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Your reference: 08/159

Muswellbrook Shire Council
PO Box 122
Muswellbrook, NSW, 2333

Mr James Fox
Chief Executive Officer
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230

Attn: Michael Seery
michael_seery@ipart.nsw.gov.au

28 August 2008

Dear Sir

Re: Review of the Revenue Framework for Local Government

Thank you for the opportunity to make a submission to the inquiry. Please see the following submission in relation to some of the questions that have been raised and also some further comments that may be described as being out the, but are worthy of consideration in any review of Local Government Revenue.

Yours Faithfully

Russell Esdaile
Director Corporate & Community Services

COMMENTS IN REGARD TO THE QUESTIONS LISTED IN THE ISSUES PAPER

Question 2 - How effective is rate pegging and what are the implications for Council's and ratepayers?

As a means of imposing fiscal discipline on Councils and limiting the impact of annual rate increases on ratepayers rate pegging has been quite effective. It may have also prevented the introduction of new and/or services and infrastructure that were not worthwhile or well planned as Councils are forced each year as part of the budgeting process to look closely at how existing levels of services and infrastructure are to be funded.

On the other hand, there can be no doubt that rate pegging has contributed to the current "infrastructure backlog" as rising costs incurred not only through normal inflation pressures but also through increased reporting and compliance costs and costs related to competing with the private sector for specialist and professional skills have diverted funds away from the level of capital renewal that has been required.

Rate pegging has also had the effect of possibly making Councils less answerable to their communities as rate pegging has become an excuse for not determining or even properly reviewing levels of service.

Question 5 - What role should IPART play in setting Local Government Rates and Charges, including charges for non-business activities?

If rate pegging in some guise is to continue, then IPART has the potential to be an excellent, independent arbiter of the rate of increase to be applied. Currently, the process of establishing a rate pegging limit can be heavily influenced by the ideological viewpoint of the incumbent political party. The current process has no semblance of transparency. Councils and the community have no way of knowing how the rate pegging limit is determined.

It may be worthwhile IPART giving consideration to setting Charges in relation to the provision of water, sewer and waste charges which are basically monopoly services provided by many local governments. Providers of these services should then be allowed to make application to levy more than the set charges in cases of special circumstances.

Council's that are able to operate these services profitably and sustainably using the charges set by IPART could then be allowed to utilise these profits to assist in the operation of general fund activities. Currently there are limits placed on the level of "dividends" that can be paid by the water and sewer funds to general fund.

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

Rather than placing limits on the role of local government which can act either as a provider of its own services or as an agency for other levels of government it would be more appropriate to clearly define the role of local government within the current Federal system. Council's are becoming heavily involved in services such as health, community services, rural fire services, emergency services etc that are thought to be State Government responsibilities. A clear definition of the responsibilities of local government and an agreement that full funding will be provided where local government acts as an agency for other levels of government is more important than setting limits.

Services and infrastructure that are provided outside these defined roles and responsibilities would then be provided by the Council in consultation with its community only after ensuring appropriate levels of service have been met with regard to the defined roles and responsibilities.

Question 14 - What infrastructure and services do Councils currently provide?

At Muswellbrook Shire Council the following services are provided: town planning and building control, community services, library services, water and sewerage services, waste including recycling collection and management, active and passive recreation, cemeteries, maintenance and renewal works on local and State roads, tourism and economic development and public arts exhibitions.

The following infrastructure is provided. Local roads and streets along with furnishings such as footpaths and kerb and gutter, sport and recreation facilities including passive recreation areas, swimming pools, indoor sports facilities and golf course, subsidised buildings for State funded community services, senior citizens, child care and other community groups, art gallery, stormwater control assets, waste management centre, library buildings, and community centre and halls.

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

Examples where there appears to be overlap with other levels of government at Muswellbrook Shire Council include:- Council administering and funding Rural Fire Service and State Emergency Services activities, and the provision of community services.

Whilst not exactly overlapping, Council partners with State Government departments and agencies in the provision of planning consents, economic development, sustainability, catchment management, sporting and tourism.

Question 22 - What scope is there for Council's to make greater use of user charges?

As a rule, Councils provide services that could not be profitably operated by the private sector and, as a result these services are funded from a collective public purse. Levying sporting groups for use of sporting facilities sounds attractive but charging users based on the actual cost of providing those services would lead to massive reductions in the number of persons participating in those sports. Conversely, levying much lower nominal amounts leads to the level of funds being collected being too small to make any significant improvements to facilities. Also it would be almost impossible, or illegal under current legislation, to raise a user charge on other facilities such as public parks, art galleries and libraries without significantly negatively impacting on the level of use of those services.

Question 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?

Various appropriate levels of debt for local government have been suggested such as the Debt Service Ratio of less than 15% suggested in the Local Government Financial Sustainability Checklist or the Debt being equal to 100% of Operating Revenues suggested in the Allen report. The Department of Water and Energy suggests a Net Debt to Equity Ratio of 20%. Any such measure would provide a solid guide to appropriate debt levels for Local Government.

The main obstacle to Local Government using greater levels of debt would be the negative effect that the interest repayments would have on the Income Statement. Funds diverted to repaying interest would need to come from reductions in service levels or infrastructure renewals unless the spending of the loans was specifically targeted at reducing Operating Expenditures such as maintenance and operations or depreciation. Greater levels of debt should only be sought with this goal in mind or if the Council is achieving an Operating Surplus.

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

The main problem with special variations is that the applications will not be successful unless the Council commits to increased and matching expenditure. Special variations are usually given to cover increased expenditure on capital renewals and the like. The Minister has advised that special variations will not be granted to cover increased operating costs; as such special variations cannot be used to improve Operating Deficits. If regular and ongoing Operating Surpluses can be achieved while ensuring full funding of appropriate depreciation of all Council infrastructure, then Local Government should be able to fix most of the issues it is currently facing.

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

A survey conducted of average residential rates levied by Group 4 Councils indicated that the average residential rate in 2007/08 ranged from \$549.62 to \$1,053.14 per annum. The average business rate levied ranged from \$485.27 to \$3,451.98. It is likely that such disparities would be found across most groups.

Rate pegging makes it difficult for those Councils with historically lower rates to catch up with their peer Councils in this regard. Perhaps IPART could provide some guidance on what should be a typical or average rate levied in each Council group. Any such figure should not be binding due to the inherent differences existing even between Councils in the same group, but it would provide those Councils with historically low rates a means by which they can increase revenues without committing to the extra expenditure required by special variations. This would improve the Operating Result for these Councils, which as stated earlier would be of enormous assistance in addressing the problems facing local government.

OUT OF SCOPE COMMENTS

Revenue From the Investment of Cash Surplus to Short Term Requirements.

Up until the release of the Cole Report and the subsequent changes to the Minister's Order in relation to Investment of Funds, Councils had available to them a wide range of investment products. These products, with their longer terms and access to a wide range of underlying assets, provided Councils with the opportunity to achieve much higher rates of return than was possible with simple term deposits. As a result, many Councils were able to obtain significant additional revenues to help relieve the burden on the ratepayer in regard to the funding of Council activities.

Obviously, investment in these products entailed a certain amount of risk, but for most Councils this can be minimised and managed through the normal fund management principles of diversification and having a full understanding of the investment being purchased. A strong Investment Policy, operated by knowledgeable staff willing to review Council's cashflow needs, constantly review the current status of investments, and properly manage the portfolio, can generate revenue more easily and less painfully to ratepayers than special variation rate increases.

The Cole Report outlined the risks of investing in the types of products that were purchased under the previous Minister's Order (e.g. CDO's, subordinated FRN's, CPDO's, CPPI and other capital protected products etc) and noted that the current market valuations, (brought about by unprecedented market events) were in many cases well down on the initial purchase

price. In addition to this reporting in the 2007/08 Financial Statements for each Council may provide further details of these "paper losses".

It is hoped that consideration can be given to this issue and the ways in which Councils can invest in a wider range of products previously available to them and therefore access the better returns that can be generated. Linked to this issue should be the requirement for further and better educating Councils about managing the risks involved.

Reviewing the Rating Legislation to Enable Rating Based on the Actual Value of Production or Use Rather than on the Unimproved Capital Value.

Muswellbrook Shire Council has, within its borders, seven large scale coal mining operations. The total rateable land value on which these operations are conducted is \$36M and will generate \$1.6M in rates revenue to Muswellbrook Shire Council in 2008/09. Production at these mines totalled 39.94 million tonnes in 2005/06 and at a current price of \$232 per tonne (coal spot price 1/4/2008) would generate up to \$9.266 billion per year for these companies.

The disparity between the revenue generated and the rates levied indicates the inadequacy of the Unimproved Capital Value as a measure of capacity to pay or even equity in rating in some cases. Other Councils will no doubt be able to produce their own examples where the Unimproved Capital Value produces similar disparities. In light of this, it is appropriate that consideration be given to how Councils can better generate revenue from sources such as this where the value of operations on land is so disproportionate to the rating land value. A local tax, levied on either production or revenue turnover levels may deserve consideration.