

**Submission
No 119**

INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Organisation: Local Government NSW (LGNSW)

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DRAFT SUBMISSION

Inquiry into the ability of local governments to fund infrastructure and services

**NSW Parliament Standing Committee on
State Development**

MAY 2024



Local Government NSW (LGNSW) is the peak body for local government in NSW, representing NSW general purpose councils and related entities. LGNSW facilitates the development of an effective community-based system of local government in the State.

OVERVIEW OF THE LOCAL GOVERNMENT SECTOR



Local government in NSW employs **55,000 people**



Local government in NSW is responsible for about **90% of the state's roads and bridges**



Local government in NSW looks after more than **\$177 billion** of community assets



NSW councils manage an estimated **4 million tonnes of waste** each year



Local government in NSW spends more than **\$2.2 billion** each year on caring for the environment



NSW councils own and manage more than **600 museums, galleries, theatres and art centres**



NSW has more than **350 council-run libraries** that attract tens of millions of visits each year



NSW has more than **400 public swimming and ocean pools**

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Introduction

Local Government NSW (LGNSW) is the peak body for local government in NSW, representing NSW general purpose councils and related entities. LGNSW facilitates the development of an effective community-based system of local government in the State.

This submission is made in draft form, pending approval of the LGNSW Board. Any amendments will be forwarded in due course.

LGNSW welcomes the opportunity to respond to the Standing Committee on State Development Inquiry into the ability of local governments to fund infrastructure and services. The full title of the review condenses down to the issue of financial sustainability of councils. This submission will use the terms interchangeably.

This submission addresses each of the Committee's Terms of Reference and provides supplementary commentary on other factors pertaining to the financial sustainability of NSW councils.

The LGNSW submission is complemented by its two appendices:

- **Appendix A** - A May 2024 report prepared for LGNSW by SGS Economics that provides evidence and analysis on the wide-ranging impacts of the rate peg for councils and communities.
- **Appendix B** - the LGNSW Cost Shifting Report prepared for LGNSW by Morrison Low in 2023, and which outlines the rapidly escalating impacts of cost shifting on local government.

Terms of Reference

That the Standing Committee on State Development inquire into and report on the ability of local governments to fund infrastructure and services, and in particular:

- a. the level of income councils require to adequately meet the needs of their communities;

- b. examine if past rate pegs have matched increases in costs borne by local governments;
- c. current levels of service delivery and financial sustainability in local government, including the impact of cost shifting on service delivery and financial sustainability, and whether this has changed over time;
- d. assess the social and economic impacts of the rate peg in New South Wales for ratepayers, councils, and council staff over the last 20 years and compare with other jurisdictions;
- e. compare the rate peg as it currently exists to alternative approaches with regards to the outcomes for ratepayers, councils, and council staff;
- f. review the operation of the special rate variation process and its effectiveness in providing the level of income Councils require to adequately meet the needs of their communities;
- g. any other related matters.

Overview

LGNSW has been a long-term advocate for reform of the current funding model for local government in NSW. LGNSW is driven by the conviction that the financial sustainability of local government in NSW is being persistently eroded. A growing number of councils are financially unsustainable under the current policy settings and the situation is deteriorating.

This conclusion is based on the experience of councils and the findings of the numerous past reviews of local government financial sustainability and the NSW rating system. These include:

- NSW Treasury Corporation's (TCorp's) [2013 report](#) on the Financial Sustainability of the NSW Local Government Sector;
- The [Final Report](#) of the Independent Local Government Review Panel;
- The [2016 IPART Review](#) of the Local Government Rating System; and even
- The [Final Report](#) of the Independent Inquiry into the Financial Sustainability of NSW Local Government (The Allan report).

These reports along with the numerous submissions and more recent expert reports presented to this Inquiry such as the SGS/LGNSW report submitted in support of this submission, provide overwhelming evidence that many NSW councils are facing a financial sustainability crisis.

The fact the Federal Government is concurrently undertaking an *Inquiry into Local Government Sustainability* adds weight to this conclusion, demonstrating national concern about the state of local government finances.

The reports and submissions commonly identify the major factors threatening the financial sustainability of councils as being:

- Rate pegging (in NSW and Victoria).
- Cost Shifting
- The decline in Financial Assistance Grants (FA Grants) as a proportion of total Commonwealth Taxation Revenue
- The inadequacy of Special Purpose Grants from the Federal and State Governments
- Regulation and constraints on council fees and charges
- Inflation
- Increasing community demands and expectations
- Natural disasters
- The inadequacy of development contributions

Other factors that can contribute to the circumstances of individual councils include geography, demographics and isolation.

Most councils are reporting a deterioration in their financial position and many fear that they are financially unsustainable or approaching unsustainability. The reports come from all categories of councils, however, as would be expected smaller rural and regional councils with high costs and a small own source revenue base are the most vulnerable.

Council financial returns reveal that there is a financial sustainability problem. The operating performance ratio (OPR) is the primary indicator of financial sustainability. Councils are considered 'financially unsustainable' if they have experienced an operating deficit for several years and no clear plan to achieve long-term financial sustainability.

45 per cent of NSW councils are not meeting operating surplus targets of 0 to 10 per cent in 2021-22, with 54 out of 128 councils recording a deficit.

The infrastructure backlog ratio is also a telling indicator of sustainability. In 2021-22, 69 councils (54 per cent) failed to reduce their backlog to the benchmark of 2 per cent

or less. Infrastructure backlog ratios ranged from 0 to 31% across all councils, with the state average being 4.2 per cent.

Councils reported a backlog for 2021-22 estimated at \$5.6 billion. This represents a substantial increase compared with \$3.8 billion in 2020-21 (47 per cent increase).

These figures provide a clear indication of a financial sustainability problem for local government in NSW.

The sustainability, resilience, and productivity of local government and their communities depends in large part on their long-term financial sustainability. The ability to provide the right mix of services and infrastructure that meets the needs of local communities is essential to the long-term growth, contribution, and ultimately liveability of NSW communities.

What is financial sustainability?

TCorp's report on the Financial Sustainability of the NSW Local Government Sector (2013) provides a detailed analysis of the position of every council. It defined sustainability in the following terms:

A local government will be financially sustainable over the long term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community.

While there are several variations of this definition, they are essentially the same. This definition is favoured as it hinges on agreement with the community. This links it to the Integrated Planning and Reporting (IPR) Framework under which NSW councils are required to make their decisions on service provision and council finances. IPR is discussed further in the following section.

It can be inferred from the definition that council financial unsustainability will severely disrupt infrastructure and service delivery and necessitate intervention by the state government.

This definition considered the potential impact that changing circumstances and emerging challenges could have on a council's operating position and service levels over the long term.

LGNSW Policy Platform on financial sustainability (extract)

Local government is a partner in the economic stewardship of NSW and responsible for the provision of a wide range of essential infrastructure and services.

However, the financial sustainability of councils has been undermined by rate pegging and other factors for over 40 years, which has resulted in the under-provision of community infrastructure and services and the deferral of infrastructure maintenance and renewal expenditure resulting in significant infrastructure backlog.

LGNSW advocates for the financial sustainability of local government through:

- 1.1. The removal of rate pegging and reform of the NSW local government rating system, including the removal of inequitable rate exemptions and greater autonomy and flexibility in rating policy, structure and practices.
- 1.2. Greater autonomy in determining fees and charges.
- 1.3. Financial Assistance Grants to be increased to at least 1% of total Commonwealth taxation revenue.
- 1.4. A review of the allocation methodology for Financial Assistance Grants.
- 1.5. Increased specific purpose grants from State and Commonwealth Governments to assist councils in meeting the infrastructure and service needs of their communities (e.g. Roads to Recovery, library grants) with allocation to be equitable and transparent.
- 1.6. An end to cost shifting onto local government by the State and Commonwealth Governments.
- 1.7. New and fairer financing opportunities for local government, with particular emphasis on infrastructure e.g. value capture, Voluntary Planning Agreements (VPAs), the removal of caps on development contributions.
- 1.8. The introduction of a broad-based property levy to replace both the Emergency Services Levy on insurance policies and the 11.7% Emergency Services Levy on local government.
- 1.9. A more flexible procurement framework to enable councils to benefit from innovative procurement practices.
- 1.10. Inclusion of climate change considerations in approved terms of reference for investigations and reviews.

- 1.11. Ownership of Rural Fire Service mobile assets to be vested in the RFS to remove the depreciation expense from councils and provide consistency between emergency services and fund councils for all costs associated with the current ownership status.
- 1.12. The NSW Government to cover the full costs of local government financial audits.
- 1.13. Establishment of a NSW Local Government Grants Agency to coordinate all the state and federal grants programs through one central agency. This would provide a single point of contact for councils and establish consistent grant application, reporting and acquittal arrangements.
- 1.14. Development and implementation of a new and agreed local government Performance Measurement Framework, and associated performance indicators.

Why the NSW Government should be concerned

In the simplest terms, the NSW Government should be concerned because at the end of the day, if councils fail, communities will not get the services and infrastructure they need and expect. Ultimately the NSW Government will be required to step in and bear the costs.

A more comprehensive rationale is provided by Adjunct Professor Graham Sansom in his submission to this inquiry (Submission 104):

Fundamentally, the Committee's Terms of Reference concern the future of local government as a constitutional partner to the State in advancing the good governance of New South Wales and the wellbeing of its people. Section 51(1) of the NSW constitution Act 1902 asserts that:

*There shall continue to be a system of local government for the State under which duly elected or duly appointed local government bodies are constituted with **responsibilities for acting for the better government** of those parts of the State that are from time to time subject to that system of local government (emphasis added).*

In turn, this raises the question of whether local government bodies can adequately discharge their responsibilities under the Local Government Act 1993. A core purpose of that Act, set out in section 7(e) is: to provide for a

*system of local government that is accountable to the community and that is **sustainable, flexible and effective**; and the Act's object (section 8) is: to enable councils to carry out their functions in a way that facilitates **local communities that are strong, healthy and prosperous** (emphases added).*

Two key points emerge from this legislation:

- *In administering the system of local government, the State has a duty to ensure its sustainability.*
- *Parliament has determined that local councils have a broad role to play in advancing the wellbeing of communities in ways that extend far beyond the often invoked notions of 'core business' or 'roads, rates and rubbish'.*

Comments on Terms of Reference

This submission will set out succinct responses to the inquiry's terms of reference before expanding on key factors impacting the sustainability of local government later in the submission.

(a) The level of income councils require to adequately meet the needs of their communities

A longer-term trend of stagnating or declining rate peg growth contrasts with rising risks to councils' financial sustainability: inflationary pressures, inadequate fiscal equalisation, and cost shifting from other tiers of government.

Despite the constraints of the annual rate peg, councils continue to exhibit their hallmark productivity: doing more with less. Over the last decade, operational and capital expenditure across the metropolitan, regional, and rural councils have grown.

Shifts in operational and capital expenditure from year to year suggest that costs to council are sensitive to changes in the regional and macro-economic context. Yet councils have few levers to assist in their flexibility and responsiveness to changing community need.

Inefficiencies in the structure of other income mechanisms, namely the financial assistance grants, state government grants, and the adequacy of infrastructure cost

recovery via development contributions, posts additional challenges in meeting community needs.

The level of income that councils require to adequately meet community needs depends on the local context and what communities expect of councils. Cost pressures differ by council type, given regional differences in market depth, cost shifting, the ability to leverage economies of scale, and the types of services provided. Community expectations have been shaped over many years by local governments' influence as a dedicated service provider across multiple domains of community life. Communities expect continuity and improvements in services over time.

The NSW Local Government Act deliberately does not specify a definitive list of the services councils should provide, nor does it indicate priorities. Instead, section 8 of the Act establishes the principles to be followed by each council in determining what it will do by way of services and regulation to meet the diverse needs of the local community.

Section 8 (c) requires councils to make their decisions on service provision by using the IPR framework, introduced by amendments to the Local Government Act 1993 in 2009. IPR was conceived and imposed as the principal means of ensuring that councils are responsive to community needs and preferences, and operate efficiently, effectively and sustainably in addressing broadly agreed priorities.

As noted by Adjunct Professor, Graham Sansom:

processes for sound financial management are a central element of IPR, which requires the preparation of firstly, long-term strategic, financial, asset management and workforce plans to determine community needs and required levels of income and expenditure. Decisions about revenue needs, including the mix of sources and setting of rates, were intended to flow from those planning processes, all of which involve extensive community engagement.

In short, IPR was intended to provide the primary pathway to determining and addressing community needs, while at the same time ensuring responsible financial management. The introduction of IPR should have made rate pegging redundant.

(b) Examine if past rate pegs have matched increases in costs borne by local government

In short, the answer is no. Even if the rate peg did mirror the CPI or other cost indices, in the past the Local Government Cost Index (LGCI) did not capture all the cost drivers impacting on local government, for example, cost shifting and population growth. It also failed to capture the different cost structures of different categories of councils. Further, it was beyond IPART's scope to address the dilemma of rural councils with a small rating base, where even a significant peg determination will generate very little additional revenue.

The past rate peg is poorly aligned with operational and capital costs. This introduces uncertainty in councils' financial outlook and how they plan and budget for their future.

Further, the past rate peg has not kept up with changes in key inflation indicators: the Producer Price Index nor the Consumer Price Index, which effectively diminishes real income and purchasing power for councils.

The past rate peg also inhibits councils' ability to catch up to maintenance shortfalls. In 2021-22, regional and metropolitan councils experienced the largest dollar value shortfall in maintenance (in total, \$51.6 million). At the same time, with increasing assets being placed on councils' books, the required asset maintenance expenditure had been growing for almost a decade.

Until recent changes to the rate peg methodology to account for population and cost drivers, the past rate peg exposed a spatial divide in the types and costs of services to different councils, e.g. the provision of water and sewer services in non-metropolitan areas.

The following tables demonstrate that the rate peg has failed to keep up with the growth in operational and capital expenditure.

Table 1: Annual growth in councils' operational expenditure per capita

Council type	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	CAGR 2012-13 to 2021-22
Metropolitan	-	1%	3%	95%	-31%	-4%	6%	0%	5%	1%	5%
Metropolitan Fringe	-	1%	0%	27%	10%	0%	21%	-12%	6%	-6%	5%
Regional Town/City	-	0%	4%	16%	-6%	0%	4%	3%	7%	4%	3%
Rural	-	-4%	-4%	96%	6%	10%	-3%	5%	10%	6%	11%
Large Rural	-	-1%	6%	25%	-6%	-4%	-13%	29%	6%	5%	4%
NSW average	-	-1%	2%	52%	-5%	0%	3%	5%	7%	2%	6%
Rate peg (%)	3.6%	3.4%	2.3%	2.4%	1.8%	1.5%	2.3%	2.7%	2.6%	2.0%	-6%

Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22). Notes: Year on year variations to expenditure is influenced by council amalgamations (2015-16). Figures exclude councils which have missing data. Actual rate peg percentage is displayed rather than annual growth.

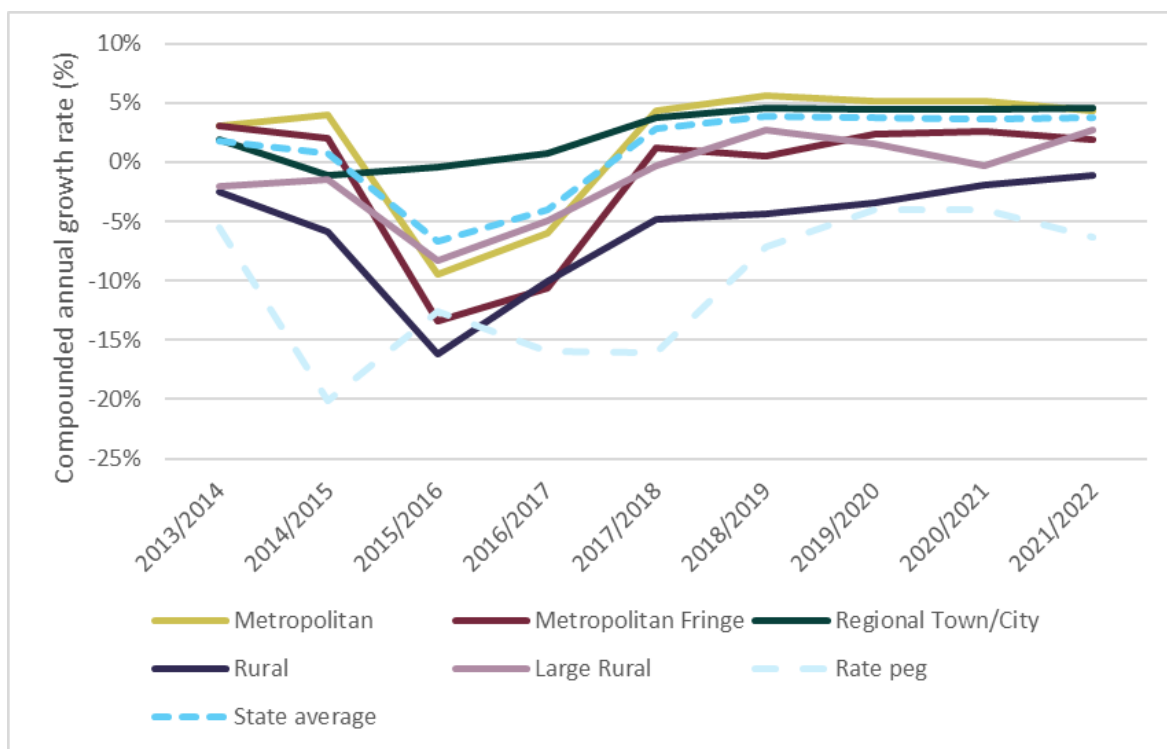
Table 2: Annual growth in councils' capital expenditure per capita

Council type	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	CAGR 2012-13 to 2021-22
Metropolitan	-	-9%	-6%	98%	-6%	-14%	-18%	34%	11%	4%	6%
Metropolitan Fringe	-	0%	4%	78%	-38%	46%	23%	-9%	3%	5%	8%
Regional Town/City	-	8%	-7%	3%	-10%	55%	7%	-4%	-13%	-5%	2%
Rural	-	5%	-14%	166%	-8%	8%	13%	3%	-6%	9%	12%
Large Rural	-	4%	-13%	50%	6%	3%	4%	-4%	6%	17%	7%
NSW average	-	2%	-7%	79%	-11%	20%	6%	4%	0%	6%	7%
Rate peg (%)	3.6%	3.4%	2.3%	2.4%	1.8%	1.5%	2.3%	2.7%	2.6%	2.0%	-6%

Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22). Notes: Year on year variations to expenditure is influenced by council amalgamations (2015-16). Figures exclude councils which have missing data. Actual rate peg percentage is displayed rather than annual growth.

The gap between the rate peg and growth in operational expenditure is further demonstrated in the following figure.

Figure 1: Compound annual growth in operational expenditure (per capita) by council type, 2012-13 to 2021-22



Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22). CAGR is calculated from a 2012-13 baseline.

(c) Current levels of service delivery and financial sustainability in local government, including the impact of cost shifting on service delivery and financial sustainability, and whether this has changed over time

Local government is an important part of Australia’s system of government and the functioning of our society. It is inevitable that its roles and responsibilities will continue to evolve and expand. This will be driven by changes in community needs and expectations, the broader operating environment including climate change, in addition to transfers and impositions of state and federal governments.

It is widely recognised that councils in NSW and across Australia are now responsible for a much wider range of functions than they were when FA Grants were introduced in 1974. Growth is most notable in the areas of social services, economic development, environmental management and new forms of regulation.

While every council delivers programs and services unique to the needs of their communities, common services include:

- Owning, investing in, and maintaining community assets such as roads, bridges, active transport networks and other assets that underpin transport and economic distribution.
- Provision of water and sewerage services in all areas outside of those serviced by Sydney and Hunter Water.
- Environmental management.
- Business services that support local firms with training and networking programs; providing facilities and services to support tourism, and the formation of local economic development strategies which leverage local competitive strengths.
- Emergency management and community support through risk management and planning as well as provision of first responder capability in the face of fires, floods, and other crises.
- Regulatory services that minimise the impact of market failures and negative externalities. This includes land use planning and development assessment; assurance on the structural sufficiency of approved buildings; health and safety; and public amenity.
- Household services, including; operation of neighbourhood and community specific aged care and disability facilities; investment in arts infrastructure, and orchestration of events, festivals and place designations which celebrate distinctive local culture; provision of community centres, early childhood centres and neighbourhood houses which enable delivery of diverse services of value to families and children, youth and various special needs groups; creation of a network of indoor and outdoor sporting facilities; and registration of pets and animals.

Because of this broad range of diverse responsibilities, local government is seen as the primary government body responsible for community liveability and social enrichment. Councils provide significant economic, social, and environmental services that enhance the liveability, productivity and economic success for their communities. This supports our state and national economies.

As noted above, many of the additional responsibilities are imposed on local government by the state and federal governments through legislation and regulation. In many cases, councils will welcome these new functions in principle, recognising that they are for the benefit of their communities. However, in imposing these responsibilities, state and federal governments fail to take into account the costs to councils in meeting these responsibilities. In the absence of commensurate funding or cost recovery mechanisms, councils will often consider these transfers as 'cost shifts'. Cost shifting is discussed in more detail later in this submission.

In every case, the application of rate pegs and insufficient use of Special Variations places unwarranted restrictions on councils' ability to raise required revenues and thus accentuates the adverse impacts of cost shifting.

(d) Assess the social and economic impacts of the rate peg in New South Wales for ratepayers, councils, and council staff over the last 20 years and compare with other jurisdictions (SGS)

The symbiosis between local authorities and their communities means that what is felt by councils, in terms of risks to long-term financial sustainability, has implications for the efficient functioning and wellbeing of the wider community.

Social and economic impacts of rate pegging are far reaching and manifest over different time horizons.

Documented impacts to ratepayers include impacts to services (service cuts, reduced service scope, and compromised quality), delays to infrastructure delivery and deferred maintenance, a compounding backlog of asset renewal, lower community protections from natural disaster, and a distortion of public expectations of local government service and infrastructure provision.

Documented impacts to councils and council staff include the erosion of financial independence, decreased staff morale and wellbeing, and a longer-term contraction in the size and competitiveness of the sector's workforce.

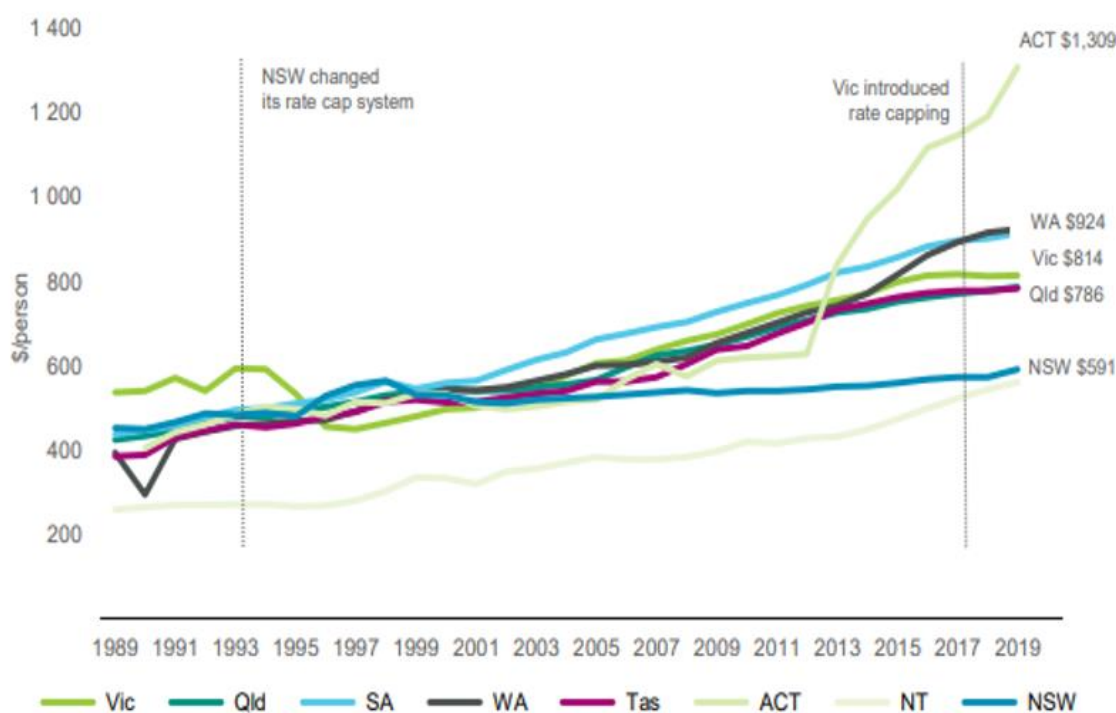
Research has shown that in most other states and territories, councils have more autonomy in setting rates and charges than in NSW. The jurisdictions where councils are able to set their own rates are Queensland, Tasmania, South Australia, Northern Territory, and Western Australia, however there are often regulatory requirements and guidelines around the process of rates setting. In Victoria, rate capping was introduced in 2016 and is linked to the Consumer Price Index and other factors.

A 2015 jurisdictional comparison of the effects of NSW's rate pegging and Victoria's previously uncapped rates highlighted that rate pegging had led to decreased equity between communities, higher levels of debt, and diminished levels of asset renewal in NSW.¹

¹ Drew, J., & Dollery, B. (2015). Careful what you wish for: Rate-capping in Victorian local government. *Journal of Australian Taxation*, 17(1), 139-167.

Since its inception in 1977, rate pegging in New South Wales has constrained local government rates revenue rises below other Australian jurisdictions that don't limit rates increases. Between 1989 and 2019, New South Wales rates per capita grew by \$139 to an amount of \$591, an average increase of 1 per cent per annum, the lowest in Australia. This has left rates per capita about 29 per cent lower than the Australian average of \$835 per capita. The following figure clearly demonstrates the impact of rate pegging on NSW rates compared to other jurisdictions.

Figure 2: Jurisdictional comparison of rates revenue per capita

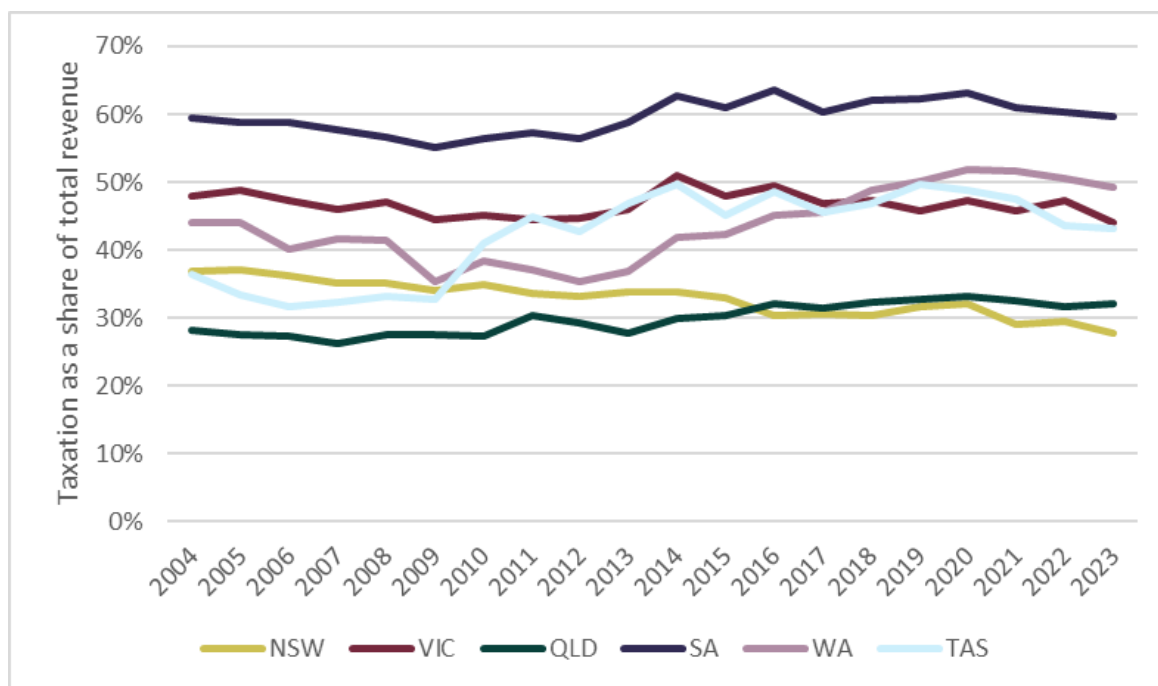


Note: Municipal rates revenue measured on a cash basis up to 1997-98, and on an accrual basis thereafter. Each state's council rates adjusted using the All Groups consumer price index for that state's capital city.

Source: Centre for International Economics (2020) based on Australian Bureau of Statistics' data

The impact of rate pegging in NSW is starkly set out in the below figure, which for NSW alone, in contrast to all other states, portrays a steady downward trend. This chart examines the share of local government property taxation (i.e. rates) as a proportion of all local government revenue, and highlights that NSW is increasingly reliant on uncertain and inefficient other sources of revenue, such as grant funding.

Figure 3: Local government share of taxation revenue against total revenue, 2005-23



Source: SGS Economics and Planning (2024), ABS (2024). Notes: NT is omitted from this analysis given its unique financial context compared to other jurisdictions.

e) Compare the rate peg as it currently exists to alternative approaches with regards to the outcomes for ratepayers, councils, and council staff

LGNSW is firmly of the view that rate pegging should be abolished. Our long-held position has been reinforced by a large and solid body of independent, government and academic reviews over the past two decades. Several of these reviews are identified earlier in this submission and the evidence is conclusive.

Removing the rate peg in its entirety would provide councils more autonomy in financing community needs and shift the needle in addressing the mismatches in income and costs described above.

LGNSW acknowledges that IPART has made a number of improvements to the Rate Peg Methodology in recent years. These include introduction of:

- a population growth factor
- a customised Emergency Services Levy factor
- a Base Cost Charge with the use of forward-looking indicators
- recognition for different council groups.

While these improvements are generally welcomed, they do not address the revenue lag of nearly 50 years of rate pegging. Average rates in NSW would have been higher for the duration. Councils would now be in a stronger financial position and communities would now be enjoying better, more efficient and more resilient infrastructure and services.

However, if the NSW Government refuses to remove rate pegging, LGNSW has previously proposed a number of alternative although not mutually exclusive interim measures to improve the rate pegging methodology and the operation of the rating system. These include the following.

- **Rate peg as a non-binding reference peg**

Change the binding rate peg into a non-binding reference peg. This would continue to be a published indicator that would influence public and political expectations and in doing so, guide councils' actual rate determination. Councils would have the discretion of exceeding the reference peg but would be subject to informed ratepayer scrutiny and would need to justify increases above the reference peg. If considered necessary, even if only for political assurance, IPART could monitor increases beyond the reference peg and intervene by exception (e.g. where increases appear to be excessive, were unsupported or failed to consider affordability.)

LGNSW recognises that alternatives to the rate pegging approach must balance a mutual commitment to strengthen the financial sustainability of NSW local governments while being attentive to the cost of living and other affordability pressures in community.

- **Allow councils to exceed the peg by a determined margin without Special Variation (SV)**

This would remove the burden of making a SV for small and moderate variations. Councils advise that the regulatory burden of the SV process coupled with political complexities acts as a deterrent to applying for an SV. This can be financially damaging where there are legitimate needs for increased rates to strengthen financial sustainability and address infrastructure backlogs. Failures to act will worsen the current situation and create larger deficiencies in future years.

- **Streamline the Special Variation process.**

IPART's ability to implement the Additional Special Variation (ASV) for the shockingly low 2022-23 rate peg and process the 86 applications in a short time period demonstrated that there is scope to simplify and expedite the SV process. If adopted in conjunction with the other recommendations, only large SVs would need to be subject to comprehensive community consultation and IPART assessment.

- **Rate Peg Floor/Minimum Peg**

LGNSW recommends the introduction of a minimum rate peg or floor. This would help avoid large shocks and coupled with the reality check would eliminate the possibility of a negative rate peg.

Options to refine the rate peg methodology also include using the Capital Improved Value to provide a more equitable view of land value by property type, developing more tailored cost indices, and better reflecting 'hidden' costs, such as those arising from cost shifting to councils. Some Victorian and Tasmanian councils use the Capital Improved Value as part of the property valuation base for calculating rates.² IPART's 2016 review of the local government rating system recommended Capital Improved value as the basis for metropolitan rates (regional councils supported this if it were to be introduced as an option), however this was not accepted by the NSW Government.³

LGNSW supports a recommendation of a Canberra Regional Joint Organisation to reset the foundation notional general rate yield to make sure that the rate base is adequate to fund infrastructure and service needs and is at least comparable with other councils in the same cohort.

² Victorian Government (2023), 'Local Government Better Practice Guide: Revenue and Rating Plans', https://www.localgovernment.vic.gov.au/_data/assets/pdf_file/0030/195294/Appendix-Three-Supporting-Documents.pdf; Tasmanian Government (undated), 'Council rates', https://www.dpac.tas.gov.au/divisions/local-government/about-councils/finance_and_planning/council_rates#:~:text=When%20councils%20set%20their%20rates,value%20of%20properties%20across%20Tasmania.

³ IPART (2016), 'Review of the rate peg to include population growth: Final report', https://www.ipart.nsw.gov.au/sites/default/files/cm9_documents/Final-Report-Review-of-the-rate-peg-to-include-population-growth-September-2016.PDF

(f) Review the operation of the special rate variation process and its effectiveness in providing the level of income councils require to adequately meet the needs of their communities

The rate peg has not provided councils with sufficient income to deliver services to their communities. The observation that there have been 178 SV applications over 10 years with 165 approved in full or in part provides clear evidence that the rate peg has been inadequate.

Councils frequently express concern that the requirements for a special variation application are onerous. Key obstacles within this process include cost, resource intensity and the need for comprehensive community engagement required for, at times, a minimal annual increase. Political factors can also complicate the process. A potential option would be to set the required rates every four years, along with the adoption of council strategic documents and infrastructure plans, seeking community approval to endorse plans and the budget required to implement outcomes. Comments in the previous section in regard to streamlining the SV process are also a relevant consideration.

(e) Other

Concerns about the ability of local governments to fund infrastructure and services need to extend beyond rates and rate pegging to include other sources of local government revenue and to give consideration to major cost drivers. The importance of grants and the major cost driver, cost shifting, are discussed in more detail in the following sections.

Recommendation 1

That rate pegging be abolished and that the Integrated Planning and Reporting (IPR) framework be relied on to allow councils to determine their rates.

Financial Assistance Grants

Next to rates, Commonwealth Financial Assistance Grants (FA Grants) are the second largest source of revenue for local government and are fundamental to the financial sustainability of councils.

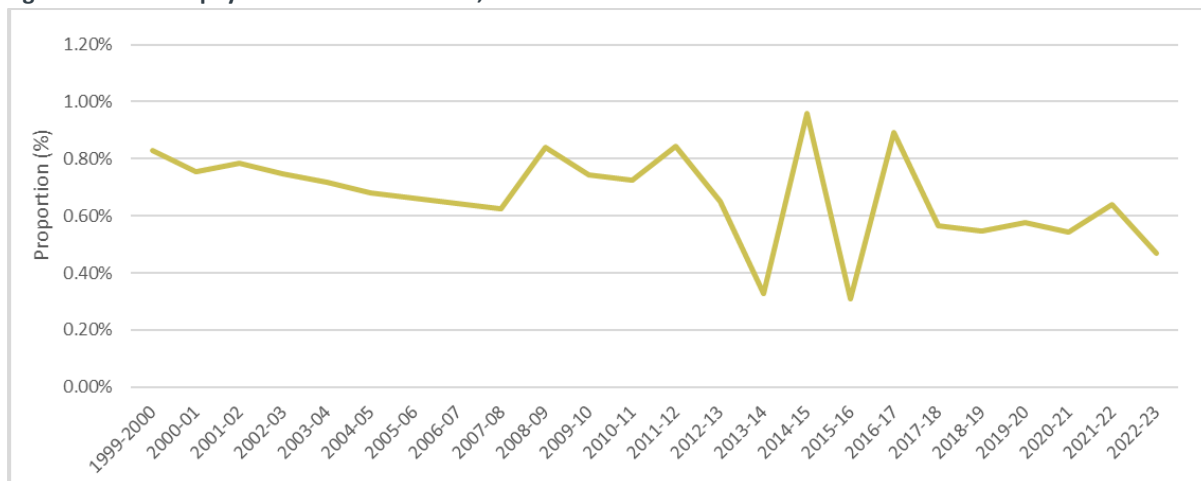
Local government must have secure, long-term, untied funding from the Federal and NSW Governments.

The ability of local government to effectively plan depends on the security and adequacy of its funding. Local government in Australia has limited options for revenue and in many cases is highly reliant on FA Grants. Recent decades have seen a slow reduction in the proportion of total tax revenues going to local government. For example, FA Grants have declined from one per cent of Commonwealth taxation revenue in 1996 to just 0.5 per cent today. This is despite increased costs and expected service delivery from local government.

The consistent downward trend of FA Grants has been coupled with ongoing cost-shifting and rate capping that increase the burden on councils and reduce their ability to raise revenue for community service delivery. Federal and State Governments are consistently requiring councils to deliver additional services with no commensurate increase in funding. LGNSW's latest cost shifting report estimates this to be equivalent to \$1.36 billion in 2021-22.

The decline in FA Grants has the greatest impact on rural and regional councils who have a much higher level of grant dependency than urban councils. For example, council financial returns show that large rural and regional councils fall well below the benchmark of 60% own source revenue on average. For example, in 2021-22 Brewarrina recorded a low of 9.8%, Lockhart 27.7%, Central Darling 33.1% and Warren 34%.

Figure 4: FA Grant payment as a share of CTR, 2000-2023



Source: SGS Economics and Planning (2024), ABS (2024).

Review of grants

Several submissions call for a review and redistribution of FA Grants. LGNSW supports a review but acknowledges that undertaking a review without a commitment from the Federal Government to an increase in the quantum of the FA Grants to 1 per cent of total Commonwealth Taxation Revenue would amount to rearranging the crumbs and not increasing the size of the cake. It would fail to address the fundamental need to link FA Grants to growth, with growth in Commonwealth tax revenue being a proxy for economic growth and reflecting the growth in demands on all spheres of government.

A simple redistribution of FA Grants based on current settings would only be a band aid solution. While it would provide some temporary relief to a number of economically disadvantaged councils at the expense of stronger, mainly metropolitan councils, it would not address the continued decline in relation to Commonwealth Taxation Revenue. It will continue to erode the relative value of the FA Grants pool. This simplistic and seemingly cost-free approach is attractive to many in government but does not provide a long-term solution.

In a case of “be careful what you wish for”, a Federal review could also trigger a review of the interstate distribution. Under current arrangements the FA Grants are distributed between states on a per capita basis. This currently means that NSW and Victoria fairly receive the funding required to support their larger populations. An interstate redistribution would likely disadvantage the councils in the most populous states, including NSW.

Furthermore, the redistribution of FA Grants without an increase in the quantum represents a form of cost shifting. It shifts the responsibility of providing support to disadvantaged communities from the Commonwealth Government onto other local governments.

Recommendation 2

That the NSW Government support local government advocacy to the Federal Government to restore the quantum of Financial Assistance Grants (FA Grants) to 1 per cent of total Commonwealth taxation revenue.

Other grants/tied grants

Alongside these changes, local government funding is increasingly provided through tied grants which stipulate clear prescriptions on how a council can spend money. Tied grants often reflect the policy priorities of the Federal or NSW Governments and not the priorities of the community. This runs counter to the very intent of the IPR framework and reduces the ability of the council to make decisions based on community need and in the best interests of their unique community circumstances.

The combination of these factors has resulted in a long-term decline in the certainty and security of funding. This prevents councils from making long-term investments in the infrastructure, services, tools, and decisions needed for their community. It is this long-term decline that sits at the heart of all issues and opportunities for local government across Australia. A lack of long-term secure and adequate funding is holding local government back from increasing the quality and breadth of services they provide to local communities across the country. Reversing the trend of the decreasing proportion of less secure funding is essential to ensure local government can continue to support liveable communities and productive economies across Australia now and into the future.

The decline in certainty and security of funding has been observed alongside greater use of grant funding for local government. While grants have offset some reduction in Federal Government funding, the use of grants has increased the uncertainty and insecurity of local government funding. It is the competitive nature of these grants, combined with their inflexibility that limits local government, decreasing their financial sustainability.

Grant funding cannot be considered as part of a sustainable baseline funding level for local government. Grant funding is often distributed at the whim of election promises and the short-term cycle of state and federal government priorities. Competitive grants are also hard to access for resource-constrained councils who may not have the staffing capacity or expertise to submit applications for additional funding. For this reason, local government advocates for secure, untied funding that removes political influence from decision-making processes, enabling councils to make long-term decisions that align with both their organisational goals and community needs.

LGNSW also supports the comments submitted by the Institute of Public Works Engineers NSW & ACT (IPWEA NSW & ACT)(Submission 29):

Eligibility criteria grants should be less onerous to enable more flexible funding timeframes and for spending on asset maintenance and refurbishments with less focus on new builds. Eligibility could be tied to the Integrated Planning and Reporting Framework, asset management or other legislated processes to ensure adequate accountability rather than complying with the ever-changing set of requirements the funding bodies produce.

The current significant focus on disaster preparedness is welcomed, but significant funding is required to build resilient infrastructure and correct past land planning mistakes which could become more significant as weather patterns change.

Lastly, the Institute is supportive of moves to reduce the burdensome governance requirements attached to current funding streams, such as a reduction in the frequency of reporting to funding bodies. Whilst these are often touted as being necessary from a compliance point of view, they quickly become a resourcing challenge for council officers. Funding provided by federal sources is typically much less onerous from a governance perspective, and yet councils manage to work well under these types of schemes.

Recommendation 3

That the NSW Government reform the grant funding process for state grants to local government to:

- **simplify the grant application and administration processes**
- **increase flexibility**
- **ensure better alignment with community priorities.**

Cost shifting

LGNSW's latest cost shifting report ([Appendix B](#)) was released in November 2023, highlighting a total cost shift to councils of \$1.36 billion in 2021-22, which is the equivalent of more than \$460 per ratepayer annually.⁴

This is a 78 per cent increase on the \$820 million cost shift identified five years prior.

What is cost shifting?

Cost shifting occurs when state and federal governments force councils to assume responsibility for infrastructure, services and regulatory functions without providing sufficient supporting funding.

NSW councils are currently being asked to absorb cost shifting worth more than \$1.36 billion each year, with the practice imposing an estimated cumulative burden of more than \$10.15 billion over the last decade.

This now amounts to an average \$460.67 paid by each NSW ratepayer, each and every year.

LGNSW's analysis makes it clear that NSW councils and communities are being asked to bear an ever-greater responsibility for state government services and infrastructure.

Cost shifting ultimately harms ratepayers, because councils are required to divert rate revenue away from existing services and infrastructure to fund the unrecoverable cost of services, programs and functions imposed by the state government.

Over the last decade, cost shifting has imposed an estimated cumulative burden of more than \$10 billion on local government. This enormous impost is increasingly eroding any possibility of financially sustainable local government. It risks the capacity of councils to deliver tailored, grassroots services to their communities and properly deliver and maintain vital local infrastructure.

With councils having to fund this ongoing subsidy for the State Government, it means communities get less or go without. They go without better roads, they go without

⁴ LGNSW Cost Shifting Report 2023: How State Costs Eat Council Rates, Morrison Low, also available online at: www.lgnsw.org.au/costshifting

better parks, they go without important community services that only councils provide, and they and their ratepayers are effectively paying hidden taxes to other levels of government.

In February 2023, LGNSW was pleased to receive a [pre-election letter](#) on behalf of the current NSW Government that acknowledged that the decade long practice of cost shifting had undermined the financial sustainability of the local government sector and placed significant strain on councils and household budgets.

At the November 2023 Annual Conference, councils unanimously resolved to call on the NSW Government to take urgent action to address cost shifting onto local government.

LGNSW and councils right across our state now seek real action from the NSW Government to address cost shifting.

Significant cost shifting components

The total quantum of cost shifting for 2021-22 was \$1.36 billion. The most significant components of this cost shifting include:

- **Emergency Services Contributions** - Councils are required to fund 11.7 per cent of the cost of Fire & Rescue NSW, Rural Fire Service (RFS) NSW and the NSW State Emergency Service (SES) through an Emergency Service Levy (ESL). Councils provide additional financial contributions to emergency services agencies in addition to the ESL.

Recommendation 4

That the Committee support the removal of the Emergency Services Levy (ESL) on local government as a priority as part of the current reform of the emergency services funding system process.

- **Forced rates exemptions** - Councils are required to exempt government and other organisations from paying rates in the local government area.

It is LGNSW's policy position that all land used for commercial or residential purposes should be subject to rates regardless of tenure. In some cases, rate exemptions should simply be abolished (e.g., Forests NSW). In other instances, it may be a matter of legislating tighter eligibility criteria and/or introducing a system of partial exemptions as applied in other jurisdictions.

Many current exemptions serve to provide financial benefits to numerous organisations, benevolent institutions, private schools, universities and some government business enterprises that are no longer justified in terms of principles of optimal taxation, particularly principles of equity and efficiency.

The distinction between charitable and social activity and commercial activity has blurred progressively over time with community orientated enterprises increasingly engaging in more commercially focused activity. Often it is no longer appropriate for local ratepayers to subsidise activities of exempt institutions where institutions act commercially, benefit from council services, and have capacity to pay.

This issue is being exacerbated by the NSW Government increasingly handing over management and ownership of public housing stock to Community Housing Providers (CHPs). While the NSW Government previously paid rates on these properties, CHPs are seeking and often achieving rate exemptions as Public Benefit Institutions (PBIs).

While councils have long called for greater NSW and Australian Government investment in public and social housing, councils are not in a position to subsidise welfare measures. This amounts to another cost-shift and such subsidies should be funded through the broader revenue bases of State or Federal Governments.

- **Pensioner rebates** – Councils are required to provide pensioner rebates on rates and other charges, for which the State government only subsidises 55 per cent of the cost, with the remaining 45 per cent funded by other ratepayers. This cost shift was estimated to amount to \$55.2 million for councils in 2021-2022, even before the additional costs of administering this rebate are considered.

The level of the mandatory rebate has not significantly risen for many years and has certainly not kept pace with inflation. Many councils, mindful of the impact of rates on some of their more vulnerable community members, have chosen to apply further voluntary rebates for pensioners. This results in an additional \$17.2 million cost to councils that should properly be borne by the NSW Government.

Recommendation 5

That the Committee recommend a separate review of the current system of rate concessions and rebates with a view to modernising the system to improve equity.

- **Waste Levy** – According to the [NSW Government](#), the waste levy aims to reduce the amount of waste being landfilled and promote recycling and resource recovery.

The waste levy was first introduced in Sydney in 1971 and has grown to \$163.2/tonne for waste generated in the Metropolitan Levy Area, and \$94/tonne for waste generated in the Regional Levy Area. The levy is applied on every tonne of waste sent to landfill from those levy areas (with some exceptions).

Margaret Crawford PSM, the NSW Auditor General at the time, highlighted in her 2020 [report](#) that the NSW Government has collected almost \$4 billion from councils and industry via the waste levy in the last five years, but only about a third of this has been reinvested into waste and environmental programs.

LGNSW acknowledges that the levy has contributed to an increase in the resource recovery rate to 67 per cent, compared with less than 10 per cent in the 1990s, but questions why only a third of levies raised are reinvested into waste and environmental programs.

The latest [National Waste Report](#) highlights the recovery rate in NSW has stagnated at 67 per cent since 2016, despite waste levy revenue increasing from \$689 million to \$889 million today. Clearly more reinvestment of the waste levy is needed to improve recovery rates.

It is not sustainable, either financially or environmentally, for the waste levy to continue inching up higher with inflation for no corresponding increase in resource recovery.

The decrease in the amount of levy revenue reinvested into councils and industry has had significant financial impacts for councils.

For instance, the Southern Sydney Regional Organisation of Councils (SSROC) 2021 Food Organics, Garden Organics (FOGO/FO) feasibility study indicates that introducing FOGO will cost on average \$15.54 million per council in year 1, or an 8 per cent increase in the cost of providing red-lidded and green-lidded bin services. The EPA's Organics Collection Grant program offered on average \$0.76 million per council if we assume the total \$65 million available is divided equally between all councils that had not yet adopted FOGO (as at 2022). Therefore, introducing FOGO will require councils without a sufficient waste reserve to raise domestic waste management (DWM) charges well above inflation.

While the DWM charge is not capped, there are limits to how much residents are able or willing to pay. For example, it is not feasible for a council to significantly increase the DWM charge from one rate notice to the next. There are also limitations on what can be included in the DWM charge. For example, it does not include council costs of managing 'waste' in public places such as public place bins, street sweeping and from council-run facilities like libraries and swimming pools. These ever-increasing costs must be covered from within council rate revenue. In addition, councils cannot pass on the significant cost of sending civil engineering and roadworks waste to landfill. Due to restrictive NSW regulation, it is difficult for councils to recycle civil waste (such as dirt, soil, concrete and asphalt) meaning ratepayers must pay for the levy when discarded in landfill.

The most effective way for NSW to achieve higher resource recovery is to reinvest *significantly more* of the waste levy than the current amount into the sector through grants for additional recovery facilities, non-contestable funding for councils, upgrades to existing waste infrastructure, funding for innovative waste solutions, and state-wide education campaigns.

The alternative is the status quo- ever more levy funds being collected from councils and industry, with no associated change in NSW's recovery rate.

Recommendation 6

That the NSW Government reinvest significantly more of the waste levy than the current amount into the sector through grants for additional recovery facilities, non-contestable funding for councils, upgrades to existing waste infrastructure, funding for innovative waste solutions, and state-wide education campaigns.

- **Library funding** – When the *Library Act 1939* commenced, the intent was that many of the public libraries established by councils would be eligible for a subsidy of up to 50 per cent from the NSW Government (A funding arrangement referred to as 'a pound for a pound').

Over decades, the proportion of funding from the NSW Government has gradually reduced. In 2022-23, councils spent \$412 million on public libraries,

while the NSW Government contributed \$40 million.⁵ Councils are certainly appreciative of the significant increase in State Government library funding since 2019-20, but councils still receive less than 9 per cent of the cost of funding their libraries from the NSW Government – a far cry from initial arrangements.

The shortfall in council finances resulting from the State Government not contributing 50 per cent of library funding in 2021-22 amounts to \$156.7 million.

- **Audit costs for local government**- Councils are increasingly raising concerns about the significant escalation of audit fees imposed on local government.

The NSW Audit Office became the auditor for all NSW councils in 2018, which has meant the appointment of contractors to councils to undertake the annual financial statement audit.

Since this time, the baseline costs of audits have continued to increase. Many councils are experiencing unsustainable audit fee increases well in excess of CPI. LGNSW is aware of audit fees for one council increasing by 168 per cent in just one year. Across the local government sector, audit fees for councils have continued to escalate at a pace far beyond the baseline local government rate peg.

This highlights the disparity between on the one hand the NSW Government giving the NSW Audit Office free rein to impose rapidly escalating costs on local government, while at the same time constricting local government's ability to pay these costs due to the rate peg imposed on councils.

At the 2022 LGNSW Annual Conference, councils resolved to call on the NSW Government to cover the full costs of audits for local governments in NSW.

- **Developer contributions**

Infrastructure contributions are made by developers to help deliver the infrastructure needed as communities grow. Faced with increasing expectations of local amenity and infrastructure services, population growth and funding constraints such as the rate peg, councils find it difficult to keep pace with public infrastructure and the service needs of community.

⁵ Public Library Statistics 2022-23, State Library of NSW.

Councils rely on development contributions to go towards funding this infrastructure to support population growth and new development. They are a key funding stream to ensure that future communities have adequate roads, drainage, community facilities, and open space.

Infrastructure contributions are a means of financing public infrastructure that is required as a direct or indirect result of new development. They are provided in the form of monetary contributions, the dedication of land and/or the provision of capital works. This is based on a long-standing impactor/beneficiary pays principle of the existing planning system i.e. new development makes a contribution towards the cost of infrastructure that will meet the additional demand it generates and benefits from.

The mechanism generally used by councils to collect these contributions is through Section 7.11 and 7.12 of the *Environmental Planning and Assessment Act 1979* (EP&A Act). Section 7.11 provides a specific rate per development which is set by the State Government.

It has been well-established that existing infrastructure contributions fail to provide councils with sufficient revenue to meet the lifecycle costs of infrastructure. Restrictions on the use of the funds and maximum caps on development contributions constrain councils' ability to fund community infrastructure attributed to growth of development and populations.

Further, while developer contributions provide some funding for capital costs in new development, they do not provide for recurrent costs, and councils are required to fund the ongoing maintenance, operating and depreciation expense associated with new infrastructure.

A further challenge is that many councils across the State do not have the financial capacity to forward fund multiple infrastructure projects while awaiting vital contributions payments from developers for those projects.

Caps on infrastructure contributions have existed for well over a decade.

In 2009, contributions payable to councils were capped at \$20,000 per residential dwelling/lot and in 2010 the cap was lifted for greenfield areas to

\$30,000⁶. The caps have not been indexed since. The Productivity Commission noted in 2020:

The caps were put in place to sustain housing supply amidst the 2008-09 Global Financial Crisis and were aimed at stimulating construction activity. The cost of providing infrastructure, and thus the contribution rates charged to development is, however, a signal of economic efficiency. Removal of these signals has therefore delivered less efficient development patterns. Moreover, over time it is likely that these subsidies were ultimately taken up in terms of higher land values.⁷

In 2013, recognising the gap between the amount councils can charge in accordance with contributions plans and the actual cost of infrastructure, the Government introduced the Local Infrastructure Growth Scheme (LIGS) to fund the gap between contributions caps and approved contribution rates for Local Infrastructure Growth Scheme transition areas. The LIGS were phased out and removed in 2020.

In the ten years since the caps were introduced, there have been significant increases in land values and construction costs – particularly in the greater metropolitan area, so it is reasonable for the thresholds to be reviewed. The fact that IPART regularly approves development contributions significantly higher than (often double) the cap in some areas validates what the true costs of development actually are.

The thresholds need to be removed or at a minimum, increased to a more realistic level. They do not accurately reflect councils' increasing infrastructure delivery costs and land values and have not been indexed for 10 years which means they have declined in real terms during this period.

IPART review and assessment of contribution plans

Councils can increase the contribution rate per development, but to do this they must submit contributions plans to IPART for independent review. IPART assesses contributions plans that propose contributions above \$30,000 per lot or dwelling in identified greenfield areas and \$20,000 per dwelling in other areas.

⁶ See timeline of system reforms in NSW Productivity Commission, [Review of Infrastructure Contributions in New South Wales – Final Report](#), November 2020

⁷ [NSW Productivity Commission, Issues Paper](#), July 2020, p 38

An IPART-reviewed contributions plan entitles the council to levy the full contributions amount.⁸

While contributions plans do have the opportunity to be reviewed, the IPART process has been typically long and complicated, potentially delaying the collection and expenditure of funds and is therefore not occurring systematically or effectively.

The IPART review adds another resource-intensive and lengthy stage into the complex process of preparing and adopting contribution plans. Historically, LGNSW has opposed the imposition of these thresholds due to the burden of the IPART review process on councils. LGNSW does not support the thresholds and maintains that councils should be empowered to do the planning for infrastructure within their local areas and to recoup contributions for the provision of infrastructure for the benefit of the community⁹.

Additionally, councils are only able to collect for 'essential works' under IPART approved plans. The Essential Works List imposed on councils specifically excludes the ability to collect for items like libraries or community centres and the like – subjecting communities to deficits of social infrastructure that can only be made up through either the use of voluntary planning agreements or provisions of additional funds from the rate base, again placing an unfair burden on councils and existing communities.

Recommendation 7

- a) That the thresholds that trigger IPART review of contributions plans be removed so that plans are not required to go through the IPART process.
- b) That the caps on development contributions be removed
- c) That the Essential Works List be reviewed.

Further detail on a wide range of cost shifting impacts is set out in the Cost Shifting Report at [Appendix B](#).

⁸ [Local Infrastructure Contributions Plans | IPART \(nsw.gov.au\)](#)

⁹ [Submission_on_Infrastructure_Contributions_Review.pdf \(lgnsw.org.au\)](#)

Recent cost shifting developments

Over the past 12 months, there have been some positive developments on cost shifting. Last year's reforms to the rate peg methodology will mean that any increases in the Emergency Services Levy (ESL) will be wholly covered by an adjustment to the rate peg. The review of the ESL, which is now underway, presents an opportunity for this longstanding matter to be sensibly resolved, if the review results in the removal of the ESL on councils and insurance policies.

However, there has also been some concerning backsliding on cost shifting, with the NSW Government proposing to impose a number of additional new costs and levies onto councils and their communities. Three examples of these potential new cost shifts are as follows:

- **Dams Safety Levy** – The NSW Government has asked IPART to recommend a methodology for a levy on dam owners, to fund the costs of the dam safety regulator. 58 councils carry responsibility for many of the 380 declared dams that would be targeted by this onerous levy, which would capture water supply, flood mitigation and recreational dams.

Beyond the direct cost impact of a new levy, the levy would also result in a reduction in councils' funds available for essential infrastructure and services, and most perversely, would reduce the funding available for local water utility asset maintenance and specialist skills.

LGNSW has strongly urged the NSW Government to discontinue its proposal to introduce a new dam levy. Instead, the NSW Government should fund the costs of its own regulator from consolidated revenue.

- **Interment Levy** – The NSW Government has also proposed imposing a new tax on every cremation, burial and ash interment across NSW. The levy is proposed to be set at \$41 per cremation, \$156 per burial and \$63 per ash interment.

109 of the 128 local government authorities in NSW operate cemeteries or crematoria. Councils are the largest provider of bodily interment in NSW, responsible for 42.8 per cent of burials in 2021-22.

Councils cannot absorb this levy into current operational budgets and will therefore have to pass on the levy to their residents and community members. This then makes interment services more expensive for individuals and families

who are grieving through what will be for many people the most challenging circumstances of their lives.

The NSW Government has proposed this levy to fund the costs of its cemetery's regulator, which will mean a saving for the NSW Government's bottom line. In effect, this proposal seeks to make councils the tax collector for the NSW Government.

Respectful and affordable interment services are a critical public good provided by local government cemetery operators. LGNSW has expressed its fundamental opposition to this levy and any moves that seek to unnecessarily increase costs for grieving families.

- **Beachwatch funding** – In late 2023, the NSW Government had announced that the costs of water quality monitoring at Sydney swimming sites would need to be borne by councils from 1 July 2024, after almost two decades of the NSW Government funding this service.

The majority of councils in the Sydney Beachwatch area do not have responsibility for sewerage management/treatment, and do not have any legal responsibility for monitoring water quality at ocean beaches.

The implication from the NSW Government was that Beachwatch monitoring would discontinue if councils did not fund this service. In reality, this monitoring has now become a community expectation and any transfer of this responsibility from the state government to councils would represent an additional cost shift onto councils.

LGNSW has expressed appreciation that the NSW Government listened to the local government sector's advocacy on this matter and decided not to proceed with shifting this cost onto councils for the 2024-2025 financial year. However, this is seemingly just a temporary reprieve until 1 July 2025, and LGNSW reiterates its call for the NSW Government to reconsider this cost shift.

Recommendation 8

That the NSW Government urgently work to ensure cost shifting onto local government is addressed through a combination of regulatory reform, budgetary provision and appropriate funding.

Summary of recommendations

RATES

Recommendation 1

That Rate Pegging be abolished and that the Integrated Planning and Reporting (IPR) framework be relied on to determine council rates.

GRANTS

Recommendation 2

That the NSW Government support local government advocacy to the Federal Government to restore the quantum of Financial Assistance Grants (FA Grants) to 1 per cent of total Commonwealth taxation revenue.

Recommendation 3

That the NSW Government reform the grant funding process for state grants to local government to:

- simplify the grant application and administration processes
- increase flexibility
- ensure better alignment with community priorities.

COST SHIFTING

Recommendation 4

That the Committee support the removal of the Emergency Services Levy (ESL) on local government as part of the current reforming the emergency services funding system process.

Recommendation 5

That the Committee recommend a separate review of the current system of rate concessions and rebates with a view to modernising the system to improve equity.

Recommendation 6

That the NSW Government reinvest significantly more of the waste levy than the current amount into the sector through grants for additional recovery facilities, non-contestable funding for councils, upgrades to existing waste infrastructure, funding for innovative waste solutions, and state-wide education campaigns.

Recommendation 7

- That the thresholds that trigger IPART review of contributions plans should be removed so that plans are not required to go through the IPART process.
- That the caps on development contributions be removed.
- That the Essential Works List be reviewed.

Recommendation 8

That the NSW Government urgently work to ensure cost shifting onto local government is addressed through a combination of regulatory reform, budgetary provision and appropriate funding.

Conclusion

The sustainability, resilience, and productivity of local government and their communities depends in large part on their long-term financial sustainability. The ability to provide the right mix of services and infrastructure that meets the needs of local communities is essential to the long-term growth, contribution, and ultimately liveability of NSW communities.

This submission makes it clear that it is in the interests of the NSW Government to work closely with local government to strengthen its financial sustainability. This submission has presented several ways in which the NSW Government could do so including:

- Removal of rate pegging
- Ending cost shifting
- Giving councils more autonomy and flexibility over their finances
- Moving from tied grants to untied grants that match community priorities
- Simplifying grant application and administration processes
- The removal of the current caps on development contributions and the review of the Essential Works List.

Local government would also appreciate the support of the NSW Government in advocating an increase in the FA Grants quantum from around 0.5 per cent to 1 per cent of total Commonwealth Taxation Revenue and increases in other Federal grants.

LGNSW would welcome the opportunity to work with the NSW Government in building a stronger NSW through a stronger local government sector.

LGNSW would be pleased to provide clarification on any matter raised in this submission. For further information, please contact,

Ability of local governments to fund infrastructure and services

NSW Parliamentary Inquiry

Local Government NSW

May 2024





Independent
insight.



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OFFICES IN CANBERRA, HOBART, MELBOURNE, AND SYDNEY ON THE COUNTRY OF THE NGAMBRI/NGUNNAWAL/NGARIGO, MUWININA/PALAWA, WURUNDJERI, AND GADIGAL PEOPLES.

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Executive summary

On 14 March 2024, the NSW Legislative Council's Standing Committee on State Development announced an inquiry into the ability of local government to fund infrastructure and services.

The inquiry will have a particular focus on the rate peg and how the rate peg shapes outcomes for ratepayers, councils, and council staff.

This paper has been prepared to address four components of the Terms of Reference for the inquiry. We summarise key findings below.

The level of income councils require to adequately meet the needs of their communities

- A longer-term trend of stagnating or declining rate peg growth contrasts with rising risks to councils' financial sustainability: inflationary pressures, inadequate fiscal equalisation, and cost shifting from other tiers of government.
- Despite the constraints of the annual rate peg, councils continue to exhibit their hallmark productivity: doing more with less. Over the last decade, operational and capital expenditure across the metropolitan, regional, and rural councils has grown.
- Shifts in operational and capital expenditure from year to year suggest that costs to council are sensitive to changes in the regional and macro-economic context. Yet councils have few levers to assist in their flexibility and responsiveness to changing community need.
- Inefficiencies in the structure of other income mechanisms, namely the financial assistance grants, state government grants, and the adequacy of infrastructure cost recovery via development contributions, pose additional challenges in meeting community need.
- The level of income that councils require to adequately meet community needs depends on the local context and what communities expect of councils. Cost pressures differ by council type, given regional differences in market depth, cost shifting, the ability to leverage economies of scale, and the types of services provided. Community expectations have been shaped over many years by local governments' influence as a dedicated service provider across multiple domains of community life. Communities expect continuity and improvements in services over time.

Examine if past rate pegs have matched increases in costs borne by local government

- The past rate peg is poorly aligned with operational and capital costs. This introduces uncertainty in councils' financial outlook and how plan and budget for their future.
- The past rate peg has not kept up with changes in key inflation indicators: the Producer Price Index and the Consumer Price Index, which effectively diminishes real income and purchasing power for councils.

- The past rate peg inhibits councils' ability to catch up to maintenance shortfalls. In 2021-22, regional and metropolitan councils experienced the largest dollar value shortfall in maintenance (totally \$51.6 million). At the same time, with increasing assets being placed on councils' books, the required asset maintenance expenditure had been growing for almost a decade.
- Until recent changes to the rate peg methodology to account for population and cost drivers, the past rate peg exposed a spatial divide in the types and costs of services to different councils, e.g. roads and infrastructure maintenance, parks and recreation facilities and community services.

Assess the social and economic impacts of the rate peg in New South Wales for ratepayers, councils, and council staff over the last 20 years and compare with other jurisdictions

- The symbiosis between local authorities and their communities means that what is felt by councils, in terms of risks to long-term financial sustainability has implications for the efficient functioning and wellbeing of the wider community.
- The social and economic impacts of rate pegging are far reaching and manifest over different time horizons.
- Future rate pegs cannot satisfactorily address the impacts of past caps to councils' ability to increase overall rate revenues. The compounding effect of this is that without more significant intervention, community services will remain underfunded and outcomes in some communities will worsen over time.
- Documented impacts to ratepayers include impacts to services (service cuts, reduced service scope, and compromised quality), delays to infrastructure delivery and deferred maintenance, a compounding backlog of asset renewal, lower community protections from natural disaster, and a distortion of public expectations of local government service and infrastructure provision.
- Moreover, the essential works list is currently limited to basic infrastructure, including land and facilities for open space, community facilities, transport, stormwater management, and the costs of plan preparation and administration.¹ Coupled with rate capping, this has resulted in new communities being developed without community infrastructure that is not just physically necessary, but necessary for communities: libraries, halls, youth and childcare facilities. The developers' objective of minimising contributions plan costs also comes at the expense of community need.
- Documented impacts to councils and council staff include the erosion of financial independence, decreased staff morale and wellbeing, and a longer-term contraction in the size and competitiveness of the sector's workforce.
- Research has shown that in most other states and territories, councils have more autonomy in setting rates and charges than in NSW. Jurisdictions where councils are able to set their own rates are: Queensland, Tasmania, South Australia, Northern Territory, and Western Australia, however

¹ LGNSW (2021), 'LGNSW Submission to IPART Review of the Essential Works List, Nexus, Efficient Design and Benchmark Costs for Local Infrastructure', https://www.lgnsw.org.au/common/Uploaded%20files/Submissions/2021/Draft_Submission-IPART_Review_EWL_and_Benchmarking.pdf

there are often regulatory requirements and guidelines around the process of rates setting. In Victoria, rate capping was introduced in 2016 and is linked to the Consumer Price Index and other factors.

- A 2015 jurisdictional comparison of the effects of NSW's rate pegging and Victoria's previously uncapped rates highlighted that rate pegging had led to decreased equity between communities, higher levels of debt, and diminished levels of asset renewal in NSW.²

Compare the rate peg as it currently exists to alternative approaches with regards to the outcomes for ratepayers, councils, and council staff.

- Alternatives to the rate pegging approach must balance a mutual commitment to strengthening the financial sustainability of NSW local governments whilst being attentive to the cost of living and other affordability pressures in community.
- It is only relatively recently, in its almost fifty-year history, that rate pegging has been the subject of formal review. Removing the rate peg in its entirety would provide councils more autonomy in financing community needs and shift the needle in addressing the mismatches in income and costs described above. The magnitude of rate changes would need to be evidence based and monitored given varying levels of socio-economic advantage and disadvantage within communities. This approach is currently in operation in South Australia.
- Options to refine the rate peg methodology include using the Capital Improved Value (CIV) to provide a more equitable view of land value by property type, developing a wider range of tailored cost indices, and better reflecting 'hidden' costs, such as those arising from cost shifting to councils.
 - Some Victorian and Tasmanian councils use the CIV as part of the property valuation base for calculating rates.³ IPART's 2016 review of the local government rating system recommended Capital Improved value as the basis for metropolitan rates (regional councils supported this if it were to be introduced as an option), however this was not accepted by the NSW Government.
 - There is a view that using CIVs can discourage capital improvements, given a 'higher valuation would result in a larger rating and taxing liability'.⁴ The available evidence on the effects of using Capital Improved Values is inconclusive. In 2013, a Tasmanian review found that both the CIV and land value are superior to the assessed annual valuation base, but did not recommend

² Drew, J., & Dollery, B. (2015). Careful what you wish for: Rate-capping in Victorian local government. *Journal of Australian Taxation*, 17(1), 139-167.

³ Victorian Government (2023), 'Local Government Better Practice Guide: Revenue and Rating Plans', https://www.localgovernment.vic.gov.au/__data/assets/pdf_file/0030/195294/Appendix-Three-Supporting-Documents.pdf; Tasmanian Government (undated), 'Council rates', https://www.dpac.tas.gov.au/divisions/local_government/about_councils/finance_and_planning/council_rates#:~:text=When%20councils%20set%20their%20rates,value%20of%20properties%20across%20Tasmania.

⁴ NSW Valuer General (2016), 'Review of the Local Government Rating System: Submission to IPART', https://www.ipart.nsw.gov.au/sites/default/files/documents/online_submission_-_office_of_the_valuer_general_-_s._gilkes_-_20_may_2016_183000000.pdf

one over the other. That review considered CIV to 'better address capacity-to-pay considerations and was best understood by ratepayers'.⁵

- Qualitative evidence suggests that the requirements for a special rate variation application are onerous to many councils and undermine the intended offering. A key challenge with this process is the rigorous and often divisive community engagement required for, at times, a minimal annual increase. A potential option would be to set the required rates every four years, along with the adoption of council strategic documents and infrastructure plans, seeking community approval to endorse plans and the budget required to implement outcomes.

⁵ Division of Local Government, Department of Premier and Cabinet (Tasmania), Valuation and Local Government Rating Review Final Report (April 2013).

1. Financing community need

Local governments' main income mechanisms are taxation (rates), user charges, grants from other tiers of government, and development contributions. For some councils, investment income is also a significant component of own source revenue, however the ability and willingness to invest is dependent on individual risk appetite and financial sustainability. In recent years, a combination of cost pressures, increased service demand, and the changing profile of community have put a spotlight on the risks to the financial sustainability of NSW local governments, and local governments across Australia.

To understand financial needs of local governments, this chapter addresses two questions:

1. What are the trends in cost and revenue influences on councils' ability to meet community need for infrastructure and services?
2. How does the rate peg (a key influence on councils' own source revenue) compare to proxy measures of income to meet community need?

Many factors shape the level of income that is required to meet community needs. These include but are not limited to: the size and growth rate of the local population, community profile and service expectations, the condition of existing infrastructure and level of new infrastructure required, and the increasing need to respond to and mitigate climate events.

In addition to this, councils have limited economies of scale and are often the provider of last resort; characteristics which are further exacerbated in regional and rural areas.

The level of income needed to *adequately* meet community needs depends on the local context and what local communities expect of their councils. Therefore 'adequacy' of income can be evaluated in many ways: socio-demographically, spatially, or by some other council and community characteristic. Importantly, what appears satisfactory at the aggregate level may be inefficiently allocated at the local scale. A situation arises in the short term that some councils better withstand cost volatility and weather economic turbulence, while others are forced to re-prioritise and reduce budgets.

Local governments' history as a dedicated service provider across multiple domains of community life suggests that communities already receive and expect continuity of these services. In addition, it is expected that these services adapt and improve over time; for example the integration of technology, best practice services delivery methods, and environmental sustainable design. For this to continue, local governments need to have clear strategic directions and services that respond to their unique community needs. In order to finance these services councils must be better supported to overcome financial constraints and the impacts of tools such as the current rate peg and its financial calculations.

A note about the geographic scale of analysis:

In this report, classifications of NSW's 128 councils are based on the Office of Local Government groupings (refer to Appendix A for full classification). Table 1 outlines the number of councils in each category:⁶

Table 1: Councils by council type, OLG classification

Council classification	Number of councils, 2020-21
Metropolitan	25
Metropolitan Fringe	9
Regional Town/City	37
Rural	15
Large Rural	42

Source: NSW OLG (2020)

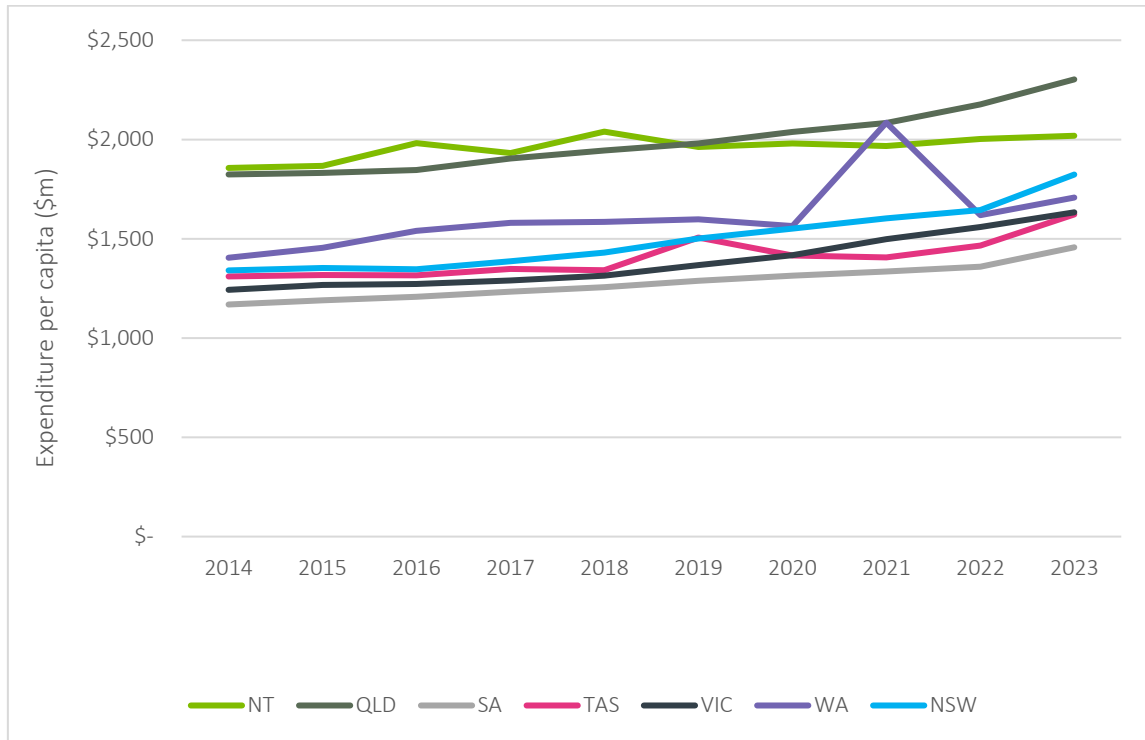
1.2 Rising operational and capital expenditure

The following analysis examines councils' operational and capital expenditure as a proxy for the level of income required to adequately meet community needs. Note that this analysis does not reflect the true costs of community needs, given that some councils may have already removed or adjusted service delivery to accommodate budgetary constraints (see Chapter 3).

Figure 1 compares total local government expenditure per capita across Australia. NSW has had the largest total increase in expenditure per capita with a compound annual growth rate of 3.5 per cent between 2014 and 2023.

⁶ NSW Office of Local Government (2020), 'Australian classification of local governments and OLG group numbers', <https://www.yourcouncil.nsw.gov.au/wp-content/uploads/2020/05/Australian-Classification-of-Local-Government-and-OLG-group-numbers.pdf>.

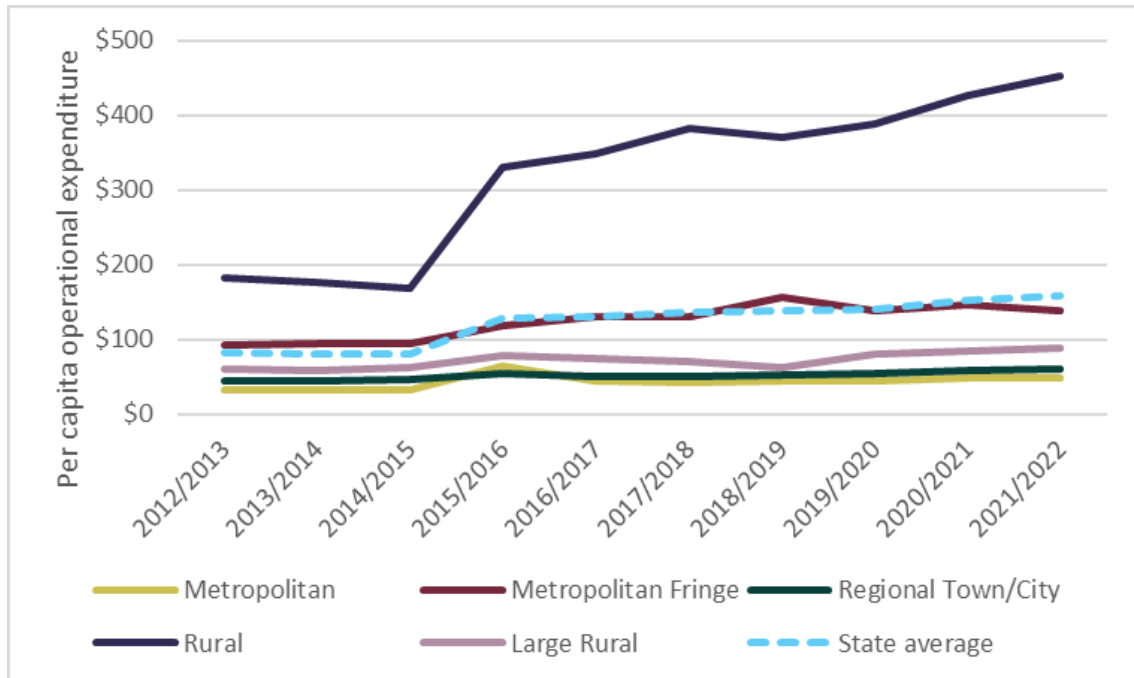
Figure 1: Total local government expenditure per capita by jurisdiction, 2014-23



Source: SGS Economics and Planning (2024), ABS Government Finance Statistics (2014-23)

In NSW, on average, rural councils incur the highest per capita operating expenses, followed by metropolitan fringe councils and large rural councils (Figure 2). Operating expenditure has also increased over the last decade for all council types, although rural councils experienced the largest proportionate increase in operational expenditure (148 per cent), followed by metropolitan councils (52 per cent), and metropolitan fringe councils (50 per cent).

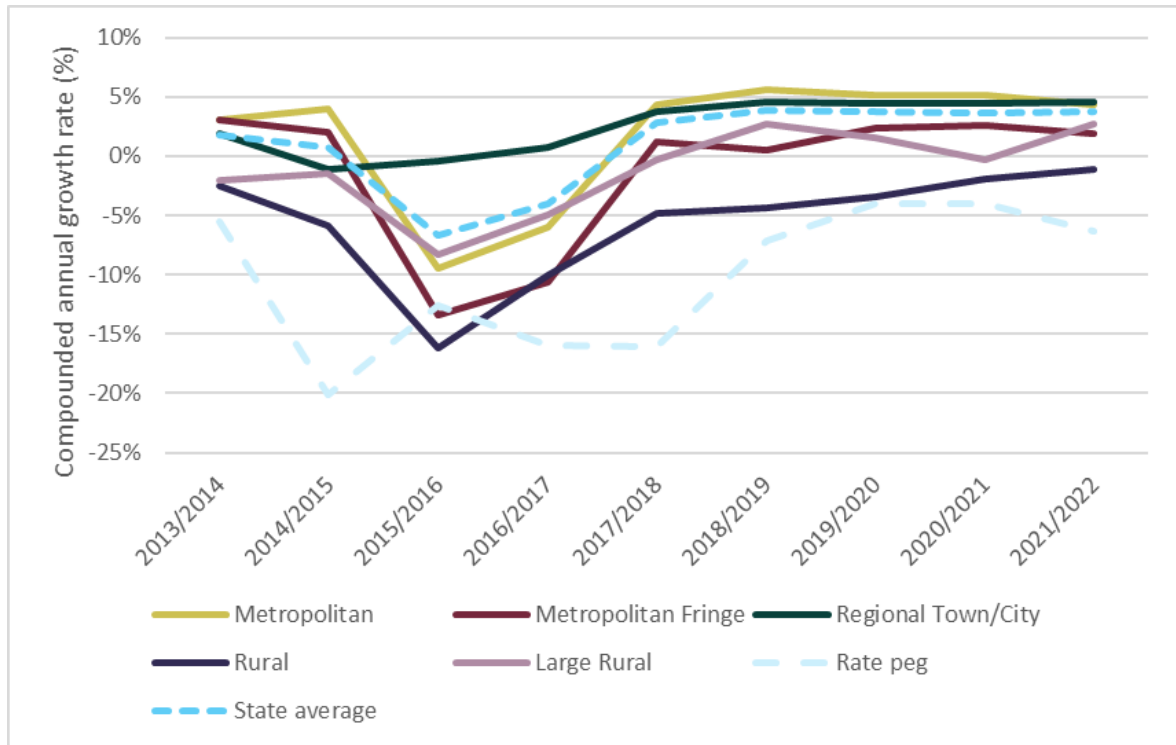
Figure 2: Average operational expenditure (per capita) by council type, 2012-13 to 2021-22



Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22).

A compound annual growth rate (CAGR) analysis of operational expenditure against the rate peg shows that over time, the rate peg has not kept up with rising service costs (Figure 3). The contrast indicates an unsustainable longer-term trend in how the rate peg keeps pace with the estimated change in the costs of councils providing current services and service levels to households, businesses, and the broader community. Despite growth in the rate peg percentage not keeping up with rising costs, councils have continued to deliver at a steady rate to communities (Figure 2).

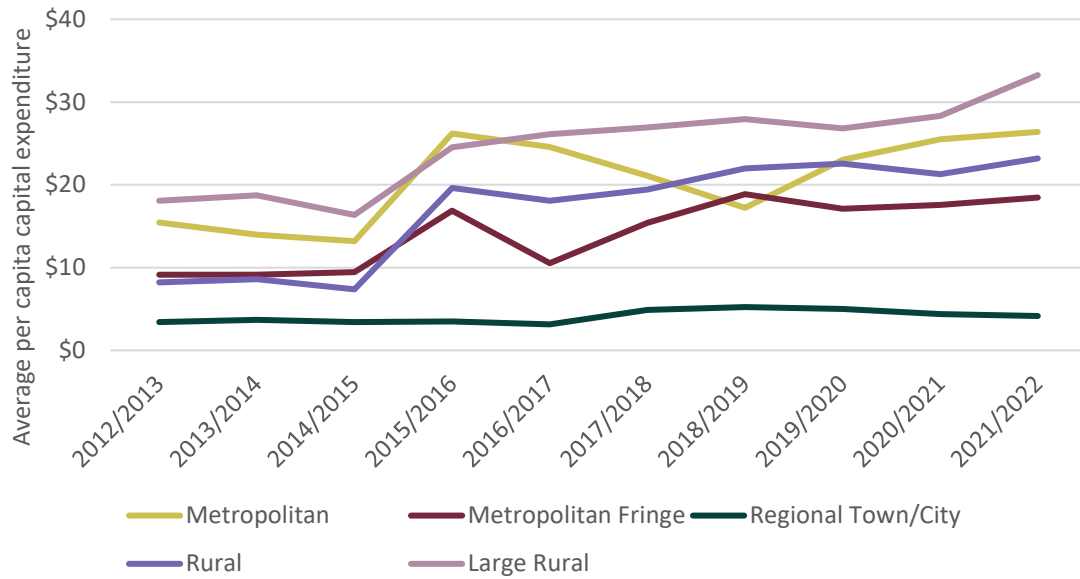
Figure 3: Compound annual growth in operational expenditure (per capita) by council type, 2012-13 to 2021-22



Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22). CAGR is calculated from a 2012-13 baseline.

All council types increased capital expenditure per capita between 2012-13 and 2021-22 (Figure 4). Generally, large rural councils incurred the highest expenditures, followed by metropolitan and then rural councils. The largest proportionate increase in capital expenditure per capita over that period was experienced by rural councils (168% increase), followed by metropolitan fringe councils (102%), and large rural councils (83%).

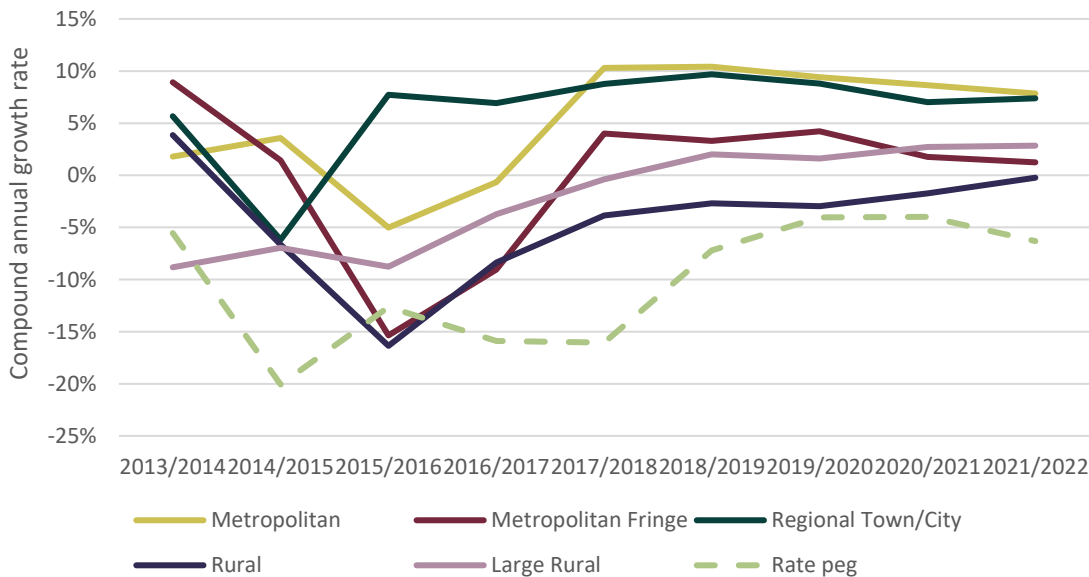
Figure 4: Total local government expenditure (per capita) by council type, 2012-13 to 2021-22



Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22).

Over the years, growth in the rate peg percentage has not kept up with councils’ capital expenditures (Figure 5). Similar to the analysis of operational expenditure, growth trends in the rate peg do not match capital expenditure patterns. This suggests that councils are finding other ways to meet community need, leading to trade-offs in other areas (Chapter 3) that may not fully be understood.

Figure 5: Compound annual growth in capital expenditure (per capita) by council type, 2012-13 to 2021-22



Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22).

A comparison of the average annual growth rates of council operational expenditure per capita (Table 2) and council capital expenditure per capita (Table 3) suggests there is no obvious relationship between the rate peg percentage and the income required by councils to meet community need. What this data also shows is that despite variations for year on year operational expenditure, all council types have had a compounded average annual growth rate of at least 4 per cent. Alternatively, the rate peg compound annual growth rate shows a shrinkage of 6 per cent. This reflects a longstanding critique of the rate peg that it imposes an arbitrary ceiling on rate increases.

Table 2: Annual growth in councils' operational expenditure per capita

Council type	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	CAGR 2012-13 to 2021-22
Metropolitan	-	1%	3%	95%	-31%	-4%	6%	0%	5%	1%	5%
Metropolitan Fringe	-	1%	0%	27%	10%	0%	21%	-12%	6%	-6%	5%
Regional Town/City	-	0%	4%	16%	-6%	0%	4%	3%	7%	4%	3%
Rural	-	-4%	-4%	96%	6%	10%	-3%	5%	10%	6%	11%
Large Rural	-	-1%	6%	25%	-6%	-4%	-13%	29%	6%	5%	4%
NSW average	-	-1%	2%	52%	-5%	0%	3%	5%	7%	2%	6%
Rate peg (%)	3.6%	3.4%	2.3%	2.4%	1.8%	1.5%	2.3%	2.7%	2.6%	2.0%	-6%

Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22). Notes: Year on year variations to expenditure is influenced by council amalgamations (2015-16). Figures exclude councils which have missing data. Actual rate peg percentage is displayed rather than annual growth.

Table 3: Annual growth in councils' capital expenditure per capita

Council type	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	CAGR 2012-13 to 2021-22
Metropolitan	-	-9%	-6%	98%	-6%	-14%	-18%	34%	11%	4%	6%
Metropolitan Fringe	-	0%	4%	78%	-38%	46%	23%	-9%	3%	5%	8%
Regional Town/City	-	8%	-7%	3%	-10%	55%	7%	-4%	-13%	-5%	2%
Rural	-	5%	-14%	166%	-8%	8%	13%	3%	-6%	9%	12%
Large Rural	-	4%	-13%	50%	6%	3%	4%	-4%	6%	17%	7%
NSW average	-	2%	-7%	79%	-11%	20%	6%	4%	0%	6%	7%
Rate peg (%)	3.6%	3.4%	2.3%	2.4%	1.8%	1.5%	2.3%	2.7%	2.6%	2.0%	-6%

Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22). Notes: Year on year variations to expenditure is influenced by council amalgamations (2015-16). Figures exclude councils which have missing data. Actual rate peg percentage is displayed rather than annual growth.

1.3 Declining value of financial assistance grants

Since 1974, the Commonwealth government's financial assistance grants (FA Grants) have provided a base level of funding to councils to deliver community services. FAGs were introduced as a way of achieving 'horizontal fiscal equalisation' (HFE), a principle that seeks to ensure that all Australians, regardless of what State or Territory they live in, can have access to services and infrastructure of the same standard.

There are two main components of the grant:

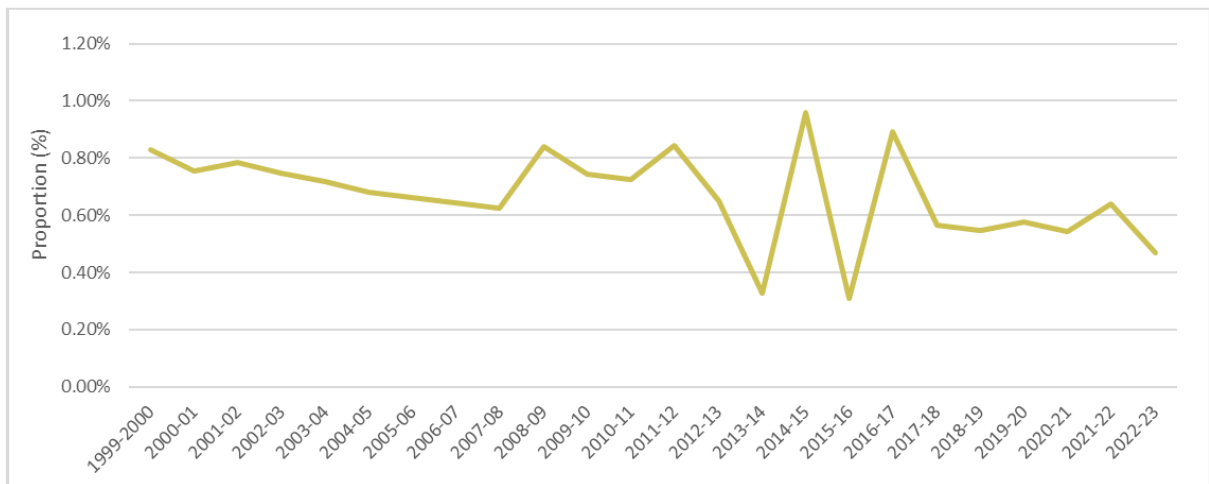
- General purpose component: unconditional funds to be spend on services, community infrastructure, or other municipal priorities. This grant component is distributed among states and territories based on population, and
- Local roads component: intended for the maintenance and construction of local road infrastructure, though councils have flexibility to apply funds to meet other road and transport related needs.

When the FA Grant program was introduced in 1970's the Hawke Government set FA Grants to be 1 per cent of Commonwealth taxation revenue (CTR). Up until 2000, both State and local government received a FA Grant which was indexed on the same basis, but the introduction of the Goods and Service Tax (GST) in that year saw the States receive a GST grant, linked to the GST tax revenue. However, local government's arrangement remained unchanged. While GST revenue continues to increase at a higher rate than FA Grants, the grant as a proportion of CTR have been steadily decreasing

(Figure 6).⁷ Currently, FA Grants sits at 0.38 per cent of CTR in 2023 which is well below the target of 1 per cent CTR.

In 2014, the Abbott Government budget repair strategy froze indexation of the grants. This was estimated to cost local communities more than \$600 million in services and infrastructure over three years, with the biggest impact felt by councils in regional and remote Australia. The 2017 Federal Budget restored indexation. The 2023-24 Budget maintains the system of payments to support local government through FA Grants.

Figure 6: FA Grant payment as a share of CTR, 2000-2023

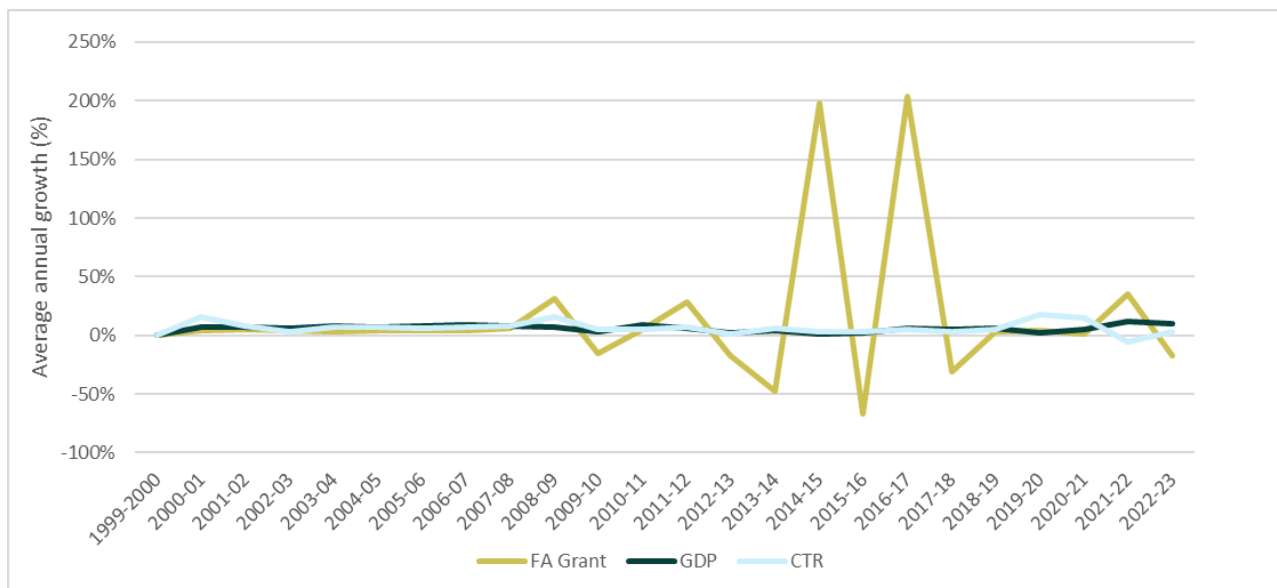


Source: SGS Economics and Planning (2024), ABS (2024).

Figure 7 compares the growth in CTR and GDP to growth in FA Grant. This demonstrates that the FA grants have considerable variability including significant decreases in some periods. In contrast, GDP and Commonwealth taxation revenue have shown more stability with growth rates.

⁷ ALGA, (n.d.), *Background on Local Government Funding*, <https://alga.com.au/policy-centre/financial-sustainability/background-on-local-government-funding/>

Figure 7: Average annual growth in CTR and GDP compared to growth in FA Grant amount, 2000-23



Source: SGS Economics and Planning (2024), ABS (2024).

There is a strong case for reinstating the proportion of CTR to 1 per cent for Local Government FAGs given the growth in population, growth in overall CTR and the expectations on local government to continue delivering services and ensuring a quality of life for their community and their limitations on growing own source revenues.

Once allocated to the State, the NSW Grants Commission distributes FA Grants funding in line with the six national principles referenced under section 9 of the *Local Government (Financial Assistance) Act 1995 (Cth)*.⁸ The principles are:

- *Horizontal equalisation*: General purpose component (untied) will be allocated with respect to local governing bodies differences in expenditure incurred against revenue raising capacity.
- *Effort neutrality*: As far as practically possible, the individual policies of local governing bodies in terms of expenditure and revenue effort will not affect grant determinations.
- *Minimum grant*: The minimum general purpose grant allocation (untied) will not be less than the amount to which the local governing body would be entitled if 30 per cent of the total amount of the general purpose grant to the State is distributed on a per capita basis.
- *Other grant support*: Other relevant grant support provided to local governing bodies to meet expenditure needs will be considered using an inclusion approach.
- *Aboriginal and Torres Strait Islanders*: Financial assistance shall be allocated to councils in a way that recognises the needs of Aboriginal and Torres Strait Islander peoples within their boundaries.
- *Council amalgamation*: Where two or more councils have amalgamated into a single body, the general purpose component of the new governing body will be equal to the combined total of

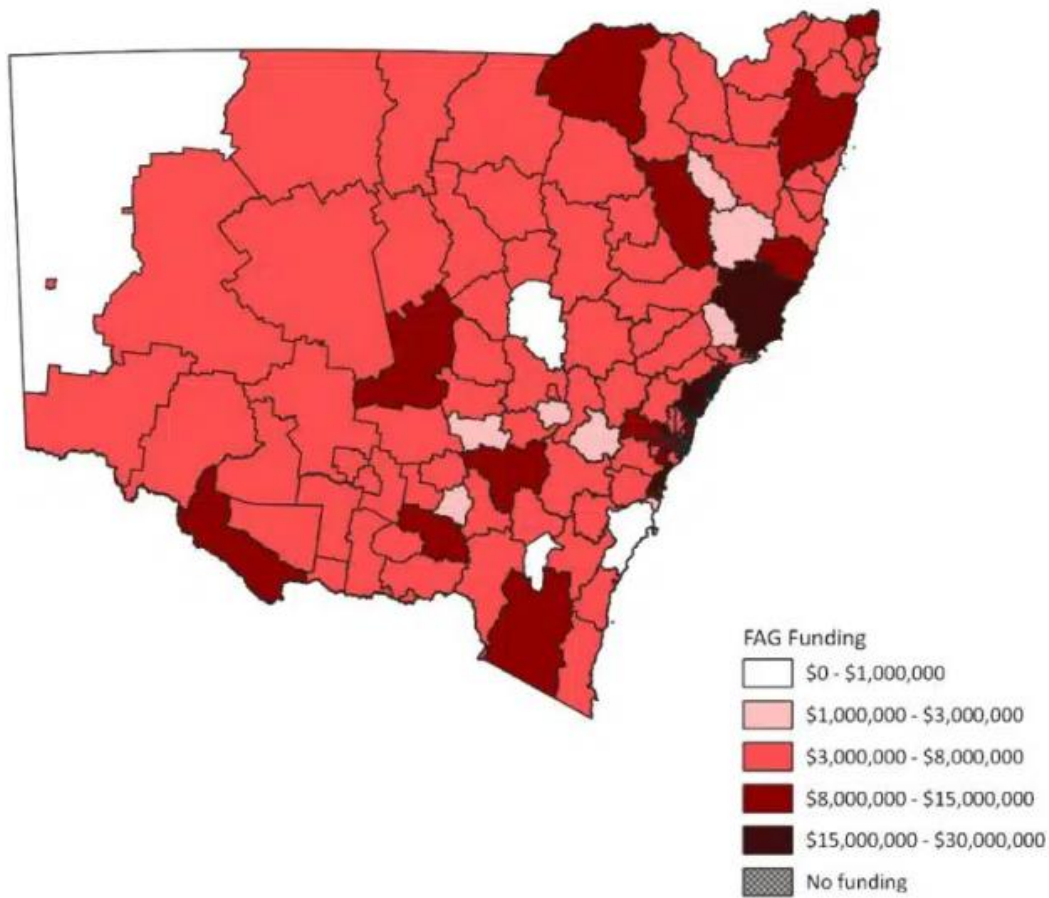
⁸ NSW Local Government Grants Commissions, (2021), *Annual Report 2020-21*, Office of Local Government

previous councils for the next four years. The identified road component will be recalculated based on length, type and usage of roads in the new local governing boundaries.

The national principles of the identified road component are based on the required road expenditure to preserve road assets. This is done through a needs assessment which considers the length, type, and usage of roads in each local governing area.

Figure 8 outlines the distribution of FA Grant funding for New South Wales councils in 2021.

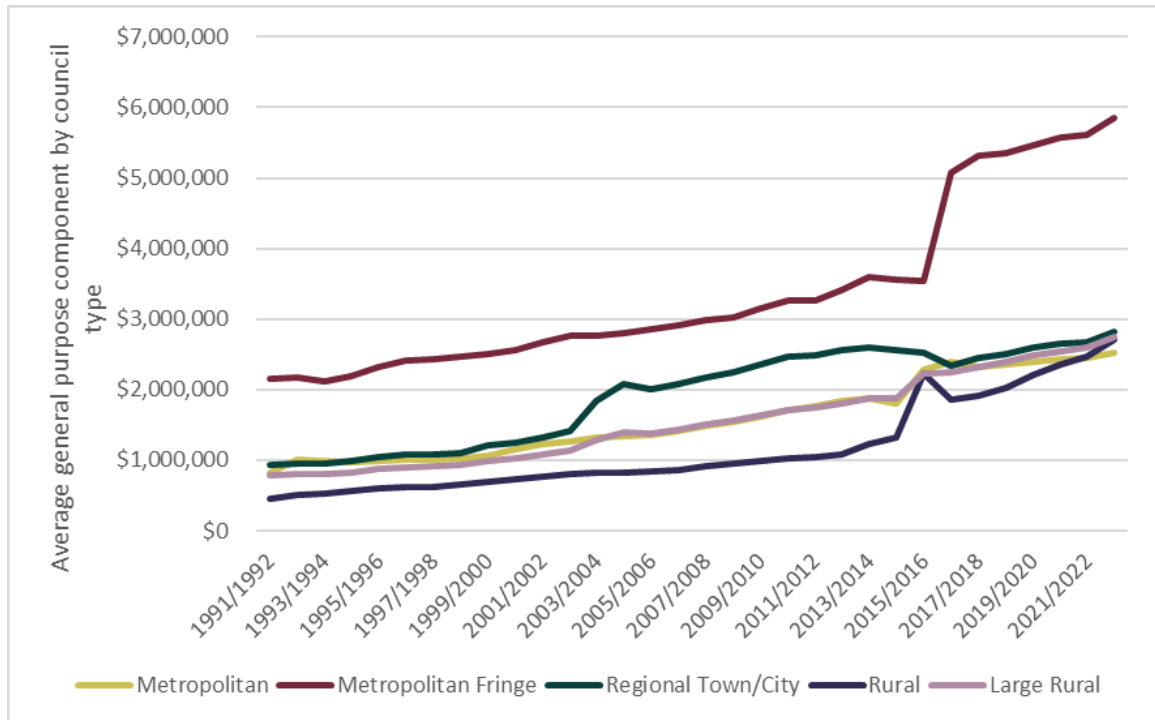
Figure 8: Distribution of FA Grant funding (\$), NSW 2021



Source: SGS Economics and Planning (2022)

On a per council basis, rural and large rural councils have consistently received lower general purpose component amounts (untied) compared to other council types over the last three decades (Figure 9). On a per capita basis, however, rural and large rural councils receive higher allocations. The increase in general purpose component allocation for metropolitan fringe, metropolitan and rural councils is a result of council amalgamations which reduced the total number of councils across NSW, increasing the funding per council by effect.

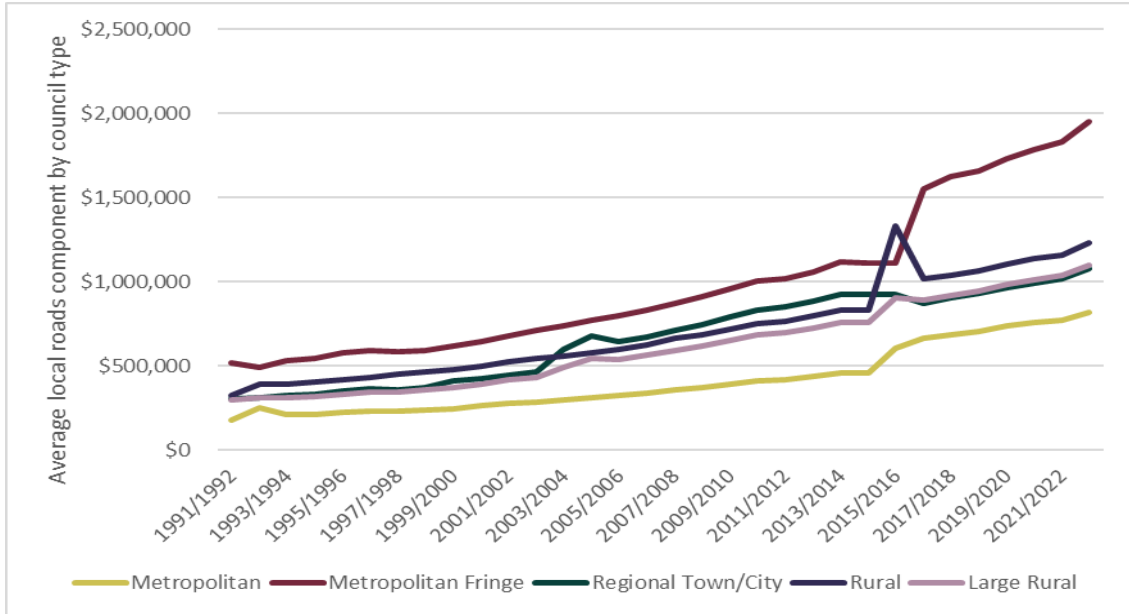
Figure 9: Average per-council General Purpose Component allocation, 1991-92 to 2022-23



Source: SGS Economics and Planning (2024), Office of Local Government NSW (1991-23).

An analysis of the local roads component of the FA Grants by remoteness shows that on average, metropolitan councils receive the lowest allocation than their regional and rural counterparts, while metropolitan fringe councils received the highest amounts (Figure 10). Note that this analysis does not include the Roads to Recovery (R2R) funding.

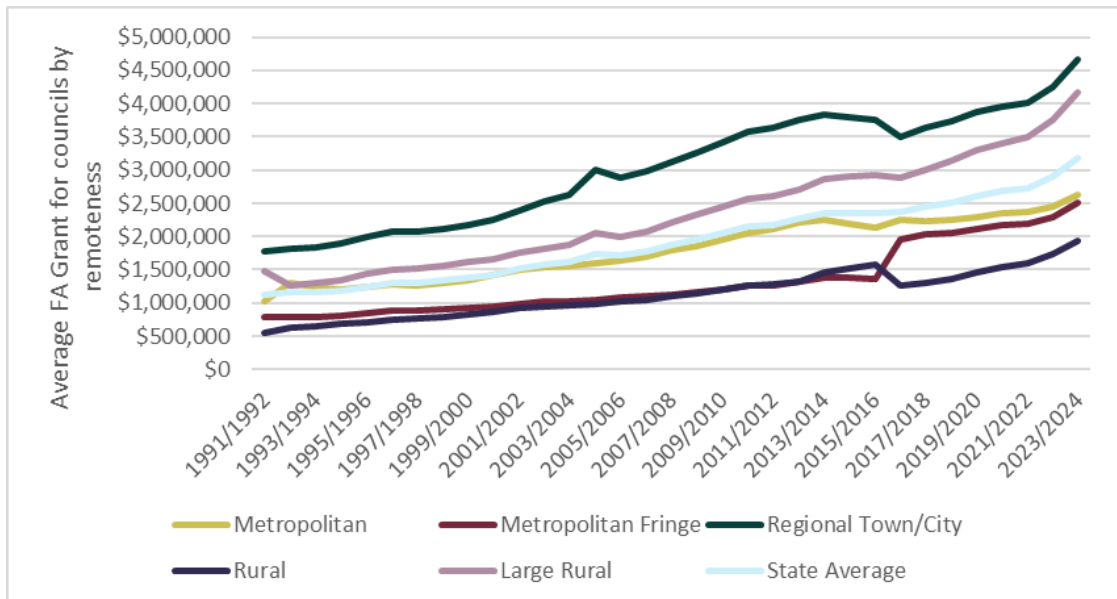
Figure 10: Average per-council Local Roads Component allocations, 1991-92 to 2022-23



Source: SGS Economics and Planning (2024), Office of Local Government NSW (1991-2023).

On average, regional town/city councils have received the highest grant allocations over time (Figure 11). This is likely due to these areas consistently having the densest population compared to counterparts. The distribution of FA grants between council classifications reflects the unique characteristics of service and infrastructure delivery across the state. For example, large rural councils often face unique challenges in filling service gaps in areas of acute thin markets. However, it is important to note that the figure below shows average grant allocations by council classification and that there is also some variation between each classification.

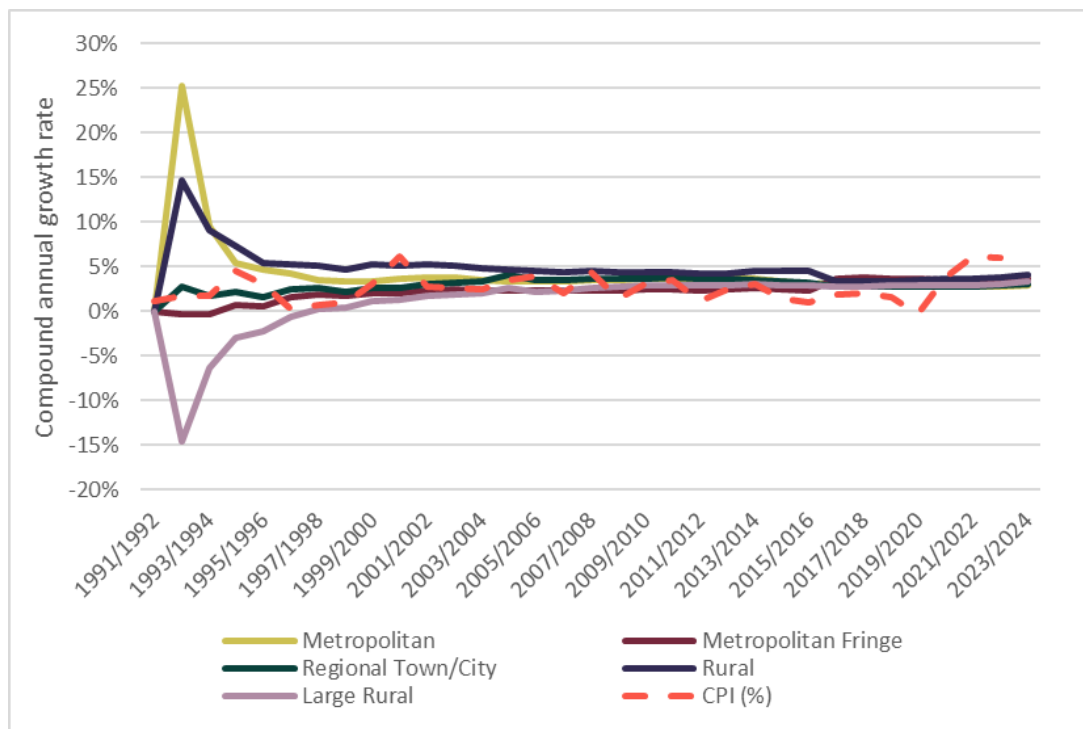
Figure 11: Average per-council FA Grant allocation (all components), 1991-92 to 2023-24



Source: SGS Economics and Planning (2024), Office of Local Government NSW (1991-2023).

In Figure 12, the FA Grants have generally aligned with CPI until 2021-22 which saw an increase in CPI and a lack of change of FA Grants funding.

Figure 12: Compound annual growth rate of FA Grants allocation (all components), 1991-92 to 2023-24



Source: SGS Economics and Planning (2024), Office of Local Government NSW (1991-2023), RBA (2024).

1.4 Limited scope and flexibility in NSW government grants

Councils have the ability to access grants from the NSW State Government to support in the delivery of infrastructure and services. These grants are most commonly tied grant arrangements that are delivered as desired by NSW government. As in other states and territories, reporting on these grants is inconsistent in NSW and is not separately detailed in financial statements. This makes comprehensive analysis of different grant components difficult to dissect.

As a proxy of tied grant funding and the change in quantum over time, the FA Grant amount per annum has been subtracted from the NSW's total grant transfers per annum. This will likely overstate the amount of funding allocated to local government as this includes grant transfers direct to community.

Figure 13 examines the average annual growth of these two grant components. It provides evidence that tied grant funding has grown since 2014-15, with an average annual growth rate of 38 per cent.

The quantum of FA Grants is more consistent due to their formula based allocation. In proportionate terms, FA grants are declining in value (refer to section 1.3). Between 2014-15 and 2022-23, FA Grants have only grown by 2 per cent per annum.

Figure 13: NSW growth in tied grant funding compared to FA Grant funding, 2005-23



Source: SGS Economics and Planning (2024), ABS (2024), Office of Local Government NSW (2024)

We note from a review of NSW grants to local governments that:

- There are limited grants available that can be used at the discretion of council, rather they are tied to specific outcomes and requirements that may not align with the community or council directions.
- Some grants, such as for libraries, are substantial in volume, e.g. the \$60 million boost for libraries over four years, announced in August 2018.⁹ Others, such as \$10 million Community Safety Fund and Screen NSW’s \$1 million in grants for organisations and councils to stage film festivals are smaller and more limited in nature. This can lead to councils delivering a service but unable to continue after the short timeframe unless additional sources of funding are identified.
- Grants are available for range of different infrastructure such as roads, water, open space, sport and recreation infrastructure, arts and cultural infrastructure, community infrastructure, EV infrastructure, community gardens, and disaster readiness infrastructure however most of this infrastructure has to be in addition to the existing capital works program.

⁹ LGNSW (2018), ‘Libraries’, <https://lgnsw.org.au/Public/Public/Policy/Libraries.aspx>

- The majority of infrastructure grants require a council contribution. This can result in councils inadvertently bringing infrastructure projects forward in order to access grants, meaning other equally or more meaningful projects are delayed or disrupted.
- Infrastructure grants can also result in councils having to increase the scope of the infrastructure project to align with grant requirements. This can lead to a more expensive infrastructure to build, operate, and maintain.
- Increased use of indemnity grants which require councils to engage contractors and spend funds upfront before claiming reimbursement, often resulting in disputes over work performed and significant delays in funding delivery. This style of grant funding also reduces participation of councils which do not have the capital to fund service delivery up front.

In order for State Government grants to be more effective, consideration should be given to:

- Infrastructure grants, that can be spent on any project across councils adopted capital works programs (this includes renewal and maintenance support) that are in alignment with NSW themes e.g. sport and recreation, community infrastructure, and roads. This will reduce the need for councils to bring in new projects throughout the year due to NSW funding, which then pushes back projects in adopted programs which are potentially a higher priority for the community and council.
- Increase funding in service and operational grants that are reoccurring over at least a two-to-three-year period. This ensures councils can employ appropriate staff, implement programs, and build in sustainability options.

1.5 Infrastructure cost recovery via development contributions

Development contributions are a key funding stream for local governments to ensure that future communities have adequate roads, drainage, community facilities, and open space. The main way that councils can collect community contributions is through Section 7.11 and 7.12 contributions. Section 7.11 provides a rate per development which is set by the State Government. This rate was set in 2012 and has not been indexed since. Councils can increase the rate per development, however to do this they must submit contribution plans to IPART for independent review.

Contribution plans are developed through council identifying the infrastructure that is required and an approximate cost to deliver this infrastructure. In theory, the contributions should cover the full cost of infrastructure that is required by that specific area. This however this is not occurring due to several factors.

- **Indexation:** As noted in the City of Sydney *Submission to Explanation of Intended Effect: Changes to Create Low-and Mid-rise Housing*, infill councils with section 7.11 contributions plans can collect a maximum of \$20,000 per dwelling (unless they submit their plans to IPART). This cap has not been indexed since 2012. Due to the shortfall in funding, the City of Sydney estimate that for every 3-bedroom dwelling constructed in the City where the Government's contributions cap applies, the City is subject to a contributions shortfall of between \$11,000 and \$20,000 per dwelling. For every

2-bedroom dwelling, the City is subject to a contributions shortfall of between \$2,000 and \$8,000 per dwelling.¹⁰

- **Review of infrastructure and costings:** While contribution plans have the opportunity to be reviewed, this is not occurring systematically or effectively. Contribution Plan No. 15 – Box Hill Precinct was recently reviewed by IPART. This review indicated that council had a funding gap of \$172 million, despite 71 per cent of development being approved and or delivered. IPART had reviewed this Plan four times prior in 2014, 2016, 2018, 2020. Despite these reviews, the Plan still resulted in a significant funding gap. It was noted in the review that since the 2014 plan was developed, infrastructure costs have risen from \$430 million to \$1 billion. This was in part due to changing of infrastructure types required and escalating infrastructure costs.

During previous IPART reviews, recommendations had been to provide an indicative contribution rate that reflects reasonable costs to deliver infrastructure in the precinct. Given the substantial gap in infrastructure funding, it could be argued that this method required more rigor. IPART also note that some of this funding gap will be alleviated as the population has significantly increased since 2014 (28,000 people to 49,000 people).

While IPART does consider how increased population relates to some infrastructure such as traffic loads, open space and drainage needs, the assessment process is slow and limited by an essential works list that does not fully reflect community needs. As a result, crucial infrastructure like libraries, community buildings and other enhancements beyond a basic level is excluded. This creates an inequitable and unaffordable burden on the community, which is expected to fund these additional services through the rate base.

For councils to achieve full proportionate cost recovery, three key risks must be addressed: the mismatch of infrastructure delivery and development timing; the risk of market take-up not matching forecasts; and land and infrastructure cost escalations. To mitigate these risks, in setting infrastructure charges Councils should be empowered to:

- Consistently apply the Net Present Value (NPV) method in calculating contributions, based on constant prices and a real discount rate, with the resultant charges being adjusted annually according to an appropriate escalation index. It is noted that some councils already do this.
- Use a higher discount rate than that advised by IPART to account for the riskiness of these investments from council's perspective. We suggest 5 per cent real for most calculations.
- Segment project and land acquisition into groups based on commonalities in cost escalation factors. Apply appropriate customised escalation indices (in addition to land indices) in subsequent operation of the infrastructure charges policy.
- Define charge areas and plan horizons on the basis that build out will be complete within, say, 15 years, based on the principle that relying on development contribution receipts beyond this timeframe is unduly risky for councils making forward investments in infrastructure.

¹⁰ City of Sydney, 2024, Submission on the NSW Government Changes to Create Low and Mid-Rise Housing

- Applying a further risk premium in the discount rate, taking it to 7 per cent real, in circumstances where councils must incorporate infrastructure projects where significant usage will be generated by development beyond 15 years.

Furthermore, to support councils that do not have a contributions plan, the state government contribution rate cap, which has not been updated since 2012, should be reviewed and increased annually considering both the Producer Price Index (PPI) and the Consumer Price Index (CPI).

2. Review of rate peg and local government costs

In NSW, the practice of tying permissible increases in general income to a rate peg percentage has attracted critique throughout the almost five decades since it was first introduced in 1977. At the time, the social, economic, and political landscape was markedly different: council rates had, on average, increased by 188 per cent between 1973 and 1976 compared to a 75 per cent in average weekly earnings and an inflation rate of 56 per cent.¹¹

The purpose of the rate peg is twofold:¹²

- To allow councils to automatically increase their rates income each year to keep pace with the estimated change in the costs of providing their current services and service levels to households, businesses, and the broader community (base costs)
- To limit the impacts of automatic increases on ratepayers, by ensuring that councils cannot increase their rates income by more than the estimated change in their base costs (unless they undertake community consultation as a requirement of applying to IPART for a special variation to the rate peg).

Whether these objectives are fulfilled in practice depends on how the rate peg is set, and the degree to which it meets the needs of councils and their communities. This was recently the focus of the Independent Pricing and Regulatory Tribunal's 2023 review of the rate peg methodology, which led to the development of a new rate peg methodology for the 2024-25 financial year.¹³

2.1 Rate peg methodology

Historically, the rate peg was based on the Local Government Cost Index (LGCI) which measures price changes experienced by councils. For example, increases in employment and construction costs, and decreases in telecommunications, information technology, and energy costs.

From July 2022, the NSW Government introduced a population growth factor in the annual rate peg. In effect, councils with growing residential populations could raise notional general income by an additional population factor.

¹¹ Dollery, B. E. (2009). Rate-pegging in New South Wales local government. https://www.ipart.nsw.gov.au/sites/default/files/documents/submission_-_review_of_the_revenue_framework_for_local_government_-_university_of_new_england_-_11_august_2009_-_website_submission.pdf

¹² IPART (2023), 'Review of the rate peg methodology', https://www.ipart.nsw.gov.au/sites/default/files/cm9_documents/Final-Report-Review-of-the-rate-peg-methodology-August-2023.PDF

¹³ Ibid.

The core rate peg (before the population factor) for each council is based on:¹⁴

- The Base Cost Change (BCC) by council group (metropolitan, regional, rural). The BCC replaces the LGCI to better reflect actual costs,
- A catch-up adjustment for past changes in the superannuation guarantee rate,
- A separate Emergency Services Levy (ESL) factor, lagged by one year, to reflect annual change in each council's ESL contribution. This would eliminate the need for local government to bear the shortfall in forecasted and actual costs until the levy is adjusted.
- Where applicable, a council-specific adjustment in the rate peg for the 2024-25 financial year to reflect the increase in ESL when increases were not captured by the rate peg because they were subsidised by NSW Government.

Councils also receive a population factor, which maintains the amount of rates collected per person in growth areas. For the 2024-25 financial year, the population factor includes:

- An annual population factor to adjust for residential population changes (excluding prison populations) from 2020-21 to 2021-22,
- A population true-up based on 2021 ABS Census of Population and Housing data.

Figure 14 shows that the rate peg has increased following the introduction of the population factor. A comparison of average rate pegs for different council groups indicates that metropolitan councils have the highest average rate peg (5.2 per cent), followed by regional (4.9 per cent) and rural councils (4.7 per cent).

¹⁴ IPART (2023), 'Rate peg for NSW councils for 2024-25', https://www.ipart.nsw.gov.au/sites/default/files/cm9_documents/Information-Paper-Rate-peg-for-NSW-councils-for-2024-25-21-November-2023.PDF

Figure 14: Rate peg percentage, 2005-06 to 2024-25



Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22).

2.2 The past rate peg is poorly aligned with operational and capital costs

Between 2012-13 and 2021-22, compound annual growth in council expenditure (ranging from 4-7.3% depending on council type) outpaced growth in the rate peg percentage (-6%) (Table 4). The *annual* change in council costs shown below illustrates the volatility year on year that councils contend with when forecasting and budgeting for the future. The rate peg imposes another layer of uncertainty in the financial outlook.

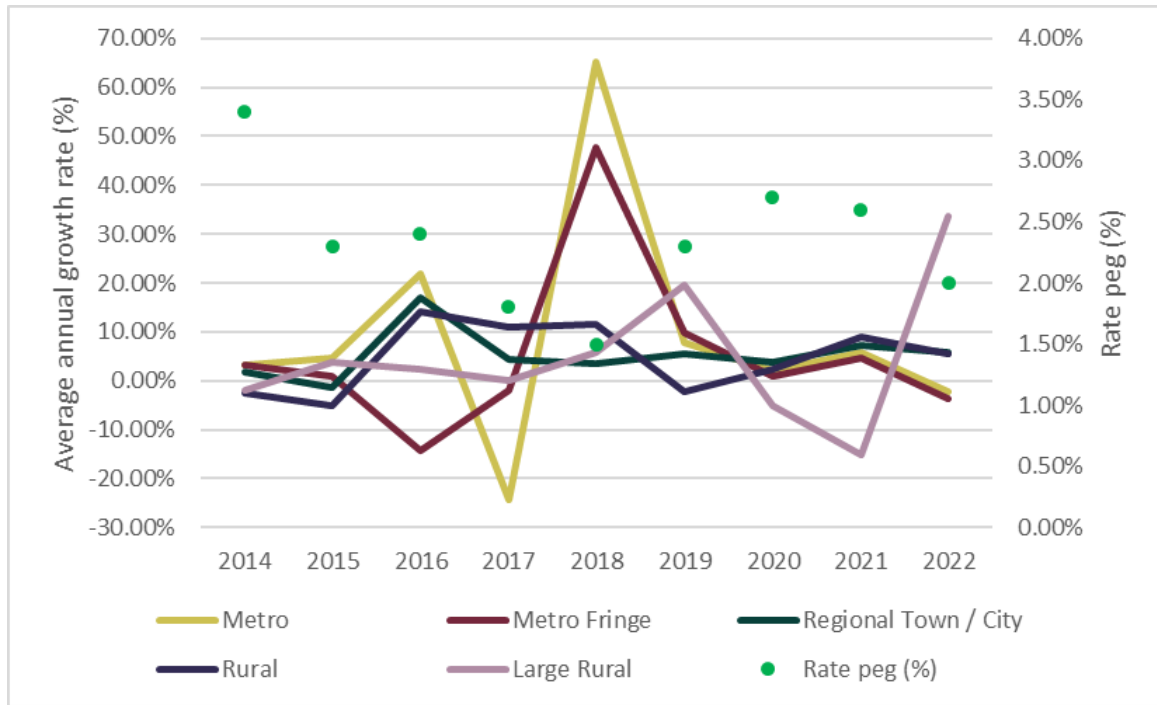
Table 4: Annual change in total council expenditure (operational plus capital), 2013-14 to 2021-22

Council type	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	CAGR 2012-13 to 2021-22
Metro	3.1%	4.8%	21.9%	-24.2%	65.2%	7.7%	2.0%	5.9%	-2.1%	7.3%
Metro Fringe	3.1%	0.9%	-14.3%	-1.8%	47.7%	9.7%	1.0%	4.8%	-3.7%	4.2%
Regional Town / City	1.9%	-1.5%	16.9%	4.4%	3.6%	5.5%	3.8%	7.3%	5.7%	5.2%
Rural	-2.5%	-5.2%	14.0%	11.1%	11.6%	-2.3%	2.3%	9.1%	5.4%	4.6%
Large Rural	-2.0%	3.7%	2.5%	0.1%	5.9%	19.7%	-5.1%	-15.1%	33.7%	4.0%
NSW average	0.7%	0.5%	8.2%	-2.1%	26.8%	8.1%	0.8%	2.4%	7.8%	5.1%
Rate peg (%)	3.4%	2.3%	2.4%	1.8%	1.5%	2.3%	2.7%	2.6%	2.0%	-6%

Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22). Notes: Figures exclude councils which have missing data (i.e. only councils with both operational and capital expenditure information available were included). Actual rate peg percentage is displayed rather than annual growth.

Figure 19 graphs the annual change in total expenditure against the rate peg for the period. For metropolitan fringe councils, there appears to be an inverse relationship between annual change in total expenditure and the rate peg. This suggests that when a low rate peg, is in place total expenditure across councils is decreases, with implications for a reduction in the scope and/or quality of service delivery.

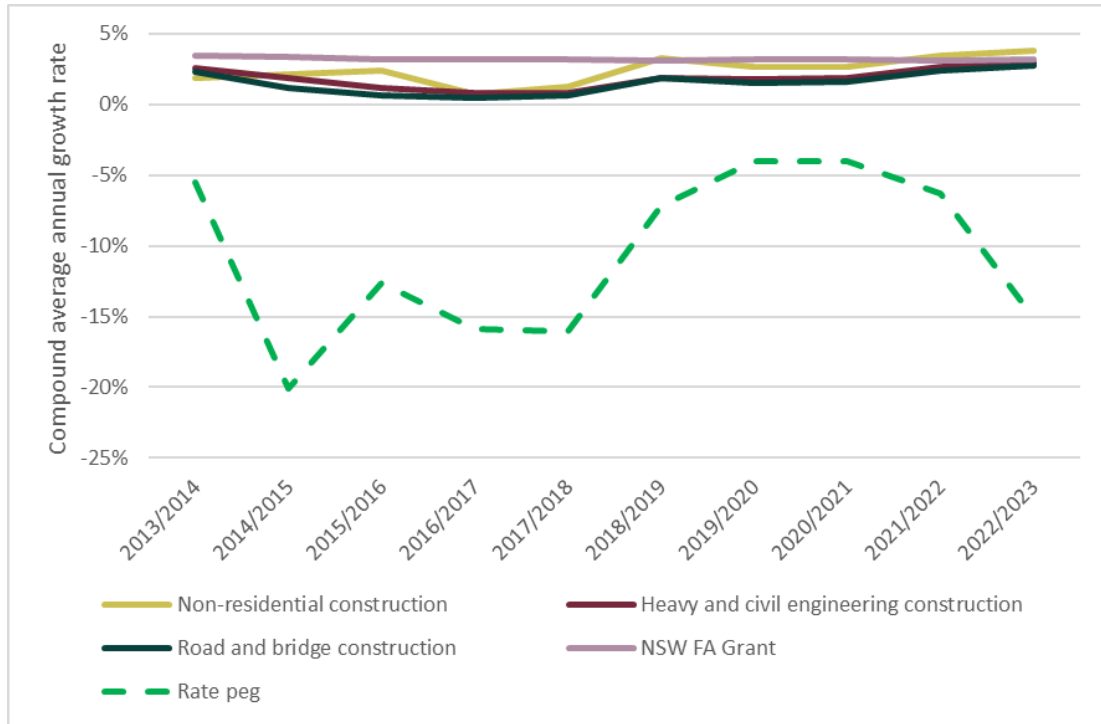
Figure 15: Annual change in total council expenditure (operational plus capital), 2014-22



Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22). Notes: Figures exclude councils which have missing data (i.e. only councils with both operational and capital expenditure information available were included). Actual rate peg percentage is displayed rather than annual growth.

An analysis of the Producer Price Index, a measure of the price change of goods and services from the perspective of the producing industry, shows a compounding escalation of construction costs in the decade to 2022-23 in NSW (Figure 16). The long-term trend is one of upward price changes in construction costs for non-residential building, roads and bridges, and heavy and civil engineering. This was occurring even before 2020, material costs and supply chain issues were widespread in the wake of the COVID-19 pandemic. The compound annual growth rate of these components of the Producer Price Index exceeds the long-term growth trend in the rate peg percentage, which sits around -5 per cent by 2018-19 onwards.

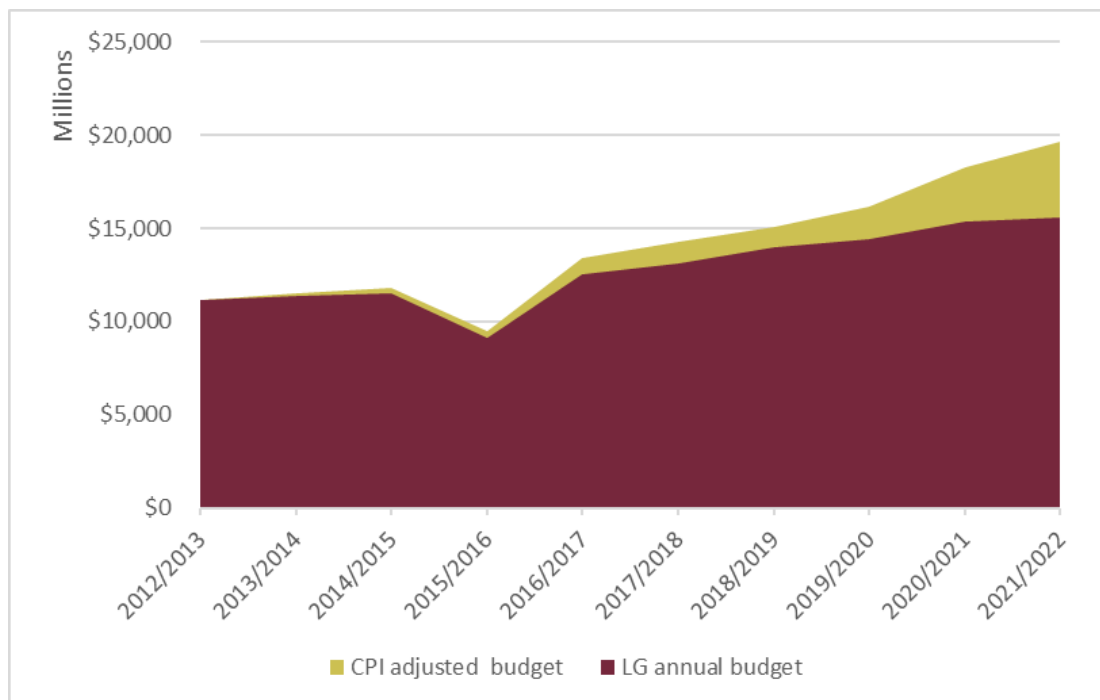
Figure 16: Compound annual growth rate of Producer Price Index and FA Grant vs rate peg, NSW, 2013-14 to 2022-23



Source: SGS Economics and Planning (2024), ABS (2024). Notes: For heavy and civil engineering construction data, figures shown are for Australia as it is available at the national level only. The compound annual growth rate is more volatile in the early years, due the calculation being based on year on year change, and smoothens to the longer-term trend by around 2018-19 at approximately -5 per cent.

Figure 17 envisages a high-level scenario where council expenditure grows in line with the CPI, assuming councils could adjust rates to match CPI growth. By comparing actual expenditure with CPI-adjusted expenditure, this can identify the shortfall in funds that councils have experienced due to rate peg restrictions. This shortfall, or rate peg deficit, is the result of consistently setting rate pegs too low to accurately reflect costs. As of 2022, the difference between actual expenditure and cost-escalated expenditure exceeds \$4.08 billion.

Figure 17: Comparison of local government budgeted total expenditure against CPI escalated expenditure



Source: SGS Economics and Planning (2024), ABS (2024), Office of Local Government NSW (2012-22)

2.3 The past rate peg has lagged wages and CPI growth

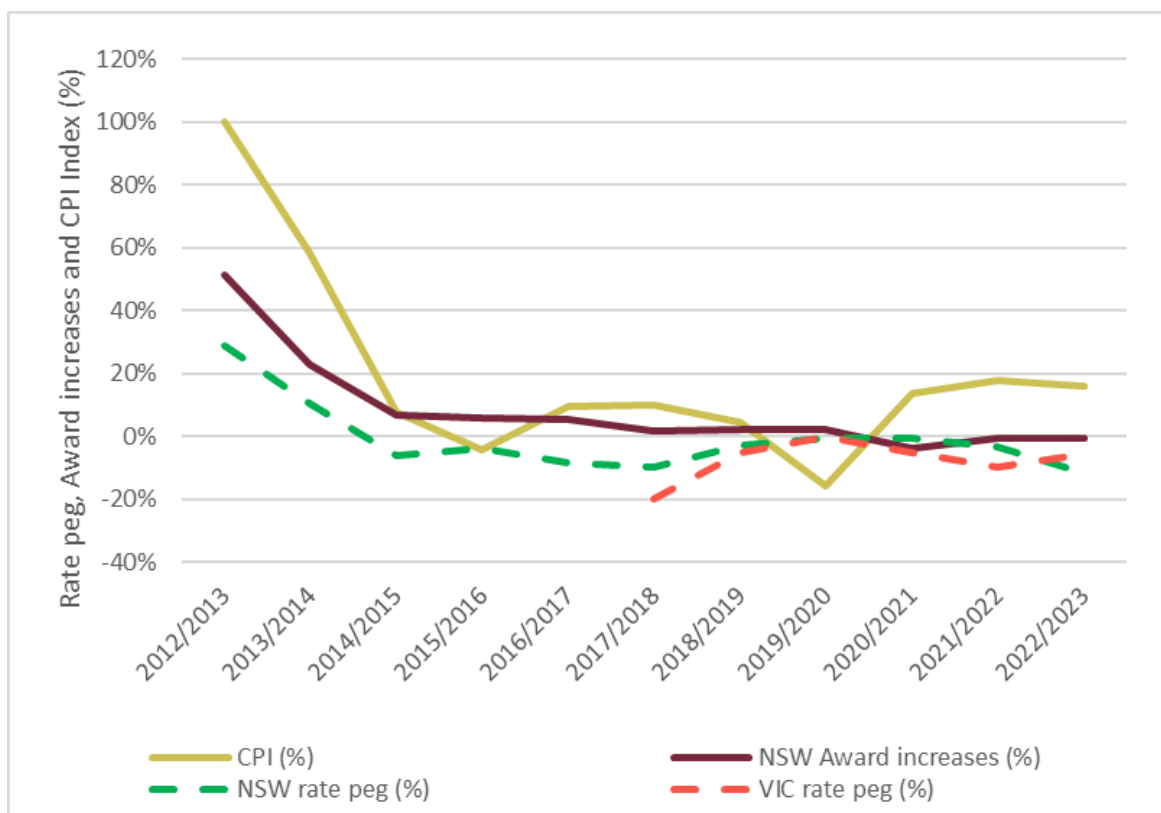
Figure 18 shows that compound annual growth in the NSW rate peg lagged the growth in the CPI and award rate increases.¹⁵

In the decade to 2023, the compound annual growth rate for local government awards decreased by 0.66 per cent, while inflation has increased by 15.76 per cent. However, it should be noted that it has been skewed by extremely low and high inflation levels in 2019-20. Meanwhile, NSW’s rate peg percentage declined at by a compound average growth rate of 11.8 per cent over the last decade.

Victoria introduced rate capping in 2016 so its compound average growth rate has been calculated from 2017-18 to 2022-23. Across this time period, Victoria has seen a decrease in the rate peg by 5.8 per cent.

¹⁵ While road and bridge construction is often a major cost factor for councils, the ABS only reports the Road and Bridge Construction Price Index back to 2020. The index has also grown more slowly compared to the CPI.

Figure 18: Compound annual growth rate of NSW award increases vs CPI vs NSW and VIC rate peg, 2012-13 to 2021-22



Source: SGS Economics and Planning (2024), LGNSW (1995-2023), RBA (2024)

2.4 The past rate peg exacerbates existing maintenance expenditure shortfalls

Local governments are responsible for 90 per cent of roads in NSW, with cost components including the construction and maintenance of roads, footpaths, and cycleways.¹⁶ Ensuring councils can maintain existing infrastructure to appropriate standards ensures councils can get the greatest life out of their assets, the community have good quality infrastructure, and all safety considerations have been met.

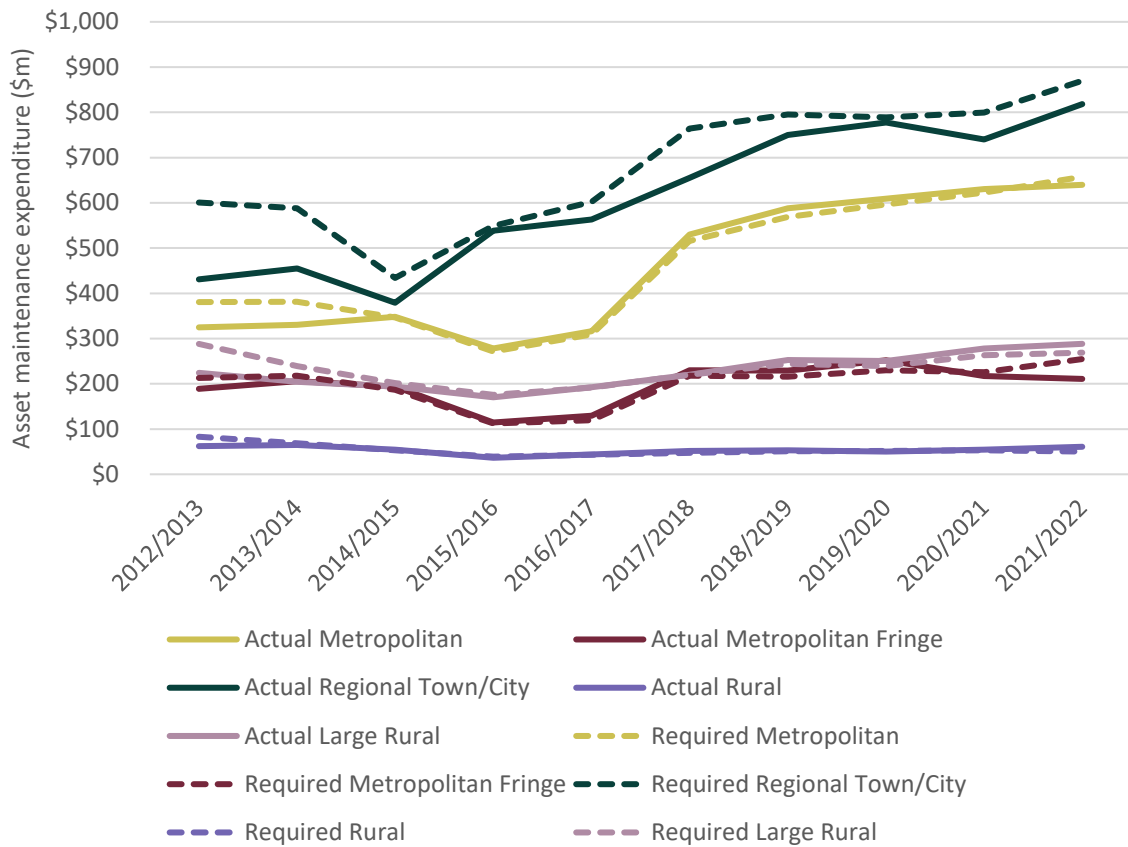
In 2021-22, approximately half of all NSW councils recorded a shortfall in the maintenance expenditure ranging from \$32,000 to \$46.8 million. A total of 9.4 per cent of all NSW councils reported a shortfall greater than \$5 million (compared to 4.6% in 2020-21)¹⁷. If councils are unable to keep up with actual asset maintenance costs, there is a risk that assets will fall into disrepair. Evidence of these impacts are further discussed in section 3.1.

¹⁶ LGNSW (2023), 'LGNSW Submission 2023-2024 State Budget – NSW Local Government Priorities July 2023', https://lgnsw.org.au/common/Uploaded%20files/Submissions/2023/LGNSW_Draft_Submission_2023-2024_State_Budget_Priorities.pdf

¹⁷ NSW Office of Local Government (2024), 'Assets', <https://www.yourcouncil.nsw.gov.au/nsw-overview/assets/>

A breakdown of actual and required asset maintenance expenditure by council type highlights that regional town/city councils are experiencing the largest dollar value shortfall in maintenance expenditures (Figure 19). In 2021-22, regional town/city councils had the largest aggregate shortfall of \$51.6 million, followed by metropolitan fringe councils (\$43.5 million) and metropolitan councils (\$17.6 million).

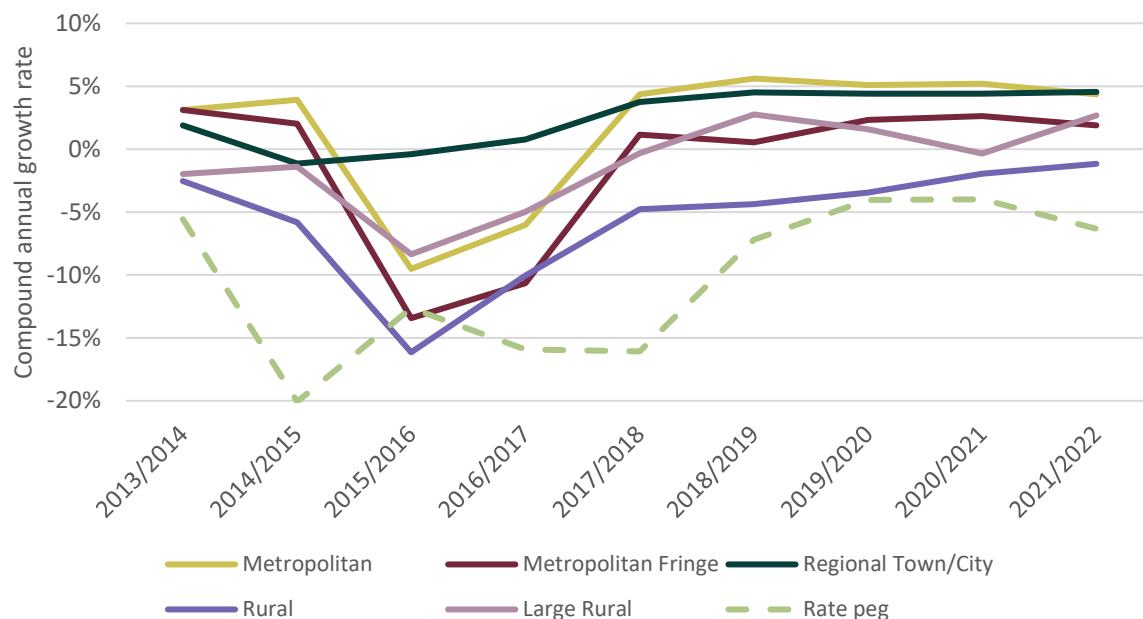
Figure 19: Actual vs required asset maintenance expenditure by council classification, 2012-13 to 2021-22



Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22). Note: OLG data does not compound shortfalls year to year, therefore shortfall gaps may be understated.

A comparison of the growth rate in required asset maintenance expenditure and the rate peg from 2012-13 to 2021-22 shows that overall, the required costs of asset maintenance has grown at a faster rate than the rate peg.

Figure 20: Growth rate in required asset maintenance expenditure vs rate peg, 2012-13 to 2021-22



Source: SGS Economics and Planning (2024), Office of Local Government NSW (2012-22), RBA (2024). Note: The compound annual growth rate is more volatile in the early years, due the calculation being based on year on year change, and smoothens to the longer-term trend by around 2018-19 at approximately -5 per cent.

2.5 The past rate peg exposes a spatial divide in the types and costs of services

There is variation across NSW in the types and costs of services provided by councils. Yet the rate pegging system does not account for the unique context of each council and their specific financial challenges. Councils in non-metropolitan NSW provide water and sewerage services. The funding mechanisms for these services vary significantly across LGAs, affecting the financial sustainability and service quality. The recent Parliamentary inquiry into Urban Water Infrastructure highlighted disparities in the condition of water and sewerage assets, including a large portion of water-related infrastructure in NSW reaching the end of its useful life.¹⁸

An analysis of recent water and sewage service expenditures suggests divergent trends: rising expenditures in large rural councils and declining expenditures in rural councils. In the year to 2019-20 and 2021-22, growth in service expenditure for these services exceeded the rate peg (Table 5, Table 6).

¹⁸ Parliament of New South Wales, (2024), *Inquiry into Urban Water Infrastructure*, <https://www.parliament.nsw.gov.au/committees/inquiries/Pages/inquiry-details.aspx?pk=1827>

Table 5: Average per-council expenditure on water supply services (year on year growth), 2018-19 to 2021-22

Council classification	2019-20	2020-21	2021-22
Large Rural	9.6%	1.2%	6.1%
Rural	7.6%	-10.0%	1.3%
Rate peg (%)	2.7%	2.6%	2.0%

Source: SGS Economics and Planning (2024), Office of Local Government NSW (2019-22).

Table 6: Average per-council expenditure on sewage services (year on year growth), 2018-19 to 2021-22

Council classification	2019-20	2020-21	2021-22
Large Rural	6.5%	-6.4%	14.6%
Rural	14.5%	-8.0%	-9.7%
Rate peg (%)	2.7%	2.6%	2.0%

Source: SGS Economics and Planning (2024), Office of Local Government NSW (2019-22).

The current rate peg system, which applies a uniform index across councils, fails to consider these local cost differences. As transportation and infrastructure maintenance cost rise with distance, councils situated further from urban areas face higher expenditures. The move towards setting rate peg individually to each council could better address these local financial pressures, ensuring a more equitable and accurate allocation of resources.

3. Social and economic impacts of the rate peg

This chapter examines the social and economic impacts of the rate peg imposed on NSW councils, summarising evidence from the literature. As noted by a recent study of the Victorian rate capping administration, the idea that ‘services will be improved if local governments are fiscally disciplined by the State government is not only counterintuitive but also refuted by empirical data’.¹⁹ The symbiosis between local authorities and their communities means that what is felt by councils, in terms of risks to long-term financial sustainability, exerts ripple effects on the efficient functioning and wellbeing of the wider community.

It is widely acknowledged that councils often serve as the ‘provider of last resort’, stepping in to deliver essential services and infrastructure when the market fails. For many councils, this has steadily become the norm rather than the exception. Cost shifting from other tiers of government, population change and changing community expectations, as well as major social and economic shocks interact to create a challenging operating environment for the sector. The social and economic costs of constrained workforce capacity at the council level compound at the sector and economy level. These impacts include: absenteeism, high turnover, lower productivity as well as longer-term medical, legal, and insurance costs.

No doubt, local governments are not alone in their experience of these macro-economic forces. However, perhaps more than any other sector, Australian councils are unique in the sheer breadth of their services delivered (and by extension their workforce skills and occupational requirements) as well as the physical and economic geographies of their communities. Therefore, the goal of supporting the financial sustainability in all councils is central to the premise of a more equitable nation.

3.1 Impacts to ratepayers

Service cuts, reduced service scope and compromised quality

Fiscal pressures impact council services in several ways. Faced with uncertain or declining budgets, councils may reprioritise which services are delivered and/or reduce service scope. Impacts to service quality also arise when budgets fail to support service standards. The extent and duration of these impacts will vary from council to council. Areas with thin markets or poorer service distribution will be among those who are least able to recover and remain resilient to financial pressures.

The evidence from Australia councils and their international peers suggests that rate pegging – and risks to financial sustainability more generally – impacts a range of services in community. These are services

¹⁹ Nahum, D. (2021). Putting a cap on community. https://futurework.org.au/wp-content/uploads/sites/2/2022/11/ASU_Rate_Caps_Report_Final.pdf

needed by young and old, across all income groups, and in urban and regional areas to enjoy basic quality of life and support healthy human development from one generation to the next:

- In NSW, councils like Georges River reduced staff by 11 FTE across services such as libraries, community events and community development programs.²⁰ SGS Economics and Planning has calculated that if councils were unable to maintain these service provisions due to service cuts, this would result in a net decrease in community welfare by approximately \$73.10 per adult each year.²¹
- Warren Shire Council's recent submission to Parliament stressed that 'the pressure on council to continue to provide services of appropriate standard to [the] community is now extraordinary'.²² The council also noted that there were 'no more creative solutions to address the financial constraints from rate puffing, except reductions in levels of service, poor condition ratings of assets, and higher risks in regard to public liability insurance actions'.²³

In other jurisdictions, the impacts include:

- Aged care and disability services – The essential services commission report on the outcomes of rate capping in Victoria found that expenditure per person decreased by \$4.90 on aged and disability services as most councils either ended or reduced their provision, relying instead on private market providers.²⁴ For councils that maintained the service provision, the required infrastructure renewal to deliver the service in line with community expectations was not met due to constrained finances.²⁵
- Children's and special educational needs services – In the UK, State budget cuts have resulted in taxpayers paying higher rates for fewer services, leisure centres, special educational needs provision and adult social care.²⁶ In Victoria, rate capping has resulted in closure of council-run kindergarten centres, increasing reliance on not-for-profit and private suppliers to minimise council costs.²⁷
- Library services – Public Libraries Victoria outlined that rate capping in Victoria directly impacted future budget considerations with many libraries having to reduce scope of community services. This included reduced opening hours and reduced expenditure on library collections.²⁸

²⁰ Georges River Council (2021), *Extraordinary Council Meeting*, Available online:

https://www.ipart.nsw.gov.au/sites/default/files/cm9_documents/Attachment-8-Extraordinary-Council-Meeting-Agenda-08-Feb-2021.PDF

²¹ SGS Economics and Planning, (2023), *The Health and Wellbeing Benefits of Public Libraries Across Victoria*, available online: <https://sgsep.com.au/projects/the-health-and-wellbeing-benefits-of-public-libraries-across-victoria>

²² Warren Shire Council (2024), 'Submission to inquiry into ability of local governments to fund infrastructure and services', <https://www.parliament.nsw.gov.au/lcdocs/submissions/85456/0030%20Warren%20Shire%20Council.pdf>

²³ Ibid.

²⁴ Essential Services Commission, (2023), *The Outcomes of Rate Capping*, Essential Services Commission.

²⁵ Legislative Council Environment and Planning Committee, (2015), *First report into rate capping policy*, Parliament of Victoria.

²⁶ Pufky, J., (2024), *LGiU Response: Spring Budget 2024*, LGiU UK

²⁷ Booker, C., (2021), *Rate rise cap pushes councils to crimp services, cut jobs, report says*, The Age, available online: <https://www.theage.com.au/politics/victoria/rate-rise-cap-pushes-councils-to-crimp-services-cut-jobs-report-says-20211214-p59hch.html>

²⁸ Public Libraries Victoria, (2015), *Local Government Rates Capping and Variation Review*, Public Libraries Victoria Network.

Demand for many of these services also shifts in line with macro-economic conditions. Periods of high unemployment may coincide with increased demand for employment-related services, library access, and community services such as food programs and referral support. Councils need to be able to adapt service delivery and respond to community needs, however require adequate funds to be able to do this.

Delays to infrastructure delivery and deferred maintenance

Rate pegging impedes the flexibility of local governments to manage the high and irregular costs of infrastructure investment and delivery. Rate pegging also leads to deferred or sub-optimal maintenance in the short-term. This compounds over the longer-term in the need for more urgent or significant replacements (see next section for discussion on asset renewal ratios).

Instances of shortfalls in capital investment, deferred maintenance, and other infrastructure impacts from rate pegging include:

- Ongoing investment and maintenance shortfalls in Victoria, impacting public open spaces, historic buildings, tourist pathways, trails, and local roads.²⁹
- UK councils increasingly engaging in asset sales as a means to raise funding, despite this being unsustainable as a 'one-off, short-term measure which ultimately affects future service delivery and does not address the structural funding issues'.³⁰
- In NSW, rate pegging has contributed to a shortfall in maintenance expenditure. In 2021-22 62 NSW councils reported a shortfall in maintenance expenditure ranging from \$32,000 to \$46.8 million. The total amount of shortfall report was \$201 million.³¹

A recent report by RMIT University considered the costs and benefits of early provision of active (combined with public) transport options in growth suburbs as an alternative to car-based travel. The study found that 'even though the cost-benefit ratios between different timeframes of delivery do not differ to a large extent, early delivery provides better returns in absolute numbers'.³² The authors also noted that early delivery expands the timeframe that community members enjoy non-car based travel, which for some individuals is key to civic participation and access to services.

²⁹ Municipal Association of Victoria (2019), 'MAV Submission to the Victorian Local Government Rating System Review', https://www.mav.asn.au/__data/assets/pdf_file/0011/24140/Submission-from-MAV-to-Rating-System-Review-1-November-2019.pdf

³⁰ LGiU (2024), 'The State of Local Government Finance in England', <https://lgiu.org/wp-content/uploads/2024/02/State-of-Local-Government-Finance-in-England-2024.pdf>

³¹ Your Council, (2023), *NSW Overview*, NSW Government, available online: <https://www.yourcouncil.nsw.gov.au/nsw-overview/assets/#:~:text=Councils'%20infrastructure%20renewal%20ratios%20ranged,21%2D22%20was%20116%25>.

³² Kroen, A., Goodman, R., Gunn, L., & Pemberton, S. (2021). Early delivery of equitable and healthy transport options in new suburbs—Final report.

A backlog of asset renewal

Infrastructure is the largest component of councils' asset base, representing a net value of over \$176.3 billion of a total \$198 billion in assets owned and controlled by NSW councils.³³ The contribution of well-maintained and fit for purpose infrastructure to the prosperity, resilience, and productivity of communities cannot be understated. Moreover, councils are often involved at the frontlines of disaster recovery and restoration. Adequate levels of asset renewal are an important lever for safeguarding against future environmental disasters and other shocks.

Data from the NSW Office of Local Government shows on several infrastructure-related indicators, councils are falling behind (note that the analysis depends on the quality and completeness of asset data from councils). For example:³⁴

- Over 50 per cent of NSW councils exceed the recommended benchmark (2%) for the infrastructure backlog ratio. The state average was 4.2 per cent in 2021-22.
- The NSW average asset maintenance ratio increased from 102 to 104 between 2020-21 and 2021-22. This indicates that on average, NSW councils were investing sufficient funds to halt a growing infrastructure backlog. However, the picture differs at the sub-state level, with metropolitan and regional councils facing prospects of a growing backlog (both council types are assessed to have an asset maintenance percentage of 98; Table 7).
- Only 46 per cent of NSW councils had adequate funds to report a satisfactory building and infrastructure renewal ratio (i.e. greater than 100).³⁵ This indicates that majority of councils are not renewing assets at a fast enough rate resulting in greater depreciation.

³³ NSW Office of Local Government (2024), 'Council Assets 2021-22 (\$ billions)', <https://www.yourcouncil.nsw.gov.au/nsw-overview/assets/>

³⁴ NSW Office of Local Government (2024), 'Assets: NSW Overview', <https://www.yourcouncil.nsw.gov.au/nsw-overview/assets/#:~:text=The%20infrastructure%20backlog%20ratio%20shows,2%25%20is%20considered%20the%20benchmark.>

³⁵ NSW Government, (2022), *NSW Overview*, available online: <https://www.yourcouncil.nsw.gov.au/nsw-overview/assets/>

Table 7: State of infrastructure renewal and backlog in NSW, 2021-22

	State average	Metro councils	Metro fringe councils	Regional councils	Large rural councils	Rural councils
Backlog	\$43.5m	\$32.5m	\$40.5m	\$80.7m	\$27.2m	\$17.4m
Backlog per capita	\$688	\$211	\$258	\$1,269	\$2,619	\$5,838
Total required maintenance	\$16.4m	\$24.6m	\$26.4m	\$21.1m	\$9.5m	\$4.7m
Total actual maintenance	\$15.8m	\$23.4m	\$21.1m	\$19.9m	\$10.2m	\$5.3m
Maintenance under/over spend	-\$645k	-\$1.4m	-\$5.3m	-\$1.15m	\$657k	\$597k
Infrastructure backlog ratio	4.2	3.4	3.2	5.0	4.4	3.5
Asset maintenance ratio	102	98	101	98	104	117
Asset renewal ratio	113	99	78	105	114	173

Source: NSW Office of Local Government (2021-22). Note: Red-highlighted cells indicate performance below benchmark; green highlighted cells indicate performance above benchmark.

Notwithstanding these issues, some commentators have deemed the issue of infrastructure backlog to be ‘endemic to all Australian jurisdictions’, as not ‘comparatively more acute in NSW’, and requiring wholesale financial intervention that cannot be achieved through removing rate pegging alone.³⁶ In this regard, rate pegging is problematic not merely as a contributor but an aggravating factor to infrastructural delays and asset condition.

Lower protections from the impacts and costs of natural disasters

As the level of government closest to the community, councils play a crucial role in emergency management and disaster response, both in the immediate aftermath and in long-term recovery efforts. Before, during and after a disaster event, councils have a role in disaster mitigation, co-ordinating local emergency management, providing immediate relief and recovery assistance, and restoring essential services and infrastructure.

³⁶ Dollery, B., & Wijeweera, A. (2010). An assessment of rate-pegging in New South Wales local government. *Commonwealth Journal of Local Governance*, (6), 56-76. <https://epress.lib.uts.edu.au/journals/index.php/cjlg/article/view/1619/1752>

However, financial constraints limit a council's capacity to prepare for and respond to natural disasters. This could result in reduced investment in disaster mitigation and adaptation measures, reduced support for affected residents and businesses, and challenges in rebuilding critical infrastructure. An absence of streamlined response and preventative measures for natural disasters compounds the immediate and longer-term social and economic costs.

With an estimated 70 per cent of all Australians living in a flood- or storm-impacted council in 2022, there is a narrowing margin of financial flexibility for councils to respond to the impacts of these events. The costs of natural disasters to the Australian economy are estimated in the order of \$38 billion per year and is expected to increase with the frequency of climate events in the future.³⁷ Areas of North East NSW are also expected to experience some of the highest cost increases nationally.³⁸

Distortion of public expectations and perceptions of local government finance

Increasingly councils have found it necessary to pursue a special rate variation (SRV) due to financial challenges. Between 2002 and 2009, the proportion of NSW councils who submitted a SRV to increase income above the rate peg ranged from 13 to 30 per cent (23 to 46 councils).³⁹ However there have been instances in which councils have initiated the SRV process but faced significant community opposition, leading to withdrawals. This is evident from public submissions.⁴⁰

In 2023, only 17 councils applied for increases in rate income, of which 14 were fully approved and 3 partially approved.⁴¹ While these figures underscore the significance of SRVs in addressing council financial needs, Nevertheless, the relatively low rejection rate raises questions about the effectiveness of the rate peg itself, especially considering the variations are approved by the same regulatory body responsible for setting the initial rate peg.

There are a range of requirements that councils must demonstrate to IPART when applying for a SRV.⁴² These are outlined in section 4.3. Here, the discussion focuses on the potential impacts of the current SRV process. In theory, the mechanism offers councils a way to increase general income to finance local infrastructure and other projects. In practice, commentators point to a general reluctance among councils to apply due to:

- An onerous application process,
- A perception that exceeding the rate peg is risky for the concerns it may raise over fair distribution of rates impacts across community, and the financial management competence of councils, and

³⁷ Deloitte (2021), 'Special report: Update to the economic costs of natural disasters in Australia in 2021', <https://www.deloitte.com/au/en/services/economics/perspectives/building-australias-natural-disaster-resilience.html>

³⁸ Ibid.

³⁹ Dollery, B., & Wijeweera, A. (2010). An assessment of rate-pegging in New South Wales local government. *Commonwealth Journal of Local Governance*, (6), 56-76. <https://epress.lib.uts.edu.au/journals/index.php/cjlg/article/view/1619/1752>

⁴⁰ IPART (2023), 'Special Variations & Minimum Rates 2023-24', <https://www.ipart.nsw.gov.au/Home/Industries/Local-Government/Reviews/Special-Variations-Minimum-Rates/Special-Variations-Minimum-Rates-2023-24>

⁴¹ IPART (2023), 'Special Variations and Minimum Rates 2023-24', <https://www.ipart.nsw.gov.au/Home/Industries/Local-Government/Reviews/Special-Variations-Minimum-Rates/Special-Variations-Minimum-Rates-2023-24>

⁴² IPART (2020), 'Guidelines for the preparation of an application for a special variation to general income', https://www.ipart.nsw.gov.au/sites/default/files/documents/olg-guidelines-special-variation-2021-22_0.pdf

- Potential for inflated community expectations if the special rate is assumed to deliver ‘more’ rather than enabling councils to catch up to maintenance backlogs and maintain current service levels.

In its submission to IPART’s review of the rate peg methodology, LGNSW outlined that a latent effect of rate pegging – beyond the material effect of the rate peg itself – is to suppress the climate in which general income is regarded as essential to council functions and sustainability.⁴³

3.2 Impacts to council and council staff

Erosion of financial independence

Ensuring councils are supported to determine a path to long-term financial sustainability is crucial for building strong, resilient, and thriving communities across NSW. The financial sustainability of NSW’s 100 largest councils was previously examined as part of the IPART review of the Revenue Framework for Local Government.⁴⁴ The assessment found that 53 of these councils were either ‘unsustainable’ or ‘vulnerable’ based on the length of time by which their financial and infrastructure balances would be eliminated through annual increases in rates in excess of annual inflation.

The ability to levy rates through the form of a property tax are one of the few powers councils hold in order to generate internal revenue to deliver services. Furthermore, it is council’s main source of funding. Rate pegging therefore places a significant burden on councils when it comes to their ability to raise revenue in line with changing community demand for services and amenities. A vertical fiscal imbalance results, whereby councils are increasingly reliant on state or Commonwealth sourced funding which is often not reoccurring and or tied to specific requirements. Equally, the vertical funding pattern aligns only with the priorities of the Federal and State Governments, and not with council’s, as expressed through their mandatory adopted Community Strategic Plans (CSP’s) as part of their broader suite of integrated planning and reporting documentation.

Decreased staff morale and wellbeing

The financial health of councils has flow-on effects for workforce capacity and staff resourcing and wellbeing. Council staff who are not adequately supported to perform their roles with the right equipment, learning and development opportunities, or other resources are more likely to disengage from the workforce. Over time, this can lead to:

- *Challenges attracting and retaining appropriately skilled and qualified workers*, particularly if the remuneration on offer is not competitive by market standards. The NSW Local Government Workforce survey found that 96 per cent of survey respondents experienced between 1 – 27 per cent unplanned turnover as a proportion of total FTE. All respondents (over 91%) reported they

⁴³ LGNSW (2022), ‘Submission: IPART Review of the Rate Peg Methodology’, https://www.lgnsw.org.au/common/Uploaded%20files/Submissions/2022/Draft_Submission_IPART_Review_Rate_Peg_Methodology.pdf

⁴⁴ IPART (2009), ‘Final Report on the Revenue Framework for Local Government’, https://www.ipart.nsw.gov.au/sites/default/files/documents/final_report_-_revenue_framework_for_local_government_-_december_2009.pdf

were experiencing skills shortages and that 66 per cent of respondents stated that this impacted project delivery. A total of 76 per cent of local governments said they were running under staff complement, representing a range of 1-242 vacancies at the local government level.⁴⁵

- *Reduced opportunities for professional development*, due to limited budgets for facilitated training and appropriate mentorship, which has wider impacts for an individual's career progression. A total of 70 per cent of respondents from the workforce survey reported unmet training needs.
- *Increased workloads, higher levels of stress, burnout, and mental health issues*. This can also lead to higher Workcover costs for local government.

Contraction of the local government workforce

Approximately 61,000 staff are employed in local government alone, equating to approximately 1.4 per cent of NSW total employment.⁴⁶

Financial stress in organisations and even the presence of financial uncertainty negatively impacts employment in several ways. Where hiring budgets are reduced, councils face decisions about scaling down their operations in the short term. Local level impacts include the psychosocial toll of job loss for the individual and its effect on household financial stress along with workplace productivity.

At the regional scale, increased unemployment (particularly if council is a major employer in the region), reduced capacity for councils to deliver essential services and maintain infrastructure, and disruption to community cohesion can result. That is, the loss in local government jobs is not just felt individually but reverberates through the wider community, with reduction in money spent in local economies. In regional and rural areas, even subtle changes to the labour market can have lasting effects for local economies.

The Australia Institute has previously examined the link between public sector salaries and employment, finding that for every \$1 million dollar reduction in public sector wages, disposable income falls by approximately \$750,000. This loss in disposable income is estimated to result in a reduction of 1.34 direct jobs.⁴⁷

3.3 Jurisdictional comparison

Research has shown that in most other states and territories, councils have more autonomy in setting rates and charges than in NSW. Jurisdictions where councils are able to set their own rates are: Queensland, Tasmania, South Australia, Northern Territory, and Western Australia, however there are

⁴⁵ SGS Economics and Planning, (2022), *Local Government Workforce Skills and Capability Survey*, Australian Local Government Association

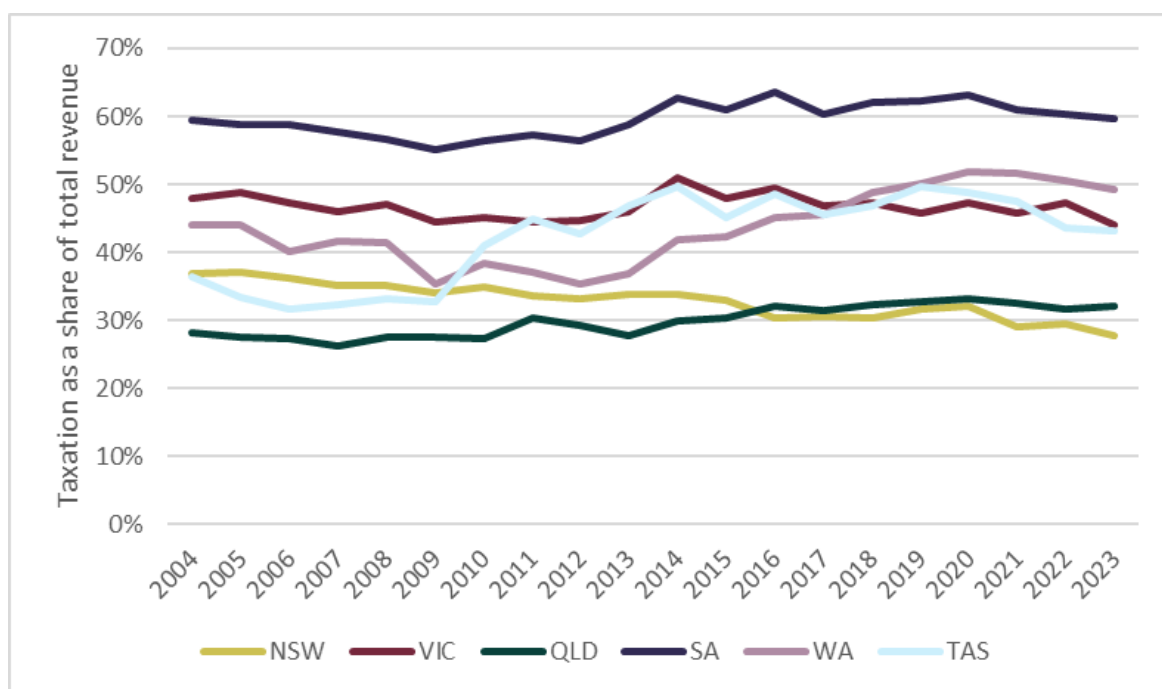
⁴⁶ ABS, (2023), *Public sector employment and earnings*, available online: <https://www.abs.gov.au/statistics/labour/employment-and-unemployment/public-sector-employment-and-earnings/latest-release#data-downloads>

⁴⁷ Denniss, R., Grudnoff, M. & Richardson, D., (2020), *The macroeconomic impact of NSW public sector pay cut*, Australian Institute, <https://australiainstitute.org.au/wp-content/uploads/2020/12/Macroeconomic-impact-of-the-NSW-public-sector-pay-cut-WEB.pdf>

often regulatory requirements and guidelines around the process of rates setting. In Victoria, rate capping was introduced in 2016 and is linked to the Consumer Price Index and other factors.

Figure 21 examines the share of taxation revenue against total local government revenue in each jurisdiction. Taxation revenue is defined solely as ‘taxes on property’ and does not represent total own-source revenue. It is evident that New South Wales, compared to other states, has experienced a long-term decline in taxation revenue. Across this analysis period, only New South Wales and Victoria, the two jurisdictions with rate restrictions, have experienced a decline in own source revenue by 9 per cent and 5 per cent respectively.

Figure 21: Local government share of taxation revenue against total revenue, 2005-23



Source: SGS Economics and Planning (2024), ABS (2024). Notes: NT is omitted from this analysis given its unique financial context compared to other jurisdictions.

The main empirical study of a jurisdictional comparison of rate pegging and its effects was conducted in response to the IPART report (2022).⁴⁸ This report examined NSW local government with its rate-peg compared to (then) uncapped Victorian local government to determine the probable impact of rate capping on Victorian councils. Three municipal performances were considered: inter-municipal revenue effort equity against residential tax effort, local government liabilities per household for NSW and Victorian councils from 2009 to 2013, and local government efficiency.⁴⁹

⁴⁸ Dollery, B. & Drew, J., (2015), *Careful what you wish for: Rate-capping in Victorian local government*, Journal of Australian Taxation, 17 (1), 139-163

⁴⁹ Ibid.

- For performance measure one, residential tax effort was measured as a proportion of residential rates paid with respect to the total annual income occurring to local residents in an LGA. This analysis revealed that rate pegging in NSW had significantly decreased inter-municipal equity and is an unavoidable consequence of any long-term rate cap regime.
- Performance measure two revealed that NSW had around 70 per cent more council debt per household in comparison to uncapped Victorian councils across the four year period (2009 -13). This comparison also demonstrated that NSW had a much larger local infrastructure backlog than Victoria.
- Lastly, it was found that evidence suggests a 'slightly higher average municipal efficiency for Victorian councils' and no conclusive evidence to support the claim that rate capping enhances municipal efficiency. This finding starkly contrasts the narrative driven by proponents of rate-pegging.

4. Alternatives to rate pegging

This chapter considers how alternatives or adjustments to the current rate pegging system might better balance the objectives of strengthening the financial sustainability of NSW local governments whilst being attentive to the cost of living and other affordability pressures in community.

The earlier chapters consolidate a breadth of evidence that the current system is resulting in suboptimal outcomes for ratepayers, councils, and council staff. For councils, rising costs are untenable without equivalent increases in revenue and/or an expansion in the revenue base. For ratepayers, limits to rate increases may seem desirable in the short-term, however there are longer-term wellbeing and productivity costs to individuals, households, and communities that arise from under-investment in services and asset maintenance.

Viewed in this light, the design of suitable alternative(s) to rate pegging must shift to a more flexible and responsive system that delivers mutual benefits for all. This system should recognise both material (e.g. meeting service costs) and intangible values (e.g. sustainable human capital for a more innovative sector future) of councils' financial sustainability.

4.1 Removing the rate peg

In 2008, IPART released an Issues Paper on a Revenue Framework for Local Government containing five options for alternative regulatory frameworks. One of these options was to 'institute measures to enhance accountability to the local community and remove mandatory rate pegging'.⁵⁰ At the time, this was the least preferred option, and so the abolition of the rate peg was not further considered in any depth, either in the Issues Paper or in the Final report.⁵¹

A primary consequence of removing the rate peg would be to enable councils more autonomy in financing community need. When councils benefit from satisfactory budgets and when council staff are supported to design, administer, monitor, and continually improve services for the community, there are mutual benefits for ratepayers.

At the same time, the magnitude of any rate changes in the short-term must be justified and carefully managed. The current proportion of household income spent on rates no doubt varies from council to council. While mechanisms such as pensioner rebates are already in place to improve the affordability of local government services, it is possible that the removal of the rate peg after almost five decades in operation could have unintended consequences. Such risks may be mitigated via rate benchmarking.

⁵⁰ IPART (2008), Issues Paper on a Revenue Framework for Local Government, https://www.ipart.nsw.gov.au/sites/default/files/documents/revenue_framework_for_local_government_-_issues_paper_-_july_2008_-_apd_website.pdf

⁵¹ IPART (2009), Revenue framework for local government, https://www.ipart.nsw.gov.au/sites/default/files/documents/final_report_-_revenue_framework_for_local_government_-_december_2009.pdf

Rate benchmarking was recommended as the preferred option from the NSW Independent Local Government Review Panel. This would involve IPART calculating and publishing an annual local government cost index with comparative data on rates increases and associated expenditure increase. There would be no official 'rate peg' but would still enable and encourage public scrutiny of council's revenue and expenditure decisions. Benchmarking could also be reinforced by a reserve power for the minister to intervene when necessary.⁵²

This form of rate monitoring is similar to the strategic oversight adopted by Tasmania and South Australia. In South Australia, the Essential Service Commission (ESCOSA) is to provide and publish advice to each local government on the appropriateness of its financial and infrastructure and asset management plans, having regard in particular to the financial contributions proposed to be made by ratepayers. ESCOSA describes the arrangement as "an advisory scheme that aims to give ratepayers confidence that the rates they pay are set at the level necessary for their council to provide the services they value".⁵³ Tasmania followed in a similar vein with the Chairs of councils Audit Panels (who must be independent of the council) set to review any proposed rates changes that deviate from a council's Long-Term Financial Plan, and/or changes to that Plan.

Removing the rate peg would further encourage councils to ensure both short and long term service and asset management planning was robust and evidence-based.

4.2 Refining the rate peg methodology

Recent reviews of the rate peg methodology have introduced a population growth factor (recommendation from IPART's 2016 review of the local government rating system) and refined the cost index (arising from IPART's 2023 review of the rate peg methodology) to better account for economic volatility in councils' operating environments.

As of 2023 the new rate peg methodology will:⁵⁴

- Measure annual change in councils' base costs for 3 groups of councils instead of one that includes all NSW councils.
- Incorporate forward-looking indicators to measure changes in council's base costs across employee costs, asset costs and all other operating costs.
- Make an explicit and separate Emergency Service Levy factor, lagged by one year, that is council specific.
- Adjust capture costs driven by external factors that affect councils
- Refine the population factor introduced as part of the 2016 review to ensure that is more accurately measures council residential populations

⁵² Samson, G., (2023), *Exploring alternate approaches to rate-pegging/capping: the differences matter*, LGiU, available online: <https://lgiu.org/briefing/exploring-alternate-approaches-to-rate-pegging-capping-the-differences-matter/>

⁵³ ESCOSA, (2022), *Local Government Advice*, Essential Service Commission

⁵⁴ IPART, (2023), *Final report – Review of the rate peg methodology – August 2023*, available online: <https://www.ipart.nsw.gov.au/documents/final-report/final-report-review-rate-peg-methodology-august-2023>

Retain the productivity factor and set this to zero until sufficient information is available for estimating a new factor.

While these adjustments represent a positive step forward in enhancing the rate peg methodology, they remain insufficient in addressing the historic deficit caused by previously over-restricted rate pegs.

Other refinements could include:

- Allowing councils to use the Capital Improved Value method to set the variable component of rates. While it is noted that some view this approach may disincentivise investments, it has also suggested that this would provide a more equitable view of land values by property type and their drivers.⁵⁵

Note: There is a view that using CIVs can discourage capital improvements, given a 'higher valuation would result in a larger rating and taxing liability'.⁵⁶ The available evidence on the effects of using Capital Improved Values is inconclusive. In 2013, a Tasmanian review found that both the CIV and land value are superior to the assessed annual valuation base, but did not recommend one over the other. That review considered CIV to 'better address capacity-to-pay considerations and was best understood by ratepayers'.⁵⁷

- Implementing a disaggregated form of rate pegging that incorporates cost indices by council type. This option was included in IPART's 2008 Issues Paper on the Local Government Revenue Framework. It suggested that councils could either be grouped based on specific criteria before being allocated a specific rate peg, or that criteria such as cost structures and service dimensions could inform a council-specific rate peg.⁵⁸ Its important to recognise that this alone does not fully address the impact of historic deficits in rate caps.
- Better reflect the range of costs to councils, such as from cost shifting, leading to more realistic revenue raising that aligns with actual needs. Cost shifting is one of the most significant challenges facing the Australian local government sector. In 2021-22, cost shifting to local government in NSW was estimated at \$1.36 billion.⁵⁹ This far exceeds historical records and represents an increase of \$540 million from the previous cost shifting survey results carried out in 2017-18. Examples of the most significant cost shifting components in NSW are detailed in Table 8.
- Defining a rate path for an extended period, ensuring that the rate cap is sufficient to cover a council's 4-year delivery program. This approach would provide certainty of the rate path and allow councils more time to assess the necessity of SRVs or explore adjustments to service levels.

⁵⁵ IPART (2023), Review of the rate peg methodology, https://www.ipart.nsw.gov.au/sites/default/files/cm9_documents/Final-Report-Review-of-the-rate-peg-methodology-August-2023.PDF

⁵⁶ NSW Valuer General (2016), 'Review of the Local Government Rating System: Submission to IPART', https://www.ipart.nsw.gov.au/sites/default/files/documents/online_submission_-_office_of_the_valuer_general_-_s_gilkes_-_20_may_2016_183000000.pdf

⁵⁷ Division of Local Government, Department of Premier and Cabinet (Tasmania), Valuation and Local Government Rating Review Final Report (April 2013).

⁵⁸ IPART (2008), Revenue Framework for Local Government, https://www.ipart.nsw.gov.au/sites/default/files/documents/revenue_framework_for_local_government_-_issues_paper_-_july_2008_-_apd_website.pdf

⁵⁹ Morrison Low, (2022), *LGNSW Cost Shifting Report – How State Costs Eat Council Rates*, LGNSW

Table 8: Cost shifting in NSW local government, 2021-22

Cost shift component	Amount (\$ million)
Waste levy A financial contribution required to be paid for each tonne of waste received at a facility. This is the largest single contributor to cost shifting in NSW.	288.2
Emergency service levy Payment to support the operations of emergency service agencies in NSW. This is the largest direct cost shift to local councils.	165.4
Pensioner rate rebates The State government imposed mandatory pensioner rate rebates but did not reimburse local councils for any financial loss.	55.2
Unmet funding agreements The State government committed to cover 50 per cent of operating cost for libraries. This was unmet and had to be covered by local councils.	156.7

Source: LGNSW (2022)

4.3 Simplifying the special rate variations process

There are several requirements of councils when applying for a special variation and minimum rates. Before applying to IPART for a special variation to general income, councils must adopt a suite of Integrated Planning and Reporting (IP&R) documents (the Community Strategic Plan, Delivery Program, Long-term Financial Plan, and where applicable, the Asset Management Plan).⁶⁰

An SRV application should reference these documents to justify to IPART:

- A demonstrated need for higher increases to charges
- Community awareness/acceptance of their rate rise plans and that the 'full cumulative increase' of the proposed special variation in percentage terms has been communicated
- A reasonable impact on ratepayers
- A process to exhibit relevant council documents to the public
- A history of well-documented council productivity improvements and cost containment strategies.

These requirements can be onerous for some councils in the time and labour needed to compile comprehensive documentation on the matters above. The 2013 NSW Independent Local Government Review panel found that councils and state agencies were spending millions of dollars in reviewing and

⁶⁰ IPART (2020), 'Guidelines for the preparation of an application for a special variation to general income', https://www.ipart.nsw.gov.au/sites/default/files/documents/olg-guidelines-special-variation-2021-22_0.pdf

determining outcomes for applications, yet the rate variations were typically less than \$1 per household per week (about 5% of the state average residential rate).⁶¹

Moreover, the process does not distinguish applications by the magnitude of special variation that is sought by the council. This prevents councils from adopting a preventative approach to the social and economic impacts (Chapter 3) if they are forced to withstand financial deficiencies over prolonged periods of time. LGNSW has recommended that councils be allowed to exceed the rate peg by a determined margin without seeking a special variation.⁶²

Furthermore, a key barrier for local governments seeking a variation is the potential backlash from community. If councils are able to adequately provide the state with evidence on need for increased rates, then the level of community engagement for each annual variation could be considered contrary. Rather this engagement could occur on a four-year cycle, along with the adoption of council strategic documents which should set the required rates to meet budget demands.

4.4 Conclusion

This paper compiles evidence of the wide-ranging impacts of the rate peg on outcomes for ratepayers, councils, and council staff. NSW local governments are vital agents of community wellbeing and prosperity. Yet financial pressures arising from cost shifting, dwindling and/or limited grant funding from Commonwealth and State governments, and a rapidly changing macro-context means the sector faces significant challenges in maintaining infrastructure and continuing services.

Despite a long-term trend of fiscal pressure, councils have been innovative and highly efficient in their responsiveness to community need. Past rate pegs have lagged key cost factors, namely wage and CPI growth. The implications of this – a retreat from core services, infrastructure delays and asset renewal backlogs, and the erosion of councils' financial independence to name several – are by now an entrenched issue that cannot be satisfactorily overcome via future rate pegs alone.

More direct intervention is needed via alternative approaches to NSW's current rate pegging. It is crucial that any approach balances improvement to the sector's financial sustainability and the unique needs of communities across NSW.

Several options for reform should be explored and/or re-examined. These include removing the rate peg altogether, refining the rate peg methodology to better reflect the range of costs to councils, and simplifying the SRV process. Removing the rate peg would grant councils more autonomy in financing community needs, as in other jurisdictions, while rate benchmarking and an extended rate path period would provide more certainty and flexibility in planning and budgeting.

⁶¹ Samson, G., (2023), *Exploring alternate approaches to rate-pegging/capping: the differences matter*, LGiU Australia, available online: <https://lgiu.org/briefing/exploring-alternate-approaches-to-rate-pegging-capping-the-differences-matter/>

⁶² LGNSW (2022), 'Submission: IPART Review of the Rate Peg Methodology', https://www.lgnsw.org.au/common/Uploaded%20files/Submissions/2022/Draft_Submission_IPART_Review_Rate_Peg_Methodology.pdf

Additionally, refining the rate peg methodology and simplifying the SRV process would also ensure that rate increases are justified and transparent for community members. These reforms seek to create a more responsive and equitable system that balances the financial sustainability of councils with affordability concerns of rate payers.

Appendix A: Council Classifications

Council classification	Councils (2020-21)	
Metropolitan	<ul style="list-style-type: none"> ▪ Bayside ▪ Blacktown ▪ Burwood ▪ Canada Bay ▪ Canterbury-Bankstown ▪ Cumberland ▪ Fairfield ▪ Georges River ▪ Hunters Hill ▪ Inner West ▪ Ku-ring-gai ▪ Lane Cove ▪ Liverpool 	<ul style="list-style-type: none"> ▪ Mosman ▪ North Sydney ▪ Northern Beaches ▪ Parramatta ▪ Randwick ▪ Ryde ▪ Strathfield ▪ Sutherland ▪ Sydney ▪ Waverley ▪ Willoughby ▪ Woollahra
Regional Town / City	<ul style="list-style-type: none"> ▪ Albury ▪ Armidale Regional ▪ Ballina ▪ Bathurst Regional ▪ Bega Valley ▪ Broken Hill ▪ Byron ▪ Cessnock ▪ Clarence Valley ▪ Coffs Harbour ▪ Dubbo Regional ▪ Eurobodalla ▪ Goulburn Mulwaree ▪ Griffith ▪ Kempsey ▪ Kiama ▪ Lake Macquarie ▪ Lismore ▪ Lithgow 	<ul style="list-style-type: none"> ▪ Maitland ▪ Mid-Coast ▪ Mid-Western Regional ▪ Newcastle ▪ Orange ▪ Port Macquarie-Hastings ▪ Port Stephens ▪ Queanbeyan-Palerang Regional ▪ Richmond Valley ▪ Shellharbour ▪ Shoalhaven ▪ Singleton ▪ Snowy Monaro Regional ▪ Tamworth Regional ▪ Tweed ▪ Wagga Wagga ▪ Wingecarribee ▪ Wollongong
Metropolitan Fringe	<ul style="list-style-type: none"> ▪ Blue Mountains ▪ Camden ▪ Campbelltown ▪ Central Coast ▪ Hawkesbury 	<ul style="list-style-type: none"> ▪ Hills ▪ Hornsby ▪ Penrith ▪ Wollondilly
Rural	<ul style="list-style-type: none"> ▪ Balranald ▪ Bogan ▪ Bourke 	<ul style="list-style-type: none"> ▪ Gilgandra ▪ Hay ▪ Lockhart

	<ul style="list-style-type: none"> ▪ Brewarrina ▪ Carrathool ▪ Central Darling ▪ Coolamon ▪ Coonamble 	<ul style="list-style-type: none"> ▪ Murrumbidgee ▪ Walcha ▪ Warren ▪ Weddin
Large Rural	<ul style="list-style-type: none"> ▪ Bellingen ▪ Berrigan ▪ Bland ▪ Blayney ▪ Cabonne ▪ Cobar ▪ Cootamundra-Gundagai Regional ▪ Cowra ▪ Dungog ▪ Edward River ▪ Federation ▪ Forbes ▪ Glen Innes Severn ▪ Greater Hume ▪ Gunnedah ▪ Gwydir ▪ Hilltops ▪ Inverell ▪ Junee ▪ Kyogle ▪ Lachlan 	<ul style="list-style-type: none"> ▪ Leeton ▪ Liverpool Plains ▪ Moree Plains ▪ Murray River ▪ Muswellbrook ▪ Nambucca Valley ▪ Narrabri ▪ Narrandera ▪ Narromine ▪ Oberon ▪ Parkes ▪ Snowy Valleys ▪ Temora ▪ Tenterfield ▪ Upper Hunter ▪ Upper Lachlan ▪ Uralla ▪ Walgett ▪ Warrumbungle ▪ Wentworth ▪ Yass Valley

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LGNSW Cost Shifting Report – How State Costs Eat Council Rates



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1 Executive Summary

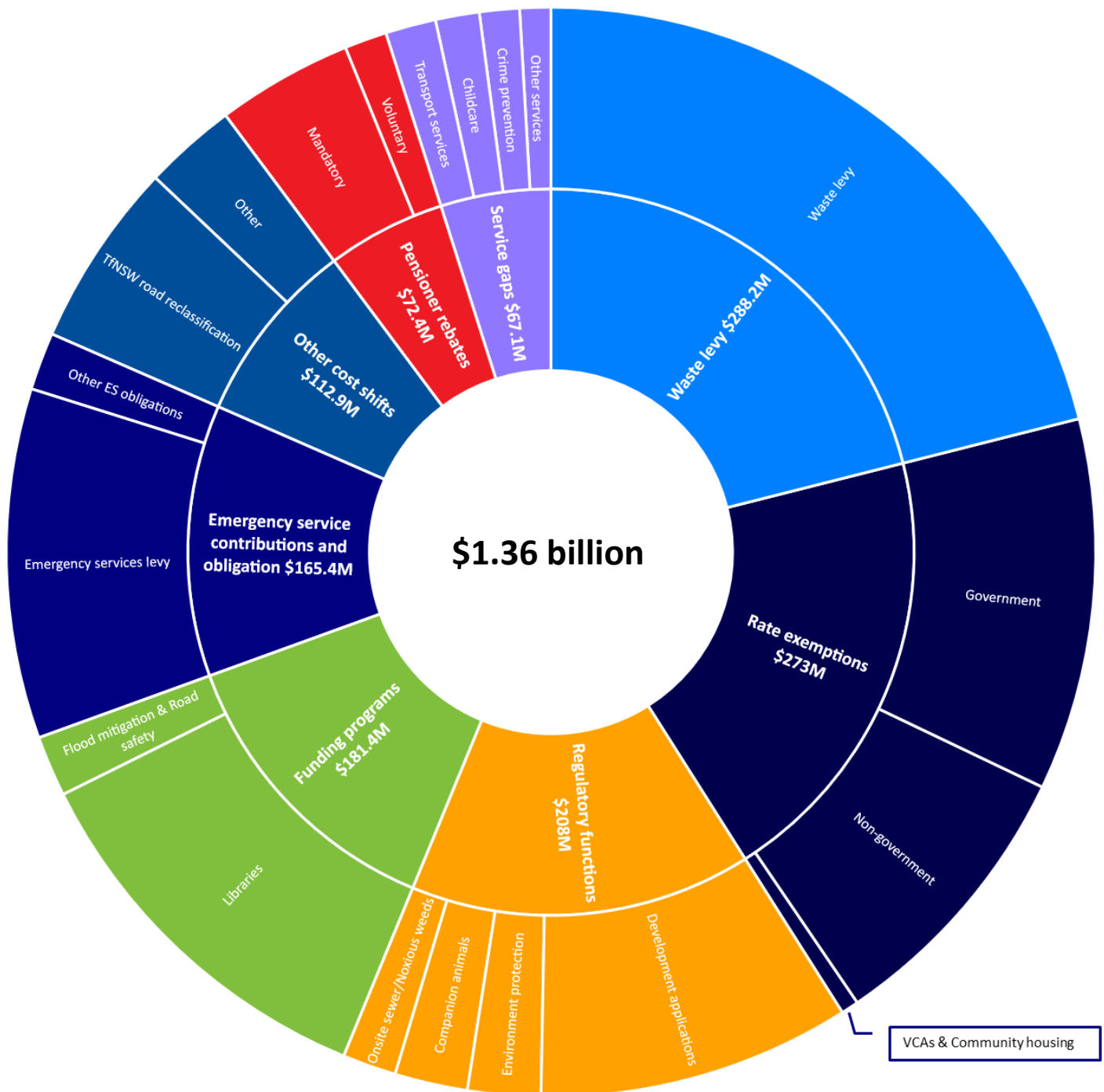
Cost shifting remains one of the most significant challenges facing the NSW local government sector. As the peak organisation representing the interests of all 128 general purpose councils in NSW, as well as special purpose councils and related entities, Local Government NSW (LGNSW) regularly monitors the extent of cost shifting onto local government via its Cost Shifting Survey.

The 2021–22 Cost Shifting Survey has revealed that cost shifting totalled **\$1.36 billion** in 2021–22 (see figure on the next page), far exceeding historical records and representing an increase of \$540 million since the Cost Shifting Survey was last carried out in 2017–18. Alarming, the increase in cost shifting has been accelerated by various State Government policies, with the most significant examples of cost shifting in 2021–22 being:

- The **waste levy**, which remains the largest single contributor to cost shifting in NSW, totalling \$288.2 million, because the NSW Government did not fully reinvest the waste levy, paid by local councils, back into waste and circular economy infrastructure and programs.
- The **Emergency Services Levy** and associated **emergency service contributions**, which totalled \$165.4 million and represented the largest direct cost shift to local councils. In 2021–22, councils contributed \$142 million through the Emergency Services Levy, \$12.7 million through Rural Fire Service (RFS) obligations, and \$10.7 million in depreciation expenses on RFS assets.
- The NSW Government’s failure to fully reimburse local councils for mandatory **pensioner rate rebates**, resulting in councils losing \$55.2 million.
- The NSW Government’s failure to cover the originally committed 50 per cent of the cost of libraries operations, resulting in an additional \$156.7 million in costs to councils.

Local councils and their communities are facing unprecedented challenges. As they lead the recovery efforts from both the COVID pandemic and repeated natural disasters across much of NSW, local councils are also grappling with the same challenges affecting the State and Federal Governments, such as rising costs, increased economic uncertainty, and severe skills and labour shortages – all of which are impacting council budgets and affecting service and infrastructure delivery in local communities. The continual shifting of the obligations and costs for State and Federal functions and services onto local government coupled with a defective rate peg system, is only making the situation worse. In 2021-22, each ratepayer of NSW has approximately \$460.67 from councils’ rates eaten by state government costs.

Figure 1 2021–22 cost shifting components



2 Background

2.1 What is cost shifting?

Cost shifting describes a situation where the responsibility for, or merely the costs of, providing a certain service, concession, asset, or regulatory function is imposed onto local government from a higher level of government (Commonwealth or State Government) without the provision of corresponding funding or the conferral of corresponding and adequate revenue raising capacity other than out of general rates.

As the council cannot raise or receive sufficient revenue to fund the imposed service concession asset or function, cost shifting forces councils to divert funding collected from ratepayers away from planned projects or services that the council has committed to the community to deliver in its Delivery Program.

In NSW, cost shifting has taken a number of forms including:

- **The Emergency Service contributions:** Councils are required to fund 11.7 per cent of the cost of Fire & Rescue NSW, Rural Fire Service (RFS) NSW and the NSW State Emergency Service (SES) through an Emergency Service Levy (ESL). 73.7 per cent of emergency services costs is funded through insurance premiums and the remaining 14.6 per cent from the NSW Government's treasuries. Councils provide additional financial contributions to emergency services agencies in addition to the ESL.
- **The waste levy:** The waste levy is not as much a cost shift to councils as an invisible tax levied on ratepayers through councils. The waste levy is a levy paid by all waste facilities to the NSW Government, the cost of this levy is recovered through the waste collection fees levied by councils, in effect shifting the burden of this tax on to ratepayers.
- **Forced rates exemptions:** Councils are required to exempt government and other organisations from paying rates in the local government area. These organisations utilise local government services and infrastructure. As they are exempt from paying rates, the burden of the costs they incur is shifted to the ratepayers to fund. Examples of exempt organisations include government departments, private schools, and non-government social housing providers.
- **Imposing additional regulatory functions:** State and Federal levels of government implement or increase regulatory requirements through legislation that is then administered by local government. The costs of this new or increased regulatory function is often not funded by the determining level of government and councils must fund this through their own revenue sources including rates.
- **Cutting or failing to adequately continue to fund programs for services that need to continue:** Many funding programs announced by State or Federal government are required to be delivered by local government but are either not fully funded from their initiation or, if an ongoing initiative, funding is reduced over time leaving councils with the decision to either continue the program and make up the burden of the cost or cease the program entirely. An example of this in Libraries, where the original commitment from State Government was to fund 50 per cent of libraries cost, it now covers approximately 8 per cent of the total costs, leaving councils to fund an additional \$156.7 million to make up the difference.

- **Pensioner rebates:** Councils are required to provide pensioner rebates on rates and other charges, for which the State government only subsidises 55 per cent of the cost, the remaining 45 per cent is funded by other ratepayers.
- **Councils absorbing the costs of service and market gaps that should have been provided by State or Federal governments:** This is particularly an issue in rural and regional NSW, where councils often must step in to provide or support a service that is traditionally delivered either directly or through subsidised private providers. This can be for a diverse range of services from aged, disability or childcare through to medical services, education, or public transport services.

2.2 Cost shifting and the rate peg

Cost shifting has been a term used for many years to describe the cost impact on local government of decisions made at the State and Federal level. It is particularly relevant in NSW where a rate pegging system is applied to restrict how local government can raise rates revenue.

The issue of State and Federal decisions having a direct financial impact on local government exists in all States and territories of Australia to some extent. In many cases, local government can be the best and most efficient partner for State and Federal government to deliver its programs or services.

Challenges arise with respect to how the State and Federal initiatives are, or continue to be, funded. In States where there is not a rate pegging system in place, local councils are able to better manage the financial impacts by adjusting rates or levying specific fees and charges to reflect the change in costs of providing the imposed service, concession, asset, or regulatory function.

The rate peg in NSW sets out the maximum amount that local councils can increase their rates by and is set by the Independent Pricing and Regulatory Tribunal (IPART) each year. In determining the rate peg, IPART does not adequately consider the cost shifting impacts on councils. As a result, increases in the costs shifted to councils identified here are not covered by a commensurate increase in rates revenue. This means that councils have to divert funding from other commitments agreed with their communities in their Community Strategic Plan and Delivery Program to fund the cost shift incurred. This has a direct impact on councils' ability to deliver services to the community and their overall financial sustainability.

2.3 This report

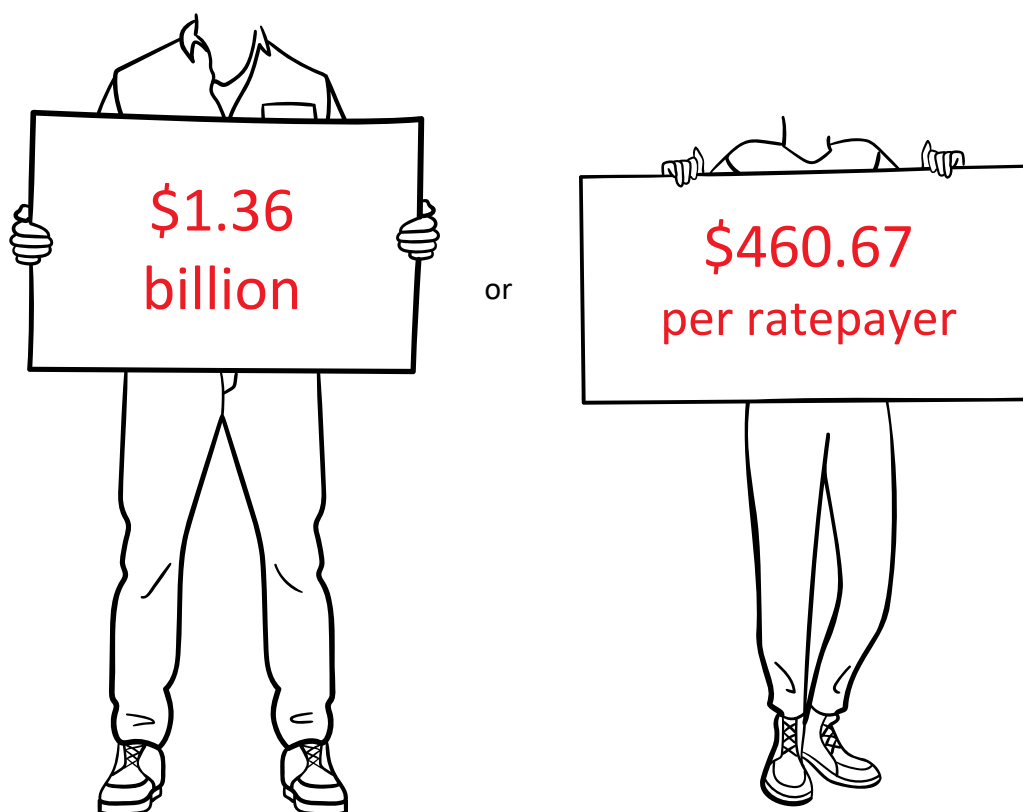
This report provides analysis and insights from the 2021–22 Cost Shifting Survey conducted in May 2023.

Section 3 of this report provides more detail on the findings from the survey, breaking down the findings into their key cost shifting areas, as identified in section 2.1 above, and Section 4 outlines the approach and methodology used in the survey and analysis..

3 Findings

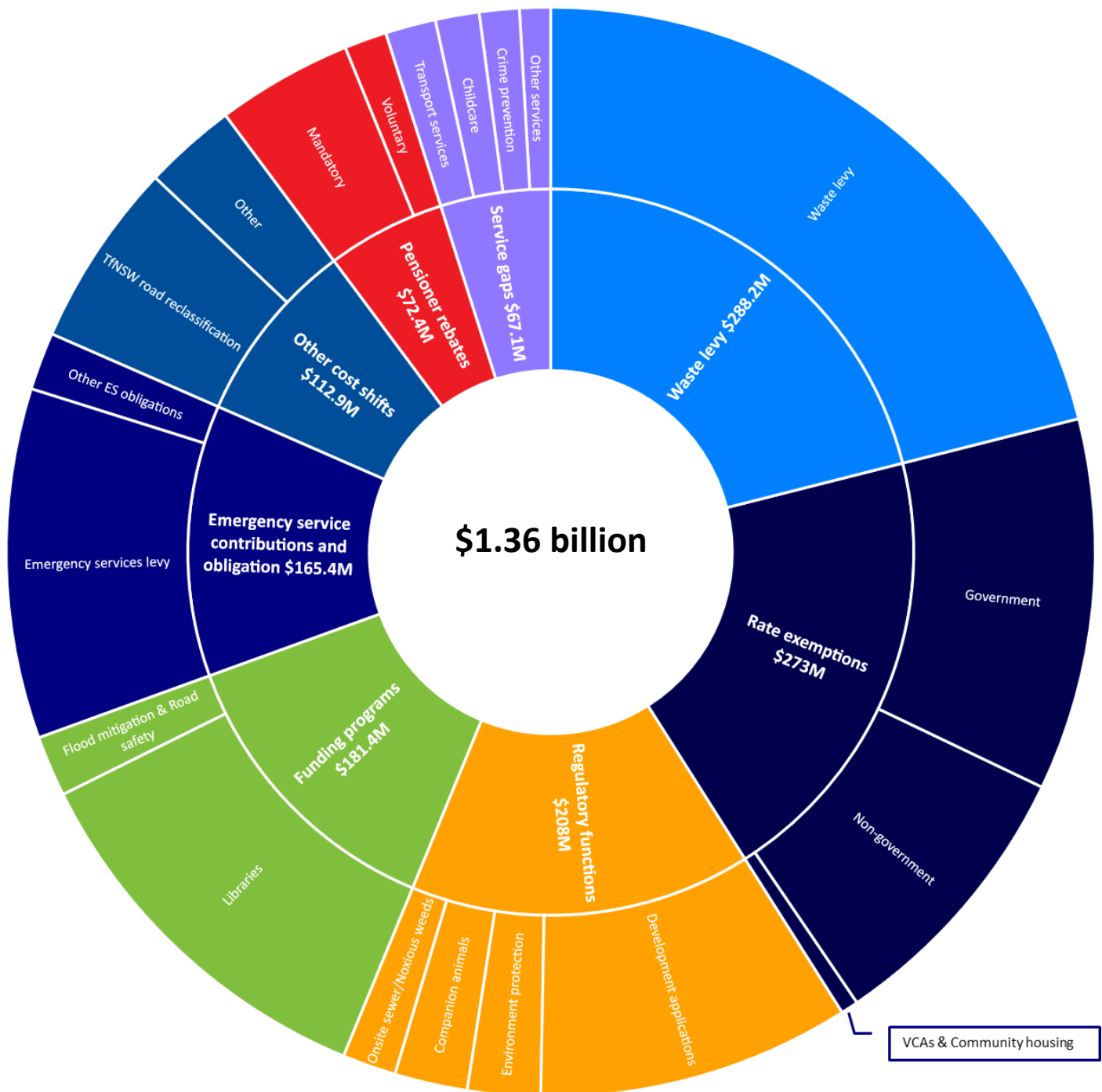
Our survey found that cost shifting cost NSW councils \$1.36 billion in 2021–22, which represents \$460.67 for each ratepayer. In effect, this is the average amount of rates that councils must divert from the services and infrastructure that council has committed to provide the community in order to fund the unrecoverable cost services, programs and functions that are imposed from the State or Federal governments.

In 2021/22,
the cost to
NSW
Councils of
cost shifting
was:



Many services, programs, and functions that the State and Federal governments require local councils to deliver, in turn provide benefits to the local communities they serve. This report does not provide an assessment on the merit of these costs, only to bring them to light. Due to the nature of how the services, programs and functions are provided and funded, cost-shifting can be hidden from view. This analysis helps to quantify and highlight these costs for all tiers of government and the community.

Figure 2 2021–22 cost shifting components



The largest direct cost shift to councils is from emergency service contributions and other emergency service obligations, totalling \$165.4 million.

However, the cost of rate exemptions are higher still, representing a total of \$273.1 million of potential rates that are exempted and redistributed to other ratepayers to pay. An additional \$288.2 million in waste levies are passed onto the ratepayers through the waste collection fees in their rates bill. A further \$156.7 million

in costs for libraries has been covered by councils to make up the difference between the committed funding for councils' libraries and the subsidies received.

While in nominal terms the largest total cost shifts have been seen metropolitan councils, was on a per ratepayer basis rural and large rural councils have seen a greater impact, as the graphs below indicate.

Figure 3 Total cost shift by council classification

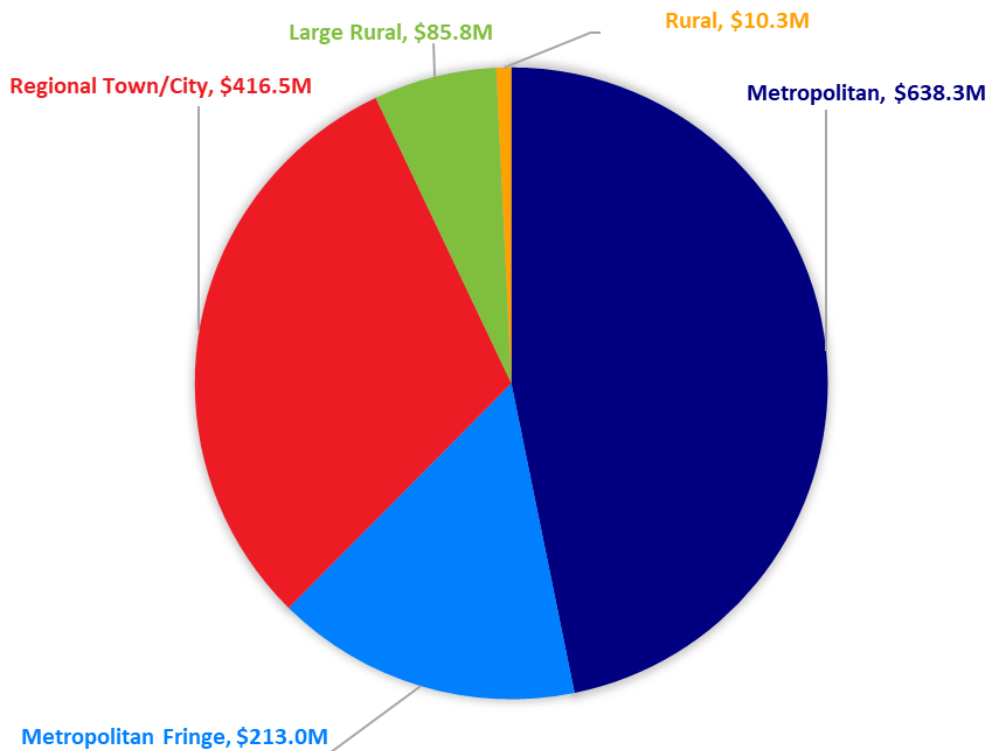
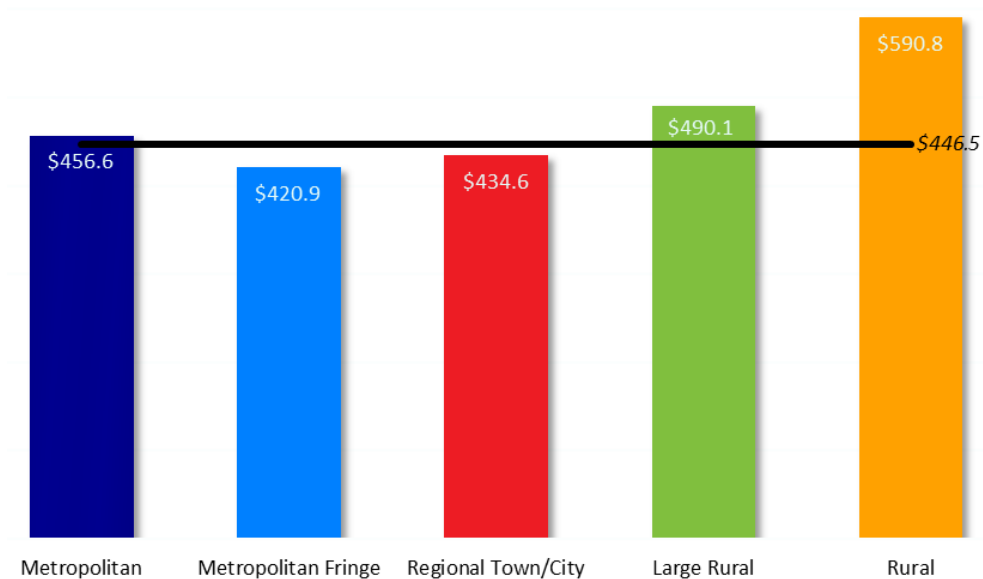


Figure 4 Cost shift per ratepayer by council classification



We will explore each component of rate shifting in the following sections.

3.1 Emergency service contributions and obligations

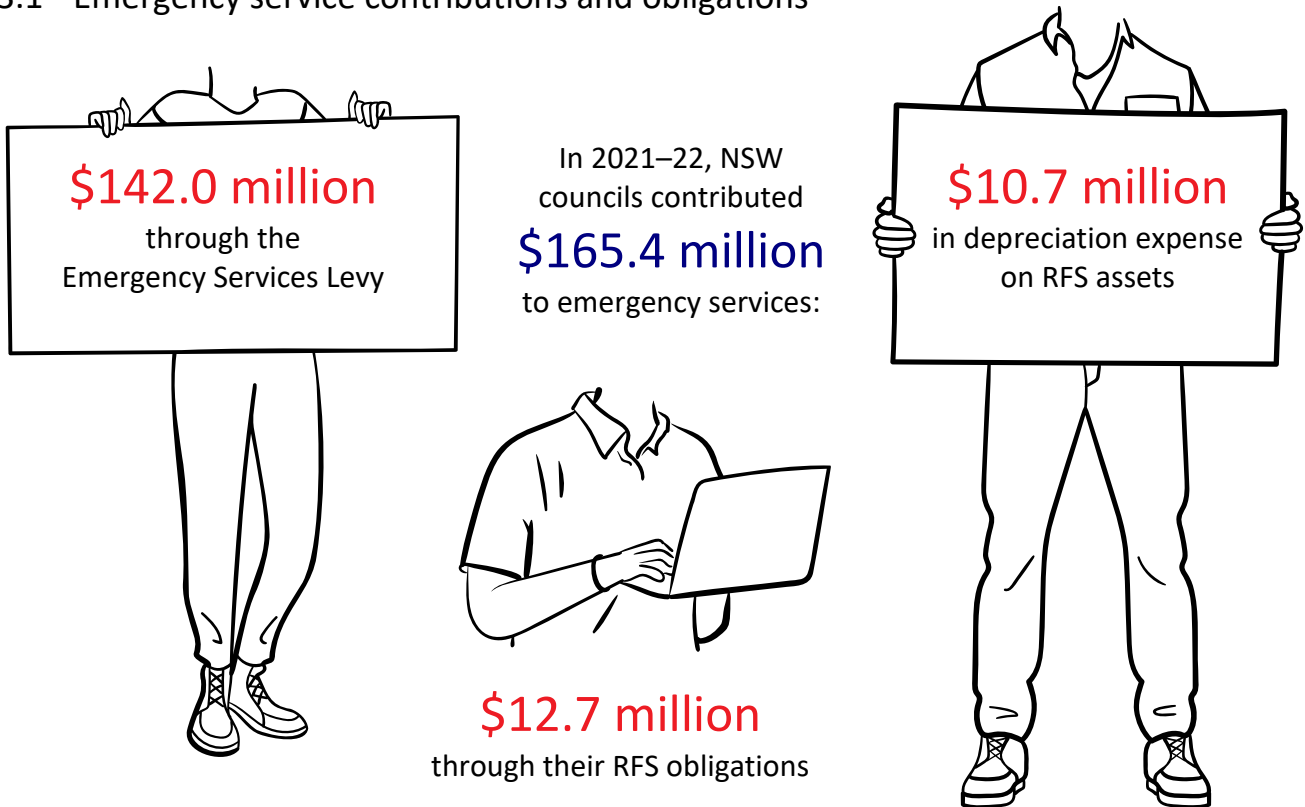


Figure 5 Emergency services contributions and obligations by council classification

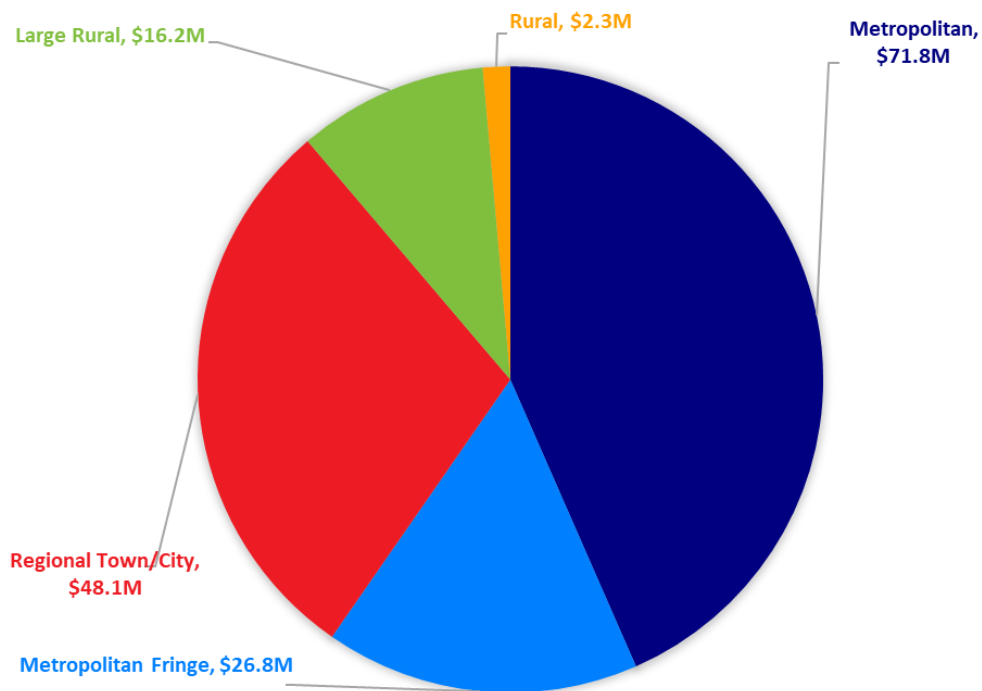


Figure 6 Respondent councils with the highest emergency services contributions and obligations burden

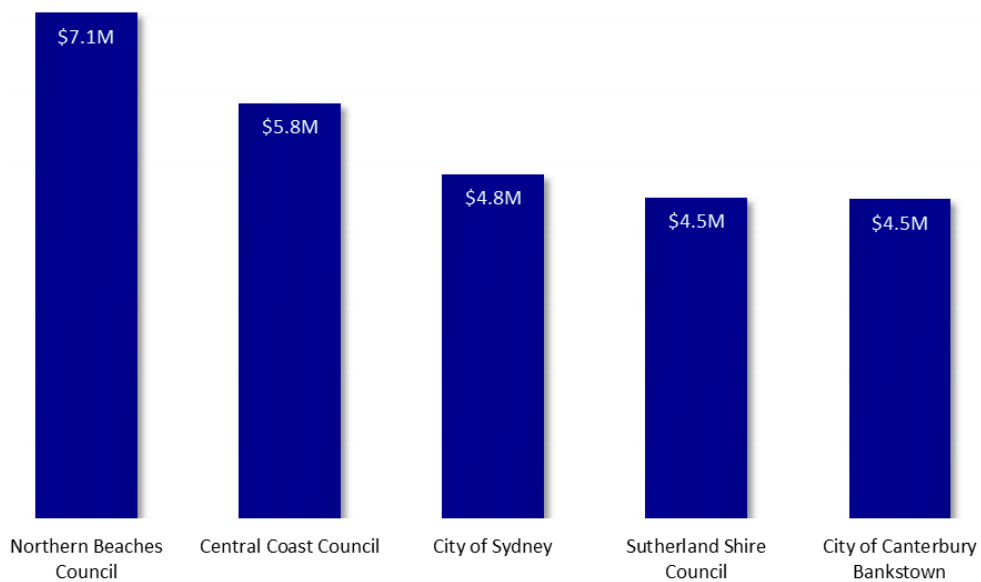
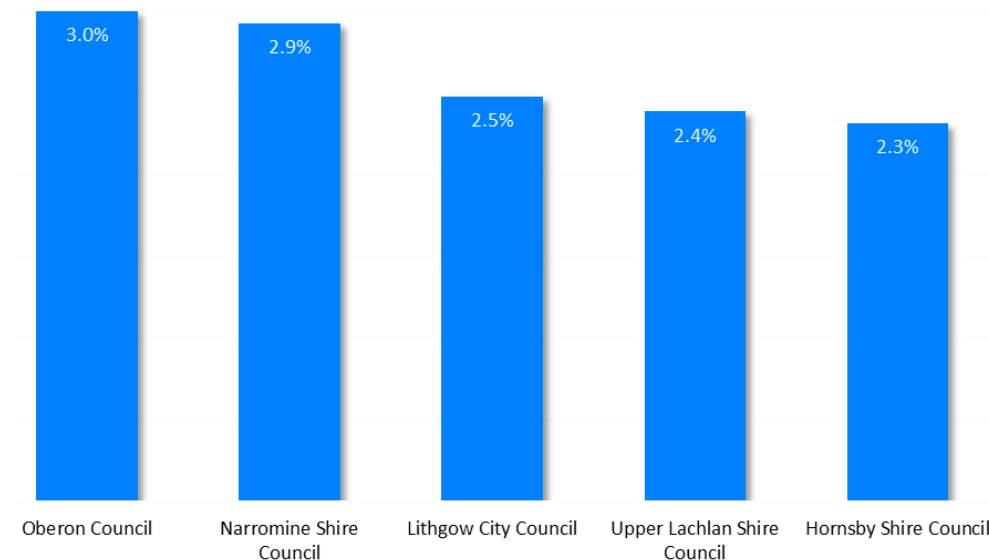


Figure 7 Respondent councils with the highest emergency services contributions and obligations burden as a proportion of total operating expenditure



NSW councils are required to fund 11.7 per cent of the NSW SES, NSW Fire and Rescue and NSW RFS budgets through a direct contribution levied each year by the State Revenue Office. This is funded directly from general revenue, primarily rates, as councils have no ability to raise revenue to fund this in any other way.

Councils also have no influence on the costs or budget setting of these organisations. This contribution of ratepayers' funds is in addition to the Emergency Services Insurance Contribution that is extracted through insurance companies, who cover 73.7 per cent of the agencies' budgets and results in higher insurance premiums for policy holders

The emergency service levy is estimated to have cost NSW councils overall \$142.0 million in 2021–22. That is a total of \$46.23 per ratepayer, which goes directly to the NSW Government as part of the emergency services contribution.

Figure 8 Respondent metropolitan and fringe councils with the largest ESL bill for 2021–22

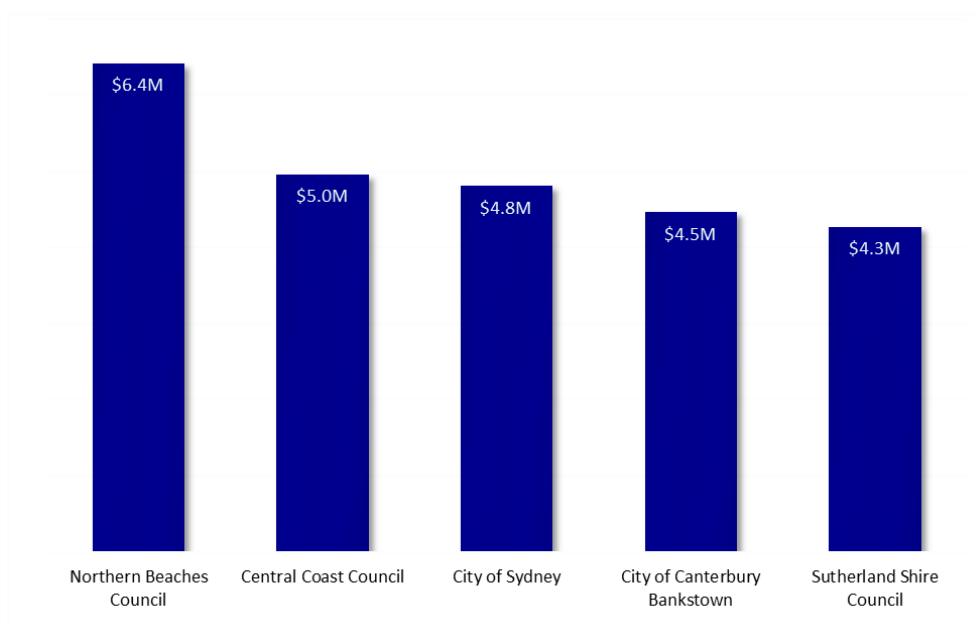


Figure 9 Respondent regional and rural councils with the largest ESL bill for 2021–22

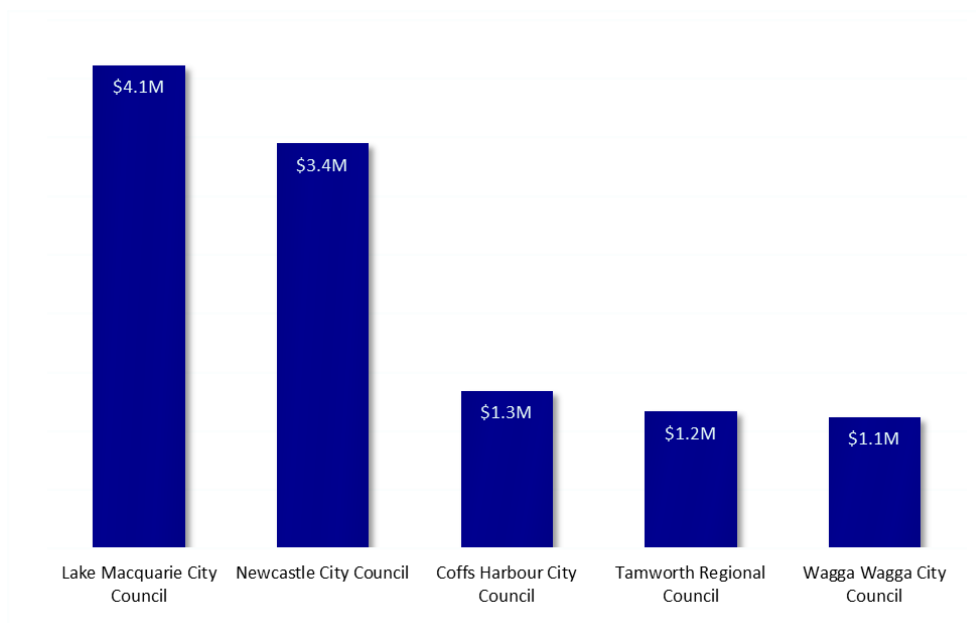
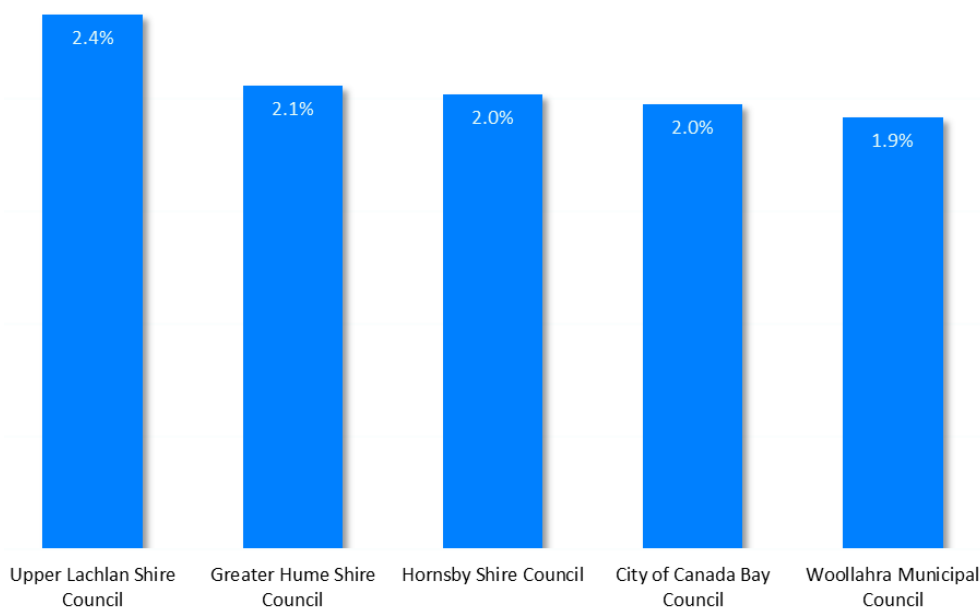


Figure 10 Respondent councils with the largest ESL bill as a proportion of total operating expenditure



In 2019, the NSW Government subsidised councils for the increase in Emergency Service Contribution costs, because of a large increase in the ESL resulting from large increase in workers compensation costs followed by the Black Summer Bushfires and the unfolding COVID pandemic. From the 2023–24 financial year, the NSW Government increased the budgets and therefore costs for the three relevant agencies and removed the subsidy at the same time. Councils were not advised of this change until after they had developed and put their 2023–24 budget on public exhibition as they are required to do. The increase represented a \$41.2 million cost increase from the prior 2022–23 financial year.

With the rate peg set at 3.7 per cent for the 2023–24 rating year, the increase in emergency services contributions has put substantial pressure on the financial sustainability of local government.

Figure 11 Top 10 councils with the highest ESL bill in 2023–24

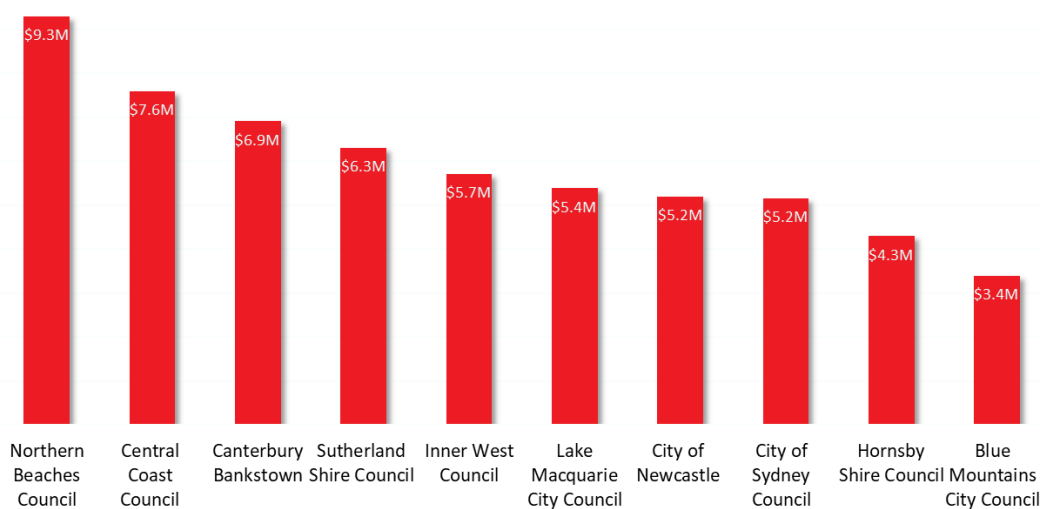
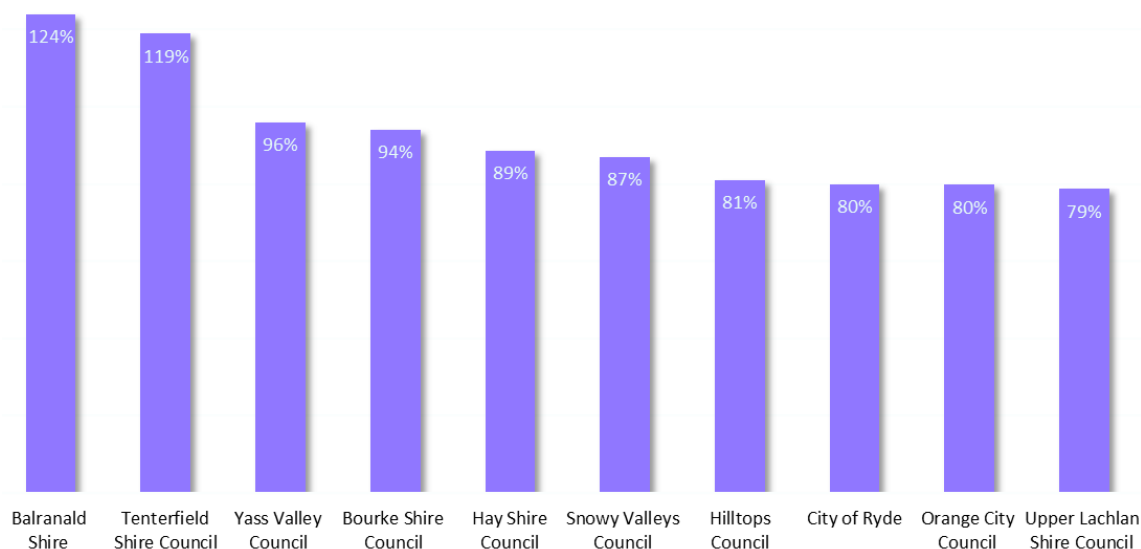


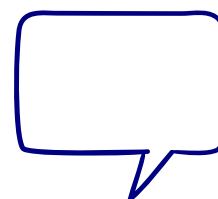
Figure 12 Top 10 councils with the highest 2023–24 ESL increase as a percentage of the rate revenue increase



The increases in emergency services contributions from councils have hit both the largest and smallest of councils.

“Two of the four biggest expense payments that Central Coast Council must make each year are for State government levies: the emergency services levy and the waste levy. They are in the millions each and are funded straight out of our rates and waste revenue.”

David Farmer, CEO, Central Coast Council



“Central Darling Shire is the largest shire in NSW covering an area of 53,000 square kilometres in Far Western NSW, but it has the smallest (and declining) population of less than 2000. CDS is not a typical shire as it consists of a series of isolated communities (Menindee, Ivanhoe, Wilcannia and White Cliffs) and large pastoral holdings. It borders the large unincorporated area of the Far West.

For Council, the Emergency Services Levy has increased by \$70,000 for 2023/24, bringing the total Council contribution to \$318,989. The increase is some \$70,000 which is more than double the increase in rates due to rate pegging.

For the 2023/2024 financial year the Council income from rates is budgeted to be \$913,000. This includes the rate peg increase of 3.7 per cent, which looks like being eaten up by the hike in the ESL.

For a Council like Central Darling this level of increase is simply unsustainable and will result in the further reduction of services to our residents.

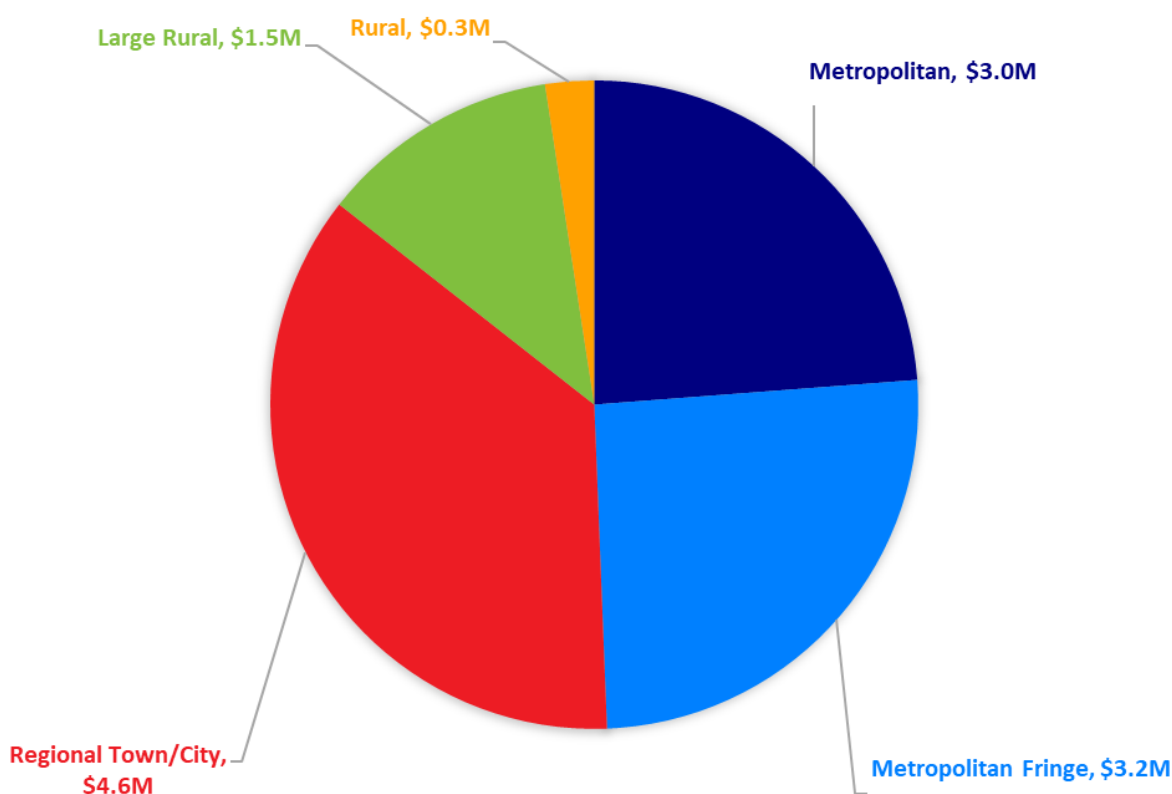
There is a clear case for the NSW Government to fully fund this increase as part of its community service obligation as small rural councils with a limited rate base cannot afford to continue to pay.”

Bob Stewart, Administrator, Central Darling Council¹

¹ Figure 11 does not include Central Darling’s actual result as it was not provided to LGNSW.

In addition to the emergency service levy, local councils are required to support the RFS and SES in other ways. This commitment seems to be different for different Councils. For example, for some councils, when the RFS annual budget is allocated back to the districts, some of these funds are vested in councils through the Rural Fire Fighting Fund (RFFF). These funds are then administered by councils to deliver repairs and maintenance of buildings and a small amount of plant and equipment. In some cases, Councils also fund other functions such as training and provision of office supplies. If the RFFF is insufficient to provide these in any one year, some councils will then provide further financial support directly to the districts to meet the difference. In 2021–22, the cost of this additional support has been estimated at \$12.7 million.

Figure 13 Additional RFS contributions by council classification

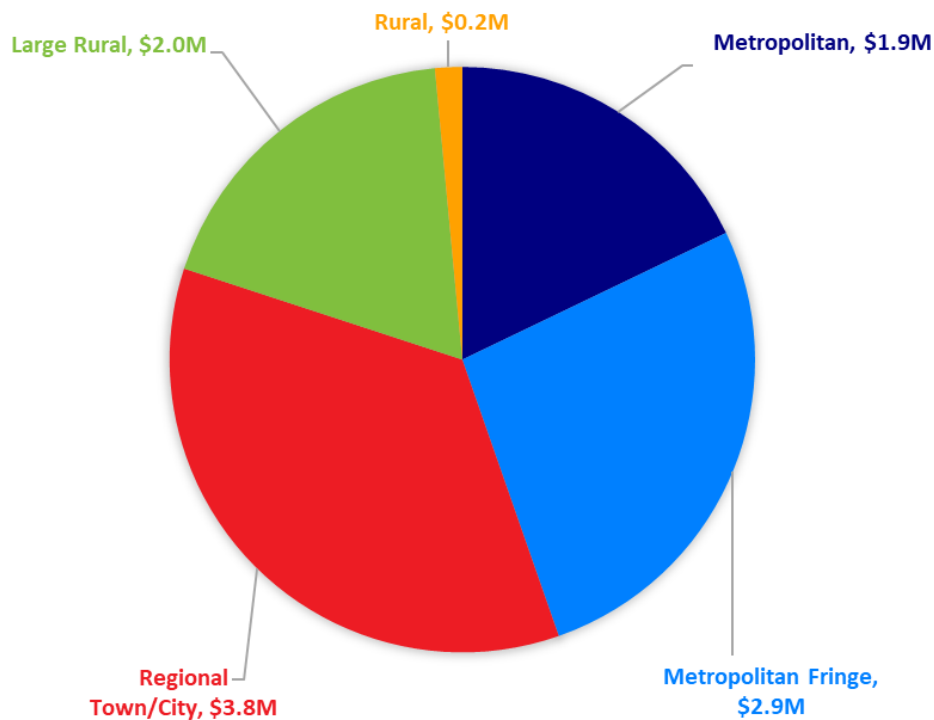


The RFS funding arrangements are the most complex of all the emergency services and creates challenges for both councils and the RFS. While councils are aware that their obligations to provide financial support to the RFS are generally over and above the RFFF, the costs at a district level are extremely volatile from one year to the next and dependent on whether there is a bushfire in the district (in which instance the district will fund some aspects of other districts' costs if they come to support the local bushfire response) or if the district comes to the aid of another district (in which instance they will receive additional funding which reduces the pressure on its own budget and therefore the financial support required from the local council).

What results is that councils have to bear the budget risk of the volatility of RFS costs and funding, while RFS districts don't have accountability for their own budgets and costs, and are not able to help to provide certainty because they don't know where the next emergency will be. Much of these volatility issues are resolved at a State level, when looking at the RFS services overall.

In addition to the direct repair and maintenance costs, councils are also required to recognise RFS red fleet assets and account for their depreciation expense in council financial reports. In 2021–22, this depreciation cost is estimated at \$10.7 million.

Figure 14 RFS Depreciation Expense by council classification



This has been a somewhat contentious issue in recent years and ultimately comes down to identifying where control of these assets lie. In summary, the NSW Government has concluded under the *Rural Fire Services Act 1997*, which states that these assets are vested to councils and therefore “on balance, councils control this equipment” under the Australian Accounting Standards². The NSW Audit Office has accepted this position in undertaking their audit function of local government.

Many councils, with the support of LGNSW, have refused to accept this position, which has resulted in 43 NSW councils receiving a qualified audit opinion of their 2021–22 financial reports. Their position is that control of these assets sits with the RFS, and therefore the NSW Government, based on the Australian Accounting Standards Board Conceptual Framework, which does not necessarily define control as a legal ownership right, but rather:

“... the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it. It follows that, if one party controls an economic resource, no other party controls that resource.”³

² Audit Office of New South Wales (2023) *Regulation and monitoring of local government*, NSW Government, 23 May 2023.

³ Australian Accounting Standards Board (2022) *Conceptual Framework for Financial Reporting*, AASB, 7 April 2022.

This issue is ongoing, and while depreciation itself is not a cash expense, the accounting for depreciation in local government has two key financial implications. Firstly, the increase in depreciation expense will reduce a council's overall surplus or increase its deficit, which has implication for a council's measures of financial sustainability. Secondly, for most local government assets, depreciation is used as the estimate of required renewal expenditure for councils to maintain assets at their current condition. In other words, councils must fund depreciation with a similar level of capital cashflow to ensure assets are kept at required standards, this is not the case for firefighting equipment, which is funded through the State Government's budget allocation to the RFS. This remains an ongoing issue at the time of writing this report.

3.2 Waste levy

The waste levy is a tax on landfill facilities and only applies to 42 metropolitan and 19 regional levy areas shown in Figure 18. Although, not technically a "cost shift" – as the cost of the levy is recovered through waste charges – it represents a somewhat "invisible tax".

The purpose of the waste levy is to provide economic incentive to alternative waste management processes, such as recycling and resource recovery. The funds raised by the waste levy go directly to NSW Government general revenue. Some funds do come back to communities and councils through grants for a variety of projects, but this only represents 10 to 15 per cent of the funds raised through the tax.

The metropolitan levy at \$147.10 per tonne in 2021–22 is nearly twice the amount per tonne of the regional levy at \$84.70 per tonne in 2021–22. Some councils, such as Central Coast and Newcastle, operate their own landfill facilities and pay the levy directly to the NSW Government. Not all councils operate landfills directly, many councils have their waste managed through contracts with private providers. While these providers will incur the levy directly, councils in the levy areas will collect waste charges that include the waste levy as a component of the waste fees. Depending on how their waste management contracts are structured, some councils have been able to provide an estimate of this levy collected in the waste fees while others have not.

Of the 51 councils surveyed who are in the levy area, 36 provided an estimate of the amount paid, which totalled \$287.8 million in 2021–22. Based on this data, we have estimated the total amount of the waste levy paid through waste collection fees in 2021–22 at \$292.9 million.

Figure 15 Waste levy by council classification

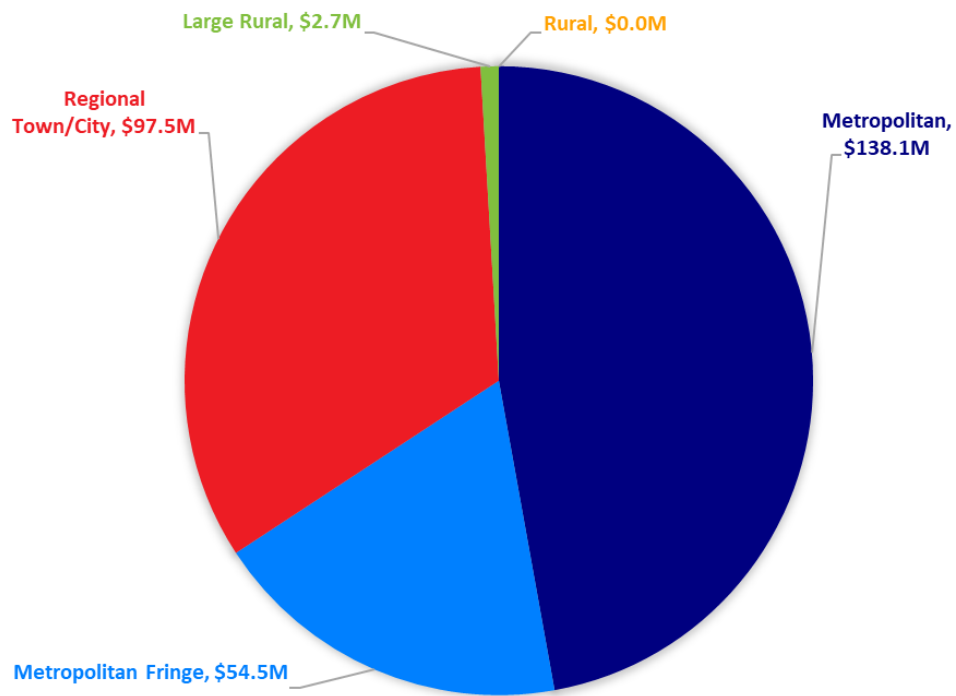


Figure 16 Respondent councils with the highest waste levy

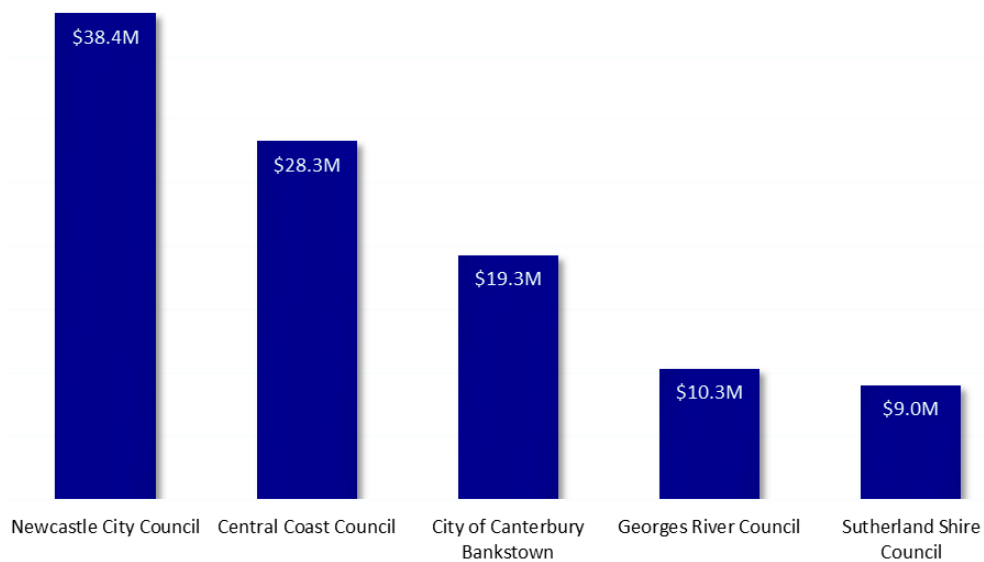
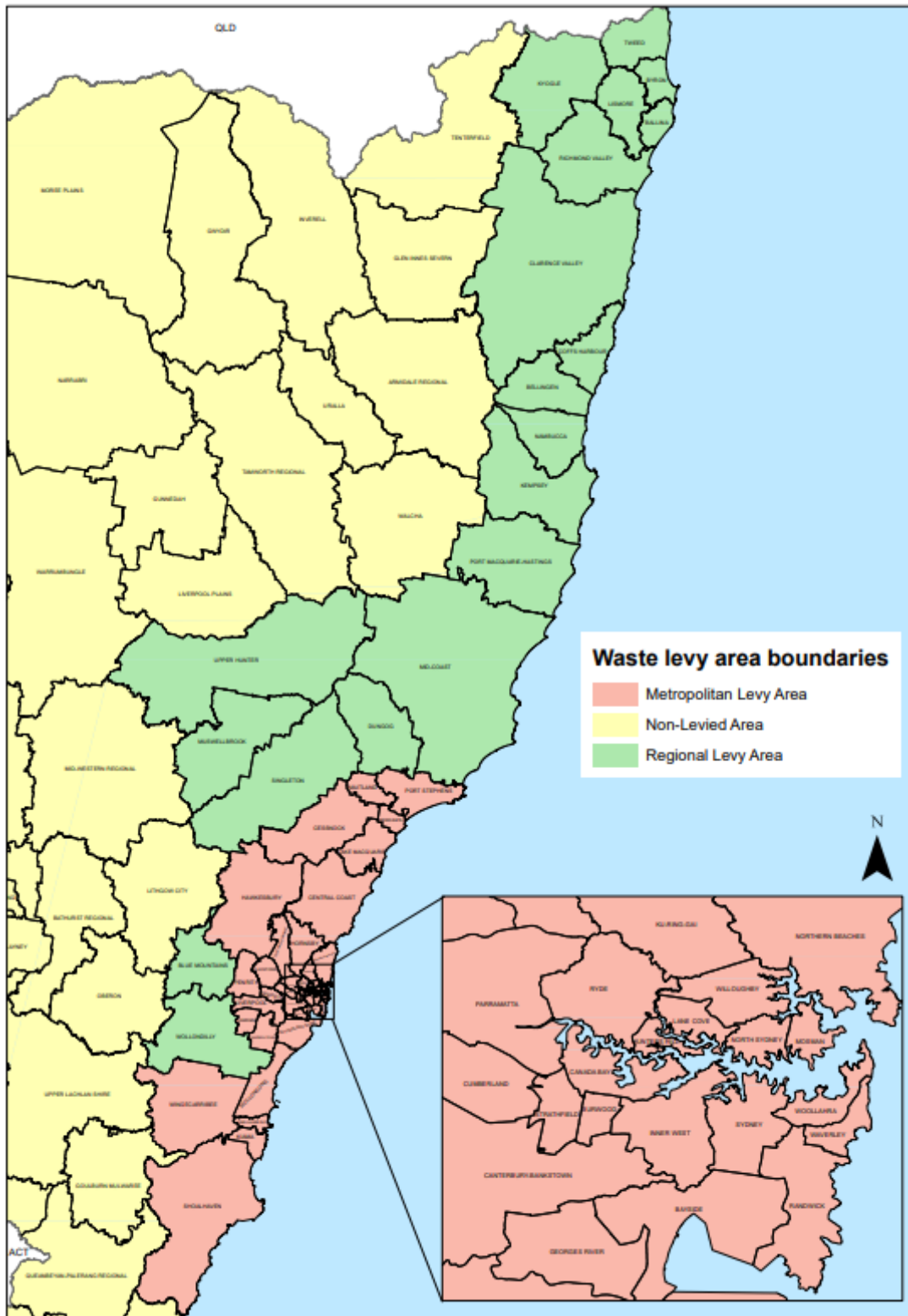


Figure 17 Waste levy area map⁴



⁴ <https://www.epa.nsw.gov.au/-/media/epa/corporate-site/resources/wasteregulation/levy-area-map.pdf?la=en&hash=C00135E31055627BB8A41EAEB222864C2655B186>.

3.3 Rate exemptions

Many government and private property owners in a local government area are exempt from paying rates to councils. Due to the way rates are calculated, this doesn't usually affect the total amount of revenue that councils are able to raise through rates. It does mean that the distribution of the rates burden falls more heavily on the existing ratepayer base.

For government-owned properties, rate exemptions are a part of a complex set of arrangements for exemptions of some taxes between the different tiers of government. State Owned Corporations (SOCs and GTEs) pay tax on lands owned and used for commercial purposes. This is provided for under competitive neutrality policy/National Competition Policy (a notable exception to this arrangement is the Forestry Corporation). Councils are exempt from most State and Federal taxes (for example land tax, payroll tax, stamp duty, and income tax). Councils are also involved in delivering a wide range of services or regulatory functions under various State and Commonwealth Acts and they receive a large number of different grants from State and Federal governments, including the untied Financial Assistance Grants that the States administer and distribute to councils.

Additionally, there are many non-government organisations that are also exempt from paying rates, including private schools, hospitals and retirement villages, as well as not-for-profit organisations such as religious organisations. While these organisations are exempt from paying rates; all expect and receive services and infrastructure from councils, the cost of which is funded by ratepayers.

Community housing was an area that we asked councils about specifically as the NSW government has been in the process of transitioning the ownership and management of public and social housing to non-government Community Housing Providers. Under past practice, social and public housing provided by State Government agencies paid rate equivalents on all their properties. CHPs are exempt from rates and more and more social and public housing is moving into this category. As a result, the rates exempt status seems to be moving with the community housing property.

The total amount of rate exemptions represented \$273.1 million, shifting approximately \$89.04 to each NSW ratepayer.

Figure 18 Rate exemptions by category

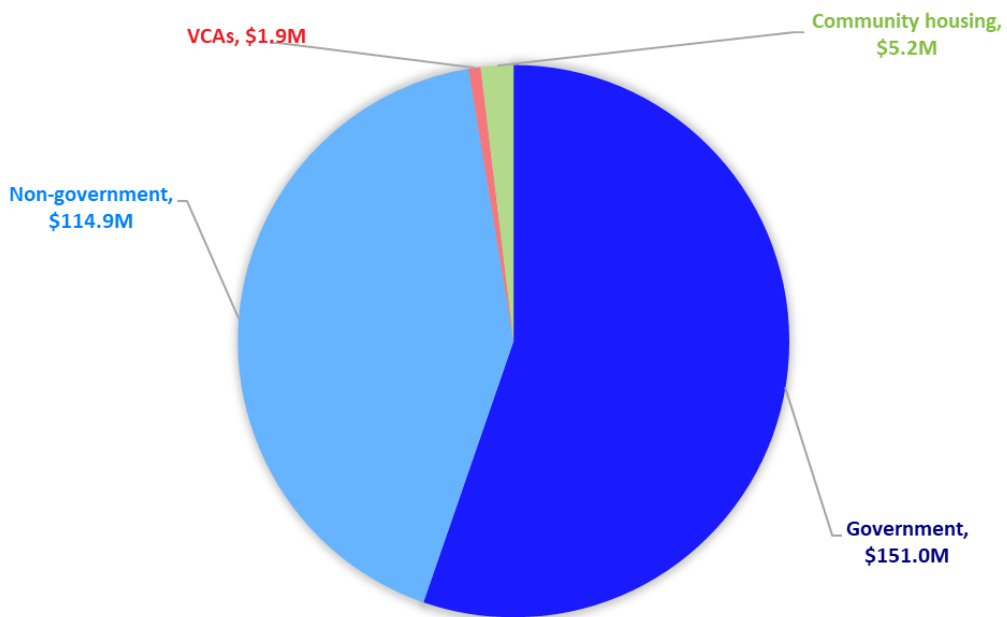


Figure 19 Rate exemptions by council classification

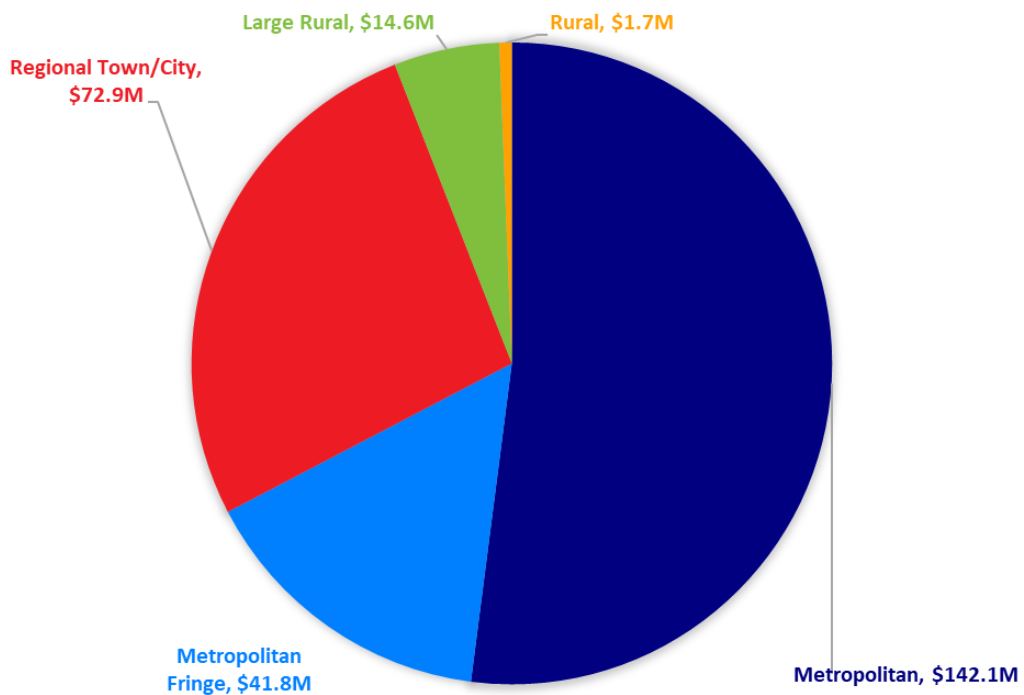


Figure 20 Average rate exemption for respondent councils as a proportion of rates revenue by council classification

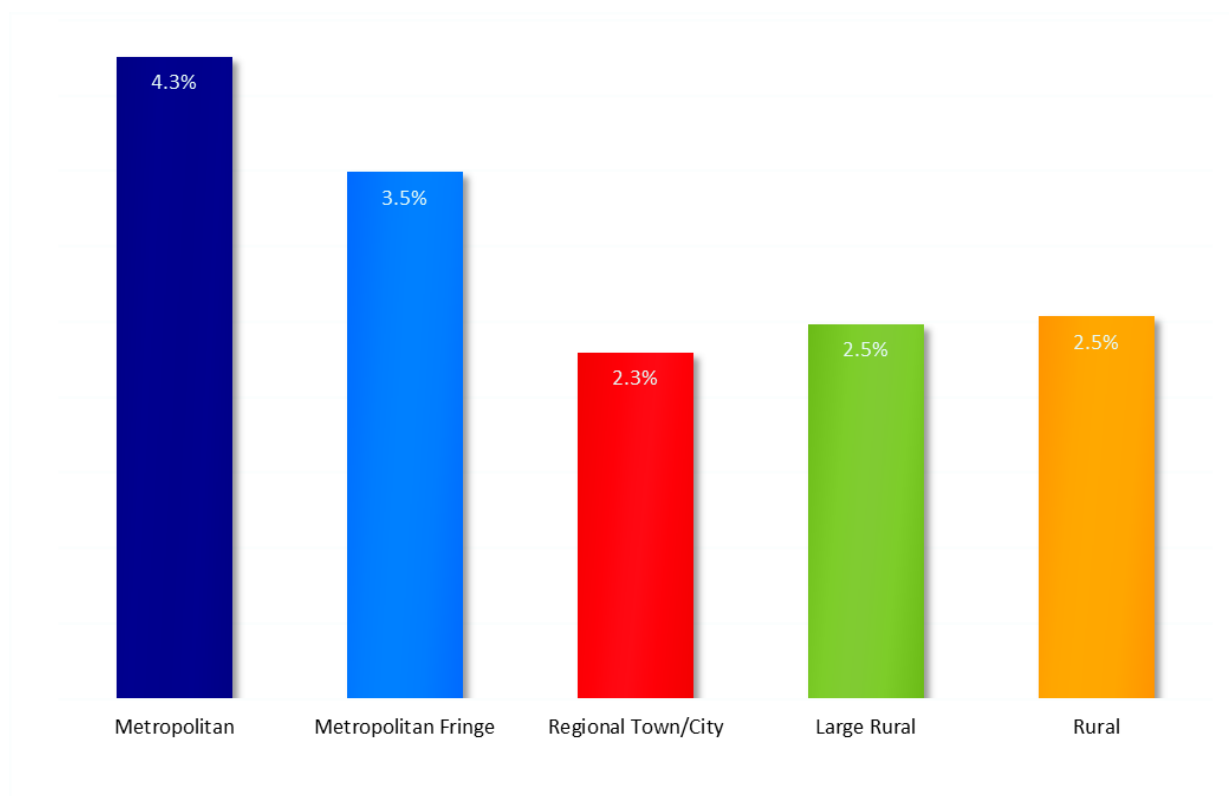


Figure 21 Respondent councils with the highest rate exemptions as a proportion of rates revenue

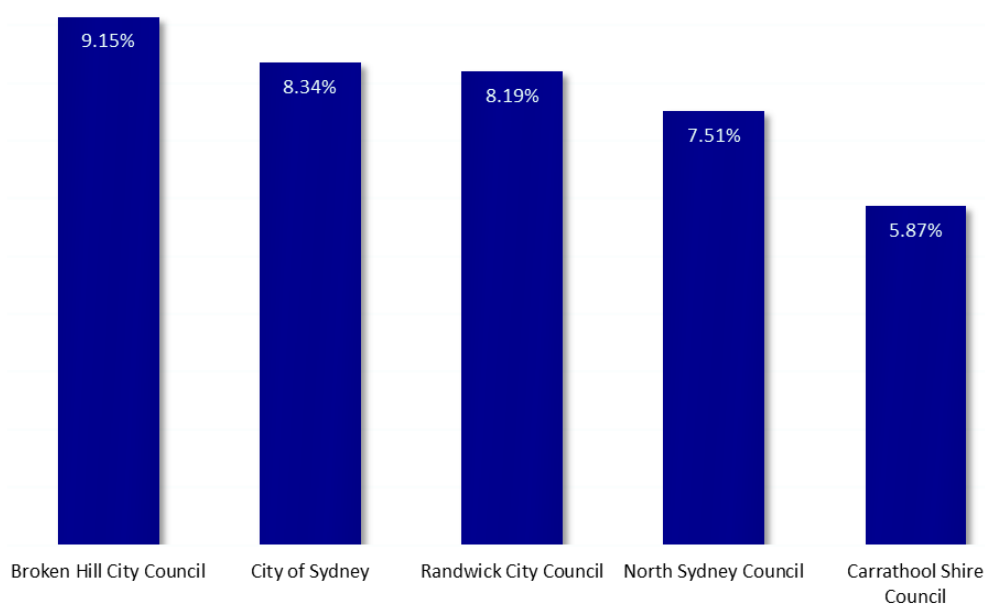


Table 1 Cost for rate exemptions

Rate exemption	Number of councils who responded to this question in the survey with a figure	Total amount of cost shift provided	Estimated total cost shift for all NSW Councils (based on population)
Government-owned property	62 (from which two councils put a figure of 0)	\$95.5M	\$151M
Non-government-owned property	61 (from which one council put a figure of 0)	\$72M	\$115M
Voluntary conservation agreements	47 (from which ten councils put a figure of 0)	\$1.2M	\$1.9M
Community housing	53 (from which 11 councils put a figure of 0)	\$3.3M	\$5.2M

3.4 Regulatory functions

In addition to the obligations under the *Rural Fire Services Act 1997*, *Fire and Rescue NSW Act 1989* and the *State Emergency Service Act 1989*, councils incur additional costs of increased regulatory responsibilities. These are additional functions or requirements that are not fully funded by increases in fees and charges.

In 2021–22, the unfunded costs for regulatory functions represented \$208.0 million.

Figure 22 Unfunded regulatory costs by category

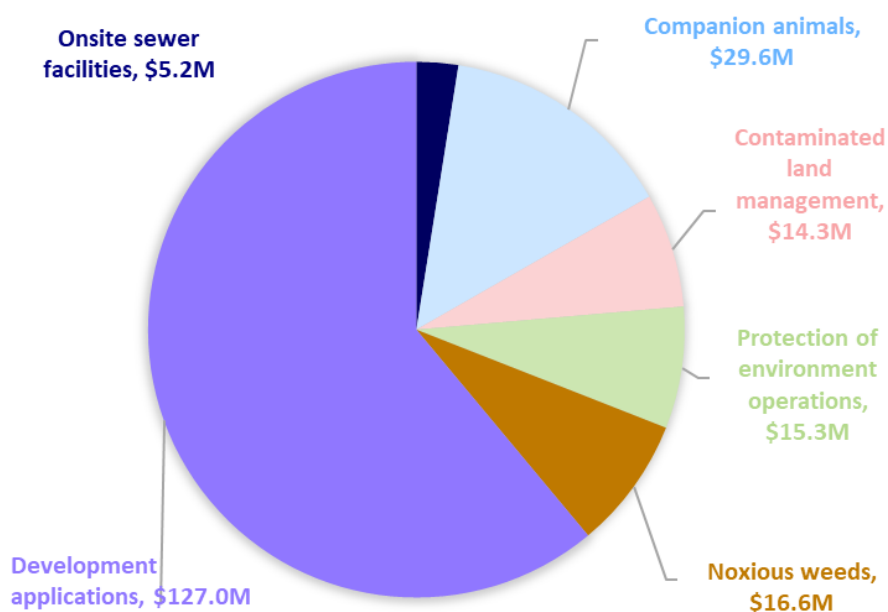


Figure 23 Unfunded regulatory costs by council classification

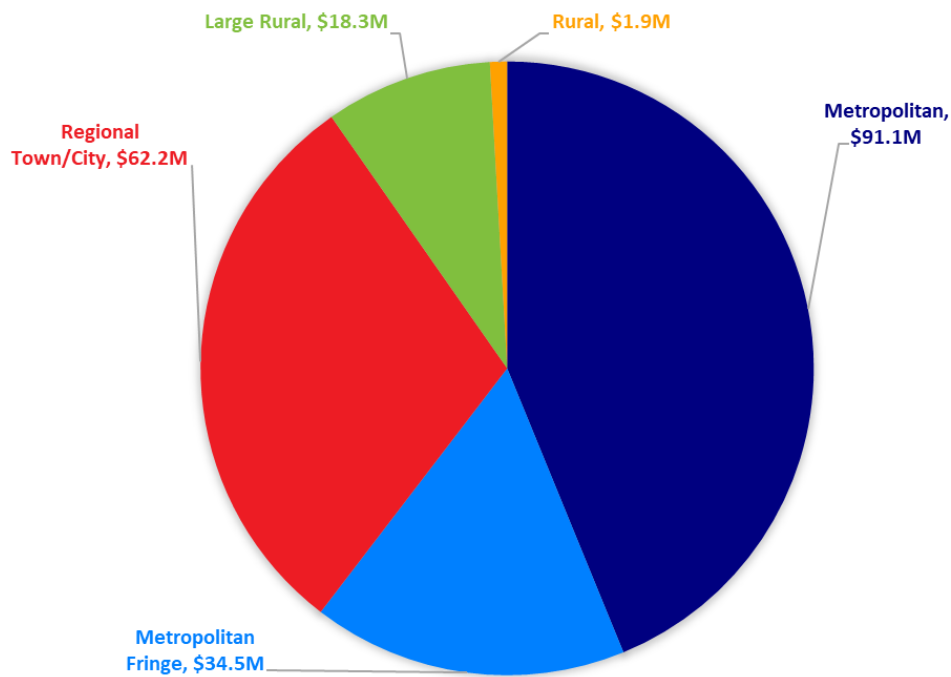
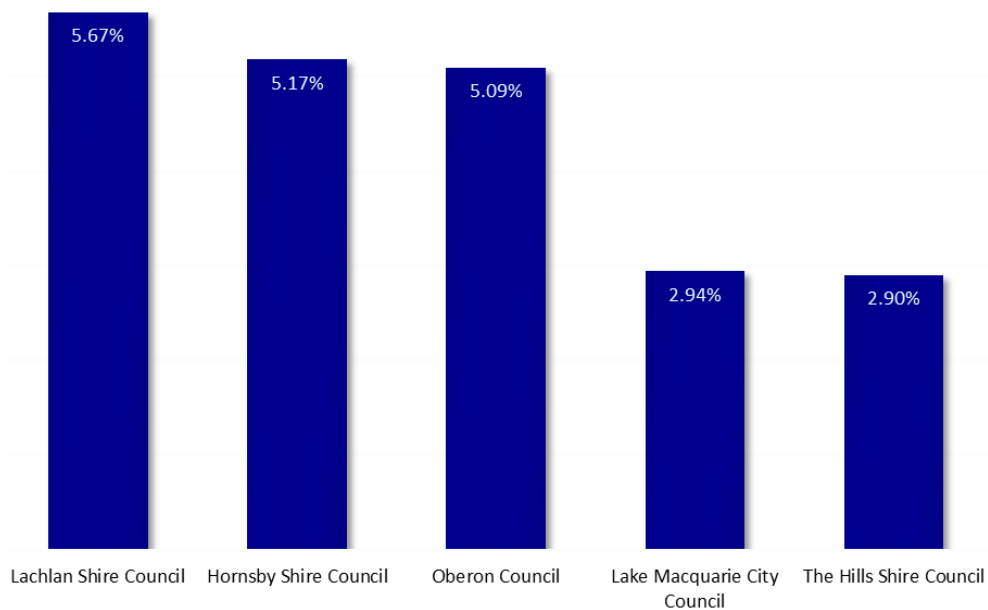


Figure 24 Respondent councils with the largest regulatory cost as a proportion of total operating expenditure



The function and total estimated costs from councils are outlined in the table below.

Table 2 Cost for increased regulatory functions that cannot be recovered through fees and charges

Regulatory function	Number of councils who responded to this question in the survey with a figure	Total amount of cost shift provided	Estimated total cost shift for all NSW Councils (based on population)
Onsite sewer facilities	35 (from which 15 councils put a figure of 0)	\$3.4M	\$5.2M
Companion animals	69 (from which four councils put a figure of 0)	\$19.6M	\$29.6M
Contaminated land management	45 (from which nine councils put a figure of 0)	\$7.2M	\$14.3M
Protection of environment operations	48 (from which four councils put a figure of 0 and one a negative amount)	\$9.9M	\$15.3M
Noxious weeds	64 (from which eight councils put a figure of 0)	\$11.1M	\$16.6M
Development applications	64 (from which five councils put a figure of 0 and one a negative amount)	\$86.7M	\$127.0M

3.5 Funding programs

Councils are occasionally required to fund the continuation of several funding programs that were instigated by the NSW Government, but for which funding commitments have, over time, either been reduced or removed entirely. The three main funding programs councils currently continue to fund are:

- **Library subsidies:** the original library funding subsidy was 50 per cent of the library services costs, however this has reduced over time. In 2021–22, councils paid an estimated \$156.7 million on library services that would have been covered by the originally committed 50 per cent State government subsidy.
- **Flood mitigation:** the program was originally established with the State and Federal governments providing 80 per cent of the costs and councils funding 20 per cent, the shortfall of this funding is estimated to be costing councils \$18.2 million in 2021–22.
- **Road safety program:** funding for programs and ongoing staff for education, however councils were not able to reduce the costs with the removal of the funding program. In 2021–22, councils have an estimated cost burden of \$6.4 million as result.

The total cost to council to continue to meet the funding shortfall of these programs was \$181.3 million, the vast majority which was the shortfall in the library subsidy of \$156.7 million.

Figure 25 Funding program costs shifted by category

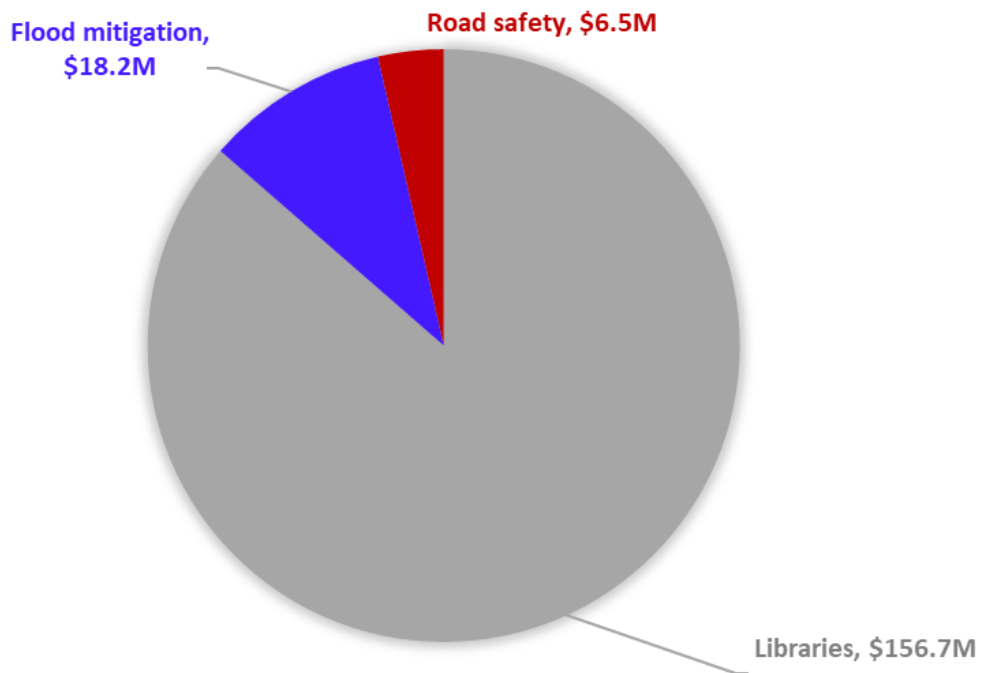


Figure 26 Funding program costs shifted by council classification

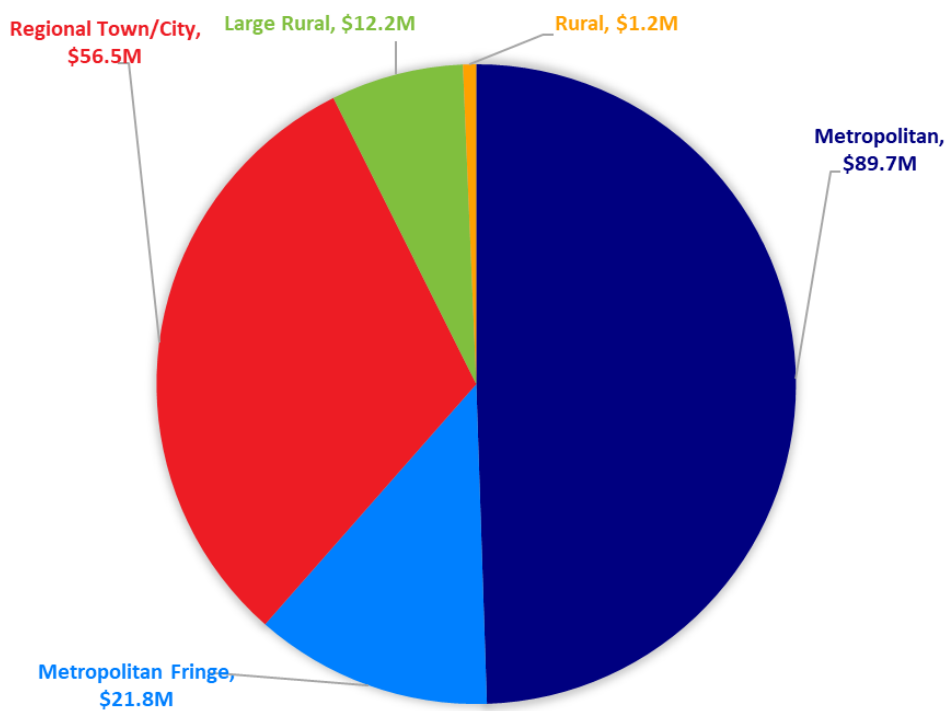
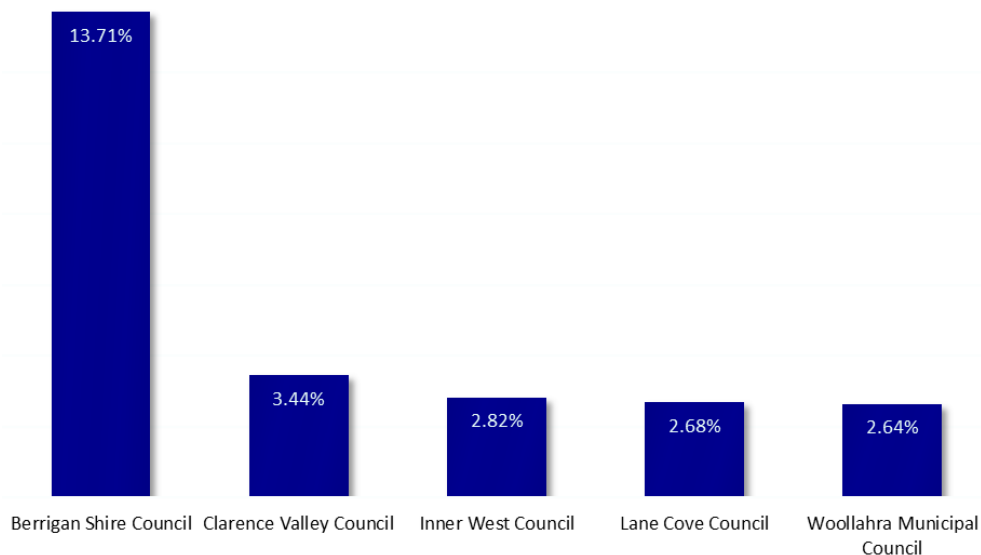


Figure 27 Respondent councils with the largest funding program costs shifted as a proportion of total operating expenditure

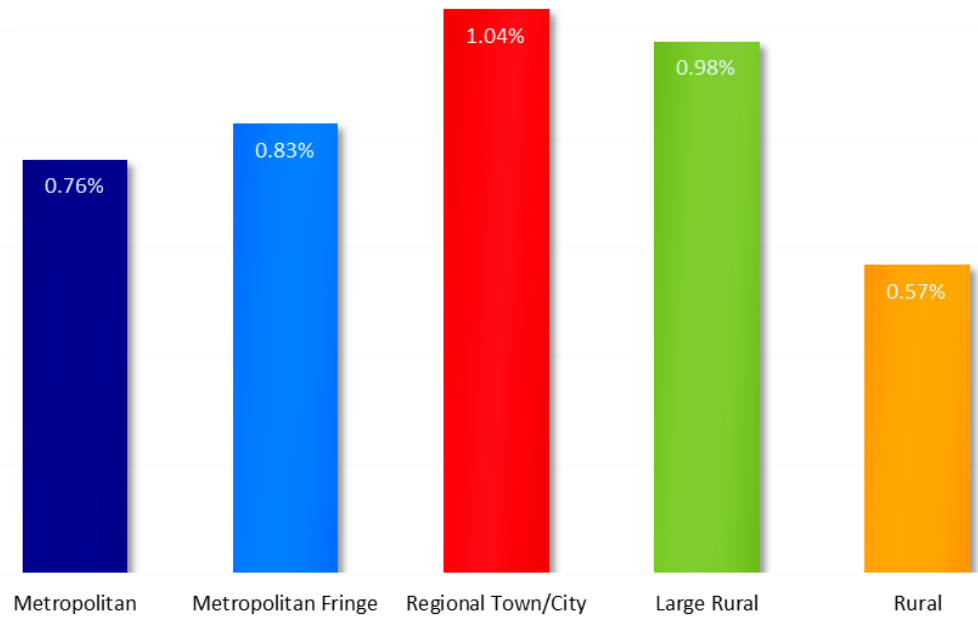


3.6 Pensioner rebates

Councils are required to provide rates rebates to pensioners, which are partially subsidised by the NSW Government. This mandatory pensioner rebate is an estimated net cost to councils of \$55.2 million. This does not include the cost of administering the mandatory pensioner rebates, as each pensioner claim needs to be registered and their details checked by the council.

The level of mandatory rebate has not risen substantially over many years, and therefore has not kept pace with inflation. As a result, many councils have elected to apply further voluntary rebates to ease the financial burden on pensioners. NSW councils incur an additional \$17.2 million in voluntary pensioner rebates. The total cost of pensioner rebates is estimated to be \$72.4 million.

Figure 28 Average total pensioner rebates as a proportion of total rates revenue by council classification



3.7 Service gaps

This section captures costs incurred by councils in providing services as a result of insufficient service provision by another level of government or a market failure of a subsidised or privatised public service. In 2021–22, it is estimated that councils spent \$66.6 million on filling these gaps.

Figure 29 Service gap costs by council classification

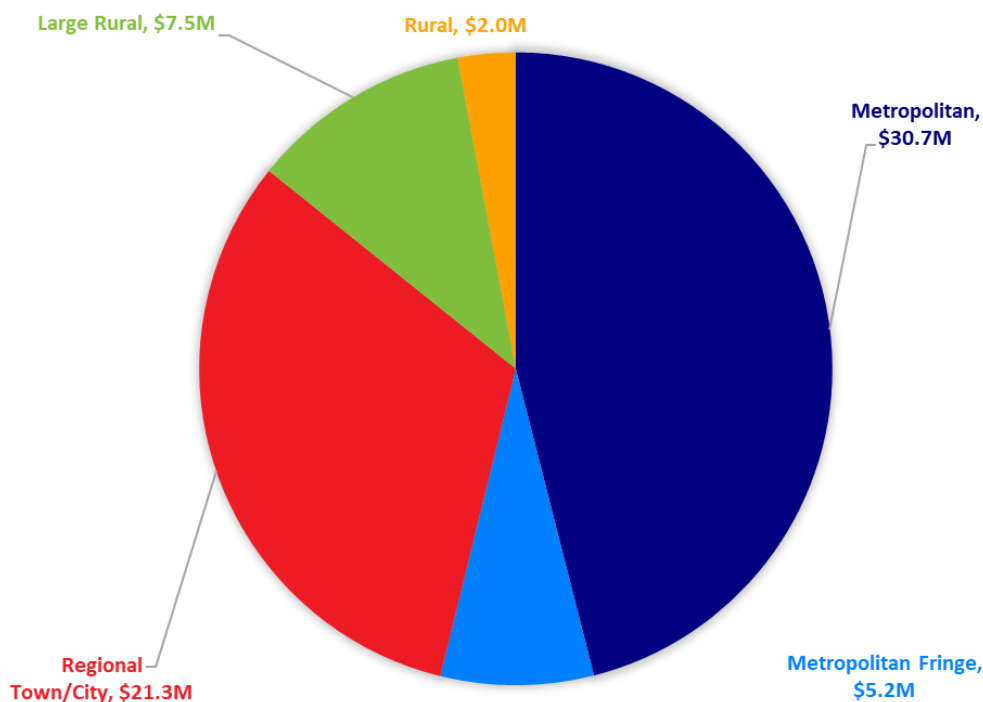
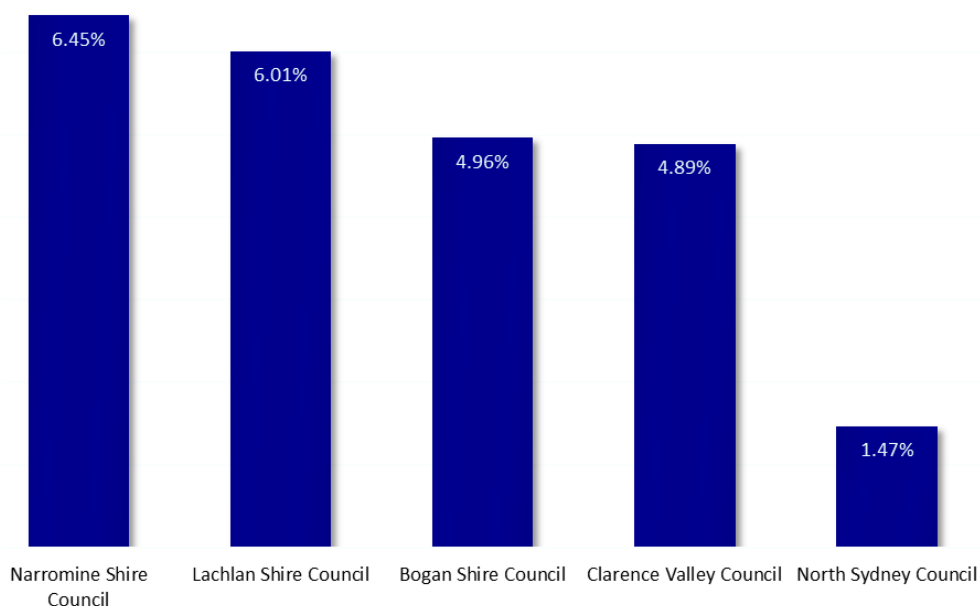


Figure 30 Respondent councils with the highest service gap cost as a proportion of total operating expenditure



The estimated costs are set out in Table 3, below.

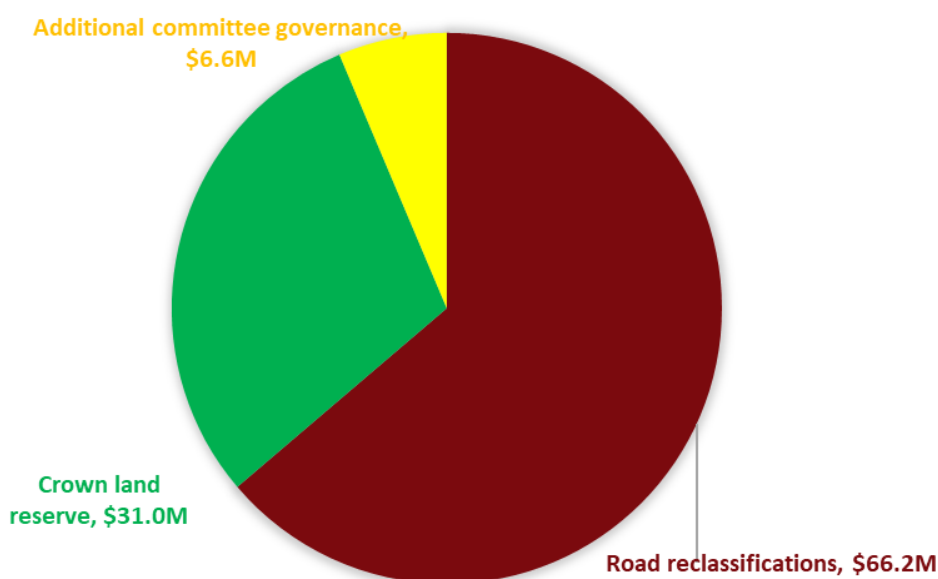
Table 3 Cost for services provided by Council as a result of a State or Federal service gap or market failure

Regulatory function	Number of councils who responded to this question in the survey with a figure	Total amount of cost shift provided	Estimated total cost shift for all NSW Councils (based on population)
Immigration and citizenship ceremonies	60 (from which ten councils put a figure of 0)	\$1.1M	\$1.6M
Crime prevention and policing	51 (from which 11 councils put a figure of 0)	\$10.2M	\$16.2M
Medical services	33 (from which 15 councils put a figure of 0)	\$2.2M	\$3.2M
Aged care services	36 (from which 19 councils put a figure of 0)	\$3.9M	\$5.6M
Disability care services	28 (from which 17 councils put a figure of 0)	\$1.4M	\$2.2M
Childcare services	49 (from which 19 councils put a figure of 0 and two councils a negative figure)	\$12.0M	\$17.8M
Transport services	37 (from which 20 councils put a figure of 0)	\$14.1M	\$20.5M

3.8 Other cost shifts

A number of other areas for cost shifting were identified and gathered in the survey and are outlined here.

Figure 31 Other cost shifts by category



Under the Transport for NSW (formerly RMS) road reclassification program in the 1990s, many roads were reclassified as local or regional road for councils to own and maintain. Of the 68 councils that responded to the survey, 32 were able to estimate the cost of this reclassification, 12 were not able to reliably estimate, and 24 stated that it was not applicable. The total estimate of costs provided by councils was \$26.7 million in 2021–22.

Under the Crown Lands Act 1989, councils have full responsibility to maintain crown reserves under council management and are expected to subsidise shortfalls in maintenance cost from general revenue. This is considered appropriate as the benefits from crown reserves under council management generally accrue to the local community. However, as a result, councils should also be entitled to any current or potential revenue from crown reserves that is required to cover maintenance and improvement cost (e.g., revenue from refreshment facilities, telecommunication facilities). The NSW Government will on occasion take over allowable revenue raising activities on council managed crown reserve land (not including national parks) or will require councils to transfer revenue from council managed crown reserve land to the State Government.

Of the 68 councils surveyed, 22 estimated the lost revenue at \$14.8 million in 2021–22. A further 27 councils were not able to reliably estimate the costs and 19 councils advised that this item didn't apply to them. This estimate does not represent the total net cost of managing (maintaining) crown lands. Nor does it include in transfers associated with the caravan park levy. Only any action by the State Government to limit revenue raising capacity or require the transfer revenue to the State Government has been considered cost shifting.

3.9 Future survey considerations

We asked councils what other areas that should be considered for future surveys. The key areas that respondents identified as costs to be captured in future surveys included:

- Monopoly services costs:
 - NSW Audit Office being the monopoly on local government external audits.
 - NSW Electoral Commission holding a near monopoly on council election administration.
- Cost of Joint Regional Planning Panels (JRPPs) requirement to access councils DAs as per mandated policy.
- Costs of mandatory On-Line Planning Portal – Implementation and ongoing operational costs.
- The Sydney Regional Development Fund Levy.
- Costs associated with Forestry NSW and impact of logging on council owned infrastructure. Rates foregone on State Forest land.
- Capturing the additional cost of Emergency Services administration staff.
- Heritage advisor costs, whilst there is some grant funding towards this it still needs to be administered by council who hand out the grant funds and do general administration.
- Cost involved in Special Variations applications given that councils have to undertake this process to recover costs shifted. This is a lengthy and resource intensive process, which is particularly challenging for smaller councils.
- Net cost of Street Lighting (Less subsidy from Transport for NSW).

- Cost of ongoing maintenance associated with the Community Water Bore program from early 2000s (the program was in conjunction with NSW Office of Water).
- Cost of management of overabundant native species doing damage to infrastructure. This is a NSW government function which is not being undertaken by the State and therefore some councils are doing it.
- Crown Land right to native title compensation (falling to Councils instead of the State).
- Any costs imposed by Service NSW (e.g., disability parking).
- Costs of sharing of facilities especially with Department of Education (schools, parks, playgrounds etc).
- Costs of maintaining State facilities that are located on Crown land.
- Provision of stormwater trunk drainage.

These additional items will need to be validated in terms of the details of what is entailed and whether they are indeed cost shifts before inclusion in any future survey.

We also recommend that some items in the current survey be considered for exclusion in future survey on the basis that they are onerous for councils to quantify and do not materially contribute to the total estimated cost shift for councils, nor are they expected to increase over time. The following items should be reviewed for exclusion:

- Road safety program (Q7) – (0.5% of total cost shift estimate).
- Onsite sewer facilities (Q10) – (0.4% of total cost shift estimate).
- Immigration and citizenship services (Q16) – (0.1% of total cost shift estimate).
- Waste management license fee (Q29) – (0.03% of total cost shift estimate).

4 About the survey

This section outlines the methodology employed to develop and administer the 2021–22 cost shifting survey.

4.1 Development of the survey

The last cost shifting survey of NSW councils was undertaken with 2015–16 financial data. We have used this last survey as the starting point for the 2021–22 Cost Shifting Survey questions. We undertook a review of the previous questionnaire guided by the following guiding principles:

- Ensure that questions are still relevant.
- Where possible maintain questions so that there can be direct year on year comparisons if required.
- Ensure that interpretation of questions is understood and consistent across all councils.
- Identify new areas of cost shifting where required.

An initial review of questions was undertaken by the project team, consisting of Morrison Low and LG NSW staff. We also established a working group that included representatives of senior leaders and financial staff of a cross section of rural, regional, and metropolitan councils. The working group undertook a review of the questions and provided their feedback through a facilitated workshop and feedback gathering tool. We also asked two leading local government academics to provide their feedback through email and one on one meetings on the questionnaire and our approach to understanding cost shifting in local government.

4.2 Conducting the survey

The final survey was provided in a Microsoft Excel format to councils on 17 April 2023 along with a request of councils' 2021–22 Financial Data Return (FDR), which contained council's audited financial Statement information. The FDR was used to gather a small amount of cost shifting information, but predominantly for data validation purposes.

4.3 Responses to the survey

Councils were asked to return their survey responses and FDRs by 8 May 2023. Some councils requested extensions to this date, which were granted up to 19 May 2023. A total of 75 out of 128 councils provided completed surveys (a 58.6% response rate), although not all answers were completed by all responding councils. Only 72 councils provided their FDRs, as three councils were still finalising their 2021–22 financial Statements at the time of survey completion date.

4.4 Data validation and analysis

Data validation included review of outliers both in total terms as well as a proportion of the council's proportion of total operating expenditure. Where possible, we also compared survey responses with councils FDR data returns to understand if there may have been discrepancies or misinterpretations of questions. This

required us to seek further information and validation with some councils on their responses to some questions.

We also utilised State Government financial reports for the Emergency Services agencies to validate to estimate of the ESL against the contributions that these agencies reported in their financial Statements.

For most questions, we have used population as the basis for estimating the total cost shift to all NSW councils for the survey data received. For some we were able to directly estimate through published reports. For example, we used the State Library's 2021–22 report on local council libraries with included operating costs and subsidies received. For other questions, such as the waste levy, where it is not relevant to all councils and there are different levels of the levy between metropolitan and regional councils, we used populations within the relevant and group councils as a basis for estimating the total cost of the waste levy.