Submission No 73

INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Organisation: Dungog Shire Council

Date Received: 26 April 2024

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26 April 2024

The Hon. Emily Suvaal MLC Chair
Chair – Standing Committee on State Development
NSW Legislative Council
NSW Parliament House
6 Macquarie Street
SYDNEY NSW 2000

Dear Ms Suvaal,

RE: Dungog Shire Council Submission to the Inquiry into the Ability of Local Government to Fund Infrastructure and Services

On behalf of the Dungog Shire Council, I am pleased to present our response to this inquiry and to participate actively in ongoing discussions as appropriate.

Our submission provides a background to our Shire accompanied by relevant commentary regarding issues of financial sustainability particularly affecting the Dungog Shire Council. This submission responds to questions a), c), e), f) and g), identified in the Terms of Reference.

Please find the submission below.

If you have any further enquiry or need direct assistance, in the first instance please contact Manager Economic Development, Dungog Shire Council

Background and Current Status

Dungog Shire Local Government Area occupies an area of 2,251 square km in the Hunter Region of NSW. The Shire has a population of 9,722 (ABS ERP 2022) and small rate base of only 5,109 ratepayers. The shire is responsible for a large road network, with around 731 km of roads under management.

The Dungog Shire is the only local government area in NSW without a state road. This means the Council is responsible for funding the maintenance and construction of its extensive road network with a very small rate base. This is the critical issue threatening our ongoing financial sustainability.

Compounding the issue, is the location of large state owned assets, including National Parks, State Forests and water catchments which occupy over 23% of the land area and which are unrateable. Over 80% of the water supply for Greater Newcastle and the Lower Hunter is supplied directly from the Dungog Shire, with catchment restrictions impacting on development potential.

The Shire is a critical part of growth plans for the Hunter region as a result of this water dependence. With a population growth rate of 1.99% annually (2023 ABS), the Hunter Regional Plan 2041 forecasts the population of Dungog Shire to grow to 14,374 by 2041 with an additional 2400 homes projected to be constructed during the life of the Plan. This rate of growth is second only to Maitland City Council area in NSW.

Ordinary Rates in respect of the year 1 July 2024 to 30 June 2025, will be levied on all rateable land in the area under the following categories and sub-categories

(a) Farmland.
(b) Residential, Residential Clarence Town, Residential Dungog, Residential Village.
(c) Business, Business Clarence Town, Business Dungog, Business Village.

Council is varying General Income by the 4.5% rate peg limit as announced by the Minister for Local Government to enable the core delivery of services. The base before the rate peg includes the Tribunal (IPART) approved variation of 5.6%. Council's capacity to improve existing levels of service to the community and ability to address the current and future needs within the shire are hampered by a lack of financial capacity.

The Valuer General's Office has provided revised land values that Council is required to implement from 1 July 2023.

This general valuation has increased the total land valuation for Dungog Shire by 135.7% with individual property variances ranging from decreases of -1% in land value to over 1,000% increases in property land value, these vast differences in land value changes may impact rates levied in the 2023-24 financial year. An increase in land value does not imply an increase in rates levied as Council is only permitted to increase its overall Rates Income by the approved Special Rate Variation of 10%, inclusive of the 4.5% rate peg. Unfortunately, the range of variance in land values impacts council's ability to level out increases across all rating categories and some ratepayers may experience an increase in General Rates greater than 10%, this impact has been minimised where possible with the vast majority of ratepayers falling within the special rate variation increase.

<u>Response to the Terms of Reference</u>

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

In terms of Dungog Shire Council's financial sustainability, we are heavily dependent on external grant funding to deliver the works and services our community need and expect. Council's own source operating revenue was 31.99% in 2022/23 which has declined from 35.34% in 2021/22 and 47.66% in 2020/21. The NSW Office of Local Government benchmark is >60%.

Whilst 73% of our total expenditure will be on roads and bridges (2023/24), 86% of the capital works program is grant funded. Council's road infrastructure backlog in 2022/23 was $26Million (indexed) and our endorsed Capital Works Program for the current financial year is approximately $42Million.

The variability of government grant funding makes it difficult to plan ahead to consistently manage and deliver capital works and clear infrastructure backlogs.

There is also greater risk of an inability to deliver our works and capital projects without greater funding certainty.

The NSW Government should streamline as far as practicable grant programs across agencies with a view to long term and consistent streams of funding to address this variability.

This clearly shows the financial difficulties of maintaining a large infrastructure network with a small population and rate base.

Over the past 10 years, we have experienced increases in the Road and Bridge Construction Index, from 106.7 in December 2013 to 141.7 in December 2023. The majority of this being in the last three years where the index has grown from 119.6 in December 2020 to 141.6 in December 2023. The Roads Service Gap (pre-SRV) between required and available funding was $7.73M per annum in Capital Renewal and Maintenance. Allowing for increased rate funding applied to this area since the implementation of the SRV but also taking into account increases in construction and maintenance costs, this figure remains at $5.2M per annum.

Own Source Revenue and Grant Dependency

The Grattan Report (Potholes and Pitfalls: How to fix local roads, released in November 2023, clearly exposed the significant underfunding of the current Federal Financial Assistance Grants (FAG) provided to Council. Clearly there is also a difference in simply increasing funding in addition to how that funding is equitably distributed.

The reduction in real value of the FAGs has affected local government finances. In 1996 the quantum represented about 1% of Commonwealth taxation revenue and now it represents about 0.5% because the grants are adjusted for the CPI, which bears no relation to the delivery of services.

In 1995-96, the Total Pool of FAGs was $1,159,600,000 and by 2023-24, it had increased to $3,246,707,973.

If FAGs were to comprise 1% of Commonwealth taxation revenue in 2023-24, the total for distribution to the States would have been $5,381,000,000 - a difference of $2,134,292,027.

NSW would have received 32.63% of that or $1,755,820,300 instead of the $996,598,246 provided.

In 1995-96 FAGs for Dungog Shire was $906,840 General Purpose Component and $484,684 1-Pads Component for a total of $1,391.524.

In 2023-24, Dungog Shire received $2,239,141 GPC and $1,158,154 LRC for a total of $3,397,295. However, if FAGs represented 1% of CTR, Dungog Shire would have received a total of $5,985,400 and many millions would have been foregone between 1996 and 2024.

In Council's submission to the NSW Grants Commission in June 2023, we outlined our concerns over the inequitable block grant funding model, which results in lower levels of funding to Dungog Shire for the same roads which received significantly greater funding in the immediately adjoining local government areas administered by Port Stephens Council and Maitland City Council. Further, when requested to provide details on specifics of the funding distribution methodology (e.g. rainfall and topography) the Grants Commission was unable to provide the information and was unaware of where to find it.

In 2020/21, it was estimated that Dungog shire had 45% of its expenditure allocated to roads, bridges and footpaths. This was more than double that of any other Council in the Hunter region. We cannot fully fund our backlogs and services required due to own source revenue being inadequate for the expectation and required levels of service. In short, we are unable to fully control the level of income provided without seeking external grant funding. Other Councils have more diversified rating systems and categories to allow them to tailor their own source revenue through rates with more certainty on that revenue.

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

Data from Dungog Shire Council indicates that as of today, the rate peg increases are just covering CPI producer price increases. However, a range of other costs is increasing above this. As an example, the costs related to insurance, fuel, gas, electricity and compliance have risen significantly above CPI and are not met by rate peg increases. This is further exacerbated because cost reduction in Council operations are very difficult to find.

Of the 10 councils in the Hunter Region, Dungog has the;

- lowest rate base, collecting 1.2% of the total Regional rates,
- lowest own source of revenue,
- highest proportion of expenditure on roads, bridges and footpaths [by a factor of greater than 50%],
- lowest proportion of expenditure on environmental services,
- the third lowest expenditure for
    - Community Services, education and housing
    - Recreational and Cultural
    - Other services

Small rural and regional councils are more significantly and negatively impacted by cost shifting than larger urban councils. Adjustment in rating policy is required to ensure they are equitable to all councils. Many smaller rural Councils, such as Dungog Shire, are heavily reliant on grant funding and are unable to meet certain ratios and still deliver on community aspirations (road network).
For example, approximately 73% of Council's revenue is derived directly from grants and contributions from the Commonwealth and State. Council is unable to deliver the required backlog of works in our Delivery Program without those grants and contributions. Our rate base is too small to fund the existing road network of over 731km.

Our elected Councillors are acutely aware of the financial challenges and decision making reflects these considerations in our annual budget and operational planning,

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

Community Strategic Plan (CSP) objectives are often beyond council capacity, which is reflected in the heavy reliance on, grant funding to deliver infrastructure expected by the community. The CSP is an aspirational document that encourages the governing body to try to meet community expectations, but also manage that expectation of "what we want" versus "what we can afford".

The theory of asset management planning to assist in setting service level objectives is paramount however not always effectively implemented due to resourcing constraints and staff capacity. Uncertainty with annual Rate pegging does not allow council to effectively undertake long term planning, nor does cost shifting from other levels of government. The heavy reliance on grants is also not an effective way to plan long terms. Variability in those external sources of funding mean planning for the workforce needed to deliver on the community vision is difficult. Both imposts impact/influence service delivery standards, budget decisions, and impact delivery of works and services. This in turn can adversely affect confidence in the Council.

The ability of council to balance the cash flow to manage the different (and sometimes uncertain), time frames for revenue and grants money (including Financial Assistance Grants), is limited by committing funds to internal reserves and the creation of reserves by "squirrelling" away small amounts as and when they become available. During annual external audits, matters of cash flow resulting from the myriad of grant funds received and expended are identified as high risk.
This will be an ongoing issue for Dungog Shire Council given our heavy reliance on grant funds. Consistent approaches from the NSW Government Agencies in the distribution of grants could assist in how this issue is managed and alleviate the pressure on Council reserves.

It Is understood that more than 180 SRV applications over 11 years have been made for the purposes of financial sustainability, addressing 'asset backlogs' and funding future 'infrastructure obligations', this indicates that the rate peg is inadequate to support financial performance and financial sustainability.

Dungog Council also agrees with the LGNSW submission regarding the IPART Review of the Rate Peg methodology November 2022, including the following;

- Councils could be allowed to exceed the rate peg by a determined margin without the need for an SRV application; this would remove the burden of making a SRV for small and moderate variations. The regulatory burden of the SRV process coupled with political complexity acts as a deterrent to applying for an SRV. This can be financially damaging where there are legitimate needs for increased rates to strengthen financial sustainability and address infrastructure backlogs. Failure to act will worsen the current situation and create larger deficiencies in future years.

- Many current rate exemptions serve to provide financial benefits to numerous organisations, benevolent institutions, private schools, universities and some government business enterprises that are no longer justified in terms of principles of optimal taxation, particularly principles of equity and efficiency.

- All land used for commercial or residential purposes should be subject to rates regardless of tenure. In some cases, rate exemptions should simply be abolished (e.g. Forests NSW). In other instances, it may be a matter of legislating tighter eligibility criteria and/or introducing a system of partial exemptions as applied in other jurisdictions.

- The distinction between charitable and social activity and commercial activity has blurred progressively over time with community-orientated enterprises increasingly engaging in more commercially focused activity. Often it is no longer appropriate for local ratepayers to subsidise activities of exempt institutions where institutions act commercially, benefit from council services, and have capacity to pay.

- It would be beneficial if the SRV process were streamlined.

Other revenue sources beyond grants and rates are very few and inconsequential in rural and regional areas to assist in sustainable service delivery. Fees and charges rarely cover the cost of services provided. Case in point, development application fees are set by the NSW Government and not Councils. They do not cover the cost of development assessment and place further burden onto the ratepayer to fund the service. This further erodes the financial position of the Council.

Dungog Shire has endorsed a strategic property management program to seek alternate own source revenue by optimising the use, disposal or acquisition of property assets. The program is in its infancy and staff capacity is proving to be an issue in progressing the program.

The uncertainty and inequity of grant funding impacts councils ability to plan and deliver efficient and effective service delivery to the community. Cost shifting from state government contributes to the impact on ratepayers cost of living. The increasing compliance burden has also been challenging to fund and resource as these costs are passed onto council without any way of increasing revenue.

There are inequities in the distribution of the Financial Assistance Grant and the RTA Block grant. The investigation of council financial models in NSW would be well served to look into identify measures to improve the capacity of small and diverse councils to increase own source revenue to support the needs of their communities and sustainably provide services required to be delivered by councils.

Other measures to consider include ensuring statutory fees and charges reflect the actual costs of providing these services.

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

The SRV process is not effective nor efficient in providing the level of income Council's require to adequately meet the needs of their communities.

The SRV process is complicated, drawn out and requires an inordinate amount of work and expense to the point where the SRV application requirements are prohibitive and exclusionary for small rural and regional councils, one size does not fit all. The process requires a minimum 12-18 month commitment from council, council staff and resourcing to prepare and compile the necessary supporting information even before an application is made. The application is then put under the IPART microscope and heavily scrutinised. This process is supported in order to ascertain the legitimacy of the council's reasoning for the SRV, however the process also appears to search for means to reject the application as opposed to supporting the application.

In this Council's case, a seven-year application was made and substantiated however IPART determined a five-year ruling only. The legislation provides for a seven year SRV. However, the appetite to acquiesce with such a request does not appear to be held by IPART. This adds to the inefficiency as council's are required to undertake the process again and in some cases for small rural and regional council's this is prohibitive.

The net result of these factors is the 'under-provision of community infrastructure and services', the continued growth of the infrastructure maintenance backlog and an 'undermining' of the financial sustainability of local councils.

It is also suggested that a review rates exemption criteria for government agencies and land assets should be considered, as almost 23% of council's area is non-rateable due to National Parks and State Forests.

g) Any other related matters.

Attraction and Retention of high quality staff

Smaller Councils consistently struggle to attract and retain the best and brightest staff needed to deliver the services and works expected by communities. Being under resourced and with lower levels of staff, often with one or less than one person employed to carry out a specific function, staff turnover results in extended vacancies and services which simply cannot be delivered until recruitment processes are completed.

Larger council's do not experience this same issue given functions are often delivered by larger teams of staff who can help to cover during vacancies. Attraction and retention of staff is an enormous challenge for the smaller rural councils with reduced financial capacity to match larger salaries and wages in metropolitan and larger regional centres.

A real issue facing Council is the inability to fund the basic level of staffing and expertise required to deliver on the Asset Management Strategies and Plans.

Audit mandate

The Audit mandate across all councils, regardless of size, has been unreasonable and contributed to an unreasonable increase in compliance costs. For example, the Audit Office of NSW increased the cost of the annual audit from $40,000 to over $110,000 in one year. Council has no option but to pay. This is unacceptable and has not been subject to a competitive procurement process. In our view, the consistency across councils by the NSW Audit Office has certainly been evident through an excessive level of scrutiny which had contributed to psychosocial risk to our finance personnel and excessive delays in the delivery of Annual Financial Statements.

Further Enquiries

We appreciate the opportunity to provide our feedback into the Inquiry and look forward to further opportunities to expand on our submission if required.

If you would like to discuss our submission, please telephone the Office of the General Manager
or our Economic development Office

Yours faithfully

Gareth Curtis
General Manager