

4 April 2014

Public Infrastructure Inquiry
Productivity Commission
Locked Bag 2
Collins Street East
Melbourne VIC 8003

Dear Commissioners

Productivity Commission Draft Report into Public Infrastructure

Local Government Infrastructure Services (Pty Ltd) (LGIS) welcomes the opportunity to provide comment to the Productivity Commission as part of the Commissioner's Draft Report into Public Infrastructure.

Introduction to LGIS

Local Government Infrastructure Services (Pty Ltd) is a company jointly owned by the Queensland Treasury Corporation (QTC) and the Local Government Association of Queensland (LGAQ). LGIS was established in 2005 with the key objective being to assist Queensland local governments manage their infrastructure challenges. As a company designed to focus on and work for the best interest of Queensland local government, we leverage networks, partnerships and access specialist advice in order to deliver efficiencies and economies of scale in infrastructure provision.

LGIS's major client assignments since 2005 have included the following:

- assisted 17 local governments with Natural Disaster Relief and Recovery Arrangements (NDRRA) assessment and procurement for \$750 million of flood damaged assets
- assisted local governments procure and deliver over \$200 million of water and sewerage requirements
- provided strategic advice and procurement support for waste services, and
- delivered water and energy demand management programs valued in excess of \$200 million.

LGAQ will assume full ownership of LGIS on 1 July 2014, which will enhance LGIS's ability to service its local government clients.

Industry overview

Queensland local governments face significant challenges as they seek to manage rising community expectations in relation to services and service levels, replace ageing infrastructure, comply with continuing reform pressure from Federal and State Government, manage mining

related growth, cope with the cost of compliance with legislative and legal requirements and the demands of an ageing population and workforce to name just a few.

Against this backdrop of demand pressures, local governments are also experiencing pressure from an affordability perspective following the loss of State Government subsidies for sewerage and water infrastructure and ratepayer expectations for councils to limit increases in rates and charges given the current constrained economic climate.

The Productivity Commission's Draft Report into Public Infrastructure seeks feedback on how efficiency measures can be incorporated into the procurement of public infrastructure. LGIS is pleased to provide the following commentary in relation to our experience working with the Queensland local government sector.

1. Efficient provision of infrastructure (as outlined in Volume 1, Chapter 2)

In a 2012 short survey conducted by Queensland Treasury Corporation, 23 local governments provided information regarding their forecast capital expenditure in relation to sewage treatment plants (STPs) and water treatment plants (WTPs). At that time information received showed that across the 23 local governments, 51 STPs and 42 WTPs would require upgrades or replacement over the period 2012 – 2030 at a combined estimated cost of \$707 million. Faced with the prospect of having to raise 100 per cent of the required financing many local governments are deferring the works.

With almost all of Queensland's 77 local governments under pressure to invest in new or upgraded infrastructure, LGIS considers that a range of non-asset solutions together with whole-of-life planning and better asset management practices have the potential to reduce or delay the need for such infrastructure and also improve financial sustainability.

Consideration of non-asset and cost offset solutions

Demand management

Consideration of non-asset solutions such as the delivery of water demand management programs have the potential to greatly reduce water and sewage collection, treatment, storage and disposal and could result in downsized or deferred plant upgrades, reduction in cost and extended life of the assets. Further, project cost-benefit-analysis should incorporate financial modelling to demonstrate the net effect of any non-asset solutions on a local government's forecast capital costs for new (or upgraded) infrastructure.

To ensure support for consideration of potential options, State and Commonwealth funding for large scale projects such as STPs and WTPs could be contingent upon demonstration that options for non-asset solutions have been considered (and/or implemented) as part of the project's cost-benefit-analysis.

LGIS has delivered a number of significant demand management programs (non-asset solutions) in Queensland over the past eight years for the State Government and collectives of local

governments. The resulting effect was a significant reduction in water consumption which in turn delayed or reduced the need for major capital investment on the part of both State and local governments. A brief summary of these is provided at Attachment A “Pressure and Leakage Program and Home WaterWise Service”.

Strategic Asset Management and whole-of-life planning

The Queensland Audit Office Report *Results of audit: Local government entities 2012-13* notes that one of the highest risks to local government financial sustainability is the lack of (or lack of adherence to) sound asset management plans.

Effective and considered management of infrastructure assets is an important part of a local government’s governance role. A key element of which is the development of Asset Management Plans that assist in timely infrastructure procurement and associated capital expenditure, maintenance scheduling, long term planning and operational requirements. The inclusion of comprehensive asset management policies and plans that link to a local government’s corporate plan assists greatly in financial forecasting, planning and decision making and financial sustainability.

Proactive, timely and strategic management of infrastructure can extend its useful life. However, LGIS has observed many cases where budgets for basic maintenance are allocated not by need, but by what the council can ‘afford’ in any given year and is typically due to the absence of detailed asset management plans and integration with council’s budget process. This often results in costs being higher than necessary when the work is eventually done.

In a review of local government financial sustainability completed in 2008, QTC found that 57 per cent of the 109 local governments reviewed responded that they did not have complete and robust asset management plans.

The development of robust asset management plans is critical for connecting future capital expenditure and maintenance with financial forecasting including informed decision making.

Optimising asset management decisions

LGIS has recently partnered with Townsville City Council (Council) in the development of a “Life-cycle cost asset management planning model” (LCCAMP). LCCAMP is an innovative approach that enables Council to bring together capital works, operations and maintenance, and service levels and quantify the interdependency of those strategies and the impacts of a decision across Council’s asset portfolio, allowing Council to target an optimal solution to asset management decision making. Performance management and risk scores are calculated, by asset class, based on a web of key performance indicators (KPIs) that define the interactions of the three strategies. Forecasting a mix of over twenty leading and lagging asset management performance metrics, over a ten year forecast period, provides a thorough picture of how Council’s asset performance is likely to be sustained into the future.

It should be recognised that LCCAMP is a sophisticated analysis tool that relies on robust and mature asset management plans and processes being in place. Given the diversity of scale and

service requirement across the 77 Queensland local governments, it is considered most suitable for larger local governments. LGIS considers that all local governments would benefit from the use of strategic modelling at the appropriate level.

Impediment to joint procurement

Commonalities clearly exist across local government boundaries and regions for the procurement of similar products or services. Where these commonalities exist, LGIS seeks to identify opportunities for joint tendering arrangements to create benefits through efficiencies and economies of scale for participating local governments. In two such cases however, LGIS has encountered impediments arising from the *Trade Practices Act*, which delayed works, incurred costs and proved difficult to navigate.

In 2008, LGIS was engaged by a collective of 14 councils (under the Central Queensland Local Government Association - CQLGA) to undertake a joint tender and contract for regional waste services. Each of the 14 councils required services that were similar in nature and believed that they could deliver significant time and cost efficiencies through a collaborative arrangement. Legal advice at the time suggested that such an arrangement could be in breach of Section 45 of the *Trade Practices Act* (which prohibits parties from entering into any contract, arrangement or understanding that has the purpose or effect or likely purpose or effect of substantially lessening competition). The CQLGA applied to the ACCC for authorisation to undertake a joint tender. Interim approval was granted by the ACCC, followed by final approval, however the request for authorisation delayed the tender process by six months and incurred legal costs and significant time delays for the councils.

In a similar example, LGIS was requested by six neighbouring local governments to undertake joint procurement of Pressure and Leakage Management services to achieve immediate water savings and defer expensive capital infrastructure costs. Although it was proposed that LGIS conduct the procurement process so that each council would enter into separate agreements with the successful contractor, legal advice suggested that this approach would also breach provisions of the *Trade Practices Act* as mentioned above. Once again, the participating councils incurred the financial and time costs of seeking ACCC authorisation. Similarly, significant time was invested on the part of multiple Queensland Government agencies in an attempt to resolve the issue and understand the full ramifications for both the State and local governments with regards to joint tendering arrangements.

To increase efficiency and reduce cost for their communities, local governments are being encouraged to consider opportunities for joint arrangements as described above. The reality however is that in a number of instances the requirement of Section 45 of the *Trade Practices Act* is acting as an impediment against consideration of such solutions.

LGIS considers that addressing this issue will result in improvement to efficient provision of infrastructure for local governments.

Capital investment in cost offset solutions

With expectations that economic conditions will remain constrained for some time and local government concerns regarding ratepayers' capacity to absorb rate increases, LGIS considers that many local governments will seek to reduce operational costs through identification of innovative capital investment opportunities. For example, LGIS is working with Winton Shire Council (WSC) investigating the use of embedded generation from geothermal power to reduce their electricity costs. With an initial capital investment of approximately \$3 million, up to 1MW in electricity could be produced to offset WSC's electricity costs. Any surplus electricity could be returned to the grid providing support for electricity supply security for the broader region. The project should also provide further benefits to WSC by lowering the temperature of the water for delivery to consumers. The lower water temperature will reduce the cost associated with cooling the water and extend the life of the pipes, also resulting in a cost saving.

The proposed solution could also benefit power distributor ERGON by potentially deferring or eliminating the need for network augmentation works and it could potentially reduce a portion of the State's ongoing Community Service Obligation.

Local governments should be encouraged to investigate suitable opportunities to reduce costs.

For consideration

- “Non-asset” solutions should be seen as an important component of a strategic asset management process and should be encouraged. This may include making any State and Commonwealth funding for significant projects contingent upon evidence that non-asset solutions have been considered.
- Local governments must be encouraged to ensure that their Asset Management Plans are fit for purpose, regularly updated and linked to financial forecasts and financial reporting.
- Strategic modelling can aid decision making by assisting with the understanding and management of uncertainty, technical complexity and consideration of multiple options. While the LGIS LCCAMP model demonstrates the sophisticated use of modelling, LGIS considers that all local governments would benefit from the use of strategic modelling aligned to the demands of the project being considered.
- Section 45 of the *Trade Practices Act*, has and is impacting local government consideration of joint tendering arrangements. LGIS considers that this issue should be addressed.
- Cost offset solutions have the potential to provide significant benefit. Local governments should be encouraged to consider suitable opportunities

2. Improving governance and institutional arrangements (as outlined in Volume 1, Chapter 7)

LGIS supports the Productivity Commission's Draft Report and draft recommendation 7.1 (page 261) that a mechanism or process be used to impose greater discipline on provision, funding and financing of public infrastructure, particularly in relation to funding provided to local governments.

LGIS considers that practices among local governments in Queensland to determine value for money and project viability are quite varied in robustness and in many instances non-existent. Small to medium-sized local governments in particular often lack in-house specialist or technical expertise to prepare an appropriate business case for proposed projects. LGIS has observed examples where decisions were made based on a technical design made to fit a budget, without a full understanding of the project need, feasibility, risks or costs. This can result in cost overruns due to scope and /or vision creep. LGIS has also observed examples where project scope is reduced or a portion of the project deferred due to actual costs being greater than the original project estimates (due to a lack of process) resulting in the project being significantly different than that originally proposed.

The lack of robust and sound decision making practices as well as the lack of in-house capability increases the risk of poor project selection and sub-optimal outcomes, by exposing local governments to cost overruns, delays in delivery and issues regarding project fitness for purpose.

A mechanism that channels projects through a robust and diligent process to demonstrate project value for money and community benefits (rather than meeting restrictive eligibility criteria) would provide benefit.

LGIS was developed to address many of the issues outlined in this paper, and since 2005, we have worked with most small to medium-sized local governments on supporting and enhancing their in-house capabilities through the provision of project management frameworks, procurement advice and good governance practices.

I would be pleased to provide further information to the Commission if needed.

Sincerely

John Curran
Chief Executive

Attachment A

Pressure and Leakage Management Program

In 2006, the Queensland Government and 10 local governments entered into an agreement with LGIS to deliver a regional water pressure and leakage management project. At the time, South-East Queensland was in the grip of one of the worst droughts on record and the State Government enacted an Emergency Water Regulation which, among other things, comprised significant capital investment in new water collection and storage infrastructure.

The Pressure and Leakage Management Program was designed to produce immediate water savings by addressing the significant losses in reticulated water from major leaks, burst pipes, reservoir overflows and varying water pressure. The capital cost of the Program was \$114 million. Of this, \$82 million was funded by the participating councils and \$32 million by the State.

According to a 2001 report by the Water Services Association of Australia (WSAA), an average of 9.6 per cent of water supply is lost in Australian water supply networks.

By controlling water pressure in the water network:

- water leaking from pipe faults and failures is minimised
- the total life of the water infrastructure is extended, thereby minimising replacement and upgrade costs and extending depreciation costs
- pipe bursts are reduced thereby reducing leakage and minimising operational and maintenance costs, and
- water consumption by residents and industry is reduced.

Outcomes:

Over a period of three years, the Program achieved:

- collective savings of 60 ML per day of potable water
- total program savings of 55,287 ML with the value of water saved during this period being \$152,314,308 (calculated at wholesale costs)
- long term financial benefits: the costs associated with burst pipe repairs in the participating council areas was reduced by up to 90 per cent and distribution entities were expected to save tens of millions of dollars annually through lower O & M costs
- improved long term water security
- early and on-going water savings, and
- environmental, social and business improvement benefits.

Home WaterWise Service

As mentioned above, the South-East Queensland drought in 2006 triggered a number of emergency measures by the State Government. One such measure was a demand management program – the Home WaterWise Service – to deliver immediate reductions in residential water consumption to prolong the region’s diminishing potable water supply. Launched in July 2006, the program entailed the retrofitting of water saving devices into residents’ homes (including water efficient showerheads, tap aerators, replacement taps and cistern weights) as well as tap leak repairs, educational prompts, advice from a licensed plumber and a customised water saving plan for each household.

The Service was available to South-East Queensland (SEQ) households during the period 2006 – 2008 and was funded at a total cost of \$44 million by the State Government and 21 participating SEQ councils. The service offered \$150 in value at a cost of \$20 to each household.

Outcomes:

Over the two and half year period, the Service achieved:

- 228,564 retrofits across all 21 participating council areas
- water savings of 30,600L per household, per year (compared with the program target of 21,000L per HH/year)
- combined annual water savings of approximately 7,000 ML or 7 gigalitres
- enduring behaviour change and lower water consumption as the norm
- reduced and deferred need for investment in major water infrastructure, and
- ongoing operating savings on the part of distribution entities and local governments.