

Inquiry into options for financing faster rail

Submission to the House of Representatives Standing
Committee on Infrastructure, Transport and Cities

Joint submission by the National Faster Rail Agency and
Infrastructure and Project Financing Agency

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IPFA Infrastructure and Project
Financing Agency



Australian Government
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1. Introduction

The National Faster Rail Agency (NFRA) and Infrastructure and Project Financing Agency (IPFA) are pleased to provide this joint submission to the House of Representatives Standing Committee on Infrastructure, Transport and Cities (the Committee) for the Inquiry into options for financing faster rail (the Inquiry). This submission also includes input from the Commonwealth Department of Infrastructure, Transport, Cities and Regional Development.

The purpose of this submission is to provide the Committee with an overview of faster rail investment in Australia and to examine the opportunities and challenges associated with financing options for faster rail, such as value capture. This submission does not provide any outcomes nor suggest any indications of the likely outcomes of the current three faster rail business cases administered by the NFRA.

The NFRA and IPFA welcome the Inquiry and look forward to further briefing the Committee and the Committee's findings and recommendations.

a. The Australian Government's role in building infrastructure and policy position on alternative funding and financing to deliver infrastructure

The Australian Government (the Government) is investing \$100 billion over ten years from 2019-20 in transport infrastructure across Australia through its rolling infrastructure plan. The Government is committed to ensuring that critical transport infrastructure that Australia needs to support economic growth and sustainability in our cities and regions is delivered.

To support this record investment in infrastructure (and stimulate co-investment), active partnerships with state, territory and local government and the private sector are essential. It has also required re-evaluation of how transport infrastructure is funded and how financing is structured to achieve the best transport and related policy outcomes possible.

The Government is committed to working with other levels of government to explore the potential for innovative funding and financing mechanisms for transport infrastructure projects. This allows the Government to leverage private sector investment and maximise value for money for taxpayers in infrastructure delivery, where appropriate.

Proposals for public funding of transport projects should consider what proportion of the project can be funded by the key beneficiaries of the project through targeted contributions, and how much should be funded by the broader community.

Innovative financing mechanisms may be appropriate for infrastructure projects that demonstrate strong net economic and social benefits, and provide a reliable income stream to support the repayment of debt or a return on investment.

IPFA has been established to provide commercial and financial advice, including in relation to funding and financing, on major infrastructure projects, investments and

complex transactions across a range of sectors including transport, industry, energy and water, and cities.

Of the \$100 billion investment over ten years from 2019-20, over \$13 billion is being provided through financing and equity investment, including:

- an additional \$8.4 billion in equity investment towards the Melbourne to Brisbane Inland Rail project, bringing the Government's total commitment to the project to over \$9 billion;
- a \$5.3 billion equity investment in the Western Sydney Airport, a city-shaping infrastructure project;
- \$380 million in equity to the Moorebank Intermodal Terminal in Western Sydney;
- a concessional loan of \$181 million to the Sunshine Coast regional Council's Sunshine Coast Airport Expansion Project; and
- provision of a \$2 billion loan to the \$16.8 billion WestConnex project – additional to the Government's \$1.5 billion grant – to help accelerate delivery.

b. Constitutional responsibilities regarding rail and the importance of engagement with the states and territories

The majority of the transport infrastructure is delivered by the states, territories or local councils. While the Australian Parliament has specific constitutional powers for railways (unlike roads where the constitution is silent), these serve to explicitly limit the Government's involvement in this area. Parliament has the power to make laws with respect to:

- the acquisition of any railways of a state but only with the consent of the state; and
- railway construction and extension in any state but only with the consent of that State.

Except where agreed by a state otherwise, railways are delivered in partnerships with the states and territories, with Commonwealth funding contributions administered under the *National Land Transport Act 2014* (the Act) and the *National Partnership Agreement on Land Transport Infrastructure Projects* (NPA).

- The objective of the Act is to assist national and regional economic and social development by the provision of Commonwealth funding aimed at improving the performance of land transport infrastructure.
- The NPA governs Commonwealth funding provided for land transport infrastructure projects administered under the Act. The current NPA commenced on 1 July 2019 and is an agreement between the states and territories and the Commonwealth.

Under the Act, railway projects are eligible for approval if they are for the construction of an existing or proposed railway in a state or Indian Ocean Territory. The construction costs associated with a railway includes signs, control equipment,

communications and lighting equipment and bridges or tunnels associated with a railway. The Australian Government cannot fund rolling stock under the Act.

The Australian Government does exercise the constitutional power for some railway projects, and is currently investing billions of dollars to build, extend and upgrade Australia's network to get freight off the road and onto rail. These projects are administered by the Australian Rail Track Corporation (ARTC), a wholly-owned Australian Government Business Enterprise that provides a vital part of the transport supply chain and the economic development of Australia – an interstate below rail network. Across five states the ARTC manages and maintains an 8,500km rail network.

In addition to Constitutional powers, projects seeking \$100 million or more of Australian Government funding or financing support are assessed on their merits through a detailed business case review process by Infrastructure Australia.

c. Purpose and functions of the National Faster Rail Agency

On 20 March 2019, the Prime Minister, the Hon Scott Morrison MP, launched the 'Planning for Australia's Future Population' strategy which outlined a 20-year vision to deliver faster and more reliable journey times along strategic rail corridors connecting major regional centres with capitals. In line with this commitment, the Government has developed a *Faster Rail Plan*.

On 1 July 2019, the NFRA was established as an Executive Agency within the Infrastructure, Transport, Cities and Regional Development Portfolio to implement the *Faster Rail Plan* in close consultation with the relevant state and territory governments and private sector proponents.

As outlined in the *Faster Rail Plan*, faster rail on strategic corridors between our capital cities and regional centres has the potential to improve the lives of many Australians, which is reflected in the NFRA's purpose statement:

To enable more people to access employment, housing and social opportunities by advising the Australian Government on faster rail opportunities between our capital cities and regional centres, and administering funding to support the delivery of agreed projects.

The functions of the NFRA, as outlined by General the Honourable Sir Peter Cosgrove AK MC (Ret'd), former Governor-General of the Commonwealth of Australia, include:

- lead the development and implementation of the Commonwealth Government's 20-year Faster Rail Plan;
- oversee the development of business cases with state and territory governments, ensuring that population and transport policy objectives are met;
- identify additional rail corridors that would benefit from faster rail services over the long term, in consultation with state and territory governments, industry and stakeholders;

- work with relevant state and territory governments in the delivery of faster rail construction projects;
- develop an investment strategy recommending how faster rail projects can be staged to link future expenditure to investment need, and increase community and industry confidence to reduce market pressures;
- work in partnership with the Infrastructure and Project Financing Agency to explore alternative funding and financing options for faster rail, such as private sector contributions and value capture opportunities; and
- provide advice on options to future proof corridors for high-speed rail, including the need for technical guidelines, corridor planning and protection.

As the Government's Executive Agency responsible for delivering the *Faster Rail Plan*, the NFRA will build strong collaborative working relationships with stakeholders to ensure the Government's population and transport policy objectives are met.

d. Purpose and functions of the Infrastructure and Project Financing Agency

IPFA is the Australian Government's in house commercial and financial adviser on major infrastructure projects, investments and complex transactions.

IPFA supports the Government to make better informed decisions, to improve delivery and governance, and to better manage investments. Its goal is to build the Government's capability to deliver its infrastructure priorities, and strengthen confidence in its investments.

IPFA's services cover the full spectrum of infrastructure across the economy, and all phases of a project or program's lifecycle from conception to divestment.

IPFA's services include:

- providing independent commercial and financial advice; including, identifying and developing opportunities for combining private and public finance and funds to achieve public purposes; analysing commercial and financial risks; and leading or supporting negotiations for complex commercial deals;
- delivering specialist infrastructure project governance and program management services including undertaking market soundings, coordinating due diligence, running or assessing procurement processes, reviewing and monitoring projects, and representing a client's interests in governance forums; and
- arranging high quality capability building and knowledge sharing activities, by bringing together industry experts and specialists and government officials to share their experiences, or through targeted secondments of IPFA staff.

Under its client based model, IPFA works closely with its client departments and agencies to ensure the decisions associated with projects and programs considered by Government are well-informed.

With regards to faster rail initiatives, IPFA supports NFRA as an Australian Government client in identifying and implementing Commonwealth funding and

financing opportunities; undertaking project business case and funding feasibility reviews; and with financial and commercial risk analysis.

e. Objectives of faster rail

The Government is committed to supporting and shaping the growth of our cities and regions by delivering faster, more efficient and reliable passenger rail journey times along strategic corridors that link our major capital cities and growing regional centres.

The *Faster Rail Plan* offers the opportunity to enhance connectivity, reduce business input costs and provide opportunities to consider new areas for industry and social activity centres and affordable housing.

Faster rail connections in particular can make rail a more attractive choice for commuters travelling into the city from surrounding regions or contra-flow commuting from capital cities to major regional centres. The speed, comfort and amenity of rail also lends itself to commuting over long distances, allowing for more productive time than would otherwise be the case in a private vehicle and helping to support the increasingly flexible nature of work.

Faster rail will open up significant opportunities for economic growth, urban renewal and land use change with the potential for rezoning and development around existing and new stations along the entire length of the corridor. At the same time, faster rail connections can create broader economic benefits for orbital and regional centres, as larger populations increase the demand for local services and attract businesses and industry to the local area.

Infrastructure Australia's *Australian Infrastructure Audit 2019* notes the opportunity for our smaller capital and satellite cities to grow, and in turn take pressure off infrastructure in our fast-growing cities, particularly in relation to congestion. Satellite cities can support growth by leveraging the infrastructure of their fast-growing neighbours and smaller capitals, through leveraging infrastructure designed to support their surrounding region¹.

Regarding a definition for faster rail, there is no internationally agreed definition of fast rail, faster rail or high-speed rail and the terms are often used interchangeably. The International Union of Railways (UIC) considers a commercial speed of 250 kilometres per hour to be the principal criterion for the definition of high-speed rail.

Faster rail is generally considered to be rail services that operate at between 130 and 160 kilometres per hour, whereas fast rail is generally considered to be rail services that operate between 160 and 250 kilometres per hour.

The NFRA's focus is on supporting the immediate challenges that our cities and regions face on congestion and travel times. The NFRA will work with jurisdictions to investigate improved rail connections that deliver demonstrable benefits for

¹ Australian Infrastructure Audit 2019

commuters. It is not just about speed, rather cost effective delivery of transport connections that deliver travel times that meet commuters needs. This includes improved capacity and reliability of services.

Evidence from faster rail investment in the United Kingdom shows that reducing rail journey times to between 1-2 hours brings increasing connectivity benefits for regional centres, while reducing transit times to one hour or less are a particular 'sweet spot' for improved access to higher paid jobs in capital city CBDs and increased economic development in regional cities².

The parties to this submission support the Government's current focus on connecting regional centres to capital cities with faster, more efficient and reliable passenger rail services, working with state governments and/or the private sector to determine the most appropriate solution on a case-by-case basis.

f. Current status of faster rail business cases

In order to assess projects identified in the *Faster Rail Plan* for future funding, detailed business cases need to be undertaken. The *Faster Rail Plan* includes a commitment to undertake faster rail business cases on strategic corridors connecting capital cities with major regional centres. To date, funding commitments have been made to eight corridors, including:

- Sydney to Newcastle
- Sydney to Parkes (via Bathurst and Orange)
- Sydney to Wollongong
- Melbourne to Greater Shepparton
- Melbourne to Albury-Wodonga
- Melbourne to Traralgon
- Brisbane to the regions of Moreton Bay and the Sunshine Coast
- Brisbane to the Gold Coast

Further detail on the Australian Government's commitments to faster rail projects is in **Appendix A**.

These corridors connect capital cities with major regional centres and warrant investigation due to the opportunity to shift commuter demand from road to rail, the potential to stimulate regional growth and provide access to jobs, services, housing and amenity.

Each business case will adhere to the Infrastructure Australia Assessment Framework which are based on the Australian Transport and Assessment Guidelines. The framework is based around an assessment of problem identification and prioritisation which then flows into initiative identification and options development which are subsequently assessed through a business case.

² McNaughton (2019) *The Geography of Time: How faster rail changes the economic and social landscape*, [Webinar], Railway Technical Society New Zealand, 19 August.

In each business case, the economic viability is determined based on an assessment of the costs and benefits of the proposal, including travel time savings. The business case will also consider the preferred route, expected construction costs, detailed assumptions based information on operational costs and revenues, along with potential private sector contributions and partnerships.

The outcomes of the business cases will inform advice to the Australian Government about investment opportunities in faster rail, including project staging and timing, as part of a rolling Investment Strategy.

g. Current infrastructure investment environment impacting delivery of the Australian Government's rolling infrastructure pipeline

Led by the Australian Government's \$100 billion infrastructure pipeline, government investment in transport infrastructure is at record levels. The parties to this submission recognise that the scale of the investment may test market capacity and capability – and in differing ways across Australia – presenting a range of challenges to the efficient delivery of transport infrastructure projects. The two headline challenges are market capacity and capability/workforce skills, which are manifesting as:

- Governments and industry are reporting increasing difficulty in sourcing experienced construction personnel, particularly engineers and project managers;
- Several state governments have received lower-than-expected numbers of bids for tenders, suggesting either:
 - a reduced appetite for projects, and/or;
 - a reduced capacity of contractors to bid across multiple projects with similar delivery timeframes;
- Procurement and delivery timeframes for some projects have increased, especially due to complexities such as tunneling and increased interface risk for major projects;
- Contractors have proposed re-assessment of risk allocation and procurement contract structures to increase the attractiveness to bid;
- Record government investment in rail infrastructure (especially in eastern states) is expected to continue until at least 2024, driven by major and mega projects; and
- The rail industry is already reporting skill shortages for maintenance and operational staff, and for trainer assessor roles.

Rail investment in Australia is increasing. The financial year 2018-19 recorded \$7.7 billion of value of work done for railways which was a 6.0 per cent increase from the 2017-18 financial year (original terms). Macromonitor forecasts railway construction work done by value in excess of \$10.0 billion annually from 2020 – 2028.

Approximately 23 per cent of the allocated \$100 billion investment in transport infrastructure is dedicated to rail infrastructure with major projects including Inland Rail; Melbourne Airport Rail Link; Regional Rail Revival Program; Port Botany Rail Line Duplication; and Sydney Metro Greater West.

The Australian Government is taking a leadership role with state and territory governments to ensure sustainable capacity and capability of the infrastructure construction sector to deliver its significant forward works program.

2. Principles for investment in faster rail

In February 2016, the Commonwealth Department of Infrastructure and Regional Development released *Principles for Innovative Financing*. This document outlines the Australian Government's goals and principles for innovative financing, many of which may be applicable to investment in faster rail:

- Transport projects are selected based on their capacity to meet identified national priorities and deliver the greatest benefit to the Australian community and economy. Only projects that will deliver a clear benefit to the public should receive funding or financing support from the Government.
- Transport proposals are assessed against the extent to which they align with integrated transport and land use planning strategies, including urban renewal and housing supply.
- Transport proposals are assessed against the extent to which technology solutions are used to optimise the capacity of existing and new infrastructure.
- Assessment of proposals for public funding of transport projects should include consideration of what proportion of the project can be funded by the beneficiaries of the infrastructure through targeted contributions and what proportion of the project should be funded by the broader community.
- The funding shares from the Commonwealth and the state and territory governments should be determined after taking into account contributions made by the beneficiaries.
- The suitability for innovative financing arrangements should be assessed for all projects before the amount of grant funding is determined.
- Project financing should be designed to minimise the level of public subsidy needed to deliver the project and meet whole-of-life asset costs.
- Private sector engagement in infrastructure and services should be optimised and any government intervention should be targeted and limited to that needed to overcome clear and specific market failures.
- Partnerships with the private sector should involve an appropriate allocation of risks. Where risk is borne by the private sector, it should be transparently priced and present value for money for the Australian public.
- Where the Commonwealth provides funds for a major infrastructure project it will reserve the right to impose conditions, including Commonwealth approval being required for key decisions in relation to the project.

Pursuing alternative funding and financing opportunities is an important part of IPFA's mandate. These opportunities may include private sector investment, government funds, public finance or returnable grants. The principles that IPFA would seek to apply in pursuing these opportunities on faster rail projects include:

- for "others" to fund projects where possible and therefore eliminate or minimise the need for Commonwealth funding. An example is the CLARA proposal for Melbourne to Greater Shepparton, which through a business case is testing whether the level of value capture contributions should be sufficient to fund that project's development;
- to bridge market failure and/or time dependent risks through public finance or returnable capital, allowing whole or partial recovery of Commonwealth funding in the future. For example, bridging a project's development with the provision of upfront financing to cover faster rail capital costs with recovery via value capture revenues when they are realised; and
- to use conditional grants to ensure outcomes are delivered, even though a capital return may not be possible. While grants should be considered a lower order funding priority some form of grant may be necessary to support some faster rail projects and encourage private sector contributions.

Noting that there are ultimately only two sources of funding, users and tax payers, consideration should also be given to how to most directly recover costs of faster rail infrastructure through direct user charges - in this case ticket prices (see Section 4b). In the case of potential new faster passenger rail services connecting regional centres to capital cities, consideration must also be given to the broader market for passenger services and the potential negative impact subsidised rail services may have on competitive commercial passenger air services.

a. Opportunities and conditions for private sector involvement

The underlying logic of the faster rail process, whereby regional centres will be better linked to capital cities with value uplift around stations and along corridors, creates strong potential for private sector involvement across the key projects. This may be through a private operator of a rail line or the private sector purchasing development rights along a rail line and at stations.

As part of the faster rail prospectus, three projects were brought forward for business case development, two of which were brought forward by the private sector and include significant forms of private sector involvement:

- Consolidated Land and Rail Australia (CLARA) Melbourne to Greater Shepparton Faster Rail SBC, and
- North Coast Connect Consortium (NCCC) Brisbane – Sunshine Coast Faster Rail.

The CLARA proposal was brought forward by a private sector consortium that has proposed that the entire project could be self-funded through Value Capture mechanisms. We note that further work is required for the consortium to satisfy the NFRA, Department and IPFA that value capture could fully fund the project. NCCC is

also investigating options for public-private partnerships in the delivery of new rail infrastructure to Moreton Bay and the Sunshine Coast.

b. Conditions for government consideration of applying value capture

Value capture can better align the funding of infrastructure with those that benefit. It can lead to better integrated planning between infrastructure and land use, increased economic benefits beyond transport objectives and earlier delivery of infrastructure.

Under Australia's federal structure, all three levels of government have important roles to play in planning and funding urban development and transport infrastructure. Given its leadership role within the federation and its funding clout, the Australian Government has an opportunity to promote value capture mechanisms as a complementary funding approach and a land planning tool.

In particular, the scale of the multi city faster rail agenda provides an opportunity to develop a Commonwealth value capture framework. This framework could be informed by existing state frameworks and could set out key guiding principles that apply to development of value capture proposals. Recognising that implementation levers lie at the state and local government level, the framework could include incentives that reward state and local governments that implement designated value capture measures, including in faster rail corridors.

Key conditions for serious government consideration of applying Value Capture include how government can:

- ensure that value capture is not an additional tax, but a more efficient and fair allocation of benefits and costs;
- demonstrate the nexus between payments made to support a new piece of infrastructure, how that infrastructure satisfies user's demands and the benefits that infrastructure provides to the party(s) providing the payment;
- collaborate early with beneficiaries to increase the benefits of a project;
- fairly identify who will benefit from a project;
- effectively identify beneficiaries' willingness to pay;
- obtain evidence that beneficiaries/end users will not only benefit from the new infrastructure, but value these benefits;
- better integrate project investment decisions into wider land use planning; and
- best manage the mismatches in timing between the upfront financing requirements of the project, the uplift in property value and when beneficiaries materially gain from these uplifts.

Section 4a highlights some of the issues and challenges associated with applying value capture mechanisms.

c. Role of states and territories in facilitating value capture

Where Australian Government investments in infrastructure are efficient and effective, the government will receive an indirect benefit in higher tax income driven by economic growth which is itself driven by a more productive transport system.

While the Government can encourage and incentivise direct value capture models for faster rail projects, direct value capture mechanisms predominantly lie with the state and local governments.

A starting point for considering any new value capture mechanisms is to recognise that state and local governments are already using value capture mechanisms to fund key trunk infrastructure. These mechanisms include:

- Special Infrastructure Contributions (SIC), which are a charge that can be included as a consent to urban and industrial development to help cover the cost of economic and social infrastructure provision; and
- developer contributions, whereby under relevant state planning legislation, developers are required, or can volunteer in exchange for increased floor space or other development rights, to provide funding or in-kind support towards the provision of public infrastructure servicing newly developed precincts.

These charges cannot simply be cannibalised but rather need to be considered against the overall quantum of value being created in assessing the scope for any new mechanisms. In the context of faster rail, these mechanisms could include sale of station development rights, incremental charges on additional airspace created as part of zoning changes around faster rail stations and land management strategies that create scope to directly capture some of the uplift in land value along the faster rail corridor.

For the Australian Government to stimulate the use of direct value capture in the development and delivery of faster rail projects across Australia, it should consider:

- working with state, territory and local governments to promote leading practice in value capture strategies;
- using the Australian Government's funding and financing capacity to incentivise project proponents to develop implementable value capture strategies;
- strengthening requirements on Commonwealth funding support, whereby conditionality goes beyond milestone payments and the like to include broader Commonwealth objectives or exposure to defined upside events (e.g. asset sale or land sale where the project has created strong value uplift); and
- stimulating market-led value capture proposals as it has done with the faster rail proposals in particular CLARA and North Coast Connect.

Local governments, with their ability to identify more closely with direct local benefits, may have more appetite for innovative funding methods, particularly if some incentive is provided. For example, Gold Coast Light Rail has a broad-based Transport Levy implemented by the local government. This was supported by the

Queensland Sustainable Planning Act, which allows local governments to levy infrastructure charges to cover the cost of providing trunk infrastructure for development.

The willingness to pay a value capture contribution is directly related to the perceived fairness of the model, the amount, hypothecation and whether an individual recognises personal benefit from the infrastructure delivered. Given the potential for value capture to make a contribution to the funding mix, there would be merit in a broader conversation between all levels of government and the community about the willingness and appropriateness of value capture mechanisms.

d. Faster rail investment must be informed by a view to the future

As a key component of the Government's *Plan for Australia's Future Population*, the Government's investment in faster rail will contribute to achieving the objectives of this plan and support the decentralisation of our largest capital cities.

The Australian Bureau of Statistics reports that Australia's population is expected to keep growing and reach approximately 33 million people by 2040. It is expected that Sydney, Melbourne and Brisbane will maintain their dominant position in Australia's population growth and distribution, with projected average growth rates of around 2 per cent a year³.

Concentrated population growth in Australia's major cities has created vibrant places that attract people and jobs and deliver high levels of innovation and productivity. It has also enabled these cities to reach economies of scale that supports further agglomeration effects. However, this population growth has heightened existing pressures on urban infrastructure, housing, services and the natural environment. The most visible pressure from population growth in these cities is traffic congestion and the costs and delays it imposes on people travelling between home, work and other activities.

As outlined previously, investment in faster rail to reduce congestion is a critical component of the Government's Population Strategy. It is important that investment in faster rail is not done in isolation, and critical, supporting regional infrastructure and policies will be necessary to ensure the full range of benefits from investment in faster rail are delivered to the regional centres they connect to. Careful Government analysis of policy levers will be required to ensure faster rail does not result in established regional orbital cities becoming dormitory suburbs of major capitals.

City and Regional Deals have the potential to complement faster rail investment by providing a mechanism to align necessary planning, investment and governance arrangements in connected regions to take full advantage of the improved connectivity. Regional Deals are tailored to each region's comparative advantages, assets and challenges and reflect the unique needs of regional Australia. It is becoming increasingly important that the water security of Australia's towns and regions is also evaluated when considering faster rail as a means of decentralisation.

³ Australian Bureau of Statistics (2018), 3222.0 – *Population Projections, Australia, 2017-2066*

e. Appropriate use of technology

The Government is working with jurisdictions to investigate improved rail connections that deliver demonstrable benefits for commuters. The focus of these investigations is cost effective delivery of transport connections that supports faster travel times, meet community needs and provides the capacity and reliable services.

As evidenced by submissions to the Government's *Faster Rail Prospectus* initiative, there are a range of innovative and in some cases embryonic and unproven technologies, such as magnetic levitation and Hyperloop technology, which have been put forward as proposed future high-speed rail solutions.

Other proven technology like high-speed (steel on) rail track is likely to be very expensive to deploy, difficult to achieve operational cost recovery from ticket prices and may have unintended environmental impacts during construction and will need careful consideration during evaluation. As such, parties to this submission support the Government's focus on connecting regional centres to capital cities with *faster* passenger rail services while ensuring options to future proof high-speed rail corridors are considered.

3. Opportunities for alternative financing options for faster rail

To develop and fully realise the objectives of the *Faster Rail Plan*, alternative financing models will need to be tapped. This section will explore the opportunities for alternative financing options for faster rail. Financing options increase in complexity as you move across the spectrum of options, from the provision of a conditional grant to returnable capital solutions like debt or an equity investment. While project risks remain largely constant, the exposure to those project risks increases as you move towards an equity investment.

Should the Government decide to provide funding as a form of returnable capital, a number of guiding questions can assist in determining the suitable funding mechanism. These include:

- is it appropriate for the Commonwealth to have direct ownership or financing in the project (e.g. if faster rail is seen as strategic infrastructure)?
- will the project generate a return that is sufficient to support a return on Commonwealth investment?
- what is the market funding gap or failure?
- what is the certainty and timing around project revenues?
- what level of Commonwealth engagement is required to ensure the desired outcome?
- has funding support from other Commonwealth agencies been investigated (e.g. debt financing from EFA, NAIF etc.).

a. Conditional Grants

Conditional grants may be provided by the Commonwealth, state or local governments to assist the funding of large infrastructure projects such as faster rail projects.

A conditional grant may include a commitment to provide a certain amount to a project. However, the drawdown upon this grant may be subject to the achievement of certain defined conditions such as development milestone achievements and/or co-contribution payments and links to Commonwealth required social and financial outcomes.

Should conditional grants be used for faster rail projects, they could be used to ensure that the Commonwealth's share of windfall gains from certain events such as potential future asset sales (including defined state land along the corridor).

IPFA believes that all levels of government should explore non grant funding options before resorting to the provision of grant funding. It should be noted that in many circumstances, the project and its economics do not support Commonwealth funding in any form other than grant based funding. However, where the project economics are supportive, Commonwealth support should be pursued on a non-grant basis. This would require careful consideration of what exposure this creates for the taxpayer.

b. Debt (Loans)

The Government can typically borrow at a lower cost and over a longer term than would be possible by other tiers of government or the private sector. This allows the potential for Commonwealth loans (concessional or non-concessional) to play a role in faster rail projects, secured against the expected value capture revenues of the projects.

Appropriately structured value capture mechanisms may provide future cashflows to support the provision and repayment of a Commonwealth loan over time. In this way, Commonwealth funding might bridge the timing mismatch of initial project construction funding requirements and value capture from receipts following delivery of a project. However, from a Commonwealth perspective, the value capture mechanisms, or other revenue streams, that would support repayment need to be fully committed and stress tested before loan execution.

From a state and local government perspective, they may seek to create and capture value around a new rail line for example through rezoning and establishing a value capture mechanism, such as a levy or hypothecation of future taxation revenue increases.

For faster rail projects, private sector proponents may seek commercial loans where debt is provided on standard commercial terms and is fully reflective of risk. In such cases, Commonwealth support may not be required if proponents can capture sufficient value creation from the project.

c. Equity

The Commonwealth may seek to contribute capital to acquire a direct interest in a project, with an expectation of future returns from project profits and distributions. In summary, an equity investment may be suitable for the Commonwealth to consider where:

- it is in the national interest to engage in commercial activities which have the ability to generate a profit;
- there is an expectation for the project to transition to non-government ownership in the short to medium term; and
- there is a market failure to contribute equity.

In IPFA's view, direct equity investments alongside state and/or private equity may result in both actual and perceived conflicts of interest and commercial outcome misalignments and may not be the most appropriate mechanism for the Commonwealth to fund a project.

d. Guarantees

Guarantees by the Commonwealth or state governments mean that they support the repayment obligations of the project debt.

Guarantees of this nature have been provided overseas before using hypothecated tax revenue models (such as Tax Increment Financing (TIF) schemes) to support projects. TIF models are unlikely to be implemented by the Government for faster rail or in any other context as the majority of discretionary land and property taxation in Australia is collected at a state and local level.

4. Funding Opportunities and constraints

With tight constraints on grant funding from the Commonwealth Government, and the competing priorities for these funds, both value capture and fare box revenue are key funding sources that need to be considered.

a. Value Capture

When a specific piece of infrastructure is funded entirely by governments from general taxation revenue, all taxpayers share the burden of paying for that infrastructure – even though many of them will not use or directly benefit from it.

By identifying and quantifying the incremental value created from the development of a new piece of infrastructure and connecting it with the funding of the development costs of that infrastructure, value capture mechanisms can assist governments fund and deliver infrastructure projects on a fairer basis.

There are two types of value capture:

- Passive value capture is where government secures increased revenues from an infrastructure project (compared to a base case) without taking any further action. For example new faster rail projects are likely to drive an increase in property values along the corridor and near stations. This will in turn increase federal and state government revenues from income taxes, stamp duties and capital gains tax over time.
- Active value capture occurs when a project is planned to generate additional revenue for the project proponent. For example, if a new faster rail line is built by a company (be it government owned or not) which also owns and develops property in the corridor served by the faster rail line, then it will directly benefit from increased property values. Alternatively, in developing a new faster rail station a state government may sell development rights or implement a new tax on additional density allowed in the precinct.

Value Capture Potential

In considering the potential scope of value capture to fund faster rail projects, it is important for government to have realistic expectations about how much value can be captured. This is especially important if a proponent proposes that the entire cost of the project can be covered by value capture.

London Crossrail (while not being fast rail and being a brownfield project), is seen as an example of best practice in modern value capture, with around 30% of the capital cost of the project sourced through value capture mechanisms.

The Bureau of Infrastructure and Transport Regional Economics' (BITRE) work surveying changes in land value for more than one hundred passenger rail projects show that passenger rail can lead to average uplifts between 6.9 and 9.5%⁴. Evidence from the Australasian Railway Association suggests that High Speed Rail in Europe and Asia has increased property values, especially for regional town centres where they connect to a major city.⁵ Consequently, while magnitudes of property value uplift are uncertain, a body of evidence does point to increased land and property values for passenger rail at all speeds where there are significant travel time savings.

However, examples where value capture made major contributions to funding cost are defined by unique characteristics, such as significantly higher population densities than regional Australia, and include the continental railroads in the United States and Hong Kong's MTR.

In the United States, the land grant railroads in the late nineteenth century saw four of the five transcontinental railroads built with substantial assistance from federal government grants of previously unsettled land (Library of Congress, 2019).

In Hong Kong, the MTRs Rail plus Property model is dependent on access to low cost land and air rights along rail corridors (available in Hong Kong as the

⁴ BITRE, Traffic infrastructure and land value uplift Information Sheet No 69.

⁵ Australasian Railway Association, The Impact of High Speed Rail on Land and Property Values, 23 February 2012

government retains land ownership). These can subsequently be developed into high density, high value, residential and commercial space and used to offset the cost of rail infrastructure.

Ultimately, faster rail proposals need to be viewed in the Australian context. We have private and leasehold land ownership, large distances and relatively small regional populations. Australia's vast distances mean that long-distance rail transport is often unable to compete with the speed and travel times offered by the aviation industry – even with generous government subsidies applied to train ticket prices.

In relation to high-speed rail and value capture in Australia, the 2013 *High Speed Rail Study Phase 2 Report* found that “value capture has the potential to partially close the commercial funding gap through measures such as government land sales and capturing the incremental impact that the HSR program would have on stamp duty, developments and rates in the HSR affected zones. However, this would be a small contribution at best”⁶. With the very long planning and construction timeframes associated with an East Coast HSR, the financing period would be similarly very long.

Implementation

As outlined in section 2c, most value capture mechanisms lie with state and local governments. To encourage additional mechanisms beyond those already applied, it is likely that some Commonwealth incentive will be required, in terms of either matching funding or inclusion of value capture commitments among project prioritisation criteria.

The current competitive faster rail prospectus based process is consistent with creating scope for implementation of value capture mechanisms. This process encouraged state and private sector proponents to team up and develop strong faster rail proposals for Government consideration. During the prospectus stage, the Government did not attach grant funding commitments for capital costs and therefore encouraged the market to bring forward projects with innovative funding solutions.

As the Government moves into the next phase of the process, it will be important, if value capture is to become a significant funding source, that Commonwealth funding or financing commitments are not made until there is a high degree of certainty over value capture revenues. For example, if a Commonwealth loan is to be repaid post-development from value capture revenues, these revenues will need to be clear enough to be sized against the Commonwealth loan and for appropriate decisions to be made about risk weightings and any security over project assets required.

b. Farebox recovery

Background

Farebox is the revenue derived from the users of rail, typically through ticket sales.

⁶ High Speed Rail Phase 2 Report

In Australia, farebox revenue does not typically cover operating costs of rail lines. Only a few fast rail systems around the world have a farebox ratio of 1:1, where the revenue derived from ticket sales cover the operating costs of the rail. Given that these cost recovering rail lines are typically in very built up areas and have high patronage (e.g. Taiwan fast rail), they serve as an optimum case for cost recovery. By contrast, rail users in Australia have a strong expectation that ticket prices will be relatively modest making any shift in this to or towards full cost recovery challenging.

However, it will be important in assessing the scope of farebox revenue to contribute to operational costs that users' willingness to pay is assessed. For example, there may be scope as in examples in the UK for premium limited stops rail services to run alongside cheaper all stop services.

Willingness to Pay

Assessments of an appropriate farebox revenue stream for a faster rail project should be based on users' willingness to pay given their existing transport options, whether they consider the faster rail option to be a "premium service", and patronage forecasts. Such calculations should recognise the value of time savings in particular but also take into account other socio-economic factors.

For faster rail projects, IPFA believes that farebox ticket prices should be structured on a full (operational) cost recovery model if it is feasible within users' willingness to pay.

To take the North Coast Connect Project as a practical example; this project aims to provide a fast rail service between Brisbane and the regions of Moreton Bay and the Sunshine Coast. A daily commute from Nambour to Brisbane for example can be done by driving approximately 3 hours per day at a direct cost of approximately \$39 (see table below). With a faster rail trip potentially taking half the time, this time saving can make a further contribution towards willingness to pay.

Element	Driving
Distance (return)	216km
Time	3hr
Cost	
Petrol	\$22.8 (15.2L @ \$1.50)
Wear and Tear	\$6
Parking	\$10
Total	\$38.8

5. Conclusion

The Australian Government is investing \$100 billion over ten years from 2019-20 in transport infrastructure across Australia through its rolling infrastructure plan, and has outlined a vision for a faster rail network through Australia.

The construction of faster and high-speed rail lines is expensive. The development of business cases alone on complex projects can cost upwards of \$100 million. A high-speed rail line connecting Brisbane, Sydney, Canberra and Melbourne has previously been investigated and was found to cost \$114 billion (\$2012) and would take 40 years to complete. These costs are likely to have escalated significantly.

To support the construction of faster rail projects, active partnerships with state and local government and the private sector are essential. This submission recommends that proposals for public funding of transport projects, such as faster rail, should consider what proportion of the project can be funded by the key beneficiaries of the project through targeted contributions and farebox recovery, and how much should be funded by the broader community. Due to many of the levers residing with state governments, and the role of state governments in the delivery of rail, their support for a project is essential. It is important though that the call on governments balance sheets (and hence exposure for the taxpayer) are clearly understood, including from future liabilities and through provision of risk transfer for example.

Innovative financing mechanisms, such as those outlined in this submission, may be appropriate for faster rail projects that demonstrate strong net economic and social benefits, and provide a reliable income stream to support the repayment of debt or provide a return on investment. The long (and in some cases very long) planning and delivery timeframes for some rail projects may create challenges in reliably financing and recovering value capture over time.

The NFRA is in the process of developing a Faster Rail Investment Strategy which will be informed by the completion of faster rail business cases currently underway for Sydney to Newcastle, Melbourne to Greater Shepparton, and Brisbane to the regions of Moreton Bay and the Sunshine Coast.

A preliminary Investment Strategy is expected to be provided to the Government for consideration in late 2020 and will be updated as new faster rail business cases are completed.

The Investment Strategy will recommend how faster rail projects can be staged to link future expenditure to investment need, and create a rolling pipeline of projects to increase community and industry confidence to reduce market pressures. The Investment Strategy will take into consideration alternative funding and financing options for faster rail, such as private sector contributions and value capture opportunities.

Appendix A

Faster Rail Prospectus Initiative

In the 2017-18 Budget, the Government made a commitment to explore the opportunities for faster passenger rail and investigate improvements to the rail connections between our cities and surrounding regional areas through \$20 million in funding to support the development of business cases.

On 9 March 2018, following a detailed competitive assessment process in line with criteria outlined in the Faster Rail Prospectus, the Government committed funding to the development of business cases for connections between Sydney and Newcastle, Melbourne and Greater Shepparton, and Brisbane to the regions of Moreton Bay and the Sunshine Coast.

The Sydney to Newcastle and Melbourne to Greater Shepparton strategic business cases are complete. The Brisbane to the regions of Moreton Bay and the Sunshine Coast business case is expected to be completed by the end of the year. Once all three are complete, the NFRA will provide advice to Government on the outcomes and possible next steps.

The Melbourne to Greater Shepparton strategic business case (undertaken by Consolidated Land and Rail Australia (CLARA)) in particular investigated the development of two new sustainable SMART cities with connections to high-speed rail along a new dedicated corridor.

CLARA has publically stated it will use will use a value capture model based on the sale of land within the CLARA cities to fund the capital costs of each city's public infrastructure and utilities as well as the upfront capital costs of a high-speed rail line linking both CLARA cities with Melbourne. This submission is not able to discuss the CLARA proposal in detail as it is commercial in confidence and yet to be considered by the Government.

Additional Faster Rail Business Cases

Building on these initial business cases, the 2019-20 Budget included a commitment to undertake additional business cases for priority faster rail corridors between Sydney to Wollongong, Sydney to Parkes (via Bathurst and Orange), Melbourne to Traralgon, Melbourne to Albury-Wodonga, and Brisbane to the Gold Coast. The National Faster Rail Agency is working with relevant state governments to secure their agreement to match funding and to project governance arrangements. The first of these business cases is expected to commence shortly and be completed in 2021.

The Government has also committed funding to undertake a business case for passenger rail services between Brisbane and Toowoomba. The scope of this business case is yet to be finalised, however, it is not expected to focus on faster rail.

Melbourne to Geelong Faster Rail

The 2019-20 Budget also included a commitment of \$2 billion to help deliver faster rail between Melbourne and Geelong. This investment builds on the Government's \$5 billion commitment to deliver the Melbourne Airport Rail Link, which will increase capacity from Sunshine to the Melbourne CBD, facilitating the delivery of faster rail services from Geelong.

A faster rail service between Melbourne and Geelong will be transformational and has the potential to significantly reduce travel times, giving more time back to commuters and unlocking new economic and social opportunities for the region.

Enabling more commuters to travel along the rail corridor from Melbourne to Geelong will also take pressure off the road corridor, further spreading the benefits of this investment.