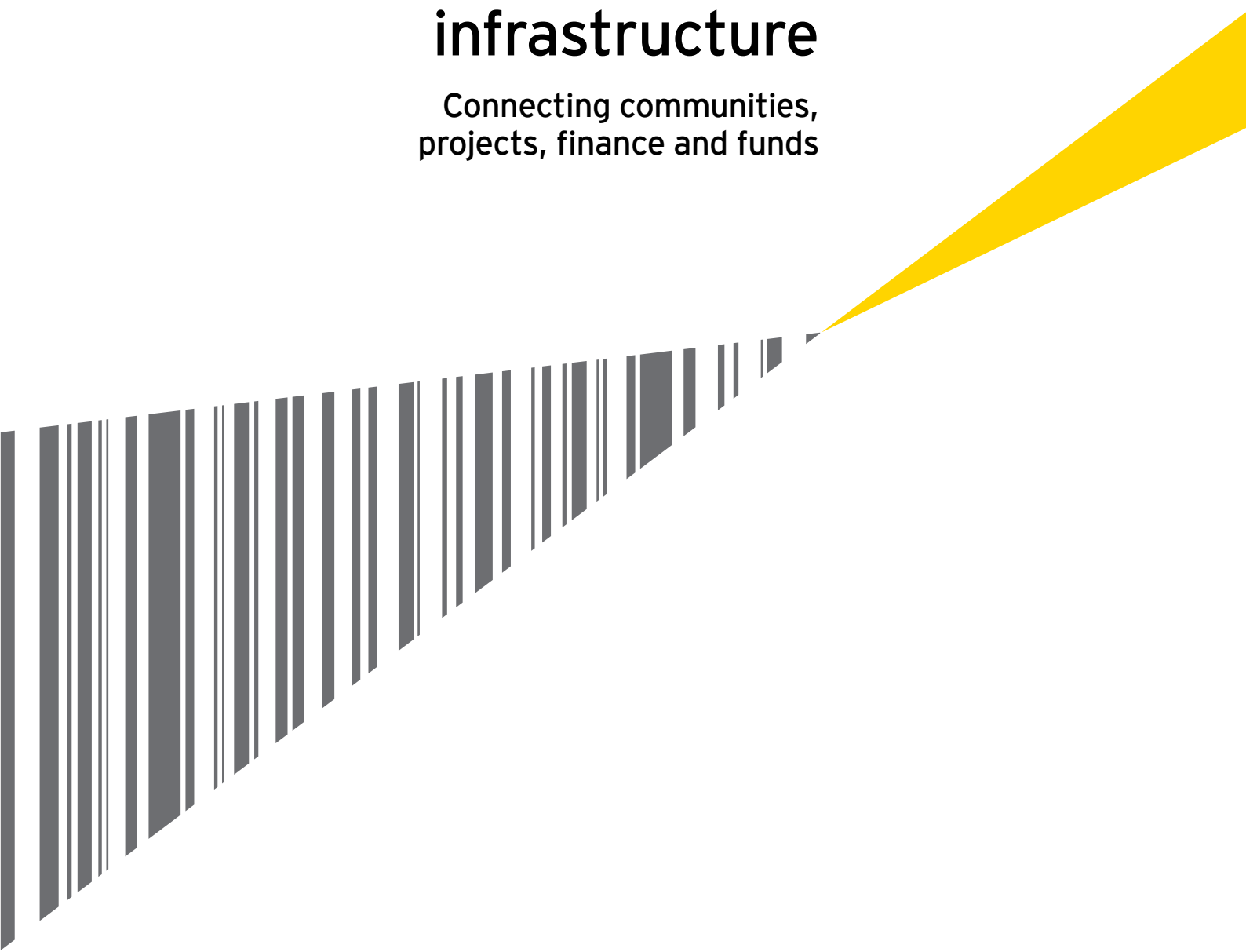


# Strong foundations for sustainable local infrastructure

Connecting communities,  
projects, finance and funds



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# Executive summary

## Australia needs greater investment in its local infrastructure

Australia's infrastructure requirements are well-documented. Inadequate investment in infrastructure leads to constrained economic activity, lower productivity and competitiveness, reduced amenity for users and declining social equity. Rather than conserving resources, low levels of investment in infrastructure impose substantial costs and ultimately Australia's economy and society lose out.

Local infrastructure is the backbone of our local communities. It provides access to welfare, education, transport, sport and recreation. It serves key environmental functions such as waste collection and disposal. Under-investment in this vital infrastructure has negative impacts on the economy, environment and social amenity.

Together, the Commonwealth, states, territories and councils are searching for ways to deliver this infrastructure. Local government is investing in infrastructure, but the rate is lagging behind the need.

There is no simple solution. What is clear is that Australia needs greater investment in its local infrastructure to create strong foundations upon which our communities can grow and prosper.

## Funding and financing infrastructure

Ultimately someone has to pay for infrastructure. Governments can either invest in infrastructure from their own revenues or impose direct charges on the users and beneficiaries of infrastructure. It really is that simple. Australians need to understand that we all need to pay for our infrastructure either from general taxes (including rates) or from direct user and beneficiary charges.

Unfortunately, the infrastructure debate is often distracted and tends to focus on finance and, in particular, the large pools of savings that Australians have accumulated in superannuation. Superannuation might play a part in financing infrastructure, but it cannot solve the funding problem.

It is important to understand the difference between funding and finance. Funding is how infrastructure is paid for. Finance describes the money that has to be raised upfront to deliver the infrastructure, and it needs to be repaid. The central issue constraining greater private sector financing of infrastructure in Australia is the lack of available funding, and not access to capital. Infrastructure must be paid for irrespective of how it gets financed.

## Local government infrastructure

This study looks at how Australian councils plan, finance and deliver local infrastructure. Wholesale reform of governance and the existing funding of local government is beyond the scope of this study. Our focus is on ways in which councils can get more infrastructure from existing funding sources.

Our extensive consultations identified challenges and barriers facing the sector. Our analysis led us to make 13 recommendations for reform. Our recommendations are complementary and require co-operation across all three levels of government.

Some of our findings are not new. They are grounded in the very status of local government within the structural hierarchy of Australian governments. Others reflect councils' ever-changing roles and responsibilities driven by both "top-down" changes, such as structural and funding reform, and "bottom-up" pressures created by shifting demographics and growing community demands.

These changes create increasing demands on local government infrastructure. Unfortunately, increased demand is not always matched by increased income to pay for it. The main challenge for the sector is how to meet its infrastructure obligations without just relying upon increased funding from the states, territories and Australian Government.

## Summary of the recommendations

Local government must continue on its path towards financial sustainability. This means integrating effective and efficient investment processes into “business as usual”. It includes clear engagement with the community about the balance to be struck between a council’s core role and the affordability of new investments in infrastructure and services. It means an honest conversation with the local community about choosing between competing priorities and raising the funds from the community to pay for infrastructure.

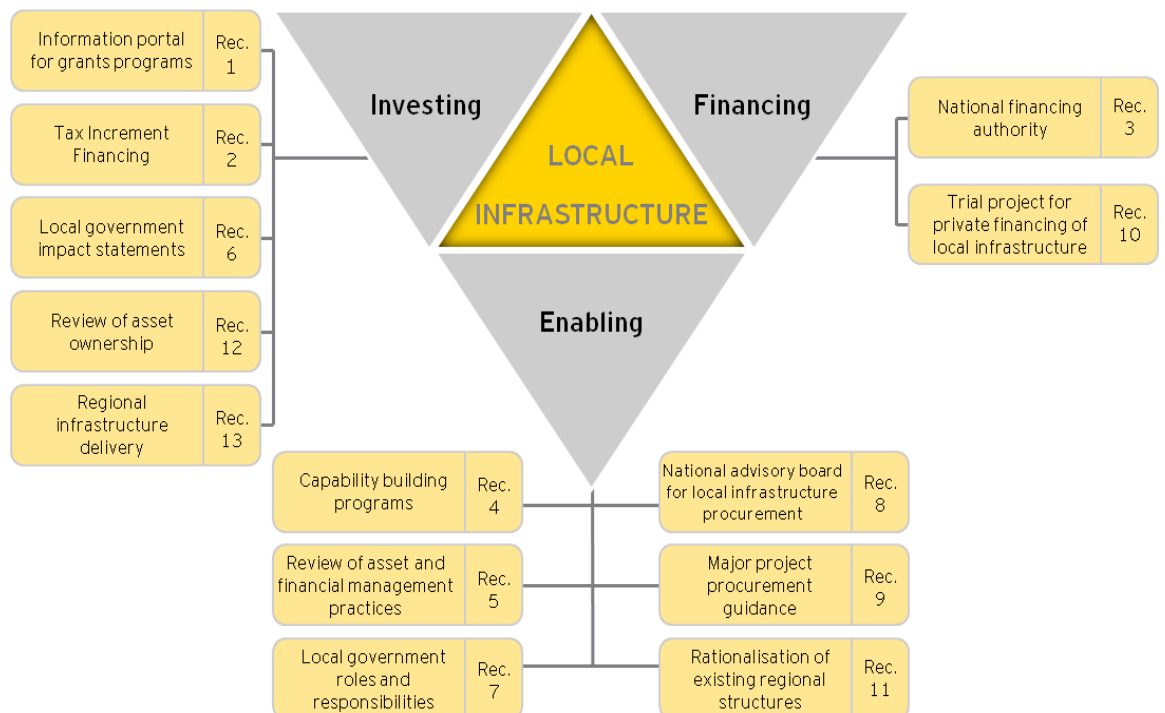
Local government must make best use of available funding. This does not only mean optimising income from rates and fees. It requires innovative procurement models, coordination at a regional level, alternative ownership structures for network assets and responsible borrowing.

Our recommendations are intended to provide practical guidance to achieve best practice infrastructure delivery. While councils can do a lot themselves, our recommendations also require some action by the Commonwealth, states and territories. For example, the key to opening up local infrastructure to institutional finance lies in using the apparatus of higher tiers of government to create the scale of borrowing that can bring risk-sensitive investors to the table. Institutional investors currently have little appetite for financing local infrastructure projects. This is generally because of the absence of projects of sufficient scale and no pipeline of projects to speak of. There is also a lack of confidence in councils having the skills and capabilities to efficiently deliver complex infrastructure.

The Australian Government, alongside state and territory governments, has far greater capabilities than local government. It can create the crucial links between the financial markets which have the capacity and capability, but not the confidence, to invest, and councils, which have the pressing need for capital, but not the means to access it.

Our recommendations fall into three broad themes:

- Recommendations to enable councils to leverage existing funding sources for **investment** in new infrastructure
- Recommendations to improve councils’ access to cost effective **finance**
- **Enabling** recommendations to improve councils’ ability to identify and develop infrastructure and gain access to specialist skills necessary to deliver innovative financing solutions.



## Principal recommendations

Each of our recommendations will require further investigation, consultation and refinement by all tiers of government. They are not the finished product, but a step in the right direction towards creating strong foundations for sustainable local infrastructure.

We propose four principal recommendations.

Our headline recommendation for the Australian Government is that it investigates establishing a **national financing authority** for local government (Recommendation 3). Building upon models which are successful overseas, the proposed financing authority would have a mandate to invest directly in local government programs by providing competitive and low-risk finance, and to facilitate inward investment. The authority would have the ability to bundle approved council borrowings into a limited number of bond issues, which could be underwritten by the Australian Government.

Infrastructure bonds are often seen as a solution for the widening infrastructure deficit. Their full potential might only be realised by concessional tax arrangements for investors, and indirect funding of projects through tax concessions goes beyond the scope of this study. The Australian Government would need to carefully consider such mechanisms as part of its broader policies on tax reform. Taxation as a way of creating profitable projects that would otherwise not go ahead risks displacing the finance markets and can lead to unintended consequences. Grant funding is much more transparent, less complex and easier to manage. However, should the Australian Government decide to develop infrastructure bonds then a national financing authority could provide the necessary governance structures and oversight to mitigate some of the risks.

While the authority would attract institutional investment into the sector, there is also a role for the Australian Government in facilitating private finance for specific projects. Local government infrastructure is often small scale and struggles to attract private finance because the returns do not justify the effort needed to deliver them. If the Australian Government committed to designing an appropriate commercial structure that is attractive to private finance, then its roll-out across the local government sector could create a market of small viable projects.

The Australian Government should therefore investigate a **demonstration project for which a financial product can be developed** and marketed to private investors (Recommendation 10). The waste-to-energy sector might be a candidate area, and the irrigation projects in Tasmania provide a useful precedent. The involvement of the Australian Government, state and territory governments in the scheme would likely be viewed positively by the market, especially if any amendments to legislation were required to make it commercially viable. A further benefit would be the development of a “pipeline” that justifies the upfront investment.

Thirdly, the Australian Government has a role in helping the local government sector create sustainable revenue streams that provide a direct link between those who benefit from new investments and those who pay for them. It should work with other jurisdictions to identify the legislative changes needed to introduce **Tax Increment Financing (TIF)** (Recommendation 2). TIF would allow councils to collect additional revenue (funding) from increases in the value of properties benefitting from new infrastructure, which can be used to support the raising of upfront finance to pay for the infrastructure. Some councils already partner with private developers to create additional funding streams by jointly developing real estate adjacent to new infrastructure to offset the costs. TIF would give councils an additional way to generate revenue from existing property owners who will benefit from new infrastructure.

We also propose that councils review their infrastructure portfolios to **identify and test the rationale for continued ownership** (Recommendation 12). Recycling assets is an effective way to generate income that can be re-invested into new infrastructure. The assets sold can also benefit from additional investment from the private sector that councils may not have the means to provide.

## Supporting Recommendations

Our analysis of council planning and prioritisation processes suggests that current capacity varies widely and there is a clear need to **sustain federal and state support** (Recommendation 4) and to implement periodic **reviews of asset and financial management practices** (Recommendation 5). To address the problems created by role ambiguity and insufficient engagement between tiers of government, we propose **local government impact statements** at the business case stage (Recommendation 6). We also urge all tiers to build on the intent of the Inter-Governmental Agreement 2006 by outlining clear steps to achieving better **clarity of their respective roles and responsibilities** (Recommendation 7).

The information and skills gap in procurement practices are addressed through the creation of a **national advisory body** (Recommendation 8) and the development of **major project procurement guidance** (Recommendation 9). Without investigating the full spectrum of infrastructure procurement options available, the ability of the local government sector to accelerate new investment will continue to be constrained by limited access to finance.

We also suggest that the Australian Government develop a **portal to bring together information and application material relating to local government grants** (Recommendation 1), as a response to concerns raised about the complexity of the current administration of grants programs. The portal (or application) could build upon the GrantsLINK website which has been set up by the Australian Government to help individuals, businesses and communities identify Commonwealth grants and assistance.

Finally, to harness the benefits of scale, we encourage the Australian Government to work with other jurisdictions to create formal **regional structures with responsibility for delivering and financing infrastructure investments** (Recommendation 13). Regional cooperation has driven positive outcomes, and could be improved if regional entities had the ability to move beyond advocacy and support towards the ownership, delivery and financing of infrastructure. The **rationalisation of the different regional frameworks** which currently exist in parallel (Recommendation 11) is also likely to reduce duplication and result in better coordination.

## Summary of findings and recommendations

### An overview of local infrastructure

- ▶ Although the experience varies according to location and community demands, Australian councils generally have responsibility for a homogenous stock of assets, including roads, land and buildings.
- ▶ The value of local infrastructure has grown at a steady pace over the last decade. However, most councils invest a relatively small amount per annum in infrastructure and this has implications for the development of in-house capability and skills.
- ▶ The infrastructure development and maintenance task is dominated by local roads networks. Non-road projects can be substantial but at the individual asset level tend to be once-off rather than regularly procured.

### Funding sources and their limitations

- ▶ There are core sources of revenue which all Australian councils are able to access. These include rates and taxes, sales of goods and services, and government grants. The relative contribution of the different income streams varies considerably from council to council.
- ▶ While there is some scope for the local government sector to increase its core sources of revenue, there are also a number of limitations which prevent individual councils from doing so.
- ▶ In the absence of extensive reform of the overall funding structure for local government, the sector needs to ensure it is best placed to make the most of the funds it currently receives. Furthermore, councils need to look towards innovative funding, procurement and financing solutions without which their ability to accelerate new investment in infrastructure will continue to be limited.

#### **Recommendation 1: Information portal for grants programs**

The Australian Government should develop a portal to bring together information and application material relating to local government grants programs in a single location.

### Borrowing for infrastructure investment

- ▶ There is significant capacity within the local government sector to optimise its level of borrowing. However, this is currently held back by the “fear of debt” and the absence of a structured local government debt product suitable for institutional investors.
- ▶ Centralised financing, where available on a state basis, currently provides the benefit of low finance costs and a government guarantee. Centralising financing on a national level would not only enhance these benefits, but is also likely to be an essential prerequisite for the creation of financial products to channel institutional investment into local government infrastructure.
- ▶ There is a role for the Australian Government in working with the states and territories to investigate the feasibility of establishing a national financing authority for local government to bridge the gap between institutional investors and Australian councils.
- ▶ Furthermore, the Australian Government can provide assistance in creating sustainable revenue streams which form a direct link between those who benefit from new investments and those who pay for them. Tax Increment Financing, whereby councils leverage future rates revenues to borrow for infrastructure investment, represents one such revenue stream.

#### **Recommendation 2: Tax Increment Financing**

The Australian Government should work with the states and territories to investigate the legislative changes that would be required to enable councils to introduce Tax Increment Financing.

### **Recommendation 3: National financing authority**

The Australian Government should work with the states and territories to investigate the feasibility of establishing a national financing authority to aggregate local government borrowing and facilitate the creation of debt products for private investors.

### **Prioritising local infrastructure investments**

- ▶ The Nationally Consistent Frameworks for local government asset and financial management - and associated programs such as the Local Government Reform Fund - have succeeded in creating momentum for improvement and a good return on the investment in capability building. However, current capacity varies widely and there is a clear need to sustain support.
- ▶ Role definition is a problem and can create cost pressures for local government and strains on the relationship between tiers of government.
- ▶ There is insufficient engagement with local government during the early stages of significant projects or policy initiatives undertaken by federal, state and territory departments and agencies. This creates an added level of complexity for local government prioritisation and planning processes.

### **Recommendation 4: Capability building programs**

Programs of targeted training and capability building in asset and financial management should be extended.

### **Recommendation 5: Review of asset and financial management practices**

Asset and financial management reform initiatives should be supplemented by periodic independent reviews of the implementation of the Nationally Consistent Frameworks.

### **Recommendation 6: Local government impact statements**

Federal, state and territory governments should commit to completing local government impact statements as part of the business cases prepared to support new policy proposals and projects, where there is likely to be a direct cost impact upon local government.

### **Recommendation 7: Local government roles and responsibilities**

All tiers of government should commit to building on the intent of the Inter-Governmental Agreement 2006 by outlining clear steps to achieving better clarity of the roles and responsibilities of each tier of government. In particular:

- a. State, territory and local governments should cooperatively review the asset registers of local governments to ensure that, for each asset class, the boundaries of responsibility are unambiguous and that an appropriate and transparent process to transfer responsibility between governments is in place.
- b. As part of its community engagement, local government should present its forecast long-term capacity to fund the role it is proposing, with specific reference to the capacity to sustain defined levels of service for existing and proposed assets, services and projects.

### **Creating value through the procurement process**

- ▶ Despite some tentative moves by local government to explore procurement models involving private finance or risk allocation, the sector has not given enough consideration to methods of procurement outside the traditional approach.
- ▶ Without investigating the full spectrum of infrastructure procurement options available, the ability of the local government sector to accelerate new investment will continue to be constrained by limited access to capital.

- ▶ Councils should consider achieving procurement efficiencies through alternative delivery models, in particular those that involve a degree of project and financing risk transfer to private sector partners. There is currently an information gap in this area.
- ▶ The lack of engagement by private investors in local government infrastructure projects is driven primarily by the absence of projects of sufficient scale within the sector. Other barriers include the lack of a clear pipeline, the absence of commercial returns and/or tradeable products for investors, and concerns around the local government sector's internal capability.
- ▶ The Australian Government has a role in generating private finance for specific projects by supporting a trial project with the aim of developing a replicable market and a pipeline of future projects.

#### **Recommendation 8: National advisory body for local infrastructure procurement**

The Australian Government should work with the states and territories to establish a national body to provide skills and oversight of local government infrastructure. Its role would include capability building and the development of policy, guidelines and other assistance.

#### **Recommendation 9: Major project procurement guidance**

Major project procurement guidance should be developed and issued to local government to promote awareness of the spectrum of alternative procurement models for infrastructure delivery.

#### **Recommendation 10: Trial project for private investment in local infrastructure**

The Australian Government should identify an opportunity for a suitable local or regional infrastructure project whereby a market can be "created", and establish a collaborative group of stakeholders to take the project forward. A "waste to energy" project may be a good candidate.

### **Regional capacity and attraction**

- ▶ The benefits of regional planning and prioritisation have long been recognised by all tiers of government, which is reflected in the large number of regional alliances and collaborations which exist today. The benefits include the prevention of duplication, better interface management and inter-government coordination.
- ▶ Improvements to the consistency and coordination of the existing regional frameworks will help regions achieve their full potential.
- ▶ Better alignment of regional structures, including voluntary alliances, could improve buy-in by member councils. In particular, this could result in a smoother application process for grants, where grant funding is available on a regional basis.
- ▶ In order to make the most of the potential of regional infrastructure planning, all tiers of government need to work together to align the different regional frameworks which currently exist in parallel. The Australian Government should collaborate with state, territory and local governments to review the most appropriate way to achieve this.

#### **Recommendation 11: Rationalisation of existing regional structures**

All tiers of government should work together to rationalise and align the regional structures which currently exist.

### **Alternative ownership structures for community assets**

- ▶ Certain local government assets may be better suited to alternative ownership structures, including corporatisation or privatisation. Not only can this provide revenue for local government, but transferring the management of assets to corporate entities can provide access to new skills, asset and risk management processes, and independent strategic planning.
- ▶ The benefits of regional planning and prioritisation could be far greater if regional structures had the ability to move beyond advocacy and support towards ownership of assets, and the delivery and financing of infrastructure investments.

- The benefits of regional delivery are likely to be greatest where they relate to network assets such as local roads. The regionalisation of local roads would make it possible to introduce competitive tendering for regional capital and maintenance programs, whereby multiple assets are bundled under a single outsourced contract.

#### **Recommendation 12: Review of asset ownership**

Local government bodies should review their infrastructure portfolios with a focus on identifying and testing the rationale for continued ownership.

#### **Recommendation 13: Regional infrastructure delivery**

The Australian Government should work with the states and territories to develop incentives that can be given to councils to create formal regional structures with responsibility for delivering and financing infrastructure investments relating to specific asset classes, with a particular emphasis on local roads.



Introduction

# Introduction

The environment in which local government delivers and manages infrastructure has evolved significantly in the last twenty years. This evolution has been characterised by major structural reform in every state but one, shifting patterns of funding, and a range of challenges created by demographic change and growing community expectations.

As both a cause and consequence of its changing role in society, it seems that the local government sector in Australia is almost permanently under the microscope.

Major reports commissioned at a national level in the last decade include the Hawker Report of 2003, the *National Financial Sustainability Study* of 2006, and the Productivity Commission report on revenue raising capacity of 2008. There have been significant studies of local government at a state level too, such as the Allan Report of 2006 in New South Wales and sustainability reports in most other states, not to mention an infinite body of work focussing on particular geographical areas or council activities, and of course the self-assessment processes undertaken by councils themselves.

This study inevitably owes much to this preceding body of work. It also owes a great deal to the individuals and organisations who have contributed to a concentrated yet comprehensive consultation process which has included councils, regional organisations, local government associations, state and territory governments, the Australian Government, peak industry bodies, academics and the private sector.

Engaging with local government stakeholders across Australia has brought back to the fore a number of issues which have been raised in the past. Indeed, many of the challenges which councillors and council staff identify today are conspicuously similar to those faced by their predecessors - local government funding, cost shifting, procurement efficiency, integrated planning and skills retention are just some examples. These are important issues which have a real impact upon the way councils deliver for their communities, and a frank assessment is needed of why the reforms of the past have not always delivered on their objectives.

On top of these “old” issues are a host of new ones which illustrate how conditions have changed in recent years.

One of these is the impact of a suite of initiatives implemented by state and territory governments and the Commonwealth, which have altered the conditions in which councils go about their business. These include structural reform, new funding programs, a stronger focus on a more regional approach to infrastructure investment, and new requirements around integrated and long-term planning.

Complementing these initiatives has been a concerted and creditable effort on behalf of councils themselves to improve their financial management, asset management and prioritisation processes. Whilst serious capacity shortages continue to exist in some areas, especially the more geographically remote councils, there are a growing number of examples of best practice implementation and innovative procurement.

However, alongside these encouraging developments are a range of challenges which continue to make it extremely hard for councils to meet their obligations to the community. First among these is that more and more is being taken on by the sector, both on its own accord or passed down from other tiers of government. As a result, the infrastructure obligations of most councils continue to grow.

Secondly, the reality of today’s fiscal environment means that it would not be prudent for local government simply to assume an ever-increasing level of funding from other tiers of government in the future.

In this context, the main challenge faced by the local government sector today is how to meet its infrastructure obligations without the ability to rely upon increased funding from states, territories and the Commonwealth.

How to address this challenge is the subject of this study. The recommendations contained within it are designed to provide a way forward for the sector to make the most of the tools and levers it already has, while at the same time to be open-minded to new ways of doing things.

Chapter 1 provides context through an overview of the nature and value of the infrastructure stock held by Australian councils. Chapter 2 identifies the sources of revenue available to councils to fund their infrastructure requirements, including an assessment of their limitations. Chapter 3 addresses the specific question of debt finance, and includes the recommendation to investigate the establishment of a national financing authority. Chapter 4 analyses how councils prioritise and plan their investments, and Chapter 5 addresses the knowledge gap that exists in relation to the range of procurement options available to the sector. Chapter 6 summarises the current regional frameworks in which councils operate and suggests that these could be rationalised and aligned. Finally, Chapter 7 looks at the case for examining alternative ownership models for community assets, in particular private ownership and regional models.

While this report aims to remain focussed on infrastructure finance, the issues are of course inextricably linked to wider questions around the broader funding framework and indeed the roles and responsibilities of councils as a tier of government. While these broader issues are touched upon, this is done so only where they impact upon local government's ability to deliver infrastructure efficiently and cost effectively.

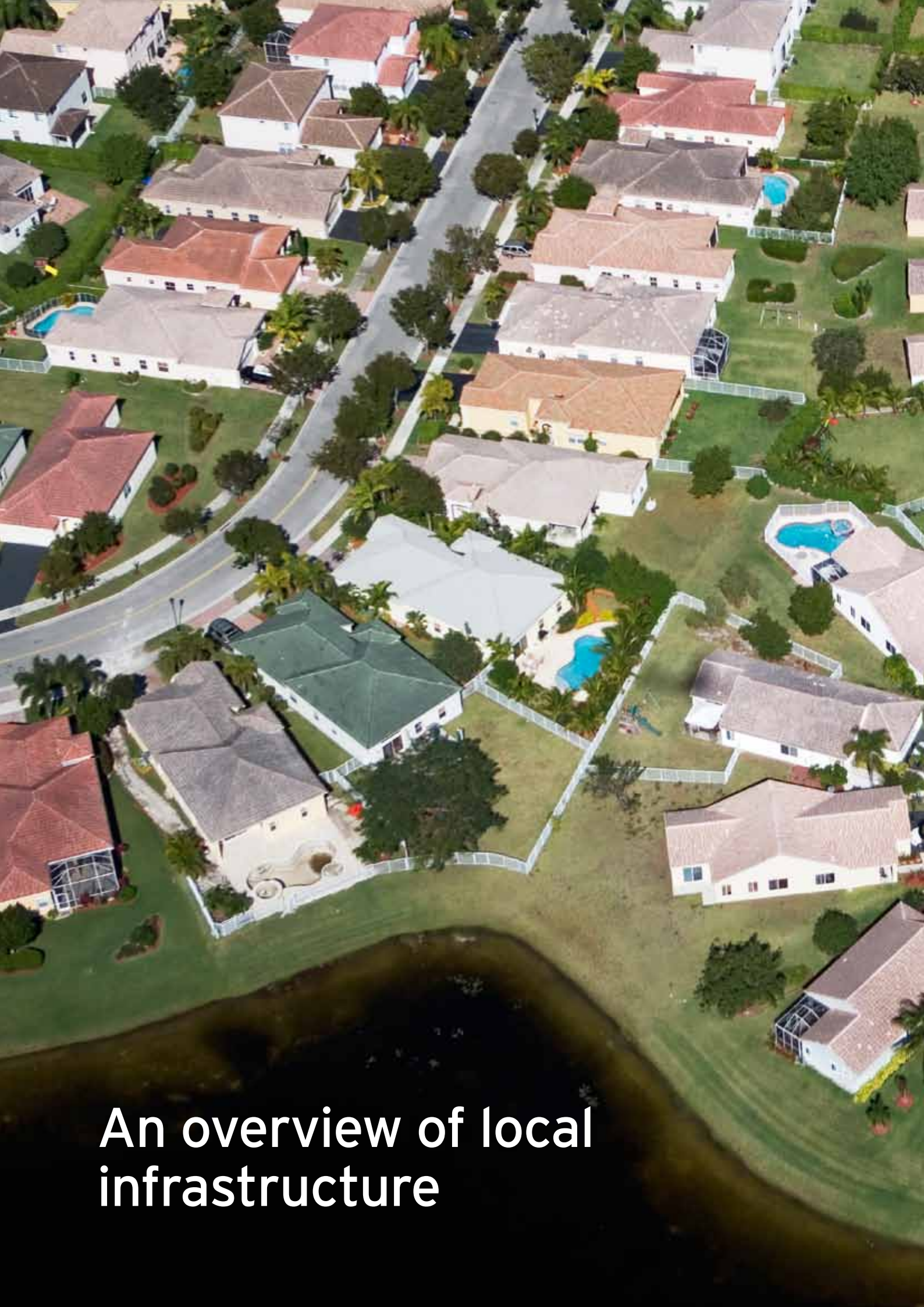
The findings and recommendations of this report must also be framed in the obvious yet important maxim that one size will never fit all. The infrastructure challenges faced by the "super" councils in South East Queensland will not be the same as those faced by other large cities such as Perth which has 30 councils. And they will certainly not be the same as those faced by the urban growth areas, the regional towns, or the huge rural councils across the Northern Territory, Queensland, South Australia and Western Australia, in which tiny populations occupy vast swathes of land and the infrastructure needs are very different.

Furthermore, councils in different states and territories operate in very different legislative environments which define and shape their ability to provide infrastructure. Rate-pegging, guaranteed borrowing, infrastructure charges regimes, ownership of water assets and specific funding programmes are just some examples of the ways in which states differ from each other.

The conclusions and recommendations in this report must therefore be viewed under the disclaimer that the relative ability of councils to adopt change will differ. We also recognise that the levers of change are controlled by a number of different parties. There are some things that individual councils need to do themselves. There are some things which require intervention at a state or territory level, and some that will require Commonwealth support. Most will require the different tiers of government to work with each other, and with regional organisations and the private sector.

What is also required is a cultural and behavioural change. To ensure the effectiveness of the recommendations put forward in this report, councillors and council officials need to be realistic about the challenge facing them, and honest about the assets they do and can control. They need to be open-minded to borrowing money where appropriate, and to recycling capital through asset disposals where required. They need to look at the cross-border alliances in which they operate, and assist the Commonwealth in putting in place a truly effective regional framework which can be given the tools it needs to deliver real benefits.

Finally, this study and its recommendations are designed to be exploratory. Each recommendation will require further investigation, consultation and refinement. Some of the concepts will be challenging, and bold decisions would need to precede any combination of these recommendations taking shape.



An overview of local infrastructure

# 1. An overview of local infrastructure

## Key findings

- ▶ Although the experience varies according to location and community demands, Australian councils generally have responsibility for a homogenous stock of assets, including roads, land and buildings.
- ▶ The value of local infrastructure has grown at a steady pace over the last decade. However, most councils invest a relatively small amount per annum in infrastructure and this has implications for the development of in-house capability and skills.
- ▶ The infrastructure development and maintenance task is dominated by local roads networks. Non-road projects can be substantial but at the individual asset level tend to be once-off rather than regularly procured.

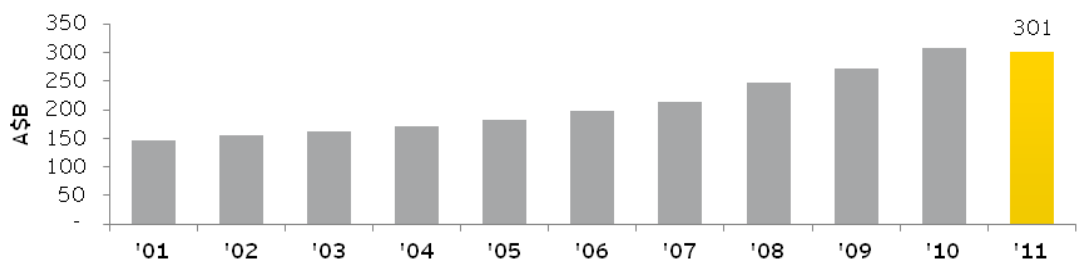
Infrastructure refers to physical assets which provide a level of amenity or service to users. The characteristics of assets can vary substantially depending on their purpose and function, technical specifications and commercial attributes. Infrastructure assets typically have a long useful life, though lifespan varies by asset.

In Australia, all three tiers of government share responsibility for the stock of publicly provided infrastructure. Local government is required to maintain a minimum quantity and quality of infrastructure to fulfil its respective legislative mandate to local communities. Infrastructure enables services to be produced and consumed in the community by residents, workers and visitors.

All infrastructure assets have an inherent servicing requirement, which typically includes periodic and reactive maintenance, renewal or refurbishment. Fulfilling the servicing requirement is essential for preserving the value of infrastructure, maximising its economic and social benefits, and minimising the associated whole-of-life costs.

Local government is responsible for a stock of assets valued at \$301bn by the Australian Bureau of Statistics (ABS).<sup>1</sup> Figure 1 shows the growth in value of local infrastructure over the last decade. The value of the stock has grown at a rate of 7.4% per annum over this period. Growth in value derives from capital investment and asset revaluation.

Figure 1: Local government non-financial assets, 2001 - 2011<sup>2</sup>

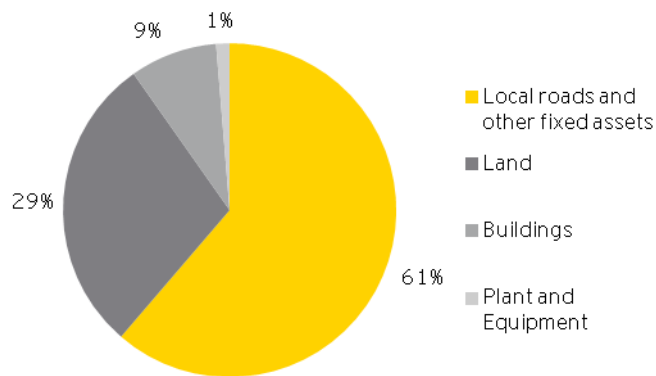


The categories of infrastructure assets provided by local government are largely homogenous. However, there are notable differences which are ultimately driven by the location of individual councils and the varying needs of their communities. Figure 2 shows the split of local government assets by category, as reported by the ABS.

<sup>1</sup> Australian Bureau of Statistics, 5512.0

<sup>2</sup> *ibid.*

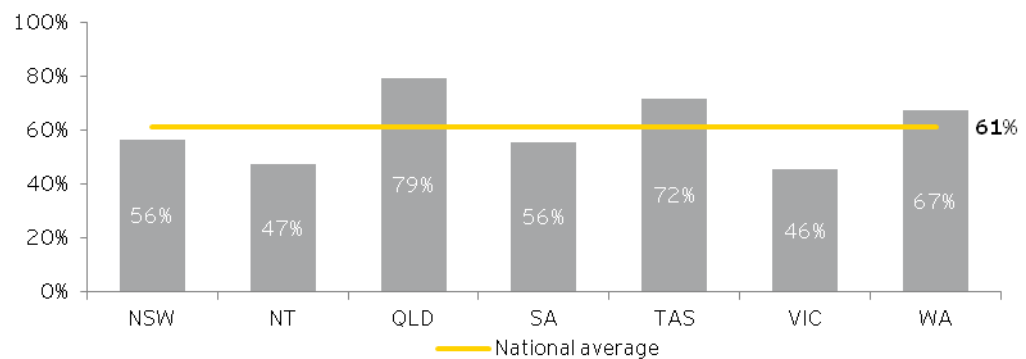
Figure 2: Local government non-financial assets, 2011<sup>3</sup>



The characteristics of the stock of local infrastructure provide important context for the analysis and recommendations provided in this report. For example:

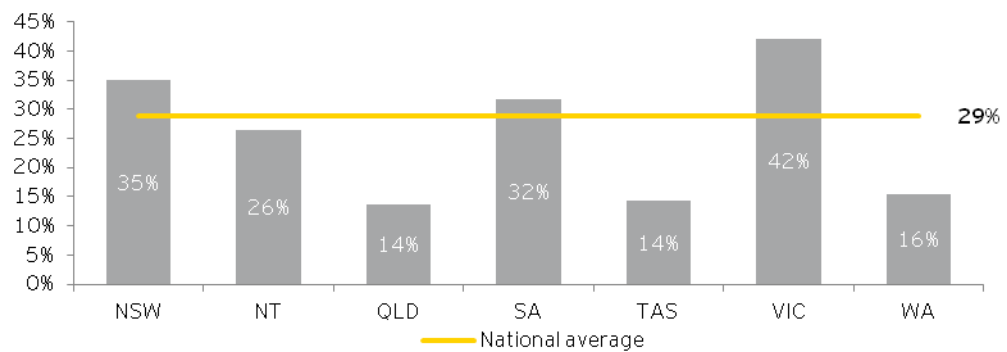
- ▶ Local road networks represent more than half of the national stock by value. For councils in regional or remote areas, road networks can represent more than 70% of the total stock (Figure 3).

Figure 3: Roads as a proportion of local government non-financial assets, 2010<sup>4</sup>



- ▶ Local government has large holdings of land, equivalent to approximately 29% of the total national stock (Figure 4).

Figure 4: Land as a proportion of local government non-financial assets, 2010<sup>5</sup>



<sup>3</sup> *ibid.*

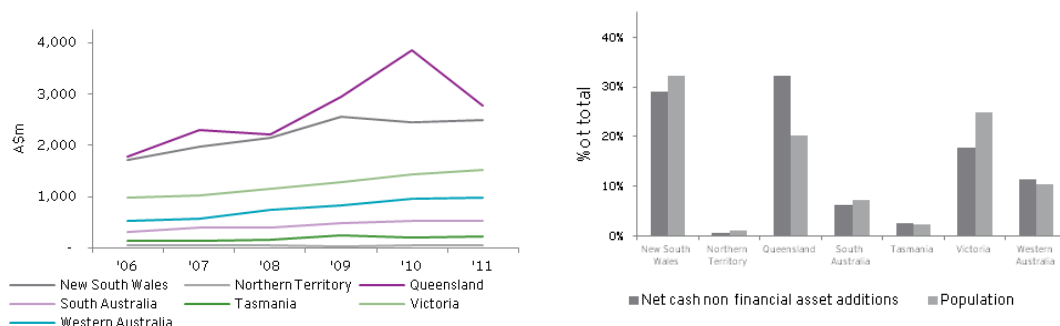
<sup>4</sup> Australian Centre of Excellence for Local Government, *Local Government Fact Sheet 3: Local Roads, Buildings and Land*, January 2012

<sup>5</sup> *ibid.*

- Civic and recreational buildings, and water assets in Queensland and parts of New South Wales, are the only other significant asset type by value.

Capital expenditure by local government in 2010 was \$9.5bn.<sup>6</sup> Adjusting for population, this spend is skewed away from those states with higher populations and higher population densities, primarily New South Wales and Victoria. Per capita spend on local infrastructure is highest in Queensland (Figure 5).

Figure 5: Net addition of non-financial assets by state/ territory<sup>7</sup>



Two important conclusions emerge from this analysis:

- The infrastructure development and maintenance task for local government is dominated by local roads networks. Non-road projects can be substantial but at the individual asset level tend to be once-off rather than regularly procured. This has implications for planning, asset management and procurement.
- Capital expenditure by most local governments is relatively low. While a simple average of national expenditure is \$17m per local government area, this figure over-estimates expenditure in most areas, because of the existence of a large number of councils with populations considerably below the average. For example, in 2010 the seven capital city councils accounted for 15% of all asset purchases despite being 7% of the national population and only 1% of councils.<sup>8</sup> By contrast, average capital expenditure in 2010 by the Small Shires in Victoria, which is a group of 22 local government areas, was \$6.8m.<sup>9</sup>

Overall, most councils invest a relatively small amount per annum in infrastructure and this has implications for the development of in-house capability and skills consistent with best practice procurement.

<sup>6</sup> Australian Bureau of Statistics, 5512.0

<sup>7</sup> *ibid.*

<sup>8</sup> *ibid.*

<sup>9</sup> Municipal Association of Victoria, *STEP Program Initiative*, Buloke Shire Council, October 2011

# Funding sources and their limitations



## 2. Funding sources and their limitations

### Key findings

- ▶ There are core sources of revenue which all Australian councils are able to access. These include rates and taxes, sales of goods and services, and government grants. The relative contribution of the different income streams varies considerably from council to council.
- ▶ While there is some scope for the local government sector to increase its core sources of revenue, there are also a number of limitations which prevent individual councils from doing so.
- ▶ In the absence of extensive reform of the overall funding structure for local government, the sector needs to ensure it is best placed to make the most of the funds it currently receives. Furthermore, councils need to look towards innovative funding, procurement and financing solutions without which their ability to accelerate new investment in infrastructure will continue to be limited.

### Recommendations

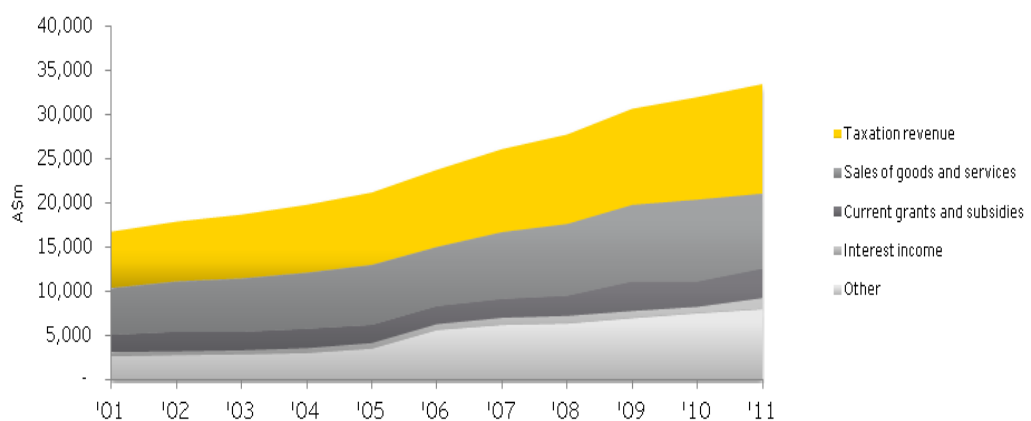
#### Recommendation 1: Information portal for grants programs

The Australian Government should develop a portal to bring together information and application material relating to local government grants programs in a single location.

Councils receive revenue from three main sources: rates and taxes, sales of goods and services (including development applications and approvals, and other fees and charges), and government grants. The former two are generally known as “own-source” revenue streams.

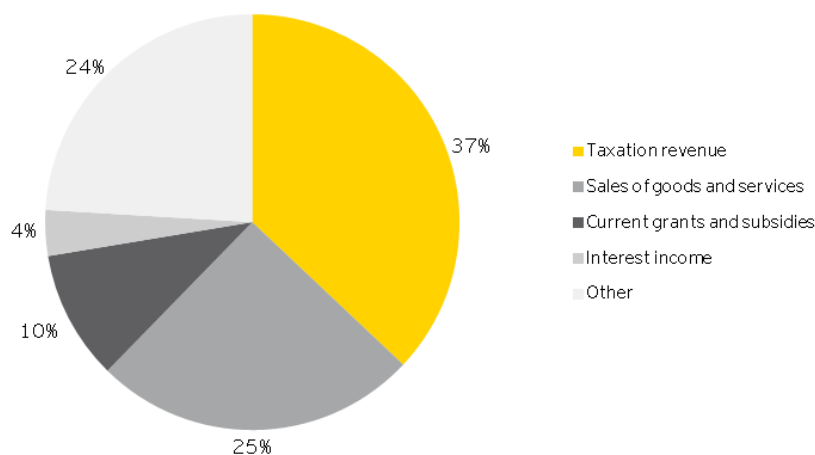
These revenues are used to meet the costs of providing services and infrastructure for the community, and of running internal functions.

Figure 6: Local government revenue sources, 2001 - 2011 <sup>10</sup>



<sup>10</sup> Australian Bureau of Statistics, 5512.0

Figure 7: Local government revenue sources, 2010-11 <sup>11</sup>



Figures 6 and 7 show the nationwide breakdown of revenue sources, but as with all trends in local government, the relative contributions of the different sources of income are heavily influenced by the underlying diversity within the sector.

There is clear statistical evidence of the correlation between the population of a local government area and the amount of own-source revenue that the council raises.<sup>12</sup> Unsurprisingly, the “more urban” the council, the greater its ability to raise money from own-source income streams such as taxation (rates) and the sale of goods and services. Equally, it has long been recognised that rural and remote councils have very little capacity to raise their own revenue and are heavily dependent upon grants.<sup>13</sup>

The study carried out in 2008 by the Productivity Commission concluded that although a number of remote and rural councils are likely to remain dependent upon grants, “most councils could do more to help themselves”.<sup>14</sup> Notwithstanding the extreme diversity across Australia, the capacity of each council to raise more funds is crucial to its ability to deliver its infrastructure priorities.

This section examines the adequacy of own-source revenue sources such as rates and the sale of goods and services (including fees and charges) in the context of funding local infrastructure. It also looks at the extent to which councils can make the best use of grant funding, and the barriers they face in doing so. Finally, it considers a further source of funding which is not always captured in conventional statistical analysis, namely where there are direct contributions by third parties towards the delivery of particular assets.

## Rates

Rates are a tax levied by the local government sector upon residential and commercial property.

In common with total revenues, ABS data shows that – in all states – the local government sector’s income from rates has risen steadily in the last decade (Figure 8).

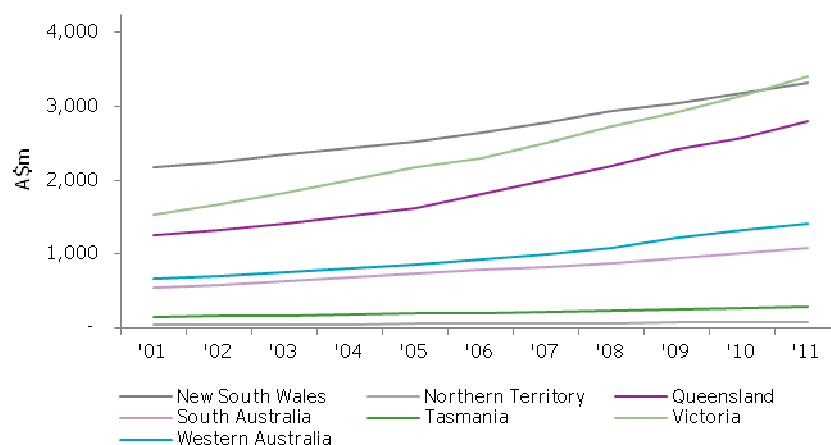
<sup>11</sup> *Ibid.*

<sup>12</sup> Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, April 2008

<sup>13</sup> Whelan, M & Whelan, R, *Local Government Financial Sustainability Focus on Small Rural Councils*, May 2010, and Australian Centre of Excellence for Local Government, *Role and Expectations of Rural-Remote and Indigenous Local Government*, February 2012

<sup>14</sup> Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, April 2008

Figure 8: Rates revenues, 2001 - 2011<sup>15</sup>



The relative contribution of rates income to local government revenue diverges greatly from council to council. While the City of Darwin, for example, collects approximately 60% of its revenue from rates, the contribution of rates in the rural-remote shires of the Northern Territory is on average 3.4%.<sup>16</sup>

The vast spectrum of experience is a reflection of the correlation between a council's income and its "rates base". The difficulties in collecting rates experienced by councils with small rates bases (for example those in remote areas or those with significant fly-in-fly-out populations) has recently led to considerable debate around the appropriateness of a property-based tax in a time when the services provided by local government go far beyond those related to property.<sup>17</sup>

Yet rates income remains the main source of own-source revenue for the sector. Hence maximising rates receipts can play a crucial role in raising funds for infrastructure investment.

Although there are significant restrictions in New South Wales, in other parts of the country councils have a relatively high degree of control over the level of income from rates, in that they are able to increase or decrease the rate of application and method of calculation, and to alter the valuation of properties and application of some exemptions.

More than any other tax, the level of rates is determined not by "ability to pay" but "willingness to pay". Putting rates up has obvious political repercussions. However, there is also a view within the sector that the community would contribute more in rates, provided they saw a recognisable improvement to local amenities and services. For example:

- ▶ The South Australian Government has noted that "there will always be a proportion of the resident population that will be unwilling to pay for goods and services, but if the reasons and purposes these funds are being raised are well known, and can be seen to be beneficial to the well-being and benefit of the community it is possible this resistance can be lessened."<sup>18</sup>
- ▶ A suburban council in Victoria recently introduced a 2.5% levy on rates (on top of the standard CPI increase) specifically to fund capital works and capital maintenance to address its asset renewal needs. Council is of the view that the level of public support for the levy was increased through strongly articulating the benefits that would flow to the community from the investment. This demonstrates an encouraging trend within local government towards greater ongoing community consultation.

However, despite this apparent capacity to leverage more rates income, there is evidence to show that councils are generally not taking full advantage of the opportunity.

<sup>15</sup> Australian Bureau of Statistics, 5512.0

<sup>16</sup> City of Darwin, *Annual Report 2010/11*, and Australian Centre of Excellence for Local Government, *Role and Expectations of Rural-Remote and Indigenous Local Government*, February 2012

<sup>17</sup> Local Government Managers Australia, *Local Government Revenue Raising Capacity: Submission to Productivity Commission Study*, August 2007

<sup>18</sup> Government of South Australia, *Submission to the Productivity Commission Issues Paper: Assessing Local Government Revenue Raising Capacity*, August 2007

Although rates receipts have increased in absolute terms over recent years, the Productivity Commission found that the ratio of rates revenue to GDP has actually been decreasing since 1990: between 1990-91 and 2005-06, the ratio of local government taxation (rates) revenue to GDP decreased from 1.03% to 0.92%. Over the same period, combined Australian and state government taxation revenue as a ratio to GDP increased. The Productivity Commission concluded that councils have considerable capacity to make better use of rates as a means of raising income.<sup>19</sup>

Behind this trend lie significant barriers which prevent the local government sector from making best use of the community's capacity and willingness to pay. These include:

- ▶ A reluctance on the part of elected representatives to increase the taxation burden on the community
- ▶ Legislative limitations in certain states and territories, in particular
  - ▶ s. 506 of the New South Wales *Local Government Act 1993*, under which the Minister for Local Government sets a limit on the percentage increase in total general income that councils can raise from rates (although councils can apply for Ministerial approval to exceed the rate-peg percentage)
  - ▶ Restrictions in the Northern Territory and Western Australia upon collecting rates from certain activities such as mining and pastoral lands
  - ▶ Restrictions in most states and territories upon collecting rates from land owned by the Crown, land used for religious or educational purposes, aged care facilities, charitable or benevolent institutions, public parks, land used for conservation and nature recreation, and Aboriginal land (other than land used for residential or commercial purposes).<sup>20</sup>
- ▶ A disconnect in some areas between the number of permanent rate-paying residents and the population benefitting from infrastructure and services, for example in areas which have significant "fly-in-fly-out" workforces.

## Sales of goods and services

The second category of own-source income is sales of goods and services. This includes payments for the issue of licenses and permits, development contributions, and user charges applied for water and sewerage services, parking, airports, community services, libraries, recreation centres, and other community facilities.

Once again, the diversity of councils across the country means that there is considerable divergence in the relative ability of councils to leverage this source of revenue.

For example, some councils are able to collect significant revenues from commercial activities:

- ▶ The City of Perth earned 37% of its revenues (\$56.5m) in 2010-11 from car parking charges and is the third largest car park operator in Australia, operating approximately 15,000 bays.<sup>21</sup>
- ▶ The Shire of Roebourne earned \$23m in 2011 from transport charges, predominantly consisting of fees for the use of Karratha Airport, which saw passenger flows of over 812,000 during the year.<sup>22</sup>

However, these are atypical examples, and involve commercial models which would be very difficult to replicate in the majority of local government areas in Australia.

While the Karratha Airport generates a huge amount of patronage from mining activity in the Pilbara region, for example, airports in other remote areas which are not rich in resources serve a community purpose only and can often be loss-making for local government. Indeed, the shortage of income-

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<sup>19</sup> Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, April 2008

<sup>20</sup> To meet the competitive neutrality requirements of the National Competition Policy principles, government trading enterprises are normally required to make tax-equivalent payments to state or territory governments. However, these payments are often not passed onto the local governments themselves. *ibid.*

<sup>21</sup> City of Perth, *Annual Report 2010-11*

<sup>22</sup> Shire of Roebourne, *Annual Report 2010-11*

generating assets is the main reason why councils are unable to make more money from fees and charges.

A secondary factor is the impact of legislative and regulatory constraints which restrict the ability of councils to raise revenue from the sale of certain goods and services.

The consultation revealed different attitudes to these constraints. On the one hand, legislation in most states and territories which specifies that fees and charges cannot exceed cost recovery levels is an entirely appropriate mechanism to prevent “profiteering”. On the other hand, the capping of development charges (also known as developer contributions or infrastructure charges) in New South Wales and Queensland, for example, is viewed by some to have a profound impact upon local government’s role in revenue raising and indeed economic development.

Figure 9: Development charges and an alternative model

### Development charges

Development charges are imposed by councils upon private development activity. They are generally met upfront by property developers when planning permission is granted and are subsequently recovered through the sale of serviced land lots.

The justification for development charges is that local government is able to recoup the cost of providing infrastructure supporting new development by passing on the costs to property purchasers. The Henry Tax Review stated that “infrastructure charges can be an effective way of encouraging the efficient provision of infrastructure to areas where it is of greatest value and of improving housing supply.”<sup>23</sup>

Even where there is significant development activity, there are barriers which prevent councils earning more from development charges:

- The imposition of development charges needs to be balanced with the ability and appetite of the property market to absorb the costs. An individual council needs to weigh up the trade off between raising revenue and deterring development – an objective of attracting inward investment will often exert downward pressure upon the rate at which development charges are set.
- There are statutory caps on the level of development charges in some states. Charges are capped at \$30,000 per dwelling in New South Wales, and at \$20,000 for a one or two bedroom dwelling and \$28,000 for a three bedroom dwelling in Queensland.

### An alternative model: Ripley Valley, Greater Flagstone and Yarrabilba UDAs

Ripley Valley, Greater Flagstone and Yarrabilba have been identified by the Queensland Government as Urban Development Areas (UDAs), where priority development will be targeted to facilitate the establishment of major new satellite communities. They provide an example of how to optimise self-source revenue for infrastructure development.

The Urban Land Development Authority (ULDA) has developed a funding framework designed to ensure that the relative contributions of the state, local government and developers towards new infrastructure in the UDAs are equitable and reasonable.

The ULDA has determined that new development will contribute to the infrastructure through:

1. A **local infrastructure charge**, payable at the time of plan sealing, to fund the provision of directly attributable infrastructure including the provision of sewer, water supply, transport and community infrastructure
2. A **value capture charge**, where the development of the UDA results in significant increases in “as of right” uses for land owners or brings forward the ability for land to be developed for residential purposes
3. An annual charge by way of a **special rate** applied to all properties in the UDAs to be collected by the council and disbursed as agreed with Treasury

<sup>23</sup> Commonwealth of Australia, *Australia's Future Tax System: Report to the Treasurer*, December 2009

## Grants

While councils' rates bases allow them to tax local communities and levy user fees and other charges, the income generated from these own-source revenue raising activities is rarely adequate to meet the infrastructure task, and nearly always requires "topping up".

In this context, the mismatch between the relative amount of taxation revenue collected by local government and its responsibilities to provide services and infrastructure to the community means that it is entirely appropriate for a portion of taxation revenues to be passed down to councils by the Australian, state and territory governments.

All councils therefore receive transfers from other tiers of government in some form, and they make up an especially high portion of overall revenue in areas where the limitations on raising own-source revenue are greatest.

Intergovernmental transfers are channelled through a variety of grants programs, including:

- ▶ Commonwealth **Financial Assistance Grants** (FAGs) are a long-standing mechanism for providing grant funding to local government. The grants are untied, giving councils the flexibility to spend them how they see fit. FAGs consist of:
  - ▶ A general purpose component which is distributed between the states and territories according to population
  - ▶ An identified local road component which is distributed between the states and territories according to fixed historical shares.

Local government grants commissions in each state and the Northern Territory recommend the distribution of the grants to local governing bodies in accordance with federal guidelines. The guidelines stipulate that grants are to be allocated to councils, as far as practicable, on a full horizontal equalisation basis, meaning that each council is able to function, by reasonable effort, at a standard not lower than the average standard of other councils in the state/territory.<sup>24</sup>

- ▶ Commonwealth **Specific Purpose Payments** (SPPs) are Australian Government funding programs provided to local government for particular activities, and are often subject to conditions on expenditure and reporting requirements. The largest SPP program is the Roads to Recovery program which provides funds direct to councils to support their own expenditure on local roads.
- ▶ The Commonwealth **Regional Development Australia Fund** (RDAF) provides funding for regional infrastructure with the objective of enhancing the economic development and liveability of communities.
- ▶ The **Natural Disaster Relief and Recovery Arrangements** (NDRRA) are grants provided jointly by the Australian, state and territory governments to local government areas affected by natural disasters for the restoration of public assets.
- ▶ Numerous **state and territory programs** which provide funds to local government for a variety of outcomes. Examples in Victoria include the Local Government Infrastructure Program, the Putting Locals First program, the Energy for the Regions program, the Green Light Plan, the Community Green Funds Grants program, the Home and Community Care (HACC) program, in addition to grants for sport and recreation facilities, kindergartens, libraries, roads and bridges, and public safety infrastructure.

But although the majority of councils in Australia are dependent to some extent upon grants income to fund their activities, there are also a number of issues which can prevent grants income being put to best use. These include:

- ▶ The necessity to channel a number of Commonwealth programs through state and territory governments is perceived to add an unnecessary level of bureaucracy to the distribution of

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<sup>24</sup> The 2011-12 federal budget contains a commitment from the government to review the equity and efficiency of the FAGs program. The review is expected to be completed in 2013.

grants. It is widely believed that the **direct funding** of local government by the Commonwealth would create efficiencies and back-office savings.<sup>25</sup>

- ▶ The large number of **disparate funding programs** can cause confusion for councils (especially smaller ones), and it is sometimes hard to know “where to look” for grants.
- ▶ Government funding programs are often administered by the relevant agency, and are not centralised. Typically, the eligibility and reporting requirements differ across programs and across administering agencies. While the rationale for this structure is generally understood, concerns were expressed during the consultation around the **administrative complexity and costs** it creates.

The consultation suggested there would therefore be merit in investigating a centralised portal to store information about the suite of grants programs for which councils are able to apply. The portal (or application) could build upon the GrantsLINK website which has been set up by the Australian Government to help individuals, businesses and communities identify Commonwealth grants and assistance.

#### **Recommendation 1: Information portal for grants programs**

The Australian Government should develop a portal to bring together information and application material relating to local government grants programs in a single location.

- ▶ As project-specific grant funding tends to be discretionary or targeted to particular circumstances, there is no **certainty** regarding its availability to each council, even though grant programs are often designed to meet identified needs in particular areas, such as libraries or roads maintenance. Grants programs are also usually time-limited. Funds under the Roads to Recovery program, for example, are guaranteed until 2018-19, while other programs such as the Regional and Local Community Infrastructure Fund and RDAF are time limited, specific programs. Given the importance of grant funding to regional and rural councils, this lack of certainty complicates the project development process:
  - ▶ The absence of long-term certainty makes it difficult for the local government sector to budget for grants income effectively, as assumptions need to be made about the probability, level and timing of receipts.
  - ▶ This has an impact upon the selection of project priorities – some projects are unaffordable without grants, in spite of their priority, and conversely, some projects are pursued ahead of others due to the availability of grant funding.
  - ▶ Where grants are made available for infrastructure projects which are “shovel ready” only, councils may invest significant amounts in pre-construction work without the guarantee of funding.
- ▶ There is a perception within the sector that when specific grants are received for capital programs, insufficient supplementary funding is provided for the **ongoing operation, maintenance and renewal** of the assets. Councils can spend untied funding, such as the FAGs, on priorities determined for the year, which can include both capital programs and routine maintenance and renewals.
- ▶ There has long been a view within sections of the local government sector that financial difficulties are caused in part by unfunded **cost shifting** by other tiers of government, and that the quantum of grants does not sufficiently cover the additional financial obligations which can arise from this practice.
- ▶ There is always likely to be a feeling within the local government sector that the **overall quantum of grants funding** it receives is inadequate. Equally, individual councils or groups of councils will always argue for a larger share of the funding pool to meet their specific priorities.
- ▶ The grants based approach fails to create incentives that encourage councils to seek **private sector investment**.

<sup>25</sup> The direct funding of local government is largely perceived to be the primary advantage of giving local government constitutional status. The issue of constitutional recognition is currently under review by the Commonwealth, including options put forward by the Expert Panel on Constitutional Recognition of Local Government in its December 2011 report on the matter.

Individual councils can of course try to maximise their grant revenue by submitting applications for the maximum number of programs, by ensuring they are compliant for each program's financial sustainability and planning requirements, and by lobbying other tiers of government. Ultimately, however, their biggest obstacle lies in the reality that they do not control the programs and will remain dependent upon the policies and actions of state and territory governments and the Commonwealth.

## Private contributions to local infrastructure

A further source of funding which is not always captured in conventional statistical analysis is the direct financial contribution made by third parties towards the delivery of particular assets.

Joint property development models typically involve partnering between councils and private developers to create funding streams to offset the costs of providing infrastructure. This model allows councils to capture value through the development of adjacent real estate by diverting some of the profits from the real estate into community infrastructure funding.

The most common example of joint property development models is where councils make use of the planning process (outside of development charges regimes) to collaborate with developers in the delivery of infrastructure. The "carrot" of planning approval can often be a powerful instrument to persuade private developers to either build or to provide funding towards new infrastructure. It is often associated with rail projects and was used in the development of Melbourne Central and Chatswood in Sydney where major residential and retail precincts were used to fund stations. Outside of major rail projects, examples include:

- ▶ The **City of Melbourne** has entered into a commercial agreement with the Mackie Group for a residential development which includes affordable housing and community facilities such as a library, maternal and child health and family services facilities, and an urban park.
- ▶ The developer of a new business park in Sydney constructed 6 new indoor basketball courts which were subsequently handed over to and operated by **Willoughby City Council**.
- ▶ **Strathbogie Shire Council** successfully negotiated for the upgrade of Creightons Creek Road to be funded by the developer of a thoroughbred training facility which would gain significant benefit from the investment.
- ▶ **Darwin City Council** is currently in negotiations with private developers to own and operate car parking bays in new private residential developments in the CBD.

While contributions of this type can be a useful tool for local government to bring forward infrastructure investment, they rely upon successful negotiation with developers and indeed upon an adequate appetite for private development within a local government area. Furthermore, where the asset is passed to local government after construction, there needs to be an adequate understanding of the operational and maintenance costs that will be borne by local government in the future.

Councils are encouraged to further consider the viability of joint property development models where land values and demographic trends exist that can support them. Later in this report, an extension of this model known as Tax Incremental Financing (TIF) is considered and recommended as a potential source of additional funding for infrastructure development.

## Addressing the "funding gap"

The infrastructure task facing the local government sector is growing. And yet the evidence suggests that councils are struggling to increase their "core" sources of funding fast enough, making it extremely difficult to meet the required investment needs.

Councillors and council officials will always lobby on behalf of their communities for additional funding from other tiers of government, and there is on-going debate around what would be an "equitable" share of the overall tax take.<sup>26</sup> However, in the absence of extensive reform to the overall funding structure, local government needs to ensure it is best placed to make the most of the funds it currently receives.

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<sup>26</sup> The Australian Local Government Association contends that the fair share quantum should increase from its current FAGs level of 0.80 per cent to 1 per cent of total Commonwealth taxation revenue, excluding GST.

In order to do this, councils first must be certain that they can correctly identify the scale of the infrastructure task and hence the capital requirement and the funding gap. To do this they must make sure that they have a firm grasp of the needs of the community and the condition of existing infrastructure. This requires robust plans and policies and an avoidance of duplication across councils, and across all tiers of government.

Furthermore, councils need to look towards innovative solutions without which their ability to accelerate new investment in infrastructure will continue to be limited.

To meet this need, councils should consider:

- ▶ Raising additional capital from alternative sources, and in particular making greater use of responsible debt financing
- ▶ Improving the processes by which they prioritise infrastructure investments
- ▶ Achieving procurement efficiencies through alternative delivery models, in particular those that involve a degree of project and financing risk transfer to private sector partners
- ▶ Enhancing regional networks and achieving efficiencies through effective cross-border collaboration
- ▶ Investigating the most appropriate ownership structure of community assets.

The role that these solutions can play, and the assistance that the Commonwealth can provide, is the subject of the subsequent chapters of this report.

A high-angle, perspective shot of a two-lane asphalt road that curves gracefully through a scenic landscape. The road is marked with two parallel yellow lines that follow the curve of the road. On the left side of the road, there is a low, rustic stone wall. Beyond the wall, there are green trees and some autumn-colored foliage. On the right side, the road curves further, bordered by a white line and more vegetation, including some trees with orange and yellow leaves. The overall scene is bright and clear, suggesting a sunny day.

Borrowing for  
infrastructure  
investment

### 3. Borrowing for infrastructure investment

#### Key findings

- ▶ There is significant capacity within the local government sector to optimise its level of borrowing. However, this is currently held back by the “fear of debt” and the absence of a structured local government debt product suitable for institutional investors.
- ▶ Centralised financing, where available on a state basis, currently provides the benefit of low finance costs and a government guarantee. Centralising financing on a national level would not only enhance these benefits, but is also likely to be an essential prerequisite for the creation of financial products to channel institutional investment into local government infrastructure.
- ▶ There is a role for the Australian Government in working with the states and territories to investigate the feasibility of establishing a national financing authority for local government to bridge the gap between institutional investors and Australian councils.
- ▶ Furthermore, the Australian Government can provide assistance in creating sustainable revenue streams which form a direct link between those who benefit from new investments and those who pay for them. Tax Increment Financing, whereby councils leverage future rates revenues to borrow for infrastructure investment, represents one such revenue stream.

#### Recommendations

##### **Recommendation 2: Tax Increment Financing**

The Australian Government should work with the states and territories to investigate the legislative changes that would be required to enable councils to introduce Tax Increment Financing.

##### **Recommendation 3: National financing authority**

The Australian Government should work with the states and territories to investigate the feasibility of establishing a national financing authority to aggregate local government borrowing and facilitate the creation of debt products for private investors.

The *funding* of infrastructure and the *financing* of infrastructure are two very different concepts, and the distinction between them needs to be fully appreciated.

Funding (explored in the preceding chapter) is how the community pays for infrastructure. Financing (such as borrowing from institutional lenders) is the money raised to put it in place. Put another way, while financing refers to raising capital upfront to meet the costs of delivering a project or program, funding is the way in which the financing costs are paid over time.

While financing can support funding, it is ultimately a secondary consideration. Local infrastructure is (and will remain) funded by the community through taxation and user charges, and meeting the infrastructure task will always be dependent upon the quantum of this funding. Additional finance may make possible individual projects or programs when funding is constrained, but it is not the solution to the underlying issues of sustainable funding.

But while financing will always be dependent upon funding, it can be crucial to the timely delivery of key community infrastructure projects. Debt finance enables councils to deliver infrastructure earlier than they otherwise would have been able and to spread the costs amongst future generations who will enjoy the benefit of the investments.

This section explores the question of local government borrowing in more detail. As part of the solution to the challenges which councils face in this area, we propose that the Australian Government work with the states and territories to investigate the feasibility of establishing a national financing authority for local government to bridge the gap between institutional investors and Australian councils.

The objective of this reform is - firstly - to enable the aggregation of borrowing to create economies of scale in what is currently a diverse and disparate sector. Secondly, in common with practice in other countries, the authority could act as a “bank” with the ability to develop financial products for the private investor market. And thirdly, it could provide and facilitate due diligence and prudential oversight for the sector (such as where concessional tax arrangements are available, for example if the Commonwealth were to develop infrastructure bonds).

## The case for borrowing

Infrastructure is by its nature capital-intensive and there is almost always the need to raise capital at the beginning of a project. Raising sufficient finance for upfront expenditure is often the largest challenge not just for local government but for any project sponsor, especially when other sources of funds are constrained. Finance can be the difference between a project going ahead or not.

Where core sources of revenue are constrained, it is often appropriate to borrow money for the purposes of meeting the capital requirement. The key benefits of debt finance are as follows:

- ▶ Debt finance enables councils to deliver infrastructure **earlier** than they otherwise would have been able.
- ▶ Debt finance allows the cost to be spread to **future generations** who will enjoy the benefit of the asset(s).
- ▶ Debt finance prevents the need to divert funds from internally-generated **renewal and maintenance budgets** to capital expenditure.
- ▶ Local government enjoys **steady and secure income streams** in the form of rates and FAGs, which can be used to meet debt servicing obligations and to secure debt facilities.
- ▶ The ability to borrow responsibly and to meet future debt servicing obligations is normally dependent upon rigorous and robust **financial governance policies and long-term planning**.
- ▶ Debt finance can facilitate **institutional investment**, for example from superannuation funds, which brings with it additional rigour and discipline.

The case for making debt financing part of the solution to tackling the infrastructure task has been widely acknowledged. Some examples include:

- ▶ Financial analysis in the **Allan Report** of 2006 found that the local government sector had significant capacity to leverage its balance sheet further. The report recommended a total of \$5.3bn should be borrowed by councils in New South Wales to address the infrastructure renewals gap, and that councils, depending on their rate of population expansion, should borrow between 30% and 60% of the cost of expanding their asset base to ensure intergenerational equity. It stated that “low levels of borrowing can be inappropriate where projects are funded through rate increases and thus current ratepayers bear the full costs of facilities and services that will benefit future users. Debt financing, however, allows the cost of such projects to be shared between present and future generations.”<sup>27</sup>
- ▶ This view was shared by the Western Australia **Systemic Sustainability Study** of 2008: “External borrowing can be an appropriate financing source in the right circumstances, especially to fund the acquisition of new non-financial assets or the upgrading of existing assets (as distinct from funding routine maintenance and the renewal of existing infrastructure assets both of which should be funded out of internal cash flows). Use of borrowing to finance upgrading or expansion of infrastructure would then free up internally-generated funds which should be devoted to financing maintenance.”<sup>28</sup>
- ▶ According to the **Productivity Commission** report of 2008, “borrowings, when undertaken prudently, are an appropriate means for local governments to finance long-lived infrastructure assets – the costs of which are often large or ‘lumpy’ and might be delayed in the absence of borrowing. The servicing of debt through rates or user charges (where appropriate) enables the

<sup>27</sup> Local Government & Shires Association of NSW, *Are Councils Sustainable?*, May 2006

<sup>28</sup> Western Australian Local Government Association, *The Journey: sustainability into the future, shaping the future of local government in Western Australia (Systemic Sustainability Study)*, 2008

cost of the asset to be matched with the benefits from consumption of the services over the life of the asset, thereby promoting inter-generational equity.”<sup>29</sup>

- ▶ A recent practice note issued as part of the Commonwealth's **Local Government Reform Fund** (2012) stated that “many councils have very low levels of net financial liabilities (debt and other liabilities less financial assets) relative to their revenue levels and the level of infrastructure assets they manage. A soundly based long-term financial plan can highlight the affordability and impact of additional borrowings (e.g. to address warranted but otherwise unachievable asset renewal). A modest increase in borrowings to fund priority needs would typically add materially very little to most councils’ total operating costs. While organisations should not borrow unless necessary to satisfy their objectives, they should also not be averse to borrowing where this is warranted, to provide cost effective and affordable, desired levels of service.”<sup>30</sup>
- ▶ The **Local Government Association of South Australia** in 2012 published an information paper for council members and staff to educate them about the benefits of debt financing.<sup>31</sup>

The conclusion reached in these studies, and others, is that a well managed and sustainable council is justified in borrowing money to help meet the costs of providing infrastructure for the community. Indeed, the benefits of responsible borrowing have been enjoyed by those councils in Australia which have actively sought to optimise their level of debt finance, examples of which include:

- ▶ **Willoughby City Council** took out a \$30m loan to finance the Civic Place performing arts centre. The interest on the loan is 3.17% plus CPI, which council believes will provide financial certainty by tailoring interest repayments to match increasing income from the development. Once the performing arts centre is built, the loan will be serviced from Civic Place commercial rents and Chatswood CBD commercial rates.
- ▶ The **City of Perth** has used its commercial income from car park operations to secure sustainable debt facilities to finance the development of both commercial infrastructure assets such as a new car park in Elder Street and social infrastructure assets such as a new library in St Georges Cathedral Precinct.
- ▶ The **City of Onkaparinga** has made strategic use of borrowing through its Major Projects Fund, whereby council resolved to raise rates by 1% per annum above previously determined rates increases, and to quarantine the additional income for the repayment of a debt facility to finance an infrastructure works program. The size of the facility is determined by the amount of revenue earned through the rates levy.

## State and territory legislative frameworks

The ability of the local government sector to borrow is defined by legislation in all states and territories. Figure 10 gives an overview of the different legislative frameworks across Australia.

Figure 10: Local government borrowing – legislative frameworks

### Local government borrowing – legislative frameworks

The **New South Wales** Government does not lend directly to local government, nor does it offer a guarantee over local government debt. It has recently established the Local Infrastructure Renewal Scheme (LIRS) which offers a 4% subsidy towards interest payments as “an incentive to councils to make greater use of debt funding to accelerate investment in infrastructure backlogs”. Councils cannot borrow at a rate which exceeds the indicative rate determined by the New South Wales Treasury Corporation.

In the **Northern Territory**, councils are able (but not obliged) to borrow from the Northern Territory Treasury Corporation.

In **Queensland**, councils are only permitted to borrow from Queensland Treasury Corporation (QTC). Provided that councils have their financial forecasting and debt policy plans in place, QTC funds are

<sup>29</sup> Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, April 2008

<sup>30</sup> Institute of Public Works Engineering Australia, *Long-term Financial Planning, Practice Note 6*, January 2012

<sup>31</sup> Local Government Association of South Australia, *Financial Sustainability Information Paper 10: Debt*, February 2012

generally readily accessible and come with competitive terms and a state guarantee.

In **South Australia**, the majority of local government borrowing is provided by the Local Government Finance Authority (LGFA) which acts independently of the state government but which enjoys a state guarantee and the same credit rating as the state government, thus enabling it to offer competitive pricing to the local government sector. Councils are not obliged to borrow from the LGFA.

In **Tasmania**, councils are restricted from borrowing an amount where the annual repayments required to service the debt would exceed 30% of the council's revenue (excluding specific purpose grants) from the previous year. Councils are able (but not obliged) to borrow from the Tasmanian Public Finance Corporation (TASCORP).

The **Victoria** Government does not lend directly to local government, nor does it offer a guarantee over local government debt. Borrowings must not be for ordinary purposes, unless included in a budget, in which case they must be secured against general rates revenue.

In **Western Australia**, councils are able (but not obliged) to borrow from the Western Australian Treasury Corporation (WATC).

Although most state and territory governments require councils to obtain ministerial approval for new borrowings, councils are able to source borrowing from private lenders in every state apart from in Queensland (where all debt is arranged through QTC).

However, councils generally prefer to borrow through a centralised body, where this option is available to them. Hence Northern Territory, Tasmanian and Western Australian councils normally arrange debt through the state government's financing authority, whereas South Australian councils generally borrow from the LGFA, which is independent but enjoys a state guarantee. The Local Government Association of South Australia stated that 95% of local government debt in the state is sourced from the LGFA.

The majority of local government representatives consulted in these states (and Queensland) indicated their satisfaction with the ease with which debt is accessible from the centralised authorities, and the competitiveness of the terms.

The benefits of borrowing through centralised institutions such as the Northern Territory Treasury Corporation, QTC, the LGFA, TASCORP, and WATC are as follows:

- ▶ Debt products come with attractive terms as a result of the access to the state's credit rating.
- ▶ Debt products come with a guarantee provided by the state government.
- ▶ Councils are able to enjoy long-term and consistent relationships with the institution, meaning that arrangement of debt products is generally quick and easy.
- ▶ Central financing institutions have relatively low overheads when compared with institutional lenders, and these savings are often passed on to councils.
- ▶ Central financing institutions can (and do) require robust financial plans to be in place, which can impose a degree of discipline upon sustainable financial planning.

Only in New South Wales and Victoria is there no state guarantee attached to local government debt. Although in theory the non-restricted models in New South Wales and Victoria should enable councils to secure low prices through market competition, in reality private institutional financiers are unable to compete with government-backed lenders which have access to the state's cost of capital and guarantees.

Figure 11: The question of credit rating

### State guarantees and credit ratings

State governments act as the financial supporters of all local government entities. This connection between the different tiers of government means that credit rating agencies aggregate local government debt with state debt when rating state governments, irrespective of whether the guarantee over local government debt is explicit or implicit:

- **Explicit:** In the Northern Territory, Queensland, South Australia, Tasmania and Western Australia, it is normally the state or territory funding authority that takes on the banking functions and thus the guarantee is relatively explicit.
- **Implicit:** The model in New South Wales and Victoria is grounded in an objective of enforcing commercial discipline in respect of access to lending, security and monitoring. The higher margin of bank debt compared to the state's cost of debt is the price paid for this discipline. But despite the fact that no explicit guarantee is given, and local government accesses debt directly from the market, it doesn't reduce the state's exposure to local government borrowing as far as the credit rating agencies are concerned. States thus have a clear interest in ensuring councils do not enter into arrangements which ultimately expose the state to liabilities that are over-priced.

In the USA, by contrast, where the statutory linkage between levels of government is weaker, local government doesn't enjoy this guarantee, and councils can and have encountered financial distress.

## The capacity to borrow

Despite the existence in most states of secure centralised debt facilities, there is considerable evidence to show that the local government sector in Australia is not making the most of its capacity to finance infrastructure procurement through responsible borrowing.

Councils continue to adopt a cautious approach to the use of debt to finance their investment in infrastructure and there remains a clear preference to use current year funding in the form of rates and grants receipts for this purpose, rather than incur additional debt.

Councils generally have strong balance sheets and there is an overall trend of under-reliance on debt. ABS data shows that, nationally, debt represents only 2.8% of net assets and interest payments represent 1.4% of total council revenue (Figure 12). This suggests that there is greater capacity to service borrowings.

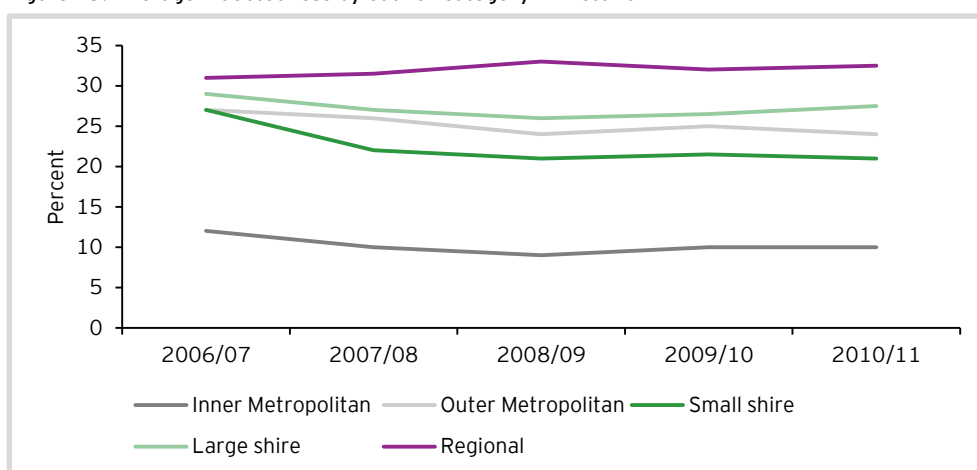
Figure 12: Local government debt metrics<sup>32</sup>

	NSW	NT	QLD	SA	TAS	VIC	WA	TOTAL
Gearing ratio Bank debt/ net assets	2.5%	0.6%	4.6%	3.8%	1.0%	1.1%	2.5%	2.8%
Debt servicing ratio Interest expense/ total revenue	1.9%	0.2%	1.8%	1.6%	0.7%	0.6%	0.6%	1.4%

The Victorian Auditor-General, as part of the annual report on local governments in the state, conducts an analysis of councils' indebtedness. The analysis looks at non-current liabilities (mainly comprised of borrowings) as a percentage of own-sourced revenue (as opposed to financial gearing where debt is generally compared to net assets) (Figure 13).

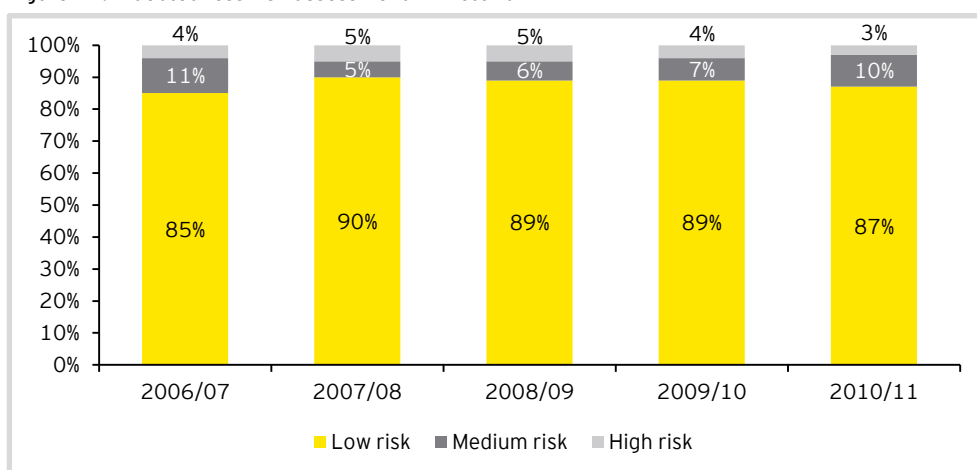
<sup>32</sup> Australian Bureau of Statistics, 5512.0

Figure 13: Average indebtedness by council category in Victoria<sup>33</sup>



In 2011, the Auditor-General concluded that in relation to indebtedness, only 3% of councils are at high risk (defined as “potentially long-term concern over ability to repay debt levels from own-source revenue”), with 10% at medium risk (“some concern”) and 87% at low risk (“no concern”) (Figure 14).

Figure 14: Indebtedness risk assessment in Victoria<sup>34</sup>



Some specific examples of the capacity to borrow include:

- Townsville City Council, which as a major metropolitan centre is likely to have a number of commercial “debt friendly” assets, and which also enjoys access to state-backed finance (through QTC), has approximately \$370m of borrowings. Whilst this may at first seem like a significant amount, it is actually relatively small when compared to the council’s asset base of around \$4bn. Townsville City Council reported an operating surplus in 2011/12.<sup>35</sup>
- The example of the City of Onkaparinga, cited above, shows it may only require a moderate rates increase to secure and service considerable finance facilities.

## Barriers to the optimal use of debt financing

The analysis above suggests that the local government sector has the capacity to make greater use of debt to finance the delivery of infrastructure, but is not taking advantage of the opportunity to do so. The consultation indicated that the flow of debt financing into the sector is constrained by four factors:

1. The “fear of debt”

<sup>33</sup> Victorian Auditor-General’s Office, *Local Government: Results of the 2010-11 Audits*, September 2011

<sup>34</sup> *ibid.*

<sup>35</sup> Townsville City Council, *2010/11 Annual Report*

2. The cost of debt
3. The lack of assets which have associated returns against which debt facilities can be secured
4. The absence of a structured debt product suitable for institutional investors such as superannuation funds.

These constraints are explored below.

## 1. The “fear of debt”

While fully funding depreciation remains the preferable method to fund these investments, additional borrowings should be given more consideration as a means of sharing capital costs with future generations.

Borrowings do not replace the need to generate adequate revenue, but can be used to provide a new infrastructure asset, or - in some circumstances - to replace and rehabilitate specific assets the council already owns.

Debt financing is a common feature of private sector project financing, and there should be little to prevent its responsible use by local government.

However, a number of councillors and elected officials take significant pride in their ability to manage their organisations with no or very little debt:

- ▶ Elected councillors appear to play a significant role in maintaining the conservative approach to the use of debt to finance infrastructure. The consultation suggested that their aversion to debt is often informed by a perception that the community regards a low debt position as a reflection of sound fiscal management. It may not be widely understood that, in fact, a low debt position means that current ratepayers are meeting the full cost of infrastructure assets, while in reality much of the benefit will actually be gained by future ratepayers.
- ▶ This attitude is likely fuelled by the implementation of debt reduction strategies by state governments in the past, driven in part by a political imperative to limit local government debt, which is amalgamated with state debt by credit rating agencies (even in Victoria and New South Wales, where local government debt does not enjoy a state guarantee).<sup>36</sup>

The “fear of debt” needs to be addressed to enable more sustainable infrastructure financing practices to develop.

Officials and elected representatives should be encouraged to recognise that debt does not necessarily mean a council is acquiring things it cannot afford. It merely provides an alternative and immediate form of capital, which can in turn promote the best use of core funding sources. Indeed, a zero-debt position usually results in *under*-investment in local infrastructure. The benefit of debt is that it enables work to be done sooner and the cost to be shared with future generations who will enjoy its benefits.

Conquering the “fear of debt” is not to say that every council should be seeking to increase its financial gearing. There is no right or wrong level of gearing, rather there is a need for councils to consider the optimal level of borrowing that can be supported by their forecast cashflows. Upper limitations of borrowings may indeed remain entirely appropriate for the sector, but they should be informed not by the “fear of debt”, but by a considered assessment of the costs and benefits of alternative financing solutions.

## 2. The cost of debt

The “fear of debt” is driven in part by the view that borrowing to procure infrastructure increases the cost of that infrastructure compared with financing it directly from rates and other core revenues.

This concern is often justified, especially when debt is sourced from the private sector financial institutions. The costs associated with raising debt from capital markets have indeed been rising in

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<sup>36</sup> There are signs that the signals coming from state governments may be shifting, as seen for example in the LIRS in New South Wales.

recent years. After initially being seen as a “safe haven”, the strain on the wholesale markets caused by the Global Financial Crisis (GFC) has led to a reduction in the deposit base in Australia. Funding prices in Australia are impacted by movements in wholesale costs in both Asia and Europe. This has had an impact on the cost of finance, particularly for longer financing tenors, and there have been a number of distressed infrastructure financings.

These costs must be evaluated alongside the benefits, and - if possible - a range of different solutions should be investigated for each individual investment.

The ability to borrow from a centralised government-backed lender is one way in which the debt service costs can be minimised, as such institutions have the ability to leverage government credit ratings and the most competitive rates. Passing these favourable rates onto councils is one of the advantages of using existing state financing agencies, and indeed would be one of the key benefits of a national financing authority.

Debt will always have a cost. It is, however, a cost which can be mitigated through responsible financial planning and through taking advantage of the availability of secure and competitive facilities. It is a cost which must be weighed up against the upside of being able to deliver or bring forward key infrastructure priorities which might not otherwise have been possible.

### **3. Returns as a form of security for lenders**

There are several examples of assets controlled by the local government sector which can and do produce significant income streams. These include airports, car parks and recreation centres. The greater and the more secure the income stream, the more attractive to lenders.

However, as a rule the local government sector has very few assets which produce commercial returns which can be used as security for borrowing. This is especially noticeable outside of Australia's urban centres, which have the greatest potential to draw upon the purchasing power of large population bases and centres of business.

An additional factor is that some councils have policies in place which prohibit borrowing against assets which do not produce income. It is a policy of Cairns Regional Council, for example, that “long-term borrowings for capital works and new assets should be limited to income producing assets that generate a net worth.” In practice this means that Cairns Regional Council can only borrow against its water and waste assets, as these are the only assets with associated revenue streams.

An innovative model which has been used overseas to “create” income streams for local infrastructure is Tax Increment Financing (TIF) (Figure 15). TIF involves appropriating increases in rates revenue arising from an investment in infrastructure in order to meet the upfront cost of providing the infrastructure. TIF enables councils to leverage forecast rates revenue growth from specific developments as a means of raising finance for the infrastructure projects that will lead (or contribute) to the anticipated appreciation.

From a local government perspective, the key feature of TIF is that it creates sustainable revenue streams which provide a direct link between those who benefit from new investments and those who pay for them. It also creates a market testing for infrastructure development in creating an upfront commitment to infrastructure through long-term funding.

Figure 15: Tax Increment Financing (TIF)

### Tax Increment Financing

TIF involves government authorities (normally local councils) forecasting the growth in receipts from rates and taxes that would be received as a consequence of an infrastructure development (either under existing rates of application or increased charges), and borrowing against this future income stream. The government authority can then invest the funds received in the neighbourhood for a prescribed period of time.

In effect, investors make a lump sum payment in return for the right to receive long-term cashflows which would otherwise have flowed to the government. The benefit for the government is that the TIF reduces the mismatch in timing between the occurrence of development costs and the realisation of benefits through tax and rates receipts.

A number of developments in the USA have been financed through TIF arrangements, such as the Mesa del Sol development in New Mexico and the Atlantic Station project in Atlanta. In England, the powers to utilise TIF have recently been granted to local authorities, and the government has identified the building of a new London Underground extension to Battersea Power Station as a potential pilot for the TIF concept, which will see money for the development borrowed by the public sector but then paid back by the retention of business rates generated by the new site. The Scottish Parliament has agreed to support up to six pilot schemes to explore the utility of TIF and in March 2011 North Lanarkshire was granted provisional approval by the Scottish Government to develop a major brownfield site, Ravenscraig.

Although TIF has been promoted by the Property Council in Australia, it has not yet been adopted. As in other countries, legislation may be required in Australia at a federal level to enable other tiers of government to implement TIF.

In some situations where TIF has been implemented overseas, tax allocation bonds have been sold by the local government at the outset of the project so that funds are available for front-end costs. The bonds are then fully or partially paid with tax increment revenues as they are collected. This requires the hypothecation of taxation revenues, which is not common practice in Australia. Whereas in the USA, TIF bonds are issued to private investors in the context of a large and liquid municipal bonds market, and thus private investors are more likely to be able to efficiently price the risks inherent in the structure, Australia does not have a deep and liquid market for semi-government bonds and does not have experience with TIF structures.

TIF revenues can be sourced from either the private or the public sector. As there is no history of TIF in Australia, there is a risk that private financing may only be available at a relatively high cost, especially as the financier would be taking on risks associated with long-term cashflows. In order to reduce the level of development risk to an acceptable level for private financiers, a local authority guarantee may be required. The value for money outcome of this approach will depend on the cost of finance imposed by the investors who are accepting risk on the materialisation of the future revenue stream.

In Australia, councils are not currently able to implement TIF regimes. Indeed, the consultation revealed little awareness within the sector of its operation and its benefits. Given the experience in other countries, it is therefore recommended that work be undertaken to explore the legislative reforms that would be required to enable Australian councils to implement TIF as a source of finance for new investments.

TIF does rely on the revenue returns (i.e. the materialisation of the forecast uplift in property values) and there is the risk that the expected increment is not realised. This also means that the price of the finance raised to develop the infrastructure will include a margin for this risk.

Indeed, while TIF provides one solution within the local government context and is not without risk, finding ways to connect funding with beneficiaries is something which needs to be addressed by all tiers of government in Australia. It is a crucial issue which lies at the heart of understanding the relationship between funding infrastructure and investment outcomes.

## Recommendation 2: Tax Increment Financing

The Australian Government should work with the states and territories to investigate the legislative changes that would be required to enable councils to introduce Tax Increment Financing.

## 4. Debt products and institutional investment

While the conventional banking sector in Australia is “open” and offers finance to councils in the form of loans and other facilities, the local government sector has not been able to tap into the institutional investment market.

The institutional investors most often cited as being best placed to take an interest in infrastructure projects are superannuation funds. While superannuation funds are investing in some public sector infrastructure projects, there are currently impediments which are preventing them from considering greater investment in infrastructure at the local government level.

Local infrastructure projects are generally not of sufficient size for superannuation funds to take equity holdings. A recent survey of superannuation firms concluded that for projects that involve an investment of less than \$100m, the cost of investing does not generally reduce in proportion to project size, meaning that the net return is insufficient to justify further consideration.<sup>37</sup>

The superannuation sector is likely to be more interested in taking debt rather than equity interest in local government projects. Barriers currently exist, however, relating to the absence of a committed and funded project pipeline, simplifying transaction processes and ensuring efficiency of government regulation and taxation (Figure 16).

Figure 16: Superannuation and infrastructure

### Superannuation and infrastructure

Superannuation funds are investing in new infrastructure in Australia – for example UniSuper, AustralianSuper and AMP have participated in recent PPP transactions. According to the Chief Executive of Industry Funds Management, “the message is clear and consistent: we have capital and intent – show us the opportunities that are consistent with our risk/ reward profile.”<sup>38</sup>

However the opportunity for greater investment is being missed. Superannuation funds have identified the following barriers to greater involvement:

- ▶ Lack of a clear pipeline and government commitment
- ▶ Lack of suitably structured projects
- ▶ Inconsistent, complex and expensive bidding processes,
- ▶ Regulatory and industry pressures.

There are a number of ways in which governments can encourage superannuation funds to increase the level of investment in infrastructure and these include:

- ▶ Development of a committed pipeline
- ▶ Delivering certainty over government funding commitment
- ▶ Appropriately structuring projects
- ▶ Increase recycling of capital
- ▶ Simplifying transaction processes
- ▶ Creating consistency and certainty of government regulation
- ▶ Further improvements in taxation system efficiency.<sup>39</sup>

Appendix 2 provides further analysis of these issues.

<sup>37</sup> Ernst & Young, *Financing Australia's infrastructure needs: Superannuation investment in infrastructure*, October 2011

<sup>38</sup> *Financial Times*, 30 January 2012

<sup>39</sup> Ernst & Young, *Financing Australia's infrastructure needs: Superannuation investment in infrastructure*, October 2011

Superannuation funds have an obligation to invest in the best interest of their members. The role of government is therefore to align funds' members' interests with those of local communities, i.e. to create the conditions where investment in domestic infrastructure is a responsible choice for fund managers.

The Australian Government is in the position to help unlock superannuation funds as a source of debt financing for infrastructure by establishing debt or convertible debt instruments that would be offered to the institutional investment market. A new infrastructure bond regime could be directed at creating an incentive for Australian superannuation funds to help fill the funding gap.

Indeed, infrastructure bonds are often cited as the panacea for the widening infrastructure deficit in Australia:

- ▶ In theory, the issuance of specific-purpose debt instruments into the capital market should be a good way for the local government sector to finance infrastructure investment. After all, the relatively low risk of default should provide a cost of capital which is attractive to investors when compared with the risk adjusted returns that could be earned on the capital markets.
- ▶ From a council perspective, local government has access to a relatively attractive income stream in the form of rates and charges, which could form a stable return attached to a fixed income security. Bond issues also satisfy the need to find intergenerational equity by apportioning the expense across those generations that are likely to benefit from the investment.

In the USA there is an active municipal bond market. Debts incurred through these bonds are usually repaid from income generated from the investment (although there is precedent in the USA for bonds predicated on future anticipated federal aid – these are known as Grant Anticipation Revenue Vehicle bonds). Appendix 3 provides further analysis of the American municipal bond market.

Compared with the USA, however, individual local government infrastructure projects in Australia have rarely been of a sufficient scale to warrant the costs of a bond issue and to attract the interest of institutional investors. Most councils do not have the in-house expertise and capacity to engage in bond issues.

The biggest difference between the USA and Australia, however, is that American municipal bonds come with attractive taxation concessions which make them significantly more attractive to investors. The indirect funding of infrastructure through tax concessions goes beyond the scope of this report, and the Commonwealth would need to carefully consider the implications of any such mechanisms as part of its wider taxation policies. Tax-efficient financing products are not without their risks and if not carefully managed can produce unintended consequences that distort the market. The alternative of direct grant funding of projects is more transparent, less complex and can be targeted at specific projects or sectors of infrastructure.

If the Commonwealth were to consider developing a new bond product for local infrastructure, there is likely to be a role for a centralised authority to both create the required scale through aggregating councils' financing requirements, and to provide due diligence and prudential oversight for any concessional tax arrangements which are made available. This is explored below.

## **Addressing the capacity to borrow: a national financing authority**

The Commonwealth is in a unique position to assist the local government sector in overcoming the barriers to the responsible use of debt finance. It can:

- ▶ Provide easily-available and competitively priced debt to the local government sector
- ▶ Increase the pool of finance by offering a structured product to the institutional investment market
- ▶ Encourage a cultural shift away from the “fear of debt”
- ▶ Enforce governance and reporting arrangements to ensure the sustainability of councils is not jeopardised.

Government-backed debt financing enables councils to access competitively priced capital facilities, whilst at the same time ensuring that appropriate rigour is applied to sustainable long-term financial planning. The positive experience of councils in engaging with state-based finance authorities is evidence of this.

However, the scale of projects and the requirements for predictable long-term returns continue to stand in the way of efficient and large-scale investment in conventional local government infrastructure projects.

The key to opening up local infrastructure to institutional investment lies in using the apparatus of higher tiers of government to create the scale which would bring risk-sensitive investors to the table. The Commonwealth, alongside state and territory governments, has far greater capacity than local government to create the crucial interface between the private markets which have the capability, but not the confidence, to invest, and councils which have the pressing need for funds, but not the means to access them.

In order to achieve this, the Commonwealth (alongside the states and territories) should investigate the feasibility of establishing an independent national financing authority to provide debt to local government and other qualifying regional delivery bodies.

### **Recommendation 3: National financing authority**

The Australian Government should work with the states and territories to investigate the feasibility of establishing a national financing authority to aggregate local government borrowing and facilitate the creation of debt products for private investors.

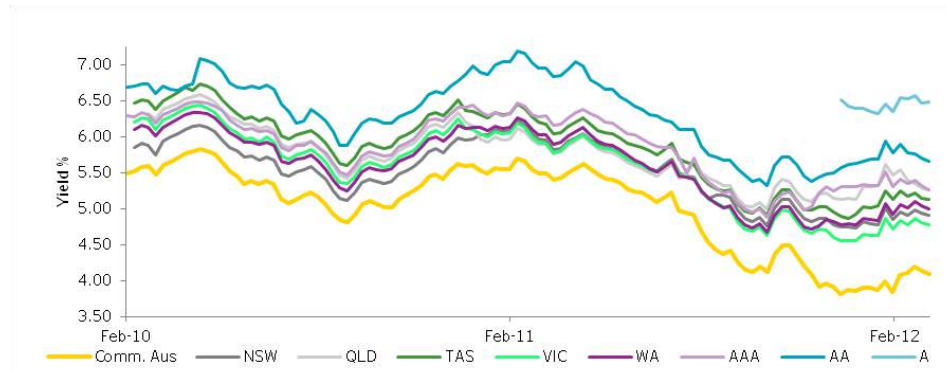
The objectives of establishing an independent national financing authority are:

- ▶ To provide all councils in Australia with access to lower-cost debt finance, as a result of:
  - ▶ The aggregation of risk and supply across many councils
  - ▶ Access to Commonwealth cost of capital (Figure 17)
  - ▶ The pass through of administrative efficiencies
- ▶ To establish a conduit between councils and capital lenders
- ▶ To provide financial and legal assistance and expertise to those councils with limited in-house capacity
- ▶ To provide finance to qualifying regional bodies which have responsibility for community infrastructure
- ▶ To apply rigour and discipline in financial planning by ensuring that the provision of finance is conditional upon evidence of long-term forecasts and evidence of the capacity to service and repay the debt (although the authority would not involve itself directly in councils' internal budgetary and planning processes)
- ▶ To act as a "bank" with the ability to develop financial products for the private investor market
- ▶ To provide and facilitate due diligence and prudential oversight for the sector (such as where concessional tax arrangements are available, for example if the Commonwealth were to develop infrastructure bonds).

Figure 17: State government vs. Commonwealth bond yields

### The benefits of access to Commonwealth guarantee: State government vs. Commonwealth bond yields

State government issued bonds have consistently tracked at a premium to those issued by the Australian Government. To compare state treasury bond issues in instances where state issues have been relatively sporadic, bonds on issue that were closest to the ten year duration have been used in the graph below as a proxy for the ten year yield.



Source: Reuters

There are a number of precedents to the practice of aggregating local government financing on a national scale, some of which are listed below.

- ▶ **Kommuninvest, in Sweden**, is a cooperative membership organisation owned and guaranteed by Swedish local governments. Of the total 310 municipalities and county councils in Sweden, 269 are currently members of Kommuninvest. Kommuninvest is the only company in Sweden to receive a rating of AAA/Aaa from both Moody's and Standard & Poors. In December 2011, Kommuninvest's lending amounted to approximately USD 24.3bn (approx \$22bn) and over the past 10 years, lending has increased by an average of 16% per year. At the end of 2011, Kommuninvest provided about 65% of its members' total borrowing. Kommuninvest regularly issues bonds, for example SEK 39.7bn (approx \$5.5bn) in Swedish Benchmark Bonds have been issued since November 2010.
- ▶ **The New Zealand Government** has recently set up the New Zealand Local Government Funding Agency Limited which will issue debt on behalf of all participating local authorities. It was established by NZ\$20m from council funding and NZ\$5m from New Zealand federal government funding. Councils are not obliged to use the agency for funding and can still seek external debt elsewhere, but if the co-operation and support from councils are sufficient, it is anticipated that the agency would achieve the credit rating, scale, and specialisation to yield significant savings for the participating councils. In February 2012, the agency issued NZ\$300m of bonds at a coupon rate of 6%.
- ▶ **In the UK**, the Local Government Association (LGA) recently appointed advisers to examine setting up a collective agency, such as a bank, to issue aggregate council bonds following a sharp rise in the rates on central government loans in 2011. The LGA modelled the impact of a Kommuninvest type scheme in England. Proposing that local authorities could borrow up to £7bn, the LGA argued in favour of a collective borrowing vehicle spanning tens, potentially hundreds, of authorities. The scheme, they argued, would be able to achieve a rate of 70-80 basis points over gilts, 45-55 points over the new Public Works Loan Board (PWLb) rate, but 20-30 points below its standard rate.<sup>40</sup>
- ▶ Furthermore, an independent report in the **UK** in March 2012 has recommended the establishment of a £30 billion National Infrastructure Bank (NIB) which would lend to private and

<sup>40</sup> Localis and Lloyds Banking Group, *Credit Where Credit's Due - Investing in local infrastructure to get Britain growing*, March 2012

public organisations to fund the construction of new infrastructure, invest directly in infrastructure projects and guarantee other banks' loans to fund infrastructure.<sup>41</sup>

The consultation tested the idea of a national financing authority with local government stakeholders, however we have not done any detailed analysis of the different options for structuring the authority and establishing governance roles and detailed functions.

Existing Treasury Corporations provide a useful starting point for a new authority, although - typically - they do not have deep experience in infrastructure finance. The current model is well-known, tried and tested.

The Export Finance and Insurance Corporation (EFIC) (Figure 18) facilitates the inward flow of investment from third parties for the purpose of facilitating the export trade of Australian goods and services. Although the services it provides do not directly apply to the local government sector, it has project finance capabilities and its structures, procedures and personnel may provide a useful input into the development of the national financing authority.

Figure 18: Export Finance and Insurance Corporation

### Export Finance and Insurance Corporation (EFIC)

The Export Finance and Insurance Corporation (EFIC) is an export credit agency (ECA), established by the Australian Government under the *Export Finance and Insurance Corporation Act 1991* with the following functions:

- ▶ To facilitate and encourage Australian export trade
- ▶ To encourage banks and other financial institutions in Australia to finance or assist in financing exports
- ▶ To manage the Australian Government's aid-supported mixed credit program (a facility which has now been discontinued, although loans are still outstanding)
- ▶ To provide information and advice regarding insurance and financial arrangements to support Australian exports.

EFIC's role is to mitigate private sector risk by acting as guarantor over financing arrangements between third party lenders and exporters, or by direct lending where a bank is unwilling to do so. EFIC offers financial products and services such as loans, guarantees and insurance to exporters, buyers and other financial intermediaries. This includes the provision of:

- ▶ Direct loans to overseas buyers
- ▶ Guarantees to the buyer's private sector lender
- ▶ Insurance over export contracts and bonds
- ▶ Guarantees over foreign exchange facilities (for the purpose of hedging export contracts).

The EFIC vehicle is profitable and either distributes profits back to the Australian Government or maintains it on balance sheet depending on the nature of the transaction.

A recent Productivity Commission report into Australia's export credit arrangements (currently in draft form) expressed concerns about some of EFIC's activities relating to competition and its role as debt guarantor.<sup>42</sup> EFIC has submitted a supplementary submission in response to the Productivity Commission's draft report, challenging a number of the findings. These issues do not detract from the relevance of EFIC, together with Treasury Corporations, as possible precedent models for the national financing authority.

The proposed national financing authority for Australia would have a mandate to invest directly in local government programs but also to facilitate inward investment. Aggregating debt can achieve

<sup>41</sup> *ibid.*

<sup>42</sup> Productivity Commission, *Australia's Export Credit Arrangements (draft)*, February 2012

what councils cannot achieve on their own, namely combining facilities into a larger unit that can offer the security to gain a good credit rating.

The authority would have its own balance sheet which it can operate independently, but with the crucial Commonwealth credit support. It would therefore have the ability to bundle approved council borrowing requirements into a limited number of bond issues, which could be underwritten by the Commonwealth. Should the Commonwealth wish to develop tax concessions for these bonds, a national financing authority could provide the necessary governance structures and oversight to mitigate the associated risks.

It is not anticipated that the national finance authority would be the only avenue open to the local government sector to source debt financing. Notwithstanding the possible restrictions of competition law, there are advantages in terms of encouraging the private capital market to compete with the financing authority in the provision of debt products. As such, it is likely that there will still remain a role for state and territory governments in the monitoring and approval of local government borrowing in their respective jurisdictions.



Prioritising  
local infrastructure  
investments

## 4. Prioritising local infrastructure investments

### Key findings

- ▶ The Nationally Consistent Frameworks for local government asset and financial management - and associated programs such as the Local Government Reform Fund - have succeeded in creating momentum for improvement and a good return on the investment in capability building. However, current capacity varies widely and there is a clear need to sustain support.
- ▶ Role definition is a problem and can create cost pressures for local government and strains on the relationship between tiers of government.
- ▶ There is insufficient engagement with local government during the early stages of significant projects or policy initiatives undertaken by federal, state and territory departments and agencies. This creates an added level of complexity for local government prioritisation and planning processes.

### Recommendations

#### **Recommendation 4: Capability building programs**

Programs of targeted training and capability building in asset and financial management should be extended.

#### **Recommendation 5: Review of asset and financial management practices**

Asset and financial management reform initiatives should be supplemented by periodic independent reviews of the implementation of the Nationally Consistent Frameworks.

#### **Recommendation 6: Local government impact statements**

Federal, state and territory governments should commit to completing local government impact statements as part of the business cases prepared to support new policy proposals and projects, where there is likely to be a direct cost impact upon local government.

#### **Recommendation 7: Local government roles and responsibilities**

All tiers of government should commit to building on the intent of the Inter-Governmental Agreement 2006 by outlining clear steps to achieving better clarity of the roles and responsibilities of each tier of government. In particular:

- a. State, territory and local governments should cooperatively review the asset registers of local governments to ensure that, for each asset class, the boundaries of responsibility are unambiguous and that an appropriate and transparent process to transfer responsibility between governments is in place.
- b. As part of its community engagement, local government should present its forecast long-term capacity to fund the role it is proposing, with specific reference to the capacity to sustain defined levels of service for existing and proposed assets, services and projects.

Prioritisation is the process of ranking competing demands. For local government infrastructure, it refers to the process of allocating scarce capital resources over a specific period. In this respect, local government is equivalent to many other public and private sector entities with a mandate to achieve the highest possible economic, social or financial returns from its capital investment programs in respect of its corporate objectives.

Prioritisation is an essential task for local government. Councils need to balance:

- ▶ Preserving amenity from the existing stock of infrastructure
- ▶ The expectations of the community
- ▶ The objectives of other tiers of government
- ▶ Long-term financial sustainability.

The funding and financing of a capital program should follow on from the process of ranking investments. High priority projects which local government cannot afford, or where grant funding is not available, can be re-scoped, staged or deferred. Alternatively, other services can be reduced to accommodate investment where the risks to sustainability from deferral are unacceptable.

The Nationally Consistent Frameworks on local government asset and financial management were introduced in 2007 to provide a set of aspirational principles and best practice guidelines for local government.

A key focus of the Nationally Consistent Frameworks is long-term financial sustainability. It is a criterion which local government, as a custodian of public money, should satisfy and is a point of reference for decisions relating to infrastructure provision. The frameworks consider long-term financial performance and position to be sustainable where “planned long-term service and infrastructure levels and standards as prioritised through community engagement and consultation are met without unplanned increases in rates and charges or disruptive cuts to services”.<sup>43</sup> In this report, ‘financial sustainability’ refers to this definition.

Recent changes in legislation and policy in most states have contributed to driving these initiatives and enforcing the uptake of the practices outlined in the frameworks:

- ▶ In **New South Wales**, the state has a new integrated planning and reporting framework as part of the *Local Government Act 2009*.
- ▶ In **Queensland**, the state has introduced requirements relating to financial sustainability and longer term planning as part of the *Local Government Act 2009* and the *Local Government Regulation 2010*.
- ▶ In **South Australia**, the state has defined a more stringent application of strategic management planning within the *Local Government (Financial Management) Regulations 2011*.
- ▶ In **Tasmania**, the state is promoting frameworks to improve the integration of long-term financial planning and asset management through the Local Government Asset Management policy (2012).
- ▶ In **Victoria**, the state amended the *Local Government Act 1989* to focus local government upon more accountable financial management and public reporting.
- ▶ In **Western Australia**, the state has amended the *Local Government (Administration) Regulations* of 1996 to include a requirement for a Strategic Community Plan and a Corporate Business Plan.

Appendix 4 provides a description of the relevant regulatory, planning and process frameworks in each state and territory.

## Current prioritisation practices and outcomes

Our focus is the extent to which prioritisation processes are effective and efficient. To make an assessment, the consultation addressed processes used to plan, procure and manage infrastructure, including creation and renewal. It also addressed councils’ outcomes regarding the delivery of infrastructure as and when it is required. The consultation explored both process and outcomes:

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<sup>43</sup> Local Government and Planning Ministers’ Council, *Local Government Financial Sustainability - Nationally Consistent Frameworks*, May 2007

- ▶ Observing **process** is critical because prioritisation should be methodical, rigorous and embedded throughout an organisation. Without rigour and coordination of process, there is a high risk of a sub-optimal allocation of resources.
- ▶ Observing delivery **outcomes** is critical because it is a tangible sign of the actual capability of an organisation in all aspects of managing infrastructure. While process provides an essential foundation, it is the quality of execution of process which drives outcomes.

Our observations are made in the context of best practice processes for planning and prioritising infrastructure projects. Appendix 5 provides a summary of what is meant by best practice and what is used for comparative assessment in this report.

## Local infrastructure prioritisation processes

Prioritisation processes should lead to the timely delivery of infrastructure which achieves councils' objectives without compromising financial sustainability. Effective and efficient prioritisation processes are identifiable through:

- ▶ A clear understanding of priorities and a stable 'pipeline' of investment - this includes the integration of priorities with overarching objectives and sector plans
- ▶ Recommending investment options which represent the highest level of net benefit to the community given corporate objectives
- ▶ Timely delivery of infrastructure
- ▶ Efficient pricing of infrastructure - this refers both to upfront costs and to whole-of-life costs, including renewal or refurbishment expenditure
- ▶ Preserving the function and levels of service provided by infrastructure.

Evidence from the consultation and recent literature suggests practice is sound in some aspects of the prioritisation processes, but material weaknesses are also apparent in others. While the observations gathered vary, many are consistent and the most significant findings are set out below. These findings may not characterise all local government bodies, but based on the breadth of consultation, we are confident that they can be considered representative of the sector.

- ▶ Many councils reported significant recent change to their prioritisation processes, and most suggested their practices had improved as a result of change. For example, many discussed new standards of documentation for business cases and asset management plans, and financial planning tools. Most also attributed change and improvement to the need to comply with various legislative (and regulatory) initiatives listed above, which are designed to bring local government in line with best practice. Some councils stated that changes to process were a result of a recognition that existing practice was poor.
- ▶ In general, there is clearly strong momentum within local government to participate in initiatives which aim to improve internal corporate capability. This includes regional and remote areas, noting their high rates of participation in Local Government Reform Fund (LGRF) projects.
- ▶ Many councils acknowledged that financial and technical aspects of investment appraisal processes are not properly integrated. A consistent weakness identified is the link between asset management practices and the long-term financial plan. The asset management plan should provide the size and timing of renewal needs for integration with forecast expenditure.
- ▶ Some councils pointed to cultural changes within their organisations, which they consider essential to change mindsets and support new processes. For example, one council reported introducing a substantially higher level of personal accountability for delivering the key performance indicators in the Community Strategic Plan, which has cascaded through the organisation.
- ▶ Many councils reported weaknesses in their engagement with the community in regard to the role of local government and issues which impact on determining priorities. A particular weakness is the understanding of service levels within council and establishing a method of communicating with the community about the long-term financial implications of different levels of amenity and service.

Observations from the consultation are supported by evidence gathered from capability building projects currently underway in New South Wales, Tasmania and Victoria. These projects are funded by federal and state governments and include a focus on identifying gaps or weaknesses in long-term planning and budgeting, which are important components of the prioritisation process. Examples include:

- ▶ A recent review of a council in **New South Wales** through the *Promoting Better Practice* program found that “council’s resourcing strategy was brief and did not link the long-term financial plan (LTFP) to the Community Strategic Plan, while the Asset Management Strategy did not link with the Community Strategic Plan, Delivery Program or Operational Plan. The review found that the LTFP needed more detail in determining assumptions and linkages with other plans, particularly Council’s Asset Management Strategy and Plans.”<sup>44</sup>
- ▶ In **Victoria**, the Municipal Association of Victoria is rolling out a program to “improve the credibility of financial information produced by municipalities”. Data reviewed from this program shows substantive gaps in capability with regard to planning and budgeting and long-term financial management. For example, a benchmarking across 22 small shires recorded a median result of less than ‘proficient’ in these areas.<sup>45</sup>
- ▶ The **Victorian Auditor-General** recently reported on business planning practices for capital works in four councils. The Auditor-General reported that “for three of the four, it was difficult to have comfort that projects had business cases or that decision makers were provided with sufficient information for decisions.”<sup>46</sup> The Auditor-General’s report states that these councils “did not adequately link their plans, nor did their corporate and divisional business plans align clearly with, and demonstrably support, the objectives and strategies in their council plans”.

Overall, while councils express confidence in their capability and can point to the infrastructure they have delivered, the weight of evidence suggests that prioritisation and delivery processes are deficient in important areas.

## Local infrastructure project outcomes

The consultation explored the extent to which infrastructure plans are delivered on time and on budget. In general, it appears that delivering a program of infrastructure investment is becoming more rather than less challenging.

Local government rightly emphasises the assets it has successfully delivered compared to budgets or plans. National data produced by the ABS shows that councils continue to invest in excess of depreciation rates, which is consistent with the strong focus on infrastructure as populations expand and demographics shift. However, the clear message from the consultation is that the pace is insufficient to meet the full suite of community priorities.

Many councils expressed frustration that local government is prevented from achieving more rapid or significant programs of investment because of issues such as revenue constraints, which are explored earlier in this report. Observations from the consultation include:

- ▶ Nearly all councils identified projects they consider priorities which they could not deliver. There are also projects which they would like to co-fund with another tier of government but could not attain funding. There was concern that, as a result, local government is not meeting legitimately-held community expectations or managing risks from assets nearing the end of their useful lives.
- ▶ For some new-build projects, poor outcomes were evident, such as delays to commissioning and costs substantially higher than budgeted. In the cases identified, root causes often lay in the early phases of project planning such as inadequate due diligence and appraisal of options.
- ▶ In many cases, outcomes for asset maintenance and renewal are poor. For a given level of amenity or service, minimising the lifecycle costs of infrastructure is essential for efficiency. However, many councils stated that investment in maintenance has historically fallen behind

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<sup>44</sup> NSW Premier & Cabinet, Division of Local Government, *Promoting Better Practice Program: Follow-Up Review Report - Port Stephens Council*, November 2011

<sup>45</sup> Municipal Association of Victoria, *STEP Program Initiative, Buloke Shire Council*, October 2011

<sup>46</sup> Victorian Auditor-General’s Office, *Business Planning for Major Capital Works and Recurrent Services in Local Government*, September 2011

requirements and, as a result, future costs to preserve amenity are substantially greater than would have been identified under diligent lifecycle and maintenance forecasts.

- ▶ For example, the Ministerial taskforce report into Tasmania's water network, and evidence from the consultation in Tasmania, identified severe under-investment in the water network when it was controlled by local government, which was in part caused by a failure to implement robust asset management practices. The result is substantial rectification costs. This issue is commonly referred to as the infrastructure deficit.
- ▶ Technical condition of assets is poor in some areas. For example, Engineers Australia *Infrastructure Report Card* for 2010 considers local roads – which are more than 60% of local government assets – a 'D+', which it defines as "poor – critical changes are required to enable infrastructure to be fit for its current and anticipated future purposes".<sup>47</sup> The report card also states that "local governments have responsibility for a large number of timber bridges that are deteriorating, and maintaining these bridges is very costly."

## Barriers to the effective and efficient prioritisation of local infrastructure

Barriers inhibiting the effective and efficient prioritisation and delivery of local government infrastructure include:

- ▶ Internal capability
- ▶ Role and financial sustainability
- ▶ Funding

### Internal capability

Weaknesses in internal capability can be further broken down into the following component parts of the prioritisation process:

- ▶ Documentation and due diligence
- ▶ Resources and skills
- ▶ Generating data on infrastructure
- ▶ Community consultation
- ▶ Focus on long-term outcomes
- ▶ Change processes
- ▶ Federal and state government support.

#### *Documentation and due diligence*

The evidence suggests that a barrier to effective prioritisation is the quality of documentation for capital expenditure on new and existing assets.

Business cases are the primary documents that:

- ▶ Substantiate the alignment between expenditure and corporate objectives
- ▶ Establish net benefit in socio-economic terms
- ▶ Identify and evaluate options
- ▶ Estimate the range of risk-adjusted out-turn costs
- ▶ Set a framework for monitoring performance and the realisation of benefits.

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<sup>47</sup> Engineers Australia, *Infrastructure Report Card 2010*, November 2010

Where local government is unable to generate business cases and associated documentation to a high standard, it is unlikely to adequately inform either decision-making by councillors or post-investment performance monitoring and risk management.

The consultation identified the following trends in the quality of documentation and due diligence:

- ▶ There are examples of ad-hoc decision-making as a result of limited detailed information on options, costs and risks.
- ▶ There is a consistent view across local government that the costs of applying for federal and state grant funding are high. As applications typically require business case documentation, this suggests that documentation of this type is too frequently not business-as-usual for the sector.
- ▶ There is a desire to change the focus of councillors and council staff from assets to outputs. That is, conceptualising options around an end rather than a means, such as “access to print and online resources” rather than “a new library”. A focus on outputs is embedded in most business case guidance and defining them is an essential step early in the process.
- ▶ It was suggested that where better information on capital expenditure is available, it empowers officers to ‘push back’ on some community (or even councillor) expectations.
- ▶ Other than roads, major projects for many councils are often irregular or one-off. This is an additional challenge for practitioners as procurement issues and risks are specific to the asset type and are likely to be better managed with the benefit of relevant previous experience.

### ***Resources and skills***

Capability and procurement processes have been identified as issues in previous research work, including a report in Victoria in 2008, which estimated better practices across local government could yield annual savings of \$180m - \$350m.<sup>48</sup>

A lack of skilled resources exacerbates the challenges of developing and delivering infrastructure projects on time and on budget. The ability to run a competitive procurement process and achieve efficient pricing is an example of the important link between skills and infrastructure provision.

The capacity of local government is highly variable by geographic location. The consultation suggested that the availability of skilled resources is a barrier in many areas, particularly outside metropolitan regions.

Councils in regional and remote areas face unique challenges recruiting and retaining skilled staff. In the Northern Territory, for example, the availability of accommodation and facilities in remote areas is so poor that many of the shire councils have their head offices in regional towns, which are located outside their shire boundaries. Central Desert Shire and MacDonnell Shire are based in Alice Springs and Victoria Daly Shire and Roper Gulf Shire are based in Katherine.

Departments of state and territory governments responsible for local government have stressed that the availability of human resources and skill levels are significant issues in the regions and many have initiated training programs tailored or directed at regional areas to address the gap. For example, the Institute of Public Works Engineering Australia is hosting seminars in regional New South Wales as part of the roll out of their practice note on long-term financial planning.

It is not only an issue for the regions. Areas with rapid population growth can quickly straddle urban and rural or coastal areas, which create quite different issues from an infrastructure perspective, such as environmental and ecological impacts, and this requires a broad composition of skills across the workforce.

### ***Generating data on infrastructure***

Condition data is an essential input for both asset management and long-term financial planning. The evidence suggests that important data is not always readily available to local government. Data gaps complicate decision-making on the timing and quantum of capital expenditure on asset renewal, and limit the integrity of long-term modelling on financial sustainability.

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<sup>48</sup> Department of Planning and Community Development (Vic), *Local Government Procurement Strategy*, September 2008

A substantial amount of work is underway in most states and territories to improve the level of knowledge of infrastructure. However, many councils are starting from a low base and even those with more sophisticated systems and processes acknowledge material gaps in their understanding of the condition of their stock of infrastructure. For example, one of the larger councils in Sydney acknowledged that their drainage network is a “blind spot” and they are not yet confident that a clear view exists on the size of the asset renewal requirement.

Many councils also identified weaknesses in the documentation of levels of service attached to their infrastructure. Specifically, there are examples of a lack of a clear understanding of the level of service to be provided by local government, or statements which are too old to be aligned with current community expectations or forecasts of financial position, and no consistent process for engaging the community to re-scope levels of amenity. For example:

- ▶ Several councils suggested they were probably providing too high a level of service for some assets and too little for others, but currently they lack the information required to form an accurate assessment.
- ▶ One council stated that the task of reviewing levels of service (for infrastructure and services) was the highest corporate priority but is still expected to require 18 months of work to improve to a satisfactory level.

### ***Community consultation***

The consultation suggested that difficulties engaging and communicating with the local community inhibit the prioritisation process. A lack of effective engagement with the community complicates long-term planning, as without buy-in, there is a risk of complaint as council adopts and actions its priorities independently. Determining the ‘adequate’ level of infrastructure, and its amenity, is a key planning input and simultaneously a legitimate concern of the local community.

In the absence of clear price signals, communities should be expected to advocate for higher levels of provision, or changes to the priority of provision, and are likely to contest the adequacy of levels of amenity. Engaging with the community to define an adequate level of infrastructure provision and amenity is an essential prerequisite for considering role, priorities and financing.

The engagement process needs to be well-run because there are inevitably assets and related functions for which elected officials, council officers and communities have different views on adequacy. An example is the capacity of civic buildings to host different types of community activities.

Amenity is also relative between areas. For example, one regional council in South Australia noted that two thirds of its road network is unsealed, which provides substantially less amenity compared with most urban areas. Other specific issues raised during the consultation include:

- ▶ The representativeness of local government staff compared with the demographic and ethnic composition of the local community
- ▶ In the Northern Territory, consultation processes as part of the negotiation of access to, and tenure of, land owned by land councils
- ▶ The limitations of community engagement in fly-in fly-out areas, where the non-resident population places heavy demands on infrastructure.

### ***Focus on long-term outcomes***

The consultation suggested that, until recently, local government did not have an adequate focus on long-term financial outcomes. That is, decisions made do not adequately take into account future impacts. Examples include:

- ▶ Evidence gathered from recent capability building through the LGRF suggests there are councils in Tasmania without either long-term financial plans or asset management plans, and some continue to rely on methods and tools developed prior to the adoption of accrual accounting across the public sector.

- ▶ The Victorian Auditor-General's report on business planning practices found that "expenditure and asset investment decisions were driven primarily by a focus on improving financial ratios, rather than by priorities emanating from service and asset planning."<sup>49</sup>
- ▶ There are cases where capital projects have been pursued (and renewal projects have been deferred) with limited understanding of the recurrent cost implications.

It is important to acknowledge that a particular focus of recent legislative amendments in New South Wales, Queensland and Western Australia has been on explicit requirements to make investment decisions in the context of long-term financial sustainability.

For example, a sharper focus on performance metrics and monitoring aligned with long-term financial outcomes is becoming more evident in some areas. Performance monitoring for infrastructure can include, for example, the quality and timeliness of cleaning of buildings or recreation areas, or the contribution of road networks to improving average travel times. Metrics can be used as tangible evidence that a prescribed level of amenity is being provided. It has other uses, such as tracking the value for money of contracts for service providers. A focus on performance from the community's perspective can drive similar focus internally and change the approach to accountability.

### **Change processes**

Adopting best practice frameworks and guidance are important aspects of change but to be effective must be integrated into "business as usual" processes. Lowering the barriers described above requires internal changes across local government. Internal change may need to be cultural as much as procedural. Indeed, cultural change arguably presents more difficult long-term challenges and requires a greater investment of time and resources. The case study below illustrates this point.

**Figure 19: Internal change – a case study**

#### **Internal change – a case study**

A growth corridor metropolitan council has embarked on a program of internal change with the aim of improving its capability to plan and manage its investment in infrastructure. In the past, council's emphasis was on delivering projects and satisfying community demands, but to the detriment of upfront due diligence, asset management, and ultimately its long-term financial position.

Council recognised that:

- ▶ Its prioritisation process should be more rigorous and robust, with primary emphasis on moving to a financially sustainable position
- ▶ A high quality of information on investment options has the dual benefit of improving decision-making by elected representatives and better informing their interaction with the community
- ▶ Competitive pressure for grant funds is increasing and a higher standard of business case and asset management documentation can be used as a competitive advantage - that is, "to speak the language of state government."

The change process has included an overhaul of the policy and procedure used for procuring major projects. Change has been approached from two directions - procedural and cultural:

- ▶ **Procedural change**  
A new project management system will use the process maps, guidance material and practitioner tools promulgated by the state government. The guidance addresses business case preparation, procurement options assessment, tendering (including standardised documents), and contract management. This package supersedes council's legacy material.
- ▶ **Cultural change**  
Achieving cultural change presents a greater challenge. Long-term employees are familiar with the legacy system, despite its deficiencies. To overcome resistance to change, council reformed its organisation structure by separating the Facilities Management and Construction department and its management, and changing the lines of upward reporting. The Construction department

<sup>49</sup> Victorian Auditor-General's Office, *Business Planning for Major Capital Works and Recurrent Services in Local Government*, September 2011

is now responsible for all investment proposals, and because asset renewal projects are subject to the same investment appraisal process, the asset management function has moved into the Construction department. This is a substantial break with the previous organisation structure. Council has hired external personnel to manage the new departments, and importantly, personnel with practical experience of the new project management system.

In total, the program of change is a substantial investment in personnel, tools and time. Council will implement a pilot program to roll out the new system incrementally, in part to demonstrate its value to the organisation and encourage a change in mindset. Full roll out is scheduled over 18 to 24 months and will require approximately \$500,000 to complete.

### ***Federal and state government support***

The Nationally Consistent Frameworks and associated capability building programs such as the LGRF have been a catalyst for improvement. These have been supported in many states by coordinated suites of voluntary support packages developed by local government associations.

Building internal capability in the local government sector offers an efficient use of public money and also facilitates the adoption of some other recommendations in this report, particularly the responsible use of debt finance, alternative procurement options and new models of regional collaboration to deliver infrastructure.

Federal and state government stakeholders have recognised the extent of change required in some council organisations to embed best practice. Direct engagement by federal and state governments has proven benefits, including increasing the level of uptake by councils, and leveraging funds to support this outcome. Evidence from the consultation and literature suggests that there is a requirement for their targeted support to be continued and extended, particularly in the regions.

### **Recommendation 4      Capability building programs**

Programs of targeted training and capability building in asset and financial management should be extended.

While support through guidance and training is important, the key to lasting and genuine change is the integration of best practice into “business as usual”. This ultimately requires cultural change over a long period.

Evidence from the consultation suggests that achieving this cultural and procedural change can be a significant challenge for the local government sector. There is a role for federal and state governments to provide assistance in this task, and the consultation suggested that councils would respond well to a periodic external view of progress that will both maintain the pressure for change by monitoring compliance with new frameworks, and support the advocates of change where a case for investment is required.

### **Recommendation 5      Review of asset and financial management practices**

Asset and financial management reform initiatives should be supplemented by periodic independent reviews of the implementation of the Nationally Consistent Frameworks.

## **Role and financial sustainability**

The role of local government evades definition and there is no single set of responsibilities and functions which apply to local government as a sector.

The services actually provided in individual areas can vary considerably. This is only partly explained by the obligations mandated by state and territory legislation; it is also likely related to the political history of different states and territories, patterns of development, and many seemingly random interactions with state and federal government over a long period.

However, councils' responsibility for infrastructure is derived from their role, and accordingly issues with role impact on their performance in relation to the prioritisation and delivery of infrastructure. These issues can complicate long-term planning and budgeting, with resultant impacts on infrastructure provision.

Issues surrounding role and financial sustainability can be categorised as follows:

- ▶ Clarity of role
- ▶ Boundaries of responsibility and function as a stakeholder in other projects
- ▶ Relationship between role and financial sustainability.

### **Clarity of role**

In the absence of a tightly defined role for local government, the federal government, state and territory governments, councils and local communities do not always have a consistent view about what the local government sector can and should do.

For example, one council officer stated that the role of local government is "to provide whatever the community wants", including social welfare services. Conversely, another believed that local government performs *too many* social welfare services and that they are not the job of local government as they are unrelated to property and have not been delegated by another tier of government.

The *Inter-Governmental Agreement Establishing Principles to Guide Inter-Governmental Relations on Local Government Matters* ("IGA 2006") stated that local government is "responsible for funding functions it chooses to undertake in an area of responsibility of other spheres of government, in addition to funding its existing core functions."<sup>50</sup>

This helps to explain the wide variety of services actually provided, including those as diverse as tourism, aged care, mental health and economic development.

However ambitious a council may be, in practice role is in large part constrained by:

- ▶ Its legacy asset base
- ▶ Personnel and financial resource requirements
- ▶ The availability and 'single purpose' conditions attached to tied grant funds
- ▶ The presence of other tiers of government as service providers.

Funding sources can guide local government to projects and this can limit their autonomy to prioritise projects. Tied grants can be 10-20% of total funding. The consultation illustrated many examples of projects which are effectively on hold until funding from other tiers is available. For example, one council's investment program includes the item "bike path development" but the corresponding indicator of success is "funding received from state and federal government".

The limited presence of the state in some areas also acts as a constraint on role, primarily from the perspective of absorbing recurrent funding which might otherwise be available to finance capital investment. As the Hawker Report noted, "local government is often the only tier left to fund or provide human services when other tiers cease or reduce funding."<sup>51</sup>

This is particularly an issue in regional and remote areas:

- ▶ The Australian Centre of Excellence for Local Government (ACELG) report on small communities observed that "indigenous councils often carry the burden of administering social programs and operating essential services and enterprises that would otherwise be the responsibility of government agencies, non-government organisations or the private sector...rural-remote and

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<sup>50</sup> *The Inter-Governmental Agreement Establishing Principles Guiding Inter-Governmental Relations on Local Government Matters*, April 2006

<sup>51</sup> Standing Committee on Economics, *Finance and Public Administration, Rates and Taxes: A Fair Share for Responsible Local Government*, November 2003

indigenous local government has often assumed a provider of last resort role in order to ensure the sustainability of small communities".<sup>52</sup>

- ▶ A report on remote Queensland councils stated that they are providing banking services, undertaker services and a bakery.<sup>53</sup>
- ▶ An example from the consultation is a general practice medical service provided by a council in remote Western Australia, noting the cost of the service is only partly funded by the state.

### ***Boundaries of responsibility and function as stakeholder in other projects***

The existence of multiple tiers of government creates interfaces, and for infrastructure, they are the points at which responsibility for asset procurement or maintenance transfers from one to another.

These relationships can be characterised by both real and perceived responsibilities, the latter representing the public's perception of where responsibility lies. For example, the failure to proceed with a particular project may result in public pressure being applied to the tier of government perceived to have the greatest capacity to fund the project, as opposed to the tier of government with real responsibility for the decision being taken. This practice highlights the importance of cooperation between the different tiers of government in the delivery of infrastructure priorities.

It is acknowledged that there are some good examples of frameworks within which state and local government work together to align their strategic plans and subsequent project selection, such as the one described in Figure 20.

**Figure 20: The Southern Integrated Transport Plan**

#### **The Southern Integrated Transport Plan**

The Southern Integrated Transport Plan is a collaborative initiative of the Tasmanian Government, Southern Tasmanian Councils Authority (STCA) and twelve member councils. The plan provides a coordinated and strategic framework to recognise and address transport issues within the Southern Region over the next twenty years. The Tasmanian Government, STCA and member councils have developed a five year action plan to identify, prioritise and take forward specific activities.

The plan's vision is a cooperative partnership approach between different levels of government for planning, coordination and funding of the transport system. State and local governments must adopt the plan's investment and planning principles in their own decision-making processes and ensure that both existing and future transport plans, such as local transport plans and corridor studies, align with the Plan.

Despite examples of good practice, however, the quality of engagement by other tiers of government (and the extent of coordination on related strategy, objectives and plans) was raised by a large number of council representatives during the consultation. The consultation identified a lack of process at the interface between tiers of government for some assets. For example:

- ▶ Participants in South Australia discussed circumstances relating to local roads which have sustained increases in patronage and capacity as a result of population growth and economic development, to the point where councils believe they cease to be local roads and should be reclassified. However, the processes in place are not satisfactorily resolving their petitions for change.
- ▶ A similar example was identified in the Northern Territory, where the territory government is seeking to transfer assets including roads, airstrips and boat ramps to local government. Local government is concerned about the condition of assets on transfer and their capacity to support ongoing maintenance and renewal without additional funding. The consultation suggests a lack of process to resolve the allocation of responsibility for these assets satisfactorily.
- ▶ Previous reports have noted similar issues including states reclassifying roads as local roads to pass the corresponding financial burden to local government. For example, the Hawker Report

<sup>52</sup> Australian Centre of Excellence for Local Government, *Role and Expectations of Rural-Remote and Indigenous Local Government*, February 2012

<sup>53</sup> Dillery, B, Wallis, J, Akimov, A, *One Size Does Not Fit All: The Special Case of Remote Small Local Councils in Outback Queensland*, Local Government Studies, Vol. 36, No. 1, 21-42, February 2010

documents the transfer of responsibility for regional roads by the New South Wales Government to Guyra Shire Council, Singleton Council and Dalrymple Shire. While the state subsequently provided annual funding for maintenance, it became inadequate.<sup>54</sup>

- Local government is often a stakeholder in individual projects procured by state and federal governments, primarily due to its role as provider of complementary or supporting infrastructure and planning for surrounding land use. The need for engagement and coordination, particularly for large projects or programs, is an added level of complexity for prioritisation processes within local government - that is, the need to coordinate the commissioning of works to achieve all of the intended functionalities of investments.

The evidence suggests that there is not enough engagement with local government during the early stages of significant projects or policy changes. Long-term planning by the sector is unnecessarily complicated by late or partial disclosure of actions which are material to their prioritisation of projects and ultimately their financial position.

State governments and the Commonwealth should be required to formally engage with local government when their actions change its role as an infrastructure provider. While this is intent of IGA 2006, it is not happening in practice. Better engagement can provide certainty around interface processes to enable councils to plan for the financial impact of receiving or transferring assets. Uncertainty complicates the ranking of priorities and forecasting of future expenditure.

Jurisdictions should commit to identifying at an early stage the potential impact upon local government of particular policies and projects or programs. To achieve this, they should commit to completing local government impact assessments at the business case stage. This would have the secondary benefit of tackling issues caused by "cost shifting", explored below.

#### **Recommendation 6    Local government impact statements**

Federal, state and territory governments should commit to completing local government impact statements as part of the business cases prepared to support new policy proposals and projects, where there is likely to be a direct cost impact upon local government.

#### ***Relationship between role and financial sustainability***

Local government needs to be able to deliver its role and maintain sustainable finances simultaneously. However, evidence gathered during this study suggests that role is not always consistent with long-term financial sustainability.

The *National Financial Sustainability Study of Local Government* in 2006 estimated that, in the "mid case", 35% of councils were unsustainable.<sup>55</sup> Notwithstanding the qualifications in that report regarding the methodology and data used, there is clearly an imperative for many councils to act to move toward financial sustainability.

To date, the debate about the causes have been prosecuted from two perspectives: local government's role is too broad to be sustainable, and local government's finances are inadequate to support its role. We suggest that a better balance needs to be struck. In some cases, a narrower role may need to be negotiated with the community; in others, increased financial support from the rates base and grant providers is required.

Clearly an undesirable outcome is inertia which leads to a higher portion of the sector trending towards unsustainable long-term financial positions.

The consultation suggested that there are few advocates of further and more restrictive definitions of the role of local government. On the contrary, the evidence suggests that the focus should be on setting practical boundaries on role at the asset level and retaining flexibility for local government to respond to changes in their communities.

<sup>54</sup> Standing Committee on Economics, Finance and Public Administration, *Rates and Taxes: A Fair Share for Responsible Local Government*, November 2003

<sup>55</sup> PricewaterhouseCoopers, *National Financial Sustainability Study of Local Government*, November 2006

This is important because local government typically has little control over the directions of change: council decision-making can be driven by patterns of economic development such as the resources boom, land use changes arising from medium density housing policies, or demographic changes. Council representatives acknowledged that society and economy-wide changes of this nature need to be considered as risks to their long-term plans and the flexibility to adjust role and amend priorities becomes an important risk management tool.

Councils need to challenge their communities when expectations for infrastructure are not consistent with financial sustainability. The evidence suggests community consultation is not sufficiently holistic to give the community a clear picture of the relationships between role and priorities, asset condition, and financial position.

To achieve this, every council should develop a long-term capacity forecast for presentation to the community. This should include an explanation of council's proposed role, the associated funding required to deliver its proposed investments, and evidence of the ability to sustain the proposed levels of service for its assets and services.

In order to assist local government in this task, other tiers of government can provide support to councils in conducting a thorough review of the boundaries of responsibility for different classes of community assets, and in particular identifying appropriate and transparent process for the transfer of responsibility between tiers of government. It is anticipated that this review will form a key input for the long-term capacity forecast presented to the community.

#### **Recommendation 7    Local government roles and responsibilities**

All jurisdictions should commit to building on the intent of the Inter-Governmental Agreement 2006 by outlining clear steps to achieving better clarity of the roles and responsibilities of each tier of government. In particular:

- a. State, territory and local governments should cooperatively review the asset registers of local governments to ensure that, for each asset class, the boundaries of responsibility are unambiguous and that an appropriate and transparent process to transfer responsibility between governments is in place.
- b. As part of its community engagement, local government should present its forecast long-term capacity to fund the role it is proposing, with specific reference to the capacity to sustain defined levels of service for existing and proposed assets, services and projects.

## **Funding**

While the quantum of funding available will vary over time, and is linked to economic activity and the political cycle, a fundamental assessment for local government is the extent to which funding levels are adequate to meet the infrastructure task.

ABS data shows that the local government sector's total revenue has risen steadily in the last decade (refer to Figure 6 in Chapter 1). Nonetheless, the local government sector considers funding to be a significant barrier to effective prioritisation and delivery of infrastructure. The consensus view is that capital funding is constrained and there are many examples of priority projects which could not proceed as a result. Various policy initiatives (such as caps on development charges) were also identified as pressures on funding sources.

Sources of local government funding and their limitations are explored in the second chapter of this report. This section highlights some issues raised in the consultation relating specifically to the impact of funding upon the effective and efficient prioritisation of infrastructure investments, in particular in relation to :

- ▶ Rates and the willingness to pay
- ▶ Funding the backlog
- ▶ Cost shifting

### ***Rates and the willingness to pay***

There will almost always be limits to a community's willingness to pay, including the appetite of elected councillors to ask communities to contribute more. The Hawker Report noted that "if the federal government provides untied funds to local government, it must be assured that local government is doing its best to maintain its essential infrastructure", and the same is arguably true for local communities.<sup>56</sup>

The willingness to pay within a community at a point in time is likely to be unique or independent of other local government areas, and ultimately difficult to determine. The rating effort will inherently be a subjective judgment for each council.

The consultation suggested that the limit on rating effort is most accurately discovered through engagement with stakeholders.

In the City of Onkaparinga, an outer metropolitan council in South Australia, for example, council described the substantial infrastructure challenges arising from rapid population growth and housing developments spread across a large geographic area. This includes providing new creek and ravine crossings and interchanges with major arterial roads in the area. To ensure a timely response to infrastructure requirements, council established a new fund to raise capital for priority capital expenditure, serviced by an increase in rates. There was concern that community sensitivity to rate increases would result in popular opposition. However, the approach has largely been accepted by the community, and the conclusion formed by council is that effective engagement and communication can win community support for clear and robustly developed infrastructure plans.

Local government, as part of an effective prioritisation process, should therefore ensure it has the skills to engage the community on the role of rating and user charges in achieving long-term infrastructure investment and financial sustainability. This requires best practice planning and forecasting tools as well as procurement and management capability, to provide a reasonable assurance that funding is both efficiently allocated and well-spent. A lack of these skills or capability is itself a barrier to effectively prioritising and funding identified priorities.

### ***Funding the backlog***

The consultation identified a substantial infrastructure gap or 'backlog' across the local government sector. The ramp-up in condition auditing of the infrastructure stock is producing a clearer picture of the size of the gap.

As an illustration, a small shire in Victoria developed modelling to determine its cumulative renewal gap. Over a 20 year period, it forecast an annual funding shortfall in renewal expenditure of between 20%-35% of operating revenue, which is forecast to accumulate beyond \$200m in aggregate.

Other councils described similar modelling exercises and stated that, in some of the scenarios modelled, investment requirements are beyond their financial capacity assuming current levels of own-source and grant revenues.

Attempts have also been made to quantify the backlog on a national level too. For example, in a submission to the Hawker inquiry in 2003, the Melbourne Metropolitan Chief Executive Officers group estimated the gap in local authority essential infrastructure funding to be \$1.65bn per annum across the nation.<sup>57</sup>

The consultation suggested that the backlog is largely a legacy problem caused by a combination of inadequate funding, asset management and renewal provisioning processes. The increased focus on asset management noted above suggests a clear intent to avoid exacerbating the gap, but clearly resolving it will consume a significant portion of future funding.

The LIRS in New South Wales shows that the scale of the problem has been recognised at state government level. The LIRS, which provides subsidies to meet interest payments on local government

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<sup>56</sup> Standing Committee on Economics, *Finance and Public Administration, Rates and Taxes: A Fair Share for Responsible Local Government*, November 2003

<sup>57</sup> City of Port Phillip, *Briefing for the Strategy and Policy Review Committee*, February 2004

loans, is an element of the New South Wales Government's Local Infrastructure Backlog Policy, which aims to support councils with "the task of reducing the vast backlog of infrastructure projects".<sup>58</sup>

Accurately identifying the size of this gap is a significant issue for the prioritisation and delivery of infrastructure. The extent of funding required to clear the backlog may be considered a barrier to investment in creating new assets. However, it is important that capital investment in renewal is considered alongside investment in new assets, to properly inform the prioritisation of projects so that all investment proposals are aligned with long-term financial sustainability.

### **Cost shifting**

Cost shifting refers to situations where the responsibility for, or the costs of, providing a service, concession, asset or regulatory function shifts to local government without corresponding funding or revenue raising capacity.<sup>59</sup>

IGA 2006 states that "the adequacy of resources available to local government is significantly impacted by cost shifting".<sup>60</sup> It has been well documented in recent literature, including a number of state-based studies:

- ▶ The *Review of the Financial Sustainability of Local Government in Tasmania* found that operating deficits and infrastructure backlogs were "systemic" and in part relate to cost shifting.<sup>61</sup>
- ▶ The Western Australia Local Government Association stated in 2008 that "most authorities cite cost shifting and the growing compliance rules determined by over 400 pieces of state legislation as significant drivers of cost and sustainability challenges facing councils across the state".<sup>62</sup>
- ▶ A cost shifting survey is completed annually by the Local Government and Shires Association of New South Wales. Its purpose is to quantify cost shifting practices. The most recently published survey data found that the cost shifting ratio is 6.35% of total income for local government before capital amounts, a ratio consistent with previous financial years.<sup>63</sup> Using this ratio, the report estimates a total amount in the order of \$520m. Other states do not prepare similar studies but evidence from the consultation suggests the underlying drivers are present elsewhere.

The consultation also provided many individual examples of new and ongoing cost shifting, which are notable given the intent of IGA 2006 to reduce the incidence.

Cost shifting is often cited as a barrier to the delivery of programs of priority projects. This is because it can reduce surplus revenue which might otherwise be available to finance capital investment.

The amounts involved can be significant and if they were fully funded or "shifted back", they could support additional investment in infrastructure. Aside from the quantum of funding, cost shifting can lead to sudden diversions in internal resources, which can hamper councils' ability to develop and evaluate investment priorities methodically. An illustration is in the box below.

**Figure 21: National Partnership Agreement on Early Childhood Education**

#### **National Partnership Agreement on Early Childhood Education**

In June 2009, the Australian and Victorian Governments signed a national partnership agreement on early childhood education. This agreement contains performance objectives, one of which is increasing the standard hours of pre-school education from 10 to 15. Local government is not a party to the agreement. However, this change has important implications for local government because

<sup>58</sup> New South Wales Minister of Local Government, *Media release*, 6 September 2011

<sup>59</sup> Local Government & Shires Association of NSW, *The Impact of Cost Shifting on NSW Local Government: A Survey of Councils - Financial Year 2009/10*, 2011

<sup>60</sup> *The Inter-Governmental Agreement Establishing Principles Guiding Inter-Governmental Relations on Local Government Matters*, April 2006

<sup>61</sup> Access Economics, *Review of the Financial Sustainability of Local Government in Tasmania*, March 2007

<sup>62</sup> Western Australian Local Government Association, *The Journey: sustainability into the future, shaping the future of local government in Western Australia (Systemic Sustainability Study)*, 2008

<sup>63</sup> Local Government & Shires Association of NSW, *The Impact of Cost Shifting on NSW Local Government: A Survey of Councils - Financial Year 2009/10*, 2011

councils provide facilities (and staff) for pre-school services in the state.


An outer suburban council in a growth corridor of Melbourne prepared a report on the impact of this change, which will result in a 50% increase in the use of existing facilities. The report found that upgrades are required immediately to seven existing facilities at an average cost \$600,000 per building. These works had not been anticipated by council and accordingly were not priorities. Limited grant funding was available through the state's Early Childhood Services Management funding programs but two significant challenges were identified: grants are capped at \$300,000 per facility, and competition for these funds had increased as other councils identified similar requirements.

The net result was a funding deficit in the order of \$1.5m - assuming works on only five facilities - which remains unfunded. For the federal and state governments, these circumstances create a risk to the achievement of the anticipated outcomes in the partnership agreement.

In common with the issues of boundaries of responsibility and role definition, the solution lies in effective engagement by states and the Commonwealth with local government during the early stages of significant projects or policy changes.

The late or partial disclosure of significant policies or programs are a significant cause of unanticipated transfer of commitments which councils classify as cost shifting. In order to minimise the incidence of this practice, jurisdictions should commit to identifying at an early stage the potential impact upon local government of particular policies and projects or programs.

To achieve this, they should commit to completing local government impact assessments at the business case stage (Recommendation 6) and working towards a better understanding of the role and responsibility of the different tiers of government (Recommendation 7).

A low-angle shot of a basketball player in a blue jersey and white shorts performing a dunk. The player is silhouetted against a bright sunset sky. The basketball hoop and backboard are visible above the player. The sun is low on the horizon, creating a strong lens flare and reflecting off the asphalt court. The background shows a flat landscape under the sunset sky.

Creating value  
through the  
procurement  
process

## 5. Creating value through the procurement process

### Key findings

- ▶ Despite some tentative moves by local government to explore procurement models involving private finance or risk allocation, the sector has not given enough consideration to methods of procurement outside the traditional approach.
- ▶ Without investigating the full spectrum of infrastructure procurement options available, the ability of the local government sector to accelerate new investment will continue to be constrained by limited access to capital.
- ▶ Councils should consider achieving procurement efficiencies through alternative delivery models, in particular those that involve a degree of project and financing risk transfer to private sector partners. There is currently an information gap in this area.
- ▶ The lack of engagement by private investors in local government infrastructure projects is driven primarily by the absence of projects of sufficient scale within the sector. Other barriers include the lack of a clear pipeline, the absence of commercial returns and/or tradeable products for investors, and concerns around the local government sector's internal capability.
- ▶ The Australian Government has a role in generating private finance for specific projects by supporting a trial project with the aim of developing a replicable market and a pipeline of future projects.

### Recommendations

#### **Recommendation 8: National advisory body for local infrastructure procurement**

The Australian Government should work with the states and territories to establish a national body to provide skills and oversight of local government infrastructure. Its role would include capability building and the development of policy, guidelines and other assistance.

#### **Recommendation 9: Major project procurement guidance**

Major project procurement guidance should be developed and issued to local government to promote awareness of the spectrum of alternative procurement models for infrastructure delivery.

#### **Recommendation 10: Trial project for private investment in local infrastructure**

The Australian Government should identify an opportunity for a suitable local or regional infrastructure project whereby a market can be "created", and establish a collaborative group of stakeholders to take the project forward. A "waste to energy" project may be a good candidate.

The majority of councils in Australia have embraced some form of engagement with external providers of infrastructure. Outsourcing models - whereby the private sector carries out a defined service for a defined fee - are common, as are management contracts - whereby the private sector carries out a range of tasks over a longer period.

These models can generally be classified as "traditional", in that they tend to be limited to the design and construction of an asset, and normally do not involve significant ongoing maintenance and operation activities. Traditional delivery models are funded by council on balance sheet, and council remunerates a contractor or supplier whilst retaining ownership of the asset. They are generally suited to low-risk procurements where the asset to be delivered can be defined with a high degree of certainty.

Despite some tentative moves by local government to explore procurement models involving private investment or risk allocation, the sector has not given serious consideration to methods of procurement outside the traditional approach. While some of the higher profile “alternative” solutions, such as public private partnerships (PPPs), are well known, there is generally limited awareness of the form and commercial structure of alternative methods, the motives for using them, and their benefits.

With the exception of Brisbane City Council, there have been few examples of local government successfully procuring large scale infrastructure projects using private finance. Conversely, there have been some high profile failures including the "Oasis Project", the PPP involving Liverpool City Council and the Bulldogs Rugby League Club.

Although the PPP model has not always translated well into the local government context, there are a range of alternative procurement methods (which may or may not include private financing) which can be successfully adapted to suit the local government environment.

Traditional delivery models have limitations which may not enable local government to achieve the best value for money and project outcomes. For large, complex or innovative projects, better value and project outcomes may be achieved by utilising a non-traditional delivery model.

In response to the challenge of operating within a constrained funding environment, there needs to be greater awareness and adoption of more complex partnership models. This will doubtless be facilitated by the growing trend - sponsored and encouraged by state and territory governments and the Commonwealth - towards more effective and longer-term asset management and financial planning. The focus on a whole-of-life approach to assessing, planning and costing infrastructure and associated services should open up projects to more sophisticated approaches to procurement.

## Non-traditional procurement models

The private sector is willing to finance and where viable even fund infrastructure, so long as projects can support a commercial rate of return that is commensurate with the risks taken. Some projects do not provide enough returns or do not generate revenue streams to support finance. Nevertheless it may still be possible to attract private investment by commercialising some part of the project.

To achieve this, alternative delivery models adapted to suit the local government context can not only help address the funding issue, they can also enable local government to take advantage of the experience and expertise of the private sector. The main argument for private sector involvement in infrastructure delivery and operation is that significant efficiencies can be driven by the profit motive and exposure to competition.

The private sector can:

- ▶ Identify and manage risks and costs
- ▶ Provide specialist management and technical skills
- ▶ Coordinate capital costs with whole-of-life operating costs
- ▶ Improve the efficiency and quality of services
- ▶ Assess market needs and capacity
- ▶ Raise financing.

A UK study in 2000 found that private sector involvement in competitive local government infrastructure delivery can lead to savings of 17%.<sup>64</sup> This figure is net of the higher financing costs borne by the private sector, meaning that the raw operational savings may be even higher. The

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<sup>64</sup> Arthur Andersen, *Value for Money Drivers in the Private Finance Initiative*, January 2000

benefits of partnership models in Australia have been set out in studies by *Partnerships Victoria* in 2004 and *Infrastructure Partnerships Australia* in 2009, amongst others.<sup>65</sup>

Figure 22: Examples of partnership models to infrastructure procurement

**Partnership models – some examples in local government: small, medium and large**

- ▶ **Strathbogie Shire Council** provides two “welcome shops” in partnership with private sector partners - in one case a winery, and in the other a highway service centre. Under the arrangement agreed between the parties, council and tourist information facilities have been constructed and are now operated on behalf of the council within the facility.
- ▶ The **Groote Eylandt and Bickerton Island Regional Partnership Agreement (RPA)** is an agreement between the Anindilyakwa Land Council (ALC), the Australian Government, the Northern Territory Government, the East Arnhem Shire Council (EASC) and the Groote Eylandt Mining Company (GEMCO) to work together to improve conditions for Indigenous people living in the Anindilyakwa region. The RPA covers the Anindilyakwa region which is located on the western side of the Gulf of Carpentaria in the Northern Territory and comprises Groote Eylandt and Bickerton Island. The Regional Partnership Agreement (RPA) addresses locally identified priorities and works towards sustainable and measurable outcomes. As part of the program, an indigenous construction company, Groote Eylandt and Bickerton Island Enterprises (GEBIE) Civil and Construction, has been formed and is providing a key role in major government housing projects.
- ▶ Coffs Harbour City Council entered into an alliance project in 2006 to design and build three major infrastructure projects, through the **Coffs Infrastructure Alliance (CIA)**, a partnership with Abigroup, John Holland, GHD, Aquatec Maxcon and CFNA and Serck Controls. This new alliance contract included the building of the Coffs Harbour Water Reclamation Plant, construction of a new Water Filtration Plant and the construction of a new road bridge. In all, the projects were worth an estimated \$160 million.

Non-traditional procurement models which may be appropriate for the local government sector, i.e. those which combine construction and operating or maintenance activities within a single project, include:

- ▶ Alliancing
- ▶ Design, build, operate, maintain (DBOM)
- ▶ Design, build, maintain (DBM)
- ▶ Design, build, finance, maintain (DBFM)
- ▶ Build, own, operate, transfer (BOOT)
- ▶ Build, own, operate (BOO).

Appendix 6 provides more information about the range of non-traditional procurement models.

<sup>65</sup> Growth Solutions Group, *Review of Partnerships Victoria Provided Infrastructure: Final Report to the Treasurer*, January 2004, and Infrastructure Partnerships Australia, *Financing Infrastructure in the Global Financial Crisis*, March 2009

**Figure 23: Local Improvement Finance Trust (LIFT)**

### Partnership models - an example from the UK: Local Improvement Finance Trust (LIFT)

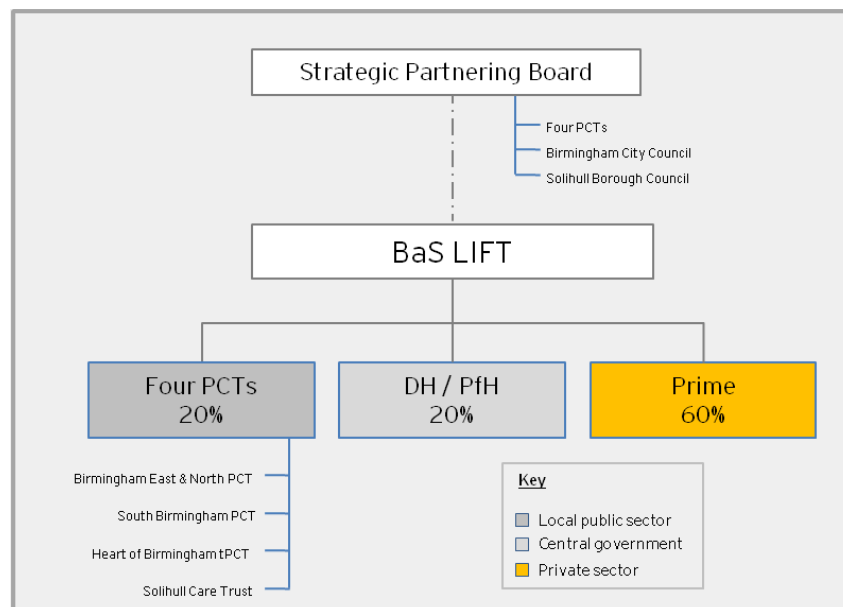
LIFT was introduced by the National Health Service (NHS) in the UK in 2000 as a private finance initiative (PFI) model for improving and developing frontline primary, community and social care facilities.

Through the LIFT process, a local primary care trust (PCT) - or a group of PCTs - engages a private sector partner to deliver a pipeline of projects. A streamlined procurement process is then used to deliver each facility through a two-staged approval process: business case with initial costing based on initial design followed by a fully costed proposal once design is agreed.

LIFT projects are delivered through the establishment of a "LIFTco" jointly owned by Partnerships for Health (PfH) acting on behalf of the Department of Health, the local PCT or PCTs, and a private sector partner. Contracts are typically for 25 years, to allow the LIFTco a guaranteed income stream to recoup development costs.

49 LIFTcos have been established to date, covering two thirds of England's population. They have delivered over £2.5bn of investment in more than 300 buildings that are either open or under construction.

For example, BaS LIFT is owned by four local PCTs, PfH, and Prime LIFT Investments Ltd (a company jointly owned by Prime Plc and Barclays Private Equity). It has completed 12 schemes to date, with a further 10 in development.



## Barriers to the adoption of non-traditional procurement models

Whilst these models are tried and tested, both in Australia and abroad, the adoption within the Australian local government sector has been limited. The barriers to greater uptake of alternative delivery models include:

### ► Commerciality and returns

The principle objective of the private sector is to achieve an adequate return on its investment. Yet most local government assets are "non-competitive" by nature, either because of the "natural monopoly" that exists over some network assets (such as water) or because they are designed to provide a service to the community for which no payment is received in return. Creating a revenue stream from these assets (and a market for it) is often a crucial prerequisite to engaging the private sector, and hence a major barrier to their involvement.

- ▶ **Scale**  
The more complex the model, the larger the projects that may be suitable. This is because the private sector's appetite to take risk is dependent upon the quantum of return. For example, Infrastructure Australia guidelines advise that the PPP model is only likely to be appropriate for projects with a total capital value exceeding \$50m.<sup>66</sup> However, there are no cast-iron rules around thresholds for different procurement models. For example, while the Safer Local Roads program in Mornington Peninsula Shire, which shares many of the characteristics of a PPP, has a value of around \$140m, a similar 15-year program in Cardinia City Council (Connecting Cardinia) is worth around \$17m.
- ▶ **Competition and the market**  
In rural and remote areas especially, the degree of competition within private contracting markets can be very limited. Service providers inevitably face higher costs in remote areas, for example relating to purchasing, travel and mobilisation. This can lead to a lack of sufficient market participants to form a competitive market, and inflated pricing. One council in regional Western Australia reported putting a tender to the market for a recreation centre, expecting it to cost \$1.1m. The lowest bid received was for \$1.9m. Whilst this may be a reflection of the quality of council budgeting, it is also likely to be evidence of the inadequacy of competition in some areas, especially those where resource companies have a strong presence. Councils in regional areas have reported that they often have only one bidder for infrastructure projects. The disadvantageous pricing implications of a limited market are exacerbated when neighbouring councils take similar projects to the market at the same time, as they are effectively competing with each other for the same contractors. On the other hand, however, while local government in regional and rural areas would like to see more competition in the contractor market, they are equally concerned that introducing new, larger contractors would have a detrimental impact on local businesses and local economies.
- ▶ **Reluctance to transfer risk**  
There can be a reluctance on the part of councils to transfer risk and responsibility for council assets and services to third parties. This is often a "cultural" issue and revolves around perceptions of "control".
- ▶ **Transaction costs**  
Transaction costs can be a significant barrier to the implementation of complex procurement models. According to a study by SGS Economics & Planning, "the actual dollar size of the infrastructure contracts are, in many cases, insufficient to gain credibility with the private sector given the significant transaction costs associated with competitive tendering."<sup>67</sup>
- ▶ **Matching the model to grant funding**  
As most grants are provided in the form of 'up-front' capital funding, there is a natural tendency to prefer procurement methods that have a matching cash flow profile, such as traditional design and construct methods. The delivery of grant funding can therefore be a further impediment to procurement methods based on long-term streams of cash flows rather than 'up-front' payments. In addition, there can be a perception that pursuing procurement methods that are not matched to the grant funding available jeopardises the receipt of that funding, which is a risk that councils under financial strain may not be prepared to take.
- ▶ **Legislative barriers**  
Effective partnering with the private sector in the delivery of infrastructure can often be facilitated by councils entering into business relationships with service providers. The entrepreneurial powers of local government are determined by the *Local Government Acts* in the different states and territories, and while most have processes in place for the establishment of corporations or other commercial arrangements by local government, there are some restrictions, most notably in Western Australia (although there is legislation currently before Parliament which would reform the powers of local government to enter into business arrangements).
- ▶ **Skills and knowledge**  
Planning and developing major infrastructure projects is resource intensive and the lack of skilled personnel within local government can be a considerable barrier. Although Brisbane City Council has a City Projects Office of over 300 people and significant capacity to plan and deliver

<sup>66</sup> Infrastructure Australia, *National Public Private Partnership Guidelines - Volume 1: Procurement Options Analysis*, December 2008

<sup>67</sup> SGS Economics & Planning, *Guidelines for a Local Government Infrastructure Financing Manual*, July 2002

major projects, this is atypical. One of the findings of the report into the “Oasis Project” PPP was that Liverpool City Council did not adequately consider the financial risk that it was exposed to at any point in the project’s lifecycle.<sup>68</sup> Furthermore, a cycle of poor understanding can lead to the propagation of “myths” around the perceived dangers of more complex models. Lessons from past experiences with private sector infrastructure financing at the Commonwealth and state government levels have not been disseminated throughout government. There is currently little guidance on non-traditional procurement models tailored specifically to the local government sector. Guidelines issued by state governments, local government associations and other organisations such as the Institute of Public Works Engineering Australia (IPWEA) provide useful resources for councils, but tend not to focus in detail on procurement models involving significant risk transfer or private finance.

The inability or unwillingness of the local government sector to embrace alternative procurement models is holding back the closure of the infrastructure gap. While greater uptake of the procurement services provided by local government associations and Regional Organisations of Councils (ROCs), for example, is crucial to achieving procurement efficiencies through accessing competitive pricing and bulk contracts, these remain largely in the realm of “traditional” procurement. There is little assistance provided in relation to more complex models.

**Figure 24: Local government association and ROC procurement services**

#### **Local government association and ROC procurement services**

The local government associations in the majority of states and territories have established centralised procurement services which offer procurement support and contract management to councils.

These organisations aim to create contractual arrangements for the procurement of goods and services, aggregate the demand for these goods and services to achieve better pricing and conditions, and eliminate the need for councils to establish their own supply contracts.

The basic model is that the association or a commercial business attached to the association is granted restricted status by the state government which allows it to enter into procurement contracts on behalf of councils. It then negotiates panel or preferred supplier agreements with a group of contractors in particular areas with agreed rates and scopes of services. Member councils can then procure through the panel arrangement without the need to go through a tender process themselves. A portion of the savings achieved is retained by the association to cover costs.

Procuring through the local government association enables councils to access specialist procurement and contract management expertise, and to take advantage of pre-negotiated and competitive pricing arrangements.

Some ROCs also provide similar services, while in the majority of states, councils are able to procure through state government contacts too.

In order to overcome these barriers, councils need to develop and demonstrate an enhanced ability to undertake due diligence and procurement options analysis at the business case development stage. This will enable a robust analysis of whole-of-life risks and the procurement models best suited to mitigate them.

At this stage there must also be an assessment of the efficiencies that can be gained from:

- ▶ Bundling capital expenditure with ongoing lifecycle and maintenance costs in order to create scale and pipeline
- ▶ Bundling together a number of individual projects in the same class, for example roads or sewer maintenance across a wide area
- ▶ Aggregating projects across council boundaries.

Value for money outcomes may be further enhanced if any of the above were combined. The Safer Local Roads program in Mornington Peninsula Shire, for example, which has created savings of around

<sup>68</sup> NSW Government, *Liverpool City Council Public Inquiry: Final Report, Findings and Recommendations*, July 2004

\$65m over 15 years for the council, involved bundling capital expenditure and maintenance for all local roads within the local government area.

Figure 25: Safer Local Roads

### Safer Local Roads

Mornington Peninsula Shire Council has achieved substantial cost and service benefits through innovative procurement of maintenance, repair and capital works on its local road network - the Safer Local Roads program. Council adopted a non-traditional approach to managing local roads, using a DBFM model to achieve savings of approximately \$65 million over 15 years.

More details of this program can be found in Appendix 7.

## Addressing the information gap

The apparent reluctance or incapacity of the local government sector to take advantage of procurement models which harness private sector expertise, experience and finance, is in part a function of a lack of awareness of the different models and their benefits, and how to test them.

To assist the local government sector, the consultation suggested that there would be a role for a national body to coordinate change, develop guidance and identify opportunities. The examples of Infrastructure Australia and 4ps in the UK provide evidence that take-up of alternative procurement models can be enhanced where advice and guidance is available from a national advisory body.

While the consultation process tested this concept with councils, it did not produce a consensus as to the ideal composition or structure of the body. More work will be required to identify and evaluate options. It was widely accepted, however, that it could play an important role in capability building and the development of policy, guidelines and other assistance.

### Recommendation 8 National advisory body for local infrastructure procurement

The Australian Government should work with the states and territories to establish a national body to provide skills and oversight of local government infrastructure. Its role would include capability building and the development of policy, guidelines and other assistance.

One of the first tasks of a national advisory body could be to produce procurement guidance for the local government sector. The aim of the guidance would be to promote awareness of the spectrum of models available for the delivery of local infrastructure.

While some guidance material has been prepared at other levels of government, no comprehensive guidelines exist for major infrastructure procurement by local government which address the unique position of Australian councils. The federal and state guidelines do not take into account the legislative, financial, political and practical constraints on local government.<sup>69</sup>

The case for guidance material is particularly strong in relation to larger or more complex projects, as the value for money outcome of non-traditional procurement models will often be proportional to the size of the project. However it will also be applicable to smaller projects, especially when they can be bundled or joined up to form a larger program. It may also be applicable to infrastructure maintenance and renewal projects, as opposed to new infrastructure developments.

It is anticipated that the guidance will provide a framework around which local government can approach the procurement of major infrastructure projects, with a particular focus on the up-front planning and investment required for successful project outcomes. The guidance would enable councils to give reasoned consideration to the range of procurement models available and to utilise, where appropriate, alternative models for the delivery of public infrastructure projects and services. It would address the issues of engagement with private sector investors and create a level of certainty

<sup>69</sup> Infrastructure Australia, *National Public Private Partnership Guidelines - Volume 1: Procurement Options Analysis*, December 2008

and confidence around local government procurement processes which would be beneficial to both the public and private sectors.

This guidance would need to be developed on the basis that each council and each project will have its own drivers and desired outcomes. It will therefore provide a framework for councils rather than detailed step-by-step instructions of how to procure a particular project.

#### **Recommendation 9 Major project procurement guidance**

Major project procurement guidance should be developed and issued to local government to promote awareness of the spectrum of alternative procurement models for infrastructure delivery.

More details about the objectives and contents of procurement guidance can be found in Appendix 8.

## **The “commercialisation” of local government assets**

A challenge for councils is how to structure projects in a way that makes them commercial and attractive to the private sector. While most local government assets will not lend themselves readily to commercial arrangements, creating a “return” can open the door to greatly enhanced leverage of private delivery and, indeed, finance. The right mix of direct funding, user charges and creating alternative funding streams should be part of the process.

One way to achieve this is through making specific assets “multi-use”, the investigation of which is now the policy of a number of councils. This can create opportunities for contractual arrangements whereby community infrastructure is co-located with commercial (for example retail or residential) infrastructure.

Where the asset in question involves a resource for which a market exists or can be created, there are further opportunities for leveraging private finance. In Tasmania, for example, the capacity to create access to more water for farmers through irrigation schemes was identified as such an opportunity. The availability of a resource (water) which has both a supply profile and demand profile has enabled the creation of a tradeable product (water entitlements) which can attract private finance.

**Figure 26: Tasmanian Irrigation**

### **Tasmanian Irrigation**

Tasmanian irrigation schemes are managed by a state-owned company, Tasmanian Irrigation Pty Ltd, which was established on 1 July 2011 as a merger of responsibilities of the Rivers and Water Supply Commission, Tasmanian Irrigation Development Board and Tasmanian Irrigation Schemes companies.

Tasmanian Irrigation administers irrigation schemes which are based upon the Tasmanian Water Development Plan. There a total of 14 schemes being developed, constructed or managed by Tasmanian Irrigation. Some of the schemes are intended to increase the available volume or increase water security in areas already utilising irrigation (such as the Winnaleah and Sassafras Wesley-Vale schemes) whilst some developments will be introducing irrigation to areas largely used for dry land production in the past (such as the Midlands scheme).

Both the state (\$80m) and the federal (\$140m) governments have made significant investments to enable the development of irrigation schemes. The remaining funds (\$93m) have been raised through the sale of water entitlements, which are offered first to occupiers of the land and then - if the occupiers do not take up 100% of the entitlements - to the open market. Once entitlements are granted they can be traded, either separately or together.

More details about Tasmanian Irrigation can be found in Appendix 9.

While the Tasmanian Irrigation example is unique in many respects, and is a state rather than local government initiative, its success in raising private finance makes it a model worth replicating. In order to do this, the Commonwealth should investigate similar opportunities in the local government sphere.

The development of a “test” project in the local government sphere could enable funds to be allocated in a targeted manner with a view to providing more intensive assistance to move the project significantly forward. The benefit of this would be that the lessons learned and intellectual property would be transferable to other councils and other projects. The project should be capable of delivering benefits compared to more traditional projects and procurement processes. It should also be capable of being replicated elsewhere, i.e. across a range of councils.

#### **Recommendation 10 Trial project for private investment in local infrastructure**

The Australian Government should identify an opportunity for a suitable local or regional infrastructure project whereby a market can be “created”, and establish a collaborative group of stakeholders to take the project forward. A “waste to energy” project may be a good candidate.

Designing an appropriate structure to attract private finance, and investing in its roll-out across local governments, can facilitate the development of a market of small projects that can be replicated.

The Commonwealth and state governments’ involvement in a test project would likely be viewed positively by the market, especially if any amendments to legislation were required to make the scheme viable. A further benefit of such a scheme would be the creation of a “pipeline”. Consultation revealed that private sector delivery partners have been unable to find the volume of business to justify upfront investment. Investors are wary of investing time and money developing models where the promise of future projects does not materialise.

There are not likely to be a large number of projects suitable for this type of arrangement – the lack of commercial assets in the local government sector has been discussed above. Local roads are not considered to be an option for this sort of exercise in the absence of a willingness to investigate tolling models. However, the waste sector – and in particular waste-to-energy (WtE) does provide an opportunity.

**Figure 27: Waste to energy**

#### **Waste to energy**

General waste is recognised as having great potential as an effective source of biomass for renewable energy generation. Generation schemes use simple technology to burn mixed waste and generate power and/or heat. They operate on two revenue streams, namely the power (and/or heat) they produce and the gate fees levied on the waste they take in. Whereas most generation stations that work by turning a feedstock, such as biomass, coal or gas, into energy need to pay for their fuel, waste plants are in the enviable position of being paid to take their fuel from others.

WtE projects can be financed through structuring an off-take agreement for both black and green energy (i.e. renewable energy certificates) with a large energy retailer who must acquire and surrender renewable energy certificates annually in accordance with the provisions of the *Renewable Energy (Electricity) Act 2000*. The Carbon Farming Initiative (CFI) is a carbon offsets scheme that will enable the generation of credits that can then be sold to other businesses wanting to offset their own carbon pollution.

Under these schemes, it may be the case that only the larger municipal waste management facilities would have projects of sufficient scale to attract private finance.



Regional capacity  
and attraction

## 6. Regional capacity and attraction

### Key findings

- ▶ The benefits of regional planning and prioritisation have long been recognised by all tiers of government, which is reflected in the large number of regional alliances and collaborations which exist today. The benefits include the prevention of duplication, better interface management and inter-government coordination.
- ▶ Improvements to the consistency and coordination of the existing regional frameworks will help regions achieve their full potential.
- ▶ Better alignment of regional structures, including voluntary alliances, could improve buy-in by member councils. In particular, this could result in a smoother application process for grants, where grant funding is available on a regional basis.
- ▶ In order to make the most of the potential of regional infrastructure planning, all tiers of government need to work together to align the different regional frameworks which currently exist in parallel. The Australian Government should collaborate with state, territory and local governments to review the most appropriate way to achieve this.

### Recommendations

#### **Recommendation 11: Rationalisation of existing regional structures**

All tiers of government should work together to rationalise and align the regional structures which currently exist.

The Australian Government has long recognised the merit of encouraging councils to look beyond their own boundaries and to work with their neighbours on a regional basis. The creation of the Regional Development Australia (RDA) network and the emphasis in the latest round of the RDA upon regional plans and cross-border submissions are examples of recent major policy outcomes to adhere to this principle.

The focus upon inter-council collaboration is also endorsed and promulgated by state governments, and indeed by the local government sector itself, as evidenced by the myriad of voluntary alliances in which councils participate. These range from Regional Organisations of Councils (ROCs), to asset specific collaborations such as Regional Roads Groups, to those which do not even involve neighbouring councils such as the National Growth Areas Alliance.

By forming these collaborative networks, governments at all levels have demonstrated awareness of the capacity constraints which can hold councils back when they act alone, and the fact that cooperative planning and prioritisation can be part of the solution. While regional planning will naturally involve a number of challenges, the benefits can be transformational.

However, the consultation on this topic revealed that there is more that can be done to capture the benefits of regional cooperation. Better consistency and coordination within the existing regional frameworks can help regions achieving their full potential. Furthermore, the benefits of regional planning and prioritisation could be far greater if regional structures had the ability to move beyond advocacy and support towards delivery and financing of infrastructure investments. This latter point is explored further in the subsequent chapter.

### The benefits of regional planning and prioritisation

The benefits of regional planning and prioritisation include:

- ▶ **“The big picture”**  
At its most basic level, regional cooperation represents an acknowledgement that local government areas are not demarcated by brick walls. The majority of residents of a particular

municipality or shire probably do not know where their local government area ends and the neighbouring one begins. The benefits of any community asset are likely to accrue to a group of people which transcends the boundaries of the local government area in which it is located. Developing strategies at a regional level allows for a holistic assessment of the needs of communities and an integrated approach to planning.

- ▶ **Prevention of duplication**  
A key benefit of seeing “the big picture” is that it should prevent duplication, which can be costly and inefficient. There is little point in a community investing in a recreation centre or library when the neighbouring council is doing the same thing just a few streets away.
- ▶ **Interface management**  
A holistic perspective should also improve the operation of individual assets where they cross council borders. This is especially important for network assets such as roads, pavements, and drains, which do not simply come to an end at the boundary between two local government areas. The effective and efficient management of these assets is often reliant upon planning at a network-wide level.
- ▶ **Inter-government coordination**  
The priorities and activities of state and territory governments have a profound impact upon those of local government. When the state invests in significant infrastructure, such as the expansion of a port or airport or the construction of a major road, there are a number of demands placed upon councils with respect to the supporting infrastructure. Regional planning bodies can provide a good forum for the sharing of knowledge and experience, the creation of relationships and networks, the efficient communication of priorities and the reduction in the number of interfaces.<sup>70</sup>

## Existing regional frameworks and their limitations

In recognition of these benefits, governments at all levels have created a number of structures to facilitate effective regional planning and prioritisation. These include groupings of local government areas drawn up by the Commonwealth and by state and territory governments, and those formed on a voluntary basis by councils themselves. The main regional structures are described below.

- ▶ **Regional Development Australia**  
RDA committees bring together all levels of government through a regional approach to supporting the development of Australia’s regions. RDA committees are responsible for developing a regional plan – in consultation with their communities – which outlines key development priorities for the region.  
  
The most recent round of the RDAF has put further emphasis on the formation of regional plans. The RDAF was created to fund regional infrastructure and enhance the economic development and liveability of communities. The current round supports capital infrastructure projects that address the highest priorities of RDA committees and have a strong regional impact.  
  
It has a secondary aim of building partnerships between government, the private sector and other key stakeholders, for example by giving preference to projects that have partnership funding provided by a combination of a local government, state or territory government, not-for-profit organisations and the private sector.  
  
The RDAF is a valuable source of funds for successful projects, and one which the local government sector is generally supportive of. On the whole, RDA and specifically the RDAF have been successful government initiatives. Our consultation identified some areas that could be addressed to improve the operation of the program and align it with other regional initiatives:
- ▶ There is some inconsistency between the boundaries of the RDA committees drawn up by the Commonwealth and pre-existing regional alignments. While in some states such as Victoria, the RDA committees align closely with state government regional areas (e.g. Regional Development Victoria, police and Department of Health areas), in other states a large number of committees do not correspond with existing regional arrangements, such as ROCs. This naturally makes it difficult to prioritise on a committee basis, as members may consider themselves more closely aligned to different regional groupings. The consultation indicated that the selection of regional

<sup>70</sup> In this report we recommend that federal, state and territory governments should commit to completing local government impact statements as part of the business cases prepared to support new policy proposals and projects, where there is likely to be a direct cost impact upon local government.

priorities for submission to the RDAF works best where the committee members have a history of collaboration.

- To date, the RDAF process has been voluntary and competitive. These attributes contribute to its success. However, there is also a risk that committees select projects that they think are more likely to be successful rather than genuine regional priorities. This may encourage second guessing Australian Government priorities, which is clearly not the intention of the initiative.
- Where a funding application is successful, the delivery of the project is the responsibility not of the RDA committee but the relevant council or councils. RDA committees have no role in delivery, and thus their function is limited to one of coordination and advocacy. Regional groupings may be able to achieve better outcomes for their members if they had an enhanced role involving the funding, financing and delivery of infrastructure.
- **State and territory government regional development frameworks**  
The focus upon inter-council collaboration is also endorsed by state and territory governments, each of which have instigated initiatives designed to develop planning at a level above local government. Regional planning gives state and territory governments the ability to focus on regional economic development and infrastructure prioritisation, enabling them to forge a valuable interface with the local government sector.

All states and territories have put in place frameworks for regional planning and prioritisation. The main initiative in each state/ territory is listed in the table below.

**Figure 28: State and territory government regional development frameworks**

State/ territory	Initiative	Description
New South Wales	Regional Strategies	Regional Strategies are prepared by state and local governments, incorporating input from other stakeholders, to determine a long-term plan for the region which takes into account anticipated population growth, housing and infrastructure requirements, and development plans. Ten plans are currently in place in either final or draft form.
Northern Territory	Regional Management Plans	Three Regional Management Plans (Northern, Big Rivers and Central) are legislated under the Northern Territory's <i>Local Government Act</i> . Regional Management Plans address key issues relating to local government in the region. The Plans also cover resource sharing and regional development within each region.
Queensland	Queensland Regionalisation Strategy	The Queensland Regionalisation Strategy provides for the delivery of a state-wide regional plan across seven regions to address issues associated with population growth, including infrastructure requirements and economic development.
South Australia	South Australian Planning Strategy	There are six regional alliances and a Metropolitan Group. They are established as regional subsidiaries under the <i>Local Government Act</i> , and undertake a coordinating, advocacy and representational role on behalf of their member councils. Each region produces a plan to guide future land use, covering areas such as economic development, infrastructure requirements and environmental assessments. Plans are developed in conjunction with the state and relevant local government bodies. The six country regions work together within the SA Regional Organisations of Councils (SAROC).
Tasmania	Regional Planning Initiative	Launched in October 2011, the Regional Planning Initiative covers three regional planning partnership projects, across the northwest, northern and southern regions, which have been established through agreements between the Tasmanian Government and respective councils and regional council bodies.
Victoria	Regional Development Victoria	The Regional Development agency provides support to five Victorian regions mainly through the Regional Growth Fund (RGF). This represents a commitment from the state of \$1bn of grant funding and support over eight years to 2018. RGF funding is allocated to: <ul style="list-style-type: none"> <li>► Provide better infrastructure, services and facilities</li> <li>► Strengthen the economic, social and environmental base of communities</li> <li>► Create new jobs and career opportunities</li> <li>► Support project planning and development</li> <li>► Leverage increased investment</li> </ul>

State/ territory	Initiative	Description
Western Australia	Regional Development Commissions	There are nine Regional Development Commissions in Western Australia, each of which is represented by a seat on the Regional Development Council - the main advisory body on regional issues to the state government. It also has an administrative role in providing funding through several state initiatives.

These initiatives have been supported by additional stand-alone policy outcomes, both financial and non-financial, for example:

- ▶ The New South Wales Government has been pursuing the Collaboration and Partnerships program, which issued a guidance paper in 2007 and a survey in 2010 designed to collate and distribute data about cross-council collaborative arrangements.<sup>71</sup>
- ▶ The Western Australian Government has stipulated that 50% of funds from the Country Local Government Fund (established as part of the Royalties for Regions program) in 2011-12 and 2012-13 is to be allocated to priorities identified by regional groups of country local governments, as opposed to individual allocations.

Again, while the achievements of state-based regional initiatives have been considerable, they are constrained where the mandated regional groupings do not correspond with other networks such as RDA committees and voluntary organisations. Furthermore, although some state-created regional bodies (such as Pilbara Cities in Western Australia) do play a role in the delivery of infrastructure, in most cases their role - like that of the RDA committees - is restricted to one of planning and advocacy. They do not have ownership of, nor control over, community assets.

- ▶ **Regional Organisations of Councils (ROCs)**  
ROCs are voluntary associations of councils with nominated representatives, an agreed constitution and a formal set of objectives. They exist primarily in New South Wales, Queensland and Western Australia (where they are known as Voluntary Regional Organisations of Councils (VROCs)).

While ROCs can be an excellent forum for cross-council collaboration, the overall picture is a mixed one. While some ROCs are poorly resourced and limited in function, others enjoy considerable support from their members and have the capability to undertake major shared service delivery and regional advocacy projects.<sup>72</sup>

The diversity of experience, even *within* states, is demonstrated by the following statistics which relate to the 17 ROCs in New South Wales:

- ▶ Membership ranges from two councils (CCROC) to 18 councils (RAMROC)
- ▶ Area covered ranges from 263 km<sup>2</sup> (SHOROC) to 190,015 km<sup>2</sup> (OROC)
- ▶ Population served ranges from 91,198 (OROC) to 1,569,870 (SSROC)
- ▶ There are five different corporate structures: s355 committee (six), incorporated association (six), unincorporated (three), incorporated association (one), and company (one)
- ▶ Staffing levels range from zero equivalent full-time staff (CCROC and MIDGOC) to over 50 (Hunter Councils)
- ▶ Annual income ranges from zero (CCROC) to nearly \$8m (Hunter Councils).<sup>73</sup>

This diversity is also in evidence in other states. In Queensland, for example, the Central Western Queensland Remote Area Planning and Development Board (RAPAD), which represents seven councils in the Central West and wider Outback region, is established as a ROC, but has a different structure to the majority of other ROCs in the state, in that it is an ASIC listed company, governed by a board of directors.

<sup>71</sup> NSW Premier & Cabinet, Division of Local Government, *Collaborative Arrangements between Councils: Survey Report*, June 2011

<sup>72</sup> Australian Centre of Excellence for Local Government & North Sydney Regional Organisation of Councils, *A Comparative Analysis of Regional Organisations of Councils in NSW and Western Australia*, January 2012

<sup>73</sup> *ibid.*

The one characteristic that all ROCs have in common is that they are voluntary organisations and (with some exceptions - mainly in Western Australia) are not generally recognised by legislation as entities which can act on behalf of their members, such as in the execution of contracts. For example, although the Southern Sydney Regional Organisation of Councils (SSROC) successfully negotiated an electricity supply contract on behalf of its members, the contract had to be reviewed, approved and ultimately signed by each individual council. In the end there were 26 councils involved in the contract, which inevitably created considerable administrative difficulties.

The absence of legal status means that ROCs are generally limited in what they can achieve. While a ROC can provide a useful forum for mutual support, mentoring and in some cases planning and prioritisation, few of them are able to procure and deliver infrastructure.

According to a recent study by the ACELG, only a few ROCs have been able to achieve a “seat at the table” in terms of contributing to regional and urban governance. By way of illustration, the ACELG has commented that in Western Australia (where ROCs are afforded the greatest legal status), “the government appear to have a clear preference for its own regional structures ... rather than ROCs as appropriate policy responses”.<sup>74</sup>

In contrast, the New South Wales Government is actively promoting ROCs as key partners in local infrastructure delivery, for example through the *Destinations 2036* initiative. However, it too has also recognised similar limitations, finding that to be truly effective, ROCs would require legislative recognition, boundary alignment, and the ability to develop models for regional services delivery.<sup>75</sup>

Furthermore, ROCs are not normally able to apply for government grants which can be applied to infrastructure programs across the region they represent. As ROCs often do not correspond with RDA committees in terms of member councils, there can therefore be an inconsistency between the voluntary group of councils planning and prioritising projects, and the federally-specified group of councils which has the ability to apply for grants to fund the same projects. This is further confused where the boundaries of ROCs cross each other, resulting in a situation where an individual council (such as Bankstown City Council in Sydney) is in more than one ROC.

► **Other voluntary alliances**

Outside of the ROC structure, councils have developed a variety of strategic clusters with the purpose of facilitating planning and prioritisation on a regional basis. For example, the Wellington Blayney Cabonne Strategic Alliance is an association of the councils of Wellington, Blayney and Cabonne, and Central Tablelands Water in New South Wales. The Alliance exists to promote cross-council collaboration, despite the fact that its member councils are also members of the Central NSW Councils ROC (Centroc), which has broadly similar objectives.

There also exist alliances which are formed on the basis not of geographic proximity, but of shared characteristics or a common objective. Examples of these include the Council of Capital City Lord Mayors, the National Growth Areas Alliance, the Western Australia Regional Cities Alliance and the South East Councils Climate Change Alliance in Victoria. While the objectives and activities of these alliances vary, they are formed on the basis of common characteristics and needs.

Although it is encouraging that the benefits of planning and prioritising infrastructure on a regional basis have been recognised, the coordination and consistency of regional initiatives could be improved by addressing the sheer number which exist in parallel.

An individual council may be a member of a number of collaborative groups at the same time. Mornington Peninsula Shire Council in Victoria, for example, is a member of the Southern Melbourne RDA Committee, the Interface Councils, the Association of Bayside Municipalities and South East Councils Climate Change Alliance - all of which have different memberships.

While each alliance of councils performs an important role on behalf of its members, the achievement of their full potential is doubtless held back by their differing objectives and governance configurations. It may be challenging for an individual council to reap the benefits of a regional alliance when it is the member of a number of other alliances with different geographies, objectives, structures, and processes. If a capital city council feels it can “get more

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<sup>74</sup> *ibid.*

<sup>75</sup> Elton Consulting, *Destination 2036 Outcomes Report*, September 2011

out of” the Council of Capital City Lord Mayors, for example, its commitment to full engagement with regional partners may be diminished.

If regional collaborations were better coordinated, there would be a number of benefits, as is currently seen in the example of the Pilbara in Western Australia. In the Pilbara, the consistency of boundaries of local, state and federal regional schemes is contributing towards a situation whereby significant investment is being channelled into a region with unique challenges brought about by the resources boom.

Figure 29: The Pilbara and the Pilbara Cities initiative

### The Pilbara

The joint vision for the area is borne out in the following programs. For each of these programs, the grouping of constituent councils is consistent: namely the Shires of Ashburton, East Pilbara, Roebourne and the Town of Port Hedland.

- ▶ The Commonwealth’s RDA (Pilbara) initiative, supported by the Pilbara Plan and funded by the RDAF
- ▶ The Government of Western Australia’s Pilbara Cities initiative, supported by the Pilbara Infrastructure & Planning Framework and jointly funded through by the state’s Royalties for Regions program, the Commonwealth Government and business investment (see below)
- ▶ The Pilbara Regional Council, constituted under the *Local Government Act 1995*, funded by the four councils in the region
- ▶ The Pilbara Development Commission, constituted under the *Regional Development Commissions Act 1993*

### Pilbara Cities

The Pilbara Cities initiative was launched by the Western Australia Government in 2009 with the aim of increasing the population of Karratha and Port Hedland to 50,000 people each, and Newman to 15,000 people by 2035, with other Pilbara towns growing into more attractive, sustainable local communities.

Over \$1bn of funding has been allocated from the state’s Royalties for Regions program. These funds are to be invested by the Pilbara Cities Office in infrastructure coordination, land and housing opportunities, community facilities and infrastructure, and economic diversification.

The injection of funds has enabled the early delivery of a new \$20m hospital in Karratha, which the state government had intended to build in six years time.

Many of the projects are to be delivered in partnership between local government and the private sector, such as a recreation centre in Port Hedland, which is funded by a combination of Pilbara Cities, the Town of Port Hedland and BHP Billiton Limited.

### ▶ Asset-specific regional alliances

In most states and territories, there are examples of the local government sector taking regional planning and prioritisation a step further by focussing upon a specific asset class. Examples include:

- ▶ In New South Wales, there are fourteen “county councils”, established by a Governor’s proclamation, which are created for a sole purpose such as the eradication of noxious weeds (eight), water supply (four), water and sewerage services (one) and floodplain management (one). County councils have many of the same responsibilities as local government areas, but cannot generally raise revenue (except in the case of water supply). They are therefore normally funded through contributions from member councils. In Western Australia, Regional Local Governments are established in a similar way, and largely perform a comparable function - many are created for a sole purpose such as waste management.
- ▶ In Queensland, the Roads Alliance and 19 Regional Roads Groups (RRGs) provide a platform for prioritising road infrastructure investments on a regional basis, as well as developing a

uniform system for collecting, analysing and reporting data on road assets. RRGs in Queensland are generally aligned with ROCs.

- ▶ In South Australia, the Special Local Road Program (SLRP) is a strategic road funding program which operates on the principle that individual councils make road funding applications to their respective regional Local Government Association (LGA) or the Metropolitan Local Government Group (MLGG), which are tasked with assessing the strategic priority of each application on a regional basis.
- ▶ In Victoria, Regional Waste Management Groups (RWMGs) are responsible for planning the management of municipal solid waste in the state. There are 13 regions which coordinate and direct the waste management activities of its member councils, based upon a regional plan. The Association for Victorian Regional Waste Management Groups (AVRWMG) is the forum for RWMGs to meet and discuss waste management and related issues.
- ▶ In Western Australia, Regional Roads Groups (RRGs) identify and prioritise regionally significant road projects and make recommendations to the State Road Funds to Local Government Advisory Committee, a body comprising representatives of the Department of Main Roads and the Western Australian Local Government Association that determines the distribution of local road funds. RRGs in Western Australia are generally not aligned with VROCs.

Evidence from the consultation suggests that these asset-specific alliances are generally perceived to be effective by their members. This is because they involve the planning and prioritisation of investment on a specific network of assets. Usually this means that individual councils assign their asset specialists to the alliances (for example the technical committees of RRGs in Queensland), or outside expertise is brought in. This enables the assembly of professional experts with the ability to take a network-wide perspective of priorities and asset needs.

But once again, successful collaborative arrangements are not able to move to the next level by taking a role in the delivery as well as the planning of investments. The assets over which the regional networks have oversight remain the responsibility ultimately of individual member councils. For reasons that are explored in the next chapter, this is preventing the full potential of the asset-specific regional collaborations being fulfilled.

## The barriers to enhancing regional capacity and attraction

The analysis of the different regional structures shows - on the one hand - that all tiers of government have recognised the positive impact of planning and prioritising local infrastructure on a regional basis. This is an encouraging development which has had profound benefit for all tiers of government.

On the other hand, however, it is apparent that the full potential of regional planning is not being realised. This is because of two factors:

- ▶ Firstly, regional structures generally have limited powers and mandates, which restrict their role to one of advocacy, support and planning. They would be able to achieve better outcomes for their members if they had an enhanced role involving the funding, financing and delivery of infrastructure. This is explored further in the next chapter.
- ▶ Secondly, where regional structures are not aligned with each other, it can prevent full buy-in from member councils. This is especially evident where funding is available on a regional basis but the regions eligible to apply do not align with voluntary alliances which already exist. Regional groupings would be able to achieve better outcomes for their members if there was greater coordination (as the example of the Pilbara demonstrates).

All tiers of government need to work together to mould the current arrangements into a regional framework which can provide more targeted assistance to councils to enable them to deliver local infrastructure in a more efficient and cost-effective manner.

## Structural reform

The “neatest” solution to this problem would be the amalgamation of local government areas to create larger councils capable of achieving economies of scale and efficiencies. Indeed, the creation of procurement efficiencies was one of the justifications for the structural reform of the local

government sector that has occurred in every state and territory apart from Western Australia in the last 20 years.

**Figure 30: Local government structural reform since 1993**

State/ territory	Year	Nature of reform	Number of councils
New South Wales	2003	Voluntary	From 172 to 152
Northern Territory	2008	Compulsory	From 61 to 16
Queensland	2008	Compulsory	From 157 to 73
South Australia	1998	Voluntary	From 118 to 68
Tasmania	1993	Compulsory	From 46 to 29
Victoria	1994	Compulsory	From 210 to 78

It is also a key driver behind the current arguments for structural reform in Western Australia and for further reform in Tasmania:

- ▶ A recent study by Deloitte Access Economics concluded that the amalgamation of the 12 councils in the south of Tasmania could lead to potential savings of 35%.<sup>76</sup>
- ▶ The case being built by the Western Australia Government for structural reform is driven by the desire to address a lack of strategic and community planning, a lack of adequate financial planning and asset management and a fragmented and inconsistent approach to planning and business procedures.<sup>77</sup> It is a case supported by the Western Australian Local Government Association, which believes amalgamation will help tackle the issue of sustainability.<sup>78</sup>

Experience from previous amalgamations would seem to support this view. For example, it is unlikely that either of the shires of Flinders, Hastings and Mornington would have been individually able to achieve the same quantum of savings as the Mornington Peninsula Shire has achieved from the Safer Local Roads program (refer to Appendix 7).

But although the case for structural reform is undeniably strong from a purely operational perspective, there are other factors which make it an extremely complex issue. Opposition to amalgamation is often given on the grounds that:

- ▶ Unless it is forced through by the state or territory government, amalgamations require the buy-in and cooperation of neighbouring organisations which may not have a history of working together.
- ▶ The costs of structural change can be considerable.
- ▶ Amalgamation often faces resistance from the community which justifiably fears it will lead to the removal of an important point of local contact, and the loss of the “local” characteristic of local government.

In light of these challenges, this report makes no recommendation in relation to structural reform. However, it should be possible to create a number of the benefits of amalgamation through means other than enforced structural reform. There are ways to achieve efficiency gains, improved capacity and capability, economies of scale and critical mass - without taking the “local” out of local government. These are discussed below.

## Aligning and rationalising existing regional frameworks

The misalignment of the existing regional structures explored earlier in this chapter is currently a major barrier to the development of regional attraction and capacity. It often prevents full buy-in from member councils, and this is especially manifest where regional funding is made available not to existing regional alliances but to “new” groupings defined by another tier of government.

<sup>76</sup> Deloitte Access Economics, *Local Government Structural Reform In Tasmania*, August 2011

<sup>77</sup> Government of Western Australia, Department of Local Government, *Reform Case Studies - Amalgamation In Western Australia, City of Geraldton-Greenough, Shire of Northam*, May 2010

<sup>78</sup> Western Australian Local Government Association, *Submission to the Metropolitan Local Government Review Panel on the Metropolitan Local Government Review*, January 2012

In order to make the most of the potential of regional infrastructure planning and (where appropriate) delivery, all tiers of government need to work together to align the different regional frameworks (including RDA committees) which currently exist in parallel. The Australian Government should collaborate with state, territory and local governments to review the most appropriate way to achieve this.

#### **Recommendation 11 Rationalisation of existing regional structures**

All tiers of government should work together to rationalise and align the regional structures which currently exist.

The starting point for this review should be the existing voluntary alliances which many councils already belong to, relate to and work well within.

A possible precedent could be the recent establishment of local enterprise partnerships (LEPs) in England. The process of establishing LEPs began with an invitation to councils to propose their own alignments. While some guidance as to size and structure was issued, it was not excessively prescriptive, leaving a degree of flexibility with the applicants. Applications were reviewed by the government and then negotiated with local government. LEPs have now been formed which include all but one council in England.

**Figure 31: Local enterprise partnerships and the Growing Places Fund**

#### **Local enterprise partnerships and the Growing Places Fund**

In June 2010, the UK Government announced the creation of local enterprise partnerships (LEPs). Local authorities and business leaders were subsequently invited to submit proposals to form LEPs and 39 partnerships have now been formed across England, covering all but one local authority.

The boundaries were agreed by ministers based on the proposals submitted by partnerships. If a LEP wishes to change its boundaries it will need to demonstrate to ministers that the new boundaries still meet specified criteria.

In November 2011, the government launched the £500m Growing Places Fund with three objectives:

1. to generate economic activity in the short-term by addressing immediate infrastructure and site constraints and promote the delivery of jobs and housing
2. to allow LEPs to prioritise the infrastructure they need, empowering them to deliver their economic strategies
3. to establish sustainable revolving funds so that funding can be reinvested to unlock further development, and leverage private investment.

LEPs have been invited to submit proposals, on the basis that they have an identified lead local authority that will receive and account for the funding, on behalf of all members of the partnership. The Growing Places Fund will not provide individual local authority allocations - the priorities for funding will need to be agreed by members of the partnership.

The government has stated that it wants to encourage LEPs to think creatively about the most appropriate arrangements for operating local infrastructure funds to maximise their economic impact. It has stated that "this might mean joining together with other local enterprise partnerships to form a larger grouping - while we expect groupings of a sufficient size to enable critical mass, it will be for local areas to decide how best to achieve this."<sup>79</sup>

An independent report in March 2012 recommended that LEPs should be given formal "receipt pooling functions" for business rates and Community Infrastructure Levy (similar to development charges) monies.<sup>80</sup>

<sup>79</sup> Department for Communities and Local Government (UK), *Growing Places Fund Prospectus*, November 2011

<sup>80</sup> Localis and Lloyds Banking Group, *Credit Where Credit's Due - Investing in local infrastructure to get Britain growing*, March 2012

A similar process in Australia might be implemented as follows:

1. All tiers of government undertake a strategic review of the roles and responsibilities of existing cross-border alliances, with the clear objective of identifying which of them can be aligned and rationalised.
2. The Commonwealth works with other tiers of government to develop guidance as to the optimal size of revised regional groupings. This process should take into account the diversity of Australia's regions and the fact that there are likely to be factors other than size that drive the formation of sustainable collaborative groups.
3. All councils are invited to recommend the composition of the alliances they wish to be a part of, based upon the guidance.
4. The Commonwealth works with other tiers of government and applicants to agree upon an agreed structure.
5. Where appropriate, the roles and responsibilities of existing regional alliances are consolidated and transferred to the new bodies.

This process of reform will not be an easy one - especially as a number of existing regional structures are very well established. Indeed, there is unlikely to be full alignment of all types of regional group, and it is anticipated that councils will not want to "give up" some of the relationships they have established.

However, it is a clear conclusion of the consultation that while the concept of regional collaboration is broadly accepted, the diversity of regional alliances is preventing them from achieving their greatest potential.

In the long-term, the creation of cohesive regional alliances may also be a step towards encouraging councils to transfer the responsibility for funding and delivery of certain assets to the regional partnerships, as explored in the next chapter. Furthermore, these empowered regional partnerships could be able to access a range of funding and financing options, such as finance from a new national financing authority.

A photograph of a sunset over the ocean, viewed through a wooden frame. The sky is filled with large, dark clouds, and the sun is low on the horizon, casting a warm, orange glow. The ocean is visible in the distance, with gentle waves. The wooden frame is made of dark wood and is positioned in the foreground, framing the view of the ocean and sky. The foreground is a wooden deck or walkway.

# Alternative ownership structures for community assets

## 7. Alternative ownership structures for community assets

### Key findings

- ▶ Certain local government assets may be better suited to alternative ownership structures, including corporatisation or privatisation. Not only can this provide revenue for local government, but transferring the management of assets to corporate entities can provide access to new skills, asset and risk management processes, and independent strategic planning.
- ▶ The benefits of regional planning and prioritisation could be far greater if regional structures had the ability to move beyond advocacy and support towards ownership of assets, and the delivery and financing of infrastructure investments.
- ▶ The benefits of regional delivery are likely to be greatest where they relate to network assets such as local roads. The regionalisation of local roads would make it possible to introduce competitive tendering for regional capital and maintenance programs, whereby multiple assets are bundled under a single outsourced contract.

### Recommendations

#### Recommendation 12: Review of asset ownership

Local government bodies should review their infrastructure portfolios with a focus on identifying and testing the rationale for continued ownership.

#### Recommendation 13: Regional infrastructure delivery

The Australian Government should work with the states and territories to develop incentives that can be given to councils to create formal regional structures with responsibility for delivering and financing infrastructure investments relating to specific asset classes, with a particular emphasis on local roads.

Despite the challenges it faces in raising sufficient capital to fund its activities, the local government sector has responsibility for a large and valuable portfolio of assets. The ACELG estimates that the sector owns over \$300bn of non-financial assets (excluding plant and equipment):

- ▶ \$25.9 billion in buildings (net of depreciation)
- ▶ \$187.3 billion in local roads and other fixed assets (net of depreciation)
- ▶ \$88.3 billion in land (this includes parklands, carparks and community facilities)

Figure 32: Value of local government land and fixed infrastructure by state (\$m)<sup>81</sup>

	NSW	NT	QLD	SA	TAS	VIC	WA	TOTAL
Buildings	8,788	379	4,787	2,023	736	6,506	2,677	25,896
Local roads and other fixed assets	68,245	726	65,477	9,867	4,165	27,416	11,409	187,305
Land	42,228	404	11,307	5,651	828	25,285	2,628	88,331
<b>Total</b>	<b>119,261</b>	<b>1,509</b>	<b>81,571</b>	<b>17,541</b>	<b>5,729</b>	<b>59,207</b>	<b>16,714</b>	<b>301,532</b>

Individual councils vary significantly in the size and nature of their asset holdings, but they all face the challenge of modernising service delivery and getting the best from available resources.

<sup>81</sup> Australian Centre of Excellence for Local Government, *Local Government Fact Sheet 3: Local Roads, Buildings and Land*, January 2012

The move towards more sophisticated asset management frameworks is likely to result in a better understanding of the use and cost of council assets, and may identify examples of the suboptimal use of council funds and of assets providing sub-standard service delivery to users.

As a result, there is an opportunity for councils (supported by other tiers of government) to investigate alternative ownership models for their assets. Many council-owned land and other assets could both be attractive to private sector investors and create opportunities for innovative partnering arrangements. Others, especially those which form part of network, might be suitable for transfer to regional structures consisting of a number of neighbouring councils.

## Alternative ownership models for individual community assets

The reality is that there are certain community assets which the private sector might be better placed to own and operate. There are two basic models for private ownership which have been trialled by the sector: privatisation and corporatisation.

### Privatisation

Privatisation is where assets are sold by public sector bodies to private sector organisations, and generally means that the latter retains little or no ownership interests in the assets.

“Recycling” capital through privatising assets can be an effective way both to raise capital for core council activities and to optimise future investment in community assets. Examples of where this has occurred in the past include:

- ▶ **Willoughby City Council** prepared a comprehensive property management plan that generated \$110 million in savings in its first two years of operation through the sale and lease of surplus properties. The plan was accompanied by a priority list of community facilities, the upgrade of which would be funded from the sale or lease of surplus assets. Council was able to establish three new community libraries, fund a new works depot, restore the heritage-listed Willoughby Incinerator and help fund the council's \$150 million Civic Place development. There are further flow-on effects to the local economy and employment through \$350 million in private sector development on former council sites.
- ▶ **Newcastle City Council** has recently approved an application to the Independent Pricing and Regulatory Tribunal (IPART) for a rates increase, which involves the disposal of 13 council properties including car parks, TPI House, the Civic Hotel and the former Lynchs Prawns site at Honeysuckle. The plan is based on an acknowledgement that assets such as car parks are more appropriately owned and operated by the private sector and the main purpose is to raise money for core infrastructure capital and renewal projects.<sup>82</sup> The proceeds are anticipated to provide \$45m for the city's works budget and to remove \$67m from its infrastructure maintenance budget.

The privatisation of a council business activity does not necessarily generate additional funding capacity (even when it is profitable). Privatisation is a way to access the present value of the future cashflows of a business or asset and will only improve the net fiscal position of a council if:

- ▶ The private sector can improve the efficiency of the asset acquired and is prepared to price this efficiency into the purchase price
- ▶ The council does not retain an inequitable portion of risk via the structure of the privatisation contract, or it is onerous for the new owner
- ▶ There is a competitive market for the asset type being privatised.

If the majority of these drivers are not present it is more likely that privatisation of assets will not produce an efficient source of funds when compared to the alternative of borrowing against the future cash flows. This assumes that local government has the capacity to invest in the asset or business as needed.

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<sup>82</sup> <http://www.abc.net.au/news/2012-02-21/council-asset-sale-to-raise-millions/384177>

## Corporatisation

Falling short of full privatisation is the corporatisation model. It involves the transfer of public sector assets to public sector-owned corporations in order to introduce corporate management disciplines to their administration, whilst still retaining some level of ownership interest.

Creating a corporate ownership and management structure for council assets can expose the assets to the benefits of private sector expertise and arms-length planning, while still retaining ultimate ownership by the community. Where community assets have been corporatised, the commercial basis of council-owned corporations can provide an important revenue stream for local government through the payment of dividends, tax equivalent payments and guarantee fees.

An example is Kimbriki Environmental Enterprises Pty Ltd which owns and operates the Kimbriki waste management site in Sydney and is owned jointly by Warringah, Manly, Mosman and Pittwater Councils. A further example is the recent water reforms in Tasmania, explored below.

## The optimal ownership model for community assets

To explore alternative models, councils should review the rationale for continued ownership. Where the case for continuing ownership is not sustained, plans to consider full or partial divestment should be produced.

### **Recommendation 12    Review of asset ownership**

Local government bodies should review their infrastructure portfolios with a focus on identifying and testing the rationale for continued ownership.

Consideration must be given to the risks involved in any divestment options, in addition to the transaction costs associated with changing the ownership structure of public assets. In particular, for smaller assets where moderate benefits may be gained through privatisation or sale, these benefits may be diluted substantially by disproportional transaction costs for bidders and may result in the transaction not being seriously considered. This in turn reduces the overall infrastructure transaction pipeline and certainty, which impacts on the ability to attract wider sources of financing for infrastructure projects.

Furthermore, the arguments for retaining assets must be considered alongside the arguments for disposal. There may also be public interest considerations that favour public ownership, such as councils needing to retain control of assets to guarantee equitable access for the community.

Equally, some assets, such as water assets and some regional airports for example, which might be attractive to external purchasers, currently bring in significant revenues for councils and there will be an understandable desire to retain them.

## An enhanced role for regional structures

The preceding chapter assessed the benefits of prioritising and planning local infrastructure at a regional level and concluded that these benefits are often not fully exploited because responsibility for the delivery of the priorities identified remains in the hands of individual councils, which face a number of challenges in terms of funding and delivery. Where individual councils do not have the capacity (in terms of funding and/or skills) to deliver the investments identified through regional plans, the benefits of regional collaboration (such as efficiency savings) can be lost.

For example, the New South Wales Minister for Local Government recently stated that ROCs would be more effective if their role was expanded to include “procurement of shared assets and resources for productivity and efficiency gains”.<sup>83</sup> Their effectiveness is limited by their inability to control assets, raise finance, and deliver capital projects.

Although there are many examples of groups of councils collaborating in the provision of joint *service* arrangements, there are, however, very few examples of the regional delivery of *infrastructure*

<sup>83</sup> Australian Centre of Excellence for Local Government & North Sydney Regional Organisation of Councils, A *Comparative Analysis of Regional Organisations of Councils in NSW and Western Australia*, January 2012

projects. Of the over 800 examples of cross-council collaboration identified in the *Collaboration and Partnerships between Councils* study, for example, only a handful related to infrastructure delivery.

Figure 33: *Collaboration and Partnerships between Councils* – infrastructure collaborations in New South Wales

<b>Collaboration and Partnerships between Councils – infrastructure collaborations in New South Wales</b>			
Of the over 800 examples of cross-council collaborations in New South Wales identified in the <i>Collaboration and Partnerships between Councils</i> survey, only a handful related to the delivery of infrastructure works. These include those listed below.			
Arrangement	Councils involved	Objectives	Principal activities
Berrigan Hay joint tendering	<ul style="list-style-type: none"> <li>▶ Berrigan Shire Council</li> <li>▶ Hay Shire Council</li> </ul>	<ul style="list-style-type: none"> <li>▶ Cost reductions</li> <li>▶ Larger scope of works to attract greater competition</li> <li>▶ Reduced contract management costs</li> </ul>	<ul style="list-style-type: none"> <li>▶ Program of capital works, e.g. renovation of reservoirs</li> </ul>
Grain Valley Road	<ul style="list-style-type: none"> <li>▶ Gunnedah Shire Council</li> <li>▶ Warrumbungle Shire Council</li> <li>▶ Wellington Shire Council</li> </ul>	<ul style="list-style-type: none"> <li>▶ Better opportunities for regional freight and tourist movement</li> <li>▶ Improved road safety</li> </ul>	<ul style="list-style-type: none"> <li>▶ Sealing of north-south regional road links, alternate to Newell Highway</li> <li>▶ Construction of 6km of narrow pavement</li> </ul>
Leeton - Narrandera Aerodrome	<ul style="list-style-type: none"> <li>▶ Leeton Shire Council</li> <li>▶ Narrandera Shire Council</li> </ul>	<ul style="list-style-type: none"> <li>▶ Maintenance and capital expenditure requirements for aerodrome infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>▶ Aerodrome maintenance</li> </ul>
Liverpool Plains - Gunnedah Sewer Pipeline Rehabilitation Project	<ul style="list-style-type: none"> <li>▶ Gunnedah Shire Council</li> <li>▶ Liverpool Plains Shire Council</li> </ul>	<ul style="list-style-type: none"> <li>▶ Rehabilitation of the sewer, developing a package attractive to contractors and creating efficiency savings</li> </ul>	<ul style="list-style-type: none"> <li>▶ Sewer mains relining and CCTV works</li> </ul>

Even in the case of the RRGs, where collaboration is focussed on planning a particular asset class, the full benefits of regional prioritisation remain untapped as the roads remain the responsibility not of the RRGs but of the member councils.

The evidence suggests that the transfer of assets and responsibility for the delivery of projects to a regional alliance of councils would have a number of benefits, and would go far in overcoming some of the barriers identified in this study. These benefits include:

- ▶ **Standardisation:** consistency in service delivery and customer relations across a larger area
- ▶ **Enhanced prioritisation:** synchronisation of planning and delivery, leading to more robust and realistic prioritisation processes
- ▶ Greater **rigour in asset management and forward planning**, especially if regionalisation is accompanied by regulatory oversight
- ▶ **Scale:** aggregation of individual projects creates a scale of investment which leads to:
  - ▶ The pooling of available funds
  - ▶ Enhanced purchasing power and more competitive tendering and pricing
  - ▶ Potential to investigate innovative procurement models
  - ▶ Reduced fixed costs per council
  - ▶ A greater ability to attract and retain the required skills and expertise

- ▶ Elimination of competition between councils
- ▶ Knowledge sharing and experience building
- ▶ The ability to attract and retain skilled professionals to deliver infrastructure priorities.

Figure 34: Review of regional airports in South Australia

### Regional airports

A recent review of council-owned regional airports in South Australia revealed a significant funding requirement.<sup>84</sup> One recommendation put forward was the development of a single local government entity to own and operate all regional airports. The benefits would include:

- ▶ Access to a pool of qualified aviation staff and associated cost savings from the removal of duplication
- ▶ Central and consistent points of contact between airports, regulators, and airlines,
- ▶ Ability to spread managerial overheads
- ▶ Common risk and incident systems and procedures.

Were responsibility for infrastructure to be transferred to regional structures, this is likely to be most beneficial where the assets in question share similar characteristics and form a network crossing council boundaries, for example:

- ▶ Water and sewerage
- ▶ Waste management
- ▶ Roads

Whereas water and sewerage assets have already been regionalised in many states and territories by means of legislative change at the state government level, waste and local roads assets continue to be owned and operated by local government almost everywhere in Australia. Where there are regional ownership collaborations in these areas, they are voluntary.

### Water and sewerage

Water, wastewater and stormwater systems are developing rapidly in order to manage the supply risks inherent in water's nature as an essential natural resource. A recent Infrastructure Australia report has highlighted the need for holistic planning of water investment, stating that "there is an emerging need to adopt more holistic strategies, which encourage efficiency improvements in network performance.... Systemic weaknesses in past supply planning, particularly in the way in which supply security perspectives were accommodated, have created a need to develop institutional, regulatory and pricing models for the water sector which can support investment in expensive, regionally-beneficial water security infrastructure."<sup>85</sup>

Management of water and sewerage assets by local government is now relatively rare and generally only found in rural Queensland and New South Wales. South East Queensland and Tasmania have recently transferred water assets out of local government.<sup>86</sup> Elsewhere responsibility and ownership of water and sewerage assets has been transferred to state or regional bodies, either publicly or privately owned.

While it is recognised that managing water assets makes up a significant component of the core activities of those councils which have control over them, there is evidence to show that they face a number of challenges in managing the assets effectively and securing the level of investment required. This has been demonstrated in recent years in analysis undertaken in those states where water assets are (or were until recently) controlled by local government:

<sup>84</sup> Hudson Howells, *Local Government Association of South Australia - Regional Airports Project*, February 2012

<sup>85</sup> Infrastructure Australia, *Review of Urban Water Security Strategies*, June 2010

<sup>86</sup> Gold Coast City Council has, however, opted out of the Allconnex vehicle, and legislation was passed on 14 February 2012 to disestablish the entity.

- ▶ The **New South Wales** Government found that a significant proportion of existing local water utility assets will require replacement over the next thirty years as they come to the end of their economic life, but local water utilities face a shortage of skilled people to adequately plan, maintain and operate water supply and sewerage systems.<sup>87</sup>
- ▶ The recent reforms in South East **Queensland** were designed to develop consistent service standards, enhance technical expertise, and optimise network planning.<sup>88</sup>
- ▶ In **Tasmania**, the Ministerial Water and Sewerage Taskforce found that there was significant underinvestment in water and sewerage assets by the local government sector, and this was caused by the challenges described elsewhere in this report, such as inadequate asset management frameworks, a political imperative not to increase rates and the inability of grants receipts to fund ongoing maintenance programs.

While still a relatively new development, the recent reforms in Tasmania appear likely to demonstrate how regionalisation has the potential to increase the quantum of investment in water assets, and provide focussed asset management and procurement efficiencies. Initial analysis of the new structure in Tasmania shows that transferring water assets to regional council-owned corporations has:

- ▶ Enabled local government to re-focus upon providing other essential services for the community
- ▶ Given the regional corporations the opportunity to leverage their expertise to manage the assets to a higher degree of sophistication, and raise funding and finance accordingly
- ▶ Enabled the introduction of separate and transparent water bills for customers, reflective of new pricing mechanisms and of the capital and service needs of the network assets.

Figure 35: Water reforms in Tasmania

#### The regionalisation of water assets in Tasmania

In July 2009, responsibility for water and sewerage services in Tasmania transferred from local government to three council-owned regional corporations (Ben Lomond Water, Cradle Mountain Water and Southern Water), with a third corporation (Onstream) created as a service provider. This major reform came about as the result of the findings of the Ministerial Water and Sewerage Taskforce, which had highlighted significant underinvestment in the water and sewerage network.

The corporations operate a regulated pricing structure, and all profits are returned to the owner councils under a tax equivalent regime. The respective owner councils appoint three “owners’ representatives” to each corporation to appoint and monitor the board, and to liaise between the board and the owner councils. While this ensures that mechanisms are in place for community consultation, in reality the owner councils play a limited role in the corporations’ planning and operations.

In spite of a challenging transition process, the Tasmanian Economic Regulator has recently reported that there have been significant improvements in the operation of the network and the supply of water.<sup>89</sup> It is anticipated that significant cost savings will accrue from the pooling of resources, the regional oversight of investment and efficiencies in relation to single contracts and elimination of duplication across a region.

It is the policy of the Tasmanian Government to build upon the reforms of 2009 by ultimately collapsing the three regional corporations into one state-wide provider, with the objective of realising the following benefits:

- ▶ An ability to draw on a broader base of skills and experience and have the scale necessary to develop expertise
- ▶ Further integration of administrative systems which would create opportunities for cost savings

<sup>87</sup> [http://www.water.nsw.gov.au/Urban-water/Local-water-utilities/Local-Water-Utilities-Inquiry/Questions-and-answers/utilities\\_local\\_faq/default.aspx](http://www.water.nsw.gov.au/Urban-water/Local-water-utilities/Local-Water-Utilities-Inquiry/Questions-and-answers/utilities_local_faq/default.aspx)

<sup>88</sup> <http://www.qwc.qld.gov.au/reform/index.html>

<sup>89</sup> Office of the Tasmanian Economic Regulator, *Tasmanian Water and Sewerage State of the Industry Report 2010-11*, March 2012

and reduce reporting and administrative effort

- ▶ Consistency in service delivery and customer relations across the state
- ▶ State-wide planning of infrastructure
- ▶ A stronger and more stable cash flow, a better capacity to manage debt, and more flexibility to deal with the significant capital expenditure program required
- ▶ A capacity to secure better services to customers and to achieve health and environmental standards sooner than under the enhanced regional model.<sup>90</sup>

A similar development occurred in Scotland in 2002, when Scottish Water was established after a merger of the West of Scotland Water Authority, the East of Scotland Water Authority and the North of Scotland Water Authority under the *Water Industry (Scotland) Act 2002*.

## Waste management

While water assets have in most places been transferred out of local government, roads and waste management are examples of network-based capital-intensive assets currently owned and operated by councils. For many of the reasons listed above in discussion of water assets, there may be grounds to question the appropriateness of continued control of these assets by local government.

The progress of the RRGs in Queensland and Western Australia, the Special Local Road program in South Australia, and the RWMGs in Victoria (and the high level of satisfaction of their members, as revealed in the consultation) has shown that investment in local roads and in waste management can be effectively prioritised at a regional level, even if the investments themselves remain the responsibility of councils.

In the waste management space, there are already a number of examples of regional delivery of infrastructure investments by councils working in collaboration with each other. A study into cross-council collaboration in South Australia concluded that waste management was the most common example of resource sharing, and the one with the greatest potential. "This is not surprising," it stated, "given the cost of waste management, increase in waste levies, the EPA requirements for the management of landfills and the SA Government's targets to achieve zero waste. It would appear that there may be further opportunities to share resources in the delivery of services in this area through the creation of a smaller number of (but larger) strategic regional waste management resource sharing arrangements designed to achieve greater economies of scale and improved management of this activity. The success and wide acceptance of resource sharing in this service area provides a positive template for other resource sharing arrangements."<sup>91</sup>

Examples include:

- ▶ In **New South Wales**, the Kimbriki landfill facility is owned and operated by Kimbriki Enterprises, which is owned by Mosman, Manly, Warringah and Pittwater Councils. The community and the four councils have direct input to Kimbriki's activities through a Sub Committee which consists of eight members, four being councillors and four community representatives from each of the member councils.
- ▶ In **South Australia**, the Southern Region Waste Resource Authority (SRWRA) is a regional subsidiary established under Section 43 of the *Local Government Act 1999* by the City of Onkaparinga, the City of Marion and the City of Holdfast Bay to operate the SRWRA Landfill Operation. SRWRA is managed by a seven member Board comprising two representatives from each of the member councils and an independent expert in waste management as chair. SRWRA owns and operates a landfill facility at Seaford Heights which is one of the state's major landfill operations receiving in excess of 160,000 tonnes of waste annually.

In each of these cases, the waste management assets (i.e. the landfill facilities) are owned and operated by a body set up and owned by a group of councils. The assets are managed independently yet under a structure which preserves ultimate control by local government. The councils involved in

<sup>90</sup> *ibid.*

<sup>91</sup> Tony Lawson Consulting, *Review of South Australian Local Government Joint Service Delivery Opportunities: Analysis of Council Responses to a Survey and Options for Implementation of Various Resource Sharing Measures*, February 2007

these regional arrangements are generally of the view that the structure delivers greater expertise in operational management and greater efficiency in investment.

## Roads

In the case of roads, there are very few examples of councils collaborating to deliver infrastructure capital works and maintenance services. There are, however, regional solutions at the state level, which have resulted in considerable cost savings. These include the \$125m five year Maintenance Alliance Agreement between VicRoads and Downer EDi to cover the maintenance of state roads in Victoria's north east, including Wodonga, Shepparton, Wangaratta and the Alpine region.

A recent report by Infrastructure Partnerships Australia has concluded that “the current division of road network responsibilities between local governments is unlikely to provide the size and scope for private operators to achieve adequate efficiency gains to make outsourcing a viable and worthwhile proposition.”<sup>92</sup> This is supported by research currently being developed by a state-based local government association, which demonstrates that contractors are likely to be far more willing to enter into tender processes and contracts for local roads maintenance if projects are aggregated across local government areas.

Developing regional road networks, within which state and local governments and asset managers could work together, would create a range of opportunities for resource sharing and cost savings. Mornington Peninsula Shire has demonstrated the savings that can be achieved through bundling over a large geographic area. The regionalisation of local roads would make it possible to introduce competitive tendering for regional capital and maintenance programs, whereby state and local assets are bundled under a single outsourced contract.

For local government, there is likely to be merit in collaborative models such as the RRGs where they do not exist. And where they do exist, their members should consider building upon the model by giving the group enhanced responsibility over – and even ownership of – the assets themselves. This would give them the “teeth” to drive real savings into infrastructure investment.

By way of example, the Far North Queensland Regional Organisation of Councils (FNQROC), which also operates as a RRG, has implemented a regional procurement program which has secured savings of \$1.5m through contracts for sodium hypochlorite and liquid alum. Given the success it has achieved in creating procurement efficiencies and planning outcomes through collaboration on a regional basis, it would be a logical step to investigate the further efficiencies that could be achieved if its responsibilities were extended to include the delivery of investments and the procurement of infrastructure services.

## The optimal model for regional capacity building

When reviewing the optimal ownership models for their assets, councils should recognise that regional bodies (corporatised or otherwise) may deliver efficiencies and operational improvements. There is a role for the Australian Government and the states and territories to assist councils make this assessment.

### **Recommendation 13    Regional infrastructure delivery**

The Australian Government should work with the states and territories to develop incentives that can be given to councils to create formal regional structures with responsibility for delivering and financing infrastructure investments relating to specific asset classes, with a particular emphasis on local roads.

While regional infrastructure delivery would in many cases deliver value to participating councils, the benefits must of course be assessed alongside the challenges involved, including:

- The regionalisation of the responsibility for certain asset classes is likely to be seen as taking away a “core” function of local government.

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<sup>92</sup> Infrastructure Partnerships Australia, *Road Maintenance: Options for Reform*, September 2011

- ▶ The need to protect community representation will require the establishment of appropriate governance structures. As a result, there may be a view that regionalisation creates “another tier of government”.
- ▶ The receipt of funding by regional bodies may require them to have legal recognition and hence need legislative change.
- ▶ Infrastructure delivery over a large geographic area can create mobilisation and logistical challenges for contractors which are passed onto project sponsors – this is likely to be particularly manifest in remote areas.
- ▶ The consolidation of resources may result in the movement of jobs from one council to another and jeopardise the role of local government as a local employer.
- ▶ Regional procurement may also be seen to jeopardise local government’s objective of supporting local business and fostering local economic development.
- ▶ Some local government areas may already be “big enough” to reap the benefits of regionalisation.

While these are genuine concerns which will rightly impact upon any decisions made, it is important to recognise that the effective aggregation of infrastructure delivery on a regional basis can assist local economic activity and reduce procurement costs.

Local government is likely to need encouragement and support to investigate enhanced collaborative models. The role for the Commonwealth is to consider the incentives it can provide to encourage councils to move in this direction. For example, the Commonwealth could use financial incentives, such as how collaborative models might be evaluated within submissions for grant funding.

However, it is important that local government is afforded the ability to take a leading role in developing the optimal regional structures for its assets.

The Tasmanian water corporations provide one such model, and the formation of a corporate entity owned by member councils may well provide an appropriate structure for the regional ownership of other assets.

“Local government will implement and maintain a governance model that integrates effective service delivery (on a regional basis) with appropriate political representation (on a local basis)”

*Vision established by the Western Australia Local Government Association Systematic Sustainability Study (SSS) Taskforce Leadership Expert Team, 2007*

However, some councils have expressed concerns about the governance arrangements involved in the Tasmanian model. History shows that a change of this nature necessarily involves a cultural shift and a feeling of a “loss of control”. Councils are understandably protective of their budgets and collaborative arrangements need to be demonstrably equitable. To be successful, the governance and resourcing arrangements have to be such that the focus is upon effective infrastructure delivery for the good of the communities represented.

Furthermore, investigation of corporatisation models must take into account the differing legislative restrictions to councils’ entrepreneurial powers set out in the *Local Government Acts* of each state and territory.<sup>93</sup>

The key challenge of creating successful regional partnerships lies in the willingness of individual councils to participate and, if necessary, to compromise. The smallest partners in any collaborative arrangement must be afforded adequate protection from “crowding out”, while the largest councils

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<sup>93</sup> In Western Australia, for example, the Western Australia Local Government Association (WALGA) has argued that legislative restrictions are a barrier to effective cross-council collaboration. WALGA has advocated for the ability of councils to form regional subsidiaries to undertake shared service delivery, a proposal which has been included within the *Local Government Amendment (Regional Subsidiaries) Bill* currently before the Western Australia Parliament. WALGA has also advocated for the ability of councils to form local government enterprises based upon the New Zealand model of Council Controlled Organisations (companies at least 50% owned by one or more local governments).

should not be forced to shoulder a disproportionate burden. Equally, the benefit of economies of scale must not be offset by the creation of additional layers of red tape.

**Figure 36: The Scottish Futures Trust and “hubs”**

### **An example from the UK: “hubs” in Scotland**

The Scottish Futures Trust (SFT) is an independent company, established by the Scottish Government in 2008, with the objective of creating value for money and savings in the delivery of public infrastructure investment. In its 2011-12 budget, the Scottish Government asked the SFT to support a £2.5 billion programme of additional investment, using the Non-Profit Distributing (NPD) financing method, to pilot a new property and estate management approach and to develop improved ways of managing risk and contingency in projects. NPD aims to limit the ability of a private sector to profit from a project by restricting its investment to debt rather than equity.

The hub initiative is being implemented by the SFT across five geographical territories in Scotland, each with a population of around one million people. In each hub territory, public sector organisations will work in partnership with each other and a private sector delivery partner in a joint venture delivery company called hubco.

One of the key objectives of the hub initiative is to act as a catalyst for the participating organisations to identify and promote opportunities for collaborative infrastructure projects.

In the waste area, the SFT is working directly with Glasgow City, the City of Edinburgh, Midlothian, North Ayrshire, South Ayrshire and East Ayrshire Councils on the development and delivery of their residual and food waste treatment projects. SFT is also supporting the Clyde Valley Strategic Waste Initiative, a major collaboration between several local authorities to explore new ways of delivering future waste treatment and disposal services across the Clyde Valley.

A further initiative developed by the Scottish Futures Trust is the National Housing Trust (NHT), which has the objective of providing up to 700 new affordable rented homes.

Under the scheme, developers build the homes, which are then purchased by Special Purpose Vehicles (SPVs) which are jointly funded by councils and private partners. The SPVs must commit to making homes available at mid-market levels of affordable rent for at least five and up to ten years before the homes can be sold. Tenants must be given the option to purchase their home at market value before it can be sold on the open market.

Participating councils' loans to fund these purchases are backed by a guarantee from the Scottish Government. The investment is therefore effectively paid for by borrowing on the back of future property sales, which allows a move away from grant funding and the delivery of affordable homes in return for less public subsidy.

# Appendices



# Appendix 1 - Terms of reference

The terms of reference for the review are as follows.

## **PART A: Prioritisation**

1. Assess how effectively and efficiently local infrastructure needs are prioritised, and subsequently funded, by local government.
  - i In making this assessment, identify the barriers to local infrastructure priorities being met where and when they are needed.
  - ii Factors to be taken into account include financial and asset management practices, the potential of intelligent infrastructure, and the impact of temporary residents (for example fly-in, fly-out workforces, significant holiday visitors/holiday home owners).
  - iii Identify best practice models or principles that could be applied to local infrastructure prioritisation.

## **PART B: Financing**

2. Identify sources of capital for future local infrastructure needs and impediments to accessing capital.
  - i Differentiate between local infrastructure assets that are in whole or in part public goods, and those that are potentially attractive to private debt and private equity investors. Identify the regulatory, institutional or other barriers to expanding these sources of private capital.
  - ii Propose options for addressing barriers to investment and alternative financing mechanisms, for equity investment (including special purpose vehicles, PPPs) and for local government borrowing. Consider the design, as well as the benefits and costs of establishing a taxable municipal bond market for local infrastructure needs.

## **PART C: Regional capacity and attraction**

3. Identify the opportunities, best practice models and principles for the regional prioritisation and financing of local infrastructure.
  - i May take into account the extent to which local infrastructure needs are integrated into state and national infrastructure strategic plans
  - ii Factors to take into account are the potential for bundling to increase the scale of the infrastructure project and lessen demand risk, the potential for bundling greenfields and mature assets as a portfolio investment, the interdependencies between projects and the need for a mix of both public and private funding within one project.
  - iii An alternative regional framework should take into account any needs for market and institutional development (capital markets, local government, regional authorities or agents) and regulatory reforms.

## Appendix 2 - Australian superannuation and infrastructure

The analysis in this section is based in part upon the findings of a recent report conducted by Ernst & Young for the Financial Services Council (FSC). In compiling the report, FSC members were surveyed on attitudes towards additional investment by superannuation funds in infrastructure.<sup>94</sup> While the survey was developed with larger state-sponsored projects in mind (where superannuation might be involved as an equity holder), a number of the findings apply also to local government projects and projects where superannuation's contribution will be in the form of debt financing.

The overwhelming message from entities involved in superannuation investment at all levels is that superannuation funds have a single function: to invest members' funds to meet their future retirement needs by optimising the level of return. Considering the optimal allocation of these funds to the wide range of available investment assets is a complex process requiring substantial analysis of the risk and return profiles of alternative asset classes.

Australian superannuation funds have demonstrated a relatively healthy appetite for providing finance for infrastructure projects. Indeed, superannuation funds in Australia have historically allocated a higher portion of their capital to infrastructure compared to other countries.<sup>95</sup>

However, as superannuation funds have grown in Australia, the country's infrastructure "gap" has widened. It is perhaps not surprising, then, that superannuation funds are seen by some to be the solution to the infrastructure gap and that there is a need to stimulate further efficient investment in infrastructure by superannuation funds and institutional investors.

While there are no material systemic issues in considering further investment in infrastructure, there are a number of barriers that need to be addressed to stimulate the current appetite to further invest in domestic infrastructure.

### Impediments to investment

#### Lack of a clear pipeline and government commitment

There is sense in the industry that the timing for projects is unclear and there is no strong pipeline in the immediate future. Some superannuation fund managers believe that insufficient planning at the sponsor level combined with poor integration between different tiers of government has in the past lead to unacceptable risk around government sponsored projects.

#### Lack of suitably structured projects

- Need for a commercial risk based return

Investment by funds is done solely for the benefit of their members. Funds do not make investment decisions based upon "social good" and thus all investments need to earn a return commensurate with the assessed risk. Project risk profiles are not necessarily designed to encourage efficient institutional investment.

- Size of investment

Institutional investors have an optimal investment size range for individual project investments and hence infrastructure projects outside this range present an additional challenge. The optimal investment range varies for each fund and is influenced by the level of resources that each fund has and any restrictions the fund may have (for example some funds can not invest more than a specified percentage of fund value into a single investment).

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<sup>94</sup> Ernst & Young, *Financing Australia's infrastructure needs: Superannuation investment in infrastructure*, October 2011

<sup>95</sup> National Australia Bank Limited, *Superannuation FX Survey 2011*, August 2011, and The Allen Consulting Group, *Enhancing Financial Stability and Economic Growth: the Contribution of Superannuation, report to the Association of Superannuation Funds of Australia (ASFA)*, August 2011

- ▶ For smaller projects (projects that typically involve an investment of less than \$100) the cost of investing does not generally reduce in proportion to project size, especially where construction or patronage risks are key elements of the project profile. This can mean that the net return after all costs is insufficient to justify further consideration.
- ▶ For larger projects, the required funding is likely to need a large consortium of fund investors, and hence there is the additional cost, complexity and inefficiencies around consortium documentation, negotiation and structuring the consortium's collective investment vehicle.

## Greenfield project risks

### ▶ Patronage risk

Greenfield patronage risk is of major concern to superannuation funds given the recent underperformance of a number of toll road projects. A number of institutional investors would be unlikely to consider greenfield investment where "naked" patronage risk (i.e. no sharing with government) or similar operational performance risks existed.

### ▶ Design and construction risk

Superannuation funds are amenable to taking design and construction risk and have done so on a number of social and economic infrastructure projects. The appetite for such risk does depend on availability of construction entities with the particular skills and financial capacity suited to individual project issues.

### ▶ Bid cost risk

Investment in greenfield projects is particularly difficult for superannuation funds, especially if participation involves a competitive tender process. The expense, time and effort involved in tender processes is often hard to justify in the light of the fundamental fiscal obligations to fund members and the difficulty in forming an accurate view on the likelihood of success.

## Inconsistent, complex and expensive bidding process

The lack of consistent, simple and clear bidding processes has been identified as a significant hurdle with respect to project tenders and is a key driver of the lack of interest in greenfield projects.

Contract and risk allocation structures differ between jurisdictions particularly with respect to greenfield project processes, and this lack of commonality exacerbates the cost of participating in a wider range of transaction processes. Bidding processes can be individually lengthy, complex and involve significant costs. Specialised skills are often required to be hired by superannuation funds in order to participate in the bidding process.

In addition, there is a sense within the superannuation industry that the focus on "competitive tension" drives project sponsors to demand too much detail at early project stages and to select too many consortia for the RFT stage. The impact on superannuation investors is to strongly discourage them from participating in this primary project market since the cost/benefit balance is poor.

In considering these concerns, it must be acknowledged that there have been significant recent improvements made by governments, including the establishment of Infrastructure Australia and adoption of standardised commercial principles, reflecting that infrastructure is a long-term business which should have robust processes

## Regulatory and industry pressures

### ▶ Regulatory pressures

The Australian Prudential Regulation Authority (APRA) has been seen to be pressing funds for more information and justification around investment in illiquid assets such as unlisted infrastructure and this additional compliance overhead can act as a deterrent against additional fund investment. Lack of clarity over what is considered a "reasonable" allocation to long-term illiquid assets is also a factor that concerns some superannuation industry participants.

► **Development of MySuper product**

Infrastructure is not seen by many in the industry to be compatible with the strong focus on low cost investments contained in the MySuper proposal – particularly as a consequence of new statutory duties for MySuper trustees. Trustees would therefore find it more difficult to allocate funds to infrastructure investment in a regulatory and competitive environment which was heavily focussed on cost.

## **Sovereign/political risk**

There always exists the risk that a change in government may lead to a change in policy direction. Given that infrastructure investment is by nature illiquid, uncertainty over how different sector values may change in response to policy changes is considered a significant issue.

Electoral cycles have impacted upon the level of risk perceived by investors. This has arisen due to lack of clarity around the timing of projects and the cancellation of large projects during the tender evaluation phase. This has increased the level of uncertainty with respect to government commitment and future pipeline.

## **Proliferation of self-managed funds**

A commonly held view is that self-managed superannuation funds would find it difficult to allocate funds to unlisted infrastructure and that the continuing proliferation of such funds represents a challenge to government entities seeking substantial increases in fund investment in infrastructure.

## **Unfavourable Australian banking terms**

Superannuation fund managers who have assessed Australian opportunities against global projects have commented that Australian bank debt terms continue to be materially less favourable to those available in the global market for infrastructure projects. It has been specifically noted that Australian banks are still reluctant to lend for longer than ten years whereas European and US loans are available for 20+ years. Poor debt terms produce unbalanced risk return ratios for infrastructure projects and limit the interest of funds in considering either green or brownfield investment.

## **Lack of specialist expertise**

Infrastructure as an asset class is highly complex, and requires specialised skills to carry out commercial, financial and tax due diligence prior to making investment decisions. The shortage of such specialist expertise has been viewed to be a key barrier to investment in infrastructure by superannuation funds in recent years.

## **Potential solutions**

### **Development of a committed pipeline**

In order to generate market confidence and stimulate further interest, a pipeline of funded projects needs to be created.

The expanded role defined for Infrastructure Australia in the 2011 Federal Budget is an important initial step in providing a more definitive picture of major projects that will require further allocation of private financing. The proposed National Infrastructure Construction Schedule is an excellent starting point as it focuses on projects that are expected to require physical construction activity in the medium term. The establishment of independent, statutory bodies with authority to control procurement of infrastructure assets, as in some Canadian states, would assist in the development of more robust and achievable pipelines.

### **Delivering certainty over government funding commitment**

Superannuation funds would support the use of additional long-term government borrowing to fund appropriately development infrastructure projects, (as opposed to borrowing to fund immediate government consumption) on both equity and certainty grounds.

There is currently a shortage of AAA rated debt products with terms longer than ten years and this naturally acts as a deterrent to lenders in structuring longer-term lending products. The issue of

government debt products in volume with terms of 20 years or greater would assist banks to efficiently price and hedge long-term lending exposure.

## **Appropriately structuring projects**

Governments need to work more closely with the private sector to develop structures that are more conducive to attracting institutional investment rather than relying on traditional models. Approaches that should be investigated are:

- ▶ Patronage risk sharing models
- ▶ Packaging projects for institutional investors so that there are multiple buy-in points aligned with differing risk/return profiles
- ▶ Optimal structuring of government funding contributions from a tax and funding cost perspective.

## **Increasing the recycling of capital**

There are a significant number of publicly owned entities operating in competitive/regulated business environments. Given there is a general consensus that material additional investment in infrastructure is required and that institutional investors favour brownfield over greenfield assets, then the potential to efficiently recycle government capital in operating businesses should be further investigated.

Strategic reviews of current government operating assets should be initiated and focused on identifying and testing the rationale for continued government ownership. Where the case for continuing government ownership is not sustained, plans to consider full or partial divestment should be produced. Infrastructure Australia could consider producing a separate pipeline of privatisation transactions.

## **Creating consistency and certainty of government regulation**

There is a view within the industry that governments see superannuation fund money as simply another pool of funds available for deployment, and this produces a lack of focus on the combined effects government policy initiatives have on fund investment.

Short-term regulatory changes without analysis of the longer-term impact can be counter-productive. Improvements to the current situation could include:

- ▶ Greater coordination between and within different tiers of governments around policy that impacts on institutional investment.
- ▶ Less “road testing” and more detailed development of policy with consequent greater certainty over announced initiatives. For example, funds have been able to include the impact of any concrete carbon initiative into their investment appraisal processes but unable to proceed with certainty over the scheme’s form and implementation timetable.
- ▶ Expanded consultation between governments and investment professionals on future policy initiatives.

## **Further improvements in taxation system efficiency**

Government intervention via short-term taxation incentives are not favoured by the superannuation industry, as these tend to distort investment patterns, such as the failure of past initiatives such as tax free infrastructure bonds to produce long-term improvements in the infrastructure investment market. Superannuation funds currently pay one of the lowest income taxation rates on investment income and gains and thus they naturally are the least influenced by income taxation incentives.

Changes to increase the efficiency of the current system may have a positive impact, for example by improving access to taxation losses locked up in special purpose vehicle entities holding infrastructure assets. In this regard the measures in the 2011 Federal Budget to assist in improving efficiency with respect to preserving the real value of tax losses accumulated early in a project’s life were a welcome first step. This should mitigate the wastage of accumulated losses in projects, when new investors enter after the early development stages. This has previously impeded superannuation funds investing in infrastructure projects in Australia.

However, if introduced as proposed, the measures will only apply to certain infrastructure projects designated by 30 June 2017 and the total capital cost of infrastructure projects that can be designated has been capped to \$25 billion. Subject to any expansion of the measure, there is doubt about whether it will have any long-term impact on the investment allocation strategy of superannuation funds.

The Federal Government's proposal to allow superannuation funds to hold an interest in a trust without adversely impacting the trust's flow through tax treatment under the public trading trust rules is also welcomed. Flow through tax treatment is important to all investors as it allows for the distribution of tax deferred income to investors. The risks associated with obtaining tax flow through treatment for trusts has been a significant impediment to the use of trusts for collective investment in infrastructure projects; necessitating complex and costly additional structuring (eg stapled arrangements involving a company stapled to a trust). Further reform to include investments in qualifying infrastructure assets as an 'eligible investment business' for the purpose of the public trading trust rules is still required to facilitate listed and widely held collective investment in infrastructure assets.

Potential land rich and landholder stamp duties imposed by state governments at rates of up to 6.5% on investments in certain brownfield infrastructure assets remain a key impediment to an efficient secondary market for these assets. Superannuation funds will typically prefer an investment in proven brownfield infrastructure assets and are therefore particularly exposed to these risks. In addition to the potential stamp duty exposures, the complexity and lack of uniformity of the stamp duty regimes as between the states significantly increases bid structuring and due diligence costs.

## Appendix 3 - Municipal bonds in the USA

State and local governments in the USA have a long history of issuing structured debt as a means of raising funds for both general obligations and particular projects and programs. This is normally through the issue of municipal securities or “muni bonds”.

American municipal securities can be classified into two distinct groups:

- ▶ General obligation bonds, issued by municipal governments secured by their future tax revenue
- ▶ Revenue bonds, issued by municipal governments secured by the revenues generated by a particular project or business unit. Examples include utility revenue bonds, seaport revenue bonds and transportation revenue bonds.

General obligation bonds often have the double guarantee that comes from being backed by both taxpayer revenue and private insurance companies. Private insurance companies guarantee general obligation bonds in the unlikely event that tax revenues decline and the municipality falls on hard times. General obligation bonds often receive a AAA rating, the highest available, simply because the insurance company guaranteeing its bonds has a AAA rating.

A unique feature of municipal securities issued in the USA has been the tax-exempt status interest payments. This has made this form of investment relatively more attractive in the eyes of investors.

**Figure 37: American bond yields**

In the USA coupon payments on municipal bonds are often exempt from federal and state taxes in certain circumstances, such as where the bond holder resides in the issuing municipality. For this reason nominal yields are often low in comparison to competing bond market products which may be of comparable risk. One method of directly comparing bond yields is to calculate an effective “pre-tax” yield on municipal bonds, as this can be directly compared to taxable bonds such as those issued by corporations. The graph below includes an assumed pre-tax equivalent yield for 10 year municipal bonds based on an assumption of a 35% marginal income tax rate, which tracks higher than the US 10 year treasury bond for the period.



Source: Reuters

Large states like California and Texas issue more municipal securities than smaller states. In addition, California muni bonds tend to have lower interest rates than similarly rated bonds from other states because higher state income taxes make the tax-free interest more compelling. In Texas, similarly rated muni bonds have higher interest rates because Texas has no state income tax, so there is no tax advantage to hold Texas muni bonds versus other state muni bonds.

There are three primary differences between the USA and Australia which have, to date, prevented the creation of a functional municipal bond market in the latter.

► **Tax**

Byrnes et al have highlighted the tax treatment as a clear difference between the American and Australian experience with municipal bonds: "Many American local government jurisdictions can employ local income taxes and local sales taxes, which represent 'growth taxes' in circumstances of a growing economic growth, a fact recognised by the investment community. By contrast, Australian local government enjoys no analogous growth tax."<sup>96</sup>

The indirect funding of infrastructure through tax concessions goes beyond the scope of this report. If appropriate, the Commonwealth would need to carefully consider the implications of any such mechanisms as part of its wider taxation policies. Tax-efficient financing products are not without their risks and if not carefully managed can produce unintended consequences.

► **Scale of project and local government capacity**

Compared with the USA, local government infrastructure projects in Australia are rarely of a sufficient scale to warrant the costs of a bond issue and to attract the interest of institutional investors. Furthermore, most councils do not have the in-house expertise and capacity to engage in bond issues.

► **Status of local government and impact upon credit ratings**

Local government debt in Australia is consolidated with state debt by credit rating agencies. This is because Australian local government is essentially a "creature" of the states, unlike in the USA, where it is more independent to the other tiers of government. Australian state governments act as the implicit financial supporter of all local government entities and thus has a clear interest in ensuring councils do not enter into arrangements which ultimately expose the state to liabilities that are over-priced.

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<sup>96</sup> Byrnes, J, Dollery, B, Crase, L & Simmons, P, *Resolving the Infrastructure Funding Crisis in Australian Local Government: A Bond Market Issue Approach Based on Local Council Income*, Australasian Journal of Regional Studies, Vol. 14, No. 2, 2008

## Appendix 4 - State and territory local government planning frameworks

The legislative framework in which local government operates differs each state and territory. This has implications for the consistency of strategic, financial, and asset management planning and reporting requirements across the sector.

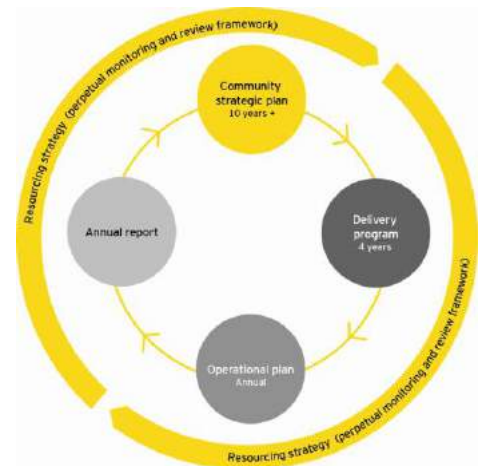
While variances across states is evident, in principle the majority of the core planning and operational frameworks are similar and often utilise a number of operational and strategic plans of varying duration. Annual budgets are consistently applied across the sector, and are supported by longer-term plans covering financial and strategic requirements. These will often be developed in the context of regional plans spanning more than one local government area, in which input through consultation is encouraged.

Longer-term strategic planning generally requires an element of community consultation, with a medium-term plan outlining the distinct delivery schedule of projects. Annual plans are widespread and present a discrete view of the operational and financing requirements in the next year. Recent reforms in legislation across several states show a push to improve the visibility and accountability of local government strategic planning.

### New South Wales

New South Wales introduced a new planning and reporting framework as part of the *Local Government Amendment (Planning and Reporting) Act 2009*. The amendments required three major plans of varying durations: a community strategic plan covering a minimum of ten years which provides the overall direction of the community in the long-term; a delivery program provides the specific actions that will be required over the next four years; and an operational plan which is a detailed resourcing and actionable strategy to implement in the short-term. These are supported by the resourcing strategy which encompasses a long-term financial plan, an asset management plan and a workforce management plan.

Figure 38: Local government planning framework, New South Wales<sup>97</sup>

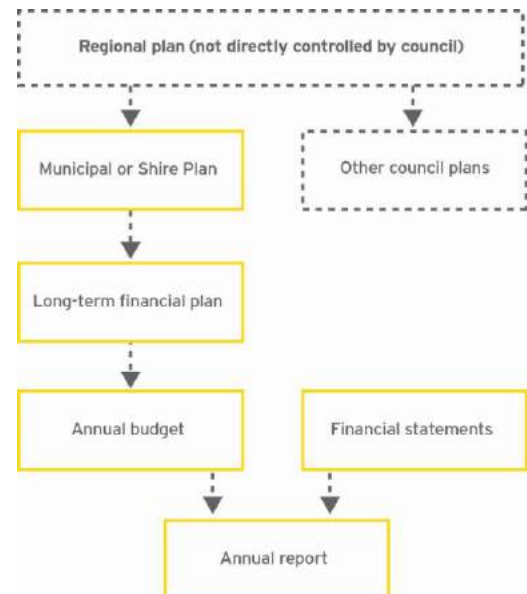


<sup>97</sup> Division of Local Government (NSW), *Planning and Reporting Guidelines for local government in NSW*, Jan 2010

## Northern Territory

The *Local Government Act* operating in the Northern Territory came into effect in 2008 and presented the minimum requirements of local governments with regard to financial management and strategy development. The legislation outlines the creation of a regional plan, which is a product of a consultative process among all local governments in a region as set out in the Act. From these regional plans, a municipal or shire plan must be developed which presents a strategic view of the local government area. These are held to be consistent with long-term financial plans, regional plans and any other strategic plans in operation in the area. Long-term financial plans are required for a four year period and includes councils' major initiatives, projected expenditures and infrastructure maintenance and development schedule. Annual budgets provide overall objectives for the year, as well as expected infrastructure development and expenditure.

Figure 39: Local government planning framework, Northern Territory



## Queensland

In 2009 the state government introduced the *Local Government Act 2009* as an overhaul of the legislative framework in which local governments operate. Wholesale changes made local government's system of planning and financial management more streamlined. Chapter three of the *Local Government (Finance, Plans and Reporting) Regulation 2010* outlines details about required documentation regarding budgets, reports, asset registers, planning documents, community engagement policies and other financial management policies. Four major ten year plans are required, comprising financial and asset management, community and infrastructure provision. The legislation aimed to reduce the prescriptive content of the regulations, instead opting for a more principles based approach to recognise that depth and content requirements may vary significantly across local government areas.

Figure 40: Local government planning framework, Queensland<sup>98</sup>

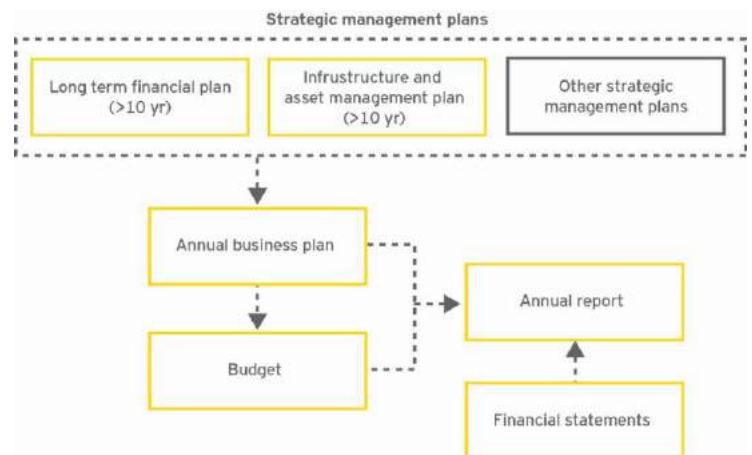


<sup>98</sup> Department of Infrastructure and Planning (Queensland), *Working with the legislation—Local Government Act 2009*

## South Australia

Reporting requirements are outlined in the *Local Government Act 1999*, which is supported by *Local Government (General) Regulations 1999* and *Local Government (Financial Management) Regulations 2011*. Under these regulations, an annual business plan is required which is fed by longer term strategic management plans. Financial and infrastructure and asset management plans are mandated by legislation and are to be at least ten years in duration. These are in turn supported by shorter, four year strategic management plans. The framework also incorporates development requirements under councils' development plans, created under the *Development Act 1993* and *Development Regulations 2008*.

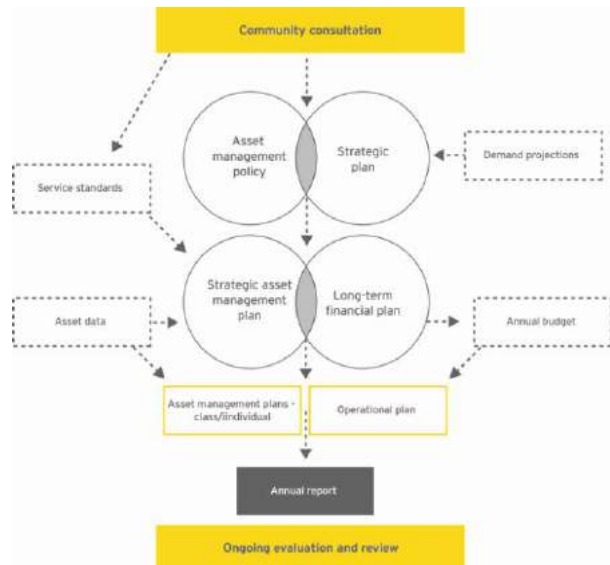
Figure 41: Local government planning framework, South Australia



## Tasmania

Part 7 of the state's *Local Government Act 1993* outlines the reporting and planning requirements of local government in Tasmania. A Strategic Plan is required to cover a period of at least five years, as well as an annual plan. In February 2012 the Department of Local Government in Tasmania delivered a Local Government Asset Management Policy. These policy guidelines offered a more comprehensive framework for financial and asset management planning in Tasmanian local government than previously offered.

Figure 42: Local government planning framework, Tasmania<sup>99</sup>



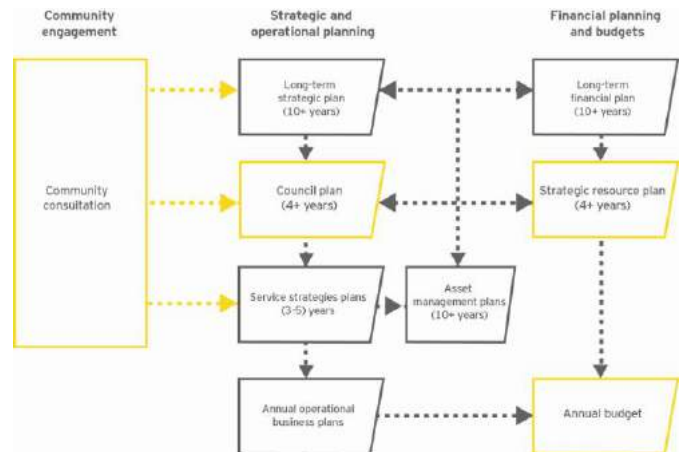
<sup>99</sup> Department of Local Government (Tasmania), *Tasmanian Local Government Asset Management Policy*, Feb 2012

## Victoria

Local government requirements for financial reporting and management are outlined in the *Local Government Act 1999*. Legislation requires a council plan, strategic resource plan and annual budget documents to be prepared. While community consultation, medium term and short term plans are required, mandated complementary plans and strategies are technically voluntary.

In September 2011 the Victorian Auditor-General's Office published a report on major capital works in local government, which outlined how the Victorian requirements operated in comparison to those of other states.

Figure 43: Local government planning framework, Victoria<sup>100</sup>



## Western Australia

The state recently introduced the Integrated Planning Framework in 2011 and amended the *Local Government (Administration) Regulations 1996* as a means to improve local government strategic and financial planning efforts. The Framework sets out minimum requirements, which include the development of two plans of medium and long-term duration. The strategic community plan is required to cover at least ten years and provide an overarching vision for the community. The corporate business plan comprises actions and systematic delivery of outcomes in line with the strategic community plan, and must be at least four years in length. The annual budget is produced as a set of specific financial requirements and actions to enable local government in the short term.

Figure 44: Local government planning framework, Western Australia<sup>101</sup>



The legislative amendments are effective from June 2013, and efforts are currently underway to support the local government sector prepare for this deadline.

<sup>100</sup> Victorian Auditor-General's Office, *Business Planning for Major Capital Works and Recurrent Services in Local Government*, September 2011

<sup>101</sup> Department of Local Government (Western Australia), *Integrated Planning and Reporting Framework and Guidelines*, October 2010

# Appendix 5 - Best practice prioritisation framework

“Best practice” refers to a set of principles which should guide the processes, methods, practices, resources applied to planning, evaluating, delivering and managing investments. This section provides an overview of best practice in the context of local government infrastructure. It is aligned with the high-level principles in the Nationally Consistent Frameworks but is broader in scope.

It is acknowledged that the large body of guidance material produced in recent years on this subject by state and territory governments, and others, have described best practice. This summary captures many components of prior guidance and is designed only to bring together the most important aspects as a point of reference to assess current practice in the local government sector.

Best practice principles describe a framework which can be implanted into an organisation. The success of the framework with regard to infrastructure outcomes depends on consistent application of the principles in substance over time and the competency and skill of the personnel involved.

Best practice is summarised in four parts:

- ▶ Defining role
- ▶ Strategy and planning
- ▶ Evaluation and delivery
- ▶ Management.

## Defining role

Role should be defined with regard to:

- ▶ Legislative requirements
- ▶ Historical role and legacy stock of assets
- ▶ Arrangements with other tiers of government
- ▶ Community expectations.

Legislative requirements generally allow for discretion with respect to the infrastructure-related services that local government may provide to meet identified needs. To properly define role, local government should have a rolling program of consultation with the community and with other tiers of government on expectations and boundaries of responsibilities respectively.

## Strategy and planning

A strategy presents an overarching set of objectives and aspirations which provide long term direction for investment in infrastructure. The strategy should reflect an informed view of future needs.

The strategy is the basis for the development of more detailed plans. An individual council should aim to implement the plans in order to achieve the strategy. Plans should be distinguished by their timeframe and should identify types of infrastructure and related services, whether new or existing.

- ▶ It is important for plans to specifically address the short and longer term. This provides focus for considering the timing of financial impacts of infrastructure investment and focus for commencing the planning and development processes.
- ▶ The plans should be coherent so that it is clear how the shorter term plan fits into the longer term plan.
- ▶ The plans should consider other plans developed by adjoining bodies, regional bodies and other spheres of government and should be consistent with them to the extent possible.

## Evaluation and delivery

Evaluation processes are used to determine the merit of specific investment proposals. They build on a clear understanding of an entity's role and purpose. The evaluation methods used should be rigorous and draw conclusions after assessing key factors such as:

- ▶ Consistency with defined role and alignment with the strategy and plans
- ▶ Outputs required including levels of service, function and performance
- ▶ Whole-of-life risk-adjusted costs
- ▶ Net socio-economic costs and benefits.

A range of due diligence methods are available to assist with the evaluation process. The use of them will depend on the nature of the infrastructure, such as its technical complexity and risk profile.

Delivery refers to the procurement of investments which are preferred as a result of the evaluation process. An assessment of procurement models should be completed after the scope of an investment is clear and a budget allocated to it. This assessment should not pre-suppose an outcome based on past practice and various 'bottom-up' assessment methods are typically used.

A procurement process should be adequately designed and resourced. The process should aim to deliver best value on a whole-of-life basis and after considering a range of factors in addition to price. It is important that the design of the process is conducive to creating competitive tension between potential providers, including in-house providers.

Where relevant to the procurement model, it is important for the procuring entity to establish continuity between the personnel involved in delivery and commissioning and those involved in ongoing management. This maximises the transfer of knowledge essential to preparing a robust asset management plan.

## Management

Management refers to the servicing function inherent in infrastructure and monitoring the realisation of benefits from it. A comprehensive asset management plan is an essential part of this management process and systems should be in place to capture the data necessary to inform the plan. Monitoring benefits is essential for measuring progress with fulfilling the strategy and this may be done through performance indicators or similar methods.

- ▶ In each case, there should be clear integration at the asset level and the corporate level, so that observed and forecast performance and related impacts at the asset level is transmitted to budgeting, reporting and planning processes.
- ▶ Management may be direct and performed in-house or may be done through contracted service providers. In either case, accountability for tasks and outputs should be clear and personnel should have the level of skills to perform them effectively.

## Appendix 6 - Procurement models

An integral part of the procurement strategy is the selection of a procurement or project delivery model. A procurement model is a structure governing the relationship of the project participants in the delivery of a project.

The procurement model forms the basis of a contractual framework for the project which broadly defines the risk allocation and over-arching commercial principles of the procurement. To a large extent, it will determine the nature and duration of the relationship between the project sponsor and the contractors.

This section presents an overview of some of the “traditional” and alternative project procurement models which may be appropriate for local government infrastructure projects. It by no means covers all of the procurement models available nor does it include a discussion of the relative benefits of each model. Each model can be adapted to the specific needs of an individual project or program.

The project delivery models covered in this section are:

**Figure 45: Traditional and alternative/non-traditional delivery models**

Traditional	Alternative/non-traditional
1. Construct only	6. Development Agreement
2. Design and Construct	7. Alliancing
3. Design, Construct and Novate	8. Design, Build, Operate and Maintain (DBOM)
4. Contract Management	9. Design, Build, Finance, and Operate (DBFO) /
5. Managing Contractor	Design, Build, Finance and Maintain (DBFM)/
	Build, Own, Operate, Transfer (BOOT)

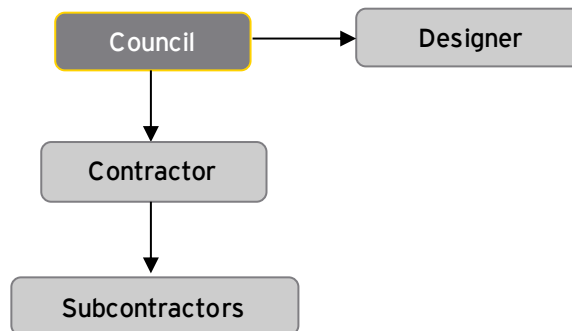
“Traditional” procurement models such as construct only and design and construct have been historically favoured by councils, owing to the existence of precedents for such models, and the familiarity suppliers and contractors have with such forms of project delivery.

Traditional models tend to be limited to the design and construction of an asset, and generally do not contemplate any post-construction maintenance and operation activities. Traditional models are funded by council on balance sheet, and council remunerates a contractor or supplier whilst retaining ownership of the asset. They are generally suited to procurement with a relatively low risk profile and where the asset to be delivered can be defined with a high degree of certainty.

In many cases, for large complex or innovative projects, better value and project outcomes may be achieved by utilising a non-traditional procurement model. These alternative models do not have a common set of features. Some apply to the design and construction period of a project and some extend to the post-construction operation or maintenance of the asset. Some are financed by council and some are financed (partly or wholly) by the private sector.

They are linked by the fact that historically, local government in Australia has underutilised these models.

## 1. Construct only

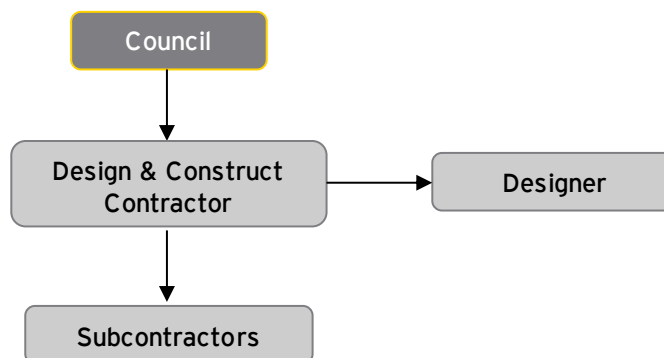


A construct only model may be alternatively described as a 'lump sum' or 'fixed price' model. It covers the construction of the asset solely and no post-construction services.

Council first engages a design team to fully develop the design documentation for the asset to be constructed. The complete design documentation is included in the tender documents for the works contractor. Council then separately engages the work contractor. The design documents form part of the construction contract, but council retains full responsibility (and liability) for the design.

The contractor is entitled to be paid the lump sum contract price for completing the works under the contract subject to contractually approved adjustments, and is entitled to this sum irrespective of the actual cost of the works. In practice, cost increases to the original sum are common, particularly due to variations, poor contract management and inadequate risk assessment.

## 2. Design and Construct

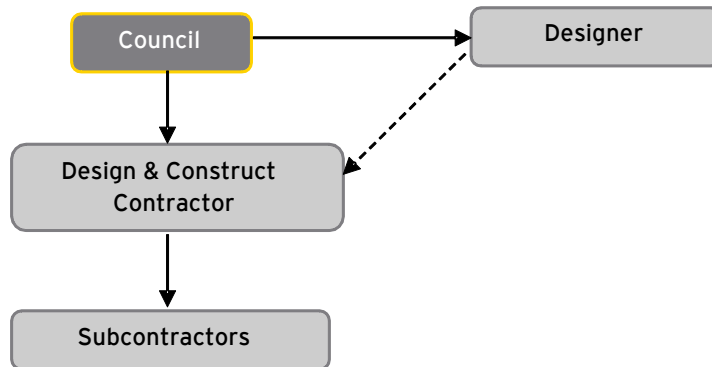


A design and construct model may be alternatively described as a 'design and build' contract.

Council prepares a design brief specifying performance and user requirements. This will often be quite a detailed document setting out council's requirements and may include some preliminary design. Council then seeks tenderers for the completion of the project in accordance with the design brief under a single lump sum contract.

The contractor will complete the design documentation and construct the works in accordance with the design documentation, relieving council of some of the administrative burden of the project. The contractor usually bears design and construction risks including fitness for purpose.

### 3. Design, Construct and Novate

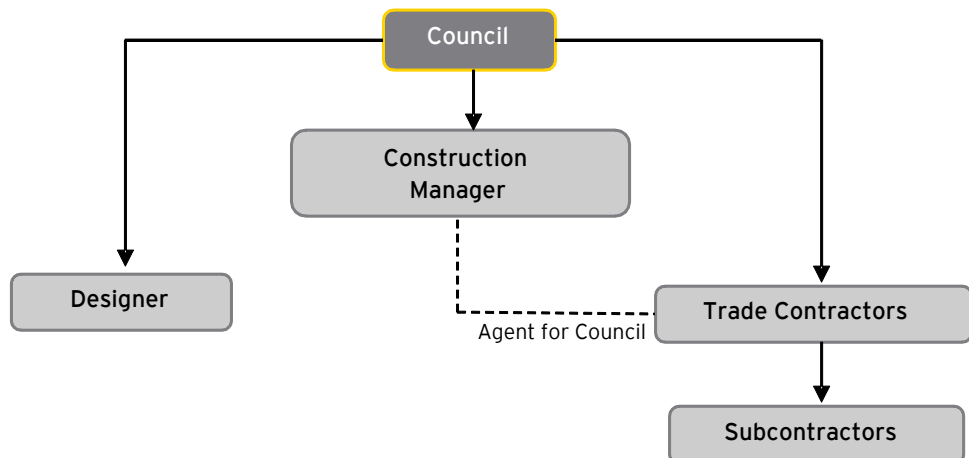


Under this model, council engages a designer to develop a preliminary or schematic design (as a minimum). Council then engages separately a contractor to design and construct the asset based on this design.

The contractor enters into the design and construct contract on the basis that it will accept a novation of the contract between council and the original designer. Through the novation, the designer becomes a subcontractor to the design and construct contractor, thereby creating a single line of responsibility between council and the contractor for the project.

After the novation, the contractor is responsible for the design produced by the designer, payment of the designer's fees and construction and design risk. The council no longer has a direct contractual relationship with the designer following the novation.

### 4. Contract Management



Under this model, the works are typically divided into discrete trade packages with designers and construction managers engaged separately.

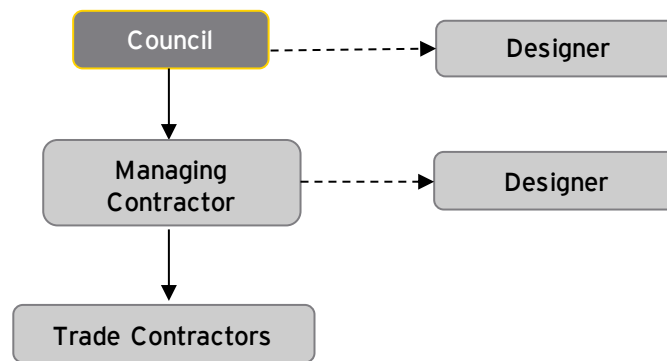
Council usually engages the designer directly and manages the design process. Council then engages a construction manager to manage the performance of the construction work.

The construction manager is essentially a project manager and this model is sometimes also referred to as a 'project management contract'. The construction manager conducts the tender process for the trade packages and enters into the contracts as agent for council. In a variation of this model, the construction manager sometimes also engages the designer as agent of council and is responsible for the design process as well.

The construction manager does not perform any works itself nor does it bear any delivery risk, including design, cost and delay risk. Council retains overall project delivery risk.

The construction manager is paid a fee for the services provided based on set rates (time) or a percentage of the value of the works (or a combination of both).

## 5. Managing Contractor



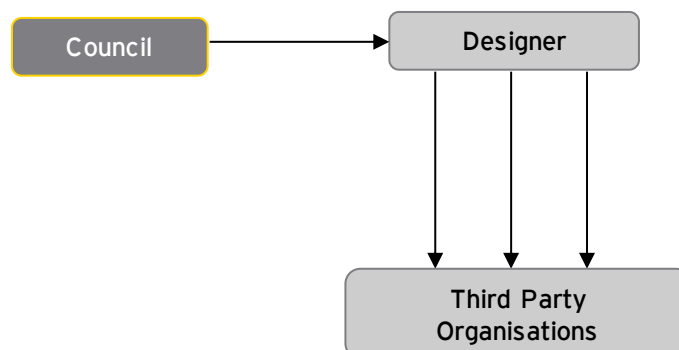
Council engages a managing contractor who contracts directly with the designer and subcontractors to deliver a project. Unlike the construction management model, the managing contractor acts in its own capacity and not as an agent of council. The managing contractor is appointed early in the project to monitor the project from tender to design to completion.

The model is flexible in that the contracting manager can be engaged to deliver a functional design brief prepared previously by council or is fully responsible for the design and delivery of the project.

The managing contractor, although collaborating with the council, is ultimately responsible for the preparation of trade package documentation and selection of tenderers and suppliers. The managing contractor assumes some documentation and quality risk and is responsible for ensuring completion of the works by the date for practical completion.

The managing contractor is remunerated by a lump sum management fee, and receives incentives for managing the project within time and cost targets.

## 6. Development Agreement



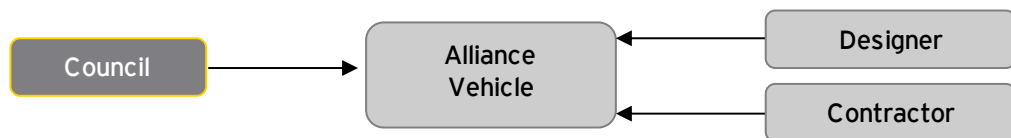
A Development Agreement involves Council engaging a contractor for the delivery of all aspects of the project, which may include the construction of the asset and provision of some services. Generally, the contractor is responsible for the overall delivery of the project, and the development agreement will contain all contractor responsibilities.

Development agreements act as a contractual 'one stop shop' providing for the development of the area, the nature and extent of the contractor's contribution to the development and the timeframes associated with these provisions.

Key aspects of the framework may include, amongst other key issues: land transfer, licenses and leases, development obligations, financial arrangements (rent, sales price), and miscellaneous items such as car parking and marketing.

The development agreement will form the overarching project document, however may contain obligations for the parties to enter into a number of other agreements, with each other or third parties, for the purposes of giving full effect to the development agreement. These agreements often deal with discrete property or planning issues such as land transfer or planning permit documentation.

## 7. Alliance



Alliance contracting is a form of procurement where council and other commercial participants (designers, contractors and key suppliers) collaborate to share in the risks and benefits of a program/project by entering into one contractual agreement.

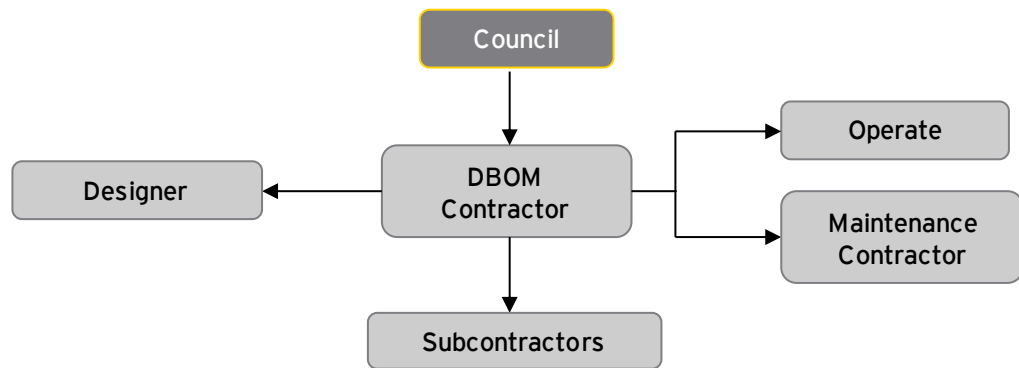
Under an alliance, the aim is to align the participants' objectives to maximise performance, proactively manage risk, reduce time and cost and achieve outstanding performance through innovative solutions. The alliance participants collaborate to develop time and cost targets during the pre-construction phase, and non-owner parties (participants other than council) receive open-book reimbursement of direct project costs. The gain share/pain share payment structure is linked to the "Target Out-turn Cost".

This approach allows for progressive design and construction of some elements before others.

There are various forms of alliances, including:

- ▶ **Project Alliances:** suitable for the construction or design and construction of a single project.
- ▶ **Program Alliances:** suitable for bundled projects where the specific number, scope, definition and budgets of the projects are unknown.
- ▶ **Services Alliances:** suitable for the long-term provision of service where council wishes to bring in external expertise. This might be relevant for operations and maintenance activities for an asset(s).
- ▶ **Sub alliances:** subordinate to an alliance and an alternative to a subcontract, sub consultancy agreement or a supply agreement. Sub alliances are appropriate where the circumstances dictate that an alliance methodology should be used rather than traditional methods of procurement.

## 8. Design, Build, Operate and Maintain (DBOM)



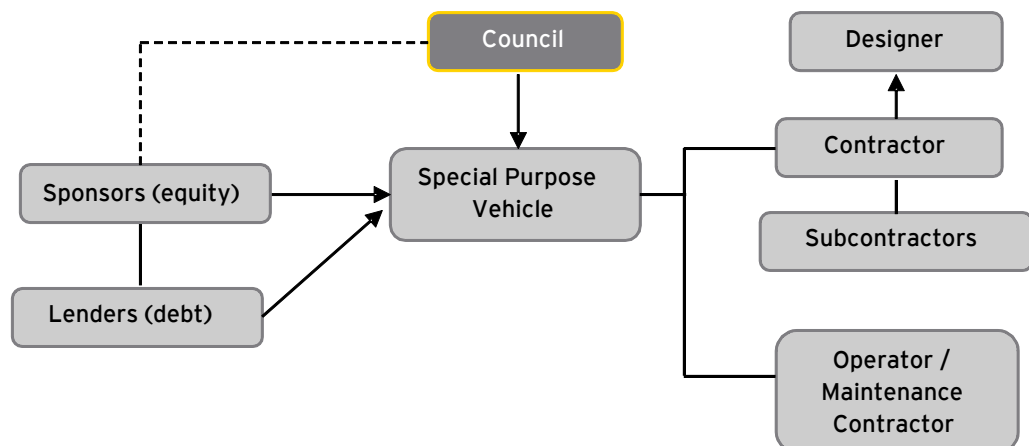
The DBOM model is like a design and construct model except, as the name suggests, it also includes operational and maintenance activities post completion of the construction phase. This method of procurement is also referred to as 'build, operate, transfer' as the operation of the asset is transferred back to council at the end of a specified operations and maintenance period.

Under this approach, Council prepares a detailed design brief and engages a single contractor to design, construct, operate and maintain the asset. The contractor is primarily responsible for associated design, construction and operation risks.

The DBOM contractor does not own the asset, but is contractually licensed to enter, operate and maintain it for a specified period. Typically, Council funds the project without a contribution from the DBOM contractor.

A variant of this model is the DBM (Design, Build Maintain) whereby the contractor does not operate the asset post-construction. The contractor does however, provide maintenance services for a specified period.

## 9. Design, Build, Finance, Operate (DBFO), Design, Build, Finance and Maintain (DBFM) and Build, Own, Operate and Transfer (BOOT)



Under the DBFM/DBFO model, Council defines its requirements in an output specification and then enters into a contract with a special purpose vehicle (SPV) to design and maintain and/or operate the asset for a specified period. A key differentiating factor of this model is that the private sector finances the project through sponsor equity and debt finance via the SPV.

Typically, council retains ownership of the asset and grants rights to the SPV under a long-term lease or licence arrangement. The operation/maintenance period may be as short as 10 years, but is generally much longer (say 15 - 40 years) to enable the SPV to repay any financing and return profits to the sponsors. At the end of the lease/licence period, Council takes over the operation/maintenance of the asset.

Under this arrangement, Council is usually not required to make any upfront payment for the design or construction of the asset, and the SPV recovers these costs through the operation of the asset (via the revenue stream generated by the asset such as usage charges), or by way of an availability charge or service fee payable by Council.

The BOOT model is similar to the DBFO model except that the SPV is to own the asset during the specified operating period and then must transfer the completed asset back to council. Like the DBFM/O models, the operating period is usually long-term (15 - 40 years). Accordingly, until the asset is transferred back to council at the end of the concession period, the SPV bears the risks associated with owning the asset.

## Appendix 7 - Mornington Peninsula Safer Local Roads program

Mornington Peninsula Shire Council has achieved substantial cost and service benefits through innovative procurement of maintenance, repair and capital works on its local road network - the Safer Local Roads program. Council adopted a non-traditional approach to managing local roads, using a Design Build Finance Maintain (DBFM) model to achieve savings of approximately \$64 million over 15 years.

Mornington Peninsula Shire Council has an area of 723.1 km<sup>2</sup> and a population of 148,394 (ABS). It was established in 1994 following the amalgamation of the previous Shires of Flinders, Hastings and Mornington.

Shortly after amalgamation, council ceased to carry out any road infrastructure services in-house, opting for a 100% out-sourced delivery model. Works were planned and procured largely on an annual basis according to demand. Resealing, major patching, rehabilitation and reconstruction were procured under separate, short-term contracts.

Council found that this approach was not resulting in optimal outcomes for roads maintenance. In particular:

- ▶ The road network asset condition was in decline
- ▶ The approach to road network maintenance, repair and renewal was fragmented
- ▶ There was limited opportunity for innovation
- ▶ There was little integration between renewal and maintenance activities
- ▶ There was a focus on short-term planning to meet short term objectives - generally limited to 12 month periods - yet there were long-term performance risks
- ▶ Separate contracts were not cost effective or administratively efficient
- ▶ Short-term contracts led to frequent contract variations.

Following extensive consultation with the community and the Victorian Government, and the receipt of professional advice, council resolved to combine its annual expenditure on repair and maintenance contracts into a single road management contract for a 15 year period. The project included an integrated approach to planning and performing works and services in relation to:

- ▶ Routine road maintenance
- ▶ Periodic reseal/rehabilitation for roads, car parks and paths
- ▶ Maintenance and repair of stormwater pits and open drains
- ▶ Upgrading works
- ▶ Capital works.

Project delivery was based on what council describes as a partnership between a single private sector contractor and Mornington Peninsula Shire Council. The contractual arrangements took effect as a DBFM arrangement.

In order to determine whether delivering the project using a DBFM model would provide good value for money outcomes compared with the existing, traditional procurement of works and services for the local road network, council engaged consultants to prepare a Public Sector Comparator (PSC) at the procurement stage.

The PSC (which is typical for PPP procurements) estimated the net present cost to council of continuing with its existing arrangements, and was compared with the shortlisted submissions as part of the tender process. This exercise indicated that the existing procurement approach would result in

costs of \$203 million over the 15 year term, while contracting with the preferred tenderer would only cost \$139 million, saving \$64 million.

The analysis found that there were a number of advantages of the long-term DBFM approach. A single contract allowed council to stay within its allocated budget and provided for capital works, such as the construction of new roads, which would otherwise have been impossible. In addition a long-term integrated contract would provide:

- ▶ Certainty in service delivery duration
- ▶ Savings in management / administration / plant costs
- ▶ Economies of scale
- ▶ Efficiencies in service delivery
- ▶ A reduction in longer term costs
- ▶ Greater innovation and added value.

The tendering process resulted in nine submissions, including some of the largest roads contractors in the market. Five submissions were subject to further evaluation and after an extensive process, the contract was awarded to Emoleum (which was subsequently acquired by Downer EDi). Unlike a typical DBFM model, the financing component of approximately \$6 million was relatively small compared with the overall project value, and the contractor funded this on its balance sheet as opposed to arranging external financing.

The key elements of the contract are as follows.

**Figure 46: Safer Local Roads - key features**

Service provider deliverables	<ul style="list-style-type: none"> <li>▶ Maintenance and repair of 1,639 km of roads over 15 years</li> <li>▶ \$6 million of capital works to be completed in the first four years</li> <li>▶ Council can also issue orders for additional works up to \$100,000</li> <li>▶ Ongoing maintenance of asset condition from completion of accelerated program</li> </ul>
Incentives/ performance	<ul style="list-style-type: none"> <li>▶ Joint ownership of performance measures</li> <li>▶ Performance monitoring includes: <ul style="list-style-type: none"> <li>▶ independent 3 yearly detailed assessment of council roads against "Payment Condition Index" (the service provider must either meet or exceed the index)</li> <li>▶ annual performance reviews including internal audit</li> <li>▶ annual customer satisfaction reviews</li> <li>▶ last resort contract termination</li> </ul> </li> <li>▶ Independent auditor engaged to monitor and measure contract performance</li> </ul>
Payment	<ul style="list-style-type: none"> <li>▶ Council pays a smooth monthly service charge subject to adjustments for indexation, additional capital works ordered and additional works resulting from new roads coming under the council's control</li> <li>▶ The monthly service charge is subject to abatement for failure to perform or inadequate performance by the contractor</li> <li>▶ While the payments are funded from council's general budget, any additional funds received from, for example, the Commonwealth's Roads to Recovery program, are factored into the service provider's schedule of works</li> </ul>
Contract management	<ul style="list-style-type: none"> <li>▶ The contract is managed by the senior representative team, services management team and an operations management team, comprising representatives of both parties</li> <li>▶ The program of works is developed by the service provider, with the input of council</li> </ul>

The Safer Local Roads program has now been running for five years, a third of the contract term. The following benefits can be identified.

**Figure 47: Safer Local Roads – key benefits**

Outcomes	<ul style="list-style-type: none"> <li>▶ Safer network, improved condition and appearance</li> <li>▶ Innovation through long-term relationship</li> <li>▶ Improved community satisfaction</li> </ul>
Cost	<ul style="list-style-type: none"> <li>▶ Higher project establishment costs with savings on procurement costs over 15 year term</li> <li>▶ Smooth repayments establishing financial certainty</li> <li>▶ Accelerated works program to achieve rapid improvements of identified areas, reducing whole-of-life costs</li> </ul>
Certainty	<ul style="list-style-type: none"> <li>▶ Certainty of works means that the renewals gap closed for 15 year period</li> <li>▶ Minimal variations</li> </ul>
Long-term added value	<ul style="list-style-type: none"> <li>▶ Long-term added value and commitment from contractor to quality</li> <li>▶ Whole-of-life consideration for all works leads to lower maintenance costs</li> <li>▶ Improved residual life and integration between renewal and maintenance</li> <li>▶ Close council-contractor relationship allows flexible service delivery</li> </ul>
Risk allocation	<ul style="list-style-type: none"> <li>▶ Performance risk borne by contractor, any residual risk is shared</li> <li>▶ Contractor takes more responsibility for quality under a long-term contract</li> </ul>
Partnership	<ul style="list-style-type: none"> <li>▶ Shared relationship based on trust encourages knowledge transfer and skill retention</li> <li>▶ Ongoing onus on the parties to maintain shared communication</li> </ul>

Council's commitment to innovation in this project has been recognised by two awards, IPWEA Australia (Vic) Excellence Award for Innovative Practice/Service Delivery and LGPA Award for Excellence – Services Delivery Initiative.

The success of this program can be attributed to the following:

- ▶ Commitment from council and willingness to transfer decision making to a third party
- ▶ Clear understanding of risk allocation, which was developed alongside the service provider following the selection of preferred tenderer
- ▶ Functional working partnership between council and the service provider
- ▶ Minimal disruption to existing contractual arrangements, in that roads maintenance had been out-sourced for some time (in councils where there are elements of in-house service delivery, the implementation of a similar program would likely result in issues surrounding employee transfer)

Whilst not a full-blown PPP, the Safer Local Roads program demonstrates how the bundling together infrastructure works over a significant area and time can create a program which is both attractive to the private sector, delivers innovation and partnership, and can ultimately provide value for money for local government.

The arrangement is especially suitable for network assets such as local roads. By way of example, Mornington Peninsula Shire investigated building upon the success of the Safer Local Roads program by implementing a similar arrangement for buildings maintenance and renewals, but concluded that the divergent characteristics of the different building classes rendered the project unsuitable for bundling. Council is currently funding academic research into ways of introducing bundled procurement in other areas – another indication of the potential council sees in this model.

# Appendix 8 - Major project guidelines for local government

This section provides further guidance on the recommended major project guidelines for the local government sector.

## Objectives

The general objectives of the procurement guidelines for local government will be to:

- ▶ Provide guidance to local government as to some of the main procurement options available and when it is appropriate to use them
- ▶ Encourage local government to properly consider the full range of procurement options for major infrastructure projects and services
- ▶ Provide local government with a clear framework for the planning and delivery of infrastructure projects and services, which takes into account the legislative, financial and political constraints of local government
- ▶ Provide guidance on the need for expert commercial, financial, technical and legal advice, as well as the development of a business case and establishing clear commercial principles for a project
- ▶ Provide guidance on appropriate tender processes, contracts and technical documents required to deliver major projects
- ▶ Assist local government to build experience and expertise within the sector
- ▶ Attract the private sector to invest in local government infrastructure and services by providing a cohesive and predictable framework thereby giving the private sector more confidence in the processes of local government procurement.

## Contents

The following topics would be included:

1. Project assessment
  - a. Identifying the need
  - b. Validating the project
  - c. Defining and scoping the project
  - d. Project governance
  - e. Council approval
2. Business case - general
  - a. Structure of a business case
  - b. Establishing the need
  - c. Project objectives and scope
  - d. Stakeholder consultation and analysis
  - e. Summary of project options
  - f. Options analysis
  - g. Financial evaluation of options
  - h. Non-financial impacts
  - i. Risk analysis
  - j. Selecting a project delivery model - the procurement strategy decision
  - k. Budget and funding
  - l. Project implementation and planning

3. Business case - funding and financing
  - a. Own-source funding
  - b. Government grants
  - c. Borrowing money
  - d. Private sector limited/non-recourse project financing
4. Business case - procurement options
  - a. Construct only
  - b. Design and construct
  - c. Design, construct and novate
  - d. Construction management
  - e. Managing contractor
  - f. Development agreement
  - g. Alliance
  - h. Design, build, operate and maintain (DBOM)
  - i. Design, build and maintain (DBM)
  - j. Design, build, finance, operate (DBFO) and design, build, finance, maintain (DBFM)
  - k. Build, own, operate and transfer (BOOT)
  - l. Build, own, and operate (BOO)
5. Project development
  - a. Project establishment
  - b. Due diligence
  - c. Statutory approvals and controls
  - d. Commercial framework
  - e. Specifications and performance requirements
  - f. Developing the project documents
6. Tender process
  - a. The tender process
  - b. Embarking on the tender process
  - c. Expression of interest stage
  - d. Request for tender stage
  - e. Evaluation of tender submissions
  - f. Negotiation
  - g. Selection of preferred tenderer
  - h. Briefing unsuccessful tenderers
  - i. Clear audit trail
  - j. Completion
7. Contract management
  - a. The contract management system
8. Project review
  - a. Timing for a project review
  - b. Who conducts a project review
  - c. Project review process
  - d. Reporting

## Appendix 9 - Tasmanian Irrigation

Tasmania is seen to be “water rich” in that it has a high ratio of rainfall to landmass. However, there has long been debate about the best way to capture this natural resource, and the optimal model for funding irrigation development.

Tasmanian Irrigation Pty Ltd was established as a state government-owned company on 1 July 2011, as a merger of responsibilities of the Rivers and Water Supply Commission, Tasmanian Irrigation Development Board and Tasmanian Irrigation Schemes companies.

The principal objective of Tasmanian Irrigation Pty Ltd is to manage irrigation schemes in Tasmania, based on the Tasmanian Water Development Plan. Projects must demonstrate the ability to provide greater water security for farmers and communities, be economically viable and environmentally sustainable.

The table below shows projects either significantly advanced or complete.

**Figure 48: Tasmanian Irrigation - projects<sup>102</sup>**

Project	Phase	Budget Dec 2011 (\$m)	Private Sector (\$m)	Government Contribution (\$m)
Whitemore Irrigation Scheme	Operations	11.26	6.22	5.05
Headquarters Road Dam	Operations	4.50	2.38	2.12
Sassafras Wesley Vale Irrigation Scheme	Operations	12.28	6.17	6.11
Winnaleah Irrigation Scheme Augmentation	Construction	10.82	4.33	6.49
Lower South Esk Irrigation Scheme	Construction	14.83	6.20	8.63
Midlands Water Scheme	Approvals	110.00	37.24	72.77
Kindred North Motton Irrigation Scheme	Approvals	10.61	3.00	7.61
<b>Total</b>		<b>174.3</b>	<b>65.54</b>	<b>108.78</b>
Projects currently under development, emergency schemes and other indirect project development costs including project management requirements and construction financing				
<b>Total</b>		<b>128.68</b>	<b>27.56</b>	<b>101.12</b>
<b>Total</b>		<b>302.98</b>	<b>93.10</b>	<b>209.90</b>

Funding is required for both construction costs, and on-going operating and refurbishment costs, and has been sourced as follows:

### Construction

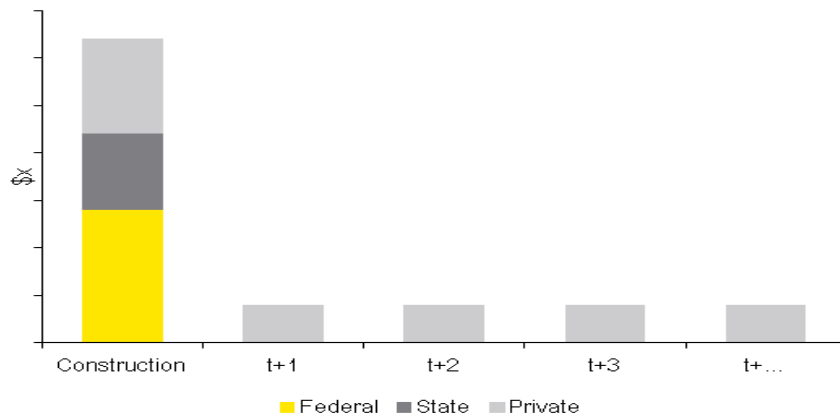
- ▶ Australian Government: \$140m (from the Sustainable Water Infrastructure Program)
- ▶ Tasmanian Government: \$80m (from the disposal of Hobart Airport, sold in 2007 for \$350m)
- ▶ Private contributions are generated from primary producers through the sale of tradeable water entitlements.

### Operating and refurbishment

- ▶ Annual charge levied onto the water entitlement holders comprising of two components:
  - a. fixed charge to recover operational costs and a provision for asset refurbishment,
  - b. variable charge that is dependent on the amount of water consumed or stored, to recover costs associated with pumping or storage

<sup>102</sup> Tasmanian Irrigation Pty Ltd

Figure 49: Tasmanian Irrigation – project funding



### Water entitlements

Water entitlements are charged at a standard cost per megalitre for all users of a particular irrigation scheme (i.e. this charge is not dependent on the irrigator's distance from the main location). Water entitlements are effectively an asset, made up of an:

- Irrigation right (right to annual allocation of water available), and
- Delivery right (right to delivery of water in nominated zone).

Entitlements last 25 years with options to rollover for additional 25 year terms. The water entitlements are not an indication of transfer of ownership over the physical infrastructure.

Water entitlements are offered first to occupiers of land. If occupiers of land within the irrigation scheme zone do not take up 100% of the entitlements they are offered to non-occupiers of land.

Once entitlements are granted they can be traded, either separately or together. Irrigation rights can be traded to any party regardless of location. Delivery rights can be traded to any party but are required to be used in the nominated zone.

## Appendix 10 - Acknowledgements

We would like to express our gratitude to the Hon Simon Crean MP, and the officials of the Department of Regional Australia, Regional Development and Local Government, for their cooperation and support during the course of this study.

We would like to thank the Right Worshipful the Lord Mayor of Darwin Graeme Sawyer, the Right Hon the Lord Mayor of Hobart Damon Thomas, and the Right Hon the Lord Mayor of Melbourne Robert Doyle for their personal interest and participation in this study.

We would like to acknowledge the following organisations for contributing to the consultation process undertaken for this study.

- ▶ Albury City Council
- ▶ Shire of Ashburton
- ▶ Shire of Augusta-Margaret River
- ▶ Australian and New Zealand Banking Group Limited
- ▶ Australian Centre of Excellence for Local Government
- ▶ Australian Local Government Association
- ▶ The Barossa Council
- ▶ Town of Bassendean
- ▶ Ben Lomond Water
- ▶ City of Boroondara
- ▶ Brisbane City Council
- ▶ Burnie City Council
- ▶ Cairns Regional Council
- ▶ Coffs Harbour City Council
- ▶ Commonwealth Bank of Australia
- ▶ Cradle Mountain Water
- ▶ City of Darwin
- ▶ Devonport City Council
- ▶ Professor Brian Dollery, University of New England
- ▶ The Export Finance and Insurance Corporation (EFIC)
- ▶ Far North Queensland Regional Organisation of Councils
- ▶ City of Fremantle
- ▶ Gold Coast City Council
- ▶ Government of Australia - Department of Regional Australia, Local Government, Arts and Sport
- ▶ Government of Australia - the Treasury
- ▶ Government of New South Wales - Division of Local Government
- ▶ Government of the Northern Territory - Department of Housing, Local Government and Regional Services
- ▶ Government of Queensland - Department of Local Government and Planning
- ▶ Government of South Australia - Office for State/Local Government Relations
- ▶ Government of Tasmania - Department of Economic Development, Tourism and the Arts
- ▶ Government of Tasmania - Department of Infrastructure, Energy and Resources

- ▶ Government of Tasmania - Department of Premier and Cabinet
- ▶ Government of Tasmania - Department of Primary Industries, Parks, Water and Environment
- ▶ Government of Tasmania - Treasury
- ▶ Government of Victoria - Department of Treasury and Finance
- ▶ Government of Western Australia - Department of Local Government
- ▶ City of Greater Dandenong
- ▶ Shire of Harvey
- ▶ Hobart City Council
- ▶ Industry Funds Management
- ▶ Infrastructure Australia
- ▶ Infrastructure Capital Group
- ▶ Infrastructure Partnerships Australia
- ▶ Institute of Public Works Engineering Australia
- ▶ Katherine Town Council
- ▶ Town of Kwinana
- ▶ Liverpool City Council
- ▶ Local Government and Shires Associations of New South Wales
- ▶ Local Government Association of Queensland
- ▶ Local Government Association of South Australia
- ▶ Local Government Association of Tasmania
- ▶ Local Government Association of the Northern Territory
- ▶ Local Government Managers Australia
- ▶ Local Government Managers Australia (Victoria)
- ▶ Local Government Managers Australia (Western Australia)
- ▶ Local Government Procurement
- ▶ Maroondah City Council
- ▶ City of Melbourne
- ▶ City of Melville
- ▶ Mornington Peninsula Shire
- ▶ Municipal Association of Victoria
- ▶ National Australia Bank Limited
- ▶ City of Nedlands
- ▶ City of Onkaparinga
- ▶ City of Palmerston
- ▶ City of Perth
- ▶ Pilbara Cities Office
- ▶ Regional Development Australia Southern Melbourne
- ▶ Shire of Roebourne
- ▶ Southern Sydney Regional Organisation of Councils
- ▶ Southern Water
- ▶ Standard & Poor's Financial Services

- ▶ Strathbogie Shire Council
- ▶ Swan Hill Rural City Council
- ▶ Tasmanian Chamber of Commerce and Industry
- ▶ Tasmanian Irrigation
- ▶ Townsville City Council
- ▶ Town of Victoria Park
- ▶ Victorian Auditor-General's Office
- ▶ City of Wanneroo
- ▶ Warringah Council
- ▶ West Arnhem Shire Council
- ▶ Western Australia Local Government Association
- ▶ City of Whittlesea
- ▶ Willoughby City Council
- ▶ Shire of Yilgarn

### **Submissions received**

While we did not call for written submissions, we would like to acknowledge the submissions received from the following interested parties:

- ▶ Cllr Ian M Tiley, Clarence Valley Council
- ▶ Ian Tiley, Chairperson - Regional Development Australia, Northern Rivers

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