

Issue 167 May 27, 2005



## *Time Passes Memories grow dim*

In the last issue, John Hunter looked at knowledge management over time within an organisation. Here we consider a broader issue—

### *How do we manage asset management knowledge over time and over generations?*

The policies and practices that we have adopted and use today are a result of what we have collectively learned from past experience.

Many of the technical policies and practices have been codified in such excellent works as the International Infrastructure Management Manual.

### *But what of our strategic lessons learned?*

Are we doomed to repeat our mistakes because we have forgotten what we once knew?

See **“Free Assets’ tries for a fashion comeback” on p. 928**

Or will we fall for the old idea (tried and failed) that we don’t need to repay debt? See p. 929.

Or the ‘build now—let someone else pay later’ philosophy now being noised about? See p. 930.

### *Asset Management is now old enough to have a history*

And to help ensure that we do not lose the lessons that we learned in earlier times, ACORN Inc—the association for making wiser community infrastructure decisions—is documenting this history. But we need your help, your knowledge and your experience if this is to be successful.

On pp 933-934 you will see some timelines prepared by Ralph Godau (you may remember some of his work from a previous issue) Ralph has undertaken to extend and update the timelines if you can send him more information. We will also be featuring asset management history—by those who have lived through it—“Living History” (coming soon).

Also in this issue

- **Asset Sales: A measure of AM effectiveness**, p. 931
- **The Economic Live of a Hospital**—calibrating from current news, p. 932
- **Readers Response—Holding Governments Accountable**, p.933

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*Like fun fur and bell-bottom trousers*

## **“FREE ASSETS” TRIES FOR A FASHION COMEBACK**

Bad ideas may never be really destroyed – they just go underground and resurface years later when the original lessons learned have been forgotten.

For example, I can remember the days **before asset management** when people spoke of ‘free assets’ – namely those assets that had been funded by developers or by another level of government. I had thought by now that, like free lunches, we were all well aware that there was no such thing as a *free* asset.

But it seems that you can still sell the ‘free asset’ notion if you dress it up. Take the latest incarnation. The argument runs like this:

- 1) We should be borrowing to fund more infrastructure - *and then forget about repaying the debt since inflation will erode the debt for us.*

Having thus disposed of repayments as a cost, the next step is to remove the interest cost burden, so move to step 2.

- 2) The argument here is that since the Federal Government gets the tax on the employment costs of building the new infrastructure, and also from ‘productivity gains’, therefore *the Federal Government should pay the interest on borrowings.*

Clever! In one swoop we have no debt repayment and no interest – hence a ‘free asset’! Only one last step remains to completely blindside ourselves and that is:

- 3) *Ignore the ongoing costs associated with the new capital acquired from the borrowings.* (i.e. the costs associated with operations and maintenance, cleaning, security, heating, lighting, cooling, & administration – all of which, however, must be paid for even if we choose to completely ignore depreciation.)

So there you have it—the **“build now—let someone else pay later”** infrastructure theory.

Other poor ideas are also resurfacing.

It has also been some time since we have heard politicians arguing to *build infrastructure for employment generating reasons*. But these arguments, too, are starting to resurface.

Why?

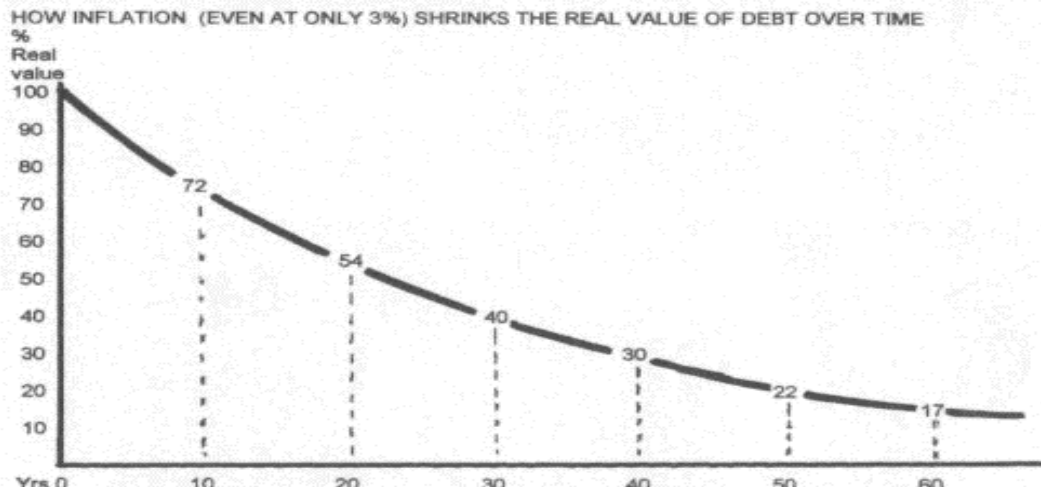
Joe Bjelke Petersen, former Queensland Premier, was famous for his observation that he could tell the health of the economy by observing the number of cranes in the skyline! He is not the only one to think this way. And it is true that building new infrastructure generates employment *–in the short term.*

But it has been years since we overtly used infrastructure spending to ‘kickstart’ the economy. The consequences of past such spending are part of our problems today. Still, it could all happen again, unless we understand – and remember – the lessons of our past. So let’s have a closer look at why the arguments above were considered unsound years ago – *and are still unsound.*

## DEBT REPAYMENT

– FORGET IT AND IT WILL GO AWAY?

The argument for inflation eroding the debt can be a persuasive one: one website promoting the “build now—let someone else pay later” philosophy provides the following graph in support of its contention that debt erodes with inflation. **It is a magician’s trick!**



### *The Magician’s Trick*

Magicians are great at getting you to focus your attention in one spot while the real action is going on somewhere else. This is the case with the ‘inflation erosion’ theory.

The magician wants you to focus on what is being eroded – but what you need to look at is what is left.

### *The “ghosts” in the works*

Take an asset with a 60-year life. After 60 years, the asset is replaced – but 17% of the cost of that asset is still on the books even though the asset is dead. For a 30 year asset, at the 60 year mark when we are installing asset Mark 3, the ghosts of asset Mark 1 (17%) and asset Mark 2 (40%) still reside in the works! *Some intergenerational equity!! (Assets also have shorter lives than we may think—See Page 932 for the life of a children’s hospital\*)*

***The ‘No Debt Repayment’ policy has been tried – and failed.*** Seductively simple, this is not a new argument; it has already been tried - and failed! During the 1980s Victoria had a stated government policy of not repaying debt argued on precisely these

grounds – that inflation would erode the debt; what is more interest payments on infrastructure debt were paid by the central government. These policies made it particularly susceptible to Keating’s “the recession we had to have” in the late 1980s. I can remember driving through the city at that time one Saturday night and the place was a ghost town! Clearly not something that the Victorians wish to resume.

### *And the Victorian Lessons Learned?*

- (1) When assets were effectively ‘free’ there was no discipline on their acquisition. In effect, asset acquisition was overdone.
- (2) The ‘ghosts’ in the works were significant even for long living assets
- (3) Trouble was the policy was applied to all assets – including equipment and computers and while it is true that passive civil components of assets have long lives, the mechanical and electrical components associated with them do not.

Today the Victorian Treasury has a capital charging policy to enforce the notion that assets are *not free*. *Victoria has also been the most active of the states in adopting sound asset management policies, principles and practices.*

## INFRASTRUCTURE SPENDING IS NEEDED

*– but let us get our arguments straight, so that we know where and when*

### Not these arguments

The ‘Build Now—Let Someone Else Pay Later’ Philosophy is supported by a number of arguments

- (1) ***The “Lemmings off the cliff” argument:*** “everybody else is doing it, why shouldn’t we?”
- (2) ***The “Put it on plastic” argument.*** This says that government budgets are so tightly strapped nowadays that they cannot afford to build infrastructure from their revenues – so let’s spend anyway and charge it up to Visa!
- (3) ***The “Head in the Sand” argument.*** The above argument might not be so bad if there was some good reason to suppose that there would be some windfall gains in the future that would support the inherited debt, but in fact the argument runs that not only are budgets tight now but they are going to get worse!
- (4) ***The “Assume the productivities” argument.*** Those supporting this build regardless philosophy—going right back to the National Infrastructure Forums of the late 1980s (supported by the Australian Federation of Construction Contractors) - tend to a broad sweeping ‘productivity’ argument for all infrastructure. However, despite numerous attempts to quantify the so-called productivity benefits, *the case has never been conclusively made for infrastructure spending in general – despite the confident rhetoric of supporters. This is because for every case of well-directed infrastructure spending there has been many that should not have been carried out.*

### *Centralism or Co-operative Federalism?*

The reason these arguments are surfacing now is because they support a push for centralism, i.e. Canberra-determined infrastructure decisions. For those who can remember, it was scrambling to spend the ‘free money’ being lavished by Canberra in the mid 80s by way of grants and low interest loans that resulted in many of the poor infrastructure decisions we are living with today.

### *With knowledge of asset management we can do better.*

One note of sweet reason in the 1990 National Infrastructure Forum was sounded by Graeme Frecker who was then President of the Australian Local Government Association. Fighting off the pleas of the developers for large federally funded construction projects, he quoted Marshall Perron, Chief Minister of the Northern Territory: “I believe it is time now for a truly national approach. However, we do not need greater centralisation of decision making in a land as diverse as ours, with more power of the central government as the Commonwealth is prone to promote. Neither do we need approaches dominated by the self interest of individual States. Rather we need a genuine partnership, a new form of federalism, ... and a truly national perspective.”

### *Business Cases*

In Washington (see last issue) the Asset Managers were facing the problems of poor local infrastructure decisions made when up to 90% of the capital cost was provided by the Federal Government. The best way that they could see to protect against unwise decisions in this ‘easy money’ environment was to require a sound business case for every federally funded project (and by extension every project).

Regional, even national, co-operation based around carefully considered individual projects supported by sound business cases is always a safer way to go than blanket fund allocations.

## ASSET SALES: A MEASURE OF EFFECTIVE ASSET MANAGEMENT

Reasoning that if agencies really know and understand their assets then they should be aware of what is needed and what is surplus – and, given the range of incentives currently in place to enable them to retain the bulk of asset sales revenues, they should be disposing of the surplus. This came out in his report to the Chancellor of the British Exchequer, "Towards Better Management of Public Sector Assets", Dec 2004.

*Sir Michael is the Director of the Institute of Local Government Studies and Professor of Public Policy at Birmingham University and Deputy Chairman of the Audit Commission*

'Asset sales are not the be all and end all of asset management', he observed, although sales is the focus of his report to advise the Government as to how it could achieve its £30 billion asset sales program by 2010.

Exactly how the Government had settled on its £30 billion target was not explained, although it may be inferred that this figure was chosen as the amount that would represent a continuation of recent trends whereby central government had been achieving asset sales of approx £1 billion per annum and local government, sales of about £4 billion per annum. The point was made that about £ 3.5 billion of that £4 billion per annum had been in the form of public housing transferred through right to buy or large scale voluntary transfer and that this scale was unlikely to continue. It was assumed that local government could make up the difference but not spelt out how this would occur.

Similarly it was not clear WHY the Government wanted to achieve £30 billion asset sales. This is mentioned in the context of increasing investment in public sector assets, yet of itself it represents a reduction. Presumably, there is also a spending target and the asset sales were designed to provide funds for reinvestment. This is supported by the inclusion of asset transfers to the private sector that

was loosely considered to be associated with greater private sector investment, even where the need to provide the public service still remained.

Achieving the \$30 billion target could be achieved in one of two main ways – disposal of surplus assets, or transfer of assets and risk to the private sector. The transfer of public houses to tenants did not strictly sit within either of these categories but was counted.

Treasuries may be interested in this report as it is one of the rare reports that actually takes a disposals focus. But I found its findings and recommendations pretty light on. For example

- It dismisses as a furphy the idea that the Treasury would allow retention of asset sales revenues – but then adjust the next year's budget downwards because of this; to my mind a legitimate fear of agencies (and *the* major barrier to the effectiveness of any capital charging regime.)
- It talks about the danger of fire sales for assets disposed of in a short period of time but does not address the issue of agencies inappropriately transferring assets to the private sector just to meet a sales quota.
- There is no discussion of the impact of asset sales on the quality (or even the quantity) of service.

This report is said to have 'made waves' in the British Government but I could find no published comment or criticism. I guess an agency would have to be pretty wary about challenging the Deputy Chair of the Audit Commission.

You can find the full report at [http://www.hm-treasury.gov.uk/pre\\_budget\\_report/prebud\\_pbr04/assoc\\_docs/prebud\\_pbr04\\_lyons.cfm](http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr04/assoc_docs/prebud_pbr04_lyons.cfm) or by choosing asset sales at the [www.amqi.com](http://www.amqi.com) resource library

## WHAT IS THE ECONOMIC LIFE OF A HOSPITAL?

Interpreting the news

### *Functional Lives*

In a previous issue (SAM 147) a survey of asset managers sought information on how functionality was bringing economic lives to an end sooner than physical condition would have suggested. The considered assessment of our 15 experienced hospital asset managers was that building structures would last 50 years before functional change required renewal.

### *Victorian Budget Provides Feedback*

Latest budget news provides an opportunity to check that assessment in the case of one hospital—the Royal Melbourne Children's for the Premier has announced that it is to be completely rebuilt.—not refurbished, but rebuilt. "The guarantee that I can give... is that all the wards will be completely, brand spanking new, completely new wards, completely new facilities, completely new conditions". It will be built on the site of the existing 42-year-old facility but while some of the old buildings would be retained for specialist services and administration, wards, theatres, etc would be rebuilt. The expected construction will begin at the end of 2007, with completion about 2011.

Since the Royal Melbourne Children's Hospital was built in 1962 This puts the economic life of *this hospital* at between 45 and 49 years, or an average of 47.

### *Does this mean that the economic lives of all hospital structures should be written down to 47?*

Before making this assessment we need to look at what has brought the life of this hospital to an end. Poor initial design? One might think so given the Premier's casual throw away line that "It was not built to last" - an unwise and likely inaccurate comment given that the hospital was one of the designs of the eminent architect, Sir Arthur Stephenson, a world famous post war hospital

designer knighted for services to hospital design. (An Australian, he was also made an honorary citizen of New York for his work in hospital design in that city), He also designed the Royal Melbourne.

### *Functional Change for Children's Hospitals*

One answer is that the required functions for *children's hospitals have changed*. Previously only children stayed at the hospital but now many parents also stay and this has led to overcrowding.

### *Functional Change for Hospitals generally*

Previously we had a nurse's station at the end of a long corridor, today the model of organisation used is for a central nursing station with ward space radiating around it, giving better sightlines and quicker and easier access. This mode of organisation needs a squarish floor plan; the previous mode required a rectangular floor plan. It is often not possible to make the organisational changes required within the existing buildings.

This organisational change also affects the Royal Melbourne, which is a little older.

### *Average Economic Life is Much Below 50*

The real economic life of a hospital could be considerably under 40 years for the following reasons:

- Building structure is the longest living element of a hospital. Fit-out, equipment, have lives of 15 years or even less.
- A hospital comprises many buildings, built over time. The Royal Children's *oldest* buildings are 43 years old. Building activity is constant, eg.
- Although the Children's hospital has now been determined obsolete and within a few years of complete renewal, \$6 million has been allocated in the last budget to upgrade the hospital's cancer ward, \$7 million for a new kitchen, \$5 million for a lift upgrade and \$8.9 million for ward rebuilding, all works to be start within months.

**Readers Response:**

***How can the Crown/Governments/Politicians be held accountable for their decisions?***

I read your article in AMQ Strategic Asset Management [ #163] with interest and feel that many of the topics under thinking forward can be categorized under the above heading.

My argument is as follows:

In Australia all Land and Natural Resources are owner by the Crown and Freehold Land Title is the same as Leasehold in Perpetuity in many other countries. Land Zoning restricts land use and penalizes those that do not comply to the Land zoning. Land Titles include a custodial responsibility, where the land or resource must not be degraded or misused. Environmental Law is based on the above premise where land degrader or polluter pays for their pollution. Example: Air/ Noise/Water pollution, Chemical spills, soil erosion and Mine environmental restoration.

Why then does the Crown/Governments exempt themselves, and the chosen few (mainly Rural land users and Government supported Industry) from the provisions of their own Law? Is it not the Crown/ Government that has caused the environmental and demographic and social problems we now face? How can the Crown/Governments/Politicians be held accountable for their decisions?

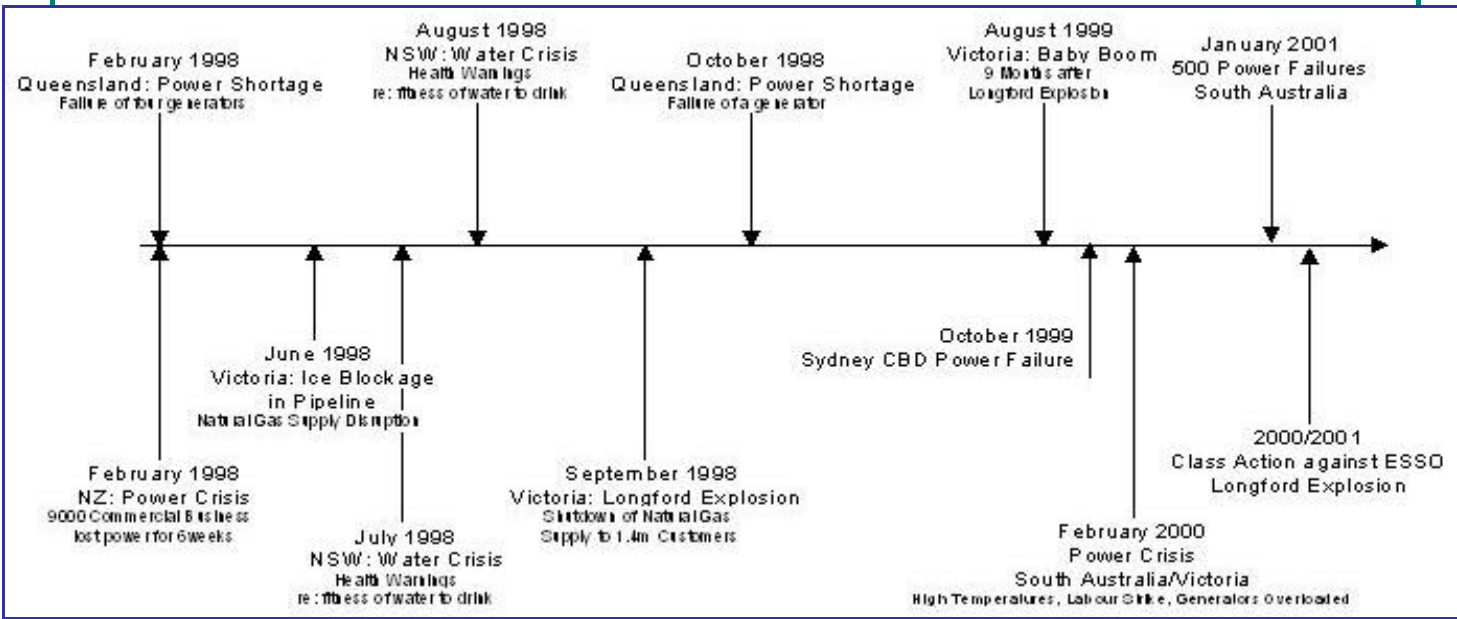
Is this not the reason why Governments/Politicians suppress community awareness in asset and environment management?

As you can see I see Asset Management as inclusive of Environmental and Resource Management and covers the "Built and Un-built Environment". The Economy being a wholly owned subsidy of the Environment.

Regards  
Robert Wells

**TIMELINES**  
Help develop and preserve AM history (see next page)

Asset Failures. See also next page



## TIMELINES

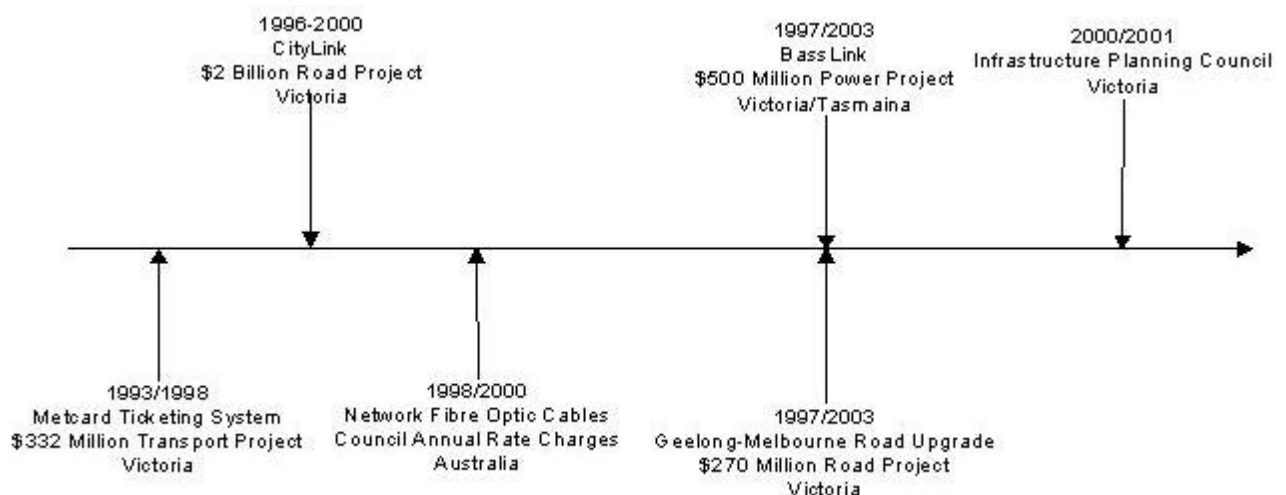
We are all captives of our history. What we do today is a reflection of what has happened in our past. Not to know this past is not to understand the present. Hence this timeline series. We are starting with just four, and for each we have coverage for just four or so years - *to start with!*

Please tell us what other TIMELINES you would like to see, and what KEY EVENTS are relevant. The growth of this facility depends on the knowledge of the asset management community, and your willingness to share that knowledge. This is not confined to Australia, we have just started with what we know. The work here is the result of postgraduate research by ACORN Inc member, **Ralph Godau** who has offered to manage this section of the site and keep our Timelines updated with new information.

See other timelines and use the coupon on [www.acorninc.org](http://www.acorninc.org)

### Infrastructure Development

This is a selection of key events in the infrastructure development in Australia. You may know of other events that have been significant for one reason or another. Please add your events using the coupon at the foot of this timeline series. Don't worry if you do not have complete details, just tell us why you think it is important.



We currently have the beginnings of timelines for **Infrastructure Failures** and **Infrastructure Development in Australia** (as you see here).

We also have timeline for **Gas Privatisation** and for **Telecommunications**

What dates can you ADD?

What new timelines can you SUGGEST?

Tell us at [www.acorninc.org](http://www.acorninc.org)