TRANSCRIPT

STANDING COMMITTEE ON THE ENVIRONMENT AND PLANNING

Inquiry into rate capping policy

Melbourne—26 October 2016

Members

Mr David Davis — Chair
Ms Harriet Shing — Deputy Chair
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Mr Cesar Melhem
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Ms Colleen Hartland
Mr James Purcell
Mr Simon Ramsay

Staff

Secretary: Mr Michael Baker

Witnesses

Ms Donna Rygate (via telephone) (sworn), Chief Executive Officer, and
Mr Shaun McBride (via telephone) (affirmed), Local Government NSW.
The CHAIR—Welcome, Donna. Welcome, Shaun. Can I just indicate that this is with respect to our inquiry into the impact of rate capping and I am very thankful to both of you for appearing via technical means tonight. That is actually very helpful to us, given New South Wales has some history with this, so we are very appreciative. What I might ask, Donna and Shaun, is if you can perhaps, in five, six or seven minutes, just give us a very short summation of your experience and how that might inform us.

Ms RYGATE—Certainly. The committee would be aware that the legislation to introduce rate pegging in New South Wales is actually some 40 years old this year and it is very true to say that rate pegging has restricted the ability of councils in New South Wales to increase rates in line with needs for those 40 years. We have got indirect suppression, I guess, of the rating effort in that it discourages councils from seeking to introduce higher rate increases via what we call the special rate variation process, even if there is a need, because it is safer to stay within the peg. We have got the perverse outcome of neglecting funding needs and we have infrastructure renewal backlogs, and the financial sustainability of councils has been weakened over the long run.

According to the 2013 final report of the New South Wales Independent Local Government Review Panel, over the period 2001 to 2010-11, growth in total revenue of New South Wales councils was 5.7 per cent per annum, compared to an average of eight per cent for the other mainland states. Rates increased by 4.4 per cent per annum in New South Wales compared to an average of eight, pointing to revenue forgone in rates over a billion dollars over that period, and that means a billion dollars that has not gone into infrastructure or service provision. Our rates revenue over the 10-year period from 2004-05 to 2014-15 increased by 5.7 per cent compared to an average of 10.9 for the other states and the Northern Territory.

The effect of the massive revenue constraints that the councils operate under here in New South Wales plays out most starkly in their inability or failure to look after their existing basic infrastructure. When they have got increasing demands for human, cultural, educational, health, and environmental services, they find it difficult to renew the slowly declining roads or to fix old pipes that are crumbling away under the ground.

Local infrastructure renewal backlogs in New South Wales are estimated to be in the billions of dollars. In 2006 the Independent Inquiry into the Financial Sustainability of New South Wales Local Government found an infrastructure renewal backlog in New South Wales of $6.3 billion. The New South Wales Treasury Corporation's assessment of the financial sustainability of New South Wales councils that was undertaken in 2013 found that the total infrastructure backlog for New South Wales councils had increased from $5.8 billion in 2009 to $7.2 billion in 2012 and the main component of the infrastructure backlog was the public roads at $4.4 billion in 2012. The Local Government Infrastructure Audit undertaken by the Department of Premier and Cabinet, Division of Local Government, as it was in 2013, confirmed the infrastructure funding situation, finding an infrastructure backlog of $7.4 billion at 30 June 2012.

We understand that that is a systemic problem, not necessarily unique to New South Wales, but because the National state of the assets report 2015 commissioned by the Australian Local Government Association showed that, of the $47 billion local government infrastructure across Australia, about 11 per cent of the total replacement value of an estimated $438 billion is in poor or very poor state and requires renewal, the bottom line for us in relation to rate pegging is that it has been 40 years of a very serious financial ball and chain around the ankles of councils in New South Wales and has put us in a very difficult position. Shaun, is there anything you would like to add?

Mr McBRIEDE—No, I think you have covered that well, other than saying our position is, naturally, that councils are accountable to their electorates and that has been demonstrated across Australia to be a sufficient constraint on excessive rate rises.

Ms RYGATE—Absolutely. We have got here in New South Wales an integrated planning and reporting process, where councils do community strategic plans, long-term financial plans et cetera, and I understand you have got something similar in Victoria. That planning, and the accountability of councils to their communities, which keeps rate rises in check, all of those things mean that it is probably not a necessary thing to have. But we have had it for 40 years, so we have got a long and sorry tale.

Mr McBRIEDE—I should add, one consequence of that, too, is that New South Wales probably has a higher dependence on fees and charges, where they have more discretion on increasing prices, than other states.
The CHAIR—Is there anything else you two want to add before we start with a couple of questions?

Ms RYGATE—I do not. Shaun?

Mr McBRIDE—No.

The CHAIR—Again, thank you for your testimony. It is actually very helpful. It puts a context around what is occurring here. If it were the other side of the equation, what is the view of ratepayers in general in New South Wales? Do they support the concept of rate pegging, as you call it, or do they have a more nuanced sort of view?

Ms RYGATE—We intend no disrespect to any of you people in Victoria who are just introducing this sort of system, but I would say that it is something that is always going to be politically attractive, to do rate pegging or rate capping, because communities get the message that they are not going to get unreasonable rate increases. The other side of that coin is that when councils in New South Wales want to charge rates above the peg, they have to go through what is called the Special Rate Variation process, and the decisions on whether they do or do not get to charge a rate above the peg are made by the Independent Pricing and Regulatory Tribunal. Through that Special Rate Variation process, councils have to undertake an enormous amount of consultation with their communities. Am I right, Shaun, that they have to get 75 per cent of support from the community before they can put it up to IPART to get an increase?

Mr McBRIDE—They must demonstrate to the satisfaction of IPART that there is community support, yes.

Ms RYGATE—So what councils do is they say to their communities, 'Listen, we need to get this piece of infrastructure,' or, ‘We'd like to build this new facility,’ or whatever, and they have to have an honest conversation with the community about how much extra money they want, how much that will cost individuals, what they are going to do with it, and then they can be held accountable for that. It is remarkable, the amount of community support that councils do get when they have that good communication with people. So, whilst it is easy to say that it is politically attractive to put a lid on rates—and I suppose it is—it is also very true that, when a conversation is had with the community about paying for something that is necessary, we find here in New South Wales that community support is pretty strong.

The CHAIR—And the actual rate cap itself, or peg, how is that number set?

Ms RYGATE—Shaun, there is that complex index thing that I will let you talk about.

Mr McBRIDE—Yes. The rate peg, as we call it, or cap in Victoria, is set by the Independent Pricing and Regulatory Tribunal in New South Wales and that has been the case for several years now. What they did in introducing that was create a Local Government Cost Index and that index provides the rate pegging limit.

The CHAIR—So what is that this year?

Mr McBRIDE—It was about 2.6 per cent, I think, from memory.

Ms RYGATE—It was 1.8 the previous year. I remember that quite well.

Mr McBRIDE—Yes.

Ms RYGATE—The index takes into account all sorts of different costs, so I suppose it takes into account wages and all those things, but also electricity—a pretty wide basket of things. Is that not correct, Shaun?

Mr McBRIDE—Yes.

The CHAIR—And the index is specific to local government?

Ms RYGATE—Yes.

Mr McBRIDE—It is. It is based on local government typical purchases, so building and construction materials will have a much higher rating there than they would, say, in the Consumer Price Index, as would...
petrol and diesel, used naturally for plant and equipment, have much higher ratings than they would in the normal household Consumer Price Index—that type of thing. They do considerable research on what local government expenditures are and what categories they are in, and they use the indices or the indexes that are appropriate for each of those, so building and construction, road and bridge construction cost indices all feed into that.

The CHAIR—The index is a single index, and obviously variations beyond that, but is there a capacity for several indices—for example, a country and a city, or a big and a small council, or something like that?

Mr McBRIDE—In the early stages that was something that was discussed at length, about having different regional indices. It was ruled out on the basis of complexity, confusion and the fact that, when it came down to the major elements, there were not necessarily large differences.

Mr MELHEM—Ms Rygate, are you able to tell me what is the revenue breakdown for councils in New South Wales? Let's say what do you collect from the rates versus grants or from federal or state government? What is the ratio? Do you want to take that on notice?

Mr McBRIDE—I can give you the actual figures on notice, but the rates make up about 40 to 50 per cent.

Mr MELHEM—Because of the rate capping, is there a debate in New South Wales about looking at a review of the funding model, for example; what money you get from rates to cover your commitments versus grants et cetera? Are there any discussions in New South Wales in relation to the funding model, with the restrictions you have?

Ms RYGATE—Certainly we have continued to raise the topic of the funding model for local government in New South Wales and we have raised it for many, many years, but particularly recently in the context of amalgamations because it is not entirely clear that just making things bigger is going to solve their financial problems. The funding system for local government here in New South Wales is hampered by rate pegging. A system of exemptions that needs reviewing is actually under review at the moment as part of a review by IPART into the rating system in New South Wales. It is hampered by cost shifting from other tiers of government and we do regular research on cost shifting. The number in our last report that was released—was that December last year, Shaun? I think so.

Mr McBRIDE—Yes, December last year.

Ms RYGATE—It was well over $600 million. It is a big number. The fourth part of that equation is of course about a fair share of Commonwealth tax revenue, so that is a big thing. Back to the issue of local revenue by source, I am just looking, Shaun, at the paper that we did for our finance summit with Enid Slack. There is a pie chart in there called 'Distribution of local revenues by source'. Would that be the one?

Mr McBRIDE—Yes.

Ms RYGATE—So, 35 per cent taxes, sales of goods and services was 37 per cent, grants and subsidies was 11 per cent, and other receipts was 17 per cent.

Mr McBRIDE—that is correct, yes.

Mr MELHEM—Thank you. One last question from me, and you can take it on notice: would you be able to provide us with the figures of how many applications for variation over the years were lodged and how many of them were successful and how many of them were not?

Ms RYGATE—We can do that, but if you want to find out more quickly than that, the Independent Pricing and Regulatory Tribunal website, ipart.nsw.gov.au, has got a section on it about local government and there is a section within that about special rate variations where they indicate how many applications they received and how many they approved, and generally they approve almost all of them.

The CHAIR—that is very helpful, thank you, and Mike can follow that up.
Ms BATH—You made a comment that there is not a tiered system in terms of rural and regional rate pegging, and different from the city to the country, and I think you mentioned that it is not too different, or something in that zone. The rural areas in Victoria do not have the same ability to raise funds through car-parking and the like. How have you addressed that? How can you compensate when there is low population/high area in terms of rate pegging?

Ms RYGATE—We have that same problem here in New South Wales. The metropolitan councils can raise money from parking meters. They can look at value capture when there is some sort of value uplift from a big development or a rezoning or something of that sort. There are all sorts of things that the rural councils really cannot tap into. One of the live questions for us here in New South Wales is then about the distribution of financial assistance grants and whether we should have a minimum grant that goes to every council or whether the proportion of the total pool that is the minimum grant should be smaller, which allows then more of the funding to be distributed on need, because we have the same kinds of issues for the rural councils as you do there. Shaun, I wonder if you would like to comment on the aspect of when they were setting up the local government index and why they did come down on having one rather than a couple.

Mr McBRIDE—The index is based on expenditure, and the expenditure patterns of rural and urban councils are quite similar in that around 50 per cent, or 45 per cent, is related to personnel costs. The next biggest category would be expenses in relation to building and maintaining roads. That does not necessarily vary much. The expenditure categories do not vary much between urban and rural. What varies between urban and rural is the revenue base and the revenue-raising capacity, which does not form part of the cost index. That is the difference that occurs there.

Just adding to what Donna was saying about the distribution of financial assistance grants and so on, the New South Wales government for the last few years has been varying the State Grants Commission formula for the distribution of grants to increasingly favour councils in the remote and rural areas of the state to give them a larger share. That was progressing and was starting to make some significant difference. It was applying to the growth in FAGs. Unfortunately, that trend was interrupted by the FAGs indexation freeze, which meant that less of the pool has been transferred than would have otherwise been. Hopefully, when the freeze ends they will be able to resume more effective rebalancing of the distribution of the Commonwealth financial assistance grants.

Ms DUNN—You talked about the $7.2 billion in backlog identified in 2012. You also talked about the councils being discouraged from applying for a variation, but then, on the same hand, councils who did were generally approved for their variation. Why is it that councils are reticent to go through a variation process and actually start to close that gap in relation to infrastructure backlog?

Ms RYGATE—I can only assume that it is politically easier to stick to the cap, and in some cases we have some councils that do not even impose the full cap. I think you people would understand the minds of politicians much better than I would.

Ms DUNN—And I did not want it to be a political question.

Mr McBRIDE—No. In the past we have had councils elected on the basis of reducing rates and things like that and that has caused long-term problems for those councils. That does not tend to happen as much now. Since the mid-2000s when we commissioned an independent inquiry into the financial sustainability, the issue has been much more in the front of mind of councillors and the local government sector, and the issue of infrastructure backlogs and the need to address those backlogs is now better understood than it used to be, and we see that councils do actually go and apply for variations now, more so than in the past. There are usually typically 22, 23 each year and the variations are often given on a multi-year basis, so council goes once and it gets four to seven years of increases approved. They do not have to go back; that 20 or so per annum is a cumulative total. So a large proportion of councils now are benefiting from variations.

Ms RYGATE—I think we will find that there are more of those as a result of the process that we have gone through that culminated in our recent round of forced amalgamations. It is called the Fit for the Future process. Councils had to make submissions to government about their financial fitness and a variety of other things. They had to provide a whole bunch of data and work out how they measured up on some key ratios and put forward plans to government about how they were going to improve their financial sustainability, and many
of the council submissions to that process indicated that they would intend to put in Special Rate Variation applications with a view to addressing some of the issues.

We do have a bit of a complication, in that for the amalgamated councils that were amalgamated earlier this year, there has been a rate path freeze imposed upon them. That means that if one of the two councils that have amalgamated had a Special Rate Variation already approved, they would continue to apply that to their part of the new amalgamated council area, whereas the people on the other side of the road, if they had not had a Special Rate Variation, cannot apply for one all year. So there is a rate path freeze there for those people, but I think we will see that there is a fair bit of pent-up demand once that rate path freeze is over.

Mr RAMSAY—Are your valuations every two years?

Ms RYGATE—Three, isn't it?

Mr McBRIDE—Yes, our valuations are every three years at present, but in New South Wales we use unimproved land value and, because of rate capping, the valuations do not impact on councils’ total rate revenue. All they do is reshuffle the rate burden around an existing local government area, based on the differential increases in property values.

Mr RAMSAY—Thank you, that was the second question, but you answered that. In response to Ms Bath’s question regarding regional councils, do you have any dedicated funding for regional infrastructure renewal? Are there specific programs targeted specifically for rural and regional councils to help with that renewal backlog, in roads and bridges particularly?

Mr McBRIDE—There are some state government programs in place at the moment for country roads and bridges that are greatly assisting councils in rural and regional areas. There have been programs in the past that have been helpful to rural and regional councils in that regard that have tended to come and go. We had a system that provided a proportion of mining royalties to be reinvested in infrastructure in the areas where the mining royalties were extracted, like the Hunter Valley in New South Wales, and some other areas where there were large mining operations. I think that program is all but expended. We also had a Country Towns Water Supply and Sewerage Program which was state government funded, which has been running for probably 15 years or more.

Ms RYGATE—A long time, yes.

Mr McBRIDE—A long time. It has helped local government water utilities in rural and regional areas deal with upgrading of their water and sewerage infrastructure systems. That program is coming to an end and is going to be replaced by something else, which is good; they are not totally abandoning the scheme. I know that in Victoria councils do not have responsibility for the water and sewerage, but in New South Wales, outside the Sydney metro and Hunter areas it is a local government responsibility. So there are a number of different programs that have been of assistance or are continuing to be of assistance.

The CHAIR—On the water side of things, I have been told that in fact water rates or the water component has gone up in a number of cases and that has provided a cross-subsidy for many councils. Is that a reasonable point?

Mr McBRIDE—(indistinct)# pricing system, which is the best practice pricing system, for want of a better name, that has been developed by the New South Wales government, large cross-subsides are discouraged. However, naturally, with a local government/water utility arrangement where you might have a town centre and then you have a number of smaller rural or remote villages, inevitably some cross-subsidy is going to occur, because otherwise it would not be viable.

Ms RYGATE—We are not talking about a whole bunch of money going out of the water businesses and into the general funds. There is actually a prohibition on that. You cannot do that under the Local Government Act here in New South Wales.

Mr McBRIDE—No. This is more about making sure that what would be unaffordable—that is, the provision of sewerage systems and potable water to some of the outlying communities—is able to be provided in an affordable way.
Ms RYGATE—Shaun, correct me if I am wrong, but I think we would reject a suggestion that councils are charging high water rates in order to fill up a gap that they cannot get in the general rates.

Mr McBRIEDE—No, we would totally reject that.

Ms RYGATE—Definitely not.

Mr McBRIEDE—Sorry, I might have heard the question wrong.

Ms RYGATE—Or I might have been suspicious about the question.

The CHAIR—No, I am just putting it to hear it. I wanted to put it to bed, that is all.

Mr McBRIEDE—No, we are definitely not allowed to use the water and sewerage operation as a way around rate pegging. No, definitely not.

Ms RYGATE—No.

Mr RAMSAY—Would you mind just putting a dollar figure on the Country Roads and Bridges Program that you talked about just prior.

Mr McBRIEDE—As I am not in the office—

Ms RYGATE—We might take that on notice and come back to Michael with that, if that is all right.

Mr RAMSAY—The term and the amount would be good, thank you.

Mr McBRIEDE—Yes, we will get that to you tomorrow.

The CHAIR—Can I thank both of you, Donna and Shaun, for your assistance.

Ms RYGATE—Absolute pleasure. May I say one thing before you hang up on us?

The CHAIR—Yes.

Ms RYGATE—Two things, actually. On that IPART website that I mentioned earlier is the draft report of the review of the rating system in New South Wales. The government would not let them look at rate pegging, but they look at a whole bunch of other stuff about the rating system in New South Wales and it is an interesting report that might be in some way relevant to your deliberations.

The CHAIR—Who did that review?

Ms RYGATE—IPART is doing it. They have put out a draft report and we are awaiting a final report by the end of the year, but it is interesting. The other thing that is interesting is a paper that we commissioned from a woman called Dr Enid Slack from the Institute of Municipal Finance and Governance at the University of Toronto in Canada about revenue options for councils in New South Wales in the context of rate pegging, which she does discuss, and I would encourage you to look at the stuff she says about how it applies here in New South Wales and in various other jurisdictions. There is lots of other stuff in there about revenues, and you sound like you are interested in all sorts of ways to get money into the system. Have a look at that as well. It is on our website.

The CHAIR—Michael will obtain those documents.

Ms RYGATE—If Michael cannot find it, he can get in touch with us and we will point him in the right direction.

The CHAIR—Can I thank both of you very much indeed. Michael may be in contact to follow up a couple of those points, but we are very appreciative of that interjurisdictional view. For us, it is actually deeply helpful.

Ms RYGATE—Our pleasure.
The CHAIR—A pleasure indeed. Thank you.

Witnesses withdrew.

Committee adjourned