the Southern City

Assessing Mandurah's Revenue Raising Capacity

City of Mandurah Submission to the Productivity Commission's Study into Local Government Revenue Raising Capacity

July 2007

Introduction

The City of Mandurah is pleased to provide a submission to the *Productivity Commission Study into Local Government Revenue Raising Capacity*. The City's submission will endeavour to respond to the study's Terms of Reference:

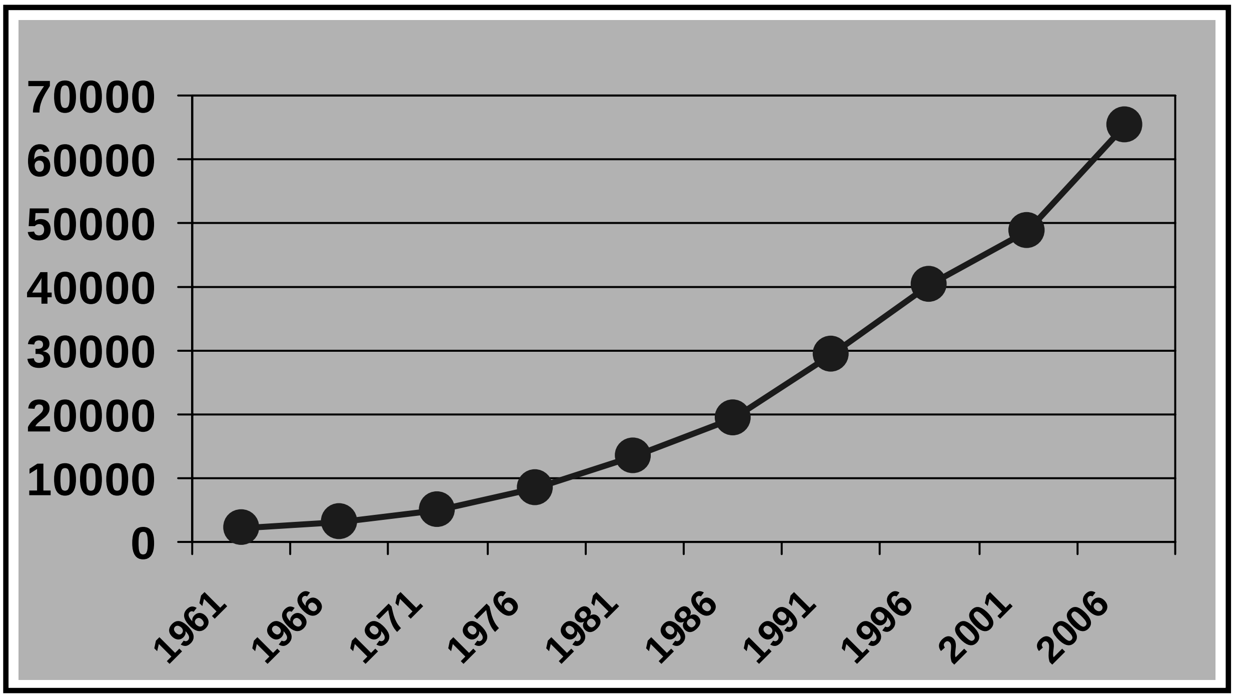
- The capacity of different types of councils (for example, capital city, metropolitan, regional, rural, remote and indigenous) to raise revenue and the factors contributing to capacity and variability in capacity over time
- The impacts on individuals, organisations and businesses of the various taxes, user charges and other revenue sources available to local government
- The impact of any State regulatory limits on the revenue raising capacity of councils.

The City's submission begins by outlining the rapid growth that the City has faced over the past 30 years, and the impact that this growth has had upon its ability to provide community infrastructure and services. It also summarises existing restrictions placed upon the ability of Western Australian Councils to raise revenue, and outlines existing inequities in the WA property rating system.

Our submission also explores the issue of Federal/State Government funding of Councils, and in particular, Financial Assistance Grants, and outlines a number of potential solutions that have been put forward to assist Councils – and particularly 'rapid-growth' Councils – to fund the provision of community infrastructure and services.

The 'Hyper-Growth' of Mandurah

Mandurah's Population Hyper-Growth 1961-2006



Mandurah, along with a small group of other Australian Local Governments, currently resides in the 'hyper-growth' category, defined as having average annual population growth over the 5-year period 2001-2006 in excess of 5% per annum. Currently, there are only nine hyper-growth Councils in Australia, and all are located in Western Australia, Victoria and Queensland. However, only in Western Australia and Queensland do non-metropolitan hyper-growth Councils exist.[1]

Mandurah is currently experiencing 5-year average growth of 6.0%, which is four times the Western Australian 5-year average (1.5%), and five times the national average (1.2%).

Australian Hyper-Growth Councils

Metropolitan Councils	2001-2006 Average Annual Growth Rate	Non-Metropolitan Councils	2001-2006 Average Annual Growth Rate
Perth (WA)	11.5%	Capel (WA)	8.2%
Melton (VIC)	9.5%	**Mandurah (WA)**	**6.0%**
Wyndham (VIC)	7.1%	Miriam Vale (QLD)	5.1%
Wanneroo (WA)	6.5%		
Melbourne (VIC)	5.8%		
Cardinia (VIC)	5.1%		

[1] *ABS Regional Population Growth* – February 2006

Effects of Rapid Population Growth on Infrastructure Provision

Rapid population growth, or ‘hyper-growth’, has the effect of pushing Councils’ ability to finance infrastructure out of balance. Rather than improving the long-term planning for infrastructure provision, it instead acts to bring forward the timing of when it will be required. Therefore, as population growth increases from its equilibrium point, the demand for infrastructure and services is brought forward, with a consequential negative impact on asset maintenance and operating costs.

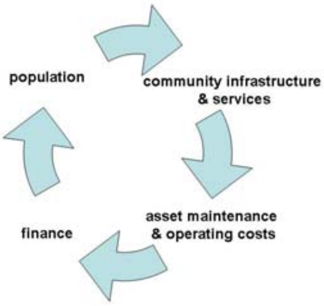


Figure 1 – Equilibrium model

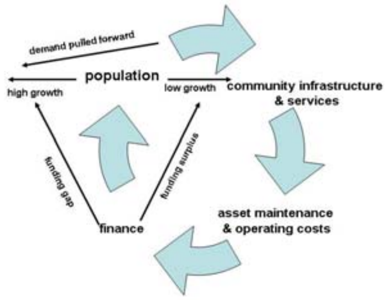


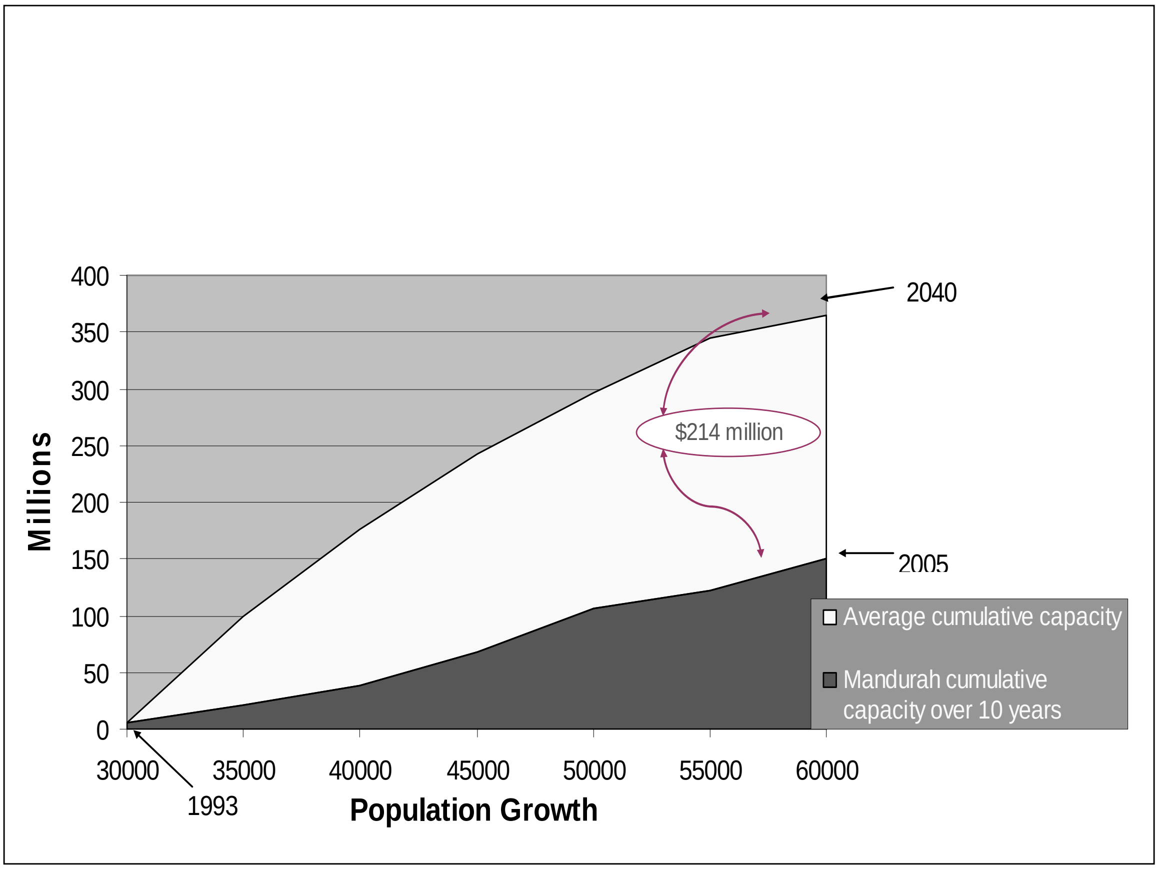
Figure 2 – Impact of growth on the equilibrium model

As Australia’s fastest growing regional city, the City of Mandurah is facing unprecedented demands on its existing infrastructure. The City’s exceptional rate of population growth means that the City of Mandurah is being required to provide as much infrastructure to cater for this rapid population growth in two years as would normally be provided over an eight to 10-year period. Put simply, the accumulation of Mandurah’s rates revenue and its borrowing capacity are being far outstripped by the growth of its population, and with it, the demands on infrastructure provision.

Australian Bureau of Statistics’ data indicates that Mandurah’s population has grown from just over 34,000 in 1993 to more than 65,000 in 2006. Had Mandurah grown at either the current WA or National five-year (2001-2006) average population growth rate (1.5% and 1.2% respectively), the City would not have reached its 2006 population of over 65,000 until either 2036 (based on the WA average) or 2047 (based on the National average).

We estimate that available funding for capital projects (rates, grants, borrowings) would have increased by well over $200 million under this scenario, as the City would have been provided with between 30 and 41 additional years in which to obtain rates revenue, government grants and borrowings. This also means that the City would have had the benefit of manageable debt levels, as its annual borrowing requirement for infrastructure provision would have been considerably less than is currently the case.

Cumulative Capital Opportunity Lost



In summary, whilst Mandurah's population hyper-growth has, to an extent, affected the City's ability to maintain its operations budget, it has seriously affected the City's ability to provide capital infrastructure for its community.

The City cannot afford to fully fund its long-term capital investment and asset replacement plan. Additional loans are not a solution because the City's existing indebtedness does not allow significant borrowing before debt service levels are breached. In addition, debt service costs create a drain on the City's future financial position, and reduce the amount available for subsequent investment. This differs from State Government borrowings, which often generate future income streams.

The higher the rate of growth experienced, the greater the funding gap becomes, and hence the need for external intervention becomes greater. Although the City of Mandurah is committed to maximising its revenue streams, this alone will not adequately allow it to accumulate sufficient resources for infrastructure provision.

Australian and State Governments have the capacity to provide interest-free, long-term loans with deferred repayment terms (possibly under a tri-level funding model). They can act in a manner that commercial lenders cannot, providing investment funds which will ultimately benefit the Local, State and National economy. An initiative such as this would enable the City of Mandurah to provide community infrastructure as required, and repay its debt from future surpluses. In particular, interest-free periods would greatly assist Local Government's ability to manage its debt level during the initial repayment stage.

Councils' Revenue Raising Capacity

WA Local Governments are hamstrung by their inability to set fee structures for services such as Building, Planning and Environmental Health. Fees are set by State Government Statute, and cannot be altered by Local Governments. Furthermore, fee structures are not keeping pace with the cost of providing the actual services, and this is particularly evident in high-growth LGAs.

For example, in the 2007/08 financial year, the City of Mandurah's Planning operating expenses amounted to approximately $2 million, whereas its revenue was only $635,000 – a shortfall of roughly $1.36 million. Because the City is unable to increase its Planning charges to recover its costs, it must therefore either fund the shortfall via other avenues, or reduce its expenditure on community services and infrastructure.

The *Local Government Act 1995; Section 6* stipulates that Local Governments cannot produce a profit from fees and charges; they are only permitted to recover their costs. However, Councils cannot recover their costs if they are unable to set their fee structures in accordance with their expenses.

Fortunately, WA Councils are not subject to rate-capping, unlike their NSW counterparts. Local Governments in Western Australia are generally free to determine their revenue-setting policies in areas such as rates, user charges etc. This theoretically allows Councils to set their rates in accordance with their annual expenditure, although the political reality of Local Government often results in rates increases often being kept to a minimum in order to avoid a community backlash at the following Local Government Election.

Another stumbling block on the road to Local Government financial sustainability is the propensity of State Governments to apply statutory exemptions to organisations that enable them to either pay no rates, or minimise their Local Government Rates liability.

For example, retirement villages that are operated by 'charitable institutions' should not be provided with rates exemptions, except for any component of the village that provides 'high-care' accommodation. The institution should not be offered a rates exemption simply because it has 'charitable' status; instead it should be offered an exemption based on the type of accommodation it provides i.e. high-care accommodation.

Also, State and Federal Government organisations are often automatically exempted from paying Local Government rates, which in some cases denies the affected Local Governments substantial rates revenue which they otherwise would receive had the property owner been a private individual or organisation. Examples of this include the Fremantle Port Authority and the Department of Defence. This practice is unfair, and should cease.

Rating of Properties

Income from rates is a critical element in Local Government funding. For the City of Mandurah, rates represent approximately 55% of all revenue, and are almost the only source of revenue that is available for general distribution, rather than tied to a particular service. However, the current land valuation method used in Western Australia is inconsistent.

An examination of the way in which land is valued by the WA Valuer General's Office (VGO) shows that:

- For improved land, the VGO assesses how much a property would realise in annual rental if it was available on the rental market. This amount, known as the Gross Rental Value (GRV), is used as the basis for rate assessments. However, there is no correlation between GRVs and the market value of land.

- In the case of vacant land, the method is different. Because vacant lots have no rental value, an artificial rental value is calculated, based on 5% of the market value of the land.

Particularly at a time of high land values, this means that GRVs for vacant land are always higher than for improved properties. This in turn means that higher rates are paid for vacant land than for improved properties. It also means that when a property is re-classified from vacant to improved, the City is in the position of not only having to refund a portion of rates for that year, but it also has a lower expectation of rates income for the future.

This anomaly is acknowledged by the VGO, who nonetheless expects that Local Governments will simply adjust their rates per dollar to compensate for this inconsistency. However, it is not the role of Local Government to use tax rates to provide an offset for a valuation system which is demonstrably inconsistent. It is the role of Local Government to provide as much equity as possible through its tax rate, but it is the responsibility of the VGO to provide a property system that provides equity on the valuation side.

This situation could be resolved by the introduction of an alternative valuation method, such as the 'Capital Improved Values' method, under which improved properties always have a higher rateable value than vacant land. Under this method, when a property is re-classified, the rate assessment is higher, and future rate income prospects for the City improve.

It is important to note however, that whilst the introduction of a 'Capital Improved Values' method of property rating would not necessarily provide additional revenue to the City, it would create greater equity for ratepayers.

Western Australia is the only Australian State to rely solely on GRVs as a property valuation method for rating purposes; however, the WA VGO has stated that there is no intention to change the current valuation system. The existing GRV system is illogical, and should be abolished; however this will not occur without the support of the Western Australian Government.

National Financial Sustainability Study of Local Government Report

The *National Financial Sustainability Study of Local Government* report was released in late 2006 by PricewaterhouseCoopers on behalf of ALGA, with the objective of developing a detailed plan to:

- Enable Councils to better meet their fiscal obligations, as well as the growing demands for infrastructure and services

- Provide a sound approach for targeted support to Local Government for consideration by other spheres of government.

The terms of reference for the study included assessing Local Government's viability; identifying issues affecting sustainability; developing recommendations to improve sustainability; and investigating potential reforms of inter-government funding. The report made a number of recommendations, both for internal reforms and inter-government funding. Among its internal reform recommendations was for Councils to:

> *'work with State Government to remove or relax legislative impediments and improve the capacity of local government to raise revenue from its own sources'.*

A key recommendation on inter-government funding was the establishment of a new *Local Community Infrastructure Renewals Fund* (LCIRF), to support councils in the more timely funding of renewals work for existing community infrastructure such as community centres, aged care facilities, libraries, health clinics and sport and recreation facilities. This fund would be based on the existing Australian Government *Roads to Recovery* program, and provide similar funding for general infrastructure renewal and replacement.

Whilst the City of Mandurah supports the implementation of the *Local Community Infrastructure Renewals Fund,* it must be recognised that this program would not assist rapid-growth Local Governments with the provision of new infrastructure. An additional LCIRF model, or a sub-category, should be established to assist rapid-growth (3%+ per annum 5-year average growth) and hyper-growth (5%+ per annum 5-year average growth) Councils with the provision of new infrastructure.

The City of Mandurah's submission fully supports the National Sea Change Taskforce's proposal to provide an additional *Community Infrastructure Fund* to support the provision of new infrastructure, particularly in rapid-growth areas. This proposal was highlighted in the Taskforce's April 2007 discussion paper – *A Policy Framework for Coastal Australia.*

However, whilst we support the Taskforce's proposal, we also consider that eligibility parameters should be established for the proposed additional *Community Infrastructure Fund*, primarily guided by historical growth trends being experienced by Councils (five-year average annual growth rates as determined by the Australian Bureau of Statistics). On the other hand, the LCIRF model proposed by the PWC report should be made available to all Local Governments, similar to the Australian Government's *Roads to Recovery* program.

Systemic Sustainability Study Report – *In Your Hands; Shaping the future of Local Government in Western Australia*

The *Systemic Sustainability Study*, undertaken by WALGA, released its final report in December 2006. The report referred to the difficulties faced by rapid-growth Councils in both providing new infrastructure and maintaining existing infrastructure, and recommended consideration of establishing a development agency model to share risk and cost in development in rapid-growth LGAs. It is vital that other levels of government understand the infrastructure provision issues faced by rapid-growth Councils, and for this reason, the concept of a development agency to assist with infrastructure provision holds merit.

There is also considerable merit in the suggestion under Section 4.9.2 of the *State Infrastructure Strategy Green Paper*, for greater infrastructure coordination among the three levels of government:

> *The Commonwealth and States could consider establishing single 'entry point' offices for consultation on infrastructure issues. Local government could participate in such an initiative*[2]*.*

The *Systemic Sustainability Study* report also called for a more transparent and sustainable funding model for roads and associated infrastructure to be developed, to relieve an estimated $120 million annual infrastructure deficit faced by Western Australia Local Governments. Section 4.9 of the *State Infrastructure Strategy* discusses intergovernmental aspects of infrastructure provision, noting that both State and Local Governments are heavily reliant on Australian Government funding for infrastructure and service provision.

In line with recommendations previously made by the Australian Local Government Association (ALGA), the *Systemic Sustainability Study* report also recommended revising the escalation methodology for FAGs from a mix of population growth and CPI to a new escalation formula tailored to Local Government cost movements (e.g. a combination of the Australian Bureau of Statistics (ABS) Wage Cost Index and Construction Cost Index coupled with population growth). The report noted that since 1997-98 Councils around Australia have lost the equivalent of $170 million in financial assistance grants from the Commonwealth, reflecting policy shifts away from a funding model shaped by population growth in favour of an approach adjusted against an inflationary indicator.[3]

The Study further recommended that State Governments should provide funding support to encourage Local Government efficiency and asset management reforms. The report noted that a significant proportion of councils have inadequate in-house skills to improve efficiency and to establish robust asset management and financial plans. It recommended that WA Councils embrace the *Western Australian Asset Management Improvement Program* (WAAMI), and further suggested that significant investment by the Western Australian Government was necessary to strengthen Local Government's asset management capacity.

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[2] *Framework for the State Infrastructure Strategy – Green Paper;* Government of Western Australia; September 2006; p.61

[3] *Systemic Sustainability Study*; Western Australian Local Government Association; December 2006; p.20

The New South Wales Government recently released a proposed new framework for Local Government asset management, in a move to create a consistent State-wide approach to improving asset management capacity. It is understood that the NSW Government is to provide funding support to help Local Governments implement the reforms, which will require Councils to develop long-term asset management and 10-year strategic and financial plans. Similar programs have already been implemented in Queensland, Victoria and Tasmania.

The City of Mandurah supports the development and implementation of State-wide (and potentially Nationally) consistent asset management plans for Local Government, and calls upon the Western Australian Government to provide financial support to assist with the implementation in WA of a similar program.

The *Systemic Sustainability Study* report also recommended substantial State Government assistance to help enhance Local Government sustainability. It proposed that the WA Government's *Connecting Local Government* program be expanded, and that a new program - *Big Ideas for a Big State* – be established, with an indicative budget of $25 million to address and fund the anticipated range of Local Government capacity building and rejuvenation projects.

The WA Government has allocated $3 million in 2006/07 under its *Connecting Local Governments* initiative, to encourage Councils to undertake voluntary structural reform. Individual grants of up to $50,000 are available for Local Governments to undertaken feasibility studies, with up to $200,000 available for implementation of projects.

Whilst the City supports the WA Government's *Connecting Local Governments* initiative as a means of helping Councils to help themselves, it is apparent that a number of WA Councils do not consider structural reform necessary. We believe that the extent of necessary structural reform will at some stage involve legislative intervention by State Government, particularly where boundary changes and amalgamations are proposed. Nonetheless, blanket amalgamations are not appropriate; rationalisation of Local Government is the key, not amalgamation.

Financial Assistance Grants

The current method of distributing the ‘General Purpose’ grant component of Financial Assistance Grants (FAGs) requires overhaul. Under the current distribution model, the general purpose grant component is apportioned by the Commonwealth Grants Commission to State and Territory Grants Commissions on a per capita basis i.e. based on the population of each State and Territory. However, when the intra-State distribution occurs, these grants are then apportioned to Local Governments based on the principles of full horizontal equalisation and the minimum grant.

The existing method of apportionment results in larger states, such as NSW and Victoria, automatically receiving larger grants (due to their large State populations), regardless of their actual need. NSW, and particularly Victoria, also have relatively low numbers of Councils relative to their total State general purpose grant allocation.

As a hypothetical example, assuming that each Council in NSW, Victoria, Queensland, South Australia and WA was allocated an equal portion of their State’s FAG general purpose grant, the result would be as follows[4]:

State	2004/05 General Purpose Grant (Actual Entitlement)	No. of Councils per State	Theoretical Entitlement per Council
NSW	$374.28m	155	$2.41m
VIC	$276.96m	80	$3.46m
QLD	$217.01m	157	$1.38m
SA	$ 85.15m	74	$1.15m
WA	$110.64m	142	$0.78m

This highlights a number of issues. Firstly, Western Australia has too many Councils; hence the need for the WA Government to continue to support structural reform of Local Government. Second, it highlights the inequity of having two separate methodologies for inter-State and intra-State general purpose grant allocations. The existing method favours States with larger populations, at the expense of States with large geographic areas but relatively small populations.

As an example, the Local Governments of Mandurah in WA, Rockhampton in Queensland, Coffs Harbour in NSW and Greater Shepparton in Victoria are each classified as Urban Regional Medium (URM) under the Australian Local Government Classification System. However, whilst all of these Councils have similar demographics and population sizes, the Western Australian and Queensland URM Councils receive a considerably smaller general purpose grant than their NSW and Victorian counterparts (Mandurah is currently the only URM Council in Australia to receive the minimum grant):

Local Government Area	**Local Government Classification**	**Population (June 2006)**	**General Purpose per capita Grant (2004/05)**
Greater Shepparton (VIC)	Urban Regional Medium	61,420	$82.82
Coffs Harbour (NSW)	Urban Regional Medium	68,315	$61.80
Rockhampton (QLD)	Urban Regional Medium	60,730	$22.98
Mandurah (WA)	Urban Regional Medium	65,273	$16.28

[4] *2003-04 Report on the Operation of the Local Government (Financial Assistance) Act 1995* – Department of Transport and Regional Services – 2005; p.42

This funding inequity is particularly apparent in Western Australia, which has more minimum-grant Councils than any other State (28 in 2004/05), which equates to 70% of WA's population being covered by the minimum grant.

Whilst Queensland and Western Australia are similar in having large geographic areas, and hence a large number of rural/remote 'high-needs' Councils, they differ significantly in their metropolitan district composition. Western Australia currently has 18 'Urban Development' Councils within the Perth Statistical District, whilst Queensland has only two within its metropolitan area, Redcliffe and Logan[5].

Also, whilst the number of minimum-grant Councils in Queensland is decreasing (11 in 2002/03; 3 in 2006/07), the number of WA minimum-grant Councils is steadily increasing (26 in 2002/03; 30 in 2006/07). This outcome highlights the inequities that occur when FAGs are apportioned via differing methodologies in each State, and the need for a national distribution model. The City of Mandurah contends that in order to ensure equity between the States, Financial Assistance Grants should be distributed directly to Local Governments by the Commonwealth Grants Commission.

Horizontal equalisation is the process of allocating funds to ensure that each Local Government in a State or Territory is able to function, by reasonable effort, at a standard not lower than the average standard of other local governing bodies in that State or Territory. The minimum grant principle ensures that each Council receives at least a minimum level of general purpose grant assistance, regardless of its perceived need.

'Disability factors' are social, economic or physical characteristics that affect a Council's relative ability to provide services, or to raise revenue. Factors are determined by State and Territory Grants Commissions, and include location, socio-economic disadvantage, and climate. Weightings are applied to the assessed expenditure need and revenue capacity for each Local Government, resulting in a Council with a high disability factor rating receiving an increased general purpose grant.

Mandurah is currently assessed by the Grants Commission as having few disability factors, hence its inclusion on the minimum grant list. However, we contend that the disability factor criteria should be widened to include 'long-term rapid population growth'. Currently, the only disability factor criteria that relates to population growth is 'extraordinary planning' which takes into account projected future population growth (based on highly conservative State Planning Authority data), but does not adequately recognise existing long-term rapid growth as a disability factor.

We believe that long-term rapid population growth should be considered a disability factor for the purposes of determining the general purpose grant allocation. Each LGA's population growth should be assessed via Australian Bureau of Statistics' *Regional Population Growth Australia* data, based on five-year average annual growth rates. The higher the five-year average annual growth rate, the higher the disability factor should be.

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[5] *2003-04 Report on the Operation of the Local Government (Financial Assistance) Act 1995* – Department of Transport and Regional Services – 2005; p.235

Recommendations

- Western Australian Councils should be permitted to set fee structures for Local Government services (Western Australian Government)

- Retirement villages that are operated by 'charitable institutions' should not be provided with rates exemptions, except for any component of the village that provides 'high-care' accommodation (Western Australian Government)

- State and Federal Government organisations should not be automatically exempted from paying Local Government rates (Western Australian and Australian Governments)

- Abolish the 'Gross Rental Value' method of valuing land, and introduce an alternative valuation method, such as the 'Capital Improved Values' method (Western Australian Government)

- State Governments should work with Local Governments to remove or relax legislative impediments and improve the capacity of local government to raise revenue from its own sources (Western Australian Government)

- Establish a new *Local Community Infrastructure Renewals Fund*, to support councils in the more timely funding of renewals work for existing community infrastructure (Australian Government)

- Establish an additional *Community Infrastructure Fund,* to support the provision of new infrastructure in rapid-growth areas; eligibility parameters should be established, primarily guided by historical growth trends being experienced by Councils i.e. based on five-year average annual growth rates as determined by the Australian Bureau of Statistics (Australian Government)

- Revise the escalation methodology for Financial Assistance Grants from a mix of population growth and CPI to a new escalation formula tailored to Local Government cost movements e.g. a combination of the Australian Bureau of Statistics Wage Cost Index and Construction Cost Index coupled with population growth (Australian Government)

- State Governments should provide funding support to encourage Local Government efficiency and asset management reforms (Western Australian Government)

- Continue to promote the *Connecting Local Governments* initiative as a means of helping WA Councils to achieve structural reform (Western Australian Government)

- Financial Assistance Grants should be distributed directly to local governments – via a national distribution model - by the Commonwealth Grants Commission (Australian Government)

- Long-term rapid population growth should be considered a disability factor for the purposes of determining the FAGs general purpose grant allocation (Australian Government)

Mark Newman
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