

NEED FOR A MORE SUSTAINABLE FUTURE FOR LOCAL GOVERNMENT

Summary - Submission to Legislative Council Economy and
Infrastructure Committee Inquiry into Local Government
Funding and Service Delivery in Victoria

MAY 2024

FinPro

Local Government Finance Professionals (FinPro) is the peak body servicing local government finance professionals in Victoria. An incorporated association, FinPro has over 800 members, representing all Victorian councils, five regional library corporations and over 20 other organisations.

FinPro aims to collaborate with the sector and State Government to benefit our communities, and we recognise that Councils play a crucial role and are part of the solutions in ensuring the financial sustainability of the sector.

Introduction

Local government enables the economic, social and cultural development of the municipal area it represents, supports individuals and groups, and provides a wide range of services for the wellbeing of the local community. This detailed analysis and report has been developed to respond to the Victorian Legislative Council Economy and Infrastructure Committee Inquiry into Local Government funding and services.

As the delivery level of government for services that impact households and communities, local government can help achieve state and national government priorities through related core service delivery – but only if there is adequate funding provided to support sustainability.

A short literature review is provided in the Appendix to the detailed report that summarises published assessments by key agencies in both Victoria and other states. Research around processes which other states have has informed FinPro's risk assessment on financial sustainability, and has informed some of our key recommendations.

This summary document complements the detailed report.

Conclusion

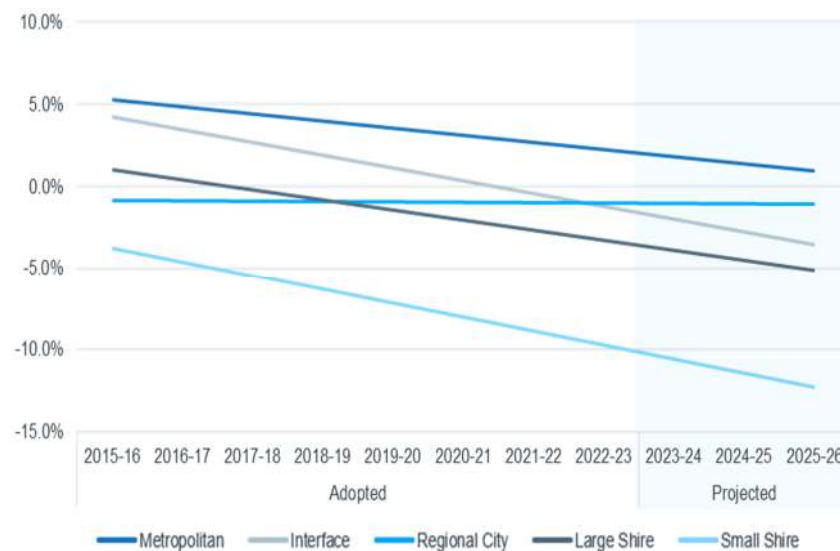
The current revenue structures for local government place the sector in a difficult financial position, reducing the capacity to support contemporary living standards for Victorian communities. While the Commonwealth Government and the Victorian Government are able to earn uncapped taxation revenue that increases with economic and population growth, supporting increasing living standards, the local government sector is reliant upon insufficient rate revenue, and Financial Assistance Grants that have not increased in real terms on a per capita basis since 1995.

In the absence of change, the short, medium and long term financial sustainability of Victorian local government entities cannot be assured. This will have a direct impact on local services, and represents a lost opportunity across shared State, Federal and Local Government policy objectives.

Key Findings

Financial Position

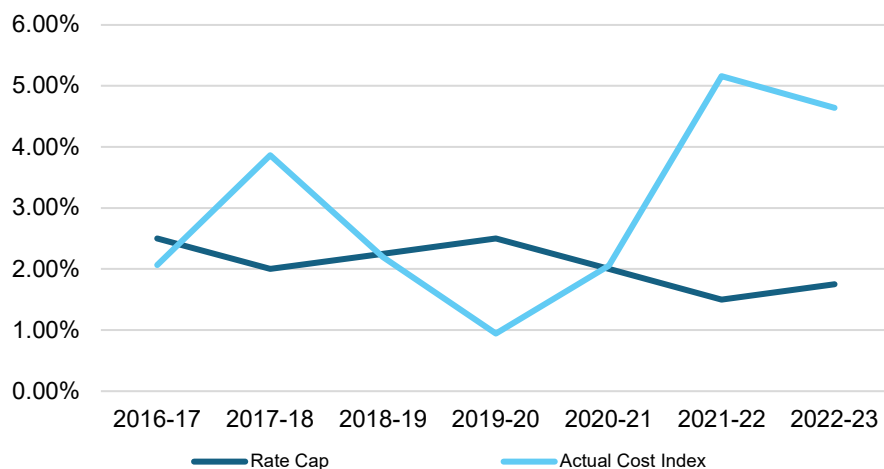
- A majority of councils have adjusted underlying deficits, with a deteriorating trend evident since 2016-17 across the council cohorts, as evidenced in the below figure.



- There has been deterioration in the unrestricted cash position across the local government sector, consistent with ESC advice to the Minister that cash reserves across the sector were deteriorating.
- The timing of grant payments made to Councils, especially the Financial Assistance Grants, masks the true financial position and performance of Councils.

Revenue

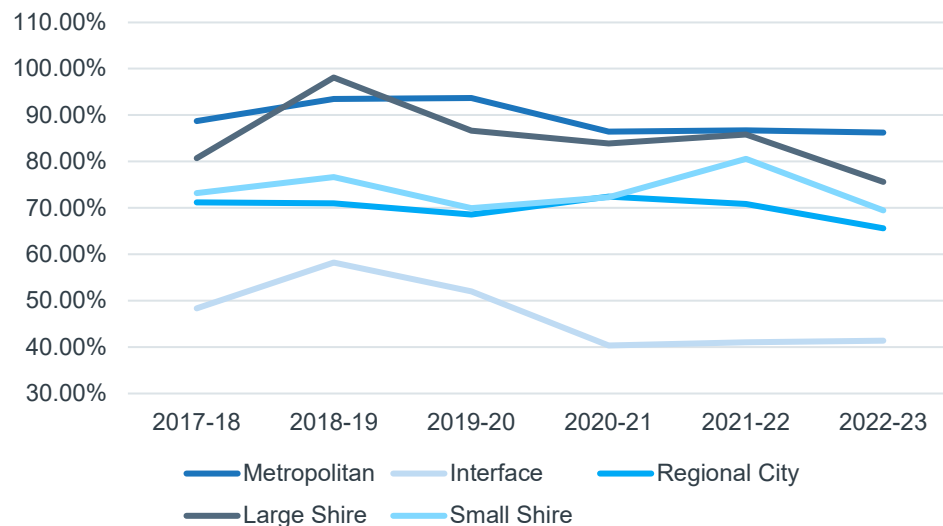
- FinPro acknowledges a rate cap is a reasonable policy approach by the State Government and is not advocating for its removal. However, the indicators used, and the criteria applied to provide advice to the Minister must be reviewed to avoid the system further impacting on local government financial sustainability.
- FinPro's view is that there is a need to introduce a Local government Cost Index for the setting of the Victorian rate cap, that reflects the costs factors of local government. The current rate cap system is not providing sufficient rate revenue to match the actual increase in the cost base of existing services and infrastructure. Using an adjusted Local Government Index, that takes into account each of Cost Price Index (CPI), Wages Price Index (WPI) and Road and Bridge Construction Index (RBCI), FinPro demonstrates that since 2016/17 (start of the Fair Go Rating System) the rate cap has resulted in a cumulative increase of 15.43%, while a possible LGCI has increased by 22.93%. The trend is demonstrated in the below graph, with further analysis in the detailed report.



- The current revenue structures for local government places the sector in a difficult financial position to fund contemporary living standards for Victorian communities. Over the last 5 years – Commonwealth Government taxation revenue has increased 31%, State Government 34% and Local Government (rates) 16%.
- As a percentage of total Commonwealth Government taxation revenue (excluding GST), the amount of Financial Assistance Grants made available to local government across Australia has decreased from 0.76% to 0.57% from 2011/12 to 2021/22.

Expenditure

- The State Budget 2024-25 highlights the financial sustainability challenges councils currently face in Victoria. Throughout its budget material, the State Government points out the 22 percent increase in infrastructure costs – an even more challenging circumstance for local government with rates capped at just 2.75 percent.
- There is insufficient investment in the renewal of existing assets to match the consumption of assets, leading to further deterioration and increased maintenance and more costly intervention over the medium to long term. Councils across all cohorts are not renewing assets at the same rate as they are consuming the assets (as measured by depreciation expense), when only including renewal and not upgrades of assets. Below figure presented renewal only investment.



Recommendations

FinPro and the sector more broadly are seeking to work collaboratively with the State and Federal Government to ensure the sustainability of local government and the continuation of the role of local government in the delivery of services to community.

The following recommendations are made for the sector to work collaboratively with the State Government to implement:

- 1 That LGV engages with the sector and establishes a risk-based assessment framework for financial sustainability of local government, including criteria set for different council cohorts, to assist both the state government, Councillors and local governments officers to take action to manage risks to sustainability.
- 2 That the ESC be required to calculate and have regard in advice provided to the Minister to a local government cost index for the Victorian local government when considering advice to the minister on setting the rate cap each year.
- 3 That the ESC be required to consider adjustments to correct historically set rate caps that were insufficient to meet the indexation of local government costs.
- 4 That LGV engages with the sector and establishes a more detailed report on assets, similar to the required schedule Report on Infrastructure Assets for NSW councils, to ensure transparency in reporting of assets and the capacity of councils to fund the necessary maintenance and capital investments.
- 5 That the Minister Local Government, LGV and local government peak bodies reengage with a model like the Victorian State-Local Government Agreement established in 2014, which seeks to enable consultation, co-design, and a fair balance of cost apportioning to achieve the best outcomes across policy domains. Recent engagement has not adhered to the responsibilities or intent of the agreement, and in some cases had significant costs shifted to local government.

The following are recommendations and specific notifications for the Committee to consider:

- 1 That the Committee notes the FinPro analysis of the financial position of local government, which is in contrast to other assessments outlined in this report that local government is in a sound financial position.
- 2 That the Committee notes the analysis provided by FinPro that a majority of councils have a deteriorating underlying adjusted deficit, deteriorating unrestricted cash and investing insufficient cash to asset renewals, resulting in an increased risk to financial sustainability of the local government sector.
- 3 That the Committee notes the combination of a deteriorating financial position and cost shifting is impacting on the capacity of local government sector to deliver core services That the Committee notes that the vertical fiscal imbalance that exists results in the local government sector being vulnerable to policy settings of other levels of government, including the allocation of grant funding, which is exacerbated in Victoria by the further restriction placed on local government by the Victorian Government through the rate capping system.

- 4 That the Committee notes there is a significant difference in the rate cap calculated for Victorian councils compared to NSW councils for 2024/25. The rate peg set for NSW councils will be 4.5%, while the rate cap set for Victorian councils will be 2.75%. Applied across the total rate revenue base for Victorian councils, the difference equates to over \$138 million in lost rate revenue for local government in Victoria. FinPro requests the Committee to recommend to the Minister for Local Government to seek the development of a Local Government Cost Index, for use in the annual rate cap calculation.
- 5 That the Committee notes the administrative, and in particular, the political challenges faced by councils seeking a higher rate cap under the Fair Go Rate System and the likely outcome that Victorian communities will experience significant rate shocks in future years when significant rate increases will be required.
- 6 That the Committee notes that, unlike the Commonwealth and Victorian governments, the revenue base of local government does not grow in line with economic growth, due to the impact of rate capping and the Financial Assistance Grant funding model – due to rates and operating grants contributing 80% of revenue in the local government sector. This means while the Commonwealth and Victorian Governments can respond to demands for higher living standards as the economy grows (e.g., additional funding for better health services and better education), the local government sector is significantly constrained to meet the demand of the community for higher living standards.
- 7 That the Committee notes that, between 2011/12 and 2021/22, Commonwealth Government taxation revenue (excluding GST) increased by 65% (or 31% in the five years to 2021/22) and Victorian Government taxation revenue increased by 98% (or 34% in the five years to 2021/22) yet Victorian local government taxation revenue (municipal rates) only increased by 54% (or 16% in the five years to 2021/22).
- 8 That the Committee notes that as a percentage of total Commonwealth Government taxation revenue (excluding GST), the amount of Financial Assistance Grants made available to local government decreased from 0.76% to 0.57% from 2011/12 to 2021/22.