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A key role of the Asset Manager is to

Generate and Examine Options

States bewail the fact that they cannot spend money fast enough because, with outsourcing, they have lost the industry knowledge and project management skills that they once had.

Councils bewail the fact that they have insufficient funds to address the pressing infrastructure issues of the day.

Both complaints are genuine.

But is our problem JUST a problem of FUNDING?

Hardly! If by some miracle the funding required were to be provided the task would THEN be to figure out how to spend it most wisely.

Perhaps this thinking and analysis should be happening now?

In this issue we look at two related issues:

The generation and examination of creative options as solutions to 'the Infrastructure Issues' (note the plural!)
Pages 91-93

And

Managing the issue of financial and service sustainability.
Pages 90, 95-96

Both of these are forward-looking issues and relate to the key role of the Asset Manager

- to examine options and consequences.

Consider and Enjoy!

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Financial Sustainability – how much is understood?

Are councils 'going broke'?

In my daily paper a few weeks back there was an article that referred to councils 'going broke'. A week or so later there was an official response under the heading 'Councils not going broke' explaining that many councils are again running deficit budgets 'because they do not have the revenue to fully fund the depreciation on the \$10 billion of community assets, including roads which they manage ... and other services they provide.'

Running a deficit budget is not 'spending more than you receive' (which is how companies go broke) but, rather, 'consuming more than you are earning'. In other words, the community is not paying its way.

The difference is not one of 'problems now' (going broke) but rather 'problems later' when the assets that are currently being run down can no longer provide service.

Should we expect Councils to 'pay their way'?



That councils running deficit budgets are not 'paying their way' is a statement of fact, not judgement. However, put this way, there is a predisposition to suppose that councils *should* be paying their way. But *should* they? And *can* they?



In the last issue, Jeff Roorda looked at the issue of managing decline in rural populations. As populations decline, councils are less and less able to manage. They are less able to provide services and this exacerbates the population decline. Where does the population go? They may swell the larger rural townships, but many move to the city fringes which are themselves struggling to be sustainable – both economically and socially – or they move to Queensland or other areas where new infrastructure has to be constructed to serve them.

The argument in the "Managing Declining Rural Populations" was that this issue is larger than the rural council concerned, with consequences for all of Australia – and thus, logically, is a 'national' rather than a 'local' problem. That means a problem for all of us to solve—and not necessarily a problem to be abdicated to the Federal Government alone.

What if we were to think of Local Government as the 'arms and legs' providing services directly to the population; with State Governments as the central body providing support for the limbs; and the Federal Government as the head, providing policy direction. This is not too far off the mark. It would then be nonsense for us to say that our arms and legs must feed and fend for themselves. The body politic is an interconnected whole.

Continued on page 95

"States can 'go broke' too"

Options for dealing with rising renewal costs

A key role of the Asset Manager is to generate and examine options. In this article I take one of the issues currently facing asset managers and outline some of the options that could be considered, looking briefly at the advantages, disadvantages and limitations of each.



“All renewal forecasts show that the level of renewal expenditure needed to maintain the existing asset stock is increasing rapidly. What are our options?”

A: Advantages
D: Disadvantages
L: Limitations

I passed this along to a colleague, Bob Ritchie, who added the ideas that you will find in italic .

If you would like to add your ideas, write to me at penny@amqi.com and I will send you a word copy of the article to make it easy for you to play with it.

1. Save now so that we have the funds for renewal when the time comes. This is essentially the argument for funding depreciation.

A: creates renewal fund; goes some way to address inter-generational equity issues.

D: When so few assets are replaced ‘as is’ it is difficult to determine how much is renewal, how much upgrade, how much simply new, and thus difficult to contain the renewal fund for the purpose for which it was set up. Worst-case scenario is that the funds could be used to expand an already unsustainable asset stock size; alternately if there is a tight constraint on the use of asset replacement funds, money would have to be borrowed for projects involving both replacement and upgrade while money would lie idle in the replacement fund.

L: Funding is only one of the problems of renewal – even with sufficient funds; there is still the problem of obtaining the skills and physical resources needed. With the ageing of the population, future skill shortages are predicted.

2. Start renewal now. Infrastructure assets (and many equipment assets) have an indeterminate life determined not by the physical inability to provide service, but rather by the diminishing quality of that service, so why not borrow and bring forward renewal while we still have the skilled labour to do it? Or, if not borrowing, then utilise some of the Federal Government’s surplus?

A: will address deteriorating service levels, will use the skilled resources that are currently available.

D: *Discarding assets with useful remaining life is to some degree wasteful, The value of this ‘waste’ ought to be costed into any economic analysis used to support earlier renewal. (This is not an argument against early renewal. It is an argument for proper valuation.)*

L: Borrowing capacity may be limited. Federal Government may need persuasion.



Technology is changing

3. Re-assess assumption that we need to renew everything we have as it ages.

A: Technology is changing and there may be newer and better ways of doing things; populations are ageing and their demands are changing, they may not want what we currently have – eg greater demand for chronic care, less demand for maternity hospitals;

D: Requires a better understanding of underlying trends and analysis of possible futures This will cost. *One question is will the cost of such studies be covered by the benefits they bring? Who is capable of doing such a meta-level study? Is THIS MORE A LIMITATION THAN A DISADVANTAGE?*

L: ?

4. Re-assess methodology underlying the forecasts

A: Most default methodologies for forecasting asset renewal are based on the renewal of whole elements at intervals, but it may be that not all of the element need renewal at that time. Identification and costing of the actual activity that needs to be done could reduce the size of the renewal projections.

D: Requires greater knowledge of the assets and what needs to be done and when
AND DITTO COMMENTS AS ABOVE

L:

5. Focus on near-term renewal and get that under control first

A: Quick runs on the board! Generally wins community and political approval

D: The closer an asset is to the end of its economic life, the fewer the options available to make savings, greater gains may therefore be made by looking to asset renewal further out

DO WE HAVE ANY META-LEVEL STUDIES WHICH SERIOUSLY EXPLORE THIS PROPOSITION? IF SO, WHAT DID THEY COST & WHAT WERE THEIR BENEFITS? IF NOT, WHAT IS THE ESTIMATE OF (A) FEASIBILITY—LIKE DO WE HAVE PEOPLE WHO ARE CAPABLE OF DOING SUCH A STUDY AND (B) COST © BENEFIT OF SUCH A META-LEVEL STUDY

L: ?

6. Focus on mid-term renewal and develop alternatives while we still have time

A: This can avoid assets falling to the level where costly renewal is necessary

D: May be difficult to get political commitment

L: OH&S and other standards may not make it possible to divert resources away from the immediate and urgent.

7. Fix when fail.

- A:** When assets reach the stage where the services are no longer possible or safe, it is easier to get community and political support for addressing them!
- D:** However, community agitation could lead to the renewal of assets that really should be dispensed with, so if this is the sensible option, some lead time may be necessary to prepare the community attitude *eg BAY TRAM*
- L:** Your risk managers will go berserk! *SO SHOOT THEM. THEY ARE NOT VERY SERVICEABLE COMMODITIES ANYWAY!*

8. Sell the assets to someone else so that it is their problem. A popular option nowadays.



- A:** If the Government does not retain residual responsibility for service this could be a workable solution
- D:** Commercial running may require some to go without service or accept a lower level of service and this may not be acceptable at a community level. Prices are likely to rise to the community (and the increase could be greater than that required if the organisation were to retain control.) *COMMERCIAL REALITY MAY BE AT ODDS WITH PUBLIC POLICY, AS FOR TELECOMMUNICATIONS SERVICES IN RURAL AREAS, IMPACTING ON SUSTAINABILITY OF RURAL POPULATIONS IN A COUNTRY ALREADY HEAVILY BIASED TO METROPOLITAN LIVING.*
- L:** Governments often can't avoid residual responsibility (e.g. sale of electricity)

Note for non-Australian readers. The Federal Government this month had a change of heart on the sale of the Snowy Mountains Hydro Electric Scheme because of public reaction to the sale of the icon—despite newspapers declaring the sale was 'for the Snowy's own good'.

9. Analyse future demand and manage it. Understanding what is driving future demand is the first step to managing it.

- A:** Managed demand reduces the cost to the organisation. If demand is managed through price rises, it can also provide revenue. If it is managed through greater community awareness, this provides cost savings and can provide greater community support for other organisational activities. *EG AIR-CONDITIONER CUT-OFF SWITCHES NOW BEING TRIALED IN GLENELG.*
- D:** Most organisations have few skills in understanding future drivers. These skills would need to be acquired and a longer time frame taken than may have been taken before. *OR, IS THERE A QUICK WAY OF SIGNIFICANTLY UPGRADING SKILLS AND ATTITUDES?*
- L:** ?

10. Analyse future technology and manage it. The rate of technology change is often determined by the demand for it.

- A:** Taking an active interest in supporting technology may mean that not only does it arrive faster but it is shaped to your needs.
- D:** Organisations would need to acquire knowledge of potential future technology
- L:** Size of organisation may be a limiting factor, so the ability to take advantage of shaping future technology could depend on the willingness of smaller organisations to form coalitions.

11. Your Choice!

Ask and ye shall receive!

In the last issue I asked for comments and suggestions on what we had done right – and what we had done wrong in asset management.

Leo Gohier says the emphasis on looking forward 10, or at most 20, years is wrong.

Leo also confirmed that the problems of managing assets in declining rural councils is impacting Canada as well.

‘Even in the newest version of the IIMM’, he writes, ‘whenever there is a reference to long term financial planning or budgeting it is for a ten year period (e. g. page 3.1333, section 4.7.5 a) and not for true life cycle planning. I would suggest that there is a need to do full life cycle costing of a service. In fact, the fixed-term financial plan should be based on the longest life cycle of the various assets that are utilised to deliver a service, and not on an arbitrary fixed-term such as 10 or 20 years. This true life-cycle financial plan is then at the strategic level, and is based on the true cost of delivering a service rather than on an asset management plan itself. More specific projects can then be developed for the assets themselves, and turned into a 5,10 or even a 20 year plan which is then at the tactical level’.

Leo,

Thank you for this comment. It is a very reasonable and logical approach and one that I can remember us arguing, too, particularly for the water industry. But there turned out to be some difficulties with this in practice, both of a strategic and tactical nature.

At the tactical level,



The longest living elements of infrastructure assets are usually (always?) passive civil structures with an indeterminate age. (This means it is not until we get close to the end that we actually can tell where the end is!) We may claim that the life of a pipe, say, is 80 years but we don't really know. This is our best estimate, really, of its *physical* life, but what is important to life cycle planning is *its economic or useful* life. (For example, in South Australia we replaced most inner city pipes much sooner than their physical life estimate because we needed to expand the size to cope with population growth, but in the country, which hasn't experienced the same level of growth, the life of similar pipes is longer.) Financial statements need to be grounded in some reliable cost projections. We still need to make estimates for longer-term forward thinking and for costing, of course, but not for budgets or financial planning.

At the strategic level

Budgeting and financial planning requirements are driven by the needs of the business, rather than the needs of the asset. Depending on the dynamics of the business, this may be 10 years for general council business and 20 years for water businesses.

Looking Ahead—Asset Managers must go further.

Whatever the corporate forward planning period, Asset Managers need to be **more long-sighted**. This means having an idea of both the DEMAND and the SUPPLY requirements out into the distance. (See SAM #190, page 66)

States can 'go broke' too

It is not only councils that can get into a financially unsustainable position.

In 1989, the Tasmanian Government was not only 'consuming more than it was earning' but was actually spending far more than it was receiving in revenues and had been borrowing heavily to fill the gap. Had no change been made to income and expenditures, it was calculated at the time that in a matter of a few short years, the state would 'hit the wall' – its interest and debt repayments would exceed its total revenue! Fortunately for Tasmania, the Field Labor Government, on taking office, both recognised and addressed the problem, drastically cutting expenditures (especially capital) and raising revenues. This was not a popular move, even though the population generally recognised the necessity for it. But the financial changes and the improvements in financial reporting that the Government put in place at that time have served Tasmania well. Few at the time, however, probably recognised what the inevitable outcome would have been had the changes not been made. In the higher echelons of government, consideration was being given to the Federal Government taking over responsibility for running the State, in effect, reducing it to the status of Territory.

And yet, our Media continue to urge us to spend more on infrastructure.

Hard on the heels of many articles about councils who have more infrastructure than they can manage to pay for, comes this editorial about state infrastructure. (Thursday 9th June, The Advertiser)

"Labor State governments are spending billions of dollars on infrastructure. But not South Australia, which is mired in indecision, most recently because of a cost blowout in major road spending plans. New South Wales and Queensland budgets, delivered on Tuesday, involve infrastructure spending of tens of billions over the next decade. Queensland is borrowing \$4.6 billion in the next financial year to help fund this spending."

.... SA is neither borrowing nor funding new infrastructure. Indeed, it seems to be still at the financial planning stage. Despite securing an overwhelming majority at the March election, the State Government is still short on ideas. ...

.... Unwisely, the Government has already ruled out toll roads, removing a potential source of funding for desperately needed infrastructure. While other states are racing ahead, SA has a one-way freeway and congested arterial roads, which have had no major upgrades for decades."

Note that there is no recognition here of

- The fact that South Australia's population is projected to decline within the next ten years – thus reducing both the necessity for extra roads and the ability to pay for them!
- Or, the fact that rising oil prices are already impacting South Australian's travel decisions, and these are likely to increase as prices rise still further.

States can go broke too, conc.

Running deficits to fund extra infrastructure is also regarded positively in this editorial

"New South Wales has a projected deficit of \$696 million for the 2006/07 financial year, a measure which has attracted some criticism because of the financial risks. N.S.W. Treasurer Michael Costa argues that the deficit is 'inevitable' and the budget is a "responsible approach" which allows the state to continue – and in some cases to expand – essential services. NSW's four-year infrastructure program will include \$1.4 billion on roads and \$1.6 billion on public transport next year alone."

Running a deficit to fund extra infrastructure could be financially sustainable if the new infrastructure generated net cash returns. But road expenditure does not – and public transport does not.

As Professional Asset Managers responsible for the future consequences of today's infrastructure decisions,

Do we not have a responsibility to inform and educate?

A responsibility both to understand and be understood?

What can you do?

Position Paper available from:

johnhoward.jra@bigpond.com
Project Manager for NAMS-AU

Inform yourself. Read any or all of the following studies—or take a shortcut and get the IPWEA's NAMS-AU Position Paper 2. "Sustainability in Service Provision" which is now available for comment. - **And then comment!** Comments will influence the preparation of the NAMS-AU " National Asset Condition and Financial Reporting Guidelines.

State	Sustainability initiative	Reference/Status
South Australia	<i>Rising to the Challenge</i> Report issues by Financial Sustainability Review Board	Final Report released August 2005. Ref: www.lga.sa.gov.au/customdata/inquiry/Publications.html
New South Wales	Independent Inquiry into the Financial Sustainability of NSW Local Government	<i>Are Councils Sustainable? Final Report - Findings and Recommendations</i> released May 2006. Ref: www.lgi.org.au/
Queensland	<i>Size, Shape and Sustainability of Queensland Local Government</i> project, supported by State funded \$25M <i>Regional Collaboration and Capacity Building</i> program over 5 years	Discussion Paper – Size, Shape and Sustainability of Queensland Local Government Issued by LGAQ March 2005. Ref: www.lgaq.asn.au Size, Shape and Sustainability guidelines to be released in near future
Western Australia	<i>Systemic Sustainability Study into the Sustainability of the Local Government Sector in Western Australia</i>	Research Reports in progress. Ref: www.walga.asn.au
Tasmania	<i>Local Government Sustainability Report</i>	Discussion Paper released by LGAT March 2006. Ref: www.lgat.tas.gov.au/site/page.cfm?u=349
Victoria	Local Govt Victoria <i>Asset Management Performance Measures Survey</i> Comprehensive National Database of Local Government Financial statistics to clearly gauge the sector's financial health	LGV surveys Vic councils annually. Data includes projected 15 yr maintenance and renewal funding and revenue. MAV with LGASA is undertaking project on behalf of ALGA. Ref MAV Bulletin Issue 560 18 November 2005

Source: NAMS-AU Position Paper 2 "Sustainability in Service Provision"