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Senator Chris Ketter
Chair Economics References Committee
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Dear Senator

The Foreign Investment Review Framework Inquiry

Industry Super Australia (ISA) – the research and advocacy arm of Industry SuperFunds – is pleased to contribute to the Senate Economic References Committee Inquiry into the Foreign Investment Review Framework.

Our interest in the Review Framework stems from the fact that we have partnered and will continue to partner with foreign entities when bidding to purchase infrastructure assets in Australia and offshore.

Industry SuperFunds

Australian superannuation savings are one of the world's top pools of private retirement savings. Assets stood at close to $2 trillion as of September 2015 and are on a 20-year trajectory towards $6 trillion, rivalling the projected assets of the Australian banking system.

Industry SuperFunds, in particular, are a critical source of patient long-term financing for unlisted assets like infrastructure. An investment time horizon measured in decades and a depth of experience has seen the Funds own, manage and develop key infrastructure that delivers quality value-for-money services to consumers as well as high and more stable returns for our members.

Over and above delivering a more comfortable retirement for our members, the continued expansion of direct long-term investment in infrastructure by superannuation funds supports a virtuous economic cycle of high skill job creation and productivity growth, both of which are critical in the face of an ageing population.

Asset recycling initiative

One of the key challenges faced by Industry SuperFunds is maintaining their desired strategic exposure to infrastructure in the face of strong cash inflows is the sometimes limited pipeline of projects brought by government to market. A limited supply of projects or assets will tend to push up the price of domestic infrastructure assets, and encourage investors, including superannuation funds, to look for opportunities overseas.

A clearer pipeline of brownfield and greenfield infrastructure projects has emerged as a result of the Australian Government's asset recycling initiative. As such, this initiative has served to create new opportunities for investors including superannuation funds.

However, the privatisation of state-owned infrastructure assets can raise significant public concerns which must be addressed, including continued amenity, pricing and employment.

These concerns can be elevated where a foreign investor is involved, and can raise additional concerns, such as the ability of public authorities to maintain oversight of an asset.

Many of these issues can be dealt with by structuring a deal with appropriate contractual and regulatory arrangements to ensure access and pricing meet consumer expectation. However, the public can be rightly concerned when the new owners are motivated by short term incentives to cut costs and jobs and bail out.

Superannuation funds – as long-term investors - have the potential to cut through concerns about private ownership of infrastructure as well as potentially ease concerns over part-ownership of infrastructure by foreign investors. This issue is addressed in the next section.

Addressing concerns about private ownership and foreign investment

Industry SuperFunds have proven themselves to be responsible investors. They seek stable, income generating assets capable of delivering sound returns over a time horizon measured in decades.

The beneficiaries of Industry SuperFunds are Australian residents, and this supports a natural sympathy with the interests of the community.

In short, it makes sense for superannuation funds to manage an asset exactly how the public desires - with a responsible approach to service provision, pricing and employment. In addition, because the Funds are long-term investors, they are likely to invest in assets to improve their efficiency and amenity.

For example, in the 18 years since privatisation, Melbourne Airport's owners (which include Industry SuperFunds) have invested significantly more capital into the asset money than has been returned in dividends on an approximate ratio of 2:1, and have effectively managed the substantial increase in passenger flow, with Melbourne Airports now serving over 30 million passengers a year, almost double the number of passenger 18 years ago.

Research from Newspoll shows public support for privatisation rises from 1 in 10, to 7 in 10, where the new owner is a superannuation fund rather than short-term investors. Where an Australian super fund owns an asset, the public continues to have a direct stake, which results in a balanced approach to ownership because the owners and users will often be the same.

It seems likely that public support for privatisation would increase, where a consortium includes foreign investors, if that consortium was led by an Australian superannuation fund. When it comes to improving the quality of assets, Industry SuperFunds have a track record in making the necessary investment over the life of an asset.

However, if Industry SuperFunds are to take the lead role in a consortium including international financiers, consideration needs to be given to reforming the bid process to lower the barriers to long-term investment. To this end, we have proposed a new competitive bid process known as the Inverted Bid Model.

Inverted Bid Model

Under the current procurement model, Australia's major infrastructure investors including Industry SuperFunds via IFM Investors rarely if ever participate in greenfield infrastructure projects as the leader of a consortium or the primary equity investor.

While deal flow has improved to some extent, very high bid costs and lengthy procurement processes remain obstacles to long-term equity investors. Industry SuperFunds do not see the relative value to divert resources away from brownfield projects despite the fact that their depth of experience, long-term investment time horizon and their appetite for illiquid assets make them ideal partners for greenfield projects.

The current bid process requires a single upfront tender for all aspects of a project including financing – debt and equity – design, construction, operation and maintenance and other project partners/advisors. This process favours short-term financiers/investment banks who depart shortly after financial close.

This results in a major misalignment of interests between the short-term financiers and the long-term interest of the projects. Short term investors are motivated by considerations other than the long-term success of project since they earn their substantial fees upfront and have no long-term stake in the asset. Such investors are motivated to structure a deal based on overly optimistic forecasts because that is how they 'win the bid'.

The Inverted Bid Model addresses this misalignment. Under the proposed model, the traditional bidding process is reversed by fixing the terms of financing through a funding competition followed by separate or bundled bids for other project partners. In other words, government tenders initially for the long-term owner operator before other project partners. This enables the long-term owner operator to add its scrutiny to secure the best outcomes in the tenders for the other aspects of the project.

In addition to aligning the interests of investors and the project, and reducing bid costs, the Inverted Bid Model can also be expected to result in greater completion, value-for money, innovation and transparency. As such, the model has been favourably received by the Australian Government and the OECD. The World Bank and Asian Development Bank consider the model could have international application in helping to unlock pension assets for investment in much needed economic and social infrastructure.

Thank you for the opportunity to contribute to this important inquiry.

Yours sincerely

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