

27 August 2008

Independent Pricing and Regulatory Tribunal  
PO Box 290  
QVB Post Office NSW 1230

*Email: [ipart@ipart.nsw.gov.au](mailto:ipart@ipart.nsw.gov.au)*

Dear Sir/Madam

### **Review of Local Government Revenue Framework**

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Submissions have been invited by 29 August 2008 in regard to IPART'S review of Local Government's Revenue Framework in New South Wales.

Baulkham Hills Shire Council was informed by way of report to the Ordinary Meeting on 26 August 2008.

Whilst your report is very comprehensive and extensive, Baulkham Hills Shire Council wishes to emphasise that any review of Local Government's Revenue Framework should also be taken in the context of constitutional recognition, expenditure framework review and the ability for those Council's that are fiscally responsible and sustainable to have greater independence in their revenue determination.

Firstly, however I do draw attention to Council's correspondence of 25 June 2008 in regard to the review of State Taxation. The proposal in that draft report that Local Government loses exemption from payroll tax and also be responsible for collection of that part of the New South Wales Fire Brigade Levy presently collected by insurance companies are both once again rejected outright. As indicated in our previous correspondence removal of the exemption of payroll tax would need to bring into question the issue of non rateability of Crown Lands. The issue of New South Wales Fire Brigade levies is as indicated in our letter of 25 June 2008, simply tax shifting. Provision of Fire Brigade Services is the responsibility of State Government not Local Government as defined in legislation and should be collected as a State Government Tax not as an impost on Local Government to avoid accountability.

Turning now specifically to Local Government Revenue. As IPART would appreciate Local Government has a range of revenue sources and unfortunately these are covered or affected or directed by a range of legislation. Quite often changes in one area have an indirect impact in other areas. For example, recent changes to the planning legislation which will restrict funds to be collected from Section 94 Contributions have the impact of requiring Council's in the future to seek special rate variations to cover the shortfall. This will result in double

dipping for some ratepayers who have already paid Section 94 contributions and then will have to subsidise other residents.

### **Rates**

Part 7 point 4 (Attachment 1) of the Issues Paper puts forward a number of options for alternative regulatory frameworks in regard to rate pegging. This Council would support option 4. ie. 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 ten year timeframe through an approved and independently audited management plan. This Audited Plan could be tabled in Parliament and made publicly available.

Baulkham Hills Shire Council has displayed and exercised extreme fiscal discipline over many years and has utilised increased revenue from growth to not only fund maintenance and infrastructure but also to establish reserves for the future. Whilst it would be nice to expect complete removal of rates capping, it would be unreasonable to expect that those unsustainable or unviable Council's have an expectation to the removal of rate capping. Criteria as outlined in option 4 in your discussion paper are worthy of consideration.

### **Fees And Charges**

All Council's as part of their management plan either have an adopted pricing policy in regard to fees and charges. Attachment 2 is this Council's pricing policy. What is not known is how consistent are management plans across the state in regard to first of all adopting a pricing policy and secondly applying it. Where Council is subject to statutory fees and charges then there would be no objection to IPART playing a role in their review. eg. Planning fees etc.

### **Interest**

There has been much said in recent times about local government investment policies. However it needs to be pointed out that firstly Baulkham Hills Shire Council had no exposure to the CDO market or similar, however where Council's did have exposure they were following guidelines set by NSW Treasury. Whilst the NSW Treasury has been quick to criticise local governments investment policies and in actual fact in recent times changes to the planning legislation will mean that the Section 94 monies will need to be invested with State Treasury, no comment was made that the policies were made by the Treasury in the first place. It is understood that not all other states had a similar exposure to CDO's and it is recommended that if Treasury wishes to further promulgate investment policies for local government, some comparison be made of those states where there was limited or no exposure to CDO's.

### **Developers Contributions (Section 94)**

Recent changes to legislation have somewhat limited the flexibility of Section 94 Contributions but not to a great extent. What is of more concern to Local Government is the timeframe in which these monies need to be spent 7 years when often land release areas go on much longer and secondly the fact that that monies rent collected are to be invested with Treasury. It is recommended that provided the appropriate criteria is applied in developing Section 94 Plans,

1. that they become non appellable
2. investment of funds remain with Local Government.

Perhaps the biggest impost on local government in terms of Section 94 is Land Acquisition. In recent years particularly in the Baulkham Hills Shire Council area and other areas this has been compounded by the impact of the Just Terms Compensation Act. This has resulted in the unreasonable determination of price in certain land purchase transactions. During recent changes to the planning legislation neither the Treasury nor the Planning Department were interested in instigating changes in the Just Terms Compensation Act. The Just Terms Compensation Act must be changed to protect local government from excessive land acquisition costs.

### **General Purpose Grants**

The principal General Purpose Grant is known as the Federal Assistance Grant. Whilst it is acknowledged from time to time governments will at a State and Federal level add extra components to these grants such as the roads component, the core General Purpose Grant is a grant that has been in place since 1975. Initially introduced as a result of an initiative of Prime Minister Whitlam whereby local government would be entitled to 2% of income tax revenue. Obviously personal income tax revenue has changed over the years as a result of a change in the nations economic development and the introduction of GST. The General Purpose Grant or Federal Assistance Grant has not kept pace with the original philosophy in terms of quantum.

However the allocation of the Grant through a hierarchy of Federal Grants Commissions supplemented by State Grants Commissions probably brings to the fore one of the greatest anomalies in local government revenue funding in the last 30 years. Whilst initial funding was based on the concept of disability, this methodology was changed to one of fiscal equalisation. The term with numerous mysteries, twists and turns has no accountability. The concept of fiscal equalisation is that all local authorities should be in a position to provide the same services. However not once in over 30 years has the Federal Government, State Government, Grants Commissions or any bureaucracy set out to establish if these funds have been used to address disabilities or subsequently fiscal equalisation. 30% of the grant is allocated on a population basis and 70% on the fiscal equalisation methodology. The Grants Commissions over the years have been reluctant to divulge fully their formulas for distribution, however it is known that a considerable component in the NSW distribution methodology is land valuations. As a result those Council's who have land valuations higher than the average are greatly disadvantaged to the extent where when recently visited by the Grants Commission, this Council was advised that in actual fact we owe the Grants Commission \$12million. Using land valuations as part of the methodology of distribution on

the basis of fiscal equalisation is ludicrous. A comparison with a similar Council reveals the following. Campbelltown Council is a growth Council with a similar population to Baulkham Hills Shire Council and yet because its land valuations are considerably less than Baulkham Hills Shire Council, it has received something like \$70million additional Federal Assistance Grants in the last 15 years. Despite this the Council is still ranked as unsustainable in the latest review. A number of specific changes need to be made to the distribution of the Federal Assistance Grant and the first of these is distribution of the entire grant on a population basis and secondly an ongoing analysis of the impact of those grants.

### **Specific Purpose Grants**

Councils have for some time received a number of Specific Purpose Grants and whilst these are welcome, in general terms they are not welcome where they provide seed funding and then Councils are left with ongoing costs to deliver programs previously the responsibility of State or Federal Governments. Another anomaly relating specifically to the role of the Local Government, is State Government Library Grants. These have declined considerably over the years by 45% as a % of budget.

Library Grants need to be restored to the same percentage of Council's Library budgets as they were 20 years ago and other Specific Purpose Grants where there is an ongoing commitment on behalf of local government should not only provide seed funding but ongoing funding. The anomalies are further exacerbated by the fact that funds in regard to specific purpose grants have often been devolved through two levels of government prior to expenditure meaning excessive overhead costs have been removed from the grant.

### **State Government Taxation**

Local Governments should immediately be removed from the burden of collection of the New South Wales Fire Brigade Levy. Whilst this Council has a enviable record in terms of volunteers in its rural fire services and administered this area prior to the State government takeover, the levy in regard to the Metropolitan Fire Brigade is a State Government tax which is once again levied on the anomaly of valuations, whilst rates capping has paralleled CPI increases over the years, the Metropolitan Fire Brigade Levy has on more than one occasion increased by more than 10% per annum, there is no accountability in terms of the annual increases and the fact that Baulkham Hills Shire Council has high valuations means that it pays a disproportionate share of the levy compared to other Metropolitan Councils.

### **Performance Indicators**

Part 6 of the Issues Paper and in particular page 39 (Attachment 3), sets out the PricewaterhouseCoopers financial performance indicators. These are useful indicators that could be utilised together with an infrastructure replacement ratio to determine whether or not rates capping should apply to individual Councils. Application of these performance indicators should also be utilised to engender a degree of competition between Councils to assist in financial sustainability.

## **Conclusion**

Highlighted above are a number of anomalies in the current revenue framework for local government. Baulkham Hills Shire Council does not see this review as an opportunity to seek further assistance but to rather have removed the number of anomalies in the local government revenue framework. The framework needs to be reviewed, revised and enhanced and then individual Councils will need to determine if they are financially viable within that framework. As an industry, local government should not seek to pursue the lowest common denominator in terms of financial sustainability which has often been the case in the past. This review provides the opportunity to stand up and be counted, however both Federal and State Governments need to be realistic and equitable in terms of not addressing an impost on Local Government in terms of State and Federal taxes nor unrealistic cost shifting.

This response has been prepared in light of the short timeframe provided however the opportunity to discuss this submission and other matters relating to local government revenue with IPART would be appreciated. Lastly, the following comments are offered. It will not be appropriate to finalise any intergovernmental and regulatory framework completely for setting rates and charges that facilitates the effectiveness and efficient provision of local government services until there is constitutional recognition of local government, a definitive framework as to the responsibilities of local government, cessation of cost shifting and measures of the efficiency and effectiveness of local government. There is no objection to IPART playing a part in setting rates and charges for future years. The present system although somewhat aligned to the CPI is not necessarily transparent or logical. In terms of the charges by other authorities, this Council works closely with the Growth Centres Commission however the work they carry out is essentially work that would have been carried out by the Department of Planning so no overlap will be seen.

Local Government should remain as the master of its own destiny particularly in the delivery of local infrastructure and services to its local community. However this should not be fettered by unfair and unequitable cost shifting and the impost of State Government taxes into local government revenue. Implementation of the performance indicators as outlined in your Issues Paper should be seen as a first step towards the sustainability of local government.

Yours faithfully



Dave Walker

**GENERAL MANAGER**

<i>Attachment 1:</i>	<i>Rate Pegging Options</i>
<i>Attachment 2:</i>	<i>Fees &amp; Charges Pricing Policy</i>
<i>Attachment 3:</i>	<i>Performance Indicators</i>
<i>Attachment 4</i>	<i>Council Report 26/8/08</i>

**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.



### PRICING POLICY

Council's adopted Financial Objective is to pursue, where possible & appropriate, cost recovery on services.

The Pricing Policy (PPS) has categorised all Council services into the following groups, namely Public Goods, Private Goods and Shared Goods. The pricing approach – Zero, Partial & Full costs recovery has been chosen depending on the type of service provided.

### PRICING PRINCIPLES

Type of Service	Pricing Approach
<p><b>Public Good</b> These goods provide a broad community benefit. Impractical to charge for service on user basis</p>	Zero Cost Recovery
<p><b>Private Good</b> Goods that benefit discrete consumers who can be charged a fee. These fall into two categories, Regulated &amp; Non Regulated</p> <p><b>Private Good – Regulated</b> Fee fixed by legislation, irrespective of cost of service</p> <p><b>Private Good – Non Regulated</b> Fee charged to cover cost of service where no community service obligation exists</p>	<p>Partial Cost Recovery</p> <p>Full Cost Recovery</p>
<p><b>Shared Goods</b> These goods provide a Private Benefit as well as a broad Community Benefit. Community Service obligation determines the percentage of cost recovery</p>	Partial Cost Recovery

These principles have been the basis for calculation of fees and charges contained in the Schedule of Fees and Charges. Where fees are set by legislation, Council has no discretionary power to alter the amount and therefore is obliged to adopt the fee.

A detailed Schedule of Fees and Charges is included in the volume of annexures to this Plan and is available on request.



**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.<sup>36</sup> 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.

<sup>36</sup> 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.

**REPORTS OF GENERAL MANAGER****ITEM-4 INDEPENDENT PRICING AND REGULATORY TRIBUNAL (IPART) REVIEW OF REVENUE FRAMEWORK FOR LOCAL GOVERNMENT****OUTCOME:** Governance**BUSINESS PROGRAM:** GENERAL MANAGER**AUTHOR** GENERAL MANAGER  
DAVE WALKER**RESPONSIBLE OFFICER** GENERAL MANAGER  
DAVE WALKER

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**REPORT**

The Independent Pricing and Regulatory Tribunal (IPART) have released a draft issues paper in regard to a review of the revenue framework for Local Government. The review is being undertaken pursuant to Section 9 of the Independent Pricing and Regulatory Tribunal Act 1992.

Submissions are required by close of business on 29 August 2008 (a request by some Councils for this deadline to be extended has been declined). An interim report is to be provided to the Department of Local Government by February 2009, a draft report to the Department of Local Government by May 2009 and a final report to the Department of Local Government in September 2009.

The issues paper covers approximately 100 pages. A considerable amount of the issues document is rhetoric. Whilst there are a number of questions raised throughout the document, IPART is to investigate and make recommendations on the following three (3) matters:

1. *An appropriate intergovernmental and regulatory framework for setting rates and charges that facilitates the effective and efficient provision of Local Government Services.*
2. *A new 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, 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.*

The review needs to have regard to a number of matters, but in particular the following:

- *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 of efficiencies.*

- *All the revenue sources available to Local Government*

In recent years there have been a number of reports into the financial sustainability of Local Government both from a National perspective and also from a New South Wales perspective the Percy Allen report, a review by PricewaterhouseCoopers, a review known as the Fiscal Star review. The latest review is a combined review by Percy Allen and Fiscal Star of the largest 100 Councils, of these only 43 have been assessed to be sustainable for the long term. Baulkham Hills Shire Council has been ranked sustainable. Some WSROC Councils have been ranked as either unsustainable or vulnerable. It is also interesting to note that Campbelltown City Council with a population similar to Baulkham Hills Shire Council and a similar growth pattern, has received \$70million more in Federal Assistance Grants over the last 15 years than Baulkham Hills Shire Council and it is ranked as vulnerable.

IPART have not addressed in their issues paper the recent review of State Taxation in which it was recommended that Local Government pay payroll tax and that the part of the Metropolitan Fire Brigade Levy presently collected through insurance policies be collected through Councils by way of an approved rate increase.

This was reported to Council on 24 June 2008. If both these actions occurred then the minimum increase in rates would be more than 6%.

Whilst the removal of rate pegging might be an ideal situation, the chances of this occurring are extremely remote and it is proposed that any submission be based on the removal of rate pegging for those Councils that are "Sustainable". The need for a more definitive revenue framework is supported. However, any review of the revenue framework of Local Government should not be considered in isolation from three (3) factors. Constitutional Recognition, Legislative Framework Review and Expenditure/Responsibility Framework Review. The various aspects of Local Government's revenue are subject to various pieces of legislation, many of which are changed from time to time without consideration of the flow-on effect or implications in terms of other pieces of Legislation. IPART'S current role in reviewing water, electricity charges etc. is a firm example of this. Whilst rates capping has paralleled CPI increases over a number of years, CPI restraint has not been forthcoming in increases approved for water and electricity as just two examples. Nor does Council have a lot of control, if any control, over how the electricity authorities operate and one example of this has been a delay in the implementation of the environment friendly street lights. On the one hand Council as a public authority is expected to meet and enhance environmental constraints, but on the other hand is subject to substantive increases above CPI for street lighting whilst at the same time the authorities follow their own agenda in terms of environmental issues.

As indicated earlier there has been in recent years a number of reviews of Local Government's financial sustainability throughout Australia and in particular New South Wales. It is pleasing to report that once again the Fiscal/Star My Review outcome for 2008 establishes Council as sustainable. Any proposal to review Local Governments Revenue Framework should be taken in the light of those Councils which are regarded as sustainable, the review should not be carried out in a way which reverts revenue or grants etc. from sustainable Councils to non sustainable or vulnerable Councils.

The attached letter to IPART highlights a number of issues pertaining to the current revenue structure of Local Government and how the framework around these issues may be improved.

**IMPACTS:**

**Financial**

There is no direct financial impact upon this report.

**Social**

This report has no direct social impact.

**Environmental**

This report has no direct environmental impact.

**RECOMMENDATION**

The Independent Pricing and Regulatory Tribunal be provided with a copy of the attached correspondence together with this report as Council's response to the IPART Review into the revenue framework of Local Government.

**ATTACHMENTS**

1. Submission to IPART

**Note:** Issues Paper distributed under separate cover (or see [www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au))