



Competitive Neutrality Complaint Investigation

Final Report

Pelican Park Recreation Centre

Mornington Peninsula Shire Council

13 June 2008

Victorian Competition and Efficiency Commission

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Key points

- The Victorian Government requires significant government business activities to comply with its competitive neutrality policy. An important aspect of this policy is the requirement that government entities engaged in business activities consider competitive neutrality issues, put in place appropriate measures to address these issues, and document their analysis. The Victorian Competition and Efficiency Commission (VCEC) is responsible for promoting compliance with this policy and investigating complaints alleging non-compliance by government businesses.
- The Mornington Peninsula Shire Council has owned and operated Pelican Park Recreation Centre since December 2003. The Centre offers learn to swim classes, group fitness activities, gym access, child care services and sells merchandise as business activities. Council data indicates that the revenues from business activities were approximately \$1 million in 2006-07.
- The Council identified these activities as significant business activities. The recreational aquatic activities were not considered business activities, consistent with the State Government's competitive neutrality policy. Initially, the Council aimed to apply full cost reflective pricing to the Centre's business activities, but in April 2006 it advised the community that this was not likely to be possible, without compromising its social policy objectives. Based on Council costing analysis, after competitive neutrality adjustments, the business activities ran at loss of nearly \$300 000 in 2006-07.
- In April to June 2006 the Council conducted a public interest test process intended to identify an approach that would achieve both the Council's social and competitive neutrality policy objectives.
- The Mornington Peninsula Ratepayers Association lodged a complaint with the VCEC as it considered that the Council had breached the competitive neutrality policy by failing to apply appropriate competitive neutrality costings to the business activities of the Centre, and in particular failing to correctly cost the rental charge for the Centre. The Association also considered that the public interest test conducted by the Council was inadequate. It did not, however, lodge a submission in the public interest test process.
- The VCEC's findings are that:
 - the Council's competitive neutrality costing exercise, while mostly thorough, has some material gaps, and thus the Council had not established what a full cost reflective pricing structure for the business activities of the Centre would be.
 - the public interest test did not satisfy the requirements of the competitive neutrality policy.
- As a result, the VCEC's assessment is that the Council has not complied with the Government's competitive neutrality policy.
- The VCEC has made recommendations in this report to enable the Mornington Peninsula Shire Council to implement the competitive neutrality policy correctly.

1 Scope of complaint

Pelican Park Recreation Centre (the Centre) is owned and operated by the Mornington Peninsula Shire Council. The Centre commenced operation on 1 December 2003 and incorporates an aquatic area, gym and aerobic facilities, a crèche, a small kiosk, and a merchandise outlet at the entrance.

The VCEC received a competitive neutrality complaint directed at the Mornington Peninsula Shire Council from the Mornington Peninsula Ratepayers Association (MPRA) on 23 May 2007.

The MPRA asserted that the Council, through the operation of the Pelican Park Recreation Centre, is not complying with the Victorian Government's *Competitive Neutrality Policy*.

The basis of our complaint is as follows:

- Council has not correctly identified, accurately costed and allocated its costs across the business activities and has not priced its fees and charges to be fully cost reflective.
- Council has not taken adequate steps to clearly identify the extent of competitive neutrality subsidies and has not taken adequate steps to inform the community of the extent of losses and resultant subsidies.
- Council has not satisfied the requirements of competitive neutrality policy through a properly conducted public interest test assessment.
- Council has not consulted with the community in an open and transparent process or manner.
- Council has failed to have due regard to the efficient allocation of resources and has failed to consider and cost alternative options or means of operating the business in a transparent way and in consultation with the community. (MPRA 2007)

The complainant is of the “opinion that the Council’s failure to correctly implement competitive neutrality policy including the failure to properly ascertain the true extent of operating losses and to adjust prices accordingly has resulted in unacceptable loss and/or subsidy to ratepayers.” (MPRA 2007)

2 Competitive neutrality policy

The Victorian Government released the *Competitive Neutrality Policy Victoria* in October 2000. The policy integrates rigorous financial principles with a strong public interest test and transparency in decision-making. The objective is to eliminate resource allocation distortions arising out of the public ownership of

entities engaged in significant business activities. This is achieved by removing unfair competitive advantages that result solely from government ownership of a business activity (Government of Victoria 2000).

In Victoria, it is the responsibility of government agencies and local governments to determine if their business activities fall within the scope of competitive neutrality policy. If the policy does apply, then the government agency or local government body is required to put in place competitive neutrality measures, including full cost reflective pricing, for its business activities if it is in the public interest to do so.

Should competitive neutrality measures jeopardise other public policy objectives, options for achieving all policy objectives, including competitive neutrality pricing, must be explored through a fully documented public interest test process.

The competitive neutrality policy states:

It is the role of the Complaints Unit to determine the extent to which an agency's actions comply or do not comply with competitive neutrality policy. (Government of Victoria 2000, p. 12)

The VCEC has no authority to investigate other concerns of complainants, for example those in relation to the Trade Practices Act, which is under Commonwealth jurisdiction.¹

In addition, the VCEC has no mandate to investigate, consider or recommend compensation. Competitive neutrality policy compliance is about achieving competitive neutrality or justifying departure from competitive neutrality and the VCEC makes recommendations to achieve this end only. VCEC reports are not intended to form the basis of or contribute to compensation claims.

In July 2003 the Victorian Treasurer, as Minister responsible for competition policy implementation, approved a competitive neutrality policy amendment covering Council owned aquatic centres. The change is outlined in *Application of Competitive Neutrality Policy to Council owned Aquatic and Leisure Centres*.

The 'recreation aquatic component' of the leisure centre is not viewed as a commercial operation but as a public amenity or community infrastructure, in the same way as roads and parks are considered community assets. (Treasurer 2003, p. 2)

The amendment also recognises that aquatic centres may be used for other activities such as gym and aerobic programs, crèche services and swim lessons

¹ *Competition Policy Reform (Victoria) Act 1995*, see for example Division 4 – Offences.

that are readily identified as significant business activities to which competitive neutrality policy applies. The policy amendment states:

The overall 'commercial operation' of the Council leisure centre should achieve full cost recovery. Full cost recovery is not required for each activity or output produced, i.e. commercial activities can cross subsidise one another. (Treasurer 2003, p. 2)

This implies that a council owned aquatic recreation centre may operate its aerobics or gym activities with a surplus which in turn is used to offset a deficit from the operation of other business activities in a centre (for example, a learn to swim program).

3 Background

A two stage feasibility study for the development of an aquatic recreation centre in Mornington Peninsula Shire was conducted in April 2000 and March 2001. Several sites were canvassed and Hastings was identified as a priority area given that the area did not have access to year round indoor aquatic facilities, including private or school facilities, and the existing outdoor pool had a limited life (Skyles Humphreys Consulting et al 2000, p. 47).

Pelican Park Recreation Centre, located on the Hastings foreshore, commenced operation on 1 December 2003. The feasibility study was based on the Council's intention that the new centre would replace the Crib Point Outdoor Pool and the Hastings Leisure Centre, as well as an existing outdoor swimming pool in Hastings (located on the same site). The construction of the Centre was costed at \$7 million. The feasibility study concluded:

It is possible that a facility on the foreshore with its high profile and ability to attract visitors as well as surrounding communities could operate with little or no annual subsidy from Council, depending on a number of management factors. (Skyles Humphreys Consulting et al 2000, p. 51)

The Council accepted that the Centre would be a significant business activity and therefore within the scope of the competitive neutrality policy. Upon the completion of the Centre, the Council 'proposed that it should operate for a full financial year (2004-05) in order to establish if full cost reflective pricing was being applied to the business'. However, in 2006 the Council found that during 2004-05 the Centre required a subsidy if it was going to meet its public policy objectives. (Council minutes, 11 September 2006)

While the feasibility study assumed the nearby Crib Point Outdoor Pool and the Hastings Leisure Centre would close when the Pelican Park Recreation Centre commenced operation, the Council subsequently decided to continue to operate

these facilities. It is unclear the extent to which this has affected the revenue of the Pelican Park Recreation Centre's commercial activities.

After two years of operation the Council concluded that 'the continued operation of the Pelican Park Recreation Centre with similar pricing to current pricing will not achieve full cost attribution in the short term, and may not achieve full cost attribution in the medium to long term.' (MPSC, 2006 Public interest test, p. 13)

The Council advised the VCEC that:

The application of full cost reflective pricing would overwhelmingly defeat the Shire's public policy objectives aimed at ensuring access to facilities and services for all sectors of the community. (MPSC 2007a, p.2)

In April to June 2006 the Council conducted a public interest test process which it believed would satisfy the requirements of the competitive neutrality policy.

The Council's public policy objectives are outlined in the Council's 2004-2007 Community Plan and relate to:

- facilitating optimal health and wellbeing outcomes for all ages
- nurturing and supporting young people and families and
- facilitating an improved level of access to recreation and leisure opportunities to provide better health and wellbeing outcomes.

The Council informed the VCEC that Hastings was listed in the 2001 ABS Socio-Economic Indexes for Areas (SEIFA) (an index of relative socio-economic disadvantage), as the most disadvantaged area in the Mornington Peninsula Shire and was one of the ten most disadvantaged localities in the state (MPSC 2007b, p. 1). Further, compared with other areas in the Peninsula, a significantly higher proportion of households who live in Hastings are on weekly individual incomes of under \$300 and there is a higher level of longer term unemployment (MPSC 2003a, pp. 61 and 110).

To combat the issues associated with adverse social and health outcomes and disadvantage the Council adopted the Mornington Peninsula Health and Well-Being Plan, which identifies the following goals:

- Healthy places and spaces
- Healthy lifestyle choices
- Active local communities
- Quality of life for all (MPSC 2003b, p. 3)

The Council advised the VCEC that holders of a Pensioner Concession card, Department of Veteran Affairs Gold Card or Health Care card, and full-time students over 15, are eligible for the municipal concession, which includes a 30

per cent discount on pricing of access to Pelican Park Recreation Centre (MPSC, 16 January 2008). The VCEC notes that the criteria adopted for concessions is similar to that commonly adopted. The complainant argued that not all those who qualify for these concessions are from lower socio-economic groups.

Offering concessional pricing is one way in which governments achieve social objectives. The Mornington Peninsula Shire Council reviews the Centre fees and charges, including the concession, as part of the annual budget process after which they are adopted by Council. It is not clear how the Council established that the 30 per cent discount was appropriate. As noted in Appendix 3, this rate is higher than that adopted by several other councils.

Prior to the conducting its public interest test in 2006 the Centre had only collated limited data on the use of its commercial activities by customers eligible for concessions. At December 2007 about 31.2 per cent of members who visited the Centre were concession paying members (MPSC email 25 January 2008). The Council has since collected more comprehensive data and is better positioned to report on the characteristics of centre users.

The operation of the Pelican Park Recreation Centre is one way the Council aims to achieve its public policy objectives.

4 Does competitive neutrality policy apply?

The threshold issue in any competitive neutrality complaint investigation is establishing whether the government activity subject to the complaint is a significant business as defined by the competitive neutrality policy.

The complaint was made against the Mornington Peninsula Shire Council through its operation of the Pelican Park Recreation Centre. The Centre offers a range of activities and services:

- Learn to swim
- Group fitness
- Gym
- Occasional child care
- Sales (Pelican Park merchandise, small range of swimwear and accessories, snack foods)

An important role of the Centre is as a venue for recreational aquatic activities, but these services were explicitly excluded from the definition of business activities following the 2003 amendment to the Victorian Government's *Competitive Neutrality Policy*.

Factors to be taken into account in determining whether the Centre undertakes business activities include whether:

- *The activities of the entity result in the sale of a good or service.* All the Centre's activities result in the sale of a good or service.
- *The costs of providing the goods or services by the entity are predominantly met by users.* The Council's Business Operating Principles included that the Centre was to operate at minimum cost to Council (Skyles Humphreys Consulting March 2001, p. 20), so costs were intended to be predominantly met by users.
- *There is an actual or potential competitor.* The Centre is the only recreational centre in Hastings. There is, however, a private health and fitness centre in Somerville (approximately ten kilometres from Hastings) offering gym, group fitness activities, swim lessons, and a number of smaller operations that offer gym or pool facilities across the peninsula.
- *The managers of the activity have a degree of independence in relation to the production or supply of the good or service and the price at which it is provided* (Government of Victoria 2000, The Treasury 2004). Most key parameters of the business are not regulated by government (Council or State), although as noted earlier, the Council requires the Centre to offer concessional prices at 30 per cent below full price.

In terms of the tests outlined above the VCEC finds that the Centre's learn to swim, group fitness, child care, sales and gym operations are business activities for the purposes of competitive neutrality policy.

The competitive neutrality policy outlines the factors which might be taken into account in determining whether a business activity (in this case, the whole Centre less the recreation aquatic facility) is significant include:

- *The size of the relevant business activity in relation to the size of the relevant market.* Pelican Park Recreation Centre is one of two fitness centres that provide swim, gym and/or group fitness programs in the Western Port area of Mornington Peninsula. The other is the Somerville Health and Aquatic Centre.
- *The influence or competitive impact of the business activity in the relevant market* (Government of Victoria 2000, p. 5). Given the distance between Somerville and Hastings, and the area from which Pelican Park draws its customers, its prices can be expected to have an impact on the market.

The Council identified the Centre as a whole as a significant business activity but has observed the 2003 amendment to the competitive neutrality policy that recreational aquatic activities are not to be treated as a significant business activity for competitive neutrality purposes.

5 Costing issues

The Council informed the VCEC that based on Council analysis it does not anticipate the Centre's business activities could achieve a fully cost reflective outcome at current prices. Total patronage is not anticipated to increase to generate the required additional revenues. Nor does the Council plan to implement a major revision of the pricing structure as it believes competitive neutrality pricing is not achievable without jeopardising Council's public policy objectives.

5.1 Competitive neutrality costing exercise

The procedure to set a price to recover a net competitive neutrality cost is outlined in the *Competitive Neutrality Guide to Implementation*. Fully cost-reflective pricing takes into account:

- All of the costs that can be attributed to the provision of the good or service;
- The cost advantage of public ownership; and
- The cost disadvantage of public ownership. (DTF 2000 p. 10.)

The Council must establish a full cost base which attributes all costs incurred in the delivery of each of the activities and make adjustments for the competitive advantages and disadvantages that have been identified in respect of the business activities.

The Council provided the VCEC with a copy of the Council's 2005-06 and 2006-07 competitive neutrality costing spreadsheets to show the extent of the subsidy and its application of competitive neutrality adjustments. The Manager of the Centre collates the direct costs of the Centre and the Finance Manager identifies the indirect costs (recharges) and competitive neutrality cost adjustments.

The Council's costing spreadsheets are thorough and allocate all the shared costs of the Centre to each of the business and non-business activities using the fully distributed costing method as outlined in the *Competitive Neutrality Guide to Implementation* (DFT 2000, p.10).

However, as the VCEC noted in its *Cost allocation methodology: guidance note* (VCEC 2007)², the *Guide to Implementation* identifies an alternative costing methodology – avoidable cost – that may be appropriate where the primary activity of an agency (or recreation centre, in this case) is non-commercial. It would appear from

² The VCEC's guidance note is intended to assist government agencies apply the 2000 policy, rather than representing a change in policy. It was released in 2007, after the Council had completed the public interest test for the Pelican Park Recreation Centre.

previous Council publications that the primary activity of the Centre is non-commercial, even though approximately two-thirds of its income comes from business activities.

The avoidable cost approach could be used for allocation of costs that are considered fixed. This would require the extra (direct) costs that would be avoided if the commercial activities were not undertaken to be estimated. Adopting this costing approach would reduce the allocation of some shared costs to commercial activities and thus the extent of their recorded costs, after competitive neutrality adjustments.³

The Council's current approach to costing complies with the requirements of the *Competitive Neutrality Guidelines (DTF 2000)*, and is consistent with the practice of many government agencies, including councils. The VCEC view is, however, that the Council should apply the avoidable cost methodology to the relevant costs of the aquatic facility within the centre, and that this would contribute to Council efforts to achieve a competitively neutral outcome.

The concept of avoidable cost is closely linked to that of 'opportunity cost', that is, the opportunities that are foregone by doing one activity rather than the best alternative.

In addition to examining the allocation methodology, the VCEC assessed whether the Council had correctly identified and calculated competitive neutrality cost adjustments necessary to determine a competitively neutral pricing structure. The competitive neutrality costing exercise requires government agencies to identify both advantages and disadvantages that arise from "differences in tax treatment, differences in the need to provide a return on investment, and related cost advantages or disadvantages which might impact on the prices that are set by government businesses." (Government of Victoria 2000, p. 4)

The VCEC identified four areas for improvement:

- *allowance for council exemption from pay-roll tax.* The share of the Centre's pay-roll allocated to commercial activities exceeds the pay-roll tax exemption threshold, and consequently an allowance for this advantage needs to be included. (DTF 2000, p.23)
- *allowance for exemption from debit tax.* This State government tax was abolished from 1 July 2005 and so this \$700 adjustment should be removed.
- *allowance for any access to lower cost insurance.* The business activities of the Centre may have an advantage if they are able to access insurance cover through the

³ From the VCEC's analysis of the Council's costing spreadsheet it would seem that most of the shared costs of the Centre have a substantial variable element. Consequently, the avoidable cost methodology could not be applied to those costs.

Council's general insurance policy at lower rates than their business competitors. If this is the case, an adjustment to the costing spreadsheet needs to be made to recognise this advantage.

- *treatment of commercial rent attributed to the business activities of the Centre.* This is a more complex issue and is discussed in Section 5.1.1. below.

Addressing the first three of these items should be relatively simple to implement. Moreover, they are unlikely to have a large impact on the estimated costs of the Centre's business activities.

5.1.1 Commercial rent

The complainant expressed particular concern that the Council understated the 'commercial rent' cost attributed to the Centre:

We are also of the opinion that Council has not charged a proper 'arms length commercial' rental for the property thereby understating the total losses of the centre and level of losses and subsidisation required for the business activities. (MPRA 2007)

The correct calculation of 'commercial rent' is important in many competitive neutrality costing exercises. The *Competitive Neutrality Guide to Implementation* states where the calculation of full costs includes an estimation of a 'commercial rent', no adjustment need be made for the cost of capital on land or premises, land tax and local government rates (which are competitive advantages). The estimate of commercial rent is required to be documented and defensible. (DTF 2000, pp. 20-22.)

The *Competitive Neutrality Guide to Implementation* further states:

The (government) agency should provide an estimate of commercial rent. This can be done through an examination of comparable rental properties, real estate documentation stating potential rental value of the premises or, should they currently pay rent, evidence that any existing rental contract is at arms length. (DTF 2000 p. 20)

The Australian Property Institute's definition of Market Rental Value is:

The estimated amount for which premises should rent, as at the relevant date, between a willing lessor and a willing lessee in an arm's length transaction, wherein the parties had each acted knowledgeably, prudently and without compulsion, and having regard to the usual terms and conditions for leases of comparable premises. (REINSW, 2001)

The VCEC asked the Council to provide information as to how the rental charge was calculated. The Council advised that the total rental charge of \$115 800 for 2006-07 included a commercial base rent component of \$66 000 plus a range of operating costs for fire service (maintenance extinguisher service) \$700; security

(alarms, patrols) \$1 500; insurance (building and contents) \$22 000; maintenance \$12 700; sanitary service \$400; landscape maintenance \$2 000; electrical/mechanical equipment maintenance \$9 000; maintenance painting \$1 500. (MPSC, 20 September 2007)

The Council informed the VCEC that the method used to assess the base rental component was consideration of ‘market evidence as a basis of comparison’. A comparison of the Net Annual Value between the Pelican Park Recreation Centre and the Somerville and Kings aquatic centres was made.

The Council’s approach involved the two qualified senior Council valuers determining a hypothetical rental value for the whole site (including those parts devoted to non-commercial activities) that excluded any specific local operating conditions (or encumbrances). The rent base was established by calculating the value of encumbrances and subtracting this from the Net Annual Value. The Council valuers advised that the following encumbrances affect the site of the Centre and therefore the rental value:

- The Centre is located on a public park (Crown Land) which is available for public use with 24 hour access.
- The site does not enjoy the normal flexibility of freehold land which detracts from the sites commercial potential and future development.
- The site is located adjacent to two restrictive site impediments which restrict use and further development of the site.
- The land is zoned Public Park and Recreation which limits the flexibility of the site’s use.

The Council further advised that “probably the most restrictive commercial feature of the site” was the Council’s support for ‘public access’ and ‘all abilities’ at the Centre. “Most commercial aquatic facilities choose to selectively operate within a sector of the market as a means of optimising the economic return of the Facility (e.g. Swimming Lessons, Coaching and Training Squads).” (MPSC, response 3 December 2007) The Council in its operation of the Centre does not assume “the Operator has full discretion to undertake business activity without reference to Community Expectations for such use.” (MPSC, response 20 September 2007)

However, it is unclear how these encumbrances affect the Centre’s ability to offer commercial activities, and/or any return generated and thus why they would reduce what a ‘willing lessee’ would be prepared to pay substantially less to rent the site for its current commercial purposes.

Capturing any such constraints in reduced estimated rents lacks transparency. If the managers of the Pelican Park are constrained in their pricing (say, a council requirement to offer a 30 per cent concession) or the method of operation of

classes⁴ or the like, then these constraints should be explicitly identified and separately costed for the public interest test.

The key issue is the avoidable cost of the use of the recreation centre's facilities for business activities. By using the facilities for these purposes it is incurring a cost which is avoidable because it is foregoing the opportunity to rent the facilities devoted to business activities to another provider. For example, what would a private firm that wished to run a swim school, or a gym or group fitness, be prepared to pay for access at a similar facility? This notional rent represents the opportunity cost to the Council of operating these business activities, rather than offering access to other potential operator(s) for alternative use.

Possible sources of this information could include any public information on the lease payments paid by private operators using similar facilities elsewhere in Victoria. For example, during the recent sale process for the freehold of the Somerville Health and Aquatic Centre, it was advertised that the facility's annual rental was \$262 000, and thus appeared to be significantly higher than the notional rents allocated to the commercial activities of the Pelican Park Recreation Centre's business activities. (realcommercial.com.au, August 2007) Many gyms are likely to use leased premises as would standalone swim schools.

Draft Recommendation One

That the Council review the estimated commercial rent of all components of the Centre used for commercial purposes. The method of estimating the rent and its apportionment between commercial and non-commercial activities, particularly for areas with shared uses, should be documented.

5.1.2 Determination of a competitive neutrality subsidy

In determining whether a business activity complies with competitive neutrality policy it is important to focus on whether the revenues of the commercial activities recover the associated costs, including any adjustments for competitive neutrality advantages or disadvantages, while being careful to exclude the costs and revenue associated with the operation of non-commercial activities.

The Council's 2006 public interest test documentation determined the competitive neutrality subsidy by taking the sum of the 'whole of Centre' operating deficit plus net competitive neutrality adjustment. The whole of Centre deficit included the deficit incurred through the operation of the aquatic facility when used for recreation purposes, which is outside the scope of the competitive

⁴ The Council cited constraints on pricing or method of operation of classes as two factors that may reduce commercial returns of the centre, and thus be encumbrances on the site (MSPC 2008).

neutrality policy. As the *Application of CN Policy to Council owned Aquatic and Leisure Centres* noted:

Councils are required to undertake the costing of the whole centre in order to allocate shared costs to each separate business unit, but would not need to declare to the public a subsidy relating to the notional cost for the non-business/recreation component that is, the 'recreational aquatic activities'. (Treasurer 2003, p. 2)

Once the costing issues identified in Section 5 are addressed, the Council will be better able to assess the extent of any deficit incurred by the Centre's commercial activities and the range of options available to meet its policy obligations.

Draft Recommendation Two

That the Council review the competitive neutrality costing exercise for the Pelican Park Recreation Centre. In addition to the issues of commercial rent addressed in Recommendation One, this costing exercise should examine whether any shared costs should be allocated using the avoidable cost methodology, and address the issues associated with adjustments for pay-roll tax, debit tax, and insurance premiums.

6 The public interest test process

Competitive neutrality policy recognises that government agencies and local governments generally have public policy objectives that are linked with the activity of the government business. If the application of a fully cost reflective pricing structure were assessed to jeopardise other public policy objectives, alternative options for achieving all policy objectives must be explored through a fully documented public interest test process.

Where a department, agency or local government considers that the implementation of a competitive neutrality measure would compromise other public policy objectives, it will need to conduct a public interest test in order to demonstrate the case for not implementing the measure in question. (Government of Victoria 2000, p. 9)

The competitive neutrality policy states that to satisfy the formal requirements of the policy, a public interest test should, at a minimum:

1. clearly identify the policy objective(s) that is to be achieved and ensure that the policy objective(s) has official endorsement (for example by a Minister, a local government body or in an official policy document);
2. demonstrate that the achievement of the stated policy objective(s) would be jeopardised if the particular competitive neutrality measure under consideration was implemented; and

3. determine the best available means of achieving the overall policy objectives, including an assessment of alternative approaches.

The public interest test should be undertaken in consultation with the community through an open and transparent process. At the conclusion of the process, the conduct and outcomes of the public interest test should be made publicly available. (Government of Victoria 2000, p. 9)

National Competition Policy and Local Government notes that:

The public interest test involves appropriate public consultation in relation to a range of costed options that council may propose to relevant stake-holders (Cameron 2002, p.11).

6.1 Pelican Park's public interest test

In April to June 2006 the Council conducted a public interest test which it believed complied with the competitive neutrality policy. The Council advertised the release of its public interest test relating to Pelican Park Recreation Centre in the 'Independent' (the local newspaper) and the 'Peninsula-Wide' (the municipal newspaper). As part of the public interest test process the Council sent interested parties copies of a public interest test document which contained:

- identification of the public policy objectives of the Centre
- identification of the Pelican Park Recreation Centre significant business activities
- summary of the financial performance of the Centre in 2004-05 and 2005-06
- a list of other aquatic, health and recreation providers in the area
- possible competitive neutrality adjustments, the Council's valuation of the land and the rental rate used
- fees and charges from the 2005-06 register
- public interest test feedback form (including six questions).

The public interest test document did not outline alternative options as to how the Council might meet the Council's public policy objectives. The document noted that if the Centre were to achieve full cost reflective pricing the Centre would have to markedly increase its income and reduce its expenditure.

The Council received two submissions from members of the community. One participant considered that the charges were too high for the average family to afford and another participant was supportive of Council subsidised services. The Council has noted that the complainant chose not to lodge a submission (MSPC 2008).

The outcomes of the public interest test were presented in a report to Council on 11 September 2006. The report concluded that the Pelican Park Recreation

Centre was a significant business and within the scope of the competitive neutrality policy. The Council also noted that the Hastings area has been identified as an area of disadvantage.

The Hastings area has been identified as an area of disadvantage with limited training opportunities. Consequently, the application of full cost reflective pricing would overwhelmingly defeat the Shire's public policy objectives aimed at ensuring access to facilities and services for all sectors of the community. Public policy objectives in relation to social, environmental and economic factors would be jeopardised if full cost reflective pricing is applied. Therefore, the continuation of a Council subsidy through ratepayer funds to Pelican Park Recreation Centre ... to address public policy issues is justified. (MPSC Meeting, 11 September 2006)

The Council endorsed the recommendation to continue to subsidise the services as determined through its Annual Budget processes which reflect the objectives of the Council's community plan.

The role of the VCEC is not to assess the Council decision to continue to subsidise the services but to investigate the complainants' concern that the 'Council has not satisfied the requirements of the competitive neutrality policy through a properly conducted public interest test assessment.' (MPRA 2007)

6.2 VCEC's assessment

The VCEC undertook an assessment of the Council's public interest test process and whether it adhered to the formal requirements of the competitive neutrality policy.

6.2.1 Public policy objectives

The first requirement of the public interest test is that the Council must have clearly identified the policy objective(s) that is to be achieved and that the policy objective(s) has official endorsement. Clarity about objectives is essential to the assessment of costed alternative options to achieve such an objective.

The Council's public interest test document included a statement of its Community Plan objectives for sporting and leisure services, which are to:

1. Support and Strengthen the wellbeing of our communities.
2. Enhance Recreation and Leisure Opportunities.
3. Sustain older residents and people with disability in our community.

Under the three general headings further objectives and statements as to how the Centre will contribute to achieving the objectives were outlined. The objectives

are of a general nature that largely relate to social inclusiveness, and health and well-being outcomes.

Perhaps the most relevant objective was: '(To) Encourage a greater range of sports and recreation activities for lower socioeconomic groups in the municipality.' (MPSC, 2006 Public Interest Test document, p. 4) The Council advised the VCEC that using the Socio-Economic Indexes For Areas (SEIFA) the Hastings area had the lowest score (896) in the Mornington Peninsula Shire. This meant that Hastings was recognised as being relatively more disadvantaged than the other areas within the municipality. As a result the Council's policy objective in relation to providing activities for lower-socioeconomic groups was more likely to be met through having the Centre located in Hastings than other areas within the municipality. (Refer to Appendix 1 for further information on SEIFA.)

6.2.2 Options in the public interest test

The Council's public interest test document states the 'Council position' that;

... it is not in the public interest to apply 'competitive neutrality' costing to Pelican Park Recreation Centre's significant business activities' on the basis that it would undermine Council's Public Policy Objectives as they relate to services and programs conducted through the centre. (MPSC, 2006 Public interest test, p. 4)

The *Competitive Neutrality Implementation Guide* suggests alternative options – rebates, reduced rates and charges (currently applied by the Council), provision of substitutable outputs – that government agencies and Councils may consider.

There are likely to be a range of options that may be considered with the aim of achieving both compliance with competitive neutrality policy and the Council's public policy objectives, including:

- Maintain the existing pricing, range of services, and operational practices, with the resulting level of under-recovery of full costs.
- Raising the full price of some services provided as business activities, and/or reducing discounts offered to some groups (for example, corporate members).
- Altering the range of services offered by the business activities, or the time they are provided.
- Contracting a private provider to operate some or all of the Centre's services, or renting the facility to a private provider subject to conditions on access for key groups.
- Offering rebate to individuals in targeted groups that can be used at a broader range of public and private health and fitness providers.

Costing these, and/or other options requires more accurate costing of the current business activities, and potentially some studies of market prices to assess likely impacts on revenues. Documentation of options would demonstrate to the community that the Council has seriously considered the specified options. This would potentially allow the Council to demonstrate the extent to which the Council's public policy objectives would be jeopardised if the Centre adopted pricing consistent with competitive neutrality, or made other changes to reduce its costs.

The VCEC found that the public interest test document, released after about 2½ years operation of the Centre, did not include sufficient or relevant data about the preferred option or any alternatives, that would be necessary for participants in the public interest test process to provide meaningful feed-back. However, the Council, through conducting the 2006 public interest test, demonstrated that it was aware of its competitive neutrality obligations, even though it did not satisfy the requirements of the policy.

The Council has noted that the data available when it conducted the public interest test in 2006 was limited as the centre was new (MPSC 2008). The Centre Management now collects a range of attendance/visitation data including the number of member and casual visits and, of these, the number of 'full-fee' and 'concession-rate' visits. The Centre Management also collects data relating to the Centre's 'All Access Program' which provides programs for older adults, peoples with disabilities and the underprivileged.

Should the Council, following its review of the Centre's costs (recommendation two) and pricing structure, continue to consider that the application of full cost reflective pricing would jeopardise its broader public policy objectives it will need to conduct a revised public interest test that satisfies the requirements of the competitive neutrality policy to achieve compliance. The enhanced data collection will help the Council to better report on the profile of centre users, and thus the implications of alternative options, as part of the public interest test process.

Recommendation Three

That the Council conduct a public interest test that meets the requirements of the competitive neutrality policy should it determine that the application of a full cost reflective pricing structure jeopardises the Council's public policy objectives.

7 Conclusion

The Council has demonstrated awareness of competitive neutrality and of its obligations to comply with the Victorian Government's *Competitive Neutrality*

Policy. It has demonstrated this by undertaking a competitive neutrality cost assessment of the Pelican Park Recreation Centre and by conducting a public interest test having determined that the application of fully cost reflective pricing principles to the Centre would jeopardise the Council's public policy objectives.

The complainant raised a number of concerns relating to the adequacy and completeness of the Council's interpretation and implementation of the competitive neutrality policy in the areas of the identification and calculation of costs and competitive neutrality subsidy, conducting its public interest test and having due regard to the efficient allocation of resources. The VCEC has investigated these concerns.

The VCEC has concluded that the Council has not fully applied the competitive neutrality policy in relation to the identification and calculation of competitive neutrality cost adjustments, the apportionment of costs between commercial and non-commercial activities, and determination of a fully cost reflective pricing structure or competitive neutrality subsidy. The VCEC also concluded that the Council in undertaking a public interest test did not fully satisfy the requirements of the competitive neutrality policy.

This report contains recommendations that are intended to assist the Council to achieve compliance. Implementation of Recommendations One and Two would allow the Council to determine the extent to which costs, after allowing for any competitive neutrality advantages and disadvantages, exceed the Centre's business income, and thus help determine fully cost reflective (competitively neutral) prices for services provided by the business activities.

Recommendation Three indicates that should Council assess that the application of a competitively neutral pricing structure would compromise its policy objectives it would then need to conduct a public interest test in order to demonstrate the case for not implementing this competitive neutrality measure.

Achieving an appropriate balance between achieving competitively neutral outcomes, and ensuring the whole community has access to services essential to achieve Council's public policy objectives is a challenging task. But achieving this balance is important to avoid discouraging private delivery of important community services in areas where governments are also active, such as health and fitness activities, as competitive provision by a range of entities can encourage innovation in products, marketing and delivery, and consequently greater participation.

Consideration of the competitive neutrality issues raised in relation to the Pelican Park Recreation Centre should also assist the Council when assessing future community infrastructure projects that may be subject to competitive neutrality policy. A greater range of options available to meet public policy objectives are necessarily available prior to an investment in a large capital project.

The VCEC will request written advice on progress with implementation of Recommendations One and Two, six months after the release of this report. At that time, the Council should then be able to advise the VCEC whether it is necessary to conduct a public interest test, and thus to implement Recommendation Three.

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Appendix 1: SEIFA Index

The Council has drawn on data from the ‘Socio-Economic Indexes For Areas’ (SEIFA) Index of relative socio-economic disadvantage to form its objectives in relation to the Pelican Park Recreation Centre. SEIFA is a relative measure of disadvantage and does not provide a measure of the magnitude of disadvantage. The indexes measure different aspects of socioeconomic conditions at the Census Collection District (CD) level summarising the characteristics of the people living in the area and can be used to rank CDs to identify areas that are more or less disadvantaged relative to others. “Based on international research and also the type of information the ABS [Australian Bureau of Statistics] collects during the census, we define disadvantage in terms of individuals’ access to material and social resources, and their ability to participate in society”.⁵

The index score helps rank areas to see the extent of the relative level of disadvantage. The ABS standardise the principle component scores to have a mean of 1,000 where areas with an index above 1,000 are above the Australian average and so relatively less disadvantaged, while index figures below 1,000 indicate areas of relatively greater disadvantage. The lowest 10% scores are smaller than 880 and the highest 10% scores are larger than 1,100.

The Council has advised the VCEC that on the SEIFA Index of relative socio-economic disadvantage (2001), Hastings has the lowest SEIFA index score in the Mornington Peninsula Shire. Hastings has an index score of 896 against the Mornington Peninsula Shire index score of 1,021. Hastings has the lowest index score in the Shire and therefore is relatively more disadvantaged than the other areas within the Shire.

The Council provided the VCEC with Pelican Park Recreation Centre membership postcode data that showed that 27% of members have the Hastings postcode. A further 19% of members have a Bittern/Crib Point postcode, which has an SEIFA index score of 989.

The ABS is in the process of developing SEIFA 2006 in preparation for its release in 2008. (ABS, p. 1). The updated SEIFA data may assist the Council in forming a view as to whether the Pelican Park Recreation Centre has assisted the Council in achieving its public policy objectives.

⁵ Adhikari, P 2006 ‘Socio-Economic Indexes For Areas: Introduction, use and plans for 2006’, ABS paper presented at the Census Analysis Conference, Canberra, July 2006, p. 4

Appendix 2: Council public policy objectives

In December 2002 the Council adopted its access and equity policy, 'Just, not just the same: An access and equity policy'. The policy "is a statement of support and principles to guide the development of action plans addressing the inequalities in the lives of Peninsula communities". (MPSC 2002, p. 3) The policy states, among other things that it will provide direction to Council on "allocating Council resources, and advocating for additional external resources to services, projects and programs targeted to the Shire's marginalised communities." (p. 3). The policy re-iterates the Council's Community Plan (July 2000 – June 2003) concerning its goal of 'Supporting and Strengthening Communities':

Develop and implement an Access and Equity Policy to promote and facilitate fair and equal access to community and social infrastructure, including access for people with disabilities. (MPSC 2002, p. 5)

The objective is promoting social inclusiveness and attempts to address potential problems caused by social marginalisation.

The Mornington Peninsula Shire aims to ensure that resources are shared fairly between the range of communities in the municipality, believing that Shire communities should have equal opportunity to use built assets, open space and services. The Shire community is diverse and not everyone finds it as easy to take up the opportunities offered. The way in which an opportunity is provided may differ, but it should respect human rights and dignity.

e.g. a person in a wheel chair may never be able to use stairs that the rest of the community uses, but a ramp built to correct standards and next to the existing public access point can provide an equally safe and dignified way to get into a community building. Parents may require child care to enable them to participate in community activities; specific age groups require specific recreation activities and the cost of services may need to be lower in comparison to some of the Shire communities so that they are affordable to anyone on a lower income.

(MPSC 2002, p. 6)

Council identified the increasing gap between the 'haves' and 'have nots' as a concern to the community (Health, Hope & Happiness: Health and Well-being Plan, 2003, p. 5). The Council strategy to address this concern was to implement the Access and Equity Policy.

Furthermore, part of the Council strategy to implement the Healthy Places and Spaces objective includes to "Establish a rolling community development program with priority given to the following areas: Rye, Rosebud, Somerville, Hastings and Mornington." (MPSC 2003b, p. 31)

The Health and Well-being Plan cites ‘Unequal in Life’⁶ (Vinson, 1999, p. 32) in which Hastings was identified as the thirteenth most disadvantaged suburb in the state. Also Mornington Peninsula Shire was identified as being the only municipality as having three suburbs listed in the top thirty disadvantaged suburbs. (MPSC 2003b, p. 175)

The centre management strategy includes meeting the ‘Health and Well Being Plan’ objectives of:

- Healthy Places and Spaces;
- Healthy Lifestyle Choices; and
- Active Local Communities.

The strategy includes to be ‘financially responsible by operating within agreed budgetary parameters’. MPSC, Community Plan 2004-2007).

⁶ *Unequal in Life. The distribution of social disadvantage in Victoria and New South Wales*, The Ignatius Centre for Social Policy Research, Jesuit Social Services, Melbourne, August 1999

Appendix 3: Membership price comparison

While the facilities offered by different centres differ, a comparison of prices assists in determining whether the pricing of a centre broadly reflects normal market rates for the activities offered.

After the complaint was lodged, the Council provided the VCEC with some pricing from five recreation centres.⁷ Council noted that when seeking pricing advice by telephone the staff of some centres would not give pricing information over the phone. For example, Pelican Park's nearest competitor at Somerville, no longer publishes list prices, but rather offers tailored packages and pricing. The VCEC compared the Council supplied data with Pelican Park Recreation Centre prices as at July 2007. However, the data collected did not enable a like-with-like comparison of the pricing of commercial services, such as gym, aerobics and swimming lessons.

Subsequently, the VCEC reviewed the published pricing of similar categories of membership at four different aquatic recreation centres (table 1). Each centre offered a core of services – access to an aquatic facility, aerobic classes, childcare services and a gym. However, it is recognised that other aspects are likely to differ, such as the quality of the facilities, and opening hours. These factors make price comparisons difficult.

The VCEC compared the membership price of the premium category of each centre (which for some centres may be called platinum, premium, ultra or other label). The premium category refers to general access to all facilities offered at the centre at peak time. The Pelican Park Recreation Centre 'platinum' membership provides three monthly and annual membership options. The Centre's full fee membership price for both the three monthly and annual memberships is above two and below two of the four centres to which its pricing has been compared.

Each centre typically offers other classes of membership. However, these are more difficult to compare. The Pelican Park Recreation Centre offers different categories of membership based on the range of activities offered and the time of access to these. The Centre offers silver, gold and platinum categories of membership. Platinum is the premium category and is priced to reflect this.

⁷ Casey ARC, Monash Aquatic, Jubilee Park Aquatic Centre Frankston, Melbourne Sport and Aquatic Centre, and the Somerville Health and Aquatic Centre.

The data outlined in Table 1 suggests that Pelican Park’s full fee ‘platinum’ membership fees are similar to those of other similar centres, which offer broadly equivalent services.

The data outlined in Table 1 indicates that the concession offered by Mornington Peninsula Shire Council (set at a 30 per cent discount to the full price) is double that of the Maribyrnong Aquatic Centre, and the City of Kingston’s Centre (15 per cent). The City of Stonnington does not offer a concession on memberships, while the Hume offers a more targeted concession, and only for the three month membership. The Shire Council noted that the concession discount is greater than what it considers is the industry standard of 20 per cent off core prices. (MPSC, email 4 March 2008)

Table 1 Premium full access membership fees

	<i>3 month</i>		<i>6 month</i>		<i>12 month</i>	
	<i>Full</i>	<i>Concession</i>	<i>Full</i>	<i>Concession</i>	<i>Full</i>	<i>Concession</i>
<i>Pelican Park (Platinum)</i>	\$240	\$168	n.a.	n.a.	\$720	\$504
<i>Maribyrnong Aquatic Centre</i>	\$430	\$366	\$550	\$468	\$850	\$723
<i>Hume Council Leisure Centres</i>	\$224	\$108	n.a.	n.a.	\$729	n.a.
<i>City of Kingston</i>	\$228	\$194	\$395	\$336	\$603	\$512
<i>Harold Holt (City of Stonnington)</i>	\$300	n.a.	\$450	n.a.	\$700	n.a.

Notes: n.a. ~ not applicable

Sources: Websites of: City of Maribyrnong website accessed 23 January 2008; Hume City Council website accessed 23 January 2008; City of Kingston website accessed 23 January 2008; City of Stonnington website accessed 23 January 2008.

In addition the Mornington Peninsula Shire Council offer two ‘corporate’ membership categories; a three month gold option and a twelve month platinum option. The corporate price is set at a 30 per cent discount to the full price. It is not clear why the ‘corporate’ discount is 30 per cent other than this being the same as the standard Council concession discount.