

*Infrastructure Partnerships  
Australia leads the national  
infrastructure debate by  
bringing together both the  
public and private sectors  
to promote partnerships in  
infrastructure provision.*

## Infrastructure Partnerships Australia

---

Submission to  
Department of Environment, Water, Heritage & Arts,  
on Draft Guidelines, National Urban Water &  
Desalination Plan  
29 August 2008



### Contact

---

**Joanne McCafferty**  
National Manager, Policy  
Infrastructure Partnerships Australia

P | 02 9240 2050  
E | [joanne.mccafferty@infrastructure.org.au](mailto:joanne.mccafferty@infrastructure.org.au)



## Infrastructure Partnerships Australia

Infrastructure Partnerships Australia (IPA) is the nation's peak infrastructure body. Our mission is to advocate the best solutions to Australia's infrastructure challenges, equipping the nation with the assets and services we need to secure enduring and strong economic growth and importantly, to meet national social objectives.

Infrastructure is about more than balance sheets and building sites. Infrastructure is the key to how we do business, how we meet the needs of a prosperous economy and growing population and how we sustain a cohesive and inclusive society.

Infrastructure Partnerships Australia seeks to ensure governments have the maximum choice of options to procure key infrastructure. We believe that the use of public or private finance should be assessed on a case-by-case basis. IPA also recognises the enhanced innovation and cost discipline that private sector project management and finance can deliver, especially with large and complex projects.

Our Membership is comprised of the most senior industry leaders across the spectrum of the infrastructure sector, including financiers, constructors, operators and advisors. Importantly, a significant portion of our Membership is comprised of government agencies.

Infrastructure Partnerships Australia draws together the public and private sectors in a genuine partnership to debate the policies and priority projects that will build Australia for the challenges ahead.

## 1. INTRODUCTION

IPA welcomes the opportunity to submit to the Department of the Environment, Water, Heritage and the Arts (Department) on the Draft Guidelines to the National Urban Water & Desalination Plan (Draft Guidelines).

This submission outlines core aspects of IPA's position on urban water management and makes specific suggestions concerning the Draft Guidelines which we encourage the Department to consider in finalising guidelines to the National Urban Water & Desalination Plan (Plan).

## 2. IPA'S POLICY POSITIONS ON URBAN WATER MANAGEMENT

Water is a vital commodity, essential to life, agriculture and industry. It is increasingly in demand as our population and the economy grows. There are increasing concerns about the way in which this vital resource is being managed. Growing demand for water and diminishing supply from existing sources requires all of us to examine how we use this scarce resource and find ways to manage our water use in a more sustainable way.

Rapid urban development in Australia's major cities has resulted in a corollary increase in the demand for urban water and wastewater services. This in turn has stretched public utilities.

There are two ways to deal with an expected deficiency in supply. Either reduce demand or augment existing water supplies.

Australian governments have embarked on rigorous campaigns to reduce water supply pressures, through the installation and encouragement of water saving and water efficient devices, public education campaigns, and through enforced reduction of the consumption of water.

IPA has argued for some time that there are more efficient ways of managing water than simply relying on demand management measures. It is unwise to encourage over-reliance on demand reduction as a long term solution to Australia's urban water needs. Governments' initiatives to reduce water demand have been widely employed across the country to effect but will eventually produce diminishing returns at the margins.

Furthermore, we believe strong legislative approaches, such as stringent water restrictions, run the risk of creating conflict and hostility between governments and their electorates, as many consumers place the blame for Australia's failure to invest in essential water infrastructure squarely with our governments.

The need for new (and renewed) water and wastewater infrastructure in Australia is one of the greatest challenges facing government in this country. The need for this infrastructure is not contested, but the responsibility for its commission, funding, delivery, political and financial risk and ultimately the success of any given piece of water infrastructure is an issue of great currency.

In May 2007, Infrastructure Partnerships Australia undertook a major research project with The Allen Consulting Group into the need for urban water reform and the key elements to achieve sound urban water management in Australia. IPA's research confirmed institutional factors are constraining investment in water infrastructure – not the lack of capital. Government should place greater emphasis on the supply side and on overcoming impediments to investments in capacity generation.

IPA is also of the view that systematic consideration of an increased role for the private sector in the provision of water and wastewater must form a part of any considered approach to securing and augmenting Australia's urban water and waste water services.

IPA submits there are six fundamental elements of 'best practice' urban water management (Figure 1). Current management practices in Australia embody most of these elements but to varying degrees. There is scope for considerable improvement, as discussed below.

FIGURE 1: THE SIX ELEMENTS OF SOUND URBAN WATER MANAGEMENT



## 2.1 Pricing urban water

A majority of Australia's water utilities are unable to charge a price that is equivalent to or in the vicinity of their long run marginal cost of producing water. Utilities with a smaller customer base are further handicapped in recovering the full cost of service delivery rendering them dependant on state and federal grants to fill in the gaps.

In any system of competitive markets, price acts as the lever which balances supply and demand. Consumers decide how much of the commodity they will consume based on the price, and the price offered by the suppliers represents the least cost method of supplying the commodity.

IPA is of the view that prices charged by water utilities should generate sufficient revenue for the water companies to cover all commercial costs of supplying water including operating, capital and a rate of return on assets.

IPA also submits that retailers should be able to purchase supplies from a competitive wholesale market.

It is important to note that non-market based pricing regimes in the water sector ensure that PPP procurement mechanisms used to develop new water infrastructure cannot be structured as “economic PPPs”. PPPs must instead be structured as “social” PPPs, relying on State “availability” payments.

## 2.2 The institutional framework for urban water management

Appropriate institutions are critical for efficient management of water resources, promoting competition and investments in new infrastructure and new energy saving technologies.

Currently nearly all water utilities are government owned and there exist inherent conflicts between the multiple roles that they perform. Typically governments have:

- a shareholder role in which they have an interest in the financial performance of the water utility;
- a welfare role ensuring that benefits of essential infrastructure like water accrue to the community at large and water utilities continue to discharge their functions at minimum cost to the environment; and
- a regulatory role ensuring a level playing field to all players in the industry and protecting consumer interests.

There are obvious conflicts between discharging all these roles. Sound governance calls for separation, clarity and devolution of these to parties which are best suited to undertake them.

IPA submits there is urgent need to consolidate the jurisdictions of smaller fragmented water utilities to make them financially viable and capable of ensuring water security to their customers. At present, judgements on key water infrastructure issues, such as the use of PPPs as a procurement mechanism, are impaired by a very narrow focus and a lack of project scale.

IPA contends that the private sector should have a greater role in investing, operating and maintaining water infrastructure (excepting water storage). We believe it can do so, in the most efficient way, under an overall regulatory framework set by government.

Where feasible, public sector water utilities should be encouraged to enter into partnerships with the private sector for construction, financing, operation and maintenance of existing and new facilities. The utilities would benefit from advice from a central PPP advisory body on PPP best practices and procurement models. The consolidation of smaller utilities would be essential in order to attract greater private sector involvement.

## 2.3 Regulation in urban water markets

Regulation of natural monopoly service providers is an accepted practice in Australia and a variety of models exist across the country in regulating economic infrastructure. For instance, in the market for gas in Australia there is a mix of both Government and privately owned transmission and distribution activities, their activities regulated by the States and Territories.

The appropriate regulatory framework for water and sewerage utilities across the nation depends on specific needs and challenges that the utilities face in times of changing business environment. However, IPA submits that sound regulation requires the regulator to be separated from the water businesses and have the power to ensure compliance and regulatory best practice.

There is also need for regulatory oversight of water trading, infrastructure access by third parties, water and environmental quality monitoring.

## 2.4 Models of private partnerships for urban water

Private involvement and contribution to water supply in Australia has grown steadily and beneficially in recent decades and through a variety of forms. The private sector is a large, essential and most likely a growing contributor in expertise, service, development and innovation.

Currently the private sector has considerable expertise in Australia in the areas of maintenance of water/wastewater assets and systems. While these may be considered as effective outsourcing arrangements, it is widely believed that these may not bring the required levels of efficiencies desired, which may be available through the involvement of private debt and equity investors.

World over, there is significant appetite among equity investors for opportunities in water assets, yet only a small percentage of the installed base of Australia's water infrastructure has been financed by private means. There is considerable scope for increased private investment in Australia's water infrastructure, given the right conditions. Table 1 outlines a few models which may be suitable for use by urban water utilities to facilitate greater involvement of the private sector.

State-controlled water authorities would derive significant benefits from accessing private finance, in particular:

- Added discipline in costs of design, construction and operation;
- Appropriate risk transfer between State and the private sector;
- Innovation in delivering solutions that optimise cost and use of latest sustainable technology;
- Re-direction of cash-flow to other areas with their portfolio of projects;
- Flexibility to drive a cost/benefit outcome based on discipline and risk transfer versus marginal increases in funding cost;
- Possibilities for market based business models.

Table 1: Models for Private Sector Participation

Type of Arrangement	Responsibilities of Operator	Financial Arrangement	Risk Sharing	Ownership of Assets
Management Contract	Supplies management services to the utility in return for a fee	Fixed fee indexed to inflation	Small	Contracting Authority
Lease	Runs the business, retains revenue from customer tariffs, pays a lease fee to the contracting authority, but does not finance investment in infrastructure assets	Revenue from customers, operating and maintenance costs, lease fee	Operating and commercial risks: Significant	Contracting Authority
Concession (e.g. PPP)	Runs the business and finances investments but does not own the infrastructure assets	Revenue from customers, operating and maintenance costs, finance costs, any concession fee	Operating and commercial and investment related risks: Major	Contracting Authority
Divesture	Runs the business, finances investments and also own the infrastructure assets	Revenue from customers, operating and maintenance costs, finance costs, any license fee	Operating and commercial and investment related risks: Major	Operator

Source: A Discussion Paper on the role of the Private Sector in the Supply of Water and Wastewater Services, Department of Prime Minister and Cabinet, August 2006.

One key point in favour of public-private partnerships (PPPs) in water is the guarantee of adequate maintenance of assets. At present the existing State monopoly water authorities can be exposed to varying dividend payments from the States.

At the financial close of a transaction, the future cost of a PPP project is known; the public sector will receive known outputs for known costs. Under a PPP structure the maintenance program is secured for, say 25 to 30 years. This ensures the taxpayer will have these assets functioning properly without risk of maintenance programs being deferred.

This is in contrast to traditional procurement where the costs of project completion and future maintenance of the assets are uncertain and remain the responsibility of the public sector and at risk to the vagaries of State budgets.

### 3. COMMENTS ON THE DRAFT FUNDING GUIDELINES

IPA commends the Federal Government's explicit commitment to working cooperatively with the states and territories to improve the security of water supplies to Australia's major cities. The Federal funding committed to support water infrastructure projects under the Plan is welcome and IPA supports the Government's decision to allocate the remaining funds (a minimum of \$809.8 million) through a competitive process.

IPA welcomes the Draft Guidelines establishing a framework for eligible proposals to be considered for assistance under the Plan. However, IPA considers that better value for

money for taxpayers – and better outcomes for Australia's cities – will result if some aspects of the Draft Guidelines are refined.

### 3.1 Extension of assistance to private sector water projects

IPA notes that the financial assistance to be provided under the plan and the Draft Guidelines appears to be primarily directed to the public sector. Although, this assistance will no doubt be welcomed by the states and territories, IPA notes that several states have already built or are in the process of building substantial desalination plants without Federal financial assistance. IPA respectfully suggests this demonstrates that many of these projects are sufficiently attractive to state and territory governments and commercially feasible to be undertaken without Federal Government financial support.

Given this fact, IPA suggests the Department further examine how the financial assistance might better used to facilitate new or "greenfield" private sector projects which are not promoted by or with the public sector. IPA is of the view that many of these projects can play a worthwhile role in securing and augmenting urban water and waste-water services even though they are not explicitly included in the public sector long-term plans.

The core issue for IPA is that private sector participation in the provision of water and other infrastructure is not only a necessity but a desirable goal for governments. As such, it should be fully encouraged by the funding arrangements which support the Plan.

### 3.2 Minor drafting issue (Draft Guidelines, p. 3)

IPA suggests that the reference to the "following flow chart" made at the bottom of page 3 should in fact read "flow chart shown on page 6".

### 3.3 Refundable tax offsets for the private sector (Draft Guidelines, p. 4)

IPA notes that under the Draft Guidelines financial assistance will be provided to successful proponents in the form of grants to public sector entities such as state, territory and local government bodies, and as refundable tax offsets (or credits) for other entities.

IPA suggests that while most projects eligible for financial assistance under the Draft Guidelines will likely be undertaken by the public sector, an increasing number will be carried out by the private sector (e.g. the Rosehill/Camellia Water Recycling Project). IPA submits that the private sector proponents of these projects should not automatically be treated differently from the public sector.

To reduce the complexity of the scheme and increase the certainty of application of the Guidelines in their final form, IPA suggests the funding assistance to all proponents under the National Urban Water and Desalination Plan could be given in the form of grants.

IPA submits that the provision of tax offsets, rather than grants, to private sector project proponents has the disadvantage of significantly deferring the benefits of the Government's financial assistance to the extent these projects are project-financed at commercial market levels. In effect, the combination of debt levels and depreciation costs would mean that many eligible projects would not be tax positive for some time (up to 5 years), so the value of the tax credit to the proponent may not be substantial in terms of its Net Present Value (NPV).

The grants provided under the Plan would necessarily need to be provided in a form that is as tax effective as possible to reduce the burden on the user of the relevant project's services. For instance, it would be desirable to ensure that the grant monies were not treated as income in the same year. Similarly, it would be important to ensure they did not have the effect of reducing the amount of private financing required below threshold levels (approximately \$150 million) and have the unfortunate effect of deterring PPP contributions.

IPA suggests grants might be directed toward the purchase or construction of stand alone aspects of the project which are not tied into the PPP financing proper. This is a technique which has been used on State Government sponsored toll road PPP contributions.

IPA suggests that an alternative approach would be to permit Local, State and Territory Governments or their agencies to receive grants for projects where the private proponent would otherwise be eligible for a tax offset and require that grant to be made directly available to the private sector proponent as a subsidy.

As the Government's objective is to facilitate projects which would otherwise not happen, it is important that funding be efficient and able to assist with a range of project delivery methods.

IPA considers that in facilitating such an approach the Draft Guidelines should be reframed to guarantee transparency and ensure subsidies are provided directly to the eligible project and its proponent, rather than going into consolidated revenue.

### 3.4 Section 6 – Eligibility Criteria (Draft Guidelines, p. 7)

Sub-sections 6(4) and (9) indicate that to be eligible for approval under the Plan, proponents must "be financially viable" and proposed projects must be "be financially viable once completed with no further call on the Australian Government for ongoing funding".

IPA considers it would be useful to applicants to clarify what the Department would consider "financially viable" for the purposes of the Eligibility Criteria.

Our concern is that the Government establish a specific benchmark for financial viability against which prospective proponents can measure themselves and their proposed projects, before making application under the Plan. For instance, sub-sections 6(4) and (9) might be expanded to include a minimum definition of financial

viability such as “able to obtain a minimum BB grade credit rating from a recognised international rating agency” or similar threshold.

### 3.5 Section 7 – Merit Criteria (Draft Guidelines, p. 7)

IPA submits that the Commonwealth should require the States to properly examine the use of procurement options which require private finance, such as PPPs, prior to the release of any Commonwealth funding under this plan. IPA observes that the Commonwealth has very successfully applied this approach in relation to national road funding via the AUSLINK program.

IPA submits that this additional requirement would encourage Local, State and Territory Governments and their agencies to make every effort to procure proposed water infrastructure projects in the most efficient manner possible. IPA suggests the requirement should apply to any infrastructure project with a capital cost in excess of \$200 million.

Following from the above, we propose the inclusion in Section 7 of the bullet point:

“The State has fully assessed and documented the suitability of privately financed procurement methods.”

IPA also suggests the Department consider providing a weighting for each of the Merit Criteria for assessment. Such a weighting system would improve the transparency of assessment and minimise time wasted by applicants with projects which are unlikely to be successful. It would also serve to underscore the Plan’s national objectives and ensure applicants are aware of the relative importance given to respective criteria. For example, the existing Merit Criteria under the Draft Guidelines might be weighted as follows:

- “1. Level of contribution to enhancing water supply security within the targeted urban area - 20%
2. Cost-effectiveness of the project - 30%
3. Cost-effectiveness of the Australian Government contribution - 10%
4. Demonstrable evidence that the proposed project is a key strategic element of the preferred long-term water supply plan for the area - 20%
5. Extent of environmental benefits and/or environmental best practice initiatives - 20%”

In the above example, by weighting “cost effectiveness” at 10% and weighting “environmental benefits” at 30%, the greater importance attached by the Commonwealth to environmental issues in assessment of proposals would be made clear, should that be the case.

### 3.6 Section 10 – Administration, Milestone Reporting and Evaluation (Draft Guidelines, p. 8)

Section 10 of the Draft Guidelines specifies that offers of financial assistance under the scheme will remain open for 12 weeks after which the offer will expire if the funding agreement has not been executed.

While IPA considers this an appropriate time frame, we suggest the Draft Guidelines include a guarantee that the Department will itself process the funding agreements within that time frame to ensure that failures in administration of the scheme do not unnecessarily result in the expiration of funding agreements.

### 3.7 Attachment B, Eligibility Criteria, Section 9 (Draft Guidelines, p. 12)

IPA submits applicants should be required to indicate where the relevant financial assistance will be spent. In the case of grant monies, the requirement could be for the proponent to describe the element of the project delivered using the funds. In the case of a tax offset, the requirement could be for the proponent to describe the saving in tax dollars.

An alternative approach may be to include this requirement under point 3 of the Merit Criteria.

## CONCLUSION

IPA recognises that issues affecting urban water utilities are varied and complex and there are no ready made solutions. Water is fundamental to life and there is nothing more important than devising suitable management strategies to efficiently allocate and manage this resource amongst its competing users.

IPA commends the Federal Government's commitment to working cooperatively with the states and territories to improve the security of Australia's urban water supplies. The Federal Government's plan to provide a minimum of \$809.8 million financial assistance under the Plan to eligible urban water infrastructure projects through a competitive process is welcome.

IPA considers the public sector has developed significant expertise in harnessing private support to build infrastructure projects and obtain the best value for money for the community. However, there is still scope for it to be far more actively involved in providing the finance, ownership and ongoing stewardship of public sector water and waste water infrastructure. The private sector is well equipped to provide the expertise and innovation that the next phase of Australia's urban water and waste water services will require.

IPA welcomes the Draft Guidelines establishing the framework for eligible proposals to be considered for assistance under the Plan. The core issue for IPA is that private sector participation in the provision of public infrastructure is not only a necessity but a desirable goal for governments. As such, it should be encouraged to the fullest extent by

the Commonwealth's National Urban Water and Desalination Plan and the funding arrangements which support the Plan.

IPA hopes that this submission demonstrates our support of this important initiative and that it is useful to the Minister and the Department in finalising the guidelines to the National Urban Water & Desalination Plan.

Any queries regarding this submission should be addressed to Joanne McCafferty, National Manager, Policy, on (02) 9240 2053.



Infrastructure Partnerships Australia  
8<sup>th</sup> Floor, 8-10 Loftus Street, Sydney NSW 2000  
[www.infrastructure.org.au](http://www.infrastructure.org.au)

T 02 9240 2050  
F 02 9240 2055  
E [contact@infrastructure.org.au](mailto:contact@infrastructure.org.au)