Local Government Managers Australia, NSW
Submission to the Productivity Commission Inquiry into Councils' Revenue Raising Capacity

Revenue Raising Capacity

In 2003 more than 2/3 of the total revenue of NSW Councils, (69.4%) came from rates, user charges and fees. However, only 35.6% of total revenue was derived from rates. Over the last 10 – 15 years, much has been made about councils diversifying their revenue streams in order to increase their financial viability. In particular the 90's saw the user pays regime become prominent, with councils looking to obtain further opportunities to raise revenue through direct user charges as the rate pegging regime was stifling councils' ability to keep pace with increasing costs. The Issues Paper clearly shows that rates and the sale of goods and services is decreasing as a % of total revenue of local government which has resulted in councils having to expand into other alternate revenue sources such as property portfolios, parking enforcement and investment income, as councils changed from net borrowers to net lenders of money. The overall ability for any council to supplement its revenue streams on this basis are ultimately more attributable to local conditions and opportunities, than the mere desire of the council to utilise this source.

Clearly in NSW the existence of rate-pegging for the last 30 years has been a major factor in limiting the ability of councils to raise rates commensurate with the need to meet infrastructure maintenance requirements and the demands of residents and rate-payers for services.

If rate-pegging did not exist then councils' rate revenue would be dependent on the amount of revenue necessary to provide services desired by the community. If a rating structure were similar to land tax then the revenue would increase equivalent to the increases in ratable valuations. In this situation, the valuation type used for rating would largely be irrelevant e.g. land value or capital improved value.

Cost shifting on to Local Government and increased statutory charges e.g. Rural Fire, are also factors which have impacted on the revenue raising capacity of councils.

Further issues include the NSW State Government decision not to pass on National Competition Policy incentive and compliance payments to Local Government, and the lack of a set portion of growth funding from the Federal Government – GST revenue or Income Tax.

Independent inquiries into the financial viability of NSW Local Government include the recent Percy Allen Financial Sustainability Inquiry and the Cost Shifting Inquiry.

Other Income

The increase in revenue derived from fines and penalties over the last five years has partly covered the decline in rates revenue as a percentage of total revenue. Part of the reasons for the significant increase in Other Income was the handing over of parking infringement from Sate Government to Local Government. However, the increase in revenue from this in the future is likely to be unsustainable for several reasons: council resources are stretched, parking infringements which account for a significant percentage of other income is plateauing and there is increased pressure from the media on the amount of revenue councils receive from infringements.

For metropolitan Councils, such as North Sydney, commercial property and parking facilities (both parking stations and parking meters) have become important sources of revenue to fund ongoing maintenance and service delivery. Parking Enforcement is a significant issue for inner metropolitan councils where demand for parking is high. This raises important revenue, however quotas or targets are not set, and the aim is to achieve parking compliance not additional funds. There should not be reliance on fines as a form of revenue, because they can fluctuate depending on whether people break the law or not.

Another source of increasing revenue in the past ten years has been from property portfolios. However, increasing interest rates and high maintenance and infrastructure costs are now stifling this source of income.

There are differences between urban and rural councils because the potential for revenue-raising differs. North Sydney Council has a relatively low proportion of revenue from rates and charges at 39% in comparison with many other councils, and particularly rural councils. North Sydney Council also receives a lower percentage of revenue from Government grants than rural councils. However North Sydney Council has a great capacity to raise revenue from property and investments because of its location.

National Competition Policy is an impediment to councils generating income from business sources as the price setting regime required by the Local Government Act puts Councils at a disadvantage with private and other government competitors.

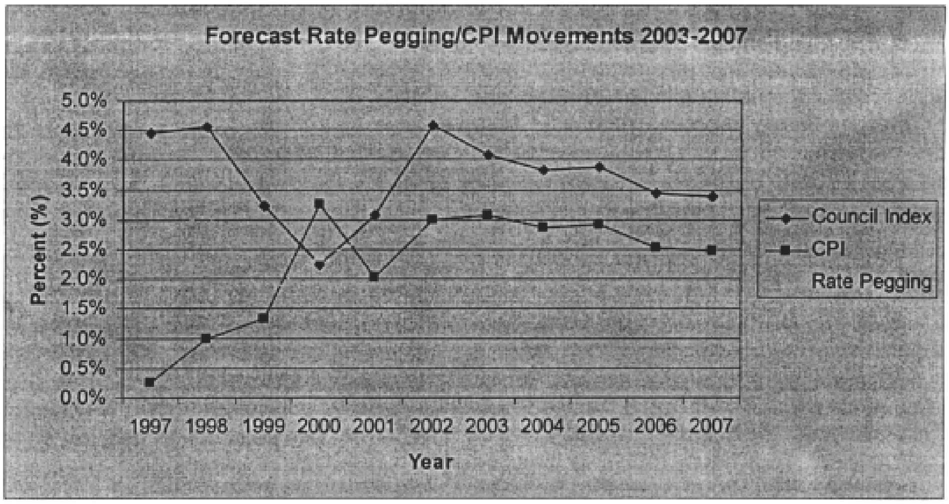
Rate Pegging

The reason for rate-pegging in NSW is a long-standing lack of confidence by successive State Governments in the ability of councils to manage their own financial affairs. The fact is that rate-pegging is politically popular at the State level. This has not stopped State Governments from raising their own taxes and charges at far higher levels than CPI over many years. The difference between increases in land tax revenues (State responsibility) and council rate revenue over the same periods of time provides a stark example of the different standards applied.

Rate capping or pegging has existed in NSW for 28 years and while the annual increase announced by the Minister for Local Government has mostly been in excess of CPI, cost increases including the NSW Local Government State Award and levies, such as the NSW Fire Brigades Levy, account for much of the rate capping increase. Rate capping is not a viable long term solution to funding local government especially with increased services required and an ageing infrastructure requiring replacement.

At the very least the methodology attached to Rate Pegging needs to be heavily revised, as capping has not even allowed Councils to keep pace with real costs. The Local Government and Shires Associations of NSW in 2003 prepared a basis for calculating the annual increase for Rate Pegging which uses a variety of indexes relevant to Local Government. Any increase in charges by the State Government which impact on Local government, should also be capped at these levels. Below is a table from the Associations which indicates how it would operate in comparison to the existing methodology.

NSW Local Government Rate Determination Model



Rate Pegging has also had the impact of being a quasi form of social engineering. It effectively means that communities which have a higher capacity to pay for new facilities and services are prevented from doing so (unless the user pays regime can be applied). This has the effect of ensuring communities with less capacity are not left behind. The levels of services and facilities in a community are therefore effectively frozen, in relative terms, and are the same as they were 25 years ago. That is, a council's current financial Rating capability is dependant on the level of rates 25 years ago, which were frozen and have only been indexed over the period. This means that despite any changes in demography which may have occurred during the intervening period, the ability of established council areas to respond is limited.

Clearly, Rate Pegging should be removed to stop the pressure on councils to develop other revenue sources such as user pays, which are effectively additional taxes for the community to comply with. Its removal will also allow communities to develop in line with their capacity to pay rather than be restricted to twenty five year old relativities.

Councils in NSW are able to make application to the Minister for a special variation to the increase of rates. Many councils have used this option to apply for special levies, such as Environment Levies or Infrastructure Levies, as well as Levies in commercial areas for streetscape improvements. These Levies are always time-limited, for example for five years. They provide much needed revenue for identified infrastructure management and improvement, such as storm water drainage. However they do not address the underlying problem of rating income not keeping up with rising costs. While the Minister has approved many special rate variations, not all applications are successful.

Setting Fees and Charges

The NSW State Government has adopted the ever increasing application of the user pays methodology, most notably in relation to road tollways. This has occurred despite increased GST revenues, (over traditional taxes) which suggests that the State prescribes to “the more sources the better” philosophy.

However, Local Government is limited in this way as many fees such as developer contributions and Freedom of Information fees are prescribed by the State and have not been reviewed for some time.

Revenue for Developer Contributions is not prescribed by the State although public and State pressure is placed on councils to limit the amount of these charges due to housing affordability, inter-generational equity etc.

Sale of Goods and Services

In the last ten years council has relied on an increase in the sale of goods and services but this is now in decline as a share of total revenue. One of the reasons for this is that council in the last ten years had an increase in revenue from Information Management sources such as Freedom of Information Applications, Copies of Publications and providing copies of documents.

Revenue derived from Freedom of Information (FOI) Applications has been in decline in the last 5 years as State Government Agencies such as NSW Ombudsman and NSW Privacy have increased pressure on councils to provide access to its files and documents free of charge under the Local Government Act. Previously, councils had used the provisions of FOI Act to charge the public to access its documents.

Revenue derived from the sale of publications is also in decline with the increase use of the internet for publishing information more publications are now available free of charge on councils websites.

Increasing Expenditures

The Model developed for the Local Government and Shires Associations of NSW in 2003; “NSW Local Government Rate Determination Model” also showed that local government expenditure is growing faster than revenue. This is the main contributing factor to the lack of financial sustainability of many NSW Local Governments. This has been caused by many factors such as cost shifting from other levels of government, infrastructure costs and the increasing needs of the community for local government to provide more services and more information to meet their needs.

The Councils' Charter in the *NSW Local Government Act 1993* sets out the expectations of local government. The Charter is quite broad-ranging leaving open to NSW councils, to a large extent, the choice of services that they provide. There are some services that councils are required to provide, and this includes waste management services, and the maintenance of local infrastructure, in particular roads, and environmental control. Councils can also choose to provide other services, such as the range of community services. The provision of services is in response to demand by the community.

There are no guidelines in NSW to assist local government to determine the range and standard of services. This is the responsibility of each elected Council.

Cost Shifting

The issue of cost shifting has been recognised by all three tiers of government and has been the subject of several inquiries and reports. Current steps are underway to develop an inter-governmental agreement to address the issue however many facets of cost-shifting are subtle, take place over long periods of time, and have multiple drivers which are difficult to identify or refute. Local Government's role is continually complicated by the impact of State and Federal government policies that do not recognise the impact at a local level. Per capita spending on environmental management and health services is increasing. This has been caused by new responsibilities such as the State of the Environment Report, the requirement to prepare a social plan and increased compliance costs.

Many services have been devolved to local government by default. For example councils were encouraged to start pre-schools with the assistance of Commonwealth funding. In the 1990's the Federal Government ceased to fund new pre-schools. Community expectations did not change and the private sector has been unable to fill the gap especially in areas like pre schools and long day care. Government needs to recognise the actual costs of providing services. For example developers should have to provide or pay the actual cost of providing community and social infrastructure rather than paying section 94 contributions that are eroded by time and do not provide for future expenditure or costs of maintaining infrastructure.

Both developed councils and developing councils are experiencing emerging community demands for new services which have no funding arrangements, such as the provision of community housing, aged care facilities and information technology services through the public library network.

Provision of Infrastructure

The maintenance and development of infrastructure is a key challenge for all Local Government, but has two differing perspectives. Councils which have established infrastructure require renewal and/or additional infrastructure to meet the pressures brought about by urban consolidation, and the resultant intensification of land use which places higher demands on existing infrastructure. The infrastructure challenge for new and developing councils primarily relates to their ability to provide any infrastructure at all, in order to meet the needs of their community.

For established metropolitan councils, their budgets are burdened by the fact that many of the infrastructure assets are old and were constructed prior to consideration of user pay principles. The depreciation/maintenance charges for these assets is such that councils are torn between the desire to maintain existing items which may not be ideal or develop newer facilities. As an example the traditional swimming centre that many councils have is no longer a viable alternative in an era of aquatic centre style facilities. Also libraries which are solely book based with minimal computer and other facilities have less community value than those which have been developed with spaces for cultural and social endeavours. Does an established council construct another asset to cater for the latter? What is the additional cost/impact when compared with a developing council building a new integrated project, largely funded from s94 contributions?

The current school of thought is that councils should be looking to private public partnerships (PPPs) to deliver infrastructure demands. While these are relatively new, there have been a number of instances where councils have been successful in utilising this vehicle to achieve a win-win scenario for the community. As has recently been evidenced by Liverpool Council and the State Government, there are also examples where with hindsight, it has proved that such public private partnerships, whilst effective in delivering the infrastructure, may do so, without the community obtaining maximum benefit. In particular, I refer to the level of returns that have been provided to the various tollway operators compared to a normal market interest rate. Clearly, if such returns were on offer, the community would have been better off receiving such returns and/or borrowing directly to avoid higher toll charges for the project to proceed.

It is important in any infrastructure provision decision to be able to evaluate the value of a PPP against other alternative funding options. The existing structure of the rate-pegging legislation for obtaining approval to exceed the permitted rate increase set by the Minister is such that it is not really viable to consider alternate funding options. All options should be considered rather than having a pre-cursor that the vehicle must be a PPP for a project to proceed.

In this regard it is recommended that consideration should be given to an alternate mechanism in which councils can fund infrastructure projects by the development of a community contract. The Local Government Act could be amended to define a process that a council could follow to gain approval for a levy to finance a particular infrastructure asset. Alternatively, some form of simplified Ministerial approval could be available, which is not determined along political lines. It is envisaged that these projects would be projects that have widespread support, yet currently have not proceeded as councils have been unable to fund them through their normal funding program.

Financial and Asset Management Skills

Good financial and asset management skills are needed in local government to assess the infrastructure funding needs, to develop long-term financial plans and to advise Councillors on the ability of councils to fund service delivery and infrastructure management and maintenance in the long-term. Without such skills, councils are left making decisions on the basis on inadequate information and planning. Revenue raising opportunities could be missed and future income streams lost.

There is a lot of competition in local government to attract suitable expertise in asset and financial management. This is an area of skill shortage. Councils in metropolitan areas generally are able to find suitable expertise so long as they pay the right price. However rural and regional councils have far more difficulty in attracting suitable and qualified people in an environment of skill shortage. The reality is that people with financial and asset management skills are attracted to the private sector, where remuneration is higher.

LGMA, NSW has been running a series of training workshops on Fair Value Asset Accounting, and will run more over the next two years to ensure that those in Local Government are trained in financial and asset management skills.

LGMA, NSW has also developed a Good Practice Toolkit which includes a module on asset management. This Toolkit is developed by Local Government practitioners for Local Government practitioners, shares skills and expertise across councils and identifies, develops and disseminates good practice.

LGMA, NSW
3 July 2007