Submission
No 120

INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Organisation: Inverell Shire Council

Date Received: 31 May 2024

30 May 2024

The Hon Emily Suvaal MLC
Standing Committee on State Development
6 Macquarie Street
SYDNEY NSW 2000

Dear Ms Suvaal,

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

Inverell Shire Council welcomes the opportunity to provide a response to the 'Terms of Reference' for the Inquiry into the ability of local governments to fund infrastructure and services.

Please find below our responses to each of the questions posed.

Please do not hesitate to contact myself should you require any further information.

Yours faithfully

Paul Pay
Director Corporate & Community Services

RESPONSE TO TERMS OF REFERENCE

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

The income required by councils to adequately meet the needs of their communities varies significantly across different types of councils—metropolitan, regional, rural, and remote. These variations are due to differing revenue-raising capacities and the substantial variations in input costs. Metropolitan councils often have higher revenue potential through property taxes and fees, whereas rural and remote councils struggle due to limited economic bases and higher costs of service delivery.

To adequately meet our community needs, Inverell Shire Council requires a level of income that aligns with the increasing costs of maintaining infrastructure and delivering essential services to its community. Over recent years, the Council has faced escalating costs in road maintenance, waste management, and community services, driven by inflation, regulatory requirements, and the need for modern infrastructure. The current income, primarily derived from rate revenue, grants, and some minor service charges, is impacting on the service delivery to our community.

Local councils in New South Wales (NSW) require a substantial increase in income to meet the growing demands of their communities. TCorp highlighted that local councils face an infrastructure backlog of approximately $7.2 billion, along with a maintenance gap of $389 million[1]. This indicates a significant shortfall in the funding needed for councils to maintain existing infrastructure and provide essential services.

The following four constraints currently reduce the ability of councils to provide services to their communities and to be sustainable in the long term:

a) **Cost Shifting and Revenue Constraints**
Local governments in NSW have experienced significant cost shifting from both state and federal governments. Essential services such as aged care, medical services, childcare, and community transport have increasingly become the responsibility of local councils without corresponding increases in funding or revenue-raising powers. The NSW Local Government Association 2021/2022 cost shifting report indicates that cost shifting costs each ratepayer between $420.90 and $590.80 per annum, depending on the classification of the council[2]. Thus, Inverell Shire Council as a large rural council needs to generate $4,269,261 in revenue to provide services for other tiers of government.

b) **Rate Pegging and Special Rate Variations**
The practice of rate pegging has further constrained the financial capacity of local governments. While intended to protect ratepayers, it has not kept pace with the rising costs of service delivery and infrastructure maintenance. Councils often resort to special rate variations to address budget shortfalls, but this process is cumbersome and not always sufficient to meet community needs. 52 councils have lodged special rate variations since 2019/2020 demonstrating that the current funding models have not kept pace with rising costs.

c) **Federal Assistance Grants (FAGs)**
When FAGs were first established in 1974, they constituted 1% of the national tax revenue, reflecting a substantial commitment to local government funding. However, over the years, the relative value of these grants has declined. As of the current

[1] TCorp Review of the Financial Sustainability of the NSW Local Government Sector (2013)
[2] Local Government NSW Cost Shifting 2023: How State Costs Eat Council Rates Report, page 7

assessment, FAGs only represent 0.51% of the national tax take. This reduction signifies that the financial support provided to local governments has not kept pace with the growth in national tax revenues or the increasing demands on local councils.

The decline in the proportion of national tax revenue allocated to FAGs has had several impacts on local governments:

- **Reduced Financial Capacity**
  Local councils have less funding to allocate towards critical infrastructure projects, community services, and maintenance of existing assets.

- **Increased Pressure on Local Budgets**
  The shortfall in grant funding has forced local governments to find alternative revenue sources, often leading to higher local taxes or service charges.

- **Service Delivery Challenges**
  With less financial support, councils may struggle to maintain the same level of service delivery, impacting community satisfaction and wellbeing.

- **Inequity**
  Smaller and rural councils, which rely more heavily on FAGs, are disproportionately affected, exacerbating existing inequalities between urban and rural areas.

d) **Limited capacity to raise interest revenue under the current Investment Order**

The Local Government Investment Order in New South Wales prescribes the framework within which local councils can manage and invest public funds. The current conservative nature of the Order emphasises security and liquidity over yield. Given the evolving financial landscape and diverse fiscal needs of councils, there is an argument that the Investment Order should be expanded to include a broader range of investment opportunities.

Expanding the range of permissible investments could allow councils to achieve higher returns. This is particularly relevant in low-interest-rate environments where traditional fixed income investments yield minimal returns. Additional revenue from investments can lessen the financial strain on councils, potentially reducing the need to increase rates or cut services.

Diversification can protect the portfolio against sector-specific downturns and market volatility. Many institutional investors and funds operate with diversified portfolios that include a mix of traditional and alternative investments. Expanding the investment scope could align local government practices with modern portfolio management theories.

Expanding the investment opportunities for local councils in New South Wales, while maintaining the primary focus on security and liquidity, requires careful consideration of investment types that balance potential returns with acceptable risk levels. Below are several investment opportunities that could be considered for inclusion in an expanded Local Government Investment Order:

- Corporate bonds
- Managed Funds (other than TCorp)
- Infrastructure Funds
- Real Estate Investments
- Real Estate Investment Trusts (REIT's)
- Structured Term Deposits

- Exchange Traded Funds (ETFs)
- Collateralised Debt Obligations (CDOs) within a very diversified portfolio, maximum of 5%

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

Rate pegging, introduced in New South Wales (NSW) in 1977, restricts the amount by which councils can increase rates each year. Until 2022/2023 the Independent Pricing and Regulatory Tribunal (IPART) set the rate peg based on a Local Government Cost Index (LGCI), which reflects cost changes in the local government sector. However, councils have long argued that the rate peg has not kept pace with actual cost increases, particularly in areas with rapidly growing populations or substantial infrastructure needs.

Historically, rate pegs in New South Wales have not aligned with the actual increases in costs borne by local governments. IPART has often set rate peg limits that are below the LGCI, which measures the actual cost increases faced by councils. For instance, between 2010 and 2020, the average annual rate peg was approximately 2.5%, while the LGCI indicated average annual cost increases of around 2.7%. This discrepancy has led to a cumulative shortfall, forcing councils to defer maintenance, reduce service levels, or seek alternative revenue sources. Inverell Shire Council shortfall during this period was approximately $561K.

Rate pegging, while intended to protect ratepayers, has constrained councils' revenue growth, often failing to keep pace with inflation and the rising costs of service delivery. This has been demonstrated in recent years with inflation significantly higher than the rate peg since 2020 as shown in the table below.

Year	Rate Peg	Inflation/ CPI)
2020/2021	2.6%	3.85%
2021/2022	2.0%	6.14%
2022/2023	0.70%	6.03%
2023/2024	3.70%	3.6% (to March 2024

IPART introduced a new Base Cost Change (BCC) Model in 2023 (used to set the 2023/2024 rate peg) to address these issues. However, the change in model did not consider the two-year lag contained in the former LGCI model. Thus, Councils did not receive any rate peg increase for the 2021/2023 years when inflation was at its peak. The long-term compounding effect of this decision may force many councils to seek special rate variations to generate sufficient revenue to meet service levels and community expectations.

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

The financial sustainability of local governments has been under strain due to several factors, including cost shifting and inadequate revenue growth.

Local governments are increasingly impacted by cost shifting, where responsibilities are transferred from state and federal governments to local councils without corresponding funding. This has led to councils taking on non-core services to make up for financial shortfalls, often with limited success. The financial burden of cost shifting is significant, with the NSW Local Government Association 2021-22 Cost Shifting Survey revealing that it added approximately $1.36 billion in costs to local governments[3].

[3] Local Government NSW Cost Shifting 2023: How State Costs Eat Council Rates Report, page 1

Financial sustainability remains a critical issue, with many councils operating at deficits and facing substantial infrastructure backlogs. The NSW Treasury Corporation reported a cumulative operating deficit of $1 billion from 2009 to 2012 and identified a $7.2 billion infrastructure backlog as of 2012[4]. Also, ALGA's 2021 National State of the Assets Report revealed that 36% of local government infrastructure is in fair or poor condition, highlighting significant underinvestment due to financial constraints[5]. Over time, the financial sustainability of many councils has deteriorated, leading to reduced service levels and deferred maintenance.

Despite these challenges, some councils, including Inverell Shire Council, have managed to maintain high levels of service delivery through prudent financial management and innovative practices. However, this is not uniform across all councils, with many smaller or rural councils facing greater difficulties. Over time, the financial sustainability of these councils has declined, leading to a backlog of infrastructure maintenance and reduced community services.

4. 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

Over the past 20 years, the rate peg in NSW has had mixed social and economic impacts on ratepayers, councils, and council staff in NSW:

- **Ratepayers**
  While the rate peg has kept property taxes relatively stable, it has also limited the ability of councils to invest in community infrastructure and services, potentially lowering the quality of life. Ratepayers have also been impacted by large special rate variations which impose large increases over one, two, or three years as opposed to more gradual increase if councils were not limited by the rate peg system.

- **Councils**
  Financial constraints have led to reduced capital investment, deferred maintenance, and limited service enhancements The lack of revenue growth due to rate pegging has meant that councils have had to make difficult decisions regarding service delivery, often reducing or eliminating services, which affects community well-being and economic development.

- **Council Staff**
  Financial pressures have often resulted in staff cuts, reduced job security, limited resources, increased workloads as councils strive to do more with less, and reliance on temporary or contract workers, which can affect service continuity and staff morale.

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

The current rate peg system is a one-size-fits-all approach that does not account for the unique financial challenges faced by different councils, particularly those in rural and regional areas.

Alternative approaches to the rate peg system include:

- **Abolishment**
  Abolishing the rate peg system entirely, which would allow councils to set their own rates and be accountable to their residents. The Integrated Planning and Reporting

[4] TCorp Review of the Financial Sustainability of the NSW Local Government Sector (2013)
[5] ALGA, 2021 National State of the Assets Report.

(IPR) framework provides Councils with a process to consult with the community to set service levels based on community aspirations and accordingly discuss the various methods how councils can raise revenue to fund such community aspirations. The process can be used to set future rate increases with community endorsement.

The Revitalising Local Government review said '*The Panel can find no evidence from experience in other states, or from the pattern and content of submissions for Special Rate Variations, to suggest that councils would subject their ratepayers to grossly excessive or unreasonable imposts if rate-pegging were relaxed.*[6]'

- **Margin above rate peg**
  Given it is unlikely that the NSW State Government will abolish rate pegging, a council determined increase above the set rate peg should be allowed to ensure councils can meet community expectations and required service levels.

  The Revitalising Local Government review recommended that the rate peg be streamlined by quoting advice from IPART for '*increased flexibility for councils to set rates within a margin of 3% above the rate-pegging limit.*'[7]

  A combination of the IPART and IPR processes should be compulsory for all NSW councils. This would set up a uniform framework for strategic planning and if adopted, in a perpetual cycle, would secure long-term financial sustainability for the majority of local government councils in NSW and eliminate the need for rate 'pegging' and special rate variations.

  Councils with more secure financial futures can better manage changes in service delivery and future planning, in comparison to the limited annual planning afforded by annual rate pegging alone.

- **Prescribe a rate peg range.**

  Providing a set rate peg range would provide greater certainty about future rates revenue which would allow Councils to adopt Long Term Financial Plan (LTFP) with greater confidence. IPART has for many years now suggested that Councils should use a 2.5% rate peg factor in their LTFP. Setting a default range of say 0-6%, would allow councils to use the IPR process to set rate increases with community consultation. Council could then use a streamlined SRV process to seek increases above the set rate peg range.

6. **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**

While the special rate variation (SRV) process theoretically allows for revenue adjustment to meet community needs, its complexity and unpredictability have limited its effectiveness. Many councils are deterred by the administrative burden and the risk of rejection, resulting in underutilisation of this mechanism. This underutilisation only kicks the can farther down the road resulting in greater increases when an application is finally made. Larger increases have a greater impact on the ratepayer.

In 2022/2023 IPART introduced a streamlined process for SRV applications to elevate an unusually lower rate peg of 0.7% compared the high inflation being experienced by councils.

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[6] Revitalising Local Government - Final Report of the NSW Independent Local Government Review Panel October 2013 page 42

[7] Revitalising Local Government - Final Report of the NSW Independent Local Government Review Panel October 2013 page 44

This streamlined process made it easier and quicker for eligible councils to apply for and receive approval for rate increases in 2022/2023. By reducing the documentation requirements and expediting the review process, IPART sought to support councils in securing necessary funding while maintaining oversight and community engagement. This initiative helped balance the need for financial efficiency with the imperative of transparent and accountable local governance. The process relied upon councils IPR documentation.

This streamlined process should be used to replace the current cumbersome and resource-intensive application process.

Conclusion

To ensure that local governments can adequately fund infrastructure and services, it is crucial to address the disparities in income distribution, match rate increases with cost escalations, and reduce the financial burdens caused by cost shifting. Reviewing and potentially abolishing or modifying the rate peg system and streamlining the SRV process, increasing Federal Assistance Grants back to 1% of Australian tax revenue are critical steps toward achieving financial sustainability and improving service delivery for communities across New South Wales.