THE VOICE OF **LEADERSHIP**

Submission to the Productivity Commission

Public Infrastructure Inquiry

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Table of Contents

Executive Summary

This paper focuses on **innovative infrastructure funding and financing techniques**.

In particular, it outlines the case for adopting a UK City Deals approach to infrastructure provision.

The UK model is instructive for several reasons – it represents

- a new priority assessment paradigm that focuses on an **economic growth budget for a region** – a "local GDP" premium;
- a **disciplined incentive system** similar to Australia's successful National Competition Policy approach;
- a **long-term infrastructure investment program** specifically designed to boost economic productivity within a coherent urban and regional policy framework;
- a **local governance mechanism that fosters collaboration and accountability** – the mechanism also encourages a joined-up *mutually-reinforcing* package of public policy programs, as opposed to departmental budget silos and ad hoc "announceables"; and,
- total **alignment** between the method for setting infrastructure priorities and the basis for determining success (and incentives).

The Property Council is currently customising the UK approach in collaboration with South East Queensland mayors and the Queensland Government. We will forward the results of this work to the Productivity Commission in early 2014.

This submission also offers a strategy for attracting patient capital to a mainstream infrastructure asset class via a tax credit enhancement regime.

The Property Council has previously published multiple submissions on infrastructure funding and financing.

In addition, there are many existing proposals designed to surmount barriers to innovative infrastructure delivery; in particular, the work of the Business Council of Australia and Infrastructure Partnerships Australia.

Rather than repeating this work, we commend their submissions to the Productivity Commission.

The Property Council is also finalising a comprehensive technical paper on alternative infrastructure funding and financing for the Victorian Government, which we will forward in early 2014.

The property industry by numbers

- $34 billion p.a. in property-specific taxes;
- $340 billion in investment grade assets under management;
- 1.3 million jobs (12.8 per cent of the total workforce);
- $148 billion in direct economic activity;
- 11.5 per cent of Australia's GDP.

About the Property Council

The Property Council represents the $670 billion property investment industry in Australia.

The Property Council's 2,000 member firms and 55,000 active industry professionals span the entire spectrum of the property and construction industries.

Our members operate across all property asset classes - including office, shopping centres, residential development, industrial, tourism, leisure, aged care, retirement villages and infrastructure.

1. Australia's Infrastructure Challenge

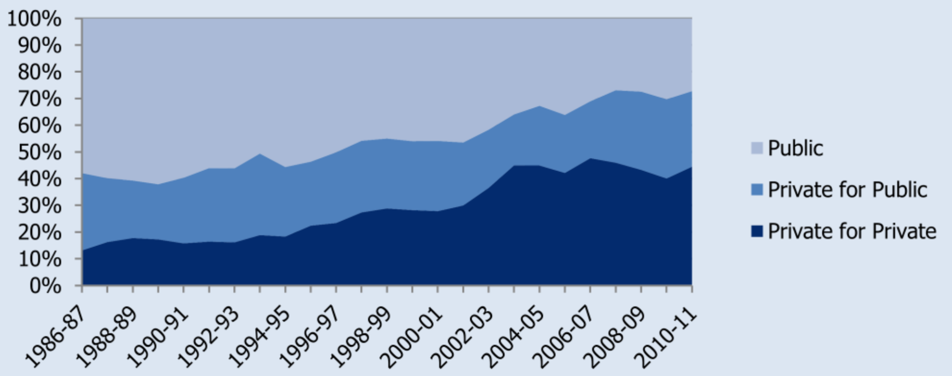
1.1 The magnitude of the challenge

Australia faces a significant public infrastructure investment task. Estimates of the public infrastructure deficit over the coming decade vary between $455 billion (ABN-AMRO) and $770 billion (Citigroup).

This significant investment challenge follows an historic period of underinvestment.

While public capital formation has generally declined as a proportion of GDP since the 1980s, private investment has increased substantially.

Figure 1 – Share of infrastructure investment by source (ABS, 5260.0)



Without above-trend investment in infrastructure over coming years our transport, energy, communications and water services will not keep pace with Australia's growing population - weakening our economic and social prosperity.

On current trends it is likely that more than 60 per cent of investment will be met by the private sector. This submission outlines how governments can make this investment more attractive to Australian and international capital.

1.2 A handbrake on Australia's productivity

Australia's multifactor productivity has been in free-fall for the past decade (see Figure 2).

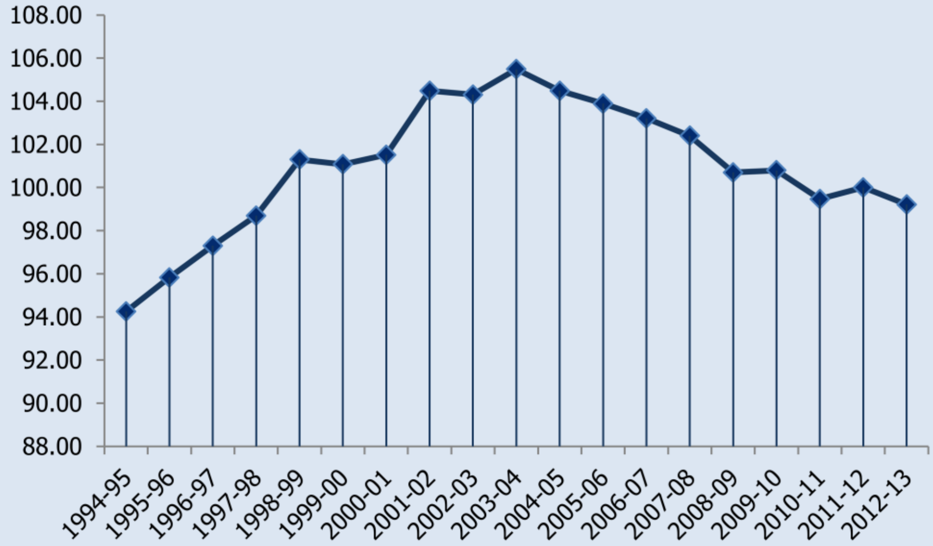
The 2010 Intergenerational Report identified investment in Australia's economic infrastructure and reform of infrastructure markets as critical to improving national productivity.

Infrastructure investment directly stimulates trade, labour mobility, competitiveness, transfer of technology and access to new resources. It also contributes to more efficient and effective delivery of public services.

The Productivity Commission has estimated that previous reforms to infrastructure services as part of the National Competition Policy generated a permanent 2.5 per cent increase in GDP. This reflects the significant role that infrastructure plays in the economy – with infrastructure services contributing 11 per cent to GDP in F2011 (BITRE 2012).

In short, further innovation in the way infrastructure is prioritised, funded and delivered could be the source of a new decade of productivity growth.

Figure 2 – Australia's Multifactor Productivity (ABS Index, 5260.0)



2. Complementary reform strategies

Major infrastructure projects face significant regulatory and financial hurdles.

Any commitment by governments to a new generation of infrastructure investment must be accompanied by efforts to minimise red tape and deepen capital markets.

This section outlines complementary reform opportunities to increase private investment.

2.1 Establish a long dated bond market

Payback periods for major infrastructure investments often exceed the term of Australian domestic bonds. This can make it difficult to raise capital for investments that deliver intergenerational benefits.

The market has already demonstrated an appetite for this type of issuance, with a consortium of banks launching a 20-year nominal treasury bond in November with a strong response.

During the 2013 Election Campaign, now Treasurer Joe Hockey indicated that he would like to see the Australian Office of Financial Management issuing bonds with 40-50 year maturity dates.

The Property Council supports moves by the Abbott Government to bring these types of securities to market. Doing so would deliver a positive impact on the Government's ability to raise capital for infrastructure investment.

2.2 Streamline major project assessments

Infrastructure developments can have a significant impact on the environment, local communities and related infrastructure.

The Productivity Commission recently completed a study into Major Project Development Assessment Processes, which concluded that the quality of state and territory processes varies markedly.

The Property Council contributed to that review and strongly supports most recommendations in the study's Final Report, including:

- the five point plan for implementing and strengthening EPBC bilaterals;
- establishing binding time limits on assessments and approvals (and limiting 'stop the clock' provisions);
- improving coordination between state-based agencies; and,
- expanding the use of upfront planning and strategic assessments.

The Property Council supported the establishment of the Development Assessment Forum (DAF) in 1998 and remains an active member.

DAF's primary achievement has been the development of the Leading Practice Model for Development Assessment (the DAF Model). The DAF Model sets out 10 leading practice principles which form a pathway to streamlined development assessment processes. A full copy of the DAF principles can be found in Box 1.

The Property Council sees a strong role for the Federal Government in encouraging implementation of the DAF principles.

The Property Council supports a National Competition Policy approach to planning reform whereby the Federal Government incentivises states and territories to fully implement the DAF model.

2.3 Delegate Federal environmental assessments and approvals

The *Environment Protection and Biodiversity Conservation Act 1999* (EPBC Act) has significant implications for the construction sector.

The EPBC Act has been subject to several reviews which examined its impact on development and sustainability objectives. The duplication between the Act and state-based environment protections is well understood and there has been no credible evidence presented that this duplication results in environmental benefits.

The EPBC Act lacks clear definitions, rules, and tests which has resulted in broad and inconsistent interpretations for more than a decade. All stakeholders have suffered from a lack of certainty and consistency.

As noted above, the property industry is among the hardest hit by this ongoing policy failing. With over 300 building and construction proposals referred to the Commonwealth in the last 12 months – construction costs and delays could be substantially reduced by delegating these powers to state and territory authorities.

Accordingly, the Property Council supports the practical approach detailed in the Productivity Commission's '*Five point plan towards bilateral approval agreements*' (PC 2013)– particularly strong oversight and strategic planning by the COAG Reform Council.

Further elements that would fast track infrastructure assessments and approvals include:

- introduction of new national standards for accrediting environmental impact assessments and approvals to better align Commonwealth and state systems;
- a more streamlined assessment process to cut red tape for business and improve timeframes for decision making, which includes an pathway for decisions on proposals within 35 business days, if all required information is provided;
- establishment of a single national list of threatened species and ecological communities to reduce inconsistencies between jurisdictions;
- provision of transparent information to educate communities about environmental assessments, including a standard practice of publishing the department's recommendation reports;
- a better heritage listing process based on a single, transparent assessment list.

Box 1 – DAF Leading Practice Principles

1. Effective policy development

Elected representatives should be responsible for the development of planning policies. This should be achieved through effective consultation with the community, professional officers and relevant experts.

2. Objective rules and tests

Development assessment requirements and criteria should be written as objective rules and tests that are clearly linked to stated policy intentions. Where such rules and tests are not possible, specific policy objectives and decision guidelines should be provided.

3. Built-in improvement mechanisms

Each jurisdiction should systematically and actively review its policies and objective rules and tests to ensure that they remain relevant, effective, efficiently administered, and consistent across the jurisdiction.

4. Track-based assessment

Development applications should be streamed into an assessment 'track' that corresponds with the level of assessment required to make an appropriately informed decision. The criteria and content for each track is standard.

Adoption of any track is optional in any jurisdiction, but it should remain consistent with the model if used.

5. A single point of assessment

Only one body should assess an application, using consistent policy and objective rules and tests.

Referrals should be limited only to those agencies with a statutory role relevant to the application. Referral should be for advice only. A referral authority should only be able to give direction where this avoids the need for a separate approval process.

Referral agencies should specify their requirements in advance and comply with clear response times.

6. Notification

Where assessment involves evaluating a proposal against competing policy objectives, opportunities for third-party involvement may be provided.

7. Private sector involvement

Private sector experts should have a role in development assessment, particularly in:

- undertaking pre-lodgment certification of applications to improve the quality of applications;
- providing expert advice to applicants and decision makers;
- certifying compliance where the objective rules and tests are clear and essentially technical; and
- making decisions under delegation.

8. Professional determination for most applications

Most development applications should be assessed and determined by professional staff or private sector experts. For those that are not, either:

Option A – local government may delegate development assessment determination power while retaining the ability to call-in any application for determination by council; or,

Option B – an expert panel determines the application.

Ministers may have call-in powers for applications of state or territory significance provided criteria are documented and known in advance.

9. Applicant appeals

An applicant should be able to seek a review of a discretionary decision.

A review of a decision should only be against the same policies and objective rules and tests as the first assessment.

10. Third-party appeals

Opportunities for third-party appeals should not be provided where applications are wholly assessed against objective rules and tests.

Opportunities for third-party appeals may be provided in limited other cases.

Additionally, the Property Council recommends that environmental assessment reform go further to include the following proposals:

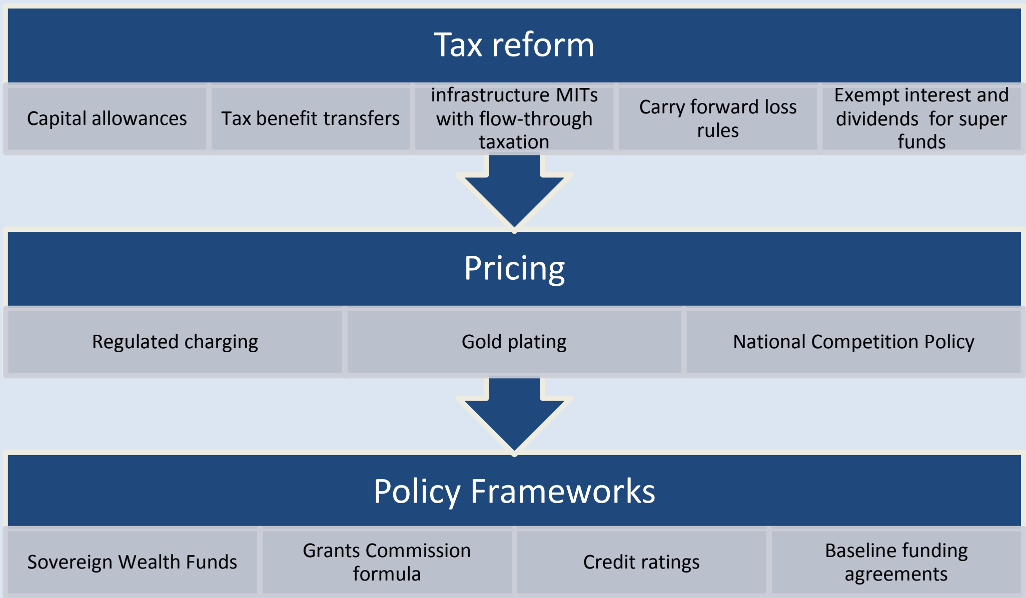
- Environmental Impact Assessment processes should be completely revised;
- decision-making authority under the EPBC Act should be delegated by the Minister to accredited states and territories, to prevent administrative log-jams at the Federal level;
- delegation is predicated on the states and territories being accredited by the Commonwealth to ensure stringent environment standards are maintained;
- the Commonwealth's role should be as an arms-length policy-making authority;
- compliance with the objectives of the EPBC Act could be ensured by the Commonwealth conducting strategic audits of decisions;
- there should be a time limit on processing applications;
- the requirements of the EPBC Act should be clearly stipulated so that stakeholders understand their compliance obligations;
- the use of public inquiry should be limited only to projects proposed by the government applicants;
- public exhibition should occur only once, at the state or territory level;
- and the term 'major projects' should be defined, so as not to capture private projects inadvertently.

The reform of the EPBC Act and its operation in practice provide an enormous opportunity to streamline review processes, synthesise environmental policies and deliver substantial savings in the red tape currently impacting the sector.

2.4 Further opportunities

Work by the Property Council, Infrastructure Partnerships Australia and the Business Council of Australia has identified a plethora of complementary measures to improve the operating environment for infrastructure proponents. Box 2 provides a snapshot of the ideas not covered in detail by this submission. Further information is available in the reports listed at Annexure A.

Box 2 – Further reform to enable infrastructure investment



3. Governance Framework for Infrastructure Investment

3.1 Importance of strengthening Infrastructure Australia

Since 2008, Infrastructure Australia has provided independent advice to governments, investors and infrastructure owners on a wide range of issues including:

- Australia's current and future infrastructure needs;
- mechanisms for financing infrastructure investments;
- policy, pricing and regulation; and,
- efficiency of the delivery, operation and use of national infrastructure networks.

Many of the Property Council's reform priorities are reflected in the *Infrastructure Australia Amendment Bill 2013* which is currently before the Senate. Our reform agenda seeks to support and build on those measures (see Box 2).

Box 3 – Strengthening Infrastructure Australia

- Appoint a Chief Executive Officer, responsible to the Infrastructure Australia Board.
- Task Infrastructure Australia with developing a rolling 15-year pipeline of major infrastructure projects.
- Conduct an audit of Australia's infrastructure asset base to support the 15-year infrastructure pipeline.
- Conduct an assessment of community-level infrastructure needs to identify funding priorities.
- Create a dedicated Funding and Finance Advisory Unit within Infrastructure Australia to harness private sector funds.
- Establish metrics for infrastructure performance and delivery.
- Commit to an Australian Infrstructure Plan and annual update on infrastructure performance and delivery.

3.2 An Australian Infrastructure Plan

The Property Council strongly supports the approach taken by the UK with its National Infrastructure Plan.

The UK National Infrastructure Plan provides an holistic snapshot of:

- the infrastructure pipeline;
- the policy, prioritisation and planning framework;
- local infrastructure delivery;
- funding and financing options; and,
- performance and delivery metrics.

An Australian equivalent of the UK plan would increase certainty for government and private sector stakeholders, maximising 'deal flow' and opportunities for ancillary investment by industries like property.

An Australian Infrastructure Plan would provide an important opportunity to improve coordination between all levels of government and industry by consulting closely with (and assigning roles and responsibilities to) relevant parties.

In addition the provisions of the UK Infrastructure Plan, an Australian version should include:

- national infrastructure spending targets (expressed as a percentage of GDP); and,
- a pathway for establishing in Intergovernmental Agreement on Infrastructure Funding.

3.3 Establish a Funding and Finance Advisory Unit

The Abbott Government has announced the establishment of a Funding and Finance Advisory Unit (FFAU) within Infrastructure Australia.

The Property Council supports an FFAU as a way of transforming the significant volume of literature on infrastructure financing into real *strategic* action.

The goal of the FFAU should be to produce a comprehensive and regularly updated 'menu' of funding and financing options for governments and infrastructure proponents.

The FFAU should be required to monitor domestic and international trends in infrastructure financing, and recommend financing options for priority projects identified in the National Infrastructure Plan or 15 to 20-year project pipelines.

3.4 A framework for industry-government collaboration

In order to effectively increase private sector investment and tackle the infrastructure backlog, the Federal Government needs to establish appropriate structures for engaging with relevant parts of Government and industry.

The Property Council recommends that an Infrastructure Advisory Panel be established, with representation from:

- the infrastructure construction sector;
- the property industry;
- the banking sector;
- Treasury;
- Infrastructure Australia;
- The Department of Transport and Infrastructure;
- local government;
- state/territory independent infrastructure bodies;
- Standing Council on Transport and Infrastructure; and,
- Australian Office of Financial Management.

The Advisory Panel should operate as a sounding board for policy initiatives and provide advice to Infrastructure Australia on appropriate financing mechanisms for identified priority projects on the 15 to 20-year infrastructure pipeline. .

4. The UK City Deal Model

4.1 Introduction to City Deals

UK City Deals are the Cameron Government's innovative strategy to build stronger urban and regional growth via smarter infrastructure investment.

The City Deal model will soon extend to 28 major UK towns.

The Greater Manchester deal signed earlier this year provides a template for other cities.

In Australian public policy terms, the UK City Deal prototype represents a National Competition Policy-style model applied to the urban and regional realm.

The core goal of the UK City Deal model is to direct infrastructure spending to projects that boost productivity, employment and economic growth.

The model also seeks to deliver complementary economic and social dividends that meet the specific needs of individual regions.

The UK model represents a radically new approach to infrastructure funding and financing philosophies.

The Property Council is currently working with the South East Queensland Council of Mayors (CoMSEQ) to adapt the City Deal approach to Australian circumstances.

An Australian model will be available to the Productivity Commission for consideration in early 2014.

At its most basic, there are five dimensions to the UK City Deal template.

1

A City Deal is a contract – the deal is a deal!

Each City Deal is codified as a contract between an economic region and the central government.

In Scotland, with its triple tier governance arrangements, there are three parties to the contract – a model that may be better suited to Australian circumstances.

A City Deal generally runs for 10 years or longer. Each deal identifies a list of priority infrastructure projects to be delivered along with benchmarks of economic and productivity growth to be achieved.

2

Local leadership

The UK approach revolves around City Deal partners.

In Manchester, the 10 existing local government authorities combined to form the Greater Manchester Combined Authority (GMCA) in 2011.

In addition, Local Enterprise Partnerships link key stakeholders – government, business, community groups – based on logical economic regions.

A Local Enterprise Partnership (LEP) is incorporated into the GMCA governance arrangements (please see break-out box).

These LEPS evolve US-style Business Improvement Districts (BIDs) into far more strategic priority setting and delivery vehicles.

Box 4 – Greater Manchester City Deal Governance

Greater Manchester is leading the way amongst the core cities, with strong, stable and effective governance across its economic area following the establishment of the Greater Manchester Combined Authority in April 20111

This strategic, corporate body has powers in its own right, so is not dependent on delegations from its constituent authorities, and decisions to pursue a particular policy are binding, providing long-term stability. This provides a stable and accountable platform for Government to devolve powers and functions as part of the City Deal process.

The Local Enterprise Partnership (LEP) is a key component of Greater Manchester's governance arrangements. Building on existing public and private partnerships, it provides a forum to have a single conversation with business leaders, enabling them to play an even more active role in securing economic growth. Political leadership is secured through the Combined Authority and decisions are cleared by the LEP.

The Combined Authority is the accountable body for LEP funding, as opposed to having to nominate a local authority to take on this role, as is the case in other LEP areas. This provides coherence and a truly joined-up approach across all ten local authorities.

A key advantage of the Combined Authority model is its joint governance arrangements for transport, economic development and regeneration, which allow for strategic prioritisation across the functional economic area. Sub-groups lead on different work-strands, with relevant partners represented on the Boards. Furthermore, the establishment of Transport for Greater Manchester facilitated much greater integration and closer working relationships with the Highways Agency and the ten local authorities on the operation and development of the road network.

Not only does the Greater Manchester Combined Authority provides a stable and strong governance structure enabling it to take on new powers and functions, it also has the gravitas to engage with central government and national agencies successfully. This will enable Greater Manchester to secure future devolution and resource prioritisation.

Source: Greater Manchester Combined Authority, Greater Manchester City Deal, 2012, page six

3

Incentives – TIF, "Earn Back" and the "self-help" model…

The UK City Deal model provides City Deal partners with a menu of financing options.

First, these partners receive baseline funding – that is, long-term certainty around core revenue streams.

Second, City Deal partners are encouraged to explore innovative forms of capital formation with the private sector.

PPPs are on this menu, as are Local Asset Backed Vehicles and Tax Increment Financing.

These models can complement traditional forms of capital raising.

In the Birmingham and Solihull City Deal, deal partners propose to raise 25 billion pounds of private capital on the back of special purpose fund – GBS Capital.

Third, the UK system rewards City deal partners that ***exceed*** their growth benchmarks.

This approach is called "earn back".

In an Australian context, "earn back" is analogous to competition payments under the National Competition Policy (NCP) model.

In short, where a City deal partner exceeds agreed growth KPIs, the central government provides a reward payment.

This payment can be used to amortise debt obligations or to capitalise new priority infrastructure projects.

Box 5 – What is the philosophy behind 'Earn Back'?

The UK City Deal program focuses on growth.

Smarter infrastructure investment grows productivity, jobs and economic output.

The City Deal methodology aims to generate higher (measurable) Gross Value Added for a region on the back of optimised infrastructure investment choices.

In theory, faster economic growth then translates into higher taxation revenue.

The chief beneficiary of this taxation premium is the UK central government.

A "payment by results" model allows City Deal partners to "earn back" a designated portion of this growth premium to supplement baseline funding.

"Earn back" represents a recognition that City Partners are:

- making hard decisions about the allocation of scarce resources; and,
- delivering on agreed performance targets within the real economy.

The goal is not simply to complete an infrastructure project on time and to budget, it is to secure the benefits of productivity, jobs and growth within the real economy.

In time, an incremental lift in taxation receipts arising from initial infrastructure spending is reinvested on a rolling basis into further high value infrastructure projects.

4

Tools and Benchmarks

The UK City Deal methodologies employed to assess infrastructure project priorities are the same tools utilised to assess performance.

The methodologies were developed by the UK Treasury, which also independently assesses performance against targets outlined in City Deal contracts – the "single assessment framework".

What is the Single Assessment Framework?

Traditional cost-benefit ratios (BCR):

- focus on a single asset or project;
- operate on the basis of rigid assumptions about growth and productivity arising from an investment – that is, BCR methodologies assume the real economy is fixed for the purposes of modelling; and,
- quantify dividends in terms of a narrow metrics, such as travel time savings, or limited "economic multipliers".

The UK City Deal program represents a major paradigm shift, where:

- the focus is on wider impacts within a defined region;
- project priorities and program success are assessed in terms of growth in jobs and productivity (along with attendant increases in tax revenue); and,
- the goal is to quantify changes in Gross Value Added (local GDP) for an economic region.

The UK Treasury has developed methodologies to drive the "single assessment framework".

In other words, the "single assessment framework" is a tool to:

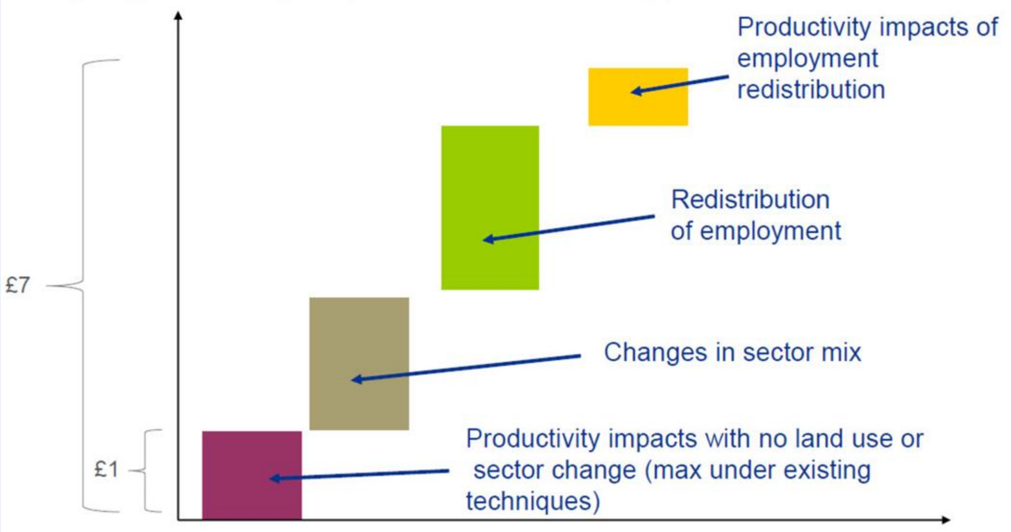
- allocate capital budgets to promote growth; and,
- provide performance benchmarks for City Deal contracts.

The following chart prepared by KPMG illustrates the scope of Gross Value Added (GVA) impacts for a New Transport Economics (NTE) approach versus traditional models.

The UK City Deal approach promotes a move away from budget silos – a "housing budget", a "transport budget" etc – to an "economic growth budget" for a region.

The lens provided by the single assessment framework shifts the fiscal focus away from isolated project evaluations to metrics that capture broader benefits – this includes welfare, housing and regeneration dividends.

Figure 3 – Gross Value Added impacts for a New Transport Economics Approach



Source: 2010 KPMG rail study for northern English cities

5

Invigilation – Keeping the Process Honest

The UK City Deal program is overseen by a Minister, currently Greg Clarke.

Clarke is Secretary to the Treasury and Minister for Cities.

This approach recognises that cities are economic assets which drive productivity and growth.

There is a unit within Treasury that helps City Deal partners assess infrastructure priorities and set GVA growth benchmarks.

These benchmarks are written into each City Deal.

Treasury also acts as an independent assessor of progress against targets.

4.2 What Makes the UK City Deal Model so Instructive?

The UK City Deal approach represents a radical rethink of infrastructure and growth policies.

It rejects the traditional approach to policy silos – education budgets, housing budgets, transport budgets and the like.

It seeks to join-up policy programs by setting productivity and growth targets. It hardwires these targets into contracts - "deals" – with the partners best placed to deliver growth over a generation.

The UK City Deal model recognises the direct link between smart infrastructure investment and urban/regional policy.

That is, productivity gains are best achieved in terms of logical economic and community catchments, not artificial political boundaries.

Australia lacks a coherent urban and regional policy framework. The UK City Deal model provides a policy philosophy that can be adapted to Australian circumstances.

In many ways, the UK City Deal approach takes the critical elements of Australia's successful National Competition Policy model and applies them to cities and regions.

This section outlines why we should take the UK City Deal path.

4.2.1 The focus is on productivity and growth

Wise choices about infrastructure investment can boost productivity.

The UK City Deal model explicitly targets a package of infrastructure projects that boost a region's economic capacity over a long-term timeframe.

This helps focus competing priorities into a coherent set of goals that can be communicated to voters.

4.2.2 City Deals encourage local leadership

City Deals promote collaboration.

City Deal stakeholders – government, community, business – are partners to a contract.

This encourages a more enterprising, strategic approach to growth and self-reliance.

In doing so, it breeds social capital and local resilience as everyone is in the same boat.

4.2.3 Smarter tools for determining infrastructure priorities

The City Deal approach moves from narrow benefit-cost analysis to an agreed measure of Gross Value Added for a region (a local "GDP").

It aligns the methodologies for selecting infrastructure investment priorities to the methodology for rewarding the performance of City Deal Partners.

It also does so within an independent assessment process controlled by Treasury.

4.2.4 Performance is rewarded

Financial rewards motivate.

The UK City Deal model allows deal partners to "earn back" a share of the growth they generate.

This financial reward motivates strategic thinking, collaboration and public policy innovation.

It also provides a clear *ongoing* incentive to deliver on long-term infrastructure investment programs.

4.2.5 City Deals help joins up economic and social goals and programs

A feature of UK City Deal contracts is the inclusion of complementary programs.

For instance, the Manchester City Deal includes:

- a Growth Hub program;
- a Skills Hub – a plan to employ 6,000 apprentices;
- a Low Carbon Demonstrator initiative – an innovative funding model to reduce emissions;
- an Inward Investment Beacon – a program for attracting international and patient capital to local projects; and,
- a housing program that aims to deliver 7,000 homes by 2017.

The Birmingham and Solihull Deal includes:

- a plan for 100,000 extra private sector jobs (generating an additional $23 billion of GVA by 2020);
- a Life Science Accelerator program;
- a Skills for Growth program; and,
- Green Deal initiatives.

In other words, City Deals foster a *mutually reinforcing* set of public policy programs.

4.2.6 City Deals promote financial literacy and skills at a local level

The Birmingham and Solihull City Deal partners have established GBS Capital which proposes to leverage $2.5 billion of seed funding into $25 billion of private capital.

The Greater Manchester Combined Authority has established a $2.5 billion "revolving infrastructure fund".

These special purpose capital formation entities are monitored and advised by the UK Treasury and operate under strict governance arrangements.

Deeper involvement by local stakeholders, who are accountable for their actions, fosters financial savvy.

4.2.7 There's less need to rely on inefficient taxes when efficient alternatives are available

Australia's panoply of inefficient taxes exist because of cost-shifting to local government, poor access to capital and policy conservatism.

A secure stream of capital for infrastructure projects (within a disciplined framework) will not only reduce reliance on inefficient taxes, it can provide the basis for phasing them out.

4. Other Funding and Financing Vehicles

5.2 Value Capture

One mechanism for financing an ongoing infrastructure program is to capture the value generated by infrastructure upgrades within a region.

Differing forms of value capture are commonly employed in comparable economies, including the United States, Denmark, New Zealand and Hong Kong.

49 states in the US have legislation enabling tax increment financing (TIF).

While variations exist depending on policy settings and governance arrangements, the basic premise of TIF is:

1. government sets a prescribed development area;
2. an infrastructure plan is agreed and rolled out;
3. a local TIF authority is entitled to a share of the incremental increases in tax revenue resulting from increased land values; and,
4. the TIF authority uses that funding to repay debt of capitalise future projects.

In 2008 the Property Council commissioned PriceWaterhouseCoopers to provide detailed advice on how the TIF model could be applied in an Australian context.

A copy of that report will be forwarded to the Productivity Commission under separate covers.

Please note that most of the jurisdictions utilising value capture mechanisms **do not also levy Australia's very wide set of property taxes**.

The Property Council sees no case for adopting broader value capture techniques while retaining Australia's extensive menu of inefficient property taxes.

No other country utilises value capture while also employing land taxes, property transaction taxes, capital gains taxes, developer charges, property-based fire services levies, car parking taxes, municipal rates, betterment taxes and augmentation fees (to name a few).

In addition, TIF, or growth area bonds, generally do not involve a surcharge on property taxes.

Instead, TIF models hypothecate the *premium* tax revenue arising from a boost in land values (driven by superior infrastructure provision) to the amortisation of infrastructure financing obligations.

In other words, value capture identifies and quarantines the lift in rating revenue attributed to infrastructure spending in a particular locale. It then directs this premium revenue to fund infrastructure in the form of an ongoing economic rent.

Australia already deploys an economic rent for most non-residential (and investment property) landholdings – land tax.

5.3 Infrastructure Bonds

The Property Council supports the Urban Coalition's model for boosting the capital available to fund local community infrastructure.

The Urban Coalition's model recommends the Australian Government (in collaboration with states and territories) foster an **urban infrastructure investment asset class**.

This asset class would offer **lower risk, attractive credit-enhanced returns** that appeal to both institutional and retail (mum and dad) investors.

Funds raised by issuing urban infrastructure investment products would capitalise a special purpose statutory investment vehicle – the Urban Infrastructure Fund - that would then provide seed finance to qualifying projects that meet criteria set by COAG.

The elements of the Urban Coalition's basic model are:

- **credit-enhanced investment products**;
- **eligible priority projects**;
- **financial instruments**;
- **project sponsors**;
- **complementary finance instruments;** and,
- **statutory entities**.

Full details on the Urban Coalition proposal can be found in '*A New Deal for Australian Cities'* – launched April 2013. Please see Appendix B of this submission.

Box 6 – What is 'local community infrastructure'?

'Community infrastructure' refers to investment projects in metropolitan and regional communities across the country.

Some examples of local infrastructure are:

- **transport** – public and active travel transport systems, railway crossing pinch points;
- **energy** – low carbon precinct power;
- **resilience** – coastal management, levees, flood control, stormwater;
- **community** - cultural and recreational facilities;
- **learning** - health, aged care, seniors facilities; and,
- **housing** facilities – affordable social housing projects.

5.4 Public-Private Partnerships

The case for public-private partnerships (PPPs) has been well established and tested in the Australian context.

The Property Council remains committed to seeing further improvements to the PPP model.

In addition to the recommendations in this submission which would improve the environment for partnership formation, we also support measures put forward by the Business Council of Australia to improve PPPs.

Box 7 – (A few) PPP reform recommendations

The Property Council supports the recommendations made by PwC in its report to the Business Council of Australia on *Infrastructure Funding and Financing*, including:

- *Consider the suitability of PPPs for every major infrastructure project;*
- *Reduce the cost of delivering PPPs and continue to develop the PPP model to expand it to more sectors;*
- *Improve risk allocation through appropriate government de-risking strategies; and,*
- *Adopt the NSW practice of considering unsolicited bids from the private sector if value-for-money is expected.*

5.5 Asset Recycling

Infrastructure Australia has identified $100 billion in public assets which could be sold into the private sector to fund future infrastructure projects.

Asset recycling has been supported by the Federal Treasurer. Currently negotiations are underway in relation to incentive payments for states which agree to sell off assets to fund new investments.

The Property Council welcomes this as initiative.

Incentivising state asset recycling is positive, however the Property Council supports further steps by the Commonwealth. Specifically, the Federal Government should instigate a process for ongoing audits of Commonwealth land assets to determine their suitability for sale and development – this has been promised on several occasions.

5.6 Producer and User Charges

5.6.1 Developer charges and levies (producer charges)

Developers face an ever-expanding range of charges and levies aimed at funding the infrastructure needs of a site.

These requirements have grown from a requirement to provide green space in the 1970s to now including the provision of community buildings, childcare centres, aquatic facilities and traffic management solutions.

Consent authorities frequently seek the full cost of infrastructure through developer charges – despite the facilities servicing a much broader area than the development site.

Developer charges are additional to a range of other levies and contributions, including:

- contributions to broader community infrastructure and maintainence;
- electricity distribution levies;
- car parking levies;
- transport levies; and,
- affordable housing requirements.

Significant equity and efficiency issues exist in relation to producer-side levies.

Firstly, development itself generates a significant windfall gain in local, state and federal taxes – meaning that further levies and charges for infrastructure and service provision can be characterised as double taxation.

Secondly, modelling by the Allen Consulting Group has demonstrated that producer levies are the least efficient of five commonly used financing mechanisms when considering their economy-wide impacts. See the report *Funding Public Infrastructure – Approaches Compared* (2003) for further details of this analysis.

5.6.2 User charges

As a general principle, if a risk adjusted return can be generated based on user charges alone the private sector would develop an asset without government support. In reality this is rarely the case and budget support for capital costs is usually required.

This means levying infrastructure users will rarely be a standalone source of infrastructure funding. However, depending on the project type and the administration costs of charging, user charges can be an effective and equitable mechanism for reducing the budget burden.

The Property Council supports the consideration of user charges on a project-by-project basis as a means of supplementing other sources of funding.

Annexure A: Property Council Policy Papers

These urban policy and infrastructure papers were commissioned and published by the Property Council (and partner organisations).

Urban Strategy

A New Deal for Australian Cities (The Urban Coalition: 2013)

Cities Strategy - snapshot (Version 3.0: 2010)

Spotlight on Australia's Capital cities – an independent assessment of city planning systems (KPMG for BEMP: 2010)

Principles for Planning Sustainable Communities (Allen Consulting Group for BEMP: 2009)

Sustainable Communities – a national action plan for urban Australia (CIE for the Sustainable Communities Roundtable: 2006)

Recapitalising Australia's Cities: a strategy in the national interest (Allen Consulting Group: 2002)

Public Finance

Growth Area Bonds (2010)

Defrosting the Credit Squeeze: Reducing barriers to finance (Allen Consulting Group, unpublished: 2011)

Tax Increment Financing (PricewaterhouseCoopers: 2008)

Funding Urban Public Infrastructure: approaches compared (Allen Consulting Group: 2003)

Infrastructure Priorities

ACT (2010)

Australia (2008)

The Hunter (2008)

Victoria (2009)

South Australia (2009)

NSW (2006)

Governance and Development Assessment

Local Government Reform in NSW (2011)

Metro Authorities – design template (2010)

Modernising Metropolitan Governance (2010)

DAF Reform Implementation Report Card (Black Swan: 2009)

Local Government – performance research (Eureka: 2006)

Making Regulatory Impact Statements More Effective (CRA International: 2006)

Renewal Corporations (Spiller: 2005)

Unfinished Business: prospects for an intergovernmental agreement on development assessment (1998)

Planning for Change: recommendations for Australia's development systems (1997)

States of Progress – an audit of planning and development control legislation in Australia's states and territories (Blake Dawson Waldron: 1997)

Metro Strategies and Infrastructure programs….

Shaping Wollongong (2013)

20 Projects – Victoria's Best Development Sites (2013)

Transforming Perth – regenerating transport corridors as a network of high street precincts – in conjunction with The Greens and the Australian Urban Design Research Centre (2012)

Adelaide: City of Lights (2012)

Delivering on Melbourne's Population Plan (Urbis 2011)

Initiatives for the Sunshine Coast (2010)

Action Plan for Canberra's Future (2010)

Future Growth -`building a stronger Victoria (2010)

30-year Greater Plan for Adelaide (2010)

Adelaide 2036 – Building on Light's Vision (2009)

A Sustainable Transport Plan for Canberra (2009)

Initiatives for the South West of Western Australia (2007)

City of Perth – survey of residents (2007)

Sydney – 10 sub regional strategies (2007-2008)

Revitalising Newcastle (2007)

Revitalising Parramatta City Centre (2007)

Initiatives for Canberra (2006)

Initiatives for Illawarra (2006)

Plan to Deliver Melbourne (2006)

Victoria 2006: policies for prosperity (2006)

Initiatives for Hobart (2005)

Initiatives for Hobart – next stage (2005)

Initiatives for the Lower Hunter (2005)

Sydney Metro Strategy – a property industry perspective (2004)

New Directions for Victoria (2004)

Capital City Co ordination for the 21st Century – a management framework for the development and planning of Perth (2002)

Initiatives for Sydney (2002)

Central City Transport – Brisbane (2001)

Adelaide – the way forward (2000)

Capital City Vision - Brisbane in the year 2000 (1998)

Housing

Beyond Reach (Allen Consulting Group, unpublished: 2011)

Greenfields are Greener (Macroplan, unpublished: 2011)

The Reality of Planning Delays (Black Swan: 2010)

Beyond Reach (CIE: 2009)

Annexure B – Fostering an Urban Infrastructure Asset Class

Urban Infrastructure Fund

Recommendation 1
Unlock private sector dollars through a new Urban Infrastructure Fund

Introduction

This section outlines a model for boosting the capital available to fund local community infrastructure.

It recommends the Australian Government (in collaboration with states and territories) foster an **urban infrastructure investment asset class through a new Urban Infrastructure Fund**.

This asset class would offer **lower risk, credit-enhanced returns** that appeal to both institutional and retail (mum and dad) investors.

Funds raised by issuing urban infrastructure investment products would capitalise a special purpose statutory investment vehicle – the Urban Infrastructure Fund - that would then provide **attractive seed finance** to qualifying projects that meet criteria set by COAG in the form of local community infrastructure.

What is `Local Community Infrastructure'?

`Community infrastructure' refers to investment projects in metropolitan and regional communities across the country.

Some examples of local infrastructure are:

- **transport** – public and active travel transport systems, railway crossing pinch points;
- **energy** – low carbon precinct power and water capture;
- **resilience** – coastal management, levees, flood control, stormwater;
- **community, cultural** and **recreational** facilities;
- **learning, health, aged care, seniors** facilities;
- **housing facilities –** affordable housing projects; and
- **protecting and enhancing biodiversity and ecosystem services –** community waterways and grassland/woodlands.

The elements of the basic model are outlined in the following sub-sections:

1. **credit-enhanced investment products** – what do they look like?
2. **eligible priority projects** – what are the criteria?
3. **issuing financial instruments** – the role of Government and intermediaries;
4. **project sponsors** – who are they and what are their obligations?
5. **complementary finance instruments** – how can infrastructure project finance be further leveraged?
6. **Urban Infrastructure Fund** – how would it be run and governed?
7. **supporting processes** – what else needs to be considered?

Some Frequently Asked Questions are also provided at the end of this section.

The funding mechanism and institutions proposed in this section are intended to **complement** both traditional sources of infrastructure finance and other innovative capital raising techniques.

1. Credit-enhanced infrastructure investment products – what do they look like?

Community Infrastructure Investment Products ***…enhance returns and manage risks***	**The goal is to develop long-dated investment products that deliver guaranteed total returns that are more attractive than standard government bond rates.** **This will require credit-enhancement as generic infrastructure-related returns are not high enough to appeal to investors.** **Two techniques are proposed:** • **a tax rate of 10% for dividends on bonds that finance eligible projects within the Urban Infrastructure Fund pool** • **a capped government guarantee.**

2. Eligible priority projects – what are the criteria?

Eligible Projects ***…to be recommended by Infrastructure Australia***	The broadening of Infrastructure Australia's remit to identify projects that qualify for credit enhancement is proposed. In addition to its current priority-setting role, Infrastructure Australia would identify community–level infrastructure projects that meet criteria, including: • COAG cities benchmarks • positive cost-benefit (including non-economic) criteria across city networks • capacity to generate sustainable cash flows or cross financing from reliable sources • capacity to provide/attract co-funding using complementary financial instruments • the quality and track record of project sponsors • demonstration of partnerships with local governments, state and territory governments, private sector and NGOs to deliver outcomes • inclusion of a set of indicators and/or targets and a robust, independent method of measurement to ensure that criteria are being met and desired outcomes achieved • there is a strategic basis for the project • there is demonstrated commitment to quality urban design, good architecture and sustainability. Guided by COAG, Infrastructure Australia would establish investment categories to ensure an optimum spread of project priorities – for instance, regional towns, outer metro growth areas, rejuvenation corridors, new master planned communities, low carbon/eco efficient networks, coastal adaptation zones. Infrastructure Australia would also regularly publish a list of projects that indicate a long-term investment pipeline. This would demonstrate deal flow opportunities to capital markets players.

3. Issuing financial instruments – the role of government and intermediaries

Australian Office of Financial Management (AOFM) ***…to manage capital raising***	AOFM would manage bond issues on behalf of the Urban Infrastructure Fund. AOFM would liaise with financial market intermediaries. Funds secured by capital raisings would be transferred to an Urban Infrastructure Fund. AOFM would also pool and securitise bundles of prospective infrastructure asset income streams to ensure they are of sufficient scale to attract institutional investors.

4. Project sponsors – who are they and what are their obligations?

Project Sponsors ***…would submit eligible projects for funding***	Project sponsors, such as local governments, statutory authorities, or regional development corporations would: • make applications for funds based on eligibility criteria • develop joint ventures with other government, private sector and NGO partners • agree to contractual delivery conditions • secure complementary funding streams that utilise approved financing pathways • provide plans for managing counterparty risk • provide evidence of capacity to manage the operating (post construction) phase of an asset.

5. Complementary financial instruments – how can infrastructure funds be further boosted?

Complementary Financing

…to diversify lines of credit and reduce reliance on the Urban Infrastructure Fund's capital

Project sponsors would complement Urban Infrastructure Fund seed capital with finance from partners and sources that may include:

Traditional Government

- Recurrent expenditure
- Other government infrastructure funds
- Other government incentives – NRAS etc.

Non-Traditional Government

- Local asset-backed vehicles (LABV)/joint project development (JPD) techniques
- Tax increment financing/growth area bonds
- Sale/lease back
- PPPs

Market Instruments

- Bank finance
- Covered bonds
- Corporate bonds
- Mezzanine/hybrid finance
- Other asset backed securities
- Other securitised/REIT index-linked structures

6. Urban Infrastructure Fund – what would it do?

Establish a Dedicated Fund ***…with governance arrangements that boost investor confidence***	The primary task of the Urban Infrastructure Fund is to: • manage disbursements of funds to sponsors of eligible (Infrastructure Australia-approved) projects, backed by strict performance contracts • ensure performance against contracts. The Urban Infrastructure Fund would also help match-make syndicates of project sponsors and facilitate financial package design. In addition, the Urban Infrastructure Fund would: • work closely with ratings agencies to develop credible early warning systems • facilitate investment tranche design. The Urban Infrastructure Fund would seek to support investor confidence through: • transparent regulatory controls and reporting that reduce the potential for default • providing information on deal flow • standardising financial information requirements (with AOFM) – simplified PDS etc. • developing a national database of projects (commenced and completed) with an assessment of the community dividends expected and delivered.

7. Supporting processes – what else needs to be considered?

What else…	**Fostering an informed market…** • promote a reputable index of Urban Infrastructure Fund products • foster an investible index **Reduce the Federal Government's cost of providing guaranteed support…** Utilise a suite of quarantining measures to classify government guarantees as a contingent liability – and, thereby, not incorporated on the Government's balance sheet, such as: • time-limited guarantees • 'burning off' guarantees upon pre-agreed milestones • guarantees restricted to agreed metrics (with the balance of risks hedged) • guarantees linked to specified credit tranches (supplemented by complementary non-guaranteed financial products, such as mezzanine or equity components). **Capital Management** Explore opportunities to effectively transfer capital deductions (depreciation etc.) to the long-term owners of infrastructure.

Frequently Asked Questions

Q: ***Infrastructure Bonds – What are they?***

A: Infrastructure bonds are a financial product designed to increase private sector investment in critical infrastructure projects.

These bonds attract private investment through a tax rebate on a proportion of the interest earned from an investment.

This credit-enhancement increases the return on projects so they compete more effectively with alternate investment products.

The tax rebate represents tax revenue foregone rather than an increase in government debt.

The infrastructure bonds introduced in the mid 1990s reduced borrowing costs by 40% compared to conventional borrowing expenses. They were poorly designed and subsequently scrapped; however, the concept remains sound.

A proposal previously considered by the Coalition estimated that an incentive (tax foregone) of $150 million would leverage $20 billion of new infrastructure investment.

Q: ***Asset Backed Securities – What are they?***

A: Asset Backed Securities (ABS) are an investment product that combines the expected income streams of underlying assets – typically mortgages, credit card debt, car loans – into a pool that is then securitised – that is, offered to investors as bonds or notes.

The value of an ABS lies in the quality of the underlying assets in the pool and the prospect of consistently tapping into the stream of revenue generated by such assets over the long-term.

Q: ***Is there a model for governing the proposed Urban Infrastructure Fund?***

A: The proposed entity is a financing authority and requires individuals skilled in governing finance and investment entities.

The guardians of the Future Fund provide one model.

The board should also include individuals experienced in all aspects of infrastructure procurement.

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