Submission
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INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Organisation: Institute of Public Works Engineering Australasia (NSW)

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The Honourable Emily Suvaal MLC
Chair
Standing Committee on State Development
Parliament House
Macquarie Street
SYDNEY NSW 2000

By email: state.development@parliament.nsw.gov.au

INQUIRY INTO THE ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Dear Ms Suvaal,

I write with regard to the Inquiry into the Ability of Local Governments to Fund Infrastructure and Services. Please find below a non-exhaustive list of observations from the Institute of Public Works Engineering Australasia (NSW & ACT) (the "Institute").

By way of background, the Institute has served the people of NSW for more than a century and stands as the leading professional association representing Public Works Professionals in NSW and ACT. With around 1000 members and Her Excellency the Governor of NSW as Patron, the Institute is dedicated to enhancing the quality of life of NSW communities.

The Institute has considered the Terms of Reference set out by the Legislative Council's Standing Committee on State Development and would be pleased to submit views on the level of income councils require, rate pegging, sustainability, and alternative approaches.

Income

While sources of funding external to rates and user fees and charges are necessary, we submit that the combination of current highly competitive grant funding practices and focus areas which have no strategic alignment leads to highly inefficient delivery of capital and operational funding.

Furthermore, the "sugar hit" nature of grants does not permit for the long-term development of staffing capacity and capability. The Institute cites the example of pothole grants of which a very high proportion (more than 85 percent) flowed through Council into contractors in many instances. Due to the timeframes involved there was no ability for some Local Government Areas to utilise operational staff, upskill operational staff or expand staffing. Whilst this may have delivered significant benefits to our communities, there was almost zero *development* to constituents.

In some of our members' councils, we have seen grant funding lead to hyper-inflated capital programs (compounded by natural disaster funding), in the order of two to three times the underlying average annual capital spend. This places an enormous strain on councils and significantly raises their risk profiles in respect of governance, reporting and capability to deliver upon outcomes.

Lastly, and most importantly, the current approach to grant funding results in an inequitable distribution of funds across NSW communities. Larger, better resourced councils are in a much stronger position to compete for, and win, funds via competitive grants. This disproportionately disadvantages smaller, more remote councils, who are arguably in greater need of the funds that these grants represent. The institute is therefore supportive of an increase to the base level of funding provided to councils, in order to reduce this inequality and provide a sustainable funding level for greater investment in local staff and resources.

Rate Pegging

“Pegging” limits the annual increase in rate revenue that local councils can levy. This restricts funds for infrastructure projects, maintenance and service delivery as councils are unable to increase their rates beyond the capped limit to deliver growing infrastructure needs. Additionally, rate capping increases budgetary pressure on local government and results in prioritisation of expenditure within many competing essential services and capital works projects such as road renewals and upgrades, community facilities, and environmental initiatives. It is the usual practice that Councils need to defer or scale back infrastructure investments due to funding constraints imposed by rate capping. This in turn results in reduced service levels for the community. So, the ultimate disbenefit of rate capping is to the community at large.

Infrastructure backlog can also be directly related to rate capping due to exceedance of demand for infrastructure to the available council funding. We have seen the backlog ratios extensively over the benchmark of two percent in many councils across NSW. Most councils have been struggling to reach that benchmark even with appropriate asset management measures due to budgetary pressures and decreased funding as a result of rate capping.

Overall, rate capping can pose significant challenges for local governments in funding infrastructure services, requiring councils to carefully balance competing priorities, optimise resource allocations, and seek creative solutions to address financial constraints resulting from rate capping.

Whilst part of the terms of reference of the standing committee is to examine this matter, the effectiveness of the rate caps in matching increases in costs borne by councils can vary depending on specific rate capping policies implemented, fluctuations in cost drivers and circumstances of each individual council. The following need to be considered:

a. Rate capping mechanism - This may vary over time with variations in the formula used to calculate the cap, exemptions granted or adjustments for specific cost pressures. Changes in rate policies can impact the extent to which rate increases align with rising cost for councils.

b. Cost drivers - Various cost drivers and cost pressures such as inflation, population growth, wage increases, infrastructure maintenance (especially increases in maintenance costs as a result of natural disasters) and regulatory requirements. The extent to which rates match increases in costs depends on how well these factors are accounted for in rate capping calculations.

c. Alternative revenues - Councils will seek “creative” alternative solutions in generating revenue as a direct result of rate capping. These may include user fees, charges, partnerships, etc. to supplement the constraints rate capping brings and address rising costs to increase their capacity to cope with cost increases under rate capping regimes.

d. Service Levels - As previously discussed, councils may reduce service levels or defer non-essential projects as many have already done so to mitigate the impact of rising costs while complying with rate caps.

e. Long term sustainability - Assessing the long-term sustainability of rate capping requires considering its implications for infrastructure investment, asset management, and financial resilience. Rate capping poses a challenge in maintaining service quality and asset condition overtime for councils.

Overall, the rate caps and increases in costs borne by councils in NSW seems to not align in a balanced way and will reduce the capacity of councils to fund their projects and services.

Indeed, it is a reasonable hypothesis that rate pegging, rather than achieving the intended outcome of reducing the cost-of-servicing for the community, has led to avoidable, inflated costs when it comes to infrastructure asset management, through budget-driven practices which do not allow for the pursuit of and delivery at the lowest whole-of-life cost.

For example, councils across both metropolitan and regional NSW have reduced reseal budgets to achieve balanced budgets. By deferring reseals, a Council may save between \$5 - \$12/m² but have committed to a premature pavement failure (which can range anywhere between \$100-250/m²). It is similarly the case that deferred basic maintenance such as table drain clearing, vegetation control and de-silting of pits/pipes is leading to amplified disaster damage.

The cost shift from state government to local government, and specifically the Emergency Services Levy, has generally far outstripped the rate cap also. For example, since 2016/17 Hawkesbury Council has seen the ESL increase on average by 9.4 percent per annum compared to the average annual rate peg of 2.5 percent over the same period.

The issues with rate pegging are also being exacerbated as the impact of climate change manifests on local council assets, impacting the ability of councils to maintain their assets at the standard their communities expect. Councils are having to discuss the possibility of lower service levels for certain types of assets, or in some cases abandon assets entirely due to the impact of climate change. In ability to increase rates beyond the rate peg would allow councils to maintain their assets to a suitable level of service in the face of climate change impacts.

Sustainability

Whilst related to grant funding, there is also the issue of misalignment between the levels of government which benefit from economic productivity, efficiencies, and savings and those which incur the costs, particularly with respect to infrastructure. An overall lift in economic output does not flow to councils, despite councils having a direct impact on productivity. Upgrading of assets, particularly structures like pavements and bridges, have a direct economic uplift, for example making businesses more profitable or lowering the cost of road-related trauma, which in turn results in an increase in tax receipts paid to or savings experienced by the State and Federal Governments. This fails councils that are left with the recurring cost and no return for the investment that has been made. Noting that this is somewhat ameliorated by grants, it will not cover recurring costs and therefore produces a completely unsustainable funding model.

There are potentially also financial impacts that councils cannot take on, such as writing down current assets and reducing useful lives. Furthermore, the capital investment which comes with “build back better” and developing more resilient infrastructure carries higher operational costs which is not considered in any funding model.

There are also a number of ancillary benefits of building back better, which are not easily quantified from a financial benefit perspective; such as increased resilience of the network during natural disasters, better accommodating the expected growth of road freight as a percentage of the overall freight task, and an improvement in the overall condition of the road network from a road safety perspective. Consideration of these benefits should not be overlooked when considering funding these types of upgrades.

Alternative Approaches

Funding eligibility criteria should be less onerous to enable more flexible funding timeframes and for spending on asset maintenance and refurbishments with less focus on new builds. Eligibility could be tied to the Integrated Planning and Reporting Framework, asset management or other legislated processes to ensure adequate accountability rather than complying with the ever-changing set of requirements the funding bodies produce.

The current significant focus on disaster preparedness is welcomed, but significant funding is required to build resilient infrastructure and correct past land planning mistakes which could become more significant as weather patterns change.

Lastly, the Institute is supportive of moves to reduce the burdensome governance requirements attached to current funding streams, such as a reduction in the frequency of reporting to funding bodies. Whilst these are often touted as being necessary from a compliance point of view, they quickly become a resourcing challenge for council officers. Funding provided by federal sources is typically much less onerous from a governance perspective, and yet councils manage to work well under these types of schemes.

Conclusion

Thank you for the opportunity to submit our position to the Committee. For more than 100 years the Institute has worked with Government to ensure public works across this state are carried out in the best interests of communities and taxpayers. The Institute would be pleased to present representatives of the Executive and Board to the Inquiry should an opportunity arise.

If you have any further questions regarding this submission, please feel free to contact me.

Yours sincerely,

The Honourable David Elliott

CHIEF EXECUTIVE OFFICER

Mr Joshua Devitt

CHIEF ENGINEER