

LOCAL COUNCIL
**DOMESTIC WASTE
MANAGEMENT CHARGES**



Discussion Paper

August 2020

Local Government

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Invitation for submissions

IPART invites written comment on this document and encourages all interested parties to provide submissions addressing the matters discussed.

Submissions are due by 6 October 2020.

We would prefer to receive them electronically via our online submission form <www.ipart.nsw.gov.au/Home/Consumer_Information/Lodge_a_submission>.

You can also send comments by mail to:

Review of domestic waste management charges

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1. IPART is reviewing domestic waste management charges

The Independent Pricing and Regulatory Tribunal of NSW (IPART or ‘we’) is currently reviewing domestic waste management (DWM) charges levied by NSW local councils.

Our preliminary analysis indicates that DWM charges may not be delivering good value for ratepayers and there may be challenges for local councils in purchasing and pricing these services.

In the past we have decided not to regulate changes in DWM charges. Going forward, we need to consider whether this approach remains appropriate.

At this stage, we consider that caution is needed and prescriptive regulation may not be appropriate. But, there may be other ways to improve transparency and share best practice guidance to help local councils and ratepayers get good quality services at cost-reflective prices.

Our Discussion Paper explains these preliminary views and asks for feedback on whether stakeholders consider that there are issues with the prices charged for DWM services, and, if so, how we should respond.

1.1 IPART has a role in limiting DWM charge variations

NSW local councils provide a range of DWM services to their residents, such as kerbside collection, drop-off facilities and periodic clean-up services. To recover the cost of these services, local councils levy DWM charges (separate to ordinary rates) on their residential ratepayers.¹

What is IPART's role?



In 2010 the Minister for Local Government delegated to IPART the function of approving special rate variations and minimum rates, and the function of varying annual council charges for domestic waste management services.

¹ Local councils cannot fund DWM services through ordinary rates revenue, but must instead fund them through levying separate DWM charges (see *Local Government Act 1993 (NSW) (Local Government Act) section 504(1) and (2)*). Councils are required to set DWM charges that do not exceed the reasonable cost of providing DWM services and revenue collected through DWM charges may only be used for DWM purposes (see sections 504(3) and 409(3)(a), Local Government Act). The NSW Office of Local Government's *Council Rating and Revenue Raising Manual* requires that revenue from the DWM charge must be kept separate from general rating income, and only used for expenditure related to DWM (see p 56 of the manual).

IPART may specify the maximum percentage by which DWM charges may be varied in a given year.² We may also impose conditions with respect to the variation of these charges.

IPART has not limited DWM charges in the past

To date, IPART has opted **not** to limit the maximum percentage by which DWM charges may be varied. In our consideration of DWM charges in previous years, we have noted that:

- ▼ Councils are required to set charges that do not exceed the reasonable cost³ of providing DWM services
- ▼ DWM costs have been independently audited as required by the NSW Office of Local Government (OLG) each year
- ▼ Many councils outsource DWM services through a competitive tender process.

IPART has therefore been satisfied that DWM charges were likely to be both reasonable and efficient, and that the cost of additional regulation would likely outweigh the benefit.

DWM charges have not been audited since 2016-17

In June 2019, OLG informed IPART that it had ceased conducting audits of the reasonable cost basis of DWM charges in 2016-17. OLG intends to enter into a wider audit arrangement with the Auditor General, and DWM charges may be included, but there is no definite plan or timeframe for this.⁴

Since being informed of this, we have undertaken some initial research and analysis of DWM charges in NSW to help inform our future decisions on DWM charges. We also asked councils to report on their DWM expenses and services for the 2017-18 and 2018-19 financial years as part of our 2019-20 Local Government Cost Index (LGCI) survey.⁵ The results from the LGCI survey questions on DWM charges are presented in Appendix B.

² IPART has been delegated authority to specify the percentage by which DWM charges may be increased under section 507, 508 and 508A of the Local Government Act.

³ The concept of reasonable cost in the context of charging for DWM services is in keeping with the principle that all costs, which can be reliably measured and reasonably associated with providing a DWM service, should be included in determining the charge for the service (OLG, *Council Rating and Revenue Raising Manual* p 56). This differs from efficient costs which refer to costs that represent the least cost way of providing services.

⁴ Advice provided at OLG-IPART Quarterly meeting, 12 June 2019.

⁵ We note that the response rate for the LGCI survey questions on DWM charges was relatively low. We received a response from 67 (ie, 52%) of councils. Of councils that responded, 42% were 'metropolitan', 30% 'regional' and 28% were 'rural'.

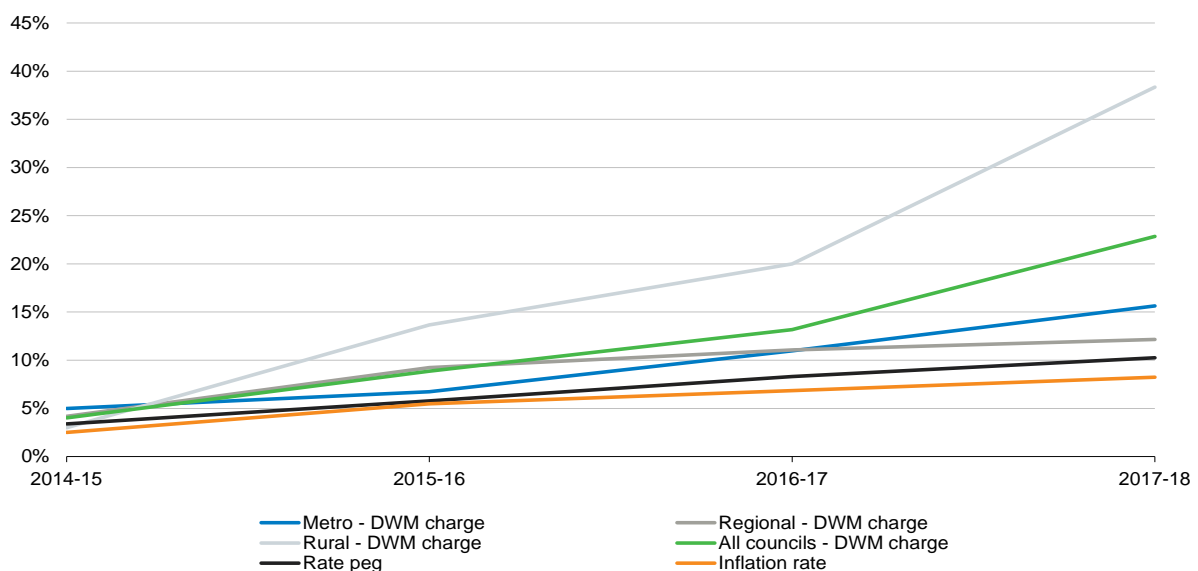
1.2 We have identified some potential issues with DWM charges

Our initial analysis suggests DWM charges may not reflect reasonable and efficient costs

We have identified several potential issues with DWM charges levied by local councils, which are usually monopoly providers of DWM services. These issues suggest that, in some cases, DWM charges may not reflect the reasonable and efficient costs of providing DWM services.

Our preliminary analysis indicates that, in general, DWM charges appear to be increasing faster than the rate peg and inflation (see Figure 1.1 and Table 1.1).

Figure 1.1 Cumulative percentage increase in DWM charges, inflation rate and rate peg from 2014-15 to 2017-18



Note: Average DWM charges and average residential rates presented do not include inflation.

Data source: OLG time series data (<https://www.olg.nsw.gov.au/public/about-councils/comparative-council-information/your-council-report/>), and IPART analysis.

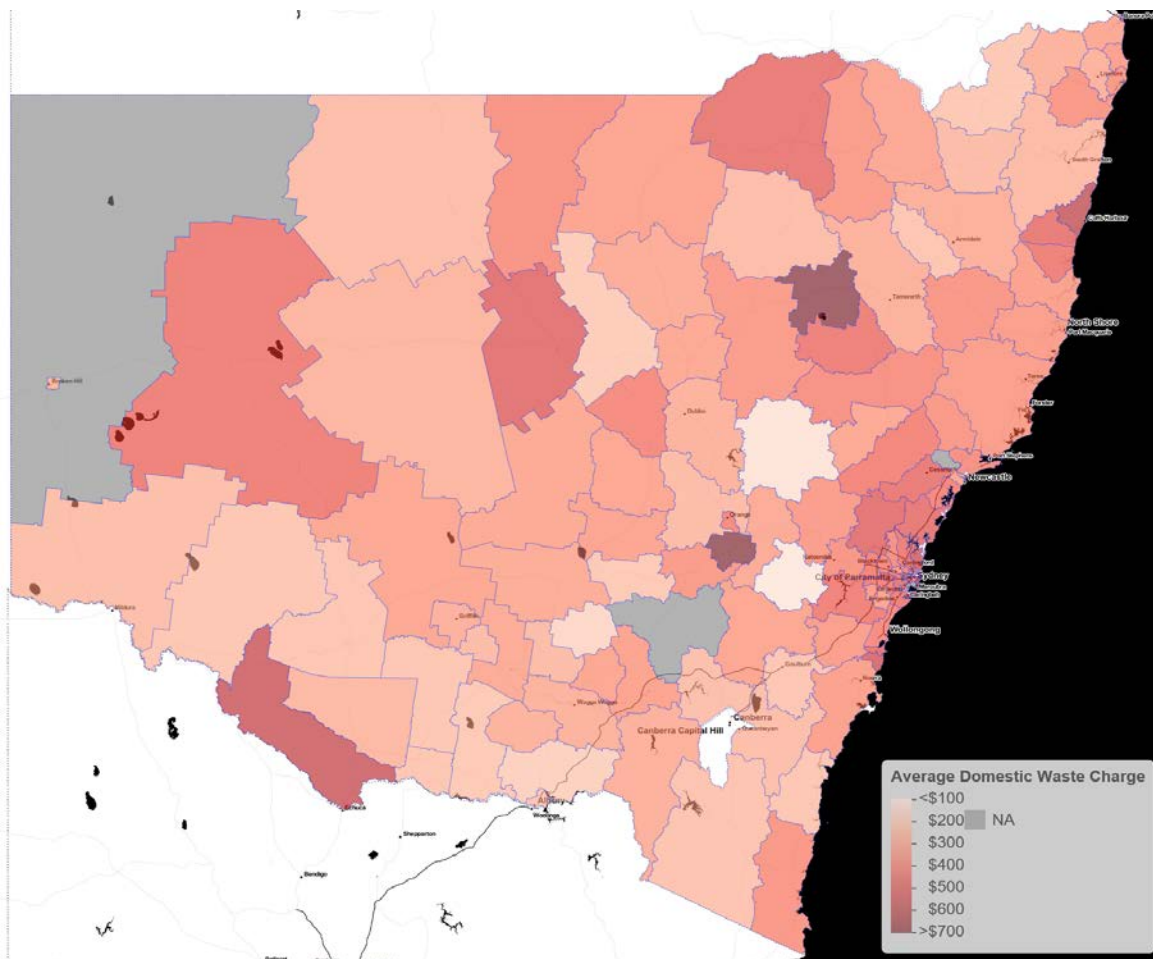
Table 1.1 Cumulative percentage increase in DWM charges, inflation rate and rate peg from 2014-15 to 2017-18

	Metropolitan	Regional	Rural	All councils
Average DWM charge	15.6%	12.2%	38.3%	22.9%
Average residential rate	12.4%	16.6%	18.5%	16.8%
Rate peg	-	-	-	10.3%
Inflation	-	-	-	8.2%

Note: Average DWM charges and average residential rates presented do not include inflation. Whilst average residential rates have increased above the rate peg much of this is likely due to special variations for specific projects or an overall increase in the level of service.

Source: OLG time series data (<https://www.olg.nsw.gov.au/public/about-councils/comparative-council-information/your-council-report/>), and IPART analysis.

Figure 1.2 Average DWM charge by NSW local council area (2017-18)



Note: Average DWM charges and average residential rates presented do not include inflation.

Data source: OLG time series data (<https://www.olg.nsw.gov.au/public/about-councils/comparative-council-information/your-council-report/>), and IPART analysis.

We have also observed that:

- ▼ There is wide variation in the number and type of DWM services provided across councils – some councils provide regular kerbside collection of general waste, recycling and organics, whilst in other areas residents deliver their waste directly to a DWM facility
- ▼ There is wide variation in DWM charges across councils (see Figure 1.2)
- ▼ Some councils appear to be in surplus for DWM services, as annual revenue from the DWM charge exceeds expenditure on providing the services (noting that in some circumstances, there may be reasonable justification for surpluses/reserves)
- ▼ Many councils either fully or partially outsource the provision of DWM services, though it is not clear that there is effective competition in the market for procuring such services, and there may be barriers to effective procurement
- ▼ Some councils appear to be allocating ‘overhead expenses’ that contribute more than half of total DWM costs.

1.3 We seek feedback on DWM charges and potential options moving forward

Based on our preliminary analysis, we consider that further investigation into how DWM charges are set is warranted.

Our next step is to engage with stakeholders, including councils, ratepayers and contractors, through this Discussion Paper. Stakeholders can respond to this Discussion Paper using our website feedback form ([hyperlink](#)) or by submitting a formal submission ([hyperlink](#)).

We are seeking feedback on:

- ▼ Whether stakeholders consider that there are issues with the prices charged for DWM services, and, if so, how we should respond, eg, whether any regulatory (or other) action is required.
- ▼ Potential options if regulatory action is required, noting that we would favour a less prescriptive approach. A proposed regulatory approach may include developing, in consultation with stakeholders:
 - A reporting, monitoring and benchmarking regime to develop a publicly available comparison tool comparing DWM charges for equivalent services across comparable councils
 - A publicly available centralised, comprehensive register of successful tender contract values for DWM services across councils
 - Pricing principles for DWM charges, to provide guidance to councils in setting DWM charges.
- ▼ The proposed pricing principles presented in Chapter 3.

After receiving and considering stakeholder submissions to this Discussion Paper, IPART may conduct a public hearing or workshop.

We will publish our decision on DWM charges for 2021-22 on the IPART website in September 2020, as part of our rate peg decision for local council general rates rather than as part of this review.

Our decisions arising from this review will likely inform our approach to DWM charges for 2022-23 and beyond.

1.4 Structure of this Discussion Paper

The remainder of this Discussion Paper is structured as follows:

- ▼ Chapter 2 outlines the potential key issues with DWM charges we have observed, and potential regulatory options, including a proposed regulatory approach for DWM charges if regulatory action is required.
- ▼ Chapter 3 sets out our proposed Pricing Principles for DWM charges.
- ▼ Appendix A provides an overview of the current state of play of DWM in NSW. This appendix was prepared for IPART by our consultant, Marsden Jacob Associates.
- ▼ Appendix B presents the results from the 2019-20 LGCI survey relating to DWM charges.

1.5 List of questions in this Discussion Paper

We are seeking general feedback from stakeholders in response to this Discussion Paper, as well as responses to specific questions including:

- 1 Is it a concern that DWM charges appear to be rising faster than the rate peg? Are there particular cost-drivers that may be contributing to this?
- 2 To what extent does the variation in services and charges reflect differing service levels, and community expectations and preferences across different councils?
- 3 Is there effective competition in the market for outsourced DWM services? Are there barriers to effective procurement?
- 4 Are overhead expenses for DWM services appropriately ring-fenced from general residential rates overhead expenses?
- 5 If IPART was to regulate or provide greater oversight of DWM charges, what approach is the most appropriate? Why?
- 6 Are there any other approaches that IPART should consider?
- 7 If a reporting and benchmarking approach was adopted, how could differences in services and service levels, as well as drivers of different levels of efficient cost, be accounted for?
- 8 Is there merit in IPART's proposed approach to developing a reporting, monitoring and benchmarking approach and pricing principles for setting DWM charges? Is it likely to be an effective approach? Why/why not?
- 9 Would IPART's proposed approach be preferable to audits of local councils' DWM charges by OLG?
- 10 Are there any issues that should be considered with regards to developing an online centralised database for all NSW councils' DWM charges to allow councils and ratepayers to benchmark council performance against their peers?

-
- 11 Do you agree with IPART's proposed pricing principles? Why/why not?
 - 12 Are there any other pricing principles or issues that should be considered?
 - 13 Could a centralised database and display of key elements of all successful DWM service contracts (eg, name of tenderer, service provided and contract amount) assist councils in procuring efficient services? If not, why not?

2. We seek feedback on DWM charges and potential options moving forward

This chapter seeks feedback on whether stakeholders consider that there are issues with the prices charged for DWM services and, if so, how we should respond.

It considers potential key issues with DWM charges that we have observed and presents potential oversight or regulatory options, including our proposed approach if, after consulting with stakeholders, we consider that action is required.

2.1 DWM charges may not reflect reasonable costs

We have undertaken some initial research and analysis of DWM charges in NSW, including asking councils to report on their DWM expenses and services as part of our 2019-20 LGCI survey. We have identified several key issues (outlined below) with DWM charges that indicate they may not reflect reasonable and efficient costs. In some cases they potentially undermine the general rate pegging process, and there may be a need to consider whether regulatory intervention is warranted.

Local councils are monopoly providers of DWM services

Through independent economic regulation, IPART aims to simulate the pressures of competition by setting maximum charges that reflect the efficient costs of providing services to consumers. In doing so, we aim to:

- ▼ Protect consumers by limiting the ability of monopolies to exercise market power
- ▼ Enable financial sustainability, whilst creating incentives for monopolies to invest prudently and efficiently, minimise costs and innovate
- ▼ Encourage consumers to use services efficiently.

Local councils, as the sole providers of DWM services in their local government areas, are essentially monopoly suppliers of these services. The vast majority of DWM service customers (ie, local council residential ratepayers), particularly in metropolitan local councils, are required to pay for DWM services and cannot opt out.⁶ That is, there is little or no competition in the market for the provision of DWM services to local council residents.

Councils are required to ensure that their DWM charges are calculated so as not to exceed the reasonable cost to the council of providing DWM services.⁷ However, particularly since 2016, there has been little oversight of this requirement. To date, IPART has not imposed any percentage limit on DWM charge increases.⁸

⁶ Section 496(1), Local Government Act.

⁷ Section 504(3), Local Government Act.

⁸ Though we note that IPART's ability to set maximum percentage variations for DWM charges likely acts as a deterrent.

DWM charges appear to be rising faster than the rate peg

Our preliminary analysis of OLG data indicates that in the four years of available data from 2014-15 to 2017-18, the weighted average of DWM charges across NSW has risen by:

- ▼ more than double (123%) the rise in the rate peg
- ▼ 178% more than inflation (see Figure 1.1 and Table 1.1).

There is wide variation in DWM charges across councils

We have also observed that there is wide variation in the number and type of DWM services and charges across councils, even across similar councils (see Figure 1.2).

In 2017-18, across all councils, the average annual DWM charge was about \$388. This represents about 40% (about \$1.2 billion) of the total revenue collected by councils from residential ratepayers.⁹

We recognise that variability in charges across councils may reflect a number of factors, such as differing service levels/types and community expectations and preferences across councils. For example, in some councils residents deliver their own waste to a DWM facility, whilst in others it is collected at the kerbside. However, we note there may be scope for greater transparency in DWM charges and services across councils.

Some councils appear to be in surplus for DWM services

Some councils appear to have over-recovered the costs of DWM services and are in surplus – at least for a period of time. Of councils responding to the LGCI survey, 75% reported a surplus for DWM services, averaging \$1.6 million (about \$81 million in aggregate) for 2018-19. The 25% of councils that reported a deficit had an average deficit of about \$0.4 million (about \$7 million in aggregate).¹⁰

We note that most councils reporting a surplus (94%) indicated they have plans to use it for capital replacements/works, site remediation and/or as a 'precautionary reserve'.

Outsourcing is common – effective competition and procurement may not be

The LGCI survey results indicate that contractor and consultancy costs are one of the largest cost categories in providing DWM services (accounting for 46% of DWM costs on average).¹¹

⁹ OLG times series data and IPART analysis.

¹⁰ IPART 2019-20 LGCI survey results and IPART analysis.

¹¹ IPART 2019-20 LGCI survey results and IPART analysis.

Many councils either fully or partially outsource the provision of DWM services (including 87% of councils surveyed), with a higher proportion of metropolitan councils appearing to outsource compared to rural councils.¹² However, it is not clear that there is effective competition in the market for such services, and there are a number of potential sources of market inefficiency in the domestic waste market, as well as barriers to effective procurement. These include the existence of a relatively concentrated market,¹³ barriers to entry for new entrants (such as high start-up and capital costs), information asymmetries and varying procurement capabilities and practices (see Appendix A, section A.4 and A.5). It is therefore not clear that contractor and consultancy costs reflect the reasonable and efficient cost of out-sourced DWM services.

Some councils seem to be allocating a high proportion of overheads

In addition to recovering contract costs for outsourced DWM services, some councils appear to be allocating overhead expenses that contribute more than half of total DWM costs, and the basis of these cost allocations is not necessarily apparent.

For councils responding to the LGCI survey, overhead expenses (on average) represent about 59% of DWM costs, whereas for residential rates expenses, overheads represent only 41% of expenses. For metropolitan councils, the proportion of overhead expenses appears comparatively higher at about 65% for DWM costs and 43% for residential rates expenses.¹⁴ There is a risk this could indicate cost-shifting from residential rates to DWM charges. That is, councils may be allocating overheads related to general residential services to DWM services (and hence charges), potentially undermining the rate pegging process.

Questions for stakeholders

- 1 Is it a concern that DWM charges appear to be rising faster than the rate peg? Are there particular cost-drivers that may be contributing to this?
- 2 To what extent does the variation in services and charges reflect differing service levels, and community expectations and preferences across different councils?
- 3 Is there effective competition in the market for outsourced DWM services? Are there barriers to effective procurement?
- 4 Are overhead expenses for DWM services appropriately ring-fenced from general residential rates overhead expenses?

¹² IPART 2019-20 LGCI survey results and IPART analysis.

¹³ For example, it is estimated that about 70% of waste collection services, 69% of MRF services and 98% of landfill services in Sydney are provided by the 3 largest service providers, respectively (Marsden Jacob analysis).

¹⁴ IPART 2019-20 LGCI survey results and IPART analysis.

2.2 If more oversight is appropriate, there is a range of potential options

IPART continuing to not limit percentage variations for DWM charges is an option¹⁵ but if greater oversight or regulatory intervention is necessary for DWM charges, there are a number of other potential options, which may include:

- ▼ Less intrusive regulation, such as:
 - Developing a set of pricing principles for setting DWM charges, as guidance for councils
 - Reporting enabling comparison of like services across similar councils
 - Detailed further investigation and regulation only applied to outlier councils
- ▼ IPART regulating price increases through setting maximum percentage variations for some or all DWM charges
- ▼ Other stakeholder suggestions.

We note that some of these options could be used in combination and that less intrusive regulation could be used to inform future IPART decisions on whether or not to set maximum percentage variations for DWM charges.

For example, a less intrusive approach such as reporting, monitoring and benchmarking and/or developing pricing principles could be used to support councils in pricing DWM services appropriately, by promoting greater transparency and public reporting of DWM charges.

Whilst there is no competition across councils for DWM services, there are 128 local councils in NSW. A large number of these councils, particularly in Sydney, Wollongong and Newcastle, are likely to face similar costs for common DWM services such as kerbside collection of general waste, recycling and organics.

DWM charge reporting could allow comparison of DWM charges across comparable councils for equivalent services (eg, kerbside collection) via a comparison table, made available on a NSW Government website and/or each council's website.

Such reporting would enhance transparency and could provide incentives to councils to ensure their DWM charges reflect reasonable and efficient costs, and are defensible. Under such a reporting regime, IPART's more detailed assessment and consideration of whether setting maximum percentage variations is appropriate may only be needed for outliers.

Questions for stakeholders

- 5 If IPART was to regulate or provide greater oversight of DWM charges, what approach is the most appropriate? Why?
- 6 Are there any other approaches that IPART should consider?
- 7 If a reporting and benchmarking approach was adopted, how could differences in services and service levels, as well as drivers of different levels of efficient cost, be accounted for?

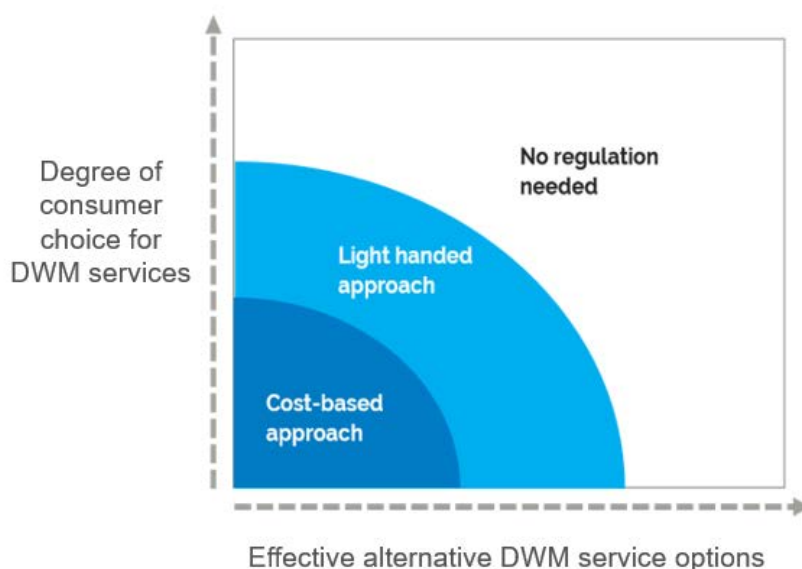
¹⁵ Noting that we cannot bind a future Tribunal.

2.3 We prefer a less prescriptive, more targeted approach if regulation is required

If regulatory intervention and/or oversight of DWM charges is required, our preliminary position is to favour a relatively less prescriptive, more targeted approach that focuses on information and guidance. This would minimise unnecessary regulatory cost and burden, such as the need for OLG to audit the basis for each council's DWM charges.

There is likely to be more need for regulation in markets that are not competitive. Figure 2.1 provides a framework for considering the appropriate approach for regulating DWM charges in NSW. The degree of regulation indicated depends on the extent of market power. Low consumer choice and a lack of effective alternative service options indicate greater regulatory intervention is likely to be required.

Figure 2.1 Assessing the degree of regulation required



As local councils are the sole provider of DWM services to residents, DWM customers have little choice of who provides DWM services and there is a lack of effective alternative DWM service options. Under the framework presented in Figure 2.1, a more intrusive approach to regulation (such as a detailed cost-based/building block approach) with IPART setting maximum percentage variations (DWM charge pegs) for councils may be appropriate.

However, we recognise that regulation itself comes at a cost and that the benefits of regulation should outweigh its costs. It is important to consider the costs of implementation, administration, compliance and enforcement of any regulatory approach.

We consider that the costs involved in setting annual maximum percentage variations (DWM charge pegs) for all councils would likely outweigh the benefits of doing so and our preliminary position is to favour a less prescriptive, more targeted approach if greater oversight or regulation is required.

We also note that the democratic process, which allows rate payers to vote councils in and out based on their levels of satisfaction with services and charges (amongst other factors), provides some check on councils' DWM charges.

2.4 If regulation is required, we propose a reporting regime and pricing principles

If regulation is required, we propose to develop, in consultation with stakeholders, a reporting, monitoring and benchmarking regime and pricing principles for setting DWM charges to:

- ▼ Improve transparency and council accountability in the setting of DWM charges
- ▼ Inform future regulatory decisions on DWM charges.

We consider this likely to be a more effective and less costly approach with lower regulatory burden than annual individual audits of all councils by OLG or the Audit Office, given informal stakeholder feedback indicating this audit process is a costly process. There may be scope to use targeted auditing of some councils' DWM charges as a complement to our proposed approach.

If, after considering stakeholder feedback, we consider that oversight or regulation of DWM charges is required, our proposed approach would be for councils to report high-level data on DWM charges for common services – eg, kerbside collection of general waste (red bin), recycling (yellow bin) and organics (green bin), council clean-up services and tip vouchers. This would allow a table to be developed that compares DWM charges for equivalent services across comparable councils. This would enhance transparency and council accountability, strengthening incentives for councils to ensure their DWM charges reflect reasonable and efficient costs and are justifiable, while also allowing us to identify outlier councils (eg, councils with noticeably higher DWM charges than comparable councils for equivalent services) for further investigation and potentially regulation. We propose that this comparison table be made publicly available on a NSW Government website and/or each council's website.

If we proceed with this approach, following feedback on the Discussion Paper, we would then consult and collaborate with OLG, local councils and other stakeholders to determine:

- ▼ Reporting requirements for local councils on DWM charges
- ▼ The most effective method, indicators and comparators for benchmarking and comparing local council DWM charges under a reporting regime.
- ▼ Appropriate pricing principles for setting DWM charges and how these would be applied.

We have drafted a proposed set of key pricing principles, which are outlined and discussed in Chapter 3. Such principles could be used to provide guidance to councils in setting DWM charges.

Under our proposed approach, local councils could be given a period of time (eg, two years) to ensure that DWM charges are reasonable when compared with similar councils/services.¹⁶

After this period, an assessment could be made as to whether all, a selected few outliers, or no councils would require further investigation and potentially maximum percentage variations to be set for those councils. As part of this assessment, we propose to assess outlier councils against our pricing principles on an 'exception' basis – eg, when councils

¹⁶ Discussed in detail in Chapter 3

which are outliers against comparable councils are unable to provide an adequate explanation as to factors that may contribute to them being outliers.

We consider this approach would enhance openness and transparency and enable outliers to either improve performance to a level that would prevent the need for IPART to specify the maximum percentage increase in DWM charges; or to justify why there is a case for their DWM charges to be materially different to other, comparable councils for similar services.

Questions for stakeholders

- 8 Is there merit in IPART's proposed approach to developing a reporting, monitoring and benchmarking approach and pricing principles for setting DWM charges? Is it likely to be an effective approach? Why/why not?
- 9 Would IPART's proposed approach be preferable to audits of local councils' DWM charges by OLG?
- 10 Are there any issues that should be considered with regards to developing an online centralised database for all NSW councils' DWM charges to allow councils and ratepayers to benchmark council performance against their peers?

3. We seek feedback on our proposed pricing principles for setting DWM charges

As part of IPART's function of determining whether or not to specify a percentage variation for DWM charges for some or all councils, we consider that IPART should apply a regulatory framework that promotes:

- ▼ Efficient cost-based pricing based on clear pricing principles
- ▼ Consideration of affordability.

In setting DWM charges, councils should ensure that DWM services match community needs and legislative requirements. DWM services should also be subject to clear quality and reliability standards.

The key objectives of pricing principles are to:

- ▼ Establish which categories of costs, including allocation of shared operational and capital costs, it is reasonable to recover in DWM charges from customers
- ▼ Promote practices that drive the quantum of those reasonable costs down to the efficient (least) cost for the given level of service
- ▼ Ensure that a council can generate revenue that is sufficient to meet its efficient costs, so that it can continue to supply DWM services to required standards over time
- ▼ Promote cost-reflective charges that send appropriate price signals to customers.

We consider that the implementation of sound pricing principles by local councils is a critical indicator of the need, or otherwise, for regulation.

Our preliminary view is that the proposed pricing principles outlined in Box 3.1 below should be applied to DWM charges set by local councils.

These pricing principles would provide guidance to local councils in setting their DWM charges. We would not audit councils' compliance with these principles. However, councils' consistent application of these principles would be important in supporting our proposed reporting and benchmarking approach. That is, to facilitate comparison, and avoid the potential need for IPART to determine the maximum percentage by which DWM charges can be varied, it would be important for councils to apply these principles.

We seek stakeholder feedback on our proposed pricing principles.

Box 3.1 IPART's proposed key pricing principles for DWM charges set by councils

- 1. DWM charges should reflect a 'user pays' approach**
 - ▼ DWM charges should recover the costs of providing DWM services, not the councils' other functions and services
 - ▼ Incremental cost allocation should be applied
 - ▼ Social programs should be funded from general rates revenue
- 2. Only reasonable cost categories should be reflected in DWM charges**
- 3. DWM charges should reflect efficient costs**
- 4. DWM charges should be transparent**
 - ▼ To assist local councils
 - ▼ To assist customers
- 5. DWM charges should seek to ensure price stability**

To give effect to these pricing principles, local councils need to be able to answer the following questions:

- ▼ Which costs should be recovered?
- ▼ How should DWM charges be structured?
- ▼ Are cost recovery charges based on efficient costs?

We further explain our proposed pricing principles in the sections below.

3.1 DWM charges should reflect a 'user pays' approach

Customers should pay for the full reasonable costs of the DWM services they receive. This is important for ensuring that:

- ▼ Councils' recover their costs, and hence are able to continue to provide appropriate levels of service
- ▼ Customers face appropriate price signals, which means they are more likely to efficiently use DWM services over time (although this also largely depends on how DWM charges are structured).

The 'full cost' represents the value of all the resources used in the provision of a service – including the costs of complying with any environmental or other regulatory requirements in the supply of the service. In addition to the costs directly associated with the service, the full cost includes an appropriate allocation of indirect costs and capital costs.

Cost reflectivity of DWM charges

The Local Government Act specifically prohibits applying income from ordinary rates to DWM services and requires that income obtained from DWM charges must not exceed the reasonable cost to the council of providing those services.¹⁷

This means that there should be no cross-funding from the DWM function to general council activities and vice versa. This may occur when the allocation of common costs between the DWM function and a council's general activities is not appropriate – ie, when the level of costs allocated to DWM services results in DWM charges that exceed the reasonable and efficient costs of providing DWM services.

It is also important that individual DWM services charges (eg, for general waste, recycling and organic waste bin collection) reflect the cost of providing those individual services.

Incremental (additional)¹⁸ cost allocation for DWM services

We consider that councils' core business is the functions it funds through general rates and that the costs assigned to DWM services should only be the incremental cost of providing that service over and above councils' core functions. The incremental cost approach can also be described in the reverse as the cost that would disappear (or be avoided) for councils if they did not provide DWM services.

The incremental cost approach is important in councils' consideration of whether to outsource DWM services (see Box 3.2 below). A consistent approach across councils to setting prices for DWM services is also important under our proposed reporting and benchmarking regime. Therefore, we consider councils should set their DWM charges on an incremental cost basis.

¹⁷ Section 504 Local Government Act.

¹⁸ In this discussion paper we are using the term incremental cost to mean the same as marginal cost or "additional" cost. A convenient way to consider the difference between average and incremental is batting scores. Before his last test innings Don Bradman had 6,996 runs. He had been dismissed 69 times. The Don was bowled for a duck in his last innings. His batting **average** was therefore 99.94. But the incremental score in the last innings (the addition to his total) was zero.

Box 3.2 Incremental cost approach and testing the market

A significant number of local councils provide in-house DWM services. The NSW Audit Office noted in its performance audit of Campbelltown and Fairfield councils that Fairfield council provided in-house DWM services, its charges were 7% above the NSW metropolitan average and it had not tested the market by way of open tender.^a

If a council is comparing the cost of contracting out DWM services to providing these services itself, it needs to ensure that it considers the council's incremental cost of providing DWM services as opposed to the average cost. This is because it is only the incremental costs that disappear if the council contracts out. If a council contracts out based on a competitive tender that is lower than the council's average cost of providing the service but not lower than its incremental cost, then the total cost of all council functions would increase and ratepayers' total bills would rise, not fall.

Example: Assume a council had 1,000 employees: 800 in general functions, 200 solely in DWM services, and 40 in HR and IT. The combined cost of HR and IT is \$4,000,000. An average cost approach would see \$800,000 ($\$4,000,000 \times (200/1000)$) of overhead costs allocated to DWM services.

However, there is generally always a fixed component of overhead expenses in any organisation. In the event that DWM services were outsourced, it is unlikely that the HR or IT managers' salaries would be cut by 20% and a number of other positions would still be necessary whether DWM services are carried out in-house or not. It might be that only 4 FTE positions can be reduced from HR and IT if DWM services were contracted out. In this case, the incremental cost approach would yield a value of \$400,000 of overheads allocated to DWM services.

^a Audit Office of NSW, Domestic waste management in Campbelltown City Council and Fairfield City Council, 5 June 2019, pp 16.

If a council has been over-allocating costs to DWM services using an alternative method (rather than an incremental cost approach) then this could be remedied, all other things being equal, by lowering the DWM charges to the efficient cost-reflective level and seeking a special variation to increase general rates by the equivalent amount.

Pensioner and hardship subsidies

If local councils provide discounts to disadvantaged customers then this subsidy should be funded from general revenue and not from DWM customers. To increase DWM charges or to use DWM reserves to fund subsidies would not reflect a user pays approach, as DWM charges would no longer reflect the proportion of costs customers impose on the system. Subsidies should be funded through general rates revenue rather than DWM charges.

3.2 Only reasonable cost categories should be reflected in DWM charges

Having established that the incremental cost approach should be used in allocating common costs to DWM service costs, we consider that councils should include the following as reasonable costs of providing DWM services in setting DWM charges:

Operating Expenditure

- ▼ Direct contract costs (if DWM services are outsourced)
- ▼ Direct labour costs
 - Salaries
 - Labour on-costs (eg, superannuation, long service leave)
- ▼ The incremental cost of indirect/joint costs, such as corporate overhead costs
 - This would only be the cost removed or avoided if providing DWM services was no longer a local council function, eg, the reduction in *actual* HR/IT staff numbers and office space lease payments
- ▼ Direct lease costs
- ▼ Direct material costs
- ▼ Vehicle allowance (if DWM services are outsourced)
 - If vehicles are shared amongst other local council functions, then a mileage allowance per kilometre should be applied rather than capital costs.

Capital Costs

Councils should establish a separate DWM services asset base/register for this purpose. DWM charges should recover allowances for a return on assets and return of assets.

- ▼ Return on assets:
 - This is a rate of return based on the depreciated value of direct assets for DWM services that the council has purchased including land (eg, for landfill)¹⁹, garbage trucks, equipment and bins.
 - The rate of return should be based on the council's discount rate as published by IPART every February and August. Currently, the rate of return is 3.6%.²⁰
- ▼ Return of assets (regulatory depreciation):
 - This is the cost of consumption or wearing out of fixed assets in a year. It should be based on straight line depreciation. For example, if a general waste bin has an average life of five years and costs \$100, then the return of assets charge will be \$20 per year for five years.

¹⁹ Remediation costs, particularly for land-fill sites can be substantial. The estimate of these costs should be capitalised (ie, added to the cost base) and recovered over the life of the land-fill.

²⁰ IPART, <https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/local-government-contribution-plans-research-net-present-value-modelling-2015-onwards/fact-sheet-local-government-discount-rate-february-2020.pdf>, accessed 12 August 2020.

DWM service costs that are not included in reasonable costs

The NSW State Government currently imposes a waste levy on all waste that is disposed of in landfill. This is currently set at \$146.00 per tonne in metropolitan areas.²¹ This funds the *Waste Less, Recycle More* initiative. The initiative provides grants and funding for activities such as improving recycling behaviour.²² Where funding is received by councils from the scheme for education, inspection and enforcement, then the cost of providing the services funded by the scheme should be deducted from the reasonable cost of providing DWM services. This is to ensure there is no double counting and over-recovery by councils.

3.3 DWM charges should reflect efficient costs

Having established the categories of costs that it is reasonable to charge customers for, we consider that an equally important task is to ensure that these costs are the minimum or efficient cost achievable by the council.

Benchmarking costs of DWM service provision across local councils could enable assessment of whether costs may be efficient.

Given that many councils either fully or partially outsource DWM service provision, and contractor and consultancy costs represent a large portion of DWM costs, it is important to ensure contractor and consultancy costs are efficient. Where a council has outsourced some or all of their DWM service provision in a competitive and contested tender using best practice procurement approaches and processes, the result of this tender could be considered as the efficient cost of providing the DWM service(s).

However, there may be aspects of contracting and procurement that act as a barrier to effective competition and reduce the ability of councils to achieve efficient costs (see Appendix A, section A.4 and A.5). For example, the length of contracts and contract provisions may in some cases prevent councils from achieving efficient costs. An inability to benchmark contractor costs due to confidentiality clauses in contracts, limited negotiating power of councils and a potential lack of guidance and/or experience in best practice procurement approaches and processes may also contribute to this.

Length of contracts/time between market testing

While market testing and benchmarking will help establish efficient costs, there is a question as to how long contracts should be written for and/or how long councils should continue with in-house provision of the DWM service before they retest the market.

²¹ NSW EPA, <https://www.epa.nsw.gov.au/your-environment/waste/waste-levy/levy-regulated-area-and-levy-rates>, accessed 12 August 2020. The waste levy is \$84.10 per tonne in regional areas.

²² <https://www.epa.nsw.gov.au/your-environment/recycling-and-reuse/waste-less-recycle-more>. accessed 12 August 2020

Current contract provisions may be a barrier to entry

In establishing efficient costs, councils may need to consider what contract provisions will deliver the lowest costs to ratepayers. For example:

- ▼ If contracts were written for the average expected life of the major capital assets, would this reduce the risk to contractors and elicit lower tender bids?
- ▼ Would overall costs be minimised if councils bought the capital equipment and contractors submitted tenders to supply only the operational component of DWM, including maintenance of equipment?

3.4 DWM charges should be transparent

We consider that DWM charges, how they are set and the costs they are based on should be simple and transparent.

Enhancing competition and transparency for councils

Benchmarking of DWM contracts across NSW would likely increase transparency for local councils and potentially assist in minimising the cost of DWM services to local councils that outsource these services.

We note that:

- ▼ Councils must undertake open tenders for contracts over \$250,000²³
- ▼ An alphabetical list of tenderers must be prepared and publicly displayed²⁴
- ▼ Where a tender is successful, the name of the tenderer and the contract amount must be made public.²⁵

Given the above, it would appear that a centralised, comprehensive register of successful tenders across councils could be developed and made public. We consider that this could help address information asymmetries in the DWM service market where there are currently a small number of suppliers and a large number of councils.

Enhancing transparency for customers

The DWM charge customers face for each service should be simple and transparent. There should ideally be a separately identified charge for each service: general waste (red bin), recycling (yellow bin) and organics (green bin) and kerbside pickup and/or tip vouchers. Where councils offer different size bins, the costs should be separately displayed. Under our proposed approach, this would enable councils to compare themselves against other councils, helping them to find potential opportunities for efficiencies. It would also empower ratepayers/customers to scrutinise their own council's charges and compare DWM charges and service provision with other councils.

²³ *Local Government Act 1993* (NSW) s. 55

²⁴ *Local Government (General) Regulation 2005* Cl 175 (3).

²⁵ *Local Government (General) Regulation 2005* Cl 179 (b).

3.5 DWM charges should seek to ensure price stability

We consider that DWM charges should seek to ensure price stability to reduce bill impacts on customers.

Councils may wish to transition DWM service charges and surpluses/deficits in the DWM service reserve over a small number of years to prevent large fluctuations in prices. Spreading capital costs over the life of the assets as discussed earlier, rather than charging them in the year of purchase, also helps to stabilise charges. The special variation process could also be used by councils wishing to introduce changes in rates or charges over a number of years, to avoid price shocks.

Questions for stakeholders

- 11 Do you agree with IPART's proposed pricing principles? Why/why not?
- 12 Are there any other pricing principles or issues that should be considered?
- 13 Could a centralised database and display of key elements of all successful DWM service contracts (eg, name of tenderer, service provided and contract amount) assist councils in procuring efficient services? If not, why not?

Appendices

A. Overview of DWM in NSW

To undertake analysis and provide input to this review, it is important to understand the context in which NSW local councils operate their DWM services. The sections below have been prepared by our consultants, Marsden Jacob Associates, and provide more information on the following:

- ▼ The role of local councils in DWM
- ▼ The way in which local councils provide DWM services
- ▼ The structure of the DWM market, and market concentration
- ▼ Barriers to entry to the DWM market.

A.1 The role of local councils in DWM

In 2017-18, more than 21.4 million tonnes of waste was generated in NSW. Of this, NSW councils collectively were responsible for the management of 4.25 million tonnes of municipal solid waste (MSW),²⁶ of which 3.5 million tonnes is domestic waste.²⁷

Domestic waste collection, recycling and disposal management is a major responsibility for local councils, and is a significant function socially, environmentally and economically. In recent years, the waste sector has undergone significant change due to shifts in domestic and global markets, government policies (such as import and export bans, and recycling targets), as well as community expectations about what happens to their waste.²⁸

²⁶ MSW is solid waste from households and local government operations, including waste placed at the kerbside for local council collection and waste collected by councils from municipal parks and gardens, street sweepings and public council bins.

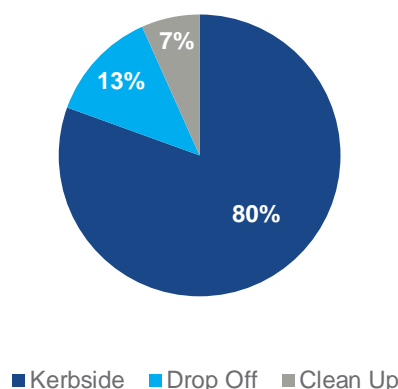
²⁷ NSW Environment Protection Authority (EPA), *NSW Local Government Waste and Resource Recovery (LG WARR) Data Report, 2017-18, Excel Appendix*.

²⁸ NSW Department of Planning, Industry and Environment, *Cleaning Up Our Act: The Future for Waste and Resource Recovery in NSW – Issues Paper*, March 2020, pp 4, 23.

A.1.1 DWM services being provided by NSW local councils

NSW local councils provide a range of DWM services to their residents, including kerbside collection, drop-off facilities and periodic clean-up services, with the vast majority of waste coming from kerbside collection (see Figure A.1).

Figure A.1 DWM services, proportion of waste by source (by weight)



Data source: NSW EPA, *LG WARR Data Report, 2017-18, Excel Appendix*.

Because NSW local councils determine the suite of DWM services to be provided to their area, there is considerable variation in the services being provided to residents, particularly where organic and dry recycling services are concerned.

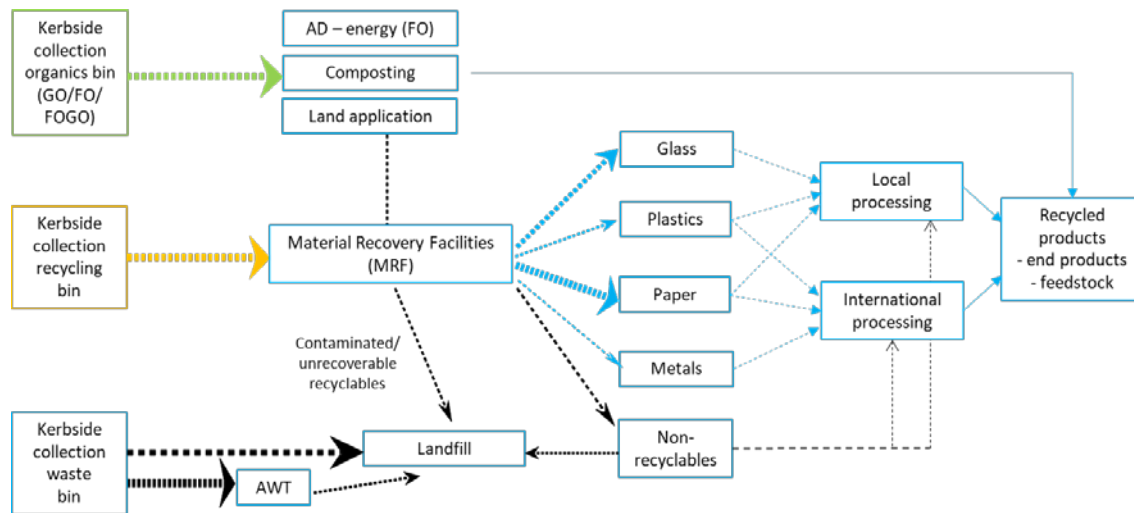
In 2017-18, NSW councils provided the following kerbside collection services to residents:

- ▼ All NSW councils provided a residual waste collection service
- ▼ 87.5% of NSW councils provided a dry recyclables collection service
- ▼ 39% of NSW councils provided an organics collection service
- ▼ Some councils also provided a number of drop-off services (81%) and clean-up services (62%).²⁹

As Figure A.2 illustrates, waste that is collected through the kerbside system either becomes recycled products (end products or feedstock), energy or is landfilled.

²⁹ NSW EPA, *LG WARR Data Report, 2017-18, Excel Appendix*.

Figure A.2 DWM services value chain



Note: “FO” refers to “food organics”, “GO” refers to “garden organics”, “AD” refers to “anaerobic digestion”, “AWT” refers to “alternative waste treatment”.

Data source: Marsden Jacob Associates analysis.

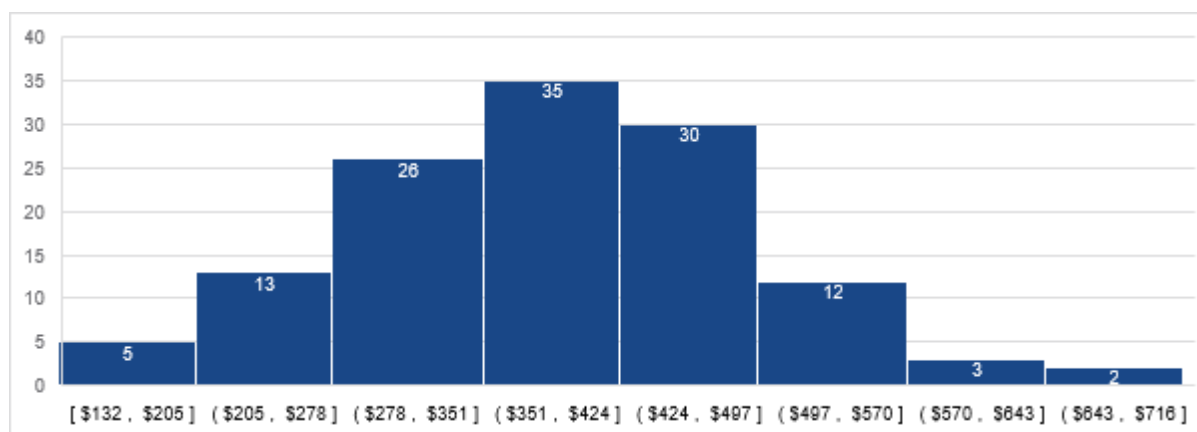
Key parts of the DWM service value chain include:

- ▼ Materials recovery facilities (MRF) – these handle a range of recyclables. At the MRF, materials are sorted into individual material streams before being sent for recycling.
- ▼ Composting facilities – where organic waste is converted into compost.
- ▼ Anaerobic digestion (AD) – a process where organic materials are decomposed by naturally occurring micro-organisms in the absence of oxygen to produce energy.
- ▼ Alternative waste treatment (AWT) – mechanical, biological and (sometimes) thermal processes to separate materials from a mixed residual waste stream (household waste).

A.1.2 DWM charges

To recover the cost of DWM services, local councils levy a DWM charge which is separate to ordinary rates.³⁰ There is considerable variation in councils' DWM charges. In 2017-18 the average annual DWM charge ranged from \$132 to \$710.³¹

Figure A.3 DWM charges, average by local government area, 2017-18



Data source: NSW EPA, *LG WARR Data Report, 2017-18*, Excel Appendix.

On average, local councils in waste levy³² paying areas have higher DWM charges than rural councils. However, there is considerable variability in the DWM charges being levied by different councils. This variability, in part, is likely a result of differences in local council characteristics (eg, density may affect average costs), underlying costs, and services provided. However, it cannot be wholly explained by the waste levy (see Figure A.4) and/or differences between councils. As discussed below, other possible explanations for this variability include:

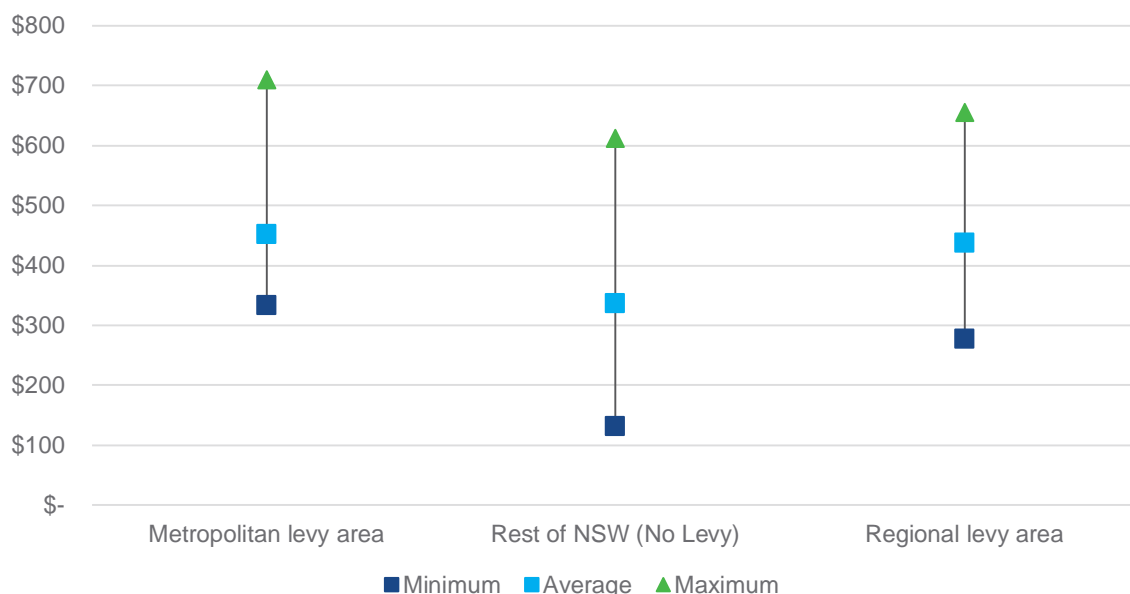
- ▼ The presence of barriers to entry to the domestic waste collection and management market, reducing competitiveness in the market
- ▼ Potential cost-shifting across council business units
- ▼ Procurement challenges, resulting from:
 - Information asymmetries, eg, with regards to contract costs
 - Regulatory hurdles, such as ACCC approval requirements for joint tendering by councils.

³⁰ Councils must not apply income from ordinary rates towards the cost of providing DWM services. Income to be applied towards the cost of DWM services must be obtained from annual charges and/or charges for services (s. 504, Local Government Act).

³¹ NSW EPA, *LG WARR Data Report 2017–18*, Excel Appendix.

³² The *Protection of the Environment Operations Act 1997* (NSW) requires certain licensed waste facilities in NSW to pay the EPA a contribution for each tonne of waste received at the facility. Referred to as the 'waste levy', the contribution aims to reduce the amount of waste being landfilled and promote recycling and resource recovery. The waste levy applies in the regulated area of NSW, which comprises the Sydney metropolitan area, the Illawarra and Hunter regions, the central and north coast local government areas to the Queensland border, as well as the Blue Mountains, Wingecarribee and Wollondilly local government areas.

Figure A.4 DWM charge, by waste levy zone, 2017-18



Data source: NSW EPA, *LG WARR Data Report, 2017-18*, Excel Appendix.

A.2 Local council DWM service delivery models

Three broad delivery models are used by local councils in the provision of their DWM services:

- ▼ **In-sourced:** Local council service provision using their own resources
- ▼ **Outsourced:** Waste service contractors are engaged to provide the services on the council's behalf.
- ▼ **Combination:** Some councils have a combination of service models, for instance collection might be undertaken by a waste service contractor while the council manages the local landfill or material recovery facility.

Preliminary analysis undertaken for this paper suggests that most local councils now outsource their DWM functions, including collection, transfer/recycling and disposal services. An estimated 95% of councils outsource at least one of these DWM functions and a significant majority of metropolitan councils contract out all functions (Table A.1).

This has been the case for quite some time, with the Productivity Commission observing in 2006 that most local council DWM functions were outsourced.³³ To facilitate this, councils are increasingly entering into partnerships with other councils to share waste disposal and resource recovery facilities, and to access more favourable waste management contracts. A number of local councils, predominantly in non-metropolitan areas, still provide some or all of their own DWM functions.

³³ Productivity Commission, *Waste Management Productivity Commission Inquiry Report*, 20 October 2006, p 56.

Table A.1 DWM services contracted out by local councils

Service contracted	Number of councils	%	Households serviced	%	Tonnage	%
All councils						
	128		3,087,985		3,582,551	
Contract out collection	80	63%	2,434,951	79%	2,799,968	78%
Contract out MRF	82	64%	1,657,663	54%	407,056	52%
Contract out organics	117	91%	2,723,398	88%	569,351	82%
Contract out Landfill	97	76%	2,282,886	74%	1,531,182	73%
Metropolitan councils^a						
	33		1,741,388		1,878,186	
Contract out collection	30	91%	1,567,249	90%	1,690,367	90%
Contract out MRF	26	79%	1,281,752	74%	308,347	77%
Contract out organics	31	94%	1,581,446	91%	258,660	87%
Contract out Landfill	31	94%	1,682,666	97%	1,136,053	96%

^a Does not include Newcastle, central coast or Wollongong councils.

Source: NSW EPA, *LG WARR Data Report, 2017-18*, Excel Appendix; IPART 2019-20 LGCI survey results and MJA analysis.

A.3 Costs of DWM services

Costs to local councils of providing DWM services can vary considerably, both between service type and between metropolitan and regional/rural areas. This variability, in part, is likely attributed to differences in local council characteristics (eg, density may affect average costs), underlying costs, and services provided.

Figure A.5 provides estimates of indicative charges to metropolitan councils of the different DWM services, showing estimates of the cost components of those charges.

Figure A.5 Indicative charges to metropolitan councils of waste services (\$/tonne)

Service/bin type	Bin size	Input costs								Total costs		
		Collection costs		Bin costs (capital costs)		Processing / disposal costs**		Waste levy		\$/lift	\$/tonne collected	\$/bin/year collected
		\$/lift	\$/tonne collected	\$/lift	\$/tonne collected	\$/lift	\$/tonne collected	\$/lift	\$/tonne collected			
Red Bin	80ltr	\$1.04	\$118.77	\$0.07	\$8.42	\$0.66	\$75.45	\$1.18	\$135.21	\$2.96	\$337.85	\$154.26
	140ltr	\$1.08	\$97.84	\$0.09	\$8.06	\$0.77	\$69.76	\$1.42	\$128.25	\$3.35	\$303.92	\$165.67
	240ltr	\$1.20	\$85.81	\$0.11	\$8.17	\$0.93	\$66.59	\$1.58	\$112.67	\$3.82	\$273.24	\$183.54
	All*	\$1.12	\$94.01	\$0.10	\$8.12	\$0.82	\$68.76	\$1.45	\$122.21	\$3.49	\$293.09	\$171.29
Yellow	240ltr	\$1.53	\$196.38	\$0.18	\$23.70	\$0.47	\$60.82			\$2.18	\$280.90	\$65.06
Green	240ltr	\$1.34	\$154.82	\$0.17	\$20.15	\$0.52	\$60.00			\$2.03	\$234.97	\$81.03
Average 3 bins*		\$1.28	\$128.40	\$0.14	\$13.87	\$0.65	\$65.34			\$2.08	\$279.53	\$104.96
Total 3 bins		\$3.98	\$445.21	\$0.46	\$51.97	\$1.81	\$189.58			\$7.70	\$808.97	\$317.39

Notes: Weighted averages across metropolitan and regional councils. Excludes AWD costs covering red bin services for some metro councils. These figures are approximations only.

* Weighted averages across bin sizes and types.

** Either landfill costs or processing costs.

Data source: NSW EPA, *LG WARR Data Report, 2017-18*, Excel Appendix; IPART 2019 Local Government Cost Index Survey; Marsden Jacob Associates analysis.

Costs and charges to regional and rural councils for these services are generally 20-50% higher than for metropolitan councils. This generally reflects lower throughput and higher unit operating costs.

A.4 Barriers to entry and sources of inefficiency in DWM markets

We have identified a number of characteristics of the DWM market that could potentially undermine its efficiency – including high market concentration³⁴ in particular segments and/or regions, high cost of market entry, market and price risk, and weak incentives to households – with different issues presenting at different points in the value chain, as summarised in Table A.2.

³⁴ Market concentration refers to the extent to which market shares are concentrated between a small number of firms and reflects the level of competition within the market.

Table A.2 DWM market issues

Issue	Collection	MRF	Post MRF processing
Market concentration	It is estimated that about 70% of waste collection services, 69% of MRF services and 98% of landfill services in Sydney are provided by the 3 largest service providers.	The largest providers of MRF services are in metropolitan areas. There is considerable geographic segmentation of industry operations, which can increase market concentration in specific areas, with many operators focusing on particular regions.	There are relatively few domestic recyclers with significant scale, but the number and scale of operations is increasing through infrastructure grant support from the NSW Government.
Market incentives/disincentives	There is no incentive for consumers to avoid putting contaminants in recycling bins. There are limited incentives for collectors to avoid breakages and cross-contamination. There is limited incentive for councils to ensure no contamination.	There is limited incentive for councils to monitor outputs of MRFs. The landfill levy provides an incentive to maximise recovery.	The landfill levy provides an incentive to maximise recovery.
Barriers to entry and competition	Capital intensive – sufficient fleet scale is needed for viable operations. Larger operators also have greater opportunity to optimise vehicle usage. Because solid waste collection is an essential basic service, consistency of supply is important. This means that established firms, with a good reputation and extensive operations, have a greater ability to reassure councils that services will be maintained without interruption. New firms therefore find it difficult to break into the market.	Capital intensive (advanced sorting technologies required). Declining prices for some materials, even when sorted (glass, paper). A lack of competition is evident, with MRF numbers limited in both metropolitan and regional areas. This, combined with high transport costs, restricts council access.	Capital intensive. Lack of guaranteed supply of quality feedstock. There is falling demand for some products/materials (especially glass containers).
Barriers to efficient markets	Significant fixed costs mean existing suppliers and entrants seek long term contracts for investment certainty. This limits flexibility in the face of changing markets. Geographic boundaries can also be present, as service providers need to have a physical presence in the locations where they provide services.	Contaminated/unsorted waste at source and breakages increase costs and greatly reduce the value of outputs. High transport costs to processors, especially from regional/rural areas. Asset ownership can be a source of flexibility (if assets are owned by councils) or a barrier to new entrants if key assets are privately owned.	High transport costs to recyclers, especially from regional/rural areas.
Information asymmetries (procurement, data collection, reporting and monitoring)	There is consumer uncertainty about what can be recycled and where recyclables go once they leave the kerbside. There is imperfect data on the quantity and quality of materials leaving the kerbside/entering MRFs – bin audit processes are inconsistent.	There is limited data on outputs from MRFs – quantity, quality and destination of materials. No agency is charged with this task. Councils have limited capacity. The timing of service procurement can have an important influence on cost to councils, particularly as the price of recyclable output can be volatile.	There is limited data on what material is being reprocessed and where. The timing of service procurement can have an important influence on cost to councils, particularly as the price of recyclable output can be volatile.

Source: IBISWorld, *Solid Waste Collection Services in Australia – Industry Report D2911*, March 2019, pp 18-21; Marsden Jacob Associates analysis.

Barriers to entry to the market for DWM services are highlighted by the high concentration of DWM service provision. For example, it is estimated that about 70% of waste collection services, 69% of MRF services and 98% of landfill services in Sydney are provided by the 3 largest service providers, respectively.

A.5 Procurement

Procurement of waste services by the private sector, and in some cases not-for-profits, is a significant function for local councils across NSW. Contracts are extensively used by local councils to procure these services. These contracts are usually adapted to suit the requirements of the local council area, however, there are many features of the contracts that are common. Contracted services include:

- ▼ Waste collections from residential premises (general waste/recycling/organics/bulky clean-up)
- ▼ Processing and resource recovery from general waste
- ▼ Processing of recyclables
- ▼ Processing of organics (garden organics and/or food waste)
- ▼ Processing/management of bulky clean-up waste
- ▼ Management of facilities (eg, landfills, recovery facilities, transfer stations, depots)
- ▼ Bulk haulage of waste
- ▼ Special services (eg, distribution of bins/food waste caddies, repairs and maintenance)
- ▼ Waste call centre services
- ▼ Development and/or delivery of community education.

Notwithstanding these common features, councils face a number of challenges and potential barriers to efficient procurement of waste services.

A.5.1 Lack of procurement experience

Local councils only procure major waste services every few years, unlike the waste service providers, who are routinely tendering and negotiating contracts. Lack of experience in procurement strategy, market analysis and contracts – experience required for effective contract negotiation – can present as a key challenge for council officers. Councils are reliant on there being a highly competitive marketplace to ensure they are achieving cost-efficient service outcomes.

However, as discussed in section A.4, there can be significant barriers to entry to the waste services market, which can limit competition and local councils' ability to minimise the cost of DWM service provision. For instance, in regional locations, if the incumbent service provider owns key infrastructure that does not revert to the council when the contract expires, this can be a material barrier to potential new entrants.

A.5.2 Legislated requirements

When local councils procure DWM services they must adhere to the Local Government Act. Two key principles govern the exercise of functions by councils under section 8A of the Local Government Act:

- ▼ Councils should carry out their functions in a way that represents the best possible value for residents and ratepayers, and
- ▼ Councils should work co-operatively with other councils to achieve desired outcomes for their communities.

Section 55 (Requirements for tendering) of the Local Government Act requires councils to invite tenders before entering into contracts, such as contracts for the supply of waste collection and processing services and the provision of waste processing facilities.

The *Local Government (General) Regulation 2005* stipulates a number of further requirements for proposed contracts for domestic or other waste management services. The requirement to invite tenders also applies to joint organisations of councils pursuant to section 400ZH (3)(c) of the Local Government Act.

A.5.3 Joint procurement by councils

Local councils may jointly procure DWM services. However, council groups routinely obtain ACCC authorisation to remove any risk of breach of the *Competition and Consumer Act 2010* (Cth) (CCA).

By conducting aspects of the procurement process jointly, councils risk breaching competition laws, as councils may be considered competitors when seeking to procure DWM services. In particular, there may be a risk of breaching the prohibitions against cartel conduct³⁵ and arrangements which have the purpose or effect of substantially lessening competition.³⁶

Council groups proposing to jointly procure DWM services often seek authorisation from the ACCC, which gives legal protection for the proposed conduct.

This requirement may be perceived as a barrier to joint procurement. However, the ACCC has approved joint procurement arrangements for more than 30 council groups, often for lengthy periods, in recognition of the public benefits of such arrangements. For instance, in 2018 the ACCC granted authorisation to Camden Council, Campbelltown City Council, Liverpool City Council, Wingecarribee Shire Council and Wollondilly Shire Council (the Applicants) to collectively tender and contract for waste processing services until 1 July 2044.³⁷

³⁵ Division 1 of Part IV of the CCA.

³⁶ Section 45 of the CCA.

³⁷ <https://www.accc.gov.au/update/accc-authorises-collective-waste-tendering-by-five-nsw-councils>.

A.5.4 Misalignment between length of contracts and the external operating environment

A number of issues arise with DWM service procurement because waste services are typically procured over the medium to long term (several years), but contracting arrangements need to be agile enough to react to a wide variety of influences, such as changing market and policy circumstances. This means that each contract is different to the last as the operating environment is continually changing.

Issues with DWM service contracts can arise from exogenous factors, such as:

- ▼ International market impacts (such as the impact of import and export bans)
- ▼ Regulatory changes regarding such matters as mixed waste organics outputs (in NSW)
- ▼ Introduction of the container deposit scheme
- ▼ Changes to insurance/liability requirements.

In addition to these external effects on waste management contracts, councils face challenges when negotiating contracts. Most particularly, capturing an agreement which all parties understand, and which supports an improved and innovative allocation of largely public monies, is challenging particularly when there can be many years between procurement actions by councils.

B. Results of 2019-20 LGCI survey relating to DWM

As part of IPART's 2019-20 LGCI survey, we asked councils about their DWM services, procurement and costs.

We asked councils:

- ▼ To describe the DWM services provided by the council
- ▼ What the council's policy on setting DWM charges is
- ▼ Whether the council outsources the processing and disposal of waste and if so, what procurement processes are in place
- ▼ The basis for cost allocation between the council's domestic waste and general operations
- ▼ What has been the financial performance of the council's domestic waste operation over the last two years.

This appendix presents results of the 2019-20 LGCI survey, as well as the results of further desktop research and analysis.

Notable limitations of the survey include that:

- ▼ Only about 52% of councils returned a response
- ▼ The majority of question responses were free text, resulting in responses that were not necessarily uniform in nature
- ▼ Not all responding councils provided a response to each question
- ▼ Given that councils self-reported, response bias is possible.

B.1 Survey results: Response rate

Table B.1 Survey responses by area classification

	Metropolitan	Regional	Rural	All councils
Number of councils	34	37	57	128
Number of councils that responded	28	20	19	67
Response rate (%)	82%	54%	33%	52%
% of councils that responded	42%	30%	28%	100%

Source: IPART 2019-20 LGCI survey results and IPART analysis.

B.2 Number of and average DWM charges

Table B.2 Number of different DWM charges for councils responding to LGCI survey

	Minimum	Maximum	Median	Average
Base DWM charges	1	13	3	4
Additional DWM charges	0	24	5	6
Total	2	34	9	10

Source: IPART 2019-20 LGCI survey results, individual council websites and IPART analysis.

Table B.3 DWM charges over time 2011-12 to 2017-18 (average DWM charge (\$/year))

Average DWM charge (\$/year)	2011-12	2017-18	% change from 2011-12 to 2017-18	Average annual % change	% of bill (ie, residential rate & DWM charge)
Metropolitan councils					
Number of councils	43	33			
Average annual DWM charge	348	469	35%	6%	29%
Average annual residential rate	881	1121	27%	5%	
Regional councils					
Number of councils	38	36			
Average annual DWM charge	268	349	30%	5%	25%
Average annual residential rate	854	1,100	29%	5%	
Rural councils					
Number of councils	71	56			
Average annual DWM charge	230	367	59%	9%	33%
Average annual residential rate	470	616	31%	6%	
All councils					
Number of councils	152	125			
Average annual DWM charge	273	388	42%	6%	29%
Average annual residential rate	682	889	30%	5%	

Source: OLG time series data, and IPART analysis (not including inflation).

B.3 Survey results: Outsourcing

Table B.4 Percentage of councils that report outsourcing DWM services

	Metropolitan	Regional	Rural	All councils
Fully outsource	64%	30%	21%	42%
Partially outsource	29%	65%	47%	45%
No outsourcing	7%	5%	32%	13%
Total	100%	100%	100%	100%

Source: IPART 2019-20 LGCI survey results and IPART analysis.

Table B.5 DWM service type outsourced by outsourcing councils, by area classification

Outsourced DWM service	Metropolitan	Regional	Rural	All reporting councils
Collection/transportation	69%	58%	77%	67%
Recycling processing	73%	89%	62%	76%
Organics processing	62%	63%	0%	48%
Landfill/waste disposal	77%	26%	38%	52%

Note: Not all councils provided responses to this question.

Source: IPART 2019-20 LGCI survey results and IPART analysis.

Table B.6 Procurement approach used by outsourcing councils, by area classification

	Metropolitan	Regional	Rural	All councils
Mixed model	25%	80%	58%	51%
Open tender only	39%	5%	0%	18%
Select tender only	4%	0%	0%	1%
Regional-based tendering arrangement only	0%	5%	5%	3%
Unknown tender arrangement	25%	5%	5%	13%
Not applicable	7%	5%	32%	13%
Total	100%	100%	100%	100%

Note: Mixed model procurement involves more than one type of procurement approach. "Open tender" refers to a competitive procurement approach open to all. "Select tender" refers to a procurement approach where tenders are sought from a selection of providers. Some regional councils undertake procurement in groups using a "regional-based tendering arrangement".

Source: IPART 2019-20 LGCI survey results and IPART analysis.

B.4 Survey results: basis for cost allocation

Table B.7 Basis used for cost allocation between the council's DWM and general operations

All reporting councils	
Historical % allocation	33%
Corporate overhead model	53%
Cost recovery basis	13%
Total	100%

Note: Not all councils provided responses to this question. A "historical % allocation" means that costs are allocated based on a set percentage. Under a "corporate overhead model" costs are allocated based on a measurable unit, eg, the number of staff and/or ICT costs. A "cost-recovery basis" recovers specific costs involved.

Source: IPART 2019-20 LGCI survey results and IPART analysis.

B.5 Survey results: reported surplus/deficit

Table B.8 Survey respondents reporting surplus/deficit for DWM services (\$2018-19)

	2017-18				2018-19			
	Metro	Regional	Rural	All reporting councils	Metro	Regional	Rural	All reporting councils
Surplus								
Number reporting surplus	23	14	16	53	25	12	13	50
% reporting surplus	82%	70%	84%	79%	89%	60%	68%	75%
Sum of surplus ('000)	79,154	15,212	5,055	99,421	56,569	17,141	7,144	80,854
Average surplus ('000)	3,441	1,087	316	1,876	2,263	1,428	550	1,617
Average surplus per household	55	37	95	52	40	48	134	44
Deficit								
Number reporting deficit	5	6	3	14	3	8	6	17
% reporting deficit	18%	30%	16%	21%	11%	40%	32%	25%
Sum of deficit ('000)	-10,616	-5,310	-270	-16,196	-1,086	-5,482	-432	-7,000
Average deficit ('000)	-2,123	-885	-90	-1,157	-362	-685	-72	-412
Average deficit per household	-54	-26	-17	-39	-5	-21	-28	-15

Source: IPART 2019-20 LGCI survey results and IPART analysis.

Table B.9 Use of reserves held in DWM fund by councils in surplus, by area classification

	Metropolitan	Regional	Rural	All councils
Replace capital eg, DWM plant, trucks	40%	17%	31%	32%
Capital works eg, expansion/upgrade of facilities	40%	50%	69%	50%
Site remediation	20%	58%	31%	32%
Precautionary reserve	24%	33%	0%	20%

Note: Not all councils provided responses to this question.

Source: IPART 2019-20 LGCI survey results and IPART analysis.

B.6 Survey results: DWM operational costs

Table B.10 Council operational costs for DWM services (2017-18 and 2018-19)

	% of costs			
	Metropolitan	Regional	Rural	All councils
Expenses from continuing operations	95%	95%	91%	95%
▼ Employee benefits and on-costs	12%	12%	24%	13%
▼ Materials and contracts	63%	55%	55%	60%
– Raw materials and contracts	5%	15%	21%	9%
– Contractor and consultancy costs	53%	35%	21%	46%
– Remuneration of auditors and legal fees	0%	0%	0%	0%
– Operating leases	0%	0%	0%	0%
– Other	5%	5%	13%	5%
▼ Other expenses	20%	27%	12%	22%
– Electricity (including street lighting)	0%	0%	0%	0%
– Emergency services levy	10%	19%	4%	13%
– Other	10%	8%	8%	9%
Infrastructure, property, plant and equipment	5%	5%	9%	5%
▼ Buildings	0%	0%	2%	0%
▼ Infrastructure – roads, bridges and footpaths	2%	4%	4%	2%
▼ Plant and equipment – machinery	3%	1%	4%	3%
▼ Furniture and fittings	0%	0%	0%	0%
▼ Office equipment	0%	0%	0%	0%
Total	95%	95%	91%	95%

Source: OLG data, 2017-18 and 2018-19, IPART 2019-20 LGCI survey results and IPART analysis.

Table B.11 Reporting councils' overheads as a percentage of expenses by area classification (2017-18 and 2018-19)

	Metropolitan	Regional	Rural	All reporting councils
Overheads as % of reported DWM expenses	65%	47%	45%	59%
Overheads as % of reported residential rates expenses	43%	37%	33%	41%

Note: We considered "overhead expenses" to include "Employee benefits and on-costs", "Contractor and consultancy costs", "Remuneration of auditors and legal fees", "Operating leases" and "Electricity".

Source: IPART 2019-20 LGCI survey results and IPART analysis.