

## **Governance Framework Review Attachment B: Funding and finance**

**File No.:** <<leave blank – Infocouncil will insert this when the report is saved in Trim>>

---

### **Purpose**

This report sets out the options and analysis informing the recommendations of the political working party in relation to additional financial decision making for local boards.

### **Comments**

#### **Background**

1. The Governance Framework Review report identified the following key issues that have been considered within the context of the Funding and Finance workstream:
  - local boards do not have to balance the trade-offs of financial decisions in the same way as the governing body needs to e.g. local boards can advocate for both additional investment in their own area and lower rates
  - inflexibility of the current funding policies to empower local board decision making. In particular local boards feel they have little or no control over the ninety per cent of their budget that is for Asset Based Services (ABS)
  - inflexibility of the current procurement processes and definition of when local boards or groups of local boards can undertake procurement of major contracts.
2. The workstream looked at a range of alternative models for financial decision making around local activities:
  - Status quo (predominantly governing body and some local board decision making)
  - Entirely local (unconstrained local board decision making)
  - Local within parameters (local board decision making, but within parameters set by the governing body)
  - Entirely regional (all governing body with local boards as advocates)
  - Joint governing body/local board (joint committees)
  - Multi-board (joint decision making of two or more local boards).

#### **Options**

3. After initial discussion with the political working party the options were narrowed down to two, for further exploration. They were:
  - Option 1: Enhanced status quo
4. This option is based on the governing body continuing to set the overall budget availability and allocating the budget between local boards (the allocation is currently based on legacy service levels). The budgets will be funded from general rates and decisions made by the governing body on the level of rates, efficiency savings and levels of service would be reflected through, as necessary, to the local board budgets. Within these parameters some additional flexibility for local decision making, especially around renewals budgets, is proposed.
  - Option 2: Local decision making (with local rates) within parameters
5. In this option additional decision making is enabled for local boards through all or some of the costs of local activities and services being funded through a local rate. This enables the local board to have much increased flexibility in determining levels of service in different activities

and to directly engage with their community on the costs and benefits of providing those services. The key risks identified with this option are the impact of redistributing the costs of local services on different communities and the additional costs of supporting local decision making.

6. The local rates option starts from a fundamental principle that governance decisions on the level of service in local activities should be made and funded by the local board. Instead of advocating for funding to the governing body, the local board would set the budget for the services it wanted to deliver (in consultation with the community) and raise the appropriate amount of rates locally.
7. Ratepayers would still receive a single rates bill, but the “local” portion of the rate and the “regional” portion of the rate would be identified separately. Effectively the general rate would go down by the amount that funds local activities, and the local rate would be based on the cost of services that each board delivers.
8. This would mean that an individual ratepayer’s bill might rise or fall depending on the current assets, service levels and delivery models in the local board area. Because these costs are currently bundled up in the general rate, these variations are smoothed out i.e. the rates from a local board area with few assets and lower service levels are subsidising services in local board areas with more assets and higher service levels.
9. The project team explored some options to mitigate risks arising from the “winners and losers” effect of a local rates model. For example keeping a portion of the local rates paid for out of the general rate would recognise the fact that many assets and services are used by people from neighbouring boards, and even from across the region. A model applying an adjustment for socio economic deprivation was also explored.
10. The local decision making model highlights the need for a significantly higher level of support and more specific professional advice to be provided to local boards. This would have an impact on the organisation generally but particularly in the operations areas that support local activities.

### **Key issues from the two models**

11. A number of key themes emerge from evaluating the two models of decision making and these form the main issues for consideration when determining the way forward:
  - Legal context – The Local Government (Auckland Council) Act 2009 sets out expectations for the two arms of governance. There is a clear expectation that local boards will reflect the priorities and preferences of their communities “in respect of the level and nature of local activities to be provided by Auckland Council...” To do this local boards need the ability to make decisions about service levels and appropriate funding.
  - Capital expenditure – Both models of decision making have assumed that decisions on major capital expenditure will be reserved to the governing body. Control of debt and the council’s credit rating are key regional issues. There is also recognition that the governing body is best placed to make decisions on investment in new assets that are essentially part of a community infrastructure network.
  - Organisational efficiency vs local decision making – Greater decision making by local boards will require a greater level of staff support and will require the organisation to gear its governance advice in a different way. This will have an impact on the resources of the organisation.
  - Regional standards vs local preferences – There are different views on whether it is better to have one standard of service across the whole Auckland region for local activities, or whether each local board should be able to prioritise and customise those services according to the needs and preferences of their community.
  - Legacy funding base – The current funding of local boards for ABS is largely based on the historical funding model from the legacy councils. As each board has inherited different numbers of assets, different levels of service and different method of delivery, the existing

funding base in very uneven. This creates difficulties for the enhanced status quo model, in that it continues the uneven distribution of funding.

- Local assets as a network – Giving local boards more decision making over the level of renewal and/or services delivered from local assets will, in many cases, impact on communities outside of the local area. To address this issue the proposal includes requirement for local boards to consult outside of their own area in certain situations.

### **Local board feedback**

12. The majority of local boards supported at the very least moving to the “enhanced status quo” model immediately. They also support providing additional decision making to allow local boards to increase or decrease service levels on ABS budgets - as long as this is cost neutral. This option has been recommended by several local boards to be named “Local decision making within a funding envelope”.
13. These local boards also, by majority, support continuing the investigation of local rates as a funding mechanism for the future. A few local boards support moving to the “Local decision making within parameters” (local rate funded) option and have proposed that, should this not proceed, that a pilot of local rates/local decision making be considered.

### **Political working party consideration**

14. At its last meeting on 6 September 2017, the working party considered the resolutions of the local boards including the option of a third “hybrid” model. Information was also presented at that meeting on the potential costs of additional organisational support as it related to local decision making on renewals.
15. The options that were considered are:
  - No change
  - Option 1 - Enhanced status quo (original model)
  - Option 2 - Local decision making within parameters (original model but suggest renaming this to “Local decision making with local rates” to distinguish from option 3 below)
  - Option 3 - Local decision making within a funding envelope (but general rate funded) – this option has emerged from the recommendations of the local boards. It is the same as Option 1 with the addition of full flexibility of decision making within a funding envelope for asset based services budgets.
16. Each of these options has some elements of change in common and others that are quite different. In order to make recommendations to the governing body, the political working party determined their support for the potential changes in approach in each area of financial decision making.

### Disposal of, and reinvestment of local assets (optimisation of service assets policy)

17. The “optimisation of service assets” policy was adopted in 2015. It allows local boards to consider the disposal of service assets in order to reinvest in other service assets (existing or new). There has been no disagreement during the discussions to date that this policy should continue.
18. It has also been proposed in previous discussion papers that, providing all policy parameters are met, the final decision on disposal and reinvestment could lie with local boards rather than being recommended back to the governing body for their approval. No issues have been raised with this proposal to date.
19. The key issue with enabling this policy to become more effective than it has been for the past two years is a commitment to provide adequate, proactive and specialist advice to local boards on how this policy could be implemented within their area. This recommendation would be consistent under all three options.

### Flexibility of renewals funding

20. All options include the proposal to give local boards the flexibility to reprioritise the allocated funding for renewals of local assets within the total amount that is allocated to each local board i.e. a bulk funding approach.
21. The governing body would still be responsible for allocating the total amount of funding available to renewals of local assets through the Long-term plan and Annual Plan budget process. The amount available would then be allocated to each local board, as it is now, based on asset condition – with assets most in need, receiving the available funding.
22. An indicative three year programme would be presented to each local board for decision, but only year 1 would be fully committed. (Committing for only one year provides for the situation where ongoing improvement of asset data may result in some re-prioritisation during the annual allocation process).
23. The intention is then to give the local board the ability to work with staff advisors to re-allocate, within the annual funding envelope.

*Implications of the change*

24. The existing approach for renewals treats assets on a network basis. The advantages of this approach are:
  - If a local board advises that an asset is low priority for renewal then the funding is moved to the next asset most needing renewal, regardless of where that asset is located. It could be argued that this is a more efficient use of scarce funding.
  - Where the budgeted costs of renewal are either under or over the actual cost, then the network approach enables these “unders and overs” to be offset against each other across the network. This also enables an efficient use of the available funding.
  - Having a large centralised fund enables emergency health and safety issues that may not have been identified before budgets were set, to be addressed promptly.
  - There is more flexibility in work programming when using the network approach with a high degree of delegation to staff. If there is hold up with one renewal then the resources can be applied to another without seeking governance decisions.
25. Moving to a local board bulk funded approach would diminish the efficiencies outlined above but would enable local boards to utilise their local knowledge to prioritise the available funding.
26. When considering the asset condition alongside the effectiveness of the services delivered by that asset, local boards will be in a position to make decisions (in accordance with their governance role) on whether the continued investment of renewal funding in an asset is worthwhile and this could potentially lead to disposal and reinvestment decisions.
27. It is also noted that the current local board delegations to staff already require that staff develop their work programme (including asset renewals) in consultation with local boards, act in accordance with any local policy or guidelines set by the local board and report quarterly to the local board on the work programme.
28. However, the move to a bulk funded approach does introduce some practical implications and two sub-options to give local boards a more flexible approach are proposed.
29. **Sub-option A** - is full decision making to local boards where both the local renewal programme and the allocated funding are managed by the local board. In this scenario it should be noted that:
  - Any over or under expenditure on renewals would need to be managed within the local board funding envelope. This would mean that where there is an underspend a local board would be able to apply that funding to another asset renewal, but on the other hand where there is insufficient budget the difference would need to be made up from within the local board’s funding envelope by reducing renewals on other assets.
  - A small proportion of the renewal budget (yet to be determined) would be held centrally to address emergency health and safety issues.

- Where a local board opts to reallocate funding from a scheduled renewal which then results in additional operational costs (e.g. additional maintenance or utility costs), these operational costs would need to be funded from the local board's LDI budget.
  - Where a local board opts to reallocate funding from a scheduled category 5 renewal which then results in a health and safety concern, the asset will be closed until funding is available.
  - The process of review and reallocation will be annual, and timed to ensure that the delivery programme is as efficient and effective as possible.
  - There may be a need to amend local board delegations to staff to reflect the additional flexibility to move funding between local activity classes.
30. In order to support the local boards in the additional decision making, estimates have been prepared of the impact on direct staffing required. This estimate assumes that local boards will review individual renewal projects at a cost level to ensure that they are receiving maximum value from the funding available. Under the network approach, where costs are managed centrally by staff, this level of scrutiny is not carried out by local boards.
31. The staffing impacts of this option are estimated to be 33 additional staff and a cost of approximately \$2.7 million per annum. This is an unbudgeted cost which would need to be considered as part of the Long-term plan 2018-2028 process.
32. **Sub-option B** – is a further option which has been developed to provide additional flexibility to local boards over the management of their renewal programme while leaving the budgets managed centrally by staff. In this option, local boards would be given the flexibility to move the renewal programme between both categories of assets e.g. libraries, swimming pools, community houses, and between individual assets, as long as the impact was fiscally neutral (based on estimated costs). The issues of “unders and overs” and emergency works would then not be an issue for local boards to manage.
33. There are still some additional costs associated with this option as, in order to support local boards in the wider decision making, the current asset data improvement programme needs to be speeded up. This is a short term cost of approximately \$850,000 per annum for 18 months to two years. Some of this unbudgeted cost would be incurred in the current year to enable implementation from 1 July 2018 and, if the approach is approved, the additional cost will be brought back to the Finance and Performance Committee for approval.
34. The working party's recommendations were originally split between a majority and minority view. However, discussions since then have resulted in a single recommendation that the governing body support moving to greater local board flexibility of decision making over the renewals programme but leaving the funding managed centrally by staff [sub-option B].

#### Flexibility of service levels and allocation of operational funding

35. Options 2 and 3 propose giving local boards far more flexibility in the use of the funding provided for the operational costs of local activities. There are several issues for consideration before deciding the best way forward in this area:
- existing inequity of funding
  - whether there should be minimum levels of service
  - impact on organisational support.

#### *Existing inequity of funding*

36. The funding of local boards for operational activities is very uneven and primarily based on the funding provided under the legacy councils. The main contributing factors to the uneven funding are:
- the number of assets that each local board has within its boundaries e.g. some have multiple swimming pools others none

- the mode of delivery of services e.g. some local boards have a council owned and operated art gallery others provide grants to community run facilities
  - the level of service provided e.g. some local boards have fully staffed community houses offering programmes, other are run just as venues for hire.
37. There is wide acceptance that the issue of number of assets is related to previous decisions and can't be changed. The mode of delivery is also largely accepted as not a major issue, although over time the local board may have the ability to change the approach.
38. The key point of contention is the different levels of service that are provided. However, establishing comparators of levels of service is not easy. The costs of service are not necessarily a good proxy for the level of that service. Different modes of delivery will have different cost structures but could still be providing similar levels of service.
39. In the local rate funded option (Option 2), this issue would be reflected and addressed through the setting of the local rate. The local rate would reflect the costs of providing services locally and the local board have the ability to adjust as necessary.
40. In the funding envelope option (Option 3), the ability of all local boards to work from a level playing field becomes more important. It is also an ongoing issue for the enhanced status quo option, where there is dissatisfaction from local boards who feel they are underfunded in relation to levels of service issues. In order to address this issue for either Option 1 or Option 3:
- further work would be required at a much greater level of detail on service levels; and
  - consideration would need to be given to funding local boards for more equitable levels of service over time.

#### *Minimum levels of service*

41. An approach that gave full flexibility, with no minimum service level, would allow the local boards to potentially exit from some services and fund others to a higher level, following appropriate community consultation. Some consideration needs to be given as to whether this would be generally acceptable, and therefore to the proposition that the governing body may wish to set a minimum level of service for all (or some) local activities.
42. There is a strong rationale for setting minimum service levels where local services are fully or partially funded from the general rate. Option 3 is fully funded from general rates and it is highly likely that Option 2 would have a significant element of general rates to mitigate the impact of rates increases on some communities.
43. The governing body may determine that minimum service levels are not required across all local activities but perhaps those with more of a network impact e.g. libraries, swimming pools, sportsfields. As identified above, in order to set minimum service levels, further work on understanding existing service levels would be required.

#### *Impacts on organisational support*

44. Throughout the discussion of this workstream it has been highlighted that there is a trade-off to be made between local decision making and organisational efficiency. The organisation has over recent years, shifted more to delivering local activities on a network basis. This has been driven partially by a desire to bring all assets across the region up to a similar standard, to provide access to similar programmes to all communities and also to achieve the ongoing organisational efficiency targets.
45. Some of the efficiency gains of the network approach are outlined in the renewals section above i.e. managing renewals funding across Auckland allows better management of over and under budgeting, changes to programming of renewals are carried out under management delegation and can be achieved with minimum delay, urgent renewals can be accommodated within an overall budget.
46. In addition to the renewal efficiencies there are other impacts of moving from the network approach to more local decision making e.g. leisure facilities are aiming to reduce operating

costs to breakeven through harmonising pricing and introducing portable memberships across the network thus increasing membership and maximising revenue (and reducing the rates component of funding). Local variations will have an opex impact and therefore a funding implication.

47. Providing support to 21 local boards so that they can individually determine the levels of service and modes of delivery of their local activities with the benefit of robust professional advice will have an impact on the level of support required. Organisational support will be required to both help local boards determine what changes they may wish to make to the mix of services in their area (proactive analysis of usage of services, community needs and policy implications) and the implications of change (impacts on parts of the community of shifts of resources, impacts on the organisation through potential changes to contracts, staffing etc.)
48. While there are clearly additional costs associated with moving towards more local decision making, a key question that needs to be addressed is, does the existing network approach to managing local assets and activities give effect to the policy intent of the Auckland Council legislation? From a governance perspective, which was the focus of this review, it is apparent that local boards are not currently able to be as locally responsive as was intended.
49. Local place making, reflecting local priorities and preferences are clear responsibilities of local boards under the legislation, which does anticipate that boards will adjust default levels of service, either upwards or downwards. Managing assets and service on a network basis provides improved efficiencies and arguably more cost effective services across Auckland but does not enable the local boards to full carry out their role under statute.
50. Discussions have been held with the operational departments to try to estimate the impact of the additional support requirements, but it is extremely difficult in the context of the current unknowns.
51. For example, if the governing body determines there should be minimum levels of service for all local activities then this would reduce the local boards' flexibility considerably. If local boards are making changes at the margins of their activities rather than fundamental changes, then the level of staff support required is significantly less and may be able to be accommodated with little increase in staff numbers and costs.
52. Another unknown is the extent of the changes that local boards may wish to make. Examples that have been raised to date include:
  - the ability to move funding between community houses, where a local board feels that one is underfunded and another overfunded
  - applying the community empowerment model differently in different places, with some local boards preferring to apply the available funding to grants for community groups rather than have staff advisors.
53. These are not major changes but would require advice on the consequences and approach to implementation. Other more significant changes could be contemplated with better advice on specific local community needs and priorities.
54. Given the difficulties in predicting the impact on the required organisational support, it is suggested that decisions in principle on which approach is supported and whether minimum service levels are desirable would enable the organisational workstream to explore further the impacts on organisational resourcing.
55. The working party recommendations is that the governing body supports, in principle, moving towards greater decision making over operational budgets for local boards but after having considered the issues of equalising services, setting minimum service levels and considering the impacts on organisational support requirements.

#### Procurement

56. Currently local boards have the ability to procure lower value, local contracts and projects. All major contracts such as the maintenance and renewal of facilities are procured centrally. Project 17 introduced the concept of much greater input from local boards in specifying service

standards before tendering for contracts. The contracts have also been constructed so that there is some ability for local boards to vary service standards within the contract.

57. Option 2 introduced the idea of local boards having full decision making over procurement but within parameters of clustering those major contracts, such as the facilities maintenance contract, and also ensuring appropriate contract periods and, alignment of timing across the region.
58. A number of practical concerns about how these parameters could be applied have been raised. Some concerns have also been raised about the potential loss of efficiency gains if there is a general move back to more local procurement.
59. The Project 17 approach has the potential to deliver many of the outcomes local boards are looking for while maintaining the efficiencies of procurement at scale. While it is early days for the implementation of Project 17, the recommendation of the working party is to continue with the approach, where there is the opportunity to apply it to other parts of local activities.

### Funding

60. The key choice for funding is whether local activities are fully funded from general rates or funded (at least in part) from a local targeted rate. The reason for considering local rates as a funding mechanism was that it was considered that this delivered both the flexibility of funding that local boards sought, and gave effect to the policy intent of the legislation for democratic accountability.
61. However, the majority of local boards have resolved to remain with general rate funding, although there is majority support for continuing to explore local rates as an option. Looking at future impacts of local rates in light of the 2017 revaluations, and more explanation of how local rates would work, were the key reasons raised in discussions for continuing the work.
62. A small number of local boards supported the local rate option and requested that if this was not fully implemented that they be given the option of a pilot.
63. There are, however, significant problems with piloting the 'local decision making with local rates option'. In order to achieve this within the rating legislation there are two choices –
  - One approach is to separate out the costs of local activities for only those local boards participating in the pilot and recover these via a local rate in the local board area. This is the simplest option but the impact is that those local boards in the pilot are paying for local activities for other local boards in their general rate as well as their own local activities in their local rate. This clearly is inequitable.
  - The second approach is to separate out all local activity costs and charge the local boards in the pilot their own costs – they would no longer pay twice as all local activities are now excluded from the general rate. However, the non-participating local boards will now have a nominal local rate applied to their rating bill. This would be allocated across those local boards on the same basis as the general rates and the financial impact would likely be minimal. However, that there would be potential confusion at the sudden appearance of this line item on all rate accounts.
64. Both approaches would require consultation with the community through the LTP or Annual Plan, depending on timing of the pilot. The challenge of communicating this as a pilot would be significant and is likely to result in confusion within the community.
65. In addition to the rating complexity, the organisation would need to gear itself to supporting the decision making of those local boards in the pilot at a much greater level.
66. As the majority of local boards do not support the local rate option at the moment, the working party's recommendation is to continue to fund local activities through general rates at this stage.
67. It is, however, recommended that further work on local rates be undertaken in response to the interest in this work from the majority of local boards and the request from four specific boards to further explore the option of an opt in model of local rates.

Suggested way forward

68. If there is a will to proceed with greater local decision making across both renewals and operational activities, then this could be done as a phased implementation. While local board resolutions have sought an immediate implementation of full flexibility of local board decision making for ABS budgets, this is not recommended as:

- the desirability of minimum service levels, and the impact of removing these, needs to be more carefully considered before a decision is made. Appropriate staff advice on these issues needs to be provided to avoid any unforeseen consequences.
- the demand for staff support for local decision making is not easily quantifiable with current information and it would be preferable to take a more measured approach.

69. An appropriate approach to a phased implementation may be:

*Step 1 (now)*

- Approve the implementation of the bulk funding of renewals approach from 1 July 2018 [sub-option B].
- Complete further work on understanding levels of service for local activities – this could be phased across different local activities based on staff advice on time and cost to achieve this. Further to this work seek options for equalising funding for levels of service across local boards.

*Step 2 (commence early 2018)*

- Determine whether the additional decision making for local boards is fully flexible or includes some minimum service levels. These may be for all activities or just those where there is more network consideration, such as libraries, swimming pools and sportsfields. Staff advice on the merits of applying minimum service levels to different local activities should be provided as part of this decision making.
- Evaluate the impact on organisational resources of implementing more flexibility in service levels and operational funding, in light of the decisions on minimum service levels. Taking this evaluation into consideration the final decisions could then be made on to what extent the flexibility of decision making would be implemented.
- Complete further work on modelling the rates impacts of the local rates option, including an opt-in model, in light of the new property valuations and report back.

70. Timeframes for Step 2 will require some further work. A more detailed timeframe and scope of work will be brought back to the relevant committee or political working party. Early indications are:

- an approximate 12 month timeframe (from January 2018); and
- an additional, unbudgeted cost of approximately \$250,000-\$350,000 for the current year (to be reported back to the Finance and Performance Committee for approval).