

29 August 2008

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

Dear Sir

I have had many years experience working in the local government industry in senior finance positions on a number of Councils and I believe I have an excellent understanding of the impact of rate pegging on local government.

I have attached to this letter my responses to a number of the issues raised in the Issues Paper. I have also closely examined the Department of Local Government's Comparative information which has assisted me in coming to the conclusions I have reached. In regard to an overview position I would like to make the following observations.

I believe there is a general misunderstanding at the amount of rates levied by Councils. The general public's view is that residential rates are too high. When looked at in terms of the annual charge the amount appears high, but when considered as a weekly charge the position is quite different.

The Department of Local Government's Comparative Information shows the following average residential rates (2005/06):

	Annual Rate \$	Rate per week equivalent \$
NSW Mean	666.00	12.80
NSW High	1,085.00	20.86
NSW Low	86.00	1.65
NSW Median	546.00	10.50

It is not until you consider rates in this way that it becomes apparent that local government rates are very low. When compared to other weekly services, rates represent good value for money. In the above table, the highest rating Council is in fact Hunters Hill. A Travel Ten Bus ticket from Hunters Hill to the City costs a single commuter \$32.00 per week, but the Hunters Hill rates cover provision of all services to every member of the household. It beggars belief that there is a need to put rate control on the lowest rating Council (Brewarrina). The obvious conclusion to be drawn from the above is that the majority of NSW ratepayers pay less than \$20 per week in rates. Those who pay more live in very highly valued properties.

With the NSW median rate of \$10.50 a week, it is obvious that a great number of Country Councils survive on much less. Rate pegging has meant that those Councils are prevented from

improving their services unless they approach the Minister for approval. It seems very petty. My conclusion in this regard is that there should be no rate pegging applied to Councils with an average residential rate of less than \$10.00 per week (\$520 p.a.) and that this level should be indexed annually.

In regard to the methodology of applying rates to properties other issues emerge. Rates are determined by the equation of land value multiplied by the rate in the dollar. Rate pegging introduced a limit in total. When a Council receives new valuations rate pegging means that where values have gone up the rate in the dollar must come down

The valuations provided have little meaning to rate payers as they purport to be the value of the land in its natural state which for the greater metropolitan area is virtually meaningless as the majority of properties all have improvements on them. It does not represent potential sale value of a property. It does not represent any potential earning capacity for an owner. It varies each three years and may result in either an increase or decrease in the amount of rates that will have to be paid by the owner.

When a valuation increases above the rate of the average increase of the local government area, owners have difficulty in comprehending why they must now pay more for the services they currently receive. Ratepayers affected in this way become disgruntled as they understandably believe they have not received any benefit from the exercise and see themselves as being disadvantaged as a result. The movement in valuations has no reflection of the services available or utilised. It is not simple. It is not transparent.

Rates purport to be a charge on wealth, based on the value of land. Such an assumption is flawed, as no consideration of the circumstance of ownership are taken into account – mortgage, pensioner/employment status and so on.

Having looked at state averages I believe there is a sound argument to consider changing rates to a local government service charge determined as flat charge for each property. Each property has the same access to the services provided. It is much simpler to understand, Councils would not be required to maintain valuation information, some surety in terms of increases each property owner would be provided and it would be quite transparent how much they would be paying is determined. Given that the majority of Councils have a minimum rate the impact on the lower valued properties will be minimal.

In terms of Business and Farmland rates these could be determined on a square meter basis which again is simple and transparent with no need for valuations that don't particularly mean anything to a land owner.

I believe that each Council should be accountable to its ratepayers and that they should be free to determine appropriate charges and be held accountable at each election. I believe there is a role for IPART to set benchmark cost increases that ratepayers could refer to so that they could challenge their Council during the Management Plan and Budget process. Councils would need to justify service level increases in this process.

I would be happy to answer questions or take part in any review if required.

Yours faithfully

Gary Mills

Issues Attachment

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

Rate pegging has certainly been effective in curtailing Council's major revenue source. There is no other organization or groups of organizations that have been able to maintain their major revenue source at or below the CPI and survive for 30 years. It is in fact a credit to NSW Local Government that they have managed. It has, however, resulted in a curtailment of proper asset management procedures because Councils have been responsive to pressures of their constituents to provide non asset services as evidenced in the Alan Report.

It has meant that Councils have been prevented from improving their facilities and services as the basis for the peg is that Council's can only provide the same level of services from one year to the next. There has been an obvious unwillingness by many Councils to seek special variations.

An analysis of the level of rates charged per household (refer to the Department of Local Government's Comparative Information 2005/06) discloses how low rates are as a tax source. Nearly 44% of Councils, including four (4) Sydney Metropolitan Councils receive less than \$10 per week per household as the average contribution, while overall, 61% of councils collect less than \$12.00 per household per week. At this level a reasonable person would question the need for such a strict control regime.

Indeed the highest rating Council – Hunters Hill collects on average, \$20.87 per household each week. To put the issue in perspective, a Travel Ten bus pass to the City from Hunters Hill costs \$32.00 for a single person, not the whole household.

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

a) Promote the effective and efficient provision of services?

The current framework has been touted as promoting effectiveness and efficiency by limiting local governments' ability to raise revenue streams that match or reflect service costs. Whilst local government has never refrained from the challenge, the ability to do so is limited and must eventually reflect the true economics involved in providing services.

b) Enhance the financial sustainability of local government?

The current framework does nothing to enhance sustainability but does in fact challenge each Council's future financial circumstances. Invariably where fees are set by legislation, Councils are restricted by the State Government's willingness to approve increases. Often the case has been that State Government charges on local government have increased beyond the CPI and local governments have been needed to restrict the overall service level provided to its constituents, meaning they suffer falling standards.

c) Meet the standard of principles for good regulation and taxation – efficiency, equity, simplicity, transparency?

The principles of efficiency, equity, simplicity and transparency are very much lacking in local government's application of revenue determination. In regard to rates, Councils determine annual amounts based on a valuation of land as determined under the valuation of land

legislation at significant cost to each council. The value is then part of a formula used to calculate the rates amount.

From the public's point of view, the valuation is difficult to understand. The valuations provided have little meaning to rate payers as they purport to be the value of the land in its natural state which for the greater metropolitan area is virtually meaningless as the majority of properties all have improvements on them. It does not represent potential sale value of a property. It does not represent any potential earning capacity for an owner. It varies each three years and may result in either an increase or decrease in the amount of rates that will have to be paid by the owner.

When a valuation increases above the rate of the average increase of the local government area, owners have difficulty in comprehending why they must now pay more for the services they currently receive. Ratepayers affected in this way become disgruntled as they understandably believe they have not received any benefit from the exercise and see themselves as being disadvantaged as a result. The movement in valuations has no reflection of the services available or utilised.

It is not simple. It is not transparent.

d) Enhance the accountability of local government?

The regulatory framework under which Councils operate removes autonomy and only purports to make Councils accountable. The measure of accountability is that Council has operated within the requirements of the legislation. It is not that Council has responsibly looked at the cost of service provision and applied an appropriate level of fees to recover costs of that service.

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

Global setting of rates and charges is not considered appropriate as it does not address the issues faced by the individual local government areas. How can you compare the needs or wants of Brewarrina with say any metropolitan council?

By issuing guidelines of general cost increases and making each Council accountable to its community for its decisions is much more appropriate as this will take into account the local issues that confront each Council.

In regard to non-business activities Council's consider the value of such services that the community derives and will support it in the form of a subsidy where it can be managed.

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? (page 7)

As above it is considered that IPART could play a valuable role in providing information that could be used by the communities in each local government area to assess the performance of their Council and its judgments of the local areas needs.

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? (page 15)

I consider that the Classification provides a reasonable broad brush basis of classifying like with like. However, the situations faced by similarly classified councils can vary dramatically. As an example, some areas of the State have remained under drought whilst other similarly classified Councils have received rain. The needs of the various communities were very different.

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

The setting of rates is a mathematical equation based exercise and accordingly is considered efficient.

17. To what extent do service levels vary between councils in their scope, value and quality of infrastructure and other assets? (page 21)

The extent can be significant. We are comparing country Councils with as little as 1,200 ratepayers with the large metropolitan Councils with over 100,000 ratepayers

18. What factors cause differences between councils provision of infrastructure and services to arise? (page 21)

The short answer is population densities. The Councils with very low populations cover vast areas, which would, if amalgamated to bring up a reasonable population but would see single areas so vast that there could be no perceived community of interest shared by the disparate small town centres.

20. What demographic, intergovernmental, economic, social, technical and environmental changes are affecting Councils now and their future revenue requirements? (page 23)

Broadly speaking Councils face considerable challenges in terms of climate change, increased costs of raw materials and energy and a changing population demographic. All of which are beyond a Council's ability to fund under the current restrictions.

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? (page 27)

Councils on the coastal fringe or who are of an inner urban nature have increasingly moved to fund their shortfalls through parking fees or parking management (fines). The options are truly limited.

22. What scope is there for councils to make greater use of user charges? (page 31)

The scope is limited to those fees that are not prescribed under legislation. In addition, Councils will have made decisions over time to subsidise fees from rate income as some services would be prohibitive if they were determined on a fully user pays basis. The community would suffer if those subsidies were discontinued.

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? (page 31)

Rates generally represent Councils' single biggest revenue source. Limiting rates at the levels experienced i.e. CPI or less has meant that Councils can only continue to offer services as existing levels or reduce those services in order to provide new services. If a Council decided to

cease or restrict a service it is usually faced with very strong community resistance and/or special interest campaigns to maintain existing services. Decisions are not necessarily taken on a pure business case review, which cannot account for a community's need for a particular service.

24. To what extent are local governments' expenditure requirements likely to grow in the future? (page 37)

Council's cost base is being driven by the price escalations in energy costs, raw materials such as steel and uncapped State Government charges, all of which are beyond Councils control. Further increases are expected once carbon trading is introduced.

25. What are the implications of this expenditure growth for rate pegging or alternative regulatory frameworks proposed by submitters? (page 37)

Rate pegging is inappropriate as the temptation to tamper with the levels to suit political outcomes will be even greater. The alternative of IPART establishing a recommended increase guide (not a limit) based on continuation of existing service levels is considered a much more efficient method which will end up with each Council being responsible and accountable for its actions.

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? (page 42)

Given the net liability ratios of the Federal and State Governments, Local Government is in a very difficult position. It should have a longer term view to increase the ratio to match the State Government over at the very least a 5 year horizon, which will see the need to increase rates significantly in that time. Current obstacles include the limited ability of Councils to finance further borrowing, where Council's existing budgets have insufficient funds for loan repayments coupled with increased borrowing costs.

27. Are there any other significant factors affecting financial performance of local government? (page 44)

Council's have limited recourse to the national taxation pool. An identified level of Financial Assistance grants as a percentage of income tax would help together with a share of GST revenues. The current distribution methodology adopted by the NSW Local Government Grants Commission has been applied since 1987. The methodology means that Council's identified as having a purported higher revenue raising capacity – high land values have been disadvantaged. Rate pegging negates so called revenue raising capacities.

Underlying this is the issue of real revenues not keeping pace with real cost increases.

28. To what extent does rate pegging affect financial sustainability? (page 44)

Rate Pegging has had a significant affect on financial sustainability. Councils respond to their communities needs for services and invariably to meet the immediate concerns. There has been a willingness to forestall infrastructure maintenance as the support for maintenance has to compete against more popular requirements.

Unfortunately the State Government does not limit its cost increases for services it provides to Local Government and over time an erosion of the revenue base has occurred as the limited revenue sources have had to be applied to cover State Government demands eg the Fire Brigade Levy, minimum service level increases for Child Care (DOCS Requirements), Election Costs etc

29. What are the appropriate measures for efficiency of local government? (page 45)

Community satisfaction, responsiveness to community's needs, transparency and accountability are seen as the cornerstone of an efficient local government. Comparative service provision costs for similar services would also provide an indicator of efficiency.

30. To what extent have councils undertaken efficiency reforms and has this been effective? (page 46)

As Councils have lived with rate pegging since 1978, they have been forced to undertake efficiency reforms. The continued existence of those Councils is reflective of the effectiveness of local government in New South Wales.

31. How does rate pegging and other constraints on councils' revenues affect the efficiency of councils' operations? (page 46)

Rate pegging does not reflect efficiencies. Does the fact that Brewarrina Council with the lowest average rate - \$1.65 per week mean it is the most efficient? Rate pegging effectively limits the services a Council can provide. Limited funds mean Council need to be efficient in the delivery of services.

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? (page 49)

Very limited if any benefit.

37. Does rate pegging increase the affordability and/or availability of local government services especially for poorer regions and sections of the community? (page 59)

Rate pegging is a limitation on Council's operations and as a result the ability of a Council to subsidise affordability or poorer sections of the community are severely limited. An analysis of the level of rating indicates that rates are the lowest form of taxation applied to households. The Department of Local Governments comparative data shows that the highest average household rate is equivalent to \$20.86 per week, the lowest average \$1.65 per week and the State average just \$12.80 per week. When compared to other weekly services, rates represent good value for money.

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. (page 61)

At the moment, no framework exists to compare costs in a manner that ensures Councils can compare 'apples with apples'. There is no industry standard that establishes how the distribution of overheads is/should or could be applied against service delivery. Many Councils do not consider overheads when determining fees which recover costs. Most Councils are not aware of the level of rates subsidy applied to service delivery.

A comparative of costs on a single service basis such Pool Admission, Child Care, Meals on Wheels, Inspections etc would be interesting but not conclusive. Many issues impact on service delivery that are a direct result of the Council's location, environmental issues such as drought, population densities and so on that will have an impact on price.

40. If there are negative unintended effects on financial viability, what modifications or alternative mechanisms would reduce these? (page 61)

IPART's contention that a 'weak property base or rate pegging' can diminish financial ability indicates a possible misunderstanding of how rate pegging works. The formula used to determine rate revenue from one year to the next means that variations in property values whether up or down have no impact on the total revenue collected as the 'rate in the dollar' is adjusted accordingly to provide last year's revenue plus the permitted increase.

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. (page 62)

Rate pegging is an interesting issue in terms of the communities understanding of how it works. After nearly 30 years of operation it is safe to say that it is still generally misunderstood. Each time there is a general revaluation of the area, ratepayers still are concerned that their rates will go up as a result. The valuation process is not transparent. The valuations provided have little meaning to rate payers as they purport to be the value of the land in its natural state, which for the greater metropolitan area, is virtually meaningless as the majority of properties all have improvements on them.

General revaluations often see significant movements in rates to be paid as certain parts of a local government area may increase disproportionately to other parts of the area resulting in an increase well above the rate peg amount. Ratepayers affected in this way become disgruntled as they understandably believe they have not received any benefit from the exercise and see themselves as being disadvantaged as a result.

Affected ratepayers do not see any equity resulting from valuation changes. There is no accountability other than for the Rating Officer who must carry out the calculations in accordance with the legislation. Apart from being an integral part of the rate calculation process, there is little benefit to anyone in knowing the rateable value. It may well be appropriate and timely that a review on the methodology of determining property charges be undertaken.

42. What alternative regulatory models could be used to regulate rates and charges in NSW? (page 65)

Applying a uniform rate peg across New South Wales is not considered appropriate as it implies that Councils are uniform in the way they provide and deliver services across the State and that they face similar issues. There are many varied factors impacting on geographic and demographic issues that just should not be dealt with in such a way. Affected Councils are then required to submit special variation applications to justify the proposed actions of a Council.

Given that 61% of Councils collect on average less than \$12 per week per household for rates, (Department of Local Government Comparative Information) rate pegging is considered to be an unnecessary restrictive burden.

It would be more appropriate for the Minister or IPART to issue a benchmark cost increase figure which would represent a reasonable figure by which Council's could increase their rates. Council's would then be accountable to their communities for their decisions if their rate increases were different to the benchmark. The community's endorsement or otherwise would be reflected in the results of future elections.

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? (page 65)

The models proffered by IPART are all worthy of consideration, however the tenant that there needs to be a control is an issue that needs to be dealt with. No other State has found it necessary to control Local Government in such a way. There is a presumption that New South Wales Councils are irresponsible and not trustworthy in determining the level of rates that they should levy.

The process of preparing Management Plans, consulting with the community and seeking comments on proposals are highly transparent, accountable and represent good governance. It is time that each Council was given back the responsibility for managing their areas. Who else knows the local community's needs better? It needs to be stressed that rating is the lowest level of taxation. The highest rating Council in New South Wales has an average weekly household contribution of \$20.86 and the majority of residential ratepayers in New South Wales pay less than this.

44. What role should IPART play in setting local government rates and charges in future years? (page 65)

As mentioned above it is considered that IPART's role should be limited to establishing a cost increase benchmark each year where Councils will be accountable to their communities if decisions are taken to increase rates above the benchmark.

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)? (page 65)

A legislative amendment would be required for the role proposed in response to 44 above.