



Local Government Enterprises as a Means of Improving Local Government

A Discussion Paper

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EXECUTIVE SUMMARY

There has been an increasing focus on issues of sustainable development and urban regeneration, which has given rise to a number of potential roles for local government in the property sector. Beyond its traditional role as a planning authority, there are measures that might be taken by local government to achieve urban regeneration objectives at the local level that might not be practicable under development models pursued by existing State agencies.

Similar issues arise in underperforming (generally rural) commercial areas where falling population or hollowing out of local services leads to economic decline as services and the associated revenues are transferred to larger or more viable centres. While private owners may be unable to obtain an adequate commercial return from an enterprise or to service the associated debts, local government may be able and willing – with community support – to trade off lower financial returns for broader social outcomes.

At the same time, there is a broad recognition of the need for local government to broaden and diversify its sources of revenue. Development of its extensive property holdings is one potential source of such revenue.

However, the involvement of local government in property ownership and development or other commercial enterprises beyond its traditional “core” functions raises a number of issues including real or perceived conflict of interest between the regulatory and ownership roles of local government, the capacity and competence of local government to undertake such enterprises and the exposure of ratepayers to financial risk.

The most efficient way to avoid potential or actual conflicts of interest, to minimise financial risk and to engage the necessary commercial and corporate expertise is through the creation of an arms’ length vehicle such as a wholly-owned company or an investment trust to hold and manage the commercial interests of a local government. The essence of such an entity is that the Board or trustees are legally obliged to operate at arms length from the local government, within the performance parameters laid down in its constitution, and to act independently of all other factors (including political pressure) within the regulatory parameters applicable to any other corporate entity.

However, Western Australia is unique among Australasian jurisdictions in imposing a blanket prohibition on the use of corporate governance structures by local government. In both Queensland and New Zealand, for example, it is common practice for local authorities to place their commercial activities in wholly-owned corporate subsidiaries under the control of external Boards. Some of these companies control assets valued at hundreds of millions of dollars that are run on a commercial basis but are ultimately owned and controlled by local government. In South Australia such separation is mandatory.

This paper argues that there are certain overarching objectives that are essential to any reform of governance for commercial activities by local government. These include the need to maximise commercial efficiency, improve the quality of decision-making in the utilisation of local government assets, prudently broaden sources of

local government income, retain local government control of its assets, and enhance community consultation in matters affecting the disposition of local government assets. It considers a range of options for reform, and proposes that the *Local Government Act 1995* be amended to provide a comprehensive suite of measures to permit, the establishment of incorporated local government entities where supported by ratepayers through community consultation.

This paper proposes that local government should be empowered – with the consent of its community through detailed consultation processes – to establish corporate entities known as *Local Government Enterprises*, governed by directors appointed for their relevant expertise, to manage and develop assets using normal commercial arrangements. A detailed process of reporting and accountability is proposed to ensure that an appropriate balance is maintained between transparency and commercial efficiency.

The paper argues that the use of such structures will improve commercial efficiency and reduce risk to ratepayers, while enabling local government to achieve strategic outcomes that are extremely difficult to achieve under current statutory restrictions.

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1.0 INTRODUCTION AND BACKGROUND

1.1 Background to the Paper

There is a broad recognition of the need for reform of the local government sector in WA. This has been identified by successive reports, including the Local Government Advisory Board Report of 2006 and the Systemic Sustainability Study of 2008, both of which found there was limited local government capacity in certain respects and a lack of long term financial viability for many local governments. In 2009, local governments in WA completed a self assessment checklist that identified capacity in areas such as asset management, planning, strategic planning and development, and financial planning. The self-reported results indicated that over 40% of local governments assessed their future performance as unsustainable.

The Commonwealth Government has also recognised the need for local government reform. A 2009 Productivity Commission report identified serious shortcomings in the future financial viability of local government throughout Australia. Commonwealth funding is being provided to WA through a National Partnership Agreement to Support Local Government and Regional Development, and is being matched by State Government recurrent funding. However, the State Government approach to local government reform has been to focus on capacity building and structural reform: it has not to date addressed the broader issue of how local governments can act in a more commercially efficient manner to develop alternative revenue streams or to enter into commercial partnerships with the private sector to achieve its objectives.

This paper takes a different approach, by examining the case for the use of subsidiary corporate structures as vehicles for greater efficiency and improved partnering practices for local government involvement in a range of commercial activities that are distinct from the commonly understood “core functions” of local government. Examples of such activities include urban regeneration projects, measures to address economic decline in regional centres, public-private partnerships to develop local government assets and measures to enhance the income-generating asset base of local governments. The paper considers the current statutory prohibition on such structures in the context of other Australasian jurisdictions, identifies appropriate issues for consideration and recommends a framework for statutory amendment to address the issue.

This discussion paper follows on from previous work commissioned by the former Department for Infrastructure and Planning (DPI) in 2007 to address statutory constraints to local government involvement in urban regeneration, which was adopted by the WA Local Government Association (WALGA) as part of its response to the 2008 Systemic Sustainability Study of Local Government.

1.2 The Case for Change

The 2007 DPI/WALGA review identified urban development as an area of particular importance that was constrained by the statutory provisions set out in the *Local Government Act 1995* (“LGA”). There is a broad recognition that planning instruments alone are insufficient to deliver sustainable development outcomes: maintaining a balance between flexibility and certainty inevitably limits the capacity of planning authorities to regulate the form of development they wish to see produced,

while the development outcomes that are best able to deliver environmental and social sustainability are often not those that meet the immediate needs of the private sector for profitability. As a consequence, profit-driven property development tends to overlook (or be unable to deliver) longer-term environmental, social and cultural outcomes.

Urban development – especially the regeneration of established older urban areas - is by its nature a highly fragmented process involving the interaction of many individual investment and development decisions by a large number of individual property owners over a prolonged period. Many such owners lack the financial resources, or the motivation, to redevelop their properties to higher or newer forms, especially in the early stages of the redevelopment cycle: there may be little or no established market for such developments in low-intensity suburban locations, and even if property owners could be persuaded of the merits of such projects they would struggle to attract the necessary financial and other resources to undertake them.

The State has responded to this challenge in some areas by the establishment of Redevelopment Authorities with wide powers to plan and implement urban redevelopment where the scale of redevelopment is suburb-wide in nature. In other areas, the Western Australian Land Authority (Landcorp) has played an important role in redeveloping property at a more localised scale. However, there is no established mechanism for the public sector to facilitate redevelopment and regeneration at the level individual or small groups of properties. There is thus a legitimate role for local government to participate in the property market in order to facilitate the achievement of such outcomes where it is beyond the capacity or appetite of the private market to do so and the scale is below the threshold appropriate to the involvement of State agencies.

Local government also needs to be better equipped to undertake public-private partnerships for the development of its assets, and may seek to undertake value-enhancing projects for purely investment or revenue-generating purposes. In addition to the regulatory-ownership conflict, the nature of such projects is such that direct local government ownership and management is not always conducive to commercial efficiency.

Similar issues have been identified where local government sees merit in providing commercial services with the intention of arresting or reversing economic decline in regional centres. In many such cases, private owners are unable to obtain an adequate commercial return from an enterprise or are unable to service the associated debts, while a local government may see opportunities to achieve broader social outcomes that justify accepting reduced financial returns.

Any involvement by local government in commercial enterprises raises issues of competence, risk, capacity and regulatory separation. Accordingly, there is a need to consider how an appropriate balance can be achieved between the need to act in a commercially efficient manner and legitimate concerns for accountability and transparency in any public sector activities. The purpose of this paper is to consider the governance issues associated with local government involvement in such matters and to propose measures to facilitate the best outcomes. The paper proposes that where local government seeks to undertake direct involvement in such projects, this should be through arms-length entities that provide the necessary separation between the regulatory and ownership functions. Such entities, with appropriate controls, can provide for local government ownership and participation in a manner

which is more conducive to commercial efficiency and regulatory transparency than is possible under current statutory constraints.

1.3 Options for Reform

The current statutory framework for local government in Western Australia, as set out in the LGA and associated regulations, contains a number of provisions that constrain local government from operating on normal commercial terms. Of particular significance are section 3.58 – 3.60 inclusive and section 6.21 which, taken together, provide almost insurmountable hurdles to the commercially efficient use of local government assets or the conduct of trading activities on normal commercial terms. These provisions are discussed in detail in Section 3 of this paper.

In general, the LGA is framed to deal with the traditional “core functions” of local government and to ensure that those functions are delivered in a manner that is within the capacity and resources of local governments. It would seem, however, that little thought was given in the legislation to the possibility of local government activity expanding beyond these traditional functions, the involvement of local government in economic or urban development initiatives, or the accumulation of investment assets to help fund local government functions. It is also apparent that the framers of the Act had little appreciation of the scale of local government ownership of freehold property, including property held for purely investment purposes, and the practical challenges associated with efficient management of such a property portfolio. Furthermore, the very concept of the role of government in general – including local government – has developed in the 15 years since the Act came into force, with a broader range of expectations as to both the capacity of public bodies to contribute to sustainable and socially worthwhile outcomes and the need for public-private partnering to achieve these objectives.

Western Australia is unique among Australasian jurisdictions in imposing a blanket prohibition on the use of incorporated subsidiary structures as a governance model for local government delivery of what are essentially commercial functions. A review of other jurisdictions in the 2007 DPI/WALGA review identified a spectrum of statutory arrangements ranging from permitting with Ministerial consent to requiring the use of arms-length entities for commercial activities. There is significant support within local government in Western Australia for the adoption of an approach broadly similar to that in New Zealand, where incorporated Council Controlled Organisations (CCOs) are widely employed to carry out a broad range of functions where (in the opinion of the shareholding local authorities) the efficiency of delivering such functions would be enhanced by the creation of professionally governed entities established for the specific purpose and where the appropriate consultation and oversight measures are in place. Whether an immediate move to such a regime is prudent, given the lack of local experience with such structure, is a matter for consideration.

There are a number of possible alternative approaches to reform in this regard, covering a spectrum from limited project-specific authority by regulation under the LGA as current operating, to an open-ended “power of general competence” within a broadly framed statute as exists in New Zealand. For the purposes of this paper, the following approaches have been considered:

- a. a “minimalist” approach, whereby the provisions of the LGA remain unchanged but the use of incorporated subsidiaries is permitted and regulated in a limited range of circumstances requiring Ministerial approval on a case-by-case basis;
- b. a “broader” approach that retains the existing regime in relation to the “core” functions of local government (and the associated assets) but enables local government to act under normal commercial conditions and structures, subject to appropriate consultation and oversight measures, in relation to other assets and functions;
- c. a “comprehensive” approach, involving general repeal of the statutory constraints so as to enable local government to conduct itself under normal commercial procedures and structures for any or all of its non-regulatory operations, but with specific legislative provisions to govern the establishment and operation of corporate subsidiaries.

These options are discussed in more detail in section 4 of this paper.

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2.0 ISSUES AND OBJECTIVES

2.1 Local Government Involvement in Commercial Activities

Increasing focus on the issues of sustainable development and urban regeneration has given rise to a number of potential roles for local government in the property sector. Beyond its traditional role as a planning authority, measures that might be taken by local government to achieve urban regeneration objectives at the local level could include:

- directly undertaking selected development projects, especially those of a form that is not attractive to the private sector (e.g. higher density or mixed use in suburban localities without a prior established pattern of such development), in order to establish or influence the market for the preferred typology;
- joint ventures with private owners to mitigate the development risk as a means of allowing projects to proceed that otherwise might not be within the capacity of a private owner;
- underwriting of specific aspects of development projects where the private sector is unable or unwilling to carry the risks involved (for example, entering into an option to acquire some of the developed property over and above what the owner would normally develop); and
- aggregation of sites to enable development to occur on a suitable scale to achieve the desired density or land use outcomes, thus reducing risk and holding costs to potential developers and allowing the local government to control the form of development through covenants on the property.

However, the involvement of local government in property ownership and/or development beyond its traditional social reasons raises a number of issues regarding public perception and the relationship with the community. These include:

- actual or perceived conflicts of interest between local government's role as a planning authority and as a property owner or developer;
- potential conflicts between political or social priorities of local government and its more commercial activities;
- conflict between the need for commercial confidentiality to achieve better returns and the responsibility for transparency and accountability to the residents and ratepayers;
- the appropriateness of any public authority undertaking commercial activities traditionally the realm of the private sector;
- the management of financial risk when public or community assets are involved;
- decision-making processes which revolve around consultation and consensus that are not conducive to making commercial investment decisions.

Similar issues arise in underperforming (often rural) commercial areas where falling population or hollowing out of local services leads to economic decline as services and the associated revenues are transferred to larger or more viable centres. In some such cases, local government may believe that there is a case for involvement in the delivery of commercial services (either directly or through an equity stake) in order to avoid triggering a “tipping point” of social decline. While private owners may be unable to obtain an adequate commercial return from an enterprise or to service the associated debts, local government may be able and willing – with community support – to trade off lower financial returns for broader social outcomes. Once again, however, the issue arises of potential conflict between the commercial and regulatory functions of local government.

The most efficient way to avoid potential or actual conflicts of interest is through the creation of an arms’ length vehicle such as a wholly-owned company or an investment trust to hold and manage the commercial interests of a local government (as well to enter into participation ventures with other parties). The essence of such an entity is that the board or trustees are legally obliged to operate at arms length from the local government, within the performance parameters laid down in its constitution, and to act independently of all other factors (including political pressure) within the regulatory parameters applicable to any other corporate entity.

Benefits of establishing such an entity include:

- (a) the ability to employ professional directors/trustees and management with experience specific to the commercial objectives of the entity;
- (b) removal of detailed investment decisions from day-to-day political processes while retaining political oversight of the broad strategy;
- (c) the ability to take an overall view of commercial strategy and outcomes rather than having each individual transaction within a complex chain of inter-related decisions being subject to the individual notification and approval requirements of the LGA;
- (d) the ability to quarantine the ratepayers from legal liability and financial risk arising from commercial or investment activities;
- (e) the ability to set clear financial and non-financial performance objectives for the entity to achieve; and
- (f) greater flexibility to enter into joint venture and partnering relationships with the private sector on conventional commercial terms.

This is a normal and proper approach in the private sector, as well as for local government in some other Australasian jurisdictions. In both Queensland and New Zealand, for example, it is common practice for local authorities to place their commercial activities in wholly-owned corporate subsidiaries under the control of external boards. Some of these companies control assets valued at hundreds of millions of dollars that are run on a commercial basis but are ultimately owned and controlled by local government. In South Australia such separation is mandatory.

2.2 Statutory Constraints

There are three specific provisions in the *Local Government Act 1995* constraining local government activities in property dealings and the use of corporate structures:

Section 3.58 requires that a local government can only dispose of property by public auction, public tender, or otherwise by giving Statewide public notice of the proposed disposition and inviting public submissions that must be considered before the disposition is made. This is a significant disincentive to private bodies seeking to undertake potentially risky development projects (such as those involved in urban regeneration), as they normally seek to prove up the commercial feasibility of a project before paying for the land, and would be reluctant to expose commercially sensitive information to their competitors.

Section 3.59 requires that before a local government undertakes a major land transaction (currently defined as any transaction greater than \$1 million in value) it must prepare and advertise a business plan that details include details of the expected effect on the provision of facilities and services by the local government, and on other persons providing facilities and services in the district, its expected financial effect on the local government and on matters referred to in the local government's Annual Plan, and the ability of the local government to manage the transaction. The business plan must be advertised Statewide for public submissions, and if through any change of circumstance or as a result of any matters raised in submissions the local government decides to vary its proposal in any significant way, it must repeat the entire process. Although there is provision for some types of transaction to be exempted by regulation, no such exemptions are provided for under the regulations to the Act.

Section 3.60 provides that a local government *cannot form or take part in forming, or acquire an interest giving it the control of, an incorporated Company or any other body corporate ... unless it is permitted to do so by regulation*. Regulation 32 of the Local Government (Finance and General) Regulations 1996 provides that a local government may participate in an incorporated association or a body corporate established under the Strata Title Act 1998, but there is no general provision permitting the establishment of trading or investment entities.

Of potentially more wide-ranging effect is the prohibition in **Section 6.21** on giving security over assets in relation to any borrowings by a local government. Section 6.21(2) provides that the only such security that may be given is the general fund (in essence, the annual rates revenue). A local government that owns commercial or investment property cannot therefore borrow against the value of that property to improve it, for example, inevitably leading to a decline in economic value. This provision also severely constrains the scale of investment that can be undertaken.

2.3 Objectives of Reform

The following overarching objectives are essential to any proposed reform:

- i) the proposed measures should maximise the commercial efficiency of local government in utilising its assets for the benefit of the community.
- ii) the proposed measures should improve the quality of decision-making regarding the utilisation of local government assets.

- iii) local governments should be encouraged to prudently broaden their sources of income in the interests of long-term financial sustainability.
- iv) a local government taking commercial risk should do so only to the extent that its “core” assets and functions are not placed at risk.
- v) ownership and control of local government assets should remain with local government, whether directly or indirectly.
- vi) governance arrangements should comply with recognised “best practice”.
- vii) the proposed measures should support and enhance the principle of community consultation in matters affecting the disposition of local government assets.
- viii) the proposed arrangements should not contravene established Competition Policy.

There may, of course, be other objectives depending on the viewpoint of stakeholders. However, it is essential to any reform proposal that an agreed set of objectives be established against which proposed measures can be tested.

2.4 Key Issues

The following key issues have been considered in reaching the recommendations set out in this paper in relation to local government corporate subsidiaries, termed (for discussion purposes) Local Government Enterprises (LGEs):

2.4.1 Defining core assets and services

There is an arguable case that the current legislation is broadly appropriate to the protection of the services and assets generally regarded as traditional “core” functions of local government. If this view is accepted, then it may be appropriate to limit the case for statutory reform to those assets and services that fall outside the “core” functions. However, this raises two key questions:

- Who should decide what a “core” function is?
- Are there “core” functions, especially those involving a joint enterprise between local governments, that might benefit from an incorporated structure?

One option is for the “core” functions of local government to be defined in a generic sense by regulation. However, this could lead to the perpetuation of a “one size fits all” approach that may not be uniformly appropriate – there is wide variance in the range of services provided by different local governments and there is no uniform approach in relation to the assets used to deliver agreed “core” functions – for example, one local government may wish to own a purpose-built library, another may wish to house its library in rented premises, while another may wish to share library services with a neighbouring local government (or provide no such service at all).

An alternative approach might be to establish a process by which each local government, in consultation with its ratepayers, determines those assets and

services that are “strategic” in relation to its particular circumstances, and to retain the current statutory provisions insofar as they relate to such “strategic” assets, while allowing greater flexibility in the case of “non-strategic” assets. Under this approach, a default position, under which all assets and functions of a local government were deemed to be “strategic” unless determined otherwise, would allow smaller local governments to avoid the cost and inconvenience of going through this process when they have neither the need nor the capacity to consider establishment of a LGE.

Whilst this approach is considered to have some merit, it also creates difficulties for local governments seeking to maximise the efficiency of what might be patently “core” functions. An example would be a decision by a group of rural local governments to combine their roadworks operations under a single standalone but jointly owned entity. For the purposes of governance as well as asset management it would make sense for such an entity to have the capacity to act commercially under the control of a Board appointed by the shareholding local governments.

On balance, it is considered that the appropriate protection of “core” assets and functions from undue risk is a matter that can and should be addressed through a robust consultation process, and that a differentiation between “core” and other assets and functions would add little to the promotion of efficient asset utilisation and is unnecessary.

2.4.2 Basis of authority

A key issue in relation to any variation to established local government practice and the establishment of a LGE is who should approve the decision. Options include:

- the Minister for Local Government or another agency of State Government
- the elected Council
- the local community

Requiring the approval of the Minister or of another agency of State Government would be consistent with a minimalist approach to reform. This approach would require the establishment of a regulatory framework for on which the approval decision was to be based – at the very least, a requirement for development of a detailed business plan and risk analysis for the proposed commercial undertaking. However, it also raises potential issues concerning the legal liability of the approving entity – for example in commercial litigation - in the event that the information on which the approval was given turned out to be incomplete or incorrect. Risk aversion on the part of approving authorities would inevitably lead to greater complexity and the likelihood that few if any such enterprises would be approved regardless of intrinsic merit.

In preliminary consultation during the preparation of this paper, the issue of a Ministerial right of veto (as distinct from obligatory approval) was considered. While opinions varied, there was a broad consensus against such an arrangement. In general, it was felt that this would leave the Minister politically and legally accountable for a commercial decision based on material that might be difficult to verify, leading to a “default” policy of rejection that would defeat the intent of the reform.

Leaving the decision entirely in the hands of the Council concerned would represent the most extreme form of devolution, and would require an appropriate oversight and

monitoring process by a competent independent entity (for example, the Auditor General). If this approach were adopted, appropriate consultation with the community would also need to be ensured.

Giving the authority to the affected local community – through stringent consultation measures – arguably provides a framework that can have sufficient flexibility to suit the differing circumstances of different local governments and vests the decision-making power with those to whom the local government is ultimately accountable. As with any such consultation process, there is a need to ensure a balance between the obligation for a local government to pay genuine regard to the expressed views of the community and the need to ensure that the consultation process is not hijacked by activists or sectional vested interests – as is the case with existing consultation requirements.

2.4.3 Governance

In keeping with principles of governance best practice and maximising the commercial efficiency of decision-making, it is essential that:

- the governance of any LGE be vested in people appointed solely for their relevant experience and expertise;
- the basis of any such appointments be transparent;
- appropriate reporting mechanisms are established that balance the need for commercial efficiency with accountability to both the shareholding local government(s) and the community;
- performance measures for any LGE be transparent and the achievement of these measures be monitored and reported;
- commercial enterprises owned by local governments enjoy no financial or regulatory advantages relative to competing private entities

A threshold issue is whether staff or elected Councillors of a local government should be appointed to the governing board of a LGE owned by that local government (whether or not they have experience and expertise specific to the nature of the entity). It is arguable that the appropriate arms-length relationship cannot be maintained if staff and/or Councillors sit on the board of a subsidiary LGE, although it might also be argued that some minority representation would improve the alignment of interests between the two bodies. It is also apparent that different approaches will be appropriate to different circumstances – for example as between a wholly-owned subsidiary commercial enterprise and a joint enterprise between local governments for the delivery of “core” functions.

To allow some flexibility, it would be appropriate to address the issue through the adoption of a policy by each local government on the appointment of directors or trustees (as the case may be) as part of the annual consultative process and separately from the actual formation of an entity. In general, however, the involvement of elected members on the boards of wholly owned LGEs should be discouraged in the interests of transparency and accountability, while the involvement of staff is a matter that may vary according to the nature of the enterprise.

2.4.4 Business planning

The formation of any LGE should be preceded by the development of a comprehensive business plan that explains the rationale for its creation, the commercial objectives to be achieved and the key financial and risk parameters under which it will operate. This paper proposes a model form of business plan for a hypothetical LGE as an illustration of the level of detail that should be required.

Apart from providing a transparent explanation of the anticipated scale, funding and viability of the proposed entity, this process will also provide a valuable “hurdle” that will ensure that any local government contemplating the establishment of an LGE fully understands the medium-term prospects of the entity, including in particular its equity and capital needs and its capacity to pay dividends to the shareholding local government. By requiring that the business plan includes pro-forma accounts of the LGE for the first 5 years of operation, as well as a statement of the benefits of adopting such a model by comparison with direct local government delivery of the proposed functions, Council and the community are given the opportunity to fully assess the likely costs and benefits of adopting the LGE model..

2.4.5 Community consultation

A key issue is to determine the appropriate degree of community consultation that should occur prior to the formation of any LGE, and thereafter during its operational life. Since the underlying purpose of the creation of such an entity will generally be commercial in nature, the level of public scrutiny should be consistent with commercial efficiency while balancing the reasonable expectations of the community for transparency and accountability.

At the establishment phase, this can be achieved by requiring stringent reporting of projected costs, revenues, risks and benefits in the initial years of operation in the consultation documents. Ongoing transparency and accountability can be achieved by the adoption of provisions regarding the publication of accounts, threshold values for major transactions requiring the consent of the Council and/or community, etc.

A key tool for any LGE will be its Statement of Intent, which should spell out (among other things) how the entity will engage with community expectations. The Statement of Intent should be a public document and the entity should be required to report against its provisions at least annually. This paper proposes detailed requirements for the Statement of Intent, including a model form of Statement of Intent for a hypothetical LGE as an illustration of the concept.

It is envisaged that the annual report of any local government with equity in a LGE would include a summary of the annual report of the LGE and details of where the full LGE report could be publicly accessed.

2.4.6 Oversight

While the directors or trustees (as the case may be) of a LGE must carry the primary legal responsibility for its operations, the question arises as to whether there is a case of an additional level of oversight at a Government level. Traditionally, local government is subject to the oversight of the Minister and his Department; however, in the case of LGEs it is suggested that a more appropriate oversight entity would be the Auditor General, but it is suggested that this issue be further reviewed in the light

of the applicable accounting and corporate law provisions that would apply to any LGE, and the treatment of ownership of shares in an LGE under existing provisions of the LGA and regulations.

2.5 Other Australasian Jurisdictions

As noted above, the DPI/WALGA review identified a spectrum of statutory arrangements in other Australasian jurisdictions relating to corporate subsidiaries of local government and the separation of commercial from regulatory functions. The findings of that Review are summarised below.

2.5.1 New South Wales

Section 358 of the *Local Government Act 1993* provides that a Council “must not form or participate in the formation of a corporation or other entity, or acquire a controlling interest in a corporation or other entity, except with the consent of the Minister”. Subsection (3) of that section provides that the Minister’s consent may be given where the Council can demonstrate that the formation of, or the acquisition of the controlling interest in, the corporation or entity is in the public interest.

This is the only other Australasian jurisdiction that retains the default presumption of a general prohibition on corporate structures for local government functions, but leaves wide discretion with the Minister to approve such arrangements, and to impose conditions on approval, if the Minister is persuaded of the public interest value in such an arrangement.

The NSW Act contains detailed provisions (at Sections 400B to 400N) relating to the establishment of Public Private Partnerships (PPPs), and the NSW Department has issued detailed guidelines for the establishment of such entities. The use of corporate structures for participation in PPPs is clearly contemplated, but not specifically referred to in the Act. In practice, these are dealt with by Ministerial consent under Section 358.

2.5.2 Victoria

Section 193 of the *Local Government Act 1989* provides that a Council may, for the purpose of performing any function or exercising any power under the Act –

- (a) participate in the formation and operation of a corporation, trust, partnership or other body; and
- (b) subscribe for or otherwise acquire and dispose of shares in or debentures or other securities of, a corporation; and
- (c) become a member of a company limited by guarantee; and
- (d) subscribe for or otherwise acquire and dispose of units in a trust; and
- (e) acquire and dispose of an interest in a partnership or other body; and
- (f) enter into partnership or into any arrangement for sharing of profits, union of interest, co-operation, joint venture, reciprocal concession or otherwise, with any person or corporation carrying on or engaged in, or about to carry on or

engage in, any business or transaction capable of being conducted so as to directly or indirectly benefit the Council.

Subsection (5C) provides that where the value of the “at risk” investment exceeds the greater of \$500,000 or 5% of the Council’s rates revenue, the approval of the Minister is required (together with that of the Treasurer if the amount exceeds \$5 million). The Minister may place conditions on or issue guidelines for such ventures, and may order a poll of voters to be held before the venture proceeds.

Subsection (11) provides that if a Council participates in the formation of a corporation, trust, partnership or other body in which it will have a controlling interest, the accounts and records of the corporation, trust, partnership or body are subject to audit and inspection as if they were accounts and records of the Council.

The Victorian Act also contains restrictions on the sale or lease of land by a Council in broadly similar terms to those of the Western Australian Act.

2.5.3 Queensland

Queensland has by far the most far-reaching provisions for corporatisation of local government functions through “local government owned corporations” (LGOC’s), devoting some 93 pages of the *Local Government Act 1993* (sections 584 to 757 inclusive) to various aspects of the establishment and operations of LGOC’s. Whilst the main focus of these provisions relates to the provision of utility services, the use of corporate structures for a broad range of other functions is also sanctioned by specific provisions relating the so-called “enterprise powers”.

Under section 496, a local government may engage in or help an enterprise if the enterprise concerns a matter that, in its opinion, is directed to benefiting, and can reasonably be expected to benefit, its area, or a part of its area, and may “do all things necessary or convenient to be done” to exercise such a power. Section 497 further provides that for the purpose of exercising such an enterprise power, a local government may form or take part in forming or be a member or take part in the management of an unlisted company or partnership, acquire and dispose of shares, debentures and securities in such a company or partnership, and commercially exploit its property rights (whether tangible or intangible). The Act provides certain restrictions on the extent of exposure to such entities, including a prohibition on providing guarantees, but these are not particularly onerous.

The Act requires that every LGOC must have a majority of independent directors, and further specifies that the primary responsibility of the Board is the commercial success of the company. There are detailed provisions dealing with circumstances in which a shareholding Council requests the Board to take any action that is not in the commercial best interests of the company.

2.5.4 South Australia

Under section 36(1) of the *Local Government Act 1999*, Councils are explicitly given “the legal capacity of a natural person” with the power to “do anything necessary, expedient or incidental to ... achieving [their] objectives”. The Act also explicitly directs Councils that they must arrange their affairs so as to separate their regulatory activities from their other activities. Section 42 of the Act empowers a Council to establish a corporate subsidiary to undertake any non-regulatory function of the Council, subject to Ministerial approval to the conferral of corporate status.

Section 201 of the Act gives Councils a general and largely unfettered capacity to deal in land that is vested in Council either in fee simple or as a lessee.

2.5.5 *New Zealand*

The *Local Government Act 2002* invests local government with the “power of general competence”, giving Councils unfettered powers to enter into commercial transactions of any kind, provided that in certain cases involving the disposal of assets deemed to be of special significance, or the transfer of functions to a corporate entity, the Act requires that a specified consultative process be followed. Subject to that consultative process, Councils may establish corporate entities (Council Controlled Organisations – CCO’s) for any purpose, either commercial, non-commercial or even regulatory in nature.

The operations of a CCO are the responsibility of its Board, and are governed by general corporations law with certain additional limitations imposed by the Local Government Act. These limitations include measures such as provisions that:

- a Council may not guarantee the liabilities of a CCO
- a Council may not advance money to a CCO at more favourable terms than would apply to the Council itself
- a CCO must appoint the Auditor-General as its auditor
- a Council must have a policy covering the appointment of directors, who must be appointed solely on the basis of their relevant experience and expertise
- a CCO must develop and operate under an annual Statement of Intent that is subject to the approval of the shareholding Council and is a publicly available document
- the proceedings and decisions of a CCO are subject to the same freedom of information and public accountability measures as apply to a Council.

It is a requirement of the Act that every Council must adopt policies defining the strategic significance of its assets: any disposal of such assets or a change in the mode of service delivery attracts specific consultative obligations. There is no limitation on the creation of subsidiary companies, although each of these is subject to the consultative processes for their establishment, including provision of detailed information regarding the nature of the company and its key financial parameters.

2.6 **Public-private partnerships**

There is broad recognition of the value of developing effective partnering relationships between public authorities and the private sector, in order to utilise the financial resources and expertise of the private sector in delivering cost-effective solutions in a range of areas. As noted above, some jurisdictions (notably New South Wales) have developed detailed protocols for managing this process in the local government sector.

Property development is one area in which a partnering approach is particularly relevant. However, the nature of the development process is such that it often requires the parties to take a staged approach to risk management, project financing and the evaluation of development options. In most cases, this is simply not possible to achieve in the context of the requirements of sections 3.58 and 3.59 of the LGA. A further complication is that, if a joint venture is established, it cannot then dispose of developed property (whether by sale or lease) using normal market practices - for example, units or sections cannot be listed for sale in the normal manner – without contravening section 3.58.

The possibility of a commercial enterprise being undertaken jointly by a local government and a private sector party (or multiples of each) raises the issue of a threshold test for determining that a corporate entity established for that purpose falls under the general definition of an LGE and hence becomes subject to the relevant provisions of an amended LGA. It is suggested that an appropriate test would be either:

- beneficial ownership of 50% or more of the shares in any such entity being held by one or more local governments; or
- control of the entity (as that term is defined under Corporations Law) resting with one or more local governments.

Below this threshold, a minority or non-controlling shareholding by local government(s) would be covered by the normal investment provisions of the LGA.

3.0 SPECIFIC COMMERCIAL OBJECTIVES FOR LOCAL GOVERNMENT

3.1 Sustainable Urban Development

State planning strategy seeks to ensure that the Perth region can accommodate future growth in a way that enables it to be economically successful, enjoyable to live in, and minimises the adverse effects of growth on the environment. This strategy is based on the proposition that a long-term solution to the region's transport and infrastructure issues requires a shift towards a more compact and sustainable urban form.

In order to achieve the objective of urban consolidation within existing suburban centres, a more proactive approach is required than has historically been the case. In many cases, the market does not support the preferred planning outcomes to the degree necessary for such developments to occur through conventional planning processes alone. In order for development of the preferred typology to occur in such cases, there is a need for local authorities to act as a catalyst; for example by acquiring strategically located property so as to ensure that it is developed to an appropriate level of intensity, or by participating with private owners to facilitate development of a compact and sustainable urban form. Furthermore, in order to properly integrate transport and landuse policies at a local level, local authorities need to be proactive in identifying sites for future transport-related facilities and development, and establishing measures to control and facilitate appropriate forms of development. Measures are also required to ensure that high quality urban design is a feature of any such development.

As the private property sector is overwhelmingly driven by considerations of financial efficiency, this can result in outcomes that (however successful as individual projects) do not address the wider needs of the community and do not produce coherent and integrated urban areas. The duty of local government to provide for the social, economic, environmental and cultural well-being of its community includes ensuring that the development of property in their communities contributes to these well-beings. It will often be the case that the only way for local government to ensure that urban centres develop in accordance with these principles is to take a strategic ownership stake, thus putting it in a strong position to exercise leverage with would-be developers to incorporate non-financial objectives into any project that requires their cooperation (as a landowner, not solely as a planning authority).

Local government should therefore be encouraged and empowered to selectively acquire or retain such interests in property as may be required to achieve sustainable urban development outcomes. This will include property to support the development of the necessary service, social and community infrastructure and property seen as strategically vital to achievement of urban consolidation, good urban design and/or integration of transport infrastructure and land use. Local government should also be encouraged to explore the creation of effective partnerships to achieve these objectives.

However, in order to facilitate such strategic land purchases in an environment of rapidly escalating prices, there is a need for property acquisition processes and management structures that will allow rapid responses to specific opportunities in the property market. Objectives underpinning such acquisitions will need to be defined in each case in terms of:

- the ability to control the pace, scale and style of development;
- economic, social and environmental benefits to the local government and its ratepayers; and
- exploitation of the local government's land ownership to encourage appropriate private sector investment or development.

Formulation of these objectives must have regard to the need to manage potential conflicts of interest arising from the multiple planning, regulatory and ownership roles of local government, and the need for equity and transparency in all matters involving local government either acting in direct competition with private sector ratepayers or taking other initiatives that might directly or indirectly advantage particular parties.

3.2 Local Economic Development

Sustainable urban development also requires a focus on balancing demand factors. One of the key drivers of a sustainable and compact urban form is the ability of local residents to earn their living within their local area. Generating the right type and balance of local economic development is therefore essential to the achievement of this objective. Among the tools for achieving this are:

- acquiring sites considered suitable for employment-generating activities, and making these available to purchasers or users on favourable terms
- using innovative approaches to property ownership to take the property cost component out of the equation for prospective investors
- acquiring and aggregating property so as to overcome fragmentation and to offer developers sites that are suitable for commercial development
- contributing ancillary functions to shore up commercial developments that might be ahead of the market

Rural and remote communities face different economic development challenges, and these are referred to in section 3.4 below.

3.3 Income Generation and Investment

There is a wide acknowledgement of the need for local government to diversify and expand its sources of income beyond rates. Many Perth local authorities own property that can contribute to this outcome. Investment property is a traditional form of (largely) capital-protected investment, and a prudent portfolio approach to the accumulation of investment assets by a local authority would require at least some of its assets to be held in the form of property (other than that required for operational or service requirements). Income from these properties can then be used to supplement rates revenue, sustain services or fund specific community development projects.

It is a point of debate as to whether it should be allowable for a local government to use income from investment activities to meet normal operating expenses and thus subsidise rates. While good financial practice would suggest that this should be

discouraged, experience has highlighted the practical difficulty in establishing a rigid boundary separating “ordinary” operating expenditure from that which might legitimately be funded from investment income, such as the additional burdens of accelerate development described below. It is recommended that this issue be addressed by way of practice guidelines rather than a mandatory prescription.

Some parts of Perth are facing unprecedented rates of growth, which is likely to continue in the next decade. In order to be proactive and strategically “ahead of the game” in managing the challenges of that growth, local government needs to invest heavily in terms of human and financial resources. The costs of doing this pose a significant problem, in that whilst over time the growth of population will generate increased revenues in these areas, these revenues lag behind the forward planning phase and can take several years to show up to any significant degree. Furthermore, those increased revenues are needed to provide the services demanded by the expanded community, leaving a permanent funding shortfall from the early stages of growth.

The introduction of a system of developer contributions to help defray the cost of infrastructure is a major step towards funding the facilities needed to service this growth. However, this does not provide a complete solution, and no mechanism exists to fund the recurrent and operating expenditure incurred in planning for and managing the effects of growth. In order to avoid imposing on the present community the cost of providing for the needs of the future community, local authorities should be encouraged to capture some of the financial benefits of the very growth that is causing the demand – by acquiring property with the specific purpose of utilising its growth in value to finance the increased cost of servicing that growth.

The financial benefits of growth tend to be enjoyed disproportionately by entrepreneurs who identify development opportunities rather than by the communities that provide the underpinning infrastructure and social fabric that make their development successful. Local government, on behalf of the community, can legitimately capture some of that benefit as a social dividend through a programme of selectively acquisition of property with value growth prospects. Such acquisitions may also serve a strategic purpose in terms of urban design or economic development considerations, allowing local government to achieve multiple objectives of acting as a catalyst for private sector development or investment while controlling the form, scale and timing of development while at the same time capitalising on increasing property values and thus delivering a return to its ratepayers.

However, if such a strategy is to be pursued it is essential that certain key principles are observed. In particular, there must be a clear and transparent arms-length relationship between the planning and commercial functions of local government, so as to avoid the perception that it is unfairly using one to the benefit of the other.

3.4 Economic Decline in Regional Centres

There is widespread acknowledgement of the difficulties faced by local communities in some regional and rural areas in attracting or retaining essential commercial infrastructure. The decline of rural banking, medical and transport services has been well documented over the last decade, but there are many, less obvious, elements to a sustainable community that are under continuing threat. In many cases, these are

traditionally private sector enterprises that can no longer operate viably in shrinking catchments – such as a pharmacy or a service station.

It should be open to local government, should it so choose, to acquire, underwrite or invest in such facilities where this is seen as contributing to the well-being of the local community, and there is no reasonably available alternative. It is self-evident that the local Council is not an appropriate model for the ownership and management of such an enterprise, which ideally requires a separate corporate structure run by a small Board appointed for its commercial expertise.

Where a local authority chooses to acquire and operate such a business for the benefit of its local community, its chances of success will depend on the efficiency with which it is managed and operated, requiring as close as possible the replication of sound private sector commercial practice. It is obvious that this must include an efficient corporate governance model and the ability (as well as the obligation) to operate like any privately-owned enterprise, including the ability to buy and sell assets, raise finance, etc

3.5 Accountability and Risk

The current statutory restrictions were introduced with the intention of ensuring transparency and accountability in local government property and commercial dealings, with the objective of removing opportunities for corruption. However, it is arguable that the existing legislation has done no better in this regard than has been achieved in other jurisdictions without such limitations. There is also no evidence in other jurisdictions that the separation of local government ownership and control through corporate subsidiaries has led to corrupt practice – if anything the reverse is true.

Apart from the unquestionable proposition that good governance requires the separation of regulatory and commercial activities, it should be acknowledged that leaving valuable assets at the disposal of elected Councillors may create opportunities for those assets to be used in ways that are designed to assist the political interests of Councillors rather than always those of the ratepayers at large (the true owners of the assets). This potential problem is inherent in the accountability model of elected local government, by contrast with the general law of accountability for directors and trustees.

In principle, elected members are accountable through the electoral process, but during the intervening period a Council is largely free to make commercial decisions according to the political policies of the majority of Councillors. Whether or not a particular decision regarding community assets is legitimate will always be a contestable issue and Councillors are entitled to argue that as long as they are re-elected they have a mandate from the voters for their actions. By contrast, directors and trustees are accountable at law on a continuous basis for ensuring that every decision they make is in the best interests of their shareholders or beneficiaries, and heavy legal sanctions apply to any breach of these duties.

It is therefore argued that placing the commercial activities of local government at arms' length from political influence - under the control of independent Boards made up of expert directors and the regulatory provisions of normal company or trust law – may produce outcomes that are less susceptible to corruption than the existing arrangements.

Another significant factor for local governments to consider when contemplating commercial enterprises of any sort is that of the risk of commercial failure, accompanied by recognition that the elected members and staff are unlikely to have the necessary commercial or corporate experience to manage that risk while seeking commercial efficiency. While most Councils will always (and appropriately) be highly risk-averse, there is in fact little in the current statutory framework to constrain local governments from placing the assets of the local government at considerable risk provided the consultation procedures of section 3.59 are followed. Perhaps paradoxically, therefore, there is likely to be less prospect of commercial failure and substantially less risk to the ratepayers if such enterprises are placed under the control of LGEs. By quarantining the assets employed within a corporate structure, the board of the entity becomes legally accountable for them and any financial risk associated with their use. Prudential controls by (for example) lending agencies act as a further constraint on reckless assumption of risk.

While greater commercial efficiency, and thus improved financial returns, should result from the use of the LGE model, it will be relevant to consider that the LGE will not enjoy the local government exemption from paying tax on any profits gained from commercial activities. Good tax planning advice will therefore be an important element of any decision to establish an LGE. On the other hand, it might be argued that the removal of this anomalous tax treatment in instances where a local government is undertaking a function that is traditionally the preserve of the private sector would represent sound public policy.

In considering the establishment of an LGE, a local government will consider a number of alternative models, and it is suggested that flexibility to do so be retained as far as possible. For example, while it would be expected that in most cases ownership of the assets under the control of the LGE would be transferred to the LGE for reasons of operational flexibility and efficiency, there may be sound business reasons (including tax efficiency) why a different approach is followed – for example, creating a trust arrangement under which the LGE has operational control but not ultimate legal ownership of the assets. This is a matter that should be addressed by local governments on the basis of the specific purpose and commercial prospects applicable to any potential entity.

4.0 IDENTIFYING AN APPROPRIATE GOVERNANCE MODEL

4.1 A Minimalist Approach

A minimalist reform to overcome the barriers outlined in this paper, while still ensuring appropriate accountability, would involve the introduction of regulations to permit the creation of Local Government Enterprises (LGE's) for specific purposes as approved by the Minister on a case-by-case basis. The 2007 DPI/WALGA review proposed such a minimalist approach that would not (it was believed) require amendment to the LGA, with the following key features:

Approved Development Projects

Local authorities would be encouraged to establish comprehensive planning strategies for urban regeneration and intensification projects within their areas, in close liaison with State planning authorities. When, and only when, such a plan meets the standards that would be required by the WA Planning Commission for an Improvement Plan, and has been approved by the Commission as such, it would be then designated as an Approved Development Project. The granting of Approved Development Project status would not necessarily mean that it would primarily be implemented by the local government, but this would be a precondition for a local government to apply to the Minister for Local Government for approval to the creation of a LGE as a vehicle for such local government participation as was appropriate to the circumstances. The scope of the proposed involvement of the local government in a development role would form part of the matters presented to the Minister for consideration.

Approved Commercial Enterprises

These would be enterprises (anticipated to occur primarily in rural and regional centres) that:

- would ordinarily be undertaken by the private sector; and
- were considered essential to the well-being of the local community; and
- but for the intervention or participation of local government, would not be reasonably available or accessible to residents of a local government area; and
- in the opinion of the Minister, should most efficiently be owned and managed by a corporate entity

Approved Investment Schemes

These would be investments by a local government that involved, or had the potential to involve or to create the impression of, a conflict of interest between the regulatory and investment activities of a local government. The most common instance of such a situation would be the holding by a local government of commercial property, or participation in a property development project, within the boundaries of the local area primarily for investment or income-producing purposes.

Implementation

The creation of LGE's would be authorised by way of a new Regulation 32A under the Local Government (Functions and General) Regulations 1996 (relating to section 3.60 of the Act), with the existing Regulation 32A being renumbered accordingly. In the longer term, following a period of evaluation of the success of those LGE's established, it would be more appropriate to amend the Act in a more comprehensive manner so as to introduce statutory performance measures and tidy up a number of related issues, including sections 3.58 and 3.59 and the investment powers of local government.

The validity of this approach would require that the proposed Regulation not be directly in conflict with the intention of the Act, a matter that could only be determined by Crown Law advice with reference to the passage of the original Act.

Analysis

While the minimalist approach could provide a basis for a limited number of LGEs under strictly controlled conditions, it also gives rise to and/or fails to address a number of related matters. In particular:

- i) there is the potential (as noted above) for the Minister to become embroiled in civil litigation in the event of an LGE becoming insolvent, if it were to be alleged that his approval should not have been given for the creation of the LGE in the first place. This would place an unacceptable onus on the Minister and the Department to verify the accuracy of the information on which an approval was based.
- ii) the minimalist approach, leaving the LGA unchanged and addressing the issue by regulation, does not satisfactorily address the problems caused by section 6.21 – it would have the effect of making the creation of an LGE the only effective option for a local government wishing to use its assets to raise debt, whether or not that structure was appropriate to its size and needs.
- iii) there may be many cases where the creation or acquisition of multiple special-purpose LGEs is appropriate (for example in an urban regeneration context), and the minimalist approach would require each such entity to have Ministerial approval, adding delays and complexity to the project and requiring a degree of Ministerial "micro-management" that is not appropriate.

The minimalist approach also raises the threshold governance question of whether an arms-length corporate subsidiary should become the sole and therefore (in effect) mandatory means by which a local government could undertake commercial activities that required debt raising and asset-trading functions. This issue has been raised in preliminary consultation during the preparation of this paper, with strong support for the notion that any reform process should also provide well-managed local governments with greater capacity to conduct their affairs on a commercially competitive basis without necessarily resorting to the establishment of a separate LGE.

4.2 A Broader Approach

A broader approach involving statutory reform could achieve an appropriate balance between commercial efficiency and accountability while avoiding the perceived problems of the minimalist approach. Such an approach involve amendments to the LGA including in particular:

- (a) the introduction of a provision requiring each local government to adopt and publish a policy on “significant” functions and assets, based on consultation with its community, an in default that all functions and assets are deemed as “significant”;
- (b) section 6.21 to be amended to provide that a local government may not give security over any asset defined as “significant” (unless approved in writing by the Minister), but otherwise may give security and raise debt on normal commercial terms;
- (c) section 3.60 to be repealed and replaced by a detailed suite of measures generally in accordance with the New Zealand legislation relating to the establishment and governance of LGEs;
- (d) a proviso that a local government may not, without the written consent of the Minister, establish a LGE for the purposes of dealing in any asset defined as “significant” or the delivery of any function defined as “significant”.
- (e) consultation in relation to the establishment of a LGE (as prescribed in the proposed new sections) being deemed to satisfy the requirements of sections 3.58 and 3.59 in relation to the transfer of any property assets from a local government to a LGE or the undertaking of a major business transaction.
- (f) investment in a LGE, if all other requirements are met, be deemed an approved investment under section 6.14.

Appropriate amendments would also be required to the *Local Government (Functions and General) Regulations 1996* to provide the framework for the proposed provisions governing Statements of Intent and business plans. These would be generally in accordance with the measures proposed in section 4.3 below. There may also be consequential amendments required to some aspects of the *Local Government (Financial Management) Regulations 1996*, especially as regards the accounting treatment of LGEs and of the local government interests in LGEs, and the proposed financial reporting requirements of LGEs.

4.3 A Comprehensive Approach

For reasons discussed in section 2.4 above, attempts to differentiate between “core” and “non-core” functions and assets of local government are likely to lead to further and unnecessary complications for local governments seeking greater efficiency of operations. Unless there is some other logical basis on which to define those aspects of local government activity to which the use of corporate subsidiaries might be appropriate while excluding all others (and none has been suggested, other than the exclusion of any regulatory function), it follows that reform should avoid such

distinctions and instead focus on how accountability and transparency is to be preserved.

That is not to advocate an entirely “open slather” approach. Rather, it would require local governments considering the use of LGEs to meet the strictest standards of transparency in consulting their communities, and the highest standards of corporate governance in the operation and oversight of LGEs. As an ancillary measure, amendments to section 6.21 to allow security to be given over land held in freehold title should be introduced to facilitate better asset utilisation by local governments without necessarily resorting to the use of LGEs

It is proposed that this be achieved by:

1. The LGA being amended to provide the following:
 - (a) section 3.60 to be repealed and replaced by a detailed suite of measures generally in accordance with the New Zealand legislation relating to the establishment and governance of LGEs;
 - (b) a proviso that a local government may not establish a LGE for the purposes of dealing with any regulatory function, or delegate any regulatory function to a LGE;
 - (c) consultation in relation to the establishment of a LGE (as prescribed in the proposed new sections) being deemed to satisfy the requirements of sections 3.58 and 3.59 in relation to the transfer of any property assets from a local government to a LGE or the undertaking of a major business transaction.
 - (d) investment in a LGE, if all other requirements are met, be deemed an approved investment under section 6.14.
 - (e) section 6.21 to be amended to provide that a local government may give security over any freehold land in addition to its general fund.
2. The *Local Government (Functions and General) Regulations 1996* being amended to:
 - (a) remove any inconsistencies created by the broadening of the power to establish or control corporate entities as related to current regulations; and
 - (b) include detailed provisions for:
 - (i) the matters to be set out in the annual Statement of Intent of a proposed LGE, and a model form of Statement of Intent along the lines of that set out in Appendix 2; and
 - (iii) the matters to be set out in the Business Plan of a proposed LGE for public consultation prior to the establishment of the LGE, and a model form of Business Plan along the lines of that set out in Appendix 3.

A specific provision of the requirements governing Business Plans would be to address whether the proposed LGE is to undertake functions currently provided

by the local government, and to explain the rationale for the proposed change including the effect on staff currently employed in those functions

3. Guidelines and a Best Practice Manual for LGEs be prepared by WALGA in consultation with the Department and other relevant State Government entities to better inform local government of the matters that will need to be addressed both in the establishment and in the ongoing operation of LGEs

A suggested suite of statutory amendments to implement this approach is set out in Appendix 1. As noted in Appendix 1, there may also be consequential amendments required to some aspects of the *Local Government (Financial Management) Regulations 1996*, especially as regards the accounting treatment of LGEs and of the local government interests in LGEs, and the proposed financial reporting requirements of LGEs. Those matters of detail are not within the scope of this paper.

4.4 Joint Enterprises

It is likely that there will be interest in establishing LGEs that are jointly owned by more than one local government. The suggested statutory amendments are therefore framed with a view to describing “participation” in a LGE in a way that would enable this, and require each local government to undertake separate consultation prior to participation.

As noted at section 2.7 above, in the case of joint enterprises that are partially owned by other (State or private) interests, it is proposed that the amended statutory provisions come into effect only when there is a majority shareholding or control (as defined in Corporations Law) of such an entity by one or more local governments.

4.5 Non-corporate Alternatives

It is likely that cases will arise in which a local government wishes to delegate responsibility for decisions affecting local government assets (other than property) to persons with appropriate expertise, without incurring the expense of establishing a LGE. This would be the case particularly with small enterprises or one-off situations where establishing an arms-length entity may not be cost-effective or practical. In such instances, some broadening of the provisions of section 5.17 may offer a partial solution. However, such an approach will not satisfactorily address most of the issues raised in this paper.

5.0 BUSINESS PLANS

It is proposed that the preparation and public advertising of a detailed Business Plan be an essential prerequisite for the establishment of a LGE. This would set out the nature of the proposed activities of the LGE in more detail than the Statement of Intent, and would include proforma financial statements showing the following information for the first 5 years of operation:

- Operating cashflow
- Profit and Loss Statements
- Balance Sheet

The purposes of this are:

- i) To provide transparency in relation to the proposed financial implications for a local government of the establishment of a proposed LGE;
- ii) To provide a starting basis for the provision of financial information required under the Statement of Intent; and
- iii) To ensure that sufficiently detailed business and financial planning has been undertaken prior to any decision to establish a LGE.

The Business Plan should also detail:

- the assets of a local government to be transferred, together with their current market valuations and any income and or liabilities associated with these assets;
- whether the proposed LGE is to undertake functions currently provided by the local government, and if so the rationale for the proposed change including the effect on staff currently employed in those functions;
- the amount proposed to be subscribed by the shareholder as equity;
- the anticipated borrowings and debt/equity ratio to be maintained

It is proposed that consultation in relation to the Business Plan for the establishment of a LGE be deemed to satisfy the requirements of section 3.58 in relation to the disposal of local government property to the LGE and section 3.59 in relation to a major land transaction.

A sample Business Plan for the establishment of a hypothetical property LGE is enclosed in Appendix 3.

APPENDIX 1: PROPOSED DRAFT STATUTORY PROVISIONS

Suggested key amendments and/or insertions to sections of the *Local Government Act 1995* and the *Local Government (Functions and General) Regulations 1996* are set out below. Other consequential amendments may also be required, including amendments to some aspects of the *Local Government (Financial Management) Regulations 1996* as noted.

3.60 Establishment of a Local Government Enterprise (*Replaces existing section 3.60*)

- (1) In this Act, “Local Government Enterprise” means:
 - (a) a company established under general corporations law in which one or more local governments hold 50% or more of the equity or a controlling interest; or
 - (b) a trust established primarily for the benefit of residents or ratepayers of one or more local government areas with the intention of holding assets formerly owned by those local governments
- (2) A local government may not form, or participate in forming, or exercise control of a Local Government Enterprise other than in accordance with this clause and the Regulations.
- (3) A Local Government Enterprise may not be established for the purposes of dealing with any regulatory function of a local government, and a local government may not delegate any regulatory function to a Local Government Enterprise.
- (4) A local government may not subscribe for shares in a Local Government Enterprise or propose to transfer assets to a Local Government Enterprise unless it first:
 - (a) carries out a consultative process as set out in section 3.60A; and
 - (b) thereafter decides* to participate in the Local Government Enterprise.

** Absolute majority required*

3.60A Consultation in relation to participation in a Local Government Enterprise (*Proposed new section*)

- (1) A local government may not participate in a Local Government Enterprise unless it first:
 - (a) prepares a Constitution, Statement of Intent and Business Plan for the proposed Local Government Enterprise; and

- (b) prepares a statement of the reasons why it believes its participation in a Local Government Enterprise will result in an improved delivery of the functions proposed to be undertaken by the Local Government Enterprise including, where reasonable and appropriate to do so, a comparison of the anticipated financial outcomes (**statement of reasons**); and
 - (c) gives local public notice in accordance with subsection (2); and
 - (d) makes available for public inspection copies of the proposed Constitution, Statement of Intent, Business Plan and statement of reasons at the local government offices and at each local government library in the district.
- (2) The local public notice is to contain -
- (a) notification that the local government proposes to participate in a Local Government Enterprise; and
 - (b) details of where and when the Constitution, Statement of Intent, Business Plan and statement of reasons for the proposed Local Government Enterprise may be inspected; and
 - (c) an invitation for submissions in relation to the proposed participation in the Local Government Enterprise to be made by members of the public within 42 days of the day on which local public notice was first given.
- (3) The Statement of Intent prepared under this section must comply with the requirements for a Statement of Intent under subsection 3.60E.
- (4) The Business Plan prepared under this section must contain such information as is specified in the Regulations.
- (5) The consultation required in subsection (1) may be undertaken as part of the local government's consultation in relation to the plan prepared pursuant to section 5.56
- (6) The local government must consider any submissions received in relation to the proposed participation in the Local Government Enterprise before deciding whether to proceed with the proposed participation.
- (7) Consultation carried out in accordance with this section shall be deemed to satisfy the requirements of section 3.58 in relation to the transfer of any property asset from a local government to a Local Government Enterprise.
- (8) Consultation carried out in accordance with this section shall be deemed to satisfy the requirements of section 3.59 in relation to the transfer of any property asset that would constitute a major land transaction, and in relation to the participation of the local government in a Local Government Enterprise being a major trading undertaking.

3.60B Appointment of directors or trustees to a Local Government Enterprise
(Proposed new section)

- (1) Every local government, before considering participation in a Local Government Enterprise, must adopt a policy that sets out an objective and transparent process for –
 - (a) the identification and consideration of the skills, knowledge, and experience required of directors or trustees of a Local Government Enterprise; and
 - (b) the appointment of directors or trustees to a Local Government Enterprise; and
 - (c) the remuneration of directors or trustees of a Local Government Enterprise.
- (2) A local government may appoint a person to be a director or trustee of a Local Government Enterprise only if the person has, in the opinion of the local government, the skills, knowledge, or experience to -
 - (a) guide the Local Government Enterprise, given the nature and scope of its activities; and
 - (b) contribute to the achievement of the objectives of the Local Government Enterprise.

3.60C Governance of a Local Government Enterprise *(Proposed new section)*

- (1) The principal objective of a Local Government Enterprise is to -
 - (a) achieve the objectives, both commercial and non-commercial, of its shareholders as specified in the Statement of Intent; and
 - (b) be a good employer; and
 - (c) exhibit a sense of social and environmental responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when reasonably able to do so; and
 - (d) conduct its affairs in accordance with sound business practice
- (2) All decisions relating to the operation of a Local Government Enterprise must be made by, or under the authority of, the board of the Local Government Enterprise in accordance with -
 - (a) its Statement of Intent; and
 - (b) its Constitution

3.60D Limitation on guarantees and lending *(Proposed new section)*

- (1) A local government must not give any guarantee, indemnity, or security in respect of the performance of any obligation by a Local Government Enterprise.
- (2) A local government must not lend money, or provide any other financial accommodation, to a Local Government Enterprise on terms and conditions that are more favourable to the Local Government Enterprise than those that would apply if the local government were (without charging any rate or rate revenue as security) borrowing the money or obtaining the financial accommodation.

3.60E Statements of Intent for Local Government Enterprises *(Proposed new section)*

Every Local Government Enterprise must have a Statement of Intent that is in a form prescribed by the Regulations and is not inconsistent with the constitution of that Local Government Enterprise.

3.60F Performance monitoring and reporting *(Proposed new section)*

- (1) A local government that is a shareholder in a Local Government Enterprise must regularly undertake performance monitoring of that Local Government Enterprise to evaluate its contribution to the achievement of -
 - (a) the local government's objectives for the Local Government Enterprise; and
 - (b) the desired results, as set out in the Statement of Intent; and
 - (c) the overall aims and outcomes of the local government
- (2) A local government must, as soon as practicable after a Statement of Intent of a Local Government Enterprise is delivered to it,
 - (a) agree to the Statement of Intent; or
 - (b) if it does not agree, take all practicable steps as provided for in the Regulations to require the Statement of Intent to be modified
- (3) Within 2 months after the end of the first half of each financial year, the board of a Local Government Enterprise must deliver to the shareholders a report on the operations of the Local Government Enterprise during that half year, setting out the information required by its Statement of Intent to be included in that report.
- (4) Within 3 months after the end of each financial year, the board of a Local Government Enterprise must deliver to the shareholders, and make available to the public, a report on the operations of the Local

Government Enterprise during that year, setting out all of the information required to be included by -

- (a) subsections 5 and 6; and
 - (b) its Statement of Intent
- (5) A report on the operations of a Local Government Enterprise under subsection 4 must -
- (a) contain the information that is necessary to enable an informed assessment of the operations of that Local Government Enterprise and its subsidiaries (**group**), including -
 - (i) a comparison of the performance of the group with the Statement(s) of Intent; and
 - (ii) an explanation of any material variances between that performance and the Statement(s) of Intent; and
 - (b) state the dividend, if any, authorised to be paid or the maximum dividend proposed to be paid by the Local Government Enterprise for its equity securities (other than fixed interest securities) for the financial year to which the report relates.
- (6) A report on the operations of a Local Government Enterprise under subsection 4 must include -
- (a) audited consolidated financial statements for that financial year for that group; and
 - (b) an auditor's report on -
 - (i) those financial statements; and
 - (ii) the performance targets and other measures by which performance was judged in relation to that group's objectives

3.60G Audited accounts to be submitted to the Auditor General (*Proposed new section*)

The audited accounts of a Local Government Enterprise and the consolidated group accounts of each local government participating in the Local Government Enterprise must be submitted to the Auditor-General within 3 months of completion of the audit.

6.14. Power to invest (*Proposed subsection (3) added to existing section*)

- (1) Subject to the regulations, money held in the municipal fund or the trust fund of a local government that is not, for the time being, required by the local government for any other purpose may be invested —

- (a) in accordance with Part III of the *Trustees Act 1962*; or
 - (b) in an investment approved by the Minister on the advice and recommendation of the Treasurer.
- (2) Regulations in relation to investments by local governments may —
- (a) provide for the manner in which an approval under subsection (1)(b) may be sought;
 - (b) prescribe classes of investment which may be made without the need to comply with subsection (1)(b);
 - (c) prescribe circumstances in which a local government is required to invest money held by it;
 - (d) provide for the application of investment earnings; and
 - (e) generally provide for the management of those investments.
- (3) This section does not apply to participation in a Local Government Enterprise established in accordance with this Act.

6.21. Restrictions on borrowing (*Proposed subsection (2)(b) added to existing section*)

- (1) Except in the case of:
- (a) overdrawings on current account from a bank or other financial institution; and
 - (b) such other form of financial accommodation (if any) as is determined by the Treasurer and notified to local governments in the State,
- a local government is only to exercise a power under section 6.20(1) with the prior approval of the Treasurer or a person authorised in that behalf by the Treasurer.
- (2) Where, under section 6.20(1), a local government borrows money, obtains credit or arranges for financial accommodation to be extended to the local government that money, credit or financial accommodation is only to be secured by giving security over:
- (a) the general funds of the local government; or
 - (b) land owned in freehold title by the local government.
- (3) The Treasurer or a person authorised in that behalf by the Treasurer may give a direction in writing to a local government with respect to the exercise of its power under section 6.20(1) either generally or in relation to a particular proposed borrowing and the local government is to give effect to any such direction.

- (4) In this section and in section 6.23 —
- “general funds” means the revenue or income from —
- (a) general rates;
 - (b) Government grants which were not given to the local government for a specific purpose; and
 - (c) such other sources as are prescribed.

Proposed inclusions in *Local Government (Functions and General Regulations 1996)* in relation to Local Government Enterprises

Part 8 – Local Government Enterprises (*proposed new part and regulations*)

39. Statements of Intent - s. 3.60E

- (1) The purpose of a Statement of Intent is to:
 - (a) state publicly the activities and intentions of a Local Government Enterprise for the year and the objectives to which those activities will contribute; and
 - (b) provide an opportunity for shareholders to influence the direction of the organisation; and
 - (c) provide a basis for the accountability of the directors to their shareholders for the performance of the Local Government Enterprise.
- (2) The board of a Local Government Enterprise must deliver to its shareholders a draft Statement of Intent on or before 31 March each year.
- (3) The board must—
 - (a) consider any comments on the draft Statement of Intent that are made to it within 2 months of 31 March by the shareholders or by any of them; and
 - (b) deliver the completed Statement of Intent to the shareholders on or before 30 June each year.
- (4) The board may, by written notice, modify a Statement of Intent at any time if the board has first—

- (a) given written notice to the shareholders of the proposed modification; and
 - (b) considered any comments made on the proposed modification by the shareholders or by any of them within -
 - (i) 1 month after the date on which the notice under paragraph (a) was given; or
 - (ii) any shorter period that the shareholders may agree.
- (5) Despite any other provision of the Act or of the constitution of any Local Government Enterprise, the shareholders of a Local Government Enterprise may, by resolution, require the board to modify the Statement of Intent by including or omitting any provision or provisions of the kind referred to in clause 8 (a) to (h), and the board must comply with the resolution.
- (6) Before giving notice of the resolution to the board, the shareholders must consult the board concerned as to the matters to be referred to in the notice.
- (7) A completed Statement of Intent and each modification that is adopted to a Statement of Intent must be made available to the public by the board within 1 month after the date on which it is delivered to the shareholders or adopted, as the case may be.
- (8) A Statement of Intent must, to the extent that is appropriate given the organisational form of the Local Government Enterprise, specify for the Local Government Enterprise and its subsidiaries (if any) (**group**), and in respect of the financial year immediately following the financial year in which it is required by subregulation 3(b) to be delivered and each of the immediately following 2 financial years, the following information:
- (a) the objectives of the group; and
 - (b) a statement of the board's approach to governance of the group; and
 - (c) the nature and scope of the activities to be undertaken by the group; and
 - (d) the ratio of consolidated shareholders' funds to total assets, and the definitions of those terms; and
 - (e) the policy of the board in relation to dividends; and
 - (f) the accounting policies of the group; and
 - (g) the performance targets and other measures by which the performance of the group may be judged in relation to its objectives; and

- (h) the kind of information to be provided to the shareholders by the group during the course of those financial years, including the information to be included in each half-yearly report (and, in particular, what prospective financial information is required and how it is to be presented); and
 - (i) the board's estimate of the commercial value of the shareholders' investment in the group and the manner in which, and the times at which, that value is to be reassessed; and
 - (ii) any other matters that are agreed by the shareholders and the board.
- (9) If a Local Government Enterprise has undertaken to obtain or has obtained compensation from its shareholders in respect of any activity, this undertaking or the amount of compensation obtained must be recorded in:
 - (a) the annual report of the Local Government Enterprise; and
 - (b) the annual report of the local government shareholder(s).
- (10) Any financial information, including (but not limited to) forecast financial information, must be prepared in accordance with the relevant Australian Accounting Standard as defined in the *Local Government (Financial Management) Regulations 1996*.

40. Business Plans – s.3.60A

- (1) The purpose of a Business Plan is to:
 - (a) state publicly the proposed activities of a Local Government Enterprise in sufficient detail to enable persons wishing to make a submission in relation to section 3.60A of the Act to be properly informed of the anticipated financial affairs of the Local Government Enterprise and the effect of its establishment and operation on:
 - (i) the local government(s) proposing to participate in the Local Government Enterprise; and
 - (ii) any other entity performing similar functions to those of the proposed Local Government Enterprise;
 - (b) provide a basis for the accountability of the directors to their shareholders for the performance of the Local Government Enterprise.
- (2) A local government proposing to form or participate in a Local Government Enterprise must prepare a Business Plan in relation to the first 5 years of operation of the Local Government Enterprise prior to inviting public submissions on the proposal.

- (3) A Business Plan prepared in accordance with section 3.60A must, to the extent that is appropriate given the organisational form of the Local Government Enterprise, specify for the group comprising the Local Government Enterprise and its subsidiaries (if any), in respect of the first 5 financial years of its operations, the following information:
 - (a) the nature and scope of the activities to be undertaken by the group; and
 - (b) details of any assets proposed to be transferred from a local government to the Local Government Enterprise; and
 - (c) the proposed funding arrangements for the activities of the group (to the extent that these can reasonably be anticipated); and
 - (d) the following proforma financial reports:
 - (i) Profit and Loss Statement
 - (ii) Balance Sheet
 - (iii) Projected cashflow
- (4) If it is proposed that the Local Government Enterprise is to undertake functions currently provided by the local government(s), the Business Plan must state clearly:
 - (a) the rationale for the proposed transfer of those functions; and
 - (b) the anticipated the effect on the employment of staff currently employed by the local government(s) in performing those functions.
- (5) Any financial information and proforma financial reports must be prepared in accordance with the relevant Australian Accounting Standard as defined in the *Local Government (Financial Management) Regulations 1996*.

Amendments to *Local Government (Financial Management) Regulations 1996* in relation to Local Government Enterprises

A number of amendments will be required to the *Local Government (Financial Management) Regulations 1996* in relation to the accounting treatment of Local Government Enterprises in the accounts of local governments and the proposed financial reporting requirements. However, the drafting of these is a matter best dealt with after further evaluation of the proposed model.

APPENDIX 2 : MODEL STATEMENT OF INTENT FOR LOCAL GOVERNMENT ENTERPRISES

A draft Statement of Intent has been prepared for a property company established by the hypothetical Town of Westralia, to illustrate the intended form and content of a typical Statement of Intent under the proposed statutory arrangements.

Draft

WESTRALIA PROPERTIES PTY LTD

Statement of Intent for the Year to 30 June 2011

1. INTRODUCTION

Westralia Properties Pty Ltd (**WPPL**) is a wholly owned subsidiary of the Town of Westralia (**Town**) and a Local Government Enterprise (**LGE**) under the *Local Government Act 1995* as amended (**Act**). WPPL is required under the Act to prepare and deliver to the Town a Statement of Intent (**SOI**) for WPPL that is to be approved by the Town as shareholder and thereafter reviewed annually. The process of negotiation and determination of an acceptable SOI is a public and legally required expression of WPPL's accountability to its shareholder.

This SOI specifies (among other things) WPPL's objectives, the nature and scope of its activities and its performance targets during the year ending 30 June 2011.

2. PURPOSE

2.1 Mission Statement

The Mission Statement of the WPPL is:

"To maximise strategic, financial and sustainable outcomes on behalf of the Town from the ownership and development of selected property assets."

2.2 Values

WPPL's core values are focused on maximising benefit for the residents and ratepayers of Westralia. It will do this by achieving, in consultation with the Town and the community, an appropriate balance between:

- financial returns from property investment and development;
- urban development outcomes determined in consultation with the Town;
- environmentally sustainable development;
- high quality urban design; and
- promotion of social and cultural diversity.

2.3 Objectives

WPPL's commercial and non-commercial objectives are:

- a) To acquire from the Town certain property assets of the Town upon establishment, and thereafter other property from time to time either from the Town or by acquisition on the open market.
- b) To develop these property assets so as to:
 - facilitate the achievement of the Town's strategic planning objectives;

- generate income by trading, developing or enhancing properties in the portfolio which can, by way of dividends, supplement the revenue of the Town; and
 - achieve financial sustainability for WPPL, to enable it to operate profitably as a property company.
- c) To demonstrate best practice in sustainable development activities.
- d) To develop effective relationships between WPPL and the community, including private sector property interests; and
- e) To undertake other initiatives at the request of the Town.

3. NATURE AND SCOPE OF ACTIVITIES

3.1 Business Overview

WPPL will function as a property investment and development company. In order to achieve its objectives, it will buy (both from the Town and on the open market) property with strategic development value, develop or enhance the value of property to add both strategic and financial value, sell property for development by others (subject to conditions related to the Town's strategic planning objectives) and enter into development partnerships with other parties. In some cases, it will hold and manage leased properties as a source of revenue.

The twin objectives of WPPL's business model are:

- To operate profitably and thus generate, by way of dividends, a dependable revenue stream for the Town; and
- To undertake development, or facilitate the development by others, of strategically located property in a way that gives effect to the Town's strategic objectives.

Initially, the main focus of activity will be to identify and implement development opportunities for nominated property currently owned by the Town with commercial or strategic value. In the longer term, WPPL will seek to identify, and acquire for development, other property within the constraints of its financial capacity to do so.

3.2 Activities

The Group's activities are subject to the provisions of the Act, corporations law (including the *Corporations Act 2001*, the *Australian Securities and Investments Commission Act 2001*, the *Corporations (Western Australia) Act 1990* and other relevant Commonwealth and State legislation governing the operation of corporations within Western Australia), this SOI and the Constitution of WPPL. During the year ending 30 June 2011 the principal activities of WPPL will be to:

- a) Acquire from the Town the properties listed in the attached Schedule, and such other property assets as the Town wishes WPPL to acquire;

- b) Formulate action plans, and initiate commercial relationships which will facilitate WPPL's long-term objectives;
- c) Undertake design, planning, costing, feasibility studies and peer reviews on selected properties within its portfolio;
- d) Subject to Board approval, undertake and complete the redevelopment of property D1;
- e) Administer leases and receive rents from leased properties, and undertake or commission such property management functions as may be required;
- f) Arrange funding for such expenses as may prudently be incurred in undertaking the activities described herein;
- g) Hire staff, consultants and contractors as required;
- h) Promote the company to the property industry and to appropriate public organisation and groups;
- i) Provide advice to the Town on development issues on request;
- j) If deemed prudent and necessary by the Board in consultation with the Town, establish such subsidiary entities (**Subsidiaries**) to hold and/or develop individual properties within its portfolio
- k) Such other activities as may be required to protect the value of WPPL's portfolio

3.3 Governance

3.3.1 Shareholder

The Town is the 100% owner of WPPL. WPPL will be the 100% owner of the Subsidiaries unless the Town approves otherwise.

3.3.2 The Board

WPPL is to be governed by a Board of up to four external directors including the Chair, appointed by the Town. Each director including the Chair is to be appointed for a maximum of two consecutive three-year terms.

3.3.3 Role of the Board

Subject to WPPL's Constitution, the Board is responsible for the proper direction and supervision of WPPL's activities. The Board aims to ensure that WPPL's business is carried out in the best interests of WPPL and with proper regard to corporate responsibility. The primary role of the WPPL's Board is to manage WPPL in line with the requirements of this SOI and governance best practice.

The Board's responsibilities include:

- To set WPPL's strategic direction;
- To direct and supervise the management of WPPL's business affairs;
- To allocate capital and resources to enable WPPL to achieve its goals;
- To ensure that WPPL's financial position is fully protected so as to allow it to meet all debts and obligations as they fall due;
- To represent and promote WPPL's interests;
- To satisfy itself that WPPL is achieving the objectives set out in the SOI;
- To ensure that WPPL has appropriate risk management and regulatory compliance policies and processes in place;
- To keep the Town informed through quarterly reports, and additionally as necessary, of progress and emerging issues;
- To be aware and informed regarding issues of concern to the Town in relation to WPPL and its environment;
- To ensure that WPPL adheres to high standards of ethics and corporate behaviour, and
- To appoint, and monitor the performance of the Chief Executive.

WPPL's Constitution sets out certain limitations in the Board's management powers. Those limitations include the requirement that the Town's approval is obtained before the Board authorises certain actions including:

- Any change to the name of WPPL;
- The adoption or modification of each SOI;
- The making of any call in respect of any moneys unpaid on any Share;
- Major Transactions as defined in corporate law;
- The incurring of any indebtedness for borrowed money, other than in accordance with any guidelines notified to WPPL in writing from time to time by the Council;
- The reconstruction or reorganisation, or the merger, amalgamation or consolidation with any person, of WPPL or the voluntary liquidation of WPPL;
- Disposal of shares in any of the Subsidiaries; or
- Any other act, matter or thing notified to WPPL in writing from time to time by the Town.

WPPL's directors are to comply with a formal Code of Conduct which is based on the Australian Institute of Directors' Code of Practice for Directors.

3.3.4 Role of the Chair

The Chair's role is:

- To evaluate the performance of and consider succession planning for the Board on an annual basis and report to the Town;
- To manage the Board effectively, providing the necessary leadership; and
- To interface with, and guide WPPL's Chief Executive.

3.3.5 *Director Fees*

The directors and Chair of WPPL will be paid fees to be determined by Council from time to time, having regard to comparable industry standards of remuneration.

3.3.6 *Executive and Consulting Services by Directors*

It is the expectation of the Town that, in general, directors will not also be eligible to be employed by WPPL on a fee-paying basis in an executive or consultancy role. However, it is recognised that from time to time it may be appropriate for such arrangements to be entered into where such services cannot efficiently be obtained externally, provided the approval of the Town is first obtained, or where the Board believes the requirement to be urgent, as soon as practicable.

3.3.7 *Director Indemnity and Insurance*

At the request of the Board, WPPL is to:

- Indemnify each of its Directors for any liability or costs referred to in sections ___ of the Corporations Act 2001; and
- Effect insurance for each of its Directors in respect of any liability or costs referred to in sections ___ of the Corporations Act 2001.

3.3.8 *Board Subcommittees*

The Board of WPPL must constitute a formal Audit and Risk Management subcommittee with a charter based on the Institute of Directors Policy Statement. The Board may also establish other ad hoc subcommittees from time to time. Directors will not be entitled to additional fees for serving on any such subcommittees unless expressly approved by the Town.

3.3.9 *Subsidiary Companies*

The Board of WPPL will also serve as the Board of each Subsidiary for so long as it is wholly owned by WPPL in accordance with the Subsidiaries' constitutions. Directors will not be entitled to additional fees for serving on any such subsidiary Boards.

Where it is proposed to dispose of shares in a Subsidiary, the proposed equity distribution and makeup of the Board of that Subsidiary will be recorded in the SOI for the relevant year.

4. SHAREHOLDERS FUNDS AND DIVIDENDS

WPPL's ratio of consolidated shareholder's funds to total assets is estimated to exceed 90% for the financial year ending 30 June 2011 and the next financial year. Thereafter, WPPL will utilise project finance as the directors deem prudent and appropriate and the ratio of shareholder funds to total assets will be adjusted accordingly.

Shareholder's funds are defined by reference to the total amount of WPPL's paid up ordinary shares plus retained earnings. Total assets are defined as all assets available to WPPL in accordance with International Financial Reporting Standards (IFRS).

Each year the Town and WPPL will agree and record the target expectations for dividends to be paid to the Town from the operating profits of WPPL. It is not intended that dividends be paid in the first two years of operation of WPPL. The longer term objective is that dividends be paid annually to Council comprising:

- The value of rents that the Town would otherwise have received from leased properties; and
- An annual dividend of not less than 5% of any increase in the value of WPPL's assets.

Distributions will be made wherever practicable out of cash reserves. However, the Board of WPPL may at its discretion elect to borrow in order to meet its dividend commitments.

5. WPPL'S ACCOUNTING POLICIES

- 5.1 WPPL is to prepare financial statements that comply with the requirements of the corporations and taxation law and the IFRS.
- 5.2 WPPL is to adopt accounting policies that are consistent with IFRS and generally accepted corporate practice.
- 5.3 WPPL is to prepare financial statements for itself and any Subsidiaries on a consolidated group basis.
- 5.4 The Auditor General of Western Australia is to be the auditor of WPPL and any Subsidiaries.

6. MEASURES BY WHICH WPPL'S PERFORMANCE MAY BE JUDGED IN RELATION TO ITS OBJECTIVES

- 6.1 Financial Performance Measures

PERFORMANCE	TARGETS
<p>Financial Performance Manage the business efficiently, maintaining cash flows as budgeted and managing land sales to achieve budgeted returns.</p>	As set out in annual budgets.
Achieve dividend flows as negotiated with the Town	As set out in dividend agreements from time to time

<p>Cost Management Ensure that costs of running the business conform to budgeted levels.</p>	As set out in annual budgets.
<p>Asset Management To ensure that all statutory requirements related to the company's land assets are met.</p> <p>Maintain effective control of development so that the value of the Company's assets is maintained.</p>	<p>Pass appropriate regulatory and compliance audits.</p> <p>Land assets to be subject to periodic independent valuation as determined by the board.</p>

6.3 Social and Environmental Key Performance Measures

PERFORMANCE	TARGETS
<p>Strategic Development Outcomes WPPL will endeavour to facilitate and, as far as it is practicable to do so, give effect to the Town's strategic planning objectives for the development of land within Westralia.</p>	<p>Compliance with existing strategic planning goals.</p> <p>Identification of innovative solutions to achieve strategic planning outcomes</p>
<p>Sustainable Development Adopt best environmental practice in carrying out its development activities.</p> <p>Seek to enshrine a commitment to sustainable environmental practices in any agreement for the sale of land or development in partnership.</p> <p>Foster improvements in urban design outcomes</p>	<p>Recognition by a peer group of environmental professionals</p> <p>Monitor all agreements for compliance.</p>
<p>Social Responsibility Adopt best practice in social inclusiveness and community consultation.</p>	<p>Recognition by ratepayers and citizens recognition that WPPL reflects these attributes.</p> <p>Establishment of effective community liaison mechanisms</p>

7. INFORMATION TO BE PROVIDED TO THE SHAREHOLDERS BY WPPL DURING THE COURSE OF EACH FINANCIAL YEAR

7.1 In each financial year, WPPL is to comply with all reporting requirements under the Act and corporations law.

7.2 WPPL will to provide to the Town:

- a) a SOI detailing all matters required in a SOI under the Act;
- b) a budget for the coming financial year and the two following years for WPPL and its Subsidiaries (the **Group**);
- c) a quarterly report on operations of the Group within two months after the end of the first and third quarters of each financial year, which is, unless otherwise agreed by the Town, to report on:
 - summarised financial statements including a comparison between actual financial year-to-date revenue and expenditure and budgeted financial year-to-date revenue and expenditure;
 - market conditions affecting the Group's current and projected operations;
 - the progress of existing development projects;
 - proposed development projects;
 - forward planning issues;
 - staff;
- d) a half yearly report, within two months after the end of the first half of each financial year, which is to report on the Group's operations during that half year and, unless otherwise agreed by Council, is to include:
 - the information required for a quarterly report described above for the period covered by the report; and
 - financial statements as at the end of, and for, the period covered by the report;
- e) an annual report, within three months after the end of each financial year, which is to report on the Group's operations during that year and, unless otherwise agreed by the Town:
 - is to include the information required for a quarterly report described above for the period covered by the report;
 - must contain the information that is necessary to reach an informed assessment of the Group's operations, including:

- a comparison of the performance of the Group with its current SOI; and
- an explanation of any material variations between that performance and the SOI;
- the dividend, if any, authorised to be paid or the maximum dividend proposed to be paid by WPPL for its equity securities (other than fixed interest securities) for the financial year to which the report relates; and
- audited financial statements for that financial year for the Group and an auditor's report on those financial statements and the performance targets and other measures by which performance was judged in relation to the Group's objectives.

7.3 WPPL will also brief the Town on an ad hoc basis throughout the year in the event of any occurrence significantly affecting the matters on which it is required to report formally.

8. ESTIMATE OF THE COMMERCIAL VALUE OF THE SHAREHOLDER'S INVESTMENT IN WPPL

It is estimated that the net value of the Town's investment in WPPL and its Subsidiaries, as measured by the issue of fully paid ordinary shares, will be approximately \$28.2 million. This value is to be assessed by the Board on completion of the annual financial statements or at any other time determined by the Board. The method of assessment will use the value of shareholder's funds as determined in the annual financial statement as a guide.

9. ANY OTHER MATTERS THAT ARE AGREED BY THE SHAREHOLDER AND THE BOARD

NIL

Schedule – Properties to be acquired from the Town

Property	Current Valuation
Development Properties	
Property D1	\$2,000,000
Property D2	\$1,500,000
Property D3	\$6,000,000
Property D4	\$3,000,000
Leased investment properties	
Property L1	\$3,500,000
Property L2	\$2,200,000
Property L3	\$4,800,000
Property L4	\$3,200,000

Draft

APPENDIX 3 : MODEL BUSINESS PLAN FOR ESTABLISHMENT OF A LOCAL GOVERNMENT ENTERPRISE

A draft Business Plan has been prepared for the establishment of the hypothetical property company described in Appendix 4, to illustrate the intended level of detail proposed to be provided for the establishment of a LGE under the proposed statutory arrangements.

Draft

TOWN OF WESTRALIA

Business Plan for the Establishment of

WESTRALIA PROPERTIES PTY LIMITED

Draft

1. INTRODUCTION

The Town of Westralia (**Town**) proposes to establish Westralia Properties Pty Limited (**WPPL**) as a wholly owned Local Government Enterprise under the *Local Government Act 1995* as amended. This Business Plan sets out the financial projections for the operations of WPPL for the 5 years to 30 June 2015.

2. NATURE AND SCOPE OF ACTIVITIES

2.1 Business Overview

WPPL will function as a property investment and development company. It will buy (both from the Town and on the open market) property with strategic development value, develop or enhance the value of property to add both strategic and financial value, and enter into development partnerships with other parties. It will hold and manage some leased properties as a source of revenue.

The twin objectives of WPPL's business model are:

- To operate profitably and thus generate, by way of dividends, a dependable revenue stream for the Town; and
- To undertake development, or facilitate the development by others, of strategically located property in a way that gives effect to the Town's strategic objectives.

Initially, the main focus of activity will be to identify and implement development opportunities for nominated property currently owned by the Town with commercial or strategic value. In the longer term, WPPL will seek to identify, and acquire for development, other property within the constraints of its financial capacity to do so.

It is not proposed that WPPL undertake any functions currently performed by the Town and no current employees of the Town are affected by the proposed establishment of WPPL.

2.2 Activities in year ending 30 June 2011

During the year ending 30 June 2011 the principal business activities of WPPL will be to:

- a) Acquire from the Town the properties listed in the attached Schedule, and any other property assets as the Town wishes WPPL to acquire;
- b) Undertake design, planning, costing, feasibility studies and peer reviews on selected properties within its portfolio;
- c) Subject to Board approval, undertake and complete the redevelopment of property D1; and

- d) Administer leases and receive rents from leased properties, and undertake or commission such property management functions as may be required.

2.3 Activities in 5 years ending 30 June 2015

During the 5 years ending 30 June 2015 it is anticipated that WPPL will:

- a) Finalise design, planning, costing, feasibility studies and peer reviews on all of the development properties within its portfolio;
- b) Subject to Board approval, undertake and complete the redevelopment of properties D1, D2 and D3 and commence the redevelopment of Property D4;
- c) Acquire one further property on the open market with a view to completing the Town's strategic development plan for Westralia;
- d) Subject to the approval of the shareholder, dispose of one of the redeveloped properties in order to generate cash for further activities; and
- e) Carry out minor repairs and improvements to leased properties so as to enhance the rental income from these properties.

3. FUNDING

3.1 Shareholders equity

It is proposed to issue to the Town shares to the value of \$28,200,000 in exchange for the properties listed in the Schedule. The Town will subscribe for further shares to the value of \$600,000 to provide initial working capital.

3.2 Borrowings

WPPL will borrow approximately \$3,000,000 in the year ending 30 June 2011 in order to fund the redevelopment of Property D1. Subject to servicing capability from rental income, it is proposed to raise further borrowings as necessary for the acquisition and redevelopment of other properties on a progressive basis.

3.3 Debt to equity ratio

WPPL will maintain a maximum level of debt to shareholder's equity of 40%.

4. PROFORMA FINANCIAL STATEMENTS

Proforma financial statements are attached, setting out projections for the 5 years to 30 June 2015 for:

- Cashflow
- Profit and Loss Statement
- Balance Sheet

Schedule – Properties to be acquired from the Town

Property	Current Rent	Current Valuation
Development Properties		
Property D1	0	\$2,000,000
Property D2	0	\$1,500,000
Property D3	\$300,000	\$6,000,000
Property D4	\$250,000	\$3,000,000
Leased investment properties		
Property L1	\$175,000	\$3,500,000
Property L2	\$110,000	\$2,200,000
Property L3	\$240,000	\$4,800,000
Property L4	\$160,000	\$3,200,000

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