muswellbrook shire council

Enquiries	
Please ask for	Joshua Brown
Direct	[redacted]
Our references	
Your reference	

25 May 2015

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

By email: ipart@ipart.nsw.gov.au

Dear Mr Boxall,

RE: Methodology for Assessment of Council Fit for the Future Proposals – Local Government Consultation Paper

I refer to the Local Government Consultation Paper released by the Independent Pricing and Regulatory Tribunal ("IPART") concerning its review of the methodology for the assessment of *Fit for the Future* submissions from NSW Councils. Muswellbrook Shire Council ("Council") has resolved to make a submission on the consultation paper.

Council accepts the importance of being able to measure infrastructure issues and aspects in accounting terms; however it should be noted that accounting measures will not always correlate with appropriate Asset Management Planning outcomes. Council submits that more focus should be placed on figures and estimations that provide solid asset management outcomes rather than accounting outcomes.

1. Road Maintenance as a percentage of asset value

The suggestion that road maintenance should represent a percentage of asset value for roads may be unrealistic. Whilst it may be true for some asset types, it is expected that the scatter of data for roads maintenance would be very wide and any comparisons effectively meaningless.

The degree of road maintenance required in a local area will vary with a number of factors, including:

- the asset condition;
- traffic loadings and volumes;
- terrain, geology;
- quality and availability of materials and technologies;
- environmental factors, including rainfall; storms, seasonal variations; heat, snow, ice, dust;
- network layout and access to plant, labour and material, etc;
- level of service decisions; and
- organisation capability, scale and efficiency

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As such, an appropriate maintenance percentage could only be developed after taking factors such as these into account.

Council submits that figures developed locally, taking into account the impact that the above factors have on local conditions, should take precedence over industry figures in circumstances where the Council can demonstrate an appropriate methodology carried out by appropriately qualified staff. Any Council that can demonstrate the existence of an appropriate methodology to its auditor and, if necessary, TCorp and the Office of Local Government ("OLG") should be able to provide the resultant figures as indications of their financial sustainability.

2. Infrastructure Renewals Ratio

TCorp provided a weighting of 7.5% to this ratio. Council submits that this ratio is more important than TCorp's weighting implies, after all the ability to replace and renew infrastructure should be the foremost measure of a Council's sustainability.

However, this ratio is currently based on an annualised depreciation figure which is not the preferred methodology in the long-term. The asset replacement required should be considered in light of the replacement and renewal of long-lived assets that by nature have 'lumps' and also 'periodic peaks and troughs' in renewal expenditure requirements. The ratio is therefore only currently a good measure for short-lived assets, such as plant or networks of many assets that each have short lives (for example, road sealed surfaces) and this difference should be recognised.

The high degree of variability between councils reported levels of service, asset lives, and valuations makes it is impossible to make any conclusions regarding relative performance of councils using this ratio

As Asset Management Maturity improves, the more preferred measure will be asset renewal expenditure levels relative to asset management plan identified renewal needs. Such figures need to be developed at a local level, taking into account the variable factors that are outlined above. A stronger tie between Asset Management Plans and budgets is required, together with a template for more consistent and comparable Asset Management Plans (AMP)

If this cannot be achieved presently across the state due to the lack of adequate AMPs, then the default could be the current ratio. However; for councils that have a demonstrated level of reliability in their AMP, the denominator should be based on data from the AMP.

In many cases where asset condition is high, or where the asset expenditure is lumpy (high value long-lived assets, or where large groups of assets will come to end of life at the same time (eg major subdivision during boom years) spending the annualised depreciation amount on renewals based on the current ratio, may well mean that some assets are being renewed prematurely, whilst funds are not set aside for the expenditure when required. A better model would involve placing some funds in asset renewals reserves to be spent at the point in time when the lumpy expenditure is needed, possibly with loan funds to adjust intergenerational equity.

3. Infrastructure Backlog Ratio

There are considerable mixed views on how this should be calculated.

In 2014, Council based its estimation of the cost to Bring to Satisfactory (BTS) as being equal to the replacement cost for the assets given a condition rating of Five (5) – that is requiring urgent renewal and replacement. This was based upon in part, condition data, age based analysis, and other assumptions.

It has been suggested that the cost to bring to satisfactory is equal to the backlog or **unfunded** renewals. It is important that the backlog be calculated based upon the level of renewal and replacement desired by Council but unable to be funded and not include works that Council has made a deliberate decision not to undertake.

Council supports the following Jeff Roorda Associates[1] suggested definition:

> Cost to bring to assets to satisfactory (BTS) should be determined by asset and risk management plans… [T]he cost to bring to satisfactory should be the total unfunded cost to renew all high residual risk assets in the current risk register.

Council further submits that the BTS analysis must be carried out for each material asset component. Network averages should not be used to determine BTS.

If service levels are declining in accordance with an adopted agreed and communicated asset management strategy, this is not backlog, nor a financial sustainability risk, provided these risks are managed and communicated.

Council is also required to report the percentage of assets in each condition rating group, which seems to have an expected relationship with 'cost to bring to satisfactory'. This is not explained in the schedule notes. They are problematic to calculate in some cases, particularly complex assets. In addition, guidance is not provided by the OLG as to whether the percentage of assets in each condition should be determined based on their replacement costs or their measureable physical attributes.

4. Efficiency (Real Operating Expenditure)

This measure seems geared to ensuring that Councils will no longer provide new services without removing services that they have previously offered. By only measuring the expense per capita, the ratio does not take into consideration sources of revenue that might be inherent in operating the new service. Under the current calculation, a new or expanded service that operated on a cost recovery or even profitable basis would perversely have a worsening impact on this ratio despite having a neutral or even positive impact on a Council's financial situation. As such, Council submits that the calculation of such a ratio should be based on the net cost of operations rather than the operating expense only.

Council appreciates the opportunity to comment. If you require further information, please contact Joshua Brown, Executive Services Manager on [redacted].

Yours faithfully,

[redacted]

Steve McDonald
General Manager

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[1] Jeff Roorda and Associates submission to the NSW Independent Pricing and Regulatory Tribunal: *Methodology for Assessment of Council Fit for the Future Proposals*, 2015.