



THE LORD MAYOR OF SYDNEY  
**CLOVER MOORE**



**19 MAY 2015**

Dr Peter Boxall  
Chair  
Independent Pricing and Regulatory Tribunal  
PO Box K35  
Haymarket Post Shop NSW 1240

Dear Dr Boxall

### **Submission - Fit for the Future Assessment Methodology**

On 27 April 2015 the Independent Pricing and Regulatory Tribunal (IPART) announced that it would undertake the role of Expert Advisory Panel of the State Government's 'Fit for the Future' process and invited public comment on its proposed methodology.

The City appreciates the opportunity to comment on the IPART draft methodology and recommends changes in key areas to ensure equity and consistency.

### **Consistency of Requirements**

IPART proposes to finalise its assessment methodology on or after 1 June, following the current consultation period—less than one month before final submissions on 'Fit for the Future' are due.

IPART needs to ensure its final methodology is consistent with the approach established in the material released by the State Government since its 'Fit for the Future' announcement on 10 September 2014. Most importantly, IPART needs to revise the emphasis on amalgamation proposals in the Independent Local Government Review Panel Report (ILGRP).

State Government Guidance Material for 'Template 1' states that "This template is designed for councils that intend to undertake a **voluntary merger**." Guidance Material for 'Template 2' states that "If the Panel recommended a merger for your council, this should be the first option that you consider. If, **after considering all the issues**, you believe your council is of the appropriate scale, you should proceed with completing Template 2 - the Improvement Proposal."

In contrast, IPART puts a significantly greater emphasis, including new expectations, on the ILGRP amalgamation proposal:

*If the ILGRP recommended a council to stand-alone or undertake structural change, then the council should demonstrate that they first considered making a proposal on this basis. If the ILGRP recommended a merger as the preferred option and the council did not propose one, **the council will be assessed as 'not fit'**, unless it presents either:*

- a sound argument (eg, using a business case) that demonstrates that **the proposed approach is superior** to the recommended merger, or*
- a merger option broadly consistent with the ILGRP recommendation to merge councils (eg, with three rather than four councils), supported by a sound argument...*

Over the past eight months, Councils have been developing 'Fit for the Future' responses aligned with the State Government's advice and undertaken required community consultation, research and significant staff time. ***It is not feasible to restart this work and IPART's assessment methodology must not 'move the goal posts' at this stage.***

### **Lack of Evidence-base for ILGRP Amalgamation Proposal**

The recommendations of the ILGRP do not provide a workable basis for an evidence-based argument of 'superior outcomes' as they are largely based on an unsubstantiated assumption that 'bigger is better'.

For the City of Sydney, the ILGRP report recommended an amalgamation of Botany Bay, Randwick, Sydney, Waverley and Woollahra councils. This combination was not supported by an evidence-based analysis or a business case, but by a set of high level principles. ILGRP argument that mergers can generate savings was not supported by any research to demonstrate the benefit for this particular proposal. Existing research points to benefit only on a case-by-case basis, not a correlation between size and efficiency, or amalgamation and improved results.

The City was forcibly amalgamated by the State Government in 2004. As detailed in our submissions to the ILGRP, the process was enormously disruptive and it took significant time and resources to align policies and systems. As we have restated in several submissions on the State Governments reform process, ***priority needs to be given to the issues of financial capacity, collaboration and coordination, and governance.***

### **Scale and Capacity**

Central to IPART's proposed methodology is the *threshold* issues of 'scale and capacity'.

The draft methodology treats this as a single criterion when in fact these are two criteria that are separate and indirectly related. Increased scale does not guarantee increased capacity.

There are no simple numerical criteria possible for the appropriate 'scale' of local councils in metropolitan Sydney, such as a specific target population or number of councils. Adequate scale is subjective and dependent on context. Specifically:



- Adequate scale depends on local government's role and responsibility. In some jurisdictions, local government has responsibilities such as transport, social housing, health, education and/or policing. The State Government has not pursued reform of the role of local government, even the transfer of full control over traditional responsibilities such as roads and development.
- The ILGRP report proposes an amalgamation for the City that would create a council with a projected residential population of 669,400—larger than the state of Tasmania. It proposes other councils with much smaller residential populations, not a one-size-fits-all approach.
- The focus on residential population ignores **broader indicators of scale**, including numbers of businesses, workers, tourists and visitors. The City services the needs of around 1.1 million people daily, which provides a clearer indicator of global scale, capacity and status than residential numbers alone.

IPART needs a clear definition of 'global city'. The consultation paper points to the Metropolitan Strategy, which indicates Global Sydney is made up of Sydney CBD and adjacent precincts, including North Sydney. In other parts of the Strategy, the broader metropolitan area is the global city. The ILGRP proposals do not align with either of these concepts.

The IPART discussion paper proposes adopting the 10 elements of strategic capacity identified by the final report of the ILGRP. While these are desirable features of good local government, most are qualitative and difficult to measure. Some are highly subjective—whether a council has high quality political and managerial leadership can depend on partisan views more than objective evidence.

IPART needs to define the meaning of the 10 key elements, how they will be measured and what role each will play in the methodology to be used by IPART.

### **Benchmarks**

The relative importance of the various financial benchmarks changed between the T-Corp assessment of councils' financial performance and Fit for the Future. The weightings have changed again in IPART's draft methodology. Although T-Corps' ratios of liquidity and capital expenditure are strong indicators of capacity, they are not included in current benchmarks.

Since their release, significant flaws have been identified in the Fit for the Future financial indicators—especially that councils are expected to have debt to be sustainable and that the asset ratios encourage over-servicing assets at the expense of other responsibilities. IPART must address these identified problems.

The City supports the T-Corp definition that *"A local government will be financially sustainable over the long term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community"*.

IPART's methodology needs to include measures of quality and effectiveness, in line with plans developed with local communities through the Integrated Planning and Reporting framework.

### Unrealistic Timeframe

There are 152 councils in NSW. IPART's Terms of Reference require the Tribunal to assess these submissions within three months and report back to the Minister for Local Government. As the Chair and CEO of IPART have acknowledged in recent forums, this is a challenging timeframe.

I note that IPART has stated clearly that it is committed to meeting the timeframe set by the State Government. However, given the shift in emphasis, lack of clearly defined and empirical benchmarks, this appears unrealistic and risks the quality of the review.

I also understand that IPART's final report will be submitted to the State Government without being made public. It is not transparent, accountable or equitable that Councils will not know how they have been rated and will have no right of reply.

Yours sincerely

**Clover Moore**  
Lord Mayor



## City of Sydney Submission – Draft Fit for the Future Assessment Methodology

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1. **How should the key elements of strategic capacity influence our assessment of scale and capacity? Are there any improvements we can make to how we propose to assess the scale and capacity criterion, consistent with OLG guidance material?**

There are a number of issues with the proposed 'criterion' of *scale and capacity*.

The IPART methodology outlines the key elements of strategic capacity in Box 3.1 page 21. In the paragraph below, the table is described as setting the requirements of '*scale and capacity*', not just strategic capacity. Additional criteria for *sufficient scale* are then set out, suggesting either an '*appropriate minimum population size*' or a *target number of councils*.

***The methodology needs to clearly define these concepts, including clarity that they are separate, if at times interrelated, concepts.***

There is no clear indication of the weighting of importance of residential population against a target number of councils within the Sydney metropolitan area.

### **Population size**

No definition of an appropriate minimum population size is provided and, given the complexity of the issues, it is unlikely that any specific number could be developed.

The appropriate scale for local government depends on the role and responsibility of local government in NSW. In other jurisdictions, local government has a much broader range of responsibilities, including transport, social housing, health, education and policing. While not all of these would be appropriate for local government in Australia, it is impossible to properly consider the right scale of local government if the responsibilities of local government are not clear. It is pointless expanding the size of local government in isolation from ***increased responsibility***.

The State Government has specifically deferred reform of local government responsibility, even the possibility of transferring (restoring) responsibility for planning and development. The State also retains veto control over the majority of other issues that do fall within the responsibility of local government.

A definition of scale must include more than just the number of residents within a council's boundaries. The City, for example, ***services over 1.1 million people***, including business owners, workers, students, tourists, visitors and residents daily.

These populations place significant demands on council, including high levels of waste and cleansing, high quality public domain and facilities, and services relating to economic development, tourism, culture and major events. The business community pays rates and, in the City of Sydney, receive two votes for each corporation.



The number of residents gives no indication of broader population numbers, the intensity of activity or a council's capacity to work with other levels of government. There is no evidence that resident numbers are an indicator of global recognition or capacity to deliver effective or efficient city governance.

### **Target Number of Councils**

The State Government has not set any target number of metropolitan councils and any attempt to do so would involve forced amalgamations. The Office of Local Government and the *Fit for the Future* proposal do not ask councils to move to a target number.

IPART has stated that its role is to assess whether Council are 'Fit' or 'Not fit'. Setting a target number of councils in metropolitan Sydney is not relevant to this and IPART should not pursue the issue.

### **Other terminology**

The draft IPART methodology proposes that submissions should be '*broadly consistent with ILGRP preferred option*'. No workable definition of '*broadly consistent*' is provided. This objective was not set by the Office of Local Government in the templates and advice provided for councils.

***IPART's definition of 'broad consistency' must provide for a council to demonstrate it can deliver good government on its current boundaries.***

One of the stated objectives is to '*establish a more equitable pattern of local government*'. No definition of a *more equitable pattern of local government* is provided. A definition could refer to equality of resident, worker and visitor population; equality of representation per resident or other population; parity of rating or financial grants provided by State and Federal Government; or similar levels of economic capacity and planned development. Given the breadth of this issue, an 'equitable pattern of local government' in all areas is unlikely to be desirable or achievable.

***The methodology needs to define the range of 'equitability' criteria if it is to objectively assess submissions against this objective.***

According to the Metropolitan Plan, "*Global Sydney is made up of Sydney CBD and adjacent precincts, including North Sydney*" (see Glossary of Terms in the Plan). In other parts of the Metropolitan Plan, the broader metropolitan area is defined as the global city. Given the diverse descriptions of what constitutes Sydney as a global city, it is not clear what criteria will be used to assess how proposals '*underpin Sydney's status as a global city*'. For example, the ILGRP does not include North Sydney and is inconsistent with the definition in the Metropolitan Plan.

***IPART's methodology needs to define 'global Sydney' if it is to be used as part of an evidence-based assessment criterion.***



The State Government's Fit for the Future documentation released in late 2014 asked councils to determine whether they should stand alone and prepare an improvement plan, or to prepare a business case if proposing an amalgamation.

IPART's draft methodology for assessing submissions indicates a business case is likely to be required if a council is not amalgamating in line with the ILGRP proposal. IPART provides no specific advice on what would constitute a business case for this purpose. Should the business case merely address the benchmark criteria, or be an in-depth economic analysis of the costs and benefits of an ongoing standalone City of Sydney versus the ILGRP recommended amalgamation?

***IPART'S methodology should closely align with existing State Government guidance and not introduce substantial new criteria when submissions are due in less than two months.***

A recent academic paper ('A Fresh Look at Municipal Consolidation' – Sansom G, Aulich C, McKinlay P, 2014) examined 17 case studies of different forms of municipal consolidation and found that:

*"...in the few cases where economies of scale were asserted, the full costs of amalgamation had not been factored into the calculation of net savings. It is clear that amalgamation (and some other forms of consolidation) imposes considerable costs in dislocation and developing new arrangements and new cultures. Almost all respondents recognised that the process of amalgamation itself generated costs that were typically not included in the balance sheet; costs such as disruption, time taken to review service levels and engage communities and compromises which often meant some leakage of cost savings to ensure buy-in from all stakeholders." (p. 9)*

*"A difficult question to determine is whether economies of scope and development of strategic capacity are stronger with amalgamation than with other approaches to consolidation." (p. 10)*

The City of Sydney was forcibly amalgamated in 2004. Our experience of that amalgamation is that council's ability to meet the key elements of strategic capacity is likely to be reduced in the short term. Our experience aligns with the findings of this recent paper that the areas of reform likely to achieve significant benefit are ***improvements to governance, finances and partnerships, including development of a relationship or respect between State and Local Government.***

***IPART's draft approach to 'scale and capacity' and its treatment of these criteria as a 'threshold' matter effectively presupposes the need for wide-ranging local government amalgamations ahead of any consideration of the evidence.***



2. Which of the 'Rural Council Characteristics' are the most relevant, considering a council must satisfy a majority of the characteristics to be considered a rural council?

This issue is not applicable to the City of Sydney.

3. Are there any improvements we can make to how we propose to assess the sustainability, infrastructure management and efficiency criteria, consistent with OLG guidance? Are there issues that we need to consider when assessing councils' proposals using the measures and benchmarks for these criteria?

The relative importance of individual criteria changed between the T-Corp assessment of councils' financial performance and the *Fit for the Future* proposal. The weightings have changed again in IPART's draft methodology.

The T-Corp weightings were:

- Financial flexibility (35%) – operating ratio, and own source operating revenue ratio
- Liquidity (20%) – cash expense ratio, and unrestricted current ratio
- Debt servicing (10%) – debt service cover ratio, and interest cover ratio
- Asset renewal and capital works (35%) – infrastructure backlog ratio, asset maintenance ratio,
- Building and infrastructure asset ratio, and
- Capital expenditure ratio.

Liquidity, worth 20% of the overall T-Corp result, and the capital expenditure ratios are ignored in the *Fit for the Future* assessment. These are strong indicators of a councils' financial capacity.

The City supports the definition of financial sustainability set out in the T-Corp assessment and reiterated in the IPART methodology that "*A local government will be financially sustainable over the long term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community*".

Financial sustainability is more than a council's operating performance ratio.

***The City welcomes the distinction between criteria that councils 'must meet', 'must demonstrate improvement in' and those that 'informs assessment'.***

However, the City agrees with the T-Corp view that "*Benchmarks do not necessarily represent a pass or fail in respect of any particular area. One-off projects or events can impact a Council's performance against a benchmark for a short period. Other factors such as the trends in results against the benchmarks are critical, as well as the overall performance against all the benchmarks*" (Financial Sustainability of the New South Wales Local Government Sector, T-Corp Report April 2013 p22).

***The IPART methodology needs to incorporate an overall assessment of performance.***



The efficiency financial criteria to be used by IPART, simply represent the overall inputs to the various services and activities an organisation undertakes divided by resident population. The criteria do not provide for speed of delivery or unit rates or quality for key services. In other states, such as Victoria, service delivery indicators are central to the measurement of local government performance.

***IPART's methodology needs to include effectiveness measure(s).***

The Office of Local Government introduced the Integrated Planning and Reporting framework into NSW Councils to "improve council's long term community, financial and asset planning". The City supports greater utilisation of the information contained within this framework, in particular the information contained with the Asset Management Plans (for example, sustainability index for assets, a 10 year measure which aligns with the life of the City's long-term financial plan).

Information freely available in councils' Integrated Planning and Reporting documents, particularly in relation to the management of infrastructure assets in the long term, needs to be used if IPART is to adequately reflect the work of councils to strategically plan the efficient and effective use of resources in providing services to the community.

Financial ratios can be a useful tool in contributing to broader performance management discussions, but viewed in isolation from any additional context or background, they risk inadequately reflecting the true financial 'health' of the council in question.

The City supports the principles of inter-generational equity implied by the debt benchmark, but does not agree that the debt is a 'must have' indicator of financial sustainability. The benchmark for this ratio requires a council to utilise at least some debt; however it would not be prudent financial management for the City to go into debt while it has cash reserves built up from underlying operating surpluses.

There is no reason why borrowing to acquire a long-term asset to be repaid through future operational surpluses provides greater intergenerational benefit than intentionally setting aside operational surpluses into restricted reserves to meet known future commitments as they fall due. This is how the City has prudentially managed its finances to deliver on its light rail contribution and Green Square commitments.

The City's current financial situation is carefully aligned with ***planning to deliver a significant, ten year capital program***. The lack of debt cannot be a marker of lack of sustainability.

Set out below is feedback on the individual financial indicators

### **'Sustainability' Measures**

#### **1. Operating Performance Ratio – 'Must Meet'**

This ratio measures a council's achievement of containing operating expenditure within operating revenue. It is important to distinguish that this ratio is focussing on *Benchmark - Greater than or equal to break-even average over 3 years*.

Currently reported as Operating Result (excluding Capital Grants and Contributions), as a percentage of Operating Revenue (excluding Capital Grants and Contributions), the ratio fails to make allowance for "extraordinary" items of expenditure (for example, light rail contributions to the State Government), which may significantly affect a council's operating performance in the short to medium term.

The inclusion of depreciation in calculating the ratio also risks distorting the result, as depreciation expense is increasingly subject to significant fluctuations as a result of a mandated asset revaluation cycle. This in turn distorts the "true" operating performance of a council.

***The City proposes that a more appropriate ratio would be:***

#### ***Total Income from Continuing Operations***

*(less Capital Grants & Contributions and unrealised gains)*

*(less Total Expenses from Continuing Operations excluding depreciation)*

*(less Asset Renewal Expenditure)*

*Divided By:*

#### ***Total Income from Continuing Operations***

*(less Capital Grants & Contributions and unrealised gains)*

This ratio would provide a more adequate reflection of the day to day operations of councils, and their ability to self-fund the underlying, ongoing requirements of their operations.

#### **2. Own Source Revenue Ratio – 'Must Meet'**

***Benchmark - Greater than 60% average over 3 years***

Earlier iterations of Own Source Revenue included only core income sources (Rates, Annual Charges and Fees & Charges). The ratio now essentially reflects income excluding grants and contributions, as a proportion of total income. The benchmark indicates that a reduced reliance upon grants is preferred, however the ratio could be altered and prove beneficial in measuring income diversity.



A similar ratio utilised in Victorian Local Government seeks to diversify councils' income bases. A diverse income base allows a council to reduce the burden placed on ratepayers and better address cost pressures that result from wages growth over time.

**The City proposes that a more appropriate ratio would be:**

***Rates, Annual Charges and Fees & Charges set by Legislation***

*Divided by*

***Total Income from Continuing Operations (excluding grants and contributions)***

A lower ratio would indicate a more diverse income base

### **3. Building and Infrastructure Renewal Ratio**

*Benchmark - Greater than 100% average over 3 years*

Utilising depreciation as a "proxy" for required asset renewals is a gross over-simplification, and not reflective of the required level of asset renewal over a period. Depreciation is, for the most part, a time based allocation of the economic benefits of an asset. The age of an asset is not necessarily reflective of its service capacity; it does not make financial sense to renew assets simply because they are old.

The City's Asset Management Plan (as part of the broader Resourcing Strategy) states, in plain terms, what the City has determined it "should be spending" to sustain critical infrastructure assets over a 10 year period, and compares this to what is "proposed to be spent", as per the Long Term Financial Plan. These projections are reflective of the City's asset renewals planning, and the more detailed calculations underpinning the required renewals figure allows.

***Required Buildings and Infrastructure Renewal***

*Divided by*

***Planned Buildings and Infrastructure Renewal***

With a 3-4 year view presented alongside a 10 year view (for the 10 year view, Present Value could be used to "normalise" results where the timing of required and planned renewal works differed).

***The City does not agree with a minimum benchmark of 100% as it risks Councils over-servicing their asset base, in order to comply with the performance requirement. A more suitable benchmark would be a Building and Infrastructure Renewal Ratio within the range of 90% to 110%.***

### **Infrastructure and Service Management Ratios**

#### **4. Infrastructure Backlog Ratio**

*Benchmark – less than 2%*

Expressing infrastructure backlog as a proportion of the Written Down Value (WDV) of infrastructure assets is unrealistic. The passing of time inherently reduces the Written Down Value of assets.

The historical absence of a consistent definition of “satisfactory standard” has left councils to interpret the “cost to bring to a satisfactory standard” on a case-by-case basis. In the City’s case, this has resulted in a cost to bring to the “City of Sydney desired standard”, which is arguably significantly higher than what might be deemed conventionally satisfactory.

The use of written down value has been highlighted by others in the industry. Ken Crawford, from Local Government Solutions, has pointed out that a Council with an asset base of \$10M, accumulated depreciation of \$9M and a backlog of \$10M would deliver a ratio of \$10M divided by \$1M or 1000%! If the Gross Book Value was used then the backlog would be 100%.

The City would also recommend utilisation of the condition assessment information, with a rating of between 1 and 5, for infrastructure assets as outlined in Special Schedule 7. This approach would provide a more complete assessment of asset condition.

***The City agrees with the observation outlined in IPART’s review of the assessment criteria for ‘fit for the future’ (September 2013) that this benchmark should only be adopted if a clear reporting standard for Special Schedule 7 is adopted and that this data is audited as part of Council’s accounts***

## **5. Asset Maintenance Ratio**

*Benchmark - Greater than 100% average over 3 years*

The principle of this ratio is sound, but the benchmark encourages waste and over-servicing of assets at the expense of other council services. The benchmark should be adjusted to be a range of between 90% and 110%.

Reliability of reported results could be improved by formalising the definition of maintenance expenditure and its distinction from asset renewal. Additionally, a disclosure of performance over a 10 year period, in addition to the current three year view would provide additional context and proof of a long term commitment to servicing council’s assets.

The methodology for the assessment of required annual maintenance may well differ between councils and is not, to the end of 2103/14, audited. The City would welcome greater standardisation of approach to this assessment.

***The City does agree with this ratio and recommends a review of the benchmark values.***



## **6. Debt Service Ratio – ‘Must Meet’**

*Benchmark: Greater than 0% and less than or equal to 20%*

The presumption of at least some debt being required to demonstrate financial fitness penalises councils that manage their finances to align with their project delivery horizons.

In addressing concerns of intergenerational equity, it should be noted that the requirement to use debt financing in protecting intergenerational equity is a case-by-case consideration. Effective management of Operating Performance and access to adequate external funding over time can allow councils to invest in long term infrastructure without the use of debt, and without undue burden on any one generation of ratepayers.

In the City's case, large volumes of developer contributions and grants provide a significant contribution towards the provision of new assets and infrastructure, and alleviate the need to use borrowings to fund new assets. Astute long term planning has allowed for the accumulation of internal cash restrictions, established and preserved in order to ensure adequate funding of major infrastructure initiatives. Penalising this kind of forward planning by 'enforcing' the use of debt funding is not appropriate.

Any assessment of this ratio needs to consider the context of the borrowings. Clearly, borrowing to finance operating deficits is not sustainable

**The City believes the benchmark for this ratio should be altered to require a result of “greater than or equal to zero, and less than 20%”.**

## **Efficiency Ratio**

### **7. Real Operating Expenditure over time (per resident)**

*Benchmark: Decrease in Real Operating Expenditure over time*

The inclusion of depreciation expense as part of Operating Expenditure unfairly distorts this ratio. Depreciation does not directly reflect the provision of services to the community over time, and is affected significantly by compulsory asset revaluation cycles. Removal of depreciation from this ratio would give a truer indication of “underlying” performance of day-to-day operations.

To rely on Operating Expenditure/Resident Population as the only measure of efficiency is flawed. It allows no consideration for individual customer services including delivery times and service levels.

Using only the residential population does not recognise that CBDs and business centres are required to provide a high level of service to business owners and workers and that tourist destinations also provide a higher level of service.

In the case of the City of Sydney, with 1.1 million people in the LGA each day, the service provision is much greater than that required for residential suburbs, with streets and public facilities cleaned multiple times a day, additional garbage collections and higher quality public domain.

***The City believes depreciation should be excluded from the numerator of this ratio as it has the potential to distort the results due to increases mandated by asset revaluations. In addition, the City believes the denominator should include resident, business, visitor and worker numbers.***

- 4. How should councils engage with their communities when preparing FFTF proposals? Are there other factors we should consider to inform our assessment of council consultation? Please explain what these other factors are, and why they are important.**

The templates and advice from the NSW Government and Office of Local Government state that councils 'will need to discuss the options with their community to complete their road map'. The draft methodology indicates that councils 'should choose methods that reflect the issues needed to be consulted upon', whether a merger or to stand alone.

The Tribunal should not expect councils to undertake consultation driven predominantly by ILGRP proposal, especially where the council puts the case it is fit for the future. Councils should not be deemed unfit based on the consultation process, particularly if they are able to demonstrate their fitness for the future.

- 5. Should council performance against FFTF proposals be monitored? If so, are there any improvements we can make on the approach outlined for councils to monitor and report progress on their performance relative to their proposals? (page 38)**

The City supports the ongoing monitoring of councils' sustainability.

The City supports a more mature assessment of council sustainability akin to that proposed by T-Corp: *A local government will be financially sustainable over the long term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community.*