

**Submission
No 122**

**INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO
FUND INFRASTRUCTURE AND SERVICES**

Organisation: Kyogle Council

Date Received: 18 June 2024

Kyogle Council submission to the Inquiry into the Ability of Local Government to Fund Infrastructure and Services – June 2024.

This submission was originally made by Council to the 2022 IPART review of the rate peg methodology. It covers Council's concerns about local government funding and the impact this has on the ability of councils to fund infrastructure and services. Council's position, as outlined in the submission, remains unchanged.

November 4, 2022

Independent Pricing and Regulatory Tribunal

Re: Review of the rate peg methodology

Thank you for the opportunity to provide input to the review of the rate peg methodology.

Council has received a report commissioned by the United Services Union (USU) in relation to this review titled, "*Rate capping in New South Wales local government: Addressing the questions raised in the IPART (2022) review of rate peg methodology: Issues paper and further recommendations for Improvement.*" Prepared by Emeritus Professor Brian Dollery. This report presents a valuable overview of the impact of rate pegging on NSW Local Government, and for regional and remote Councils in particular, and its conclusions and recommendations are strongly supported.

There are three main areas that Council would like to bring focus upon during the review. These are;

1. The discrepancy between the implementation and intent of the rate peg, and the challenges and operating environment of regional and remote Councils
2. The significant shortfall in the rate peg methodology associated with labour costs
3. The lack of consideration in the current rate peg methodology for cost shifting and the ever increasing regulatory and compliance burden facing local government

Limiting the ability of a council to generate revenue, undermines its ability to deliver services and to attract and retain residents. The current oppressive arrangements stack the odds against rural and regional councils and limit their ability to service their community and encourage growth.

What we are seeing in rural and regional NSW, is the revenue available to councils diminished to such an extent, that it has led to a decline in services and become a major factor leading to net migration away from these areas. At almost every turn, there is another government regulation, restriction or redirection of funding that reduces revenue available to these councils to deliver services for their communities. The increased audit requirements, emergency services contributions, regional roads transfers, minimum per capita payment in Australian Government Financial Assistance Grants (FAGs), rate pegging, matching funding requirements for external grants, competitive grants focused on areas of growth, are all examples of this cumulative impact of revenue pressures that is perpetuating declining population trends.

For clarity, the rate peg does not allow for the general revenue of councils to increase with price increases each year. The rate peg is specifically designed to reduce the real level

of income generated by councils to below the cost of delivering services, through the application of an arbitrary “*productivity factor*” over many years, which has left councils in NSW on the brink of financial failure.

There is a pronounced vertical fiscal imbalance that exists in the Australian federation, and a dramatic horizontal fiscal imbalance between councils in NSW that threatens the long-term sustainability of local government in NSW. There have been severe revenue constraints and cost shifting liabilities imposed on local government by the NSW state government. This situation has led to a crisis in the financial sustainability of local government in NSW and the services it delivers to the local communities. There has been an awareness of this crisis for well over a decade now, and despite multiple reviews and inquiries providing recommendations and solutions, the situation remains essentially unchanged today.

Horizontal fiscal imbalance occurs if different governments at the same level in a federation (eg different councils) possess unequal capacity to provide public services. This horizontal fiscal imbalance is obvious when comparing local government areas across NSW, with the services delivered in many regional, rural and remote communities a far cry from those afforded to their metropolitan counterparts.

The principles for the distribution of FAGs were designed to help address this in some way. However, they have also been criticised for the limitation that the minimum per capita amount of the FAGs distribution places on this objective, seeing a significant portion of this funding directed to those Councils that least need it. Councils on the minimum grant generally:

- Have greater revenue raising capacity
- Are not relatively disadvantaged
- Have economies of scale
- Are geographically smaller
- Experience year on year growth

The minimum per capita amount severely restricts the state’s ability to allocate an additional share of FAGs to those that need it to deliver a minimum service level, to communities that lack access to economies of scale or scope, have low socio-economic status, or are remote. The per capita minimum grant amount is increasingly diverting income away from those who need it the most, and adding to the horizontal fiscal inequity that exists between metropolitan and regional communities.

In essence, the very councils that are now being considered to be able to generate additional general rates revenue by altering the peg to include an allowance for growth, are already receiving a disproportionate share of the funding available through the FAGs. This is funding that should be going to those councils that need it most, which are generally those lacking growth. Now IPART has in place a system that allows these same councils to generate even more income, and as if to rub salt into wounds, councils that genuinely need more revenue, are excluded from the process.

The financial relationship between state and local government in NSW is cause for much angst. The NSW Government does provide special purpose grants to local government, but for the most part these have historically been essentially partial compensation for the transfer of assets and/or service responsibility such as Regional Road grants, the Country Towns Water Supply and Sewerage Program, library subsidises and pensioner rebates. Not only is the revenue transfer from the NSW government to local government relatively small, there is the control over general rates revenue, as well as the impact of cost shifting associated with a variety of services imposed onto local government by the state.

Cost shifting occurs when the responsibility for, or merely the cost of, providing a certain service, concession, asset or regulatory function is shifted from one sphere of government

to another, without corresponding funding or revenue raising ability required to deliver that new responsibility. Cost shifting forces councils to divert ratepayers' funds away from much-needed local infrastructure projects, to meet additional demands placed on them by state and federal governments.

The Local Government NSW Cost Shifting Report from (Local Government NSW, 2018) outlined the extent of cost shifting on local government in NSW and concluded that cost shifting continues to place a significant burden on councils' financial situation. The key points from this report are summarised below;

- cost shifting was estimated at \$820 million in 2015/16 (or around 7.5% per cent of councils' total income)
- cost shifting is up \$150 million from 2013/14, and totals \$6.3 billion over the last 10 years
- cost shifting exceeds the estimated annual infrastructure renewal gap
- The NSW government is responsible for 98% of the cost shifting with the federal government responsible for the remaining 2%
- The main contributors are;
 - EPA Waste Levy - \$305 million
 - Emergency services contributions - \$127 million
 - Public libraries shortfall - \$130 million
 - Pensioner rebate reimbursement gap - \$61 million
 - The rest are various regulatory and compliance burdens

In relation to the impact of rate pegging on Councils, the 2006 report "*Are Councils Sustainable? Final Report: Findings and Recommendations of the Independent Inquiry Into the Financial Sustainability of NSW Local Government.*" (Allan, Darlison, & Gibbs, 2006) shows that the overall rate increases in NSW were lower than in any other state between 1995/96 and 2003/2004. The increases over this period were; NSW (29.2%), ACT (35.2%), Tas (36.3%), SA (55.1%), QLD (55.6%), WA (64.8%), Vic (66.1%)

The increase in Gross Domestic Product (GDP) for this same period was 61.8%. If NSW rates revenue was allowed to increase in line with GDP over the period, this would have provided for an extra \$600 million in rates revenue annually. This would have more than likely allowed local government in NSW to avoid the annual funding shortfall and financial burden it faces today.

In order to ameliorate the financial sustainability crisis facing local government in NSW, and provide ongoing clarity and stability around the level of funding for local government, there is a need to significantly alter the rate pegging system, if it is unable to be removed altogether, and provide certainty for local government revenue.

Additionally, there is a need to reduce the impact of cost shifting from state to local government by;

- Reducing the regulatory and compliance burden on local government
- The NSW Government taking back responsibility for Regional Roads
- Increased library funding
- Fully funding pensioner rebates
- Removing the EPA waste levy from councils outside the metropolitan and coastal growth areas
- Placing all NSW Government Levies and taxes such as the Emergency Services Contributions, outside the general revenue affected by rate pegging

Where an area has population decline and/or a static population, this lack of growth also reduces access to economies of scale. When this is combined with ongoing increased government compliance requirements, additional cost shifting to local government, and increased community expectations, the cost of delivering services increases on a per capita basis for these communities. Where the previous review of the rate peg to include population growth falls down, is that it failed to recognise this, and offered no opportunity for additional income generation for these councils.

Where the biggest flaw lies, is that the current rate peg methodology groups all councils into a single Local Government Cost Index (LGCI) model. This model fails to account for differences in the cost of service delivery, and access to economies of scale, that exist across the many councils in NSW. The model is heavily skewed towards metropolitan and large regional councils, and significantly disadvantages rural and remote councils by comparison.

A recent example is the increases in Emergency Services Levy, which was accounted for in the LGCI as a 0.02% increase in general rates revenue in 2021-22, but for Kyogle Council the actual increase in the ESL that year was 1.6% of the total general rates. So, of the 2.6% rate peg, 60% of the additional income generated went straight back to the NSW Government in ESL increases alone. The cumulative impact of the increases in ESL since 2018-19 has been equivalent to 2.94% of general rates, with the LGCI providing for a cumulative increase in general rates of 0.2% over the same time.

This is just one example of many where the LGCI model fails to account for what are significant discrepancies between rural, remote, regional, and metropolitan councils.

The latest example of this is the intended mandatory Internal Audit Committee and Internal Audit Function proposed by the OLG. This will impose an estimated additional annual cost in the order of \$150,000 for Kyogle Council, and there is no consideration for this in the LGCI model or the rate peg for 2023/24.

The ESL and EPA Waste Levy already account for 10% of total general rates revenue for Kyogle Council, which is then handed to the NSW Government. If the state wishes to recover these costs from the local community, then at the very least, this must be accounted for outside the rate pegging system.

One of the greatest challenges facing local government in regional and rural areas of NSW is the attraction and retention of skilled staff. There are significant vacancies across the state and across the range of different roles within councils. Historically, the rate peg has included what the IPART has described as a “productivity factor”. This factor has the effect of limiting council’s ability to generate revenue to fund its work force. To make this worse, the LGCI uses a labour cost factor that, by IPART’s own admission, does not reflect the actual labour cost increases.

When the changes in the relative cost of labour for local government since 1992, are compared to the ABS Wage Price Index that is used in the LGCI for the same period, this shows a shortfall of 6.78% between the revenue generated through the rate peg, and the increase in labour costs.

What this has done, rather than drive “productivity or efficiency” is create a working environment where councils are unable to retain skilled staff, been forced to reduce the work force size, and are unable to financially reward staff for improvements in productivity or performance. This has led to a high turn over of staff, skills shortages across the sector, and put local government in regional NSW in a position where it is unable to compete on the labour market. This stems from a fundamental lack of understanding of the challenges facing councils outside the metropolitan areas and large regional centres.

In order to achieve productivity gains and efficiencies, staff need to be retained for longer periods, become multi-skilled, and be able to share their knowledge and skills with the

next generation of employees. The reality of the labour market is that this costs money, it doesn't save money. Productivity is measured by quantity and quality of output, not cost. The IPART methodology has made no attempt to ever quantify the output or quality of services delivered to regional communities, and instead only compares the per capita cost. The actual expenditure and costs of delivering services is also heavily linked to the revenue available, and hence the rate peg. So rather than the rate peg leading to increased productivity and/or reduced costs per unit, it has led to a decline in the quality and quantity of services as councils are forced to deliver the same or more services with less funding.

This situation is further exacerbated due to the constantly changing operating environment and ever-increasing construction and regulatory standards, and community expectations. The end result of this is that the unit cost is increasing, as is the quantum of the works involved to "maintain" service levels. The current rate peg methodology does not take into consideration any quantifiable data that relates to the actual services being delivered, or the quality in which they are being delivered. The whole system has been focused on limiting per capita expenditure, in an environment where there is an ever-increasing per capita service delivery expectation, and therefore cost.

The result is a perverse one, where the community has been "protected" from large increases in rates, but in return they have had to endure a gradual reduction in the quantum and quality of the services they are provided.

Recommendations

The main outcomes that should be considered in the review of the rate peg methodology to address the issues raised in this submission are;

- Use of different cost indexes for the different council types;
 - Metropolitan
 - Metropolitan Fringe
 - Regional Town/City
 - Large Rural
 - Rural
- Implementation of a fixed four year "minimum" rate peg amount of say 2.5% to provide security of revenue for planning purposes
- Provide for a rate peg "range" within each different council types based on the assessed data for each category
- Apply a growth factor to all councils based on the state wide average growth figures, with an additional allowance for those councils with higher than average growth
- Use of the NSW Local Government Award increases, and the mandatory superannuation payments applied instead of a lagging ABS Wage Price Index
- An additional labour cost "market factor" applied to make up for the long-term wages gap created by the rate peg of 6.78%
- Significantly reduce the indexation factors used in the LGCI to exclude depreciation and loss of disposal of assets, and include the following;
 - Employee benefits and on-costs
 - Building and Construction Materials
 - Construction works – roads and bridges
 - Construction – Buildings
 - Transport/Plant and Equipment
 - Emergency Services Contributions

- Other Cost shifting and Regulatory Compliance Costs
- All other costs (at CPI)
- Utilise a mix of actual data and projections to reduce the “lag” in the various indexation factors used in the LGCI

Responses to the Questions raised in the IPART review of rate peg methodology Issues Paper.

1. *To what extent does the Local Government Cost Index reflect changes in councils' costs and inflation? Is there a better approach?*

The current LGCI does not accurately reflect the changes in council's costs and inflation. An example comparison was done for Kyogle Council using the 2021/22 rate peg LGCI outcomes, resulting in an index for Kyogle Council of 17.1 compared to the 0.9 calculated by IPART, which was subsequently reduced to 0.7 when applied as the rate peg. The current methodology is too generalised, resulting in no real relevance for regional and rural councils.

2. *What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?*

Refer to the Recommendations included at the end of the main submission.

3. *What alternate data sources could be used to measure the changes in council costs?*

Refer to the Recommendations included at the end of the main submission.

4. *Last year we included a population factor in our rate peg methodology. Do you have any feedback on how it is operating? What improvements could be made?*

The premise that the Rate Peg should be varied for those areas that are experiencing growth, whilst remaining in place to restrict those areas that are experiencing population decline, is almost akin to planning for the destruction of regional communities, and will only serve to expand the gap between those that have and those that have not. This flies in the face of the principles of Horizontal Fiscal Equalisation, and is seen as deeply insulting to struggling regional and rural communities.

If there is going to be a population growth factor applied over and above the rate peg, then it should be applied on the basis of the state-wide growth figure, and apply to every council. This will encourage those who have the capacity to raise additional revenue through available sources to do so, while ensuring that those not presently experiencing growth, have an opportunity to provide their community with a standard of services that might encourage growth in their areas.

Areas with higher than the average growth across the state could still be allowed to increase their rates at a higher factor if needed.

If the population growth factor were to be applied in this manner, it would be simple to administer, and the worst that could happen is a series of thriving and vibrant communities right across the whole state, which would benefit of all of NSW.

5. *How can the rate peg methodology best reflect improvements in productivity and the efficient delivery of services by councils?*

By ensuring that local government has sufficient revenue to attract and retain skilled staff, and is able to reward productivity and performance through increased remuneration and employee conditions. Refer to the Recommendations included at the end of the main submission.

6. *What other external factors should the rate peg methodology make adjustments for? How should this be done?*

Refer to the Recommendations included at the end of the main submission.

7. *Has the rate peg protected ratepayers from unnecessary rate increases?*

No. The rate peg has resulted in decreased financial sustainability, political reluctance to implement adequate revenue increases, and created numerous “urgent” situations that have resulted in large Special Rate Variations, which is the exact opposite of protecting ratepayers interests.

8. *Has the rate peg provided councils with sufficient income to deliver services to their communities?*

No. The rate peg has resulted in reduced service levels as councils attempt to deliver the same services with less revenue than required.

9. *How has the rate peg impacted the financial performance and sustainability of councils?*

The rate pegging system has resulted in the financial sustainability of regional and rural councils being at great risk.

10. *In what ways could the rate peg methodology better reflect how councils differ from each other?*

Refer to the Recommendations included at the end of the main submission.

11. *What are the benefits of introducing different cost indexes for different council types?*

The rate peg LGCI may have some relevance for regional and rural councils.

12. *Is volatility in the rate peg a problem? How could it be stabilised?*

Yes. Refer to the Recommendations included at the end of the main submission.

13. *Would councils prefer more certainty about the future rate peg, or better alignment with changes in costs?*

Both. Refer to the Recommendations included at the end of the main submission.

14. *Are there benefits in setting a longer term rate peg, say over multiple years?*

Yes, in the form of a “minimum rate peg”. Refer to the Recommendations included at the end of the main submission.

15. *Should the rate peg be released later in the year if this reduced the lag?*

Yes, if the rate peg includes a “minimum” limit, and the factors used include projected data rather than only using the lagging data currently used. Refer to the Recommendations included at the end of the main submission.

16. *How should we account for the change in efficient labour costs?*

Refer to the Recommendations included at the end of the main submission.

17. *Should external costs be reflected in the rate peg methodology and if so, how?*

Yes, particularly those associated with cost shifting and the regulatory and compliance burden placed on councils. Refer to the Recommendations included at the end of the main submission.

18. *Are council-specific adjustments for external costs needed, and if so, how could this be achieved?*

Yes, but through the use of a “minimum rate peg” and a range of the peg for each classification of councils, that would allow some autonomy of decision making and annual variation based on each council’s needs. Refer to the Recommendations included at the end of the main submission.

19. *What types of costs which are outside councils’ control should be included in the rate peg methodology?*

Primarily those associated with cost shifting and the regulatory and compliance burden placed on councils. Refer to the Recommendations included at the end of the main submission.

20. *How can we simplify the rate peg calculation and ensure it reflects, as far as possible, inflation and changes in costs of providing services?*

Refer to the Recommendations included at the end of the main submission.

Kyogle Council
Local Government Cost Index Comparison 2020-2021

Cost Component	Kyogle Council Figures							IPART Figures		
	2021 Financial Stmts Ref.	2020	2021	% Change	Weight as at Jun-20	Change to Jun-21	Calculation of Kyogle Index	Weight as at Jun-20	Change to Jun-21	Published Index
Operating Cost Components					%	%		%	%	
Employee Benefits and On-costs	Page 25	8,807	9,103	3.36%	18.30%	3.36%	0.61	38.4	1.2	0.44
Plant & Equipment Leasing								0.3	1.1	0.00
Operating Contracts - 401	Trial Balance	4,289	4,166	-2.87%	8.91%	-2.87%	-0.26	2.1	0.4	0.01
Legal & Accounting Services	Page 25	131	101	-22.90%	0.27%	-22.90%	-0.06	0.8	1.4	0.01
Office & Building Cleaning Services								0.3	1.4	0.00
Other Business Services								6.2	1	0.06
Insurance	Page 25	373	390	4.56%	0.77%	4.56%	0.04	1.2	3	0.04
Telephone and Internet Services	Page 25	91	88	-3.30%	0.19%	-3.30%	-0.01	0.4	-2.4	-0.01
Printing, Publishing and Advertising								0.6	2.3	0.01
Motor Vehicle Parts - 524	Trial Balance	120	177	47.50%	0.25%	47.50%	0.12	0.3	-1.2	0.00
Motor Vehicle Repairs - 413	Trial Balance	26	31	19.23%	0.05%	19.23%	0.01	0.4	1.4	0.01
Automotive Fuel - 522	Trial Balance	552	379	-31.34%	1.15%	-31.34%	-0.36	0.8	-2.4	-0.02
Electricity	Page 25	318	273	-14.15%	0.66%	-14.15%	-0.09	2	-3.8	-0.07
Gas								0.1	-6.8	-0.01
Water & Sewerage								0.4	-6.6	-0.03
R, F, K, B & D Building Materials - 506, 507, 508 & WIP Exp	Trial Balance	3,432	3,352	-2.33%	7.13%	-2.33%	-0.17	2.5	1.1	0.03
Other Building & Construction Materials								0.7	0	0.00
Office Supplies								0.3	0.9	0.00
Emergency Services Levy	Page 25	317	377	18.93%	0.66%	18.93%	0.12	1.5	0	0.00
Other Expenses	Page 4	9,330	10,975	17.63%	19.38%	17.63%	3.42	8.4	1.5	0.13
Capital Cost Components										
Buildings - Non Dwelling	Page 36 & 37	551	1,840	233.94%	1.14%	233.94%	2.68	4.2	1.1	0.00
Construction Works - R, D, F, K & B	Page 36 & 37	17,962	20,864	16.16%	37.32%	16.16%	6.03	21.9	1.1	0.25
Construction Works - Other	Page 36 & 37	125	1,444	1055.20%	0.26%	1055.20%	2.74	2.5	-0.3	0.03
Plant & Equipment - Machinery etc	Page 36 & 37	1,635	2,717	66.18%	3.40%	66.18%	2.25	3.1	0.1	-0.01
Plant & Equipment - Furniture etc	Page 36 & 37							0.1	-0.4	0.00
Information Technology & Software	Page 36 & 37	74	84	13.51%	0.15%	13.51%	0.02	0.7	0	0.00
Sum of Figures		48,133	56,361							
Total Change in LGCI							17.1	100		0.9