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Introduction

This submission is in response to the NSW Independent Pricing and Regulatory Tribunal (IPART) issues paper in September 2022. Overall, Bega Valley Shire Council does not believe that the current approach to rate pegging is a suitable instrument and it restricts local government rating in meeting the needs of our community.

We support the Minister's review and provide comments to highlight the inadequacy of the current system by responding to the 20 questions raised in the IPART issues paper.

1. **To what extent does the Local Government Cost Index reflect changes in councils' costs and inflation? Is there a better approach?**

While the mix of components in the LGCI may be notionally appropriate, it is suggested each should be subject to a discrete moving index (for example, over three years to smooth out risk of bill shock).

The discrete moving index should be assigned to each council cohort, so that

I. labour costs reflect known award and superannuation movements in advance
II. financial effect of emergency services levy (ESL) is removed and separately calculated by the council cohort (if a separate ESL charge is not introduced)
III. movement in insurance costs moderated by advice from local government insurance pools and mutuals
IV. movement in electricity and fuel market forecasts are captured
V. other indices should reflect the nearest capital city for those council cohorts (eg Sydney, Canberra, Brisbane, Melbourne)

It is extremely important to recognise that the mix of services councils provide varies greatly and subsequently so do their cost drivers. It is important to also recognise that supply chain costs for councils also vary greatly and can impacted by local and regional labour force markets as well as materials availability.

2. **What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?**

- Three-yearly survey of council cohort costs (perhaps through joint organisations) to record ranges of cost movements for the LGCI major cost components, and recalibrated per cohort
- The LGCI point of determination should be June 30 of the previous financial year to draw on movement in three year average and applied from 1 July the following financial year with consideration of forward inflationary projections rather than solely historical movements.

3. **What alternate data sources could be used to measure the changes in council costs?**

Consider a weighted LGCI by OLG Group or cohort to reflect the following factors:

- freight disadvantage (for example distance from metro or regional city as source of skills, contractors and supplies)
- skills disadvantage (for example access to skills where significant premiums apply to short term staff, specialised technical experts or consultants)

- rating capacity disadvantage (for example historically low rate base, demographic change, economic change, social changes and rental vacancies)
- obligations to fill the void for delivery of other NSW services in our communities (for example providing services and accommodation to house critical public workers eg health and education)
- exposure to competitive construction stimulus such as mines, SAP, Snowy 2.0, Aerotropolis
- nett cost of administering State legislation should be included in setting the rate peg (for example crown lands management, rural fire service asset management)
- additional loads on assets due to non-ratepaying beneficiaries (for example tourists, freight and state activities such as forestry operations).

4. **Last year we included a population factor in our rate peg methodology. Do you have any feedback on how it is operating? What improvements could be made?**

The discounting of any general rate increase from a population peg through deduction of supplementary levies from new assessments should cease as

i. rate growth by generation of assessments supports the ongoing maintenance and renewal of assets; while the population peg supports the extension of services to a growing demographic and,

ii. provides transparency and certainty to councils and community of the nature and value of rate increases giving regard to the assets and services needed to achieve social and economic outcomes

5. **How can the rate peg methodology best reflect improvements in productivity and the efficient delivery of services by councils?**

The automatic 0.2% productivity factor discounted from the annual rate peg, should be abolished. Each council has different service levels and community needs and improvements in productivity are part of our IP&R process. Any productivity gains should be encouraged and allowed as they will surely encourage efficiencies within individual organisations that directly link to benefits achieved through delivering priorities of their communities identified in the legislated IPR framework. Penalising councils for efficiency gains is a disincentive for innovation and undermines investment in service improvements that are unable to be funded when revenue is restricted by the rate peg and generates far-less income than costs of delivery.

6. **What other external factors should the rate peg methodology make adjustments for? How should this be done?**

- Changes in asset maintenance and renewal (ie depreciation) expenses, including those that are a result of grant funded and development 'gifted' assets.
- Change Government policy where devolved regulatory and policy agenda programs are committed to be delivered by local councils and are not fully offset by ongoing grant funding, fee recovery or restricted by funding conditions.
- The nett costs to councils as consequence of manipulating cash flow by funding partners and the underestimating or underfunding reinstatement of assets by government for delivery disaster recovery activities.

7. **Has the rate peg protected ratepayers from unnecessary rate increases?**

Yes. To be financially responsible, councils have generally matched expenses (on assets and services) to the available funding generated by the rate peg. The impact of matching expenses to rate pegged income is a reduction in the service levels that Council can deliver. Over decades, councils have not been able to invest the funds required and assets have not been renewed as required. This compound effect has lead to communities using aged infrastructure, creating financial, social and safety risks.

The impact of the rate peg limiting revenue means that councils required to deliver assets and services expected by the community sees consistent operating losses and an organisation that cannot demonstrate financial sustainability.

The long-term impact of rate peg is that communities, rather than a steady increase that reflects the economic environment, is then subject to significant increases through special rate variations, inconsistent with the principle of intergenerational equity.

8. Has the rate peg provided councils with sufficient income to deliver services to their communities?

No, for the following reasons:

I. Dependent on the foundation of the original LGA general rate base, the imposition of rate pegging, emergency service levies and unsubsidised pension rebates has eroded local government's ability to deliver the diverse range of services and assets expected (by community survey and Community Strategic Plan). Community expectation on council's increase every year.

II. Fundamental to the legislated responsibilities of councils is to match revenues and expenses, be financially sustainable and invest responsibly in infrastructure. Cost escalation and other political, social, environmental, technological and economic drivers impact councils costs beyond the restrictions applied on available revenue through the rate peg.

III. The evidence of 165 SRV applications over 10 years, with 70% of councils applying more than once, for the purposes of 'financial sustainability' and 'asset backlog' for example, would demonstrates the rate peg is inadequate to provide councils with sufficient income.

9. How has the rate peg impacted the financial performance and sustainability of councils?

i. Based on OLG data, for several years, the majority of NSW councils are producing consolidated operating deficits, with nearly all producing General Fund annual deficits, and trend lines deteriorating.

ii. The frequency of natural disasters has narrowed community focus on the condition of assets, and an expectation of improved maintenance performance.

iii. Local government is the nursery of skills in the development and construction sectors. The migration of skilled workers out of local government (and regions) is bearing a higher cost of employment of staff, contractors and consultants.

iv. Consequently, council's reputation (in part) plays a part in community views on proposals when the only option available to council to improve financial performance is to increase rates by a lengthy SRV process.

v. The size of SRVs are growing towards 100% while councils trying to address the historical limitations that have been placed on them.

vi. Implementing a three year rolling rate peg average plus population peg smooths out bill shock and provides certainty of revenue growth. Councils can maintain financially responsible decision making by matching revenue to expenses mitigating the risk of having to reduce services and ongoing asset deterioration by lack of investment.

10. In what ways could the rate peg methodology better reflect how councils differ from each other?

Our recommendation is that the council classifications from OLG groups to 'cohorts' be implemented. Factors such as growth, geographical distance and cost profiles across metro, coast, regional city, regional, rural and remote councils are already used to categorise councils with similar profiles and operating environments.

11. What are the benefits of introducing different cost indexes for different council types?

1. Reframe the cohorts for councils as an alternate for OLG group classifications and IPART rate pegging: to recognise the differing growth, revenue and cost profiles, and modify the respective financial and asset ratios accordingly

    i. metro

    ii. coastal

    iii. regional city (or combine with metro fringe)

    iv. regional

    v. rural

    vi. remote

2. Reset the foundation notional general rate yield for councils and the means of indexation: noting many of the growth councils (eg coastal, regional city) were farming or fishing communities when rate pegging began in the 1970s. Councillors are subsequently reluctant to impose higher taxes on that heritage. The impact of sea and tree change migration, ageing populations and a linear system of infrastructure exposed to climate risk are all factors that should be available for like-councils to reflect the changing nature of the land and people in the local community and generate the needed revenue to deliver the changing expectations from local assets and access to services.

A council's general operating cash revenues should exceed operational cash expenses, by the equivalent of the non-monetary depreciation value, which may then be appropriated for capital renewals. Indexes for different council types reflect the operating environment of cohorts which will more accurately reflect the costs, potential for generating income and be a more meaningful measure when assessing results against NSW financial performance benchmarks.

12. Is volatility in the rate peg a problem? How could it be stabilised?

Yes.

IPART will be fully aware of the challenges councils recently presented with the 2022-23 LGCI being released at 0.7%.

To stabilise the LGCI the data used needs to align more closely with the current financial environment and use a period of rolling averages factoring in forward projections. It would preferable to base the rate peg on the future operating environment rather than historical. This aligns with the requirement for councils strategic planning detailed in the integrated planning and reporting framework.

13. Would councils prefer more certainty about the future rate peg, or better alignment with changes in costs?

Predicting future CPI inflation for the long term is difficult and of concern. A better alignment to actual costs is recommended and where possible using known future costs indexes, for example, NSW Local Government (State) Award for labour costs and the Reserve Bank of Australia (RBA) forecast CPI.

14. Are there benefits in setting a longer term rate peg, say over multiple years?

This is a possible solution, however ratepayers should have a greater say in how their council is operating and to determine the level of services and quality of life that aligns best with their ability to pay for those services. Inflation volatility, pandemics and natural disasters can contribute to the community's ability to pay and also add to the operating costs of individual councils differently and the ability to adjust this annually should remain.

To avoid volatility in the rate peg, the use of a rolling 3-year average of the historical LGCI weighted at 50% with a forward-looking (RBA CPI) forecast projecting inflation weighted at 50%. The estimation uncertainty of the forward forecast will then correct itself by being factored into the next year rolling 3-year average.

This approach would provide stability in smoothing out the long-term revenue to match the growth in long term expenditure and any resulting efficiency gains through economies of scale.

15. Should the rate peg be released later in the year if this reduced the lag?

No. Councils need to prepare their operational plan and annual budget early in the new calendar year to meet public exhibition and community consultation timelines. The current release dates support this outcome.

16. How should we account for the change in efficient labour costs?

We believe accounting for actual labour costs should be aligned with changes in the NSW Local Government (State) Award to be more reflective of council's costs. The cost of attracting quality staff should also be factored in, these costs may be identified through sector based advertising agencies and industry remuneration surveys.

We do not believe that productivity factors can be accurately measured in a sector as diverse as local government

17. Should external costs be reflected in the rate peg methodology and if so, how?

Yes, if rate-pegging is not abolished in NSW.

External costs that apply to all NSW councils should be included in the rate peg methodology. A 3-year rolling average across cohorts of councils should be determined each year.

18. Are council-specific adjustments for external costs needed, and if so, how could this be achieved?

Council specific adjustments for external costs are needed, examples of external costs include but are not limited to;

- Tracking Federal and State imposed targets, and the cost to achieve them.
- Utilising the IP&R documents to understand any future needs of each council.
- Creating a simple 'council submission' process that enables the exchange of information to enable IPART visibility and approval.
- Audit Risk and Improvement Committee (ARIC).
- Compliance activities such as pool inspections, food shops and others.
- Stormwater Management Charge – charges set by regulations have remained unchanged since 2006-07.
- Cost-shifting has an impact on how income from land rates is diverted. We oppose all forms of cost shifting and the imposts on local communities. We provide this data for information purposes only and it should not be included as an adjustment for external costs:
- Councils paid $127 million in mandatory local government contributions to fund the state government's emergency service agencies in 2015-16.

- The NSW Government makes the lowest per capita contribution to public libraries of any state and territory government in Australia at just $3.76 per capita in 2015-16. Councils footed the bill for a $130 million shortfall in funding required to operate the state's 450 public libraries.
- Councils continue to lose income annually due to NSW Government's failure to fully reimburse councils for mandatory pensioner rate rebates, unlike all other state and territory governments in Australia.
- Councils incur significant costs for activities required to meet regulatory burdens associated with companion animals, noxious weeds, flood controls and other activities.

19. What types of costs which are outside councils' control should be included in the rate peg methodology?

- Costs that apply to all councils uniformly should be included in the rate peg methodology.
- Local government has been subject to significant cost shifting from other levels of government. Recently we received information showing the mandating of the NSW Audit Office has seen an increase in audit fees of 88% over the past 9 years.
- Changes to legislation that affect all councils, often result in additional costs to the local community, examples include but are not limited to the mandating of the audit office, rather than competitive tendering and superannuation payments for elected councillors.
- Reserve bank inflation projections
- Employee costs as a result of Award and EBA negotiations.

20. How can we simplify the rate peg calculation and ensure it reflects, as far as possible, inflation and changes in costs of providing services?

Where possible the LGCI should be future facing, as is the case with special rate variation applications. Cost components in the LGCI that can be sourced from forward looking known variables, such as labour costs should be included.

In question 14 we agree that setting a long-term peg could be a solution, with nearly 40% of the LGCI attributable to labour costs and the Local Government (state) Award being set for 3 years it may be an achievable solution to link the two periods.

Closing the gap in the data used from historical sources needs to be a priority.

Conclusion

Council believes the current methodology is flawed in a number of ways and has contributed to the overall financial erosion and sustainability of Local Government in NSW in conjunction with other imposed requirements on Council's.

Should you wish to discuss the content of this submission further or the future of rate pegging in NSW I would be more than happy to participate.

Yours sincerely

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