Review of Rate Peg Methodology

Issues Paper September 2022

1. **To what extent does the Local Government Cost Index reflect changes in councils' costs and inflation? Is there a better approach?**
2. **What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?**
3. **What alternate data sources could be used to measure the changes in council costs?**

Response:

As stated in the Issues Paper, rates income is the single most important source of unrestricted income for Councils. The recent Pandemic demonstrated this importance as it was only our rates income that we could reprioritise in order to continue to provide essential services and infrastructure to the community.

The Local Government Cost index (LGCI) in itself and the way it is calculated is not a concern for our Council. The problem is that in times of volatility, it may not reflect reality. The inflation that we are all currently experiencing will not go away in the short term. Councils are required to prepare Budgets and Long-Term Financial Plans considering future award increases, as driven by the Local Government State Award, inflation, and any other legislated increases externally imposed such as superannuation.

Recently the Australian Tax Office has reviewed FBT for carparking which were to come into effect from April 2022. While this has been postponed it is still under review. If the changes being mooted are imposed, then this will have significant financial implications on Councils.

When Delivery Plan budgets are formulated, the projected rate peg is a key assumption. This is where the current LGCI fails. It looks to the past and does not factor in current and future market and economic conditions such as increasing cost of materials to maintain infrastructure. These lags have a compounding effect on Councils and have an impact on financial sustainability.

Section 8B of the *Local Government Act* 1993, states the principles of sound financial management for NSW councils. It is important to note that part(d) of Section 8B states "Councils should have regards to achieving intergenerational equity, including ensuring the following: (i) policy decisions are made after considering their financial effect on future generations, (ii) current generation fund for the cost of its services." It is arguable that Councils cannot prima facie comply with this part of the Act given the centralised control of the primary source of income.

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?**

Response:

This has not achieved anything for an established Council such as City of Ryde. We are experiencing significant growth and the supplementary levies that City of Ryde receives results in a zero-percentage allowance in the rate peg from the population growth factor.

The population growth factor does not consider the visitor movement in and out of Ryde and nor does it consider the utilisation of our facilities and services from residents outside the area or from neighbouring Local Government Areas. Macquarie Park is the northern anchor of Sydney's Eastern Economic Corridor, it is a designated health and education precinct, and strategic centre and jobs are expected to grow from around 58,500 in 2016, to 79,000 by 2036. Student places are expected to grow from 32,500 to 55,000 by 2030, making it the third largest concentration of jobs and students in NSW. The current population factor does not take this type of growth into account nor the needs of such high-density areas.

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

Response:

The Integrated Planning and Reporting (IP&R) framework now requires Councils to undertake service reviews.

As per the IP&R guidelines, section 4.3 "to encourage continuous improvement across the council's operations, the Delivery program must identify areas of service that the council will review during its term, and how the council will engage with the community and other stakeholders to determine service level expectations and appropriate measures". Section 4.4 further states "The Delivery Program must address ongoing improvements to the efficiency, productivity, financial management and governance of the council."

With the current and future inflationary market conditions, it is very difficult for Councils to achieve significant efficiencies. Like many our Council is still struggling to recover the financial impacts of the Pandemic on our income given significant demographic changes such as working from home. Cost shifting from other tiers of government and legislated costs such as the emergency services levies, local government election/bi-election costs, compliance costs, cyber security costs etc are increasing at a greater pace than felt before. Key utility cost such as the gas used for our aquatic centre in Ryde (used by residents well beyond our border) have quadrupled and insurance premiums are increasing. It is clear rate pegs are lagging behind and the effects of this shortfall are being felt across the industry. The only option will be period applications for special rate variations to mitigate financial insolvency. This of course makes no sense when a key reason for such applications is the failure of the rate peg system.

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

Response:

External costs that are outside of Council's control such as Emergency Service Levies, Streetlighting, Sydney Region Development Fund, Election Costs, Utilities, Valuer General costs, etc. There are also factors such as future legislative changes which may impact Councils for example, the carparking FBT which will have significant implications, this is still under review by the Australian Tax Office.

Supply chain issues, shortages of contractors in the market, global economic factors are all having a significant impact on Councils, plus the recent health crisis as mentioned previously. Climate change, impacts of natural disasters, the recent floods and heavy rainfall and bushfires and also the cyber security costs need to be all taken into account.

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

Response:

With the rate capping, yes it has and with backward looking data, absolutely. However, this has caused issues for the future generation going forward. To repeat as per Response to Question 1, we need to ensure that the current generation pays for current services and that this doesn't create a burden for the future generations.

The stormwater management charge which was introduced in 2006/2007 has not been indexed at all. These costs are huge and have escalated significantly and needs to be reviewed now.

Council always looks for alternative streams of revenue so that they are not reliant on rates due to rate capping. However recently some Councils introduced a compliance levy which was to pay for development monitoring and regulatory activities, however this was removed by Department of Planning. These compliance and regulatory costs are enormous for Councils and the removal of this fee meant that City of Ryde could not recoup $1.3m per annum, resulting in a shortfall of income.

In addition, there are fees that are set by Statute which are outside of Council's control. These fees have never been reviewed with the increases in costs. They have either not been indexed or changed for long periods.

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

Response:

No it has not, as it has not kept pace with the significant increases in inflation and award increases, current and future market and economic conditions and global factors. You only need to look at the volume of special variation applications that have been approved by IPART from 2011/2012.

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

Response:

Yes it has. The recent rate peg announcements have made it very difficult and has not kept pace with the inflation and award increases etc. This has a compounding effect on Councils.

Table below shows the Rate Peg announcements taking into account the Local Government Cost Index with a comparison to the Award and Superannuation increases. This analysis is excluding the current and future market conditions as LGCI is based on historical data. Over time, it has definitely impacted the financial performance and sustainability of Councils. This is also evidenced by the high number of special variation applications being made to IPART.

	2022/23	2021/22	2020/21	2019/20	2018/19	2017/18	2016/17	2015/16	2014/15	2013/14	2012/13	2011/12
Cost Index	**0.90%**	**1.80%**	**2.60%**	**2.70%**	**2.30%**	**1.50%**	**1.78%**	**2.47%**	**2.80%**	**3.70%**	**3.41%**	**3.00%**
Less Productivity Improvement Factor		0	0	0	0	0.00%	0.00%	-0.04%	-0.20%	-0.20%	-0.22%	-0.20%
Plus/ (Less) Carbon Price Advance									-0.30%	-0.10%	0.40%	
Plus another increase to meet costs of 2021 Election (One-off)	-0.20%	0.20%										
Rounding							0.02%	-0.03%			0.01%	
Rate Peg	**0.70%**	**2.00%**	**2.60%**	**2.70%**	**2.30%**	**1.50%**	**1.80%**	**2.40%**	**2.30%**	**3.40%**	**3.60%**	**2.80%**
Plus Population Growth Factor	0.00%											
Total Rate Peg	**0.70%**	**2.00%**	**2.60%**	**2.70%**	**2.30%**	**1.50%**	**1.80%**	**2.40%**	**2.30%**	**3.40%**	**3.60%**	**2.80%**
Award increase	**2.00%**	**2.00%**	**1.50%**	**2.50%**	**2.50%**	**2.35%**	**2.80%**	**2.70%**	**2.60%**	**3.25%**	**3.25%**	**2.15%**
Superannuation Increase	**0.50%**	**0.50%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**	**0.00%**	**0.25%**	**0.25%**	**0.00%**	**0.00%**
Rate Peg Over / (Below) Award & Superannuation Increase	**(1.80%)**	**(0.50%)**	**1.10%**	**0.20%**	**(0.20%)**	**(0.85%)**	**(1.00%)**	**(0.30%)**	**(0.55%)**	**(0.10%)**	**0.35%**	**0.65%**

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

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

Response:

There are a lot of factors that differentiate Councils from each other. Location, population, demographics, asset base, types and levels of service provided, etc.

Other than historical data, in order to support different cost indexes, not sure what the basis or methodology could be used to create multiple rate pegs as again it will be backward looking.

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

Response:

The only reason it is volatile is because it is backward looking. It needs to focus on current and future market conditions plus mandated award and superannuation increases and any other legislative imposed factors.

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

Response:

Yes, more certainty is better for Councils so that we can plan better, however it will need to be flexible so that changes in costs are accounted for too. As per response to Question 1, we need to ensure that the current generation funds for the cost of these services and does not create a burden for the future generations.

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

Response:

Yes it would be easier for Councils so that they can prepare budgets and long-term financial plans. It would then be beneficial to revise the rate peg if the indexes are higher, again there should be mechanisms in place if there is a lag so that the rate peg eventually catches up.

Based on recent events though, it may be difficult to predict future increases accurately. There may be ways to counter this by allowing catchups in the following years so that costs are aligned with the rate peg increases in the future.

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

Response:

No this will only delay our planning. We already have tight deadlines to produce our strategic plan documents. The announcements made by IPART previously did not give Councils sufficient time to formulate budgets and long-term financial plans. It might be best to adjust the rate peg in the following year if the indexes are higher than the announced rate peg, this will ensure lags are accounted for.

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

Response:

The NSW Local Government Award should be used on top of the superannuation increases and any other legislated increases such FBT carparking (still under review).

17. Should external costs be reflected in the rate peg methodology and if so, how?
18. Are council-specific adjustments for external costs needed, and if so, how could this be achieved?
19. What types of costs which are outside councils' control should be included in the rate peg methodology?

Response:

Yes external costs should be reflected in the rate peg. Examples of external costs include below but are not limited to:

- Emergency Services Levies which now incorporates Workers Compensation
- Streetlighting
- Election and possible Bi-Election costs
- Valuer General Fees
- Sydney Region Development Fund
- Part subsidised Pensioner Rebates
- Audit fees & mandated performance audits
- Insurance premium costs
- Utilities
- Cyber Security Costs
- Supply chain issues
- Natural Disaster Costs
- Planning, Compliance and Regulatory costs

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?**

Response:

Focus on the current and future market conditions. The rate peg needs to consider the Local Government State Award increases, the imposed superannuation increases and any other legislated changes that are imposed as a minimum with additional allowances for inflationary costs and other costs as highlighted in response to Question 19 if this is higher than the minimum. The ATO have the FBT carparking legislation which is still under review, and this may have significant financial implications for Councils.