LAKE MACQUARIE CITY

11 November 2022

INDEPENDENT PRICING AND REGULATORY TRIBUNAL (IPART)
ISSUES PAPER: REVIEW OF RATE PEG METHODOLOGY

Submission by Lake Macquarie City Council

Introduction

Lake Macquarie City Council (Council) welcomes the opportunity to provide feedback on the IPART's Draft Report on the Review of Rate Peg Methodology.

Council believes the review is timely and justified. The inflationary impacts of the current extraordinary economic environment have highlighted the deficiencies in the current rate peg methodology. The discrepancy between the rate peg and actual cost pressures will lead to financial distress for many councils and an inability to meet the commitments made in the delivery and operational plans they have presented to their communities.

Council believes the rate peg system is by nature problematic and argues that councils with a demonstrated track record of good financial management, planning and reporting should have the capacity to set rates in accordance with the revenue and expenditure choices of their communities – consistent with the principle of 'earned autonomy' articulated in IPART's 2009 Revenue Framework for Local Government report.

Staff have prepared the following responses to the questions posed in the discussion paper. In addition, Council considered a Councillor-led motion at its Ordinary Meeting on Monday 31 October 2022 and resolved to make a submission to IPART on the Review of the Rate Peg Methodology. A copy of the Business Without Notice motion is attached to this submission for reference.

Submission

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

As a methodology, the Local Government Cost Index (LGCI) is a reasonable measure of costs and inflation. The data is publicly available, consistent and reflective of the main cost categories within councils.

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However, the problem, as the Issues Paper notes, is the two-year lag between the availability of Australian Bureau of Statistics (ABS) data and its application in rate-setting. The rate peg for December 2021 highlights how inconsistent two-year-old data can be with inflationary pressures at the time the peg is applied. The LGCI for December 2021 determined growth at 0.7 per cent, as it was drawing from data during the COVID-19 pandemic when the Consumer Price Index (CPI) remained low. At the time of the release, however, the CPI was 3.5 per cent due to supply issues following COVID-19 supply chain impacts, and fuel costs had increased by about 20 per cent over the previous 12 months.

Market volatility and fluctuating costs provide problems for a cost index. There is the expectation that an index will even out over time, but this is not the case with rates. If the peg is set below the CPI in a given year, a council loses that income forever from its rate base.

Council believes there are a number of potential solutions that could minimise the impact of the two-year lag. IPART could consider using a mixture of lag and leader indicators. The current calculations are based on lagging price indicators, so the use of leading indicators, such as Treasury or federal or state budget predictions, could potentially provide alternative information that is more current and relevant.

The October federal budget had CPI projections to June 2026 (see Figure 1); we suggest the same or similar data sources could be used for the purpose of setting the rate peg.

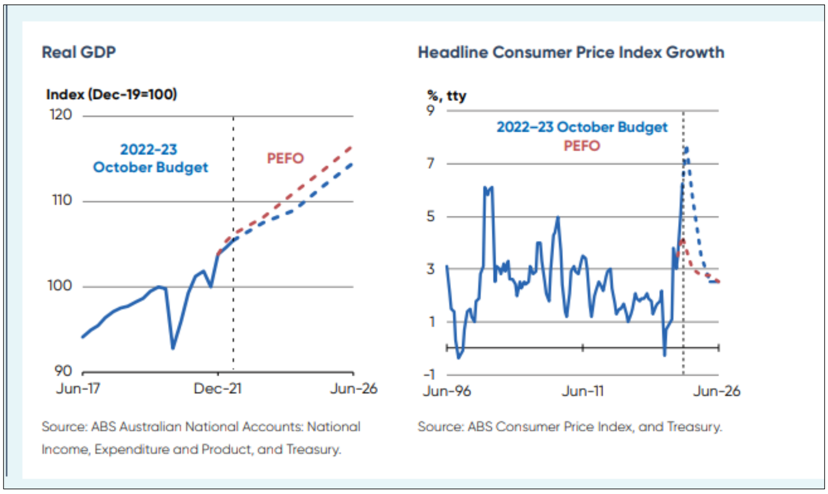

Figure 1: SOURCE: [Budget October 2022-23 - Building a better future]

Another potential solution could be the weighting of various information sources and trends. The weighting of historical and forecast data could be calculated so that the most recent actuals and predictions are weighted more heavily than older information.

The LGCI index collects data on councils' expenditure every four to five years and uses this data to update the weighting of the cost components. Capturing this data over a shorter time frame could provide a more accurate overview of expenditure.

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

Key costs for councils, such as fuel, wages and building materials, are tracked quarterly in CPI figures. Using this index to set the rate peg could help to eliminate the two-year lag that results from reliance on ABS data.

Another data source could potentially be tied to the current reporting framework for councils. The Financial Data Return that is prepared and lodged with the Office of Local Government annually could be an alternative method of tracking costs – the major cost categories within councils can be separated out and metrics provided on changes in cost base, such as the cost per litre of fuel.

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

As noted above, comparative cost base data collected from current reporting, such as the Financial Data Return, financial statements or annual reports, could be used to measure changes in council costs.

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?

Council supports the continued inclusion of a population growth factor but has concerns about the way it is currently applied and the extent to which it is reflective of the actual growth of councils and demands made on rates income. In the 2022-2023 financial year, Lake Macquarie Council received 0 per cent increase for the population factor, which does not reflect the rate at which our city is growing. Lake Macquarie's population increased from 197,371 in the 2016 Census to 213,967 in the 2021 Census (8.4 per cent growth). Council receives supplementary valuations during the financial year, however these are insufficient to cover the increased demands on our city. Council's experience is that the current application of the population factor is based on incorrect assumptions, and therefore not fulfilling its intended purpose.

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

Financial sustainability and community expectations are driving improvements in productivity and efficiencies in councils. This is a necessity as rate pegging does not cover the increasing costs of providing services. While improvements in productivity and efficiencies are positive, these can only compensate to a small degree for deficiencies in funding due to rate pegging that does not account for population and cost increases.

We do not agree with the inclusion of a productivity measure, as this methodology is based on the assumption that all councils are coming from a position of inefficiency and low productivity, which has not been validated.

The productivity measure is also based on a false assumption that councils can operate impervious to the expectations of the communities they serve. Communities across the state demand ever-increasing quality of service, new services, and facilities that are fit for evolving purposes. Communities are also very sensitive to cost pressures and are able to directly influence council decisions on fees and charges as well as rates. In the main, communities are willing and able to hold councils to account without the very blunt, inaccurate and potentially counter-productive measures used by IPART.

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

Local government elections result in an increase in costs leading up to and following an election, including induction costs for councillors, training and purchase of equipment. Council factors an estimated $1.5 million into financial planning for election-related costs over a four-year cycle, in addition to the increased demand on employee resources. These costs are increasing. An email from the Electoral Commission in October 2022 flagged that the predicted costs for the 2024 elections will be “far exceeding CPI or inflation”.

Inflationary pressures can pose a considerable financial burden on councils if not accurately reflected in the rate peg. For instance, the current increase in building costs has resulted in price creep of between 5 and 26 per cent on capital works projects Council is currently undertaking, or about to go to market on, over the past 12 months.

Other external factors that rate peg does not consider are:

1. expected impacts with the reinstating of the ceiling and floor principle for the Financial Assistance Grant

This grant is a vital source of operating income for councils to use for the ongoing maintenance of high-cost infrastructure such as roads and bridges, as well as for additional operating costs associated with being in regional areas. The changes to this grant from 2022-2023 financial year onwards will result in many councils, including Lake Macquarie City Council, receiving less funding from this grant source.

2. increasing superannuation guarantees for staff and newly introduced superannuation guarantees for councillors
3. changes in legislation that require additional resources to manage

Examples of these changes are the new changes to the Privacy and Personal Information Protection Act 1998 and mandatory notification of data breaches. Also, the new Risk Management and Internal Audit Framework for Local Government.

4. the introduction of the NSW Planning Portal

This requires significant ongoing management, which requires additional resources.

These external factors are in the most part financially detrimental to the Council and further restrict Council’s ability to deliver cost-effective and efficient services.

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

It is Council's view that the rate peg has prevented increases required to maintain basic levels of service to the community. It has also prevented increases that maintain financial sustainability. This is demonstrated in Figure 2, which illustrates the disparity between CPI increases and the rate peg since early 2021.

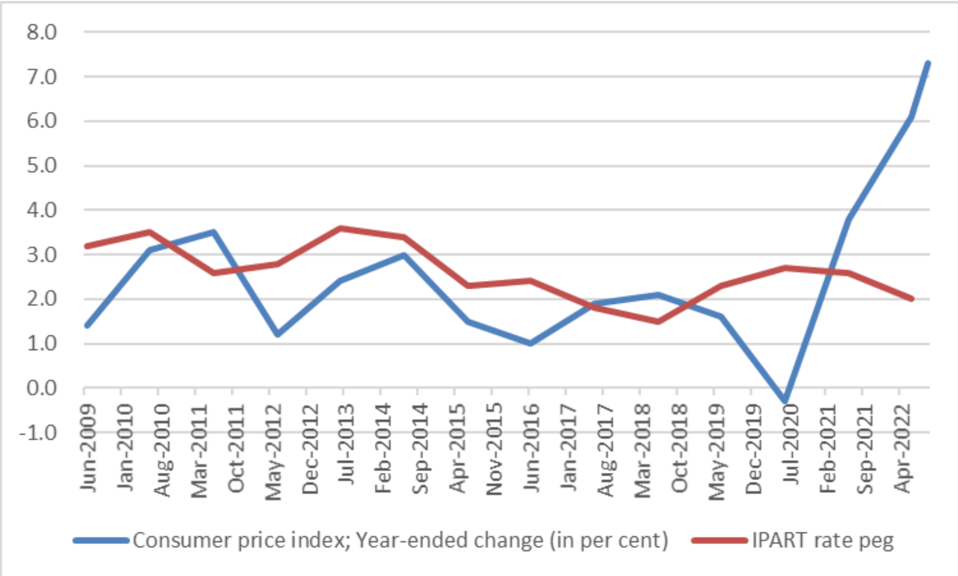

Figure 2: SOURCE: CPI :https://www.abs.gov.au/
Rate peg:https://www.ipart.nsw.gov.au/Home/Industries/Local-Government/For-Ratepayers/The-rate-peg

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

Council does not believe the rate peg allows for councils to generate sufficient income from rates to deliver services to a satisfactory level. At present, the gap between income and expenditure is widening to the extent that many councils, including ours, are running operating losses and general fund deficits in order to deliver the services their communities need and expect.

As noted in previous responses, these pressures are exacerbated by other factors that are either reducing income or increasing expenditure or resource requirements, including:

- expected negative impacts with the reinstating of the ceiling and floor principle for Financial Assistance Grant
- increased workload associated with the introduction of the NSW Planning Portal
- changes to Privacy and Personal Information Protection Act 1998 and mandatory notification of data breaches
- the new Risk Management and Internal Audit Framework for Local Government.

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

The rate peg continues to adversely affect the financial performance and sustainability of councils.

The percentage of total revenue that is derived from rates at Lake Macquarie City Council in financial year (FY) 2022 equates to 44 per cent. IPART has pegged rates at 2.5 per cent for FY2023, despite the current level of inflation of 7.3 per cent. This equates to a 4.8 per cent discrepancy and is set to have a significant impact on the ability of our council, and all councils across NSW, to deliver the planned services and infrastructure in existing one-year operational, four-year delivery programs and 10-year financial plans.

IPART has pegged rates at 3.7 per cent for FY2024. The Reserve Bank of Australia is predicting inflation to be 5.75 per cent by late next year. Again, this equates to a potential discrepancy of 2.05 per cent which will have a significant impact on Council's ability to meet our intended service delivery, infrastructure and maintenance program in our existing plans.

If left unaddressed, the financial modelling prepared by Council suggests total financial cumulative impacts across the next two financial years (outlined in the table below) could be $20 million on our operational plans, $63 million on our four-year delivery program and $159 million on our Long-Term Financial Plan. (The impacts are compounding, so each year's impact carries forward to future years.)

Financial Year	Difference in Inflation and Rate Peg	Year 1 Operational Plan financial impact (non-compounded)	Year 4 Delivery Program financial impact (non-compounded)	Year 10 Long Term Financial Plan impact (non-compounded)
FY 2023	(7.3% - 2.5%) = 4.8%	$7m	$30m	$81m
FY 2024	(5.75% - 3.7%) = 2.05%	$6m	$25m	$68m

Figure 3: SOURCE: Lake Macquarie City Council

Financial sustainability and the impact of rate pegging on revenue is an issue affecting many councils, including many other councils of similar size and scale to Lake Macquarie City Council. Analysis of the financial results of 11 Group 5 councils, including the 2021 financial year, shows:

- only two have had operating surpluses in all of the past six years
- in 2021, one council has a surplus above 10 per cent of rates
- in 2021, seven councils have a surplus between 0 and 4 per cent
- in 2021, three councils have an operating deficit between 6 and 17 per cent.

	Consolidated								
	Operating result								
	(before capital income and before IPP&E revaluations thru the P&L)								
Merger	**Council**	**20/21**	**19/20**	**18/19**	**17/18**	**16/17**	**15/16**	TY Surplus	Surplus Count
	Shellharbour City Council	30%	30%	46%	37%	35%	24%	1	6
	Tweed Shire Council	2%	5%	14%	15%	10%	8%	1	6
	Maitland City Council	4%	6%	-8%	5%	0%	-6%	1	4
	Newcastle City Council	-17%	-2%	1%	1%	2%	4%	0	4
	Port Macquarie-Hastings Council	4%	-4%	4%	3%	18%	14%	1	5
	Port Stephens Council	4%	-7%	18%	10%	17%	16%	1	5
	Shoalhaven City Council	-6%	-13%	5%	13%	4%	9%	0	4
	Wollongong City Council	0%	-6%	-4%	4%	15%	1%	1	4
	Lake Macquarie City Council	1%	-7%	-6%	7%	6%	11%	1	4
	Coffs Harbour City Council	1%	-15%	6%	1%	3%	-4%	1	4
Merger	MidCoast Council	-13%	-7%	5%	554%			0	2

Figure 4: SOURCE: LG Solutions “Debits & Credits” – April 2022 edition

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

There are many factors that differentiate councils, including metropolitan and regional categorisations, which take land mass and population into account, and whether or not councils manage water and sewer.

Other factors that differentiate councils, and can have a significant impact on costs, include vulnerability to natural disasters, kilometres of road per capita, topography, and the presence of waterways (lakes, beaches etc) that require management, infrastructure and staff resources.

Presently, the LGCI uses Sydney CPI data but a better reflection of the differentiation between metropolitan and regional and rural councils could perhaps be achieved by using separate data sources for each, relevant to either metropolitan councils or those in other areas of the state.

IPART could also consider a range for the rate peg, rather than a single rate for all, to better allow for differences between councils.

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

Well-selected, alternative cost indexes would allow better alignment with the actual cost of services. Individual councils have very different expenditure profiles. For instance, councils in newer growth areas will have a greater requirement to build new infrastructure, whereas councils in established areas with lower population growth will have a greater focus on infrastructure upgrades and maintenance.

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

It is Council's view that it is not volatility that is problematic but the disconnect between the rate peg and rising cost impacts on councils.

As previously referenced, IPART has pegged rates at 2.5 per cent for FY2023, despite the current level of inflation of 7.3 per cent. This equates to a 4.8 per cent discrepancy. IPART has pegged rates at 3.7 per cent for FY2024 whereas the Reserve Bank of Australia (RBA) is predicting inflation to be 5.75 per cent this time next year.

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

Better alignment with changes in cost is preferable to longer term certainty because of the problems created by having a rate peg that does not reflect the economic environment and real cost pressures on councils, as outlined in the previous responses to this submission. While there is some benefit to future planning in having more certainty about projected rates income, that benefit is outweighed by the risk of adverse impact if the rate peg is set too low.

The further ahead the projections are made, the more inaccurate they become as the financial environment changes, and at present there is not an opportunity for that forecast to be adjusted in response to changes in costs. However, if the risk of the rate peg getting out of step with the cost environment can be addressed, it is Lake Macquarie's experience that long-term revenue certainty is conducive to good financial planning and increased community confidence. This was exemplified during a period when Council had an approved seven-year Special Rate Variation. That seven-year period was characterised by certainty and confident financial planning.

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

As noted in the previous response, while more certainty can assist with future planning, the further ahead that projections are made, the less reliable they become.

IPART could consider setting a longer-term rate with the ability to make adjustment if economic conditions change dramatically from the forecast. However, that capacity should only apply to adjusting the rate peg up as a reduction would compromise the ability of councils to meet obligations to the community, forcing them to either revise operational plans or run deficits. One option worth considering may be to establish an adjustable projection on a rolling four-year basis. Four years coincides with the length of a council term and sits comfortably with the four-year period of the delivery program required under the Integrated Planning and Reporting Framework.

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

The September timing of the rate peg is not necessarily a problem, however the introduction of a review period closer to the start of the financial year (post the December quarter CPI announcement) would be beneficial if the rate could be subsequently adjusted to better reflect the economic environment.

Having the review period extend beyond December would make it difficult for councils to adjust draft operational plans, budgets and long term financial plans, with most commencing preparations of Integrated Planning and Reporting documents towards the end of the previous calendar year.

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

This approach assumes that all councils have inherently addressable labour inefficiencies. How does IPART know this is the case?

There are significant challenges across local government in the current labour market in staff retention and talent attraction, with councils finding it difficult to compete with renumeration and conditions offered by the private sector and state and federal government agencies.

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

As noted in previous responses in this submission, external factors can affect cost pressures on a council significantly. These external factors include:

- high population growth
- natural disasters
- kilometres of road per capita
- topography
- waterways (lakes, beaches etc)
- remoteness
- technology infrastructure
- Local Government Award provisions.

These impacts are exacerbated by other factors that can adversely affect income, expenditure and resources such as:

- expected negative impacts with the reinstating of the ceiling and floor principle for Financial Assistance Grant
- increased workload generated by the introduction of the NSW Planning Portal
- changes to Privacy and Personal Information Protection Act 1998 and mandatory notification of data breaches
- the demands of the new Risk Management and Internal Audit Framework for Local Government
- Cost-shifting by state and federal governments.

Additionally, the current Special Rate Variation (SRV) process is a costly and resource-heavy process that can affect a council's financial position and service delivery. The cost of applying for a SRV is a disincentive to many councils pursuing them, ironically resulting in those that arguably need them most often deciding against investing the time, money and resources required for the exercise.

While grant funding can provide an initial financial boost to a council, the projects supported by them generate additional and ongoing costs that must be met by councils, including:

- co-contribution costs in some cases, often requiring loans
- lifetime maintenance costs of funded assets
- depreciation
- other operating costs such as insurance
- requirements of grant funding programs that projects must be new (ie: not already accounted for in operational plans or delivery programs), resulting in additional costs for councils if a co-contribution or other top-up costs are required.

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

Council believes consideration of council-specific external costs should be considered in setting the rate peg. This could potentially be achieved through the following:

- a rate peg range rather than a single rate for all
- different inflators for metropolitan versus regional and rural councils
- weightings of the LGCI done at individual council level
- councils having capacity to set their own rates increase, with only those significantly outside the average having to justify their position (similar to what was proposed in the review of domestic waste charges).

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

Consistent with earlier responses in this submission, Council believes the following costs outside of councils' controls should be considered in setting the rate peg:

- cost shifting from other levels of government – such as pensioner discounts, RFS assets, childcare
- costs arising from changes to legislation such as the Privacy and Personal Information Protection Act 1998 and mandatory notification of data breaches
- costs arising from the new Risk Management and Internal Audit Framework for Local Government
- costs arising from the introduction of the NSW Planning Portal
- increasing superannuation guarantees and the Local Government Award
- the Emergency Services Levy.

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?

Some suggestions for consideration include:

- introducing a review period closer to start of financial year (post December CPI) with capacity for the rate peg to be automatically adjusted if required.
- Using a mixture of lag and leader indicators (The current calculations are based on lagging price indicators only, so the potential use of leading indicators, such as

Treasury or federal or state budget predictions, could potentially provide alternative information that is more timely and relevant.)

- weighting of historical and forecast data so that the most recent actuals and predictions are weighted more heavily than less current information and data
- a rate peg range rather than a single rate for all
- different inflators for metropolitan versus regional and rural areas
- weightings of the LGCI done at individual Council level
- councils having ability to set their own rates increase, with only those significantly outside the average having to justify their position.

Contact

Thank you for the opportunity to comment on the IPART Review of Rate Peg Methodology Issues Paper. For further engagement on the matters discussed in this submission, please contact:

Bjorn Lategan
Chief Financial Officer
[redacted]

Yours sincerely

[redacted]

Morven Cameron
Chief Executive Officer

Attachments

1. Councillor motion – Ordinary Meeting 31 October 2022
2. Council resolution – Ordinary Meeting 31 October 2022

Business Without Notice – Monday 31 October 2022

Deputy Mayor – Cr Adam Shultz

Title:

Participate in review of rate peg methodology submission process and acknowledge the immediate significant inflationary financial impacts identified

Background:

At the Local Government NSW conference held in the Hunter Valley between 23 and 25 October 2022, both the NSW Minister and Shadow Minister for Local Government urged all 128 councils across the state to provide a submission to the consultation process that the Independent Pricing and Regulatory Tribunal (IPART) is currently undertaking in reviewing the rate pegging methodology. Any changes to the rate pegging approach arising from the review will not apply until at least Financial Year (FY) 2025.

This matter is urgent due to:

- the rapidly changing and unprecedented economic environment in which costs are rising across all areas of the economy, many directly affecting council services
- the imminent deadline for submissions to the IPART review, which is 4 November 2022.

The percentage of total revenue that is derived from rates at Lake Macquarie City Council (LMCC) in FY2022 equates to 44 per cent.

IPART has pegged rates at 2.5 per cent for FY2023, despite the current level of inflation of 7.3 per cent. This equates to a 4.8 per cent discrepancy and is set to have a significant impact on the ability of LMCC, and all councils across NSW, to deliver the planned services and infrastructure in existing one-year operational, four-year delivery programs and 10-year financial plans.

IPART has also pegged rates at 3.7 per cent for FY2024. The Reserve Bank of Australia (RBA) is predicting inflation to be 5.75 per cent this time next year. Again, this equates to a potential discrepancy of 2.05 per cent which will have a significant impact on LMCC's ability to meet our intended service delivery, infrastructure and maintenance program in our existing plans.

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If left unaddressed, the financial modelling prepared by LMCC's Chief Financial Officer (CFO) and finance team provide total financial cumulative impacts across the next two financial years could be $20 million on our operational plans, $63 million on our four-year delivery program and $159 million on our Long-Term Financial Plan. (The impacts are compounding, so each year's impact carries forward to future years.)

The inflationary financial impacts as outlined will lead to financial distress for many councils and an inability to deliver on the plans they have presented to their communities.

IPART, the NSW Government and councils across NSW (including LMCC) need to collaborate so that councils do not have to seek surprise Special Rate Variations (SRVs), which will have a significant impact on their communities in the future.

Recommendation

Council:

A. makes a submission to IPART on the review of rate peg methodology

B. requests as part of the IPART submission that a population growth factor continue to be included for communities that experience significant population growth and the need to deliver additional services and infrastructure

C. writes to the NSW Minister and Shadow Minister for Local Government and IPART to highlight the financial impact that inflation and other cost increases are currently having and are forecast to have on our one-year Operational Plan, four-year Delivery Program and 10-year Long-Term Financial Plan, and request an immediate collaborative approach be taken to resolve the significant financial issues identified given the unprecedented economic environment and rising costs across the economy.

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Moved. Cr. Shultz
Seconded. Cr. Jones

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For the Motion	Against the Motion
Cr. Adamthwaite	
Cr. Antcliff	
Cr. Conroy	
Cr. Grigg	
Cr. Belcher	
Cr. Pauling	
Cr. Bishop	
Cr. Shultz	
Cr. Jones	
Cr. Buckley	
Cr. Warner	
Cr. Fraser	
(carried)	

(Carried)

As this concluded the business the

Chairperson terminated the meeting at 7.51pm.

Minutes adopted by resolution of Council,

at its meeting held on 28 November 2022.