KPMG

City of Hobart

Doone Kennedy
Hobart Aquatic Centre

Public Benefit Test
Discussion Paper

November 2022

Background

The Doone Kennedy Hobart Aquatic Centre (DKHAC) has been the subject of a competitive neutrality complaint lodged by a private sector pool/ gymnasium operator with the Office of the Economic Regulator (OTER) associated with the pricing practices adopted by the DKHAC.

Introduction

The DKHAC facility comprises a 50m pool, 25m pool, leisure pool, diving pool, meeting rooms, gymnasium and café.

The Centre provides several services including gymnasium and personal training, memberships that provide access casual swimming, various learn to swim programs, along with a cafeteria, retail area and hosting of swimming and other aquatic events.

Since some of these activities can compete with private sector providers, it is important that council comply with Competitive Neutrality Principles in accordance with a methodology prescribed in Department of Treasury and Finance's Application Statement, National Competition Policy – Applying the principles to Local Government in Tasmania, December 2013.

Complaint summary

Council received a competitive neutrality complaint through the OTER in relation to business activities conducted at the DKHAC. The Complainant to OTER lodged a Competitive Neutrality Complaint Form, which claims, in summary:

- The business activities of the DKHAC and the Complainant are the same in some ways in three areas:
  1. lap swimming/ memberships
  2. fitness centre and personal training
  3. swim school
- The Council (through the DKHAC) is in breach of the section 5(b) of the Competitive Neutrality Principles.
- The DKHAC's pricing for all services is significantly lower than what the Complainant must charge to cover all operating costs, and this is affecting memberships/ patronage.

In its investigation of the Complaint, OTER came to the following headline conclusions, as set out in its report to the Council in September 2020:

- The Council has recognised the DKHAC as a Significant Business Activity (SBA), but full cost attribution has not been applied to the pricing of the services
- NCP allows the Council to charge less than full cost, if it can be demonstrated, through a robust and independent public benefits assessment, that it is in the public benefit that the service is offered at prices that are below full cost.

The Council has committed to OTER to work through a systematic process to address the findings. Due to COVID-19 impacts, OTER has granted Council an extension to address the findings by July 2023.

Approach to address the findings

KPMG was engaged by Council to assist with the analysis required to address OTER's findings. In summary the scope and approach to the work undertaken to date has required the following steps:

1. Undertake the necessary full cost attribution analysis for the activities/ services that are the subject of the complaint at the DKHAC.
2. Analyse the pricing of those activities/ services at the DKHAC against other public sector and private sector providers.
3. Determine whether Council's pricing of those services/ activities is reflective of the fully attributed costs of delivering those services/ activities.
4. If the pricing of those services/ activities is not cost reflective, establish a case for a CSO or undertake a Public Benefit Test to demonstrate that there is a net public benefit in not applying full cost attribution pricing.

The analysis undertaken indicates that a Public Benefit Test will be required for one of the activities/ services covered by the complaint, that being lap swimming/ memberships. This Discussion Paper summarises the analysis and invites submissions as part of Public Benefit Test.

Approach to meeting the Guidelines

In order to address OTER's requirements, an approach has been agreed that comprises the steps outlined below.

The Department of Treasury and Finance's guidelines entitled The Public Benefit Test for the Corporatisation of Local Government Public Trading Enterprises (1998) provides **guidelines as to when and why public benefit tests are required, what the public benefit test comprises and how it should be conducted.**

According to the Guidelines, an activity can be described as having a public benefit, if on the whole, it can be demonstrated that the **benefits it provides to the community, outweigh the costs** of the activity to the community.

The Guidelines suggest that the public benefit assessment should be undertaken in **consultation with the community**, including affected businesses that would be adversely affected by unfair competition, through **an open and transparent process.**

In addition, there should be a mechanism to be able to **share the results** of the public benefit assessment to interested parties.

September - October

- Outline the findings of the analysis undertaken by KPMG
- Obtain Council approval with the content of the Discussion Paper and the consultation approach

Step 1: Discussion Paper

November - December

- Release this Discussion Paper to elicit submissions from the community
- Collate the feedback received through the consultation process

Step 2: Community Consultation

January - February

- Compile outputs from Step 1 and Step 2 into an initial Public Benefits Test report

Step 3: Public Benefit Test

March - April

- Implement any changes DKHAC pricing programs if required
- Implement outcomes of the analysis by 1 July 2023

Step 4: Implement outcomes

Full cost attribution analysis

In order to comply with the Guidelines, the first step was to undertake Full Cost Attribution analysis for those services that were the subject of the complaint.

Total revenue
$5.16M

Operating deficit
$1.24M

CNCs
$2.18M

Total deficit
$3.43M

Full Cost Attribution Analysis

According to the Guidelines for Implementing Full Cost Attribution in Government Agencies (1997) the fully attributed cost of a SBA is the value of all resources consumed by an entity in the provision of that SBA (i.e., full cost) plus competitive neutrality costs (i.e., imputed costs). Fully attributed cost consists of:

i) operating costs (direct and indirect overheads); plus

ii) capital costs (direct and indirect); plus

iii) competitive neutrality costs (CNCs).

A Full Cost Attribution (FCA) financial model was designed and substantially refined in consultation with DKHAC and Council's Finance staff.

The outputs generated provide a reasonable basis to formulate some conclusions.

Due to the impacts of COVID-19 on the operations of the DKHAC in the 2019-20 and 2020-21 financial years, that analysis has been confined to the 2018-19 financial year. The headline findings from that analysis are outlined below.

Overall findings

The size and nature of the DKHAC results in high running costs. This caused the facility to run at a substantial deficit in FY19 of $1.24M before considering competitive neutrality costs of $2.18M and a deficit of $3.43M after all costs.

Competitive neutrality costs that need to be added to the operating costs mainly comprise the opportunity cost of capital and council rates.

In FY19 the DKHAC had total income of $5.6M. The major expense categories in order of largest to smallest were Labour, Materials, Depreciation and other expenses at $3.39M, $2.38M, $881k and $220k respectively. Materials expenditure included $95k of water and sewerage costs and $483k of Energy costs.



Full cost attribution analysis

Further detailed analysis was undertaken into the three services/ activities that were the subject of the complaint

Lap swimming

Deficit of $2.77M and comparable pricing with other providers





There is limited scope to increase pricing for these activities to be fully cost reflective, due to the likely impact on demand and so this will be the focus for the Public Benefit Test.

Lap swimming/ memberships

The Memberships service line refers to revenue and expenses associated with swimming (Blue) memberships at the DKHAC. The analysis found:

1. These services attracted a combined deficit of $2.77M, driven mainly by a large percentage of overheads and competitive neutrality costs being allocated to these functions, based on pool usage data.
2. Pricing data suggests the DKHAC pricing schedule for both membership and casual swimming was within the price range of competitors. Cost/ unit analysis shows that current membership and casual swim prices would need to have increased by a weighted average of 81% and 158% respectively in order to be cost reflective, assuming no impact on demand for memberships and casual swims.
3. Given the required increase, there would appear to be limited scope to increase pricing for these activities to be fully cost reflective, due to the likely impact on demand. As such, subject to any further revisions and refinement of the FCA model, ongoing funding for these functions and maintenance of current prices (or close to) will need to be justified as part of a Public Benefit Test.



Full cost attribution analysis

Further detailed analysis was undertaken into the three services/ activities that were the subject of the complaint

Fitness centre

$185K deficit with some scope to increase prices to be cost reflective



Swim school

Surplus of $49K with some scope to increase prices to align with other providers



Fitness centre and personal training

- These services attracted a combined deficit of approximately $185k, of which $138k applied to the Gymnasium and $47k applied to Personal Training.
- Pricing data indicated that DKHAC **gym memberships were broadly in line** with the market across the various membership categories.
- One notable difference was that several competitors required a joining fee ranging from $40 at Kingborough to $99 at Oceania and All Aerobics. This presented Council with an option to increase Gym Membership income and reduce the net deficit for this service line.
- Given the comparatively smaller net deficit for these functions, there may be **scope for Council to adopt cost reflective pricing** and not require these functions to attract CSO funding or form part of a broader public benefit test.

Swim school

- This function covers the provision of learn to swim classes through three programs – the In-Term Program, the School Holiday Program and the mandatory Government funded Program for years 3-6.
- Combined, these program reported a modest surplus of around $49k, with the surplus of the Term Program, offsetting deficits in the Holiday Program and the Government's Learn to Swim program (where there is limited scope for negotiation on pricing).
- Analysis of pricing suggested the DKHAC's cost per lesson for the Term and Holiday Programs, at $21 was **towards the lower end of the range**, with only one competitor offering a lower price and all others charging up to $21.
- Based on the analysis, the DKHAC's pricing for both Term and School Holiday Swimming programs were broadly cost reflective albeit the hourly rate was towards the lower end of the range of pricing set by competitors.
- This suggests these functions **need not attract CSO funding or form part of a broader public benefit test.** However, the deficit-making nature of the Government's Learn to Swim Program could give rise to an identifiable CSO funding allocation in line with a specific policy objective.

Public Benefit Test considerations

The Public Benefit Test applied to lap swimming and memberships needs to set out the costs and benefits of the programs and services it delivers to substantiate the reasons for not adopting fully cost reflective pricing. Some examples of the factors that could be discussed in depth in the Public Benefit Test are outlined below.

Potential advantages of the current pricing arrangements (benefits)

Societal/ community benefits

- Improved community health and well being
- Improved water safety awareness and skills

Economic benefits

- Attracts expenditure from visitors to the region
- Facilitates the staging of national and international events
- Provides services to citizens not based in the Hobart LGA
- Allows demand in the region to be better matched and reduces wait times

Customer benefits

- Provides a broader array of programs beyond lap swimming for clubs/ teams
- Offers services that have similar prices to operators of other facilities
- Provides affordable access to disadvantaged community members
- Facilitates access to therapeutic activities for the elderly

Financial and administrative benefits

- May require less rigorous governance and financial management
- May reduce need for marketing expenditure

Potential disadvantages of the current pricing arrangements (costs)

Societal/ community benefits

- Potential to create a competitive disadvantage for similar businesses

Economic benefits

- Risk of distorted market for comparable services and programs
- May discourage competition and/ or private sector investment in expansion

Customer benefits

- Higher cost pricing may discourage excess-demand - crowding, queuing, congestion
- Customers may attach a higher value to the services if they are more reflective of the costs of provision

Financial and administrative benefits

- May require more disciplined financial reporting and cost management
- May require expenditure on marketing to maintain/ grow market share

Invitation for submissions

Purpose

The purpose of the Public Benefit Test is to determine whether there is a net public benefit from applying full cost attribution principles to a significant business activity - in this case, the lap swimming and membership programs that form part of the DKHAC.

Full cost attribution principles are used to neutralise the net competitive advantage enjoyed by a public entity arising from its public ownership.

Your say

Council is keen to hear from a broad range of stakeholders to capture your thoughts about the outcomes shared in this Discussion Paper.

Questions that may assist stakeholders to assemble your thoughts include the following:

1. What are your thoughts about the findings of the cost analysis shared in this Discussion Paper?
2. What do you believe to be the benefits of keeping access to lap swimming and memberships at or around their current prices?
3. How important to you is it that the current prices for lap swimming and memberships be kept at, or around their current levels?
4. What do you believe to be disadvantages of keeping the prices for lap swimming and memberships at levels that are significantly less than the cost of providing those services?
5. How important to you is it that the current prices for lap swimming and memberships be significantly increased to be more reflective of the costs?
6. Overall, considering the benefits and costs, what would you recommend to Council?

> The onus is on public entities to conduct an objective public benefit assessment to substantiate that the public benefit will not be served by applying competitive neutrality principles.

The options available to lodge your submission are as follows:

1. Completing the online submission form https://yoursay.hobartcity.com.au/public-benefits-test
2. Email your written submission to coh@hobartcity.com.au
3. Post your written submission to
   DKHAC Public Benefit Test
   KPMG, Level 3/100 Melville Street,
   Hobart TAS 7000

Submissions close at midnight, Sunday 11th December 2022