



January 26, 2008 12:33am AEDT

Super ideal to provide funds for infrastructure

In a time of scarce resources and market volatility, public-private partnerships are the best way to fund major projects, writes Adele Ferguson | *January 26, 2008*

THE announcement of the country's biggest public-private partnership, the \$7 billion-plus M4 East road network in NSW, coming around the same time the federal Government has established the Infrastructure Australia statutory body, heralds a new era in the battle to fix the country's infrastructure mess.

The aim of both announcements is to reduce bottlenecks, road congestion and improve the environment, all for the good of the economy.

The project will link Sydney's main western motorway to the city fringe and provide a new freight link between Sydney's motorway network and the port and airport precinct in the city's southeast.

It will also include a 14km tunnel to link Port Botany to the network.

The project will be a public-private partnership (PPP) and The Australian understands that it will include multiple tollways to entice the private sector to play a role.

With roads, rail and water at crisis point, and a deficit of more than \$90 billion in infrastructure spending in Australia, the federal and state governments have little choice but to invite the private sector to increasingly fund more projects.

Last Monday, Prime Minister Kevin Rudd created a statutory body, Infrastructure Australia, to audit the nation's infrastructure needs, provide a priority list of targets and work out ways to tap into Australia's \$1.1 trillion in super funds to bankroll a nation-building program of new roads, ports and water projects.

The body will be ratified in parliament next month and then move quickly to appoint a board of 12, comprising bureaucrats and private sector leaders.

Many names have been touted from the private sector, including Transfield Services chairman Tony Shepherd, Leighton Holdings chief executive Wal King, Bilfinger Australia chairman and former NSW premier Nick Greiner, Macquarie Bank's Nicholas Moore, United Group chairman Trevor Rowe and Infrastructure Partnerships Australia chairman Mark Birrell.

The next step is to audit Australia's infrastructure inventory and then create a list of priority projects across the nation. All up, Rudd expects the audit and the list to take a year.

But as Mitch King, chief executive of infrastructure funds management outfit Lighthouse Infrastructure says, the Government's plan is a welcome one.

"It is logical, necessary, politically courageous -- if it is to be implemented balancing the various interest groups (state versus state, federal versus states, local government, private sector) and recognises the capital efficiency and role of the private sector," he says.

But he says the main problem is the excessive timing. A year to create a list suggests this is not a real plan, according to King.

"By that time, the Government will have lost valuable time and be in its second year. Also there is a significant skills shortage to physically deliver the projects with engineers, investment banks, builders either overseas in Europe or Dubai or in the mines in WA or Queensland," he says.

King suggests the following to make the idea a reality:

- * Create the list quickly -- numerous lists already exist and agreement on projects should be expedited.
- * Build momentum -- prioritise some deliverable projects and put resources behind them.
- * Standardise the approach to documentation and risk allocation across all projects.

* Reduce bid risk -- nominate preferred parties/bids early to allow resources to be devoted to more projects and have the private sector actively compete and innovate, not build up bid costs.

King believes it will require some gutsy calls, but the federal Government clearly has the mandate and can leave a legacy for future generations if it acts quickly. King is spot on. Given the size and importance of the NSW road project, and the need for private funding, if the Rudd Government is smart it should use this project as a case study for what it needs to do to create an environment conducive to private sector involvement.

In Australia about 3.1 per cent of superannuation money is invested in infrastructure, but much of that is directed overseas due to lack of opportunities in Australia.

ASFA, the Australian superannuation funds peak body, which represents more than \$880 billion of funds, says its members are excited by the opportunity to invest in infrastructure.

But ASFA director of policy and best practice Brad Pragnell says super funds are focused on commercial returns, so they would need to be economically suitable.

In the case of roads, that would generally mean charging tolls, or some other user-pays system.

Indeed, Paul Zwi, the head of equity research at Centric Wealth Advisers, which has \$6 billion in funds under advice, says there are numerous implications that need to be carefully considered by the super funds and the governments.

"Governments can reallocate taxpayers' money to social programs such as hospitals, which is good for the nation," Zwi says. But he warns that if essential infrastructure is in private hands, there is an incentive to maximise profits by raising the cost of usage more aggressively than would otherwise be the case if it was in government hands, because the funds are interested in returns, not worrying about sacrificing votes at the ballot box.

"There are many implications that have to be carefully thought through, because you could end up with a situation where the relevant government has to buy the asset back because it was run down," he says.

Superannuation funds are starting to get a big appetite for infrastructure assets, whether through direct investments or through an infrastructure fund or trust.

For instance, AMP owns 50 per cent of Melbourne Airport, while Westpac, through its Hastings infrastructure funds, has stakes in Melbourne Airport, Perth Airport, toll roads and water assets.

Victorian Funds Management Corp (VFMC), which manages \$41 billion of super funds, invests less than 3 per cent of its money in infrastructure.

In September it made its first directly owned infrastructure investment, with a 19.6 per cent stake in the Birmingham International Airport.

VFMC chief executive Syd Bone says he would like to invest more of its funds in infrastructure, particularly in Australia, if the opportunities present themselves.

He says infrastructure assets are a popular asset class because they are generally monopolies, have a long investment horizon and provide a steady flow of cash back to the funds.

He says the benefit of taking direct stakes in infrastructure is control.

"You can get seats on the board, and because they aren't listed they are not subject to the sort of volatility that we see today," he says.

David Bryant, group executive of investments at Australian Unity, which has more than \$6 billion in funds under management, says superannuation funds are required under law to invest for the sole purpose of providing adequate returns for retirement funds.

He says the sole purpose test precludes them from investing for the social good.

The upshot is any investment a superannuation fund makes has to stack up on commercial returns and that generally means adopting a "user pays" model.

Infrastructure Partnerships Australia national manager of public affairs Brendan Lyon says, with an infrastructure shortfall, the Government is prudent to seek to match retirement savings with urgent

infrastructure projects in Australia.

"The lack of opportunities for superannuation investment has led to a situation where 30 per cent of retirement savings are being invested offshore at a time when Australia's infrastructure shortfalls are becoming urgent," he says.

Tony Shepherd, the chairman of Transfield Services, one of the biggest infrastructure companies in Australia, applauded the use of superannuation funds to bankroll infrastructure in Australia.

He says the notion of states running infrastructure was ideologically backward.

"What is magical about state ownership? We live in a user-pays society. The difference is instead of using our taxes to pay for the infrastructure we are directly paying for the use and getting a return in our super. What's wrong with that? It is certainly more transparent," he says.

Like most working in the private sector, Shepherd is keen to get the statutory body up and running quickly to create an environment that not only allows for more private sector involvement, but better uses our retirement funds.

Given the recent flogging of the share market, and the likely negative returns many funds will produce in the next quarter, direct investment in infrastructure is looking more attractive.

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