision of public services. This can be achieved through by right sizing of the footprint and tenure of asset usage and leveraging asset delivery and management best practices from the private sector.

Once procuring entities have made the strategic decision to utilise leasing for their physical asset requirement needs, existing Government Procurement Rules and leasing guidance published by the Functional Lead for Property (where applicable) should be followed.

## What is a lease?

A lease is a contractual arrangement that grants a lessee the exclusive right to use an asset owned by the lessor for a defined period in exchange for regular periodic lease payments. Although the lessor retains ownership of the assets throughout the lease term, lease contracts can include provisions for the transfer or purchase of the asset at the conclusion of the lease. Real estate, equipment and fixed assets are common assets that are leased.

Lease arrangements involve the provision of financing by the lessor. However, leasing should not be regarded as a financing tool and the provision of external financing itself should not be a driver in choosing leasing over alternative approaches. Depending on the nature of the asset and contract terms, the lease arrangement may result in substantially the same fiscal and accounting impact as traditional procurement approaches.[3]

Variants of leasing include:

- Build-to-lease: a new asset is developed for the sole purpose of leasing; the asset could be commissioned by an anchor tenant or developed independently without an anchor tenant in place.
- Lease-to-own: a long-term lease is used to finance and smooth the capital costs of a new asset which is expected to transfer into the lessee's ownership at the end of the lease term.
- Co-location: different entities leasing different portions of the same facility to share facilities and costs and enable convenience for common patrons.
- Sale and leaseback: the asset owner sells the asset to the lessor and then leases the asset back from the lessor. In the private sector, a key objective for this type of transaction is to procure cheaper or additional financing – this rationale is not likely to be valid in the public sector context.

Leasing can be applied to both new and existing assets (ie, via sale and leaseback).

## Key advantages of leasing

The key advantages that distinguish leasing from other procurement methods include:

- Flexible footprint and improved utilisation – leasing provides flexibility at specified dates[4] to increase or decrease the physical footprint occupied as public service requirements change.
- Improved asset delivery and performance – periodic lease payments that only commence once the asset is constructed (if new) and operational, and are subject to performance abatements incentivises lessors to deliver on agreed asset outcomes (including whole-of-life asset maintenance).
- Potential for reduction in upfront capital needs – co-investment, co-location and transfer of residual asset value to private sector partners can reduce the total capital outlay required to achieve the desired asset outcomes.

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[3] See the Accounting and Fiscal Implications section for more information.

[4] Greater flexibility through the ability to adjust requirements at the end of the contract term. Flexibility is generally reduced during the contract term and any changes (in particular, reductions to footprint) can result in poor value for money outcomes.

# Project and policy characteristics suitable for strategic leasing

The approach to procure a proposal's asset requirements should only be considered once the underlying policy objective has been identified and agreed. As with all forms of procurement, choosing a leasing approach to asset requirements does not alter the investment case or policy objectives of a project.

Leasing may be applicable for both new and existing (via a sale and leaseback) assets. The same project and policy characteristics apply in both circumstances.

Strategic leasing should be considered when the proposal exhibits the following characteristics.

## Key project and policy characteristics

| | |
|---|---|
| 1 | Policy requirements are not durable and may vary unpredictably over the economic life of the asset |
| 2 | Similar market assets are regularly developed and utilised by the private sector |
| 3 | A low degree of asset and service design integration is required |
| 4 | Delivery of public services by the private sector is not required |

Not all characteristics need to be satisfied for procuring entities to consider leasing is a viable approach to procuring their physical asset requirements.

**Characteristic 1:** Policy requirements are not durable and may vary unpredictably over the economic life of the asset

The underlying policy objectives mean there is likely to be material changes to the specifications and performance outcomes required for the physical asset. These may include physical changes to the asset, a change of asset location, or an increase or reduction of footprint, within the economic life of the asset.

When policy requirements are likely to vary over the economic life of the asset, better outcomes may be achieved by aligning the tenure of physical assets with the likely tenure of the policy requirement. This alignment allows the physical assets to be adjusted according to the prevailing policy requirement.

Tenure of physical assets that extend beyond policy requirements will mean assets are held for longer than they need to be and/or are not fit-for-purpose resulting in under or over-utilisation and/or neglect.

This characteristic may stem from conscious policy objectives, general uncertainty, or shock events. For example, transitional housing required as part of disaster relief.

**Characteristic 2:** Similar market assets are regularly developed and utilised by the private sector

Market assets are defined as assets that can be used interchangeably between the public and private sector and have viable alternative private sector market for its use.

Generally, the physical specifications and performance outcomes required for the asset are not 'government-specific'. These assets could be delivered solely as or alongside similar market assets. The assets could have mixed or multiple uses and are likely to have alternative private sector demand.

Where the asset required is relatively generic (eg, housing, car parking, healthcare hubs) and could have a range of applications, it is unlikely that there will be a strong imperative for the Crown to retain ownership of the asset. In such a case the best value for money option may be through a lease arrangement.

The required asset may still have sector-specific features or fit-out, but these are in line with similar market assets within the sector. For example, health clinics that require healthcare specific plumbing and drainage or a research laboratory where the building structure is relatively generic, but the fitout and building services are specialised.

Where the required asset is highly specific to the proposed use (eg, prison or hospital), it is more likely that Crown ownership will be preferable. The limited alternative uses of such an asset will mean that, in a lease arrangement, a private owner will likely seek to recover the full cost of the asset over the duration of the lease.[5] This is less likely to represent value for money for the Crown, relative to traditional and other alternative procurement methods[6] (eg, Public Private Partnership ("PPP")).

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5 The private sector is unlikely to efficiently manage the residual value risk for an asset with no viable alternative private sector demand and will seek to fully recover capital costs within the lease term.

6 Value for money may still be achievable but this will need to be assessed on case-by-case basis.

**Characteristic 3:** A low degree of asset and service design integration is required

The underlying policy objective has a greater focus on the provision of the physical asset rather than the utilisation of the physical asset to deliver a public service or outcome. The public service being delivered, or policy outcome sought may be inherent in the provision of the physical asset. For example, the provision of shelter or accommodation.

Some level of asset and service design integration may still be required but these requirements are in line with sector-specific market standards.[7] For example, community health hubs are likely to require healthcare specific asset and design integration, but the private sector has developed the relevant intellectual property.

However, specifying performance outcomes and regimes will still be desirable to ensure the private sector lessor is incentivised to provide the expertise and innovation they have at their disposal.

In circumstances where a high degree of asset and service design integration is required and/or the integration is only applicable in a 'government-specific' context then other procurement approaches that allow greater client control (eg, traditional models) or facilitate greater innovation potential and risk transfer (eg, PPP), may be more appropriate.

**Characteristic 4:** Delivery of public services by the private sector is not required

Core public services (eg, healthcare, teaching, tenant management) being delivered through the physical asset remains the responsibility of the respective public sector entity. The private sector partner is not expected to contribute to the delivery of these public services, beyond the provision of the physical assets to agreed service levels, including delivering soft and hard maintenance.[8]

The contractual arrangements for leasing are unlikely to be sufficient, nor would it likely be a suitable starting point to develop a model, for a proposal that requires private delivery of public services.

If policy objectives require the private sector to deliver public services along with the provision of the physical asset, then a more comprehensive approach (such as PPP or an alternative delivery model) will likely be necessary to facilitate greater opportunities for innovation and ensure appropriate controls and monitoring are in place.

*See Appendix 1 for examples of suitable and unsuitable projects scenarios across medium- and long-term leases.*

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7 Characteristic 3 has linkages with Characteristic 2 because as an asset requires a greater degree of service design and asset integration, that is also not readily available in the market, then the asset is not likely to be a market asset.

8 Soft maintenance means services that improve the amenity of the facility – including cleaning, security, waste management, catering, landscaping. Hard maintenance means the upkeep of the physical asset, often in relation to building elements that are integral to its structural integrity, weathertightness and general functionality – including maintenance of the exterior, HVAC, fire safety systems, plumbing, electricity and mechanical functions.

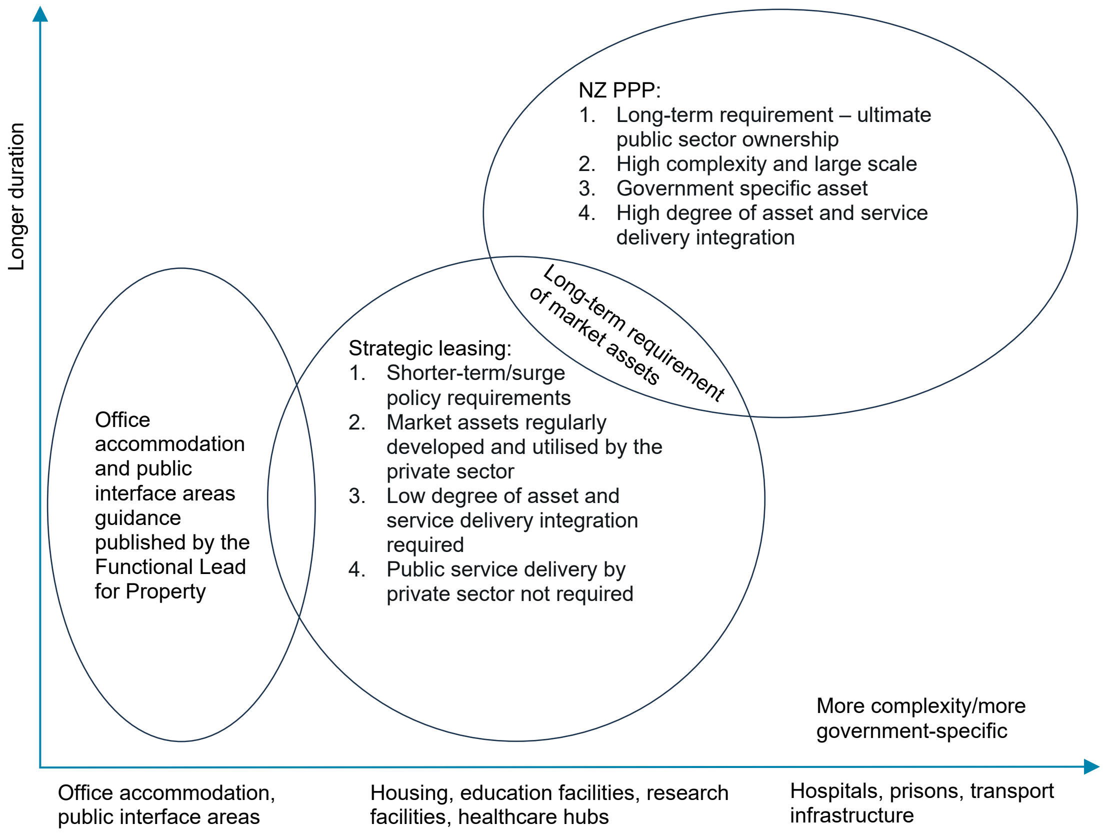
# Landscape of procurement approaches that use private finance

The project and policy characteristics specified in the previous section should guide procuring entities towards greater use of leasing for relatively less complex assets required over the medium- to long-term.

The NZ PPP Policy provides guidance for large scale, long-term and complex projects, including for both horizontal and vertical infrastructure assets.[9] The Strategic Leasing Guidance provides advice on the next notch down of long- to medium-term but relatively less complex assets. Finally, lower complexity assets like office accommodation and public interface areas are covered by existing guidance published by the Functional Lead for Property (Chief Executive of MBIE) and on the New Zealand Government Property Group website.

Figure 1 provides a simplified illustration of the landscape of different privately financed procurement approaches.

**Figure 1: Landscape of procurement approaches that utilise private financing**




9 Horizontal infrastructure refers to roads, electricity lines, water and sewerage networks and other utilities (ie, assets that lay horizontally from point to point). Vertical infrastructure refers to above ground improvements (ie, assets that raise vertically from the ground).

## Edge-cases

Large scale market assets required over the long-term may be suitable for leasing as well as other procurement options (including traditional models or the NZ PPP model).

Whether or not the underlying land within the leasing arrangement is owned by the government or by the lessor may be a key determinant in whether the proposal is suited to leasing or other procurement options.

These 'edge-cases' will have a less clear-cut choice of procurement model and will need to be evaluated on a case-by-case basis followed by second opinion assurance – this is standard practice for all procurement options analysis.

## Nature of the lease arrangements

**Long-term lease** (eg, 25+ years) arrangements will typically be associated with proposals that commission new assets in areas of weak private sector demand.

When there is insufficient alternative private sector demand:

- the investor and developer of the new asset will require the full recovery of project capital costs within the initial lease term, and
- shorter lease terms would leave the private sector partner with residual value risk that they are unlikely to accept or efficiently price.

These are likely to be considered 'finance' leases.

*More information on 'finance' leases can be found in the Accounting and fiscal implications section.*

Long-term lease 'edge-cases' include commissioning of new market assets in areas of strong private sector demand and the Crown expects to own the assets at the end of the lease term.

**Medium-term** lease arrangements will typically be associated with proposals that can utilise existing assets or are commissioning new assets in areas where there is strong alternative private sector demand (eg, when co-locating with private sector tenants where the government is not an anchor tenant).

When there is sufficient alternative private sector demand, the investor and developer will be able to efficiently manage residual value risk and price the risk of finding alternative tenants for the asset.

*See Appendix 1 for examples of suitable and unsuitable projects scenarios across medium- and long-term leases.*

# Technical and commercial considerations

Strategic leasing should only be used where it offers value for money over the contract life relative to traditional procurement methods, and in some cases, other alternative procurement methods (eg, PPP). This means obtaining improved asset outcomes from a project for the same or lower risk-adjusted net present cost than if it were procured using other procurement methods.

Procuring entities should consider the following elements to ensure value for money is maintained. These are a mix of quantitative assessment recommendations and commercial considerations.

The purpose of the quantitative assessments is to provide a counterfactual case. This is used to determine if the leasing option will provide greater value for money than the highest scoring traditional procurement option.

The purpose of the commercial considerations is to provide procuring entities with the key contractual terms that will help drive value for money when structuring lease arrangements.

Before considering quantitative factors, procuring entities should first be satisfied that the proposal's physical asset requirements sufficiently meet the qualitative project and policy characteristics specified by this guidance.

*Detailed guidance each of these technical and commercial considerations will be available in the NZ PPP policy guidance once it has been refreshed and republished in accordance with the policy enhancements recently endorsed by Cabinet (EXP-24-MIN-0056 refers). The square bracketed placeholder references in the table below will be updated once the refreshed NZ PPP policy guidance becomes available.*

Table of technical and commercial considerations overleaf.

| | Medium-term leases | Long-term leases |
|---|---|---|
| **Quantitative assessment** | | |
| **Public sector comparator (PSC)**<br>An estimate of risk adjusted whole of life cost of a project if it were delivered by the procuring entity using traditional procurement methods.<br>A PSC typically comprises of:<br>• a reference product<br>• value of transferred risks<br>• adjustments for public sector advantages (tax).<br>Detailed guidance and methodology can be found in [section x.x / paragraph x.x] of the NZ PPP Policy guidance. | Not required – however agencies should provide a counterfactual traditional procurement option, which may or may not represent the same level or quality of service, for comparison.<br>Primary safeguards for ensuring value for money are the qualitative criteria (ie, market assets procured on market terms comparable with private sector demand).<br>In most medium-term lease cases, ownership will not transfer to the lessee at the end of the lease term so any counterfactual asset residual values should be considered as part of the value for money assessment. | Recommended – PSC used as a benchmark against which to assess the net present cost of procuring the project via leasing.<br>Compares the cost of procuring a project via leasing with a PSC that represents the cost if the procuring entity were to deliver the asset and services itself using conventional procurement.<br>The lease arrangement should only proceed for a project where the lease delivers improved outcomes for the same or lower cost than the alternative traditional approach (as established by the PSC). |
| **Risk-adjusted discount rate**<br>Used to reflect the different levels of risk associated with future cash flows under different procurement options.<br>Detailed guidance and methodology can be found in [section x.x / paragraph x.x] of the NZ PPP Policy guidance. | Recommended – a risk-adjusted discount rate should be used to discount future cash flows to their present value. This discount rate should reflect the level of risk transferred to the counterparty.<br>Discounted cash flow analysis is used to compare the different cash flow profiles of the PSC and leasing transactions on a consistent basis.<br>When a PSC is required, these cashflows should be discounted at the corresponding risk-adjusted discount rate of the proposed procurement model (eg, design and build) and risk allocation of government delivery. | |
| **Commercial considerations** | | |
| **Risk allocation**<br>Individually identified risks should be allocated to the party best able to manage and mitigate that risk (in the sense of either reducing the likelihood of it occurring or reducing the cost of rectification or reinstatement).<br>Detailed guidance can be found in [section x.x / paragraph x.x] of the NZ PPP Policy guidance. | Adhere to industry norms or standard government practice (where applicable). | Recommended – Procuring entities should consider the whole-of-life project risks and the optimal risk allocation between the public sector entity and private sector.<br>A risk allocation schedule should be completed to ensure that risks transferred to the private sector partner are well understood and valued for the PSC. |

| | Medium-term leases | Long-term leases |
|---|---|---|
| **Performance regime and payment mechanism**<br>The performance regime and payment mechanism incentivise enhanced asset performance throughout the operating period. Ensures that payment is only made once the asset is complete and available, and only in relation to performance outcomes delivered.<br>Detailed guidance and methodology can be found in [section x.x / paragraph x.x] of the NZ PPP Policy guidance. | Adhere to industry norms or standard government practice (where applicable). | Recommended – the required level of asset performance should be prescribed in terms of outcomes by the procuring entity at the outset of the procurement phase.<br>The procuring entity will need to consider how a performance regime can incentivise the delivery of those outcomes through payments abatements as well as penalties for incidents for non-performance.<br>Payments should be calculated based on the actual performance of the asset and required service outcomes. |
| **Hand back (transfer of ownership) provisions**<br>Provisions detailing the conditions, processes, and requirements for transferring the asset from one party to the other at the end of the contract term.<br>Detailed guidance can be found in [section x.x / paragraph x.x] of the NZ PPP Policy guidance. | Adhere to industry norms or standard government practice (where applicable).<br>In most medium-term lease cases, it will be the procuring entity (ie, lessee) handing back the asset to the lessor according to make-good provisions. | Recommended – for lease arrangements this is technically a “transfer of ownership” provision, however the principles of NZ PPP Policy hand back provisions apply.<br>Procuring entities should consider if negotiating a transfer of ownership at the end of the lease term represents value for money.<br>If a transfer of ownership is desirable the procuring entity needs to prescribe the conditions, processes, and requirements for the transfer of asset at the onset of the procurement phase. |
| **Crown capital contributions**<br>Crown capital could be applied alongside private finance during the construction or operational phases.<br>Detailed guidance can be found in [section x.x / paragraph x.x] of the NZ PPP Policy guidance. | Not applicable – if the procuring entity believe there is a compelling case for Crown capital contributions raise this with your Vote Analyst. | Crown capital contributions may be considered for larger scale lease arrangements or for financially material specialised fitout items, where it retains sufficient private capital at risk and represents value for money.<br>Detailed guidance can be found in paragraph [x.x] of the NZ PPP Policy guidance. |

## Standard Form Contracts

Procuring entities can refer either:

- Auckland District Law Society: Deed of Lease, or
- New Zealand Government Property Group (“NZGPG”): Government Standard Develop Agreements and Agreements to Lease

as potential starting points for contractual negotiations.

Whether the templates identified above are practical starting points will depend on the asset being leased. Procuring entities should seek relevant legal expertise and advice.

The NZGPG standard form agreements are drafted for office accommodation and public interface area lease arrangements. These agreements are unlikely to be suitable for assets of a different nature to office accommodation and public interface areas.

Long-term lease arrangements are likely to require more adaptation or bespoke contracts to account for the specified technical and commercial considerations.

# Accounting and fiscal implications

The accounting and fiscal treatment of a lease transaction must be assessed on a case-by-case basis. In determining the accounting treatment agencies need to consider Treasury Instructions[10] and Crown Accounting Policies.[11] A general guide is provided below for agencies to incorporate into initial advice on strategic leasing opportunities.

In general, the contractual characteristics of leases can result in their classification as one of two types of leases: finance leases and operating leases.

| Lease | Description | Fiscal Impact | Budget Impact |
|---|---|---|---|
| **Finance** | Finance leases transfer, to the Crown as lessee, substantially all the risks and rewards of a leased asset (ie, is equivalent to ownership). | Finance leases require recognition of an asset and liability, and these amounts are amortised over the term of the lease arrangement.<br>The operating balance will be impacted by the annual depreciation on the asset recognised under the finance lease and the finance cost associated with the contract.<br>The financial liability (if held by a core Crown agency) will impact net core Crown debt. | The impact on the operating balance is not generally managed against the Budget operating allowance.<br>The impact on net core Crown debt is generally managed against the Budget capital allowance. |
| **Operating** | Operating leases allocate substantially all the risks and rewards of a leased asset with the lessor. | No asset or liability is recognised in relation to the leased asset.<br>However, an annual expense is recognised during the lease term that will impact the operating balance. | The impact on the operating balance is managed against the Budget operating allowance.<br>There are no capital implications. |

10 https://www.treasury.govt.nz/sites/default/files/2024-08/treasury-instructions-2024.pdf

11 https://www.treasury.govt.nz/information-and-services/state-sector-leadership/guidance/reporting-financial/accounting-policies

# Appendix 1: Illustrative examples of when to use leasing

The section has three subsections: medium-term leases, long-term leases and unsuitable project scenarios.

These illustrative examples are hypothetical and are not references to any historical or imminent projects.

## Medium-term leases

### Example A1: Medium-term housing for natural disaster relief

Policy objective: Provide housing for an extended but not permanent period as part of the Government response to a major natural disaster that has displaced a community.

The procuring entity commissions the construction of a new suburb of housing[12] and agrees to lease these houses for a period of 7-10 years. As lease arrangements with the Crown expire, the leases will progressively convert to private leases, or sold to residents or on the open market.

Key characteristics:

- medium-term policy requirement – affected residents are expected to recover (eg, settled insurance payouts, found appropriate housing) so it is not necessary for the Crown to provide permanent arrangements
- market assets – houses are regularly developed and used by private sector
- no asset and service design integration required – no unique or special services are required to deliver this policy objective
- delivery of public services by the private sector is not required – management of tenants and services are provided by the relevant Crown entity. However, the maintenance of the assets should be outsourced to the private sector partner/s.

Medium-term lease arrangements are sufficient to provide private sector partner/s sufficient confidence to commit capital because the commissioned assets are market assets and given the circumstances should attract strong private sector demand at the expiration of the Crown's leases.

Benefits the Crown versus traditional procurement options include:

- less capital outlay given the private sector retains the residual value of assets
- private sector partners are incentivised to design and construct assets that are attractive to private demand resulting in well-designed and built assets

[12] Community infrastructure will be required as part of this new suburb but in the interest of being concise, this example assumes the associated infrastructure is funding, financed and procured by traditional methods.

- incentivising private sector partners to complete assets on time given no lease payments are made until assets are completed
- as a lessee the Crown should not be responsible for any cost overruns.

A counterfactual approach involves the Crown commissioning and owning a new suburb of housing. This approach requires a larger capital commitment with no clear avenue for the Crown to recycle and redeploy its capital into other policy initiatives, once residents have recovered. The Crown may end up owning houses that can reasonably be owned by the private market.

### Example A2: Co-location of community health hubs with the private sector

Policy objective: Provide outpatient healthcare services in a well populated urban centre.

The procuring entity enters 7-year lease arrangement with a listed property developer to lease three units out of a 10-unit healthcare orientated facility currently in the early stages of development. The listed property developer will lease the remaining units to the private sector.

Key characteristics:

- medium-term policy requirement – the types or way outpatient services are provided by the Crown can be expected to change over the 7-year period
- market assets – relevant healthcare facilities are developed and used by the private sector
- some asset and service design integration are required – however, these are not government-specific requirements that reduce alternative private sector uses
- delivery of public services by the private sector is not required – healthcare services are be provided by the relevant Crown entity. However, the maintenance of the assets should be outsourced to the private sector partner.

A medium-term lease is sufficient to provide the private sector partner confidence to continue development because there is likely strong alternative private demand to take over the Crown's leases at the end of the lease term. This assumption is based on the assets being in a well populated urban centre and there being private sector co-tenants.

Benefits to the Crown versus traditional procurement options include:

- less capital outlay given the private sector retains the residual value of assets
- private sector partners are incentivised to design and construct assets that are attractive to private demand resulting in well-designed and built assets
- incentivising private sector partners to complete the asset on time given no lease payments are made until the asset is completed and operational
- incentives are in place to maintain asset to agreed standards given lease payment will be abated for non-performance
- as a lessee the Crown should not be responsible for any cost overruns.

The counterfactual approach involves the Crown commissioning and owning a new community health hub. This approach may require the Crown to develop a smaller than economic facility or a larger than required facility and lease the remaining space to the private sector. This may be less value-for-money or require a larger capital commitment. Ownership can also result in the Crown being responsible for underutilised facilities if policy changes result in service changes.

### Example A3: Transition to exit or downsizing of services

Policy objective: Consolidate polytechnic education facilities due to sustained reduction in student demand.

The responsible Crown entity sells and leases back a polytechnic education facility in an area where there has been a sustained reduction in student demand. The footprint leased back is smaller and sized to current requirements.

Key characteristics:

- medium-term policy requirement – a more comprehensive consolidation of services is likely in the medium-term but the location and degree of reduction is subject to ongoing analysis and uncertain economic conditions
- delivery of public services by the private sector is not required – education services will be provided by the relevant Crown entity. However, the maintenance of the assets should be outsourced to private sector partner.

This sale and partial leaseback arrangement allows an immediate reduction of footprint to reflect current student demand and facilitates further reductions at the end of the lease term. This is a relatively more ‘certain’ scenario compared to the counterfactual of a sudden and complete exit which may not provide time for the market to prepare alternative uses for the property, likely attracting a higher risk premium and less favourable sale price.

Sale and leaseback are not likely to provide material fiscal and/or balance sheet capacity benefits. Any capital gains achieved from the sale[13] may be offset by the higher capital costs associated with the lease.

In this example, the primary benefit of the sale and leaseback is to facilitate a smoother transition from Crown ownership to private ownership.

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[13] If the facility is in a high growth urban centre with land that has higher value alternative uses, the Crown could capture this value and release balance sheet capacity through a sale and partial leaseback. This is less likely in areas where there is no commercially viable alternative use for the facility or land (eg, in areas experiencing a general reduction in population or economic growth which has led to the change in underlying policy requirement).

# Long-term leases

## Example B1: Long-term social housing

Policy objective: provide long-term social housing in a satellite suburb within a metropolitan region.

The procuring entity commissions the construction of off-site military housing via a 25-year ‘lease-to-own’ arrangement. The private sector partner will build, own, maintain and transfer ownership to the Crown at the end of a 25-year lease term.

Key characteristics:

- long-term policy requirement (does not meet Characteristic 1)
- market assets – houses are regularly developed and used by private sector
- no asset and service design integration required – no unique or special services are required to deliver this policy objective
- delivery of public services by the private sector is not required – management of tenants and services are provided by the relevant Crown entity. However, the maintenance of the assets should be outsourced to the private sector partner/s.

Benefits to the Crown versus traditional procurement options include:

- private sector partners are incentivised to design and construct assets that are attractive to private demand resulting in well-designed and built assets
- incentivising private sector partners to complete assets on time given no lease payments are made until assets are completed
- physical asset levels of service will be maintained to agreed standards (lease payment abatements for non-performance)
- as a lessee the Crown should not be responsible for any cost overruns.

A long-term lease is unlikely to result in less capital outlay.

Long-term social housing is an edge-case that could be procured through a long-term ‘lease-to-own’ arrangement as well as alternative private finance procurement options like PPP. Although the assets are relatively less complex, the long-term nature and enduring ownership requirement could justify the use of PPP. Whether leasing or PPP is more appropriate will likely depend on the scale of the housing requirement – significant scale is required to justify the additional procurement costs of PPP.

Further counterfactual approaches involving traditional procurement and Crown ownership could also be justified given the long-term requirement and low complexity of the assets.

### Example B2: New regional healthcare hub

Policy objective: provide public healthcare services through a new regional healthcare hub rather than at hospitals in neighbouring urban centres.

The procuring entity commissions the construction of a new regional healthcare hub via a 25-year ‘lease-to-own’ arrangement. The private sector partner will build, own, maintain and transfer ownership to the Crown at the end of a 25-year lease term. The Crown will be the only tenant for the facility.

Key characteristics:

- long-term policy requirement (does not meet Characteristic 1)
- market assets – relevant healthcare facilities are developed and used by the private sector
- some asset and service design integration are required – however, these are not government-specific requirements that reduce alternative private sector uses
- delivery of public services by the private sector is not required – healthcare services are be provided by the relevant Crown entity. However, the maintenance of the assets should be outsourced to the private sector partner.

In this example full capital recovery by the private sector partner over the lease term is required because the asset is greenfield, the Crown is the only tenant and there is unlikely to be alternative private sector demand for the facility (due to the regional location). A long-term lease is most appropriate to facilitate this capital recovery. Shorter-term arrangements would likely be less cost efficient or leave the private sector with intolerable residual asset value risk.

Benefits to the Crown versus traditional procurement options include:

- private sector partners are incentivised to design and construct assets that are attractive to private demand resulting in well-designed and built assets
- incentivising private sector partners to complete the asset on time given no lease payments are made until the asset is completed and operational
- incentives are in place to maintain asset to agreed standards given lease payment will be abated for non-performance
- as a lessee the Crown should not be responsible for any cost overruns.

A long-term lease is unlikely to result in less capital outlay.

A long-term regional healthcare hub is an edge-case that could be procured through a long-term ‘lease-to-own’ arrangement as well as alternative private finance procurement options like PPP. The long-term nature, relatively more complex nature and enduring ownership requirement could justify the use of PPP. Whether leasing or PPP is more appropriate will likely depend on the scale of the regional healthcare hub – significant scale is required to justify the additional procurement costs of PPP.

Further counterfactual approaches involving traditional procurement and Crown ownership could also be justified given the long-term requirement for the assets.

# Unsuitable Project Scenarios

## Example C1: Long-term remote housing

Policy objective: provide long-term housing a rural area.

The procuring entity will deliver the housing assets through a traditional design and build contract, then enter a sale and leaseback of the housing with a third-party on a 25-year lease. The tenor of the lease allows full capital recovery by lessor and transfer of ownership of the housing to the Crown at the end of the lease term.

Project characteristics:

- long-term policy requirement (does not meet Characteristic 1)
- the assets are regularly developed and used by the private sector but are in a remote area with no alternative private sector demand (does not meet Characteristic 2)
- low asset and design integration required
- delivery of public services by the private sector is not required.

In this scenario, the lease adds no value to the procurement of the housing assets. Although the characteristics of the asset may indicate leasing is appropriate, this is overridden by the policy circumstances (ie, remote location and long-term requirement).

Further, due to the procuring entity choosing to deliver the assets themselves the private sector discipline and incentive advantages of 'lease-to-own' arrangements are not present.

## Example C2: New regional prison

Policy objective: provide additional prison capacity.

The procuring entity commissions the construction of a new prison via a 25-year 'lease-to-own' arrangement. The private sector partner will build, own, maintain and transfer ownership to the Crown at the end of a 25-year lease term.

Project characteristics:

- long-term policy requirement
- the asset is only developed for government uses and has no alternative private sector demand
- a high degree of asset and service design is required – the asset is complex and highly specialised to government requirements
- delivery of public services by the private sector may be required.

The project does not meet any of the Strategic Leasing project and policy characteristics.

In this scenario, a lease arrangement is unlikely to achieve the innovation and risk transfer potential for a project of this nature and size. Alternative procurement approaches like PPP are more likely to accommodate the complexity of this project and facilitate greater risk transfer and innovation more efficiently.