



Great Southern Regional Infrastructure Plan 2006

GREAT SOUTHERN DEVELOPMENT COMMISSION *Building partnerships for regional prosperity*

1.0 Introduction

Through the Terms of Reference of the State Infrastructure Strategy, the State Government recognizes that a new approach to infrastructure provision is needed to build a strong economy and community. Under the Strategy's Objectives there are the dual aims of maximizing cooperation across the three spheres of government and the engagement of the private sector in the process.

Significantly for State Government agencies, this will require a paradigm shift to the planning and managing infrastructure requirements across rather than within portfolio structures to support better outcomes for the State in a more strategic way.

The purpose of this submission is:

1. to put forward an Infrastructure Plan which, in a regional context, engages key stakeholders in the process of infrastructure planning albeit within the constraints of the time-line for submissions. The Plan seeks to articulate regional priorities for key infrastructure, programs and services that will drive the region's sustainable development towards the future,
2. present a model, based on case illustrations, where a regional coordination process could be established that both engages the community on the validity of infrastructure priorities and provides detailed advice to Government on such priorities,
3. suggest a possible coordination model across the State, which, allows for a degree of independence from portfolio interests through engagement of independent expertise from within the business and human services field,

4. to undertake a brief review of current funding models away from the traditional role of government being the sole provider of infrastructure, suggesting options as a way forward to meeting the infrastructure demands of the future.

2.0 Great Southern Region

Any analysis of infrastructure needs requires an understanding of the economic and demographic context and an analysis of the likely drivers. The GSDC presents the following overview.

The Great Southern region is located on the south coast of Western Australia, running for 250 kilometers along the South coast and extending northwards for approximately 200 kilometers to include 12 local government areas. The region incorporates large areas of forest, broad acre agriculture and significant tourism assets, such as the Porongurup and Stirling Range national parks and the Fitzgerald Biosphere.

The total land area is 39,007 square kilometers, representing 1.5 percent of the State's total area. The estimated resident population was 53,794 in 2002. The region's administrative hub is Albany, which is also its largest service centre and the region's port. The region's economic base is in primary production, featuring broad acre cropping, wool, livestock, fishing and plantation forestry. Tourism comprises approximately 10% of regional economic activity and is perceived as a potential growth area.

2.1 Demographic overview of the Great Southern Region

Regional population growth

In 2006 the resident population for the Great Southern is estimated to be 55,000 (2.7% of the State). By 2026 the population is projected to increase to 63,400 (2.4% of the State's population), which equates to an average annual growth rate of 0.71% over the next 20 years. This growth represents about half of the State's projected average annual growth rate of 1.4%.¹

However, new industrial developments such as the proposed Southdown Magnetite Mine and Lignor's Engineered Strand Lumber Plant are both expected to be significant employers. This could result in a higher population growth rate than projected in the WA Planning Commission's 2005 *Western Australia Tomorrow* report.

¹ Western Australian Planning Commission, *Western Australia Tomorrow*, Nov 2005.

Spatial distribution

While the overall population for the region is increasing, the distribution is changing. In 1986 the three coastal shires of Albany, Denmark and Plantagenet accounted for 67% of the region's population. By 2006 that proportion will have increased to 77%. The shift is projected to slow down over the next 20 years with around 80% of the region's population residing in these three Local Government Areas (LGAs) by 2026.

The changing distribution reflects nationwide trends of population shifts to the coast. This is sometimes referred to as the 'sea change' phenomenon. The decline or slower growth of some inland LGAs is tied to changing farming practices, i.e. increasing capitalisation and the trend toward fewer, but larger farms. Despite the population shift, it should be noted that agricultural production is expected to continue to increase.

Of the Great Southern LGAs, the Shire of Denmark is projected to have the largest average annual population growth rate of around 2% to 2026. Albany is projected to have about a 0.8% average annual growth rate over this period. This growth rate could increase if industrial developments currently proposed in timber processing and mining come to fruition.

According to a recent Bureau of Rural Sciences Study (2005)² the expansion of the blue gum plantation industry has been a contributor to population growth in Albany, where much of the employment generated is based.

Age distribution

The most pronounced shift in age distribution over the next 20 years will be in the 65+ age group, which is projected to grow from 15% to 24% of the region's total population. This will be largely due to increased life expectancy, the baby boomer generation moving through the population's age structure and the migration effect.

The past couple of years have already seen a significant increased investment in housing for the elderly in the form of retirement villages and associated healthcare services. The next 20 years will see continued growth in community infrastructure to cater for the growing needs within this population segment.

2.2 Economic drivers of the Great Southern region

The Great Southern economy is based predominantly on the production and export of primary commodities. Regional industry activity averages some \$1.9

² Schirmer et al, *Socio-economic impacts of plantation forestry in the Great Southern Region of WA, 1991 to 2004*, Sep 2005, p1-123.

billion per annum with crops, wool and livestock disposals contributing nearly 42%. As in all regions of Western Australia, the Great Southern is seeking to diversify its economic base, provide services that support a good quality of life and manage its natural resources in a sustainable manner. The key contributors to the regional profile include the following:-

- While the region's economic base remains focussed on primary production, within the agricultural sector there has been increasing levels of farm diversification within the past decade. The region's wine industry has tripled in size and consistently produces premium wines. Horticultural activity continues to increase and has significant potential for further growth. On-farm aquaculture has grown with the production of marron, yabbies and finfish.
- Tourism is a significant contributor to the Great Southern regional economy. In line with the State trend, the majority of visitors to the Great Southern region are domestic and mainly from intrastate. In 2004 approximately 601,000 domestic and international visitors generated \$203 million in expenditure for the region.
- The maturing of the plantation timber industry is generating increasing harvest tonnages across large areas of the higher rainfall belt. The increased activity is driving major heavy haulage transport and handling initiatives. Further value adding in the sector will be dependent on securing competitively priced power supplies.
- Indigenous communities across the region are seeking to improve their total cultural, social, economic and environmental wellbeing. Development projects in which Indigenous people are wholly or partly the owners tend to be in the areas of the arts, tourism and the retailing of traditional products. In addition to enterprise development, there is a strong interest in a range of employment and training initiatives. The issues of unemployment, underemployment and welfare dependency are continuing problems for many communities.
- Initiatives to add value to existing primary products and attract manufacturing industries have been constrained by a lack of infrastructure and associated services, such as power.
- A changing population distribution between the coastal areas of the region and the inland Shires is apparent. Approximately 76% of the region's population lives in the local government areas of Albany, Denmark and Plantagenet. A further concentration of the population to these southern areas is forecast to reach 81% by 2011. While this trend has been occurring for decades due to farm amalgamations and the increasing capital intensity of agriculture, adverse seasonal conditions in recent years has made this situation more pronounced. Decreasing population in rural towns limits the provision of services and impacts on the social fabric of these communities.

- The regional population is older on average than it is for the State and this differential is continuing to expand. Albany and the South Coast continue to grow as a retirement destination. Subsequently retirement housing is a growth area in the Albany sub-region, as is the associated demand for health services.
- Conversely, the Great Southern has a lower than average number of 20 to 39 year olds. To some extent this may reflect on the shortage of suitable employment opportunities for this age group.
- The resource maintenance of the region's fragile environment is dominated by land care, catchment management and water resource issues, driven regionally by SCRIPT Inc. The protection and allocation of water resources has emerged as a key driver in the economy, environmental innovation, and community sense of place.

2.3 The importance of the regional context

As seen from the above analysis, comparable to some other regions, while the Great Southern economy is of modest size, it still plays a unique contribution to the WA economy.

Hence it is important to note that while many of the infrastructure projects needed in the Great Southern are reasonably small scale, in the regional context they are often extremely significant. An initial infrastructure investment can achieve comprehensive regional development outcomes. For example, the \$46 million Fletcher Abattoir received \$5.2 million in State Government infrastructure support in 1998. The abattoir currently has the capacity to employ over 500 people at full production. A similar story occurred with the WAMMCO meat processing plant.

The emerging plantation resource industry has sparked investment in woodchip production. With peak timber production scheduled to occur in 2008, additional jobs in the emerging industry will have a positive socio-economic impact in the Great Southern region. According to an impact study, conducted in 2005 by the Bureau of Regional Sciences³ on the plantation sector, a \$1 million investment leads to the employment of 17 people in the region.

Thus any allocation of regional funding should take into account the relative socio-economic impact that it will have on the region. The Canadian Strategic Infrastructure Fund provides an example of a model that takes into account regional differences when prioritizing infrastructure needs. Whereas it varies the dollar value requirement for a project to qualify as 'large' based on regional populations, a model which was based on the employment generation outcomes

³ *Op.Cit.*, Schirmer et al, p23.

of infrastructure investment would seem to be the most equitable way to prioritize regional infrastructure needs in Western Australia.

3.0 Process of engaging the community

In December 2005, the GSDC sought responses from Great Southern Regional stakeholders on their future infrastructure requirements up to 2025. Twenty three submissions were received and this input was added to the information gathered as part of the 2005 Great Southern Regional Priority Plan⁴ and 2005/06 WA Budget Papers⁵. This process established an audit of the Great Southern region's infrastructure needs (see Appendix 1).

4.0 Delivery of Community Infrastructure needs

The effective implementation of the Strategic Infrastructure Plan will require a substantial change to the way infrastructure projects are currently planned and funded. The current procedure of capital planning involves the annual competitive bidding processes by individual agencies, with substantial involvement of Treasury, in the assessment and provision of advice to the Expenditure Review Committee.

4.1 Coordination Models

Regional Integration

At a regional level, the current Government has made significant steps to move away from the 'silo model' into fostering a culture of managing across rather than within portfolio departments.

In June 2003, the Cabinet Standing Committee on Regional Policy determined that Regional Priority Plans (RPPs) be developed for each of Western Australia's nine, non-metropolitan regions. The plans were to be developed using sustainability framework and principles and be consistent with the Regional Policy Statement. It was also determined that the RPPs should have the support of key regional stakeholders.

The Plans have enabled the identification of existing opportunities arising from an understanding of the regional resource base that could be pursued in the immediate future. The RPPs sought to articulate regional priorities for key

⁴ Great Southern Development Commission, *Great Southern Regional Priority Plan*, Nov 2005, p1-35.

⁵ Department of Treasury and Finance, *Western Australian Budget 2005 – 06 (Budget Paper No.1, Budget Paper No.2, Budget Paper No.3)*, May 2005 p1-1110.

infrastructure programs and services that will drive the sustainable development of the region towards the future.

The net result was to provide the Government with a holistic overview of the immediate regional priorities and it has been used in determining the five year timeframe for the Regional Priority Plan.

Apart from the Priority Plan, there are a range of infrastructure coordinating processes that Development Commissions are either driving or significantly involved in. Some of these are direct infrastructure provision, such as timber roads or involving planning issues which have infrastructure impacts, such as the Lower Great Southern Regional Planning Strategy⁶.

Significantly, the Commission is involved in working with the private sector in coordinating and planning infrastructure outcomes for key industry developments such as the proposed Southdown magnetite mine at Wellstead and the Mirambeena Timber Processing Precinct for the proposed Lignor and Beacons timber processing projects.

In these instances, GSDC chaired coordinating forums comprised of relevant state government planning and approval agencies, infrastructure providers and the industry proponents to achieve positive industry outcomes.

A useful model involving industry and the Government is the Timber Industry Road Evaluation Strategy (TIRES). This model represents a good example of forward infrastructure planning for the road infrastructure as the timber industry matured to harvesting. The 20 year plan has enabled the State Government and Local Government to establish funding priorities by road by year to ensure the road infrastructure is maintained and expanded⁷.

The TIRES five year plan is attached⁸ (see Appendix 2). It significantly influenced major State Government Infrastructure funding such as the ring roads around Albany and Mount Barker. It has enabled a partnership arrangement between Local Government, State Government and industry in terms of road funding with the industry itself contributing approximately 35 cents per tonne, per kilometre to road maintenance.

Unfortunately, despite the five year plan being well received by the former Deputy Prime Minister, it was not able to attract Auslink funding due to political intervention through the election process.

⁶ Western Australian Planning Commission, *Lower Great Southern Planning Strategy*, Sep 05, p1-124.

⁷ State Timber Industry Regional Evaluation Strategy (TIRES) Coordinating Committee, *Bluegum Plantation Industry Regional Transport Infrastructure*, May 2000, p1-44.

⁸ Lginfo Group, *Five Year Regional Transport Plan for the Timber Industry in the Great Southern TIRES Region*, Dec 2004, p1-30.

At the human and welfare services level, twelve regional managers meet regularly to coordinate key service issues in the context of the Government's 'Harmonising WA's Social Policy agenda' and develop strategies to achieve the aims and objectives of this policy. This forum has an agreed vision, goals and strategies which is reviewed every 6-12 months and report to the Director General's Human Services Working Group in terms of progressing the whole of Government agenda.

Towards a regional model

There are already a number of significant coordinating mechanisms operating in the Great Southern for the delivery of infrastructure. Some agencies such as Western Power and the Water Corporation are also suggesting models whereby more detailed forward planning could be undertaken constructively with partners, albeit within their specific portfolio areas.

For example, Dr Des Lehmann, Western Power Country Services Manager, proposes the use of a Community Development Forum. Such a partnering arrangement would include key government agencies such as Western Power, Office of Energy, Regional Development Commissions, LandCorp, representatives from State Treasury and other stakeholders like Shire CEO's and local members. Such a Forum could explore opportunities to expand and reinforce a country network where it would be deemed 'uneconomical' for Western Power to do so without significant financial assistance in the form of private contributions and grants from Treasury⁹.

As a result of the above initiatives and lateral thinking by the large infrastructure agencies, GSDC advocates that a 'Regional Infrastructure Advisory Board' could be established to provide detailed advice and priorities on the regions' infrastructure needs as follows:

- Identify existing and future infrastructure needs.
- Identify short, medium and long term priority areas for funding.
- Liaise directly with the Government over priority areas.

GSDC assesses that the essential ingredients are already established for such a regional Board which could also include Treasury. The Development Commissions could chair and service the Board.

Under the Board other targeted coordinating processes could continue such as the Country Development Forum, TIRES, Lower Great Southern Implementation Strategy and Regional Managers Forum. This information would ensure a

⁹ Lehmann, D, *A Proposal for the Provision of Increased Capacity in Country WA*, (undated).

dynamic process and relay updates to the Regional Infrastructure Implementation Board.

State Integration

A number of States are grappling with the planning and implementation of infrastructure. The GSDC has reviewed a number of plans and assesses the South Australian model could be viewed as a possible option for further investigation.

The South Australian Government has successfully documented an Infrastructure Plan and has essentially developed its priorities. It suggests a five step strategy, (Appendix 3) in delivering infrastructure plan from¹⁰:

1. Identifying the service need,
2. Outlining the case for change and defining the services required,
3. Substantiating and assessing the project,
4. Determining the funding method and resource allocation,
5. Delivering the project.

The South Australian case outlines a model where a project moves from a particular agency into the broader decision making process within the frame work of a public private delivery continuum. The South Australians have undertaken stage 1 of the process very well, that is engaging their communities and documenting in priority terms projects across the State with significant region by region input.

GSDC assesses that WA is close on the heels of the South Australian model with its current process. However we assess the quandary in the planning process relates to the practical implementation phase, i.e., moving a project from a portfolio structure into an integrated and more rigorous whole of Government and whole of State approach.

To assist in this process the following key issues need to be addressed in developing a model for Western Australia.

1 Developing criteria for prioritisation of projects

The selection criteria against which infrastructure proposals are considered would be designed to support the overall goals and objectives of the State and they would be ranked according to how well they advanced those goals.

¹⁰Government of South Australia, *Strategic Infrastructure Plan for South Australia 2005/06 – 2014/15*, April 2005, p1-161.

Beneath such macro-criteria consideration should be given to needs-based assessment. Needs-based funding requires a complex, micro-oriented methodology, and requires a consensus on how to define and measure need for a particular service.

Needs-based assessments would allow smaller projects that impact significantly on smaller regional communities to be equally weighted against larger more expensive projects.

2 Mechanism of assessment

Options should be considered that allow broader involvement of expertise beyond the political process.

For example, the South Australian “kitchen cabinet” involves leading business, community and welfare representatives in the decision making process with relevant Cabinet Ministers also tracking outcomes.

Another example could be establishing an Independent State Body to oversee infrastructure funding. This would involve specific expertise from within the business and human services field. However how such a body relates to the political body is an important issue. Reporting direct to the Premier away from portfolios interests could be an option reinforced by the Premier’s current role as Minister for State Development.

3 Regional considerations

As indicated above, Development Commissions through the Government initiative have established to varying degrees, coordinating mechanisms in providing advice to government on infrastructure needs. Such mechanisms should be analysed, with recommendations on stakeholder involvement, assessment process and more importantly how the regional coordinating mechanism could relate to the State process.

4.2 Potential WA Funding Models

A funding plan will ensure the effective delivery of built infrastructure in the State of Western Australia to continue strong economic growth in the next 20 years. This funding plan should consider the success of previous models and appropriate application of a possible Future Fund, Municipal Bonds, and the use of Public Private Partnerships.

Future Fund Model

It is worth noting that there are no global examples of ‘Future Fund’ based models being used solely for infrastructure development purposes. The

suggestion has been made by the Federal Labor Party leader Kim Beazley that the current Costello Future Fund Model¹¹ should be used for funding community infrastructure needs (see Appendix 4). The fund would be given a broad investment mandate that the Federal Labor Party envisages would include commercially attractive infrastructure investments. This would encompass specific government investment in 'low risk' infrastructure projects that offer a strong long-term rate of return¹².

The Norwegian Government Pension Fund¹³ is a good example of a Future Fund model, that could be readily adapted to funding infrastructure projects. In this particular case while all investment by the fund is directed overseas, a fixed proportion of 4% of returns is directed towards the Federal budget, unspecified. In the Western Australia case budget surpluses and mining royalties could potentially seed the Future Fund in a similar way to Norway, which is currently funded by petroleum royalties (see Appendix 4). However the returns could be allocated specifically to infrastructure.

Case Example: – Future fund application in Western Australia

GSDC assessed the application of such a model to funding the infrastructure needs of government trading enterprises such as ports. Whilst it is possible that such developments could be funded entirely by the commercial sector, this could lead to the to private wharves and private channels in ports which not only limit the revenue opportunities for ports but also raises issues of common use with a mix of private and public ownership of wharves, ship loaders and channels.

The traditional approach of commercial borrowing for infrastructure requires Treasury approval. This can create some problems where commercial enterprises borrowing may, according to Treasury impact on the State's AAA credit rating.

The Albany Port has itself raised with GSDC an approach in managing non-commercial investment which could not be commercially funded by ports. For example, the development of a very basic container trade in the Port, as presented in Appendix 4, would require an investment of \$4-\$6 million. The port suggests that the development of a fund from Port dividends would be a suitable funding source for such non-commercial. Currently WA ports currently pay all the normal and state and federal government company taxes.

¹¹ Neilson, L and Webb, R, *The Future Fund Research Note*, <http://www.aph.gov.au/library/pubs/rn/2004-05/05rn43.htm>.

¹² Beazley, K, *Address to the AusRail Conference, Sydney Convention & Exhibition Centre - 24th November 2005 Speech*, <http://www.alp.org.au/media/1105/speloo240.php>.

¹³ Australian Department of Parliamentary Services, *The Future Fund Research Note (Norwegian Model)* <http://www.aph.gov.au/library/pubs/rn/2004-05/05rn43.pdf> and; Finland Ministry of Finance, http://odin.dep.no/fin/english/topics/pension_fund/bn.html.

GSDC assesses taking the Port's argument a step further, whereby a portion of all dividends paid by government trading enterprises is pooled for an "Infrastructure Development Fund" would be a way of building up such a "Fund" combined with mining and other royalties in much the same way the Norwegians have done. Over time through the investment of such funds would break the nexus between the State's capital requirements, capital raising and borrowings, and AAA rating.

Public Private Partnerships

Public Private Partnerships, PPPs, (also referred to as Public Finance Initiatives in the UK) are partnerships between the public sector and the private sector for the purpose of designing, planning, financing, constructing and/or operating projects that would traditionally be financed by the public sector. The rationale behind PPPs is that they have the potential to offer better value for money, in the form of lower construction, lower operating, and more efficient long-term maintenance costs, than comparable public-sector projects (see Appendix 5).

The model as highlighted in the Appendix has mixed success in Australia. This contrasts to overseas experience. For example, Ireland launched a PPP program in 2000 lasting to until 2006. In the case of the road network, some 11 projects covering 250kms have been implemented with payment secured via combination of direct tolls and unitary payments by the government¹⁴.

In the UK it is estimated that trade in the public services could ultimately net the private sector some 30 million pounds under PPP arrangements¹⁵.

Use of PPPs, without direct user charging, are an alternative method of obtaining government debt when a project is unable to be funded from regularly funding sources and the community is prepared to go into debt to obtain that project on a "hire purchase" basis.

A method commonly used in UK for roads is shadow tolling. This has been described by Price Waterhouse Coopers as "a payment made by government direct to a private sector road operator for provision of a service (rather than a road asset) such that a road user may freely use that section of the road"¹⁶. No direct tolling is involved.

Another method other than tolls currently being used to fund road investment is value capture. Value capture is more often used to fund transit developments,

¹⁴National Roads Authority, *Public Private Partnership*, <http://www.nra.ie/PublicPrivatePartnership/>

¹⁵ CUPE Research Branch, *Lessons Learned: The UK Experience of Privatization of Public Services*, <http://www.cupe.ca/www/privatization/18576>.

¹⁶ Price Waterhouse Coopers, *Review of PPP Structures*, a report by Price Waterhouse Coopers, Dublin, Stationery Office, 2001.

but can be used to fund road infrastructure in the right situation. Value capture usually involves seeking payment from private land owners who will benefit from the road construction¹⁷. For example, value capture is being used to fund PPP Brownfield's development in Sydney at the Green Square Brownfield's land development project.

Extending the concept of value capture can include offering private investment the opportunity to develop land in return for their infrastructure investment or perhaps the provision of a license to a private company to sell or make use of the road reserve.

As presented in Appendix 5, GSDC assesses given the very mixed success of PPPs, the use of this model of funding is still at the evolutionary stage in terms of effective legislation and control framework. Given the size of the Australian economy, there could well be the case for a universal domestic approach in the use of PPP's to deliver infrastructure.

Municipal bonds model - USA

Municipal bonds are debt instruments issued by State and Local Governments in the US to raise funds for public works. Effectively each electorate pays for 'their' infrastructure needs. They come in two forms, Revenue Bonds and General Obligation Bonds. The difference between the two is dependant on the kind of collateral used to secure their payments of interest and principal¹⁸.

General Obligation bonds offer investors a relatively 'safe' investment vehicle while providing State and Local Governments with funds for community improvements such as roads, bridges, parks etc. The local authority uses its tax capabilities to meet its obligations. (see Appendix 6).

Revenue bonds are based on the user pay principals of "tolling" which are repaid using the revenue generated by the specific projects the bonds are issued to fund, for example car parks.

In Australia, a version of bonds for infrastructure was tried unsuccessfully through the Develop Australia Bond.

¹⁷ Wragge, H, *Australian Academy of Technological Sciences and Engineering, ATSE Focus No. 110*, <http://www.atse.org.au/index.php?sectionid=446>

¹⁸ WM Financial Strategies, *Services for Issuance of General Obligation Bonds*, <http://munibondadvisor.com/GOServices.htm>

5.0 Conclusion

This submission is intended to highlight the immediate and future infrastructure requirements facing the Great Southern Region over the next five, ten and twenty years. This submission will also provide suggestions as to what the GSDC views as potential models for the most effective funding, allocation and coordination in a State and Regional context.

However the essential point for infrastructure provision for the Great Southern Region remains. With many burgeoning industrial developments arising, small infrastructure investments can lead to large socio-economic employment outcomes. Thus these infrastructure projects should be ranked amongst high priority, high cost projects in other Western Australian regions.

Appendix 2

*The TIRES five-year Transport Plan*¹⁹

¹⁹ *Op Cit.*, Lginfo Group, p1-30.

Appendix 3

*The South Australian five-step planning and delivery framework proposal*²⁰

Step 1: Strategic analysis and identification of infrastructure needs

- Ongoing process focused on 5-10 year timeframes and objectives of the South Australian Strategic Plan
- Process begins with the preparation of the Strategic Infrastructure Plan
- Process is supplemented from time-to-time by a series of individual agency plans to be approved by government

Step 2: Project definition

- Initial scoping and definition of the required services of a project
- If appropriate meets service delivery objectives, including an analysis of the associated asset management implications
- Triple bottom line considerations

Step 3: Business case

- Development of a full business case or justification of the project
- Considers whole-of-life costs
- Sustainability targets
- Role of government
- Financing and procurement options
- The government will resolve competing project priorities and is their responsibility

Step 4: Funding method and resource allocation

- A decision is made on the funding method
- May involve an allocation of state capital funds or opportunities for private participation
- Government has the capacity to consider unsolicited bids
- Where a private firm perceives a commercial opportunity in solving a public infrastructure need, it may require assurances from the government concerning protection of its intellectual property
- The government will also have the capacity to strike sensible, open and transparent deals involving a contracted lump-sum price, provided the public interest is protected by ensuring that the price agreed to is fair
- Balance of cost against risk. Where the private sector assumes a substantial set of risks with respect to the provision of an item of infrastructure, this will be traded off in the price charged to the public sector
- Regardless of the financial position of the government, only projects that satisfy cost-benefit and other project appraisal criteria should be considered for funding

²⁰ *Op Cit.* Government of South Australia, p1-161.

Step 5: Delivery of the project

- Detailed design and procurement stage of the project
- Consideration of a full range of public and private sector delivery options
- Capitalise on the strengths of the respective sectors
- Barriers to private sector investment will be removed where possible and appropriate
- Best outcome for state
- Attention given to competition, regulation or service standards
- Progress in implementing the priority initiatives in the plan will be monitored closely
- Additionally, the plan will be revised to incorporate new priorities as they emerge

Appendix 4

The Future Fund Model²¹

The 2005 Future Fund Bill commits the Government to establish a dedicated financial asset fund consisting of cash and investments to meet unfunded superannuation liabilities. Specifically these liabilities tallied at least \$91 billion in 2005 and include:

- Commonwealth Superannuation Scheme (CSS) *completely unfunded*
- Defence Force Retirement Benefit Scheme (DFRDB) *completely unfunded*
- Military Superannuation and Benefits Scheme (MSBS) *partly funded*
- Public Sector Superannuation Scheme (PSS) *partly funded*

The Fund aims to accumulate assets to meet these superannuation liabilities that will become payable at a time when spending pressures associated with an ageing population are likely to hit. The onus will mean the current generation is responsible for funding its liabilities and also fund liabilities accrued in the past.

How it works

In 2005, the government announced that The Future Fund would receive seed capital of \$18 billion prior to July 1, 2006.

Future budget surpluses, proceeds from assets sales (assets themselves such as shares in Telstra - \$34 billion) and reinvested annual fund earnings will build up the fund until it can cover the expected \$140 billion in unfunded liabilities that should be reached in 2020.

Legislation will allow the Fund to be given a wide-ranging investment mandate. However investment into infrastructure, property and areas where the national interest could be compromised would be prevented.

The fund will only be drawn upon from either 2020 or when an independent actuary determines that there is enough money in the fund to cover the Government's superannuation liabilities.

Management of Fund

The fund will operate independently, managed by a specially established statutory authority – the Future Fund Management Agency – which will cost the Government \$32 million over four years to set up. The Agency will pay its costs from earnings so that it isn't reliant on annual budget appropriations and is responsible for implementing the board's decisions. The Agency will provide

²¹ *Op Cit.*, Australian Department of Parliamentary Services, p1-3.

administrative and policy support. However, investment activities will be outsourced to private sector funds managers.

Treasurer, Peter Costello has appointed six part-time board members, with former Commonwealth Bank chief executive David Murray appointed as chairman of the board of guardians that will oversee the fund. The board will be responsible for the fund's investment and performance (aiming to seek real returns over the long term of (4.5-5.5 %)). Also, the board will be able to gain exposure to non-financial assets and overseas assets through pooled investment vehicles.

The Federal Ministers responsible for the fund will issue an investment mandate to the board outlining what the fund can invest in, appropriate investment risk levels and expectations for returns. Investment into sound policy and national interest areas will be restricted. **Direct investment into non-financial assets such as infrastructure prevented.**

Most of the money is expected to be invested in Australian assets although overseas assets could also attract the fund's cash.

The legislation includes some measures to minimize market distortion and eliminate potential for conflicts of interest for the government as a market regulator, such as rules that the fund not hold more than 20 % of a foreign-listed company nor take a controlling interest in locally listed Corporations.

In terms of functionality, there are real concerns over the consequences the large influx of money will have on the Australian Stock Market.

Federal Government's role

- Develop and decide on appropriate legislation, seed capital source to meet the challenges of an ageing population without driving the budget into deficit.
- Ensure future taxpayers did not face even higher taxes.
- Decide upon investment mandate, risk levels and returns.
- Strengthen the Australian Government's financial position.
- Alignment with the ongoing implementation of the Government's Retirement Incomes Policy, simplification of the Superannuation system (abolition of the Superannuation surcharge and provision of incentives for individuals to make additional voluntary contributions) and resolving the long-term problem of funding government employee pensions.
- Reform of financial policy for the benefit of future generations.
- Robust measures to guard the fund from being raided by any future Government. Funds will be directed for the purpose of what is created.

The Labor Party's Federal leader Kim Beazley announced in 2005 that The Future Fund Model could be used for major infrastructure projects "to invest in the productive capacity of the country". He argues that it is by boosting productivity growth over the long term that Australia will be best able to meet the demands of an ageing population.²²

The model would adopt the same corporate governance arrangements as for the Government's *Future Fund*. In setting the broad investment mandate, Labor would ask the Board to consider the full range of investment opportunities suitable to the return and risk objectives of the Fund, which they envisage would include commercially attractive infrastructure investments.

Mr Beazley has gone on to say that this fund would be part of the following five phase plan Labor would implement;

1. conducting a national *Infrastructure Audit*;
2. establishing a national infrastructure *Priority List*;
3. creating a Commonwealth Statutory Body (called *Infrastructure Australia*) to drive rebuilding;
4. design the right funding structure for investment; and
5. putting into place the right competition policy framework.

*Norway*²³

Norway's Government Pension Fund is a continuation of the former Petroleum Fund, which was formally established in 1990. It has two main purposes. One is to limit the adverse effect of oil revenues on other sectors of the economy (the so-called 'Dutch disease'). A rise in the real exchange rate resulting from oil exports has the potential to curb growth of other exports and in the import-competing sector by making exports more expensive and imports cheaper. (Norway has also set an annual inflation target of two and a half percent as part of the measures to combat its case of the Dutch disease). The second purpose is to act as a long-term savings vehicle to cope with expenditures arising from the ageing population. Transfers from the Fund to the budgetary process are limited to 4 % of the capital year, which is equal to the estimated long-term real rate of return from the fund. The fund is also a tool to ensure the transparent use of the petroleum revenues.

All revenue from the sale of the North Sea oil is directed into the fund. This capital is invested outside Norway to counter any rise in the real exchange rate resulting from oil exports (capital outflows cause the exchange rate to depreciate). Investments are subject to ethical guidelines and an environmental sub-fund is part of the portfolio.

²² *Op Cit.*, Beazley, K, p.1

²³ *Op Cit.*, Australian Department of Parliamentary Services, p3.

The Central Bank, Norges Bank is responsible for the management of the Government Pension Fund, on behalf of the Ministry of Finance. The fund is invested in financial instruments abroad, where 60% of the portfolio is allocated to fixed income instruments and 40% to equities. The fund is well diversified. The equity portfolio has a geographical split of 50% in Europe and 50% in America and Asia/Oceania. For the fixed income portfolio, 55% is invested in Europe, 35% in America and 10% in Asia/Oceania. Within the regions, the portfolio is distributed between countries according to market capitalisation weights.²⁴

²⁴ *Economic and Monetary Policy*, Norway Mission to the EU, <http://www.eu-norway.org/policyareas/economy+monetary/>, last accessed 2nd February 2006.

Appendix 5

Public Private Partnerships²⁵

Another possible infrastructure funding model is a Public Private Partnership (PPP, also called Public Finance Initiatives (PFIs) in the UK). While there is no concrete definition of a PPP, it is generally considered to be a partnership between the public sector and the private sector for the purposes of designing, planning, financing, constructing and/or operating projects that would traditionally be regarded as falling within the remit of public sector.

Key Features of PPPs;

- a private partner investing in public infrastructure, and providing related non-core services to the government or to the community on the government's behalf,
- the government retaining responsibility for the delivery of core services such as teaching and clinical services, and
- the government and private party working together under long-term arrangements, whereby the payments to the private sector party depend upon its continuing to deliver the specified services to the agreed performance standards. Failure to meet these standards results in the private partner not being paid.

The following is a list of Public Private forms of involvement in infrastructure, from the traditional and well established form through to PPPs in their purest form.

Traditional Design and Construction (TDC)

The Government, as principal, prepares a brief setting out project requirements before inviting tenders for the design and construction of the project. Private sector contractors undertake to design the project in accordance with the brief, and construct it for an agreed sum, which may be fixed or subject to escalation.

Operation and Maintenance Contract (O&M)

These projects involve the private sector operating a publicly-owned facility under contract with the Government.

Lease - Develop - Operate (LDO)

²⁵ *Op Cit.*, National Roads Authority, p1-2.

Op Cit., CUPE Research Branch, p1-4.

Op Cit. Price Waterhouse Coopers, p1-5.

This type of project involves a private developer being given a long-term lease to operate and expand an existing facility. The private developer agrees to invest in facility improvements and can recover the investment plus a reasonable return over the term of the lease.

Build - Own - Maintain (BOM)

This type of arrangement involves the private sector developer building, owning and maintaining a facility. The Government leases the facility and operates it using public sector staff.

Build - Own - Operate - Transfer (BOOT)

Projects of the Build-Own-Operate-Transfer (BOOT) type involve a private developer financing, building, owning and operating a facility for a specified period. At the expiration of the specified period, the facility is returned to the Government.

Build - Own - Operate (BOO)

The Build-Own-Operate (BOO) project operates similarly to a BOOT project, except that the private sector owns the facility in perpetuity. The developer may be subject to regulatory constraints on operations and, in some cases, pricing. The long term right to operate the facility provides the developer with significant financial incentive for the capital investment in the facility.

Source: Tasmanian Department of Treasury and Finance, [Guiding Principles for Private Sector Participation in Public Infrastructure Provision](#)

Why use PPPs?

PPPs operate as a compromise of the public and private sectors, being neither nationalized nor privatized assets and services. Thus, politically, they represent a third way in which governments may deliver some public services.

Reasons governments are attracted to PPPs include; the potential for value for money, early project delivery, gains from innovation, obviating the need to borrow to finance infrastructure investment, and access to improved services.

The main rationale behind PPPs is that they offer value for money, in the form of potentially lower construction costs, lower operating costs and possibly more efficient long-run maintenance, than comparable public-sector projects.

Key considerations in deciding whether value for money will be achieved include;

- whether the project size justifies the transaction and management costs;
- whether there is a defined & measurable service delivery function or output mechanism;
- whether there is scope within the project delivery for the optimization and the allocation of manageable risk to the private sector;
- whether there is scope for private sector innovation, value adding and/or cost reductions in the delivery and operation of the service;
- whether there is real value in transferring responsibility for the operational and maintenance phase of the project to the private sector;
- whether there is an identifiable market of private sector bidders prepared to compete for the opportunity to deliver the project;
- whether comparisons between delivery options made on a whole of life basis demonstrate project savings; and
- that account is made of financing, construction and operation costs as well as maintenance and rehabilitation costs and other factors providing potential value for money.

For further information in this area look at *Partnerships for Growth: Policies and Guidelines for Public Private Partnerships in Western Australia*, published by the Department of Treasury and Finance.

In reality PPPs have had a mixed success rate globally. There is now evidence suggesting that significant cost savings can be secured from PPP delivery relative to the public sector alternative (a recent report suggests a weighted average saving of nine per cent against the risk adjusted Public Sector Comparator²⁶) and UK Treasury research into completed PFI projects showed 88 per cent coming in on time or early, and with no cost overruns on construction borne by the public sector. Previous research has shown that 70 per cent of non-PFI projects were delivered late and 73 per cent ran over budget. They have been heavily utilized in the UK, with private investment comprising 10-13.5% of Public Sector Net Investment over the period 1998-9 to 2003-4.

However in Australia, there have also been a string of highly publicized PPP failures domestically in recent times, for example; the Sydney Harbour Tunnel where motorists saw a rapid rise in toll charges to cover commercial miscalculations, the Sydney Airport Rail (which went into receivership only months after opening), and most recently the public relations nightmare that surrounded Sydney's Cross City Tunnel where the public purse has again been used to support yet another commercial miscalculation.

These have been attributed to a relative degree of inexperience and a lack of adequate research in the PPP field domestically. Successful PPPs require an

²⁶ Fitzgerald, P. *Review of Partnerships Victoria Provided Infrastructure*, January 2004, pp.17

effective legislative and control framework and for each partner to recognize the objectives and needs of the other. Guaranteeing benefit from PPPs requires recognition of the relative strengths and weaknesses of each type of structure and the aims and objectives of each party. Of particular importance is the role of the public sector, which may transform itself from a service provider to an overseer of service contracts.

While the benefits of partnerships with the private sector in PPPs can be significant, such relationships should not be seen as the only possible course of action and are undoubtedly complex to design, implement and operate. Many alternative sources of financing are available, which should not be discounted in the erroneous belief that PPPs always offer the best solution. Clearly PPPs need to be carefully assessed in the context of the project, the public benefit and the relative gains to be achieved under various approaches.

Commonwealth Role

In light of the recent PPP failures in NSW it could be argued that there is a need for governmental management, implementation and administration guidelines on the use of PPPs to deliver infrastructure, that would be drawn up with cooperation and input from the Commonwealth and State governments to provide a universal domestic approach to the use of PPPs to deliver infrastructure.

Appendix 6

Municipal Bonds – A US model for funding public works infrastructure

*Key features*²⁷

There are two types of municipal bonds used in the United States, Revenue Bonds and General Obligation bonds. The difference between the two types is the kind of collateral used to secure their payments of interest and principal. General Obligation Bonds offer investors a relatively safe investment vehicle while providing states and local governments with funds for community improvement.

General Obligation Bonds are debt instruments issued by states and local governments in the US to raise funds for public works. General Obligation Bonds are unique in that they are backed by the full faith and credit of the issuing municipality. This means that the municipality commits its full resources to paying bondholders, including general taxation and the ability to raise more funds through credit. The ability to back up bond payments with tax funds is what makes General Obligation Bonds distinct from revenue bonds, which are repaid using the revenue generated by the specific project the bonds are issued to fund (fees from a public parking garage, for example).

General Obligation Bonds give municipalities a tool to raise funds for projects that will not provide direct sources of revenue such as roads and bridges, parks and equipment. As a result, General Obligation Bonds are typically used to fund projects that will serve the entire community; Revenue Bonds, on the other hand, are used to fund projects that will serve specific populations, who provide revenue to repay the debt through user fees and user taxes.

The principal reason municipal General Obligation Bonds are such low-risk investments is that they are backed by the full faith and credit of the municipalities that issue them. This means that municipalities can apply funds raised from various kinds of taxes. The default risk of General Obligation Bonds is low, since the municipality has the option of raising taxes to meet its obligations.

States and local municipalities that levy income or sales taxes may apply the revenue they generate to pay principal and interest on General Obligation Bonds. Various kinds of fees, such as license fees, can be used as well. Most cities and towns, however, typically rely on various kinds of ad valorem taxes, taxes based on the value of private and business holdings within the municipality. Property and real estate taxes are the most common types of ad valorem taxes available to municipalities. For example, if a town creates a bond issue to fund a new

²⁷ Morning.com's interactive classroom, *Revenue Bonds*,
(<http://news.morningstar.com/classroom2/printlesson.asp?docId=5394&CN=COM>)

school building, it may increase the property tax rate in order to ensure that it will have sufficient income to meet its obligations to bondholders.

Pros and cons

GO bonds are prized for their relative safety as investments. Because the credit of a municipality stands behind them, GOs typically have high bond ratings, higher than revenue bonds tend to. The reason is the municipality's power of taxation: A city or town always has the option of raising tax rates or levying new taxes in order to meet its obligation to bondholders. As a result, it is rare for a municipality to default on its GO bonds. GO bonds typically rate with U.S. Treasury securities and high-grade corporate bonds for investor confidence. With revenue bonds, by contrast, if the project the bonds fund does not raise sufficient revenue, there is at least the possibility that the municipality may default on the bond issue.

However, as with other examples of low-risk investments, the trade-off for safety is lower returns. GO bonds typically pay lower interest than revenue bonds, precisely because the credit behind them makes the possibility of default so remote. However, many GO bonds offer tax-free returns, which can make up for lower interest rates, especially for investors in higher tax brackets.

How are GO bonds issued

Many states and local governments in the US require public hearings and/or special 'bond elections' to gain community approval for undertaking a bond issue for public works.

Once community approval is secured, a competitive bond sale is preferred. Most states and municipalities would engage the services of a reputable financial house to prepare the best bonding plan for each particular situation, including the financing plan, documentation preparation, bond marketing plan, credit review and rating, etc.²⁸

General obligation bonds are typically sold in denominations of \$5,000. While it is sometimes possible to buy directly from the municipality, most GO bonds are purchased on the secondary market.

Develop Australia Bond (DAB) scheme²⁹

The DAB scheme ran in Australia from 1992 to 1997 to assist private sector involvement in infrastructure. The scheme involved the transfer of tax benefits from project proponents to project financiers. In return for giving up these benefits, project proponents received lowered interest rates on borrowings from

²⁸ WM Financial Strategies, *Services for Issuance of General Obligation Bonds*, <http://munibondadvisor.com/GOServices.htm>

²⁹ Reserve Bank of Australia Bulletin, *Privatisation in Australia*, Dec 1997, p13.

financiers of the project. Issues of infrastructure bonds under DAB were limited before May 1994, when several changes were made to enhance their appeal. This resulted in an upsurge of proposals and the scheme was frozen in late 1996 and ended in 1997 due to its cost to the Budget. The DAB scheme was replaced with a tax rebate scheme.

³⁰ Fitzgerald, P. *Review of Partnerships Victoria Provided Infrastructure*, January 2004, pp.17