Submission
No 72

INQUIRY INTO LOCAL GOVERNMENT IN NEW SOUTH WALES

Organisation: Blacktown City Council

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Blacktown City Council

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The Hon. Paul Green
Chair
Legislative Council General Purpose Standing Committee No. 6
Parliament of NSW
Macquarie Street
PO Box Q290
SYDNEY NSW 2000

Dear Mr Green

Submission – Inquiry into local government in New South Wales

Blacktown City Council is pleased to take the opportunity to provide these comments in relation to your committee's Inquiry into the Fit for the Future process and the broader issues of local government sustainability.

Council's comments are attached and arranged under the main headings of the Inquiry's Terms of Reference. I have also requested to address the public hearings called for the Inquiry and trust that this will be confirmed in due course.

Council's long term vision for the City of Blacktown clearly states the roles of governance, strategic civic leadership and service provision which local government must play under its legislative charter.

Blacktown City is the largest council in NSW by population, representing over 332,000 residents. We face significant challenges and pressures which must be overcome to reach our objective to become a city of excellence. Council is committed to balancing the provision of the services and facilities needed in one of the largest and fastest growing cities in Australia at a modern, contemporary standard while at the same time building new communities bigger than most other cities in NSW.

Blacktown has addressed these issues while remaining debt free and with average residential rates below that of our contemporaries across the city and region. However, the long term challenge of maintaining critical City assets and appropriate service levels within the current constraints of local government is immense.

Thank you for your consideration of Council's views. Should you wish to discuss this matter further, please do not hesitate to contact me

Yours faithfully,

Kerry Robinson
General Manager

BLACKTOWN CITY COUNCIL

SUBMISSION TO NSW LEGISLATIVE COUNCIL

***Inquiry into local government in New South Wales* (announced May 2015)**

Introduction

Blacktown City Council welcomes the opportunity of making comment to the Inquiry into local government.

The key issues for Blacktown City, and for the industry, which we urge the Inquiry to address, are outlined below under headings from the Inquiry's Terms of Reference.

It is not intended to respond to all the matters identified in the Terms of Reference, but to comment under the relevant topics on those issues of most concern to us.

Blacktown City is the largest local government area by population in NSW and the fourth largest in Australia, with an estimated resident population in 2014 of over 332,000. The City contains the majority of the North West Growth Centre of metropolitan Sydney and is expecting a further 25 years of sustained growth, to reach a total population of some 540,000 residents.

Blacktown City Council supports the rigorous analysis of local government through a well considered reform process and acknowledges the need to improve the efficiency and viability of the sector.

Council has consistently and strongly put forward the view that the financial sustainability of the sector is one of the critical issues and reiterates the need to remove the pressures creating this problem. This is seen as a higher priority than concentrating the efforts of Government on sweeping structural changes, that may not achieve the desired outcomes. It is imperative that radical change is not adopted simply for its own sake. Where incremental changes can achieve comparable results, these need to be given first consideration.

1. The New South Wales Government's 'Fit for the Future' reforms

Blacktown City has played a proactive role in the strategic review of the local government sector since the Destination 2036 workshop in 2011. We seek to work collaboratively with the State Government and our fellow councils for stronger and more sustainable local government.

In broad terms, the main priority areas identified by Blacktown City throughout the process have included the following:

- Financial sustainability – adequate local government revenue secured through abolition of rate pegging, other improvements to the rating system, address of Government cost shifting and taxation reforms (this issue is further discussed in section 3 of our submission below).

- Infrastructure provision – effective whole-of-government address to the adequate provision and maintenance of infrastructure. The requirements go beyond addressing the infrastructure renewal backlog and entail long term forecasting and planning for asset maintenance, renewal and expansion to meet present and future community needs. Failure of successive State governments to deal with the infrastructure gaps in order to manage significant increases in population has left an unwanted legacy.

- Strategic regional planning – better coordinated regional planning for metropolitan Sydney and Government commitment to provide the infrastructure and services required by the metropolitan plan in a timely manner.

- Confirming the role of local government – greater clarity on the role of local government and the share of services which it should provide, including constitutional recognition and a strengthened Inter Governmental Agreement.

In general, the FFTF package provides a very limited response to many of these important strategic priorities. Its major focus has been on the assessment of councils through a limited set of financial benchmarks (refer section 2 of our submission) and on the amalgamation of councils (refer section 5).

FFTF to date also does not deal with the key governance issues identified by the Independent Local Government Review Panel (ILGRP), although it is understood that this focus may be re-established by the intended revision of the Local Government Act in coming months.

The practicality of the FFTF assessment timeline proposed (i.e. to assess 144 council proposals in approximately 12 weeks) has also been very fairly criticised as being unrealistic and tokenistic. The opportunity for councils to respond individually and in depth to findings which may very significantly affect the wellbeing of their communities has not been clearly established.

Scale and capacity of councils

Blacktown City clearly has the scale and capacity to stand alone as a strong and sustainable council in the future of NSW local government. We have submitted an 'improvement proposal' to stand alone under the existing local government structure. This is consistent with the preferred option for Blacktown which was identified by the report of the ILGRP.

Blacktown City Council has long established and well proven credentials in strategic planning and advocacy, as a representative of its local community, as a regional stakeholder and as an effective partner for government.

We have no concerns with meeting the application of the **strategic capacity** criterion of FFTF.

However, we recognise and respect the serious concerns raised by the industry regarding the **scale criterion** and the absence of any clear statement of, or rationale for, a population threshold test for councils in metropolitan Sydney.

2. Fit for the Future financial indicators and benchmarks

We have previously identified to the Office of Local Government (OLG) and to IPART significant concerns regarding the financial indicators and benchmarks used as criteria for FFTF. We do not consider the arbitrary application of these measures to the industry to be a balanced or appropriate means to judge financial sustainability or 'fitness' as a council.

Major issues include:

- Appropriate consideration in the application of the indicators and benchmarks to the realistic circumstances of high growth councils (including revenue sources, asset growth and depreciation)

- Review of the appropriate timeframe for the FFTF assessment of some indicators to consider 10 years (as per the Integrated Planning and Reporting guidelines) rather than 5 years.

In regard to both these points, a more nuanced or tiered assessment, depending on the council's actual circumstances, would be appropriate, rather than a rigid 'one size fits all' assessment.

Blacktown City does not believe that such an approach provides a suitable assessment framework for councils, either within metropolitan Sydney or across NSW. The diversity of councils and communities is not appropriately reflected in the limited and rigid nature of this framework.

Overall, the financial and infrastructure benchmarks do not provide an adequate or complete indication of a council's performance or long-term sustainability.

OLG has previously acknowledged that some of the FFTF indicators are inappropriate for councils in high growth areas, such as Blacktown City and Camden, which contain the majority of the North West and South West Growth Centres of Sydney. The timing of that growth is also critical, as IPART has set a 5-year timeframe for its benchmarks. Development of the North West Growth Centre is expected for another 20 years, which is the real and critical setting for those councils affected.

Blacktown City is financially one of the soundest councils in NSW, as consistently attested by our external auditors, PricewaterhouseCoopers. Nevertheless, we presently meet the benchmark for only 1 of the 7 FFTF indicators and are unlikely to meet several of the benchmarks in the short to medium term. This does not indicate an unsustainable financial position but rather the inadequacy of the indicators. They do not reflect the need to manage high growth, provision of new infrastructure and the maintenance and renewal of a multi-billion dollar asset stock.

If Blacktown City Council were to seek to meet the FFTF benchmarks, rather than to base its decisions on prudent financial management, the measures which we might need to undertake would not necessarily improve Council's current and projected financial sustainability.

Blacktown City strongly advocates that the FFTF criteria should be supplemented with additional and more balanced financial information, based on councils' Long Term Financial Plans and relevant financial reporting.

These issues are further detailed by the commentary on each of the FFTF indicators and benchmarks which is provided in **Appendix 1**. This is supplemented by **Appendix 2** on the impact of depreciation.

<u>Other financial indicators and considerations</u>

As noted above, the indicators used as part of FFTF apply a one size fits all methodology. This is not necessarily appropriate for all councils which will have different local factors that impact the results.

Local Government NSW has published an independent review of the FFTF criteria and has proposed a number of improvements which should be made prior to any assessment of councils. Blacktown City supports this request and has previously asked that the following specific matters be considered in a review of the benchmarks:

- Depreciation – the current lack of consistency in NSW local government practice and reporting means that councils with a conservative policy regarding depreciation, such as Blacktown City, are disadvantaged by some of the FFTF benchmarks (this issue is addressed in more detail in **Appendix 2**)

- Asset renewal funding – the indicators should include assessment of forecast asset renewal funding gaps (as is required for a council's Long Term Financial Plan and Asset Management Strategy). This would more accurately depict a council's funding shortfall for future asset renewal expense against the annual depreciation expense

- Lack of any indicators which adequately address liquidity, available working capital and debtor management, traditionally the key measures of local government financial sustainability.

Other key factors which should be included in a proper assessment of local government financial sustainability include cost shifting from federal and state governments and the impact of major changes to grant programs especially the federal government's Financial Assistance Grants to local government (FAGs).

3. The financial sustainability of the local government sector

Blacktown City Council strongly endorses the view expressed at Destination 2036 that "Financial sustainability is arguably the key requirement to achieving strong and sustainable councils that can deliver services that the community wants and can afford."

Fundamental to the long term financial sustainability of local government is the need for an adequate and secure revenue base which allows it to meet current and projected expenditure requirements.

This is broader than merely ensuring that current revenue flows are adequate for meeting current expenditure requirements. It necessarily includes the capacity to maintain existing infrastructure and to fund the renewal of ageing infrastructure. It also includes the capacity to meet potential challenges including population growth, an ageing population, technological change and climate change. These challenges are particularly acute for Western Sydney, which faces a projected population increase of more than 1 million over the next 25 years and the increased infrastructure and service requirements this will bring.

Council Revenue System

Council considers review of local government revenue streams as one of the highest priorities for reform. Current rating provisions of the local government legislation should be reviewed to ensure the system enables NSW councils to be financially sustainable and to deliver the services and infrastructure required in their communities

Revenue system reform should include:

- Further reform in the current rating system, particularly the abolition of rate pegging, with the responsibility for the determination of annual increases in rates transferred to individual councils
- Seeking compensation under an Inter-Governmental Agreement for cost shifting to local government
- Addressing the infrastructure problem in local government through increased Commonwealth and State grant funding
- Review of current rate exemption categories, including removing or reducing rate exemptions for properties owned by the Department of Housing and schools
- Establishing more flexible rating categories
- Reviewing pensioner rate rebates (unchanged since 1993)
- Deregulation of fees and charges.

The revenue system strategy should also consider the implications of the Henry Tax Review and identify opportunities for local government. The Henry Tax Review addressed a number of issues directly affecting the long term financial sustainability of local government, including:

- the need for councils to have sufficient autonomy in setting rates
- integration of rates and land tax
- the distribution of financial assistance grants
- the potential for expanded road user charges
- the problem facing Australians in relation to housing affordability
- the cost of providing aged care in a country with an ageing population
- the longer term financial capacity of the states
- the application of economic rent.

Rate Pegging

The most significant general issue affecting NSW councils' financial sustainability is rate pegging. The long-term policy of rate pegging in NSW represents a very clear negative impact on the ability of councils to deliver essential services to growing populations.

The regulation of council income through rate pegging is a situation overdue for urgent review. It is a policy which is directly at odds with the responsibilities which councils carry for long term strategic planning for the communities we serve and the statutory requirements for long-term planning for finances and infrastructure. Given the growing expectations for councils to do more, then surely they have the financial capacity to determine their own rates in a responsible and transparent manner.

Despite recent changes in the assessment of special rate variations, the rate cap merely factors in underlying costs and inflationary pressures and ignores the reality of escalating expenses to fund growing community demands for increased services and infrastructure. Notwithstanding recent improvements which have (in some years) seen IPART allowing rises above inflation and more in line with increasing costs of local government, rate pegging has still limited the ability of many councils to adequately vary their rates and to better secure their own financial positions. Increases in rate pegging have not kept pace with overall cost increases incurred by local government and in particular the backlog of infrastructure maintenance work and renewal work that cannot be funded.

State and Federal Grants

As stated by WSROC in a submission to the ILGRP:

> The need for greater rate autonomy and the pressure to raise rates stems largely from the long term decline in Financial Assistance Grants and the parallel increase in expenditure expectations of local government. While rate flexibility would provide some relief for many councils, it must be recognised that it would impose greater burdens on low socio-economic communities across many parts of western Sydney.

> While individual councils should have the right to decide their own rate levels, equity considerations demand that those fundamental funding questions which put so much pressure on council finances must be addressed as a matter of urgency.

The ILGRP's assumption in its report that local government cannot expect increases in total state and federal funding should be challenged. Given the impact of cost shifting (see below), there is a strong and logical case for a more equitable distribution of revenue between levels of government. However, we acknowledge that there is no "silver bullet" and that it is unlikely that local government will see the increases in revenue commensurate with its responsibilities from state and federal governments.

The point must be made nevertheless that the decline in these revenue sources has seriously added to the pressure being faced by local government and that the other two tiers of government therefore have a responsibility to ameliorate those pressures which they have either created or exacerbated.

The decline in Financial Assistance Grants over the past 20 years is now seriously exacerbated by the freeze in the indexation of FAGs announced in the 2014 federal budget. For Blacktown City, in cumulative terms, this will mean a projected reduction in FAGs funding at the end of the 3 year period (2014 – 2017) of around $4.6 million.

This freeze in assistance from the Federal Government impacts on the overall level of available funding for Council to provide essential services expected by the community and appropriately manage the maintenance of our assets. At a national level, freezing Financial Assistance Grants at their 2014 level for 3 years will result in a permanent reduction of 13% in this vital source of local funding.

It is vital that the NSW Parliament supports the immediate restoration of the indexation of FAGs. This would restore some $50 million in federal funding to local communities in NSW.

Cost Shifting

Along with the challenges which are inevitable from its role and from the increasing expectations of our communities, local government is required to provide a range of services that had been previously provided by the other spheres of government. The majority of cost shifting has historically been from State to local government but in more recent years there is also evidence of cost shifting by the Federal Government.

The details and effect of cost shifting on local government sustainability is documented in the annual survey conducted by Local Government NSW. The most recent report published estimates the impact on NSW local government at around $520 million in 2011/12, equivalent to 5.63% of total non-capital revenue.

The impact of cost shifting for Blacktown City Council is around $15.1 million per annum, or 6% of operating revenue (excluding capital grants and contributions).

The major areas of cost shifting include:

- the withdrawal or reduction of financial support once a program is established (the trap of 'seed funding' to new and attractive facilities and services by State or Federal Government without an ongoing funding mechanism)
- the transfer of assets from State Government without appropriate funding support
- the requirement to provide concessions and rebates without compensatory payments
- increased regulatory and compliance requirements imposed through local government rather than by Government agencies.

Cost shifting should be addressed by defining more clearly the functions, roles and responsibilities of local and state government, specifically including costs and overlap between services, and for it to be included in an enhanced Inter-Governmental Agreement.

Use of Borrowing

The point is clearly made in WSROC's submission to the Panel that the "increased use of borrowing to fund long term assets (subject to the council's financial position)" (p. 18) must be approached with caution and is not in any case a substitute for reform to the revenue system, as discussed above.

As stated by WSROC in its submission which is cited above:

> Debt financing of assets only creates a future burden for servicing and repayment unless those assets are sufficiently productive to generate revenue greater than the associated debt servicing costs. Most community assets, even though they may add significantly to community amenity and well-being, are unlikely to be in this category. Thus while borrowing might help councils address their infrastructure backlog, it may not do anything to improve their long term financial sustainability. Further, while future revenue sources remain uncertain, those risks are increased.

Blacktown City Council has been debt-free for over 15 years and has used the savings from its former debt repayments to establish and maintain an Infrastructure Sinking Fund (ISF) which provides a valuable funding mechanism for the provision and renewal of key local infrastructure. While the mix of revenue and funding available to Council will remain under review, the ISF model as an alternative to borrowing has brought substantial advantages to achieving community outcomes in Blacktown City.

Section 94 Contributions

The financial challenge which dwarfs all others for Blacktown City is the limits placed on Section 94 developer contributions in growth centre developments. Blacktown City has a dramatic funding shortfall to address if we are to provide local infrastructure in our new areas.

Council faces a $137 million funding ‘gap’ for the provision of community facility buildings in the North West Growth Sector, as these facilities are no longer considered as ‘essential local infrastructure’ by the State Government, and cannot be levied on development.

The Section 94 cap of $30,000 per lot in growth centre developments (despite some recent flexibility in the Government’s approach) leaves those councils responsible for metropolitan Sydney’s growth with a massive challenge to provide local infrastructure in our new areas.

This is a threshold issue for growth area councils in NSW – the challenge of properly funding infrastructure for development areas. The challenge cannot be met without the State Government properly directing the policy and financial formula over which it has control. The current policy is leaving growth councils with a funding shortfall to provide local infrastructure in its growth areas. The legislation should be amended to allow the use of developer contributions for community facilities.

With these facilities now unfunded, across the Western Sydney region the shortfall is estimated to be around $3 billion. This relates only to the current definition of “Essential Infrastructure” and does not include the cost of other historically S94 funded facilities such as community facility buildings.

The situation is imposing unacceptable pressure on the finances of many of the region’s councils, as well as impacting on the communities who are forced to suffer with inadequate infrastructure. As a matter of urgency this needs to be addressed.

Reforms should provide much greater flexibility by reinstating exemptions to the cap when councils can show that current levels are inadequate. This is most evident in community infrastructure. The purchase of the land for community infrastructure is included; but not the construction of it. This does not allow for creating high quality housing estates where there is a real risk of inadequate supply of expected community facilities like aquatic centres, community hubs or libraries.

If these reforms can’t be implemented then the State Government needs to take on greater responsibility for funding necessary local infrastructure.

4. Monitoring of local government performance

New South Wales has no comprehensive or meaningful performance measurement framework for local government.

Blacktown City supports the intention of developing a better, more consistent approach to measuring council performance. We were an active participant in the OLG performance measurement framework project arising from Destination 2036. Regrettably, this project, which was announced by OLG in 2013, was not completed. It has apparently been superseded by the very limited and selective performance indicators employed in FFTF.

We would urge consideration of the significant body of relevant work done in recent years in other States and at the national level on local government performance measurement. The sector should draw as far as practicable on these sources, in order to promote consistency of practice and minimise unnecessary re-invention.

The principle of moving from onerous compliance-based reporting to more meaningful performance-based measures and to reporting which is more meaningful to the community is strongly supported.

This direction would reflect the intentions of Integrated Planning and Reporting and the stated concerns of the NSW Auditor General and the ILGRP regarding the way councils are monitored and measured.

It is Council's view, in common with the sector, that the NSW Comparatives data and reporting process requires a major overhaul. Again, this review was commenced by OLG following Destination 2036, but has not been completed.

Developing an agreed State-wide means to measure the contribution of council performance to community outcomes would be a further phase of the project and one which is in keeping with the intensions of IP&R as a sector-wide reform.

In this regard, it is noted that Council is progressing its own Quadruple Bottom Line (QBL) reporting, based on best practice. Council would welcome the opportunity to participate in and draw on a State-wide approach to the measurement of community outcomes.

Blacktown City supports the proposal made in FFTF that:

- councils would report performance on outcomes in the Annual Report
- the Auditor General would reassess performance periodically as part of the new role of the Audit Office of NSW in the sector, as proposed by the ILGRP – in this regard, our support would be conditional on appropriate consultation with the local government industry on this measure and its costs.

5. Council amalgamations

As has been clearly identified by the industry, and by many experts including Professor Graham Sansom who chaired the ILGRP, a limited focus on council amalgamations is unlikely to produce the strong and sustainable local government sector which is the objective of reforms.

In regard to the relative costs and benefits of amalgamations, we note that other councils and stakeholders have conducted or commissioned research in this area and will be better placed to comment. We also note the limited body of evidence provided by the ILGRP report in this respect. The research studies on the effects of amalgamations which have been published by academic bodies in Australia clearly suggest that any assumptions as to the benefits of amalgamations should be thoroughly tested.

Blacktown City Council has not separately taken a position on specific issues regarding the structure and boundaries of NSW local government which have been raised by the reform process. We would support a practical, rather than theoretical, approach to reform in this area.

In general, as stated in an earlier WSROC submission to the ILGRP, Blacktown City:

> … would be very concerned about any attempts to pursue theoretical goals without serious consideration of the diversity of issues, communities of interest, geographical features, projected population growth, local identity centres, existing asset structures, levels of debt, financial performance and a raft of other factors that may limit any benefits from amalgamation.

While it is acknowledged that for reasons of history and demography, some councils may not have the financial or strategic capacity required for long term sustainability, Blacktown City does not in principle support the forced amalgamation of NSW councils.

This approach seems particularly inappropriate in Western Sydney, where local government areas are large and the key challenges are of meeting the needs of growth rather than of inadequate scale. The lack of clear and conclusive evidence of net efficiencies, savings and community benefits arising from forced amalgamations in the experience of NSW or other jurisdictions urges caution rather than any radical process.

As it is acknowledged that amalgamation may be beneficial to some areas of NSW, the need highlighted by the ILGRP to examine and advise on barriers and incentives to voluntary amalgamation is certainly supported.

If any amalgamation option is to be considered seriously, it is imperative that the process is carefully planned in a fully consultative way that takes into account all the local variables involved.

6. The role of co-operative models for local government

We are open to consider the results of the Joint Organisation trials conducted under FFTF. The exclusion of Sydney councils from this pilot phase, however, necessarily means that the experience and evidence to date is limited.

Pending this consideration, we offer the following comments based on the experience of Western Sydney in this area.

Role of ROCs

Blacktown City is a strong and active member of WSROC and supports an appropriately expanded role for Regional Organisations of Councils (ROCs) in the local government system. As stated by WSROC in its submission to the ILGRP:

> The ROCs bring a highly valuable regional focus that cannot be achieved by state-wide organisations. This is essential for strategic regional planning, for regional advocacy and for regional service and resource sharing.
>
> An enhanced role for the ROCs provides a viable and less disruptive alternative to amalgamations in most situations. It carries the potential for significant savings through resource sharing, provides for a regional focus in strategic planning and allows easier engagement with the other levels of government. At the same time it allows for a continuation of the strong advocacy undertaken by ROCs such as WSROC.

Another argument advanced in favour of council amalgamation is the improved capacity for regional strategic planning rather than having councils mired in their own parochial concerns. Yet this could be achieved without amalgamation. An enhanced role for ROCs in regional and sub-regional planning would reduce the need for amalgamation by providing a more strategic regional approach to planning issues.

Shared Services

Support for and removing the legislative barriers to shared service arrangements between councils and through the ROCs would be an appropriate and valuable reform measure.

As assessed by studies including the 2013 report for ACELG by Gooding Davies, the ROCs may be a far cheaper and effective alternative to seeking these efficiencies by amalgamation. As stated in the WSROC submission cited above:

> The key is in identifying and exploiting those opportunities rather than forcing amalgamation which may achieve some of those benefits but at much greater cost. Government support for this process would be beneficial.
>
> An enhanced role for the ROCs would assist individual councils to continue their pivotal role in meeting the needs, aspirations and priorities of their local communities,

but at the same time benefitting from the economies of scale and scope which some argue would come with amalgamation.

Alternative Service Delivery

The Destination 2036 initiative to investigate and develop alternative service delivery models for local government is worth pursuing. There are many examples where successful arrangements exist for services that are undertaken across councils, such as the co-operative local government self insurance schemes set up by a number of Sydney councils (Westpool and Metropool).

However, it would be challenging to manage other operational services without detailed structural arrangements in place. These arrangements would need to be explored to determine whether it can be achieved within council structures and not considered a precursor to the outsourcing of services. This is something that Blacktown City Council would only support where there is appropriate consultation with relevant workforce groups.

APPENDIX 1 – ANALYSIS OF FFTF FINANCIAL INDICATORS AND BENCHMARKS

The following detailed commentary on each of the FFTF financial indicators and benchmarks supplements the information which is provided in section 2 of this submission.

- **Operating Performance Ratio**
  (> or equal to break-even average over 3 years)

The definition of 'operating expenditure' includes depreciation. Whilst the calculation of this ratio is technically correct and an applicable measure for most industries, it does present a misleading result for some councils, particularly those such as Blacktown City that are experiencing a significant level of growth in their infrastructure asset base.

It is unlikely and not reasonable to expect that a growth council will be able to, nor should it be aiming to fully cash fund its depreciation whilst it is experiencing high levels of growth. In the case of Blacktown City, the reason for this is we currently have an annual depreciation expense of around $60 million.

Over the next 20 years, we will build another $2.8 billion worth of infrastructure assets. Annually this will be more than $100 million in additional infrastructure assets that will be depreciated each year. This means our depreciation expense will increase by around $2 million each year.

This annual increase in depreciation means that for this indicator the actual cost required to renew the City's assets will be incurred sometime in the future. That is, the annual depreciation expense is recognised once the asset is constructed, however as these are long life assets, they usually do not require large amounts of maintenance or renewal funding at this early stage of their life.

Additionally, a large portion of these infrastructure assets are funded from Section 94 developer contributions that do not generate revenue as they are community assets. Therefore, during the growth period, the annual depreciation will increase at a much higher rate than operating revenues, most notably rates income. This ultimately means that a growth council will struggle to generate an operating surplus including depreciation during a period of significant growth.

It is recognised though, that when a growth council moves into the maintenance phase and is no longer growing, the annual depreciation expense will level out to a large degree. It is at this stage that it is reasonable to expect that the operating revenues will over time increase at a much faster rate than depreciation expense, at which time annual operating surpluses should be able to be achieved. As such, for a 'growth' council this indicator is not considered as meaningful as it is for a 'maintenance' council.

Growth councils need to be planning for the renewal of these assets when they are due, which means positioning themselves financially to have sufficient funding available in the long term when the actual renewals require funding.

- **Own Source Revenue Ratio**
  (> 60% average over 3 years)

For a high growth council, this indicator is largely affected by the level of development activity and Section 94 / works in kind income. The benchmark is not appropriate for high growth councils which receive a large proportion of their revenue from Section 94 developer contributions.

To guarantee to meet the benchmark, Council would have to very substantially increase its rates and/or fees and charges. Blacktown City submitted a detailed analysis of its revenue policy and forecasts to IPART as part of our successful Special Rate Variation application for 2014/2015. To seek a large additional rate increase simply in order to meet this FFTF benchmark would not be in keeping with either the NSW rating system or prudent management.

- **Building and Asset Renewal Ratio**
  (>100% average over 3 years)

The quantum of Blacktown City's assets is currently $2.8 billion, and this is growing at over $100 million per annum.

In order to achieve this benchmark, Council would need to spend around $47 million per annum on asset renewal. This is not realistic under the NSW rate pegging system. Following a major new funding strategy adopted from 2014/2015 (including the Special Variation which was approved by IPART), Blacktown City is effectively managing and reducing its renewal backlog.

This benchmark is also impacted by the effect of depreciation (refer to **Appendix 2**).

We would question the rationale of having a benchmark of a 100% average over 3 years, that is, fully funding depreciation when new assets are just being constructed. On this basis, councils might be overcapitalising, or over-renewing assets before this is actually required. Blacktown City's asset renewal forecasting is based on comprehensive physical assessment and mature asset management systems.

- **Infrastructure Backlog Ratio (<2%)**

Council expects to meet the Infrastructure Backlog benchmark over the next 10 years, which is the statutory local government financial planning cycle, but not within the 5 year timeframe of the FFTF benchmarks.

As noted above, consideration should be given to realistic FFTF assessment timeframes, as well as to the benchmarks themselves.

- **Asset Maintenance Ratio**
  (>100% average over 3 years)

Blacktown City does not object to this benchmark in principle. However, we note the industry discussion (through IPWEA and other expert bodies) on the need to better define the relationship of 'renewal' and 'maintenance' funding.

- **Debt Service Ratio**
  (>0 and less than or equal to 20% average over 3 years)

The formula for this indicator is obviously flawed and Blacktown City strongly urges its reconsideration.

The benchmark is calculated such that a council 'fails' the indicator because it is debt free. While we acknowledge that the use of debt is practical for councils in some instances, a debt free status is of value to a council and it is inappropriate to set a benchmark which requires all councils to have debt. This does not recognise the value to some councils of being debt free and other financial measures they have in place for recurrent expenditure where debt is not appropriate.

It is noted that state and federal governments over recent decades have actively worked to significantly reduce the use of debt.

Previously, Blacktown City had significant levels of debt, which by the 1990s seriously impacted its financial sustainability. Having worked very hard to become debt free, Council established an Infrastructure Sinking Fund, which was set up to be (in lieu of debt) a source of funding for major capital works. This sinking fund has contributed over $280 million in the past 20 years to infrastructure provision and renewal.

The appropriateness of Blacktown City's approach in this regard was acknowledged by IPART in its assessment of our Special Rate Variation application for 2014/15.

- **Real Operating Expenditure per capita over time (a decrease in real operating expenditure per capita over time)**

Blacktown City meets this benchmark and does not object to it as one measure. However, for this single ratio to be taken as an indication of a council's 'efficiency', in isolation from its full financial and service delivery performance, is manifestly inadequate.

Better and more comprehensive industry measures of efficiency need to be established. In this regard, it is regrettable that the expected NSW Performance Measurement Framework (which was to have been published by OLG in 2014) has not been completed.

APPENDIX 2 – IMPACT OF DEPRECIATION ON FFTF FINANCIAL BENCHMARKS

The value of depreciation estimated by councils has a significant impact on the following 3 FFTF indicators:

- Operating performance ratio
- Building and asset renewal ratio
- Declining real operating expenditure per capita over time.

Problems with depreciation

- Can be artificially adjusted to provide a better result
- No industry standard on depreciation rates for different types of assets
- Not a true reflection of the consumption of the asset or level of required intervention
- Difficult to accurately align with Asset Management Plans.

There is no State-wide standard for the application of depreciation in NSW local government and consequently there is a general lack of consistency across the industry in how depreciation is measured. This makes these criteria difficult to rely on, especially for comparative purposes.

It is not suggested that all councils must have exactly the same depreciation rates, as the useful life of an asset is dependent on many things such as when and how an asset was constructed, its level of use etc. Accordingly, the useful life of each local road may be different having regard for local factors. There would be many other similar examples, the point is the FFTF benchmark analysis does not really take these individual characteristics into account.

Blacktown City context

Blacktown City Council is responsible for some $2.8 billion of public assets. This asset base has grown by $1 billion since 2001 (resulting in an increase in annual depreciation of approximately $18 million) and will continue to grow rapidly with the expansion of the City over the next 25 years.

These new assets don't require funding now, they will require renewal funding in the future. Council currently depreciates these assets on average over 58 years, it being noted that infrastructure assets comprise a number of sub-categories with depreciation varying according to the useful life of the asset.

Our current approach to depreciation is based on:

- Condition assessments
- Different rates of depreciation for different asset components
- Expected useful life of each asset component
- Estimated remaining useful life of each asset.

The useful life of all assets is based on the detailed analysis of Council's infrastructure assets. Not all other councils have applied the same rigour to projecting the useful lives of infrastructure assets.

Required depreciation adjustment for the FFTF benchmarks to be achieved

If Blacktown City was able to increase the average useful life of its assets by 20 years, our annual depreciation expense would be reduced by around $10 million. Even with this change to our depreciation methods, however, Blacktown City would still not meet the FFTF indicators.

A better measure would be to assess how well a council is funding its infrastructure asset renewal funding requirements on an annual basis. That is, as assets are due for renewal, how well are we actually matching the funding to the renewal requirements. Council has an asset renewal funding strategy, which is based on meeting the annual renewal funding requirements as projected through detailed asset management planning.

Since the TCorp review of local government finances in 2013, some councils would have been tempted to adjust their depreciation standards in order to improve their overall assessment on a number of financial indicators.

Blacktown City's depreciation rate is 1.733%, meaning our infrastructure assets are on average being fully depreciated over 58 years.

Blacktown City would need to reduce its depreciation by $27.5 million to achieve each of the FFTF indicators.

This means an average rate of depreciation of 1.05% annually or depreciating all of our assets over 95 years as opposed to our current average of 58 years.

Comparative information on Depreciation

The following table is a comparison of the different rates of depreciation used by a sample of councils for their depreciable infrastructure assets (roads, footpaths and drainage).

Table 1 – comparative information on depreciation

000's	Infrastructure (depreciable) Fair value	Depreciation expense	%	Average # Years to fully depreciate assets
Blacktown City Council	2,214,422	38,385	1.733%	57.69
The Hills Shire Council	1,240,816	12,055	0.972%	102.93
Penrith City Council	1,059,922	9,015	0.851%	117.57
City of Sydney	1,942,537	34,954	1.799%	55.57
Parramatta City Council	1,143,413	19,703	1.723%	58.03
Manly Council	299,188	3,044	1.017%	98.29
Lane Cove Council	254,729	3,358	1.318%	75.86
Average (excluding Blacktown)			**1.280%**	**78.12**
Recalculate Blacktown depreciation @ sample average	2,214,422	28,346	1.280%	**78.12**
Recalculate Blacktown depreciation @ 1%	2,214,422	22,144	1.000%	**100.00**

- Blacktown City's depreciation rate is 1.733%, meaning our infrastructure assets are on average being fully depreciated over 58 years
- The average rate for the other councils included in the table is 1.28% or 78 years
- If our infrastructure assets were depreciated at the same rate as the average of the sample group, our depreciation on these assets would be $10 million less
- This reduction still wouldn't be enough for us to achieve all the FFTF indicators.