PROPERTY COUNCIL of Australia

PROSPERITY | JOBS | STRONG COMMUNITIES

Submission on the Delivering an Infrastructure Plan for Queensland Directions Paper

1 July 2015

Contents

1. Executive Summary

The Property Council would like to thank the Government for the opportunity to provide feedback on the *Delivering an Infrastructure Plan for Queensland Directions Paper* (Directions Paper).

The Property Council has long advocated for the introduction of a transparent and accountable system for assessing, prioritising and delivering critical infrastructure in Queensland.

The *State Infrastructure Plan* (SIP) foreshadowed in the Directions Paper will be an important step in identifying the infrastructure our state needs in order to cater for its growing population and attract new residents to Queensland.

Combined with the introduction of *Building Queensland,* these initiatives will enable the property industry in Queensland to invest with greater certainty regarding the future delivery of infrastructure.

With limitations on the public funds available to finance the infrastructure we need, *Building Queensland* must take the lead in changing in the way we prioritise and invest in infrastructure in Queensland.

This includes the examination of new funding models, such as 'UK City Deals', whereby there is a greater focus on the economic growth and jobs that infrastructure unlocks, rather than traditional measures of cost and benefit, such as upfront cost to Government or alleviation of traffic congestion.

Aside from the public sector-led initiatives outlined by *Building Queensland* and in the SIP, there is increasingly a need to work with the private sector to reduce barriers to the delivery of infrastructure and leverage available funds to deliver the best outcome for Queensland.

As the property industry is responsible for the delivery of much of the 'hard' and 'soft' infrastructure in new and expanding communities, it will be important to engage with them in the development of the SIP and potential funding models, as well as inviting stakeholders to present ideas for how existing Government assets could be better utilised.

To ensure Queensland receives the right infrastructure in the right place, for the right cost, the Property Council provides the following submission and key recommendations for the Government's consideration.

2. Summary of recommendations

1. Link land use planning with infrastructure planning.
2. Draw on the model of Local Government Infrastructure Plans to inform the development of the State Infrastructure Plan.
3. Prioritise catalytic infrastructure.
4. Implement a process for involving all government agencies in the development of the State Infrastructure Plan.
5. Monitor and report on return on investment from infrastructure.
6. Develop a transparent framework for unsolicited proposals.
7. Ensure effectiveness, equity and efficiency in alternative funding models.
8. Instigate a pilot project for 'UK City Deals' in South East Queensland.
9. Reduce reliance on infrastructure charges (developer levies) in funding infrastructure.

3. Property industry's contribution to the Queensland economy

The property industry in Queensland creates the homes we live in, the offices in which we work, and the shopping centres and recreational areas where we spend our leisure time.

It has a larger footprint on the Queensland economy than any other industry[1].

3.1 Contribution to Gross State Product (GSP)

The property industry directly contributed $33.8 billion to GSP in Queensland in 2013-14, representing 11.4 per cent of total GSP.

It is estimated to have contributed a further $49.9 billion to Queensland GSP through flow-on demand for goods and services.

3.2 Contribution to employment

The property industry directly employed 239,772 full time equivalent (FTE) employees in Queensland in 2013-14, representing 12.1 per cent of the state's workforce.

The industry also supported some 292,684 additional FTE jobs through flow-on activity.

Approximately 27.4 per cent of wages and salaries paid to Australian workers are generated by the property industry.

3.3 Contribution to government revenues

The property sector in Queensland contributed approximately $9.9 billion in combined State Government tax revenues and local government rates, fees and charges revenue in 2013-14. This equates to 49.8 per cent of total State taxes and local government rates, fees and charges revenues in 2013-14.

[1] All the statistics in this section are sourced from AEC group, 2015

4. Planning Queensland's infrastructure

Importance of infrastructure

Queensland has been without an infrastructure plan for three years. Prior to this period, several iterations of state and regional infrastructure plans existed, however the majority of projects were unfunded, and there was a high degree of uncertainty regarding the prioritisation process.

In order to move Queensland forward, it is important that our state has an infrastructure plan that business and the community can rely on to make investment and purchasing decisions.

Along with addressing deficiencies in the current system, it must also unlock and enable new growth, in order to provide economic growth and prosperity for all Queenslanders.

4.1 Link to land use planning

For the *State Infrastructure Plan* (SIP) to be successful, it is critical that it is linked to land use plans through the regional planning process.

Regional plans provide the community with an understanding of where new development and redevelopment will occur, and are intended to resolve many of the conflicting State Interests on a regional scale.

The *South East Queensland Regional Plan* (SEQRP) has been successful in consolidating development and providing a vision for the region, however one of its major downfalls has been the lack of certainty regarding infrastructure.

For the property industry to deliver new communities, there must be clarity regarding the future provision of infrastructure in the region.

In existing growth areas, the majority of community angst regarding development relates to congestion and additional traffic impacts. Much of this angst can be alleviated through a clearly articulated plan for the upgrading of existing infrastructure, or provision of new infrastructure.

Outside of existing high growth areas, linking land use plans with infrastructure can facilitate new development and provide the industry with direction as to where new development will be encouraged.

The SIP will, however, need to look beyond the 'big ticket' items that are traditionally seen in infrastructure plans, to less obvious infrastructure needs such as sewerage lines and treatment plants.

While roads and rail are front of mind for many and are often noted on land use plans, it will ultimately be the planning and provision of the less visible infrastructure networks that will facilitate new development and economic growth for Queensland.

The Property Council recently undertook a study tour to Melbourne to better understand how the Metropolitan Planning Authority (MPA) has successfully married land use and infrastructure planning to deliver greater land supply and lower land costs than in Queensland.

The MPA has established a clearly articulated growth boundary, and within it, a number of discrete precincts. Each one of these precincts has its own structure plan developed within two years of its declaration as a growth area.

These structure plans identify all of the trunk infrastructure needs for the area, along with estimated costings and a plan for funding and delivery.

Through directly linking the infrastructure needs of the precincts with the land use intention, the property industry in Victoria is able to invest in growth areas with the certainty that the mooted infrastructure will be delivered.

With the SEQRP under review at the same time as the SIP is being developed, there is a great opportunity for the Government to link land use planning with a plan for identifying, prioritising, funding and delivering infrastructure in the region.

4.2 Local Government Infrastructure Plans

As part of the revised Queensland infrastructure charges framework introduced in July 2014, local governments in Queensland are required to develop Local Government Infrastructure Plans (LGIPs) by July 2016 (noting this deadline is mooted to change).

These LGIPs will provide all stakeholders with a detailed understanding of the infrastructure required in each local government area, along with an estimated cost and delivery timeframe.

Through the establishment of LGIPs, all stakeholders will be provided with a high degree of certainty regarding what will be delivered when and at what cost, as well as the opportunities for bringing timeframes forward.

LGIPs will require local governments to have a solid understanding of their own budgetary processes and revenue sources in order to provide the certainty necessary to give the LGIPs effect.

The State Government is not required to deliver a similar plan, and it is unclear what the relationship will be between the LGIPs and the SIP.

As LGIPs are currently being developed, the State Government will not have a clear understanding of the infrastructure mooted to be provided by local governments when developing the SIP.

The Property Council notes there is an opportunity for the State Government to draw from the LGIP model when developing the SIP, as its transparency provides an unprecedented level of certainty for all stakeholders.

4.3 Focus on catalytic infrastructure

In developing the SIP, the Property Council encourages the Government to look beyond traditional methods of prioritising infrastructure, and instead focus on the catalytic infrastructure that will unlock growth and create jobs for Queenslanders.

As noted above, infrastructure has traditionally focussed on roads and rail in order to appease community angst regarding development.

Instead, infrastructure must be prioritised based on its potential to deliver benefits- economic and social- to the state.

The Property Council has undertaken a considerable amount of research over the past five years on different models of funding and prioritising infrastructure, in order to leverage available funds and provide greater returns for stakeholders.

Research undertaken for the Property Council by Urbis in 2014 demonstrated that within 7 years, a 900 lot residential subdivision will not only provide housing for 900 families, it will create over 500 construction jobs, contribute over $120 million to gross regional product, and provide over $28 million in additional taxes to State and local governments.

Prioritising catalytic infrastructure- such as the S1 sewer line in Brisbane- will unlock growth, create jobs and provide an ongoing source of revenue for the State and local governments.

Another piece of research undertaken by KPMG on behalf of the Property Council (explored more fully in 5.3.1 and attached at Appendix 1), further examines how the 'UK City Deals' model of prioritising infrastructure could be utilised in Queensland, starting with a pilot project in South East Queensland.

This delivery model recognises the importance of prioritising infrastructure based on its economic and/or social returns, rather than on politically-influenced decision making.

The Government's Priority Development Infrastructure Co-Investment Program established in July 2014 as part of Queensland's revised infrastructure charging framework was the first step towards prioritising infrastructure based on its potential to unlock growth, and will provide ongoing returns to the Government.

While this Program is still in its infancy and the overall extent of the benefits returned to Government are unclear, it has enabled the delivery of major projects such as the Beaudesert Town Centre Bypass, which will in turn be the catalyst for the development of the Bromelton Industrial Estate.

The NSW Government has established a similar program, the Housing Acceleration Fund, which provides funding for infrastructure projects such as water, road or electricity projects, which accelerate the development of infrastructure that will enable new housing and industrial development to occur.

This fund was recently topped up with an additional $400 million in the NSW Budget, funded through the increase in stamp duty revenue received by the Government over the previous year, predominantly paid through residential property transactions.

Through prioritising those projects that unlock growth and thereby create jobs and economic prosperity, the Government also stands to receive ongoing returns through the increase in development activity and its associated tax revenue.

4.4 Social infrastructure in private sector developments

It is unclear from the Directions Paper how the Government seeks to address the planning and delivery of social infrastructure in Queensland. While the Paper highlights health, education, art & cultural and recreational infrastructure as being part of the pipeline of projects in the SIP, the reality of how this infrastructure will holistically be planned is uncertain.

At present, there is little consistency between Government agencies and departments when it comes to planning for the infrastructure that each requires, particularly in major greenfield developments.

In many instances, private developers are required to negotiate with each agency on the social infrastructure requirements of the development. This can often come at a time when decisions have already been made by other Government departments about desired land uses, and approval given to proceed with the development.

The current lack of certainty and absence of a formal process for determination of social infrastructure requirements threatens to undermine the feasibility for projects going forward.

As noted earlier, when identifying new growth areas, the MPA in Victoria undertakes a comprehensive structure planning process for each precinct.

As part of the structure planning process, the MPA is required to consult with each Government department and agency to determine their predicted needs and expectations regarding funding and delivery.

This extends beyond hard infrastructure to include schools, health, recreation and other social infrastructure requirements.

A similar process in Queensland, whereby the Department of Infrastructure, Local Government and Planning is tasked with working side-by-side with each agency to identify social infrastructure requirements, would allow the SIP to include an accurate reflection of an area's future needs and provide greater certainty for the development industry.

4.5 Reporting and measurement of outcomes

There is little accountability in Queensland regarding the benefits of public sector expenditure on infrastructure. Many projects have been prioritised based on their political value, rather than quantifiable social and economic returns for the state.

The introduction of *Building Queensland* will provide a new level of oversight at the front end of the prioritisation process, however there is no mechanism to determine which infrastructure projects have delivered returns for Queensland.

The Property Council encourages the Government to consider the introduction of an accountability mechanism, whereby large scale infrastructure is monitored to determine the overall benefit from the Government's investment.

Accurate representation of the return on investment of infrastructure projects will assist in future prioritisation, and provide quantifiable outcomes to reinforce benefits of the Government's decision making process.

5. Funding Queensland's infrastructure

Leveraging available funds to deliver the greatest benefit

There has been much discussion about the limitations in public funding, and the need, therefore, to leverage available funding to get the greatest return on investment.

With the property industry already contributing 49.8 per cent of total State taxes and local government rates, fees and charges revenues in 2013-14, the Government must now look at new avenues of funding infrastructure in Queensland.

Numerous funding models exist both in Australia and overseas that have the potential to operate successfully in Queensland.

Any traditional or alternative model of funding, however, must move beyond the current view of infrastructure as a 'cost' to the recognise its value as an 'investment'.

5.1 Unsolicited proposals

Governments are increasingly recognising the value of the assets they own, and actively seeking to achieve their highest and best use through partnerships with the private sector.

However, the Government does not always have the answer on what the highest and best use for an asset may be, so it is important that proponents are able to approach the Government with proposals that will assist in the delivery of the Government's key policy objectives.

In 2012 (and revised in 2014), the NSW Government developed a *Guide for Submission and Assessment of Unsolicited Proposals* (Appendix 2) that outlines a transparent and streamlined approach to the public and private sectors working together to develop and deliver innovative ideas.

Through establishing this Guide, the Government has provided private sector proponents with the confidence and certainty they require to bring proposals forward.

Its clearly articulated framework also provides the Government with the transparency necessary to consider proposals, and ensures they meet broader strategic Government objectives.

The Queensland Government has stated its willingness to work with the private sector, however as there are no clear guidelines regarding the consideration and assessment of unsolicited proposals, proponents are unable- or reluctant- to bring forth proposals.

The Property Council encourages the Government to develop a transparent framework for unsolicited proposals, in order to allow the private sector to bring forth proposals that will deliver social and economic benefits for the community.

5.2 Existing research on alternative funding models

As previously noted, the Property Council has undertaken significant research into infrastructure funding models that could be utilised in Queensland.

In the wake of the Global Financial Crisis, the Property Council commissioned the AEC Group to undertake research into alternatives to traditional financing methods. (The full report *Financing Public Infrastructure in Queensland*, can be found at Appendix 3).

The research provides an overview of existing funding models, including:

- General taxation
- Government borrowing
- User charges
- Developer contributions, and
- Public Private Partnerships.

It also provides an analysis of alternative infrastructure financing methods, including:

- Specific purpose securitised borrowing- issuance of debt instruments, such as bonds;
- Certificates of participation- where governments enter into agreements with not-for-profit entities that issue bonds to finance facilities, which are then leased back by the government;
- Value capture levy- aims to capture the uplift in land value that results from planning, development on infrastructure;
- Specific purpose levies- implementation of an ad hoc levy to meet specific infrastructure needs of an area;
- Growth area bonds- issue of bonds to finance infrastructure tied to a specific area and repaid through tax revenues collected in a defined area; and
- Business improvement districts- stakeholders within a defined boundary make a collective contribution towards the maintenance and promotion of an area.

Each of the alternative methods examined in the report has been analysed to determine its relevant strengths and weaknesses, particularly in terms of effectiveness and efficiency as a financing method for a range of infrastructure projects.

As the benefits of each alternative model are determined through meeting the objectives of individual projects, there is no one clear alternative funding model that will suit all Government infrastructure projects.

There are, however, a number of models- such as specific purpose levies and value capture levies- which add additional taxes on individual property owners and do not meet the basic principles of effectiveness and efficiency.

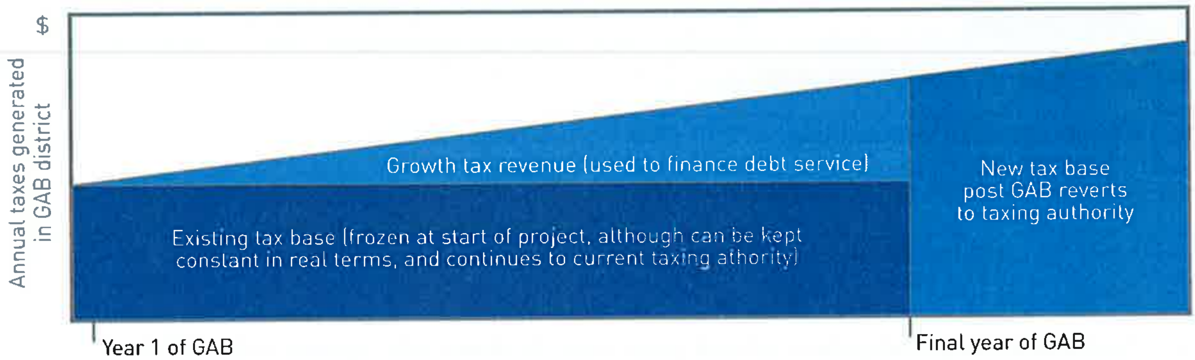
Others, such as Growth Area Bonds (otherwise known as Tax Increment Financing, or TIF), are widely used internationally to fund investment in renewal and expansion areas.

As per the diagram below, the Growth Area Bond model is delivered through the Government issuing public bonds to the estimated value of the infrastructure needed for the area (both hard and community infrastructure).

As the area expands with housing, public and commercial development, the additional tax revenue flows to Government, and repays the bond and the declared interest amount.

After the bond has been repaid to investors, the remaining revenues are kept by the Government, and can be reinvested in future infrastructure projects.

Figure 1: The Basic GAB Model



The Property Council encourages the Government to continue to look at a range of alternative funding methods, as well as inviting proposals from the public on new and better ways to finance infrastructure in Queensland.

5.3 UK City Deals

As noted in 4.3, in 2013, the Property Council commissioned KPMG to undertake research into the 'UK City Deals' model of infrastructure funding, to determine whether a variation of this alternative method of prioritising and funding infrastructure could be used in South East Queensland (SEQ)

Introducing UK City Deals- A smart approach to supercharging economic growth and productivity (Appendix 1), provides an overview of how the model operates successfully in the UK, and how it could be applied to the Australian context.

The success of City Deals is premised on the ability of catalytic infrastructure to unlock economic growth. This is achieved through reassessing how infrastructure is prioritised, and investing in those projects that will provide the greatest return in terms of jobs growth and productivity.

Fundamentally, the City Deals approach involves governments and the private sector working together to share in the costs and resultant benefits of delivering new infrastructure.

It acknowledges that often while local governments or the private sector pay the upfront cost of infrastructure delivery, the returns on this investment are delivered to another level of government through an uplift in various forms of taxation revenue.

City Deals allow partners in investment to 'earn back' some of this increased taxation revenue, which is delivered by the faster economic development that the delivery of infrastructure has enabled.

City Deals help deliver economic, social and sustainability goals, and promote political leadership to boost economic productivity.

Utilising the existing Council of Mayors structure in SEQ, there is an opportunity for the Queensland Government to undertake a pilot SEQ City Deals project, to determine how this innovative and successful overseas model can be utilised to deliver infrastructure in Queensland.

5.4 Infrastructure charges

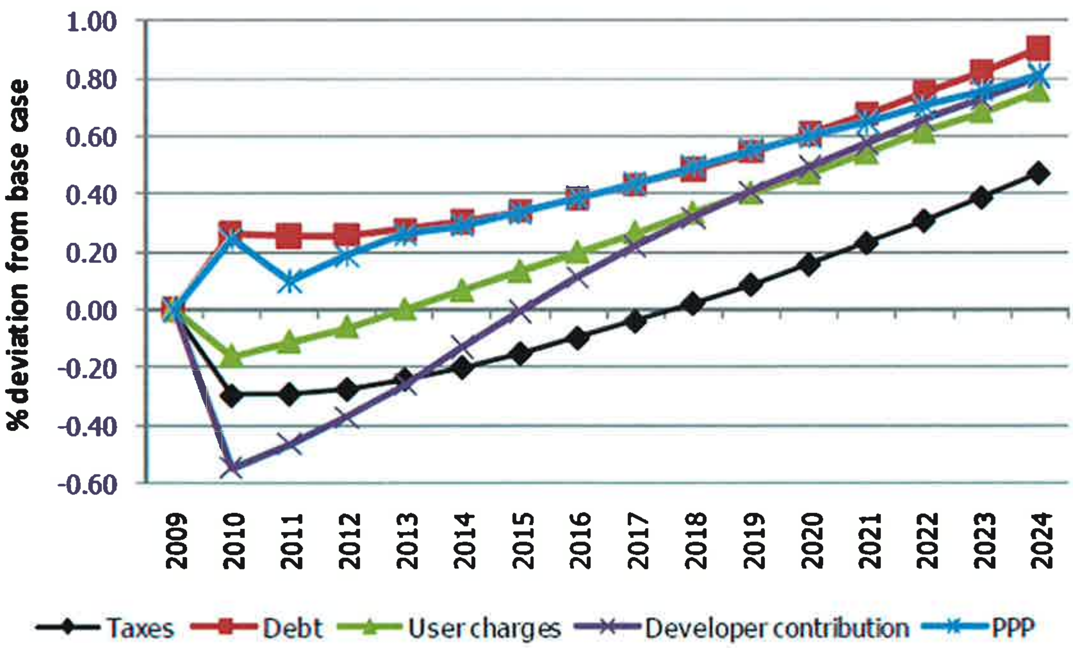
Much of the new and upgraded infrastructure in Queensland is delivered directly by the property industry, or funded through local government infrastructure charges.

As noted in the *Financing Public Infrastructure in Queensland Report* (Appendix 3), while infrastructure charges (or developer contributions) are effective in funding public infrastructure, they are inefficient and very inequitable. They are also subject to high compliance and administration costs.

The table below demonstrates that the implementation of developer charges as a tax on construction has the effect of reducing employment for the first five years.

It has a significantly worse impact on employment than the other traditional financing methods of tax, debt, user charges and public private partnerships.

Figure E.1: Employment change from traditional financing methods based on a $1 billion increase in expenditure



Source: Prime Research

While a significant amount of work has been done to improve Queensland's infrastructure charging framework over the past five years, infrastructure charges remain a highly inefficient and inequitable form of funding public infrastructure.

As part of the discussion regarding the future funding of public infrastructure, the Property Council encourages the Government to focus on alternative funding methods that deliver more equitable outcomes and have a positive impact on job creation in Queensland.

6. Conclusion

The Property Council would like to again thank the Committee for the opportunity to provide a submission on the *Delivering and infrastructure plan for Queensland-Directions Paper*, and for the opportunity to be involved in ongoing stakeholder consultation.

If you have any further questions about the Property Council or the detail included in this submission, please contact Chris Mountford on 07 3225 3000, or cmountford@propertycouncil.com.au.

Yours sincerely

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Introducing UK City Deals

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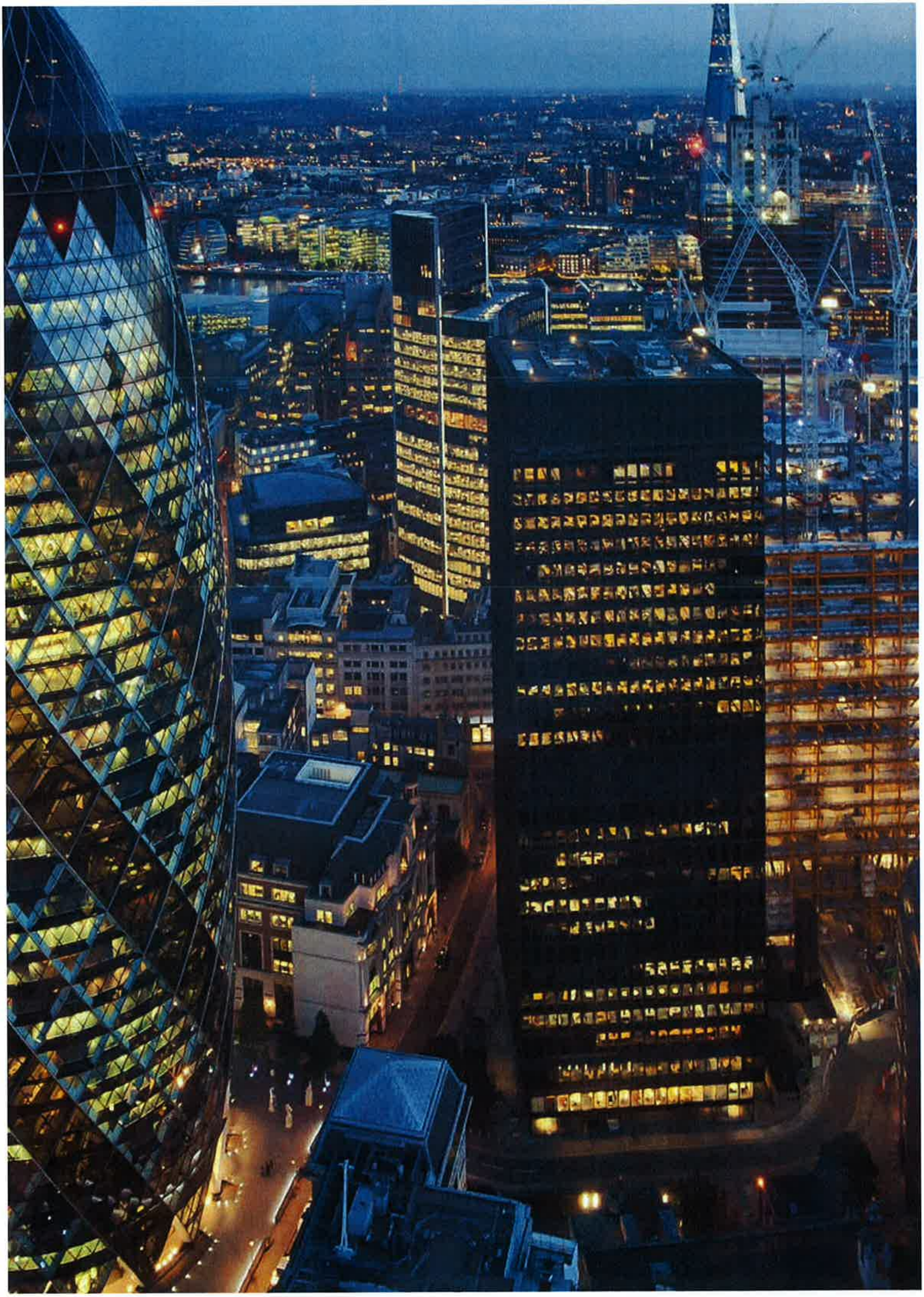

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Preface

Nine reasons why the UK approach to urban and regional growth provides a model for Australia

The UK City Deal model is the British Government's innovative strategy for building stronger urban and regional growth via smarter strategic planning, infrastructure investment and local governance.

This publication by KPMG and the Property Council of Australia summarises the City Deal approach and why it provides a model for Australia.

More than 20 City Deals have now been signed with more on the way.

The Greater Manchester deal signed in 2012 provides a template for the most ambitious of these deals. This includes the Greater Cambridge City Deal signed in June 2014, in per capita terms, arguably the most ambitious yet.

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 more ambitious City Deals involve establishing a growth benchmark for a city or region in return for a dose of growth focused self-help.**

The UK model determines an economic growth budget for a designated region, measured as gross value added – a local "GDP".

A city or region that exceeds this benchmark on the back of its self-help then receives a fiscal reward – that is, a share of the windfall tax arising from additional economic growth.

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

Here are nine reasons why we commend the UK approach.

Ken Morrison
Chief Executive,
Property Council
of Australia

Paul Low
Partner, KPMG

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.

A City Deal generally runs for 10 years or longer. Each identifies a list of priority infrastructure projects to be delivered, along with economic performance benchmarks.

2

The focus is on productivity and growth

Wise choices about infrastructure investment boost economic productivity.

The UK City Deal model explicitly targets a package of infrastructure projects that lift 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 business and the community.

3

City Deals encourage local leadership and good governance

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.

4

City Deals utilise smarter tools for determining infrastructure investment priorities

The City Deals 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 a methodology for rewarding the performance of City Deal partners.

All City Deal contract proposals are independently assessed by the UK Treasury, which also monitors annual progress towards agreed economic goals.

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

- 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 achieve ongoing improvements 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

City Deals unlock access to innovative financing

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 development – a growth windfall.

The UK City Deal model also gives City Deal partners access to a menu of financing options.

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

Second, City Deal partners are encouraged to enter into innovative types of capital formation partnerships with the private sector.

Public-private partnerships (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.

Incentive payments can be used to amortise existing debt obligations faster, or to finance new priority infrastructure projects.

6

City Deals help join up economic, social and sustainability 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 new homes by 2017.

The Birmingham and Solihull City 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

City Deals promote powerful political leadership that boosts economic productivity

The UK City Deals program is overseen by a Minister who works closely with the Treasury portfolio.

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

To broker the deals across central government departments (including the Treasury), there is a central unit that helps City Deal partners assess infrastructure priorities and set GVA growth benchmarks.

These benchmarks are written into each City Deal.

Where deals involve additional payments to a city linked to additional growth (like the most recent Greater Cambridge deal), there is a role for an independent assessment of delivery to reassure both sides that they are getting a fair deal.

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 financing vehicles are monitored by the UK Treasury and operate under strict governance arrangements.

Deeper involvement by local stakeholders, who are accountable for their actions, fosters financial know-how.

9

There is less need to rely on inefficient taxes when efficient alternatives are available

Australia's panoply of inefficient taxes exist because of cost-shifting between governments, 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 but may also provide the basis for phasing them out.

Introduction

Central and local government in the United Kingdom (UK) have collectively developed and implemented a new model for infrastructure funding and delivery. This City Deal model has provided a foundation for a growing number of city regions in the UK to overcome infrastructure deficits, reduce funding shortfalls and grow local economic activity.

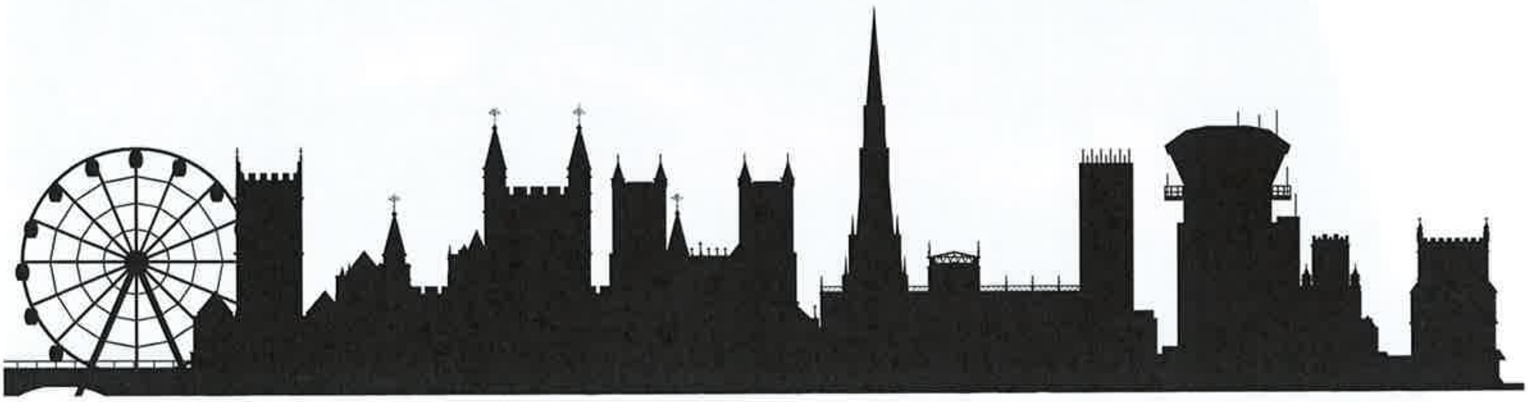
The model developed for the UK has:

- enabled a range of local governments to ***come together and agree*** on local infrastructure priorities;
- initiated a dramatic ***increase in local investment; and***
- ***cut through political discourse*** to focus on ensuring investment ***maximises economic growth.***

The model has enabled a more financially sustainable approach to infrastructure financing through the implementation of a ***"long-term rolling investment"*** approach that draws on new sources of committed funding. This has provided greater certainty around infrastructure investment; a commitment to prioritisation of infrastructure around economic growth outcomes; and the capacity to fund a greater scale of infrastructure than has historically been possible.

The UK City Deal model was first conceived in Greater Manchester, and this remains the most mature City Deal. The deal was struck between the 10 local authorities and central government, because Greater Manchester was able to quantify that it offered:

- ***a net measure of economic growth*** at a sufficiently large level of geography (whole of Greater Manchester), such that most of the displacement effects of individual schemes are netted out;
- a program which robustly ***prioritises net increases in jobs and productivity*** at the appropriate level of geography;
- ***a commitment to reinvest all money earned back*** in further GVA-prioritised schemes – this provides a rolling investment fund that can target sustained economic growth, rather than a one-off step change; and
- ***up-front money over and above central government funding*** that earns the right to the fiscal gain share – the point being that this self-help generated tax is genuinely additional for the Exchequer (Treasury).



The successes experienced in the UK provide a range of lessons for the prioritisation and funding of infrastructure in Australia. The challenges that both countries face are the same – specifically, ***not only how to identify the infrastructure that will best drive economic growth but also how to fund the delivery*** of this enabling infrastructure. The benefits of the model that have eventuated from resolving this challenge are summarised over the remainder of this chapter. They include:

- urban productivity;
- liveability dividends;
- governance; and
- revenue optimisation.

Urban Productivity

A core tenet of the UK City Deal model has been the prioritisation of infrastructure investment on the basis of the capacity of that ***infrastructure to deliver productivity improvement and jobs growth***.

This reflects a shift in accepted transport assessment methodologies in the UK, whereby the ***growth benefits associated with infrastructure investment become the central focus for the value for money assessment***. In practice, this also means focusing on the outcomes that generate the tax revenues that pay for publicly funded investment, an inherently more commercial and entrepreneurial approach than is generated by more traditional appraisal methods. This has helped to capture the employment growth that can be attracted and incentivised through improved connectivity and sound infrastructure investment.

All projects within the scope of the deal are effectively ranked on the basis of their capacity to deliver productivity and employment outcomes. The onus is then placed back on stakeholders to determine how far down the list they are willing to fund. Ultimately, this has resulted in a much more rational approach to investment decision making. It makes it harder to argue for investment programs that generate fewer jobs and less growth, which is what reordering of projects prioritised on the basis of maximum impact of funds invested would mean.

It has also enabled decision makers to ***better engage with business and the community,*** as investment decisions are being made around a central tenet of economic growth.

The linkages between the infrastructure covered under existing City Deals (transport, housing and urban regeneration) and productivity are summarised in the diagram below.

Transport investment

- Changes in connectivity
- New and more productive business attraction

Housing investment

- Induced local employment
- Displacement of activity
- Changes in connectivity
- New and more productive business attraction
- Congestion alleviation – travel time savings
- Increased productivity

Regeneration investment

- Displacement of activity
- Changes in connectivity
- New and more productive business attraction

GVA / tax uplift

Liveability Dividends

The core concept of a deal also ***provides a substantial incentive for local authorities to invest*** in supporting the realisation of economic outcomes. If economic growth resulting from the investment exceeds agreed benchmarks, the city can earn back a share of the incremental tax revenue generated for the central government.

This has resulted in cities ***joining up economic and social programs*** to maximise the benefit associated with infrastructure investment.

For instance, the Manchester City Deal includes:

- a Growth Hub program;
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- a housing program that aims to deliver 7,000 homes by 2017.

The Birmingham and Solihull City 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.

As demonstrated above, these City Deals have fostered a mutually reinforcing set of public policy programs and investments.

Governance

The UK City Deal model has proven to be a model that ***has benefited both central and local government*** in the UK, as well as the community and private sector. This has been achieved through a consistent focus on:

- net growth in economic activity and productivity; and
- net growth in employment.

The appeal of these outcomes has formed the foundation for regional collaboration to achieve a mutually beneficial deal. The negotiations at the heart of the deal have enabled ***an improved relationship between metropolitan local authorities and the central government***, as well as increased engagement and cooperation at the local level.

The deal has also paved the way for new approaches to metropolitan governance, as local authorities seek to establish the most efficient governance structures to underpin the deal and readily implement key decisions around investment. This renewed focus on local governance has encouraged a more enterprising approach to infrastructure matters, and provided ***greater ownership over regional planning and direction***.

Revenue Optimisation

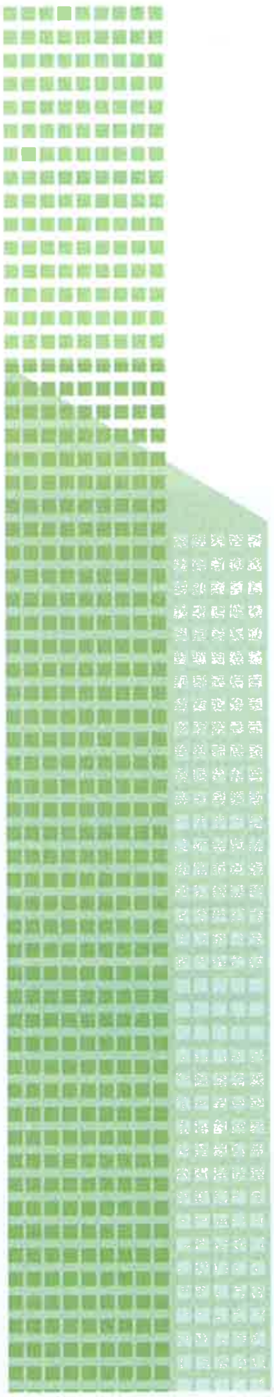
A new approach to funding has proven ***a turning point for the model in the UK***. While it was the final element of the model to be finalised, the inclusion of an earn-back incentive has provided the basis for a sustainable revenue stream to reinvest in the deal.

As previously highlighted, the earn-back incentive provides a financial motivation for local and central government authorities to maximise economic growth, central government revenue generation, and, ultimately, additional funding to reinvest in new infrastructure projects. ***This incentive motivates strategic thinking, collaboration and public policy innovation***.

Effective prioritisation at the outset ensures that available investment funding is channelled towards the projects that are going to maximise economic growth. This ensures the community and ultimately the economy receives ***the greatest return on infrastructure investment***. Furthermore, the long-term prioritised infrastructure program provides clarity on projected expenditure, with the earn-back incentive ensuring that local authorities commit to the delivery of the program.

In addition to the benefits listed above, key lessons learned from the UK City Deal model and their applicability to Australia are summarised over the remainder of this document.

UK City Deals History and Philosophy



The more significant City Deals, including the recently agreed Greater Cambridge deal, have been developed with two central objectives:

1. to cause ***a step-change in the level of infrastructure being delivered***; and

2. to ***maximise the economic growth realised*** as a product of this investment.

The model was developed and refined in Greater Manchester, and is now what the more ambitious cities are seeking to replicate.

The UK governments recognised the need for change, understanding that a new model for infrastructure prioritisation, funding and delivery was required to address the downfalls of the current infrastructure system. The key ***driving factors for the change*** to the new model in the UK were:

- realisation that what cities were asking for (total of project-by-project bids in the pipeline) was (even pre Global Financial Crisis) heading for 20 times the available budget, turning ***investment decisions into a huge source of tension*** and conflict between central and local government, with the UK Department for Transport (DfT) having to use a long, drawn-out appraisal challenge process as a means of managing demand;
- recognition that a combination of project-by-project traditional benefit–cost ratios (BCR) and ***lobbying was a very costly and inefficient allocation mechanism***, particularly against the background of central government's balanced growth objectives and cities' ambitions to grow their economies;
- recognition (sparked by the London Crossrail project) of ***the role of transport infrastructure in driving economic performance***, leading to fundamental questions about the traditional fixed (i.e. jobs, population and incomes are fixed) BCR approach to appraisal; and
- increasing ***interest in alternative funding mechanisms*** (value capture etc.) and (with Crossrail as a case study) questions about how to maximise incentives to develop and deploy these.

Of the above reform drivers ***the most pertinent was the pressure on DfT budgets***, with Treasury persuading DfT to set and publish expenditure guideline budgets at a regional level.

While this approach helped bring home budget realities and aligned formal bids to DfT to something much closer to its budget, in the absence of a regional tier of government it was far from the complete solution.

It did, however, prove to be a major stepping stone towards the new model by forcing places like Greater Manchester to think radically about what a fuller reform package might look like – particularly one that would deliver the economic outcomes it was seeking, which it recognised would require a fully funded and fit-for-purpose investment program.

The philosophy of this reform package is summarised overleaf. It focuses on:

- economic prioritisation;
- infrastructure, growth and reward;
- stakeholder engagement; and
- investment accountability.

Economic Prioritisation

Core Philosophy

Clear and quantified investment decision making based on agreed prioritisation metrics.

Certainty on the investment pipeline and priority.

The UK City Deal model has a relatively regimented prioritisation process in order to effectively manage available funds and infrastructure delivery. This prioritisation process ensures that ***investment is made on the basis of economic priority***, rather than any other influencing factors.

Prioritisation under the UK City Deal model is achieved by maximising a lead objective, namely economic growth. A series of secondary program minima have also been identified and included in the prioritisation process in some Deals. These are included to ensure that non-negotiable policy outcomes are also accounted for (i.e. economic growth distribution, environmental impact etc.).

By applying a lead objective and a series of minima, UK cities have ensured that a transparent, quantitative approach is undertaken when selecting the relative ranking of projects for investment. This maximises the return on investment for all stakeholders.

This process has resulted in ***increased certainty for the development sector*** and clarity on the likely pipeline of infrastructure projects that the government will commit to delivering. This certainty has encouraged investment and associated economic growth in precincts surrounding nominated infrastructure priorities. The increased certainty from prioritisation also ***benefits government by providing clarity*** on forward financial projections and the sequential roll-out of spatial planning for development.

Infrastructure, Growth and Reward

Core Philosophy

Maximise infrastructure led economic growth to achieve positive employment, productivity and financial outcomes.

The City Deal model is underpinned by the premise that ***everyone benefits*** but not everyone benefits all at once, or even during the early years of the City Deal's implementation. City Deals are developed through careful and considered negotiations between all contributing stakeholders.

During the initial stages of these negotiations, stakeholders will clearly articulate expectations for the deal, including the nomination of key metrics, outcomes desired from the deal and the financial motivation for participation. These are refined over time to form the core tenets of the deal. In all deals agreed to date, economic growth has been identified as the leading metric, and the foundation for prioritisation and earn-back. This has proven to be as critical to the vision for the deal as it has been for the retention of stakeholders, with the transparency of the analysis and objectives a clear factor in ongoing participation.

The reward associated with finalising the negotiations on a City Deal concept can be broken into two clear incentives:

1. anticipated ***growth in government revenue streams*** beyond otherwise projected levels; and
2. ***reduction in long-term infrastructure funding shortfalls*** through the development of a new, sustainable infrastructure funding mechanism.

Stakeholder Engagement

Core Philosophy

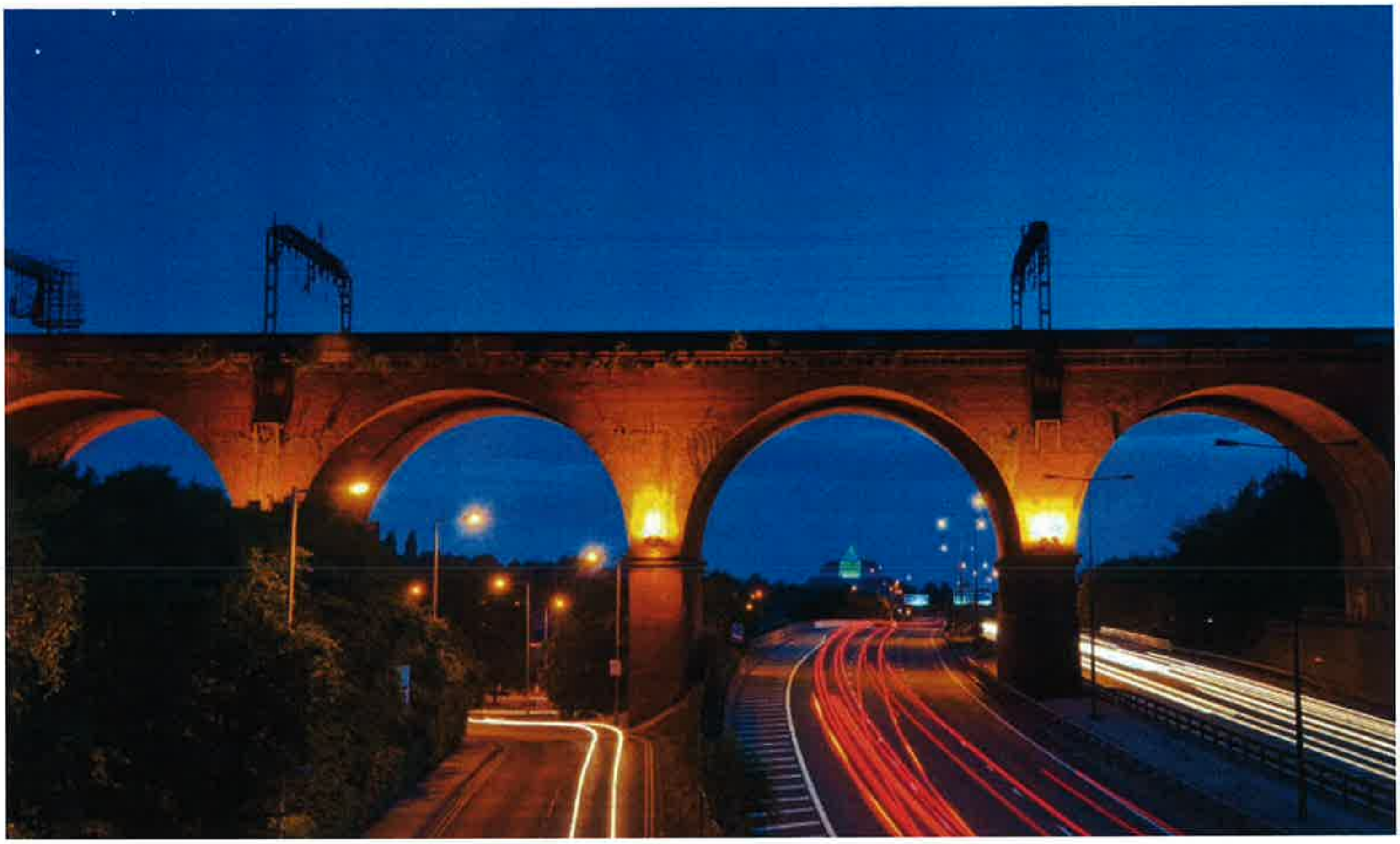
Greater collaboration and accountability between stakeholders.

The UK City Deal model was initially developed to determine whether city regions could achieve a better infrastructure and economic outcome by acting collaboratively, rather than individually, and by engaging with central government and each other to do so.

In Greater Manchester there was a ***fundamental shift in the mindset of decision-makers*** to allow for consideration of changes to infrastructure funding, prioritisation and delivery. This collaborative approach to implementation allowed the City Deal concept to develop and, in turn, realise the current growth in investment and economic outcomes.

Formalised mechanisms to help facilitate this were developed at the outset to establish an agreed, fair and beneficial arrangement to guide implementation. In Greater Manchester, the 10 leaders agreed:

- ***to establish the Greater Manchester Transport Fund (GMTF)***, designed to combine the various contributions being made to the program to the best effect; and
- ***to establish the Greater Manchester Combined Authority (GMCA)*** – in effect a new tier of government, accountable to a cabinet of the 10 leaders of Greater Manchester, with powers to deliver joint programs, starting with the transport fund program.



These new structures drove collaboration in both planning and delivery of enabling infrastructure. A change in perceptions on infrastructure delivery was coupled with the commitment to providing the necessary funds to ***realise a collective vision for the region***.

Stakeholders, through their commitment to implementing the City Deal, became more ***accountable to the outcomes identified by the deal*** and made the local investments necessary to maximise regional benefit.

Investment Accountability

Core Philosophy

It is a deal – a contribution of funding and support in exchange for a satisfactory economic and financial return.

Under the City Deal model, stakeholders agree to a certain set of responsibilities to ***ensure that the long-term goals of the deal are realised***. This commitment is a contract that ensures that stakeholders are accountable to supporting the long-term implementation of the deal.

The appointment of a regional governance body to oversee the implementation of the City Deal is an important factor in driving stakeholder and investment accountability. This body has provided a clear ***articulation of financial contribution commitments, responsibilities and expected outcomes***.

This increased investment accountability is ***further reinforced through public accountability*** to the delivery of the identified infrastructure plan by both the community and the development sector. The financial contribution commitments agreed to by the stakeholders governing the deal are made in order to maximise economic outcomes for the city. The public can then be aware that decisions made by the government during the course of the City Deal period should be made in line with the parameters of the City Deal. If decisions are not, they would contradict the notion of "economic growth" for the region. This accountability has proven key to the political commitment to realising the terms of the deal.

Features of City Deals

The City Deals that have been approved to date have a number of common foundation elements. These common elements can be collated into three core pillars for the model, namely:

- 'Real economy' prioritisation;
- Establishing governance and metrics; and
- Funding parameters.

These pillars and associated core elements are summarised in the table below. Each of the elements is discussed in further detail below.

Pillar	Core Element
Real Economy Prioritisation Prioritising projects by their impact on increasing jobs and economic output	**Objectives and Minima** **Scope and Prioritisation** **Metrics**
Establishing Governance and Metrics Program agreed based on performance of projects against key metrics	**Geography** **Governance Structures**
Establishing Funding Parameters Agreeing baseline budgets, payment by results and "self-help"	**Funding** **Benefit**

Real Economy Prioritisation

Prioritising projects by their impact on increasing jobs and economic output

Objectives and Minima

City Deals are heavily reliant on the establishment of a transparent and quantifiable measure of success. The determination of this measure is entirely dependent on the region and overall goal for implementing the City Deal; however, it needs to reflect a strong link to the type of infrastructure being prioritised, and the funding streams for government (i.e. taxation) that could ultimately benefit from the investment.

Beyond the leading objective of any City Deal, it is important that a number of minima are identified and built into the model to ensure a balanced approach to the prioritisation of infrastructure projects.

City Deals have a clear goal and quantifiable measures of success

In Greater Manchester, the lead objective of the City Deal was economic growth through GVA contribution. This was linked to transport, housing and regeneration infrastructure projects and programs. In addition, minima were developed, including CO_2 reduction and improved employment accessibility.

Scope and Prioritisation

The scope of infrastructure is specifically linked to the set objectives of the City Deal and region more broadly. Following the determination of scope, the prioritisation of infrastructure projects is critical to implementing a City Deal in any established region. The priority listing of infrastructure projects determines the order in which they are funded by the government through the City Deal model. It is important that prioritisation is undertaken using the set objectives and minima determined for each specific region in which a tailored City Deal is being implemented. The primary aim of prioritisation is to avoid attempts in the "end game" to redefine the criteria in order to change priority rankings, and subsequent alterations to the funding schedule for infrastructure projects.

City Deals involve a clearly defined prioritisation of infrastructure projects for the region. The highest ranking projects are funded and delivered first.

In Greater Manchester, infrastructure projects and programs were prioritised based on the objectives and minima related to GVA contribution and employment accessibility. As a result of these set objectives and minima, transport infrastructure projects were ranked more highly with respect to overall priority for the region.

Metrics

The monitoring of performance based on the set objectives and minima of the City Deal within a region is critical to the realisation of long-term benefits. Metrics are developed to both measure success and determine the scale of benefit realisation for all stakeholders involved in a certain City Deal.

City Deals' success is determined on the basis of a number of agreed metrics

Metrics in Greater Manchester were developed to measure the overall benefits gained through the City Deal. Investment in infrastructure was measured using metrics specifically designed for the type of infrastructure that was invested in. In Greater Manchester, the ultimate outcome that was measured was GVA/tax uplift. This was measured through understanding benefits and impacts such as business attraction, travel time savings and increased connectivity.

The metrics used in the Greater Manchester City Deal have been drawn on by other locations and adjusted to reflect the particular nature of the local geography. For example, West Yorkshire is more polycentric than Greater Manchester and has prioritised its investment program using program minima that ensures geographic spread of the additional employment opportunities created.

Metrics utilised by UK Deals

Feature	Greater Manchester	West Yorkshire
Context	Population: 2.7m GVA: £46bn	Population: 2.5m GVA: £43bn
Lead Objective	Maximise local jobs and productivity (GVA)	Maximise local jobs and productivity (GVA)
Programme minima	Reduction in transport CO2 emissions; above average increases in employment connectivity for most deprived 25% of wards (IMD basis)	Better than average improvement in accessibility for the most deprived 25% of LSOAs (IMD basis); employment accessibility in any district being at least half the average; aspiration to reduce transport CO2 emissions
Geography	Net impacts at the GM level	Net impacts at the GM level
Scope	Initially transport but expanding over time to other forms of infrastructure	All transport, plus some regeneration schemes at the margin

The program minima are the metrics that the program as a whole has to address, not each and every scheme. The benefits associated with infrastructure investment, and their relative linkage to the lead metric of economic (GVA) growth, are summarised in the diagram below.

Transport investment

- Changes in connectivity
- New and more productive business attraction

Housing investment

- Induced local employment
- Displacement of activity
- Changes in connectivity
- New and more productive business attraction
- Congestion alleviation – travel time savings
- Increased productivity

Regeneration investment

- Displacement of activity
- Changes in connectivity
- New and more productive business attraction

GVA / tax uplift

Establishing Governance and Metrics
Program agreed based on performance of projects against key metrics

Geography

The City Deal model is based on the identification of a functional geography, usually a number of smaller local regions that collaborate to better deliver infrastructure and achieve the set objective of the deal.

The geographic boundaries of deals generally align with either the metropolitan area or a broader, pre-defined regional geography. Alignment of City Deal geographies to the boundaries of existing governance entities simplifies any concerns about local authorities opting in or opting out of the City Deal.

City Deals have a regional and functional boundary

The City Deal in Greater Manchester brought together 10 local authorities: eight metropolitan boroughs and two cities.

Governance

The governance structures employed to implement a deal are just as important as the mechanical details of the deal itself. It is important to establish a suitable structure for the specified geography, to ensure that all stakeholders are held accountable to responsibilities and that benefits from the deal are realised and shared across the combined region.

It is important that any governance structure employed to deliver the deal within a region should hold statutory power. This will increase the likelihood of success and benefits generated through the implementation of the deal.

City Deals have a clear accountability to a single governance structure

Greater Manchester established a statutory combined authority (GMCA) accountable to the leaders of the 10 local governments which has the authority to levy the 10 authorities to deliver agreed programs. Additional entities were developed to facilitate delivery:

- *Transport for Greater Manchester (Committee);*
- *Business Leaders Council;*
- *Local Enterprise Partnership; and*
- *Local Transport Body for Greater Manchester.*

Real Economy Prioritisation

Prioritising projects by their impact on increasing jobs and economic output

Funding

The delivery of infrastructure, no matter the focus, is dependent on funding. Funding for the delivery of infrastructure under the City Deal model generally comprises baseline funding and earn-back funding. Baseline funding is funds contributed to a centralised funding pool by government and other stakeholders initially. Baseline funding provides certainty around future funding streams. Earn-back funds are generated through the implementation of the City Deal in a particular region and extend beyond the initial baseline funding commitments made by stakeholders.

Funding can also be generated through contributions beyond baseline funding from key stakeholders – this is termed "self-help funding". Self-help funding determines how far down the prioritisation list the City Deal will be able to fund.

City Deals have a number of funding sources, but contributions must be determined at the outset and committed to for the life of the deal

In Greater Manchester, baseline funding was commensurate with historical funding levels by central government. Self-help funding was generated through local governments deciding to capture funds through a combination of:

- *revenues;*
- *tolls;*
- *tax increment finance;*
- *levies;*
- *rational developer contributions; and*
- *dedicated local taxes.*

The self-help funds generated were divided amongst the local governments on a population pro rata basis. In Greater Manchester, earn-back funds are returned as further investment and economic growth. Earnings at the end of each five-year period are banked for the remainder of the 30 years of the City Deal, which allows Greater Manchester to borrow against these banked revenues to fund further infrastructure program delivery.

Benefit

City Deals seek to deliver an outcome whereby all stakeholders are better off. This is the foundation of the collaboration required between stakeholders. These benefits, inherently linked to the set objectives of the deal, are important to ensuring the ongoing support and participation of key stakeholders for the long term.

City Deals are a *deal* between stakeholders – benefits are realised across the board; however, these benefits may be realised at significantly different times during the deal implementation.

In Greater Manchester, there was a mutual agreement between all stakeholders that benefits gained through the City Deal would be shared appropriately across the regions. Importantly, the long-term realisation of benefits was established at the deal outset to ensure that all stakeholders were aware that "quick wins" would be limited.


Great
Northern
Castlefield

UK Deals and Their Progress

Various City Deals are currently being implemented across the United Kingdom. More than 20 City Deals have now been signed with many more being negotiated.

This section investigates select examples of the City Deal implementation and highlights the key differences between deal applications across different regions. It also investigates the differing levels of maturity and progress of each deal. In addition to investigating the process undertaken in Greater Manchester, this section includes insight into the processes undertaken in:

- Glasgow City Region; and
- Leeds City, West Yorkshire and York Region.

Greater Manchester Experience

The Greater Manchester City Deal took a number of years to conceptualise and finally be implemented. This reflects the fact that it was the first deal to be adopted. The approach taken by Greater Manchester is broken down into the 10 key milestones below:

1	Establish baseline budget	→	Provided GM with clarity about "do nothing" funding
2	Lead metric (objective) and minima agreement	→	Established the "rules" and prioritisation objectives for all 10 GM authorities
3	Funding stream agreement	→	Determined the potential funding levers the deal might pull
4	Infrastructure project evaluation	→	Economic evaluation of projects whole-of-life costs and benefits
5	Develop economic model for prioritisation	→	Compared the results of the economic evaluation of each project
6	Prioritisation of infrastructure projects	→	Priority list of infrastructure projects are determined and signed off by all governing authorities
7	Local decisions on scale of self help contributions	→	Determined how far down the priority list funding would go
8	Develop earn-back mechanism	→	Agreement on benchmarks GM had to achieve in order to earn back contributions
9	Reinvest earn-back funding	→	Funding contributed to a rolling infrastructure investment fund
10	Establish regulatory body (GMCA) to maintain program delivery	→	Effectively governs the long-term delivery of the program and reinvestment of earn-back funding

Greater Manchester's earn-back deal (and thus the formula that benchmarks its growth) starts in 2015/16. This is 6 years after Greater Manchester's self-help investment started, and some 3 years after the first major deal-funded project was completed. This is the earliest Greater Manchester expects to see supply-side-driven growth impacts along the corridors benefiting from the investment.

Benefits from the City Deal model eventuate after a significant period of time. It is important to realise that the City Deal model is a long-term commitment for achieving longer term benefits.

Key Points:

- Transport investment focus
- Statutory combined authority governance structure – legally binding decisions
- Lead objective: maximise local jobs and productivity (GVA)
- Minima: reduction in transport CO_2 emissions; above average increases in employment connectivity for most deprived 25% of wards (IMD basis*)

Glasgow City Region

The Glasgow City Region (GCR) includes eight local authorities, namely Glasgow, East and West Dunbartonshire, Renfrewshire, East Renfrewshire, North and South Lanarkshire and Inverclyde.

On 4 July 2014, the UK Government confirmed it will provide £500 million toward a City Deal for Glasgow. The Scottish Government has agreed in principle to match this funding. Local governments across the region have committed a further £130 million, with further work around the terms of the City Deal to be confirmed over coming weeks.

Glasgow Economic Leadership was established in 2012 as an informal partnership to enhance the growth of the city region's economy; however, there is currently no single overarching strategy for infrastructure investment in GCR. When developing a prioritisation framework, the local case for using GVA as the lead metric for a fund is strengthened by its alignment with the city and city region's economic aspirations.

In principle agreement to a deal has been reached with local government, however further work to define the governance arrangements for the deal will be required. These arrangements will focus on establishing the objectives of investments and defining the fund's decision metrics, for taking decisions on overall investment priorities, and for determining the risk allocation and delivery framework. The governance framework will need to reflect both the geography of the fund and the range of parties involved.

Key Points:

- Instructive on three-tier government interactions
- Informal partnership between stakeholders – a more formal approach to governance is currently being developed

Leeds City, West Yorkshire and York Region

In July 2014, the Leeds City Region (LCR) Enterprise Partnership agreed to a £1 billion Local Growth Deal with the UK Government. The key differences with Greater Manchester are the LCR's more polycentric economic geography and lower physical density. These differences are reflected in a differing set of program minima, which emphasised the need for geographic balance in terms of improved employment opportunities, and in the nature of the projects that score highly in terms of GVA/£ of net cost.

The LCR is a partnership that represents 11 local authority districts that form a functional economic area. It is led by a legally constituted board elected from each of the 11 partner councils and operates on a "one member, one vote" rule. Although voluntary it is also seen as an effective governance structure but one lacking the strength of a combined authority.

As with Greater Manchester, this fund is focused on transport with the majority of funding being locally contributed.

Key Points:

- Transport investment focus plus some regeneration schemes
- Legally constituted board (voluntary)
- £1 billion of investment – majority locally contributed
- Lead objective: maximise local jobs and productivity (GVA)
- Minima: better than average improvement in accessibility for the most deprived 25% of LSOAs (IMD basis*); employment accessibility in any district being at least half the average; aspiration to reduce transport CO2 emissions

* The IMD is the UK's Index of Multiple Deprivation which is a Lower layer Super Output Area (LSOA) level measure of multiple deprivation. This measures seven indices of deprivation: income, employment; health and disability; education, skills and training; barriers to housing and services; living environment; and crime.

Key Considerations

The UK City Deal approach to infrastructure funding has proven successful in delivering increased economic activity, infrastructure funding and development certainty in a number of cities and is continuing to be rolled out across the United Kingdom.

The application of the model to Australia, however, should not represent a wholesale transfer of the UK approach. Rather, regions considering a new approach to infrastructure funding should consider developing an approach that is suitable to their city/region.

Key areas that regions need to consider include the core elements of the boundaries that the model would be confined to; the approach that would be taken to prioritise infrastructure; and the framework that would be applied to negotiate funding parameters between all parties.

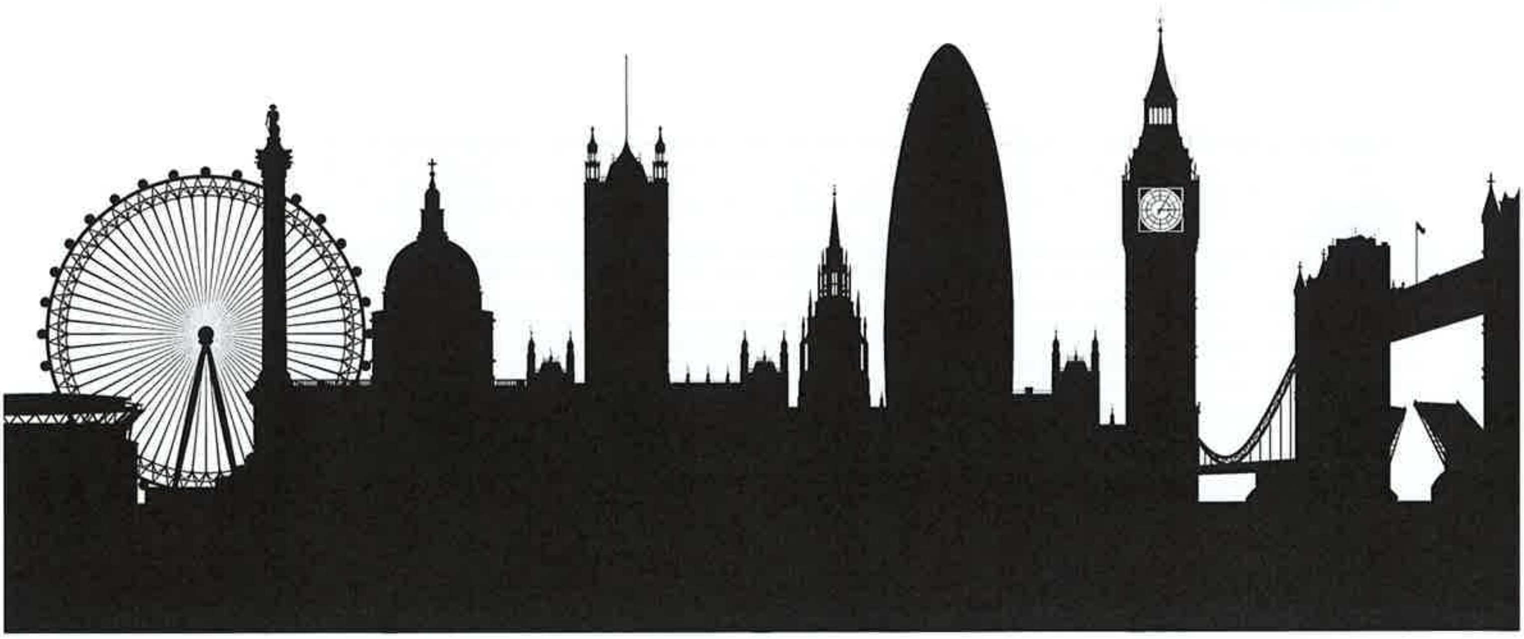
Effective early governance will be central to the success of any domestic model. Once stakeholders have agreed to the terms of a suitable governance approach they will need to consider:

1. ***negotiation of the boundaries of the potential model*** – *i.e. will the 'in-scope' infrastructure be regional, sub-regional, transport specific, urban regeneration etc.?;*
2. ***agreement on key metrics and an approach to economic prioritisation*** – *i.e. what are the tools that we need to measure the metrics we have identified, which are suitable for the infrastructure scope we have nominated?; and*
3. ***negotiation of the funding parameters for the potential model*** – *i.e. who will contribute what levels of funding and in-kind support, and how will any earn-back negotiation be framed?*

Early analysis with stakeholders in Queensland has indicated that these queries can be resolved through effective negotiation and the involvement of key parties. This experience will provide a foundation for further consideration of the applicability of the model to other states and regions across Australia.

Glossary

BCR	Benefit Cost Ratio
DfT	UK Department for Transport
GCR	Glasgow City Region
GM	Greater Manchester
GMCA	Greater Manchester Combined Authority
GMTF	Greater Manchester Transport Fund
GVA	Gross Value Added
IMD	Index of Multiple Deprivation
LCR	Leeds City Region
LSOA	Lower layer Super Output Area
UK	United Kingdom
WY	West Yorkshire



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NSW GOVERNMENT

UNSOLICITED PROPOSALS

GUIDE FOR SUBMISSION AND ASSESSMENT

February 2014

CONTENTS

1 PREMIER'S STATEMENT

The NSW Government is determined to deliver the change the people of NSW have called for to rebuild our State and make NSW number one.

Work is well underway to rebuild the economy, return quality services, renovate infrastructure, strengthen our local environment and communities, and restore accountability to government.

Responsible economic management requires sound strategic planning coupled with rigorous fiscal discipline.

To this end, the NSW Government launched its Guide for Submission and Assessment of Unsolicited Proposals in January 2012 (Guide), in order to further engage with the private sector in the development and delivery of new infrastructure and services.

The NSW Government is encouraging the best ideas and solutions from the private sector and a greater level of private sector investment and participation in projects, with rigorous planning and costing to deliver the highest standards of public value – and confidence to investors and the community.

The Guide outlines a transparent and streamlined approach that is facilitating the NSW Government and private sector working together to develop and deliver innovative ideas.

Its key objective is to provide consistency and certainty to private sector participants as to how their unsolicited proposals will be assessed within a transparent framework with key drivers for the NSW Government being how the proposal helps meet a strategic Government objective and value for money.

With many proposals received, the NSW Government has sought feedback from industry and reviewed and improved the Guide and its underlying processes to potentially increase the quality of proposals received. This updated Guide enhances, clarifies and streamlines certain aspects of the Guide to improve outcomes for industry and Government alike.

2 INTRODUCTION

The NSW Government is continually seeking to capture value, and unique and innovative ideas from industry that provide real and tangible benefits to the people of New South Wales. In order to achieve this it procures projects, goods and services by two broad means –

1. **Government initiated procurement processes.** This is the predominant form of procurement and is based on competition through tendering in order to achieve value for money in a fair and transparent manner. Such procurement is driven by the Government's strategic and operational planning processes and allows efficient and timely delivery of Government services. This form of procurement is not covered by this Guide.

2. **Non-Government sector initiated proposals, not solicited by Government through the process described in 1. above.** The non-Government sector includes private individuals, companies, not-for- profit entities and non NSW Government owned Local Authorities such as councils. Such proposals are by definition outside the normal planning and procurement processes of Government but may offer opportunities for real value for Government. These proposals are administered under this *Guide for Submission and Assessment of Unsolicited Proposals.*

The unsolicited proposals process is not a substitute for routine competitive procurement by Government.

While direct negotiation with a proponent in response to an Unsolicited Proposal may be pursued in justifying circumstances, Government's usual procurement approach is to test the market. This generally results in the demonstrable achievement of value-for-money outcomes and provides fair and equal opportunities for private sector participants to do business with Government.

The Government will generally only consider proposals where both the proposal and its proponent have unique attributes such that others could not deliver a similar proposal with the same value-for-money outcome. Government will consider directly negotiating with an individual or organisation that presents an Unsolicited Proposal (see Glossary) where circumstances justify this approach and at its absolute discretion.

This Guide sets out the processes to be followed by both Government and Proponents in developing Unsolicited Proposals. It represents commitment by Government to the allocation of resources to meet its responsibilities as outlined in this Guide. It is recognised that a Proponent will be entitled to a fair rate of return for its involvement in a project and that outcomes should be mutually beneficial for the Proponent and Government. Further, Government recognises the right of Proponents to derive benefit from unique ideas. The approach to the identification, recognition and protection of intellectual property rights will be addressed and agreed with the Proponent during Stage 1 of the process as set out below.

A four stage assessment process has been developed to guide the evaluation of proposals. This is described in detail in section 5. The process involves:

- ***Pre-submission concept review stage*** – An optional initial, pre-lodgement meeting between the proponent and the Department of Premier and Cabinet (DPC) to discuss the key attributes, benefits, requirements and assumptions underlying the potential proposal. This is not a compulsory stage, but proponents planning to formally submit an unsolicited proposal are strongly advised to arrange such a meeting with DPC, prior to committing substantial resources to the development of the proposal. A key part of this meeting will be the demonstration of the unique attributes of both the proposal and the proponent in order to progress through the process. The Government may provide feedback at this stage as to whether it considers that the proposal, as presented, is consistent with the Guide. Notwithstanding this feedback, it is the proponent's decision as to whether it proceeds with making a formal Stage 1 submission.

- ***Stage 1***

  a) Initial Submission and Preliminary Assessment – DPC will undertake a Preliminary Assessment of the proposal in conjunction with the relevant agencies to determine if the submission constitutes an unsolicited proposal and if it contains sufficient potential grounds to justify direct dealing and therefore undertake a Stage 1 assessment. Government reserves the right to further consider, or not consider, Unsolicited Proposals beyond this stage at its absolute discretion. The Unsolicited Proposals Steering Committee approves progression, or otherwise, to Stage 1.b).

  ***b) Strategic Assessment* of Initial Submission** – Includes a comprehensive initial assessment of the proposal to identify the potential benefit to Government of further consideration and development with the Proponent. The outcome is advice to the Proponent of progression to Stage 2, or that the Government does not wish to proceed.

- ***Stage 2 - Detailed Proposal*** requires the Proponent and Government to work cooperatively in the development and assessment of a Detailed Proposal. The outcome is advice to the Proponent of progression to Stage 3, or that the Government does not wish to proceed.

- ***Stage 3 - Negotiation of Final Binding Offer*** involves the finalisation of all outstanding issues with a view to entering into a binding agreement, should the Government accept the final offer.

Where the Government assesses a proposal as not meeting the criteria, including uniqueness, the Government reserves its usual right to go to market. The Proponent will be provided with the opportunity to participate in the procurement process should the concept be offered to the market, but will have no additional rights beyond those afforded to other market participants. If the Government elects to go to market in such circumstances it will respect any IP owned by the Proponent.

The unsolicited proposals assessment process is separate to other Government statutory approvals processes e.g. planning.

A glossary of terms used in this Guide is included in section 7.

A Government Website at http://www.nsw.gov.au/unsolicitedproposals has been established that includes information and supporting template documents that will be of assistance to organisations when contemplating if and how to present an Unsolicited Proposal to Government.

3 GUIDING PRINCIPLES

3.1 OPTIMISE OUTCOMES

By their nature, Unsolicited Proposals are unlikely to be the current focus of Government's strategic planning. Proposals must therefore be considered in light of the wider benefits and strategic outcomes that may be derived. In order to proceed however, proposals must be broadly consistent with State objectives and plans, and offer some unique attributes that justify departing from a competitive tender process. Outcomes must always be in the best interest of the State.

In order to demonstrate that optimal Value for Money will be achieved, an "open book" approach to negotiations is to be adopted once the proposal has progressed to Stage 2 assessment. Government will develop an independent project cost estimate that will be used as a benchmark for assessing Value for Money. Government will also consider whole-of-Government impact and cost. The approach to demonstrating Value for Money will be generally consistent with Infrastructure Australia guidelines.

In order to guide the Proponent, Government will provide an early indication of an acceptable return on investment and other requirements to be achieved by the Proponent in the delivery of its proposal.

3.2 UNIQUENESS

Proposal and Proponent to be uniquely able to deliver proposed service

Most unsolicited proposals received have been assessed as being insufficiently unique to warrant direct dealing with a particular proponent. For unsolicited proposals to progress through the assessment process, the uniqueness needs to apply to both the proposal and the proponent. The essential questions to be addressed in any Unsolicited Proposal are –

- Can this proposal be readily delivered by competitors? If the answer is yes, then what, if any, justification would the Government have to the public for not seeking best value through a competitive tender process? What benefit(s) would the Government gain?

- Does the proponent own something that would limit the Government from contracting with other parties if the Government went to tender? This would include intellectual property, real property and other unique assets.
- Are there other attributes which may not necessarily stand alone as unique but, when combined, create a "unique" proposal? This may include genuinely innovative ideas, including financial arrangements or solutions that are otherwise unlikely to be defined and put to market (e.g. alternatives to providing a Government service or substantive processes, products or methods for delivering a service that is not offered by other service providers and constitute a significant departure from traditional service delivery).

Types of proposals that are NOT considered unique and/or proposals that are unlikely to be progressed

- Proponents seeking to directly purchase or acquire a Government-owned entity or land parcel. Unless the proposal presents a unique opportunity to Government, the Government is unlikely to enter into such an arrangement without an open tender process. Standard land transaction proposals will be referred to Government Property NSW or the owner agency for consideration.
- Proponents with an existing government licence to provide goods or services seeking to bypass a future tender process.
- Proposals for significant extensions to existing contracts, or the next stage of a staged project on the basis that the contractor is already "on-site" or has some other claimed advantages, absent of other "uniqueness" criteria
- Proposals seeking to develop land that is not owned by the government or the proponent.
- Proposals that do not contain a commercial proposition for the Government.
- Proposals that identify the proponent's skills or workforce capability as the only unique characteristic are unlikely to progress to Stage 2. A proponent with personnel holding superior expertise or experience in a particular field is not sufficient for the government to justify bypassing an open tender. For example, a proposal to deliver niche healthcare services to a local community would need to demonstrate that the claimed skills could not be procured or developed elsewhere in the market.
- Proposals to provide widely available goods or services to government. This includes proposals for government to purchase standard office administration products, software development and other readily available services. The default procurement process is to hold an open tender.
- Proposals seeking only to change Government policy that have no associated project
- Proposals for consultancy services
- Proposals for projects where the tender process has formally commenced, whether published or not
- Proposals that are early concepts or lack detail
- Proposals seeking grants e.g. scientific research
- Proposals whose claim to uniqueness is trivial e.g. a 'unique' view from particular site.

Example: an unsuccessful unsolicited proposal

The proponent currently holds a 5-year contract to provide maintenance services for government-owned buildings, and has a demonstrated record of delivering quality services to Government and other clients. The proponent's contract is due to expire in 12 months and the government is planning to commence the usual open tender process. The proponent submits an unsolicited proposal to the Government to extend the existing contract for a further 5 years without going to tender. The key unique quality claimed by the proponent is demonstrated experience in delivering maintenance services and a good relationship with the relevant government agency.

This unsolicited proposal would be unlikely to progress to Stage 2 because there is an established market to provide the required service, and the proposal has not demonstrated any genuinely unique characteristics. The Government would likely proceed with an open tender process to procure the services.

3.3 ASSESSMENT CRITERIA

Proposals will be initially assessed against the Assessment Criteria in the table below. Assessment will be based on the proposal satisfactorily meeting each of the criteria. Additional Criteria relevant to a particular proposal may also be applied at later stages. If so, the Proponent will be informed of the criteria in order for these to be addressed in its Detailed Proposal during Stage 2.

Uniqueness	Demonstration of unique benefits of the proposal and the unique ability of the proponent to deliver the proposal. In particular the following are to be demonstrated – • Can this proposal be readily delivered by competitors? If the answer is yes, then what, if any justification would the Government have to the public for not seeking best value through a competitive tender process? What benefit(s) would the Government gain? • Does the proponent own something that would limit the Government from contracting with other parties if the Government went to tender? This would include intellectual property, real property and other unique assets. • Are there other attributes which may not necessarily stand alone as unique but, when combined, create a "unique" proposal? This may include genuinely innovative ideas, including financial arrangements or a unique ability to deliver a strategic outcome. It is possible that the Government might agree to initiate market testing of a new proposal that has merit, but is not unique.
Value for Money	Does the proposal deliver value for money to the NSW Government? What are the *net* economic benefits of the proposal (the status quo should be defined)? Is the proposal seeking to purchase a Government asset at less than its value in exchange for other services? Consideration will be given to factors such as: whole of life costs and revenue, quality, risk borne by Government, benefits gained, qualitative and whole of Government outcomes including timely achievement of

	objectives.
Whole of Government Impact	What is the opportunity cost for Government if it were to proceed with the proposal? Is the proposal consistent with the Government's plans and priorities? Consideration will be given to whether the proposal would require Government to re-prioritise and re-allocate funding.
Return on Investment	Is the proposed return on Investment to the proponent proportionate to the proponent's risks, and industry standards?
Capability and Capacity	Does the proponent have the experience, capability and capacity to carry out the proposal? What reliance is there on third parties?
Affordability	Does the proposal require Government funding, or for the Government to purchase proposed services? Does the Government have these funds available or budgeted and if not what source would be proposed?
Risk Allocation	What risks are to be borne by the proponent and by the Government? Where risks can be quantified and valued they may also be considered under the value for money criteria.

3.4 INTERACTIVE PROCESS

The Government will manage an interactive process with the proponent at all formal stages of assessment, commencing with the formal pre-lodgement meeting set out in Section 5. During both the pre-lodgement meeting and the Stage 1 Assessment this interaction will be limited to clarification of the proposal by Government in order to effectively carry out the assessment. It will not be an opportunity to negotiate the details of the proposal. This opportunity will arise in later stages if the proposal proceeds past the Stage 1 Assessment.

3.5 PROBITY

Government seeks to conduct its commercial dealings with integrity. The assessment of Unsolicited Proposals must be fair, open and demonstrate the highest levels of probity consistent with the public interest. The assessment of Unsolicited Proposals will be conducted through the application of established probity principles that aim to assure all parties of the integrity of the decision making processes. These principles are outlined below.

Maintaining impartiality

Fair and impartial treatment will be a feature of each stage of the assessment process. The process will feature a clearly defined separation of duties and personnel between the assessment and approval functions.

Maintaining accountability and transparency

Accountability and transparency are related concepts. The demonstration of both is crucial to the integrity of the assessment.

Accountability requires that all participants be held accountable for their actions. The assessment process will identify responsibilities, provide feedback mechanisms and require that all activities and decision making be appropriately documented.

Transparency refers to the preparedness to open a project and its processes to scrutiny, debate and possible criticism. This also involves providing reasons for all decisions taken and the provision of appropriate information to relevant stakeholders. Relevant information regarding proposals under consideration at Stage 2 should be publicly available (note in some cases Government may agree to not disclose a proposal at Stage 2 of the assessment process, if requested by a Proponent).

Managing conflicts of interest

In support of the public interest, transparency and accountability, the Government requires the identification, management and monitoring of conflicts of interest. Participants will be required to disclose any current or past relationships or connections that may unfairly influence or be seen to unfairly influence the integrity of the assessment process.

Maintaining confidentiality

In the assessment of Unsolicited Proposals there is need for high levels of accountability and transparency. However, there is also a need for some information to be kept confidential, at least for a specified period of time. This is important to provide participants with confidence in the integrity of the process. All proposals submitted will be kept confidential at Stage 1 of the assessment process.

Obtaining value for money

Obtaining optimal value for money is a fundamental principle of public sector work. This is achieved by fostering an environment in which Proponents can make attractive, innovative proposals with the confidence that they will be assessed on their merits and where Government appropriately considers value.

3.6 RESOURCE COMMITMENTS

In order for an Unsolicited Proposal to progress, Government (both central Government and relevant agencies) and the Proponent will be required to commit resources. The staged approach to assessment as detailed in section 5 of this Guide seeks to balance resource input at each stage in order to reduce the potential for unnecessary expenditure.

While this Guide sets out information and processes to minimise costs for Proponents, Government will not normally reimburse costs associated with Unsolicited Proposals.

3.7 GOVERNANCE ARRANGEMENTS

Governance arrangements will include whole of Government oversight and co-ordination through DPC, a single, overarching Unsolicited Proposals Steering Committee, proposal specific Steering Committees where required, proposal specific assessment committees, and a staged approach to assessment, negotiation and contracting.

Once a proposal reaches Stage 2 of the assessment process, Government will establish appropriate governance arrangements that will detail the make-up and responsibilities of the Steering Committee and assessment/technical panels, management of confidentiality and conflict of interest, and provide details of the appointed Proposal Manager and probity advisor.

In preparing the governance arrangements, Government will have regard to relevant processes and approval requirements in related procurement policy documents. This may include:

- NSW Public Private Partnerships Guidelines (August 2012)
- National PPP Guidelines

- NSW Code of Practice for Procurement
- ICAC Guidelines for Managing Risks in Direct Negotiations
- NSW Code of Tendering.

Unsolicited proposals that seek to enter into a Public Private Partnership (PPP) should comply with the NSW PPP Guidelines, where applicable.

3.8 PARTICIPATION AGREEMENT

A Participation Agreement provides an agreed framework for Stage 2 which will be entered into by both Government and the Proponent in order to ensure the alignment of expectations regarding participation in the process.

The Participation Agreement will contain:

- Acknowledgement that a Value for Money outcome is a requirement for the proposal to proceed
- Assessment Criteria and other relevant Government requirements
- Communication channels, including a prohibition on lobbying
- Agreement regarding cost arrangements
- Resource commitments
- Conflict of interest management arrangements
- Confidentiality requirements
- Commitment to following an open book approach to discussions
- Timeframe
- Approval requirements.

Stage 3 Agreement

A Stage 3 Agreement provides an agreed framework for participation in Stage 3 which will be entered into by both Government and the Proponent in order to ensure alignment of expectations. The Stage 3 Agreement will contain (but not limited to):

- Communication channels, including a prohibition on lobbying
- Agreement regarding cost arrangements
- Resource commitments
- Conflict of interest management arrangements
- Confidentiality requirements
- Timeframe
- Approval requirements
- Outline of any conditions arising from Cabinet's consideration of the Detailed Proposal
- Schedule of items and issues to be negotiated (this may be provided separately to the Stage 3 Agreement).

3.9 MONITORING

DPC will establish a structured periodic review to assess the effectiveness of the approach to dealing with Unsolicited Proposals and Direct Approaches.

4 ROLES AND RESPONSIBILITIES

4.1 PROPONENT

The Proponent is required to:

- Prepare an outline Submission and meet with DPC to discuss its unique characteristics and other key principles, prior to lodgement of a formal submission. This involves the Proponent completing an initial Schedule of Information Requirements.
- Prepare and lodge with DPC an Initial Submission for Preliminary or Stage 1 Assessment. This involves the Proponent completing the Schedule of Information Requirements and attaching any other relevant information.
- Enter into a Participation Agreement if recommended to proceed to Stage 2
- Provide a Detailed Proposal at the conclusion of Stage 2
- Provide a Binding Offer at the conclusion of Stage 3.

4.2 GOVERNMENT (CABINET)

Proposals will be submitted to Government (Cabinet) for approval prior to any progression of a proposal to Stage 2 or 3, and prior to the signing of any agreement.

Projects requiring capital and/or recurrent funding require the approval of Government. The required approval process will be described to the proponent.

4.3 DEPARTMENT OF PREMIER AND CABINET

The Department of Premier and Cabinet (DPC) will take the lead role in the receipt and coordination of the consideration of Unsolicited Proposals. This will include appointing the Proposal Manager and as appropriate, chairing the Steering Committee. Involvement of relevant agencies will be managed by DPC.

4.4 STEERING COMMITTEES

Unsolicited Proposals Steering Committee

An overarching Unsolicited Proposals Steering Committee has been established comprising senior representatives of the following agencies:

- Department of Premier and Cabinet (Chair)
- NSW Treasury
- Infrastructure NSW

Representatives of other agencies may be required to provide resources and input to assist in Steering Committee decision-making. Membership of the Steering Committee may change from time to time.

Responsibilities

The Steering Committee is responsible for:

- Reviewing recommendations made by the Proposal Manager or Assessment Panel at Stage 1 and agreeing proposed course of action
- Confirming the unique elements of the proposal and agreeing the approach to managing intellectual property

- Approving the Governance Plan to be applied to Stage 2
- Approving the makeup of the Assessment Panel
- Agreeing feedback to be provided to Proponents
- Defining the Reference Project
- Confirming the approach to assessing Value for Money, including endorsing the Public Sector Comparator (if appropriate)
- Providing policy and inter-agency input to deliberations
- Monitoring progress of assessments
- Considering recommendations from the Assessment Panel during Stage 2
- Endorsing negotiation conditions prior to Stage 3
- Reviewing recommendations at conclusion of Stage 3
- Making recommendations to Government.

Proposal Specific Steering Committees

For certain proposals the Unsolicited Proposals Steering Committee or Cabinet may direct a proposal specific Steering Committee be established to oversight assessment of that proposal. This would normally be the case only for proposals proceeding to Stage 2 of the assessment process. This proposal specific Committee would have the relevant responsibilities as outlined above, but will report to the Unsolicited Proposals Steering Committee on progress.

4.5 PROPOSAL MANAGER

A Proposal Manager has been appointed by DPC in order to receive and progress consideration of Unsolicited Proposals. The Proposal Manager has the following responsibilities, unless otherwise documented in the Governance Plan:

- Receive Unsolicited Proposals
- Undertake an initial compliance check
- Facilitate the Assessment Panel and/or Steering Committee
- Act as contact point for Proponents
- Facilitate interactions between the Proponent and Government
- Facilitate the preparation of information provided to the Proponent
- Coordinate assessment, including input from advisers
- Coordinate preparation of Assessment Reports
- Provide assistance to Government agencies with a responsibility for assessing Unsolicited Proposals.

Once a proposal proceeds to Stage 2, a separate Proposal Manager will be appointed specifically for that proposal.

4.6 ASSESSMENT PANEL

An Assessment Panel comprising appropriately qualified representatives will be established to undertake the assessment. The involvement of the Assessment Panel during Stages 1 and 2 will vary depending on the nature of the proposal. The makeup will be approved by the Steering Committee.

The Assessment Panel will:

- Report to the Steering Committee
- Participate in meetings with the Proponent, where appropriate
- Assess the Initial Submission and Detailed Proposal against the Assessment Criteria
- Prepare recommendations to be made to the Steering Committee
- Prepare Assessment Reports as required by the Steering Committee
- Consider issues raised by the Steering Committee
- Prepare a proposed schedule of items for negotiation during Stage 3 (to be approved by Steering Committee and/or Cabinet, if required).

4.7 AGENCIES

Unsolicited Proposals received by agencies will not be accepted and should be forwarded to the Department of Premier and Cabinet as set out in the Guide. Where a proposal affects a particular agency, that agency will commit appropriate resources to fully participate in the assessment and proposal development processes.

4.8 ADVISERS

Advisers may provide expert advice to the Assessment Panel and Steering Committee. The following key advisers may be appointed to provide specialist expertise to assist in project scoping and assessment:

- Legal
- Financial
- Technical
- Environmental.

Other advisers may be appointed where specialist input is required.

Advisers are to follow all project governance and probity requirements.

4.9 PROBITY ADVISER

A probity adviser may be appointed for large-scale projects or where probity risk is considered sufficient to warrant appointment. If appointed, the role of the probity adviser is to monitor and report on the application of the probity fundamentals during the assessment process. Probity advisers are usually appointed at Stages 2 and 3 of the assessment process.

The probity adviser will report to the chair of the Steering Committee and will be available to Proponents to discuss probity related matters.

In the absence of a probity adviser, this role will be undertaken by the Proposal Manager.

Proponents are able to request the appointment of a probity adviser.

5 THE PROCESS

5.1 INTRODUCTION

This section outlines a four stage assessment process for the consideration of Unsolicited Proposals. It is recognised that the nominated stages may be refined in order to most effectively manage the assessment of any particular proposal. For example, each stage may include a number of milestones to be achieved in order to prevent unnecessary expenditure and to provide confidence for the Proponent to continue. Any milestones or changes to the stages will be discussed and agreed with the Proponent.

5.2 PRE-SUBMISSION CONCEPT REVIEW STAGE

Objective

For the proponent to meet with DPC (which may at its discretion include relevant agencies) in order to formally explore whether the proposal is likely to meet the Stage 1 assessment criteria, in particular the uniqueness criteria, and to guide proponents in their decision regarding whether to lodge their proposal. This is not a compulsory stage, but proponents planning to formally submit an unsolicited proposal are strongly advised to arrange such a meeting with DPC, prior to committing substantial resources for the development of the proposal.

Timing

It is recognised that there may be numerous discussions at many levels between the proponent and Government stakeholders in order to ascertain Government needs and to better understand the business environment. These are informal discussions and are outside the realm of this Guide.

This initial meeting represents the first formal step in assessing the merits of each Unsolicited Proposal and may be before or after lodgement of the full proposal. The Government's strong preference is that this occurs before formal lodging of any proposal and commencement of Stage 1.

Proponent responsibilities

In order for this meeting to be helpful, the proposal needs to be developed to a stage where the key inputs and outcomes have been identified, key assumptions and requirements of Government are clear, and other key elements have been identified. In particular, the unique ability of the proponent to deliver the proposal should be demonstrated and documented. The initial Schedule of Information Requirements at Section 8 should be completed, as well as the Pre-Lodgement Meeting Checklist at Section 9. Irrespective of the outcomes of this meeting, proponents may lodge their proposal formally.

Government responsibilities

Where the Government is of the view that there is little prospect of the uniqueness criteria being met, it will communicate this to the proponent. In such circumstances, the Government reserves the right not to advance assessment of the proposals to Stage 1 assessment as set out below.

5.3 STAGE 1

a) INITIAL SUBMISSION and PRELIMINARY ASSESSMENT

Objective

For DPC to undertake a Preliminary Assessment of the proposal in conjunction with the relevant agencies to determine if the submission constitutes an unsolicited proposal and if sufficient justification exists to justify direct dealing and therefore undertake a Stage 1 assessment. Government reserves the right to further consider, or not consider, Unsolicited Proposals beyond this stage at its absolute discretion. The Unsolicited Proposals Steering Committee approves progression to Stage 1.b).

Proponent responsibilities

During Stage 1.a), the Proponent is responsible for:

- Preparing an Initial Submission in accordance with the Schedule of Information Requirements listed on the Government Website
- Identification of unique elements of the proposal
- Forwarding the Initial Submission to the Director General, DPC
- Responding to requests for further information. The information to be provided will depend on the size and complexity of the proposed project.

Government responsibilities

During Stage 1.a), Government is responsible for:

- Promptly acknowledging receipt of the Initial Submission
- Undertaking an initial compliance check to ensure the required information has been provided
- Requesting further information from the Proponent if required. This may involve clarification meetings with the Proponent in order to promote clarity of Government requirements
- Undertaking a Preliminary Assessment that will be based on the potential for the proposal to satisfactorily meet the Assessment Criteria
- Preparing a Preliminary Assessment Report for review and approval by the Steering Committee
- Steering Committee approval to progress to Stage 1.b), if warranted
- Notification of the Preliminary Assessment outcome to the Proponent.

Outcomes

The following outcomes may result from this stage:

- The Submission is considered suitable for progression to Stage 1.b)
- The Submission is not considered suitable for further consideration.

Feedback

Proponents will be provided with written feedback on whether their Submission has progressed to Stage 1.b) or reasons for a decision not to proceed with a proposal.

b) STRATEGIC ASSESSMENT of INITIAL SUBMISSION

Objective

For Government to undertake a comprehensive initial assessment of the proposal to identify the potential benefit to Government of further consideration and development with the Proponent.

Proponent responsibilities

During Stage 1.b), the Proponent is responsible for:

- Responding to requests for further information. The information to be provided will depend on the size and complexity of the proposed project.

Government responsibilities

During Stage 1.b), Government is responsible for:

- Establishment of the Assessment Panel
- Requesting further information from the Proponent if required. This may involve clarification meetings with the Proponent in order to promote clarity of Government requirements
- Undertaking a formal assessment. The assessment will be based on the potential for a subsequent Detailed Proposal to satisfactorily meet each of the Assessment Criteria if progressed to Stage 2
- Preparing an Assessment Report for review and approval by the Steering Committee
- Preparing a draft Participation Agreement for all proposals deemed appropriate to progress to Stage 2
- Notification of the initial assessment outcome to the Proponent
- Government approval to progress to Stage 2, if warranted.

Outcomes

The following outcomes may result from this stage:

- The proposal is considered suitable for progression to Stage 2
- The proposal, in concept form, is deemed of sufficient interest to Government to warrant further development and progression to a more defined project either with the original Proponent or with a view to bringing a project to market
- The proposal is not sufficiently unique to justify direct negotiations with the Proponent. In this case, the Steering Committee will agree a recommended course of action
- The submission is considered suitable for referral to the relevant agency for further consideration if the project appears to have merit, requires a relatively low resource commitment by Government, is low risk, affects a single agency only and does not conflict with a whole of Government initiative
- The Submission is not considered suitable for further consideration.

Feedback

Proponents with proposals considered suitable to proceed to Stage 2 or referral to an agency for further consideration will be provided with the following information:

- A summary of the assessment findings
- The proposed process for the further development and consideration of a Detailed Proposal, including governance arrangements

- Guidance regarding: value, scope, appropriate target return on investment parameters, timing, risk and other limitations affecting the Detailed Proposal in order to avoid unnecessary costs for the Proponent
- A Draft Participation Agreement.

Written feedback providing reasons for a decision not to proceed with a proposal will be provided.

Brief details of all Unsolicited Proposals that progress to Stage 2 will be included on the Government Website. Generally, the Government seeks to disclose all proposals in this stage. In some cases, Proponents may request that proposals are not listed, if this would pose significant risks to commercial negotiations or intellectual property. The Government considers each request and may agree not to disclose a proposal. The ability to undertake an assessment in confidence is considered essential to creating a receptive environment to elicit innovative private sector proposals.

5.4 STAGE 2 – DETAILED PROPOSAL

Objective

For the Proponent and Government to work cooperatively in the development and assessment of a Detailed Proposal, which may require a degree of preliminary negotiation on key issues, subject to the nature of the proposal.

Proponent responsibilities

During Stage 2, the Proponent will:

- Enter into a Participation Agreement
- Attend the Establishment Meeting
- Participate in Proposal Development Workshops
- Prepare and submit a Detailed Proposal in a form previously agreed with Government that addresses each of the Government's Assessment Criteria. This may include draft commercial terms for Government's consideration, if appropriate.

Government responsibilities

During Stage 2, the Government will:

- Enter into a Participation Agreement
- Facilitate an Establishment Meeting in order to:
    - ➢ Provide feedback to the Proponent regarding risks and concerns with the Initial Submission
    - ➢ Provide guidance to the Proponent regarding Government requirements
    - ➢ Agree the approach to managing Proposal Development Workshops
    - ➢ Advise of the relevant Assessment Criteria
    - ➢ Agree the format for the Detailed Proposal, including the information and level of detail required
    - ➢ Commence discussions concerning the acceptable commercial and legal terms (with a view to developing draft commercial and legal terms that will form the basis of a final binding offer).
- Commit appropriately experienced and qualified resources to participate in the Stage 2 process
- Prepare an internal Governance Plan

- Define a Reference Project which accurately reflects the scope of the proposal
- Investigate benchmarking and prepare the Public Sector Comparator for the Reference Project, where appropriate
- Participate in Proposal Development Workshops. Where appropriate, the Government may establish commercial/technical teams to guide and liaise with the proponent. These teams will provide information to the Assessment Panel which will in turn report to the oversighting Steering Committee.
- Provide further information to the Proponent to assist with proposal development
- Receive the Detailed Proposal
- Undertake assessment of the Detailed Proposal (by the Assessment Panel) against each of the Assessment Criteria
- Request further information from the Proponent as required
- Prepare an Assessment Report (by the Assessment Panel) and make recommendations to the Steering Committee
- Make recommendations to Government.

Outcomes

The following outcomes may result from this stage:

- The Detailed Proposal is considered acceptable to progress to Stage 3
- The Detailed Proposal not considered suitable for further consideration.

Feedback

- Proponents progressing to Stage 3 will be provided with a draft Stage 3 Agreement and a schedule of items and issues to be negotiated (this may be provided separately to the Stage 3 Agreement).
- Written feedback providing reasons for a decision by Government to not proceed will be provided.

5.5 STAGE 3 – NEGOTIATION OF FINAL BINDING OFFER

Objective

To finalise all outstanding issues with a view to entering into a binding agreement.

Proponent responsibilities

During Stage 3, the Proponent will:

- Enter into a 'Stage 3 Agreement'
- Participate in the negotiation process
- Submit a Binding Offer, including appropriate legal and commercial terms.

Government responsibilities

During Stage 3, Government will:

- Enter into a 'Stage 3 Agreement'
- Inform the Proponent of the process and protocols for negotiation
- Provide the Proponent with a schedule of items for negotiation
- Prepare an internal Governance/Negotiation Plan
- Commit appropriately qualified resources to complete negotiations, including legal, financial and technical advice where appropriate

- Undertake a comprehensive assessment of the Binding Offer
- Define the appropriate Contract Management arrangements to monitor and ensure contracted outcomes are delivered
- Make recommendations to Government (Cabinet).

Outcomes

The following outcomes may result from this stage:

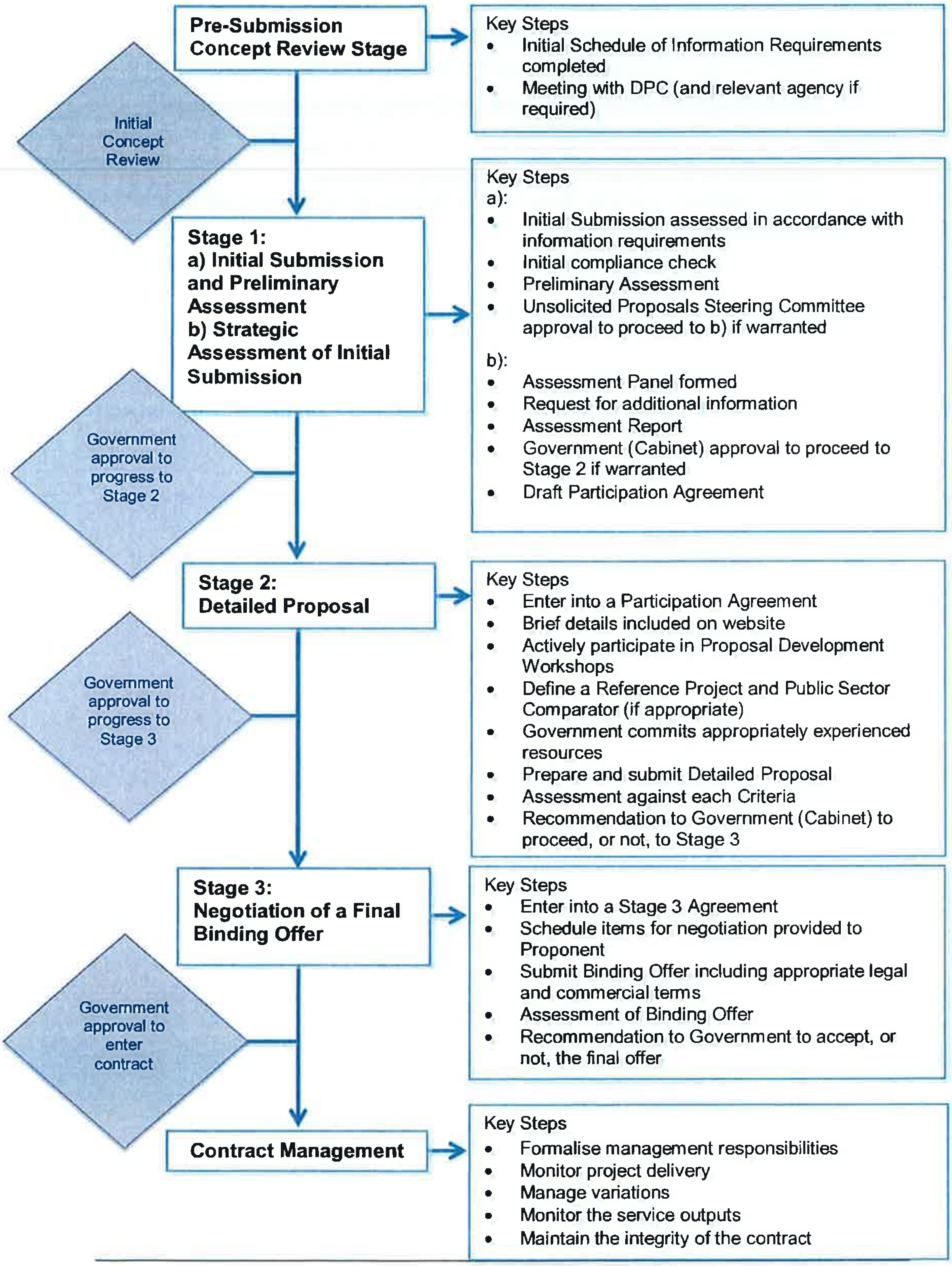
- Recommendation to Government that the Binding Offer be accepted
- Recommendation to Government that the Binding Offer not be accepted.

Feedback

- Notification of recommendations and ongoing procedures
- Written feedback providing reasons for a decision to not proceed will be provided to the Proponent.

6 PROCESS FLOWCHART

Key Stages in the Consideration of Unsolicited Proposals



7 GLOSSARY OF TERMS

Term	Meaning
Assessment Criteria	The criteria upon which Proposals will be assessed
Assessment Panel	A panel of Government representatives established to assess an Unsolicited Proposal (this may include specialist advisors)
Binding Offer	A formal proposal submitted by the Proponent at the conclusion of Stage 3 which is capable of acceptance by Government
Detailed Proposal	A submission by a Proponent to Government at the conclusion of Stage 2
DPC	The NSW Department of Premier and Cabinet
Establishment Meeting	The first meeting between Government and the Proponent held at the commencement of Stage 2
Government	The NSW State Government
Government Website	http://www.nsw.gov.au/unsolicitedproposals
Initial Submission	A submission by the Proponent during Stage 1 which briefly describes the proposal (in accordance with the Schedule of Information Requirements)
Initial Schedule of Information Requirements	Information to be prepared by Proponent in preparation for pre-lodgement meeting with DPC
Intellectual Property	Inventions, original designs and practical applications of good ideas protected by statute law through copyright, patents, registered designs, circuit layout rights and trademarks; also trade secrets, proprietary know-how and other confidential information protected against unlawful disclosure by common law and through additional contractual obligations such as Confidentiality Agreements.
Participation Agreement	An agreement signed by Government and the Proponent at the commencement of Stage 2
Proponent	The person or organisation that submits an Unsolicited Proposal
Proposal Development Workshop	Interactive meetings held between Government and Proponent representatives with the aim of progressing proposal development
Proposal Manager	The person with responsibility for coordinating Government input for the receipt and assessment of an Unsolicited Proposal

Public Sector Comparator	An estimate of the hypothetical whole-of-life cost for Government to undertake the project using traditional procurement methods
Reference Project	The defined scope of the project incorporating vision, objectives, physical and service, deliverables and timeframe
Stage 3 Agreement	An agreement signed by the Government and the Proponent at the commencement of Stage 3.
Steering Committee	A committee of senior Government representatives with responsibility for oversight of Government consideration of Unsolicited Proposals (this may include independent chair/members)
Unsolicited Proposal	An approach to Government from a Proponent with a proposal to: • Build and/or finance infrastructure, and/or • Provide goods or services where Government has not requested the proposal.
Value for Money	The overall value to Government. Consideration given to factors such as: • Whole of life cost and revenue • Quality • Risk borne by Government • Benefits gained • Whole of Government outcomes.

8 SCHEDULE OF INFORMATION REQUIREMENTS

This form is to be completed by organisations in presenting an Unsolicited Proposal to Government (note: must be a registered organisation). Please ensure all sections of this form are adequately addressed. Information may be presented in the form of cross referenced addenda if preferred.

An initial version of this schedule should be prepared prior to the formal "Pre-Lodgement" meeting with DPC.

Organisation Name:		**Address:**	
Identity:	[Individual, sole trader, company, etc.]	**Type of organisation:**	[Profit / non-profit, educational, small business, etc.]
Contact person(s) details for evaluation purposes:		**Date of submission**	
Concise title and abstract of proposal (approx. 200 words)			
Short Title Abstract			
Proposal details			
i. Objectives of the proposal ii. Method of approach iii. Nature and extent of anticipated outcomes iv. Benefits the proposal will bring to the State			
Assessment Criteria			
Please provide a brief description of how the proposal would meet each of the assessment criteria. Refer to section 3.3 of the Guide for detailed description of each criteria and items to be addressed. 1. Uniqueness i.e. what are the unique elements of the proposal that would provide justification for Government entering into direct negotiations with the Proponent? Unique elements may include characteristics such as: - Intellectual property or genuinely innovative ideas			

- Ownership of real property
- Ownership of software or technology offering a unique benefit
- Unique financial arrangements
- Unique ability to deliver strategic outcome
- Other demonstrably unique elements.

2. Value for money
3. Whole of Government impact
4. Return on investment
5. Capability and capacity
6. Affordability
7. Risk allocation

Financial and commercial details

Please provide a brief description of the financial and commercial details of the proposal and the proponent's financial capacity to deliver the proposal. Clearly explain what the proposed commercial proposition is.

Costs and Requirements of Government

Please provide details of costs to Government.

Clearly explain the requirements of Government emerging from the proposal (what are you seeking from Government?). This may include legislative/regulatory amendments, finance or the use of Government assets, facilities, equipment, materials, personnel, resources and land. What would be the cost of Government providing this? (e.g. what would be the value of the Government land?)

Risks

Please provide a list of proponent and Government risks.

Organisation

Please provide a brief description of:

i. Your organisation
ii. Previous experience in delivery of similar project
iii. Past performance operating similar project
iv. Facilities to be used (e.g. land owned by proponent or Government land)

Intellectual property

If applicable please provide a description of the following:

i. Inventory of each item of intellectual property
ii. Nature of the intellectual property claimed (e.g. copyright, patent, etc.)
iii. The owner(s) of the intellectual property claimed
iv. Registration details (where applicable)

v. Details of any items for which confidentiality is wholly or partly claimed.			
Other statements			
For example, please detail any applicable organisational conflict of interest and environmental impacts.			
Preferred contractual arrangements			
Agency points of contact			
If applicable, please provide names and contact information of any other agency and Government points of contact **already** contacted regarding this proposal.			
Period of time for which the proposal is valid	Minimum six months	**Proposed duration of the arrangement**	

This proposal is to be signed by a representative of the proponent authorised to represent and contractually bind the proponent.

Name: ______________________________

Position: ____________________________

Signature: ___________________________

Date: _______________________________

9 PRE-LODGEMENT MEETING CHECKLIST

The following checklist should be completed prior to the formal "Pre-Lodgement" meeting with DPC.

		YES	NO
1	Have you completed the initial Schedule of Information Requirements?	☐	☐
2	Are you the only party that could deliver your proposal?	☐	☐
3	Have you documented why the product/service you are proposing (or similar) cannot be delivered by a competitor?	☐	☐
4	Do you own any intellectual or real property required for your proposal?	☐	☐
5	Have you documented your ownership of any intellectual or real property required for your proposal?	☐	☐
6	Does your proposal contain unique elements that could not be replicated by others, other than related intellectual or real property?	☐	☐
7	Does your proposal contain unique elements that would require the Government to contract with your company if the Government went to tender?	☐	☐
8	Have you documented the unique elements (other than related intellectual or real property) of your proposal that could not be replicated by others, and which provide tangible benefits to the NSW Government?	☐	☐
9	If you answered "NO" to any questions, have you documented in the (initial) Schedule of Information Requirements the basis you believe the Government should consider your proposal, given that it is likely it does not meet basic "uniqueness" criteria as set out in the Guide. Note – in some cases the Government may recognise merit in your proposal, but want to ask the market to confirm value for money. Please discuss this with DPC in the pre-lodgement meeting.	☐	☐

Financing Public Infrastructure in Queensland

Property Council of Australia (Queensland Division)

Final Version 1.1

March, 2010

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Executive Summary

This report presents alternatives to traditional financing methods for public infrastructure.

In light of the global financial crisis and the rapidly changing economic environment the Property Council of Australia (Queensland Division) (PCA) desires to play a leadership role in the debate over appropriate approaches to finance public infrastructure in Queensland.

To facilitate this role, this report has been commissioned to present information on and to assess, traditional and alternative financing mechanisms. It is not the intention of this report, or the PCA, to promote certain financing alternatives or specific public infrastructure projects.

The Queensland Government is faced with a significant public infrastructure task...

It is clear that Queensland is at a crossroads in how the backlog and future required level of public infrastructure is to be financed. There is an identified $124 billion of public infrastructure required by 2026 (in SEQ alone) to be partially financed through a four year borrowing program of $28.3 billion, most of this in 2009-10 as a stimulus measure to maintain employment through the economic downturn. This is occurring at a time when Queensland Government revenues are collapsing due to the global and local contraction in economic activity.

Whilst the Queensland Government intends to partially address the shortfall through cuts in grants to local government and asset sales these approaches are not without their difficulties. Cuts to local government grants shift the problem of financing the infrastructure the grants would finance to elsewhere, whilst asset sales are meeting some resistance. The asset sales are further clouded by a lack of appetite and liquidity within the private sector to finance public sector infrastructure.

Furthermore, the Queensland Government proposes to reduce its public infrastructure investment in the future to focus on improving its fiscal position in which case there is a question over where the financing will come from for the remaining infrastructure required to 2026.

...and wants to include the private sector more.

The Queensland Government's position appears to include private sector involvement for the provision of public infrastructure but, a concerted effort needs to be made to actively encourage and facilitate the involvement of the private sector. The intention of this paper is to examine traditional and alternative financing methods that may encourage more private sector provision of public infrastructure.

There are a number of public infrastructure financing methods used in Queensland...

Governments in Australia generally uses a variety of financing methods for the provision of public infrastructure. Whilst these can have different names they generally fall into one of the following five categories:

- *General taxation* - covers the full range of Commonwealth, State and Territory taxes, and also includes municipal rates levied by local government;
- *Government borrowing* - the issuing of long-term government debt, typically in the form of various bonds (in Queensland through Queensland Treasury Corporation);
- *User charges* - fees levied on the consumer of the goods and charges which generally cover cost recovery through to full commercial pricing;
- *Developer contributions* - an upfront user charge for future infrastructure services, generally required prior to construction; and
- *Public Private Partnerships* - where the private sector is contracted to design, build, operate, manage and finance new infrastructure and meet government obligations for a set period of time.

...but there are also a broader range of alternative financing methods.

There are many other alternative methods of financing public infrastructure in use around the world. The following have been selected and included in this report:

- *Specific Purpose Securitised Borrowing* – issuance of debt instruments such as bonds, debentures and inscribed stocks in the capital market to finance a particular project;
- *Certificates of Participation* – where governments enter into agreements with not-for-profit entities that issue bonds to finance facilities that are leased back by the government;
- *Value Capture Levy* - aims to capture the uplift in land value that results from the planning process, development of land, or construction of beneficial infrastructure;
- *Specific Purpose Levies* – implementation of an ad hoc levy to meet specific infrastructure needs of an area;
- *Growth Area Bonds* – issue of bonds to finance infrastructure enhancement that are tied to a specific area repaid through future tax revenues collected in a defined area; and
- *Business Improvement Districts* – stakeholders within a defined boundary make a collective contribution towards the maintenance and promotion of an area.

All financing methods needs to be understood and their characteristics assessed.

Each financing method has unique characteristics and suitability to different public infrastructure projects. Both traditional and alternative financing methods were assessed against nine characteristics including:

1. *Effectiveness* – ability of the method to mobilise sufficient funds in a timely manner;
2. *Efficiency* - considers the impact of a funding method upon wellbeing in general;
3. *Equity* - the fairness or otherwise of a method;
4. *Stability/reliability of the revenue base* - a consistent and predictable source of revenue is preferred to a source that is subject to shifting and unforeseeable influences, as is one that grows reliably over time;
5. *Administration costs* – the cost to raise the finance and minimise the scope for evasion or avoidance;
6. *Compliance costs, certainty and transparency* – the costs of ensuring the method stands up to public and investor scrutiny;
7. *Stakeholder support* – to what extent will the method be accepted as reasonable.
8. *Risk management* – the assignment of non-diversifiable project risks and management of the overall project risk; and
9. *Exposure to market or other disciplines* – the extent to which borrowers and lenders share, signal and can act on information on project prospects and risks on investment decisions.

In addition the traditional financing methods were subject to an economic assessment following previous work by The Allen Consulting Group (2003). This was undertaken using the Monash Multi-Regional Forecasting model (MMRFM), a dynamic multi-regional, multi-sectoral applied general equilibrium model of the Australian economy.

The assessment of traditional financing methods shows a preference for methods that match the costs to the benefits over time.

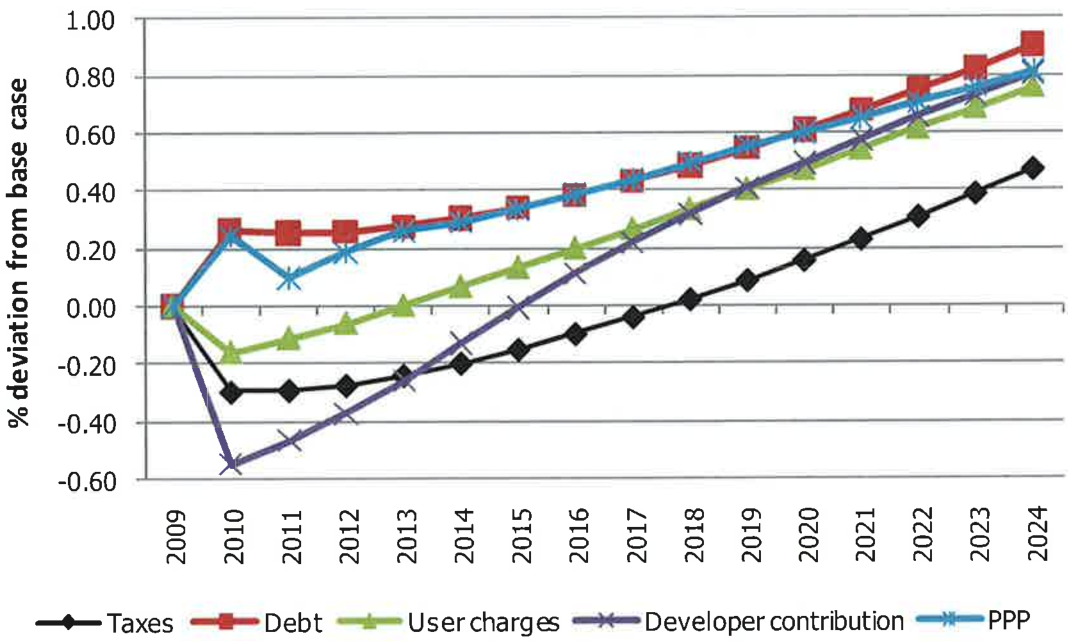
Whilst a qualitative assessment is to some degree subjective and should be interpreted as an indication rather than a definitive measurement, the assessment does indicate that government debt has stronger characteristics that the other traditional methods. The beneficial characteristics of government debt include: very stable revenue base (government guaranteed), very low administration costs, very low compliance costs, high certainty and transparency and minimal exposure to other management disciplines.

PPPs do not rate as well in the assessment even though they are largely debt funded and in this regard should have similar characteristics to government debt. They are impacted by very high administration costs, very high compliance costs, concerns around certainty and transparency and very high exposure to other management disciplines leading to high levels of information asymmetry[1].

Developer charges perform poorly in the qualitative assessment due to their inefficient and inequitable nature. Furthermore they are impacted by high administration costs and high compliance costs and low certainty and transparency.

From a quantitative perspective, using employment as the indicator, the modelling results indicate that financing methods that match the costs of the infrastructure with the benefits to the community over time should be preferred (Government debt and PPPs). Other methods show a negative impact in the early stages of the infrastructure's life and consequently never deliver the same level of employment benefits. Taxation is a particularly poor performer and is shown to have a negative impact on employment for almost nine years.

Figure E.1: Employment change from traditional financing methods based on a $1 billion increase in expenditure



Source: Prime Research

All of the alternative financing methods presented could be used in Queensland with the appropriate adjustments to the legislative framework.

All of the alternative financing methods considered in this report appear to be relatively successful in the jurisdictions in which they are used. This gives a level of confidence that they could be used in Queensland to finance public infrastructure. Indeed with the exception of business improvement districts, all alternative financing methods have direct application to a large number of projects contained in the SEQIPP.

In line with the qualitative assessment of the traditional financing methods, those related to debt, i.e. special purpose securitised borrowing and certificates of participation, have more favourable characteristics than most of the others. As demonstrated overseas, in particular in the US, both of these debt instruments appear to be particularly suited for statutory authority use, including local government, and can be used finance a wide variety of discrete economic and social infrastructure.

Value capture and special purpose levies are suitable methods to raise finance but suffer from the perception of being a new tax that may not be used for the purpose it is

[1] Where one party has more or better information than the other which may create an imbalance of power in transactions.

designed for. Value capture levies appear to have had implementation difficulties in some jurisdictions but remain a very equitable means of distributing windfall gains from planning decisions.

Likewise growth area bonds have some very attractive features and have been shown by PriceWaterhouseCoopers (2008) to be viable in Australia.

Business improvement districts have many strong characteristics mainly because they are voluntary and the businesses that contribute are expected to be the main beneficiaries. However, they are only suitable for relatively minor public infrastructure due to the voluntary nature of the funding base and a strong desire to accrue benefits locally.

Almost all financing alternatives presented require changes to legislation for them to be used in Queensland. Legislation changes for some of the alternative financing methods would be fairly minor in nature (e.g. debt instruments) but other legislation would probably meet with resistance (e.g. growth area bonds and levies) if they were perceived as a new tax.

The findings of this report lead to a number of recommendations for consideration in the future provision of public infrastructure in Queensland.

1. **Usage of alternative financing methods** - *The Queensland Government should investigate alternative financing methods for the provision of public infrastructure.*

The current Queensland Government budgetary constraints and economic circumstances combined with the extensive list of public infrastructure projects outlined in the SEQIPP along with other regional plans indicate the need for alternative methods of financing public infrastructure.

2. **More encouragement of private sector involvement** - *The Queensland Government should examine its current PPP experiences to increase the attractiveness of PPPs to the private sector as well as offer alternative financing methods.*

The Queensland Government position and private sector desires both indicate the need for a greater involvement by the private sector in the provision of public infrastructure. However, the Queensland Government needs to consider effective and efficient ways of encouraging and facilitating private sector involvement possibly using alternative financing methods.

3. **Matching of financing methods to public infrastructure** - *The Queensland Government should indicate suitable financing mechanisms for each SEQIPP and other regional public infrastructure projects and where appropriate invite initial financing proposals from the private sector.*

The current State Budget only looks ahead four years, whilst the SEQIPP has a 21 year timeframe. Where the value and the timing of projects are identified it is unclear how these projects will be financed beyond the four year term of the State Budget. Indicating suitable financing mechanisms into the future would provide some indication to the private sector which projects may be available to them. With this information the Queensland Government could invite financing proposals from the private sector, on an annual basis, that may improve the timing, cost and delivery of public infrastructure projects.

4. **Provide additional financing methods to statutory authorities** - *The Queensland Government should investigate the use of additional financing mechanisms for public infrastructure provision by statutory authorities such as local government and the ULDA.*

With the regionalisation and increasing size and responsibilities of local government in Queensland, local government are being required to finance more and larger public infrastructure projects. At the same time grant support is being removed by the Queensland Government. Therefore local government and other statutory bodies that supply infrastructure, such as the ULDA, should have access to a wider range of financing methods and mechanisms to involve the private sector in the provision of public infrastructure.

Table of Contents

Abbreviations

ARTC	Australian Rail Track Corporation
ASX	Australian Stock Exchange
BAB	Build America Bonds
BID	Business Improvement District
CBA	Central Borrowing Authority, e.g. QTC
CCTV	Closed Circuit Television
COAG	Council of Australian Governments
CoP	Certificate of Participation
DIP	Department of Infrastructure & Planning (Queensland)
GAB	Growth Area Bond
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GTE	Government Trading Enterprise
IAQ	Infrastructure Association of Queensland
ICS	Infrastructure Charges Schedule
IMF	International Monetary Fund
PAF	Project Assurance Framework (Queensland Government)
PBC	Port of Brisbane Corporation
PCA	Property Council of Australia
PIP	Priority Infrastructure Plan
PPP	Public Private Partnership
PNFC	Public Non-Financial Corporation
MYFER	Mid Year Fiscal and Economic Review
NFPS	Non-Financial Public Sector
VFI	Vertical Fiscal Imbalance
VfM	Value for Money Framework (Queensland Government)
QCA	Queensland Competition Authority
QML	Queensland Motorways Limited
QTC	Queensland Treasury Corporation
SEQIPP	South East Queensland Infrastructure Plan and Program
SDM	Supported Debt Model
SPV	Special Purpose Vehicle
TIF	Tax Increment Financing
UDA	Urban Development Area
ULDA	Urban Land Development Authority

Glossary

Assessment bond	A bond issued by government that is secured from the revenues generated by property taxes of properties located within the government boundaries.
Business Improvement District	A business-local government partnership in which businesses in a defined area pay an additional tax or fee in order to fund improvements within the district's boundaries.
Certificate of Participation	A bond issue is created in order to fund a project and rather than owning the facility during the period of construction, the government leases the facility and makes instalment payments toward the lease.
Developer contribution	An upfront charge for future infrastructure services generally paid in the form of land, money, or works in kind by developers to state or local governments.
Financing	The acquisition of monetary resources to undertake capital investments.
Financing vehicle	The arrangement or method by which public infrastructure projects are financed.
Funding	The subsequent act of payment or the servicing of any debt associated with the initial financing of public infrastructure.
General budget appropriation	The xuthorization by a legislative entity that allocates a designated amount of public finances to a government for a specified purpose, such as a public infrastructure investment
General Government	Public entities predominantly financed through taxes and government grants, e.g. Department of Health.
General obligation bond	A bond secured by the taxing and borrowing power of the issuing government, rather than from the revenue of a given infrastructure project.
Growth Area Bonds	A specialised form of debt financing where future property tax revenues are set aside to repay the bond. Also know as TIF.
Information asymmetry	Where one party has more or better information than the other and creates an imbalance of power in transactions.
Public Non-Financial Corporation	Public entities whose primary function is to provide goods and services that are sold in markets, non-regulatory, non-financial in nature and where the sale of goods and services are their main source of revenue, e.g. electricity, ports, water.
Public Private Partnership	An agreement between public and private sector entities on the financing and provision of public infrastructure.
Non-Financial Public Sector	The consolidation of the General Government and Public Non-Financial Corporation sectors.
Revenue bond	A bond issued by government that is secured from the revenues generated by a public infrastructure project.
Specific purpose borrowing	Borrowing activities for specific purposes, including the financing of public infrastructure.
Specific purpose levy	A levy or charge imposed for a specific purpose, including the financing of public infrastructure assets
Supported Debt Model	A PPP where a significant portion of the debt is supplied by government.
Tax credit bond	Bond issued by a government, whereby the tax liability imposed with respect to interest payments are reduced by an amount equal to the specified tax.
Tax exempt bond	Bond issued by a government, whereby interest payments are not subject to federal income tax and/or sub national income tax.
Value capture levy	A value capture levy aims to capture the uplift in land values that result from the planning process, development of land or or construction of beneficial infrastructure.

Source: Various

1. Introduction

In light of the global financial crisis (GFC) and the rapidly changing economic environment the Property Council of Australia (Queensland Division) (PCA) desires to play a leadership role in the debate over appropriate approaches to finance public infrastructure in Queensland.

To facilitate this role, this report has been commissioned to present information on and to assess, traditional and alternative financing mechanisms.

It is not the intention of this report, or the PCA, to promote certain financing alternatives or specific public infrastructure projects. However in line with the PCA's (2009) submission to the Federal Review into Australia's Future Tax System it is the report's intention is to identify alternative options for financing infrastructure projects.

1.1 Public Infrastructure

For this report public infrastructure are capital assets owned by government (or are ultimately owned by governments) or where the community funds the investment through fees and charges. There are basically two types of public infrastructure (Productivity Commission, 2009, p3):

- *Economic infrastructure* — incorporates the physical structures from which goods and associated services are produced that enter as common inputs to many industries, and which play a large part in determining efficiency, industry costs and levels of production. These include network infrastructure: road; rail; communications; electricity; gas; water supply; sewerage; and drainage, and nodal infrastructure such as ports and airports.
- *Social infrastructure* — includes the facilities and equipment directed at satisfying society's needs. Includes: educational facilities; cultural facilities; hospitals; libraries; sporting facilities, convention centres; and parks.

There is also *environmental infrastructure* which protects the environment and the services that the environment supplies to the economy or to sustain human life. Environmental infrastructure includes: national parks; catchment management; wetland restoration; and revegetation. Environmental infrastructure financing is not included in this report.

1.2 Report Objectives

The objectives of this report are to identify and describe traditional and alternative public infrastructure financing approaches and to:

- Assess them using qualitative criteria (e.g. effectiveness, efficiency, equity, administrative cost, stability/reliability of the revenue base, compliance costs, stakeholder support, incentives for risk management and exposure to other management disciplines);
- Model the economic impacts of traditional financing methods;
- Assess the risks and potential barriers to use of the alternative financing methods;
- Describe the required governance arrangements for alternative financing methods; and
- For alternative financing methods examine their strengths and weaknesses, suitable projects, obstacles and solutions within the Queensland context.

1.3 Report Structure

Following the above objectives the report is structured as follows:

- *Section 1 Introduction* – scope, objectives and structure of the report;
- *Section 2 Report Context* – description of the financial, economic and policy environment;
- *Section 3 Public Infrastructure Financing Methods* – identification of the traditional and alternative public infrastructure financing methods to be discussed;
- *Section 4 Assessment Framework* – description of the assessment framework applied to the various financing methods;
- *Section 5 Assessment of Traditional Financing Methods* – assessment framework applied to traditional financing methods;
- *Section 6 Assessment of Alternative Financing Methods* - assessment framework applied to alternative financing methods;
- *Section 7 Application of Alternative Financing Methods in Queensland* – discussion of the alternative financing methods including strengths, weaknesses, applicability to projects, obstacles and solutions; and
- *Section 8 Summary and Recommendations* – summarises the findings of the report and presents recommendations.

Property Council of Australia 2010 Advocacy Agenda

The Queensland Division of the Property Council of Australia represents over 340 member companies ranging from property owners, developers, investors, managers to professional service providers to the property industry.

The 2010 Advocacy Agenda for Queensland sets the policy priorities that will drive the Property Council's engagement with all levels of government throughout the year.

Our first focus for 2010 is **infrastructure** – where we are looking for increased spending on urban infrastructure, a reduction of infrastructure charges and improved Government planning, infrastructure coordination and delivery. Pursuing alternative infrastructure financing models is a key pillar of these actions.

Our second focus issue is **planning for realistic outcomes**. The Property Council is strongly advocating for simpler, clearer planning rules and realistic infill and greenfield targets – which would lead to increased and more affordable land supply. If we are to meet the targets set by the South East Queensland Regional Plan we need an industry aware government, and planning policies that help deliver good community outcomes.

The third area of focus is closely linked with the second one: **quicker development assessment**. The property industry needs faster and more rational development assessments that provide greater certainty in time frames and approval outcomes.

Our fourth focus area is **regional growth and diversity** – where we recognise that stable economic growth and support for the property industry in regional areas is essential for a strong and vibrant Queensland economy.

The fifth area of focus is to **facilitate greater opportunity for sustainable outcomes**. Retro greening of existing building stock, fast tracked 'Green Door' development assessments, bigger incentives for green developers and owners are some of the issues that the Property Council will focus on in 2010.

And last but certainly not least is the issue of **land tax and the valuation system**. Further annual increases of 30% are simply unsustainable and will see investors choose interstate investment options.

2. Report Context

It is important to present some brief context around the need for governments to examine alternative approaches to financing public infrastructure, which has traditionally largely been through budget appropriation and/or debt financing with these largely considered to be the most efficient approaches. However, a number of recent shocks to the global and local economic and financial environment have triggered a need to review traditional financing methods and to consider alternatives.

2.1 Global Financial Crisis

One of the key financial and economic shocks impacting the Queensland economy over the last 18 months has been the global financial crises (GFC). In April 2009 the International Monetary Fund (2009, p. 1) stated:

> *The global economy is in a severe recession inflicted by a massive financial crisis and an acute loss of confidence. Wide-ranging and often unorthodox policy responses have made some progress in stabilizing financial markets but have not yet restored confidence nor arrested negative feedback between weakening activity and intense financial strains. While the rate of contraction is expected to moderate from the second quarter onward, global activity is projected to decline by 1.3 percent in 2009 as a whole before rising modestly during the course of 2010. This turnaround depends on financial authorities acting decisively to restore financial stability and fiscal and monetary policies in the world's major economies providing sustained strong support for aggregate demand.*

Strategies employed by national governments to restore financial institutions to health have generally been along three lines:

- Ensuring that financial institutions have access to liquidity;
- Identifying and dealing with distressed assets; and
- Recapitalising weak but viable institutions.

On the economic front, governments have used monetary policy (through low or zero official interest rates) and fiscal policy (through stimulus packages) to provide short term support to falling demand. For example, the Australian Government's response to the GFC and subsequent global recession has been to announce the $42 billion *National Building Economic Stimulus Plan*[2] to support jobs and invest in future long term economic growth. Combined with lost tax revenues (estimated to be $210 billion to 2012-13) the stimulus package will cause the Australian Government net debt position to increase from -0.4 per cent of GDP in 2008-09 to 13.6 per cent of GDP in 2012-13.

Of the $42 billion more than $18 billion of funds have already been approved nationally across the infrastructure elements of the Plan.

[2] Amalgamation of December 2008 *Nation Building Package* and the February 2009 *Nation Building and Jobs Plan*.

Table 2.1: Breakdown of approved projects and payments by jurisdiction to 30 June 2009

	Number of Approved Projects	Approved Funding
NSW	11,368	$5,876 m
VIC	6,365	$3,907 m
QLD	8,060	$3,588 m
WA	3,355	$1,479 m
SA	2,720	$1,400 m
TAS	758	$431 m
ACT	317	$279 m
NT	590	$325 m
National Projects	17 (ARTC)	$1,300 m (ARTC & Energy Efficiency)
TOTAL	**33,550**	**$18.6 billion**

Note: ARTC refers to the Australian Rail Track Corporation Ltd
Source: Commonwealth Department of Prime minister and Cabinet (2009)

The impacts of the Australian Government's stimulus packages is that there will be considerable investment in public infrastructure over the short to medium term as a means of:

- Maintaining and creating employment;
- Stimulating development and economic growth; and
- Enabling broader investment programs.

The stimulus package will be financed using debt which will result in a historically large budget deficit that will need to be repaid from cash flows in the longer term. By necessity the borrowing will crowd out some private sector investment and this crowding out will compound with the decline in asset values and general liquidity caused by the GFC to provide for a poor private infrastructure investment environment.

To illustrate the point above a survey by the Infrastructure Association of Queensland (IAQ) in December 2008[3] of leading Australian financial services firms found that there was evidence of capital rationing with lending ceilings being experienced in the range of $300 million (economic infrastructure projects) to $700 million (social infrastructure projects). A revisiting of the survey respondents in May 2009 found no significant change in debt market conditions with the major problems being the refinancing of capital intensive assets due to mature between 2009 and 2011.

Paradoxically, in the longer term government investment in public infrastructure will decline as governments seek to repair their own balance sheets in which case they may look to the private sector to plug the gap. The choice of financing methods appears therefore to be tied to the economic fortunes of providers and as these economic fortunes shift so should the usage of alternative financing approaches for public infrastructure.

2.2 Queensland Government

2.2.1 Revenue

The Queensland Government receives revenue from a variety of sources with traditionally 2/5 from Commonwealth Government current grants. In 2009-10 the share from taxation revenue is estimated to fall from 27.6% to 25%, whilst the capital grants from the Australian Government will increase from 2.9% to 10%. Revenue from royalties and land rents is estimated to fall from 10% to 4.9%. This makeup highlights the significant vertical fiscal imbalance between the Commonwealth and the State.

[3] Cited in Regan (2009).

Table 2.2: Budgeted Queensland General Government Revenue, $ million

Revenue	2008-09	share	2009-10	share
Taxation revenue	10,106	27.6%	9,287	25.0%
Grants revenue				
Current grants	14,631	40.0%	15,025	40.4%
Capital grants	1,056	2.9%	3,710	10.0%
Sales of goods and services	3,385	9.3%	3,650	9.8%
Interest income	2,199	6.0%	2,017	5.4%
Dividend and income tax equivalent income				
Dividends	841	2.3%	884	2.4%
Income tax equivalent income	210	0.6%	266	0.7%
Other revenue				
Royalties and land rents	3,644	10%	1,806	4.9%
Other	509	1.4%	548	1.5%
Total Revenue	**36,582**	**100.0%**	**37,192**	**100.0%**

Source: Queensland Government (2009b)

In contrast to the State Government, local government in Queensland only has a small reliance on grant revenue from other governments (7.2%) relying more heavily on its own revenue sources through sales of goods and services (35.6%) (mainly water and sewerage and cleansing) and other revenue (27.5%).

Of the taxation component of the Queensland State Government revenue just four taxes will make up almost 75% of taxation revenue. These are payroll tax (29.5%), transfer duties (18.3%), motor vehicle registration (13.3%) and land tax (11.3%).

Table 2.3: Queensland Local Government Revenue, 2007-08

Revenue	$ million	share
Taxation revenue	2,192	27.2%
Current grants and subsidies	580	7.2%
Sales of goods and services	2,868	35.6%
Interest income	194	2.4%
Other	2,214	27.5%
Total Revenue	**8,048**	**100.0%**

Note: Data is most recent year available.
Source: ABS 5212.0

Table 2.4: Budgeted Queensland Government Taxation Revenue, 2009-10

Source	$ million	share
Payroll tax	2,736	29.5%
Duties		
Transfer	1,704	18.3%
Vehicle registration	410	4.4%
Insurance[1]	441	4.7%
Other duties[2]	22	0.2%
Total duties	*2,577*	*27.7%*
Gambling taxes and levies		
Gaming machine tax	572	6.2%
Health Services Levy	44	0.5%
Lotteries taxes	232	2.5%
Wagering taxes	41	0.4%
Casino taxes and levies[3]	100	1.1%
Keno tax	18	0.2%
Total gambling taxes and levies	*1,006*	*10.8%*
Other taxes		
Land tax	1,047	11.3%
Motor vehicle registration	1,237	13.3%
Fire levy	295	3.2%
Community Ambulance Cover	145	1.6%
Guarantee fees	175	1.9%
Other taxes	69	0.7%
Total taxation revenue	**9,287**	**100.0%**

Notes:
1. Includes duty on accident insurance premiums.
2. Includes duty on life insurance premiums and mortgage duty.
3. Includes community benefit levies.

Source: Queensland Government (2009b)

The narrowness of these taxes and their exposure to economic influences has implications for their use in financing public infrastructure. Firstly the quantum of funds raised at $9 billion would only fund half of the budgeted 2009-10 capital works expenditure. Secondly, their exposure to economic influences means that the actual revenues may be somewhat volatile presenting a cash flow risk.

In local government the main source of taxation revenue is through general and special rates levied on property owners.

2.2.2 Response to the GFC

Similar to the Australian Government, the Queensland Government's response to the GFC has been to continue to invest in infrastructure ($18.2 billion in 2009-10) (to support jobs) with the down side that the State Budget will be in deficit for many years to come.

This is at a time when the State's revenue raising capacity is falling. Since the *State Budget 2008-09* the economic downturn has reduced forward estimates of revenue from royalties, State taxes and GST by $15 billion. The General Government sector's net operating deficit is forecast to reach approximately $1.9 billion in 2009/10 and increase to approximately $4 billion in 2011/12. Returning the budget to surplus is likely to impede future public infrastructure spending by the Queensland Government.

Furthermore the borrowing of the State is set to exceed $85 billion by 2012/13, an increase of 176% from 2007-08. The debt repayment from this increased borrowing, combined with higher interest rates due to the loss of the AAA credit rating will consume a higher amount of the State's revenues. For the General Government sector alone the interest bill is estimated to increase from $583 million in 2008/09 to 2,299 million in 2012/13. This will need to be financed from General Government revenues

Table 2.5: Queensland Government Budget Projections, $ million

Tax		07/08	08/09	09/10	10/11	11/12	12/13
General Government	Net operating balance	-$1,559	-$574	-$1,954	-$3,459	-$4,090	-$3,290
	Capital purchases	$3,668	$4,422	$6,354	$5,341	$2,773	$661
	Borrowing (net)	$5,226	$4,996	$8,308	$8,800	$6,864	$3,951
	Borrowing	$6,238	$10,765	$18,775	$27,898	$34,707	$39,234
Public Non-Financial Corporations	Net operating balance	$1,274	$356	$341	$252	$583	$1,058
	Capital purchases	$6,356	$7,049	$5,773	$3,592	$2,581	$1,829
	Borrowing (net)	$5,082	$6,693	$5,432	$3,340	$1,998	$771
	Borrowing	$24,613	$33,524	$38,949	$42,453	$44,923	$46,285
Non-Financial Public Sector (Total)	Net operating balance	-$1,297	-$1,062	-$2,485	-$4,179	-$4,607	-$3,655
	Capital purchases	$13,865	$11,471	$12,127	$8,933	$5,354	$2,491
	Borrowing (net)	$9,243	$12,533	$14,612	$13,112	$9,961	$6,145
	Borrowing	$30,925	$44,288	$57,723	$70,350	$79,630	$85,519

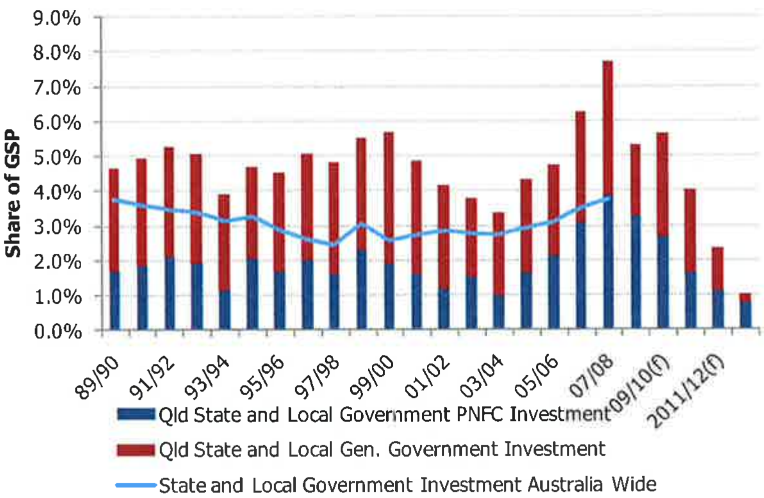
Source: Queensland Government (2008a and 2009b)

2.2.2.1 *New Spending or Catchup?*

For many years Queensland has recorded faster economic growth than the rest of Australia. Queensland Treasury (2003) identified growth in labour resources as one of the chief causes. This research also demonstrated the need for higher rates of capital investment (including public expenditure) in Queensland than the rest of Australia to maintain living standards in the face of continued strong population growth.

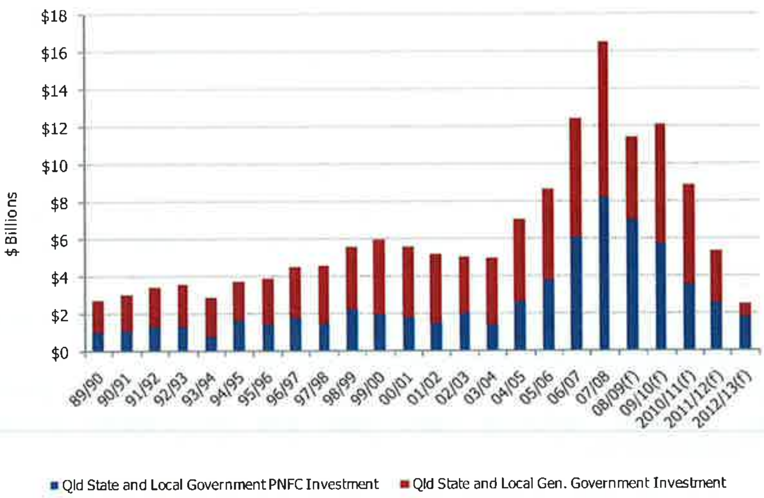
Since 2004/05, Queensland, State and Local Government investment has risen in both the General Government and Public Non-Financial Corporations (PNFC) sectors (Figure 2.1). In 2007/08 capital expenditure by the Queensland State and Local Governments was around $16.5 billion (Queensland Government, 2008a) or 7.7% of GSP, its highest level in almost 20 years.

Figure 2.1: State and Local Government Investment as a share of Output



Note: (f) denotes forecast, based on Queensland Government projections only.
Source: ABS (2008a) and Queensland Government (2008a and 2009b)

Figure 2.2: State and Local Government Investment in Queensland



Note: (f) denotes forecast, based on Queensland Government projections only.
Source: ABS (2008a) Queensland Government (2008a and 2009b)

In evidence of Queensland's improving stock of infrastructure, it is often noted that the Queensland Government has undertaken a large capital works program (Figure 2.2), and per capita public investment is higher than in other states. However, Queensland requires higher per capita investment to maintain living standards owing to its faster pace of population growth. Secondly, the expenditure could simply be catch-up investment to compensate for years of underinvestment.

Figure 2.1 and 2.2 also contain the forward estimates. These indicate a decline in future investment expenditure to below trend by 2012/13. Given the identified amount of infrastructure to be provided in just South East Queensland (see Section 2.2.2) it is not clear where the financing will come from. But it is clear that the traditional sources of budget appropriation or government debt will play a much smaller role.

2.2.2.2 *How the Queensland Government will recover?*

The Queensland Government (2009b) in the *State Budget 2009-10* has implemented a number of measures that are aimed at improving Queensland's fiscal position by an estimated $5.4 billion over four years including:

- Revised fiscal principles including a commitment to return to surplus – this can mainly be achieved by raising more in taxes, grants from the Australian Government, or lower recurrent and capital expenditures;
- Abolition of the Queensland Fuel Subsidy Scheme;
- Further public sector efficiency measures which leverage off savings from the recent machinery of government changes;
- Reform to local government grants and subsidy programs – in effect reducing grants for public investment expenditure by local government, which raises the question of where the financing for local government will come from;
- Revision to the Government's wages policy; and
- Changes to procurement policy.

Furthermore, a significant asset sales program has been announced that will take place over the next three to five years and is expected to yield $15 billion in revenue. This program will involve:

- The sale of Forestry Plantations Queensland's softwood business and possibly its hardwood plantations;
- The sale of Queensland Motorways Limited's (QML) business, incorporating a major upgrade of the Port of Brisbane Motorway;
- The sale of the Port of Brisbane Corporation Limited's (PBC) business and assets;

- The sale of QR Limited's (QR) above and below rail coal businesses and assets, along with Ports Corporation of Queensland Limited's Abbot Point Coal Terminal;
- The intention to instigate negotiations with the Australian Government over the potential sale of other parts of QR's below rail network to the Australian Government-owned Australian Rail Track Corporation (ARTC); and
- Investigating options for the most appropriate way to offer the sale of Queensland Rail's bulk freight, intermodal, retail and regional freight services to the market.

The asset sales program has already met with considerable resistance from the public and unions, to the extent that the unions may actively campaign against the Government at the next State election.

The asset sales are aimed at funding the Queensland Government's infrastructure program (Queensland Government, 2009, p14):

> *The program of asset sales will play an important role in funding the Government's infrastructure program, reducing State debt and encouraging private sector provision of infrastructure.*

However, the asset sales are also targeted at returning the State to its AAA credit rating which has a sting in the tail for future infrastructure spending (Queensland Government, 2009, p14):

> *This will go a long way toward reducing the current level of indebtedness of the State and demonstrate to ratings agencies and financial markets the Government's willingness to reduce debt and return the State to a solid fiscal position. Post the current forward estimates, when the worst of the global economic crisis has passed, the Queensland Government will reduce the capital program to levels under $10 billion per year and look at further policy measures to improve revenue and reduce expenditure to assist in bringing the net financial liabilities to revenue ratio back within a range comparable to other larger states.*

The conclusion from the *State Budget 2009-10* position and comments made above is that the Queensland Government needs the private sector to become more involved in the provision of public infrastructure. This involvement will need to be actively encouraged and facilitated.

Mid Year Fiscal and Economic Review (MYFER)

On 4 December 2009 the Queensland Government released its MYFER. The general government net operating surplus in 2008-09 improved from the assessment of a deficit of $574 to a surplus of $35. However, the operating balance for 2009-10 is now expected to be a deficit of $2.351 billion compared to a forecast of $1.954 billion at the time of the 2009-10 Budget. The change is mainly related to:

- $227 million downward revision to royalties due to exchange rate appreciation;
- Conversion of the Commonwealth's contribution to the Gold Coast Rapid Transport project to equity (reduces revenue by $365 million);
- Traveston Dam decision resulting in payment of $265 million to Queensland Water Infrastructure (non-recoverable);
- Revenues are expected to increase by $133 million; and
- GST revisions are expected to increase by $183 million.

Beyond 2009-10 there are improvements in the net operating balance of each year. Deficits of $2.5 billion and $3.3 billion are now expected compared to $3.3 billion and $4.1 billion at the time of the 2009-10 Budget. The main contributions to these upward revisions are increases in taxation, royalty and GST revenue.

Source: Queensland Government 2009c

2.2.3 State Infrastructure Policy & Future Investment

The policy of the Queensland Government towards public infrastructure and its funding is mainly encapsulated within two documents: *Towards Q2: Tomorrow's Queensland* and the *South East Queensland Regional Plan 2009-2031*.

2.2.3.1 *Toward Q2: Tomorrow's Queensland*

The Queensland Government's (2008b) vision for 2020 is framed around five ambitions. One of these ambitions *"Strong - We want to create a diverse economy powered by bright ideas"* contains a target that Queensland becomes Australia's strongest economy, with infrastructure that anticipates growth (measured by economic growth). In regard to the underpinnings of past economic performance and infrastructure the Queensland Government (2008b, p. 15) states:

> *The Queensland Government's budgeted capital program has more than tripled from $5.3 billion in 2003–04 to $17 billion in 2008–09. Private business investment, which primarily relates to construction activity and the purchase of machinery and equipment, is forecast to double over the same period to an estimated $36 billion.*

In relation to the future the Queensland Government (2008b, p. 17) states:

> *To be Australia's strongest economy in 2020, we must plan for the challenges ahead, and build on the strength of our current economic foundations. This means doing more than just maintaining our performance – we need to improve upon it.*
>
> *Achieving this target will require joint action by the Queensland Government, other levels of government, industry and individuals in the community.*
>
> *The Queensland Government will play its part by:*
>
> - *setting solid foundations for our State's economy, by maintaining a strong budget position and competitive taxes*
> - *continuing to plan for and invest in infrastructure that allows our economy to grow, like roads, rail, public transport, ports, water and energy infrastructure*
> - *encouraging the creation and growth of new industries throughout the state, to secure our future against changes in the global economic environment*
> - *investing in skills and creativity, to boost the productivity of our people*
> - *helping Queenslanders who are out of the workforce to participate, to supply the labour our economy will need*
> - *simplifying regulation, which can be a barrier to industry and business growth*
> - *assisting industry to adjust to a carbon-constrained world.*
>
> *We need the Australian Government to support our efforts, including by increasing their investment in the infrastructure that connects our economy, like roads, railway connections, public transport and broadband.*

2.2.3.2 *South East Queensland Regional Plan 2009-2031*

The Queensland Department of Infrastructure and Planning (2009a) *South East Queensland Regional Plan 2009-2031* is a plan to manage south east Queensland regional growth and change in a sustainable way.

Within the *SEQ Regional Plan* Regional Outcome 10 covers Infrastructure of which one of the key challenges is noted as *"developing innovative funding and delivery mechanisms"*. A key program is (Queensland Department of Infrastructure and Planning, 2009a, p. 125 paragraph 10.2.5):

> *Identify the best delivery options and funding mechanisms for infrastructure projects with due consideration of benefits, public interests and risk management.*

In terms of funding, the notes to the Infrastructure planning, coordination and funding policy (Queensland Department of Infrastructure and Planning, 2009a, p. 125) states:

> *Funding of regional infrastructure must address whole-of-life costs to ensure equity between current and future beneficiaries and users. Where appropriate, options for funding and delivery of these projects will be evaluated through the Queensland Government's value for money framework. This framework promotes innovation and ensures maximum effectiveness of planned investment.*

> *A number of funding and charging mechanisms are used to finance infrastructure projects and services. These include federal and state taxes, local government rates, state agency funding, special-purpose levies, user charges, private investment, public private partnerships and developer contributions. The Queensland Government has a process to identify projects that are suitable for public private partnerships.*
>
> *Where the Queensland Government is providing new infrastructure to lead development ahead of anticipated demand, landowners and developers of new areas who stand to benefit significantly will be required to contribute to capital works infrastructure provision through mechanisms such as a State Infrastructure Agreement, or contribute works or land in lieu. In some instances, mechanisms such as State Infrastructure Agreements can support the timely delivery of infrastructure programs ahead of anticipated demand.*

The Queensland Department of Infrastructure and Planning (2009b) *SEQ Infrastructure Plan and Program 2009–2026* (SEQIPP) outlines the government's infrastructure priorities for the SEQ region to support the *SEQ Regional Plan*. The SEQIPP was first released in 2005 and is updated annually to reflect and align with the latest planning and budget commitments. It sets timeframes and budgets to ensure infrastructure is delivered to support the region's growth.

In regard to funding the SEQIPP (Queensland Department of Infrastructure and Planning, 2009b, p. 14):

> *The government funds infrastructure from government cash flows, borrowings and alignment of the government's capital portfolio.*
>
> *The Queensland Government has established the Project Assurance Framework (PAF) and Value for Money (VfM) Framework in order to ensure high quality project initiation, evaluation and delivery. These frameworks are the minimum standard for project initiation, evaluation, procurement and assurance across the Queensland public sector.*
>
> *The PAF is a whole-of-government project assessment tool that establishes a common approach to assessing projects at critical stages, and aims to maximise the value for money outcomes for project investments.*
>
> *Where the PAF identifies a potential public private partnership, the VfM framework provides the assessment guidelines to determine if a public private partnership should be pursued and ensures the respective skills of each sector are best used to deliver effective infrastructure and services in a timely manner.*

The SEQIPP identifies 378 identifiable projects worth $124 billion in estimated infrastructure investment which include:

- $94.6 billion in road, rail and public transport;
- $4.6 billion in water;
- $3.3 billion in energy networks;
- $5.8 billion in health;
- $6.8 billion in social and community infrastructure; and
- $9.1 billion in completed projects.

It is not clear how this level of infrastructure will be financed especially given the decline in future State Budget estimates of capital expenditure, or to what level the Government is committed to financing and therefore by deduction the level it expects the private sector to finance.

2.3 Review of Australia's Future Tax System

On 13 May 2008 the Australian Government announced the *Review of Australia's Future Tax System*. The review is examining the current tax system and will make recommendations to position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century.

The thrust of the Queensland Government (2009a) submission to the review identified that there is too much vertical fiscal imbalance (VFI) between the states and the Commonwealth[4] and that the taxing powers that the states have are restricted to narrow tax bases (e.g. payrolls, land, motor vehicles and mining royalties). These narrow tax bases are also exposed to economic downturns, highlighted by the GFC which has caused some property values to decline, restricted finance availability for property transactions and has affected the price and volume of mining exports. At the same time population growth and demographic change are adding pressure to state budgets.

The PCA (2009) made a submission to the *Review of Australia's Future Tax System* and specifically focused on issues associated with 'developer levies' (as one method for financing public infrastructure):

First: *Increase the use of government borrowing, Public Private Partnerships (PPPs), Business Improvement Districts (BIDs) and Tax Increment Financing (TIF)*[5] *to fund future infrastructure, in preference to inefficient funding strategies such as developer levies.*

Second: *Developer levies should be the funding option of last resort and abolished completely in the medium term.*

Third: *Developer levies should only be levied to capitalise public infrastructure directly related to the additional demand for public infrastructure created by a development project, after taking account of community-wide and intergenerational benefits that should be funded by the broader society.*

Fourth: *There should be a direct nexus between the incidence and size (in dollar terms) of a development levy and the specific public infrastructure the levy is capitalising.*

Fifth: *Development levies collected by government and statutory authorities should be audited on an annual basis and returned if not spent within two years.*

Sixth: *The Council of Australian Governments (COAG) should establish a formal framework for implementing the above reforms.*

Seventh: *The Council of Australian Governments (COAG) should commit to trial Tax Increment Financing (TIF) in three pilot studies in each state and territory.*

The PCA (2009) submission also explicitly identified Tax Increment Financing (TIF) and Business Improvement Districts (BIDs) as alternative financing mechanisms to developer levies. These financing methods are discussed in Sections 6.5 and 6.6 of this paper respectively.

The outcomes of the Review are important in relation to funding public infrastructure since any recommendations may have implications for traditional financing methods.

2.4 Summary

It is clear that Queensland is at a crossroads in how the backlog and future required level of public infrastructure is to be financed. There is an identified $124 billion of public infrastructure required by 2026 (in SEQ alone) to be partially financed through a four year borrowing program of $28.3 billion, most of this in 2009-10 as a stimulus measure to maintain employment through the economic downturn. This is occurring at a time when Queensland Government revenues are collapsing due to the global and local contraction in economic activity.

[4] The Commonwealth capacity to raise revenue is disproportionately greater than its expenditure responsibilities and the States' expenditure responsibilities are far in excess of the revenue they raise.

[5] Renamed as Growth Area Bonds.

Whilst the Queensland Government intends to partially address the shortfall through cuts in grants to local government and asset sales these approaches are not without their difficulties. Cuts to local government grants shift the problem of financing the infrastructure the grants would finance to elsewhere, whilst asset sales are meeting some resistance. The asset sales are further clouded by a lack of appetite and liquidity within the private sector to finance public sector infrastructure.

Furthermore, the Queensland Government proposes to reduce its public infrastructure investment in the future to focus on improving its fiscal position in which case there is a question over where the financing will come from for the remaining infrastructure required to 2026.

The Queensland Government's position appears to include private sector involvement for the provision of public infrastructure but, a concerted effort needs to be made to actively encourage and facilitate the involvement of the private sector. The intention of this paper is to examine traditional and alternative financing methods that may encourage more private sector provision of public infrastructure.

3. Public Infrastructure Financing Methods

This section identifies the traditional public infrastructure financing methods in use in Australia and Queensland and also a number of alternative financing methods used in Australia but used in other jurisdictions.

3.1 Traditional Methods

Investment in public infrastructure is either financed from public sector revenues or savings or by capital markets from borrowings or equity. From an international perspective Chan, C., Forwood, D., Roper, H., and Sayers, C. (2009) list the main public infrastructure financing methods as:

- *General budget appropriations* – includes using taxation revenue or general public debt or inter-government transfers;
- *Specific purpose securitised borrowing* – issuance of debt instruments such as bonds, debentures and inscribed stocks for the purpose of financing specific infrastructure;
- *Off budget financing by government trading enterprises* – either through debt, retained earnings or equity injections from the shareholder government;
- *Development contributions* – an upfront user charge for future infrastructure services, generally required prior to construction; and
- *Public private partnerships* – where the private sector is contracted to design, build, operate, manage and finance new infrastructure and meet government obligations for a set period of time.

In a previous assessment of financing alternatives The Allen Consulting Group (2003) identified the following broad methods of financing public infrastructure:

- *Government borrowing* — the issuing of long-term government debt, typically in the form of various bonds, by all levels of government;
- *Taxes* — covers the full range of Commonwealth, State and Territory taxes, and also includes municipal rates levied by local government;
- *User charges* — fees levied on the consumer of the goods and charges which generally cover cost recovery through to full commercial pricing;
- *Producer levies* — the variety of charges levied directly on the supply or production of infrastructure, including developer charges; and
- *Special purpose vehicles* — dedicated entities created for the purpose of providing public infrastructure and the associated services. It includes government trading enterprises and the spectrum of public/private provision. Characteristics of SPVs are that they are commercial in nature and off-Budget entities.

The Allen Consulting Group (2003) considered capital payment and grants from the Commonwealth and dividends from the retained earnings of government trading enterprises (GTEs) as a transfer of funds raised directly from other sources and therefore did not include them for that reason. This report takes a similar view.

In relation to the Queensland Government the following financing methods are traditionally used:

- General taxation;
- Borrowings through QTC;
- Commonwealth Government grants (in reality government taxation re distributed);
- Sale of goods and services (user charges); and
- Private sector (Public Private Partnerships).

For Queensland local government the following financing methods are traditionally used:

- Taxation through property rates;
- Borrowings through QTC;
- Commonwealth and State Government grants and subsidies;
- Sale of goods and services (user charges); and
- Developer contributions.

From the literature and types of financing used by the Queensland Government and Queensland local government the following traditional financing methods are included in this report:

- General taxation;
- Government borrowing;
- User charges;
- Developer contributions; and
- Public Private Partnerships.

3.2 Alternative Methods

There are many other alternative methods of financing public infrastructure in use around the world. From an examination of Chan, C., Forwood, D., Roper, H., and Sayers, C. (2009) and other literature (see References) the following have been selected and included in this report:

- *Specific Purpose Securitised Borrowing* – issuance of debt instruments such as bonds, debentures and inscribed stocks in the capital market to finance a particular project;
- *Certificates of Participation* – where governments enter into agreements with not-for-profit entities that issue bonds to finance facilities that are leased back by the government;
- *Value Capture Levy* - aims to capture the uplift in land value that results from the planning process, development of land, or construction of beneficial infrastructure;
- *Specific Purpose Levies* – implementation of an ad hoc levy to meet specific infrastructure needs of an area;
- *Growth Area Bonds* – issue of bonds to finance infrastructure enhancement that are tied to a specific area repaid through future tax revenues collected in a defined area; and
- *Business Improvement Districts* – stakeholders within a defined boundary make a collective contribution towards the maintenance and promotion of an area.

4. Assessment Framework

Each financing method has different characteristics and suitability to different public infrastructure projects. This section describes the details of the assessment framework undertaken for the chosen traditional and alternative financing methods.

4.1 Traditional Methods

4.1.1 Description

A description of the financing method and where relevant, comments on the Queensland Government relationship with the financing method.

4.1.2 Usage

Usage of the financing method and discussion of the type of projects that the financing method is best suited to including case studies where relevant.

4.1.3 Qualitative Assessment

A number of evaluation frameworks are available with which to assess the financing alternatives. The evaluation framework used by The Allen Consulting Group (2003) uses seven key characteristics. These are:

- *Effectiveness* – ability of the method to mobilise sufficient funds in a timely manner;
- *Efficiency* - considers the impact of a funding method upon wellbeing in general;
- *Equity* - the fairness or otherwise of a method;
- *Stability/reliability of the revenue base* - a consistent and predictable source of revenue is preferred to a source that is subject to shifting and unforeseeable influences, as is one that grows reliably over time;
- *Administration costs* – the cost to raise the finance and minimise the scope for evasion or avoidance;
- *Compliance costs, certainty and transparency* – the costs of ensuring the method stands up to public and investor scrutiny; and
- *Stakeholder support* – to what extent will the method be accepted as reasonable.

Chan, C., Forwood, D., Roper, H., and Sayers, C. (2009) used the following characteristics:

- *Risk management* – the assignment of non-diversifiable project risks and management of the overall project risk;
- *Transaction costs* – the cost of arranging and managing finance, and costs associated with delay or uncertainties with availability of finance; and
- *Exposure to market or other disciplines* – the extent to which borrowers and lenders share, signal and can act on information on project prospects and risks on investment decisions.

Blending the two approaches together gives a set of nine characteristics used in this report's qualitative assessment framework:

1. Effectiveness;
2. Efficiency;
3. Equity;
4. Stability/reliability of the revenue base;
5. Administration costs;
6. Compliance costs, certainty and transparency;

7. Stakeholder support;
8. Risk management; and
9. Exposure to other management disciplines.

A qualitative evaluation by its very nature is designed to assess the degree to which what is being evaluated meets the beneficial aspects of the characteristic being assessed. The method adopted by The Allen Consulting Group (2003, p. 72) was one of a tick, cross or question mark explained as:

> *Ticks represent a judgement that a funding approach results in generally favourable outcomes against a criterion. In almost every case there are pros and cons and a tick reflects a view that the balance is positive. Crosses reflect the opposite view. A question mark indicates there is some uncertainty or ambiguity about the performance of the approach against a criterion.*

To add some more definition for this qualitative evaluation a five point scale is used which allows for a strong and weak support measure for each characteristic as well as a middle or ambiguous position. Each of the characteristics and their evaluation scale is given below and described in **Appendix A**.

Table 4.1: Qualitative evaluation characteristics

Characteristic/Measure	Weak 1	2	Ambiguous 3	4	Strong 5
Effectiveness	Very ineffective	Ineffective	Ambiguous	Effective	Very effective
Efficiency	Very inefficient	Inefficient	Ambiguous	Efficient	Very efficient
Equity	Very inequitable	Inequitable	Ambiguous	Equitable	Very equitable
Stability/reliability of the revenue base	Very instable	Instable	Ambiguous	Stable	Very stable
Administration costs	Very high	High	Ambiguous	Low	Very low
Compliance costs, certainty and transparency	Very high	High	Ambiguous	Low	Very low
Stakeholder support	Very low	Low	Ambiguous	High	Very high
Incentives for risk management	Very low	Low	Ambiguous	High	Very high
Exposure to other management disciplines	Very high	High	Ambiguous	Low	Very low

4.1.4 Quantitative Assessment

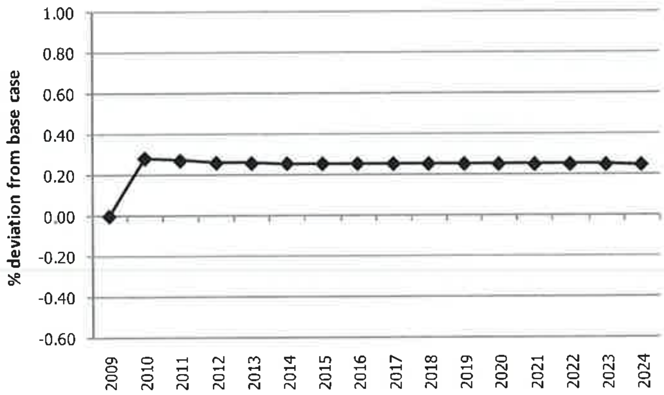
The economic impact of public infrastructure construction and utilisation along with the associated financing method can be quantified for a number of standard criteria used in evaluating economic policies (output and employment). Following The Allen Consulting Group (2003) and Giesecke, Dixon and Rimmer (2008) the scenario considered is a permanent $1 billion increase in the annual public infrastructure spending in Queensland from 2010-11 against a base case forecast of business as usual. The additional spending is assumed for road and rail projects. The construction and subsequent benefits from the additional infrastructure expenditure and use are kept constant for each of the different financing methods. The impacts have been quantified over a 15 year period for each of the five traditional financing methods[6].

The quantitative assessment has been undertaken using the Monash Multi-Regional Forecasting model (MMRFM), a dynamic multi-regional, multi-sectoral applied general equilibrium model of the Australian economy. The MMRFM is used widely in policy assessment throughout Australia. Readers are referred to The Allen Consulting Group (2003) and Giesecke, Dixon and Rimmer (2008) for an in depth discussion of the model.

[6] The results presented in this report were undertaken by Prime Research and differ from the analysis in the previous work undertaken by The Allen Consulting Group (2003) and Giesecke et al (2008). While both analyses are conducted using the MMRF model, the versions of the model used are separated by at least four years of development work, which will have had an impact on model outputs. Also, importantly, the mechanisms chosen to simulate the imposition of various fund raising instruments may have been different. A description of what has been applied is contained in **Appendix B**.

Figure 4.1 illustrates the impacts on Queensland employment relative to the base case forecast following the unfunded additional $1 billion expenditure in the construction industry. Under the labour assumptions in the model the additional spending lifts Queensland employment by a permanent 0.25% from the base case forecast.

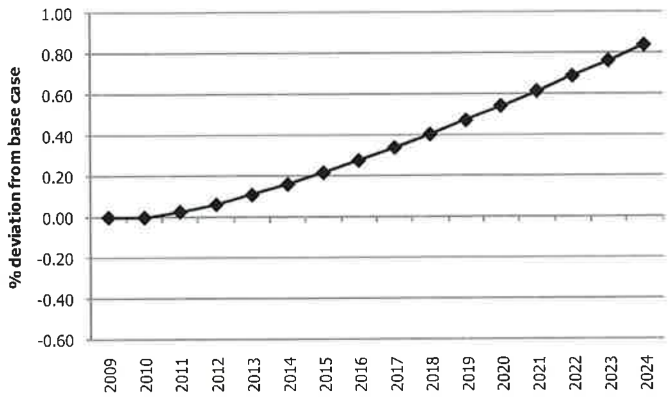
Figure 4.1: Employment change from construction expenditure



Source: Prime Research

Figure 4.2 illustrates the impacts on Queensland employment of the returns that flow from each $1 billion infrastructure project (excludes the construction and financing shocks). The increase in employment is generated through productivity increases from use of the infrastructure (in this case road and rail).

Figure 4.2: Employment change from productivity benefits



Source: Prime Research

For the assessment of each traditional financing method, the aggregate employment change is presented including the shocks of construction expenditure and productivity benefits on employment as indicated above with the employment impacts of the financing approach. The individual financing method effects are explained further in **Appendix B**.

4.2 Alternative Methods

4.2.1 Description

A description of the financing method.

4.2.2 Usage

Usage of the financing method in other jurisdictions and discussion of the type of projects that the financing method is best suited to including case studies where relevant. In addition Section 7 indicates which alternative financing methods may be suitable for some SEQIPP projects.

4.2.3 Qualitative Assessment

This assessment is the same as that for traditional methods described above.

4.2.4 Risks & Barriers to Use

A brief discussion of the risk allocations and other current barriers to use for the method to be used in Queensland.

4.2.5 Governance Arrangements for Use

A brief discussion of governance arrangements that would need to be in place for the method to be used in Queensland although these need to be subject to further legal investigation.

5. Assessment of Traditional Financing Methods

This section applies the assessment framework described in the preceding section to the chosen traditional financing methods.

5.1 General Taxation

5.1.1 Description

Governments have legislative authority to impose financial charges on individuals or legal entities. Finances raised are used to provide goods and services that would generally not be provided otherwise, generally known as public goods or services.

The types of taxation and the amounts raised by the Queensland Government and local government in Queensland were detailed in Section 2.2.1.

5.1.2 Usage

It is generally difficult to identify from public sources the public infrastructure projects that are funded by taxation. Most if not all taxation revenue enters consolidated revenue from which government allocates departmental recurrent and capital expenditure budgets. Queensland is expected to raise $9 billion in 2009-10 from taxation which would only fund half of the 2009-10 capital works expenditure if fully allocated to the capital budget.

5.1.3 Qualitative Assessment

Generally taxation is an effective method of financing public infrastructure but its efficiency depends on the tax base and the stability of the revenue raised by the tax. Administration costs of government taxation, especially existing taxes, are generally very low.

Table 5.1: Qualitative assessment of government taxation finance

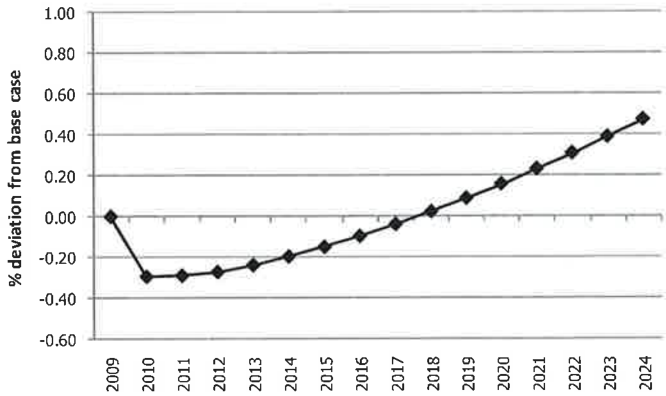
Characteristic	Discussion	Measure	Score
Effectiveness	The Queensland Government has significant taxation powers which includes (for detail see Table 2.3): • Payroll tax • Transfer duties • Land tax • Gaming machine tax Through these taxes and the ability to vary them the State can raise funds for investment in public infrastructure in a timely and effective manner.	Effective	4
Efficiency	Broad taxes such as the GST are generally considered efficient, however, narrow and specific taxes are generally considered inefficient because they distort resource allocation decisions. As State taxes are narrow, raising funds through taxation to fund infrastructure is generally inefficient.	Inefficient	2
Equity	Because taxes are generally raised from the community it follows that where they are invested in public infrastructure that benefits the whole community the approach is equitable. Some intergenerational inequity may occur as the taxes are raised from the current generation while the benefits accrue over the life of the infrastructure.	Equitable	4
Stability/reliability of the revenue base	Whilst state taxes are considered to be fairly narrow and thus subject to macroeconomic influences, Queensland also obtains a significant (and growing) share of the Commonwealth GST revenues which is a much more broad based tax.	Stable	4
Administration costs	The cost for the Queensland Office of State Revenue to manage revenue, grants and subsidies was $0.62 per $100 in 2007-08. In contrast the figure for the ATO was 1.11 per $100 in 2007-08.	Very low	5

Characteristic	Discussion	Measure	Score
Compliance costs, certainty and transparency	Most taxpayers face significant costs in complying with taxation requirements in the form of own time and external advisors. Taxes are generally certain during the year but may change at budget times. Taxes are generally understood.	Ambiguous	3
Stakeholder support	Most taxpayers resent paying taxes especially additional State taxes that are distortionary to resource allocation and where the direct benefits of the tax are not clear.	Low	2
Incentives for risk management	Changing existing taxes is generally well managed with resources applied to ensure compliance. The risk management aspects of using government taxation to finance public infrastructure depend on the quality of public management of the procurement process and operations.	Low	2
Exposure to other management disciplines	Taxation is subject to parliamentary scrutiny and subject to binding budget constraints.	Low	4

5.1.4 Quantitative Assessment

Figure 5.1 shows the impact on Queensland employment of the $1 billion increase in infrastructure spending financed using tax increases. The increase in upfront taxation required to fund the additional infrastructure expenditure appears to have a more detrimental impact on employment than the construction and would take between eight and nine years for employment to benefit from the stimulus.

Figure 5.1: Employment change from government taxation financing



Source: Prime Research

5.2 Government Borrowing

5.2.1 Description

Commonly used for long-lived assets, debt financing of infrastructure allows a government to match the financing costs with the revenue generated by that infrastructure.

In the 1980s each state jurisdiction established a central borrowing authority (CBA). Bringing all government borrowing under one umbrella results in greater efficiency. In Queensland, the CBA is the Queensland Treasury Corporation (QTC) which raises money for on-lending to Queensland Government departments, local authorities, government owned enterprises and public sector bodies. Funds are sourced in both the domestic (45%) and international (55%) markets through the issuance of a variety of debt instruments.

5.2.2 Usage

According to the QTC website, QTC currently has $33 billion of funds on issue. Of these approximately $3 billion are on loaned to local government customers. Since the debt is non-specific it is not possible to identify which items of public infrastructure debt has been used to fund unless the item of public infrastructure is contained within a separate legal entity and the financial accounts are published.

The Queensland Government is planning to use debt to fully finance its short-term capital works program (Queensland Government, 2009, p. 132):

> *Over the Budget and forward estimates period, total additional General Government net borrowings and advances of $28.302 billion are planned to fund the $28.282 billion worth of capital projects in the General Government sector and $1.191 billion worth of equity injections to the Public Non-financial Corporations sector to support expansion of the State's water, ports, energy and rail infrastructure.*

5.2.3 Qualitative Assessment

Government borrowing is a very effective method for financing public infrastructure although its efficiency is ambiguous. Other benefits include the method being a very equitable and very stable source of finance along with low administration and compliance costs.

Table 5.2: Qualitative assessment of government borrowing

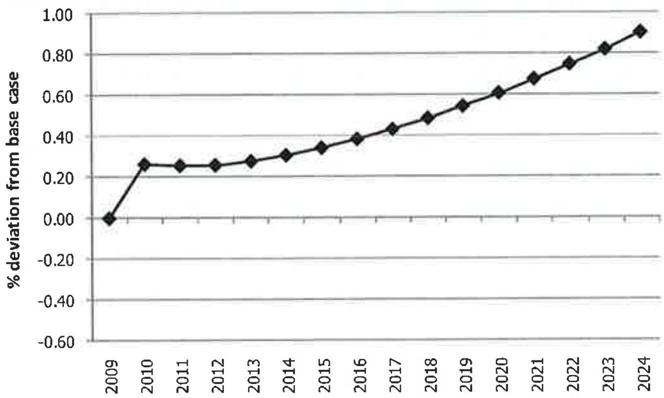
Characteristic	Discussion	Measure	Score
Effectiveness	The Queensland Government can efficiently raise and manage substantial amounts of debt capital through QTC at a low cost subject to the Charter of Fiscal Responsibility.	Very effective	5
Efficiency	Where the benefits of public infrastructure financed through debt are greater than the costs economic efficiency is improved. Government debt is believed to be a lower cost of capital than private financing. There is a danger that excessive levels of government debt will impose a decline in efficiency through higher cost of debt and therefore reduced investment.	Ambiguous	3
Equity	The repayment of debt can be more closely aligned with the benefits of the infrastructure to current and future taxpayers balancing intergenerational equity.	Very equitable	5
Stability/reliability of the revenue base	Debt finance raised by the government, provided it is well managed, is a stable and reliable source of finance (unless the government in question cannot meet its repayment obligations)	Very stable	5
Administration costs	Whilst not benchmarked against other financial institutions, it is assumed that QTC can ensure low transaction costs.	Very low	5

Characteristic	Discussion	Measure	Score
Compliance costs, certainty and transparency	There are few compliance costs in public debt.	Very low	5
Stakeholder support	Stakeholders can be critical of low government debt levels and high debt levels.	Ambiguous	3
Incentives for risk management	Raising debt is well managed through QTC. The risk management aspects of using government debt to finance public infrastructure depend on the quality of public management of the procurement process and operations.	Low	2
Exposure to other management disciplines	Debt raising is subject to parliamentary scrutiny.	Very low	5

5.2.4 Quantitative Assessment

Figure 5.2 shows the impact on Queensland employment of the $1 billion increase in infrastructure spending financed using government borrowing. Using borrowing to finance the infrastructure only requires increases in other revenues (such as taxation) to fund principle and interest repayments, therefore the employment impacts are negligible compared to raising taxes at the outset to pay for the infrastructure.

Figure 5.2: Employment change from government borrowing



Source: Prime Research

5.3 User Charges

5.3.1 Description

User charges are prices or fees charged for receiving services from an infrastructure asset.

Generally user charges are highly regulated as many of the providers are monopolies or are GTEs in competition with the private sector. In Queensland the regulator is the Queensland Competition Authority (QCA)[7] which has a responsibility to ensure that:

- Significant government business activities which compete with the private sector do so fairly (Competitive Neutrality);
- Government owned monopolies and privately owned water monopolies do not abuse their market power (Monopoly Prices Oversight); and
- Essential infrastructure is accessible to all potential users (Third Party Access).

5.3.2 Usage

Within the GTE sector this is one of the chief sources of revenue to fund operations and for investment. In Queensland user charges are in place for the following:

- Electricity – e.g. Tarong Energy (generator), Powerlink (transmission), Energex, Ergon (retailing);
- Ports – Far North Queensland Ports Corporation Limited, Port of Townsville Limited, North Queensland Bulk Ports Corporation Limited, Gladstone Ports Corporation Limited, Brisbane Port Corporation;
- Rail – Queensland Rail access charges;
- Toll roads – Queensland Motorways Limited (QML);
- Water – e.g. SEQ Water, Sunwater, council water businesses; and
- Wastewater and waste disposal – all councils.

5.3.3 Qualitative Assessment

User charges are generally considered ineffective because they rarely cover the full cost, however, they are considered efficient and very equitable.

Table 5.3: Qualitative assessment of user charges

Characteristic	Discussion	Measure	Score
Effectiveness	User charges do not generally cover the cost of capital otherwise the investment would be made by the private sector. Any subsidisation or shortfall in user charges may be funded through the government or through a lower return to government.	Ineffective	2
Efficiency	User charging should encourage use of the infrastructure up to the level where the cost of supplying an additional unit would be greater than its value to the customer. Therefore user charging results in an efficient allocation of resources between sectors of the economy. In practice however this does not occur and depending on the public good characteristics of the infrastructure user charging is either too high to encourage optimal use and too low to recover the cost of capital (unless a monopoly).	Efficient	4
Equity	User charges are generally equitable where the users pay an appropriate price for their use and there are no cross subsidies between users.	Very equitable	5

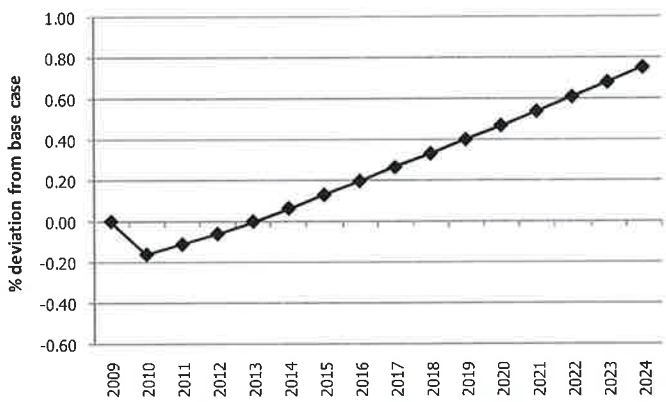
[7] As part of the national electricity market (NEM) reforms from 1 July 2010 the Queensland electricity distribution network businesses (Ergon Energy and Energex) will apply to the Australian Energy Regulator (AER) to determine their total revenue requirements.

Characteristic	Discussion	Measure	Score
Stability/reliability of the revenue base	Where the infrastructure is a monopoly the stability/revenue of the revenue base is assured. Where it is not a monopoly then the stability/revenue of the revenue base may be subject to market fluctuations or avoidance (e.g. toll road).	Ambiguous	3
Administration costs	User charges are generally small and frequent resulting in many transaction. The cost to capture user charges are often labour or capital intensive.	High	2
Compliance costs, certainty and transparency	Compliance costs are generally low depending on technology used. User charges generally have high certainty (e.g. CPI increases) and are transparent.	Low	4
Stakeholder support	The direct link between the cost and the service is generally acceptable.	High	4
Incentives for risk management	The main risk in user charges is the demand risk which impacts on the revenue base. There may also be regulatory risk that controls increases in charges not related to operational costs or the cost of capital.	Low	2
Exposure to other management disciplines	Use charges are subject to regulatory scrutiny. There is also exposure to demand forecasting.	High	2

5.3.4 Quantitative Assessment

Figure 5.3 shows the impact on Queensland employment of the $1 billion increase in infrastructure spending financed from user charges. User charges in the form of a tax on transport and rail cause employment to fall once the infrastructure becomes available, but recover after four years.

Figure 5.3: Employment change from user charges



Source: Prime Research

5.4 Developer Contributions

5.4.1 Description

Developer contributions (or infrastructure charges) are widely used by local governments in Australia to fund urban infrastructure associated with the development of land. Whilst the developer will generally include local roads and drainage in their subdivision they are also required to contribute to other urban infrastructure that would be impacted on or be demanded by the new population, including headworks infrastructure (e.g. water, arterial roads) and social infrastructure (e.g. parks, libraries and affordable housing). The forms of contribution can either be transfer of land, work-in-kind, or monetary.

5.4.2 Usage

In Queensland development contributions are enabled in the *Integrated Planning Act 1997*. The basis for charges is a priority infrastructure plan (PIP) which identifies an infrastructure charges schedule (ICS) for eligible development contributions. In late 2008 the Department of Infrastructure and Planning (2008) released draft *IPA Infrastructure Guideline 2/08 – Infrastructure charges schedule* including a *standard infrastructure charges schedule*, one of the key elements in the *Housing Affordability Strategy*. The *standard infrastructure charges schedule* sets out what local governments can and cannot charge for in developing their PIPs. The schedule will give more certainty to local governments, developers and the community.

From late 2009 the *Sustainable Planning Act 2009* will supersede the *Integrated Planning Act 1997*. The processes for making and amending priority infrastructure plans will be moved from the Act to a statutory guideline. The Bill contains new arrangements allowing the guideline for making infrastructure charges schedules to provide for:

- The phasing in of infrastructure charges;
- The charge rates in the schedule to be adjusted for inflation; and
- Credits recognising factors such as current use.

New provisions have been included in the Bill to allow for negotiations about infrastructure charges notices, regulated infrastructure charges notice and regulated State infrastructure charges notices.

The degree to which developer contributions currently fund urban infrastructure is not readily available in Queensland because they are grouped with other revenue sources in the official statistics.

5.4.3 Qualitative Assessment

Developer contributions are considered effective in financing public infrastructure but are considered inefficient and very inequitable. There are also high administration and compliance costs.

Table 5.4: Qualitative assessment of developer contributions

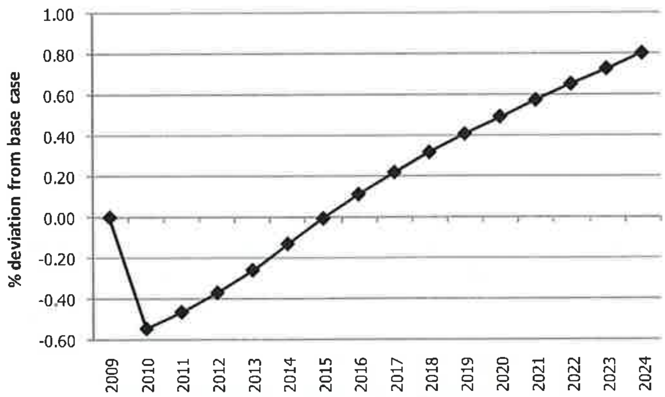
Characteristic	Discussion	Measure	Score
Effectiveness	Developer contributions have generally been an effective means of raising finance for public infrastructure.	Effective	4
Efficiency	The efficiency of developer contributions depends on how the contribution mechanism impacts on price signals, incentives and transaction costs. Headworks charges, for example, are cost reflective, may incentivise away from greenfields developments (i.e. maybe more expensive) and have low transaction costs. A land contribution is not cost reflective, incentivise towards low quality land and has very low transaction costs.	Inefficient	2
Equity	Developer charges must be reflected in end prices to purchasers. If developer charges increase as they must do being cost reflective the end result will be higher prices paid by purchaser whilst surrounding existing property holders receive a windfall gain.	Very Inequitable	1

Characteristic	Discussion	Measure	Score
Stability/reliability of the revenue base	As development occurs so too does demand for public infrastructure therefore development levies should provide a stable/reliable revenue base.	Stable	4
Administration costs	Developer levies that are paid by developers result in a smaller number of transactors however there can often be protracted negotiation and legal processes involved.	High	2
Compliance costs, certainty and transparency	Developer charges often involve high compliance costs, uncertainty and a lack of transparency unless fixed (e.g. NSW $20,000 per residential block). They are not transparent to purchasers.	High	2
Stakeholder support	The uncertainty is not supported by developers whilst purchasers are unaware. Governments need the funding source. Generally there is more stakeholder support where there is certainty and a nexus between charges and infrastructure provision.	Ambiguous	3
Incentives for risk management	Risk management for both developer and government depends on the type of developer contribution. For developers, there is demand risk in that if developer charges are too high resulting in higher asking prices demand for product will be lower. Where the developer contribution is in kind the developer can reduce uncertainty but the government risks inheriting a lower quality infrastructure.	Ambiguous	3
Exposure to other management disciplines	The information asymmetry depends on the nexus between the developer charge and the government. For example where the developer contributes cash they do not necessary know (or care) what they are getting. Where the developer contributes infrastructure the government does not necessarily know what they are getting.	Ambiguous	3

5.4.4 Quantitative Assessment

Figure 5.4 shows the impact on Queensland employment of the $1 billion infrastructure spending financed from developer contributions. The implementation of the developer charges as a tax on the construction sector has the effect of reducing employment from the base case for the first five years.

Figure 5.4: Employment change from developer contributions



Source: Prime Research

5.5 Public Private Partnerships

5.5.1 Description

There are many types of public private partnership (PPP) but essentially they typically involve a partnership between the public and private sector where the private sector is contracted to design, build, operate and manage and, most importantly, finance new infrastructure or services and meet government obligations for a set period of time (typically 20 to 30 years).

Typically a Special Purpose Vehicle (SPV) or stand-alone business will be used to finance and deliver a PPP project. There has also been a number of innovative financing techniques used to spread risk and lower the total cost of finance by the private sector including: securitisation of PPP loans; the credit guarantee finance scheme; tax-exempt private activity bonds; refinancing of debt; and equity sales in specialised secondary markets.

The Allen Consulting Group (2007) found that PPPs demonstrate a cost efficiency over traditional procurement methods ranging from 30.8% (from project inception) to 10.4% (from contractual commitment) to completion. There was also a time efficiency with PPPs found to be completed 3.4% ahead of time on average compared to 23.5% behind time for traditional projects.

However, PPPs are not without their difficulties which mainly relate to the consistency and level of the associated revenues. For toll roads in particular traffic volumes may not meet forecast levels prompting the venture to significantly increase tolls or, in the worst case collapse. These adverse outcomes point to the need to consider alternative mechanisms for the private sector to be involved in the financing of public infrastructure.

5.5.2 Usage

In Australia there were 30 PPP projects worth $17 billion between 2000 and 2006. The bulk of these were in NSW and Victoria with only 2 in Queensland. In 2006-07 PPPs accounted for around 5% of public infrastructure investment.

Table 5.5: Sample PPPs in Australia, 2000 to 2006

New South Wales
• Alternative Waste Technology Facility • Cross City Tunnel • Lane Cove Tunnel • New School Project #1 • West Sydney Orbit (Westlink M7) • Bonnyrigg Living Communities Project (Social Housing) • Long Bay Forensic And Prison Hospitals Project • Mater Hospital, Newcastle • RailCorp Rolling Stock • Broadwater Co-generation Plant II • Parramatta Transport Interchange
Victoria
• Casey Hospital • County Court • Metropolitan Mobile Radio • Mobile Data Network • Royal Melbourne Showgrounds • Southern Cross Station • Victorian Correctional Facilities • EastLink
Queensland
• Brisbane North South Bypass Tunnel (Clem 7) • Southbank Education and Training Precinct

Source: The Allen Consulting Group (2007)

The Queensland Government's PPP Policy applies to public infrastructure projects where the expected capital value will exceed $30 million or the whole-of-life cost of delivering the facility will exceed $50 million. The Value for Money Framework (VfM) provides the basis for the implementation of Queensland's PPP Policy. It provides a comprehensive set of procedures to evaluate the range of project delivery options for infrastructure and identifies the best value for money outcome for the government and the community. The VfM applies to all infrastructure projects above $100 million over the life of the asset.

Further details on the two Queensland PPP projects are:

- *Brisbane north-south bypass tunnel* (now known as Clem Jones Tunnel - Clem 7) - 6.8 kilometre toll road including twin, two-lane 4.8 kilometre tunnels connecting Woolloongabba in the south to Bowen Hills in the north. The project is being delivered on behalf of Brisbane City Council by SPV RiverCity Motorway Group, which is publically listed on the ASX. RiverCity Motorway Group will finance, design, construct, commission, operate and maintain Clem 7 for a period of 45 years.
- *Southbank education and training precinct* - involves the development of eight teaching blocks, comprising 11 new and four refurbished buildings on a four hectare site in South Brisbane. The project SPV is Axiom Education Queensland comprising John Holland, ABN Amro and Spotless Facilities Management. Axiom will design, construct, finance, operate and maintain the precinct over a 34 year period.

More recently the following PPP projects have commenced in Queensland:

- *Airport Link* - 6.7km toll road, mainly underground, connecting the Clem 7 Tunnel, Inner City Bypass and local road network at Bowen Hills, to the northern arterials of Gympie Road and Stafford Road at Kedron, Sandgate Road and the East West Arterial leading to the airport. The SPV is BrisConnections sponsored by Macquarie Capital Group, Thiess and John Holland and is listed on the ASX. BrisConnections will finance, design, construct, commission, operate and maintain Airport Link for 45 years.
- *SEQ Schools Project* – seven new schools (six primary and one secondary) progressively between 2010 and 2014. The project is being delivered by Aspire Schools, a consortium led by Leighton Contractors and Commonwealth Bank. Aspire Schools will undertake the financing, design, construction and maintenance of the schools for approximately 30 years while all core school and education services will be provided by the Department of Education and Training. This is the first PPP to be financed using the Supported Debt Model (SDM) developed in Queensland, incorporating fully underwritten private sector funding including from nabCapital alongside public sector funding from QTC.

5.5.3 Qualitative Assessment

PPPs are considered effective and efficient, however, the administration costs and compliance costs are very high. The methods allows for a very high level of incentives for risk management but also has very high exposure to other management disciplines resulting in high levels of information asymmetry.

Table 5.6: Qualitative assessment of public private partnerships

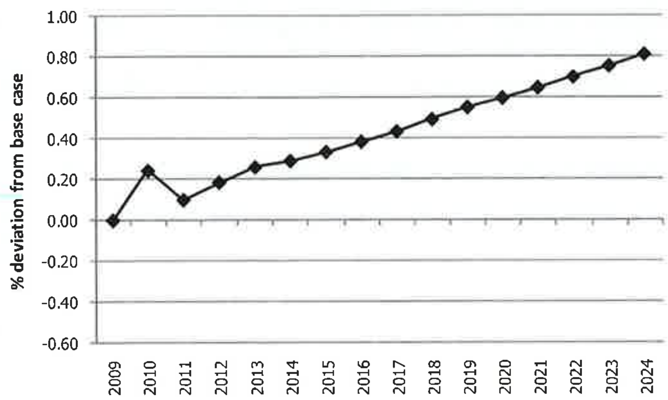
Characteristic	Discussion	Measure	Score
Effectiveness	PPPs are an effective financing option where the private sector is considered a better risk manager.	Effective	4
Efficiency	PPPs will improve efficiency where there are incentives for a project to be completed on time and on budget and where risk associated with the project is better managed. However, there is a risk that any associated user charges will be set higher than they should be.	Efficient	4
Equity	PPPs which incorporate user charges are generally equitable where the users pay an appropriate price for their use and there are no cross subsidies between users.	Very equitable	5
Stability/reliability of the revenue base	PPPs will generally self select where there is a stable/reliable revenue base. There may also be negotiated revenue support levels from the Government to ensure a base level of revenue.	Stable	4
Administration costs	PPPs ensure substantial establishment costs as well as ongoing performance monitoring, enforcement of contractual conditions and detailed reporting.	Very high	1

Characteristic	Discussion	Measure	Score
Compliance costs, certainty and transparency	Ongoing compliance costs from both the operator, regulator and government. Due diligence and financing costs are high. Transparency may be reduced due to confidentiality reasons.	Very high	1
Stakeholder support	PPPs supported by both private sector and government. Consumers are supportive of the infrastructure provision but do not want to be charged too much.	High	4
Incentives for risk management	The attractiveness of PPPs is to allocate risk to those who can best manage it. Contracts need to reflect this.	Very high	5
Exposure to other management disciplines	Exposure to financiers, investment advisers and investors.	Very high	1

5.5.4 Quantitative Assessment

Figure 5.5 shows the impact on Queensland Employment of the $1 billion increase in infrastructure spending financed from the private sector. The use of private sector debt has to be financed from user charges. The combination of private debt requiring principal and interest repayments and the user charges implemented as a tax result in a small positive increase in employment from the base case.

Figure 5.5: Employment change from private borrowing and user charges



Source: Prime Research

5.6 Summary

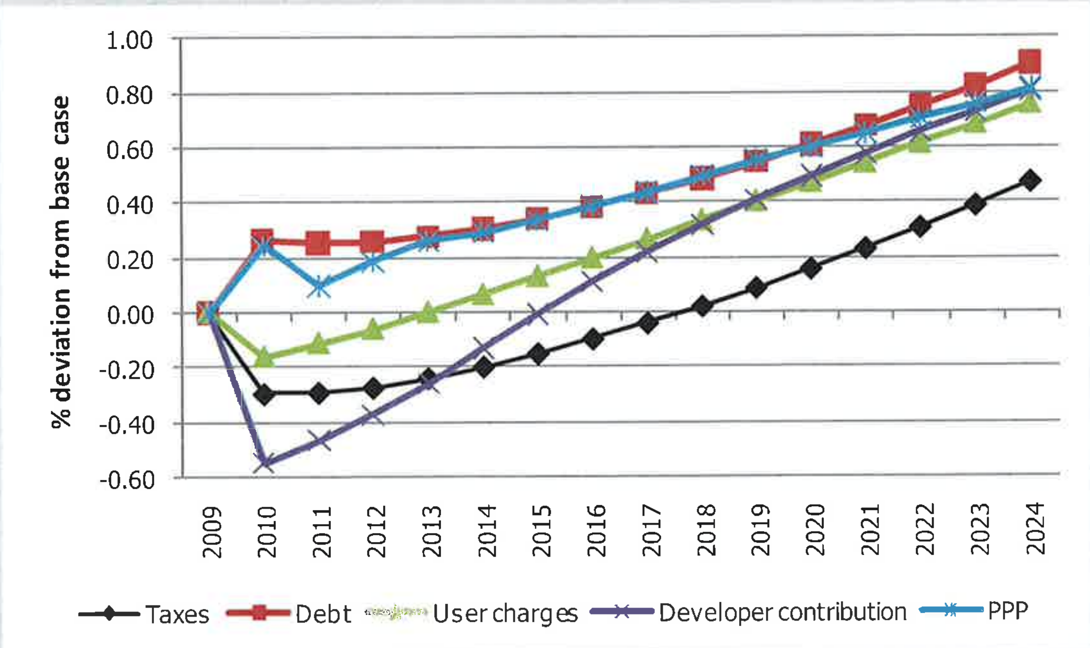
Whilst a qualitative assessment is to some degree subjective and should be interpreted as an indication rather than a definitive measurement, the assessment does indicate that government debt has stronger characteristics that the other traditional methods. The beneficial characteristics of government debt include: very stable revenue base (government guaranteed), very low administration costs, very low compliance costs, high certainty and transparency and minimal exposure to other management disciplines.

PPPs should fare better in the assessment than they do since they are largely debt funded and in this regard should have similar characteristics to government debt. However, they are impacted by very high administration costs, very high compliance costs, concerns around certainty and transparency and very high exposure to other management disciplines leading to high levels of information asymmetry.

Developer charges perform poorly in the qualitative assessment due to their inefficient and inequitable nature. Furthermore, they are impacted by high administration costs and high compliance costs and low certainty and transparency.

From a quantitative perspective, using employment as the indicator, the modelling results indicate that financing methods that match the costs of the infrastructure with the benefits to the community over time should be preferred (government debt and PPPs). Other methods show a negative impact in the early stages of the infrastructure's life and consequently never deliver the same level of employment benefits. Taxation is a particularly poor performer and is shown to have a negative impact on employment for almost nine years.

Figure 5.6: Employment change from traditional financing methods based on a $1 billion increase in infrastructure expenditure



Source: Prime Research

6. Assessment of Alternative Financing Methods

This section applies the assessment framework described in the preceding section to the chosen alternative financing methods.

6.1 Specific Purpose Securitised Borrowing

6.1.1 Description

Specific purpose securitised borrowing is used to finance a particular project with the debt being repaid from the income that the project generates. In Australia quasi-government entities used specific purpose bonds from the mid-1800s until the late 1970s when reforms in the financial sector and the movement to central borrowing authorities (CBAs) in each jurisdiction (e.g. QTC) resulted in the demise of specific purpose borrowing. Fund raising through bonds by the likes of QTC no longer specifies the purpose of the borrowing or the entity using the funds.

6.1.2 Usage

This type of financing is only really common in North America. In France, Germany and the UK, public sector borrowings other than by the national government are sourced from financial institutions such as municipal banks.

In North America they are called *municipal bonds*. Municipal bonds are issued by states, cities, and counties, or their agencies to raise capital for projects such as bridges, roads, hospitals, schools, sewer systems, stadiums, airports, power plants, prisons or for other needs. In the US there is also a form of government called Special Districts. These are government entities such as school districts that provide one specific type of service to one municipality or to multiple municipalities. Special Districts include water districts, fire districts, power districts, sewer districts and airports.

There appears to be no real limitation to the size of the bond issue other than the ability of the issuer to make the coupon payments through its taxing power.

The methods of issuing debt are governed by an extensive system of laws and regulations, which vary by state. Bonds bear interest at either a fixed or variable rate of interest, which can be subject to a cap known as the maximum legal limit. If a bond measure is proposed in a local county election, a Tax Rate Statement may be provided to voters, detailing best estimates of the tax rate required to levy and fund the bond.

Different types of municipal bonds are secured by various types of repayment sources, based on the promises made in the bond documents:

- *General obligation bonds* - promise to repay based on the full faith and credit of the issuer; these bonds are typically considered the most secure type of municipal bond, and therefore carry the lowest interest rate;
- *Revenue bonds* - promise repayment from a specified stream of future income, such as income generated by a water utility from payments by customers; and
- *Assessment bonds* - promise repayment based on property tax assessments of properties located within the issuer's boundaries.

One of the primary reasons municipal bonds are considered separately from other types of bonds is their special ability to provide tax-exempt income. Interest paid by the issuer to bond holders is often exempt from all federal taxes, as well as state or local taxes depending on the state in which the issuer is located, subject to certain restrictions.

The type of project or projects that are funded by a bond affects the taxability of income received on the bonds held by bond holders. Interest earnings on bonds that fund projects that are constructed for the public good are generally exempt from federal income tax, while interest earnings on bonds issued to fund projects partly or wholly benefiting only private parties, sometimes referred to as private activity bonds, may be subject to federal income tax.

The laws governing the taxability of municipal bond income are complex, however, bonds are typically certified by a law firm as either tax-exempt (federal and/or state income tax) or taxable before they are offered to the market.

Case Study 6.1: Example of a utility revenue bond - Omaha Public Power District

The Omaha Public Power District (OPPD), a Special District, issued a series of Electric System Revenue bonds worth US$245 million in 2007. The proceeds of the bonds were to be used for capital expenditures.

Both the principal and interest on the bonds are secured by the revenues, income, receipts and profits from the electricity supplies. The utility retails electricity to 47 cities and villages. It also wholesales electricity to five municipalities.

The due diligence makes it clear that OPPD has no taxing power and that the bonds are not the obligations of the State of Nebraska. It is also clearly stated that the State or any of its political subdivisions is not liable for the repayment of the bonds.

Source: The Allen Consulting Group (2003)

A more recent type of bond is the Build America Bonds (BAB). BABs are a taxable municipal bond created under the *American Recovery and Reinvestment Act 2009* that carry special tax credits and federal subsidies for either the bond holder or the bond issuer. Many issuers have taken advantage of the BAB provision to secure financing at a lower cost than issuing traditional tax-exempt bonds. The BAB provision is open to governmental agencies issuing capital expenditure bonds before 1 January 2011.

Municipal bonds can be used for a wide variety of capital projects provided there is assurance through taxation power or revenue stream that the coupon or interest payments can be met.

6.1.3 Qualitative Assessment

Special purpose securitised borrowing has many parallels with government debt currently used as a financing method in Queensland. It maybe that special purpose securitised borrowing has higher stakeholder support due to knowledge regarding what the debt is being used to finance but this introduces slightly higher administration and compliance costs.

Table 6.1: Qualitative assessment of special purpose securitised borrowing

Characteristic	Discussion	Measure	Score
Effectiveness	At present the Queensland Government can efficiently raise and manage substantial amounts of debt capital through QTC at a low cost subject to the Charter of Fiscal Responsibility. The debt raised by QTC is not identified to the customer or a project. A move back to specific purpose bonds would still be effective if facilitated through QTC but would require more scrutiny by potential purchasers and ratings agencies.	Effective	4
Efficiency	Where the benefits of public infrastructure financed through debt are greater than the costs economic efficiency is improved. Since the debt is raised for a specific purpose the risks and therefore costs are directly related to the characteristics of the public infrastructure being financed.	Efficient	4
Equity	The repayment of debt can be more closely aligned with the benefits of the infrastructure to current and future users balancing intergenerational equity.	Very equitable	5
Stability/reliability of the revenue base	Debt finance raised for specific purposes can provide a reliable source of finance however the cost of that finance will be influenced by the stability/reliability of the revenue source used to repay the debt.	Ambiguous	3
Administration costs	In a well functioning debt market and where managed by a CBA administration costs should be minimised.	Low	4
Compliance costs, certainty and transparency	There are few compliance costs in public debt although for specific purpose debt there may be higher compliance costs. Certainty and transparency are improved over general debt.	Low	4
Stakeholder support	Specific purpose borrowing is common in many other jurisdictions and in the private sector and thus provided it is prudently managed will be well supported.	Very high	5

Characteristic	Discussion	Measure	Score
Incentives for risk management	Raising debt for specific projects will ensure that debt levels are transparent and appropriately managed although this does depend on the quality of management.	High	4
Exposure to other management disciplines	Debt raising is subject to parliamentary scrutiny. With specific debt, purchasers will be more inclined to investigate the project risks and determine the necessary return.	Ambiguous	3

6.1.4 Risks & Barriers to Use

Specific purpose securitised borrowing by governments in Australia was phased out in the 1980s in favour of CBAs that raise non-specific debt and on-lend to government departments, local authorities, government owned enterprises and public sector bodies.

In Queensland the CBA is QTC. Under the *Queensland Treasury Corporation Act 1988* there does not appear to be any legislative impediment to specific purpose securitised borrowing through different types of bond issues.

Risks associated with specific purpose securitised borrowing relate to those reasons why Australian governments moved to CBAs in the 1980s. That is CBAs resulted in a more efficient and effective means of raising government debt. A move back to specific purpose securitised borrowing could possibly increase the cost of raising debt and the cost of that debt as individual bond issues would carry their own credit rating.

If bonds issued by the State were to attach certain taxation benefits then these taxation benefits could only be within the taxing powers of the State unless special arrangements are made with the Commonwealth Government. The most suitable of these would be recurrent property taxes such as land tax, or council rates.

Under the *Statutory Bodies Financial Arrangements Act 1982*, statutory bodies (which includes local government and the ULDA) may only borrow with the Treasurer's approval (Section 34) and that borrowing has to be in Australian dollars within Australia. Local governments are not restricted to borrowing through QTC but still require approval from the Treasurer for any borrowings.

Statutory bodies such as local governments would not currently have the skills and capacity to manage their own bond issues. It is possible that the financial overview of statutory bodies by QTC (on behalf of the Treasurer) would be diminished if statutory bodies were able to raise their own debt. Without appropriate financial oversight financial sustainability issues may arise.

6.1.5 Governance Arrangements for Use

Governance arrangements for specific purpose securitised borrowing to be used would require:

- Legislative change to allow statutory bodies to issue specific purpose bonds;
- An independent central bond issuing body with the appropriate legislative power (such as QTC) to market and sell specific purpose bonds;
- An independent organisation to monitor statutory body financial performance;
- Independent ratings agencies to rate the risk on various bond issues;
- An efficient market for the trading of bonds; and
- If there are to be preferential taxation arrangements for certain bonds, a legislative approval process for the granting of taxation relief.

6.2 Certificates of Participation

6.2.1 Description

A variation on specific purpose securitised borrowing is the Certificate of Participation (CoP) or lease revenue bond. A bond issue is created in order to fund the construction of a capital facility that is within the city limits. Rather than owning the facility outright during the period of construction, the city leases the facility during the construction period and makes instalment payments toward the lease. When the payment schedule is completed, the municipality assumes ownership of the completed facility.

For the investor, the CoP represents proof of involvement in the bond issue. Purchasing a share of the lease revenues can be an attractive alternative to the more traditional bond for a couple of reasons. Payments are made to the investor for the duration of the project, based on the percentage of share that the investor has in the lease agreement. This means that the investor does not necessarily have to wait for a bond to mature before he or she begins to receive a return on the investment. Of course, payments specified by the terms of the CoP can be deferred until later in the project, if the investor prefers to receive larger payments at less frequent intervals.

In the unlikely event that the municipality defaults on the arrangement, the terms of a CoP provide investors with the ability to assume control of the facility. Once the default is complete and the transfer of title is in the hands of the investors, they are free to do with the asset as they see fit. This includes the ability to either complete the facility and sell it to a private investor, or choose to band together and use the completed structure for purposes of their own.

6.2.2 Usage

CoPs are popular in the US where they have been used to finance a wide range of capital projects.

Case Study 6.2: Orrick – Pioneer of Lease Revenue Bonds and Certificates of Participation

Orrick is the leader in lease and COP financing in California and is active in these financings in other states as well. Since 1985, Orrick served as bond, underwriter's or special counsel in more than 1,000 lease transactions totaling more than $47 billion. Orrick was counsel to the underwriters in connection with the largest multiple lease financing, the $760.8 million bankruptcy recovery financing for Orange County. These lease revenue bonds or certificates of participation have been used to finance such projects and programs as:

- office buildings, public administration buildings, courthouses, police and fire stations, civic center complexes, museums and convention centers
- elementary and high school buildings, relocatable school buildings and "land bank" programs for growing school districts
- telephone, telecommunications and data processing systems
- college and university buildings and equipment, including laboratories, high technology educational facilities, libraries and instructional facilities
- prison, jail and other correctional facilities
- health care facilities
- cogeneration projects and other electric power facilities
- water system facilities
- wastewater treatment facilities
- aviation hangars and other airport facilities
- parking structures
- public golf course and recreational projects
- open space
- asbestos removal projects at schools
- unfunded pension liabilities
- land acquisition
- light rail transit
- equipment, buses, computers and other personal property

Source: http://www.orrick.com/practices/public_finance/leaseRevenue.asp

As can be seen from the case study a Lease Revenue Bond or CoP can be used for a wide variety of capital projects providing there is a revenue stream to pay the coupon or interest on the bond.

6.2.3 Qualitative Assessment

The assessment below relates to a situation where the not-for-profit sector builds and owns the infrastructure and the public sector takes a long lease prior to transfer. The infrastructure is largely financed with debt.

Table 6.2: Qualitative assessment of certificates of participation

Characteristic	Discussion	Measure	Score
Effectiveness	In a well functioning debt market and where the customer providing the revenue is able to fund the debt CoPs have been shown to be an effective method of raising finance in overseas jurisdictions.	Effective	4
Efficiency	Where the benefits of public infrastructure financed through debt are greater than the costs economic efficiency is improved. Since CoPs are debt raised for a specific purpose the risks and therefore costs are directly related to the characteristics of the public infrastructure. Having the not-for-profit sector involved in delivery of the infrastructure may also ensure on time and on budget delivery.	Efficient	4
Equity	The repayment of debt can be more closely aligned with the benefits of the infrastructure to current and future users balancing intergenerational equity.	Very equitable	5
Stability/reliability of the revenue base	Debt finance raised for specific purposes can provide a reliable source of finance however the cost of that finance will be influenced by the stability/reliability of the revenue source used to repay the debt. In the case of a CoP with a unity payment the revenue is very stable.	Stable	4
Administration costs	Administration costs are likely to be higher than just debt because there are costs associated with the financing and with the leasing.	High	2
Compliance costs, certainty and transparency	Compliance costs are low. There is certainly of lease payments and transparency in all dealings.	Low	4
Stakeholder support	The method will have support from the not-for-profit sector and the public sector.	High	4
Incentives for risk management	Under the arrangement it would appear that risks are appropriately allocated to those who can best manage them.	Very high	5
Exposure to other management disciplines	There will be a number of parties involved in a CoP such as financier, debt purchaser, lessor and lessee.	High	2

6.2.4 Risks & Barriers to Use

From the examples given above the use of CoPs seemingly relates to more minor and specific use items of public infrastructure which would indicate that the risks of investment are quite specific and may therefore require a higher rate of return. However the overall reputation of the statutory body acquiring the asset may act to dampen this risk. Similarly the ability of the investor to assume ownership of the asset if the borrower defaults may serve to reduce the risk.

Given that the statutory body is essentially entering into a hire purchase arrangement with a provider and that provider is raising the finance through a private bond issue, it does not appear that there would be any legislative barriers to use. Statutory bodies may however have limits imposed on their financial commitments or the nature of the financial arrangements that they can enter into.

6.2.5 Governance Arrangements for Use

Governance arrangements for use mainly concern the procurement process and the contractual arrangements that are required between the statutory body and the supplier. Projects of a certain size will probably still require the approval of Queensland Treasury.

6.3 Value Capture Levy

6.3.1 Description

A value capture levy aims to capture the uplift in land values that result from the planning process, development of land or construction of beneficial infrastructure, i.e. they target the portion of the economic rent created by the planning process rezoning the land and therefore making it more valuable (windfall). The levy is generally only captured when the property changes ownership. Levy receipts are then used to fund infrastructure to support development.

6.3.2 Usage

In NSW, value capture levies were introduced in 1970 under the *Land Development Contribution Act 1970* and the *Land Development Contribution Management Act 1970* in respect of declared land (non-urban Sydney region). The levy was set at 30% of the increase in land value when the land was sold. The Acts were superseded in 1973 by an amendment act but not repealed.

The only other jurisdiction that has a value capture levy is the ACT via the *ACT Land (Planning and Environment) Act 1991* Change in Use Charges (CUCs). All land is leasehold in the ACT and if leases are varied in a manner that increases the value of the use and development rights attaching to the land, a charge is payable to give back some of the increased value to the community.

Case Study 6.3: UK Government and Uplift Levies

The 1947 'Development Charge' was the first attempt to levy windfall gains from land development. The charge was levied at 100 per cent of the excess value attributable to the granting of planning permission, relative to the existing use value on the date development began. The levy was abolished because it reduced land coming forward for development, and the revenue raised was substantially lower than expected.

The 1967 Betterment Levy aimed to capture value above 110 per cent of existing use value, so as to provide an incentive to sell by allowing some development gain to be made, the charge was introduced at 40 per cent with the stated intention of raising it higher. It was abolished because, among other problems, the complexity of the legislation allowed many developers and landowners to avoid paying by 'establishing' that work had begun prior to the charge's introduction and again, the measure raised far less money than was initially expected.

The 1973 Development Gains Tax aimed to extend the Capital Gains Tax regime by taxing at rates of up to 82 per cent for individuals, and 52 per cent for companies, the gains from disposing of land possessing development potential. However, rapidly changing market conditions, and a change of Government to one with different development gain ideas soon after the tax's introduction, meant that the measure had little time to exercise an influence on the land market.

The development of Land Tax was charged on each occasion of the realisation of development gain flowing from disposals of land after August 1976. The tax contained several different features to its predecessors. These include levying the charge not only on actual sales, but also on assumed disposals where development projects began on land without a preceding land sale. There were also numerous exemptions from the tax. However, the complexity of the tax led to a proliferation of avoidance regimes and resulted in the tax falling disproportionately on smaller landowners, leading to allegations of unfairness.

Further, from 2005 to 2007 the UK Government consulted extensively on the introduction of a Planning Gain Supplement (PGS). The aim of PGS was to capture a portion of the land value uplift created by the planning process, in order to help finance additional infrastructure while preserving incentives to bring forward land for development. The proposed approach as to capture a percentage of the difference between the 'current use value' i.e. the value of the land under its current use of the immediately prior to planning permission being granted, and the 'planning value' i.e. the value of the land for its new use immediately after the granting of planning permission. The UK Government never publicly announced the percentage of the uplift it intended to capture.

The introduction of PGS was eventually scrapped because of significant stakeholder concerns about the workability of the proposal and the reallocation of funds to Local Authorities to pay for infrastructure. The introduction of the PGS was supposed to be accompanied by a scaling back of s106 agreements (similar to s94 in NSW), and central Government intended to keep a portion of the PGS to pay for regional and subregional infrastructure. Councils and developers were concerned that a significant proportion of funding would be kept by the Treasury and reallocated elsewhere, thus reducing the certainty of infrastructure delivery and harming development.

The UK Government is currently exploring the introduction of a 'Community Infrastructure Levy' – a fixed levy that Local Authorities would charge on top of existing s106 agreements for regional and subregional infrastructure.

Source: Various

The UK, Israel, US, Hong Kong, Singapore and Denmark all have some variation of a value capture levy or betterment tax.

Interestingly the Queensland Urban Land Development Authority (ULDA) (2008) has published an *Infrastructure Contribution Framework* to assist in the development of areas within the Urban Development Area (UDA). The key objective of the framework is to (ULDA, 2008, P. 1):

> *...provide transparency and certainty in relation to infrastructure contribution obligations expected from the State and local governments, the local community and the development industry. These contributions are required to deliver the infrastructure necessary to enliven the transformation of the Urban Development Area to achieve the vision outlined in the Development Scheme.*

It is anticipated that the ULDA's Development Schemes will provide development yield increases in the precincts within UDAs and that for this to occur the level of infrastructure works will be over and above what councils would normally fund.

The first real application of this policy has been proposed for Bowen Hills. To fund the additional infrastructure, affordable housing and ecological sustainability it is proposed that 50% arising from the value uplift be applied as a contribution where a developer wants to redevelop above the current permitted BCC City Plan densities. This would be in addition to the BCC infrastructure charges schedule.

6.3.3 Qualitative Assessment

Whilst the effectiveness and efficiency of a value capture levy are assessed as ambiguous, the method is considered as very equitable with very low compliance costs and high levels of certainty and transparency.

Table 6.3: Qualitative assessment of value capture levy

Characteristic	Discussion	Measure	Score
Effectiveness	It is not clear if a VCL is an effective means of financing infrastructure as value is not created unless there is a changing in zoning (although it is the changing in zoning that requires the additional investment in public infrastructure) and the need for land sales to actually occur.	Ambiguous	3
Efficiency	The efficiency of a VCL depends on how the levy impacts on price signals, incentives and transaction costs. If the VCL is too high landowners may not sell.	Ambiguous	3
Equity	A VCL is equitable since it captures windfall gains from an individual at a point in time and distributes them to many individuals across time.	Very equitable	5
Stability/reliability of the revenue base	As development occurs so too does demand for public infrastructure therefore a VCL should provide a stable/reliable revenue base.	Stable	4
Administration costs	Administration costs once the mechanism is established should be minor. Difficulties may be experienced in determining the value uplift amount.	Low	4
Compliance costs, certainty and transparency	Compliance costs will be low (similar to transfer duty). The VCL will be certain and transparent to vendors but not purchasers.	Very low	5
Stakeholder support	Unlikely to be supported by vendors as acts as a disincentive to sell. Likely to be supported by governments due to low administration costs and redistribution effect.	Ambiguous	3
Incentives for risk management	Implementation should generally be well managed with resources applied to ensure compliance. The risk management aspects of using government taxation to finance public infrastructure depend on the quality of public management of the procurement process and operations.	Low	2
Exposure to other management disciplines	The VCL would be subject to parliamentary scrutiny and subject to binding budget constraints.	Low	4

6.3.4 Risks & Barriers to Use

The main risks involved in a value capture levy are:

- It may create a disincentive for landowners to bring land to market if they believe the levy may not be permanent or if the levy rate is too high; and
- If the calculation mechanism is too complex it will be difficult for landowners and developers to calculate their levy.

A current barrier to use is that there is no legislative framework in place for a value capture levy in Queensland. Assuming the value capture levy is a replacement for other financing mechanisms such as developer contributions and transfer duty there will need to be considerable modeling to understand incidence and revenue impacts.

6.3.5 Governance Arrangements for Use

Governance arrangements required for the implementation of a value capture levy are:

- Legislative framework;
- Establishment of administrative and compliance unit within Office of State Revenue including an appeals mechanism;
- Extensive and ongoing education campaign;
- Recording of all land values at the point in time the value capture levy is to commence to form a base from which value increases are measured; and
- Repeal of legislation that the value capture levy replaces.

6.4 Specific Purpose Levies

6.4.1 Description

Ad hoc levies can be used by governments to raise finance for a specific purpose. However where they are not linked directly back to the services they are levied upon they are often regarded as a tax.

6.4.2 Usage

Examples include:

- *Sydney Bed Tax* – In September 1998 the NSW Government implemented a bed tax of 10% on Sydney CBD and North Sydney hotels to finance the 2000 Sydney Olympics campaign. The bed tax was abolished with the introduction of the GST in 2000.
- *Perth Parking Levy* – Parking operators have to pay a levy to the WA Government for all parking spaces. The funds are collected by the City of Perth. The *Perth Parking Management Act 1999* requires that money raised by the levy be used within the city to fund or improve the bus system, improve public transport access, enhance the pedestrian environment and bicycle access.

Specific purpose levies are often contentious and work best where there is a very clear nexus (and transparency) between the levy and the provision of the infrastructure or service.

6.4.3 Qualitative Assessment

Whilst specific purpose levies can be effective they are considered inefficient and inequitable. Administration costs and compliance costs can be very low, however there is generally poor stakeholder support of what is essentially considered a new tax.

Table 6.4: Qualitative assessment of specific purpose levies

Characteristic	Discussion	Measure	Score
Effectiveness	SPLs can be effective in that they raise finance through regular and easily altered means.	Effective	4
Efficiency	SPLs are generally considered inefficient because they distort resource allocation decisions. SPLs can also be levied on a narrow base.	Inefficient	2
Equity	The degree of equity in a levy depends on the relationship between those levied and those benefiting from use of funds. SPLs unless very broad based are generally not equitable.	Inequitable	2
Stability/reliability of the revenue base	Unless extremely narrow and avoidable SPLs are generally a stable/reliable source of finance.	Stable	4
Administration costs	Administration costs are generally minor where an existing payments mechanism can be used (e.g. Queensland Ambulance levy contained in electricity bills).	Very low	5
Compliance costs, certainty and transparency	Compliance costs are low and the SPL generally very certain and transparent.	Very low	5
Stakeholder support	Stakeholders are generally against SPLs as they are viewed as a additional tax. There will also be circumstances where it is perceived that the funds raised by the SPL are not fully used for the intended purpose.	Very low	1
Incentives for risk management	Implementation should generally be well managed with resources applied to ensure compliance. The risk management aspects of using SPLs to finance public infrastructure depend on the quality of public management of the procurement process and operations.	Low	2
Exposure to other management disciplines	SPLs would be subject to parliamentary/council scrutiny and subject to binding budget constraints.	Low	4

6.4.4 Risks & Barriers to Use

The major risks associated with special purpose levies are poor stakeholder support as they are often viewed as a very targeted tax with little faith that the revenue raised will be used for the specific purpose it is being raised for. This in turn presents a political risk to voter intentions.

The only significant barrier to use is the need to pass specific legislation for their implementation, which requires majority support within the parliament or council.

6.4.5 Governance Arrangements for Use

Governance arrangements required for the implementation of a specific purpose levy are:

- Legislative framework;
- Establishment of administrative and compliance unit including an appeals mechanism;
- Extensive and ongoing education campaign; and
- Comprehensive reporting mechanism demonstrating funds raise are used for the specific purpose.

6.5 Growth Area Bonds

6.5.1 Description

Growth area bonds (GABs), also known as Tax Increment Financing (TIF) in the US, is a specialised form of debt financing where future property tax revenues are set aside to repay bonds issued to finance items of public infrastructure. When new public infrastructure is developed it normally spurs new property development and higher valuations, both of which increase the revenue from property taxes such as transfer duty and municipal rates.

Under GAB financing, specific GAB districts are established with a plan outlining the district's infrastructure needs and their cost. A financing body would issue GABs that are tied to a specific region and its future tax revenue collections. Alternatively, generic state government bonds could be issued until investors have confidence in the GAB process.

The new public infrastructure encourages property development and higher valuations in the GAB district. Property tax revenue in the GAB district increases and this increment to tax revenue is used to make repayments on the bonds. When the debt has been repaid, the entire tax revenue from the district reverts to the original taxing authority.

GABs are different from value capture levies in that GABs target the growth in property taxes levied on a continuous basis, whereas a value capture levy will only capture part of the growth when a property changes ownership. GABs require a defined area whereas value capture levies can apply within a defined area or a whole jurisdiction.

6.5.2 Usage

Since the 1950s, TIF has been used throughout the US to fund a range of infrastructure and development projects. Today, 49 US states have TIF enabling legislation. While the concept of TIF is widely applied throughout the US, details of how it is implemented (e.g. in terms of scale and types of development, eligibility requirements, and definition of tax increment) vary from State to State, and can be tailored to suit the needs, policies and governance arrangements of specific areas.

Case Study 6.4: Peninsula Town Centre, Virginia

Infrastructure/development

Shopping centre redevelopment, including commercial and residential space, streets, public open space and pedestrian infrastructure.

Financing package and TIF arrangements

The city created the Peninsula Town Centre Community Development Authority (CDA) to assist in development of the following public improvements associated with the project:

- construction of a 750 space carpark.
- construction of on-site utilities and infrastructure, including new public streets, footpaths, public parks and landscaping, water, wastewater, electricity and other utility services.

The developer and the city negotiated a financing structure that included the use of:

- Incremental tax revenue expected to be generated within the project (100% of Real Property Incremental Revenues, 50% of Sales Tax Incremental Revenues, 25% of Meals Tax Incremental Revenues and 50% of Amusement Tax Incremental Revenues).
- Special Real Property Tax – the City Council will levy and collect a special tax on each taxable parcel of real property within the CDA.
- Back-up Special Assessment to the extent that Incremental Tax Revenues and the Special Real Property Tax are insufficient to repay debt service with respect to the Bonds, the CDA will levy the Back-up Special Assessment on the owners of taxable real estate in the CDA.

The CDA is responsible for processing incremental revenues.

Timeline

In approximately 2003, the city and the developer began devising a plan to re-develop the Mall site. Once the planning and political processes were complete in early 2006, the TIF commenced with Bonds sold and placed in September 2007.

Source: PriceWaterhouseCoopers (2008)

PriceWaterhouseCoopers (2008) tested the viability of a GAB in Australia in two case studies. It found that a GAB would repay 75% of a metro rail station and accompanying infrastructure upgrades in the Sydney suburb of Gladesville in 18 years, and 75% of the infrastructure costs of the Sydney south west growth centre in 19 years.

6.5.3 Qualitative Assessment

TIFs appear to be an effective and very efficient mechanism for the provision of public infrastructure. However they have ambiguous equity outcomes and very high administration costs.

Table 6.5: Qualitative assessment of growth area bonds

Characteristic	Discussion	Measure	Score
Effectiveness	TIFs appear to be an effective means of financing infrastructure since the infrastructure is self funded. Furthermore it does not impact on housing affordability upfront.	Effective	4
Efficiency	Since the increase in wealth of those within the GAB district is in proportion to the increase in asset value that the GAB facilitates the mechanism is very efficient.	Very efficient	5
Equity	For the reasons outlined above GABs appear equitable however the hypothecated taxes cannot be used by government for other more equitable purposes and increases in property values within a GAB area may dislocate lower socio economic groups.	Ambiguous	3
Stability/reliability of the revenue base	In the early stages there may be considerable uncertainty over the likely increase in property values and therefore taxation revenue used to fund the GAB.	Ambiguous	3
Administration costs	Administration costs are higher due to the need for a GAB authority to be in place to administer the GAB district.	Very high	1
Compliance costs, certainty and transparency	Compliance costs are absent as the existing taxes are already in operation.	Very low	5
Stakeholder support	It would appear that there would be reasonable levels of stakeholder support since GABs may reduce or replace developer contributions increasing housing affordability at commencement.	High	4
Incentives for risk management	A GAB provides some market discipline in that infrastructure selected for funding must produce a benefit through increased property values.	High	4
Exposure to other management disciplines	Debt raising is subject to parliamentary scrutiny. With specific debt, purchasers will be more inclined to investigate the project risks and determine the necessary return.	Ambiguous	3

6.5.4 Risks & Barriers to Use

The major risk associated with GABs relates to the timing, level and uncertainty of revenue during the early years. This is because the revenue is tied to the increase in taxation revenues created by the expected increase in property values created by the new public infrastructure. In the US this risk is often mitigated by switching between general obligation bonds and revenue bonds once the project is up and running and the GAB revenue has stabilised.

A further risk is the impact to revenues should the government change existing taxes upon which the revenue streams to repay the GABs are dependent.

In addition to legislative requirements to allow GABs, the Queensland Government may not support the notion of hypothecating tax revenue that normally flows to consolidated revenue. Government generally prefers full flexibility over how taxation revenues are spent.

GABs may not be suitable for use by statutory bodies such as local government due to their limited taxation powers.

6.5.5 Governance Arrangements

Governance arrangements required for the implementation of GABs are:

- Legislative framework;
- Establishment of a GAB authority, its roles and responsibilities;
- Selection mechanism for GAB areas and public infrastructure; and
- Mechanism for dealing with changes to dependant taxes.

It would also be assumed that bonds would be considered as special purpose nature and thus the governance arrangements indicated for special purpose securitised borrowing would also apply.

6.6 Business Improvement Districts

6.6.1 Description

A business improvement district (BID) is a business and local authority partnership in which businesses in a defined area pay an additional tax or fee in order to fund improvements within the district's boundaries. BIDs may go by other names, such as business improvement area (BIA), business revitalisation zone, community improvement district, special services area, or special improvement district. BIDs provide services, such as cleaning streets, providing security, making capital improvements, and marketing the area. The services provided by BIDs are supplemental to those already provided by the municipality.

6.6.2 Usage

There are nearly 1,000 BIDs in the United States. New York City has 64 BIDs, the most of any city. BIDs exist in other major American cities, including Los Angeles, Chicago, Houston, Philadelphia, Atlanta, San Francisco, Seattle, and Washington, DC.

In Canada, Toronto has 65 BIAs within its city limit. Montreal has 14. In the province of Alberta, they are termed "business revitalization zones". There are nine zones in the city of Calgary and 10 in Edmonton.

In England and Wales, BIDs were introduced through legislation (the *Local Government Act 2003*) and subsequent regulations in 2004. The Circle Initiative, a five-year scheme funded by the London Development Agency, set up the first pilot BIDs, five in London, all of which had successful ballots (a vote to implement the levy) by March 2006. As of October 2009 there were 30 operational BIDs across Greater London.

In March 2006, the Scottish Executive announced funding for six pilot BIDs in Scotland.

Case Study 6.5: City of San Diego, California, Business Improvement District

The City of San Diego's BID program, the largest in the state of California and one of the most active in the nation, is administered by the City's Office of Small Business. San Diego's program dates back to 1970 with the creation of the Downtown Improvement Area, California's first metropolitan downtown district. Since that time, the small business community and the City of San Diego have created 18 separate districts, with another two in the preliminary stages of formation. More than 11,000 small businesses participate in these self-assessment districts, raising more than $1 million annually.

The BIDs have developed a variety of successful marketing activities that generate business for the districts. These activities range from special events such as restaurant tours, block parties, weekly farmers markets and holiday festivals to developing public relations and marketing materials. BIDs use the Internet, develop coupon books, coordinate cooperative advertising campaigns and develop and distribute district brochures. BIDs also coordinate some of San Diego's most popular, large-scale street festivals, including the Adams Avenue Street Fair, Gaslamp's Mardi Gras and Hillcrest's CityFest. BIDs also market the districts to potential businesses in an effort to reduce vacancies, provide a good mix of businesses and strengthen the BID. All of these activities help to further market the district to customers.

The formula for determining the assessment amount is determined by the business organization that initiates the BID process, not the City. The respective business group takes into account the type, size, and location of the businesses. Assessments are levied on businesses on the basis of relative benefit from the improvements and activities to be funded. In San Diego, the fees generally range from $40 to $500 per business each year. A few of the newer BIDs have higher fees, ranging from $90 to $1,200 per year, with some anchor businesses paying up to $5,000 to support BID-related projects.

The fees help to fund BID board-approved business-related activities and improvements which will benefit the businesses. Activities, programs and improvements range from farmers' markets to business promotions to installing street lighting and removing graffiti. By pooling private resources, business owners in BIDs collectively pay for activities which they could not afford on an individual basis. Further, since a BID fee is a benefit assessment and not a tax, BIDs can consistently enact programs and activities without relying on public funding.

The City collects the fee on an annual basis. The BID assessment is included as a separate charge on the business tax certificate bill that every business receives. All assessment funds are returned to the BIDs through annual contract agreements. The City of San Diego does not charge BIDs for the City staff or administrative costs associated with this service.

Source: www.sandiego.gov

6.6.3 Qualitative Assessment

BIDS are deemed both very effective and very efficient because local business determines the fee and the purpose to which those fees are to be used. In this regard they are therefore more suited to smaller public infrastructure projects.

Table 6.6: Qualitative assessment of business improvement districts

Characteristic	Discussion	Measure	Score
Effectiveness	BIDs can be effective in that they raise finance voluntarily through the local jurisdiction and are used for specific means.	Very effective	5
Efficiency	BIDs are generally considered very efficient because the funds raised are used on specific nominated projects that individual businesses would not be able to afford.	Very efficient	5
Equity	The degree of equity in a BID fee depends on the relationship between those levied and those benefiting from use of funds. BIDs where funds are raised by business are generally expended on projects that will benefit business.	Equitable	4
Stability/reliability of the revenue base	Unless extremely narrow and avoidable BIDs are generally a stable/reliable source of finance.	Stable	4
Administration costs	Administration costs are generally minor as existing municipal tax collection mechanisms are used.	Very low	5
Compliance costs, certainty and transparency	Compliance costs are low, the BID fees are determined by business in the BID area and are generally certain and transparent.	Very low	5
Stakeholder support	Since local businesses have initiated the BID there is likely to be a high level of stakeholder support.	High	4
Incentives for risk management	The risk management aspects of using BIDs to finance public infrastructure depend on the quality of public management of the procurement process and operations.	Low	2
Exposure to other management disciplines	BIDs are subject to business scrutiny and subject to binding budget constraints.	Low	4

6.6.4 Risks & Barriers to Use

A real risk from the use of BIDs is that the fees raised will not be used for the purposes specified and that the costs of provision may not be kept under control requiring an increase in the fees.

Within Australia many districts form Chambers of Commerce and/or Retailers Associations to act as advocates between local business and local authorities such as the council, emergency services, schools and sporting associations. Whilst these organisations will have membership fees to support their operations, it is unusual for them to raise sufficient funds for public infrastructure. Rather these organisations tend to lobby for infrastructure provision.

The idea that businesses raise funds for public infrastructure will therefore be a paradigm shift and there may be political risks that business is perceived to be paying local authorities to provide them with benefits and that the benefits may be subsidised by the ratepayer.

There are currently no barriers that prevent private interests funding public infrastructure in agreement with a local authority.

6.6.5 Governance Arrangements for Use

The case studies indicate that there are formal arrangements around BIDs to ensure that there is a need for a BID, the majority of businesses vote for establishment of a BID and contribute to it, and that the local authority can run the BID.

Governance arrangements required for the implementation of a BID are:

- Legislative framework;
- A comprehensive BID proposal (or business plan);

- Organisation of the formal BID ballot or vote; and
- Establishment of BID company, procedures and governance;
- Calculation, collection and enforcement of the BID fee/levy; and
- The preparation and commitment to the baseline service agreements.

The London BIDs website[8] provides a comprehensive BID toolkit based on UK legislation.

6.7 Summary

All of the alternative financing methods considered in this report appear to be relatively successful in the jurisdictions in which they are used. This gives a level of confidence that they could be used in Queensland to finance public infrastructure.

In line with the qualitative assessment of the traditional financing methods, those related to debt, i.e. special purpose securitised borrowing and certificates of participation, have more favourable characteristics than most of the others. As demonstrated overseas, in particular in the US, both of these debt instruments appear to be particularly suited for statutory authority use, including local government, and can be used finance a wide variety of discrete economic and social infrastructure.

Value capture and special purpose levies are suitable methods to raise finance but suffer from the perception of being a new tax that may not be used for the purpose it is designed for. Value capture levies appear to have had implementation difficulties in some jurisdictions but remain a very equitable means of distributing windfall gains from planning decisions.

Likewise growth area bonds has some very attractive features and have been shown by PriceWaterhouseCoopers (2008) to be viable in Australia.

Business improvement districts have many strong characteristics mainly because they are voluntary and the businesses that contribute are expected to be the main beneficiaries. However, they are only suitable for relatively minor public infrastructure due to the voluntary nature of the funding base and a strong need to accrue benefits locally.

Almost all financing alternatives presented require changes to legislation for them to be used in Queensland. Legislation changes for some of the alternative financing methods would be fairly minor in nature (e.g. debt instruments) but other legislation would probably meet with resistance (e.g. growth area bonds and levies) if they were perceived as a new tax.

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[8] www.londonbids.co.uk

7. Application of Alternative Financing Methods in Queensland

This section summarises the strengths, weaknesses, suitable projects, obstacles and solutions for the use of each alternative financing method in the Queensland context.

7.1 Specific Purpose Securitised Borrowing

SPSB has many of the same strengths as government debt in that it is an effective, efficient and very equitable means of financing public infrastructure. Its main weakness is that because the debt is for a specific purpose it will be exposed to many management disciplines which may increase the likelihood of information asymmetry occurring. Despite this the method is likely to have high levels of investor support due to returns being closely related to the risk of the specific purpose to which the debt is applied.

SPSB are suitable for any small to large economic or social infrastructure where there is a stable and reliable revenue stream to repay the debt. It is not suitable for infrastructure where there is no reliable revenue stream. Suitable projects contained in the SEQIPP could include any network infrastructure with an associated revenue stream such as:

- Springfield passenger rail line;
- Toowoomba water pipeline: Wivenhoe to Cressbrook;
- Halys to Springdale to Blackwall (500kV) electricity transmission line
- Halys to Springdale to Greenbank (500kV) electricity transmission line; and
- Swanbank A Substation rebuild.

Some social infrastructure such as the Ipswich hospital redevelopment, Sunshine Coast University Hospital and schools would also be suitable to be financed by SPSB where there is a revenue stream (or unitary payment).

The main obstacle to using SPSB is that the Queensland Government and statutory bodies have raised non-specific debt through QTC for the last thirty years. Local government, whilst not restricted to borrowing through QTC cannot issue their own bonds. However, given the amount of debt likely to be raised to fund infrastructure projects over the next four years, all of which is subject to the same credit rating, it may be prudent for the Queensland Government or statutory bodies to consider using use SPSB, administered by QTC. For certain projects that may be considered higher risk use of SPSB may quarantine the debt so as to not affect the Queensland Government's credit rating (and hence interest cost) of the non-specific debt administered by QTC.

7.2 Certificate of Participation

CoPs have similar strengths and weaknesses to SPSB but have higher potential for information asymmetry and administration costs and therefore possibly weaker stakeholder support.

CoPs are suitable for any small to medium scale economic or social infrastructure where there is a lease in place to generate reliable revenue. They are not suitable for infrastructure where there is no reliable revenue stream. Suitable projects contained in the SEQIPP could include any new building related social infrastructure where the Queensland Government or a statutory authority is the lessee such as:

- Sunshine Coast University Hospital;
- Schools;
- Ipswich Court, Watch House and Police Station; and
- Gatton Correctional Precinct.

There do not appear to be any obstacles for the use of CoPs as they are a variation on the build, own, lease and transfer theme with the investment entity supplying the capital (e.g. building) having responsibility for raising finance through a bond issue. This maybe attractive to the Queensland Government, or statutory bodies, where they do not wish to carry the capital costs of the project on their own balance sheets but instead lease a facility paid for from their operational funds.

7.3 Value Capture Levy

The strengths of a VCL are in its equity (ability to capture windfall gains from individuals and redistribute them to many individuals) and very low administration and compliance costs (application of a formula). Weaknesses associated with VCLs are poor stakeholder support, especially from vendors especially if the levy rate acts as a disincentive to sell.

VCLs will generally work best for any small to medium scale economic or social infrastructure required to support rezoning to a higher land use where there is a nexus between the infrastructure and the development. Suitable projects in the SEQIPP for financing using a VCL would therefore include any that benefit residents in or adjacent to a rezoned area. These may include:

- Petrie to Redcliffe rail corridor and line;
- CoastConnect: Caloundra to Maroochydore quality bus corridor;
- Schools;
- TAFE campuses; and
- Sport and recreation facilities.

The VCL financing method faces significant obstacles in that it would require new legislation and may be viewed as a new tax. For a VCL to be acceptable it would have to replace one or more other financing methods (e.g. developer charges) and demonstrate that it would raise similar levels of funds, at no higher cost, and would be more equitable than the financing method it was replacing.

7.4 Specific Purpose Levies

The main strengths of a SPL are low administration and compliance costs making it an effective means of raising finance. Offset against these strengths are inefficiency, inequality and generally very low stakeholder support.

Public infrastructure for which SPLs are suitable include any small scale local economic or social infrastructure that the levy is raised for and fully allocated to. They should not be used for general revenue. Example SEQIPP projects may include:

- Local social infrastructure such as sport and recreation facilities;
- Trails and great walks; and
- Land acquisition for green space preservation (not in the SEQIPP).

Similar to a VCL, an SPL requires specific legislation which presents an obvious obstacle for their use as a financing mechanism. To sell a SPL the scheme must appear highly credible. That is the money raised will be used for the intentioned specific purpose and that the financials associated with the SPL will be transparent.

7.5 Growth Area Bonds

GABs' strengths lie with its effectiveness and efficiency as a financing method along with low compliance costs and high certainty and transparency. Stakeholder support should also be generally high since the additional taxes raised will be spent within the GAB boundaries. Offset against these strengths are high administration costs.

Because a GAB is generally confined to a local area they are suitable for any small scale economic or social infrastructure required to support a specific development where there is a nexus between the infrastructure and the development. They are not suitable for projects that benefit communities outside of the specific development. Selected projects contained within the SEQIPP that would be suitable for GABs include:

- Local social infrastructure such as sport and recreation facilities;

- Health precincts (where they predominately service the local community);
- Springfield passenger rail line; and
- Petrie to Redcliffe rail corridor and line.

These last two rail projects are included as they will terminate in communities that should then experience increases in property values due to the reduction in travel times to larger centres.

The major obstacles to GABs are the need for legislative change, a new administrative statutory authority and potential resistance by the Queensland Government to the hypothecation of general taxation revenue to fund specific projects. Since no new tax is being raised the legislative aspect should not prove to be a significant barrier. The new administrative statutory authority would be seen as an additional expense but could be established as part of an existing body, e.g. ULDA.

7.6 Business Improvement Districts

BIDs have many strengths, first and foremost because they are voluntary with benefits flowing directly to the businesses who contribute. Their voluntary nature is also their main weakness as their success is directly related to the level of energy, participation and contribution of local businesses.

BIDs are most suitable for any small local scale economic or social infrastructure where there is a benefit from the infrastructure to those funding it. Most of the SEQIPP projects are probably too large for consideration for this type of financing. Types of infrastructure generally funded by bids include:

- Improved directional signage;
- Local websites;
- Security such as CCTV; and
- Road and surfacing improvements.

The main obstacle to BIDs are having the appropriate legislation in place. However there are currently no barriers to a local chamber of commerce providing funds to a local government for certain local infrastructure improvements.

7.7 Summary

With the exception of business improvement districts, all alternative financing methods can have direct application to a number of projects contained in the SEQIPP. However legislative change is required for their use.

8. Findings & Recommendations

This final section summarises the findings of the report and concludes with four recommendations around the use of alternative financing mechanisms, more encouragement of private sector involvement in the delivery of public infrastructure, matching of traditional and alternative financing methods to SEQIPP and other regional public infrastructure and expanding the range of financing methods of statutory bodies.

8.1 Findings

It is clear that Queensland is at a crossroads in how the backlog and future required level of public infrastructure is to be financed. There is an identified $124 billion of public infrastructure required by 2026 (in SEQ alone) to be partially financed through a four year borrowing program of $28.3 billion, most of this in 2009-10 as a stimulus measure to maintain employment through the economic downturn.

Whilst the Queensland Government intends to partially address the shortfall through cuts in grants to local government and asset sales these approaches are not without their difficulties. Furthermore, the Queensland Government proposes to reduce its public infrastructure investment in the future to focus on improving its fiscal position. In this scenario there is a question over where the financing will come from for the remaining infrastructure required to 2026 let alone other parts of the State.

The Queensland Government uses a range of traditional financing methods for public infrastructure provision including taxation, debt, user charges, developer contributions and PPPs. PPP usage is relatively new in Queensland and there are refinements required to facilitate further private sector involvement. Local government use municipal rates, debt, user charges and developer charges to finance infrastructure projects.

There are a range of alternative financing methods that are used in other jurisdictions that should be examined for their application in Queensland. Most of these alternatives have barriers to use that require legislative intervention for them to become available. However, an expansion of financing methods may ensure public infrastructure can be delivered earlier than the Queensland Government's finances allow resulting in a boost to productivity, employment and economic growth. In addition the regional local governments that now govern sizable populations should have access to alternative financing methods.

Quantitative modelling of traditional financing methods showed that those with debt (government and PPPs) as their primary means of financing produce better economic outcomes in the short and longer term due to the matching of debt payments with the long life of the asset. Other traditional methods were not assessed as being quite so beneficial form both a qualitative and quantitative perspective.

A qualitative assessment of alternative financing methods indicated that all methods except BIDs have some validity to be used to finance public infrastructure such as that contained in the SEQIPP. However a number of legislative and other barriers need to be overcome before they can be used. Ultimately the choice of financing method is likely to be closely related to the nature of the public infrastructure project being considered as well as the financial position of the procuring government(s) at the time.

8.2 Recommendations

The findings of this report lead to a number of recommendations for consideration for the future provision of public infrastructure in Queensland.

1. **Usage of alternative financing methods** - *The Queensland Government should investigate alternative financing methods for the provision of public infrastructure.*

The current Queensland Government budgetary constraints and economic circumstances combined with the extensive list of public infrastructure projects outlined in the SEQIPP along with other regional plans indicate the need for alternative methods of financing public infrastructure.

2. **More encouragement of private sector involvement** - *The Queensland Government should examine its current PPP experiences to increase the attractiveness of PPPs to the private sector as well as offer alternative financing methods..*

The Queensland Government position and private sector desires both indicate the need for a greater involvement by the private sector in the provision of public infrastructure. However, the Queensland Government needs to consider effective and efficient ways of encouraging and facilitating private sector involvement possibly using alternative financing methods.

3. **Matching of financing methods to public infrastructure** - *The Queensland Government should indicate suitable financing mechanisms for each SEQIPP and other regional public infrastructure projects and where appropriate invite initial financing proposals from the private sector.*

The current State Budget only looks ahead four years, whilst the SEQIPP has a 21 year timeframe. Where the value and the timing of projects are identified it is unclear how these projects will be financed beyond the four year term of the State Budget. Indicating suitable financing mechanisms into the future would provide some indication to the private sector which projects may be available to them. With this information the Queensland Government could invite financing proposals from the private sector, on an annual basis, that may improve the timing, cost and delivery of public infrastructure projects.

4. **Provide additional financing methods to statutory authorities** - *The Queensland Government should investigate the use of additional financing mechanisms for public infrastructure provision by statutory authorities such as local government and the ULDA.*

With the regionalisation and increasing size and responsibilities of local government in Queensland, local government are being required to finance more and larger public infrastructure projects. At the same time grant support is being removed by the Queensland Government. Therefore local government and other statutory bodies that supply infrastructure, such as the ULDA, should have access to a wider range of financing methods and mechanisms to involve the private sector in the provision of public infrastructure.

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Appendix A: Qualitative Evaluation Criteria

This appendix further explains the qualitative evaluation framework used in Section 3.

Effectiveness

The effectiveness of a funding approach is the timelines in which sufficient funds can be raised. There are often several hurdles that need to be cleared to secure funds including Treasury gateway processes, legal issues, community backlash and political concerns.

Efficiency

Efficiency considers the impact of a funding approach upon wellbeing in general. It essentially asks the question does the measure make people, the community at large or the environment better or worse off? Measures which distort economic decision making with regard to investment or consumption patterns can lead to outcomes that shrink overall wellbeing. Methods that allow the full economic, social and environmental costs to be accurately reflected in prices will, in general, be those that least distort economic activity and lead to the best outcomes for the community.

Equity

Equity is concerned with the fairness or otherwise of a method. It concerns social justice issues surrounding sharing the burden of revenue raising fairly between individuals who have differing abilities to pay. A revenue raising measure, for example, is generally deemed fair if there is horizontal as well as vertical equity.

Stability/reliability of the revenue base

A consistent, predictable and growing source of revenue is preferred to a source that is subject to variation.

Administration costs

The administrative costs of using a method are critical to both efficiency and effectiveness. Raising finance from a few companies or individuals is much cheaper than implementing a new tax on the whole population.

Compliance costs, certainty & transparency

The compliance costs of ensuring certainty and transparency are important for all stakeholders including politicians, government officers, investors and the community.

Stakeholder support

Whatever financing method is used there will be winners and losers and therefore the level of support maybe more about reasonableness, the outcome of a fair process, or trust in a fair decision-maker.

Incentives for risk mangement

Not surprisingly the lower the risks and uncertainty associated with a project, the lower the return investors are likely to be comfortable with and thus the lower the cost of the project. The sources of investment risk include:

- *Construction risk* - risk associated with the physical construction and warranty phases of infrastructure project development;

- *Operational risk* - risk associated with operating a service, including the potential for systems failure;
- *Demand risk* - risk associated with variation of the demand for a public infrastructure service from initial expectations;
- *Network risk* - risk associated with network infrastructure facilities whereby the demand of a given asset depends on decisions made with respect to other elements of the network;
- *Technological risk* - risk associated with technological change that could render existing infrastructure obsolescent or stranded;
- *Financing risk* - risk associated with variation of the financing costs for a public infrastructure service from initial expectations; and
- *Regulatory (sovereign) risk* - risk associated with the potential for government legislation, regulation and agreements to change and thus impact relevant investment. At a broader level, it can be known as sovereign risk, encompassing such actions as industry nationalisation.

A financing vehicle that can allocate project risk to those that can better manage those risks can reduce the overall level of project risk. For each financing method risk management is about best aligning risk to the appropriate parties along with appropriate incentives to better manage those risks. The risk management scale is therefore difficult to define and assign across the range of risk sources as it depends on the parties involved and the risk management allocations.

Exposure to market or other disciplines

The issue considered here is information asymmetry, where one party may have beneficial information that another party does not with the end result being that the project costs more than it should and there are winners and losers. Since it cannot be known in advance what or where information asymmetries may lie, one can only assume that the more parties involved the higher propensity there is for information asymmetry to occur. The scale is therefore based on the potential for information asymmetry to occur.

Appendix B: Qualitative Modelling Approach

The following table explains the key elements and an explanation of the economy wide impacts reflected in the modelling undertaken by Prime Research.

Table B.1: Funding Options, Modelling Approach and Assumptions

Financing method	Key elements	Economy wide impacts reflected in the analysis
Government Taxes	An increase in broadly based state taxation of sufficient size to pay for the annual infrastructure spending. For simplicity the revenue streams utilised reflected the current mix of state taxes in the model's database.	The state's tax levels rise relative to the taxes in other states, leading to a loss of competitiveness and some labour and capital market adjustments (i.e. other states benefit at the expense of Queensland).
Government debt	Government borrowing sufficient to pay for the infrastructure investment. Aggregate state taxes were then used as the instrument for collecting sufficient revenue to pay for the annual interest charge. An annual interest rate of five percent was assumed over the life of the analysis.	Taxation levels rise, but to a lesser extent than under the "average state taxes" financing approach; however, the application of this higher level of taxation persists beyond the cessation of increased infrastructure investment. The negative impacts described for "average state taxes" are therefore smaller but more persistent.
User charges	It was assumed that the infrastructure spending was directed evenly between road and rail developments. User charges were modelled as a tax on the use, by industry and by private households, of road transport and rail transport, where the charges were sufficient to pay for the annual infrastructure spending.	Higher charges (simulated through taxation on the use of road and rail transport services) also reflects on Queensland's competitiveness to the benefit of other states and territories. User charges have a direct link into the prices in the model and so are directly linked to producer and household costs.
Developer charges	Where the construction industry is assumed to be the representative of the producers/developers. Developer charges was modelled as a property tax levied upon the construction sector of sufficient size to pay for the annual infrastructure spending.	Taxation levels rise relative to other states with the same implications as described under "average state taxes". The narrow nature of the tax base places all of the adjustment through the construction sector of the economy.
Public Private Partnership	A commercial enterprise borrows to pay for the infrastructure investment. Revenue from user charges (modelled as described above) were used to meet the annual interest charge. An annual interest rate of nine percent was assumed over the life of the analysis.	User costs rise, but to a lesser extent than under the "user charges" financing approach; however, the application of these higher costs persist beyond the cessation of increased infrastructure investment. The negative impacts described for "user charges" are therefore smaller but more persistent.

Source: Prime Research

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