



# **Assessing Local Government Revenue Raising Capacity**

***Response to -  
Productivity  
Commission  
Issues Paper***

July 2007

## **Introduction**

Hornsby Shire Council is supportive of the move to review the revenue raising capacity of local governments, particularly in the New South Wales context where fundamental inconsistencies exist between the way the role of NSW local government has been defined by the Local Government Act (1993) and the funding regime in which local governments operate. This inconsistency was a re-occurring theme in the recent NSW Local Government Inquiry 2006 (The Allen Report) commissioned by the NSW Local Government and Shires Associations.

We trust our comments will be of assistance in formulating the draft report. Unfortunately Council feels constrained in responding to a number of the questions as the replies require an assessment of objective or empirical evidence which is not readily available to Council. Therefore please note our comments refer mainly to the experience and environment within which Hornsby Shire Council operates, namely a shire that includes the major centre of Hornsby as well as a number of secondary centres. The shire also includes a rural sector and has large tracts of bushland. It is a shire where service growth and expenditure has grown faster than capital expenditure as the shire has moved from a development and growth area to a maintenance area over the past 15 years

The Productivity Commission's study terms of reference has three strands, namely:

- the capacity of councils to raise revenue,
- the impacts of councils' revenue raising on local constituents, and
- the impacts on councils of regulatory limits imposed by State Government.

This response attempts to address each strand from Hornsby Shire Council's perspective and, where appropriate, also comments in general terms on the philosophy that underlays Council's position.

Hornsby Council also offers additional comment on productivity gains and reducing unit costs because this has been a primary focus for many councils as a means of 'freeing up' revenue in order to redirect it to service provision and infrastructure maintenance.

# **The capacity of councils to raise revenue**

### **Hornsby Council's financial environment**

The Shire of Hornsby is a large outer Sydney council with a population of over 150,000 residents who come from a variety of ethnic backgrounds. The shire includes major centres such as Hornsby itself, secondary centres such as Pennant Hills and Epping, along with villages, islands, river communities and a large rural district stretching from Dural to Wisemans Ferry. The shire is very large by metropolitan standards. Of its 510 square kilometres over 65% is bushland. As noted on the previous page it is a shire where service growth and expenditure has grown faster than capital expenditure as the shire has moved from a development and growth area to a maintenance area over the past 15 years

Council's estimated budget position is set out below, indicating a 'close to break even' position

	<i>\$ million (rounded)</i>		
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>
Operating revenue	-93.49	-96.43	-99.31
Operating expense including depreciation	94.75	96.96	99.05
Net Operating Result	1.26	0.53	-0.26
Capital expenditure	23.85	24.42	24.91
Capital income	-8.21	-7.9	-8.06
Net Operating and Capital Result	16.9	17.05	16.59
Funding sources:			
depreciation	-11.64	-11.64	-11.64
loans, restricted assets	-5.56	-5.29	-4.25
	-17.2	-16.93	-15.89
Budget Result after Funding	-0.3	0.12	0.7

### **Revenue trends at Hornsby Council**

Hornsby Council's primary recurrent source of revenue is the general rate which accounts for approximately 60% of revenues from ordinary activities. Section 94 (Development Contributions) income, which has been Council's prime source of new capital infrastructure funding for the past 15 years is declining because the opportunity for substantial new release development has been effectively exhausted. Future multi-unit development is likely to be on a smaller scale.

Other sources of income for Council are either declining in real or absolute terms, for example income from fees and charges, or occur in the form of one-off windfalls such as grants which often require a matching financial contribution.

## The capacity of councils to raise revenue

### Where the money comes from (estimated)

Income for the 2007/08 to 2009/10 financial years will be derived from several major sources as set out below:

	2006/07* \$ million	2007/08** \$ million	2008/09 \$ million	2009/10 \$ million
Rates and Charges	64.39	67.13	69.36	71.61
Interest	3.14	2.80	2.95	3.10
Fees and Charges	13.56	12.85	13.16	13.43
Grants and contributions	7.62	7.66	7.84	7.99
Other	2.95	3.05	3.12	3.18
<b>Total</b>	<b>91.66</b>	<b>93.49</b>	<b>96.43</b>	<b>99.31</b>

**Rates and Charges :** This includes all ordinary rates, catchments remediation rate, Hornsby Quarry loan rate and garbage charges.

**User Fees and Charges:** This includes fees from development applications and revenue earned from aquatic & sports centres, nursery and pre-schools, commercial waste services, park and oval hire and property rentals.

**Grants and Contributions :** This includes development contributions, the Federal Government's Financial Assistance Grant and numerous smaller amounts from governments for services including nursery and pre-schools, bushfire, children's services, various community services, libraries, roads, various environmental grants, street lighting and pensioner rate subsidy.

**Other :** This includes many items such as fines, recycling income, vehicle private use fees and income from road closures.

### Council rates

Hornsby, like other NSW councils is significantly limited in rate raising activities because state governments have dictated the annual rate pegging increase for 30 years. Since the introduction of the 1993 Local Government Act the average general rate increase in NSW is 2.89%, less than the Australia wide average increase over that 10 year period of 5.7%.

Hornsby Shire Council has had three rate variations, two to fund remediation of water catchments and one to pay for the compulsory acquisition of the Hornsby Quarry site. The Catchments Remediation Rate was introduced in 1994 and is set at 5% of the total ordinary rate revenue. In 2007/08 the Catchments Remediation rate will yield \$2,479,000. The Hornsby Quarry Loan Rate is approved by the Minister to be levied each year to meet the loan repayments until 2014/15. It will yield \$2,641,000 in 2007/08.

### Interest income

In general terms, councils' interest income is dependent on market interest rates. It is obviously also dependent on the quantum of principal invested.

Other than development contributions which may involve retaining those funds for a number of years to fund a specific high cost project, councils cannot justify holding and investing large amounts of funds on an ongoing basis. Therefore, in conjunction with relatively stable bond and

interest rates, it is not surprising interest income has not varied significantly over the last 10 years.

### **Fees and charges**

In NSW there is significant government intervention in price setting. Fees for planning and building are dependent on the state of the housing market and fees for many other regulatory functions are set by the NSW government. For community facilities, users including community and sporting groups will not accept full cost recovery pricing so annual increases are usually at CPI or thereabouts.

Waste collection charges on the other hand, reflect the full cost of providing the service which includes contractor price increases, ever increasing waste disposal costs and state government levies. Most of these costs are not regulated by the NSW Government; they are market related and contribute significantly to the increase in this category of (cost recovery) revenue. It must be recognised there is also a direct and corresponding increase in waste service costs that offset the increase in revenue. In 2006/07 Hornsby Council charged approximately \$13,270,000 in fees for the provision of a domestic waste management service.

### **Other income**

The study comments that 'other income' appears to be the fastest rising revenue source in local government. It is assumed grants and contributions from other levels of government are included in this category and reflect a changed approach from these agencies in contributing directly to local governments for specific programmes such as bushfire prevention, bushland and waterway regeneration, biodiversity enhancements, youth and aged programmes and road improvement programmes. In most cases there are corresponding costs associated with these contributions, e.g. NSW Fire Brigades, Rural Fire Services, Roads to Recovery, street lighting and matching fund requirements etc.

### **Capacity to raise own-source revenues**

The principal factors determining the magnitude of Council's revenue raising base include:

- The limitations of the land valuation system as a growth source
- The size of the underlying population base
- The ability of the community to pay
- The quantum of non rateable properties, e.g. schools, hospitals, churches, defence establishments
- Rate pegging increases determined by the Minister for Local Government in NSW
- Structuring of the rating system to extract maximum rate revenue within policy constraints
- Ability of council staff to access grant opportunities
- Magnitude of additional facilities provided and the resultant increase in fees charged
- Emphasis or ability of councils to collect infringement/fine income
- Level of development activity
- Quantum of funds able to be invested, the market rates of interest and the skill levels in being able to invest and derive enhanced revenue from those funds
- The willingness of government agencies to contribute directly to council programmes
- Income sources associated with cost shifting from other levels of government
- Increases in waste collection costs charged to ratepayers is offset by increases in waste collection costs payable to third parties
- Ability to attract parking fees and fines
- Extent of businesses in the area
- Extent of farmland in the area
- Extent of new development-attracting S94 levies
- Approval of special rates
- Extent of business activities-e.g. child care centres

- The extent of work done for third parties
- Water and sewage responsibilities done for third parties

State and territory local governments differ markedly in their capacity to raise own source revenue for a vast number of reasons, including those above. A major difference can be attributed to their “stage of development”, for example whether they are expanding, their relative size, the skill levels of staff and the State in which they are located.

### **Key determinants of constituent willingness to pay for services**

The key determinants of the capacity of resident households, organisations and businesses to pay for services provided by their local governments are obviously household disposable income and the economic success or commercial viability of the local economy.

The Allan Report found that in NSW 80% of residents believe they get worthwhile and appropriate services in return for rates paid. The Report also found the majority of NSW residents supported rate increases in order to receive higher levels of service or avoid cuts in existing services.

### **Setting fees and charges**

The largest fee charged by Hornsby Council relates to the provision of domestic waste management. In 2006/07 Hornsby Council charged approximately \$13,270,000 in fees for the provision of a domestic waste management service. The NSW Local Government Act 1993 states a council may charge and recover an approved fee for any service it provides relating to domestic waste management services. In effect the fee charged for domestic waste management is a zero cost recovery exercise in that domestic waste management fees must reasonably cover the cost of the service. Council can neither subsidise the service nor profit from the provision of the service.

In the same period council expected to receive over \$3,700,000 in development application fees. Many of these fees are covered by statute and council has no discretion in altering the fees, such fees are ‘set’ by State Government. In 2000 the Independent Pricing and Regulatory Tribunal (IPART) conducted a review of development fees and charges including those regulated by State Government. The review concluded that full cost recovery of this service not be recommended. Consequently, development fees and charges, with the exception of the Business Activity component, recover less than 50% of the cost to council.

Property certification services are at the other end of the spectrum in that council considers this service to be a business activity in direct competition to others in the market. Fees for these services are based on commercial principles and National Competition Policy, and therefore may generate a profit.

The other area generating substantial fees, but not profits, is childcare. The childcare standards of service are bound by legislation but council is able to set the level of fees in direct competition to other childcare service providers. The fees Hornsby Council expected to generate in 2006/07 were almost \$2,800,000. Childcare, like property certification, is a business activity of council and the fees are based on the same principles except that councils often find themselves in the position of responding to the demand for services for children less than 2 years of age, traditionally the most unprofitable sector of childcare. Community expectations influence the level of child care fees set by council. There is a presumption that council-provided childcare is a community benefit and fees will be lower or at par with market rates, but that the quality of care will be higher than non-council providers. If a council wants to operate a fully commercial operation it will need to manage community expectations.

Indeed many of the services provided by Council are provided on the basis of the need to establish equity of access for the less financially advantaged within the community.

### **Revenue from non residents**

The ability of local governments to augment their revenues with fees and charges collected from non residents is constrained by the capacity to identify the residential status of an individual and the capacity to maintain a method of identification of local residents which has integrity and is cost efficient.

There are opportunities for some councils to raise revenue from non-residents, e.g. beachside councils can charge beach parking fees, city based councils can charge for parking and councils with caravan parks can charge fees. Libraries, aquatic centres, child care centres and other facility hires will derive various levels of income from non residents (but this may also contribute to operating losses or subsidies and/or other necessary expenditures). Numerous other sources of revenue are tapped but these are nearly always immaterial, e.g. the sale of information leaflets and maps, book fines and swimming pool admission fees.

Tourism has always been a potential avenue for revenues to be collected from non residents. This could be in the form of an accommodation tax or admission charges to tourism facilities. The ability to impose such charges would differ between local governments, dependent on facilities, area attractions and visitation levels.

There does not appear to be any significant untapped revenue source that would be allowed by the state government in NSW or approved by the ratepayers, although a local sales tax (or percentage of GST) is widely used overseas.

Giving councils access to revenue from the Goods and Services Tax (GST) and moving away from the principles of horizontal fiscal equalisation currently applied via a complex formula that appears to discriminate against 'established' councils would give all councils access to revenue from non residents.

### **Development contributions**

Since 1993 Hornsby Shire Council has levied development contributions. To date about \$70 million has been collected and over \$50 million spent on providing new facilities or upgrading existing facilities.

Until 2005, there were no legislated dollar limits to contributions that can be required or charges that can be collected. The limits were by way of a requirement to demonstrate that a particular development would generate a demand for new, or the augmentation of existing, services and facilities as well as the requirement to determine whether or not the cost of the service should be funded by the new population or partly apportioned to the current population. Since 2005 Councils also have the capacity (vide Section 94A) to levy flat rates to development based on the capital cost of the development. This rate is capped at 1% for development greater than \$200,000.

Although the legislative changes of 2005 provide some flexibility in the administration of the contributions (pooling of funds and internal borrowings) the use of the contributions is limited to capital works only.

There are a number of issues related to contributions as a revenue raising capacity, namely:

- The contributions are very sensitive to changes in the economy and particularly the development industry. An adverse consequence of this sensitivity is that it is rare, in



## **The capacity of councils to raise revenue**

established areas, that sufficient contributions are collected to fully fund (in a timely way) the services or facilities identified in the contributions plans; and

- The contributions are limited to capital works. Yet the operational/long term maintenance of the services and facilities require greater funding which places greater pressure on the budget and contributes to the infrastructure funding problems identified in the Allen Report.

The contributions variously affect individuals, organisations and businesses. Individuals, particularly those purchasing real estate, bear the burden. Developers see it as contributing to the high cost of new housing. For the community, it raises expectations of services being provided which may never occur; or if it does occur it may not be timely. For Councils, there is at times a lack of appreciation of the supplementary funding required or the on going cost of maintaining the facility or services.

Development contributions have assisted Council in funding new, or augmenting existing infrastructure. However, it has also created administrative and budgetary problems which disable Council from providing some of the services and facilities in a timely way. It is considered that an infrastructure levy could be a more equitable and sustainable way to recover the costs of new and upgraded assets. However, for such a levy to be acceptable it would need to be tied to a long term asset funding and management strategy and administered in a similar way to the development contributions.

### **Fines and pecuniary penalties**

It is debatable with all fines as to the extent the fine is viewed as a deterrent or as a revenue raising opportunity.

Businesses receiving fines are subsidised through the taxation system by way of a Section 51(1) deduction under the Income Tax Act. There may be a view that such a fine is part of the normal cost of doing business. There is limited scope to significantly increase these fees which are currently on a cost recovery basis, otherwise business owners and others would roundly criticise council for 'back door revenue raising'.

The issuing of fines is also operationally and administratively costly to councils as they do not issue fines in the same volumes as the state government (e.g. speeding) and can not instigate disincentives such as cancelling of licences as can the state government.

### **Interest income**

There is little connection seen between local government cash reserves and state government imposed borrowing limits as any connection would imply councils borrowing funds and then re-investing those funds as an arbitrage opportunity. Generally councils borrow when there is a specific approved project. If the project was cancelled or deferred, there would be little point in maintaining those borrowings.

### **Borrowings**

The state government approval required for borrowings forces councils to carefully consider the need for the borrowing and the financial implications such as funding the repayments. Councils, therefore, need to have a borrowing policy in place that requires detailed analysis of each borrowing and its repayment.

The NSW government also has a requirement for specific analysis when the proposed borrowing is to be used to fund a building project. This arose from substantial borrowings requested in previous years to construct "edifices", income from which could never repay the loan and which would require significant maintenance, to the detriment of other services and facilities.

### **Cash reserves**

Cash reserves are necessary for all individuals, organisations and governments. The issue is perhaps the extent of these reserves and what they are/are intended to be used for.

Reserves can be accumulated over time in order that a project can be undertaken but this can create intergenerational issues. Development reserves (\$94 etc in NSW) may need to be accumulated over time but if not spent in a reasonable time, may indicate new ratepayers are not receiving the facilities they have paid for.

Cash reserves also form the basis of treasury investments and provide the basis for internal loans if required. On the other hand, excessive cash reserves may indicate a "lazy balance sheet". Councils should not have a mandate to grow cash reserves for the sake of it.

### **Income from competitive grants**

Hornsby Council annually submits between 30 - 44 grant applications with a combined value of more than \$1.4 million per year, and a realistic expectation of being awarded at least \$800,000. Most grants come from state and federal governments and generally Council is required to meet strict oversight performance standards during the term of the project funded by the grant and all project expenditures must be strictly accounted for. Detailed program goals must be developed, approved and carried out as specified in the grant application. Any project changes must be approved by the government. All project phases must be completed on time and the project must be successfully completed.

With funding cutbacks and competition for them becoming more intense, seeking a grant always requires significant time and effort up front with no guarantee of success.

### **Council limits on own source revenue**

Many local governments would have policies which in effect limit their own source revenue raising capacity. These policies are likely to revolve around issues such as:

- equity between socio economic levels within the local community,
- facilities which are seen to be funded predominantly from rate income and the imposition of an additional charge would be seen as double dipping,
- the need to assist economic development or increase tourist visitations and
- social equity issues which may be based upon existing precedents and the difficulties of retrospective re-pricing of those precedents.

At the same time it is often a council's revenue increasing practices that limit revenue raising. For example, if services provided such as libraries, swimming centres and sporting fields were to be priced at full cost recovery or more, the facilities are likely to be under-utilised and councils would be roundly criticised by residents, ratepayers, the media and state governments.

### **Cross subsidies**

The principal implication of applying or removing cross subsidies would be extreme community dissatisfaction in respect of removing cross subsidies from traditional areas such as libraries, parks and ovals and aquatic centres. This would be offset financially by a huge reduction in visitor numbers and in total a reduction in gross income requiring further price rises. In the end no-one could afford to enter these facilities. On the other hand, applying additional cross subsidies would make little difference to library patronage for example, as they are almost always fully utilised.

There is a shortage of available land and little money to buy it to create additional facilities therefore doubling the number of parks and ovals in urban areas is academic.

# **The impacts of state legislation on revenue raising**

### **The impact of land categories**

Restrictions on land valuation methods are not considered to affect the capacity of local government to raise revenue.

The NSW Minister for Local Government imposes rate capping on local government without consultation, therefore additional land categories would not alter the quantum of rates revenue raised. It is possible however, that if rate pegging was removed, the utilisation of alternative valuation methods may give local government the opportunity to achieve other objectives. For example, if an improved or capital valuation method was used for rating purposes, and subject to rate pegging being removed, rate income could increase because of the economic activity, particularly building activity within the local government area. The revitalisation of degraded areas can be positively encouraged by the local authority's interventions.

It is also possible to achieve greater community and local authority support for development at an increased density if increased services and facilities were provided to existing residents at no increase in the current individual rate burden.

Differential rate setting is often not pursued because it requires software modelling skills which not all councils possess. There may also be a view that total revenue will not alter given the notional yield limitation in NSW.

### **Rate pegging in NSW**

Rate pegging has been in place in NSW for 30 years and is enshrined in Section 506 of the NSW Local Government Act 1993.

The Act does not state the reasons for rate pegging. There may be a view that councils could otherwise give themselves "unreasonable/outrageous" rate increases which may damage the state government in elections, at least in those local seats. There may also be a perception that state government gains positive recognition for keeping local councils "under control" in respect of limiting councils' rate revenue rises.

Rate pegging significantly limits the ability of local governments to raise council rate revenues, particularly in those councils with a small number of ratepayers. However there is the opportunity to apply for special rate variations but this provides more benefit to councils with larger ratepayer base as they can raise more special rates. Again smaller councils are constrained by their small rate base. In smaller less well resourced councils, the expertise may not available to prepare the applications and the resulting special rate if approved, may be insignificant.

The maintenance of rate pegging has, as a positive, forced local government in New South Wales to comprehensively review other sources of revenue and pursue operational and other efficiencies. It should also have encouraged councils to review the levels of service they offer, although it is not possible to say with confidence that this has actually occurred.

Rate pegging has led to some local government authorities being inventive in the application of fees and charges and development contributions. In some instances as a consequence, the NSW State Government has imposed limits on these new charges or prohibited their application, e.g., development contributions.

On the other hand the imposition of rate pegging in NSW obviously places an artificial restriction upon the percentage of total income which can be achieved from rates. This artificial restriction impacts on the arithmetical calculation of the shares of each own source revenue and has the potential to distort comparisons.

The imposition of rate pegging also creates a significant barrier to the utilisation of valuations upon which rates are based as an indicator of revenue raising capacity. Higher valuations may be indicative of a higher capacity of a rate payer to fund an increase in rates, but in NSW, higher valuations are not indicative of a council's ability to increase the rates, as they are constrained by the rate pegging increase approved by the Minister.

There are a couple of major restrictions upon local government's ability to raise revenue from rates and other sources. One is the perception that the introduction of user pay charges is perceived as double dipping, when rates are seen as the revenue source for the provision of such services. Secondly, when councils are inventive, the NSW State Government imposes ceilings on the level of charges which can apply, or alternatively when a source of revenue is provided to local government by the State, it is provided on a "*strings attached*" basis, which limits its ability to be applied in all circumstances.

### **Regulation of Domestic Waste Management Fees**

The largest fee charged by Hornsby Council relates to the provision of domestic waste management. In 2006/07 Hornsby Council charged approximately \$13,270,000 in fees for the provision of a domestic waste management service. The NSW Local Government Act 1993 states a council may charge and recover an approved fee for any service it provides relating to domestic waste management services. In effect the fee charged for domestic waste management is a zero cost recovery exercise in that domestic waste management fees must reasonably cover the cost of the service. Council can neither subsidise the service nor profit from the provision of the service.

The NSW Government has elected to exempt this charge from the rate pegging regime. It may be speculated that this action was in response to the State's decision to increase the levy payable for the disposal of waste at a rate far in excess of inflation, (The '*do as I say, not as I do*' factor). There is a strong case for local government to be subject to the same constraints as the State in the setting of fees and charges for the various activities it undertakes. Conversely, there is sound argument to exempt other activities from the limits of rate pegging.

### **Regulation of Development Application fees**

In 2006/07 council expected to recover over \$3,700,000 in development application fees. Many of these fees are covered by statute and council has no discretion in altering the fees, these fees are 'set' by State Government. In 2000 the Independent Pricing and Regulatory Tribunal (IPART) conducted a review of development fees and charges including those regulated by State Government. The review concluded that full cost recovery of this service would not be recommended. Consequently, development fees and charges, with the exception of the Business Activity component, cover less than 50% of the cost to council

### **Legislative requirement for setting or raising fees and charges**

There is a legislative requirement to advertise proposed fees and charges for 28 days and then have them adopted by council. If any new fees are proposed to be charged, the process must be repeated.

There is also a legislative requirement for councils to develop and advertise a Fees and Charges Pricing Policy for all categories of cost recovery and nominate the category against each fee.

**General constraints to increasing fees and charges**

- Local government is required to advertise its fees and accept submissions on these
- Local communities will not accept large fee increases
- Fees for sports grounds, tennis courts and aquatic centres cannot reflect the true cost of provision because sporting groups and the local media will protest loudly and accuse councils of driving the young people to crime and away from wholesome exercise
- Planning fees are largely set by the state government
- Councils may decide to accept younger children at child care centre as a community benefit because this is where the shortages exist. Private operators tend to concentrate on care for older children as this is more profitable
- Commercial practices are sometimes difficult to emulate in the climate of transparency and strong governance

**Under/over recovery of costs**

- Councils often have fee/income shortfalls but rarely seem to have cost shortfalls. In child care centres and aquatic centres for example, there are set staffing levels and therefore fixed costs, not dependent on daily/weekly attendances
- The level of fines is not set at the cost of the service provided
- In many situations in the Planning area, fees are set by the state government and the staffing levels and therefore costs necessary to maintain regulatory services is ignored. There is not a direct correlation between the level of building activity and consequent fee income in the short/medium term with the necessary staffing levels which are set for the medium to long term.
- There are situations where a more expensive outcome or unintended consequence was not anticipated, however the fee structure is not sufficiently flexible to recover the additional costs incurred, thus leading to a financial loss on the job/activity

# Revenue raising and local constituents

Hornsby Shire Council regularly consults its community on a range of issues including satisfaction with council services. Hornsby residents value the provision of parks, playgrounds and swimming pools and expect council to actively protect the natural environment, provide local infrastructure and maintain services to the community. Local constituents expect and pressure council to increase local services in return for rates paid.

### **Limits on raising fees**

In some instances legislation provides for the power to set fees and charges at a level in excess of the cost of supply. However the vast majority of council's revenue is restricted by legislation, competition, community pressure and media scrutiny.

Proposed increases in fees, for example library fees or the hiring of sportsfields is often met with vigorous opposition. Similarly attempts to rationalise assets often fail because of loud community pressure. Councils in many cases operate with one hand tied behind their back due to state government regulation, community consultation requirements, media attention and time consuming complaint mechanisms. It seems unlikely these constraints will dissipate.

### **General comments**

If councils in NSW were able to increase rates significantly (which they are currently not able to do with rate pegging) there would be some financial difficulties for pensioners, retirees and new home owners. Businesses are able to claim a tax deduction which alleviates the pain somewhat.

Land valuation methods and rate pegging shift the rates burden between ratepayers in NSW.

To a large extent in NSW, rates and rate pegging increases are the source of funds for paying staff. However this source of revenue also funds all the traditional and non cost recovery services provided by councils, such as park and oval hire, aquatic centres, non competitive planning services, subsidised property rentals etc.

### **Efficiency and equity considerations**

There is always a view that, the greater the extent of ad valorem rating (compared to no/minimal use of minimum rating and base amounts), the more individual ratepayers in high value properties are treated inequitably as they do not use more of councils services compared to a ratepayer in a lower value property. However councils' rating structures are based on principles of equity and approximate ability to pay. This is achieved by combining minimum rates, base rates and ad valorem rating. Given the history of land rating, it is difficult to envisage any other form of impost on residents that would fund local government operations.



### **Cross subsidisation**

At Hornsby Council there is very little cross-subsidisation of goods and services as there are limited profitable enterprises providing funds for non profitable and operational expenditure. However rates revenue is the funding source for more and more responsibilities transferred from other levels of government.

Services are operated under one of six pricing structure:

- Statutory (Legislated and council has no power to alter this fee eg freedom of information application fees)
- Zero Cost Recovery (The service provides broad community benefit and council accepts the responsibility for providing and funding these services from general revenue, eg Access to information held by council and Library Services)
- Partial Cost Recovery (The service may be subsidised to stimulate demand or to enable specific users to access the service, eg environmental education or services for youth)
- Full Cost Recovery (The fee is calculated based on the full recovery of annual operating and maintenance costs eg construction costs of vehicular crossings)
- Commercial Business Activity (The fees are based on commercial principles and may accrue a profit eg Commercial Waste Management)
- Demand Management (The fee is greater than the direct cost of the service as a disincentive eg childcare waiting list fee)

If cross subsidies were removed and users (individuals, organisations and businesses) were charged the full cost of providing a service the usage fees would increase dramatically at libraries, aquatic centres, sportsfields and most other 'community benefit' services. If council was to move to 'fee for service' model, ratepayers could expect lower annual rates to cover infrastructure maintenance but higher fees for many services. Those on lower incomes may not be able to afford to swim at the local pool or borrow items from the library.

Councils are obliged to concentrate on the provision of services to the community rather than pursuing commercial opportunities. The more general response in this situation is to reduce services. Another response may be to borrow funds hopefully to apply to capital project funding.

Many councils have analysed their services from a mandatory and discretionary perspective and found little room to move in reducing or eliminating discretionary services.

Services that have been shifted from other levels of government are estimated to cost Hornsby Council over \$7 million per annum and these are funded by rates and other general purpose revenues. Numerous other services receive no funding and are therefore funded by general revenue.

As stated above, the construction and maintenance of parks and reserves cannot be funded from entry or hire fees and are therefore (cross) funded by general revenue. Sports centres, while they have high occupancy rates, cannot charge a fee that will recover the cost of the building and therefore as the buildings age, more maintenance and eventual replacement will be required and this cannot be funded from entry fees.

**Subsidised services**

In general, local government has become adept at allocating resources where the Council considers the service to be most required.

Where services are subsidised, it is generally not funded by imposing higher rates or other fees and charges but by reducing services or expenditure elsewhere. For example at Hornsby Shire Council there was spirited debate concerning turf cricket wickets. These are maintenance intensive during the season, including requiring weekend groundsmen. The cost could only be recovered from 24 cricketers. There is a national psyche about the grass roots of Australian cricket, and it is the provision of local turf wickets that provide future Australian cricketers with the environment to develop their skills. There is a significant subsidy required for the provision of turf wickets.

As previously mentioned full cost recovery will not be accepted by community and sporting groups. If the library were to charge say \$5 for each book borrowed or for each person entering the library, the library would be under-utilised and council could expect the local media to vigorously decry the situation. Similarly, if park and oval hire was fully charged, the grounds would be also be under-utilised.

**Long lived assets**

Councils do not use the return on their long-lived assets (profit and depreciation) to cross subsidise services. Council derives little return from long life assets and the vast majority are in fact liabilities. Few councils can afford to fund depreciation as a means of creating an asset replacement reserve. Any operating surplus derived from an asset is usually applied to other unrelated but necessary services.

# Productivity gains and reducing unit costs

**Productivity gains**

Hornsby Shire Council has been actively pursuing productivity improvements and efficiency reforms in order to respond to rising community demands and expectations for a growing range of services. Council has made significant progress in recent years including:

- Syndicated with four other councils for contemporary technology solutions
- Provided customers with online access to most council services
- Implemented an energy performance contract to conserve energy and produce savings
- Absorbed the increasing costs of governance, for example public access to documents
- Reviewed and re-tendered its telecommunications contract
- Improved the manner of stores inventory and moved to just-in-time inventory

**Reducing unit costs**

The issues paper considers that expanding the scale of a council's operations may reduce unit costs. Expanding the scale of Hornsby Council's operations is unlikely given that it is already one of the largest councils in NSW.

The internet is increasingly being used by residents as the preferred way of communicating with local councils and it offers opportunity for reducing unit costs for some services, for example animal registrations, development applications and access to land and other information. Hornsby Council is actively evaluating, improving and increasing its provision of on-line services to residents.

The comment on page 24 of the issues paper "A local government could be considered as operationally inefficient if it is possible to increase its supply of goods and services for given expenditure or reduce its costs for a given level of services", presumes that councils are not actively pursuing productivity improvements and expanding services. For example Hornsby Council has absorbed the increasing costs of governance, particularly public access to documents, through increased efficiencies and productivity improvements without decreasing service levels in other areas. The comment also ignores the reality of community demand for a 'maximalist' approach service delivery.

**Service levels**

Council delivers a wide range of services and most of those services are delivered at a level of high quality. Some services consume more resources than others, and most services can be provided at different levels, depending on the need and nature of the service. For example potholes on busy roads could be repaired on same day, within 24 hours or within 5 days. The varying levels of response have financial and risk implications for Council and a satisfaction implication for the customer. The level of response Council chooses to provide needs to consider those factors.

The community also has perceptions about expected levels of service and what is considered unacceptable, and those perceptions impact on the range and level of services provided. Guidelines regarding the appropriate range and standards of service, including the allocation of lifecycle infrastructure costs would be of assistance generally in determining revenue requirements however rate-pegging in NSW means Hornsby Council is unable to set its rates according to need or its customers' willingness to pay without applying to the Minister for a special rate variation.

**Financial and asset management skills - Councillors**

Councillors are elected for a fixed four year term in NSW while councils' projects, assets and services are delivered over multiple generations.

Councillors are not required to have financial training and may have a disinclination to further training offered after their election to council perhaps because they are less interested in this area of council's operations or simply do not have the time. The same comment may apply to state and federal politicians, however state and federal politicians are elected to a full time role and have the support of parliamentary staff whereas time commitments of local government make this extremely difficult.

**Financial and asset management skills - Staff**

It is becoming difficult to attract experienced finance and asset management managers to local government as these skills are in demand across the country and it is difficult to offer appropriate salaries. Consequently the skill level of staff is not rising and often consultants are the only way forward.

This is not necessarily a problem if the projects/studies/models can be maintained by existing staff. In fact it may be inefficient to maintain very experienced highly paid specialists on the payroll if their skills are not in constant demand or their recommendations are postponed or ignored.

There may also be a view held in some councils that prospective senior staff who have not worked in local government are at a disadvantage in facing the diversity and challenges of local government. The degree of the learning curve for new staff depends on the commercial and common sense skills brought and most importantly, the skills and attitudes of the staff reporting, the software systems in place, the integrity of the data bases and the documentation of policies, procedures and processes.

In the main, small rural and remote councils face the greatest difficulties, however all councils which do not recognise the importance of specialised financial management and asset management skills tend to have trouble attracting and retaining this type of professional staff.