Submission No 59

INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Organisation: Local Government Professionals Australia, NSW

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Standing Committee on State Development
NSW Parliament
Macquarie Street
SYDNEY NSW 2000

To the Chair of the NSW Standing Committee on State Development

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

Local Government Professionals Australia, NSW is the leading association representing the professionals in NSW local government.

The Association welcomes the inquiry into the ability of local governments to fund infrastructure and services.

The financial sustainability of NSW councils is a significant issue, especially as the cost of delivering core services to communities continues to rise.

Income

Local councils in NSW deliver essential goods, services, and facilities to the people in their areas and finance their activities from a variety of revenue sources, one of which is rates revenue. Rates revenue accounts for about one third of the total combined income of NSW councils. The other main sources of income are user fees, government grants and infrastructure contributions.

These various revenue streams enable councils to deliver extensive services to their communities with the cost of delivering services impacted by many factors including the increased costs in construction and development costs, the impact of natural disasters and the COVID pandemic have depleted revenue and increased operational costs and the cost of living and resulting increases in labour costs.

Councils also face increasing operating costs and decreasing revenue as a result of:

- Cost shifting from state and federal governments.
- Decline in Financial Assistance Grants per capita in real terms
- Increased regulatory requirements resulting in increased reporting requirements
- Increased mandated expenses e.g. expenses relating to audit and elections

The Rate Peg

The rate peg is the highest percentage amount that a council can raise its general rates income for the year. The rate peg does not cover domestic waste management collection, water and wastewater charges. The main reason for the rate peg is to protect ratepayers from 'unneeded' and 'excessive' increases in their rates bills. The Independent Pricing and Regulatory Tribunal (IPART) has been responsible for setting the rate peg under the authority of the Minister for Local Government since 2010.

In 2023 IPART clarified that the rate peg has two purposes:

1. To let all councils automatically increase their rates income every year to keep up with the estimated change in the costs of providing their existing services and service levels to households, businesses and the wider community.
2. Limit the effect of these automatic increases on ratepayers, by making sure councils cannot raise their rates income more than the estimated change in their costs, without asking their communities through the special variation process.

The June 2022 review of the rate peg methodology, enabling the rate reg to be based on the Reserve Bank of Australia CPI forecast, was welcomed by councils. Previously the rate peg was based on historical data, therefore not addressing current or future state.

In 2021/22 that rate peg was set at 0.7% just before inflation soared to 7.1% by June 2022.This difference was mainly due to the rate peg methodology relying on past inflation, which created a two year delay and resulting in a shortfall in revenue that will yield long term consequences.

The new prospective rate peg methodology that has been used by IPART for the 2024/25 financial year disregards actual CPI for local government operating costs (except for employee costs) and is based on the Reserve Bank of Australia CPI forecast. This methodology should be assessed over time as even this could create a persistent problem for the sustainability of local government services, where the RBA CPI forecast is lower than the actual costs to sustain local government services.

The rate peg has also overlooked the opportunity to keep pace with land value and value capture from redevelopment as the rate cap has kept rates artificially low and ignored large increases in land value. In past 10 years land value have increased 5 times higher than the rate cap. If rates had kept pace with land value, there would be sufficiently amount of rates income to fund the maintenance that arise from new assets that are funded from developer contributions. This was maybe unintended as the rate cap was set in 1979 and has not been reviewed since.

Cost Shifting

Cost shifting has had a significant and detrimental impact on local government service delivery and financial sustainability. It has increased the financial burden on councils, strained their ability to provide essential services, and contributed to budget deficits and reduced reserves. The problem of cost shifting has persisted over time, and the lack of action to address it has further compounded the challenges faced by local government.

- Cost shifting has placed a significant financial burden on local councils. Councils are expected to deliver services and infrastructure without receiving sufficient funding from higher levels of government.
- The lack of adequate funding due to cost shifting has strained local government's ability to deliver essential services to their communities. This includes services such as waste management, water supply, road maintenance, and community programs.
- Additional financial responsibilities without corresponding funding have led to budget deficits, reduced reserves, and increased debt levels for many councils.
- Cost shifting has been a persistent and increasing problem and has been addressed in numerous reports including those published by Local Government NSW, IPART and the Productivity Commission.
- Few recommendations from previous reports have been implemented by the government or the sector. This lack of action has further exacerbated the financial challenges faced by local councils.

Social and Economic Impacts of the Rate Peg

Social Impacts:

1. Ratepayers: The rate peg has had mixed social impacts on ratepayers as whilst it helps to limit increases in rates, which can be beneficial for households and businesses with limited financial capacity; it also limits the ability of councils to provide improved services and infrastructure, impacting the quality of life in local communities.
2. Councils: The rate peg restricts council's ability to meet the growing demands and expectations of their communities, leading to challenges in delivering essential services, maintaining infrastructure, and implementing community programs.
3. Council Staff: The rate peg limits overall resources available for recruitment, training, and development with impacts staff morale and job satisfaction, with these impacts compounded when councils are unable to meet community expectations due to financial constraints.

Economic Impacts:

1. Ratepayers: The rate peg helps to control the rate of increase in rates, which can provide stability and predictability for households and businesses in their operating costs. However, it may also limit the ability of councils to invest in economic development initiatives and infrastructure projects that could stimulate local economies.
2. Councils: The rate peg can limit council's capacity to fund essential services, maintain infrastructure, and invest in economic development projects. This can hinder local economic growth and job creation.

3. Council Staff: The rate peg may limit opportunities for career advancement and may lead to cost-cutting measures, including staff reductions or freezes, which can affect job security and financial stability.

Alternative Approaches

The peg methodology is inflexible for both councils and the community. It hinders the delivery of the Community Strategic Plan, it has a narrow scope, worsens financial sustainability issues, and does not allow for rate changes to match cost changes for individual councils. The methodology overlooks demand for service level changes, the effects of extreme weather events, and other sustainability issues. The current system relies on a special variation process to get approval for rate increases above the peg, instead of setting up a sustainable rate methodology from the beginning.

LG Professionals, NSW firmly believes that a better approach would be to utilise the existing NSW Local Government Integrated Planning and Reporting (IPR) Framework to better effect.

The IPR legislation in NSW supports the financial sustainability of councils by providing a framework for strategic planning, financial management, and accountability. It promotes long-term financial planning, asset management planning, transparency, accountability, community engagement, performance monitoring and reporting, compliance and oversight, financial objectives and strategies, financial reporting and accountability, risk management, and financial resilience.

The legislation helps councils assess their financial position, identify future funding needs, plan for the sustainable delivery of services and infrastructure, and make informed decisions to allocate resources effectively based on regular community engagement.

Effectiveness of Special Rate Variations

The process of applying for a special variation is costly and controversial. This is partly because IPART views any rise above the rate peg as 'unjustified' or 'extreme'.

As the 15 applications approved by IPART in 2023 with an average rate rise of 45% show, the special variation process has turned into a desperate option. This trend has persisted for 2024 with five councils seeking an average increase of 35%. Most of the applications come from councils that serve rural and regional areas.

When the rates increase at such high levels, it demonstrates the problems with the sector’s ability to remain sustainable without a change to the current framework to avoid cutting services suddenly.

A reliance on SRVs without addressing underlying financial issues is not a sustainable approach. Councils need the freedom to work with their communities to set the rates that meet their respective needs. They also need to capitalise on alternate revenue sources, cost containment strategies, and productivity improvements to achieve long-term financial stability.

Conclusion

It is firm view of LG Professionals, NSW that the existing NSW Local Government Integrated Planning and Reporting Framework is the key to financial sustainability in NSW Councils.

- The peg method limits both councils and the community, as the rate peg framework restricts the ability of the council to accomplish the Community Strategic Plan and the Council's Four Year Delivery Program.
- The rate peg worsens the financial viability issues of councils by preventing council's ability to change their rates according to their costs and community service demands.
- The rate peg does not reflect the need for adjustments in service levels, the effects of severe weather events and other sustainability issues, nor does it account for cost increases when inflation is growing rapidly.
- The rate peg relies on a special variation process to raise rates beyond the rate peg to support ongoing operations and changes in service delivery, instead of setting up a sustainable rate method from the beginning.
- The special variation application process is costly in resources and politically disputed and past rate pegs have not matched service delivery cost increases borne by councils.

The current approach is not working, and an alternative approach is required that recognises the unique challenges of local governments.

Councils strive to keep rates as affordable as possible, while also providing the services and infrastructure that our communities need and want as expressed in their Community Strategic Plans.

We cannot achieve this with a mandated rate peg system that seems to be unable to support the delivery of regional services and infrastructure in a changing and fast-paced economic environment.

The LG Professionals, NSW Board and I would welcome the opportunity to explore the financial sustainability of NSW local government with you further, and when required, our members would make themselves available for future working parties or steering committees to address this growing problem.

Yours sincerely

David Tuxford
President