

Dr Bronwyn Kelly

25 May 2015

Dr Peter Boxall, AO
Chairman
Independent Pricing & Regulatory Tribunal
Level 15, 2-24 Rawson Place
Sydney NSW 2000

Submission on “Methodology for Assessment of Council Fit for the Future Proposals”

Dear Dr Boxall

Please find below some comments on matters that might be taken into account when confirming the methodology for assessing Fit for the Future proposals. These comments are offered to help maximize the guidance that might be provided by IPART to the State Government on the final form of mergers required to achieve both the scale/capacity objectives and the financial sustainability objectives for councils across NSW.

1. Issue: There is likely to be an issue with councils’ completing the wrong template. This might be minimised by a slight wording change in the Methodology.

Councils have been confused about whether to submit proposals under template 1 or 2. This confusion has arisen from wording in the OLG template guidelines which implies:

- on one hand that councils must complete template 1 if they currently do not have sufficient scale and capacity (as per the ILGRP recommendations), but
- on the other hand that councils can only complete template 1 if they can form group of councils that are willing to merge voluntarily.

The reality in the fine print of the guidelines is that if a council isn’t able to answer “yes” to the question of whether it has scale and capacity according to ILGRP recommended merger, then the council must complete template 1 and must propose a form of merger that is either identical to or broadly consistent with the ILGRP recommended merger, regardless of whether the council has succeeded in obtaining voluntary agreement to a merger from all councils named in the ILGRP merger recommendation for their council.

In other words, for councils where the ILGRP deemed a merger was necessary to achieve scale and capacity, the *form* of a merger is voluntary (within limits) but the *fact* of a merger is not.

Several councils have failed to grasp this, which is not surprising given the confusing messages in the template guideline.

Because of the confusion about this, some councils that are in fact required to propose a merger (due to the government's acceptance that they do not have sufficient scale and capacity) will nevertheless be likely to submit a proposal to continue standing alone and will simply complete template 2 instead of template 1. The City of Sydney is one such council that has resolved to use template 2 and by-pass template 1, when in fact they are really supposed to be completing template 1.

Some councils earmarked by the ILGRP for a merger will also use – or, more accurately, *misuse* – template 2 to argue that they are fit for the future and can achieve scale and capacity, without a merger, because they can demonstrate a capability of meeting the criteria for financial sustainability, effectiveness and efficiency. That is, they will attempt to use the criteria in template 2 as evidence of having met (or being able to meet) the criteria for scale and capacity in template 1 but will have actually avoided addressing the criteria in template 1 entirely. Lots of councils are operating under the assumption that if they can prove they can meet the financial benchmarks under template 2, then they won't need to merge; whereas in many cases there's actually very little relationship between being able to meet or not meet the financial criteria in template 2 and being able to achieve or not achieve sufficient scale and capacity under template 1.

The above noted confusion is currently luring councils into a belief that there is a virtual "escape route" from the prospect of mergers that probably isn't there at all in reality. Several are considering taking this escape route and the likelihood of IPART receiving proposals which don't really conform to the guidelines is therefore quite high.

It's apparent that IPART has attempted to reduce the effect of this confusion in its draft methodology by signaling that councils that were earmarked for a merger by the ILGRP, but which in the end propose no merger at all, will be deemed "not fit" by IPART unless they can show that not merging is "superior" to the recommended merger. IPART has also made it clear in point 3 on page 6 of the Methodology that it will be assessing scale and capacity in each case *before* it assesses proposals against the other three criteria (indicating that for councils that are earmarked for a merger, the financial criteria are an important but still secondary consideration to the scale and capacity criteria). These are good strategies by IPART in that they create a process that should effectively compel councils to provide comparative assessments of their own proposal and the original ILGRP starting point proposal. But the methodology is probably still not specific enough about the particular criteria that must be addressed by councils in their comparative assessments of how well various mergers will perform in achieving sufficient scale and capacity.

If councils by-pass template 1 (because they won't seek or can't get other councils to work with them on a voluntary merger) and opt instead to go straight to template 2, this will leave IPART without a reasonable assessment of how those councils' proposals compare with the ILGRP starting point in terms of achieving scale and capacity. These problems will arise for IPART particularly when assessing the fitness of any council that can prove that a merger would actually worsen their current financial outlook. There will be several councils that could prove this quite easily; ie., they will be able to make an argument that their proposal not to merge is superior to the ILGRP proposal because the merger recommended by the ILGRP will worsen their current financial position. Alternatively they may be able to make an argument that merging with fewer councils than the ILGRP recommendation is superior to the ILGRP recommendation merely because their smaller proposal meets the financial benchmarks, but ignoring the possibility that the smaller proposal might still not achieve sufficient scale and capacity. Councils arguing along these lines will seek to rely solely on the financial arguments to the exclusion of any evidence which suggests that:

- they should merge for other reasons such as strategic capacity, and
- the net financial position of the councils that should have merged would be enhanced overall (even though their own financial position might temporarily get worse).

If councils make this sort of argument and exclude certain types of comparative information about various merger options, there is a very real prospect that IPART will be unable to provide the state government with guidance on which merger combinations are actually most likely to be able to solve sector's sustainability problems overall. In that case the State Government will end up back where it started and the map of local government will still be pockmarked with unsustainable councils alongside sustainable ones.

IPART might minimize this problem of councils' opting out of template 1 if IPART officers were to complete the comparative assessments against the scale and capacity criteria themselves. But as it's highly likely that officers won't have time for this, an alternative way of avoiding the problem is to introduce a slight wording change to the methodology as shown in the table below. This wording change is more specific in requiring councils to demonstrate that their proposal is superior to the ILGRP starting point in terms of the scale and capacity criteria in template 1, not just the financial criteria in template 2:

On page 6, change this wording ...	to this wording ...
<p>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:</p> <ul style="list-style-type: none"> – a sound argument (eg, using a business case) that demonstrates that the proposed approach is superior to 	<p>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 a sound argument that demonstrates that the proposed approach is superior to the recommended merger in terms of each of the criteria for scale and capacity in Box 3.1.</p> <p>If the ILGRP recommended a merger as the preferred option</p>

<p>the recommended merger, or – a merger option <i>broadly consistent</i> with the ILGRP recommendation to merge councils (eg, with three rather than four councils), supported by a sound argument, ...</p>	<p>and the council proposed a different merger, the council’s proposal will be assessed as ‘not fit’, unless it presents a sound argument that demonstrates that:</p> <ul style="list-style-type: none"> - the proposed approach is superior to the recommended merger in terms of each of the criteria for scale and capacity in Box 3.1, or - the proposed merger option is <i>broadly consistent</i> with the ILGRP recommendation to merge councils (eg, with three rather than four councils), in that it will result in a council that can: <ul style="list-style-type: none"> (a) perform as well or better than the recommended merger in relation to the scale and capacity criteria, and (b) meet the criteria for sustainability, effectiveness and efficiency within a tolerable period of time.
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If this wording is adopted, it will have the effect of preventing councils from using criteria in template 2 to frustrate the objective of creating councils with sufficient scale and capacity. It will also help prevent sub-optimal merger combinations, eg., mergers that proceed with fewer councils than those proposed by the ILGRP and which therefore still leave some councils standing alone and unable to achieve sufficient scale and capacity.

2. Issue: Councils are likely to complete template 1 in a manner that will be unhelpful to IPART in assessing the comparative performance of different merger options in achieving scale and capacity. This might be addressed by expanding section 1.3 of template 1.

The form for template 1 doesn’t require councils to provide a comparative assessment that will enable IPART to decide which proposal is “superior” in terms of achieving sufficient scale and capacity. Instead it allows councils to claim that their proposal achieves sufficient scale and capacity without reference to the potential better or worse performance of the original ILGRP proposal.

IPART might provide additional guidance to councils intending to complete template 1 by stipulating that that their submission on the performance of their merger proposal should be provided along with direct and clear comparisons of the council’s proposal with the ILGRP proposal in terms of the criteria for scale and capacity. A possible simple template for this is provided as **Attachment A** (see below).

3. Issue: Councils are likely to complete template 1 in a manner that will be unhelpful to IPART in assessing the comparative performance of different merger options in delivering the key priorities of their various Community Strategic Plans (CSPs) and the State Government’s regional growth plan for their area. This might be addressed by expanding section 2.1 of template 1.

The form for template 1 doesn't require councils to provide a comparative assessment that will enable IPART to decide which proposal is "superior" in terms of successfully merging CSPs and delivery of CSPs. It provides even less help in assessing how well various proposals for mergers will enhance development and delivery of adopted regional growth plans. Instead it allows councils to claim that their proposal delivers priorities without reference to the potential better or worse performance of the original ILGRP proposal. And it allows them to ignore the need for improvement in mechanisms for regional planning and infrastructure delivery almost entirely.

IPART might provide additional guidance to councils intending to complete template 1 by stipulating that their submission on the performance of their merger proposal should be provided along with direct comparisons of the council's proposal with the ILGRP proposal in terms of both delivery of the CSP and regional growth priorities. A possible template for this is provided as **Attachment B** (see below).

4. Issue: The formula used to calculate the Infrastructure Backlog Ratio currently uses the Written Down Value of the assets. It may be better in the long run to use replacement value instead of WDV.

Use of WDV makes less sense in the case of public sector assets that are highly unlikely to be sold, such as roads. And if the value is written down to zero on an asset that cannot be disposed of, when in fact the cost to replace it is quite distinct from its WDV and quite high in comparison, this will provide a misleading view of the council's capacity to extinguish its backlog and prevent its re-growth. If the formula were changed to use replacement cost of the total asset portfolio of infrastructure, buildings, other structures, depreciable land and improvement assets, this would be more meaningful but this might require reconsideration of the currently proposed benchmark of "Less than 2%".

If the government has adopted this formula and benchmark and is not willing to consider a change at this point, IPART might still take this into account when considering a council's fitness for the future. For instance if this is the only criterion affecting the acceptability of an otherwise sound proposal, IPART might consider discounting its effect or even discarding it in judging the proposal.

5. Issue: The proposed benchmark for measuring efficiency is to achieve a decrease in real operating expenditure per capita over time. Establishment of a measure of change in labour productivity may be more effective in establishing a real view of efficiency gains over time.

It's noted that IPART has modified this measure slightly by saying that the operational savings per capita should be calculated net of IPR supported service improvements. This measure isn't really useful for a couple of reasons:

- a. Several councils have their whole service profile covered by their IPR, as indeed they should, and they can't separate out their "IPR supported service improvements" from the rest of their business. After they've finished delivering what's covered by their IPR, there's no more services to be delivered and therefore no prospect of savings per capita because no money is being spent on non-IPR services. For these councils there'd be nothing left to measure.
- b. Several councils can increase service levels (inside or outside their IPR frameworks) if they can access enough own source income to do so. This can mean that their operating expenditure per capita will rise but the rise is desirable and doesn't necessarily imply inefficiency. Effectively if this happens (as it does quite often for instance in child care services) it's nothing more than an increase in expenditure per capita on services which may or may not be "discretionary" but which people want in any event and which might even be quite efficient. Another good example is parking services in high density metropolitan areas. These necessitate quite significant increased expenditures per capita but the community is nevertheless net better off financially and in terms of amenity. They would be worse off if spending per capita dropped on this sort of service.

While it may be too late to change this measure for purposes of assessing whether councils are fit for the future, a new measure might be considered if there is an intention to measure councils' ongoing performance in efficiency (eg., through the Auditor General). Substitution of the above measure with a measure about labour productivity may prove more useful and may be easier for councils to calculate. As councils are almost entirely operating in the services sector (as opposed to primary or manufacturing industries), labour productivity would be a more relevant measure of efficiency than movements in expenditure per capita. A formula for measuring changes in labour productivity through time can be set up with relative ease for use by all councils. For an example of a formula for labour productivity in use in Local Government, see Waverley Council's Special Rate Variation Application 2011, Attachment 4, Long Term Financial Plan 3.1 (LTFP3.1) pp. 97-98. LTFP3.1 is available online at:
http://www.waverley.nsw.gov.au/__data/assets/pdf_file/0013/22180/LTFP_3.1.pdf

6. Issue: Some councils may have difficulty describing how their proposal performs in relation to the scale and capacity criteria in Box 3.1. This might be addressed a little if some examples are provided about the sorts of things councils might take into account when describing the benefits of their proposal for achieving scale and capacity.

The criteria for scale and capacity are essentially qualitative and hence more subjective or speculative than the financial criteria, so it can be difficult to find a language capable of showing the difference in performance of various merger options. It may be useful, particularly for councils around the area of the global capital city or around Parramatta, if they are encouraged to show how their proposal compares to the ILGRP proposal in terms of the benefits that may come for:

- potential developments for tourism;
- potential expansion of the services sector (eg., financial, information, telecommunications) particularly in the capital city and Parramatta;
- potential financing and construction of new major infrastructure for transport, roads (particularly in rural areas), shipping, airport services, etc.;
- potential human services sector developments in health, education, etc.;
- potential to meet regional employment growth objectives and objectives for establishment of new industries if flagged in regional growth plans; and
- potential to accommodate increased population density targets in regional plans and support it with improved community services sector programs.

Otherwise the risk is that decisions about scale and capacity will be made only in the context of councils' financial parameters or localism. Localism is fine but it can actually work against the creation of appropriately sized major cities or regional groupings. Something more than financial efficiency, local autonomy and parochialism should be taken into account when designing a global capital city or a major regional city such as Parramatta or a strategic regional centre. That's the whole point of the ILGRP recommendations. The fact is several councils will be able to say they can meet the financial criteria and will claim this means they are fit for the future. But an ability to meet the financial criteria really only means they are fit for the present and for delivery of their current service levels. It doesn't set them up as entities capable of delivering new sustainable futures built on efficient investment in major infrastructure and support services. Asking councils to look at how their proposals will perform in relation to these more futuristic criteria will be more likely to uncover the right combinations for mergers than a simplistic reliance on financial parameters which, after all, have really only been set up for the purpose of measuring capacity to deliver existing services rather than future services.

I trust this information is of assistance and hope it makes your task easier. Best wishes with your assessments.

Yours sincerely

Bronwyn Kelly

Dr Bronwyn Kelly was the Director Corporate & Technical Services at Waverley Council for 15 years until July 2014. She is currently a freelance consulting adviser on Local Government Reform, an Associate of the Australian Centre of Excellence in Local Government at the University of Technology of Sydney, and a campaigner for preservation of publicly owned Australian heritage.

Attachment A

Sample table to be added to section 1.3 of template 1. The intention of this table is that each council should be driven to explain which merger performs best on each of the criteria and why.

How do the merger proposals meet the key elements of strategic capacity?			
Elements of strategic capacity	Merger identified by ILGRP	Proposed Merger (if different from ILGRP recommended)	Retaining the status quo (if proposed)
How well does the proposal work to create a more robust revenue base and increased discretionary spending?			
How much does the proposal increase the scope to undertake new functions and major projects?			
How much does the proposal increase the council’s ability to employ a wider range of skilled staff?			
What increases in knowledge creativity and innovation would be created by the proposal?			
How effectively does the proposal enhance the council’s capacity to attract and retain advanced skills in strategic planning and policy development?			
In what ways does the proposal create more effective regional collaboration?			
How does the proposal improve the council’s credibility as an effective advocate?			
How does the proposal increase the chances of the council becoming a capable partner for State and Federal agencies?			

How do the merger proposals meet the key elements of strategic capacity?			
Elements of strategic capacity	Merger identified by ILGRP	Proposed Merger (if different from ILGRP recommended)	Retaining the status quo (if proposed)
How well does the proposal perform in supplying resources necessary to cope with complex and unexpected change?			
How well does the proposal perform in supplying resources necessary to meet the service and infrastructure needs of the expected population growth?			
How much does the proposal increase the potential for high quality political and managerial leadership?			

