Submission No 124

INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Organisation: Tenterfield Shire Council

Date Received: 24 June 2024

To: Legislative Council
Standing Committee on State Development

Re: Inquiry into the ability of local governments to fund infrastructure and services

From: Hein Basson - General Manager
Tenterfield Shire Council
P O Box 214
TENTERFIELD NSW 2372

Date: 24 June 2024

Dear Sir/Madam,

Please find below, Council's submission in relation to the "Terms of Reference" regarding the Standing Committee on State Development inquiry into and report on the ability of local governments to fund infrastructure and services etc.

Council consents for this submission to be uploaded to your website.

We look forward to appearing as witnesses this Wednesday 26 June 2024 virtually at 1.35pm.

Yours Sincerely,

Hein Bassin
General Manager

SUBMISSION IN RESPONSE TO THE TERMS OF REFERENCE PROVIDED

Terms of Reference

That the Standing Committee on State Development inquire and report on the ability of local governments to fund infrastructure and services, and in particular:

a. The level of income councils requires to adequately meet the needs of their communities.

Tenterfield Shire Council has inadequate income to meet the requirements of its community. Council is heavily dependent on external grant funding. As of 30 June 2023, Councils Own Operating Source Revenue ratio was 24.08%, well below the benchmark of greater than 60% required by the Office of Local Government. Council maintains total infrastructure assets valued at approximately $582 Million with a small base of approximately 5,100 ratepayers. Capital grants and contributions formed 48% of Council total revenue in the 2023/24 financial year. The other major source of income was Operational Grants which contributed approximately 28% of Council's total revenue, of which the Financial Assistance Grant (pre-paid 100% in advance for the 2023-24 financial year) formed part of. Revenue from rates and annual charges contributed approximately 16.7 % to the total revenue (including capital grants), which is less than the Region Average (Norther Rivers) of 28.93% and lower than the similar sized Rural Councils Group (Large – 3000 to 20,000 population) of 21.87%.

The three highest contributing factors under Council expenditure is Employee Costs, Materials and Services, and Depreciation.

Employee costs include wages, salaries, leave entitlements, superannuation, workers compensation and other employee related expenses. For Tenterfield Shire Council this represents 25% of its overall expenditure.

The cost of materials and contracts, consisting of raw materials, contractor, and consultancy costs have increased significantly over the past few years because of the construction cost index rises, which are typically higher than CPI. (Please see the point below for further information.) Cost increases in insurance and electricity have also noticeably increased by approximately 15% compared to previous years.

Depreciation expenses contributes approximately 26.3% of Council's overall expenditure and though consistent with the regional average and similar comparable sized rural local government entities, Council is challenged to fund these costs due to inadequate rates and annual charges.

Further, Council which has a low revenue base often struggles to balance its cash reserves during periods of natural disaster. The State Government funding model requires Councils to initial pay for natural disasters works under the so-called "Emergency Works and Immediate Reconstruction Work" program, and then have their claims assessed at a later stage. Tenterfield Shire Council had to totally deplete its internal reserves to fund this type of works; posting a negative unrestricted cash reserve for the 2022/23 financial year. Council is currently still awaiting the outcome of some of these claims as reimbursements back to Council – more than a year after the disaster event.

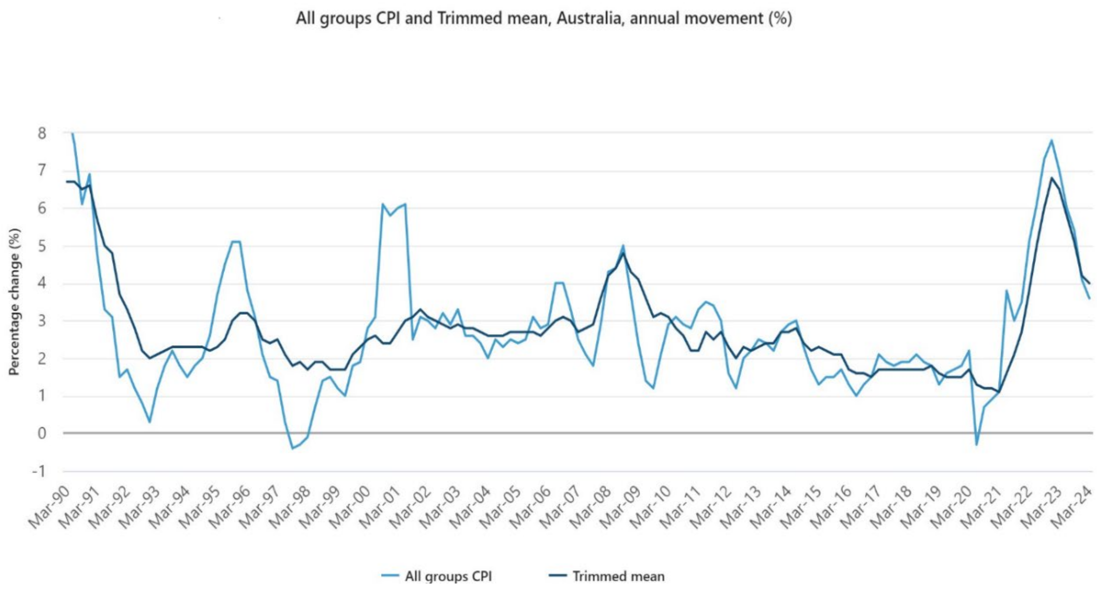
b. Examine if past rate pegs have matched increases in costs borne by local governments.

Council is constrained by the NSW Government's rate capping policy that had been in place since 1978. Typically, for the vast majority of the 45 years that this policy had been in place, the Independent Pricing and Regulatory Tribunal (IPART) had not been giving the true Consumer Price Index (CPI) and inflation percentages through to the local government sector – hamstringing this sector to keep track with cost rises as rate increases were capped at percentages lower than CPI.

The construction industry's cost rises are generally higher than "normal" CPI, as the cost of steel and cement, to name only two examples, have risen by much higher percentages than other commodities – certainly within the last number of years. A significant portion of Council's General Fund revenue (rates and charges) is spent on its roads infrastructure, where construction materials are being used.

Therefore, the compounding effect of this rate capping policy of the State Government has eroded Councils' ability to raise adequate revenues to keep up with increasing costs.

The Australian Bureau of Statistics' borrowed graph below shows the annual CPI (all groups) from March 1990 to March 2024.



Over the past three years commencing the June 2021 quarter, it is evident that the nominal rate peg recently announced by IPART of 2.5% is not sufficient when comparing this percentage with the annual CPI (all groups), as is depicted below:

	All groups CPI (%)
Jun-21	3.8
Sep-21	3
Dec-21	3.5
Mar-22	5.1
Jun-22	6.1
Sep-22	7.3
Dec-22	7.8
Mar-23	7
Jun-23	6
Sep-23	5.4
Dec-23	4.1
Mar-24	3.6

Specifically, to this Council, the rate peg methodology does not cater for the costs borne by Council. IPART in December 2021 published an information paper titled "Rate Peg for NSW Councils for 2022/23" stating:

For the first time, the rate peg for 2022-23 will include a population factor that varies for each council in NSW depending on how fast its population is growing. IPART has set the 2022-23 rate peg for each council at between 0.7% and 5.0%, depending on its population factor. The population factor ranges between 0% and 4.3%."

However, this translated to the Tenterfield Shire Council only being awarded a rate peg of 0.7% for the 2022/23 financial year.

As can be seen from the table above, in September 2022 the CPI was 7.3% and for June 2023 it was 6%. The compounding effect of these discrepancies creates chaos for Council's finances; forcing it pursue higher percentage SRV-applications just to financially survive and maintain service delivery to its community.

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.

Council continues to struggle to make ends meet and provide services to its communities, which situation is exacerbated with increasing cost shifting from state government.

The cumulative impact of a rate pegging model which does not match realistic inflation and the continuous cost shifting by the State Government accelerated this Council towards a financial unsustainable organisation – negatively impacting the service delivery to the community, which includes the timely maintenance and renewal of infrastructure assets.

Please refer to cost shifting report (attached) produced by independent consultant Morrison Low on behalf of LGNSW for the 2021/2022 financial year.

Specific to Tenterfield Shire Council, the following significant Cost Shifting items have impacted Council.

- <u>Emergency Service Levy</u> – As invoiced from Revenue NSW, the total invoice was for $374K in the 2021/2022 financial year, moving to $520K for the 2023/2024 financial year.

- <u>Pensioner Rebate</u> – The net cost incurred by Council due to the mandatory pensioner rebates for rates and charges was $154K for the 2021/2022 and 2022/2023 financial years. This represents the total amount of the mandatory concessions minus the State Government's reimbursement.

- <u>Public Libraries</u> – The total expenditure for libraries including depreciation on asset for the provision of the service costed Council $484K over the past year. Yest, Council needs to work under the strict guidance and supervision of the State Library Service, regulated by a different legal mechanism than the *Local Government Act 1993*.

- Rural Fire Service (RFS) Assets – Council will incur an additional annual depreciation expense of $345K if RFS assets are to be recognised in Council books. Council takes a firm view that RFS assets are not controlled by Council and has participated in the public inquiry regarding the recognition of RFS assets. Council will be qualified in its Financial Statements for 30 June 2024.

- Noxious Weeds – The total net cost of service for Council is $72K each year, taking into consideration the Weeds Action Plan Operating Grant of approximately $82K each year.

- Ranger – Council's net cost to manage companion animals within its local government area is approximately $150K – including some other ranger-related activities.

- Cost of Local Government Election – Council has allocated $75K for election expense for the 2024/2025 financial year. There is a strong argument that, because local government has no Constitutional recognition, and is functioning as an extension of the State Government, these democracy-related costs should be borne by the States instead of creating another impost for local councils.

- Audit Fees – the cost to Council has considerably increased for audit fees since the NSW Audit Office formally took over the auditing of local Council in NSW. Recently, the audit cost from financial year end 2023 to 2024 has increased by 25%. This fee is funded by Council's General Fund revenue that could have been used for e.g., road infrastructure maintenance or renewal.

d. Assess the social and economic impacts of the rate peg in New South Wales for ratepayers, council, and council staff over the last 20 years and compare with other jurisdictions.

It is difficult to compare the social and economic impact of the rate peg in NSW with other jurisdictions. Apart from Victoria, the other states and territories do not regulate rates income. Rather, Councils are permitted to adjust the level of their rates income to align with their prepared budget for each financial year. IPART's "Review of rate peg methodology" states the following (p. 30):

Jurisdiction	Method
Victoria	• Uses a rate cap method, similar to NSW. The rate cap is set equal to the December forecast of the CPI from the Victorian Department of Treasury and Finance. • The Essential Services Commission (ESC) is responsible for recommending rate cap increases to the Minister for Local Government. • The Victorian method is flexible, as shown in 2022-23 when the ESC recommended that the rate cap should not be set outside of the historical range of 1.50% to 2.50%.[a] • Councils can seek approval for a higher rate cap from the ESC, if the rate cap decision does not meet their needs. • The rate cap for 2022-2023 was set at 1.75%.[b]
Western Australia, Queensland, South Australia, Tasmania and Northern Territory	• In these jurisdictions councils have the autonomy to set their rates at the level needed to achieve the required income in their budgets.[c] • Each jurisdiction has varying legislative requirements and restrictions on councils, but broadly councils have authority to independently set rates. • An example of a restriction is that in Western Australia, a council's income from general rates is limited, such that income from rates cannot exceed 110% of the budget deficit or be less than 90% of the budget deficit.[d]
ACT	• The ACT does not have local governments and instead land rates are set by the ACT government.

a. Essential Services Commission, Advice on the average rate cap for 2022-23, November 2021, p 1.
b. Essential Services Commission, Average annual rate caps.
c. Productivity Commission, 5 Year Productivity Review - Supporting Paper No. 16 – Local Government, August 2017, p 10.
d. *Local Government Act 1995* (WA), s 6.34.

Particularly to Tenterfield Shire Council, it is evident that over the past years the rate peg prescribed by IPART fell significantly short of the actual cost of conducting business operations. This led to Council having significant operating deficits, which increase with growths in the construction cost index, wages growth (including superannuation increases) and utility charge adjustments.

The impact of carrying such operating deficits results in Council having no other option than to move towards Special Rate Variations to maintain services and in some instances, having to terminate particular services or reduce service levels across the local government area.

Council currently projects an operating deficit of $3.513 Million for the 2024/2025 financial year (before capital income), with this operating loss growing to approximately $4.026 Million by 2033/2034 if no SRV is initiated. As a comparison to prior financial years the cost of depreciation particularly on infrastructure assets has increased by $1.8 Million, as the cost of construction and labour increased significantly over the past two years.

Importantly, Council also faces regional inflation which is driven by changes in the national construction policy and industry arena and disaster recovery projects where construction specialists and general labour find more employment opportunities in areas either recovering from natural disasters (e.g. Lismore) or moving towards high growth areas such as Brisbane, Toowoomba and Western Sydney – thereby increasing consultant and contractor cost for Council in a rural and regional setting.

This not only has an impact on the community, but also Council staff who are confronted with strenuous and highly anxious processes to reduce "internal" expenses to bring the budget in the black, e.g. revisiting the organisational structure to identify possible savings and terminating services like tourism – handing it over to the local Chamber of Commerce.

Mentioning another example, Council had to close its School of Arts for several months (a major tourist attraction to town but as a business unit not generating adequate income), which not only impacted the community but also particular staff members who were consequently made redundant.

As the rate peg affects the Council's General Fund, it is also important to note that Council also operates its own Water, Sewer and Waste functions. With growing costs of maintaining and renewing assets, the total cost of conducting an efficient business is challenged by community's capacity to pay.

The increase in fees and charges of these externally restricted funds are separate from ordinary rates per se, however, adds to the bottom line of ratepayers' combined annual rates and charges invoice.

Council's inability to maintain and renew its assets, especially critical assets such as roads and bridges, further impacts on the quality of life of its residents.

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

It is evident that the current rate peg methodology does not reflect the revenue required for Council to be considered financially sustainable, nor does it reflect the realistic construction cost index for regional councils.

It is also evident that Council relies heavily on Operating and Capital Grants. The Financial Assistance Grant (FAG) plays a crucial role in providing Council with ongoing revenue assistance, however, it is important to urgently revisit this funding model:

a) FAGs were initially implemented as representing one percent of total Commonwealth revenues. It now represents less than 0.5% of these revenues, yet Local Councils are expected to financially survive still delivery much-needed service, take on more expenditure as cost-shifting for the State Government, and survive the compounding effect of the State Government's rate peg policy. Therefore, the Federal Government has to increase the total available FAGs available to Council – which should result in a higher level of financial distribution to this Council.
b) Potentially the distribution FAGs across NSW could also be reassessed. Councils with significant asset infrastructure backlogs and unsatisfactory renewal and maintenance ratios could potentially be allocated more funds compared to metro-based Council which have significant other own source revenues to assist them in generating income and therefore carry healthy unrestricted fund reserves.

Instead of seeking additional funds through an SRV process, Councils could potentially lodge funding applications to receive additional funds through a FAG assessment and restricting those funds for specific infrastructure renewal and maintenance related projects. This option could especially be helpful in the instance of communities which have been categorised as low-income generating communities.

Additionally, the rate peg methodology should be deemed inadequate in understanding the actual needs of rural Councils and should frankly be abolished. The expectations of communities should inform the Integrated

Planning and Reporting Framework and associated rate rises, in conjunction with CPI-considerations. This approach should provide for community expectations, their ability to afford these hopes, and the Council's ability to deliver these projects are intrinsically linked.

f. Review the operation of the special rate variation process and its effectiveness on providing the level of income Councils require to adequately meet the needs of their communities.

The rate peg fails to meet the desired income to provide some "General Fund" services to Council's community and maintain and renew its infrastructure assets into the future. The NSW Office of Local Government established guidelines for applying for an SRV to IPART. These guidelines are:

- A demonstrated need for higher increases to charges;
- Community awareness/acceptance of their rate rise plans and that the 'full cumulative increase' of the proposed special variation in percentage terms has been communicated;
- Reasonable impact on ratepayers;
- A process to exhibit relevant council documents to the public;
- A history of well-documented council productivity improvements and cost containment strategies.

Tenterfield Shire Council, having gone through the process of recently applying for an SRV, views the required SRV-process to be draining – leaving the organisation in a state of exhaustion. To conduct an independent assessment on the community's capacity to pay, Council must engage external consultants, driving up the actual cost of preparation of the application. Further, arguably the most negative aspect is that the SRV is proposed for future years, however, the data assessment for these applications is based on past trends and census findings consisting of old and outdated data. This inconsistency should lead to the both the process and its application being questioned. Further, IPART's direction is for Council to use a 2.5% rate peg percentage for future year projections e.g., developing a Long Term Financial Plan over the next 10 years – providing the community in all probability with a false picture of the Council's operating results at the time of community consultation.

The prescribed suite of Integrated Planning and Reporting Framework (IPRF) documents also require a substantial number of resources to be developed – which includes further significant community consultation – as well as to maintain and monitor.

Rural Councils face an extreme shortage of key staff, and the challenge to attract and retain well qualified and experienced staff, lead to increased costs of engaging consultants or contractors. Even with an up to date set of IPRF-documents, the local government industry is ever changing with an increasing trend for Councils to provide ever-increasing qualitative data to the State Government without any demonstrated or perceived industry benefits.