Urban Coalition - Urban Infrastructure Fund

> *Recommendation 1*
> *Unlock private sector dollars through a new Urban Infrastructure Fund*

Introduction

This section outlines a model for boosting the capital available to fund local community infrastructure.

It recommends the Australian Government (in collaboration with states and territories) foster an urban infrastructure investment asset class through a new Urban Infrastructure Fund.

This asset class would offer lower risk, credit-enhanced returns that appeal to both institutional and retail (mum and dad) investors.

Funds raised by issuing urban infrastructure investment products would capitalise a special purpose statutory investment vehicle – the Urban Infrastructure Fund - that would then provide attractive seed finance to qualifying projects that meet criteria set by COAG in the form of local community infrastructure.

What is `Local Community Infrastructure'?

`Community infrastructure' refers to investment projects in metropolitan and regional communities across the country.

Some examples of local infrastructure are:

- transport – public and active travel transport systems, railway crossing pinch points;
- energy – low carbon precinct power and water capture;
- resilience – coastal management, levees, flood control, stormwater;
- community, cultural and recreational facilities;
- learning, health, aged care, seniors facilities;
- housing facilities – affordable housing projects; and
- protecting and enhancing biodiversity and ecosystem services – community waterways and grassland/woodlands.

The elements of the basic model are outlined in the following sub-sections:

1. credit-enhanced investment products – what do they look like?
2. eligible priority projects – what are the criteria?
3. issuing financial instruments – the role of Government and intermediaries;
4. project sponsors – who are they and what are their obligations?
5. complementary finance instruments – how can infrastructure project finance be further leveraged?
6. Urban Infrastructure Fund – how would it be run and governed?
7. supporting processes – what else needs to be considered?

Some Frequently Asked Questions are also provided at the end of this section.

The funding mechanism and institutions proposed in this section are intended to complement both traditional sources of infrastructure finance and other innovative capital raising techniques.

1. Credit-enhanced infrastructure investment products – what do they look like?

Community Infrastructure Investment Products

...enhance returns and manage risks

The goal is to develop long-dated investment products that deliver guaranteed total returns that are more attractive than standard government bond rates.

This will require credit-enhancement as generic infrastructure-related returns are not high enough to appeal to investors.

Two techniques are proposed:

- a tax rebate of 10% for investors purchasing bonds that finance eligible projects within the Urban Infrastructure Fund pool
- a capped government guarantee.

2. Eligible priority projects – what are the criteria?

Eligible Projects

...to be recommended by Infrastructure Australia

The broadening of Infrastructure Australia's remit to identify projects that qualify for credit enhancement is proposed.

In addition to its current priority-setting role, Infrastructure Australia would identify community–level infrastructure projects that meet criteria, including:

- COAG cities benchmarks
- positive cost-benefit (including non-economic) criteria across city networks
- capacity to generate sustainable cash flows or cross financing from reliable sources
- capacity to provide/attract co-funding using complementary financial instruments
- the quality and track record of project sponsors
- demonstration of partnerships with local governments, state and territory governments, private sector and NGOs to deliver outcomes
- inclusion of a set of indicators and/or targets and a robust, independent method of measurement to ensure that criteria are being met and desired outcomes achieved
- there is a strategic basis for the project
- there is demonstrated commitment to quality urban design, good architecture and sustainability.

Guided by COAG, Infrastructure Australia would establish investment categories to ensure an optimum spread of project priorities – for instance, regional towns, outer metro growth areas, rejuvenation corridors, new master planned communities, low carbon/eco efficient networks, coastal adaptation zones.

Infrastructure Australia would also regularly publish a list of projects that indicate a long-term investment pipeline. This would demonstrate deal flow opportunities to capital markets players.

3. Issuing financial instruments – the role of government and intermediaries

Australian Office of Financial Management (AOFM) *...to manage capital raising*	AOFM would manage bond issues on behalf of the Urban Infrastructure Fund. AOFM would liaise with financial market intermediaries. Funds secured by capital raisings would be transferred to an Urban Infrastructure Fund. AOFM would also pool and securitise bundles of prospective infrastructure asset income streams to ensure they are of sufficient scale to attract institutional investors.

4. Project sponsors – who are they and what are their obligations?

Project Sponsors *...would submit eligible projects for funding*	Project sponsors, such as local governments, statutory authorities, or regional development corporations would: • make applications for funds based on eligibility criteria • develop joint ventures with other government, private sector and NGO partners • agree to contractual delivery conditions • secure complementary funding streams that utilise approved financing pathways • provide plans for managing counterparty risk • provide evidence of capacity to manage the operating (post construction) phase of an asset.

5. Complementary financial instruments – how can infrastructure funds be further boosted?

Complementary Financing

…to diversify lines of credit and reduce reliance on the Urban Infrastructure Fund's capital

Project sponsors would complement Urban Infrastructure Fund seed capital with finance from partners and sources that may include:

Traditional Government

- Recurrent expenditure
- Other government infrastructure funds
- Other government incentives – NRAS etc.

Non-Traditional Government

- Local asset-backed vehicles (LABV)/joint project development (JPD) techniques
- Tax increment financing/growth area bonds
- Sale/lease back
- PPPs

Market Instruments

- Bank finance
- Covered bonds
- Corporate bonds
- Mezzanine/hybrid finance
- Other asset backed securities
- Other securitised/REIT index-linked structures

6. Urban Infrastructure Fund – what would it do?

Establish a Dedicated Fund

...with governance arrangements that boost investor confidence

The primary task of the Urban Infrastructure Fund is to:

- manage disbursements of funds to sponsors of eligible (Infrastructure Australia-approved) projects, backed by strict performance contracts
- ensure performance against contracts.

The Urban Infrastructure Fund would also help match-make syndicates of project sponsors and facilitate financial package design.

In addition, the Urban Infrastructure Fund would:

- work closely with ratings agencies to develop credible early warning systems
- facilitate investment tranche design.

The Urban Infrastructure Fund would seek to support investor confidence through:

- transparent regulatory controls and reporting that reduce the potential for default
- providing information on deal flow
- standardising financial information requirements (with AOFM) – simplified PDS etc.
- developing a national database of projects (commenced and completed) with an assessment of the community dividends expected and delivered.

7. Supporting processes – what else needs to be considered?

What else...

Fostering an informed market...

- promote a reputable index of Urban Infrastructure Fund products
- foster an investible index

Reduce the Federal Government's cost of providing guaranteed support...

Utilise a suite of quarantining measures to classify government guarantees as a contingent liability – and, thereby, not incorporated on the Government's balance sheet, such as:

- time-limited guarantees
- 'burning off' guarantees upon pre-agreed milestones
- guarantees restricted to agreed metrics (with the balance of risks hedged)
- guarantees linked to specified credit tranches (supplemented by complementary non-guaranteed financial products, such as mezzanine or equity components).

Capital Management

Explore opportunities to effectively transfer capital deductions (depreciation etc.) to the long-term owners of infrastructure.

Frequently Asked Questions

Q: *Infrastructure Bonds – What are they?*

A: Infrastructure bonds are a financial product designed to increase private sector investment in critical infrastructure projects.

These bonds attract private investment through a tax rebate on a proportion of the interest earned from an investment.

This credit-enhancement increases the return on projects so they compete more effectively with alternate investment products.

The tax rebate represents tax revenue foregone rather than an increase in government debt.

The infrastructure bonds introduced in the mid 1990s reduced borrowing costs by 40% compared to conventional borrowing expenses. They were poorly designed and subsequently scrapped; however, the concept remains sound.

A proposal previously considered by the Coalition estimated that an incentive (tax foregone) of $150 million would leverage $20 billion of new infrastructure investment.

Q: *Asset Backed Securities – What are they?*

A: Asset Backed Securities (ABS) are an investment product that combines the expected income streams of underlying assets – typically mortgages, credit card debt, car loans – into a pool that is then securitised – that is, offered to investors as bonds or notes.

The value of an ABS lies in the quality of the underlying assets in the pool and the prospect of consistently tapping into the stream of revenue generated by such assets over the long-term.

Q: *Is there a model for governing the proposed Urban Infrastructure Fund?*

A: The proposed entity is a financing authority and requires individuals skilled in governing finance and investment entities.

The guardians of the Future Fund provide one model.

The board should also include individuals experienced in all aspects of infrastructure procurement.

Q: *Are there any models for the Urban Infrastructure Fund?*

A: The financing instruments proposed in this paper are used in dozens of cities around the world.

Two examples of entities that specialise in local government finance are:

- Municipal Finance Authority of British Columbia
- New Zealand Local Government Financing Agency.

The United States operates a widespread `muni' (municipal) bond market.

Nevertheless, the concept proposed in this paper relies on the pooling of income streams from entities with marginal (but long-term) cash flows. The concept also utilises Australia's unique superannuation system – which is why a special purpose entity is proposed.

Q: *What is the Urban Infrastructure Fund likely to finance?*

A: Firstly, the Urban Infrastructure Fund will provide seed finance to quality projects. It is expected that project sponsors will also secure complementary capital.

The elements of the qualifying criteria are outlined in chapter five.

In addition, finance would focus solely on development and redevelopment capital, not meeting operational costs.

Q: *What should the scope of the Fund cover?*

A: The scope of the Urban Infrastructure Fund could cover both Nation Building Projects as well as Community Infrastructure.

Nation Building Projects - These are large-scale projects with capital construction costs greater than $100 million, such as transport projects. These projects will be assessed by Infrastructure Australia and aimed at driving productivity and equipping Australia for a low-carbon future. The criteria for this scale of infrastructure should build on Infrastructure Australia's existing categories and Nation Building 2's themes. However it should not be restrictive and there should be no exclusion of any type of infrastructure as long as it meets productivity, liveability and sustainability goals.

Community Infrastructure Projects – will include projects such as community, cultural and recreation facilities, learning, health, aged care and seniors facilities.