

Competitive Neutrality Policy

Childcare Services Documentation



Department	Family, Youth and Children
Responsibility	Pam Newton
Activity/Service/Function	Childcare Services
Date of last update	28/07/20
Approved (Member of Executive Leadership Team)	GM Community & Economic Development

Executive Summary

Council currently operates five early education and care services within the municipality. This activity is within the scope of National Competition Policy (for more detail, refer to Appendix 1).

National Competition Policy (NCP) was introduced in 1995 to implement a program of economic reforms to ensure competitive markets could freely operate in Australia and to avoid anti-competitive practices. Part of this policy aims to ensure that where governments, including local government, provide activities in markets where private businesses also operate, they are competing fairly in those markets. NCP operates on the basis that competitive markets generally best serve the interests of the community.

In Victoria, the state's commitment under NCP are implemented under the Victorian Government's Competitive Neutrality Policy (CNP) and administered by the Commissioner for Better Regulation.

The policy requires local governments in Victoria to undertake four steps to apply the CNP.

1. Identify if the activity in questions (childcare) is a significant business activity
2. Assess the benefits and costs of introducing CNP measures
3. Conduct a public interest test where required
4. Implement competitive neutrality measures if required following the above

Under competitive neutrality provisions, Council is only required to implement competitive neutrality measures if the expected benefits outweigh the expected costs (both financial and non-financial). Documenting defensible reasoning for Council's decision that is based on the best information available that will withstand scrutiny is critical to ensure Council is compliant with competitive neutrality.

Council has undertaken a range of measures to ensure it is compliant with National Competition Policy and acting in the public interest. This includes undertaking a range of consultation activities to understand what is valued by the local community and setting clear policy objectives it aspires to achieve for children's services in the municipality (for more detail, refer to Appendix 2). It has also

Competitive Neutrality Policy

Childcare Services Documentation



sought to mitigate competitive neutrality risks by reducing any subsidy provided by Council through incremental fee increases and a range of efficiency measures.

This document canvasses the public interest and any potential risks of available measures that Council could implement to ensure the operations of early childhood education services meet the requirements of National Competition Policy.

The analysis concludes that it is in the public interest for Council to continue operating services for the following reasons:

- The Council policy objective of ensuring access to quality early childhood education may not be achieved if Council implemented further competitively neutral measures as the services provide greater levels of accessible care and quality education for vulnerable children in the municipality than other providers.
- The ongoing COVID-19 pandemic has highlighted the importance of early education and care as an essential service. It has also generated market uncertainty for early education and care providers in the short to medium term. Continuing to operate will contribute to the stability of services available in the City of Port Phillip and ensure children, particularly those who are experiencing factors associated with higher levels of vulnerability, have access to quality early education and care providers.
- Any direct subsidy by Council has been substantially reduced through a range of efficiency measures and Council's pricing model is comparable within the local market.

This finding will be reviewed at a minimum annually to ensure that the activity continues provide services to children whose families are experiencing factors associated with vulnerability, the activity continues to minimise any direct subsidy by Council and have regard for how the local early education and care market is operating.

Competitive Neutrality Policy

Childcare Services Documentation



Competitively Neutral Measure Assessment

The following section provides an analysis on what public interest, if any, is met by Council directly operating the four centres and what risks, if any, to public interest would there be if Council adopted the competitively neutral measure of transitioning out of operating the centres. It also considers the impact of competitively neutral measures that may be available to it such as implementing fully-cost reflective prices and changes to governance.

1. Background

Following its determination that Council's early education and care activities were in the scope of National Competition Policy, Council undertook a range of activities to address any risk of non-compliance. This included:

- Undertaking a detailed competitively neutral cost analysis based on Council's operations in 2017/18
- Mitigating any ongoing risk that Council is non-compliant with competitively neutral provisions by incrementally increasing fees above CPI each year and implementing a range of efficiency measures to reduce the quantum of any subsidy.
- Developing *Every Child, Our Future: Children's Services Policy* to articulate its objectives for children's services in the municipality and inform any deliberations regarding public interest and the risks to public interest of potential competitively neutral measures.

1.1 Competitively neutral cost analysis

A competitively neutral cost analysis in 2018 of the four Council-run childcare services (excluding Barring Djinang Kindergarten) found that at a daily fee of \$125, Council was subsidising these centres by \$2.049M in 2017/18 using a fully distributed cost methodology¹. In order to adopt the competitively neutral measure of fully cost-reflective pricing, the report estimated that the daily fees

¹ The 2018 assessment used a fully-distributed cost methodology which allocates all indirect costs to the business activities. More recent advice from Better Regulation Victoria (2019) suggested that either an avoidable cost methodology or overhead estimation could be applicable in this circumstance. The avoidable cost methodology acknowledges that, in practice, indirect costs (for example, Council IT and HR supports) would be incurred even if the business activity wasn't operated by Council. The overhead estimation method looks at what percent of revenue is usually allocated to this function by similar businesses. Council has adopted the later approach and assigned a nominal 5% of revenue as the cost of overheads for this activity.

The analysis also assumed that the requirement in Council's Enterprise Agreement to pay above award wages did not constitute a competitive disadvantage. If the difference in wages between Council's agreement and the award was considered a competitive disadvantage, Council would have been able to justify lower prices as competitively neutral. It should also be noted that Council would still have been making a substantial financial contribution to the service and Council has a responsibility to ensure its use of resources are in the public interest.

Competitive Neutrality Policy

Childcare Services Documentation



would have needed to increase to \$154 per day. At this time, Council considered the viability of these daily rates, however, an external review by Grosvenor Public Sector Advisory found that these fees were likely to be uncompetitive and were likely to result in continued subsidy by Council because of reduced utilisation.

1.2 Reducing quantum of any subsidy

Since the analysis undertaken in 2018, Council has been able to substantially reduce any direct subsidy by gradually increasing fees and implementing efficiency savings.

In 2018/19, the direct cost to Council of operating its four services was reduced to \$850,000 compared with \$1.54 million in 2017/18. With continued focus on efficiency measures and fee levels, Council's results to 31 March 2020 showed a significant further reduction in the operating subsidy to \$240,000 year to date.

From April 2020 Council's results have been significantly impacted by new funding measures introduced by the Federal Government in response to the Covid-19 pandemic. Council was required to accept 50% of fee income for the balance of the 2020 financial year, despite not being eligible for the Job Keeper wage subsidy. This put council at a competitive disadvantage to many other centres operating in the municipality. Council's loss for the three-month period to 30 June 2020 was approximately \$700,000, despite reducing casual and agency staffing levels significantly in response to lower attendance levels at Council centres.

Further reductions in any direct subsidy have been initiated in Council's draft Budget 2020/21 which proposes charging for public holidays (which is standard for the industry) and continuing a range of efficiency measures.

As a result, Council's 2020/21 budget proposes that the services will operate with a total contribution of \$130,000 from Council's general revenue with a budgeted daily fee of \$133.50 (Frozen at the 2019/20 rates). When adjustments for competitive advantages and disadvantages are applied the total subsidy provided to the service is approximately \$400,000.

1.3 Development of the *Every Child, Our Future: Children's Services Policy*

Council's [*Every Child, Our Future: Children's Services Policy*](#) outlines Council's agreed policy objectives and parameters for Council's role in early education and care services. The seven objectives in the policy are the foundation of any deliberations regarding public interest.

Council consulted broadly to understand the views and preferences of users, other service providers and the community in general in the development of the policy. This enabled Council to determine how it can best act in the public interest and meet the NCP requirements under the public interest test (for more detail refer to Appendix 2).

In March 2019, Council specifically asked for feedback on several competitively neutral measures. During the consultation, Council heard that there was a preference that Council-run childcare services continue to be operated by Council and strong support for not-for-profit services (with a

Competitive Neutrality Policy

Childcare Services Documentation



limited distinction made between whether the service was community-run or Council-run). Council's Children's Services Community Reference Group also indicated a preference for sector consisting of council-run, community-run and the private sector to provide choice and support for families.

2. Key Information

Council's *Every Child, Our Future: Children's Services Policy* makes a commitment to support a thriving early education and care sector in Port Phillip that provides quality service options enabling choice and accessibility for all children and families and ensuring early years' services are financially sustainable and aligned with relevant policies and legislation.

The following section canvasses the potential risks to these objectives associated with implementing competitively neutral measures that are available to Council through its policy. It is worth noting, that Council's *Every Child, Our Future: Children's Services Policy* limits any transition of Council-operated services to other providers to a community-managed model and assumes continued support for community-managed providers through fair and equitable tenancy and funding arrangements.

Accessibility for all

Overall, the capacity of the market contributes to whether services are accessible (i.e. whether families can access places when they need it). Over the past three years, new private-for-profit operators have entered the market (particularly along commuter routes) and there was evidence that in particular areas, supply of places is greater than demand. This suggests supply has been responding to demand. Additional capacity was anticipated in the next two years with two new for-profit services planning to open between 2021 and 2022. However, the unknown economic impact of the ongoing COVID-19 pandemic presents significant uncertainty regarding how both supply and demand factors may change for services operating in the City of Port Phillip.

Council's policy also seeks to address any disadvantage that children from more vulnerable families may experience by making quality care available to these children in our municipality. This is based on evidence that children from vulnerable backgrounds receive a disproportionate benefit from quality, early childhood education. Anecdotally these families experience actual or perceived barriers to accessing services. Internal data indicates that the number of children associated with vulnerability factors placed via Council's centralised waitlist at Council-operated services is greater than the number placed at community-run services. This suggests that Council-operated services are more accessible to children whose families may be experiencing factors associated with poor long-term outcomes for the child. Council's ongoing role in direct delivery provides some certainty in achieving Council's policy objective, that children experiencing factors associated with vulnerability can access quality education and care. There is a risk that this would be diminished if Council transitioned out of direct service delivery.

Competitive Neutrality Policy

Childcare Services Documentation



Choice and affordability for families

The cost of childcare in the City of Port Phillip is one of the highest in Victoria². It is unknown whether Council's role in direct childcare provision is having a positive or negative influence on the affordability of services or what the impact would be if Council was no longer a provider. Fees in the municipality vary greatly (between \$120-\$165 per day) and analysis in September 2019 indicates that Council's fees are currently priced in the middle of prices in the local market.

In general, the price of community-managed childcare is lower than the price of Council-operated services and other private (both for-profit and not-for-profit providers). This is partially attributable to Council's subsidies of these services but also suggests that these providers may be able to provide a lower-cost service that provide more affordable fees for families.

Service quality

Overall, services in the City of Port Phillip are of high quality when assessed against the National Quality Standards (introduced in 2012) and there are limited differences between different types of providers operating in the City of Port Phillip.

Supporting a thriving early education and care sector

There are a range of factors outside of Council's control that create the conditions for a thriving early education and care sector and an absence of evidence that Council is restricting competition. That new entrants are continuing to enter the local market suggests that Council's role in early education and care is unlikely to have severely restricted the local market. A key factor in the early education and care sector is the financial support and policy provided by the Federal Government for these essential services.

The recent COVID-19 pandemic has introduced significant uncertainty regarding potential changes to supply and demand. Temporary Federal government relief packages were designed to ensure providers can continue to operate whilst demand changed. It is unknown whether these measures will be sufficient to allow all providers operating in the municipality to remain viable and what the impact of an economic recession will have on care-giver decisions regarding use of early education and care services thus impacting on demand. This uncertainty also increases the likelihood that potential operators would not be willing to take on the risk of operating services if Council was to transition out services. Council has the option to reassess this risk in the future.

In addition to the evidence that Council-operated services are fulfilling Council's public policy objective of supporting vulnerable children, there is some justification that the costs of

² According to administrative data released by the Department of Education, in September 2019, average hourly fees in the City of Port Phillip were the fifth highest in the state. On average hourly fees were higher in Bayside (no Council-operated), Stonnington (small proportion Council-operated), Boroondara (no Council-operated) and Glen Eira (small proportion Council-operated).

Competitive Neutrality Policy

Childcare Services Documentation



implementing competitively neutral measures may outweigh the potential benefit, particularly at this time of uncertainty.

Risk of increased subsidy by implementing full-cost recovery pricing

Increases to daily fees are fully passed on to families as current daily fees are above the federal government cap. In September 2018, Council engaged Grosvenor Public Sector Advisory to assess the implications of the indicative full cost recovery rates on demand for Council-operated services. Grosvenor found that the fees required were higher than the market average and there was a real risk that demand would be reduced, particularly for those services in the north of the municipality where there was greater availability of places from other providers. If demand for Council's services reduced because of changes to fees Council services may experience reduced utilisation and would have to provide additional subsidy to maintain the services.

Therefore, any changes to fees need to be managed carefully to ensure that the service provides value for money in the current market and Council does not perversely increase its subsidy through covering the costs associated with reduced utilisation. Council's improved operations have significantly reduced any potential fee increase. For example, under a model of competitively neutral pricing, Council would need to charge a daily fee of approximately \$138 compared with the budgeted fee of \$133.50 in 2020/21. Under the Federal Government's Early Education and Care Relief Package Council will be restricted from increasing fees. Given the uncertainty and the potential affordability issues arising from COVID-19 pandemic any additional fee increase is not recommended at this time. Council has the option to reassess this in the future.

Costs of transitioning to community-managed model

Council's *Every Child, Our Future: Children's Services Policy* limits any transition out of direct provision of services only to the community-managed model. If Council were to transition to community managed services, transfer of ownership would mean Council would be liable for significant costs (estimated at approximately \$4 million) in the short-term. Based on Council's 2020/21 budget and including provisions for reductions in corporate overheads that are likely to be obtained, it is estimated that this cost will take approximately 10 years to recover. It is possible that transaction costs could be reduced through a staged approach however market uncertainty at this time and the improved performance of the services means proceeding with this option at this time is unlikely to be in the public interest. Council has the option to reassess these costs in the future.

Costs of corporatisation

There are different governance models that Council could implement to further 'commercialise' or 'corporatise' the operation of the services while retaining ownership of the services. This includes delegated committees. These would involve some transition costs that are unlikely to warrant the marginal benefit of improved performance that this competitively neutral measure seeks to achieve. Council has the option to reassess this risk in the future.

Competitive Neutrality Policy

Childcare Services Documentation



Risks associated with remaining in-service delivery

Council needs to consider that by remaining in direct service delivery it will be subject to market changes in a time of uncertainty, including a potential decline in enrolments in a recession. There is also the risk that there may be further instances where Council is excluded from government funding available to other providers because it is a government organisation (as happened with the recent decision that Council run services could not access JobKeeper). This may impact on Council's objective in its policy to ensure services are financially sustainable. Careful management of the financial performance of the services will partially mitigate this risk.

By remaining in service delivery, Council may also be perceived by other operators as a competitor. This may present a risk to our ability to work across the sector to achieve the objectives of the Children's Services Policy that will need to be mitigated by being open and transparent about what it is seeking to achieve by operating early education and care services.

3. Conclusion

This analysis demonstrates that, whilst there are some risks to Council in remaining in direct service delivery, it is overall in the public interest for Council to continue operating early education and care services for the following reasons:

- The Council policy objective of ensuring access to quality early childhood education may not be achieved if Council implemented further competitively neutral measures as the services provide greater levels of accessible care and quality education for vulnerable children in the municipality than other providers.
- The ongoing COVID-19 pandemic has highlighted the importance of early education and care as an essential service. It has also generated market uncertainty for early education and care providers in the short to medium term. Continuing to operate will contribute to the stability of services available in the City of Port Phillip and ensure children, particularly those who are experiencing factors associated with higher levels of vulnerability, have access to quality early education and care providers.
- Any direct subsidy by Council has been substantially reduced through a range of efficiency measures and Council's pricing model is comparable within the local market.

This finding will be reviewed a minimum annually to ensure that the activity continues provide services to children whose families are experiencing factors associated with vulnerability, the activity continues to minimise any direct subsidy by Council and have regard for how the local early education and care market is operating.

Competitive Neutrality Policy

Childcare Services Documentation



Appendix 1: Significant Business Test

The following section provides the outcome of the significant business test to determine whether competitive neutrality applies. It firstly assesses whether it meets the requirements of a business activity and secondly whether it would be considered significant.

Part 1 – Is it a business?	
Factor	Assessment
<i>Do the activities result in the sale of a good or service?</i>	Yes
<i>Are the costs of providing the goods or services of the entity predominantly met by users?</i>	Yes
<i>Is there an actual or potential competitor?</i>	Yes
<i>Does the management of the activity have a degree of independence in producing or supplying the good or service and the price at which it is provided?</i>	Yes
Conclusion: Childcare is a business activity of Council.	
Reasoning:	
<p>Council operates five childcare (long day-care) services within the municipality. The most recent addition was in 2018 which will be operated by Council for two years before being transitioned to a community managed centre.</p> <p>Users engage the service to provide daily care to children over the course of a working week, for an ongoing period. Approximately 80% of costs are met through user fees. These user fees are highly subsidized by the Commonwealth government. Commonwealth subsidies are on a sliding scale which is correlated with household income.</p> <p>Childcare is also provided by not-for-profit and for-profit enterprises and this is a significant business within Australia. There is an array of other providers across the municipality. Some are council-supported childcare providers (in council buildings, with some targeted council subsidies). A significant proportion of the market (more than 56% in 2019) is provided by private for profit childcare providers. One not-for-profit provider currently operates in the market.</p> <p>The difference in service offering between council and other providers is minimal because of the level of regulations surrounding childcare provision and similarity in service offering (for example operating hours) therefore the services may be considered 'substitutable'. For these reasons, the provision of long day care services is a business activity of Council.</p>	
Part 2 – Is it significant?	
Factor	Assessment
<i>Does it have an annual revenue greater than \$500,000 or is it expected to grow rapidly?</i>	Yes
<i>Is the scale of the business activity larger than or comparable to its private competitors?</i>	Yes
<i>Is there evidence that it has an influence or competitive impact of the business activity in the relevant market?</i>	Yes
Conclusion: Childcare is a significant business activity of Council. This was disclosed publicly in a report to Council on 5 December 2018 (Report 9.6 Children's Services Policy Development, point 4.21.1)	

Competitive Neutrality Policy

Childcare Services Documentation



Reasoning:

Revenue in 2018/19 was \$9.2M in user fees and \$400,000 in government grants which is above the threshold for annual revenue.

Based on the number of available long day childcare places (excluding kindergarten only centres like Barring Djinang), Council operates 14.3% of services in the local market (2019 analysis). Based on the number of long day childcare centres, Council operates 14.6% of places in the local market (2019 analysis). This has decreased slightly since 2017/18 by 2 percentage points as more providers enter the market.

When comparing market share in the north of the municipality (encompassing the suburbs of South Melbourne, Port Melbourne and Albert Park), Council's market share is lower at 10% places and higher in the south of the municipality (encompassing suburbs of St Kilda, Elwood, St Kilda East and Balaclava) with a share of 21%.

The VCEC investigation of Hobsons Bay Council's childcare activities in 2014/15 concluded that on balance their business was significant for CN purposes despite having a smaller proportion of the market than the City of Port Phillip. On this basis, we believe that Better Regulation Victoria would deem Port Phillip's childcare business to be a significant business.

In 2018, Council received legal advice that confirmed it was likely that Council-run childcare services may be a significant business (within scope of national competition policy) but that subsidies provided to community-run childcare centres were outside of the scope of competitive neutrality policy.

Competitive Neutrality Policy

Childcare Services Documentation



Appendix 2: Public Interest Test Compliance Questionnaire

The following section summarises how this analysis complies with the requirements under the public interest test.

Requirement	Supporting evidence and actions to be undertaken
<ul style="list-style-type: none"> - Clearly identify the policy objective(s) that is to be achieved and ensure that the policy objective (s) has official endorsement 	<p>Council has developed Childrens Services policy objectives in consultation with the community. This was formally adopted by Council on 5 September 2018.</p> <p>Criteria met: 5 September 2018</p>
<ul style="list-style-type: none"> - Demonstrate that the achievement of the stated policy objective (s) would be jeopardized if the particular competitive neutrality measure under consideration was implemented - Determine the best available means of achieving the overall policy objectives including an assessment of alternative approaches 	<p>This paper canvasses the risks to policy objectives if Council implemented competitive neutrality measures and makes recommendations regarding alternative approaches.</p> <p>Criteria met: 5 August 2020</p>
<ul style="list-style-type: none"> - The public interest test should be undertaken in consultation with the community through an open and transparent process. 	<p>Council released <i>Every Child, Our Future: Policy Issues and Option Paper</i> for a period of extended consultation in March 2019. This sought community feedback on a range of recommendations including five options for Council's role in early education and care. Council has engaged the community and services providers in an open and transparent way in the development of <i>Every Child, Our Future: Children's Service Policy</i>.</p> <p>Criteria met: 5 September 2019</p>
<p>Conclusion: Requirements met</p>	