

Ability of local governments to fund infrastructure and services

NSW Parliamentary Inquiry

Local Government NSW

May 2024





Independent
insight.



© SGS Economics and Planning Pty Ltd 2024

This report has been prepared for Local Government NSW. SGS Economics and Planning has taken all due care in the preparation of this report. However, SGS and its associated consultants are not liable to any person or entity for any damage or loss that has occurred, or may occur, in relation to that person or entity taking or not taking action in respect of any representation, statement, opinion or advice referred to herein.

SGS Economics and Planning Pty Ltd
ACN 007 437 729
www.sgsep.com.au

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

Contents

Executive summary	1
1. Financing community need	5
1.2 Rising operational and capital expenditure	6
1.3 Declining value of financial assistance grants	12
1.4 Limited scope and flexibility in NSW government grants	18
1.5 Infrastructure cost recovery via development contributions	20
2. Review of rate peg and local government costs	23
2.1 Rate peg methodology	23
2.2 The past rate peg is poorly aligned with operational and capital costs	25
2.3 The past rate peg has lagged wages and CPI growth	29
2.4 The past rate peg exacerbates existing maintenance expenditure shortfalls	30
2.5 The past rate peg exposes a spatial divide in the types and costs of services	32
3. Social and economic impacts of the rate peg	34
3.1 Impacts to ratepayers	34
3.2 Impacts to council and council staff	40
3.3 Jurisdictional comparison	41
4. Alternatives to rate pegging	44
4.1 Removing the rate peg	44
4.2 Refining the rate peg methodology	45
4.3 Simplifying the special rate variations process	47
4.4 Conclusion	48

APPENDICES

Appendix A: Council Classifications	50
---	----

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)

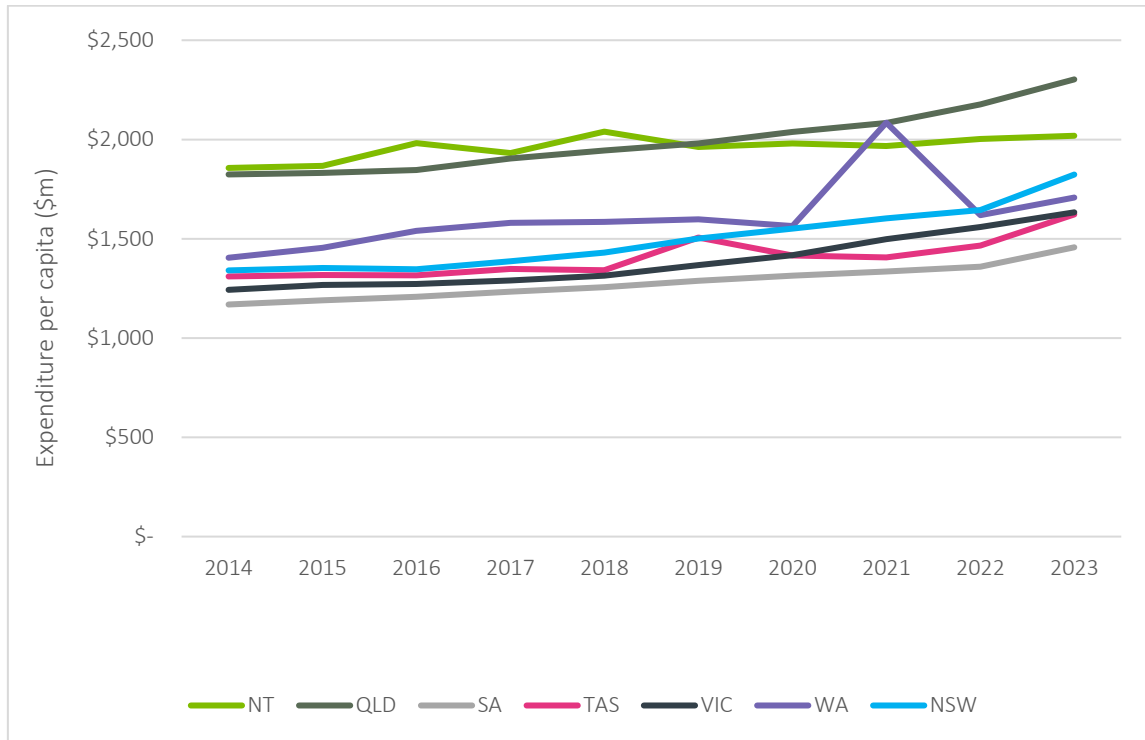
1.2 Rising operational and capital expenditure

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>.

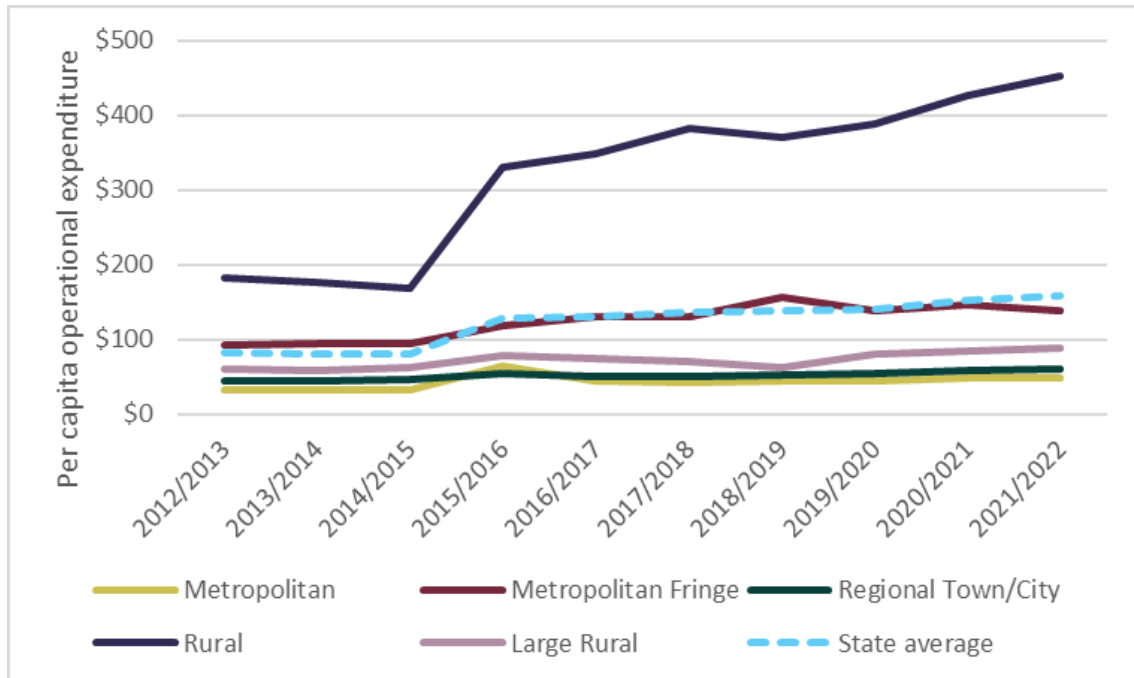
Figure 1: Total local government expenditure per capita by jurisdiction, 2014-23



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).

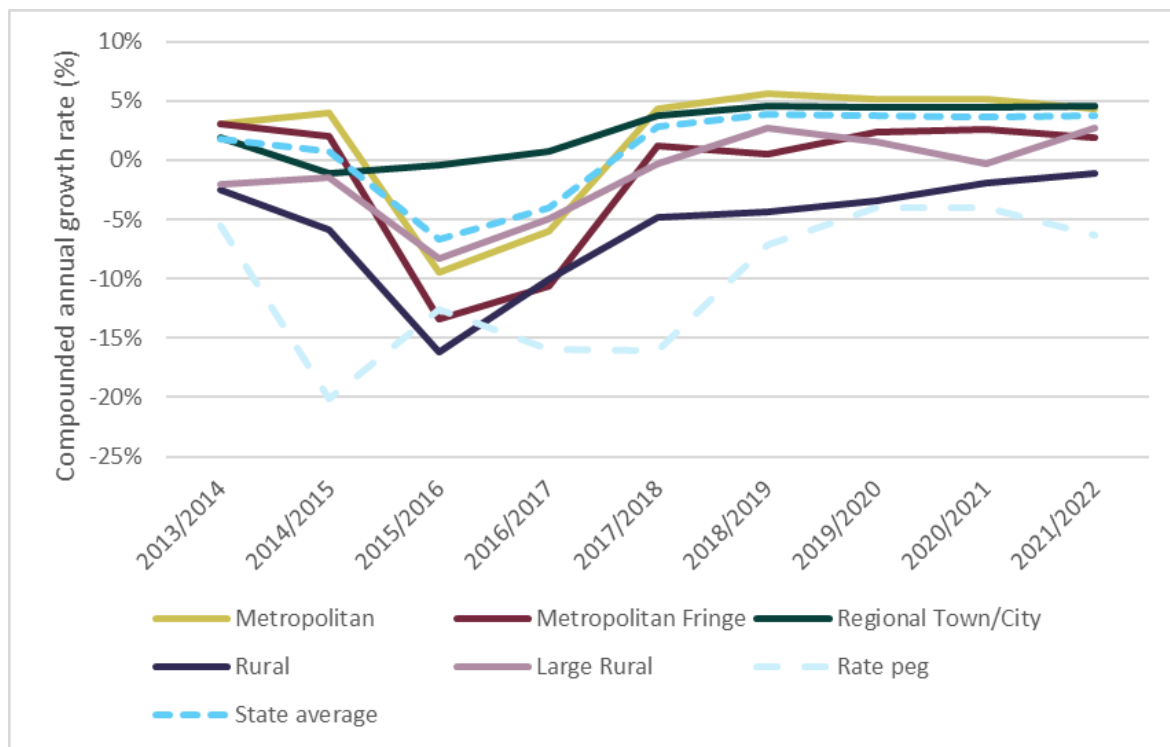
Figure 2: Average operational expenditure (per capita) by council type, 2012-13 to 2021-22



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).

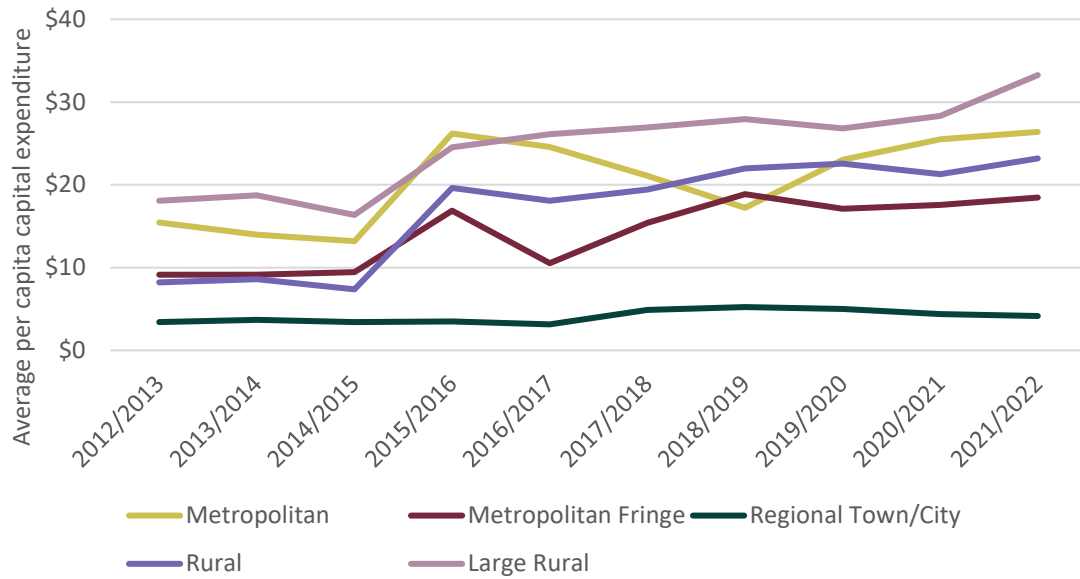
Figure 3: Compound annual growth in operational expenditure (per capita) by council type, 2012-13 to 2021-22



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%).

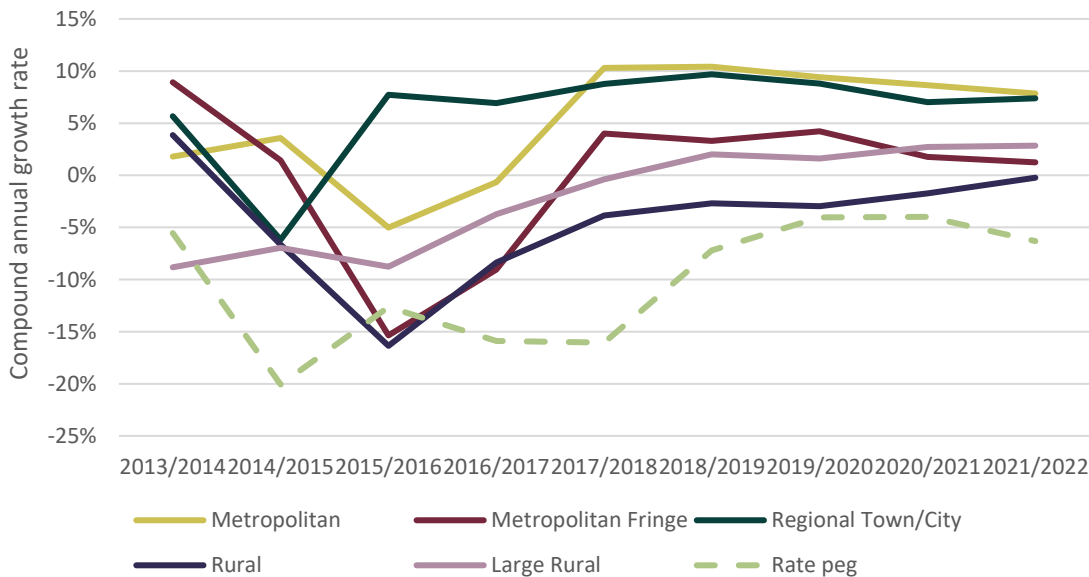
Figure 4: Total local government expenditure (per capita) by council type, 2012-13 to 2021-22



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:

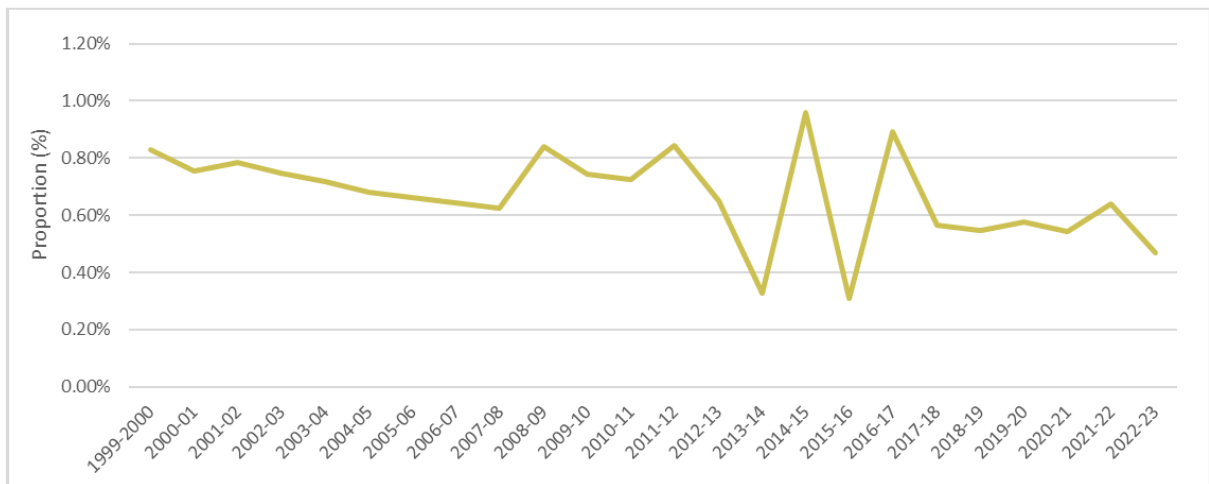
- General purpose component: unconditional funds to be spend on services, community infrastructure, or other municipal priorities. This grant component is distributed among states and territories based on population, and
- Local roads component: intended for the maintenance and construction of local 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

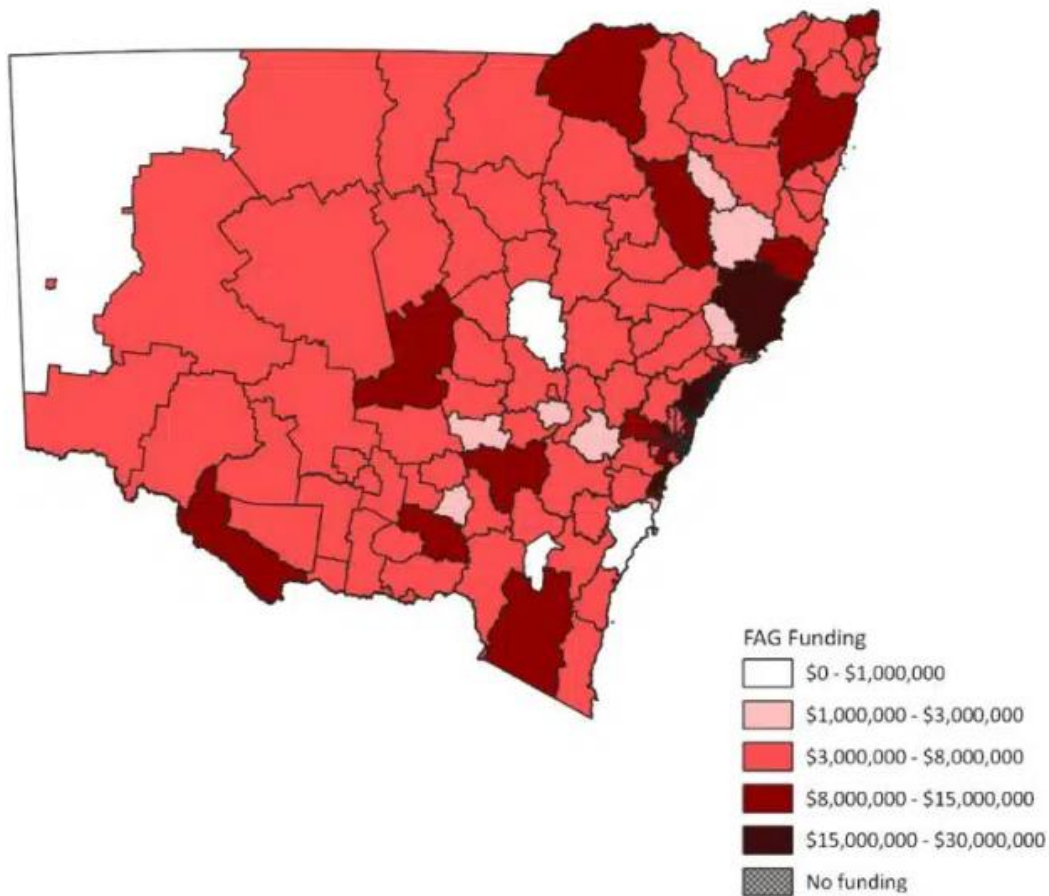
⁸ NSW Local Government Grants Commissions, (2021), *Annual Report 2020-21*, Office of Local Government

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.

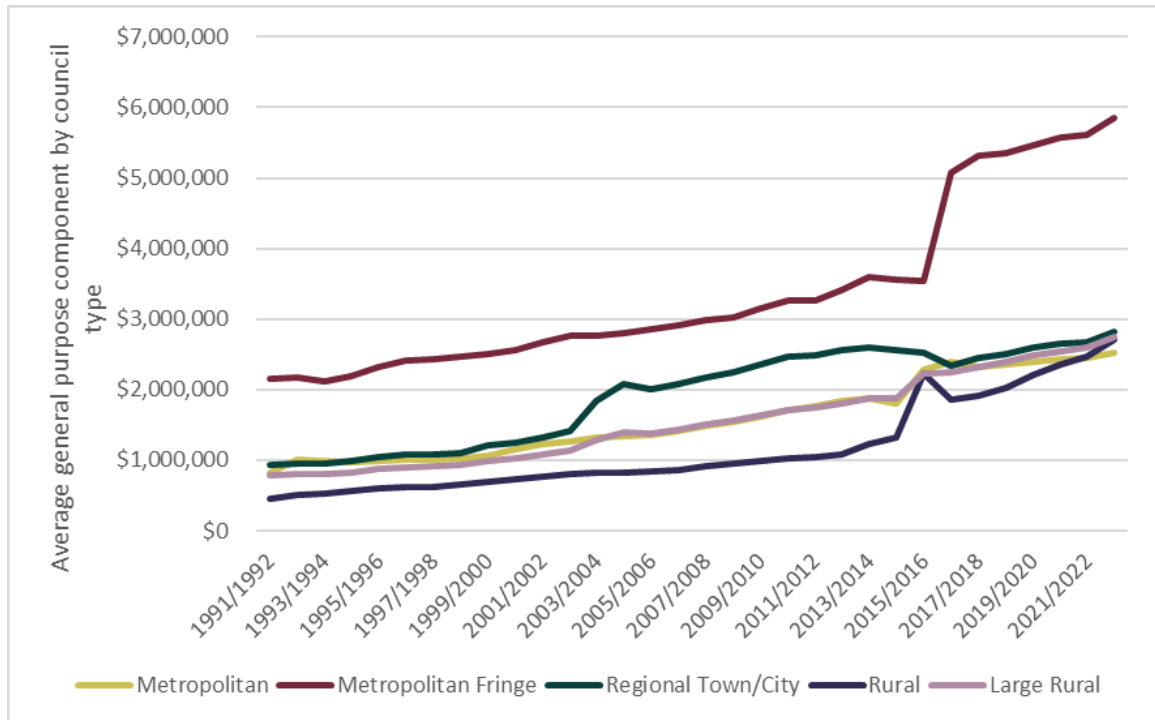
Figure 8: Distribution of FA Grant funding (\$), NSW 2021



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.

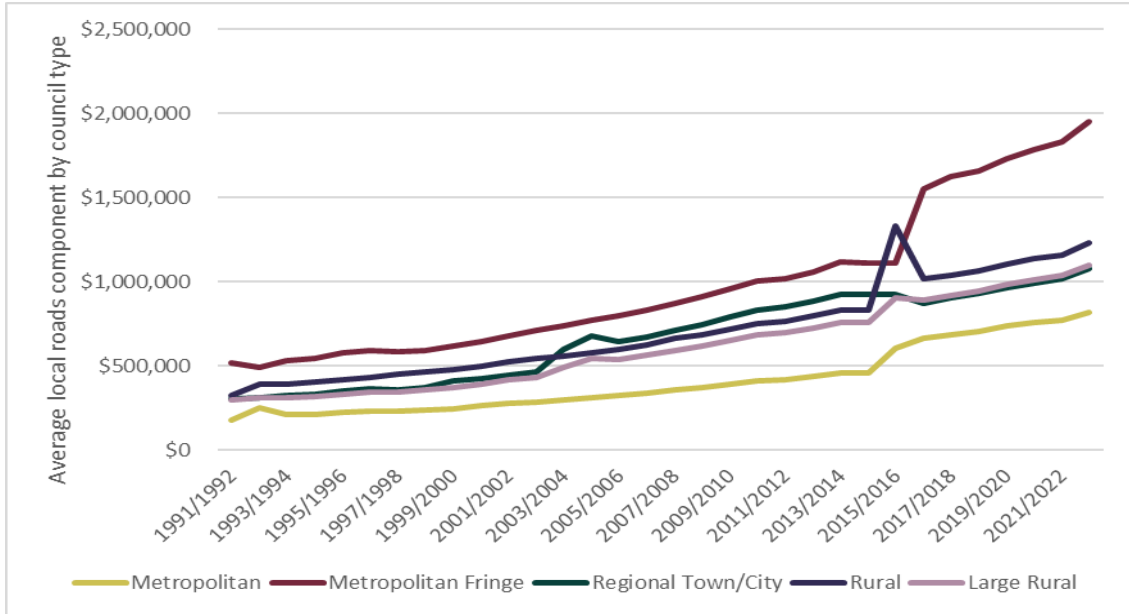
Figure 9: Average per-council General Purpose Component allocation, 1991-92 to 2022-23



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.

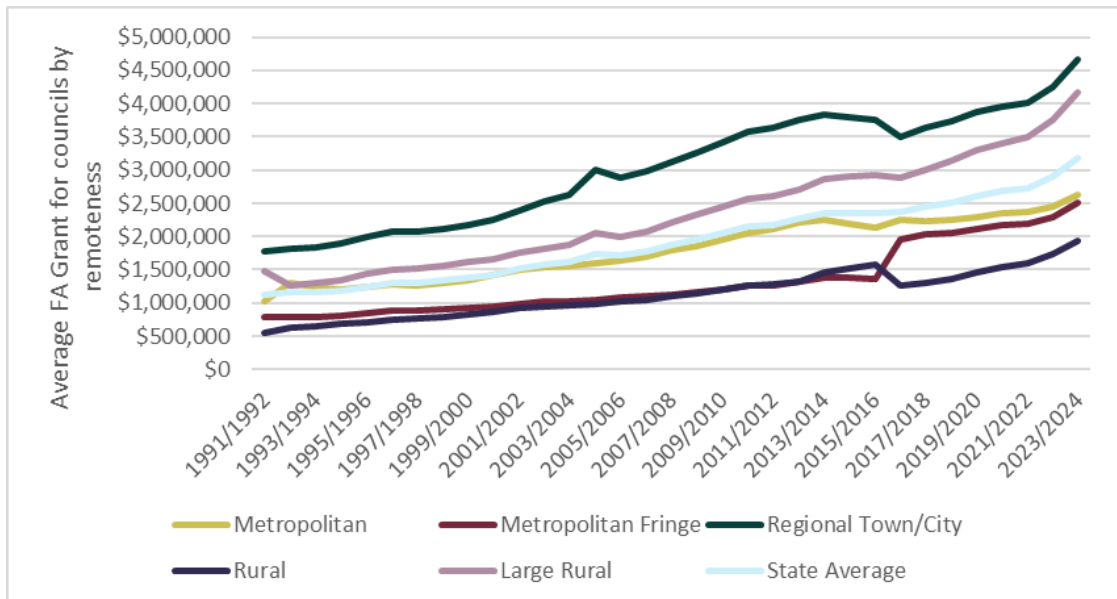
Figure 10: Average per-council Local Roads Component allocations, 1991-92 to 2022-23



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.

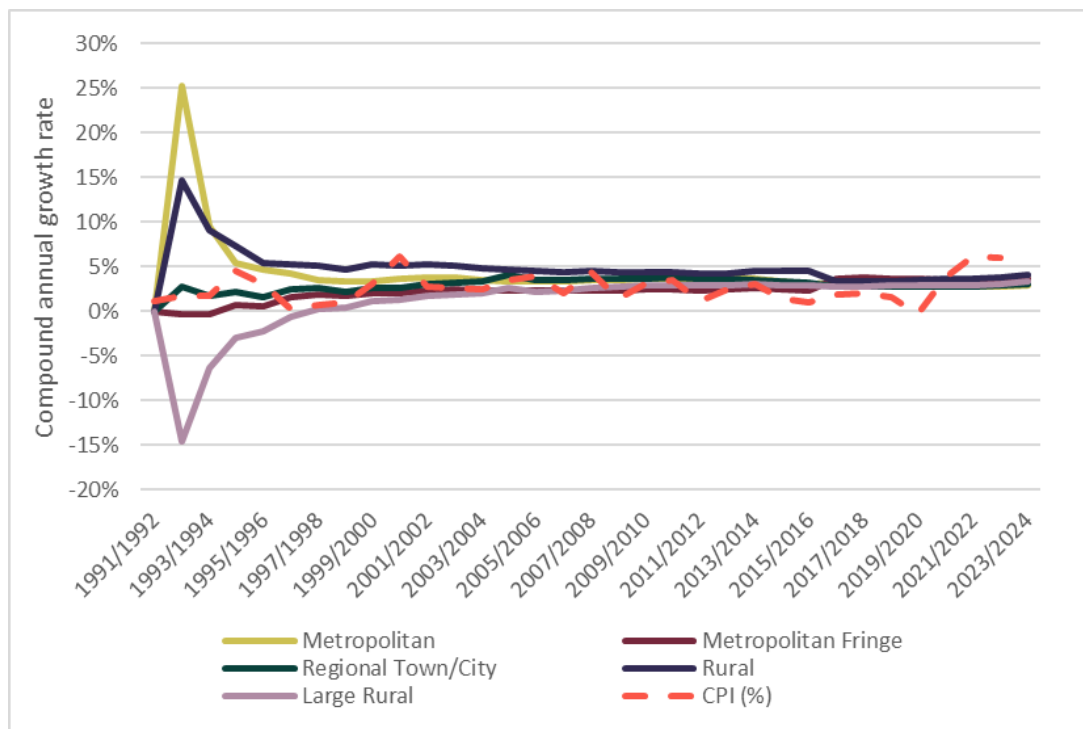
Figure 11: Average per-council FA Grant allocation (all components), 1991-92 to 2023-24



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

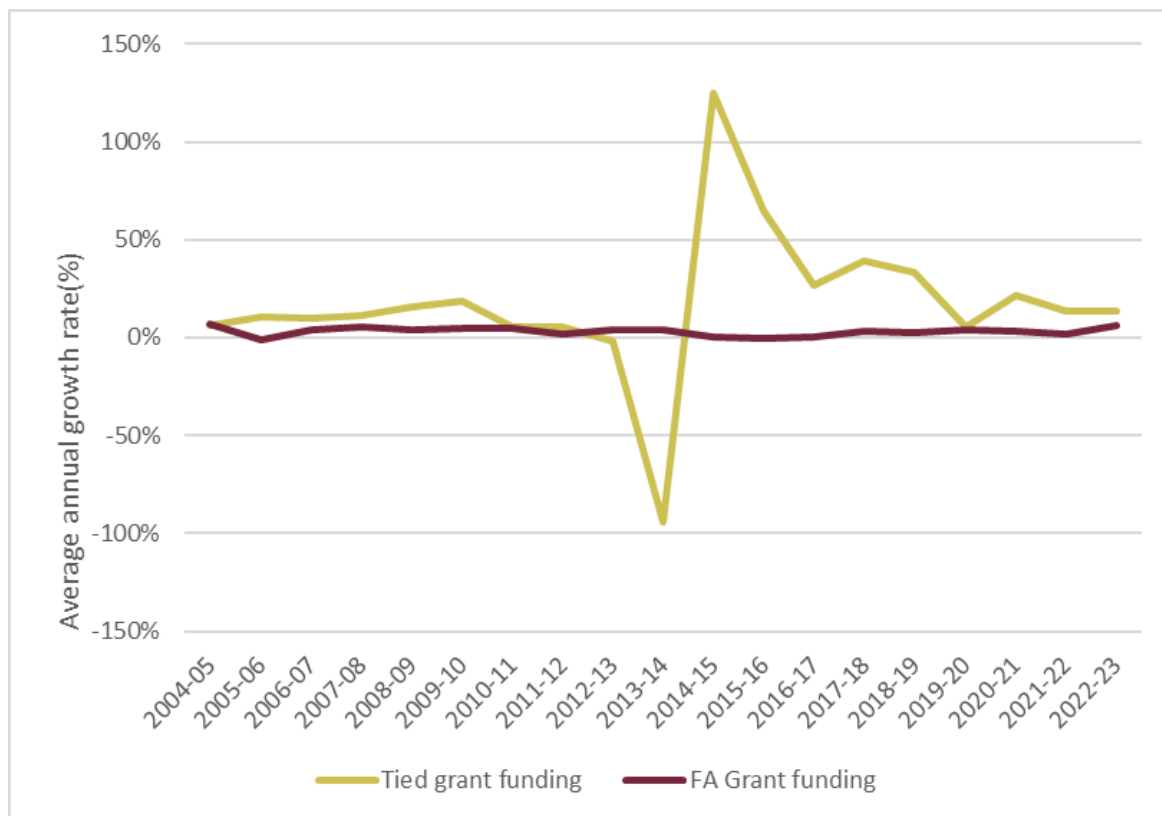
Councils have the ability to access grants from the NSW State Government to support in the delivery of infrastructure and services. These grants are most commonly tied grant arrangements that are delivered as desired by NSW government. As in other states and territories, reporting on these grants is 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.

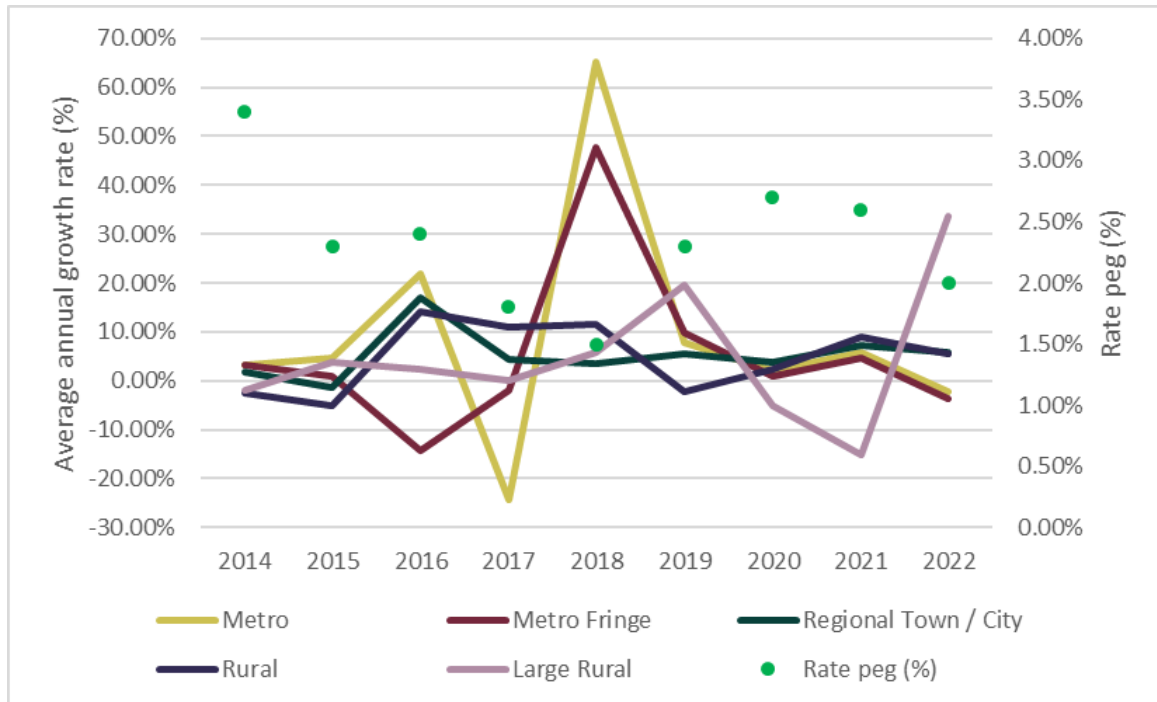
Table 4: Annual change in total council expenditure (operational plus capital), 2013-14 to 2021-22

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.

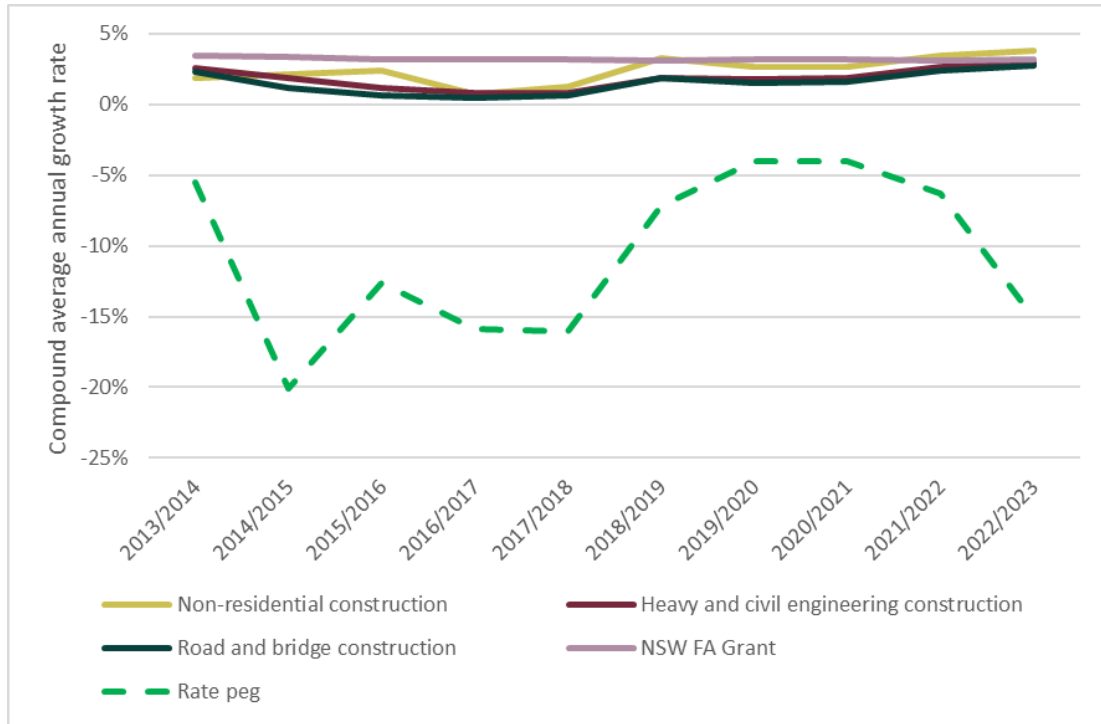
Figure 15: Annual change in total council expenditure (operational plus capital), 2014-22



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.

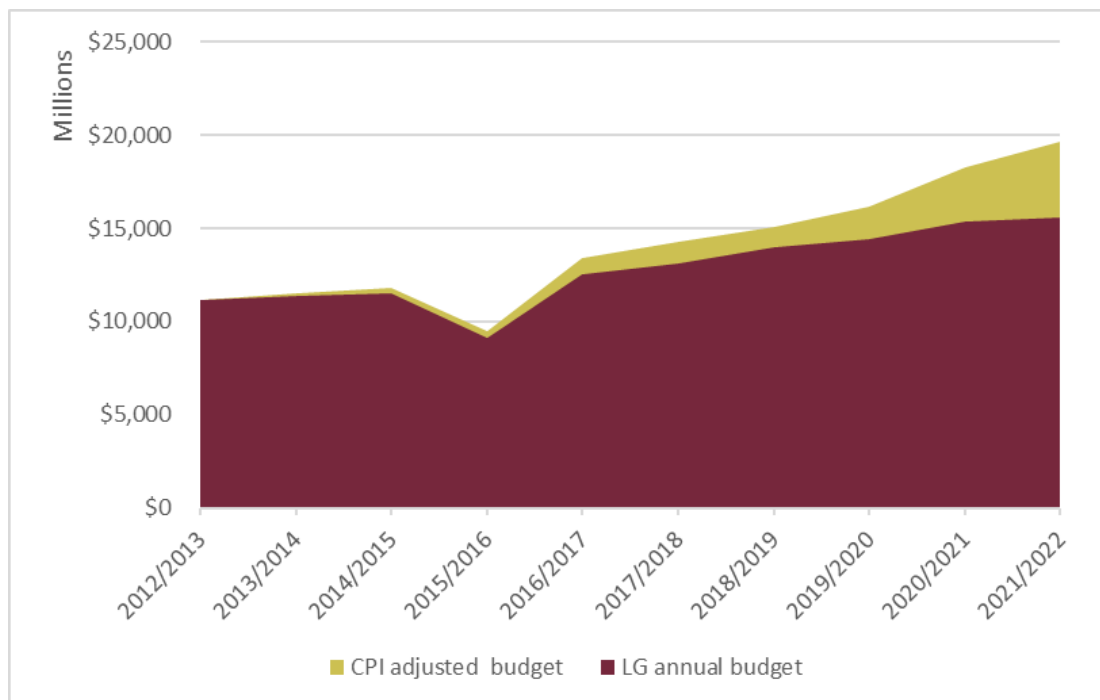
Figure 16: Compound annual growth rate of Producer Price Index and FA Grant vs rate peg, NSW, 2013-14 to 2022-23



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

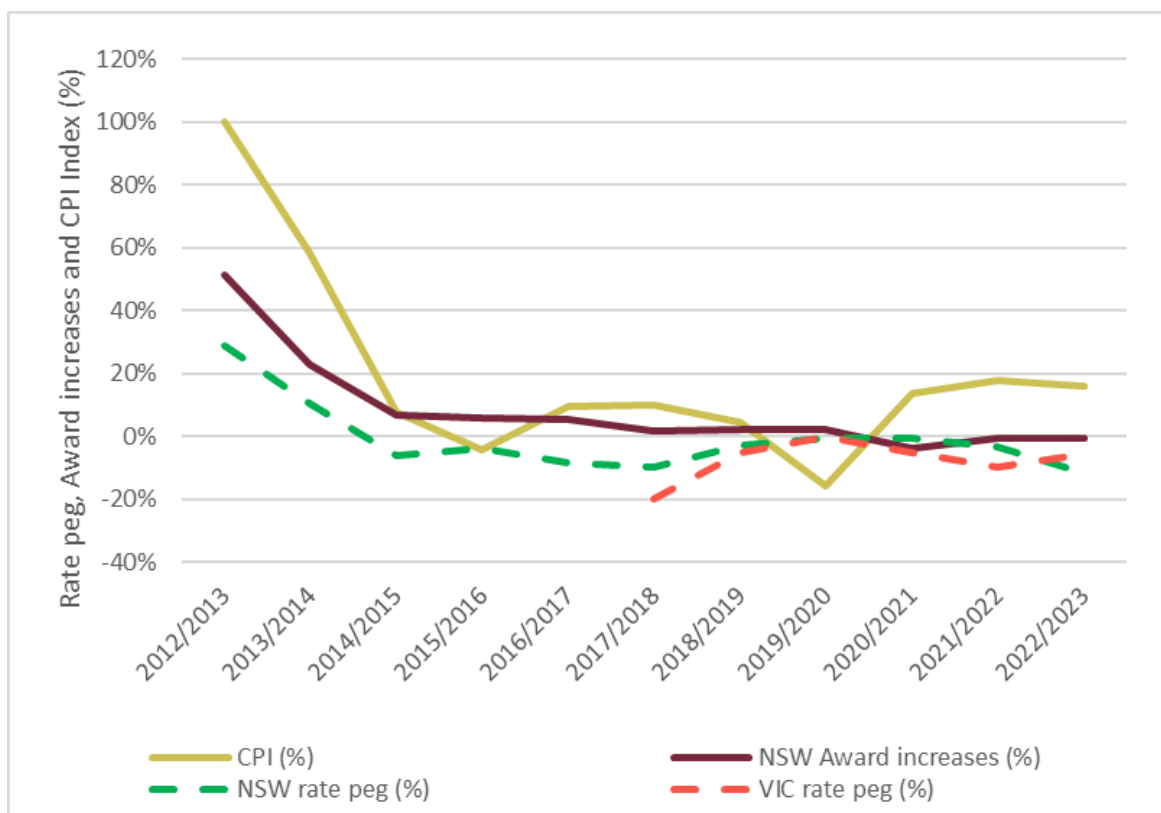
Figure 18 shows that compound annual growth in the NSW rate peg lagged the growth in the CPI and award rate increases.¹⁵

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.

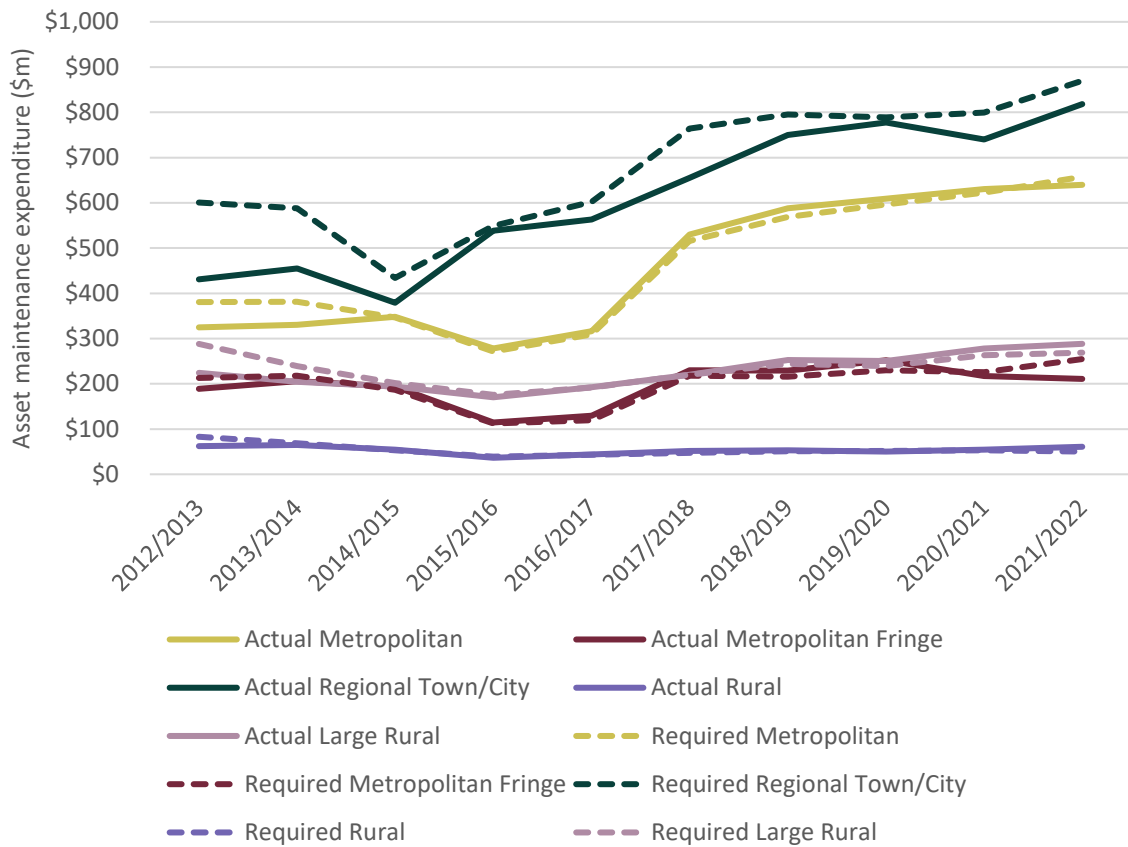
In 2021-22, approximately half of all NSW councils recorded a shortfall in the maintenance expenditure ranging from \$32,000 to \$46.8 million. A total of 9.4 per cent of all NSW councils reported a shortfall greater than \$5 million (compared to 4.6% in 2020-21)¹⁷. If councils are unable to keep up 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).

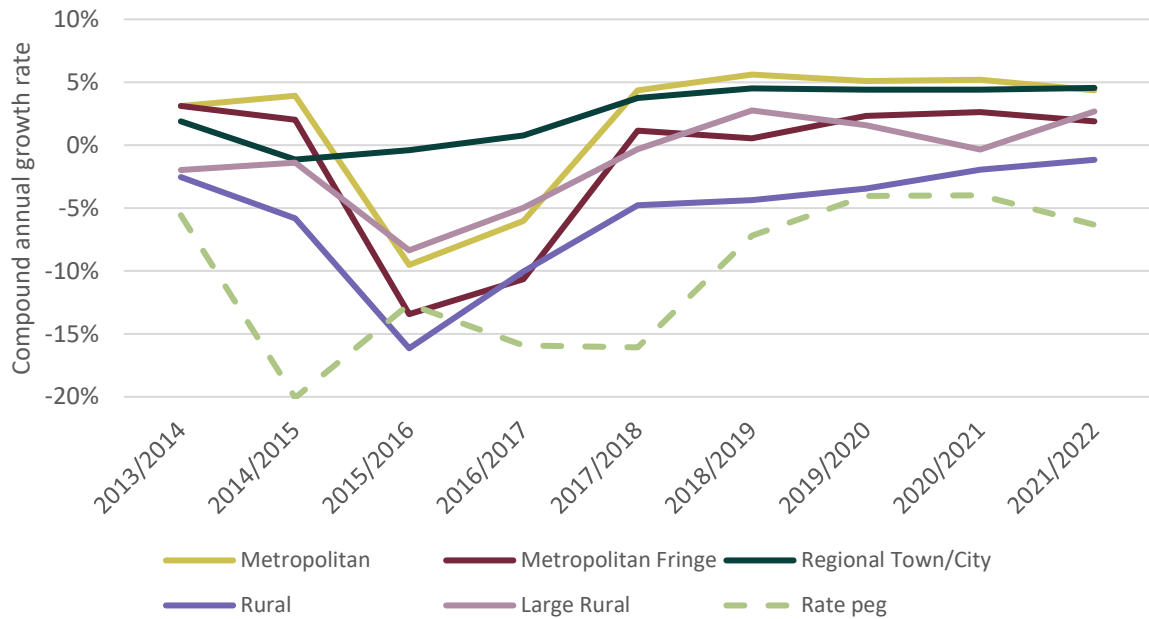
Figure 19: Actual vs required asset maintenance expenditure by council classification, 2012-13 to 2021-22



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

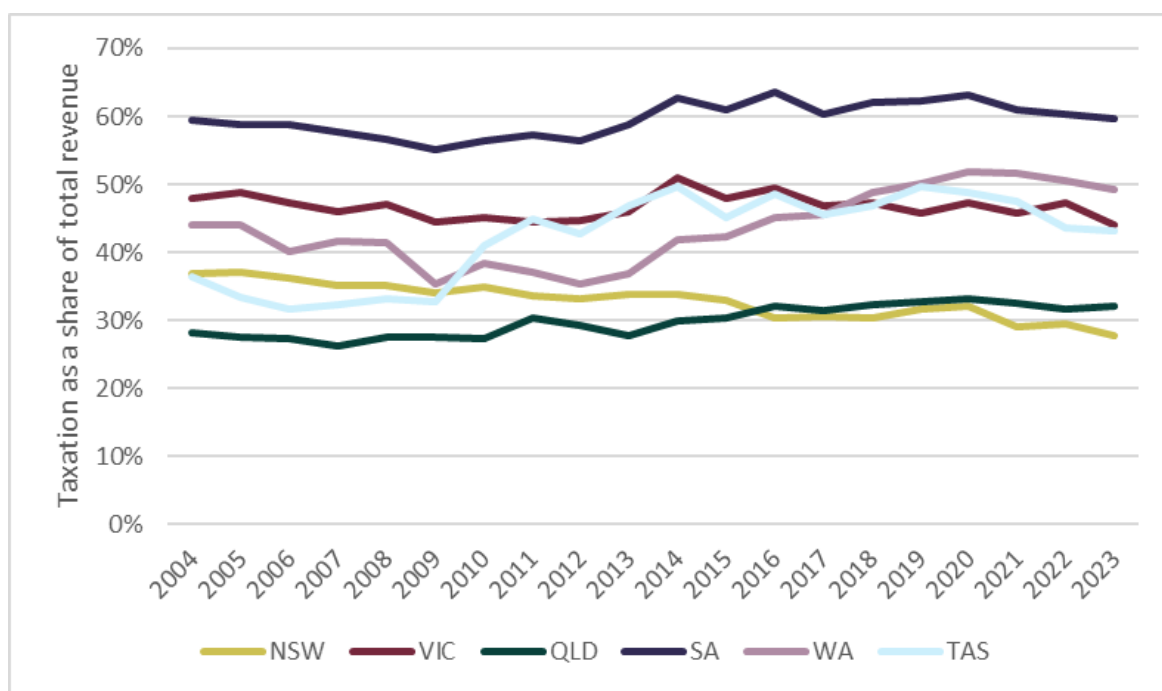
⁴⁶ ABS, (2023), *Public sector employment and earnings*, available online: <https://www.abs.gov.au/statistics/labour/employment-and-unemployment/public-sector-employment-and-earnings/latest-release#data-downloads>

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

CANBERRA / NGAMBRI /
NGUNNAWAL / NGARIGO

Level 2, 28-36 Ainslie Avenue
Canberra ACT 2601
+61 2 6257 4525
sgsact@sgsep.com.au

HOBART / NIPALUNA

PO Box 123
Franklin TAS 7113
+61 421 372 940
sgstas@sgsep.com.au

MELBOURNE / NAARM

Level 14, 222 Exhibition Street
Melbourne VIC 3000
+61 3 8616 0331
sgsvic@sgsep.com.au

SYDNEY / WARRANG

Suite 2.01/50 Holt Street
Surry Hills NSW 2010
+61 2 8307 0121
sgsnsw@sgsep.com.au

