LG Sustainability Inquiry – Opening Statement – Always Thinking Advisory

1 No Change is No Option

i. NSW requires a functioning and sustainable system of local government. Communities are often agnostic to the provider of assets and services.
ii. Unlike other States, NSW councils' revenue-raising and productivity has been suppressed.
iii. Intrastate migration into regions brings metro service expectations. Metro councils have superior revenue raising capacity to regional and rural councils.
iv. Low revenue recoveries limit service and asset choice to community.
v. Planning and reporting constrictions placed on councils by State, causes capacity risk.
vi. Depreciation is double-edged…removal of accounting and revaluation for depreciation as a 'barometer', risks councils returning to underspend on renewals to balance overall budget.
vii. Community-led IPR (planning, programs, projects) is preferred.

2 Common Issues

i. **Many reports have been prepared for Government** regarding sustainability, outlining the issues with rate pegging, restrictions on revenue raising, and impacts of reporting and cost shifting:
   - IPART, Productivity Commission, KPMG, TCorp, Deloitte reports refers.
   - Government should take account of the cost and impact on local councils of other reforms (Fit for Future, mergers) and recent natural disasters, should further reforms ensue from this Review.

ii. There remains **chronic underfunding** of local government:
   - financial assistance grant (FAG) < 1% commonwealth tax revenues (CTR)
   - libraries receive < 50% subsidy of standard costs
   - pension rebates are subsidised < 100% (+ non indexation for many years)

iii. **Grants are particularly volatile**:
   - emphasised by recent infrastructure stimulus and disaster recovery
   - regular timing, process and cost gaps; and risk of delayed claims (FY crossover)
   - grant terms generally exclude project management and contingency/escalation
   - grant terms generally exclude allowance for asset lifecycle costs
   - councils often lack capacity to apply, acquit and deliver grant funded projects
   - suggest options for allocated ,rather than competitive, grants

iv. **Intergovernmental transfers (cost shifting) are hidden taxes**:
   - nett regional roads maintenance and depreciation costs are borne by councils
   - state-controlled emergency service levy and assets control charged to councils
   - waste levy is indiscriminately applied and under-allocated, while generous rate exemptions (incl GTE), continue to apply

v. **Gaps are widening**:
   - 'one size does not fit all' (benchmarks, rate peg, grant allocations)
   - council costs (construction-development activity ~ PPI) mostly exceed CPI in multiples
   - legislated-driven movement from assets to environment, economy and community
   - > 60% local councils regularly publish operating deficits (masked by prepaid FAG)
   - regional-rural councils mostly lack organisation capacity and maturity in specialist area
   - access to key skills (asset, project, planning, financial) and funded traineeships
   - depreciation is growing faster than rates for many councils
   - grant funded and developer gifted assets MRD undercooked, and often exceed rates generated

vi. **Parts of legislation needs a refresh**:
   - clarify LG role and relationship to State (Act)

3 Focus on Options and Opportunities

i. **Assets first, Nice next**:
   - local government's primary (and traditional) responsibility is for the lifecycle management, maintenance and renewal of assets (infrastructure, utilities, facilities) as services to property, which support people (health, culture, recreation, safety).
   - the purpose of publicly funded infrastructure is to -
     - connect (economy)
     - accommodate (community)
     - protect (environment)
     - mitigate (risk), and
     - stimulate (growth)

ii. **Local councils could be considered an arm of the State** and therefore may be subject to annual 'appropriations' or 'allocated grants' by Government (like other agencies):
   - appropriations from State GST may be allocated also through the Grants Commission – at least to offset the (lack of) revenue raising capacity of many councils while they administer the regulatory obligations set by Government.
   - State taxes (including GST) generated from State economic activity may underpin infrastructure that supports Government housing, climate resilience and social policy ambitions, and may target LGAs of significant growth or subject to significant climate (and disaster) risk.
   - Commonwealth and State taxes (under disaster funding arrangements) may sponsor the betterment of assets (infrastructure, utilities, facilities), to minimise future service disruption or asset replacement costs.

ii. **Local government's revenue raising capacity should be commensurate with its agreed roles** and responsibilities, so:
   - the *Local Government Act 1993* (Act) should be refined to clarify those responsibilities between the State and local government.
   - external grants should either be to help local councils meet minimum responsibilities that cannot be fully funded by normal rates and charges, or to fully fund activities on behalf of another tier of Government.
   - appropriations or GST-derived grants should be allocated to councils equitably, perhaps by their scale of asset responsibility (km, ha) with a per capita coefficient.
   - statutory fees should be based on standard costs by council cohort. Commercial services should fully recover their economic costs, including cost of capital.
   - the rating and pricing policies should guide the rates of return for private good and market-based services provided by a council. It would also illustrate the under-recovery of regulatory service costs, as a consequence of charging caps and (cost-shifting) protocols imposed by Government.

iii. With a **reliance by community on fit-for-purpose assets** (infrastructure, utilities and facilities):
   - taxes (rates, annual charges and grants) should fund the operation, maintenance and renewal of assets and associated debt servicing (OMRD).
   - development contributions should assist renewal of assets.
   - grants, development contributions, debt and accumulated operational surpluses (reserves) should fund the upgrade and expansion of assets.
   - Government should continue to sponsor new assets to stimulate growth or resilience.

iv. **Tax, service, risk and asset settings should be community-led and councillor-moderated** through a refined Integrated Planning and Reporting (IPR) framework, noting:

- councils *generally have* adequate annual taxes (rates, annual charges and reliable grants) to fund asset operations, maintenance, repair and depreciation OMRD (~3-4% asset WDV), to be guided by responsible asset management.
- councils *do not* have adequate revenues to fund what government policy and regulation *seeks*, and the community *wants*.
- Government may have adequate property taxes (land tax, stamp duty) to sponsor housing infrastructure, supported by State and local development contributions.
- councils still require government grant sponsorship for growth (utilities) and resilience (build back better or BBB) of assets to contemporary (IPWEA/IIMM) standards.
- councils also require flexibility to 'opt in/out' for disaster repairs, and front-loading repairs and replacement of assets through 'pay and do' grants, rather than councils' underwrite and cashflow those works, before claiming costs from Government.
- clarity (or listing) of 'essential public good' (CSO), shared, private, regulatory, market and utility functions (in the Act) is desired.
- IPR should be supported by an OLG-led service catalogue from which councils may frame (and engage community on) their respective local service role, trends, service criticality, asset reliance and risk, maximum allowable outage (MAO), scope, levels of service (LoS), pricing principle and key performance metrics (KPI).
- standardising accounting tools for activity-based costing, and asset condition and depreciation, all of which should improve consistency in unit costs benchmarking, fee recoveries and distribution of grants.
- articulation of services and asset standards (with associated costs) provides choice to community to pursue options for services or assets beyond those distinguished in the service catalogue as 'essential' (mandated by legislation); from 'important' (adopted by council strategy or plan, or sponsored by Government); or 'discretionary' (effort neutral).

v. **Rate yields should be re-based**:
- acknowledge the introduction of rate-pegging caught many coastal, regional and rural councils in a 1970's 'time trap', widening the gap between revenue raising and essential expenditures – without the politically volatile interventions of a rating SRV.
- smooth the prospect of bill shock through once-a-term rate yield uplift or 'corrections'.
- priority setting and trade-offs by councils, together with transparent funding, decision making, assets obsolescence, and managing expectations is required.
- rate categories may be aligned to landuse zones, differentiating investor (eg STRA, energy, tourism, land bank) uses into subcategories, enabling recovery of cost surges.
- rate yields for new development estates should be framed to at least recover the estimated annualised OMRD for the assets to be gifted to council.
- establish SRV categories (CSP ambition, restore working capital, yield correction or stabilisation, matching infrastructure grants or contributions, special purpose).
- remove deduction of supplementary (growth) levies from the population peg (IPART).

vi. Government should amend/clarify the Act to **enable broader application for annual charges**:
- s501 (1) does permit a charge for '*any services prescribed by the regulations*.'
- that section may be a vehicle to link the Act to the Fire and Emergency Services Levy.
- like QLD, enable councils to levy annual charges for a range of asset and service purposes – in addition to general rates. In that way through IPR engagement, citizens are aware of the purpose, outcomes, timeframes and reporting arrangements.
- these represent additional or 'special purpose' services beyond the normal 'essential public good services' of a local council, but nonetheless sought by the community.

- o enable fixed term special infrastructure levies to match specific infrastructure grants and development contributions to accelerate planned and approved housing.
- o enable parity charging for regional and rural councils to at least the level of metro council + Sydney Water charges, where the current $25 urban property charge for stormwater does not even cover depreciation.

vii. **Mitigate hidden taxes**, revising Government policy and associated legislation to enable:
- o removal of intergovernmental transfers and rating exemptions (emergency services levy, pension rebate, and certain residential and GTE rating exemptions).
- o transfer regional roads and emergency service assets control and funding to State.
- o recovery of utility asset maintenance, renewal and debt service (MRD) expenses through annual charges, and operations through user charges; together with a broader derivation of dividends from those utilities.

viii. Government should **assist local councils prepare a Financial Sustainability Plan (FSP)** each term, nominating key issues, principles, pathway, organisation capacity and performance:
- o reappraise and rank the status and enduring importance of existing strategic actions and projects, alongside community surveyed ranking of satisfaction and importance.
- o utilise the Act (s8B) and TCorp framework as benchmarks of sustainability, and redesign financial, asset, resilience and workforce indicators through that lens.
- o the financial plan (LTFP) should reflect the FSP path, with profiles, scenarios, forecasts and revenue recoveries; and annotations on reliability/risks of estimates and grants.
- o the sustainability of councils could be monitored through the lens of lower and upper thresholds (for example, the operating performance ratio may be -10% to +10%) to signal a council in distress, or a council raising more revenues than required; or that asset renewal performance is acceptable within a 90-110% range, with annotation in the financial statements which may reference influence of disaster grant funding.
- o the revised indicators should signal if a council is displaying the sustainability risks to enable appropriate interventions (SRV, service or asset reviews, PIO) – rather than rely on a sequence of financial statements to disclose the risk, albeit too late.
- o the NSW Government and local government should collaborate to transition high risk local councils to 'moderate' settings within the next term of council, then to a 'sound' rating by the second term.

ix. **Transparency and accountability should improve** through:
- o separation of benchmarks, reporting, grant allocations, rate peg and SRV into council cohorts (metro, regional, coastal, rural, remote), or ABS-classified Groups.
- o expansion of budget and financial reporting formats to include an operating and capital account, delineating revenues from service expenditure and asset OMRD, and a total budget forecast result – rather than the typical Income Statement format.
- o alternate rate models, differentiating asset and service standards by subcategory.
- o IPWEA-standard lifecycle estimation and costing of assets; and the assimilation and audit of Notes in annual financial statements of infrastructure value, expenditure and condition data.
- o preparation of an End of Term (EoT) report comprising state of environment and state of infrastructure annexures; and an ARIC attestation of the financial sustainability, trends and risk of the council.
- o 'Fund', 'QBL' or 'Service' accounting and reporting for assets, utilities (water, sewer, waste, stormwater) and special purpose annual charges or levies.

x. **Partner local government sector with OLG, IPART and IPWEA** in the sustainability reforms.

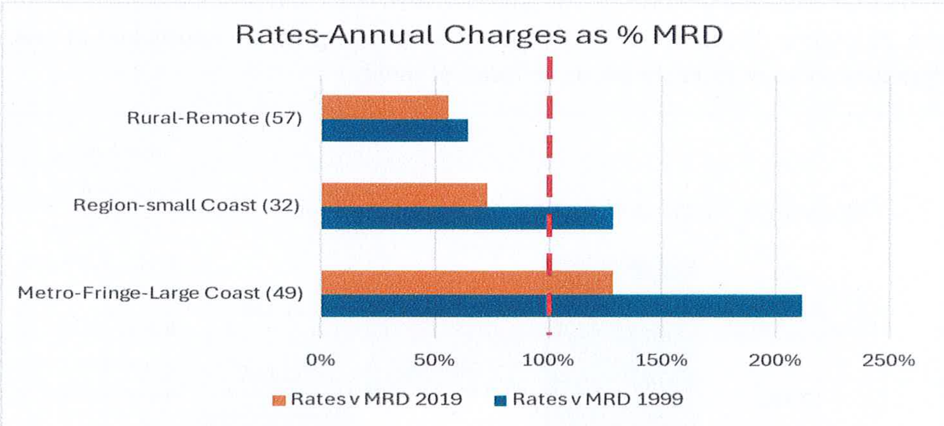
1 Notional MRD Actual v Required Expenditure v Rates per Average Council Group

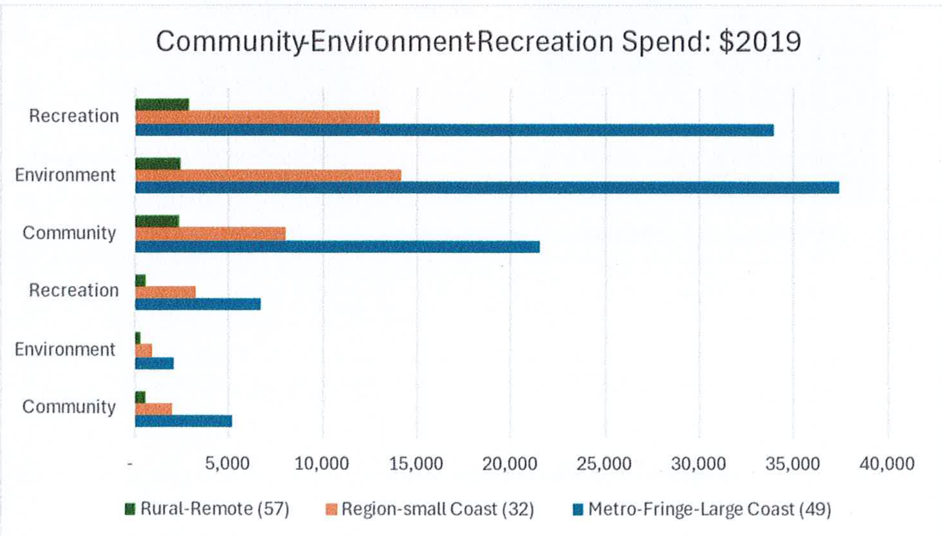
Asset Expenditure comparison FY22

Group	LGA	Pop'n	3% WDV ($,000))	4% WDV ($,000))	5% WDV ($,000))	Asset WDV** ($,000) ss7	Actual MR (ss7)	Actual D (ss7)	MRD ($,000)	Rates + AC ($,000)
2	Burwood	40,397	9,916		16,527	330,538	7,788	7,569	15,357	34,039
3	Fairfield	209,030	45,373		75,621	1,512,418	42,224	32,369	74,593	124,444
4	Bathurst	43,653	39,547	52,730		1,318,238	23,470	29,935	53,405	51,039
5	Tweed	97,151	72,242	96,322		2,408,054	28,831	57,348	86,179	125,312
6			-	-	-				-	
7	Campbelltown	177,689	41,230			1,374,320	12,485	26,643	39,128	125,361
8			-	-	-				-	
9	Murrumbidgee	3,564	7,872			262,397	2,804	5,141	7,945	6,044
10	Tenterfield	6,798	14,545			484,821	6,984	6,784	13,768	11,260
11	Inverell	17,919	23,938			797,942	10,517	10,388	20,905	22,929
11	Snowy Valley	14,901	18,971			632,364	13,123	8,653	21,776	18,000
	* pending revaluation timing									

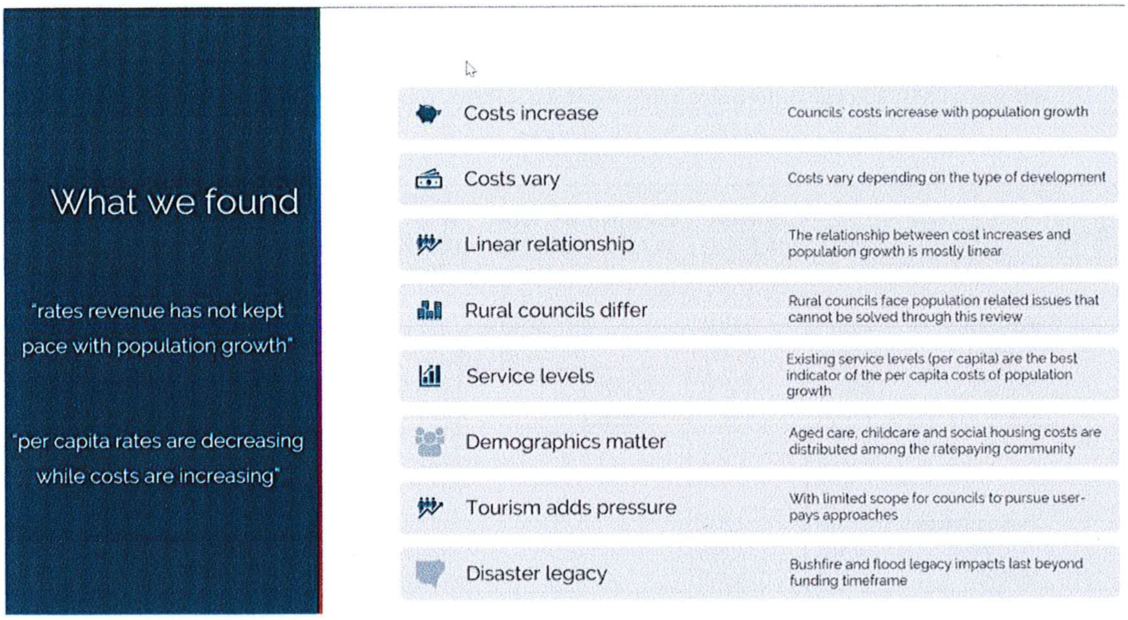
Based on average expenditure council per Group. Snowy Valley is a 2016 merged council.

2 Shift in Spend: From Property to People Services





3 Findings: IPART Report: Rate Peg Review



4 Alternate Rating Model

A council's budget may be displayed to illustrate the gaps between costs and revenues separately for assets and services, prompting discussion, decisions and priority setting for the application of rates and fees, or changes to services or asset standards, or levels of service.