Submission
No 94

INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Organisation: Name suppressed

Date Received: 26 April 2024

[redacted]

The Director
Standing Committee on State Development
Parliament House, Macquarie Street
Sydney NSW 2000

26 April 2024

Dear Sir/Madam,

Submission – Ability of local governments to fund infrastructure and services

Thank you for the opportunity to make a submission in response to the enquiry by the NSW Legislative Council's Standing Committee on State Development into the ability of local governments to fund infrastructure and services. The opportunity to comment is welcomed.

We have included a response to each of the items identified in the Terms of Reference below.

(a) <u>The level of income councils require to adequately meet the needs of their communities</u>

The level of income councils require to adequately meet the needs of their communities is a function of the funding required to maintain services, renew community infrastructure and deliver the priorities identified in the Community Strategic Plan, which is the result of significant community consultation. The cost of funding these activities increases in accordance with wage increases and market increases in infrastructure maintenance and construction costs. However, councils must address the challenges of Rate Peg not matching cost increases borne by local governments, cost shifting from State Government agencies, and a reduction in grant funding from State and Federal Governments. Therefore, due to factors outside their control councils generally do not have sufficient income to fund the needs of their communities.

The NSW Government plays a critical role in strategic planning initiatives to manage the operating model and cost structures for expenses that have a significant impact on Council's results. An example of this is identifying alternative landfill sites for waste disposal for Sydney metropolitan councils, developing long-term sustainable waste disposal solutions such as waste to energy, and identifying viable markets and uses for recycled waste. The identification of commercially practical solutions to these problems could significantly reduce waste disposal costs, which is a major operating cost for Local Government, and would reduce the level of income required by councils to fund this service. However, at present these costs continue to grow due to a lack of strategic direction and severe capacity constraints in the waste disposal industry.

Cost shifting from the NSW Government to Local Government is a growing issue that often occurs with little notice. Examples of this are the 63% increase in the Emergency Services Levy for 2023/24, the 7.65% increase in Section 88 Levy on waste by the NSW EPA effective 1 July 2023,

[redacted]

and the 142% increase in the Audit Fee since the Audit Office of NSW took over responsibility for the external audit of Council 8 years ago. But cost shifting extends beyond direct cost allocation to underfunding in grant allocations. An example of this is the RMS Block Grant that has been static for several years whilst the underlying cost of maintaining the infrastructure assets has grown significantly due to rising material costs and workplace safety costs. Therefore, the NSW Government needs to better consider the implications of their cost shifting and provide more notice to Local Government so that cost recovery planning can be managed better. For example, the EPA should not announce Section 88 Levy increases after councils have set their Domestic Waste Charge for that year.

To reduce the volatility of councils funding needs, and the financial impost on ratepayers, State Government agencies need to be more accountable for funding when they mandate project priorities for Local Government. For example, [redacted] NSW has mandated a program of [redacted] works for [redacted] Council that places a significant funding impost on its residents over a 4 year period. The majority of the funding for these projects is sourced from Council funds, which requires them to be diverted from community priorities in order for Council to meet is legislative obligations. Whilst Council has utilised the Integrated Planning and Reporting Framework to establish project priorities, it is difficult to implement the priorities identified through engagement with the community in development of the Community Strategic Plan when the State Government subsequently imposes its own priorities on Local Government.

Income can be sourced from the [redacted] to fund [redacted] works, however, the [redacted] is legislated and has not increased for over 17 years.

The challenges of Local Governments income needs and project funding requirements are amplified by a lack of advance warning from the State Government agencies that provide the funding, and funding arrangements that are not in the best interest of Local Government. This includes funding arrangements that require councils to spend their funds first, and milestone funding provided after councils have incurred the project costs. In addition grant funding agreements are increasingly stipulating that contingency funding is withheld by the grant issuer, and audit fee costs for the acquittal must be incurred by Local Government.

The State Governments late notification of the timing of Financial Assistance Grant Funding each year, and ongoing plans to address rural council funding issues by reducing funding to metropolitan councils, makes advance planning and forecasting income levels to meet funding requirements by Local Government more challenging than it ideally should be.

Sydney Metropolitan councils must manage a decline in Federally Funded Financial Assistance Grants (FAGs) arising from the reallocation from metropolitan to regional councils. [redacted] Council (Council) has a large migrant community with more than 70% of its residents speaking a language other than English at home, [redacted].
However, the General Purpose Component of Councils FAG has reduced by $1.74 million (18.8%) during the past 10 years, with the NSW Local Government Grants Commission recently advising that Council's FAG funding is set to be reduced by a further 4% in 2025-2026, with a yet to be determined reduction to be applied in 2024-2025.

The reduction in other revenue sources such as FAG's compounds councils funding issues and the problems with the current Rate Peg setting methodology.

The current Rate Peg setting methodology effectively makes it mandatory for councils to regularly apply for Special Rate Variations (SRV's) in order to remain financially sustainable because Rate Peg has consistently lagged behind wages and cost growth and councils are left with no alternative but to apply for SRV's because they have exhausted productivity and efficiency saving opportunities in prior years.

The SRV application and approval process is too onerous and time consuming for councils, but necessary because:

- Current income constraints arising from limitations in the Rate Peg setting process does not allow councils to service community needs – under the Integrated Planning and Reporting (IP&R) Framework councils undertake significant community consultation in order to prepare the Community Strategic Plan, which is adopted by Council. However, Rate Peg does not provide councils with sufficient funding to maintain and renew community infrastructure and deliver the priorities identified by its community in the Community Strategic Plan.
- There is no allowance for the significant financial impact of cost shifting to local government – responsibility for costs and services continue to be transferred to local government, and whilst some of these costs and services are partially grant funded, the residents are required to subsidise the funding shortfall. However, this is not taken into account in the Rate Peg calculation, which means that other essential community services need to be reduced, or SRV's applied for by councils.

  In addition councils are required to use the services of other government agencies whose cost increases are not constrained by Rate Peg (NSW Electoral Commission, Audit Office of NSW, etc.).

The Rate Peg should take into consideration individual councils Delivery Program and Long-Term Financial Plan cost projections.

Councils with legacy infrastructure issues arising from urban release areas of the 1960's, 70's and 80's developed prior to the introduction of developer contributions do not receive sufficient funding to address historical infrastructure issues relating to limited open space and associated infrastructure issues such as footpaths without the benefit of population growth from new urban land release. New release areas incorporate adequate planning for infrastructure and open space, and councils where new urban land is released within their LGA benefit from changes to the rate peg methodology to incorporate a population growth factor. But this does not address historical infrastructure issues and has the potential to widen the divide between councils with growing populations from land releases and councils with infrastructure backlogs.

In addition, council's need to manage a reduction in funding for infrastructure and services when affordable housing is transitioned from NSW Land and Housing to Community Housing Providers (CHP) because the CHP's are receiving exemptions from land rates as Public Benevolent Institutions pursuant to Section 556 of the Local Government Act 1993 (NSW).

Residents of CHP's are amongst the most disadvantaged members of the community and require a higher level of support from Council. However, the revenue from land rates is reducing for councils with larger levels of community housing as the ownership of more housing is transferred to CHP's. This means that infrastructure funding is reducing for councils with growing levels of CHP's. The issue is not addressed in the current rate peg methodology.

This issue is compounded for [redacted] Council because it is experiencing an increase in community housing within its LGA as large community housing redevelopments include a significant amount of affordable housing stock. Therefore, not only is Council's existing rates base reducing as rate paying affordable houses are transitioned to CHP's, but new housing developments with CHP owned properties are not contributing to the cost of the infrastructure and services required to support the population growth arising from these redevelopments.

Council also has an above average number of pensioners. Twenty percent of Council's residential ratepayers are pensioners. These residents receive discounted rates and Council incurs additional costs to service these vulnerable members of the community.

Therefore, the combined impact of flaws in the current Rate Peg setting process, reductions in State and Federal Government funding, cost shifting and a lack of support in strategic planning for state wide issues (i.e. waste disposal and flood management) places unnecessary pressure on council's income because councils are not provided with the suitable means to ensure all communities have reasonable access to critical infrastructure such as parks, footpaths and community facilities.

(b) Examine if past rate pegs have matched increases in costs borne by local governments

As noted above in response to terms of reference issue (a), Rate Peg has consistently lagged behind wages and cost growth for a sustained period of time.

The cost of maintaining and renewing infrastructure has been growing at more than Rate Peg due to global economic factors and inflationary pressures arising from the level of infrastructure works undertaken by the State and Federal Governments. But insufficient allowance has been made for this in the Rate Peg calculations.

[redacted] Council is an insourced service provider who is a major employer of local community members. This has resulted in employee costs accounting for 45% of its total expenditure. However, Rate Peg has consistently lagged behind wage increases, as evidenced by the fact that Local Government Award increases have exceeded Rate Peg for 8 of the last 10 years. The only exceptions were during COVID in 2020 and 2021.

Further, Rate Peg makes no allowance for State Government cost shifting, reduced funding allocations or the negative financial impacts on local government arising from State Government policy decisions. So its clear that Rate Pegs have not matched increases in the costs borne by local governments.

(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

As noted above in response to terms of reference issue (a), cost shifting has increased significantly over time. Cost shifting for councils occurs in the form of both reduced grant funding from the State Government and shifting of responsibility for services and maintenance costs from the State Government to councils.

Responsibility for costs and services continue to be transferred to local government, and whilst some of these costs and services are partially grant funded, the residents are required to subsidise the funding shortfall. However, this is not taken into account in the Rate Peg calculation, which means that other essential community services need to be reduced, or SRV's applied for by councils. In addition councils are required to use the services of other government agencies whose cost increases are not constrained by Rate Peg (NSW Electoral Commission, Audit Office of NSW, etc.).

Cost shifting from the NSW Government to Local Government is a growing issue that often occurs with little notice. Examples of this are the 63% increase in the Emergency Services Levy for 2023/24, the 7.65% increase in Section 88 Levy on waste by the NSW EPA effective 1 July 2023, and the 142% increase in the Audit Fee since the Audit Office of NSW took over responsibility for the external audit of Council 8 years ago. But cost shifting extends beyond direct cost shifting to underfunding in grant allocations. An example of this is the RMS Block Grant that has been static for several years whilst the underlying cost of maintaining the infrastructure assets has grown significantly due to rising material costs and workplace safety costs. Therefore, the NSW Government needs to better consider the implications of their cost shifting and provide more notice to Local Government so that cost recovery planning can be managed better. For example, the EPA should not announce Section 88 Levy increases after councils have set their Domestic Waste Charge for that year.

To reduce the volatility of councils funding needs State Government agencies need to be more accountable for funding when they mandate project priorities for Local Government. For example, [redacted] NSW has mandated a program of [redacted] works for [redacted] Council that places a significant funding impost on its residents over a 4 year period. The majority of the funding for these projects is sourced from Council funds, which requires them to be diverted from community priorities in order for Council to meet is legislative obligations. Whilst Council has utilised the Integrated Planning and Reporting Framework to establish project priorities, it is difficult to implement the priorities identified through engagement with the community in development of the Community Strategic Plan when the State Government subsequently imposes its own priorities on Local Government.

Income can be sourced from the [redacted] to fund [redacted] works, however, the [redacted] is legislated and provides insufficient funding because it has not increased for over 17 years.

Sydney Metropolitan councils also need to deal with revenue shifting by the State Government because they must manage a decline in Federally Funded Financial Assistance Grants (FAGs) arising from the reallocation of funding from metropolitan to regional councils. [redacted] Council (Council) has a large migrant community with more than 70% of its residents speaking a language other than English at home [redacted] However, the General Purpose Component of Councils FAG has reduced by $1.74 million (18.8%) during the past 10 years, with the NSW Local Government Grants Commission recently advising that Council's FAG funding is set to be reduced by a further 4% in 2025-2026.

The reduction in other revenue sources such as FAG's compounds councils funding issues and is another form of cost shifting.

It could also be argued that the State Governments strategy to outsource community housing is a cost shifting strategy that is impacting council's funding for infrastructure and services. Council's revenue is reduced when affordable housing is transitioned from NSW Land and Housing to Community Housing Providers (CHP) because the CHP's are receiving exemptions from land rates as Public Benevolent Institutions pursuant to Section 556 of the Local Government Act 1993 (NSW).

Residents of CHP's are amongst the most disadvantaged members of the community and require a higher level of support from Council. However, the revenue from land rates is reducing for councils with larger levels of community housing as the ownership of more housing is transferred to CHP's. This means that infrastructure funding is reducing for councils with growing levels of CHP's. The issue is not addressed in the current rate peg methodology.

This issue is compounded for [redacted] Council because it is experiencing an increase in community housing within its LGA as large community housing redevelopments include a significant amount of affordable housing stock. Therefore, not only is Council's existing rates base reducing as rate paying affordable houses are transitioned to CHP's, but new housing developments with CHP owned properties are not contributing to the cost of the infrastructure and services required to support the population growth arising from these redevelopments.

Council also has an above average number of pensioners. Twenty percent of Council's residential ratepayers are pensioners. These residents receive discounted rates and Council incurs additional costs to service these vulnerable members of the community.

Therefore, the increase in the level and forms of cost shifting to local government has impacted service delivery and the financial sustainability of councils because it has reduced their ability to fund the construction and maintenance of critical community infrastructure.

The NSW State Government established numerous financial and infrastructure performance measures that are included in councils' annual financial statements to ensure that they remain financially sustainable and continue to invest in the renewal of infrastructure assets. However, due to cost shifting and government grant funding contraction councils are either not achieving the performance measures, or are reducing services and new projects required by the community in order to achieve the infrastructure renewal targets. So there is not currently a reasonable balance between service delivery and financial sustainability.

(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

The social impact of Rate Peg is that essential services to vulnerable community members have been reduced due to the financial constraints imposed by Rate Peg and the need to reduce costs in order to be financially sustainable, and the economic impact is that there has been reduced expenditure on maintenance of services and infrastructure. This is demonstrated by the limited number of councils that achieve OLG's financial benchmarks included in their annual audited financial statements.

The social downside of maintaining the existing Rate Peg system is that councils won't have sufficient resources to service financially disadvantaged community members with a large demand for its services. Therefore, it will potentially widen the economic divide between councils servicing more affluent areas and those with less affluent migrant communities.

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

The use of Rate Pegging has limited NSW councils' ability to deliver services rather than protect ratepayers from unnecessary increases. NSW councils' have a legislative requirement to comply with the strict IP&R framework that requires extensive community consultation and reporting. Councils are also conscious of the financial demands on its community and the need to provide value for money services. So it is unnecessary to impose a further financial constraint of Rate Pegging on councils which limits their ability to service community infrastructure and deliver the priorities identified in the Community Strategic Plan.

The Office of Local Government requires councils to include numerous financial and infrastructure performance measures in its annual financial statements to ensure that they remain financially sustainable and continue to invest in the renewal of infrastructure assets. However, it is difficult to achieve all these indicators and fund the investment required in the maintenance and renewal of infrastructure whilst delivering critical services to the community when the Rate Peg consistently lags behind wages and cost growth.

Therefore, it would be appropriate to take into consideration individual councils Delivery Program and Long-Term Financial Plan cost projections because these have been developed after consideration of community priorities identified during consultation to develop the Community Strategic Plan, and have been publicly exhibited. The Delivery Program is the result of a robust process and Rate Peg should take the cost projections from it into account to provide councils with sufficient funding to maintain and renew community infrastructure and deliver the priorities identified in the Community Strategic Plan. This could be incorporated into a Rate Peg methodology based on predicted costs, with a true-up of prior year estimates to actuals incorporated into the calculation.

This would provide a better outcome for ratepayers who would see community consultation taken into account and prioritised appropriately with adequate funding, and council staff satisfied that the community consultation is delivering tangible benefits to council's constituents.

(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

As noted above in response to terms of reference issue (a), the current Rate Peg setting methodology effectively makes it mandatory for councils to regularly apply for Special Rate Variations (SRV's) in order to remain financially sustainable because Rate Peg has consistently lagged behind wages and cost growth and councils are left with no alternative but to apply for SRV's because they have exhausted productivity and efficiency saving opportunities in prior years.

However, the SRV application and approval process is too onerous and time consuming for councils, and is designed to address short-term needs, not long-term structural funding issues. IPART's published criteria for assessing SRV's is that they should be required to maintain essential community services or regional projects and that they will be granted in whole or part for a single year or up to seven years. Therefore, they are not designed to address councils' long-term financial sustainability.

The role of IPART is essentially to be a financial gatekeeper to limit the level of SRV's, but this doesn't assist councils to achieve the level of income required to adequately meet the needs of their communities

(g) Any other related matters

There are no other related matters to comment on.

Thank you for the opportunity to make a submission, if you have any questions, please do not hesitate to contact me on [redacted]

Yours faithfully

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