



28 August 2015

Local Government Rates Capping and Variation Framework Review
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne VIC 3000

Dear Sir/Madam,

A BLUEPRINT FOR CHANGE

Local Government Rates Capping & Variation Framework Review Draft Report – Vol 1

We write with regard to the above document and thank you for the opportunity to comment.

Public works practitioners play a crucial role in the planning and delivery of public works and engineering services to the community. The Institute of Public Works Engineering Australia (IPWEA) is a national association providing member services and advocacy for those involved in this important sector. Its Victorian Division (IPWEA Vic) has members representing practitioners in state and local government, as well as private industry.

This submission has been prepared on behalf of – and with contributions from – IPWEA Vic members and with the support of the IPWEA Vic Board. Member contributions were sourced from a series of regional workshops held in Horsham, Colac and Yarrawonga, and a metropolitan workshop in South Morang at which your Andrew Chow was our guest speaker.

In considering the proposed Rates Capping & Variation Framework the IPWEA Vic has focused its efforts not on whether municipal rates should – or should not – be capped but on identifying ideas, opportunities and tools to proactively address the implications of a rates cap. Our aim is to support practitioners working within local government by helping them to identify and implement innovative ways of improving efficiency, effectiveness and productivity whilst maintaining high quality service delivery to Victorian communities.

Our earlier submission to the Essential Service Commission (ESC) in May 2015 indicated that IPWEA Vic was keen to identify practices that would enable practitioners to respond effectively to the financial constraints of a rates-capped environment in such a way that the capacity and capability of the local government sector were not diminished and that infrastructure asset maintenance and renewal was not unreasonably compromised.

IPWEA Vic confirmed its support for the adoption of an appropriate index, supported the key principles outlined in the April 2015 consultation paper and urged that an effective performance compliance reporting and auditing system be established to ensure that the objectives of the Framework were sustainably achieved. Our submission also highlighted that – in parallel with the introduction of rates capping – IPWEA Vic would strongly support the advocacy for increased commitment by councils to capital funding for public infrastructure renewal and upgrade through borrowing and the responsible use of debt.

Finally, our submission highlighted the importance of service planning, asset management plans, road management plans and long-term financial plans as key components of Council's responsibilities in relation to the provision of services to the community and the physical public infrastructure that supports the delivery of those services.

IPWEA Vic congratulates the ESC on its willingness to constructively engage with the many stakeholders involved in what will represent a significant shift in the way Victorian Councils manage their municipalities. We confirm our in-principle support for the proposed Rates Capping & Variation Framework and pledge to assist both the ESC and local government practitioners transitioning to a new environment in any way possible.

That said, IPWEA Vic remains concerned by some key elements of the Framework and offers the following recommendations for ESC consideration:

1. WORKFORCE CAPACITY DEVELOPMENT

A capped-rates regime will challenge local government to deliver the services expected by its communities within a cash-constrained environment. This will inevitably require the adoption of innovative and sustainable approaches to infrastructure procurement, management and maintenance, thereby necessitating high-level project/service planning and asset management skills at a municipal level.

IPWEA Vic is concerned that some Councils may lack the workforce capability and/or capacity to meet these challenges and that staff development funding may be an early casualty of operational efficiency measures, particularly in the following areas:

- Community consultation/stakeholder engagement
- Program management

- Risk management
- Quality management
- Procurement management
- Service planning and budgeting
- Asset management planning
- Road management planning
- Long-term financial planning
- Regional/cross-boundary service development and negotiation

We encourage the ESC to monitor expenditure cuts related to staff development and to advocate for support from the state government to make available dedicated funding for local government workforce capacity development.

2. FINANCING

Volume 1 of the Draft Report encourages Councils to consider funding alternatives as well as municipal rates increases, whilst the VAGO Indebtedness Ratios shown in Fig. 1 of Volume II of the Draft Report confirm that indicators currently sit at less than 40%...well below the 60% high-risk VAGO indicator.

In early 2014, the Australian Centre of Excellence for Local Government (ACELG) commissioned significant research on local government finance and published a paper entitled Debt is Not a Dirty Word: The Role and Use of Debt in Local Government. The paper was prepared by John Comrie with support from consortium partner IPWEA.

Amongst its findings, the research suggested that – closely managed – the use of debt by local Councils would address infrastructure backlogs, support organisational performance and sustain local communities.

Local government is traditionally debt-averse and whilst additional borrowings may assist Councils, it is imperative to ensure that such measures do not become high risk. There are long-term risks to good governance if the very best financing solutions are not put in place.

We encourage the ESC to monitor council indebtedness ratios and the application of loans to fund long-life infrastructure projects to ensure adequate capital renewal investment to sustain existing assets.

Further, we are concerned that some Councils may not have access to the commercial skills necessary to negotiate optimal debt-financing arrangements.

We encourage the ESC to provide guidance to local government in the area of debt-financing and to provide access to reduced-interest borrowing.

3. RATES CAP

The modelling in the Draft Report – whilst perhaps only indicative – forecasts annual rate caps from 2016-2019 to be in the order of only 3%. This comes at a time of reduced Federal and State Government grant availability and increased expenditure demands (e.g. flood management infrastructure management and maintenance).

Figures released recently by the Municipal Association of Victoria indicate that municipal rates accounted for almost 60% of Council revenue in 2013-14 and that the average rate increase across Victorian Councils during this time was at a 10-year low of 3.8%, or \$67.

We are concerned that the forecast rates caps are significantly less than Councils have been accustomed to, suggesting that there will be an explosion of rate cap variation applications and/or debt financing commitments or worse, a significant decline in the provision of Council services and/or infrastructure development.

We encourage the ESC to reconsider the rates cap calculation to ease the transition from historic rate increase levels to those mandated under the new framework.

Further, Table 1.3 in Volume II of the Draft Report suggests that the total proportion of expenditure on materials, services, contract payments and net capital works is close to 60% of Councils total spend. It is therefore important to ensure the index applied takes into account the 'real' cost increases that local government experiences. The 60% of the non-labour Council expenditure comprises materials and capital works, the cost of which is reportedly increasing at a rate greater than the CPI. This direct link to public works infrastructure investment may result in expenditure cuts to this important area which will directly impact on Councils ability to provide sustainable services to the community.

We support the use of an efficiency factor as it will encourage Councils to seek innovative ways to reduce costs, notwithstanding that a variation may be sought for special situations supported by a robust business case. IPWEA Vic would be very keen to work with local government via researching, training, modelling and supporting innovative practices to assist Councils meet or exceed requisite efficiency targets.

We encourage the ESC to reconsider the rates cap calculation taking into account the cost increase pressures on the non-labour component of the calculation and to consider introducing a Construction Price Index into the calculation, particularly in view of the volatility of oil prices. IPWEA Vic would be keen to work with the ESC in developing and delivering support programs for Local Government to assist with innovation and productivity improvements.

We also encourage the ESC to defer the adoption of a binary ‘yes/no’ response to rates cap variation applications until at least Year 2 of the program and to provide constructive feedback to applicants to ease the transition to the new environment. IPWEA Vic can assist in this regard if required.

Finally, we encourage the ESC to seek the authority to determine flood mitigation infrastructure maintenance and/or construction work to be a ‘service priority’ under the Rates Capping & Variation Framework and to provide any Council applying for a variation to the rates cap for such work with every assistance.

4. OUTCOME MONITORING

The Draft Report highlights that Victorian Councils manage around \$78 billion worth of assets that support the delivery of services to the community. IPWEA Vic supports the statement that the Rates Capping & Variation Framework needs to recognise Council’s responsibility to maintain and invest in their infrastructure. Based on the 2014 VAGO audit, a number of concerns exist around local government capability in the areas of asset management and maintenance. IPWEA Vic strongly supports the development of clear-cut and robust indicators to measure Councils infrastructure needs.

IPWEA Vic contends there are two key indicators that must be carefully monitored as part of the rate capping and variation framework:

1. Assessment of the renewal gap

The assessment of the renewal gap must be based on a more sophisticated methodology than Depreciation. A Depreciation methodology has the ability to assess the Annual Average Asset Consumption (AAAC) but when developing 10-year financial plans the variability of the renewal demand based upon the actual condition of assets will be very different to depreciation.

This is particularly evident when the AAAC of rapidly growing municipalities is compared to the actual renewal demand based on condition and other relevant factors. In this situation the AAAC significantly overstates the current renewal demand and does not predict when increase or peaks will occur.

IPWEA Vic strongly contends that the capital renewal demand should be based on sound asset inventory, brownfield renewal unit rates, carefully considered asset lives, accurate asset condition ratings and an agreed point of intervention on the asset condition degradation curve determined in consultation with the community. To calculate the renewal gap then requires Council determination of the investment it intends to make on renewal of existing infrastructure over the corresponding 10-year period.

The indicator should be calculated for each year of the long-term financial plan and should simply be the proposed capital renewal expenditure divided by the calculated renewal demand. A sustainable ratio equal to or greater than 1 should be the objective.

All local governments must invest in regular, sound asset data collection regimes supported by functional Asset Management Systems capable of turning data into knowledge for management and Council decision-making.

2. Assessment of asset management competency

The accuracy of the assessment of the 10-year renewal demand and the development of a 10-year capital works program is directly proportional to the asset management competency of the organisation.

IPWEA Vic strongly believes that an indicator of asset management competency is crucial to assessing the validity of any renewal gap calculation. The outcome monitoring of local government should therefore be subject to a consistent and robust assessment of asset management competency.

The MAV's STEP program uses a standard assessment tool but this is based on municipal self-assessment. It is IPWEA Vic's view that whilst the assessment tool is sound, the slow progress of some municipalities to achieve even Core Asset Management Competency relates more directly to the commitment of the organisation to make the required changes.

Inadequate staff training, asset management skills and succession planning also impact on competency improvement. We are also aware of at least two Victorian Councils that favour the IPWEA NAMS.PLUS tools and templates based upon the International Infrastructure Management Manual.

These matters must be addressed by all local governments. Any cost-cutting or de-skilling in these areas will only compound the problems already evident and the difficulties associated with improving the asset management competency of Victorian local government.

The use of a standard assessment tool must be established and be made mandatory but with independent validation.

Any assessment tool – such as the National Asset Management Assessment Framework – should include an assessment of the status of a Council's Service Planning processes as these are critical to sound asset management and vital in a rate-capped environment that may impact on service delivery decisions.

IPWEA vic – with the support of IPWEA’s significant asset management expertise– would be keen to work with the ESC, local government and industry to develop an education and training tool to support best-practice in this most important area of local government management.

The ESC could also consider whether a prescribed level of Asset Management Competency (based on an agreed indicator) is a prerequisite for seeking a rates cap variation relating to new and/or upgrade infrastructure projects.

We encourage the ESC to develop clear indicators for both Renewal Gap and Asset Management Competency. IPWEA vic offers to assist the ESC in this process using our own asset management skills and resources.

In closing, IPWEA vic is committed to the best-practice establishment, management and maintenance of infrastructure that sustainably serves Victorian communities.

The transition to a rates-capped environment will no doubt confront local government with some challenges in the short-term, however we re-iterate our intention to assist the ESC and our Council colleagues with the successful implementation of the Rates Capping & Variation Framework in any way possible.

We trust the above informs your deliberations and ask that any queries regarding this submission be directed to the undersigned via david.hallett@ipwea.org.

Finally, we would appreciate acknowledgement in the Final Report as a peak sector body.

Yours faithfully,



David Hallett
Chief Executive Officer