

# **Governance framework review discussion document: Funding and Finance workstream**

## **Purpose and problem definition**

1. This paper provides an overview to the political working party on the two options that were mandated at the 4 May 2017 meeting to be further progressed, and seeks direction on recommendations to the governing body.

## **Background**

2. The Gareth Stiven report identified a level of dissatisfaction with the current status in regard to the funding of local boards and the level of control over their budgets, including the procurement process.
3. At the PWP meeting on 4 May 2017 a range of options for addressing the issues raised was presented for consideration. The PWP narrowed the options down to two and asked that further work be done and reported back on the detail and implications of those two options. The options were:
  - Enhanced status quo
    - existing model with more local control over ABS budget
    - general rate funded
  - Local decision making within parameters
    - range of options around parameters
    - setting local rates, but looking at mitigation options for redistribution effects

## **Problem definition**

4. The current approach to decision making for budgets and funding allocation is an attempt to balance the desire for regional control over financial parameters and basic levels of service with some devolvement of decisions to the local board level.
5. Budgets for those services and activities that are classified as “local” are currently in the order of \$350 million of annual operating costs. These budgets are allocated to each local board but, in practice, local boards have full discretion over less than 10 per cent of this amount. There is also limited ability for local boards to influence some procurement decisions for operational activities. New investment decisions (purchase and major upgrades of assets) for local services and activities are primarily made at the

governing body level. The local board role is confined to influencing the design and specific location of these assets.

6. The situation is further complicated by the fact that the budget allocation between local boards is primarily based on legacy funding and levels of service which, inherently, are uneven in approach. There are different levels of service, operating models and age of assets driving the allocation of the budgets.
7. Another exacerbating factor is the limited availability of additional funding to address the historic issues. The desire to keep rates at a level considered affordable, along with the need to address core infrastructure issues does not leave any capacity for addressing some of the legacy funding issues for local activities and services.

## Analysis

8. As already noted the current model of funding allocation and decision making on budgets is a hybrid of regional and local decisions. It lacks clarity and accountability, but does allow a balance between regional efficiency gains, control of financial parameters and basic levels of service, with some local decision making.
9. The current model was initially developed by the Auckland Transition Agency (ATA) leading into the amalgamation of the Auckland councils. It has had minor refinements over the past few years but with six years of experience of operating the model it is timely to consider how it could be improved.
10. Having considered the range of options presented for discussion at the 4 May meeting, the PWP felt the two options that should be further explored were “enhanced status quo” and “local decision making within parameters”.

## Options and analysis

11. Attached to this report is a more detailed description of the two options. As in previous papers the description, analysis and potential impacts of the options has been broken down into the key elements of financial decision making:

- New investments
- Disposals
- Renewals
- Operations
- Procurement
- Funding

12. While the detailed description and analysis in the attached paper has been broken down into the key financial decision areas noted above, there are a number of key issues and themes from that work which need to be considered as a whole. These themes are summarised below and form the main issues of consideration when determining the recommended way forward.

### **Issue 1 - Legal context for the two options**

13. In considering the legal context for the models, the Local Government (Auckland Council) Act 2009 sets out the expectations for the two arms of governance. Section 20 (20)(a) provides that in a Local Board Plan the local board should “*reflect the priorities and preferences of the communities within the local board area in respect of the level and nature of local activities to be provided by the Auckland Council over the next three years....*”

14. This indicates the ability of the local board to vary service levels and priorities within their own area. Section 16 (1)(a) also sets out that local boards are responsible, and democratically accountable, for decision making on non-regulatory activities that are allocated to them.

15. Enabling more financial decision making would be consistent with the policy intent of the legislation.

### **Issue 2 - Capital expenditure**

16. When considering the responsibility for capital expenditure the key issue is overall financial sustainability. Capital expenditure on new investments and renewals is a significant strategic financial issue. The investment in new and upgraded assets is a major driver of council’s costs going forward.

17. The fast growth of the city and the demands created by underinvestment in the past mean there needs to be careful consideration of the balance of the capital programme (new assets, upgrades and renewals) and tight control of the debt to revenue ratios for the purposes of maintaining council’s credit rating and financial sustainability. This would be extremely difficult to achieve in a devolved decision making model.

18. The discussions of the PWP recognised this issue and the fact that decisions on major asset investments are best made at regional level rather than by a local board, whose role is to consider and advocate primarily for their local community. These decisions are guided by plans such as the regional community facilities plan and LBs are a key input into the development of such plans.

19. For these reasons, both of the models presented for feedback work on the assumption that major capital expenditure will continue to be a governing body decision and that the operating expenditure costs associated with these decisions (depreciation, interest etc.) will be funded by general rates.

20. However, local boards will continue to have access to a local capital expenditure fund, as presently, for minor capital projects. This is provided for within the overall capital budget and so LB decisions within that funding envelope do not impact on forecast debt levels and financial ratios.

### **Issue 3- Organisational efficiency vs local decision making**

21. The impact on the resources of the organisation of a more devolved decision making model was identified early in the first discussions on this workstream. The more detailed analysis has confirmed that initial expectation.

22. Giving local boards more decision making over renewal allocations, operational programmes, levels of service, modes of delivery, optimisation of local assets, procurement, determining their own budgets and a local rate, will all require the organisation to gear its support to local boards in a very different way.

23. There will be resource implications but the extent of those is difficult to determine and will take more detailed work than has been able to be completed to date. It is not necessarily just about adding more resources to existing structures within the organisation, but considering a different approach to supporting local boards. This work will form part of the organisational support workstream.

24. There is also the potential to lose some of the gains that have been made since amalgamation through procurement at scale. Project 17 has set a new model for procurement which has attempted to maximise the efficiencies of large scale procurement with flexibility for local boards to move service levels within certain parameters. In the “local decision making within parameters” model it has been suggested that parameters be set to capitalise on this approach i.e. geographic clustering, minimum contract periods and alignment of contract timelines.

25. However, while efficiency is a significant and valid concern, the ability of local boards to work with their communities to shape the delivery of local services and activities was always a clear intent of the Auckland Council legislation. The move to centralisation of organisational support, driven by the desire to maximise efficiencies, does not necessarily lend itself to supporting local decision making with a full range of expertise.

### **Issue 4 - Regional standards vs local preferences**

26. Throughout the discussions to date there have been varying views on the desirability of having one standard of service across the region versus letting each community determine its local preferences (through the local board).

27. Having one standard of service across the region would considerably lessen the need to give local boards more decision making. Service standards would be determined centrally, with local board input, and applied across Auckland. There are valid arguments for consistency of service, but it is not necessarily what was envisaged for local activities when the governance model was designed. The key issue for

implementation of this scenario is addressing the legacy funding inequities (see below) and determining what a standard level of service should be.

28. The local preference approach envisages that each local board area would determine its own priorities and then set a budget (and potentially a local rate) to deliver on those priorities. This could result in local activities and services looking somewhat different in various parts of the region. For example:

- More wealthy communities may envisage a community house/hall/centre primarily as a venue for hire. Other less wealthy areas may wish to fund a variety of programmes to support their community.
- Some boards may have much more of an environmental focus than others due to the nature of the location and prioritise their budget accordingly.

29. Determining where in the spectrum of regional standardisation vs local preference Auckland wishes to be is a key issue in how much financial decision making is enabled for local boards.

## **Issue 5 - Legacy funding base**

30. A major issue to be overcome going forward is the inequity of funding in the current baseline budgets.

31. The initial set-up of the local board budgets was primarily based on legacy funding of local activities. The legacy councils had quite different approaches to service levels and modes of delivery (in-house services, contracted out, grants to community providers etc.).

32. These approaches have effectively been set as the basis of service delivery since. It results in very different levels of funding to each local board. In addition, local assets are not distributed evenly between local boards - there are different numbers of libraries, pools, parks etc. in each local board area.

33. When considered together, these issues result in very different levels of funding to local boards and very different abilities to re-allocate and leverage funding within their current budget envelopes. This has been a key difficulty in considering future options. It is also the cause of discontent for many boards who feel that their ratepayers are contributing to higher levels of service in other areas while not receiving those levels of service locally.

34. The “enhanced status quo” model starts from a very uneven base. None of the options to address this are attractive i.e.

- a) a redistribution of existing funds – while this would be of benefit to lower funded boards, it is likely to create significant concerns for better funded boards – with an instant drop in levels of service. Determining the basis for reallocation would also be difficult exercise.

- b) A top-up of all local boards to the highest level of service. The costs of this would likely be significant and, again, there is considerable difficulty in identifying how that would be applied.
- c) Some combination of the above.

35. A local rate does help address the inequitable funding problem. Those boards that currently have lower levels of funding will experience an overall rate decrease, giving them the opportunity to either pass on the decrease to the ratepayers or increase levels of service within the existing rate levels.

## **Issue 6 - Local assets as a network**

36. Assets classified as local in the current allocation of decision making, also act as a network. The catchments for use of local assets vary widely depending on the individual asset. Some will be primarily local (e.g. a community house), others will span across a wide area e.g. West Wave pool and the central library.

37. All assets currently classified as local have been assumed to stay as they are and be part of the decision making of the local board in whose area they are located. However, it is recognised that in some cases there is a wider interest than that of just the local board area.

38. In the “local decision making within parameters” model, a local board could propose a change in levels of service for an asset located within their boundary but with a much wider community of users. There could also be similar impacts in either model with the bulk funding of renewals. The proposal in the attached paper is to ensure that other affected local boards, the governing body and the wider community are consulted. Proposals to change service levels need to be signalled through the LTP and Annual Plan processes and consultation would be tailored to ensure appropriate input.

## **Issue 7 - Funding**

39. The two models attached have been developed based on two different approaches –

- a) the existing approach to funding local services and activities through the general rate; and
- b) some of the costs of local services and activities (direct operating costs) being funded through a local rate.

Each of these approaches to funding pose different challenges.

40. The key factors with the general rates based approach are:

- Overall funding and therefore to a large extent, levels of service, for local activities are determined by the governing body
- It is difficult to address the historical funding inequities
- All ratepayers pay the same (based on property value).

41. The key factors with a local rate are:

- The rate will reflect the level of service delivered in that area
- The local board can set their own budgets to reflect local community priorities
- The redistribution of rates may impact more in communities least able to afford it.

42. Another key concern that is raised in the funding discussion is a perception that moving to local preferences and local rates is a “return to the days of the old borough councils” and undermines the purpose of the amalgamation. However, it should be noted that:

- Local activities represent only 10 per cent of the council group expenditure. Ninety per cent is controlled and focused regionally (through the governing body and CCOs).
- The proposal in the attached paper for local rates has been pared back to only direct operating costs for local activities and represents approximately 6-7% of total operating costs or 13-14% of total rates.
- The Auckland Council legislation envisaged local boards being responsive to local communities and specifically allows for local targeted rates.

## Issue 8 - Data and policy gaps

43. Through the process of analysis of the two models it has become increasingly clear that in order for any significant improvement to be achieved in local decision making there will need to be considerably more work in a number of different areas of data integrity and policy development. Some of this work is already underway but not all of it. Key gaps currently are:

- Robust asset information and condition assessment
- Understanding and policy development for service standards across the various areas of community services
- Information on the costs of local services
- Improved budget and financial information

44. The implementation programme will need to address these issues.

## Conclusion

45. The two models of financial decision making for local boards highlight some key issues that go to the heart of the governance model as well as some practical issues that would need to be resolved as part of any implementation.

46. The key considerations in relation to financial decision making for local activities require a weighing up of:

- Maximising organisational efficiency vs enabling local decision making
- One standard of service (for local activities) across Auckland vs services tailored to local preferences

- Managing local assets as a network or as part of a place based approach
- A centralised budgeting and rating approach or a devolved one with capacity to local service levels and costs.

47. In summary the two proposed models of financial decision making having the following characteristics:

a) Enhanced status quo –

- Limited additional financial decision making – may not give full effect to legislative intent of local boards with local decision making and accountability
- Maintains the efficiencies of more centralised organisational support and procurement at scale
- Governing body determines budgets and therefore levels of service - tends towards regional standards
- Unlikely to address legacy inequities of funding in the short term
- General rate funded therefore no redistribution effect, but also does not address perceived inequity of boards funding higher levels of service in other areas

b) Local decision making within parameters –

- Gives more decision making and accountability to local boards – may be more in line with legislative intent
- Will be less efficient as additional resources will be required to support local decision making
- Levels of service will tend to be more varied across the region
- Enables local boards to address funding inequities
- Redistribution of rates will impact on some communities who can least afford it.