

ORDINARY COUNCIL

Thursday 15 February 2024

Ordinary Council Meeting

Thursday, 15 February 2024

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LGNSW Cost Shifting Report –

How State Costs Eat Council Rates



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1 Executive Summary

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

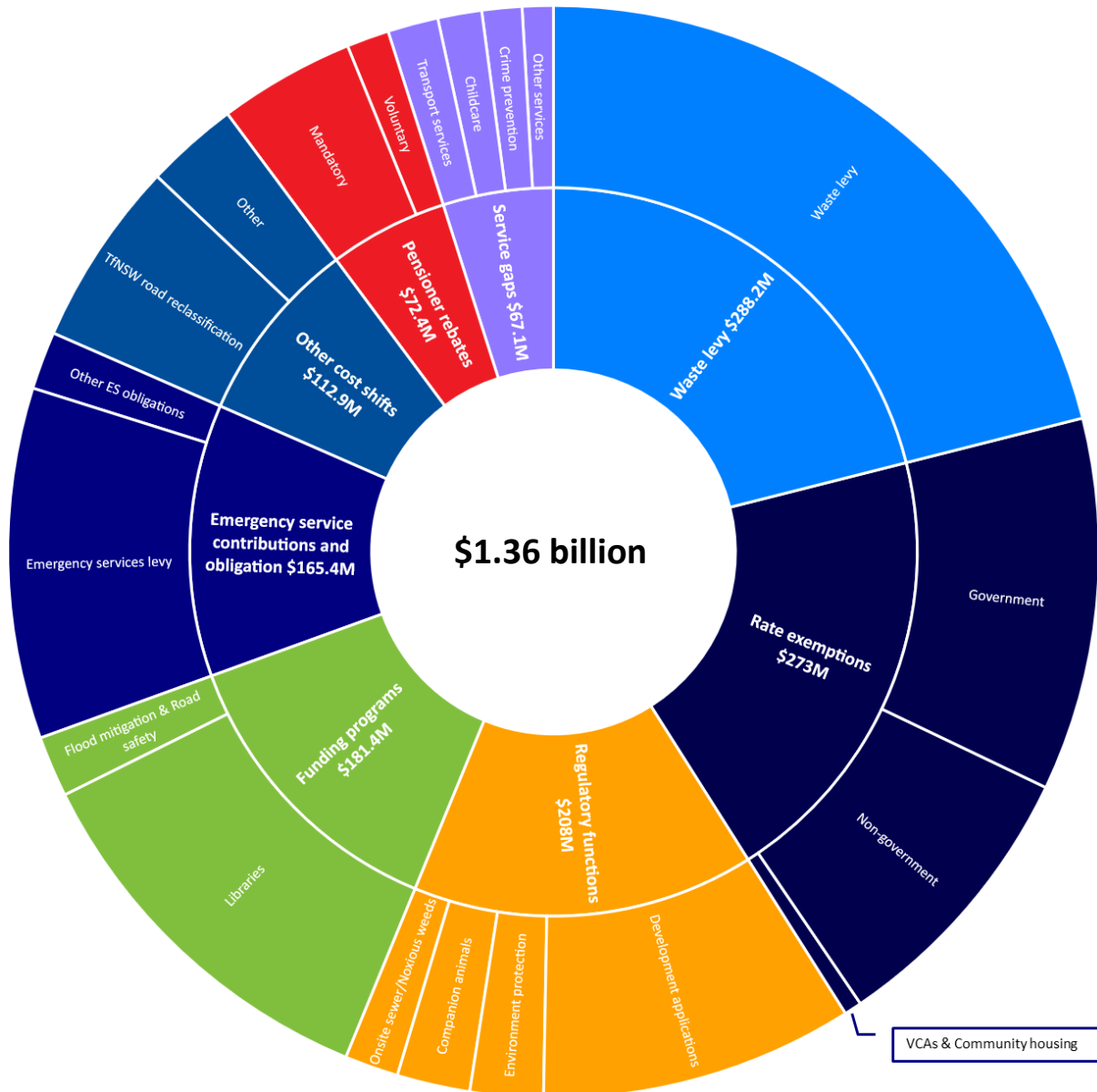
The 2021–22 Cost Shifting Survey has revealed that cost shifting totalled **\$1.36 billion** in 2021–22 (see figure on the next page), far exceeding historical records and representing an increase of \$540 million since the Cost Shifting Survey was last carried out in 2017–18. Alarming, the increase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

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

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



Figure 1 2021–22 cost shifting components





2 Background

2.1 What is cost shifting?

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

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

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

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



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

2.2 Cost shifting and the rate peg

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

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

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

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

2.3 This report

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

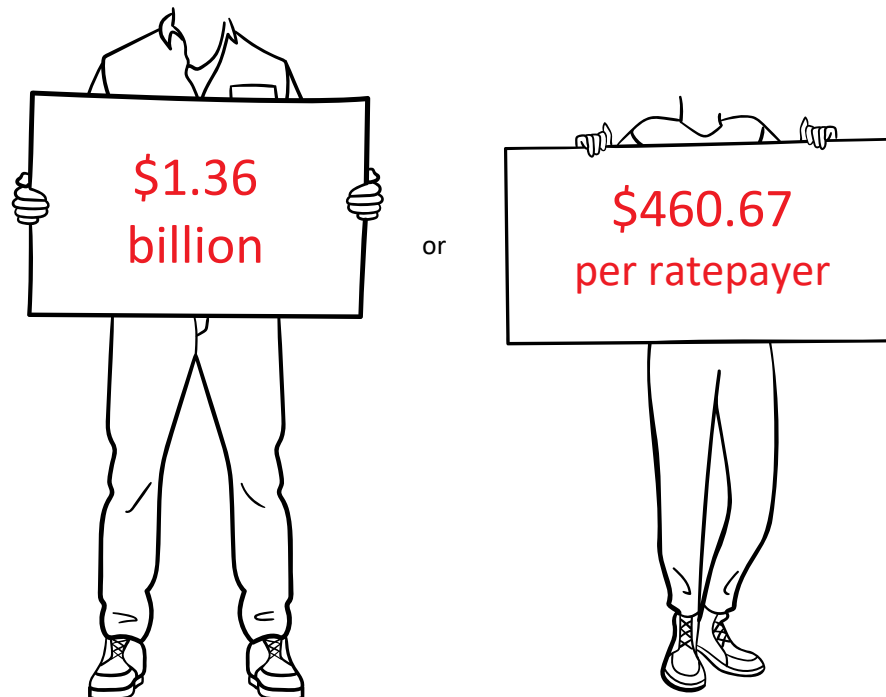
Section 3 of this report provides more detail on the findings from the survey, breaking down the findings into their key cost shifting areas, as identified in section 2.1 above, and Section 4 outlines the approach and methodology used in the survey and analysis..



3 Findings

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

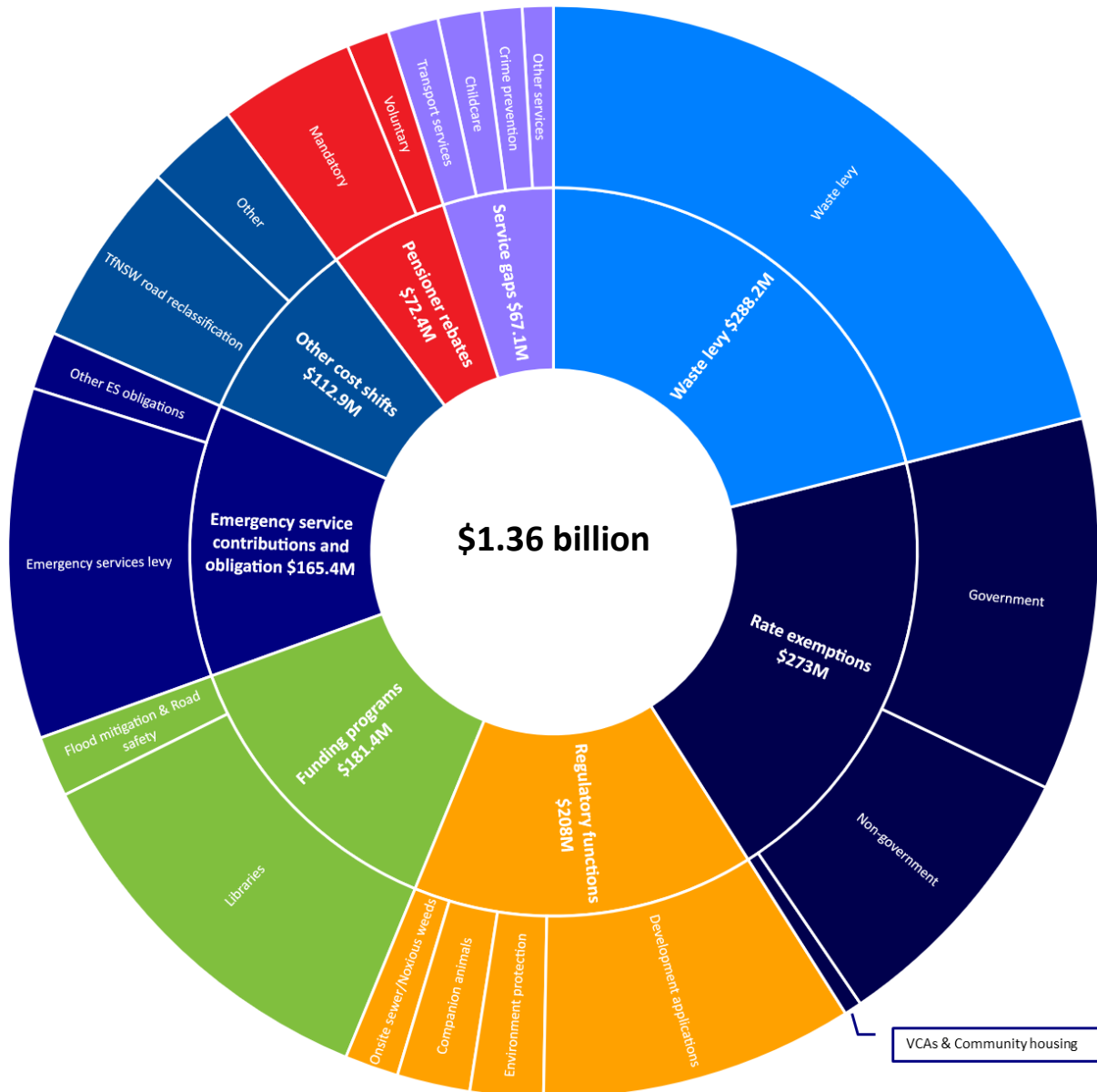
In 2021/22,
the cost to
NSW
Councils of
cost shifting
was:



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



Figure 2 2021–22 cost shifting components



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

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



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

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

Figure 3 Total cost shift by council classification

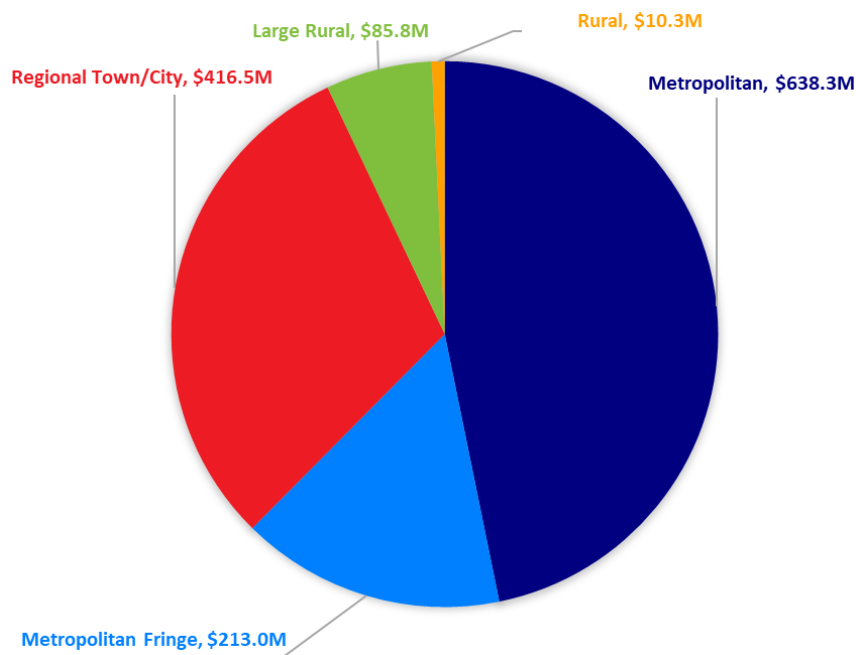
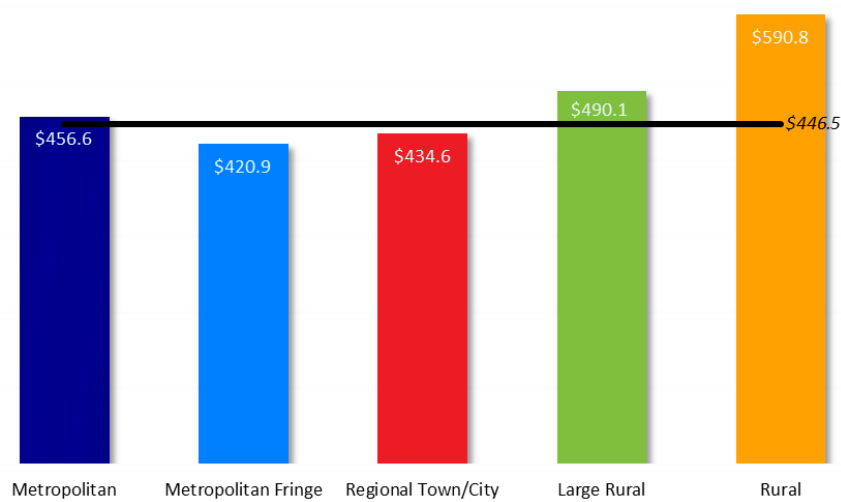


Figure 4 Cost shift per ratepayer by council classification





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

3.1 Emergency service contributions and obligations





Figure 5 Emergency services contributions and obligations by council classification

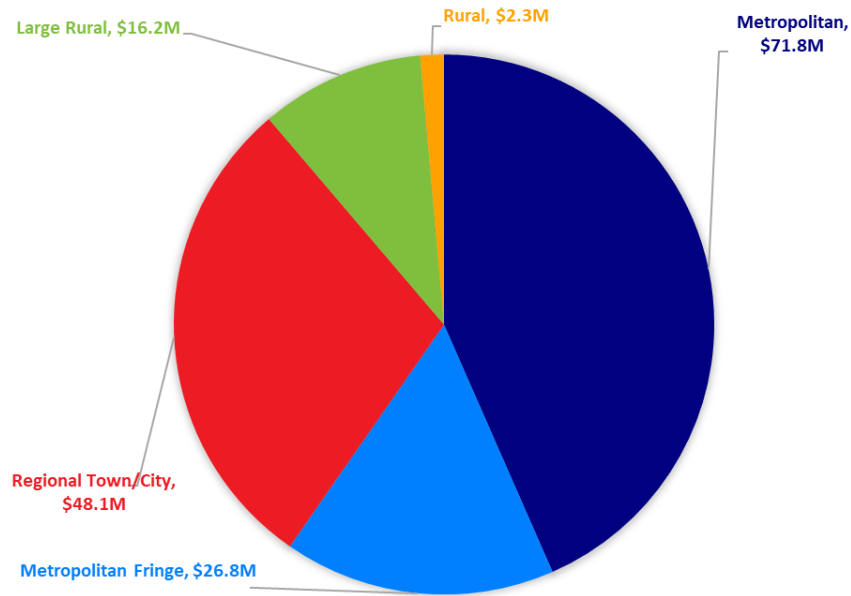


Figure 6 Respondent councils with the highest emergency services contributions and obligations burden

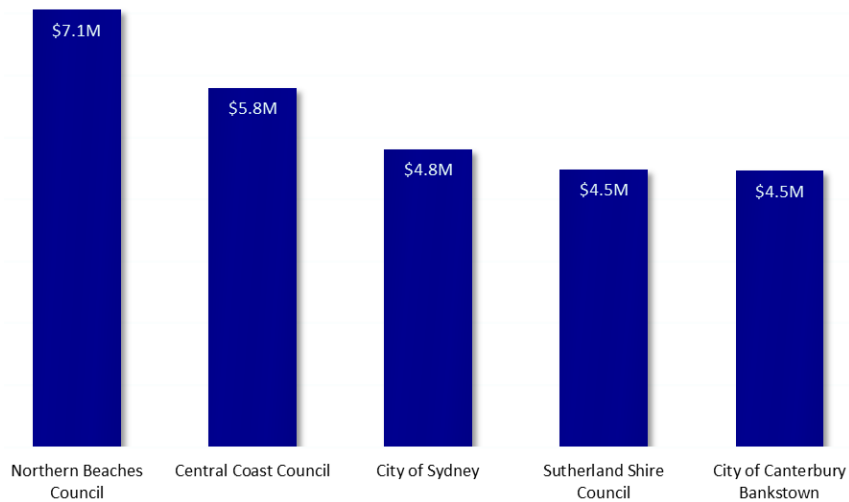
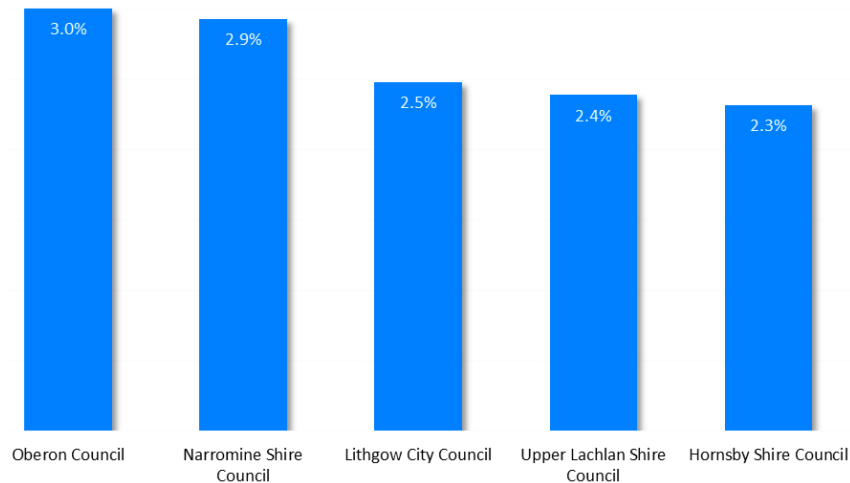




Figure 7 Respondent councils with the highest emergency services contributions and obligations burden as a proportion of total operating expenditure



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

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

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



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

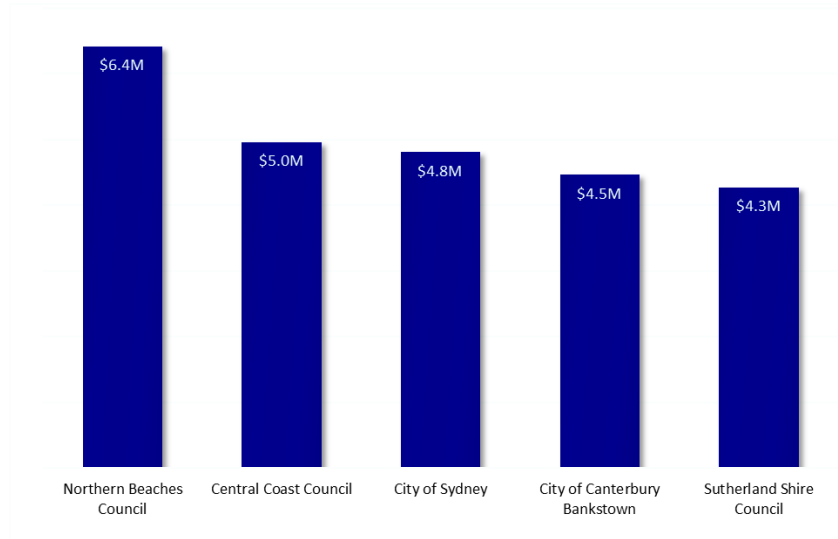
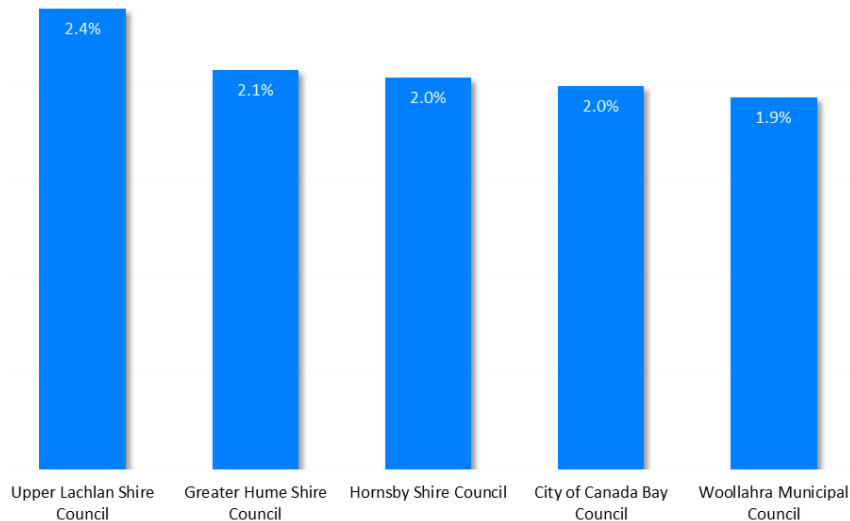


Figure 9 Respondent regional and rural councils with the largest ESL bill for 2021–22





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



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

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

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

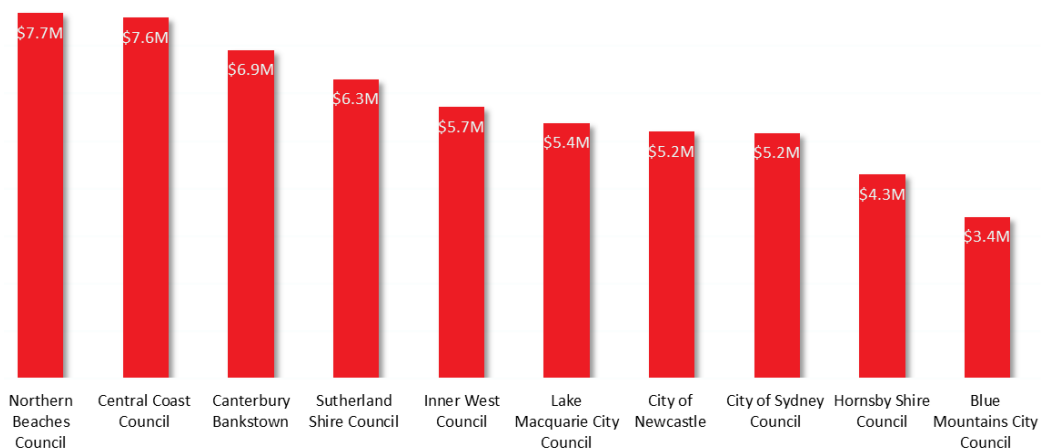
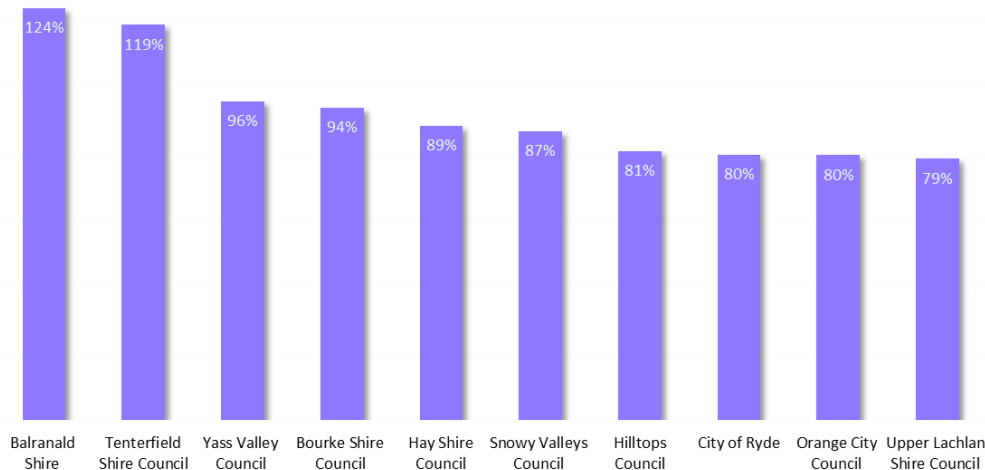




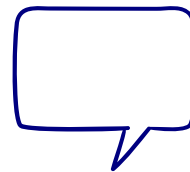
Figure 12 Top 10 councils with the highest 2023–24 ESL increase as a percentage of the rate revenue increase



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

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

David Farmer, CEO, Central Coast Council



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

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

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

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

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

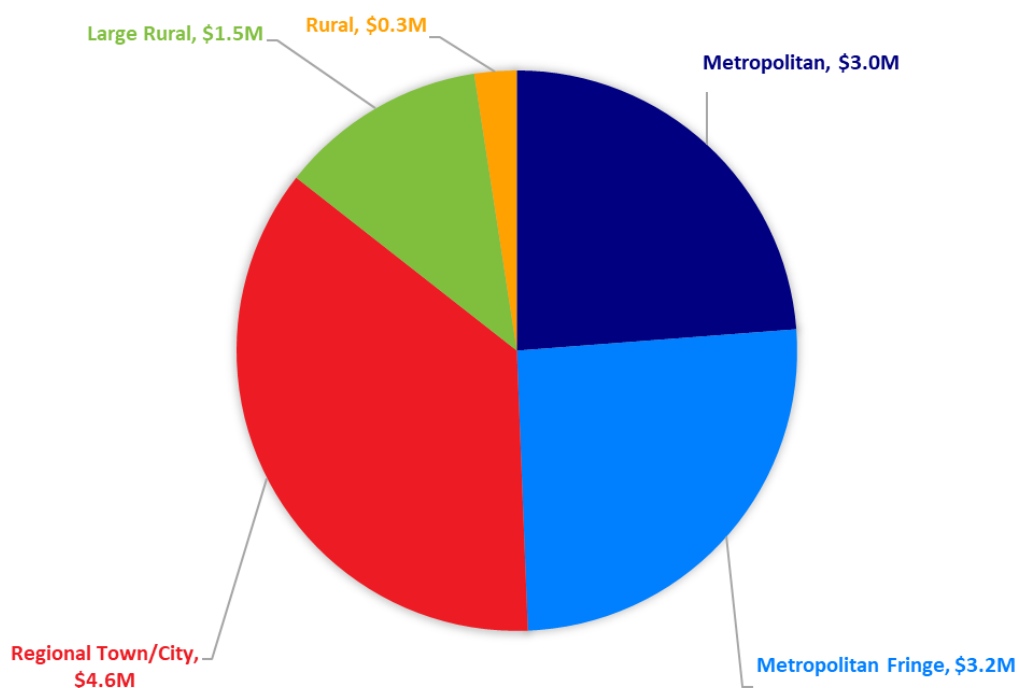
Bob Stewart, Administrator, Central Darling Council¹

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



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

Figure 13 Additional RFS contributions by council classification



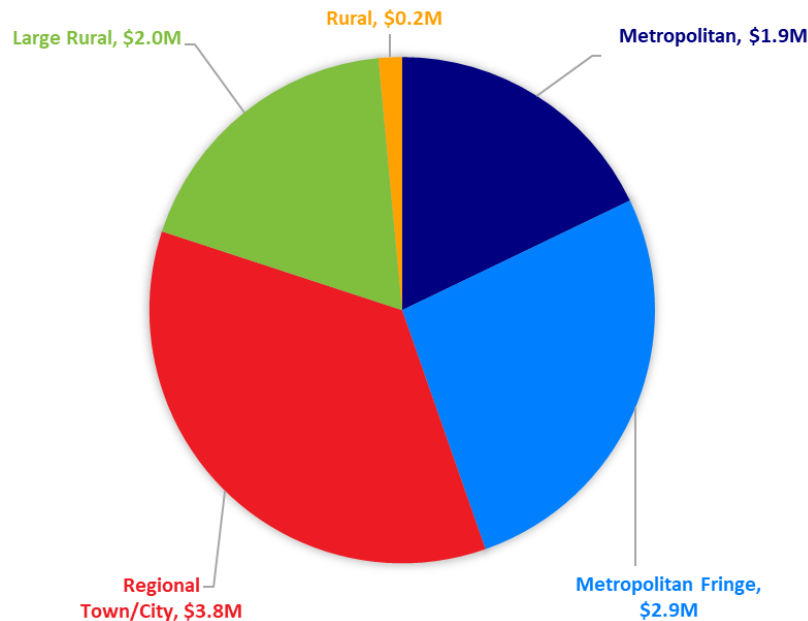
The RFS funding arrangements are the most complex of all the emergency services and creates challenges for both councils and the RFS. While councils are aware that their obligations to provide financial support to the RFS are generally over and above the RFFF, the costs at a district level are extremely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

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



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

Figure 14 RFS Depreciation Expense by council classification



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

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

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

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

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



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

3.2 Waste levy

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

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

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

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

1 Leadership and Governance

What we are trying to achieve

A community that works together in decision making that is defined as ethically, socially and environmentally responsible.

What the result will be

We will have:

- A community that has the opportunity to be involved in decision making
- Open, easy, meaningful, regular and diverse communication between the community and decision makers
- Partnerships and collaborative projects, that meet the community's expectations, needs and challenges
- Knowledgeable, skilled and connected community leaders
- Strong corporate management that is transparent

How we will get there

- 1.1 Inform and engage with the community about what Council does using varied communication channels
- 1.2 Maintain strong partnerships between all stakeholders - local, state and federal — so that they are affective advocates for the community
- 1.3 Demonstrate leadership
- 1.4 Use innovative, efficient and sustainable practices
- 1.5 Ensure strong corporate and financial management that is transparent and accountable

2 Your Community Life

What we are trying to achieve

A healthy, inclusive and vibrant community.

What the result will be

We will have:

- Community hubs that provide access to services and social connections
- A safe, caring and connected community
- A healthy and active community that is supported by recreational infrastructure
- A strong community that is able to identify and address social issues
- Community participation in events, programs, festivals and activities

How we will get there

- 2.1 Create a community that feels safe
- 2.2 Advocate for social inclusion and fairness
- 2.3 Provide quality programs, community facilities and public spaces, for example, community halls, parks and vibrant town centres
- 2.4 Empower the community through encouraging active involvement in projects, volunteering and events
- 2.5 Promote a creative and culturally rich community

4 Your Natural and Built Environment

What we are trying to achieve

A connected, sustainable, accessible community and environment that is protected now and into the future.

What the result will be

We will have:

- Effective management and maintenance of essential water, waste and sewer infrastructure
- A community that is prepared for natural events and climate change
- Sustainable and environmentally sensitive development outcomes that consider the impact on the natural environment
- Accessible transport network for our communities
- Infrastructure provision and maintenance that meets community expectations and needs
- Well planned communities that are linked to encourage and manage growth
- Accessible and protected waterways, foreshores, beaches and bushlands
- An environment that is protected and conserved for future generations
- Renewable energy options that are understood and accessible by the community

How we will get there

- 4.1 Provide (appropriate) infrastructure and services including water cycle management, waste management, and sewer management
- 4.2 Aim to minimise the impact of natural events and climate change, for example, floods, bushfires and coastal erosion
- 4.3 Facilitate development that is compatible with the natural and built environment
- 4.4 Plan for integrated transport systems that help people get around and link our communities
- 4.5 Plan for integrated and connected communities across the Port Macquarie-Hastings area
- 4.6 Restore and protect natural areas
- 4.7 Provide leadership in the development of renewable energy opportunities
- 4.8 Increase awareness of issues affecting our environment, including the preservation of flora and fauna

