Australian Government

NORTHERN AUSTRALIA INFRASTRUCTURE FACILITY

Consultation Paper

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Foreword

As the first Minister for Northern Australia, it is my pleasure to release this paper on the Northern Australia Infrastructure Facility (NAIF).

The Australian Government recognises the enormous economic potential of northern Australia, and is committed to its development. The White Paper on Developing Northern Australia (White Paper), released in June 2015, articulates an ambitious vision for the north and sets out our plan to develop its vast untapped economic potential.

The White Paper acknowledges that governments cannot do this alone, and that our role is primarily as facilitators: to help our communities and businesses to prosper by creating the right conditions for investment and innovation.

The NAIF is an integral part of the Government's strategy for northern Australia. Commencing from 2016-17, it will offer up to $5 billion in concessional loans to encourage and complement private sector investment in economic infrastructure that otherwise would not be built. The NAIF will also bring forward the construction of infrastructure that would otherwise not be built for some time.

Through the NAIF, the Commonwealth will partner with the private sector and the governments of the Northern Territory, Queensland and Western Australia, to provide loans on concessional terms for the construction of major projects such as airports, ports, roads, rail, energy, water, and communications infrastructure. These are the types of economic infrastructure needed to further open the north for business and to deliver wider public benefit for the rest of Australia.

The goal of the NAIF is not to crowd out private investment. NAIF loans will only fund projects that are commercially viable, and the extent of their concessionality will be carefully calibrated to the needs of specific projects.

The establishment of the NAIF is a significant step forward for northern Australia, and for the way infrastructure is financed in this country. This paper sets out the Government's proposed policy framework for the NAIF, including the gaps that NAIF loans are intended to fill, eligibility criteria, and the characteristics of NAIF loans.

The Government is keen to receive feedback from potential project proponents and other interested parties. All comments should be provided by 30 November 2015 via email: naif@industry.gov.au.

The Hon. Josh Frydenberg MP
Minister for Resources, Energy and Northern Australia

Section 1: The Government's plan for infrastructure in northern Australia

Infrastructure development, including the establishment of the NAIF, is fundamental to the Government's plan for northern Australia.

Northern Australia has just 5.6 per cent of Australia's population but contributes over 11 per cent of Australia's gross domestic product and is spread across over 40 per cent of our land mass. The White Paper recognised the great potential for further economic and population growth in northern Australia. Having the right backbone economic infrastructure in place will be critical to driving this growth.

The Government has already committed nearly $5 billion of its $50 billion nationwide investment in transport infrastructure to northern Australia.

These investments include over $3 billion for northern sections of the Bruce Highway, $208.4 million for the Cape York Region Package, $172.2 million for the North West Coastal Highway and $90 million for the Northern Territory Regional Roads Productivity Package.

Despite this investment, infrastructure in northern Australia continues to face cost and service challenges, resulting in critical infrastructure gaps.

Northern Australia has low population density and, with the exception of the resources sector, smaller and dispersed industry. This makes it difficult to capture the economies of scale that support commercially viable infrastructure at competitive prices. In particular, the demand for multi-user infrastructure can be difficult to predict. Distance, remoteness and the north's unique climate also add to these challenges. For example, the wet season compresses construction and maintenance schedules into a six or seven month window.

Infrastructure Australia's Northern Australia Audit – Infrastructure for a Developing North 2015 identified more than 180 infrastructure needs in northern Australia. The report identified infrastructure gaps across sectors including airports, communications, energy, ports, rail, roads and water. It also acknowledged that a range of funding and financing solutions will be needed to deliver the projects that meet these needs.

The NAIF complements the Government's continued financial support for infrastructure in northern Australia through traditional grant funding.

Grant funding continues to be an appropriate source of funding for infrastructure that serves public purposes, particularly for social infrastructure. However, the Government's capacity to provide grants, which are funds provided for infrastructure without requiring repayment, is necessarily limited. Project finance (that is, loans rather than grants) can reduce the call on the federal Budget, allow assistance to be targeted in a more effective manner, impose more commercial disciplines on loan recipients, and also has the potential to catalyse further private sector investment.

Other countries have successfully adopted financing programmes to accelerate infrastructure investment.

For example, the United States Federal Government has used concessional loans and other financing assistance to catalyse the delivery of US$79 billion in transport infrastructure through the Transportation Infrastructure Finance and Innovation Act Program (TIFIA).

Section 2: Objectives for the NAIF

The Government's objectives for the NAIF reflect its priorities for the development of northern Australia and the importance of ensuring public funds are invested for the benefit of the wider economy.

TABLE 1: NAIF OBJECTIVES

Through the NAIF, the Government is committed to:

- supporting the construction of economic infrastructure that provides a basis for the longer term expansion of industry and population in northern Australia;
- ensuring the Commonwealth is repaid in full and provides only the concessionality necessary to allow a particular project to proceed;
- operating in partnership with commercial lenders, not in competition;
- supporting infrastructure projects that are highly unlikely to proceed, or would only proceed at a much later date, without NAIF assistance;
- being credible in financial markets and meeting public sector accountability standards; and
- catalysing further private sector investment in northern Australia.

Role of the NAIF

The Government intends that the NAIF will be used to fill gaps in the infrastructure financing market for northern Australia.

In general, private lenders are willing and able to fund Australian infrastructure projects which exhibit strong underlying economics. However, there are two key circumstances where NAIF financing could supplement private lending.

Patient capital

A NAIF loan may be an appropriate source of 'patient' capital which extends beyond the term of typical bank loans, and has more flexible repayment options.

Loan terms offered by commercial banks are usually limited to five to seven years. This introduces significant risk for equity investors in long-life assets, as the terms under which debt is refinanced (in particular, risk pricing) will affect equity returns. Constraints placed on projects by commercial lenders may also result in rates of return that are positive but not high enough to justify a decision to invest. Where future revenue and growth patterns are uncertain or difficult to predict, projects are unlikely to proceed.

Patient capital may be able to accommodate slower growth in demand for the infrastructure asset by relieving a call on its cash-flow by deferring the repayment of loan principal and permitting some cash to be returned to equity investors. A longer loan term would also help to reduce refinancing risk which arises from the mismatch between the relatively short-term focus of senior debt and the long economic life of infrastructure assets.

Large-scale projects

In some large-scale project finance transactions, there may be an absolute limit to the volume of senior debt available, irrespective of the project's viability. A project may be commercially viable, but lack sufficient scale of commercial debt to achieve an acceptable level of gearing. Lender concentration risk may also reduce the quantum of debt available. In these circumstances, a NAIF loan may be provided on the same, or substantially similar terms, as those set by participating private financiers.

Section 3: Delivery model

Delivery model objectives

Given the scale of its lending operations, and the need to operate in partnership with other financiers, it is essential that the NAIF has credibility in financial markets and meet expectations of public sector accountability.

TABLE 2: DELIVERY MODEL OBJECTIVES

The NAIF will:

- have a robust governance and administration framework that subjects loan decisions to at least the same level of financial analysis, risk structuring and due diligence required by commercial lenders such as banks;
- utilise expert advisers and consult with other participating financiers;
- operate in a nimble and proactive manner, to enable the NAIF to partner effectively with private enterprise;
- have a clear risk management framework, informed by the NAIF's eligibility criteria, which covers the extent and nature of project risk that may be taken on by the NAIF;
- provide the minimum level of loan concessionality required to allow a project to proceed; and
- only lend to projects which are able to repay the Commonwealth in full, including covering the Commonwealth's operational costs and cost of borrowing.

Institutional arrangements

The Government intends to appoint an independent statutory Board which will make the investment decisions for the NAIF. The Board will be led by an independent chair, and draw on an existing Commonwealth corporation with the requisite expertise, such as the Export Finance and Insurance Corporation (Efic), to provide loan administration and back office support.

The NAIF Board will make investment decisions in accordance with an investment mandate prescribed by the Minister for Northern Australia (which will be informed by the NAIF eligibility criteria, discussed in Section 4 below). Consistent with the operation of Efic, the Minister will also retain certain, limited powers of direction in relation to the Board.

To enable the NAIF to operate alongside the private sector, applications will be considered on a rolling basis, rather than in application rounds, and the terms and conditions of loans will be negotiated on a case-by-case basis.

As announced in the 2015-16 Budget, loans will be able to be drawn down from 1 July 2016 at the earliest.

Section 4: Eligibility for loans

To be eligible for a NAIF loan, project proponents must be able to establish that they satisfy the mandatory criteria, which are set out in Table 3. Infrastructure projects will not be eligible for NAIF loans unless they meet all of these criteria. There are additional, non-mandatory criteria set out in Table 4. While these are not essential, preference will be given to projects that also satisfy these criteria.

TABLE 3: MANDATORY CRITERIA

1. The proposed project involves construction or enhancement of economic infrastructure.	Economic infrastructure incorporates physical structures which are associated with the flow of goods, services, information and workers between buyers and sellers. It includes, but is not limited to, rail, roads and public transport, water, energy and communications networks, ports and airports.[1] The project must bring new capacity online either through the construction of new infrastructure or by materially enhancing existing infrastructure. It must be highly likely to have a long-term impact on the economic capacity of northern Australia. The refinancing of existing debt that does not involve the creation of new capacity is ineligible.
2. The proposed project will be of public benefit.	The project is: (i) capable of serving multiple users; and (ii) produces benefits beyond those able to be captured by project proponents.
3. The proposed project is unlikely to proceed, or will only proceed at a much later date, without NAIF assistance.	Applicants will need to demonstrate that NAIF assistance is necessary to enable the project to proceed. Improving the return to investors on projects that capital markets are already willing to finance is not the purpose of the NAIF.
4. The project is located in, or will have a significant benefit for, northern Australia.	Northern Australia includes all of the Northern Territory, and those parts of Queensland and Western Australia above the Tropic of Capricorn. It also includes the important regional centres of Gladstone (Queensland), Newman (Western Australia) and Exmouth (Western Australia), which have boundaries that intersect with the Tropic of Capricorn.[2] Projects do not need to be entirely within these boundaries if they produce significant benefits to northern Australia. For example, a project that enhances north-south connectivity may be eligible.
5. Commonwealth loan monies are not the majority source of project funding.	NAIF finance will not exceed 50 per cent of total debt for the proposed project. This is in keeping with the principle that the NAIF will work in partnership with commercial and other financiers who should provide the majority source of finance.
6. The loan will be able to be repaid.	The project proponent will need to present comprehensive financial modelling to demonstrate the ability of the project to repay the NAIF debt in full and on time. Evidence of satisfaction of this criterion will be strengthened by identifiable financing from non-government sources and/or committed capital from the private sector. Financial commitments from the relevant state and/or territory governments will also be taken into account. In circumstances where some private finance may have already been secured, much of the material required for the financial assessment should already exist.

Preference will be given to projects which meet one or more of the non-mandatory criteria in Table 4.

TABLE 4: NON-MANDATORY CRITERIA

1. The NAIF financing component for the proposed project is for an amount of $50 million or more.	A project could include multiple pieces of infrastructure that are aggregated into a single project.
2. There is an identified need for the proposed project.	The project meets an infrastructure need identified through a Commonwealth, state or territory assessment process, such as the Northern Australia Infrastructure Audit.
3. The proposed project has state or territory endorsement.	Evidence of state/territory endorsement may involve being: (i) direct debt and/or equity investors in the project; (ii) a proposed loan counterparty to the NAIF; (iii) the project facilitator; (iv) a provider of statutory approvals for the project; or (v) a provider of in-kind support. Project assessment under a Commonwealth, state or territory project development process, pipeline or priority list, with sponsorship or assistance by the relevant state or territory, would also be evidence of state or territory endorsement.

1 *Public Infrastructure Productivity Commission Inquiry Report Volume 1* (Productivity Commission), p.54.

2 As in the *Northern Australia Audit: Infrastructure for a Developing North Report* (Infrastructure Australia January 2015), p.15.

Section 5: Loan characteristics

The NAIF will offer concessional loans to enable eligible projects to proceed. The NAIF will not offer grants or other forms of financial assistance.

Importantly, the provision of a NAIF loan would not provide any form of Government guarantee regarding a project's overall financial success or represent any commitment by the Commonwealth to provide any additional forms of project funding.

NAIF loans will be negotiated on a case-by-case basis. Standard commercial loan terms will be used, except to the extent that a concession is needed for a project to proceed. The NAIF will have sufficient flexibility to negotiate financing contracts, including repayment terms, in order to encourage and/or facilitate private sector participation.

SUBJECT	CHARACTERISTICS
TERMS AND CONDITIONS	Terms and conditions will differ across projects supported by the NAIF, reflecting individual project characteristics and financing requirements, including co-financing arrangements.
CONCESSIONALITY	Concessions will only be provided to the extent required to ensure the project's viability. The concessional features of a loan will be tailored to meet project needs and, without limiting the scope of features that may be negotiated, may include a lower interest rate, longer loan tenor and/or different repayment arrangements than might be provided by the private sector. For example, the repayment schedule for NAIF principal could take account of the project's projected cash flows. Terms may include conditions whereby the repayment schedule is modified subject to actual financial performance, year by year. Interest may be required to be paid in full on a regular basis (for example, quarterly) but could be capitalised during construction and in the commissioning or ramp-up phase of a project. Additionally, where a NAIF-financed project performs better than expected (for example, where patronage is higher than estimated) loan conditions could include flexibility to reduce the degree of concessionality.
POSITION IN CAPITAL STRUCTURE	A NAIF loan may form any part of the capital structure. For example, there appears to be scope to use subordinated debt in a targeted way to address the market gaps the NAIF is designed to address. For example, the TIFIA program in the United States offers loans that are subordinated in their call on project cash flows but rank equally with senior debt in the event of insolvency. This is different to the prevailing way that subordinated debt is used in Australian markets, where the nature of the subordination is generally across both cash flow and security, as senior lenders will typically require that subordinated debt must be the equivalent of equity for the purpose of their risk analysis.
ABILITY FOR COMMONWEALTH TO PARTICIPATE IN UPSWING	Provisions could be included so that the Commonwealth can share in better than expected financial performance by a project, or terms that would encourage refinancing of the NAIF loan by the private sector when the project's financial performance permits. The inclusion of these terms will be considered on a case-by-case basis.

Section 6: Consultation questions and next steps

The purpose of this document is to seek feedback on the mandatory and non-mandatory criteria for NAIF loans, the proposed objectives and characteristics of NAIF loans, and the proposed delivery model.

Consultation questions

Feedback is invited on the following questions.

1. Are there any other financing gaps, which are not captured by the two categories identified in Section 2, which the NAIF could usefully fill?
2. Are there any alternative delivery models for the NAIF which would be more appropriate and adapted to the objectives set out in Section 2?
3. Are there any examples of economic infrastructure that would be transformative for northern Australia, but may not meet all of the proposed mandatory eligibility criteria?
4. Are any of the proposed mandatory eligibility criteria more appropriate as non-mandatory criteria, or vice versa?
5. Having regard to the Government's priorities for northern Australia (Section 1), and the NAIF objectives (Section 2), are there any additional or alternative eligibility criteria that would be appropriate?
6. Having regard to the Government's priorities for northern Australia (Section 1), and the NAIF objectives (Section 2), should any additional or alternative loan characteristics be considered?

Feedback must be provided by 30 November 2015, via email: NAIF@industry.gov.au. Further consultation will occur once draft legislation has been finalised.

Next steps

KEY STEPS	TIMING
Public consultation on design including the eligibility criteria	30 November 2015
Exposure of draft legislation	Early 2016
Introduce legislation to Parliament	First quarter of 2016
Loans able to be drawn down	July 2016

Enquiries

Further information on the White Paper can be found at http://northernaustralia.gov.au. For additional information on the NAIF visit www.industry.gov.au/naif. If you have further inquiries, please write to the NAIF team at NAIF@industry.gov.au, or contact:

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