Corporate Services. S Moore
Phone: 02 4974 2129

3 November 2022

Scott Chapman

Review of the rate peg methodology

Rates and Annual Charges is the most significant revenue source to all local councils. The rate peg and its associated methodology has a material impact on the services that can be provided to our residents and any discrepancy between the peg and cost changes has long and on-going effects.

City of Newcastle welcomes this review into the rate peg methodology. Our responses to the questions within the issues paper are detailed on the following pages.

Should you require any further information on this matter please contact me on

Yours faithfully

Scott Moore
Manager Finance, Property and Performance

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 only reassessed on a four yearly basis. Structural shifts in council services or legislation that require additional expenditure early in that period are missed and cannot be caught up.
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 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?

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.
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.
By applying a productivity requirement across all councils, it 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.
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.
It should be noted that Newcastle was afforded 0.5% in addition to its rate cap determination of 0.7% for 2022/23, yet when the NSW Government provided all Councils the opportunity to seek a revised rate cap of 2.5%, Newcastle’s population factor of 0.5% was removed without explanation.

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

The NSW public has an expectation that all levels of government adapt to the UN sustainability goals and address risks to do with 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.

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

CN 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 but could also have been 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?

This is not the case. 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? 14

NSW had rate pegging in use for 37 years when in 2013 the NSW Independent Local Government Review Panel (The Panel) released its report "Revitalising Local Government" 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. This meant that without corrective action, these Councils' financial position will deteriorate and could become classified as Weak, Very Weak or Distressed. The Panel's conclusion sums 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.
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?

We agree with IPART's view that if the rate peg is to be retained, the methodology behind its calculation can be improved. An analysis of the variability of the costs for differing Council types e.g, regional, rural, metropolitan should be undertaken. We agree 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 weighting of 26.9% will have varying relevance on each Council type depending on the volume of roads/bridges 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. 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.