

## Developing funding and delivery models to boost private infrastructure investment

In the current economic climate, accessing private funding for Australia's large infrastructure projects is ever more difficult. At the opening session of the Committee for Economic Development of Australia's (CEDA) InfraStructuring Australia conference series, sponsored by Clayton Utz, Ernst & Young and Marsh Pty Ltd, public and private sector delegates explored funding and delivery models to boost private infrastructure investment.

### Moving in the right direction

Before the global financial crisis (GFC), Australia was making progress in terms of giving industry confidence about an ongoing and stable pipeline of projects and funding. After years of uncoordinated infrastructure development, the Federal Government established Infrastructure Australia to audit the nation's infrastructure, reform the funding decision-making process and advise on the appropriate level of government involvement in individual sectors.

At the same time, the Building Australia Fund contemplated some \$20 billion to address major infrastructure issues. Similarly, several states announced long term infrastructure plans to deal with cities' growing pains. But then the GFC changed the game. According to Tony Canavan, Coordinator-General, Victoria's Nation Building and Jobs Plan, "Suddenly the low debt positions of both the Commonwealth and most states were seriously eroded as stimulus measures were put in place. Suddenly the \$20 billion became \$8 billion and some state projects were called off or deferred until things improved."

### Attracting investors with a stable and transparent pipeline

Delegates from both the private and public sector believe the key to restoring investors' faith is certainty of pipeline and certainty of process.

This will require some straight talking, with the public sector making clear which projects are important and which ones fall into the 'maybe' bracket.

Iwan Tirta, Director of Infrastructure Advisory at the Royal Bank of Scotland, believes national coordination is also important. "You can't have three big projects, pulling against the same pool of resources, all due at the same time."

“ We need to work to develop true partnerships that appropriately allocate risk to where it can be best managed and recognise the demands of all the stakeholders. I believe that governments and clients must again take control of the process and not leave it to lawyers.”

Bill Wild, Deputy Chief Executive,  
Leighton Holdings Limited.

## Improving the PPP process

While recognising that Infrastructure Australia has already begun to streamline the public-private partnership (PPP) process by providing consistent guidelines, delegates identified many aspects of the PPP model that, from a contractors' perspective, are in need of review. The biggest three are managing risk, reducing bid costs and encouraging innovation.

### ► Managing risk

Both government and public sector understand the need to better manage risk.

At the moment, a project is looked at in totality with risk and returns averaged across it. This approach inevitably results in winners and losers. As John Pitt, Managing Director of Pitt & Sherry, says, “At the moment we jumble all the risk up and try and tie it into one package. We might be better off de-coupling it.” He recommends experimenting with the idea on some smaller projects.

There are already some examples where the riskier parts of a project that might be deterring private investment have been unbundled. In the Gold Coast rapid transit project, which requires dealing with hard geotechnical issues and contaminated land, Queensland is looking at making an initial upfront investment of government money to de-risk everything below the ground.

Not everyone agrees with this approach, however, with one delegate wondering if de-coupling risk will create uncertainty and may act as a barrier to whole-of-life innovation. Nevertheless, delegates concur that the notion of testing an unbundled model has merit.

### ► Reducing bid costs

While noting that the Council of Australian Governments (COAG) is reviewing barriers to competition and efficiency in PPP procurement, including ways to lower bid costs, delegates feel more needs to be done, with many overseas examples of governments overcoming bid cost issues by tackling them head-on.

Paul Oppenheim, Managing Director Australia Plenary Group, notes the difference between Australia and Canada, where bid losers are paid from an honorarium fund built into every tender's cost structure. Bill Wild reports the Hong Kong Government actually changing the rules to help contractors buy new equipment they needed to deliver the bid.

Tony Shepherd, Chairman of Transfield Services Limited and ConnectEast Group Limited, agrees that the PPP model needs to flexibly adapt to the times. He suggests that, where the government runs a two horse race, with full documentation down to the wire and both teams have spent \$30 million plus, government should buy the losing bid. “It should be a pre-condition that they will buy all the IP [intellectual property] in the losing bid and transfer any good bits to the winner. Then you'll get value for money.”

He wonders whether costs could be held down if duplicate effort was eliminated by government by providing traffic, environmental and community studies to both participants. “That's not to say each participant won't want to go and do more on it, but at least some of the basic costs could be covered.”





“ I’m a great believer in probity, but I think the most successful PPP projects have been the ones where the government has engaged with the industry early and got some good ideas before they actually went to EOI [expression of interest].”

Tony Shepherd, Director, Transfield Services Limited and ConnectEast Group Limited

He notes that, in Hong Kong, the government is much more specific. “In one project, they picked the corridor, the basic cross section of the design and the concept design. That saved a massive amount of planning and money. I’d suggest there are many of our jobs where the government could do the basic design and leave the detail.”

► **Encouraging innovation**

However, if government becomes increasingly prescriptive, how will that affect innovation – one of the main reasons for choosing the PPP model?

Delegates expressed concern with PPP projects where the government has done all the background analysis, consultation and planning, got all the statutory clearances and started its land acquisition process then goes into the market and asks the private sector to be innovative. There is a view that there must be an opportunity to involve the private sector earlier.

Ultimately, Tony Canavan believes the Commonwealth Government will be the key to improving the PPP delivery model. “Having driven towards national guidelines for PPPs, I think it’s absolutely fair enough that the Commonwealth now insists these guidelines are used.”

**Attracting alternative financing options**

Alex Foulds, General Manager, Nation Building, Infrastructure Investment Division, Federal Department of Infrastructure, says the Government is looking at a range of alternative financing options, including the use of equity. “While equity is

a new way for the Australian Government to invest, work done to date has identified that, through the right project, equity can be an effective investment.” Paul Oppenheim differentiates between active and passive equity. “The question of equity is still evolving. I think it may not necessarily be equity as we traditionally think of it, in terms of financial equity directly into project vehicles. It might be equity in the outcomes or equity in the program benefits that projects need to deliver.”

Arthur Williams, Building Division Manager for Abigroup says his organisation is happy to take equity stakes in large scale projects, but cautions: “Contracting is a very large and fragmented marketplace and it’s not going to suit everybody.”

Tony Shepherd says it’s hard for government to be a sizable equity investor in a PPP project “because then they are sort of judge, jury and executioner. My view is that if the Government wants to make a financial contribution to a project, they should do so upfront to make the project more viable and enable a better finished product.”

‘Funding cocktails’ are one alternative to alliances, PPPs or traditional design-construct-maintain models. The Gold Coast rapid transit project is one example, where \$365 million came from the federal government, \$464 million from the state government and \$120 million from the local council.

However, Dan Fitts, Partner at Clayton Utz, cautions that whilst increased government funding through funding cocktails may reduce the debt burden falling on the private sector, increasing the number of stakeholders in a project could create greater complexity, risk and uncertainty.

“ We’re often in the situation where we’re paying significant fees, success fees, margins, contractor’s fees and so on and then we’re left with the long-term operating risk.”

Ian Silk, Chief Executive, AustralianSuper

## Increasing super fund investment

At many levels, the superannuation industry appears to be a natural investor in infrastructure development projects: a long-term investor for long-term projects. However, according to Ian Silk, Chief Executive of AustralianSuper, by its nature, infrastructure will always be a relatively small part of the super fund portfolio.

“In the case of AustralianSuper we’ve had a material allocation to infrastructure for well over a decade, so we don’t need to be convinced of the investment merits of it. We’ve got an allocation of about 13% at the moment, but across the industry there’s about 5% of the industry invested in infrastructure.”

He believes this figure is unlikely to increase substantially for three reasons. First, because risk and return considerations prevent most super funds from incorporating higher allocations. Second, due to liquidity issues, since super funds have a 30-day statutory requirement to accede to members’ requests to transfer money between funds. This is a particular concern in the retail sector – the industry’s second largest segment – which is considerably more dependent on voluntary contributions. Third, because of low interest from the industry’s biggest sector – self-managed funds.

An important issue to address is the lack of alignment between the interests of super funds and other parties. Super funds are typically long-term investors, whereas financiers and builders often have a shorter-term focus.

Despite these barriers, Ian agreed more could be done to attract super fund investment, including having a robust, national pipeline of infrastructure projects and a less complex bid process.

## Taking up insurance bonds

Delegates were open to idea of insurance bonds competing with bank guarantees, now they are price competitive. David Duffield, Director of Marsh Pty Ltd reported the insurance market has a good appetite for infrastructure projects.

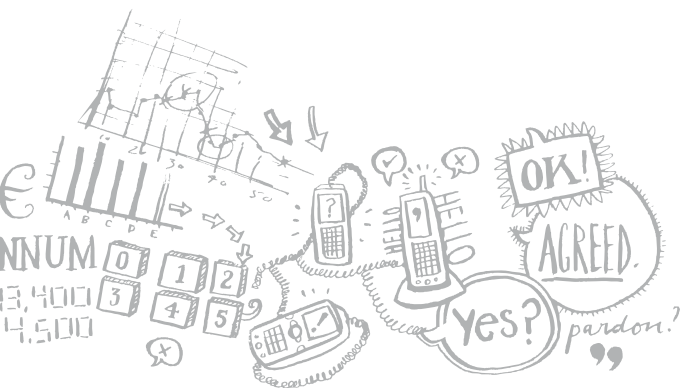
“In fact, many global insurers have been gearing up their capacity to be able to underwrite these particular projects. Perhaps insurance bonds and bank guarantees could work together, which may help in terms of taking off some of the financial pressure.”

## Continuing micro-economic reform

Finally, delegates agreed on the need for micro-economic reform. According to Alex Foulds, “Removing duplication in the pre-qualification assessment process will enable constructors to more easily apply for a pre qualification across jurisdictions, increasing competition, driving better value for the Australian tax payer and facilitating greater productivity.”

The next event in this CEDA conference series will be held in **Adelaide on Friday 23 April**, addressing Australia’s Energy Infrastructure. The Hon Patrick Conlon MP, Minister for Energy, will deliver a keynote address on South Australia’s energy infrastructure and the need to adapt to a climate change era. Minister Conlon will be joined by an expert commentary panel for an important discussion and assessment on the state’s energy infrastructure requirements.

Register online at: [www.ceda.com.au/events](http://www.ceda.com.au/events)



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