

# Investment Guidelines

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# Introduction

The *Investment Guidelines for Government Owned Corporations (Guidelines)* set out the key principles for Government Owned Corporations (**GOCs**) to adopt when undertaking investments and other such related activities within the scope of this document, ensuring shareholding Ministers' requirements are met whilst enabling GOCs to pursue commercial opportunities and create shareholder value. The Guidelines apply to all GOCs and statutory authorities, except for QIC Limited. For the purposes of this document, "GOCs" refers to all relevant entities and "shareholding Ministers" includes responsible Ministers of statutory authorities.

The parent GOC board is accountable for ensuring the Guidelines are followed by all controlled entities of the GOC with the Guidelines to be endorsed through a statement of compliance in the parent GOC's Statement of Corporate Intent (**SCI**) for the relevant financial year.

## Overview

The Guidelines are intended to complement each GOC's SCI and internal governance arrangements without diminishing the board's responsibility for its investment decisions and corporate performance.

The objectives of the Guidelines are to:

- clearly set out the expectations, priorities and risk concerns of shareholding Ministers without compromising the responsibility and accountability of GOC boards;
- ensure GOCs undertake commercial investments and create a framework that holds the board accountable for their investment decisions;
- replicate, as far as possible, private sector market disciplines to manage the government's risk exposure from the investment activities of GOCs; and
- provide confidence to industry participants that market-type disciplines are being applied by GOCs.

The Guidelines reflect a "shareholder" perspective. This approach improves the clarity of objectives and clearly separates the government's role as shareholder from its other, potentially conflicting, roles. Other policy objectives requiring a different perspective may be addressed elsewhere.

The State of Queensland does not guarantee any obligation arising from the investment activities of a GOC or its controlled entities or entities in which the GOC has an investment stake and, as such, all loan documents and business agreements prepared by a GOC are required to acknowledge section 130 of the *Government Owned Corporations Act 1993 (Qld)* (GOC Act). GOC officers are also prohibited from:

- providing any written note or oral representation that could imply government assistance would be forthcoming in support of difficulties associated with a financial arrangement in which the GOC has a stake; and/or
- entering into contractual arrangements or undertakings that would produce the effect of an actual or contingent obligation on government to support a GOC.

### Pre-emptive rights

GOCs are required to consult with shareholding Ministers prior to entering into a legally binding contract that contains clauses pertaining to pre-emptive rights. A pre-emptive right provides a third party, that has an ownership interest in a venture with a GOC, a first right to acquire the GOC's interests in the venture.

### Guarantees

A GOC should not provide guarantees to its controlled entities or assume any liability of their controlled entities, unless specifically approved by shareholding Ministers. Guarantees should not be provided to non-controlled entities.

### Governing law and jurisdiction

Investment documentation should preferably stipulate the laws of Queensland as the governing law regardless of whether the investment is predominately based in Queensland or outside of Queensland.

## Scope

These Guidelines:

- cover all non-financial investments, including asset refurbishment and replacement, new capital expenditure, acquisitions, and certain major, long-term or multi-stage projects;
- do not cover purely financial investments which are covered by the corporation's own financial policies and the requirements outlined in the Code of Practice for GOCs' Financial Arrangements; and
- do not cover activities characterised by an absence of direct equity investment, such as consultancy services.

Although major contracts are not generally viewed as investments, their significance warrants their inclusion in the definition of investments for the purposes of these Guidelines. Unless otherwise agreed, major contracts require approval by shareholding Ministers (and early engagement with shareholder departments). Major contracts include, for example, revenue contracts, coal and gas supply contracts for generator GOCs, power purchase agreements, offtake arrangements, or similar, but exclude operating expense contracts and regulated network support agreements.

Investment approvals may also be required for other contracts as agreed by shareholding Ministers, including those with long-term risk exposures to the State.

Consulting services are not covered by these Guidelines. The *Guidelines for Export of Services by GOCs* covers consultancy services, operating and management contracting services, and licensing or sale of intellectual property. These activities are characterised by an absence of direct equity investment, other than for minor current inventory stock typically associated with export of services. Where the export of a service is accompanied by a direct equity investment, the GOC will also need to comply with these Guidelines.

If a GOC is unsure whether their investment proposal is covered by, or complies with, the Guidelines, they should contact Queensland Treasury for clarification.

### **Complementary guidance**

These Guidelines may need to be read in conjunction with other policies, procedures, and guidelines.

The *Queensland Procurement Policy (QPP)* and its associated *Best Practice Principles (BPP)* apply to all government agencies, including GOCs. The QPP contains information which will assist in clarifying the requirements of GOCs when considering non-financial investments.

The BPPs encompass best practice: workplace health and safety systems and standards; commitment to apprentices and trainees; industrial relations; and history of compliance with procurement tendering and other government policy.

The *Government Owned Corporations Guidelines for Joint Venture Agreements (JV Guidelines)* will also be of assistance to GOCs in clarifying the expectation of shareholding Ministers in respect of contractual obligations involved in projects which are not technically joint ventures. GOCs should have regard to the JV Guidelines when negotiating appropriate terms and conditions in respect of major, long-term or multi-stage projects as well as joint ventures.

# Investment principles

## Principle 1

Investments restricted to commercially viable projects within the GOC's core business activities

Consistent with the objectives of the GOC Act, only those projects which are capable of yielding a commercial return should be undertaken by GOCs. Shareholding Ministers will consider investment proposals primarily on their commercial viability and investment merits.

GOCs are to pursue investments strictly within their "core business" as agreed by shareholding Ministers in accordance with their SCI, shareholder mandate and/or statement of strategic expectations.

In evaluating investment proposals, GOCs should seek to earn a rate of return at least equal to the appropriate risk-adjusted weighted average cost of capital as calculated by the *Government Owned Corporations – Cost of Capital Principles*.

GOCs are expected to fully comply with the QPP and support relevant local content and benefits targets; however, household consumers should not be impacted by higher prices to achieve preferred procurement outcomes.

Shareholding Ministers retain discretion to pursue their broader policy objectives where an investment will contribute to the strategic goals of the Government. These objectives will generally be pursued and defined through other mechanisms (e.g., community service obligations as provided for under the GOC Act).

## Principle 2

GOC investments subject to approval and notification requirements

Individual GOCs have been advised by shareholding Ministers of notification and approval thresholds for potential investments. The thresholds apply to GOCs and their controlled entities, except where otherwise agreed by shareholding Ministers. Table 1 summarises GOC obligations for investments (based on investment cost); however, shareholding Ministers may request any investment proposal to be submitted for approval.

**Table 1:** Investment thresholds

Investment cost $\geq$ Approval threshold	GOCs to seek prior written approval from shareholding Ministers to proceed with an investment
Investment cost $\geq$ Notification threshold	GOCs to notify shareholding Ministers of a Board-approved investment decision
Investment cost $<$ Notification threshold	GOCs not subject to notification or approval, unless otherwise determined by shareholding Ministers

Notifications may be provided through periodic reporting to Queensland Treasury (e.g., quarterly reporting) or by other agreed arrangements. Regardless of cost, GOCs should also notify shareholding Ministers of investments:

- having public policy implications; or
- involving third parties (associated with joint venture or similar such agreements).

## GOC engagement

GOCs are advised to inform shareholding departments of any potential investments as soon as possible on a no-surprises basis to facilitate any approvals process. In all circumstances, shareholding Ministers require GOCs to notify them of any investments prior to implementation (i.e., when the GOC Board approves an investment decision).

Moreover, the GOC should advise shareholding Ministers of any planned projects involving potentially sensitive investments or contracts, including those with longer term and strategic implications.

## Cost and value

Thresholds are based on the total cost of an investment, including operating and capital expenditure occurring over time relating to the initial investment.

Multi-stage investment proposals requiring board approval at each stage of the process requires separate approvals by shareholding Ministers. Shareholding Minister approval must be obtained prior to the first framework agreement being executed for the proposal, which maps out the proposed overall structure of the project and the GOC's future commitments. It is not acceptable for a GOC to break a single large investment into smaller component parts to circumvent the investment approval thresholds.

The value of a contract (or series of related contracts in a project) should be calculated using the present value (PV) of all revenue or expense flows over the life of the contract (or contracts) using an appropriate risk-adjusted WACC calculated consistent with the GOC Cost of Capital Principles. Shareholding Ministers' prior approval must be sought for any negative PV investment.

### **Financing arrangements**

Investment approvals are separate to financing arrangements. GOCs should refer to the *Code of Practice for Government Owned Corporations' Financial Arrangements* when considering financing arrangements.

### **Regulated investments**

GOC investments in monopoly environments are subject to economic regulation by a regulatory authority. The regulatory authority allows for the GOC's asset base in the determination of a regulated rate of return. This allows the GOC to determine the level of "regulated investment" it can make in its asset base to ensure the assets remain productive and to provide for growth.

Arrangements for regulated investments currently apply to the electricity network businesses (transmission and distribution) and to parts of Queensland Rail's network.

Shareholder concerns relate to the potential scale of investments involved and the fact that where a requirement for open access has been determined, the regulator's decision effectively only provides a cap on revenue. Provision has been made for investments contemplated within decisions by the regulators on monopoly rates of return, to be reviewed and endorsed by shareholding Ministers prior to GOCs proceeding with projects, subject to the regulated investment approval thresholds. Shareholding Ministers may require a GOC to take specific steps in relation to such projects, whilst having regard to the GOC's commercial imperatives, for example, in relation to prioritisation, financing arrangements or how a project is undertaken.

### **Queensland Procurement Policy**

Under the QPP, provisions were included to ensure suppliers meet clear "best practice principles". GOCs must apply the BPPs to all major projects of \$100 million and above.

If a GOC is unsure of whether their investment proposal is subject to the QPP, they should contact Queensland Treasury for clarification.

### Principle 3

#### Shareholding Ministers to be informed of investment decisions

GOC boards are accountable for their investment decisions. As such, investment proposals requiring shareholding Ministers' approval must be approved by a GOC board before being submitted to shareholding Ministers for their consideration.

Early consultation with Queensland Treasury is required for expressions of interest, memoranda of understanding, framework agreements and unsolicited approaches for significant projects to determine whether approvals are required.

GOCs must provide shareholding Ministers with the necessary information to assess investment proposals, to determine whether the project is commercially sound, enhances shareholder value and whether it gives rise to any broader public policy implications for government. Shareholding Ministers also require relevant information to confirm all appropriate probity processes have been followed by the board and senior management in developing the proposal.

In all cases, early consultation with Queensland Treasury on a no-surprises basis is encouraged to assist in facilitating the shareholder approval process.

#### **Business case development**

For investments requiring approval, GOCs are required to submit a full business case to enable shareholding Ministers to assess the project's commerciality, including analysis using a cost of capital based on the GOC Cost of Capital Principles.

Under the *Building Queensland Act 2015*, one of the functions of Building Queensland is to assist or lead the preparation of business cases for investment proposals that exceed \$50 million or \$100 million in cost, respectively. GOCs should be aware of the circumstances when this applies to an investment proposal. Building Queensland has developed a Business Case Development Framework<sup>1</sup>, to assist GOCs with the development of high quality business cases. The Framework aligns with best practice to ensure Business Cases enable Government to evaluate and compare investment opportunities. Similarly, the government's Project Assessment Framework (PAF) also provides guidance regarding the range of issues to consider when developing a business case.

The board is to provide a summary of the process and findings used by the board in its due diligence review of the investment.

Shareholding Ministers may engage appropriately qualified advisers to review critical or more complex investment proposals. The adviser will report directly to shareholding Ministers. The cost of these independent reviews will be borne by the GOC. GOCs will be consulted and advised about the cost of the independent review and kept fully informed as the consultancy continues. Independent advisers will be required to adhere to appropriate arrangements to ensure the strict confidentiality of information made available by GOCs.

GOCs should incorporate sufficient time into their project development schedules to allow for shareholding Ministers' consideration. Proposed investments will be assessed by shareholding Ministers in an expeditious manner, with commercial realities recognised, and GOCs kept informed of progress.

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<sup>1</sup> <http://buildingqueensland.qld.gov.au/wp-content/uploads/2016/12/Business-Case-Development-Framework-Overview.pdf>

## **Principle 4**

GOCs must consider investment risks

GOCs are expected to undertake risk assessments of their investment proposals and implement appropriate risk mitigation strategies. This undertaking should also be confirmed to shareholding Ministers. The risks that will be considered will vary with the investment being undertaken. The purpose of any risk review is to manage risks in a way that will deliver the optimum outcome to the GOC.

The PAF explicitly requires a risk assessment to be conducted and a project Risk Register to be developed as part of the development of a business case. The *Building Queensland Business Case Development Framework* also provides guidance on establishing risk management frameworks within business cases.

A (non-exhaustive) list of potential risks includes:

### **Construction Risk**

GOCs' investment activities are often focused on construction projects, including capital maintenance. Construction projects are generally complex and are characterised by continuous decision-making due to the many sources of risk and uncertainty. Project risks in achieving deadlines and cost targets are significant and therefore it is essential that a GOC identifies risk sources and monitors these risks actively.

Example risk categories include:

- Economic: the risk that the project's output will not be saleable at a price that will cover the project's operating and maintenance costs and its debt service payments.
- Supply: the risk that the GOC is unable to access a competitive group of suppliers for various inputs or only a limited group of suppliers exist, placing upward pressure on prices.
- Completion: the capacity to complete within given timeframes will be very dependent on the management of other risks, including the ability of the construction company to deliver.
- Environmental: the risk that a proposed project may not receive environmental approvals or there are environmental issues resulting from the project due to poor management.
- Technological: inherent risks exist where there is use of new or unproven technologies.
- Force Majeure: the impact of uncontrollable events, including weather and industrial disputations.

### **Counterparty Credit Risk**

Credit assessments are to be undertaken for contractual counterparties in accordance with each GOC's approved credit risk policy as outlined in the Code of Practice for GOCs' Financial Arrangements.

Consideration of the counterparty's credit risk profile should enable appropriate risk mitigation strategies to be determined and clearly specified in tender contracts, for example, the requirement for bank guarantees.

The aim of any risk mitigation strategy is to attempt to ensure that the GOC is not financially disadvantaged due to non-performance of a counterparty under a contract. Mitigation strategies could include the requirement for:

- a parent company guarantee as long as the parent has an appropriate credit rating from an international rating agency; or
- a bank guarantee from an appropriately rated bank.

Careful consideration needs to be given to accepting insurance bonds given a GOC is unable to access the notional value of the bond on demand.

Counterparties in joint ventures or similar such projects are typically characterised by low levels of equity, with financier-secured assets. As such there is no capacity to take security and consideration of contracted off take is essential, as well as profitability, potential parent guarantees and/or third-party guarantees.

## **Contractual Risk**

GOCs should not enter into a contract, framework agreement or memorandum of understanding that may bind a GOC to advance an investment proposal irrespective of shareholding Ministers' approval being obtained.

Prior to entering into any legally binding arrangements involving joint ventures, limited recourse structures, or other investment arrangements with third parties, a GOC board should obtain comprehensive transaction documentation summaries and risk matrices that outline the effect of the arrangement and the key risks to be borne by transaction participants.

## **Joint Ventures (or similar arrangements)**

Joint venture (JV) or similar arrangements should be entered into only where such arrangements are considered to be the most appropriate vehicle for achieving a GOC's financial and strategic objectives. When considering alternative investment arrangements, GOCs are encouraged to identify a corporate structure that will protect their investment when undertaking a project with third parties and should ensure risk sharing arrangements are commensurate with their own contribution to a joint venture relationship established with third parties. Arrangements should be best structured to balance commercial arrangements, returns, risk, flexibility and protection, in consultation with shareholding Ministers.

GOCs are expected to comply with the JV Guidelines as appropriate and confirm to shareholding Ministers that the GOC is not carrying a disproportionate share of risk associated with an investment involving a third party.

GOCs should only announce or commence construction of a project where the prior approval of shareholding Ministers for JV arrangements and agreements has been granted.

## **Information, communications and technology**

Given their size and the nature of their businesses, GOCs typically make large investments from time to time in upgrading IT software and infrastructure. Investments of this nature require particular attention to be given to people or cultural risk.

### **Principle 5**

Interstate and overseas investments permitted in specific circumstances

Adopting a national focus or investing outside of the Queensland market should only be considered if the investment aligns with a GOC's core business and strategic direction as detailed in the GOC's SCI.

As a general rule, interstate and overseas investments continue to be strictly limited in recognition of the numerous risks such investments pose and the preference of shareholding Ministers that GOCs concentrate their business activities within Queensland.

## **Interstate Investments**

GOCs operating in a developed or competitive national market may be able to pursue interstate investment opportunities only with prior shareholding Ministers' approval (regardless of investment cost). Such investments will need to be commercially sound, of strategic advantage to the GOC, and consistent with its core operations within Queensland.

Asset purchases from other states that do not constitute a continuous investment or presence in that state are not considered interstate investments and are subject to approval and notification thresholds.

## Overseas Investments

Overseas investments may be permitted only in very limited circumstances and on a case-by-case basis as approved by shareholding Ministers. Some of the considerations include:

- investments are consistent with, and complementary to, the GOC's core business;
- investments are commercially sound;
- clear competitive advantage can be demonstrated; and
- sovereign risk is broadly equivalent to Australia.

Overseas asset purchases that do not constitute a continuous investment or presence in an overseas market are not considered overseas investments and are subject to approval and notification thresholds.

### **Principle 6**

GOCs to monitor investments and keep shareholding Ministers informed

Shareholding Ministers expect to be readily informed of GOC investments across all stages of a project (e.g., business case development, procurement, approval, delivery, and completion).

Shareholding Ministers must be notified immediately of any adverse circumstances affecting the progress or performance of a GOC investment, or emergence of any risks not previously identified, along with proposals for remedial action to mitigate these circumstances. An appropriate forum for notifying shareholding Ministers of progress is through the quarterly report process to Queensland Treasury.

GOCs are expected to undertake post-completion reviews of a project including assessment of performance against key objectives such as planning and risk management, commercial performance and project management. Shareholding Ministers may request GOCs to provide this review for their consideration and may undertake independent reviews from time to time.

Investment monitoring and review is a key aspect of shareholding Ministers' overall assessment of a GOC's performance. Shareholding Ministers may assign a higher or lower investment approval threshold to a GOC based upon this assessment.

# Flowchart

