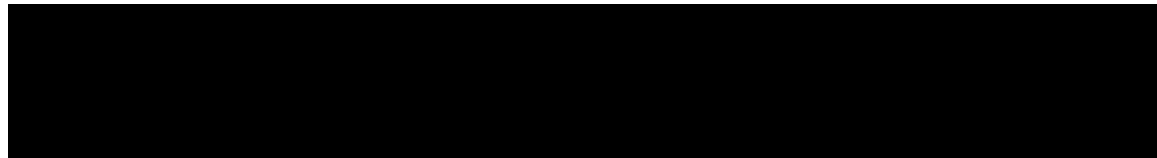


**Methodology for Assessment of Council
Fit for the Future Proposals
Local Government – Consultation Paper April 2015**

Submission of Response

**INSTITUTE OF PUBLIC WORKS ENGINEERING AUSTRALASIA
(NSW DIVISION)**

25 May 2015



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EXECUTIVE SUMMARY

IPWEA (NSW Division) appreciates the on-going opportunity to participate in developing improved criteria for the sustainable management of Councils and the infrastructure Councils manage on behalf of their communities.

This paper is provided in response to IPART's Local Government – Consultation Paper April 2015 on the Methodology for Assessment of Council Fit for Future Proposals. This paper takes account of on-going collaboration and discussions with the NSW Auditors Advisory Group, the Office of Local Government and IPWEA NSW regarding improving the management of infrastructure controlled by Councils across NSW.

IPWEA (NSW Division) has stated a mission *to enhance the quality of life of NSW communities through excellence in public works and services. This is achieved through our professional association that effectively informs, connects, represents and leads public works professionals for NSW.*

IPWEA NSW has a set of values that requires respect, integrity, passion, excellence, recognition and ownership in everything we do.

IPWEA (NSW Division) is therefore ideally placed to take a lead role in enhancing outcomes for communities across NSW, by assisting practitioners within Local Government, and partnering with the Office of Local Government, the NSW Auditors Advisory Group and IPART.

The management of infrastructure owned and managed by NSW Local Government represents the key expenditure item for Councils across NSW. This is one of the principal issues impacting Councils as they try to move toward being 'Fit for the Future'. More importantly, the success or failure of our industry to get this balance right, has significant consequences for our communities in relation to risk management including directly impacting on public health and safety, and financial sustainability.

The integrity of sound and consistent technical advice needs to be maintained to allow decision-makers to set appropriate levels of service; cognisant of the risks they potentially expose their communities to, both in the short and long-term.

IPWEA (NSW Division) is the centre of excellence in asset management and has the capacity to partner with Office of Local Government to provide guidance notes and benchmarking processes that will ensure:

- improved transparency to communities regarding infrastructure and the funding required to achieve an agreed level of service
- a more holistic approach to managing infrastructure with improved consideration of risk and legislated obligations on Councils
- improved consistency of reporting by Councils against the 'Fit for the Future' criteria
- benchmarking of underlying supporting assumptions to ensure a 'reasonableness' test
- improved confidence of Engineers, Accountants and other practitioners in the information supporting key financial and risk management decisions of Councils

IPWEA (NSW Division) also believes there is an opportunity to make simple improvements that will greatly assist Local Government and the Office of Local Government. IPWEA (NSW Division) looks forward to the opportunity of working with the Office of Local Government, the NSW Auditors Advisory Group and IPART.



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1. Background

In April 2015 the Independent Pricing and Regulatory Tribunal (IPART) published a Local Government – Consultation Paper titled *Methodology for Assessment of Council Fit for the Future Proposals* which posed five specific questions to consider in formulating a response. These specific questions are:

- 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?
- 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?
- 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?
- 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.
- 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?

This submission is in response to those issues, together with a number of more general observations which might assist in directing the process to reaching more appropriate outcomes.

2. Response to IPART Questions

2.1 Scale and capacity

IPWEA (NSW Division) is the leading professional association representing Engineers and Public Works Officers engaged in public works and engineering, with the majority of members working in, or providing services to, Local Government (and the NSW Government).

IPWEA has taken a lead role at both the NSW and Australasian level to progressively build the capacity within our industry through the development of technical publications, provision of conferences, regional forums and training. The evolution of this work has seen:

- the creation of the NSW Roads & Transport Directorate with representation from IPWEA NSW,

LGNSW, RMS and Transport for NSW. The Directorate will hold the NSW Roads Congress on 1 June, 2015 at NSW Parliament Theatre with a key focus on solutions being 'Fit for Purpose'

- significant improvements in the number of Councils with asset management plans in place, at least to a 'core' level
- the creation of NAMS.AU specialising in Asset Management

Our sister organisation, the NSW Water Directorate, has undertaken a similar role to the NSW Roads & Transport Directorate, except that it focusses on the water and sewer businesses.

This is a journey that has seen significant improvements in data collection and quality of analysis to better inform asset management planning, and the integrated planning and reporting process underpinning Local Government.

IPWEA (NSW Division) believes it is well positioned to deliver the knowledge and capacity-building needed to support improved outcomes to assist Councils deliver services that are 'Fit for Purpose', and assist Councils in meeting the NSW Government's 'Fit for Future' criteria.

There has been a significant focus on the financial indicators of Councils; this alone will not be sufficient. Local Government needs an action plan to ensure it continues to have the right people with the right skills to meet the needs of communities into the future.

Infrastructure management plays a critical role in the financial sustainability, efficiency and risk management for Councils and the communities they serve. Any assessment of capacity should include:

- i) a requirement for Councils to appoint a Chief Engineer with suitable engineering degree qualifications to oversight infrastructure management and delivery, whilst being able to ensure that Councils manage risks involved in the provision and maintenance of infrastructure in an effective manner. Only professionally trained and educated engineers can pursue this task on behalf of the community
- ii) a structure that provides suitable depth of qualified Engineers and Technical staff that provides the skills needed now, and a succession pathway to ensure these skills continue to be developed within Local Government for tomorrow
- iii) have, unless suitably justified, Cadet Engineers and Cadet Technical staff to provide a suitable training ground for the Engineers and Technical staff of tomorrow

IPWEA (NSW Division) is prepared to work with the LGEA, Universities, OLG and LGNSW to develop a student placement program that will increase the level of 'practical' experience provided to under-graduates, to ensure job readiness and provide qualified skilled resources to all Councils, particularly those in regional NSW.

IPWEA NSW Board members are already working to see improvements in undergraduate course content to meet the contemporary needs of Local Government. This includes initiating conversations with Universities about providing a greater emphasis on asset management and long-term financial planning.

In any proposed merger, Councils should be required to show they have incorporated a suitable structure of skilled and experienced Engineers and Technical staff at different levels that supports the immediate and long-term needs of the community, as well as providing a succession and skills development pathway for the future. This is even more critical where small Councils are proposed to be merged. Simply reducing staff numbers would provide a 'fool's paradise', with high risk to the community and the long-term sustainability of Councils.

2.2 Rural Councils

The characteristics for a rural council in our order of priority are:

1. Long distance to a major (or sub) regional centre
2. Low rate base and high grant reliance
3. Small and static or declining population spread over a large area
4. High importance of retaining local identity, social capital and capacity for service delivery
5. Difficulty in attracting and retaining skilled and experienced staff
6. Challenges in financial sustainability and provision of adequate services and infrastructure
7. Local economies that are based on agricultural or resource industries
8. High operating costs associated with a dispersed population and limited opportunities for return on investment
9. Limited options for mergers.

IPWEA (NSW Division) suggests that almost all of the characteristics on this list would be met by councils that consider themselves to be Rural Councils.

These rural regions provide high value commodities that support the NSW and Australian economies and provide for the well-being of cities (e.g. through food) as well as often providing exports to assist the balance of trade. They typically have a small, and in some cases declining, ratepayer base. Funding models and assessments must take account of these realities.

2.3 Fit for Future Criteria

2.3.1 Sustainability

Operating Performance and Own Source Revenue

All Councils should be able to include Federal Assistance Grants in their revenue. This is a relatively stable income source.

John Comrie in his *Review of TCorp's Report 'Financial Sustainability of the NSW Local Government Sector'* dated October 2014 in relation to the Own Source Operating Revenue Ratio suggests:

This ratio measures the extent of a council's reliance on external funding sources. It is calculated by expressing a council's rates, utilities and charges revenue for a period as a ratio of its total operating revenue (inclusive of capital grants and contributions) for the same period.

I see merit in this type of indicator but would argue for refinements. First of all I suggest that consideration should be given to including financial assistance grants revenue in the numerator (or at least having an additional indicator that included such that was given equal weighting with this one). Such revenue is in the main a reliable source of revenue for local governments (despite the Commonwealth's decision to hold the quantum constant in nominal values over the three years following 2013/14). For many rural councils with small populations financial assistance grants are a major source of revenue that they should comfortably rely on in planning affordability of future proposed works and services. (I would not make the same arguments in relation to Roads to Recovery or other grants which unlike FAGs would not require legislative change for their availability to be discontinued or annual quantum reduced). The basis of distribution of the available FAGs pool is such that councils with greatest needs for FAGs receive a higher share.

IPWEA (NSW Division) argues that the NSW Government can make smart changes to the funding model to better support Local Government as a whole. This would include:

- i) Redistribution of FAG grants to regional Councils (i.e. to Councils outside of Sydney, Newcastle and Wollongong)
- ii) Changes to the rating system to better recoup the cost of serving high and medium density developments. This would allow Councils to reasonably grow their revenue in city areas to replace redistributed FAGS. This would also provide an incentive for Councils to meet the NSW Government's planning targets for increased densities in our cities to prevent urban sprawl and provide overall efficiencies for all levels of Governments.
- iii) Provision of low interest loan funding to all Councils

IPWEA (NSW Division) believes that the NSW Government should work with Local Government to advocate for Australian Government's Roads to Recovery Program to be made permanent. This would recognize the significant on-going benefit this brings to the sustainability of the 90% of roads looked after by Local Government, and the positive impact this has on road safety outcomes, as well as the social and economic well-being of NSW. The Roads to Recovery funding program, has now been committed to 2019 and should therefore be able to be incorporated as revenue.

A Council's own source revenue may be adversely impacted by one-off grants and other income sources. This should not adversely impact the assessment of a Council's 'Fit for Future' status. For example, a Council may receive a substantial grant to upgrade and replace an existing asset to provide an improvement in economic efficiency, to help drive the NSW economy forward. This should be seen as a positive outcome for the NSW community.

Building and Asset Renewal Ratio (BARR)

If a Council meets the break even Operating Ratio measure, there should be adequate revenue to provide for appropriate management of its infrastructure.

IPWEA (NSW Division) agrees, in general terms, with the requirement to meet or improve this ratio

within five years, provided there is adequate provision for acceptable variations to the suggested trend. Such variations can easily occur through the injection of funds to replace assets (e.g. loan or grant funded replacement), which will have an on-going impact on the three- year average asset renewal ratios.

Strict adherence to a need to 'improve', may act as a disincentive to sensible use of loan funded programs to treat high- risk backlog or renewal works. It may also penalize Councils who have advocated strongly for their communities and successfully achieved grant funding. Many of these grants are targeted to support NSW Government economic growth and community safety targets (e.g. replacement of a bridge with a modern equivalent that supports higher productivity transport options to address the 'first mile' issue).

These capital injections may provide a temporarily high renewal ratio followed by an apparent decline. Such variations in the ratio may be based around providing optimized sound management of infrastructure and risk, which should be seen as a positive, rather than something to penalise.

Depreciation is also a 'backward looking' accounting figure, in effect reflecting the value of the consumption of the asset. It also needs to be recognized that this is an estimate of cost based on a range of variables and predictive elements, especially for long lived assets. This should be emphasized that this estimate is subject to variations upon review.

All Councils should be encouraged to undertake a review of unit rates annually and apply these to revise the depreciation calculation, with a major revaluation then undertaken in accordance with the OLG schedule. This approach is already implemented in the water and sewer business within LG. This approach would improve consistency across all asset classes and mitigate potentially high variations in depreciation under the current (full) revaluation schedule.

What is more important than past depreciation, is what renewal work is falling due and how a Council is dealing with its infrastructure backlog, as well as other relevant infrastructure matters when making decisions. A long- term financial plan that demonstrates sound management of these aspects is a more prudent measure than a single ratio.

In cases where a Council's long lived infrastructure is only part way through its useful life, depreciation may represent an amount far higher than the immediate need. Whilst it is reasonable for the current community to pay for the consumption of the infrastructure in use, IPART should give consideration to how a Council responds to other identified infrastructure demands. Council should also retain the ability to place funds into an asset renewal reserve, with such 'provisioning' to be included in Council's renewal ratio.

IPWEA (NSW Division) has offered to work with OLG, the NSW Auditors Advisory Group, and now IPART, to develop improved mechanisms for assessing sustainable infrastructure management.

When determining how a Council needs to manage its existing asset portfolio, it must consider more than just asset renewal based on condition. In some cases this means creating new assets to maintain the existing level of service or to comply with legislative requirements. These will not be covered by depreciation, but should be considered in Councils' forward asset (and risk)

management plans. Examples include:

- Addressing network deficiency – for example:
 - Providing new guardrail to address road safety risk under the NSW Government’s Civil Liabilities Act 2002
 - Adjusting a building to improve accessibility and meet the requirements of the NSW Government’s Disability Inclusion Act 2014
- Matching developer contributions in accordance with the NSW Government’s Environmental Planning and Assessment Act 1979 (and associated amendments)
- Providing capacity upgrades to maintain the existing level of service (e.g. increasing the capacity of a distributor road to cater for growth from development so that traffic congestion is maintained at a reasonable level of service, avoiding community frustration and adverse impacts on the economy and business)

The current focus on meeting the ‘Fit for Future’ infrastructure renewal ratio alone may in fact be counter-productive for local Councils, their communities and the NSW Government economic and community safety targets.

These examples also demonstrate how changing standards, often set by the Australian and NSW Governments for excellent reasons, are not able to be delivered in a rate capped environment. Allowing peak bodies such as LGNSW and IPWEA NSW to have a seat at the table to assess the infrastructure management and financial impacts of such legislative proposals, and help determine how these changes might be funded is likely to provide better outcomes in the future.

The NSW Government is to be applauded for implementing grant schemes to assist in some areas (e.g. Fixing our Country Roads Program, Country Passenger Transport Infrastructure Grants Scheme).

Other examples placing pressure on the cost of services under the current rate pegged environment include higher standards and increasing costs associated with Workplace Health and Safety and Environmental legislation. These are worthy pursuits, but often require additional costs compared to historical levels as standards are increased. These costs are transferred to Local Government and its ratepayers and residents.

IPWEA (NSW Division) did seek representation on the Ministerial Advisory Group, however was unsuccessful).

NSW Roads & Transport Directorate – 2014 Asset Benchmarking Report

In 2006 the IPWEA (NSW Division) Roads & Transport Directorate engaged Jeff Roorda and Associates to carry out a benchmarking report to determine the state of transport infrastructure assets across NSW. The first report (2006) highlighted the scale of the long- term underfunding of roads and bridges presenting a significant risk to Councils and their communities. The report concluded that current levels of road funding were NOT sustainable and identified a life cycle funding gap of \$783 million per annum.

The latest Road Asset Benchmarking Report 2014 (to be released at the 2015 NSW Local Roads Congress on 1st June 2015) reports:

The road funding gap for NSW councils is estimated at \$447 million based on the data from the 150 responding councils extrapolated to 152 councils. Funding at this level will require a 41% increase on 2013/14 road expenditures if asset management principles are not further developed to manage the gap. Asset management principles to be applied to managing the funding gap include:

- *ensuring that all councils have adequate accurate knowledge on their road assets and how their assets are performing,*
- *ensuring that sealed roads are resurfaced/resealed at the optimum time to maintain waterproofing of pavements,*
- *consulting with and select appropriate levels of service and costs to meet community needs and available resources,*
- *ensuring that unsealed roads are resheeted at the optimum time to meet agreed service levels within available resources,*
- *making efficiencies in operations, maintenance, resurfacing and pavement renewal aimed at reducing life cycle costs,*
- *improving maintenance practices and funding if necessary to extend pavement life and defer projected renewal,*
- *rationalising (dispose) of unnecessary infrastructure assets,*
- *adjusting service levels in consultation with the community,*
- *identifying future renewal needs and expenditure required to meet agreed service levels and document in a road asset management plan,*
- *increasing funding, and*
- *a combination of all actions above.*

While this report shows a significant improvement in asset management capacity and application since 2006, it also clearly shows that asset management alone will NOT overcome the funding gap problem.

2.3.2 Infrastructure and Service Management

Infrastructure Backlog Ratio (IBR)

IPWEA (NSW Division) supports a requirement for Council's to reduce the amount of backlog of infrastructure works. Therefore, under the current ratio, a requirement to show improvement over five years is reasonable.

IPWEA (NSW Division) believes the backlog ratio and the requirement to meet the IBR, should be modified in the following ways:

- i) Change the denominator to current replacement cost (in place of written- down value). The real measure of backlog is against the total replacement cost of the infrastructure. This is also

less susceptible to distortion from factors such as growth, which may artificially reduce the ratio without a Council taking action to address backlog

- ii) Increase the value (or ratio) to 2.5-3.0 times annual depreciation. The current backlog ratio represents less than one year of depreciation. Infrastructure is often long lived with unpredictable events (e.g. prolonged wet periods) and uncertainties (e.g. ground conditions) significantly influencing actual outcomes. Works programs should be well planned in advance of the year they are budgeted, otherwise inefficiencies in service delivery may be introduced. The current ratio methodology has a level set at 2%. This essentially means a Council would be budgeting for predicted rather than actual works based on the level of service expected by the community. This also limits a Council's ability and flexibility to plan a response over a longer period when unusual events occur, taking appropriate account of risk and community impact in prioritizing works. This is evident in some parts of the North Coast of NSW currently where Councils have experienced on-going periods of wet weather and floods, resulting in significant infrastructure backlogs, and potentially not yet seen premature failure of assets. Whilst some of this infrastructure work will be treated under Natural Disaster Funding arrangements, much of the increased infrastructure decline will need to be met by local Councils.
- iii) Increase the timeframe to meet the criteria. Councils can introduce cost effective solutions to respond to backlog over a longer period (e.g. 10-20 years). Simple strategies such as fully funding the infrastructure replacement need for short lived assets (i.e. assets with a useful life of less than 20 years) will result in the cycle of renewal removing backlog in time. These strategies often support assumed long lives of other asset components (e.g. meeting reseal renewal targets will help protect expensive structural road pavements from premature failure). Lack of resealing at 7-8 year intervals reduces the life of the road asset and leads to a reduced level of passenger safety due to 'less than adequate' friction between vehicle tyres and the road surface.

IPWEA (NSW Division) believes there is also a need to improve the definition of the cost to bring to satisfactory that determines the quantum of the backlog. IPWEA has offered to work with OLG to:

- better define how to calculate the backlog
- provide standard underpinning criteria (e.g. road hierarchy, condition assessment methodologies) and typical ranges of useful lives for use by LG in NSW (which will also aid depreciation assessment)
- provide training to LG Engineers and Technical staff to further build capacity within Councils

We believe this approach will provide a more realistic and consistent assessment of the infrastructure renewal work needed to meet the agreed level of service, using the optimum infrastructure renewal method (e.g. partial versus whole of component renewal).

Asset Maintenance Ratio (AMR)

IPWEA (NSW Division) has been involved in discussions with OLG in regard to the AMR. It agrees that Councils should meet or improve this ratio within five years. We recommend however that this requirement commence from 2015/16 onwards.

OLG have now confirmed that this ratio only applies to routine maintenance (actual expenditure compared to required expenditure). It is clear that the definition of this ratio (within special

schedule 7) has been interpreted legitimately, but differently by different Councils. Therefore historical analysis of this ratio may be based on differing definitions and inclusions.

IPWEA (NSW Division) has offered to work with OLG to better define the term 'maintenance' for the purpose of calculating this ratio, and to include this in training of industry practitioners.

Debt Service Ratio (DSR)

IPWEA (NSW Division) supports the appropriate use of debt to deliver long lived infrastructure to communities, to ensure inter-generational equity and allow improved asset, financial, risk and health management.

2.4 Community Engagement

Community engagement is an essential component of working with the community to determine what services and infrastructure it needs, and what it is prepared to pay for.

Councils are already required to appropriately engage with their communities via the integrated planning and reporting (IPR) processes. This is essential. Nevertheless, community engagement needs to be well managed and cost effective.

Councils also develop a wide range of strategic documents, all of which undergo extensive community engagement processes and State Government review in many cases.

IPWEA (NSW Division) encourages IPART to make use of the existing IPR and related engagement processes wherever practicable, rather than requiring new or extra processes, which cost the community.

IPWEA (NSW Division) notes that in effectively communicating with a a community, Councils need to indicate that to pay more to maintain the existing level of service, whilst being a difficult message to deliver, is the wise decision to make financially. This is complicated by the low rate of decline in asset condition of long lived infrastructure and the need to fully fund depreciation under the Operating Performance measures (in some cases requiring a renewal reserve to be created to meet future infrastructure replacement needs).

2.5 Planning to be Fit for Future and Reporting

IPWEA (NSW Division) believes the IPR requirements need to be reformed to require:

- all Community Strategic Plans to be linked to the Asset Management and Long- Term Financial Plans. CSPs are often aspirational documents, however they need to be better linked to long-term affordability so that community expectations are consistent with the cost of service provision.
- a single chapter within the Delivery Program and Operations Plan on Infrastructure Management to provide:

- a snapshot of infrastructure ratios and measures including how a Council proposes to deal with the issues of:
 - routine maintenance
 - infrastructure renewal and upgrades
 - network deficiency
 - works to address capacity issues with existing infrastructure
 - other new infrastructure sought by the community
 - disposal of infrastructure
- proposed works program summaries, funding and key performance indicators
- a revised Special Schedule 7 for inclusion in the annual report that summarises the actual outcomes at the end of the financial year (compared to the predicted outcomes outlined in the Operations Plan)

IPWEA (NSW Division) believes this approach would provide greater transparency to communities compared to the current approach where the infrastructure expenditure to spread throughout the Operations Plan and in the annual report, limiting both ease of use and interpretation.

IPWEA (NSW Division) has offered to work with OLG and the NSW Auditors Advisory Group to develop the appropriate templates and guidelines to assist in this process.

3. CONCLUSION

IPWEA (NSW Division) is a recognised leader in the field of infrastructure and asset management. Our ethos and connections within the Local Government industry mean we are well placed to influence positive change.

It seeks to partner with the Office of Local Government, LGNSW, the NSW Auditors Advisory Group and IPART, to improve the management and reporting on infrastructure to our NSW communities.

IPWEA (NSW Division) believes there is an opportunity to make simple improvements that will greatly assist Local Government, as outlined in this paper and the communities they serve.

This paper outlines proposals to improve:

- Integrated Planning and Reporting (IPR) as it relates to the Community Strategic Plan, Delivery Program and Operational Plan
- Special Schedule 7 (SS7) so that it better reflects the decisions facing a Council (and their Asset Managers)
- modifying and better defining the Fit for the Future criteria to provide greater flexibility to Councils in managing their assets and meeting legislated obligations
- building capacity within Local Government

By working together, IPWEA NSW believes the following outcomes can be achieved:

- Improved transparency to communities about infrastructure and the funding required to achieve an agreed level of service.
- A more holistic approach to managing infrastructure with improved consideration of risk and legislated obligations on Councils.
- Improved consistency of reporting by Councils against the 'Fit for the Future' criteria.
- Benchmarking of underlying supporting assumptions to ensure a 'reasonableness' test.
- Improved confidence of Engineers, Accountants and other practitioners in the information supporting key financial and risk management decisions of Councils.

Ultimately these improvements will provide improved information for decision-makers so they may determine the appropriate level of service and the associated cost for their communities.

We look forward to the opportunity to discuss these issues in greater detail.

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