



Submission to the Productivity Commission Public Infrastructure Inquiry

Cbus (United Super Pty Ltd) provides superannuation services to construction, building and allied industry workers and retirees, their families and their employers. Cbus was established in 1984 and is one of Australia's oldest industry superannuation funds.

The fund has some 700,000 members and 90,000 employers. Cbus manages assets valued at \$25 billion.

Cbus operates on a profit-for-members basis. All returns are used for the advantage of fund members and there are no dividends paid to stakeholders.

The Trustee board of Cbus provides equal representation between employer and employee representatives, with an independent Chair and other independent directors. Master Builders Australia nominates employer representatives including those from other employer associations aligned with building and construction. Employee representatives are nominated by the ACTU and the major trade unions representing the construction industry workforce.

The composition of the Trustee board, our history with and continued strategic focus on employers and members in the construction and building industry and the longer-term investment horizons inherent in superannuation, provide Cbus with a unique alignment and appetite for public infrastructure and unlisted property investment, development and ownership.

Cbus is an affiliate of Industry Super Australia (ISA) and Cbus adopts and supports ISA's broader submissions to this Inquiry.

Primarily, this submission focuses on responding to the question raised in the Productivity Commission's Issues Paper:

"What are the impediments to greater private sector involvement and financing of public infrastructure by institutional investors, such as superannuation or pension funds? What is the scope for superannuation funds to benefit from financing more public infrastructure, and the reasons why they are not already doing so?"¹

In doing so, this submission will also touch on a range of other matters raised in the Commission's paper.

Infrastructure investment

Cbus welcomes the Treasurer's recognition in the terms of reference for this inquiry that:

¹ Productivity Commission Issues Paper, "Public Infrastructure", November 2013, page 16.

“Efficient public infrastructure plays a key role in a competitive and productive economy and the ongoing funding and financing of infrastructure development in Australia is therefore of critical importance.”²

Investing in and building infrastructure is a critical driver of productivity, employment and wage growth, not to mention social, economic and political cohesion. Indeed the Productivity Commission has estimated that improving productivity and efficiency to achieve best practice in energy, transport, infrastructure and other activities could, after a period of adjustment, increase GDP by nearly 2 per cent.³

That said, there remain significant challenges in ensuring that, as a nation, we can achieve that ‘best practice’.

Citigroup, in 2008, estimated the infrastructure needs in Australia over the next decade to be \$770 billion. More conservative estimates fix the infrastructure ‘gap’ at between \$300 and \$450 billion. Former Treasury Secretary, Ken Henry stated in 2010, that [even]...

“..if we doubled the annual investment typically undertaken in economic and social infrastructure, it would still take 8 years to close the[se] suggested infrastructure gap.”⁴

The OECD has also noted Australia’s infrastructure deficit stating it is due in part to underinvestment throughout recent decades but also to “weak co-ordination between public infrastructure and development and fiscal management” and a “lack of co-ordination between the various levels of government and between jurisdictions at the same level.”⁵

Given current public fiscal constraints, as dwelt upon by the Federal Treasurer in the recent Commonwealth MYEFO announcement and through State Government fiscal ambitions to maintain AAA ratings, tax payer capacity to meet all of the ‘gap’ in infrastructure is increasingly unlikely.

Yet the challenges of increasing populations, particularly in urban areas; climate change; enhancing productivity; and transitioning the economy from the resources construction boom all remain.

Indeed, for the construction industry, the cooling of the resources construction phase poses significant challenges. The ability to transition skilled employment from the mining sector back into urban and regional communities, will largely depend on infrastructure and property construction facilitation.

² Productivity Commission, Public Infrastructure, “Public inquiry – Terms of reference”

³ Productivity Commission, 2006. *Potential Benefits of the National Reform Agenda. Report to the Council of Australian Governments.*

⁴ Henry, Ken, *To build or not to build* Address to the Conference on The Economics of Infrastructure in a Globalised World. 18 March 2010.

⁵ *OECD Economic Surveys – Australia*, Volume 2010/21, OECD, Paris, November

Despite the enormity of the challenge and the constraints on the public purse, it would be exceedingly detrimental to Australia’s environmental, social and economic outlook to cede ground on infrastructure planning and development. For this reason we welcome this inquiry.

Cbus invests in infrastructure equity and debt both directly and through pooled investment manager Industry Funds Management (IFM) and Hastings Funds Management. 0.7% of the Cbus fund is co-invested in NSW ports and a further 9.6% of the fund is invested in infrastructure through the investment managers.

Cbus infrastructure debt investments include natural gas pipelines, hospitals, showgrounds and coal export terminals.

Cbus is a ‘buy and invest’ infrastructure equity investor in roads, rail, ports, airports, utilities including water, energy and telecommunications and social infrastructure.

The fund also invests in international infrastructure assets which have helped diversify the portfolio across the asset class.

Ever mindful of the sole purpose test of Trustees of members’ retirement funds, the first test that Cbus applies to these investments is to determine whether they are in the best interest of fund members.

Cbus targets a long-term net (after tax after fees) return from infrastructure of 9.0% pa. Excluding the 5 year period (impact of the GFC), this has been achieved. The chart below shows that the return contribution to the Fund’s total return from infrastructure is quite strong, apart from years when listed equity markets perform strongly (eg over the last year).

	1 Yr	3 Yrs (pa)	5 Yrs (pa)	10Yrs (pa)
Cbus Total Fund	17.4%	9.4%	5.8%	7.9%
Cbus Infrastructure	11.0%	11.7%	5.7%	9.9%*

Note: * Gross of fees and taxes. Net return not available for 10yrs.

APRA’s recent testing of investment performance of funds over the period 2004 to 2010 to determine what, if any, difference illiquid assets (unlisted infrastructure and property) may have on fund performance and return to members found that at least one quarter of the net risk-adjusted 144 basis points outperformance by not-for-profit funds over retail funds, could be attributed to a higher share of illiquid assets.⁶

⁶ Cummings and Ellis, 2011. *APRA Working Paper, Risk and Return of Illiquid Investments*

The alignment between long term superannuation investment, particularly in profit-for-members industry super funds, and the longer-term investment horizon of infrastructure projects (usually 20 – 30 years) and their typically stable and predictable cash flows, makes infrastructure investment an attractive proposition to fund members.

As well as the strong returns for members, investment in infrastructure supports growth and jobs.

For Cbus, as the fund for the construction and building industry, the investment in illiquid assets such as unlisted infrastructure and property has a further benefit for our members and employers as the construction of such assets directly supports the industry and provides employment for current and prospective fund members.

Former Commonwealth Treasurer, Peter Costello, noted earlier this year in reference to the \$5.1 billion purchase of Ports Botany and Kembla that:

“Industry funds are dying to get into infrastructure and there isn’t enough of it.”⁷

This highlights some of the opportunities and challenges in infrastructure development for Australia.

On the one hand, there is a large ‘gap’ in infrastructure needs and funding, yet there is an appetite from private investors and particularly industry superfunds for infrastructure investment.

Cbus maintains an appetite for public infrastructure investment but submits that there are inhibitors to that appetite that can and should be addressed to ensure potentially higher levels of investment from superfunds and the private sector.

Potential Investment Inhibitors

Need for Planned Infrastructure Program

Former Treasury Secretary, Ken Henry observed that the GFC exposed flaws in Australia’s infrastructure planning and development not only in the ability to deploy ‘shovel-ready’ infrastructure construction projects as a counter-cyclical macroeconomic policy, but in a wider “lack of strategic planning for the nation’s infrastructure needs”.⁸

It is recognised by Cbus that the previous Commonwealth Government implemented steps to address some of these matters by having Infrastructure Australia cost and prioritise infrastructure projects, identifying a pipeline of projects and investigating financing models.

⁷ Costello says super fund at forex risk, The Australian Financial Review, 8 March 2013. Pg 18.

⁸ Henry, Ken. Ibid Pg.19

However, the lack of a unified infrastructure funding and procurement process and strategic plan, along with the three tiers of government all being involved in funding and planning infrastructure, continues to fragment and slow infrastructure development.

Cbus would like to see an infrastructure program developed that provides certainty of an accelerated number of projects coming to market. This in turn would allow greater investment scrutiny, competition and the capacity to explore different funding and bid arrangements.

Recommendation: A strategic, agreed and certain plan for the release and indicative cost of infrastructure projects should be developed and adhered to across all levels of government to provide investors with a level of certainty of a pipeline of opportunity. An accelerated number of projects coming to market will increase competition and drive the exploration of different funding and bid arrangements.

Bidding Processes

The high upfront costs emerging from the current 'single bid model' create a 'barrier to entry' for many investors, including Cbus, from seeking to participate in public infrastructure funding.

This is often compounded by traditional or existing partners closing-out access to new entrants.

The cost and process inhibitors in the bidding process makes investment in smaller infrastructure projects, such as those in social infrastructure (hospitals or schools), more unpalatable because of the cost/return profile.

Traditionally the risk return profile of investment in infrastructure has often been unworkable for super investors, as they are exposed to all the risk but often with single-digit returns.

In addition, the interests of syndicate leaders, investment banks and construction companies are not aligned with those of equity investors with the bid process structured in their favour.

Cbus submits that the way to reduce restrictive bid costs, align stakeholder interests, reduce leakage and ultimately provide greater benefit to superfund members – and therefore attractiveness to investment by superfunds – is to invert the bid process by tendering initially for the long term owner operator ahead of residual finance and construction.

Cbus supports the detailed submissions by ISA to this inquiry that will expand on alternative bidding processes.

Liquidity Arrangements

APRA regulated superfunds properly maintain liquidity levels that allow them to meet both the needs of fund members entering into retirement, in death, or should they exercise their choice to move to an alternative superannuation service provider.⁹

However, there is no way of calculating exactly what this liquidity level should be given the 700,000 different individual circumstances of Cbus members.

As a \$25 billion fund run only to benefit members, Cbus has always been and remains confident of always meeting its obligations to members and Cbus Trustees accept and support the liquidity obligations of the fund.

This submission has already detailed the merits of infrastructure and unlisted property investment for members, both in terms of returns and alignment with investment horizons. The issue that requires address is how do superfunds, prudently and in the interest of their members, lift their appetite for infrastructure investment to help meet the nation's needs while meeting their liquidity obligations?

A number of options have been canvassed on this issue and on debt financing models and Cbus is still actively exploring those options through ISA.

Some options that have been highlighted and deserve further detailed attention include:

- government establishing a liquidity guarantee for APRA regulated superfunds, similar to the deposit guarantee provided to approved deposit-taking institutions during and post the GFC; and/or
- government establishing a liquidity pool mechanism that allows individual contributing funds access to liquidity should certain levels of risk be attained.

This could free up further appetite for illiquid investment amongst superfunds whilst being prudently counterbalanced by sole purpose obligations and increased costs of investment through the fee imposed on the guarantee or the cost associated with accessing the liquidity pool.

Cbus would also draw the Commission's attention to the further drain on liquidity and therefore investment in infrastructure by superfunds caused by the exiting of fund members to the Self Managed Superannuation Fund (SMSF) sector.

The SMSF sector now stands at some \$500 billion. It is largely fed by people convinced of the opportunity to increase their retirement incomes by directly controlling their

⁹ Members may seek to access their funds under a range of other circumstances such as financial hardship or upon exercising options to access voluntary contributions ahead of retirement age for which adequate liquidity must be provisioned.

superannuation investments, leveraging the assets therein and maximising superannuation taxation thresholds to minimise total tax payable. This is increasingly popular at a time of record low interest rates.

However, unlike members of industry superfunds who, through their collective pool of funds, invest in economic and social infrastructure and therefore, in part, return the concessional taxation treatment of their superannuation to the community and nation's benefit, SMSF members do not.

SMSF contributions to unlisted Australian infrastructure investment are virtually zero. Instead, one of their growing areas of investment is in leveraged residential property, driving further negative outcomes of reducing availability and affordability of housing.

Local accountants, lawyers and financial planners convincing superfund members to exit their funds in favour of establishing an SMSF, adds to the liquidity uncertainty of those superfunds placing further pressures on the funds capacity to invest in long term assets such as infrastructure.

Recommendation: That further policy exploration into government liquidity guarantees or pooling options for APRA regulated superfunds be undertaken through consultation with the industry.

Cycling infrastructure and superfund investment

As previously stated, greenfield infrastructure investments are critical to address the challenges the nation and the construction industry face in the future. However, greenfield projects are not always suitable for super fund investment because of risk return profiles.

By comparison, brownfield infrastructure investments can be more attractive to superfunds owing to greater certainty of return and less construction and patronage risks.

Cycling of infrastructure may present a solution for governments to fund new infrastructure projects through the sale of existing infrastructure.

Cbus, along with industry superfunds more generally, is mindful and sensitive to the political concerns of the community regarding privatisation of public assets.

Because Cbus is a 'buyer investor' looking to improve the quality of infrastructure assets over the longer term, public concern can be eased over issues of private equity seeking short term returns via cost cuttings, service downgrades, employment reductions, carve ups and sell offs.

Investment and ownership in brownfield infrastructure by industry superfunds, could be the political game changer that frees up capital to be invested in new and needed infrastructure by governments.

Cbus supports the concept of bringing forward the list of potential government-owned logistics, energy and water assets as possible investment opportunities while cautioning governments to consider the community sensitivities in their choice of partners or potential owners and to use the sale proceeds to invest in new and necessary infrastructure.

Recommendation: That a list of projects that are ready and able to be invested in, particularly brownfield asset sales, be brought forward and that governments, in choosing their partners for asset sales give particular attention to long term, 'buy and invest' models that meet community sensitivities.

Other potential regulatory inhibitors

APRA has found that not for profit funds, such as Industry Superfunds have characteristics which can sustain a relatively high level of illiquid investment due to scale, member demographics and strong cash flows.

Such characteristics are derived from the legislated SG; the strong product offer of being run solely for the benefit of members, no commissions and low fee structures; and through an affinity with industry that provides a low cost, workplace distribution model.

Cbus submits that policy or regulatory changes that impact upon those characteristics be properly weighed against the possible consequences they may have on both the appetite and capacity for industry funds to increase investment in infrastructure.

Conclusion

Cbus thanks the Productivity Commission for the opportunity to comment on this important matter and looks forward to further consultation opportunities as the Commission releases its reports and recommendations on the matter.

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