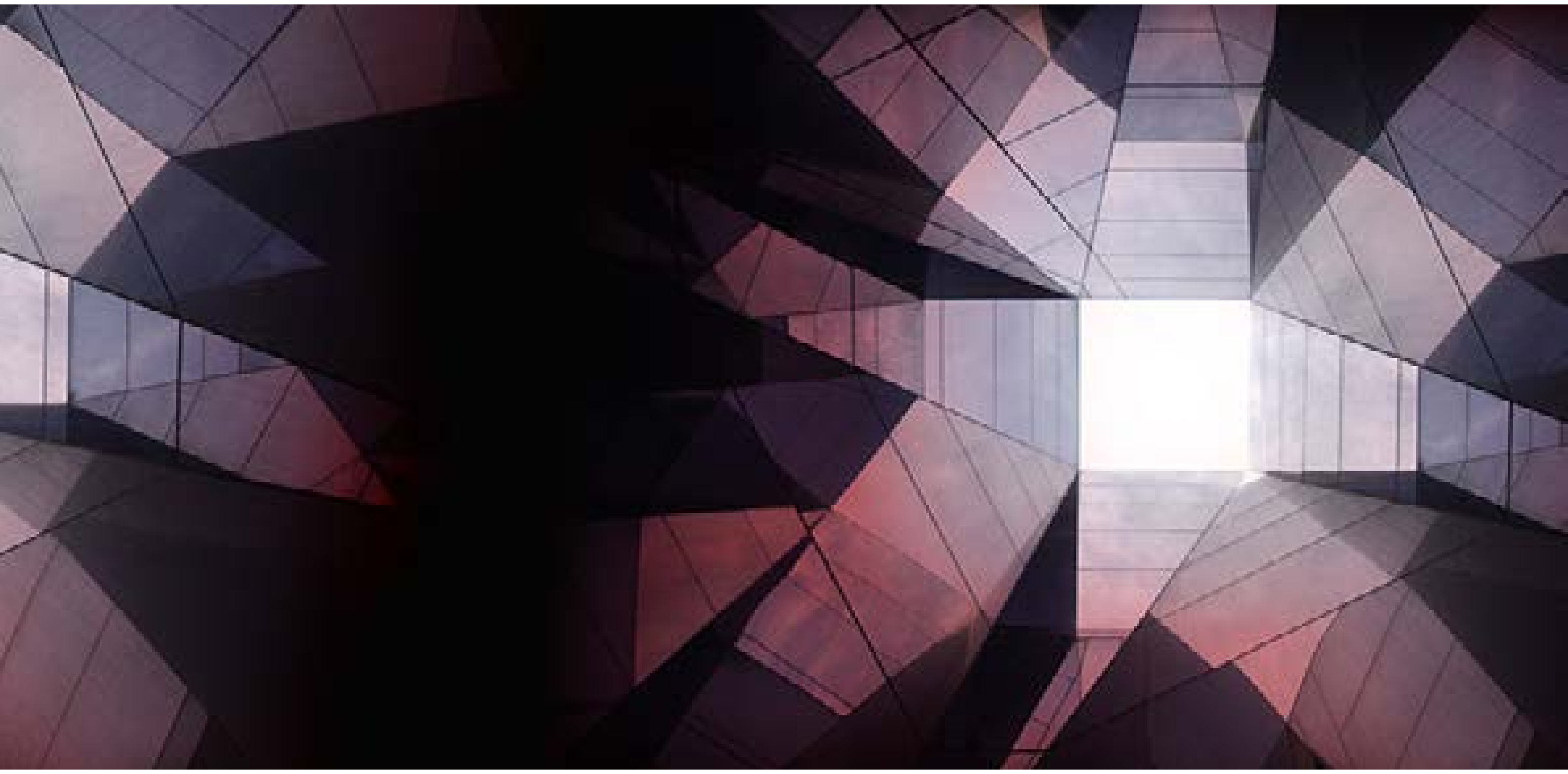


Government Asset Recycling
Making more achievable

Greater bang for funding buck

Applying a new lens to building Australia's infrastructure pool.

Asset recycling in the spotlight

Getting superior bang for capital spending buck and maximising infrastructure asset usage and value has always been important to governments (and their local communities). Increasing investment in infrastructure to meet the long-term social service and economic needs of the nation is clearly a key policy objective and commitment of the current Federal and State Government.

The announcement of the Commonwealth's Infrastructure Growth Package (IGP) earlier this year presents significant opportunities for the states and territory governments to progress building key new infrastructure. However the challenge before them is making sure that they balance longer term service standard requirements against short term infrastructure gains. Picking the right assets to divest requires a 'customer lens' to be applied.

The IGP (and its two components – the $5 billion Asset Recycling Initiative (ARI) and $6.6 billion for new infrastructure investments) represents a unique value proposition for the states and territories. This was evidenced by their collective signing of a Council of Australian Governments National Partnership Agreement in 2014.

But if they want to take advantage of opportunities presented by ARI, in particular, quickly fine-tuning their asset strategies with a fresh perspective on whole-of-government and end user outcomes is now required.

The states and territories have only two years to identify, bid and agree with the Commonwealth the assets they will commit to sell, the projected value any sales might unlock, and how this pool of capital will be redirected into new infrastructure investment.

ARI investment assistance eligibility criteria will play a key role in framing their infrastructure and asset strategies, driving a focus, first, on determining which assets should be recycled, and second (and simultaneously), deciding what newly created assets should look like.

Ultimately, they will need to ensure their asset selection process (for investment rather than divestment) meets both the eligibility criteria but also, and more importantly, the long term needs of their communities, customers and users.

Eligibility criteria for funding

For projects to be eligible for funding under the ARI, proposed infrastructure projects must:

1. Demonstrate a clear net positive benefit
2. Enhance the long-term productive capacity of the economy
3. Where possible, provide for enhanced private sector involvement in both the funding and financing of infrastructure.

With importance clearly placed on productive economic impacts and private sector involvement, these very broad criteria can present challenges for state and territory governments and their agencies and departments. For example:

- Assets for which the benefits and productive capacity improvements are not easily quantified
- Assets that are 'office' focused and therefore not typically subject to commercial market competition.

Asset management – the need for change

Since the introduction of the ARI, the spotlight has shone even brighter on state and territory capital assets and capital spending, prompting questions such as:

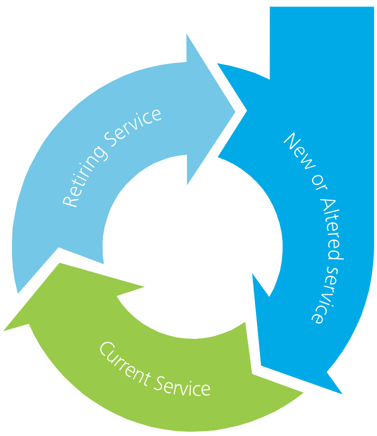
- Are they maximising the use and value of their current assets?
- What are the most efficient forms of asset utilisation and ownership to meet service needs?
- Are current assets actually aligned with service needs and, if not, how can the focus of these assets be changed to meet those needs?
- What is the best role for government – as an owner, an operator, or a regulator?
- And perhaps most importantly of all – can they determine the right, or best, answers to these questions, and develop supporting business cases, to seek agreed Commonwealth funding, complete a sale and commence construction by May 2019[1]?

The following diagram depicts an asset management framework that could be used to help develop responses to some of these questions and 'diagnose' the asset health (and need for investment) of an agency, department and, ultimately, a state or territory.

[1]The Commonwealth's Asset Recycling Initiative requires sale of approved assets to have been completed and commencement of new infrastructure development by May 2019.

Cluster & Agency Strategy

How do services influence the asset portfolio?



New or Altered Service

- Should we procure new assets?
- Can we utilise current (Cluster) assets?
- Can we change the focus of current assets to meet service need?

Current Service

- Do we have the most efficient form of asset utilisation to meet the service need?
- Does the service utilise the asset fully?
- Can assets be held more efficiently by private sector, whilst maintaining service delivery?

Retiring Service

- Should we dispose of the associated assets?
- Should we hold the asset for future service needs?

How do assets influence the services portfolio?

Asset Strategy & Planning

- What services utilise our current asset portfolio?
- What return, if any, are we anticipating from the portfolio?

Asset Concept Design & Build

- Will redefining an asset make it more attractive to other/new services?
- Do we have the most efficient form of design, construct, operate and maintain (e.g. GOCO. Government owned Company)?
- Are design standards optimised to fulfil service need at lowest cost?

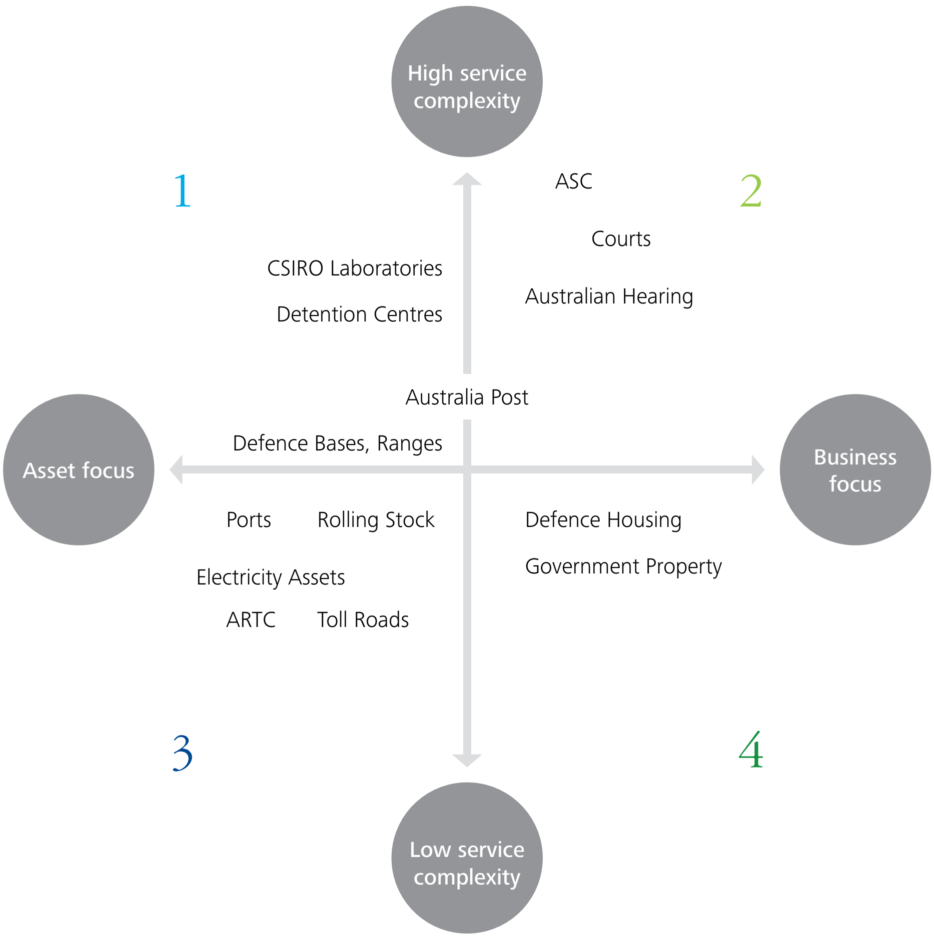
Operations & Redefinition

- How will the asset impact service costs?
- Will the asset be funded by the service?
- Do other underutilised assets fulfil the service need?
- Is the proposed asset the most efficient form of fulfilling the service need?

Applying a different lens

While understanding consumer impacts can be complex, the following matrix has been developed to help state and territory governments understand the breadth and depth of available divestment opportunities, frame solutions to elicit private sector involvement and investment, and determine and prioritise opportunities that meet ARI requirements[2].

Considering the use of government assets along two continua (a) complexity and (b) business focus, is a useful way to help highlight which assets could have greater customer impacts in service delivery compared to others. Those 'high' on either axis (and especially if high on both, see quadrant two in the matrix below) will require consideration beyond purely asset value. The connected service delivery is integral to the asset's value (in non-typical infrastructure valuation amounts) therefore any divestment strategy will need a corresponding sophisticated review and strategy for ensuring the continuity of customer services in the future.



[2]We note that some of the items are Federal and not eligible for funding under the ARI, however the government's intent is nevertheless to consider those assets for recycling.

Service delivery model

Thinking through the service delivery model, how the assets are utilised, and the investor profile for the assets, will help finesse the approach and strategy for asset divestment and investment opportunities.

1. Recycling of, or investment in, assets linked to complex service delivery, but where the asset still plays a key role, will require a different 'marketing' and contestability solution, and involve strategic market sounding to determine investment appetite. The divestment of these assets may be challenging, particularly where the private sector may already have better 'facilities'.

2. Recycling of assets which are used in the delivery of a highly complex service, and have a strong business focus (such as land title offices) may be challenging to take to market, again since the private sector may already have access to similar or better facilities. However there is an opportunity to generate interest for new investment based on potential associated revenue streams (eg leases), particularly if these assets are straightforward to run and the current government services being delivered in/through them can relatively easily be moved to other lower cost locations or assets, or moved to more technology-linked delivery modes.

3. Assets where the related service delivery is not complex, but is heavily reliant on a large 'expensive' asset, will be attractive to the private sector based on certainty of attached future revenue streams. Often these assets can be attractive based on this revenue, however can result in cost and/or service implications which are not beneficial to the community. These considerations need to be weighed up, particularly if the asset is being put forward for sale (e.g. service vs proceeds).

4. Recycling of assets which are connected to low complexity service delivery and whose outcome is business rather than asset related, would appeal to a certain type of investor (eg residential defence house properties), which would fall in this quadrant, have previously been 'sold' into an investment trust vehicle.

Conclusion

Prioritising asset recycling opportunities involves careful and well informed analysis and planning, viewed through both service and timing lenses.

Ultimately, two key questions need to be answered:

1. What are the future service requirements (segmented by industry/geography/sector)?
2. What asset (if at all – by type, size, location, current, new etc) is best able to deliver to these requirements in the most effective, efficient and productive way?

Opportunities to leverage the Commonwealth's ARI can be understood by carefully considering state and territory asset pools and strategies, which may qualify unconsidered or less obvious divestment opportunities that are attractive to the private sector.

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