Institute of Public Works Engineering Australasia Limited
NSW Division

New South Wales

Review of the Local Government Rating System
Local Government — Issues Paper April 2016

Submission of Response

INSTITUTE OF PUBLIC WORKS ENGINEERING AUSTRALASIA (NSW DIVISION)

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EXECUTIVE SUMMARY

IPWEA (NSW Division) appreciates the on-going opportunity to participate in developing an improved rating model for the sustainable management of Councils and the infrastructure Councils manage on behalf of their communities.

This paper is provided in response to IPART's *Review of the Local Government Rating System Local Government — Issues Paper April 2016*. This paper addresses the review of the ratings system as an essential component of an improved funding model which is necessary if councils are to become sustainable and are to become capable of maintaining their infrastructure assets.

IPWEA (NSW Division) has stated a mission *to enhance the quality of life of NSW communities through excellence in public works and services. This is achieved through our professional association that effectively informs, connects, represents and leads public works professionals for NSW.*

IPWEA NSW has a set of values that requires respect, integrity, passion, excellence, recognition and ownership in everything we do.

IPWEA (NSW Division) is therefore ideally placed to take a lead role in enhancing outcomes for communities across NSW, by assisting practitioners within Local Government, and partnering with the Office of Local Government.

While IPWEA (NSW) does not have expertise in determining the mechanics of Local Government rating systems, it does have considerable expertise in defining the context in which rate revenue performs a critical role in the overall operations of councils. This submission focuses on defining the existing funding gap for transport related infrastructure assets and how rating must be used to insure the ongoing sustainability of councils.

The road funding gap for NSW councils is estimated at $447 million based on the data from the 2014 Road Asset Benchmarking Report. This represents a substantial increase on current expenditures if councils are to close the infrastructure funding gap.

IPWEA (NSW) does not support looking at rating in isolation and imposing a four year rating freeze as the best approach to dealing with the infrastructure funding gap problem. The current review may be able to recommend a more equitable distribution of rating within a council area (UV v ICV), establish rating categories and exemptions, and review mandatory concessions but it will do little to address the underlying issue of providing sustainable funding model for infrastructure assets.

Any changes to the rating system must be directed at better recouping the cost of serving high and medium density developments. This would also provide an incentive for Councils to meet the NSW Government's planning targets for increased densities in our cities to prevent urban sprawl and provide overall efficiencies for all levels of Governments.

Given these circumstances, a rating moratorium for a four year period can only lead to an increase in net operating costs and a significant medium to long term deterioration in

sustainability.
In addition, the funding of new capital projects during the initial four year period will simply add extra assets to an infrastructure inventory that cannot currently be maintained.

The considered application of the existing Integrated Planning and Reporting framework by newly created councils combined with extensive community consultation can provide a solution to this problem. IPWEA (NSW Division) encourages IPART to make use of the existing IPR and related engagement processes wherever practicable, rather than requiring new or extra processes, which cost the community.

IPWEA (NSW) has considerable expertise in the infrastructure asset management and renewal area and would like to continue to work with IPART, the Office of Local Government and the State Government to develop a sustainable rating system that will meet community needs for the future.

Table of Contents

1. Background

In April 2016 the Independent Pricing and Regulatory Tribunal (IPART) published a Local Government — Issues Paper titled *Review of the Local Government Rating System.* IPART has 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 Terms of Reference ask IPART 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".

The Terms of Reference also set out the issues that must be considered as part of the review, 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.

Finally, the Terms of Reference require recognition of the importance of the Integrated Planning and Reporting framework that allows NSW councils to draw various plans together and how they interact.

IPWEA (NSW) does not have expertise in determining the mechanics of Local Government rating systems. It does, however, have considerable expertise in defining the context in which rate revenue performs a critical role in the overall operations of councils.

This submission will focus on defining the existing funding gap for transport related infrastructure assets and how rating must be used to insure the ongoing sustainability of councils.

Financial Imperatives

To provide some perspective in support of our submission the following sections detail the financial environment in which councils are operating. The significance of this information is that councils essentially have three sources of revenue:

- Rates
- Fees and Charges
- Grants

Loans are not a source of revenue, rather a management tool for providing the appropriate timing of expenditure.

2.1 TCorp's Key Findings

In April 2013 TCorp published a report titled *Financial Sustainability of the New South Wales Local Government Sector.* The key findings of this report were:

From its assessment of the 152 Councils and its analysis of the outcomes, TCorp considers that the key findings are:

1. ***Operating deficits are unsustainable** - The majority of Councils are reporting operating deficits and a continuation of this trend is unsustainable. In 2012 only one third of Councils (50) reported an operating surplus. Over the 2009 to 2012 Review Period, the cumulative operating deficits for all Councils in NSW totalled $1.0b*
2. ***2012 operating deficits are understated** - The cumulative operating deficit of all Councils in 2012 of $288m understates the severity of the current position. In the 2012 financial year the Federal Government prepaid half of the 2013 Financial Assistance Grants which most Councils declared as revenue in 2012. Removing the impact of this prepayment results in the normalised deficit for the 2012 financial year being $469m, an increase of $181m*
3. ***Sustainability is deteriorating** - The sustainability position is expected to deteriorate over the short term for nearly 50% of all Councils, based on current LTFP. Should the current Outlooks eventuate, 70 of the 152 Councils in NSW (46%) would be rated as Weak or lower within three years*
4. ***Consultation with the community is required** - Addressing the expected continued deterioration of Councils' financial positions will require an extensive consultation process with the community to consider a combination of revenue increases, expenditure reductions and service level reviews*
5. ***Need to prevent further deterioration** - Achieving a breakeven operating position for Councils is one factor that will assist in preventing further deterioration in the financial position of the local government sector. The achievement of a breakeven operating position would provide sufficient funds to meet future requirements for maintenance of assets and services but it would not provide sufficient funds to address the current (2012) reported Infrastructure Backlog of $7.2b, nor any as yet unquantified asset maintenance funding gap that may exist*
6. ***Improved focus created by the Integrated Planning and Reporting (IP&R) process** – The introduction of the IP&R process in 2009 has increased Councils' focus on longer term planning and strategy. TCorp recognises that Councils are at different stages of implementing the full suite of IP&R requirements. Continued work on refining AMPs, and methodologies for valuing Infrastructure Backlog will improve the quality of LTFPs and assets information over time. Councils who have not as yet completed their initial work under the IP&R process, need to do this urgently to provide a clearer picture of their financial status and future financial requirements*
7. ***Asset management planning is improving** - Asset planning is improving but will require further (and ongoing) iterations for most Councils. Whilst the majority of Councils have now*

completed their initial AMP, the analysis and discussions with Councils indicates that it can take a number of iterations before a high level of certainty can be attached to the outputs of the AMP

8. ***An asset maintenance gap exists*** *– Councils' reported expenditure on the maintenance of their assets shows an annual shortfall in spending on asset maintenance. In 2012 alone, the reported maintenance gap was $389m across the local government sector in NSW, and has totalled $1.6b over the last four years*
9. ***Regional performance varies*** *- There is a higher proportion of Councils rated as Weak and Very Weak in the north coast region and the far western region of the State, compared to other regions. Much of this variation in performance can be attributed to population density, where lower levels of population and hence lower proportional numbers of rate payers are available to meet the costs of maintaining and renewing assets*

2.2 NSW Roads & Transport Directorate – 2014 Asset Benchmarking Report

In 2006 the IPWEA (NSW Division) Roads & Transport Directorate engaged Jeff Roorda and Associates to carry out a benchmarking report to determine the state of transport infrastructure assets across NSW. The first report (2006) highlighted the scale of the long- term underfunding of roads and bridges presenting a significant risk to Councils and their communities. The report concluded that current levels of road funding were NOT sustainable and identified a life cycle funding gap of $783 million per annum.

The latest Road Asset Benchmarking Report 2014 (released at the 2015 NSW Local Roads Congress on 1st June 2015) reports:

The road funding gap for NSW councils is estimated at $447 million based on the data from the 150 responding councils extrapolated to 152 councils. Funding at this level will require a 41% increase on 2013/14 road expenditures if asset management principles are not further developed to manage the gap. Asset management principles to be applied to managing the funding gap include:

- *ensuring that all councils have adequate accurate knowledge on their road assets and how their assets are performing,*
- *ensuring that sealed roads are resurfaced/resealed at the optimum time to maintain waterproofing of pavements,*
- *consulting with and select appropriate levels of service and costs to meet community needs and available resources,*
- *ensuring that unsealed roads are resheeted at the optimum time to meet agreed service levels within available resources,*
- *making efficiencies in operations, maintenance, resurfacing and pavement renewal aimed at reducing life cycle costs,*
- *improving maintenance practices and funding if necessary to extend pavement life and defer projected renewal,*
- *rationalising (dispose) of unnecessary infrastructure assets,*
- *adjusting service levels in consultation with the community,*
- *identifying future renewal needs and expenditure required to meet agreed service levels and document in a road asset management plan,*

- *increasing funding, and*
- *a combination of all actions above.*

While this report shows a significant improvement in asset management capacity and application since 2006, it also clearly shows that asset management alone will NOT overcome the funding gap problem.

2.3. Rating Implications

It is our contention that the essential first step is to determine the magnitude of the funding problem and then to look at the range of alternatives that might provide solutions.

Looking at rating in isolation and imposing a four year rating freeze does not seem to be the best approach to dealing with the infrastructure funding gap problem. It does not address the social equity or service obligations across the diverse nature of local governments in New South Wales that are serviced through the provision of public infrastructure. For instance, higher density housing in regional areas for example would reflect on a lower social economic demographic in contrast to inner city dwellers.

The current review may be able to recommend a more equitable distribution of rating within a council area (UV v ICV), establish rating categories and exemptions, and review mandatory concessions but it will do little to address the underlying issue of providing sustainable funding model for infrastructure assets.

Any changes to the rating system must be directed at better recouping the cost of serving high and medium density developments. This would also provide an incentive for Councils to meet the NSW Government's planning targets for increased densities in our cities to prevent urban sprawl and provide overall efficiencies for all levels of Governments.

3. Existing Rate Paths for Newly Merged Councils

IPWEA (NSW) has major concerns on the subject of the recommend 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".

The first three findings of the TCorp Report, are:

1. **Operating deficits are unsustainable** - The majority of Councils are reporting operating deficits and a continuation of this trend is unsustainable. In 2012 only one third of Councils (50) reported an operating surplus. Over the 2009 to 2012 Review Period, the cumulative operating deficits for all Councils in NSW totalled $1.0b
2. **2012 operating deficits are understated** - The cumulative operating deficit of all Councils in 2012 of $288m understates the severity of the current position. In the 2012 financial year the Federal Government prepaid half of the 2013 Financial Assistance Grants which most Councils declared as revenue in 2012. Removing the impact of this prepayment results in the normalised deficit for the 2012 financial year being $469m, an increase of $181m
3. **Sustainability is deteriorating -** The sustainability position is expected to deteriorate over the short term for nearly 50% of all Councils, based on current LTFP. Should the current Outlooks eventuate, 70 of the 152 Councils in NSW (46%) would be rated as Weak or lower

within three years

The financial position of the councils that gave rise to the above assessments are largely the councils that were ultimately judged as being “unfit for the future”. It is essentially these councils that have been recommended for merger.

Given these circumstances, a rating moratorium for a four year period can only lead to an increase in net operating costs and a significant medium to long term deterioration in sustainability.

In addition, the funding of new capital projects during the initial four year period will simply add additional assets to an infrastructure inventory that cannot currently be maintained.

The considered application of the existing Integrated Planning and Reporting framework by newly created councils combined with extensive community consultation can provide a solution to this problem. IPWEA (NSW Division) encourages IPART to make use of the existing IPR and related engagement processes wherever practicable, rather than requiring new or extra processes, which cost the community.

IPWEA (NSW) supports the development of a framework from year one that allows reasonable rate increases across the new council based on a clear demonstration of need to increase expenditure on infrastructure assets to reduce the existing funding gap. Postponing this until year five will substantially worsen the new council’s financial position.

4. IPWEA (NSW) Expertise

In May 2015 IPWEA (NSW) provided a response to IPART’s *Local Government – Consultation Paper April 2015* on the Methodology for Assessment of Council Fit for Future Proposals. This paper detailed on-going collaboration and discussions with the NSW Auditors Advisory Group, the Office of Local Government and IPWEA NSW regarding improving the management of infrastructure controlled by Councils across NSW including improved reporting. The information contained in that submission provides supporting documentation for this submission.

In addition to the extensive work carried out with the Office of Local Government IPWEA (NSW) through the Roads & Transport Directorate is about to update its NSW Local Road Construction Cost Forecasts 2012-2022 publication. This report provides indexes of the costs associated with undertaking road construction work in the local road sector in NSW. This supports Councils in providing an objective cost assessment of their road infrastructure assets over the next four to ten years.

5. CONCLUSION

IPWEA (NSW Division) is a recognised leader in the field of infrastructure and asset management. Our ethos and connections within the Local Government industry mean we are well placed to influence positive change.

While IPWEA (NSW) does not have expertise in determining the mechanics of Local Government rating systems, it does have considerable expertise in defining the context in which rate revenue performs a critical role in the overall operations of councils. The submission focuses on defining the existing funding gap for transport related infrastructure assets and how rating must be used to insure the ongoing sustainability of councils.

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IPWEA (NSW) has considerable expertise in the infrastructure asset management and renewal area and would like to continue to work with IPART, the Office of Local Government and the State Government to develop a sustainable rating system that will meet community needs for the future.

We look forward to the opportunity to discuss these issues in greater detail.

6. Contact Details

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