LG Solutions
www.lgsolutions.net.au

3rd November, 2011

Local Government Team
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230

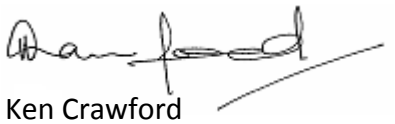
Dear Sir/Madam,

Re: Measuring and Assessing Productivity Performance in Local Government
Local Government - Discussion Paper (September 2011)

We welcome the opportunity to provide our thoughts on IPART's Productivity discussion paper issued in September.

Accordingly, we provide our comments on IPART's paper & issues therein below.

Yours sincerely,



Ken Crawford
(Director - LG Solutions)

A. Of the 8 issues that IPART has raised for comment & feedback, we are surprised that the actual concept (& application) of deducting a Productivity Factor from the General granted to NSW Councils is not in itself an issue available for comment.

It would appear from the discussion paper that the application of a productivity factor is beyond debate in the setting of future the percentages across NSW Local Councils.

We would have thought that IPART within this paper should have sought specific comments on the Productivity Factor from the Industry & interested parties one year down the track from its initial application.

B. Regarding IPART's definition of Productivity being:

$$\frac{\textbf{OUTPUT (volume, quantity \& quality)}}{\textbf{INPUT}}$$

there would appear to be three (3) ways to improve productivity:

(i) Increase outputs (for the same level of inputs),
(ii) Decrease inputs (for the same level of outputs), or
(iii) a combination of both (i) & (ii).

We would like to put forward that the use by IPART of a Productivity Factor discount on the percentage is a "blunt instrument" that only seeks to enforce productivity by decreasing inputs (by decreasing the supply of revenue available to purchase inputs).

The application of a Productivity Factor discount to the does not take into account that Councils can increase the outputs of the services they deliver whilst retaining the existing level of Inputs !!

In effect, discounting the annual increase by a Productivity Factor forces Councils to live with less money rather than let them provide more services with their existing (continuing) revenue stream inflated for full cost increases !

The Implications of this are:

1. **Councils no longer have a choice on how to increase productivity as far as the application of the Productivity Factor is concerned - productivity is to be increased by enforcing reducing inputs (ie. reducing revenue).**

   It takes away productivity choices from Councils & more importantly what Councils do with the productivity savings.

   The Productivity Factor means that productivity savings are channelled into lower rates & not increased services !!

2. **Councils which find they cannot maintain existing service levels with a revenue stream that does not match annual cost increases (by way of application of the productivity factor on general rate revenue) will by default have to reduce services.**

C. **Given the acknowledged "Infrastructure Backlog" relating to existing Local Government Infrastructure Assets** that need replacing or reinstatement but for which Councils do not have the available financial assets or revenue streams to fund them, **we question whether the productivity discount factor is appropriate or "good policy".**

We note on IPART's document that a Productivity Factor discount *"is consistent with the cost index approach that we (IPART) use for other industries that we regulate (such as the taxi industry)"* - however the business of taxi services could not be said to have a unfunded infrastructure backlog and accordingly we cannot see a taxi service Productivity Factor discount as appropriate justification to a Local Government one!!

WHY !?

Quite simply, a paring back (each year) of General Rate Income increases means the reduction of available future revenue streams which could be used to start funding the infrastructure backlog !

Is the Productivity Factor discount a material amount in terms of fighting the Industry wide Infrastructure backlog ?

In accordance with the NSW Local Government Inquiry (LGI) Final Report issued in May 2006, the Infrastructure Backlog totalled $5.3 billion (for general Infrastructure, excluding WF & SF).

If we look at NSW Local Government as a whole, each **0.1** of a percent that is used to discount the annual percentage collectively reduces the potential Rate revenue "take" of NSW Councils by $3.064M per annum (.001 x $3,064,852,030 | **source…**General Rate Income Revenue as per DLG Council Comparative Data 0910).

Comment

If instead of losing this potential revenue each year via the application of IPART's productivity discount, Councils were permitted to levy the productivity discount and pool the money together in a **NSW LG Industry Infrastructure Fund**, this would generate total cumulative cash funds over 10 years of $181 million (for every 0.1 % of productivity factor).

If this **NSW LG Industry Infrastructure Fund then "leveraged" these cash flows** by taking out a series of annual Loans (with say a 25 year term) over this 10 year period, and used the Productivity Discount cash flows to pay the loans back (principal & interest), then in fact **the Fund would in fact open up a pool of loan funds totalling $400M to fund Infrastructure over the next 10 years** - all fully funded !!

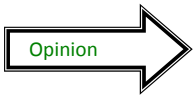
Such an amount of $400M represents 7.5% of the backlog.

Of course if the productivity discount factor happened to be 0.2 % for a year, the loan funds available would total $800M (over 10 years) and so on…as per the table below:

	Average Productivity Factor over the next 10 years				
Prodctivity Factor	0.1 of 1 %	0.2 of 1 %	0.3 of 1 %	0.4 of 1 %	0.5 of 1 %
Loan Funds leveraged	**400M**	**800M**	**1,200M**	**1,600M**	**2,000M**
% of Infrastructure backlog	**7.5%**	**15.1%**	**22.6%**	**30.2%**	**37.7%**

As can be seen above, a 0.5 of 1% productivity factor if levied by Councils (instead of being lost thru a reduced rate peg) would generate $2 billion of loan funds @ 7% interest (fully serviced by the revenue streams of the levied productivity factor) - representing 37.5% of the Infrastructure backlog.

In having to give the productivity factor money to an Industry LG Infrastructure Fund, Councils would still be achieving productivity gains equal to the discount amount (as the funds are not available to be spent by them), but more importantly instead of the funds being lost to the Industry, they are instead utilised to help fund the Infrastructure Backlog !!



Accordingly, we would suggest that IPART &/or the State Government give consideration that the productivity discount factor % amount (as determined each year by IPART) still be levied by Councils each year & remitted to an Industry wide Infrastructure backlog fund for priority works across the State.

This fund would then leverage the cash flows by taking out loans & allocate the funds to Councils across NSW based upon need & urgency & be funded by the future levy amounts at Council level.

IPART make mention within the Discussion Paper that *"in our view the annual (including any productivity adjustment) should be set in the expectation that current service levels will be maintained and that cost reductions and efficiency savings will not be obtained at the expense of service standards, unless approved by the community"*.

Given the existence & extent of the Infrastructure backlog, it could be argued that current service standards across Councils year in year out are falling since infrastructure renewals are not keeping pace with degradation - a position that seems to go against the basic tenet of IPART's that the (& productivity discount factor) should be set in the expectation that service levels are maintained !!

We would contend that while Councils have (an ever increasing) Infrastructure backlog, a Productivity Factor discount factor that reduces Councils available general revenue in future years (below that of annual cost increases) cannot achieve IPART's tenet that such revenue discounts will not reduce service levels.

D. A Productivity Factor discount (applied against the Rate Peg) must mean that those Councils that are genuinely driving productivity "in house" are being penalised by having to find additional productivity savings that are brought down by IPART.

The IPART Productivity Factor discount is applied to ALL Councils and does not take into account whether individual Councils have already factored in productivity gains into their coming years budget - whether by way of increasing services or reducing costs.

If Councils were able to be granted an exemption from having to apply the productivity factor (to their) where they can already show a minimum productivity saving (or gain) for the next year, then Councils might be more prepared to seek productivity gains at earlier stages than hold back knowing future amounts have an inbuilt productivity factor they must achieve !!

Without such an exemption regime, a forced productivity factor could in fact be promoting the maintenance of inefficient practices or a lack of incentive to drive productivity when Councils have to find the savings anyway by receiving less than costs are increasing by in each future year.

E. In relation to the 8 specific issues for commentary within the IPART discussion paper, we submit our responses on the next page.

1. **Is the current method of using an economy-wide measure of productivity and then discounting it for application to the NSW local government sector the most appropriate for future years? If so, which ABS series would be most appropriate?**

   If a productivity factor must be applied to the factor, then we think an economy wide measure is most appropriate as a surrogate for a NSW Productivity measure.

   Further we would advocate a public sector measure instead of a private sector measure. Private sector productivity gains we would suggest are higher given the profit motive of the private sector and this is not the basis of Local Government nor the underlying incentive for productivity improvements in Local Government.

   Accordingly, we think a private sector productivity measure is a distorted measure of productivity for the Public Sector.

2. **If not, what alternative measures would be more appropriate for determining a productivity factor?**

   No alternative measures are tendered by us.

3. **Can councils measure some (or all) of their productivity gains in terms of changes in physical units (that is, in volumes or quantities) of inputs and changes in prices paid for inputs? if so, in what ways would these changes be expressed?**

   The problem here is that many of Council's services are community "public good" services where the benefits are hard to directly attribute to a service and the benefits flow not to Council but to the community !! Not all Councils services can have their consumption measured.

4. **Are productivity improvements able to be captured within councils' Long Term Financial Plans? If so, please illustrate.**

   Regarding productivity improvements on the "Input" side (ie. reducing costs):

   - Cost reduction productivity improvements (by way of specific expense line items that have projected expenditure reductions attached to them) can be incorporated into an LTFP,

   - Productivity Discount Factors can be set to reduce the various inflation indices by applicable % amounts across all of Council or particular services,

Regarding productivity improvement on the "Output" side (ie. increasing service delivery levels, new services or having services utilised by more of the community):

- An LTFP would be unable to capture & display increases in a Council's productivity relating to 'providing more services, higher levels of services or a greater number of beneficiaries".

  An LTFP focuses on the cost of services…and not on the service level output, improvements or enhancements which in a lot of cases would not have any dollar impact & therefore cannot be seen in an LTFP.

5. What indicators should IPART use in assessing the productivity of Councils?

Instead of isolating Industry wide data to assess productivity, IPART could instead ask individual Councils applying for an SRV what measures are in place or will be put in place to measure the efficiency of their service delivery & to target/assess ongoing productivity improvements.

HOWEVER REGRADING INDUSTRY WIDE PRODUCTIVITY ASSESSMENT…

it's maybe all too hard for a lot of "public benefit" goods !!

How do you measure the productivity improvements of a Council's Beach Lifeguard Service !?

- No. of Lifeguards to Rescues
- No. of Lifeguards to Beach Users
- Cost per Beach User
- Surveillance hours per day

especially when some of these ratio's may improve but at the cost of higher risks to the bathing public !!

How does weather get factored into the productivity measures !?

6. How can productivity improvements be improved over time?

It should be taken into account that Councils do not provide all services "in house" but use external third party contractors. As such, productivity relating to these services may not be under Council's direct control or power over the short term - but rests with the contractors !!

7. Are net costs of individual services useful in measuring and comparing council performance?

Net Costs of services in isolation do not take into account (i) the level of customer satisfaction, (ii) the level of service provided or (iii) the level of services required by the community.

Unless such net costs per service per council is couched in terms of a per unit measure relative to (a) satisfaction of level or (b) level service provided, we cannot see the benefit of comparing the Net Service Costs per se across Councils.

Furthermore, the Net Service Costs of a Council can also year in year out be effected by the receipt of grant funding or the termination of grant funding - yet both of these events would not (and should not) be seen as comments on the productivity of the Council itself !

The loss of a grant (for external reasons) would increase the net cost of a service relative to a prior year, but should not result in a conclusion that the Council's productivity (or performance) has deteriorated of it's own accord or due to inefficiency.

8. Can councils demonstrate how the cost escalation assumptions in their Long Term Financial Plans are derived and why they are reasonable in the light of current inflationary trends?

Council's should be able to provide **(i)** a cost index matrix from their LTFP that identifies the indexation across various types of expense items & **(ii)** the sources/publications used that tie in with the LTFP cost index matrix.

We have attached (next page) an example matrix within our LTFP V3 which details actual annual changes in types income & expenditure which should permit the identification of the cost escalation assumptions within a Council's LTFP model.

XYZ Council
10 Year Financial Plan for the Years ending 30 June 2022
Global income and expenditure changes
Scenario: Base Case

ACTUAL changes over previous year after applying Index %s & individual changes)

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Operating Income										
Rates - Ordinary	3.05%	4.14%	4.14%	4.14%	4.13%	4.13%	4.13%	4.13%	4.13%	4.13%
Annual Charges	8.16%	8.03%	4.61%	5.17%	0.95%	3.62%	3.62%	0.94%	1.01%	0.98%
User Charges - Specific	7.35%	8.70%	5.54%	5.48%	3.89%	5.84%	6.30%	7.83%	6.57%	4.19%
Fees & Charges - Statutory & Regulatory	3.27%	3.29%	3.29%	3.07%	3.58%	3.58%	3.57%	3.56%	3.56%	3.56%
Fees & Charges - Other	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Other Revenues	2.93%	1.85%	2.97%	2.98%	3.47%	3.47%	3.46%	3.47%	3.47%	3.47%
Operating Grants - General Purpose (Untied)	1.91%	2.15%	2.15%	2.15%	2.22%	2.23%	2.23%	2.23%	2.24%	2.24%
Operating Grants - Specific Purpose	-3.72%	3.38%	1.93%	3.06%	2.95%	3.49%	3.24%	3.54%	3.21%	3.24%
Operating Expenditure										
Employee Costs - Salaries	-6.69%	3.57%	4.05%	4.19%	4.09%	3.10%	4.07%	4.07%	4.07%	4.07%
Employee Costs - Other	3.76%	3.08%	3.08%	3.08%	3.56%	3.56%	3.54%	3.55%	3.54%	3.54%
Materials & Contracts - Raw Materials & Consumables	-2.01%	4.60%	5.36%	6.18%	3.19%	4.39%	4.54%	4.54%	4.56%	4.44%
Materials & Contracts - Legal Expenses	-2.87%	3.08%	3.07%	3.06%	3.59%	3.60%	3.58%	3.57%	3.56%	3.57%
Other Expenses - Insurance	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Other Expenses - Utilities	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Other Expenses - Other	-1.88%	-1.04%	7.40%	3.14%	6.91%	-1.91%	3.60%	3.61%	8.44%	-1.06%

Etract of actual annual expenditure changes from LG Solutions LTFP V3