

Review of the Local Government Rating System

Local Government — Issues Paper
April 2016

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Invitation for submissions

IPART invites written comment on this document and encourages all interested parties to provide submissions addressing the matters discussed.

Submissions are due by 13 May 2016.

We would prefer to receive them electronically via our online submission form <www.ipart.nsw.gov.au/Home/Consumer_Information/Lodge_a_submission>

You can also send comments by mail to:

Review of Local Government Rating System
Independent Pricing and Regulatory Tribunal
PO Box K35
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Late submissions may not be accepted at the discretion of the Tribunal. Our normal practice is to make submissions publicly available on our website <www.ipart.nsw.gov.au> as soon as possible after the closing date for submissions. If you wish to view copies of submissions but do not have access to the website, you can make alternative arrangements by telephoning one of the staff members listed on the previous page.

We may choose not to publish a submission—for example, if it contains confidential or commercially sensitive information. If your submission contains information that you do not wish to be publicly disclosed, please indicate this clearly at the time of making the submission. IPART will then make every effort to protect that information, but it could be disclosed under the *Government Information (Public Access) Act 2009* (NSW) or the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW), or where otherwise required by law.

If you would like further information on making a submission, IPART's submission policy is available on our website.

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1 Introduction

The Independent Pricing and Regulatory Tribunal (IPART) is conducting a review of the local government rating system in NSW. Our aim is to recommend reforms to improve its efficiency and equity so as to ensure councils can implement sustainable fiscal policies over the longer term.

This review is part of an ongoing process of review and reform, aimed at improving local government's strength and effectiveness. Among other things, this process has included the Independent Local Government Review Panel's wide-ranging review and recommendations in 2013,¹ and the NSW Government's response to these recommendations, including its *Fit for the Future* reform package in 2014, and proposals to create new councils by merging existing councils.

The purpose of this Issues Paper is to outline how we propose to approach this review, explain how stakeholders can provide input, and to discuss the issues on which we seek comment.

1.1 What we have been asked to do

We have been asked to undertake the review under section 9 of the *Independent Pricing and Regulatory Tribunal Act 1992* in accordance with the terms of reference (ToR) provided by the Premier. These ToR ask us to:

- ▼ review the current rating system and recommend reforms that aim to enhance councils' ability to implement sustainable and equitable fiscal policy, and
- ▼ recommend a legislative or regulatory approach to achieve the Government's policy that there will "be no change to the existing rate paths for newly merged councils for four years".²

¹ Independent Local Government Review Panel, *Revitalising Local Government*, October 2013, at <http://www.localgovernmentreview.nsw.gov.au/>, accessed 1 March 2016 (Panel Report).

² NSW Government, *Media Release – Stronger Councils for Sydney and Regional NSW*, at <http://www.nsw.gov.au/media-releases-premier/stronger-councils-sydney-and-regional-nsw>, 18 December 2015, accessed 16 March 2016.

These ToR set out the issues we must consider in making our recommendations, including:

- ▼ the rating burden across and within communities, including consideration of multi-unit dwellings
- ▼ the appropriateness and impact of current rating categories and exemptions, and mandatory concessions
- ▼ the land valuation methodology used as the basis for determining rates in comparison to other jurisdictions
- ▼ the capacity of a merged council to establish a new equitable rating system and transition to it in a fair and timely manner, and
- ▼ the objectives and design of the rating system according to recognised principles of taxation.

They also specify that we must take account of the Independent Local Government Review Panel's Final Report, the Government response to this report, and the 2013 NSW Treasury Corporation (TCorp) report '*Financial Sustainability of the NSW Local Government Sector*'.³

In addition, they ask us to recognise the importance of the Integrated Planning and Reporting framework that allows NSW councils to draw various plans together and understand how they interact.⁴

A copy of the ToR is provided in Appendix A. A summary of reports noted above (and other relevant work) is in Appendix B.

1.2 How we propose to approach this review

We propose to approach this review as two separate tasks. The first is to review the current rating system and recommend changes to improve its efficiency, equity and sustainability. The second is to consider and recommend the appropriate approach for implementing the Government's policy of freezing existing rate paths for newly merged councils for four years. Our approach to the review is outlined in Box 1.1.

³ NSW Treasury Corporation, *Financial Sustainability of the NSW Local Government Sector, Findings Recommendations and Analysis*, April 2013.

⁴ Office of Local Government, *Integrated planning and reporting*, at <https://www.olg.nsw.gov.au/councils/integrated-planning-and-reporting>, accessed on 1 April 2016.

Box 1.1 IPART's approach to the review

Review the performance of the current rating system and potential improvements

1. **Define the current rating system in NSW.** We set out the system that governs how current rates are set as context for this review.
2. **Establish the recognised principles of taxation that we should employ in assessing and recommending changes to the current rating system.** We will investigate and consider the objectives and design of the rating system according to our established principles.
3. **Assess the current approach for calculating the level of rates applicable to a ratepayer against these principles.** In accordance with our ToR we will consider:
 - ▼ the ratings burden across and within communities, including consideration of apartments and other multi-unit dwellings; and
 - ▼ the land valuation methodology used as the basis for determining rates in comparison to other jurisdictions.

We will also assess rating structures, including the policy related to base and minimum amounts, and options for increasing councils' flexibility in using those charges. In addition, we will consider the rating burden across communities, and whether there is scope for the rating system to better support the NSW Government's policy of encouraging urban renewal. We will assess land valuation methods and whether other methods could be more appropriate.

4. **Assess the current approach for determining who should pay rates against the principles of taxation.**

We will analyse the available exemptions and mandatory concessions, in light of the NSW Government's commitment to provide rate concessions to pensioners. In doing so, we will consider the appropriateness and impact of the current rating categories, exemptions, mandatory concessions and rebates.

5. **Recommend reforms to improve the efficiency, equity and sustainability of the current rating system based on the findings of Steps 2 to 4.**
6. **Consider the issues that might arise for merged council areas after the expiry of the rate path freeze.** We will consider their ability to establish a new equitable system of rating, and transition to it in a fair and timely manner, taking account of the NSW Government's commitment to protect NSW residents against excessive rate rises.

Recommend appropriate approach to achieve the rate path freeze policy

7. **Outline our interpretation of the Government's policy and consider how the rate path freeze might work in practice.** We will consider the implications for new special variations and impact on taxpayers, including consideration of rating structures, and rating categories.
 8. **Identify alternative legislative and regulatory approaches for implementing the rate path freeze policy.** We will assess complexity, flexibility and level of certainty of legislative amendments, in making a balanced recommendation on the appropriate approach.
 9. **Make recommendations on the legislative and regulatory approach to achieve the Government's rate path freeze policy based on our findings in Steps 7 and 8.**
-

1.3 How stakeholders can provide input to this review

For this review, we will undertake our own analysis and conduct public consultation. This issues paper is the first step in our consultation process. We invite all stakeholders and interested parties to make written submissions in response to the paper by 13 May 2016. (Details on how to make a submission can be found on page iii.) We will also hold a public hearing on 26 April 2016 to give stakeholders another opportunity to respond.

Our ToR require us to provide an interim report to the Minister for Local Government in June 2016, outlining our recommendations on the appropriate approach for implementing the Government's policy of freezing existing rate paths for four years for newly merged councils.

We will publicly release a draft report in August 2016 covering all issues, and invite stakeholders to respond by making a submission and/or attending public hearings in September 2016. We will consider all stakeholder comments before making our final decisions and providing our final report to the Minister for Local Government in December 2016.

Table 1.1 provides an indicative timetable for the review. We will update this timetable on our website as the review progresses.

Table 1.1 Indicative timetable for this review

| Milestone | Timeframe |
|---|----------------|
| Release Issues Paper | 13 April 2016 |
| Hold Public Hearing | 26 April 2016 |
| Receive submissions to the Issues Paper | 13 May 2016 |
| Provide Interim Report to Minister | 17 June 2016 |
| Release Draft Report | August 2016 |
| Hold public hearing(s) in Sydney and possibly 1 regional town | September 2016 |
| Receive submissions to the Draft Report | September 2016 |
| Provide Final Report to Minister | December 2016 |

Note: These dates are indicative only.

1.4 What the rest of this paper covers

The rest of this paper discusses our proposed approach to the review in more detail, as well as our preliminary views (where we have them). It is structured as follows:

- ▼ Chapter 2 provides context for the review by outlining the current rating system in NSW.
- ▼ Chapter 3 outlines the recognised principles of taxation against which we propose to assess the rating system.

- ▼ Chapter 4 analyses the current method for setting rates in NSW using the tax principles. It also explores alternative methods that could provide councils with greater flexibility in setting rates with the method for valuing property, use of base and minimum amounts, and making rating categories.
- ▼ Chapter 5 analyses current exemptions and the mandatory pensioner concession using the tax principles. It also explores alternatives to providing full exemptions for some land uses and different ways for structuring the pensioner concession.
- ▼ Chapter 6 outlines our interpretation of the Government's policy of freezing the existing rate paths for newly merged councils, and the options for implementing this policy.
- ▼ Chapter 7 discusses options to allow merged councils to establish new and equitable rating systems in a fair and timely manner.

1.5 List of issues on which we seek comment

Throughout this paper, we have identified the issues on which we seek stakeholder comment at this stage of the review. Stakeholders may address all or some of these issues, and are also free to raise and discuss any other issues that they feel are relevant to the terms of reference. For convenience, a full list of the issues we seek comment on is provided below:

Taxation principles

- | | | |
|---|---|----|
| 1 | Do you agree with our proposed tax principles? If not, why? | 15 |
|---|---|----|

Assessing the current method for setting rates

- | | | |
|---|---|----|
| 2 | What valuation method should be used as the basis for determining the ad valorem amounts in council rates? Should councils be given more choice in selecting a valuation method, as occurs in other states, or should a valuation method continue to be mandated? | 20 |
| 3 | Should councils be required to use the Valuer General's property valuation services, or should they also be able to use a private valuation firm (as occurs in Victoria and Tasmania)? | 20 |
| 4 | What changes (if any) should be made to the Local Government Act to improve the use of base and minimum amounts as part of the overall rating structure? | 22 |
| 5 | What changes could be made to rating categories? Should further rating categories or subcategories be introduced? What benefits would this provide? | 23 |

- 6 Does the current rating system cause any equity and efficiency issues associated with the rating burden **across** communities? 24
- 7 What changes could be made to current rate pegging arrangements to improve the rating system, and, in particular, to better streamline the special variation process? 25
- 8 What changes could be made to the rating system to better encourage urban renewal? 26
- 9 What changes could be made to the rating system to improve councils' management of overdue rates? 26

Assessing exemptions, concessions and rebates

- 10 Are the land uses currently exempt from paying council rates appropriate? If a current exemption should be changed, how should it be changed? For example, should it be removed or more narrowly defined, should the level of government responsible for providing the exemption be changed, or should councils be given discretion over the level of exemption? 33
- 11 To what extent should the exemptions from certain state taxes (such as payroll tax) that councils receive be considered in a review of the exemptions for certain categories of ratepayers? 33
- 12 What should the objectives of the pensioner concession scheme be? How could the current pensioner concession scheme be improved? 35

Freezing existing rate paths for newly merged councils

- 13 We have interpreted the rate path freeze policy to mean that in the four years after a merger, the rating path in each pre-merger council's area will follow the same trajectory as if the merger had not occurred. Do you agree with this interpretation? 36
- 14 Within the rate path freeze period, should merged councils be permitted to apply for new special variations:
 - For Crown Land added to the rating base?
 - To recover amounts that are 'above the cap' on development contributions set under the *Environmental Planning and Assessment Act 1979*?
 - To fund new infrastructure projects by levying a special rate? 39
- 15 Are there any other situations where merged councils should be able to apply for new special variations within the rate path freeze period? 39

- 16 During the rate path freeze period, should merged councils only be able to increase base amounts and minimum amounts each year by the rate peg (adjusted for any permitted special variations)? 41
- 17 During the rate path freeze period, should merged councils be able to allocate changes to the rating burden across rating categories by either:
- relative changes in the total land value of a rating category against other categories within the pre-merger council area, or
 - the rate peg (adjusted for any permitted special variations)? 41
- 18 Do you agree that the rate path freeze policy should act as a ‘ceiling’, so councils have the discretion to set their rates below this ceiling for any rating category? 41
- 19 What other discretions should merged councils be given in setting rates during the rate freeze period? 41
- 20 We considered several options for implementing the rate path freeze policy. Our preferred option is providing the Minister for Local Government with a new instrument-making power. What are your views on this option and any other options to implement the rate path freeze policy? 44

Establishing new, equitable rates after the 4-year freeze

- 21 Should changes be made to the LG Act to better enable a merged council to establish a new equitable system of rating and transition to it in a fair and timely manner? If so, should the requirement to set the same residential rate **within a centre of population** be changed or removed? 48
- 22 Should approved special variations for pre-merger councils be included in the revenue base of the merged council following the 4-year rate path freeze? 49
- 23 What other rating issues might arise for merged councils after the 4-year rate path freeze period expires? 49

2 | The current rating system in NSW

Local councils provide a range of infrastructure and services to ratepayers and residents in their local government area. To fund their costs, councils:

- ▼ levy rates on property owners in their area
- ▼ charge fees for the use of specific services (user charges)
- ▼ receive grants from the State and Federal governments
- ▼ generate other revenue, for example, from fines, developer charges and interest, and
- ▼ raise funds through borrowings.

This review only considers rates included in a council's general income.⁵ The system that determines how these rates are currently calculated in NSW is set out in the *Local Government Act 1993* (LG Act).⁶ The sections below outline the key features of this system, including:

- ▼ the rate structure
- ▼ the rating categories
- ▼ the treatment of high-density property
- ▼ the rate peg and special variation process
- ▼ the different types of rates included in a council's general income
- ▼ the land valuation process, and
- ▼ the infrastructure and services funded by rates.

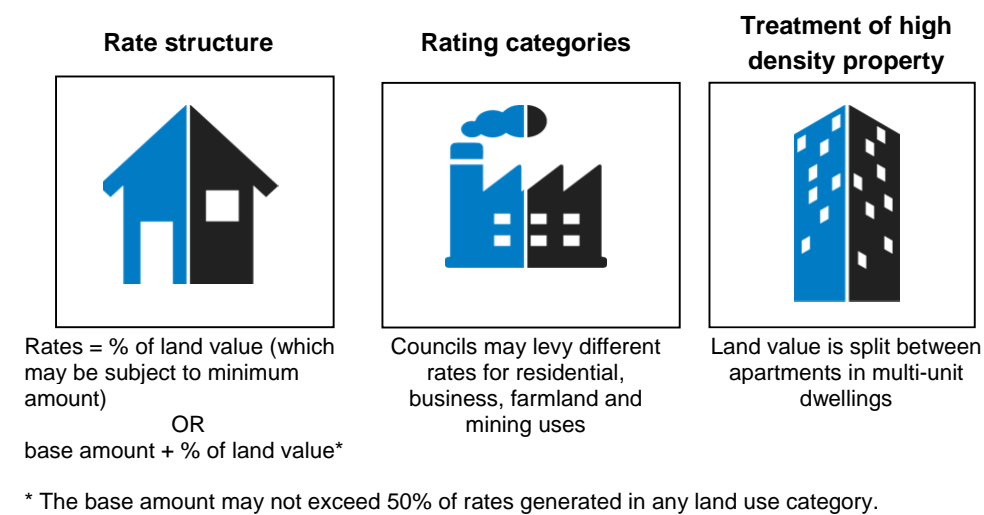
⁵ This is income derived from ordinary rates, special rates and specified annual charges (section 505 of the *Local Government Act 1993* (NSW)). Special rates and charges for water and sewerage are not included in a council's general income.

⁶ For more detailed information on the current rating system, see the LG Act (Chapter 15, Sections 491-607), and the NSW Department of Local Government, *Council Rating and Revenue Raising Manual*, 2007.

2.1 Overview of how council rates are set in NSW

Figure 2.1 provides an overview of how council rates are set in NSW.

Figure 2.1 How council rates are set in NSW



Data source: *Local Government Act 1993*.

2.2 Rate structure

Under the LG Act, a rate may consist of:

- ▼ an ad valorem amount (which may be subject to a minimum amount), or
- ▼ a base amount to which an ad valorem amount is added.

In NSW, an **ad valorem amount** is a variable charge set as a proportion of the unimproved land value (UV) of the rateable property – that is, the value of the property without any buildings, houses or other capital investments.

A **minimum amount**, where applied, is a flat charge which applies instead of the ad valorem amount, when it is greater than the ad valorem amount.

A **base amount**, where applied, is a fixed charge that is levied equally against all rateable properties within a given rate category, or subcategory of land use.

There is no restriction on the proportion of revenue a council can generate from the ad valorem amounts included in rates. However:

- ▼ revenue generated from the base amount cannot exceed 50% of the total revenue from any particular rating category, and
- ▼ the minimum amount cannot exceed a statutory limit (set at \$497 in 2015-16⁷).⁸

In 2013-14, the ad valorem rate on land value accounted for 75% of all NSW council rate revenue. It is the primary method for raising rating income. Base and minimum amounts accounted for an average of 15% and 10% of council rate revenue respectively across NSW (noting that not all councils apply these rates).

2.3 Treatment of high-density property

Where the rateable property consists of multiple units, such as a block of apartments, the ad valorem amount is split between the units. For example, if a block of four apartments and a house have the same unimproved land value, the rates payable by the owners of each apartment would be 25% of those payable by the house owner, assuming that no minimum or base amounts apply.

2.4 Rating categories

Councils may vary the way they calculate rates for different categories of property. For example, they can use a different percentage of the unimproved land value to calculate the ad valorem amounts, apply different minimum amounts, or add different base amounts. There are four main rating categories:

1. residential
2. business
3. farmland, and
4. mining.

Councils may also determine subcategories within each of these four categories, and vary the way they calculate rates for each subcategory. However, the degree of flexibility varies across categories. In particular, the LG Act requires that residential rates for all properties **within a centre of population** are calculated the same way. This requirement raises issues which will need to be addressed for newly merged councils in urban areas (see Chapter 7 for more detail).

⁷ This ceiling only applies to ordinary rates. A different ceiling applies to special rates: \$2 (section 548(3)(b) of the LG Act).

⁸ Councils that wish to set a minimum amount above the statutory limit are required to submit a minimum rate application to IPART for review and assessment. IPART has been delegated authority to approve minimum amount variations from the Minister for Local Government.

Finally, there are also a range of land uses which are currently exempt from paying rates (or exempt from paying a portion of rates). These include national parks, charities and education institutions (see Chapter 5 for more detail).

2.5 Rate peg and special variation process

The LG Act sets out a process that regulates the amount by which councils increase their general income, the main component of which is rates revenue from ordinary and special rates (see section 2.6 below). Each year, IPART determines the maximum percentage by which a council may increase its general income in the coming year, known as the 'rate peg'. We calculate this percentage based on the estimated annual change in NSW councils' costs, adjusted for any improvements in productivity. The total amount of general income collected from rates revenue is typically called the 'rating burden'.

Councils then set their rates for each rating category so that their annual general income does not increase in percentage terms by more than the rate peg for that year. This gives them some flexibility to vary the increase in rates across categories (eg, to increase residential rates by a higher percentage than farmland rates), as long as the total increase in revenue does not exceed the rate peg.

Councils can apply to IPART for a 'special variation' to allow them to increase general income above the rate peg for a range of reasons, including to provide additional services, to replace ageing assets, or improve financial sustainability.

The Integrated Planning and Reporting (IP&R) framework is an important part of the special variation process. As part of the IP&R framework, when applying for a special variation, councils are required to engage the community in a discussion on how the funding required will deliver services and infrastructure that meet the community's expectations about service levels. The IP&R framework is discussed further in Appendix B.

2.6 Different types of rates

There are two different types of rates included in a council's general income:

- ▼ ordinary rates – councils are required to make and levy an ordinary rate for each year on all rateable land in their area.
- ▼ special rates – councils have the discretion to levy a special rate for:
 - works or services provided or proposed to be provided, or
 - any other special purpose.

Special rates can be levied on subgroups of ratepayers. For example, a special levy could be applied to all properties in a specific area or development, even if it is within a centre of population.

2.7 Land valuation process

Councils do not undertake the land valuations used to calculate the rates applicable to each property themselves. Instead, they are required to use the unimproved land valuations provided by the NSW Valuer General.

The Valuer General values all land in NSW, and provides services to a range of users including to the NSW Government for the purpose of levying land tax.

In comparison, councils in Victoria and Tasmania have the option of using other valuers to estimate property values for the purpose of levying rates.

2.8 Infrastructure and services funded by rates

Typically, income from rates is used to fund (or partly fund) infrastructure and services that have the characteristics of ‘public goods’ or ‘mixed goods’. Services with the characteristics of ‘private goods’ are generally funded through user charges (see Box 2.1 for more information.)⁹

Box 2.1 What are public, private and mixed goods?

The infrastructure and services provided by councils fall into three categories:

- ▼ **Public goods:** where one person’s consumption does not prevent others from consuming it and it is difficult or not practical to charge consumers to use it. Examples include local roads, footpaths and parks.
 - ▼ **Private goods:** where consumption by one person prevents another from consuming the same unit of that good. Examples include, water, sewerage and garbage collection.
 - ▼ **Mixed goods:** that have a mixture of private and public good characteristics, such as libraries and community centres.
-

⁹ The LG Act recognises this principle in allowing direct charges for services such as water and sewerage (Section 501), mandating direct charging for waste (Section 496), and not including these user charges in the council’s general income for rate base purposes (Section 505).

3 Establishing principles of taxation

The first step in our proposed approach for reviewing the current rating system is to establish the “recognised principles of taxation” that we will employ in assessing and recommending changes to this system, as required by our terms of reference.

The key tax principles that we propose to use to assess the rating system are:

- ▼ efficiency
- ▼ equity
- ▼ simplicity
- ▼ sustainability, and
- ▼ competitive neutrality.

The sections below outline each of these principles.

3.1 Efficiency

Efficiency comprises two main sub-principles: the principle that taxes should minimise changes in behaviour, and the benefits principle.

3.1.1 Taxes should minimise changes in behaviour

Taxes that minimise changes to production and consumption decisions are more efficient. The more that taxes that are designed to raise general revenue change behaviour, the greater the welfare loss.¹⁰

The Henry Tax Review found that local rates were the most efficient of all current taxes used by any level of government, because changes in behaviour from rate taxes are small. It estimated that for every dollar raised through rates, there were welfare losses of just 2 cents. In comparison, the welfare losses associated with other State and Commonwealth taxes ranged from 8 to 70 cents per dollar raised.¹¹

¹⁰ The welfare loss of taxation is known as the excess burden of taxation, and is the distortionary cost that taxes cause by reducing the amount of productive activity that would otherwise occur in a free market.

¹¹ Henry K, *Australia's future tax system – Final Report*, May 2010 (Henry Tax Review), p 13.

3.1.2 Benefits principle

The income raised from rates is generally used to fund (or partly fund) infrastructure and services that have the characteristics of ‘public goods’. The benefits principle is that each person’s share of funding for public goods should be proportional to the benefits they receive from these goods.

However, the benefits principle is difficult to apply because people generally under-state their willingness to pay for the benefits that they receive from public goods.^{12,13} In practice, proxies that are correlated with people’s willingness to pay for public goods are used to estimate benefits received.

3.2 Equity

Equity also has two sub-principles: the benefits principle (discussed above) and the ability to pay principle.

3.2.1 Ability to pay

People should contribute to funding public goods according to their **ability to pay**. **Ability to pay** has two components:

- ▼ The **horizontal equity principle** requires people of equal capacity to pay the same amount of tax.
- ▼ The **vertical equity principle** requires people who are better off to pay more tax than those who are worse off, so the burden of tax is proportional to the taxpayer’s means.

Property-based taxes such as rates are generally regarded as equitable, because property value correlates with wealth and ability to pay.

3.3 Simplicity

Taxes should be easily understood, difficult to avoid and have low costs of compliance and enforcement. If a tax is easy to understand and is fair, compliance is generally high.

Property-based taxes such as rates are generally hard to avoid, as the government holds comprehensive land ownership records.

¹² A person’s willingness to pay for goods should generally be equal to the benefits they receive from those goods.

¹³ This is due to the **free-rider** problem. People have an incentive to under-state their willingness to pay for public goods, if their stated willingness to pay is then used as the basis on which taxes are levied on them.

3.4 Sustainability

To be sustainable, the income generated by a tax should be reasonably reliable, able to withstand volatile economic conditions, and grow over time to support the future needs of government.¹⁴

3.5 Competitive neutrality

Competitive neutrality requires businesses competing with each other to be treated in a similar way. This principle is used to promote fair and efficient competition between public and private businesses.

IPART seeks comment

- 1 Do you agree with our proposed tax principles? If not, why?

¹⁴ Our consideration of sustainability will encompass the requirement of the terms of reference to consider the current financial sustainability of local government in NSW, including the findings and deliberations of NSW Treasury Corporation report *Financial Sustainability of the NSW Local Government Sector*, 2013.

4 | Assessing the current method for setting rates

The second step of our approach for reviewing the current rating system is to assess the current method for setting the rates applicable to a particular property owner. This involves assessing the elements of the current system that affect the rating burden **within** communities (ie, within the same local government area) using the recognised principles of taxation (discussed in Chapter 3). These elements include:

- ▼ the valuation method used to set ad valorem amounts
- ▼ the use of base amounts and minimum amounts, and
- ▼ the rating categories.

This step also involves considering other aspects of the current rating system specified in our terms of reference, including:

- ▼ the rating burden **across** communities in NSW (in different local government areas across NSW), and
- ▼ whether the current rating system provides appropriate scope for councils to promote the Government's policy for encouraging urban renewal.

This chapter also considers how councils manage their overdue rates.

Where relevant, we will take account of the rating systems used in other jurisdictions, the findings of the Independent Local Government Review Panel (the Panel) and other matters listed in our terms of reference.

The sections below provide further information and preliminary analysis on each of these considerations.

4.1 Valuation methods used to set ad valorem amounts

As Chapter 2 discussed, the current rate structure includes an ad valorem amount (which may be subject to a minimum amount) or an ad valorem amount plus a base amount. To calculate the ad valorem amount for a particular property, the ad valorem rate (a fixed percentage) is multiplied by the assessed value of the property.

Across Australian jurisdictions, three valuation methods are used to calculate the value of property for the purpose of rating. These are:

1. The **unimproved land value (UV)** method, which values the property excluding the value of buildings, structures and other capital improvements.
2. The **capital improved value (CIV)** method, which values the property based on the market value, or the value inclusive of all capital improvements.
3. The **annual rental value (ARV)** method, which values the property based on its rental value.

One of the key differences between these methods is how they treat high-density properties that include multiple units (such as an apartment block). As Chapter 2 discussed, a UV methodology divides the land value between each unit for the purpose of rating. In contrast, the other methods use the market value or rental value of each individual unit.

4.1.1 Valuation methods across jurisdictions

As Chapter 2 discussed, NSW councils are required to use the UV method for calculating ad valorem amounts. Queensland councils are also required to use this method. However:

- ▼ in Western Australia, councils must use the ARV method in Perth, and the UV method in the rest of the state
- ▼ in other states, councils can choose any of the three methods:
 - councils in Victoria and South Australia overwhelmingly favour CIV
 - councils in Tasmania tend to employ ARV, and
 - councils in Northern Territory rely on UV because the data required to use CIV or ARV is not available.

Internationally, a CIV-type method appears more common and is mandated in the United States and the United Kingdom. In New Zealand, councils can choose between UV and CIV. Further information on the valuation methods used in selected overseas jurisdictions is provided in Appendix D.

4.1.2 Who applies the valuation method

Councils generally do not assess the value of properties themselves. In NSW and some other Australian states, they are required to use the valuation services provided by the state Valuer General. However, in Victoria and Tasmania, councils can choose to use either their state-based Valuer General or a private firm for property valuation services.

4.1.3 Analysis of alternative valuation methods against tax principles

We have done some preliminary analysis on how the UV and CIV methods compare using the tax principles discussed in Chapter 3. We have not focused specifically on the ARV method, as for our purposes it is similar to the CIV method in that both methods take into account the total market value of the land and dwelling. The ARV is often determined as a percentage of the assessed CIV for administrative simplicity and/or due to data constraints. The arguments for ARV are generally similar to those for CIV.

Arguments for retaining the UV method

UV may better meet the efficiency principle, that taxes should minimise changes in behaviour, than CIV. Under a UV method, rates do not change if additional capital is invested into a property so they do not influence ratepayers' decisions to make capital improvements or develop their land. In contrast, CIV is a tax on both land and capital. Under a CIV method, rates increase as additional capital is invested in a property. This may discourage ratepayers from productive investments, and so the CIV method may be less efficient than the UV method.

UV is arguably simpler and more cost effective to implement than CIV. Because UV is the current method used in NSW, changing to an alternative method would incur costs. In addition, land valuations across NSW are currently estimated by sampling land values for a relatively small number of properties each year. Under a CIV method, an estimate of capital improvements by property would be required.¹⁵ Valuations could also be required more frequently, when additional improvements are made.

Arguments for moving to a CIV method

CIV may better meet the benefits principle. The market value of a property may better correlate with the benefits received by the owners from the provision of public goods by the council. For example, an apartment block with a number of residents will typically derive more benefits from council services than a nearby single house occupying land of equal value.

CIV may be more equitable. For example, residential ratepayers who own more expensive houses or apartments would pay higher rates than those with lower-cost homes. These ratepayers tend to have a higher ability to pay.

¹⁵ In other jurisdictions, detailed and up-to-date data on capital improvements are collected. For example, in Victoria, this information is collected through supplementary valuations. For further details, see Department of Transport, Planning and Local Infrastructure (Victoria), *2016 Valuation Best Practice Specifications Guidelines*, July 2014.

CIV is potentially more sustainable over time. Because it includes both land and capital, a CIV method would result in a broader tax base than UV. The Grattan Institute estimates, across Australia, the total value of capital improvements in 2014 was roughly equal to the total value of land, suggesting that CIV is about twice as broad a tax base as UV.¹⁶ The broader base means a lower overall ad valorem rate can be set, although it would apply to a higher property value. Over time, as the proportion of high density dwellings increases, the ratio of capital to land increases, and CIV therefore becomes more broadly based relative to UV. (See Appendix E for further details.)

CIV is likely to be more readily and easily understood by the public. As most people have a better understanding of the market value of their property than their unimproved land value, they are likely to find a CIV approach easier to understand.

4.1.4 The Panel's views on UV, CIV and the rating of apartments

The Independent Local Government Review Panel also analysed the alternative valuation methods. The Panel found that the use of UV has caused a significant issue with the rating of apartments in Sydney:

Currently, the unimproved value of the land occupied by a block of apartments is split between the owners of individual dwellings (strata titles), such that each is rated on only a small fraction of the total value. As a result, owners of apartments worth millions of dollars pay less in rates than owners of nearby houses worth much less, and all or most owners of apartments may pay the same minimum council rate irrespective of the differing market values of their properties.¹⁷

The Panel concluded this outcome was inequitable, and suggested that moving to a CIV method would be preferable in selected local government areas. Alternatively, it suggested the 'residential' land use category could be split into two new rating categories, one for detached housing and another for multi-unit dwellings. Councils could then use CIV for multi-unit dwellings only.

4.1.5 Options for the valuation method in a future NSW rating system

Based on the preliminary analysis outlined above, we consider there are a number of feasible options for the valuation method used in calculating ad valorem amounts in NSW rates. These include:

- ▼ Continuing to mandate the use of the UV method.
- ▼ Mandating the use of a CIV-type method (eg, CIV or ARV or some similar method). This could be restricted to some local government areas, as the Panel suggested and as occurs in Western Australia.

¹⁶ Daley J and Coates B, *Property Taxes*, Grattan Institute Working Paper No. 2015-5, July 2015, p 5.

¹⁷ Panel Report, p 40.

- ▼ Allowing councils to choose between a UV method or a CIV-type method, as occurs in Victoria, South Australia and Tasmania.
- ▼ Allowing councils to set a new rating category for multi-unit apartments, and mandating the use of a CIV method for that category, as the Panel suggested.

In addition, there are also options related to the property valuation services councils use. These include continuing to require councils to use the NSW Valuer General's services, or allowing councils to choose whether to use private valuation firms.

IPART seeks comment

- 2 What valuation method should be used as the basis for determining the ad valorem amounts in council rates? Should councils be given more choice in selecting a valuation method, as occurs in other states, or should a valuation method continue to be mandated?
- 3 Should councils be required to use the Valuer General's property valuation services, or should they also be able to use a private valuation firm (as occurs in Victoria and Tasmania)?

4.2 Use of base amounts and minimum amounts

As Chapter 2 discussed, under the current rate structure, rates may comprise an ad valorem amount plus a base amount, or an ad valorem amount which may be subject to a minimum amount. Both base and minimum amounts are fixed charges. In addition:

- ▼ revenue generated from the base amount cannot exceed 50% of the total revenue from any particular rating category, and
- ▼ the minimum amount cannot exceed a legislated ceiling (set at \$497 in 2015-16¹⁸).

Currently, a little over half of all NSW councils use base amounts for at least one rating category.¹⁹ In 2013-14, these amounts accounted for at least 45% of ordinary rates in approximately a quarter of all NSW councils, and the maximum 50% in 12 councils. This suggests the current 50% revenue cap on base amounts could be a constraint for some councils.

In addition, about 60% of all NSW councils use a minimum amount in at least one rating category. For these councils, minimum amounts accounted for 15% of ordinary rates, on average.

¹⁸ This ceiling only applies to ordinary rates (section 548(3)(a) of the LG Act). A different ceiling applies to special rates: \$2 (section 548(3)(b) of the LG Act).

¹⁹ Data on the use of base and minimum amounts were obtained from Rating Return data which councils are required to provide to the Office of Local Government under Section 429 of the LG Act.

Most other states also give councils the option to levy base and/or minimum amounts. However, Queensland and Western Australia do not allow base amounts, and Victoria does not allow minimum amounts. (See Appendix D Table D.1 for more detail.)

4.2.1 Analysis of base amounts and minimum amounts against tax principles

Our preliminary analysis suggests that base amounts may be an **efficient** way to recover some council costs. Councils incur a range of fixed costs in supplying infrastructure and services that benefit all ratepayers, regardless of their land or property value. Base amounts can be an **efficient** method for councils to recover these fixed costs. They are also **simple** to calculate and administer.

However, base amounts may **not be equitable**, because they may not reflect the ratepayer's ability to pay or the benefits received. For example, a dwelling with one occupant pays the same base amount as a dwelling with four occupants, although it is likely that the latter will derive a larger benefit from the public goods that councils provide. Furthermore, base amounts have little relation to the per capita drivers of councils' costs.

Further, base amounts also tend to place a greater burden on less well-off ratepayers. In other words, they are regressive because owners of low value dwellings effectively pay a higher rate of tax than owners of expensive dwellings.

Our preliminary analysis also suggests that minimum amounts have fairly similar advantages and disadvantages as base amounts. They can be an efficient way to recover councils' fixed costs, but are also regressive as lower-valued properties effectively pay a higher rate of tax.

4.2.2 Options for base and minimum amounts in a future NSW rating system

Based on the preliminary analysis outlined above, there are a number of options for levying base and minimum amounts. These include:

- ▼ Giving councils further flexibility to levy base amounts on a per capita basis, per bedroom, or using some other criteria. However, this would incur implementation costs and be more administratively complicated.
- ▼ Changing or removing the restriction that revenue generated from the base amount cannot exceed 50% of the total revenue from any particular rating category. This restriction was introduced to ensure that rates are determined predominantly according to the value of rateable property.²⁰
- ▼ Changing or removing the legislated ceiling on the minimum amount, which is currently set at \$497 for ordinary rates.

²⁰ NSW Department of Local Government, *Council Rating and Revenue Raising Manual*, 2007, p 36.

IPART seeks comment

- 4 What changes (if any) should be made to the Local Government Act to improve the use of base and minimum amounts as part of the overall rating structure?

4.3 Rating categories

As Chapter 2 outlined, the current rating system includes four rating categories which reflect the primary use of the land. These are residential, business, farmland and mining.²¹ Councils may elect to apply different rate structures to each category.

In addition, councils may determine subcategories within each category and apply a different rate structure for each subcategory. A subcategory may be determined for:

- ▼ **residential** property according to whether the land is rural residential land or is within a **centre of population**
- ▼ **business** according to a **centre of activity**
- ▼ **farmland** according to the **intensity of land use**, the irrigability of the land or economic factors affecting the land, and
- ▼ **mining** according to the **kind of mining** involved.²²

Other states typically class rateable land into a larger number of separate categories for the purposes of ratings. For example, South Australia has nine separate land use categories, including a category for vacant land. Tasmania has seven land use categories and allows councils to vary rates if land is vacant.

Victoria does not explicitly define a list of land use categories for rating, but instead allows councils to declare separate rate categories provided that “the objectives of the differential rate and the criteria on the basis of which that rate was declared” is specified.²³ This approach allows multiple rating categories to be used.

²¹ LG Act, section 514.

²² LG Act, section 529.

²³ *Local Government Act 1989* (Vic) section 161. That said, when councils are setting differential rates, they must have regard to Ministerial Guidelines. These guidelines **do** list types of land that are considered appropriate and inappropriate for differential rates. For more details, see Department of Transport, Planning and Local Infrastructure (Victoria), *Ministerial Guidelines for Differential Rating*, April 2013.

4.3.1 Analysis of rating categories using tax principles

The Productivity Commission review of local government revenue raising capacity provided an analysis of rating categories using standard tax principles. The review found that differentiating rates according to land use is appealing on a number of grounds. According to the report:

Differential rating provisions generally increase the capacity of councils to raise revenue from property rates. They do so by enabling councils to structure better rates payable to the different capacities to pay of, and the services received by, different categories of ratepayers.²⁴

This suggests that allowing different rating categories based on land use are consistent with the principles of efficiency and equity.

4.3.2 Options for rating categories in a future NSW rating system

Based on the preliminary analysis outlined above, there may be scope to increase the number of land use categories from four, or increase the ability of councils to define further subcategories of land use for setting rates. For example:

- ▼ Splitting the residential category into detached housing and apartment properties categories may provide for more efficient and equitable ratings of multi-unit dwellings (as suggested by the Panel).
- ▼ The business land use category is currently quite broad, encompassing all industries other than mining and agriculture.²⁵ Allowing further differentiation may increase efficiency.

Such changes could allow councils to tailor rates across a wider variety of land uses to better meet the needs and wants of their local communities.

At the same time, a system that allows for too much granularity can incur costs and increase complexity. It could also reduce the transparency of the rating system, and may result in rate structures that depart from recognised tax principles. For example, levying higher rate charges on more successful business centres of activity could undermine efficiency and competitive neutrality.

IPART seeks comment

- 5 What changes could be made to rating categories? Should further rating categories or subcategories be introduced? What benefits would this provide?

²⁴ Productivity Commission Report, p 104.

²⁵ The ABS separately identifies over 100 industries outside of agriculture and mining that would be currently classed as 'business' in the NSW rating system.

4.4 Rating burden across communities

Under our terms of reference for this review, we are required to consider the rating burden **across** communities, which we understand to mean across different local government areas. The Panel also suggested the rating burden may not be spread equitably across communities in NSW.²⁶

In our view, the rates levied by a local council should be used to fund the provision of infrastructure and services in that local government area, and should reflect the costs of this provision. They should not be used to fund the services provided by councils in other local government areas.²⁷ Such cross-subsidisation would tend to reduce the efficiency, equity, simplicity and sustainability of the rating system.

IPART seeks comment

- 6 Does the current rating system cause any equity and efficiency issues associated with the rating burden **across** communities?

4.5 Rate pegging and special variations

Under the current rate pegging arrangements, IPART determines the maximum percentage by which a council may increase its general income (primarily from rates) each year, known as the ‘rate peg’. If they wish to increase their general income by more than this rate, councils can apply to IPART for a ‘special variation’. (See Chapter 2 for more information.)

A key issue highlighted by the Panel Report was that, in their present form, rate pegging arrangements impact “adversely on sound financial management”.²⁸ It suggested three options to make the current arrangements more effective:

- ▼ streamlining the application and approval process for special variations
- ▼ introducing earned autonomy, where certain councils demonstrating consistent high performance could earn complete exemption from rate pegging, and
- ▼ replacing rate pegging with rate benchmarking.²⁹

In its response, the NSW Government said it is “committed to a rating system that protects local ratepayers from unfair rate rises. It recognises, however, the improvements in council strategic planning under IP&R [Integrated Planning and Reporting] and therefore supports removing unwarranted complexity, costs and constraints from the rate peg system”.³⁰

²⁶ Panel Report, p 41.

²⁷ The Henry Tax Review reaches a similar conclusion, arguing that taxes used for redistribution should be levied by the Federal government. See Henry Tax Review, p 673.

²⁸ Panel Report, p 42.

²⁹ Panel Report, pp 43-44.

³⁰ Office of Local Government, *Independent Local Government Review Panel recommendations – NSW Government Response*, September 2014, p 5.

In line with our terms of reference, we will consider the Panel's findings on the current rate pegging arrangements, as well as the Government's response, particularly its commitment to protect NSW residents against excessive rate increases.

IPART seeks comment

- 7 What changes could be made to current rate pegging arrangements to improve the rating system, and, in particular, to better streamline the special variation process?

4.6 Policy of encouraging urban renewal

In reviewing the current rating system, our terms of reference require us to take account of the NSW Government's policy of encouraging urban renewal. The NSW Government's *A Plan for Growing Sydney* defines the Government's policy of urban renewal across Sydney as "the process of planning and delivering changes to infrastructure, streets, and the public domain to deliver the greatest community benefit".³¹ This policy includes:

- ▼ using the Greater Sydney Commission to support council-led urban infill projects
- ▼ increasing housing density in areas that are connected to an integrated transport system, and
- ▼ providing direct local infrastructure to population centres where there is growth.³²

Our preliminary view is that the current rating system provides scope for councils to partner with other levels of government to promote urban renewal.

Section 495 of the LG Act allows councils to levy special rates on any subset of rateable land within its area to meet the costs of delivering additional services, facilities or activities to ratepayers.³³

Councils can also use special variations, and the levying of special rates in distinct areas, to collect additional rates revenue to fund urban renewal projects that provide benefits to discrete areas. Special rates could also be used to partner with other levels of government in developing and funding infrastructure projects which benefit the local community.

³¹ Department of Planning & Environment (NSW Government), *A Plan for Growing Sydney*, December 2014, p 21.

³² Department of Planning & Environment (NSW Government), *A Plan for Growing Sydney*, December 2014, pp 8-11.

³³ The special rate may only be levied on those parcels of land which benefit from, have access to, or contribute to the need for the works, services, facilities or activities.

IPART seeks comment

- 8 What changes could be made to the rating system to better encourage urban renewal?

4.7 How councils manage overdue rates

When rates become overdue, councils may charge penalty interest on the overdue amount. Councils may also seek a court order to require payment, and enforce the debt using debt recovery powers under the *Civil Procedure Act 2005* (NSW).³⁴

It appears that some councils might be pursuing relatively low value claims for overdue rates through the courts. The Department of Justice found that:

- ▼ just over one-third of all civil claims in the Local Court involve councils pursuing overdue rates, and
- ▼ over 80% of claims are for amounts of \$2,000 or less.³⁵

Model litigant obligations require NSW government agencies to endeavour to avoid litigation wherever possible.³⁶ However, using the Local Court as the primary means of recovering overdue rates may be an attractive option for councils, irrespective of the amount overdue, as the penalty interest rates councils are permitted to charge could mean that there is no incentive to resolve debt issues early. We understand that less than 1% of all claims for unpaid rates are defended.³⁷

Where financial hardship is the underlying cause of rates being overdue, a more sustainable and equitable approach may include councils offering more flexible payment options. We note that similar arrangements are used by water and energy utilities when their customers are experiencing financial difficulty.³⁸

IPART seeks comment

- 9 What changes could be made to the rating system to improve councils' management of overdue rates?

³⁴ For example, the council could apply for an order to seize and sell the ratepayer's personal property to settle the overdue rates.

³⁵ Personal communication, Letter from NSW Department of Justice to IPART, 5 April 2016.

³⁶ NSW Department of Justice to IPART, *Model Litigant Policy for Civil Litigation*, July 2008 (<http://www.justice.nsw.gov.au/legal-services-coordination/Pages/info-for-govt-agencies/model-litigant-policy.aspx>, accessed 7 April 2016).

³⁷ Personal communication, Letter from NSW Department of Justice to IPART, 5 April 2016.

³⁸ See for example Part 2, Division 6 of the *National Energy Retail Law* (NSW).

5 Assessing exemptions, concessions and rebates

The third step in our approach for reviewing the rating system is to assess the current method for determining who pays rates, including:

- ▼ the exemptions from rates, which are based on land type or use, and
- ▼ the concessions on rates available to pensioners.

Our assessment will involve analysing the exemptions and concessions using the tax principles discussed in Chapter 3, and identifying the potential options for reform. Where relevant, we will take account of rating systems in other jurisdictions, the findings of the Independent Local Government Review Panel (the Panel) and other matters listed in our terms of reference.

5.1 Exemptions from rates

Section 555 of the *Local Government Act 1993* (LG Act) exempts certain land uses from **all** rates (see Table 5.1). In addition, Section 556 exempts certain land uses from all rates other than water and sewerage charges (see Table 5.2).³⁹

³⁹ As discussed in Chapter 2, this review only covers the income derived from ordinary rates, special rates and some annual charges. It does not review special rates or charges for water and sewerage charges.

Table 5.1 Main land uses exempted from all rates

| Land type | Details |
|--|--|
| Crown land | No rates are payable unless the land is under private lease. |
| National parks and conservation areas | All land within a national park, historic site, nature reserve, state game reserve, karst conservation reserve, land subject to a conservation agreement and land associated with the Nature Conservation Trust of NSW. |
| Water corporation land | Land within a special or controlled area for Sydney Water or Hunter Water, land vested in or owned by Water NSW for installed water supply works, land within a special area for a water supply authority. |
| Land used for religious purposes | Land that belongs to a religious body which is used in connection with a church or other building used for public worship, a residence of a minister of religion, a building used for religious teaching or training. |
| Land used for schools | Land which is used in connection with a school inclusive of playgrounds, and buildings occupied as a residence by school teachers, caretakers or employees. |
| Land vested in an Aboriginal Council | Land vested in an Aboriginal Land Council that is not being used for a residential or commercial purpose, and land that is of spiritual or cultural significance that has been declared so by resolution with the approval of the Minister for Aboriginal Affairs. |
| Rail infrastructure land owned by a Public transport authority | Land vested in or owned by a public transport agency, for installed rail infrastructure facilities. |
| Land used for oyster cultivation | Land below high water mark and used for any aquaculture relating to oyster cultivation. |

Source: *Local Government Act 1993*, section 555.

Table 5.2 Main land uses exempted from all rates other than water and sewerage charges

| Land type | Details |
|--|---|
| Public places | Includes public reserves, cemeteries and free public libraries. |
| Mineral claims | Land that is the subject of a granted mineral claim, held under private lease from the Crown. |
| Public charities | Where the land is used for the purposes of the charity or public benevolent institution. |
| Public hospitals and other health purposes | Includes land vested in the Minister for Health, the NSW Health Foundation and the local health district. |
| Universities | Land vested in university or university colleges used solely for its purposes. |
| Special listed groups | Sydney Cricket Ground, Zoological Parks Board (exempt under regulation 123), Royal Agricultural Society, Museum of Sydney and Museum of Contemporary Art. |
| Cattle dipping | Land leased to the crown for cattle dipping. |

Source: *Local Government Act 1993*, section 556.

5.1.1 How exemptions compare with tax principles

Exemptions are a subsidy to the exempt land use that is funded by local ratepayers. In considering exemptions, the key questions that arise are whether a subsidy is appropriate, and if so, what is the correct level of subsidy and who should pay for it.

In general, who should pay for an exemption should relate to who receives the public benefits from the goods and services provided by the exempt land use:

- ▼ If the benefits of an exempt activity are largely confined within the local government area boundary, then it may be appropriate for local ratepayers to fund the cost of the exemption.
- ▼ However, if the benefits are distributed beyond the local council area, it may be more equitable for the state government to share the funding costs of the exemption.⁴⁰

We have done some preliminary analysis on exemptions using the tax principles discussed in Chapter 3. This analysis is based on the overall impacts of exemptions on the community, businesses and other levels of government, and is discussed below.

Efficiency

Rate exemptions can have a positive or a negative impact on economic efficiency. For example, exemptions that result in larger spending on goods and services that produce large net social benefits may increase economic efficiency. This could include the exemptions provided to some education institutions and hospitals.

Exemptions may also prevent extra costs being imposed on state and federal governments when they provide public goods such as national parks, protected forests, and public places. The tax base of state and federal governments may be less efficient than council rates in funding public goods.

However, the provision of rate exemptions narrows the tax base, increasing the level of taxation for remaining ratepayers. This could have a negative impact on economic efficiency as, all else being equal, a higher rate of tax will cause larger changes in behaviour.

Exemptions may also change land use away from what would have occurred without any exemptions. Exemptions that do not provide substantial benefits to the community are inefficient if they stop land being put to its best use.

⁴⁰ An example might be the Royal Flying Doctor Service which provides health services across all outback areas.

The exemptions provided to organisations may also encourage them to overuse council services, if they are not required to pay for direct costs, such as water and sewerage services.

Equity

Rate exemptions are subsidised by local ratepayers. This may be equitable when the exempt activity provides a large benefit to local ratepayers, or where the exempt organisation has limited ability to pay.

For example, some religious or charitable institutions may have limited ability to pay rates. Exemptions may allow them to spend more on social goods such as helping the disadvantaged in the local area, which results in more equitable outcomes for society.

Public schools and hospitals also can provide large social benefits and may have limited ability to pay rates without reducing service levels, or shifting additional costs onto state and federal budgets.

In addition, rate exemptions for commercial activities, such as the logging of state forests, mining or oyster cultivation, may not be equitable. The enterprises that undertake these activities generally have the ability to pay rates. Therefore, it may be more equitable to require them to make some contribution to local rates, especially where the activities are pursued for private profit.

Simplicity

Having a large number of exemptions will increase the complexity of the rating system. Increased complexity could result in higher costs of administering and monitoring exemptions. Exemptions should be kept to a minimum to promote simplicity, and only granted, or retained, where there are clear net benefits from doing so. NSW legislation has progressively provided for a larger number of exemptions. There may be scope for these to be rationalised.

Conditions that apply to exemptions should be objective, transparent and targeted to minimise the extra burden on local rate payers and the scope for disputes on eligibility. Furthermore, the costs of administering exemptions, monitoring compliance and determining eligibility should be low.

Sustainability

Broader tax bases tend to be more sustainable, as they can collect more revenue, tend to be more able to withstand volatile economic conditions and less susceptible to tax avoidance. Exemptions reduce the size and diversity of the rate base, and therefore may compromise sustainability.

Rate exemptions may especially compromise sustainability if:

- ▼ the existing rate base is small (eg, in rural and remote local government areas) and
- ▼ the exempt institutions impose substantial additional costs in the local government area (eg, forest logging causing road degradation).

Competitive neutrality

Competitive neutrality requires businesses competing with each other to be treated in a similar way. If rate exemptions are provided to government enterprises or charitable institutions that compete with the private sector, such as retirement villages or child care centres, this may result in the private sector incurring higher costs than the institutions receiving exemptions. Efficiency losses can occur if this cost disadvantage causes more efficient private providers to reduce, or to withdraw, the supply of services. In such cases, removing or narrowing the exemption may result in better outcomes.

5.1.2 Options for exemptions in a future NSW rating system

Our preliminary analysis suggests there could be several alternatives to exemptions for some of the land uses that are currently exempt from rates. These include removing the exemption for some land use categories, narrowing the exemption, giving councils discretion over the level of exemption, and replacing some exemptions with rebates.

Removing exemptions

There are several reasons that it could be appropriate to remove an exemption for a land use category. These include where:

- ▼ the exemption does not provide sufficient public benefits for the local community
- ▼ commercial activity is being carried out on the land providing the land owner with the capacity to pay rates
- ▼ the use of the land is contributing to substantial extra costs for the council, or
- ▼ the land owner is receiving substantial private benefits from council services.

Narrowing the exemption

Exempt land is sometimes used for more than one activity. In situations where a commercial activity is located on exempt land, it may be appropriate to levy rates on the portion of land used in profit generating activities. For example, this could allow commercial activities located within education or charitable institutions to be separately identified and have rates levied on the land associated with the activity, while the remainder of the institution retains the exemption.

Tighter targeting of exemptions may have merit on equity and competitive neutrality grounds, and may lead to more efficient land use decisions being made. However, it might sometimes be difficult in practice to identify the proportion of the land used in profit-generating activities.⁴¹

Giving councils more discretion over the level of exemptions

Local councils do not have discretion on the granting or level of exemption for land use types listed under sections 555 and 556 of the LG Act. For some of these land use types, such as public charities, it may be more equitable if councils were given some scope to reduce the level of exemption below 100%. Councils could determine the level of exemption depending on factors such as whether public benefits flowed mainly to the local community or more broadly.

Flexibility could be achieved either by allowing councils to determine the level of exemption for certain activities, or allowing them to make additional rating categories and subcategories for these activities. However, this additional flexibility could result in an increased number of disputes if ratepayers disagree with the level of exemption offered by council.

Replacing exemptions with rebates

It may be appropriate to replace some exemptions with rebates. A rebate could be a partial reduction in rates payable for those land users that meet eligibility criteria, or who make an application to the council.

Some of the advantages of using rebates are that they:

- ▼ make the associated costs more transparent, and tend to receive greater scrutiny, ensuring the original intent of the policy is maintained
- ▼ can better and more narrowly target particular activities and land uses that generate high public benefits
- ▼ provide a mechanism to give varying levels of rate relief rather than the 'all or nothing' approach under the current exemptions, and
- ▼ can provide a mechanism for state and local governments to share costs in granting rate relief, which may be appropriate where the public benefits from the activity flow widely.

Examples where rebates may be a better policy than a full exemption include government land supplying services that are sold, such as rail infrastructure land, water corporation land, the Sydney Cricket Ground, and the Museum of Sydney.

⁴¹ An example where this may be difficult is where a university partners with a private firm in undertaking research.

5.1.3 Councils also receive exemptions from tax

Local government also receives exemptions from paying state and federal government taxes, such as payroll tax, stamp duty and income tax. Therefore, in conducting further analysis we will take a holistic approach. That is, we will also look at the consistency and efficiency of tax arrangements between levels of government overall – including the exemptions councils receive as well as those they are required to provide.

If some exemptions councils are required to provide are changed, it may also be appropriate to review some exemptions they receive. Any changes should improve overall efficiency, equity and competitive neutrality.

IPART seeks comment

- 10 Are the land uses currently exempt from paying council rates appropriate? If a current exemption should be changed, how should it be changed? For example, should it be removed or more narrowly defined, should the level of government responsible for providing the exemption be changed, or should councils be given discretion over the level of exemption?
- 11 To what extent should the exemptions from certain state taxes (such as payroll tax) that councils receive be considered in a review of the exemptions for certain categories of ratepayers?

5.2 Concessions for pensioners

Our terms of reference require us to consider the appropriateness and impact of mandatory concessions, and also take account of the NSW Government's commitment to providing rate concessions to pensioners.⁴²

The Government introduced mandatory pensioner concessions for council rates and charges in 1989. Under the current scheme, eligible pensioners⁴³ are required to apply to their local council to receive a 50% discount on their combined ordinary council rates and waste service charges, up to a maximum of \$250 per annum.⁴⁴ The cost of providing this discount is shared between the NSW Government (55% or \$76 million) and the local council (45% or \$62 million).⁴⁵

⁴² Office of Local Government, *Independent Local Government Review Panel recommendations – NSW Government Response*, September 2014, p 4.

⁴³ Eligible pensioners are residential property owners who hold a pensioner concession card (PCC), hold a Gold card embossed TPI (Totally and Permanently Incapacitated), hold a Gold card embossed EDA (Extreme Disability Adjustment), or are a war widow or widower or wholly dependent partner entitled to the DVA income support supplement.

⁴⁴ See Office of Local Government, *Factsheet: Pensioner Concessions on Council Rates and Charges*, 2011. Available at: <https://www.olg.nsw.gov.au/sites/default/files/Pensioner-concession-factsheet-2011.pdf>, accessed 17 March 2016.

⁴⁵ Panel Report, p 40.

NSW councils can also voluntarily offer additional concessions to pensioners.

5.2.1 What pensioner concessions are available in other jurisdictions

Table 5.3 compares the NSW concession scheme with pensioner concessions available in other states. While the quantum of concession offered is comparable, there are a few key differences in pensioner concessions across states:

- ▼ In all states other than NSW, the funds for the concession are wholly provided by the relevant state or territory government. In NSW, these costs are partially recovered from other ratepayers.
- ▼ In South Australia and Western Australia, there are arrangements for pensioners to defer the payment of a portion of their rates.

Table 5.3 Pensioners' concessions on rates across Australia

| | Type of Relief | Value of relief | Funding source |
|------------|-----------------------------|---------------------------------|--------------------------|
| NSW | Concession only | 50% discount, up to \$250 pa | 55% state 45% council |
| VIC | Concession only | 50% discount, up to \$213 pa | 100% state |
| QLD | Concession only | 20% discount, up to \$200 pa | 100% state |
| WA | Concession or rate deferral | 50% discount | 100% state |
| SA | Rate deferral only | All rates in excess of \$500 pa | 100% state |
| NT | Concession only | 62.5% discount, up to \$200 pa | 100% state |
| TAS | Concession only | 30% discount, up to \$425 pa | 100% state |

Note: Figures as at 16 March 2016.

Sources: NSW *Local Government Act 1993*, NSW *Local Government Regulation 2005*, *Local Government Act 1989* (VIC), *Local Government Act 2009* (QLD), *Local Government Regulation 2012* (QLD), *Local Government Act 1999* (SA), *Local Government (General) Regulation 2013* (SA), *Local Government Act 1995* (WA), *Local Government (Financial Management) Regulation 1996* (WA), *Local Government Act 1993* (Tas), *Local Government Act 2008* (NT), NTPCCS Policy Manual, January 2016.

In South Australia, the Postponement of Rates Scheme allows retirees to postpone paying council rates and finance them through a loan against the equity in the home.^{46,47} Ratepayers incur interest on the outstanding amount set at the council's average borrowing cost and compounded monthly. This accrued debt is payable when the property is sold or transferred to someone else.

⁴⁶ For details, see *Local Government Act 1999* (SA), section 182A and *Local Government (General) Regulations 2013* (SA), regulation 18.

⁴⁷ Prior to 2015, the South Australian government also offered a pension concession of up to \$190. In 2015, this pensioner concession was replaced with a broader 'cost of living' concession of up to \$200 for pensioners and low income earners. For more details, please see: Government of South Australia, *Cost of Living Concession*, available at: <http://www.sa.gov.au/concessions/costofliving>, accessed 23 March 2016.

5.2.2 Analysis of pensioner concessions using tax principles

Pensioner concessions have a number of impacts on both local councils and other ratepayers.

- ▼ To the extent they are not financed by the state government, they reduce the contribution pensioners make towards council revenue. This narrows the rate base, and thus reduces economic efficiency.
- ▼ Pensioner concessions also result in a subsidy to pensioners who own property, and those who will inherit their estate. The cost is borne by taxpayers and other ratepayers. Such a redistribution can be inequitable.
- ▼ The impact of the pensioner concession is not evenly distributed as it results in a greater burden on councils and ratepayers in areas with a high proportion of pensioners. These may be low income areas, particularly in rural areas which have seen a net emigration of younger households.

The design of the current concession scheme in NSW (ie, a 50% or \$250 discount, whichever is lower) promotes equity because the discount it provides is likely to be worth relatively more to pensioners with lower value properties and less ability to pay. It also ensures the overall growth in the cost of the scheme is contained over time. However, it also decreases the real value of the concession by inflation or about 2.5% per year.

5.2.3 Options for pensioner concessions in a future NSW rating system

There are several options that could be considered for pensioner concessions, each of which will achieve different objectives. These include:

- ▼ **Retaining the current concession scheme.** This option meets current welfare objectives and is consistent with the NSW Government's commitment to providing rate concessions to pensioners. However, the Panel suggested "it is doubtful whether funding such a concession ought to be a local government (or even state government) function within Australia's federal system".⁴⁸
- ▼ Replacing the current concession scheme with a **rate deferral scheme** as occurs in South Australia. This option could better ensure asset-rich, income-poor ratepayers are not adversely affected by council rates. This option would also lower the cost to councils and government.
- ▼ **Introducing an asset test** that limits eligibility for the concession where the property is over a certain value (for example, \$1 million). This option prevents ratepayers subsidising pensioners who are asset-rich.

IPART seeks comment

- 12 What should the objectives of the pensioner concession scheme be? How could the current pensioner concession scheme be improved?

⁴⁸ Panel Report, p 40.

6 Freezing existing rate paths for newly merged councils

For councils that merge as part of the *Fit for the Future* process, the NSW Government has announced a policy of freezing their existing rate paths for four years. The aim of this policy is to provide ratepayers with certainty about their rates.⁴⁹ Our second task in this review is to recommend a legislative and regulatory approach to implement this policy.

The sections below outline:

- ▼ our interpretation of the policy and how it affects each element of the rating system for newly merged councils, and
- ▼ the legislative and regulatory options for implementing this policy.

6.1 IPART's interpretation of existing rate path freeze policy

We interpret the Government's policy to mean that for the four years after a *Fit for the Future* merger, rates would continue to be set in each pre-merger council area so that the rate path in that area follows the same trajectory as if the merger had not occurred. That is, this rate path should comprise the pre-merger council's general income⁵⁰ in the year the merger takes place,⁵¹ adjusted by the following two external factors:

1. the rate peg OR any special variation approved for the council prior to its merger, and
2. the expiry of any temporary special variations that applied to the council prior to its merger.

IPART seeks comment

- 13 We have interpreted the rate path freeze policy to mean that in the four years after a merger, the rating path in each pre-merger council's area will follow the same trajectory as if the merger had not occurred. Do you agree with this interpretation?

⁴⁹ NSW Government, *Media Release – Stronger Councils for Sydney and Regional NSW*, at <https://www.nsw.gov.au/media-releases-premier/stronger-councils-sydney-and-regional-nsw>, 18 December 2015, accessed 16 March 2016.

⁵⁰ This is income derived from ordinary rates, special rates and specified annual charges (section 505 of the *Local Government Act 1993* (NSW)). Special rates and charges for water and sewerage are not included in a council's general income.

⁵¹ That is, the financial year beginning 1 July.

6.1.1 What about new special variations?

Under our interpretation of the rate path freeze policy, a merged council would generally not be eligible for new special variations during the rate path freeze period. However, we propose they should retain the discretion to apply for new special variations in three limited circumstances. Specifically, new special variations:

1. where former Crown Land has been added to their rating base during the freeze period⁵²
2. for development contributions that are 'above the cap' under the *Environmental Planning and Assessment Act 1979* (NSW),⁵³ and
3. to fund new infrastructure projects in their area by levying of a special rate.⁵⁴

Adding former Crown Land to a merged council's rating base may lead to higher demand for its services and an increase in its costs. Therefore, merged councils should have the discretion to apply for a special variation to their general income (above the rate peg limit) to take account of this cost increase.

Development contributions are payments by developers to councils that are used to fund community facilities and infrastructure for new developments. If a council's development contributions for an area exceed the relevant cap,⁵⁵ the council may seek to fund the gap by applying for a special variation.^{56,57} Merged councils should be able to apply for this type of special variation during the freeze period, otherwise it could limit the funds available for a new development's facilities and infrastructure.

Similarly, merged councils should be able to apply for special variations to fund new infrastructure projects. While such special variations may reduce certainty for some ratepayers about the amount of their rates during the freeze period, the alternative may cause councils to reduce their infrastructure development below that required by the community during this period.

⁵² Provided that the special variation only applies to the general income of the council whose pre-merger area now includes the former Crown Land.

⁵³ Provided that the contributions are only recovered through special rates on parcels of land that will benefit from the development.

⁵⁴ The special rate would be levied under Section 495 of the LG ACT.

⁵⁵ Local development contributions are capped at \$30,000 per residential lot or dwelling for greenfield areas, and \$20,000 per residential lot or dwelling for all other areas (Minister for Planning direction under section 94E of the *Environmental Planning and Assessment Act 1979* (NSW)).

⁵⁶ Office of Local Government, *Guidelines for the preparation of an application for a special variation to general income for 2016/17*, January 2016, p 23.

⁵⁷ Alternatively, a council may seek to fund this gap by applying for government funds under the Local Infrastructure Growth Scheme (<http://www.planning.nsw.gov.au/About-Us/Our-Programs/Local-Infrastructure-Growth-Scheme>, accessed 30 March 2016).

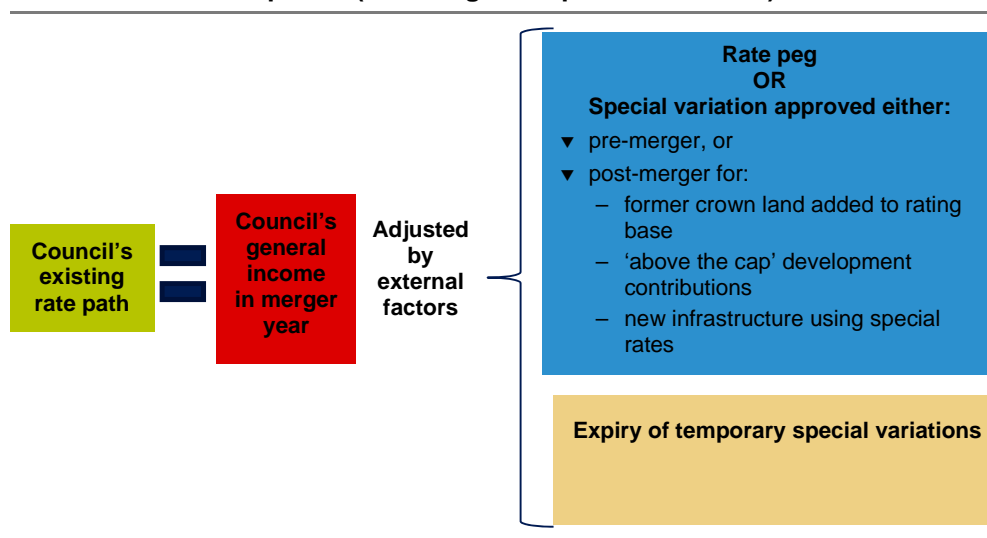
This third discretion, if allowed, would be granted only in very limited circumstances. That is:

- ▼ to fund **new infrastructure**
- ▼ using a **special rate**, and
- ▼ the special rate would only be levied on parcels of **land that benefit** from the infrastructure.

Councils would need to apply under the special variation process for approval of this special rate.

Figure 6.1 illustrates our interpretation of a pre-merger council's existing rate path, including new special variations that it would be able to apply for in limited circumstances.⁵⁸

Figure 6.1 A pre-merger council's existing rate path over the rate path freeze period (including new special variations)



⁵⁸ The merged council would be the actual entity that applies for the new special variation. This special variation, if approved, would then only impact on revenue that the merged council can recover from the pre-merger council area that contains the former Crown Land, new development or new infrastructure project (as applicable).

IPART seeks comment

- 14 Within the rate path freeze period, should merged councils be permitted to apply for new special variations:
 - For Crown Land added to the rating base?
 - To recover amounts that are ‘above the cap’ on development contributions set under the *Environmental Planning and Assessment Act 1979*?
 - To fund new infrastructure projects by levying a special rate?
- 15 Are there any other situations where merged councils should be able to apply for new special variations within the rate path freeze period?

6.1.2 What discretions will merged councils have in setting rates during the rate path freeze period?

Under our interpretation of the rate path freeze policy, the rates⁵⁹ payable on each parcel of land should only change as a result of external factors (eg, rate peg), and **not** as a result of the council merger. In other words, the pre-merger council’s existing rate paths for all categories and sub categories of land will **also** follow the same trajectory as if the merger had not occurred.

Therefore, merged councils will have limited discretion as to how they set rates. For example, during the freeze period, merged councils would not be able to redistribute their rating burden between:

- ▼ the pre-merger council areas that make up the new merged council area
- ▼ base or minimum amounts and ad valorem amounts, or
- ▼ rating categories⁶⁰ within the pre-merger council areas.

Otherwise, the rates collected from each ratepayer may not be consistent with the Government’s objective of providing rate certainty.

Changes to the amounts within a rate structure

As Chapter 2 outlined, local councils may calculate rates using an:

- ▼ **ad valorem amount** (ie, a variable charge calculated as a percentage of the unimproved land value of the rateable property), which may be subject to a **minimum amount**, or
- ▼ **ad valorem** amount plus a **base amount** (ie, a fixed fee levied equally on all properties within a given category).

⁵⁹ That is, those rates that generate the rate revenue that is included in a council’s general income.

⁶⁰ In this section, each reference to ‘category’ should be read as ‘category (or subcategory)’.

We consider that merged councils should only be able to increase base amounts and minimum amounts each year by the rate peg percentage, subject to:

- ▼ base amounts and minimum amounts being adjusted for any relevant existing or expiring special variations, and
- ▼ where the minimum amount is set at the maximum limit under the LG Act, it continue being set at this limit.

Changes to rates by rating categories

Ordinary rates are levied on rateable land. This land is divided into four categories: residential, business, farmland and mining. Councils may further divide these categories into subcategories.⁶¹

Changes to a council's rating burden arise from increasing its general income by the rate peg each year.⁶² This changed rating burden then needs to be distributed among ratepayers. We propose that merged councils should not have the discretion to determine which rating category should bear the changed rating burden. Instead, rates for each category should either vary according to:

- ▼ the relative change in the total land value of that rating category against other categories within the pre-merger council area (**relative change method**), or
- ▼ the rate peg, to fix the percentage share of rates revenue in each rating category (**fixed share method**).

Under the relative change method, the increase in rates for each category would be determined by relative changes in land value. Business and residential land categories would bear the change in rates in proportion to their relative change in land values. For example, if business land values increased by more than residential land values, business rates would increase by more than residential rates. The combined increase in these rates would then match the increase in council rates permitted under the rate peg. Under this method, changes in rates would be driven solely by the rate peg and changes in relative land values.

Under the fixed share method, rates for each category of land would be increased by the rate peg (irrespective of changes in land values).

We propose councils would have discretion to allocate the changed rating burden each year either by the **relative change method** or the **fixed share method**.

⁶¹ Only on the basis of criteria specified in the *Local Government Act 1993* (NSW).

⁶² In this section, each reference to 'the rate peg' should be read as 'the rate peg (or any applicable special variation)'.

Discretion to set rates below the maximum

The rate path freeze policy acts as a ‘ceiling’ on rate increases, in that it determines the maximum rates that merged councils can charge in each pre-merger council area during the freeze period.

However, councils would have the discretion to set their rates below this ceiling for any rating category,⁶³ particularly in view of the substantial financial savings that could be generated by the mergers.⁶⁴ This option provides councils with the flexibility to begin implementing a fair and equitable rating system in the lead up to the end of the freeze period. This issue is discussed in detail in Chapter 7.

IPART seeks comment

- 16 During the rate path freeze period, should merged councils only be able to increase base amounts and minimum amounts each year by the rate peg (adjusted for any permitted special variations)?
- 17 During the rate path freeze period, should merged councils be able to allocate changes to the rating burden across rating categories by either:
 - relative changes in the total land value of a rating category against other categories within the pre-merger council area, or
 - the rate peg (adjusted for any permitted special variations)?
- 18 Do you agree that the rate path freeze policy should act as a ‘ceiling’, so councils have the discretion to set their rates below this ceiling for any rating category?
- 19 What other discretions should merged councils be given in setting rates during the rate freeze period?

To further explain our interpretation of the Government’s policy, Table 6.1 outlines how each element of the current rating system would operate during the freeze period.

⁶³ Under our proposed approach, if a council chooses to charge a rating category below the maximum, it would not be able to charge another rating category above its maximum to recover the foregone revenue.

⁶⁴ According to a report prepared by KPMG on behalf of the NSW Government, the proposed mergers have the potential to generate a net financial benefit to councils of around \$2.0 billion across over the next 20 years (NSW Government, *Local Government Reform: Merger impacts and analysis*, December 2015, p 2).

Table 6.1 Rating system during the rate path freeze period

| Element of rating system | How element would operate during rate path freeze period |
|---|---|
| Rate peg | <ul style="list-style-type: none"> ▼ The rate peg would continue to be set in the current way. |
| General income | <ul style="list-style-type: none"> ▼ The maximum general income of a merged council would be the sum of the 'maximum general incomes' calculated for each pre-merger council area, which are calculated separately using general income in merger year adjusted by the rate peg and other external factors listed in Figure 6.1. ▼ Where a pre-merger council area is split between multiple newly merged councils, calculation of the 'maximum general income' would require the newly merged councils to consider all land within the entire pre-merger council area. |
| Ordinary rates, rate structure | <ul style="list-style-type: none"> ▼ Different rate structures would apply within merged council areas. Rates revenue would be set based on the rates in each pre-merger council area, and would only vary according to the rate peg, changes in land values, and other external factors listed in Figure 6.1. ▼ The ad valorem amount in any ordinary rate would only be adjusted for changes in the rate peg and other external factors. ▼ The base amount or minimum amount in any ordinary rate would only be adjusted by the rate peg. ▼ Councils would not be eligible to apply to set their minimum amount above the level set out in the LG Act and LG Regulation. ▼ Where any active variations of minimum amounts have been already approved, these could also increase by the rate peg. ▼ Merged councils would not be able to determine new categories or subcategories of land, or to combine existing subcategories of land, for existing ratepayers. |
| Ordinary rates, rating categories | |
| Special rates, within general income | <ul style="list-style-type: none"> ▼ Where a special rate is not the subject of an existing temporary special variation, it would be treated in the same way as an ordinary rate. ▼ Where a special rate is the subject of a temporary special variation, it would remain at the level approved under the special variation until the special variation ends. After that, the council would no longer be able to levy the special rate. |
| Annual charges and special rates, outside of general income | <ul style="list-style-type: none"> ▼ Annual charges and special rates outside of general income would continue to be set as they are currently set. ▼ The planned Emergency Services Property Levy, announced by the NSW Government on 10 December 2015, would not be affected by the rate path freeze policy. |
| Special variations | <ul style="list-style-type: none"> ▼ Any existing temporary special variations would continue to apply until they expire. ▼ Merged councils would generally not be able to apply for special variations during the freeze period. However, we propose that special variations could be allowed: <ul style="list-style-type: none"> – where former Crown Land has been added to the rating base – for development contributions that are 'above the cap' under the <i>Environmental Planning and Assessment Act 1979</i> (provided that the contributions are only recovered through special rates on parcels of land that will benefit from the development), or – for other special rates for new infrastructure (provided the special rate is levied on parcels of land that will benefit from the new infrastructure). |

6.2 Options for implementing the rate path freeze policy

Legislative change would be required to implement the rate path freeze policy. It could not be achieved under the *Local Government Act 1993* (LG Act) in its present form.

We have identified three possible approaches to implementing the rate path freeze policy. These approaches are outlined below, in IPART's order of preference.

6.2.1 Option 1: Amend the LG Act to introduce a new instrument-making power

The LG Act could be amended to provide for a new instrument or regulation-making power. This instrument would need to be able:

- ▼ to vary or displace current provisions in the LG Act as they apply to a newly merged council during the four years following the merger, and
- ▼ to impose obligations during the four years following the merger for the purpose of implementing the rate path freeze policy.

For example, the instrument-making function could be given to the Minister for Local Government. Amendments to the LG Act could require the instrument to set out a methodology that merged councils must apply when setting their rates.

This broader instrument-making power would need to strike a balance between providing the flexibility to implement a complex rate-setting mechanism that may require adjustments, and providing some certainty around the rate path freeze policy.

6.2.2 Option 2: Amend the LG Act to expand the Governor of NSW's proclamation power

This option would broaden the Governor's existing merger proclamation power under section 218A of the LG Act. To implement the rate path freeze policy, the expanded proclamation power would allow the Governor to displace certain provisions of the LG Act as applied to merged councils, and impose obligations during the four years following the amalgamation – the same as the instrument-making power under Option 1.⁶⁵

⁶⁵ Such a proclamation-making power would be closer in scope to the power to make 'restructuring orders' under Part 10C of the *Local Government Act 1989* (Vic).

For this option to be effective, the legislative amendments would need to commence before the Governor makes any merger proclamation. While Option 2 would require slightly less substantial amendments to the LG Act than Option 1, it provides less flexibility in relation to timing. It would also require the mechanism for the rate path freeze to be duplicated in each merger proclamation.

6.2.3 Option 3: Providing for the rate path freeze entirely through amendments to Chapter 15 of the LG Act and LG Regulation

This approach would involve substantial amendments to the LG Act and LG Regulation. While this would provide greater certainty than the previous options, it would increase the complexity of these instruments, as the entire rate-setting mechanism to apply during the freeze period would need to be set out in these instruments.⁶⁶

IPART seeks comment

- 20 We considered several options for implementing the rate path freeze policy. Our preferred option is providing the Minister for Local Government with a new instrument-making power. What are your views on this option and any other options to implement the rate path freeze policy?

⁶⁶ The amendments would need to create temporary, sometimes partial, exceptions that apply only to newly merged councils where existing provisions conflict with the rate path freeze (such as sections 493(2), 495, 497, 498(3), 499(1) and (4), 529(1) and (3) and 548(1)).

7 Establishing new, equitable rates after the 4-year freeze

After the 4-year rate path freeze expires, merged councils will be required to set new rates across the whole post-merger area. As part of our review, we will consider any issues that might arise in setting equitable rates or transitioning to them in a fair and timely manner, and analyse how these issues could be addressed. In doing so, we will take account of the NSW Government's commitment to protect NSW residents against excessive rate increases.

At this stage, we have identified two issues related to:

- ▼ the current requirement to set a single residential rate within a centre of population (rate equalisation), and
- ▼ the treatment of special variations approved for a pre-merger council.

The sections below discuss each of these issues and the options for addressing them.

7.1 Residential rate equalisation within a centre of population

There are no specific provisions in the LG Act addressing the levying of rates following a merger of several councils. However, Section 529(2)(b) of the LG Act specifies that councils are only allowed to set different residential rates within a local government area on the basis of two subcategories, specifically “whether the land is rural residential land or is **within a centre of population**”.⁶⁷

⁶⁷ The Office of Local Government revenue raising manual provides guidelines for interpreting the “within a centre of population” definition. It states that:

- “Separate towns or villages may be regarded as discrete centres of population.
- A centre of population should not be a device intended to enable rating variations within an homogeneous suburb or suburbs, or by street, or by any special feature such as proximity to water.

It is clear that subcategorisation on the basis of centres of population may have limited application within the suburbs of the main urban centres.”

For more details, see Department of Local Government, *Council Rating and Revenue Raising Manual*, 2007, p 23.

In practice, this means councils must set the same residential rate **within a centre of population**. As a merged council within Sydney would comprise one centre of population, it could not set different residential rates within the post-merger area after the 4-year freeze expires. Instead, it would have to instantaneously set the **same** residential rate structure for the whole area when the ordinary rate is made on 1 July 2020 after the rate path freeze expires.⁶⁸

Rate equalisation may cause excessive rate change

The requirement to equalise residential rates within a centre of population could expose some Sydney residential ratepayers to large rate increases following the expiry of the rate path freeze. The issue may also arise with some regional mergers. That said, council mergers are expected to deliver cost savings for the merged council areas, so these cost savings could be used to offset rate increases. Nevertheless, large residential rate increases could still occur in some instances.

For example, when a council that levies low residential rates per dollar of land value merges with another that levies high residential rates per dollar of land value, it could lead to substantial rate increases for some homeowners and commensurate decreases for others.

To illustrate this, consider two merging councils, Council A and Council B, that:

- ▼ each collected the same amount of local rate revenue prior to their merger, but
- ▼ Council A levied residential rates at 0.1% per dollar of land value, and Council B levied residential rates at 0.2% per dollar of land value.

Under the current LG Act, residential rates need to be equalised in first the year after the rate path freeze ends, which could cause a once-off increase in rates of 33% in Council A's area and a once-off fall of 33% in Council B's area.⁶⁹

During our *Fit for the Future* assessments in 2015, some councils provided evidence to IPART that under rate equalisation their residents may be exposed to rate rises of between 20% and 50%.⁷⁰

⁶⁸ In contrast, councils will be able to levy different rates for businesses in different centres of activity. In other words, councils will be able to charge different rates for businesses in different suburbs.

⁶⁹ These rate changes may be reduced if the council adopted base amounts in the new rating structure.

⁷⁰ Please refer Council Improvement Proposals, available at the IPART Fit for the Future website: http://www.ipart.nsw.gov.au/Home/Industries/Local_Govt/Fit_for_the_Future

Other examples include:

- ▼ When councils that have different rating structures merge, rate equalisation could result in sizeable rate changes for individual residential ratepayers. This could occur when a pre-merger council which extensively used minimum or base amounts merges with another council that only used ad valorem amounts.
- ▼ When councils that set different residential rates based on higher/lower service levels merge, the equalised post-merger rates could increase substantially in the lower service/lower rate pre-merger council area. Thus, ratepayers in that area would cross-subsidise those in the higher service council area over the short to medium term.

These issues are less likely to arise for rural councils that merge, as residential rural land typically comprises separate towns or villages, and the LG Act states that these can be regarded as discrete centres of population. Thus, there is no requirement for merged rural councils to set a single residential rate for the whole merged area.

7.1.2 Options for addressing issues related to rate equalisation

We have identified several options for addressing the issues arising from rate equalisation across merged council areas after the rate freeze expires. These include:

- ▼ removing the rate equalisation requirement from the LG Act
- ▼ allowing merged councils to gradually equalise rates after the rate freeze expires, and
- ▼ using other potential changes to the rating system to offset the impact of rate equalisation.

Remove the rate equalisation requirement

If the requirement to set the same residential rate within a centre of population was removed, a merged urban council would be able to prevent excessive rate rises by setting different residential rates within the enlarged post-merger area.

If implemented, the existing merger proposals would result in much larger council areas in Sydney. This raises the question whether rate equalisation within a population centre remains an appropriate principle. Larger councils may need to have some capacity to charge different residential rates based on local considerations.⁷¹

⁷¹ Different local rates could be based on local factors such as the demand for, or cost of supply of, local government services.

However, if this requirement were removed, it may be important to place additional obligations on councils to protect local ratepayers from inequitable rates.⁷² For instance, councils might only be allowed to set rates within a defined range.

Allow merged councils to gradually equalise rates

Instead of requiring merged councils to instantaneously equalise residential rating structures after the rate path freeze expires, councils could be allowed a longer time period to adjust rates for the merged council. This could:

- ▼ allow the council to smooth rate changes for residents, especially if the council is also implementing other rating or merger reforms
- ▼ give the council more time to adjust service levels across the enlarged post-merger area, and
- ▼ provide greater time for the merger savings to be realised which could reduce the size of any rate increases that may be needed.

A local council could be given the option when transitioning to the new system of restricting real rate changes to no more than 5% per year (or some other percentage).

Use other changes to the rating system to offset rate increases

In this Issues Paper, we have identified a number of options for reform to the current rating system. If implemented, these changes would have impacts on the distribution of the rating burden across merged council areas. These changes could also offset the impact of the rate equalisation requirement.

For example, Chapter 4 identified a number of options to provide councils with more flexibility to choose a valuation base for levying rates, and with varying base and minimum amounts. This flexibility could be used by merged councils to smooth the impact of the merger on the ratings burden within the local community.⁷³

IPART seeks comment

- 21 Should changes be made to the LG Act to better enable a merged council to establish a new equitable system of rating and transition to it in a fair and timely manner? If so, should the requirement to set the same residential rate **within a centre of population** be changed or removed?

⁷² Section 8(1) of the LG Act does require councils “to raise funds for local purposes by the fair imposition of rates”.

⁷³ For example, a shift to CIV would be expected to reduce the gap between the value of apartments and houses for the purposes of rating. To the extent that properties with higher assessed land values – typically houses – could face large rate increases following the expiry of the rate path freeze, a shift in the ratings method could reduce the magnitude of rate increases for these properties.

7.2 Approved special variations for merged councils and other issues

A council that has been merged may have had a special variation approved prior to the merger. As discussed in Chapter 6, under our interpretation of the rate path freeze, the general income of a merged council during the rate path freeze would include any extra revenue from special variations that have been approved for pre-merger councils. As the pre-merger council ceases to exist after a merger, the special variation approved prior to the merger, and the extra permissible revenue associated with it, also legally ceases to exist.

To address this issue, IPART interprets the rate path freeze to mean that the general income of the larger merged council should include any extra revenue from special variations that have been approved pre-merger. The extra revenue from approved special variations would be included in the merged council's rate base both during the 4-year rate freeze and afterwards.⁷⁴

This policy would apply to both approved special variations operating only during the 4-year rate freeze and those of longer duration.

To do this, the Governor's merger proclamation power could be used to include any approved special variations in the rate base of the merged council.⁷⁵

IPART seeks comment

- 22 Should approved special variations for pre-merger councils be included in the revenue base of the merged council following the 4-year rate path freeze?
- 23 What other rating issues might arise for merged councils after the 4-year rate path freeze period expires?

⁷⁴ Temporary special variations would drop out of the rate base when they expire as would have occurred if a merger had not taken place.

⁷⁵ The Governor's proclamation could include facilitating provisions that allow the merged council to recover the additional revenue the pre-merger council would have recovered under an already approved special variation.



Appendices

A Terms of Reference



Dr Peter Boxall AO
Chairman
Independent Pricing and Regulatory Tribunal
PO Box K35
HAYMARKET POST SHOP NSW 1240



Reference: A1444504

18 DEC 2015

Dear Dr Boxall

Pursuant to section 9 of the *Independent Pricing and Regulatory Tribunal Act 1992*, I am writing to request the Tribunal undertake a review of the Local Government rating system in accordance with the attached Terms of Reference.

The implementation of an efficient and equitable rating system is a key component of the Government's *Fit for the Future* reforms, and will ensure all councils are able to implement sustainable fiscal policies and reforms over the longer-term.

Critically, the Tribunal's review should seek to recommend a legislative or regulatory approach to support the Government's policy of freezing existing rate paths for a period of four years for councils that merge as part of the *Fit for the Future* process.

An interim report outlining options and recommendations to achieve this commitment should be provided to the Minister for Local Government within six months. A final report addressing all aspects of the terms of reference should be provided to the Minister within 12 months.

Should you have any questions or wish to discuss this matter further, please contact Mr John Clark, Executive Director, Local Government Reform on 9228 3570 or john.clark@dpc.nsw.gov.au

Yours sincerely

A handwritten signature in blue ink, appearing to read "Mike Baird".

MIKE BAIRD MP
Premier

End: Terms of Reference, Local Government Rating System in NSW

Terms of Reference

The Local Government Rating System in NSW

I, Mike Baird, Premier of New South Wales, approve the provision of services by the Independent Pricing and Regulatory Tribunal (IPART) under section 9 of the *Independent Pricing and Regulatory Tribunal Act 1992* (IPART Act) to the Minister for Local Government for the review of the local government rating system in accordance with these 'terms of reference'.

General

IPART is to undertake a review to identify and make recommendations for potential reforms to the rating system for local government in NSW. These recommendations will aim to:

- Enhance the ability of councils to implement sustainable and equitable fiscal policy and
- Provide the legislative and regulatory approach to achieve the Government's policy of freezing existing rate paths for four years for newly merged councils.

In investigating and making recommendations for this review, IPART is to consider:

- a) the performance of the current rating system and potential improvements, including consideration of:
 - the rating burden across and within communities, including consideration of apartments and other multi-unit dwellings;
 - the appropriateness and impact of current rating categories and exemptions, mandatory concessions and rebates;
 - the land valuation methodology used as the basis for determining rates in comparison to other jurisdictions;
 - the impact of the current rating system on residents and businesses of a merged council and the capacity of the council to establish a new equitable system of rating and transition to it in a fair and timely manner.
 - the objectives and design of the rating system according to recognised principles of taxation.
- b) current examples of municipal best practice rating policies and schemes;
- c) the impact of the current and alternative frameworks for the rating system on communities and businesses and their capacity to pay; and
- d) any other matter IPART considers relevant.

In undertaking its review under these Terms of Reference, IPART is to take account of:

- the importance of Integrated Planning and Reporting in determining the revenue required to deliver services and infrastructure;
- the current financial sustainability of local government in NSW, including the findings and deliberations of the NSW Treasury Corporation report Financial Sustainability of the NSW Local Government Sector, 2013;
- the findings and deliberations of the Independent Local Government Review Panel and subsequent Government response;
- the NSW Government's policy of encouraging urban renewal; and
- the NSW Government's commitment to protect NSW residents against excessive rate increases and to providing rate concessions to pensioners.

Public consultation

IPART should consult with relevant stakeholders and NSW Government agencies by releasing an Issues Paper and Draft Report for their review on the IPART website. IPART should also consult with the Fit for the Future Ministerial Advisory Group.

IPART may also hold public hearings for the purposes of this review.

Timeframe

An interim report with recommendations on the legislative and regulatory approach to achieve the Government's policy of freezing existing rate paths for four years for newly merged councils should be submitted to the Minister for Local Government within 6 months of signing of the Terms of Reference.

A final review report should be formally submitted to the Minister for Local Government within 12 months of signing of the Terms of Reference.

Governance

IPART should provide progress briefings at regular intervals or as requested to the Chief Executive, Office of Local Government.

The Minister for Local Government will decide on the timing of release of the final report.

Supporting information and recommendations

IPART is to collect relevant material and data to establish the impacts to councils, communities and NSW of the current rating system, and to provide reasons for any recommendations for reform.

Background

The Independent Local Government Review Panel (Panel) made a number of recommendations regarding general reform of the local government system in NSW, including options to strengthen the revenue base of local government.

As part of its response to the Panel, the NSW Government has agreed to commission IPART to undertake a further review of the rating system reflecting on issues raised by the Panel regarding the equity of the current system.

The Government also committed to introduce a new Local Government Act from 2016. This review will inform the rating provisions in the new Act.

B Reports to be considered by IPART

B.1 TCorp Report on Financial Sustainability

Following an assessment of 152 NSW councils, the 2013 TCorp report into financial sustainability of NSW councils⁷⁶ made a number of key findings, including:

- ▼ Operating deficits are unsustainable – only one third of councils in 2012 reported an operating surplus. Over the period 2009 to 2012, the cumulative operating deficit of NSW councils totalled \$1.0 billion.
- ▼ The total infrastructure backlog of NSW councils had reached \$7.2 billion by 2012.
- ▼ Financial sustainability is deteriorating with 50% of councils' financial outlook likely to be rated 'weak' or lower by 2016-17.
- ▼ A large asset management gap exists within the sector with a \$389 million deficit in 2012 alone.
- ▼ Councils need to start consulting their communities about ways to either increase revenue, lower existing service levels and or standards, and pursue efficiency savings.

Fit for the Future council submissions showed improved financial sustainability

IPART assessed 144 Fit for the Future (FFTF) proposals from NSW councils against a number of criteria, including financial criteria, and published its final report, *Assessment of Council Fit for the Future Proposals* in October 2015.

In its FFTF assessments in 2015, IPART only found 27 of 144 councils, or 19%, as not meeting the financial criteria because of continuing operating deficits over the next five to 10 years.

In addition, the infrastructure backlog had substantially reduced since the TCorp report. The TCORP backlog of \$7.2 billion in 2012 corresponded to an average backlog ratio of about 13%. By contrast, in FFTF councils reported an average backlog ratio of 6.5% in 2014, with councils' forecasting this ratio to fall to about 2.5% by 2020.

⁷⁶ NSW Treasury Corporation, *Financial Sustainability of the NSW Local Government Sector, Findings Recommendations and Analysis*, April 2013.

A major driver for this reduction was a re-estimation of depreciation schedules. Councils in FFTF typically used depreciation lives of between 55 to 100 years.

B.2 Independent Local Government Review Panel Final Report (Panel Report)

The NSW Government in April 2012 appointed the Independent Local Government Review Panel to review the NSW Local Government sector, including a review of the local government rating system. The Panel Report contained a number of key recommendations, which are summarised in Box B.1 below.

Box B.1 Independent Local Government Review Panel – key reform recommendations relating to the rating system

- ▼ Set local rates for apartments and other multi-unit dwellings more equitably and efficiently, in order to raise more revenue. Councils could be given the option of using Capital Improved Value (CIV) or the market value of the property to levy residential rates (p 40).
- ▼ Reduce or remove excessive rating exemptions and concessions that are contrary to sound fiscal policy and jeopardise councils' long-term sustainability (p 39).
- ▼ Some concessions for disadvantaged ratepayers are justified, but social welfare should not be a local government responsibility. Arrangements for pensioner concessions should be reviewed (p 40).
- ▼ Streamline the special variation process, or provide earned autonomy from rate-pegging for some councils, or replace rate-pegging with a new system of 'rate benchmarking' (p 42).
- ▼ Reduce the number of councils, particularly in Sydney, to create higher capacity councils that can better partner with the State Government in developing Sydney (p 72).
- ▼ The government consider giving larger councils in inner Sydney expanded responsibilities. These councils could use increased rates revenue to contribute more to sub-regional infrastructure and transport projects, freeing up state resources to be spent elsewhere (p 102).
- ▼ Commission IPART to undertake a review of the rating system (p 55).

Source: Independent Local Government Review Panel, *Revitalising Local Government*, October 2013.

B.3 NSW Government response to the Panel

The Government response to the Panel Report's recommendations on the rating system is set out below.

Table B.1 Government response to selected ILGRP Recommendations

| | |
|---|---|
| Recommendation on a review by IPART | Commission IPART to undertake a further review of the rating system focused on: <ul style="list-style-type: none"> ▼ Options to reduce or remove excessive exemptions and concessions that are contrary to sound fiscal policy and jeopardise councils' long term sustainability. ▼ More equitable rating of apartments and other multi-unit dwellings, including giving councils the option of rating residential properties on Capital Improved Values, with a view to raising additional revenues where affordable. |
| Position | Supported |
| Government Response | The Government notes the issues raised by the Panel in relation to the equity of the current rating system. It remains committed however to protecting ratepayers from unfair rate rises and to providing rate concessions for pensioners. The Government will commission IPART to conduct a rating review to reflect these issues. |
| Recommendations on current rating system | Either replace rate-pegging with a new system of 'rate benchmarking' or streamline current arrangements to remove unwarranted complexity, costs, and constraints to sound financial management. |
| Position | Supported |
| Government Response | The Government is committed to a rating system that protects local ratepayers from unfair rate rises. It recognises however the improvements in council strategic planning under IP&R and therefore supports removing unwarranted complexity, costs and constraints from the rate-peg system, where there is evidence that the council has taken steps to reduce unnecessary costs before seeking to impose an increased burden on ratepayers. The OLG will work with IPART to amend the guidelines to develop a streamlined process for <i>Fit for the Future</i> councils wanting to increase rates above the rate peg, and to offset revenue loss through Financial Assistance Grants (FAGs) redistribution. |

Source: Office of Local Government, *NSW Government Response: Independent Local Government Review Panel recommendations and Local Government Acts Taskforce recommendations*, September 2014, pp 4-5.

The Government also responded to the Panel's analysis on council mergers by commissioning IPART to conduct an analysis of councils' FFTF proposals. The IPART *Assessment of Council Fit for the Future Proposals* released in October 2015 found 57 councils were fit and 87 councils were not fit.

B.4 Integrated Planning and Reporting

The Integrated Planning and Reporting (IP&R) framework requires NSW councils to prepare:

- ▼ a 10-year Community Strategic Plan, which identifies long term priorities
- ▼ a Resourcing Strategy (comprising a Long Term Financial Plan of at least 10 years, an Asset Management Plan and a Workforce Plan)

- ▼ a 4-year Delivery Program, which identifies service and works at a program level that are to be funded, and
- ▼ a 1-year Operational Plan (containing an annual budget).

IP&R enables councils to better achieve community priorities from effective planning, to meet the community's expectations about service levels and funding priorities. IP&R should underpin decisions on the revenue required by each council.

The special variation guidelines and IPART's assessment process are based on an expectation councils will have engaged the community in a discussion on the funding required through the IP&R process.

C Recent reviews relating to council rates

Productivity Commission Review (2008)

The Productivity Commission report, *Assessing Local Government Revenue Raising Capacity*,⁷⁷ released a number of findings regarding the local government rating system.

- ▼ Rates are a relatively efficient tax base, creating no or few distortions in choice (p 139).
- ▼ Metropolitan councils have good capacity to increase revenue through raising residential rates (p 64).
- ▼ Council rate revenue is not constrained by the valuation methodology adopted (p 102).
- ▼ Differential rating provisions increase the capacity of councils to raise revenue from property rates, by allowing councils to structure rates based on capacity to pay and benefits received (p 104).
- ▼ In principle, using UV is more economically efficient than CIV, as CIV may distort land use decisions away from capital improvements. In practice, the low level of rates across Australia means the efficiency effect of one methodology over another is likely to be relatively small (p 102).
- ▼ Rate pegging in NSW and the partial reimbursement of concessions has limited NSW councils' ability to increase their level of own source revenue (p XXXIII).

IPART Review of State Taxation (2008)

IPART was asked to recommend reforms to the NSW tax system. The Final Report, *Review of State Taxation, Report to the Treasurer*, was published in October 2008.⁷⁸ Among other matters, the report recommended the NSW Government should:

- ▼ increase reliance on broader based, simpler and more transparent taxes that facilitate modern business practices (p 7)

⁷⁷ Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, Research Report (Productivity Commission Report), April 2008.

⁷⁸ IPART, *Review of State Taxation - Final Report*, October 2008.

- ▼ reduce reliance on inefficient, distorting taxes in favour of more neutral taxes. Payroll and land taxes are reasonably efficient, whereas stamp duty and insurance taxes are inefficient (p 7)
- ▼ over the long term develop a strategy for increasing property holding taxes (eg, broadening the land tax base, increasing the land tax rate and/or increasing municipal rates on land values) to fund substantial reductions in purchaser transfer duty and insurance taxes on a revenue-neutral basis (p 10)
- ▼ remove the payroll exemption for councils and lower the rate over time (p 8)
- ▼ remove the levy on insurance companies to fund the fire service and instead fund fire services with an increase in council rates⁷⁹ (p 9)
- ▼ broaden the base of land tax to include owner occupiers to fund a reduction in purchaser transfer duties (p 119), and
- ▼ introduce new environmental levies, congestion taxes, parking charges and road pricing (p 11).

IPART Revenue Framework for Local Government (2009)

The NSW Government requested IPART to review the framework for regulating council rates and charges.⁸⁰

- ▼ The report found whilst rate pegging had limited NSW councils' rates revenue to a level below that of the other states, when user fees and charges were taken into account, rises in total council own source revenue was broadly the same for NSW and the other States (p 4).
- ▼ IPART recommended a more flexible approach to rate increases rather than just rate pegging. The Government subsequently adopted IPART's recommendations in establishing the system that is currently in place where (p 8):
 - each year IPART calculates the percentage change in the local government cost index – adjusted for productivity, and advises the Minister
 - the Minister advises the rate peg for the following year, and
 - the Special Variation process allows councils to apply for one or multi-year price paths above the rate peg.

⁷⁹ This recommendation has subsequently been adopted by the NSW Government. For more details, please see NSW Government, Media Release – Stronger Councils for Sydney and Regional NSW, at <https://www.emergency.nsw.gov.au/media-releases/2015/nsw-moves-to-a-fairer-system-for-funding-fire-and-emergency-services.html>, 10 December 2015, accessed 16 March 2016.

⁸⁰ IPART, *Revenue Framework for Local Government – Final Report*, December 2009.

Henry Tax Review (2010)

The Report on Australia's Future Tax System (Henry Tax Review)⁸¹ had a number of findings and recommendations in relation to the local government rating system.

- ▼ Council rates are an effective and efficient broad based tax.
- ▼ Councils should be given more autonomy in setting rates (ie, as councils are answerable to residents there is no need to impose rate pegs) (Recommendation 120).
- ▼ There are arguments for and against using either Capital Improved Value (CIV) or Unimproved Value (UV) as a rate base (p 692).
 - Under the 'benefits tax' view, CIV is the better approach because it recovers spending on local public goods that benefit the property owner.
 - Under the 'capital tax' view, UV is better as it does not distort the decision to invest.
- ▼ Distortions and efficiency costs from CIV are small.
- ▼ Over time, many inefficient state taxes such as stamp duty should be abolished, and the revenue collected as an integrated rates bill (Recommendation 121).
- ▼ Government grants to councils should be on a needs basis with no minimum guaranteed grant (p 694).
- ▼ As the owners of 80% of Australia's roads, councils should be entitled to receive money from congestions charges, and a proportion of the money collected from heavy vehicle mass distances charges (p 696).

New Zealand Local Government Funding Review (2015)

A discussion paper by the National Council of Local Government New Zealand in February 2015, *Local Government Funding Review*, highlighted the following.⁸²

- ▼ The report recommended New Zealand councils make greater use of existing revenue tools particularly user charges for services such as water, waste management and sewage disposal (p 43).
- ▼ Debt funding, particularly for inter-generational asset investment is underutilised meaning that current generations of ratepayers are disproportionately covering the cost of infrastructure (p 77).
- ▼ General rates are roughly progressive: higher value properties pay more. However, land based businesses such as farming may be disproportionately affected (p 54).

⁸¹ *Australia's future tax system*, Final Report, May 2010.

⁸² National Council of Local Government New Zealand, *Local Government Funding Review*, Discussion Paper, February 2015.

- ▼ The report is critical of rate exemptions imposed by the central government, arguing that they are in effect a forced contribution by the local government to the funding of these services. Where these exemptions exist the report argues that they should be the result of a localised exemption decided at the local council level (p 58).
- ▼ New Zealand councils have the authority to set their own rates remission policies, including rate postponement for ratepayers over 65. This gives older 'asset rich/cash poor' ratepayers the option of postponing some or all of their rates for a fixed or indefinite period subject to interest charges and administrative costs (p 62).

D | Rating Practices in Other Jurisdictions

Table D.1 Council rating methodology across Australian

| | NSW | VIC | QLD | SA | WA | TAS | NT |
|-----------------------------------|--|--|---|--|--|---|--|
| Valuation method | UV | Councils may choose from: <ul style="list-style-type: none"> • UV • CIV • ARV 73 of 79 Councils use CIV, the rest use ARV | UV | Councils may choose from: <ul style="list-style-type: none"> • UV • CIV • ARV 60 out of 68 councils use CIV | <ul style="list-style-type: none"> • Rural land – UV • Non-rural land – ARV • UV mandatory for mining and petroleum interests | Councils may choose from: <ul style="list-style-type: none"> • UV • CIV • ARV 24 out of 29 Councils use ARV, the remaining 5 use CIV | Councils may choose from: <ul style="list-style-type: none"> • UV • CIV • ARV All councils use UV |
| Base amount (Fixed charge) | Option for base amounts by land use category, up to 50% of general revenue for that category | Option for 'municipal charge' up to 20% of sum total of general revenue and revenue from municipal charges | No option for base amount | Option for base amount, up to 50% of general rates | No option for base amount | Option for base amount of up to 50% of general rates | Multiple base amounts for different purposes according to land use/location categories |
| Minimum amount or rate | Option for minimum amount up to a legislated ceiling for ordinary and special rates | No option for minimum amount | Option for differential minimum amount by land use categories | Option for minimum amount application for up to 35% of properties. It cannot be used in addition to a base amount | Option for differential minimum amounts for up to 50% of premises, unless capped at \$200 | Option for minimum amount, but it cannot be used on top of a base amount | Option for different minimum amounts according to land use/location categories |
| Rate categories | Option for differential rates across four land use categories and multiple subcategories | Option for differential rates across multiple land use categories | Option for differential rates across multiple land use categories | Option for differential rates across nine land use categories, with option for specified land location categories | Option for differential rates across multiple land use categories | Option for differential rates across eight land use categories; no restriction on land location categories | Option for differential minimum amounts in addition to fixed charge |

Sources: IPART staff research, NSW *Local Government Act 1993*, NSW *Local Government Regulation 2005*, *Local Government Act 1989* (VIC), *Local Government Act 2009* (QLD), *Local Government Regulation 2012* (QLD), *Land Valuation Act 2010* (Qld), *Local Government Act 1999* (SA), *Local Government (General) Regulation 2013* (SA), *Local Government Act 1995* (WA), *Local Government (Financial Management) Regulation 1996* (WA), *Local Government Act 1993* (Tas), *Local Government Act 2008* (NT).

Notes: UV denotes Unimproved Value, CIV denotes Capital Improved Value, ARV denotes Annual Rental Value.

Table D.2 International Jurisdictions

| Country | Method | Comments |
|--------------------|-----------------|--|
| New Zealand | CIV, UV or ARV | Revalued every 3 years with values approved by NZ Valuer General. |
| Canada | CIV | Market value is assessed by relevant bodies. Average rates vary widely across Canada. |
| UK | CIV using bands | The UK uses banded market value, with the number of bands varying throughout the UK. |
| Ireland | CIV using bands | 20 bands of property value are defined and rates are charged progressively. The first 19 bands cover properties valued up to €1.0m, with rates for each band 0.18% of the mid-point of the band. The 20th band covers properties valued above €1.0m, with a tax rate of 0.18% applied to first €1.0m, and 0.25% on remaining value above €1.0m. Councils can reduce the LPT charge, and in 2016, 11 local authorities reduced their LPT rate by 1.5% to 15%. |
| USA | CIV | The median rate in each state varies between 0.18% to 1.89% of market value of the property. |
| Denmark | UV | The municipal real estate tax rate is levied on the land value. The tax rate is between 1.6% and 3.4%, varying depending on the location. |
| Singapore | ARV | Property tax rates on owner-occupied (7 bands) and non-owner occupied (5 bands) residential properties are applied on a progressive scale. All other properties continue to be taxed at 10% of the ARV. |
| Hong Kong | ARV | Rateable values are reviewed annually. Exemption is available to premises below a prescribed rateable value. No distinction made between owner occupied property or otherwise. |

Sources: IPART staff research;

<http://www.localcouncils.govt.nz/lqip.nsf/wpgurl/About-Local-Government-Local-Government-In-New-Zealand-Council-funding>

http://www.cscd.gov.bc.ca/Lgd/library/revenue_source_review/An%20Analysis%20of%20Property%20Taxation.pdf

<https://www.gov.uk/government/statistics/council-tax-levels-set-by-local-authorities-in-england-2011-to-2012>

<http://www.revenue.ie/en/tax/lpt/liability.html>

<http://www.tax-rates.org/taxtables/property-tax-by-state>

<http://www.globalpropertyguide.com/Europe/Denmark/Taxes-and-Costs>

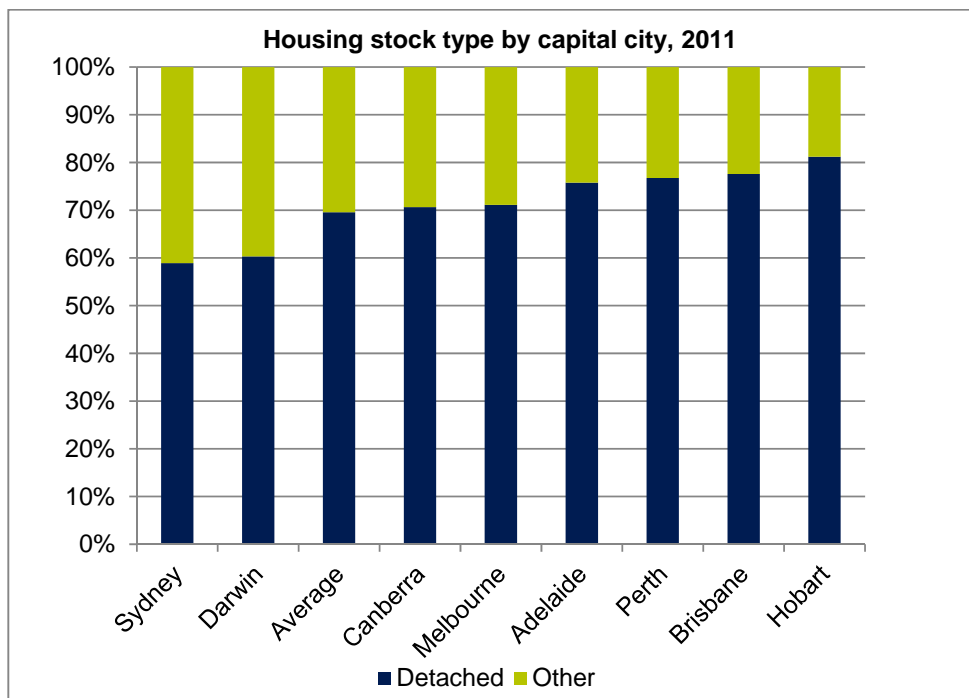
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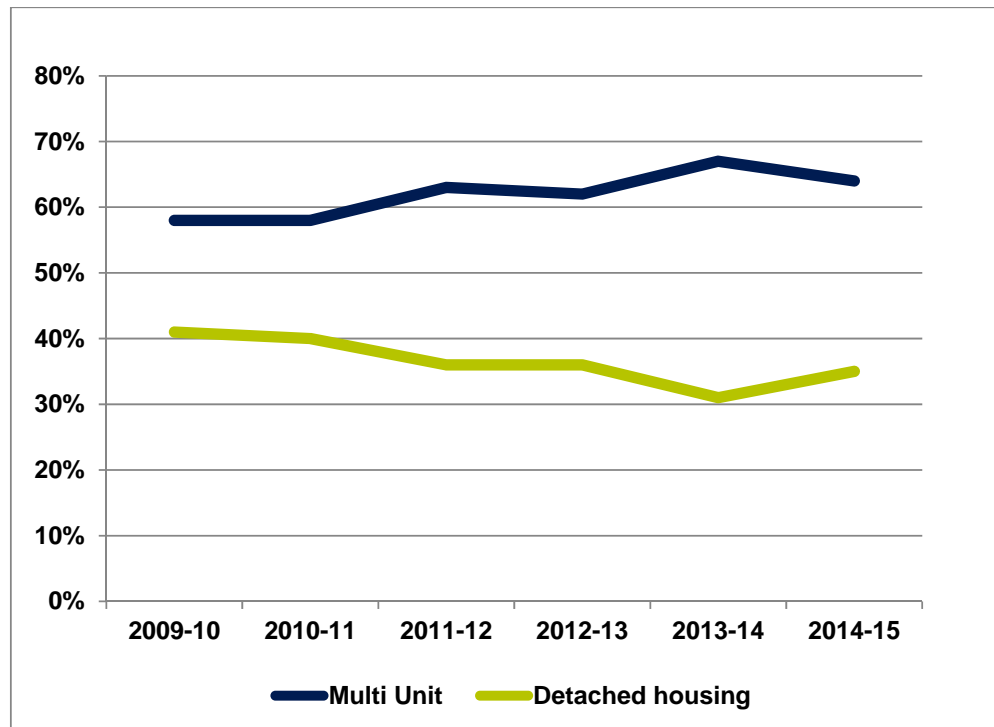
E Housing Composition in Sydney

Figure E.1 shows Sydney has the highest proportion of multi-unit dwellings of Australia's capital cities at 40%, compared with 20% to 30% in other capital cities, and 30% Australia wide.

Figure E.1 Dwelling type percentages by capital city



Data source: ABS, 2011 Census of Population and Housing.

Figure E.2 Dwelling approvals by type in Sydney

Data source: Department of Planning & Environment, Annual Report 2014-15; ABS, Building Approvals, Australia, Cat. No. 8731.0.

The proportion of apartments in Sydney is rising over time. Figure E.2 shows:

- ▼ In 2009-10, detached housing was 41% of total Sydney approvals and multi-unit dwellings comprised 58%.
- ▼ By 2014-15, detached housing was just 35% of approvals with multi-unit dwellings comprising 64%.⁸³

Consequently, the appropriate treatment of multi-unit dwellings in council rate bases will be an increasingly important issue for NSW, and Sydney in particular, because the proportion of apartments is rising over time.

⁸³ Department of Planning & Environment Annual Report 2014-15, p 30. Multi-unit dwellings include apartments, villas, townhouses, terraces and semi-detached homes.

