

Dear Chair

I am writing on behalf of the Fit for the Future Ministerial Advisory Group (MAG) concerning the methodology for assessment of council Fit for the Future proposals.

The MAG consists of two representatives from Local Government NSW, one representative from the United Services Union, and one representative from Local Government Professionals Australia. I have been appointed as the Independent Chair of the MAG. The primary purpose of the MAG is to consolidate the views of key stakeholders and provide advice to the Minister for Local Government on the direction and implementation of the Fit for the Future program.

Since its establishment, the MAG has been particularly concerned about the way Fit for the Future proposals will be assessed. The timeframes for finalising the assessment methodology and the period that the Panel will have to undertake assessments have been key issues of concern for the MAG. As a general comment the MAG queries how the time between closure of the exhibition period and releasing of the final methodology allows for detailed consideration of feedback received.

The terms of reference for the Expert Panel were developed in consultation with MAG members and I am pleased that the final document reflects many of the amendments that were recommended by them individually, even though timing evidently prevented the collective view of the group being considered. I note in any event that the terms of reference require the Panel to consider the advice provided by the MAG in developing the assessment methodology.

I am pleased to provide the following advice which the MAG strongly believes should be considered in finalising the methodology.

### Scale and Capacity

The assessment of the scale and capacity criteria has been at the centre of MAG concerns regarding Fit for the Future. The MAG notes comments by IPART at the consultation sessions about being obliged to assess councils' proposals in strict accordance with these and other aspects of the Government's approach, and also the areas where the draft methodology has taken a different approach from or advanced the thinking on the position articulated in the guidance that has been issued to date.

Compared to the guidance material previously released by the Office of Local Government (OLG) on scale and capacity, the MAG members agreed that the Consultation Paper released by IPART took a different focus around mergers and 'scale and capacity' in the proposed methodology.

The MAG makes the following recommendations to the Expert Panel:

1. The benchmark for councils recommended by ILGRP to merge, when the council is proposing an alternative or non-merger option, should be changed from 'demonstrating superiority to the merger option' to 'demonstrating a result which is consistent with the strategic capacity criteria in Box 3.1'.
2. The Expert Panel methodology should indicate that the Panel will consider the whole of a council's proposal when assessing the threshold issue of scale and capacity.
3. In assessing a council's scale and capacity, the Expert Panel should not refer to a 'minimum population size' and 'target number of councils'.
4. In assessing councils, and regional councils in particular, the Panel should give significant weight to the councils' important community role and contribution to local identity. Part 4.1 of the methodology needs to better address the fact that some rural councils are the centres of communities with unique identities which may not be best preserved through bigger council areas. The purpose of structural reform in regional areas must include the needs of such communities and not merely be about prioritising large regional centres.
5. The Expert Panel should clarify if there are specific goals in relation metropolitan councils and how that will impact upon the assessment of proposals made by those councils. There is specific concern for the MAG members that it seems that the only acceptable option for City of Sydney and surrounding councils appears to be a large-scale merger which includes the CBD and the airport.
6. The methodology should be amended to consistently reflect that many councils already possess sufficient 'scale and capacity.' This recommendation relates to Part 1.3 of the consultation paper which, in summarising the methodology, suggests that there are only two approaches for proposals: councils which 'need to undertake structural change by merging with one or more other councils,' and those which 'currently have sufficient capacity without any structural change.' The MAG believes that this may be inconsistent with the suggestion in OLG guidance that councils could consider alternatives to merger which would achieve requisite strategic capacity.

I note that the MAG believes that councils should be able to show the impact of local water utilities on their ability to meet the Fit for Future benchmarks and criteria. It is therefore pleasing that the Expert Panel will consider how the performance of the General Fund is affected by a water utility business as part of this assessment, as relevant.

#### Economic criteria and efficiency

The MAG notes that issues with the efficiency criterion have been highlighted by the sector repeatedly since the announcement of Fit for the Future. There is almost universal agreement in the sector that councils should work towards being more efficient. It is considered that the benchmark of 'decreasing real operational expenditure per capita over time' is not a complete measure of efficiency. The two clearest ways for a council to address the criterion are to 1) cut services and labor costs; and/or 2) increase their population, neither being a mark of efficiency.

The MAG believes that rural councils are particularly disadvantaged by the criterion because their operational costs are generally not dependent on population (repairing roads, maintaining land and assets) whilst their populations are often in decline.

The MAG is also of the view that the criterion should take into account the efficiency element which already exists within the Local Government Cost Index (LGCI), an efficiency which has primarily come from proportionally decreasing labor costs over the last 3 years. If it is assumed that the LGCI is the basis for 'real operational expenditure,' then it follows that a council which sees its expenditure grow in line with the LGCI would be becoming more efficient.

The MAG recommends the following:

7. The Expert Panel should clarify that it plans to use the LGCI rather than CPI when assessing real operating expenditure.
8. The efficiency criterion, as set out in Part 3.3.3 of the consultation paper, should be amended so as to include the notion that a council's declining population should not negatively impact on a council's efficiency rating. The criterion should also be amended to note that a council which sees its expenditure per capita increase in line with the LGCI will satisfy it.
9. The efficiency criterion should be regarded with the weighting of 'informs assessment,' rather than 'must demonstrate.'

#### Process

Para 2.f) of the terms of reference provides: that the Panel must "give councils the opportunity to provide additional information. This may include the opportunity for councils to present in person."

Whilst it is acknowledged that the terms of reference will not be changed, the MAG believes that councils should have the option of presenting their submission to the Panel and that there may also be occasions when the Panel asks for submissions to be made in person.

In addition, the view of the MAG is that councils should have the opportunity to submit amended submissions in circumstances where the Panel assesses a council to be 'provisionally' not fit for the future. Bearing in mind the significant time constraints, the MAG agrees that councils should work hand in glove with the Expert Panel to adjust proposals. It was recognised that this would need to be administered appropriately so that proposals didn't keep "going backwards and forwards".

The MAG therefore recommends that:

10. Consideration be given to extending the timeframe for the assessment period for those councils listed as provisionally 'not fit' to be given the opportunity to amend their proposals or give further evidence.

#### MAG Working Group – Review of criteria and benchmarks

To assist IPART in finalising the assessment methodology, I have been asked to forward you the attached summary of a review that a MAG working group previously prepared on the criteria and benchmarks. The group reviewed the key strengths and weaknesses of each measure and provided

comment which the MAG believes should be considered during the assessment of Fit for the Future submissions. Please see TAB A.

On behalf of the MAG, thank you for the opportunity to provide advice on the assessment methodology.

Yours sincerely

Peter Achterstraat AM  
Chair

## TAB A - MAG Briefing Paper 14 April 2015

### FFTF Assessment Criteria and Benchmarks – Guidance and Advice to Expert Panel

Measure, Definition and Benchmark	Strengths	Weaknesses	Implications/Considerations
<p><b>Operating Performance Ratio (greater or equal to break-even average over 3 years)</b>  <i>Total continuing operating revenue (exc. capital grants and contributions) less operating expenses</i>  <i>Total continuing operating revenue (exc. capital grants and contributions)</i></p>	<ul style="list-style-type: none"> <li>High significance - Comrie suggests a greater weighting.</li> <li>Generally accepted as an important ratio.</li> </ul>	<ul style="list-style-type: none"> <li>Depreciation in the numerator has an impact ongoing. Data could be considered unreliable i.e. easily manipulated to affect desired result.</li> <li>Important to note that this benchmark will not be achievable in the short to medium term by many councils. Objective should be to look for improvement over time.</li> </ul>	<ul style="list-style-type: none"> <li>Although this is an important measure - care needs to be given to not over emphasise.</li> <li>Need a balanced view – this measure is impacted by the results of other measures and need to be conscious that good performance is not being managed through under performance in other areas for example under funding asset maintenance.</li> </ul>
<p><b>Own Source Revenue Ratio (greater than 60% average over 3 years)</b>  <i>Total continuing operating revenue less all grants and contributions</i>  <i>Total continuing operating revenue inclusive of all grants and contributions</i></p>	<ul style="list-style-type: none"> <li>Risk Assessment Tool – measures financial autonomy &amp; flexibility.</li> </ul>	<ul style="list-style-type: none"> <li>Differences between rural and metro. councils : <ul style="list-style-type: none"> <li>source of aggravation for rural councils as many cannot realistically be expected to ever achieve the 60% benchmark.</li> </ul> </li> <li>Need to understand context that it represents a factor in the risk assessment of a council and reflects on a council's financial flexibility.</li> </ul>	<ul style="list-style-type: none"> <li>The context of the council must be considered e.g. rural council – small rate base and lower ability to generate other own source revenue vs. Metro Council large rate base and ability to generate other own source through e.g. fees and charges.</li> <li>Assumptions that metro councils are expected to exceed this benchmark whilst some rural councils may never reach the benchmark of 60% but instead continue to show improvement over time.</li> <li>FAGs an important, ongoing, consistent revenue stream for councils, particularly rural councils and needs to be part of context considerations.</li> </ul>
<p><b>Building and Infrastructure Asset Renewal Ratio (greater than 100% average over 3 years)</b>  <i>Asset renewals (building and infrastructure)</i>  <i>Depreciation, amortisation and impairment (building and infrastructure)</i></p>	<ul style="list-style-type: none"> <li>Provides an indicator of asset management and sustainability.</li> </ul>	<ul style="list-style-type: none"> <li>Depreciation in the numerator has an impact ongoing. Data is considered unreliable i.e. easily manipulated to affect desired result.</li> <li>Building and Infrastructure Asset data is unreliable. Different interpretations, methodology and data quality means the indicator lacks comparability.</li> </ul>	<ul style="list-style-type: none"> <li>How robust is the asset data for the council being assessed?</li> <li>Potential for expert panel to access expert technical support to assess infrastructure measures.</li> <li>Expert technical support a must for this and other asset indicators.</li> </ul>
<p><b>Infrastructure Backlog Ratio (less than 2%)</b></p>			<ul style="list-style-type: none"> <li>How robust is the asset data for the council being assessed?</li> </ul>

<p><b><i>Estimated cost to bring assets to a satisfactory condition</i></b>  <b><i>Total (WDV) of infrastructure, buildings, other structures and depreciable land improvement assets</i></b></p>	<p>As above.</p>		<ul style="list-style-type: none"> <li>• Difficult to use for comparing councils but for an individual council provides information regarding the size of the task facing a council in terms of being able to bring its infrastructure to an acceptable standard.</li> <li>• Expert panel to access expert technical support to assess infrastructure measures essential.</li> </ul>
<p><b>Asset Maintenance Ratio (greater than 100% average over 3 years)</b>  <b><i>Actual asset maintenance</i></b>  <b><i>Required asset maintenance</i></b></p>	<p>As above.</p>	<ul style="list-style-type: none"> <li>• Asset data reliability issues.</li> <li>• Lack of comparability due to difference in definition/interpretation of asset maintenance vs. renewals.</li> </ul>	<ul style="list-style-type: none"> <li>• How robust is the asset data for the council being assessed?</li> <li>• Difficult to compare councils, but if a council is underspending in this area on a regular basis, this ratio is a potential warning sign that could lead to declining asset standards in future years.</li> <li>• Expert panel to access expert technical support to assess infrastructure measures essential.</li> </ul>
<p><b>Debt Service Ratio (greater than 0 and less than or equal to 20% average over 3 years)</b>  <b><i>Cost of debt service (interest expense &amp; principal repayments)</i></b>  <b><i>Total continuing operating revenue (exc. capital grants and contributions)</i></b></p>	<ul style="list-style-type: none"> <li>• Provides an indicator of intergenerational equity.</li> </ul>	<ul style="list-style-type: none"> <li>• Important to note that this is primarily a measure of inter-generational equity.</li> <li>• Need and capacity to utilise debt varies widely between councils.</li> </ul>	<ul style="list-style-type: none"> <li>• Debt interaction with infrastructure measures e.g. is debt being effectively used to reduce backlog?</li> <li>• Need to consider infrastructure needs of the individual council and community and ensure balance between current and future funding.</li> <li>• Expert technical support a must for this and other asset indicators.</li> <li>• The group thought this was important to consider but is less significant than the other major indicators.</li> </ul>
<p><b>A decrease in Real Operating Expenditure per capita over time</b></p>	<ul style="list-style-type: none"> <li>• Provides a proxy measure of efficiency.</li> </ul>	<ul style="list-style-type: none"> <li>• Proxy measure.</li> <li>• Methodology issue.</li> <li>• Decline in expenditure is not necessarily a sign of efficiency.</li> <li>• Decline in population is not a sign of inefficiency.</li> <li>• Lacks comparability.</li> <li>• General tendency for this to increase over time due to increasing roles and responsibilities and rising community demands.</li> </ul>	<ul style="list-style-type: none"> <li>• Need to understand the operating context of the council, especially as it relates to the community needs expressed through the IP&amp;R process. Context is crucial.</li> <li>• Need to ensure performance is not driven by demographics</li> <li>• Efficiency is considered an important factor, but this is not considered to be a meaningful measure.</li> </ul>