

STRATEGIC # 327 ASSET MANAGEMENT

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Indicators, Abatement, & Land under Roads

Using Indicators in the Public Sector.

When there are many indicators, it may be hard for decision makers to know how to weight up one against another. So, should we simplify? Have just one indicator? But if so, does it not cease to 'indicate' and become an 'instruction'? This week we look at Indicators

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All, of course, with specific reference to asset management!

"Those who cannot remember the past are condemned to repeat it." (George Santayana.)

Over the last 25 years many ideas have arisen and eventually been settled. What do you remember of

Abatement Factors. p.6

Valuing Land Under Roads, pp 7-8

What others do you remember?

And just for fun.

"The Focussed Asset Manager" - how a young man searched for and found found asset management nirvana - through a focus on service!

As always, please consider and enjoy!
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USING INDICATORS IN THE PUBLIC SECTOR



In SAM 324 I wrote about the dangers of using a simple indicator such as relating renewal to depreciation.

I had the following comment from one of the State Auditors-General. He makes two very interesting points: He says:

1. "I agree that a ratio of renewal: depreciation is too simplistic and that there are real risks to be managed, but 'it is only an indicator'.
2. "I find the bureaucracy loves to find things too complex to address and then they do nothing, probably why performance indicators haven't got very far in the public sector.

And these in turn raise two important points about indicators in the public sector.

The first is a question of competence - the ability to understand that 'it is only an indicator' and *what that means in practice*. *This goes to the heart of what ability is needed in order to use indicators.*

The second suggests that performance indicators would be more/better used in the public sector if they were to be simplified. *Should performance indicators be simplified? And if so, how should this take place? When is the end result 'simple' and when does it become 'simplistic'. (Bearing in mind, Einstein's comment that we should make things as simple as possible - and no simpler!)*

Let us consider these in the reverse order:

*first the **question of simplifying**
and then the **question of ability of interpretation***

1. SIMPLIFYING PUBLIC SECTOR INDICATORS

An instrument panel is simply **a set of indicators.**



Without many hours of flying instruction would you expect to be able to correctly interpret the information provided by these indicators - and keep the plane from crashing?

But perhaps we can make it easier for the pilot!

What if we were to 'simplify' the panel - just keep the altimeter for example, or the speedometer? Maybe just the fuel gauge?

Perhaps you could do without the compass, or the airspeed indicator, or the directional gyro? And is the turn indicator really necessary? What about the variometer (the vertical speed indicator)?

Well, you don't have to be a trained pilot to figure out that actually you DO need all the instruments on the panel.

And this is just for a simple two seater Cessna, not even a Boeing 707. And it is just for just one aircraft - not a fleet of aircraft. And even a fleet of aircraft would present far less decision points than the far greater variety of assets and asset questions facing the average council.

Do we really think that the task of managing an ever changing and wide range of public sector assets with all their attendant services and disparate user groups, can be managed by a few simple indicators?

2. INTERPRETING PUBLIC SECTOR INDICATORS

Using INDICATORS to
make a sound
diagnosis



Imagine you go to the doctor with a sore throat (an indicator)

That sore throat could be caused by a virus, or by bacteria, or, in more severe circumstances it could indicate throat cancer - or even AIDS.

What action should the doctor prescribe?

Clearly one simple indicator - the sore throat - is not enough. The doctor has to ask more questions to determine the appropriate diagnosis and treatment. In other words he has to seek information *from more indicators*. He will therefore examine you and ask you a number of questions. And the more serious the outcome, the likelihood is that he will ask more questions - not less.

Now the reason that we go to the doctor is because he **has the training** to know what questions to ask (i.e. what indicators to seek) and he knows how to **interpret** the great range of information that these indicators present.

What is common to both the pilot and the doctor is that they have been trained to interpret a range of indicators and, taking all the information into consideration, to make a sound diagnosis of the situation.

Decision makers in the public sector, however, are usually not chosen for their specialist expertise in the assets that support the services they provide.

Let us look to the private sector for an answer!

INDICATORS - making them work!

Indicators in the Private Sector

The board will often have technical expertise in the area in which the indicators are being used, but they set up specialists or specialist advisory panels, who have more in-depth expertise, to advise them.

There may be a number of such advisory panels - for example, technical, financial, risk and safety. The Board will ask questions to clarify the issues for themselves but generally will accord each panel or expert the respect due their expertise.

Each indicator - and the range of indicators in total - will be as detailed and complex as is needed to get the job done well. *The indicators themselves are not simplified.*

Simplification, if it is needed, will be taken into account in the presentation of the information to the board.

Applying this model to Public Sector Asset Management

Asset managers develop and utilise a wide range of indicators; these are not 'simplified', they are as complex as the issues need them to be. But complexity does not matter because Asset Managers are trained to handle them. Asset management is a specialist discipline (like being an airline pilot or a doctor).

Asset managers are now able to achieve professional qualifications and to attest to their competence. Asset management is a supported specialist field of inquiry.

Avoiding the Danger of Over-Simplification

By adopting indicators of an appropriate level of complexity for the purpose in hand and having them interpreted by those who are trained in the interpretation, we are able to make renewal decisions, for example, based on the entire range of relevant indicators - age, condition, renewal profiles, changes in technology, issues of labour or material shortages, etc. etc.

It is then the task of the Asset Management Team as a specialist advisory panel to communicate the information they have discovered to the board in a manner that will allow the board to come to a reasoned decision.

The answer to the Indicator Dilemma is thus to entrust their use to Specialist Asset Managers

Those who cannot remember the past are condemned to repeat it.

George Santayana.

Over the last 25 years many ideas have arisen and been wisely discarded - but these ideas unfortunately do not stay buried, they lie in wait until the time is right and then they resurface. The only defence is ... and vigilance.

How good is our corporate asset management memory?

Help me to record some of the crazy things we did in the past - so that we don't have to discover all over again how crazy they are. I now have a new section on my website. Here is the first 'memory'.

DO YOU REMEMBER WHEN?



We spoke about "Abatement Factors"?

In the late '80s and early '90s when infrastructure assets were being brought to book for the first time, the replacement values being applied worried many people who were used to thinking in terms of the historic costs of these assets. They reasoned that if we were to apply realistic depreciation rates to these values, this would represent a great increase in the realised cost of the service. But never doubt the ingenuity of man when confronted with a problem! The 'abatement' argument ran like this... "Well, it may cost \$X if we were to replace them today, but we are not going to replace them today. By the time (10, 20 or more years hence) we do replace them, *technology will have reduced the cost*. So let us write down the replacement cost to recognise this." Figures of from 30-60% were regularly suggested.

Do you remember?

What else do you remember? Help us avoid 'reinventing wheels that never should have been invented in the first place'.

Do you remember discussion on...

VALUATION OF LAND UNDER ROADS

Another of the issues that used to bedevil us was the vexed problem of the valuation of land under roads. And as this issue may yet arise for those newly adopting asset management it is worth casting an eye back over it. It is also an interesting example of how thinking in terms of 'service' rather than 'asset' led to the solution of a valuation conundrum.

Councils held serious concerns about valuing the land under roads.

One of their concerns, of course, was the cost of getting the valuations. And what would they do with the valuations once they had them? It was not really as if they could do much to manage land under roads. Carving up the road and selling the land under it was generally not an option. Moreover most of the new roads that they were acquiring were being handed over from the developers of new subdivisions. Policy makers were in two minds, on the one hand the principle of valuing the land seemed right, but the land values would be so high that they would swamp the value of the renewable assets that the council was responsible for managing.

State Highways Departments,

led by NSW, on the other hand, were very much aware of how much they had to pay for land in order to construct new highways and wanted it included. (Treasuries, including NSW, were generally not so keen!)

And then there was the problem of HOW to value the land?

Well, said the valuers, we could value it at the same value as the land adjoining it, that's what we usually do.

But, said the councils,

the value of the adjacent land is only as high as it is *because* the road is there. You have to be able to get to your house. The cost of access is absorbed in the price of the land for the house.

In meeting after meeting, discussion went around in circles and got nowhere. The trouble was that nearly everybody assumed that whatever answer was chosen would have to apply equally to State and National Highways as for local roads in residential areas.

The opposing points of view revolved around whether the infrastructure was principally providing access or services to abutting properties, versus providing for arterial or trunk movement of traffic, energy or other commodities.

In the former case (council roads) the values of abutting properties (and used for the purpose of valuation) are themselves raised by virtue of the access and services directly

connected in, and as such the road reserves are intrinsically linked to the properties; in new housing estates land prices naturally include a component covering the land required for infrastructure provided by the developer. This indivisibility of property value from the access and services provided renders the road reserve unsalable in itself.

In the latter case (highways), the passing of arterial traffic or commodities in a road reserve (or any reserve for infrastructure) is independent from properties with a common boundary where vehicular access or access to services is denied as a matter of policy (eg, high speed, high voltage, etc).

Furthermore it was argued that with Highways there was a real cost incurred as in many cases the land had been reserved for long periods prior to the infrastructure being constructed. This represents an opportunity cost, as the land may otherwise have been developed. In other cases land is acquired, representing a real project expenditure to provide the infrastructure. Ostensibly the right- of-way is saleable if the arterial or truck infrastructure facility is no longer required.

As long as it was assumed that what we did for local roads we would also need to do for highways in terms of valuation, and vice versa, there seemed to be no solution.

The breakthrough came when people came to focus not on the asset itself as on the service being rendered, the purpose of the asset.

Then it was seen that it was perfectly rational to include land in the valuation for highways where the purpose of the road was transport and where access was denied to adjacent properties (e.g. freeways and controlled access highways). In these cases the use of 'adjacent land values' to value the land under road could be seen to be reasonably independent. However, where the service provided by the road was to provide access to properties, it was clear that the value of the properties already included the cost of the land used for this purpose.

Thinking in terms of service also allowed for those roads which provided access to properties but was substantially more than the two lanes nominally required to provide vehicular access. Here it was decided that the land under the additional lanes could be included in the value of the road. The premise here was that the road could be narrowed and the surplus land sold if the arterial function was no longer required.

In essence this meant that the vast majority of council controlled roads would not have land included in the valuation but that State controlled freeways would.

In both situations , the financial information for land under infrastructure pertains to what can actually be managed, and the sale, or retention decision can only be managed if the land is actually saleable. This is in line with the criteria for recognition of non-current assets being "control".

And just for fun!

I wrote this 17 years ago. You may like to think of what the young man would be looking for today.

The Focussed Asset Manager

(for which Kenneth Blanchard and Spencer Johnson "The One Minute Manager" have had no responsibility whatsoever, but I kind of hope they would have liked to.)

Once there was a bright young man who was looking for an effective asset manager. He wanted to work for one. He wanted to become one. He had searched far and wide and spoken to many people.

He had spoken to finance officers who had told him about valuing assets and keeping good asset registers and the young man could see that a good information base was important but he thought there was more to asset management than that.

He had spoken to maintenance engineers who had emphasised the importance of ensuring that assets were maintained so as to minimise the long term cost. The young man could see that life cycle costing was important, but he thought there was more to asset management than that.

He was beginning to think that he was on the wrong track, when one day he heard of a council, not far away, that was providing excellent service. It kept in touch with the community and introduced new services when required, withdrawing old ones as they were no longer needed and although its rates were not the lowest, they were certainly in the low bracket. The community spoke highly of their council which, they said, was both responsive and responsible.

The young man became excited. Surely here he would find the kind of asset manager that he had been looking for .. The young man arranged to see the AM on the following day and arrived promptly at his office. He was greeted in a relaxed manner. "What can I do for you, young man?"

"Well sir, I have spoken to asset managers who have explained to me the importance of asset valuations and having good asset registers, and I have spoken to asset managers who have stressed the importance of minimising the life cycle costs of assets by appropriate maintenance and I can see that they are important but I think that there must be something more - it's just that I don't know what it is"

The AM smiled, "Your instincts are right, young man, finance and maintenance are extremely important, but without a proper focus neither can be deployed to full advantage."

The AM noted the puzzled frown on the young man's face so he said, "Say you go on holiday and you have no idea where you want to go or any idea of how to get there or what to do, what do you suppose might happen?"

"I guess I would just wander around, doing a bit of this and a bit of that until it was time to go to work again", the young man replied.

"Now, if you had made up your mind to go to a particular place and you had planned how to get there and some of the things that you might do when you were there, do you think you would have a better holiday?" "Much better, I wouldn't waste my time, I would be able to achieve something."

"Well", said the AM, "it's pretty much the same with asset management. Many asset managers just wander around fixing this, preserving that, cutting the costs on something else, but they don't have a plan and they don't have a clearly defined aim. We have both, and that gives us our focus. It's what makes us successful."

"How does it. work" asked the young man

"First of all, we recognise that it's not assets but services that interest our ratepayers, it's not whether we have a state of the art Lawnmower, it's whether we keep the grass cut. "

"But they don't want to pay a lot for it!" exclaimed the young man.

"No, indeed," replied the asset manager, "That's why we have a plan that enables us to provide our services at the lowest possible cost - and we are always looking for ways to increase the service and reduce the cost even further."

"So focus is knowing what your customers want - and having a plan for providing it at the lowest possible cost?" said the young man, writing it down in his notebook.

"Spot on!" said the AM, "For each of our major assets, we have clearly defined service objectives. For example, the objective for the road network in the town centre is

COMING UP NEXT

Note: Services is an idea whose time has at last arrived! In the 2011 IPWEA Conference, 12 papers dealt with how you measure and monitor service levels (cf 4 in 2009). In the next several issues of "Strategic Asset Management" we will be looking at the different ways that have been tried and how successful they have been.