

1. EXECUTIVE OVERVIEW

Expenditure Projections

This study examined the renewal requirements of 78 Victorian Councils under a range of default assumptions. The projections made are *not* forecasts of future *actual* spending, *nor* are they forecasts of future *desired* spending. They reflect expenditure that would be required if no rationalisation of asset portfolios or other improved asset management were to take place. If the projections "hold true", Councils have failed to heed the messages contained in these pages. The size of the problem, however, is such that even with rationalisation and management improvement, increased expenditure *will* be necessary.

The Projections Provide Information for Councils

The expenditure projections and their relation to current spending levels, given in the "sustainability" indices, indicate the management task ahead for Councils. *A Council's current position is largely a function of its past patterns of growth.* The sustainability indices provide sets of information useful for future planning by individual Councils. They are *not* performance measures. Still less are they benchmarks or "league tables". Uninformed use in this way could detract from their usefulness for management in addressing the future renewal challenge.

Ageing Assets

Councils all over Australia are now facing the problem of ageing assets in need of renewal. Many of these assets were never funded by the Councils in the first place but came by way of grant (from State or Commonwealth), from developer contributions or from a shift of responsibilities for previously State owned assets to local government. Had Councils been responsible for funding all of their infrastructure, it is highly likely that they would have acquired less. Moreover their rate levels would have been increased to meet the needs of asset acquisition and some of this higher level of rate revenue may have continued on to be available for renewal. As it is, Councils now have to prepare for increased funding to meet the needs of asset renewal.

The Task

Infrastructure in Victorian Councils is worth around \$23.3 billion in current replacement terms, or approximately \$13,000 per household. Managing these assets on behalf of the community is a big responsibility and good management requires good information. Councils know that some of these assets are now in need of renewal - but how many assets? How much will it cost to renew them? When will resources be required to be spent, or other management action taken, to avoid asset deterioration and loss of service?

The objectives of this study are to:

1. determine the ability of Councils to meet long term investment needs in the renewal and acquisition of infrastructure assets;
2. develop a model for examining the challenges of the task; and

3. make recommendations to improve the management of Victorian local government infrastructure assets.

Default Assumptions

The asset renewal assumptions contained in this study are "default" projections. They indicate the size of the funding problem that would arise if nothing were done to change current asset levels, standards, utilisation, etc. The default projections used in this study are that:

- all existing assets are to be renewed when their time is up;
- they will be renewed with assets substantially the same as the assets already in existence - i.e. they will not be upgraded (or downgraded);
- the economic lives will remain as in the original estimates and not change over the forecast period;
- the real cost of renewal will not change over the forecast period;
- maintenance and management practices will remain as they are now; and
- technology will remain as it is now.

A Corporate Approach is Essential

Changes to the default assumptions will need to come from corporate management. Asset Management is a corporate responsibility and cannot be delegated solely to technicians. If the renewal challenge is to be met, it will be by senior management taking a corporate wide and service outcome focus. For this reason strategic and corporate wide information should be produced and assessed at a senior management level. This requires Councils to prepare long term financial plans rather than just an annual budget.

Time for Planning

Renewal spending is projected to increase considerably over the next 20 or so years, reflecting the growth of asset stocks in the past.

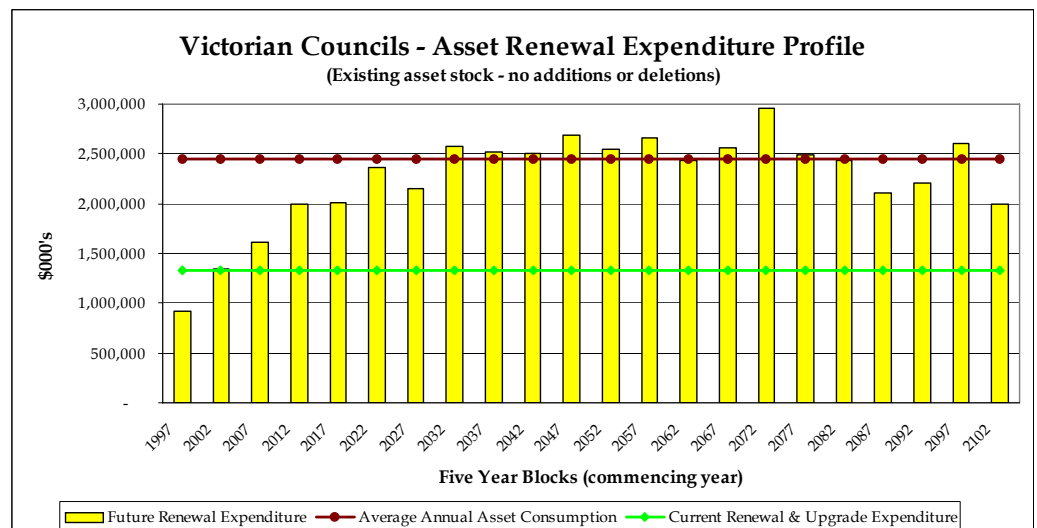


Figure 1.1

The lower horizontal line in Figure 1.1 above indicates the current level of spending on renewal and upgrade of assets. The bars indicate the forecast levels of renewal under the default assumptions for each five year period. The

upper horizontal line represents the long term average renewal requirement for current asset stocks.

Unless steps are taken to change the situation, within ten years the amount of required renewal alone will reach, then exceed, the current levels of renewal and upgrade combined. By the year 2012 required renewal will have more than doubled from current levels. This suggests that Councils have up to ten years of planning time to make necessary management adjustments to minimise required increases in renewal funding requirements. Councils who do not use this time wisely face a serious lowering of service standards generally because of a likely lack of funds to maintain assets at appropriate levels

This is an aggregate picture, some Councils will have more planning time - and some will have less.

Need for Improved Data

The quality of data varied between Councils and between assets. Road asset data was generally considerably better than that for other assets. During the survey site visits it was observed that technical data was of better quality than demand or utilisation data. Lack of good quality demand data limits the ability to match asset acquisition to service delivery requirements and without this, there is a tendency to acquire too many assets and at inappropriate standards.

It was found that, because the distinction is not required for external reporting, Councils were unable to distinguish capital spending designed to renew existing services, from that designed to improve existing services or to extend services to a greater number of ratepayers. This distinction is fundamental to informed strategic asset management and is a serious deficiency of existing data.

Managing Renewal Will Require Resource Re-Allocation

A corporate approach to asset management is essential because future renewal will not affect assets uniformly. Of the total amount of asset renewal required in the period 1997-2002, for example, roads account for 60% and buildings 27%, a 2.2:1 ratio. (Refer Figure 1.2)

Five years later, in 2002-2007 (see Figure 1.3) roads renewal requirements have increased from 60% to 64% and buildings renewal requirements have fallen to 20% of the total. This, however, does not tell the full story as total renewal requirements have also risen - from \$918m to \$1343m. This means that, in order to meet renewal, the budget of the roads sector *will need to increase by 58%* while the budget for the buildings sector will only need to *increase by 9.5%*.

However by the following five year period (2007-2012) the projected renewal requirements for buildings has actually fallen in real terms. The required change in the budget for buildings is *now -17.4%*. Roads, meanwhile, continues to absorb ever more of the renewal dollar. By this time roads renewal represents 73% of the increased total renewal, *increasing its budget by a further 38%*. In the space of ten years the ratio between the renewal budgets of roads and buildings has gone from 2.2:1 in favour of roads, to 5.8:1.

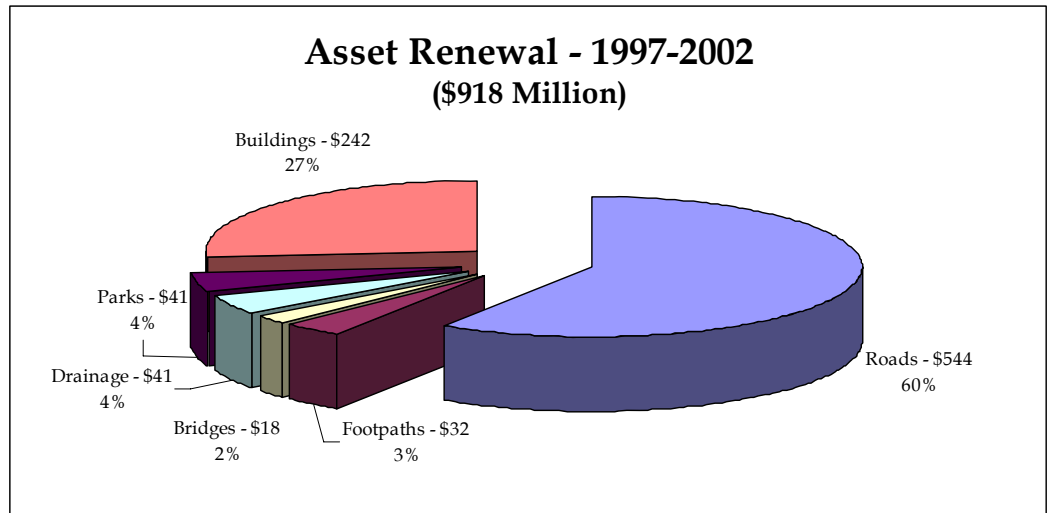


Figure 1.2

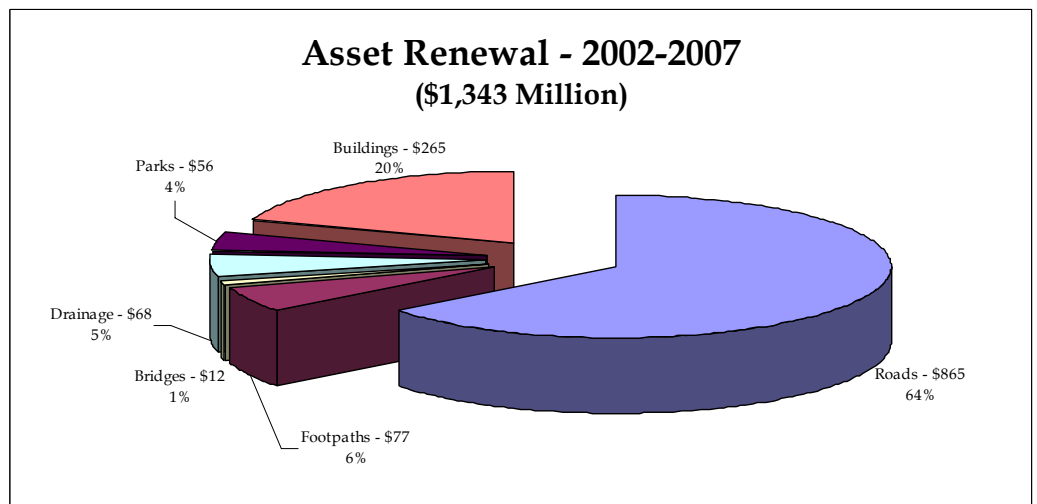


Figure 1.3

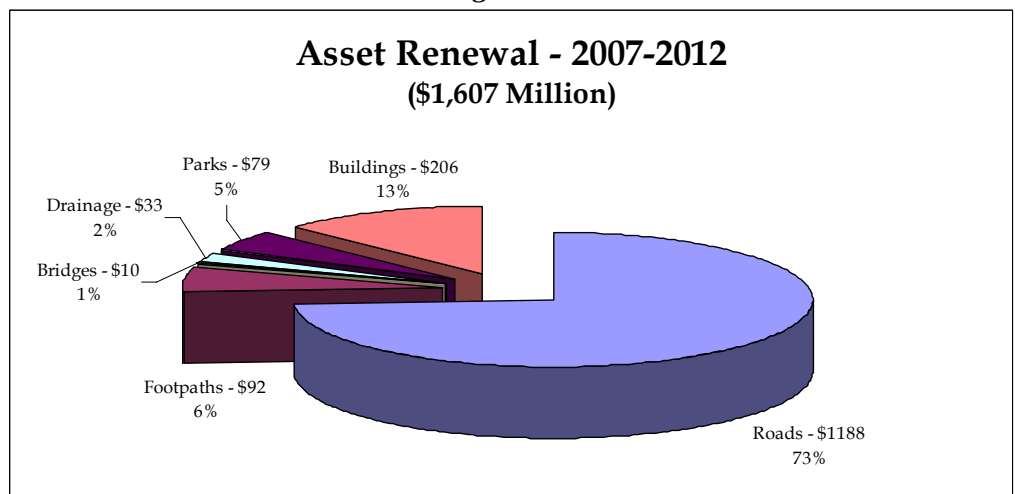


Figure 1.4

Such large swings in resourcing are very difficult to manage at both a resourcing *and* a human management level and need corporate direction and lots of planning time.

Strategic Asset Management Plans

Ratepayers need to know the renewal issues and how Councils are tackling them. It is recommended that strategic asset management plans be prepared and reported in the Corporate Plan along with performance targets and performance measures. Suggestions for suitable performance indicators are provided that can be incorporated in the Office of Local Government's performance monitoring program. Having identified their situation and analysed their options, Councils need to identify, in their corporate plans, what their future renewal problems are and what they are going to do about them. There should also be ongoing training available for Councils in strategic asset management at both middle and senior management levels.

Infrastructure Assets are Different

Ordinary assets wear out and are completely replaced with new. Infrastructure assets are complex systems, either networks or facilities, that are not replaced as a whole but rather continuously renewed by piecemeal replacement of component parts. This enables the entire asset system to continue almost indefinitely. Ordinary depreciation methods are not useful for assets which are effectively not replaced but renewed. It is recommended that the Office of Local Government explore the infrastructure option of Condition Based Depreciation which is more accurate and provides a better management tool.

Community Consultation

More community consultation is required and a greater degree of rigour in the analysis and presentation of asset options both for renewal and for new assets.

Rate Increases are not the only Option

The earliest reaction to the realisation of increased renewal was to seek an increase in rates. In fact an increase in rates is often seen as *the* solution to the problem of ageing assets. But, in fact, it is only one of a number of options available to Councils - and good corporate management would ensure that increases in rates are the option of last resort rather than the first approach. Many management options are reported in the Study, with illustrative examples.

Management Options

The difference between the projected renewal expenditures and the current level of renewal expenditures represents the gap that needs to be met by creative management effort. This includes, *amongst others*

- reducing costs by
- ✓ asset rationalisation and reviewing asset growth strategies
- ✓ more efficient utilisation, operations, maintenance
- ✓ choosing low cost over high cost asset strategies

- ✓ demand management
- changing the composition of capital spending from new to renewal

- making forward provision for renewal by
- ✓ reducing debt to create future borrowing capacity
- ✓ creating renewal reserves
- increasing revenues by user charges

Councils “in need”

Where projected near term renewal significantly exceeded current spending levels for Councils, they were identified as potentially "in need". To determine whether the gap reflected real need or was the result of poor data and inappropriate asset management, these Councils were examined according to a situational check list. The same list has been provided for the use of all Councils. It suggests ways to check the appropriateness of Council's self reported data, particularly with respect to age, economic life and condition.

Of the initial 14 Councils identified as "in need" in the draft report, 4 took the opportunity to refine their data according to the check list and are no longer “in need”. For the 10 Councils remaining it was noted that the economic lives adopted were uniformly in the short to medium range, indicating the high end of service delivery aspirations, with very high levels of renewal unattended to ("backlog"). In the majority of cases the suggested "backlog" was inconsistent with reported asset condition. Better condition analysis is required by these Councils to determine their real position.

Backlog

Where assets are actually being renewed on cycles longer than considered optimal by asset managers, the extra funding needed to shorten the cycle is referred to as "backlog" or "catch up maintenance". An alternative way to view this situation is to recognise that it is the *actual* not the *desired* renewal cycle that defines the current service level being achieved. *Funding the backlog is equivalent to increasing service levels.*

The Study does not suggest that some increase in standards may not be desirable in certain cases. However *the focus of the Study was to project the cost of maintaining existing services and service levels over time.* Thus no allowance has been made in the model for funding backlogs. The decision to increase service levels will be made by Councils in the light of overall needs and funding ability. Service level increases and other growth capital requirements are additional to the renewal requirements forecast in this study.

Individual Council Information

Each Council is to be provided with information on its own assets with modelling capability to perform a variety of ‘what if’ scenario analyses.

Planning Time Should Not Be Frittered Away

When the Chairman of the South Australian Public Accounts Committee spoke to New York City Council officers he asked when they had first become aware of their burgeoning asset renewal problems. “When maintenance bills started

to accelerate” they replied. And then what did you do? “Well, we cut maintenance funding, we had to because of the budget”. And then what happened? “All hell broke loose” was the exasperated answer “Things started breaking down, the problem got out of hand much more quickly than we imagined”. It is a matter of public record that when painting was stopped on a major bridge in New York, it had so badly rusted within just three years that bits were literally falling off. The under-maintained roads became so bad that only buses designed for under-developed countries could manage the roughness.

New York did not have the benefit of knowing what was ahead of it in time to plan. Victorian Councils do.

This time should not be wasted.

Summary of Key Recommendations

Section 2 of this report provides 17 recommendations for improving the management of assets throughout Victorian Local Government. The thrust of those recommendations is:

- the recognition that asset management is a corporate, not a technical, responsibility;
- the need for good information;
- the need for comprehensive asset management planning;
- the need for community involvement in establishing service standards;
- the need for rigour in financial assessments; and
- the need for performance measurement of asset management.

Adoption of any of these management practices will help Councils avoid some of the increasing renewal costs projected in the model. Thus the model’s projections are not prescriptive nor even necessarily descriptive. *The message is that the projected results can be avoided by changing the assumptions!* In this sense, the projections are not expected to “hold true”. Were they to do so, it would mean that Councils had ignored the opportunity to learn from the information provided here.