PENRITH CITY COUNCIL
Serving Our Community

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The Independent Pricing and Regulatory Tribunal
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Dear Ms Milne

Penrith City Council submission to IPART Discussion Paper

Penrith City Council (PCC) appreciates the opportunity to provide comments on the IPART Discussion Paper "*Measuring and Assessing Productivity Performance in Local Government"(September 2011)*

The need for certainty in the new regulatory framework is essential for councils to plan for future operations and much needed capital investment for their communities. We acknowledge IPART's efforts to establish regulatory certainty through the ongoing engagement with the local government industry to ensure equitable and effective outcomes.

PCC strongly supports IPART's intention to improve existing approaches to assessing productivity and efficiency without imposing unreasonable reporting requirements on councils. In this context, Council provides these comments as its submission to IPART.

The following comments respond to the eight questions raised in the discussion paper.

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?***

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

Council supports the ongoing application of the Local Government Cost Index (LGCI) in setting the rate peg for local government as it more appropriately reflects the rise in costs associated with running a council compared to any other broad economic index (eg CPI). However Council does <u>not</u> support the principle of discounting the LGCI by a productivity factor in order to come up with a final annual rate peg percentage applied to all NSW councils. The three reasons for this position are listed below.

Firstly, the discussion paper on page 4 states:

> *2.3 What is the role of the productivity factor?*
>
> *In our Final Report on the Review of the Revenue Framework for Local Government in 2009, we recommended that the annual rate peg should be set so that it is equivalent to the annual change in the LGCI* ***minus an annual productivity factor. This method is consistent with the cost index approach that we use for other industries that we regulate (such as the taxi industry).***

The above quote implies as local government is similar to other industries regulated by IPART then the methodology can be consistently applied. Council disagrees with this premise.

The local government 'industry' is distinctly unique to that of 'other industries' eg the taxi industry, electricity and water providers. IPART's own discussion paper, "Revenue Framework for Local Government (December 2009) states that "*Our analysis has shown that there is great diversity between councils in NSW in terms of their size, characteristics, expenditure needs and scope to raise own-source revenue. We consider that the framework for regulating council rate revenues should take account of this diversity" (section 2.6, page 27).* Furthermore, each council delivers a broad spectrum of services (and goods) with the business mix varying greatly from council to council, not to mention the variety of funding structures underlying each service. The diversity of services (or the businesses mix) can span from childcare, swimming pools, road maintenance and construction, animal control; planning and advocacy, just to name a few. Very few industries, if any, would be required to deliver 47 distinctly different services as in the case of PCC. In addition, there is a marked difference in community expectations as to service delivery from councils in growth versus established areas, rural versus urban and metropolitan versus regional versus fringe councils.

Under the Australian Classification of Local Government, the DLG categories Penrith as an Urban Fringe Very large Council (UFV). In 2005, the NSW government named Penrith as a Regional River City in its 25 year planning framework. In addition, PCC is a member of the National Growth Areas Alliance (NGAA) as one (out of 24) of Australia's fastest growing municipalities. Compared to many other metropolitan councils, Penrith as a growth council has had to address the pressures associated with a lack of public transport and social infrastructure and services, housing diversity and local employment opportunities. Therefore PCC is subject to costs that relate to this city profile. Examples of unique costs PCC has had to bear as a very large regional growth council include the upfront costs for planning for growth, the additional costs associated with planning for and managing multiple new release areas and the costs of providing services and facilities to a wider region.

PCC is unique compared to many other councils. Therefore, the assertion that the cost index methodology *which subtracts a productivity factor* is appropriate for all local councils due to its similarity to other industries is erroneous.

Secondly, the reduction in the annual rate peg calculation by a productivity factor is not seen as an effective long term inducement for councils to seek sustainable productivity gains. If the LGCI is considered an acceptable measure of cost increases by councils each year, then an annual rate peg reduced by a productivity factor only serves to place council's financial sustainability in a adverse position as real dollars are eroded over time. This was the situation under the previous ministerial rate peg system which has existed over the last 3 decades before 2010. Under the previous system, there is evidence that arbitrary rate pegging below the CPI forced councils especially in the early years, to be more efficient and to seek more sizeable productivity gains. However, in the longer term, in keeping with the laws of diminishing returns, the number and size of ongoing productivity and efficiency gains became more difficult to achieve each year compared to the cumulative inflationary effects of the funding gap between rates and the cost of operations. Councils as prudent financial managers, were inevitably forced to apply for special variations particularly to meet the infrastructure backlog and growing capital works program in order to meet this shortfall.

The net effect of applying an annual productivity factor especially for councils with a track record of productivity improvements and efficiency gains, is to force councils to eventually apply for SRV as the only viable means of increasing the rating base to meet funding shortfalls. The cut in the LGCI index or the process of having to go through a SRV application process is not an effective long-term motivator for local councils to seek out productivity improvements.

Thirdly, by comparison, NSW stands alone as the only Australian state that is subject to the discounted rate capping system. As stated in the IPART *Revenue Framework for Local Government – Other Industries Final Report 2009 (page 34)*

> *NSW is currently the only state that uses this approach to regulate council revenues. Currently councils in most other Australian states have a higher degree of autonomy in setting their rates and charges than councils in NSW. The only exception is the Northern Territory.*

In Victoria, the current government policy allows councils to determine rates. Under this policy Victorian councils must prepare a Rates and Charges Impact Statement and undertake community consultation. In Queensland, the procedures for rate setting are set out in the Local Government Act 1993 (Qld), but ultimately, each council is responsible to its own constituencies. In Tasmania, the Local Government Act 1993 (Tas) places the onus on local government for setting rates and charges. In South Australia, the Local Government Act 1999 (SA) accepts that councils are responsible to their own constituencies for the taxes they set requiring all councils to have and publish a rates policy and undertake community consultation before making significant changes to this policy. In Western Australia, the Local Government Act 1995 (WA) does not provide the state government with powers to directly set council rates but requires that councils develop their budget within a community consultation/planning framework.

In short no other state is subject to a rate peg system, let alone one with a built-in productivity factor, as an inducement to encourage councils to make productivity improvements. Furthermore there is no evidence to support the position that the extent of productivity improvements from NSW councils would exceed those originating from other states, under this system.

If there is no opportunity to remove the productivity factor, then Council supports the use of ABS estimates for productivity growth in calculating the productivity factor for local government. However two questions arise in selecting a suitable ABS productivity growth measure. These include:

i. Is labour productivity the only way to measure productivity growth?

ii. Which industry productivity measures reflect the diversity of goods and services provided by councils?

In response to these two questions, Council does not believe that the use of a single economy-wide labour productivity index in the calculation of the rate peg for future years would be sufficient. It is recommended that a more appropriate ABS productivity growth measures which take into account labour, materials and the impact of system/technology improvements should be used. In addition, the productivity factor should combine the productivity measures from industries which have similarities to how councils operate. This might include productivity growth measures from the construction industry, public administration and community services all of which could be averaged to provide a reasonable basis for the local government productivity factor.

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?***

Penrith City Council is fortunate in that is has a well established system of documented Service Specifications for each of the 47 services that it operates. The specifications document input costs for labour, materials and plant as well as allocated staff time (hours) against service activities. The Service Specifications can provide the ability to record productivity change over time in terms of labour hours, volume of work activity and quality of outputs.

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

Productivity improvements can be incorporated into Council's long term financial plans with known or realised productivity improvements being easier to include. Known dollar savings can be addressed by removing these amounts from the plans in the relevant year. Council's current Long Term Modelling system allows for multiple scenarios or versions to be run allowing Council to change assumptions within the model and this would be utilised for known monetary savings. Taking grass cutting as example Council currently predicts the amount of land which is to be dedicated in future years and applies a dollar value to this land to be maintained. If Council was to achieve productivity savings through the purchase of new mowing technology which reduced the amount of time taken then these savings could be redirected towards the costs associated with growth. This could then be reflected in the long term financial plan.

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

Given the broad economic definition of *productivity (or efficiency)* outlined in the discussion paper, it is important that there be standards set regarding the measurement of productivity.

At an organisational level, it would difficult to measure overall Council productivity purely based on the DLG comparative indicators (*refer to Table 3.1, IPART Discussion Paper*) although such data may provide some indication as to a council's workforce and use of day labour versus contractors.

Council agrees that ***service based productivity measures*** would be better for comparing councils acknowledging that the "*move towards service-based measures would require a consistent framework across NSW councils that included definitions, measurement methods*" *(page 11, IPART discussion paper).* The Division of Local Government would be best placed to commence this process.

In terms of the Special Variations application requirements, councils should be required to document productivity improvements beyond pure cost savings expressed in present and future dollars. Productivity measures should also reflect, for example, staff time saved (hours, days) or improvements in customer response times.

Future SRV applications may require councils to complete a productivity template which could also be used by councils as part of their community engagement strategies or as part of their annual report back to the community, if the SRV was approved.

Suggested information that an applicant council might include in their report on productivity improvements is listed below:

- Service(s) impacted by Productivity Improvement
- Brief description of Productivity Improvement
- Impact of Productivity Improvement (eg increased outputs, increased revenue/profit, reduced costs/cost savings, faster response times, improved customer satisfaction/complaints reduction, wider reach, risk reduction/elimination, energy/water savings, future cost avoidance)
- How this was achieved? (eg Improved/better materials, tools, equipment, systems, training, skills, management practices, contracting & tendering, work processes, technology, partial or full service disengagement)
- Once-off or Recurrent (x number of years)
- Net cost savings and the years in which these cost savings will be realised
- Conversion of staff time (hours, days) saved to dollars saved
- Return on Investment (optional)

- What the Council will do with the Productivity Improvement (eg factor into budget 'bottom line', reallocated to priority areas, increase service levels, change staff levels, increase in staff capacity etc)

6. ***How can productivity indicators be improved over time?***

As mentioned earlier, council-wide productivity indicators would need to be service-based measures within a consistent framework across NSW councils that included definitions and measurement methods. Once established a review panel consisting of IPART officers and representatives from a diverse range of metropolitan and regional/rural councils would annually review these indicators for ongoing relevance and benefit.

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

This would only be useful if the service was to be cost neutral however a lot of local government services have a community benefit built into them. It would be necessary to include additional information when looking at net costs for most services. Using the grass cutting example previously mentioned the net cost of this service may have remained the same or increased slightly from the previous year however Council has been able to maintain additional land compared to the prior year. This same principle may also apply when comparing budget to actual.

A comparison of net costs <u>within</u> a Council for service delivery over a number of years that takes into account cost variables would be useful to demonstrate relevant productivity levels. As previously stated, comparison between councils is far more difficult to verify given the differences in operational structure, services provided and policy decisions made.

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?***

Councils Resource Strategy outlines Councils assumptions and how they were derived. The assumptions are based on the information available at the time including historical trends. Acknowledging the difficultly in accurately projecting key assumptions the IPR Framework requires that Councils consider sensitivity analysis in the Long Term Financial Plan and produce three different scenarios (planned, conservative and optimistic scenarios).

Council gives careful consideration to all factors when framing the annual budget and its long term financial plan. The cost assumptions in the Long Term Financial Plan for existing services are based on a mixture of historical data eg CPI and agreed increases in wages awards and escalation clauses in long term contracts. Estimates are made as to when growth will occur and the corresponding increase in service levels required. Service level increases are based upon Council service specifications which provide detailed costings for activities which can then be applied to the growth estimates.

Council welcomes IPART's invitation to make comment on the discussion paper. I trust that the comments provided in this submission provide valuable assist to IPART officers in their task to improve how productivity performance in local government is measured and assessed both in the setting of the rate peg and in the special variation application process.

Yours faithfully

Barry Husking
Director