COUNCIL OF CAPITAL CITY LORD MAYORS

INNOVATIVE INFRASTRUCTURE FINANCING

Australian Governments are facing a growing demand for public infrastructure projects coupled with a diminishing capacity to pay for this infrastructure through core revenues. New research has been undertaken to explore innovative financing mechanisms available to help build the infrastructure our nation needs.

Local government delivers a range of infrastructure, including local roads, bridges, footpaths, water and sewerage (in some states), drainage, waste disposal and public buildings (libraries, community facilities etc). Providing and maintaining infrastructure is one of the most important responsibilities faced by Australian capital city councils, but it also presents one of their largest challenges.

OVERVIEW

Research conducted by EY on behalf of the CCCLM concludes that the extent of the infrastructure task in Australian capital cities is significant, and not getting any smaller, evidenced by indicators such as high demand for assets, maintenance backlogs and rising renewal costs. In light of this, capital cities are investigating their funding and financing capacity and the way to apply capital to addressing the challenge.

CAPITAL CITIES AND DEBT FINANCE

While debt finance in the form of conventional bank loans (or in some jurisdictions, Treasury Corporation loans) is readily available to councils in Australia, the local government sector has not been able to use its strong credit fundamentals to leverage sources of debt that attract the most favourable pricing, nor has it been able to tap into or create an interface with the institutional investment market.

Compared with other types of local government, capital city councils are unique in their capacity to leverage own-source revenues. Capital cities are also unique in respect to the nature and size of projects undertaken.

But debt plays a small role in the balance sheet of most capital cities. Some have no debt at all, and the majority have a debt service coverage ratio (representing the ability to repay debt) well above the national average for all local government in Australia.

There is therefore an opportunity for capital city councils to use innovative funding solutions to deliver infrastructure projects.

In the context of sound financial management and project planning, the key benefits of optimising the role of debt within the capital structure are that it can:

- enable councils to deliver new infrastructure when it is required and earlier than they otherwise would have been able
- enable the funding and development of 'user pays' or other income-generating infrastructure such as toll roads
- allow the smoothing of the payments for new investment over time
- prevent the need to divert funds from internally-generated renewal and maintenance budgets to capital expenditure
- enable councils to invest in the renewal and lifecycle costs of existing infrastructure, which are time-sensitive and if not delivered can increase the whole-of-life cost of an asset
- allow the cost of infrastructure to be shared with future generations who will enjoy the benefit of the asset
- open the door to new sources of investment, for example from institutional finance providers, which bring additional rigour and discipline.

OPTIMISING THE ROLE OF DEBT

Australia's capital city councils are very well placed to move towards an optimal debt load supported by a range of sources. The key findings of the EY research are as follows:

- State Government Treasury Corporation loans are likely to remain the cheapest form of borrowing available in the short and medium term.

- For those councils that do not have access to State Government Treasury Corporation loans, conventional bank debt is likely to provide the most flexible and cost-effective form of debt finance for small and medium borrowing requirements.

- For those councils with larger borrowing requirements, significant savings might be achieved through issuing a public bond into the Australian market. Although bond issuance involves an element of cost and complexity, the relative saving for a large issue when compared with conventional bank debt can be material over the term of the instrument.

- Councils would be able to achieve a more favourable outcome from alternative borrowing solutions if they were to enter into collective arrangements with other councils, and give the market the opportunity to provide a lower cost of borrowing based upon the combined credit credentials and economies of scale associated with bundling.

- Any tax concessional arrangements for lenders in the future could drive down costs for borrowing councils and drive a more favourable outcome from alternative borrowing solutions that qualify for the concession.

- Any future borrowing activity would need to take regard of the legislative constraints that are placed on local government by state governments.

- US public bonds, US private placements, AUD private placements or AUD retail bond issuances are not considered suitable borrowing solutions for Australia's capital city councils at the current time.