

Executive summary

The catalyst for this inquiry was the NSW Government's Fit for the Future reform program for local government, which was announced in September 2014. The Fit for the Future program was a direct response to the final reports of the Independent Local Government Review Panel (ILGRP) and the Local Government Acts Taskforce, as well as the findings of Treasury Corporation's review of the financial sustainability of NSW Local Government, and the Local Government Infrastructure Audit.

Calls for reform of the local government sector have been building for some time and inquiry participants expressed widespread support for reform, including support from the sector itself. However, the committee questions whether the Fit for the Future program is the best way to achieve reform.

The Fit for the Future process (Chapter 3)

A major component of the Fit for the Future program was a requirement for local councils to prepare proposals, by 30 June 2015, demonstrating how they intended to become 'fit for the future'. The Independent Pricing and Regulatory Tribunal (IPART) was appointed on 22 April 2015 to assess councils' Fit for the Future proposals. IPART provided its assessment to the NSW Government on 16 October 2015, and the Government subsequently released the report on 20 October 2015. IPART found 71 per cent of Sydney metropolitan councils and 56 per cent of regional councils to be 'not fit'. The committee believes it is unfair and misleading for the Government and IPART to label these councils as 'unfit' and calls on the Premier and the NSW Government to withdraw such statements.

Inquiry participants raised concerns regarding the appointment of IPART and the deadlines for providing and assessing council proposals. These included questions about IPART's expertise in local government and its ability to assess some elements of the criteria. While IPART has significant capacity to analyse the finances of local government, the committee finds that it does not have the demonstrated skills or capacity to assess the overall 'fitness' of councils as democratically responsible local bodies. In relation to time frames, the committee finds that IPART's appointment occurred too late in the Fit for the Future process and that the 30 June 2015 deadline for councils to submit proposals was too short.

A recurring criticism from inquiry participants was that the Government's reform package was too focused on amalgamations and structural reform, rather than addressing the entire set of recommendations made by the ILGRP. The committee considers that a more constructive approach to the Government's reform program would have been to implement other recommendations of the ILGRP prior to embarking on any structural reforms to the local government sector.

Nonetheless, there are a number of positive outcomes resulting from the Fit for the Future reforms. Chief among these is the fact that it has encouraged local councils across the state to review their long term financial sustainability and consider ways to improve their performance, even though the process was too rushed for councils to take full advantage of it.

The financial sustainability of councils (Chapter 4)

The financial sustainability of local councils in New South Wales has been of significant concern for some time. Both Government and independent reviews have highlighted concerns over infrastructure backlogs, underspending on asset maintenance and operating deficits of numerous councils.

There is significant variability in the financial position of councils throughout the state. Factors affecting this include the population size and density, incomes of rate payers and number of businesses in the council area.

In addition to the variability between councils, there are a number of factors which have affected financial sustainability of all councils over an extended period of time. These include rate pegging, rate exemptions, regulated charges and cost shifting by state and federal governments. The freezing of Financial Assistance Grants will also have a significant immediate impact as well as a significant cumulative impact in coming years.

Numerous inquiry participants called for removal of rate pegging because they said it adversely impacts on the sound financial management of local councils. The committee considers that communities should be able to decide the level of services provided by their local council and the rates they are willing to pay for such services. We therefore recommend that the government evaluate the option of removing rate pegging and allowing rates to be set by local councils in consultation with their community.

In relation to Financial Assistance Grants, the committee is concerned about the decision to freeze the grants at their current level and calls on the Minister for Local Government to work cooperatively with the local government sector to petition the Australian Government to seek a reversal of the decision. In addition, the committee supports the redistribution of the grants according to need, so that the councils in the most need of financial assistance receive the bulk of the federal funding.

Cost shifting by state and federal governments is an issue that is having a significant impact on the financial sustainability of local councils. The committee believes that where the NSW Government devolves responsibility for providing services, assets (such as regional roads), concessions, or other regulatory functions to local government, it should provide full cost recovery.

Another issue raised by inquiry participants was the contribution that water utilities operated by local councils make to the financial sustainability of those councils. The committee therefore recommends that those water utilities that are currently operated by local councils remain under councils' control.

Merits of the Fit for the Future criteria (Chapter 5)

The four criteria used by IPART to assess whether councils are 'fit for the future' were scale and capacity, sustainability, infrastructure and service management, and efficiency. Each of the criteria, except scale and capacity, had a number of associated performance measures and benchmarks.

Scale and capacity was the threshold criterion for Fit for the Future proposals and, in the committee's view, it was also the most problematic. The key problems with this criterion were that it was ill-defined and difficult to objectively measure. The committee is of the view that any criteria for making assessments about the future of local councils should be clearly defined, objective, measurable and verifiable, particularly if those assessments may lead to widespread structural reforms. It is the committee's opinion that the scale and capacity criterion does not satisfy those parameters. Accordingly, it was not an appropriate criterion to include in the Fit for the Future assessment criteria.

Of the three performance measures associated with the sustainability criterion, the committee considers that the operating performance ratio is the most useful indicator of a council's financial position and long term sustainability. However, a drawback of this measure, along with a number of the other Fit for the Future measures, is its reliance on depreciation data.

The committee heard that there is a lack of consistency between councils in how depreciation is determined. The committee considers there is scope to implement a more uniform approach and therefore proposes that the Office of Local Government make use of the Auditor-General's expertise and, in consultation with the local government sector, develop guidelines to ensure greater consistency across councils in the treatment of assets.

Many of the other performance measures for the Fit for the Future criteria were criticised by stakeholders. The committee finds it troubling that the future of some local councils in New South

Wales could be influenced by such measures. Accordingly, the committee concludes that there is significant uncertainty about the reliability of many of the Fit for the Future performance measures, which undermines the validity of the assessments on whether councils are ‘fit’ or ‘unfit’.

Amalgamations (Chapter 6 & 7)

The amalgamation of local councils was a core issue raised throughout the inquiry. This issue was brought into sharp focus by the ILGRP’s 2014 report *Revitalising Local Government*, which outlined a number of preferred merger options for local councils in New South Wales.

Process for considering amalgamations

Currently, the *Local Government Act 1993* requires amalgamation proposals to be examined by the Boundaries Commission or the Director-General. In its report, the ILGRP recommended strengthening the independence of the Boundaries Commission and the process for examining amalgamation proposals. We support the ILGRP’s recommendation to ensure a robust and consultative process is in place before any further steps are taken by the Government in relation to council amalgamations. Further, the committee finds that a strengthened and more independent commission may make up for some of the flaws in the Fit for the Future process to date.

Costs and benefits of amalgamations

The committee notes there are mixed views about the costs and benefits of amalgamations of local councils. While many stakeholders opposed ‘forced’ amalgamations, some inquiry participants took a firm position of support for amalgamations.

According to those who support amalgamations, one of the key benefits is the potential for increased strategic capacity. Other benefits suggested by inquiry participants included streamlined administrative processes, reduced operating expenses, improved service delivery and simpler planning systems.

On the other hand, those who opposed amalgamations suggested that the costs of mergers included high transitional costs related to the integration of systems, staff, premises and governance structures, disruption to service provision, and potential losses in staff expertise and experience. The impact on a council’s budget position may also be a concern, especially if the residents of one council are expected to take on the debt and infrastructure backlog of a neighbouring council through a merger.

The potential costs for rural and regional communities, particularly small rural townships that would no longer be the business centre of a local council, were raised by some inquiry participants. The committee heard that these smaller centres can suffer the most from council amalgamations.

The employment protections in the *Local Government Act 1993*, which apply to the majority of council employees across the state, do not apply to senior staff such as general managers. The committee is of the view that special consideration needs to be given to ensure there is adequate support and assistance for such staff in the event that their positions are lost in an amalgamation. Of particular concern are senior staff located in rural areas, who may need to relocate to another area to seek new employment. We therefore recommend that the NSW Government put in place a program to support senior staff affected by amalgamations.

In regard to the impact of amalgamations on rates, the evidence was mixed. Some stakeholders suggested that rates would decrease as a result of mergers, while other said they would increase. The committee notes that there are likely to be some winners and some losers following any amalgamation as disparate rating systems are aligned.

Although questions were raised about the rigour and robustness of empirical research on the impacts of amalgamations, much of the available evidence appears not to support claims of cost savings and efficiency. The committee finds that the projected economic benefits of council amalgamations have

been consistently overstated by the proponents of forced amalgamations and the costs and extensive diseconomies of scale caused by amalgamations have not been adequately explained by those same proponents.

Given the numerous concerns raised by stakeholders about the costs of amalgamations the committee is of the view that the case for amalgamations, and in particular, forced amalgamations, has not been made. The apparent lack of empirical evidence to demonstrate the benefits of amalgamations lends further weight to these concerns. The committee therefore calls on the NSW Government to commit to a policy of no forced amalgamations of local councils. The only exception to this policy should be in circumstances where it can be established that a council is severely financially unsustainable to the point of bankruptcy or unable to maintain an acceptable level of service provision.

Factors affecting the outcome of amalgamations

The committee heard that there are a multitude of factors that can affect the success of amalgamations. Such factors include the level of community support for amalgamation, the availability of resources and support to assist councils, the level of planning and communication, the availability of incentives, and whether there is a genuine partnership approach between the State Government and local government sector.

The committee considers that there appear to be better outcomes for amalgamations that occur in a voluntary way and are supported by the community. However, the committee acknowledges that there is some contention over the distinction between ‘voluntary’ and ‘forced’ amalgamations.

The committee was troubled by the fact that there was no disclosure of what the next steps in the Fit for the Future process would be after IPART provided its final report to the Government. The committee is concerned that this reflects either a lack of transparency or a lack of a clear road map or plan for the future of the local government sector in the state. The committee considers that at the outset of any program to transform the local government sector, it should be vital to have a clear understanding of the entire process and to be able to inform and explain to the community how this process will work.

There have been fears of amalgamation throughout the entire Fit for the Future process. This has been very disruptive and has undermined the sector’s trust from the outset. The committee considers that a better approach would have been to start a discussion on the role and functions of local government, rather than focusing on reducing the number of councils.

We found that the NSW Government failed to build on the consultative approach established during *Destination 2036* to develop a road map for the future of the local government sector, and appears to have neglected to adequately consult with the community, or effectively partner with the sector, to continue those reforms.

The committee considers that for any amalgamations that may arise out of the Fit for the Future process there is merit in ensuring that the transitions to new councils are well-managed. To this end, the committee recommends that the NSW Government consider allowing for a period of transition to ensure effective planning, consultation, implementation and ongoing service delivery to communities. Such changes, however, should not preclude use of the Boundaries Commission, and should not be inconsistent with the committee’s recommendation to strengthen the Boundaries Commission process.

Protecting and delivering democratic structures for local government (Chapter 8)

Councils play an important role within the local community, especially in regional areas. We note inquiry participants’ fears that amalgamation of local councils could mean a loss of local identity, community uniqueness and local decision making. The committee acknowledges the importance of keeping the ‘local’ in local government to ensure it remains close to the people it serves.

In relation to the election of mayors, the committee makes recommendations to encourage referendums on whether mayors should be popularly elected by voters or elected by councillors, and to increase to two years the period a mayor elected by the councillors is to hold office. We also recommend that the NSW Government consider amending the electoral legislation to introduce donation and spending caps for candidates at local government elections.

Cooperative models for local governance (Chapter 9)

The committee examined a number of cooperative models for local governance in New South Wales, including Regional Organisations of Councils (ROCs), the Joint Organisations Pilot Program and the Joint Regional Authority Model.

The committee notes the promising signs shown by the Joint Organisation Pilot Program operating in five regional areas and recommends that the Joint Organisations model be offered to all councils in New South Wales.

The committee is also impressed by the presentation of the joint regional authority model from the Hunters Hill, Ryde and Lane Cove Councils and sees very real merit in this style of joint organisation being given statutory support in preference to forced amalgamations.