IPART New South Wales

Independent Pricing and Regulatory Tribunal

NSW Independent Local Government Review Panel

IPART Submission on Consultation Paper

Local Government — Submission
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Executive Summary

The Independent Local Government Review Panel has been asked to find ways to strengthen and improve local government in NSW.

The Panel's Consultation Paper - *Strengthening your Community*[1] provided IPART and other stakeholders with an opportunity to submit comments to the review.

IPART reviewed the revenue framework for local government in 2009 and was given new functions relating to rate-setting and contribution plans in 2010. We have primarily drawn on our experience in these roles in making our submission. This year, we also began a review of the various licensing and compliance functions of local government.

Our submission

Based on our experience in local government, we seek to make a number of observations about local government in NSW.

We made some of these observations in our 2009 Review of the Revenue Framework of Local Government in NSW,[2] and in our 2010/11 Annual Report on our local government functions to the Ministers for Local Government and Planning and Infrastructure.[3] We have separately made a submission to the review of the NSW planning system.[4]

Our submission does not specifically address the Panel's 3 questions posed in its Consultation Paper, which are directed towards local councils and their communities.[5] Instead, we raise a number of issues in considering how to improve the financial strength and effectiveness of the local government sector. In particular, we focus on how to strengthen the financial sustainability of more vulnerable councils, particularly smaller councils. We have also identified the need for more user friendly, comparative information about the relative performance of councils to further enhance the accountability of councils to their communities.

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1 NSW Independent Local Government Review Panel, *Strengthening Your Community*, Consultation Paper, July 2012.

2 IPART, *Revenue Framework for Local Government* - Final Report, December 2009.

3 IPART, *Report on IPART's functions in relation to local government in 2010/11 – Report to Ministers*, October 2011.

4 IPART, *NSW Planning System Review – IPART Submission on the Green Paper*, September 2012.

5 The Panel asked: 1. What are the best aspects of NSW local government in its current form?; 2. What challenges will your community have to meet over the next 25 years?; and 3. What 'top 5' changes should be made to local government to help meet your community's future challenges?

In summary, the issues we have raised in our submission are as follows:

- **LGAs vary widely** in size, demographics, topography and economic base. This variety creates a diverse range of challenges for councils when it comes to providing infrastructure and ensuring their financial sustainability.
- **Local governments are ideally placed to stay focused on local issues** and to both understand and meet the needs of their communities. Understanding community preferences requires a significant amount of **community engagement** by councils.
- The level of efficiency is likely to vary considerably across councils but we have found that **most are aware of their need to be as efficient as possible**. Collaborative arrangements can lead to efficiency gains and savings for councils, and should be further supported where possible.
- **The rate pegging regime is more flexible than many realise**. Special variations are an integral part of it, and they allow a council to apply to increase revenue by more than the rate peg. In addition, part of council revenue is not pegged eg, waste and other user charges.
- **More flexibility can be injected into the rate pegging system** in such a way that it would reduce compliance costs and potentially improve council accountability to communities.
- There is often a **fundamental mismatch between small, usually rural, councils' expenditure responsibilities and their revenue bases.** Applying for a special variation will not usually resolve the mismatch because of the council's limited rates base. Alternative solutions are needed if such councils are to be financially sustainable.
- **NSW Treasury Corporation's (TCorp) current review of every NSW council's financial sustainability will provide an important input to the Panel's work** and will help to identify which councils are currently at risk of being unsustainable.
- **Two possible initiatives to strengthen the performance of unsustainable councils** are to have them **amalgamate** with other councils or **increase the level of financial assistance to them**.
- **In principle, council amalgamations can increase economies of scale, reduce overheads and provide efficiency gains**. Benefits may be realised even if the amalgamating councils are not particularly small in size, or currently unsustainable.
- However, **voluntary amalgamation would need to be in the interests of both councils**, and **amalgamation would not provide the solution for all small, rural councils.** Notwithstanding the benefits of these councils curbing expenditure and achieving other efficiency gains where possible, they will usually require increased financial assistance to achieve sustainability.

- The **current grants system appears to be inadequate to address the long-term financial sustainability of many small rural councils** heavily dependent on grant income. At present, the Commonwealth grants system provides a minimum level of financial assistance grants to all councils on a per capita basis, regardless of need. Given the different capacity of councils to generate other revenues, minimum per capita grants to councils with the least financial need limits the funding pool for those councils with the greatest need. **We recommend that the NSW Government provide input to the Federal Government's review of the Local Government Financial Assistance Grants program** to increase the pool of funding for councils with the strongest financial need.
- In addition, there can be **significant costs and complexity for councils in seeking other State and Federal Government funding because of the range of grants that are available**. We consider that a **review of the current grants system in NSW** that improves the coordination and allocation of grants to councils with the most need will also assist in strengthening their financial capacity.
- **Many councils have the capacity to borrow more for their infrastructure needs**, and the Government's new Local Infrastructure Renewal Scheme is an important step in encouraging councils to seek loan funding to address backlogs. Further encouraging councils with the capacity to borrow more to do so to address backlogs can help improve performance in the longer term.
- **Funding infrastructure for new developments in rapidly growing LGAs** can be a challenging dilemma for some councils. We have made a submission to the Government's Green Paper on the planning system. In summary, we support development contributions being based on the principles of beneficiary pays, cost reflectivity, transparency and simplicity. There may, however, be a case for sharing the cost of development among the wider community where zoning or other restrictions limit redevelopment of established areas.
- **User friendly information on the relative performance of councils is lacking**. IPART recommends the establishment of an online resource for the public which publishes a set of KPIs on local council performance, and enables ratepayers and other community members to compare their council, for example, on rates, other charges, service levels and productivity performance.

1 Diversity of local government

There is significant diversity in local government. Councils have different capacities to generate income and their financial performance and service needs are variously affected by geography, demographics, community preferences and population growth. For example, rural councils that serve small populations can have much less scope to raise revenue than those serving large populations. Yet given these councils' lower population density, their expenditure needs per capita can be higher due to the large size of the area they serve (and the long total length of the roads they are responsible for). A small ratepayer base in other regional, urban or fringe councils can also potentially threaten the council's long term financial sustainability.

A number of reviews have shown that there are large differences between the sustainability of large metropolitan or regional councils and that of smaller councils, particularly rural councils. Some of the larger councils consistently run operating surpluses and need to invest surplus funds, but other smaller councils consistently run operating deficits, often falling further behind with asset maintenance and renewal work, and needing to run down cash reserves and manage cash flows from one year to the next.

There also appear to be significant differences in management capacity, and staff and councillor knowledge and skills. We make this observation based on how councils have met the criteria of assessment in applying for special variations.

This diversity among councils matters when looking at ways to strengthen the financial viability of the sector. It suggests that some reforms will need to be tailored to the specific circumstances of particular groups of councils. It also suggests that councils may be able to learn from, and to assist, each other in finding ways to minimise costs and define best-practice approaches.

2 Current strengths of local government

2.1 Catering to local needs with a focus on community engagement

One of the strengths of local councils is their ability to understand and meet the needs of their communities. This is often achieved through effective community engagement. Through the councils that have applied to IPART for a special variation, we have seen a range of capability - from best practice engagement, through to less satisfactory consultation. However, overall, local councils have demonstrated to IPART a capability to consult about expenditure on projects or programs for which funding has later been sought via a special variation application. In general, local councils achieve much closer engagement with their constituents than occurs at State and Federal Government levels.

2.1.1 Enhanced engagement under the Integrated Planning and Reporting Framework

The Integrated Planning and Reporting Framework (IPRF) has required councils to develop a range of strategic and resourcing plans, in consultation with their communities. This builds on previous engagement activities undertaken by councils to develop their (former) management and social plans, and in other areas such as residential and commercial planning and development.

Both councils and communities have benefited from enhanced engagement under the IPRF. In particular, it has improved council transparency and accountability to their communities. However, it can be a costly process for councils. In addition, given that the IPRF has been introduced by different groups of councils in a phased fashion over 3 years, not all councils are as well advanced as others in implementing the reforms, and some will take longer to implement them fully.

2.2 Efficiency gains for councils from collaborative arrangements

NSW local government collaborative arrangements and resource sharing have been in place for a long time and can deliver a number of benefits to councils, including the exchange of best practice and cost savings.

In our role in assessing special rate applications, we have seen many councils give examples of collaborative arrangements which have led to an efficiency gain or cost saving for the council. For example, the WBC Alliance between Wellington, Blayney and Cabonne Councils and Central Tablelands Water claims to have achieved savings of over $4.2m for the councils, primarily through resource sharing initiatives. Hunter Councils Inc also shares member council resources for training needs, records storage and environmental programs with substantial financial benefits for membership councils.

2.2.1 Survey of Collaborative Arrangements in NSW

The Division of Local Government (DLG) has been systematically collecting information about the range of collaborative arrangements between NSW councils since 2005. The most recent survey, published in June 2011, found that all councils benefited from the arrangements in some way, with many commenting that they were essential to their long term sustainability. The range of benefits included:

- increased opportunities for regional and subregional strategy development
- increased cost savings and economies of scale
- reduced duplication
- provision of services not otherwise available to their community

- improved access to technical expertise or higher quality work
- better environmental outcomes
- other benefits like time savings; increased productivity; strengthened relationships and networking; coordination of investment; standardised documents and processes; and more efficient service delivery.[6]

The survey report also noted a number of challenges to collaborative arrangements. These included significant costs and added responsibilities of staff and councillors, a lack of start-up and ongoing funds to support such arrangements, difficulties with leadership and governance arrangements, difficulties in assessing the costs and benefits of the arrangements, and difficulties in ensuring a fair breakdown of responsibilities among participating councils.

2.2.2 Supporting councils to undertake further collaboration

We support the NSW Government continuing to help councils to collaborate where possible, and to build their capacity in the areas such as governance, analysis of financial performance and sustainability, cost-benefit analysis and strategic and business planning. This help can take the more general form of guidance, workshops and training programs, or more targeted advice and guidance for councils in considering particular alliances.

We also suggest that the Government could look at providing additional incentives for councils to explore such arrangements, particularly in regions where, to date, such arrangements have not been adopted or are not producing the desired outcomes.

3 Rate pegging and its impact

3.1 Impact on council revenues

As shown in Table 3.1 below, the annual average percentage growth in local government tax revenue and total revenue since 2000/01 has been lower in NSW than in 4 other states. From this it could be argued that rate pegging has contained the growth in rates in NSW.

6 NSW Department of Premier and Cabinet, Division of Local Government, *Collaborative Arrangements between Councils – Survey Report*, June 2011.

Table 3.1 Annual average percentage increases in revenue 2001/02 - 2010/11

Government	Taxation Revenue	Total Revenue
NSW – Local	4.4	5.7
Victoria – Local	8.2	8.8
Queensland – Local	8.6	7.8
South Australia – Local	7.0	7.0
Western Australia – Local	8.1	8.4
NSW – State	5.0	6.1
Commonwealth	5.5	5.5

Source: ABS, Government Finance Statistics, Australia, 2010-11, Cat No. 5512.0.

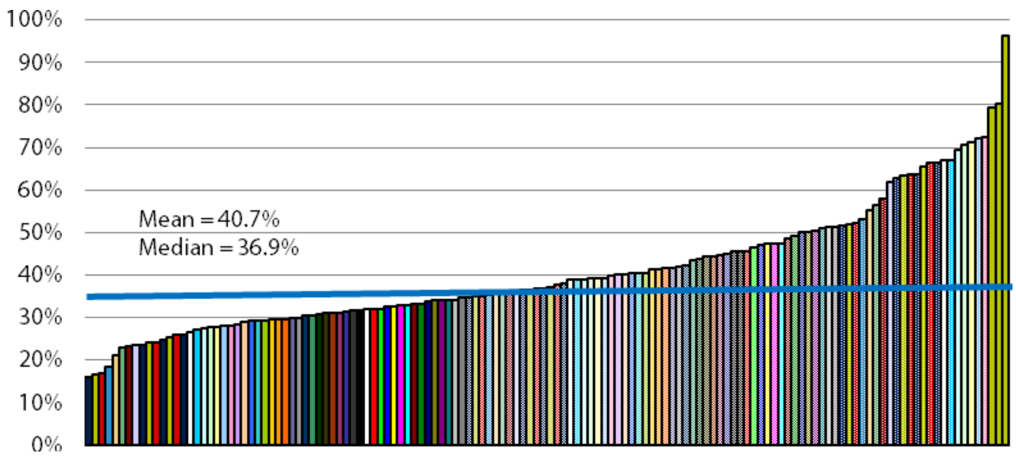
Of course, there remains great variability in the growth in rates and total revenue among councils. At the upper end, some councils have experienced strong growth, have had a number of high special rate variations, or have increased non-rate revenue eg, user charges and fines. At the lower end, councils have either not taken up the full rate peg in previous years, have not sought special variations, or do not have the ability to increase income from non-rate sources. It may be that ratepayers in these councils have limited capacity to pay higher rates or charges.

Figure 3.1 shows the growth in total rates per assessment for individual councils over the period 2001/02 to 2010/11.[7] Each vertical line represents a different council. The heavy horizontal line represents the rate peg for the period and reflects total growth in rates and annual charges of 34.6% over the 10 years. It is expected that if councils were increasing rates in line with the rate peg amount, their total rate revenue per assessment would increase by a similar amount. However, the actual increase in rates per assessment has varied widely among councils.

A significant number of councils have not increased their rates in line with the rate peg. Often these councils are small rural councils where councillors have not supported rate increases, or have promoted themselves on the basis that they will not increase rates. Anecdotally, a few councillors and general managers have indicated to IPART that the presence of the rate peg actually helps councils to achieve rate increases that might not otherwise be agreed by councillors.

7 A number of councils were amalgamated during this period so they have been excluded from the analysis. Also excluded are councils with significant outlier results and 1 council for which rates data was not available for 2010/11 (Snowy River Shire). The data in Figure 3.1 are for 136 councils.

Figure 3.1 **Increases in total rate revenue per assessment (%), 2001/02 to 2010/11 (nominal)**



Note: Excludes mining rate revenue and assessments. Also excludes councils that were amalgamated during the period, councils with outlier results and Snowy River Shire Council whose rates data were not available for 2010/11.

Data source: DLG comparative data, 2001/02 and 2010/11, and IPART calculations.

3.2 Rate peg tied more closely to council costs

Following IPART's review in 2009, the Government gave IPART responsibility for setting the rate peg based on a Local Government Cost Index (LGCI), with allowance for a productivity factor. The LGCI is a price index which measures the average movements in the prices paid for inputs for ordinary council activities funded from general rate revenue. It is a lagged index, with the index for the 2012/13 financial year based on price changes in the year to September quarter 2011 compared with the year to September quarter 2010.

IPART has set the rate peg for 2011/12 and 2012/13. Back-casting the IPART LGCI indicates that past rate pegs were usually less that the increase in the productivity-adjusted LGCI. This is showed in Table 3.2, noting that there is no productivity factor applied to the LGCI in any year.

Table 3.2	Comparison of the LGCI and historical rate peg (%) (2004-2013)								
	04/05	05/06	06/07	07/08	08/09	09/10	10/11	11/12	12/13
LGCI	4.3	4.2	3.6	4.1	3.4	3.1	3.4	3.0	3.4
Rate Peg	3.5	3.5	3.6	3.4	3.2	3.5	2.6	2.8[a]	3.6[b]
Difference	-0.8	-0.7	0	-0.7	-0.2	+0.4	-0.8	-0.2	+0.2

[a] In the first year IPART determined the rate peg, it applied a productivity factor of 0.2%.

[b] Includes an additional 0.4% for a carbon price advance and a reduction of 0.2% for the productivity factor.

Table 3.2 demonstrates that the introduction of the productivity-adjusted LGCI as a basis for setting the rate peg has allowed councils to better set their rates closer to the average rise in their unit costs. Even without rate-pegging, the LGCI provides an important indicator to the sector about the average movements in local government costs.

IPART therefore recommends that a LGCI should continue to be calculated and published to provide a transparent and independent indicator of average council price movements. A similar index is published in SA by The South Australian Centre for Economic Studies.

3.3 Additional improvements in the rate pegging and special variations processes

In the first year that IPART set the rate peg (2011/12), we brought forward the announcement of the peg for the coming financial year by 6 months to December. We also released special variation decisions in early rather than late June (which was the previous practice). Local councils have indicated to IPART that they prefer that these decisions are announced as early as possible to inform their forward planning.

For all of our decisions, including the rate peg, productivity factor, special variation and minimum rate determinations, we publish a report which presents a statement of reasons for our decisions. This has ensured clarity and transparency in the process for both councils and their communities.

In undertaking our functions, we have liaised closely with councils and have set out our expectations for community engagement associated with proposed rate increases. We have observed a high level of accountability among councils which have presented proposed programs of expenditure and rate increases to their community for consideration.

In assessing applications for special variations from councils, we have granted longer multi-year variations up to the maximum of 7 years as permitted by section 508A of the Local Government Act (rather than limit them to 4 years of consecutive increases which was usually the case in previous decisions). This has provided greater certainty over the longer term for councils that sufficiently met all of the assessment criteria.

3.4 The benefits of a more light handed regulatory approach

Rate-pegging in NSW has ensured that councils closely examine their spending, looking for possible efficiencies and productivity improvements to contain spending.

However, it can be argued that the current approach to rate pegging is relatively rigid because councils must apply for a special variation even if they are seeking a modest increase above the rate peg. This results in an administrative and financial cost to councils.

We consider that one of 3 options would reduce these costs. One option is simply to remove rate pegging and let councils set their own rates. Experience from other jurisdictions suggests that rates would increase substantially, at least for some councils. For example, past experience from other states indicates average increases each year of around 7% to 9%, compared with 4.4% for NSW (Table 3.1). Also, it would not help councils that are unwilling to increase rates in line with inflation, let alone sufficiently to improve their financial sustainability (the tail end in Figure 3.1).

Another option is to set a margin above the rate peg of, say, 3 percentage points, which councils could apply for under a more streamlined special variation process. This process would involve less onerous criteria than the current special variations criteria but would require councils to demonstrate that the rate increase is needed.

The advantage of this approach, which would continue to be implemented within the special variation framework, is that councils would not have to undertake costly application processes for small rate increases. The special variations that would be assessed against the more stringent criteria would be for applications in which a council sought a significant rate increase.

A third option is to introduce earned autonomy into the process, as IPART recommended in its 2009 review.[8] This would mean that councils which satisfy a range of performance measures related to sound financial management, transparent consultation and effective implementation of the Integrated Planning and Reporting Framework, would be able to set their rates autonomously without the need for a special variation application.

This option would reduce compliance costs, and councils would be more directly accountable to their communities for the rates they set. A potential drawback is that councils may increase their rates substantially.

8 IPART, *Revenue Framework for Local Government - Final Report*, December 2009, p 9.

4 Financial sustainability challenges for small councils

Financial sustainability challenges are often experienced by the smaller-sized councils due to the limited size of their revenue base.

4.1 Population distribution of NSW councils

In NSW, there are 52 councils with populations fewer than 10,000. Virtually all are rural councils, except Deniliquin (which the DLG classifies as an 'urban, small to medium-sized regional town or city').[9] Of the 51 rural councils:

- 4 have populations up to 2,000
- 21 have populations between 2,001 and 5,000, and
- 26 have populations between 5,001 and 10,000.

The remaining 21 rural councils are considered to be 'very large' and have populations between 10,001 and 20,000.

There are also 50 councils in NSW which are classified as 'small to medium-sized, with populations up to 70,000'. Of these, 32 are classified as 'urban, regional towns or cities', 15 are classified as 'urban, metropolitan councils' and 3 are 'urban fringe councils'. Just 1 of these Sydney metropolitan councils has a population less than 20,000 (Hunter's Hill) and another has less than 30,000 (Mosman).

The other 30 councils in NSW are classified as 'urban (either regional, metropolitan or fringe) with populations greater than 70,000'.[10] The 4 largest councils each have populations more than 200,000 residents.

9 DLG, *Snapshot of NSW Councils: Comparative Information on NSW Local Government Councils 2009/10*. The Australian Classification of Local Governments (ACLG) system classifies councils into 22 categories according to their socio-economic characteristics and their capacity to deliver a range of services to the community. The DLG has reduced this to 11 groups because some of the ACLG categories contained few or no councils in NSW.

10 ABS, Estimated Resident Population, Local Government Areas, NSW, *Regional Population Growth 2001 to 2011*, cat no 3128.0, 31 July 2012.

4.2 IPART's 2009 review findings on council sustainability

In our 2009 review, we found that more than two-thirds of all NSW councils are sustainable on a recurrent basis (ie, relating to a council's operating expenditure and revenues), but that those in the rural and urban fringe areas are less likely to be sustainable. The challenges faced by rural councils are often related to their limited revenue-raising capacity and can be more endemic, while for the councils in urban fringe areas, the operating budget pressures usually arise due to growth challenges.[11]

We also found that more than half of NSW councils were maintaining capital expenditure at levels that are considered to be sustainable, even though many appear to significantly underutilise debt to fund long lived assets. Other councils are not maintaining their capital expenditure and renewal needs.

As part of our 2009 review, we also undertook a detailed case study analysis of 11 councils. We found that the financial sustainability of councils can change significantly in a relatively short period. This suggests that councils have flexibility to vary their revenue and expenditure policies, and most have flexibility to adapt their funding and liquidity policies to make better use of their available revenue capacity. However, small, rural councils can be an exception.

4.2.1 Small rural councils face the most significant financial challenges

Our case study analysis in 2009 suggested that rural councils with small populations (less than 10,000 people) have the greatest risk of being unsustainable over the long-term. This was largely because they have a lower capacity to increase their own source revenues, especially their rate revenues. Also, the costs of infrastructure needed to service the community remain relatively high per capita compared with the costs for councils with large, high-density populations.[12]

These councils face a fundamental mismatch between their expenditure responsibilities and their narrow revenue base. Small rural councils also tend to have less capacity to increase their total revenues for various reasons:

- Rates make up a small proportion of total revenues (around 30% compared with 50% for metropolitan councils). They therefore rely more heavily on grants from higher levels of government, which they have limited ability to influence.
- The areas they serve have a small, and often declining, number of ratepayers compared with more financially sustainable rural councils.

11 IPART, *Revenue Framework for Local Government – Final* Report, December 2009, pp 77-102.
12 Ibid.

- Their ratepayers often have a restricted capacity to pay. The restriction may stem from the fact that retired ratepayers are a relatively high proportion of the population, or that farmland ratepayers have suffered prolonged drought or other adverse economic conditions. Only rarely will there be mining ratepayers that can contribute substantially to revenues.

These characteristics suggest that small rural councils cannot raise sufficient own-source revenue to achieve and maintain long-term financial sustainability. Higher rate levels may be needed, but will often not alone be sufficient to address the long-term financial sustainability of these councils because rates revenue make up a small share of their overall revenue base.

4.3 NSW TCorp review of council financial sustainability

The NSW Treasury Corporation (TCorp) is currently conducting a review of the financial sustainability of all 152 councils in NSW and will report its findings to the State Government by the end of year. The review will encompass each council's existing financial performance and position, its financial forecasts including its capacity to meet increased debt commitments, future sustainability, and benchmarking with other councils. This research will inform the Panel and the Government about the current outlook for sustainability of councils across NSW.[13]

4.4 Options to address sustainability challenges of smaller councils

We consider that there are 2 possible solutions for the smaller, unsustainable councils to address the fundamental mismatch between their revenue base and expenditure responsibilities:

- amalgamate, or
- increase the level of financial assistance to them.

Another option for councils is to reduce expenditure. However, we acknowledge that in many cases, the budgets of small, rural councils have already been placed under considerable pressure given limited revenue growth, and councils have already had to re-evaluate their expenditure priorities. The symptoms of budgetary pressure include growing asset backlogs, and the difficulty that many councils are experiencing in maintaining assets and other services.

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13 NSW Department of Premier & Cabinet, Division of Local Government, *TCorp Assessment of Financial Sustainability*, Circular to Councils No. 12-23, 5 July 2012.

As we have already noted, in some regions, councils have been able to reduce some of their costs by sharing facilities and resources. These are positive steps for local government and should be further encouraged, where possible. However, given the extent of the revenue shortfalls some of the councils are experiencing, it is unlikely that some relatively minor cost reductions will properly address their financial concerns. Instead, difficult decisions about the council's responsibilities in terms of overheads, asset provision and the range of services to the community may need to be made.

4.4.1 Council amalgamation

Amalgamations are a contentious issue for local councils but remain a way for some councils to address their financial sustainability challenges. One of the primary benefits of council amalgamation is that it may increase economies of scale and reduce council overheads, and for many councils struggling with capacity issues, this may be necessary.

Amalgamation may be one way to achieve the scale benefits that collaboration can provide, but with a single, managing council to oversee the larger scale operations. In some circumstances, amalgamation may serve to enhance the financial viability of medium-sized councils as well as smaller ones.

One of the directions of Destination 2036 is to remove the barriers for local councils to amalgamate voluntarily. In situations where a council is financially unsustainable in its present form, it may be sensible for it to amalgamate with a nearby council that has a stronger revenue base. However, voluntary amalgamations will only be chosen if both local communities and councils are supportive of the amalgamation. Based on past experience, it is unlikely that many voluntary amalgamations will occur.

Another difficulty with amalgamations, voluntary or otherwise, is that they are still unlikely to solve the original population density challenge of smaller, rural councils. Further, councils may not always be conveniently located to amalgamate with a nearby, well-resourced council.

Tiley and Dollery suggested that council amalgamation is not suited to the large, remote Western areas of the State.[14] They suggested that areas where amalgamation may be beneficial include the Sydney metropolitan area which has over 40 local government entities, the Far North Coast and New England regions, and areas east of the Great Dividing Range (where there are a number of smaller shire councils).

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14 Tiley, I and Dollery, B, "Local Government Amalgamation in New South Wales", *Working Paper Series*, Centre for Local Government, University of New England, April 2010, pp 34-35.

4.4.2 Increased financial assistance to unsustainable councils

To assist struggling councils with limited potential to further reduce expenditure and for which amalgamation is not an option, the only remaining option is to increase the level of financial assistance to them.

The Commonwealth Government provides funding to local government in 2 main forms. First, it provides annual untied financial assistance grants (which are paid in quarterly instalments through the State Governments, as:

- general purpose grants, distributed on an equal per person basis, or
- identified local road grants, distributed among the States on the basis of historical shares.

Secondly, it provides specific purpose payments direct to local governments which are tied to service provision eg, Roads to Recovery program.

In our 2009 review, we noted that all councils receive a minimum financial assistance grant from the Federal Government, regardless of need. These minimum grants account for at least 30% of the total amount of general purpose grants NSW is entitled to under section 9 of the *Financial Assistance Act 1995* (Cth). In some cases, councils that are running substantial surpluses receive these minimum grants. One of the key principles of the allocation of grants payments is to achieve horizontal equalisation, but these minimum grant provisions may undermine this objective.[15]

Our analysis suggested that if these provisions were removed, the additional funding available for distribution to councils based on need would go a long way towards assisting small rural councils to achieve financial sustainability. In 2011/12, the level of general purpose grant funding to 23 NSW councils on the minimum grants amounted to around $40m.[16]

Commonwealth Review of the Financial Assistance Grants Program

The Commonwealth Government has announced that the Commonwealth Grants Commission will commence a review of the Local Government Financial Assistance Grants program with the final report expected in December 2013.[17]

We recommend that the NSW Government should provide input to this review process that those local councils with the greatest financial need should receive increased funding, either by increasing the overall pool of grant funding available, or restricting the payment of minimum grants to all councils.

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15 IPART, *Revenue Framework for Local Government – Final Report*, December 2009, p 100.

16 NSW Local Government Grants Commission, *2010-11 Annual Report*, pp 14, 28-32 and IPART calculations.

17 Simon Crean MP, Minister for Local Government, *Review of Financial Assistance Grants*, Media Release, 31 August 2012.

Difficulties for councils associated with other grant programs

In addition to Federal funding, local councils receive grants from State Governments for a range of other purposes eg, roads, energy efficiency programs, libraries, sport and recreation programs or regional development projects, and there are many more examples.

As Ernst & Young noted in its recent report on local government infrastructure in Australia, there are a large number of disparate funding programs from State Governments which can cause confusion for councils, especially smaller ones.[18]

Councils can sometimes find it difficult to know "where to look" for grants. Many are made available on an ad-hoc basis, and so councils cannot incorporate them into their longer term planning. Some grants also require councils to make significant commitments of expenditure to attract a government contribution. Further, government funding programs are often administered by the relevant agency, and are not centralised, or coordinated between State and Federal Governments. Typically, the eligibility and reporting requirements differ across programs and across administering agencies. In addition, this disparity can add to the administrative complexity and cost for councils, and may prevent grants being awarded to councils with most need.

Ernst & Young recommended that the Australian Government should develop a portal to bring together information and application material relating to local government grants programs in a single location. This portal would build upon the GrantsLINK website already available to the community.

We recommend that the Panel should consider a review of the grants system within NSW to examine:

- how the grants system may be further improved to ensure that councils with the greatest need receive adequate grant funding
- whether grants (including for infrastructure) need to be better targeted, for example towards regional alliances of councils to ensure sufficient scale (and thus better prospects of attracting private sources of investment)
- how to ensure that grants which seed a new service or program ensure the council has sufficient ongoing maintenance funding for the program (otherwise, they may have the effect of cost shifting)
- what additional information at a State level could be provided to councils to reduce complexity and compliance costs in the current grants system.

[18] Ernst & Young, *Strong foundations for sustainable local infrastructure - Connecting communities, projects, finance and funds*, Report prepared for the Department of Regional Australia, Local Government, Arts and Sport, June 2012, pp 22-23.

5 Funding infrastructure

5.1 Further scope for councils to optimise borrowings

IPART's 2009 review found that, in general, NSW councils were significantly underutilising debt for their asset needs.[19] We found that many councils avoid debt funding for long life infrastructure assets and as a result, infrastructure backlogs have remained higher than would have been the case with more balanced funding strategies. The case study councils we examined tended to fund new capital expenditure with operating revenues, an approach which is not always consistent with the principle of intergenerational equity[20].

These findings are similar to the finding of other reviews into local government in Australia. Most recently, Ernst & Young, in its report on local government infrastructure in Australia, found that councils continue to adopt a cautious approach to the use of debt to finance their investment based on a "fear of debt".[21]

The recent introduction of the NSW Government's Local Infrastructure Renewal Scheme (LIRS) has been an important step in helping local government to increase their capacity to optimise borrowing. The Scheme provides 4% loan subsidies to provide an incentive to councils to make greater use of debt funding to accelerate investment in infrastructure backlogs and augment other funding options.[22]

We support an incentive such as this being offered to councils to address their backlogs and effectively utilise debt. Despite the benefits that debt can deliver, namely intergenerational equity and being able to spread the costs of a significant project over time, some councils still maintain a culture of debt avoidance.

More education and the promotion of best-practice regarding the use and management of debt may help to reduce the reluctance of some councils to take on debt when it is sensible and prudent to do so.

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19 IPART, *Revenue Framework for Local Government – Final Report*, December 2009, pp 77-102.

20 The concept of intergenerational equity means that the costs of long lived assets (like infrastructure) are shared between current and future users, based on their share of the use of the assets over their life.

21 Ernst & Young, *Strong foundations for sustainable local infrastructure - Connecting communities, projects, finance and funds*, Report prepared for the Department of Regional Australia, Local Government, Arts and Sport, June 2012.

22 Don Page MP, NSW Minister for Local Government, *NSW Government Interest Subsidy Delivers $430m in Community Infrastructure*, Media Release, 5 August 2012.

5.2 Growth councils and funding infrastructure in new residential developments

IPART's local government functions include reviewing certain section 94 development contributions plans on behalf of the Minister for Planning and Infrastructure. This followed the State Government's introduction of 'hard caps' which limit the amount of section 94 development contributions councils can collect.

Councils affected by the introduction of the section 94 development contributions caps were able to apply for funding from the State's Priority Infrastructure Fund (PIF). Allocations of PIF funding have been made to The Hills Shire Council and Blacktown Council for contribution plans that were reviewed by IPART in October 2011. In July 2012, the Government announced that the PIF was to be replaced with funding from the Housing Acceleration Fund.[23] Since then, IPART has reviewed 2 more plans for Blacktown City Council.

Councils affected by the section 94 development contributions caps are also able to seek a special variation to their rates revenue. To date, no councils have sought a special rate variation to fund shortfalls for contributions plans infrastructure.

In the current system, one of the fundamental questions for growth councils is 'who should pay for the infrastructure?' We have presented our views in our response to the Government's Green Paper, *A New Planning System for New South Wales*. In summary, we support development contributions being based on the principles of beneficiary pays, cost reflectivity, transparency and simplicity.[24] There may, however, be a case for sharing costs among the community as a whole where zoning or other restrictions limit redevelopment of established areas.

6 Need for more benchmarking information

At present, the benchmarking of local government is largely limited to the comparative data published annually by DLG. This data currently includes broad rating, financial and corporate (eg, staffing) measures, but little about service provision or community satisfaction indicators. A number of the data sets (eg, Special Schedule 1 on council expenditure and revenue by service category) are not reliable enough to compare peer councils because of the differences in how councils collect and report information.

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23 Brad Hazzard MP, NSW Minister for Planning & Infrastructure, *Funding to Help Boost Housing Supply*, Media Release, 17 July 2012.

24 IPART, *NSW Planning System Review – IPART Submission on the Green Paper*, September 2012.

Research commissioned by DLG in February 2011 has highlighted how the development of a community indicators resource could help to identify gaps and priorities for new local government data sets.[25]

IPART released a discussion paper on productivity performance in September 2011, inviting feedback on possible indicators that should be used in assessing council productivity.[26] Initial feedback from council financial staff indicated the importance of benchmarking for understanding their council's performance, but provided little in the way of appropriate indicators by which it may be achieved.

We consider that the development of benchmarking will improve performance assessment (including on productivity), customer engagement and decision-making in the local government sector. This type of benchmarking information would also be particularly important if the current rate pegging system were to be eased or removed, because councils could potentially just increase rates instead of seeking productivity improvements or savings.

Councils can be proactive through representative groups such as the Local Government Finance Professionals to work together to develop standardised approaches to data reporting, and useful benchmarks on productivity and service performance. The NSW Government could also play a role in facilitating a coordinated approach to the development of benchmarking information for local government.

6.1 Benefits of more comparative information available to the public

We also see value in the public having access to additional local council comparative information in an accessible online format, akin to the My School website. Ideally, such information would be accessible in a user friendly, online database where residents can search data about their council and see how it compares with peers in a number of areas, for example:

- ordinary residential or business rate levels by land value
- waste management and stormwater charges
- value of development contributions
- number of council staff per capita
- council revenue or expenditure per capita
- performance on particular areas of service provision.

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25 DLG, *Integrated Planning and Reporting Framework - Community Indicators Project*, prepared by Elton Consulting and the Institute of Sustainable Futures, University of Technology Sydney, February 2011.

26 IPART, *Measuring and Assessing Productivity Performance in Local Government - Discussion Paper*, September 2011.

We have received a significant amount of correspondence from ratepayers of various LGAs raising concerns about their council's rates or charges and its level of efficiency, and we consider that this additional type of information would be of benefit to ratepayers in assessing their council's performance.