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Local Government Board
The Future of Local Government Review
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Dear Local Government Board of Directors

The Future of Local Government Review

Stage 1 Feedback Submission – Dorset Council, Director Corporate Services

The below written submission will hone in on two key areas of *The Future of Local Government Review, Stage 1, (report dated June 2022),* as opposed to attempting to answer every consultation question in the report.

Section 2 – Role of Local Government in the 21st Century Tasmania

Question - Do you agree with the Role Statement? Does it make sense? Are there any gaps?

Observation – The role statement seems to put equal weighting to the three highlighted statements and the statements leave the scope of local government very open ended. With such a large scope it could be perceived that the board does not have clarity as to what problem they are trying to solve with the local government review? This wide scope has also negatively impacted the consultation feedback received during stage 1, whereby some of the answers by respondents suggest a lack of understanding of the current role of the various levels of government; being federal, state and local government. This raises the question – if the respondents were clear as to the role of local government in the context of what the federal and state governments currently are responsible for, would the themes of climate change, environment and human services been such a high priority in the report findings for local government? While the answer is unclear, the respondents certainly moved away from the core responsibility of local government as a custodian of assets and infrastructure (an asset manager), more towards fringe and peripheral future responsibilities. When one views each of the 29 municipal Statements of Financial Position, every municipal area's financials are dominated by infrastructure holdings.

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Solution – The role statement, and any consultation in stage 2, could be preceded by a clearly defined descriptor of the current role of the various levels of government. This could include a clear listing of non-negotiable services local government must provide, especially those services that the federal and state governments do not provide, now and into the future. This may result in better quality submissions? Unless the state government has an intent of taking over various asset classes of infrastructure from local government, then the core responsibility of local government must be to make trade off decisions in the allocation of capital towards infrastructure, assets and service delivery that represents agreed community requirements and needs. This will ensure that the core role of local government is preserved and the extremely wide scope of the local government review does not result in greater emphasis on peripheral tasks and responsibilities for local government. It is noted the themes of climate, environment and human services are clearly not peripheral at a state or federal level. The topics of climate change and health are very technical fields which are best dealt with at the policy level of government and centralised, as opposed to local government being seen as a catch-all for services that may be missing, or deficient, at regional levels.

Section 4 – Opportunities, Issues, and Challenges (Infrastructure focus only)

Question – Do you think the Future Visions capture what 'success' would look like if all our councils were working well? Is there anything you would add or remove?

Observation – The focus of this observation is on the Future Vision – Infrastructure Provision and Management. The Future Vision states local government will have *"…the sustainable financial capacity to plan, fund, and build required new infrastructure, while also managing their existing renewal and replacement obligations"*. While on the surface the meaning of the statement seems self-evident, the word 'sustainable' is problematic as to what that actually means for each Council from a service delivery perspective?

The Tasmanian Audit Office (TAO) AGR 2020-21 Volume 2 – Local Government Chapter report paints a very grim picture indeed, stating that only 10 councils had an asset sustainability ratio on average equal to or above 100% over the selected 4 year period. The interim review states that over a seven-year period (2014/15 to 2020/21) urban councils on average had a lower asset sustainability ratio than rural councils, despite having scale and the ability to charge higher rates.

The question then to ask is can the sector, in particular the urban councils, catch-up their renewal programs? With year-on-year 30 June 2022 indexation factors for all of Dorset Council's asset classes being 8% to 10.9% compared to a National CPI of 6.1% and the Tasmanian CPI at 6.5%, if anything, the renewal gap is further widening for local government in real terms. These are real cost increases that must be reflected in future renewal funding requirements that are not reflected in depreciation figures.

The interim report notes that from 2013 to 2020 Tasmanian councils had the lowest rate of depreciation of assets of all states, suggesting that the mix of assets is anticipated to last longer than the mix in other states. The report also observes that TAO made useful life recommendations for local government in 2013, as opposed to making it mandatory for councils to follow this guidance.

In the context of the word 'sustainable' as per the Future Vision statement there are 3 key observations:

1.) The general public at times have a view that 'bigger is better' as far as Council efficiency and that amalgamation of councils is the panacea to perceived inefficiency of councils. The paradox to this thinking is not supported by the numbers whereby urban councils with less kilometres of roads (the road asset class being the biggest dollar contributor for all Tasmanian council Statements of Financial Position) per capita when compared to rural councils, are not adequately covering their depreciation levels with their replacement/renewal of existing assets. This is despite urban councils having the ability to attain greater income through rates and charges as a result of scale attained through larger populations relative to their asset bases than rural councils have the ability to do.

2.) Asset sustainability ratios are a very rough guide, and clearly have to be viewed along with other ratios and financial information, and averaged over a longer timeframe than used in the interim report as renewal capital works would not exactly mirror depreciation levels over the short term. The statistics do however paint a picture of the majority of councils not covering depreciation levels for renewals, with urban councils being below rural councils from the latest available data. This is an alarming statistic. Depreciation is a real cost to council and the amount reflected in financial statements is directly linked to the value of council's asset base. Council's asset base is reflected at either historical cost or fair value / replacement cost ascertained during the most recent revaluation. The main point being that depreciation is a historical number that is an inadequate proxy for required future spend as it does not take into account the relevant indexation factor for future renewals. Therefore over time the asset renewal gap for local government is widening as each year passes as councils should at least be meeting depreciation levels and an appropriate indexation factor to reflect future price increases.

3.) An alternative conclusion in relation to Tasmanian councils having the lowest rates of depreciation of all states may point to the fact that Tasmanian councils are stretching out their asset management programs to fit their current income base and to meet various TAO ratio guidelines. It is unlikely that Tasmania has some special dynamics whereby assets last longer than mainland Australia counterparts. Dorset Council benchmarking of depreciation rates and asset useful lives utilised by Tasmanian councils suggest many councils are using asset useful lives longer than those prescribed by TAO as per "Report of the Auditor-General No.5 of 2013/14 – Infrastructure Financial Accounting in Local Government". This hides the true reality of the free operational cash flow required to fund future capital renewals. A council amalgamation could result in an increase in rates for ratepayers. An example of such an amalgamation scenario would be as follows:

i.) One of the councils reflects reality as far as future spend required for the renewal of their asset base.

ii.) The other council is stretching out useful lives and inadequately covering asset renewals.

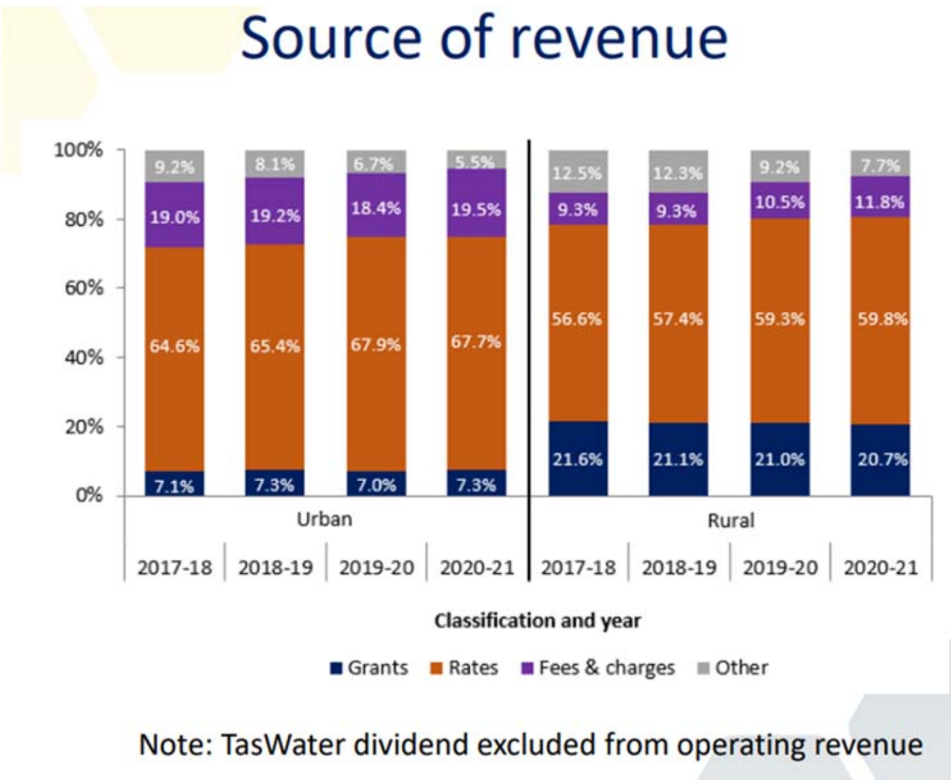
iii.) On amalgamation council should undertake a comprehensive revaluation of the new asset base utilising the suggested useful lives by TAO which reflect basic service levels required for infrastructure.

iv.) This scenario may show operational savings from synergies including labour savings, scale attained through better contractual arrangements etc. The operational savings would pale in comparison to the upward infrastructure revaluation. This is due to the material value of infrastructure assets on Council Statements of Financial position. This upward revaluation of assets would mean overall greater operational cash flow would be required ongoing to fund asset renewals which would actually lead to higher rates post amalgamation.

Solutions

1.) Any amalgamations could be grouped into like categories i.e. urban versus rural councils. Here there must be an understanding that urban councils have the ability to attain scale in rates income and Financial Assistant (FA) Grant funding must clearly reflect this fact by ensuring appropriately indexed FA Grant funding goes to rural councils. Also setting expectations with the public that rural councils will have a larger percentage of their income base funded by FA grants than urban councils and ensuring the general public understand why this is the case.

The TAO AGR 2020-21 Volume 2 – Local Government Chapter report clearly shows the current state of the larger grant funding as a percentage to total income for rural councils as per the below graph (any amalgamation of rural versus urban municipalities would create a larger gap than below):



2.) FA Grants must also reflect actual indexing relevant to council costs going forward. In recent years FA Grant funding has not kept up with actual cost increases faced by councils which puts more pressure on the rate base. FA Grants are aligned to CPI which is not a relevant indexation figure for an asset and infrastructure manager. While National and Tasmanian year-on-year CPI was 6.1% and 6.5% for 30 June 2022, Council's actual 30 June 2022 year-on-year indexation was 10.9% for buildings, 7.11% for roads, 8.46% for bridges and 9.06% for stormwater. On top of this Dorset Council has seen its FA Grant funding decline in real terms over the last 7 years, whereby if indexing was applied over that period, Council would be receiving almost $0.5 million more per annum in FA grant funding today.

Adequate asset renewal funding is at the core of financial sustainability for local government. Council Financial Management Strategies / Long Term Financial Plans / Long Term Asset Management Plans are key documents that are the starting point to ask more questions of councils. The key to council sustainability is not whether depreciation is covered, which should be the absolute minimum on average over a longer period, but on the actual future cost to renew those assets which logically must be at the very least the depreciation figure indexed upwards annually.

There may be examples where long life assets do not need renewal for many decades and understanding where each council is in their renewal cycles for each asset class. An example here is Dorset Council's stormwater asset sustainability ratio is at 39% over the next 10 years, however a majority of these long life assets do not require renewal spend until 2050. Therefore the stage 2 review of councils must also investigate whether any asset sustainability ratio shortfalls are actually accompanied by "banking" that depreciation shortfall plus an annual indexation factor in council surplus cash? This will ensure that future generations are not lumped with once in a generation type spend.

3.) To ensure like-for-like comparisons of Tasmanian council sustainability, TAO must enforce useful lives for assets to ensure consistent comparisons. TAO must also ensure councils are appropriately classifying assets into the relevant renewal / new / upgrade designations. Therefore the local government review board must ensure when reviewing council sustainability, consistent assumptions are utilised for forward estimates for all strategic documents, including long tern financial plans and long term strategic asset management plans, meaning:

i.) Greater emphasis is placed on councils past and future operational cash flows, as opposed to underlying surpluses, to limit accounting shenanigans with regards to the non-cash depreciation figures and thus the misrepresentation of funding requirements of existing assets by materially misstating depreciation costs, either intentionally or unintentionally; and

ii.) All long term infrastructure planning by the board utilises a standard per unit asset cost for rural and urban councils asset base to reflect a standard amount of funds required to deliver services and compare those against council long term financial plans e.g. utilising a standard cost for each road type and segment by square metre for roads. The State Grants Commission can assist with this information. Material variances of council actual costs when compared to standard costs can then lead to meaningful discussions, such as a council having a construction team that can build roads cheaper than contractors (Dorset Council is an example).

iii.) A Dorset Council Audit of Council Long Term Financial Plans found some councils index future cash flows, while others do not. Infrastructure expenditures have increased over and above National and Hobart CPI for the last two years. Therefore the review board may want to analyse council long term financial plans and ask questions of council to ensure current infrastructure replacement costs reflect current price increases? The board may also want to ask councils whether council long term financial plans appropriately index future cash flows? Ensuring up-to-date infrastructure replacement costs, and appropriately indexed future replacement costs, will paint a more accurate picture in regards to operational cash flows required to fund renewal of council assets and infrastructure. Consistent indexing could be utilised for urban and rural councils in long tem financial plans to ensure a consistent picture of financial sustainability is reached across councils. The ultimate aim here is to uncover whether council amalgamation will in fact lead to a more efficient and effective council, or whether rates may actually need to be increased to fund asset renewal gaps?

If you have any questions in regards to the above, please do not hesitate to contact the writer on 6352 6576.

Yours faithfully

John Marik
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Dorset Council