IPART Review

Revenue Framework for Local Government

Submission of the
Urban Development Institute of Australia (NSW)

September 2008

INTRODUCTION

The Urban Development Institute of Australia NSW (UDIA NSW) is a proud advocate of the urban development industry. Our members generate more than $15 billion worth of activity for the NSW economy annually. Our members include developers, regulators, and affiliated professionals.

UDIA NSW has reviewed the Independent Pricing and Regulatory Tribunal's (IPART) Issues Paper on its Review of the Revenue Framework for Local Government and appreciates the opportunity to comment. The financial sustainability of local government is a major contributor to the viability of responsible, ethical and sustainable urban development and as the voice of the industry, UDIA NSW believes it can provide recommendations that will assist in the provision of an appropriate financial and regulatory framework for NSW councils.

The NSW Government has since 1977 maintained a tight regulatory regime on councils' capacity to raise revenue, intended to foster an efficient and prudent approach to fiscal discipline. Rate pegging was designed to encourage and indeed force councils to manage their capital and service expenditure in the context of a constrained and relatively inflexible revenue stream. This approach has helped to foster an entrepreneurial enthusiasm in many councils who have sought to identify and maintain additional revenue streams. Contrary to the strict reporting and regulatory regime for rate pegging, most of these alternative sources of revenue have not been subject to any rigorous third party review.

One of the significant contributors to council revenues has been development contributions. UDIA NSW appreciates that the consideration of development contributions have been explicitly excluded from the scope of this Review other than to the extent that they will impact on rate pegging. UDIA NSW believes that this approach to the Review implicitly acknowledges the role devlopment contributions have played in providing a resource to fund services and infrastructure in the absence of a direct nexus to new development.

UDIA NSW contends that fundamental to any investigation of the revenue framework for local government must be the consideration of the appropriate governance framework to deliver council services. IPART's review of the revenue framework overlooks the fiscal benefit that can be derived from more efficient service and infrastructure provision and UDIA NSW would strongly encourage the expansion of the terms of reference to address this opportunity.

The fiscal responsibility of local government is paramount to the viability of the urban development industry. The failure of the current revenue framework to provide a sustainable funding mechanism for urban expansion is an acute demonstration of the need for widespread reform. UDIA NSW welcomes the IPART review and appreciates the opportunity to contribute to this important debate.

RATE PEGGING

The collection of rates provides the most effective means of revenue collection for local government. It is a broad, efficient means of taxation that provides a consistent and reliable revenue source for councils.

The NSW Government has since 1977 maintained a tight regulatory regime on councils' capacity to raise revenue through rate pegging. Rate pegging arbitrarily constrains the capacity of local authorities to utilise their broadest most efficient revenue source to fund expansions in service and infrastructure provision. This is highlighted in the Productivity Commission's recent report, Assessing Local Government Revenue Raising Capacity,

> *"The rate of growth in rates revenue in New South Wales has been among the lowest of all jurisdictions over the past seven years, for which reliable data are available. New South Wales also has rate revenue per person below that of most other jurisdictions. Rate pegging in New South Wales appears to be restricting revenue raised from rates, notwithstanding scope for councils to seek variations to mandated rate increases. In addition, only partial reimbursement of concessions affects the revenue of local governments in New South Wales. The evidence suggests that the NSW Government has chosen to have a more significant constraining influence on the revenue raised by local governments than have other State governments."*[1]

Ironically, the tight regulation of rate pegging has fostered an environment for largely unchecked expansion of council revenue raising from alternative sources. These alternative sources have not been regulated or subject to an equivalent degree of accounting rigour. This has included the expanded use of development contributions to fund infrastructure backlogs and to generate accrued interest income from unspent contributions.

The increased dependence on development contributions has led to an expansion in charges for new homebuyers and a corresponding decrease in urban development investment. NSW recently has experienced a near fifty year low in dwelling production with only 29,300 commencements. The production of fewer homes has provided less development contribution income for councils. The Productivity Commission found that:

> "*Rate pegging has dampened revenue raised from rates in New South Wales relative to other States and there seems to have been little offset from non-rates revenue sources in recent years."*[2]

Rate pegging was designed to encourage and indeed force councils to manage their capital and service expenditure in the context of a constrained and relatively inflexible revenue stream. UDIA NSW contends that this has forced councils to make more effective use of less stringent regulation of alternative revenue sources to supplement rate income. In the case of development contributions, this has had a significant, deleterious impact on housing affordability.

The diversity, size and varying characteristics of local government areas are all fundamentally important factors that affect a council's capacity to generate income. These factors are largely ignored by the regime of rate pegging. UDIA NSW contends that there is an acute need for a more flexible approach to regulating local government revenue.

As councils are monopoly providers of some basic community services, in the interests of open and transparent governance, there is a strong case for some regulation in determining their rates, fees and charges. UDIA NSW contends however that an arbitrary approach to such regulation is undesirable and fails to adequately address the dramatic disparity in challenges faced by different authorities.

---

[1] Australian Government Productivity Commission (2008), *Assessing Local Government Revenue Raising Capacity,* Productivity Commission Research Report, Melbourne.
[2] Ibid.

Discretionary Differential Rating

The use of differential rating at a council level recognises the structural and temporal variances on the rate base and provides the necessary flexibility for a local authority to tailor charges according to demand for services and infrastructure. The Productivity Commission found that;

> *"Differential rating provisions generally increase the capacity of councils to raise revenue from property rates. They do so by enabling councils to structure better rates payable to the different capacities to pay of, and services received by, different categories of ratepayers."*[3]

UDIA NSW believes that the dramatic disparity in challenges faced by the different councils provides a compelling case for the introduction of a differential rating scheme for entire local government areas. This scheme would provide a greater degree of flexibility to account for councils who must provide for significant increases in dwelling production or employment while maintaining a regulatory role for the NSW Government or its delegate.

The use of differential rating recognises that some local government areas have different strategic roles to play in delivering broader regional outcomes. It could provide scope for a qualitative assessment of the needs of different councils to provide infrastructure and services while providing opportunity for councils to utilise an increased revenue source to meet local demands.

A differential rating scheme would allow the NSW Government to moderate the impact of development contributions on new homebuyers by providing a more efficient and equitable way for councils to fund infrastructure. The Government has provided a strategic framework to support growth in NSW through the Metropolitan and Regional Strategies. It is important that these strategic documents are supported by an appropriate economic framework for councils to deliver infrastructure and services to facilitate and support planned growth.

UDIA NSW suggests that while such a differential rating scheme should be determined on a qualitative needs-basis, IPART should have an upfront role in identifying and quantifying the range of needs that should be delivered by the council. This would assist in ensuring that the scheme avoids abuse from spurious claims for local needs. IPART would also be responsible for providing advice on appropriate rate ranges

UDIA NSW advocates a role for IPART in providing a framework for local government rates through:

- determining a series of differential rate variations for groups and/or types of councils based on an assessment of the need for the LGA to achieve local and sub-regional outcomes such as employment and housing creation;

- providing advise to councils on appropriate rate ranges and processes; and

- reserving the right to cap proposed council rate increases if IPART determines the increase to be unjustifiable.

This model affords councils the opportunity to exercise more control over their principle revenue stream within the context of an acknowledged strategic regional context. It recognises that some councils have more demands for capital and operational expenditure than others and provides more flexibility to meet those challenges accordingly. Importantly, it also ensures an overarching role for IPART in determining a broad advisory framework for the range of charges that should apply in different areas, and also in ensuring that councils are

[3] Australian Government Productivity Commission (2008), *Assessing Local Government Revenue Raising Capacity,* Productivity Commission Research Report, Melbourne.

not abusing the flexibility of the system to introduce rate increases in the absence of adequate justification.

RECOMMENDATION 1

UDIA NSW recommends that rate pegging be abandoned and replaced with a more flexible and fiscally responsible differential rating mechanism regulated by IPART.

RECOMMENDATION 2

UDIA NSW advocates a role for IPART in providing a framework for local government rates through:

- *determining a series of differential rate variations for groups and/or types of councils based on an assessment of the need for the LGA to achieve local and sub-regional outcomes such as employment and housing creation;*
- *advise councils on appropriate rate ranges and processes; and*
- *reserve the right to cap proposed council rate increases if IPART determines an increase to be unjustifiable.*

DEVELOPMENT CONTRIBUTIONS

On 1 February 2008, the Minister for Planning revealed that NSW Councils had collectively accumulated $1.3 billion in unspent s94 developer contributions[4]. Despite significant amendments to s94 allowing borrowing between trusts and the effective extinguishing of nexus, councils experience difficulty in utilising development contributions in combination with consolidated revenue to deliver infrastructure.

Recent reforms to the *Environmental Planning and Assessment Act 1979* have sought to codify the range of facilities for which councils can levy new development and have also introduced a number of key considerations councils must make when preparing a contributions plan. UDIA NSW anticipates that this will likely result in some rationalisation of the scope of existing contributions plans but will not necessarily lead to lower levies for new development. Importantly, there is no explicit review or arbitration role for the NSW Government in examining the quantum of the charge.

There are structural and procedural inefficiencies that prevent councils from making best use of development contributions and therefore diminishing the efficiency of their use of rate revenue. These include:

1. the spatial and temporal base for development contributions is often too narrow to allow for efficient revenue collection and can result in delayed and fragmented capital expenditure;

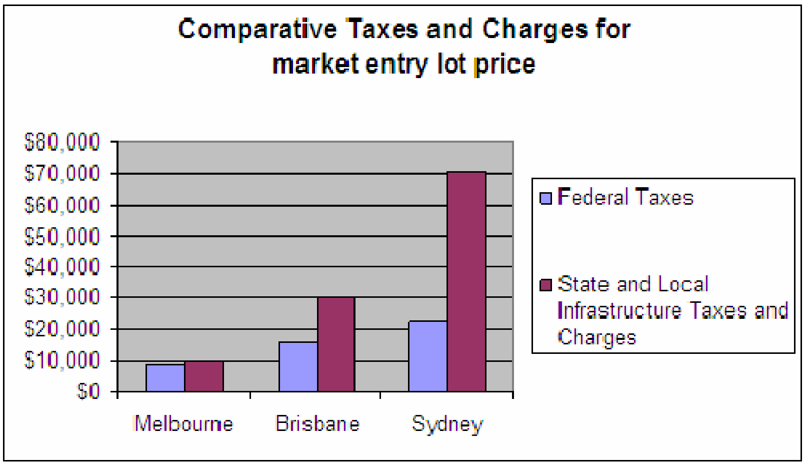
2. the scope of facilities included in contributions plans can be too broad, with only a proportion of the cost of each capital item apportioned to the revenue from development contributions. This means that councils' are required to fund the remaining capital cost from existing consolidated holdings or other revenue streams; and

3. there are no third party review mechanisms to confirm that councils are making prudent assessments of infrastructure demands and ensuring efficient procedures and structures for delivering the infrastructure in a timely fashion.

[4] Minister for Planning (2008) Australian Financial Review, 2-3 February 2008

These structural and procedural constraints have resulted in an over dependence on the use of development contributions to fund infrastructure that benefits the broader rate base, rather than specifically to support and facilitate new development. The loose regulatory control on the role of development contributions has led to the scenario where the mortgage repayments of new homebuyers have been used to supplement council revenues. This has had a significant deleterious impact on housing affordability.

Development contributions are a narrow form of taxation that is inefficient, inequitable, and complex. Their use in providing community wide infrastructure in the context of insufficient consolidated revenue contrasts dramatically with the simplicity, efficiency and transparency of the broad income base provided by rates.



The cost of providing housing in Sydney is already dramatically more expensive than in Brisbane or Melbourne courtesy of the continual cost shifting to new homebuyers. New homebuyers in Western Sydney are paying twice as much in state and local levies than they would in Brisbane and more than seven times than in Melbourne.

The provision of an efficient revenue source to fund infrastructure to support growth is the principal determinant of housing affordability in NSW. The most efficient revenue source for local infrastructure is rate revenue. UDIA NSW contends that rate pegging should be replaced by a more flexible scheme that allows councils to efficiently and effectively plan for growth and does not compromise housing affordability.

COUNCIL GOVERNANCE

Fundamental to any investigation of the revenue framework for local government must be the consideration of the appropriate structural framework to deliver council services. This is acknowledged in the Issues Paper and will be considered by IPART with regard to the standard principles for good regulation and taxation, including; efficiency, equity, simplicity, and transparency. Structural reform to local government has the potential to generate significant economic and social benefits for New South Wales and warrants consideration as part of the IPART Review.

One of the most contentious features of Australian microeconomic reform has been the restructuring and amalgamation of local government areas[5]. With rare exceptions, structural reform has been instigated by the state governments, and most often in the context of the financial, legislative and corporate governance reforms advanced over the same period[6]. New South Wales and Western Australia are the only states in which significant structural reform has not yet occurred.

Although the objectives and modus operandi of state-based structural reform to local government vary significantly, one of the common principle arguments advanced is for public finance consolidation. This is based on the economic theory that the size of a particular government should correspond with the 'benefit region' or the area of the benefit flowing from the infrastructure and services it provides to constituents. This concept from a local

[5] Sproats, K. (1998), Australian local government reform in the 1990s, *Public Productivity and Management Review.*
[6] Dollery, B & Worthington, A (2000), *An Analysis of Local Trends in Australian Local Government,* University of New England School of Economic Studies.

government perspective provides that there is an optimal community size for an individual council, based on the infrastructure and services the authority can or should provide. In a constrained funding environment, it could be reasonably argued that the best council structure would be one that delivers services the most efficiently.

The conventional argument viz a vis governance efficiency suggests that larger councils with a broad rate base have the capacity to generate the necessary economies of scale in service and infrastructure provision and therefore are more inclined to maintain fiscal sustainability. Their scale also provides a broader market from which to gather alternative revenue streams, including the selling of goods and services. It also suggests a greater level of containment of the benefit area within the council boundary.

One argument for consolidating local government areas is that the benefit derived from services provided by one council can extend into neighbouring jurisdictions, and this may not be reflected in the revenue derived by the authority in providing the service. This generates inefficiencies in the service provision. The corresponding argument would suggest that in some cases a council's scale is too small to generate comparable benefits experienced by constituents in larger local government areas.

This is evidenced by the inability of some councils to utlise development contribution revenue to fund local infrastructure. In 2003 UDIA NSW published a report showing that the Sydney Councils alone had accumulated close to $800 million in unspent contributions. This is not entirely surprising given the narrow spatial scope some Sydney councils have to deliver infrastructure to the community. Within a 15km radius of the Sydney CBD are 27 councils, governed by more than 300 elected councillors.

	Council	Number of Councillors	Number of DAs	Value of DAs Millions	Mean DA Assessment Time
1	Ashfield	15	306	$43.30m	66
2	Auburn	12	385	$165.50m	117
3	Bankstown	15	1143	$192.40m	59
4	Botany Bay	12	378	$102.60m	87
5	Burwood	12	286	$34.40m	39
6	Canada Bay	12	619	$209.50m	52
7	Canterbury	7	660	$83.30m	73
8	Hunter's Hill	9	147	$35.20m	109
9	Hurstville	9	1237	$153.00m	38
10	Kogarah	7	445	$136.40m	48
11	Ku-Ring-Gai	9	1408	$361.10m	60
12	Lane Cove	13	410	$89.90m	84
13	Leichardt	12	539	$91.50m	109
14	Manly	13	478	$83.00m	124
15	Marrickville	12	546	$59.60m	66
16	Mosman	10	374	$216.00m	122
17	North Sydney	7	591	$236.50m	77
18	Randwick	15	921	$214.40m	37
19	Rockdale	12	579	$997.10m	63
20	Ryde	12	1048	$824.10m	69
21	Strathfield	10	314	$47.10m	103
22	Sutherland	12	1356	$271.10m	25
23	Sydney City	12	2610	$2,600.00m	38
24	Warringah	12	1148	$312.00m	69
25	Waverley	10	674	$123.40m	78
26	Willoughby	9	928	$433.00m	64
27	Woollahra	15	871	$242.80m	102
	Total	**305**	**20401**	**$8.3Billion**	**73.2 days**

NSW Development Performance Monitoring 2006-2007

These councils alone accounted for more than 20,000 development applications in 2007 and corresponding development contributions. Many of the capital items intended to be funded by these development contributions can provide sub-regional benefits, but some councils lack the critical mass and regional influence to deliver the infrastructure. This is evidenced by the prolonged accumulation of unspent funds.

These infrastructure items are needed to support dwelling and population targets that underpin the Sydney Metropolitan and Regional Strategies. There is a need for councils to act in the regional interest by supporting growth through efficient governance, sympathetic regulation and infrastructure provision. The structural framework in NSW and Sydney in particular, is not delivering this framework and needs reform.

UDIA NSW is not suggesting that the size of a local government area is the exclusive determinant of efficiency and indeed fiscal sustainability. A large council with a significant urban release area would be faced with a dramatically different set of challenges to a small inner-metropolitan authority, regardless of the scale of the rate base.

What is clear is that councils need to have more regional influence to support growth and deliver the most efficient provision of services. This must be a product of structural reform. Significant structural reform in Victoria, in which the number of councils was reduced from 210 to 78 over the period August 1993 to February 1995 delivered savings of $249 in the restructured system in the first year[7]. There is undoubtedly a significant efficiency dividend to be delivered by ensuring that local government boundaries are better reflective of the benefit that a single council can and should deliver through its service and infrastructure provision.

UDIA NSW contends that the fiscal benefit from structural reform to local government in NSW that can be derived is significant and must not be overlooked. UDIA NSW recommends that IPART expand the review to examine the potential for structural reform to deliver greater efficiency in local government service and infrastructure provision.

RECOMMENDATION 3

IPART examine the potential for structural reform to deliver greater efficiency in local government infrastructure and service provision.

[7] Dollery, B & Worthington, A (2000), *An Analysis of Local Trends in Australian Local Government,* University of New England School of Economic Studies.

CONCLUSION

Ensuring the fiscal and operational sustainability of local government is fundamental to the viability of the urban development industry and the provision of housing affordability in NSW. UDIA NSW believes that significant reform is required to deliver a framework that provides greater capacity for councils to meet their capital and operational expenditure obligations in the most efficient fashion. UDIA NSW strongly supports this IPART Review and has provided three recommendations it believes should be considered by the Tribunal in its examination and development of the future regulatory framework.

RECOMMENDATIONS

1. UDIA NSW recommends that rate pegging be abandoned and replaced with a more flexible and fiscally responsible differential rating mechanism regulated by IPART.

2. UDIA NSW advocates a role for IPART in providing a framework for local government rates through:

   - determining a series of differential rate variations for groups and/or types of councils based on an assessment of the need for the LGA to achieve local and sub-regional outcomes such as employment and housing creation;

   - advise councils on appropriate rate ranges and processes; and

   - reserve the right to cap proposed council rate increases if IPART determines an increase to be unjustifiable.

3. IPART examine the potential for structural reform to deliver greater efficiency in local government infrastructure and service provision.