2 September 2009

Review of Regulatory Framework of Local Government – Draft Report
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230
E: ipart@ipart.nsw.gov.au

Dear IPART,

So far I have only had time to quickly look at your draft report on a *Revenue Framework for Local Government* so I will confine my comments in this submission to its *Introduction and Executive Summary*.

With two important qualifications (outlined below) I agree with the general thrust of IPART's recommendations since they accord with those of the Independent Inquiry into Local Government Sustainability (LGI) with which I was associated.

The main difference between the IPART and LGI reports, is that the latter favoured Option B (i.e. greater revenue autonomy for councils in return for them adopting long term strategic, financial and asset management planning with the involvement of their communities was adopted by New Zealand) rather than delaying this devolution of power by injecting an intermediate stage, namely default Option A (which preserves rate caps which were first imposed over 30 years ago).

Nevertheless, I understand the rationale for IPART's two-step proposal. It provides the NSW Government with a stepping stone (Option A) for making the desirable transition from its present 'command and control' approach to a more enlightened 'guided democracy' (Option B).

Yet there are two changes that IPART should make to its proposal in its final report if this two-step approach is to encourage rather than impede councils becoming financially sustainable. They concern:

1. Prerequisites for a council to shift from Option A to Option B

IPART seems to be saying that a council should not be eligible to adopt Option B if its financial performance is not adequate (see 1.4 – first paragraph of page 9, 1.4 – first two paragraphs of page 10, and 1.6.7 – recommendations 20, 21 and 22 of page 14).

Research commissioned by the LGI and subsequently by Review Today shows that almost half of the largest 100 councils (and possibly a larger share of the rest) would fail this test often because of an inadequate revenue base to meet their statutory obligations, especially with regards to the upkeep and renewal of essential local infrastructure. Yet these very councils require the fiscal autonomy that only comes with Option B in order to achieve sustainable financial outcomes (i.e. performance).

So I would suggest that the threshold requirement for a council to be eligible to adopt Option B not be adequate financial **performance** (which may merely reflect a revenue shortfall), but rather adequate financial and asset management **policies and practices**.

This would mean amending the first paragraph and dot point of page 9 from "councils would need to earn their independence by demonstrating … a track record of sound financial **performance**" to a "… a track record of sound financial **policies and practices".**

Alternatively, I would suggest the conditions for admission to Option B be evidence of a council's (i) adoption of sound financial and asset management policies and practices in recent years, and (ii) recent *improvements* to its financial performance (in response to a change in policies and practices) notwithstanding that a council might still not be financially sustainable..

Such a change to the text would flow through to other parts of the Introduction and Executive Summary dealing with the eligibility requirements for Option B, particularly section 1.4 – first two paragraphs of page 10, and section 1.6.7 – recommendations 20, 21 and 22 of page 14).

2. Requirements on a council already operating under Option B.

It's not clear to me what IPART proposes as the conditions that should apply to councils granted revenue autonomy under Option B because section 1.6.7 – recommendation 21 on page 14 appears to be the requirements for getting that status, rather than those applying under Option B.

I would suggest that a council that was awarded this freedom because of good management and governance policies and practices (rather than financial results) be required to:

- Prepare a long term strategic plan incorporating a services provision plan, asset management plan and financial and funding plan that demonstrated that it would achieve sustainability within 10 years (or in exceptional circumstances 20 years), and

- Involve its community in setting future directions for revenue raising and spending in its strategic plan as happens in New Zealand.

By council sustainability is meant sustainable services, infrastructure and finances within an acceptable and affordable rates, fees and charges policy.

Concentrating on only one of these four objectives is a common trap councils fall into. For instance promoting services growth at the expense of necessary infrastructure renewal and not raising sufficient revenue to achieve an adequate operating surplus has been the experience of many NSW councils.

Council sustainability was defined by the LGI (and subsequently by Review Today in its individual council sustainability reviews and annual overview of the sustainability of the largest 100 NSW councils) to mean:

(a) Achieving an adequate annual operating surplus (say at least 2.5% of total rates, fees and charges revenue) so that a significant portion of the cost of expanding the capacity of physical assets (as distinct from renewing the existing asset stock that should be funded from depreciation provisions) is borne by the current generation of ratepayers rather than shifted to future generations by relying entirely on borrowings for asset enhancements,

(b) Limiting net financial liabilities to a level consistent with an investment grade credit rating (normally no more than 80% of a councils total operating revenue provided that debt charges can be serviced from operating revenue),

(c) Maintaining and renewing local public physical assets so that their condition meets minimum acceptable standards for ensuring that they are 'sound, safe and sightly'. As a rule of thumb any 'backlog' of infrastructure maintenance and renewals should not exceed 2% of the restoration value of total physical assets under the control of councils so as to mitigate social, environmental and economic risks.

(d) Providing adequate local public services to the community to meet social, economic and environmental objectives consistent with the community's capacity and willingness to pay for such services (evidence would suggest that a council's per capita operating services expenditure excluding maintenance, interest and depreciation should not be less than three quarters of the weighted average benchmark of this measure for NSW councils of the same classification for that council to meet its community's minimum service expectations which might be higher than its minimum statutory obligations).

(e) Levying rates, annual charges, statutory fees and user charges that are adequate to achieve a minimum operating surplus ratio (of say 2.5%), a maximum net financial liabilities ratio (of say 80%), a maximum infrastructure backlog ratio (of say 2%) and a minimum operating services ratio (of no less than 75% of the weighted average operating services per capita of comparable NSW councils).

Please note that the above indicative ratios apply to the operating and capital accounts of councils excluding their water and sewerage businesses. The latter are by and large financially sustainable thanks to charging policies guided by mandatory long term asset and financial management plans.

<u>IPART should define what is meant by council sustainability as it's critical to any revenue framework for local government.</u>

Finally, I would question the finding by IPART that both the financial position and condition of infrastructure of local government in NSW are no worse than that of other states (first and second paragraphs of page 6).

Our estimation of the national local government infrastructure backlog based on extrapolating the results of the local government enquiries in five states would suggest that NSW's infrastructure backlog ratio is worse than that of the rest of Australia (see attached table).

If the infrastructure backlog ratio is added to the net financial liabilities ratio of councils to give a 'broad liabilities ratio' then the financial position of local government in NSW would appear to be worse than that of other states even if the net financial liabilities ratios were similar.

<u>In my view using a narrow accounting definition of financial position (that focuses on the net financial liabilities ratio to the exclusion of contingent liabilities such as maintenance and renewal backlogs) overstates the financial sustainability of NSW council revenue and spending policies.</u>

I look forward to reading and commenting on IPART's entire report, but that won't be possible until after your deadline for submissions on the 18th September because I will be overseas until mid October.

IPART has made an important contribution to the research and policy thinking on NSW local government sustainability which deserves wide public exposure, discussion and debate and hopefully a constructive response by the NSW government.

Yours sincerely,

Professor Percy Allan AM
Research Director
Review Today Pty Ltd

allan@reviewtoday.com.au

National estimate of council sustainability

State LGI Estimates (excluding Water & Sewerage)	Infrastruc Renewals Backlog	Debt Charges over 25 yrs (assuming 6.3% interest)	Infrastruc Renewals Gap (per annum)	Infrastruc Funding Gap (per annum)
NSW (152)	$4,769m	$379m	$385m	$764m
SA (68)	$300m	$24m	$20m	$44m
WA (142)	$1,750m	$139m	$110m	$249m
Vic (79)	$806m	$64m	$81m	$145m
Tas (29)	$85m	$7m	$25m	$32m
Subtotal	$7,710m	$613m	$621m	$1,234m
Pro-rata National Est	$10,185m	$810m	$820m	$1,630m

Source:
Percy Allan, *The Future of Local Government in the Federation*, Address to the Tenterfield Conference on Reforming Australian Federalism organised by Griffith University, 24th October, 2008.