the Southern City

# *Assessing Local Government Revenue Raising Capacity*

**City of Mandurah submission to the Productivity Commission's draft research report into Local Government revenue raising capacity**

**February 2008**

## Introduction

The City of Mandurah is pleased to provide its submission to the Productivity Commission's draft research report into *Local Government Revenue Raising Capacity*, released in December 2007.

The City's previous submission (July 2007), which responded to the Study's Terms of Reference, endeavoured to outline the difficulties faced by rapid-growth and sea-change regions in providing adequate infrastructure and services for their constantly changing communities. It also summarised the existing restrictions that are hindering Western Australian Councils' ability to raise revenue, including inequities in the WA property rating system, rates exemptions for retirement villages operated by charitable institutions, and rates exemptions for Commonwealth and State agency-owned properties.

Mandurah's submission also supported and expanded upon several proposals aimed at providing Local Government with a sustainable revenue base, including the PricewaterhouseCoopers' proposal to establish a new *Local Community Infrastructure Renewals Fund*, and to revise the Financial Assistance Grants escalation methodology to more accurately reflect the true costs of Local Government infrastructure provision.

The City's submission noted a suggestion of the WA's Government's *State Infrastructure Strategy Green Paper*, that greater infrastructure coordination among the three levels of government was necessary for the existing massive nationwide infrastructure backlog to be overcome. It further noted a recommendation of the Western Australian Local Government Association's *Systemic Sustainability Study*, which called for a more transparent and sustainable funding model for roads and associated infrastructure to be developed, and also recommended that State Governments should provide funding support to encourage Local Government efficiency and asset management reforms.

On the issue of structural reform of Local Government, the City reiterated its position 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, it noted that blanket amalgamations are not appropriate; rationalisation, rather than amalgamation, is the key to achieving Local Government sustainability.

## Response to Draft Report's Findings

The Productivity Commission's draft research report outlines the current revenue-raising issues facing Local Government. The City of Mandurah takes particular note of the report's analysis of 'Constraints on Rates' (Chapter 6.1), and 'Constraints on Fees, Charges and Contributions' (Chapter 6.2), and responds to the findings as follows:

***Finding 6.1*** *In principle, rates revenue is not constrained by limits on the range of land valuation methods available to councils or the specific type of land valuation method applied because councils can adjust the rate in the dollar to achieve their revenue requirements.*

City of Mandurah response: Whilst Councils could theoretically adjust the rate in the dollar to achieve their revenue requirements, they must be mindful of their community's capacity (and willingness) to pay. In addition, significant rates increases result in only one section of the community i.e. ratepayers, being responsible for funding the delivery of services, facilities and infrastructure to all users.

***Finding 6.2*** *Differential rating provisions generally do not constrain the capacity of councils to raise revenue from property rates.*

City of Mandurah response: Agreed.

***Finding 6.3*** *Rates exemptions required to be provided by local government are generally, at least partially, offset by reciprocal tax arrangements. The net effect of these arrangements on the financial position of local governments is not clear. Exemptions do not necessarily constrain aggregate revenue.*

City of Mandurah response: This is a tenuous argument, as it makes the assumption that WA Councils are now being offered an exemption for a tax that they were never required to pay in the first place, in exchange for having to provide a rates exemption that was never previously provided. Rates exemptions on retirement villages operated by 'charitable institutions' <u>do</u> constrain Councils' aggregate revenue, and their net effect on the financial position of Local Governments is considerable, particularly in a City such as Mandurah that has approximately 18 aged care and retirement villages either operating or under construction.

***Finding 6.4*** *Where rates concessions are not fully reimbursed, revenue forgone may be able to be offset by implementing rates increases for other ratepayers.*

City of Mandurah response: Again, this is dependent upon the community's capacity and willingness to pay. It also begs the question why one sector of the community should be forced to make up the revenue shortfall created when another sector of the community is provided a rates exemption.

***Finding 6.5*** *Rate pegging has dampened the revenue raised from rates in New South Wales relative to other States and there seems to have been little offset from non-rates revenue sources.*

City of Mandurah response: Agreed, although not applicable to Western Australia.

***Finding 6.6*** *Most fees and charges are set by the councils. A small number of fees and charges are statutorily set by other levels of government, although mainly at the State level.*

City of Mandurah response: In Western Australia, the primary revenue raising fees and charges (e.g. planning and building, swimming pool and commercial premises health inspection fees) are regulated by State Government. These fees should not be regulated by the State, as they severely restrict Local Government's own-source revenue raising capacity. The City estimates that it could significantly increase its fees and charges revenue if these restrictions were lifted.

***Finding 6.7*** *Nationally, developer contributions per new dwelling commencement have increased substantially over the four years to 2005-06, thereby adding to council revenue.*

City of Mandurah response: Developer contribution levies are not Local Government 'revenue'; they are funds set aside for the provision and maintenance of specific development facilities, and cannot be used for any other purpose. Furthermore, no developer contribution model exists within Western Australia at present.

## Additional Comments – Financial Assistance Grants

The draft report made only minor mention of the value of Financial Assistance Grants to Local Government (as it is a source of funding rather than revenue), and although it noted the FAGs variance between urban and rural Councils, it did not highlight the existing inter-state funding inequity that currently exists.

The current method of distributing the 'General Purpose' grant component of Financial Assistance Grants 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 FAGs distribution method allows outer metropolitan and inner regional Councils in populous States such as NSW & Victoria to automatically receive significantly larger grants – on average 4 to 5 times the grant received by similar sized WA Councils - regardless of their actual need.

For example, in 2004/05, the City of Mandurah's General Purpose FAGs entitlement was $884,800 ($16.28 per capita), whereas Coffs Harbour City (NSW) received just over $4 million ($61.80 per capita), and the City of Greater Shepparton (VIC) received more than $4.9 million ($82.82 per capita). This is despite all three Councils having similar population sizes and demographic structure.

The City of Mandurah contends that the Commonwealth Grants Commission should introduce a 'national distribution' model, providing General Purpose grants directly to Local Governments (bypassing the States), based on their relative 'need' (horizontal equalisation), rather than on their State's population. If the Australian and State Governments are serious about achieving an equitable national distribution of funds, then surely each Australian Council should be assessed against all other Australian Councils when competing for FAGs funding, rather than against only those Councils in their state?

Whilst each State's Local Government Grants Commission would no longer be responsible for determining the final quantum to be distributed among its Councils, they would retain a significant role in collating data on each Council within their State, and comparing each Council's disability factors with those in other States to determine which Councils have the greatest need.

The Productivity Commission's draft report briefly mentioned the PricewaterhouseCoopers' *National Financial Sustainability Study of Local Government* report, released in November 2006. The PWC study was given the task of assessing Local Government's viability, identifying issues affecting sustainability, developing recommendations to improve sustainability, and investigating potential reforms of inter-government funding, and made a number of recommendations in the areas of internal reform and inter-government funding.

One of the key PWC recommendations was revision of the current FAGs escalation methodology for 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). Whilst the Productivity Commission draft report noted the PWC report, it unfortunately did not highlight this key PWC recommendation.

**Additional Comments – Infrastructure Funding**

The Productivity Commission draft report also did not mention the PWC report's proposed introduction of a *Local Community Infrastructure Renewals Fund* (LCIRF). The LCIRF was proposed to support councils in the 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.

The City of Mandurah supports the implementation of an *LCIRF,* but considers that an additional model should be established to assist Councils experiencing long term rapid growth with the provision of new infrastructure. This proposal was highlighted in the City's previous submission.

In April 2007, the Australian Labor Party's National Conference outlined Labor's infrastructure and nation-building platform, which included the creation of *Infrastructure Australia* to assist in the planning and coordination of Australia's infrastructure needs. *Infrastructure Australia* will be an independent statutory authority whose role will be to analyse, monitor, report and assess delivery and operation of major infrastructure projects, and develop coordinated and objective approach to longer-term planning and development of nationally significant infrastructure.

In January 2008, the Prime Minister, the Hon. Kevin Rudd MP, announced that Federal Cabinet had approved the establishment of *Infrastructure Australia*. The Prime Minister announced that *Infrastructure Australia* would be a 'core statutory advisory council' with three primary roles:

1. To audit the current state of Australia's infrastructure stock;

2. To ensure that, subject to the audit's findings, a national infrastructure priority list is created, in order to best target the public dollar;

3. To work with State and Territory government, and other layers of government, as well as the private sector to ensure that these priority infrastructure projects are delivered[1].

Infrastructure Australia will also assess how to effectively coordinate public-private partnerships, particularly superannuation funds.

Infrastructure Australia will advise the new Federal Department of Infrastructure, and will consist of 12 members. Five members (including the Chair) will be from the private sector, three from the Commonwealth, three from State and Territory Governments, and one from Local Government (ALGA). *Infrastructure Australia* legislation is due for introduction during the first session of Federal Parliament in February, and the composition of the advisory council will also be announced at this time.

The City of Mandurah supports the creation of *Infrastructure Australia*, as a means of effectively coordinating and funding essential community infrastructure at the Local Government level.

[1] Australian Labor Party official website; Press conference 21 January 2008

## **Additional Comments – ALGA 10-Point Plan**

In September 2007, the Australian Local Government Association released its *10-Point Plan to Reinvigorate Local Communities*. The 10-Point Plan highlighted the ongoing struggle by Australian Local Governments to remain sustainable, and the actions required by the Australian Government to ensure that Local Government sustainability is upheld. The plan, which appears not to have been mentioned in the Productivity Commission draft report, is based on four priorities:

- Fair funding - a share of total Commonwealth taxation revenue; introduction of a *Community Infrastructure Renewal Program*; permanent *Roads to Recovery* funding; implementation of roads asset management plans;

- Fair treatment - direct Federal-Local partnerships; continuing to address cost shifting;

- Formal recognition – formal recognition of Local Government in the Australian Constitution;

- Meeting future challenges – responding to climate change; securing water resources; supporting sustainable urban regions; providing affordable high speed broadband.

As highlighted by PricewaterhouseCoopers in its November 2006 *National Financial Sustainability of Local Government* report, there exists a current national backlog of approximately $14.5 billion in Local Government infrastructure renewals. To address this massive infrastructure shortfall, the PWC report recommended the introduction of a *Local Community Infrastructure Renewals Fund* (LCIRF), providing approximately $250 million per annum for infrastructure renewal and replacement.

ALGA's 10-Point Plan concurred with the PWC report, calling for the implementation of a $250 million per annum *Community Infrastructure Renewal Program* for infrastructure renewal and replacement, although ALGA suggested that the fund could be limited to a four-year term. The City of Mandurah supported the implementation of ALGA's proposed *Community Infrastructure Renewal Program*, but contended that the program should not be used only for renewal and replacement of existing infrastructure assets, but be also used to build new infrastructure.

In April 2007, the National Sea Change Taskforce released a draft discussion paper – *A Policy Framework for Coastal Australia,* which supported the PWC proposal, but went further to recommend the introduction of an additional *Community Infrastructure Fund* for the provision of new infrastructure in 'sea-change' Local Government areas. The Taskforce paper outlined the additional needs of sea change Councils, including the need for new infrastructure to meet increasing tourism demands, to maintain existing tourism facilities, and to cope with large seasonal population fluctuations.

The City of Mandurah contends that the *Community Infrastructure Fund* proposed by the National Sea Change Taskforce should provide additional funding for Councils that are experiencing both long-term rapid population growth and large seasonal population fluctuations.

ALGA's 10-Point Plan also urged the Australian Government to increase Financial Assistance Grants to at least 1% of total Commonwealth taxation revenue, in line with the PWC report's recommendations. According to ALGA, FAGs funding has declined from 1.01% in 1996/07 to 0.76% in 2007/08. The City of Mandurah supports ALGA's call for the FAGs escalation methodology to be based on a combination of population growth and real Local Government costs e.g. wages and construction costs, rather than being based on population and CPI growth alone.

However, the City of Mandurah contends that reform of Financial Assistance Grants should go further, and that the existing national-state-local method of allocating FAGs should be overhauled, and replaced with a national distribution system.

## Additional Comments – ALGA 2008/2009 Budget Submission

In January 2008, ALGA released its 2008/2009 Budget Submission – *National Objectives Need Local Delivery* – to the Australian Government. The ALGA submission outlined five strategic priorities, which included delivery of Federal election commitments, reforms to intergovernmental relations, investing in national roads and transport systems, streamlining Local Government regulation, and addressing climate change and indigenous housing. The City's submission focuses on the following ALGA strategic priorities:

- Reform to Local Government general purpose funding;
- Investment in community and strategic infrastructure through Local Government.

The ALGA submission noted that, since the establishment of the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations in 1999, the level of FAGs funding to Local Government has not kept pace with the growth of Commonwealth and State revenue.

> *Yet the methodology for determining Local Government FAGs has remained relatively unchanged for decades, and is not linked to growth in the economy, unlike the general purpose funding for the States and Territories which is provided through the GST.*[2]

ALGA's submission called for a fixed share of Commonwealth taxation revenue of at least 1 per cent, which it claimed would increase Local Government FAGs funding from approximately $1.82 billion currently, to $2.44 billion in 2008/09.

The submission also highlighted the difficulty faced by Local Government in increasing rates, as State Governments become increasingly dependent upon property taxes. ALGA claimed that the tax burden placed on property owners by State Governments has increased from 30 per cent to 41 per cent of total State taxation revenues over the past six years. It also noted the effect of vertical fiscal imbalance (VFI) on State and Local Government budgets.

[2] Australian Local Government Association; 2008/2009 Budget Submission – *National Objectives Need Local Delivery*; January 2008; p.8.

> *Similarly, under our Federal system, the Commonwealth has an obligation to achieve horizontal equalisation across States and across Local Governments to ensure that all citizens receive equitable levels of government services. Currently FAGs are not adequately addressing VFI or horizontal equalisation.*[3]

The City of Mandurah concurs with ALGA's claim, particularly as it relates to the existing (and growing) inter-State FAGs horizontal equalisation inequity.

On the issue of Local Government infrastructure funding, ALGA made the valid point that many Councils, particularly those in regional and rural areas, are being forced to defer infrastructure investment and renewal in order to meet recurrent costs.

> *Much of Local Government's infrastructure was built in the 30 years to 1975, often with the assistance of one-off capital grants from other spheres of government, and is now reaching the end of its economic life. While the Federal Government is helping Local Government to address the roads infrastructure issues through the Roads to Recovery program (R2R), the issue of community infrastructure is a growing problem.*[4]

ALGA reiterated its call for the establishment of a *Community Infrastructure Renewal Program*, funded at $250 million per annum for four years, for the renewal and replacement of ageing community economic and social infrastructure. The City of Mandurah supports ALGA's submission, however it disagrees with the recommendation to <u>not</u> fund <u>new</u> infrastructure, which ALGA claims "would require additional revenues to maintain and renew."

Whilst the City acknowledges that the construction of new community facilities would ultimately add to Local Governments' future maintenance and renewal costs, in rapid-growth areas, the provision of new infrastructure is an unavoidable undertaking. It would be a pointless exercise to seek funding for renewal of a 30-year old community building designed to cater for a local population of say 10,000, when the current local population has since quadrupled.

For example, the City of Mandurah's Aquatic and Recreation Centre (MARC) was opened in 1982, when Mandurah's population was approximately 15,000. By 2001, with the City's population at almost 50,000, the MARC had already reached a 'saturation' plateau, with annual attendance in excess of 450,000 people. With the City's current population approaching 62,000, swimming areas at the MARC are consistently overcrowded, and existing facilities are inadequate to cater for current – let alone future - community demands. To suggest that the City should merely refurbish its existing swimming facilities, rather than seek to build new infrastructure to cater for population growth, would be illogical.

ALGA's submission also supported the establishment of *Infrastructure Australia*, as proposed by the Australian Government. As previously advised, the City of Mandurah supports the establishment of *Infrastructure Australia*.

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[3] Australian Local Government Association; 2008/2009 Budget Submission – *National Objectives Need Local Delivery*; January 2008; p.11.
[4] Australian Local Government Association; 2008/2009 Budget Submission – *National Objectives Need Local Delivery*; January 2008; pp.12-13.

**Additional Comments – Revenue Raising**

The Productivity Commission draft report noted that on average, Local Government's are currently raising about 90 per cent of their own-source revenue potential, which indicates that Councils' own-source revenue-raising capacity could theoretically be increased by about 10 per cent. This finding appears to support the view of many Councils that Local Governments are generally unable to continue providing adequate community infrastructure and services through the use of the rates mechanism alone.

Therefore, the Productivity Commission's claim that the major constraint on revenue raised by Local Government is 'the democratic process itself' i.e. their communities' willingness to pay, is unconvincing, as it is apparent that no amount of rates-hikes will completely eliminate Local Government's existing community infrastructure shortfall (estimated by PricewaterhouseCoopers at approx. $14.5 billion). Other sources of funding are required to bridge the growing infrastructure provision gap, and should include the removal of existing restrictions on Local Government fees and charges. The City of Mandurah estimates that it could significantly increase its fees and charges revenue if these onerous restrictions were lifted.

The draft report also appears to lack a clear definition of the difference between Local Government revenue and Local Government funding. The report's claim that Local Governments may source revenue through borrowing is questionable, as borrowing is not strictly a source of revenue, but a means of obtaining the equivalent of rates payments in advance, at which a premium (interest rates) is payable. Similarly, grants from other levels of government are not considered revenue, but rather 'top-up' packages intended to ensure that all Local Governments can provide services of a comparable nature.

The Productivity Commission report should also place greater emphasis on the link between Local Government's limited revenue raising capacity and its inability to adequately maintain assets and provide infrastructure. The report appears to concentrate on Local Governments' ability to finance its day-to-day operations, rather than its ability to fund long-term infrastructure planning, provision and maintenance.

Finally, the City contends that the report should place greater prominence on one of the greatest issues currently being faced by Australian Local Governments - cost-shifting. Particular areas of focus should be on incidences whereby Local Government assumes responsibility for a service, but is not adequately compensated for provision of the service; and the increased burden being placed on fewer rate payers as other users of community services and infrastructure are no longer required to pay rates e.g. retirement village residents.

## Recommendations – 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**

- **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**

- **Establish *Infrastructure Australia* to analyse, monitor, report and assess delivery and operation of major infrastructure projects, and to develop a coordinated and objective approach to longer-term planning, funding and development of significant Local Government community infrastructure. *Infrastructure Australia* would coordinate Commonwealth funding provided under the *Local Community Infrastructure Renewals Fund* and the additional *Community Infrastructure Fund***

- **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**

- **Ensure that the quantum of Commonwealth FAGs general purpose funding to Local Government remains at or above 1 per cent of total Commonwealth taxation revenue**

- **Provide Financial Assistance Grants directly to local governments via a national distribution model.**

## Recommendations – Western Australian Government

- **Introduce legislation to allow Western Australian Councils to set their own fee structures for Local Government services, and to use revenue to cross-subsidise other local community services and infrastructure as required. This outcome would significantly reduce Councils' reliance on rates as its primary source of own-source revenue**

- **Legislate to discontinue the practice of providing WA retirement villages that are operated by 'charitable institutions' with rates exemptions, except for any component of the village that provides high-care accommodation**

- **Abolish the 'Gross Rental Value' method of valuing land in Western Australia, and introduce an alternative valuation method, such as the 'Capital Improved Values' method**

- **State Governments to facilitate funding support to encourage Local Government efficiency and asset management reforms**

- **Continue to promote the *Connecting Local Governments* initiative as a means of helping WA Councils to achieve structural reform, whilst also promoting the rationalisation of Local Governments in Western Australia.**

## Recommendations – WA & Australian Governments

- **Establish long-term rapid population growth as a disability factor for the purposes of determining the Financial Assistance Grants general purpose grant allocation**

- **Legislate to discontinue the practice of exempting State and Federal Government organisations from paying Local Government rates.**

Mark Newman
**Chief Executive Officer**