



GOVERNMENT OF
WESTERN AUSTRALIA

Special Inquiry into Government Programs and Projects

OSPREY VILLAGE REPORT

FEBRUARY 2018



Special Inquiry into Government Programs and Projects

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Inquiry into Osprey Key Worker Village

Mr M C Wauchope AO
Commissioner
Public Sector Commission
Locked Bag 3002
WEST PERTH WA 6872

Dear Mr Wauchope,

INQUIRY INTO OSPREY VILLAGE

Further to my letter of 21 December 2017, I am pleased to present the report of the Inquiry into Osprey Village, conducted in accordance with the Terms of Reference and section 24 of the *Public Sector Management Act 1994*.

Due to a conflict of interest declared by the Special Inquirer, Mr John Langoulant for the Special Inquiry into Government Programs and Projects, the Osprey Village was examined separately from the 31 programs and projects.

Osprey Village in Port Hedland is one of the projects under the *Delivering Affordable Housing to Key Workers Program* initiative funded through the Royalties for Regions program. Two other projects under this initiative, Hedland 125 Service Worker Accommodation and Pelago East were examined in the Special Inquiry led by Mr Langoulant. This report should be read in conjunction with the Royalties for Regions chapter in the broader Special Inquiry report as the Osprey Village was included in the assessment of the overall governance, strategy and administration of the Royalties for Regions program.

A hearing for the Royalties for Regions program was held on 12 October 2017 with Department of Communities. Although a hearing was not held specifically for Osprey Village, the Department of Communities provided very detailed information to Questions of Notice. Four written submissions that relate to the Pilbara Accommodation were received. The Inquiry took into account previous audits and reviews, and focused on specific project management stages for the project, providing a comprehensive analysis.

I would like to express my appreciation to all who contributed and assisted with this report, in particular the Special Inquiry team members who worked diligently and to the highest standard. In addition the Department of Communities and Department of Primary Industries and Regional Development are acknowledged for providing the information to assist with the examination of the project.

I am confident that the recommendations outlined in this document and in the Special Inquiry into Government Programs and Projects report will better prepare the State Government for the challenges of a contemporary business environment, limit wasteful expenditure and offer an increased level of accountability to taxpayers.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'S. Black'.

Stephanie Black
Special Inquirer

1 February 2018

ACKNOWLEDGEMENTS

The report on the Inquiry into Osprey Village has been made possible through the contribution of a highly capable team of people from a range of WA State Government agencies. I extend my gratitude to the below public sector employees who were dedicated throughout the duration of the Inquiry.

- Lara Connor, Department of Finance
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- Natasha Polzin, Department of the Premier and Cabinet
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- Julian Partridge, Public Sector Commission

In addition, I would like to show my appreciation to Peter Kennedy for writing support and DTI for transcription services.

The Department of Communities and Department of Primary Industries and Regional Development also provided us with assistance, and I thank them for their cooperation.

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OSPREY VILLAGE

“The rushed nature of this project resulted in a number of key decisions being made prior to the setting of any formal governance structure. All up, the project cost the Government \$95 million more than expected”

–Stephanie Black, Special Inquirer.

The Osprey Village was a development in Port Hedland designed to meet the significant pressure on accommodation in the Pilbara caused by rapid developments in the resources sector.

Key project decisions were made before any formal governance structure was finalised. As a result, inadequate planning led to poor contract negotiations and adverse financial outcomes for the Government.

The Department of Housing entered into an interim agreement with Fleetwood Corporation in October 2012 to enable construction to start before negotiations for a build, own and operate public private partnership were completed.

Costs started to mount. Initially \$20.5 million was allocated from Royalties for Regions funding. During negotiations the Department of Housing allocated an additional \$25 million for civil works and was then required to find an extra \$8 million for “unforeseen land development costs”¹.

The project management and formation of the project documentation was disparate and ad hoc. No business case for the proposed long term venture was developed.

¹ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

Government agency:

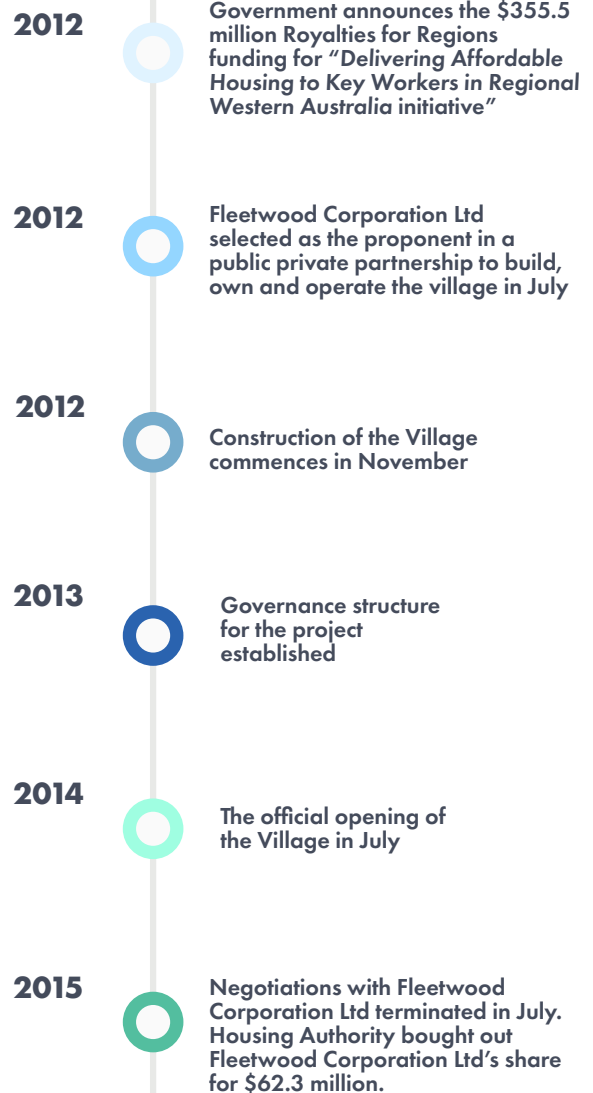
Department of Housing (until 30 June 2015), Housing Authority (from 1 July 2015 to 30 June 2017), Department of Communities (from 1 July 2017)

Project timeline:

February 2012 – July 2015

Total cost to Government

\$115.7 million



The Department of Housing and Fleetwood Corporation had still not reached agreement on the build and own portion of the proposed partnership when construction was completed. Negotiations then failed and the Department of Housing entered into a Management Agreement with Fleetwood Corporation.

Fleetwood Corporation was bought out and is now entitled to a minimum annual payment of \$3.8 million to manage the day-to-day operations of the village which opened in 2014. The occupancy rate for the December 2016 quarter was only 37 per cent.

SUMMARY

The Osprey Village (Port Hedland) project was approved in 2012 under the \$355.5 million *Delivering Affordable Housing to Key Workers in Regional Western Australia* initiative.² Royalties for Regions funding of \$20.5 million was provided as seed capital to attract proponents to participate in the build, own and operate public private partnership model with the Department of Housing (now part of the Department of Communities).³

Fleetwood Corporation Ltd was selected through a procurement process and contributed \$42 million towards the construction costs.⁴ In October 2012 Fleetwood Corporation and Department of Housing entered into an interim agreement to enable the construction of the village to commence in November 2012⁵ while negotiations on the final agreement were continuing.⁶

The construction of the village was completed in 2014 and was around \$33 million over budget due to unforeseen land development costs.⁷ The Department of Communities contends, however, that it was always part of the proposition that \$25 million worth of civil works would be funded from the agency's budget and therefore the cost overruns were only \$8 million.⁸

The initial plan was for Fleetwood Corporation Ltd to build, own and manage the day to day operations of the village once the construction was completed. However, the negotiations on the final agreement to build, own and operate were not resolved one year after construction of the village was completed. As the build and own portion of the agreement negotiations failed, the Department of Housing only entered into a Management Agreement with Fleetwood Corporation.

The Housing Authority bought out Fleetwood Corporation's share for \$62.3 million through a vendor finance agreement while Fleetwood Corporation continued to manage the village. There have been media reports that the value of Osprey Village plunged \$42 million in a year,⁹ Fleetwood Corporation made \$20 million in profit from its initial investment when the Government bought out its share in 2015.

Taking into consideration the cost for the buy-out and the \$33 million cost overruns, Osprey Village was \$95 million above the initial expected cost to the State Government.

Previous reviews of the Osprey Village project, including by KPMG in June 2013, have been conducted. The reviews identified weaknesses in the planning, business case, procurement and governance arrangements and provided recommendations for improvement.

² Department of Regional Development and Lands, Memorandum of Understanding – Royalties for Regions Project, Osprey Key Worker Village, South Hedland, 20 (22 June 2012)

³ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

⁴ KPMG, Housing Authority Osprey Key Worker Village, 1 (September 2015)

⁵ Department of Housing, Osprey Key Workers Village: PCG Meeting Minutes (29 November 2012)

⁶ Department of Housing, Briefing note Osprey Key Workers Village South Hedland (18 October 2012)

⁷ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

⁸ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

⁹ D. Capron, "Taxpayers lose \$42 million on village", www.thewest.com.au, (1 July 2016)

The Special Inquirer's examination of this project found that key project decisions were made prior to the establishment of any formal governance structure. In addition, planning was inadequate and contributed to poor contract negotiations and failure of the two parties to reach agreement. This caused an adverse financial impact on the State. The Department of Housing commenced construction of the village prior to settlement of the final agreement and it is apparent that no robust project management framework was applied to the project.

The Special Inquirer understands this project was considered urgent to address a severe housing shortage in Port Hedland at the time. The Special Inquirer notes that there have been some improvements in project management at the Department of Communities with a recently implemented Project Management Framework.¹⁰

PROJECT SYNOPSIS

In June 2012 the Department of Housing obtained Royalties for Regions funding of \$20.5 million under the *Delivering Affordable Housing to Key Workers in Regional Western Australia* initiative.¹¹ The funding was to provide a seed capital contribution for a project in Port Hedland to deliver a minimum of 250 dwellings to house key workers in a "lifestyle" village on 10 hectares of the Housing Authority's "Osprey" subdivision in South Hedland.

The accommodation would consist of one and two bedroom dwellings with shared amenities and recreational facilities to provide affordable rentals for up to 300 key workers.¹² The Department of Housing confirmed that a business case was developed for the purposes of obtaining the \$20.5 million Royalties for Region funding but that no business case for the total investment was prepared.¹³

The Royalties for Regions seed capital contribution of \$20.5 million was to cover site works, part of the construction of dwellings and project management costs.

The Department of Communities advised the Special Inquirer that an additional \$25 million was allocated from the Department's budget for land assembly, site preparation, access roads, civil works and community infrastructure. The Department advised that this funding was treated separately from project costs as the land was to be developed and retained under government ownership.¹⁴

In June 2012 the Housing Authority commenced negotiations for a public private partnership with Fleetwood Corporation to build, own and operate the village. Fleetwood Corporation was to contribute \$42 million towards the construction costs.¹⁵

In October 2012 Fleetwood Corporation and Department of Housing entered into an interim agreement to enable the construction of the village to commence in November 2012¹⁶ while negotiations on the final agreement were continuing.¹⁷

In addition to the \$25 million for land assembly and site preparation mentioned above, the Department of Housing was required to fund an extra \$8 million due to unforeseen land development costs such as water and electricity infrastructure issues and an unseasonal storm and rain event¹⁸

¹⁰ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

¹¹ Department of Regional Development and Lands, Memorandum of Understanding – Royalties for Regions Project, Osprey Key Worker Village, South Hedland, 20 (22 June 2012)

¹² Department of Regional Development, Osprey Key Worker Village, South Hedland Final Report, 9 (date unknown)

¹³ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

¹⁴

¹⁵ KPMG, Housing Authority Osprey Key Worker Village, 1 (September 2015)

¹⁶ Department of Housing, Osprey Key Workers Village: PCG Meeting Minutes (29 November 2012)

¹⁷ Department of Housing, Briefing note Osprey Key Workers Village South Hedland (18 October 2012)

¹⁸ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

Occupation of the village commenced in March 2014 and its official opening occurred in July of the same year. As the final agreement between the Department of Housing and Fleetwood Corporation was yet to be signed, an interim management agreement was developed.

In July 2015, one year after the official opening of the village, the interim agreement entered into in October 2012 was terminated as the parties failed to agree on the terms of the final agreement.

In line with the terms of the interim agreement, the Housing Authority had to reimburse Fleetwood Corporation for specified costs.¹⁹ The Housing Authority paid \$62.3 million to Fleetwood Corporation through a vendor finance agreement.²⁰ Consultation occurred with the Western Australian Treasury Corporation and the Department of Treasury and external legal advice was sought during the negotiation of the vendor finance agreement.²¹ This represents a \$20 million profit for Fleetwood Corporation on its initial \$42 million investment.

Fleetwood Corporation currently receives a minimum of \$3.8 million per annum for the day-to-day operation and maintenance of the village under the 15 year management term.²² Payments will increase if revenue from the Osprey Village exceeds \$5 million per year. Although the village has never been fully occupied, Fleetwood Corporation is receiving a guaranteed return based on 95 per cent occupancy.

EVALUATION OF THE PROJECT

Governance

The rushed nature of this project resulted in a number of key project decisions being made prior to the establishment of any formal governance structure for the project. The Project Control Group was established in August 2012, well after the project commenced and the meeting minutes provided to the Special Inquirer were largely operational action lists.²³ Further, the Special Inquirer did not receive any evidence of documentation of the roles, responsibilities and delegated authority of the project control group.

A brief stakeholder engagement plan was included in the project implementation plan finalised in January 2013, three months after the construction of the village began. There appears to have been a lack of coordination and communication with the key stakeholders from early in the project. An internal audit by KPMG in June 2013 found deficiencies in the project governance and stated:

- there was no governance body to oversee and direct the project;
- roles and responsibilities within the project team were not defined;
- there was limited formal reporting to the Project Director, Project Sponsor and the Corporate Executives; and
- a framework was not developed to monitor and report against overall project objectives and key performance indicators.²⁴

¹⁹ Lavan Legal, Interim Agreement to Proceed, 27 (26 October 2012)

²⁰ Housing Authority, Vendor Finance Agreement with Fleetwood Corporation Limited, 4 (20 July 2015)

²¹ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

²² Ibid.

²³ Department of Housing, Meeting minutes Osprey Key Workers Village (6 August 2012)

²⁴ 25 KPMG, Internal Audit Report – Osprey Workers' Village Pilbara Fleetwood Contract Management Processes, (June 2013), 6

The 2013 KPMG report concluded that a joint steering committee, as required by Cabinet to provide oversight for all the projects under the *Delivering Affordable Housing to Key Workers in Regional Western Australia* initiative, was not formally established.²⁵ The Special Inquirer sighted evidence, however, that a joint steering committee was established in March 2013 and the terms of reference were endorsed by the Minister for Housing and the Minister for Regional Development and Lands in April 2013.²⁶

The joint steering committee convened quarterly and was chaired by the Housing Authority with representatives from the Department of Treasury and the Department of Regional Development and Lands (now the Department of Primary Industries and Regional Development).²⁷ The committee received quarterly project status reports.

The Department of Communities advised the Special Inquirer that stakeholders, primarily through the joint steering committee, were adequately informed on the progress of the negotiations.²⁸ In line with the recommendations from the June 2013 KPMG report a Project Board was established to provide oversight and accountability, with documented roles and delegated authority included in the terms of reference. A monthly status reporting framework was developed.²⁹

The Special Inquirer is of the view that despite this and based on the evidence provided, the reporting was inadequate and full visibility of project status was not provided to key stakeholders. Key risks and issues, such as the ongoing failure to agree between Fleetwood Corporation and the Department of Housing, were not raised with the joint steering committee until June 2015.

The September 2015 internal audit by KPMG found that the quality of reporting was inconsistent. There was a lack of evidence to demonstrate that outstanding actions were followed up, particularly in relation to the negotiations with Fleetwood Corporation. The reporting of information to the project board was not consistent with the information reported to the joint steering committee. The risks and major issues were not clearly separated and reported under the heading "Risks" in the reports.³⁰

A final agreement was still not signed three years after Fleetwood Corporation was selected as the preferred proponent. As a consequence of the unsatisfactory negotiations of the terms in the interim agreement, the Housing Authority was required to pay Fleetwood Corporation costs when both parties failed to agree on the terms of the final agreement.³¹

²⁵ Ibid.

²⁶ Department of Housing, Briefing Note to Minister, Royalties for Regions Affordable Housing Policy Framework and Joint Steering Committee Terms of Reference (24 April 2013), 26.

²⁷ Department of Housing, Briefing Note to Minister, Royalties for Regions Affordable Housing Policy Framework and Joint Steering Committee Terms of Reference (24 April 2013), 26.

²⁸ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

²⁹ KPMG, Internal Audit Report: Osprey Workers' Village, (September 2015), 23.

³⁰ KPMG, Internal Audit Report: Osprey Workers' Village, (September 2015), 24-25.

³¹ Lavan Legal, Interim Agreement to Proceed, 27 (26 October 2012)

PROJECT MANAGEMENT

Business case

The Special Inquirer found that the project management and formation of the project documentation was disparate and ad hoc from the inception of the project and a robust project management framework was not applied.

The February 2012 business case for the broader \$355.5 million *Delivering Affordable Housing to Key Workers in Regional Western Australia* initiative briefly mentioned "Osprey Subdivision" as an exemplar project. It stated "Housing have secured 160 hectares of land in South Hedland" and "approximately 10-15 hectares will be used to construct a key worker village"³². It further noted that this was in line with "program theme four" in the business case, however, the Special Inquirer notes that the program theme refers to affordable housing for "NGO workers". Program theme three refers to key workers accommodation.³³

The business case for the Osprey Village was developed in May 2012, but only for the purposes of obtaining Royalties for Regions funding of \$20.5 million.

When questioned during its hearing with the Special Inquirer about Royalties for Regions funding and the *Delivering Affordable Housing to Key Workers in Regional Western Australia* initiative, the Department of Communities stated

"...if we go back - this is actually a file from 2014, working notes - and within that noted that, Royalties for Regions programs in Housing's perspective fell into the categories of:

build it, they're here

build it, they're coming

build it, and they will come

build it, or they'll leave

build it, or they'll never come".³⁴

The Department of Communities confirmed that no comprehensive business case for Osprey Village was developed and it could not locate analysis or rationale for how the initial capital requirements were determined.³⁵

The Department of Communities contends that it was always part of the proposition that \$25 million for the civil works would be funded from the agency's budget and not from Royalties for Regions funding.³⁶ There was no mention of the requirement for civil works in the business case for the Royalties for Regions funding and there was a statement that "total government investment was \$20.5 million".³⁷ Documentation provided to the Special Inquirer showed that probity advice was sought on the additional \$25 million capital injection in January 2012 during the request for proposal stage. It stated

³² Department of Housing, *Delivering Affordable Housing to Key Workers in Regional Western Australia*, Business Case (undated), 16

³³ *Ibid*, 13-14

³⁴ Department of Communities, *Hearing with Special Inquiry*, 12 October 2017, 9

³⁵ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

³⁶ *Ibid*.

³⁷ Department of Housing, *Business Case Proposal for Osprey Key Workers Village South Hedland* (May 2012), 3.

“Advice is sought on the reconfiguration of the project funding necessary to deliver the project on a financially viable basis and its impact on the RFP process..... Negotiations have revealed that further capital is required to facilitate rents at a level low enough to achieve the primary objective of affordable rental housing for Key Workers in Hedland. It is estimated that further capital injection by the Housing Authority estimated at \$25 million is required to enable a commercially viable project for the preferred proponent..... This additional funding of \$25 million brings total funding to \$45 million and is essentially a subsidy to fund the development..... In discussions with Fleetwood Corporation it is intended that the \$25 million will be deployed to the civil works phase. Fleetwood will be contracted to oversee the civil works as project manager for a fee of \$1.8 million.”³⁸

The advice from the probity auditor to the Department of Housing was dated 18 January 2012. This was the day before Department of Housing formally sought the probity auditor’s opinion on this additional capital injection to the project. The letter to the probity auditor stated “The Department is of the view that this additional funding would be required for all proponents to achieve financial viability”.³⁹

Taking into consideration the civil works and the \$8 million required for the unforeseen land development costs, and an unseasonal storm and rain event, the Special Inquirer has concluded that the cost overruns for the construction were \$33 million.

The Special Inquirer also observed that there was lack of a detailed assessment of project options and there were no mitigation strategies to address the risks identified in the risk register. Although the risk that the Department and Fleetwood Corporation would not be able to agree on the terms of the main contract was identified in April 2013, there were no controls or mitigation strategies in the register.⁴⁰

The project’s focus appeared to be short-term and there was no consideration of the whole project lifecycle. The documentation, including business case, project implementation plan, risk register and timelines, was focused on the procurement of a proponent and the construction. While some financial modelling was undertaken it was finalised close to the completion of construction in October 2013 and did not include a scenario-based cost analysis to reflect risks, such as low property market demands or a sensitivity analysis to reflect uncertainties. For a project of this nature the financial modelling should have been completed prior to the negotiation with Fleetwood Corporation for the term sheet and the interim agreement

³⁸ Department of Housing, Letter to Probity Auditor (18 December 2012) 1

³⁹ Ibid.

⁴⁰ Department of Housing, Risk Register, Project – Osprey Key Worker Village (April 2013), 1.

Procurement processes

Previous reviews, including the KPMG report in September 2015, found that the project’s procurement process appears to be impartial, transparent and consistent with public sector accountability requirements.⁴¹

As a residential housing project, Osprey Village⁴² was not subject to oversight by the Department of Finance and the procurement plan, evaluation report and contract management plan did not require endorsement by the State Tender Review Committee.

There was no evidence of clear policy applied to the procurement of this project. Based on the documentation provided and using the State Supply Commission’s policies as a benchmark, the Special Inquirer made the following observations.

State Supply Commission policy and requirement	Department of Housing adherence to process
Value for money	
<p>A public authority is required to ensure procurement of goods and services achieves the best value for money outcome through detailed assessment and comparison of cost and non-cost factors. Non-cost factors include fitness for purpose, technical and financial issues, supplier capability, sustainability, risk exposures, availability of maintenance, service and support, compliance with specifications, ease of inspection and communication and delivery.</p>	<p>Department of Housing engaged Global 2020 Business Consultants to conduct an assessment of risk, financial capacity and capability and overall due diligence for each respondent to the request for proposal. There is evidence that the Department of Housing complied with this policy as the Special Inquirer observed detailed value for money assessments that included costs and non-cost factors.</p>
Probity and accountability	
<p>The probity and accountability policy requires that a public authority conduct its procurement activities ethically, honestly and fairly and be able to account publicly for its decisions and take responsibility for the achievement of procurement outcomes. All communication during the bidding process must be consistent so that it does not advantage or disadvantage one supplier over others. Bidders are able to obtain feedback, and there are processes in place to manage supplier complaints.</p>	<p>A probity auditor was engaged to observe, review and provide guidance and reasonable assurance that processes and procedures were complied with.^a The probity report identified that the selection of the preferred proponent, Fleetwood Corporation was undertaken consistent with the request for proposal, project implementation plan and evaluation plan.^b</p> <p>After the announcement of the preferred proponent Fleetwood Corporation, the probity auditor noted that there was no formal negotiation plan and key project decisions had not been undertaken within the approved governance process outlined in the project implementation plan.^c Therefore key decisions such as negotiation of the term sheet in July 2012, interim agreement clauses in August 2012 and variation of \$25 million to cover the civil works costs in October 2012 were made without appropriate governance.^d</p>

⁴¹ Public Sector Commission, Final Report Review of the Osprey Key Workers Village Project, (26 October 2015), 13.

⁴² Ibid, 25.

State Supply Commission policy and requirement	Department of Housing adherence to process
Open and effective competition	
<p>The open and effective competition policy requires that a public authority provides suppliers with fair and equitable access to government supply opportunities while maintaining the transparency and integrity of government procurement. It requires that a public authority must conduct an open tender through public advertisement for all procurements with estimated contract value of \$250 000 and above. Where the awarded contract value is \$50 000 or above a public authority must publish the contract details on Tenders WA after the successful bidder has been notified.</p>	<p>The request for proposal was publicly advertised on TendersWA website and is compliant with this policy. The Special Inquirer observed, however, that the tender decision was not published on the TendersWA website after Fleetwood Corporation was announced as the preferred proponent. The request for proposal is listed as “all offers declined”.^e</p>
Procurement planning, evaluation reports and contract management	
<p>Public authorities are required to have effective planning at the project initiation stage, quality evaluation processes and effective contract management post-contract award which are critical to facilitating successful contract delivery. The decision making process is to be recorded in an evaluation report for all written quotes and public tenders. For procurements with a total estimated value of \$5 million and above a procurement plan, evaluation report and contract management plan must be developed and submitted to the State Tender Review Committee. Where contract variations are valued at \$5 million and above either individually or cumulatively, a contract variation memo must also be submitted to the State Tender Review Committee.</p>	<p>No procurement plan or evaluation report were prepared. The Special Inquirer observed that only minutes of the evaluation panel meeting to assess the request for proposal were prepared. The minutes included the scoring of the respondents but did not include any final outcomes to formally conclude the evaluation process.</p>

^a Department of Housing, Key Worker Village for Osprey Development Probity Plan, (April 2012), 4.

^b Probity Auditor, Probity Report – Osprey Key Worker Village, (17 October 2013), 1.

^c Probity Auditor, Probity Report – Osprey Key Worker Village, (17 October 2013), 2.

^d Probity Auditor, Probity Report – Osprey Key Worker Village, (17 October 2013), 2.

^e TendersWA, Unawarded details for tender HOU0365812, www.tenders.wa.gov.au (11 February 2015).

Contract negotiations

The Special Inquirer observed that one of the causes of the adverse financial implications to the State, which totalled \$95 million, was the lack of governance and planning, particularly in the lead up to and during the contract negotiation stage. The term sheet which contained negotiated terms that resulted in a financial detriment to the Government was signed in July 2012 prior to the establishment of any governance structure and did not have documentation to support the development of the terms.⁴³

It appears that the Department of Housing was unprepared to manage urgent housing projects and relaxed the procurement requirements following the selection of the preferred proponent to meet time-critical milestones. This included rushing the contract negotiations and prematurely commencing the construction of the village prior to signing of the final agreement.

The Department of Housing and Fleetwood Corporation failed to reach agreement for the construction, delivery and management of the village a year after the construction was completed and therefore the interim agreement had to be terminated.

There was no evidence of a contract negotiation strategy, stakeholder consultation and financial and risk assessment to justify the decisions undertaken during the negotiations with Fleetwood Corporation. The Project Board was not kept up to date with the key issues with the negotiations and the Special Inquirer only sighted a brief statement stating “negotiations continue with Fleetwood” in the monthly project status updates.⁴⁴

The probity report from 2013 stated that there was a number of outstanding issues on the negotiations and this presented potential probity and contractual risks which were not mitigated.⁴⁵ The Housing Authority stated that consultation with the Western Australian Treasury Corporation, the Department of Treasury and external legal advisors was undertaken during the negotiation of the vendor finance agreement.⁴⁶ Based on the documentation provided, the Special Inquirer has concluded that there was lack of a complete negotiation log to record the key issues that were preventing mutual agreement. There was no comprehensive analysis of the potential scenarios to inform decision-making prior to termination of the interim agreement.

A draft paper entitled “Commercial Terms and Management Agreement Summary” which considered some scenarios of the negotiation was prepared for the Department of Housing’s Investment Committee. It is unclear whether this was the final version or whether it was actually presented.⁴⁷ Consequently, the Special Inquirer was unable to determine whether the conclusion of the contract negotiations leading to the payment of \$62.3 million to Fleetwood Corporation, the payment terms within the vendor finance agreement, the guarantee of 95 per cent occupancy rates to Fleetwood Corporation for the first five years and the minimum management fee of \$3.8 million per annum, represented a commercial compromise or it was the best available option to the State at the time.

Improvements to project management

Previous reviews made recommendations to better prepare the agency for future projects and the Department of Communities has stated it has addressed all of the key recommendations from previous audits and reviews, including scoping, approvals, business case, procurement, delivery, evaluation, close out and records management.⁴⁸

⁴³ KPMG, Internal Audit Report: Osprey Workers’ Village, (September 2015), 9.

⁴⁴ Department of Housing, Project Monthly Report, (March 2015), 10.

⁴⁵ Probity Auditor, Probity Report – Osprey Key Worker Village, (17 October 2013), 2.

⁴⁶ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017.

⁴⁷ Department of Housing, Commercial Terms and Management Agreement Summary, (October 2013).

⁴⁸ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017.

KPMG finalised an internal audit in January 2017 to review the application of the Housing Authority’s recently implemented Project Management Framework across three new projects. The review found that there was significant progress in improvements to the agency’s project management.⁴⁹ KPMG identified there was room for further improvement, specifically in developing guidance for project approvals, risk management, options evaluation and reporting.⁵⁰

The Special Inquirer also observed that the Project Management Framework has not addressed the procurement requirements for complex construction projects, including guidance on policy and processes particularly during the procurement planning, tender process and contract negotiations.

Operations management

Rental policy and occupancy

The Eligibility and Rent Policy for the Osprey Village was first approved by the Minister for Housing on 15 October 2013.⁵¹ The Department of Communities provided the Special Inquirer with evidence that in 2013 the property market in Port Hedland was “at breaking point” due to accommodation shortages.⁵² Therefore, the first Eligibility and Rent policy was reflective of the situation at the time.

The rents in Port Hedland have been declining since September 2014⁵³ and the Department of Housing was mindful of competition policy and the risk of artificially leading the market in a “chase to the bottom”. The Department of Housing reviewed the policy throughout 2014 and 2016. Changes made to the policy to improve occupancy included revision of rental rates and eligibility criteria and a more flexible rental model that involved paying a percentage of household income to ensure the private market was not adversely affected. In December 2016, repurposing of 30 per cent of the village provided seniors housing. Government Regional Officers Housing scheme leases and short term business leases also occurred.⁵⁴

The Department of Communities has stated that at no stage since the commencement of the occupancy of Osprey Village has the occupancy rate fallen below 34 per cent (100 households) as outlined in the table below.⁵⁵ The fact remains, however, that occupancy rates have been well under 100 per cent throughout.

QUARTER	OCCUPANCY RATE
September 2014	42%
December 2014	48%
March 2015	48%
June 2015	71%
September 2015	79%
December 2015	61%
March 2016	57%
June 2016	50%
September 2016	42%
December 2016	37%
As at October 2017	68%^{56 57}

⁴⁹ KPMG, Internal Audit, Commercial Operations’ Project Management Framework Assessment, (January 2017), 2-3.

⁵⁰ Ibid, 18-19.

⁵¹ Department of Housing, Briefing Note Osprey Key Worker Village Approval of New Rent and Eligibility Policy, (30 July 2014), 1.

⁵² A. Massey, “Town is at breaking point”, North West Telegraph, (30 January 2013).

⁵³ Department of Regional Development, Joint Steering Committee Project Status Updates (June 2014)

⁵⁴ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

⁵⁵ Ibid.

⁵⁶ Ibid.

⁵⁷ Department of Regional Development, Joint Steering Committee Project Status Updates (September 2014 to December 2016)

The Osprey Village has had a total operating loss of approximately \$16.5 million between 2014 and October 2017.⁵⁸ The Department of Communities stated that the Osprey Village was not to be operated as a profit making venture and its key objective was to supplement the private housing market for low to middle income workers. The Department advised that the government contribution required for the Osprey Village compares favourably to the annual contribution required for public housing.⁵⁹

An October 2016 review by Umwelt Australia Pty Ltd identified that the building of Osprey Village had directly led to positive social outcomes and the creation of a sense of community.⁶⁰ The stakeholder consultation for the review indicated that there had been a “good community response” to the project and that “it was needed”.⁶¹

Based on the information and documentation provided, the Special Inquirer observed that the Osprey Village is well managed from a policy and occupancy management perspective. The Department of Communities is proactively monitoring the rental market and making changes to the Eligibility and Rent policy to reflect market conditions as appropriate. The Department of Communities stated that it is ideal to have the village occupancy at around 70 per cent so that the Government can respond quickly to new opportunities, such as assisting business expansion in the town. This would not be feasible if the village was fully occupied.⁶²

Management of Fleetwood Corporation

The day to day operations of Osprey Village are currently administered through a management agreement with Fleetwood Corporation which was signed on 20 July 2015. Based on the management agreement, Fleetwood Corporation is entitled to a minimum management fee of \$3.8 million per annum and the fee increases as the total rental income collected increases as provided in the table below.⁶³

Osprey Village Income (per annum)	Management fee (per annum)
\$1 to \$5 000 000	An amount equal to \$3.8 million (exclusive GST)
\$5 000 001 to \$7 000 000	An amount equal to: \$3.8 million; plus Osprey Village income in excess of \$5 million (exclusive GST)
\$7 000 001 upwards	An amount equal to: \$5.8 million; plus 50 percent of Osprey Village income in excess of \$7 million (exclusive GST)

Management Fee for Osprey Village

⁵⁸ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

⁵⁹ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

⁶⁰ Umwelt Australia Pty Ltd, Delivering Affordable Housing to Key Workers in Regional Western Australia: Program Evaluation (October 2016), 40-41

⁶¹ Umwelt Australia Pty Ltd, Delivering Affordable Housing to Key Workers in Regional Western Australia: Program Evaluation (October 2016), 40-41

⁶² Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

⁶³ Department of Communities response to Special Inquiry questions on notice, received 30 October 2017

The Department of Communities submitted a contract management plan for the management of Fleetwood Corporation. This was, however, labelled as a draft version dated September 2016. The Special Inquirer was not provided with any evidence as to whether the Department of Communities has followed up with the obligations stated in the contract management plan. For example, it is stated that the contract management plan is to be reviewed annually with the first review occurring in September 2017. The Special Inquirer did not see any evidence that a review occurred in 2017.

Based on the documentation provided, there was no evidence to demonstrate that the Department of Communities is proactively monitoring the key performance indicators of Fleetwood Corporation or conducted performance reviews to ensure that it has fulfilled its obligations under the management agreement. Evidence of contract reviews to assess the ongoing value of the agreement was not provided to the Special Inquirer.

While it is accepted that the Department may be managing the contract, as ownership of the village has been transferred the Government, it is critical for Department of Communities to ensure that the village is operating appropriately and safely and the condition of the village at the end of the contract period is sound.

Record keeping

The Department of Communities provided all information and documents that were requested by the Special Inquirer.

FINDINGS

1. Key project decisions were made prior to the establishment of any formal governance structure to oversee the management of the project and guide decision-making. This led to poor decision-making and unsatisfactory negotiation outcomes for the State of the terms with Fleetwood Corporation.
2. An internal audit in June 2013 found deficiencies in governance, project management and procurement processes. These were largely rectified by Department of Housing by December 2013. Due to the rushed nature of the project, however, the damage had already been done.
3. Project planning, project management and formation of the project documentation was disparate and disorganised at the inception of the project. There was no adequate project management framework applied to the project.
4. A business case for the full project lifecycle for the Osprey Village was not prepared. A business case for the purposes of securing Royalties for Regions funding of \$20.5 million was only developed in May 2012 and did not identify the additional costs that would need to be outlaid to ensure the financial viability of the project.
5. The project was focused on short-term timelines and there was no consideration of the whole project lifecycle. The focus was only on the initial procurement of a proponent and the construction stages. There was no financial analysis or sensitivity analysis conducted for the project's whole of life cost.
6. Due to the lack of a negotiation plan, negotiation log or cost benefit analysis of the options, the Special Inquirer is unable to determine whether the conclusion of the contract negotiations represented

a commercial compromise or that it was the best available option to the State at the time. These negotiations led to the payment of \$62.3 million, the payment terms within the vendor finance agreement, guaranteeing Fleetwood Corporation 95 per cent occupancy rates for the first five years and the minimum management fee of \$3.8 million per annum.

7. As the Osprey Village was a residential housing development project, its procurement processes were not subject to involvement by Department of Finance and the procurement plan, evaluation report and contract management plan did not require endorsement by the State Tender Review Committee. These documents were not developed and no clear procedures or policy that applied to the procurement of this project were provided to the Special Inquirer.
8. Osprey Village appears to be reasonably well managed from a rent policy and occupancy management perspective. The Department of Communities is proactively monitoring the rental market and making changes to the Eligibility and Rent Policy to reflect market conditions when required. The ability for the Department to react quickly to rent changes, however, is problematic.

DEPARTMENT OF COMMUNITIES' VIEW

The Department of Communities provided a response to the draft findings. This included further documentation. Where appropriate the findings have been adjusted to reflect the added evidence.

The Department states that the Osprey Village project was a number of inter-related activities and that existing governance and approvals structures and arrangements were used. Based on the evidence provided, the Special Inquirer has not changed the finding.

The Department states that in relation to Finding 5, financial analysis was undertaken on the basis of market, cost and revenue information known and available at the time. The Special Inquirer has not been provided any documentation to substantiate this response. The only financial analysis provided was from October 2013 when the construction was close to completion. Financial modelling should have been undertaken on several aspects of the project. For example, there was no financial modelling provided in relation to the guaranteed payment for 95 per cent occupancy of the village.

Finding 6 relates to the lack of negotiation documentation and the resulting payments to Fleetwood Corporation. The Department of Communities maintains that the final agreement represents a fair arrangement for both parties and value for money to government. The Special Inquirer does not agree that this contention is supported by evidence and has not adjusted the finding.

Procurement processes were undertaken in accordance with the Housing Act 1980 which does not require adherence to Department of Finance procurement requirements. The Special Inquirer believes that inclusion of a procurement plan, evaluation report and contract management would have been good governance and would expect this would be a component of procurement practice for a housing development of this nature.

RECOMMENDATIONS

The Department of Communities must develop guidelines and principles to improve its agility in being able to handle future urgent projects that need to be 'fast-tracked' while still meeting project objectives within tight timelines. The guidelines should incorporate structured project management disciplines, a governance framework, business case development and options evaluations as well as procurement processes that are aligned to the State Supply Commission policies.

1. The Department of Communities should ensure that it follows up with the obligations stated in the contract management plan including annual reviews of the contract management plan, proactively monitoring the key performance indicators of Fleetwood Corporation Ltd and conducting performance reviews to ensure that it has fulfilled its obligations under the management agreement.
2. The Department of Communities must conduct annual contract reviews to ensure Fleetwood Corporation have fulfilled its obligations under the management agreement and to assess the ongoing value of the agreement.

APPENDIX

GLOSSARY

Contract management plan

A plan containing all the pertinent information about how the contract is to be managed and which identifies and addresses all relevant issues through the life of the contract.¹

Department of Regional Development (and Lands)

As a result of machinery of government changes, from April 2013, Department of Regional Development and Lands was renamed as the Department of Regional Development. The Department of Lands was established as a stand-alone department. From July 2017, the Department of Regional Development was consolidated into the Department of Primary Industries and Regional Development.

Final Agreement

The proposed build, own and operate public private partnership between Department of Housing and Fleetwood Corporation Ltd that was negotiated for three years but never eventuated.

Government agency

As a result of machinery of government changes, the government agency responsible for the Osprey Village is Department of Housing from 2012 to 30 June 2015, followed by the Housing Authority from 1 July 2015 to 30 June 2016 and it is currently managed by Department of Communities.

Interim Agreement

An interim agreement between Department of Housing and Fleetwood Corporation created to cover a period of 12 weeks initially to allow the construction to commence while a formal agreement is negotiated,² but the period was extended 24 times until it was terminated in July 2015.

Key Worker

Low-to-moderate income earners in the retail, tourism, health, education or hospitality service industries that are integral to establish functioning communities in regional towns.³

¹ Department of Finance, Procurement Practice Guide (August 2017)

² Department of Housing, Interim Agreement Synopsis (18 October 2012), 1.

³ Department of Housing, Delivering Affordable Housing to Key Workers in Regional Western Australia Business Case (February 2012), 2-10

Open tender

The process of publicly inviting offers to supply or provide services involving specifications and detailed documentation.⁴

Request for Proposal (RFP)

Request by the government agency for the submission of proposals, expression of interest or other submissions capable of resulting, with or without further negotiation, in a contract.⁵

Royalties for Regions

The Royalties for Regions program is governed in the *Royalties for Regions Act 2009*, which provides the legislative framework for the Royalties for Regions Fund and the establishment of the Western Australian Regional Development Trust. The Act provides for the equivalent of 25 per cent of the State's forecast annual mining and onshore petroleum royalties to be hypothecated into a fund that is separate from the Consolidated Account.⁶

State Supply Commission policy

Supply policies issued under and in accordance with section 28 of the *State Supply Commission Act (1991)*.⁷

State Tender Review Committee

The administrative, advisory committee established to review high value, high-risk procurement processes.⁸ The State Tender Review Committee is chaired by the Department of Premier and Cabinet and includes a team of five experienced representatives from various government agencies.

Tenders WA

Means the WA Tendering System (www.tenders.wa.gov.au) providing direct access to Government contracting information, including early tender advice to suppliers, advertising of tenders, electronic tender lodgement and award of Government contracts valued at \$50,000 and above.⁹

Term Sheet

Executed on 17 July 2012 as an agreement before the Interim Agreement.

⁴ Department of Finance, Procurement Practice Guide (August 2017)

⁵ Department of Finance, Procurement Practice Guide (August 2017)

⁶ Department of Regional Development and Lands, Royalties for Regions Giving back to WA Communities, (undated), 4.

⁷ Department of Finance, Procurement Practice Guide (August 2017)

⁸ Department of Finance, Procurement Practice Guide (August 2017)

⁹ Department of Finance, Procurement Practice Guide (August 2017)

LIST OF MEETINGS

DATE	ATTENDEES
15 May 2017	Mr Euan Ferguson AFSM
15 May 2017	Hon Premier Mark McGowan MLA Department of the Premier and Cabinet
15 May 2017	Public Sector Commissioner Mr Mal Wauchope AO
16 May 2017	Acting State Solicitor Mr Nick Egan
17 May 2017	Under Treasurer Mr Michael Barnes Department of Treasury
17 May 2017	Auditor General Mr Colin Murphy Office of the Auditor General
7 June 2017	Public Accounts Committee
14 June 2017	Department of Primary Industries and Regional Development
14 June 2017	Productivity Commission
16 June 2017	Office of the Information Commissioner
29 June 2017	Department of the Premier and Cabinet
30 June 2017	Public Sector Commissioner Mr Mal Wauchope AO
2 August 2017	Auditor General Mr Colin Murphy Office of the Auditor General
1 September 2017	ACIL Allen Consulting

LIST OF HEARINGS

DATE	ATTENDEES
15 May 2017	Department of Communities Mr P. Whyte, Acting Director General Mr G. Cash, Assistant Director General Housing Mr S. Bell, Director Housing Programs Mrs T. Allen, Director Business Development

LIST OF WRITTEN SUBMISSIONS

NUMBER	SUBMITTER	CONTENT
2	Chamber of Commerce and Industry WA	Swan River Pedestrian Bridge Royalties for Regions
5	City of Karratha	Pilbara Accommodation Pilbara Underground Power Project Bulgarra Regional Sports Complex Karratha Hospital relocation
7	Department of Fire and Emergency Services	Elizabeth Quay Perth Stadium Swan River Pedestrian Bridge Pilbara Accommodation Wanangkura Stadium Fiona Stanley Hospital Perth Children's Hospital QEII Hospital parking St John of God Midland Public Hospital
18	Parliamentary National Party of Australia (WA)	Ord River Irrigation Expansion Project Pilbara Accommodation Pilbara Underground Power Project The Ningaloo Centre Bulgarra Regional Sports Complex Wanangkura Stadium

**SPECIAL INQUIRY INTO
GOVERNMENT PROGRAMS AND PROJECTS**

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