

Asset Management and Capital Investment Program

Introduction

- 2.1 Defence manages approximately \$71.5 billion of total assets. During the 2012-13 financial year, Defence continued efforts to improve its financial and asset management capabilities. Some of the highlights mentioned in the *Defence Annual Report 2012-13* include moving to a shared service delivery model for asset accounting and a maturing data assurance network to swiftly identify and resolve asset management issues as they occur.¹
- 2.2 The Approved Major Capital Investment Program consists of those projects that cost more than \$20 million and which, following approval, have been transferred from the Defence Capability Plan (DCP) to the Defence Materiel Organisation (DMO) for the management of their acquisition. During the 2012-13 financial year, a total of 27 projects were approved with a combined value of \$4.3 billion.²

Base rationalisation

Background

- 2.3 The management of Defence bases is conducted in accordance with the Government's strategic basing principles:

¹ *Defence Annual Report 2012-13*, p. 149.

² *Defence Annual Report 2012-13*, p. 151.

- Australian Defence Force (ADF) base locations should align with Australia's strategic requirements and ensure critical capabilities are dispersed for security reasons;
- functions at Joint and Service levels should be aligned to consolidate units into fewer, larger and sustainable multi-user bases;
- bases should be positioned near industry and strategic infrastructure to maximise opportunities for industry support;
- to improve personnel retention, bases should be located in 'family friendly' areas wherever possible; and
- the urban and regional disposition of bases should facilitate the provision of reservist and cadet capabilities.³

2.4 In line with these principles, the 2012 Force Posture Review assessed whether the ADF was correctly positioned to meet the current and future strategic challenges facing Australia. The Review concluded that although Australia's strategic environment does not necessitate widespread changes in the location of ADF bases, some bases and training facilities needed to be upgraded. These upgrades were focused on improving the capacity of bases, facilities and training areas to support the future capabilities of the ADF.⁴

2.5 Addressing the concerns raised in the 2012 Force Posture Review, the 2013 *Defence White Paper* proposed a reduction in the number of inefficient defence bases and facilities that required constant maintenance and support. The 2013 *Defence White Paper* further stated that:

The Government has directed Defence to pursue estate consolidation in accordance with the broad plan developed by the Defence Estate Consolidation Project. Defence will consult fully with stakeholders in implementing these plans and in bringing forward individual proposals for Government consideration. Defence will also continue to remediate its ageing bases and facilities, prioritising estate works based on safety of personnel and support to capability.⁵

Enhancing the efficiency of base rationalisation

2.6 Speaking to the Committee on base rationalisation, Defence reaffirmed its ongoing consolidation of capability units into super-bases such as RAAF Base Amberley, RAAF Base Edinburgh and Gallipoli Barracks. These

3 *The Strategic Reform Program 2009: Delivering Force 2030*, p. 23.

4 *2013 Defence White Paper*, p. 47.

5 *2013 Defence White Paper*, p. 52.

efforts have been designed to ensure the cost-effective delivery and sustainment of ADF capability. Defence also acknowledged that it has been considering a different approach to base rationalisation that places greater emphasis on cost-effectiveness as opposed to force structure.⁶

2.7 The Committee noted that most of Defence's recent base activity has occurred in the northern parts of Australia. The Committee questioned whether the lack of potential respite postings in more temperate areas was an issue for staff and personnel.

2.8 Defence stated that there were differing perspectives on this issue across all three services. For Navy, there is an ongoing difficulty to try and move personnel from postings in the north of Australia to the South. Defence also discussed the general perspective of the Army on this issue:

From Army's perspective two things have occurred that provide relief from tropical postings – Townsville and/or Darwin, and Darwin in particular. There is the building up of Edinburgh in South Australia; 7RAR are moving down there and other elements of the 1st Brigade. I was up at 1st Brigade only about three weeks ago. They are still working out exactly what the mix is in the headquarters element that is down there, and the administrative element, but you are getting a better division now. So the 1st Brigade split between Darwin and Townsville needs to settle, but there are at least opportunities now for people to move between those two locations. We have not had an infantry battalion in South Australia for a long time – when 3RAR came to Holsworthy back in the eighties – so I think that has been of help.

The second aspect would be Plan BEERSHEBA turning the three brigades, which are quite dissimilar in capability, into similar brigades. That will spread the armoured corps in particular further around the country – down into Brisbane – particularly the armoured capability tanks. I think that as that settles down over time there will be more opportunity for people to move around at least four major army bases. Two of those are out of the tropics and two will be in the tropics.⁷

2.9 With this in mind, the Committee queried the rationale behind the recent reduction of Paterson Barracks in Tasmania given the small distribution of defence capability and bases already within the state. Defence remarked

6 Mr Richardson, Department of Defence, *Transcript*, 6 June 2014, p. 22.

7 Gen Hurley, Australian Defence Force, *Transcript*, 6 June 2014, p. 23.

that this constituted part of the Army's broader base rationalisation to reposition their reserve and regular units.⁸

Disposal of land

2.10 The Committee enquired as to how Defence manages the disposal of its land assets.

2.11 Defence responded that the nature of land disposal is case-specific for each property. When questioned over the length of time for the disposal process once the Department of Finance has authorised the disposal, Defence stated that sign-off generally occurs towards the end of the process. Defence elaborated that this can sometimes be a protracted process:

For example, if it is a priority sale to a local government there can be extended negotiations about the value that would be involved in that sale. Sometimes priority sales are at market value but sometimes they are not at market value, and that would be an agreement through government. I would say that usually within a few months of Finance sign-off we should be well into the market in terms of selling processes.⁹

2.12 Defence told the Committee that there is a disposal list which is regularly updated and reviewed. When a Defence asset is to be disposed of, the Australian Valuation Office provides an initial quantitative evaluation as a basis from which to negotiate with potential sellers. If a property is to be sold on the open market, Defence then informs the professional selling agency of the target selling price. When questioned further on the tendering process and structure, Defence stated that:

It could be varied but, if I look at the way we sold Fortuna Villa in Bendigo at the beginning of last year, that was through an open market tender process, using a local real estate agent with instructions to maximise the value to the Commonwealth from that sale.¹⁰

2.13 Defence told the Committee that it also engages with local government and state authorities over properties likely to be disposed. It is openly approached by local governments with expressions of interest and

8 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 23.

9 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 24.

10 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 24.

preliminary requests for priority sale agreements for properties open for disposal.¹¹

- 2.14 The Committee asked how much land had been gifted, assigned or transferred on peppercorn lease arrangements, and to which organisations since 1 January 2007. Defence offered the following remarks:

Defence has gifted 120 000 square metres of the former Jezzine Barracks in Townsville, Queensland, to the Townsville City Council for community use and heritage protection.

Defence has identified 82 774 845 square metres of land (where figures are readily available) that is currently leased under peppercorn arrangements (defined as \$1 per annum if and when demanded).¹²

- 2.15 Defence provided a list of organisations that currently lease this land on a peppercorn basis. This list can be found in Appendix C.

Defence Logistics Transformation Program

- 2.16 The Defence Logistics Transformation Program (DLTP) makes up part of a broader collection of reforms known as the Strategic Reform Program. This program is designed to improve the efficiency and effectiveness of Defence logistics network. The *Defence Annual Report 2012-13* noted that DLTP remains on track to deliver on its stated intent.

- 2.17 The *Defence Annual Report 2012-13* mentions that the Parliamentary Standing Committee on Public Works approved \$752 million in new logistics facilities. Additionally, a significant milestone was achieved with the signing of the Land Material Maintenance contract with Transfield Services (Australia). This agreement consolidates the delivery of equipment maintenance services from three separate contracts into one.¹³

- 2.18 In regards to the DLTP, the Committee sought comment from Defence on the National Storage and Distribution Centre at Moorebank currently nearing completion. Defence responded:

The project is on schedule, particularly if we focus on Moorebank, which is one of the bigger pieces of that project. We are anticipating being in a position to move out of the old storage facilities that we have around Moorebank in the first half of next

11 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 24.

12 Department of Defence, *Submission No. 4*, pp. 2-4.

13 *Defence Annual Report 2012-13*, p. 111.

year and to move into the new facilities, which will come online around that time.¹⁴

- 2.19 Defence confirmed that it is undertaking a significant rationalisation of inventory in new warehouses such as Moorebank in order to reduce the storage of out-dated and old stock. Where possible, Defence ensures as much of this stock is sold on the market.¹⁵

School of Military Engineering

- 2.20 The Committee requested an update on the School of Military Engineering presently under construction in Holsworthy. Defence stated:

We are essentially closing down Steele Barracks, which is the existing school of military engineering, to facilitate the government's intermodal terminal, which will be built in that area. We are moving that school onto Holsworthy Barracks and, as part of that process, taking the opportunity to do some redevelopment of the barracks there. We are completing a complete new school of military engineering with all of the facilities that you would expect. It is almost like building a small town in the barracks. The project is currently on schedule. The 2016 course will go into that school rather than the existing school.¹⁶

- 2.21 Regarding the current School of Military Engineering at Steele Barracks, the Committee was interested to hear how much the land was valued at by the Department. Defence responded that 333.5 hectares was valued at approximately \$261.7 million. It was noted, however, that this valuation does not take into account the actual asset value of the buildings on the site.¹⁷

Heritage buildings

- 2.22 Defence currently has in excess of 2,000 heritage property structures spread across the Defence estate. These structures occur on both Commonwealth Heritage Listed (CHL) properties and on other Defence properties known also to contain heritage buildings which have not been

14 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 25.

15 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 25.

16 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 26.

17 Department of Defence, *Submission No. 4*, p. 3.

- formally assessed under the CHL (including former Register of the National Estate sites).¹⁸
- 2.23 Developments to the Defence estate which impact on heritage values also carry additional costs related to heritage approvals and management requirements.¹⁹
- 2.24 One of the main costs associated with the management of heritage buildings is maintenance and upkeep. Defence finds the process for removing properties from the heritage list to be a much more difficult experience than to simply add properties to the list. Costs for maintaining heritage properties as part of the Defence estate are funded through the overall estate management budget allocation. There is no separately identifiable amount relating to the properties that are heritage listed.²⁰
- 2.25 Defence also noted their need to comply with the *Environment Protection and Conservation Biodiversity Act 1999*. This means that all property disposals are required to undergo an environment assessment. As part of this process, a heritage assessment is also conducted. The Department of the Environment then decides whether there are environmental or heritage issues, and if so, the type of action that must be taken in accordance with the aforementioned act. Defence clarified this process through an example:
- A good example at the moment ... would be the deconstruction of the hammerhead crane in Garden Island in Sydney. Although it is not a heritage listed structure, it has heritage interest and significance, so we had to go through that heritage and environment process. As a result of that, there are some constraints on how we deconstruct the crane and some of the documentation we have to put in place ... to preserve the images of that crane.²¹
- 2.26 Defence explained that this example highlighted the inherent complexity and delays involved in attempts to fulfill both federal and state legislative requirements.²²
- 2.27 The Committee asked Defence whether there were any initiatives in place to gauge the interest of the corporate sector, or encourage Public-Private Partnerships to help fund the maintenance or upgrade of heritage buildings. The Committee was also interested in hearing whether such

18 Department of Defence, *Submission No. 4*, p. 7.

19 Department of Defence, *Submission No. 4*, p. 7.

20 Department of Defence, *Submission No. 4*, p. 7.

21 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 24.

22 Mr Richardson, Department of Defence, *Transcript*, 6 June 2014, p. 24.

initiatives had been used to enhance the versatility of heritage buildings in term of their uses.

2.28 Defence admitted that it had not undertaken a lot work in that area:

We have not done a lot of work in that context. Some of our heritage assets are used. If you go to many of our bases, there will be museums on the bases. They are very often in older heritage listed parts of the base. They are not run by Defence; they are run by volunteers or local organisations. So we do try to reuse those sorts of assets where possible. Maybe we could do more, but a lot of our heritage assets are very old and not really in a usable condition. We just maintain them at absolute minimum investment.²³

Single LEAP Project

2.29 The ADF's Single Living Environment and Accommodation Precinct (LEAP) project is a multi-phase project to deliver up to 6,400 permanent living-in accommodation units as part of the strategy to replace substandard living-in accommodation for single ADF personnel with new accommodation that meets contemporary standards.

2.30 Phase 2 of LEAP commenced construction in September 2011 and completion of the final package is scheduled for February 2014. The *Defence Annual Report 2012-13* states that the project has achieved its targets for 2012-13 and construction remains on schedule to complete the facilities on or before contracted dates.²⁴

2.31 The Committee requested an up-date, to which Defence responded that Single LEAP phase two was now complete:

At the moment we are looking at what the requirements are for the next round of accommodation improvements. Single LEAP was all about on-base single people; there are parts of the estate where our single accommodation is not up to scratch, and so it is a question of looking at what is the next move. As we do base redevelopments, the living-in accommodation is always one of the places that is considered for improvement, and there are options between building and owning ourselves or refurbishing what we

23 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 28.

24 *Defence Annual Report 2012-13*, p. 152.

already own, or going again to something like a public-private partnership. That is being worked through at the moment.²⁵

Contracts evaluated for success or failure

2.32 The Committee invited evidence from Defence on the manner in which contracts are evaluated for success or failure, particularly in regards to key performance indicators and associated penalties for not meeting deadlines.

Comprehensive Maintenance Service and Base Service contracts

2.33 For Comprehensive Maintenance Services (CMS) and Base Service (BS) contracts which deliver regional estate management services, Defence noted that these contracts were assessed through a performance management framework that includes strategic, compliance and performance indicators.

2.34 In the case where contracts fail to meet the indicators contained within the performance management framework, Defence told the Committee that this would result in reduction in performance based payments to the contractors involved. The penalty and reduction in payments depends upon the nature of the contract, and could be anywhere up to twelve percent of the scheduled monthly service fee.²⁶

Major capital facilities investment contracts

2.35 For contracts concerning major capital facilities and investment, contractors are required to implement appropriate management strategies that account for all of their activities. These activities include:

- Methodology;
- Quality assurance;
- Work health and safety;
- Site and environmental management;
- Time and cost control;
- Commissioning and handover;
- Whole-of-life cost of facilities from development to disposal;
- Employment and training opportunities for indigenous Australians;

25 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 29.

26 Department of Defence, *Submission No. 4*, p. 16.

- Increasing the participation of women; and
- Adding and retaining trainees and apprentices.²⁷

2.36 Defence expanded further on the evaluation of these contracts:

These aspects are evaluated as part of the tender process and achievement of them is monitored on a regular basis by Defence through the term of the project. In the case of Head Contracts, if the deadline is not met, the contractor is normally subject to the application of liquidated damages, i.e. a genuine pre-estimate of the losses Defence would suffer as a result of the contractor's default.

In the case of Managing Contractor contracts, a similar process is undertaken. However, liquidated damages do not apply and key performance indicators (KPIs) tailored for each project are used in conjunction with financial incentives. If the KPIs are met, the contractor is eligible for payment from the incentive pool.

Any breach of contract by either type of contractor can result in the payment of damages to Defence.²⁸

Small and Medium Enterprise

2.37 The Committee asked Defence to explain the extent to which small and medium enterprises (SME) are involved in the tendering process for Commonwealth infrastructure projects.

2.38 Defence responded that its spend of \$1.2 billion per year makes up less than one per cent of construction activity in Australia. To promote competition in the open market, Defence is required to use a range of tendering mechanism processes:

We tend to use contracts that either appoint a prime contractor at a fixed price for a piece of work or appoint a project management contractor. They would earn a fee for managing the project on our behalf and then tender packages of work within a contract. ... The majority of my team's work is spent operating what you would call the government process side of the business, working out what the requirement is, working on approvals through government and the like and running a competition in the market to place contracts which are either a fixed price to go and build

27 Department of Defence, *Submission No. 4*, p. 16.

28 Department of Defence, *Submission No. 4*, p. 16.

something or a design and then a contract to build. So we rely very heavily on the expertise of the market.²⁹

- 2.39 Defence explained that they adopt a tendering model before engaging the market. There is a tendency for relatively uncomplicated projects to be managed by a prime contractor. For more complex projects, Defence appoints a project management agency which then subcontracts the work out to SMEs and primes. Ultimately, the level of risk involved in a project dictates the extent of Defence involvement in the subcontracting process.³⁰
- 2.40 The Committee questioned how accessible the tendering process was for SMEs in attempting to compete with primes and ensuring equal access. Noting that all Defence projects are contracted through AusTender, Defence told the Committee it ensures full visibility to the market through:
- An annual procurement list documenting contracts likely for tendering in the next 12-month period;
 - An annual conference with the Defence construction sector; and
 - Facilitating ongoing discussion and engagement with the construction industry.³¹
- 2.41 Defence acknowledged that its ability to support SMEs depended on the type of contract on tender. CMS and BS contracts which deliver regional estate management services:
- ...have a mandated requirement in contract terms and conditions to engage a minimum of 10% Small and Medium Enterprises in sub-contracting. CMS contractors are required to provide quarterly reports on SME engagement. A review of quarterly reports indicates that all contractors are achieving the minimum SME engagement rate of 10% with some achieving a rate of up to 83%.³²
- 2.42 However, these arrangements differed for major capital construction projects that go beyond the capacity of SMEs in the construction industry:
- To assist SMEs in gaining Defence capital facilities work, Defence utilises a Managing Contractor methodology whereby delivery of components of the project are undertaken by the mandatory engagement of subcontractors. Tendering this sub-contract work, which is primarily undertaken by SMEs, is done on an open-book basis with total visibility by Defence. The Managing Contractor's

29 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 27.

30 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 27.

31 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 27.

32 Department of Defence, *Submission No. 4*, p. 17.

tendering process is required to mirror the Commonwealth Procurement Rules, including competitive tendering.³³

- 2.43 Furthermore, SMEs and primes that are unsuccessful in their bids for tender are offered debriefs from Defence.³⁴
- 2.44 In the case where a prime is awarded a contract, the Committee asked whether Defence imposed any obligations on the prime to ensure that the flow of payments to sub-contracted SMEs is protected.
- 2.45 Defence informed the Committee that they have standard contracting templates that provide a range of obligations pertaining to the flow of payments. In addition, Defence requires that prime contractors sign statutory declarations on payment procedures. However, Defence acknowledged that there remain some difficulties with the process:
- We have had cases like that, and they normally occur where a subcontractor has for whatever reason gone out of business and a sub-sub-contractor then writes to us and says, 'But we haven't been paid', and yet we have a statutory declaration from a subcontractor that went out of business that they had made all due payments. It is a difficult area because generally once we are down at that third-tier subcontractor level Defence has no contractual relationship with that subcontractor. Our contractual relationship is with the prime or the head contract, and below that they are not relationships that we have in a legal sense.³⁵
- 2.46 Defence informed the Committee that it was not aware of any outstanding payments to sub-contractors of CMS and BS. In relation to the Major Capital Facilities Program, Defence acknowledged three cases where the relevant prime contractor had become either insolvent, placed in voluntary administration or had payments due to sub-contractors:
- On investigation, the outstanding payments are normally for work undertaken post the payment of monies which were due and payable under the relevant sub-contract. Subject to the applicable State or Territory legislation, any monies due to the contractor are paid to the administrator or liquidator for distribution to the creditors.³⁶

33 Department of Defence, *Submission No. 4*, p. 17.

34 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 27.

35 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 28.

36 Department of Defence, *Submission No. 4*, p. 18.

- 2.47 Defence stated that they are looking at other more effective mechanisms to ensure the flow of payments is maintained from Defence to the prime to the subcontracted SMEs.³⁷

Committee comment

- 2.48 The Committee notes the apparent inconsistency between the basing principles (outlined in paragraph 2.3) and the approach (outlined in paragraph 2.6) being considered which may place greater emphasis on cost-effectiveness over force structure considerations. The Committee is concerned to understand if budget pressures are causing Defence to take measures not focussed on optimising capability.
- 2.49 The Committee considers that the impact of funding constraints on the management of the Defence estate is not well explained or reported to the Parliament via Senate Estimates or the Defence Annual Report review process. As a means of encouraging better informed public discussion, the Committee believes Defence should improve the accessibility of information on the impact of real cost pressures in estate management. This should highlight any cases where such cost pressures lead to regular use of safety risk management for operational assets, such as fuel farms. This may assist in informing the Parliament of the upkeep and maintenance costs associated with the sustainment of capabilities and forces.
- 2.50 The Committee is concerned that more could be done to ensure effective use of taxpayer's money in respect to heritage property assets within the Defence estate. If there is not sufficient public value placed on the buildings to attract funding via a specific appropriation or even a public private partnership, the Committee questions why Defence should have to divert funds away from estate maintenance that directly supports operationally relevant assets.
- 2.51 In regards to the involvement of SMEs in Defence tendering processes, the Committee believes Defence should consider further initiatives to facilitate and enhance the involvement of Australia's defence SMEs in the procurement process. The Committee also reaffirms the importance of ensuring that there is a consistent flow of payments from primes to subcontracted SMEs for those projects where a prime has been awarded a tender.

37 Mr Grzeskowiak, Department of Defence, *Transcript*, 6 June 2014, p. 28.

Recommendation 1

The Committee recommends that the Department of Defence review contract templates and procurement processes to ensure that, to the extent possible, payments flow to small and medium sized enterprises subcontracted by primes in a timely manner.

Recommendation 2

The Committee recommends that Government review the process by which Defence properties are placed on the Commonwealth Heritage List and ensure that, where properties are listed, they are suitably funded either by a specific appropriation or through a public private partnership.