Blacktown City Council
Growing with Pride

F14/2025

25 May 2015

Ms Lucy Garnier
Executive Director Local Government
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB POST OFFICE NSW 1230

Dear Ms Garnier

Submission – IPART's methodology for assessment of Council Fit for the Future proposals

Blacktown City Council appreciates the opportunity to comment on IPART's proposed method of assessing councils in the Fit for the Future (FFTF) process.

Council is presently exhibiting its draft response to the FFTF requirements. As Blacktown City clearly meets the scale and capacity requirements identified in the process, Council has resolved to submit a stand-alone 'improvement proposal' on which our community is being consulted.

Blacktown City shares the concern expressed by the industry regarding the unrealistic timeframe which has been set for the submission and assessment of proposals. This may lead to a process which is inadequate and insufficiently transparent to provide a sustainable way forward for local government. Subject to this, I provide the following comments on the assessment criteria.

While I appreciate the challenge of ensuring that diverse councils across NSW are measured on a 'level playing field', Blacktown City has a significant concern with the proposed methodology for assessment of FFTF submissions which has been published in IPART's consultation paper. Our concern relates particularly to the benchmarks which are provided for a council to be assessed as sustainable.

Overall, the financial and infrastructure benchmarks do not provide an adequate or complete indication of a council's performance or long-term sustainability. Blacktown City supports the call made by Local Government NSW for improvements to be made to the published criteria prior to the assessment of proposals.

Blacktown City is one of the financially strongest councils in NSW, as is attested by our FFTF proposal. Nevertheless, we presently meet the arbitrary benchmark for only 1 of the 7 FFTF indicators and are unlikely to meet several of the benchmarks in the short to medium term. This does not indicate an unsustainable financial position. In some instances, the measures which Council might need to undertake to meet the benchmarks, should it determine to do so, would not improve Council's current and projected financial sustainability.

The FFTF financial criteria are addressed in our submission in the proper context of Council's actual financial position. Blacktown City strongly advocates that these inadequate measures should be supplemented with additional and more balanced financial information, based on councils' Long Term Financial Plans and the statutory reporting which is used by local government auditors to assess council finances.

The Office of Local Government (OLG) has previously acknowledged that some of the FFTF indicators are inappropriate for councils in high growth areas, such as Blacktown City and Camden which contain the majority of the North West and South West Growth Sectors of Sydney. Your consideration is requested of a more appropriate approach to assess councils depending upon their level of growth.

We also ask that the following specific matters be considered in a revision of the benchmarks to be undertaken prior to the assessment phase:

- Depreciation – the current lack of standardisation in NSW local government practice and reporting means that councils with a conservative policy regarding depreciation, such as Blacktown City, are disadvantaged by some of the FFTF benchmarks

- Asset renewal funding – the indicators need to include assessment of forecast asset renewal funding gaps (as for a council's Long Term Financial Plan and Asset Management Strategy), which more accurately depict a council's funding shortfall for future asset renewal expense against the annual depreciation expense

- Own source revenue – the benchmark is not appropriate for high growth councils which receive a large proportion of their revenue from section 94 contributions

- Use of debt – while we acknowledge that the use of debt is practical for councils in some instances, a debt free status is of significant value and it is inappropriate for OLG or IPART to set a benchmark which requires all councils to have debt

- Lack of any indicators which adequately address liquidity, available working capital and debtor management, traditionally the key measures of local government financial sustainability

More detailed information regarding Blacktown City's views on the proposed assessment methodology is provided in the attached document.

Thank you for your consideration of Council's concerns. Should you wish to discuss this matter further, please do not hesitate to contact me on 02 9839 6516.

Yours faithfully,

[redacted]

Wayne Rogers
Director Corporate Services

BLACKTOWN CITY COUNCIL

SUBMISSION TO INDEPENDENT PRICING AND REGULATORY TRIBUNAL

Consultation Paper – *Methodology for Assessment of Council Fit for the Future Proposals* (released April 2015)

Introduction

Blacktown City Council welcomes the opportunity of making comment on the proposed methodology for assessment of council Fit for the Future (FFTF) proposals by IPART.

It is not intended to respond to all the matters identified in the paper, but to comment under the relevant headings on those issues of most concern to us.

Blacktown City has played a proactive role in the strategic review of the local government sector and seeks to work collaboratively with the State Government and our fellow councils for more secure and sustainable local government.

We have previously identified to the Office of Local Government (OLG) significant concerns regarding the financial indicators and benchmarks used as criteria for FFTF. These concerns are not mitigated by the proposed IPART methodology, which in some cases increases the arbitrary application of measures which Blacktown City does not consider balanced or appropriate to judge financial sustainability.

The key issues for Blacktown City, and for the industry, which should be addressed by revision of the proposed methodology, are outlined below under the 5 suggested "Questions for stakeholder feedback" in the consultation paper (page 11).

Major issues include:

- Appropriate consideration in the application of the indicators and benchmarks to the realistic circumstances of high growth councils (including revenue sources, asset growth and depreciation)

- Review of the appropriate timeframe for the FFTF assessment of some indicators to consider 10 years (as per the Integrated Planning and Reporting guidelines) rather than 5 years.

In regard to both these points, IPART should consider a more nuanced or tiered assessment, depending on the council's actual circumstances, rather than a rigid 'one size fits all' assessment.

Question 1 – Assessment of scale and capacity criteria

Blacktown City clearly has the scale and capacity to stand alone as a strong and sustainable council in the future of NSW local government. Our improvement proposal is consistent with the preferred option identified by the report of the Independent Local Government Review Panel (ILGRP).

Blacktown City is the largest local government area by population in NSW and the fourth largest in Australia, with an estimated resident population in 2014 of over 332,000. The City is expecting a further 25 years of sustained growth, to reach a total population in excess of 500,000 residents.

Blacktown City Council has long established and well proven credentials in strategic planning and advocacy, as a representative of its local community, as a regional stakeholder and as an effective partner for government.

We have no concerns with meeting the application of the **strategic capacity** criterion.

However, we recognise and respects the serious concerns raised by the industry regarding the **scale criterion** and the absence of any clear statement of or rationale for a population threshold test for councils in metropolitan Sydney. Blacktown City Council is opposed to any forced local government amalgamations.

Question 2 – Rural council characteristics

Council does not comment on the matters covered in this question.

Question 3 – Assessment of sustainability, infrastructure management and efficiency criteria

Blacktown City has significant concerns, which we have previously addressed to the Office of Local Government, regarding the indicators and the arbitrary benchmarks which are set in the FFTF process as the measure of a council's sustainability, infrastructure management and efficiency.

Our concerns are exacerbated by the IPART proposal to assess 3 of the benchmarks according to a status of 'must meet within 5 years'.

Blacktown City does not believe that a 'one size fits all' approach provides a suitable assessment framework for councils, either within metropolitan Sydney or across NSW. The diversity of councils and communities is not appropriately reflected in the limited and rigid nature of this proposal.

Overall, the financial and infrastructure benchmarks do not provide an adequate or complete indication of a council's performance or long-term sustainability.

OLG has previously acknowledged that some of the FFTF indicators are inappropriate for councils in high growth areas, such as Blacktown City and Camden, which contain the majority of the North West and South West Growth Centres of Sydney . Your consideration is requested of a more appropriate and tiered approach to assess councils, depending upon their level of growth. The timing of that growth is also critical, as IPART has set a 5-year timeframe for its benchmarks. Development of the North West Growth Centre is expected for another 20 years, which is the real and critical setting for affected councils.

Blacktown City is financially one of the soundest councils in NSW, as consistently attested by our external auditors, PricewaterhouseCoopers. Nevertheless, we presently meet the benchmark for only 1 of the 7 FFTF indicators and are unlikely to meet several of the benchmarks in the short to medium term. This does not indicate an unsustainable financial position but rather the need to manage high growth, provision of new infrastructure and the maintenance and renewal of a multi-billion dollar asset stock.

If Council were to seek to meet the FFTF benchmarks, rather than to base its decisions on prudent financial management, the measures which we might need to undertake would not necessarily improve Council's current and projected financial sustainability.

Blacktown City strongly advocates that the FFTF criteria should be supplemented with additional and more balanced financial information, based on councils' Long Term Financial Plans and relevant financial reporting.

These issues are further detailed by the following commentary on each of the indicators and benchmarks. This is supplemented by **Appendix 1** on the impact of depreciation.

- **Operating Performance Ratio**
  (> or equal to break-even average over 3 years)

The definition of 'operating expenditure' includes depreciation. Whilst the calculation of this ratio is technically correct and an applicable measure for most industries, it does present a misleading result for some councils, particularly those such as Blacktown City that are experiencing a significant level of growth in their infrastructure asset base.

It is unlikely and not reasonable to expect that a growth council will be able to, nor should it be aiming to fully cash fund its depreciation whilst it is experiencing high levels of growth. In the case of Blacktown City, the reason for this is we currently have an annual depreciation expense of around $60 million.

Over the next 20 years, we will build another $2.8 billion worth of infrastructure assets. Annually this will be more than $100 million in additional infrastructure assets that will be depreciated each year. This means our depreciation expense will increase by around $2 million each year.

This annual increase in depreciation means that for this indicator the actual cost required to renew the City's assets will be incurred sometime in the future. That is, the annual depreciation expense is recognised once the asset is constructed, however as these are long life assets, they usually do not require large amounts of maintenance or renewal funding at this early stage of their life.

Additionally, a large portion of these infrastructure assets are funded from Section 94 developer contributions that do not generate revenue as they are community assets. Therefore, during the growth period, the annual depreciation will increase at a much higher rate than operating revenues, most notably rates income. This ultimately means that a growth council will struggle to generate an operating surplus including depreciation during a period of significant growth.

It is recognised though, that when a growth council moves into the maintenance phase and is no longer growing, the annual depreciation expense will level out to a large degree. It is at this stage that it is reasonable to expect that the operating revenues will over time increase at a much faster rate than depreciation expense, at which time annual operating surpluses should be able to be achieved. As such, for a 'growth' council this indicator is not considered as meaningful as it is for a 'maintenance' council.

Growth councils need to be planning for the renewal of these assets when they are due, which means positioning themselves financially to have sufficient funding available in the long term when the actual renewals require funding.

- **Own Source Revenue Ratio
(> 60% average over 3 years)**

For a high growth council, this indicator is largely affected by the level of development activity and Section 94 / works in kind income. The benchmark is not appropriate for high growth councils which receive a large proportion of their revenue from Section 94 developer contributions.

IPART has stated that Financial Assistance Grants will be taken into consideration for rural councils when assessing this ratio. This should also be the case for metropolitan councils. IPART has advised that:

> *there will be an element of discretion from the Panel whether the FAGs is relevant to be considered in that Council's case. So it'll be up to the Council to make the case as to why the FAGs should be included in the figure.*
> (transcript of IPART Sydney consultation meeting, 11 May 2015)

Blacktown City receives around $18 million - $19 million per annum in FAGs. Given the FAG is recurrent in nature and not tied to any specific purpose, it is considered appropriate that it be included as part of a council's own source revenue. The treatment of FAGs by IPART will therefore substantially determine our status in regard to this benchmark.

Subject to this consideration, to guarantee to meet the benchmark, Council would have to very substantially increase its rates and/or fees and charges. Blacktown City submitted a detailed analysis of its revenue policy and forecasts to IPART as part of our successful Special Rate Variation application for 2014/2015. To seek a large additional rate increase simply in order to meet this FFTF benchmark would not be in keeping with either the NSW rating system or prudent management.

- **Building and Asset Renewal Ratio
(>100% average over 3 years)**

The quantum of Blacktown City's assets is currently $2.8 billion, and this is growing at over $100 million per annum.

In order to achieve this benchmark, Council would need to spend around $47 million per annum on asset renewal. This is not realistic under the NSW rate pegging system. Following a major new funding strategy adopted from 2014/2015 (including the Special Variation which was approved by IPART), Blacktown City is effectively managing and reducing its renewal backlog.

This benchmark is also impacted by the effect of depreciation (refer to **Appendix 1**).

We would question the rationale of having a benchmark of a 100% average over 3 years, that is, fully funding depreciation when new assets are just being constructed. On this basis, councils might be overcapitalising, or over-renewing assets before this is actually required.

Blacktown City's asset renewal forecasting is based on comprehensive physical assessment and mature asset management systems.

- **Infrastructure Backlog Ratio (<2%)**

It is noted that this ratio is based on the written down value of infrastructure. It is not correct to use a written down value when the replacement value is effectively the gross book value. This point has been made by the industry (e.g. at the Sydney consultation forum on 11 May 2015).

Council expects to meet the Infrastructure Backlog benchmark over the next 10 years, which is the statutory local government financial planning cycle, but not within the 5 year timeframe of the FFTF benchmarks.

As noted above, consideration should be given to realistic FFTF assessment timeframes, as well as to the benchmarks themselves.

- **Asset Maintenance Ratio**
  (>100% average over 3 years)

Blacktown City does not object to this benchmark in principle. However, we note the industry discussion (through IPWEA and other bodies) on the need to better define the relationship of 'renewal' and 'maintenance' funding.

- **Debt Service Ratio**
  (>0 and less than or equal to 20% average over 3 years)

The formula for this indicator is obviously flawed and Blacktown City strongly urges its reconsideration.

The benchmark is calculated such that a council 'fails' the indicator because it is debt free. While we acknowledge that the use of debt is practical for councils in some instances, a debt free status is of value to a council and it is inappropriate to set a benchmark which requires all councils to have debt. This does not recognise the value to some councils of being debt free and other financial measures they have in place for recurrent expenditure where debt is not appropriate.

It is noted that state and federal governments over recent decades have actively worked to significantly reduce the use of debt.

Previously, Blacktown City had significant levels of debt, which by the 1990s seriously impacted its financial sustainability. Having worked very hard to become debt free, Council established an Infrastructure Sinking Fund, which was set up to be (in lieu of debt) a source of funding for major capital works. This sinking fund has contributed over $280 million in the past 20 years to infrastructure provision and renewal.

The appropriateness of Blacktown City's approach in this regard was acknowledged by IPART in its assessment of our Special Rate Variation application for 2014/15.

- **Real Operating Expenditure per capita over time (a decrease in real operating expenditure per capita over time)**

Blacktown City meets this benchmark and does not object to it as one measure. However, for this single ratio to be taken as an indication of a council's 'efficiency', in isolation from its full financial and service delivery performance, is manifestly inadequate.

Better and more comprehensive industry measures of efficiency need to be established. In this regard, it is regrettable that the expected NSW Performance Measurement Framework (which was to have been published by OLG in 2014) has not been completed.

Other indicators and considerations

As noted above, the indicators used as part of FFTF apply a one size fits all methodology. This is not necessarily appropriate for all councils which will have different local factors that impact the results.

Local Government NSW has published an independent review of the FFTF criteria and has proposed a number of improvements be made prior to the assessment of proposals. Blacktown City supports this request and has asked that the following specific matters be considered in a review of the benchmarks to be undertaken prior to the assessment phase:

- Depreciation – the current lack of consistency in NSW local government practice and reporting means that councils with a conservative policy regarding depreciation, such as Blacktown City, are disadvantaged by some of the FFTF benchmarks *(this issue is addressed in more detail in **Appendix 1**)*

- Asset renewal funding – the indicators should include assessment of forecast asset renewal funding gaps (as is required for a council's Long Term Financial Plan and Asset Management Strategy). This would more accurately depict a council's funding shortfall for future asset renewal expense against the annual depreciation expense

- Lack of any indicators which adequately address liquidity, available working capital and debtor management, traditionally the key measures of local government financial sustainability.

Other key factors which should be included in a proper assessment of local government financial sustainability include cost shifting from federal and state governments and the impact of major changes to grant programs especially the Financial Assistance Grant (FAG).

Question 4 – Community engagement

It is noted that there are no requirements for councils preparing an improvement proposal in keeping with the ILGRP preferred option for that council to consult their community.

Notwithstanding this, Blacktown City has provided its community and stakeholders with the opportunity to engage with the FFTF process and to provide feedback on its draft improvement proposal. Our community engagement program includes a 28-day public exhibition and the provision of a consultation web page.

Question 5 – Monitoring of FFTF performance

Blacktown City supports the proposal that

- councils would report performance on FFTF outcomes in the Annual Report
- the Auditor General would reassess performance periodically as part of the new role of the Audit Office of NSW in the sector, as proposed by the ILGRP – in this regard, our support would be conditional on appropriate consultation with the local government industry on this measure and its costs.

APPENDIX 1 – IMPACT OF DEPRECIATION ON FINANCIAL BENCHMARKS

The value of depreciation estimated by councils has a significant impact on the following 3 FFTF indicators:

- Operating performance ratio
- Building and asset renewal ratio
- Declining real operating expenditure per capita over time.

Problems with depreciation

- Can be artificially adjusted to provide a better result
- No industry standard on depreciation rates for different types of assets
- Not a true reflection of the consumption of the asset or level of required intervention
- Difficult to accurately align with Asset Management Plans.

There is no State-wide standard for the application of depreciation in NSW local government and consequently there is a general lack of consistency across the industry in how depreciation is measured. This makes these criteria difficult to rely on, especially for comparative purposes.

It is not suggested that all councils must have exactly the same depreciation rates, as the useful life of an asset is dependent on many things such as when and how an asset was constructed, its level of use etc. Accordingly, the useful life of each local road may be different having regard for local factors. There would be many other similar examples, the point is the FFTF benchmark analysis does not really take these individual characteristics into account.

Blacktown City context

Blacktown City Council is responsible for some $2.8 billion of public assets. This asset base has grown by $1 billion since 2001 (resulting in an increase in annual depreciation of approximately $18 million) and will continue to grow rapidly with the expansion of the City *(refer to section 1)*. These new assets don't require funding now, they will require renewal funding in the future. Council currently depreciates these assets on average over 58 years, it being noted that infrastructure assets comprise a number of sub-categories with depreciation varying according to the useful life of the asset.

Our current approach to depreciation is based on:

- Condition assessments
- Different rates of depreciation for different asset components
- Expected useful life of each asset component
- Estimated remaining useful life of each asset.

The useful life of all assets is based on the detailed analysis of Council's infrastructure assets. Not all other councils have applied the same rigour to projecting the useful lives of infrastructure assets.

Required depreciation adjustment for the FFTF benchmarks to be achieved

If Blacktown City was able to increase the average useful life of its assets by 20 years, our annual depreciation expense would be reduced by around $10 million. Even with this change to our depreciation methods, however, Blacktown City would still not meet the FFTF indicators.

A better measure would be to assess how well a council is funding its infrastructure asset renewal funding requirements on an annual basis. That is, as assets are due for renewal, how well are we actually matching the funding to the renewal requirements. Council has an asset renewal funding strategy, which is based on meeting the annual renewal funding requirements as projected through detailed asset management planning.

Since the TCorp review of local government finances in 2013, some councils would have been tempted to adjust their depreciation standards in order to improve their overall assessment on a number of financial indicators.

Blacktown City's depreciation rate is 1.733%, meaning our infrastructure assets are on average being fully depreciated over 58 years.

Blacktown City would need to reduce its depreciation by $27.5 million to achieve each of the FFTF indicators.

This means an average rate of depreciation of 1.05% annually or depreciating all of our assets over 95 years as opposed to our current average of 58 years.

<u>Comparative information on Depreciation</u>

The following table is a comparison of the different rates of depreciation used by a sample of councils for their depreciable infrastructure assets (roads, footpaths and drainage).

Table 1 – comparative information on depreciation

000's	Infrastructure (depreciable) Fair value	Depreciation expense	%	Average # Years to fully depreciate assets
Blacktown City Council	2,214,422	38,385	1.733%	57.69
The Hills Shire Council	1,240,816	12,055	0.972%	102.93
Penrith City Council	1,059,922	9,015	0.851%	117.57
City of Sydney	1,942,537	34,954	1.799%	55.57
Parramatta City Council	1,143,413	19,703	1.723%	58.03
Manly Council	299,188	3,044	1.017%	98.29
Lane Cove Council	254,729	3,358	1.318%	75.86
Average (excluding Blacktown)			**1.280%**	**78.12**
Recalculate Blacktown depreciation @ sample average	2,214,422	28,346	1.280%	**78.12**
Recalculate Blacktown depreciation @ 1%	2,214,422	22,144	1.000%	**100.00**

- Blacktown City's depreciation rate is 1.733%, meaning our infrastructure assets are on average being fully depreciated over 58 years
- The average rate for the other councils included in the table is 1.28% or 78 years
- If our infrastructure assets were depreciated at the same rate as the average of the sample group, our depreciation on these assets would be $10 million less
- This reduction still wouldn't be enough for us to achieve all the FFTF indicators.