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To whom it may concern

On behalf of the Lord Mayors of Australia's capital cities I welcome the opportunity to provide a submission to the Productivity Commission's review into the funding, financing and scope to reduce costs in the provision of major public infrastructure. Our submission has been informed by contributions from Adelaide City Council, the Brisbane City Council, and the City of Hobart; providing direct insight from a range of differing local governments.

The Council of Capital City Lord Mayors represents the interests of the Lord Mayors (and Chief Minister) of Australia's eight capital cities. Collectively, Australia's capital cities drive national economic growth, creativity and innovation:

- some 14 million Australians – two thirds of our population – live in a capital city [1]
- our cities generate over 60 per cent of Australia's GDP[2]
- together, the capital city councils administer around $35 billion in assets and injected over $4.7 billion into the Australian economy in 2012/13[3]

The economic and population load faced by Australia's cities is set to grow into the future, with our capital cities forecast to grow by 10 million people more by 2056.[4] Managing this growth and maximising opportunities will require cooperation and partnerships between Australian governments. In particular, governments will need to work together to plan and fund major infrastructure.

Infrastructure investment is vital to productivity, driving national income growth and consequently impacting the well-being of all Australians. Transport congestion, just one impediment to productivity, is an 'avoidable' cost expected to exceed $20 billion by 2020[5] with capital cities feeling the greatest impact.

High level observations

Capital city councils are keen to explore new forms of funding and financing of public infrastructure projects. Revised financing options such as the recent examples of delivery mechanisms in NSW and recent considerations by Brisbane City Council in recycling investment in toll roads should form part of future considerations.

There remains a broad and diverse range of models available to provide public infrastructure delivery. Delivery mechanism should be based on individual projects assessment of investment grade and appropriate risk allocation that delivers best value for money. Traditional PPP at one level are expensive procurement exercises. PPP models from Europe provide increased certainty for government and private sector on delivery outcomes and the value drivers focus on infrastructure solutions and value rather that high risk financing solutions.

[1] ABS *Labour Force Survey (Cat:8291.0.55.001)*, June 2012 – Excludes ACT and NT due to unavailability of city data
[2] SGS Economics *Australian Cities Accounts 2011-12* Nov 2011, REMPLAN 2011
[3] Combined Capital City oerpating and capital budgets 2012/13
[4] ABS *Labour Force Survey (Cat:8291.0.55.001)*, June 2012 – Excludes ACT and NT due to unavailability of city data
[5] Bureau of Transport and Regional Economics

Brisbane City Council's recent experience on Legacy Way project delivered significant value through DCMO procurement with subsequent financing consideration to engage the private sector on monetising future revenue stream for reinvestment in other infrastructure. The most important factor remains the appropriate risk allocation to deliver best value for money outcome for the community recognising private sector return requirements for investments.

The Brisbane City Council has not experienced significant issues associated with coordination across different level of government. The more important issue would be the commitment to contribute or fund projects.

In relation to opportunities to benefit from existing assets, the most significant constraint remains current government policies.

With regarding to construction costs for projects, the Brisbane City Counil experience is that land costs, labour costs, physical capital, cost of financing vary significantly across different projects and are individual project sensitive. It also noted that large scale infrastructure or major projects attract a significant delivery overhead in relation to stakeholder engagement, project controls and required government authorities' consents, approvals, and review.

Responses to specific questions

Does the proposed definition of public infrastructure capture all forms of infrastructure that should be considered by this inquiry?

We believe the definition needs to capture elements of management, operation and maintenance responsibility for assets that are generally available for use by the public. This will cover assets donated to government by developers. This could apply whether or not the carrying out of the responsibilities are contractually handed over to another party to manage, operate and maintain the infrastructure on behalf of the owner.

From a local government perspective public infrastructure can include land, buildings and public realm infrastructure; roads, footpaths, stormwater, urban elements, parks and artworks.

What types of nationally significant economic infrastructure should be within the scope of this inquiry?

The CCCLM suggests that the following infrastructure be within the scope of this review:

- Transport infrastructure – roads, rail lines, busways and bus infrastructure, ports, airports etc
- Power - generation, distribution lines
- Telecommunications – distribution networks
- Water – supply, storage, treatment and distribution pipelines
- Sewerage – sewers, treatment plants and outfalls

What mechanisms are in place to identify and measure the infrastructure needs of the community? How effective are they and what other mechanisms could be used?

Local government use extensive community consultation practices to determine the needs of the community. In some jurisdictions, effectiveness could be improved by improved data sharing between other government agencies and other, especially neighbouring, local governments to get a more holistic view.

In Queensland, mechanisms in place include:

- Regional plans
- State and local long term infrastructure plans
- Regional and local integrated transport and land use plans
- Population and economic growth forecasting
- Transport modelling

In terms of effectiveness, we make the following comments:

- Models are only as good as the information inputs and level of calibration to existing conditions
- There is lack of agreement on growth forecasts
- There is a lack of scenario testing
- Policy positions are at times in conflict with likely outcomes (e.g. decentralisation of population and employment growth)
- Unrealistic assumptions in modelling can undermine effectiveness – e.g. unrealistic estimates of future use of assets to inflate BCR and rate of return on investment

What are the circumstances that might lead to governments over- or under-investing in infrastructure

Governments might under or over invest due to:

- A lack of available funding to meet all priority infrastructure needs – both for creation of new assets and maintenance of existing assets
- Fear of/over-reliance on debt financing
- Failure to plan the rollout of a pipeline of key infrastructure – either insufficient funding or "playing catch-up" and paying high prices due to temporary shortages of labour and materials
- Politics or policy decision
- Lack of awareness or expertise
- Short term cost savings
- Lack of forward planning
- Economic environment

What is the appropriate distinction between the funding and financing of public infrastructure?

Funding must underpin financing. Funding can be raised directly through user pays, or indirectly from the community through taxes, rates and charges.

In the main, local government aims to fund infrastructure maintenance from rates and new assets from revenue or borrowings. Where opportunities exist it seeks support from State or Federal Government through grants, or project funding.

How is public infrastructure currently funded and financed in Australia, including by the Commonwealth, the states and the private sector? How has the composition of different forms of funding and financing of public infrastructure in Australia changed? In particular, how has the role of the private sector in the provision of public infrastructure changed?

The Brisbane City Council mostly funds infrastructure through rates and charges collected from the community and from Federal and State grants and contributions. Council is in the process of asset recycling, by long-term leasing of the tolling rights for the Go Between Bridge and Legacy Way to

Queensland Motorways Holdings Pty Limited and QIC Limited. This will release capital to fund new assets.

Other methods used by the Brisbane City Council have included:

- PPP for funding the Clem Jones Tunnel
- donations were sought from the community towards the restoration of City Hall.

In South Australia, the Local Government Association offers opportunities for low interest loans that along with State and Federal support could cover the cost of major upgrades or the creation of new assets.

What models can be used to provide public infrastructure? How do alternative models vary in their ability to address real or perceived limitations compared with more standard forms of public sector procurement? How adaptable are the different models between types of infrastructure? How do different models influence the efficiency of provision, funding and financing of public infrastructure?

Traditional 'Construct to Design' provides the most certainty about cost and is suitable where there is little scope for innovation and where there is sufficient time to fully design and scope the project. Both design and construction can be carried out internally by councils or outsourced from consultants and contractors.

Where the design and construction phases need to overlap due to time constraints, the need for constructor input into design, or there is a level of risk (e.g. geotechnical conditions) 'Design and Construct', 'Early Contractor Involvement' or an 'Alliance' model (competitive or non-competitive) may be used. The latter is particularly useful where innovation is required, as the gain share component helps to drive creativity

Public Private Partnerships have been used by the Brisbane City Council for high cost, large scale infrastructure projects, however unrealistic traffic volume expectations and adverse public reaction to user pays charging have led to the management companies going into receivership, though the financial risk to Council has been limited.

What is the extent of the use of PPP models in Australia for different types of public infrastructure including in comparison to other countries and over time? What is the nature and scale of efficiency benefits from PPPs, including those arising from bundling the design, construction and operation phases? What are the costs or weaknesses of PPP models? Should the risks associated with PPPs be shared appropriately between governments and the private partner?

The Brisbane City Council has mainly limited the use of PPP models to deliver tunnels, roads and bridges where tolls can be applied.

Generally, the City of Hobart's infrastructure projects do not generate income. Those that do generally do not generate a financially viable return. Thus, private sector involvement is generally not viable, unless heavily subsidised.

What principles should guide the consideration of the most efficient model for delivery and operation of public infrastructure (by the public or private sectors)?

- level of risk
- need for innovation
- complexity of the project – the need for constructor involvement in design
- scale and cost of infrastructure

Are current systems for raising revenue for public infrastructure services providing appropriate signals for efficient use and for new investments? If not, what scope is there to improve these systems?

Are there any coordination issues between the different levels of government and the private sector in the provision of public infrastructure? If so, what implications does this have for funding and financing decisions?

To what extent do coordination issues present barriers to efficient investment in public infrastructure?

Does the scope for each level of government to impose user charges or taxes and other charges affect the provision of public infrastructure, and/or the funding and financing mechanisms used?

In answer to the above questions, local government in Australia is restricted in the methods available to it to raise revenue. For example, Brisbane City Council cannot levy taxes and are restricted to rates and charges, relying on contributions from State and Federal governments to assist in funding more major projects.

In the current financial circumstances, there is adverse public reaction to raising rates much beyond CPI increases.

Brisbane City Council is unique in having responsibility for almost all the major arterial roads within the middle and inner areas. In other states, these arterial roads are the responsibility of state governments.

What factors affect a government's capacity to effectively contract with the private sector for the delivery of public infrastructure, including the expertise required to enter into complex and lengthy contracts?

The experience of the Brisbane City Council is that it cannot enter into a contract with a private entity for the delivery of public infrastructure without demonstrating that funding is available to pay for the entire commitment.

Over the past decade, Brisbane City Council has built the expertise to manage complex and lengthy contracts for the provision of significant economic infrastructure. Council has procurement procedures and governance controls in place to assist and assure effective contracts with the private sector at all phases of project development and delivery.

What are the roles of the different levels of government in the implementation of different funding and financing mechanisms for public infrastructure?

As the level of government with the greatest ability to raise revenue through taxation, the CCCLM believes that the Federal Government's focus should be to assist state and local government in procuring funds for delivery of significant economic infrastructure. It should not be directly involved in the procurement and delivery of public infrastructure. Infrastructure Australia (IA) should maintain its role of prioritising the pipeline of nationally significant infrastructure projects and provide further assistance to state and local governments in development of these projects to "ready to proceed" status.

In terms of state governments, roles vary across jurisdictions and how much responsibility is delegated down to local government for management of the major road network. In Queensland, the State Government:

- has a key role in maintaining prequalification registers of contractors based on their ability to perform various levels of complexity of road and bridge construction and their financial capacity to undertake expensive projects.
- maintains specifications and standard drawings for road construction and maintenance through Transport and Main Roads.
- provide a level of funding to local government through the Transport Infrastructure Development Scheme (TIDS) and Safest program for safe infrastructure for schools and administer federal blackspot funding programs.
- The Queensland Coordinator General and Department of State Development, Infrastructure and Planning oversee the provision of coordinated projects, particularly with regard to managing the Environmental Impact Statement process.

The roles of local government in delivering public infrastructure also differs across Australia, depending on the responsibilities of the individual local government authority. Brisbane City Council's role is relatively unique, being closer to that of a state government in being directly responsible for identifying and prioritising major infrastructure projects, securing funding, and delivering, operating and maintaining the completed infrastructure. Smaller and regional councils will have a reduced level of involvement in infrastructure delivery.

What are the strengths and weaknesses associated with the current arrangements by which different levels of governments interact? Do these arrangements create any perverse incentives or influence the choice of different funding and financing mechanisms?

A weakness experienced by capital city councils is the ability to access funding, particularly from the Federal level, outside of "one-size-fits-all" programs to local government such as Roads to Recovery. While still beneficial in enabling additional smaller scale projects, this limits the ability of Australia's larger councils to fund major projects. For instance, Brisbane City Council has been unable to secure funding for some larger projects through IA in part because it appears to be in competition for funding with the Queensland Government.

What are the strengths and weaknesses of the current institutional environment within which decisions about the provision of public infrastructure are made? How does this differ for different types of public infrastructure? How does this influence the extent to which efficient investments are prioritised?

Investment grade infrastructure offers an important opportunity for investment by alternative funding models. For this type of investment ownership of the final asset may be shared along with important decision making.

What decision-making and policy frameworks do governments and the private sector use to determine whether to invest in public infrastructure, and in particular, to evaluate the risks associated with infrastructure investment?

In local government, decisions to invest in public infrastructure are generally made around community needs or requirements, taking into account economic viability and sustainability.

Cost benefit analysis is the main decision making tool, however, there are known shortcomings with just determining the traditional transport benefits – travel time savings, vehicle operating costs, accident cost savings, externalities and reduced operating (usually maintenance) costs – especially for public transport

projects, where the impact on private vehicles often outweighs the benefits to public transport passengers.

The cost of infrastructure provision is high in brownfields areas where land acquisition and the relocation of major public utility plant (PUP) is almost always necessary. There is also almost always the need to construct improvements under traffic, limiting productivity rates and increasing costs for traffic management and changeovers during the construction process. These high costs generally result in benefit cost ratios of less than 1, based on only the traditional transport benefits, and the high discount rate of 7% required by IA. Quantification of other benefits arising from the provision of infrastructure can be difficult.

What alternative funding mechanisms for public infrastructure should be considered in this inquiry? What are the strengths and weaknesses of each, trade-offs to consider, and what principles should guide their use?

- Debt financing – weaknesses: intergenerational impacts of committing future governments to debts to pay for infrastructure; the ability of governments to manage and pay down debt in the face of pressures for additional spending
- PPPs – weaknesses: risk allocation; lack of public willingness to pay for infrastructure provision
- Increasing taxation to fund additional economically significant infrastructure – weakness: lack of public willingness to pay for infrastructure provision
- Investment grade infrastructure using Super funds or investment funds - may take away the ownership and decision making from the original owner.

What are the different types of revenue streams that can be created to attract private sector finance for public infrastructure projects, such as user charges, availability payments and any other mechanisms? How widely are these currently used for different types of public infrastructure?

- tolls
- road pricing generally
- increased taxation

What costs and benefits should be taken into account when considering the suitability of user charging for public infrastructure? What impediments exist to the wider application of user-pay funding arrangements for public infrastructure, and how does this differ for different infrastructure types? How could such impediments be addressed?

- equity has to be a key consideration – eg tolls are generally not applied to roads with direct access to residences and businesses
- does the cost reflect the benefit? This is particularly relevant to costs which impact freight
- the main impediment to wider application of user-pays funding models is that most people are not aware of the true cost of travel and are not willing to pay that cost

Under what circumstances are specific risks better left to government to manage or bear (for example, due to the nature of the infrastructure service or the government's greater ability to pool risks) or transferred to the private sector?

Government agencies tend to try and transfer as much risk as possible on projects, which lead to higher project costs, as contractor's price to allow for risk. Government bodies should look at what risks are acceptable for them to take on in order to reduce the price of projects where feasible.

So-called 'Alliance' contracts are said to be effective risk-sharing mechanisms. Does experience bear this out?

Proper Alliances are effective for risk-sharing, however many projects are delivered under contracts badged as 'alliances' but not managed accordingly. If an alliance project does go over budget, ultimately the government organisation will wear the brunt of the cost (other parties just tend to lose their profit margins at this point), so although alliances are good for risk sharing, there is still an amount of risk that is borne by the government agency.

Is there any evidence of government policies or regulation impeding private sector participation in the provision and financing of infrastructure projects?

Yes, private sector puts a huge price on risk it cannot manage.

How does the cost of land vary in the provision of different infrastructure projects? How significant is this cost as a share of the total costs of infrastructure projects?

Acquisition of land is based on market value for the highest and best use of the land. For brownfield sites in major cities, land is a significant cost, though this will depend on the number of full property acquisitions (where we impact the principal improvement on the site) that are required.

What policies might be relevant to lowering the costs associated with land acquisition and access (including reducing delays)?

- corridor preservation
- land banking

What is the overall role played by the work practices, the industrial relations system and its institutions in increasing costs in the construction industry? What specific features of that system are at fault, and how could they be corrected? What other associated reforms or cultural changes may be required for effective employee/employer relationships? How can such changes be best implemented?

- Skill shortages and cost pressures

What are the main drivers of overall infrastructure construction costs in Australia?

Civil projects cost more to deliver in Tasmania than inter-state. The main reason for this is that there is less competition in the market place. Additionally, there are other factors such as increased cost of materials due to the smaller market and the cost of freight across Bass Strait.

Is there any scope to reduce labour shortages by using less skilled labour or by using technologies that substitute for labour?

Yes always but dependant on task and level of supervision.

To what extent have skill shortages contributed to the cost pressures for public infrastructure construction projects? What evidence is there for current shortages among specific occupations? Are skill shortages likely to be persistent?

Currently in South Australia there has been a decrease in government spending, which has affected the construction industry. Because of this at present resources are available at competitive rates.

How have 457 visas (and their underpinning arrangements) remedied skill shortages, and with what impacts on costs?

457 visas helped to address skill shortages when they were present (during the construction boom a few years back). Given that at present there is a shortage of work in South Australia in the industry and employers have been making Australian staff redundant, there should be a review of how many 457 visas are issued and in what situations.

What are the appropriate policies to address skill shortages?

- Market structure and behaviours

Does whether the client is public or privately owned have implications for the cost of the project? If so, why, and what is the evidence for this? If not, do other client characteristics affect the cost of the project?

Local government is often overcharged by suppliers for work that it undertakes, due in part to lack of forward planning.

Are there differences in contracting arrangements across firms?

Yes, based on relationships and size of the firm.

Is the market for major infrastructure projects efficient? If not, what is the source of the inefficiency and how can it be remedied?

Organisations have to invest heavily in replying to tenders, this cost is added to the overall price.

Do the divisions of the bigger market players effectively compete against each other?

Yes, it seems to be the case.

To what extent does 'project' risk affect the cost of a project?

Risk of not incurring cost increases leads to calls for fixed price contracts which may be an overall higher price.

Is there scope for the greater use of incentives to curtail cost increases?

Possibly, however it is easier to positively incentivise (i.e. reward for good performance) contracts than negatively incentivise (i.e. punishment for poor performance).

To what extent have poor contracting arrangements resulted in cost overruns for major projects? How can this be avoided in the future?

Likely high, good contracts form the basis for mitigating risk on projects.

To what extent does the current procurement design favour market incumbents and exclude potential market entrants?

Likely that this is the case. Prior history working with a particular company or prior experience are often used as tender evaluation criteria.

EY Report - Infrastructure Financing Solutions for Australia's Capital Cities

Earlier this year the CCCLM commissioned research to examine the infrastructure needs and funding capacity of Australia's capital cities councils. Released in August 2013, the research concludes that capital city councils face a growing demand for public infrastructure projects coupled with a diminishing capacity to pay through debt. It suggested that new, innovative financing mechanisms need to be considered to help fund the infrastructure our cities need, involving collaboration between Federal, State and Territory governments and capital cities

Complete copies of the EY's report is available at: www.lordmayors.org and enclosed is a high level summary of this research.

The CCLCM would be delighted to discuss this research and our observations with you in more detail. Contact details for capital city experts who contributed to this submission are provided below, should the Productivity Commission wish to discuss comments made in this submission.

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Alternatively please contact me on 02 6285 1584 or cheryl.thomas@lordmayors.org if you would like further details on issues raised in this submission.

We look forward to contributing to future phases of the Commission's work.

Yours sincerely

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