

COST RECOVERY PRICING

SIMPLE TIPS TO ENSURE YOU MAXIMISE THE USER PAYS APPROACH

LGFP PRESENTATION

THURSDAY 22ND NOVEMBER 2018

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OUTCOME DRIVEN

QAO REPORT 17 EXTRACTS

“A Council is financially sustainable if it can maintain its financial capital and infrastructure capital over the long term ... In 2016/17, 44 Councils were at high or moderate risk if becoming unsustainable”

“(QLD Councils) have significantly more autonomy than Councils in other states ... they can tailor their rates and charges to meet the needs of their communities. However, with this autonomy comes the responsibility to be very clear about how and why rates decisions are made.”

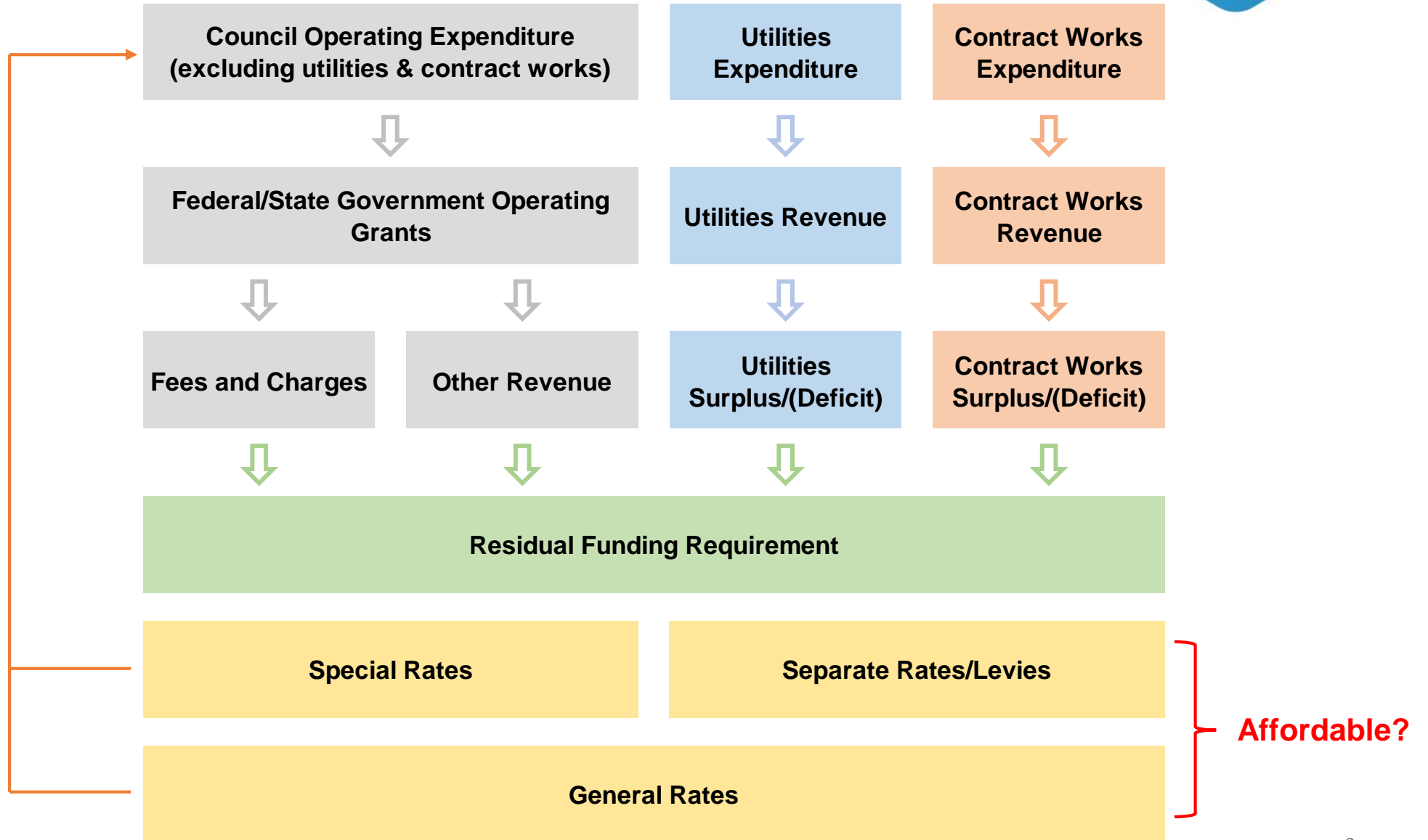
“... decisions to increase rates and charges at certain levels are not directly linked to their forecast revenue needs. Rather, they increase rates at levels that Councils consider to be fair and reasonable for their ratepayers, rather than with a focus on operating sustainably over the long term without eroding their physical asset base.”

“(4 of 5 Councils did) not fully understand the cost of providing their utilities and the extent of any cross-subsidisation of them from general rates or other charges”

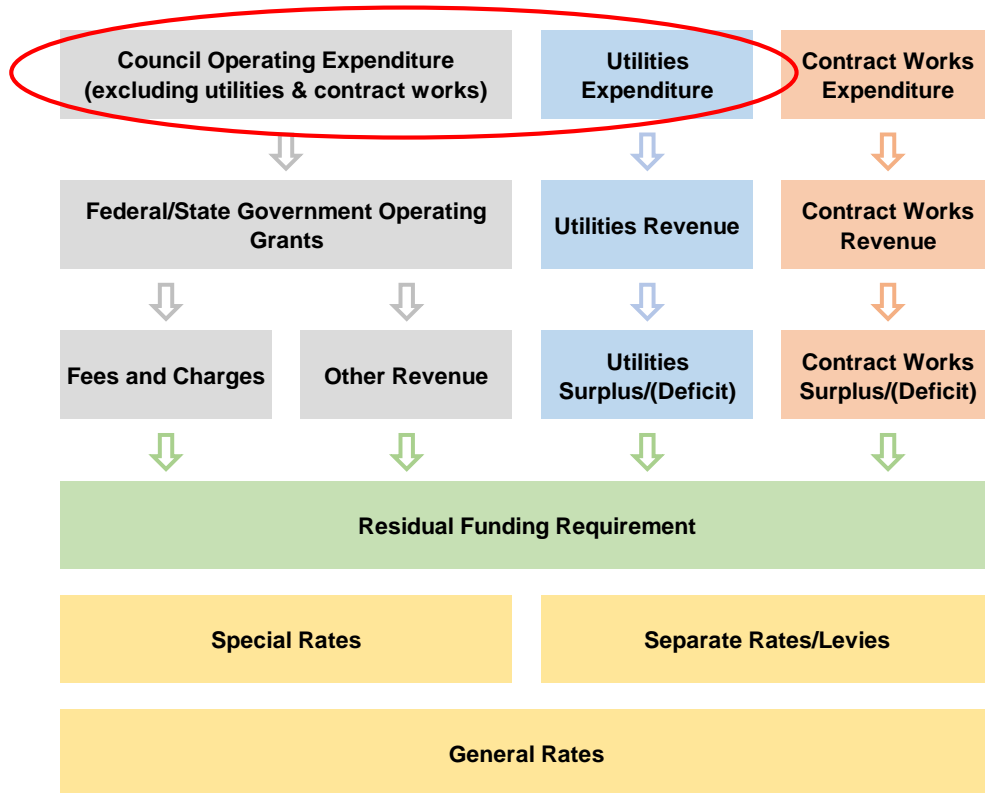
“...absence of detail (from rates strategies) limits the ability of ratepayers to understand the drivers of general rates (and)... makes it hard to compare and predict the level of general rates that different Councils charge for similar properties”

“...none of the 5 Councils could demonstrate that their communities had input to their budgets and rate setting decisions... (nor in) determining the level of quality of services and facilities the Councils provide and the rates and charges the community is prepared to pay for them.”

FUNDING FRAMEWORK



SERVICES



Does your Council and community understand what services you provide and why?

What service levels are required / desired?

Does the community have any input into services and service levels?

Have you prioritised services and service levels in a constrained funding environment?

Have you identified any redundant or reduced services resulting from demographic / technological change?

SERVICES

DETERMINATION OF SERVICE REQUIREMENTS & GAPS

Identification of Applicable Drivers

- Statutory obligations
- Council strategic objectives
- Demands and community needs (based on socio-demographic characteristics, location of development, etc.)
- Community expectations

Determination of Service Requirements

- Types of services, locations and beneficiaries (including classification and level of importance)
- Standards/levels of service
- Method of delivery of service (considering technology, infrastructure and lifecycle costs, etc.)
- Council responsibility in service provision

Definition and Measurement of Current Service Provision

- Identify and define current service provision and service levels/targets (including classification and level of importance)
- Review current asset/infrastructure portfolio (including utilisation), resourcing and cost
- Determine reasons for underlying service provision and service levels, and Council responsibility in service provision
- Determine the cost of providing each service at the current (and required if not met) service level

Identification of Service Gaps

- Compare service requirements with current service provision and service levels by location
- Identify service gaps
- Determine the infrastructure, lifecycle costs and resourcing implications to address service gaps
- Identify under-utilised or obsolete assets/infrastructure

OBJECTIVE = Alignment of services and service levels with strategic drivers and objectives

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DLG GUIDANCE

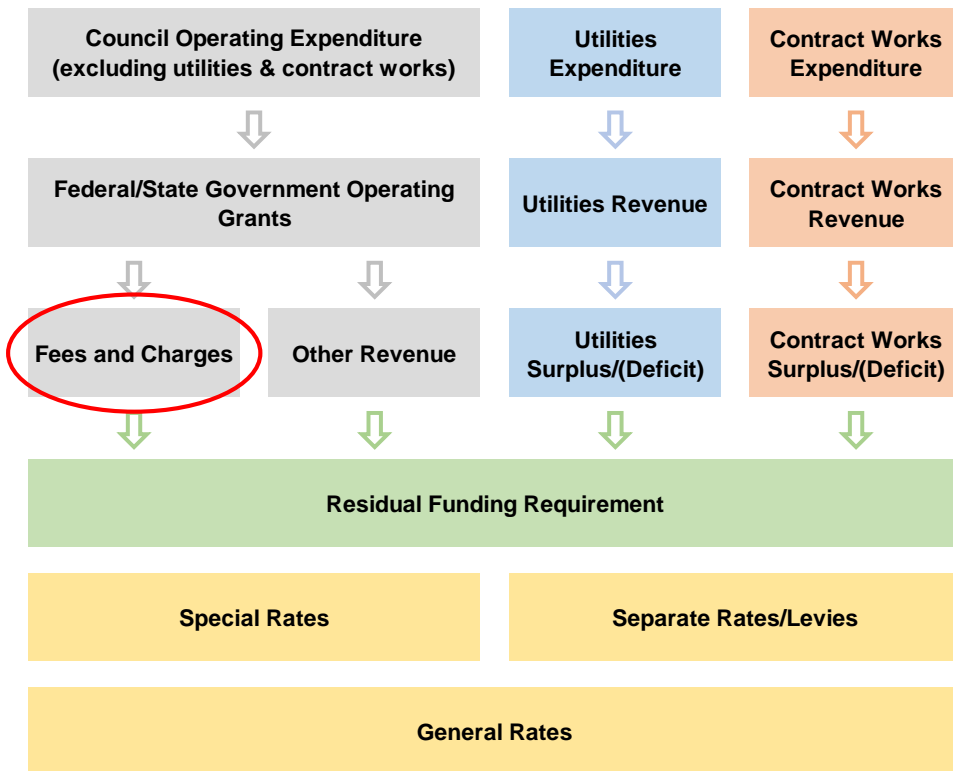


“Community understanding of the relationship between LG services and infrastructure and council’s planning and budgetary processes can lead to more informed discussions between the LG and its community about what LG services and infrastructure are most valued and needed.”

(Own source revenue: policies and options for local governments – a reference, Sep 2013)



FEES & CHARGES

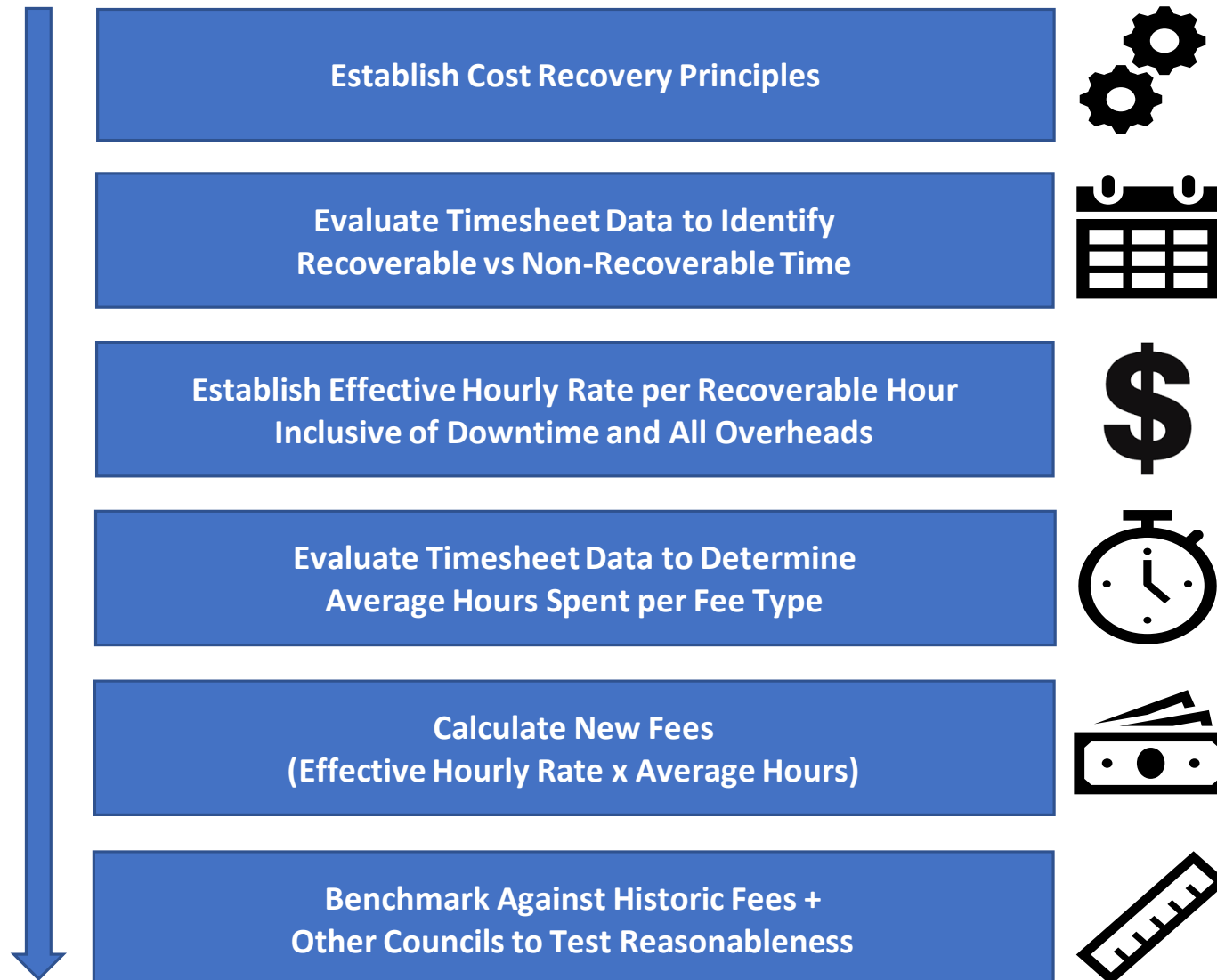


Do you recover indirect resource/overhead costs within your fees and charges (office cost, IT, HR, finance)?

Is your method of determining fees and charges robust and transparent?

How often do you review the resourcing effort required in providing services subject to fees and charges?

FEES & CHARGES



FEES & CHARGES

“A cost-recovery fee must not be more than the cost to the LG of taking the action for which the fee is charged.”

Local Government Act 2009 S97(4)

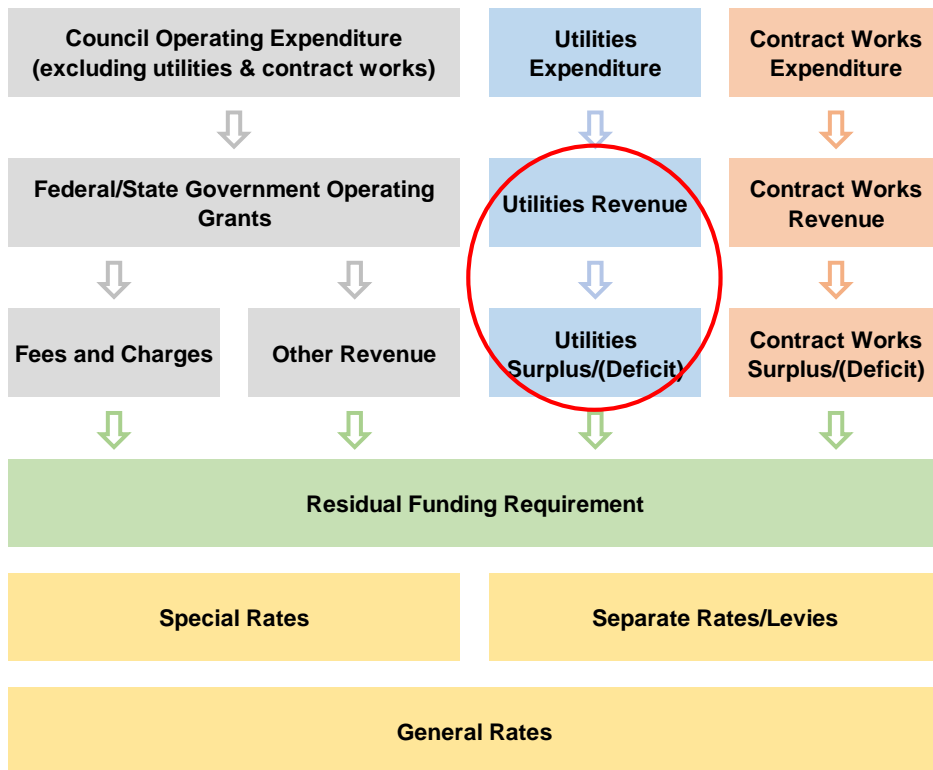
NEED: Justifiable basis for resource hours/costs that can be proven

NEED: Justifiable basis for the overheads applied that can be proven

SOLUTION: Permanent timesheets or timesheet sampling over time

SOLUTION: Appropriate activity-based costing model calculating an oncost rate on labour or LG&S

UTILITY PRICING



Do you recover indirect resource/overhead costs from your water, sewerage and waste functions?

Do you know where you sit in terms of overall cost recovery – lower bound vs upper bound?

Do you fully understand the implications of future investments on cost recovery levels?

How affordable are your utility services?

Do you have an appropriate allowance for landfill rehabilitation liabilities?

Are there surpluses available for the general fund?

UTILITY PRICING

- LG Regulation 2012 (S41) – full cost recovery should be applied for water and sewerage services:
 - Operating costs
 - Indirect/overhead costs
 - Depreciation
 - Return on capital (a positive rate the LG decides)
- Broader regulatory guidance indicates that cost recovery should be at least in accordance with ‘lower bound pricing’ and progress should be made towards ‘upper bound pricing’
- QAO: Councils need to implement an appropriate costing model to understand full cost of delivering utilities and use this model annually to review pricing

WATER / SEWER PRICING

Lower Bound Cost Recovery	Amount
Operating Expenditure (excluding interest & depreciation)	\$ 5,000,000
Corporate Overheads	\$ 750,000
Depreciation	\$ 4,500,000
Interest Expense	\$ 250,000
Lower Bound Cost Recovery	\$ 10,500,000

If no calculation exists, use 10%-15%

Upper Bound Cost Recovery	Amount
Operating Expenditure (excluding interest & depreciation)	\$ 5,000,000
Corporate Overheads	\$ 750,000
Depreciation	\$ 4,500,000
Return on Capital	\$ 3,412,500
Upper Bound Cost Recovery	\$ 13,662,500

Includes recovery of interest expense + return to Council

Return on Capital Calculation	Amount
<i>Written Down Value of Assets (including land)</i>	\$ 75,000,000
<i>less Estimate of Historically Subsidised or Contributed Assets</i>	\$ 22,500,000
<i>Value of Council's Capital Investment</i>	\$ 52,500,000
<i>times Real Pre-Tax Weighted Average Cost of Capital</i>	6.50%
Return on Capital Target	\$ 3,412,500

If no calculation exists, use 30%

Old DLG guidance of 10yr bond rate + 3.5% still ok

WASTE

- Same concept as W&S applies
- However, if you use a collection contractor, then a return on expenditure for collection services is more appropriate – adopt 10%
- You should include an appropriate provision for rehabilitation liabilities + landfill land value impairment – that asset on your books is not saleable at the end of its life!
- Indepth guidance on landfill accounting should be forthcoming from QAO (working group in progress with LGFP representation)

WASTE



Get assumed weights right when pricing services:

- 12-14kg per lift for red lid bin
- 10-12kg per lift for yellow lid bin (although this will fall due to CDS!)
- bulk bins 80-100kg per cubic metre



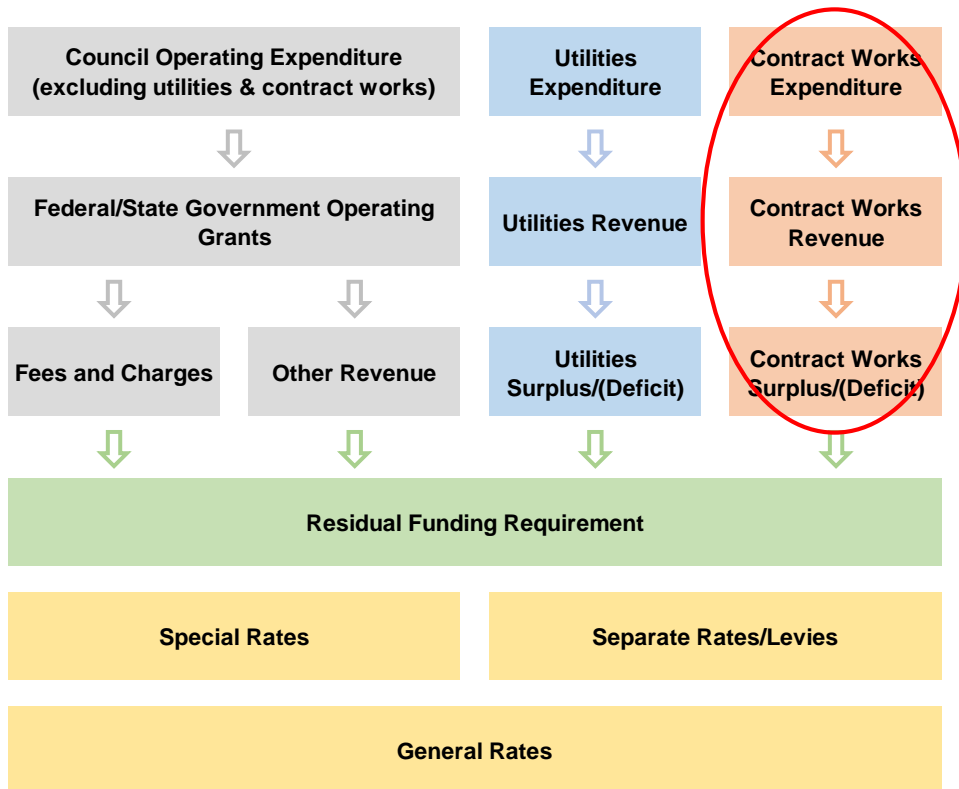
Collapse in recycling market means that recycling comes at a cost – free receipt of recyclables at waste facilities now requires subsidisation unless you charge at the gate



Waste levy implications:

- Council facility waste disposal costs will increase impacting general fund
- Commercial waste utility charges will need to include levy component based on assumed weights
- Commercial component of mixed use bins needs to include levy BUT only chargeable on commercial rate notices
- Ok to include as separate line item on rates notice but with specific wording such as “*Service charge to cover the waste levy*”

CONTRACT WORKS



What contract works do you undertake and why?

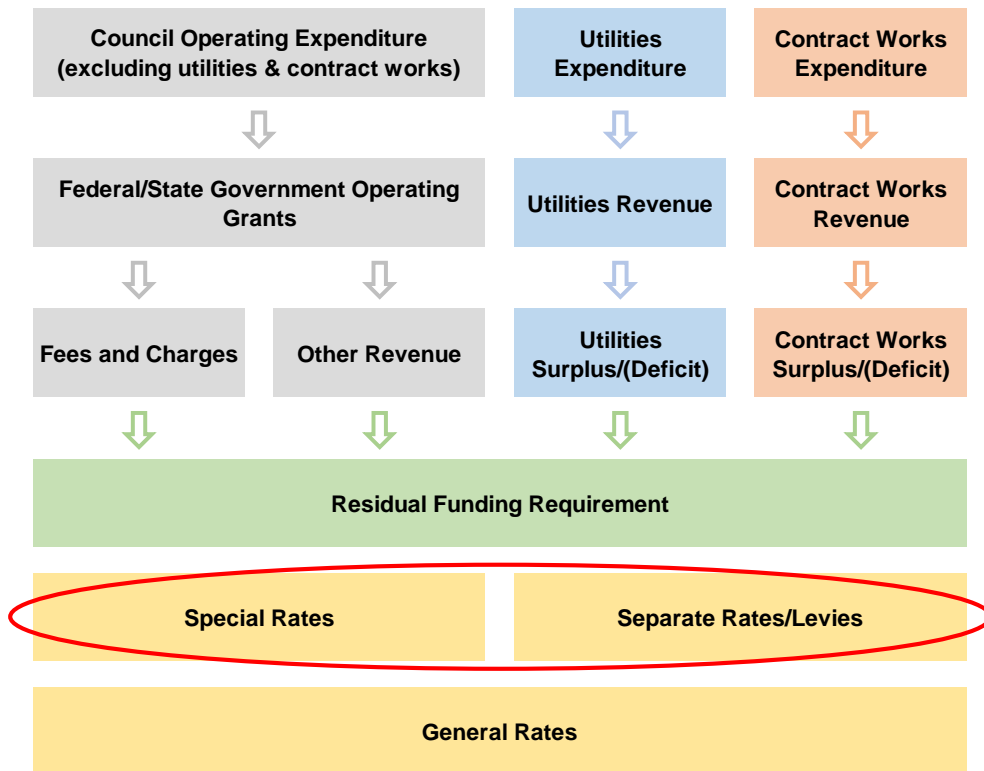
Are you fully recovering plant costs and indirect resources/overhead costs + earning a margin?

Are you carrying additional employees (and costs) in the hope of contract works continuing into the future?

What would your Council look like without these contract works?

What are the ST/MT/LT benefits to your finances/communities from undertaking contract works?

SPECIAL/SEPARATE RATES

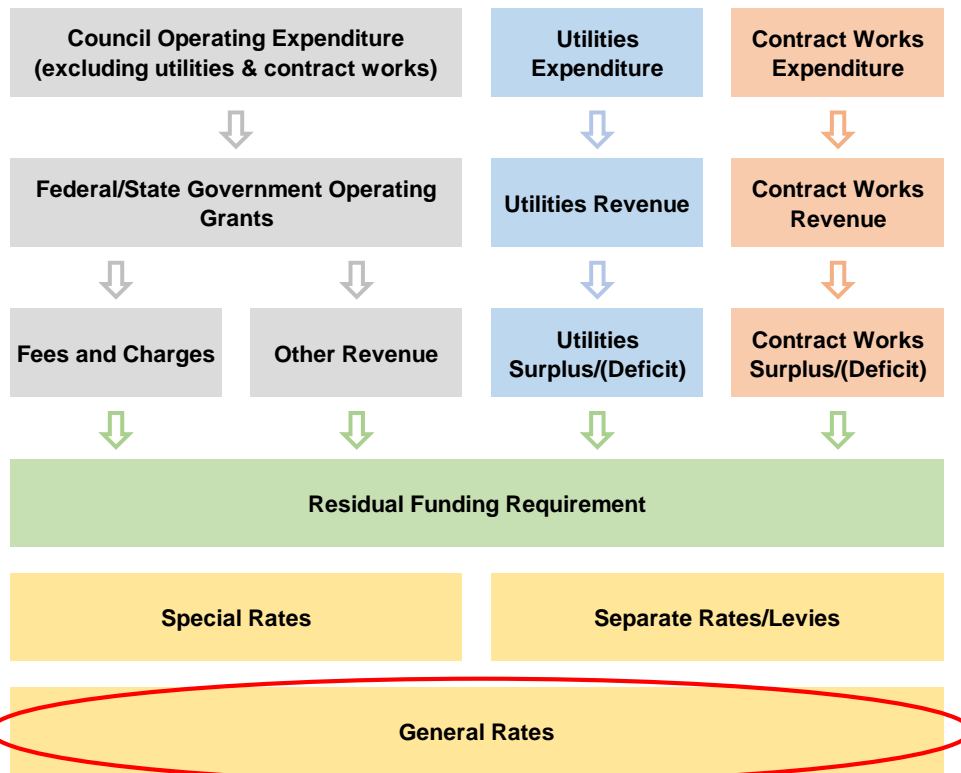


Do you provide specific infrastructure/services to certain parts of your community?

Are there non-core services you provide that would be more appropriately funded through separate rates/levies?

Do your separate rates just form part of your general fund bucket of revenue – if so, what is the reasoning for having separate charges in place?

GENERAL RATES



Do your rate categories appropriately reflect the different sectors of your community/economy?

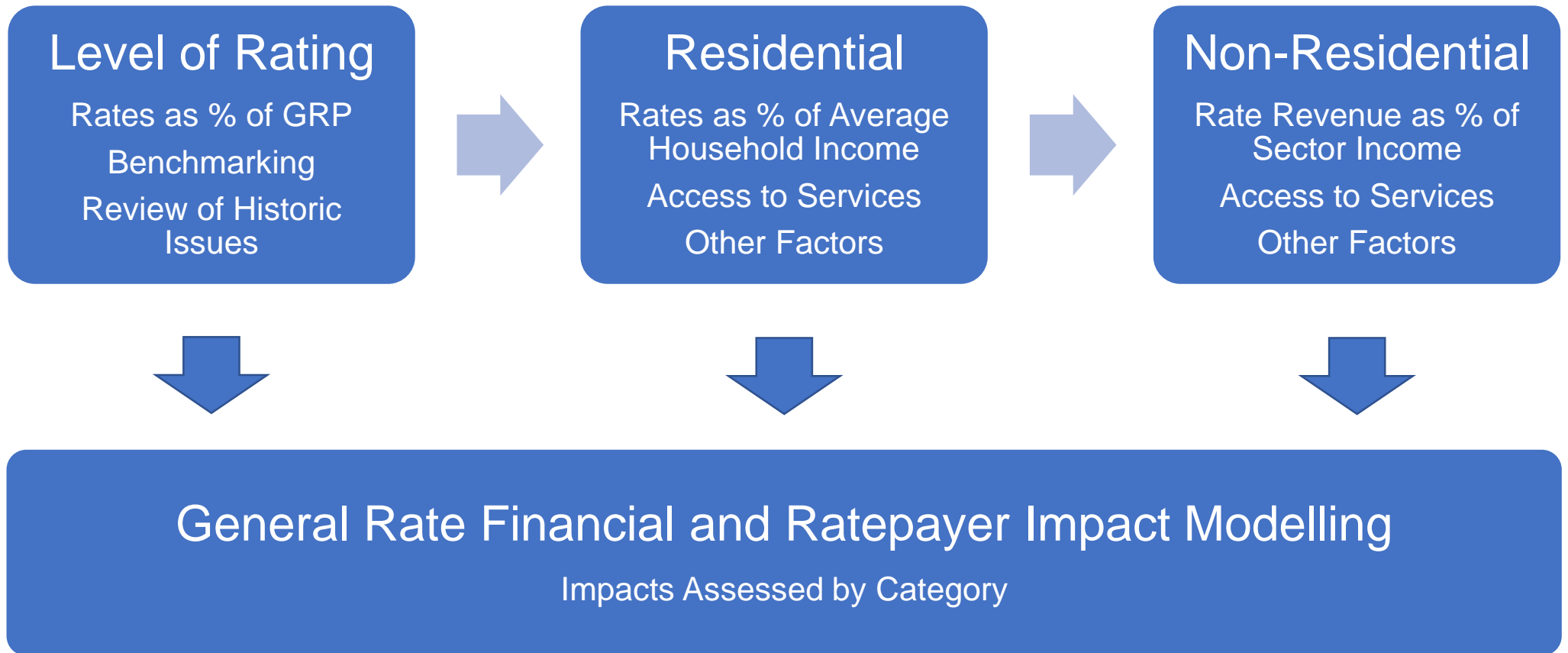
How do you determine what minimum rate to apply to each category?

How do you determine rates in \$ and why are some categories higher than others?

What land uses receive greater relative benefits from, or impose greater relative costs on, infrastructure and service provision?

How do you ensure underlying taxation principles are maintained following valuation amendments?

GENERAL RATES



GENERAL RATES

- Residual funding mechanism after cost recovery is applied to utility charges, fees and charges, and separate / special rates
- Fund services, facilities and activities of broad community benefit, although some land uses receive greater benefits from, or impose greater costs on, these activities
- Cannot be set on capacity to pay but can be based on value of land and capacity of land to generate income, in addition to the cost of delivering infrastructure and services to the land
- Even Councils with a limited ratepayer base must manage rates revenue well to contribute towards long-term financial sustainability
- Rating effort should generally be around 1.5%-2.0% of GRP in aggregate and 1.5%-1.6% of average household income

GENERAL RATES

- Presently, rating policies are high level and ambiguous
- Need to better communicate basis for rating differentials, e.g.:
 - Minimum rates applicable to rural residential 20% less than urban residential due to reduced access to selected services
 - Rates on commercial 1.5 times that for residential due to greater impact on roads and public place management
 - Rates on shopping centres 2 times that for commercial due to greater peak traffic impacts
 - Rates on quarries and feedlots higher in lieu of transport user charges/infrastructure contributions
- Determine how rating decisions support financial sustainability
- Future proof rates, e.g. rates on solar/wind generation

WHERE TO FROM HERE?

Is the QAO report a warning shot?
LGs can't be seen to be abusing
generous rating and charging powers
– need to lead from the front

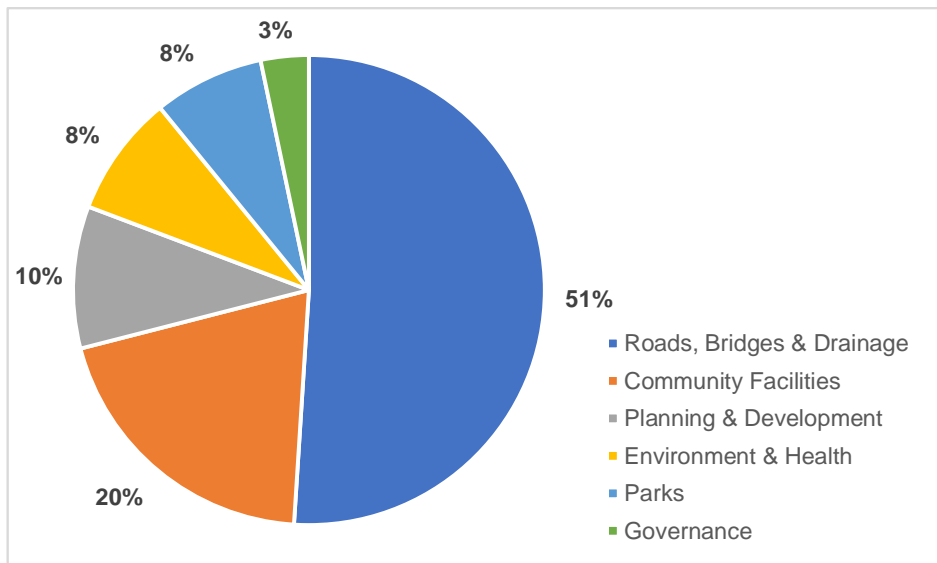


- Greater transparency regarding the basis for rating categories and differentials
- Enhanced linkage between rating decisions and financial sustainability
- Greater awareness of full cost of utility services
- Enhanced community engagement and consideration of willingness to pay when preparing budgets, setting rates and deciding what services / service levels are provided

KISS TIP 1

Educate and engage with your community on services and service levels to optimise the costs that need to be recovered

What do general rates pay for? Is that the right mix of spending vs what your community wants/needs?

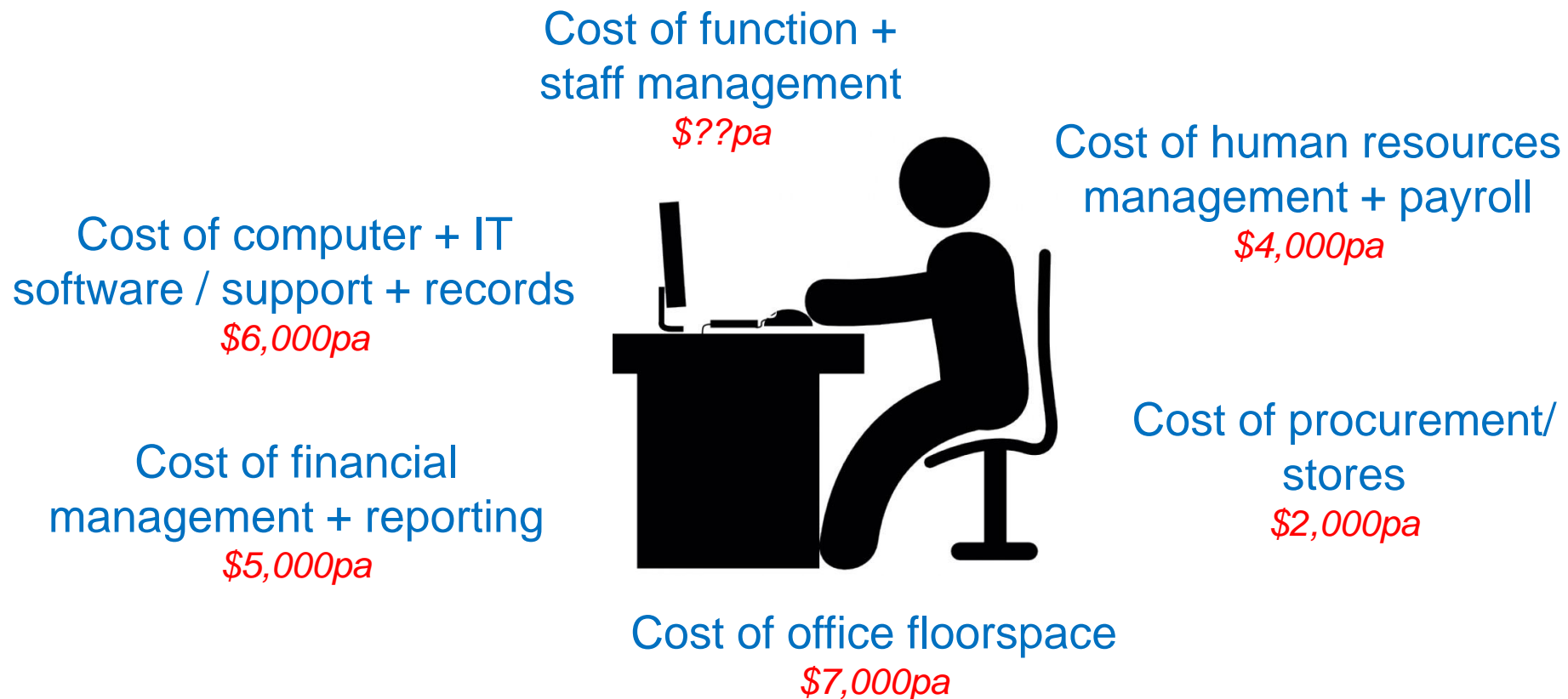


Is your community satisfied with your service levels and value for money?

Performance Area	Rating /5
Road Condition	3.14
Water Pressure	4.10
Water Quality	3.84
Sewerage Service	4.22
Access to Parks	3.66
Access to Pools	3.79

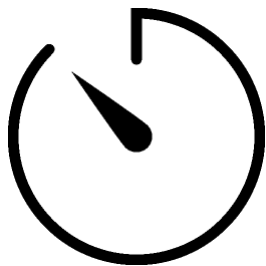
KISS TIP 2

Recoup all overheads through user charges (fees and charges, water and sewerage charges, waste charges) and contract works



KISS TIP 3

*Regularly sense test your resourcing assumptions
underlying fees and charges through timesheet
sampling*

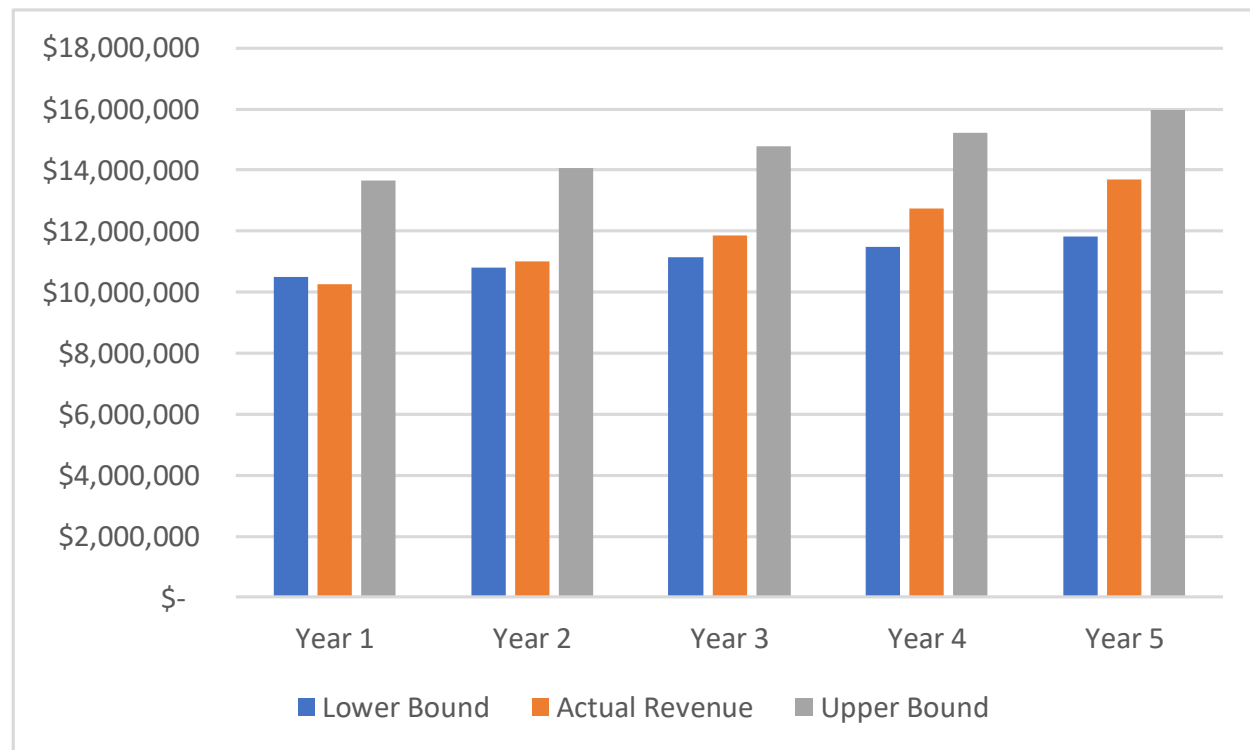


KISS TIP 4

Calculate the full cost of your utilities using simple cost recovery calculations to make informed decisions

Establish what 'positive return' is to be targeted by each fund and set price paths to achieve this return

Reassess your position as part of annual budgets and assess impact of capex programs



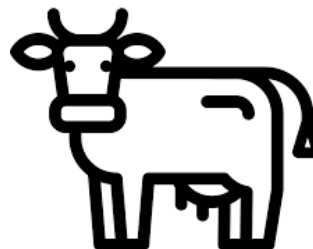
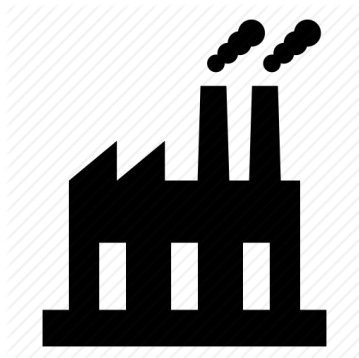
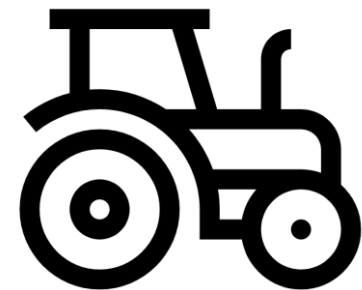
KISS TIP 5

Ensure you fully understand your waste lifecycle costs and account for rehabilitation liabilities and landfill impairment appropriately, as well as calculate and account for the portion of your utility charge attributable to disposal of waste and processing of recyclables through assumed lift weights



KISS TIP 6

Be clear and transparent in how you determine rating categories and differentials and ensure principles are maintained following revaluations



OPTIMISE COST RECOVERY

KISS are ending their touring days and will play our shores for the final time late next year, but Councils do not have an option to pull up stumps!

Make sure you remain financially sustainable by improving cost recovery from all aspects of your operations

Remember – your communities need you to be able to rock n roll all night ~~and party every day~~ forever and a day!!



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