Submission No 90

INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Organisation: Canberra Region Joint Organisation

Date Received: 26 April 2024

Canberra Region Joint Organisation's submission to the NSW Parliament's inquiry into the ability of local government to fund infrastructure and services

Introduction

This submission is from the Canberra Region Joint Organisation which comprises eleven NSW councils as members of the joint organisation, as well as the Canberra Airport & ACT Government:

- Goulburn Mulwaree Council
- Snowy Valleys Council
- Eurobodalla Shire Council
- Bega Valley Shire Council
- Snowy Monaro Regional Council
- Queanbeyan Pelerang Regional Council
- Yass Valley Council
- Upper Lachlan Shire Council
- Hilltops Council
- Wingecarribee Shire Council
- Wagga Wagga Regional Council

This submission is to the Standing Committee on State Development's inquiry into the ability of local government to fund infrastructure and services which will examine:

- level of income councils require to meet the needs of their communities,
- if past rate pegs have matched council cost increases,
- current levels of service delivery and financial sustainability in local government including the impact of cost shifting,
- social and economic impacts of the rate peg and compare with other jurisdictions and alternative approaches, and
- operation of the special rate variation process.

Submissions have been called for at the commencement of the inquiry's process with guidance as to submission content from the inquiry's terms of reference, generally as above, with no specific questions, issues or discussion items/paper prepared by the committee as yet.

This submission to the inquiry is in addition to individual submissions that have been made by Canberra Region Joint Organisation member councils.

Terms of Reference

Canberra Region Joint Organisation and many of its member councils provided submissions to the previously commissioned IPART review of council funding models. We ask that these submissions, which we understand have been collated and passed on by IPART to the committee undertaking this replacement review, are taken into consideration as additions to the inquiry's terms of reference.

Level of income councils require to meet the needs of their communities

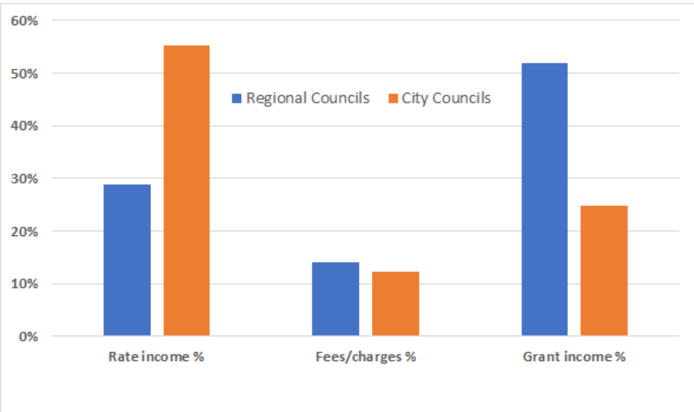
There is simply not enough operational revenue across the rural and regional local government system to cover operational costs associated with servicing communities' needs, let alone meet community expectations as captured in the (mandated) integrated planning and reporting process and resulting plans.

The committee's attention is drawn to the recent Local Government Audit Office report which clearly shows the level of income for councils is not adequate and the significant reliance of councils on state and federal government grants.

There remains an urgent need to redress the erosion of federal financial assistance grants to local government, this being the subject of sustained advocacy from the local government sector already and not the subject of this submission. Suffice to say that purposeful policy decisions at federal level year after year opt to continue the erosion and, in the case of freezes of federal assistance grants indexation, hasten the erosion with no subsequent policies to ever 'catch up' the compounding impact of past freezes on local government sustainability nation-wide.

Local governments only collect 3.5% of taxation nationally and need support from other tiers of government to provide the services and maintain the infrastructure their communities need.

The NSW state formula for allocation of federal assistance grants to councils has inherent fairness concerns between regional and metropolitan councils with there being a demonstrated need to recognise both the significant reliance of rural and regional councils on grants for funding of community services and council operations compared with metropolitan counterparts (refer graph below with source figures taken from published financial statements of NSW council over the past two years) and clear differences between regional & metropolitan councils with respect to both operational revenue and expenses.



A much higher reliance by rural and regional councils on grants compared with rates is problematic because grants revenue, by nature, is more uncertain and volatile than rates revenue due to the competitive nature of many grants, political imperatives and state and federal election cycles all affecting availability and amount of grants, making financial planning on the revenue side more difficult for regional councils. Councils are required to develop and work to long-term (ten-year) plans and, given that grant funding from other levels of government can be half to three quarters of the revenue in regional councils, these ten-year plans are often wildly inaccurate.

Reliance upon grants is even more marked in smaller rural regional councils with 70% of their revenue in the form of grants, compared with average grants contribution to total revenue across all NSW councils of 18% (Australian Bureau of Statistics, 2020-21).

Compared with metropolitan councils, rural and regional councils:

- have a smaller rate base due to smaller populations and many more kilometres of roads, water & sewer networks to maintain, renew and depreciate
- suffer more disasters & damage to assets, natural environment, economy & community wellbeing and are therefore disproportionately affected by chronic delays through disaster recovering funding arrangements in assessing and paying funds to councils which are responsible for disaster recovery
- have less ability to raise non-rates own source revenue (eg. parking fees/meters/fines revenue)
- have large areas that are national parks, state forests or public reserves which are not rateable and yet must be serviced in terms of access roads, pest and weeds management, biodiversity protection and visitor experience enhancement
- face more hurdles generating revenue from entrepreneurial pursuits given need to not compete with small/local suppliers
- are much more reliant upon grants than rates.

all of which contribute significantly to inequitable financial sustainability pressures between metropolitan and regional councils.

The committee's attention is drawn to published financial statements of all councils and the demonstration of financial unsustainability of rural and regional councils evidenced from basic analysis of rural and regional councils.

For example, over the past two years:

- 50% of rural and regional NSW councils reported operating losses with losses masked by federal financial assistance grants being paid early
- total operating losses of rural and regional NSW councils in 2022-23 was around $150 million, including positive impact of operating surpluses where achieved
- a growing percentage of rural and regional councils (23% in 2022-23) report that their depreciation cost is higher than their total rate revenue
- unrestricted cash reserves from the 85 rural and regional councils in NSW was less than 40% of the unrestricted cash reserves of the 15 metropolitan councils, and
- average own source revenue in rural and regional councils was around 45% compared with metropolitan councils at 64%
- significantly higher borrowings by rural and regional councils compared with metropolitan councils

Many rural and regional NSW councils have been required to respond to and lead the recovery from multiple disasters. These disaster occurences will not reduce and, as such and quite rightly, the focus is slowly turning to building resilience within our communities in the built, economic, social and community and natural environments. The majority of resilience-building work lies with councils and so, operational costs are affected not only be direct response and recovery work but by preparedness, mitigation and resilience-building work. Canberra Region Joint Organisation member councils are grateful for federal-state disaster assistance funding arrangements that supported the repair of numerous assets, however, accessing funding is complex, excludes major and important assets such as water and sewer assets, community halls or public amenities and, nonsensically, does not have provision for betterment.

Current levels of service delivery and financial sustainability in local government including the impact of cost shifting

Councils' financial management is not a revenue vs expenditure exercise, or councils could operate like the private sector and stop financially unviable services, clearly not an available choice for the public sector service and infrastructure providers that councils are. Councils are established to deliver services to the community with costs intended to be shared across the ratepayer base. If services and infrastructure, facilities and equipment, programs and staffing are to be cut or reduced or descoped to match limited revenue base, then it is communities that suffer the consequences, just as they do if rates are increased.

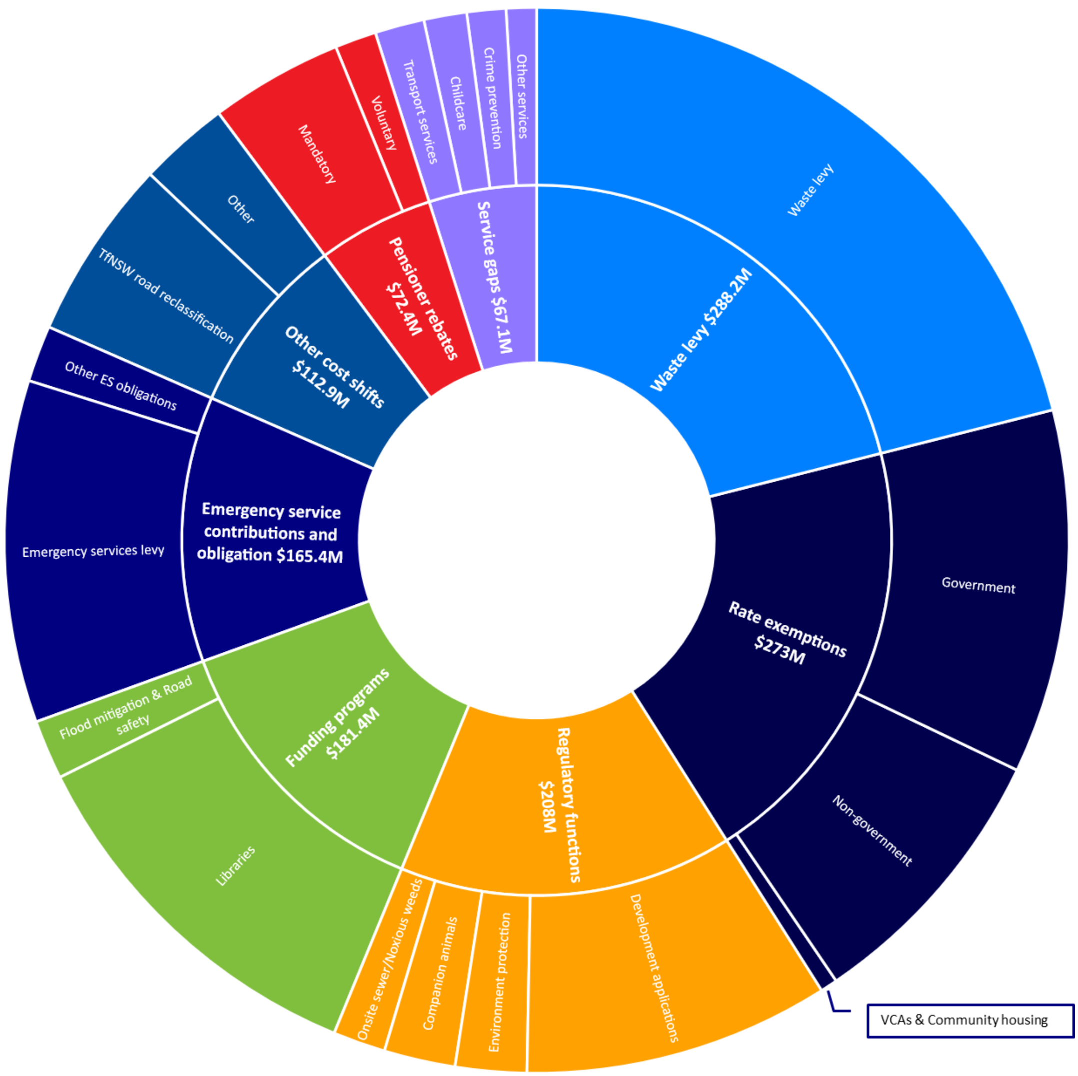
Not so typically identified as cost shifting, but negatively impacting on council's operational costs all the same, is the design of state and federal capital grants. Councils are relied upon heavily by other tiers of government to deliver on *their* objectives and policies via funded grant programs and councils are beholden to state and federal government to be in the 'grants race' for the sake of the communities they serve and to attempt to address their financial requirements by any means possible.

The design of state and federal grants programs drive up councils' operational costs as follows:

- new, expanded or improved infrastructure with no assistance for resulting increased whole-of-life costs (maintenance, depreciation, operating costs)
- cost of accessing capital grants (unfunded operational cost of applying, managing, reporting and acquitting grants
- cost of managing grants (unfunded cost of project management, administration and corporate and management overheads associated with delivering grant-funded capital projects)

Many councils understand that they have been fortunate in accessing state and federal grants to help deliver a range of projects, however as governments seek to manage their own budgets, they are now seeing a reduction in available grant funding. Together with the processes of accessing and managing grants and delivering grant-funded projects, which takes resources away from community services and programs and from maintaining and renewing existing infrastructure, the resulting new or upgraded assets, often much valued by the community, add to the maintenance and depreciation costs councils must fund in a severely revenue-constrained environment.

In terms of more commonly considered cost shifting, the committee's attention is drawn to LGNSW's 2021-22 Cost Shifting Report - How State Costs Eat Council Rates for analysis of categories and sub-categories of cost-shifting experienced by NSW councils (refer figure below). None of these categories, with the partial exception of emergency services levy, are included in rate peg calculations.



In addition, legislative and regulatory changes and mandatory targets are regularly put in place by state government with little or no consultation, nor seemingly, consideration of their operational cost burden on councils, let alone ongoing operational funding support.

Recent examples include the mandating of food organics green organics (FOGO) waste reduction targets, compliance and reporting requirements on councils as local water utilities operators, Childsafe protections, Respect at Work and work health and safety changed requirements, introduction of audit, risk and improvement committees and associated governance and auditing accountabilities, NSW Government financial reporting requirements of Local Government currently necessitating depreciation to be double-counted in financials, introduction of the cemetery trust levy and additional compliance requirements associated with local government waste contract tenders.

Expectations for the filling of service gaps in areas with thin service markets, predominantly in regional and especially in rural areas inevitably falls to the local areas. Councils are responsible to meet community service expectations, partially by virtue of integrated planning and reporting requirements in many, varied service areas which attract no operational funding such as aged care and services, health services, disability services case management, banking and postal services, child care, workers' accommodation and environmental and biodiversity management.

The committee's attention is drawn to a report undertaken by LGNSW in November 2023, showing that cost-shifting from the state government is equivalent of more than $460 per ratepayer.
https://lgnsw.org.au/Public/Public/Advocacy/Cost-shifting.aspx

Past rate pegs and if they have matched council cost increases

Rate pegs generally follow movements in the Consumer Price Index (CPI) or the newer Local Government Cost Index whereas local government materials and services costs increases generally exceed these and wage increases often are not reflective of CPI.

Examining whether past rate pegs have adequately matched increases in costs borne by local governments is important as is having a future focus with respect to the future of the rate pegging system. Cost pressures, including inflation, rising wages and infrastructure maintenance all impact councils' ability to deliver services effectively. The rate peg has not matched the increase in costs borne by local government in recent years.

An extreme was the 2022-23 rate peg set by IPART at 0.7% at a time when inflation in Australia was 6- 7%. While councils' costs are not necessarily determined by CPI, in fact councils' costs for materials and services and often wages are much higher than inflation, councils are not immune to the effects of the high inflation. Over the previous ten years, the rate peg was around 2.5% on average, less than Local Government Award increases and indices that better reflect council's costs than CPI.

More recently IPART has moved in the right direction developing a new base cost change model with three components being employee costs, asset costs and all other operating costs excluding the emergency services levy which is considered as a separate factor with further work underway. The population factor is also a step in the right direction, however there are other variables which are not allowed for in the formula and the inherent issues of rate pegging not keeping pace with changes in council costs structures persists. Past rate pegging has been based on historical data whereas it needs to recognise current, emerging and future circumstances. Rate pegging is, by nature, applied across the board, however it needs to also be considered on an individual basis.

The continued application of a rate peg is considered to be politically motivated and a long-held response to an inherent lack of understanding of local government business and lack of respect for the role and essential nature of local government and its services rather than a fiscally sound approach.

With a rate peg in place, increases to operational costs faced by regional councils has far exceeded what they have been able to increase their rate-based revenue by. In particular, road construction and maintenance costs have increased more rapidly in recent years, this being a major area of rural and regional costs resulting in rural and regional NSW councils being under constant financial unsustainability. Increasing costs are made worse by the significant areas that rural and regional councils are responsible for and their distance from more main services and population areas.

There have been an increase in special rates variations applied for and approved over the last 10 years, indicating that rate pegs have not adequately matched increase in council costs.

Social and economic impacts of the rate peg and comparison with other jurisdictions and alternative approaches

With regards to general rates revenue, NSW rural and regional councils collect significantly less than their counterparts in Victoria and South Australia, both state jurisdictions which also cap rates increases. According to NSW IPART's Final Report Review of the Rate Peg Methodology, in 2020-21 Victorian regional rates were $500 above NSW's regional rates and $1000 above NSW's rural rates, per year.

In states without a rate peg set by state government, it falls to democratically elected councillors to understand council's finances and services and their communities and set rates as well as explain rates and service levels decision-making to their ratepayers. While many factors are at play, fundamentally, councillors setting rates and infrastructure and service levels establishes an accountability between voters and their councillors that is not possible with an externally set rate peg.

Rather, a rate peg which sets councils up for financial failure means that councils, in particular rural and regional councils where non-rates revenue generation is very limited, can really only look at the expenses side of their business in the form of cost efficiencies and service cuts or service level reductions. Reducing services, or service levels, directly and negatively impacts communities who use council-provided infrastructure and services, expounds occupational safety risks for staff working in aging council facilities, maintaining aging council infrastructure and working with aging council equipment and exposes future councils and ratepayer generations to increased cost burden associated with under-maintained and -renewed infrastructure.

The alternative within the rate pegging system of seeking special rates variations is hard on communities as well, from a financial planning perspective for both households and businesses.

Rate pegging also effectively means that it is near impossible for councils to add programs, services or facilities to address social issues, needs or equity by limiting the ability of councils to fund these services even if their community is willing to pay for them through general rates increases. Councils are routinely expected to address market failures or gaps in social services throughout rural NSW but cannot afford to do so.

Operation of the special rate variation process

If rate pegging remains, there will also remain the need for special rates variations. If special rates variations are inevitable then the process, which takes months and causes significant unrest and relationship disestablishment between communities and councils, needs simplification. It also needs to be an accepted part of rate pegging that there will always be circumstances, and not necessarily individual to just one or two councils, where variations to the rate peg are needed.

Canberra Region Joint Organisation members that have been through the special rates variation process for financial review, services review and community consultation, successfully or not, in recent times report that it degrades community trust of councils.

As significant employers in rural and regional areas in particular, councils play a critical role in our local services and jobs economy. Going through service reviews and the special rates variation process disrupts normal service delivery and puts negative pressure on council organisational cultures, the process being very challenging for staff who generally must live and work in their local government area.

Given that even substantial special rates variations in the order of, say, 50% rates increase over three years do not address rural and regional council's sustainability, it is little wonder that many councils decide to delay the inevitable and not pursue special rates variations, electing instead to borrow funds or unresponsibily under-invest in assets and infrastructure, creating inter-generational burden on future councils, state and federal governments and ratepayers and ultimately all taxpayers.

The special rate variation process plays a crucial role in providing councils with additional income to meet the needs of their communities. The existence of a process to undertake special rate variations is valued as it allows councils to increase their income to try and adequately meet their community's services and infrastructure needs. Stronger support and consideration as to how state government, via IPART or other parts of government, can better support councils applying for special rates variations would be welcomed.

Other matters:

Canberra Region Joint Organisation echoes calls by its member councils to:

- introduce a state equivalent of federal financial assistance grants with a structured funding methodology for operational funding to support councils
- remove rate pegging and allow elected councils to determine rate increases needed to deliver services, in consultation with their communities
- fully fund pensioner rebates
- review and streamline state-federal disaster funding assistance arrangements and NSW Natural Disaster Essential Public Asset Restoration Guidelines to include water and sewer assets, community halls and public toilets and allow for betterment when councils are required to rebuild assets
- review and simplify special rates variation processes and shift the burden of proof to the state to justify why an increase should not be permitted for a council that can demonstrate the need for an increase
- provide increased visibility of grant funding program announcements, reduce delays in issuing deeds and reduce the onerous grant acquittal reporting
- allow greater flexibility in grant funding programs including provision for:
  - existing council employee costs, where employees work on grant-funded projects, to be funded to grant-funded projects
  - funding of corporate, administrative and management overheads
  - program level funding for asset categories not just individual projects
  - sensible contingency thresholds acknowledging the reality of cost escalation which occurs between application and project commencement and share the cost burden of materials and services increases that are beyond local government control
  - provide grant funding programs that support strategic planning and strategy development
- where cost shifting clearly exists reimburse Councils for service provision, ongoing and indexed over time
- allow the rating of forestry and other currently unrateable government land
- review legislative fees and charges to include indexation over time
- cap the cost of local government elections and instruct the NSW Electoral Commission to introduce electronic voting systems