



21 May 2015

Dr Peter J Boxall  
Chairman  
Independent Pricing and Regulatory Tribunal  
PO Box K35  
HAYMARKET POST SHOP NSW 1240

Dear Dr Boxall

**Subject: Submission on proposed Fit for the Future Assessment Methodology**

Thank you for the opportunity to comment on your proposed Methodology for Assessment of Council Fit for the Future Proposals.

Please find below my comments, on behalf of Lake Macquarie City Council, on the specific questions you have put, except Q2, which relates to the characteristics of rural councils, and is not relevant to Lake Macquarie. I have also included some general observations about the findings of the Independent Local Government Review Panel (ILGRP) and the proposed Fit for the Future (FFTF) assessment process.

### **Response to Specific Questions**

#### **1. *How should the key elements of strategic capacity influence our assessment of scale and capacity?***

I generally support the elements of strategic capacity identified by the ILGRP and reproduced as Box 3.1 of the draft Methodology. However, I do not agree that strategic capacity is proportional to scale.

The significant majority of the empirical literature, both internationally and in Australia, casts considerable doubt on whether larger councils have greater strategic capacity than smaller councils. On this basis, neither adoption of a minimum population threshold, nor a target number of councils in a particular region is likely to have a material influence on performance against the elements of strategic capacity that the ILGRP has articulated.

The ILGRP's assessment has made the case for strategic capacity particularly difficult to argue, as it has not presented an evidence-based case to support its contentions about scale. The difficulty understanding the ILGRP's proposals is exacerbated by the NSW Government's response to the ILGRP's findings, which suggest, for example, that Lake Macquarie, with a population of over 200,000 and a positive financial position, does not have adequate scale and our adjoining neighbour, Cessnock, with a population of about 55,000 and a weak financial outlook does have adequate scale. I note, as an aside, that the NSW government incorrectly cites the ILGRP's recommendation 47 (see response to Q5) in relation to the proposals for the Hunter, Central Coast and Illawarra.

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*"Quality Lifestyle"*

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While these strategic capacity elements are qualitative in nature, there are a number of quantitative proxies that you may wish to consider including:

- Non-financial comparative data for comparable groups produced by the Office of Local Government (OLG), for example the Comparative Information On NSW Government 2012-13 (OLG, 2014), which provides quantitative measures of performance in relation to council services and community leadership, in addition to assets and finances;
- Community satisfaction surveys;
- Contributions to NSW and Federal government policy development; and
- Contributions to the delivery of NSW and Federal government projects.

In addition to these proxies, the Integrated Planning and Reporting Framework (IP&R) provides specific requirements for councils to determine, in consultation with their communities, strategic environmental, social, economic and civic leadership objectives that meet community expectations. Councils' ability to determine and meet these expectations are an important measure of strategic capacity.

**3. *Are there any improvements to how we propose to assess the sustainability, infrastructure management and efficiency criteria?***

I understand that you are constrained by your Terms of Reference to assess FFTF proposals against the criteria and benchmarks published in the template guidance. Within these constraints, I support the scaling approach you have proposed in Tables 3.3, 3.5 and 3.7 of the draft Methodology. This approach provides for councils to be assessed against their capacity to improve performance in criteria relating to infrastructure backlog, asset maintenance, and building and asset renewal, rather than meet the OLG's benchmarks at a point in time.

In relation to per capita real operating expenditure, I support a range of measures including a 'no net increase' approach for efficient councils like Lake Macquarie. Lake Macquarie will have limited capacity to continue to reduce operating expenditure while concurrently seeking to address its infrastructure backlog.

It would also be useful to assess a council's past performance with respect to real operating expenditure per capita against other councils within the relevant OLG grouping (see Figure 1). Assessing a council's past and present performance using other measures of efficiency, such as staff to population ratio, would also be instructive. Taken together, these are important measures of relative efficiency, that would assist you to assess which councils are already making significant progress in this area.

I note and support your comment, on page 31, that exceeding the asset maintenance benchmark of 100% may be an indication of inefficient management. Lake Macquarie aims for an asset maintenance ratio in the range of 90-100%, as this range does not 'gold plate' assets and is consistent with the level of service for which our community is willing to pay. It would be useful to identify an optimal range for a number of other criteria, such as is applied to debt service ratio. For example:

- Operating performance ratio of between -5% and 5%;
- Own source revenue ratio of between 60% and 90%;
- Building and asset renewal ratio of between 95% and 105%;

- Infrastructure backlog ratio of between 2% and 5%; and
- Asset maintenance ratio of between 90% and 100%.

Providing a benchmark range would provide more realistic guidance about optimal performance.

**Explanation:** This indicator shows the amount of operating expense incurred by council in delivering its services per head of population. It is a primary measure of efficiency in the use of economic resources for the benefit of the community.

**Measurement:** Total Operating Expense / Total Population

**Result:** Lake Macquarie delivers its services with a lower cost per capita than its peer group of councils and demonstrates long term economic efficiency.

#### Group 5 Councils

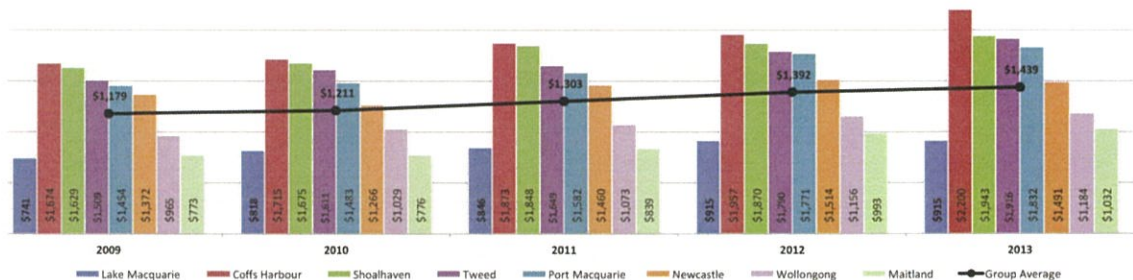


Figure 1 – Operating expenses per capita for Group 5 councils

I accept that you are constrained in your capacity to consider alternative methods for calculating criteria. However, I would like to take this opportunity to recommend replacement cost as a more appropriate denominator for calculation of an infrastructure backlog ratio than written down value. IPART and OLG have suggested that the infrastructure backlog ratio is a measure of whether a council is managing its infrastructure sustainably. In particular, the infrastructure backlog ratio is intended to indicate whether a council has completed asset renewals to ensure its infrastructure remains in a 'satisfactory' condition. In the vast majority of cases, when a council renews an infrastructure asset, the costs it incurs are not equivalent to the written down value (depreciated replacement cost) of that asset. The current replacement cost for an asset typically provides a more accurate estimate of the cost a council will incur to renew the asset. I acknowledge that in some circumstances, low-cost renewal techniques can be used to bring an infrastructure asset to a 'satisfactory' standard, without incurring the entire current replacement cost. However, my experience indicates that such circumstances apply to a minority of local government infrastructure asset renewals. For the purpose of using a single measure to assess whether a council is managing infrastructure renewals sustainably, current replacement cost is a more suitable denominator than written down value.



In addition, you may wish to consider factors such as community expectations about levels of service, and community capacity to pay for the level of service required to meet FFTF sustainability, infrastructure service provision and efficiency criteria.

**4. *How should councils engage with their communities when preparing FFTF proposals?***

I support OLG's requirement that any merger proposal should be supported by a resolution of each elected council and include evidence that affected communities have been consulted on the proposal.

I also support your intention to assess the objectiveness and rigour of any consultation process undertaken to support either a merger or improvement proposal, and your suggestion that the scale of consultation should be commensurate with the extent of change proposed.

The Methodology (p36) refers to limited consultation, if any, being required for councils that the ILGRP has identified as having sufficient scale and capacity. I note that this approach will be unworkable, as the ILGRP does not actually make a recommendation regarding the scale and capacity of any council; it merely identifies options.

In addition to consultation conducted specifically for councils' FFTF submissions, you may also wish to consider the results of other recent consultation relating to a council's performance, such as community satisfaction surveys, consultation conducted for special rate variation applications, and consultation undertaken as part of a council's IP&R framework.

**5. *Should council performance against FFTF criteria be monitored***

I support your proposal for councils to report performance in their annual reports. It would be useful if standard data collection and accounting treatments were developed for reporting of infrastructure backlog and asset renewal ratios, so that there was some certainty about the comparability of data. I note that IPART supported this position in its 2013 submission to the ILGRP.

For example, in the case of the infrastructure backlog ratio:

- There is no consistent or auditable standard for the reporting of infrastructure backlog;
- Standard of satisfactory asset condition is widely interpreted between councils at their discretion;
- Measurement criteria for valuation of costs to restore assets to a satisfactory condition is not mandated;
- The measurement and valuation methodology by councils can change from year to year without notification; and
- Alternative calculation and valuation methods have not been formally evaluated on behalf of all NSW councils.

As such, applying an arbitrary measurement criterion, such as the infrastructure backlog ratio to all councils will result in flawed conclusions, based on widely varying interpretations and inconsistent data.

I am unconvinced that the ILGRP's proposal for the Auditor General to be responsible for periodically reassessing councils' FFTF performance would make a meaningful contribution towards the goal of ensuring councils are fit for purpose and sustainable. The current FFTF criteria are a narrow subset of indicators that would be required to understand properly any council's overall performance. I suggest that an entity with expertise extending beyond the financial realm would be more suitable to review the full suite of future performance information reported by councils.

Common sense would suggest this should be the OLG. With an appropriate mandate and resource availability, OLG could build its capacity to monitor local government performance and support councils to improve performance. This enhanced oversight of councils would add tremendous value to local communities, local governments and the NSW government.

## **General Observations**

### ***ILGRP Recommendations***

While the findings of the ILGRP have become somewhat politicised, it is important to focus on its goal, which, as you are no doubt aware, was to propose (IGLGRP, 2013, p10):

*"A more sustainable system of democratic local government with added capacity to meet the needs of local and regional communities, and to be a valued partner of State and federal governments."*

Amalgamations *per se* were not recommended by the ILGRP; they were presented as potential options. You may wish to amend the language used throughout the draft Methodology for accuracy in this respect.

For the Hunter, the specific recommendations were to:

- Recommendation 47: Seek evidence-based responses from Hunter and Central Coast councils to the Panel's proposals for mergers and boundary changes, and refer both the proposals and responses to the proposed Ministerial Advisory Group (section 18.1) for review, with the possibility of subsequent referrals to the Boundaries Commission (14.1 and 14.2)
- Recommendation 49: Pursue the establishment of Joint Organisations for the Hunter and Illawarra in accordance with Recommendation 35 (14.1 and 14.3)

Lake Macquarie City Council provided a detailed evidence-based response (LMCC, 2013) to government in relation to the IPLGRP's proposals that Newcastle and Lake Macquarie be amalgamated and that the southern part of Lake Macquarie be transferred to a joint Gosford-Wyong council. This response concluded that there was no material benefit to the Lake Macquarie community from these proposals.



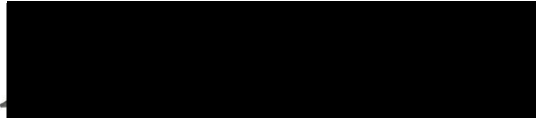
In relation to recommendation 49, Lake Macquarie strongly supports the Joint Organisation model and has been intimately involved in Hunter Councils Inc's successful nomination to pilot the JO model.

***Social and Community Context***

The capacity of a particular proposal to meet the specific needs of the relevant community is an important consideration when determining whether a council is FFTF. Local government has a critical role to play in realising community expectations and influencing local outcomes. Alignment of local government boundaries with communities of interest and practice, where possible, improves the capacity of local governments to meet the needs of their communities. In assessing FFTF proposals, you may wish to consider whether the service model and asset base of any proposal dilute or strengthen this capacity.

Should you require further information, please contact me on 4921 0220.

Yours sincerely



Brian Bell  
**General Manager**