



## LOCAL GOVERNMENT ACT REVIEW >>> DELIVERING FOR THE COMMUNITY

### SUMMARY DISCUSSION PAPER

### INCLUSIVE

# Beneficial enterprises

## Introduction

In addition to the regulatory functions provided by local governments, local governments provide a broad array of services to the community which can have a commercial orientation for example: gymnasiums, pools, parking facilities, childcare facilities, sport complexes, caravan parks and regional airports.

While these activities provide services to the community, they also add to the complexity of the local government's business structure and recordkeeping. In some cases, these services are large enough to be carried on as an individual business in their own right.

The local government sector has been requesting that it be given additional powers to form independent corporations. These entities could be used to manage part of a local government's existing business activity or pursue new commercial opportunities.

## What powers do WA local governments currently have?

Currently under the Act, local governments have two options for forming independent corporate bodies: a regional council and regional subsidiaries.

### Regional council

A regional council is a corporate entity formed by two or more local governments. The corporation is a separate legal entity from the local government that conducts business activities in its own name, has similar powers to that of a local government

and is subject to all the financial and auditing requirements which apply to a local government.

A regional council can be formed to carry out any purpose which the member local governments could perform individually. This includes commercial activity, investment of money or the provision of community services such as waste management and recycling facilities.

### Regional subsidiary

The ability to form regional subsidiaries was introduced in 2017 as a way of encouraging local governments to work more closely together with neighbouring councils to deliver services to the community or carry out functions such as payroll or records management. As a result, a regional subsidiary is smaller in scope and subject to less regulation than a regional council. The governing board can consist of members who are not elected members or local government staff thus allowing people with special expertise to be engaged to oversee the activities.

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A regional subsidiary is only required to provide annual budgets and financial statements. All other financial reporting is determined by the subsidiary's charter as set out by the local governments that created the subsidiary.

## Major trading undertaking and major land transactions

A local government can undertake any trading activity that has an expenditure up to:

- \$5,000,000 for metropolitan local governments;
- \$2,000,000 for a major regional centre; or
- Less than 10% of their operating expenditure for all other local governments.

or

a major land transaction that has an expenditure up to:

- \$10,000,000 for metropolitan local governments;
- \$2,000,000 for a major regional centre; or
- Less than 10% of their municipal fund for all other local governments.

under the normal course of business. For transactions over these limits, the local government must prepare a business plan and which is released for public comment for a period of at least six weeks.

## What can local governments do in other jurisdictions?

Each jurisdiction has developed a different framework. In Queensland and Victoria the business or trading activities undertaken by local governments are called beneficial enterprises. Below is an overview of the powers to create a beneficial enterprise in each jurisdiction.

| Jurisdiction                | Ability for a local government to form a beneficial enterprise  |
|-----------------------------|---|
| <b>New South Wales</b>      | <ul style="list-style-type: none"><li>▪ A local government can form with the Minister's consent.</li></ul>  |
| <b>Victoria<sup>1</sup></b> | <ul style="list-style-type: none"><li>▪ A local government can:<ul style="list-style-type: none"><li>o be a member of a corporation;</li><li>o participate in the formation of a corporation;</li><li>o acquire shares in a corporation; and</li><li>o appoint people to be a Director(s) on a Board (if applicable).</li></ul></li></ul>   |
| <b>Queensland</b>           | <ul style="list-style-type: none"><li>▪ A local government can enter into a:<ul style="list-style-type: none"><li>o Partnership (although not an unlimited partnership);</li><li>o Corporation limited by shares (not listed on the stock exchange);</li><li>o Corporation limited by guarantee (not listed on the stock exchange); and</li><li>o Another association of persons that is not a corporation.</li></ul></li></ul> |
| <b>South Australia</b>      | <ul style="list-style-type: none"><li>▪ A local government can:<ul style="list-style-type: none"><li>o Establish a business; or</li><li>o Participate in a joint venture, trust, or partnership.</li></ul></li></ul>  |

<sup>1</sup> The powers described are not within the current *Local Government Act 1989* (Vic), but are currently before the Victorian Parliament within the Local Government Bill 2018.

| Jurisdiction           | Ability for a local government to form a beneficial enterprise   |
|------------------------|--|
| <p><b>Tasmania</b></p> | <ul style="list-style-type: none"> <li>▪ A local government can form or participate in a: <ul style="list-style-type: none"> <li>○ Corporation;</li> <li>○ Partnership, trust or other body;</li> <li>○ Company limited by guarantee; or</li> <li>○ Project or activity for the purpose of raising revenue.</li> </ul> </li> <li>▪ The consent of the Minister is required if: <ul style="list-style-type: none"> <li>○ the proposal exceeds \$250,000 or 5% of the local government's annual rate revenue; or</li> <li>○ the proposal requires the council to borrow money if they have total borrowings exceeding 30% of its general revenue.</li> </ul> </li> </ul> |

## New Zealand Model – Council Controlled Organisation

Local governments in New Zealand also possess the power to form corporations known as Council Controlled Organisations (CCOs), these are designed to serve a far broader role than the role that local government corporations serve in Australia.

Under New Zealand legislation, a CCO:

- (a) May be formed by an individual local government.
- (b) Can pursue any purpose, including purely commercial activities which have no connection to a local government purpose.
- (c) Does not require any consent from the Government.
- (d) Debts cannot be guaranteed by the local government.
- (e) May be partially owned by private shareholders.
- (f) Is subject to financial scrutiny by the Auditor General.

New Zealand has a two-tier system of government, meaning local governments provide and manage services which are usually done by Australian State and Territory governments, for example water utilities and public transport.

### What are the opportunities for reform?

The local government sector through the Western Australian Local Government Association (WALGA) has long advocated to be able to establish corporate entities that are independent of the local government and which operate under normal company law. These entities would be able to deliver projects and services needed by the community, for example leisure centres, waste management, regional airports, and land development/urban renewal projects that would otherwise not be undertaken by the private sector.

WALGA's proposed Council Controlled Organisations (CCO) scheme is similar to the New Zealand scheme and includes:

- An existing business can be converted into a CCO.
- One (or more) local governments must have a controlling share.
- A CCO will be regulated under company law (including the relevant taxation regime).

- CCOs will be required to produce an annual report (and the local government will be required to refer to the CCO in their annual report).
- Directors are to be appointed based on their skills, knowledge and experience (not just because they are an elected or staff member of the local government).
- A minimum of three directors/trustees regardless of the corporate structure adopted.
- A CCO can borrow money from a commercial lender, Treasury Corporation or from a shareholder local government.
- A CCO cannot be used for core functions (for example regulatory functions).

The model proposes that a local government would not be able to provide a guarantee or security for the debts of a CCO; lend money to the CCO unless on market terms (including transaction costs); or provide any financial advantage (for example, subsidised fees, charges and rates).

Prior to creation a local government would have to consult widely; prepare a Statement of Intent (which would be reviewed annually by the forming local government) and prepare a business plan.

WALGA suggests that the Statement of Intent should provide how the entity will engage with community expectations, outline the reporting requirements to the local government, and be publicly available.

The business plan will provide the rationale for its creation, the commercial objectives to be achieved, and the key financial and risk parameters under which it will operate. The plan is intended to provide a transparent explanation of the anticipated scale, funding and viability of the proposed entity. It would ensure that any local government (and community) contemplating the establishment of a CCO fully understands the medium-term prospects of the entity, including equity and capital needs and its future capacity to pay dividends to the shareholding local government.

## Other considerations

### Competition with the private sector

In the 1990s, the Federal and State Governments considered the ways that government bodies interacted with the economy and the impacts they could have on the free market. The result was the development of the National Competition

Policy (NCP). This agreement requires all levels of government to adhere to competitive neutrality principles whenever they conduct commercial activity. One of these principles is ensuring that government-controlled businesses do not enjoy a competitive advantage simply because they are publicly owned and backed by public money.

While local governments are not direct parties to the NCP, State Governments are required to apply the NCP to the local government sector when administering legislation. The State Government also has a commitment to ensuring that any amendments to the Act are within the spirit of the NCP principles.

NCP does not apply to non-business and non-profit activities. Local governments wishing to establish a beneficial enterprise for commercial activity would be required to assess whether the proposed beneficial enterprise will impinge on the NCP principles. This will require the local government to assess if the activity they intend to undertake is firstly, a business activity, opposed to a regulatory or governance activity and then if the business activity is a significant business activity.<sup>2</sup>

### Risks involved

As with all activities there is always risk – who bears those risks needs to be considered.

#### Financial risks

The initial funding for the establishment of the beneficial enterprise will be borne by the local government, and therefore the ratepayers. A beneficial enterprise that is conducting an activity such as providing services to the community is likely to be doing so at a loss. This will consequently require continued injections of capital from the local government.

A beneficial enterprise that is established to conduct a commercial activity will still need financial support from the local government during the start-up phase. All commercial activity is subject to a risk of failure. The higher the possible returns, the greater the risk that these will not be achieved. A failed enterprise will reflect badly on the local government that established it and could have wider effects on the community.

<sup>2</sup> NCP only applies to 'significant business activities', for further information see <http://archive.treasury.gov.au/documents/275/PDF/cnps.pdf>.

## Concerns with privatisation

Some members of the community have raised concerns with beneficial enterprises being used to privatise local government services. While WALGA proposes that a beneficial enterprise will not be used to provide regulatory functions, local governments employ a significant number of employees that provide services that are not regulatory in nature.

The concerns raised include the possibility of lower wages, less secure employment conditions, employees being employed outside the protection of the Western Australian Industrial relations system, and less accountability of public money.

These risks need to be weighed against the potential benefits associated with permitting a local government to form a beneficial enterprise.

## Which local governments should have the ability to form a beneficial enterprise?

Beneficial enterprises are complex and present risks to the council and ratepayers. With the need to obtain legal and financial advice there are significant costs to establish such an organisation. There is also the question of what funding will be provided to the enterprise to enable it to operate.

### Ability to form a beneficial enterprise based on an assigned salaries and allowances band

One approach would be to set the eligibility threshold based on an assigned band. Banding is currently used by the Salaries and Allowances Tribunal (Tribunal) to set the remuneration of council members and local government CEOs. Local governments are categorised into one of four bands based on a model that incorporates factors such as population, diversity of services, significant social, economic and environmental issues and expenditure.

Examples of which local governments fall into which band is shown below:

| Tribunal Band | Example local governments  |
|---------------|--|
| 1             | Bayswater, Bunbury, Gosnells, Kalgoorlie-Boulder, Port Hedland, Swan |
| 2             | Esperance, Harvey, Northam, Nedlands, Vincent, South Perth, Subiaco  |
| 3             | Capel, Claremont, East Fremantle, Gingin, Ravensthorpe, Yilgarn      |
| 4             | Bruce Rock, Cue, Dundas, Peppermint Grove, Yalgoo, Westonia          |

Incorporating Tribunal bands could better reflect the diversity and varying capacity of local government. On the other hand, it could be argued that investment or financial risk is not aligned with the factors used by the Tribunal.

### Ability to form a beneficial enterprise based on local government expenditure

Local governments in Western Australia vary considerably in respect to their capacity to raise revenue and their expenditure. For example, the combined operating budget of the State's 40 smallest local governments is less than the annual operating expenditure of the State's largest local government.

An alternate methodology would be to provide all local governments with the ability to form a beneficial enterprise but to place a cap on the amount of money the local government could invest based on their annual average expenditure. Under this approach, local governments would only be able to form a beneficial enterprise if the investment was less than a set percentage of that local government's average annual operating expenditure over a set number of years up to a maximum amount.

### **Example – ability to form a beneficial enterprise scaled to expenditure**

Over the last three financial years a given local government has had an annual operating expenditure of \$63m, \$60m and \$59m. The three-year average expenditure of the local government is \$60.6m

If the ability to form a beneficial enterprise was scaled according to expenditure, the local government would need to have a cost of investment less than a set percentage of their average annual expenditure.

In this scenario, if the prescribed percentage was 0.5%, for example, the investment threshold would be \$303,000 (0.5%), \$606,000 (1%) or \$1.2 million (2%).

Note: The median (average) local government operating expenditure in Western Australia is \$10 million. The threshold for the median local government would be: \$50k (if set at 0.5%), \$100k (1%), \$200k (2%), \$500k (5%) \$1 million (10%).

There are a range of issues that have not been discussed in this paper about the ability for a local government to form a beneficial enterprise. More information can be gained by reading the full paper.

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## **Have your say**

Have your say on these important issues by completing the [survey](#) or emailing [actreview@dlgsc.wa.gov.au](mailto:actreview@dlgsc.wa.gov.au). A [more detailed paper](#) is also available.

