The impact of population growth on council costs and revenue

29 June 2021

This information paper sets out:

- our approach
- what we found about councils' costs
- how costs are funded.

The Independent Pricing and Regulatory Tribunal of NSW (IPART) investigated the impact of population growth on council costs and revenue to better understand the impacts of reform on the rate peg. We informed our analysis by:

- engaging The Centre for International Economics (The CIE) to undertake a desktop analysis of council costs and revenues
- considering information provided by councils through submissions to our IPART's *Review of the rate peg to include population growth – Issues Paper* (Issues Paper)
- developing case studies with councils to highlight specific issues
- interviewing high-growth and regional councils
- conducting workshops with regional councils and metropolitan councils.

We found:

- The main driver of a council's costs is the size of its population or number of ratepayers in an area. Council costs per person varies across metropolitan, regional and rural councils.
- The relationship between operating and capital expenditure is mostly linear.
- Some evidence of economies of scale exists. However, there is also evidence of additional costs associated with a growth phase, which are predominantly capital costs.
- The council costs that increase with population growth depend on the type of development that occurs as there are differences between greenfield and infill developments.

- A growing gap exists between population growth and the additional revenue councils receive from population growth.
- Councils have highlighted that per capita rates are decreasing while costs are increasing.
- While expenditure has grown over time, rates revenue has not kept pace with population growth.
- Depreciation expenses vary between councils and backlog ratios may not be a good indicator of falling service levels.
- The rise in secondary dwellings like granny flats and other non-rateable properties increases the population without any change to rateable income.

We also found:

- The historical evidence and analysis of methods for increasing rates suggest the costs of growth are not being fully met for NSW councils in general. Faster growing councils tend to be unable to recover additional revenue in proportion to their growth.
- An expenditure gap exists between the cost of growth and what councils spend. A smaller increase in the operating margin (revenue less operating costs) exists for faster growing councils.
- Councils have recovered some growth-related revenue through supplementary valuations. However, a councils' capacity to recover enough through supplementary valuations varies depending on their rate structure, land values and the type of development. On average, councils are recovering around 60% of the costs of growth (using per capita rates as a proxy for the costs of servicing an additional resident) through supplementary valuations.
- We expect under-recovery of the costs of growth means growing councils will be unable to maintain their service levels. However, there is insufficient data on service levels to adequately test this proposition.

We learned from councils that the greatest challenge of a growing population is the expanding gap between costs of servicing their communities and the revenue obtained from their 2 main revenue sources: rates and developer contributions. The reasons for the expanding short fall between costs and revenue vary between councils – including differences in demographics, whether they are metropolitan or regional and whether growth is mainly from greenfield or infill development:

- Infill population growth is mostly associated with new apartments which are usually charged a minimum rate.
- Regional councils cover larger areas but service less population. They also provide a more diverse range of services to their communities, which often have less capacity to pay.
- Pensioner rebates – councils with many pensioners note that the NSW Government continues to fund 55% of the rebate. The remaining 45% is a cost to councils and communities. As the aging population grows, so too does the gap between what is funded and what is left to be recovered by councils and their ratepayers.

- Seasonality of population influxes adds pressure to services, with limited scope for councils to pursue user-pays approaches to recover the costs. Influxes may be from daily employment and business, tourists, short-term seasonal farm workers, mine staff or those working on multi-year major infrastructure projects like Snowy Hydro 2.0 or highway upgrades. For some councils there are considerable daily pressures on facilities from being business and employment hubs. Other councils experience intra and interstate population pressures.
- Demographics influence council costs differently, for example, aged care, childcare and social housing can vary with their costs being distributed among the ratepaying community.
- Some councils noted the legacy of disasters like bushfires and flood is felt for a long time, longer than what may be covered by disaster funding.
- We heard from some regional councils that COVID-19 has further challenged population growth forecasts, with increased intrastate migration to regional areas and less movement of young adults to metropolitan areas.

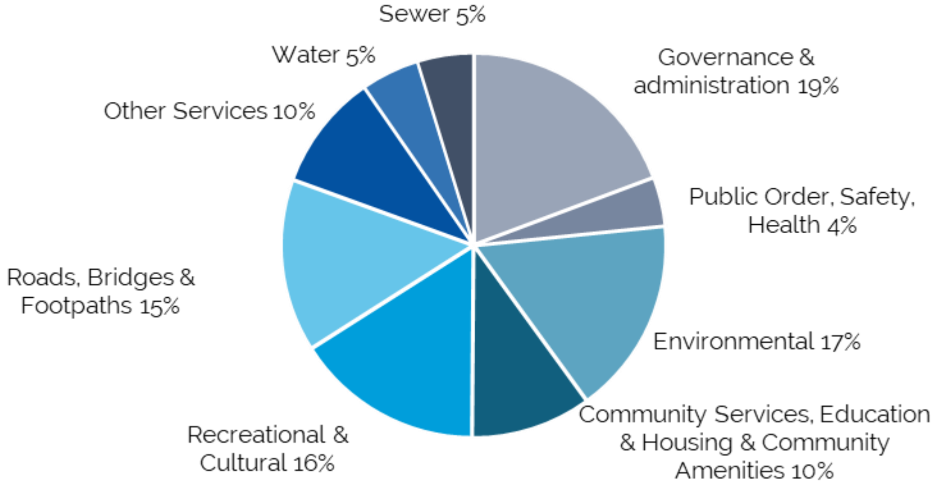
1 Councils provide a range of functions and services

The functions and services councils provide to their residents were valued at around $12.1 billion in 2018–19.[1] The functions and services provided and the costs of providing these vary between councils. Costs on a per capita basis are much higher for regional and rural councils because:

- they have lower population bases from which to recoup rates revenue
- they often provide additional services to their communities (such as aged care)
- they often service larger geographical areas and may need to provide multiple access points for service delivery
- some regional councils hold and maintain significant asset bases.

Figure 1 sets out the typical cost breakdown across a range of council functions and services. The largest proportion of council expenses are in governance and administration (19%), environment activities (17%) and recreational and cultural activities (16%).

Figure 1 Cost breakdown for council functions and services for 2018–19



Note: Not all functions are undertaken by all councils – for example, metropolitan councils do not incur costs related to water and sewer because these are provided by Sydney Water.

Source: IPART analysis and OLG Your Council data.

The annual cost per person varies across council types. Table 1 sets out the costs per person for different council types:

- Rural councils have higher costs per person than other council types. For example, annual governance and administration costs for rural councils are $1018 per person – $751 higher than the $267 per person incurred by metropolitan councils. Further, roads, bridges and footpaths have the highest annual costs per person for rural councils at $1407 per person – 1167% higher than the costs incurred by metropolitan councils.
- Metropolitan and metropolitan fringe councils have lower annual costs per person than other council types due to economies of scale arising from higher population densities in smaller geographical areas. For metropolitan councils, costs per person are lower, at $1141 per person in 2018–19 – 80% lower than rural councils at $5605 per person and 34% lower than all councils at $1717 per person.

Table 1 Council costs per person, by council type, 2018–19

Cost ($/person)	Metropolitan	Metropolitan fringe	Regional town/city	Large rural	Rural	All councils
Governance and administration	267	340	292	499	1018	304
Public order, safety, health	64	49	63	100	217	64
Environmental	228	249	321	290	290	261
Community services, education and housing and community amenities	152	141	155	254	548	159
Recreational and cultural	239	206	273	337	457	250
Roads, bridges and footpaths	111	193	318	804	1407	229
Other services	79	97	241	452	1081	154
Water	n/a	63	165	319	396	151
Sewer	n/a	70	177	208	191	145

Note: n/a—Water and sewer expenditures are not incurred for metropolitan councils because these services are provided by Sydney Water.

Source: IPART analysis and OLG, Your Council data

Council submissions to our Issues Paper noted costs vary depending on several factors:[2]

- **Younger families** increase demand for facilities such as community facilities and recreational spaces such as sports fields and playgrounds.
- **Older generations** have different expectations and demand services such as community halls and libraries.
- **Social housing** such as community housing and aged care are increasingly operated by public benevolent institutions or charitable organisations that are exempt from paying rates. Councils with this type of residential accommodation continue to provide services such as libraries, footpaths, open space and leisure facilities. However, no revenue is recouped for these costs. Social housing is not evenly distributed across councils and some councils' experience higher levels of non-rateable properties.
- **Pensioners** pay reduced rates. The NSW Government funds 55% of the pensioner rebate, with the remaining 45% subsidised by the council.
- Councils that settle **humanitarian entrants or refugees** into their local government area (LGA) face different types of costs to provide and support for this type of population growth.
- **Day visitors** come into some LGAs for employment. While these visitors do not pay rates, they contribute to wear and tear on local infrastructure (e.g. increased traffic on roads).
- Increasing numbers of **tourists** use, but do not pay for, local facilities in some LGAs such as Byron Bay, Tamworth and Waverly. While councils can recoup revenue from hotels that are categorised as 'businesses' for rating purposes, residential properties that are let as Airbnbs or other holiday lettings must be charged residential rates.

- **Secondary dwellings** do not provide facilities such as off-street parking and have little or no recreation space. Costs of providing these facilities fall on councils without adding to rate revenue. Submissions note this does not align with taxation principles of efficiency or equity.

We conducted interviews and workshops with councils to inform our analysis. These consultations highlighted that, while some issues are common across all councils, regional and rural councils face particular challenges. These challenges are discussed below.

Issues facing regional and rural councils

- Regional and rural councils face a variety of cost pressures
- Short-term visitors can add to costs of councils
- COVID-19 may increase regional population

Regional and rural councils face different cost pressures

- Regional and rural councils provide a more diverse range of services to their communities – for example, aged care, childcare, water and sewerage services.
- Regional and rural councils have smaller rate bases over which to spread growth-related costs.
- Regional and rural communities are typically more geographically dispersed with lower population density. To ensure services are accessible and equitable councils may need to pay for outreach services and multiple delivery points.
- In some cases, regional and rural ratepayers have less capacity to pay and are already paying rates much greater than ratepayers in metropolitan areas.
- Many regional and rural councils are facing critical housing shortages, which is leading to increases in secondary dwellings that add to population density but not to rates revenue.
- Some regional and rural councils have been more successful than others in obtaining grants for infrastructure projects. Where councils are successful, the ongoing maintenance and operating costs of that infrastructure must be paid for by ratepayers.
- Depreciation of ageing asset bases and asset renewals are significant issues for regional and rural councils. Many have substantial backlogs. Increases to the rate peg are insufficient to cover these costs.

Short-term visitors can add to costs of councils

- People visit LGAs for a variety of different reasons, such as tourism, work or study.
- Temporary increases in population due to major infrastructure or other projects can attract workers and their families for several years during the project. These increases in population may not be captured in population data if they visit the area between censuses.
- High visitor numbers place greater strain on infrastructure (such as roads) and services. However, the cost of maintaining infrastructure and providing services is paid for by ratepayers.
- Councils have had mixed success imposing user charges to target visitors (such as parking charges), but in many cases have limited ability to fund services through user charges. Revenue obtained from user charges is insufficient to meet the cost of servicing visitors.
- For councils with high levels of tourism, use of residential properties for Airbnb or other holiday rentals poses challenges. While these properties are run as businesses, they are categorised as residential properties and charged residential rates.
- Some regional and rural councils have ageing populations with significant numbers of pensioners. For these councils, pensioner rebates are a significant cost burden.

COVID-19 may increase regional population

- Regional and rural councils told us COVID-19 has significantly increased intra-state migration from metropolitan areas to the regions. Young professionals are also choosing to remain in regional areas rather than move to metropolitan areas. Councils expect this increase in population to be permanent.

The information was drawn from submissions by regional and rural councils; interviews and workshops with regional councils.

2 Council costs increase with population growth

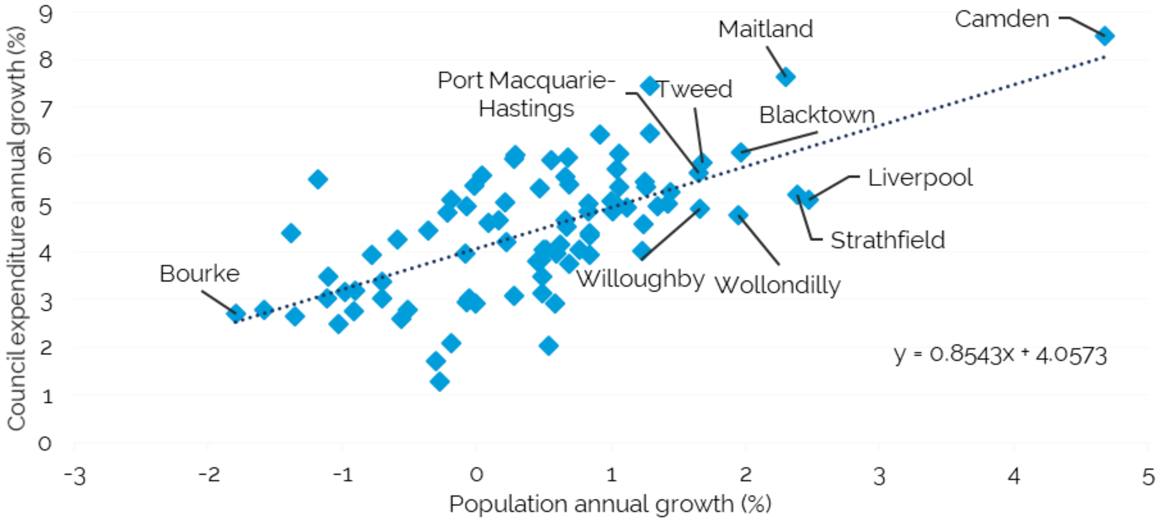
Our research shows council costs increase as population grows. Cost increases are driven by extra residents, extra rateable and non-rateable properties, and increased community expectations of the functions and services councils provide.

Costs associated with population growth include capital and ongoing operating costs, including significant depreciation costs that councils use to renew ageing assets. Costs are also incurred to replace assets to meet regulatory requirements regarding accessibility and sustainability and increasing community expectations.

Council cost increases also depend on the type of development undertaken to cater for growth, which can either be greenfield and infill developments. These costs are discussed in section 3.3.

Historically, population growth in NSW has increased council expenditure. Figure 2 shows a 1% increase in population results in a 0.85% increase in council expenditure.[3]

Figure 2 Population and council expenditure average annual growth in NSW from 1999 to 2019



Note: Excludes LGAs that did not exist for the entire sample period. Excludes Albury, Lithgow and Oberon, whose borders changed in 2004. Excludes Hills and Hornsby, whose borders changed in 2016.

Source: The CIE, Analysis of rate peg options to account for population growth, 19 May 2021, p.15.

Analysis of the functions and services provided by councils show that population, or a highly correlated factor such as number of rateable properties as the main cost driver across every expenditure item.[4]

We also investigated whether any associated economies of scale exist, and found the following:

- Expenditure for larger councils does not increase in the same proportion as the increase in population.
- There are economies of scale for some cost items.
- Doubling a council's population implies a range of costs increasing by 72% to 95%.[5]

Table 2 sets out the identified economies of scales in different functions and services councils provide in different states. For NSW councils, 6 of the 11 items identified have economies in scales.

Table 2 Economies of scale in council expenditure categories, by state

	NSW	VIC	QLD	WA	SA	TAS
Administration	Yes	Yes	Yes	No		Yes
Recreation and culture	Yes	No	Yes, for councils less than 10,000 people	No	No	Yes
Waste management		Yes	Yes, for councils less than 10,000 people		No	Yes
Transport	Yes	Yes	Yes, for councils less than 10,000 people	No	No	No
Law, order and public safety	Yes		Yes, for councils less than 10,000 people	No	No	No
Education, health, welfare and housing	Yes		Yes, for councils less than 10,000 people	No		No
Planning and building control	Yes				No	Yes
Family and community services		No		No	No	
Aged and disabled Services		No			No	
Environment		Yes	Yes, for councils less than 10,000 people		No	
Business and economic services		Yes	Yes, for councils less than 10,000 people			

Note: The CIE report has approximately aligned expenditure categories across councils. These categories may vary.

Source: The CIE, Analysis of rate peg options to account for population growth, 19 May 2021, pp 9–10.

Overall, a council's costs will increase with the size of its population. Cost increases are driven by increases in assets and the services provided. In submissions to the Issues Paper, councils and peak bodies submitted that the following general costs increase with an increase in population:[6]

- ongoing infrastructure maintenance and capital costs
- asset renewals and depreciation of buildings, roads, footpaths, parks and other assets
- providing community services such as libraries and aquatic centres
- providing new and embellished assets
- increased demand for services in general
- increases in service-related costs, including overheads such as information and communication technology and human resources
- maintenance and operational costs of developer-constructed assets
- increases in secondary dwellings, which do not offer services and facilities such as off-street parking and little to no recreation. Costs of providing these facilities fall on councils, with no additional land rates payable. As noted previously, councils submitted this does not align with taxation principles of efficiency or equity.
- increased service level expectations of new residents in LGAs who demand new and embellished assets and services, with increased maintenance costs

- costs of maintaining environmentally sensitive land or riparian corridors that have little or no development potential, which can include bushland or land subject to flooding. In some cases, this land has been dedicated to local councils who manage it in perpetuity.
- costs of acquiring land and property for affordable housing, open spaces and recreation. Sydney-based councils submitted that this is an expensive venture for them.

3 Operating and capital costs increase with population

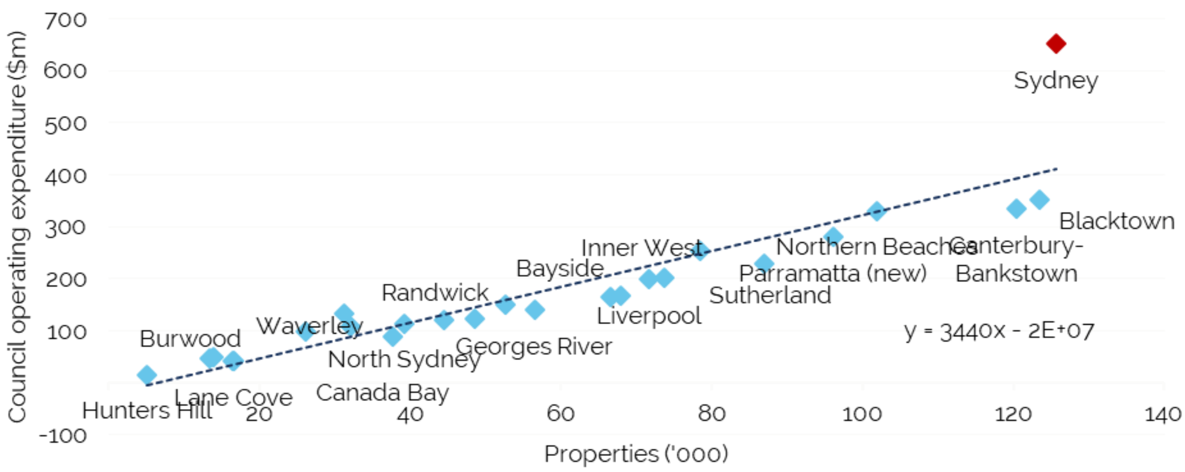
We have established that councils' costs increase as population grows. In this section, we examine the types of costs that increase – that is, the relationship between population growth and growth in operating and or capital costs.

3.1 Drivers of councils operating costs

When population increases, the number of rateable properties usually also increases. Providing functions and services for these rateable properties increases a council's operating costs. Operating costs for NSW councils have increased as the number of rateable properties has grown. Figure 3 and Figure 4 show that councils' expenditure increases vary with council type. We found on average, a council's expenditure:

- increases by $3440 for each additional rateable property in metropolitan LGAs
- increases by $3250 for each additional rateable property in regional areas.[7]

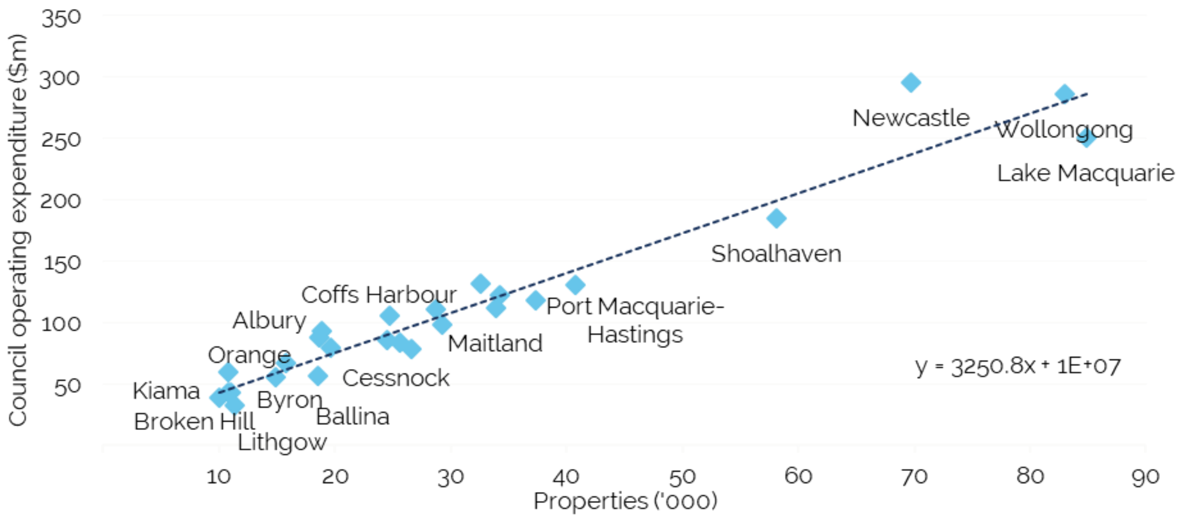
Figure 3 Council operating expenditure and rateable properties in metropolitan councils, 2018–19



Note: Operating expenditure on a per property basis is significantly higher in the City of Sydney because most (approximately 75%) of its rates income is paid for by businesses.

Source: The CIE, Analysis of rate peg options to account for population growth, 19 May 2021, p 16.

Figure 4 Council operating expenditure and rateable properties in regional councils, 2018–19

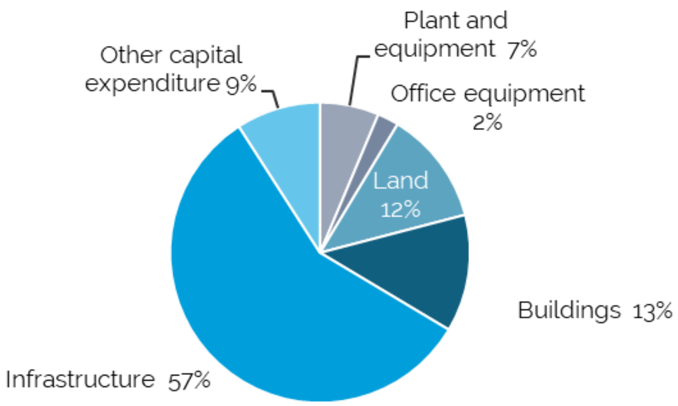


Source: The CIE, Analysis of rate peg options to account for population growth, 19 May 2021, p 16.

3.2 Drivers of council capital costs

In 2018–19, responses to IPART's survey, which informs the local government cost index, indicated total capital expenditure by NSW councils was $3.3 billion, or 37% of all council costs. Figure 5 shows 57% of all capital costs incurred by councils was spent on infrastructure such as roads, bridges, and footpaths. The second largest capital expense was buildings (13%), followed by land (12%), and other capital expenditure (9%).[8]

Figure 5 Capital costs across different activities for all NSW councils, 2018–19



Source: The CIE, Analysis of rate peg options to account for population growth, 19 May 2021, p 20.

Our analysis found capital expenditure incurred by councils:

- will be more lumpy than operating expenditure and is only available for a few years and only for some councils
- is driven by both the level of population and the amount of population growth, specifically:
  - larger councils and faster growing councils incur higher capital expenditure per year
  - each person is associated with capital expenditure of $202 per year
  - each additional person in a LGA is associated with capital expenditure of $12,938 per year.[9]

3.3 Costs vary with the type of development

The type and magnitude of council costs from population growth also depend on whether the development undertaken to cater for growth is greenfield or infill development. Greenfield development occurs on land with no previous urban footprint and requires a complete set of new infrastructure. Infill developments occur on land previously developed, including urban renewal precincts.[10]

Differences in costs exist between greenfield and infill developments. Costs associated with infill developments include redeveloping existing infrastructure. Councils with infill developments use almost 67% of their rates revenue to fund this infrastructure, with less revenue available to provide all other services.[11]

In contrast, councils with greenfield developments use 36% of their rates revenues to pay these infrastructure costs.[12] Typically, greenfield developments incur high capital costs upfront. Councils with greenfield developments tend to raise a larger proportion of their revenue from developer contributions or works-in-kind agreements, which reflects:

- the higher need for new infrastructure to support a growing community[13]
- a clearer nexus (or link) between the new infrastructure required to enable development and the services and amenities required.

The difference in costs between greenfield and infill development poses challenges for councils' financial sustainability and ability to maintain consistent service levels for growing communities with increasing expectations.[14] In submissions to the Issues Paper, councils note differences in costs between greenfield and infill developments:

- Greenfield developments require construction of new assets such as roads, stormwater management assets, open space and in some cases the purchase of environmental conservation land. While some local infrastructure is initially constructed and paid for by developers, council provide the ongoing management and maintenance of the assets. Councils also note greenfield developments have an impact on existing assets and increase demand for community services across the LGA.

- Councils noted that in some cases the infrastructure required to service infill development already exists. However, the demand from new residents still impact existing infrastructure, increasing maintenance and operational costs. When infill developments contribute to the need to deliver new infrastructure or open space, it can come at a significant cost to councils because of the higher land values and construction costs in built urban areas.

We worked with Blacktown City Council and Bayside Council to provide specific examples of greenfield and infill developments catering for population growth, and the costs to councils associated with these developments. These examples are set out below.

Costs and revenue from greenfield development Blacktown City Council

Blacktown City Council provided information to show the costs of servicing greenfield development and the increase in rates revenue it receives after development occurs.

Riverstone and Alex Avenue precincts

The Riverstone and Alex Avenue precincts cover 1395 hectares located in Sydney's North West Growth Area. When finished, the new community will provide an estimated 19,842 new homes for 58,279 people.

The two precincts are covered by one contributions plan, which includes $903 million for land and works for local infrastructure. Around $542 million (60% of the plan) is allocated to acquiring land for local infrastructure. Costs in the contributions plan have been paid for by developers and subsidised by the State Government.

The plan provides for active and passive open space (sporting fields and parks/playgrounds), water management facilities (stormwater detention basins, channels and stormwater treatment), traffic management facilities (local roads, roundabouts, traffic signals) and land for community facilities (aquatic centre, library, community centres). It does not include the construction costs of community facility buildings.

Population growth increases council costs

The information from the council highlights the capital and operating costs associated with the new development. Population growth within greenfield areas requires:

- new essential infrastructure to enable development
- replacing existing assets, such as roads
- additional community facilities to support the higher population.

According to the council, the increased capital costs not covered by developer contributions can be significant. For example, the increased population in the Riverstone and Alex Avenue precincts has resulted in, or contributed to, the need for:

- $224 million for an aquatic centre and community hub with an indoor recreation centre
- $128.5 million for additional open space to support higher than anticipated population
- $30 million for additional depot and administration centre costs
- $580,000 per annum for asset renewal cost for section 7.11 funded transport and water management infrastructure.

External borrowing to fund additional capital infrastructure would result in overall interest costs of around $132 million or an average cost of $6.5 million per annum.

The council estimates ongoing costs from the additional population in the precincts to be $5.4 million per annum. The increased costs reflect additional capital works and expanded existing services, including:

- community service subsidies (for the aquatic centre/community hub)
- open space, transport and water management infrastructure maintenance costs
- pensioner rebates, new information technology systems, street lighting, and postage costs
- local government election, Valuer General and bank fees
- support and frontline staff.

The council's rates revenue increases, but not enough to maintain per capita rates

Before adopting the contributions plan in 2010, the council reported average rates revenue for the area of $764 per capita, with a total rate yield of $6.4 million (2021 dollars). The population was around 7800 and the area mostly comprised larger lots of 2 hectares or more.

For 2020–21, average rates have fallen to $447 per capita, although the total annual rate yield increased to $15.7 million. Total population is now around 35,000. Since 2010, the increase in rates revenue can be attributed to a net increase in unimproved land value of around $9.3 million. More than half of all properties are levied the minimum rate which is currently $978 per dwelling.

Source: Information from Blacktown City Council, 18 May 2021.

Costs and revenue from infill development Bayside Council

Bayside Council provided information to show the costs of servicing infill development and the increase in rates revenue it receives after development occurs. This case study also highlights how new infill developments usually pay a minimum rate.

Overview of Bayside Council local government area

Bayside LGA is located 7 to 12 km south/south-east of Sydney's central business district. It was formed in 2016 following the merger of the City of Botany Bay and the City of Rockdale. It has over 62,036 dwellings with an average household size of around 3 people per dwelling. Bayside has a multicultural population and diverse housing, including detached dwellings, medium density housing and high-rise development. Central to the area are the international transport hubs of Kingsford Smith International Airport and Port Botany.

Bayside has a current residential population of approximately 178,000, and a population density of 36.35 persons per hectare. The population is expected to increase to 234,600 by 2041. The council estimates the non-resident working population of 72,770, results in a combined total population of 251,150.

Approximately 90% of new dwellings built in the area are medium and high-density infill development.

Infill development requires councils to enhance existing, and deliver more, open spaces and community assets

New housing and people increase demand for community assets such as parks, open spaces, libraries, sports fields, public pools, and other communal spaces.

Most new developments are apartments and townhouses, which increases demand for open space and community assets. Once constructed, new assets require ongoing maintenance and servicing. Further, existing assets that need replacing must be built to modern standards, which integrate costly aesthetically enhanced, sustainable design elements with higher safety standards.

On average, the council has delivered $45 million in capital works per annum over the past 3 years, including both new and renewed assets. It has budgeted another $60 million of capital works for 2021–22. Some, but not all, of the council's capital works are funded through developer contributions.

The council projects infill development–related new infrastructure and asset renewal over the next 10 years will cost approximately $750 million. However, funding for this expenditure is forecast to be only $468 million, leaving a net funding gap of $282 million (or $28.2 million per year). The Council also forecasts an asset maintenance shortfall of an additional $40 million over the same period (i.e. $4 million per year).

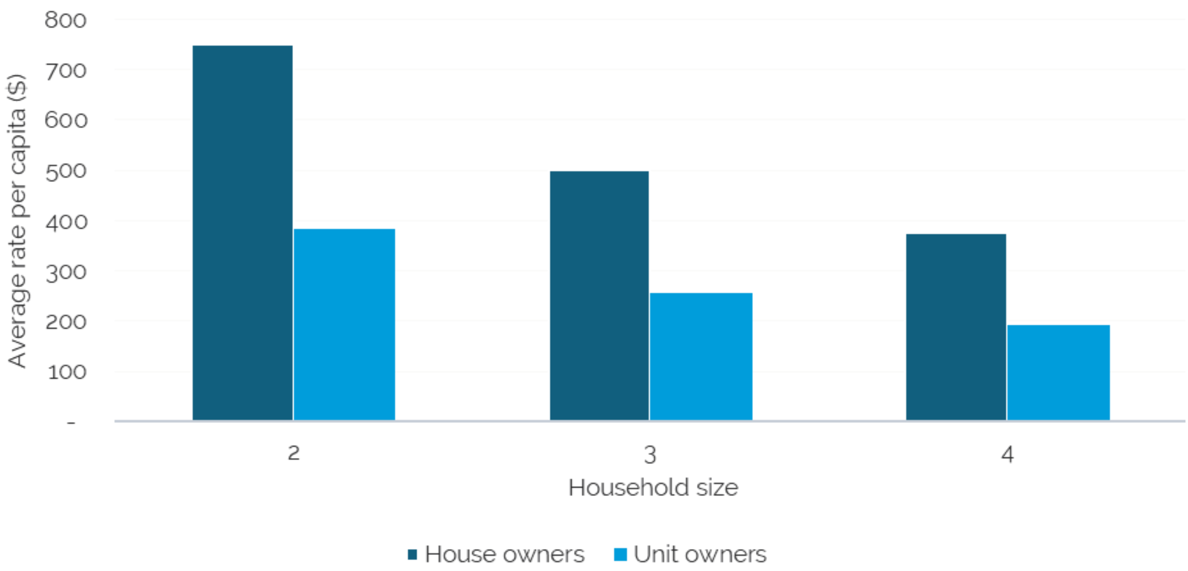
Income from rates may not keep pace with expenditure for infill councils

The council estimates approximately 60% of its total revenue (excluding capital grants) comes from rates and annual charges.

The current average ordinary rate per capita is approximately $450. In contrast, average operating expenditure per capita is $840, while average operating and capital expenditure per capita is $1100.

The additional rates income the council receives when new dwellings are built does not cover the costs of population growth. Because new dwellings are predominantly medium and high-density infill development, rates income per capita is falling. The figure below shows the average rate per capita for a house and a unit block on a similar parcel of land across different household sizes.

Figure 6 Average Rate per Capita (house owners vs unit dwellers)



Source: Information from Bayside Council, 14 May 2021 and 11 June 2021.

The council attributes the revenue shortfall to 3 key factors:

- Historically, the rate peg does not account for population growth.
- The LGA's minimum rate is too low.
- The rating system is flawed because the ad valorem component of rates is based on the unimproved value, rather than the capital improved value, of land.

Without reform to the rate peg, the council must rely on special variations to fund ongoing costs associated with servicing its growing population.

Source: Information from Bayside Council, 14 May 2021 and 11 June 2021.

4 How costs associated with population growth are currently funded

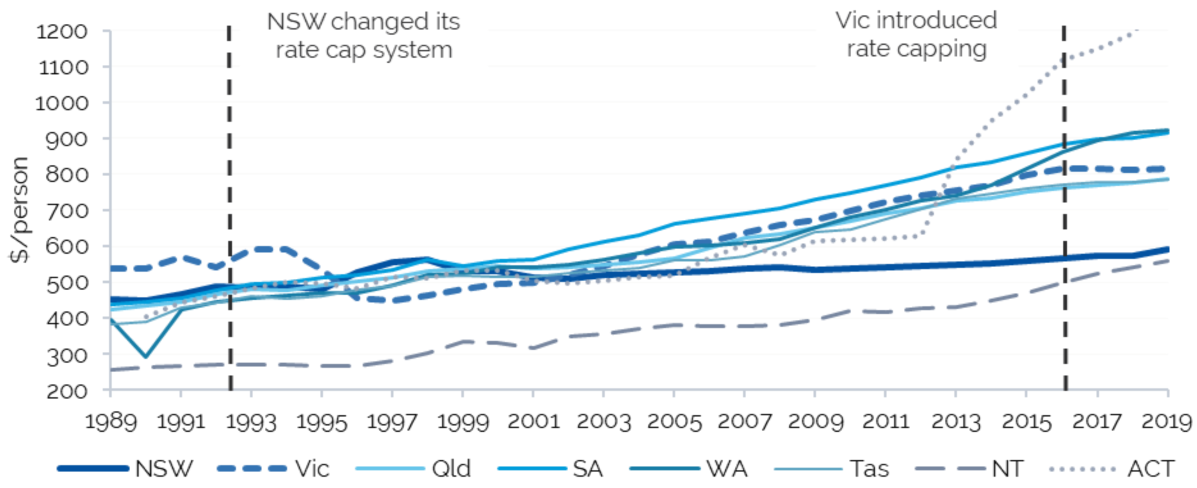
As local communities grow, councils need to provide infrastructure and services to new residents and businesses. In Information Paper 1, we list out the variety of ways councils source revenue.

In 2018–19, NSW councils collected total revenue of around $15 billion through the rating system. NSW councils' rates revenue has grown over time, but not as quickly as other components of revenue.

Since 1977, rates in NSW have been subject to a rate peg which caps the amount of general income (which is predominantly compromised of rates revenue) a council can earn. As a result, rates revenue has declined as a proportion of total revenue.

Currently, NSW and Victoria are the only states with a cap on rates revenue growth. Figure 7 shows rates revenue received by local government in NSW has grown at a significantly slower pace compared with other states and territories, where a rate peg does not apply.

Figure 7 Real council rates per capita, by jurisdiction, 1989 to 2019

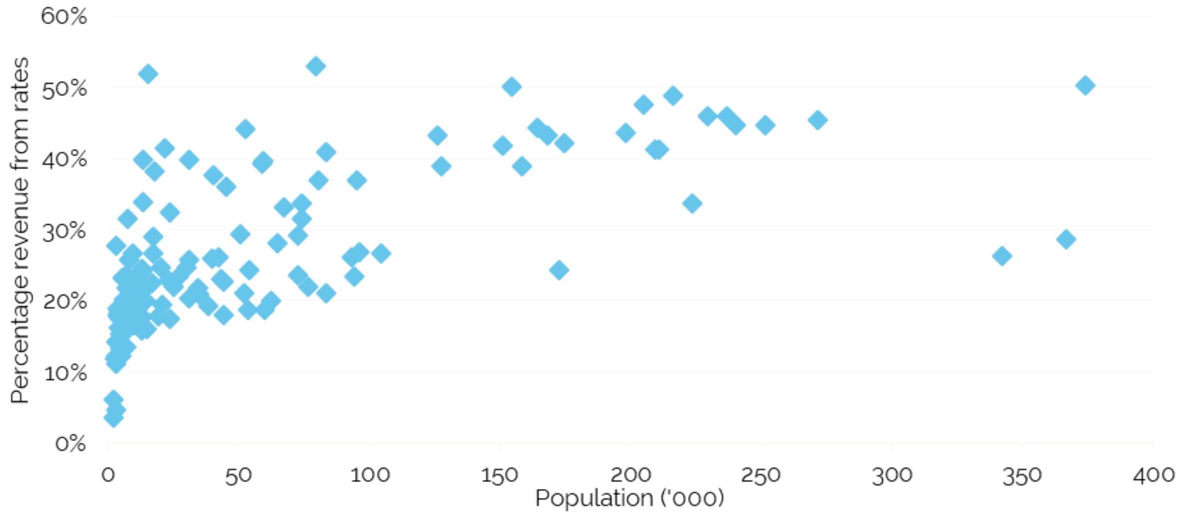


Note: ACT increases rapidly because it has transitioned away from stamp duty and towards land tax (i.e. rates). Municipal rates revenue is measured on a cash basis up to 1997-98, and on an accrual basis thereafter. Each state's council rates has been adjusted using the All Groups Consumer Price Index for that state's capital city.

Source: The CIE report, Analysis of rate peg options to account for population growth, 19 May 2021, p 27.

Figure 8 shows that for councils with more than 100,000 residents, rates make up a larger share of total revenue. For these councils, rates are 40% of their total revenue, compared with 17% for councils with fewer than 10,000 residents.[15]

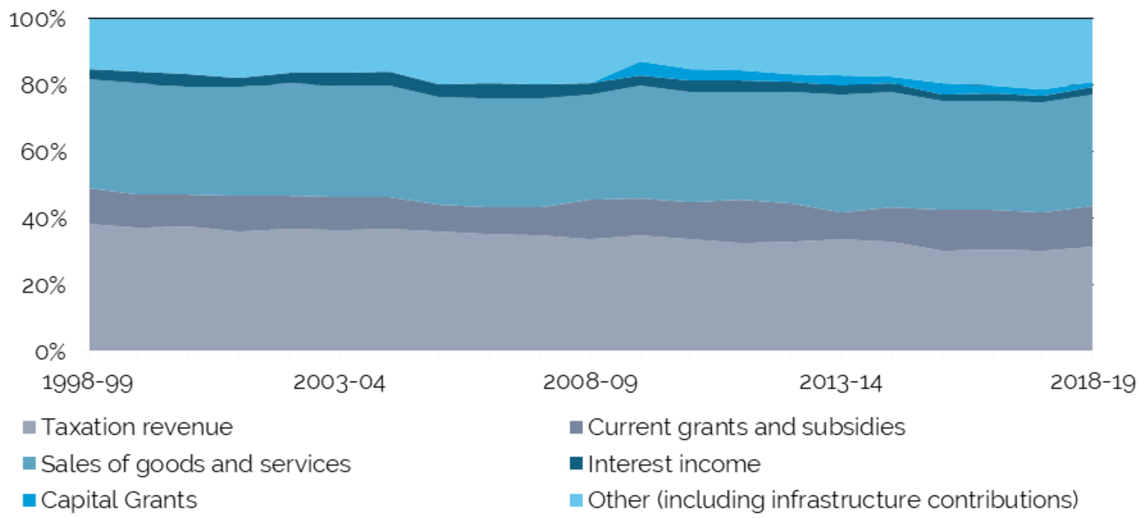
Figure 8 Rates portion of revenue for NSW councils, 2018–19



Source: OLG Your Council data,

Figure 9 indicates that over time rates have become a smaller share of revenue, reflecting the operation of the rate peg.[16]

Figure 9 NSW local government revenue sources, 1998–99 to 2018–19

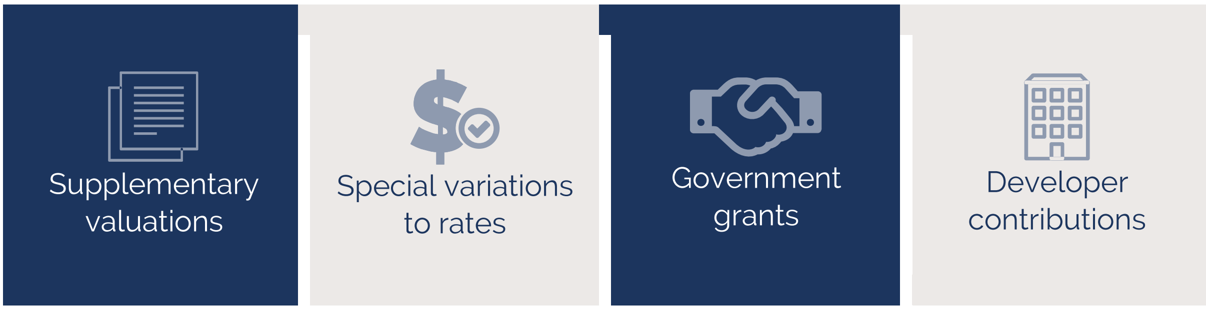


Source: The CIE, Review of infrastructure contributions in NSW South Wales, 2 December 2020, p 25.

4.1 Council revenue outside the rate peg

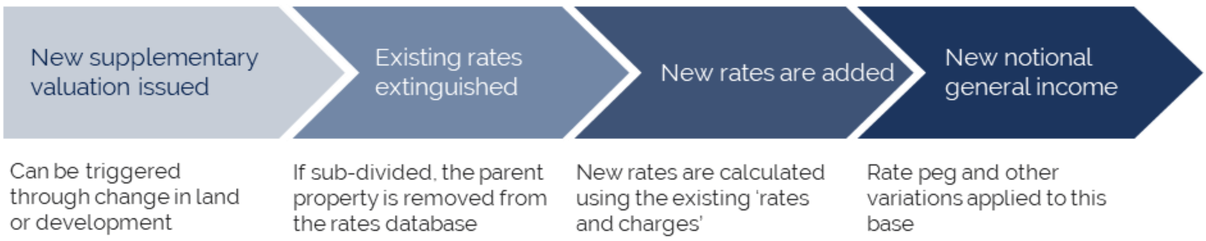
The amount by which a council can increase its general income (mainly rates) is capped by the rate peg. There are several ways councils can source income to fund the costs associated with population growth other than through increases to general income from the rate peg. These include:

- supplementary valuations
- special variations
- developer contributions
- government grants.



4.1.1 Supplementary valuations

Councils are partly compensated for higher population growth through higher rates revenue, mainly from the supplementary valuations process.[a] Councils can use additional income from supplementary valuations to provide services to additional residents and ensure that infrastructure is serviced and maintained.



[a] Rates can also grow through Crown Land Adjustments, however the impact is minimal.

Box 1 describes the events that trigger a supplementary valuation.

Box 1 When is a supplementary valuation issued?

When changes to a property are recorded, the Valuer General will issue a supplementary valuation with a new land value, outside the usual 3 to 4-year valuation cycle.

Supplementary valuations can occur where:

- there is a change in the property area, description or dimensions of the land
- land is rezoned or there are changes to the features of the land
- a subdivision occurs
- land that was previously valued separately is valued together
- land that was previously valued together is valued separately.

Source: NSW Valuer General, Your supplementary Notice of Valuation – Fact Sheet, January 2020.

Rate structures, land values and the type of development determine the increase in rates revenue from the supplementary valuation process.

Box 2 provides an example of a supplementary valuation.

Box 2 Supplementary valuation example

The supplementary valuation process allows a council to receive additional income because of changes in the rateable properties:

- A property pays rates of $2000 as a residential house.
- The property is rezoned and redeveloped into 20 apartments. Each apartment now pays $500 each in minimum rates.
- Total rates payable on the apartment block is $10,000. The council can increase its income by $8000.

Source: The CIE, Analysis of rate peg options to account for population growth, 19 May 2021, pp 28.

Councils with higher population growth usually have more development or redevelopment activities that trigger supplementary valuations, such as land rezoning and subdivision.

Historically, supplementary valuations have not fully compensated councils for increased costs due to population growth.[17] The supplementary valuation process usually results in most councils receiving less income from rates for each new resident compared with existing residents. Some types of developments, such as secondary dwellings, or developments on land owned by a public benevolent institution or public charity, result in population increases but do not trigger supplementary valuations. Councils therefore do not receive additional income to service these additional residents.

If rates were to increase in proportion to the growth in population, supplementary valuations would, on average, account for around 60% of this growth.[18] Our analysis indicates this percentage has increased over time as more councils seek to increase their minimum rates.

We found the relationship between population growth and growth in rates revenue was much weaker from 2008–09 to 2018–19, than from 1998–99 to 2007–08.[19] We also found:

- Councils with no population growth have, on average, experienced growth in rates revenue of around 4.9% per year.
- For each percentage point increase in population growth, general income increases by approximately one-quarter of a percentage point, although the relationship is not statistically significant.[20]

IPART has previously noted that unimproved land values do not increase enough when higher density apartments and businesses are built to adequately compensate councils through the current ratings system.[21]

Even if rezoning occurs, the increase in rates from the higher unimproved land value will be much lower than the increase in costs to service more residents and businesses. This difference is because as housing density increases, land value becomes a smaller share of property value, and less representative of the costs of providing council services to ratepayers. In this situation, councils only receive additional income by levying fixed charges (i.e. base or minimum rates) across a larger number of properties.[22] A council's existing rating structure, that is the mix of *ad valorem* and fixed charges across categories, affects the amount of additional income received through supplementary valuations.[23]

The actual amount of rate growth that councils can receive from supplementary valuations depends on the:

- rate structure used by a council – for example, councils with:
  - a larger part of rates from minimum and base rates will receive a larger increase from supplementary valuations
  - larger differences between rates for land being rezoned (such as farmland to residential) will receive a larger increase from supplementary valuations
- land value increase from the rezoning – where there is a larger land value increase, then councils will receive a larger rate increase from supplementary valuations
- extent to which population growth is accommodated through new development, rather than in ways that do not trigger a supplementary valuation (such as more people in existing houses or secondary dwellings etc).[24]

Overall, submissions to our Issues Paper support supplementary valuations as they exist in the current rating system. There were mixed views about whether we should account for supplementary valuations in a rate peg that includes a population growth factor. Submissions raised the following points about supplementary valuations:

- Without an alternative model, supplementary valuations are the only mechanism that allows the rate base to expand with population growth.
- No change to the supplementary valuations process is needed, because existing parcels of land can be redefined by registering a new plan (mainly a deposited or strata plan) and re-evaluated following re-ascertainment or valuation objections.
- The supplementary valuation process is appropriate for small levels of growth that can be picked up each year and where the increase doesn't significantly increase costs. The process is not suitable for rapid or sustained population growth where the cost increase is more than the additional increase to the notional income that a supplementary valuation provides.
- Benefits from supplementary valuations depend on where growth is occurring – that is, the mix of base and *ad valorem* rates for the existing rate category to which new properties are being added.
- The increase in number of rateable properties from the supplementary valuation process is a delayed indicator of growth, but not a definitive measure. The process does not account for other types of population growth-related residential developments, such as granny flats and general property extensions, growth in boarding houses and seniors living developments, portable housing in residential caravan-park type developments, conversions of garages, and relatives living with their children.[25]

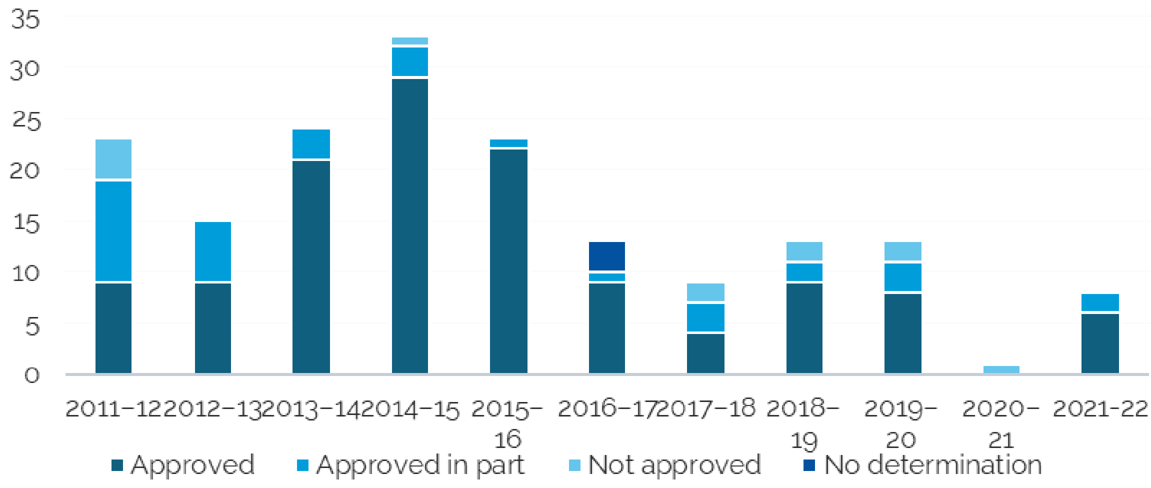
Generally, submissions considered the supplementary valuation process an inadequate measure of growth because it does not account for some types of growth. Further, the related increase in revenue does not keep pace with the increase in growth-related costs.

4.1.2 Special variations

Councils can also fund the costs of population growth by applying to IPART for a special variation (SV) to increase their general income by more than the rate peg. IPART assesses these applications against criteria established by the NSW Office of Local Government. Councils must demonstrate the need for the additional revenue, show evidence of community consultation, and assess the impact on affected ratepayers.

Since 2011–12, when IPART commenced setting the rate peg for NSW councils under a delegation from the Minister for Local Government, we have received 175 SV applications from councils (on average, around 16.7 applications per year) (Figure 10). Of these applications, 19% were approved in part and in 74% were approved in full.

Figure 10 Special variation applications to IPART, 2011–12 to 2021–22



Source: IPART analysis

Councils can have different reasons for submitting an SV application to meet their expenditure requirements. Some of the reasons that councils applied for an SV to increase their general income over the recent 2021–22 process included:

- maintaining or improving service levels
- renewing infrastructure and deteriorating assets
- improving and ensuring financial sustainability
- delivering key priorities in a Community Strategic Plan and Delivery Program
- undertaking large infrastructure projects such as aquatic facilities
- maintaining assets and infrastructure
- undertaking long-term maintenance and management of land dedicated by a developer.

4.1.3 Developer contributions

Councils can collect developer contributions via a section 7.11 contributions plan, which specifies the link between the new development and the increased demand for infrastructure.[26] Alternatively, councils may levy up to 1% (in most areas) of the estimated cost of new development under a section 7.12 contributions plan to fund new infrastructure.[27]

Developer contributions must be used for the purpose for which they were collected, and within a reasonable time. These contributions provide for base-level infrastructure to support development and to meet the infrastructure needs of the growing population. However, they do not provide for the operating and maintenance costs of this infrastructure or increases in the volume of services demanded by the additional population.

Submissions to our Issues Paper noted limitations of developer contributions, including:

- whole of life costs such as operating, maintenance and renewal costs (whether infrastructure has been funded by contribution plans and grants, or dedicated by developers)

- infrastructure that has not been deemed essential by the state government, including libraries, community centres, aquatic facilities, and day care centres
- expansion of facilities and infrastructure for additional demand that is not allowed or viable under developer contributions
- costs of applying for an SV to account for population growth
- infrastructure service above base level
- unfunded portions of contribution plans (due to apportionment criteria)
- the cost of infrastructure above the cap on development contributions
- additional demand from development that is not funded by developer contributions.[28]

4.1.4 Government grants

As the gap between costs and revenue increases, there is a greater reliance on grant funding, especially for regional councils.

One mechanism for councils to fund the shortfall between revenue and costs is accessing federally funded Financial Assistance Grants (FAGs), which are distributed to the states and territories. These grants comprise a general-purpose component according to population (i.e. on a per capita basis) and an identified local road component relating to fixed historical shares. Councils have discretion to spend the grants according to local priorities.

The NSW Local Government Grants Commission makes recommendations to the Minister for Local Government about how to distribute funding to councils under the FAG program. Recommendations are in accordance with the national principles for allocating grants among local governing bodies (councils) under the Commonwealth *Local Government (Financial Assistance) Act 1995*.

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1 The CIE, *Analysis of rate peg options to account for population growth*, 19 May 2021, p 6.
2 Various submissions including: Bayside Council, Submission to IPART Issues Paper, p 1; Blacktown City Council, Submission to IPART Issues Paper, pp 4–5; Blacktown City Council, Submission to IPART Issues Paper, pp 4–5; Byron Shire Council, Submission to IPART Issues Paper, pp 1–2; Canada Bay Council, Submission to IPART Issues Paper, p 1; Canterbury-Bankstown Council, Submission to IPART Issues Paper, pp 2–4; North Sydney Council, Submission to IPART Issues Paper, p 4; Tamworth Regional Council, Submission to IPART Issues Paper, p 3; NSW Revenues Professionals, Submissions to the Issues Paper, p. 4; Campbelltown City Council, Submission to IPART Issues Paper, pp 2–5; Wollongong City Council, Submission to IPART Issues Paper, p 2; Wollondilly Shirt Council, Submission to IPART Issues Paper, p. 2; Canberra Region Joint Organisation, Submission to IPART Issues Paper, p 4; Cessnock City Council, Submission to IPART Issues Paper, p 2; City of Newcastle, Submission to IPART Issues Paper, p 1; Clarence Valley Council, Submission to IPART Issues Paper, p 1; The Hills Shire Council, Submission to IPART Issues Paper, p. 3; Cumberland City Council, Submission to IPART Issues Paper, pp. 5–9; Inner West, Submission to IPART Issues Paper, pp. 2–3; Ku-ring-gai Council, Submission to IPART Issues Paper, p. 3; NSW Revenues Professionals, Submissions to the Issues Paper, pp. 6–7; City of Ryde, Submission to IPART Issues Paper, p. 2; Hornsby Shire Council, Submission to IPART Issues Paper, p. 2; Liverpool City Council, Submission to IPART Issues Paper, pp. 3–6; Northern Beaches Council, Submission to IPART Issues Paper, pp. 1–2; Wentworth Shire Council, Submission to IPART Issues Paper, p. 3; Wollondilly Shirt Council, Submission to IPART Issues Paper, p. 2; Georges River Council, Submission to IPART Issues Paper, pp. 1–4; Hawkesbury City Council, Submission to IPART Issues Paper, pp 1–2; Local Government NSW, Submission to IPART Issues Paper, pp 4–5; Lane Cove Council, Submission to IPART Issues Paper, pp 1–2; Maitland City Council, Submission to IPART Issues Paper, pp 2–3; Mid-Western Regional Council, Submission to IPART Issues Paper, pp 1–3; Port Stephens Council, Submission to IPART Issues Paper, pp 1–4; Queanbeyan-Palerang Regional

Council (QPRC), Submission to IPART Issues Paper; Randwick City Council, Submission to IPART Issues Paper, pp 2–4; Wagga Wagga City Council, *Wagga Wagga City Council's response to questions*, pp 5–6; Waverly, Submissions to IPART Issues Paper, pp. 1–2; Shellharbour City Council, Submission to IPART Issues Paper, pp 1–2; Wentworth Shire Council, Submissions to IPART Issues Paper, pp. 1–2; Willoughby City Council, Submissions to IPART Issues Paper, pp. 3–5; WSROC, Submission to IPART Issues Paper, pp. 13–17.

3 The CIE, *Analysis of rate peg options to account for population growth*, 19 May 2021, p 15.

4 The CIE, *Analysis of rate peg options to account for population growth,* 19 May 2021, p 7.

5 The CIE, *Analysis of rate peg options to account for population growth,* 19 May 2021, pp 8–10.

6 Various submissions including: Bayside Council, Submission to IPART Issues Paper, p 1; Blacktown City Council, Submission to IPART Issues Paper, pp 4–5; Blacktown City Council, Submission to IPART Issues Paper, pp 4–5; Byron Shire Council, Submission to IPART Issues Paper, pp 1–2; Canada Bay Council, Submission to IPART Issues Paper, p 1; Canterbury-Bankstown Council, Submission to IPART Issues Paper, pp 2–4; North Sydney Council, Submission to IPART Issues Paper, p 4; Tamworth Regional Council, Submission to IPART Issues Paper, p 3; Campbelltown City Council, Submission to IPART Issues Paper, pp 2–5; Wollongong City Council, Submission to IPART Issues Paper, p 2; Wollondilly Shirt Council, Submission to IPART Issues Paper, p. 2; Canberra Region Joint Organisation, Submission to IPART Issues Paper, p 4; Cessnock City Council, Submission to IPART Issues Paper, p 2; City of Newcastle, Submission to IPART Issues Paper, p 1; Clarence Valley Council, Submission to IPART Issues Paper, p 1; The Hills Shire Council, Submission to IPART Issues Paper, p. 3; Cumberland City Council, Submission to IPART Issues Paper, pp. 5–9; Inner West, Submission to IPART Issues Paper, pp. 2–3; Ku-ring-gai Council, Submission to IPART Issues Paper, p. 3; NSW Revenues Professionals, Submissions to the Issues Paper, pp. 6–7; City of Ryde, Submission to IPART Issues Paper, p. 2; Hornsby Shire Council, Submission to IPART Issues Paper, p. 2; Liverpool City Council, Submission to IPART Issues Paper, pp. 3–6; Northern Beaches Council, Submission to IPART Issues Paper, pp. 1–2; Wentworth Shire Council, Submission to IPART Issues Paper, p. 3; Wollondilly Shirt Council, Submission to IPART Issues Paper, p. 2; Georges River Council, Submission to IPART Issues Paper, pp. 1–4; Hawkesbury City Council, Submission to IPART Issues Paper, pp 1–2; Local Government NSW, Submission to IPART Issues Paper, pp 4–5; Lane Cove Council, Submission to IPART Issues Paper, pp 1–2; Maitland City Council, Submission to IPART Issues Paper, pp 2–3; Mid-Western Regional Council, Submission to IPART Issues Paper, pp 1–3; Port Stephens Council, Submission to IPART Issues Paper, pp 1–4; Queanbeyan-Palerang Regional Council (QPRC), Submission to IPART Issues Paper; Randwick City Council, Submission to IPART Issues Paper, pp 2–4; Wagga Wagga City Council, *Wagga Wagga City Council's response to questions*, pp 5–6; Waverly, Submissions to IPART Issues Paper, pp. 1–2; Shellharbour City Council, Submission to IPART Issues Paper, pp 1–2; Wentworth Shire Council, Submissions to IPART Issues Paper, pp. 1–2; Willoughby City Council, Submissions to IPART Issues Paper, pp. 3–5.

7 The CIE, *Analysis of rate peg options to account for population growth,* 19 May 2021, pp 15–16.

8 The CIE, *Analysis of rate peg options to account for population growth*, 19 May 2021, p 19.

9 The CIE*, Analysis of rate peg options to account for population growth, 19 May 2021, pp 19–20.*

10 NSW Productivity Commission**,** *Review of Infrastructure Contributions in NSW South Wales,* November 2020, p 25.

11 NSW Productivity Commission**,** *Review of Infrastructure Contributions in NSW*, November 2020, p 26**.**

12 NSW Productivity Commission, Review of Infrastructure Contributions in NSW, November 2020, p 26.

13 NSW Productivity Commission*, Review of Infrastructure Contributions in NSW South Wales,* November 2020, p 26.

14 NSW Productivity Commission, *Review of Infrastructure Contributions in NSW South Wales*, November 2020, p 26.

15 The CIE, *Analysis of rate peg options to account for population growth*, 19 May 2021, p 26.

16 The CIE, *Analysis of rate peg options to account for population growth*, 19 May 2021, p 25.

17 The CIE, *Analysis of rate peg options to account for population growth*, 19 May 2021, p 29.

18 OLG Data, IPART calculations.

19 The CIE, *Analysis of rate peg options to account for population growth*, 19 May 2021, p 30.

20 The CIE, *Analysis of rate peg options to account for population growth*, 19 May 2021, p 30.

21 IPART, *Review of the Local Government Rating System,* December 2016, p 51.

22 IPART, *Review of the Local Government Rating System*, December 2016, p 51.

23 IPART, *Review of the Local Government Rating System*, December 2016, p 11.

24 The CIE, *Analysis of rate peg options to account for population growth*, 19 May 2021, pp 33–34.

25 Various submissions including: LGNSW submission to IPART Issues Paper, p 6; NSW Revenue Professionals Inc. submission to IPART Issues Paper, p 7; Wentworth Shire Council submission to IPART Issues Paper, p 2; Northern Beaches Council submission to IPART Issues Paper, p 2.

26 This is known as 'development-contingent infrastructure'.

27 This is lower than what would be collected under a section 7.11 plan. The Productivity Commissioner's review recommended an increase to the maximum rate for section 7.12 levies, equivalent to 3% of residential development, which would enable more councils to benefit from the simpler requirements of the section 7.12 levy. NSW DPIE, Local infrastructure contributions policy. Councils can also levy developer contributions through Voluntary Planning Agreements or Works-in-Kind Agreements.

28 The Hills Shire Council, Submission to IPART Issues Paper, p. 3; Blacktown City Council, Submission to IPART Issues Paper, p. 5; Cumberland City Council, Submission to IPART Issues Paper, pp. 10–11; Campbelltown City Council, Submission to IPART Issues Paper, p. 4; Inner West, Submission to IPART Issues Paper, pp. 2–3; Ku-ring-gai Council, Submission to IPART Issues Paper, p. 3; NSW Revenues Professionals, Submissions to the Issues Paper, pp. 6–7; City of Ryde, Submission to IPART Issues Paper, p. 2; Hornsby Shire Council, Submission to IPART Issues Paper, pp. 2–3; Liverpool City Council, Submission to IPART Issues Paper, pp. 4–5; Northern Beaches Council, Submission to IPART Issues Paper, p. 3; Wentworth Shire Council, Submission to IPART Issues Paper, p. 3; Wollondilly Shirt Council, Submission to IPART Issues Paper, p. 2; Canterbury-Bankstown Council, Submission to IPART Issues Paper, pp 2–4;.