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Dear Dr Salerian

I am writing in response to the Productivity Commission's invitation to provide written comments on the Commission's draft research report *Assessing Local Government Revenue Raising Capacity*. I regret the delay in replying but felt that my response may benefit from the Roundtable held by the Commission on 27 February 2008. I appreciate the opportunity for the Department to be included in the Roundtable.

While the draft report is generally factually correct, there are a number of clarifications or amendments I believe should be made for NSW, and these are outlined below.

Finding 6.5 - This finding appears to ignore the narrative and analysis in the report (pp103-105) that "...rate pegging in New South Wales is not absolutely binding" (p103) and that councils can seek special rate variations that are generally supported by the Minister. In this regard, the report notes that, for 2007/08, the approval of special rate variations "...resulted in rate increases in some councils of just below 10 per cent, equivalent to nearly three times the rate peg". The finding also appears to contradict the observation that, between 1998/99 and 2005/06 real rates revenue per person in NSW was largely unchanged, whereas in Western Australia, which does not have rate pegging, real rates revenue per person fell slightly.

I therefore request that Finding 6.5 be amended as follows:

Rate pegging appears to dampen revenue raising from rates in New South Wales relative to other States, although this is mitigated somewhat by the system of special rate variations, which allows councils to apply for rate increases above the rate peg amount.

Chapter 2.1: An introduction to local government – This section provides an overview of the institutional and functional characteristics of local government throughout Australia. In doing so, it bases much of its discussion on the concept of "local governing bodies", which are eligible to receive financial assistance from the

Australian Government under the *Local Government (Financial Assistance) Act 1995*. For 2005/06, this includes 663 local governments and 37 declared bodies. In NSW there are three declared bodies – the Lord Howe Island Board (LHIB), the Silverton Village Committee and the Tibooburra Village Committee. The LHIB is constituted under the *Lord Howe Island Act 1953*, while the Silverton and Tibooburra Village Committees are incorporated bodies under the *Associations Incorporation Act 1984*. The LHIB and, to a lesser extent the Village Committees, perform some of the functions of a local council. All three bodies are entitled to receive financial assistance grant funding under the Local Government (Financial Assistance) Act, although they are not entitled to a share of the local roads component, as they are not responsible for local roads.

While I appreciate the reasoning for including these bodies within the discussion in Chapter 2.1 and the comparative information in Table 2.1, in the absence of explicit qualification it does lead to some confusion and potentially misleading conclusions for NSW. In Table 2.1, for example, it lists the minimum population for a local governing body as 57. This figure relates to Tibooburra Village Committee. However, the council with the lowest population in NSW is Urana Shire, with approximately 1,400 residents. This difference may lead some readers to assume that the data for NSW in Table 2.1 is not correct.

I therefore suggest the following amendments:

- Para 1, p9 – amend the end of the paragraph to state “*These include the two village committees within the unincorporated area of NSW and Lord Howe Island, the Outback Areas Community Development Trust...*” Alternatively, this qualification could be included as a footnote.
- Para 6, p10 - amend the end of the paragraph to state “*...(such as the Outback Areas Community Development Trust in South Australia and the Village Committees in NSW).*”
- Para 2, p11 – include a footnote for NSW listing the LHIB and the Village Committees as not having local road responsibilities.
- Table 2.1 – Either exclude from the NSW figures those bodies that are not constituted under the NSW *Local Government Act 1993* or, alternatively, include a note stating that the figures include the LHIB and the Silverton and Tibooburra Village Committees.

Rate concessions – Councils in NSW are compensated for 55 per cent of the cost of rate concessions provided under s575 of the NSW Local Government Act (Reductions for eligible pensioners). This arrangement is noted correctly at p99. However, pXXX states that NSW councils receive “...only partial compensation for concessions...” This phrase infers a level of compensation of less than 55 per cent of the actual cost. At p175, the report notes that councils are reimbursed “...half of the value of concessions”. For consistency and accuracy reasons, it is requested that the actual amount of 55 per cent be applied in each instance.

Chapter 6.2: Constraints on fees charges and contributions – It should be noted, in relation to the report’s discussion on developer contributions (pp113–118), that the NSW Government is currently reviewing developer contribution arrangements for councils in NSW. Details can be found on the Department of Planning’s website at www.planning.nsw.gov.au

I trust these clarifications and comments are of assistance.

By way of general comment, I would also like to indicate that the issue of community willingness to pay, as discussed in Chapter 4, is addressed in NSW in some detail through the special variation (rate peg) process. To be successful, applications by councils to exceed the rate peg must be accompanied by a sound business case with demonstrated community support.

I would also like to draw your attention to an improved planning and reporting process currently under development in NSW. Integrated planning and reporting will require councils to prepare long term strategic plans with fully costed delivery programs, in consultation with their communities. This will further improve the ability of councils to forecast and plan for required expenditure on services in the context of realistic revenue raising capacities.

I have attached for the Commission's reference a detailed summary of the legislative arrangements operating in NSW for local government rates, fees and charges, grants borrowings and investments.

Yours sincerely

Garry Payne AM
Director General

NSW LOCAL GOVERNMENT REVENUE RAISING

1 Sources of council income

[Section 491](#) of the *Local Government Act 1993* (the Act) sets out the main sources of a council's income. They are as follows:

- rates
- charges
- fees
- grants
- borrowings
- investments.

Rates and annual charges revenue is generally the most important source of revenue for councils, followed by grant revenue. These sources of revenue are relatively stable from year to year and allow councils to plan and use sound financial budgeting methods to achieve their objective. User charges are commonly levied in water usage, trade and extra domestic waste management collection. Fees are generally charged for goods and services, providing information and in connection with a council's regulatory functions.

The following comparative data identifies the percentage and amount received for all NSW councils in 2005/06.

Comparative performance for 2003/04, 2004/05 and 2005/06

Table B2.11

Sources of income from continuing operations	2003/04 %	2004/05 %	2005/06 %
Rates and annual charges	47.7	48.4	48.2
User charges and fees	16.8	16.7	16.5
Interest	3.8	4.2	4.2
Grants	16.0	15.3	16.4
Contributions and donations	11.5	10.8	9.5
Other revenues	4.2	4.6	5.2
Total income from continuing operations	100.0	100.0	100.0

The total dollar amounts and the percentage change between 2004/05 and 2005/06 are shown in Table B2.12.

Table B2.12

Sources of income from continuing operations	2003/04 \$m	2004/05 \$m	2005/06 \$m	2005/06 change %
Rates and annual charges	3,132	3,313	3,499	5.6
User charges and fees	1,108	1,148	1,200	4.5
Interest	252	288	308	6.8
Grants	1,053	1,053	1,188	12.9
Contributions and donations	758	743	693	-6.7
Other revenues	279	315	377	19.9
Total income from continuing operations	6,582	6,860	7,265	5.9

Factors that may have led to changes in rates and annual charges, apart from the approved 3.5% general rate increase, include special variations, supplementary valuations, additional rateable properties and increases in unpegged rates and charges such as water, sewerage and domestic waste management.

Data sources for this indicator: Council financial reports, income statement including capital receipts, excluding gain from sale of assets and interest in joint venture/associates.

2 Rates

Although the actual position has always varied from council to council, the main financial resource of a council has been, traditionally, rating - in particular, ordinary rating.

It is generally acknowledged that rating should be considered as one of several elements, and a very important one, available for usage in a council's overall revenue raising system and finances.

The distinguishing feature of the Act is that it allows councils to strike a better balance between ordinary rate revenue and the revenue requirements of particular works or services which may be more appropriately financed by way of special rating or annualised or pay for use charges or fees or combinations of one or more of these elements.

The Act provides unprecedented flexibility between rating and charging options in recognition of the need to encourage councils to use modern pricing policies and techniques to manage demand and resources. Simultaneously, the Act seeks to achieve heightened transparency of councils' financial activities and to expose their revenue decisions to greater public scrutiny and input in the furtherance of local accountability and responsibility.

3 Types of rates

[Section 492](#) of the Act provides that rates are of 2 types:

- ordinary rates
- special rates.

It should be noted that rates and charges will not be subject to GST.

4 The ordinary rate

By virtue of [section 494](#) of the Act, council is required to make and levy an ordinary rate for each year on all rateable land in its area.

This is a mandatory requirement. In that regard, it has been held that a council can be compelled by a court order to make an ordinary rate.

5 Rate pegging

Part 2 of Chapter 5 of the Act, empowers the Minister for Local Government to limit the increases in councils' revenue from general income and also increases in the levels of annual domestic waste management services charges.

Since 1976, a Standing Committee of Department of Local Government and NSW Treasury officers has advised the Minister each year on the maximum "rate pegging" increase that should apply generally in the following year.

The methodology used by the Committee to calculate the recommended variation for general income is to determine the projected annual increase in costs that would be incurred by a typical council delivering services at levels comparable to the previous year.

Rate pegging is applied to the notional general income rate income of the council not to the rates or individual parcels of land. This was introduced from the 1989 year as the former system had resulted in great inequities between properties.

The approved general variation allows councils a moderate increase in income to meet essential service requirements. Councils may need to examine options for productivity savings and expenditure reduction. Councils do not need to take up the increases. If a council does not take advantage of the full rate peg available for a particular year, it can recoup the shortfall in either or both of the next two years.

Councils have discretion to adjust the incidence of rates between categories and subcategories of properties. They must publish the proposed rate structure prior to making the rates each year.

Rate increases over the last six rating periods are:

2002-03	3.3%
2003-04	3.6%
2004-05	3.5%
2005-06	3.5%
2006-07	3.5%
2007-08	3.4%

The rate pegging system has broad community support as a fiscal discipline on councils and the community at large expects councils to exercise tight restraint over expenditures and to make savings through productivity improvements. It is possible that councils have not reviewed their operations to the full extent or achieved similar levels of savings as those required by State agencies.

6 Rate increases over 7 years – section 508A

On 6 May 2004, legislation was passed (section 508A of the Act) enabling a council to apply for a special variation to increase its general income by more than the general variation (rate peg) each year for a number of years (up to a maximum of 7 years).

This has effectively given councils greater flexibility in generating enough income to implement a comprehensive long-term program of improvement for their community. Approval for a special variation under the legislation will only be granted if the council can demonstrate that it has made significant progress in both planning and operational performance, policy development and benchmarking of its activities. The council will need to make a submission to the Minister addressing a number of criteria including a detailed financial plan for at least the next 10 years, a detailed capital works program and evidence of community support for the proposal.

While many councils would not currently be in a position to satisfy the criteria, it is anticipated that the legislation may be an incentive for councils to strive for the high standard of operation that is expected of them.

7 Special variations

Under s508 of the Act, the Minister may approve of a council increasing its annual general income beyond the general variation. When applying for a special variation, councils must demonstrate prudent fiscal management and a level of community support or understanding for the increase. A total of 28 applications for special variations were submitted for consideration for 2007-08. Of these, 25 were approved and 3 were declined.

Generally, an application under section 508(2) will be considered in the following circumstances:

- Where additional income is necessary to finance a project which has regional significance or a demonstrable regional economic benefit. Regional significance and/or benefit would be demonstrated by joint participation by several councils in planning and/or execution of the project or by state/commonwealth participation in planning or contribution of funds towards the project or by demonstrated consistency with a relevant regional management plan (e.g. a catchment blueprint) endorsed by the state government.
- Where additional income is necessary to finance new or enhanced local government services or facilities specified in a comprehensive principal activity statement in the council's draft management plan. Proposals

may include infrastructure maintenance or replacement programs and services related to sustainable natural resource management, waste management, environmental protection, pollution control and protection of public health.

- Where additional income is necessary to meet substantial increases in government contributions or charges (for example: variation of charges by the Valuer General, NSW Fire Levy or Rural Fire Contribution).

In the majority of these circumstances the project funding requirements should have a definite time horizon after which time the special variation would lapse. However, there may be circumstances where the funding requirements are of an on-going nature and in these circumstances the special variation would not lapse. In the case of service enhancements or additional infrastructure operating costs there is an expectation that productivity improvements will be achieved to offset ongoing costs. The proposed initiative is also expected to have clear outcomes which are capable of being measured.

8 The special rate

Council has a discretion whether to make a special rate.

Special rates must be made pursuant to [section 495](#) of the Act but may be levied under either section 495 or the provisions of Division 2 of Part 5 of Chapter 15. In the former instance, the special rates may be levied for works or services provided or proposed to be provided by council (eg town improvement works benefiting a specific locality, tourism promotion benefiting a particular ratepayer sector) or for other special purposes. Special rates relating to water supply, sewerage and drainage must be levied in accordance with the provisions of Division 2 of Part 5 of Chapter 15 (sections 551-553) in all cases where the infrastructure is in situ.

Special rates are also capable of application across all ratepayers. For example, all ratepayers in a council area could be made subject to a special rate intended to finance a project that will benefit the whole of the council area. It should not be levied on properties that will not benefit.

9 Charges

The Act also enables the making and levying of charges. Charges may be annualised or based upon usage. A charge may be made in relation to specified services provided by council (eg provision of water, sewerage or drainage services or the collection of garbage). A charge may be set at a level that enables part or full cost recovery.

Council may impose charges in addition to ordinary rates and special rates or in substitution for special rates that may be made for the same purposes as a charge. The level of a charge can be differentiated according to a broad range of criteria ([section 539](#)).

A charge, when made, has the same characteristics as a rate concerning payment, the accrual of interest (if the charge remains unpaid) and the procedures that may be taken for its recovery.

The system of charges in the Act seeks to confer the maximum possible degree of flexibility, in recognition of the need to allow and encourage councils to implement modern pricing structures and policies for the basic services and utilities concerned.

A charge may be made in addition to an ordinary rate, and in addition to or instead of a special rate, the exception being domestic waste management service revenue raising.

10 Fees

Council may (except as otherwise provided by [section 608](#) of the Act) charge and recover an [approved fee](#) for any service it provides.

Fees if unpaid do not become a debt upon the land and will be recoverable as civil proceedings against the person who requested and was provided with the service to which the fee relates.

11 Grants

Local government financial assistance grants are general purpose grants that are paid to local councils under the provisions of the Commonwealth [Local Government \(Financial Assistance\) Act 1995](#). This legislation also details how the total amount of grant funds is determined and how the funds are to be distributed between the states and territories.

Each state must have a Local Government Grants Commission for it to receive funding and it is the responsibility of these Commissions to make recommendations on the allocation of grants in their state.

The two components of the grants are distributed on the basis of principles developed in consultation with local government.

With the **general purpose component** the Grants Commission attempts to assess the extent of relative disadvantage between councils. The approach taken considers cost advantage in the provision of services on the one hand (expenditure allowances) and an assessment of the revenue raising capacity on the other (revenue allowances).

The **local roads component** is assessed on the basis of council's proportion of the state's population and the lengths of roads and bridges.

The total funds paid to councils are unconditional grants and councils have complete autonomy in deciding how the funds should be spent.

12 Borrowings

[Section 621](#) of the Act enables councils to borrow "at any time" for any purpose allowed under the Act. Borrowing refers to any form of debt incurred where there is an obligation to repay over a fixed term. A council may borrow by way of an overdraft or loan or by any other means approved by the Minister ([section 622](#)).

A council may give security for any borrowing in any manner prescribed by regulation under [section 623](#)(1) of the Act. Currently no regulation is in force for this section. However, the I as the Minister for Local Government am empowered

to impose limitations or restrictions on borrowings raised by a council ([section 624](#)).

Restrictions on borrowings by council are included in the Minister's Borrowing Order. The restrictions are as follows:

A council shall not:-

1. borrow at an interest rate in excess of the indicative interest rate as calculated by the New South Wales Treasury Corporation;
2. borrow for a period of less than thirty (30) days nor for a period in excess of the estimated life of the asset for which the borrowing is made;
3. borrow from any source outside the Commonwealth of Australia nor in any currency other than Australian currency;
4. pay a placement fee exceeding 0.25% of the total amount being borrowed;
or
5. pay a documentation fee, or any other fee associated with a borrowing, exceeding 0.1% of the total amount being borrowed.

Recent changes has allowed councils to borrow funds without Ministerial approval (Circular to Councils 07/35).

13 Internal loans

[Section 409](#) of the Act safeguards moneys raised for a specific purpose by requiring that they be spent on the purpose for which they were raised.

[Section 410](#)(3) allows money that is not yet required for the purpose for which it was raised to be lent (by way of an internal loan) for use by the council for any other purpose if the loan is approved by me as the Minister for Local Government.

14 Investments

[Section 625](#) provides that a council may invest money that is not, for the time being, required by the council for any other purpose. However, this can only be done within guidelines by order of the Minister for Local Government published in the government gazette (No. 94 dated 29/7/05).