Financial assistance grant allocation methodology

AUGUST 2022

Information paper

Queensland Local Government
Grants Commission

Queensland Government

Contents

In 2021, the Commission undertook a review of the allocation methodology used to distribute Queensland's share of the Commonwealth Government's FA Grant to councils.

The purpose of the review was to ensure the Commission's allocation methodology is achieving a more equitable distribution of the FA Grant in accordance with the Commonwealth National Principles, with a focus on achieving greater horizontal fiscal equalisation for Queensland local governments.

The objectives of the Commission's review and changes to the allocation methodology were:

Transparent
Councils understand the methodology and how their allocation is determined

Equitable
Outcomes address relative disadvantage in the current environment

Simple
Minimises complexity in the approach

Reliable
Data is consistent and obtained from trusted sources

Stable
Methodology ensures low variability of allocation outcomes

The Commission completed its review in December 2021 and has advised councils that the new FA Grant allocation methodology will be implemented over a three-year transition period commencing from the 2022-23 FA Grant.

This Information Paper presents an overview of the new FA Grant allocation methodology.

Further information about the Commission, FA Grant and 2021 allocation methodology review are available on the Commission's website.

Background

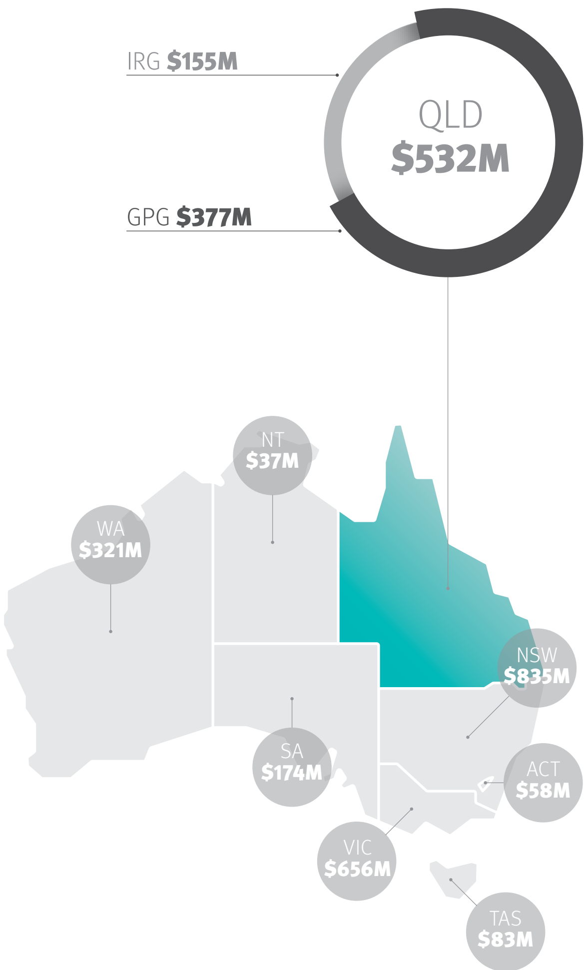
About the financial assistance grant (FA Grant)

All local governments in Australia receive an FA Grant allocation from the Commonwealth Government, as determined by individual state and territory grants commissions.

For 2021-22, the Commonwealth Government allocated $2.7 billion for the FA Grant, of which Queensland received $532 million (a 19.7% share of the total pool). There are two components to the FA Grant, the GPG component and the IRG component. Queensland's 2021-22 FA Grant was comprised of $377 million in GPG funding and $155 million in IRG funding.

All FA Grant funding is disbursed to local governments, with the costs of administering the grant to local governments met by individual states and territories. FA Grant funding is untied and may be spent by individual councils on local priorities.

2021-22 distribution ($2.7B)



About the Commission's role

The Queensland Local Government Grants Commission (the Commission) is an independent statutory authority whose primary role is to make recommendations about the allocation of the FA Grant to Queensland councils.

The Commission's statutory powers come under both Commonwealth and State legislation.

Commonwealth legislation establishes a set of National Principles that the Commission must follow in making recommendations about the allocation of the FA Grant. This includes a requirement that FA Grant funding is to be allocated such that, to the extent possible, councils are able to deliver at least an average standard of services to the community ('horizontal fiscal equalisation').

More information on the National Principles are provided by the Commonwealth Government here.

Overview of previous funding methodology

The figure below shows the Revenue and Expenditure categories used in the previous GPG model as well as the cost and revenue adjustors (or multipliers). The gap or difference between a council's assessed expenditure need and assessed revenue capacity would determine its raw GPG or need.

Assessed expenditure (need)	–	Assessed revenue (capacity)	=	Raw grant
State averages		**State averages**		**Determines share of GPG pool that council receives**
Administration^		Rates*		
Public order and safety*		Garbage		
Education, health*		Other fees and charges		
Garbage^		Other grants		
Community ammenities*				
Town planning^				
Industry development^				
Environmental protection^				
Roads^				

^Scale, location
*Scale, location, demography

*SEIFA index

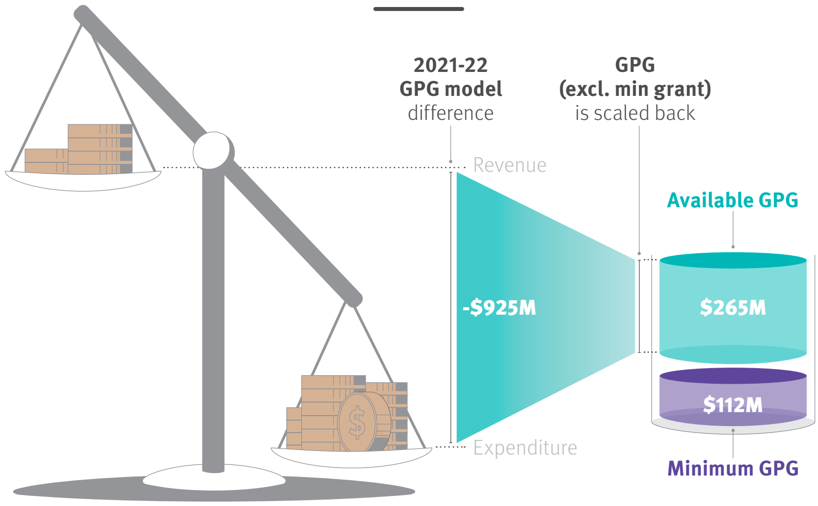
This raw grant or 'need' would then be scaled back to the available funding in the GPG allocation.

The IRG is one of the national principles and requires this component of the funding to be distributed on the basis of councils' relative needs with regards to preserving their road assets.

Under the previous model the IRG was calculated by a simple proportional allocation by population and road length.

Further detail on the previous methodology can be found in the Commission's annual reports here.

Raw grant and scaling



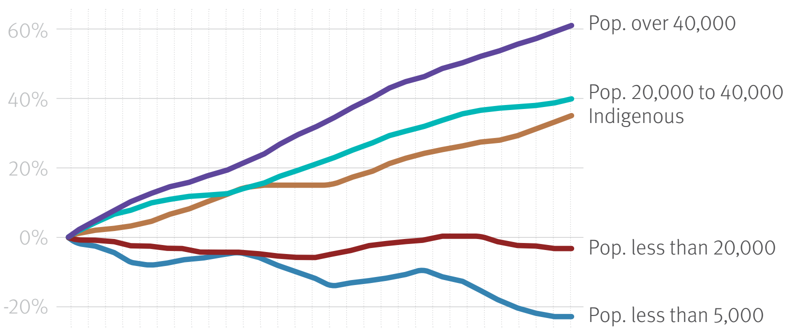
Case for change

Financial sustainability challenge

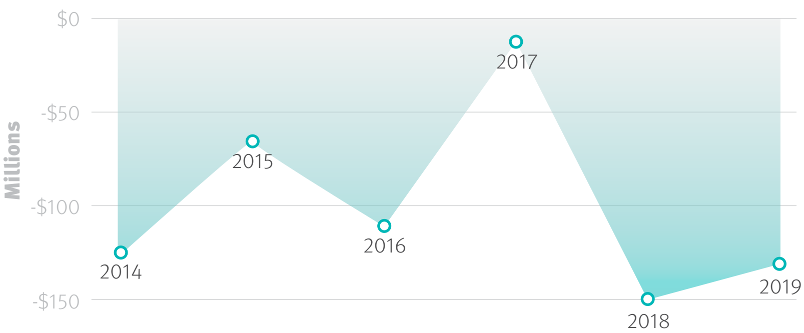
Financial sustainability is a significant challenge for all Queensland local governments. This challenge has been heightened by the impacts of COVID-19 and local governments are subject to increased pressures on revenues, rising costs and growing community expectations.

This sustainability challenge is not the same across all local governments. Population, a key driver of a council's ability to fund the delivery of services to their community is changing. Trends for small councils show that populations are generally declining. Increasingly, councils with small and reducing populations are also becoming the provider of last resort for a range of services, including post offices, banks and funeral services.

Population change over the last 30 years



Historical operating deficits for all councils with population <20,000



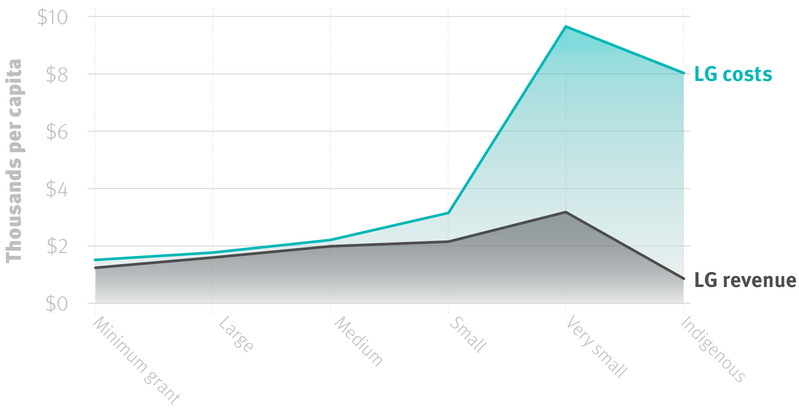
Councils with a population of less than 20,000 do not have the capacity to derive sufficient revenue to meet their cost base. As council size decreases, costs and revenue per capita diverge. This gap widens for councils with population below 1,000. This structural challenge has resulted in historical operating deficits over the last 5 years. Councils with populations of less than 20,000 have incurred a combined net operating deficit of $103 million per annum.

Regardless though of the size of a population there is a minimum operating cost for councils to deliver their important services. Analysis of data available shows that this is approximately $10 million. Councils with small populations have difficulty deriving sufficient revenue to meet their cost base. As mentioned above, as a council size (by population) decreases, the per capita revenue and expenditure diverge.

The objective of the FA Grant funding is to try and enable all councils to meet an average standard and must be distributed in accordance with the requirements of the Act.

In response, the Commission determined that a review of the minimum grant councils and the methodology used to distribute the FA Grant was required to address the relative need of all Queensland councils in an equitable way. The Local Government Association of Queensland 2020 conference also resolved to request the Commission review the methodology.

Per capita revenue and costs (by council group)



Methodology limitations

There were a number of limitations from the previous methodology that the Commission was keen to address.

Firstly, caps and collars were previously applied to the GPG outcomes. Over time and combined with external factors such as the 3 year freeze in the total FA Grant pool from 2014-15, this delayed transition to the model's outcomes.

The Commission also considered the old model was too heavily driven by population – particularly in the IRG calculation. By removing the road assessment from the GPG and implementing a similar per kilometre assessment in the IRG, both of these factors have been improved.

Finally, the previous model did not sufficiently capture the greater need of the small, rural and remote councils, relative to that of the larger councils. By shifting the GPG calculation to a fiscal capacity approach (measuring need by the gap between revenue potential and revenue capacity, adjusted for cost factors) the new model will achieve a greater balance in this regard.

Key methodology changes

Key methodology changes are identified throughout this paper. The following provides a summary:

GPG changes

New approach to the gap – the gap or 'need' is calculated by revenue capacity & adjusted by cost factors

New indices have been introduced to the methodology. These are:

- Water & Wastewater Revenue
- Dispersion cost factor
- Population segment uplift (adjustor)

Other changes:

- Removal of the roads factor element in the distribution calculation
- Removal of the prior Caps and Collars approach that limited funding distribution change over time

IRG Changes

IRG – the majority (85%) of the pool is distributed to non-minimum grant councils

New minimum grant councils

The new FA Grant allocation methodology increases the number of minimum grant councils from 10 to 15 and introduces a transparent trigger for determining new minimum grant councils. One of these councils was already transitioning to a minimum grant status, with four new minimum grant councils identified in this review.

Under the new allocation methodology, councils with a population greater than 80,000 are to be classified as a minimum grant council.

In considering the distribution of the FA Grant, the Commission reviewed how other jurisdictions distribute funding and impose a minimum grant. The Commission found that in New South Wales, Western Australia, and South Australia all councils with a population greater than 50,000 persons are classified as minimum grant councils.

Lowering the population threshold for a local government to be classified as a minimum grant council brings Queensland's FA Grant allocation methodology more in line with other jurisdictions.

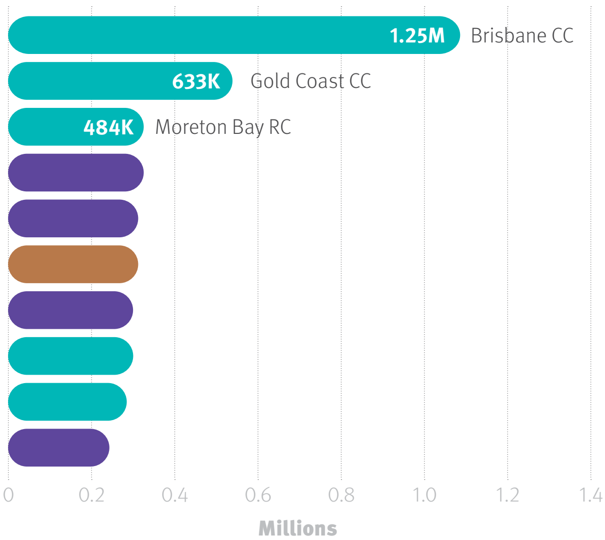
Queensland has five out of the ten largest local government areas in the country, including the top three. These five local government areas account for almost 60% of Queensland's population.

Queensland has eight of the 20 smallest local government areas in Australia and the largest Queensland council is more than 4,700 times larger than its smallest. The next highest ratio is Western Australia at approximately 2,700 times larger.

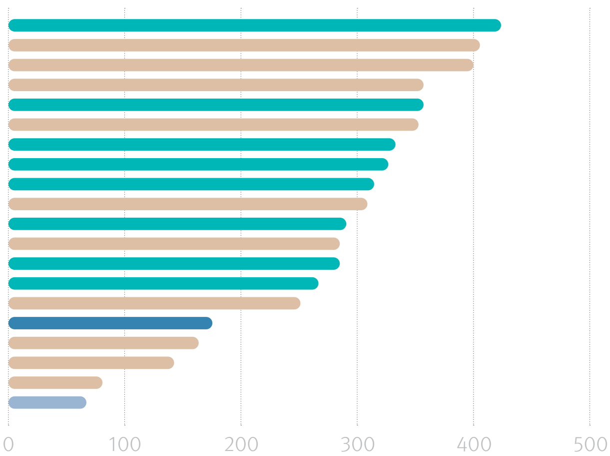
Larger councils have more flexibility to generate revenue to support average level of service in their communities.

Increasing the number of minimum grant councils from 10 to 15 is expected to provide an additional $28 million of funding for redistribution to smaller, remote and indigenous councils.

10 largest LGs in Australia by population



20 smallest LGs in Australia by population



The following diagram shows the components of the GPG calculation.

General purpose grant (GPG) and identified road grant (IRG) allocation

General purpose grant

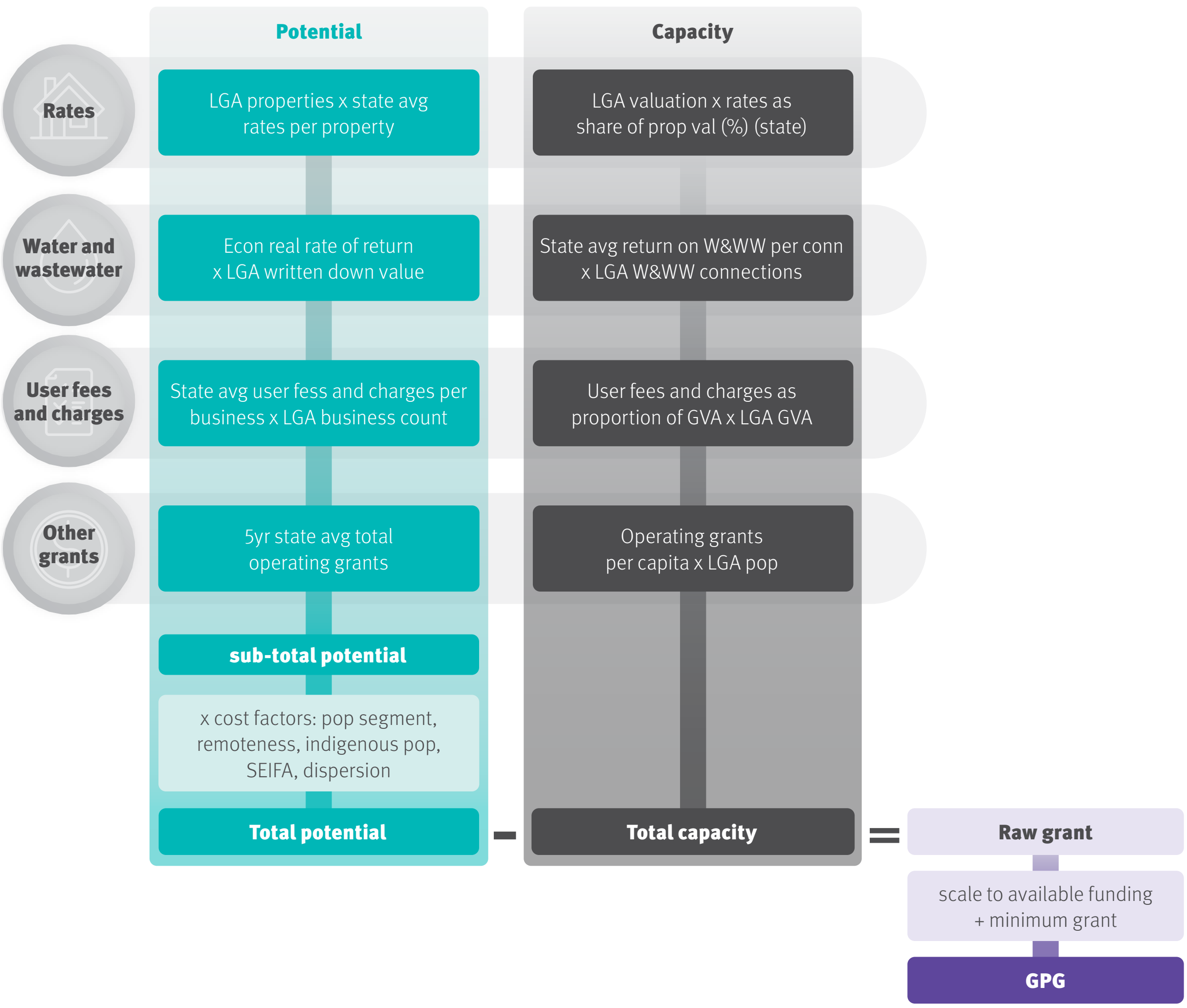
The allocation of the GPG component of the FA Grant is determined by identifying the grant 'need' each council has, relative to the 'average' Queensland council. This provides a basis to determine the proportion of the GPG allocated to an individual council.

The previous GPG method calculated a gap, or 'need', between assessed revenue and assessed expenditure. The new allocation method will also calculate a gap but based on councils' Fiscal Capacity.

A council's Fiscal Capacity is measured by assessing the difference between the potential to raise revenue (conditions of an 'average council') and their capacity to raise revenue. This acknowledges the revenue raising challenges faced by many small, rural and remote councils.

Fiscal Capacity is considered to be a better measure for allocating the FA Grant because it better reflects the differences in challenges faced by small and remote councils to provide an average level of service.

Components of the GPG calculation



The table below lists the key inputs used to determine GPG fiscal capacity:

Revenue	Expense
Rates › General rates › Ratable property value (combined) › Number of ratable properties	**Segment level uplift** › Population
Water and wastewater › Rate of return on water assets › Number of connections › Water bill per connection	**Cost factors** › SEIFA › Dispersion › Remoteness › Indigenous population
User fees and charges › LGA GDP (gross value added) › Number of businesses › User fees and charges revenue	
Grants › All grants included	

The capacity gap determination takes into consideration the council specific cost factors of remoteness, economies of scale, demographics (represented by the SEIFA index), dispersion and a population segment multiplier.

It is important to note that, consistent with the National Principles and previous allocation methodology, minimum grant councils also receive their portion of the GPG, with 30 per cent of the GPG pool allocated on a per capita basis.

Key changes to the GPG calculation

The following key changes have been made to the calculation of the GPG:

- Water & Wastewater Revenue input added
- Garbage revenue removed
- Road expenditure removed (now only assessed in IRG)
- Expenditure categories removed,replaced by cost factors which multiply Revenue Potential
- Changes to adjustors/multipliers (dispersion added; others change in calculation/treatment).

Identified road grant

The IRG is one of the national principles and this component of the funding is to be distributed on the basis of councils' relative needs with regards to preserving their road assets.

Under the previous model the IRG was calculated by a simple proportional allocation using population and road length. The Commission considered the population component of this calculation (37.15%) to be a limitation of the model which was not considered in the previous methodology review. This element has been removed allowing a larger proportion of the IRG pool to be distributed to non-minimum grant councils.

To better reflect the cost to councils of preserving road assets, the new allocation methodology determines IRG allocations using a roads cost relativity index, provided by the Department of Transport and Main Roads and road length data.

Removing population from the IRG calculation allows a larger proportion of the IRG pool to be distributed to non-minimum grant councils. The funding pool is split with approximately 15% of available funding going to minimum grant councils and 85% going to non-minimum grant councils.

The following diagram shows the components of the IRG calculation.

Other changes

Where possible, all input data to the model will be averaged over 5 years, providing greater stability to outcomes and reducing the need for caps and collars (GPG) and improving the stability of the model over time.

Components of the IRG calculation

Whole of sector outcome

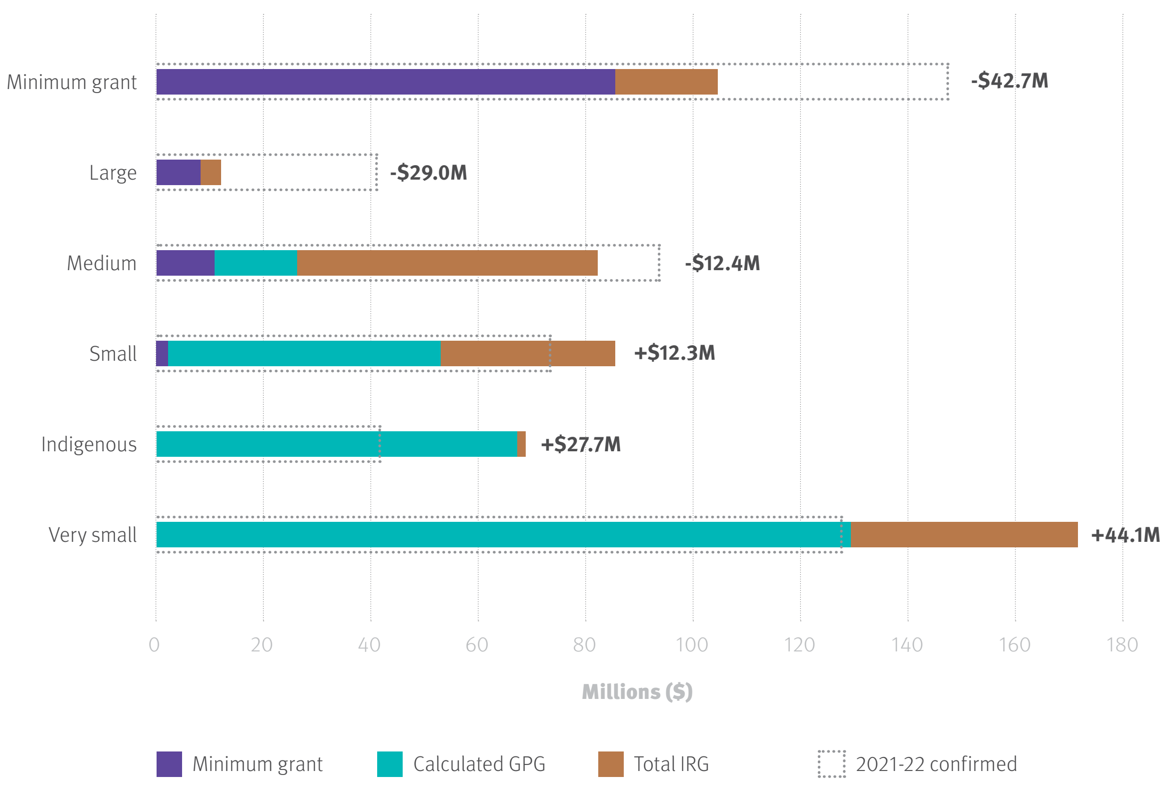
The Commission believes a more equitable funding distribution has been achieved with more funding to be distributed under the new model to councils with a greater need (predominantly small and indigenous councils). Based on the 2022-23 FA Grant allocation to Queensland ($576M):

57 of 77 councils (74%) in Queensland will receive a greater funding allocation under the new FA Grant methodology in 2022-23.

20 councils (26%) will receive a reduced allocation. For these councils the average reduction is approximately 0.3% of operating revenue.

Implementation of the review outcomes will be staged over a three-year period commencing in the 2022-23 year.

Overall impact – allocated with 2021-22 $525M



Note: all numbers in the diagram are indicative only and will be updated for the 2022-23 allocations

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