The context of our review

29 June 2021

This information paper sets out additional background information not provided in the Independent Pricing and Regulatory Tribunal of NSW's (IPART's) Draft Report, including:

- the context for this review within the wider reforms to the developer contributions system
- statistics highlighting how population growth is occurring
- more information on key concepts such as the NSW ratings system
- a glossary.

1 The current ratings system does not adequately compensate councils for population growth

As local communities grow, councils need to provide infrastructure and services to new residents and businesses. Councils source revenue in a variety of ways:

- property rates
- sale of goods and services, which includes fees and charges for services such as waste management, water and wastewater, recreation and building approvals
- grants from the Australian Government administered through the NSW Grants Commission, and other grants such as capital grants
- other revenue, including levying developer contributions
- interest income.

In NSW, the amount of revenue councils can raise through rates is limited by the rate peg and increases in rates from supplementary valuations due to changes in land value. However, this additional revenue is insufficient to maintain per capita rates for many councils with growing populations.

Councils can levy developer contributions through development contribution plans to fund development-contingent infrastructure. But this additional revenue does not cover the ongoing operating or maintenance costs of infrastructure. The same is true of grants income.

With limited avenues to raise discretionary income from alternative sources to fund new services and infrastructure, some councils have needed to apply to IPART for a 'special variation' so their general income can rise in line with their population growth.

Reforming the rate peg to account for population growth, will allow councils to provide services for new residents and maintain delivery standards for their communities.

1.1 The NSW Government has committed to reforming the rate peg

The NSW Government committed to allowing councils to align their income with population growth in its June 2020 response to a recommendation in IPART's 2016 review of the local government rating system. The NSW Productivity Commission made a similar recommendation to allow councils' general income to increase with population in its 2020 review of infrastructure contributions in NSW, which was accepted by the NSW Government.

1.2 The rate peg limits how fast rates can rise

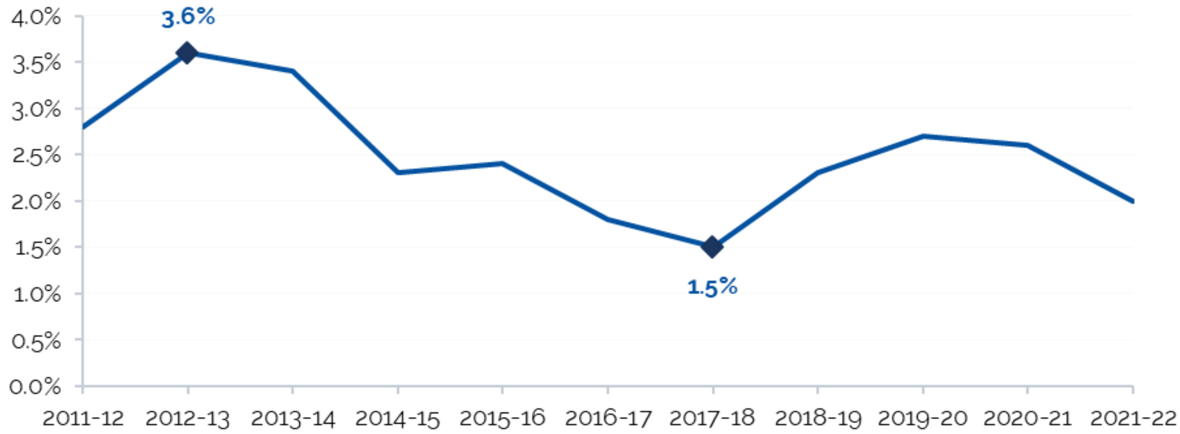
The rate peg is the maximum percentage by which a council may increase its general income for the year. General income mainly comprises rates revenue, but also includes certain annual user charges. It excludes stormwater and waste charges, and water and wastewater charges.

The rate peg applies to total revenue collected from these sources rather than to individual rates. Councils have discretion to determine how to allocate a rate peg increase between different ratepayer categories, so long as the total increase in revenue does not exceed the maximum permitted by the rate peg. For example, a council could decide to increase business rates by more than residential rates.

IPART is responsible for setting the rate peg each year.[1] IPART has previously set one rate peg applicable to all NSW councils. Following recent changes to the *Local Government Act 1993* (LG Act), IPART may now specify different rate pegs for different councils and specify a methodology for calculating the rate peg rather than specifying a percentage. The intent is to allow for councils to increase their income in line with the population growth within their communities.

The average rate peg set by IPART has been around 2.5%. Figure 1 charts the rate peg over the period 2011–12 to 2021–22. The highest rate peg was 3.6% due to the introduction of the carbon price, and the lowest rate peg was 1.5%, attributed to a low inflationary environment.

Figure 1 Changes in the rate peg, 2011–12 to 2021–22



Source: IPART website: Rate peg for NSW councils for 2021-22.

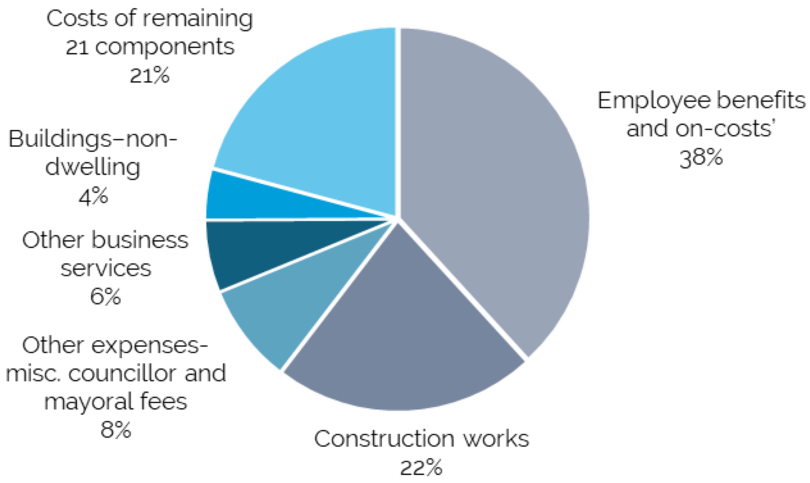
The rate peg is primarily determined by measuring changes in IPART's local government cost index (LGCI). The LGCI reflects the increase in costs experienced by the average council. In calculating the annual rate peg, IPART may adjust for improvements in productivity in addition to the LGCI. In some years we make additional adjustments; for example, the rate peg for 2021–22 included an adjustment for the costs of the 2021 local government elections.

The LGCI includes operating and capital cost items. While the proportions vary from year to year, operating costs are around 70% and capital costs around 30% of the total costs.[2]

The LGCI has 26 components, with the 5 largest components comprising 79% of the total costs, as illustrated in Figure 2.

While the rate peg accommodates changes in the price of services faced by an average council, it does not include changes in the volume of services required. This volume is likely to increase for councils experiencing population growth.[3] Since councils have limited alternative sources of discretionary income, rate pegging limits their overall ability to raise revenue. If overall land values rise, or the number of ratepayers increases, *ad valorem* rates must fall so total revenue does not exceed the approved increase. Within the rate peg, councils have discretion over the distribution of rates between the categories of rateable properties (i.e. farmland, residential, mining and business).

Figure 2 Local government cost index components



Source: IPART website: Rate peg for NSW councils for 2021–22.

Additional information on the rate peg can be found on IPART's website at: The rate peg.

1.3 The developer contributions system is being reformed

New development may create the need for additional local infrastructure, such as parks, community facilities, roads and stormwater drainage. This additional infrastructure can be funded through developer contributions.

Councils can collect developer contributions via a section 7.11 contributions plan, which specifies the link between the new development and the increased demand for infrastructure.[4] Alternatively, councils may levy up to 1% (in most areas) of the estimated cost of new development under a section 7.12 contributions plan to fund new infrastructure.[5,6]

Developer contributions must be used for the purpose for which they were collected, and within a reasonable time. These contributions provide for base-level infrastructure to support development and meet the infrastructure needs of the growing population. However, they do not provide for the operating and maintenance costs of this infrastructure or increases in the volume of services demanded by the additional population.

In December 2020, the NSW Productivity Commissioner completed his review of the infrastructure contributions system in NSW. The NSW Government accepted all 29 recommendations from this review and has developed a roadmap to implement reform to the system.[7]

1.4 Councils can ask IPART for a special variation

If a council seeks to increase its general income by more than the rate peg percentage, it must obtain approval for a 'special variation' from IPART. IPART assesses these applications against criteria established by the NSW Office of Local Government.[8] Councils must demonstrate the need for the additional revenue, show evidence of community consultation, and assess the impact on affected ratepayers.

Councils can use this additional income to fund the costs of population growth, and for other purposes such as infrastructure renewal.

1.5 Supplementary valuations can impact council income

Councils also increase their general income outside the rate peg where the Valuer General issues supplementary valuations that increase land value. Supplementary valuations are issued outside the usual 3 to 4 year general valuation cycle when changes to property are recorded on the Register of Land Values. Supplementary valuations can be triggered in various circumstances, in particular:

- land rezoning (e.g. the zoning of a property changing from farmland to residential or low to high density residential) on request by council
- development that contains a subdivision where a new rateable property is created.

The change in general income resulting from supplementary valuations is determined by applying a council's current rating structure (i.e. base rates and/or *ad valorem*) for:

- re-zonings – the difference between the new and old valuations for the rateable property is added or subtracted from the rate base
- subdivision – rates for the new rateable properties are charged based on the council's rating structure, and the previous property's rates are extinguished.

Supplementary valuations can result in land values increasing or decreasing, impacting the rates revenue received for the affected properties. Councils' general income can be reduced where supplementary valuations result in a reduction in rate income.

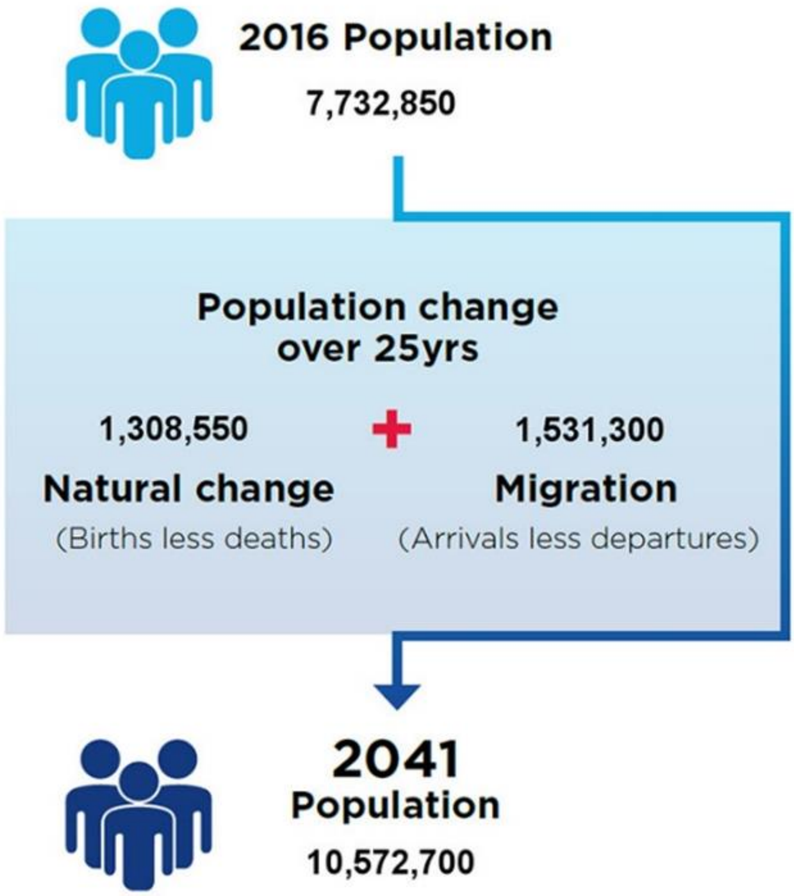
Supplementary valuations do not increase council income where they are associated with development of non-rateable properties. This can include, for example, development on land owned by a public benevolent institution or public charity. Supplementary valuations are not issued for development of secondary dwellings unless the unimproved value of the land changes.

Recent analysis in the Valuer General's review of the impact of rezoning potentiality on land values[9] showed increases in land values occur before rezoning all the way through to the final subdivision of the development. Timing implications for rates revenue associated with the supplementary valuation process therefore exist, because supplementary valuations can occur at both rezoning and sub-division.

2 The NSW population will continue to grow

The NSW Government estimates the NSW population will grow from 7.7 million in 2016 to 10.6 million in 2041 (Figure 3).

Figure 3 NSW population projections



Source: Department of Planning, Industry and Environment, Full NSW population projections.

Between 2014 and 2019, NSW's population grew by 1.5% per year on average.[10] Some local government areas (LGAs) experienced higher growth during that period, including Camden at 8.1%, Sydney at 3.8%, and Strathfield and Parramatta at 3.1% per year.[11]

The Department of Planning, Industry and Environment (DPIE) projects the NSW population will grow by 1.4% per year over the next 5 years, reaching 9 million by 2026.[12] Some LGAs are forecast to experience higher growth over that period, including Burwood at 3.8%, Camden at 3.7%, The Hills Shire at 3.6% and Strathfield at 3.3% per year.

Box 1 What is population growth and how is it measured?

Population growth at the state level consists of 3 key elements: natural increase (births and deaths), net overseas migration, and net internal migration from other states and territories.

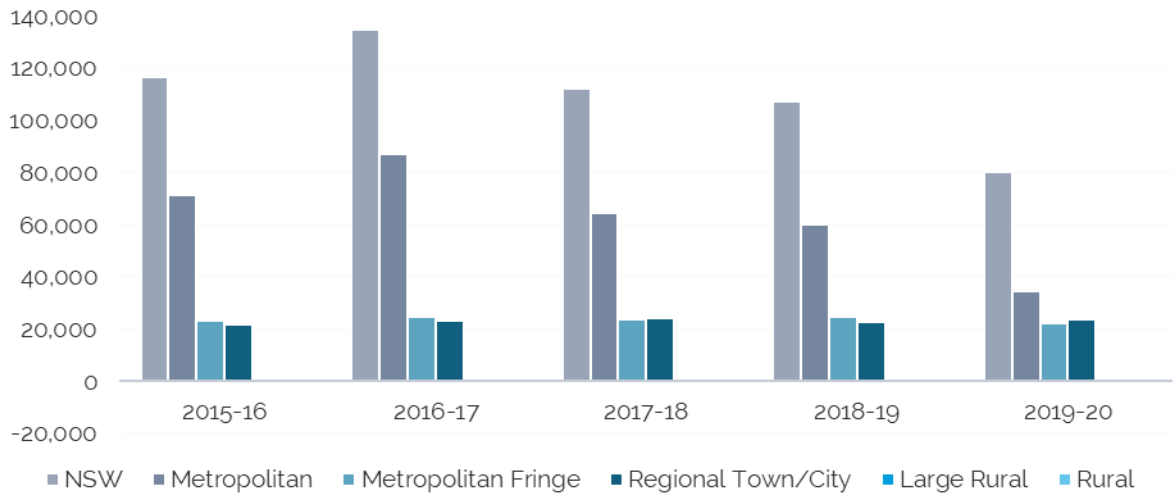
The Australian Bureau of Statistics publishes historical growth statistics at the national and state and territory levels, calculated as the yearly change in estimated resident population. Population estimates are based on the usual place of residence within Australia.

The most recent local government area growth statistics are for 30 June 2020, released in March 2021.

DPIE publishes projected growth in 5-year intervals to 2041. The most recent projection is from 2019, with the next update due in 2022.

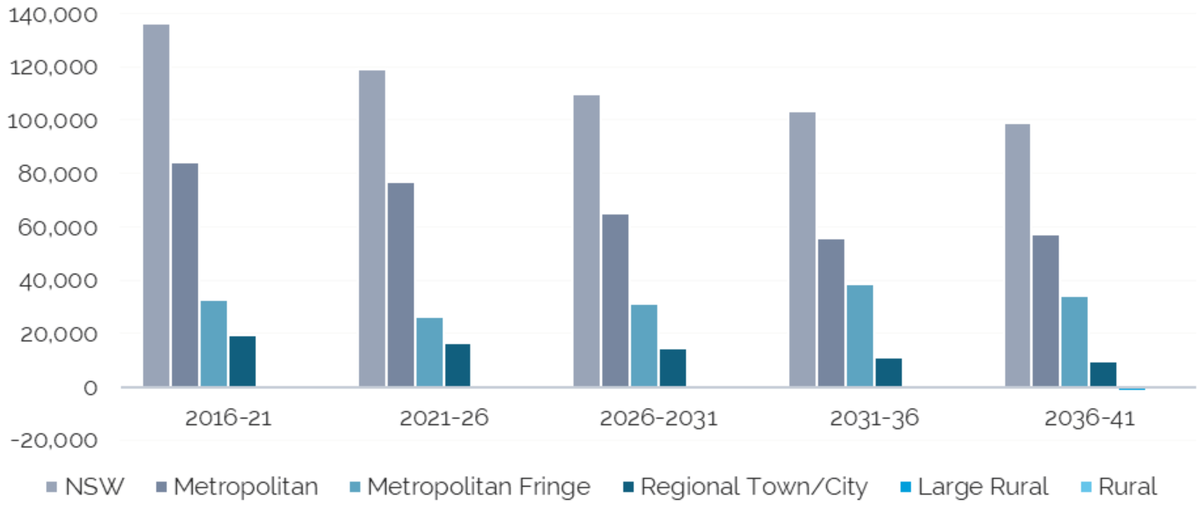
Figure 4 and Figure 5 show historical and projected population growth for NSW.

Figure 4 Historical population growth for NSW



a. the chart includes the aggregate projected population growth of large rural and rural councils, however the aggregate projected change was almost zero.
Source: ABS, Australian Demographic Statistics, cat. no. 3101.0, 18 March 2021 and IPART analysis.

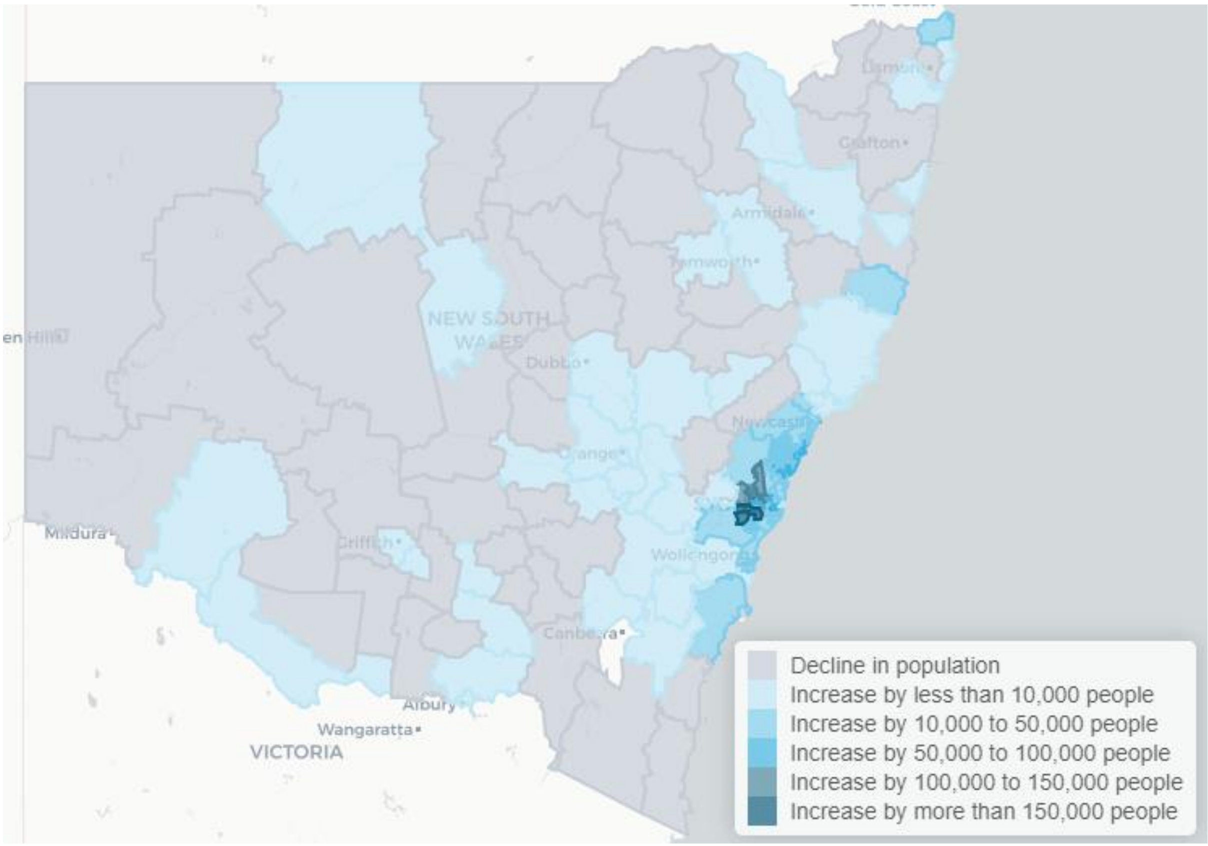
Figure 5 Projected population growth for NSW



Source: NSW DPIE (December 2019) NSW population projections and IPART analysis.

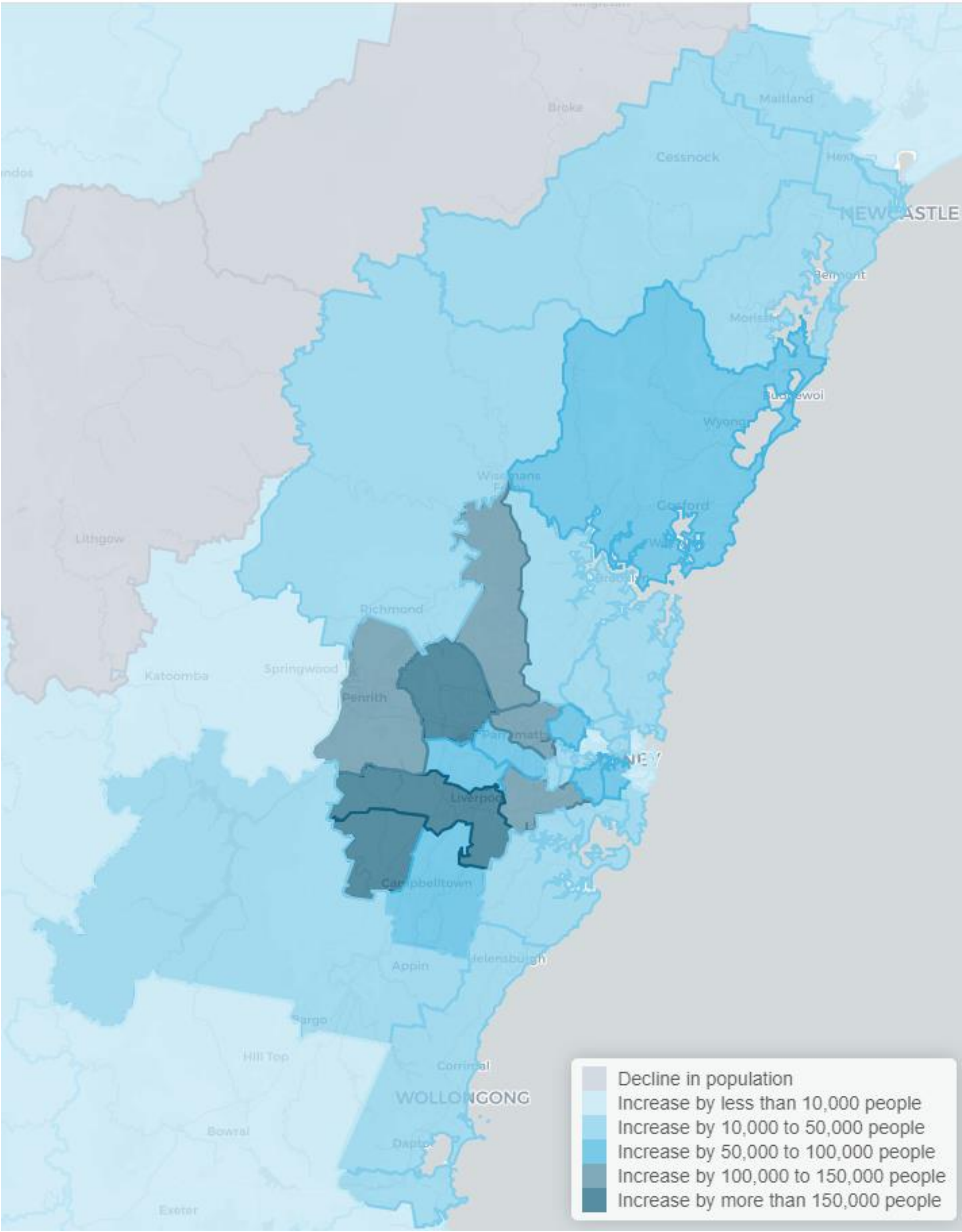
Figure 6 and Figure 7 map the projected population growth for NSW and Sydney and surrounds.

Figure 6 Projected population growth for NSW between 2021-41



Source: NSW DPIE (December 2019) NSW population projections and IPART analysis.

Figure 7 Project population growth for Sydney and surrounds between 2021-41



Source: NSW DPIE (December 2019) NSW population projections and IPART analysis.

2.1 COVID-19 has impacted growth in 2020

The Australian Bureau of Statistics reported the NSW population grew by 1.0% in 2019–20, down from 1.3% in 2018–19[13], and lower than DPIE's projected rate of 1.7%.[14] In the 2020–21 Budget, the Centre for Population projected almost no growth in the NSW population in 2020–21 and 2021–22, with population growth expected to increase to 1.0% by 2023–24.[15]

DPIE cited in its 2020 population insights that events in NSW, other parts of Australia and globally are affecting population change in 2020.[16] Key factors include the continued drought, bushfires, the COVID-19 pandemic and the resulting economic recession.

Net overseas migration has been the largest contributor to population change in NSW in the past decade.[17] The Australian Government closed international borders in March 2020 in response to the COVID-19 pandemic, decreasing net overseas migration dramatically. The impact on population growth is expected to continue until borders reopen.[18] Factors including the rollout of the COVID-19 vaccine, the vaccine's effectiveness, and the speed of re-opening international borders will impact future population projections.

Submissions to our issues paper supported the trends seen in population estimates due to the fall in net overseas migration. However, submissions also highlighted the impact that inter and intra state migration was having on their local government area. This was particularly evident in submissions from regional councils which suggested their populations had been increasing over the past 18 months.

3 The ratings system in NSW is determined by the LG Act

The LG Act determines how rates are calculated in NSW, as shown below

Rate Structure	Rating Categories	High Density Property
Rates = % of land value[a] (ad valorem rate) **OR** Base[b] + % of land value	Councils may levy different rates for different categories	Unimproved land value is split between apartments in multi-unit dwellings

a Maybe subject to a minimum rate

b The base amount cannot constitute more that 50% of the total rates in that rating category or subcategory.

Source: *Local Government Act 1993.*

3.1 Rate structure

Under the LG Act, councils determine the distribution of the rating burden between ratepayers. A council's rating structure can be either:

- an *ad valorem* amount (which may be subject to a minimum amount), or
- a base amount to which an *ad valorem* amount is added.

In NSW, an *ad valorem* amount is set as a proportion of the unimproved land value of the rateable property – that is, the value of the property without any buildings, houses or other capital investments. Councils can set a minimum amount that *ad valorem* properties can be charged to ensure all ratepayers contribute an equitable share.

A base amount, where applied, is a fixed charge that is levied equally against all rateable properties within a given rate category, or subcategory of land use, in addition to the *ad valorem* amount.

The proportion of revenue a council can generate from the *ad valorem* amount included in rates is not restricted. However:

- revenue generated from the base amount cannot exceed 50% of the total revenue from any particular rating category
- the minimum amount charged cannot exceed the statutory minimum amount,[19] unless approved by IPART.

Where the rateable property consists of multiple units, such as a block of apartments, a single land value is determined for the site as a whole. The assessed unimproved land value for an individual apartment is then calculated by dividing the total land value according to each apartment's allocation.

3.2 Rating categories

Councils can vary the way they calculate rates for different categories of property. For example, they can use a different percentage of the unimproved land value to calculate the *ad valorem* amounts, apply different minimum amounts, or add different base amounts. The four main rating categories are:

- residential
- business
- farmland
- mining.[20]

Councils may also determine subcategories within each of the 4 categories, and vary the way they calculate rates for each subcategory. However, the degree of flexibility in determining rating subcategories under the LG Act varies across categories.

A range of land uses or land ownerships are also currently exempt from paying rates (or exempt from paying a portion of rates). These include, for example, national parks, charitable organisations and educational institutions.

3.3 Different types of rates

Two different rate types are included in a council's general income:

- Ordinary rates – Councils are required to make and levy an ordinary rate for each year on all rateable land in their area.
- Special rates – Councils have discretion to levy a special rate to meet the cost of any works, services, facilities or activities to be provided or undertaken in their area. Special rates can be levied on subgroups of ratepayers who benefit from, contribute to the need for, or have access to, the works, services, facilities or activities. For example, a special levy could be applied to all properties in a specific area or development where ratepayers will benefit from new services.

3.4 Glossary

Term	Meaning
ABS	Australian Bureau of Statistics
***Ad valorem* rate**	A Latin term meaning "according to value." In this context it refers to the component of rates based on the unimproved value of land.
Capital improved value or CIV	Capital improved value (CIV) is the total market value of the land plus buildings and other improvements.
Developer contributions	Developer contributions are monetary payments or works-in-kind agreements that supply or contribute towards the cost of local infrastructure. They are charged by councils when new development occurs and provide land and infrastructure including open space, parks, community facilities, local roads, footpaths, stormwater drainage and local roads.
Financial Assistance Grants or FAG	The Financial Assistant Grant program provides funding support from the Australian Government to local governments across Australia. Local government grants commissions in each state and the Northern Territory recommend the distributions of the funding under the program in accordance with the *Local Government (Financial Assistance) Act 1995* (Cth) and the National Principles for allocating grants.
Council general income	Income from ordinary rates, special rates and annual charges, with some exclusions such as special rates and charges for water supply services, sewerage services, waste management services, annual charges for stormwater management services, and annual charges for coastal protection services.
Greenfield development	Real estate construction on previously undeveloped land often on the fringe of metropolitan areas or near townships.
Infill development	The process of developing vacant or under-used parcels of land typically for residential purposes within existing urban areas. Also referred to as 'urban consolidation', 'medium density housing', 'redevelopment' or 'high rise development'.
IPART	The Independent Pricing and Regulatory Tribunal of NSW
Local government cost index or LGCI	An index used by IPART in setting the rate peg which measures price changes over time for cost items relevant to NSW councils.
Local Government Act	*Local Government Act 1993* (NSW)
Local government area or LGA	A local government area is an administrative division that a local government council is responsible for.

Term	Meaning
Minimum rate	A minimum amount of a rate specified under section 548 of the Local Government Act.
OLG	Office of Local Government
Rate peg	The term 'rate peg' refers to the maximum percentage amount NSW councils may increase their general income each year. IPART (as the Minister's delegate) specifies the rate peg each year in an order published in the gazette under section 506 of the Local Government Act. IPART can specify different rate pegs for different councils or specify a methodology for calculating the rate peg.
Special variation or SV or SRV	If approved, a special variation to the rate peg allows a council to increase its total general income above the rate peg. A special variation can be approved for a single year or up to seven years.
Supplementary valuation	Supplementary valuations are issued by the NSW Valuer General between general valuations when changes to property are recorded on the Register of Land Values. This can happen when properties or parcels of land are physically changed, subdivided or rezoned; or to correct a previous error.

1 The Minister for Local Government has delegated this function to IPART: Delegation under section 744 of the *Local Government Act 1993*, dated 6 September 2010.
2 IPART, Reweighting of Local Government Cost Index, 12 May 2020
3 Productivity Commission, *Review of Infrastructure Contributions in New South Wales* , 3 December 2020, p 40.
4 This is known as 'development-contingent infrastructure'.
5 This is lower than what would be collected under a section 7.11 plan. The Productivity Commissioner's review recommended an increase to the maximum rate for section 7.12 levies, equivalent to 3% of residential development, which would enable more councils to benefit from the simpler requirements of the section 7.12 levy.
6 NSW DPIE, Local infrastructure contributions policy, 29 April 2021.
7 NSW DPIE, *NSW Government Response to NSW Productivity Commission's Review of Infrastructure Contributions in NSW*, 2021.
8 Office of Local Government, *Guidelines for the preparation of an application for a special variation to general income*, 2020.
9 Valuer General NSW, *Review of the impact of rezoning potentiality on land values*, February 2021, p 42.
10 Australian Bureau of Statistics, National, state and territory population, June 2020, 17 December 2020.
11 Australian Bureau of Statistics, National, state and territory population, June 2020, 17 December 2020.
12 NSW DPIE, NSW population projections, December 2019
13 Australian Bureau of Statistics, Australian Demographic Statistics, cat. no. 3101.0, 18 March 2021
14 NSW DPIE, Population, Household and Implied Dwelling Projects by LGA (ASGS 2019), December 2019, NSW annual average growth between 2016-21.
15 Australian Government Treasury Budget Paper No. 3, Appendix A: Parameters and Further Information, 6 October 2020, Table A.2.
16 NSW DPIE, 2020 population insights. Annual population insights supplement to the NSW population projections, December 2020.
17 Parliament of Australia, Australia's changing population, accessed on 10 June 2021
18 The University of Queensland How coronavirus could hit Australia's population in the next 20 years, 6 August 2020.
19 The 'statutory minimum amount' refers to the amount specified in the *Local Government (General) Regulation 2005* for the purposes of section 548(3)(a) of the *Local Government Act 1993*.
20 The *Local Government Amendment Act 2021* provides for a new rating category for environmental land. The relevant provisions have not yet commenced.