Submission
No 37

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

**Organisation:** Cootamundra-Gundagai Regional Council

**Date Received:** 24 April 2024

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Hon Emily Suvaal MLC
Chairperson
Standing Committee on State Development
Legislative Council
NSW Parliament
Macquarie Street
SYDNEY NSW 2000

Hon Emily Suvaal MLC,

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***RE: Inquiry into the ability of local governments to fund infrastructure and services***

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Cootamundra-Gundagai Regional Council at its ordinary meeting held 23 April 2024 considered a report regarding the above matter and resolved to lodge a submission to the above inquiry. For context, Cootamundra-Gundagai Regional Council (CGRC) was formed in May 2016 as a result of the forced merger of the former Cootamundra and Gundagai Shire Councils resulting in a council which now has an annual operating budget of approximately $50m.

Almost since the time of the forced merger in 2016, the pursuit of demerger back to the former boundaries has been pursued resulting in Local Government Boundaries Commission processes in 2021 and 2022, the latter resulting in the former Minister for Local Government approving a demerger. With the election of a new State Government in March 2023 and the appointment of a new Minister for Local Government, Hon Ron Hoenig MP, CGRC created a demerger pathway (S204 and s212 of the Act), that required, amongst other things, to produce a plan which demonstrated two financially viable and sustainable councils post a demerger of CGRC.

In producing a Financial Sustainability Plan to support the demerger, it became abundantly clear that the financial sustainability challenges for CGRC in the main are not caused simply by a merger/demerger. The issues are far more systemic with a number of contributing factors that have escalated and eroded any real chance that a council, merger or otherwise, had to remain sustainable.

This submission will address each of the Terms of Reference established for this inquiry.

**a) the level of income councils require to adequately meet the needs of their communities.**

Like most councils in NSW, the fundamental issue for CGRC is to prepare and produce a balanced or surplus operating result (i.e., excluding capital grants and contributions in the Income Statement). It is that result that influences the Operating Performance Ratio (OPR) that is benchmarked by the NSW Office of Local Government (OLG) at 0%. A negative result is a deficit. A trend of cyclic surplus and deficit is acceptable (e.g., accounting and timing practice induced), provided an 'average' balanced (0%) result endures across the 10 year financial planning horizon.

A regular and deeper annual deficit becomes structural and requires intervention – usually by a special rate variation (SRV).

And, like most councils, the revenue and expense gaps for CGRC widen each year, becoming increasingly dependent (and vulnerable) on the volatility of grants. The following charts illustrate those and other key trends since 2019.

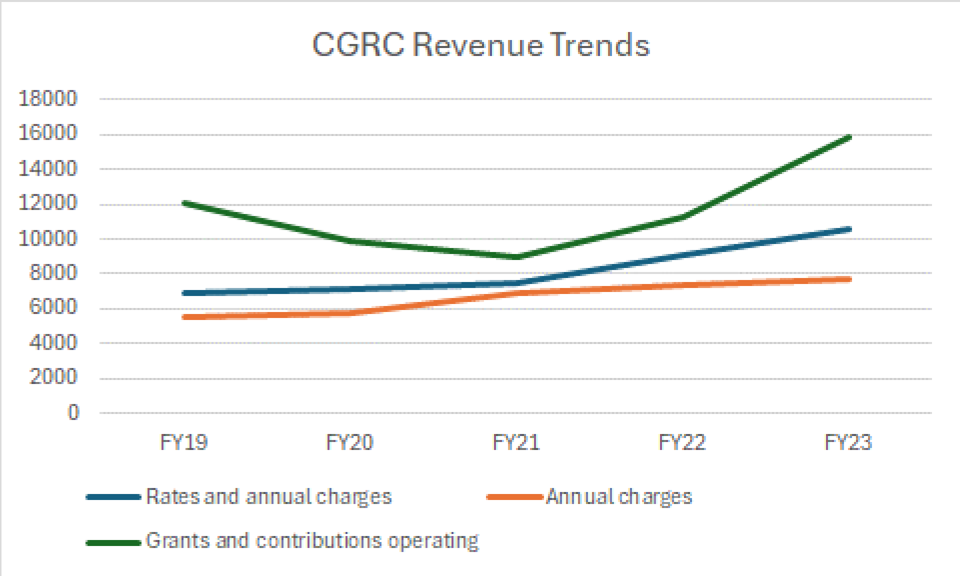


Chart 1

Note: depreciation expense represents 70% of annual rates and charges

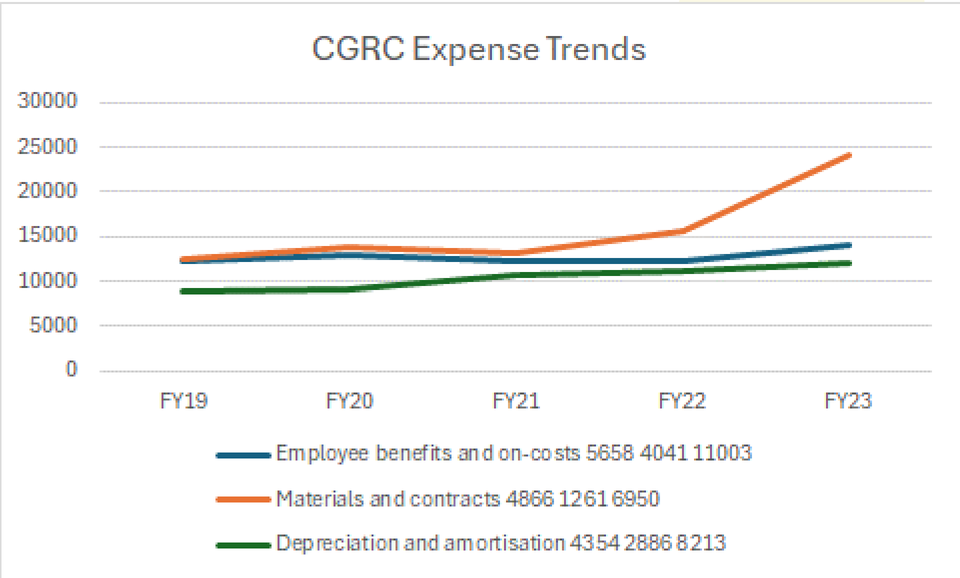


Chart 2

Note: cost of materials escalation

Note: depreciation annual growth absorbs ~ half rates and charges growth

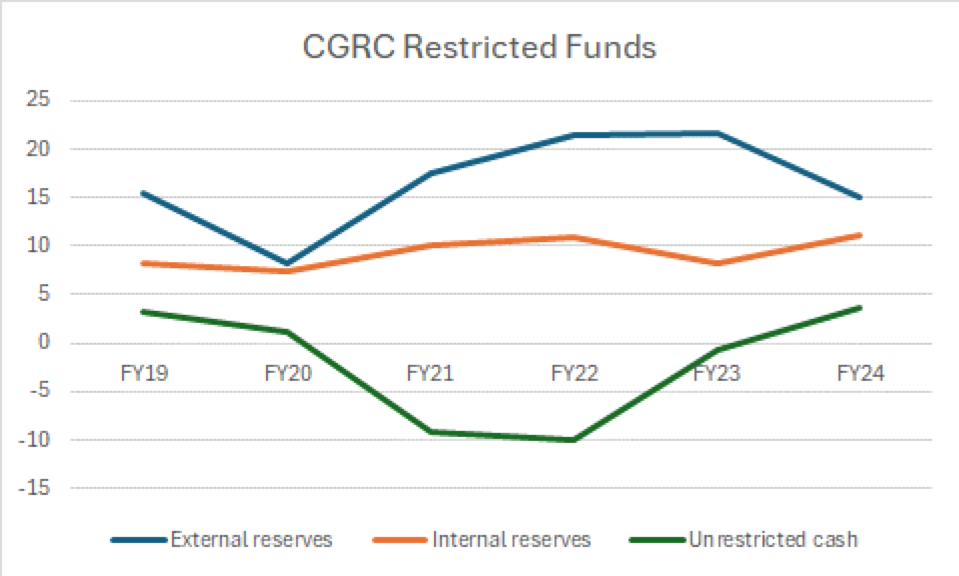


Chart 3

Note: negative unrestricted cash

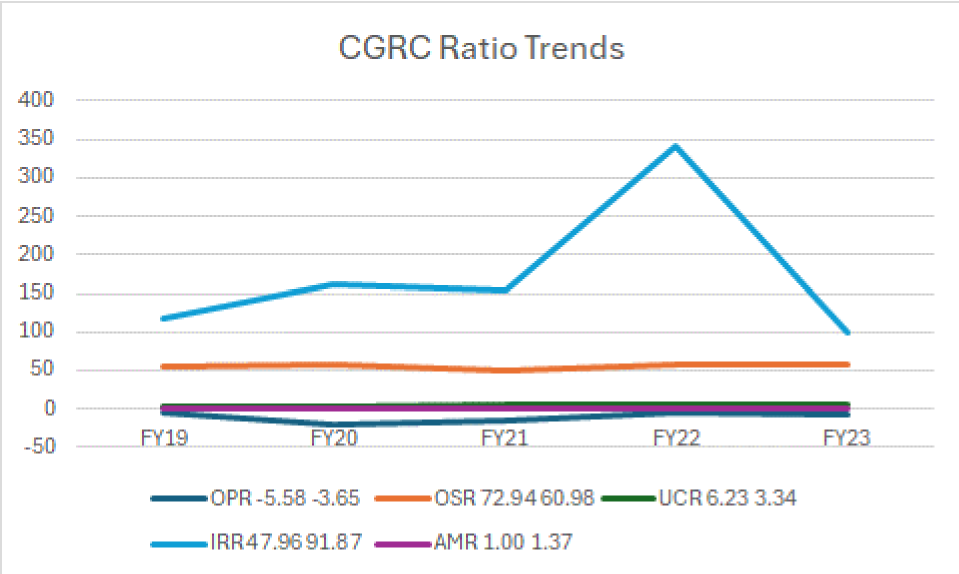


Chart 4

Note: grant-stimulated asset renewals

Other than negative OPR and non-record of asset maintenance, all other indicators are within benchmark.

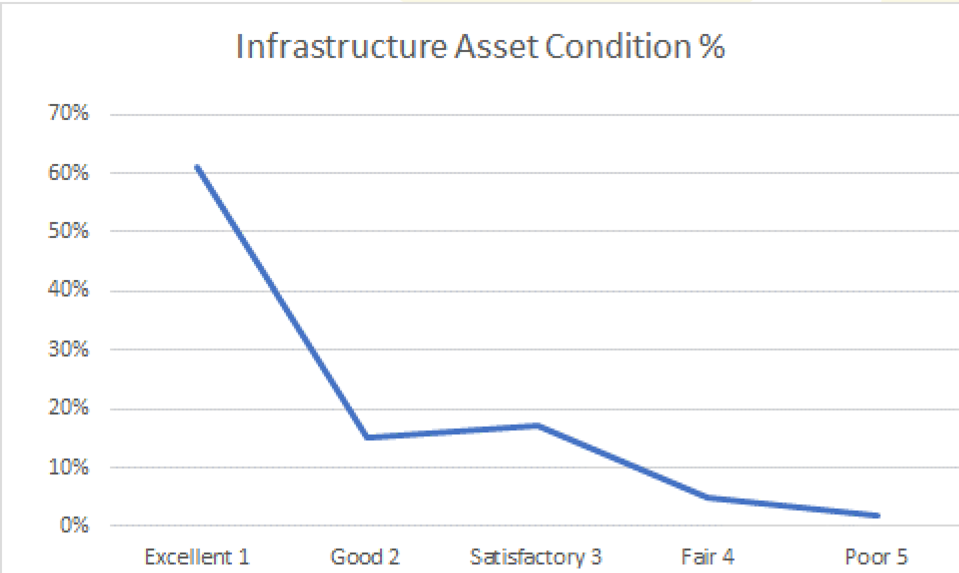


Chart 5

Note: general good condition of assets (excl utilities)

The basic indicator of sustainability for a council is to regularly produce a balanced or surplus operating result, indicating resources are available to expend on capital (renewal/upgraded assets). In essence, the annual movement in cash and investments (and subsequent mix of reserves and unrestricted cash) is a reasonable barometer of the financial health of a council. The following table draws on the pre-merger financial statements of Cootamundra Shire and Gundagai Shire and tracks comparative annual results, using data from the Cashflow Statement and other Notes.

| | | | | Statement of Cashflows - Trends | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| FY15 | FY15 | $2023 | | ($,000) | FY18 | FY19 | FY20 | FY21 | FY22 | FY23 | OP24 |
| Cootamundra | Gundagai | C+G | | | | | | | | | |
| 7,026 | 4,102 | 14,956 | | Rates and annual charges | 11,996 | 13,022 | 13,884 | 14,550 | 16,588 | 18,269 | 19,264 |
| 4,529 | 1,553 | 8,174 | | User charges and fees | 7,212 | 8,978 | 8,114 | 7,523 | 7,356 | 10,806 | 4,986 |
| 534 | 297 | 1,117 | | Interest received | 1,103 | 900 | 537 | 144 | 117 | 697 | 1,245 |
| 4,767 | 4,237 | 12,101 | | Grants and contributions | 11,354 | 17,019 | 11,658 | 20,947 | 25,666 | 27,564 | 20,970 |
| 766 | 1,046 | 2,435 | | Other income | 2,556 | 3,474 | 1,311 | 881 | 528 | 1,563 | 1,301 |
| 17,622 | 11,235 | 38,784 | | | 34,221 | 43,393 | 35,504 | 44,045 | 50,255 | 58,899 | 47,766 |
| 5,550 | 3,842 | 12,623 | | Employee benefits and on-costs | 12,469 | 12,099 | 12,430 | 12,286 | 13,175 | 13,922 | 14,709 |
| 5,640 | 1,919 | 10,159 | | Materials and services | 14,615 | 13,988 | 13,678 | 13,693 | 14,642 | 25,956 | 19,824 |
| 68 | 28 | 129 | | Borrowing costs | 148 | 131 | 111 | 230 | 222 | 184 | 146 |
| 2,022 | 2,050 | 5,473 | | Other expenses | 3,793 | 3,964 | 3,609 | 3,097 | 2,146 | 903 | 1,572 |
| 13,280 | 7,839 | 28,384 | | | 31,025 | 30,182 | 29,828 | 29,306 | 30,185 | 40,965 | 36,251 |
| | 261 | 351 | | Sale of real estate assets | 186 | 793 | 347 | 1,368 | 453 | - | |
| 305 | 168 | 636 | | Proceeds from sale of IPPE | 663 | 1,208 | 1,223 | 1,188 | 1,728 | 109 | |
| | 3,000 | 4,032 | | Proceeds from borrowings | | | 4,430 | 4,000 | | | |
| 305 | 3,429 | 5,018 | | | 849 | 2,001 | 6,000 | 6,556 | 2,181 | 109 | |
| 2,650 | 3,217 | 7,885 | | Purchase of IPPE | 10,539 | 21,443 | 22,000 | 24,897 | 16,998 | 9,963 | |
| 165 | | 222 | | Purchase of real estate assets | 10 | 781 | 186 | 4 | 55 | - | |
| 119 | 1 | 161 | | Repayment of borrowings | 410 | 428 | 414 | 1,052 | 1,275 | 1,315 | |
| 2,934 | 3,218 | 8,268 | | | 10,959 | 22,652 | 22,600 | 25,953 | 18,328 | 11,278 | |
| - 733 | - 122 | | Inc Stat | Nett operating result (excluding capital grants) | - 9,376 | - 2,910 | - 6,248 | - 5,469 | - 4,977 | - 3,779 | - 7,694 |
| - 452 | 2,313 | | | Net change in cash and cash equivalent | - 1,467 | 3,821 | - 2,201 | 2,556 | 2,039 | 7,161 | |
| 16,312 | 9,972 | | | Total cash, cash equivalents and investments | 34,471 | 27,015 | 16,781 | 18,276 | 22,273 | 29,070 | |
| 5,132 | 6,989 | | C1-3 | Externally restricted reserves | 16,800 | 15,473 | 8,166 | 16,232 | 21,679 | 21,683 | |
| 6,647 | 2,504 | | C1-3 | Internally restricted reserves | 16,755 | 8,192 | 7,363 | 10,003 | 10,866 | 8,203 | |
| 4,533 | 479 | | C1-3 | Unrestricted reserves | 916 | 3,350 | 1,252 | - 7,959 | - 10,272 | - 771 | |
| 4,354 | 2,886 | 9,731 | Inc Stat | Depreciation, amortisation and impairment | 8,072 | 8,941 | 9,344 | 10,600 | 11,194 | 12,149 | 10,536 |
| -5.58% | -3.65% | | | Operating Performance Ratio | -29.61% | -5.79% | -19.47% | -15.31% | -4.98% | -7.53% | |
| 72.94% | 60.98% | | | Own Source Revenue Ratio | 65.28% | 54.93% | 56.88% | 49.62% | 57.68% | 58.60% | |
| 6.23% | 3.11% | | | Unrestricted Current Ratio | 5.40% | 3.27% | 2.91% | 5.00% | 6.47% | 6.40% | |
| 18.91 | 55.23 | | | Debt Service Ratio | 0.66 | 12.67 | 5.26 | 4.55 | 6.21 | 5.40 | |
| 0.83% | 0.00% | | | Asset Maintenance Ratio | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | |
| 110.30% | 104.57% | | | Infrastructure Renewal Ratio | 112.60% | 117.03% | 162.48% | 154.34% | 340.36% | 98.79% | |
| 3.14% | 0.00% | | | Infrastructure Backlog Ratio | 6.95% | 7.60% | 4.10% | 3.32% | 3.49% | 4.26% | |

$2023: CPI=1.344

**Table 1**

Using the normal Income Statement format, the table indicates significant growth in revenues raised and expenses borne in the subsequently merged entity (CGRC). Notably, the annual investment in infrastructure was significant, which has manifest then in growth in depreciation expense, compared to the former councils.

While employment growth is relatively flat compared to the indexed staffing costs of the former councils, it has been the extraordinary escalation in contracts and materials costs (evident also in the development and construction sectors) as the primary driver of growth in expenses. Assuming the near doubling of materials costs in FY23 was an aberration, preceded by a similar doubling over three years of disaster and stimulus-led grant income, the normalised revenue and expenditure differences between the (indexed) former councils and CGRC would be deemed acceptable. This is particularly so given the expected harmonisation of service levels due to merger.

The standout from Table 1, has been the growth in depreciation, growing by 50% since FY18. This has contributed significantly to the deterioration in annual financial results for CGRC.

**b) examine if past rate pegs have matched increases in costs borne by local governments.**

In the main, the Rate Peg increase set annually by IPART, previously the NSW State Government, has been less than the annual CPI increases as recorded by the Australian Bureau of Statistics. It also should be acknowledged that the increases to the renewal, maintenance and operations of council infrastructure and services are often substantially more than the CPI index. As mentioned in c) below, in recent times those type of costs have increased around 3 times CPI.

For the majority of regional/rural councils in NSW, often the next single largest revenue stream after rates revenue is the Financial Assistance Grants (FAG). When one considers that the FAG revenue stream has been diminishing in real terms over many years now, one can see the importance of the rate revenue stream to councils in regional/rural NSW.

To provide an example of the budgeting dilemma faced by most regional/rural NSW councils, a summary of the 2023/24 increase in rates yield for CGRC based on the IPART approved 3.7% Rate Peg is approximately $390,000. For the same period, the Local Government (State) Award required a 4.5% increase to wages effective 1 July 2023. Utilising the salaries and wages identified from the 30 June 2023 Financial Statements, the expected increase in salaries and wages for the period 1 July 2023 to 30 June 2024 for the Award increase alone is approximately $570,000.

The scenario described in the paragraph above is more often than not the norm, i.e., any increase in rates revenue from the Rate Peg is more often than not totally consumed by Award increases for salaries and wages. And, on top of this councils are exposed to a myriad of other increases in materials, contracts, insurance and other costs, all of which need to be absorbed in the annual budget process.

The end result is that the levels of service expected by our communities are jeopardised and the ability to renew and upgrade infrastructure is compromised, ultimately also impacting on service levels to the community.

**c) current levels of service delivery and financial sustainability in local government, including the impact of cost shifting on service delivery and financial sustainability, and whether this has changed over time.**

Like most NSW councils, CGRC has experienced many factors that have contributed to making a financial position unsustainable and ongoing service delivery a challenge for Council.

The impacts of consecutive natural disasters and the COVID pandemic during the last five years has significantly depleted revenue and increased operational costs. Had CGRC not ‘opted-in’ to disaster repair and recovery arrangements with (then) Resilience NSW, many of the repairs and restoration of damaged infrastructure would have been undertaken by contractors and underwritten by council, resulting in Council awaiting reimbursement for approved works through the respective NSW agencies – and often across financial years (which in turn distorts financial results).

In several cases, the infrastructure damaged by natural disasters was restored with funding through Commonwealth and NSW disaster grants, rather than renewed through Council funding at a later date. A reader of CGRC financial statements would note several years of above-benchmark expenditure on renewals, and an elevation in the condition ratings of several road and bridge assets – largely due to those grants.

However, the grants stimulus prompted by the disasters and pandemic generated several 'after shocks' for CGRC and many other local councils – the future costs of operations, maintenance, repair (OMR) and depreciation of new, upgraded or renewed assets funded by grants, was more than often not adequately accounted in future budgets.

A similar picture plays out in local government areas that may have experienced significant population or development growth. Infrastructure and facilities constructed through new developments and 'gifted' to councils, also may not have adequately accounted those OMR costs in budget forecasts, nor raise adequate revenues through subdivision and associated supplementary rates.

Both the above circumstances create market pressure for scarce skills (planning, engineering, finance, environment), contractors and resources (energy, fuel, steel, concrete, bitumen). Local government is fundamentally in the business of development and construction - those costs have grown around **three times CPI**.

Estimates (and timing delays) for infrastructure projects (the subject of competitive grant applications) have often been 'under-cooked,' requiring CGRC and other councils to source funding to meet the cost gap, or de-scope the project – or in some cases, even return the grant. In recent years, some councils unfortunately deferred borrowing, and now face higher interest charges to fund those projects.

In addition, many councils reduced or removed development charges, deferred debt recovery, or received lower revenues as business activity quietened during Covid.

If local councils were fortunate enough to hold suitable levels of working capital, they were able to partly absorb some of these recent "shocks." Unfortunately, CGRC saw a rapid decline in its reserves and working capital over recent years, then 'overdrawn' to $10m in 2022 for example.

Cost shifting through legislation and policy settings of state and federal government forces councils to assume responsibility for infrastructure, services and regulatory functions without providing appropriations or permitting fees to enable cost recovery. LGNSW's latest cost shifting report was released in November 2023, highlighting a total cost shift to councils of **$1.36 billion** in 2021-22, which is the equivalent of more than **$460 per ratepayer** annually. In CGRC's case this would equate to approx.. $3.1m per annum based on its rate base.

When you combine the above together with the flatlining of the financial assistance grants below 1% of Commonwealth taxation revenues, this rounds out the general sustainability stressors in local government.

**d) assess the social and economic impacts of the rate peg in New South Wales for ratepayers, councils, and council staff over the last 20 years and compare with other jurisdictions.**

| Year | Rate Peg | CPI |
|---|---|---|
| 2024/25 | 4.7% | |
| 2023/24 | 3.7% | 5.6% |
| 2022/23 | 0.7% | 6.6% |
| 2021/22 | 2.0% | 2.9% |
| 2020/21 | 2.6% | 0.8% |
| 2019/20 | 2.7% | 1.6% |
| 2018/19 | 2.3% | 1.9% |
| 2017/18 | 1.5% | 1.9% |
| 2016/17 | 1.8% | 1.3% |
| 2015/16 | 2.4% | 1.5% |
| 2014/15 | 2.3% | 2.5% |
| 2013/14 | 3.4% | 2.4% |
| 2012/13 | 3.6% | 1.8% |
| 2011/12 | 2.8% | 3.3% |
| 2010/11 | 2.6% | 2.9% |
| 2009/10 | 3.5% | 1.8% |
| 2008/09 | 3.2% | 4.4% |
| 2007/08 | 3.4% | 2.3% |
| 2006/07 | 3.6% | 3.6% |
| 2005/06 | 3.5% | 2.7% |

As pointed out in b) above, the simple consideration of CPI as the lone cost increase index applicable to local government is fundamentally flawed. The Table above sets out the Rate Peg and CPI indicators from 2005/06 to 2024/25. The Table clearly sets out that CPI has exceeded the Rate Peg in many years, and the Rate Peg has exceeded CPI in other years. The reality is that the development and construction sector traditionally experiences increases over and above CPI and local government activities in many ways are more closely aligned to this sector.

As mentioned in c) above, the development and construction sector in recent years for example has experienced increases in costs of doing business **three times the CPI.** And point b) above clearly establishes that CGRC's annual increase in rate revenue as permitted by the Rate Peg, is more than consumed by Award increases to salaries and wages. Over and above this, Council is exposed to CPI, development and construction cost factors etc. on materials and contracts which are rarely, if at all, covered by the Rate Peg increase.

This scenario has forced councils in regional/rural NSW, including CGRC, to review/assess its ongoing operations to create efficiencies and innovation in all that we do. Our workforces are constantly challenged to find new and innovative ways of going about their business and arguably most workforces of regional/rural councils in NSW have been subjected to "lean" principles.

There comes a point where cutting expenditure and constantly looking for efficiencies in an organisation that has been cut to the bone, will result in risks to staff and the community, and ultimately challenge the organisation to provide sustainable services to its community. Arguably, many councils find themselves in this situation now and the difficulties will only increase into the future.

e) **compare the rate peg as it currently exists to alternative approaches with regards to the outcomes for ratepayers, councils, and council staff.**

With the exception of NSW and Victoria, which had a State Government imposed Rate Peg of sorts introduced in 2016/17, all other States have an approach to budget setting and application of rates to properties based on the service needs of the community taking into consideration the community's capacity to pay.

The mechanics of how the rates are set in various jurisdictions may vary, according to the use of Unimproved Capital Value (UCV), Unimproved Value (UV), Gross Rental Value (GRV) and a mix of rates in the dollar and/or base rates however, these jurisdictions maintain the autonomy to set their budgets and rates in consultation with their communities.

In NSW, the Rate Peg has been in place since 1976/77, introduced by the then Wran Government, and whilst the principles and application of the Rate Peg has varied somewhat over the years, the fact is that the NSW Government, or its appointed Agency, has unilaterally imposed a limit on the ability of local councils to raise rate revenue in line with the current and future needs of individual communities.

Other jurisdictions in Australia seem to foster a strong partnership between State and Local Government, recognising also that councils need to have strong engagement with their communities that justifies the budget and rate setting principles applied by local councils. At the end of the day, councillors are elected by their communities and through the ordinary election process, the community has the power to express its view through the ballot box.

f) **review the operation of the special rate variation process and its effectiveness in providing the level of income Councils require to adequately meet the needs of their communities.**

In the NSW jurisdiction, if Rate Pegging is to continue, at least the Special Rate Variation (SRV) process enables a council and its community the opportunity to seek an increase in rates, either temporarily or permanently, to enable the delivery of identified projects and/or improved infrastructure renewal and/or service outcomes.

Obviously, a strong requirement of the SRV process is engagement with the community, engagement which demonstrates criteria including demonstrated need, community awareness, impact on ratepayers, public exhibition of relevant documents, and documented productivity improvements and cost containment strategies.

In an environment where the Rate Peg continues to be imposed by the State Government, or its Agency, a process will be required which enables local councils and their communities the opportunity to seek consideration of increases over and above the Rate Peg for projects/services necessary for local communities from time to time.

The counter argument to this situation is allowing greater autonomy for local councils in NSW by enabling those councils to set budgets and rates in consultation with their communities. This may be supported by the NSW Office of Local Government, in consultation with IPART, establishing budget/rate setting guidelines, or similar, for councils to ensure some level of consistency from one council to the next.

This approach would be reinforced further by the principle that the ballot box at the ordinary election of councillors every four years provides the opportunity for communities to voice their support or otherwise for those who represent them on council.

**g) any other related matters.**

The subject of the inadequateness of the funding pool for Financial Assistance Grants has been raised over the last three decades. The situation has only worsened over this same period, and the financial sustainability challenges for local government in Australia have increased substantially, particularly for rural/regional councils.

Obviously, this is not new for local government right across Australia. With a diminishing revenue base being experienced by most Councils in rural/regional NSW and Australia for that matter, the expectations of our communities continue to rise in contrast to our ability to satisfy these community expectations. Additionally, it is common for other levels of government to place additional responsibilities on local government without any corresponding allocation of resources.

It is suggested that a review of the principles and objectives of the Financial Assistance Grants Scheme is required to ensure alignment with our constituents' expectations. In addition, it is obvious that an increase in the annual Financial Assistance Grants funding pool to 1% of Commonwealth taxation revenue would result in an injection of untied funding that would allow councils to maintain and renew infrastructure to required standards, provide essential services and respond to often valid requests for new services and enhanced service levels expected by our communities. It is common knowledge that Financial Assistance Grants were originally introduced with a platform of 1.2% of personal income tax revenue, earmarked to increase to 2.0%. This has never occurred and in fact currently Financial Assistance Grants sits at around 0.5% of Commonwealth taxation revenue.

**Conclusion**

Whilst the content of CGRC's submission predominantly refers to CGRC's financial sustainability challenges as evidenced through its very recent preparation of a Financial Sustainability Plan to support a demerger proposal, in some cases reference has been made to regional/rural councils in NSW. In broad terms, most of the financial challenges experienced by CGRC would be equally experienced by other regional/rural councils, however, these challenges would in many instances be somewhat different to the challenges faced by our metropolitan counterparts who often enjoy access to a more diverse range of revenue streams.

In essence, a one size fits all approach to financial sustainability for all NSW councils is not appropriate. Each council has a uniqueness to its community, infrastructure base and service offering requiring flexibility and autonomy in any proposed solution to the financial sustainability challenges of NSW councils.

Should you require further information or wish to discuss the matter please contact the undersigned

Yours faithfully

Steve McGrath
Interim General Manager

24 April 2024