Submission to IPART Rates methodology Issues paper

The IPART Review of the rate peg to include population growth final report was issued in September 2021.

This report acknowledged that service levels, and costs, are different across councils. This report stated that analysis found a mostly linear relationship between council costs and population growth. The new methodology applied to all councils, including those experiencing low growth, so in fact a one size fits all approach. The revised methodology allows councils' rates revenue to rise with population growth. It is not structured to support Councils' who are experiencing stable or declining populations. The residents of these local government areas still expect a stable or improved level of service. Low or no growth councils are still faced with inflationary cost pressures.

For rural and regional councils, due to their often smaller rates base and often larger geographical areas, the cost of service provision is actually higher per capita. IPART has recognised in this in the Appendix of the report stating "Regional councils cover larger areas but service less population. They also provide a more diverse range of services to their communities, which often have less capacity to pay".

All of these factors are recognised to some extent by IPART but not taken into account in a one size fits all approach to setting the rates peg.

Role of state and federal government grants

IPART view

IPART noted it expected that some councils will remain reliant on state and federal government grants, such as those with declining populations and those with populations less able to afford rate increases. Where government funding is intended to fund capital or operating costs associated with population growth, funding should remain targeted to those councils that need it most.

IPART stated that issues of social and economic disadvantage and capacity to pay, should be dealt with through state and federal government initiatives such as grants or other funding mechanisms.

What is actually happening to federal and state government grants in the Local Government sector?

The Australian Local Government Association (ALGA) published a paper titled Background on Local Government Funding stating "that while the roles and responsibilities of local government have grown significantly over time, its revenue base has not". According to this report, in the 1970's the Commonwealth Government, recognised that rapid changes in responsibilities faced by council's required direct support from the Commonwealth. Since 1996, Financial Assistance Grants have declined by around 43% in relative terms, from about 1% to 0.55% of Commonwealth Taxation Revenue. ALGA stated it will continue to advocate that rate-capping and pegging place an artificial block on councils being able to respond to their communities' needs and future priorities.

The ALGA paper noted over time, the roles and responsibilities of local governments have increased as a result of increasing community demand, downwards cost shifting from State and Commonwealth governments, and the need to address market failure (particularly in rural areas where it is commonly not financially viable for the private sector to provide essential goods and services such as aged care or childcare). The report noted in the past 25 years there has been over a fourfold increase in spending by local government in nominal terms (6.7% per annum compound growth rate) with total outlays increasing from $8.2 billion in 1994-95 to $38.8 billion in 2018-19.

Page 37 of the IPART Review of rates Peg Methodology paper states that Operating and capital grants and contributions per capita grew by 65% from 2010-11 to 2020-21. IPART noted that operating grants and contributions per capita grew by just 7% over the same period. Therefore Councils, in particular rural councils cannot rely on increases in grants to grow revenue.

IPART states the rate peg methodology is currently designed to allow councils to increase their rates income each year by an amount that reflects inflation and changes in the types of costs a typical council would incur. *What is a typical or average council?* While IPART states in the Issues Paper that they recognise that councils and communities across NSW have differing needs and circumstances and understand that each council faces a unique set of challenges, in the past this has not been taken into account when setting the rates peg. IPART's Appendices utilises the Office of Local Government's council 5 classifications, being Metropolitan, Regional town/city, Metropolitan fringe, rural and large rural, to identify the key differences between councils' characteristics and sources of income. It can be concluded there is no typical council but Councils could be grouped for the purpose of a setting a rates peg.

1. *To what extent does the Local Government Cost Index (LGCI) reflect changes in councils' costs and inflation? Is there a better approach? What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?*

   The LGCI Information Paper December 2010 p.3 states the annual percentage change in the LGCI is calculated on an annual average basis by comparing the average level of the index for the latest 4 quarters with the average of the index for the preceding 4 quarters.

   The rate peg for 2023-24 is based on the change in the average price of the costs incurred by a typical/average council over the 2020-21 and 2021-22 financial years. The price change to end June 2022 is not the actual change over 12 months but the average over 2 years. What is average or typical will vary across the state.

   Councils are actually getting further behind & costs are not being kept up with. It is difficult to justify IPART's claim that the LGCI measures price changes over the past year. This is explained below.

   IPART claims this is the most up to date actual data currently available. This is not factually correct. With advanced modelling technology and regular real time data reporting, there should be no reason why IPART could not have up to date costs reflected in the current year rates peg. The Producer Price Indices for the June 2022 quarter were released by the Australian Bureau of Statistics on 29 July 2022. The 2023-2024 Rates peg was issued on 29 September 2022.

   Councils were instructed in July 2022 by the NSW Audit Office to ensure their Infrastructure, Property, Plant and Equipment assets such as roads & bridges were indexed to bring them up to current cost. The NSW Roads & Bridges Constructions Index to June 2022 (Index 3101) was the appropriate index to use. The rise for the 12 months to 30 June 202 was 7.7% according to the ABS. IPART stated the road and bridges construction index rose 5.2% in the 2021-22 financial year. This is not correct, the index rose 7.7%; the average over 2 years was 5.2%. By adjusting, the rates peg to the true actual price increase of 7.7%, in just the 2 roads construction lines, should have resulted in a larger minimum rate peg, as roads construction has the second highest weighting after employee costs in the LGCI.

Similarly, in the 2022-2023, the rates peg had an allowance of 1.1% for the roads construction whilst the ABS Producer Price Index was 2.9%. For the period 1 July 2020 to 30 June 2022, the index went up 10.6% but IPART has allowed for only 6.6%. These types of differences have a larger impacts during inflationary periods.

The LGCI does not utilise Council related data in all instances. The employee benefits and on costs has a weighting of 38.6%. This the largest weighted item in the LGCI. This utilised an increase of 2.0% in employee benefits and on-costs, measured by the ABS Wage Price Index for the NSW public sector. Council staff are paid under the Local Government State Award 2020, so this would seem to be the correct measure of cost change. Local Government State Award wage increases are set 3 years in advance. This is publicly available therefore no reason for IPART not to use this, and to have forward looking figures.

The 2023-24 rate peg included an adjustment of 0.2% to allow for the change in the superannuation guarantee in 2021-22. This too far behind given the Australian Taxation Office (ATO) publishes superannuation rates many years in advance. It has been Commonwealth legislation for many years with known dates & percentages to be met. ATO website is currently showing rates up to the 2027-2028 year. For the 2023-2024 financial year, the superannuation guarantee will be actually 11%, not the 10% allowed for in the rates peg.

IPART's statement that the adjustments for super and wages in the LGCI allows the rate peg to more accurately measure the cost of labour for councils, is unable to be justified.

Emergency Services Levy and planned electricity are often released in advance and before the rates peg so current or forward looking amounts could be used.

The Local Government Association of QLD (LGAQ) has been publishing an <u>annual</u> council cost index since 2005. The data released by them in 2020 showed council costs for providing a unit of service have increased by approximately 80 per cent over the past 19 years. Their research has shown that input cost increases have accounted for this.

Since 2006, the Local Government Association of Tasmania has published a Council Cost Index (CCI). The Council Cost Index for the 2022 year for Tasmania was 4.06%.

NSW Councils would not be widely different to their state counterparts. Why, then should the rates peg be decreasing or at least not be relatively stable.

2. *What alternate data sources could be used to measure the changes in council costs?*
   Refer to answers to question 1. Accurate, up to date, forward facing and council related information.

3. *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 2023-2024 IPART rates peg release showed only 32% of Councils (41 out of 128) obtaining a population factor. The 2022-2023 IPART rates peg release showed a similar percentage of Councils with a population factor increase. It can be concluded that the majority of NSW Councils are not benefitting from the revised Rates Peg methodology released on 5 October 2021.

The population factor would in theory support, to a certain extent, Councils with keeping up with costs, in particular high population growth Councils. There needs to be some mechanism to support Councils with low growth or a declining/stable population, which are the majority in the state.

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

   Whilst, IPART is required to have regard to a productivity factor in addition to the LGCI in setting the annual rate peg, labour productivity is a matter for the employer. The award document states that parties to the Local Government State Award are committed to co-operating positively to increase the productivity, structural efficiency and financial sustainability of Local Government. Enterprise bargaining has a resulted in productivity improvements to obtain all or some benefits under agreements, and are designed to improve productivity and reduce administration costs.

   In addition, through the Strategic Plan, the community sets the service level & key initiatives to be delivered. It is then up to Council through the Resourcing Strategy and Long Term Financial Plan to decide how services should be efficiently provided.

   A reduction in costs should benefit the individual community, not have an arbitrary amount deducted by IPART. The Lachlan Shire for example has 3 population centres dispersed across the shire. This means we have 3 water and 3 sewer treatments plants which is not efficient but is a necessity to provide clean drinking water and adequately manage sewerage in accordance with legislation. A number of Councils in NSW have large geographical areas with dispersed populations, yet there is no mechanism to support this, despite IPART acknowledging different Councils having different cost bases.

5. *What other external factors should the rate peg methodology make adjustments for? How should this be done?*
   See response to questions 16 & 17.

<u>Questions 6 & 7 are answered as one below.</u>

6. ***Has the rate peg protected ratepayers from unnecessary rate increases?***
7. ***Has the rate peg provided councils with sufficient income to deliver services to their communities?***
   History would suggest the rates peg does not. There is a long term history of Special Rates Variations (SRV) and the 2022-23 Additional Special Variation approval. Rates have indeed risen above the rates peg. Worst still Councils have incurred significant costs in preparing applications to satisfy IPART and through the community consultation process. Ultimately the community has ended up with less services and deferred projects to pay for the SRV process. Who wins here?

   Table B.2 on page 36 of the Review of rate peg methodology report 182 SRV were approved from 2011-12 to 2022-23 with average cumulative increases ranging from 20% to greater than 35%.

   It appears that the rates revenue was always needed, it just required an SRV or a financial crisis, such as Central Coast to get the increase. It seems to be a matter of timing. The rates may have been lower in the past but as demonstrated, large increases were eventually needed, often over long timeframes, to maintain financial sustainability and at least maintain a minimum level of services.

For the 2022-23 year, IPART approved Central Coast Council's extension of its current 3-year temporary rate increase for a further 7-year period, starting from 2024-25.
Hunter's Hill Council and Snowy Valleys Council's permanent rate increases over 2 years.
Kyogle Council's permanent rate increase for 2022-23.

Snowy Valley was able to demonstrate financial need and was approved a 35.95% cumulative increase over 2 years. The IPART report noted without the special variation, the council's financial position would continue to deteriorate over the next 10 years. The council's financial modelling showed without the special variation, it would have an operating deficit of $27.3 million by 2031-32.

Central Coast Council was approved to extend its temporary 15% 2021-22 SV over the period 2024-25 to 2030-31, to repay $150m in emergency loans and to secure the council's ongoing financial sustainability.

After the 2022-23 base rates peg of 0.7% was announced, there was an industry wide outcry, it was later acknowledged by IPART that the rate peg was lower than many councils expected. An Additional Special Variation (ASV) was subsequently approved with the guidelines requiring councils to show that they had budgeted for higher income than that provided by the rate peg and that they need the additional money to deliver on the projects they have already planned and included in their budgets. IPART approved applications by 86 NSW councils to increase their rates above the level of the annual rate peg. It cost more to get what was always needed so the community paid twice, through a reduction in services to fund the ASV and an increase in rates.

To approve a Special Rates Variation (SRV), IPART must be satisfied Councils comply with the requirements set out in Office of Local Government's guidelines. This includes compliance with the Integrated Planning & Reporting framework which ultimately underpins decisions on the revenue required by each council, and whether the council requires a special variation to meet those needs. Given the number of approvals, the increased rates were always needed.

8. *How has the rate peg impacted the financial performance and sustainability of councils?*
As set out in my response to questions 6 & 7, it seems the rates peg has had a detrimental impact on some or all NSW councils.

On 20 October 2015, the NSW Government released IPART's assessments of NSW Councils Fit for the Future proposals. Only 52 of the 139 proposals (around 37%) were found to be "Fit for the Future". Interestingly the report showed the majority of metropolitan Sydney councils as not fit. 7 years on and Councils such as Central Coast, Hilltops & Kiama are in financial difficulty.

The Australian Local Government Association's 2020-23 Strategic Plan identifies work on strengthening local government financial sustainability as a strategic priority. Therefore it could be concluded that things are not actually improving, despite government intervention and IPART recommendations. Clearly the rates peg system is failing to provide sufficient revenue to maintain financial sustainability.

<u>Questions 9 & 10 are answered as one below.</u>

9. *In what ways could the rate peg methodology better reflect how councils differ from each other?*
10. *What are the benefits of introducing different cost indexes for different council types?*
IPART states in the Issues Paper that they recognise that councils and communities across NSW have differing needs and circumstances and understand that each council faces a unique set of challenges. The LGCI Information paper released by IPART in December 2010 acknowledged that survey results indicated considerable variability in cost profiles among individual councils. There were also systematic differences, on average, between the cost structures of urban and rural councils. Nonetheless, IPART decided not to adopt separate urban and rural cost indexes.
It seems that no lessons have been learnt from 2010 to 2022, and the problems remain the same.

IPART's Appendices utilises the Office of Local Government's (OLG) council 5 classifications, being Metropolitan, Regional town/city, Metropolitan fringe, rural and large rural, to identify the key differences between councils' characteristics and sources of income. It can be concluded there is no typical council but perhaps Councils could be grouped for the purpose of a setting a rates peg per group of Council. For example, one rates peg for each of the 5 OLG classifications. Whilst this might not work for every Council, it could be a better option, in particular for Councils with low or no population growth.

11. *Is volatility in the rate peg a problem? How could it be stabilised?*
Volatility is a significant problem with the rates peg and since IPART commenced setting the rates peg, it has become more volatile.

The Local Government Association of QLD (LGAQ) has been publishing an <u>annual</u> council cost index since 2005. The data released by them in 2020 showed council costs for providing a unit of service have increased by approximately 80 per cent over the past 19 years.

Why then such volatility and declines in rates pegs?

The *Local Government Act NSW 1993 and associates regulations* require Councils to, amongst other things,

- plan strategically, using the integrated planning and reporting framework, for the provision of effective and efficient services and regulation to meet the diverse needs of the local community;
- consider social justice principles;
- consider the long term and cumulative effects of actions on future generations
- have a 10 year Community Strategic Plan;
- have a long-term Resourcing Strategy for the provision of the resources required to perform its functions; and
- have 10 year Long Term Financial Plan to deliver on the Community Strategic Plan.

It is difficult for Councils to plan strategically and meet the legislative requirements when the rates peg is subject to annual change.

Historically (prior to IPART setting the rates peg) the rates peg from the 2005/06 to 2009/10 financial years ranged from 3.2% to 3.6%. This was relatively stable. IPART commenced setting the rates peg in 2011/12 financial year. In the last 10 years, the base rate peg has varied from 0.7% to 3.7%.

After the 2022-23 base rates peg of 0.7% was announced, there was an industry wide outcry, and it was later acknowledged by IPART that the rate peg was lower than many councils expected. An Additional Special Variation (ASV) was subsequently approved with the guidelines requiring councils to show that they had budgeted for higher income than that provided by the rate peg and that they need the additional money to deliver on the projects they have already planned and included in their budgets. IPART approved applications by 86 NSW councils to increase their rates above the level of the annual rate peg.

12. *Would councils prefer more certainty about the future rate peg, or better alignment with changes in costs?*
    The rates peg needs to be more forward looking. Forward looking information is available such as Local Government State Award wages increases, Emergency Services Levy increases, Superannuation increases, planned electricity increases and indexes are released before the rates peg as well.

    The Producer Price Indices for the June 2022 quarter were released by the Australian Bureau of Statistics on 29 July 2022 and the 2023-2024 Rates peg was issued on 29 September 2022.

    With advanced modelling technology & the 24/7 availability of data, there should be no reason why IPART could not have up to date costs reflected in the current year rates peg. This would support Councils better in an inflationary environment. If IPART was to set a 4 year rates peg (aligning with for example Council elections and so Council Delivery Plans) which would be the minimum base rate. The rates peg could be indexed upwards once a certain inflationary target is met. The target could align with Reserve Bank monetary policy. Currently, the Reserve Bank has an ‘inflation target’ which seeks to keep consumer price inflation in the economy to 2–3 per cent, on average, over the medium term. This is independent and publicly available data.

    With the quarterly release of Producer Price Indices by the ABS, there is sufficient independent data available. This would align with Council’s Delivery Plans and provide some certainty. History has shown the rates peg has been too low over the past 10 years, with very few years over 3%.

13. *Are there benefits in setting a longer term rate peg, say over multiple years?*
    A flat rate over a period of time would not have benefits in an inflationary environment. A flat rate with ability to increase may be an option. If IPART was to set a 4 year rates peg (aligning with for example Council elections) which would be the minimum base rate. This would align with Council’s Delivery Plans and provide some certainty. The methodology could include a multiplier to allow for an increase above this when inflation went above a certain target. The target could align with Reserve Bank monetary policy. Currently, the Reserve Bank has an ‘inflation target’ which seeks to keep consumer price inflation in the economy to 2–3 per cent, on average, over the medium term. This is independent and publicly available data.

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

There appears to be no need for this. With advanced modelling technology & the 24/7 availability of data, there should be no reason why IPART could not have up to date costs reflected in the current year rates peg. The Producer Price Indices for the June 2022 quarter were released by the Australian Bureau of Statistics on 29 July 2022 well before the 2023-2024 Rates peg was issued by IPART on 29 September 2022.

15. *How should we account for the change in efficient labour costs?*
Whilst, IPART is required to have regard to a productivity factor in addition to the LGCI in setting the annual rate peg, labour productivity is a matter for the employer. The award document states that parties to the Local Government State Award are committed to co-operating positively to increase the productivity, structural efficiency and financial sustainability of Local Government. Enterprise bargaining has a resulted in productivity improvements to obtain all or some benefits under agreements, and are designed to improve productivity and reduce administration costs. These are the appropriate mechanisms to drive efficiency.

In addition, through the Strategic Plan, the community sets the service level & key initiatives to be delivered. It is then up to Council through the Workforce Management Plan (as part of the Resourcing Strategy) and Long Term Financial Plan to decide how services should be efficiently provided.

A reduction in costs should benefit the individual community, not have an arbitrary amount deducted by IPART. The Lachlan Shire for example has 3 population centres dispersed across the shire. This means we have staff at 3 water and 3 sewer treatments plants which is not efficient but is a necessity to provide clean drinking water and adequately manage sewerage in accordance with legislation. A number of Councils in NSW have large geographical areas with dispersed populations, yet there is no mechanism to support this, despite IPART acknowledging different Councils having different cost bases.

16. *Should external costs be reflected in the rate peg methodology and if so, how?*
17. *Are council-specific adjustments for external costs needed, and if so, how could this be achieved?*

External costs have been allowed for in the rates peg in some cases such as the election costs. The allowance of 0.2% was very low. For Lachlan Shire, this equated to $32 and cost of the election was just over $59,000.

The Emergency Services Levy (ESL) that has been included in the peg, but again an arbitrary amount has been allowed. Rural and regional councils will have the largest asset bases across geographically dispersed areas. This results in multiple sheds, multiple pieces of plant and equipment etc. so a larger cost on these councils, of which Lachlan Shire is one.

The Financial Assistance Grant contains a disability factor for population, road length etc. so this could be utilised similar to the population factor.

Groups of council might be affected similarly, where it could be possible to apply a cost factor if more than one rates peg was implemented or an addition to one rates peg like is applied for the population factor.

External costs such as increasing pensioner rebates driven by ageing populations are not recognised in the rates peg. The NSW Government funds 55% of the rebate with the remaining 45% a cost to councils and communities. As the ageing population grows, so too does the gap between what is funded and what is left to be recovered by councils and their ratepayers. A recoupment through a similar mechanism such as the population factor could potentially be used to allow for this in the rates peg.

Other types of external costs are driven by market failure or a failure of other levels of government to provide the service such as aged care, youth services or airports. These types of costs would not necessarily be included in the cost index as they might not be delivered by a typical or average council. What services are included in the typical or average council? For Councils providing a set of services outside of the typical or average council, a mechanism similar to the population factor could be included.

This would be difficult to apply external costs affecting individual Councils on an individual Council basis. There could be a similar but far more simplified process, for an Additional Special Variation to allow individual councils to have additional revenue requests considered.

18. *What types of costs which are outside councils' control should be included in the rate peg methodology?*
    See response to questions 16 & 17.

    Cost shifting is also a major issue for Councils and this won't be reflected in a change in the Producer Price Index. The Australian Local Government Association (ALGA) published a paper titled Background on Local Government Funding stating "that while the roles and responsibilities of local government have grown significantly over time, its revenue base has not".

    The ALGA paper noted over time, the roles and responsibilities of local governments have increased as a result of increasing community demand, downwards cost shifting from State and Commonwealth governments, and the need to address market failure (particularly in rural areas where it is commonly not financially viable for the private sector to provide essential goods and services such as aged care or childcare). The report noted in the past 25 years there has been over a fourfold increase in spending by local government in nominal terms (6.7% per annum compound growth rate) with total outlays increasing from $8.2 billion in 1994-95 to $38.8 billion in 2018-19.

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

    The rates peg does not appear to be overly complicated. IPART states the rate peg methodology is currently designed to allow councils to increase their rates income each year by an amount that reflects inflation and changes in the types of costs a typical council would incur.

    However the current rates peg setting methodology has a number of significant failings, namely:
    - One size does not fit all
    - The rates peg is not forward looking

- IPART acknowledges that costs pressures are not uniform across Councils-this could be due to population density, development, location, multiple assets across a large shire with a small population that is not centrally located
- Lag indicators-using data that is averaged & well out of date, when up to date data is publicly available
- Increased volatility and lower rates peg than pre IPART setting the rates peg
- What is a typical or average council?
- Seems to be a lack of consultation with rural, small regional - IPART stated it worked with councils to understand how council costs and revenue are impacted by population growth. The report stated it worked with Byron Shire Council, Wagga Wagga City Council and Cessnock City Council, Blacktown City Council and Bayside Council. There is no mention of rural Councils and central west/far west councils, west of the great divide such as Lachlan Shire, Burke Shire, Bathurst Regional (does have a population increase according to the 2023-2024 rates peg) & Orange.