3 July 2019

Dr Matthew Butlin
Presiding Commissioner
South Australian Productivity Commission
GPO Box 2343
ADELAIDE SA 5001
Emailed: sapc@sa.gov.au

Dear Dr Butlin,

RE: Inquiry into Local Government Costs and Efficiency – Methodology Paper

The South Australian Local Government Financial Management Group (SALGFMG) appreciate that Commissioners Tate and Findlay were able to attend the Executive Meeting on Friday 22 June 2019, and are seeking to engage with our membership in relation to the Independent Inquiry into Local Government Costs and Efficiency. We understand the timeframes that are in place for the enquiry are tight, however, this does limit the opportunity for extensive engagement with our membership, especially in terms of the methodology and technical aspects of the inquiry. We would welcome further engagement throughout the process so that further relevant information can be provided to support the Inquiry.

The SA Productivity Commission Methodology Paper includes the graph below:

Figure 1 General rates per rateable property

Source: SALGGC (2017b), ABS (2019), SACES (2019).

This graph indicates that on average rates have gone up around 52% over the 10 year period, that if your property rates were $1,000 in 2008/09, you were paying $1,520 in 2017/18. This is unlikely to be correct. The impact on an average residential ratepayer may be very different, if the mix of development has been skewed toward commercial growth, with high rates for low number of assessments. Also, if new residential property construction is of higher average property value than the existing average property value, it will impact the calculation shown above. The results in the graph are likely to be distorted by Adelaide City Council being a capital city council with distinctive characteristics with respect to its rating profile, and income sources which is not representative across other council.

The increase in general rates revenue is comprised of two components: the rate increase for existing rate payers, and the rates paid by new rate payers of newly created properties (ie resulting from subdivision of existing properties), which we term growth. It would be possible to gather growth data from within our SALGFMG membership, to distinguish growth and average rate increases, and to provide this information for residential, commercial and industrial, and vacant land; we would welcome that request.

For example, the City of Salisbury, over the period 2010/11 – 2019/20 has had a total average rate increase of 36.6%, compounding the average rate increase over the 10 year period. However, general rate revenue in this time has increased by 40.6%. The total number of assessments has increased by 8.3% with detail provided in the table below:

Number of Assessments

	2010/11	2019-20	Variance	
Residentail	51,202	55,938	4,736	9.2%
Commercial Shop	647	747	100	15.5%
Commercial Office	210	199	(11)	(5.2%)
Other Commercial	1,322	1,450	128	9.7%
Light Industrial	261	291	30	11.5%
Other Industrial	281	285	4	1.4%
Prim Production	221	200	(21)	(9.5%)
Vacant Land	1,467	1,095	(372)	(25.4%)
Other	145	157	12	8.3%
Marina	0	0	0	0.0%
Total Rateable	**55,756**	**60,362**	**4,606**	**8.3%**

The mix of properties has changed quite significantly, and the reduction in vacant land and primary production land being developed into residential and commercial properties has supported an increase in average rates per assessment, however, this is not the impact felt by an individual ratepayer. There is around a 50% differential on commercial rates, and this helps to drive up the average rate per assessment, and over this time the average rate per assessment increased from $1,184 to $1,665, being a 40.6% increase on average. This example helps to illustrate the true impacts for ratepayers and highlight that a consideration of general rate revenue per assessment is not an accurate approach to consider the impacts on the community from rate increases.

There are a number of other factors that have influenced the movement in general rates over this time, with further details on these provided below.

OPERATING DEFICITS

When comparing the Consumer Price Index (CPI), Local Government Price Index (LGPI), and General Rate Revenue increases over the past 10 years, consideration should be given to the focus that Councils have had on becoming financially sustainable since the independent inquiry into local government sustainability undertaken in 2005. The key indicator of financial sustainability is the operating surplus, and the number of Councils in a deficit position in 2009/10 was 36 compared with 12 Councils in deficit in 2017/18 sourced form SA Local Government Grant Commission Data Base Reports (SALGGCDBR), and represented in the table below:

Operating Deficit Councils

		2009/10 '000	2017/18 '000
1	Adelaide City		(17,381)
1	Adelaide Hills	(209)	
3	Barunga West	(307)	
4	Berri Barmera	(1,770)	
1	Burnside	(2,626)	
1	Campbelltown	(1,489)	
1	Coober Pedy	(287)	(1,411)
3	Flinders Ranges	(65)	(920)
1	Gawler	(2,915)	
4	Grant	(874)	
3	Kangaroo Island	(2,073)	(1,346)
3	Karoonda East Murray		(923)
4	Light Regional	(3,647)	
4	Mallala / Adelaide Plains	(324)	(234)
1	Marion	(1,187)	
4	Mid Murray		(2,762)
1	Mitcham	(1,444)	
1	Mount Barker	(83)	
3	Mount Remarkable	(337)	
3	Northern Areas	(1,565)	
1	Norwood, Payneham & St. Peters	(588)	
1	Onkaparinga		(3,958)
3	Orroroo/Carrieton	(660)	
3	Peterborough	(1,499)	(1,204)
1	Playford	(2,681)	
2	Port Augusta	(2,418)	
2	Port Lincoln	(245)	(429)
2	Port Pirie	(5,208)	
1	Prospect	(92)	
4	Renmark Paringa	(746)	
1	Salisbury	(1,497)	
3	Southern Mallee	(116)	
3	Streaky Bay	(571)	
1	Victor Harbor	(342)	
4	Wakefield	(718)	
1	Walkerville	(136)	
2	Whyalla	(1,251)	
3	Wudinna District	(101)	
3	Yankalilla	(723)	(102)
4	Yorke Peninsula	(3,113)	(164)
		(43,907)	**(30,834)**
	CPI	17.6%	
	Equivalent 2017/18 Amount	**(51,647)**	**(30,834)**

The total deficit position of these 36 Councils was $43.9M in 2009/10, which when adjusted for inflation is the equivalent of $51.6M in 2017/18, compared to a deficit in 2017/18 of $30.8M, with data being sourced from SALGGCDBR, an improvement of $20.8M. Of the deficit Councils in 2017/18 Adelaide City Council had moved from being in surplus in 2009/10 to a $17.4M deficit. Given the size of this deficit, and the resources and capability for Adelaide City Council further analysis of this result for 2017/18 is warranted to understand whether it was the result of a one-off impact. It would also be worthwhile understanding what is driving the deficits of Onkaparinga and Mid Murray Councils.

Given the overall decrease in the level of deficits over the period, it is reasonable to expect rate increases above the level of cost increases, and consequently the financial sustainability agenda has required higher rate increases.

It should be noted that timing of payments of the Financial Assistance Grants (FAG) can have significant impacts on Councils end of financial year operating result. In the 2017/18 financial year four quarters of payments were received, two quarters for the 2017/18 year grant, and 2 quarters paid in advance for the 2018/19 year grant. So the timing of the FAG is not an issue for the 2017/18 financial year, however, should the inquiry decide to look at other financial years, utilising the adjusted operating surplus contained within the notes of Council annual financial statements is worthy of consideration.

RATE REBATES & OTHER REDUCTIONS

Referring to General Rate Revenue ignores that there are amounts that are applied that reduce general rate revenue including Tier Adjustments, Rate Capping, Mandatory Rebates, and Discretionary Rebates with the figures below being from the 2018/19 rate survey, noting 61 Councils responded, with these figures representing a 2.7% reduction in rate revenue.

	2018/19
Tier Adjustments (Section 158)	$1,304,833
Mandatory Rates Rebates (Section 160-165)	$31,673,992
Discretionary Rates Rebates (Section 166)	$5,666,190
Rate Capping (Section 153)	$3,343,166
Total	**$41,988,181**

Across the sector there has been sizeable increases in mandatory rebates, which has resulted in increases in general rate revenue to offset this impact. The rebate for Community Service Organisations under S161 of the Local Government Act 1999 increased from 25% to 75% from 2013 to 2015. Also over the past 6 years SA Housing Trust (SAHT) has divested large quantities of stock to community housing associations, noting that the SAHT pays rates on the residential properties it owns, whereas Community Housing Associations effectively pay 25% as they are entitled to the mandatory rebate of 75% under S161. The impact of this does not rest equally over all Councils, with SAHT stocks being typically held in areas with lower property values, and this approach has then led to cross subsidisation from other ratepayers within the affected Councils with low capacity to pay. Arguably this financial impact should have been borne by the State Government instead so as to not affect communities of disadvantage, which is what used to occur prior to the influx of properties captured under S161.

The City of Charles Sturt is an example of a council with significant increases in mandatory rebates. Mandatory rebates were $796k in 2008/09 growing to $2.13M in lost revenue by 2017/18. This is an increase of 169% over the 10 years and largely results from the legislative changes in relation to community housing associations mandatory rate rebate.

OTHER REVENUE IMPACTS

The Financial Assistance Grant (FAG) received remains stable year on year, effectively reducing in real terms as there is no indexation applied. This reduction in real terms causes a funding gap and can contribute to higher rate increases. Comparing the Grant Commission data from 2007/08 to 2017/18, the funding mix for SA councils shows the increased reliance on rates, and a decline in grants as a proportion of total operating revenue, depicted in the table below:

Operating Revenue Mix			
	2008/09	**2017/18**	**Variance**
Total Rates	65.4%	72.0%	6.6%
Statutory Charges	3.1%	2.7%	-0.3%
User Charges	9.4%	8.3%	-1.0%
Grants Subsidies & Contributions	17.0%	13.5%	-3.4%
Investment Income	1.1%	0.4%	-0.7%
Reimbursements	2.1%	1.3%	-0.8%
Other Revenues	1.8%	1.6%	-0.3%
Share of Profit - JV & Associates	0.2%	0.1%	-0.1%

The decline in FAG may also be partially offset by other operating grants which may have grown over this period. Typically other operating grants are tied, and consequently result in higher expenditure, whereas FAG is untied meaning that it is available to fund Council's existing services.

In addition to this, the Commonwealth Government imposed an indexation freeze on grants from 2014/15 to 2016/17, which has reduced the income of South Australian Councils by $36M over this period (https://www.lga.sa.gov.au/page.aspx?u=6868&c=75855). In addition the Local Roads Supplementary grant was removed in 2014/15 before being reinstated in 2017/18 which resulted in loss of income by Councils of $37M (https://www.lga.sa.gov.au/page.aspx?u=6737&c=37491)

It is difficult to draw conclusions from the above table in relation to statutory and user charges as there are potential volume impacts, a number of statutory fees were not adjusted for CPI during the period of the inquiry, and some were and continue to be set below the cost to provide the service. Work was undertaken by SALGFMG in the period 2011-2014 so that the cost basis of fees could be determined, and using this information approaches were made to the State Government for changes in statutory fees. There was some success with food inspection fees, however, there are other fees which are significantly below the cost of providing the service, and while these fees are now adjusted for CPI, they result in cross subsidisation from general rate revenue. When the Truss Inspection requirement was introduced, rather than taking into consideration the differences in costs for geographically large councils compared to geographically small councils, a single fee was set and resulted in deficits for this service for geographically large councils, as analysed in report for the LGA by UHY Haines Norton "Development (Trusses) Variation Regulations 2011 Cost of Compliance and Cost Recovery Fees" May 2013. Other fees that have been set below cost include Section 7 certificates and Planning fees which is evident when compared to other states fees. This places more reliance on rate revenue as Councils are unable to charge appropriately for direct service provision.

Interest income will have been impacted by lower interest rates, however it can also be impacted by the level of funds invested. Over the period from 2008/09 to 2017/18 Interest Income reported has declined from $17.4M to $10.3M, and when adjusted for inflation, the decrease is $9.9M. It is reflected in the table above as a reduction in its proportion of the revenue mix, having declined by 0.7%.

WASTE SERVICE CHARGES & COST INCREASES

When considering general rate revenue it is important to understand that some Councils have a separate service charge for waste, whereas other Councils include waste in the costs for recovery within general rate revenue. The information on the proportion of Council with waste as a separate charge is 38 of 61 Councils who responded to the 2018/19 Rates Survey undertaken by the LGA, with further details provided in the table below:

Waste Service Charge	**No**	**Yes**
Metro	18	1
Rural	5	37
Total	**23**	**38**

Waste costs have increased significantly through market issues such as China Sword, but also through significant increases in the EPA solid Waste levy over the past 10 years, and for Councils without a separate waste charge these costs are recovered within general rates, and therefore contribute to higher general rate increases. The EPA solid waste levy rates are depicted in the table below (data sourced from Data SA website), and over the 10 year period there has been a 400% increase in the levy, with a further 40-50% increase by mid 2019/20:

Solid Waste Levy			**Rural**	**Metro**
1-Jul-09	to	30-Jun-10	$13	$25
1-Jul-10	to	30-Jun-11	$13	$26
1-Jul-11	to	30-Jun-12	$18	$35
1-Jul-12	to	30-Jun-13	$21	$42
1-Jul-13	to	30-Jun-14	$24	$47
1-Jul-14	to	30-Jun-15	$26	$52
1-Jul-15	to	30-Jun-16	$29	$57
1-Jul-16	to	30-Aug-16	$31	$62
1-Sep-16	to	30-Jun-17	$38	$76
1-Jul-17	to	30-Jun-18	$44	$87
1-Jul-18	to	30-Jun-19	$50	$100
1-Jul-19	to	1-Jan-20	$55	$110
1-Jan-20	to	30-Jun-20	$75	$140

The planned increase for 2019/20 was $3/tonne for Metro Councils and $1.50 for Rural Councils. The higher increase announced through the State Government Budget 18 June 2019, was after Councils consulted with their communities about the budget and annual plan, and rate increase. The lack of consultation with Councils by the State Government, the apparent lack of a strategic plan that underpins the rationale for the increase, the lack of linkages between this revenue and schemes to reduce land fill, and the uncertainty it creates in the Local Government sector are all cause for concern. For some Councils the increase in the Solid Waste Levy represents as much as a 0.8% increase in rates in 2019/20 and a further 0.5% increase in 2020/21 (assuming there are no further increases in the levy).

INFLATION INDEXES

The comparison of rate increases to the LGPI is also problematic. The LGPI is not a price index in a pure form. It is influenced by not just the costs of what is purchased but also the volume of what councils are purchasing, and consequently is not a true reflection of the cost increases faced by the industry. Further, it relies on grant commission data which is not audited and may be incorrect in some instances, which detracts from the reliability of the LGPI. For example, the indicator can be impacted by Councils who have undertaken service reviews and reduce their service provision, which is not reflective of the changes in costs experienced by others in the sector.

Given the cost structures of Local Government, CPI is not a relevant cost index as it does not represent the bundle of goods that Councils purchase. Looking at the cost structures of Councils, Employee costs make up a significant portion, as does depreciation. A mixed index of the Wage Price Index, CPI, and some consideration that unit rates for infrastructure revaluation are typically higher than CPI (resulting higher depreciation for existing assets), is more relevant.

We consider that a 50% WPI, 30% Road and Bridge construction Index and 20% CPI hybrid is more reliable and independent, transparent and efficient to produce. It goes part way to recognizing

Councils cost structures with 30-40% of expenditure being employee costs, and contractual services being largely outsourced labour costs.

INFRASTRUCTURE

Growth from development takes different forms and results in increased costs for Council. Growth includes minor capital improvements on residential properties which may not have a significant impact on council services in isolation, although this type of development when taken together reduces green space on private property and impacts on drainage systems. Other forms of development include development on vacant allotments, infill development in existing suburbs, and construction of new industrial and commercial facilities. This results in greater consumption of Council's services and assets, such as additional drainage capacity and increased wear and tear on roads, additional kerbing and footpaths in areas surrounding the development, due to increased traffic volumes. This also increases demand for Council services consumed by additional residents and visitors to the area.

Providing for additional assets and services for growth is not the only way Local Government depreciation and maintenance costs increase. Many Rural Councils grew their assets in the post war boom, and many Metro Councils have older assets as well. These assets are maintained, but they no longer provide the service standard that our communities expect. When we renew these assets there is significant uplift that is required to meet user demand. This increases depreciation costs, and as the footprint of buildings changes maintenance costs also increase. There is also demand for new assets with the mix of new and renewal expenditure being: Renewal $435M and New/Upgrade $390M per 2017/18 SALGGCDBR.

Growth in rates revenue from new subdivisions and new construction supports the provision of assets to growing communities, however, there are also changes in community expectations resulting in improvement of existing assets or new assets result in higher maintenance costs and depreciation costs, over and above the application of an inflation index.

Depreciation is a significant cost for Local Government, representing approximately 23% of its operating costs (2017/18 SALGGCDBR), but this is not the case for other tiers of government which have relatively lower levels of infrastructure. Compounding this is that Local Government also has the narrowest ability to raise revenue through taxation. When grant funding is provided from other levels of government to fund new infrastructure, there are implications for the operating result in future financial years as the new asset must be depreciated and maintained, as there is no additional income to cover these increased costs, it leads to higher rate increases. Grants can also result in fiscal illusion in that the Community believes new assets are attainable and affordable, as the grant results in lower levels of debt than would otherwise have resulted, and consequently rates are not increased as much as they would if there were interest payments on the debt.

Grant funding, especially for infrastructure, can be a significant burden on Councils as not only is there the need to provide our own capital funds to match the grant funding, there is the associated increase in interest costs, maintenance and depreciation following the construction of the asset. The same applies for assets donated by other tiers of government.

Changes in Accounting Standards can have significant impacts on depreciation. Recent changes in the reuse of materials in situ with a decision by the Australian Accounting Standard Board (Agenda Decision June 2015), no longer being regarded as a valid residual under direction from the Australian Accounting Standards Board resulted in increases in deprecation for road assets. This was an increase in depreciation costs of around $400k for the City of Salisbury in the 2015/16 financial year, and the equivalent of 0.5% rate increase. The impact will vary from Council to Council, and data can be gathered from our membership on request.

Depreciation is driven by the condition of assets, the value of assets, and the life of assets, and as assets are revalued generally every 3-5 years with condition assessments performed, this can reset assets value and lives. Along with updates to unit rates applied to these assets, it can lead to significant changes in depreciation. As we are dealing with long life assets and there is a requirement to be conservative, it is very difficult to determine accurately what the life of an asset is. Further, as engineering techniques continue to develop, such as lining failing pipes, there is need to consider lives of assets that are not tried and tested. If a pipe fails and it is replaced with a pipe of a larger size (radius) some councils regard this as renewal, some as new, some as upgrade.

Over the last 10 years there has been a focus on gaining a better understanding of our assets and how to make economic decisions in terms of renewal, upgrade and maintenance. Through this period asset management plans have been developed, asset management systems implemented, improvements in the depreciation of assets, and discovery of assets that we did not know we had through asset audits. During this 10 year period total depreciation expense has increased 48% for the sector (SALGGCDBR), and given the driver for councils to be financially sustainable this increase has been passed on to ratepayers to ensure they are paying for their consumption of resources, which is an improvement in inter-generational equity.

Asset Management will continue to be a focus as we refine our strategic asset management plans, undertake modelling to understand how changes in service standards impact on expenditure, and through better knowledge within the industry, standardize some aspect of asset treatment in respect of new and renewal, upgrade and modern equivalent. There is a need for more resources to be focused on the asset management effort so that each Council has the capacity to be managing their asset base in the most economical way, which will lead to longer term efficiency, but may also result in higher costs in the shorter term to enable these improvements to be made.

CHANGES IN SERVICE PROVISON

The table below provides a summary of changes in activity spending as reported in the SALGGCDBR for 2011/12 compared to 2017/18, noting that the Grants Commission only commenced reporting expenditure by activity from 2011/12.

TOTAL EXPENDITURE BY ACTIVITY	2011-12 ($000)	%	2017-18 ($000)	%	% Movement
Business Undertakings	151,198	8.3%	158,642	7.1%	**-1.2%**
Public Order and Safety	18,302	1.0%	15,605	0.7%	**-0.3%**
Health Services	43,601	2.4%	47,505	2.1%	**-0.3%**
Community Support	146,948	8.0%	169,493	7.6%	**-0.5%**
Community Amenities	26,615	1.5%	50,809	2.3%	**0.8%**
Library Services	101,307	5.5%	141,574	6.3%	**0.8%**
Cultural Services	33,273	1.8%	36,537	1.6%	**-0.2%**
Economic Development	46,484	2.5%	85,881	3.8%	**1.3%**
Agricultural Services	11,598	0.6%	6,736	0.3%	**-0.3%**
Waste Management	155,352	8.5%	198,395	8.8%	**0.4%**
Other Environment	198,118	10.8%	268,961	12.0%	**1.2%**
Recreation	246,289	13.5%	334,295	14.9%	**1.4%**
Regulatory Services	131,140	7.2%	173,862	7.7%	**0.6%**
Transport	413,377	22.6%	453,011	20.2%	**-2.4%**
Governance / Finance Charges & Other Functions	106,028	5.8%	102,739	4.6%	**-1.2%**
Total Operating Expenses	**1,829,630**	**100.0%**	**2,244,045**	**100.0%**	

The table indicates that spending has increased with expansion in community building and aspirational services over the period. Councils are providing additional services in Community Services, Library Services, Economic Development and Recreation. Councils have also been impacted by legislative changes resulting in increased expenditure in Regulatory Services, with examples including Local Nuisance and Litter Control Act, Dog and Cat Management Act and the Development Act.

OTHER COST DRIVERS

Employee costs represent 35% of councils total operating cost (2017/18 SALGGCDBR). This cost is driven by Enterprise Bargaining Agreements and often include no forced redundancy clauses resulting in labour being largely a fixed cost. From 2008/09 many Councils had wages increase in the order of 4% to 6%, falling to around 3% in 2014/15 and more recently in the order of 2%, and more reflective of wages growth in the broader economy. Rate increases should be reviewed in light of wages growth impacts, and data can be sourced from our membership about Enterprise Agreement percentages on request.

In addition to increases in the Solid Waste Levy, cost shifting through the mandatory rebates for supported accommodation, and that statutory fees are set at levels that do not cover the cost of service provision, there is the requirement for Councils to charge the Natural Resource Management levy on behalf of State Government. Often the NRM levy increases significantly more than CPI, with the increase over the past 10 years being approximately 100%. This levy is included on the rates notice, and the community may not appreciate that these funds are remitted to the State Government. There are hidden costs in managing the levy which the trivial administration fee does not cover, such as the costs of staff time and systems to support the calculation of the levy applicable to each rate account, the collection effort, and the cost of funding the cash deficit from non-payment of the levy. Further the Emergency Services levy has increased by nearly 200% over the period 2008/09 to 2017/18. We believe that any analysis of councils consideration should be given to the impact these imposed levies have on rates increases.

OTHER CONSIDERATIONS

Over the past 10 years Councils in South Australia have adapted and improved in a number of ways including the embedment of the model financial statements, standardised reporting on financial sustainability indicators, implementation of the Better Practice Internal Controls Framework, implementation and increased sophistication of long term financial planning, and increasing maturity in asset management.

Measuring efficiency in local government ignores that Councils exist to serve their communities, and it is the community that determines the services and assets provided, rather than a focus on efficiency. Councils only collect enough in rates to pay for the cost of services and infrastructure required; there is no windfall gain with all rates levied being invested in each community. A council is there to serve the needs of its ratepayer and there will always be a level of inherent inefficiency due to the demands of the community. There is opportunity for Councils to improve communication with their communities to ensure that the community is informed about services and the associated costs, and the impacts of adding services or raising service standards.

Benchmarking across Councils will not improve efficiency, it takes resources away from service delivery, increases red tape and administrative overheads and is a distraction from improvement initiatives. The rationale for this is that each Council calibrates its services to meet their community's needs. When we compare across Councils it takes time to understand whether we are comparing on a like for like basis and further time to understand the remaining level of difference. It is found that services are intentionally different because each Council is serving the needs of its distinct community. For example some communities will choose to have a number of libraries, whilst others may have a single library; this will result in higher costs and higher services in the first Council, but it is the choice of that community, and there is little value in the comparison. Looking at each individual Council over time provides useful information about improvement in resource utilisation and service provision which is much more relevant than comparing across councils.

As a sector there is open sharing of best practice and learning from each other. The professional networks that exist across local government support participating in Councils improvement journeys as we take the best from each other, and adapt it for our own organisations. Further understanding of the culture of sharing best practice in Local Government is worthy of further consideration by the Commission, and we would welcome the opportunity to discuss our experiences of this.

The timing of this Inquiry with short lead times for consultation, and the distraction of many of our members currently as a result of the significant increase in the solid waste levy are a cause for concern. We have 200 members, with 65 of the 68 Councils represented within our membership, which will enable us to offer significant and varied input into the Inquiry. The SALGFMG are open to sharing as much relevant information with the Commission as possible and request that we are provided opportunities and time to do this. We also request that the SALGFMG is provided the opportunity to be represented on the Inquiry Reference Group through a formal request from the Commission.

Yours sincerely,

Kate George
President