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Committee Secretary
Infrastructure, Planning and Natural Resources Committee
Parliament House
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Dear Sir

Submission to inquiry into the long-term financial sustainability of local governments

Thank you for providing Council with the opportunity to make a submission to the inquiry into the long-term financial sustainability of local governments.

Council's submission is structured in accordance with the key review areas identified.

Financial planning and long-term forecasting

Reductions in Revenues other than Rates and Charges
A significant issue for councils has been the reduction in funding sources they receive other than from rates and utility charges. This has occurred for a range of reasons but key reasons for Scenic Rim include the downturn in the economy in 2008 that affected a number of different revenue sources and the reduction of government grants, which is an issue for all councils and includes the freezing of financial assistance grants at current levels. Changes were also introduced by the Queensland Government to cap infrastructure charges during this time resulting in lower funding levels available to fund infrastructure associated with new development.

As a result, many of Council's revenue sources have remained at static levels or even reduced since it formed in 2008. Council estimates the current funding 'gap' created by this trend to be in the order of $3.3 million per annum. This places a burden on the level of funding required to be generated from rates and utility charges, which must be generated through effecting rate increases on the community.

Financial Sustainability Reviews
Despite the range of challenges faced, Scenic Rim Regional Council has reached a financially sustainable position. A key driver of this has been Council's effort to put financial sustainability at the forefront of decision making since 2008. This position has been strongly driven by the Executive and respective Councils during that time.

Upon formation in 2008, Council undertook an independent review of financial sustainability as part of the development of the 2009-10 budget and long term financial forecast. Council was provided with advice on the indicators and assumptions in the long term financial forecast to assist Council in setting its budget parameters.

This review demonstrated that, provided Council continued with the recommended budget parameters contained in the long term financial forecast, the financial sustainability indicator targets recommended by Queensland Treasury Corporation could be achieved from 2011-12 onwards and this has occurred.

Council has since undertaken regular financial sustainability reviews using independent specialists with the latest conducted in April 2016. This review found Council was on track to achieve long term financial sustainability and Council is consistently rated by the Queensland Audit Office as having a low risk of financial unsustainability in their annual report to State Parliament on the outcomes of local government audits.

Financial sustainability reviews have assisted Council in setting a path to achieve a financially sustainable outcome and continue to provide an independent check that Council remains on the right path. An important factor in Council's financial position today is that it set a plan in place several years ago and remained committed to that plan. It would be important for any council facing financial challenges to have a similar strategy recognising, of course, that a plan is not a solution where inherent funding shortages are evident. At the very least, however, the availability of a long term financial forecast covering ten years based on reasonable assumptions is necessary to understand what lies ahead in terms of financial challenges.

<u>Asset condition data and asset management plans</u>
Council's physical non-current assets have a total value of $820 million. Over 90% of Council's assets are referred to as infrastructure assets. These are assets with long useful lives whose value is measured at replacement cost.

The majority of Council's assets cannot be sold to generate funding as they are used to provide services or are public goods.

The challenge for Council is that these assets must be maintained at a certain level in order to provide a satisfactory level of service provision to the community. Council must allocate its scarce resources over the vast network of assets that it is responsible for in order to achieve this in all areas.

Council measures how well it is doing this by evaluating the asset management plan outcomes for each major asset class. Asset management plans can tell Council whether the level of resources allocated to assets is keeping them at the level required to achieve satisfactory service provision.

Where asset management plans produce unsatisfactory outcomes i.e. they identify significant funding gaps between what is needed and what is made available then Council must evaluate what options it has available to address the funding gap. This can include increasing revenues, changing the level of service provided, reprioritising available funding and, in some circumstances, providing additional funding through borrowings.

Recent natural disasters in the form of repeated flooding in the Scenic Rim region have increased this challenge. While funding has been made available through the Natural Disaster Relief & Recovery Arrangements (NDRRA) to fix the worst affected areas of Council's road network much of the remainder of the network has also experienced repeated inundation, which has resulted in overall deterioration of the road network. The effect on the network is still being measured and any detrimental impacts will be evident in future asset management plans prepared for roads.

The inability to source appropriate levels of funding for effective infrastructure renewal and replacement is one of the top two issues identified by local government in Queensland and is probably the most critical issue facing local government across Australia. It is generally acknowledged that assistance is unlikely to be received from the Queensland or Commonwealth Governments in addressing this challenge. Therefore, Council must have a focus on asset renewal and replacement and this should represent a higher priority than the creation of new assets where decisions regarding the scarce allocation of resources have to be made.

In addressing the asset management challenge, Council has formed an Asset Management Steering Committee. This Committee meets regularly and is comprised of the Council's Directors, Manager Works and Asset Management Coordinator. The establishment of this Committee has assisted with a broader understanding of the asset management challenge being understood across Council, the establishment of agreed priorities in relation to asset management improvement and a coordinated effort being implemented in relation to asset management.

Council is also starting to invest higher levels of funds into social infrastructure such as playground upgrades and town beautification projects. This can sometimes be at odds with one of the core asset management principles of renew and replace first. However, Council is in a region where significant opportunities exist to create jobs growth and if investment is not made in social infrastructure then it runs the risk of the region becoming a place that people commute to rather than want to live in. Council sees investment in social infrastructure as necessary to drive economic development through attracting people to live in the region. The availability of infrastructure grants to assist with such projects, such as Building our Regions and the Building Better Regions Fund are seen as significant opportunities for councils to access funding for projects that they otherwise may not be able to fund themselves.

Community engagement on future service levels

Public goods are assets and services that one individual can consume without reducing its availability to another individual and from which no one is excluded. The majority of Council’s services fall into the category of public goods including roads, bridges, footpaths, public parks and libraries. In addition, some services cannot be operated on a full user pays service because the resulting fees would be too high and people would not be able to afford them. Public facilities such as swimming pools and community services such as leisure and sporting programs are run on the basis that they are partly subsidised by rates and charges.

Council must raise rates from the community to cover the cost of public goods therefore rates are a tax similar to goods and services tax and income tax. However, this concept is not well understood by the community who still view rates as a ‘fee for service’ and not a tax.

This creates challenges for Council as the community has high expectations about what they should receive in return for paying rates and does not understand why Council must increase rates in order to provide increased funding for public goods each year.

Financial sustainability targets

Benchmarking

The LGAQ Better Benchmarking tool has been useful for Council but is sometimes difficult to use for comparison due to the impacts on financial reports of NDRRA flood restoration programs and the different methods councils use for delivering services i.e. whether services are contracted out or delivered in-house. However, it is continuing to evolve and improve and is considered a very useful tool.

Further development of this tool to incorporate other types of benchmarks that could assist with service level comparisons between councils would be extremely useful. While some information exists in relation to industry benchmarks it is not often easily obtainable or comparable.

Borrowings
It has been widely recognised that the local government sector has traditionally had low levels of borrowings. In recent years there have been some major changes in the level of borrowings that local government is responsible for and borrowing levels are greater than they have ever been. This is largely due to the change in perception around borrowings whereby traditionally borrowings have been viewed negatively by councils themselves and the general public.

A working paper prepared by John Comrie for the Australian Centre of Excellence for Local Government suggests that borrowings should be considered where there are significant asset renewal backlogs. The cost of using borrowings in such instances should be considered against the eventual cost of allowing assets to deteriorate without intervention and the likely impacts to the community and local economy by allowing this to occur.

The net financial liabilities ratio developed defined in the Financial Management (Sustainability) Guideline 2013 suggests a target of less than 60% per annum is acceptable; however, this is a one size fits all approach. Councils have to be mindful of issues such as what financial capital is needed to fund infrastructure for future growth forecasts and what impacts would be felt from unfavourable movements in interest rates before determining what is an appropriate level of borrowings.

Often the associated need to lift operating revenues to accommodate the repayment of borrowings is not well understood. Borrowings are not 'free money' and are merely a deferment of cash outflows to a later date with an interest penalty. The additional funding required usually needs to be sought from increases in rates unless expenditure can be reduced.

<u>Financial sustainability ratios</u>
Council consistently uses the relevant measures of financial sustainability as required by s.169(5) of the Act and would like to see these remain as the core ratios used across councils to enable benchmarking and comparisons to occur.

Council also uses the cash holdings ratio and debt service cover ratio to supplement these ratios and would eventually like to implement the asset renewal funding ratio, which is defined in the Financial Management (Sustainability) Guideline 2013 but not mandatory. The asset renewal funding ratio is seen as a better ratio to evaluate financial sustainability than the asset sustainability ratio as often there is little correlation between deprecation (used for the asset sustainability ratio) and funding requirements from asset management plans (used for the asset renewal funding ratio) due to the inclusion of funding required for the upgrade of existing assets usually evident in asset management plans.

<u>Procurement policy and value for money</u>

Procurement Efficiency
The legislation governing local government procurement has not been updated in several years and, as such, the dollar values associated with medium-sized and large-sized contractual arrangements specified in s.224(2) of the Local Government Regulation 2012 (the Regulation) is considered low in the context of Council's overall current spend.

As an example, Scenic Rim Regional Council's total operating and capital expenditure will be in the order of $45 million for the 2017-18 financial year excluding employee costs. The large-sized contractual arrangement value represents 0.4% of this expenditure.

In the context of Council's operations, a large-sized contractual arrangement value of $500,000 would represent around 1% of the relevant expenditure. This would allow Council to be more agile and operate more efficiently due to the longer timeframes associated with a public tender process as opposed to a quotation process. This is important particularly in the context that under s.224(4) the expected value of contractual arrangement with a supplier for a financial year, or over the proposed term of the contractual arrangement, is the total expected value of all of the local government's contracts with the supplier for goods and services of a similar type under the arrangement.

The medium-sized contractual arrangement threshold minimum of $15,000 is also considered low and consideration should be given to increasing this threshold minimum in line with a review of the large-sized contractual arrangement value.

Under s.224(8) the threshold for a valuable non-current asset is $5,000 for plant or equipment and $10,000 for another type of non-current asset. In the context of the requirement under s.227(1) to first invite written tenders or offer the non-current asset for sale by auction, the thresholds are not in line with what is considered a reasonable value to warrant the expense of undertaking a public tender or auction process. Increasing the thresholds for valuable non-current assets would assist with more efficient disposal processes to be undertaken and open up the availability of alternative disposal processes that would increase the return to Council from the disposal of low value items.

The requirements in the Regulation to advertise tenders in a newspaper are considered out of date in today's electronic world and considering that most councils use electronic tendering systems where suppliers can register and be immediately advised of tender opportunities. Advertising tenders in newspapers also adds unnecessary cost and time to the procurement process given the use of electronic tendering systems.

In the area of procurement exemptions, the types of exemptions outlined in s.231-233 are all very similar and could be accommodated under one exemption if the wording was streamlined.

Under s.235(a) and (b) exemptions exist where only one supplier may be available or the services sought are specialised and it would be impractical or disadvantageous for the council to invite quotes or tenders. However, both exemptions require obtaining a council resolution. This process is time consuming and results in numerous reports to Council to obtain approval for using a supplier for purchases for as little as $15,000. In comparable interstate local government legislation exemptions exist for supplies such as "a consultancy or other professional services". Having such an exemption that does not require a council resolution for any value in the Regulation would assist with improving the efficiency of Council's operations. An alternative would be to not require a council resolution for these exemptions for medium-sized contractual arrangements.

The requirement to publicly advertise contracts worth $200,000 or more on Council's website under Part 4 of the Regulation has made it easier for contractor details to be obtained and used as part of a scheme to attempt to get vendor bank details changed with the aim of councils unknowingly diverting contractor payments to fraudulent entities. These schemes have resulted in all changes to vendor masterfile details now required to be verified through secondary checks and authorised before they can be updated. This has added significant time to existing processes for staff. Removing the requirement to publicly advertise contractor details would assist with reducing the risk that councils now face from these schemes.

Value For Money
Value for money is one component of the sound contracting principles outlined under s.104 of the *Local Government Act 2009* (the Act) but is probably the guiding principle for most councils. For Council this has to be strongly considered in the context of development of competitive local business and industry. The region has many smaller suppliers and Council is one of the largest purchaser of goods and services in the region.

This consideration goes further than just deciding whether to buy widgets locally to support local business or to source them from a supplier outside the region because they are cheaper.

In 2017-18 Council will be undertaking a $43 million flood restoration program. Council could have outsourced this program to be project managed by a contractor but this would invariably result in a contractor outside of the region being appointed and Council's local suppliers would have limited opportunity to participate in the supply of goods and services to the program. Council has decided to bring the project management in-house by appointing additional staff on a temporary basis to ensure that local suppliers are not excluded from the opportunity to benefit from such a large program of work being undertaken in the region.

Councillors have strong views regarding local procurement. The concept of 'local' is not defined and to staff local often means a supplier within the local government area; however, to a councillor local may mean a smaller context such as the available suppliers within the town that the work is being undertaken in, particularly in regional areas. The visibility of council projects to local suppliers often results in criticism if goods or services are sought in other parts of the council area or outside of the region even if they may have been provided as part of a larger contract where the goods or services represent a small component. The way projects are delivered often has a larger impact on the ability for local suppliers to participate than mechanisms such as weightings for local suppliers because most of Council's local suppliers have limited capacity. For example, they may be able to supply the painting services but not services involving painting, building and landscaping.

For this reason, Council operates a number of preferred supplier panels to enable use of local suppliers that are in line with Councillor expectations whilst ensuring value for money and compliance with the procurement policy is maintained. These panels are reviewed regularly and are established under formal contracting arrangements to ensure Council's risk is managed and minimised.

<u>Other matters</u>

Cost Shifting from Other Levels of Government
From time to time the Commonwealth and Queensland Governments amend their responsibilities and this can result in the cost of those responsibilities shifting to other levels of government including local government. Often while the responsibility is shifted to another level of government no corresponding funding is provided. A recent example is the transfer of the responsibility for monitoring fruit bat activity from the Queensland Government to local government. Implementing activities to deter fruit bats away from urban living environments has resulted in significant increased costs to Council.

Increasing Costs of Compliance
Changes in legislation also result in increased costs of compliance . An example is recent changes to the requirements for traffic control plans and standards. These changes are estimated to cost Council an additional $350,000 per annum from 2017-18 onwards and Council has had to employ an additional staff member to manage this function. These types of increased costs also impact on community groups who close roads as part of their community activities with each road closure estimated to cost up to $5,000 per event where previously there was minimal cost involved.

Financial Assistance Grants
In the 2013-14 budget Council had grant funding of over $1 million reduced due to a reduction in the general purpose financial assistance grant allocation and the withdrawal or reduction of capital grants and subsides by the Queensland Government. This has meant Council has had to replace this funding either through alternative sources of revenues such as rates and charges or reductions in expenditure.

Council's analysis on the general purpose financial assistance grant allocation has identified that it receives far less per capita than similarly classed councils such as Lockyer Valley Regional Council and Somerset Regional Council. The higher level of funding received by other councils enables them to provide a higher level of subsidy per ratepayer. Council receives around half the level of funding of similarly sized councils. Council has pushed for a change in the grant allocation methodology to occur in order to address this inequity from the Queensland Local Government Grants Commission (QLGGC). Council believes that the current QLGGC methodology for the allocation of the general purpose component of the financial assistance grant leads to an inequitable distribution of these funds. The methodology is heavily weighted towards land valuations in order to assess rating capacity of individual councils.

The heavy reliance on land valuations as a measure of fiscal capacity is in contrast with findings from the Productivity Commission in its review of local government revenue raising capacity that "income is a more appropriate indicator of fiscal capacity of a local government than the rateable value of land".

If Council received a general purpose grant subsidy similar to that of similar sized councils it would see an increase in its general purpose grant. This would assist with alleviating pressure on rates and charges as a funding source and represent a fairer redistribution of this grant funding pool.

In 2014-15 the Commonwealth Government announced that it was freezing the level of financial assistance grant funding for a period of three years. This decision is estimated to reduce grant funding to Local Government by $925 million by 2017-18. For Council the impact was estimated to have resulted in the loss of funding of more than $4 million over the life of its ten year long term financial forecast. The announcement in the Federal budget that indexation to financial assistance grants will be restored is good news but Council continues to be impacted by the QLGGC's grant allocation methodology.

Local Government share of Australian Taxation Revenue
Vertical fiscal imbalance exists in relation to Australian taxation revenues where revenue collection at different levels of government does not match expenditure requirements. In 2011-12 the share of taxation revenue by sphere of government was broken down as follows:

- Federal 81.5%
- State 15.3%
- Local 3.4%

Local government only collects 3.4% of all government taxes but is responsible for 36% of non-financial assets held by all spheres of government.

Smaller councils with low population densities and large service areas bear the brunt of this impact and a more even spread of taxation revenue consistent with the share of assets held would greatly assist in addressing the issue of financial sustainability in local government.

Yours faithfully

Craig R Barke
CHIEF EXECUTIVE OFFICER