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**Methodology for Assessment of
Council Fit for the Future Proposals**
Independent Pricing and Regulatory Tribunal
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Dear Sir/Madam

**METHODOLOGY FOR ASSESSMENT OF COUNCIL FIT FOR THE FUTURE
PROPOSALS**

In response to the Independent Pricing and Regulatory Tribunal's (IPART) request for local government feedback on how Council Fit for the Future proposals will be assessed, please find attached Newcastle City Council's submission.

For further enquiries please contact Council's Director Corporate Service, Glen Cousins on [REDACTED] or mail@ncc.nsw.gov.au.

Yours faithfully

A large black rectangular redaction box covering the signature area of the letter.

Ken Gouldthorp
GENERAL MANAGER

Consultation Paper

Methodology for Assessment of Council Fit for the Future Proposals (Methodology)

Submission from Newcastle City Council (NCC)

The Independent Pricing and Regulatory Tribunal (IPART) have sought submissions on the above referenced Consultation Paper. The Office of Local Government (OLG) Fit for the Future (FftF) guidelines require that the recommendation of the independent Local Government Review Panel (ILGRP) Report be considered as the starting point for councils to consider whether they are FftF. This report recommended that NCC amalgamate with Lake Macquarie City Council (LMCC).

To facilitate the consultation process IPART has developed a series of questions for stakeholders to consider. They have also invited comment on any other aspect of the proposed Methodology. The IPART questions are reflected below together with NCC's responses.

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?

Scale and capacity have been established as the threshold criterion for determining whether a council is FftF and accordingly take precedence over the more objective financial criteria, which are only assessed after a council has met the Scale and Capacity test. This introduces significant subjectivity into the FftF assessment.

Councils are required to use the ILGRP Report recommendation as the starting point for determining whether they meet the Scale and Capacity Criteria. In the case where a merger is recommended it is not clear from the Methodology how they will determine whether a merged council will better meet all of the key elements of the Scale and Capacity criterion than a stand-alone council. While "appropriate minimum population size" and "a target number of councils..." has been suggested by IPART as a possible assessment consideration to determine sufficient scale no clear guidance has been provided on what these target numbers will be or how they have been determined. This issue is particularly unclear given that some of the councils for which a merger recommendation has not been made will be significantly smaller than some of the councils, such as NCC and LMCC for which a merger is the preferred option.

As indicated above the Methodology appears to place a heavy focus on the number of residents (ie population size) as a basis for assessing scale. Other metrics such as Gross Regional Product and number of jobs provided within the Local Government Area (LGA) may be more relevant indicators of scale. Councils like Newcastle (ILGRP preferred option is a merger) and Wollongong (ILGRP preferred option is standalone) both have significant commercial and business activity in their respective LGAs and receive significant rating revenue from business ratepayers. This distorts the correlation between population size and many of the key elements of strategic capacity being used to assess Scale and Capacity. Can IPART clarify how this potential distortion will be addressed and whether metrics other than population size will be considered?

The Methodology indicates that they will base their assessment on the 10 key elements of Strategic Capacity identified in the ILGRP Report. These are all qualitative

requirements which will, by necessity, be subjectively assessed. The terminology used to describe the elements also includes comparative words such as "more robust", "more effective" and "wider range". Yet the Methodology provides no clear articulation of how that assessment will be undertaken or the benchmarks against which the council will be comparatively assessed. For example how will IPART assess whether a merged council has a greater ability to employ a wider range of skilled staff than a "stand-alone" council.

It would be helpful if IPART were able to provide some guidance of the type of evidence that IPART will be seeking to complete their assessment and possibly some examples of how IPART considers the elements can be met.

The methodology also indicates that if the ILGRP preferred option is not adopted by the council IPART "...will examine whether the council has adopted an alternate option which is consistent with the ILGRP objectives..." Can IPART clarify what objectives this refers to?

Table 3.1 indicates that alternative options need to be superior to the ILGRP preferred option. This is a more onerous requirement than previous OLG guidance and also appears contrary to standard business practice when assessing alternate business models which normally requires an alternate option (ie proposed merger) to be superior to the current option (ie status quo) in order to consider change. The incremental benefit is required to provide some reward for the risk associated with the change. Put another way, to undertake change which does not provide a significant benefit over the current business model does not adequately recognise the risk associated with change, or the cost associated with implementing the proposed change. Prudent business practice would dictate that uncertainty of outcomes, risks to anticipated benefits, uncertainty of costs and operational impacts/costs during any transition usually require a merger / amalgamation to achieve higher benefits to off-set the risk associated with these uncertainties.

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?

This question is not relevant to NCC accordingly no response has been provided.

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?

The ILGRP report was based on financial data up to the end of the 2012 financial year. This data is now out of date and accordingly any progress towards achieving financial sustainability since that date should be given a strong weighting in assessing council performance against the relevant criteria. Recent progress also demonstrates the extent to which councils have been proactive in addressing any underlying financial sustainability issues, infrastructure and service management capability and operating efficiency. In the case of NCC we have made substantial improvements in most of the key FftF metrics. The Council has already made good progress towards achieving financial sustainability and is well progressed on becoming FftF, as measured by the relevant metrics. To ensure an accurate assessment of a council's financial situation due consideration should be given to more recent financial performance and in particular any positive trends over recent years.

This progress, made prior to the implementation of the FftF initiative, also demonstrates that Council has the capability and resolve to act proactively and decisively to improve Council's performance and has the 'runs on the board' – this provides confidence that the Council can actual deliver the additional improvements included in the FftF Improvement Plan. Furthermore, it provides sound evidence of the key elements required to demonstrate Strategic Capacity (eg scope to undertake new functions and major projects; ability to employ a wider range of skilled staff; resources to cope with complex and unexpected change).

The Comrie report highlighted the most important metric for sustainability is achieving a modest operating surplus, excluding capital contributions (Comrie suggests a weighting of at least 50% for that metric in a basket of relevant metrics). The rationale is that if a council has a strong underlying operating position it has the financial capacity over time to address other sustainability metrics, in particular asset maintenance and renewal.

While the Methodology indicates that IPART intend to "scale the benchmarks in order of importance" (p26) there is no indication of how this scaling will be weighted or if the above recommendations will be taken into consideration.

The financial inputs to infrastructure backlog metric are not subject to audit. This may result in inconsistent calculation of this metric between councils. It may also allow inconsistent calculations between years within a given council depending on the assumptions or Methodology applied. How does IPART intend to address this potential inconsistency?

Prevailing guidance is that remediating assets before they become part of the backlog can be a more cost effective strategy than fixing some of the assets that have already been classified as not of a satisfactory condition (as the cost of remediation is significantly less than the cost of replacement and assets which are not in a satisfactory condition will already require significant cost to restore and this cost will not increase substantially if not addressed immediately). A focus on rapidly addressing the backlog might result in renewal work being inefficiently prioritised (ie poor quality assets are remediated at high cost, in priority to remediating more assets before their condition becomes unsatisfactory. This may ultimately result in an increased cost to councils and therefore a sub-optimal outcome for the community. Will IPART consider this issue in its assessment?

A possible solution may be a more sophisticated metric that also includes the change in condition of pre-backlog assets so progress in this area is captured and councils are recognised for more appropriate asset renewal strategy. Performance against this broader more sophisticated metric would also provide further evidence of a council's Strategic Capacity.

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

The IP&R process underpins the development of a council's strategic objectives. The Long Term Financial Plan (LTFP), Delivery Program and Operational Plan are the key components of the IP&R process. In the case of NCC and many other councils this process has been diligently and robustly undertaken since it was implemented. In the case of NCC, addressing the financial sustainability of the organisation and its infrastructure backlog are some of the key objectives consistently addressed in all of the relevant IP&R documentation.

NCC implemented the "Road to Recovery" program as a key initiative of its 2013-17 Delivery Program. This program underpins NCC's plans to achieve financial sustainability by improving operating efficiency and the underlying operating result, in addition to addressing the infrastructure backlog. These are also the key objectives of the FftF initiative. Extensive community consultation has been undertaken since 2012 in the development and updating of the 2013-17 Delivery Program as well as during the recent successful SRV application process, which was a key element of the "Road to Recovery" program.

As NCC will be submitting a Template 2 Improvement Proposal, which is broadly consistent with all of the relevant IP&R documents, it was considered that additional specific community consultation on the FftF response was neither necessary nor a cost effective use of Council resources, given that no significant new changes are being proposed. Accordingly it is NCC's view that due consideration should be given to this consultation process, undertaken during the development of the relevant IP&R documents and SRV application, when the panel considers the level of consultation undertaken during the FftF process.

NCC has also undertaken a range of community satisfaction surveys to assess the community's attitude towards the provision of services in the city. These survey results are relevant to the issue of the "social and community context of the council". Will these be taken into consideration when assessing council consultation?

The Methodology states "...where the ILGRP recommended that a council already had sufficient scale and capacity, would require more limited consultation, if any". However the Methodology is silent on the level of consultation required where a merger is the preferred option, but where that option was not pursued by the relevant council. I also note that the OLG guidelines indicated there was no community engagement requirement where a council does not pursue a recommended merger option and submits Template 2.

It is also suggested that any relevant council resolutions in regard to the ILGRP recommendations should inform IPART's assessment of Council's community engagement and consultation (refer attached NCC resolution dated 28 May 2013).

5. Should council performance against FTFF 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?

As indicated in our comments at Question 4 above the FftF criteria are entirely consistent with the strategic objectives that underpin NCC's Delivery Program and LTFP. Accordingly we can see no reason why the performance targets, FftF objectives and strategies/initiatives should not be built into the relevant elements of the councils' IP&R documents. For example:

- the Community Strategic Plans should place emphasis on reaching a sustainable outcome (goals regarding operating performance, cash and investments targets for liquidity etc), becoming more efficient etc in the provision of services (ie the strategies not only focus on services but the cost of providing those services and how scarce council resources will be prioritised).
- LTFP should reflect projections and impact of the FftF Improvement initiatives.
- Delivery Program and Operating Plan reflect financial outcomes, projects and relevant KPI's.

NCC believes that it is important that the future FftF performance is monitored on an ongoing basis and considers that the Annual Report provides the appropriate reporting mechanism. NCC also considers that periodical independent review of the reported performance, as suggested, is wholly consistent with the principles of good governance.

Other Comments

- In what would appear to be an oversight the Hunter, Central Coast and Illawarra are specifically excluded from Group G: Larger rural and regional councils (refer Table 2.1 p17 and appendix B p46) and are not specifically referenced anywhere else in the Methodology.
- As has been noted by a number of other well regarded industry experts that one of the FftF ratios has been inappropriately defined and as a result produces a potentially misleading result. The definition of the Building and Infrastructure Backlog Ratio requires the written down value (WDV) of assets to be used as the denominator in the equation, while the numerator is based on current estimated cost. This distorts the ratio as it is comparing current replacement values (ie new unutilised asset value) with values based not only on historical cost, but which have also been reduced by depreciation (ie old residual value). In simple terms the ratio does not compare "like for like". We request IPART review this ratio in order to determine a more accurate measure of the level of infrastructure assets that have fallen below minimum maintenance or renewal intervention levels.
- This consultation process (including the sessions undertaken via webcast in Sydney) raises some significant issues which require further clarification. In terms of process, if there are any significant changes to the Methodology will consideration be given to extending the FftF submission deadline beyond 30 June 2015 to provide sufficient time for council's to respond to these changes.
- The Methodology indicates that other factors including the "social and community context of the council" will be considered during the assessment process. Could IPART provide clearer guidance on how the potential negative impacts on the community arising from any diseconomies of scale will be taken into consideration during the assessment process?
- The Methodology indicates that when considering the criterion of Scale and Capacity it will consider "...whether the council's proposed option is broadly consistent with..." the ILGRP's preferred option and if the council does not adopt the preferred option it will be considered as unfit "unless it presents a sound argument that demonstrates that the proposed approach is superior to the recommended merger". However the OLG guidelines indicate that a Council Merger Proposal (Template 1) can only be completed if all parties to any proposed merger agree on pursuing a merger. If this is not the case, regional councils have no option but to submit a Template 2 Council Improvement Proposal. However IPART have indicated that one of the other factors to be considered in their assessment is the "...rigour by which the ILGRP's preferred option for scale and capacity were explored by the council..." This appears inconsistent with the OLG guidelines and also an unnecessary and ineffective requirement if one merger party is strongly opposed to a merger, which leaves the other parties no option but to complete Template 2.

ACTION ITEM

Ordinary Council
Tuesday, 28 May 2013

SUBJECT: NOM 28/05/13 - NEWCASTLE CITY COUNCIL OPPOSES MOVES TO AMALGAMATE WITHOUT CONSULTATION

RESOLVED: (Councillors T Doyle/M Osborne)

That Newcastle City Council:

- 1 Commit to continue to strongly support local government as the level of government with the greatest grassroots participation and closest connection to people.
- 2 Maintain the right of local residents in local councils to determine the future of their councils and their local representation.
- 3 Work with our community and other councils to implement those recommendations of the Local Government Review Panel that increase the financial autonomy of local councils by ending rate pegging; and
- 4 Oppose the long-term agenda of the Local Government Review Panel to merge metropolitan and regional councils regardless of the wishes of local residents.
- 5 Notes that:
 - a) It has strong concerns that the Local Government Review Panel is proposing the merger of Newcastle City Council with Lake Macquarie council without consulting the residents in either of these local government areas.
 - b) Newcastle City Council has strong community support and that there is no clear case for it to be merged with neighbouring councils; and
 - c) That any merger of Newcastle City Council with neighbouring councils will inevitably reduce the level of local representation and strength of local democracy in the Hunter.
- 6 A workshop be held for Councillors to better inform them of the status of the Panel's work and its latest report. Council can develop a set of principles, upon which a submission can be written by Council Officers and submitted to the Panel.