IPART
New South Wales

Independent Pricing and Regulatory Tribunal

Revenue Framework for Local Government

Other Industries — Issues Paper
July 2008

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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 29 August 2008.

We would prefer to receive them by email <local_government@ipart.nsw.gov.au>.

You can also send comments by fax to (02) 9290 2061, or by mail to:

Review of the Revenue Framework for Local Government
Independent Pricing and Regulatory Tribunal
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Our normal practice is to make submissions publicly available on our website <www.ipart.nsw.gov.au>. 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 subject to appeal under freedom of information legislation.

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

Contents

1 Overview

Local government is the third tier of government in Australia, and provides a range of essential services to local communities. In NSW, the rates and charges that local councils levy are a major source of funding for local government. Therefore, the regulation of these rates and charges can have a significant impact on local government's ability to provide these services.

Since 1977, the regulation of council rates in NSW has been largely based on an approach known as 'rate pegging'. Under this approach, each year the NSW Government determines the maximum amount by which councils can increase their annual general income,[1] based on recommendations from the Department of Local Government and NSW Treasury. Individual councils must then adjust their rates and annual charges so their general income increases by up to this maximum amount, or seek a special variation to the amount.

IPART notes that the NSW Government has a long-standing commitment to rate pegging,[2] largely because the approach imposes fiscal discipline on councils. For example, by capping their annual revenue from rates and annual charges, rate pegging ensures that councils keep tight control over their expenditures and encourages them to make savings through productivity improvements.

However, local government believes rate pegging places financial pressure on councils, and prevents them from charging rates that reflect local needs. Local government considers that rate pegging has restricted councils' ability to provide infrastructure and services that meet the needs of their community, and reduced their financial viability.

In recent years, a range of national and state level reviews have examined the financial position of councils. For example, at the national level, three reports have been released, including one by a House of Representatives Standing Committee in 2003 (the Hawker report),[3] one commissioned by the Australian Local Government Association in 2006 (the PwC report),[4] and one by the Productivity Commission in

1 Annual general income is largely revenue from property rates. It does not include other forms of revenue such as fees, fines, water or sewerage rates and domestic waste management service charges.

2 The Wran Government introduced rate pegging in 1977 and it has continued to operate since. In announcing this review the current Minister for Local Government stated that the Iemma Government remains committed to rate pegging.

3 Commonwealth of Australia, *Rates and Taxes: A Fair Share for Responsible Local Government*, Standing Committee on Economic, Finance and Public Administration, October 2003.

4 PricewaterhouseCoopers, *National Financial Sustainability Study of Local Government*, November 2006.

2008 (the PC report).[5] At the state level, the most recent reports include an independent inquiry commissioned by the Local Government and Shires Associations of NSW in 2006 (the Allan report),[6] and one by the Queensland Local Government Reform Commission in 2007 (the Queensland report).[7]

These reviews have considered issues such as council governance, financial sustainability, revenue raising capacity, efficiency and cost shifting. While rate pegging has been discussed in these reports, none have specifically considered a framework for regulating council revenue in NSW.

In May 2008, the Premier of NSW asked the Independent Pricing and Regulatory Tribunal of NSW (IPART) to assist the Department of Local Government (DLG) by conducting a review of the regulation of council rates and charges in NSW. The review will be undertaken under Section 9 of the *Independent Pricing and Regulatory Tribunal Act 1992* (IPART Act).

IPART is to investigate and make recommendations on the following three matters:

1. an appropriate inter-governmental and regulatory framework for setting rates and charges that facilitates the effective and efficient provision of local government services
2. a role for IPART in setting rates and charges in future years
3. a framework for setting the charges levied by certain public authorities, such as Sydney Harbour Foreshore Authority (SHFA), Redfern Waterloo Authority (RWA), Sydney Olympic Park Authority (SOPA) and the Growth Centres Commission (GCC), to enable these authorities to recover costs for the provision of services that are normally provided by local government.

1.1 Terms of reference for the review

The terms of reference require IPART, in undertaking this review, to have regard to a range of matters, including:

- the role of local government in delivering infrastructure and services to the community
- the current and future financial position of local government and the scope for efficiencies
- all the revenue sources available to local government
- the socio-economic impacts of rates and charges, including the ability of families and pensioners to meet their rate obligations
- differences between metropolitan, regional and rural councils

5 Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, April 2008.
6 Allan, P, Darlison L and Gibbs, D. *Independent Inquiry into the Financial Sustainability of NSW Local Government*, 2006.
7 Queensland Reform Commission, *Report of the Local Government Reform Commission*, 2007.

- the findings of recent reviews of local government (such as those noted above)
- the matters in Section 15 of the IPART Act.

In addition, the terms of reference specify that IPART is **not** required to consider issues related to the valuation of individual properties, or matters associated with the operation of councils' water and wastewater businesses. (The full terms of reference are provided in Appendix A; the matters in section 15 of the IPART Act are provided in Appendix B.)

IPART notes that the Minister for Planning has recently introduced changes to the *Environmental Planning and Assessment Act 1979* (EP&A Act) that affect the treatment of section 94 contributions (developer contributions).[8] Subject to the proclamation of Schedule 3 of the *Environmental Planning and Assessment Amendment Act 2008* (EP&A Amendment Act), Section 94 and Section 94A contributions will be known as 'Direct Contributions' and 'Indirect Contributions' respectively. These contributions are an important source of revenue for many councils in growth areas. While IPART will take account of the impact of developer contributions and the recent changes to the EP&A Act on councils, it will not review or make recommendations that impinge on the changes to the EP&A Act.

IPART is to provide a draft report to the Minister for Local Government by 13 May 2009, and a final report by 13 September 2009.

1.2 Review process and expected timing

As part of its review process, IPART will undertake extensive public consultation. IPART invites all interested parties, including councils, community groups and members of the public, to make submissions to this issues paper, which identifies the questions on which IPART particularly seeks comment. However, stakeholders are free to raise and discuss other issues they consider to be relevant to the terms of reference for the review. Submissions are most useful to IPART when they are detailed, provide evidence to support the views they express, and move beyond identifying problems to suggesting solutions. Details of how to make a submission can be found at the front of this paper. Please note that the closing date for submissions is 29 August 2008.

IPART also proposes to undertake face-to-face consultation with key stakeholders, including holding public roundtable workshops, and conducting regional meetings with councils. IPART will carefully consider all written submissions prior to holding the public roundtable meetings. These meetings will be used to explore and debate key issues raised in submissions on which IPART considers it needs more

8 The *Environmental Planning and Assessment Amendment Bill 2008* was passed by the Upper House on 17 June 2008 and given Assent on 25 June 2008. The Amendment Act is not yet commenced. The details of the bill may be found at the Department of Planning website www.planning.nsw.gov.au/planning_reforms/index.asp.

information, and issues where it wishes to 'test the waters' regarding possible recommendations.

In addition to consultation, IPART will conduct its own research and analysis. For example, given the diversity of councils in metropolitan, regional and rural areas of NSW, IPART proposes to undertake detailed analysis of a sample of 'typical' councils based on, for example, size (large/medium/small) and location (metro/regional/rural). This will enable it to better understand the financial pressures and impacts on councils.

IPART will release a draft report that sets out its draft recommendations and explains its draft regulatory framework, and invite submissions in response to this report. It will consider these submissions before finalising its report and recommendations, and delivering this final report to the Minister for Local Government by 13 September 2009.

In undertaking the review, IPART will allow scope to provide an interim report to the Minister in February 2009 for the purpose of setting rates revenue from 1 July 2009, if it finds that this is necessary.

Table 1.1 sets out the indicative timetable for the review. This timetable may change during the course of the review. IPART will maintain an up-to–date review timetable on its website (www.ipart.nsw.gov.au).

Table 1.1 Indicative review timetable

Task	Timeframe
Release Issues Paper	14 July 2008
Receive public submissions	29 August 2008
Provide interim report (if required)	February 2009
Provide draft report to Department of Local Government	May 2009
Provide final report to Department of Local Government	September 2009

1.3 Scope of the review

The terms of reference require IPART to review rates and charges. IPART notes that, currently, the regulation of council revenue relates only to rates and annual charges both of which are charges against the land. However, councils can also charge fees for the provision of services which may be either business or non-business activities.

In relation to business activities (eg, abattoirs), the Local Government Act requires councils to set these charges in accordance with pricing principles adopted in its Management Plan. Most of these activities could be provided by another organisation on a competitive basis. IPART's review does not include the fees for these activities.

In relation to non-business activities (eg, giving information or providing a service in the exercise of its regulatory functions), councils are required to set the fees for these services inline line with factors set down in the Local Government Act. These charges are generally for the provision of services that councils provide on a monopoly basis. They can potentially provide an important source of revenue if rate revenue is capped.

Box 1.1 Rates, charges and fees

Rate - A tax on property which is for a local purpose and assessed and paid to local government. Under the Local Government Act, a rate may consist of:

a) an ad valorem amount (ie, an amount calculated according to the rateable value of the property), or

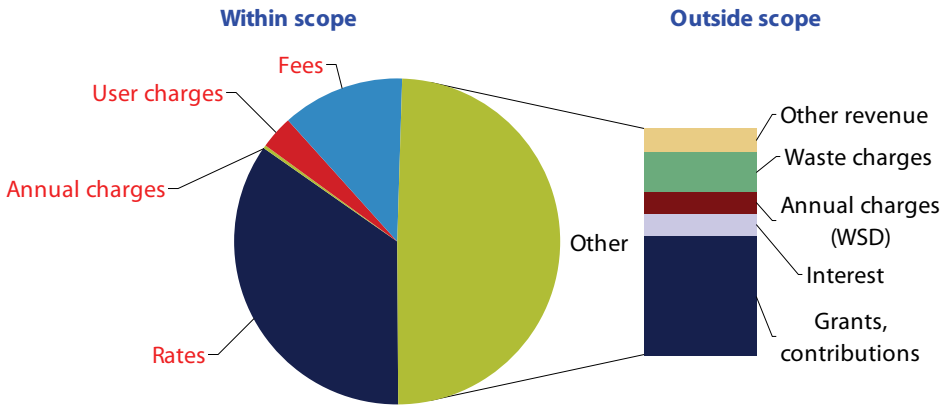
b) a base amount to which an ad valorem amount is added

Fees - A charge imposed by council for the provision of a service at the time of its use. This is charged to the user of the service and is not a charge against the land.

Annual charges - A charge levied by council on an annual basis for provision of services. These charges are levied against the land.

This regulatory framework is a control on council revenue but currently controls one revenue source only (ie, income from rates and certain annual charges). Due to the interrelationship between rates and charges, IPART considers that its review should include user charges for non-business activities in its scope for the review. Thus IPART will examine rate and annual charge revenue as well as revenue from user charges or fees. Figure 1.1 shows the sources of income and whether they are included in this review.

Figure 1.1 Review sources within scope for review



Note: Red text shows revenue included in review. WSD = water, sewerage and drainage.
Data source: DLG, unpublished data.

1.4 Criteria for assessing alternative regulatory frameworks

IPART's overall task in this review is to recommend a framework for regulating council rates and charges. In formulating its recommendation, IPART will need to assess the options for such a framework against the criteria for a good regulatory framework. IPART proposes that these criteria will include that the framework:

1. promotes the effective and efficient provision of local government services
2. enhances the financial sustainability of local government
3. meets the standard principles for good regulation and taxation, including:
   a) efficiency
   b) equity
   c) simplicity
   d) transparency
4. enhances the accountability of local government.

1.5 Overview of issues on which IPART seeks comment

In undertaking this review, IPART considers that there are a number of key questions in relation to the regulation of local government revenues that it would like stakeholders to address. These key questions are listed below. In addition, throughout the Issues Paper IPART has identified a number of subsidiary issues. These issues are listed in Appendix E.

1 What is the role of local government and how is it determined?

2 How effective is rate pegging and what are the implications for councils and ratepayers?

3 What are the objectives for a regulatory framework for local government revenues?

4 How does the current regulatory framework for council revenue, or any alternative framework:

- Promote the effective and efficient provision of services?
- Enhance the financial sustainability of local government?
- Meet the standard of principles for good regulation and taxation – efficiency, equity, simplicity, transparency?
- Enhance the accountability of local government?

5 What role should IPART play in setting local government rates and charges, including charges for non-business activities?

6 Should IPART have a determinative role provided by legislation or should IPART's role be limited to making recommendations, if and when requested by the Minister?

7 To what extent do government authorities - such as SHFA, SOPA, RWA and the GCCs - provide services that duplicate or overlap with those of local government?

8 What are the implications for local government rates where these authorities provide services normally provided by local government?

9 Should a common regulatory framework be introduced for these authorities?

1.6 Structure of this issues paper

This issues paper is intended to help stakeholders provide meaningful input into the review and to address the issues on which IPART seeks comment. The paper is structured as follows:

- Chapter 2 provides an overview of local government in NSW
- Chapter 3 discusses the role of local government
- Chapter 4 considers the revenue of councils
- Chapter 5 discusses the expenditure of councils
- Chapter 6 discusses the financial position and efficiency of councils
- Chapter 7 considers the framework for regulating local government
- Chapter 8 discusses the framework for regulating the public authorities.

2 Local government in NSW

After the Commonwealth Government and the State and Territory Governments, local government is the third tier of government in the Australian Federation. Local governments are characterised as general purpose governments, which are representative of and directly accountable to their local community.

Although local government has been in existence for more than 160 years, it is not recognised in the Australian Constitution. This means that the Commonwealth Government does not have legislative power with respect to local government. Rather, this power lies with the States and Territories (States),[9] and local government is established under individual State legislation.

The sections below provide an overview of local government in NSW, including the legislative framework, the sources of revenue, the key characteristics of local councils, and the forms of cooperation and partnerships between councils and other forms of government.

2.1 Legislative framework

Section 51 of the *Constitution Act 1902* (NSW) ensures that a system of local government exists in NSW. The *Local Government Act 1993* (NSW) (Local Government Act) provides the regulatory framework for Councils, their function, responsibilities and governance. The Local Government Act is administered by the Minister for Local Government through the Department of Local Government.

The Local Government Act was introduced to replace the previous *Local Government Act 1919*. The Local Government Act was intended to provide more local autonomy and flexibility, by being less prescriptive about councils' role and functions, while introducing greater public accountability and stricter regulation for corporate planning and reporting.

9 The term 'States' is used in this Issues Paper to encompass the activities of both States and Territories.

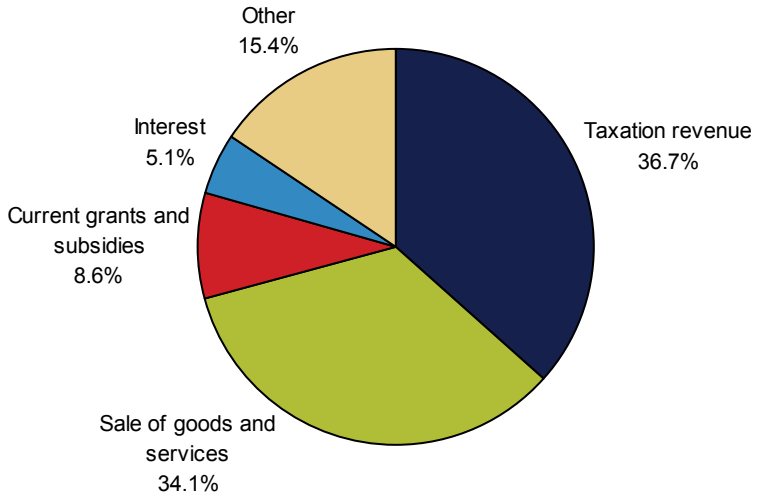
2.2 Revenue sources

Local councils in NSW have a number of revenue sources,[10] including:

- own-source taxation revenue (ie, council rates)
- the sale of goods and services (eg, user fees and charges, water and sewerage fees, fees for regulatory services and rental income)
- grants and subsidies from the NSW and Commonwealth Governments
- interest (ie, revenue from financial assets)
- other (including fines, contributions and donations).[11]

As Figure 2.1 indicates, in 2006/07 the bulk of NSW councils' revenue (86.3 per cent) came from their own taxes (or rates), sale of goods and services (eg, charges and fees), while less than 10 per cent came from grants and subsidies. This indicates that councils are reasonably self-sufficient.

Figure 2.1 NSW councils' sources of revenue, 2006/07



Data source: ABS, *Government Finance Statistics 2006-07*, Cat No 5512.0.

The Local Government Act allows for:

- Ordinary rates – councils are required to make and levy an ordinary rate for each year on all rateable land in its area (Box 2.1 lists land that is exempt from rates).
- Special rates – councils have the discretion to impose a special rate. Special rates may be levied for works or services provided or proposed to be provided or for other special purposes.

10 Section 491 of the Local Government Act sets out the main sources of a council's income. They are rates, charges, fees, grants, borrowings and investments.

11 This analysis is based on the operating statement which does not include items such as borrowings and asset disposals.

- Charges – councils may make and levy charges in relation to specified services provided by council (eg, water and sewerage services or the collection of garbage). Charges may be annual or based upon usage. A charge, when made, has the same characteristics as a rate concerning payment, accrual of interest and recovery of the charge.
- Fees – councils may charge a fee for any service it provides. Unlike charges fees are not a debt on the land and are recoverable through civil proceedings.

Box 2.1 Land exempt from rates

All land in a local government area is 'rateable' unless it is 'exempt from rating'.[12] The types of land exempt from all rates (under section 555) include:

- land held by the Crown, not being leased for private purposes
- land within a national park, historic site, nature reserve or state game reserve
- land subject to a conservation agreement
- land occupied by a church or another building used or occupied for public worship
- land occupied by a building used or occupied with religious teaching or training, or as a residence for a minister of religion
- land that belongs to and is occupied and used in connection with a school
- land that is within a special area for the Hunter Water Corporation or other water supply authority
- land that is vested in the NSW Aboriginal Land Council or a Local Aboriginal Land Council and is declared under Division 5 of Part 2 of the *Aboriginal Land Rights Act 1983* (this may also exempt land from all charges in some circumstances)
- land owned by the Rail Infrastructure Corporation
- land below the high water mark and used for any aquaculture relating to the cultivation of oysters.

Some land is exempt from all rates, other than those relating to water supply and sewerage service (section 556). However this land is not exempt from annual charges made under section 501. The types of land exempt under section 556 include:

- land that is a public place, common or public reserve
- land used as a public cemetery, public library, public hospital, college, university or mining rescue company
- land that belongs to and is used by a public benevolent institution or charity
- land belonging to the Sydney Cricket and Sports Ground Trust or the Zoological Parks Board.

No land is exempt from user charges made under section 502 of the Act.

Source: Department of Local Government, *Council Rating And Revenue Raising Manual*, 2007.

12 Local Government Act, section 554.

As Chapter 1 noted, each year the NSW Government sets the maximum amount by which councils may increase their annual general income (which is largely revenue from property rates, plus annual charges other than for water and sewerage charges and waste management charges).[13] Councils must set their rate levels and annual charges so their general income increases by up to this maximum amount, or apply for a special variation of the amount. Box 2.2 provides a general description of rate pegging.

Box 2.2 Rate pegging in NSW

Under the Local Government Act (Part 2 Limit of annual income from rates and charges) the Government may set a limit on the total amount of income that a council can raise from general income, ie, income from ordinary rates, special rates and annual charges. The Minister for Local Government may specify the percentage by which councils' general income for a specified year may be varied. This is called the rate peg percentage (See section 506 of the Local Government Act).

General income for these purposes does not include certain rates and charges such as special rates for water supply and sewerage, charges for water supply and sewerage services and annual charges for waste management and storm water management services. (See Section 505 of the Local Government Act for definition of general income.) It also excludes user charges, interest, grants, contributions and donation (eg, section 94 charges under the EP&A Act) or other revenues (eg, fines and business activities).

Rate pegging applies to a council's overall general income and not to rates on individual properties. Hence within rate pegging is it possible for some rates to increase by more than the rate peg limit while others may increase by less than the rate-peg limit. In some cases rates may decrease from the previous year. A council's rating structure and valuation changes are the main factors that will determine what happens to rates on an individual property. Rating structures may change significantly from year to year.

2.3 Contributions for public amenities and services within a local government area

Councils may also fund infrastructure within a development through developer contributions. The EP&A Act enables councils to impose monetary contributions as a condition of development consent subject to the regulatory framework provided in the Act and Regulations. Council may grant a development consent subject to a condition requiring the dedication of land free of cost and/or the payment of a monetary contribution ('direct contributions') where development will or is likely to require the provision of, or increase the demand for, public amenities and public services within the area. A council may impose a requirement that the applicant pay a levy of the percentage of the total cost of carrying out the development ('indirect

[13] Section 505 of the Local Government Act defines general income as income from ordinary rates, special rates and annual charges, other than for water and sewerage services and waste services.

contributions'). Council needs to authorise these charges by preparing a contributions plan.[14]

The NSW Government's Planning Reforms as contained in the *Environmental Planning and Assessment Amendment Act 2008* (the Amendment Act) make Councils accountable for ensuring that the key considerations for development contributions are complied with and establishes a two tier system for local council contributions. Councils can still levy for key community infrastructure as they do now.[15] The Amendment Act sets out the key community infrastructure which includes land, works and buildings.[16] The Amendment Act has not yet commenced and is expected to commence in stages.

The Amendment Act carries forward the existing powers of the Minister for Planning which enable the Minister to limit infrastructure contributions by kind, type or maximum amount and enhances powers which enable an additional contribution over and above the maximum amount in specified circumstances. It requires plans and timeframes for delivery of infrastructure items to be met and enables the Minister to direct Councils to use unspent contributions to provide infrastructure to communities within reasonable time frames.[17]

However it retains key provisions of the existing legislation to ensure that councils continue to obtain the full range of community infrastructure the former public amenities and public services subject to new accountability requirements. Also untouched by the Act is the range of infrastructure that the state can require for a contribution for in a State contributions area.

This review will not consider the impact of these changes other than to the extent that they impact on rate pegging. Beyond that these changes are outside the terms of reference for the review.

2.4 Council characteristics

There are currently 152 general purpose councils in NSW. This number has fallen over the years, largely due to structural reforms. For example, in 1910 there were 324 councils, but by July 1993 this number had fallen 177, due to voluntary mergers or compulsory amalgamations. By July 2001, it had fallen again to 172. In September 2003, the NSW Government began a further reform program aimed at achieving an appropriate structure for local government, and improving the efficiency and effectiveness of councils' service delivery. This resulted in 42 councils being dissolved and 22 new councils being established between February and September 2004, bringing the total number of local councils to the current 152.

14 EP&A Act, Section 94B.
15 EP&A Amendment Act 2008, see Division 2.
16 EP&A Amendment Act 2008, which amends the Environmental Planning and Assessment Regulation, Clause 31A.
17 EP&A Amendment Act 2008, Schedule 3, section 116L.

Councils differ significantly in the size and characteristics of the area they serve. For example, councils like Blacktown, Parramatta or Newcastle serve areas that are considered to be major cities in their own right, whereas large area rural councils, like Balranald or Bourke Shire, serve areas that are almost entirely agricultural.

In terms of the size of the area they serve, councils vary from 5.8 square kilometres (Hunters Hill Council) to 53,510.8 square kilometres (Central Darling Shire Council), with an average area of 4,658 square kilometres. About 25 per cent of all councils serve an area that is smaller than 200 square kilometres.

In terms of the population they serve, councils vary from less than 1,400 people (Urana Shire Council) to more than 280,000 people (Blacktown Council), with an average population per council of 44,560. NSW has the second largest average population per council of all States. In comparison, the average population per council across Australia is approximately 28,432, while the average per council in Victoria (which has the largest average population per council) is 62,774, and the average per council in the Northern Territory (which has the smallest average population per council) is around 3,016.[18]

In terms of the population density of the area they serve, NSW councils range from only five people per 100 square kilometre (Central Darling Shire Council), to about 6,600 people per square kilometre (Waverley Council in urban Sydney).

Table 2.1 summarises selected characteristics of local councils in NSW.

Table 2.1 Selected characteristics of NSW local councils, 2005/06

	Area (km^2)	Population (number of people)	Density (people/km^2)	Road Length[c] (km)
Minimum	5.8	1,389	0.045	0
Median	2,735	20,901	7.41	881
Average	4,658	44,560	688[a]	895
Maximum	53,511	283,458	6,624.8	3,245
Total	708,050	6,773,088	9.57[b]	143,782

a Average of population densities for all Councils.

b Average population density for all of NSW (ie, total population divided by total area).

c Length of road that local government is responsible for.

Source: Department of Local Government, *Comparative Statistics on New South Wales Local Government Councils*, 2005/06. DOTARS (2007), *Local Government National Report 2005-06*, Table 1.2.

As noted above, in 2004 the total number of councils in NSW fell by 20. This was largely due to the amalgamation of small to medium, rural and agricultural councils into larger jurisdictional units. Table 2.2 shows the number of councils serving a range of population sizes in 1997/98 and 2005/06 (ie, after these amalgamations took

18 Department of Transport and Regional Services (DOTARS), *Local Government National Report 2005-06*, Table 1.2, 2007.

place). The table shows that even after the amalgamations, nearly half of NSW councils serve populations of less than 20,000.

Table 2.2 Number of NSW councils serving different sized populations

Population served	Number of councils 1997/98	Number of councils 2005/06
Less than 5,000	48	26
5,000 to 10,000	30	27
10,001 to 20,000	24	20
20,001 to 50,000	32	33
50,001 to 100,000	24	26
100,001 to 150,000	11	7
150,001 to 200,000	6	11
More than 200,000	2	2
Total number of councils	177	152
Average population of councils	35,273	44,560

Source: Department of Local Government, *Comparative Statistics on New South Wales Local Government Councils*, 1997/98 and 2005/06.

The Terms of Reference require IPART to have regard to the differences between councils (eg, metropolitan versus rural, small versus large). A common categorisation of councils is the Australian Classification of Local Governments (ACLG) which classifies councils into 22 categories according to their socioeconomic characteristics and their capacity to deliver a range of services to the community. Box 2.3 describes the classification of councils.

Box 2.3 The Australian Classification of Local Governments

Councils are first classified as either urban or rural. Urban councils are then divided into four categories– capital city, metropolitan developed, regional town/city or fringe. Rural councils are divided into three categories – significant growth, agricultural or remote. The final classification step for both urban and rural councils is based on population eg, small, medium, large and very large.

Each council is given a numerical category and a three letter based alpha code. For example 2(UDS) means the council is urban, metropolitan developed and small and in category two.

DLG created 11 groups (identified by group numbers 1 to 11) by merging a number of the groups because of the small number of councils in them. As well, a few of the groups are not applicable to NSW as they have no members. For example, in the Urban category towns have been categorised in two population sub-categories (up to 70,000 and more than 70,000) instead of four. In the Rural category, the sub-categories of 'Significant Growth', 'Remote Extra Small' and 'Remote Small' are not applicable in NSW.

Note: The classification is explained in DLG, *Comparative Information 2005-06*, pp 11-12.

IPART notes that the Department of Local Government (DLG) puts NSW councils into 11 groups or categories instead of 22. This is because several of the ACLG categories contained either no NSW councils or only one or two councils. In this Issues Paper IPART has adopted the DLG classification of 11 categories and IPART intends to use this classification in its analysis for the review. However, for the analysis in this issues paper, councils have been further classified into five location-based categories as shown in Table 2.3.

Table 2.3 Classification for NSW local government councils by location

Classification	DLG Group Number
Sydney City	1
Metropolitan developed	2,3
Regional town/city	4,5
Fringe	6,7
Rural	8,9,10,11

Note: This classifications follows that used by Brooks, J, 2006, NSW *Local government revenue and expenditure analysis*, for the Independent Inquiry into the Financial Sustainability of NSW local government.

Source: DLG, Comparative Information, 2005/06.

IPART seeks comments on the following:

10 Is the Department of Local Government modification of the Australian Classification of Local Governments (ACLG) a suitable framework within which to consider the differences between councils?

2.5 Cooperation and partnerships between councils

Several ways in which councils cooperate with each other and with other tiers of government are increasingly being used in NSW. These include:

- Councils establishing cooperative partnerships with adjacent councils, commonly called Regional Organisations of Councils (ROCs), to pursue mutual benefits. Currently, there are 19 of these voluntary groups of councils in NSW, operating a variety of joint projects such as joint purchasing and resource pooling.
- Councils forming wider strategic alliances to operate a variety of joint projects, ranging from joint purchasing of assets to sharing the administrative services of specialist staff. For example, under the New England Councils' Strategic Alliance, the participating councils undertake joint tendering, and share core support functions and plant utilisation.
- Councils providing an industry superannuation fund and pooled insurance arrangements.
- Councils and the NSW Government establishing a number of formal and informal partnerships, in the form of bilateral, regional or state-wide arrangements under which councils are often represented by the Local Government and Shires Associations of NSW (LGSA).

Such forms of cooperation and partnerships are also an important trend internationally and elsewhere in Australia. In the UK, for example, councils are required to establish local strategic partnerships with a range of key stakeholders and service providers. In Tasmania, the State Government has entered into individual partnership agreements with all councils to pursue agreed priorities. Queensland, South Australia, Western Australia and the Northern Territory are all actively pursuing partnership approaches.[19]

[19] Independent Inquiry into the Financial Sustainability of NSW Local Government (Allan Inquiry), *Background and Issues Paper*, October 2005, pp 15-16.

3 What is the role of local government?

In reviewing the regulatory framework for setting council rates and charges, IPART will need to examine the role of local government, particularly in the delivery of infrastructure and services.

Several of the previous reports on local government (see Chapter 1) have included a discussion of this role, and IPART will consider the issues raised in these discussions, and progress made in addressing these issues, during its review. IPART will also have regard to any submissions made to previous reviews that are in the public domain, and welcomes further comments on the role of local government in submissions to this review.

The following sections provide a brief overview of the role of local government, the variations in the roles of councils across NSW, and the changes in the role of local government that have occurred in recent years.

3.1 Role of local government

While local governments have existed in Australia since 1840,[20] their role has expanded in recent years, and they now play an important role in the political and social life of Australian society.

In NSW, the *Municipalities Act 1858* established a system for the permissive constitution of municipalities leading to the establishment of 50 local government areas. These first local government structures initially delivered only property-based services - such as building and maintaining roads, and collecting and disposing of rubbish - and this remained the case for many years. However, as the Allan report noted, since the 1960s, there has been a marked shift in composition of the services provided by local government away from property-based services and towards human services.

[20] The Adelaide Corporation was created in 1840 and the incorporation of the City of Sydney and the Town of Melbourne followed two years later.

The Local Government Act contains a Charter to guide councils in carrying out their functions.[21] As part of this Charter, councils are required to:

- provide (either directly or on behalf of other levels of government) adequate, equitable and appropriate services and facilities for the community
- manage the assets for which they are responsible
- exercise regulatory functions, and
- raise funds for local purposes by the fair imposition of rates, charges and fees, and by income earned from investments.

The Local Government Act imposes few limitations on what services local government can provide.[22] Rather, its intention is to provide councils with the flexibility to provide services in response to the changing needs of their communities. Thus, to a large extent, an individual council's policy choices determine its role.

However, the provision of infrastructure and services is a critical part of this role. The extent to which councils fulfil this part of their role in an appropriate, equitable, effective, efficient and safe manner has significant implications for all citizens of NSW and for the broader national economy.

Currently, the 152 councils in NSW provide a diverse range of infrastructure and services to meet the diverse needs of rural, regional and metropolitan communities.

3.1.1 Infrastructure

The infrastructure provided by local government should effectively serve the needs and priorities of the community. Infrastructure commonly provided by councils includes:

- roads, pavements, traffic lights, bridges and other transport facilities
- stormwater and drainage systems
- libraries, sporting fields, town and community halls, and car parks
- childcare and aged care facilities.

In addition, councils in rural areas may also be responsible for infrastructure such as livestock sales yards, airports and caravan parks.

IPART notes that the Allan report found that to be most effective, a local council's provision of infrastructure should be confined to items that fall within the area it serves. The Allan report proposed that when a council provides regional infrastructure, it should either be compensated by neighbouring councils, or by a higher tier of government representing a wider constituency. For example, the

21 Chapter 3, Section 8, Local Government Act 1993.
22 Chapter 6, Section 24, Local Government Act 1993.

report specifically suggested that the State government should be responsible for regional roads, rather than rural councils.

3.1.2 Services

The Allan report drew attention to the model of fiscal federalism, which prescribes that each tier of government should provide services where the benefits fall within its jurisdictional area. Thus the Commonwealth Government should provide services with nationwide benefits; State governments should provide services with statewide benefits; and local governments should provide services with local benefits. In addition, each tier of government should finance its own service delivery through a mix of taxes, fees, charges and other levies, as it sees fit.

The services typically provided by local councils include those related to engineering, recreation, health, welfare, security, building, planning and development, administration, culture and education.[23] Some of these services are operated as commercial activities on a full cost recovery basis, rather than as services funded from rates or other general revenue. Examples include water and sewerage services and, in some instances, garbage services, and some leisure and recreational activities.

3.1.3 What is the appropriate role for local government?

IPART is interested in better understanding and defining the appropriate role of local government. It notes that the Allan report described two distinct views of this role. The first, a minimalist view, holds that councils are the 'body corporate' of a local community and thus should foster the community's common property and regulate what property owners may do with their properties. The second, a maximalist view, holds that each council is the government of the area it services, and thus should be concerned with the welfare of the whole community in this area, even if this means duplicating the roles of other tiers of government.

It has been argued that the Local Government Act, particularly the Charter included in this Act, reflects a maximalist position, but that the rate pegging approach used to regulate rates and charges constrains councils' revenues and thus may limit the capacity of local government to provide a wider range of services.[24]

IPART seeks comment on the following issues

11 How does the current regulatory framework impact on the efficiency of rate setting by councils?

12 What is the current role of Local Government and its limits? Where does this role come from? Is it self imposed or is it legislated?

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23 House of Representatives, *Rates and Taxes: A Fair Share for Responsible Local Government*, p 6.
24 Allan Report, p 12.

13 What should be the limits on the role of local government?

14 What infrastructure and services do councils currently provide?

15 What infrastructure and services should councils be responsible for?

16 To what extent is there overlap with other levels of government?

3.2 Variations in the role of councils

Each council in NSW provides a different combination of infrastructure and services, and different service levels. Each also faces different circumstances and financing pressures. Thus they are likely to be differently affected by the approach used to regulate council rates and charges.

One notable difference is in the roles and responsibilities of rural and metropolitan councils. For example:

- Rural councils often serve a large geographic area with a low population density and substantial road networks. Many rural councils are also responsible for providing water and drainage services. This means they have small rating base from which they must fund significant infrastructure maintenance and renewal costs. In contrast, most metropolitan councils serve smaller areas with high population densities, less substantial road networks and no responsibility for providing water and drainage services.
- In relation to the provision of social or cultural facilities, such as libraries and sporting fields, rural councils with small populations are likely to have less wear and tear on these facilities, which may lower the total costs of provision. However, they may also be required to provide multiple facilities across a large geographic area to serve scattered communities, and this may increase the total costs per capita. In contrast, metropolitan councils with large populations are able to provide larger, concentrated facilities at a lower cost per capita, but the higher level of usage may increase the total costs of provision.
- In relation to access to skilled staff, rural councils can face difficulties in attracting skilled infrastructure managers. Rural councils are concerned that their capacity to provide infrastructure is further compromised by workforce shortages.

In addition, rural councils situated far from major centres often provide services previously supplied by Commonwealth and State Government bodies. For example, rural councils in NSW now operate or provide space for aged care facilities, airports, banking services, Centrelink agencies and postal services and even provide surgeries and accommodation for doctors and nurses involved in general practice.[25] IPART notes that the size of councils necessarily influences the viability of providing such services and is interested in investigating whether economies of scale may exist with regard to the provision of particular services.

25 Allan Report, p 152.

Another notable difference is in the roles and responsibilities of councils in growth areas and those in established areas. Councils serving areas where the population is growing often have more variety of new and old infrastructure, with new infrastructure being funded to some extent through developer contributions. Councils serving areas with 'static' or declining populations have greater concentrations of existing, ageing infrastructure.

IPART is particularly interested in examining evidence of variation in the service levels provided by different councils.

IPART seeks comments on the following:

17 To what extent do service levels vary between councils in their scope, value and quality of infrastructure and other assets?

18 What factors cause differences between councils provision of infrastructure and services to arise?

19 To what extent are ratepayers satisfied that Councils provide services that are appropriate and delivered effectively and to acceptable standards?

3.3 Recent changes in the role of local government

Many aspects of local government infrastructure were originally funded and built by other tiers of government. However, ownership – and thus responsibility for maintenance and renewal – of roads, public buildings, and drainage and water systems were transferred to councils with the passage of the *Local Government Act (NSW) 1919*.

Since then, ongoing changes to the responsibilities and activities of local government have resulted in more infrastructure being transferred to NSW councils. Most recently, in 1995, the responsibility for regional roads was passed from the State Government to local government.[26]

In its review of the *Local Government Financial Assistance Act 1995* (Commonwealth), the Commonwealth Grants Commission found that the composition of local government expenditure had changed, reflecting the shift away from providing property-based services to human services. In particular, there was an increase in the relative importance of expenditure on recreational and cultural services, housing and community amenities, and education, health welfare and public safety services.[27] Box 3.1 sets out the activities that make up the functional categories.

26 Allan Report, p 115.
27 Rates and Taxes: A Fair Share for responsible Local Government, p 10.

Box 3.1 Classification of local government functions

ADMINISTRATION

Corporate Support, Engineering & Works

PUBLIC ORDER & SAFETY

Contributions to Fire Service Levy, Fire Protection – Other, Animal Control, Beach Control, Enforcement of Local Govt Regs, Emergency Services

HEALTH

Administration & Inspection, Immunisations, Food Control, Insect/Vermin Control, Noxious Plants, Health Centres

COMMUNITY SERVICES &EDUCATION

Administration, Family Day Care, Child Care, Youth Services, Other Families & Children, Aged & Disabled, Migrant Services, Aboriginal Services, Education

HOUSING & COMMUNITY AMENITIES

Housing, Town Planning, Domestic Waste Management, Other Waste Management, Street Cleaning, Other Sanitation & Garbage, Urban Stormwater Drainage, Environmental Protection, Public Cemeteries, Public Conveniences, Other Community Amenities

RECREATION & CULTURE

Public Libraries, Museums, Art Galleries, Community Centres, Public Halls, Other Cultural Services, Swimming Pools, Sporting Grounds, Parks & Gardens (Lakes), Other Sport & Recreation

MINING, MANUFACTURING & CONSTRUCTION

Building Control, Abattoirs, Quarries & Pits, Other

TRANSPORT & COMMUNICATION

Urban and Rural Roads and bridges, Footpaths, Aerodromes, Parking Areas, Bus Shelters & Services, Water Transport, RTA Works (State), Street Lighting, Other

ECONOMIC AFFAIRS

Camping Areas, Caravan Parks, Tourism & Area Promotion, Industrial Development Promotion, Saleyards & Markets, Real Estate Development, Commercial Nurseries, Other Business Undertakings

Source: DLG

Recent research by Proteus Management Group in 2006 for the Allan Inquiry suggests that there have been further changes in local government expenditure since 1995/96:[28]

- the fastest growing areas of expenditure have been housing and community amenities (87.6 per cent), public order and safety[29] (79.2 per cent), and economic affairs (75.5 per cent)
- expenditure on transport and communications (largely road maintenance and depreciation, though not necessarily renewal) increased markedly in 1996/97 (70.1 per cent), but has stabilised since then, and
- expenditure on health (8.7 per cent) and mining, manufacturing and construction[30] (7.0 per cent) have decreased in real terms (the CPI has risen 20.9 per cent over the same period).

IPART seeks comment on the factors influencing the changing role of Local Government and any anticipated future changes.

20 What demographic, intergovernmental, economic, social, technical and environmental changes are affecting Councils now and their future revenue requirements?

28 Proteus Management Group, *NSW Local Government Revenue and Expenditure Analysis*, p 21.

29 The ABS classifies public order and safety as including police, fire and other emergency services. For councils this includes enforcement of council regulations, eg animal control and parking.

30 These are standard industry classifications. Mining, manufacturing and construction is combined – IPART notes that local government is not involved in mining and manufacturing, but is responsible for building control, abattoirs and quarries and pits.

4 Councils' Revenue

To effectively fulfil their role and functions, local councils need an adequate revenue base. The sections below discuss the sources and composition of NSW councils' revenue, variations in the capacity of councils to raise revenue, and how the composition of councils' revenue has changed in recent years.[31]

4.1 Sources of revenue

Local councils in NSW obtain their revenue from four main sources:

1. council rates (taxes levied on property owners, and calculated on the basis of land value)
2. user charges and fees (mainly for services and infrastructure provided)
3. grants and subsidies from the Commonwealth Government (in the form of Financial Assistance Grants and Specific Purpose Payments[32] and the NSW Government (in the form of financial grants for specific purposes and services)
4. revenue from council business activities, interest income, dividends and fines.

Local councils are empowered through state legislation to raise revenue through rates, but are not able to impose any other form of taxation. Within the constraints of rate pegging, councils are able to adjust the level and composition of their rates revenue, by altering the percentage rate in the dollar applied to the rateable property and the structure of rates. (The structure of rates often comprises a fixed charge, and a variable charge based on the land value.) However, councils ability to increase their overall level of rates revenue in any year is constrained by rate pegging (discussed in detail in Chapter 7).

The legislative and regulatory framework also enables councils to raise revenue through user fees and charges, interest, fines and other penalties. In general, councils are able to levy a wide range of fees and charges, including service and utility charges, regulatory fees and other fees for service. The levels of some charges are statutorily set, however most are discretionary. The requirements of National Competition Policy (NCP) can constrain a council's ability to raise revenue through fees and charges for significant business activities, where these charges are required

31 Where possible, the latest relevant figures have been used in discussion of the issues, however IPART notes that updates will be necessary as new data become available.

32 Pursuant to the Local Government (Financial Assistance) Act 1995 (Commonwealth).

to be set on the basis of recovering full cost (competitive neutrality) or where prices are subject to price monitoring.

Councils can earn interest income from cash investments, securities and other financial assets. They are permitted to invest in Commonwealth or State Government securities, or a financial institution that is approved or guaranteed by the State. They may also finance activities through borrowings. Previously, NSW Treasury had imposed global borrowing limits on the aggregate borrowings of all NSW councils. This arrangement ceased several years ago. In 2007, the administrative requirement for Ministerial approval of proposed loans by councils also ceased. However, the Department of Local Government is still required to include the aggregate borrowings of councils in its annual Council Loan Reporting Returns to NSW Treasury.

4.2 Composition of revenues

In 2006/07, local councils in NSW had total revenues of $7.5 billion, up from $7.1 billion the previous year (see Table 4.1). This was higher than the total revenue of all other states except Queensland.

Most of the revenue (86.3 per cent) was own-source (ie, taxation (or rates revenue), sales of goods and services (or user fees and charges) and interest). Only 8.6 per cent was from grants and subsidies, which indicates a considerable level of self sufficiency overall. Most of the revenue from grants and subsidies was from the Commonwealth Government, in the form of general purpose grants, local roads grants and specific purpose payments.

There are significant variations in the revenue sources collected by local government in different states. There tends to be an inverse relationship between taxation revenue and revenue obtained from the sale of goods and services. The states with greater reliance on taxation revenue, (South Australia (57.9 per cent), Victoria (47.2 per cent) and Western Australia (43.5 per cent)) collected less revenue from the sale of goods and services, whereas the states with less reliance on taxation revenue, (Tasmania (32.2 per cent) and Queensland (26.0 per cent)) obtained greater revenue from the sale of goods and services. NSW local government, which is subject to rate pegging, is close to the average, with a relatively even split in terms of its reliance on either revenue source.

IPART notes that the data includes revenue from councils' water and sewerage operations. However, this is a local government function in some States (eg, Queensland and in non-metropolitan NSW) but not in Victoria, South Australia or Western Australia.

Table 4.1 Local government revenue sources by State, 2006/07 ($m)

Source	NSW	VIC	QLD	WA	SA	TAS	NT	TOTAL
Taxation revenue	2,768	2,502	2,003	1,001	833	218	63	9,388
	36.7%	47.2%	26.0%	43.5%	57.9%	32.2%	15.9%	37.0%
Sale of goods and services[a]	2,574	1,036	2,888	516	266	276	71	7,627
	34.1%	19.5%	37.4%	22.4%	18.5%	40.8%	18.0%	30.1%
Current grants and subsidies [b]	649	589	484	197	178	80	160	2,337
	8.6%	11.1%	6.3%	8.6%	12.4%	11.8%	40.5%	9.2%
Interest [c]	387	78	170	97	25	24	9	790
	5.1%	1.5%	2.2%	4.2%	1.7%	3.6%	2.3%	3.1%
Other [d]	1,165	1,096	2,171	490	137	78	92	5,230
	15.4%	20.7%	28.1%	21.3%	9.5%	11.5%	23.3%	20.6%
Total	7,542	5,301	7,715	2,302	1,439	676	395	25,372

[a] Revenue from the direct provision of goods and services by general government and public corporations. This category includes user fees and charges, water and sewerage fees, fees for regulatory services, rental income, and revenue for acting as an agent on behalf of other levels of government.

[b] Grants and subsidies include revenue received from the voluntary transfers by governments and other entities.

[c] Interest and dividend income includes revenue derived from owning financial assets, such as interest on bank account balances and government securities.

[d] Other income includes all revenue which is not in the other three categories. This includes fines, contributions and donations.

Source: ABS, *Government Finance Statistics 2006-07*, Cat No 5512.0.

4.3 Variation in Councils' ability to raise revenue

Councils' capacity to raise revenue varies significantly, due to the diversity in the size and other characteristics of local government areas in NSW (see section 2.4). For example, the amount of revenue a council can raise through rates and user charges is determined by population of the area it serves, the economic activity and rating base in this area, and its own ability/willingness to impose user charges.

Table 4.2 compares the composition of Sydney City's revenue with each of the four different categories of local government areas (ie, metropolitan developed, regional town/city, fringe and rural). This comparison shows significant variations in the importance of different revenue sources. Rural councils tend to have a high dependence on grants revenues and lower dependence on rates revenue. There is also a higher reliance on contributions and donations in the developing fringe and regional towns. On the other hand, metropolitan developed and fringe councils rely more on rates and annual charges. Notably, Sydney City also has a substantial reliance on other revenues (which includes fines, external works and business activities), accounting for approximately 20 per cent of revenues. Figure 4.1 shows the composition of revenue for 2006/07 by council category.

Table 4.2 Composition of local government revenue by council category, 2006/07 (%)

Classification	Rates & annual charges[a]	User charges & fees	Interest Revenue	Grants	Contributions and Donations	Other Revenue [b]
Sydney City	53.2	17.2	7.1	2.3	0.5	19.7
Metropolitan developed	60.6	15.6	5.1	10.8	1.3	6.5
Regional town/city	45.5	25.4	6.4	16.2	3.0	3.5
Fringe	58.2	17.1	5.6	12.1	2.6	4.4
Rural	39.9	21.9	5.5	22.4	4.5	5.8
NSW total	51.4	19.9	5.8	14.4	2.6	6.0

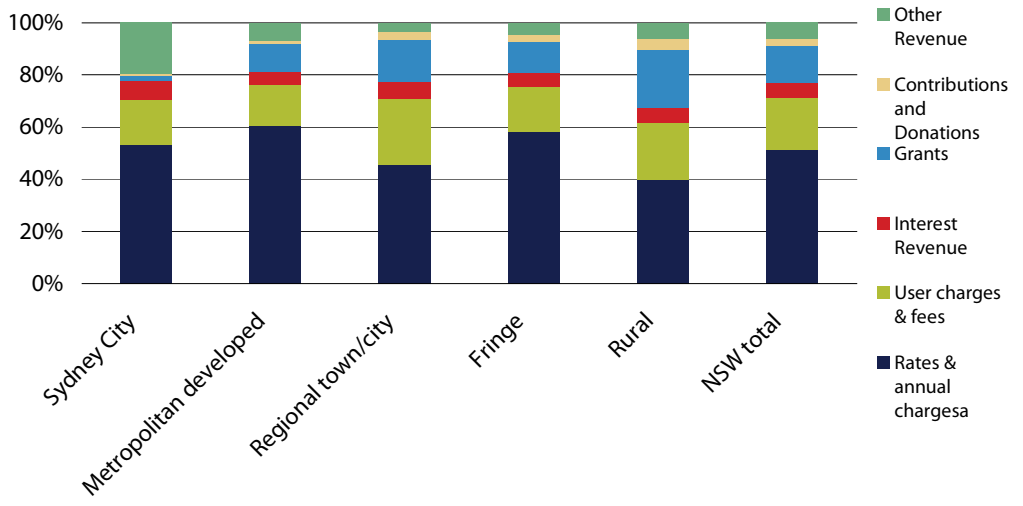
a Excludes water, sewerage and drainage.

b Includes fines, external works, and business activities.

Note: Total may not add due to rounding.

Source: DLG, unpublished data.

Figure 4.1 NSW Local government revenue distribution 2006/07



Note: Rates and annual charges excludes water, sewerage and drainage.

Data source: DLG, unpublished information.

IPART seeks comments on the following:

21 What are the implications of the different revenue sources and revenue raising capacities for rate pegging or alternative regulatory frameworks which may be proposed?

4.4 Changes in the composition of council revenue

Table 4.3 shows the changes in the composition of NSW local government revenues over the period 1997/98 to 2006/07. The rates component as a proportion of councils' total ordinary revenue was stable at around 48 per cent with little variation from year to year, which may reflect the constraint of rate pegging. There were slight declines in the revenues from user charges, and grants and contributions and donations as a proportion of total ordinary revenue, and an increase in other operating revenues (see also Figure 4.2).

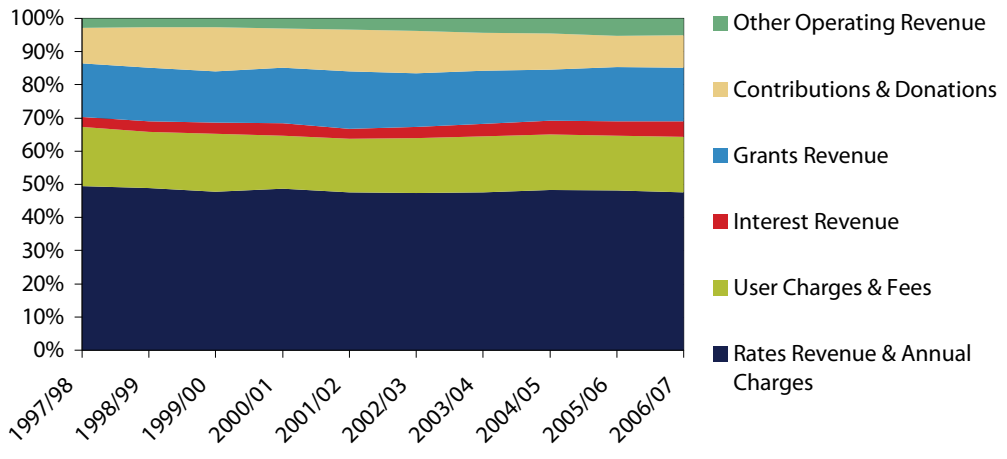
Table 4.3 Composition of NSW local government revenues, 1997/98 to 2006/07 (%)

	Rates & annual charges	User charges & fees	Interest Revenue	Grants	Contributions and Donations	Other Revenue
1997/98	49.5	17.8	3.0	16.2	10.7	2.7
1998/99	48.9	17.0	3.1	16.1	12.3	2.7
1999/00	47.7	17.5	3.4	15.5	13.3	2.7
2000/01	48.7	16.0	3.7	16.8	11.9	3.0
2001/02	47.5	16.2	3.0	17.3	12.7	3.3
2002/03	47.3	16.7	3.4	16.2	12.7	3.8
2003/04	47.6	16.8	3.8	16.0	11.5	4.2
2004/05	48.3	16.7	4.2	15.3	10.8	4.6
2005/06	48.2	16.5	4.2	16.4	9.5	5.2
2006/07	47.6	16.6	4.8	16.1	9.8	5.1

Note: Includes water and sewerage, grants and contributions include capital amounts. Total may not add due to rounding.

Source: DLG comparative statistics, DLG unpublished data.

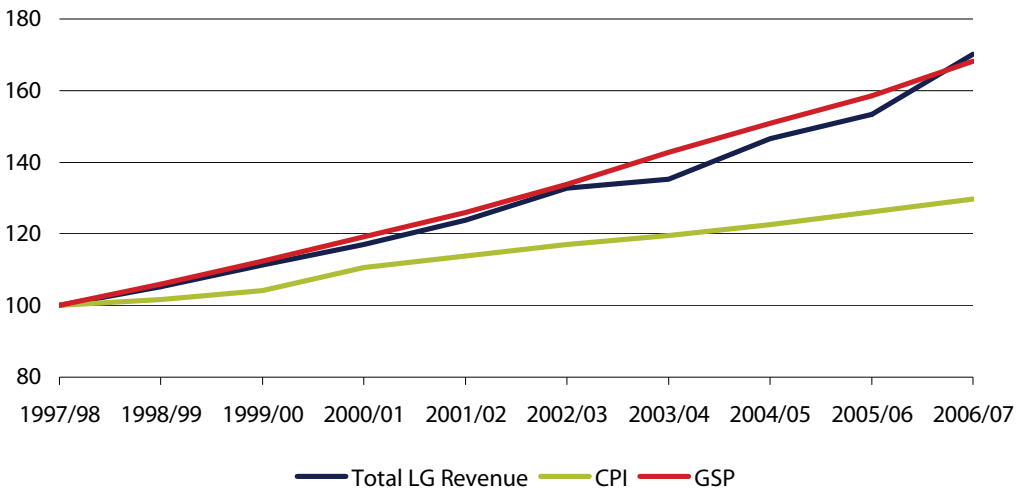
Figure 4.2 Composition of NSW local government revenues, 1997/98 to 2006/07



Data source: DLG, Comparative information, 1995/96 to 2005/06, DLG Data, unpublished.

Figure 4.3 compares the growth in NSW total revenues (excluding water and sewerage), CPI and GSP over the period 1997/98 to 2006/07. Total revenue has grown in excess of CPI growth for the whole period. Total revenue grew in line with GSP from 1997/98 to 2002/03 and then fell further below up to the 2004/05 year, where total revenue growth moved back in line with GSP growth and in 2006/07 total revenues was greater than GSP growth.

Figure 4.3 Total Revenues-Comparative Growth 1997/98 to 2006/07



Note: Base Year is 1994/95.

Data source: DLG Comparative information 1994/95 to 2005/06; ABS Cat No. 5220; ABS Cat No. 6461, DLG data.

Table 4.4 shows the changes in the composition of NSW councils' revenue over the nine years from 1998/99 to 2006/07, as well as changes in the key economic indicators. The table indicates that per annum, councils' ordinary (or total) revenue rose by 5.5 per cent over this period in nominal terms. This is less than the 6.2 per cent increase in ordinary revenue excluding water and sewerage. NSW Gross State Product (GSP) rose by 6.0 per cent, while the Consumer Price Index (CPI) for Sydney rose by just 3.1 per cent per cent. Revenue from rates and annual charges, user fees and charges and total grant income rose more or less in line with ordinary revenue. In contrast, interest income and other income (including fines and contributions) rose by 11.4 per cent and 14.3 per cent respectively, while contributions and donations rose by 2.6 per cent.

In terms of real changes over this period, (ie, changes after discounting for inflation as measured by the CPI), councils' total ordinary revenue rose by 2.4 per cent, while ordinary revenue excluding sewerage and water rose by 3.0 per cent. In comparison, NSW GSP rose by 2.5 per cent per annum, and NSW and Commonwealth Government revenues rose by 0.1 and 4.9 per cent per annum respectively.

Table 4.4 Changes in composition of NSW Local Government Revenue, 1998/99 to 2006/07, %

	Nominal Change	Real Change	Nominal Change per annum	Real Change per annum
Ordinary revenue (excluding water and sewerage)	61.8	26.8	6.2	3.0
Ordinary revenue (total)	53.7	20.5	5.5	2.4
Rate revenue and annual charges	49.6	17.3	5.2	2.0
User charges and fees	50.4	17.9	5.2	2.1
Grant income	53.7	20.5	5.5	2.4
Contributions and donations	23.2	-3.4	2.6	-0.4
Interest	137.8	86.5	11.4	8.1
Other	192.2	129.1	14.3	10.9
Consumer Price Index (CPI) Sydney	27.6	na	3.1	na
Gross State Product (GSP)	58.8	21.5	6.0	2.5
Gross Domestic Product (GDP)	72.2	35.0	7.0	3.8
NSW State Govt. revenue	28.3	0.6	3.2	0.1
Commonwealth Govt. revenue [a]	87.4	46.9	8.2	4.9
Implicit Price Deflator (GDP)	27.5	na	3.1	na
Implicit Price Deflator (GSP)	30.7	na	3.4	na

[a] Includes GST.

Note: Base year 1998/99.

Source: CPI, ABS Cat No. 6401; GSP, ABS Cat No 5220; GDP, ABS Cat No. 5204; NSW State and Commonwealth Rev, ABS Cat No 5506, LG revenues, DLG comparative information and unpublished data, calculated.

Council rates and annual charges

Over the period 1998/99 to 2006/07, NSW local government rates revenue has grown faster than the CPI but less than GSP. The growth of NSW rates revenue over this period has been less than that of the Commonwealth Government. Real income received from rates and annual charges over the same period increased by 2.0 per cent. Factors which may have led to changes in rates and annual charges apart from the approved general rate increase include special variations, supplementary

valuations, additional rateable properties and increases in unpegged rates and charges such as water, sewerage and domestic waste management.

User fees and charges

Over the period 1998/99 to 2006/07 total user charges revenue has grown more than CPI growth (Table 4.4) but in line with the growth in rates and charges. User fees and charges is an area that has experienced significant growth in the past few decades. In the 1970s, fees and user charges comprised 13 per cent of total revenue. With the increase in the number, and diversity, of services offered by local government this revenue source has now grown to around 20 per cent. Sales of goods and services typically include development applications and approvals and use of recreation and cultural facilities. In many jurisdictions the state government sets statutory limits on the fees and charges for these types of services, particularly in relation to development applications and consents.[33]

General purpose grants

General purpose grants revenue has grown at a rate less than CPI and GSP growth for the period from 1998/99 to 2006/07.

IPART seeks comments on the following:

22 What scope is there for councils to make greater use of user charges?

23 To what extent has the control of rates revenue under the rate pegging regime limited overall revenue growth or encouraged greater use of non-rate revenue?

[33] PricewaterhouseCoopers, 2006, *National Financial Sustainability Study of Local Government*, commissioned by the Australian Local Government Association, p 52.

5 Councils' Expenditure

As Chapter 3 discussed, the role of local government has expanded in recent years shifting away from the provision of traditional property-based services towards human services. This changing role is likely to have led to changes in the overall level and composition of councils' expenditure. If councils are to effectively play an increased role in providing infrastructure and services, they will need an adequate revenue base to remain financially sustainable.

The following sections outline the composition of councils' expenditure at the State level, and variations in the composition of NSW councils' expenditure based on council category. The subsequent sections discuss the changes in councils' expenditure for different purposes and future growth in expenditures.

5.1 Composition of Councils' expenditure

In 2006/07 total expenditure by local government in NSW was around $6.9 billion (see Table 5.1). The most significant areas of expenditure were general public services, housing and community amenities, and transport and communication. NSW and Queensland have the highest expenditure on general public services respectively, which is more than double the expenditure of Victoria. Victoria spends considerably more on education, health, and welfare than the rest of the states. These differences reflect the diversity in local government's role, responsibilities and priorities across the states.

Table 5.1 Local government expenditure by purpose, by State, 2006/07 ($m)

Purpose	NSW	VIC	QLD	WA	SA	TAS	NT	TOTAL
General public services[a]	1,683	601	1,511	222	179	95	84	4,376
% of total	24.3	12.5	25.1	11.2	13.2	15.3	21.5	19.8
Public order and safety	223	109	103	66	21	7	3	532
% of total	3.2	2.3	1.7	3.3	1.6	1.1	0.8	2.4
Education, health and welfare	411	882	93	137	112	33	20	1,691
% of total	5.9	18.3	1.5	6.9	8.3	5.3	5.1	7.7
Housing and community amenities	1,489	924	1,840	306	280	227	106	5,172
% of total	21.5	19.2	30.6	15.4	20.7	36.5	27.1	23.4
Recreation and culture	899	853	574	459	239	71	30	3,126
% of total	13.0	17.7	9.5	23.2	17.7	11.4	7.7	14.1
Transport and communications	1,353	927	1,387	616	297	135	36	4,752
% of total	19.6	19.3	23.1	31.1	22.0	21.7	9.2	21.5
Other[b]	860	515	508	174	224	52	112	2,447
% of total	12.4	10.7	8.4	8.8	16.6	8.4	28.6	11.1
Total	6,919	4,812	6,016	1,982	1,353	622	391	22,096

a General public service includes legislative and executive affairs; financial and fiscal affairs, external affairs, foreign economic aid, general research, general economic and social services, general statistical services, and government superannuation benefits.

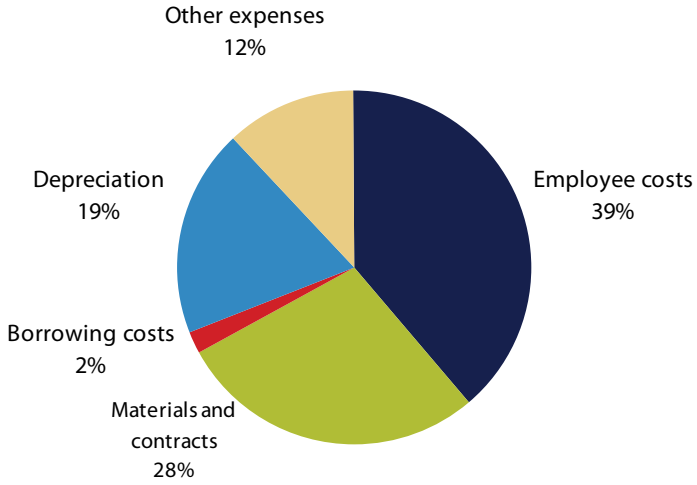
b Other includes the categories fuel and energy, agriculture, forestry and fishing, mining, manufacturing, & construction, other economic affairs, public debt and other.

Note: These figures do not include capital outlays, mainly on roads.

Source: ABS, *Government Finance Statistics 2006-07*, Cat No 5512.0.

When NSW councils' total expenditure for 2006/07 is broken down by administrative function, employee costs account for 39 per cent of local government expenses. Other components are 28 per cent for materials and contracts, 19 per cent for depreciation, 12 per cent for other expenditure and 2 per cent for borrowing costs (see Figure 5.1). These values are for 2006/07 and are aggregated across NSW councils. However, this breakdown will also vary between individual councils.

Figure 5.1 Composition of council expenses 2006/07



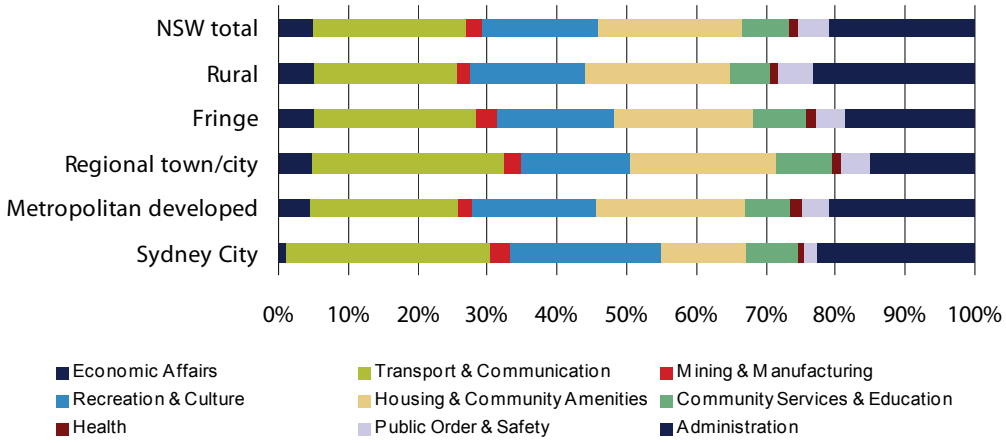
Data source: DLG, unpublished data.

5.2 Variations in councils' expenditure, by council category

Given the diversity of their roles and activities, the composition of councils' expenditure varies significantly by council category, and also within council categories. Figure 5.2 compares the composition of Sydney City Council's operating expenditure with the composition for council's within each of the four categories of councils and NSW in aggregate for 2006/07. This comparison indicates:

- Rural councils' expenditure on administration is relatively high, while the expenditure of fringe and regional town/city councils on administration is a much lower proportion of expenditure.
- Most councils spend more than 20 per cent of their expenditures on transport and communications, reflecting the importance of road construction and maintenance for this category of councils.
- Sydney City Council has markedly different patterns of expenditure than other councils, with higher expenditure on administration and transport and communication, and lower spending on housing and community services.
- Fringe, metropolitan developed and regional town/city councils have relatively higher expenditure on housing and community amenities.
- Across all categories of council, the relative expenditure on health is low.

Figure 5.2 NSW local government expenditure distribution, by council category 2006/07



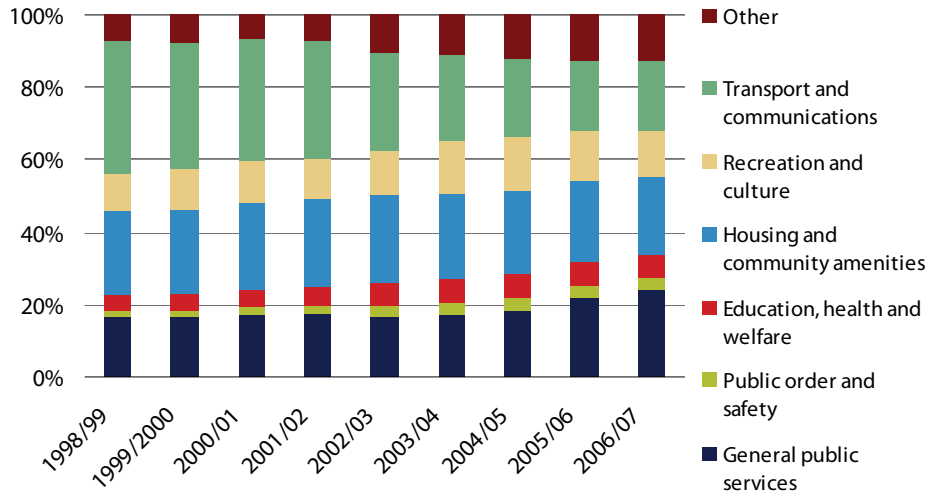
Note: Excludes expenditure on water and sewerage services.

Data source: DLG, unpublished data 2006/07.

5.3 Changes in Councils' expenditure

Figure 5.3 shows the expenditure by NSW councils by purpose since 1998/99. Over this period, councils' expenditure on general public services has increased from 16.7 per cent to 24.3 per cent of total expenditure, while expenditure on transport and communications has declined from 36.0 per cent to 19.6 per cent.

Figure 5.3 NSW Expenditure by purpose 1998/99 to 2006/07



Data source: ABS, *Government Finance Statistics 2006-07*, Cat No 5512.0.

The level of debt among NSW councils is low, with net borrowing in 2006/07 of $199m.[34] These low levels of debt raise concerns on the intergenerational equity of local government projects, particularly long-lived infrastructure and environmental assets.

Low levels of borrowings can be inappropriate where projects are funded through rate increases and thus current ratepayers bear the costs of the benefits of future users. Debt financing, however, allows the cost of such projects to be shared between present and future generations. Increasingly the use of debt financing would, however increase levels of financial risks. This may be of concern to the community and state and local government. Local government must seek ministerial approval prior to entering a contractual arrangement to borrow among other restrictions (see Box 5.1)

Box 5.1 NSW Local government borrowing restrictions

Section 621 of the Local Government Act enables councils to borrow at any time for any purpose under the Act while Section 624 empowers the Minister to impose limitations or restrictions on borrowings raised by a council. The restrictions on borrowings by council are included in the Ministers Borrowing Order. Currently, the order specifies that councils shall not:

- borrow at an interest rate in excess of the indicative interest rate as calculated by the NSW Treasury Corporation
- borrow for a period of less than (30) days nor for a period in excess of the estimated life of the asset for which the borrowing is made
- borrow from any source outside the Commonwealth of Australia nor in any currency other than Australian currency
- pay a placement fee exceeding 0.25% of the total amount being borrowed
- pay a documentation fee, or any other fee associated with borrowing, exceeding 0.1% of the total amount being borrowed.

The general manager is also obliged under clause 230 of the Local Government (General) Regulation 2005 must within 7 days after the council borrows money under a loan contract the general manager must notify the Director General of the Department of Local Government of the details of the borrowings.

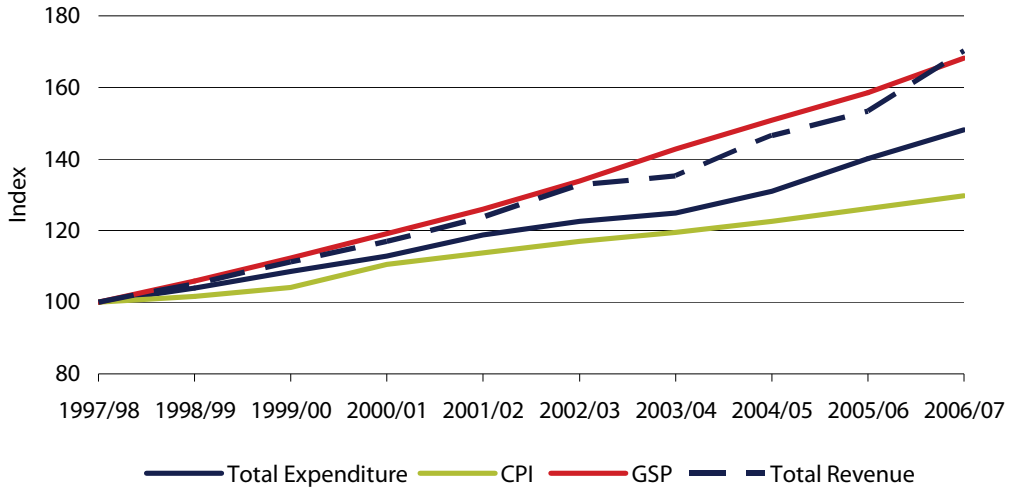
Source: Department of Local Government, 2007, Council Rating and Revenue Raising Manual.

Figure 5.4 compares the growth of local government's total operating expenditure and total revenue with changes in Sydney CPI and GSP between 1997/98 and 2006/07. The figure shows that councils' operating expenditure grew by more than the change in CPI, but less than GSP. Total revenue growth kept pace with GSP over the period. Total revenue was just below GSP from 1997/98 to 2002/03. From 2002/03 to 2005/06 total revenue growth began to fall further below GSP, however,

34 ABS *Government Finance Statistics 2006-07*, Cat No. 5512.

by 2006/07 total revenue was above GSP. Councils' total revenue also grew by more than CPI. Councils' revenue growth remained above the growth in expenditures over the period, with the gap increasing.

Figure 5.4 Growth in NSW councils' total expenditure and revenue compared to changes in CPI and GSP 1997/98 to 2006/07



Note: Total revenue and total expenditure excludes water and sewerage.
Data source: DLG comparative information, DLG unpublished information.

5.4 Future expenditure growth

Future changes in expenditure have important implications for the financial viability of NSW councils. Even if councils' current financial position was comfortable, it is likely that foreseeable growth in their expenditure base over the long-term may affect their financial viability.

A council's future financial requirements are determined by the costs of continuing to provide current services and implement current policies and by the cost of providing additional services and functions to meet changing needs. Therefore, it is important to consider:

- The likely impact of additional functions and spending pressures.
- Expected growth in input costs.
- Expected growth in per capita demand for services.

IPART seeks comments on the following:

24 To what extent are local governments' expenditure requirements likely to grow in the future?

25 What are the implications of this expenditure growth for rate pegging or alternative regulatory frameworks proposed by submitters?

6 Councils' financial position and efficiency

The financial performance and long-term financial position of local councils is vital to the interests of ratepayers, local communities and the State. A council's financial performance and thus financial position essentially depends on the balance between its revenues and expenditures over the longer-term. The information presented in Chapters 4 and 5 provides some evidence on councils' revenues and expenditures to inform submitters on the overall financial position of local government, now and in the future. It is also noted that, previous research on local governments at the state level, for example the Hawker Report (2003) and the Allan Report (2006) found that a significant proportion of NSW councils are facing financial difficulties.[35]

The section below discusses NSW councils' recent performance against a selection of indicators of financial performance. The subsequent sections discuss some of the factors that influence councils' current financial performance and future sustainability, and the role of efficiency improvements in enhancing this sustainability.

6.1 NSW councils' recent financial performance

Previous reviews of local government in Australia have identified numerous indicators of councils' financial performance and position that can be used to identify when councils are facing financial pressure and when their viability is at risk. For example, the PwC report used five indicators for its financial key performance indicators (KPI) analysis (see Box 6.1).

The sections below summarise NSW councils' recent performance against three possible indicators — operating surplus (deficit) ratio, interest coverage ratio and annual renewal/replacement ratio.

[35] See Appendix C for more details.

Box 6.1 PwC's financial performance indicators

The PwC's financial KPI analysis used the following five indicators:

- Operating surplus (deficit) – which is total operating revenue less total operating expenses. This is an indicator of a council's ability to meet its operating expenses with its operating revenue stream. The analysis used a benchmark operating deficit of 10% of total revenue, as councils with deficits larger than this are spending well beyond its revenue base and potentially at risk of sustainability problems.
- Interest coverage – which is earnings before interest and tax (EBIT) divided by borrowing costs. This measures a council's ability to pay interest on its outstanding debt. The analysis used an interest coverage benchmark of 3 which provides a generally guide to delineate a financially sustainable level of borrowing. An interest coverage value below 3 indicates that a council may have problems in repaying debt and associated interest.
- Sustainability ratio or capital expenditure divided by depreciation. This ratio is a measure of the net increase or decrease in the asset base. Results over 1.0 indicate that a council's overall asset base is increasing, or being replenished, at a rate above the consumption of assets. Results under 1.0 indicate a declining asset base and potential sustainability risks. Council sustainability ratio results need to be interpreted with care due to factors such as infrequent as well as inconsistent asset revaluations and depreciation approaches.
- Current ratio (or current assets divided by current liabilities) is a measure of ability to meet short-term debt obligations. The analysis used a benchmark value of 1 for the current ratio with councils at below 1 being more at risk of liquidity problems.
- Rates coverage (total rates revenue as a proportion of total expenses), which is a measure of a council's ability to cover its costs through its own tax revenue. The analysis used a benchmark result of 40% as the point that measures adequate self-funding, with results below 40% indicating a greater dependence on other revenue streams such as grants, and hence more risk of sustainability issues.

Source: PricewaterhouseCoopers, 2006, National Financial Sustainability Study of Local Government, commissioned by the Australian Local Government Association.

6.1.1 Operating surplus (deficit) ratio

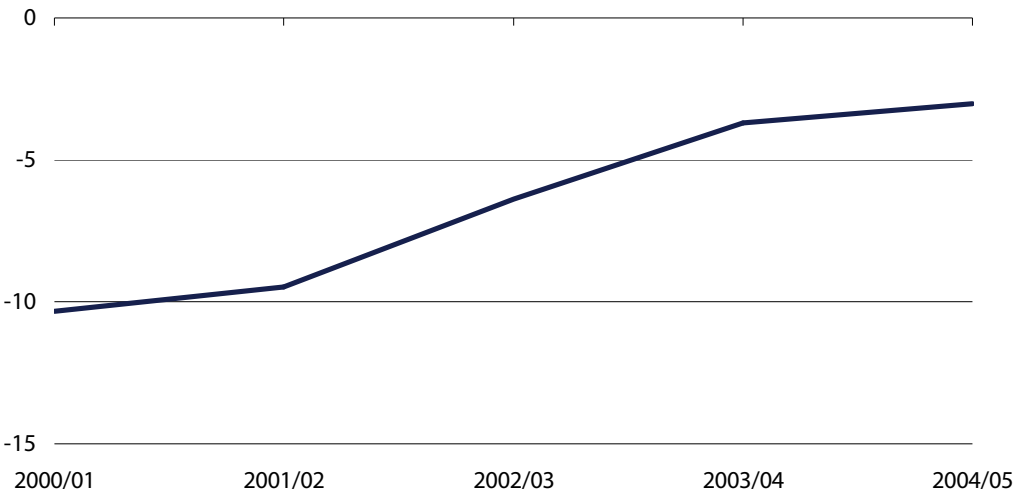
The operating surplus (deficit) is defined as total operating revenue less total operating expenses and indicates the council's ability to meet operating expenses with its operating revenue stream.[36] It can also be used to measure intergenerational equity. If a council has an operating surplus, it means that its operating revenues are sufficient to fund its current operating activities. However, if a council has an operating deficit its revenues are insufficient to fund current operating activities, and liabilities must be incurred to finance those operations.

[36] Access Economics (2006) calculates the operating surplus/deficit as: revenues from ordinary activities before capital amounts *less*; gains from disposal of assets, gains from revaluation of assets, expenses from ordinary activities, *plus* any losses from the disposal of assets or their revaluation.

The operating surplus/deficit ratio is defined as the council's operating surplus/deficit as a percentage of its annual own-source revenue. Figure 6.1 shows this ratio for all NSW councils over the period 2000/01 to 2004/05. The figure indicates that, at an aggregate level, councils have been running consistent operating deficits over the period, although the deficits have fallen in recent years from around 10 per cent in 2000/01 to less than five per cent in 2004/05.

The benchmark for a healthy operating surplus/deficit ratio is considered to be around zero. As Box 6.1 notes, the PwC report considered that an operating deficit ratio of 10 per cent or more is an indicator that a council's financial sustainability may be at risk. The NSW total government sector had an operating surplus ratio of 4.6 per cent in 2004/05 compared to a ratio of -3.0 per cent for all NSW councils.

Figure 6.1 Operating surplus ratio, all NSW councils, 2000/01 to 2004/05



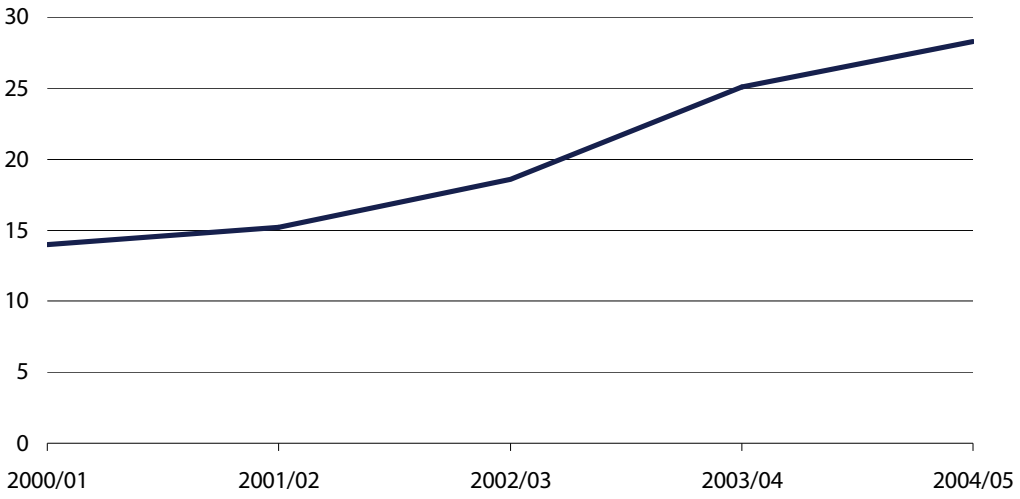
Data source: Access Economics, Local Government in NSW, for the Independent Review Panel.

6.1.2 Interest coverage ratio

The interest coverage ratio measures the annual debt-servicing burden of councils, and thus provides an indicator of their financial position. It is measured as operating revenue (excluding interest income) less operating expenses, as a percentage of net interest expense. A council's financial position is strong if its interest payments can be met comfortably with its annual income and existing rating effort. This is shown by a large interest coverage ratio.

Figure 6.2 shows that the net interest coverage ratio for NSW councils for the period 2000/01 to 2004/05 was substantially above benchmark ratios, at between 15 and 25. This suggests that councils' debt servicing burden is currently very low.

Figure 6.2 Net interest coverage ratio, all NSW councils, 2000/01 to 2004/05



Data source: Access Economics, Local Government in NSW, for the Independent Review Panel.

Box 6.2 PwC's Net Financial Liabilities Ratio

The net liability ratio may provide a more useful indicator of non-sustainability than the net interest coverage ratio (above). This is because the high demand for rate funded local government services generally results in earnings before interest and tax (EBIT) being lower than in most other sectors of the economy.

According to the PwC report, the net financial liabilities ratio represents total liabilities less financial assets expressed as a percentage of operating revenue. A net financial liability may be necessary for a council to grow and effectively increase its asset base although a particularly large net liability ratio indicates that a council may have increased assets beyond its financial capacity.

PwC estimates that local councils have a national average net liability ratio of 6.7%. This compares to the Commonwealth Government's ratio of 11% and the state governments of NSW (65%) and South Australia (73%). Moreover, rural remote and rural agricultural councils average negative net liability ratios of -15% and -2% respectively.

These figures, if they reasonably reflect the situation within NSW local government, indicate that there may be room for councils to increase loan borrowings particularly when these financial liabilities reflect investment in priority infrastructure backlogs.

Source: Pricewaterhouse Coopers, 2006, *National Financial Sustainability Study of Local Governmen*t, commissioned by the Australian Local Government Association.

IPART seeks comments on the following:

26 What is an appropriate level for the net liability ratio and what obstacles prevent local government from making greater use of loan borrowings (debt) as a means of financing priority infrastructure renewal/replacement?

6.1.3 Asset renewal/replacement ratio

The capital performance of a council is considered adequate if its capital expenditure on the renewal or replacement of non-financial assets broadly matches the cash flows generated to cover its annual depreciation expense. It can be argued that in order to maintain financial viability, councils should invest in capital expenditure at a level at least equal to their depreciation expenses. In principle, this ensures that their asset bases do not diminish over time and reduce to a level where they cannot provide adequate infrastructure and services.[37] However, this depends on the appropriateness of the asset valuations.

Positive annual net acquisition of non-financial assets for renewal/replacement purposes occurs where capital expenditure on the renewal or replacement of these assets exceeds the annual depreciation expense on those assets. A positive asset renewal/replacement ratio relieves future ratepayers from renewing or replacing such assets consumed in the current period. Controversially, negative annual acquisition of non-financial assets for renewal/replacement purposes refers to the annual depreciation expenses exceeding renewal or replacement of these assets. In this situation, the responsibility for this portion of the renewal/replacement of such assets effectively shifted to future ratepayers.

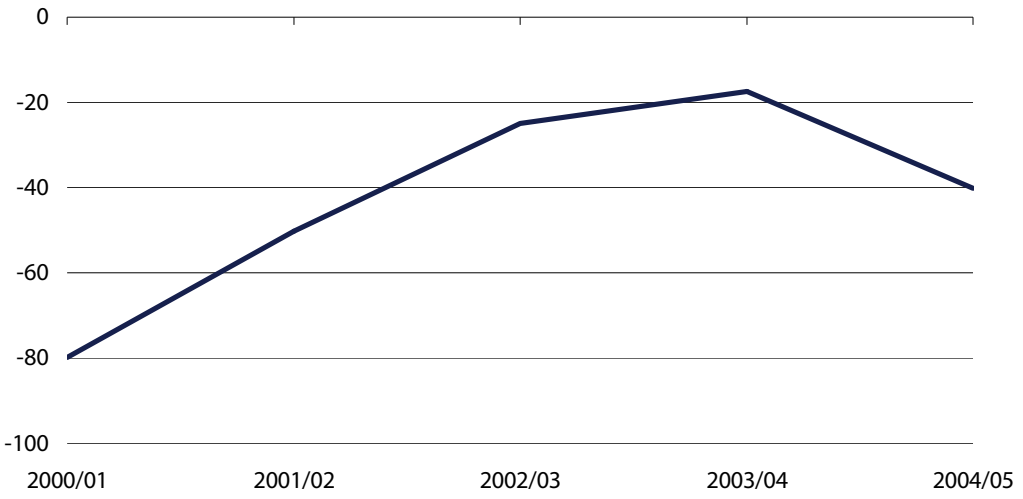
Figure 6.3 shows the annual renewal/replacement ratio[38] for all NSW councils over the period 2000/01 to 2004/05. The figure indicates that on average, the annual capital expenditure of NSW councils on the renewal or replacement of existing assets fell short of the annual depreciation of those assets by $400 million, or 40 per cent of that capital expenditure in 2004/05. A persistent shortfall in capital expenditure on the renewal/replacement of existing assets against annual depreciation expense may shift current ratepayers' share of funding of infrastructure renewal/replacement onto future ratepayers.[39]

37 PricewaterhouseCoopers, 2006, *National Financial Sustainability Study of Local Government*, commissioned by the Australian Local Government Association.

38 The ratio is calculated as: renewal/replacement capital expenditure *less* depreciation expense, divided by the renewal/replacement capital expenditure. Given the lack of published information on the each council's annual capital expenditure which is for renewal/replacement purpose, these figures were estimated (see Access Economics 2006).

39 The quality of these estimates depends on the accuracy of local government in valuing assets and depreciation.

Figure 6.3 Annual renewal/replacement ratio, all NSW Councils, 2000/01 to 2004/05



Data source: Access Economics, Local Government in NSW, for the Independent Review Panel.

In summary, these indicators suggest that NSW councils' recent performance against these three indicators suggests that, at least at an aggregate level, their balance sheet is strong, and there is no over reliance on debt financing. The interest coverage ratio may even suggest that councils' current levels of debt are too low. Debt financing is appropriate for the financing of new infrastructure or upgrading infrastructure, however there is a tendency for councils not to borrow, even though it may be prudent to do so. However, the annual renewal/replacement ratio tends to suggest that councils may be generating an infrastructure backlog, and this may pose a risk to the long-term viability of local government finances.

6.2 What factors affect councils' financial sustainability?

A council's financial performance is considered to be sustainable when it can meet its planned long-term service and infrastructure levels and standards without unplanned increases in rates or disruptive cuts to services.[40] It is important that councils are financially sustainable because this:

- ensures that the rating burden is shared equitably between the current and future ratepayers
- prevents the councils from having to rely on debt to meet operating deficits
- reduces the economic losses caused by unpredictable changes in council's rating effort.[41]

[40] See Local Government and Planning Ministers Council, Local government financial sustainability nationally consistent frameworks, Framework 1.

[41] Financial Sustainability Review Board, 2005, *Rising to the Challenge, Towards Financially Sustainable Local Government in South Australia*, Volume 2, Supporting Analysis p. 10.

A review of the financial sustainability of local government must consider all the factors that affect a council's current and future revenues and expenditures, and the balance between them over the long-term.

Previous reviews have identified many factors, both external and internal, that may have a negative affect on a council's financial performance and position including:

- minimal (or negative) revenue growth
- legislation or regulation that constrains its capacity to raise revenue (such as rate pegging)
- expansion in its role, which may be caused by devolution, where another sphere of government gives local government responsibility for new function, increasing service standards and community expectations, its own policy choices, and cost shifting from other tiers of government
- increases in costs, including wages, maintenance and construction costs
- increases in costs that are greater than revenue growth, resulting in operating deficits
- changes in the demographic profile of the area it serves, such as an ageing population
- limited access to strong financial and asset management skills which can help to identify sustainability problems, optimise renewals expenditure and improve revenue streams.

IPART seeks comments on the following:

27 Are there any other significant factors affecting financial performance of local government?

28 To what extent does rate pegging affect financial sustainability?

6.3 Can efficiency improvements improve councils' financial sustainability?

A council's level of efficiency refers to how well it uses resources to produce goods and services. By improving its efficiency, a council can provide more or better quality services and infrastructure with the same level of resources, or the same level and quantity of services with fewer resources.

In recent years, a number of reforms have been implemented to improve efficiency levels in local government. These reforms include structural reforms (such as amalgamations), the use of outsourcing non-core activities, the commercialisation of services, and the use of cooperative arrangements such as regional service delivery and shared services.

The Commonwealth Department of Transport and Regional Services is responsible for reporting on the efficiency levels of local government, as part of its annual National Report on Local Government Financial Assistance Grants. In its 2005/06 report, the Department found that local government is performing its role satisfactorily and with reasonable efficiency.

6.3.1 How should efficiency be measured?

Currently, the efficiency of Australian local government is measured through comparative performance indicators. In NSW, the State Government requires councils to submit annual reports on their performance in 18 areas. The Department of local government then compiles annual comparative performance tables that cover 30 KPIs across 11 categories including rating, financial, corporate, library services, domestic waste management and recycling services, planning and development services, environmental management and health services, recreation, and leisure services community services.[42]

These comparative indicators do not take account of the significant differences in the size and other characteristics of the areas served by individual councils. Thus the comparative indicators may not be the most appropriate measures for efficiency improvements without further disaggregation and analysis.

IPART seeks comments on the following:

29 What are the appropriate measures for efficiency of local government?

6.3.2 What is the potential to use efficiency improvements to improve the financial sustainability of NSW councils?

Over the past 25 years, the role of local government has expanded significantly (see Chapter 3) while local government expenditure has remained approximately 1 per cent of GDP. Local government has actively engaged in reform to improve the efficiency and effectiveness of the sector. As part of these reforms, councils have undergone structural reforms, and have introduced a range of corporate practices including corporatisation of council owned enterprises, outsourcing of services and generally becoming more outcomes focused.[43]

A particular issue for this review is whether rate pegging or other constraints on revenue raising, promote greater efforts to improve efficiency. For example, rate pegging encourages councils to find other appropriate sources of revenue, such as user fees and charges. User fees and charges may be a more efficient means of raising revenue than rates and thus rates pegging may in fact improve the efficiency

42 See the Department of Local Government's website, www.dlg.nsw.gov.au.

43 Local Government and Shires Associations, 2006/07 NSW State Budget, submission to the NSW State Government on behalf of NSW local government, p. 9.

of councils' finances. This is because user charges signal the costs of the services provided and encourages better use of the services.

IPART seeks comments on the following:

30 To what extent have councils undertaken efficiency reforms and has this been effective?

31 How does rate pegging and other constraints on councils' revenues affect the efficiency of councils' operations?

7 Framework for setting rates and charges levied by local councils

One of IPART's key tasks in this review is to recommend an appropriate regulatory framework for setting council rates and charges that facilitates the effective and efficient provision of local government services in NSW. In addition, IPART is to recommend what role IPART should play in setting limits on these rates and charges in future years. The sections below provide an overview of the current framework for regulating council rates and charges, and the approaches used in other jurisdictions. The subsequent sections discuss the effectiveness and efficiency of the current regulatory framework, the options for alternative regulatory frameworks, and a possible role for IPART in setting council rates and charges in the future.

7.1 What is the current framework for regulating council rates and charges in NSW?

As Chapter 1 outlined, the current framework for regulating council rates and charges in NSW is based largely on an approach known as rate pegging. Each year, the NSW Government sets the maximum amount by which councils can increase their annual general income (which is largely derived from property rates), based on recommendations from the Department of Local Government and NSW Treasury. Individual councils must then set their rates and charges for the year so that their general income does not increase by more than this amount. Alternatively, they may apply for a special variation to the maximum amount.

7.1.1 How does rate pegging work?

Under Chapter 15 of the Local Government Act, the NSW Government may cap the total amount of income that a council can raise from ordinary rates, special rates and annual charges in a specified year (known as annual general income). The Minister for Local Government may specify the percentage by which each NSW council's general income may increase in a specified financial year. This percentage is known as the 'rate peg percentage'.[44]

For rate pegging purposes, general income does not include certain rates and charges. These include rates for water supply and sewerage, charges for water supply and sewerage services, and annual charges for waste management and storm

[44] See Section 506 of LGA 1993.

water management services.[45] Nor does it include user charges, interest, grants, contributions and donations (eg, Section 94 contributions) or other revenues (eg, from fines and business activities).

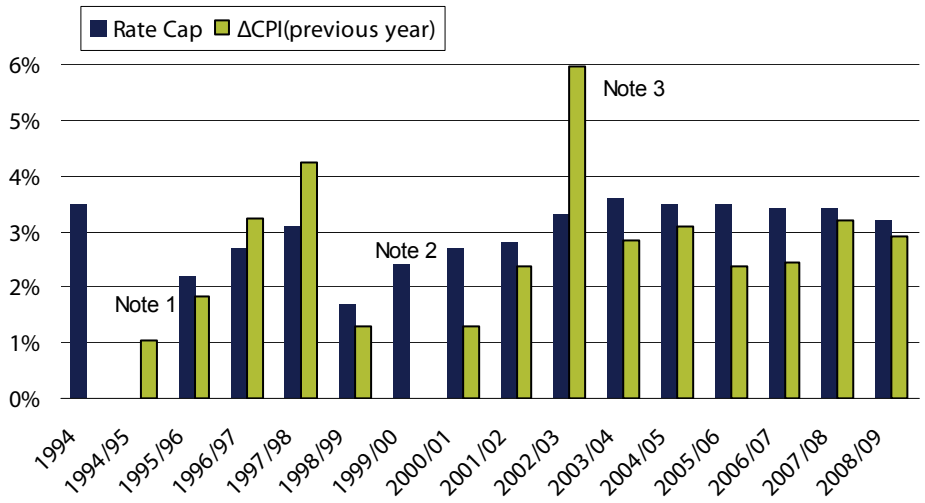
The rate peg percentage applies to a council's total annual general income, not to the rates for individual properties. Therefore, the council has the flexibility to increase some rates by more than the rate peg percentage, and others by less. It can also decrease some rates compared to the previous year if it wishes. The main factors that affect how the rates for an individual property will change from year to year are the council's rating structure and changes in the valuation of the property.

The annual rate peg percentage is usually announced in March each year. Councils can then submit their requests for a special variation to this percentage (see section 7.1.2 below). The Minister for Local Government usually makes a determination on each request by June, to enable each council's new rate to take effect from 1 July.

For 2008/09, the rate peg percentage is 3.2 per cent. This percentage reflects the projected annual increase in costs that a typical council delivering services at levels comparable to the previous year is likely to incur over this year.

Figure 7.1 shows the rate peg percentages for each year since 1994, and compares these percentages with the change in CPI since the previous year.

Figure 7.1 Annual rate peg percentage and change in the CPI, 1994 to 2008/09



Note: (1) Financial year rate peg percentages commenced in 1995/06. (2) The change in CPI for 1998/99 was 0%. (3) The change in the CPI for 2001/02 reflected the impact of the introduction of the GST which was not allowed for in setting the rate peg percentage for2002/03.

Data source: Department of Local Government, *Annual Reports* (various) and ABS *Consumer Price Index* Cat No 6401.0.

45 See Section 505 of LGA 1993 for definition of general income.

7.1.2 What are special variations?

Councils that consider they will be adversely affected by limiting the increase in their annual general income to the rate peg percentage can seek a special variation to this percentage, under either section 508(2) or 508A of the Local Government Act:

- Section 508(2) enables the Minister for Local Government to approve a percentage increase to a council's general income for a specified year that is greater that the rate peg percentage approved under section 506 of the Act. An increase approved under section 508(2) is for a specified year. However, it does provide for an escalated base for future rate pegging increases.
- Section 508A enables the Minister for Local Government to approve a percentage increase to a council's annual general income by an amount that is greater than the rate peg percentage for up to a maximum of seven years.

IPART seeks comments on the following:

32 If variations under Section 508(2) provide for an escalated base for future rate increases under rate pegging, what benefits do councils gain from making application under the alternative Section 508A?

The Department of Local Government provides guidance to councils wishing to apply for a special variation.[46] Such councils are required to exhibit and adopt a management plan before the end of each financial year,[47] which includes statements that explain the council's revenue policy for the next year.[48] The revenue policy must include details of all proposed rates and charges for the following year, and the council must give members of the public an opportunity to comment on it.

It is noted that the criteria for applications are quite broad and non-specific. The DLG outlines the process for lodging applications, the format of application and the reasons for applying.[49]

For 2007/08, 28 of the 152 councils in NSW applied for a special variation under section 508(2). Most of these were to enable the council to raise additional revenue for infrastructure renewal or maintenance. Twenty five of the applications were approved as submitted, and three were approved in part. A further six councils applied for a special variations under Section 508A, of which two were approved as submitted, three were approved for the first year only with the remaining years to be further reviewed, and one was not approved.

Tables 7.1 and 7.2 summarise the special variation applications made under each section for 2007/08, indicating the reason for seeking the variation, and the percentage increase sought and approved.

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46 DLG, Circular to Councils *Applications for Ministerial Approval for a Special Variation to General Income*, Circular No 07-53 (See www.dlg.nsw.gov.au).

47 See Section 406 of LGA 1993.

48 Section 404.

49 Department of Local Government Circular to Councils dated 29 October 2007.

Table 7.1 Special variation applications made under Section 508(2) for 2007/08

Council	Reason	% sought	% approved
Ashfield Municipal	To construct/redevelop the Ashfield Civic Centre	9.80	9.80
Ballina Shire	For infrastructure maintenance /renewal works	7.15	7.15
Bega Valley Shire	To maintain current level of services	9.76	9.76
Blayney Shire	To redevelop the Blayney Community Centre	11.04	3.40
Bombala	To maintain on-going services and maintenance	9.46	9.46
Byron Shire	To improve services and fund infrastructure renewal	8.39	8.39
Dungog Shire	For infrastructure maintenance and renewal	9.82	9.82
Great Lakes	For infrastructure works including community facilities	9.68	9.68
Hawkesbury City	For infrastructure renewal including roads, parks, playgrounds and gardens	9.50	9.50
Holroyd City	To allow the council to impose a Special Infrastructure Levy for asset maintenance	9.90	9.90
Hunters Hill	For capital works and asset maintenance	7.54	7.54
Lake Macquarie	For infrastructure maintenance and renewal	8.54	8.54
Lane Cove	To implement the council's Sustainability Action Plan	9.35	9.35
Lithgow City	To build an indoor swimming pool, gym, sports arena & associated buildings	8.33	3.40
Liverpool City	To continue funding the council's Environment Plan Project	5.54	5.54
Manly	To allow the council to impose an Infrastructure Levy for asset renewal and maintenance	5.80	5.80
Marrickville	To fund the Dulwich Hill Main Street Program	3.41	3.40
Mosman Municipal	For infrastructure maintenance and renewal	9.34	9.34
Muswellbrook Shire	For infrastructure maintenance and renewal	9.44	9.44
Nambucca Shire	For urban street rehabilitation, rural roads rehabilitation and bridge reconstruction	5.30	5.30
Newcastle City	For infrastructure rehabilitation and renewal	9.95	9.95
North Sydney	To upgrade stormwater pipes, and undertake water recycling, repairs to seawalls & road upgrades	9.95	9.95
Palerang	To fund road resheeting and resealing programs	10.31	10.31
Randwick City	For infrastructure maintenance and replacement	8.48	8.48
Rockdale City	For infrastructure maintenance and replacement	8.40	8.40
Willoughby City	To help repay a loan used to fund the council's Civic Place Project	5.17	5.17
Woollahra Municipal	For infrastructure maintenance and replacement	9.69	9.69
Young Shire	For infrastructure maintenance and replacement	6.37	6.37

Source: NSW Dept of Local Government, *Annual Report 2006/07*, pp 126-127.

Table 7.2 Special variation applications made under Section 508(A) for 2007/08

Council	Reason	% sought each year		% approved each year	
Gilgandra Shire	For infrastructure works and maintenance	2007/08	18.5	2007/08	10.9
		2008/09	11.0		
Gosford City	To fund the council's Civic Infrastructure Strategy	2007/08	9.48	Not approved; to be further reviewed	
		2008/09	9.98		
		2009/10	9.98		
		2010/11	9.98		
		2011/12	9.98		
Richmond Valley	To fund community infrastructure	2007/08	10.06	2007/08	10.06
		2008/09	7.5	Remaining years to be reviewed further	
		2009/10	7.5		
		2010/11	7.5		
		2011/12	7.5		
Wagga Wagga	To fund infrastructure works and maintenance	2007/08	5.63	2007/08	5.63
		2008/09	9.25	2008/09	9.25
		2009/10	9.25	2009/10	9.25
		2010/11	4.18	2010/11	4.18
		2011/12	4.18	2011/12	4.18
Wingecarribee	To fund infrastructure works and maintenance	2007/08	9.56	2007/08	9.56
		2008/09	9.50	Remaining years to be further reviewed	
		2009/10	9.50		
		2010/11	9.50		
		2011/12	9.50		
Wollongong City	To fund infrastructure works and maintenance	2007/08	5.54	2007/08	5.54
		2008/09	5.70	2008/09	5.70

Source: NSW Dept of Local Government, *Annual Report 2006/07*, p 128.

7.2 How are council rates and charges regulated in other jurisdictions?

In most other Australian states, local councils have more autonomy in setting their rates and charges than NSW councils. In other countries, the roles and responsibilities of local government vary significantly, which makes comparison with NSW difficult. Most local governments in Australia have a relatively small role when compared with other developed countries, eg, more limited functions, lower expenditure shares, and lower tax sources available.

7.2.1 Other Australian States[50]

Victoria

Under the *Local Government Act 1989* (Vic), the Victorian Minister for Local Government has the power to control local government rate setting. The current government policy allows councils to strike their own rates. Under this policy, councils must prepare a Rates and Charges Impact Statement and undertake community consultation.

Queensland

The *Local Government Act 1993* (Qld) establishes procedures for rate setting. The Queensland Government does not limit rate increases. Ultimately, each local council is responsible to its own constituencies.

Tasmania

The *Local Government Act 1993* (Tas) places the onus on local government for setting rates and charges. The Act requires all councils to publish budgets and make all decisions about rates and charges at open meetings with well-publicised agendas. The Act also requires councils to prepare a five-year strategic plan, and an annual operational plan that relates to the strategic plan, and to undertake community consultation in preparing these plans.

South Australia

The *Local Government Act 1999* (SA) accepts that councils are responsible to their own constituencies for the taxes they set. The Act requires all councils to have and publish a rates policy. It also requires councils to undertake community consultation before making significant changes to this policy.

Western Australia

The *Local Government Act 1995* (WA) does not provide the Government with powers to directly set council rates. It is generally considered that local government elections are the best test of the financial management capacity of local government.

However, the Act requires that councils develop their budget within a community consultation/planning framework. It also imposes conditions related to the rates a councils set, including that the minimum rate cannot apply to more than 50 per cent of properties. It also requires councils to seek Ministerial approval if the highest rate for an individual property is greater than twice the lowest rate within the LGA.

50 LGSA, *NSW Local Government Rate Determination Model*, July 2003, pp 3-5.

Northern Territory

The Northern Territory *Local Government Act* allows councils to set their own rates. However, it stipulates that councils should not budget for a deficit, and requires councils to publish and publicise their budgeting process.

Australian Capital Territory

ACT property owners pay rates and land tax to provide funding for municipal and other essential services. The imposition of rates and land tax are authorized and administered under the *Rates Act 2004* (ACT). The amount of rates payable has two components – a fixed charge and a valuation charge for each rateable property. In calculating rates payable different fixed charges and valuation charges are required to be applied to residential, commercial and rural properties[51]. The valuation charge is based on Unimproved Capital Value of the land.

7.2.2 Other countries

Local government's role and functions, and its revenue raising responsibilities, differ significantly across countries. Compared to other federations, such as the United States, Canada and Germany, local government in Australia has very limited functions, a lower share of expenditure responsibilities, and fewer available sources of taxation revenue. For example, in 2004, local government revenue constituted less than three per cent of total taxation revenue in Australia, compared with almost 15 per cent in the United States and about eight per cent in Canada and Germany.[52]

Comparisons with the United Kingdom are less relevant because of the unitary system of government used there. Under this system, local councils are the administrative arms of the central government, and are used to deliver services such as health and education. In contrast, in federal systems these functions reside with autonomous intermediate governments (such as state or provincial governments).

Canada

The Canadian federal system consists of a federal government, provincial governments and local governments. Local governments consist of municipal governments and smaller specific-purpose local authorities, such as school boards. Examples of services provided by municipal governments include transportation (roads), emergency services, property-related services, land use planning and social and health services. Due to increased expenditure by provincial governments, local

51 See www.revenue.act.gov.au/rates.

52 Productivity Commission (2008) *Assessing Local Government Revenue Raising Capacity*, Productivity Commission Research report April 2008, p 15.

governments' share of total government expenditure in Canada (mainly in social services areas, particularly health) has decreased.[53]

New Zealand

New Zealand has a unitary system of government. The local government sector consists of both regional and territorial councils (which include district and city councils). Territorial councils have functions that are similar to those of Australian councils. However, regional councils are responsible for functions that are outside the scope of Australian councils, including civil defence preparedness, harbour navigation and safety, marine pollution and some water management. Like the NSW and other State Governments, the New Zealand Government has undertaken reform of local government in recent years, including amalgamations. As a result of these reforms, the sector has taken on new responsibilities, beyond traditional service delivery areas.

Appendix D provides a more detailed overview of the UK, Canadian and New Zealand rating system. With the exception of the UK, it would seem that the extent and form of control of local government rates and taxes is less than is the case in New South Wales.

7.3 How effective and efficient is the current framework for regulating council rates and charges in NSW?

In assessing the effectiveness and efficiency of the current rate pegging approach to regulating council rates and charges, it is useful to consider the following issues:

- What are the goals and objectives of rate pegging?
- How significant are the special variations to the rate peg percentage?
- What are the socio-economic impacts of rate pegging and special variations?
- To what extent do the existing rate pegging arrangements promote the efficiency and effectiveness of local government?
- To what extent to the existing rate pegging arrangements enhance the financial viability of local government?
- To what extent does rate pegging meet the standard criteria for good revenue raising/taxation, and enhance the accountability of local government?

53 Shah, *Local Governance in Industrial Countries*, Public Sector Governance and Accountability Series, the World Bank, Washington (2006).

7.3.1 What are the goals and objectives of rate pegging?

The Local Government Act is not explicit about the goals and objectives of rate pegging. However, as Chapter 1 noted, the NSW Government has had a long-standing commitment to this approach, largely because it imposes fiscal discipline on councils. IPART assumes that the Government's objective in using this approach is to create a financial incentive for councils to control their expenditure and seek savings through efficiency improvements.

The debate on regulation of council revenue raising through rate pegging has seen various pros and cons put forward:

Pros:

- prevents the misuse of monopoly power in the supply of some basic community services
- helps to control cross-subsidisation and restrict council provision of non-core services and infrastructure that might prove to be unsustainable to rate payers
- manages the risk of poor governance in the local government sector
- limits the ability of councils to divert funds from essential infrastructure to other projects, and spend on marginal services that are better provided by the private sector.

Cons:

- limits councils' ability to provide local services
- prevents infrastructure backlogs from being addressed
- requires councils to consider higher user pays charges which could result in pricing inequities
- runs counter to principles of democracy and accountability of local government.

7.3.2 How significant are the special variations to the rate peg percentage?

Data from the Department of Local Government indicate that the number of applications for special variations per year increased from 30 in 2002/03 to 34 in 2007/08, with a spike of 46 applications in 2005/06 (see Table 7.3). Over the last three years, between 22 per cent and 30 per cent of the 152 councils in NSW have applied for a special variation.

More councils apply for a special variation under Section 508(2), than under Section 508(A) (which can apply for multiple years). This may be because when a special variation is approved under Section 508(2), a new, higher general income base for the council is established. Thus, the next year's rate peg percentage (or approved special variation) will apply to this new base. In contrast, when a special variation is approved under Section 508(A), the Minister places an expiration date (of up to

seven years in the future) on the special variation as a special condition of approval. Thus the council's general income base would decrease again when the special variation expires.

Table 7.3 Applications for special variations under both categories to the rate peg percentage, for 2002/03 to 2008/09

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Rate peg percentage	3.3	3.6	3.5	3.5	3.6	3.4	3.2
Number of applications for special variation received	30	23	25	42	46	34	26
Number of applications for special variations approved	23	23	22	30	39	30	24

Source: NSW Department of Local Government Annual Report 2006/07 and Comparative Information on NSW Local Government Councils 2005/06.

Of the 34 applications for a special variation received for 2007/08, 13 were from metropolitan Sydney councils, three were from larger regional councils (ie, Newcastle, Wagga Wagga and Wollongong), and the remaining 18 were from rural councils.

Of the 30 applications approved for 2007/08, 23 involved an increase of 6.8 per cent or more (ie, double the general rate peg percentage of 3.4 per cent), and, of these, 21 involved an increase of 8 per cent or more. There was no discernible trend regarding the size of the variations sought by metropolitan councils compared to rural councils.

From the public data it is not clear how many councils are benefiting in any one year for previous and current special variations. Questions have also been raised as to the frequency with which some councils may apply for special variations.

IPART seeks comments on the following:

33 What is the frequency and pattern of individual council requests for special variations to the rate cap?

Over the six year period shown on Table 7.3, there has been an increase in the proportion of applications approved as submitted. For example, in 2002/03 only 14 out of 30 applications were approved as submitted, while in 2007/08 29 out of 34 applications were approved as submitted.

As section 7.1.2 above discussed, there has been an increase in the number of councils applying for special variations in recent years. In most cases, the reason is to fund infrastructure and renewal expenditure. However, as Figure 4.2 shows, user charges as a proportion of local government revenue have remained relatively constant over recent years, which suggests that rate pegging is not causing councils overall to

increase or introduce new user charges. It is noted that certain councils have done so in the case of parking meters and also drawn increased enforcement revenues.

IPART seeks comments on the following:

34 Are rate pegging special variations becoming the norm rather than the exception with local councils and should alternatives to existing rate pegging practices be considered to provide greater certainty for councils and reduce the need for Government approvals?

35 Given the role of special variations and the other revenue sources for local government, does rate pegging effectively constrain the level of rates and total revenues for local government?

36 Should councils be able to achieve a permanent increase in revenue by applying for a special variation?

7.3.3 What are the socio-economic impacts of rate pegging?

Only a limited number of studies have attempted to measure the distributional impact of rates and charges across Australian councils.[54] However, some estimates derived using data from the ABS and state grants commissions are available.[55] These estimates need to be treated with caution, because it is difficult to provide comparable measures of the net burden of fees and charges across local government areas, due the significant variation in the way these charges are set. For example, the provision of user-pay services might be discretionary or compulsory, fully paid for by users or cross-subsidised by rates.

Nevertheless, the available estimates indicate that the ratio of expenditure on rates to income across local governments is not very high. The PC Report suggests that for most councils, the rates incidence is between 1.5 per cent and 1.8 per cent of after-tax income.[56] The ABS Household Expenditure Survey data suggests that the rates incidence is around 1.7 per cent, or less, of after-tax income for half of all Australian households.[57] However, the incidence of rates across the nation and the states varies. It is generally higher in rural and remote local government areas than metropolitan areas, and is lower in areas with higher average incomes.

54 Bentley (1973) *The Australian Local Government Tax Base*, Australian Economic Papers, pp21-25 June;. Harding and Warren (1999) *Who Pays the Tax Burden in Australia? Estimates for 1996-97*, Online Discussion Paper No 39, University of Canberra.

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

56 Productivity Commission, (2008) *Productivity Commission Research Report, Assessing Local Government Revenue Raising Capacity*, p 135.

57 Productivity Commission, (2008) *Productivity Commission Research Report, Assessing Local Government Revenue Raising Capacity*, p 135.

Two principles are commonly used to guide decisions about setting the fee or charge for an individual service: the benefit principle and the ability to pay principle:

- using the benefit principle, councils would set the charge for an individual service so that the community members who benefit from and value these services contribute most to the total costs of providing the services
- using the ability to pay principle, councils would set the charge based so that individuals contribute to the cost of the services based on their ability to pay (usually measured by their incomes).

IPART notes that councils are likely to have multiple objectives in setting rates and fees and charges. In practice, they appear to apply a combination of the benefit and the ability to pay principles. For example, the provision of concessions to some rate payers (eg, pensioners) reflects the ability to pay principle.

The two-tiered rate structure used by councils reflects the use of a combination of the benefit principle and the ability to pay principle. The fixed, minimum rate component suggests councils have applied the benefit principle, as property owners who receive similar benefits from at least some services to the property are charged the same amount, regardless of the value of the property. The variable component suggests that councils have applied the ability to pay principle, as owners of higher valued properties are charged more than owners of lower valued properties.

However, it is difficult to value the benefits individuals obtain from using local services at a council level, particularly when they are public goods and services. In addition, councils typically used rates to subsidise the cost of using some local government services for which fees and charges can be applied (such as sport and recreation facilities) to provide some degree of equity and access to users.

While on balance rates primarily reflect the capacity-to-pay principle, charges or fees and fines give greater weight to the benefit principle. Hence the balance between rates and other revenue sources change the balance between these principles in revenue raising.

An assessment of the impacts on individuals, businesses and organisations of regulated revenue raised by local councils needs to be undertaken within each local government area. Councils have the scope to influence the distribution of rates and fees and charges across residents and users of services by altering:

- the percentage rate in the dollar applied to rateable land
- the structure of rates (eg, imposing fixed and variable components, tiered or different rates)
- the categorisation of land for the purposes of applying differential rates (eg, residential, commercial or rural)
- the valuation method applied to each category of land (this is not the case in NSW where councils are required to use unimproved capital value (UCV))

- the levels of fees and charges and the extent to which they fully recover costs or rely on cross subsidies from rates revenue
- the concessions available for particular classes of property use or property owners or users of services (eg, items of heritage).

Rate pegging could have a range of potential socio-economic impacts. If it is successful in encouraging a council to be more disciplined in its spending and increase its efficiency, then rate pegging is likely to keep rates in that local government area at an efficient level, and prevent unnecessary rate rises, to the benefit of all rate payers, and to the economy in general. However, if it means that a council cannot set its rates at a level that reflects the level of expenditure required to meet local needs, or if the council is not able to increase its efficiency, then rate pegging might mean that the council:

- Provides services that are below what is expected by the community. This outcome would be likely to most effect community members who are on low incomes, as they are less able to obtain similar services from the private sector.
- Does not undertake adequate maintenance and renewal of the infrastructure it is responsible for. This outcome could mean that the infrastructure deteriorates, which could reduce its safety and reliability. It could also result in higher maintenance costs at a future time.
- Increases or introduces new user charges and fees (which are not constrained by rate pegging) so it can generate sufficient revenue. This could adversely affect community members on low incomes, as they are less able to afford the higher or additional charges.
- Applies for a special variation to the rate peg percentage to enable it to generate sufficient revenue. This would cause the need for additional resources to be expended in preparing, assessing and making a determination on the application.

IPART seeks comments on the following:

37 Does rate pegging increase the affordability and/or availability of local government services especially for poorer regions and sections of the community?

Pensioner rebates

The Local Government Act provides pensioner rebates[58] on all ordinary rates and domestic waste management services, water management services, as well as water and sewerage rates and charges.[59] The NSW Government, through the Department of Local Government, is only required to reimburse local councils through the

[58] Concessions are available to eligible pensioners who occupy a dwelling as their sole or principal place of living. An eligible pensioner is someone who receives a pension under the *Social Security Act 1991* or a service pension under the *Veterans' Entitlements Act 1986* and holds a pensioner concession card issued by the Commonwealth Government. People who receive a pension from the Commonwealth Department of Veterans' Affairs and do not have income and assets that would prevent them from being granted a pensioner concession card are also eligible.

[59] Local Government Act, Part 8 Concessions.

Pensioner Rebate Scheme for 55 per cent of the concession.[60] As the PC Report points out the majority of the states compensate local governments in part or in full for mandatory concessions.

The Pensioner Rebate Scheme gives pensioners a rate concession up to a maximum of $250. The level of concession has remained unchanged since 1989.[61] Councils have the discretion to provide further pensioner concessions from their own resources and can provide extensions in time to pay rates. In 2008/09, the estimated cost to the State budget is $76 million.

IPART seeks comments on the following:

38 In addition to the Pensioner Rebate Scheme, are there any other specific measures that could be introduced to address any social impact issues arising from the regulation of council revenues?

7.3.4 To what extent do the existing rate pegging arrangements promote the efficiency and effectiveness of local government?

The performance of any organisation is generally measured along two dimensions - efficiency and effectiveness.

- Efficiency indicates how well an organisation uses resources in producing goods or services. In most cases, financial performance indicators are used to measure efficiency. In local government, increased efficiency would involve providing the same level of services for less cost.
- Effectiveness indicates how well an organisation performs its tasks. Effectiveness can be measured by assessing whether it meets its organisational goals or the expectations of its customers, and the quality of the service it provides. In local government, effectiveness involves providing the right mix of local services to implement council policies and ensuring that services or service levels change in response to changes in community demands.

By constraining increases in their revenues from rates, rate pegging can potentially create incentives for councils to improve their efficiency. However, the benefits of this approach depend on whether the arrangements for rate pegging actually constrain councils' revenues, whether imposing constraints on revenues is an effective means of promoting efficiency, and whether these constraints lead to reduced effectiveness (such as under provision of services). It may be more effective to create incentives for improved efficiency by alternative or complementary means, such as requiring councils to monitor and report on key performance indicators (KPIs) linked to their revenue and service plans.

60 The Scheme is funded 55 per cent by the NSW Government and 45 per cent by councils.
61 Department of Local Government, *Annual Report, 2005-06*, p 37.

Currently, the main means of evaluating the performance of local councils in Australia is through comparative performance indicators. In NSW, the Department of Local Government requires councils to submit annual reports on their performance in 18 areas, including financial results, infrastructure status, employment information, and progress made in meeting specified external legislative requirements.[62] However, these indicators do not take into account the significant variations in the size and other characteristics of the areas local councils serve (see Chapter 2). In addition, the indicators and the ranking systems used by the Department appear to deal only with efficiency, and not effectiveness.

IPART seeks comments on the following:

39 Which performance measures should be developed for councils (or groups of councils) to provide information on outcomes, outputs, processes, inputs and cost effectiveness in their service delivery.

7.3.5 To what extent does rate pegging enhance or diminish the financial viability of local government?

The financial sustainability of councils is linked to issues such as cost disabilities, revenue disabilities and governance issues.

The effect of rate pegging on financial sustainability depends upon the extent to these factors (cost and revenue disabilities) can be taken into account in determining councils' financial risk issues and revenue needs. However IPART noted in the context of transfers between State and Commonwealth, complex methods to fully adjust for these factors can create unintended inefficiencies.[63]

Murray and Dollery argue that one important indicator of financial risk is whether the council faces cost disabilities in the provision of its services due to population dispersion, age/sex distribution of its population, difficult terrain /climate, urban congestion and economies of scale.[64]

Another important factor is whether the local government faces revenue disabilities, such as a weak property base or rate pegging.

IPART seeks comments on the following:

40 If there are negative unintended effects on financial viability, what modifications or alternative mechanisms would reduce these?

62 *Local Government Act 1993*, Chapter 13, Part 4, S428.
63 IPART, *Review of State Taxation, Report to the Treasurer, Draft Report*, June 2008, p 142.
64 David Murray and Brian Dollery, "Local Government Performance Monitoring in New South Wales: Are at Risk Councils Really at Risk?" in *Economic Papers*, Vol 24, No 4 December 2005, pp 332-345).

7.3.6 Does rate pegging lead to changes in the composition of councils' revenue?

The composition of a council's revenue is made up in varying proportions from rates (ordinary and special), charges, fees, grants, borrowings and investments. As section 7.1.1 discussed, rate pegging only applies to a council's general income, which includes some rates and annual charges, and does not include user charges and fees.

As Chapter 6 discussed, the revenue from annual rates and charges as a proportion of councils' total revenue from continuing operations has remained relatively stable through the periods 2003/04 to 2005/06. The same is true for user charges and fees.

7.3.7 To what extent does rate pegging promote simplicity and transparency

IPART considers that it would be useful to consider what are the merits of the rates relative to the following standard criteria for assessing regulatory options - simplicity and transparency.

Simplicity: The present rating system is administratively cost efficient. The reason for this is that the tax base (land) is not mobile and stays broadly the same in both physical and usage terms from one year to the next. Changes in ownership are notified to councils. The main exceptional administrative cost associated with the land tax value is the cost of regular valuations to a reasonable level of accuracy.

Transparency: While there are concerns about the basis of property valuation, local government rates are a transparent tax.

However, there appears to be no clear basis for determining the level of the rate peg each year. For example, it has been argued that since rate pegging was introduced, there has been no adequate explanation of the methodology for setting the rate pegs, including cost indices used.[65] While it may appear that the general rate increase is set using changes in the CPI and Average Weekly Earnings,[66] it would seem that some other considerations influence the calculation, as the rates set do not align with an equal weighting scenario. Furthermore, the criteria for special variations are not transparent.

IPART seeks comments on the following:

41 To what extent does rate pegging enhance or diminish the revenue raising by local government when assessed against the above criteria for taxation options by altering the revenue mix or enhancing/diminishing criteria such as efficiency, equity, simplicity, and accountability.

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65 Abelson, P (2006) *Local Government Taxes and Charges*, Applied Economics, pp 1-9 wwwappliedeconomics.com.au/pubs/pdf/06_LG_taxes_and_charges.pdf.

66 Local Government and Shires Associations of NSW, *NSW Local Government Rate Determination Model,* Prepared by the National Institute of Economic and Industry Research, trading as National Economics, July 2003, p 3.

7.3.8 How does rate pegging affect accountability and responsibility of local government?

Under the current rate pegging arrangements councils that wish to increase their general income by more than the regulated amount need to apply for a special variation. The process of assessing and making determinations on applications for special variations seeks to ensure that the reasonableness of all applications is scrutinised, and this may enhance councils' accountability, eg, through the councils' being required to prepare a Management Plan for public consultation.

Because councils are suppliers of basic monopoly services, it may be argued that like private monopolies, the price of their services should be regulated. The counter argument to this is that local councils should be directly accountable to their constituents through elections for the level of rates and quality of service. On this argument constraining rates reduces accountability.

Rate pegging limits autonomy but these impact on autonomy are not the same as its impact on local government accountability.

Accountability is immediately affected by the fact of an external, public limit on a major revenue source. The impact on autonomy is more subtle because even in the absence of rate pegging, community pressures and comparison with other governments would constrain to a degree the choices available. Thus the rate peg may not be as binding as it seems. Secondly, other income sources of local government are significant and are not regulated. Finally rates and other incomes are sufficient to provide councils with a high degree of autonomy.

7.4 Options for alternative regulatory frameworks

IPART has identified five options for alternative regulatory frameworks:

1. **Retain existing rate pegging arrangements** but:
   - Publish the economic indicators or indices to be used in determining the uniform rates cap to be applied across local government each year.
   - Modify the special variations process to ensure that the mandatory criteria required to justify a Section 508 (2) or a Section 508A variation are published and that the process of application and approval is fully transparent and forms part of local government regulatory system.
   - Leave all charges unregulated (except s 94 charges which are being dealt with separately under amendments to the NSW Planning and Assessment Act).
2. **Implement a more disaggregated form of rate pegging which incorporates cost indices relevant to each council (or groups of councils).** This option would be as for option 1 but either:
   - Group councils based on specific criteria and calculate a rate peg specific to each grouping, or

- Calculate a specific cap for each council based on specific criteria (eg cost structures, service dimensions).

3. **Reduce the scope of rate pegging** to cover only local government revenue needed to fund operating expenditure and thus exclude capital expenditure from rate pegging (noting that operating expenditure should include some expenditure approximating asset depreciation). This option includes:
   - Leaving other fees and charges (except s 94 charges) largely unregulated as is.
   - Providing separate guidelines on operating and capital expenditure planning and pricing. These guidelines could require approaches to operational revenue raising, related expenditure, capital expenditure plans and costings, pricing policies and charges, depreciation policy and proposed funding options including debt financing and public private partnerships. A section on relationship of Section 94 plans to these guidelines could be included.
   - Modifying the special variation arrangements as described in Option 1 above.
4. **Maintain rate pegging power but promote greater freedom** by exempting individual councils from rate pegging subject to a mandatory demonstration of:
   - financial accountability and governance
   - financial sustainability
   - comparative efficiency and effectiveness indicators (including affordability and availability of local services and facilities)
   - ability to achieve the above objective criteria over a 10 year time frame through an approved and independently audited management plan. This audited plan could be tabled in Parliament and made publicly available.

   This option may require regulatory changes to current Management Plans prepared under the *Local Government Act 1993* - Chapter 13, Part 2 Management Plans.
5. **Institute measures to enhance accountability to the local community and remove mandatory rate pegging.** This option includes compulsory reporting on a comparable basis to enable comparisons between councils. Where councils fail to meet these criteria a default rate cap could apply. While IPART has included this option for discussion, it notes that the Minister for Local Government favours the continuing of rate pegging.

   In addition, in assessing Options 1 and 2, IPART will also consider whether councils should also be required to develop a 10 Year Management Plan, as outlined in Option 3 above.

IPART seeks comments on the following:

42 What alternative regulatory models could be used to regulate rates and charges in NSW?

43 How do the various alternatives rate against the criteria listed above ie, financial accountability and governance, financial sustainability, comparative efficiency and effectiveness indicators including affordability and availability of local services and facilities?

7.5 The role for IPART in setting council rates and charges in the future

The terms of reference require IPART to recommend the role for IPART in regulating council rates and charges in future years.

IPART notes that such a role would utilise IPART's analytical experience and transparent public processes. The role for IPART would depend on the particular regulatory framework in place. However, it could be either a determinative role, in which IPART sets the any cap on increases in rates and charges, or a recommendatory role, in which IPART makes recommendations on maximum increases in rates and charges and the Minister responsible for Local Government is required to make the final decision.

While a determinative role could occur annually, or over another specified period. A recommendatory role could require the Minister responsible for Local Government to initiate a review by providing IPART with terms of reference. In this case, whether IPART was to conduct the review of rates and the nature of its review would be at the discretion of the Minister for Local Government. However, a recommendatory role could involve a standing direction, through legislation or regulation, that would not require an annual reference from the Minister.

IPART seeks comments on the following:

44 What role should IPART play in setting local government rates and charges in future years?

45 How should IPART's role be implemented (for example, by a legislative amendment giving IPART a determinative role or by a terms of reference from the Minister requiring recommendations from IPART)?

8 Framework for setting the charges levied by other public authorities

Several other public authorities provide services that would normally be provided by councils, including the Sydney Harbour Foreshore Authority, the Sydney Olympic Park Authority, the Redfern-Waterloo Authority and the Growth Centres Commission. The terms of reference ask IPART to recommend a framework for setting the charges levied by these authorities, to enable them to recover of costs of service provision.

The following sections provide a brief overview of each of these authorities, and outline the issues IPART will need to consider to develop a common framework for setting their charges.

8.1 Sydney Harbour Foreshore Authority

The Sydney Harbour Foreshore Authority (SHFA) was established under the *Sydney Harbour Foreshore Authority Act 1998*. Its legislated area includes The Rocks, Darling Harbour, Circular Quay promenades and foreshore land at Rozelle, Ballast Point and White Bay), and within these areas it is responsible for:

1. protecting and enhancing the natural and cultural heritage of the foreshore area
2. promoting, co-ordinating, managing, undertaking and securing the orderly and economic development and use of the foreshore area, including the provision of infrastructure
3. promoting, co-ordinating, organising, managing, undertaking, securing, providing and conducting cultural, educational, commercial, tourist, recreational, entertainment and transport activities and facilities.

SHFA also undertakes several property-related functions on behalf of the NSW Government, including provision of some local government services, planning and development; natural and cultural heritage and public domain; and promotional activities.

8.1.1 Provision of local government services

SHFA manages a portfolio of historic buildings located at The Rocks, Darling Harbour, the Circular Quay promenades, and foreshore land at Rozelle, Ballast Point and White Bay. It also manages property on behalf of other agencies including the promenades of Circular Quay, Circular Quay West, King Street Wharf and the Sydney Conservatorium of Music. In addition, SHFA administers the Luna Park Reserve Trust and Cooks Cove Development Corporation.

SHFA provides a wide range of municipal services to these precincts that normally would be provided by local government. These services include cleaning, waste management, security, parks and gardens maintenance, utilities and landscaping. Additionally, the council and SHFA share costs related to the maintenance of roads, footpaths and parks with SHFA's legislative area, based on the respective ownership of these assets.

SHFA does not receive corresponding rates revenue for the undertaking of these services. Instead, tenants holding long-term leases (99 years) within SHFA's precincts are obliged to pay property rates to the City of Sydney. Further, SHFA is also liable to pay Council rates for shorter term leases, with the exception of those leases where tenants have agreed to take up the liability for payment of rates to the Council.[67]

SHFA funds these services and the rates it pays through rents and cross-subsidising the remainder of the costs involved through the Authority's other commercial activities.

As SHFA recovers its costs from its tenants this raises the question as to whether the tenants are paying twice for some of the services provided.

8.1.2 Planning and development

SHFA has a planning and development role that involves processing development applications that relate to premises and land within its legislative area. It also assesses development plans and develops master plans on behalf of the Minister for Planning in relation to The Rocks, Darling Harbour, Luna Park and Ballast Point.

In addition, the Minister has delegated the role of determining 'minor' development applications to SHFA. These include applications for temporary events and associated structures, works to the public domain (such as landscaping and street furniture), changes of use, fit-outs, signage, outdoor seating areas, alterations to existing buildings, and some new building additions within its legislative area.

[67] Properties used for public purposes, including the Sydney Convention and Exhibition Centre and Darling Harbour car parks, do not attract council rates.

SHFA is involved in the development of surplus government land (for example, Barangaroo or East Darling Harbour) on behalf of the Government. It also provides advisory services to other agencies for land use planning, heritage and urban design.

8.1.3 Natural and cultural heritage and public domain

SHFA is responsible for the natural and cultural heritage conservation planning and maintenance within its legislative area. This involves the enhancement, management, maintenance and regulation of the landscape and public areas with a focus on The Rocks, Darling Harbour and (in the future) Barangaroo. SHFA also provides public domain lighting, security and cleaning services, children's playgrounds and public toilets.

SHFA also provides other related services in the foreshore area, including a 24-hour ranger and horticulturalist services, and foreshore park maintenance and development. It is also developing new parks at Ballast Point and Barangaroo (East Darling Harbour).

In addition, SHFA implements the *Roads Act 1993*, as a road authority, in respect to the public roads within its legislative area.

8.1.4 Promotional activities

SHFA promotes Sydney as a destination domestically and overseas. Its promotional activities include visitor marketing and promotion, visitor information centres, commercial and retail marketing activities, tourism development and event development and sponsorship.

This role is consistent with the expectations of the Government and the community that Sydney CBD be promoted domestically and overseas as a major destination for visitors and business and that major community events (NYE, Australia Day, etc) at The Rocks/Darling Harbour be co-ordinated by Government.

8.2 Sydney Olympic Park Authority

The Sydney Olympic Park Authority (SOPA) was established under the *Sydney Olympic Park Authority Act 2001*. It is responsible for managing the public assets of Sydney Olympic Park, including the open spaces, venues, parklands and development areas.

SOPA is tasked with ensuring the development of an integrated township called 'Sydney Olympic Park'. This involves pursuing the following objectives:

1. Sydney Olympic Park to become an active and vibrant town centre within metropolitan Sydney
2. Sydney Olympic Park to become a premium destination for cultural, entertainment, recreation and sporting events
3. new developments to be carried out in accordance with best practice environmental and town planning standards
4. the natural heritage of the Millennium Parklands to be protected and enhanced.

To achieve these objectives, SOPA carries out the following functions:

- promoting, co-ordinating and managing the orderly and economic development including provision and management of infrastructure
- promoting, co-ordinating, organising, managing, undertaking, securing, providing and conducting cultural, sporting, educational, commercial, tourist, recreational, entertainment and transport activities and facilities
- Protecting and enhancing the natural and cultural heritage of the site with a focus on the Millennium Parklands
- Providing, operating and maintaining public transport facilities within Sydney Olympic Park
- Liaising and maintaining arrangements with Olympic organisations, such as the International Olympic Committee and the Australian Olympic Committee Incorporated.

In addition, SOPA has statutory power to establish a ranger service. It is also able to undertake initiatives to promote and increase the recreational, historical, scientific, educational and cultural value of the Millennium Parklands.

8.2.1 Planning and development

Under the Sydney Olympic Park Authority Act, SOPA may exercise the functions of a council (within the meaning of the *Local Government Act 1993*) in relation to Sydney Olympic Park.

SOPA, like SHFA and Redfern-Waterloo Authority, has (delegated) consent authority functions under Part 4A of the *Environmental Planning and Assessment Act 1979*, including planning assessment of development applications as well as a minor determination role.

Where development is carried out by SOPA, it may exercise the functions of a council in relation to approvals for plans of subdivision under the *Conveyance Act 1919*, the *Strata Schemes (Freehold Development) Act 1973*, the *Strata Schemes (Leasehold Development) Act 1986* or the *Community Land Development Act 1989*.

8.2.2 Provision of local government services

SOPA has legislative authority to carry out the functions of a council within Sydney Olympic Park. The Authority, like SHFA, is responsible for the delivery of municipal services within the park that usually would be provided by local government. This includes roads and footpath maintenance, street lighting and cleaning, stormwater services, community facilities and amenities, open space and landuse planning.

Lessees within the park pay property rates to Auburn council rather than to SOPA. Over the next 2-4 years, the revenue to the council from these rates is expected to rise significantly, as new commercial development and the first tranche of residential development are brought on-stream.

While it is expected council will provide waste management services (garbage removal) for the new residents, SOPA will continue to fund its other local government related services.

In the absence of rates revenue or a corresponding payment from Auburn Council, SOPA relies on its commercial activities to cross-subsidise the costs of these municipal services. This raises the questions noted above in regards to SHFA.

8.3 Redfern-Waterloo Authority

The Redfern-Waterloo Authority (RWA) has responsibility for revitalising the Redfern-Waterloo area through urban renewal. The *Redfern-Waterloo Authority Act 2004* established RWA to:

1. encourage the development of Redfern-Waterloo into an active, vibrant and sustainable community
2. promote, support and respect the Aboriginal community in Redfern-Waterloo having regard to the importance of the area to the Aboriginal people
3. promote orderly development of Redfern-Waterloo taking into consideration principles of social, economic, ecological and other sustainable development
4. enable the establishment of public areas in Redfern-Waterloo
5. promote greater social cohesion and community safety in Redfern-Waterloo.

RWA is required to:

- Promote, facilitate, manage and undertake the social, economic and sustainable development and use of their respective operational areas, including the development and management of land, the provision of infrastructure and the establishment of public areas.
- Pursue commercial opportunities for local businesses and cultural development (including to address the needs of the Aboriginal community).
- Enhance, manage, improve, maintain and regulate the use of the public places.
- Promote, co-ordinate, organise, manage, undertake, secure, provide and conduct cultural, educational, commercial, recreational, entertainment and transport activities and facilities in the operational area.
- Process applications for developments, which in the opinion of the Minister of Planning have a capital investment value of no more than $5 million. RWA is also able to process applications for modification of development consents where consent was issued by the Minister of Planning where the consent relates to State significant sites in Redfern-Waterloo.
- Levy developer contributions.
- Implement the *Roads Act 1993* for public roads vested with the agency.
- Provide and promote housing choices (including for Aboriginal residents).
- Approve State infrastructure or other significant projects that are declared to be a project for the purposes of Part 3A of the *Environmental Planning and Assessment Act 1979*.
- Attract employment opportunities for local residents.

In most cases, the City of Sydney Council is the consent authority for development and/or works on all other land not identified as a State significant site within the Redfern-Waterloo Authority operational area. Development applications for these proposals are lodged, processed and assessed by the Council.

8.3.1 Provision of local government services

RWA's focus is to promote development of surplus Government land owned by various State agencies within its borders. The local council provides the full range of municipal services and receives property rates from property owners. RWA does not incur expenses for local government related activities.

RWA's direct ownership of property is limited to the Australian Technology Park which is exempt from council rates.

8.4 Growth Centres Commission

In December 2004, the NSW Government announced the new land release plan for the South West and North West Growth Centres as a key plank of the Metropolitan Strategy for Sydney. The Growth Centres will accommodate 30 to 40 per cent of Sydney's long-term housing growth.

The Growth Centres Commission (GCC) was established by the NSW Government to ensure that new development proceeds with infrastructure and services planned, funded and linked to the sequence of land release.

GCC has the planning, development and financial management capabilities of a development corporation. It will design and manage a streamlined planning and development approval process along with the timely provision of infrastructure promoting high-quality new development.

GCC is responsible for working with infrastructure agencies, industry, local councils, landowners and the community to make the plans for the Growth Centres a reality.

Box 8.1 Description of the North West and South West Growth Centres

The North West and South West Growth Centres are greenfield areas designated by the NSW Government for future urban development. Greenfield land is land not currently developed for urban purposes such as housing which will be investigated for development the future.

The North West Growth Centre is approximately 10,000 hectares within the local government area (LGA) boundaries of Baulkham Hills, Blacktown and Hawkesbury. It will contain about 70,000 new homes, be centred on the Rouse Hill Major Centre, and is made up of 16 'precincts'.

The South West Growth Centre is within the LGA boundaries of Liverpool, Camden and Campbelltown and comprises 18 Precincts over approximately 17,000 hectares with capacity for around 110,000 new homes. It will be supported by a Major Centre at Leppington.

GCC works under a *State Environmental Planning Policy 2006* (the Growth Centres SEPP), which is a legal document that establishes the planning rules and objectives for the Growth Centres. The GCC's functions are to:

1. prepare plans for the funding and development of regional infrastructure
2. control precinct plans within the North West and South West Growth Centres
3. make recommendations to the Minister for Planning regarding new precincts for staged land release
4. administer, including collection, holding and management, of Special Infrastructure Contributions to pay for regional infrastructure
5. implement regional infrastructure in consultation with state agencies to support new development

6. negotiate with government, landowners and developers to ensure development is facilitated in a sustainable and timely way.

8.4.1 Provision of local government services

Some of the functions of GCCs overlap with those of local government, including its responsibilities for:

- partnering with infrastructure agencies and councils through Local Government Coordination Committees
- managing the timing and sequencing of land releases, mix of housing and the types of centres and employment lands in the Growth Centres, infrastructure timing, costs, and contributions and communication with local communities and landowners
- coordinating and streamlining infrastructure provision to assist forward planning and improve integration with local infrastructure planning
- requiring councils to apply the Growth Centres SEPP when making decisions about land within the Growth Centres
- ensuring jobs will be closer to home by planning for employment and industrial areas within the new communities and providing public transport infrastructure.

The GCCs seek to deliver efficiency savings to government and developers by simplifying the planning process. However, GCCs focus on land use planning does not involve the delivery of municipal services or the imposition of property rates on property owners. Growth Centre councils continue to be responsible for delivering these services and levying rates within their local government areas.

8.4.2 Funding for GCC's program

The NSW Government is to fund (via the Budget cycle) 25 per cent of the required regional infrastructure identified in the Special Infrastructure Contribution Practice Note and 100 per cent of the cost of building social infrastructure such as schools and hospitals. The remainder of the cost of regional infrastructure identified in the Practice Note will be funded by a Special Infrastructure Contribution.

This will be supplemented by funding made available by developer contributions, identified through Section 94 plans (written by local councils during precinct planning), for local infrastructure – such as parks, playing fields and libraries – including related recurrent expenditure.

The Growth Centres Commission's focus on land use planning involves close collaboration with Sydney Water. However it is Sydney Water Corporation and not the Commission that is responsible for delivering, funding and charging (through Section 73 contributions) for water, recycled water and sewage treatment services to the Growth centres.

8.5 Issues related to developing a common framework

IPART's investigation and recommendations on an appropriate framework will facilitate the effective and efficient provision by these authorities of local government related services (similar though not necessarily limited to shown on Table 8.1 below).

An important aspect of the proposed framework will be the appropriate setting of charges that will enable these authorities to recover costs for the provision of services.

Table 8.1 Common activities across the authorities

Activities	SHFA	SOPA	RWA	GCC
Council rates paid by:				
- Agency	√	X	X	X
- Lessees/property owners	√	√	√	√
S94/Contributions	√	X	√	√
Property management	√	√	√	X
Planning assessment/approval	√	√	√	√
Development/Infrastructure	√	√	√	√
Natural/Cultural heritage – planning or delivery	√	√	√	√
Public domain & regulations	√	√	√	X
Regional promotions	√	√	√	X
Transport planning	√	√	√	√
Roads Act 1993[68]	√	√	√	X

Source: IPART.

Table 8.1 indicates that SHFA, SOPA, RWA and GCC broadly share a range of revenue and service activities. Further, as the above activities (amongst others) are also traditionally undertaken by local councils, there appears to be considerable common focus between these authorities and councils in terms of their scope of operations. This reflects that each of the authorities, for example SOPA, have been established as specialised property agencies to operate purpose specific sites of strategic importance to the State Government and deliver a standard and/or range of services over and above that can be afforded by neighbouring councils.

The future regulatory framework, it will need to assess overlaps between these authorities and local government with respect to the provision and, in particular, the funding of services and the objectives embedded within related legislation.

68 *Roads Act 1993* – Under this legislation roads vested with SHFA, SOPA and RWA, respectively, cannot be provided, opened, dedicated, closed or realigned except with the consent of these respective authorities.

IPART seeks comments on:

46 Whether a common legislative or regulatory framework be introduced to improve consistency in the levying of charges by authorities (such as SHFA, SOPA, RWA and GCC) that provide services akin to those provided by local government?

47 The best form for this legislative or regulatory framework to take?

48 To the extent that these authorities provide services that overlap with or duplicate those of local government, what benefits and disadvantages arise from the duplication of service provision?

49 To the extent that these authorities provide local government services how should the costs of these services be recovered? To what extent would these arrangements promote:

- Efficiency
- Equity
- Simplicity
- Transparency.

50 Similarities and significant differences (in quantum, scope or standard of service) between SHFA, SOPA, RWA and neighbouring councils in regards to:

- current regulatory frameworks including governance arrangements, accountability to the local community and the role of the State Government in setting fees and charges and determining revenue levels and/or mix
- property related services including land use planning, the processing of development applications, development activities, the levying of developer contributions, conservation of natural and cultural heritage, management of public domain areas and provision of infrastructure
- management of major events and regional promotions, and
- responsibilities under the *Roads Act 1993*.

51 The potential overlap between the Growth Centres Commission's development approval and infrastructure planning processes and those used by Growth Centres Councils.

52 The extent to which SHFA, SOPA, RWA and the GCC, respectively, impact upon the costs incurred and revenues generated by the corresponding councils.

Appendices

A Terms of Reference

I, Morris Iemma, Premier of NSW, under section 9 of the *Independent Pricing and Regulatory Tribunal Act 1992* (the 'IPART Act'), approve of the Independent Pricing and Regulatory Tribunal ('IPART') entering into an arrangement with the Department of Local Government to provide assistance to the Department by conducting a review with the following terms of reference.

IPART is to investigate and make recommendations on the following matters:

1. An appropriate inter-governmental and regulatory framework for the setting of rates and charges that facilitates the effective and efficient provision of local government services in NSW.
2. A role for IPART in setting of local government rates and charges in future years.
3. A framework for setting of charges by certain public authorities such as the Sydney Harbour Foreshore Authority, Redfern Waterloo Authority, Sydney Olympic Park Authority and the Growth Centres Commission to enable these authorities to recover costs for the provision of services that are normally provided by local government.

In undertaking this review, the IPART is to have regard to:

- the particular role of local government in the delivery of infrastructure and services to the community;
- the current financial position of local government;
- the present roles and responsibilities of local government, and the extent to which these are self-determined or determined by statutory requirements;
- the current and likely future level of expenditure required by local government to undertake its responsibilities;
- the scope for greater efficiency in the provision of local government services, including the use of total asset management planning;
- all of the revenue sources available to local government, the potential adequacy of these revenue sources, constraints on those revenue sources, and the financial capacity of local government to meet its statutory obligations and remain financially sustainable;
- the extent to which local government provides infrastructure and services that overlap those provided by other levels of government;

- the socio-economic impacts of rates and charges, including the ability of families and pensioners to meet their rate obligations, and local government hardship and concessions policies;
- differences between metropolitan, regional and rural councils, and also between new development areas and established suburbs;
- the current process by which increases in rates and charges are determined and whether this process adequately meets local government wage cost and other expenditure adjustments;
- the roles and responsibilities of local government and State Government in determining local government revenues; and
- any relevant recent reviews of local government such as those conducted by the NSW Local Government and Shires Associations and the Productivity Commission.

In addition, IPART is to consider the matters listed under section 15 of the IPART Act to the extent that they are relevant to this review and they are not otherwise addressed by the matters set out above.

In undertaking this review, IPART is not required to consider, review or make recommendations on:

- issues relating to the valuation of individual properties; and
- matters associated with the operation of councils' water and wastewater businesses.

IPART should provide a draft report to the Minister for Local Government within 12 months of commencement. IPART may also make an interim report to the Minister for purposes of setting rates revenues from 1 July 2009. The draft report should be made publicly available and comments invited from interested parties. A final report is to be provided to the Minister within a further 4 months of the draft report.

Background

The roles and responsibilities of local government have evolved over many years. The *Local Government Act 1993* sets out the means by which councils are financed. Councils have the power to set rates and charges on individual properties in line with local needs and the provisions of the Local Government Act 1993, which requires that rates that councils set must be fair and equitable. Local government revenue is also influenced by statutory requirements set out in other legislation, such as the developer contributions provisions of the *Environmental Planning and Assessment Act 1979* (currently under review). Local Government also derives revenue from the Commonwealth Government and other sources. A significant component of the revenue base of councils has been subject to 'rate pegging' since 1976, with provision for special variations.

B Matters to be considered under section 15 of the IPART Act

15 Matters to be considered by Tribunal under this Act

1. In making determinations and recommendations under this Act, the Tribunal is to have regard to the following matters (in addition to any other matters the Tribunal considers relevant):
   a) the cost of providing the services concerned,
   b) the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standard of services,
   c) the appropriate rate of return on public sector assets, including appropriate payment of dividends to the Government for the benefit of the people of New South Wales,
   d) the effect on general price inflation over the medium term,
   e) the need for greater efficiency in the supply of services so as to reduce costs for the benefit of consumers and taxpayers,
   f) the need to maintain ecologically sustainable development (within the meaning of section 6 of the Protection of the Environment Administration Act 1991) by appropriate pricing policies that take account of all the feasible options available to protect the environment,
   g) the impact on pricing policies of borrowing, capital and dividend requirements of the government agency concerned and, in particular, the impact of any need to renew or increase relevant assets,
   h) the impact on pricing policies of any arrangements that the government agency concerned has entered into for the exercise of its functions by some other person or body,
   i) the need to promote competition in the supply of the services concerned,
   j) considerations of demand management (including levels of demand) and least cost planning,
   k) the social impact of the determinations and recommendations,
   l) standards of quality, reliability and safety of the services concerned (whether those standards are specified by legislation, agreement or otherwise).
2. In any report of a determination or recommendation made by the Tribunal under this Act, the Tribunal must indicate what regard it has had to the matters set out in subsection (1) in reaching that determination or recommendation.

C Earlier Reviews on Council Revenue

There have been a number of reviews of local government in NSW and elsewhere in Australia since 1990 as shown in Table C.1. The following sections summarise some of these reviews.

Table C.1 Reports on local government in Australia 1990-2008

Year	Report	Author	Coverage
1990	Inquiry into Local Government Rating and other revenue powers and resources	Oakes Committee	NSW
1991	Report of the Local Government Rating Task Force	Rating Task Force	NSW
2003	House of Representatives Standing Committee on Economics, Finance and Public Administration	Hawker	Australia
2006	Independent Inquiry into the Financial Sustainability of NSW Local Government	Allan, Darlison and Gibbs (for LGSA)	NSW
2006	National Financial Sustainability Study of Local Government	PwC (for ALGA)	Australia
2007	Report of the Local Government Reform Commission	Reform Commission	Queensland
2008	Assessing Local Government Revenue Raising Capacity	Productivity Commission	Australia

Hawker Inquiry (2003)

The Hawker Report (2003) examined the affect of cost shifting on local government's financial position. A major conclusion drawn from the inquiry was that council's have maintained their financial position by allowing the existing physical infrastructure to deteriorate. That is, there is a significant infrastructure renewal gap in Australia and asset standards are decreasing. This situation is a direct response to the financial pressures faced by local government and is not sustainable in the long-term. As such the Hawker Committee[69] made a number of recommendations that have since been implemented.[70]

[69] See, House of Representatives Standing Committee on Economics, Finance and Public Administration, 2003, Rates and Taxes: A Fair Share for Responsible Local Government, Parliament of the Commonwealth of Australia and the government response.

[70] DOTARS, *Local Government National Report, 2005/06*, chapter 6.

Allan Inquiry (2006)

The LGSA commissioned the Allan Report (2006) to undertake an analysis of the financial sustainability of local government. The Allan Inquiry employed gap analysis methodology to establish the actual situation in a number of key areas (infrastructure, services, revenues, governance and administration) to ascertain how this compares with the desired situation. In each case, the current position was found to be deficient and a number of recommendations were made to reduce the gap. Overall, the report concluded that councils are able to fund the ongoing routine maintenance of their infrastructure; however, they do not have sufficient revenue to fund future asset renewal. Additionally, council's lack asset management skills and systems to undertake future asset renewals.

Access Economics

As part of the Allan Inquiry, Access Economics was engaged to assess local government finances in NSW. Access Economics found that operating deficits are prevalent and this is combined with a substantial infrastructure renewals backlog. Factors identified as contributing to this situation include the shortcomings in financial governance policies and practices of NSW, as well as the inadequate reporting of council's financial position and performance. Improvements in such policies and practices would enable council's to recognise financial performance problems and allow it to take action.

Similarly, Access Economics examined the financial sustainability of local government in Tasmania. It was estimated that one in five councils are financially unsustainable, this represents eight per cent of the states population being served by councils considered to be financially unsustainable. Tasmanian councils generally exhibit operating deficits, with rates revenue growing less than expenses, despite council's strong balance sheet. The major financial pressures for Tasmanian councils is the operating deficits and the annual renewals gap and associated infrastructure backlog, although preliminary estimates show this to be manageable.

Likewise for Western Australia, council's have been running operating deficits and funding this through capital surpluses, therefore cutting back on annual renewals and creating an infrastructure backlog. It is estimated that 21 per cent of the states population is being served by a council categorised as being financially unsustainable. For South Australia, 50 per cent of the population is served by council's categorised as financially unsustainable.

Financial Sustainability Review Board, South Australia (2005)

This inquiry into the sustainability of long-term financial performance and position of council's in South Australia was commissioned by the states local government association. Similar to the reviews in other states, the Financial Sustainability Review Board found that South Australian council's had a strong balance sheet because of a low level of debt. However, examination of operating statements shows consistent

operating deficits and an infrastructure backlog. It was estimated that 33 councils in SA, accounting for 50 per cent of the states population, were classified as unsustainable or vulnerable.

PwC

PwC was commissioned by the Australian Local Government Association to report on the financial sustainability of local government at a national level. PwC completed financial ratio analysis for a sample of 100 councils and stratified these results to be a representative sample. They also extrapolated results from the Access Economics state based sustainability studies to get a national picture of the financial sustainability problem facing local government. The PwC estimate that approximately 10 to 30 per cent of Australia's councils have sustainability issues. In relation to sustainability by council type, the PwC ratio analysis indicated that rural remote and rural agricultural councils are the council types more likely to be experiencing viability problems, whilst a significant number of urban fringe councils are also facing challenges. The general finding in Australia is that councils facing sustainability issues are developing infrastructure backlogs due to the funding gap between current and required revenue to enable them to clear the backlog and lift renewals expenditure to the optimal level.

Productivity Commission (2008)

The PC Report[71] undertook an analysis of the revenue raising capacity of local government, a key factor impacting on local government's financial sustainability. The Commission undertook multivariate regression analysis using stochastic frontier technique to identify the scope for different types of councils to raise additional revenue. Given the diversity of factors affecting a council's revenue raising efforts, variables controlling for these factors such as community income and demographic attributes were included within the regression analysis. The wide variations in the revenue raising effort indicate that there are other factors affecting revenue raising effort. Their analysis focussed on the ALGA classification of councils at a national level and found that all councils have the ability to raise additional revenue; with capital city, urban developed and urban fringe councils with the greatest scope. Rural and remote councils have the least scope to raise additional revenue.

71 Productivity Commission, 2008, Assessing Local Government Revenue Raising Capacity, Australian Government, April 2008.

D Regulation of rates overseas

The following section details the roles and responsibilities of local councils and the local council tax systems of three countries. Two of these are Canada and New Zealand which have federal systems similar to Australia. The other is the United Kingdom which has a unitary system of government but has retained centralised rates capping powers comparable to those in New South Wales.

D.1 Canada[72]

The Canadian federal system consists of a federal government, provincial governments and local governments. According to the *Constitution Act 1867* everything not mentioned as belonging to the provincial governments comes under the power of the federal government. The provincial governments re responsible for issues explicitly given to them in Canada's written constitution the *Constitution Act 1867*. Through the provincial legislature the provincial government has the power to enact or amend laws and programs related to:

- Natural resources
- Hospitals
- Property and civil rights in the province
- Education
- Administration of justice
- Social services.

In turn Canadian local governments consist of municipal governments and smaller specific purpose local authorities such as school boards. Examples of services provided by municipalities include transportation (roads), emergency services, property related services, land use planning and social and health services. Due to increased expenditure by provincial governments, local governments share of total government expenditure in Canada (mainly in social services areas, particularly health), has decreased.[73]

72 Government in Ontario. www.yourlocalgovernemnt.com/ylg/govinont.html.

73 Shah, *Local Governance in Industrial Companies*, Public Sector Governance and Accountability Series, the World Bank, Washington (2006).

The *Municipal Statute Law Amendment Act 2006* recognizes municipalities as responsible, accountable governments. The broader powers and significant legislative freedoms enable municipalities to better determine the appropriate mechanisms for delivering municipal services to their communities. The new accountability framework departs from the previous one size fits all regulatory provincial approach.

The Act ensures that local councils are accountable to the public and that the processes for making decisions are more transparent. Municipalities can now have a more effective accountability regime with the authority to establish an integrity commissioner, ombudsman, auditor general and lobbyist registrar.

The Municipal government collects property taxes from each property owner. The taxes are calculated by multiplying the assessed value of a property by a tax rate. There are two parts to the tax rate:

- the municipal tax rate which is set by the municipal government and
- the education tax rate which is set by the provincial government.

A municipality can set different tax rates for different classes of property, and the main classes of property include residential, multi –residential, commercial and industrial. While most of the money for financing the municipal services is raised through the property taxes paid for by residents and businesses, additional funding comes from 'user fees' or 'non tax' revenue from parking fines, and some funding comes from the provincial government.

D.2 New Zealand[74]

The Labour led government that came into power in 1999 rewrote both the rating legislation and the local government act. The local government act was influenced by recent developments internationally, most importantly the *Local Government Act of 2000* (England) which conferred on local authorities a power to promote well being. Councils in making decisions are now subject to rules requiring them to give consideration to the views and preferences of persons likely to be affected by those decisions at each stage in the decision making process.

Importantly councils are now required each six years to go through a process of identifying community outcomes for the intermediate and long term future of their district or region. The community outcomes in turn, underpin what is now the key planning document for New Zealand local authorities- the Long Term Council Community Plan (LTCCP). This is prepared every three years but with a provision which enables local authorities to make amendment s between LTCCPs subject to public consultation and compliance with certain audit requirements.

74 Peter McKinlay, *Autonomy versus Accountability: the New Zealand Experience*, Local Government Centre, Auckland University of Technology, 19 Jan 2006. (www.lgsa-plus.net/resources/documents/mckinlay).

From an accountability perspective two very important requirements apply. Firstly certain decisions may only be taken if they were provided for in the LTCCP. The second requirement is that the LTCCP must contain a report from the local authority's auditor (in practice the Auditor–General) on the extent to which the local authority has complied with the act in respect of the LTCCP, the quality of the information and assumptions underlying forecasts information provided in the plan, and the extent to which the information and performance measure provide an appropriate framework for the meaningful assessment of the actual levels of service provision.

Changes to rating legislation further reinforced the autonomy of council. They have retained all of the rating tools which they had previously and have been given a new and potentially very powerful one, the targeted rate. This now allows councils to establish a rate ad valorem or as a fixed amount in respect of any property or properties defined in terms of a wide range of characteristics. The New Zealand councils now have the legal powers to tailor make almost whatever rating system they wish with only limited statutory constraints (ie, such as a restriction on the percentage of revenue which may be raised through a uniform annual general charge).

In the New Zealand system, the central government is not involved with local government as is the case in Australian states or in the United Kingdom. Accountability to the community rather than government intervention, is seen as the appropriate means of protecting the ratepayer. This has been combined with a policy stance by successive governments, both that rating should be the principle funding mechanism for local government, and that it is adequate to meet the needs of councils. This has been reinforced in Local Authority Funding Issues:

> …overall our conclusion is that rates levels, and their projected increases, do not place an unsustainable burden on communities in relation to the services and facilities provided … many of these are basics services, like water and sanitation, are mandated by the community through the political process.[75]

There are features of the New South Wales local government system which make it considerably different from New Zealand's such as heavy reliance on Federal Government funding either directly or indirectly and associated with that the interplay between local, state and federal governments.

75 Joint Central Government/Local Authority Funding Project team, *Local Authority Funding Issues, July 2005,* p 49.

D.3 United Kingdom[76]

Council tax is a local tax based on the capital value of a property, raised by local authorities to help pay for local types of services. Council tax provides a part of the money that is required to provide the services that local communities need, for example policing, fire services, providing support to the elderly and vulnerable, the maintenance of parks and open spaces, rubbish removal and street cleaning.

However not all of the money needed by local councils is raised through council tax. Central Government is providing local councils in England with over 70 billion pounds in 2008/09 (an increase of 4 per cent from 2007/08), to enable them to deliver all of the services that the community expect. This includes specific and general grants and non domestic rates.

In dividing this up between councils, the government takes account of the number and values of the properties in each area and the cost of providing services there. The Government recently announced the first ever three year settlement form local government in England- by 2010/2011 the settlement will provide a 45 per cent real terms increase since 1997 in Government funding for local authorities. A guide to how the local government fiancé settlement works can be found at www.local.communities.gov.au/fiance/0607/simpguide.pdf

In the past the Government set a cap or budget requirement limit for each council. This limit was announced before councils set their budget requirements. The Government has not done this since 1998/99. Local authorities are responsible for setting council tax bills in light of their budget for the year but the Government has powers to cap excessive increases. Capping action has been instigated against eight authorities in 2008/09. For 2006/07 and 2007/08, the Government has made clear its expectations that the average council tax increase in England should not exceed 5 per cent in either year; and that it will not hesitate to use its capping powers if that proved necessary.

Local authorities decide the total amount of council tax they wish to raise. The rules for deciding how that amount is then raised from individual properties are set out in the legislation. Properties in England are placed in one of eight bands depending on what the property would have sold for in April 1991. The council tax rises in set proportions through the bands. The tax bill for each parcel of land will depend upon the band in which the property falls and on decisions by the council on overall spending levels.

The Valuation Office Agency (VOA) is responsible for allocating a council tax banding to all homes in England, maintaining the council valuation lists and answering queries. Council tax bills do not just take into account the value of the property but also the circumstances of the residents through a system of discounts and exemptions.

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76 See www.communities.gov.uk/localgovernment/localgovernmentfinance/counciltaxes and www.communities.gov.uk/news/corporate/government-welcomes-lyons.

Council tax bills do not just take into account the value of property but also take into account the circumstances of the residents through a system of discounts and exemptions. For example persons living alone are entitled to 25 per cent off the bill, a full time student will not have to pay council tax. Those who are living with and caring for someone who is not a family member will not be counted for council tax purposes. Persons on a low income may be entitled to council tax benefit which can cover up to 100 per cent of the tax bill.

In his Inquiry into Local Government (published in March 2007), Sir Michael Lyons concluded that the council tax system should be retained and that conclusion was supported by the Government. The Inquiry concluded that the tax system had a number of significant practical advantages. For example its yield was predictable and stable and was relatively easy to collect. The tax system also strongly reinforced the accountability of local authorities to their communities and helped to provide a link between the tax people pay and the benefits they take from local services.

The evidence from the Lyons Inquiry also showed that revaluation would not have a significant effect on the fairness of council tax relative to income. Sir Michael's analysis showed that following a revaluation more than four million properties could go up by at least one band which could cause significant disruption for individuals and families. The Government has therefore made a commitment not to revalue during the lifetime of the Parliament and that no revaluation was expected to be considered until after 2010/2011. At that point there would need to be clear benefits given to households that could be involved.

E Issues

IPART has identified the following issues as being important to this review and seeks comment on them.

1 What is the role of local government and how is it determined? 6

2 How effective is rate pegging and what are the implications for councils and ratepayers? 7

3 What are the objectives for a regulatory framework for local government revenues? 7

4 How does the current regulatory framework for council revenue, or any alternative framework: 7

- Promote the effective and efficient provision of services? 7
- Enhance the financial sustainability of local government? 7
- Meet the standard of principles for good regulation and taxation – efficiency, equity, simplicity, transparency? 7
- Enhance the accountability of local government? 7

5 What role should IPART play in setting local government rates and charges, including charges for non-business activities? 7

6 Should IPART have a determinative role provided by legislation or should IPART's role be limited to making recommendations, if and when requested by the Minister? 7

7 To what extent do government authorities - such as SHFA, SOPA, RWA and the GCCs - provide services that duplicate or overlap with those of local government? 7

8 What are the implications for local government rates where these authorities provide services normally provided by local government? 7

9 Should a common regulatory framework be introduced for these authorities? 7

10 Is the Department of Local Government modification of the Australian Classification of Local Governments (ACLG) a suitable framework within which to consider the differences between councils? 15

11 How does the current regulatory framework impact on the efficiency of rate setting by councils? 19

45 How should IPART's role be implemented (for example, by a legislative amendment giving IPART a determinative role or by a terms of reference from the Minister requiring recommendations from IPART)? 65

46 Whether a common legislative or regulatory framework be introduced to improve consistency in the levying of charges by authorities (such as SHFA, SOPA, RWA and GCC) that provide services akin to those provided by local government? 75

47 The best form for this legislative or regulatory framework to take? 75

48 To the extent that these authorities provide services that overlap with or duplicate those of local government, what benefits and disadvantages arise from the duplication of service provision? 75

49 To the extent that these authorities provide local government services how should the costs of these services be recovered? To what extent would these arrangements promote: 75

- Efficiency 75
- Equity 75
- Simplicity 75
- Transparency. 75

50 Similarities and significant differences (in quantum, scope or standard of service) between SHFA, SOPA, RWA and neighbouring councils in regards to: 75

- current regulatory frameworks including governance arrangements, accountability to the local community and the role of the State Government in setting fees and charges and determining revenue levels and/or mix 75
- property related services including land use planning, the processing of development applications, development activities, the levying of developer contributions, conservation of natural and cultural heritage, management of public domain areas and provision of infrastructure 75
- management of major events and regional promotions, and 75
- responsibilities under the *Roads Act 1993*. 75

51 The potential overlap between the Growth Centres Commission's development approval and infrastructure planning processes and those used by Growth Centres Councils. 75

52 The extent to which SHFA, SOPA, RWA and the GCC, respectively, impact upon the costs incurred and revenues generated by the corresponding councils. 75

F Glossary

ABS	Australian Bureau of Statistics
ACLG	Australian Classification of Local Governments
ALGA	Australian Local Government Association
Annual Charges	A charge levied by council on an annual basis for provision of services. These charges are levied against the land.
CPI	Consumer Price Index
DLG	Department of Local Government
DOTARS	Department of Transport and Regional Services (Commonwealth) (now Department of Infrastructure, Transport, Regional Development and Local Government)
EBIT	Earnings Before Interest and Tax
FAG	Financial Assistance Grant
Fees	A charge imposed by council for the provision of a service at the time of its use. This is charged to the user of the service and is not a charge against the land.
GCC	Growth Centres Commission
GDP	Gross Domestic Product
GSP	Gross State Product
GST	Goods and Services Tax
IPART	Independent Pricing and Regulatory Tribunal
KPI	Key Performance Indicator
LGA	Local Government Area
LGSA	Local Government and Shires Associations

LTCCP	Long Term Council Community Plan (NZ)
NCP	National Competition Policy
OECD	Organisation for Economic Cooperation and Development
PC	Productivity Commission
PwC	PricewaterhouseCoopers
Rates	A tax on property which is for a local purpose and assessed and paid to local government. Under the Local Government Act, a rate may consist of: (a) an ad valorem amount (ie, an amount calculated according to the rateable value of the property), or (b) a base amount to which an ad valorem amount is added.
ROC	Regional Organisation of Councils
RWA	Redfern Waterloo Authority
SEPP	State Environmental Planning Policy
SHFA	Sydney Harbour Foreshore Authority
SOPA	Sydney Olympic Park Authority
SPP	Specific Purpose Payment
UCV	Unimproved capital value
VOA	Valuation Office Agency (UK)