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3 April 2014

Public Infrastructure Inquiry
Productivity Commission
Locked Bag 2, Collins Street East
Melbourne Vic 8003
By email infrastructure@pc.gov.au

Dear Sir/Madam,

Public Infrastructure: Provision, Funding, Financing and Costs

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the Productivity Commission's Inquiry into Public Infrastructure: Provision, Funding, Financing and Costs.

About ASFA

ASFA is a non-profit, non-politically aligned national organisation. We are the peak policy and research body for the superannuation sector. Our mandate is to develop and advocate policy in the best long-term interest of fund members. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90% of the 12 million Australians with superannuation.

General Comments

Our attached submission contains responses to the guiding questions and draft recommendations in specific topics. ASFA has only provided responses to those questions that materially impact on, or have application to, the superannuation sector – in particular, superannuation funds and their members.

I trust that the information contained in this submission is of value. If you have any queries or comments regarding the contents of our submission, please contact ASFA's Director Investments and Economy, Gordon Noble on 0411 109 998 or by email gnoble@superannuation.asn.au.

Yours Sincerely,

A handwritten signature in black ink that reads 'Pauline B Vamos'.

Pauline Vamos
Chief Executive Officer



Submission

Public Infrastructure: Provision, Funding, Financing and Costs

4 April 2014

Provision, funding and financing

DRAFT FINDING 5.1 SHORTAGE OF CAPITAL

There is no shortage of private sector capital that could potentially be deployed to finance public infrastructure in Australia. Private capital markets will finance most projects at the 'right price'.

ASFA notes the analysis by the Productivity Commission on investment in infrastructure by Australian and international pension funds. On average Australian superannuation funds are estimated to have invested around 5% of their total assets in infrastructure compared to less than 1 per cent in the rest of the world. It is estimated that Australian superannuation funds hold around \$63 billion in infrastructure. In addition funds hold investments in listed infrastructure companies and infrastructure debt through their fixed interest portfolios.

It is projected that superannuation capital will increase from \$1.8 trillion to \$6 trillion by 2037. The increase in superannuation capital alone suggests that there will be a significant pool of capital that may invest in infrastructure. The appetite for Australian superannuation funds to invest in infrastructure is supplemented by international investors that are increasingly seeking exposure to infrastructure. Infrastructure is becoming a growing international asset class for pension funds and insurers who are seeking to match long term liabilities with long term, low volatile, cash flow positive assets. According to the Prequin Investor Report 2014, the level of institutional investor capital secured by private infrastructure funds that closed in 2013 was USD 38 billion, an increase of 31% on funds that closed in 2012 and 58% on funds that closed in 2011. ASFA is supportive of global capital, in particular long term pension capital, investing in Australian infrastructure. With USD 21 trillion of capital in OECD pension fund systems alone this is a significant pool of capital that can be attracted to invest in Australian infrastructure if the right projects and taxation structures are available.

Submissions to the Productivity Commission have focused on the availability that some sectors of the superannuation industry have to invest in infrastructure. ASFA notes that infrastructure investment funds are commercially available, including equity and debt products. ASFA recognises that infrastructure is an asset class that is suited to large institutional investors who have the resources to conduct due diligence and the scale to make large scale investments. We expect that ASX's Managed Funds Service which is in the process of being rolled out, will enable direct investors to invest in professionally managed infrastructure investment funds at low cost. This will provide the ability to access SMSF capital if products are offered that meet their needs.

ASFA notes that while there is large pool of capital to invest in infrastructure, both domestically and internationally that there are challenges financing small scale infrastructure projects. Australia has overwhelmingly focused on development of large-scale infrastructure. Small-scale infrastructure has the capacity to deliver significant economic and social outcomes. However one of the impediments to developing small-scale infrastructure is due diligence and bidding costs. A different approach to developing small-scale infrastructure is required that addresses the challenges that investors have conducting due diligence on small projects.

Whilst ASFA concurs with the Productivity Commission's draft finding that there is no shortage of capital to finance public infrastructure in Australia, superannuation funds face challenges investing in infrastructure in the future. In particular liquidity has been identified as an issue, which is discussed in the Productivity Commission's draft report.

In the short to medium term ASFA does not believe that liquidity constraints will impinge on the ability of superannuation funds to invest in infrastructure at a scale that will meet supply. However it is important that there is an understanding of the way that liquidity may impact on superannuation investments in the future.

Superannuation Fund Liquidity Issues

ASFA notes the Productivity Commission’s analysis on superannuation fund liquidity issues, in particular that while investment in infrastructure assets can deliver an appropriate risk-weighted return for superannuation fund members, it is just one of many asset classes, and it cannot be assumed that investment in infrastructure assets will always be appropriate.

Whilst superannuation is subject to preservation rules, Australia’s system of choice of fund, which was introduced in 2005 means that superannuation fund members are able to make active investment choices and switch to alternative financial providers. This has implications on superannuation fund liquidity. The importance of managing liquidity risks within superannuation funds has been highlighted in recent years. Liquidity risks derive from a number of separate sources:

Currency hedging

Superannuation funds make active decisions about hedging of currency risks for international investments. This can be done at an investment level, or portfolio level, with most funds establishing currency hedging arrangements at a portfolio level. A movement in the Australian dollar can have both a positive or negative impact on investment returns. General experience is that superannuation funds hedge half of their international investments. In circumstances where the Australian dollar drops superannuation funds must utilise cash holdings to meet funding of derivative commitments.

Illiquid Assets

Superannuation funds invest in illiquid assets including direct property and infrastructure. Superannuation funds earn a ‘illiquidity premium’ that compensates investors for the lack of liquidity. The combination of the illiquidity premium and the nature of investments which have strong track record of positive returns and lower volatility are reasons why superannuation have appetite to invest in illiquid assets. Whilst secondary markets do exist for infrastructure assets it can be difficult in times of market stress to quickly sell an infrastructure asset.

Pension Commitments

Superannuation funds may make payments to retirees in a number of forms. For members with small account balances this may be in the form of withdrawal requests. Superannuation funds also offer pension products for members. Payments can be in the form of regular payments that are used by members to fund day to day living expenses. Superannuation funds need to ensure they have sufficient liquidity to meet these payments as and when they become due.

The advent of choice for superannuation members, combined with the ready access to online functionality by members raises the likelihood of a fund receiving significant requests for redemptions or switches over a short time period. In the GFC period, we observed, in some – not all a period where up to 50% of membership looked to switch from their current option to a lower risk option. For a fund with significant illiquid assets this presents two problems: firstly having the ready access to cash to pay out redeeming members; and secondly ensuring that remaining members are not disadvantaged by a “fire sale” of less liquid assets.

Regulation is also heightening the focus on liquidity risks. APRA have placed significant emphasis on liquidity risk management in the post-GFC environment. Prudential reviews have focused on the magnitude of less liquid securities and the effectiveness of the Fund's Liquidity Management Plan (LMP) as set out in the new Investment Governance requirements in SPS530.

An approach which may be considered to mitigate these issues is the use of repurchase arrangements or overdraft facilities. A number of our superannuation funds have put such arrangements in place, as part of their liquidity management plan. These arrangements are typically between the superannuation fund and a major bank. The contract is a commitment by the bank to provide cash either: a) by way of an overdraft type facility, or b) by way of a repurchase agreement where collateral is provided by the superannuation fund.

ASFA notes the Productivity Commission's comments that liquidity facilities may offer more risks than they address and that the issue of superannuation fund liquidity should be addressed.

ASFA believes that the issue of liquidity should be addressed from a superannuation system perspective. We do not favour measures that would enable liquidity relief for one particular asset class. Other asset classes including venture capital, private equity and direct property seek to have access to superannuation capital. Any measure which favoured infrastructure as an asset class over other asset classes is likely to have impacts on the ability of other asset classes to access capital.

ASFA recognises that there are moral hazard issues with providing superannuation funds with ability to access liquidity in excess of current prudential arrangements. It is important that superannuation funds have the ability to access liquidity in the future, particularly as more members move into the drawdown phase where pension payments are made. ASFA has made a submission on liquidity to the Financial System Inquiry and has been engaging with the FSI Secretariat on this issue. We believe that this issue is best handled by the FSI at a system level.

DRAFT FINDING 6.1 GOVERNMENT FINANCING

Where project selection decisions are consistent with recommendations made in this report, there is additional capacity for the Australian and State and Territory Governments to finance public infrastructure from their own balance sheets through the issue of sovereign debt and/or through tax.

From a whole of system perspective superannuation capital is available to invest not just in privatised assets and greenfield infrastructure but in sovereign bonds. Superannuation funds invest in sovereign bonds through their fixed interest portfolios. In addition life insurers invest significantly in Australian government bonds through insurance premiums that are generated through superannuation funds. Should governments with strong credit ratings offer sovereign debt to investors it is likely that there will be significant demand. It is a matter for governments to decide whether to seek private investment in infrastructure or finance activity themselves. A key focus for governments is naturally ensuring that credit ratings are maintained at levels that are attractive to institutional investors.

INFORMATION REQUEST 5.1: BOND FINANCE

The Commission seeks feedback on the availability of bond finance for public infrastructure projects in Australia.

- *To what extent are there impediments to the development of the Australian bond market to support investment in infrastructure?*

- *To what extent are there barriers to Australian infrastructure firms accessing international bond markets?*

One of the outcomes of the GFC was the collapse of the monoline insurance market. The role of monoline insurers in the infrastructure market was to insure bonds, guaranteeing that if a bond defaulted that the insurer would cover the principal and interest. The impact of the monoline insurance market was to create AAA debt that was attractive to institutional investors out of project bonds that carried more risk.

The Australian project bond market closed at the end of 2007, principally due to the Global Financial Crisis. According to Infrastructure Australia the bond market had provided approximately \$6.2 billion of long term wrapped project bonds from 2005 – 2007 and \$2.3 billion of long term unwrapped project bonds from 2000 – 2006.

Infrastructure Australia examined the impact of the closure of the monolines on infrastructure in an Infrastructure Debt Financing Paper issued in January 2013. According to Infrastructure Australia “since the closure of the project bond market, Public Private Partnerships have in the main been financed with short term bank loans at significantly higher margins – increasing refinancing risk and potentially reducing public sector value for money.”

Wesptac in its recent submission to the Productivity Commission Inquiry on infrastructure noted that all new greenfield projects since the Global Financial Crisis had been financed by banks. Whilst the resilience of Australia’s banks during the GFC was one of the major reasons why Australia’s economy avoided a deep recession, the capacity of the banking system to finance future infrastructure is likely to be constrained by Basel III. The impact of Basel III is to force banks around the world to hold more capital against loans. Banks are required to hold more capital against infrastructure financing than for other activity such as retail deposits.

The depth of the banking sector’s structuring and transaction expertise means that despite the implementation of Basle III, banks in Australia are still likely to have an appetite for infrastructure finance. Whilst banks continue to play a major role in infrastructure financing, according to PwC’s global report *‘Capital Markets: The Rise of Non-Bank Infrastructure Project Finance’* we are at the tipping point of the involvement of capital markets outside of North America financing infrastructure projects. “There is a clear opportunity for the private sector to provide infrastructure financing via project bonds and non-bank lending. Project bonds and non-bank lending could provide a flow of suitable highly rated assets direct to pension plans and life insurance companies.”

PwC argue that project finance markets are also becoming more sophisticated at dealing with construction risk, which has deterred some superannuation and pension funds from investing in infrastructure. They cite that a major reason for the slow uptake of infrastructure project bonds is a lack of clarity (amongst both governments and project sponsors) regarding the feasibility of bond finance relative to the “tried and tested” route involving one or more of bank debt, multilateral finance and capital contributions.

ASFA notes the Productivity Commission’s analysis on the Australian corporate bonds market in particular that total annual issuance has recovered to levels approaching pre-global financial crisis levels with issuance at the BBB credit rating level increasing as a proportion of total issuance from around 25 per cent in 2012 to around 45 per cent in 2013. In addition the Commission notes that a nascent unrated and sub-investment grade market has emerged.

ASFA believes that a number of factors will support the development of Australia's bond market over the long term:

- Superannuation capital is projected to grow from \$1.8 trillion to \$6 trillion by 2037. The growth of superannuation capital will support continuing investment in bonds.
- The transition for many superannuation fund members from accumulation to post retirement will support a shift in asset allocation from growth to defensive investments.
- Legislative reforms will make it easier for Self Managed Super Funds to invest directly in bonds through listed markets.
- The growing scale of superannuation funds is resulting in the development of in-house investment skills which will enable funds to execute directly in domestic markets.
- The low yield global environment is encouraging international investors to look further afield for investments with attractive yields. With the right settings there is the capacity to attract international investors to invest in Australian bonds.

Whilst the long term environment is supportive for infrastructure bonds ASFA recognises the short term challenges that Australia faces, in particular with the banking sector's new capital requirements impacting on the ability of banks to provide infrastructure debt for projects.

There has been discussion that superannuation funds can step in to fill the breach if the banking sector is unable to supply debt finance.

It is important that there is an understanding of the particular constraints superannuation funds face in this regard. One major issue is that a superannuation fund that invests in the equity of an infrastructure asset does not want to also hold debt in the same project. The reason for this is that in the event that the asset becomes distressed and moves into liquidation the interests of equity and debt investors are different. Superannuation funds would find themselves in a conflicted position where this was the case.

Superannuation funds are investing in both debt and equity of the same entity in some circumstances. In particular superannuation funds invest in the equity of banks as well as taking on bank debt. Where superannuation funds invest in debt and equity in the same entity it will be because there is a low expectation that the entity will fail and the super fund itself does not have the capacity to directly influence the outcome if there was to be a failure.

The conflict of investing in both debt and equity is able to be addressed through other participants in the superannuation industry. There is also a significant pool of pension capital globally that has an appetite to invest in bonds that can be attracted to Australia with the right policy settings.

Taxation

International experience is demonstrating that it is possible to stimulate capital markets through financial innovation. Credit enhancement is one way that governments can intervene to incentivize non-bank investment. Guarantees and risk sharing arrangements can also be used. ASFA notes the Productivity Commission's comments that government guarantees and tax concessions are not costless.

Superannuation funds are not looking for taxation incentives to invest in infrastructure. The issue for superannuation funds is not just the rate of return on an investment, but whether to invest or not. In this regard a major factor that influences superannuation investment is the stability of the regulatory environment. In a world where governments are likely to be fiscally constrained,

government support should be regarded as a scarce commodity. Government support can be used not just to make a project commercial by providing capital but to address investors' core issues around risk. As investors embrace higher yielding investment in a low yield environment the need for credit enhancement may change over time and should be constantly monitored.

INFORMATION REQUEST 6.1: PROJECT SPECIFIC INFRASTRUCTURE BONDS

The Commission seeks views on the costs and benefits of governments issuing project-specific infrastructure bonds, with the interest rates reflecting the risks of the project and which explicitly do not have a government guarantee.

Whilst the media has referred to the opportunity to create Aussie infrastructure bonds, the reality is that the market for project specific infrastructure bonds would not be structured for 'mum and dad' investors. Fund raising for large infrastructure projects is never likely to be achieved by going direct to the SMSF market. Project bonds are by their nature specific to the project. Even with credit enhancement investing in project bonds is likely to remain the realm of sophisticated investors that understand the implications of different term sheets. The development of a project finance market is also in the interest of the banking sector, which will be able to use its structuring and transaction expertise to establish projects, with the finance ultimately held by a different group of asset owners.

Where project specific infrastructure bonds are well structured with attractive yields it can be expected that superannuation funds will invest.

INFORMATION REQUEST 6.2: CONVERTING INFRASTRUCTURE BONDS

The Commission seeks views on the costs and benefits of governments issuing converting infrastructure bonds to finance greenfields infrastructure investments.

ASFA believes that there is likely to be future demand by long term investors to invest in greenfield infrastructure. There have been well publicised commercial toll road projects that have resulted in losses to superannuation funds. In the aftermath of the Global Financial Crisis there was also an aversion to investing in riskier projects. However ASFA believes that where projects are well structured, including greater transparency around governance and patronage risks that superannuation funds will be prepared to invest.

Superannuation funds have a variety of different objectives from their infrastructure investments. There are some superannuation funds that will actively seek construction risk on the basis that taking on risk is one way of delivering investment returns. Superannuation funds have recently invested in greenfield infrastructure projects where off-take agreements for instance in the energy sector have been part of the project parameters.

ASFA believes that whilst converting bonds are one option that can be considered as part of the overall financing mix that the primary focus must be on establishing well structured, viable projects in the first place. In this respect ASFA is supportive of the Productivity Commission's recommendations on governance.

INFORMATION REQUEST 6.3: INVERTED BID MODEL

The Commission seeks feedback on the advantages and disadvantages of alternative procurement processes focused on long-term equity, such as an 'inverted bid' model. In particular, the Commission is interested in how an alternative procurement process should be designed to maximise efficiency gains and the likely benefits and costs of such an approach.

ASFA notes the comments by the Productivity Commission on the 'inverted bid' model. ASFA is not specifically recommending this model but we note that the sentiment behind it is based on recognising that superannuation funds as long term investors should have more influence in PPPs.

One of ASFA's criticisms of PPP processes is that superannuation funds face a challenge in putting up speculative capital to finance the bidding costs of a PPP. One of the implications of this is that PPPs have in the past been dominated by commercial providers with short term incentives.

A significant reason why superannuation funds, and their investment managers, find it difficult to participate in tender processes is that, unlike banks and constructors, investment managers are unable to defray bidding costs across their other investments. The more expensive, and time consuming, a bidding process is, the less likelihood that superannuation funds, and their investment managers, will be able to directly participate. Where a super fund incurs costs in a bidding process, and the bid is unsuccessful, those costs must be recouped from other investment capital.

A consistent view that has been expressed to ASFA is that consortium interests, being short term focused; do not necessarily coincide with the interests of superannuation funds. Superannuation funds are long term investors in infrastructure with 25-40 year times frames. The current PPP framework has encouraged a transactional approach to infrastructure investment that is focused on short term interests. Recent taxation discounts on infrastructure projects have in fact primarily provided benefits to constructors.

As superannuation funds increase in scale there will be increased capacity for funds to directly participate in consortia. ASFA supports reforms to PPP processes that address long term investor needs.

Institutional and Governance Arrangements

DRAFT FINDING 7.1: DEFICIENCY OF INSTITUTIONAL AND GOVERNANCE ARRANGEMENTS

Institutional and governance arrangements for the provision and delivery of much of Australia's public infrastructure are deficient and are a major contributor to poor outcomes.

ASFA notes the Productivity Commission's analysis that poorly chosen infrastructure projects can reduce productivity and financially burden communities for decades with infrastructure that is at once expensive to maintain and unnecessary.

To deliver sustainable investment returns infrastructure needs the support of community and bi-partisan political support. The danger of selecting projects according to short term political criteria is that there is no guarantee that projects will increase productivity in the long term. Infrastructure projects that are not economic have a real cost in that the funds that superannuation funds have allocated to a project could have been allocated to alternative investments. This is not just about the opportunity cost of investing in other infrastructure projects. Superannuation funds invest in a

diversified range of assets including capitalising Australian companies that may offer alternative economic benefits.

There is significant global interest in the role that infrastructure investment can play supporting economic growth. There is no doubt that infrastructure can play an important role in driving long term economic growth. However there is danger where infrastructure comes to be seen as a tool to stimulate short term economic growth.

SMART Infrastructure Facility at the University of Wollongong have recently released a Green Paper 'Infrastructure Imperatives for Australia' that states *"an institutional mind shift is required where infrastructure should not be just a counter cyclical economic policy past time. The infrastructure industry does not function well as a 'short-order' cook. It would be beneficial to the nation to expand the supply capacity of the infrastructure industry and for governments to engage it in a more consistent manner with a 10 to 15 year project pipeline."*

Superannuation funds are long term holders of infrastructure assets and will be owners of assets long after short term economic stimulus has passed through the economy. In order for there to be long term community support for private investment in infrastructure assets it is important that the customers that are served by the infrastructure asset are happy. The experience of the superannuation sector is that the terms of the original investment will significantly impact the success of the investment in the long term. Examples of toll roads in Australia where investors paid upfront fees to governments have not ended up happily for investors. Inefficiency in bidding process that has led to a bias for projects that projected traffic that proved to be well in excess of reality undermined the confidence of superannuation fund investors.

ASFA also understands that if assets are sold too cheaply then this can lead to community resentment. This in turn creates electorate support for regulatory changes that would have the impact of winding back windfall gains. For superannuation funds who are long term investors it is important that the sale, or development of infrastructure assets strikes a balance between value for the community and value to investors.

ASFA concurs with SMART's Green Paper comment on the role of the private sector financing infrastructure:

"The reality is that while infrastructure can be partnered with the private sector, when there is a failure or breakdown the community will almost always turn, as a last resort, to the government to fix it. Hence the partnership between the government and the private sector must be robust and directed at maintaining strong community confidence. The increasing reliance on private investors to fund public infrastructure places an even greater imperative on governments to have the ability to interact, negotiate and secure outcomes in the best interest of the community. This requires strong institutional architecture, including anti-corruption agencies. Governments need to be open and transparent about the relationship with private sector participants and the value such participants provide to overall infrastructure development."

There are number of possible options that could be explored:

The establishment of an independent body that could oversight bids, establish standardised conditions and seek to remove error risk on forecasts out of bidding processes, which it is argued leads to an adverse selection process where the consortium with highest traffic projection (in regards to a toll road) is prepared to make the highest bid.

PPPs should be designed to address the potential for additional long term investments in an asset. As an example this could be in the form of establishing corridors in respect to future rail or road expansion or room for extra classrooms or hospital wings in the case of social infrastructure. It is very difficult and prohibitively expensive to try to retrofit investments in the future and this detracts from the long term social and economic benefits that the infrastructure asset can deliver.

Sustainability considerations should be factored into the PPP frameworks. As long term investors, superannuation funds aim to integrate environmental, social and governance factors into their investment processes. There are a number of ways in which sustainability can be factored into infrastructure. In particular ASFA notes the work being done by the Australian Green Infrastructure Council to develop a series of green rating tools, in a similar way to the way that green star ratings have been developed for the built environment.

Capital Recycling Model

ASFA notes the Productivity Commission's analysis that the capital recycling model could replace the need to undertake cost-benefit analysis, in particular where the proceeds of an asset sale are automatically hypothecated to investment in new infrastructure projects. Further that the availability of funds may mute incentives to examine user charges.

ASFA supports the 'recycling of capital model' but recognises that this is an issue ultimately for government. In discussions with Federal and State Ministers the superannuation industry has consistently advised that superannuation providers are willing investors in infrastructure, on the right terms and the right price. The recycling of capital model should principally be seen as a mechanism for governments to communicate to their electorate that proceeds of asset sales will be used in ways that will provide the community with new infrastructure. We do not believe that the recycling of capital model is inconsistent with a commitment to investigating user pays, transparency around project selection and cost-benefit analysis of projects.

DRAFT RECOMMENDATION 2.1: PRIVATIZATION

There is no continuing case for retention of certain infrastructure in public hands. Accordingly, State and Territory Governments should privatize their government-owned:

- *electricity generation, network and retail businesses*
- *major ports*

ASFA is supportive of governments privatising assets. Superannuation and pension providers are the natural holders of mature assets including ports and energy assets.

ASFA understands that privatisation can lead to community concern about how assets will be managed in the future. Australian superannuation funds have a long track record of investing in infrastructure. As long-term investors, superannuation funds are interested in achieving long-term sustainable investment returns. Our interests align with those of the community and governments that are interested in ensuring that assets are managed responsibly for the long-term benefit of society.

Whilst ASFA is supportive of governments privatising assets we believe that it is critical that there is public support for privatisation of specific assets. There are some assets, in particular water, where there is a high degree of public sensitivity around transfer of the asset to private investors. It is not in the interests of superannuation funds, who often compete to attract members, to buy assets where

there is a strong degree of public resentment at the privatisation. Superannuation funds in effect represent the Australian community and on this basis the transfer of an asset to superannuation funds can be viewed as the community having a stake in the investment.

ASFA understands that many privatised assets will be subject to regulation. From the perspective of the superannuation sector the best infrastructure investments are those where there is long term community acceptance of private ownership. This reduces political pressure for regulatory changes to pricing structures which can have significant impacts on the value of an asset.

ASFA believes that all stakeholders including investors, constructors, banks and governments have a role to play in communicating the benefits of privatisation of assets to the community.

INFORMATION REQUEST 2.1: PROSPECTIVE PRIVATISED ASSETS

The Commission seeks views on other prospective infrastructure assets that the Commonwealth, States and Territories should consider for privatization.

ASFA is not proposing that particular assets are privatized. We note that there is existing market demand for mature, cash flow businesses.

ASFA believes that governments need to establish community support for privatization. Prior to sales of particular assets being announced governments should clearly signal their intention that privatization is being considered and provide the community with the opportunity to raise issues of concern around the future management of the asset.

DRAFT RECOMMENDATION 7.1: GOOD GOVERNANCE ARRANGEMENTS

Institutional arrangements for the provision and delivery of public infrastructure should incorporate good governance arrangements, including:

- *the principal objective of ensuring that decisions are undertaken in the public interest*
- *clear and transparent public infrastructure service standards*
- *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)*
- *efficient allocation and monitoring of project risks between government and the private sector*
- *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*
- *sufficiently skilled employees who are responsible and accountable for performing their functions*
- *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)*
- *principles and processes for selecting efficient financing mechanisms and transparency of financing arrangements*
- *performance reporting and independent evaluation of public infrastructure project performance*

ASFA is supportive of the draft recommendations. Strong governance will support public confidence in infrastructure which is important to investors to establish a stable investment environment. Rigorous cost-benefit analysis is required to ensure that projects that are selected for prioritisation have the capability to deliver long term economic benefits which in turn will support the ability of projects to deliver commercial outcomes over the long term.

ASFA would note that there is the potential that the cost of conducting cost-benefit analysis could result in a bias that larger projects are prioritised ahead of smaller projects. Smaller infrastructure projects have the capacity to deliver significant economic value. When implementing these recommendations governments should ensure that measures are put in place to ensure that smaller projects are not deterred as a result.

User Charges and Betterment Levies

ASFA notes the Productivity Commission's comments that efficient user charges are an effective means to reveal willingness to pay for new infrastructure and to improve the use of existing infrastructure. User charges are already the norm for most types of economic infrastructure, such as electricity, telecommunications, gas and water.

ASFA is supportive of broadening the funding base of projects. A factor that should be considered in establishing policy around user charges and betterment levies is the transition that the Australian economy is undergoing due to demographics. Australia has an aging population. This has been identified through the Government's Intergenerational Reports. Over the next fifteen years the retirement of baby boomers from the workforce will result in a structural change in the proportion of workers that support each retiree. Currently around five workers support each retiree. In coming decades 2.7 workers will support two retirees.

The implication of the changing structure of society will mean that there are limits on the financial burden that workers will be able to bear. This is particularly important in relation to toll roads. Many workers do not have control over their working hours. This has impacts where it is proposed that congestion charges be introduced to reduce congestion at peak times.

ASFA supports user pays principles and believes that user charges are an important way of funding infrastructure. If accompanied by betterment charges the burden on working Australians is partly reduced.

A key focus for ASFA is creating a stable long term investment environment for infrastructure. A key element to achieving stability is support from the customers of an infrastructure asset. If customers feel that others are receiving a free ride through uplift in property values that they do not share in, then resentment can lead to political pressure for regulatory pricing changes. Our experience suggests that governments have in the past been prepared to put elector interests ahead of the interest of investors. Betterment charges are one way of ensuring the burden of cost is shared amongst the beneficiaries of a project.

Infrastructure Bank

ASFA notes the Productivity Commission analysis of the arguments around establishing an Infrastructure Bank.

ASFA does not believe that an Infrastructure Bank would result in an increase in the investment by superannuation funds in infrastructure. Superannuation funds that invest in infrastructure, either directly or through investment managers at the moment seek to build a portfolio of assets that

meets their particular risk/return objectives. Overtime superannuation funds will rebalance their portfolio by buying more of a particular kind of asset and selling other assets where valuations may be attractive.

Diversified infrastructure investors would have little attraction investing in an Infrastructure Bank, particularly since the investors would have no control of the portfolio of assets within the portfolio. For an Infrastructure Bank to meet the needs of investors it would need to be completely independent of government and have the ability to reject investments. It would need to only invest in assets where the market was failing to invest. There may be arguments for an Infrastructure Bank in respect to small scale infrastructure where investors struggle to invest because due diligence costs are prohibitive.

ASFA concurs with the Productivity Commission that an Infrastructure Bank would be under pressure to fund projects that would otherwise not pass a cost-benefit assessment.

INFORMATION REQUEST 7.1: PIPELINE

ASFA notes that Productivity Commission's current inclination is that the package of measures it is proposing would be sufficient to constitute a 'pipeline' that would assist purchasers and tenderers in forward planning and to minimise costs.

ASFA notes that the Commission does not see merit at this stage in the Australian Government publishing a list of projects into the future as publishing such a list would not address the fundamental impediments to achieving the efficient provision of public infrastructure in Australia.

ASFA's perspective is that it is important that governments have a consistent attitude to the role of investors in projects. ASFA has not been seeking a project list but an indication of whether governments will seek private investment in projects.

To use the 'pipeline' analogy one of the challenges has been that governments have turned 'on and off' the investment tap according to the position of budgets. When government was receiving strong revenues from the commodities boom it was notable that the investment pipeline was turned off. Superannuation funds continued to invest in infrastructure but started to seek investments internationally.

ASFA acknowledges that there is a need for flexibility in the actual list of projects that are brought forward for construction. A consistent approach to seeking private investment will provide superannuation funds with greater visibility over potential investments that may be available. An investment pipeline is important for a number of reasons:

- A pipeline of projects will provide superannuation funds with a clear pathway of projects that will be coming on line. Infrastructure investments are lumpy and in order to 'digest' them into a portfolio a superannuation fund needs to be able to plan future investments
- A pipeline of investment projects will enable superannuation funds, and other institutional investors to build bidding teams. Where projects are sporadic institutional investors cannot justify keeping bidding teams together. A pipeline of projects therefore results in competitive tension which would otherwise not necessarily be there.
- A pipeline of projects addresses the tendency for governments to seek infrastructure projects that have short term political appeal. This may relate to delivering benefits to a segment of the electorate, or may focus on projects that offer short term economic stimulus.

DRAFT FINDING 7.2: POLITICAL EXPEDIENCY

For the proposed reforms to institutional and governance arrangements (draft recommendation 7.1) to have their intended effect, governments at all levels must commit to and support them, even when that leads to project selection decisions that are not politically expedient. The proof of that commitment lies in rejecting projects that have obvious appeal yet fail a transparent cost–benefit test and in choosing projects which may not be as popular but offer long-term net benefits to the community.

Politically expedient infrastructure decisions ultimately create an environment that is not supportive to long term investment. Governments should consider the impact of decisions on the overall investment environment. This is not just important in relation to the establishment of projects but the regulatory environment around existing projects. A case in point is the decision of the Spanish Government to change renewable energy feeding tariffs after investments had been made. The change to the regulatory environment which was politically expedient at the time has an impact on the assessment that future investors make concerning investing in Spanish infrastructure in the future.

We refer to our comments earlier in this submission that there is an opportunity cost of political expedient infrastructure decisions that do not increase productivity which is the alternative investments that superannuation funds could have made that can have significant economic and social benefits.

Better Data Collection

DRAFT RECOMMENDATION 8.2: BENCHMARKING

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.

ASFA supports this draft recommendation.

ASFA notes the Productivity Commission’s comments that data problems beset the detailed analysis of the costs and productivity of public infrastructure construction. A coordinated and coherent data collection process can address this and improve future project selection decisions.

Benchmarking data will assist infrastructure investors to analyse risk and should, all things being equal, result in investors making better informed investment decisions that lead to improved investment performance that will ultimately benefit superannuation fund members. Benchmarking data will support consistency across projects which can lead to efficiency and will also support community confidence in infrastructure which is important to establish a stable investment environment.