



Independent Pricing and Regulatory Tribunal
via www.ipart.nsw.gov.au/Home/Consumer_Information/Lodge_a_submission

25 May 2015

Enclosed is a submission regarding the Methodology for Assessment of Council Fit for the Future Proposals.

In summary, I am concerned that the “data consistency issues” IPART has identified (page 31 of the Methodology) in relation to interpreting a council’s reported asset renewal, backlog and maintenance performance will prevent the meaningful assessment of infrastructure performance at individual councils.

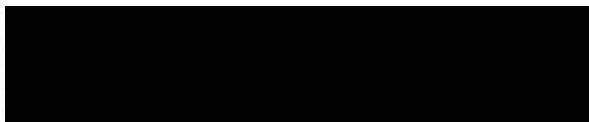
This should be the central concern of the *Fit for the Future* program, given the stated aim is to “improve the strength and effectiveness of local government in providing services and infrastructure that communities need”.

To address these issues, requirements for asset management planning and reporting must be improved in the OLG *IPR Manual and Guidelines* as well as the *Code of Accounting Practice* so as to address three key issues:

- Defining “satisfactory” infrastructure (and so defining the “real” backlog)
- Nominating a definite end point to “the future” (and so evaluating whether or not the backlog will increase – the renewal ratio doesn’t help if applied to the entire asset portfolio, particularly for long lived assets)
- Communicating concerns with the “state of the assets” clearly and consistently (rather than relying on dollars alone to quantify the backlog).

A proposed solution using “Infrastructure Dashboards” for each asset category, supported by Asset Management Plans aligned to this framework, is outlined in the following.

While this solution can’t be implemented in time to influence the content of council *Fit for the Future* proposals, understanding the key issues and principles underpinning the solution can be of assistance to IPART in “looking behind the numbers” and meaningfully assessing council infrastructure performance.



Ben Lawson
Director
Common Thread Consulting Pty. Ltd.
Coffs Harbour, NSW
0428 191 558
ben.lawson@commonthreadconsulting.com.au
www.commonthreadconsulting.com.au



Submission to IPART: *Fit for the Future* Assessment Methodology

IPART has asked for stakeholder feedback on a number of questions. This submission relates to question 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?

This submission is made in the hope that the program that set out to “improve the strength and effectiveness of local government in providing services and infrastructure that communities need” doesn’t resort to measuring finances alone. I fear there is a real risk of this happening.

IPART’s temporary Tribunal member, John Comrie, said in comments for LGNSW that:

- SA councils are no longer required to report results for [the Building and Infrastructure Renewal Ratio] because results were found to be meaningless
- there is a high degree of subjectivity by and inconsistency of approach between councils in quantifying asset renewal backlogs [i.e. Infrastructure Backlog Ratio]
- the Asset Maintenance Ratio suffers from similar data reliability problems.

Comrie concluded by saying that:

Providing that a council has reasonably reliable accounting records and long-term financial planning assumptions and is committed to and is forecasting ongoing achievement of modest operating surpluses (net of capital revenues) I would suggest (prima facia) that it is ‘fit for the future’.

The Operating Performance Ratio may be the “core measure of financial sustainability” (page 29), but the “core business” of councils is to provide services and infrastructure... so infrastructure performance must be assessed if this process is to be meaningful.

IPART itself notes (page 31) the difficulty it sees in doing so:

We will be assessing these performance measures for infrastructure performance and debt in a holistic manner, that is, in the context of the council’s overall capital sustainability as reflected by its Asset Management Plan (AMP). In addition, we consider there may be data consistency issues that need to be taken into account when interpreting a council’s reported asset renewal, backlog and maintenance performance, as there is no current requirement for this data to be routinely audited.

The root cause of these “data consistency problems” isn’t a lack of auditing but rather problems in asset *planning*: the *reporting* is just the end of a process. Consequently, looking for answers in AMPs rather than just the ratios (while applauded) won’t be easy.

Following is an analysis of three key issues that must be addressed if councils are to meaningfully plan for infrastructure and a proposed solution to do this that could form the basis of new AM planning and reporting requirements in OLG’s *IPR Manual and Guidelines* and *Code of Accounting Practice*. That will come too late for IPART’s *Fit for the Future* assessments, but it may help you know where to look.

This proposed solution is offered, for now, to help IPART “look behind the numbers” and meaningfully assess infrastructure performance and so (hopefully) answer a fundamental question arising from *Fit for the Future*: is this council providing the infrastructure its community needs, and can it do so into the future?

1. Definition of “Satisfactory” Infrastructure

The “infrastructure backlog” in NSW is overstated. The root cause is that the OLG *Code of Accounting Practice* prescribes the “cost to bring to satisfactory” as the cost to bring assets in condition 3, 4 & 5 up to condition 2.

This system is illogical: condition 3 assets (in “average” condition) are defined by OLG as needing maintenance work, not renewal, but maintenance will not bring an asset in condition 3 up to a 2 and “required annual maintenance” is reported separately. Whatever calculation is made, it is abstract, and not something councils actually do.

More to the point, assets must spend time in condition 3 if the life cycle cost is to be minimised (i.e. if councils are to provide infrastructure at a reasonable cost). In fact, condition 4 assets (as measured by many councils) are often “satisfactory” too.

The reality is that while many councils previously overstated the backlog, the need to get a “tick” for *Fit for the Future* is pressuring them to understate it... and so still not grapple with the “real” backlog, the “state of the assets” now.

The solution to this isn’t to “re-calibrate” condition rating systems so that condition 4 or 5 assets line up with the need for renewal, but rather to distinguish between *asset condition* and *what makes an asset “satisfactory”*.

Asset condition measures the physical attributes of an asset (e.g. rutting of a road pavement) and plots these over time from new to failure. These are *objective* measures.

But the triggers for what makes an asset “unsatisfactory” are to a degree *subjective*: a decision to be made by each council in consultation with their community.

For example: a road in a CBD may be “unsatisfactory” in condition 3 for aesthetic reasons, whereas a road servicing two properties in a low speed environment may be “satisfactory” right up to the point of physical failure (5+).

There are three basic factors that must be considered in determining whether or not an asset is “satisfactory”. These are whether the asset provides:

- **an affordable level of service (community)**
- **at the minimum life cycle cost (sustainability) and**
- **an acceptable level of risk (governance).**

The point at which asset condition “triggers” it being deemed unsatisfactory (backlog) will be different for each factor and, to a certain extent, for each community.

Minimising life cycle cost is a subset of risk (financial risk), but the backlog is a communication, not a technical, problem and this is what must be said: many councils aren’t minimising life cycle costs because they aren’t resealing their roads frequently enough. This leads to premature failure of the underlying pavement... so rather than spending \$5 that they “don’t have” on resurfacing, councils must find \$30 or more to renew the pavement. Address this, and we’ll achieve a “step change” in sustainability!

It is important to note that the alternative to the condition 2 benchmark in the OLG *Code* (the level of service agreed with the community) is insufficient also: a road that needs a reseal provides a “satisfactory” level of service (i.e. it’s not too bumpy) even after the surface has begun letting water into the pavement. It’s not until the pavement fails (at which time it’s too late for a reseal) that the level of service becomes unsatisfactory.

In summary, while condition data is the most important (and available) information councils have available, it can’t be a “black box” that spits out the backlog. Councils need to think about the factors above – *why* assets are satisfactory or not.

Whether councils report a high or low backlog, IPART should be asking *why* the council considers its assets satisfactory or not, and bear in mind the factors identified above.

2. A Definite End Point to “the Future”

I disagree with IPART’s statement (page 29) that the Building and Infrastructure Asset Renewal Ratio “measures whether a council’s assets are *deteriorating* faster than they are being renewed”: rather, it measures whether assets are *depreciating* faster (financial, rather than infrastructure capital is being measured).

Getting a handle on “whether a council’s infrastructure backlog is likely to increase” is central to *Fit for the Future*, but the renewal ratio won’t help... at least not when it is applied across the council’s asset portfolio as a whole.

It is potentially valuable in relation to short lived assets, provided the estimated useful life (identified at note 1 of the financial statements) is appropriate. Over the 10 year Long Term Financial Plan, renewal funding for reseals should equate to the depreciation expense based on a useful life of say 15 years (for bituminous surfacing, not asphaltic concrete which lasts longer). If IPART was to limit assessment in AMPs to the issue of underfunding reseals, it could spark a “step change” in sustainability, as noted above.

But the bulk of General Fund assets are long lived: road pavements, stormwater pipes and buildings last 60, 80, 100+ years and renewal profiles are often “lumpy” (big peaks and troughs). The 3 year average that supposedly takes this into account is nothing.

The reality is two councils can report the same renewal ratio but one have most assets in condition 1, 2 and 3 (therefore needing to spend far less than depreciation on renewal) while the other has a lot in condition 4 and 5 (therefore needing to spend far more than depreciation on renewal).

So how does IPART differentiate between these two situations? A quick look at the percentage of assets in condition 1, 2, 3, 4 and 5 in Special Schedule 7 (SS7) will give an indication... but remember, these percentages are based on written down value (WDV) not total replacement cost (TRC), so the figures are massively distorted (as is the Backlog Ratio, which also uses WDV). If a council reports 5% of its road network is in condition 5 this doesn’t mean 5% by *length*, but 5% by *current fair value*. 1km of road in condition 5 is virtually written down to its residual value (if these were allowed in the accounting standard!) whereas 1km of road in condition 1 is valued almost at the TRC.

A clearer picture of whether assets are “young” or “old” is available in last year’s SS7: compare WDV to TRC (“valuation”)... but this remains a very blunt instrument!

A far better approach for long lived assets is to forecast expected deterioration over the next 10 years, subtract renewals funded in the Long Term Financial Plan (LTFP) and forecast the backlog: the “state of the assets” in 10 years time.

Why 10 years? It is a reasonable time horizon for decision making by councillors (2.5 terms), it aligns with the LTFP, Community Strategic Plan and AMPs and it is within the “foreseeable future” for assets while being long enough to forecast substantial change.

Depreciation for long lived assets relies on estimates of what’s going to happen in 60, 80 or 100 years. The fact is we’re not sure. Estimates of depreciation are improving (particularly councils and regions using Jeff Roorda and Associates’ *DataShare* platform and sampling methodology), but depreciation alone is a poor benchmark to use to gauge whether a council is “keeping up with deterioration” (even putting aside the massive variations in renewal need that arise from “lumpy” renewal profiles).

Critically, adopting a definite end point to assess the future “state of the assets” begins to foster AM capabilities like predictive modelling (which will improve depreciation estimates) and life cycle optimisation (which will actually improve sustainability).

It will also invites meaningful community engagement: “this is what our infrastructure will be like in 10 years” not “look at our renewal ratio, we need more money”.

3. Communicating Infrastructure Status Clearly and Consistently

The last (but not least) issue that needs to be overcome if councils are to meaningfully plan for infrastructure is communicating status clearly and consistently.

As noted under point 1 whilst asset condition is an *objective* measure, what is “satisfactory” is to a certain extent *subjective*, to be determined by each council in consultation with their community.




The reality is that the same infrastructure (say, a local road in an urban area with a significant amount of rutting) could be considered “unsatisfactory” by a wealthy metro council, but be the envy of a struggling rural community.

I’m not suggesting that the objective measures of asset condition should be abandoned. These are critical for a number of reasons: firstly, to back up the conclusions reached by each council (*why* assets are “unsatisfactory”, *why* their assets are of concern or not), secondly to benchmark between councils and thirdly (last but not least!) to back up the need for redistribution of FAGs based on the quantifiable differences between councils in terms of their financial capacity and need for assistance with infrastructure.

I’m proposing that the:

- ***subjective* determination by each council in consultation with their community of whether or not the “state of the assets” both now and forecast in 10 years is “satisfactory” (made based on the same definition: affordable levels of service, minimising life cycle cost and acceptable risk)**
- **informed by *objective* measures of asset condition (physical attributes of the asset that can be consistent and comparable between councils)**
- **must be communicated (reported) via a *normative* system highlighting any concerns each council has with regards to the factors making up the definition of “satisfactory” infrastructure in a clear and consistent manner.**

Traffic lights are perfect, and can be used as follows in regards to each factor:

-  **Major concerns**
-  **Moderate concerns**
-  **Minor or no concerns**

Dollar figures don’t make the backlog meaningful to the community – this does.

Dollar figures don’t help councillors make informed decisions – this does.

Dollar figures don’t encourage staff to focus on the priorities – this does.

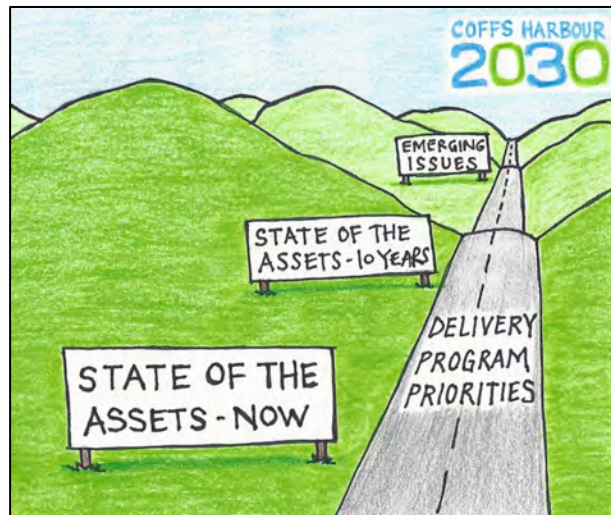
Dollar figures don’t make the backlog auditable, nor make council progress in terms of infrastructure performance assessable under *Fit for the Future* – this does, when an Asset Management Plan aligned to this framework supports it.

4. Putting the Solution Together: Infrastructure Dashboards

My proposed solution (a new asset management planning and reporting framework) that overcomes the key issues discussed above can now be assembled:

- traffic lights communicate major, moderate and minor (or no) concerns
- with the “state of the assets” – both now and that forecast in 10 years time
- in relation to each factor determining whether or not an asset is “satisfactory” (affordable levels of service, minimum life cycle cost and acceptable risk).

I propose putting this solution together in 1 page “Infrastructure Dashboards” for each asset category (supported by AMPs aligned to this framework) that enable councils to “tell the story about infrastructure” in the form depicted below.



The logo for Coffs Harbour 2030 (the strategic plan for my community) highlights that the goal of this story – where we are headed – is the priorities and aspirations of the community as set out in the Community Strategic Plan.

This approach provides the foundation for:

- effective engagement with communities regarding our infrastructure challenges
- clearer formulation of recommendations for funding priorities by staff based on the current “state of the assets” (i.e. based on the key issues of concern)
- informed decision making by councillors in adopting the Delivery Program
- regional collaboration and capacity building (ways to engage the community, common systems of objective measurement, strategies to optimise life cycle cost that may lead to collaboration regarding actual service delivery)
- auditable asset reporting (because AMPs back up what is reported)
- assessment of infrastructure sustainability based on a forecast of backlog, rather than attempting to measure deterioration via financials alone (the renewal ratio)
- meaningful monitoring of progress on *FFTF* proposals relating to infrastructure.

The debt I owe to Jeff Roorda and Associates will be obvious to those familiar with their dashboards, but I’d also like to acknowledge the GMs of MIDROC for their input in refining this approach and IPWEA NSW for the opportunity they gave me to get a better handle on infrastructure challenges faced by the diversity of NSW councils when I delivered the *Fit for Purpose* workshops across the state for them earlier this year.

That said, this submission is from Common Thread Consulting Pty. Ltd. I hope it assists IPART in making more meaningful assessments of infrastructure performance at councils, but even more I hope these ideas add value to revisions of the OLG *IPR Manual and Guidelines* and *Code of Accounting* to overcome the issues identified: this is desperately needed by our industry... and our communities.



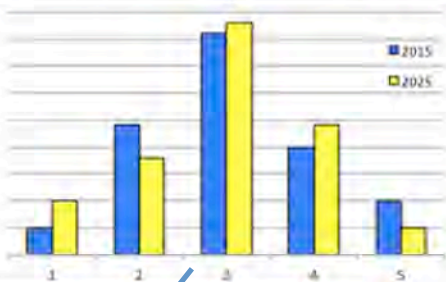
How to read an “Infrastructure Dashboard”

Proportion of Council’s total asset portfolio

Strategic Objectives from the Community Strategic Plan

Proportion of funds spent on operating and maintaining (OPEX), renewing and upgrading (CAPEX) these assets

These traffic lights highlight major, moderate or minor (or no) concerns (red, amber, green) with the “state of the assets” now and in 10 years in relation to the factors defining “satisfactory” infrastructure (level of service, life cycle cost and risk). The “backlog” is the cost to fix the issues of most concern.

URLOGAL SHIRE COUNCIL			
 \$150M to renew	Sealed road pavements 650km of roads		 \$1.5M OPEX \$3.6M CAPEX
	“we have safe roads that meet the needs of all of our community”		
Current “State of the Assets” \$15.3M backlog	Affordable Level of Service	Minimising Life Cycle Cost	Acceptable Risk
	Why there are moderate concerns	Why there are major concerns	Why there are moderate concerns
Delivery Program Priorities (4 year Budget)	<ul style="list-style-type: none"> Activities to prevent premature failure of pavements (resealing, table drain maintenance, pothole patching) Activities to address the backlog (renewal of very poor pavements, prioritised based on risk) 		
“State of the Assets” in 10 years \$5.6M backlog	Affordable Level of Service	Minimising Life Cycle Cost	Acceptable Risk
	Why moderate concerns remain	Why there are expected to be only minor concerns remaining	
Comparison of asset condition now v’s 10 years 1 = new 5 = very poor			Emerging issues: growing renewal need as more pavements age, expected to peak in 2065.

This chart shows the forecast change in asset condition from now to 10 years time, taking account of the expected deterioration and also the renewal activities that are funded in Council’s Long Term Financial Plan