

Public Infrastructure Inquiry
Productivity Commission
Locked Bag 2, Collins Street East
Melbourne Vic 8003

Dear Sir or Madam

Submission in response to the Public Infrastructure Draft Report

The Property Council welcomes the Productivity Commission's Draft Report on Public Infrastructure as an important contribution to the dialogue around infrastructure funding, financing, prioritisation and delivery.

The Property Council supports the vast majority of the measures recommended by the Draft Report - as indicated by our responses to the Draft Report's individual proposals (see Annexure 'A').

The sum total of the recommendations relating to public interest, transparency, independent analysis and quality governance - if implemented - would deliver the kind of project pipeline the private sector has sought for several years.

These improvements combined with more systematic and tailored adoption of innovative funding and financing techniques will help drive confidence and continue the necessary upswing in private infrastructure investment.

However, the Property Council believes the Draft Report has room for improvement on three fronts:

1. it lacks a cohesive method for hard-wiring proposed reforms into government funding mechanisms;
2. it supports value capture too broadly, potentially endorsing double-taxation of property;
3. it dismisses the benefits of a credit-enhanced bond market without looking closely at overseas examples.

This submission provides details on how the Final Report can benefit from improvements in these areas.

UK City Deals

While we support the basic proposals and principles contained in the Draft Report, it lacks a cohesive method for hard-wiring proposed reforms into government funding mechanisms.

The Property Council submits that an adapted version of the United Kingdom's City Deals approach would tie the Draft Report's recommendations into a consistent and implementable reform package.

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UK City Deals are the Cameron Government's innovative strategy for building stronger urban and regional growth via smarter strategic planning, infrastructure investment and local governance.

In Australian public policy terms, the UK City Deal prototype represents a National Competition Policy-style approach to economic development.

The core goal of UK City Deals is to direct infrastructure spending to projects that boost productivity, employment and economic growth.

The UK model represents a **radically new approach to infrastructure priority-setting, funding and financing.**

The UK model determines an economic growth budget for a designated region. Regions are rewarded for achieving and exceeding these growth budgets.

The UK City Deals approach aligns with key themes and recommendations from the Draft Report, namely:

- **Governance**
 - improved interaction between local, state and regional governments;
 - principles for project assessment and selection;
 - establishment of purpose-built authorities responsible for project assessment and performance.
- **Project prioritisation**
 - transparent cost-benefit analysis;
 - objective priority based on contribution to economic growth and social wellbeing;
 - transparent review of public-private cost sharing arrangements;
 - delivering certainty to the investment pipeline.
- **Improved metrics**
 - funding linked to demonstrated economic benefits drives improvement in measurement and reporting;
 - accountable governance structures oversee and report on set geographic areas;
- **Funding**
 - project and region-specific funding arrangements instigated to complement public capital: including user charges, levies and taxation earn-back.

City Deals will soon extend to 28 major UK towns and regions.

The Greater Manchester deal signed in 2012 provides a template for other cities.

The Property Council is working with partners, such as the Urban Coalition, the Australian Sustainable Built Environment Council (ASBEC), and all spheres of government to adopt the City Deal approach to Australia's strategic needs.

Here are nine reasons why we commend the UK approach.

1. A City Deal is a contract – the deal is a deal!

Each City Deal is codified as a contract between an economic region and the central government.

In Scotland, with its triple tier governance arrangements, there are three parties to the contract – a model even better suited to Australian circumstances.

A City Deal generally runs for 10 years or longer. Each deal identifies a list of priority infrastructure projects to be delivered along with benchmarks of regional economic and productivity growth to be achieved.

2. The focus is on productivity and growth

Wise choices about infrastructure investment will boost economic productivity.

The UK City Deal model explicitly targets a package of infrastructure projects that boost a region's economic capacity over a long-term timeframe.

This helps focus competing priorities into a coherent set of goals that can be communicated to voters.

3. *City Deals encourage local leadership*

The UK approach revolves around City Deal partners.

In Manchester, the 10 existing local government authorities combined to form the Greater Manchester Combined Authority (GMCA) in 2011.

In addition, Local Enterprise Partnerships link key stakeholders – government, business, community groups – based on logical economic regions.

This encourages a more enterprising, strategic approach to growth and self-reliance.

In doing so, City Deals also foster the growth of social capital and local resilience as everyone is in the same boat.

4. *Smarter tools for determining infrastructure priorities*

The City Deal approach moves from narrow benefit-cost analysis to an agreed measure of Gross Value Added for a region (a local "GDP").

It aligns the methodologies for selecting infrastructure investment priorities to the methodology for rewarding the performance of City Deal Partners.

It also does so within an independent assessment process controlled by Treasury.

The UK City Deal program represents a major paradigm shift, where:

- the focus is on wider impacts within a defined region;
- project priorities and program success are assessed in terms of **growth in jobs and productivity** (along with attendant increases in tax revenue); and,
- the goal is to quantify changes in Gross Value Added (local GDP) for an economic region.

The UK City Deal approach promotes a move away from budget silos – a "housing budget", a "transport budget" etc – to an **"economic growth budget" for a region.**

The lens provided by a comprehensive assessment framework shifts the fiscal focus away from isolated project evaluations to metrics that capture broader benefits – this includes welfare, housing and regeneration dividends.

5. *Performance is rewarded*

Financial incentives motivate and reward smart thinking.

The UK City Deal model allows deal partners to "earn back" a share of the additional taxation dividend generated by faster economic growth.

This financial reward motivates strategic thinking, collaboration and public policy innovation. It also provides a clear ongoing incentive to deliver on long-term infrastructure investment programs.

The UK City Deal model provides City Deal partners with a menu of financing options.

First, these partners receive baseline funding – that is, long-term certainty around core revenue streams.

Second, City Deal partners are encouraged to explore innovative forms of capital formation with the private sector.

PPPs are on this menu, as are Local Asset Backed Vehicles and Tax Increment Financing.

These models complement traditional forms of capital raising.

In an Australian context, "earn back" is analogous to competition payments under the National Competition Policy (NCP) model.

This payment can be used to amortise debt obligations or to capitalise new priority infrastructure projects.

6. *City Deals help join-up economic and social goals*

A feature of UK City Deal contracts is the inclusion of complementary programs relevant to a region.

For instance, the Manchester City Deal includes:

- a Growth Hub program;
- a Skills Hub – a plan to employ 6,000 apprentices;
- a Low Carbon Demonstrator initiative – an innovative funding model to reduce emissions;
- an Inward Investment Beacon – a program for attracting international and patient capital to local projects; and,
- a housing program that aims to deliver 7,000 homes by 2017.

The Birmingham and Solihull Deal includes:

- a plan for 100,000 extra private sector jobs (generating an additional \$23 billion of GVA by 2020);
- a Life Science Accelerator program;
- a Skills for Growth program; and,
- Green Deal initiatives.

In other words, City Deals foster a **mutually reinforcing set of public policy programs.**

7. *Powerful political leadership that boosts economic productivity*

The UK City Deal program is overseen by a Minister who also holds a Treasury portfolio.

This approach recognises that cities are economic assets which drive productivity and growth.

There is a unit within Treasury that helps City Deal partners assess infrastructure priorities and set GVA growth benchmarks.

These benchmarks are written into each City Deal.

Treasury also acts as an independent assessor of progress against targets.

8. *City Deals promote financial literacy and skills at a local level*

The Birmingham and Solihull City Deal partners have established GBS Capital which aims to leverage \$2.5 billion of seed funding into \$25 billion of private capital.

The Greater Manchester Combined Authority has established a \$2.5 billion “revolving infrastructure fund”.

These special purpose capital formation entities are monitored and advised by the UK Treasury and operate under strict governance arrangements.

Deeper involvement by local stakeholders, who are accountable for their actions, fosters financial savvy.

9. *There’s less need to rely on inefficient taxes when efficient alternatives are available*

Australia’s panoply of inefficient taxes exist because of cost-shifting between government, poor access to capital and policy conservatism.

A secure stream of capital for infrastructure projects (within a disciplined framework) will not only reduce reliance on inefficient taxes, it can provide the basis for phasing them out.

Value Capture

One mechanism for financing an ongoing infrastructure program is to capture the value generated by infrastructure upgrades within a region.

Differing forms of value capture are commonly employed in comparable economies, including the United States, Denmark, New Zealand and Hong Kong.

49 states in the US have legislation enabling tax increment financing (TIF).

While variations exist depending on policy settings and governance arrangements, the basic premise of TIF is:

1. government sets a prescribed development area;
2. an infrastructure plan is agreed and rolled out;
3. a local TIF authority is entitled to a share of the incremental increases in tax revenue resulting from increased land values; and,
4. the TIF authority uses that funding to repay debt of capitalise future projects.

In 2008 the Property Council commissioned PriceWaterhouseCoopers to provide detailed advice on how the TIF model could be applied in an Australian context.

Please note that most of the jurisdictions utilising value capture mechanisms **do not also levy Australia's very wide set of property taxes.**

The Property Council sees no case for adopting broader value capture techniques while retaining Australia's extensive menu of inefficient property taxes.

No other country utilises value capture while also employing land taxes, property transaction taxes, capital gains taxes, developer charges, property-based fire services levies, car parking taxes, municipal rates, betterment taxes and augmentation fees (to name a few).

In addition, TIF, or growth area bonds, generally do not involve a surcharge on property taxes.

Instead, TIF models hypothecate the premium tax revenue arising from a boost in land values (driven by superior infrastructure provision) to the amortisation of infrastructure financing obligations.

In other words, value capture identifies and quarantines the lift in rating revenue attributed to infrastructure spending in a particular locale. It then directs this premium revenue to fund infrastructure in the form of an ongoing economic rent.

Australia already deploys an economic rent for most non-residential (and investment property) landholdings – land tax.

This should be made clear in the Productivity Commission's Final Report to avoid ambiguity and ensure double-taxation of property is not tacitly recommended.

Conclusion

The Property Council supports the finding that capacity exists within both government balance sheets and the private sector to increase spending on infrastructure, under the right policy settings.

Leveraging this capacity requires a significant improvement in the governance and financing mechanisms for infrastructure at all levels of government – similar to those proposals put forward in the Draft Report.

The Property Council would like to see the Draft Report extended to include detail on how these reforms could be drawn together in a cohesive framework for infrastructure planning, deliver and ex-post performance assessment.

The UK City Deal model provides an instructive case study in how this might occur, and we commend that model to the Productivity Commission for adoption in its Final Report.

While forms of value capture have proven successful overseas, there are stark differences in the number and quantum of taxes levied on property in Australia and those jurisdictions. Any application of value capture must not increase or broaden the existing property tax burden.

The Draft Report questions the market failure in the long-dated bond market. Because such a market has not existed in Australia our financial institutions lack the expertise to develop this whole new asset class from scratch.

For this reason we maintain that there is a role for the Federal Government in establishing long dated bonds to foster Australia's skills base and generate market interest within the private sector.

The Property Council has considered the Draft Report's recommendations in detail and provided responses which can be found in Annexure 'A' to this submission.

We would welcome the opportunity to discuss these issues in more detail with the Commission. To arrange a meeting please contact Charlie Thomas, National Policy Manager, on CThomas@propertyoz.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Peter Verwer', with a stylized flourish at the end.

Peter Verwer
Chief Executive

Enc. Detailed responses to Draft Public Infrastructure Report recommendations

DRAFT RECOMMENDATION	OUR STANCE	COMMENTS
<p>DRAFT RECOMMENDATION 7.1</p> <p><i>Institutional arrangements for the provision and delivery of public infrastructure should incorporate good governance arrangements, including:</i></p> <ul style="list-style-type: none"> • <i>the principal objective of ensuring that decisions are undertaken in the public interest</i> • <i>clear and transparent public infrastructure service standards</i> • <i>effective processes, procedures and policy guidelines for planning and selecting public infrastructure projects, including rigorous use of cost-benefit analysis and transparency in cost-benefit assessments, public consultation, and public reporting of the decision (including a transparent review of the decision by an independent body, for example, an auditor-general or Infrastructure Australia)</i> • <i>efficient allocation and monitoring of project risks between government and the private sector</i> • <i>use of transparent and competitive processes for the selection of private sector partners for the design, financing, construction, maintenance and/or operation of public infrastructure</i> • <i>sufficiently skilled employees who are responsible and accountable for performing their functions</i> • <i>principles and processes for considering funding arrangements, including application of user-charging as the default funding arrangement where this is appropriate, and transparency of funding decisions (including public reporting of decisions and periodic review by an independent body, for example, an auditor-general or Infrastructure Australia)</i> • <i>principles and processes for selecting efficient financing mechanisms and transparency of financing arrangements</i> • <i>performance reporting and independent evaluation of public infrastructure project performance.</i> 	<p>Support.</p>	<p>These arrangements are sound and should be a requirement for any public entity receiving capital from another public entity.</p> <p>It should be noted that the UK City Deal model takes these principles away from a case-by-case application and assesses the full network of economic benefits arising from infrastructure investment using a single assessment framework.</p>

DRAFT RECOMMENDATION	OUR STANCE	COMMENTS
<p>DRAFT RECOMMENDATION 2.1</p> <p><i>There is no continuing case for retention of certain infrastructure in public hands. Accordingly, State and Territory Governments should privatise their government-owned:</i></p> <ul style="list-style-type: none"> • <i>electricity generation, network and retail businesses</i> • <i>major ports</i> <p><i>subject to appropriate processes to ensure value for money.</i></p>	Support.	Asset recycling is an appropriate mechanism for raising revenue for reinvestment in new infrastructure. These asset types have been recycled successfully in the past.
<p>DRAFT RECOMMENDATION 7.3</p> <p><i>Australian Government funding or other forms of assistance (such as loans and government guarantees) for public infrastructure that is provided to local, State and Territory Governments should be conditional on the following:</i></p> <ul style="list-style-type: none"> • <i>use of effective cost-benefit analysis and transparency of assessments including the methodology and assumptions</i> • <i>evidence of a demonstrable net public benefit from the project which is not obtainable without Australian Government support</i> • <i>evidence that competitive processes will be used for the selection of financing, design, construction, maintenance and operation of public infrastructure services where these tasks have been outsourced to the private sector</i> • <i>evidence that the relevant government has efficiently used opportunities for users and other beneficiaries to fund the infrastructure through measures such as user charges, betterment levies and property development charges</i> • <i>ex post evaluation and publication of public infrastructure project outcomes.</i> <p><i>Consultation on the criteria to be applied and any potential implementation issues associated with such an approach should be undertaken with local, State and Territory Governments.</i></p> <p><i>All governments should be encouraged to apply the above principles and actions to their own-funded projects.</i></p>	Support.	Note that these conditions are inherent to the operation of the UK City Deals model.

DRAFT RECOMMENDATION	OUR STANCE	COMMENTS
<p>DRAFT RECOMMENDATION 7.2</p> <p><i>All governments should take deliberate steps towards implementing institutional reforms in the road sector for cars and other light vehicles that improve project selection processes, facilitate greater adoption of direct user charging mechanisms, and more directly link road charge revenue with future spending on roads. The consideration of institutional reforms for cars and other light vehicles should take into account the current reforms being developed for heavy vehicles under the Heavy Vehicle Charging and Investment reform process.</i></p> <p><i>The Commission considers that a road fund model should form the basis of starting a long-term transition to a more commercial approach to project selection and road provision for cars and other light vehicles. To be effective, the road fund needs to have access to adequate sources of funds, a significant degree of autonomy, and transparent processes for determining the level and allocation of funds.</i></p> <p><i>Institutional and governance arrangements adopted should include a formal procedure for consultation with road users and the broader community, as well as systematic post-project evaluation and periodic review of the arrangements.</i></p>	Support.	Improved institutional arrangements to enable more flexible road user charges are worth exploring.
<p>DRAFT RECOMMENDATION 4.1</p> <p><i>The Australian Government should actively encourage State and Territory Governments to undertake pilot studies on how vehicle telematics could be used for distance and location charging of cars and other light vehicles. To do so, the Australian Government should: offer to partly fund these pilot studies; work with the States and Territories to coordinate and share experiences; and ensure that motorists are consulted, potentially via roads and motorists associations. The pilot studies should be designed to inform future consideration of a (revenue-neutral) shift to direct user charging for cars and other light vehicles, with the revenue hypothecated to roads.</i></p>	Support.	

DRAFT RECOMMENDATION	OUR STANCE	COMMENTS
<p>DRAFT RECOMMENDATION 8.1</p> <p><i>Given high and rising land costs in urban areas, governments should ensure that project selection take explicit and detailed account of available alternatives, including the enhanced use of existing infrastructure, pricing solutions and cheaper build options. Governments should also consider ways in which land policies can be improved in this area, given the deficiencies in the current planning of land reservation in most jurisdictions in Australia.</i></p>	Support.	Better forward planning will improve investor certainty and reduce costly acquisition programs.
<p>DRAFT RECOMMENDATION 11.1</p> <p><i>Governments should invest more in the initial concept design specifications to help reduce bid costs, but in doing so, provide opportunities for tenderers to contest the specifications of the design.</i></p>	Support.	
<p>DRAFT RECOMMENDATION 11.2</p> <p><i>When tendering for major infrastructure work under design and construct arrangements, governments should consider contributing to the design costs of tenderers on the condition that governments own the design, where a thorough prior assessment has demonstrated that design innovation is both worth seeking and likely to be received.</i></p>	Support.	
<p>DRAFT RECOMMENDATION 11.3</p> <p><i>Government clients should alter the timing of information provision in the tendering process for infrastructure projects so that non-design management plans are only required of the preferred tenderer. The obligation to produce documents upon becoming a preferred tenderer should remain a condition of the initial request for tender.</i></p>	Support.	

DRAFT RECOMMENDATION	OUR STANCE	COMMENTS
<p>DRAFT RECOMMENDATION 11.4</p> <p><i>The 'early contractor involvement model' should be trialled to test the costs and benefits of applying past contract performance by tenderers as a means of constructor selection, consistent with the practices of some private sector clients.</i></p>	Support.	The Property Council would support a trial of this model. The trial should be conducted transparently and results made available to other government and industry stakeholders.
<p>DRAFT RECOMMENDATION 11.5</p> <p><i>For complex infrastructure projects, government clients should provide concept designs using Building Information Modelling (BIM) to help lower bid costs, and require tender designs to be submitted using BIM to reduce overall costs. Governments should give serious consideration to where in their better practice guides they may specify the use of BIM.</i></p>	Support.	The Property Council actively supports wider uptake of BIM.
<p>DRAFT RECOMMENDATION 11.6</p> <p><i>Within the request for tender, government clients should provide opportunities for tenderers to contest the key standards of the design where they have previously assessed scope exists for innovation to occur.</i></p>	Support.	
<p>DRAFT RECOMMENDATION 11.7</p> <p><i>Australian, State and Territory Governments should remove the requirement for local content plans, such as the Australian Industry Participation plans, from tenders for all projects.</i></p>	Support.	Australian Industry Plans are an expensive and ineffective requirement worthy of repeal.
<p>DRAFT RECOMMENDATION 11.8</p> <p><i>For larger and more complex projects, government clients should pre-test the market to gain insights into possible savings from packaging the project into smaller components, reducing the level of risk borne by any one contractor, and promoting greater competition by relatively smaller construction companies.</i></p>	Not supported.	This should be subject to investigation by an expert agency such as Infrastructure Australia to better understand the impacts on economies of scale, rather than recommending costly and time consuming market testing on a case-by-case basis.

DRAFT RECOMMENDATION	OUR STANCE	COMMENTS
<p>DRAFT RECOMMENDATION 11.9</p> <p><i>Government clients should invest more in understanding the site risks for infrastructure projects and update the information provided to tenderers during the request for tender stage in consultation with potential contractors. In order to achieve this, government clients should not rush to market.</i></p>	Support.	
<p>DRAFT RECOMMENDATION 12.1</p> <p><i>All Australian governments should adopt the Victorian building code guidelines (or ones with an essentially similar framework) for their own major infrastructure purchases. The Australian Government should require compliance with these guidelines as a precondition for any infrastructure funds it provides to State and Territory Governments.</i></p>	Support.	
<p>DRAFT RECOMMENDATION 12.2</p> <p><i>The Australian Government should increase the ceiling of penalties for unlawful industrial relations conduct in the construction industry.</i></p>	Support.	

DRAFT RECOMMENDATION	OUR STANCE	COMMENTS
<p>DRAFT RECOMMENDATION 8.2</p> <p><i>The Australian Government should fund the development and ongoing implementation of a detailed benchmarking framework for major infrastructure projects in Australia. This would substantially assist in the future planning and evaluation of projects, and is an essential factor in the much-cited pipeline of projects.</i></p> <p><i>The benchmarking should, at a minimum, include information on tender costs and other procurement outcomes, completion times and final out-turn costs and levels of remuneration and industrial disputation.</i></p> <p><i>The provision of data to support the benchmarking framework should be a requirement attaching to all Australian Government funding for major infrastructure projects. Mechanisms should also be developed to capture similar data from projects funded by other levels of government and consideration should be given to what information might be gathered from the private sector to enhance the quality of information provided by the benchmarking.</i></p> <p><i>This ongoing benchmarking must be seen to be independent of both government and industry influence and also be seen as technically robust and credible.</i></p>	Support.	
<p>DRAFT RECOMMENDATION 13.1</p> <p><i>The Australian Workforce and Productivity Agency should make and publish regular projections of labour demand from public infrastructure construction. Information collected and produced as part of the proposed benchmarking activities (draft recommendation 8.2) should support this activity, including data from all cost-benefit analyses undertaken for infrastructure projects that receive Commonwealth funding.</i></p> <p><i>The private sector and State and Territory Governments should be invited to participate in providing data pertaining to non-Commonwealth-funded projects.</i></p>	Support.	

DRAFT RECOMMENDATION	OUR STANCE	COMMENTS
<p>DRAFT RECOMMENDATION 13.2</p> <p><i>In a reformed partnership with key stakeholders, the administrators of training funds should review existing objectives, conditions and processes around funding allocation. The parties should agree on suitable guidelines that will be able to meet the current needs of industry, as well as their likely future needs in an environment where there is a more continuous flow of infrastructure investment.</i></p>	Support.	
<p>DRAFT RECOMMENDATION 14.1</p> <p><i>The current Review of the Australian Government Building and Construction OHS Accreditation Scheme should examine options such as 'recognition' and 'provisional accreditation', with a view to the implementation of measures to improve access to Commonwealth-funded projects for firms not presently operating in Australia.</i></p>	Support.	The Property Council supports an assessment of this avenue for encouraging competition, provided strict OHS standards are applied even-handedly.