Local Government Grants Commission

Information Paper

2016-17 Financial Assistance Grants

What are local government financial assistance grants?

Local government financial assistance grants are general purpose grants that are paid to local councils under the provisions of the Commonwealth *Local Government (Financial Assistance) Act 1995*. This legislation also details how the total amount of grant funds is determined and how the funds are to be distributed between the States (including the ACT and the NT).

Who decides how much each council should receive?

Each State and the Northern Territory must have a Local Government Grants Commission for it to receive funding. It is the responsibility of each Grants Commission to make recommendations on the allocation of grants in its State. In NSW the Grants Commission makes recommendations to the NSW Minister for Local Government. If accepted the recommendations are referred to the Commonwealth Minister responsible for the grants programme for final approval.

Who is on the Grants Commission?

The NSW Commission has four members nominated by the NSW Minister for Local Government and appointed for terms of up to five years (members may be reappointed). At least two commissioners must be persons who are or have been associated with local government in NSW and one, the deputy chairperson, must be an officer of the Office of Local Government. The membership as at 30 June 2016 was:

The Hon Jenny Gardiner	Chairperson *(former Member of the NSW Legislative Council)*
Tim Hurst	Deputy Chairperson *(Acting CEO, NSW Office of Local Government)*
Alan McCormack	Member *(former General Manager, Parkes Shire Council)*
Graeme Fleming	Member *(former General Manager, Cabonne Council)*

How should councils spend the money?

Although there are two separately identified grant components, the total funds are paid to councils as unconditional grants. Each council has complete autonomy in deciding how the funds should be spent, and is accountable to its rate payers.

How much money is involved and how is it distributed?

The estimated national entitlement for 2016-17 is $2.289 billion. This is made up of a general purpose component ($1.585 billion) and a local roads component ($703 million).

The general purpose component is distributed on a basis that takes into account each State's share of the national population. NSW receives $508 million, or 32.051% of the national pool.

The local roads component is distributed on the basis of fixed shares of the national pool - for NSW it amounts to $204.1 million (29% of the national funds).

It should be noted that the total funds are passed on to councils. The Grants Commission's operating costs are met by the NSW Government.

How are the grants paid to councils?

The payments are usually made by way of quarterly instalments commencing in mid-August each year. This is followed by instalments in mid-November, mid-February and mid-May.

The Commonwealth legislation provides for annual indexation of the national funding pool that takes into account CPI and population estimates, with subsequent adjustments for actuals.

However, as part of the 2014-15 Federal Budget the Government announced that it *"…will achieve savings of $925.2 million over four years by pausing indexation of the Local Government Financial Assistance Grants Programme for three years commencing 1 July 2014."* Accordingly, there will be no significant adjustments to the overall national funding pool for CPI and population growth until the 2017-18 year, although minor annual adjustments for each year's *final factor* are still required.

A small underpayment for the general purpose component grant of $92,780 occurred for NSW in 2015-16. The underpayment, which resulted from the Commonwealth Treasurer's determination of the *final factor* for 2015-16, as required by the legislation, will be taken into account as part of the quarterly instalments paid to local authorities during 2016-17.

How does the Grants Commission assess the grants?

The two components of the grants are distributed on the basis national principles under the provisions of the Commonwealth Act and NSW principles, which have been developed in consultation with local government.

The **general purpose component** of the grants attempts to assess the extent of relative disadvantage between councils. The approach taken by the Commission considers the extent of cost disadvantage in the provision of services on the one hand (**expenditure allowances**) and an assessment of the relative capacity of councils to raise revenue on the other (**revenue allowances**). The national principles require that the method used to assess the grants should exclude, as far as practicable, councils' policies and practices (the **effort neutral** principle).

The Commonwealth Act specifies that all councils are entitled to a **per capita minimum grant**, based on 30% of the general purpose component. For 2016-17 the minimum amount is $20.01 per capita. Twenty-one councils are protected by the minimum grant provision.

The **local roads component** is assessed on the basis of councils' proportion of the State's population and the lengths of local roads and bridges. The formula was developed by Roads and Maritime Services.

Can you tell me more about expenditure allowances?

Expenditure allowances are part of the general purpose component of the grant. They are calculated for each council for a selected range of council functions, such as libraries, health, building control, recreation, roads, etc. Expenditure allowances attempt to compensate councils for the extent of relative disadvantage because of issues beyond their control.

Council policy decisions concerning the level of service provided, or if there is a service provided at all, are not considered (effort neutral).

How does the Commission calculate expenditure allowances?

Expenditure allowances are calculated for 20 functions or areas of expenditure. An additional allowance is calculated for councils outside the Sydney area that recognises their isolation.

The general formula for the calculation of expenditure allowances is:

Allowance = No. of Units x *Standard Cost* x *Disability*

Where:

> ***No. of Units*** is the measure of use of the function for the Council. For most functions the number of units is the council's population. For others it may be the number of properties or the length of local roads.
>
> The ***Standard Cost*** is the average of annual average net expenditure, per unit, by all councils in the State, averaged over five years.
>
> The ***Disability*** is the measure of the extent of relative disadvantage a council faces in providing a standard service because of issues beyond its control. For each function the characteristics likely to influence the cost are identified and measured. The measure is then related to the potential additional costs to councils.

The following example illustrates this:

Using Library Service as an example:

The unit of use is population. Council A has a population of 10,000. The standard cost of library service is $34.16 per capita.

It is assumed that a council with a population of 10,000 would spend $341,600 on library services (ie. 10,000 x $34.16).

The expenditure allowance is the estimate of how much extra it would cost Council A to provide the necessary service due to inherent characteristics of its area. So for each function those inherent factors likely to influence the cost of that function are identified and measured. For libraries the factors identified are:

> ***non-resident borrowers:***
> *recognises additional cost of providing services to an above average proportion of non-residents.*
>
> ***aged:***
> *recognises the extra cost of providing special services to the aged such as large print books or home visiting services where there is an above average proportion of aged persons.*
>
> ***students:***
> *recognises students as a major user group of library services.*
>
> ***non-English speaking background:***
> *recognises additional costs of information provision where there is an above average proportion of the population from NESB.*
>
> ***population distribution:***
> *recognises extra cost of providing services in more than one urban centre.*
>
> ***other:***
> *special characteristics of the area which may be highlighted by Council in submissions and during discussion with the Commission.*

For each factor's measure the Commission determines a weighting to reflect its significance in terms of additional cost. These are summed to produce a disability factor for the Council.

For example if Council A has 3 urban centres, an above average proportion of non-resident borrowers and an above average proportion of aged it may be assessed as having a disability of 20%. This would be included in the calculation:

10,000 x $34.16 x 0.2 = $68,320

in other words, it is estimated that it would cost the council $68,320 more than the standard council because of its inherent disabilities. $68,320 becomes Council A's expenditure allowance for libraries.

What about the assessment of revenue raising capacity?

The Commission is attempting to assess a ranking of councils in terms of their relative capacity to raise revenue. The calculation of revenue allowances involves determining each council's theoretical capacity to raise revenue by comparing land values per property to a State standard and applying the State standard rate-in- the-dollar. For comparative purposes the Commission purchases valuation data that has been calculated to a common base date for all councils by the Valuer-General.

To reduce seasonal and market fluctuations in the property market, the valuations are averaged over three years. In the revenue allowance calculation, councils with low values per property are assessed as being disadvantaged (positive allowances). Councils with high values per property are assessed as being advantaged (negative allowances). That is, the theoretical revenue capacity of each council is equalised against the State standard.

To be consistent with the effort neutral principle the Commission's approach excludes the rating, financing and entrepreneurial policies of individual councils. For the same reason a council's current financial position is not considered.

Why use property values at all? Aren't there better measures of revenue raising capacity?

The Commission has found that property values provide a useful State-wide basis for comparative analysis. The assessment of relative capacity of councils to raise revenue is an issue that involves more than councils' rating capacity. In this broader context property values provide a measure of the changes that occur in the relative economic wealth between council areas from year-to-year. For example, in times of economic growth property values increase. In times of economic decline property values fall. An examination of other data sets, such as tax, retail sales, and census information, shows them to be less reliable, less timely, and not able to provide the same State-wide comparative basis as property values.

I understand the Commission discounts the revenue allowance. What does that mean?

In developing the methodology the Commission was concerned that the influence of the Sydney property values would distort results if the natural weighting was applied. That is, the revenue allowances would have substantially more significance than the expenditure allowances. This issue was discussed with the Commonwealth and the approved principles provide that *"revenue allowances may be discounted to achieve equilibrium with the expenditure allowances"*. As a result both allowances are given equal weight.

The discounting helps to overcome the weighty nature of the revenue calculations, in particular the impact of the Sydney metropolitan property values.

The objective approach to discounting revenue allowances reduces the extreme positives and negatives calculated, yet maintains the relativities established in the initial calculation.

Why is rate pegging not considered when calculating a council's revenue raising capacity?

The calculations are essentially dealing with relative disadvantage. Since rate pegging affects all councils the Commission does not specifically consider it.

How does the number of non-rateable properties affect the calculations?

Non-rateable properties are excluded from the Commission's calculations. The calculations deal with relativities between councils, based on an assessment of rateable properties only.

How do the Commission's calculations compare to the Commonwealth funding for the general purpose component?

The Commission's calculation of general purpose grants is initially made without reference to the total of funds available from the Commonwealth. The notional general purpose grant to each council must be re-scaled, firstly to the available funds, and secondly to bring those councils below the per capita minimum ($20.01 for 2016-17) up to that level, as required in the Act. Each council receives less than half of their assessed as need, based on the Commission's calculations.

Why do the grants to councils vary from year to year?

Generally movements in the grants are caused by:

Population Changes

The source for estimated resident population data (preliminary) as at 30 June 2015 is ABS publication *Regional Population Growth, Australia, 2014-15* (cat. no. 3218.0), with population estimates for the new Parramatta and Cumberland Councils, and adjustments for the Hills and Hornsby Councils, being provided by the NSW Department of Planning.

When comparing the preliminary 2015 population figures to the preliminary 2014 figures (those used in last year's grant calculations), the NSW population increased by 1.32%. Individual council area population variations ranged from a reduction of 3.26% for Bourke Shire to an increase for Camden of 7.71%.

Population is the multiplier used in the calculation of disability expenditure allowances for thirteen functions.

Changes in Standard Costs and Disability Measures

standard costs

Special Schedule 1 data from all councils' statements of accounts is used to calculate the State average or standard costs for the expenditure functions assessed.

In an attempt to improve the stability of the grants the Commission uses a five-year moving average of the annual standard costs. Averaging over five years produces shares that are more stable than annual averages. It is acknowledged that it does so at the expense of responsiveness to annual variations.

annual fluctuations

For some functions the measures used to determine disability factors can vary significantly year-to-year. These changes in relative disadvantage will be reflected in changed grant relativities.

disability factors

In an attempt to deliver improved outcomes to smaller rural communities the modelling has been adjusted:

- the standard cost for unsealed local roads in the general purpose component continues to be weighted to reflect the inability of small rural councils to adequately fund these roads;
- similarly, a weighting has been applied to the isolation allowance; and
- -5%/+10% limiting has been applied.

Local Road and Bridge Length Variations

Road and bridge length data is collected from all councils annually. Variations in the data affects the distribution of both the general purpose and the local roads components of the grants.

State-wide the local road length reported by councils increased by 16 km, compared with the previous year's 137 km increase. The overall length of bridges on local roads increased by 993 m, compared with last year’s 845 m increase.

Variations for individual council’s road lengths range from an increase of 83 km to a reduction of 122 km. Changes to reported bridge length ranged from an increase of 655 m to a 1,248 m decrease.

Changes in Property Values

Property values form the basis of the Commission’s assessment of revenue allowances. Changes in relativities between councils' per-property-values and those of the State average affect grant outcomes.

Councils showing the greatest decreases in their revenue allowances generally represent those LGAs where property values have remained stable or are rising, compared to the State average.

Councils in areas of declining economic activity (generally reflected in falling property values) have generally shown increases in their revenue allowances.

How is capital expenditure treated?

The requirements for capital expenditure or major infrastructure renewal are not considered, largely because of the practical and theoretical problems involved.

In order to assess capital expenditure requirements the Commission would have to undertake a survey of the infrastructure needs of each council and then assess the individual projects for which capital assistance had been sought.

This would undermine council autonomy, because the Commission, rather than the council, would determine which projects were worthwhile.

In addition, councils that had failed to adequately maintain their assets could be rewarded at the expense of those that did maintain them.

What about a council's money making venture?

This is a policy decision by the council and, therefore, it is not considered in the Commission's calculations (effort neutral).

Can the Commission help out if a council’s money making venture fails?

No. The Commission is not a lender of last resort for councils with financial problems, nor does it underwrite the entrepreneurial operations of councils.

The Commission has no form of reserves to fall back on. The total allocation of funds each year is distributed to councils in that year.

What about debt servicing?

Debt servicing is really related to council policy and is, therefore, excluded from the Commission’s calculations.

What about poor decisions of the past?

This is also linked to the issue of council policy, albeit in the past.

Does a council’s level of expenditure on a particular function affect the grant?

Generally not. The use of council’s expenditure in the calculations is generally limited to determining a State standard, or average, cost for each selected function. The standard costs for these functions are then applied to all councils in calculating their grants. What an individual council may actually spend on a function has very little bearing on the standard cost or its grant. Variations in standard costs reflect industry expenditure trends.

What about efficiency? Are efficient councils rewarded in some way?

Yes. Because a council’s grant is assessed independent of policy decisions of the council, a council that provides a cost effective service still receives grant funding which it can allocate to other areas according to its priorities. The efficient council will benefit from its efficiency.

The Commission groups councils according to the Australian Classification of Local Government categories. Do these groupings affect the grant outcomes?

No. These categories are merely a convenient way of grouping councils for analysis purposes. They have no bearing on the grants themselves. The grants are assessed on a whole-of-State basis.

What happens in the event of council amalgamations?

National principles provide that “*where two or more local governing bodies are amalgamated into a single body, the general purpose grant provided to the new body for each of the four years following amalgamation should be the total of the amounts that would have been provided to the former bodies in each of those years if they had remained separate entities.*”

Where can I get more information?

You can get more information about the grant process by contacting the NSW Grants Commission at:

5 O’Keefe Avenue, Nowra NSW 2541
Locked Bag 3015, Nowra NSW 2541
Telephone: (02) 4428 4132 Fax: (02) 4428 4199
Internet: www.olg.nsw.gov.au (follow links)
E-mail: grants@olg.nsw.gov.au

Information is also available from the Australian Government’s web site at www.regional.gov.au/local/