



Inner West Council

Rates Benefit and Service Pricing Report Revised

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Introduction

The purpose of this report is to consider challenges and issues that need to be addressed in developing Council's Revenue Policy, namely the merger obligations to the three rating structures that are currently in place and review Council's service pricing. Council is required to establish and transition to a single rating structure on 1 July 2020.

In reviewing the current rating structures, Council will need to understand if there is any potential inequity between the allocation of rates across different property categories and subcategories and therefore a need to consider reallocation between categories and subcategories. The harmonisation process provides an opportunity to review and improve the equity and transparency of the rating structure.

The other element of the revenue policy is Council's approach to service pricing in terms of the extent or level of cost recovery and the balance between private and public good. A pricing matrix establishes Council's current position and enables Council to take a considered approach in strategically changing the pricing regime to the cost recovery philosophy determined by Council.

Council will need to develop and undertake a comprehensive community consultation and engagement program to gather feedback as an input into Council's decision making process.

A Rates Harmonisation Briefing paper has been completed that details the rates statutory obligations and the taxation principles. The paper also highlights the strategic challenges and issues that Council needs to consider as part of the harmonisation process. An objective of the briefing paper is to provide rate structure scenarios and options for Council consideration.

The Rates Benefit and Service Pricing modelling undertaken and detailed in this report has, and will continue to inform the rates modelling process, the range of scenarios that will be developed and considered by Council. In the ongoing review of Council's Revenue Policy, Council has the opportunity to reposition its service pricing regime, if Council is of mind to change the level of cost recovery. Any change will have an impact on the total rate yield.

Rates Benefit Model

The objective of undertaking a high level rates benefit assessment is to better understand the benefits that ratepayers have access to resulting from the rates they pay. The outcomes are:

- to ascertain the level of alignment between access to service benefits and the rates paid
- to provide information for Council to consider improving / changing the alignment of service benefits to rates paid.

Methodology

Some ratepayers have more access to, make more use of, and benefit more from different council services funded by rates. Rating subcategories can be used to group ratepayers with a view to more closely aligning rates to the relevant local services received.

The rates benefit modelling establishes the principle that the ratepayer benefits are the net cost of services allocated to a rating category. The allocation of service operating costs to the different rating categories generates the access to benefits for that rating category.

The analysis allocates the operating costs for each service (the benefit) to a rating category through the rates benefits model which compares the rates paid to potential benefits received.

The allocation methodology has two criteria:

- Direct beneficiary of the service
- Council-wide benefit

The direct beneficiary criteria are assessed based on the rating category, or a portion thereof, accessing and/or receiving a specific service benefit. For example, specific information was provided on types of Development Applications allowing allocation of benefits to all the rating categories accordingly.

The council-wide benefit criteria are distributed on a per assessment basis. For example, Corporate and Finance services are allocated to each of the rating categories based on the percentage of rate assessments within each category. This reflects that there are no direct or specific benefits for a particular rating category.

This modelling provides a level of analysis of the proportionate service benefits allocated to each of the rating categories to evaluate whether there is inequity between categories. When compared to the cost of service provision, it can be used to inform the recommendations for the target rate revenue yield for each rating category and sub category.

Observations and comparisons

Comparison of rates paid and benefits allocated across categories

The analysis is based on a high level assessment of the allocation of net service costs (benefit) to each of the rating categories, using the agreed apportionment assumptions contained in the Rates Benefit Model, referred to in Appendix A.

The results from the assessment of rates benefits shown in the following Rates Benefits in Table 1 indicates that there is a level of inequity as both Business rating categories are paying significantly more rates than the benefits the category has access to.

The total rate income for the Business category is \$36.27m and the estimated equivalent ratepayer contribution to benefits is \$29.72m. This represents 1.2 times rate payment to benefits. The anomaly in this category is the Mall sub category of .53 benefits ratio¹. The reallocation of \$600,000 from Business General to the Business Mall increases the benefit ratio to .86, while decreasing business general from 1.26 to 1.23. This better reflects the service and infrastructure benefits that Malls have access to directly relating to the business activities.

Conversely the residential ratepayer is potentially under-contributing to the service benefits. The total rate income for the category is \$82.58m yet the estimated equivalent ratepayer contribution to benefits is \$89.13m. This represents 0.93 times the rate payment to benefits.

¹ Rates Benefit and Service Pricing Report May 2019 page 3

Using the principles of the benefit allocation approach suggests that the business category should pay less in rates and residential should pay more. However, the rates benefit model should only be used as a general guide to illustrate to Council a potential issue in the current rating structure.

Table 1 Rates Benefits Table

Description	Assessment Numbers	Rate Income	Gross Ratepayer Benefit	Equivalent Contribution to benefits
Residential	70,797	\$ 82,580,584	\$82,823,713	\$89,132,671
Business General	4,584	\$24,899,647	\$18,857,295	\$20,293,718
Business Industrial	1,237	\$ 9,826,677	\$7,098,037	\$7,638,718
Business Mall	4	\$1 ,542,703	\$1,658,194	\$1,784,504
Totals	76,622	\$118,849,611	\$110,437,239	\$118,849,611

Note: Refer to Appendix A for details of the Rates Benefit Model.

Service Pricing Model

The objective of undertaking the service pricing analysis is to allow Council to assess the level of ratepayer funding for service provision. The outcomes are:

- to identify full cost and income for each service
- to determine the level of cost recovery for each service
- alignment to Council's pricing policy and the actual cost of each service
- to provide information and a guide for Council to adjust funding sources for each service.

Methodology

The Service Pricing Model is a strategic level tool designed to support Council's decision-making process around the appropriate level of ratepayer funding allowing Council to put in place an ongoing review of service objectives and policy decisions against the cost of services.

Our approach to our service pricing model is to firstly create a Pricing Policy Matrix and including a range of cost recovery for each category within the matrix. Secondly, the model includes the full and net cost of each Council service so that Council can review its decisions about the appropriate sources of funding. Finally, the model includes the full list of Council services aligned / allocated to a category of the Pricing Policy Matrix, along with the proportion of cost recovery for each.

The model assesses the actual income and expenditure for each service, based on Council's most current available data, providing the actual level of cost recovery for each service which can then be compared with the Council's desired future state. This enables Council to take a strategic view of cost recovery, using this as a driver for change in the service delivery culture of the organisation.

The service pricing model can provide full transparency of Council decisions in distributing the cost of service provision to ratepayers. Knowing the full cost of services is important when setting prices and making decisions about the appropriate sources of funding.

Observations and analysis

Analysis of service cost recovery

The critical driver for the level of cost recovery is the application of Council's Pricing Policy Matrix. Table 2 below details the range of cost recovery for each of the categories in the matrix.

Table 2 Pricing Policy Matrix

Code	Cost Recovery %	Name	Description
MarketP	100% - 115%	Market Price	The pricing for these services is expected to recover the full cost of providing the service along with generating an appropriate rate of return.
FullCR	90% - 100%	Full Cost Recovery	Prices are determined in order to help ensure that scarce resources are not wasted and promote efficient investment in infrastructure, services and personnel.
SubstantialCR	50% - 90%	Substantial Cost Recovery	The pricing for these services is set below the financial cost of providing the service. The fees received are expected to make a significant contribution towards the cost of provision. With the balance being met from general revenues.
MarginalCR	25% - 50%	Marginal Cost Recovery	The pricing for these services is set below the financial cost of providing the service. The fees received are expected to make a marginal contribution towards the cost of provision. With the balance being met from general revenues.
MinimalCR	0% - 25%	Minimal Cost Recovery	The pricing for these services is set below the financial cost of providing the service. The fees received are expected to make a minimal contribution towards the cost of provision. With the balance being met from general revenues.
SecurityDep	5%	Security Bond Deposit	To offset the cost of damages, non-return of Council property and unpaid fees.
Statutory		Statutory Amount	This is the amount required to be charged by statute.

The spectrum of the matrix is very broad; at one end customers who consume private services who directly obtain specific benefits. They should pay for the full cost of the service through user fees and charges and potentially a market margin to achieve a commercial market return that can contribute to public type

services. At the other end of the spectrum are those services that are provided for public good with little or no charge to the consumer of the service.

However, many of Council's services have a mix of public and private characteristics, so the challenge and opportunity for Council is to determine the most effective revenue policy approach to fund the total service provision of Council. Strategically this will enable Council to rebalance the revenue streams and identify those services that require future adjustments to the current service pricing regime.

As illustrated in Table 3 below, having applied the pricing policy matrix, there is a significant range of cost recovery with each of the pricing policy categories. For example, in the Minimal Cost Recovery category (0%-25%) recovery ranges from 0% to 17.4%.

The outcome of the service pricing analysis indicates that Council recovers some 43.48% of the total cost of service provision. The range of cost recovery is largely dependent upon the service pricing matrix which reflects the decisions that Council has taken, over time, in responding to the needs of the community.

As you would expect, due to the type of service there are a number of services that have no or very low cost recovery – Community and Engagement, Assets and Environment and Customer Service and Business Excellence. Conversely there are services that have high cost recovery such as Resource Recovery – 123.1% Regulatory Services – 131.1% and Children and Family Services – 95.9%. Full details of the cost recovery for each service are detailed in Table 3 below.

Table 3 Service Cost Recovery

Current Level of Cost Recovery			43.48%	44.51%	
Row Labels	Sum of Direct Revenue	Sum of Operating Expenses	Sum of Cost Recovery	Pricing Policy	Target Cost Recovery %
Assets & Environment					
DGM - Assets and Environment	\$ 0	\$479,372	0.00%	MinimalCR	
Environment and Sustainability	\$387,869	\$4,552,524	8.52%	MinimalCR	
Footpaths, Roads, Traffic and Stormwater	\$10,002,515	\$35,136,867	28.47%	MarginalCR	
Property Services	\$5,181,332	\$17,995,531	28.79%	MarginalCR	
Trees, Parks and Streetscapes	\$1,858,803	\$35,894,978	5.18%	MinimalCR	
Resource Recovery	\$40,301,000	\$32,729,000	123.14%	FullCR	
Development Applications	\$4,353,000	\$8,084,000	53.85%	SubstantialCR	
Regulatory Services	\$17,032,000	\$12,991,000	131.11%	FullCR	
CFO & Administration					

Row Labels	Sum of Direct Revenue	Sum of Operating Expenses	Sum of Cost Recovery	Pricing Policy	Target Cost Recovery %
Finance	\$489,279	\$5,007,766	9.77%	MinimalCR	
ICT	\$222,437	\$6,463,474	3.44%	MinimalCR	
Procurement	\$15,000	\$1,183,991	1.27%	MinimalCR	
Risk, Policy & Insurance	\$1,537	\$3,253,121	0.05%	MinimalCR	
Community & Engagement					
Aquatics	\$8,725,401	\$11,199,649	77.91%	SubstantialCR	
Children and Family Services	\$17,533,800	\$18,277,365	95.93%	FullCR	
Communications, Engagement and Events	\$89,439	\$4,138,880	2.16%	MinimalCR	
Community Services and Culture	\$741,976	\$11,757,760	6.31%	MinimalCR	
DGM - Community and Engagement	\$ 0	\$736,649	0.00%	MinimalCR	
Integration, Customer Service and Business Excellence	\$500	\$5,940,086	0.01%	MinimalCR	
Library and Historical Services	\$176,387	\$10,961,391	1.61%	MinimalCR	
Strategic Planning	\$1,720,274	\$9,894,353	17.39%	MinimalCR	
Corporate					
Corporate Support Services	\$1,178,751	\$10,479,257	11.25%	MinimalCR	
General Manager					
General Managers Unit	\$ 0	\$1,049,315	0.00%	MinimalCR	
Human Resources	\$155,126	\$3,965,023	3.91%	MinimalCR	
Legal	\$286,999	\$1,852,213	15.49%	MinimalCR	
Grand Total	\$110,453,441	\$254,023,580	43.48%		44.51%

Note: Direct Revenue includes annual charges, user charges, user fees and other revenues. It excludes all rates, grants and contributions, while Operating Expenses includes all expenses. Refer to Appendix A for details of the Service Pricing Model.

The service pricing models affords Council the opportunity to review and consider its level of cost recovery into the future. Council can use the Target Cost Recovery % column as a means of having a discussion with staff to set short and long term targets. The target cost recovery percentage of 44.51% is an example of reviewing each service and is detailed in the Service Pricing Model – Refer Appendix A.

This assists in taking a holistic approach to revenue policy avoiding the common method of basing fees and charges on historic levels. Concurrently, the model can aid Council and management in refocusing the business and operational approach to service delivery. This can be achieved both at an organisational and service level.

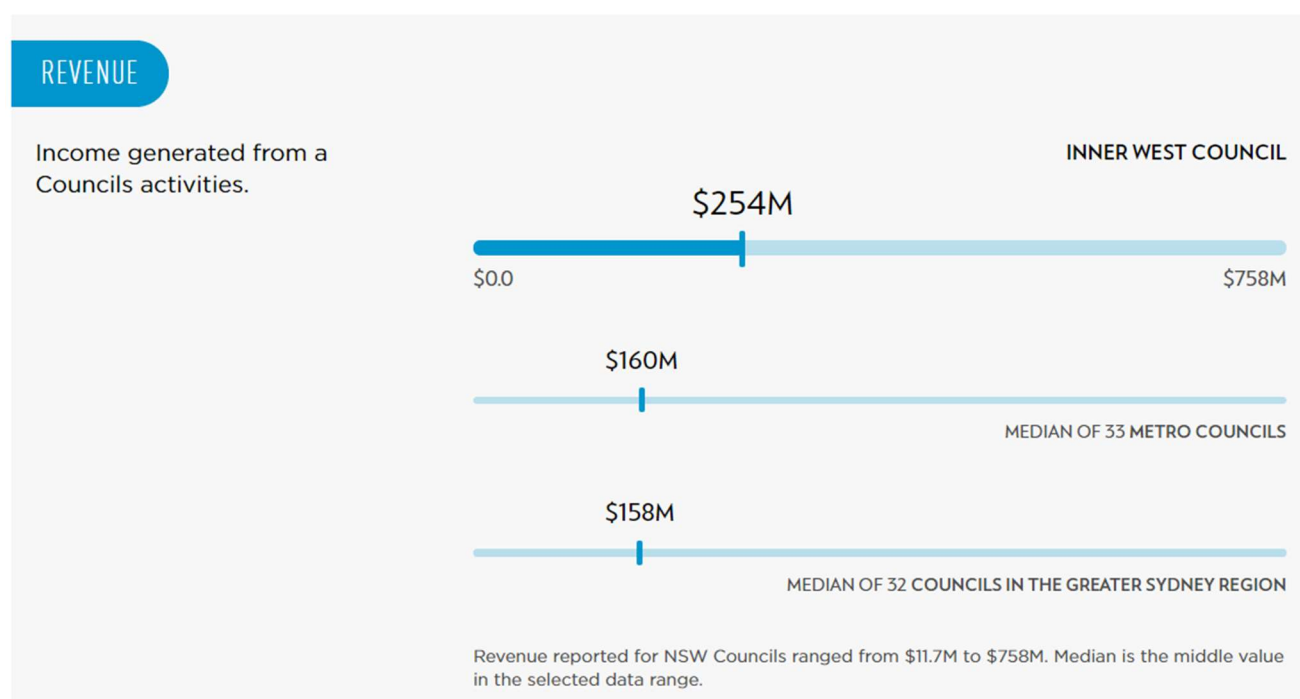
The appetite to change the level of income generated directly from service provision can be tested from an organisational perspective by increasing the total current level of cost recovery from 43.48%. For instance, each 1% increase in cost recovery represents \$2.54m. This could lead to a reduction in net benefit costs allocated in the rating benefits model, thus improving the alignment of rates paid and benefits received.

For example only, should the Footpaths, Roads, Traffic and Stormwater Service cost recovery be increased by say 7% to 35.5% Cost Recovery, this would generate an additional \$2.5m and reduce the net cost of service.

Comparisons total income and user fees and charges

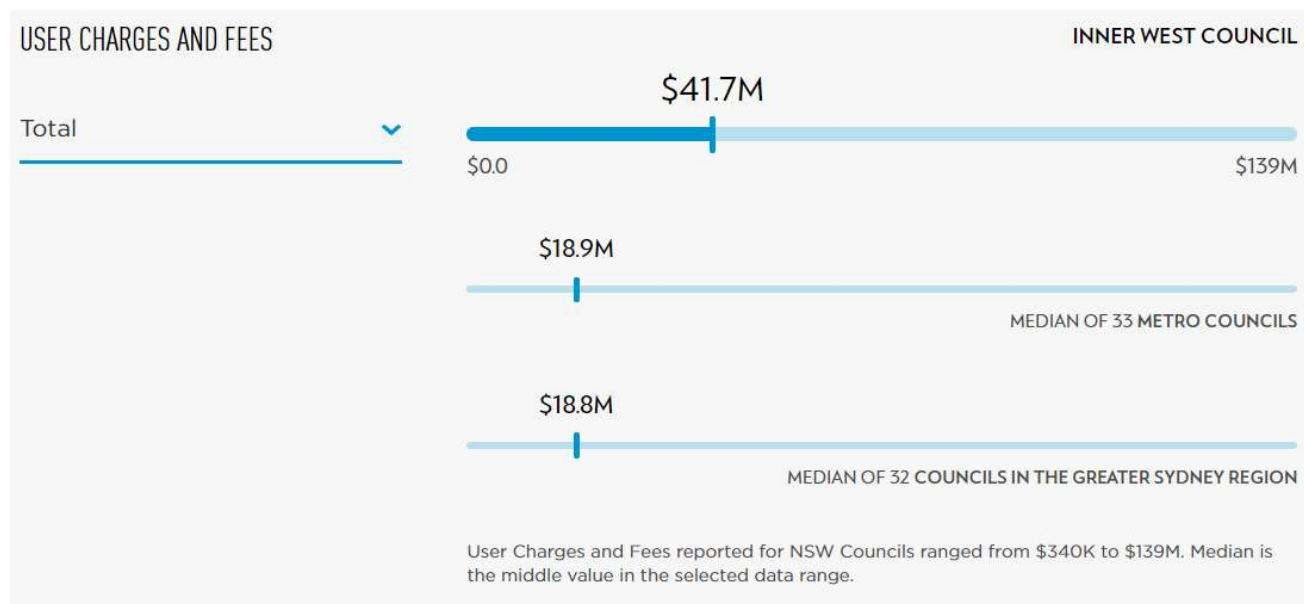
Following are comparisons of Inner West Council with metropolitan Councils of total income generated from all Council activities. This information is from the 2017/18 Financial Statements – Report on Local Government 2018 Audit Office of NSW.

Figure 1 Total Council Income



Inner West Council's total income is some 58% above the median for metropolitan Councils, reflecting the size and services provided by Council. However total income from operating activities is \$236.8m which excludes capital grants and net gain on sale of assets.

Figure 2 Total User Fees and Charges



Inner West user fees and charges are 2.2 times higher than the median metropolitan Council. The income collect from user fees and charges represents 17.6% of the total operating income. In gaining a better understanding of all income collected for service provision Table 4 compares user fees and charges, and other income as a percentage of total operating income for the 2017/18 year with other merged metropolitan Councils. Inner West Council is at the higher end of the scale.

Table 4 User Fees and Charges and Other Income comparisons

Council	Total Council Income	Total Operating Income*	Total Fees and Charges^	Fees & Charges as % of Operating Income
Inner West	\$254.0m	\$236.8m	\$65.7m	27.7%
Parramatta	\$297.9m	\$249.9m	\$48.4m	19.4%
Cumberland	\$206.0m	\$176.0M	\$32.8m	18.6%
Canterbury Bankstown	\$322.9m	\$293.4m	\$42.3m	14.4%
Northern Beaches	\$391.1m	\$337.5m	\$105.1m	31.1%

*Excludes capital grants and contributions and Nett gain/loss on assets sold

^Includes Fees and Charges and Other income

Appendix A

The Rates Benefit and Service Pricing Model has been provided under separate cover as an Excel spreadsheet.