

IPART: Revenue Framework for Local Government: Other Industries – Draft report, July 2009

Our comments concentrate on costs indexing, ratepayer protection and the ‘opt-out’ proposal in Option B, and council debt funding.

Option A – Costs indexing

There appears to be considerable merit in the proposed development of an IPART index of local council costs for the purpose of reference in the context of rate pegging generally. A formula acceptable to the local government sector would reduce the discontent that councils voice in relation to current procedures, at least according to their submissions to this review. We note, however, that many of the councils’ complaints about the irrelevance/arbitrariness of the present CPI-based system could, fairly readily, migrate in time to the new Index as individual councils seek to differentiate themselves from the generalised model. Additionally, the economic and efficiency distortions associated with price/tax escalation based on cost-of-service-provision formulae warrant recognition beyond the simple “*Index – x*” device suggested by IPART.

Ratepayers might not worry too much about all that: they could reasonably hope (if not actually expect) that an adopted rate level discipline – any official rate oversight, probably – would have real content and real teeth. It is not clear that they could find it in all the proposals of the draft report.

Some aspects of the proposed IPART index invite further exploration; some would benefit from clarification:

- The composition of a costs index is important, as is its contemporaneity. In composite indices, the inclusion of individual cost components may be an issue, and weightings need revision from time to time. Updating procedures and intervals are intrinsically break-points for continuity, and so – with IPART’s proposed 5-year cycle – a transitional mechanism is potentially of considerable relevance in a rate-pegging scenario.
- The DWMC is assessed on actual costs of council operations in this area and is recouped as a uniform charge from property-owners on that basis. There is no obvious reason for domestic waste management costs to be included in an IPART Index for rate pegging purposes. There may be other services in this category. They need to be explored.

- Council services are variously provided to users at actual, concessional, and no cost. Cost recoupment is an issue not well explored in the draft report; it would bear closer examination. There is a strong argument in efficiency and equity that, *if* rates are indexed by an IPART index under Option A, all council fees and charges should also be indexed by the IPART Index. The equity argument resounds especially strongly with ratepayers. It also has implications for council services provided in competition with the private sector such as those of private certifiers, where councils may choose to restrain their fees in order to retain market share. Obviously, services provided without charge need to be integrated into that framework; their continued exclusion from revenue streams would need special and convincing justification, of a kind not addressed in the draft.
- Administrative and legal limitations on council fees and charges are important elements of the local government revenue framework, but they receive scant attention in the draft report. We think they warrant close scrutiny, particularly having in the light of the specific requirement of the terms of reference para 3 for IPART to have regard to *all* revenue sources, their adequacy, and constraints on them.
- The practical effect of having an IPART Index in the Option A context would be the virtually automatic indexation of rates by councils. That would not differ much from the mechanics of the current situation, and would probably be acceptable from ratepayers' viewpoints. However, it would have economic efficiency implications of the kinds normally associated with automatic price escalation elsewhere. IPART will be familiar with them; they warrant consideration.
- The medium term revenue path associated with Option A seems generally comparable to the current special levy mechanism, with the advantage that criteria might be more explicit and evidently consistent. At present, ratepayers have only hazy comprehension of the various components of the total rate, including terminating special levies. They are given no information at all about the extent of the subsidy component of full rates attributable to concessions for other ratepayers. The authorised life of special levies is a matter of some interest (much like the 3X3 road funding taxes were) especially in the face of realistic expectations that they will not cease at their use-by date, but become incorporated in new rate structures.
- Importantly, there is presently no formal mechanism by which ratepayers can present their views about special levies directly to the Minister when they are dissatisfied with a council's treatment of their views. In a context of a medium term revenue path, such discontent is rather more likely to arise than it would in a single year context. In our experience, Departmental responses to ratepayer organisations who direct concerns to the Minister have emphasised the (prior) community access to the council itself. It has not been clear how the 'community' is defined.
- The role and impact of the *minimum rate* mechanism and current controls over its maximum level warrant discussion and analysis separately from that directed to the ordinary rate. As medium-density residential development becomes more

common in the metropolitan area, rate bills attributable to individual strata units, company title properties, and to garages and other outhouses on separate titles are attracting growing interest among ratepayers. Noting that the IPART Review is not to cover the land value basis of rating, it remains that the framework of local government revenues needs to take account of the realities of that base. The draft report does not seem to address the impact of the minimum rate – and its present control - at all.

- The *diverse and growing role* of local government has evolved without the benefit of clear boundaries for rate funding. Our earlier submissions advocated the assignment of rate revenues to defined purposes, with other purposes served by non-rate revenues of various kinds. We are disappointed that IPART does not appear to be able to accommodate this view.

Option B

Despite the evident concern about consultation and community support generally, the economically and politically important distinction between ratepayers and the community at large is not made effectively in the draft. This was a basic issue in both of our previous submissions. Rateable assessment numbers/resident population comparisons indicate that there are some 1+ resident non-ratepayers for every ratepayer entity. Non-resident service users widen that gap, but are also properly considered to be part of the local community.

Rates averages might be thought to tell the story fairly clearly: for 2006-07, the IPART documentation shows taxation revenues/head \$413, taxation revenues/property assessed \$997, and DLG returns for 2006-07 show average rate/assessment \$3,659 (\$3,834 in 2007-08). Those high-level averages indicate that, simply stated, non-ratepayers as a class easily out-number ratepayers in the collective category of a local ‘community’, and rates concessions are an important element in council finances. The level and role of the minimum rate – and the controls limiting it - also need consideration in that context, especially in metropolitan council areas where multi-unit dwellings are common and becoming more so. The minimum rate, and the practice of rating strata title and company title property on land value, weaken the average rate/assessment calculations, and offer little useful information about affordability for anyone.

From the viewpoint of ratepayers, the presentation of *per head* averages of rate burdens uses a divisor (of resident population) that is basically meaningless.

Some of the submissions to the IPART review have indicated that the absolute sum of the annual rate bill for residential property is not much of a problem... a few hundred dollars a year, contrasting with the (higher) typical family outlays on telecommunications and the like. Perhaps that is so, although it varies with location.

But there is an argument that all residents of and visitors to a council area, property-owners *and* others, benefit from the basic – read ‘*traditional*’ - services provided by councils. That argument underpinned the move in the 1993 NSW legislation to sanction use of the base charge as a component of the rate mechanism, so establishing an (optional

to the council) element of equity among council ratepayers. That kind of argument also underpins the various proposals for a local government poll tax that have surfaced over time in Australia and elsewhere, but which have been ultimately rejected on grounds that are encapsulated in the term 'affordability'. It provides support for a more rational approach to the control mechanism applied to the minimum rate.

Apart from the populist implications of 'community support' mechanics, there is little expressed reference in the draft report to the *affordability* of rates, despite the direct reference to the concept in para.3 of the IPART terms of reference. This contrasts with the evidence elsewhere of active interest of governments and agencies in affordability of public transport fares, power bills, bank charges, developer charges, housing rentals and the like.

Given that there are two very distinct classes of ratepayers - those whose rates are payable in full, and those who receive much-reduced concessional rate bills by virtue of pensioner concessions - the affordability of rates is not a simple issue. Those who pay 'full' rates bear a substantial part of the burden of funding concessions to other ratepayers - but without the benefit of means testing. But it is important in considering the need for a fairly sensitive oversight of council rating decisions, partly because the impact of such concessions will vary among councils according to local demographics, as well as social and economic profiles. It puts a serious query on the validity of a broadly-based ratepayer acceptability concept such as that suggested for implementation in an 'opt-out' mechanism of the Option B type.

A practical aspect of the canvassing of support for council programs lies in the implications of the IPART *Survey Option* suggestion relating to community engagement and ratepayer consultation. Community engagement by any procedure may be comforting to non-ratepayers, but when it is unrelated to the rate level implications of proposals/plans it is of little utility to ratepayers and their concerns. *For example*, taking the exemplary numbers cited at page 178, if 25-30 per cent *of ratepayers* were surveyed, and assuming 50-60 per cent *of them* supported a proposal/plan, it could be approved by only 8.5-18 per cent of ratepayers. The number of survey dissenters, and the dissent of the (much larger) unsurveyed remainder of ratepayers might well be significant, and could undermine confidence in the outcome of the survey. No clear mechanism for dealing with that dissent is obvious. (Actually, the text is not totally clear about the ratepayer/community distinction that is relevant for the purpose).

It might well be thought that responsible councils will not overcharge their captive ratepayers, especially if those ratepayers can be said to accept the burden. That seems to be the logic behind the Option B proposal.

The same might be said of other pricing and taxing entities having a market or geographic or other form of advantage enabling them to operate and charge for their services without direct competitive discipline. However, there is an important distinction.

In commercial transactions, charges are clearly attributable to the service/product transaction involved, and customers may choose not to purchase the product/service, or to reduce purchases. In local government, the rate is not attributable to any specific service/menu of services, and the provision of the council's generic services cannot be avoided or rejected by the ratepayer. IPART has not accepted our view that rate revenues should be assigned to defined council purposes, but we are unsure of the reasoning leading to that conclusion.

Further, while commercial and legal remedies available to consumers and customers for commercial overcharging are available and tangible, the electoral remedy for council adventurism expressed in excessive rate burdens does not reinstate the *status quo ante* for ratepayers; it merely (potentially) removes some of the players from the scene should they offer themselves for re-election in the future. Whatever happens, current ratepayers continue to bear the financial burden of past councillors' exuberance.

This lack of tangible remedy for perceived excess in levying a compulsory tax is a fundamental component of ratepayers' concerns to ensure that some form of objective oversight and discipline is directed on a continuing basis to protect their interests. It underlies our objection to the Option B 'opt-out' concept in the draft report.

In conjunction with the '*No taxation without representation*' principle often associated with democracy, there is some argument in favour of ensuring that the opinions of those who actually pay the rates are given appropriate weight in consultations about rating levels. (Except in the context of a poll tax discussed below, the converse principle, '*No representation without taxation*' is not usually argued and is probably not acceptable in local or other government in modern times).

Accepting the distinction between 'community' and 'ratepayers', the simple arithmetic of the 16.4.5 *Survey Option* at p.178 of the draft report implies that the opinions of ratepayers can readily be outvoted by people who do not pay rates (at least directly), and could well be dependent on the proportion of concessional ratepayers in the survey. Repeated references to 'the community' in this draft report – and, understandably - in much council literature tend to obscure the reality that full and concessional ratepayers may well have real and important interests divergent among themselves, and they in turn may differ separately or together from the interests of the majority of citizens.

That mirrors the real world.

The very pronounced scarcity of specific ratepayer submissions to this IPART Review implies:

- an almost universal lack of interest among residential ratepayers in the specific subject of rates, contrary to the judgment of the successive governments that have sustained rate pegging in NSW for so long, *or*
- a surprisingly high and almost universal level of confidence in the (then) Minister's statement that the Government remains committed to rate pegging, made when the IPART Review was announced, which may now be diluted

- substantially by the IPART Option B opt-out proposal, and by recognition that retention of ratepegging was not specified in the IPART terms of reference, *or*
- an almost universal belief that the councils participating in the Review, including the great majority that have argued that rate pegging should be abandoned, can be relied on to guard the interests of ratepayers without the need for regulatory oversight of rate levels (also contrary to the judgment of the successive governments that have sustained rate pegging in NSW for so long), *or*
 - a lack of ratepayer confidence in the utility of making submissions to and/or about local councils anyway.

The first three explanations lack practical credibility. The fourth implication bears examination. It reflects the kinds of perceptions created when community-based and individual submissions to councils are summarily dismissed by staff and/or councillors, and when numbers of submissions are given weight over the content of submissions. It may also help to explain the relative scarcity of references to *affordability* - ratepayer capacity to pay - in the IPART draft report.

Of interest in the present context, it also reflects the opacity of much council material that is nominally put out for public scrutiny. Too often in practice, such material is virtually indecipherable by people not actively and directly involved in the council affairs. As a potential remedy for that, the draft report refers optimistically to the eventual outcome of the NSW Government's current Integrated Planning and Reporting Framework proposals that are under development by DLG, and offers some suggestions for their improvement, and for other initiatives, all of which seem sensible.

Assuming that eventually a genuinely accessible format will emerge, it remains that even perfect understanding by ratepayers and others of a council's rating proposals and general and genuine popularity of the works and services proposed to be provided, cannot provide assurance that the rates/revenue path included in the package will be affordable, reasonable in the economic circumstances of the time, and/or insulated from sharp and onerous fluctuation. Nor, of course, can it provide assurance of the soundness of priorities allocated to service provision when the use of rate revenue is not confined to identified activities. In the absence of hypothecation of rate revenue, the fungibility of money ensures that ratepayers can have no useful comprehension of a relationship between the rate burden and the council service menu.

Apart from recognition of the direct and relevant impact of the relatively brief property turn-over time-scale of seven years or so, which is crucial in a forward-planning-based approach to rating discipline because of its impact on the identities of ratepayer units, something more is needed. Rate-pegging has usually been thought to provide some comfort for ratepayers in that kind of context. Opting out of ratepegging under Option B, even with Ministerial/Departmental oversight, will not – and we think *cannot* - provide it.

Council debt

A clue to council suspicion of/discontent with rate pegging may lie in consideration of what might be termed ‘unforeseen circumstances’, and ‘community exigencies’ of a significant scale, that could originate in natural disasters, or financial disasters of the kind experienced by many councils in the current CDO –based turmoil of the GFC, or structural failures of ageing infrastructure. An urgent and unforeseen need for funding in such circumstances can result, may be large, and may well be critical. In such a case, recourse to ratepayers without the restraint of a rate peg may well appeal to councils. From the viewpoint of ratepayers, however, it can be onerous, arbitrary, and uncertain in its results.

We do not think Option B is intended or could be proposed to meet this kind of case which necessarily assumes unplanned and un-predicted circumstances that would not and could not have been included in the consultative documentation. Clearly, borrowing can and should meet special needs of that kind. A council’s credit rating is the obvious key to the appropriate strategy for dealing with a major contingency scenario.

No such justification is apparent to us for the routine use of debt funding for ordinary services and routine capital works of councils at other times. The better route for ordinary times lies in proper – or at least in much-improved - planning of works and services, and revenues, and outlay programs. Inter-generational equity, like virtue, is desirable in principle, but ratepayers might be excused for preferring the lower costs associated with current funding to the inflated costs that ultimately result from interest imposts on borrowed funds.

The net creditor position of many councils that is identified by IPART (although reduced by the incursions of CDO losses) may well be a version of this approach, to the extent that it sees funds accumulated at interest over time to pay for major works and services that are delayed until they can be paid for. The delay costs are up-front and obvious – usually expressed in community complaints about tardiness of works - and may cause some increment to the eventual scope/cost of the works to be undertaken, but at least in financial terms they are offset by the earnings stream during the delay period. At completion of the works, the assets are in pristine condition, and there is no more to pay for them.

In contrast, debt funding captures current costs for projects, but by extending the payment for them over time it enlarges the total outlays required while the assets so funded are themselves deteriorating. At the end of the payment period, the Council is left with more costly assets, in less-than-pristine condition. Ratepayers are not necessarily keen on this aspect of the outcome.

The IPART attitude to council debt, (and that of other local government commentators cited in the draft report) seems to encourage and support the use of borrowings *as a*

norm, and without regard to the urgency or predictability of the works they fund, or the eventual costs of loans. We cannot support that approach.

Specifically, the ‘eligibility qualification’ for Option B appears to encourage the assumption of (some reasonable level – whatever that may be - of) debt as an indicator that all appropriate avenues of funding have been explored. This may be intended to be reassuring to ratepayers in principle, for it might be taken to mean that users of services were paying fairly for them, un-hampered by the kind of fees restrictions that attend basic library services, or development application processing, for example. In practice, that may be - and probably is - an erroneous interpretation. We identified the issue in our earlier submissions. It is not clear to us how IPART would treat the burden on/ benefit to ratepayers of the NSW Government’s ceiling on development assessment fees, and of the various State Government levies on councils such as those related to fire services and planning. Nor indeed is it clear why *ratepayers* – a clear minority of a local community - should shoulder those burdens, especially if they require resort to debt funding.

If it is intended that the responsible financial practice criterion will encompass evidence of resort to debt funding, it would fail ratepayers because of the practical and unavoidable fact that a Council’s debts are a charge on the rates, and ultimately on the ratepayers who may have to forfeit their land if they cannot pay their rates. While ratepayers may have nominal input to development of programs and funding proposals, they are clearly outnumbered by non-ratepayers. If they are financially naïve, their electoral (or written) input may bear little relationship or relevance to the realities of a council assuming debt burdens for years ahead in their names without reliable insight into their real circumstances.

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I record my appreciation of the courtesy extended to me at the Sydney Workshop held on 2 September 2009.

Hylde Rolfe, Principal
9 September 2009