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28 August 2008

Review of Revenue Framework for Local Government
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230
Sydney NSW 2000

Attention: Michael Seery

Dear Sir,

Re: Review of the Revenue Framework for Local Government

Thank you for the opportunity to provide comment on this matter.

Council, at its meeting of 26 August 2008, resolved to submit the following response to the "Revenue Framework for Local Government – Other Industries - Issues Paper" released by IPART in July 2008.

In responding to IPART's fifty two (52) questions, Council saw fit to group them into the following categories:

A. the legislative framework and revenue sources of local government in NSW
B. the role of local government and the services it provides
C. Council's broad income and expenditure requirements
D. Council's overall financial sustainability and performance
E. alternative frameworks for setting rates and charges levied by Councils

Each of these categories is explored in greater detail below, with a response provided to the more pertinent questions posed by IPART within each of the categories.

A. The legislative framework and revenue sources of local government in NSW

The regulatory framework for determining local government revenues is outlined in various sections of the Local Government Act, 1993 (the Act). Specifically, Chapter 15 of the Act details how Councils are financed and outlines the primary sources of revenue available to Councils. Section 506 of the Act states that

"The Minister may, by order published in the Gazette specify the percentage by which councils' general income for a specified year may be varied".

This is commonly referred to as the rate pegging limit established by the Minister for Local Government each year. Increases beyond the Minister's limit can only be considered by submitting a case for a special rate variation to the Department of Local Government (DLG).

A number of questions have been posed by IPART in this category, the more pertinent ones are as follows:

What is the effectiveness of rate pegging and what are the implications for Councils and ratepayers?

Response: rate pegging is effective insofar as it provides some degree of certainty in terms of rate increases for ratepayers. Debate about how annual rate increases are actually determined by the Minister has raged in the industry for many years. There is no definitive science in the formula used to arrive at the rate increase in any given year, and if there is it is not transparent, nor readily available.

One of the primary consequences of rate pegging has been the increasing degradation of public infrastructure. This is the single largest issue confronting the industry today. With rate pegging, and whilst ever there are competing priorities (including maintaining existing services and satisfying ever increasing statutory requirements) to consider, Councils will continue to have difficulty in funding the infrastructure backlog without applying for a special rate variation.

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

Response: the role of rate setting should largely rest with Council and its community to determine with the DLG performing an overseer's role, interjecting only where material variations of a reasonable rate increase are sought.

Councils, via the management plan process and extensive public consultation, should be directly accountable to their constituents through local government elections for the level of rates and quality of service they propose. In essence, by leaving the current rate pegging regime in place we are actually endorsing the reduction of accountability to the public.

It is believed that IPART has no role to play in the determination of Council rates - this is a matter that each Council and its community should determine. If, however, rate pegging were to remain then IPART could play an advisory role in developing a new framework for the DLG to apply in arriving at a 'reasonable' rate increase (i.e. applying some local government specific science to the formula used to determine 'reasonable' annual rate increases).

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

Response: Council has a relationship with the GCC and can only make an informed comment on the services it provides. The GCC is primarily charged with accelerating major rezonings in order to 'get more lots on the ground'. The GCC do this in a number of ways including facilitating the timely delivery of major infrastructure to support new release areas and by attempting to secure concurrences from major State Agencies (such as DECC, DWE, RTA etc) up front as part of the rezoning process rather than down the track (i.e. at DA stage) - this is an area that has continually frustrated local government for years.

Council and the GCC have worked in a collaborative manner to release the first 2 major rezonings in the South West Growth Centre Corridor (Oran Park and Turner Road). The GCC is not providing a local government service, they are facilitating a State Government direction to have more lands available for residential and business use (in an accelerated manner).

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

Response: if the suggestion is that these authorities do indeed provide a local government service, then the answer is clearly that this would compromise the extent to which local government could otherwise increase their rates.

However, this is not the case as the reality is the State Government's planning reform agenda is putting extraordinary upward pressure on Council's budget to deliver this agenda (i.e. more Council resources are required to assist with this reform and in a much shorter timeframe) and, in the absence of identifying any alternate source of revenue, is likely to accelerate Council's case for a special rate variation.

B. The role of local government and the services it provides

The role of local government is largely defined in the Act and is regulated by the DLG. This role encompasses a number of key activities including making economic, environmental and social decisions on behalf of the community, effectively communicating and participating with the community, and providing leadership and strategic direction for the community.

A number of questions have been posed by IPART in this category, the more pertinent ones are as follows:

Is the current role of local government self-imposed or legislated?

Response: the vast majority of Council's role is legislated by the Act. The role of Councils has grown exponentially over the past two (2) decades with the relentless policy of cost shifting from the State Government. There are elements of Council's role which are self-imposed (e.g. - the necessary development of strategy and policy to address local needs) however this is becoming an increasingly difficult exercise to manage given the limited funds available and the priority the legislative role must have (as deemed by the State Government for reporting purposes) in order for Council's to be compliant.

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

Response: service levels vary greatly between Councils. The size and evolution of a Council often defines its service provision level – those Councils which are largely developed have a fairly exhaustive, albeit static, range of services they provide their community whilst developing Councils are still establishing their full complement of services.

Typically, larger Councils have a more expansive rating base to work from and, as such, have a larger pool of discretionary funds available to allocate to existing or new services. With this larger pool of discretionary funds available comes the luxury of creating, for example, business units that specialise in non-core (entrepreneurial) services such as property development and/or units that compete for external works outside of their LGA. Often, part of the income derived from non-core (entrepreneurial) services subsidise core services to enable these services (assets) to be delivered at a higher standard.

Typically, the services of smaller or rapidly growing Councils, with a limited rate base (and therefore limited discretionary funds), are confined to those that satisfy legislative requirements and those which the community consider absolutely essential but very little else.

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

Response: to some extent there is an overlap with State Government in areas such as community services, health welfare and public safety. The total portfolio of each of these areas is often not the single responsibility of any particular tier of government. Both State and local governments have responsibility for specific elements or aspects of the total portfolio in each area, often making it difficult to manage, draw a line of who is responsible for what aspect (and the funding that is commensurate with that responsibility) and most importantly, explain to the community who is ultimately responsible for delivering the service.

C. Council's broad income and expenditure requirements

Councils obtain their revenue from four (4) main sources

1. Council rates
2. user charges and fees
3. grants and subsidies from the Commonwealth Government and the NSW State Government
4. revenue from Council business activities, interest income and fines.

Council spends its revenue on the following five (5) expenditure items

1. employee costs
2. materials and contracts
3. depreciation (non-cash)
4. borrowing costs
5. other expenses (e.g. service delivery)

The role of local government has expanded in recent years, shifting away from the traditional property-based services towards human services. 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.

A number of questions have been posed by IPART in this category, the more pertinent ones are as follows:

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

Response: rate pegging has severely limited revenue growth to the extent that Councils have had to actively pursue non-rate revenue to keep essential services operating. The real concern here is that unlike rate revenue, non-rate revenue cannot be guaranteed in any given year as it is largely dependent upon the capacity and willingness of users to utilise services that generate non-rate revenue. In other words, price tolerance needs to be carefully considered as we don't want to discourage the use of our assets or become non-competitive with the private sector, or our neighbouring Councils for that matter.

Councils are also bound by the principles contained in the National Competition Policy which advocates competitive neutrality and reasonable cost recovery.

Councils across NSW have resorted to issuing parking fines and rely on this revenue source to fund their operations. In some cases, the figure is in excess of $20 million per annum. Whilst this Council may have very legitimate reasons for doing this, it raises fundamental questions about the ever increasing departure from Council's core revenue sources, and indeed the service this revenue provides.

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

Response: if history is any indication, expenditure requirements will continue to increase exponentially in to the future. Examples include

1. infrastructure backlog - substantial funding over a number of years will be required to renew existing assets due to the impact of rate pegging
2. cost-shifting - unless this relentless policy ceases, Councils will be required to continually fund services previously provided by the State Government
3. existing services - the real cost of existing services (e.g. wages, fuel, utilities, insurance etc) is rising at a much faster rate than the Ministerial rate-pegging limit
4. future services - with the growth proposed for Camden, rate increases (under the current rate-pegging regime) will only part-fund the cost of future services. In the absence of other revenue sources or the abolition of rate pegging, this will exacerbate the operational funding gap dilemma most Councils are already currently confronted with
5. compliance - costs will continue to increase as new layers of compliance are added to Council's statutory obligations, and

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proposed changes to policy - for example, the recommendation to remove payroll tax exemptions that currently apply to local government and the changes to the Fire Service Levy will significantly increase expenditure.

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

Response: It would appear the implications of this expenditure growth for rate pegging will necessitate an ever increasing demand for more special rate variations under the current regulatory framework.

If rate pegging is not abolished, Councils simply cannot afford to redirect the necessary funds towards addressing the infrastructure backlog issue without compromising other equally important services we currently provide the community without applying for a special rate variation.

D. Council's overall financial sustainability and performance

A Council's financial sustainability and performance (and thus its financial position) essentially depend on the balance between its revenues and expenditures over the longer term. Primary indicators used to determine a Council's financial position and performance include the operating surplus (or deficit) ratio, interest coverage ratio and the asset renewal ratio.

A number of questions have been posed by IPART in this category, the more pertinent ones are as follows:

What are the significant factors affecting financial performance of local government?

Response: the following factors have had a significant negative impact on local government's financial sustainability and performance over the past 20 years:

- minimal and/or lagging revenue growth
- rate pegging
- stagnant regulatory fees and charges
- cost shifting
- significant increases in expenses such as wages, maintenance and construction costs, utilities, insurance premiums etc
- demographic changes (e.g. aging population)
- planning reforms (e.g. limiting section 94 charges)
- additional compliance requirements

To what extent does rate pegging affect financial sustainability?

Response: rate pegging has had a significant impact on the financial sustainability of local government. It is a well known fact that Council rates have grown much less than Gross Domestic Product (GDP), Gross State Product (GSP) and State land taxes over the past two (2) decades. Coupled with relentless cost-shifting and ever decreasing financial assistance from the Federal and State Government (e.g. Financial Assistance Grants), continued rate pegging will result in more and more Councils applying for special rate variation every year (as many as 1 in 4 Councils already apply for a special rate variation each year) or force existing services to be drastically cut. Clearly, the rise in special rate variations is a sign that the current rate pegging regime is not working.

E. Alternative frameworks for setting rates and charges levied by Councils

Interestingly, though not surprising, there have been a total number of 226 special rate variation cases submitted for consideration to the Minister for Local Government over the past 7 years. Of these, 191 special rate variations have been approved (note: there are 152 Councils in NSW).

Based on the number of special rate variations approved over the past 7 years, it is fair to state the following:

i. the NSW local government sector is experiencing significant financial difficulty under the current rate-pegging regime
ii. the current revenue framework for NSW local government is simply not working and the number of special rate variations approved is a consequence of its ineffectiveness
iii. the administrative burden on both Council (as the submitter) and the DLG (as the assessor) with respect to special rate variations is a significant impost, one that could be redirected to provide more value to Councils and their communities.

IPART has identified five (5) options for alternative regulatory frameworks

1. Retain 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 process to ensure that the mandatory criteria required to justify a special rate variation is published and the process of application and approval is fully transparent and forms part of local government regulatory system**
- **leave all charges unregulated**

Comment:

Whilst this framework would be a step in the right direction (by promoting a more scientific and transparent approach to determining annual rate increases) it still fails to address the fundamental problem - rate pegging.

2. Implement a more disaggregated form of rate pegging which incorporates cost indices relevant to each Council (or group 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 (e.g. cost structures, service dimensions etc)**

Comment:

This framework is considered too complex (particularly if a different cap is to be applied to every Council), too subjective (and political), and could potentially reward Councils who fail to effectively and efficiently manage their cost structures or service dimensions. Additionally, like Option 1, this alternative fails to address the fundamental problem – rate pegging.

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 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 rate variations arrangements as described in Option 1 above**

Comment:

This framework has some merit insofar as it removes the capital expenditure element (of which infrastructure backlog is a major part) from the rate pegging equation. However, this alternative still anticipates rate pegging would apply to operational expenses (this represents 50% of Council's total budget) and, as such, could not be supported.

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 timeframe through an approved and independently audited management plan. This audited plan could be tabled in Parliament and made publicly available**

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Comment:

This framework could work however it is believed that larger Councils would have a distinct advantage over smaller Councils because they have the resource capacity to deliver these additional requirements - i.e., reward those who can afford it. There would be great debate about what indicators should be used and what benchmarks would be appropriate for each. This framework also involves a significant amount of unnecessary bureaucracy and compliance and with it, an additional cost burden which is not translated directly to improved local service(s).

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.**

Comment:

This framework could be supported subject to understanding exactly what the criteria and compulsory reporting entails (for example, whether the criteria would be process-based or outcomes-based). Like Option 4, enhanced accountability may favour those larger Councils who have the resource capacity to address additional requirements.

CONCLUSION:

The review of the local government revenue framework presents an opportunity for all NSW Councils to critique alternative frameworks proposed by IPART, argue that other State Agencies (such as the GCC) do not provide local government services, and that IPART has no role to play in determining local government rates and charges.

It is well documented that the DLG is moving towards a mandate whereby Councils must prepare long term community strategic plans, strategic asset management plans and resourcing strategies to support these plans. Surely, if these requirements were invoked then the case for abolishing rate pegging becomes all the more compelling.

NSW is the only State in Australia where rate pegging exists. As is the case in every other State in Australia, with appropriate accountability and transparency in place, the role of determining annual rates and charges in NSW should be a matter for Council and its community to decide.

Council trusts IPART will use this constructive response to formulate a comprehensive report to the DLG, one that reflects the views and concerns of a sector that is firmly committed to servicing the ongoing needs of its communities.

Yours sincerely,

Steven Kludass
ACTING GENERAL MANAGER