COFFS HARBOUR CITY COUNCIL

Issues Paper – Review of rate peg methodology – September 2022

City of Coffs Harbour responses

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

The LGCI appears a considered and customised approach. However, the LGCI weightings are based on a fixed ratio, recalculated using expenditure data collected from NSW Councils on a four to five yearly basis. Structural shifts in council services or legislation that require additional expenditure early in that period are missed and cannot be caught up. These weightings should be reassessed more frequently on a three year moving average.

Structural shifts coupled with the lag on the indexing of the cost elements, can and has resulted in significant mismatches between actual cost escalation for councils and the rate peg. This mismatch then gets built into the base and accumulates in future financial years. The Rate Peg has no adjustment mechanism within the rate peg to claw back this lag, leaving councils no option but to apply for a special rate variation.

The wages price index is inadequate for measuring cost growth as it does not reflect changes in the skill levels of employees within industries. The services provided by councils are changing and require employees with high level and higher paid skills sets. An example of this being a council proactively transitioning toward an increasingly digital world by strongly investing into specialist IT and customer experience resourcing**.**

The rate-peg methodology itself is fundamentally flawed given the 2-year lag between the calculation of the LGCI and its application within the rate peg. In periods of price volatility this has created budgetary issues for Councils as well as confusion for ratepayers who are unclear why their rates are either significantly below or above the consumer price index.

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

Existing categorisation, split and usage of various indices is a reasonable approach to addressing the measurement of annual council costs in a general way across the sector.

The rate peg requires a mechanism that improves ability to act in a timelier fashion based on higher level data. That can then be adjusted the following year based upon the more micro level actual cost inflation data.

For example, utilisation of the RBA Statement of Monetary Policy forecasts could be seen as a means of utilising independent, well-informed data to determine the costs base for a future year (rather than utilisation of outdated historical actual data to determine forecasts). The following year, the actual data and then eventual variance to that of the RBA forecast applied could be applied to the rate peg as an adjustment. Although also imperfect, this method aims to ensure the rate peg is

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more reflective of costs of the future period and councils would then know in advance that the following year what the adjustment might mean for their revenue.

Another alternative to utilising for forward looking inflation is market-based data (rather than RBA academic data). This could be done by utilising the breakeven forecast inflation rate. Being calculated as the difference in yields on nominal and inflation indexed commonwealth government securities (CGS).

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

Firstly, utilising the actual wage increase data for local government employees, or the known NSW Local Government (State) Award wage increases, would more accurately reflect labour costs.

Secondly, known annual increases in materials and services as utilised by all councils, such as construction materials and electricity costs, would better reflect the increasing burden on council's general income that is limited to rate pegs well below these inflationary factors.

Splitting the application of weightings based on council classification rating would make sense to account for the difference cost composition for regional v rural v metro-based councils.

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 population factor is a progressive reform in calculating the rate peg and is a long overdue attempt to compensate Councils for providing additional services as population within their LGA grows. The NSW Productivity Commission (PC) has commented the Population Factor is welcome "as a necessary complement to an efficient, reformed infrastructure contribution system.

Significant population growth in many LGAs over the last few decades is not a new occurrence hence it is disappointing that there has been no retrospective adjustment to reimburse Council for past growth. This is despite the acknowledgement by IPART and PC that "councils receive less income from rates for each new resident compared to existing residents." An opportunity to remedy this situation still exists and should be taken as the population growth data and Supplementary Valuation data is freely available to calculate past lost rate income and reimburse Councils accordingly.

An alternative to the population factor now included in IPART's rate peg methodology, would be to consider the annual increase in rateable assessments for each local government area, given the one to two year lag in ABS population data. The increase in number of rateable assessments is more reliable and timely data available to reflect the increased burden on services to properties.

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

Encouraging productivity at the council level should be enacted by performance indicators encouraging behaviour and monitoring of council performance rather than reducing income. For example, the current OLG Financial Performance Measures provide the encouragement and means to ensure councils remain productive. Performance of councils against these benchmarks then needs to be assessed and analysed to enable a determination made on how productive councils are.

As most NSW councils are actively pursuing efficiencies to try and achieve or maintain financial sustainability, applying a productivity requirement across all councils, disadvantages proactive councils. Proactive councils that seek and implement productivity improvements to enable redistribution of finite resources to enact change are punished as they are still hit with the requirement to find additional productivity improvements.

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

NSW residents by and large have an expectation that all levels of government address risks associated with environmental sustainability and climate change. These changes are reinforced through legislation from departments such as the NSW EPA. The rate peg needs to be responsive to progressive cost changes to guide and support councils meet current challenges that are outside of traditional council services and ratepayer expectations.

An example is the transition to electric vehicles. This will come with upfront significant costs not just in terms of the capital cost but also the skill sets of existing staff and infrastructure to support the effectiveness of the fleet. A rate peg that provides cost increases but assumes a 'like for like' asset replacement will be inadequate and financially discourage councils from meeting NSW Government targets including reducing carbon net emissions to zero by 2050.

Other examples are the increasing limited availability of construction materials that is driving costs up from budget expectations, increasing fuel costs for the operation of plant and fleet, and electricity charges for council facilities.

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

City of Coffs Harbour is unaware of any "unnecessary rate increases". No doubt rate-pegging was specifically intended and designed to prevent excessive increases in rates, and to encourage councils to become more efficient. We believe this has occurred and don’t disagree that rate pegging has its mechanisms to protect the community from excessive rate increase, however this could also have be achieved without rate-pegging, by allowing councils to set rates in consultation with residents.

The existing I P & R framework fosters increased transparency, responsibility and accountability between councils and ratepayers. Both ratepayer affordability and financial sustainability are the key considerations whenever councils deliberate over annual rate income increases.

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

For many NSW councils, the answer is no. Numerous independent reviews have arrived at the same conclusion i.e. the rate peg creates increasing financial hardship for councils and their communities as it does not permit councils to meet the risings costs of serving their communities. Whether it be the NSW Productivity Commission’s Green Paper, the Henry Review of Taxation, the NSW Treasury Corporation’s assessment of the financial sustainability of NSW councils or the NSW Independent Local Government Review Panel’s Final Report – all agree that rate peg detrimentally affects Council's ability to deliver and maintain local services and infrastructure.

Additionally, the rate-peg methodology itself is fundamentally flawed given the 2-year lag between the calculation of the LGCI and its application within the rate peg. In periods of price volatility this has created budgetary issues for Councils.

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

As demonstrated by the number of NSW councils that have applied for Special Rate Variations to address ‘financial sustainability’, it is evident that the rate peg has impacted on financial performance and sustainability.

The NSW Independent Local Government Review Panel (The Panel) released its report "Revitalising Local Government" in 2013. This report considered the financial impacts of rate pegging on NSW councils and found that nearly half of all councils rated Negative (73 councils) in terms of NSW Treasury Corporation's indicators. The Panel’s conclusion summed up the impacts of rate-pegging in that, "whilst there is certainly a case for improving efficiency and keeping rate increases to affordable levels, the rate-pegging system in its present form impacts adversely on sound financial management. It creates unwarranted political difficulties for councils that really can and should raise rates above the peg to meet genuine expenditure needs and ensure their long-term sustainability". This has led to excessive cuts in expenditure on infrastructure maintenance and renewal, leading to a mounting infrastructure backlog across NSW.

Additionally, the avenue to exceed the rate income as determined by the rate cap i.e the Special Variation process, continues to incur a significant regulatory burden on councils. The NSW Government has noted that it “supports removing unwarranted complexity, costs and constraints from the rate-peg system” however there has been no action to enable the SRV process to be made simpler.

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

If the rate peg is to be retained for NSW councils, the methodology behind its calculation needs to be reviewed further and improved to reflect differing council types. An analysis of the variability of the costs for differing council types e.g., regional, rural, metropolitan should be undertaken. We agree with IPART’s comment that different councils’ costs of providing goods and services and their capacity to raise income to meet these costs varies significantly.

Table 4.1 within the Issues Paper illustrates this point with the significant variation in costs associated with road maintenance between Council types. The current LGCI weighting of 26.9% for road and bridge construction will have varying relevance on each Council type depending on the volume and condition of roads and bridge structures to be maintained. This reinforces the need to better reflect within the LGCI how and the extent to which differences between councils leads to differences in how councils’ costs change over time due to inflation and other external factors.

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

It's about acknowledging and addressing the variability of cost profiles between different Council types. Fundamentally, the rate peg is about allowing councils to increase their rates income each year by an amount that reflects inflation and changes in the types of costs a council incurs. This can be done more effectively by calculating differing cost indexes for different Council types based on the significance and types of expenses for each. Furthermore, we also acknowledge the additional complexity that will result from calculating differing cost indexes however the enhanced accuracy and relevance cannot be ignored.

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

There is no question price volatility is an issue in the current rate peg methodology. The 0.7% 2022-23 rate peg provides sound evidence of this. Without the Office of Local Government's intervention to allow ASV applications, many Councils' rate income would have been significantly lower than what was budgeted for and provided for within their Long-Term Financial Plans.

Comparison to the NSW Local Government (State) Award salary increase of 2% demonstrates the inadequacy of the proposed rate peg to cover known increases in labour costs alone. In short – the outcomes would have been disastrous for councils and their communities.

The volatility could be addressed by the use of moving averages and introducing more forward looking metrics into the rate peg calculation.

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

Certainty regarding future rate pegs would greatly enhance councils' ability to undertake forward planning. This provides confidence to the community that actions are funded and allows councils to enter into long term contracts. However, it's more important that councils are provided certainty that the Rate Peg will align with cost increases than determining the percentage increase.

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

The disadvantages outweigh any advantages and it's difficult to recommend metrics that would lead to an accurate forecast. A longer-term rate peg provides a stable and predictable revenue source for longer term financial forecasting but it opens Councils up to a range of additional financial sustainability risks, funding pressures and pressures on maintaining service levels, and limits flexibility and ability to be nimble and responsive.

Arguably, one of the primary issues witnessed with the current methodology is one of timeliness for measuring changes in councils' costs and inflation. Extending the time period of the rate peg does not address this.

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

The rate peg should be released in October-November each financial year to enable NSW councils to have adequate time to review and revise future budget forecasts.

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

As acknowledged by IPART, labour costs are the largest single cost component in the LGCI however basis for this component, being the NSW public section wage price index (WPI), does not include changes in the superannuation guarantee, reflect the NSW Local Government (State) Award minimum annual increase nor does it consider council specific Enterprise Agreements.

At a minimum, labour costs should reflect the minimum award and superannuation guaranteed increases.