Ripe for Reform

A submission on the IPART Review of the Revenue Framework for Local Government

Property Council of Australia – September 2008

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Executive Summary

The Property Council of Australia welcomes the opportunity to comment on the Independent Pricing and Regulatory Tribunal's (IPART) review into the *Revenue Framework for Local Government* released for public exhibition on 14 July 2008.

The Property Council is the national representative of the property industry. Our members help shape, build and finance our cities and have a long term interest in the future of our urban and regional centres.

Local government's revenue framework is in urgent need of reform.

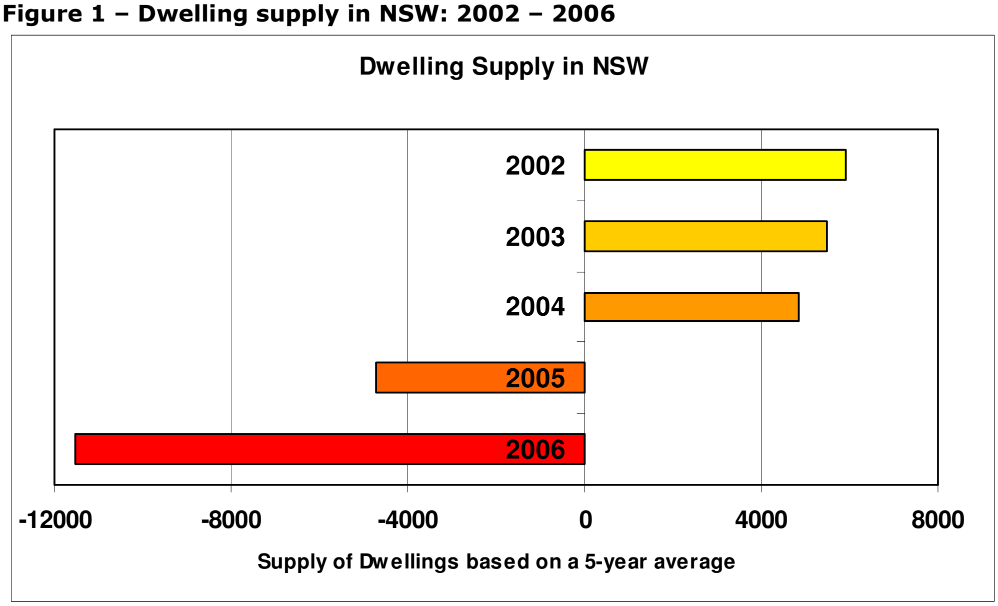
Our major concern is local government's increasing reliance on development levies to fund infrastructure. Such practice shows a complete disregard for the impact of levies on housing affordability. It is also inequitable from an intergenerational perspective through making purchasers of new homes and business investors pay for new infrastructure, despite the fact that the benefits accrue to others in the community as well as future generations.

The inability of local government to fund required and vital infrastructure and services is well documented. A recent study by FiscalStar into the financial sustainability of the largest 100 local councils in NSW showed that one in three councils surveyed were financially unsustainable. The study found that substantial changes to these councils' existing financial and infrastructure policies were necessary to ensure their survival.

Levies are far too high and restricting development activity. In Sydney there is an undersupply of more than 6,000 dwellings per annum compared with Government's growth targets under the Metropolitan Strategy.

For NSW, the situation is even more stark. Based on a five year average, in 2006 there was an undersupply of over 11,000 dwellings.

Figure 1 – Dwelling supply in NSW: 2002 – 2006



The Property Council strongly opposes any introduction of new state infrastructure or development levies. The fact is that levies also go unspent. In the last financial year, unspent section 94 levies topped $620 million in Sydney alone.

Unfortunately, any suggestion to revise levies to stimulate the housing and construction sectors is met with a hysterical response from the local government sector. The Government must take the lead to reform local government revenue framework, given the sector appears unable and unwilling to reform its financial management.

We are keen to assist the NSW Government and local government sector in finding alternatives to development levies. In addition to the traditional forms of council funding, the following methods should be considered by the Government and form part of IPART's final report:

- **Tax Increment Financing** (TIF) allows government to capture increases in tax revenues attributable to an increase in property values within a prescribed development area (TIF district) and use those revenues for neighbourhood renewal projects for a defined period of time.

- The **Business Improvement District** (BID) model is a powerful and flexible funding mechanism used extensively in the US, Canada and UK to improve the vitality and viability of commercial areas. BIDs are grassroots organisations driven by local businesses providing services to the business community over and above those supplied by the council. Stakeholders within a defined boundary vote to make a collective contribution towards the maintenance and promotion of the area.

Ryde City Council is currently considering a BID for Macquarie Park – one of the fastest growing commercial centres in Australia.

Rate pegging is recognised as one of the main constraints on the ability of local government to raise sufficient revenue to provide services to the community. The review highlights the lack of any methodology for deciding rate increases.

The Government should institute measures to enhance accountability to their community and remove mandatory rate pegging. Rate pegging diminishes the financial viability of local government. No other state or territory in Australia employs this system to decide local government rates.

Any increase in rates however should be linked to a decrease in development levies and responsible expenditure. A lifting of rate pegging should see:

- increased fiscal discipline;
- defined infrastructure strategies for each local government area; and
- council amalgamations.

The following sections of this paper outline our key issues and recommendations.

1. Key Recommendations

1. **The NSW and Local Government sector should commit to no new development levies to fund infrastructure.**

2. **The NSW Government should establish a joint taskforce to investigate alternative methods of funding infrastructure and report by the end of this year focusing on:**

   a. **Tax Increment Financing**

   b. **Business Improvement District model using Ryde City Council's Macquarie Park as a pilot.**

3. **The first act of this infrastructure funding taskforce should be to prepare a paper recommending alternative mechanisms to the Government by December 2008.**

4. **The NSW Government should abolish rate pegging subject to strict financial accountability to the local government sector.**

5. **The Government should link any increase in local government rates to a reduction in development levies.**

6. **Local councils should develop compulsory infrastructure strategies with a supporting forward capital expenditure program.**

7. **The Government should initiate structural reform as part of a new framework of the local government sector to create larger councils in metropolitan regions, better reflecting their Metropolitan Strategy sub-regions.**

2. Introduction – The need for reform

Local government in NSW is in urgent need of reform. The Property Council supports a strong, effective and sustainable local government sector that manages competing demands in an efficient and effective manner.

The Property Council participated in the Local Government and Shires Association's (LGSA) 'Strengthening Local Government Taskforce' business roundtable in November 2006. The roundtable made suggestions to improve governance structures in local councils including extending mayoral terms to four year terms and abolishing rate pegging[1].

Percy Allen AM was commissioned in 2006 to conduct an independent inquiry into the sustainability of local government in NSW. His Final Report – *Are Councils Sustainable?* released in May 2006 found that local government continues to face a number of significant challenges. The report uncovered a 'number of pressing problems that need urgent attention', the most significant being a $6 billion+ backlog of infrastructure renewals.

In August 2007, the LGSA called on the Government to provide a reform implementation fund allowing councils to carry out reforms focusing on strategic planning and asset management[2]. We support such reform.

In July 2008, FiscalStar[3] released their report into *The Financial Sustainability of the Existing Financial and Infrastructure Policies of NSW Councils*. This review found that of the largest 100 councils in NSW, 35% are not financially sustainable. A further 20% of the councils were rated as financially vulnerable and would meet significant challenges in the future if no changes were made to existing policies.

This means that substantial adjustments to existing revenue-raising and/or expenditure policy settings are needed if local government's present financial and infrastructure imbalances are to be corrected over the next five to ten years.

The stability and predictability of the council's rates, fees and charges are therefore at risk, and the rate burden does not seem to be shared fairly between the council's present and future ratepayers.

Reform must also focus on increasing the financial accountability of local government. While rate pegging certainly restricts the capacity for councils to function and grow, the sector must have more disciplined budgets. This includes longer term financial planning and defined infrastructure strategies. This point will be discussed in section four of this submission.

[1] LGSA Media Release (22/11/06) 'Business Roundtable Calls for Changes to Way Councils Are Governed' – available at www.strengtheningLG.lgsa.org.au
[2] LGSA Media Release (08/08/07) 'State Called on to Provide Reform Implementation Fund to Councils' – available at www.strengtheningLG.lgsa.org.au
[3] FiscalStar's purpose is to develop and implement a system of financial sustainability ratings applying to local government authorities in Australia and New Zealand. FiscalStar is independent of councils and uses available data to assess their sustainability.

3. No new development levies

Development levies are a significant and growing revenue source for local councils.

The Property Council's Residential Development Council commissioned BIS Shrapnel in 2007 to analyse supply and demand for housing in NSW. It found that state and local government taxes, levies and charges are adversely affecting new dwelling affordability and housing construction.

An audit of unspent section 94 levies in Sydney by the Property Council concluded that over $620 million was not being spent on the community. The following figure demonstrates how much some councils depend on these levies.

Figure 2 – Top ten section 94 contributions as a percentage of total income in Sydney Metropolitan Councils from 1 July 2006 – 30 June 2007.

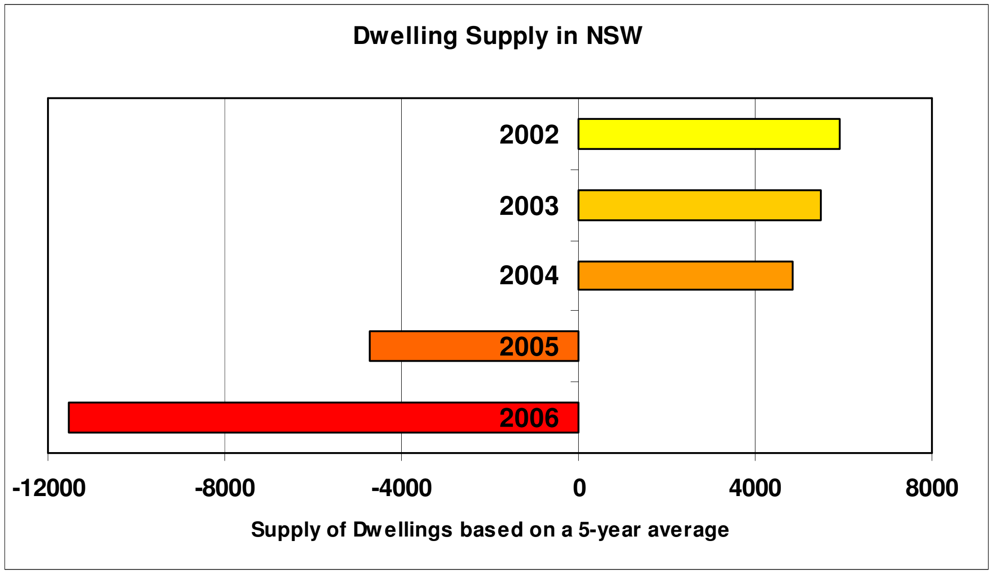
Council	S.94 Contributions July 2006 - June 2007	S.94 as a Percentage of Total Income
	'000	%
Camden	13,806	23.6%
Ku-ring-gai	17,512	18.8%
Pittwater	11,901	13.5%
Penrith	13,986	8.4%
Blacktown	17,827	7.7%
Kogarah	2,642	7.0%
Strathfield	7,966	7.0%
City of Sydney	27,582	6.6%
Mosman	1,838	6.3%
Ryde	4,814	5.7%

These levies makes housing and commercial development more expensive. The impact of development levies on production and affordability seems to be rarely considered. The cost of these levies has meant that the industry has not been able to supply housing and employment generating development at a price the market is willing to meet.

The Property Council has long advocated for a reform of development levies in the State. This infrastructure funding policy is working against the Government's growth objectives. It also promotes intergenerational inequality by making purchasers of new homes and businesses pay for new infrastructure, despite the fact that the benefits accrue to others in the community as well as future generations.

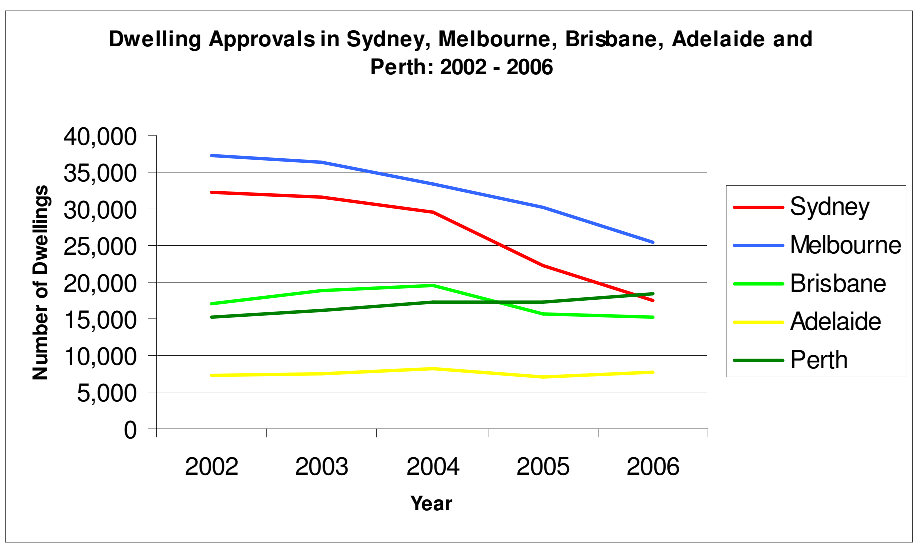
Figures 3 and 4 below demonstrate the extent to which dwelling approvals have fallen below the five year average. It shows the chronic undersupply that NSW is facing caused in part by large levies on new residential development.

Figure 3 – Dwelling supply in NSW: 2002 – 2006



No other state or territory funds state-level infrastructure through levies to the same extent as NSW. The graph below shows that Sydney is falling dangerously behind other capital cities in supply of new dwellings in real terms.

Figure 4 – Dwelling approvals in major capital cities: 2002-2006



We repeat our call for IPART to recommend that the Government investigate alternative methods of funding infrastructure and have less reliance on levies.

Recommendation

1. The State and Local Government sector commit to no new development levies to fund infrastructure.

4. Alternative funding of infrastructure

The Property Council recommends alternative methods of funding infrastructure which should be examined by Government and supported by the local government sector and form part of IPART's final report.

Tax Increment Financing (TIF)

The Property Council of Australia commissioned Pricewaterhouse Coopers (PwC) in 2007 to advise how Tax Increment Financing (TIF) could be applied in Australia.

Used extensively in the United States, TIF allows government to capture increases in tax revenues attributable to an increase in property values within a prescribed development area (TIF district) and use those revenues for neighbourhood renewal projects for a defined period of time.

TIF is used predominantly by local government in the United States. In NSW it is likely that TIF would be more effective if directly controlled by the State Government and were targeted at growth areas of state and regional significance.

PwC tested the viability of TIF in Australia via two case studies. It found that a TIF would repay 75% of a metro rail station and accompanying infrastructure upgrades in the Sydney suburb of Gladesville in 18 years, and 75% of the infrastructure costs of the Sydney south west growth centre in 19 years.

Business Improvement District (BID)

The Business Improvement District (BID) model is a powerful and flexible funding mechanism used extensively in the US, Canada and UK to improve the vitality and viability of commercial areas. BIDs are grassroots organisations driven by local businesses providing services to the business community over and above those supplied by the council. Stakeholders within a defined boundary vote to make a collective contribution towards the maintenance and promotion of the area.

The Property Council considers that establishing a BID model will be an important element to help deliver local infrastructure and services required to facilitate the growth and revitalisation of many of the identified centres.

Ryde City Council is currently considering a BID at Macquarie Park, one of the fastest growing commercial centres in Australia. Since 2005, total office space at Macquarie Park has grown by over 30%. A further 136,705 square metres is expected out to 2010. Such growth requires a massive investment in infrastructure and Ryde City Council has taken the bold step in trialling a BID. This important initiative should be used as a pilot to examine its applicability on a wider scale.

Recommendations

2. **The NSW Government should establish a joint taskforce to investigate alternative methods of funding infrastructure and report by the end of this year focusing on:**

    a. **Tax Increment Financing**

    b. **Business Improvement District model using Ryde City Council's Macquarie Park as a pilot.**

3. **The first act of this infrastructure funding taskforce should be to prepare a paper recommending alternative mechanisms to the Government by December 2008.**

5. Abolish rate pegging

Rate pegging constrains the financial capacity of local government. As IPART notes, no other state or territory in Australia pegs the rate that local government can charge its constituents.

The Property Council supports lifting rate pegging as part of a wider reform package of the entire sector. However, this should be subject to:

- Greater fiscal discipline and accountability of local government;
- Compulsory infrastructure strategies with a forward capital expenditure program;
- Council amalgamations; and
- Linking rate increases with a decrease in levies.

The Government should consider the recent findings into local government financial sustainability in New Zealand. A report by David Shand, *Local Government Rates Inquiry* for the New Zealand government does not support rate capping considering it a "too blunt an instrument to achieve restraint"[4].

Rather, the report advocates for a better analysis of revenue and financial policies of each council, similar to other tiers of government. The local government sector should adopt clear and measurable financial targets out to three years.

Percy Allen AM also recognised the disparity between requirements and reality of infrastructure provision in his final report on local government.

> *Each local council should have a total asset management system for the whole of life planning, acquisition, registration, operation, maintenance, disposal and renewal of each component of its infrastructure. Sufficient funds should be set aside each year for routine maintenance, renewal of depreciating assets and the expansion of the asset stock to meet the short to medium term future needs of the local community.*

However, the reality of the situation was that only one in five councils were managing infrastructure risk via asset or risk management plans.

Any lifting of rate pegging should be linked to a decrease in development levies. Local government always highlight that levies are needed for necessary infrastructure. However they appear to dedicate little of their own budgets to new infrastructure, relying on levies to pay for it.

Any lifting of rate pegging must be accompanied by comprehensive infrastructure strategies to ensure that financial gains are not spent on haphazard initiatives which then lets them continue to rely on levies. The other tiers of government all have infrastructure strategies in place as cornerstones of their planning policies, local government should be no exception.

[4] Local Government Rates Inquiry Panel, *Funding Local Government: Executive Summary,* Local Government Rates Inquiry, Wellington 2007.

Amalgamations

There are too many councils in NSW compared with our counterparts in Queensland and Victoria. Melbourne has 31 councils following amalgamations in the 1990s serving a population of 3.85 million – averaging 124,194 constituents per council. Brisbane's model of one council serves over 1 million people.

In Sydney there are 39 councils serving 4.29 million – averaging 110,179 constituents per council. IPART should recommend in its final report the initiation of a process of compulsory amalgamations to improve the local government sector.

The Property Council believes that in Sydney alone, the 44 councils should be reduced to around ten in line with the Government's Metropolitan Strategy sub-regions.

Recommendations

4. **The NSW Government should abolish rate pegging subject to strict financial accountability to the local government sector.**

5. **The Government should link any increase in local government rates to a reduction in development levies.**

6. **Local councils should develop compulsory infrastructure strategies with a supporting forward capital expenditure program.**

7. **The Government should initiate structural reform as part of a new framework of the local government sector to create larger councils in metropolitan regions, better reflecting their Metropolitan Strategy sub-regions.**

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