

11 September 2008

Review of the Revenue Framework for Local Government
Independent Pricing and Regulatory Tribunal
City of Sydney
PO Box Q290
QVB Post Office, NSW 1230
By email: local_government@ipart.nsw.gov.au

Dear Sir or Madam,

Re: Review of the Revenue Framework for Local Government – Issues Paper, July 2008

The Urban Taskforce is an industry organisation representing Australia's most prominent property developers and equity financiers. Our membership also includes key infrastructure providers, economists, planners, architects and lawyers involved in property development.

We are pleased that the NSW Government have sought the advice of IPART on this important issue. Local government taxes, fees and charges have had a significant and adverse impact on the development industry. Because local councils are being asked to do more with less funding, councils across the state are being forced to make some very hard decisions when it comes to service and infrastructure provision. Without appropriate funding local councils are either forced to leave existing infrastructure to deteriorate, not provide additional services and/or facilities or seek an alternative source of funds.

Finding an alternate source of funding has been the preferred option of local councils and unfortunately, the "cash-cow" has been the developer. Developer contributions are being relied upon to fund a significant proportion of local infrastructure and services. In some cases, the provision of local infrastructure is being provided entirely by developer contributions of some type. This type and level of taxation on development has without doubt caused a slowing of development activity, particularly in the residential sector, which has contributed to the current collapse in NSW property development.

Money's been flowing in to other states, such as Victoria and Queensland at the expense of NSW, prompted (in part) by the highest local council developer charges in Australia. Figures from the Australian Bureau of Statistics (ABS) earlier this month revealed that approvals for new homes in NSW are at an all time low. In the 12 months to July 2008 only 31,000 new home approvals were issued. This is the lowest figure ever recorded for NSW by the ABS.

Meanwhile Victoria has recorded the highest ever level of building approvals in its history and recorded the highest value of building approvals in the nation. The lack of new homes has been painful for young families struggling to save for their first home deposit.

Earlier this month the Department of Housing revealed that Sydney had seen an 18 per cent increase in rents for three bedroom homes and a 15 per cent increase for two bedroom apartments in the last financial year.

The collapse in property development is also denying public services of much needed revenue. Last week, the former NSW Treasurer revealed that stamp duty revenue fell by \$180 million in the first two months of the financial year.

In its review of the *Revenue Framework for Local Government* IPART must consider how rate pegging has made local government seek alternative means of income. IPART should also consider the

continuing role for local government. That is, should local government be expected to provide more than their legislative requirements, and to what extent does local government provide services that replicate those already provided by the State?

We note that NSW is the only state that adopts the rate pegging approach to local council rate revenue. This is in itself a matter for concern and worthy of further investigation. The Urban Taskforce is pleased to provide the following comments for your further consideration.

1. Background

In NSW a major source of funding for local government are the rates and charges. The amount that can be raised fundamentally impacts on local government's ability to provide infrastructure and services. Since 1977, council rates in NSW have been regulated by the state government based on a philosophy that was to encourage restraint and exercise control over expenditure. This approach relied upon state government regulation that "pegged" rates each year to a maximum amount by which councils can increase their annual general income. This approach may have been appropriate in 1977, but demands review today.

IPART's terms of reference and issues identified for inclusion in its review are appropriate and useful and the Urban Taskforce submission has been drafted to provide further general comment on the:

- role of local government;
- implications of rate pegging; and,
- extent that the control of rates revenue under the rate pegging regime has encouraged greater use of non-rate revenue.

Furthermore, our submission provides some general commentary on the implications of rate pegging on development and housing affordability.

2. What is happening at the local level?

Recent media reports confirm that councils are short of money and will need to seek alternative income if they are to survive. It has been widely reported that "without the extra income the councils will have to let rundown facilities deteriorate further, or appeal to federal and state governments to bail them out. These are the main findings of a second survey by analyst Fiscal Star of the financial health of the biggest 100 councils, which cover 95 per cent of NSW's population".¹

Making the situation even more alarming is that there are already numerous councils who are carrying an infrastructure backlog that far exceed their ability to fund. Council rates don't come close to providing the funds needed to meet current service and infrastructure needs, let alone meeting future needs. The resultant of this funding 'gap' has been at the expense of infrastructure maintenance and new infrastructure construction. This means that critical local infrastructure had deteriorated sharply.²

The House of Representatives Standing Committee on Economics, Finance and Public Administration found that the Australian local government is under fiscal stress stemming largely from inadequate sources of funding.³

¹ Grennan, H. *Sydney Morning Herald* July 29, 2008 accessed from <http://www.smh.com.au/articles/2008/07/28/1217097148488.html>

² Dollery, B., Wallis, J. & Allan, P. (2006) The Debate that Had to Happen But Never Did: The Changing Role of Australian Local Government, *Australian Journal of Political Science*, 41:4, 553 — 567

³ House of Representatives Standing Committee on Economics, Finance and Public Administration ['Hawker Report']. (2003). *Rates and Taxes: A Fair Share for Responsible Local Government*. Canberra: Commonwealth of Australia.

Additional funds from the Federal Government are highly unlikely and because of the rate pegging system that has been in operation in NSW for some thirty years, it is unlikely that additional funds can be raised by way of rate increases.

What this means for local government and the communities that they service in NSW is obvious. Council will either seek to supplement their income through other means or reduce their level of service. Experience, particularly in the growth areas of Sydney where pressure for additional infrastructure and services is at its greatest, has shown that councils look to developer contributions to supplement income for the provision of infrastructure and services. For example the recent section 94 plan exhibited for the North Kellyville proposed a contribution of up to \$50,700 per dwelling.

Australian local governments are facing increasing community demands for the provision of service infrastructure. Because additional funding from the upper tiers of government has not been forthcoming and the ability to raise additional funds through rate increases has been constrained, local governments have sought private funding for public infrastructure.⁴

3. The implications of rate pegging - How Councils are making up the short fall in funding

Local councils have limited access to resources. Generally there are only four sources of funding to finance municipal infrastructure services. These are:

- direct charging for a service such as user charges and annual access charges (water, sewer etc);
- charging developers for the cost of providing a service or requiring the developer to install the infrastructure themselves;
- property rates or through government grants; and,
- additional borrowings to cover the cost of capital outlay for major infrastructure capital

Placing a restriction on one or more of these sources will obviously place pressure on those that are not as restricted. In many cases, developer contributions are being relied upon for the provision of expensive capital infrastructure.

Local government revenue as a proportion of national income has been falling relative to other tiers of Australian government. Access Economics conducted an investigation into this matter and "calculated that the share of the national tax take accruing to local government has declined from just over 6% in 1970–71 to 4.28% in 2003–04. Similarly, as a proportion of total Commonwealth tax revenue, the value of Commonwealth Financial Assistance Grants (FAGS) will have fallen from 1.18% in 1993–94 to just over 0.77% in 2007–08 on current budget estimates."⁵

Evidence shows that there is growth in local government fees and charges relative to council rates. This demonstrates that Australian local government is partly overcoming constraints on rates income by shifting some of its funding efforts towards user fees and charges. Fees and user charges have been found to be the second most significant source of revenue for councils after rates. In fact, fees and user charges have grown from 13 per cent of total revenue in the 1970s to exceed 30 per cent in 2003–04.⁶

The Federal Government's independent economic advisor, the Productivity Commission, prepared a report titled *Assessing Local Government Revenue Raising Capacity*. It revealed that Baulkham

⁴ Cannadi, J. & Dollery, B. (2005) An Evaluation of Private Sector Provision of Public Infrastructure in Australian Local Government. *Australian Journal of Public Administration*. 64 (3): 112-118.

⁵ Dollery, B., Crase, L. & Byrnes, J. (2006) Local government failure: Why does Australian local government experience permanent financial austerity?, *Australian Journal of Political Science*, 41:3,339 — 353

⁶ ALGA [Australian Local Government Association]. (2005). *Federal Budget 2005–06: Towards a Fair Share*. Canberra: ALGA, in Dollery, B., Crase, L., & Byrnes, J. (2006) Local government failure: Why does Australian local government experience permanent financial austerity? *Australian Journal of Political Science*, 41:3,339 — 353

Hills Shire Council, Mosman Municipal Council and Willoughby City Council had each admitted that rate pegging creates an incentive to increase fees and charges as an alternative source of revenue to rates.⁷

Regretfully, in NSW there is a very broad basis to councils to recover their costs through developer charges. The Productivity Commission has found that:

New South Wales and Victoria appear to have the most flexible legislative arrangements for accessing developer contributions, with legislative scope to levy for a broad range of economic and social infrastructure needs (such as public transport, child care centres, libraries, community centres, recreation facilities and sports grounds) beyond basic infrastructure. Other jurisdictions may not have scope to apply a levy for these facilities.⁸

4. What has been the impact of increased reliance on developer contributions?

The Urban Taskforce makes no secret of the fact that it is an industry group representing the Australian development industry. Be that as it may, evidence has clearly shown that local and State Government taxes and fees are a major contributor to the chronic shortage of land for urban development. Though local councils may argue that because rate revenue is pegged, state government approval for special rate increases is not forthcoming and Commonwealth grants are in decline, they have no other option but to fund infrastructure by way of developer contributions. The real and most concerning impact of this approach is that land available for residential development is becoming more expensive, which in the end is making housing in NSW less affordable.

Experience with the South West growth centre has proven that when the charges on the developer increase the selling price of each lot to a level that it is above the market value of land, no new lots are produced. The developer is unable to recover the cost of producing land and putting lots on the market, which in reality means no new housing in the areas where demand is at its highest.

There is no doubt that we are in a housing affordability crisis. There is a need for at least an additional 40,000 dwellings per annum to come close to meeting underlying housing demands.⁹ Unfortunately we are not coming close to meeting this demand. In NSW, underlying demand for housing is 47,800 dwellings for the 2008/09 period, however 'starts' are only 29,140.¹⁰ Nationally, we need to be building approximately 170,000 new homes each year just to keep up with increases in demand and we are not getting even close to this figure.¹¹

Sydney is the most affected city with supply now 40 per cent below estimates of underlying demand. Unless significant initiatives are put in place so that there are improvements on the cost and availability fronts, housing prices will continue to escalate.

The evidence is overwhelming. Taxes placed on development are having a detrimental impact on housing supply. Housing affordability cannot be addressed in an environment where demand is high, but supply is constrained.

IPART must properly investigate the extent to which local councils shift the cost of infrastructure provision to the developer and to what extent this approach is due to rate pegging.

⁷ Productivity Commission (2008) *Assessing Local Government Revenue Raising Capacity: Productivity Commission Research Report April 2008* 112

⁸ Productivity Commission (2008) *Assessing Local Government Revenue Raising Capacity: Productivity Commission Research Report April 2008* 172.

⁹ HIA (2008) *Monetary Policy Overcooked*. Media release 9 July

¹⁰ HIA (2008) *Million New Homes Required in 5 Years*. Media release 30 June

¹¹ HIA (2008) *National Outlook, March quarter*. March 2008

5. The role of local government

The Urban Taskforce's opinion on this matter is clear. Local governments are forced to look to other sources of funding to meet escalating community demand. Increasingly, this source is the private sector, a sector that can no longer bear additional cost burden. The development industry is slowing, housing is not being produced at anywhere near the rate urgently required and hence we find ourselves with a chronic undersupply of housing. A house is now unaffordable for a great majority of our population.

Whether local government is provided with additional funds or not, it is clear that there is an urgent need to debate the appropriate role for local government. It is abundantly clear that increased demands placed on local council by the upper tiers of government and the community is the main draw on finite resources. In this regard the way forward for this enquiry is to investigate and establish the appropriate role for local government and then to consider structural reforms for improved service delivery and efficiency.

There has been a significant change in Australian local government service provision over the past twenty or so years. Services have shifted away from traditional narrow 'services to property' towards broader 'services to people'. This has occurred incrementally, in an ad hoc manner without any real debate on the apparentness of this transformation. We have seen an expansion of local government roles beyond those traditionally delivered by the local sector. In some instances, local authorities have taken on responsibility for social issues, including health and community safety. As councils have shifted focus towards social issues, arguably the domain of State and Commonwealth governments, there has been a reduction in expenditure in areas that are traditionally local government core business. For example, a shift in focus towards human services resulted in a reduction in expenditure on roads from more than 50 per cent in the 1960s to slightly more than 25 per cent by 1997–98.¹²

There is wide acceptance that local government is under fiscal pressure from inadequate sources of funding. It is unrealistic to suggest that local councils should simply reduce service to their 'core functions,' whatever they may be. However, local governments role must not compete, replicate or overlap with services provided by other levels of government.

Community opposition to service reduction would ensure that local politicians continue to work towards maintaining and/or increasing community amenities and services, not a reduction. Therefore, IPART must ensure that its review focuses on the appropriate role for local government and this role be the foundation of further investigation into the establishment of an appropriate funding framework.

6. Structural reform

A review of the revenue framework for local government must include an investigation of local government structure and need for reform. A robust investigation into local government must consider structural reform including council amalgamation. Though this is a contentious issue, major changes in demography, employment and infrastructure in local government areas must mean that historical local boundaries are becoming obsolete. Furthermore, advances in technology, communications and transportation means that larger local government areas are possible. The potential for cost savings is significant. The Victorian experience with local council amalgamation is testament to this. When the number of local councils was reduced from 210 to 78 between August 1993 and February 1995 savings of \$248 million eventuated in the first year of the new system.¹³

¹² Dollery, B., Wallis, J. & Allan, P. (2006) The Debate that Had to Happen But Never Did: The Changing Role of Australian Local Government. *Australian Journal of Political Science*, 41:4, 553 — 567

¹³ Worthington, A. & Dollery B. (2002) An Analysis of Recent Trends in Australian Local Government. *International Journal of Public Sector Management*, Vol. 15, No. 6, pp 496-515

This is not to suggest that forced, across the board amalgamations are called for. Recent research suggests that there are instances where amalgamations are warranted and merges can bring greater financial stability to council, but these need to be assessed carefully to ensure that large inefficient councils are not produced. Furthermore, efficiency can be improved through regional service provision, shared service arrangements, outsourcing and state-wide purchasing initiatives.¹⁴

We encourage IPART to explore the potential for cost savings and efficiency gains brought about by local government structural reform as part of its review into revenue frameworks for local government.

Conclusion

The Urban Taskforce is passionate about government reform as a means of bringing about operational and fiscal efficiency. If the revenue framework and role for local government is not properly reformed – with the abolition of rate pegging - inappropriate taxes will continue to be imposed on developers, housing and lot production will continue to slow, infrastructure will deteriorate and community service standards will worsen. We encourage IPART to pursue this matter vigorously and we await the results of a robust review.

Once again, thank you for providing us with the opportunity to offer our comments and should you require any further clarification of the content of this correspondence, please feel free to contact me.

Yours sincerely

Urban Taskforce Australia

A handwritten signature in black ink that reads "Aaron Gadiel". The signature is written in a cursive style with a long horizontal stroke extending from the bottom of the name.

Aarón Gadiel
Chief Executive Officer

¹⁴ Dallery, B., Byrnes, J. & Crase, L. (2008) Structural Reform in Australian Local Government, *Australian Journal of Political Science*, 43:2, 333 — 339