

LGNSW Submission to IPART Review of the Local Government Rating System

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Executive summary

Local Government NSW (LGNSW) welcomes the Independent Pricing and Regulatory Tribunal of NSW's (IPART's) Review of the Local Government Rating System.

The review presents the opportunity to improve the equity and efficiency of the NSW rating system so that it reflects modern community needs and demands. It also provides the much needed opportunity to improve the financial sustainability of councils.

LGNSW has provided detailed responses to the questions posed by IPART. LGNSW's main positions include:

Rate pegging

LGNSW is strongly of the view that rate pegging is unnecessary and should be abolished. The primary reasons for this are that:

- Rate pegging has been made redundant/obsolete by the implementation of Integrated Planning & Reporting (Community Strategic Plan, Long Term Financial Plan etc.);
- Rate pegging has contributed to the infrastructure renewal backlog and weakened the financial sustainability of NSW councils;
- Rate pegging distorts the operation of a land valuation based rating system. Valuations do not raise net revenue but merely redistribute the rate burden within a council area;
- Councils are democratically accountable and this keeps rates in check; and
- Historical experience of other jurisdictions without rate pegging has shown that rates did not blow out.

Setting rates and valuation methods

LGNSW generally favours capital improved value (CIV) as the method of valuation for rating purposes in urban areas. CIV would help remove the rating discrepancies and inequities associated with higher density development. Outside metropolitan areas, councils may not see any benefits from such change. Ideally, councils would have a choice of methodology that is applied in their area.

Rate exemptions

It is LGNSW's policy position that all land used for commercial or residential purposes should be subject to rates regardless of tenure. In some cases, rate exemption should simply be abolished (e.g. Forestry Corporation of NSW). In other instances it is a matter of legislating tighter eligibility criteria and/or introducing a system of partial exemptions.

Many current exemptions serve to provide financial benefits to numerous religious organisations, benevolent institutions, private schools and some government business enterprises that are no longer justified in terms of principles of optimal taxation, particularly principles of equity and efficiency. The distinction between charitable and social activity and commercial activity has blurred progressively time with community orientated enterprises increasingly engaging in more commercially focused activity. Often it is no longer appropriate for local ratepayers to subsidise activities of exempt institutions where institutions act commercially, benefit from council services, and have capacity to pay (e.g. state owned corporations, commercial activities in National Parks).

Pensioner concessions

LGNSW supports pensioner concessions and has advocated that they be increased to more realistic levels. However, as a welfare measure these concessions should be fully funded by

other spheres of government with a broader taxation base. Currently, councils fund about 45% of the rebate with the remainder funded by the NSW Government. The NSW Government is the only state government that does not fully fund mandatory pensioner concessions.

Given the limited revenue base of local government it is unfair that it should be required to fund this form of welfare assistance. Providing welfare and income support is the responsibility of other spheres of government which are able to spread the cost of such assistance more equitably and efficiently over a broader revenue base. Also, costs of pensioner concessions are inequitably distributed among councils, with councils in many coastal areas, regional centres and some older established suburbs experiencing higher concentration of pensioners. Furthermore, those who qualify for rebates are disproportionately represented in low income areas with high demand for council services but limited revenue raising capacity.

There is a particular inequity in terms of pensioner concessions for Sydney Water services which are fully funded by the State Government and are significantly more generous than those provided under the Local Government Act. The State Government should fully fund all concessions

Freezing existing rate paths for newly merged councils

LGNSW is firmly of the view that a rate path freeze for newly merged councils is totally contrary to the objectives of local government reform and will be ultimately damaging for affected communities. Councils have expressed the view that it is counterproductive and that it will make the complex and sensitive merger process even more difficult.

Freeze on special rate variations

LGNSW strongly believes that the freeze on special rate variations needs to be abandoned and newly merged councils be allowed to apply for variations when they are able to satisfy the normal special rate variation criteria.

While amalgamating councils will still receive normal rate pegging adjustments, these will only assist in providing for maintenance of the status quo in terms of infrastructure and services. They will not allow the new council to fund and provide improved or additional services or to take corrective action to address infrastructure renewal backlogs. Without the ability to raise additional rate revenue during the freeze period, new councils will be faced with a structural deficit and the need to seek a larger and more sudden increase at the end of the freeze.

Freeze on rating structures

LGNSW submits that the freeze on ratings structures must be removed. Newly merged councils should be allowed to commence a phased rate and service level harmonisation well within the first four years of the new council.

In the presence of rate pegging, the freeze on rating structures and policies primarily raises equity issues. The freeze instantly polarises the community by creating winners and losers - those locked into lower rates and those locked into higher rates. At the same time, most ratepayers are going to expect that service levels are equalised at the highest level previously offered by any pre-existing councils. This will create a dilemma for new councils in the absence of increased rate revenue; i.e. do they:

- Maintain differential service levels for different parts of the community for the duration of the freeze?
- Reduce service levels in some parts of the community to allow subsidisation of increased services levels in other parts in an attempt to achieve sub optimal equalisation?

Such outcomes are divisive, would not be acceptable to communities and are not sustainable. It is concerning that the proclamations pre-empt the findings of the IPART review by imposing a rate structure freeze for the 2016-17 rating year.

The following pages contain LGNSW's detailed response to IPART's issues paper.

Opening

Local Government NSW (LGNSW) is the peak body for councils in NSW, representing general-purpose councils and associate members including 12 special-purpose county councils and the NSW Aboriginal Land Council. LGNSW facilitates the development of an effective community-based system of local government in NSW.

LGNSW welcomes the Independent Pricing and Regulatory Tribunal of NSW's (IPART's) Review of the Local Government Rating System.

LGNSW has long been seeking a comprehensive review of the NSW local government rating system. A review of the rating system was a key recommendation of the Independent Local Government Review Panel in 2013 and it is pleasing that the NSW Government has finally commenced this process. However, LGNSW believes that reform of the rating systems should have preceded the NSW Government's council amalgamation process.

This review presents the opportunity to improve equity and efficiency of the NSW rating system and bring an archaic 19th century based rating system into the 21st century so that it reflects modern community needs and demands. It also provides the opportunity to improve the financial sustainability of councils.

LGNSW commends IPART on its issues paper for the Review of the Local Government Rating System. The paper provides a broad and comprehensive overview of the rating system in NSW and explores how it compares to regimes in other states and territories. It covers many issues associated with the rating system that LGNSW and councils have consistently raised and sought to have addressed.

LGNSW responds to the questions raised by IPART in the following section.

This submission remains subject to endorsement of the LGNSW Board.

Comments on questions in issues paper

LGNSW makes the following comments in response to the questions posed in the issues paper:

Taxation principles

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

LGNSW agrees that the proposed taxation principles are appropriate for this review.

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?*

LGNSW generally favours capital improved value (CIV) as the method of valuation for rating purposes in urban areas. While it may be argued that unimproved capital value (UCV) methodology theoretically promotes the highest and best use of land, many would argue that a CIV allows for more equitable outcomes.

LGNSW refers to CIV as defined in the *Victorian Valuation of Land Act (Vic) 1960 (VLA)*:

“Capital improved value (CIV) – capital improved value means the sum which land, if it were held for an estate in fee simple unencumbered by any lease, mortgage or other charge, might be expected to realize at the time of valuation if offered for sale on any reasonable terms and conditions which a genuine seller might in ordinary circumstances be expected to require.”¹ CIV is commonly known as the total market value of the land plus buildings and other improvements.

CIV provides a more accurate reflection of the market value of a property and is therefore more easily understood by ratepayers. It also provides a more accurate indication of the land owner’s capacity to pay. Importantly, CIV would help remove the rating discrepancies and inequities associated with high density development in urban areas.

As the Independent Local Government Review Panel points out:

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. Not only are such outcomes inequitable, but they also mean that the rating system is raising far less revenue than it reasonably could.

Equity issues can be addressed to some extent by increasing minimum rates and by changing the way the value of the land is distributed amongst the owners of strata-titled

¹ Victorian Valuation of Land Act (Vic) 1960.

properties. However, these are only partial solutions and do not enable a council to capture significantly increased revenues from apartments overall. The only way both objectives can be achieved is by changing the valuation base to Capital Improved Value (CIV).²

However, it needs to be noted that, in a rate pegging environment, change in the valuation methodology would have little direct effect on a council's revenue raising capacity. Its main impacts would be on the distribution of the rate burden within a council area.

Outside a rate pegging environment, capital values could increase a council's rate revenue raising capacity by increasing the valuation base. Within a rate pegging environment, there may be indirect advantages via greater flexibility to maximise rate revenue through special rate variations, for example, better targeting of capacity to pay.

LGNSW acknowledges that implementation of the CIV methodology would be complex and costly given the investment in, and the entrenchment of, the current site value/UCV system. However, it is a goal that the NSW Government should work towards for urban areas.

Councils outside metropolitan areas may not see any benefits from such change. Ideally, councils would have a choice of methodology that is applied in their area. Western Australia applies UCV valuations in non-metropolitan areas and Annual Rental Value in metropolitan areas, and Victoria allows councils to choose between valuation methodologies.

In the event that the implementation of CIV is rejected, or during a likely significantly long transition period before CIV is fully implemented, LGNSW advocates the introduction of a separate category of residential rates for multi dwelling properties such as apartment blocks. This would enable councils to address equity and revenue issues by setting the ad valorem amount of the rate at different proportions of the unimproved land value for single dwelling properties and multi dwelling properties.

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)?

There is currently a high degree of satisfaction among NSW councils with the valuation services provided by the NSW Valuer General. Any potential efficiency gains as a result of opening the market to the private sector and making it contestable would appear to be already captured by way of the tender outsourcing process to private sector valuers that the Valuer General already uses to undertake the valuations.

Furthermore, oversight and quality control by the Valuer General are important in providing a robust and credible process in what can be a very politically sensitive area.

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?

LGNSW does not see any need to change the Act in regard to base and minimum rates.

² NSW Independent Local Government Review Panel, Revitalising Local Government – Final Report, (2013), page 40.

LGNSW considers that the options to apply base and/or minimum rates are important rating policy tools for councils. They provide councils with a degree of flexibility in determining the appropriate rating policies for their communities.

LGNSW agrees with IPART that they are efficient instruments. It is also acknowledged that they may not be equitable if left unchecked. LGNSW considers that the current restrictions on the application of base and minimum rates provide an acceptable balance.

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

Generally, LGNSW sees merit in expanding the number of rating categories or sub-categories that councils may be able to apply. Greater flexibility would allow for more efficient and equitable targeting of rates. It would also allow for more appropriate rating of new residential and business forms, particularly if the rate peg was removed.

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

LGNSW is of the view that the major inequities relate to the overall funding model for local government rather than the rating system itself.

Councils with small rate bases, such as many rural and regional councils, struggle to fund their expenditure responsibilities from rating and are often heavily dependent on intergovernmental transfers. Fiscal transfers are an appropriate and important funding source for local government to make up the shortfall between local government's own source revenue and its expenditure functions (vertical fiscal imbalance) as well as to achieve horizontal fiscal equalisation among councils in Australia. However, the current quantum of equalisation transfers – Financial Assistance Grants from the Australian Government - is not sufficient to “fully” equalise councils’ capacity to provide services and this raises significant equity concerns.

Also, councils that experience significant population growth are hampered by rate pegging and caps on development contributions and would benefit from more adequate funding tools to support, and potentially capture the value increase associated with, new development and urban renewal. Metropolitan councils whose communities demand a much wider set of services would benefit from more autonomy and flexibility in their revenue tools.

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?

General comments on rate pegging

LGNSW submits that rate pegging is unnecessary and should be abolished.

The primary reasons for this are that:

- Rate pegging has been made redundant by the implementation of Integrated Planning & Reporting (Community Strategic Plan, Long Term Financial Plan etc.);
- Rate pegging has contributed to the infrastructure renewal backlog and weakened the financial sustainability of NSW councils;

- Rate pegging distorts the operation of a land valuation based rating system as it means that valuations do not raise net revenue but merely redistribute the rate burden within a council area;
- Councils are democratically accountable and this keeps rates in check; and
- Historical experience of other jurisdictions without rate pegging has shown that rates did not blow out.

A more detailed discussion is provided below.

Rate pegging is inappropriate and unnecessary because the democratic process, together with processes of community strategic service planning, are sufficient for taxpayers (ratepayers) and their elected representatives (councillors) to make informed choices about what the community wants and is willing to pay for. As distinct from regulated (monopoly) industries, local government decision makers are democratically elected by, and are accountable to, their communities. Restricting the budgetary authority of elected representatives interferes with this accountability and constitutes a violation of the democratic principle of budgetary sovereignty of elected bodies over taxes paid by their constituents.

The introduction of community strategic planning under the Integrated Planning and Reporting (IPR) initiative should have made rate pegging redundant. Under IPR's long term strategic service and resource planning framework, objectives are agreed upon with the community. IPR is supported by comprehensive long term financial planning, asset management systems and monitoring of financial sustainability. The community is effectively determining a council's future revenue paths, including rate increases. The community strategic planning framework ensures understanding of and support by the community, councillors and council staff of the community's long term goals, the resources required and trade-offs involved in achieving them, and the necessity of setting priorities.

Rate pegging also has the potential to diminish the effectiveness of uncovering community preferences. This is because it provides a political fall-back position - a way of least resistance where taxes are assumed to be "okay" and would not need justification. This could provide an inherent disincentive to fully uncover community preferences and willingness to pay both in terms of fewer services and lower taxes and more services and higher taxes.

Rate pegging also creates an unrealistic expectation in the community and pressure on elected members that rate growth should be contained indefinitely. Even though NSW councils may apply for special variations to general income which allow for rate increases over and above the rate pegging limit, councils are generally reluctant to do so as rate pegging provides a public benchmark and creates public expectations about maximum rate increases. This places political pressure on councils to stay within the limit and not seek special variations.

Rate pegging was introduced to NSW in 1977 and, until recently, NSW was the only state in Australia that imposed rate pegging. NSW rate revenue growth has consistently lagged behind other jurisdictions resulting in NSW having the lowest per capita rates. This has placed NSW councils in a far weaker financial position than councils in other states. However, the experience of other states and territories also demonstrates that removing rate pegging will not result in dramatic rate increases. While rates have grown more slowly in NSW than in other states in recent years, rates in other states have not increased excessively.³ The political process holds councils in check. Currently (2014/15), the highest council rates per capita are

³ For a comprehensive analysis see: IPART, Comparative analysis of local government revenue and expenditure in Australia, (2009), pages 17ff.

collected in South Australia (\$810), followed by Western Australia (\$771), Victoria (\$753) and Queensland (\$704). Council rates per capita are significantly lower in NSW at \$520.⁴

LGNSW maintains that rate pegging is an unnecessary intervention that distorts the operation of the rating system and produces negative consequences, including the direct and indirect suppression of the rating effort.

In the long run, rate pegging has resulted in:

- Under-provision of community of infrastructure and services;
- The deferral of infrastructure maintenance and renewal expenditure resulting in massive infrastructure backlog; and
- Undermining the financial sustainability of councils.

Rate pegging is a costly regulatory mechanism. It means that whatever else is done to fix the rating system will be less effective than it could be.

Further improvement of the current systems

LGNSW acknowledges the significant improvements in the transparency, predictability and timeliness of the rate pegging and special rate variation regime that have occurred since IPART assumed administration of the regime. LGNSW commends IPART on this, and on the technical support it has provided to councils that have applied for special rate variations.

LGNSW continues to oppose the application of a productivity adjustment in the determination of the rate pegging limit. The primary reason is that taxpayer (i.e. ratepayer) funded general government activities and services cannot be suitably captured by the concept of productivity. Productivity is a measure of output from a production process, per unit of input, with the unit measure of output related to the resources spent in its production. Productivity adjustments are normally applied to regulated prices of providers of specific commercial services. Local government's general government and regulatory activities are not comparable to commercial service provision. They lack marketed output, often are not priced and commonly have multidimensional objectives (e.g. provision of public spaces, parks and gardens; human services promoting inclusive and healthy communities; urban planning and regional development; environmental management).

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

LGNSW is not aware of any pressing need to change the rating system to encourage urban renewal. Rates are unlikely to be a material factor in driving urban renewal; other costs have a much greater bearing such as land, labour, materials and cost of capital.

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

Councils have not raised any issues with LGNSW regarding the collection of overdue rates.

⁴ Australian Bureau of Statistics, Taxation Revenue, Australia, 2014-15, (2016) and Australian Bureau of Statistics, Regional Population Growth, Australia, (2016). Please note that population in unincorporated areas has not been included in the rates per capita calculation.

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?*

Exemptions

There are a number of rate exemptions present in the current rating framework that result in inefficiencies and inequities and therefore reduce the effectiveness of the rating framework.

Distinction between charitable activities and commercial ones is increasingly blurred

The distinction between charitable and social activity and commercial activity has progressively blurred over time, with community orientated enterprises increasingly engaging in more commercially focused activity. Often it is no longer appropriate for local ratepayers to subsidise activities of exempt institutions where those institutions act commercially, benefit from council services, and have capacity to pay (e.g. state owned corporations such as the Forestry Corporation of NSW).

Many facilities operated under the banner of churches, charities and benevolent institutions, such as housing, residential facilities and retail outlets, often bear little distinction from privately owned housing or business facilities. Also, it appears too easy to qualify as a benevolent institution as it simply requires including the correct wording in the organisation's charter or articles.

Many exemptions serve to provide financial benefits to numerous organisations, benevolent institutions, non-core activities of private schools and some government business enterprises that are no longer justified in terms of principles of optimal taxation, particularly principles of equity and efficiency. They often represent a legacy of 19th century norms that are not part of 21st century reality.

Impact of transferring social housing properties to non-government organisations

With respect to social housing, the issue of exemptions for social housing providers is exacerbated by the recent NSW Government activity of transferring social housing properties owned and managed by Housing NSW to non-government organisations that claim, or are likely to claim, council rate exemptions as charitable institutions. As a result, councils face corresponding reductions in rating income. These reductions can be significant, particularly for councils with large social housing areas (e.g. Campbelltown City Council, Blacktown City Council, Nambucca Shire Council, and Port Macquarie-Hastings Council).

Universities and schools are becoming increasingly commercial

Universities are increasingly transforming into large business like entities but currently retain their exemption from rates. Given the transformation it is time to question the justification for blanket exemption. Modern university lands host a range of activities, many of which should

arguably be rateable. This includes activities conducted on a commercial basis, student housing and speculative property development.

Similarly, rate exemptions apply to the large land holdings of many prosperous private schools, a large proportion of which is used for private sporting, recreation, staff accommodation and other non-core educational uses.

Commercial leases in National Parks

Private and commercial leases in National Parks are exempt (such as leases for ski resorts and holiday accommodation), which is inconsistent with the treatment of private and commercial leases on Crown Lands that are subject to rates.

Case studies

A number of case studies on inefficient and inequitable rate exemptions are provided in the appendix to this submission.

General comments on rate exemptions

In all the circumstances mentioned above, and those in the appendix, rate exemptions have the potential to violate the principle that all stakeholders with the capacity to pay should contribute equally to the public services provided by local government.

Furthermore, many of the exemptions are effectively welfare measures and the question remains whether local government is the appropriate sphere of government to be funding state-imposed welfare programs. It is far more equitable for such measures to be funded by other spheres of government with a broader taxation base.

It is LGNSW's position that all land used for commercial or residential purposes should be subject to rates regardless of tenure. In some cases, the exemption should simply be abolished (e.g. Forestry Corporation of NSW). In other instances it is probably a matter of legislating tighter eligibility criteria. Consideration should also be given to introducing graduated exemptions in some categories, i.e. partial exemptions.

In 2013, LGNSW commissioned Deloitte Access Economics to undertake a review of, and prepare a report on, local government rating exemption provisions.⁵ Deloitte Access Economics' report provides a comprehensive review of existing rate exemptions including a framework for assessing the adequacy of exemptions based on principles of optimal taxation.

It validates many of the criticisms that LGNSW has repeatedly made and recommends the removal or redesign of many of the rate exemption provisions. The report also includes various case studies that demonstrate the inefficiencies and inequities of the exemption regime, such as on state forests, National Parks, and retirement villages.

Deloitte Access Economics finds that exemptions have typically been motivated by notions of equity, concession for charitable activities or public good/service provision. Over time, these exemptions have evolved and, when analysed, it is apparent that the principles of optimal taxation are compromised in a variety of respects including:

⁵ Deloitte Access Economics, Review of local government rating exemption provisions, (2013).

- Efficiency, to the extent that land use decisions are distorted from their socio-economic optimum.
- Simplicity, to the extent that councils are obligated to undertake additional and burdensome administrative activities.
- Equity, to the extent that exemptions are granted where capacity to pay exists or where the recipient is a material beneficiary of council services.⁶
- Fiscal sustainability, to the extent that they generate material revenue losses and/or generate scope for revenue bases to be unduly eroded over time.
- Cross-border competitiveness, where they impact decisions to invest or reside within a particular jurisdiction.
- Competitive neutrality, where they are provided to government-owned enterprises in competition with commercial businesses.⁷

Deloitte Access Economics recommends reform with the aim of rating commercial activities where there is not a strong excess of community benefits over cost to council, that is, where equity is compromised from both a benefit principle and capacity to pay perspective. In some instances, this suggests revocation of an existing exemption; in others it implies refining the current provisions. Effective refinement can be achieved via more explicit specification of the exempt activities that can be undertaken by the exempt entity or by utilising partial rebates (though the scope of this review does not extend to consideration of what magnitude these should take). The latter will be preferable where the costs of specifying and monitoring exempt activities outweigh their benefits.⁸

Note re apparent error in issues paper

It appears that the issues paper contains an error in its description of the rate exemption regime on pages 27, 28 and 30. The rate exemption provisions in the *Local Government Act 1993 (NSW)* do not contemplate, as indicated in the issues paper, water and sewerage charges pursuant to sections 501 (annual charge) and 502 (usage charge) of the Act but merely water supply special rates and sewerage special rates pursuant to section 495 of the Act.

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?

LGNSW does not believe this is relevant to this review. It would only be relevant if it was proposed that all NSW Government owned properties should be subject to rates.

LGNSW is not proposing rates should apply to all NSW Government properties; only to land owned by state owned corporations which are undertaking commercial activities or commercial activities on Government land. Also, certain prescribed business activities of councils, for example the provision of water supply and sewerage services, are already subject to state taxes such as payroll taxes.

⁶ In applying the principle of equity, both capacity to pay and benefit principle have been assessed. In the case of the latter, the benefit has been considered in net terms – that is, considering any social or economic benefit accruing to the local community, net of any cost to councils (that is, utilisation of council services). The broader benefits enjoyed beyond the borders of the council jurisdiction are not of primary interest in this evaluation, as they do not justify subsidisation at a municipal level. This is the domain of other spheres of government. See Deloitte Access Economics, *Review of local government rating exemption provisions*, (2013), page 31.

⁷ Deloitte Access Economics, *Review of local government rating exemption provisions*, (2013), page 29.

⁸ Deloitte Access Economics, *Review of local government rating exemption provisions*, (2013), page 32.

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

LGNSW supports pensioner concessions and has advocated that they be increased to more realistic levels. However, as a welfare measure these concessions should be fully funded by other spheres of government with a broader taxation base.

Currently, councils fund about 45% of the rebate with the remainder funded by the NSW Government. The NSW Government is the only state government that does not fully fund mandatory pensioner rate rebates.

The cost of mandatory pensioner rate rebates is a rapidly growing burden for many councils and it is affecting the level and range of services that councils are able to deliver. This scheme already costs some individual councils more than \$1 million annually. The total cost to councils is now around \$64 million annually. Many councils will not be able to afford further increases in the funding they have to provide for pensioner rate rebates.

The issue of pensioner rebates is exacerbated by Australia's ageing population. The number of people living in NSW aged 65 years and over will increase from just over 1 million people (1 in 8 people) in 2012 to 2.3 million (1 in 4 people) in 2050. In regional NSW, these challenges will be greater as regional NSW has an older age profile compared to Sydney, with population ageing becoming more pronounced.⁹ Despite growing superannuation coverage, many retirees will still be pensioners or partially funded retirees who will become pensioners at some stage after retirement.

Given the limited revenue base of local government it is unfair that it should be required to fund this form of welfare assistance. Providing welfare and income support is the responsibility of other spheres of government which can spread the cost of such assistance more equitably and efficiently over a broader revenue base.

Also, costs of pensioner concessions are inequitably distributed among councils, with councils in many coastal areas, regional centres and some older established suburbs experiencing higher concentration of pensioners. Furthermore, those who qualify for rebates are disproportionately represented in low income areas with high demand for council services but limited revenue raising capacity.

LGNSW acknowledges that the level of the mandatory pensioner rate rebate has been static since 1993 even though rates and other costs of living have increased significantly. This matter has frequently been on LGNSW's conference agenda and LGNSW has called on the NSW Government to increase the mandatory pensioner rate rebate on the condition that local government is fully reimbursed for the loss of rating income associated with the rebate.

Pensioner concession on water charges - pensioners in regional NSW are worse off

The *Local Government Act 1993 (NSW)* also requires councils to provide mandatory pensioner concessions on water supply and sewerage charges, which total \$175 per annum per pensioner assessment. Again, councils are only partly (55%) reimbursed by the NSW Government for the revenue lost.

⁹ NSW Ageing Strategy 2012.

However, there are significant differences in the level of, and the reimbursement for, pensioner concessions for water and sewerage charges provided by councils in regional NSW and by Sydney Water in the Sydney metropolitan area and Hunter Water in the Hunter.

Pensioner concessions provided by Sydney Water can add up to about \$600 per annum on a typical residential bill (mainly rebates on service (fixed) charges not usage charges). Sydney Water's rebates are recognised as a community service obligation (under competition policy principles) and, unlike concessions provided by councils, fully reimbursed by the NSW Government.

The table below demonstrates the significant discrepancies and different treatment of pensioners in regional NSW and metropolitan Sydney. That is, it reflects that pensioners in regional NSW are significantly worse off than their Sydney counterparts as a result of the NSW Government's water rebate policy.

Table: Comparison of typical residential bills (TRB) and net TRB after pensioner concessions of Sydney Water and selected councils; 2013/14

Utility	TRB for water supply in \$	TRB for sewerage in \$	TRB total \$	Net TRB after pensioner concession* %	Area
Sydney Water	572	571	1,143	566.55	Sydney
Hunter Water	402	606	1,008	not available**	Regional NSW
Shoalhaven City Council	317	714	1,031	856	
Gosford City Council	475	576	1,051	876	
Tamworth Regional Council	638	738	1,376	1,201	
Young Shire Council	623	720	1,343	1,168	
Median LWU	582	669	1,251	1,076	

*Under the *Local Government Act 1993 (NSW)*, councils have to provide mandatory pensioner concessions on their water supply and sewerage charges (\$175 per annum in total). The NSW Government reimburses only 55% of this (social welfare) expenditure. Sydney Water is also required to provide pensioner concessions on charges which are estimated at \$576.45 applying the 2015/16 rules of 100% concession of water access charge of up to \$102.52 per annum; and 83% of wastewater service charge on the typical residential bill. The full costs of the concession are funded by the NSW Government as a community service obligation.

**Hunter Water's website does not provide information on the amount of the concession..

Freezing existing rate paths for newly merged councils

General comments

LGNSW believes a rate path freeze for newly merged councils is contrary to the objectives of local government reform and will be ultimately damaging for affected communities. Councils have expressed the view that it is counterproductive and that it will make the complex merger process even more difficult.

The freeze on rating structures and the freeze on special rate variations need to be considered separately as each has different consequences.

Freeze on special rate variations

While amalgamating councils will still receive normal rate pegging adjustments, these will only assist in providing for maintenance of the status quo in terms of infrastructure and services. It will not allow the new council to fund and provide improved or additional services or to take corrective action to address infrastructure renewal backlogs.

Indeed, given the significant costs of forced amalgamations and recognising that few if any savings are achieved in the first four years of amalgamation, it is more likely that infrastructure and service provision and financial sustainability would deteriorate at a faster rate than would have been the case without the merger.

Without the ability to raise additional rate revenue during the freeze period, new councils will be faced with the need to seek a larger and more sudden increases at the end of the freeze.

This is contrary to the objectives of the reform program and is clearly not in the interests of the communities, councils or the NSW Government. It is essential to abandon the freeze on special rate variations and allow the newly merged councils to apply for such variations when they are able to satisfy the normal special rate variation criteria.

Freeze on rating structures

In the presence of rate pegging, the freeze on rating structures and policies primarily raises equity issues. Councils are concerned that it is potentially very divisive. The freeze instantly polarises the community by creating winners and losers - those locked into lower rates and those locked into higher rates.

At the same time, most ratepayers are going to expect that service levels are equalised at the highest level previously offered by any pre-existing councils. This will create a dilemma for new councils in the absence of increased rate revenue; i.e. do they:

- Maintain differential service levels for different parts of the community for the duration of the freeze?
- Reduce service levels in some parts of the community to allow subsidisation of increased services levels in other parts in an attempt to achieve sub optimal equalisation?

Such outcomes would not be acceptable to communities and are not sustainable. Provision needs to be made to allow for phased rate and service level harmonisation to commence well within the first four years of the new council.

The fact that IPART now has to review and determine how the rate path freeze should work is evidence that the freeze was an ill-conceived attempt at a politically expedient fix. LGNSW is strongly of the view that the freeze should be abandoned.

It is concerning that the proclamations pre-empt the findings of the IPART review by imposing a rate structure freeze for the 2016-17 rating year.

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?*

LGNSW agrees with this interpretation. However, LGNSW is concerned that it may also be interpreted as meaning that the rate trajectory of individual ratepayers will not change for four years. This will frustrate rate harmonisation and contribute to divisiveness.

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?*

It is LGNSW's position that newly merged councils should be allowed to apply for these variations, and any others normally available to councils, when they are able to satisfy the normal special rate variation criteria. The criteria above only represent a sub-set of the existing normal criteria; for example, they do not include variations to address infrastructure renewal backlogs.

15. *Are there any other situations where merged councils should be able to apply for new special variations within the rate path freeze period?*

Yes, where a special variation is required to improve council performance against benchmark criteria (e.g. infrastructure renewal backlogs, chronic operating deficit under current settings).

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)?*

No. LGNSW refers to its general comments on the freeze provided above.

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)?*

Yes. LGNSW maintains that councils should at least have the discretion to allocate changes to the rating burden across categories.

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?*

LGNSW does not believe that there should be a ceiling, but if it were to apply in that way councils should 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?*

LGNSW maintains that newly merged councils should have the same discretions as non-merging councils.

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?*

LGNSW objects to the proposed option of giving the powers to the Minister. This will politicise the implementation process. If the freeze were to be implemented it should be done through a depoliticised mechanism.

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?*

LGNSW refers to its general comments on the freeze provided above.

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?*

Yes. Depriving councils pre-approved variations will be detrimental to the merger outcome. In having a special variation approved, the council established a financial need. If the variation was subsequently denied, the proven need could not be addressed during the period of the freeze.

23. *What other rating issues might arise for merged councils after the 4-year rate path freeze period expires?*

LGNSW refers to its general comments on the freeze provided above.

Final comments

LGNSW commends IPART on developing, and providing for comment, a thorough and methodical issues paper for its Review of the Local Government Rating System. LGNSW has attempted to comprehensively answer the questions posed in the paper.

For any clarification, or to request further details, please contact Shaun McBride, Senior Strategy Manager, on [REDACTED]

LGNSW would be pleased to continue to assist IPART in undertaking this important review and looks forward to working with IPART on improving the local government rating system.

Appendix – Case studies on rate exemptions

Case study 1 - Rate exemptions for commercial activities

Tumut Shire Council was (until 12 May 2016) a rural council located on the South West Slopes of NSW. It had a population of 11,250 and a land area of 4,567 square kilometres.

More than half of the land area of the former council area (62%) was unrateable due to rate exemptions pursuant to section 555 of the *Local Government Act 1993 (NSW)*.

A significant proportion of this unrateable area is used for commercial activities including:

- State forests managed by the Forestry Corporation of NSW;
- Ski resorts and holiday accommodation in National Parks; and
- Dams managed by Water NSW

Across the area, there are private enterprises undertaking the same or similar activities, and they pay rates (e.g. private forestry industry).

Exemptions for the Forestry Corporation of NSW

The Forestry Corporation of NSW, a state owned corporation, manages over 2,000 square kilometres of pine plantation in NSW; 940 square kilometres of which are located in the former Tumut Shire Council. Forestry Corporation of NSW does not pay any rates on these land holdings.

However, these landholdings are clearly used for commercial purposes. Forestry Corporation of NSW's plantations support world class processing and paper pulp industries with an estimated economic output of \$517 million. The corporation's annual report for 2014/15 details a profit of \$45 million.

The annual report also notes that the corporation receives ongoing funding from the NSW Government to deliver services to regional communities such as fire fighting and forest tourism.

Also located in the former Tumut Shire Council area, are extensive privately owned and operated plantation pine forests with an area of over 100 square kilometres. However, in contrast to the Forestry Corporation's plantations, owners of private plantations are required to pay rates on these landholdings which contribute to local service provision.

Exemptions for water supply dams

Commercial dam operations by Water NSW, a state owned corporation, are exempt from paying rates, whereas other water supply dams that yield a commercial return pay rates.

Blowering Dam, covering an area of 45 square kilometres, is operated by Water NSW. Water NSW does not pay rates on this land.

On the other hand, Jounama Pondage, covering 4.1 square kilometres and located directly above Blowering Dam, is operated by Snowy Hydro Limited, a company under the Corporations Act. Snowy Hydro Limited does pay rates on the land.

Exemptions for commercial activities in National Parks

Located in the Kosciuszko National Park are several ski resorts and holiday accommodation facilities that are operated by the private sector. However, rates are not paid on these landholdings that are used for commercial activities due to the general exemption from rates for National Parks.

These activities, whilst making a major economic contribution to the local economy, also have significant impacts on council operations, particularly with respect to providing road transport and necessary community infrastructure and services. However they do not contribute to funding of these services by way of rates.

Case study 2: Housing development on university land

In this case study the “objects and functions” of a university were changed so that the university may exercise commercial functions comprising the commercial exploitation or development for the university’s benefit, of any facility, resource or property.

The university proceeded with a residential development of up to 800 homes on land originally gifted by the NSW Government. During the subdivision phase the university approached Council X seeking a rate exemption on the development land on the basis that the land that was vested in a university, or a university college, and used or occupied by the university or college solely for its purposes.

Council X served its notices on the land being developed for private housing and the university agreed, under protest, to pay the rates but still maintains that it is entitled to an exemption. The site of the campus and surrounds that are vacant and undisturbed by the residential development, including student accommodation, continues to be exempt.

Case study 3: Transfer of public housing to community housing providers

Council X is potentially exposed to \$6.5 million per annum in lost land rates revenue

Council X has a significant number of Housing NSW properties within its area. The council has concerns about the impact of Housing NSW’s transition from bricks and mortar into a strategic management role by transferring some of its responsibilities to community housing providers.

In accordance with the funding arrangement changes recommended by the Henry Tax Review in 2009, affordable/social housing has been classified as public benevolent in nature. This has filtered down into the local government arena and has consequently been interpreted as exempt in accordance with section 556(h) of the *Local Government Act 1993 (NSW)* as “land that belongs to a public benevolent institution or public charity and is used or occupied by the institution or charity for the purposes of the institution or charity.”

NSW councils have challenged the consequence of this change for a number of reasons not least of which being that homes used for the same purpose held by Housing NSW are subject to rates.

In a recent case before the Land and Environment Court, a community housing provider was successful in its claim for an exemption on the basis that its purposes are charitable. There is concern that this has set a precedent.

Council X has already experienced a shift in the number of residential parcels being held in outright ownership of community housing providers or via vesting provisions within the council area. However, Council X has not conceded to any applications for exemptions to date.

Despite this, the risk for Council X is significant. Within the council area are around 5,500 individual parcels of land currently held by Housing NSW that are currently rated accordingly and there are close to 350 parcels held by community housing providers. Therefore, Council X is potentially exposed to \$6.5 million per annum in lost land rates revenue.

ENDS