

Local Government
Association of NSW



Shires Association
of NSW

**Local Government Association of NSW and
Shires Association of NSW**

Submission to

Productivity Commission Inquiry

**Assessing Local Government Revenue
Raising Capacity**

July 2007

Index

1. Introduction	2
2. Executive Summary/ Key Positions	2
3. Financial sustainability – identifying and responding to the challenge	4
3.1. The Independent Inquiry into the Financial Sustainability of Local Government in NSW	4
3.2. Strengthening Local Government Program	5
4. Issues and Questions	6
4.1. Revenue	6
4.1.1. Trends in Local Government Revenue	6
4.1.2. Capacity to Raise Own Source Revenues	9
4.2. State and Territory Government Regulatory Constraints	11
4.2.1. Land Rating and Valuation Methods	11
4.2.2. Rate Pegging.....	12
4.2.3. Concessions and Exemptions	15
4.2.4. Setting Fees and Charges.....	18
4.3. Impacts on individuals, organisations and businesses	22
4.3.1. Council Rates	22
4.3.2. Developer Charges and Contributions	24
4.3.3. Fines and Pecuniary Penalties	26
4.3.4. Interest income	26
4.4. Factors influencing expenditure and revenue raising.....	27
4.4.1. Operational Efficiency of Local Government	27
4.4.2. Service Levels and Pricing	28
4.4.3. Financial and Asset Management Skills.....	29
4.4.4. Incentive Effects of Grants and Subsidies.....	30

1. Introduction

The Local Government and Shires Associations of NSW (the Associations) are the peak bodies representing the interests of all 152 general purpose councils, the 9 divisional Aboriginal land councils and the majority of special purpose county councils in NSW.

The Associations welcome the opportunity to make a submission to the Productivity Commission's review of Local Government Revenue Raising Capacity. This is a timely review given the recent comprehensive reviews of the financial sustainability of Local Government in NSW and other states as well as a national review commissioned by the Australian Local Government Association.

While supportive of the terms of reference for the research study, the Associations are disappointed that the terms did not extend to include the adequacy of Commonwealth and State grant funding to Local Government. Grant funding is a major component of Local Government revenue and the adequacy of Local Government's revenue raising capacity cannot be roundly addressed without reference to it.

The submission provides a summary of the Associations' key positions and then proceeds to address most of the individual questions raised in the Productivity Commission's Issues Paper. We have also submitted the Final Report of the Independent Inquiry into the Financial Sustainability of Local Government in NSW entitled *Are Councils Sustainable? – Final Report: Findings and Recommendations*. This is a current, comprehensive and independent report that is referenced extensively in our submission.

2. Executive Summary/ Key Positions

NSW Local Government is under financial duress. This has been confirmed by the Independent Inquiry into the Financial Sustainability of NSW Local Government that found that around:

- 25% of NSW councils are not financially sustainable under current policy settings;
- 50% are potentially vulnerable; and only
- 25% are in a relatively strong financial position.

A key finding of the inquiry was that NSW Local Government has accumulated a huge infrastructure renewals backlog of \$6.3 billion that continues to grow by \$500 million per annum. This is considered by many to be a conservative estimate. The Inquiry estimated that Local Government would need to increase revenues by at least \$900 million per annum to deal with the backlog and ongoing renewals. This does not include the additional revenue required for growth infrastructure or to deal with demands for improved services.

There are several, sometimes interrelated reasons for this financial situation, including:

- Rate pegging and other legislative constraints on councils fees and charges;
- The decline in Commonwealth and State financial support for Local Government relative to economic growth (GDP, GSP) and the growth in national taxation revenues;
- The expanding roles and responsibilities of Local Government, a trend explicitly recognised by the Commonwealth Grants Commission, The Hawker Report and other reviews;
- Cost and responsibility shifting onto Local Government by the State and Commonwealth Government, again a trend recognised by the Hawker Inquiry and subsequently acknowledged by the national *Intergovernmental Agreement Establishing Principles Guiding Intergovernmental Relations on Local Government Matters*, (2006); and
- Deficiencies in Local Government financial and asset management practices.

The central issue is the inadequacy of Local Government's revenue base to meet the demands being placed on it.

Rate Pegging

NSW is the only jurisdiction to apply rate pegging to Local Government rates. As a result, rate growth in NSW has lagged all other jurisdictions over the last 10 years and NSW now has the lowest rates per capita. The Associations maintain that rate pegging is an unnecessary intervention that distorts the operation of the rating system and produces negative consequences. Not the least of which is the direct and indirect suppression of the rating effort.

The Associations advocate removal of rate pegging. However, as an interim measure the Associations have advocated the use of a Local Government specific cost index as the basis for determining the rate pegging limit. This would help ensure that rate pegging limit more accurately reflects the real cost movements faced by councils. This would help provide certainty and as a published index it would provide the transparency that is now lacking.

Fees and Charges

NSW councils are increasingly moving towards full cost recovery and commercial pricing policies where this is appropriate and where council has the discretion. This is at least partially in response to the financial constraints of rate pegging.

Many Local Government fees and charges remain regulated by NSW legislation. The Associations advocate the relaxation such regulations.

Exemptions and Concessions

The Associations are calling for a review of rate exemptions and concessions. The scope of exemptions in NSW is currently too wide and exemptions granted to charities, benevolent institutions, schools and churches need to be more accurately targeted. Many of the exemptions originated in the late nineteenth and early twentieth century and it is questionable whether they are appropriate under modern institutional arrangements.

Remaining exemptions to some of the commercial activities of the NSW Government should also be eliminated. This includes the commercial plantations of Forests NSW. National Parks should also be required to make contributions in lieu of rates to councils.

Pensioner rate concessions should be fully funded by the State or Commonwealth Government. We understand that NSW is the only jurisdiction that requires councils to fund nearly half the cost of these concessions. Welfare and income support are the province of the Commonwealth Government and state and territory governments who are able to spread the cost of such assistance more equitably over a broader revenue base.

Conclusion

The measures listed above will not fully alleviate the financial deficiencies of NSW Local Government.

Rating is the only taxation measure available to Local Government and accounts for approximately 36% of total revenue in NSW. This narrow taxation base places a severe restriction on a Local Governments capacity to raise revenue generally. Further, the rating base varies significantly between Local Government areas, an aspect only partially addressed by the horizontal fiscal equalisation principles of the Local Government grants process. Unlike the Commonwealth Government and state governments, Local Government does not have the flexibility to spread its taxation effort over a suite of taxation tools.

The restricted taxation base has led to a growing reliance on fees and charges but this avenue of recourse is reaching its limitations. User charges are the second largest source of revenue and already represent 34% of Local Government revenue in NSW. Local Government already achieves a much higher cost recovery ratio than other spheres of government from the application of user fees and charges. On a national basis, the cost recovery ratio for Local Government is 37% compared to ratios of 4.3% for the Commonwealth and 12.2% for the states. This partly reflects the type of services provided by Local Government. However, it also suggests that Local Government is already maximising its use of fees and charges and that there may be limits to the extent that Local Government can increase its cost recovery efforts. Apart from general community resistance to ever increasing fees and charges, there are important equity and governance considerations. Many council services, by their very nature, cannot be provided on a cost recovery basis. Further, the opportunities to raise revenue in this way vary significantly between councils. For example parking meters are an option restricted to high density commercial and tourist areas.

There needs to be a substantial increase in financial assistance from the Commonwealth and the states to Local Government.

Given the high degree of vertical fiscal imbalance in the Australian taxation, it is the responsibility of the Commonwealth Government to ensure that allocations to other spheres of government are commensurate with their roles and responsibilities.

The inquiry and other studies have demonstrated how grants have fallen well behind economic and national taxation growth. The Associations fully support the recommendation in the ALGA submission to this Inquiry that:

“The quantum of Commonwealth transfers should increase to at least 1% of total Commonwealth taxation revenue (excluding GST). This would ensure that councils gain access to a revenue stream that grows in line with the growth of the economy and therefore can keep pace with demand for service delivery and infrastructure provision.”

At the same time, the Associations recognise that there is a need for councils to improve their own performance. The Associations are currently working in partnership with the Department of Local Government, the Local Government Managers Association and the Institute of Public Works Engineers Australia on concerted programs to improve financial and asset management practices.

3. Financial sustainability – identifying and responding to the challenge

3.1. The Independent Inquiry into the Financial Sustainability of Local Government in NSW

In response to the widespread concerns about Local Government's financial capacity to meet the growing demand for infrastructure and services, the Associations commissioned the Independent Inquiry into the Financial Sustainability of Local Government in NSW in September 2005.

A panel consisting of three persons with extensive experience in public policy and management, but independent of Local Government or the Associations, was appointed to undertake the inquiry over a six-month period ending on 30 April 2006. The panel members were:

- Percy Allan AM (Chair & Research Director) – A public finance and management consultant and former head of NSW Treasury;
- Libby Darlison – A social policy and change consultant; and
- Diana Gibbs – A management and economic development consultant.

The inquiry's terms of reference included:

- To assess the current financial position and performance of the NSW Local Government sector and its individual councils;
- To assess the adequacy of existing NSW Local Government physical infrastructure and service delivery in terms of (i) its statutory obligations, (ii) community, State Government, and Commonwealth Government expectations of its role and functions, and (iii) challenges posed by changing demographic, economic, social, environmental, technical and governance trends;
- To assess the financial capacity of Local Government to meet its statutory obligations, expected functions and emerging challenges; and
- To identify possible financial, administrative, governance and intergovernmental reforms that could address any shortcomings and gaps uncovered by the above research.

The inquiry was a major undertaking provided with a budget of over \$600,000. Accordingly, the inquiry was able to undertake extensive consultations and investigations and commission major research assignments.

The inquiry conducted 12 stakeholder workshops with about 400 participants and surveyed over 250 participating councillors and council staff. It commissioned a professional poll of over 900 NSW residents to canvass community expectations on the role of Local Government and willingness to pay for services. It also met twice with the NSW Minister for Local Government and interviewed 26 senior officials in eleven State Government and two Commonwealth Government agencies.

The inquiry received and analysed over 170 written submissions to its *Background and Issues Paper* (October 2005) and *Interim Report: Findings and Options* (March 2006). Submissions came from councils and regional organisations of councils as well as other stakeholders including government agencies, professional associations, environmental groups, community groups, businesses, unions and interested members of the public.

The inquiry benchmarked the administrative capacity of nine councils and compared the back-office costs of 58 councils. With the help of 19 councils it measured the amount of cost shifting by other tiers of

government. The inquiry commissioned Access Economics to analyse the financial situation of all 152 councils and Jeff Roorda & Associates to undertake an extensive survey of over 100 councils on the condition and management of their infrastructure. Altogether, the inquiry commissioned more than 30 research papers and reports dealing with various issues affecting Local Government.

On 3 May 2006, the inquiry released its Final Report entitled *Are Councils Sustainable – Final Report: Findings and Recommendations* containing 49 firm recommendations as to how to improve the financial sustainability of NSW Local Government.

The major finding of the inquiry was that NSW Local Government faces an infrastructure renewal backlog of \$6.3 billion that is growing by about \$500 million annually and that Local Government has inadequate revenue to respond to this crisis. Principle reasons for this include insufficient intergovernmental grants and own source revenue restrictions imposed by the State Government. Twenty-five per cent of councils were identified as financially unsustainable because their current financial capacity was not sufficient to meet their expected financial requirements over the long term without having to introduce substantial or disruptive revenue and/or expenditure adjustments. The inquiry also found that councils need to improve their long term strategic and financial planning and asset management.

The inquiry made a range of recommendations which can be summarised as follows:

- Clarify Local Government's role relative to other spheres of government through an intergovernmental agreement;
- Boost revenues from rates, charges and grants (abolish rate pegging, increase FAGs);
- Renew infrastructure to overcome a growing backlog (requires \$900million in additional annual revenue to meet annual renewal gap and pay debt charges for borrowings to close the present backlog);
- Improve financial data and reporting;
- Save money through resource sharing and better prioritising services; and
- Improve long term strategic and financial planning, including asset management, based on community engagement.

All reports and papers produced by the inquiry as well as submissions and responses can be accessed on the inquiry website: www.lgi.org.au.

3.2. Strengthening Local Government Program

Following the release of the inquiry's final report, the Associations in August 2006 established the Strengthening Local Government program to facilitate a sectoral response to the findings and recommendations of the inquiry and strengthen the financial sustainability of Local Government to build a strong and sustainable Local Government sector that will contribute to fairer, more harmonious communities, a more productive economy, and environmentally sustainable development.

The program was led by the Strengthening Local Government Task Force which was made up of key Local Government stakeholders including the Associations, the Local Government Managers Australia (NSW Division), the Institute of Public Works Engineering Australia (NSW Division), and the NSW Department of Local Government (observer status). The task force was supported by specialist working groups which included a wide range of experts and professionals from the Local Government sector, social, environmental and community groups, government agencies and businesses.

Working groups were formed in the following areas:

- Intergovernmental Relations and Community Relations;
- Financial Management;
- Corporate Governance and Performance Measurement;
- Resource Optimising and Capacity Building; and
- Promoting Local Government Leadership.

In the area of asset management the task force contributed to and promoted the position paper on asset management and financial planning prepared by NSW Infrastructure Task Force. The task force also contributed to the Department of Local Government's integrated strategic planning and reporting project and the NSW Strategic Alliance Network.

The task force extensively consulted with councils and other stakeholders. It held 17 workshops throughout NSW as well as two roundtables for businesses, community and environmental groups in Sydney. Furthermore, a comprehensive website was established to inform about the program and provide resources (www.StrengtheningLG.lgsa.org.au).

In June 2007, the Strengthening Local Government Task Force endorsed and presented to the Associations its recommended positions and actions on the 49 recommendations of the inquiry with the recommendation that the Associations provide them to the NSW Government to facilitate a whole-of-government response. In July 2007, the Associations endorsed these positions and actions and provided them to the NSW Government. They will form the basis for continued work by Local Government sector in NSW.

4. Issues and Questions

The following section addresses most of the individual questions raised in the Productivity Commission's Issues Paper. The following acronyms are used in this section:

CPI	Consumer price index
DLG	NSW Department of Local Government
EPA Act	<i>Environmental Planning and Assessment Act (NSW) 1979</i>
FAGs	Commonwealth Financial Assistance Grants
GDP	Gross domestic product
GSP	Gross state product
ICV	Improved capital value
LGI	Local Government Inquiry - The Independent Inquiry into the Financial Sustainability of NSW Local Government
LG Act	<i>Local Government Act (NSW) 1993</i>
MP	Member of Parliament
SPPs	Commonwealth special purpose payments
UCV	Unimproved capital value

4.1. Revenue

4.1.1. Trends in Local Government Revenue

What are the principal factors explaining the trends in revenue from councils' various sources?

The Productivity Commission's Issues Paper indicates an upward trend in all categories of Local Government revenue.¹ This is consistent with the findings of the LGI, which found modest real growth in all categories of NSW Local Government revenue over the period 1995/96 to 2003/04. While maintaining real growth over this period of 21.6%, the LGI found that Local Government lagged NSW State Government revenue growth of 30.3%, Commonwealth revenue growth of 30.7% and NSW GSP growth of 31.3% over the same period.²

Like the Issues Paper, the LGI also demonstrated varying growth rates for different revenue categories over the period 1995/96 to 2003/04:

- The slowest growth was rate income with real growth of only 0.8% p.a;
- Grant income grew by only 1.0% p.a;
- User fees and charges grew by 2.4% p.a: and
- Contributions and donations growth most strongly at 5.4% p.a.

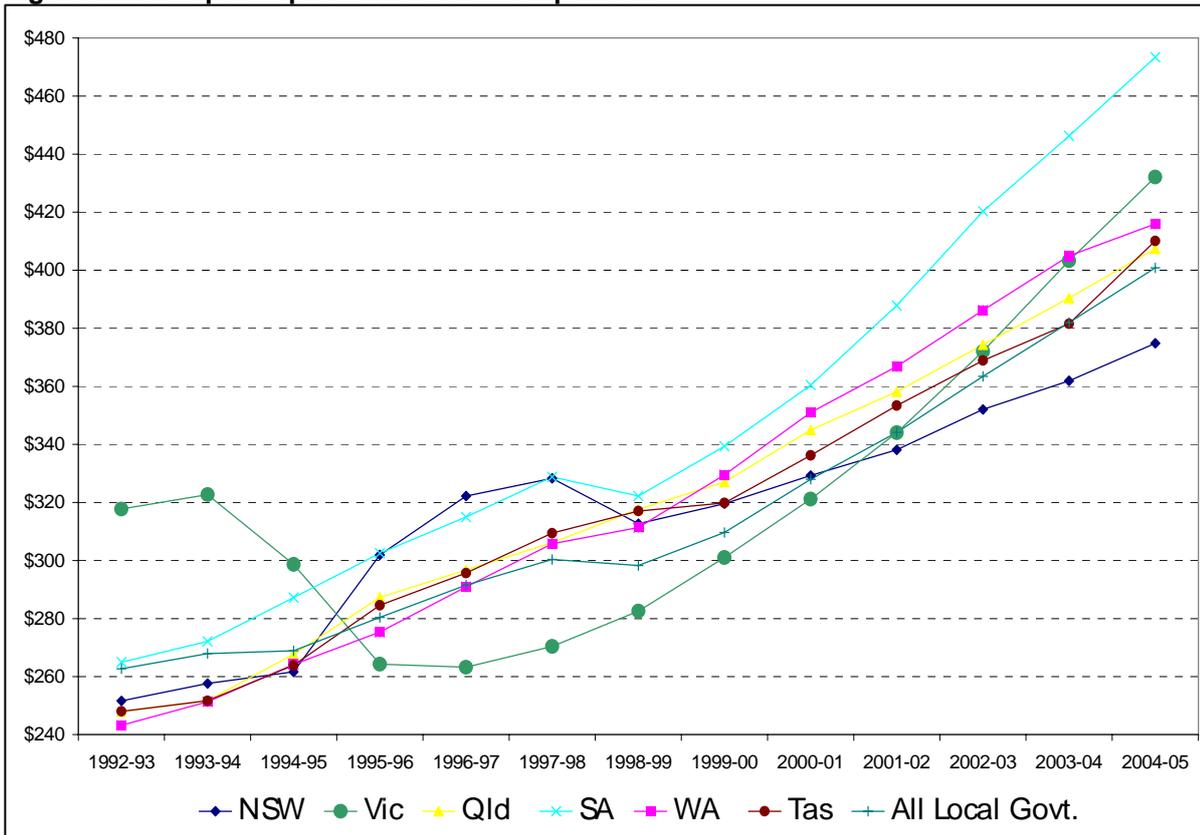
There are several reasons for the differing growth rates.

As illustrated in Figure 1, rates revenue growth in NSW has lagged that of all other states and the Northern Territory during the period and as a result NSW has the lowest rates per capita of any jurisdiction in Australia. This strongly suggests that rate pegging is a major revenue constraint on NSW councils. Given the size of the NSW economy, it is also likely that this has dampened national average growth in rate revenue.

¹ Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, May 2007, pp12-15.

² LGI, *Final Report*, Section 9.2, pp196-197.

Figure 1: Rates per Capita – Interstate Comparison



Source: MAV Viability Index, 2007.

The major component of grant income, FAGs, have grown at a similar rate to NSW rates, marginally exceeding CPI. This is because FAGs are only escalated in real terms per capita (CPI plus population growth) and are not linked to Commonwealth taxation growth or GDP growth.

User fees and charges, including annual charges, have been growing quite steadily in real terms. This suggests a growing reliance on user fees and charges for the provision of goods and services. It would also reflect the growing application of user pays and full cost recovery principles in pricing policies. This is particularly evident in the provision of water and sewerage services by councils, where full cost recovery is effectively mandated.

Contributions and donations largely consist of developer contributions and, paradoxically, block grants from the NSW Roads and Traffic Authority for regional and local road maintenance.³ Developer contributions for local infrastructure are collected under section 94 of the EPA Act or under section 64 of the LG Act where they relate to water and sewerage infrastructure. The relatively strong growth in contributions revenue is probably explained by two factors:

- The increasing application of user pays and full cost recovery principles; and
- The strong growth in the Australian economy over the last decade reflected in development.

Further information on this issue is available in Chapter 9 of the LGI's Final Report.

While the longer term data supports the trends discussed above, it should be noted that the DLG publication *Comparative Information on NSW Local Government Councils 2004/05* indicates the proportion of revenue derived from contributions and donations has declined from 12.7% to 10.8% between 2002/03 and 2004/05.⁴

Why has 'other income' been growing at a faster rate than council rate revenues and sales of goods and services?

³ Block grants from the NSW Roads and Traffic Authority, a NSW state agency, are classified as contributions and not as grants from the NSW State Government.

⁴ DLG, *Comparative Information on NSW Local Government Councils 2004/05*, 2006, p66.

The growth in 'other income' identified in the Issues Paper includes developer contributions. As noted above, developer contributions have been a strong area of growth over the past decade and are likely to be the main driver of growth in 'other income' as defined in the Issues Paper.

As noted above, rate revenues in NSW have been constrained by rate pegging.

Growth in revenue from sales of goods and services has growing steadily in real terms despite the fact that many fees and charges are regulated under NSW Government legislation. Regulations cover a range of fees including planning and building related fees, health inspections, dog registrations, rating certificates and so on. Regulated fees are only adjusted periodically (3-5 years) and adjustments are usually related to CPI only.

The Associations advocate greater freedom for councils in setting fees.

Do these trends differ between states and territories, and between urban, rural, remote, and indigenous local governments? If so, what are the primary factors explaining such differences?

Does the composition of council revenue (shares of each own-source revenue — rates, fees and charges, and 'other') differ between states and territories, and between urban, rural and remote local governments? If so, what are the primary factors explaining such differences? Do these factors have implications for the potential revenue raising capacity across different types of councils?

The Associations are not in a position to provide detailed comment on the difference in trends between states and territories other than to note that growth in rate revenue has been much slower in NSW as noted above.

The composition of revenue between metropolitan, regional, fringe and rural councils in NSW varies significantly. This is clearly demonstrated in Table 1 extracted from the LGI report.

Table 1: Composition of Local Government revenue by council category, 2003/04 (%)

Area	Rates and annual charges	User charges and fees	Interest revenue	Grants	Contributions and donations	Other revenue
Sydney City	53.7	17.7	4.6	1.8	4.8	17.5
Metropolitan developed	57.6	14.1	3.7	9.8	8.0	6.7
Regional town/city	43.4	19.4	4.0	16.3	14.6	2.3
Fringe	51.9	14.6	3.9	13.2	13.6	2.7
Rural	32.3	18.9	3.4	31.9	11.6	1.9
NSW total	47.6	16.8	3.8	16.0	11.5	4.2

Source: LGI, Final Report, Section 9.2, p196 (Table 9.2).

The differences in composition will affect the respective revenue trends to some extent. The major difference involves the proportion of revenue raised by rates compared to grants, with rural councils having a much higher degree of grant dependency.

Other differences include the proportion of contributions and donations, with the lower proportions recorded for Sydney and the metropolitan areas likely to be reflecting both a broader revenue base and the absence of development contributions for water and sewerage infrastructure. Councils are not responsible for water and sewerage within the Sydney and Hunter regions.

The higher proportion of 'Other Revenue' recorded in the Sydney and metropolitan areas is likely to be the result of broader revenue raising opportunities. This could include investment income, property rents, rental of outdoor space (e.g. footpath cafes) and infringement revenues among other items.

The Associations do not have revenue trend data for comparison of urban, regional, rural and remote areas.

4.1.2. Capacity to Raise Own Source Revenues

What are the principal factors that determine the magnitude of the various revenue raising bases available to local governments?

There are numerous factors that determine the revenue raising base available to councils. These include:

- Population and population density;
- Socio-economic profile of area;
- Disposable income/capacity to pay;
- Willingness to pay/ demand for infrastructure and services;
- Commonwealth and State Government grants policies and practices;
- Revenue options available to council (legislative or otherwise);
- Revenue constraints (such as rate pegging); and
- Land values (potentially, not necessarily).

What are the key determinants of the capacity and willingness of resident households, organisations and businesses to pay for services provided by their local governments?

The factors that determine the capacity and willingness to pay are likely to be similar for rates, fees and charges. In relation to rates the LGI found that:

“First, rates are not a large impost for most households. Rates are typically around \$600 [annually] per household in average income areas. These charges are in line with (or less than) typical utility bills such as annual electricity and telephone charges.

Second, the revenue that can be raised from the rate base is actually constrained by disposable household income, not by land values. Whether or not an average household can pay \$600 a year (or a low income household can typically pay \$400 to \$500 a year) depends on their income after Commonwealth taxes and transfers. Changing the revenue base will not change this fundamental fact.

Thirdly, as reported by IRIS Research (2005, p8), the community at large does not oppose rate increases when necessary: ‘About 70 per cent of surveyed residents provided a medium to high support rating for the statement ‘I would rather see council rates rise than see cuts in local services’.’ However, support for a rate rise rather than service cuts was stronger in wealthier households with incomes \$100,000 and above.”⁵

Other factors that could come into the question of willingness to pay rates, fees and charges include:

- The service expectations of the community;
- The quality and level of infrastructure and services provided by councils; and
- Community knowledge or recognition of what infrastructure and services councils are supplying.

In regards to the latter, community members often do not have an understanding of which sphere of government actually provides the infrastructure and services that they use and let alone the cost. Many assume that certain council infrastructure and services are provided and/or funded by the State Government when this is not the case. This is something councils need to address when seeking to increase rates, fees and charges.

What scope is there for local governments to augment their revenues with fees and charges collected from non-residents?

How and why might the scope to do so differ between local governments?

The scope varies widely between councils and, where opportunities exist, the overall scope is limited by the revenue options available to councils.

⁵ LGI, Final Report, Section 9.3, p203.

Councils with high visitation rates such as commercial, employment or tourist destinations have much greater opportunities than those that do not. For tourism destinations the opportunities will frequently be seasonal.

The direct options available to councils to raise fees from visitors are largely limited to parking fees, entry fees to council attractions or facilities, rental of council facilities (e.g. halls, sporting facilities, caravan park accommodation⁶) and usage fees for services and equipment (e.g. coin operated barbecues, laundry facilities in council operated caravan parks).

Indirectly, high non-resident visitor concentrations may lead to increased demand from businesses such as cafes or restaurants to rent public footpath space from councils for outdoor seating. Similarly, circuses, carnival operators, concert promoters and other outdoor entertainment businesses may also seek to rent public space from councils from time to time.

Under rate pegging, high non-resident visitation numbers do not provide an opportunity to generate increased overall rate revenue. While businesses may benefit from non-residents and this may ultimately be reflected in property values, rate pegging means that a council's total revenue from rates is capped. In this environment increased property values may only result in a redistribution of the rate burden between categories or by location.

Do local governments have policies, which in effect, limit their own-source revenue raising? If so, what are these policies and what might be factors holding back councils from increasing their own-source revenue? What might stand in the way of changing the policies to expand the ways, and extent to which local governments raise revenues?

The potential constraints on rate revenue are discussed in other sections of this submission. The response to the above question therefore only concerns the pricing policies of councils.

Recommendation 25 of the LGI proposes a review of current pricing policies of councils and suggests that the DLG issue best practice guidelines for pricing of council services. It is envisaged that, with consistent pricing guidelines, councils could raise more revenue, improve rationing of demand for council services and provide a more consistent framework for full or partial cost recovery. A review of Local Government pricing policy produced for the Strengthening Local Government Task Force is provided below.

Textbox 1: Local Government pricing policies for fees and charges

Local Government Pricing Policies

Overall there are 5 general cost treatments for fees and charges available to councils:

- **Legislative cost** – whereby prices are determined by legislation;
- **Zero cost** – whereby Council fully absorbs the cost of the service;
- **Partial cost recovery**- tied to a fee or charge to offset the cost of the service but which has some form of subsidy reflecting equity or public benefit objectives;
- **Full cost recovery** – tied to efficiency and revenue neutral objectives; and
- **Market or competitive pricing** – tied to council business operations and bound by competitive neutrality principles. Council business operations must have cost structures and pricing that does not use its public ownership status to generate a competitive advantage over private providers. For example competitive neutrality prohibits councils from cross subsidising their business services from non-business operations in order to offer discounted business services and undercut private sector competitors.

Fees and service revenues are the main areas where councils can apply varying cost treatments. Section 608 of the LG Act allows councils to charge or recover a fee for any service it provides such as:

- Supplying a service, product, or commodity;
- Giving information;
- Providing a service in relation to council's regulatory functions; or
- Allowing admission to a building or other council owned venue.

In determining which cost treatment is appropriate for each type of service, Councils are guided by principles of "fair imposition" and "user pays". *Fair imposition* principle is contained in Section 8 of LG Act which sets out the

⁶ Most caravan parks operated by councils in NSW are on Crown lands under the care control and management of councils. Revenue raised on these sites must be reinvested in the caravan park and surrounding Crown lands. They do not provide a source of general revenue.

council's charter and states that *councils may raise funds for local purposes by fair imposition of rates, charges and fees, by income earned from investments, and when appropriate by borrowings and grants*. The principle of *user pays* is attached to those council services that are made available to the public but not necessarily provided collectively and generically to all ratepayers. Hence payment is sought from the user or direct beneficiary of the service rather than imposing that cost on all ratepayers.

Mindful of these pricing principles, councils commonly split their services and fee treatments into the following categories:

- **Simple revenue services** – such as parking fees and specific “user pays” services
- **Non-business or “traditional” council services** – free or partial cost services associated with community service obligations such as public library services or community venue hire
- **Competitive or business services** – whereby Council services compete with the private sector providers such as building approval services or nursing homes or child care facilities
- **Legislated or exclusive services** – such as charges for council infrastructure access or planning approval lodgement fees tied to exclusive or monopoly service provision by councils

For some time councils have been exploring new revenue opportunities by breaking down their broad service categories into sub-categories with different cost treatments.

For example, a council may provide a free (zero cost) resident membership for local libraries but charge a partial cost for use of internet facilities and photocopying services, and apply full cost charges for lost or damaged books. Similarly a council may apply the prescribed legislative fee for the issue of a building certificate, a partial cost charge for variations or reissue of certificates, and full cost for the restoration work (ie guttering and paving) relating to the approved building work.

A council may also apply differential fees on the basis of the type of service user. For example councils may allow discount venue hire fees for not-for-profit organisations compared with hire rates for private or commercial operators.

While Councils have the discretion across these areas to set fees and charges, under section 610F of the LG Act, a council must not determine the amount of a fee until it has given public notice of the fee and considered any submissions. In addition there are transitional, disclosure and review requirements imposed on ongoing fees and charge arrangements. Through these mechanisms councils are implicitly required to assess their particular community's capacity to pay and set appropriate price policies.

Are there any untapped revenue sources that local governments could use to augment or change the mix of their revenue raising? Would any potential new revenue sources be stable or variable over time?

On a broader level, a major potential revenue source would be rents for the commercial placement of pipes, wires, poles and cables in public corridors. As noted elsewhere, section 611 of the LG Act provides a limited historical precedent for this. However, there would need to be legislative changes to enable the application of this practice to be expanded to include telecommunications, water and electricity.

In the absence of rate pegging, special rates, often referred to as levies, could be more effectively utilised to increase revenue. For example; special rates could be applied to raise additional revenues from tourism and entertainment precincts. At present, revenue from special rates forms part of general income which is pegged. Without a special rate variation, the targeted application of special rates only results in a redistribution of the rate burden not an increase in revenue.

4.2. State and Territory Government Regulatory Constraints

4.2.1. Land Rating and Valuation Methods

To what extent do limits on land categories that local governments can adopt for rating purposes restrict their capacity to raise rate revenues?

Limits on categorisation have not been generally recognised as a significant revenue raising constraint in NSW. As illustrated in Table 2, the LG Act provides considerable scope for categorisation with major four categories which may be further sub-categorised on various criteria.

Table 2: Land categories and sub-categories for rating purposes

Category	Sub-categorisation options
Farmland	Intensity of land use Economic factors Reduction in land value ⁷
Residential	Rural Centre of population
Mining	Kind of mining
Business	Centre of activity

Mixed Development Apportionment Factors provide a further rating option for mixed development lands. They allow councils to rate parcels of land with both residential and business uses proportionally according to those uses, based on these factors as determined by the Valuer General.

NSW councils are also able to apply minimum rates and base rates in their rating policies; further expanding options to vary the rating mix. The base amount may yield up to 50% of income from the rate category or sub-category.

With a rate pegging system, further options to categorise would only result in a redistribution of the rate effort, not an increase in rate revenue.

What are the principal reasons why some local governments do not pursue differential rate setting even where they are free to categorise their own land?

The majority of NSW councils do apply differential rating, at least to the category level. Flat rating structures are rare in NSW. The decision not to further sub-categorise in some instances is primarily for reasons of administrative simplicity.

Do restrictions on land valuation methods affect the capacity of local governments to raise revenue? If so, how and to what extent?

In NSW, valuations for rating and land tax purposes are provided exclusively by the Valuer General. Valuations are provided on an UCV basis.

A change in the valuation methodology would have little direct effect on a council's revenue raising capacity in a rate pegging environment. However, it will potentially affect the distribution of the rate burden within a council area.

While it may be argued that UCV methodology theoretically promotes the highest and best use of land, many would argue that a ICV basis allows for more equitable outcomes. ICV provides a more accurate reflection of the market value of a property and the owner's capacity to pay.

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. For example, many high value units in North Sydney City Council area pay minimum rates while other properties pay significantly more.

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.

4.2.2. Rate Pegging

What are, or might be, the reasons for rate pegging?

⁷ The introduction of reduction in land value as a basis for sub-categorisation is a recently introduced transition criterion to help councils deal with the separation of land and water for land valuation purposes.

NSW is the only state that currently applies rate pegging. Rate pegging was introduced in response to the prevailing economic and political environment of the mid 1970s and it is doubtful that the concerns of the time are still relevant.

An interim form of rate pegging was reintroduced to NSW by the Wran Government in 1977. A revised system, much the same as is currently operating, was implemented in 1978. A form of rate pegging had previously operated in NSW between 1901 and 1952, after which it was discontinued because of its impracticality. The situation had been reached where the majority of councils were successfully applying for an exemption or variation in the limit. This situation was administratively cumbersome and ultimately self defeating.

The Labor Party committed itself to the introduction of rate controls during the 1976 state election campaign.

The justification and appeal of rate pegging needs to be considered against the backdrop of the time. The 1970s were a period of rapid social, political and economic change. The pertinent aspect in relation to rate pegging was that the roles of, and relationships between, spheres of government had changed substantially.

The Whitlam Government had established a more direct relationship between the Commonwealth and Local Government. While this involved substantial increases in direct financial assistance to Local Government it was also accompanied by an expanded range of roles and responsibilities. This expansion of the roles and responsibilities of Local Government were also driven by increased community demands and expectations.

To quote Independent State MP John Hatton during the debate on the rate pegging bill:

“The responsibilities of Local Government have grown so rapidly that they have completely outgrown the revenue base and, despite the impetus of money in the form of direct federal grants from the Whitlam Government, which have been carried forward by the Fraser Government, this is still the case.”

At the same time, public perceptions about government were changing, particularly in relation to perceived excesses. While this applied to all spheres, Local Government as the most accessible and familiar sphere of government was particularly vulnerable to criticism.

Most importantly, it was a period of high inflation that impacted on rates through both escalating property values and increasing council operating costs. It was also a period when many believed that wage and price freezes were an appropriate response to inflationary pressures. This view was promptly discredited, however, rate pegging, an analogous concept, is still maintained.

The impetus for the introduction of rate pegging was provided by the rapid escalation of rates in the early 1970s. In the four years, 1973 to 1976, rates increased by an average of 118% while average weekly earnings increased by only 75% and the consumer price index by 56%. Annual increases of between 30 to 40% had been applied in many areas. While this was largely the result of the factors such as expanded roles and responsibilities, it was easy for the public to perceive the increases as excessive.

Interestingly, the argument that rate increases were excessive is not supported by comparison with the revenue growth of other spheres of government. While Local Government general rate revenue increased by 148% between 1970 and 1976, NSW Government revenue increased by 212% and Commonwealth Government revenues increased by 167%. Clearly, Local Government rate increases were quite modest compared to the revenue increases of other spheres of government - a situation that persists today.

Rates are a highly visible form of taxation and because they are presented in the form of bill to be paid annually or quarterly, ratepayers are very conscious of the amount paid and changes from year to year. This is not true of many other major forms of taxation. Bracket creep allows income tax revenues to quietly escalate with little protest by taxpayers and GST revenues escalate in a like manner.

The introduction of rate pegging was also made easier by increases in the level of Financial Assistance Grants by the Commonwealth Government, which many perceived to be a substitute for rate revenue.

In brief, the rationale for the introduction of rate pegging is summarised in the following points:

- It was a period of high inflation and the public were demanding stringency measures;
- Grant funding was (wrongly) perceived as a substitute for rate revenue; and
- Rates increases, unlike many other tax increases, are highly visible.

More recent arguments for maintaining rate pegging include the view that Local Government should reduce its reliance on rate (tax) revenue in favour of user fees and charges for services. Further, the major political parties in NSW appear to believe it is popular and the relevant NSW bureaucracies appear to like to maintain the control mechanism.

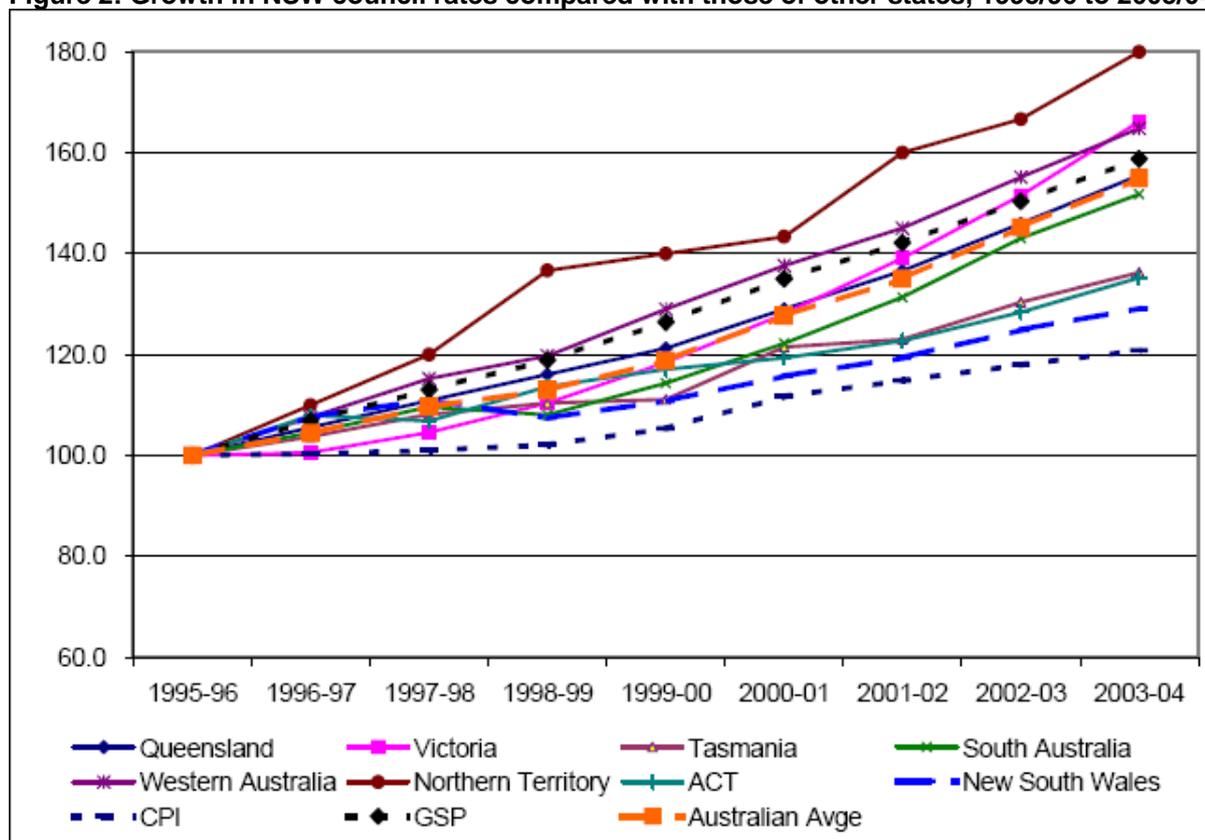
The experience of other states and territories supports the Associations position that rate pegging is an unnecessary intervention. While rates have grown more slowly in NSW than in other states in recent years, rates in other states have not increased excessively. This supports the Associations view that the political process holds councils accountable.

To what extent does rate pegging limit the ability of local governments to raise council rate revenues?

The available evidence indicates that rate pegging is a major revenue constraint on Local Government in NSW. As noted previously and illustrated in Figure 2 below, rate revenue growth in NSW has lagged that of all other jurisdictions and NSW now has the lowest rates per capita.

Even though NSW councils may apply for special variations to general income which allow for rate increases over and above that rate pegging limit, the LGI found that actual increases in average rate revenue only marginally exceeded the rate pegging limit for the period 1995/96 to 2003/04.⁸ This indicates that the rate pegging system has a broader dampening effect than the actual limit.

Figure 2: Growth in NSW council rates compared with those of other states, 1995/96 to 2003/04



Source: LGI, Final Report, Section 9.2, p198, (Figure 9.2).

A likely explanation for the dampening effect is that rate pegging provides a public benchmark and creates expectations about maximum rate increases, placing political pressure on councils to stay within the limit and not seek special variations.

This has negative consequences in the long run, these include:

- Depriving communities of infrastructure and services;
- The deferral of infrastructure maintenance and renewal expenditure; and

⁸ LGI, Final Report, Section 9.3, pp207-208.

- Undermining the financial sustainability of councils.

A further criticism of the rate pegging system is that it lacks transparency. There is no official or publicised methodology on which it is based and ultimately it is a political decision. While the rate pegging limit has tended to track CPI over the past 10 years, there have been exceptions and the system is vulnerable to political manipulation.

A major flaw of the rate pegging system is that it effectively breaks the traditional nexus with land valuation. As discussed earlier in this paper⁹, valuations do not drive revenue under rate pegging; they only serve to redistribute the rate burden within council areas.

It could also be considered hypocritical for rate pegging to be maintained on Local Government while NSW State Government land taxes remain uncapped.

The Associations have opposed rate pegging since it was introduced. However, while advocating removal of the system, the Associations have promoted the adoption of a Local Government cost index as an interim measure. The Associations developed an alternative model, the *NSW Local Government Rate Determination Model*¹⁰, and presented this to the NSW Government in 2003. The model provided a specific Local Government cost index as the basis for determining the rate pegging limit. This would help ensure that the rate pegging limit would more accurately reflect the actual cost pressures facing councils. As a public index, it would also overcome the lack of transparency associated with the current system.

Further information on the issue of rate pegging is available in Chapter 9, pages 207 to 211 of the LGI's Final Report.

Are local governments able to raise revenues from other sources to compensate for the potential revenue raising limits imposed by rate pegging? How, and with what consequences?

As noted above, NSW councils are increasing their reliance on 'fees and charges' and 'other income' to compensate for the constraints of rate pegging.¹¹ There is an increasing trend towards full cost recovery or commercial pricing policies where appropriate.

4.2.3. Concessions and Exemptions

To what extent do mandated exemptions and concessions limit the ability of local governments to raise council rate revenue?

The LG Act provides for a wide range of exemptions, many of which were carried over from the *Local Government Act (NSW) 1919* and which, in the Associations' view, are outdated and no longer appropriate.

The Associations are calling for a review of rate exemptions. This is consistent with LGI recommendation 23 which states:

“The State Government should review and remove rate exemptions for all land use for commercial or residential purposes regardless of ownership.

This includes State Government trading enterprises (e.g. NSW Forests landholdings used for commercial forestry) and benevolent organisations' commercial activities (e.g. retirement homes and business premises). Councils should also be allowed to apply Section 611 charges for all commercial use of public spaces (e.g. underground pipes and cables, street poles, overhead wires).¹²

The types of land exempt from all rates are included under section 555 of the LG Act:

- Land held by the Crown, not being leased for private purposes;
- Land within a national park, historic site, nature reserve or state game reserve;
- Land subject to a conservation agreement;

⁹ See above 4.2.1.

¹⁰ Local Government and Shires Associations of NSW, *NSW Local Government Rate Determination Model*, Prepared by the National Institute of Economics and Industry Research, 2003, Sydney, Melbourne.

¹¹ See above 4.1.1.

¹² LGI, Final Report, Section 12.6, p307.

- Land occupied by a church or another building used or occupied for public worship;
- Land occupied by a building used or occupied with religious teaching or training, or as a residence for a minister of religion;
- Land that belongs to and is occupied and used in connection with a school;
- Land that is within a special area for the Hunter Water Corporation or other water supply authority;
- Land that is vested in the NSW Aboriginal Land Council or a Local Aboriginal Land Council and is declared under Division 5 of Part 2 of the Aboriginal Land Rights Act 1983 (this may also exempt land from all charges in some circumstances);
- Land owned by the Rail Infrastructure Corporation; and
- Land below the high water mark and used for any aquaculture relating to the cultivation of oysters.

The types of land exempted from rates other than water supply and sewerage special rates are included under section 556 of the LG Act:

- Land that is a public place, common or public reserve;
- Land used as a public cemetery, public library, public hospital, college, university or mining rescue company;
- Land that belongs to and is used by a public benevolent institution or charity; and
- Land belonging to the Sydney Cricket and Sports Ground Trust or the Zoological Parks Board.

The Associations are not opposed to rate exemptions where they are justified; for example, genuine benevolent institutions and charities, public lands, schools and hospitals. The Associations concerns are that in modern times 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.

Further we are concerned that some commercial uses of state owned lands remain exempt from rates. This includes commercial activities within national parks, unleased properties held by land holding agencies and the commercial forestry plantations of Forests NSW. The latter compete with private plantations which do pay rates, so there is also a competitive neutrality issue here.

The Associations have also called for new a new provision to be inserted in the LG Act to allow councils wider powers to charge for the commercial use of public spaces. This relates to cables, pipes and wires under or over public corridors. Limited provision is provided under section 611 of the LG Act to charge for such usage. However, this is not enforceable in most instances.

What are the existing arrangements in each State and Territory regarding the payment of council rates and rate-equivalents by Australian, State and Territory landholders?

NSW state owned corporations are generally required to pay rates under sections 9(b) and 20F(b) of the *State Owned Corporations Act (NSW) 1989*. Rates are paid directly to councils. This policy was adopted to apply competitive neutrality principles under National Competition Policy. However, as illustrated in Table 3, a number of other NSW Government businesses remain exempt.

Table 3: NSW Government businesses exempt from council rates

Business	Section 555(1) LG Act exemption
TransGrid	Pays no rates despite liability under s 20F(b) of the <i>State Owned Corporations Act (NSW)1989</i>
Pacific Power	Pays rate equivalents despite being exempted under the <i>Electricity (Pacific Power) Act 1950</i>
Fish River Water Supply Auth.	Pays no rates on unleased land under section 555(1)(a)
Sydney Catchment Authority, Sydney Water & Hunter Water	'Special Areas' and 'Controlled Areas' exempted under section 555(1)(c) and 555(1)(c1)
Landcom	Pays no rates on unleased land under section 555(1)(a)
Department of Housing	" "

Business	Section 555(1) LG Act exemption
Crown Property Portfolio	" "
Department of Public Works	" "
Waterways Authority	" "
Sydney Harbour Foreshores Authority	" "
Honeysuckle Develop. Corp	" "
Land & Property Information	" "
State Forests of NSW	Pays no rates on unleased land under section 555(1)(a)
National Parks & Wildlife Services	Exempt from paying rates "whether or not the land is affected by a lease, license, occupancy or use" under section 555(1)(b)
State Transit Authority	Pays no rates on unleased land under section 555(1)(a)
Rail Infrastructure Corporation	Pays no rates on unleased land under section 555(1)(g1)
State Rail Authority	Pays no rates on unleased land under section 555(1)(a) and 555(1)(g1)
Sydney Cricket Ground Trust	Pays no rates on unleased land under section 556(1m)
Wollongong Sports Trust	Pays no rates on unleased land under section 555(1)(a)
State Sports Centre Trust	" "
Parramatta Stadium Trust	" "
Sydney Ports Corporation	Liable under <i>State Owned Corporation Act (NSW) 1989</i>
Newcastle Port Corporation	" "
Port Kembla Port Corporation	" "
Zoological Parks Board	Pays no rates on unleased land under section 556(1)(n)
Sydney Opera House Trust	Pays no rates on unleased land under section 555(1)(a)

Commercial/private leaseholds on Crown lands are subject to rates however, as noted above, commercial leaseholds in national parks are not subject to rates. This is an anomaly that needs to be addressed.

State and Commonwealth Government departments and agencies do not pay rates or rate equivalents on properties they own. Commercial leaseholds on Commonwealth lands typically pay a rate equivalent (e.g. Sydney Airport).

The Associations maintain that all government business or trading activities, particularly those that compete with private competitors should be subject to rates. This is based on the Associations' policy principle that all lands used for residential or commercial purposes should be subject to rates regardless of ownership and the principle of competitive neutrality.

What are the existing arrangements in each State and Territory regarding the provision of concessions, and the compensation by State and Territory governments for the loss of revenue by local governments from these concessions?

Pensioner rebates are the major concession available in NSW. While all states provide pensioner concessions, NSW is the only state that requires councils to fund approximately half the cost of the concession.

Eligible NSW pensioners are entitled to rebates on:

- All ordinary council rates and charges for domestic waste management services up to \$250;
- All water supply special rates or charges not to exceed \$87.50; and
- All sewerage special rates or charges not to exceed \$87.50.

The expense of the rebate is jointly funded by councils and the NSW Government on a 45:55 basis. The level of the compulsory rebate has been static since 1993. Similar pensioner rebates are provided in other states and territories but are fully funded by the respective state and territory governments.

Australia's population aged 65 and older is projected to increase from 2.5 million (12%) in 2002 to 4.2 million in 2021 (18%). Based on this figure, over a quarter of the population in most Local Government areas will be aged over 65.

Despite growing superannuation coverage, many of the retirees will still be pensioners or partially funded retirees who will become pensioners at some stage after retirement.

There are also mounting pressures to increase the levels of the rebates and extend them to self funded retirees. Of immediate concern are recent amendments to Commonwealth legislation whereby asset limits for Centrelink purposes are to increase from 20 September 2007. These trends will potentially swell the number people receiving concessions and dramatically increase the cost of concessions.

The cost of compulsory pensioner rate rebates is a rapidly growing burden for many councils and is affecting the level and range of services that councils are able to deliver. The scheme already costs some individual councils well in excess of \$1 million annually. The total cost to councils is now around \$76 million annually. This is the result of an ageing population. The impact on councils is uneven with higher concentration of pensioners in many coastal councils, regional centres and some older established suburbs. Many councils are advising that they will not be able to sustain the growing cost in the medium to long term.

It should also be recognised that the cost is inequitably distributed. Those who qualify for rebates are disproportionately represented in low income areas, areas that already have a high demand for council services but a limited revenue raising capacity. Given the limited revenue base of Local Government it is unfair that it should be required to fund this form of welfare assistance. This form of benefit should be funded by from the broader revenue base of the state or federal governments. As previously noted, the NSW Government is the only state government that does not fully fund pensioner rate concessions.

To what extent do exemptions and concessions limit the ability of local governments to raise revenues?

The impact of concessions and rebates varies widely between councils. As noted above, pensioner concentrations are higher in particular Local Government areas. The same is true of exemptions. For example, many councils have a large proportion of their land areas taken up by national parks or Forests NSW; others have concentrations of government offices, schools and hospitals.

Aggregate data on the cost of exemptions is not available.

Are local governments exempt from taxes and charges by other tiers of government? If so, what are they? Does any lack of reciprocity favour or disadvantage local governments?

Local Government is exempt from company tax and its core activities are exempt from NSW payroll tax and stamp duties. Certain prescribed activities are subject to payroll tax if they exceed the threshold (e.g. water, sewerage, cemeteries, abattoirs etc).

As part of the incomplete reciprocal charging regime, Local Government no longer receives exemptions or concessions from state owned water corporations or state owned electricity utilities.

4.2.4. Setting Fees and Charges

What are the regulatory requirements and guidelines applied to local governments for setting fees and charges?

To what extent are local governments constrained in setting fees and charges? To what extent are the requirements and guidelines followed by local governments?

To what extent do local governments under or over-recover the costs of supplying goods and services?

What scope would there be to raise additional revenue if the limits were removed?

To what extent does local government legislation or other relevant legislation explicitly provide the power to set fees and charges in excess of the cost of supply?

If powers are not explicitly provided, to what extent, if any, does this limit the ability of councils to raise revenue from introducing new fees and charges?

NSW Local Government can collect charges for service to properties which are levied on the parcel of land for which the service is provided and fees for supplying other services, a product or commodity, for giving information or for providing a service in relation to council's regulatory functions.

The following sections will deal with:

- The regulatory environment for the setting and pricing of charges;
- The regulatory environment for the setting and pricing of fees; and
- Scope for additional revenue.

Charges (annual charges and user charges)

Power to set charges

Legislation prescribes what property services councils can levy charges for. Pursuant to chapter 5, parts 1, 2, 4 and 5 of the LG Act councils can levy charges for the following services:

- Water supply services; section 501 LG Act;
- Sewerage services; section 501 LG Act;
- Drainage services; section 501 LG Act;
- Waste management services (other than domestic waste management services); section 501 LG Act;
- Any services prescribed by the regulations; section 501 LG Act;
- Domestic waste management services; section 496 LG Act; and
- Stormwater management services; section 496(a).

Charges can be levied either as an annual charge or as a charge for actual use (user charges, section 502 LG Act); apart from charges for stormwater management services which can only be levied as annual charges.

In addition, councils can levy an annual charge on the person for the time being in possession, occupation or enjoyment of a rail, pipe, wire, pole, cable, tunnel or structure laid, erected, suspended, constructed or placed on, under or over a public place (section 611 LG Act).

In practice, annual charges are mainly levied for domestic waste management services. User charges are commonly levied on water and sewerage services (outside the Sydney and Hunter regions), commercial waste and extra waste management services.

Regulatory restrictions and guidelines

General "capping" of income from charges

Similar to rate pegging, the Minister for Local Government has the power to specify the proportion by which income from certain charges can be varied in relation to previous year's income. However, in practice the Minister has not applied this power, apart from the fact that income from annual charges for drainage services and any charges councils levy for services as prescribed by the regulations are included under "general income" which is currently limited (rate pegging); section 505(a) LG Act.

Income limitation could be imposed on the following charges:

- Annual charges for domestic waste management services; sections 505(b) and 507 LG Act;
- Annual charges for stormwater management services; sections 505(c) and 510A LG Act;

Charges for water supply, sewerage and domestic waste management services are subject to mandatory rebates for pensioners; section 575 LG Act; which are only partly reimbursed by the NSW Government.¹³

General regulatory requirements on pricing

Generally, the amount of a charge need not be limited to recovering the cost of providing the service, except as provided by section 503(2) LG Act (limitation to cost recovery of a charge for a service if the land is not rateable by a special rate for that service) and section 504(3) LG Act (limitation to reasonable cost for domestic waste management services; see below).

The DLG in its *Rating and Revenue Raising Manual* advises that funds received as a result of levying a charge may not be used otherwise than for the purpose for which the charge was levied.¹⁴

Section 539 LG Act generally prescribes what criteria are relevant in determining the amount of a charge: councils may have regard to (but is not limited to) the following:

- The purpose for which the service is provided;
- The nature, extent and frequency of the service;
- The cost of providing the service;
- The categorisation for rating purposes of the land to which the service is provided;
- The nature and use of premises to which the service is provided;
- The area of land to which the service is provided; and
- In the case of water supply services—the quantity of water supplied.

The DLG in its *Rating and Revenue Raising Manual* recommends that while the amount of a charge need not be limited to recovering the cost of providing the service, the amount of a charge would still need to be "reasonable".¹⁵

However, the LGI found the DLG guidelines recommendations, as well as the provisions in the LG Act vague. They do not define or discuss the nature of costs, the treatment of sunk costs, pricing according to marginal cost principles where appropriate, the treatment of accrued versus cash costs, the allocation of joint overhead costs, the treatment of depreciation, or the appropriate real return on capital.¹⁶

Specific constraints and requirements

The following restraints and requirements apply to specific services:

- Water and sewerage and liquid trade waste management (water and sewerage services are provided by council businesses outside the Sydney and Hunter regions of NSW):
 - Pursuant to the 1994 Council of Australian Governments agreement on a strategic framework for the efficient and sustainable management of the Australian water industry, councils are required to adopt best practice pricing principles, full cost recovery and transparency as policy objectives for water supply and sewerage businesses and liquid trade waste services.
 - Best practice pricing for water supply includes an appropriate usage charge together with a cost reflective access charge. Best practice pricing for sewerage includes a two-part tariff for non-residential customers, a uniform sewerage bill for residential customers and appropriate trade waste fees and charges for all dischargers of liquid trade waste.¹⁷ The Department of Water and Energy provided guidelines for councils on best practice management and pricing guidelines.
 - Water and sewerage services (38 per cent of total turnover of Local Government businesses) and waste collection and related services (8.8 per cent, *ibid*) are commercial businesses and as such expected to meet the requirements of National Competition Policy (NCP) if their annual turnover is greater than \$2million (category 1 businesses). Requirements imposed by NCP are:¹⁸

¹³ See above 4.2.3.

¹⁴ DLG, *Councils Rating and Revenue Raising Manual*, (2007), p43.

¹⁵ *Ibid*, p43 and pp54-58.

¹⁶ LGI, *Final Report*, Section 9.4, p215.

¹⁷ DLG, *Councils Rating and Revenue Raising Manual*, (2007), p44.

¹⁸ See See LGI, *Final Report*, Section 9.4, p214, 216. In 2003/04, the 126 local water utilities providing these services had a total turnover of \$806 million and total assets under management of \$10.6 billion. Of these LWUs, 51 were category 1 businesses and required to apply corporate principles to their operations

- Adoption of a corporate model;
 - Inclusion of debt guarantee fees;
 - Factoring into prices an appropriate return on capital invested;
 - Quantification of and making explicit community service obligations;
 - Operation in the same regulatory environment as other businesses;
 - Inclusion in costs the same taxes as faced by private businesses
 - Pay-for-use water supply pricing;
 - Full cost recovery;
 - Removal of cross subsidies;
 - Trade waste pricing;
 - Performance reporting and benchmarking; and
 - Payment of tax equivalents and the ability to pay dividends from water and sewerage businesses to councils' general funds.
- Domestic waste management charges:
 - Income to be applied to domestic waste management must be obtained from charges for this service; section 504(2) LG Act. Income from ordinary rates cannot be applied towards the cost of providing domestic waste management services; section 504(1) LG Act.
 - Domestic waste management charges must be calculated not to exceed the “reasonable cost” to the council providing those services; section 504(3) LG Act.
 - Pursuant to section 510 LG Act, the annual charge for domestic waste management services for a parcel of rateable land must not exceed the charge for the previous year as limited by general income restrictions for that charge, if imposed; section 507 LG Act.
 - Stormwater management charges:
 - Pursuant to clause 125A of the *Local Government (General) Regulation (NSW) 2005*:
 - An annual charge for stormwater management services may only be levied on land categorised for rating purposes as residential or business;
 - The charge cannot apply to vacant land;
 - The charge cannot be levied on a parcel of land subject to a special rate or charge for which the primary purpose is to provide a stormwater management service;
 - The charge cannot be levied by a council if it has received a special variation from the Minister for Local Government for which the primary purpose is to provide a stormwater management service;
 - The charge cannot exceed the anticipated cost (if less than maximum charge) or the maximum charge (if anticipated cost greater than maximum charge); and
 - Pursuant to clause 125AA of *Local Government (General) Regulation (NSW) 2005* the maximum charge that may be levied on rateable land is:
 - \$25 for land categorised as residential; and
 - \$25 per 350 square metres (or part thereof) for land categorised as business.
 - Charges pursuant to section 611LG Act:
 - The annual charge is to be based on the nature and extent of the benefit enjoyed by the person concerned.

Fees

Fees are the main areas where councils can apply varying cost treatments. Prices are determined by pricing guidelines and council policies.

Section 608 LG Act allows councils to charge or recover a fee for any service it provides such as:

- Supplying a service, product, or commodity;
- Giving information;
- Providing a service in relation to council's regulatory functions; or
- Allowing admission to a building or other council owned venue.

A review of Local Government pricing policies is provided above.¹⁹

Scope for additional revenue from charges and fees

¹⁹ See above 4.1.2, Textbox 1.

Full charging for the use of water and dividends from water and sewerage businesses

The LGI found that few if any councils charge for the water as a resource itself. In this, they are following common practice in NSW where the Independent Pricing and Regulatory Tribunal regularly sets water prices to reflect expenditures and makes no allowance for the scarcity value of water. Accordingly, the Inquiry suggests fully charging for water as a scarce resource.²⁰

Also, the rate of return on assets employed is low even by utility standards and does not reflect the rate of return available from alternative uses of scarce capital resources. This indicates that not only is there no scarcity charge for water itself, but that the charges for the use of capital and other resources are also too low.²¹

Pursuant to section 409(5) LG Act, councils with water supply and/or sewerage businesses are allowed to pay a dividend from any operating surplus of those funds to their general fund. The payment of dividends is subject to the council complying with best practice guidelines published by the Department of Water and Energy.

However, besides covering its accounting costs, water and sewerage businesses are not obliged to earn an economic rate of return on its equity so that its dividend payout can be truly commercial.²²

Parking fees

The LGI found that councils, particularly in metropolitan areas already collect parking fees but there might be scope for more effective use of this type of fee.

Where there is a shortage of parking facilities (on or off street), the principle of efficient allocation suggests charging at the market-clearing price. This ensures that scarce parking space is utilised most efficiently. Parking fees are also an effective way of ensuring that visitors pay for local services. While groups who lose free parking rights may resist the new charges and the fines that go with overstaying parking meters, councils have powers to exempt local residents from parking fees and often do so for short stays or in residential streets and popular local amenity areas.²³

Recently there has been concern about rising fines for parking. Parking fines rose from \$60 million in 2002/03 to \$95 million in 2004-05. However, this concern is largely misplaced. The key issue is not whether fines are charged, but whether parking fees are reasonable. Parking fees are an inevitable and necessary method for fairly and efficiently dealing with limited road space subject to excessive demand.²⁴

Road usage fees

Roads and open spaces are high value assets of local councils. They are also a source of long-run financial viability. It is important that use of roads and open spaces be appropriately rationed and used in the public interest and this is likely to involve charging commercial returns for the use of scarce resources.²⁵

4.3. Impacts on individuals, organisations and businesses

4.3.1. Council Rates

What would be the effects on individuals, organisations and businesses of local governments increasing council rates?

As noted previously, rates represent a small proportion of disposable income and, perhaps more significantly, a small proportion of the overall tax burden on individuals, organisations and businesses.²⁶

Rates represent only 3% of the tax revenue collected in Australia.

²⁰ LGI, Final Report, Section 9.4, pp216 and 220.

²¹ Ibid, p216.

²² Ibid, p216.

²³ Ibid, pp217-218.

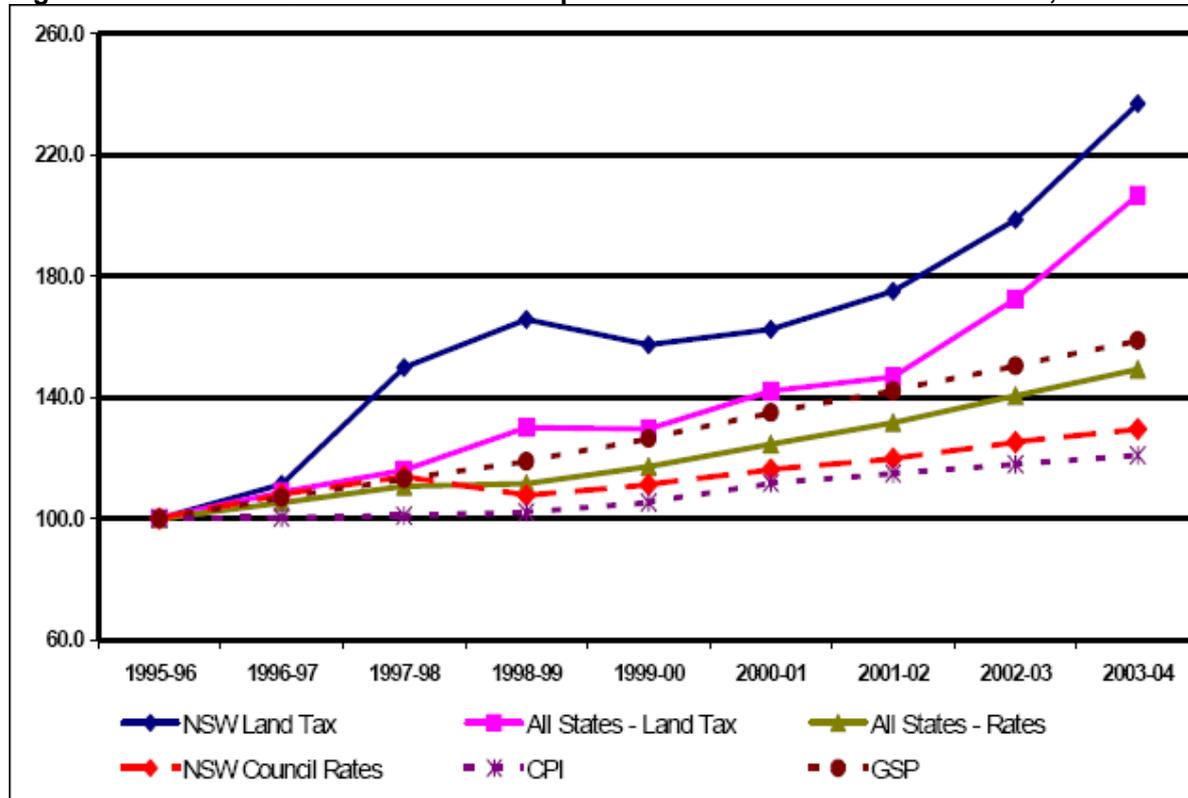
²⁴ Ibid, p218.

²⁵ Ibid, p217.

²⁶ See above 4.2.2.

However, this is not to say that rates represent a relatively underutilised form of taxation that is the panacea for Local Governments financial needs. Rates cannot be considered in isolation from the overall tax burden on the Australian public. Further, the potential to raise additional rates is becoming increasingly crowded out by the encroachment of state land taxes. Figure 3 below demonstrates the escalation of state land taxes compared to council rates.

Figure 3: Growth in NSW council rates compared with Land Tax and other indices, 1995/96 to 2003/04



Source: LGI, Final Report, Section 9.2, p198, (Figure 9.1).

Given the effects of rate pegging, there is the need and the scope for increased rates in NSW. However, given the vertical fiscal imbalance inherent in the Australian taxation system, a major part of the solution to the financial needs of Local Government lies in a fairer share of national taxation revenues.

To what extent are council rate revenues used to subsidise the delivery of goods and services for which fees and charges are collected? What are the consequences?

Once again the extent varies between councils and will depend on the composition of council revenue, community needs and council policies.

To what extent do efficiency and equity considerations contribute to the attractiveness of council rates as a source of local government income?

It is probably the inherent efficient and equitable basis of rating that has maintained it as the core revenue raising mechanism for Local Government. The NSW rating system, like most rating systems, is based on the principles of benefit (efficiency) and capacity to pay (equity).

The LGI determined that a sound Local Government rating system should exhibit four traits; financial adequacy, administrative simplicity, equity and efficiency.²⁷

It concluded:

- That rating was an adequate tax base for most metropolitan and large regional councils but noted that it was not so for many rural councils with small and/or declining rate bases;
- That the system is administratively cost efficient;

²⁷ LGI, Final Report, Section 9.3, p202.

- That rating was an equitable system overall, although with some deficiencies; and
- That it is efficient.²⁸

Further information on the issue of council rates is available in Chapter 9, pages 202 to 207 of the LGI's Final Report.

4.3.2. Developer Charges and Contributions

Information on the legislative and administrative framework for development contributions in NSW can be found in an extensive set of practice notes issued by the NSW Department of Planning.²⁹ The following notes draw on these practice notes and additional information can be found in the practice notes.

To what extent do local governments employ developer contributions and charges to finance investments in new and upgraded assets?

The provisions of section 94 and 94A of the LG Act and planning agreements under the EPA Act enable councils to obtain development contributions as a means of funding local infrastructure and services that are required as a result of new development. They may only be applied to capital costs.

The DLG publication *Comparative Information on NSW Local Government Councils 2004/05* provides statistics for each council and for all councils on contributions and donations. However, contributions pursuant to section 94 and 94A of the LG Act are not itemised separately. Each council reports on the level of contributions raised in any one year in their annual reports.

Are there legislated limits to contributions that can be required or charges that can be collected?

Councils are required to publish plan for contributions pursuant to section 94 LG Act which sets out the formula for determining the level of contributions.³⁰

Councils may also set a fixed rate development levy under section 94A of the Act. The *Local Government (General) Regulation (NSW) 2005* limit the maximum amount that can be levied to 1% of the cost of the development. Amendments to the legislation late last year also placed other limits on the levy, including:

- Levy cannot apply to developments valued at less than \$100,000;
- Maximum levy of 0.5% for developments valued at between \$100,001-\$200,000; and
- The levy cannot be applied to development for the purposes of disabled access, affordable housing and some other categories of development.³¹

Are there legislated constraints on the use of revenue raised from developer charges?

Under the legislation, section 94 of the LG Act can only be applied to the capital funding of facilities. The only recurrent funding permitted is the ongoing maintenance of roads where heavy vehicular traffic movements arise directly from specific development activity, such as mining. Planning agreements do, however, allow levies to be put towards recurrent funding.

What are the effects on individuals, organisations and businesses of the use of developer charges and contributions?

What is the most appropriate way to recover the costs of new and upgraded assets?

The LGI in its Interim Report found that:³²

²⁸ Ibid, Section 9.4, pp202-207.

²⁹ The practice notes can be accessed via the Department of Planning's website at http://www.planning.nsw.gov.au/planning_reforms/developmentcontributions.asp.

³⁰ Ibid, see practice note: "Determining rates for different types of development".

³¹ See Planning Circular - Changes to the application of section 94A of the EPA Act – ministerial direction (issued 6 December 2006) at http://www.planning.nsw.gov.au/planningsystem/pdf/circulars/ps06_020_s94a_am.pdf

³² LGI, Interim Report, Section 9.4, p177.

“The principle of developer contributions is a sound one. Developer contributions are efficient and equitable. They are efficient because they set charges that should reflect the real costs of local public infrastructure needed to support a private development and so ensure that such a development does not occur when its total costs exceed its total benefits in both a private and public sense. Also, they provide a mechanism for financing development.

They are equitable because the charges are borne by the beneficiary of the works. The major beneficiary is the owner of the land on which the development is made. As shown in Abelson³³, when the supply of land for urban housing is fixed and the price of housing land exceeds its value in alternative uses, as is usually the case in NSW, developer charges reduce the price of land. When the supply of housing land is fixed, the number of new houses supplied is independent of developer charge. The price of new houses is determined by the relative attractiveness of the new housing compared with the existing stock of housing. This relative attractiveness is not affected by charges that the developer has paid.

However, developer charges have to be paid from somewhere and, in general, development is a competitive business so the charges cannot come out of developer profits. Faced with developer charges, developers bid less for land. Of course, if developers already hold land, they pay the extra charge as the landowner. In the absence of developer charges, the land price would be substantially higher. This would be inequitable because the landowner has contributed nothing to this higher price.

In practice, there can be problems in the application of developer charges. There needs to be a nexus between the charges and the development and it can be hard to determine in advance exactly what costs will be involved. Special problems arise when development incurs ‘lumpy’ infrastructure. It can also be difficult to identify marginal incremental costs when development occurs in established areas. Many councils simplify administration of developer contributions by estimating an average rather than marginal or project specific cost for a new development. Dollery³⁴ argues that this is inappropriate because it sends the wrong price signals to developers and may encourage the wrong form of development.

In a working paper on developer charges for the Inquiry, Dollery³⁵ concludes that developer charges have worked well and that there is a strong case for expanding them.”

The proceeding discussion refutes the most common criticism that developer charges add to the cost of housing, particularly impacting on first home buyers. These arguments are supported by the Productivity Commission’s *Inquiry Report into First Home Ownership* (March 2004) which found:

While infrastructure charges, like other costs of bringing housing to the market, have increased over time, they cannot explain the surge in house prices since the mid-1990s. The claimed cost savings and improvements in affordability from reducing reliance on developer charges for infrastructure appear overstated:

- Most categories of charges are both justified and desirable on efficiency/equity grounds;
- Housing affordability should not be significantly affected by greater reliance on upfront charging as opposed to charging over time;
- Developer charges for those items of social or economic infrastructure that provide benefits in common across the wider community have generally been relatively small; though such infrastructure should desirably be funded out of general revenue sources; and
- Even if the cost of providing infrastructure to new developments were shifted onto the wider community, housing affordability might not be greatly enhanced.

Developer charges and contributions for infrastructure should be:

- *Necessary*, with the need for the infrastructure concerned clearly demonstrated;

³³ Abelson P, *The Real Incidence of Imposts on Residential Land Development and Building*, Economic Papers, 1999, Vol.18, 85-90 and Abelson P, *Taxation and Subsidies for Housing and Land: Market Impacts and Economic Efficiency Implications*, Paper presented to 34th Annual Conference of Economists, 2005, Melbourne.

³⁴ Dollery B, *Developer Contributions and Local Government Infrastructure*, For LGI Final Report, Sydney, 2006.

³⁵ *Ibid.*

- *Efficient*, justified on a whole-of-life cost basis; consistent with maintaining financial disciplines on service providers by precluding over-recovery of costs; and
- *Equitable*, with a clear nexus between benefits and costs, and only implemented after industry and public input.

Those imposing developer contributions and charges should:

- Follow guidelines based on these principles and be subject to independent regulatory scrutiny;
- Provide for 'out of sequence' development if developers are prepared to meet the cost consequences;
- Be open to proposals for alternative infrastructure arrangements that meet the needs of the households concerned;
- Allow appeals on the amounts charged, or their coverage; and
- Be accountable for how money raised from charges is spent.

The Associations support the conclusion that developer contributions are efficient and equitable means for funding infrastructure.

4.3.3. Fines and Pecuniary Penalties

What are the effects on individuals, businesses and organisations of fines and other pecuniary penalties and increases in them?

The purpose of fines and pecuniary penalties is to act as a deterrent from action that would otherwise be inappropriate and to encourage behaviour that is for the benefit of the whole society. The effect of the increase in the quantum of a fine may have different effects on individuals and businesses dependent on the size of the increase in the fine.

What measures are there in place to protect against the possibility that local governments might view fines as a revenue raising instrument more than as an appropriate deterrent?

There has been no evidence to indicate that councils use fines primarily as a source of revenue. Further, the level of fines for particular offences is prescribed under state legislation, not by council policy. When a council issues an infringement notice it can generally only issue the infringement at the amount set by legislation.

Recently there has been concern about rising fines for parking. Parking fines rose from \$60 million in 2002/03 to \$95 million in 2004/05. However, this concern is largely misplaced. The key issue is not whether fines are charged, but whether parking fees are reasonable. Parking fees are an inevitable and necessary method for fairly and efficiently dealing with limited road space subject to excessive demand.³⁶

If conflicts of interest arise between deterrence and revenue raising, is there any evidence of the effects on individuals, organisations and businesses?

Firstly, as noted above, there is no evidence that councils issue infringements primarily for the purpose of revenue raising. Secondly, deterrence is not the only reason that infringements are issued. There is also the public interest to be taken into consideration as a reason for issuing infringements; e.g. to recover some of the cost for damage caused by the actions of individuals or business under the environmental legislation.

4.3.4. Interest income

To what extent are local government cash reserves the result of State government imposed borrowing limits?

The Associations are not aware of any research that indicates that the level of Local Government cash reserves are the result of State Government imposed borrowing limits. The current levels of cash reserves are more likely to reflect the debt-averse policies and practices of councils.

Further information on the issue is available in Section 11.4 of the LGI's Final Report.

³⁶ LGI, Final Report, Section 9.4, p218.

4.4. Factors influencing expenditure and revenue raising

4.4.1. Operational Efficiency of Local Government

To what extent is there scope for local governments to reduce the unit costs of their operations? If so, how might they most effectively reduce their costs?

What effect would such cost reductions have upon their revenue raising requirements?

How and to what extent have structural reforms, such as boundary changes of local governments and service sharing arrangements, affected operational efficiency?

Economies of Scale

The LGI found that there is uncertainty as to whether the concept of larger councils actually produces significant economies of scale:

Firstly, a review of academic research concluded that no satisfactory Australian study has yet been conducted into economies of scale in municipal service provision, largely because most studies focused on total per capita costs of councils rather than the average cost of delivering a specific council service under different volume scenarios.³⁷

Secondly, the assumption that the number of council residents is an accurate indicator of total needs ignores the fact that population needs may be quite diverse across Local Government areas depending upon the demographics. Also, areas heavily frequented by non-residents such as shoppers, tourists and commuters also skew per capita expenditure as councils need to serve them too. For instance, the people who use the Sydney CBD far outnumber its permanent residents. Further, population size says little about the extent of various capital outputs being used to produce goods and services. For instance, a rural council with a small population but a large land area may have a huge road network that inflates its expenses because of high maintenance and depreciation.³⁸

Finally, the LGI did not find evidence that amalgamation reduce unit costs of services. Instead, it found that population density in any given area and not population size is the determining factor influencing unit costs. Negligible savings in administrative costs are offset by increased travel allowance and other support cost.³⁹

The LGI concluded that resource sharing and regionalised provision of services can enhance the efficiency of municipal service delivery if it is applied through more specific and flexible structures which are able to determine delivery of which service would benefit from resource sharing in their particular circumstances and to implement such arrangements.⁴⁰ Ad-hoc resource sharing models and regional organisations of councils and other strategic alliances provide such structures. A case study involving a study by Bombala Shire Councils supports this conclusion.⁴¹

Managerial efficiency

In terms of managerial and administrative efficiency, Local Government in NSW is well placed within the world best practice model applied by the LGI in a benchmarking exercise with nine NSW councils. Service performance and maturity of management practices were found to be above those of both the Local Government sector and service organisations generally in other parts of the world.⁴²

Furthermore, according to the results of a corporate overheads study undertaken with 58 NSW councils, which assessed the efficiency of corporate support services by looking at the back office cost in relation to total expenditure, NSW councils outperform NSW Government benchmarks and the results of most state government agencies.⁴³

³⁷ Ibid, Section 10.5, p258.

³⁸ Ibid, p258.

³⁹ Ibid, pp259-262.

⁴⁰ Ibid, pp262-266 and 10.5.9.

⁴¹ Ibid, p259.

⁴² Ibid, Section 10.4, pp245-249.

⁴³ Ibid, pp250-252.

4.4.2. Service Levels and Pricing

What guidelines and requirements are available to assist local governments to determine the appropriate range and standard of services, to measure and allocate their costs, to determine their revenue requirements, and to set rates, and fees and charges, accordingly?

Do guidelines properly take into account the allocation of infrastructure costs over the life of long-lived assets such as local roads, libraries and other facilities?

Strategic and service planning

There is currently no requirement for councils to undertake long term strategic (service) planning and reporting.

The main “planning and budgeting” instrument is the management plan. Pursuant to sections 402 to 407 of the LG Act, during each year, councils must prepare a management plan with respect to activities for at least the next 3 financial years and the revenue policy for the next financial year.

In terms of reporting, councils must prepare financial reports for each financial year (section 413 LG Act) and an annual report on their achievements with respect to the objectives and performance targets set out in their management plans (section 428 LG Act).

Apart from these reporting requirements, there are currently several unrelated requirements such as the state of the environment report or social reporting which are not integrated into the plans and reports mentioned above.

The LGI confirmed that there is no comprehensive and simple corporate planning framework for councils in NSW. The management plan merely reports on proposed ‘activities’ (outputs) and provides the basis for a one-year council budget. Although quarterly reporting on the achievement of activities is required in the management plan, and these reports are useful to see how budgets are being met, they do not really assist in measuring the effectiveness of activities in achieving outcomes.⁴⁴ The plan is operational in focus and does not look beyond 3 years.⁴⁵

The Inquiry concluded that councils need to introduce long term strategic service plans focussed on outcomes their communities need (recommendation 34). It also found that there is the need for improved coordination among levels of government via an intergovernmental agreement to avoid duplication of services.⁴⁶

The Associations are currently closely working with the DLG on the introduction of a mandatory integrated strategic planning and reporting framework underpinned by long term asset management and financial planning.⁴⁷

Asset management and reporting

Currently the biggest problem for NSW Local Government is asset management with only about 20 per cent of NSW councils managing their assets through adequate asset management policies and plans. Unlike the rest of the NSW public sector, there is no mandated requirement for total asset management principles and practices to be adopted by NSW councils.⁴⁸

Pursuant to section 428(d) of the LG Act, councils are required to report on asset condition in their annual reports; the “*Condition of Public Works*” report (Special Schedule 7). The condition report focuses on the estimate of the amount of money required to bring council infrastructure up to a “satisfactory” standard. Councils are also required to comply with AAS27 - *Accounting Standards for Government*.

AAS27 and the *Condition of Public Works* report are the only mandatory requirements. NSW councils are not required to apply specific asset management processes or standards such as AAS 4536 Life Cycle

⁴⁴ Ibid, Section 10.2, p236.

⁴⁵ Ibid, Section 7.5, pp172-173.

⁴⁶ Ibid, pp172-173.

⁴⁷ See DLG, *Planning a Sustainable Future – An Options Paper on Integrated Planning and Reporting for NSW Local Councils*, (2006) and DLG, *Asset Management Planning for NSW Local Government – A Position Paper* (2007)

⁴⁸ LGI, Final Report, Section 6.3, pp125 and 134.

Assessment or AAS4360 Risk Management. Nor are councils required to adopt any of the many existing infrastructure management processes such as *International Infrastructure Management Manual* (IIMM) or the NSW Government's *Total Asset Management* (TAM) system that applies to state agencies.⁴⁹

Furthermore, the current infrastructure accounting and reporting are regarded deficient in various aspects including:⁵⁰

- Lack of consistent recording, classification and valuation of assets;
- Meaningless *Condition of Public Works* report which does not provide a definition of what is "satisfactory" and is not linked to service levels required by the community;
- Inconsistent determination of depreciation data;
- Inadequate separation of maintenance expenditure, capital expenditure for renewal, and for enhancement or new assets;
- Inadequate of no identifications of the infrastructure renewal gap; and
- Inadequate asset management systems.

As noted above, the Associations are currently closely working with the DLG on the introduction of mandatory asset management policies and plans as part of the integrated strategic planning and reporting initiative.

The new framework will be guided by and consistent with the first national infrastructure financial management guidelines currently being developed by the National Asset Management Strategy (NAMS) Committee.

In a staged introduction process beginning with the financial year 2006/07 (water and sewerage assets) NSW councils are and will be required to value their non-current asset consistently according to the fair value methodology.

4.4.3. Financial and Asset Management Skills

What effect might the lack of financial and asset management skills of managers and lack of appreciation of the relevant issues by councillors have on the revenue raising capacity and effort of local governments?

To what extent do local governments find difficulty in attracting and retaining suitably qualified experts in financial and asset management?

What types of local governments experience the greatest difficulties?

General Comments

Any lack of financial and asset management skills significantly reduces the ability to strategically plan for the long term, set the right priorities and avoid wasteful short term decisions. In such a scenario, revenue and expenditure policies are likely to be sub-optimal.

Currently the biggest problem for NSW Local Government is asset management with only about 20 per cent of NSW councils managing their assets through adequate asset management policies and plans.⁵¹ Although there are councils who do asset management and financial planning well, many councils, particularly in regional and rural areas, struggle or will struggle to implement asset management and financial planning systems for a lack of strategic guidance, technical expertise and financial resources.

As discussed, the DLG in consultation with the Association is in the process of reshaping the strategic planning and reporting process and introduce a mandatory integrated framework of strategic planning based on community needs and priorities and underpinned by strategic financial and asset management. However, the Associations are concerned as to whether councils have the technical and financial resources to implement the new framework.

The shortage of strategic and technical capacity is mainly caused by a lack of financial flexibility and revenue limitations which make it difficult for councils to compete with the private sector and other government

⁴⁹ Ibid, pp125-126.

⁵⁰ Ibid, pp126-137.

⁵¹ Ibid, p 134.

instrumentalities and attract and retain professional staff. This is further exacerbated by the current skills shortages, particularly in regional and rural areas.⁵²

Skills shortages

Local Government is facing significant skills shortages. Strong economic growth, buoyant labour markets and demographic trends have created skills shortages throughout the Australian economy, including metropolitan areas. Nowhere is this shortage felt more acutely than in rural and regional areas, where Local Government is one of the single largest employers.⁵³

According to a recent survey of councils' skills shortages⁵⁴, 92 per cent of councils reported existing or emerging skill shortages with the greatest deficiency being in planning and engineering. Less severe shortages were evident in certain trades (e.g. mechanics and building), finance and other areas (e.g. environment, health and building inspectors and surveyors). Demand for certain council occupations related to aging populations, such as disability support workers, are also likely to increase.⁵⁵

4.4.4. Incentive Effects of Grants and Subsidies

What grants and subsidies are provided to local government by State and Territory governments? What is the value for each category of grant? Are there any terms and conditions attached to these grants? Do these terms and conditions distort the incentives of local governments to raise their own revenue? If so, how and why?

What grants and subsidies are provided by the Australian Government? What is the value of each category of grant? Are there any terms and conditions attached to these grants? Do these terms and conditions distort the incentives of local governments to raise their own revenue? If so, how and why?

The Associations are not aware of any evidence to indicate that council own source revenue raising efforts are generally distorted by state or Commonwealth grants. The upward trends in rate, goods and services and other income identified in the Productivity Commissions Issues Paper⁵⁶ support a conclusion that Local Government is maintaining or strengthening its revenue raising effort.

State and Commonwealth grants and subsidies are insufficient to alleviate a councils needs to raise own source revenue. Grants represent only around 15% of NSW Local Government revenue on average with 85% of revenues derived from own sources. Further, the LGI notes the ongoing decline to local Government as a proportion of GDP:

“The first and most important one [concern] is the ongoing decline in the allocation of grants from all sources (Commonwealth FAGs and SPPs and state grants) to Australian Local Government. These have declined from nearly 0.6 per cent of GDP in the mid-1980s to less than 0.4 per cent today.... In 2003/04 total FAGs to Australian Local Government (general purpose and local roads component) represented 0.18% of GDP.”⁵⁷

It is more likely that tied grants or SPPs will distort expenditure decisions rather than revenue raising decisions, particularly where they involve matching contributions from councils. The potential effect is to divert expenditure from higher local priorities to the Commonwealth or state priorities that are being funded.

Further information on the issue is available in Section 9.5 of the LGI's Final Report.

⁵² Ibid, Section 4.4, p80.

⁵³ Ibid, Section 3.3, p53.

⁵⁴ Redletterinformation, *Survey of Skills Shortages in NSW Local Government – A report prepared for the NSW Department of Local Government on behalf of the Training and Professional Skills Shortages Task Force*, Sydney, August 2005.

⁵⁵ LGI, Final Report, Section 3.3, p53.

⁵⁶ Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, May 2007, pp12-15.

⁵⁷ LGI, Final Report, Section 9.5, p226.