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Driving Business Success for Consulting Firms in the Built and Natural Environment

17 October 2014

Overview of Project Appraisal
Department of Infrastructure and Regional Development
media@infrastructure.gov.au

To Whom It May Concern,

RE: Overview of Project Appraisal Paper

Consult Australia is pleased to respond to the Overview of Project Appraisal paper as the Department develops its Project Appraisal Framework.

Consult Australia welcomes the Government's consideration of the important issues raised in the paper alongside the commitment to further engage across state and territory governments and with industry.

Consult Australia is the industry association that represents the business interests of consulting firms operating in the built and natural environment. Our member firms' services include design, architecture, technology, engineering, surveying, legal and management solutions. We represent an industry comprising some 48,000 firms across Australia, ranging from sole practitioners through to some of Australia's top 500 firms. Collectively, our industry is estimated to employ over 240,000 people, and generate combined revenue exceeding \$40 billion a year.

The criteria governing cost benefit analysis are generally not well understood by the public, are subject to change and influence, and are increasingly politicised. A robust project appraisal framework to guide decision making is critical in this context. This submission provides both high-level and technical feedback on the paper as follows:

Limitations and opportunities

Consult Australia has long advocated that critical in assessing the merits of public investment in infrastructure is the application of a broad cost-benefit analysis. Increasingly infrastructure projects are viewed as 'ready to proceed' only where utilisation is close to capacity. Governments' vital role in facilitating longer-term benefits from infrastructure investment, as part of integrated strategic land-use planning, and a vision for our cities and regions, needs to be re-established.

To that end we welcome the acknowledgement in this paper of the importance of all aspects of the 'business case' (including the Strategic Merits Test, the Cost Benefit Analysis, and the Appraisal Summary Table) in informing recommendations and decisions regarding infrastructure investment.

Specifically the paper notes that 'In determining the overall merit of a project, considerations should not be limited to the monetised benefits and costs captured in the CBA' (page 4), and that other activities in the appraisal process (stakeholder consultation, preliminary engineering design, financial assessment, risk assessment EIS, equity impacts, land use etc.) must also be considered.

This is a critical point, but one that is under-emphasised in the remainder of the paper, particularly as it addresses the potential of Wider Economic Benefits (WEBs) analysis and the limitations on applying WEBs in the Australian context.

The opportunity for careful use of WEBs, and alternative approaches to CBA and business case evaluation, to address some of those shortcomings associated with narrow CBA deserves further attention. For example, the paper notes the various limitations associated with CBAs, describing: the timeframes against which projects are assessed, margins of error, optimism bias, uncertainty, and difficulties in capturing non-monetised impacts. But perhaps one of the most significant of these limitations, as addressed in the discussion of Wider Economic Benefits (WEBs), is the note that 'Conventional CBA omits the additional benefit to society of the increase in tax revenues that accrues to the government.'

Given an increasing emphasis in public policy debate on the capacity for infrastructure to drive productivity, opportunities to address and mitigate these limitations through more detailed consideration of all aspects of the business case, and use of WEBs should be further explored, with clear policy recommendations for governments. For example, the observation that econometric analysis supporting an understanding of productivity elasticities has not been undertaken in Australia (though they have in the United Kingdom and New Zealand) should be clearly reflected in recommendations for further research as a priority.

Risk, scope and early investment

The paper notes margins of error associated with rapid CBAs, but still suggests that this methodology may be a cost-effective way of gauging whether a proposal is likely to pass a detailed appraisal. Even at the detailed appraisal level our member firms observe that +/-10% estimates are frequently requested in cases where there is inadequate definition of the scope of work required to deliver the project.

The major challenge at the early stage of a project is to fully understand, predict and cost all the consequential requirements of a major infrastructure project. Too often the initial estimates focus only on the core elements of the project and do not fully comprehend the consequential impacts and associated costs. This often relates to utility services impacts, relocations, or other functional requirements that only become apparent as more design work and operational reviews take place. Front-end effort to fully define the project with all associated requirements will provide greater reliability of the capital estimates that are used in the CBA. There are many examples of where so-called contingencies are used to "cover unknowns" in the estimate but these are usually inadequate. Examples include the need to bolster power supply networks to support electrified trains and light rail schemes, changes to local road layouts due to freeway construction, or realignment of major services due to construction works.

The need for clear project definition and 'front end loading' supporting detailed analysis at this stage of the assessment needs to be emphasized as a precondition for successful CBA delivering these margins. The Productivity Commission's observation that unrealistic cost and demand forecasts arise due to strategic misrepresentation further underscores the importance of effective and transparent project definition at the start.

Better definition of a gated decision making process is required to ensure appropriate levels of effort and time are expended in project definition at each stage of the decision making process. The paper should consider recommendations or guidelines to government regarding the percentage of initial investment required in project definition and estimation on the basis of the total project cost budget. There are such guidelines in the resources sector and a wealth of industry knowledge that can be used to strike suitable investment levels at each stage of the process. However, the success of this approach is dependent on there being clear and rigid control of the change management process over the life of the project. The reliability of initial and even final estimates is intimately linked to the scope of work to be undertaken and the circumstances in which the work is to be completed. Each of these elements can impact significantly on the estimates.

Understanding patronage modelling

The paper should more directly address the issue of patronage modelling and its risks. The reliability of patronage modelling is a major concern that requires considerable and ongoing investment by Governments. There are now sophisticated modelling tools available, but they require extensive attitudinal surveys to generate the data required to properly support the basis of the modelling. Unless there is a dedicated program for patronage modelling that is comprehensive across all relevant modes, the reliability of CBA analysis is at serious risk.

Patronage predictions have as much to do with land-use patterns as community attitudes and so there is a need to integrate these two predictive modelling aspects. Too often there is a disconnect, and practitioners in each area do not collaborate closely enough. Governments need to be clear that in both transport and planning, the aim is to reach a consolidated view of the future that supports good decision making.

There is also the need to ensure that the modelling process is transparent and well understood across a wide range of those using the predictions. Too often the model architecture and algorithms used are not subject to appropriate cross-checking to ensure accountability for predictions upon which major investment decisions are made.

There is a need to recognise the shortcomings of patronage modelling and for governments to invest in appropriate technologies as well as practitioners to improve performance in this vital area. It also needs to be recognised that models need to be kept up to date to reflect current community attitudes and drivers. Algorithms designed to model public attitudes and decision making 20 or even 10 years ago no longer fully apply today. Governments need to recognise that ongoing research and investment is required to keep models up to date

Supporting transparency

The paper reiterates the Productivity Commission findings regarding the benefits of public CBAs. Consult Australia supports transparency in infrastructure decision making. Governments should be clear what assumptions, models and policy settings have been used to develop a given business case. Additional benefits from this transparency would flow from industry understanding the short and long term context in which a given project is to be delivered and the potential impact for other projects in the pipeline.

The importance of evaluating success

Consideration in the revised National Guidelines for Transport System Management (NGTSM) of additional material to facilitate post-completion evaluation is to be commended. There are significant benefits to firstly identifying the expected benefits of a project, and then secondly confirming and measuring those benefits. This is particularly the case where private investment may be sought, but also to demonstrate through hard evidence success or otherwise against objectives. This approach will deliver significant long term benefits and learnings to inform future project development and decision making.

Discount rates

The paper suggests discount rates of between 4% and 7% as appropriate. Feedback from Consult Australia's member firms suggested 7% was arguably high relative to other countries and having been in place for some time it potentially reflects habit, rather than evidence based practice. Further review of appropriate rates based on different types of infrastructure may be warranted.

Independent evaluations to support real options

There is merit in governments commissioning independent evaluations of “real options”, removing any risk of bias and providing a more comprehensive assessment than what might be delivered through any single government department. For example, analysis of major infrastructure developments should include consideration of not only transport issues, but also land-use and utility aspects in the overall context of existing policy and long-term planning in a given area. This will support a whole-of-government approach, particularly where major investments are involved. External and independent consultants are often best placed to undertake this type of analysis. However, as already noted, there needs to be adequate budget and time available as well as cooperation across government agencies.

Conclusion

We commend this paper as a valuable contribution to a better understanding of the risks and opportunities associated with existing and future use of appraisal methodologies supporting infrastructure decision making. As noted in our more detailed comments above, there is a further opportunity through this paper for more detailed recommendations for governments to significantly improve current processes, and expand our understanding and application of newer methodologies to ensure those projects with the greatest overall benefits are appropriately prioritised.

The paper concludes by advocating a ‘cautious approach is needed for incorporating other objectives such as equity and promoting productivity into decision making’. Given the overriding importance of these factors in driving the case for infrastructure investment, we contend that this paper should provide clear recommendations for governments to understand what next steps should be taken to ensure these factors can be more effectively included in future decision making.

To discuss the contents of this submission further, please contact Jonathan Cartledge, Director of Policy and Government Relations on phone: (02) 8252 6711; or email: jonathan@consultaustalia.com.au.

Yours sincerely,



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