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## 6 The effects of legislative and regulatory factors

### Key points

- A variety of legislative and regulatory restrictions are imposed by State Governments on the use by local governments of the revenue-raising instruments available to them. In particular:
  - rates exemptions are required to be given which reduce local governments' rates bases and do so differentially across local government areas
  - land valuation methods often are prescribed and there are limits on the extent to which local governments can apply differential rating structures within and between classes of ratepayers
  - statutory limits are imposed on some fees and charges for local government services, often at levels below the full costs of providing the services.
- There are some partial offsets. For example, local governments are exempt from some State and Commonwealth taxes. Also, State grants for the provision of some services subject to statutory limits on fees, reduce the net claim on local government revenues, to some extent:
  - Nonetheless, the restrictions generally affect the ways in which local governments can raise revenue.
  - As a result, they affect the distribution of the burden of revenue raising within communities and can have adverse consequences for the economic efficiency of the outcomes of local governments' decisions.
- Overall, however, in most jurisdictions the major constraint on revenue raising by local governments appears to be policy choices they make in response to the preferences of their local communities.
- The NSW situation appears to be somewhat different. Rate pegging and reimbursement of 55 per cent of State-mandated pensioner concessions suggest that the NSW Government has chosen to have more influence on local government revenue than have other State Governments.
- There is a case for periodic reviews of the restrictions and regulations imposed on local government by other spheres of government to assess both their rationales and their benefits and costs.

There are a number of legislative and regulatory requirements and restrictions placed on how local governments collect revenue from property rates, fees, charges and contributions. The potential limitations of local government processes were

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identified in chapter 4. Associated with these, possible motivations for legislative or regulatory controls on local government revenue raising are outlined in box 6.1.

**Box 6.1 Why regulate local government revenue raising?**

The literature contains various arguments that might support the case for regulation of local government revenue raising.

- It has been argued that because local governments are monopoly suppliers of some basic community services, their rates, fees and charges should be regulated to prevent misuse of monopoly power (Abelson 2006).
- Governments at higher levels might consider that the governance challenges in the local government sector are best overcome by direct regulation (Stiglitz 1999).
- Voters, if aware of the limitations of council governance, might prefer that other spheres of government impose legislative and regulatory constraints on councils' revenue-raising capacity (Dollery, Crase and Byrnes 2006).

Several submissions to this study have supported regulation of local government revenue raising on such grounds:

- Some argue for rate pegging on the basis that it limits the ability of councils to divert funds from essential infrastructure to other projects, and to spend on marginal services which are better provided by the private sector (Crisp, sub. 3).
- The Vacluse Progress Association (sub. 7) maintains that regulations on rates protect ratepayers somewhat from subsidising council services to non-ratepayers.
- The New South Wales Farmers' Association (sub. 43) claims that farmers need protection from further redistribution of the rates burden to them.
- The Launceston Municipal Ratepayers' and Residents' Association (sub. 10) suggests that Australian Government-imposed disincentives (such as withholding grants) to local governments that excessively burden their ratepayers (which it describes as setting rates above the national average) would be desirable for ratepayers. This would help to control cross subsidisation and restrict council provision of non-core services and infrastructure that might prove to be unsustainable by ratepayers.

In this chapter, the nature of these requirements or restrictions are identified and their impact is explored. The Commission's terms of reference refer only to their possible consequences for the revenue-raising capacity of local governments. However, constraints on the level and structure of rates, fees, charges and contributions might also influence the economic efficiency of revenue and spending decisions made by local governments. Similarly, they might affect the distribution of the burden of revenue raised among ratepayers (an issue which is examined in greater detail in chapter 7). Some of these consequences on efficiency and distribution are also noted in this chapter.

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In explaining the nature and importance of these constraints and their consequences, it is useful to distinguish between revenue from *rates* and revenue from *fees, charges and contributions* because:

- legislation and regulation apply differently for rates than for fees, charges and contributions
- as a general rule, it is more efficient to use rates revenue to fund public goods and services because these cannot be funded through market mechanisms, and to use fees, charges and contributions to fund goods and services with substantial private good characteristics because of the advantages of preference revelation.

## 6.1 Constraints on rates

In broad terms, revenue from untied grants and property rates constitute local government's general revenue — that is, revenue that is not tied to, or derived from, the provision of particular services. Property rates are the only tax instrument, and discretionary source of general revenue, available to local governments.

In this section, the legislative and regulatory constraints on the level and structure of rates, that have been identified by participants in this study as having an impact on local government revenue raising and decision making, are examined. Key constraints include:

- the land and property valuation methods imposed or allowed
- the ability to impose differential rates on different categories of ratepayer and other elements of the rating structure
- the exemptions required to be made for particular classes of land owners or users, offset by reciprocal tax arrangements (in part or in full)
- the concessions that must be applied to some categories of ratepayers, offset by reimbursements (in part or in full)
- rate pegging (currently imposed only in New South Wales, but to apply to residential rates in the Northern Territory for the next three years).

Some broad efficiency and distributional issues relating to rates revenue are discussed in box 6.2.

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### Box 6.2 Rates revenue — some efficiency and distributional issues

Access to sufficient rates revenue is necessary if local governments are to:

- provide services for which user fees cannot be charged appropriately (for example local roads, bridges, street lighting, drainage systems, many parks, visitor centres and some human services, such as public health campaigns)
- subsidise the provision of services for which other community members benefit in addition to the private benefits of individual users (that is, there are positive externalities)
- fund services where equity of access is considered important (for example, libraries, community centres and public toilets).

If legislative or regulatory factors constrain the capacity of local governments to raise revenue from rates, they might prevent local governments from providing these services and subsidies at the levels preferred by their communities (that is, levels for which the community would otherwise be willing to pay through rates).

Such legislative or regulatory constraints might also induce other distortions in local government decision making. Councils, for example, might decide to fully cost recover through user fees and charges, the provision of some services even though there is a case to at least partially subsidise them from rates. Or they might attempt to exceed cost recovery levels in order to generate extra income to supplement constrained rates revenue.

Another possible outcome of legislative or regulatory constraints might be to limit local governments' capacity to achieve the distribution of rates burdens among different ratepayers than they otherwise would choose. To the extent that this is so, or that local governments respond to rates revenue constraints by seeking other funding sources (or reducing services), there will be distributional consequences for ratepayers, in addition to efficiency impacts.

## Prescribed valuation methods

State Governments specify in legislation property valuation methods that can, or must, be used by local governments. These vary considerably across jurisdictions (table 6.1). In Victoria, Tasmania and the Northern Territory, councils have the greatest freedom of choice among three different bases. In South Australia, there are three choices, but two of these apply only in specific circumstances. In Western Australia, two methods are used, but these are restricted by land type, effectively meaning that there is no choice of methods. In New South Wales and Queensland, councils are restricted to a single valuation method. More information on valuation methods is provided in appendix B.

**Table 6.1 Property valuation methods permitted to be applied**

<i>Group<sup>a</sup></i>	<i>Method</i>	<i>NSW</i>	<i>Vic</i>	<i>Qld</i>	<i>WA<sup>b</sup></i>	<i>SA</i>	<i>Tas</i>	<i>NT</i>
A	Assessed annual value (AAV)						✓	
	Annual value (AV)					✓ <sup>c</sup>		✓
B	Capital improved value (CIV)		✓					
	Capital value (CV)					✓	✓	
	Improved capital value (ICV)							✓
C	Gross rental value (GRV)				✓			
	Net annual value (NAV)		✓					
D	Site value (SV)		✓			✓ <sup>c</sup>		
	Land value (LV)	✓					✓	
E	Unimproved capital value (UCV)							✓
	Unimproved value (UV)			✓	✓			

<sup>a</sup> Various terms are used across jurisdictions to describe methods that are essentially the same and these are grouped together. <sup>b</sup> Two methods are used in Western Australia, but these are restricted by land type: UV for rural only and GRV for non-rural only. <sup>c</sup> The AV and SV methods can be used in South Australia if the council declared rates for that land on that basis for the previous financial year; or if the council declared rates for that land on the basis of capital value for the previous three financial years.

Source: State government legislation various.

### *Views about prescribed valuation methods*

A number of submissions made to this study and reports commissioned by local governments suggest that prescribed valuation methods might be a constraint on revenue raising, both on rates revenue and total own-source revenue (PwC 2006; Beale, sub. 9; Local Government Association of Queensland [LGAQ], sub. 11; Local Government Managers' Association of New South Wales [LGMANSW], sub. 17; Pilbara Regional Council, sub. DR76; Shire of Collie, sub. 55; Mosman Municipal Council, sub. 60). It is argued that a limited choice of valuation methods constrains the flexibility of local governments to raise rates revenue, thereby reducing councils' ability to raise sufficient revenue to meet their infrastructure requirements and demands for public goods and services. This is claimed to be especially the case in New South Wales, Queensland and Western Australia.

Specifically, it is suggested that greater choice of valuation methods is associated with higher rates revenue per person and higher rates revenue growth. PwC data comparisons appear to indicate that, where State Governments permit councils to choose between valuation methods, councils tend to have the highest average rates revenue per person and have had the highest rates revenue increases over the five years to 2004-05 (Australian CEOs Group, sub. 18; PwC 2006).

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Beale (sub. 9, p. 8) claims in relation to New South Wales:

... the doubtful usefulness of the inflexible UCV indicates a new base is necessary plus the fact that users are not paying is the ultimate cause of lack of funds, from which the other problems [such as financial sustainability] are a natural progression.

Similarly, the Local Government Association of New South Wales (LGANSW) and the Shires Association of New South Wales (SANSW) (sub. 52, p. 12) argue:

ICV would help alleviate the apparent distortion where, for example, very high value home units pay significantly less rates than free standing homes (of comparable or lesser value) in the same council area ... Outside a rate pegging environment, capital values could increase a council's rate revenue-raising capacity by increasing the valuation base. Within a rate pegging environment, there may be indirect advantages via greater flexibility to maximise rate revenue through special rate variations; for example, better targeting of capacity to pay.

#### *Assessment of prescribed valuation methods*

The low rates of annual revenue growth in recent years in New South Wales and Queensland (figure 6.1), prima facie, appears broadly consistent with the view that prescribed valuation methods constrain rates revenue. This proposition is consistent with strong rates of growth in Victoria and South Australia. This, however, does not explain the low rates of growth in Tasmania and the Northern Territory, which are both permitted to use several property valuation methods for rating. Moreover, these statistical comparisons are far from conclusive, for two reasons.

First, it is likely that other factors have more directly influenced the rates revenue growth experienced in these jurisdictions. The low growth in New South Wales is more likely to be driven by rate pegging (discussed later in this chapter) than the land valuation method *per se*. Similarly, Victoria's highest increase in annual rates revenue over the period is likely to reflect, at least in part, a catch-up in response to the rates reductions imposed during the 1990s when local government amalgamations took place. Also, for South Australia, local government has a relatively heavy historical reliance on rates, rather than fees and charges, compared with other jurisdictions (South Australian Government Officials, Adelaide, pers. comm., 7 May 2007).

Second, and more fundamentally, it is not obvious why local governments using a particular valuation method, say UCV, should be more constrained than those using another, say CV. Local governments can set a higher rate in the dollar on their lower UCV valuation base to raise the same total revenue from their ratepayers as they would if they used CV. In such circumstances, rates revenue growth would reflect aggregate budget requirements rather than choice of valuation methods.

Figure 6.1 **Growth in real council own-source revenue**

Per person, per year, 1998-99 to 2005-06<sup>a, b, c</sup>



<sup>a</sup> Data are adjusted to 2005-06 dollars using the ABS non-farm GDP deflator. <sup>b</sup> Other revenue includes fines, developer charges and contributions, and other current and non-current revenue. <sup>c</sup> Data for Victoria before 2001-02 are derived from the Victorian Grants Commission collection because earlier years are unavailable from the ABS collection at the local government level. Data for the Northern Territory are from 1999-2000 to 2005-06 because data for 1998-99 are considered unreliable.

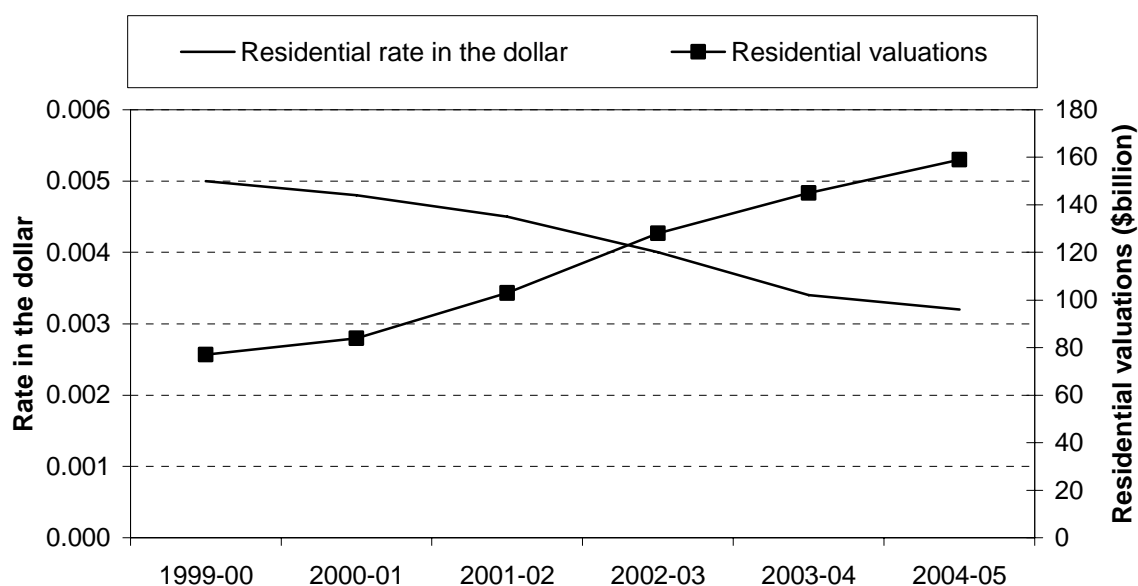
Source: ABS unpublished; Productivity Commission calculations.

The WALGA (sub. DR78, p. 4), however, notes that there are regulatory restrictions on rates for land covered under State Agreements. The Pilbara Regional Council (sub. DR076, p. 2) provides an example of how the requirement under s. 6.30 of the *Local Government Act 1995* (WA) to use specified amounts based on the size of land (appendix B) and on UV for rating natural resources, constrains the amount of rates revenue raised from commercial land under State Agreements:

Accordingly the unimproved value of 40 000 hectares of land being mined is only \$100 000. And to provide some perspective, this is less than a quarter of the price of an average home in the Pilbara.

Because councils alter the rate in the dollar each year to align with their budget requirements, rates revenue is typically less volatile than the underlying property valuations. Evidence of this using SA data shows that over the period 1999-2000 to 2004-05, as residential property valuations increased, the rate in the dollar decreased (figure 6.2). Similar results are available for Darwin (Darwin City Council unpublished).

**Figure 6.2 Residential property valuations and rate in the dollar**  
South Australia



Source: Adapted from Local Government Association of South Australia (LGASA) (2007).

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.*

Choice of valuation methods, however, will have implications for efficiency and distributional consequences of local government decisions. Using UCV (or SV) as the rates base is more economically efficient compared with CV. The use of CV (or annual rental equivalent) might distort land use decisions because it creates a disincentive to make capital improvements to property. Thus, in principle, the prescribed use of UCV and UV in New South Wales, Queensland and Western Australia have efficiency advantages (while not constraining rates revenue, in aggregate) over other methods. In practice, any efficiency effect of land valuation method adopted is likely to be relatively small in Australia because rates are relatively low.

In addition, the distribution of the rates burden between ratepayers will be different between valuation methods. Rates per residence, for example, would be higher under UCV, relative to CV, for those living in an inexpensive house compared with

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those living in an expensive apartment block on land of similar value.<sup>1</sup>

## **Differential rates and other elements of rating structures**

State Governments specify in legislation the rating structures (minimum rates, fixed and variable components, tiered or differential rates) that are permitted.<sup>2</sup> These specifications vary across jurisdictions and are described in detail in appendix B.

There are broad limits to the extent to which councils may determine the composition of land categorisation (for example, residential, commercial, farmland or agricultural, and mining) and other structural elements (for example, the setting of fixed and variable rates components). There are sometimes more detailed specifications within this. For instance, NSW land is not to be categorised as farmland if it is rural residential land. There are also other flexible rating options in some jurisdictions. Among them, ‘mixed development apportionment factors’ provide further rating options in New South Wales allowing councils to rate land with both residential and business uses proportionally (LGANSW and SANSW, sub. 52; *Local Government Act 1993* s. 518[B], 519 and 515[2]).

### *Views about differential rates and rating structures*

The dominant view from participants and other commentators appears to be that constraints imposed by State Governments on rating structures are minimal, and that the legislative categorisations of differential rates provide adequate scope and flexibility. The LGANSW and SANSW (sub. 52), for example, noted that the Local Government Act provides considerable scope to categorise properties for rating purposes, as well as minimum and base rates, and special rates mechanisms. Most NSW councils apply differential rating to at least the main, four-category, level of property type. Administrative simplicity appears to be a primary reason for not more fully utilising differential rating options, such as property type sub-categories.

Similarly, the LGAQ (sub. 11) notes that legislative flexibility of differential and special rating instruments assists Queensland councils to more fully access rates revenue.

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<sup>1</sup> Such differences might cause interactions between perceptions of value for money and willingness to pay, although they might be able to be mitigated through the use of differential rates sub-categories in some jurisdictions (Queensland, for example), but not in others (New South Wales, for example).

<sup>2</sup> There are also *special* and *separate* rates in some jurisdictions (see appendix B for details). The characteristics of these rating instruments are more similar to fees and charges than to rates, because they are identifiable to the service for which they are collected and to those they benefit.

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## *Assessment of differential rates and rating structures*

Rating structures that councils are typically permitted to apply provide them with a high degree of flexibility. However, the ability of local governments to differentiate between and within categories of ratepayers is not unlimited. In particular:

- there can be limits on the degree of differentiation allowed between ratepayer categories. In Victoria, for example, ‘the highest differential rate in a municipal district must be no more than 4 times the lowest differential rate in the municipal district’ if using CIV (s. 161[5] *Local Government Act 1989* [Vic])
- where minimum rates can be applied, there usually are limits on the proportion of properties that can be subject to them, or on the proportion of rates revenue that can be collected from them
- more generally, within each differentiated ratepayer category, councils are restricted to applying uniform rating structures, including a uniform rate in the dollar of property valuation.

Generally, these sorts of restrictions do not limit the capacity of local governments to meet their overall revenue requirements. They can, however, limit the ability of local governments to determine the distribution of rates burdens between and within categories of ratepayers. For example, in the residential rates category, some councils report that they are constrained in setting the rate in the dollar by their assessment of what pensioners can afford to pay (after taking into account State Government funded concessions). Since councils can only apply a single uniform rate in the dollar to all residential ratepayers, this might limit their capacity both to raise revenue in the residential category and to distribute the rates burden to reflect their preferred outcomes. However, the strategic use of, for example, minimum rates, fixed charges, and concessions or rebates, can help to alleviate some of these impacts.

Some councils use sophisticated modelling approaches to rate setting, taking into account all of the options available to them and can do so at a cost outweighed by the resulting substantial benefits (Maroondah City Council, sub. DR93). For other councils, the costs of modelling and administering complex rating structures is likely to lead them to choose not to fully utilise the flexibility which, in principle, is available to them.

### FINDING 6.2

*Differential rating provisions generally increase the capacity of councils to raise revenue from property rates. They do so by enabling councils to structure better rates payable to the different capacities to pay of, and services received by, different categories of ratepayers.*

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## Rating exemptions

Rating exemptions are prescribed in State legislation. Although these vary across jurisdictions, common exemptions include much Commonwealth and State-owned land, and land used by public hospitals, libraries, cemeteries, charities, religious organisations, universities, schools and foreign embassies, many of which are non-government not-for-profit organisations. Exemptions are described in detail in appendix B.

### *Views about rating exemptions*

According to some submissions and research, rating exemptions act as constraints on rates revenue-raising capacity (Australian CEOs Group, sub. 18; Australian Local Government Association, sub. 50 and DR79; Beale, sub. 9; City of Boroondara, sub. 24; City of Gosnells, sub. 12; City of Mandurah, sub. 36 and DR73; Department of Transport and Regional Services [DOTARS], sub. 38; Guyra Shire Council, sub. 23; LGANSW and SANSW, sub. 52; Local Government Association of the Northern Territory [LGANT], subs. 46, DR92; LGAQ, sub. 11; Municipal Association of Victoria, sub. 22; North Sydney Council [NSC], sub. 13; NSW Farmers' Federation, sub. DR75; Victorian Farmers' Federation, sub. 31; Wellington Shire Council, DR74; Western Australian Local Government Association [WALGA], subs. 51, DR78; Willoughby City Council, sub. 30).

Rates exemptions provided by councils to other spheres of government are extensive. For example, the NSW Farmers' Federation (sub. DR75, p. 2) states:

... the Association would hypothesise that the effect of rating exemptions has a more severe effect on rural, regional and remote councils. For example, National Parks do not currently pay local council rates. With 7 per cent of the State covered by national parks it represents a significant area of land within local government areas where no rating revenue is raised ... Similarly 34 per cent of NSW land area is State forest. Forests NSW currently do not contribute towards local government rates although there are some situations where agreements between Forests NSW and local councils provide for funding of some roads and local bridges ... Furthermore, rural areas of NSW are also experiencing an increase in the number of small landholders who are purchasing agricultural land and gifting or donating this land for conservation purposes. This land is in turn taken out of the land base on which rates are levied and results in a reduced ratepayer base.

It has been further suggested by Dollery, Crase and Johnson (2006, p. 33):

That State Governments are exempt from rates, even for some commercial activities ... further limits the revenue-raising powers of local government, and sees local communities subsidise the activities of State Governments.

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Others suggest that, although rate exemptions to other spheres of government are a constraint, they are not a major one. In particular, some arrangements enable local governments to levy rates on selected State-owned land (PwC 2006). LGAQ (sub. 11, p. 4) notes:

... while rate exemptions provided to State and Federal government agencies do have some impact on the revenue base of councils, it is not as significant [an] issue as it once was. Most government agencies that are of a commercial nature do pay general rates. However, there are some anomalies that should be addressed.

Where rate equivalent payments are made directly to Australian or State Governments by entities that have received local government rates exemptions, these are not always subsequently redistributed to local governments (Dollery, Crase and Byrnes 2005; Hawker Committee 2003). The LGMANSW (sub. 17) claims that the NSW Government does not necessarily pass on these payments to local government.

Some commercial activities, such as business initiatives by airport lessee companies on Commonwealth Government-owned land, are partly exempt from rates in some cases. According to the Australian Mayoral Aviation Council (2007, p. 4):

In the further interests of the policy of competitive neutrality, the Commonwealth has included in the airport leases a clause which requires the airport lessee companies to pay to the relevant local authority an amount equivalent to rates for those parts of the airport site which are leased or on which financial or trading operations take place. The lease provisions are very clear and specific but the Department of Transport and Regional Services has continued to administer the lease in such a way, contrary to the lease provisions, as to encourage the airport lessee companies to expect that they are entitled to some sort of discount on the amount payable. Such action clearly puts the airport lessee companies in a privileged position compared to other similar ratepayers.

Some non-government operations of an essentially commercial nature on rates-exempt land also escape rates payments. As the City of Mandurah (sub. 36, p. 7) explains:

... retirement villages that are operated by 'charitable institutions' should not be provided with rates exemptions, except for any component of the village that provides 'high-care' accommodation.

Similarly Wellington Shire Council (DR74, p. 2) states:

A key issue for us is the inability to rate infrastructure that is owned by large corporations which is currently exempted in Victoria (and maybe other States). Specifically Council has gas pipelines traversing the municipality which are currently unrateable under the Victorian Gas Act. Latrobe City Council has a similar issue with coal mining and electricity generating plant in the Latrobe Valley ... The impact of State regulation has potential from time to time to disrupt and erode Council's revenue base. A current example of this is the Victorian Government's 'Water Unbundling'

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initiative which separates the value of irrigation water from the value of the property and therefore excludes it from municipal valuation for rating purposes. Council estimates that this particular initiative will cost us \$500 000 per annum on a recurring basis.

The LGANT (sub. DR96) also identifies that even after the NT New Local Government Reform initiatives are implemented, not all classes of mining tenements (for example, licences) will be rateable.

### *Assessment of rating exemptions*

The City of Gosnells (sub. 12, p. 1) attempts to quantify exemptions to charities in Western Australia, arguing they are a major constraint on local government revenue-raising capacity:

Section 6.26(2)(g) of the Western Australia *Local Government Act 1995* ‘prevents local governments from rating land used exclusively for charitable purposes.’ The estimated value of rate revenue forgone by local governments in Western Australia as a result of this legislation is around \$6.5 million.<sup>3</sup>

Although exemptions prevent local governments from raising rates revenue from rates-exempt entities, they do not limit overall rates revenue. However, rates exemptions can limit revenue raising for some councils, such as those with low rates bases, such as some rural and many remote and Indigenous councils, or those that have large exemptions relative to their rates base. For these councils it might not be feasible to compensate for rates exemptions by applying higher rates to other ratepayers.

FINDING 6.3

*Rates exemptions reduce local governments’ rates bases and do so differentially across local governments with different proportions of exempt land. Whether exemptions constrain the overall capacity of local governments to raise revenue from rates depends on the extent to which it is (politically) feasible for them to set rates higher than otherwise would be required on non-exempt land.*

Although local governments are obliged to provide rates exemptions to other spheres of government, there are also reciprocal tax arrangements, whereby local governments receive exemptions from paying taxes and charges to other spheres of government. Local governments, for example, receive exemptions from payroll tax,

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<sup>3</sup> ABS (unpublished) data indicate that WA rates revenue for 2005-06 is \$928 million, therefore \$6.5 million in forgone revenue is approximately 0.7 per cent.

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stamp duty and debits tax, as well as income tax.<sup>4</sup> These might, at least partially, offset any disadvantage experienced from rates exemptions given by local governments to other spheres of government (FSRB 2005; LGAQ, sub. 11).<sup>5</sup>

There is a paucity of data available to assess the net effect of rates exemptions plus the gains from Commonwealth and State provided tax benefits (that is, reciprocal tax arrangements). Available estimates of the net effect are incomplete and inconclusive (City of Ryde sub. 45; FSRB 2005; SCEFPA 2003; LGAT sub. 42; Victorian Government 2007). For example, LGAQ (sub. 11) suggests that, in Queensland, reciprocity might largely offset the impact on local government revenue arising from Commonwealth–State exemptions (and concessions, discussed below). Further, LGAQ (sub. 11, p. 29) estimates:

... mandated exemptions and concessions potentially amount to around \$100 million per annum in revenue forgone across Queensland councils ... councils are exempt from some taxes and charges of other spheres of government ... It is very difficult to accurately estimate the extent of benefit conferred on Queensland councils from such exemptions. It is possible that they could be around the \$100 million mark noted as the revenue lost by mandated rate exemptions and concessions.

Rating exemptions also have efficiency and distributional implications. One potential efficiency issue is that exemptions might benefit private entities by reducing the cost of producing their goods and services. This can distort economic activity, by encouraging increased consumption of these goods and services. LGANSW and SANSW, and NSC provide examples:

... the distinction between public and private or commercial use is becoming blurred in many instances. This arises in areas such as seniors residential and aged care facilities. Many facilities operated under the banner of churches, charities and benevolent institutions bare little distinction from privately owned complexes and facilities. Similarly, many councils cannot see why rate exemptions apply to the large land holdings of many private schools, a large proportion of which is utilised for sporting, recreational, staff accommodation and other non-core educational uses. (LGANSW and SANSW sub. 52, p. 16)

Government buildings, government agencies and private schools attract large numbers of workers and students from outside the North Sydney Council's boundaries who utilize the local facilities without making any financial contribution. If these organisations were rateable then Council could expect to receive a significant increase in rate revenue. (NSC sub. 13, pp. 4-5)

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<sup>4</sup> Debits tax has been abolished in some jurisdictions (for example, New South Wales and Western Australia) but continues to apply in others. For example, in Victoria local governments are exempt from debits tax unless it relates to business activities of local government (SROV 2007).

<sup>5</sup> NSC (sub. 13), however, claims that NSW local governments are disadvantaged because they are not completely exempt from taxes and charges of other spheres of government.

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In addition, rating exemptions have distributional effects. Abelson (2006, p. 8) suggests that there are inequities in some jurisdictions due (in part) to wide ranging rate exemptions. The City of Boroondara (sub. 24, p. 6) explains:

The existence of rate exempt properties reduces the opportunity to raise revenue as the rating burden is transferred to the owners of remaining rateable properties.

The total dollar amount of rates required for a council's budget will not change, but the burden of rates will be higher than otherwise on rateable properties, and these distributional impacts will vary between local governments.

### **Rating concessions and rebates**

Rating concessions and rebates are prescribed in legislation across jurisdictions. These are commonly for pensioners and other welfare recipients (holders of Commonwealth health care cards and various State concession cards — see, for example, *Rates and Charges [Rebates and Deferments] Act 1992 [WA]*). They even apply to some privately owned commercial property (see below).

#### *Views about rating concessions*

In most jurisdictions, rates revenue losses from State government mandated levels of pensioner concessions are fully rebated by State Governments (Australian CEOs Group, sub. 18; Australian Local Government Association, sub. 50; Beale, sub. 9; City of Boroondara, sub. 24; DOTARS, sub. 38; LGANSW and SANSW, sub. 52; LGANT, sub. 46; LGAQ, sub. 11; Municipal Association of Victoria, sub. 22; NSC, sub. 13; WALGA, sub. 51).

However, there are some exceptions. Most notable is the case of New South Wales where only 55 per cent of rates revenue lost from pensioner concessions is reimbursed by the State Government (Dollery, Johnson and Byrnes 2007; IIFS 2006; NSC, sub. 13).

LGAQ (sub. 11, p 18) maintains that legislatively required concessions are one of the few constraints on council rating in Queensland and provides an example of:

... the requirement of s. 25 of the Queensland *Valuation of Land Act 1944* to give developers a 40% concession on rates per property while they are still in the original developers name. In addition, Councils cannot charge a minimum rate on these lots resulting in some situations where the developer landowner pays less than \$10 in rates per subdivided lot. This contrasts with rates paid by individual owners of vacant lots who would typically pay a minimum of between \$350 to \$400 in general rates ... Because of the concession, the properties pay only \$12 million, an effective subsidy by other ratepayers of some \$8 million.

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Local governments in some jurisdictions (see appendix B, table B.3) can choose to waive, rebate or defer revenue owing to councils. Concessions of this nature appear to be policy choices of individual local governments, as distinct from State legislative or regulatory requirements. The LMRRA (sub. 10, p. 27) gives the example that Launceston City Council is providing various concessions to private, for-profit organisations and this results in forgone revenue to the Council:

Launceston ratepayers are burdened beyond a reasonable level through Council-owned properties not being let to the public at large at commercial rental rates plus equivalent municipal rates (including water, sewerage and fire levy's etc.) and land tax, commonly charged in the private sector for commercial tenancies.

COTA (2005, p. 2) claims that in Western Australia:

... some local government authorities are considering abandoning their early payment discounts for rates as the State Government does not compensate them for the discount.

Further, the WALGA states that 'State mandated concessions for local government rates should be funded by the State' (sub. 51, p. 23) implying that (other than pensioner concessions on rates) not all other concessions are fully reimbursed.

### *Assessment of rating concessions*

Whether or not legislated rating concessions reduce rates revenue-raising capacity by local governments depends on:

- the extent to which councils are compensated by other spheres of government for the lost revenue
- the ability to recoup any remaining rates revenue forgone by increasing the rates paid by other ratepayers, in order to meet councils' total budget requirements
  - any minimum, or fixed amount, of rates might prevent councils setting a sufficient level of rating for residential (or urban) ratepayers to compensate for concessions, in areas with high levels of people eligible for concessions.

Information presented here suggests that councils (with the exception of those in New South Wales), are fully reimbursed for rates concessions to pensioners that local governments must provide at the discretion of State Governments. This is generally the most significant concession, by value.

Another issue (albeit not due to statutory requirements) associated with foregone rates revenue through concessions, is that many local governments set council policy to provide pensioner concessions that are above the level required and rebated by, State Governments. The rebated value of the concessions relative to rates otherwise payable appears to have diminished over time (in some States) and

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local governments have self-funded additional concessions and rebates.

An example from the WALGA, however, notes that there are sometimes specific circumstances whereby State regulation does prohibit councils granting a concession in relation to a rate or service charge on the basis of whether the land is occupied by the owner of the land (WALGA, sub. DR78; *Local Government [Financial Management] Regulations 1996* part 5, reg. 69[A]). This might have revenue-raising implications if it means that a council sets the rate in the dollar for residential ratepayers lower than it would have if it was permitted to offer concessions to owner-occupiers (in order to reduce the rates burden on owner-occupiers).

Notwithstanding that there might be little revenue-raising constraint arising from rating concessions, they have a distributional impact on the remaining rateable properties, as previously discussed in the ‘rating exemptions’ section.

### **Rate pegging**

Rate pegging refers to State government restrictions on the annual percentage increase in rates revenue. Rate pegging is currently applied in New South Wales only (and has been since 1977). However, NT residential rates are to be capped in municipalities to the Consumer Price Index (CPI) for the first three years (DLGHS 2007) of the NT Government’s New Local Government reform program. Rate pegging was also applied temporarily in Victoria in the early 1990s and in South Australia in the late 1990s (Dollery, Crase and Byrnes 2006; IIFS 2006; PwC 2006). These rate freezes (and rates reductions in Victoria) were applied as part of a package of local government reforms that included amalgamations, intended to achieve efficiency savings (Australian Services Union, sub. 27; OMPLG Victoria 1996).

The Australian Services Union (sub. 27, p. 15) notes:

... local government and some hundreds of councils throughout Australia are, or have been, faced with rate pegging or limitations of one sort or another by some State Governments.

Any State Government can, through its regulatory powers, impose some form of capping on annual movements in rates. The FSRB (2005, p. 55) notes, for example, that in South Australia:

State politicians have proposed capping annual movements in rates to CPI movements. Such a cap based on the CPI — or any other index that does not reflect the annual movement in (efficient) costs of providing services — is unwarranted and will only put upward pressure on rates at some time in future.

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Similarly, the LGASA (sub. DR86, p. 20) notes ‘increased regulation is a constant threat to local government. For example, a cap on rates based on the CPI is always a possibility’. Further, this does not take into account the circumstances of individual councils.

This section focuses on the NSW rate pegging system, the only ongoing system operating currently, to illustrate the issues involved in this form of constraint on rates revenue raising (box 6.3 and appendix B).

**Box 6.3 Rate pegging in New South Wales**

Under s. 506 of the *Local Government Act 1993*, the NSW Government sets a limit on the percentage increase in total general income that councils can raise from particular rates and charges. This is called the rate-peg percentage and it is specified by the Minister for Local Government each year.

Under s. 508 of the Act, councils can apply for Ministerial approval to exceed the rate-peg percentage (that is, seek a special variation). This approval is usually for one year, but can be for up to seven years. There are extensive informational and reporting requirements associated with such applications.

*Source:* DLG (2006, 2007d); DLG (sub. DR92).

*Views about rate pegging*

On the basis of submissions and literature considered, there are perceived to be three main effects of rate pegging (Australian Services Union, sub. 27; Baulkham Hills Shire Council, sub. 28; Beale, sub. 9; Economic Planning Advocacy, sub. 14; Fitton, sub. 26; LGANT, sub. DR96; LGMANSW, sub. 17; Mosman Municipal Council, sub. 60; NSW Inland Forum, sub. DR88; Shoalhaven City Council, sub. 25; Willoughby City Council, sub. 30). Specifically, it is suggested that rate pegging might:

- constrain the scope for local governments to raise sufficient rates, and total own-source revenue, to meet community preferences for local government services
- create an incentive to increase fees and charges as an alternative source of revenue to rates
- create additional compliance and administrative costs.

Each of these claims is examined below, including the extent to which any of these effects might distort local government decision making.

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One view is that rate pegging in New South Wales is a significant constraint on revenue raising, both on rates revenue and total own-source revenue. It is claimed that this is because it limits the ability of councils to raise:

- revenue autonomously (Hornsby Shire Council, sub. 40; Lane Cove Council, sub. 16; LGANT, sub. DR96; LGAQ, sub. 11; LGAT, sub. 42; Mosman Municipal Council sub. 60; NSC, sub. 13; Penrith City Council, sub. 19; Tumbarumba Shire Council, sub. 8)
- rates commensurate with the need to meet infrastructure requirements and community demand for local public goods and services (Australian Services Union, sub. 27; Bankstown City Council, sub. 41; Baulkham Hills Shire Council, sub. 28; Dollery, Crase and Byrnes 2006; LGANT, sub. DR96; Sutherland Shire Council, sub. 39).

Access Economics (2006a, p. v) states:

... were councils with relatively low rates revenue per assessment and/or relatively low degrees of cost recovery in their tax-supported sector not constrained by rate pegging and other forms of State government regulation, they would be able to increase their revenue-raising efforts to levels commensurate with higher-effort councils. Admittedly, a proportion of differences presently observed among councils in per person revenue collections is no doubt due to differences between them in average household and business income levels. However, even if only 50 per cent of the observed differential in per person collection levels were eliminated, our modelling indicates that the combined effect of increased investment income and increased revenue-raising effort could see the total operating revenues of the tax-supported sector of NSW councils on average a further 12 per cent higher in real per person terms in 10 years time.

In some cases, this constraint might adversely affect financial sustainability by exacerbating fiscal stress on local governments. This might especially apply to councils servicing a growing population, compared with councils with either a static, or a diminishing population given that the increase relates to total rates, not rates per person.

Even where special variations to increase rates are approved by the Minister, it is claimed that these do not address the underlying, ongoing problem of rates revenue not keeping up with rising costs (Australian Services Union, sub. 27; Bankstown City Council, sub. 41; City of Boroondara, sub. 24; Fitton, sub. 26; Guyra Shire Council, sub. 23; LGANT, sub. DR96; LGMANSW, sub. 17; NSC, sub. 13; Penrith City Council, sub. 19; Shoalhaven Shire Council, sub. 25).

An alternative view is that rate pegging is not a significant constraint on rates, or own-source revenue raising because:

- rates revenue might be constrained by factors other than rate pegging — most

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importantly, the willingness of communities to pay. That is, if the peg were removed, rates might be similarly constrained by political factors

- other provisions, including special variations, allow considerable discretion in raising rates revenue
- the ability to raise revenue from other sources allows considerable discretion in raising revenue even where rates are restricted.

In particular, local governments might be induced to offset pegged rates revenue by seeking increases in revenue through user fees and charges, where possible. In New South Wales, Crisp (sub. 3) asserts that permitting cost transfers (this is both capital and operational) from general rates to charges for services, enables a council to offset constraints that otherwise would apply because of rate pegging. Lane Cove Council (sub. 16) and the LGMANSW (sub. 17) explain that rate pegging is largely the reason why local governments over the past 10 to 15 years have accessed more direct user charges (such as from property portfolios, that might comprise council premises, community facilities, parking stations and rental properties), parking fines and investment income as alternative revenue sources to rates.<sup>6</sup>

### *Assessment of rate pegging*

The international literature provides examples which suggest that rate capping is a constraint on rates revenue. Some US studies suggest rate capping:

- reduces the level and growth of property rates revenue in capped jurisdictions compared with uncapped ones
- changes the composition of revenue from property rates to other taxes, fees and charges (ACIR 1995; Dye and McGuire 1997; Mullins 2004; Mullins and Joyce 1996; Shadbegian 1999).

The Australian literature documents similar outcomes (Carnegie and Baxter 2006; Crase and Dollery 2005; Dollery, Crase and Byrnes 2005, 2006; FSRB 2005).

Nevertheless, rate pegging in New South Wales is not absolutely binding. There are provisions for councils to seek Ministerial approval to increase their revenue beyond the rate peg, to raise special rates and to exercise discretion in setting base and *ad valorem* amounts of ordinary rates (Abelson 2006; *Local Government Act 1993* NSW).

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<sup>6</sup> It is likely that the provision of local government services in most jurisdictions has shifted somewhat from rates funding to a greater emphasis on user fees and charges because of the economic reform culture in all spheres of government over the past couple of decades.

Many councils have successfully applied for special levies, such as environmental levies or infrastructure levies, as well as levies in commercial areas for streetscape improvements. Further, if a NSW council does not take advantage of the full rate peg available for a particular year, it can recoup the shortfall in either or both of the next two years (Abelson 2006; DLG 2007a, 2007d).

The NSW Minister for Local Government appears to approve most applications (on average 82 per cent, over the past seven years) by councils to increase rates by more than the rate peg (table 6.2). For 2007-08, this resulted in rates increases in some councils of just below 10 per cent, equivalent to nearly three times the rate peg (AFR 2007; Lynch 2007; Nicholls, Jacobsen and Garnaut 2003).

**Table 6.2 Applications to exceed the NSW rate peg**

Year	Total councils		Councils applied			Applications approved		Rate peg
	No	No	No <sup>b</sup>	%	No <sup>c</sup>	No <sup>d</sup>	%	%
2001-02	173	27	1	16	10	8	67	2.8
2002-03	172	30	2	17	14	8	73	3.3
2003-04	153	23	–	15	14	9	100	3.6
2004-05	152	25	–	16	22	–	88	3.5
2005-06	152	42	2	28	24	6	71	3.5
2006-07	152	39	2	26	27	6	85	3.5
2007-08 <sup>a</sup>	152	34	–	22	28	3	91	3.4

<sup>a</sup> Data for 2007-08 might be under-reported because, for example, the Department of Local Government has indicated the Minister will likely approve another council's application of 5.54 per cent which is not included above. <sup>b</sup> Withdrawn applications. <sup>c</sup> Approved as requested. <sup>d</sup> Approved at a lesser amount than requested.

Source: Lynch (2007); DLG (2006); DLG (sub. DR92); DLG unpublished.

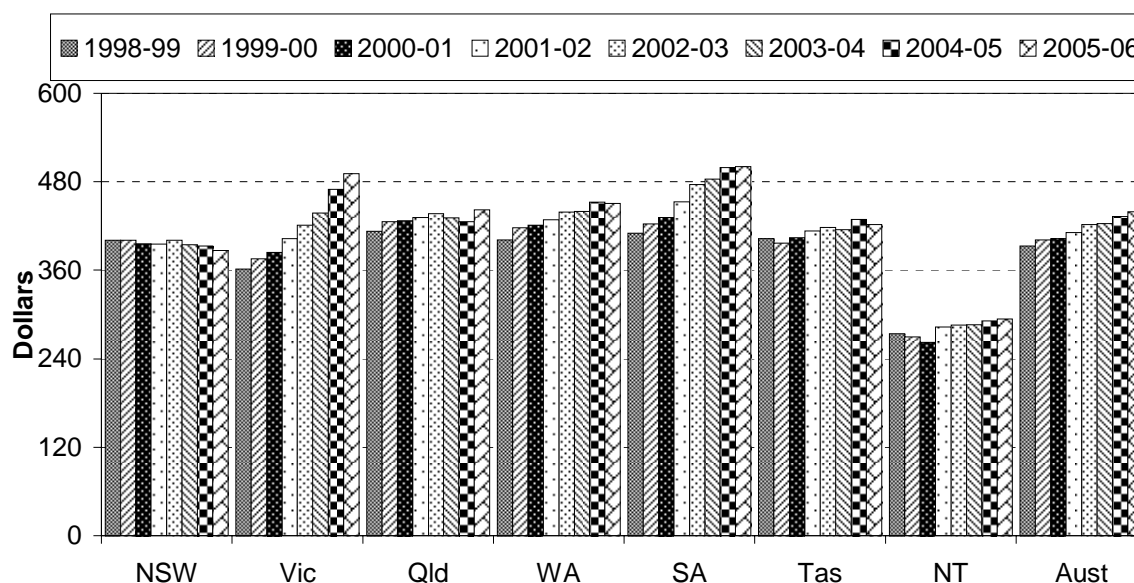
Notwithstanding the approval of numerous applications, the NSW Inland Forum (sub. DR88, p. 3) states that 'previous ministers have publicly stated that they will not approve applications which exceed 10 per cent regardless of the merits of the application'. Some statistical evidence also appears to support the view that rate pegging does restrict increases to rates revenue. New South Wales had the lowest average real rates revenue per person (\$387, compared with other jurisdictions between \$422 and \$501 per person) in 2005-06 (Northern Territory results excluded, because many areas were not rateable in 2005-06) (figure 6.3). Furthermore, NSW real rates revenue per person was largely unchanged between 1998-99 and 2005-06, compared with increases in all other jurisdictions, and an average national growth of 1.4 per cent per year (figure 6.1, presented earlier).

Moreover, the statistical evidence does not support the view that rates constraints can be offset by other revenue sources. NSW councils have the lowest growth in real own-source revenue per person of 0.3 per cent a year over the period 1998-99 to 2005-06, compared with a national average of 2.2 per cent per year (figure 6.1).

In particular, local governments in New South Wales had a lower than average growth rate from sales of goods and services. NSW revenue per person from sales of goods and services increased by 0.2 per cent per year compared with the national average annual growth per person from 1998-99 to 2005-06 of 1.9 per cent.

This might be driven, at least in part, by the already higher levels of revenue from sales of goods and services by NSW local governments. Specifically, real revenue per person from sales of goods and services was \$343 on average in 1998-99 compared with the national average of \$292. Between 1998-99 and 2005-06, NSW local governments sales of goods and services revenue per person ranged from \$342 to \$369, higher in each year than the national average, which ranged from \$292 to \$346 (ABS unpublished, PC calculations).<sup>7</sup> This might suggest that any opportunity to offset forgone rates revenue with additional fees and charges might have been utilised some time ago, ahead of local governments in other States, in response to the introduction of rate pegging, and the scope for further increases has been minimal more recently.

Figure 6.3 Real rates revenue per person<sup>a</sup>



<sup>a</sup> Data are adjusted to 2005-06 dollars using the ABS non-farm GDP deflator.

Source: ABS unpublished; Productivity Commission calculations.

<sup>7</sup> In adjusting sale of goods and services data to remove revenue amounts raised from commercial water and sewerage services, results are consistent with this trend. NSW real revenue per person from sales of goods and services was \$194 on average in 1998-99 compared with the national average of \$176. Between 1998-99 and 2005-06, NSW local governments sales of goods and services revenue per person ranged from \$184 to \$200, higher in each year (except in 2001-02, where it was approximately equal) than the national average, which ranged from \$161 to \$201.

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## Overall assessment of rating issues

Analysis suggests that the overall impact on revenue raising of State government legislative and regulatory requirements is minimal in most jurisdictions because of the considerable flexibility in rating regimes. Most constraints can be mitigated, at least to some extent, because they are either avoided or other categories of revenue are raised. However, New South Wales appears to be the exception. Its rates revenue raising per person has been the lowest of all jurisdictions over the past seven years and appears to be restricted by rate pegging. Further, there is only part compensation (55 per cent) for State mandated concessions.

The political visibility of rates is high, largely because they are paid in a lump sum or quarterly (Caulfield 2000; Groenewegen 1990; Oates 2001). The political environment, rather more than legislative and regulatory constraints of State Governments, is likely to be the key factor driving revenue-raising decisions of local governments.

Legislative and regulatory impacts on the capacity of most local governments to raise rates revenue appears to be minimal. Notwithstanding this, there are both economic efficiency and distributional effects that might arise from State government restrictions on rating levels, structures, exemptions and concessions.

FINDING 6.4

*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 in recent years.*

## 6.2 Constraints on fees, charges and contributions

A wide variety of local government services are provided on the basis of users paying a fee which covers at least part of the costs of supply (see appendix B). These range from charges in some jurisdictions for the supply of water and sewerage services, to fees for the use of recreational and sporting facilities and for licences (for example, dog registration) or for permits (building approvals and on-street parking).

Some broad efficiency aspects of fees and charges are discussed in box 6.4. Conceptually, it is useful to distinguish between two broad categories of services and their associated fees and charges.

- *Compulsory* services and charges that ratepayers cannot avoid. Typically, these are property based services such as sewerage, garbage collection and disposal,

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and recycling. Most local governments use fixed annual charges for such services, usually accompanying rates notices. Other examples are the special rates that a local government can levy for a service that is judged to especially benefit particular properties.

- *Discretionary* services that residents can choose to consume or not, and hence pay or not pay, according to their preferences. These range from some property services (such as development and building approvals and use of larger garbage bins), to a range of human services, recreational activities and information provision.

**Box 6.4      Some efficiency aspects of fees and charges**

In situations where services have private goods characteristics, it is generally preferable to provide them on a fee-for-service (user-pays) basis, rather than fund them out of rates revenue. If user charges are set to appropriately recover the opportunity cost of the resources used to supply the services, and the quantity supplied is responsive to user demand (willingness to pay), an efficient outcome is likely to result. Such an outcome is less assured if these services are funded out of rates revenue and service levels determined through political and administrative processes.

This is the case where the services are purely 'private' in that the benefits of their use by each consumer accrue solely to that user. But even where there are judged to be 'spillover benefits' to the rest of the community from an individual's (or group's) use of a service (such as is argued to be the case for library services, sporting facilities and building and other approvals), a presumption exists in favour of their provision along commercial lines for the private benefit component. Targeted subsidies for the spillover benefit to users or providers of the services would encourage the desired service levels. Only subsidies, not total costs, would be funded out of rates revenue, thereby reaping the benefits of market discipline in service production and consumption.

Statutory or regulatory requirements or limits applied to setting user fees and charges might sometimes enhance, and other times detract from, appropriate fee setting by local governments. A requirement, for example, that local governments fully recover the costs of providing a service is likely to encourage more efficient outcomes than if local governments were to subsidise service provision from their rates revenue. On the other hand, imposing limits on fees and charges to levels below the opportunity cost of service delivery will encourage over-consumption of local government services, and require subsidisation from rates revenue.

This distinction, as well as the structure and level of associated fees and charges is particularly important for assessing the efficiency and distributional impacts of the pricing of individual goods and services provided by local governments.

The likely consequences of a number of requirements and limitations placed on the setting of fees and charges by local governments are analysed in the remainder of

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this section. These restrictions include:

- pricing principles that can or must be applied — in particular, partial cost recovery requirements and pricing and costing guidelines and frameworks
- statutory price capping of the levels of some fees and charges by State Governments
- limitations on the range of services for which charges can be applied — in particular, developer charges and contributions.<sup>8</sup>

### **Partial cost recovery and costing and pricing frameworks**

This section relates to user fees and charges that are associated with council activities provided to the community through the sale of goods and services, or rental of property or facilities. These fees and charges, for the most part, are not statutorily set. Fees of this type include those for: camping, swimming pools, land clearing and community hall hire.

Partial cost recovery arrangements are commonly applied in some jurisdictions to some goods and services.<sup>9</sup> In virtually all jurisdictions, for example, councils provide services for garbage waste collection. These services generally have identifiable beneficiaries and specified fees and charges, but do not always reflect full cost recovery.

Partial cost recovery arrangements sometimes reflect legislative requirements but, in other instances, reflect local government policy choices, especially relating to discretionary services.

#### *Views about partial cost recovery and costing and pricing frameworks*

Restricting fees and charges to less than full cost recovery constrains local governments' ability to raise own-source revenue. In some jurisdictions (for example, New South Wales), annual charges for property services (in addition to rates) are capped (Abelson 2006). The LGAQ (2006) asserts that local governments

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<sup>8</sup> The *ultra vires* issue, whereby a council cannot introduce new fees and charges where these are not specifically provided for in the legislation, might be another restriction. *Ultra vires* is defined as 'outside legal authority or beyond the scope of an organisation'.

<sup>9</sup> Full cost recovery requirements are commonly applied to the commercial water and sewerage services where they are provided by councils in New South Wales (non-metropolitan only), Queensland and Tasmania. Full cost recovery arrangements do not constrain revenue-raising by local governments and these pricing arrangements are efficient. Full cost recovery arrangements are not discussed further in this chapter.

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would benefit from improved ability to recover infrastructure costs. The FSRB (2005, pp. 55-6) claims that the fees and charges that SA local governments are permitted to apply are highly restrictive, generally preventing full cost recovery.

Further, the WALGA indicates that concessions must be applied to a number of fees and charges but are not always fully funded. For example, WA councils are required to apply a 50 per cent pensioner concession on at least some charges, with no rebate from the WA Government. The *Dog Act 1976* Regulations 4(2), for example, provides for pensioners to be charged 50 per cent of the fee otherwise payable. There is no State funded rebate provided in this case (WALGA unpublished). Examples of unfunded concessions also apply in Victoria.

### *Assessment of partial cost recovery and costing and pricing frameworks*

Notwithstanding the fee and charge setting restrictions operating in most jurisdictions, these do not appear to be a major constraint on revenue raising, both on fees and charges revenue and overall revenue. Indeed, the LGASA (sub. 53, p. 13) notes:

... in activities such as sewerage/drainage schemes, off street car parking and caravan parks local councils more than cover operating expenses through the revenue raised.

In Western Australia, the City of Gosnells (sub. 12, p. 43) notes that it can apply commercial principles to increase and broaden the user charges base, as it is not constrained from doing so by regulation or legislation. The WALGA notes that there are sometimes specific exceptions to this, whereby State regulation does specify, for example, that councils cannot impose parking fees in some areas (such as at Cottesloe beach foreshore) (WALGA, sub. DR78).

In Queensland, there are no specific guidelines or requirements relating to cost measurement and allocation for local government service levels and pricing (LGAQ, sub. 11, p. 33). Even in New South Wales, where there are regulatory constraints upon a council raising revenue from fees and charges, these are not always strictly enforced (Crisp, sub. 3, p. 2). The Vacluse Progress Association (sub. 7, p. 5) notes:

Councils in New South Wales are broadly free to decide what they do [regarding fees and charges] ... Woollahra categorises its fees and charges according to whether they represent full cost recovery, partial cost recovery, and subsidy.

There are also special rates associated with property-based services that are effectively a charge. In Queensland (*Local Government Act 1993*, s. 971), for example, a local government may levy a special rate on rateable land for a service if it considers that the land or the occupant specially benefits from that service, or that

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the use made of the land specially contributes to the need for the service. These special rates can be targeted to specific services and their beneficiaries, reducing the need for general rates to be used to fund such specific benefits.

Fees and charges relating to non-property based services (for example, human services, recreational and cultural activities, provision of facilities and information) appear to be largely unconstrained. Determination, for example, of a fee or charge in Western Australia is not limited to the cost of providing the service, other than specified or regulated services (*Local Government Act 1995*, s. 6.17). In Tasmania, a broad range of fees and charges need not be fixed by reference to the cost of service provision (*Local Government Act 1993*, s. 205).<sup>10</sup>

In addition, many non-property related goods and services provided result from local government policy decisions where State Government constraints do not necessarily apply. The broad scope and flexibility to set such fees and charges is implicitly provided by regulation allowing local governments the autonomy to set prices (appendix B, table B.3). This flexibility is important where many of these types of services result in identifiable private benefits, suggesting that a user-pays approach is the most efficient. Where there are some spillover public benefits (such as improving community health through immunisation programs), it is appropriate to charge a fee that partially cost recovers and to subsidise the remainder from general revenue sources.

### **Statutory setting and capping of fees and charges**

This section relates to user fees and charges that are set by State Governments. SA councils, for example, are subject to specified fees under the *Aerodrome Fees Act 1998*, *Development Act 1993*, *Dog and Cat Management Act and Regulations 1995*, *Environment Protection Act 1993*, *Natural Resources Management Act 2004*, *Public and Environment Health Act 1987*, and *Road Traffic Act 1961*, among others.

The dollar amount (or other measure) of particular fees and charges is sometimes specified under local government, or other, legislation. The *Environmental Planning and Assessment Regulation 2000* (NSW), for example, provides that the maximum council fee for approvals relating to the erection or demolition of a building, or the carrying out of work, and having an estimated cost within the range of \$50 001 — \$250 000, is \$352, plus an additional \$3.64 for each \$1000 by which the estimated cost exceeds \$50 000 (s. 246(1)). Similarly, a maximum fee of \$364 is

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<sup>10</sup> There are some exceptions to this, such as the provision of information free of charge required by broader legislation in New South Wales (discussed in the statutory fees section).

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payable for approvals relating to the erection of a dwelling with a construction cost of \$100 000 or less (s. 247).

It should also be noted that, councils are *required* by legislation to provide some specified services, such as the planning and building approvals noted above. That is, not only is the fee or charge set by State Governments for the particular service, it is also mandatory for councils to provide the service. This, in turn, raises the possibility of councils having to provide services with fees set below the cost of provision.

### *Views about statutory capping of fees and charges*

The FSRB (2005, pp. 55-6) claims that the SA Government regulates a significant number of fees and charges that are levied by councils. These include fees for development assessment applications, waste inspection and control, and public notification. Furthermore, a reluctance to allow regulated fees and charges to recover, or keep pace with, forces councils to recover costs through rates.

The South Australian Centre for Economic Studies (SACES) (2007) found that 76 per cent of council respondents perceived that the SA Government's imposition of maximum charges can be a significant constraint on council revenue raising. Examples cited by respondents included development applications, building inspections and searches and where works cost more than the maximum charge. It also found that 71 per cent of council respondents perceived State regulation preventing the application of user charges to be a significant constraint on revenue raising. Respondents cited examples such as charges for waste management.

In the case of New South Wales, IIFS (2006) notes that charges for domestic waste management, water supply and sewerage, use of public spaces and parking meters, parking fines and developer charges for water supply and sewerage are not subject to State controls (that is, are not capped) (p. 18), but recommends that restrictions on some other fees (for example, development application processing fees) be lifted to allow councils to determine them (p. 29).

The NSC (sub. 13) provides evidence from a study on the total cost of operating the development application process in 2002 (developer contributions are covered in a later section). It found that only 23 per cent of the cost was recovered by way of statutory fees. Consistent with this, Woollahra Municipal Council and the Vacluse Progress Association argue:

We are limited by statutory fees. Development and building applications are a prime example of the community actually subsidising developers ... deregulation of fees [is needed] so that each council can properly charge developers for their activities

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within any council area. (WMC in IPART 1998, p. 42)

The statutory ceiling on many of the development fees and charges that councils may levy ... are in many instances well below those charged by the New South Wales Planning Department for services of a similar nature. (VPA sub. 7, p. 3)

In the Northern Territory, planning (development assessment) or building regulation fees and charges are Territory Government revenue (LGANT 2007), indicating that there is no possibility of NT local government raising revenue from this source (and accordingly councils do not bear the costs). However, local government is permitted to mandate contributions toward infrastructure external to a development, but only for car parking, roads and drainage (NT *Planning Act 1999*, part 6).

The LGMANSW (sub. 17, p. 4) provides examples of other State government impositions that reduce local governments' revenue-raising capacity by restricting the range of services for which fees can be set:

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 Privacy NSW 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 the FOI Act to charge the public to access its documents.

### *Assessment of statutory fees and charges capping*

A summary of the extent of statutory limits relating to local government fees and charges is provided in appendix B, table B.3. Two major issues are evaluated here to ascertain the effects on revenue-raising capacity.

State government legislation and regulations can determine both whether or not:

- it is mandatory for councils to provide a particular service
- the fees that can be charged for a particular service are set, or capped, by State Governments.

Various combinations of such requirements and restrictions are possible. The different degrees of restriction on local governments in relation to service provision and the extent of cost recovery that is possible are identified in figure 6.4.

**Figure 6.4 Level of restriction**

	<i>Mandatory services</i>	<i>Discretionary services</i>
<i>Statutorily set or capped fees or charges</i>	Most	Intermediate
<i>Council set fees or charges</i>	Intermediate	Least

*Most restrictive:* mandatory services (required by State Governments through legislation or regulation to be provided by local governments) and statutorily set or capped fees and charges.

*Intermediately restrictive:* mandatory services (required by State Governments through legislation or regulation to be provided by local governments) but with council set fees and charges or discretionary services but with statutorily set or capped fees and charges.

*Least restrictive:* discretionary services with council set fees and charges.

Two specific issues need to be addressed in order to assess the significance of State government imposed restrictions on fees and charges:

- the number and scope of services subject to statutory fee setting or capping
- the potential cost to revenue — that is, the scale associated with State government imposed requirements and restrictions.

*Number and scope of statutorily set or capped fees and charges*

While comprehensive information about specific statutory fees and charges is difficult to access, some local governments distinguish in their fees and charges schedules those components set by State Governments (box 6.5).

These examples suggest that there are few fees and charges statutorily set relative to those set by councils. Prima facie, the impact of specific statutory limits as a constraint on overall revenue raising can be ameliorated by generally liberal arrangements for setting other fees and charges, and rates, in most jurisdictions.

FINDING 6.5

*In most jurisdictions, only a small number of fees and charges are statutorily set by State Governments. Most are set by councils and the extent to which they recover costs will largely reflect the preferences of their communities.*

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### Box 6.5 Examples of statutory fees and charges

The following examples, one for each jurisdiction, are taken from published local government schedules of fees and charges for 2007-08, legislation and regulations. Most categories of fees and charges contain no items that are statutorily set or capped. Fees and charges' categories that are most commonly statutorily set or capped are FOI, planning, building control and development application related services.

*New South Wales* — Of approximately 625 fees and charges (excluding caravan parks), 73 are statutorily set in Ballina Shire Council. These range from no charge for 20 hours of processing FOI personal requests (after payment of \$30 application fee) to in excess of \$15 875 for development application fees. Interest of 10 per cent is statutorily set for overdue rates (*Local Government Act 1993* s. 566; DLG 2007e)

*Victoria* — Of approximately 520 fees and charges, 18 are statutorily set in the City of Boroondara. The dollar amounts and/or percentages of statutory fees are not identified. Interest of 11 per cent is statutorily set for overdue general and special rates (*Penalty Interest Rates Act 1983*)

*Queensland* — Of approximately 910 fees and charges, 410 are statutorily set under the *Building Act 1975*, the *Integrated Planning Act 1997* and other legislation in Cairns City Council. Fixed fees range from 20 cents for in-library photocopying to up to \$12 039 for commercial recreation facilities. Interest is statutorily capped to a maximum of 15 per cent for overdue rates (*Local Government Act 1993*, s. 1018).

*Western Australia* — Of approximately 600 fees and charges, 58 are statutorily set in Town of Victoria Park. Fixed fees range from \$0.20 cents for FOI request photocopies to in excess of \$10 642 for development applications. Interest of 5.5 per cent is statutorily set for rates instalments and 11 per cent for overdue rates and service charges (*Local Government [Financial Management] Regulations 1996*).

*South Australia* — Of approximately 175 fees and charges, 13 are statutorily set in Kangaroo Island Council. These range from \$50 for deposits on Aviation Security cards to more than \$348 for new waste control systems. Interest of 7.25 per cent is statutorily set for overdue rates in addition to a 2 per cent fine (*Local Government Act 1999*).

*Tasmania* — Of approximately 275 fees and charges, one appears to be statutorily set in Dorset Council. Interest is statutorily capped at the ten-year long-term bond rate plus 6 per cent for overdue rates in addition to a fine of up to 10 per cent (*Local Government Act 1993*, s. 128).

*Northern Territory* — Of approximately 200 fees and charges, five appear to be statutorily set in Palmerston City Council. Interest on overdue rates and charges is set by council (*Local Government Act 2005*, s. 82).

*Source:* Various 2007-08 local government fees and charges schedules.

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### *Level of restriction*

Where fees and charges are statutorily set by other spheres of government, there are issues of revenue adequacy, especially where provision of the associated services is required by other governments or councils. That is, the services are mandatory and the prices are statutorily set or capped.

The impact of fees and charges set by other spheres of government on a council's overall financial position is illustrated by the case of the City of Boroondara (sub. DR71, p. 2):

Fees and charges have significant revenue implications in terms of cost recovery for a particular service. While statutory fees do not form a large proportion of a Council's revenue, the quantum is important in terms of a local government's capacity to receive adequate compensation for the provision of the statutory services. Statutory planning fees and land information certificates provide an example. In these two instances, failure by the Victorian government to index fees for many years resulted in considerable cost shifts from specific service users to the general ratepayer. In fact for Boroondara, the cost of the State Government's failure to index statutory planning fees between 2001 and 2007 is estimated at \$320 000. The land information certificates fee was established in 1992 at \$20, and is still \$20!

The revenue foregone from lack of indexation seems minor. However, a more material issue, is the level of cost recovery from mandatory services with statutorily set or capped fees and charges. Extending the example of the City of Boroondara, the Council processed 1273 planning permits in 2006-07. On average, the direct cost of processing planning permits was \$2653 per permit (this estimate excludes overhead costs such as IT, finance and building maintenance). On average, the statutory fee received was less than \$698 per permit, which equates to a revenue shortfall for the planning permits process of nearly \$2.5 million (or 3 per cent of total rates revenue) to be funded from rates, grants and other revenue.

Using examples from Victoria, the services that councils are mandated to provide and for which the related fees and charges are set or capped, are generally for functions such as *planning and development* or *building control* (MAV DR81; MAV Officials, personal communications, 12-17 March 2008). According to MAV estimates, based on Victorian Grants Commission data, the statutorily set fees and charges relating to planning and development recover 22.2 per cent of the associated total expenditure of \$223 million and for building control, 56.6 per cent of the associated total expenditure of \$48 million is recovered (sub. DR81).

#### FINDING 6.6

*Where councils are required by another sphere of government to provide a service that has a statutorily set or capped fee or charge below full cost recovery, associated revenue-raising capacity from fees and charges is constrained.*

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Local governments choose to provide a large range of services that are not strictly mandatory. Grants are often available to assist in the provision of these services but may carry restrictions on fees and charges that can be levied. That is, there are other council services that councils are not required to provide but do have revenue-raising capacity issues due to associated set or capped fees and charges.

As a case in point, the MAV (sub. DR81, pp. 9-10) provides an analysis based on Victorian Grant's Commission 2005-06 data, that Victorian councils (aggregated average) providing 'maternal and child health' services recover only 2 per cent of the expenditure relating to this function from associated user fees and some funded by tied grants. A similar situation occurs with libraries, where, conditions of State grants preclude charging for core services.

The MAV provides estimates of service costs (both those statutorily required to be provided and those that are delivered through council policy choice). These costs are based on averages across all Victorian councils using Victorian Grant's Commission data (sub. DR81, pp. 9-10) indicating that for goods and services that are:

- essentially private (infants and mothers service, home and community care, libraries, planning and development, building control, and community welfare), own-source revenue from licences, charges, fees and fines funds 15.5 per cent of the cost of these functions
- mixed public-private (local laws and preventative safety), own-source revenue from licences, charges, fees and fines funds 42.9 per cent of the cost of these functions
- essentially public (council operations and administration, local roads, footpaths, kerb and channel, traffic control, street beautification, street lighting, street cleaning, fire protection, environment protection, passive recreation, community amenities), own-source revenue from licences, charges, fees and fines funds 3.3 per cent of the cost of these functions.

The revenue shortfall from applying statutory fees and charges (91.4 per cent), is sourced from rates (72.1 per cent) (MAV sub. DR81, PC calculations) with the remainder presumably from grants and other sources. The major statutorily binding constraint on own-source revenue principally relates to private goods and services that a council in Victoria is *required* by other spheres of government to provide (such as planning and development, and building control) and has a statutorily prescribed fee attached that represents less than full cost recovery. Principally public goods are most appropriately fully funded by rates (and grants) and mixed public-private goods and services are most appropriately funded at least partially by rates (and grants). In the absence of these restrictions, councils would only partially cost recover in many cases, to reflect the preferences of their communities.

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The LGASA (sub. 53, p. 13) also indicates that for equity reasons, local governments may choose to under recover costs:

... there are also issues of social equity that are raised with regard to many of the goods and services provided ... local councils are mindful of the issue of social equity and community access in setting user charges for the use of community services and amenities such as sporting and swimming facilities. These considerations often result in less than full cost recovery being achieved for access and use to these community facilities and might be regarded as a form of community service obligation.

Similarly, NSC (sub. 13, p. 6) indicates:

Generally councils under-recover the costs of supplying goods and services, because of the need to provide value for money to the rate-payers, willingness of residents to pay and community service obligations.

It is not possible to provide a comprehensive assessment of the impact on local governments of the statutory setting of fees and charges by State Governments. Clearly, it is most restrictive where the service provision is mandatory and the fee or charge is set below full cost recovery. Even in cases where provision of the service is not strictly mandatory — library services, for example — the pricing restrictions attached to the applicable grants similarly restrict local government revenue-raising capacity.

FINDING 6.7

*State government setting and/or capping of fees and charges applies to some services which councils are not legislatively required to provide. But where these services are provided (for example, because of community pressure), the impacts on councils are no different from the provision of mandated services at fees that do not cover costs.*

An assessment of the appropriateness of specific State set fees and charges, as well as mandated services for local government, is not included here. Notwithstanding this, it would be desirable for the regulation of revenue raising through fees and charges, and services that local governments are required by other spheres of government to provide, to be subject to periodic review to assess the cost-benefit effects (as with private sector regulation) on councils and communities (chapter 8; Office of Best Practice Regulation 2007).

FINDING 6.8

*There is a case for periodic reviews of the restrictions and regulations imposed on local government by other spheres of government to assess both their rationales and their benefits and costs.*

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## Developer contributions

The legislative arrangements for each jurisdiction collecting revenue from developer contributions are set out in appendix B.<sup>11</sup> Generally, councils can:

- levy property developers up-front for the cost of providing a service or infrastructure
- require developers to construct infrastructure and transfer it to local government upon completion
- require developers to donate land to local government for facilities such as public open space and roads.

The scope for collecting developer contributions is greatest in Queensland, Tasmania and parts of New South Wales because local governments are responsible for providing commercial water and sewerage services to which much developer activity relates.<sup>12</sup> The LGAQ (sub. 11, p. 6) notes, for example:

Contributions (primarily from developers) is the third most significant source of revenue for Queensland councils providing \$815 million in 2004-05, with 95 per cent of these contributions being of a capital nature. This is primarily the result of the responsibility of Queensland Councils for water and sewerage infrastructure, with headworks charges being a major component of developer contributions in Queensland.

As a general rule in local government, developer contributions can only be used to fund specific infrastructure investments, and cannot therefore be used to subsidise other services to the community.

### *Views about developer contributions*

The Australian Chamber of Commerce and Industry (ACCI) (sub. 62, pp. 7-8) claims that developer charges are over-recovered:

Developer charges should only recoup the direct costs of infrastructure and are not used for general revenue raising. In some areas developer charges are well in excess of the actual costs of infrastructure ... It is also important to prevent 'gold plating' of infrastructure (unnecessarily high expenditure on infrastructure). This can be prevented by measures to control the costs of building infrastructure and other activities that are subject to user charges.

Consistent with this, Master Builders Australia and the Housing Industry

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<sup>11</sup> The NSW Government is currently reviewing developer contribution arrangements for councils (NSWDLG DR92).

<sup>12</sup> Victorian legislation also provides for councils to supply and charge for water services, but these are currently not provided by Victorian councils (*Local Government Act 1989*, s. 162).

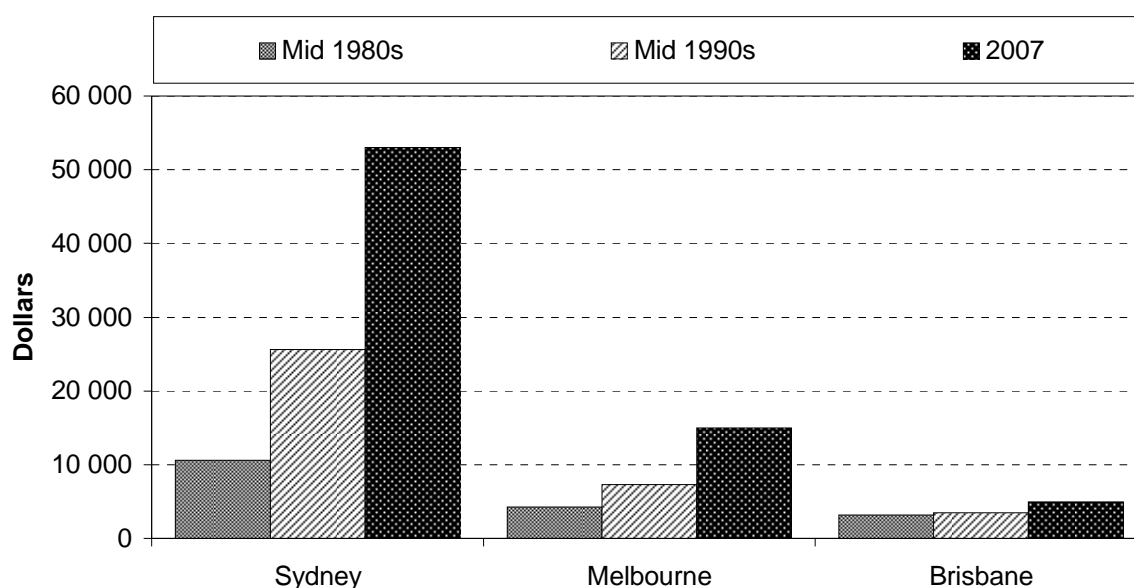
Association (HIA) assert that the reliance on development levies in many jurisdictions has grown dramatically (HIA, sub. 47; Master Builders Australia, sub. 48). The HIA (sub. 47, p. 19) claims that in Sydney:

... if a developer is charged around \$100 000 per allotment in development levies, HIA would expect up to \$40 000 of this to be a local levy with the remainder being for regional infrastructure and servicing components.

In Brisbane, a new Infrastructure Contributions Planning Scheme Policy developed by Brisbane City Council outlines plans under the state-based Integrated Planning Act that will see development levies across the city increase by 40 per cent taking the average to a total of \$25 000 per allotment.

Further, the HIA provided examples of two councils where the *local government component* of developer charges and contributions was around \$53 000 per lot (HIA unpublished). Average estimated local government developer charges and contributions for three capital cities over time are shown in figure 6.5 (HIA unpublished).

**Figure 6.5 Local government developer charges and contributions per lot**  
Various years, estimated average, real dollars<sup>a, b</sup>



<sup>a</sup> Data are adjusted to 2006 dollars using the ABS non-farm GDP deflator. <sup>b</sup> Data are HIA estimates of primary charges for lot developments based on case studies and other research.

Source: HIA Economics Group unpublished; Productivity Commission calculations.

A related view from an ACCI member is that there might be double charging by councils, if applied once through the up-front developer charge and again through ongoing property rates (Canberra, pers. comm., 20 June 2007). Dollery (2005) makes a similar point, referred to as ‘double-dipping’, arguing that those that have

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purchased land on which developer contributions to construct capital facilities have been levied should not then contribute to the capital cost from rates or charges. This principle holds, irrespective of whether the contribution paid by the developer is passed back to the land vendor or forward to the purchaser.

On these points, the Economic Planning Advocacy (sub. DR67, p. 2) comments:

... costs estimates are routinely excessive, works are abandoned at a whim, Council's collect grants and contributions for the same works, contributions are indexed and most works are new.

There is also the issue of 'gold plating', or conversely, 'lead plating', which might determine infrastructure quality and will affect the level of revenue raising across councils for similar types of infrastructure.

An opposing view is that local government own-source revenue raising can be constrained by the failure to recover fully development costs. Dollery (2005) estimates that, because developer contributions are calculated using historic and estimated costs, councils absorb a shortfall of between 10 and 20 per cent.<sup>13</sup> There are also some exemptions to cost recovery from developer contributions. Dollery (2005, pp. 4-5), for example, claims that the NSW Government has consistently argued that development for 'social purposes' (for example, building hospitals) should be exempt from the associated developer levy.

The FSRB (2005, pp. 56-7) claims, in relation to South Australia, that access to developer contributions is highly constrained by State legislation:

Compared with the case in other States, SA councils have limited means to legally access contributions from developers. As a result, South Australia has the lowest level of developer contributions in Australia. This has the effect of shifting the cost of providing infrastructure for new and infill development from developers and purchasers of land to all ratepayers.

There needs to be clear legislative power to levy developer contributions for the wider cost of their development, so that councils have the powers to recover their costs where private benefits are clearly involved. The introduction of arrangements on a similar basis to those in place in some other States would provide some relief for ratepayers.

Similarly, SACES (2007) suggests that 63 per cent of respondents to a survey undertaken for the LGASA perceive that the extent to which the legislative regime makes it possible to achieve full cost recovery relating to developer contributions occurs in only a few cases. The LGASA notes that development contributions are

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<sup>13</sup> The Economic Planning Advocacy (sub. DR67, p. 2), however, notes that, while historical cost was an issue for a limited number of works, that has been remedied in that these are now also indexed to the date of the Contribution Plan, before the contribution calculation is made.

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only voluntary (sub. DR86) and that (sub. 53, p. 16):

SA legislation provides extremely limited power to require developer contributions particularly beyond a development site (except in relation to open space and car parking).

### *Assessment of developer charges and contributions*

In New South Wales, Victoria and Queensland, a formal development plan is required before developer contributions can be levied by local government (DIPNR 2005; DLGPSR 2004; DSE 2003). WA local governments do not have the authority under planning legislation to require developer contributions except where expressly provided for in town planning schemes which have been recommended by the WA Planning Commission and approved by the Minister (WAPC 2007).

All jurisdictions can levy developer contributions for roads, and all, except the Northern Territory, for parks. New South Wales and Victoria appear to have the most flexible legislative arrangements for accessing developer contributions, with legislative scope to levy for a broad range of economic and social infrastructure needs (such as public transport, child care centres, libraries, community centres, recreation facilities and sports grounds) beyond basic infrastructure. Other jurisdictions may not have scope to apply a levy for these facilities. However, in some jurisdictions (for example, Tasmania), voluntary arrangements are expressly allowed for, which enables local governments to negotiate for developer provision of infrastructure to meet economic, social and environmental needs as a condition of obtaining various approvals. Further, unless precluded by legislation, voluntary arrangements can be made.

Local governments in most jurisdictions can levy property developers for the cost of service provision or have developers construct infrastructure at their own expense (table B.3).<sup>14</sup> Where this is the case, it suggests that regulation of developer charges and contributions is not a constraint on revenue-raising capacity to meet specific expenditure needs.

The developer contributions component of local government revenue has grown considerably in recent times in most jurisdictions. The national annual real average growth rate was 8.2 per cent per new dwelling commenced over the four years to 2005-06, with the highest growth in Tasmania (ABS 2007e, unpublished; Productivity Commission calculations).<sup>15</sup>

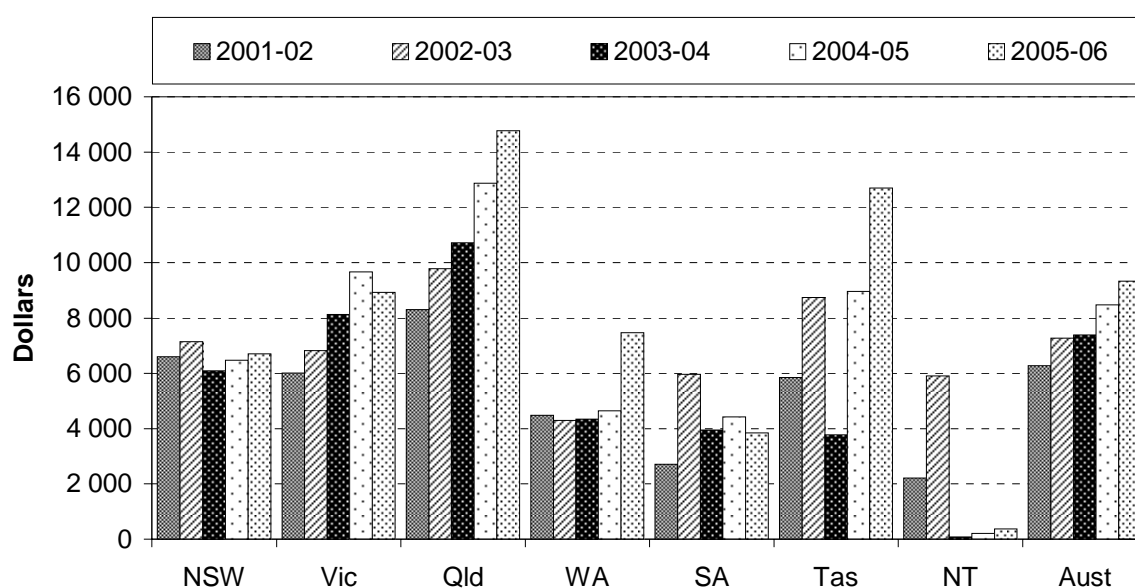
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<sup>14</sup> Generally, developer contributions are paid in advance of construction (see for example, IPART 2007).

<sup>15</sup> The ABS dwelling units commenced data are estimates from the quarterly *Building Activity*

In contrast, revenue raised from developer contributions to local governments appears to have declined in New South Wales between 2002-03 and 2003-04, increasing in the following years to 2005-06 (with a growth rate of 0.3 per cent over the four years to 2005-06). The latter result reflects changing patterns of development activity in New South Wales (figure 6.6).<sup>16</sup> The data in figure 6.6 are based on developer contributions to local governments only, that is, other amounts of developer contributions are also paid (or provided) to other spheres of government.

**Figure 6.6 Developer contributions revenue per new dwelling commenced**  
2005-06 dollars<sup>a, b, c, d</sup>



<sup>a</sup> Data are adjusted to 2005-06 dollars using the ABS non-farm GDP deflator. <sup>b</sup> A building is commenced when the first physical building activity has been performed on site in the form of materials fixed in place and/or labour expended. A dwelling is a self-contained suite of rooms intended for long-term residential use. <sup>c</sup> The NT revenue data prior to 2002-03 are considered unreliable and are not reported. NT local government can levy developers only for contributions to car parks, roads and drainage infrastructure, external to a development. <sup>d</sup> Results might be driven somewhat by timing differences, and/or time lags, in the data.

Source: ABS (2007e); ABS unpublished; Productivity Commission calculations.

Real developer contributions revenue per new dwelling commenced was highest in Queensland in all years to 2005-06, followed next by New South Wales to 2002-03, Victoria in 2003-04 and 2004-05, and Tasmania in 2005-06 (figure 6.6). Important

*Survey* which comprises new dwellings in established areas as well as in broadacre developments. Data for dwellings on new land releases alone are not available. Results reported are therefore understated because the denominator used is overstated.

<sup>16</sup> In recent years development activity levels have been highest in Victoria, Queensland and Western Australia and higher than the national average per rateable property in these jurisdictions (ABS 2007e; Productivity Commission calculations).

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caveats to these data are:

- developer contributions data used are based on an ABS revenue category ‘assets acquired below fair value’ and includes other assets contributed and/or donated
- assets acquired below fair value data total \$213 million for New South Wales and \$343 million for Victoria in 2005-06. An analysis of councils’ published annual financial reports (PC forthcoming, pp. 120-21) estimates total developer contributions at \$232 million for New South Wales (8 per cent higher than the ABS data) and \$454 million in Victoria (24 per cent higher than the ABS data) in 2005-06.
- the analysis based on individual councils’ financial reports indicates that for the 10 largest councils receiving developer contributions in New South Wales and Victoria, approximately 91 per cent is cash in New South Wales compared with 14 per cent in Victoria (the remainder are in-kind contributions). This suggests:
  - in-kind contributions might be more reflective of future expenses (related to infrastructure maintenance and replacement) than increases in current revenue
  - cash contributions might be more reflective of increases in current revenue as well as future expenses and might cancel each other out
  - ... further cash contributions are tied to future infrastructure development and cannot be used by councils to supplement operating expenses.

Developer contributions revenue is tied to future infrastructure investment and/or reflects current sunk assets, therefore, revenue and expenditure relating to developer contributions are likely to be equal over time. That is, where assets are contributed in-kind in year one, these are depreciated over their useful lives which might be across many years (except for the related land component because this does not depreciate). Actual cash contributed in year one is (presumably) offset by a corresponding liability in the form of a provision for future capital purchases and is spent on land, facilities and infrastructure, sometimes in a subsequent year.

Future expenses arising from either assets contributed, or funded subsequently through current cash contributions saved, are most appropriately funded through rates to avoid ‘double-dipping’.

#### FINDING 6.9

*Nationally, developer contributions per new dwelling commencement have increased substantially over the four years to 2005-06. However, the effect of developer contributions (either in cash or in-kind) on councils is generally likely to be revenue neutral over time.*