Lane Cove Council
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Review of the Rate Peg Methodology – Issues Paper
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop,
Sydney NSW 1240

Dear Tribunal,

Re: Submission: Review of the Rate Peg Methodology – Issues Paper

Lane Cove Council welcomes the opportunity to provide comment on the review of the current rate peg methodology.

The 2021 IPART determination of a 0.7% rate increase for 2022/23 highlights the current rate pegging methodology has its shortcomings and is non-representative of the real costs Councils face in servicing the needs of their communities today. Similarly, it is Council's view that the high number of SRV applications over the past decade reflects the fact the rate peg is insufficient in providing the range of services, service levels, activities, functions, programs and projects the community has come to expect.

With respect to the specific questions IPART pose in the Issues Paper, the following responses are provided.

Q1. To what extent does the Local Government Cost Index reflect changes in councils' costs and inflation?

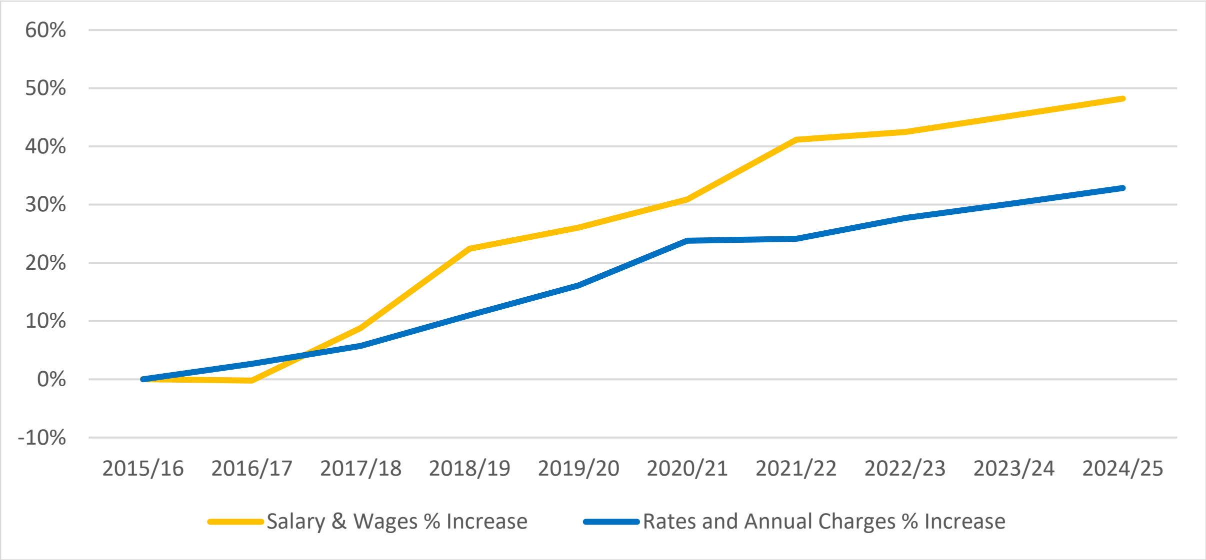
Q2. What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?

The LGCI would benefit from more items that represent a typical 'basket of goods and services' purchased by NSW Councils. For example, it is unclear to what extent recurrent 'operating and maintenance costs' (excluding the salaries and wages component) are adequately represented in the LGCI. Operating and maintenance costs represent as much as 40% of a Council's total operating budget and it is here where Councils feel the volatility of inflationary pressures the most in their budgets.

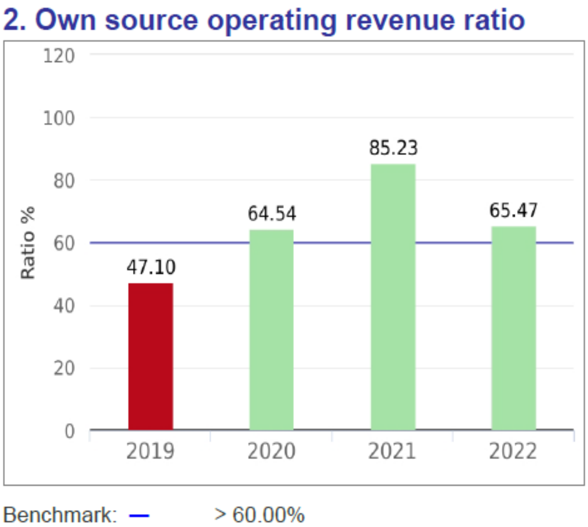
As evidenced by the current economic climate, there is a significant timing gap between the inflationary impact of a good/service (ie the cost) and the necessary income increase to cover that cost (ie the rate increase). There needs to be some forward-facing factor applied that progressively recognises these cost challenges as they occur rather than the rearward facing approach currently adopted in IPART's methodology.

Similarly, the amount of compliance Councils are required to do is ever increasing. It is unclear how these costs are captured and accounted for (if at all) in the 'basket of goods/services' or the rate peg methodology.

The following graph demonstrates that unless Councils are unable to diversify their revenue streams, rate capping is unable to allow a Council even to match, in percentage terms, the cumulative growth in Salaries and Wages to meet the needs of the community.



To respond to this issue, Councils that have diversified their revenue such as Lane Cove in response, are considered to be outside tolerance if they have less than 60% own source revenue (from Rates) which means the user-pays approach has its limitations as an alternative revenue stream.



An option IPART may want to consider is the development of a rate peg 'range' which would act as a reference point for Councils to commence a conversation with their community about services and service levels that might be possible within the realms of the 'range' as opposed to those services and service levels that might require the exploration of a special rate variation. IPART may wish to consider developing criteria to accompany the rate peg 'range' so it is clear to Councils what is expected of them in consulting with their community before a further increase, via a special rate variation application, is contemplated.

Alternatively, the proposition outlined by the NSW Revenue Professionals in their submission to IPART has significant merit. The proposition calls for the use of a rolling 3-year average of the historical Local Government Cost Index weighted at 50% with a forward-looking forecast projecting inflation weighted at 50%. The estimation uncertainty of the forward forecast would then correct itself by being factored into the next year rolling 3-year average.

Q3. What alternate data sources could be used to measure the changes in council costs?

There is a wide range of actual and accurate data that exists, including data captured in audited annual financial statements, annual financial data returns etc as well as data that relates to wages and salaries via negotiated Local Government (State) Award annual increases that is established every 3 years.

Q4. 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 ABS population data used to inform the population factor has proven to be problematic. The primary concern relates to the 'lag' in the information used to determine the population factor. For example, the 2022/23 population factor uses information relating to 2020/21 during the height of the covid pandemic where it was well known migration rates (intrastate, interstate and international) were severely stifled. Population growth is not simply a function of residential growth. Many metropolitan council's experience costs associated with population in other ways, including the cost of transitory workers, students and visitors who consume local services and assets without paying local rates. This adds an unrecognised local expense to councils who are needing to fund an expansion of services and assets to accommodate demand well beyond the confines of its local rate paying residents.

The goal of seeking to maintain the average rate income per head of population is difficult to calculate on a year-year basis. The current formula in its two years of operation has not seen any increase provided to Lane Cove Council despite more than 900 rateable properties being levied post construction and subsequently requiring servicing by Council. A better version of calculating 'population' increase, would be to use the nett number of rateable properties by which a Council area increases by in the previous 12 months multiplied by the average persons per dwelling derived in the most recent census information. For example, 900 additional rateable properties are added multiplied by 2.41, the current average household size, equals the 'population' increase. It is true there can be population decline in the short term by externalities such as negative migration which is considered in IPART's current formula, however longer term, increases in dwelling numbers are the best measure of population trends.

Council maintains that its rates for 2023/24 ought to have increased by an additional 1.1% (from 3.7% to 4.8%) based on its population growth (and after deducting the income derived from supplementary rates).

Q5. How can the rate peg methodology best reflect improvements in productivity and the efficient delivery of services by councils?

Ongoing service and service level reviews are annual discussions that occur as part of Council's integrated planning and reporting responsibilities. Generally speaking, they are also discussed in the context of limited recurrent funding (income), the primary source of which is rates. The purpose of rate pegging was to allow Councils to continue to provide the same services and service levels.

Rate increases have simply not kept pace with the increasing costs associated with providing services at adequate service levels. Penalising councils for productivity gains and other efficiencies is a disincentive for innovation and should be removed from the rate peg methodology.

Q6. What other external factors should the rate peg methodology make adjustments for? How should this be done?

The following external costs should have adjustments related to them in the rate peg methodology:

- additional costs associated with legislated requirements relating to planning, compliance and other related legislative changes;
- additional expenditure related to cost shifting; and
- the cost of public health events such as the COVID-19 pandemic.

Refer to the response in Question 8 for other examples of external factors that impact the local government sector.

Q7. Has the rate peg protected ratepayers from unnecessary rate increases?

Council would never support ‘unnecessary’ rate increases. It would, however, support rate increases commensurate with the real cost of maintaining services and service levels. The dramatic increase in approved special rate variations since 2010 supports the fact the rate peg has long been inadequate in meeting the cost of services and service levels the community has come to expect.

Decisions to keep rates low and not pursue a special rate variation will invariably lead to a diminution of services and/or services levels, to the detriment of the community.

Q8. Has the rate peg provided councils with sufficient income to deliver services to their communities?

The rate peg has not provided council with sufficient income to deliver services to communities that they have come to expect in recent years. Community expectations have grown exponentially over the past 10 years and Councils are now responsible for more services than ever before, all of which have come at significant costs to Councils. Examples include:

- responses to climate change;
- climate resilience planning and ongoing management;
- investments in renewable energy;
- cyber security investment and ongoing management;
- the ever-increasing demand for on-line services and interactive community engagement;
- necessary investments in mobile and digital technology (particularly in the contactless post-Covid environment we now operate in);
- compliance matters, including the formation and ongoing support of internal audit, risk and improvement committees and the increase in general reporting requirements; and
- the monopolisation of elections by the NSWEC.

Council maintains that ‘upward adjustments’ are justified to reflect the incremental costs associated with these examples. This is particularly so, given Special Rate Variations are generally reserved for specific capital projects or asset renewal related works, not to fund income shortfalls in providing recurrent services to the community.

It is noted that in the Issue Paper that Council’s operating income per capita grew by 43% between 2020/11 and 2020/21. Council maintains this figure is inflated by the fact that many Council’s secured special rate variations during this period, the vast majority of which were for asset renewal purposes because of rising infrastructure backlogs. The reality is Councils only pursue special rate variations because the rate peg is insufficient in addressing the typical recurrent asset renewal needs of its community.

Q9. How has the rate peg impacted the financial performance and sustainability of councils?

Yes, but it would vary Council to Council. There is evidence to suggest that many Council’s that would have been negatively impacted by rate pegs of the past subsequently sought a special rate variation to compensate for the shortfall in income. Moderate and affordable rate peg increases over a sustained period of time surely must be preferable to sharp increases in rates via a special rate variation.

Q10. In what ways could the rate peg methodology better reflect how councils differ from each other?

One option might be to develop multiple pegs based on geographical location (metropolitan, regional, rural). This would, in some way, reflect the fact that there are fundamental differences (in both services and costs) between Councils across NSW.

Q11. What are the benefits of introducing different cost indexes for different council types?

The Local Government Cost Index is likely to be more reflective of each Council’s cost of providing services to their communities, as opposed to one peg that asserts to reflect the costs of all Councils across NSW.

Q12. Is volatility in the rate peg a problem? How could it be stabilised?

Yes, as evidenced by the original IPART rate determination of 0.7% for 2022/23. The Local Government Cost Index needs to incorporate forward-facing factors and possibly use rolling averages to ‘true up’ rates in a progressive manner.

Q13. Would councils prefer more certainty about the future rate peg, or better alignment with changes in costs?

Certainty about future rate pegs would be beneficial but not essential. However, as evidenced recently, the volatility of cost increases in a high inflationary environment is not necessarily conducive with long term rate peg setting.

Better alignment with changes in costs is essential. As previously mentioned, a much wider representation of services and their respective costs needs to be considered in the ‘basket of goods’ with a more forward-facing approach to cost estimation.

Q14. Are there benefits in setting a longer term rate peg, say over multiple years?

Yes, in theory, there would be benefits is setting rate pegs over multiple years as it would give Council’s a longer term horizon upon which it could plan. However, Council feels the immediate priority ought to be developing a more robust and rigorous rate peg that reflects the actual costs of delivering services to the community and one that can withstand the volatilities of high inflationary environments.

Q15. Should the rate peg be released later in the year if this reduced the lag?

Yes, any improvement in reducing the lag would be welcomed. There will need to be a cut-off date, however, so that Councils can fulfill their integrated planning and reporting obligations in a timely manner. Consideration should also be given to the point Council has already raised in relation to setting forward-facing indices, not just historical data.

Q16. How should we account for the change in efficient labour costs?

Council maintains that the most reliable source of labour costs is the State (Local Government) Award and superannuation guarantee levies as mandated by the Federal Government. Productivity savings in labour are counterintuitive. Generally, productivity savings in labour are coupled with technological investments to either partially replace or supplement labour.

Put differently, dividends from efficient labour costs are generally reinvested in automation technologies that drive further labour efficiencies and/or improve productivity. Discounting labour efficiencies from the labour calculation provides a disincentive to continue this progressive path.

Q17. Should external costs be reflected in the rate peg methodology and if so, how?

Yes, all costs should be included in the rate peg methodology. As previously stated, the ‘basket of goods/services’ is non-representative of all Council costs.

Q18. Are council-specific adjustments for external costs needed, and if so, how could this be achieved?

Yes, they are required. Council’s response to Question 8 in part addresses this issue. Additionally, cost shifting from other tiers of government has had a profound impact on Council’s expenditure budget. Examples include pensioner rebate subsidies, the emergency service levy, the ever increasing waste levy and ever declining subsidisation the State Government provides towards local library services. These either need to be recognised in the ‘basket of goods and services” or the rate peg methodology as proportionate fixed amounts added to the rate peg.

Q19. What types of costs which are outside councils’ control should be included in the rate peg methodology?

As outlined in the response to Question 18, Council believes costs that apply to all councils ought to be included in the rate peg, otherwise thy ought to be identified as unique fixed costs that can be proportionately recovered through some other means such as an annual charge.

Q20. How can we simplify the rate peg calculation and ensure it reflects, as far as possible, inflation and changes in costs of providing services?

As previously mentioned, the Local Government Cost Index needs to be more forward-facing. Reduce the lag between historical data used and apply appropriate forward-facing indices that best reflect the current and emerging economic environments.

Council thanks IPART for the opportunity to provide input into this important matter. Should you have any questions arising from this submission, please feel free to contact [redacted].

Yours Sincerely,

[redacted]

Craig Wrightson
General Manager