Review of the National Partnership Agreement on Asset Recycling

27 September 2018

EY

Building a better working world

Jane Holmes
Structural Reform Group
The Treasury
Level 6, 120 Collins St,
Melbourne VIC 3000

Review of the National Partnership Agreement on Asset Recycling

Dear Jane,

Ernst & Young was engaged on the instructions of the Treasury to conduct a review of the National Partnership Agreement on Asset Recycling, in accordance with the work order dated 19 June 2018.

The results of Ernst & Young's work, including the assumptions and qualifications made in preparing the report, are set out in Ernst & Young's report dated 27 September 2018 ("Report"). The Report should be read in its entirety including the cover letter, the applicable scope of the work and any limitations. A reference to the Report includes any part of the Report. No further work has been undertaken by Ernst & Young since the date of the Report to update it.

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Yours sincerely,

Dean Yates
Partner

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Terms of reference

Review of the National Partnership Agreement on Asset Recycling

Context

1. The National Partnership Agreement on Asset Recycling ('the Agreement') commenced on 2 May 2014 and expires on 30 June 2019.
2. The Agreement was designed to assist in addressing State and Territory funding constraints that limited their ability to invest in additional economic infrastructure. It aimed to increase investment in productivity enhancing infrastructure by encouraging the sale of state-owned assets to unlock funds and recycle the capital into additional infrastructure.
3. The Agreement requires a review to be completed approximately 12 months prior to expiry (clause 36).

Scope

4. The review will examine the extent to which the objective and outcomes of the Agreement have been achieved. In particular the review will consider the extent to which the Agreement:
   4.1. Reduced funding constraints for additional infrastructure investment
   4.2. Increased economic activity, employment and improved living standards, and
   4.3. Enhanced the productive capacity of the economy.
5. In addition, the review will consider whether the objective and outcomes of the Agreement have been achieved by:
   5.1. Selling state-owned assets, and
   5.2. Increasing investment in additional economic productive infrastructure.

Process for conducting the review

6. The Commonwealth Treasury shall be responsible for ensuring that the conduct of the review is in accordance with the requirements of the Agreement and the federal financial relations framework.
7. The review will be undertaken by an independent evaluator reporting to the Project Lead, Structural Reform Group, Commonwealth Treasury.
8. The Commonwealth and all relevant States and Territories will be invited to participate in the review, including through a mix of written correspondence, teleconferences and face-to-face meetings, as appropriate.
9. The review is expected to be completed by July 2018.

Review outcomes

10. A report on the outcomes of the review will be prepared by the Commonwealth Treasury.

Executive summary

EY was engaged by the Treasury to undertake a review of the National Partnership Agreement on Asset Recycling (the NPA). Specifically, the review was to examine the extent to which the objectives and outcomes of the NPA, in relation to reducing funding constraints for additional infrastructure, increasing economic activity and enhancing productive capacity, have been achieved. In conducting the review, EY was asked to investigate three basic questions on the:

- Effectiveness of the NPA
- Efficiency of the outputs of the NPA
- Appropriateness of the policy or program.

In undertaking the review, consultation was undertaken with jurisdictions and infrastructure agencies. Key findings and themes from the stakeholder consultations are presented in this report. EY performed a desktop review of publicly available information to support comments made by jurisdictions where applicable, but was not required to interpret or assess the views expressed by stakeholders or to make recommendations.

Effectiveness in achieving the outcomes and objectives of the NPA

Based on stakeholder comments, the NPA has been effective in achieving its outcomes and objectives in relation to reducing funding constraints for additional infrastructure, increasing economic activity and enhancing productive capacity, for jurisdictions that participated in the NPA.

For those jurisdictions that participated, these outcomes and objectives were achieved by selling state owned assets and investing in additional economic infrastructure. The NPA supported the achievement of certain state-led reforms to divest assets and to invest in economic infrastructure, and in some cases brought forward the timing of those reforms but generally did not catalyse consideration of new divestments or reinvestments.

The effectiveness of the NPA overall in achieving its outcomes and objectives was constrained:

- Many jurisdictions did not participate by nominating assets for divestment, either because asset divestment was not a policy priority at the time, or because there were no assets ready for sale within the NPA timeframes.
- Non-physical assets were not considered eligible for consideration as asset divestment or required lengthy negotiations prior to being approved, and assets already considered as state priorities did not qualify as "additional" infrastructure.
- Some jurisdictions reported difficulties in reaching agreement on what was "additional" investment, and that the NPA effectively encouraged them to put forward projects that were not necessarily considered the highest priority under well-considered state infrastructure strategies, since in some cases, the highest priority projects already have funding committed and was not considered additional.
- The funding pool was reduced when not all of the funding available at 30 June 2016 had been allocated. A cap was placed on the reduced funding pool with some jurisdictions commenting that they were unable to receive additional funding where actual sale proceeds exceeded initial estimates.

Efficiency in delivering on the outputs of the NPA

The level of Commonwealth incentive payments for jurisdictions that participated under the NPA had a positive influence in bringing forward the timing of asset divestment and reinvestment, as well as generating a commensurate level of reinvestment from jurisdictions.

The level of efficiency in implementing asset divestment and reinvestment was variable with some jurisdictions experiencing confusion, delays or barriers:

- The timeframes provided under the NPA were a barrier for some jurisdictions to deliver on the asset divestments and reinvestment, where preliminary scoping of projects had not already been undertaken.
- No formal consultation or advice was provided by the Commonwealth when the funding pool was decreased, with some jurisdictions experiencing uncertainty in the availability of funding.
- Some jurisdictions experienced delays in payment and greater reporting burden as a result of requesting changes to asset schedules or where there were multiple small assets being divested.
- Some agencies suggested that the terms and conditions of the NPA were applied inconsistently between jurisdictions, with some projects being approved for investment that were not business case ready.
- Infrastructure Australia (IA) and Department of Infrastructure, Regional Development and Cities (DIRDC) provided a review and an advisory function on the reinvestment projects proposed by jurisdictions, given IA has a mandate in reviewing projects where Commonwealth investment exceeds $100 million, and DIRDC administers the National Partnership Agreement on Land Transport Infrastructure Projects. The roles of IA and DIRDC were not specified in the NPA and some jurisdictions reported being unclear about their roles.

Appropriateness of the policy under the NPA in the future

While the willingness and capacity for jurisdictions to undertake large scale asset divestments in the future may be limited by policy priorities at the time, jurisdictions would welcome the opportunity for further collaboration with the Commonwealth to undertake future reforms.

In order to provide a degree of flexibility in which reinvestment projects are undertaken, jurisdictions argued that it would be better if funding and monitoring requirements were tied to outcomes rather than specific projects. Further, some jurisdictions were of the view that the 15% funding contribution was too low considering the level of direction and oversight required by the Commonwealth. A higher funding contribution percentage could have incentivised more jurisdictions to participate in the NPA, however, the reasons for non-participation were varied between jurisdictions and it is difficult to draw conclusions on the adequacy of the 15% funding contribution.

The structure of the report

The findings have been structured under the following headings, in line with the section of the NPA:

- Objectives, outcomes and outputs
- Roles and responsibilities
- Financial arrangements
- Performance monitoring and reporting
- Future of the NPA.

As some findings relate to more than one question, the following table provides a mapping of the findings discussed in the following sections against the questions of effectiveness, efficiency and appropriateness.

Question	Finding numbers
Effectiveness	1, 2, 3, 4, 5, 8
Efficiency	4, 6, 7, 8, 9, 10, 11, 14, 15
Appropriateness	5, 12, 13, 14, 15

About the review

1. The NPA on Asset Recycling

In the 2014-15 Budget the Government committed $5 billion in funding to the Asset Recycling Initiative (ARI). The ARI provides incentive payments to state and territory governments that sell government owned assets and reinvest the proceeds into additional economic infrastructure. The initiative is administered by the Commonwealth Treasury in accordance with the NPA on Asset Recycling.

The NPA was signed on 2 May 2014 and will expire on 30 June 2019. The outcomes articulated in the Agreement are:

- Reduced funding constraints for additional infrastructure investment
- Increased economic activity, employment and improved living standards
- Enhanced productive capacity of the economy.

The NPA sets out the eligibility criteria for asset sales and infrastructure investments and the conditions under which the incentive payments will be made.

The Commonwealth and state and territory governments were required to agree asset divestments and additional projects to be funded under the NPA by 30 June 2016. The Commonwealth reached bilateral ARI agreements with New South Wales, Australian Capital Territory and Northern Territory governments, worth a combined $2.3 billion.

New South Wales

Date of agreement: March 2015

Funding: $2.19 billion

Examples of project funded: Sydney Metro, Smart Motorways, Parramatta Light Rail, Pinch Points and Clearways.

Australian Capital Territory

Date of agreement: February 2015

Funding: $67.14 million

Examples of projects funded: Canberra Light Rail.

Northern Territory

Date of agreement: May 2016

Funding: $40.40 million

Examples of projects funded: Ship lift and Marine Industries project, Roper Highway upgrade, Tanami Road upgrade, T-Gen project.

2. Scope of the review

EY was engaged by the Treasury to undertake a review of the NPA. Specifically, the review was to examine the extent to which the objectives and outcomes of the NPA in relation to reducing funding constraints for additional economic infrastructure, increasing economic activity and enhancing productive capacity have been achieved.

In addition, the review is to consider whether the objectives and outcomes of the NPA have been achieved by:

- Selling state-owned assets
- Investing in additional economic infrastructure.

3. Methodology

Design

The project commenced with designing the questions to guide the review, which were developed in consultation with the Treasury (Appendix A). The review questions were informed and guided by the Terms of Reference for the Review, and the Federal Financial Relations 'A Short Guide to Reviewing National Partnerships'.[1] These questions were aimed to investigate three main issues:

- The effectiveness of the NPA
- The efficiency of the outputs
- The appropriateness of the policy or program.

Consult

The consultation process included teleconferences or face-to-face meetings with jurisdictions and infrastructure agencies.

1. **Face-to-face or teleconference consultations** were conducted to discuss the review questions. Prior to the consultations, participants were sent the review questions.
2. **A written summary** of the consultation notes was distributed to the meeting attendees for any clarifications and further comments.

All jurisdictions were contacted and offered the opportunity to provide input into the review. The stakeholders that agreed to be consulted included:

- Australian Capital Territory (ACT) Treasury
- New South Wales (NSW) Treasury
- Department of Treasury and Finance Victoria (VIC)
- Department of Treasury and Finance Tasmania
- Department of Treasury Western Australia
- Department of Treasury and Finance South Australia (SA)
- Department of Treasury and Finance Northern Territory (NT)
- Infrastructure Australia
- Infrastructure Partnerships Australia
- Department of Infrastructure, Regional Development and Cities.

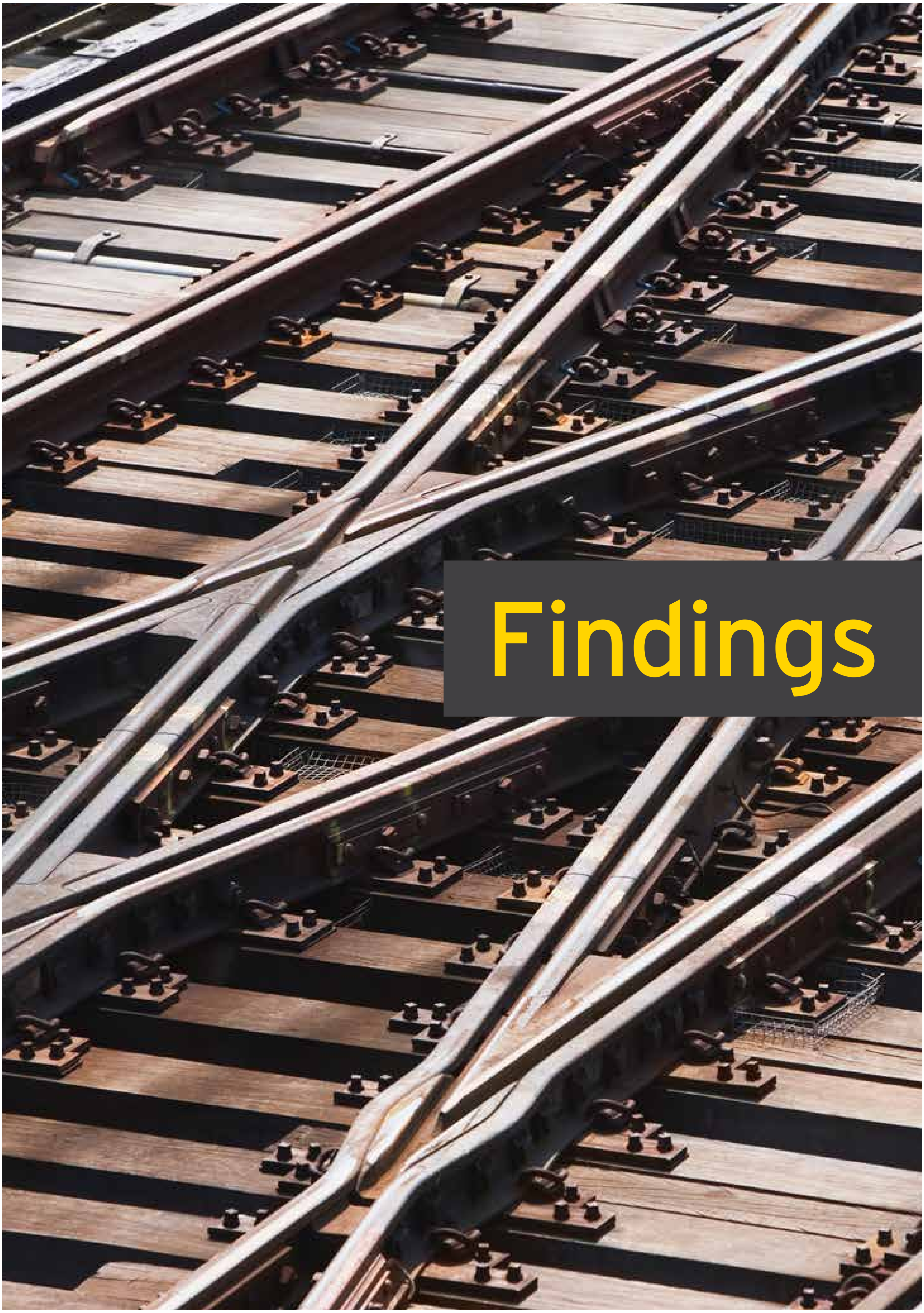
Queensland Treasury declined the opportunity to participate in the review.

Consider and report

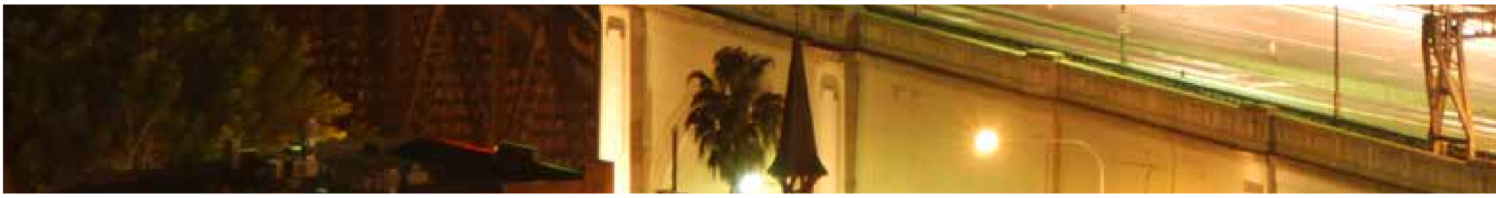
The consultation notes were analysed to identify key findings and themes of the review which are presented in this report. EY performed a desktop review of public available information to support comments made by jurisdictions where applicable. EY was not required to interpret or assess the views expressed by stakeholders or to make recommendations.

1. Federal Financial Relations (2015) A Short Guide to Reviewing National Partnerships, http://www.federalfinancialrelations.gov.au/content/guidelines/Short-Guide_review_2015.pdf. This guidance document was referred to in developing the review questions.

Findings



Summary of key findings



Objectives, outcomes and outputs

1. Funding constraints were reduced for jurisdictions that participated in the NPA, with Commonwealth funding providing impetus for asset divestments

Comments relating to the NPA

For jurisdictions that participated in the NPA, Commonwealth funding provided for asset recycling did help reduce funding constraints through supporting the achievement of certain state-led reforms, as opposed to catalysing consideration of new divestments. The NPA did this by helping garner additional community support for the implementation of such reforms. The Commonwealth funding and policy support provided additional momentum and incentive for government decisions to be made. It also clearly demonstrated to the community that not only did the Commonwealth support the divestment, but that it would also ensure proceeds were directed to new economic assets.

Jurisdictions commented that asset divestment meant greater capacity on the balance sheet, with debt levels maintained within reasonable parameters. NSW attributed low debt levels to continued surpluses and its asset recycling strategy, with $18.2 billion of the gross sale proceeds allocated to debt repayments.[2] Further, proceeds from asset sales alleviated fiscal pressures in the NSW forward estimates.[3] The ACT noted that asset sales allowed it to "restructure [its] balance sheet" and invest in economic infrastructure.[4]

Comments relating to the administration of the NPA

There was also some feedback that the Commonwealth needed to be more sensitive in the need to maintain confidentiality for commercially sensitive information during a transaction for the purpose of public announcements. An instance was reported where NPA timelines were at odds with the time needed to optimise the sale value of a particular transaction. Such a situation was regarded as working against the objective of relieving funding constraints.

Some jurisdictions also suggested that the Commonwealth's application of the NPA in relation to asset sales constrained their ability to participate. For example, financial assets, such as selling a stream of income to the private sector or withdrawing from a regulated financial market and allowing the private sector to enter, were either considered ineligible or required lengthy negotiations before it was considered eligible under the NPA. In such instances, funding constraints for those jurisdictions were not reduced.

2. NSW Government, Budget Paper No. 2: Budget Statement 2017-18, p 1 - 4.
3. NSW Government, Budget Paper No. 1: Budget Statement 2015-16, p 2 - 9.
4. ACT Government, Budget Paper 3: Budget 2015-16, p24.

2. Economic activity increased for jurisdictions that participated in the NPA

Comments relating to the NPA

The experience of jurisdictions differed depending on their participation in the NPA. For jurisdictions that participated, the level of total reinvestment ranged from more than $14 billion[5] in NSW, almost $448 million in the ACT[6] and more than $269 million in the NT.[7]

Feedback from jurisdictions that participated in the NPA is that the investment in infrastructure negotiated under the NPA produced an increase in economic activity through, for example, increased construction activity and employment. There is limited publicly available information on the additional economic activity that is directly attributable to the NPA. In general, NSW has experienced higher than average annual employment growth since April 2015, with over 192,000 additional people being employed.[8] Over a year to February 2017, NSW's total annual average employment growth was 1.4%, and construction accounted for 1 percentage point of growth.[9] In the ACT, over 3,500 jobs were supported by the Canberra Light Rail in 2017 – the major project funded by the NPA.[10] The NT also acknowledged that investment in economic infrastructure is necessary to create jobs and stimulate its economy.[11]

It was commented that the support under the NPA for projects that meet long term economic infrastructure opportunities in regional economies also allowed additional scope for jurisdictions to nominate projects that may not have met the condition that projects demonstrate "clear net positive benefits".

An infrastructure agency commented that the NPA complemented other initiatives at the time, for example by helping to fund passenger rail projects (such as the Sydney Metro in NSW and the Canberra Light Rail in the ACT) that would not have been funded under the National Partnership Agreement on Land Transport Infrastructure Projects. The ARI NPA was introduced at a time when the Australian Government's policy was focused on road and freight rail projects.

5. Schedule to the NPA, New South Wales Asset Divestments and Projects, Schedule B, p B - 6.
6. Schedule to the NPA, Australian Capital Territory, Schedule A, p A - 6.
7. Schedule to the NPA, Northern Territory, Schedule C, p C - 3.
8. NSW Government, 2017-18 Budget Papers, Budget Paper 1: Budget Statement, p 3 - 4.
9. ibid
10. ACT Government, Budget 2017-18, Budget Paper 2: Budget in Brief, p36.
11. NT Government, Budget 2017-18, Northern Territory Economy, p6.

3. Productive capacity increased for jurisdictions that participated in the NPA

Comments relating to the NPA

It is too early to determine if the productive capacity of the economy has been enhanced by the NPA. However, jurisdictions that participated in the NPA expressed a view that it had a positive influence on productive capacity, for example:

- A productivity gain was generated by asset divestments, as assets would be managed more efficiently by the private sector.
- Capital deepening of governments allowing for investment decisions that contribute to longer term economic growth.

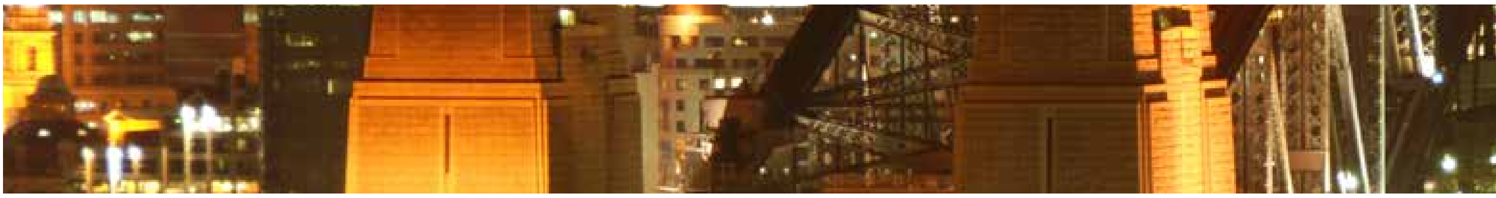
In NSW, the long term lease of electricity assets is anticipated to improve efficiency and reduce the pressure on electricity prices in the future.[12] The factors that affect electricity prices are complex and it is difficult to attribute price movements to specific factors such as the NPA. The Independent Pricing and Regulatory Tribunal (IPART) in NSW has found that since 2013-14, the average bill for residential customers has increased by 2% due to rising wholesale costs, however, in real terms this is in fact a 5% price reduction.[13]

Comments relating to the administration of the NPA

Some jurisdictions reported difficulties in reaching agreement on what was "additional" investment, and that this process effectively encouraged them to put forward projects that were not necessarily considered the highest priority under well-considered state infrastructure strategies (this is because in some cases highest priority projects already have funding committed). Therefore, to the extent that the NPA directed investment to lower priority projects, this may have resulted in a lower boost to productive capacity than may have otherwise been achieved.

12. NSW State Infrastructure Strategy, http://www.infrastructure.nsw.gov.au/media/1141/sis_report_section110_print.pdf

13. IPART, https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/investigation-compliance-monitoring-electricity-publications-market-monitoring-201617/fact-sheet-performance-of-the-nsw-retail-electricity-market-201617.pdf



Objectives, outcomes and outputs

4. The level of Commonwealth incentive payments for jurisdictions that participated under the NPA had a positive influence in bringing forward the timing of asset divestments and reinvestment, as well as generating a commensurate level of reinvestment from jurisdictions

Comments relating to the NPA

Based on comments from consultations, the NPA did have some influence in bringing forward asset divestment for jurisdictions that participated in the NPA. The following estimated incentive payments from the Commonwealth encouraged jurisdictions to proactively sell assets and reinvest proceeds into productivity boosting infrastructure:

- NSW: $2.19 billion[14]
- NT: $40.40 million[15]
- ACT: $67.14 million[16]

In total, it is estimated that around $2.3 billion would be provided to jurisdiction under the NPA, as a 15% uplift on the sale proceeds from asset divestments, generating a similar value (more than $2.2 billion) in reinvestments from jurisdictions.[17]

As discussed in Finding 1, stakeholders commented that Commonwealth support for transactions through available funding played a role in garnering additional community support for infrastructure reform packages. Further, the NPA provided an impetus for government decisions to be made.

It was suggested that the additional balance sheet capacity from the asset divestment allowed reinvestment in projects to be undertaken earlier. For NSW, the programs in the table below were brought forward under its asset recycling program, complemented with funds from the NPA.

Project/Program	Estimated years accelerated
Sydney Metro City and Southwest	5 - 7 years
More Trains, More Services	Up to 2 years
Pinch Points and Clearways	Up to 5 years
M4 Smart Motorway	Previously unfunded
Gateway to the South Pinch Points	Up to 5 years
Northern Beaches B-Line	2 - 5 years

Source: NSW Government, Budget 2017-18, Budget Paper No. 2: Infrastructure Statement, p 3-2.

5. The linkage to asset divestment was the main cause of non-participation

Comments relating to the NPA

Overall, a more generally held view was that the NPA's impact in bringing forward reinvestment was limited because many jurisdictions were not able to participate. The linkage to asset divestment was one of the main causes of non-participation, either because asset divestment was not a policy priority at the time, or because there were no assets ready for sale within the NPA timeframes.

Some states did not support asset divestment as a policy, in particular in the context of Infrastructure Australia's recommendation that suggested some states and territories should privatise their electricity and water businesses.[18] For example, the Queensland Government, in its State Infrastructure Plan, stated that "the Queensland Government does not support asset sales and will not support the recommendation that Queensland should consider divesting all electricity network assets".[19] The Western Australian Government, in the context of the long term lease of Western Power and Horizon Power, stated that "a decision to sell the assets will only be made following confirmation that divestment is in the best interests of taxpayers and electricity consumers".[20]

14. Commonwealth Budget Paper No. 3: Federal Financial Relations 2017-18, p50 and Commonwealth Budget Paper No. 3: Federal Financial Relations 2018-19, p50.
15. Commonwealth Budget Paper No. 3: Federal Financial Relations 2017-18, p50 and Commonwealth Budget Paper No. 3: Federal Financial Relations 2018-19, p50.
16. Commonwealth Budget Paper No. 3: Federal Financial Relations 2017-18, p50 and Commonwealth Budget Paper No. 3: Federal Financial Relations 2018-19, p50; Final Budget Outcome 2014-15, Part 3: Australia's Federal Relations, Attachment A: Payments to the States, p73; Final Budget Outcome 2015-16, Part 3: Australia's Federal Relations, Attachment A: Payments to the States, p73; Final Budget Outcome 2016-17, Part 3: Australia's Federal Relations, Attachment A: Payments to the States, p69.
17. As outlined in Finding 2.
18. http://infrastructureaustralia.gov.au/policy-publications/publications/files/Australian_Infrastructure_Plan.pdf
19. https://dsdmip.qld.gov.au/resources/plan/sip/sip-part-b-2016.pdf
20. https://www.treasury.wa.gov.au/Site-content/Asset-Sales/Updates/Proposed-Long-Term-Lease-of-Western-Power-Networks-and-Horizon-Power-s-North-West-Interconnected-System/

Roles and responsibilities

6. Operational interactions between jurisdictional and Commonwealth Treasury officials worked well however there is scope to improve communication on key decisions

Comments relating to the administration of the NPA

Governance arrangements worked well at the officer level between State Treasury officials and the Commonwealth. It was suggested that having a single point of contact for each party involved in the agreement is a more efficient coordination mechanism than having all relevant agencies (e.g. infrastructure, transport departments, etc.) involved in the communication process.

However, some jurisdictions noted that the Commonwealth did not consult with the jurisdictions or provide formal advice when the available ARI funding pool was decreased. In addition, the two stage funding arrangement under the NPA, where a "true-up"[21] occurs for the payment of the second instalment, added to the uncertainty felt by some jurisdictions when the available funding pool decreased.

According to the 2016-17 Commonwealth Budget Papers, unallocated funds from the ARI were returned following negotiations with jurisdictions, which was expected to decrease payments by $453 million in 2016-17, and $854 million over three years to 2018-19.[22] As signatories to the NPA, jurisdictions indicated they would have welcomed the opportunity to comment prior to this budget decision.

21. Under the NPA, payments are made in two instalments for each project, firstly at the commencement of the sale process based on 50% of the book value of assets, and then finally at the completion of the asset sale and commencement of construction of infrastructure projects. "True up" in this context refers to the reconciliation that occurs for the second payment between the actual proceeds of the asset sale and the first payment from the Commonwealth based on asset book value.

22. Commonwealth of Australia, Budget 2016-17, Budget Strategy and Outlook: Budget Paper No. 1, p 3-28.

7. Further clarity needed around the roles of Infrastructure Australia (IA), Department of Infrastructure, Regional Development and Cities (DIRDC), and line of sight between Treasuries and delivery agencies

Comments relating to the administration of the NPA

Outside the Treasury to Treasury relationships, governance arrangements were less clear. Some of the issues that emerged were:

- **Articulation of IA's and DIRDC's roles under the NPA.** Jurisdictions were asked to provide information to IA and DIRDC on some of the proposed reinvestment projects. IA's mandate is to provide a review function where projects receive more than $100 million in Commonwealth funding. DIRDC was requested by the Commonwealth Treasury to provide input given it administers the National Partnership Agreement on Land Transport Infrastructure Projects. The roles of IA and DIRDC were not specified in the NPA and some jurisdictions reported being unclear about their roles.
- **No line of sight from delivery agencies to project funding** as the NPA has been managed through Treasury officials. This means there is a category of Commonwealth-funded infrastructure projects that have different governance arrangements to those that are managed directly by delivery agencies. This means there are separate assessment and approval processes, as well as separate reporting arrangements.
- **Lack of clarity on how much Commonwealth funding was allocated to each project where the same project receives funding from multiple agreements.** Some transport projects have received funding under both the ARI NPA and the National Partnership Agreement on Land Transport Infrastructure Projects. This means it may be difficult to monitor when certain requirements apply to specific projects, for example, when projects exceed $100 million of Commonwealth funding and therefore should be assessed by IA.

Financial arrangements

8. The NPA timeframe often precluded projects where preliminary analysis had not previously been undertaken and this reduced the impact the NPA had in encouraging additional investment in infrastructure

Comments relating to the NPA

Most stakeholders agreed that the timeframes in the NPA provided an incentive for jurisdictions to make decisions about asset divestment and investment. In particular, the "first come, first served" approach to funding meant that jurisdictions had an incentive to make decisions and it maintained the momentum of the NPA.

Most jurisdictions agreed that the timeframes under the NPA meant that projects selected for divestment or reinvestment would already have been scoped prior to the NPA. The NPA timeframes did not always provide sufficient time, where projects needed to be developed from scratch. Therefore, whether the NPA provided funding for additional economic infrastructure was questioned.

Further, some jurisdictions expressed the view that while the Commonwealth was looking to provide funding for "additional" infrastructure projects under the NPA, the projects also needed to meet the jurisdiction's own overarching infrastructure strategy or priorities. This means jurisdictions may already have done preliminary work to define and scope the projects and therefore these projects may not be considered "additional" under the Commonwealth's definitions. It was suggested that this definition of "additional" infrastructure created an incentive for jurisdictions to put forward projects that were not identified priorities.

The time required to develop new divestment and reinvestment projects depends on a range of factors, such as their overall complexity, size, technical requirements, interdependencies with other projects or government policies, and environmental, financial, and technology risks. As a result, different projects require different timeframes to be ready for procurement, making it difficult to determine what would constitute optimal or sufficient timeframes under a future NPA.

EY was not asked to review documentation of all projects and therefore cannot determine if there was evidence to support the comments made.

9. The structure of the NPA and its funding mechanisms are at times not adequately flexible to deal with changes at the project level or where there are multiple small projects

Comments relating to the administration of the NPA

Based on feedback from the consultation process, the current governance process and funding mechanisms are not well suited to handle arrangements where there are multiple smaller projects that need to be approved for funding, or where there are changes to approved asset schedules.

Under clause 27 to 29 of the NPA, schedules to the NPA need to outline the specific assets to be sold and the additional infrastructure projects subject to reinvestment. Further, the schedules need to be updated by written agreement between the relevant jurisdictions as additional asset sales and infrastructure projects are agreed. Under Clause 37, variation of the Agreement is to be in writing.

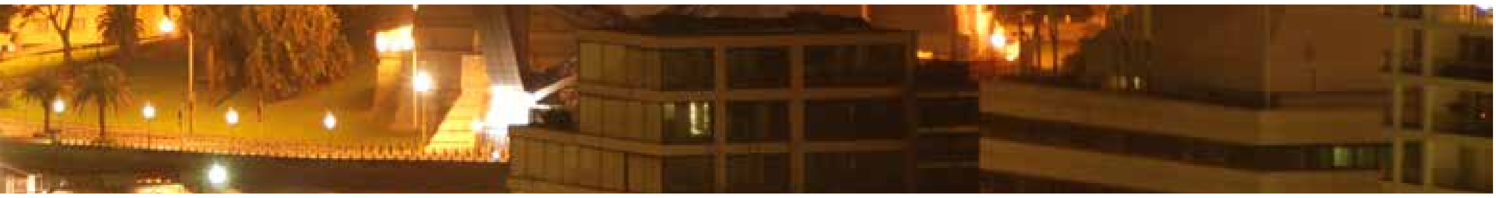
Despite the processes as outlined in the NPA, some jurisdictions have experienced lengthy approval processes for reinvestment projects, or where requests are made to change asset schedules. In relation to approval for reinvestment projects, one jurisdiction claimed it experienced intensive data requirements and no context was provided for the information requested. Jurisdictions also sought further guidance on arrangements for changing approved asset schedules.

The lengthy approval process has also meant that some jurisdictions have experienced delays associated with payments under the NPA.

While the NPA provides consistency across jurisdictions in terms of collaboration with the Commonwealth, it was suggested that more flexibility was needed to accommodate a diverse range of funding needs amongst jurisdictions. For example, flexibility in terms of structure and funding is important where jurisdictions are at different stages of development and implementation.

EY was not asked to examine evidence of payment processes to verify reasons for delays.

To provide additional flexibility in the NPA, funding could be tied to outcomes rather than to specific projects. This is discussed at Finding 14.



10. Inconsistent application of the terms and conditions had a negative impact on stakeholders' perceptions of the NPA

Comments relating to the administration of the NPA

It was suggested by some jurisdictions that the terms and conditions of the NPA were applied inconsistently, with some projects being approved for funding under the NPA that were not business case ready, while some projects were disallowed for the same reason.

For example, it was suggested that some of the projects that were approved for funding under the NPA would not have been funded under the assessment criteria of the National Partnership Agreement on Land Transport Infrastructure Projects, where the criteria is more focused on cost benefit analysis and robust business cases.

EY was not provided full documentation of all projects and cannot determine if there was evidence to support the comments made.

Performance monitoring and reporting

11. Reporting was time consuming when multiple transactions were involved and leveraging jurisdictional reporting processes may be more efficient

Comments relating to the administration of the NPA

As jurisdictions had different divestment and reinvestment timeframes, they are at different stages of undertaking the performance reporting requirements under the NPA. Feedback from those that have more experience in undertaking performance reporting differed depending on the number of assets divested and number of projects reinvested. In general, the feedback was that the reporting requirements were not too onerous, particularly if they only had a limited number of larger transactions or projects.

The Australian National Audit Office (ANAO) reported on the Effectiveness of Monitoring and Payment Arrangements under National Partnership Agreements, and reviewed the level of evidence required to support payment against risk ratings of NPAs, as rated by Treasury. The ANAO found that the level of evidence required for the ARI, in the context of the asset sale of Transgrid in NSW and the ACTTAB in the ACT, was consistent with the risk rating assigned.[23]

However, one jurisdiction suggested the reporting requirements were considerable. It was commented that the Commonwealth reporting requirement changed over time. For example, prior to 2017-18, requests for payment (Statements of Assurance) were separate to updating the schedule of assets (updated once a year in the lead up to the Budget). This process was changed to require an updated schedule of assets with each request for payment. Where there were a large number of smaller assets being sold, this meant that the reporting requirements were substantial. Further, the "true-up" process between market value and book value of assets under the NPA created confusion where there are multiple smaller assets being sold at different points in time. This confusion created a reporting burden where an updated schedule of assets is required each time a payment request is made.

It was also suggested that reporting could be more efficient if the Commonwealth process leveraged or mirrored existing jurisdictional reporting arrangements. Jurisdictions have their own investment assurance frameworks and processes. Further, it was argued that separation of payment milestones and reporting milestones could be more efficient for jurisdictions in terms of managing project reporting and avoiding delays in receiving payment. However, it was acknowledged that from a due diligence perspective, payment on milestones was important.

23. Australian National Audit Office, ANAO Report No. 42 2017-18: Effectiveness of Monitoring and Payment Arrangements under National Partnership Agreements, p39-41.

Future of the NPA

12. While participating jurisdictions were supportive of asset recycling, there may be limited capacity to offer large scale asset divestments for future NPAs

Comments relating to the future of the NPA

Most jurisdictions that participated in the NPA and infrastructure agencies were supportive of asset recycling as it could lead to longer term growth. However, jurisdictions that participated also commented that they may have already divested or are in the process of divesting most of their large assets. It was suggested that an assessment of the capacity to undertake further divestment is needed prior to a further NPA on asset recycling, as there may be limited assets available for divestment in jurisdictions. Further, the requirement to divest assets under the NPA also meant that some jurisdictions did not participate.

Going forward, many jurisdictions feel that they would be better prepared for a similar NPA. Some jurisdictions now have long-term infrastructure plans, and would be better placed to identify projects in which to reinvest. By providing an incentive, the current NPA also provided State Treasury officials with a wider forum in which to voice ideas for asset recycling reform.

EY was not asked to review documentation to verify comments made.

13. There is broad support for continued Commonwealth-State collaboration in future reforms

Comments relating to the future of the NPA

There is general support from jurisdictions and infrastructure agencies for future Commonwealth-State collaboration for reform. Areas of broader reforms suggested include:

- Relevant reform recommendations as outlined in IA's Australian Infrastructure Plan, and the Harper review.
- Ascertaining areas where jurisdictions bear short term "pains" (for example loss of revenue or increase in costs in the short term), but the national economy reaps the long term benefits (and in turn the Commonwealth through tax revenue). Examples of reform areas include: better use of infrastructure, land tax, road user charges, maintenance, and operational efficiencies (for example as driven by public transport franchising).
- Identifying specific areas to improve productivity, for example supporting infill/greenfield development.
- Funding for specific programs that achieve an overarching strategy. For example, freight strategy, rail optimisation, road optimisation, and better use of assets generally.

There was some support for future NPAs to include local governments. However, it was acknowledged that the capacity of local governments to undertake reform may need to be developed. Further, the opportunities available for local governments to divest assets and invest in infrastructure may be limited. Local governments generally do not have many substantial assets to recycle, besides water infrastructure and land.

It was suggested that for future NPAs, there should be consideration of whether the level of funding offered by the Commonwealth provides adequate incentive for the jurisdictions to undertake reform. A key incentive for one jurisdiction was that the Commonwealth payment was exempt from GST redistribution. It was suggested the Commonwealth could do sensitivity testing around the amount of funding that would provide enough incentive for jurisdictions to undertake different areas of reform.

Future of the NPA

14. Funding and monitoring could be tied to outcomes rather than specific projects, where the Commonwealth's terms and conditions are proportional to the level of funding

Comments relating to the future of the NPA

It was suggested that the Commonwealth could tie funding to broader policy outcomes, rather than specific projects, and provide funding to jurisdictions to achieve and be accountable for those outcomes.

The National Partnership Agreement on Universal Access to Early Childhood Education – 2018 is an example of a recent intergovernmental agreement where funding is linked to: 1) an agreed implementation plan; and 2) performance against benchmarks for specific outcomes.[24] Adopting a similar outcomes based approach for the NPA on ARI could be achieved through agreement on the desired outcomes, associated performance indicators and performance targets as part of the NPA. This would require clear definitions of the target outcomes, for example, number of, or percentage increase in, additional jobs in the construction industry, reducing travel time for a proportion of the population in metropolitan areas, or a decrease in the debt to asset ratio for jurisdictions.

In general, jurisdictions expressed the view that more flexibility in the reinvestment decision would be desirable. As an example, Commonwealth funding could be provided to deliver on sophisticated business plans. Further, a number of jurisdictions have long term infrastructure strategies and have set up specific funds to support infrastructure investment and the Commonwealth could consider providing funding into existing state arrangements rather than insisting on agreeing specific projects.

While it was recognised that linking divestment and reinvestment in the NPA maintained momentum in the infrastructure sector, it was also suggested that these are two separate decisions. Linking divestment and reinvestment decisions together could have distortive effects and future NPAs should consider these as separate decisions.

It was also suggested that the terms and conditions of the NPA should be proportional to the amount of funding it provides. Even though all jurisdictions signed up to the NPA, a number of jurisdictions felt that the application of it was different and the terms and conditions of the NPA were directive and did not provide flexibility in reinvestment. In the view of some jurisdictions, such an approach is not supported by the 15% uplift on project funds provided by the Commonwealth. The terms and conditions of the NPA were more suited to a situation where the Commonwealth was a full funding partner, rather than just providing a 15% uplift.

A higher funding uplift from the Commonwealth could have incentivised more participation, however, a conclusion cannot be drawn given jurisdictions had different reasons for not participating in the NPA as discussed in Finding 5.

24. http://www.federalfinancialrelations.gov.au/content/npa/education/national-partnership/UAECE_with_all_signatures.pdf

15. Provide clear definitions of key terms in the NPA

Comments relating to the NPA and the future of the NPA

For future NPAs, a specific section on the definition of key terms that are agreed by jurisdictions could streamline the administration of the NPA and avoid lengthy negotiations once the NPA has been signed. During our stakeholder consultations, there have been a number of key terms in the NPA that have generated comments due to their perceived strict application or lack of specific definition, for example:

- Additional infrastructure investment – whether projects that have already been identified as priorities by jurisdictions were considered as "additional".
- Sale of state-owned assets — whether the sale of a financial asset such as a stream of income would be considered as an asset sale.
- True-up under a two stage milestone payment process – confusion in relation to the second stage payment and that the funding pool can be adjusted under the Budget process. To avoid confusion, the NPA could clearly define that the funding pool available for the NPA is subject to the Commonwealth Budget process, and that a review of the available funding pool will be conducted at specified times with written advice being provided of the funding available to jurisdictions.
- Assurance on compliance with Building Codes 2013 - whilst clause 12(f) of the NPA outlines that jurisdictions have the responsibility to provide the necessary assurances to the Commonwealth that only builders with the necessary Australian Government accreditation should be contracted, this could be clearly defined as a requirement of the State of Assurance in clause 33 and 34 to remove doubt on the monitoring arrangements.

Some jurisdictions also suggested changes to terms that have been clearly defined in the NPA. Under the NPA, the second payment milestone requires construction of infrastructure projects to have commenced. Some jurisdictions suggested that the second payment milestone could be defined as when a contract is signed, as that is the point that they consider to be the commencement of an infrastructure project.

Most jurisdictions also highlighted that the performance indicators in the NPA were measures of outputs or activity, and not measures of outcomes as indicated in the NPA.

It was suggested that performance indicators could be developed by considering:

- The efficiencies that are being achieved by recycling assets, for example, in terms of productive capacity unlocked by reinvesting in infrastructure.
- Benchmarking the different NPAs and associated investment programs in participating jurisdictions.
- Benefit realisation metrics in the context of specific projects funded by the NPA, in compliance with business cases and other relevant project studies.

The difficulties in measuring NPA outcomes were noted. In order to collect data to quantify outcomes, there would need to be specific arrangements put in place. For example, measuring the economic activities generated by the projects may be desirable to track the NPA's objectives and outcomes, however, this would require comparison against a counterfactual (i.e. what would have happened if the project did not occur).

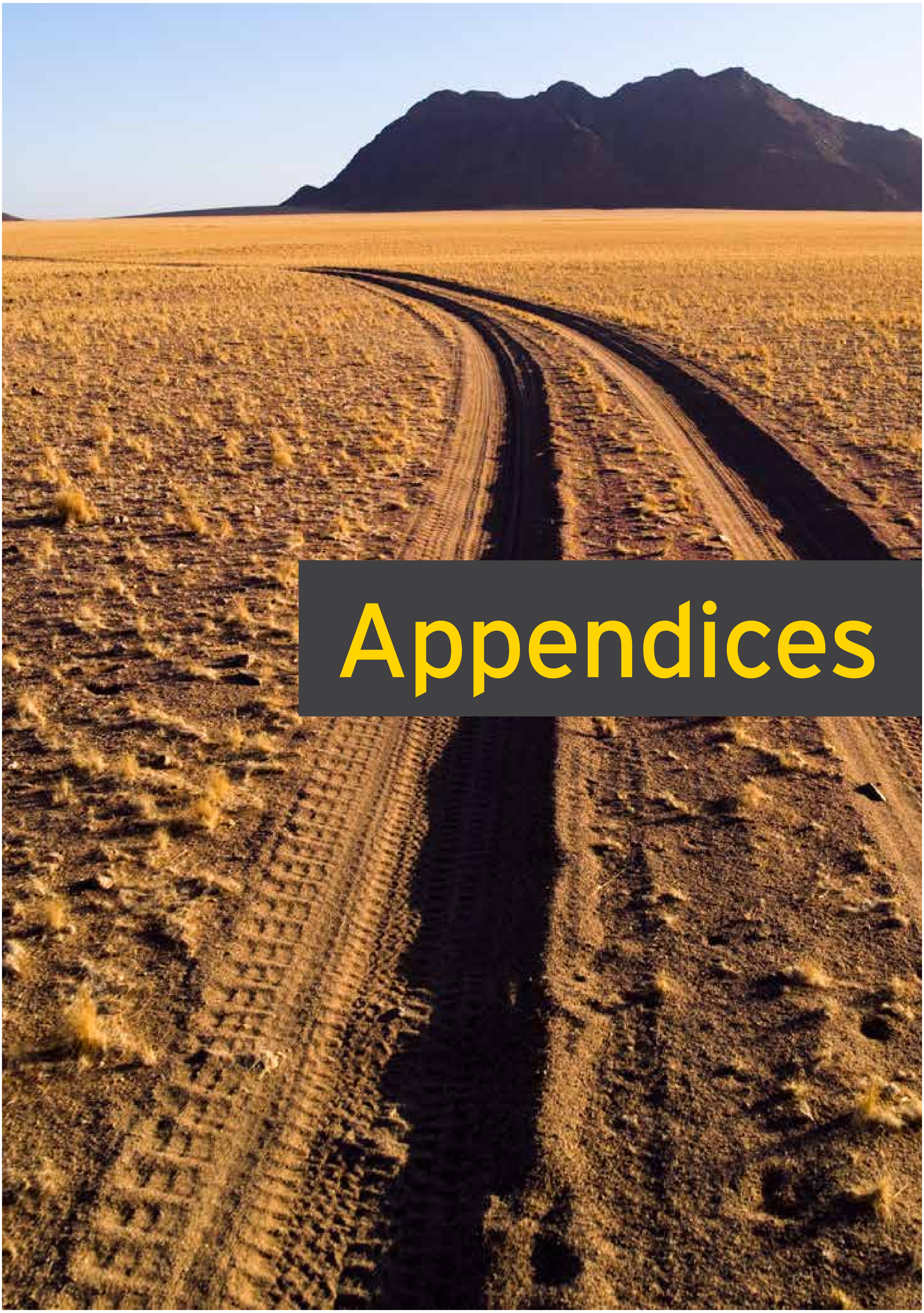
Conclusion

The NPA was effective in achieving the objective and outcomes of reducing funding constraints, increasing economic activity and increasing the productive capacity of the economy. The extent to which it was effective was limited by the fact that only three jurisdictions participated by nominating asset divestments and reinvestments.

The level of efficiency in delivering on the outputs of sale of state-owned assets and investing in additional economic infrastructure was variable for participating jurisdictions depending on the level of preparation that had already been undertaken on eligible projects, whether there were a small number of large projects versus multiple smaller projects, and whether there were changes to asset schedules.

For future NPAs, although participating jurisdictions are in favour of asset recycling, there could be limited willingness and capacity to divest large scale state-owned assets. There is continued support for collaboration between Commonwealth and jurisdictions on reforms in general. Given only three jurisdictions chose to participate under the NPA's terms and conditions, the form of future collaborations between jurisdictions could consider:

- Different areas of reform such as those outlined in the IA's Australian Infrastructure Plan, and the Harper review.
- Levels of funding uplift above 15% to provide greater incentives for jurisdictions to participate, particularly taking into account the level of oversight the Commonwealth is seeking as part of funding agreements.
- Tying funding to outcomes to be achieved rather than specific projects.
- Performance metrics to measure outcomes as well as outputs.



Appendices

Appendix A
Review questions

1. Has the NPA and the successful delivery of projects through the NPA been effective in contributing towards achieving the objectives and outcomes of the agreement, specifically, has it:
    a. reduced funding constraints for additional infrastructure investment; and/or
    b. increased economic activity, employment and improved living standards; and/or
    c. enhanced the productive capacity of the economy?
2. Were the performance metrics in the NPA appropriate in measuring the achievement of the outcomes?
3. To what extent did the NPA increase your State/Territory's capacity to:
    a. sell state-owned assets; and/or
    b. invest in additional economic infrastructure?
4. To what extent did the timeframes provided in the NPA present a barrier to the successful delivery of projects to achieve the objectives and outcomes under the agreement?
5. Are the governance arrangements, roles and responsibilities of parties to the agreement suitable and working effectively?
6. Did the NPA complement DIRDC's existing program of work?
7. What has been your experience with regard to the performance monitoring and reporting arrangements (financial and other), including quality, timeliness, accuracy and appropriateness of reporting arrangements?
    a. To what extent have the performance monitoring and reporting arrangements assisted or hindered the achievement of the objectives?
    b. How have you managed the data collection and performance monitoring and reporting requirements that have been required?
    c. Please provide any additional feedback on the efficiency of performance monitoring and reporting requirements under the NPA.
8. Does there remain a need for Commonwealth and State Government activity and/or collaboration in this policy area, and, if so, should an NPA be maintained? Why / why not?
9. Are the structure of the NPA and its funding mechanisms appropriate for achieving its objectives and outcomes?
10. Please provide any other feedback on the appropriateness or efficiency of the NPA. What changes would you recommend to improve the appropriateness and efficiency of the NPA?
11. Please provide any other feedback on issues that have arisen for your agency in regard to the NPA.

Appendix B

Schedule of consultations

Schedule of consultations				
Jurisdiction	**Agency**	**Date**	**Time (AEST)**	**Face-to-face or teleconference**
Australian Capital Territory	ACT Treasury	22 June 2018	3.30pm - 5.00pm	Face-to-face
New South Wales	NSW Treasury	25 June 2018	9.30am - 11.00am	Face-to-face
–	Infrastructure Partnerships Australia	25 June 2018	11.30am - 12.30pm	Face-to-face
Western Australia	Department of Treasury Western Australia	26 June 2018	4.30pm - 6.00pm	Teleconference
Victoria	Department of Treasury and Finance VIC	27 June 2018	10.00am - 11.30am	Face-to-face
Tasmania	Department of Treasury and Finance Tasmania	27 June 2018	3.15pm - 3.30pm	Teleconference
–	Infrastructure Australia	28 June 2018	9.00am - 10.00am	Face-to-face
Commonwealth	Department of Infrastructure, Regional Development and Cities	28 June 2018	2.00pm - 3.30pm	Face-to-face
South Australia	Department of Treasury and Finance South Australia (SA)	3 July 2018	10.00am - 11.00am	Face-to-face
Northern Territory	Department of Treasury and Finance NT	3 July 2018	11.00am - 12.00pm	Face-to-face

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