



6 December 2019

Committee Secretary
House of Representatives Standing Committee on Infrastructure, Transport and Cities
PO Box 6021
Parliament House
Canberra ACT 2600
ITC.reps@aph.gov.au

Dear Committee Secretary

RE: INQUIRY INTO OPTIONS FOR FINANCING FASTER RAIL

Infrastructure Partnerships Australia is pleased to provide this submission to the Committee's Inquiry on *Options for financing faster rail*.

Infrastructure Partnerships Australia is an independent think tank and executive member network, providing research focused on excellence in social and economic infrastructure. We exist to shape public debate and drive reform for the national interest.

Our submission highlights the important difference between funding and financing, and calls for a clear focus in the Inquiry on how the potentially substantial public investments in future faster rail projects can be *funded*. This submission also makes clear that, when it comes to project decision-making, public benefits and user outcomes must come first. While there is likely to be a role for alternative funding sources, such as value capture, in funding potential faster rail projects, decisions should be made based on the projected public benefits of a project relative to its costs – not whether funding can be raised through measures such as value capture.

The submission references two recent reports by Infrastructure Partnerships Australia that provide useful context for the Inquiry. These reports are attached to our submission.

Focus on funding not financing

Infrastructure Partnerships Australia is concerned by the Inquiry's focus on finance, as opposed to funding for potential faster rail projects. It is important to establish the critical difference between these concepts. Finance is the capital, in the form of debt and equity, that is used for an upfront transaction, while funding is the revenue stream used to pay off those capital costs. The simplest way to understand this is to think about buying a house – the mortgage is the finance, typically provided upfront by a bank, and the funding is the mortgage repayments over the life of the loan, drawn from a household's income.

There is no shortage of finance available for the right Australian infrastructure projects. Australia has highly competitive debt and equity markets comprised of sophisticated domestic and international providers that include banks, superannuation funds, investment funds and other institutional investors. These financiers



typically regard Australian infrastructure as an attractive investment proposition when structured with an appropriate cash flow via user revenue or taxpayer contributions (funding). Ninety percent of investors surveyed for Infrastructure Partnerships Australia's recent *2019 Australian Infrastructure Investment Report* (attached to this submission) identified the attractiveness of Australian infrastructure investments. This report also found that investors saw a *lack* of investment opportunities – productive infrastructure projects seeking private finance – as a major barrier to investment.

Clearly, a lack of financing for Australian infrastructure at competitive rates is not a problem that needs solving.

Conversely, funding *is* a major constraining influence on public infrastructure investment in Australia. A combination of factors – most particularly population growth in urban areas, Australians' changing needs and ageing infrastructure assets – mean the need for infrastructure investment in Australia has never been greater. Most Australian governments are responding, with record spending on infrastructure – largely on transport projects – to help reshape the networks Australians rely on, and to create liveable places to work and live around the assets they build. Infrastructure Partnerships Australia's recently released *Australian Infrastructure Budget Monitor 2019-20* (attached to this submission) showed that all governments increased their share of total expenditure on infrastructure over the forward estimates compared to the previous budget year.

But this public funding has to come from somewhere – and that burden will largely fall on taxpayers. A number of governments are fiscally constrained and are raising more debt to pay for infrastructure. While current availability and low cost of capital make such an approach attractive – and one which Infrastructure Partnerships Australia support when delivered in concert with strong discipline on recurrent expenditure – this debt will ultimately need to be repaid.

The Asset Recycling Initiative has helped to fund major infrastructure investments in the NSW, Victoria, and other states to a lesser extent over recent years. States that did not embrace this program, such as Queensland, have materially worse fiscal settings and substantially smaller infrastructure programmes. Across all jurisdictions, further asset recycling could ease fiscal strains and catalyse future investment by releasing some public assets into well-structured, well-regulated markets.

When considering potential faster rail projects, it is important to consider where the *funding* is going to come from. While user charges may provide a viable future funding stream, these projects are still likely to require a considerable public subsidy, placing a substantial call on the broader tax base through government budgets. This may be justified, given the potentially significant public benefits faster rail connections to regional centres could bring, and the business cases being developed will shed light on the projected balance of benefits and costs for these potential projects. But irrespective of a project's potential merits, it will be essential to consider how (and when) taxpayers will be required to pay for these large public investments.

Public benefits should drive the outcome, not 'value capture'

When it comes to public infrastructure decisions, public benefits and user interests must always come first.

Much has been written about the potential role of 'alternative' funding sources for infrastructure, through options such as value capture, over recent years. For all the talk of these sources, there has been very little change to how Australian public infrastructure projects are funded. Well-established forms of value capture such as developer contributions, local government levies, stamp duties and sale of air rights have continued to provide funding for some suitable transport projects. Only the ACT Government has initiated the most

effective, efficient and fair form of value capture through its program of broad-based land tax reforms.

Other forms of value capture, based on 'black-box' calculations of potential value uplift from future projects have been considered and proven almost impossible to initiate. Put simply, the theory of these types of value capture has not survived first contact with the real world in Australia.

The reality is that funds derived through value capture must come from somewhere. Those people and businesses asked to provide additional funding for infrastructure through value capture must be able to clearly see that their contribution matches or exceeds the value they will derive from the infrastructure project once it is delivered. The more complex the mechanism, the harder it will be to implement. This hurdle has proven too difficult to clear for many Australian transport projects over recent years.

It is important to note that value capture does not change the fundamentals of a project, and so should not factor into whether or not a public infrastructure project is built. Instead, this decision should be based on the merits of a project, including a range of potential economic, social and environmental benefits, relative to its costs.

Making project decisions on the basis of estimated funding available through sources such as value capture could lead to the wrong projects being prioritised, with finite public resources not flowing to their best use. Allowing value capture to influence project design can only lead to sub-optimal public benefits and a worse deal for not only infrastructure users but also taxpayers more broadly. It may be viable and sensible to align the profit incentive of these developers with public benefits where there is an overlap – indeed, this is a natural consequence of well-designed and delivered infrastructure. But in instances where property developers are allowed to influence project scope, this could be highly economically damaging as users are left with a piece of infrastructure that does not best meet their needs for decades to come.

Value capture can and should be considered for faster rail projects, and could provide a way of ensuring the beneficiaries of public infrastructure make a fair contribution to project costs. But the evidence in Australia and other similar countries that have attempted to deploy value capture as an infrastructure funding mechanism suggests that this contribution will be a minor part of the broader project funding mix for a major project such as faster rail.

Some models of value capture are not useful in Australia

Other forms of proposed value capture, such as Tax Increment Financing or variations on this model, miss the point entirely and are not useful in Australia. As the name suggests, this model helps to provide *finance* for projects. This model has only worked in other countries where the procuring entity could not attract sufficient project finance through other means – in particular where the municipal procurer is not investment grade credit rated. While the TIF model has been applied in different ways, each application has provided a contractual architecture to provide surety for public investments essentially by hypothecating taxation to development entity – albeit at a premium on conventional forms of finance. For governments in Australia, which typically have strong credit ratings, low costs of capital and no shortage of potential private partners, TIF can only introduce unnecessary complexity and raise project costs. In short, in the Australian context, TIF is a solution to a problem we don't have, with an increased risk profile we don't need.

Thank you for your consideration of this submission. Should you require further information, or would like Infrastructure Partnerships Australia to provide further evidence through this Inquiry, please contact Mr Jon Frazer, Director of Policy & Research

Yours Sincerely

ADRIAN DWYER
Chief Executive Officer

Attachments:

- *2019 Australian Infrastructure Investment Report*
- *Australian Infrastructure Budget Monitor 2019-20*