Review of Fees for Development Control Services

Report on Competitive Neutrality in Pricing

INDEPENDENT PRICING AND REGULATORY TRIBUNAL
OF NEW SOUTH WALES

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Review Report No 98-4 **December 1998**

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FOREWORD

In April 1995, the Council of Australian Governments ratified the National Competition Policy, including the Competition Principles Agreement. Under this agreement, the NSW Government is to ensure that competition policies and principles are applied by local governments, including local councils. An integral part of this policy relates to the need for competitive pricing neutrality to be adopted in respect of all services provided in a competitive environment.

On 1 July 1998, new legislation was implemented reforming the development approvals and control process within the Environmental Planning and Assessment (EP&A) Amendment Act and Regulation. The new development assessment system introduces an integrated system for providing consent to development. A proposed development is assessed by a process which reflects the significance of that development. Building approvals have been replaced by a system of certification which allows for accredited private certifiers to compete with councils.

The Premier has requested that the Tribunal review the pricing principles for development control fees, and establish guidelines for competitive neutrality. This report covers the Tribunal's recommendations on the guidelines to be applied by councils in setting prices for contestable services. The Tribunal's recommendations in respect of fees for monopoly development control services, will be published in a separate report.

In developing these guidelines, the Tribunal has considered the views of a variety of interested parties. The Tribunal published an issues paper and a consultation paper which stimulated various submissions. In addition, a working group was formed to assist the Tribunal in this review.

A clear, efficient and practical policy for establishing prices for contestable services is essential to the effective and smooth implementation of competition for services previously provided solely by local councils. By adopting these principles, councils will ensure that they determine prices in a manner which protects them from complaints and which complies with both the spirit and the requirements of the competitive neutrality aspects of the Competition Principles Agreements.

The Tribunal has not recommended specific prices for the contestable services. Rather, the Tribunal has established guidelines by which competitively neutral prices are to be determined. In determining these guidelines the Tribunal has examined cost allocation and pricing issues relevant to local councils. Other factors considered in this report include the efficacy of the complaints mechanism, the preferred method of introducing competition and the registration of certificates.

I would like to acknowledge the assistance provided by all the interested parties who participated in the working group and who provided comments and submissions to the tribunal.

Thomas G Parry
Chairman
December 1998

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EXECUTIVE SUMMARY

1. Introduction

This report provides local councils with guidelines for the setting of fees for contestable services. Traditionally, five types of services have been provided solely by local councils which will now be opened up to competition. These services involve the issuing of: complying development certificates, construction certificates, compliance certificates, occupation certificates and subdivision certificates. This report is the result of a detailed investigative process which has involved publishing both an issues paper and a consultation paper, forming a working group and considering numerous submissions.

The Tribunal will publish its recommendations on other aspects of the review of fees for development control services in separate reports. A second report will cover the Tribunal's recommendations in regard to the fees for issuing planning and building certificates, other administrative fees and councils' registration of certificates. A third report, dealing with fees for development applications (excluding complying developments) will be issued in July 1999.

2. Purpose of this report

The main purpose of this report is to recommend principles to guide local councils in the setting of fees for issuing the above-mentioned certificates.

In addition, this report makes recommendations in respect of the following issues:

- the lifting of the Minister's Pricing Order
- the monitoring of competition
- the need for councils to register complying certificates
- the setting of council charges for the registration of certificates under the new integrated development control system.

3. Contestability and the accreditation system

The NSW Government is responsible for ensuring that the principles incorporated in the Competition Principles Agreement are applied by local government. In carrying out this responsibility, local government has been subject to numerous reforms, most notably, the adoption of competitive neutrality principles. For councils, this means that the fees charged for competitive services must be competitively neutral.

The accreditation system by which private certifiers will obtain registration, is expected to be operational by January 1999. Councils must be ready for the introduction of competition by this date.

4. Cost allocation and pricing

The pricing of contestable services must be both transparent and cost reflective. In practice, markets are not perfectly competitive and a range of pricing strategies may be feasible from time to time. This leads to the concept of upper and lower limits for prices. The Tribunal recommends that the avoidable costs methodology be used to establish the lower bound for prices. Councils have the option of setting prices by other methods, such as fully distributed

costs, if the resulting price does not fall below the avoidable cost floor price. If markets are effective, councils will not be able to charge more on a sustainable basis, than the stand-alone costs.

This report provides an explanation of the major cost allocation methodologies. It also provides a practical example of using the avoidable costs method (see Attachment 5 to this report).

The Tribunal has recommended that councils should not be subject to any additional ring-fencing requirements over and above those which already govern substantial council businesses.

5. Guidelines for competitively neutral pricing

Despite the Tribunal's recommendation that councils use avoidable costs to determine a floor price for contestable services, *councils may price their services below avoidable costs to fulfil community service obligations***.** They may do this provided the fees charged are determined in advance, through an open and transparent process, and the extent of the community service obligation is clearly defined.

Councils may package their services, including both contestable and monopoly services, provided that the price component for the contestable service is identifiable and is not below the avoidable cost of providing that service. The price component of the package relating to monopoly services should not exceed any maximum established by price regulation.

6. The complaints mechanism

Every council needs to establish a system of recording and dealing with complaints relating to competitive neutrality.

If a complaint is not resolved at council level, the complainant has further avenues of review including (depending on the circumstances), the Department of Local Government, the Ombudsman and the Australian Competition and Consumer Commission (for further details see section 6.1 of this report).

A new mechanism for dealing with complaints made by the public against private certifiers has been put in place under the Environment Planning and Assessment Amendment Act 1997 (see page 19).

7. Competition issues

The Tribunal recommends that competition be introduced simultaneously throughout New South Wales, irrespective of the contestable service provided, or the region in which a council is situated. At the same time, the Tribunal recommends that the Department of Urban Affairs and Planning implement a system for monitoring and reporting on the effectiveness of competition throughout the state.

The Tribunal recommends that the Minister's pricing order, which establishes a maximum price for certain services, remain in place until 1 July 1999 with the proviso that councils may charge below the "maximum" fees prescribed under that pricing order. Following 1 July 1999, the pricing order should be subject to review by the Minister for Planning.

8. Other issues

The Tribunal recommends that councils be allowed to recover the costs of registering certificates, provided that any fees levied on private certifiers, are also levied on the council itself.

A consultant has been engaged to review the method by which the new registration fee is to be ascertained. The Tribunal's recommendation in respect of the new fee, will be contained in a separate report which is expected to be issued in January 1999.

1 INTRODUCTION

1.1 Background

Pursuant to section 12A of the *Independent Pricing and Regulatory Tribunal Act 1992*, the Premier requested the Independent Pricing and Regulatory Tribunal ("the Tribunal"), to:

- develop principles and indicative fees for the development control services provided by local councils
- provide guidelines to assist in setting fees for complying development and post-approval processes which are to be opened up to competition (contestable services).

This is the Tribunal's final report in respect of the guidelines to be applied by councils in setting prices for contestable services. The Tribunal's recommendations on fees for monopoly development control services will be published separately.

The *Environmental Planning and Assessment Amendment Act 1997* contains provisions which expose parts of the development approval process to competition. That legislation provides for five types of development activity to be assessed by *accredited certifiers*, in competition with local councils. The five types of certificates which may now be issued by accredited private certifiers are:

- ***complying development certificates*** which verify that a development proposal complies with the relevant building standards and may be carried out
- ***construction certificate****s* which indicate that building plans and specifications comply with engineering and other technical standards
- ***compliance certificates*** which are issued at various stages of the development, to indicate the work complies with the requisite standards
- ***occupation certificates*** indicating that the new building is fit for occupation and use
- ***subdivision certificates*** which verify that the development complies with council's planning approvals. These certificates must be issued before the plan can be registered at the Land Titles Office.

When the accreditation system is operational, local councils may have to compete with accredited private certifiers for the opportunity to issue the above certificates.

Once these certificates have been issued either by a council or an accredited certifier, these certificates must be registered by councils. Fees for this activity are discussed in chapter 8 of this report.

This report provides guidelines to enable local Councils to set fees for issuing the five certificates, all five being contestable services, in a manner which meets the government's competitive neutrality requirements.

1.2 Review process

One chapter of the Tribunal's issues paper, published in December 1997, deals with the competitive neutrality aspects of this review. A working group has helped the Tribunal to identify issues for further consideration. The working group members are listed in Attachment 2.

In July 1998, the Tribunal published a consultation paper, outlining its initial views on the pricing of contestable services and seeking public submissions on that issue.

On 18 September 1998, the Minister for Urban Affairs and Planning wrote to the Tribunal requesting that the review be split into parts (a copy of the letter is provided in Attachment 3). The first part comprises a report, to be published in December 1998, on the competitive neutrality issues of contestable services. A second report will be issued in January 1999 focussing on the setting of fees for planning certificates, building certificates, and for other administrative fees. A further part of the review ie, that part relating to non-complying development applications, is requested to be finalised by July 1999, with an interim report due in April 1999.

The Tribunal has agreed to split the review in this manner. However this report relates only to the competitive neutrality issues. A second report to be issued in late December 1998, will cover the Tribunal's recommendations in regard to non-contestable planning certificates, building certificates and other administrative fees. The Tribunal has engaged the services of Pannell Kerr Forster to undertake further analysis of 12 councils in respect of these fees. The Tribunal's final recommendation on these issues will consider the consultant's findings.

The Tribunal has considered all the submissions made in response to both the issues paper and the consultation paper, as well as the comments made and issues raised by the working group.

1.3 Purpose of this report

The primary purpose of this report is to guide local councils in the setting of fees for contestable services.

In addition, this report makes recommendations in respect of: lifting the Minister's Pricing Order; monitoring competition; the need for councils to register certificates; and the setting of fees by councils for the registration of certificates under the new integrated development control system.

2 KEY ISSUES AND PROPOSALS

2.1 Issues raised

The issues raised during the course of this review, as outlined in the Tribunal's issues and consultation papers are:

- whether councils' current costing systems allow for the application of competitive neutrality principles to contestable services
- how the application of avoidable costs (as defined and explained in section 4.2 of this report), may impact on contestable services
- whether ring-fencing of contestable from non-contestable services is viable
- whether councils have adopted tax equivalent regimes
- whether a fixed floor price should be set for the five contestable services once effective competition has been established
- whether and how councils should be able to subsidise some services to pursue legitimate policy goals
- how to introduce competition
- whether councils should be able to package services, including both contestable and monopoly services
- whether councils should charge a fee for recovering the costs of registering certificates
- how effective is the complaints handling system.

In addition, the Department of Urban Affairs and Planning has requested advice from the Tribunal as to when the pricing order issued by the Minister[1], should be lifted. The Tribunal's recommendations and conclusions on this issue are in section 7.3 of this report.

A summary of the submissions received on the above issues is provided in Attachment 4.

[1] This order, which set maximum prices for certain development control activities, was published in the Government Gazette of the State of NSW, No. 101, Week 27/98, 3 July 1998 at pp. 5189 to 5192.

3 CONTESTABILITY AND THE ACCREDITATION SYSTEM

3.1 National competition policy

In April 1995, the Council of Australian Governments ratified the National Competition Policy, including the Competition Principles Agreement signed by the Commonwealth and all the States and Territories of Australia. The competition policy aims to promote an economically efficient use of resources by increasing the extent that public sector providers of goods and services are exposed to competition. The agreement sets various principles by which government business activities are to become more efficient through exposure to competition. The agreement seeks to:

- provide for independent pricing surveillance of government business enterprises
- apply competitive neutrality principles to the significant business activities of government
- structurally reform government monopolies
- review legislation to remove anti-competitive provisions, subject to cost / benefit analysis
- provide for third party access to essential infrastructure owned by the private and public sectors.

Paragraph 3.1 of the "NSW Government Policy Statement on the Application of National Competition Policy to Local Government", June 1996, states that the NSW Government is to ensure that these principles are applied to local government, despite the fact that local governments themselves are not party to the agreement.

3.2 Recent reforms

Numerous reforms are being implemented to ensure that the competition principles are applied by local government. Of primary importance to this report are reforms introducing competitive neutrality between local councils and the private sector. These reforms include: the separation of non-contestable functions from commercial activities, a review of legislation to allow the accreditation of competitors, greater flexibility in price setting and the establishment of an appropriate complaints mechanism.

As discussed in 1.1 above, the *Environmental Planning and Assessment Amendment Act 1997* contains provisions that expose a significant portion of the development approval process to competition. The Act allows for the accreditation of certifiers from the private sector. These certifiers will be able to compete with local governments in issuing: complying development certificates, construction certificates, compliance certificates, occupation certificates and subdivision certificates. Other development control activities for example, the issuing of planning and building certificates, will not be subject to competition.

3.3 The accreditation system

Part 4B of the *Environmental Planning and Assessment Act 1979* provides for the accreditation of certifiers. Pursuant to s. 109S of that Act, the Minister for Urban Affairs and Planning may, in accordance with clause 81C of the *Environmental Planning and Assessment Regulation 1994*, authorise any professional association to serve as an accreditation body to determine who is competent to provide the contestable services of local councils.

By notice in the NSW Government Gazette[2], the Institution of Engineers, Australia, has been authorised to accredit private certifiers. It is anticipated that by January 1999, additional professional associations will be similarly authorised.

3.4 Fees for competitive services

Despite legislative and structural reform, competition will not occur in respect of contestable services if councils' prices are set at such a low level that no private sector competitor can survive. A local council might achieve this by setting prices below costs for the contestable service and recouping the additional costs from services in which the council has monopoly power. In such circumstances, the benefits of charging lower fees for providing contestable services would be offset by higher fees charged for the monopoly service. Guidelines or regulation of fees for monopoly services may limit the scope for such "cross-subsidies".

The key requirement in setting fees for contestable services is that the fees allow the costs of providing services to be recovered over the medium to long term.

[2] NSW Government Gazette, No.152, 23 October 1998 p 8456.

4 COST ALLOCATION AND PRICING

4.1 Introduction

Cost allocation requires that the costs of the resources used by a particular business unit be determined. This is a practical, but not always easy, matter to determine. Appropriate cost allocation requires appropriate cost recording and allocation systems, not to mention the exercise of judgment.

From an economic perspective, prices should signal the resource cost of supplying a particular service. From a financial perspective, prices must provide a secure revenue base for the commercial provision of that service on an on-going basis. The basic principles to consider when setting prices are that they should be cost reflective and transparent.

Cost effective pricing should indicate the costs of providing a particular service to the customer. There are various alternative methodologies for ensuring cost reflective prices. These are discussed further in section 4.2 below. In this report, the Tribunal has recommended that the lower limit on prices for contestable services be based on avoidable costs (see Chapter 5). If competition is effective, a product will not be able to sustain a price above stand-alone costs (ie, the cost of providing only the relevant activity on a stand-alone basis).

Cost effective pricing must not include any cross subsidisation of council activities. Cross subsidisation results where the costs of providing one council service are not recovered from the price charged for that service, while the costs of another service are overpriced. This leads to inefficiency in resource use. The over-priced service is likely to be under utilised, whereas demand for the subsidised service may be heightened.

The issue of transparency of price setting is addressed by provisions in the *Local Government Act 1993* which requires prices to be notified in council management plans and to be open to public scrutiny.

4.2 Methods of cost allocation

4.2.1 Fully distributed costs

Fully distributed costs is an accounting term for the way in which all the costs of a business are allocated across that business' activities, in accordance with some pre-determined allocation policy. The items allocated include: direct costs such as wages and materials, indirect costs such as a portion of overhead costs, and the costs of support services.

One way of allocating costs to contestable activities, is on a pro-rata basis. For instance, accommodation costs can be allocated on the basis of the floor space occupied by the specific business activity as a proportion of the total floor space of the agency. Alternatively, the allocation of costs could be made on the basis of the staff hours utilised in providing the contestable activity, as a percentage of total time expended in the agency.

4.2.2 Marginal costs

Marginal costs are the costs of producing an additional unit of a product or service. This measure generally includes only direct costs, which vary with output.

Marginal costs can be measured in both the short and long run. The short run gives the best indication of the costs of producing an additional unit at a specific point in time. However, short run marginal costs can vary dramatically as input prices may vary with seasonal fluctuations etc. In addition, short run marginal costs do not give a sound basis upon which a new entrant to the market can make investment decisions, as there is no measure of the capital costs, which are fixed in the short term.

Long run marginal costs are the costs of producing an additional unit of service when the capacity can be varied. Long run marginal costs are a better basis for making investment decisions as the variability inherent in the short run marginal costs formula is excluded. However, long run marginal costs are difficult to measure.

4.2.3 Avoidable costs

Avoidable costs (also termed incremental costs), is a medium to long term concept[3]. It is calculated on the basis of the costs which would be avoided by an agency if a particular service was not provided.

Avoidable costs include direct costs such as labour and materials and some indirect costs, such as personnel costs, which vary when the product is not supplied. The extent of overhead costs to be included in the calculation of avoidable costs, will depend on the nature and size of the activity, as well as the time period over which costs are assessed to be avoidable. For instance, rent will often be included. However, if the activity in question is so small that it requires no additional floor space, then rent would not be avoided if the service was no longer provided. Consequently, rent would not be included in the avoidable costs of that activity. At the other extreme, if a substantial business activity is fully ring-fenced, then the entire cost of the unit constitutes avoidable costs.

The table below illustrates the major differences between the above three cost methodologies.

Table 4.1 Treatment of Costs under Different Allocation Methods

Type of cost	Is the cost included in the cost base?		
	Short run marginal cost (SRMC)	Fully distributed cost (FDC)	Avoidable/ incremental cost
Direct costs (eg direct labour, material)	Yes	Yes	Yes
Executive costs	No	Yes	No
Rent	No	Yes	Often, but not always
Other overhead costs	No	Yes	To the extent that they are avoidable if the activity is not undertaken
Capital costs exclusive to the activity	No	Yes	Yes
Joint capital costs	No	Yes	To the extent that they are avoidable if the activity is not undertaken (often “no” in practice)

Source: *Cost Allocation and Pricing*, Commonwealth Competitive Neutrality Complaints Office Research Paper, Productivity Commission, October 1998, p 11.

[3] Cost Allocation and Pricing, October 1998, Commonwealth Competitive Neutrality Complaints Office, Productivity Commission, Research Paper.

As the table shows, avoidable and marginal costs are always lower than fully distributed costs. The lower the amount of joint or shared costs, the less the degree of divergence. If a council completely ring-fenced its operations into separate business units (and paid for its share of council overheads and support services), the entire cost of that unit would be avoidable and hence, should be recovered in fees.

Avoidable costs are the minimum sustainable price in a contestable market. Prices below that minimum, result in losses which must be funded from other services. This subsidisation is not sustainable in the long term. However, there is a range of possible price outcomes. The maximum price consistent with effective competition is that based on stand-alone costs. The stand-alone cost is the cost of providing that service in isolation. The service may be able to be provided more cheaply by providing it jointly with other services, in which case there are economies of scope associated with the product.

The Tribunal's view is that avoidable costs should be used as a lower limit when determining price. A council may of course recover fully distributed costs, or costs somewhere in between these limits, if it wishes. The main argument against avoidable costs is that this approach will disadvantage private sector competitors by allowing council competitive businesses to take advantage of the fixed and shared costs provided by council. This is not inconsistent with economic efficiency because the council is recovering at least the additional costs underlying the activity.

A practical example of cost allocation is included in Attachment 5 to this report.

4.3 Costs to be included in prices

4.3.1 General costs

As mentioned above, the Tribunal has determined that avoidable costs should be used as the basis for determining the lower limit for prices.

In putting this guideline into practice, councils need to identify all the costs of providing competitive services. Councils must ensure that appropriate costs are properly accounted for and are captured in prices. This minimises the risk of having complaints lodged and determined against the council.

The Tribunal does not believe it is appropriate to adopt a highly prescriptive approach in these guidelines. The costs to be included in the avoidable costs formula will vary between councils, depending on the specific nature of the activities in question and how they relate to other council business. Councils may choose to adopt a costing methodology by which prices are set above avoidable costs. The use of avoidable costs is a minimum requirement under these guidelines. The councils themselves and their financial staff are best placed to determine costs, because these staff understand the circumstances surrounding the operation of the business. Nevertheless, the Tribunal expects every council which charges fees for contestable services to have undertaken a costing exercise to determine those fees, and to be able to document the costing exercise. This includes assessing:

- direct labour costs of the activity in question
- management costs
- indirect and overhead costs such as the costs of :
  - office accommodation
  - office equipment (including depreciation)

- professional and public liability insurance
- external and internal technical assessments (if not accounted for in direct labour costs)
- personnel and other support services (including financial services)
- any clerical and administrative support not accounted for in direct labour costs
- motor vehicles including depreciation
- records management
- electricity, telephone and other similar costs
- cleaning, building maintenance and other similar costs.

The proportion of these costs allocated to contestable services will depend on the specific nature of the activity in question and whether the fully distributed costs, or avoidable costs methodology is used. If the avoidable cost method is used, some of the above items may not be included in the cost calculations. However, where a cost (such as a support service) can be attributed proportionally to an activity, it is avoidable and should be included in cost calculations.

The Tribunal's key requirement is that councils be able to document a rigorous, consistent, and transparent process which validates the assessment of costs and shows how fees are determined.

4.3.2 Competitive neutrality adjustment

In addition to the costs identified above, local and state government businesses may receive a *net competitive advantage* over their private sector counterparts, purely as a result of their public ownership. If not corrected, this will produce inefficiencies in service delivery by the public sector at the expense of the private sector and the general community (because the true cost of providing that service is not being reflected in prices).

The NSW Government's guidelines on competitive neutrality allow councils considerable discretion as to how they implement the competitive neutrality pricing principles. However, where a council business receives an annual sales turnover/gross operating income of $2,000,000 or more (a category 1 business), councils are expected to adopt competitive neutrality principles in full. This includes proper separation of the business from other council activities. If a council believes the application of competitive neutrality principles to such a business will be detrimental overall, it must conduct a public and independent cost benefit analysis to determine the net cost. Less strict requirements are applicable to smaller council businesses.

Competitive neutrality adjustment requires the following calculations:

- **tax equivalent payments**[4]**:** These must be assessed for the relevant business. They include (where these taxes are not currently being paid):
  - fringe benefits tax
  - sales tax (including the motor vehicles used by the business's staff)
  - financial institutions duty
  - payroll tax
  - sales tax
  - land tax
  - stamp duty

[4] Tax equivalent and rate of return payments are notional payments made to the council (representing the owner on behalf of the community), which will be used to fund other services.

– any other State or Commonwealth tax for which the local government business is exempt.

Income tax is levied on the profits of a business. While income tax should not be considered a specific cost for the purpose of pricing a good or service, it needs to be taken account of in terms of assessing the rate of return required on capital invested. Accordingly, the return on capital invested needs to be set at a pre-tax level as would be applied by a private sector competitor ie it should include a provision equivalent to the corporate income tax rate.

- ***debt guarantee fees***: These must be determined for any loan the council makes on behalf of the business, or which benefits the business. Generally a council enjoys a discount from the standard commercial rate solely because of its public ownership. However, given the low levels of capital invested in the contestable business activities, debt guarantee fees are unlikely to be a major issue.
- ***rate of return***: The rate of return on the capital invested in the business is a legitimate cost to business which should be recovered in prices. Normally a return is calculated on the assets invested in the business. However, this will be difficult for the business activities in question, given that the business is labour intensive and the amount of the capital invested is small. In these circumstances, the Tribunal considers it appropriate for a council to determine a profit margin based on the operating costs of the business. The Tribunal believes it is the responsibility of each council and its financial adviser to determine an appropriate rate of return.

In order to demonstrate the application of competitive neutrality, the Department of Local Government's Guidelines require, at a minimum, that category 1 businesses (annual turnover in excess of $2m) should be reported as separate business activities in councils' operating statements. The guidelines also recommend separate accounting for other council business activities.

As discussed above, the Tribunal's key requirement is that each council be able to document a rigorous, consistent and transparent process which identifies its costs in supplying competitive services. Separate accounting of these services is necessary so a council can demonstrate to an outside body that it has fully adopted the principles of competitive neutrality.

4.4 Accounting for the costs of providing competitive services

Many councils have advised that they have systems, or are currently developing systems, which allow for the separate accounting of the costs of contestable services. Some councils have indicated they do not have a suitable system, or that they anticipate some difficulty in implementing such a system. One of the major problems perceived by such councils is difficulty in allocating overheads.

Although the basis for allocating overhead expenses may be difficult to determine, overheads are a component of the cost of providing services which must be taken into account. Under the avoidable costs methodology, overhead and indirect costs are included only to the extent that they are avoided if the activity ceases. The use of avoidable costs as a lower limit for prices reduces the extent to which overhead and indirect costs are included. By contrast, a portion of all overhead and indirect costs are calculated when using the fully distributed costs methodology.

4.5 Ring-fencing requirements of competitive council business

The above discussion highlights some of the difficulties associated with setting fees for competitive services where the competitive activities are provided in combination with a broader range of non-competitive activities. Problems arise for councils concerning how to effectively allocate costs between the competitive and non-competitive activities while ensuring that the requirements of competitive neutrality are met.

The most direct response to this problem is to separate (ring-fence) the competitive business activity from other council activities. If that business utilises council resources such as office space or support services, it should be required to pay the council an amount which reflects the cost of providing those services. As long as the business is making some return above its costs from fees, from the council's viewpoint, it is covering its costs. From the public's viewpoint, the business is competing "fairly" or in a competitively neutral fashion (provided the return covers tax equivalent payments).

The disadvantages of ring-fencing are the internal dislocation and disruption caused to staff, the establishment expenses, and the ongoing potential loss of economies of scale or scope. There is also the practical problem of ring-fencing a business where its staff are required to perform other non-commercial council functions.

While a few councils have indicated they are developing systems to ring-fence contestable services, other councils have expressed problems with ring-fencing and indicated that the costs of introducing ring-fencing make the process uneconomic.

From 1 July 1998, the Department of Local Government requires separate accounts to be kept for businesses with an annul sales turn over of at least $2,000,000. This conforms to NSW Government Policy on the Application of National Competition Policy to Local Government. Although the Tribunal encourages councils to ring-fence contestable businesses, the Tribunal does not recommend additional ring-fencing requirements be imposed on councils.

4.6 Information and education on cost allocation methodologies

As mentioned above, cost allocation can be a difficult process. As well as this report, various publications may help councils to carry out their duties in this regard. The Department of Local Government has issued guidelines for developing a pricing policy[5] and implementing competitive neutrality[6].

The Tribunal recommends that Department of Local Government, in conjunction with the Local Government and Shires Associations, develop and run workshops for councils on the various cost allocation methodologies and the concept of avoidable costs.

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5 Department of Local Government, *Developing a Pricing Policy: A Guide for Local Government.*

6 Department of Local Government, *Pricing and Costing for Council Businesses; a Guide to Competitive Neutrality.*

4.7 Summary of the Tribunal's recommendations on cost allocation

The Tribunal recommends that:

- ***avoidable costs be set as the lower limit when determining prices, although councils may recover costs above this limit, for example to recover fully distributed costs***
- ***councils be required to document a rigorous, consistent and transparent process which justifies the assessment of costs and demonstrates how fees have been determined***
- ***although councils are encouraged to ring-fence contestable businesses, no additional ring-fencing requirements have been recommended by the Tribunal***
- ***the Department of Local Government in conjunction with the Local Government and Shires Associations, develop and run workshops on various cost allocation methodologies in order to help councils understand and apply these principles.***

5 GUIDELINES FOR COMPETITIVELY NEUTRAL PRICING

5.1 Introduction

In April 1995, the Commonwealth, State and Territory Governments agreed to implement nation-wide competition policy reforms. The resulting agreement, the Competition Principles Agreement contains a series of measures to promote competition.

One principle of the Competition Principles Agreement is competitive neutrality. This policy aims at eliminating any net competitive advantages of government business activities that arise solely as a result of their public ownership. Competitive neutrality principles apply when government business activities are operating in a competitive environment.

The purpose of the following guidelines is to assist local councils to price their contestable services in a competitively neutral way. Efficient pricing leads to efficient resource usage, improved customer service and ultimately, to an improved standard of living. Set out below are some of the key elements of competitively neutral pricing.

5.2 The concept of floor and ceiling prices

A floor price is the minimum price charged for a service. By setting a floor price, or a methodology for determining a floor price, councils will be required to ensure the price charged does not drop below the minimum price which accords with competitive neutrality principles. In other words, councils will be prevented from hidden cross subsidisation.

A ceiling price is the maximum price which may be charged for a service. Setting a maximum price for potentially contestable services, will ensure that councils do not overcharge for the services they provide. Not all councils are expected to be subject to effective competition at the same time. Whilst competition may be introduced from January 1999, not all councils will be operating in a competitive environment at that time. A ceiling price could be imposed to prevent councils from taking advantage of the monopoly situation which may exist prior to the establishment of competitors in the marketplace.

5.3 Floor price at avoidable costs

The Tribunal has determined that the floor price for contestable services is to be determined by the use of avoidable costs methodology. This floor price is not fixed by imposing a prescribed dollar amount for contestable services. By setting a lower limit for prices at avoidable costs, councils have the freedom to price above this level by using say, fully distributed costs.

The use of avoidable costs is supported by the Productivity Commission. In its research paper, *Cost Allocation and Pricing*[7], the Commission states "… the most relevant revenue base for determining whether prices are competitively neutral is the avoidable costs of the business unit — the costs the agency would save if the business unit ceased operating."

Recent discussions with the NSW Treasury indicate that Treasury also supports the use of avoidable costs as a floor price. The rationale for avoidable costs is that a business which

[7] *Cost Allocation and Pricing*, Commonwealth Competitive Neutrality Complaints Office Research Paper, Productivity Commission, October 1998, p 19.

can earn revenue at least equal to its avoidable costs, will impose no costs on the non-commercial agency in which it is housed, and will generate a commercial rate of return on its own assets.

The actual price charged for each of the five contestable services will vary from council to council, depending on various factors including: the cost to that council of providing the service, the marketing strategy of the council, and the desire of the council to actively seek new customers. Councils are free to pursue their own strategies in regard to pricing provided the principles for competitive neutrality are met, and the minimum price for a contestable service is no less than the avoidable costs. This policy of setting a methodology for floor prices allows councils significant flexibility in price setting. Councils are not restricted to using the avoidable costs methodology, which is required only for the setting of minimum prices.

5.4 Community service obligations

Despite setting a floor price based on avoidable costs, councils may still provide discounts below the avoidable costs floor price, in order to fulfil community service obligations. This is acceptable provided the fees charged by way of a discount are determined in advance and through an open and transparent process. The nature and extent of the community service obligations must be clearly specified but would typically include waiving or discounting fees for developments undertaken by non-profit or charitable organisations, or for the benefit of the broader community.

The cost of community service obligations is funded internally by councils. Where a business owned by a council is adequately ring-fenced, a notional payment should be made for revenue foregone in fulfilling community service obligations. Ideally, councils should provide funding for such discounts irrespective of whether the service is provided by the council or another service provider.

When prices are set in advance and are transparent, complaints about the perceived misapplication of community service obligations may be received through the complaints process (outlined in chapter 6 of this report).

5.5 Bundled services

At present, councils offer a discount when a combined construction certificate / development application is lodged. The amount of the discount usually equates to 15% of the normal fees of the construction certificate. An issue which must be determined, is whether councils should be allowed to offer discounts when operating in a competitive marketplace.

Private business is able to offer discounts and specials, for example to attract new clients. There is no reason in principle why councils should be prohibited from undertaking similar marketing practices. However, in this period prior to the establishment of effective competition, councils are operating in a monopolistic environment. Moreover, councils benefit from the advantages to be derived from incumbency. Accordingly, such pricing practices might be viewed as a misuse of market power, aimed at preventing possible competitors from entering the market. Councils are alerted to the possibility of such arguments arising, and complaints being lodged.

Hornsby Shire Council indicates in its submission, that if economies of scale are available through packaging, these economies should be passed on to customers. The Local

Government and Shires Associations of NSW suggests that as private certifiers will be discounting services, there should be no impediment to councils operating similarly. The working group generally supports the right of councils to package services, including contestable and non-contestable services.

The Tribunal has determined that, provided certain requirements are met, councils should be able to offer packaged services, including a mixture of competitive and monopoly services. The required conditions are that the pricing of the package be transparent and that the component of price relating to contestable services does not fall below the avoidable cost of providing that service in that situation.

An example may be of assistance. Assuming a council offers the contestable service of issuing a compliance certificate, for say $100. In setting this fee, the council has identified the cost involved as being $100 on a fully distributed costs basis. The same council also charges $100 for monopoly development applications. The cost of obtaining these two services separately, from the same council is thus $200. The council may however, offer the client a package deal. The package would mean that if the client agreed initially to have both these services provided by the council, the council would perform the services for the reduced price of $150. This price represents a $50 discount on the price that would be paid if the services were requested separately.

The provision by councils of discounts and packages of this nature, does not breach the competitive neutrality principles provided that the price of each component of the package is identified on the invoice.

In addition, in order to satisfy the competitive neutrality guidelines, that part of the price which applies to the contestable service must not fall below the floor price, ie below avoidable costs. Similarly, the component of the packaged price relating to the monopoly service must not exceed the regulated amount.

There are two ways in which such a discounted package price could be offered legitimately, without breaching the competitive neutrality principles. Firstly, the council's usual price of $100 for each service may be based on fully distributed costs. In order to attract business, the council may decide to offer packaged services. The component of the packaged price relating to the contestable service is now based on avoidable costs. As the avoidable costs represents the floor price of contestable services, the council is not breaching competitive neutrality guidelines by discounting the price of the contestable component to that limit.

Secondly, even if the council’s normal price for its contestable service is based on avoidable costs, the avoidable cost associated with a contestable service which is provided in isolation may be greater than the avoidable cost of providing the service as part of a package with other services. The difference in cost may relate to reduced administration and processing costs associated with simultaneously handling both applications. Thus, even if the avoidable costs of providing the contestable service in isolation is $50, the avoidable cost of providing that service as part of a package may be less than $50. In this way, offering a discount for packaged services may still meet the principles of competitively neutral pricing. The discount in this scenario results from the reduction in costs resulting from the simultaneously lodging of the application for both the contestable service and the monopoly service. The discount does not result from any uncompetitive pricing practices. However, councils must be able to provide detailed costing information in support of avoidable costs in these circumstances.

5.6 Resolving difficulties

The price councils charge for providing contestable services, is subject to the complaints mechanism outlined in chapter six of this report. If complaints to the council are not resolved, the complainant may first complain to the Department of Local Government, or some other review body.

Councils should be aware that their pricing of contestable services may be subject to scrutiny from other bodies. Councils should be in a position to justify the prices charged for services. The onus is on councils to maintain appropriate records and to set prices in accordance with the guidelines set out in this report.

The Tribunal recommends that the Department of Local Government as the primary review body, in conjunction with the Local Government and Shires Associations, actively assist councils to resolve difficulties they may experience in identifying avoidable costs, or in otherwise meeting the requirements of competitively neutral pricing.

5.7 Summary of the Tribunal's recommendations on pricing

The Tribunal recommends that:

- ***A floor price for contestable services be determined by applying the avoidable costs methodology. Councils may set prices anywhere between this floor price and a price based on fully distributed costs. This allows councils some pricing flexibility.***
- ***Councils may package their services, including both contestable and monopoly services, provided the pricing of the package is transparent and the component of the price relating to the contestable services does not fall below the avoidable costs of providing that service in that situation.***
- ***The price for any monopoly component in such a price package is not to exceed maximum price established through price regulation.***
- ***Councils may provide discounts below the avoidable costs floor price in order to fulfil community service obligations, provided the charges are determined in advance, through an open and transparent process.***

The Tribunal advises that:

- ***The manner in which councils price contestable services may be subject to scrutiny via the complaints mechanism. Councils must be in a position to provide detailed costing information to justify their prices and the methodology used to determine them.***

6 COMPLAINTS MECHANISM

6.1 Complaints against fees

A complaint about fees may arise if a potential competitor of a government business perceives it is being adversely affected, or being denied a market opportunity, because a government business has a net competitive advantage resulting solely from its public ownership status.

The party lodging the complaint about fees must first approach the relevant council to clarify and attempt to resolve the matter. All councils are required to have a mechanism to deal with complaints against fees. Councils are required to detail in their annual reports, how they have dealt with competitive neutrality complaints.

If a complaint is not resolved by the council, the complainant may request that the matter be reconsidered by an independent complaints body. There are four bodies for dealing with such complaints against fees. The primary body handling such complaints is the Department of Local Government and most complaints which are not adequately resolved by the Council itself, should be directed to that Department. However, other independent review bodies do have a role in some limited circumstances.

The **Department of Local Government (DoLG)**. DoLG is responsible for reviewing complaints against local councils and is usually the most appropriate investigative body for competitive neutrality issues. Details of the local government complaints mechanism are provided in the DoLG's publication, *Guide to Competitive Neutrality – Pricing and Costing for Council Business, July 1997*. Any finding of DoLG must be tabled at a council meeting.

The **Ombudsman**. The Ombudsman is authorised to investigate complaints about the conduct of a local council.

The **Independent Commission Against Corruption (ICAC).** Pursuant to section 10 of the *Independent Commission Against Corruption Act 1998*, any person may lodge a complaint with ICAC about a matter that concerns, or may concern corrupt conduct.

The Australian Competition and Consumer Commission (ACCC). Councils are required to comply with the *Trade Practices Act 1974*. Anti-competitive practices such as predatory pricing, or other forms of misuse of market power may be in breach of this Act. The ACCC has extensive enforcement powers against individuals, corporations and government businesses which breach the *Trade Practices Act 1974*.

6.2 Other complaints

A complaint may arise against the actions of a private certifier. A new mechanism has been put in place under Division 3 section 109V-109ZF of the Environmental Planning and Assessment Amendment Act 1997. These sections provide for the relevant accreditation body and the Administrative Decisions Tribunal to investigate and determine complaints made against accredited certifiers.

7 COMPETITION ISSUES

7.1 Implementation options

The introduction of competition will require all councils to assess: the services they will provide, the full costs of providing those services and the marketing strategies required to promote those services. These consideration raise issues concerning the best way to introduce competition.

The following proposals on the implementation of competition have been presented to the Tribunal:

- competition should be phased in, with various services being opened to competition gradually
- external benchmarks and performance indicators should be used to introduce competitive services
- further time should be allowed for councils to: ascertain which services to specialise in, assess the full costs of service provision and determine appropriate marketing strategies.

Although some differences in opinion were expressed, the working group established by the Tribunal Secretariat was of the general view that competition should be introduced simultaneously for all services and across all regions. The working group accepted that whether competitors will actually set up business, is an issue that will be resolved in the marketplace. Some councils may not face the same degree of competition, or as quickly, as others.

7.2 Capacity of councils to change prices

A major difficulty councils will face when operating in a commercial environment, results from section 612 of the *Local Government Act 1993*. This provision, when read in conjunction with sections 405 and 705, requires councils to publicly exhibit all fees for 28 days in their annual plan of management.

If, after the date on which the management plan take effect:

a) a new service is provided, or the nature or extent of an existing service is changed, or

b) the regulations in accordance with which the fee is determined are amended,

the council must give public notice (in accordance with section 705), for at least 28 days of the fee proposed for the new or changed service, or the fee determined in accordance with the amended regulations.

The degree of flexibility that point (a) above gives to councils is a matter for debate and legal interpretation. It seems unlikely however, that the clause would allow price changes solely on the basis of changing market conditions. This means that s. 612 imposes significant constraints on councils which are trying to compete for business in a market where their competitors may change their prices at any time.

The Tribunal understands this provision is being examined by the Department of Local Government as part of its review of anti-competitive legislation. The Tribunal has been informed that no amendments are expected during the current session of Parliament.

The Tribunal supports the DoLG's review of this legislative provision and recommends that councils be granted greater pricing flexibility so that they may effectively compete for business in a competitive market. At the same time, councils should be required to comply with the pricing principles set out in this paper.

7.3 Minister's order on pricing

On 30 June 1998, the Minister for Urban Affairs and Planning issued an order to regulate fees for certain development control activities.

The Tribunal has been asked by the Department of Urban Affairs and Planning to provide a recommendation as to when this order should be lifted.

It is currently anticipated that the accreditation system will be operational from 1 January 1999. The extent of the competition which will result is unknown at this stage and may occur at different times for different councils.

The options for the Minister in regard to the pricing order, are as follows:

- to lift the pricing order prior to 30 June 1999 when the accreditation system for private certifiers will be operational
- to leave the pricing order in place until 1 July 1999
- to lift the pricing order with effect from 1 July 1999, but establish a monitoring and reporting system to ensure councils do not take advantage of their monopoly position (in those areas where competition is not fully effective)
- to maintain the pricing order until a competitive market is established, whenever this eventuates.

The Minister's pricing order establishes a maximum price for services. It does not set the minimum price. Thus, councils are not restricted from reducing their prices for contestable services by virtue of the operation of the pricing order. However as discussed above, there are legislative restrictions on councils adjusting prices.

When a competitive environment emerges, it is likely councils will want to decrease fees, not increase them. The operation of the pricing order should not impede councils' capacity to compete with private certifiers. The pricing order does however, prevent councils from raising their prices if they are still operating in an monopoly environment in the short term. In the absence of the pricing order and in a monopoly environment, there would be little to prevent councils from increasing their prices to unacceptable levels.

In view of this possibility and considering that the pricing order of itself should not restrict councils from otherwise competing with private certifiers, the Tribunal recommends that the pricing order remain in place until 1 July 1999, when it expires. The Minister should then reassess the market situation and make a determination in regard to the pricing order.

7.4 Monitoring and reporting procedures

For the introduction of competition to be effective, councils are required to introduce significant reforms, most notably, ensuring their pricing of contestable services is cost reflective, transparent and adheres to the principles of competitive neutrality.

The system is enforced largely through the existence of the complaints mechanism, by which potential competitors to the council and other interested parties, may complain if they are of the opinion that a council has a competitive net advantage due to their public status.

Where private certifiers are slow to enter the marketplace as competitors, as may be the case in rural or isolated areas, the beneficial effects of competition will be limited. Furthermore, once the Minister's pricing order is lifted, councils may not be restrained from engaging in anti-competitive pricing policies.

To overcome these potential problems, the Tribunal stresses that the effectiveness of the system needs to be closely monitored by the Department of Urban Affairs and Planning. Monitoring should include ensuring councils report on the fees they are charging for contestable services. The accreditation bodies may also be asked to collect information on the number of certificates issued to private certifiers. This monitoring would assist the Department's investigation of any complaints. It would also ensure that the pricing policies of councils operating in areas of little or no competition, were monitored and appropriate action was taken against anti-competitive pricing behaviour.

7.5 Summary of the Tribunal's recommendations on competition issues

The Tribunal recommends that:

- ***the Minister's pricing order not be removed prior to 1 July 1999, when it is due to expire***
- ***the effectiveness of competitive reforms be monitored by the Department of Urban Affairs and Planning.***

The Tribunal supports:

- ***the review of section 612 of the* Local Government Act *and recommends that councils be given greater pricing flexibility.***

8 OTHER ISSUES

8.1 Registration of certificates

Councils are required by law to register post-approval and complying development certificates. One issue to be decided is whether councils should recover a fee for the cost of registering these certificates and if so, how that fee is to be determined.

Most of the submissions received by the Tribunal support councils levying a fee to recover the cost of registering these certificates. The majority of submissions indicate that this fee should be payable to the council by the certifier, with the cost to be passed on to the user / developer for payment. Some councils questioned the use of avoidable costs as the basis for assessing the costs of registering these certificates.

The Tribunal has recommended, in principle, the levying of fees by councils for the registration of certificates. The Tribunal stresses that any registration fee levied on private certifiers must also be levied on councils (when councils require certificates to be registered). The fee a council charges to its own customers for registering certificates, should be of the same amount as the fee charged to private certifiers. To do otherwise would be to impose an unfair additional cost on the private sector.

The Tribunal has engaged a consultant to assess the registration fees to be charged by councils and the basis upon which such fees should be calculated. The Tribunal's recommendation in respect of this new fee and other administrative fees, will be included in a separate report to be released in January 1999.

8.2 Summary of the Tribunal's recommendations on registration of certificates

The Tribunal recommends that:

- ***councils be permitted to levy fees in order to recover the costs of registering certificates, provided that any fees charged to private certifiers are also charged to customers of the council itself***
- ***the quantum of this registration fee and of other administrative fees, be included in a separate report.***

ATTACHMENT 1: TERMS OF REFERENCE

I, Bob Carr, Premier of New South Wales, refer under Section 12A of the *Independent Pricing and Regulatory Tribunal Act 1992*, the following matter to the Independent Pricing and Regulatory Tribunal:

> … the review and development of a pricing policy and recommended indicative fees charged by Local Government and other consent authorities for development control services under the Environmental Planning and Assessment Amendment Bill 1997, recently passed by the NSW Parliament.

The purpose of the review is to:

1. develop principles and indicative fees for the development assessment system (excluding complying development); and
2. provide guidelines to assist in the setting of fees for complying development and post-approval processes, which are to be opened up to competition.

In particular the Tribunal shall:

a) review the overall current pricing policies and fee structures of consent authorities as they relate to the development, building and subdivision functions under the Environmental Planning and Assessment Act 1979, Local Government Act 1919 and Local Government Act 1993

b) identify those fees that may warrant continuing government regulation having regard to the guiding principles for legislative review specified in clause 5(1) of the Competition Principles Agreement

c) examine through case studies, current practice with respect to the charging of fees and the principles established in this respect

d) review the extent and type of research that has been undertaken in respect of the development of these pricing policies and fee structures

e) report on the level and structures for the charging of fees by Local Government and other consent authorities for development control services as proposed under the Environmental Planning and Assessment Amendment Bill 1997

f) make recommendations covering monopoly development assessment functions in respect of a transparent pricing policy, with indicative fees for a range of councils having regard to consumer satisfaction and community participation and the balance of efficiency, effectiveness, quality delivery of service and equity consideration

g) develop principles which will provide guidance for the setting of fees for complying development certificates and for post-approval processes, having regard to competition policies.

ATTACHMENT 2: PUBLIC HEARINGS AND CONSULTATION

As part of the consultation process for this review, meetings were held with organisations involved in local government, and with metropolitan and rural councils. Representatives of these organisations also presented their views at public hearings held as part of the review. The input provided at these meetings and public hearings was of significant value to the review. The Tribunal is grateful for the high level of co-operation and participation from all those involved.

Organisations which participated in meetings during the review

Bankstown City Council
Baulkham Hills Council
Blacktown City Council
Building Control Commission, Victoria
Corowa Shire Council
Department of Infrastructure, Victoria
Department of Local Government
Department of Urban Affairs and Planning
Hastings Council
Health and Building Surveyors Association
Housing Industry Association
Institution of Surveyors
Julie Bindon & Associates
Kogarah Council
Liverpool City Council
Local Government and Shires Associations
New South Wales Treasury
North Sydney Council
Office of Local Government, Victoria
Parkes Shire Council
Penrith City Council
Property Council of Australia
Royal Australian Planning Institute
Scott Carver Pty Ltd
Singleton Shire Council
Sutherland Shire Council
Sydney City Council
Total Environment Centre
Tweed Shire Council
Urban Development Institute of Australia
Western Sydney Regional Organisation of Councils
Wagga Wagga City Council
Willoughby City Council
Woollahra Municipal Council

Members of the Working Group on development control fees

Eric Groom, Independent Pricing and Regulatory Tribunal (Chairperson)
Kerry Bedford, Department of Urban Affairs and Planning
Elsie Choy and Rita Felton, Independent Pricing and Regulatory Tribunal
Leonie Dennis, Housing Industry Association
Patricia Gilchrist and Gordon Wren, Urban Development Institute of Australia
Ian Glendinning, Environmental Health & Building Surveyors Association
Murray Kidnie and Shaun McBride, Local Government and Shires Associations
Warwick McInnes and Ken Morrison, Property Council of Australia
Michael McMahon, Waverley Council
Keith Richardson, Royal Australian Planning Institute
Michael Rolfe, Total Environment Centre
John Scott, Department of Local Government
Alan Wells, Singleton Council

Presenters at public hearings

Sydney, 9 March 1998

Department of Urban Affairs and Planning	Kerry Bedford, Manager – Regulatory Reform
Local Government and Shires Association	Sean McBride, Policy Officer
	Darrell Fitzgerald, Policy Officer
Wyong Shire Council	Daniel Smith, Manager Development Services
Housing Industry Association	Leone Dennis, Assistant Director – Planning and Development
Blacktown City Council	Wayne Gersbach, Manager Statutory Planning

Sydney, 10 March 1998

Property Council of Australia	Mark Quinlan, Executive Director
	Julie Bindon, Chair – Planning and Economic Development Committee
	Warwick McInnes, Development Manager
Institution of Surveyors	Peter Price, Federal Councillor
	John Monteath, Federal Councillor
	Richard Phillips, Executive Officer NSW Division
Eurobodalla Shire Council	Peter Tegart, Director Environmental Services
Urban Development Institute of Australia	Patricia Gilchrist, Executive Director
	Laurie Rose, Councillor
Liverpool City Council	Tanya Antony, Senior Environmental Health and Building Surveyor
	Owen Sergeant, Principal Building Surveyor

ATTACHMENT 3: LIST OF SUBMISSIONS

Submissions to Draft Terms of Reference

Organisation	Name
Armidale City Council	S. Gow
Blue Mountains City Council	P. Bawden
Casino Council	R. Schipp
Department of State and Regional Development	L. Harris
Department of Urban Affairs and Planning	K. Bedford
Gosford City Council	J. Murray
Hornsby Shire Council	R. Ball
Housing Industry Association, NSW Division	P. Fielding
Institute of Municipal Management	C. Gregg
Institution of Surveyors	R. Phillips
Local Government and Shires Associations	M. Kidnie
Maclean Shire Council	R. Donges
Mosman Municipal Council	V. May
Pittwater Council	D. Fish, A. Gordon
Royal Australian Planning Institute	D. Broyd
Ryde City Council	S. Weatherley
Snowy River Shire Council	P. Reynders
Sutherland Shire Council	J. Rayner
Tweed Shire Council	D. Broyd
Urban Development Institute of Australia	P. Gilchrist
Vaucluse Progress Association	M. Rolfe

Submissions to Issues Paper

Organisation	Name
Armidale City Council	S. Gow
Bankstown City Council	G. Beasley
Bathurst City Council	C. Pitkin
Baulkham Hills Shire Council	M. Watt
Blacktown City Council	W. Gersbach
Blue Mountains City Council	P. Bawden
Broken Hill City Council	K. Boyle
Byron Shire Council	R. Kent
Cessnock City Council	J. Tupper
Concord Council	R. Marshman
Department of Urban Affairs and Planning	S. Holliday
Environment Protection Authority	N. Shepherd
Eurobodalla Shire Council	P. Tegart
Fairfield City Council	C. Weston
Gosford City Council	R. Benson
Greater Lithgow City Council	S. McPherson
Holroyd City Council	J. Thompson

Hornsby Shire Council	P. Hinton
Housing Industry Association, NSW Division	S. Kerr
Hunter's Hill Council	B Smith
Institution of Surveyors NSW Inc.	R. Phillips, P. Price
Inverell Shire Council	D. Pryor
Kempsey Shire Council	B. Casselden
Kogarah Municipal Council	G. Clarke
LandCom	M. Burt
Liverpool City Council	T. Antony
Local Government and Shires Association	M. Kidnie
Long Service Leave Payment Corporation	K. Napper
Maclean Shire Council	R. Donges
Maitland City Council	D. Evans
Master Builders' Association	C. Bourne
Meriton Apartments Pty Ltd	H. Triguboff
Muswellbrook Shire Council	C. Gidney
Northern Suburbs Regional Planning Group	J Vescio
NSW Treasury	J. Pierce
Pittwater Council	D. Fish
Port Stephens Council	P. Westin
Property Council of Australia	M. Quinlan
Queanbeyan City Council	H. Percy
Rockdale City Council	S. Blackadder
Rockdale City Council	G. Raft
Royal Australian Planning Institute	D. Broyd
Shoalhaven City Council	W. Gee
Strathfield Municipal Council	D. Smith
Sutherland Shire Council	J. Rayner
Total Environment Centre	J. Angel
Tweed Shire Council	R. Paterson
Urban Development Institute of Australia	P. Gilchrist
Vaucluse Progress Association	M. Rolfe
Willoughby City Council	J. Owen
Wollongong City Council	A. Roach
Woollahra Municipal Council	G. Fielding
Wyong Shire Council	K. Yates

Submissions to Consultation Paper

Organisation	Name
Burwood Council	Brian Olsen
Canterbury City Council	Jim Montague
Cessnock City Council	S F Leathley
Department of Local Government	Garry Payne
Gosford City Council	John Murray
Hawkesbury Nepean Catchment Management Trust	Malcolm Hughes
Hornsby Shire Council	Peter Hinton
Housing Industry Association NSW Division	Elizabeth Crough
Hunter's Hill Council	Barry Smith
Hunter's Hill Council	Joe Vescio

Kogarah Municipal Council	Geoff Clarke
Landcom	Ray Gilmore
Leeton Shire Council	E C M Stoneman
Local Government & Shires Association	Murray Kidnie
Manly Council	Ruth Holten
Marrickville Council	Maurie Smith
North Sydney Council	Sue Francis
Northern Suburbs Regional Planning Group	Joe Vescio
Orange City Council	Paul Morgan
Penrith City Council	Paul Morgan
The Institute of Surveyors NSW Inc.	Richard Phillips
Vaucluse Progress Association	Michael Rolfe
Wentworth Shire Council	David McMillan
Willoughby City Council	John C Owen
Wollongong City Council	Rod Oxley
Woollahra Municipal Council	Penny Carl

ATTACHMENT 4: SUMMARY OF SUBMISSIONS TO THE CONSULTATION PAPER

This section attempts to summarise the range of comments received in many submissions that were provided in response to the consultation paper and during public hearings.

How can private certificate registration costs be recovered?

Apart from one council, which suggests that the information submitted by private certifiers could be included in existing registers without any significant imposition on councils, there is wide support for councils charging fees for registration costs.

The general view is that private certifiers should be charged a fee by council for the registration of certificates, for maintaining the register, and for making information from the register publicly available. There are suggestions that payment should be made when a certificate is lodged, or identified during the development consent to allow a single payment for all certificates. Another alternative is that fees be charged annually, with pro rata payments for part of a year.

There is a suggestion that councils be able to offer an advertising service to certifiers, with the fee included as part of the certificate registration fee.

Complaint handling mechanisms for contestability

A few councils state that they are currently developing appropriate complaint mechanisms for handling against delivery of service. One council is expanding its existing mechanism so that service request complaints can be handled separately from complaints about performance or anti-competitive behaviour.

There is a proposal that if a council's mediation process is unsatisfactory to the customer, an external conciliation and mediation panel should be available, providing access to further mediation rather than going straight to litigation in the Land and Environment Court. This proposal relates to complaints about the service provided.

One council expressed concerns about the lack of accountability of private sector operators.

Few comments were received in regard to complaints about fees for contestable services.

Are councils' current costing systems and structures capable of pricing contestable work?

Many councils indicate that they are currently able, or are currently developing systems, to account for costs and set reasonable fees for contestable services.

Some councils have inadequate financial or administrative systems in place, or anticipate some difficulty in implementing adequate systems.

How the application of avoidable costs may impact on contestable development control services

Some councils question the use of avoidable costs and indicate that fully distributed costs would be more appropriate.

The working group confirms that the specification of avoidable costs as a lower bound for prices is appropriate. This would not prevent councils from using other bases for pricing, such as fully distributed costs.

Ring-fencing contestable and non-contestable activities

Some councils indicate that ring-fencing is being undertaken. However, most have not achieved this yet, and others are unsure whether it can be achieved.

Tax equivalent regimes

A few councils indicate that they have adopted tax equivalent regimes, or are developing appropriate systems to do so. Other councils have not developed such systems, and some see problems in so doing.

Should councils have the option of pricing in a non-competitively neutral way to pursue community goals?

There is wide support for the view that councils should have this option, provided that the level of subsidy is clearly stated and is the wish of the community.

Two councils express concern that if the private sector is able to increase and decrease fees, and councils don't have the same degree of flexibility, councils ability to compete will be impeded. There is a proposal that councils be subject to the same pricing mechanisms as private sector organisations, being permitted to set prices to gain a market edge, or being able to run at a loss in the short term.

Should councils be able to package services, including monopoly DA assessments?

The working group generally supported the ability of councils to package services, including contestable and monopoly services. The working group indicated that its support was tempered by the need for pricing transparency and pricing in accordance with contestable principles.

Introducing competitive services and pricing

There are suggestions that a timetable and guidelines for implementation be developed, including the establishment of a pilot group of councils. There was also a suggestion that pricing guidelines be established in conjunction with the private sector.

One council suggests that local environmental plans (LEPs) are the key to introducing contestability. Local government needs to identify complying development in its area. DUAP may need to provide direct support to councils needing assistance.

The working group generally considers that competition should not be introduced progressively eg, with metropolitan followed by rural, but should apply state wide.

ATTACHMENT 5: COST ALLOCATION: A PRACTICAL EXAMPLE

The following example has been taken from the *Cost Allocation and Pricing Research Paper*, October 1998, prepared by the Commonwealth Competitive Neutrality Complaints Office, Productivity Commission. The Tribunal appreciates the assistance of the Productivity Commission in this regard.

Assume a department has a policy division and a specialised computing division. The computing division consists of just under 10% of the departmental staff.

The department's mainframe computer is used solely by the computing division and operates at around 70% capacity with a capital cost (including depreciation) of $50,000 per annum. This cost is fixed regardless of its use. Such spare capacity is not uncommon and may arise from a number of factors including:

- lumpiness in the capacity of the equipment
- anticipation of greater (non commercial) demands in the system in the future
- not using the equipment at night
- poor investment decisions.

Given that the capacity of the system never exceeds 70%, the department accepts a contract for data processing from another agency. The department expects this extra processing work will use the remaining 30% capacity of the computer system over the following 12 months.

The department needs two extra processing employees (at a costs of $80,000) to cope with the additional workload associated with the private contract. The number of systems employees will remain the same. Some new expenditure on: training ($2,500), new equipment ($3,000) and travel ($3,000) is expected. Overheads, such as communications costs are also expected to increase (by $5,800), while maintenance, rent and electricity expenses are expected to remain the same.

The following table shows the department's total costs before and after it has accepted the commercial activity.

Table: Cost Structure at Departmental Level

Cost structure	***Before***		***After***	
Annual Costs	*Non-commercial activities*	*No of Staff*	*Non-commercial & commercial activities*	*No of Staff*
	$		*$*	
Cost of capital (computer)	50,000		50 000	
Labour:				
• **Computing**	**500,000**	**8**	**580,000**	**10**
• Policy & program	3,000,000	75	3,000,000	75
• Executive	400,000	5	400,000	5
• Other corporate	350,000	10	350,000	10
Training	100 000		102,500	
Furniture & Fittings	100,000		100,000	
Other equipment	60,000		63,000	
Rent	1,000,000		1,000,000	
Electricity	170,000		170,000	
Travel	75,000		78,000	
Telecom	270,000		275,800	
Stationery	80,000		80,000	
Total	**6,155,000**	**98**	**6,249,300**	**100**

The cost of the commercial activity, when calculated using the avoidable cost methodology, is much lower than if the fully distributed approach is used.

The cost of the commercial data processing activity using the avoidable cost method is $94,300 ($6,249,300 minus $6,155,000). It comprises labour ($80,000), training ($2,500) and some overheads that vary with the level of output ($11,800). The cost of capital in this example is not included, since capital is an expense which would have been incurred regardless of whether the commercial service was provided.

By contrast, the cost of the commercial data processing activity on a fully distributed cost basis is $196,000. This is calculated as the total of costs exclusive to the commercial business, plus a portion of indirect / overhead costs. For the purposes of simplicity, indirect costs have mainly been allocated to the commercial activity on the basis of the proportion of commercial staff to total staff (2%). The fully distributed cost has been calculated as follows:

Item	***Cost $***
Labour: computing staff (direct cost)	80,000
Training (direct cost)	2,500
Equipment (direct cost)	3,000
Travel (direct cost)	3,000
Cost of Capital (pro-rated on capacity) 30% x $50,000	15,000
Labour: systems staff (pro-rated on capacity of usage) 30% x $150,000*	45,000
Labour: Executive 2% x $400,000	8,000
Labour: Other corporate 2% x $350,000	7,000
Furniture & fittings 2% x $100,000	2,000
Rent 2% x $1,000,000	20,000
Electricity 2% x $170,000	3,400
Telecommunications (this has been pro-rated as an overhead expense) 2% x $275,800	5,500
Stationery 2% x $80,000	1,600
Total	**196,000**

The large difference in costs in this example arises because the avoidable cost calculation does not include rent, some corporate overheads, or capital costs. However, in many cases, the divergence may be quite small:

- For instance, the exclusion of rent and corporate overheads in the example is based on the judgment that two extra personnel can be located within the existing accommodation and would not increase corporate costs. But if more staff were required, the commercial activity might cause rent and corporate costs to increase as the commercial activity would require increased floor space and other corporate expenditure. In general, the greater the proportion of commercial activity to total activity, the greater the likelihood that some level of indirect costs will be avoidable.

* Computing labour cost is $580,000 including systems staff ($150,000) and processing staff ($430,000). The cost of the additional staff required to service the commercial activity ($80,000) is charged directly to the contract.

- Similarly, while it will be appropriate in many cases not to attribute joint capital costs to the activity, in others some attribution of these costs will be justified. For instance, an agency may make an investment on the basis that it will be financially viable only if used for both commercial and non-commercial activities. Alternatively, extra capacity may be built into an asset because of planned use by a commercial activity. In these situations, the commercial activity causes the costs to be incurred and should bear some of the capital costs even though, once its installed, the costs may not be avoidable.

As these considerations illustrate, it is not possible to mechanistically apply the avoidable cost method. Deciding what is avoidable, even if a rule of thumb such as a five year timeframe is adopted, often requires judgment. The key question is whether an agency can reasonably expect to avoid a particular cost, if the activity does not take place.