

24 May 2015

Ms Lucy Garnier
Executive Director, Local Government
Independent Pricing and Regulatory Tribunal
Level 15, 2-24 Rawson Place
Sydney NSW 2000

Dear Ms Garnier

Consultation Paper: *Methodology for Assessment of Council Fit for the Future Proposals*

In response to your call for submissions, I am writing to clarify some aspects of the approach taken by the Independent Local Government Review Panel (ILGRP) in framing its final report *Revitalising Local Government*. It is pleasing to see that IPART has revisited several of the themes pursued by the ILGRP in its consultation paper.

I do not wish to offer a point-by-point commentary on IPART's proposed methodology, nor is it my intention to critique the *Fit for the Future* (FFTF) package. However, the consultation paper raises a number of methodological issues that involve interpreting the ILGRP's findings and proposals, and some further background on the Panel's thinking may be helpful before IPART commences its council-by-council assessments.

ILGRP's 'Systems' Approach

The ILGRP sought to consider the future of the local government sector as a whole, and of local government in the inter-government framework, and thus formulated a package of measures comprising both systemic changes and council- or region-specific reforms. In particular, the Panel considered it essential that any structural reform be accompanied by further improvements to Integrated Planning and Reporting, financial and asset management, the revenue base (including 'streamlining' rate-pegging), management skills, productivity, and both corporate and political/democratic governance.

Such improvements were also fundamental to the Panel's understanding of 'strategic capacity'. However, whilst inherent in the FFTF criterion of 'scale and capacity', the ILGRP's broader package has been somewhat overshadowed by FFTF's perceived focus on financial ratios and benchmarks. Anecdotal evidence suggests that as a result the need for wide-ranging, longer-term measures to build sustainability and capacity is often being confused with short-medium term 'budget repair', which is not what the ILGRP intended. The latter would represent a much narrower (and almost certainly less fruitful) approach.

The Panel envisaged a staged implementation process along the following lines:

- Review and amend systemic policies in the areas mentioned above *as a precursor to, or in parallel with, structural reform*

- Fine-tune and implement the concept of regional Joint Organisations (see below) to advance sustainability and provide *an essential foundation* for structural reform in non-metropolitan regions
- Undertake group-by-group assessments of potential mergers/major boundary changes over a period of several years.

It is difficult to see how IPART will be able to make robust assessments of individual councils without some indication as to how the broader policy framework for the sector is expected to evolve. For example, *guaranteed* access to low-cost borrowings, ‘streamlined’ rate-pegging arrangements and other changes to the rating system (fewer exemptions and concessions, the option of using CIV for apartments etc) could make a crucial difference to a council’s ability to meet the FFTF financial benchmarks. Similarly, mandatory further enhancement of IPR and corporate and political governance would have a significant bearing on whether or not councils were judged to have adequate ‘strategic capacity’.

The Operating Context

The ILGRP’s analysis gave prominence to a range of external forces impacting the local government sector. Importantly, these included ongoing socio-economic changes that have differential impacts from one region and local area to another, as well as growing fiscal pressures on all levels of government. These forces seem likely to interact in a way that could have severe consequences for many local councils. In particular, pressures on federal and state budgets mean that local government cannot rely indefinitely on continuation of the high levels of grant funding and road maintenance contracts that support so many NSW councils.

Of particular importance will be the future quantum and distribution of federal financial assistance grants (FAGs). It is understood that this issue may be addressed through the current Federation White Paper and tax reform processes – perhaps leading to significant changes beyond 2016. A Commonwealth Grants Commission review of FAGs was presented to the Treasurer in December 2013 but has yet to be made public. It considered amongst other things whether the guaranteed minimum grant to all councils irrespective of need should be maintained in its current form, and whether the current National Principles should be amended. This could impact, for example, the current ‘effort neutral’ approach (ie councils continue to receive funding irrespective of their sustainability, efficiency and effectiveness).

Abandoning the minimum grant guarantee could free-up large sums to support smaller (in population) rural-remote councils, but equally it could offer a significant federal budget saving. In this regard, the ILGRP questioned whether ever increasing support to councils that are fundamentally unsustainable – at least in their current form – could be justified.

Map 1 in *Revitalising Local Government*, which identified ‘Councils at Risk’, pulled together a number of factors, including the latest official population projections, the TCorp assessments (including importantly the future outlook), the Office of Local Government’s infrastructure audits, levels of grant dependency and the robustness of councils’ rating base (reflecting in part the health of local and regional economies). This was an attempt to take a more rounded look at sustainability and capacity that went well beyond financial ratios.

Changes in the operating environment mean that any assessment of councils’ FFTF proposals must be based on assumptions about key future trends. For many councils, such assumptions will ultimately determine their FFTF status.

Merger Options

There is a widespread perception that the ILGRP 'recommended' a very large number of council mergers, and hence that those 'recommendations' can provide a starting point for FFTF assessments. This requires clarification.

The ILGRP was tasked with formulating 'options' for, amongst other things, structures and boundary changes. In its final report, the Panel did indeed put forward a number of 'Preferred Options' for mergers, but in every case it offered an alternative in case subsequent detailed examination of the merger proposal (or Government policy) pointed in a different direction.

Analysis of sections 13-15 of the final report, including Tables 8 and 11, yields the following summary of the Panel's Preferred Options involving mergers:

- 31 metro councils into 8 (plus one substantial boundary change)
- 6 Lower Hunter/Central Coast councils into 3
- 24 rural and regional councils into 11 (focused on strengthening regional centres or councils with very small populations that are adjacent to one or more suitable partners).

Thus only 61 of the 144 councils now required to submit a FFTF proposal were subject to 'preferred mergers'. For the other 83 there was either no merger option at all (42), or the merger option was given equal weight (pending further investigation) with 'no change' (conditional for most non-metropolitan councils on participation in a 'fully fledged' regional Joint Organisation – see below).

A 'Rural Council' option (see below) was canvassed for 11 councils. Ten of those might otherwise have been 'preferred' for mergers.

Regional Joint Organisations

The ILGRP put great weight on the establishment of regional Joint Organisations of councils (JOs) across the whole of the State except the Sydney metropolitan region, Central Coast and Far West. It did so for two main reasons:

- Research had identified a very large number of 'Councils at Risk' in non-metropolitan NSW and had pointed to the potential of greatly enhanced regional collaboration, resource sharing and shared services delivery as a means of assisting those councils to address the *medium-long term* pressures they face.
- Robust regional organisations were also seen as providing a platform for much-improved, more productive inter-government relations, including State-local partnerships, leading amongst other things to long-term gains in efficiency and effectiveness of infrastructure provision and service delivery.

Therefore introduction of 'fully-fledged' JOs along the lines envisaged by the ILGRP was fundamental to there being a 'stand-alone' option for many smaller non-metro councils. In its Table 11, the Panel often offers the option of 'Council in XYZ Joint Organisation or merge with...'. The inference is that for those councils full participation in the wide-ranging activities of a JO is a pre-condition to becoming what would now be termed 'Fit for the Future'.

Regrettably, a lengthy delay occurred in launching the JO pilots (which the Panel had envisaged being completed by now), and the Government decided against requiring extensive resource-sharing and shared services as a core function of JOs. Pilot JOs are not due to report until the end of 2015, after the FFTF assessments. Moreover, it seems that some other core elements of the Panel's proposal for JOs, notably incorporation of existing County Councils, and establishing Regional Roads Groups and Regional Water Alliances (the latter previously recommended in the 2009 Armstrong-Gellatly report),

are not being pursued at this stage. Again, this means that assessments of individual councils may have to depend on a number of critical assumptions about the extent to which they will benefit from resource-sharing.

Rural Councils

The ILGRP put forward a tentative model for a new category of 'Rural Council' – one with somewhat reduced responsibilities commensurate with limited resources. This idea emerged from the need to find a way forward for councils in sparsely populated rural areas where distance or other factors mean that a merger is either unviable or unlikely to yield substantial benefits (the 'two basket cases' problem). Extensive resource sharing and shared services delivery (to the point of fully shared administrations in some cases), managed under the auspices of a JO, plus a number of other cost-saving measures (eg streamlined governance), were seen as vital elements in the Rural Council concept. The Panel envisaged that in due course the Local Government Act would be amended to include a 'category' of 'Rural Council' with defined characteristics and a package of modified provisions governing their operations.

However, the Panel did *not* formulate and recommend a detailed model or specific amendments to the Act. Rather, it recommended a Working Group be established to undertake that task. This has not occurred and as a consequence there appears to be no firm indication as to how the structure and operations of a 'Rural Council' would differ from those of other small (in population) rural-remote councils, nor a set of *essential* steps such a council would need to take to justify and underpin its continued separate existence – and especially to justify continuing, very substantial grant support. Perhaps IPART will be able to develop a set of criteria in the course of undertaking its assessments of those councils included in the ILGRP list of potential 'Rural Councils'. Box 33 in *Revitalising Local Government* offers a starting point. By coincidence, the recent 'Recovery Plan' for Central Darling Shire adopted a very similar approach to that of the Panel.

Metropolitan Areas

In the case of the Sydney region, the Central Coast and the Lower Hunter the ILGRP was firmly of the view that wide-ranging council mergers were essential as part of *a broader agenda to improve metropolitan governance, planning and management*. Therefore, it is essential to note that (with the exception of Dungog Shire) the Panel's arguments were based overwhelmingly on the need for councils to achieve adequate strategic capacity as units of government, as effective democratic institutions, and as valued partners of the State government in managing the future of Australia's foremost 'global city'. Whilst some metropolitan councils need to improve various aspects of their financial performance, the revenue base available to them is generally more than sufficient for this to be achieved within their current boundaries. Similarly, the great majority have considerable scope to improve efficiency where necessary through changes to their own operations or through cooperation with others. Thus contrary to views expressed in some quarters, *the ILGRP did not base its case for metropolitan mergers on the need to improve financial sustainability or to achieve increased efficiency and cost savings as a primary objective*. IPART may wish to give some weight to the Panel's broader strategic objectives when making its assessments.

Ongoing Process

The ILGRP was clear that the number of councils in NSW needs to be reduced – on all the available evidence there will be neither financial nor human resources sufficient to sustain 152 high-capacity local governments that can meet the needs of their local communities and places. The Panel reached that judgement by taking a long-term view across a broad range of criteria and trends. However, if FTF determinations are essentially short-medium term, and based largely on achieving benchmarks for financial ratios, then it is likely a substantial number of councils seen by the ILGRP to be 'at risk'

will be able to make a credible case that they could continue in their current form. The question then will be whether action taken now amounts to any more than a temporary 'fix'.

The ILGRP's 'preferred options' for mergers would reduce the total number of councils by 39 to 113. The eventual outcome may be more or less depending in particular on whether or not truly robust regional organisations are established and can offer a genuine alternative to mergers for more of those 'Councils at Risk'.

In the case of metropolitan areas, and as noted above, different priorities and criteria would apply.

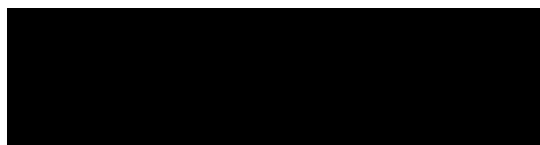
For mergers to occur and prove durable, the ILGRP saw a need for a much-improved statutory process for identification of options, analysis, consultation and determination. In turn, this would require a more independent, better-resourced Boundaries Commission. The Panel also proposed that groups of councils be referred progressively to the Commission for detailed investigation over the next few years. This would facilitate thorough, transparent, independent and firmly evidence-based assessment of merger proposals, including extensive community and stakeholder consultation, ensuring due process for all concerned. The Panel was particularly concerned that:

- Mergers should be designed to pursue 'big picture', long-term strategic goals rather than simply ad hoc 'marriages of convenience' that may achieve little more than a reduction in council numbers – this 'big picture' agenda is especially important in metropolitan Sydney
- Sound business cases and implementation plans must be prepared – this will presumably require considerable work over and above IPART's assessments
- Public debate should be informed by thorough, independent reports on all available options (as occurs in New Zealand), and not rely solely on material prepared by affected councils.

The Government's position on the ILGRP's recommended approach appears unclear. However, unless the Local Government Act is amended the current provisions requiring a formal process of investigation and consultation, with a recommendation to the Minister by the Boundaries Commission, must be followed at some point, and additional criteria for consideration of amalgamations set out in the Act will need to be taken into account. Meanwhile, it seems that IPART has been tasked only with determining whether each council is FFTF based on the Government's current, more limited criteria. Without clarity on the legal process to follow, that may prove problematic.

I hope those comments are helpful.

Yours sincerely,



Graham Sansom
Former Chair, Independent Local Government Review Panel