4

Impact of the GFC on local government

4.1 Local governments across Australia have been affected by the GFC. Indirectly, by its impact on local economies, and directly by its impact on council revenues. Specifically, councils have suffered from:

- decreases in income as property development slows;
- decreases in rates revenue; and
- reduced income from poorly performing investments.[1]

4.2 These effects have not been felt evenly across all local governments. In a similar manner to its impact on business, the GFC has disproportionately affected local governments in areas dependent on housing growth and single industries. It has also substantially impacted the balance sheets of local governments in NSW and WA that had council money invested in collateralised debt obligations (CDOs).[2]

4.3 Local governments source their income from rates, the sale of goods and services, government grants and various other sources.[3] There is an indication that rate revenue has slowed[4] and in some cases declined dramatically:

> …rates have been declining rapidly as a result of a significant slowing in the housing market for Mandurah. The City's 2007/08 interim rates revenue was $1.11m; however, 2008/09 Budget

---

1 Department of Infrastructure, Transport, Regional Development and Local Government, *Submission No. 153*, p. 5.

2 Mr Adrian Beresford-Wylie, *Transcript 14 August*, p. 65.

3 Australian Local Government Submission to Productivity Commission study into local government sources revenue, July 2007.

4 National Sea Change Task Force, *Submission No. 43*, p. 13 & City of Townsville, *Submission No. 68*, p. 13.

forecasts have been reduced to $550,000 (Original budget $1.05m - 48% reduction).[5]

4.4 Building and planning fees have, in some cases, been hit particularly hard. In Mandurah, where building activity has been strong for some time, their revenue from building and planning fees halved:

> Our building application fees are about $1.8 million a year. They have dropped to about half a million dollars a year. Our planning fees were about $800,000 a year previously. They have dropped to about $400,000 a year… at an inert waste disposal site, which takes just building rubble, where we were getting $600,000 a year in revenue from it, we are getting about $150,000 this year. So that is an indicator, again, of the lack of building activity that is occurring. Probably this financial year, there will be about a $3 million impact on 2008-09. We suspect it will be $4 million or $5 million next year. [6]

A similar situation has occurred on the Gold Coast, another high growth area, where a range of cancelled developments has led to a reduction in council income.[7] Revenue reductions amounting to millions of dollars has a substantial impact on a council's operations.

4.5 The Shire of Busselton has found itself faced with a choice between decreasing services or increasing its rate structure. It has also considered cutting back on infrastructure spending and employee numbers.[8] Neighbouring shires have considered spending less on tourism and visitor servicing, ceasing staff appointments and instigating a wage freeze for the 2009-10 financial year.[9]

4.6 In an attempt to assist local governments around Australia weather the GFC, the Commonwealth Government brought forward a portion of 2010's Financial Assistance Grants payment 'to help councils manage cash flow'.[10] It is also expected that the Nation Building and Jobs Plan, Community Infrastructure Program and the Jobs Fund will stimulate local

---

5 City of Mandurah, *Submission No. 49*, p. 4.

6 Mr Mark Newman, *Transcript 1 May 2009*, pp. 7-8.

7 Mr Grayson Perry, *Transcript 4 August 2009*, p. 13.

8 Councillor Wesley Hartley, *Transcript 30 April 2009*, pp. 2-3.

9 Mr Dean Unsworth, *Transcript 1 May 2009*, pp. 4-5.

10 Department of Infrastructure, Transport, Regional Development and Local Government, *Submission No. 153*, p. 5.

economies, thereby assisting local governments to maintain revenue streams.[11]

4.7 In addition to the Commonwealth Government support provided to local communities, some councils have chosen to increase rather than reduce spending in the face of declining revenue. Gold Coast City Council has introduced a stimulus package to 'engender confidence within the local economy'.[12] Its stimulus spending is designed to target 'those projects that are "shovel ready" and will deliver on job creation, retention and economic growth'.[13]

4.8 Few local governments, however, have the luxury of introducing significant stimulus spending measures during economic downturns. Indeed, many councils have found that the money they already had is no longer contributing returns, as a result of declining interest rates and losses from investments.

4.9 The Committee received evidence indicating that some councils in Western Australia and NSW had exposure to investments which have declined considerably since the onset of the GFC because the investments were linked to the sub-prime mortgage market in the United States. Investment in CDOs, in particular, has been the main cause of the mark-to-market book losses of some councils in these states. CDOs are best explained by Michael Cole, author of the 2008 Review of NSW Local Government Investments report, commissioned by the NSW Government in response to council losses:

> CDOs are a type of structured Asset Backed Security (ABS) that gain exposure to the credit of a portfolio of fixed income assets and divides the credit risk among different tranches, each with a different level of risk and return: senior tranches (rated AAA), mezzanine tranches (AA to BB), and equity tranches (unrated). The collateral for CDOs includes [mortgage-backed securities] MBS, ABS, leveraged loans and corporate bonds. By combining low rated sub-prime MBS with high rated collateral, originators were able to create highly rated CDOs that could be widely distributed to traditionally conservative investors such as commercial banks, insurance companies and pension funds.[14]

---

11 Department of Infrastructure, Transport, Regional Development and Local Government, *Submission No. 153*, p. 5.

12 Gold Coast City Council, *Submission No. 74*, p. 16.

13 Gold Coast City Council, *Submission No. 74*, p. 16.

14 Michael Cole, *Review of NSW Local Government Investments: Final Report*, April 2008, p. 7.

4.10 Evidence provided to this inquiry regarding council investment losses has come predominantly from NSW regional councils. Broken Hill City Council has had to write-down its investments in the last financial year by just over $2 million and there is a probability that this financial year, the council will need to write-down the face value of its investments another $1.5 million to $2 million.[15]

4.11 This will have a substantial impact on the Council's service provision:

> …we have had to defer some of our capital programs. We have set ourselves a long-term capital expenditure level of just over $5.6 million, whereas last year and this year we spent or are aiming to spend over $7.6 million. We have had to wind that back significantly for the future based on our ability to finance the works.[16]

4.12 Councils sought out investments with the 'highest return available', so long as they were consistent with the restrictions imposed by the NSW Local Government Minister's 2005 Ministerial Investment Order.[17] The councils in question were also 'aggressively sold these complex investment products' by suppliers, who, in some cases, were distributing the products as well as acting as advisers to councils.[18] Lehman Brothers, in particular, were active in the WA and NSW markets.[19]

4.13 It should be noted that these investment products were highly rated by ratings agencies and did adhere to the Minister's Investment Order. Councils, however, are 'governed by their fiduciary responsibility as trustees for the prudent investment of public funds'[20] and therefore, should have been less willing to accept the risk/return trade-off associated with these products.[21] Councils in NSW would have also been aware of Circular No. 06-70 issued in November 2006, which stated that:

> Ratings in no way guarantee the investment or protect an investor against loss. Councils should not misinterpret prescribed ratings as an implicit guarantee of investments or entities that have such ratings.[22]

---

15 Mr Desmond Bilske, *Transcript 7 July 2009*, p. 6.

16 Mr Desmond Bilske, *Transcript 7 July 2009*, p. 6.

17 Michael Cole, *Review of NSW Local Government Investments: Final Report*, April 2008, p. 9.

18 Michael Cole, *Review of NSW Local Government Investments: Final Report*, April 2008, p. 10.

19 Mr Adrian Beresford-Wylie, *Transcript 14 August*, p. 65.

20 Michael Cole, *Review of NSW Local Government Investments: Final Report*, April 2008, p. 10.

21 Michael Cole, *Review of NSW Local Government Investments: Final Report*, April 2008, p. 11.

22 NSW Department of Local Government, *Circular to Councils No. 06-70: Investment Requirements for NSW Councils*, 27 November 2006, pp. 2-3.

4.14 Stated responsibilities and advice from state governments was not sufficient in guiding council staff, who did not always take great care in examining investment products:

> ...if people had read the 50 to 100 pages of information that was provided behind each of the investment products, there would have been some concerns, generally, from staff in their advice to take on the higher-rate return on investments.[23]

4.15 The Cole report, presented in April of 2008, agreed, citing eight recommendations intended to strengthen and clarify the investment order provided to NSW councils. The final recommendation in the report called on the NSW Department of Local Government to release investment policy guidelines similar to those issued in February 2008 by the Western Australian Department of Local Government in response to council losses in WA.[24]

4.16 The NSW Government accepted all eight of Cole's recommendations, issued a revised Ministerial Investment Order in August 2008 and has drafted investment policy guidelines for local councils in NSW.[25] The Committee expects that revised investment guidelines issued in WA and NSW, will lead to a more conservative investment regime and help councils in both states.

4.17 The Committee is concerned, however, that within the draft NSW investment guidelines there is no guidance similar to that issued by the Director-general of the Department of Local Government under Circular to Councils No. 06-70, citing the danger of relying too heavily on the rating of an investment product. Perhaps this omission reflects a consistent policy. Within the same circular, it is suggested that despite the need for caution when assessing investment ratings, 'ratings provide the best independent information available'.[26] The role of rating agencies in the GFC should serve to highlight a need for policy change. At the very least, any new investment guidelines should encourage caution when assessing an investment product's rating.

---

23 Mr Desmond Bilske, *Transcript 7 July 2009*, p. 6.

24 Michael Cole, *Review of NSW Local Government Investments: Final Report*, April 2008, p. 6.

25 See NSW Department of Local Government, Draft Investment Policy Guidelines, May 2009, http://www.dlg.nsw.gov.au/DLG/DLGHome/documents/Information/draft%20investment%20policy%20guidelines.pdf, accessed 24 September 2009.

26 NSW Department of Local Government, *Circular to Councils No. 06-70: Investment Requirements for NSW Councils*, 27 November 2006, p. 3.

4.18 The WA and NSW experience should also serve as a reminder to councils in other states. Although none were affected, the need to properly handle risk in investing public money is a lesson that should be heeded by councils across the country.