Submission
No 44

INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Organisation: Lake Macquarie City Council

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Standing Committee on State Development
Parliament House
SYDNEY NSW 2000

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

Introduction

Lake Macquarie City Council (Council) appreciates the opportunity to contribute to the Standing Committee on State Development's inquiry into the ability of local governments to fund infrastructure and services.

Lake Macquarie is the largest local government area by population in the Hunter region. Council's 1300 employees serve a population of 220,000 people across more than 90 suburbs, towns and villages within a geographically diverse area of 650 square kilometres.

Council has operating revenue exceeding $290 million, an annual capital works budget of more than $100 million, and an asset base valued at $3.7 billion.

Council staff have prepared the following responses to select Terms of Reference.

Responses to Terms of Reference

1. The level of income councils require to adequately meet the needs of their communities

One of the most significant factors influencing the level of income required to meet the needs of communities is increased expectations on the level and standards of infrastructure and services councils are expected to provide. Communities rightfully expect that councils respond to expectations on important matters such as accessibility of sporting and community facilities, diversity and inclusion, First Nations recognition, environmental priorities, impacts of climate change, resilience to natural disasters and validation of supply chains to ensure ethical compliance. In order to adequately and equitably address the needs of all in our community, and meet expectations on corporate social responsibility, councils must invest significantly in resources and infrastructure, beyond what may have been expected even a decade ago.

To cite a few examples, sporting and other community facilities must meet accessibility requirements, councils must take reasonable steps to ensure that the goods and services they procure are not the product of modern slavery, and climate change considerations and disaster resilience need to be incorporated into planning and asset delivery. In Lake

Macquarie, for instance, we have areas that are prone to inundation from future sea level rise and have had to undertake extensive planning and community engagement measures to address this risk, which places considerable demand on resources. These additional requirements have generally not been recognised by state and federal governments with proportional increases in funding.

Another significant factor affecting the delivery of infrastructure is the post-COVID escalation in building costs, which has an adverse impact on the ability of councils to fund new infrastructure or to repair and replace existing assets (with replacement of existing assets being approximately half of our ongoing capital spend). The inflationary impact on construction costs due to the high cost of labour and materials has continued to drive project costs up steeply since mid 2021, well beyond what would otherwise be considered reasonable contingency ranges that are customarily built into council budgets. Cordell's Construction Cost Index shows prices increased by 4.2 per cent in 2020, 7.3 per cent in 2021 and 11.9 per cent in 2022 before beginning to normalise in 2023, returning to 2.9 per cent. Steel costs alone increased by 57 per cent between 2021 and 2022.

An example of this impact on just one project is the 34 per cent increase in construction costs our Council has experienced on an extensive upgrade of the Hunter Sports Centre – a major regional facility. In just 18 months, costs increased from an initial projection of $39.4 million to $52.6 million, due to unprecedented inflationary pressures in the building industry. With grant top-ups unavailable from either state or federal governments, Council had to secure a loan to cover the cost increase and allow the project to proceed, placing a significant impost on budgetary resources. This pattern of steeply increasing costs has been repeated with many smaller Council projects as well. It speaks to a need for indexation of significant infrastructure grants to ensure major projects are not put at risk, or councils forced to underwrite project overruns to cover increased costs beyond their control.

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

Council supports the new methodology IPART has developed for determining the rate peg, but in transitioning from a backward-looking metric to a forward-looking one, councils will still bear the financial impact of high inflation in the 2022-2023 financial year, which drove costs up well above what the rate peg allowed to be recouped from ratepayers.

Council calculated in a 2022 submission to IPART that it would be adversely impacted by a $7 million cost deficit in its 2022-23 operational plan budget due to the difference between inflation, at 7.3 per cent, and the rate peg, which was 2.5 per cent. While we welcome the introduction of a new methodology that will better forecast inflationary impacts, we note that the change from one methodology to another will leave councils uncompensated for higher increases in cost in the 2022-2023 year.

3. **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**

Cost-shifting from state to local government is an ongoing issue that contributes significantly to the financial burden on councils. Analysis by independent consultants Morrison Low for Local Government NSW calculated the total cost shifted to NSW councils in the 2021-22 financial year was $1.36 billion, or $460.67 per ratepayer per year.

Some significant areas of cost-shifting include:

- the Emergency Services Levy (ESL)
- depreciation of Rural Fire Service ‘Red Fleet’ assets
- rate exemptions (ie: non-rateable or discounted properties)
- administration of development applications and regulatory functions.

The ESL represents cost-shifting at its worst, as it is imposed on councils without any mechanism for them to recover costs. The levy increase for the state’s 128 councils in 2023-2024 amounted to almost $77 million, with the total cost imposed on the local government sector increasing from $143 million in the 2022-2023 financial year to $219 million in 2023-2024. This represented a 53.1 per cent increase, completely dwarfing the base rate peg of 3.7 per cent, as set by IPART for 2023-2024.

The increase in costs this year reflects a 73 per cent increase in the State Emergency Service budget and an 18.5 per cent funding increase to Fire and Rescue NSW. The impact of these large increases on councils’ finances was particularly severe in 2023-2024 as a result of the NSW Government deciding to scrap the subsidy for council ESL payments.

For Lake Macquarie, the ESL increased by $1,008,449 (19.8 per cent) for 2023-2024, bringing the total Council contribution to $6,088,351. The increase in the ESL, combined with the discontinuation of the subsidy, resulted in a $1,854,311 impact on Council’s 2023-2024 budget. This amounted to 28.3 per cent of the expected increase in rate income for 2023-2024.

Timing of the ESL levy is also problematic, as it is set after most councils have adopted their operational plans for the forthcoming year.

Councils support a well-funded emergency services sector and the critical contribution of emergency services workers and volunteers (many of whom are councillors and council staff). However, it is essential that these services be supported through an equitable, transparent and sustainable funding model.

The mandated recording of RFS mobile assets (the ‘Red Fleet’) is another significant issue for councils. While not a cash expense, it has the effect of increasing depreciation, which in turn has an adverse impact on council operating results, and hence councils’ measure of financial sustainability.

Lake Macquarie is adversely affected by the depreciation of Red Fleet assets by more than $400,000 per year, despite not operating or controlling the assets, nor having any involvement in purchasing decisions surrounding these vehicles.

The cost of mandated rate concessions and exemptions in NSW also has considerable impact on council finances. Pensioner rebates, for example, cost our Council about $2 million net each year, even after state subsidies.

A rising issue is cost-shifting due to changes in NSW Government regulations that increase the administrative and resourcing burden on councils. An example of this is the mandatory implementation of the NSW Planning Portal, which Lake Macquarie City Council calculates has required an additional two fulltime positions in our council alone to absorb additional workload and maintain processing times.

Cost-shifting from state to local government seems to be increasing, as more government agencies seek to relieve their own financial pressures by passing costs on to local government. In recent months, two new examples have emerged, with the NSW Government seeking to introduce a Dams Safety NSW regulation levy and expand the Interment Industry Levy.

Also, in late 2023, Council was advised of significant increases for some Crown Lands licences, from $11,655 per annum to $265,862 per annum, in respect to licences for an environmental purpose. Council staff lodged requests for rent waivers for all licences for an environmental purpose, and the waiver was accepted, but for 2024-25 only at this stage. Other Crown Land licence fees are still required to be paid, even though Council is already managing the land on behalf of the Crown.

This trend is not sustainable for local government and puts councils under unreasonable pressure to either absorb additional costs imposed by the State Government or pass them on to ratepayers and customers. This inquiry provides an overdue opportunity to scrutinise the extent of cost-shifting experienced by councils and recommend better frameworks for financial coordination between state and local governments.

4. **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**

Historically, the special rate variation process has been a costly and resource-heavy process that can affect a council's financial position and level of service delivery. These factors deter many councils from pursuing special rate variations, which ironically results in the organisations that arguably need them most often deciding against investing the time, money and resources required for the exercise.

The length and complexity of the process has removed the agility of councils to respond to cost pressures as they arise, meaning that spending cuts are the only realistic means of addressing shortfalls.

5. **any other related matters.**

i. Indexing of grant funding to account for inflation

Grant funding to councils by the NSW Government for partnership projects is typically provided using a dollar figure that is either determined by the NSW Government or via a cost estimate provided by the applicant at the time of application. Given the volatility of the construction industry, regional economic pressures and the potential for grant announcements to be delayed, this leaves councils vulnerable to external inflationary factors that result in increased project costs. In recent years, high inflation, labour and materials shortages have pushed construction costs up well beyond what would otherwise be considered reasonable contingency ranges built into council budgets.

Shifting to a funding model that recognises project risks related to commencement and planning delays, inflationary impacts and latent project conditions, could ensure that councils are not left with the burden of delivering projects that become unaffordable due to external factors beyond their control. Grant funding for major projects, with a capital spend of $5 million or more, could be indexed to the Construction Cost Index or granted on a percentage-based funding ratio, rather than funding being awarded at a fixed amount, so that project risks are shared and mitigated between levels of government. Performance measures could be built into funding agreements to ensure project overruns are due to external factors and not project mismanagement.

ii. <u>Funding for operational costs of assets</u>

Councils rely considerably on grants and development contributions to fund asset and infrastructure construction, upgrades and maintenance, but both sources of income are focused on capital and ignore operational cost impacts.

Providing new facilities for communities incurs both capital costs – including land acquisition, design and construction – and lifecycle, or operational, costs – including depreciation, staffing and maintenance of the asset.

Lake Macquarie City Council estimates that for every dollar it spends on capital, an additional six cents in yearly operational costs is incurred for the life of the asset. For a $100 million building program, an additional $6 million per year in operating costs is incurred.

This imposition of additional operating costs that cannot be funded through grants or development contributions forces councils to provide lifecycle funding from other budgetary sources.

iii. <u>Applicability of metrics to measure performance and drive best practice</u>

Community members and councils can use a range of metrics to compare key data and performance with that of other councils. Financial metrics used include operating results, cash management ratios, net profit, and income from both external sources (grants) and own-source revenue such as rates, fees and charges and investment revenue. However, these metrics do not always accurately reflect the overall financial health of a council, or drive sustainable practices, as receipt of some significant sources of income – such as Financial Assistance Grants or competitive grant funding – is not always aligned with the year in which the expenditure is incurred.

Also, as councils have substantial asset bases, factors such as depreciation and revaluations that are not captured in standard metrics can have a significant impact on the operating result of councils and community perception of financial performance.

Consideration should be given to the financial metrics used by the Office of Local Government to set performance objectives and measure councils' financial sustainability. Metrics should more accurately represent the impact of factors such as balancing cash and cash reserves with less impact of asset depreciation and revaluation factors, and matching of income to expenses between financial years.

Council also recommends the Local Government Code of Accounting and Financial Reporting be reviewed, including the schedule for its annual release and whether the Audit Office of NSW should have a role in the development of the Code.

iv: Infrastructure to support housing growth

The NSW Government is proposing to fast-track rezonings to facilitate the delivery of new housing under the Transport Oriented Development (TOD) and Low- and Mid-Rise Housing (Diverse and well-located) programs.

Lake Macquarie City Council is broadly supportive of initiatives to increase housing supply and diversity through the delivery of more low-rise and mid-rise homes in well-located areas near service centres and public transport. We also acknowledge the urgency of the housing crisis and the need for policy that facilitates new development quickly. However, we have concerns about the lack of commitment to ensuring areas targeted for housing growth have adequate infrastructure to meet the needs of increased population.

The proposed planning changes will require new or improved infrastructure such as roads and transport, recreation facilities, health and education facilities and open space. Some of the targeted train stations under the TOD program are significantly under-resourced, lacking basic facilities and accessibility.

Under the TOD program, the NSW Government is providing $520 million within the Tier One Accelerated Precincts for community infrastructure, such as critical road upgrades, active transport links and good quality public open spaces. However there has been no similar commitment for funding to support the Tier Two areas, which includes Lake Macquarie and other areas outside of Sydney, nor the Low- and Mid-Rise Housing program. It is critical that the NSW Government provides adequate funding mechanisms to ensure delivery of the infrastructure required to support both programs.

Council suggests that dedicated infrastructure funding streams should be explicitly linked to both the TOD and Low- and Mid-Rise Housing programs to specifically fund additional or enhanced infrastructure needed to support the NSW State Government's housing reforms. This includes both state-owned and council-owned infrastructure.

Conclusion

Council appreciates the opportunity to provide this feedback. In summary, Council staff offer the following recommendations.

Recommendations

1. State Government funding to councils should account for the increased expectations of communities to deliver infrastructure and services that are inclusive and respond to environmental factors such as the impacts of climate change and resilience to natural disasters.

2. State Government should consider ways it can help councils address the significant financial impact of increased building and construction costs. This could include indexing major grant allocations (eg: $5 million or over) to the Construction Cost

Index, or using a grant funding system based on sharing project costs based on a percentage rather than awarding a fixed amount.

3. State Government should consider how councils can be compensated for the financial impact of high inflationary costs in the 2022-2023 financial year, as the transition from the former backward-looking rate peg methodology to the new forward-looking one will effectively leave councils uncompensated for these costs.
4. The Special Rate Variation Process should be quicker and less resource-intensive, to ensure financially challenged councils are not deterred from participating.
5. The practice and extent of cost-shifting should be investigated – with emphasis on the financial impact on councils of the Emergency Services Levy – and more equitable frameworks developed for cost-sharing between state and local governments.
6. State Government should consider how ongoing operational costs of assets and infrastructure can be accommodated within grant programs or other funding streams.
7. Metrics used to measure performance and sustainability of councils should more accurately represent results with less impacts of factors such as asset depreciation and revaluation, and matching of income to expenses between financial years, with the Local Government Code of Accounting and Reporting reviewed to reflect this.
8. Dedicated infrastructure funding streams should be explicitly linked to both the TOD and Low- and Mid-Rise Housing programs to specifically fund additional or enhanced infrastructure needed to support the State Government's housing reforms.

Council would welcome the opportunity to participate in any follow-up hearings or discussion.

Should you require further information on the matters raised, please contact Chief Financial Officer Bjorn Lategan

Yours sincerely

Morven Cameron
Chief Executive Officer