Murrumbidgee
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Submission: IPART Review of rate peg methodology

We firstly draw your attention to the report entitled *Rate capping in New South Wales Local Government: Addressing the Questions Raised in the IPART (2022) Review of Rate Peg Methodology: Issues Paper and Further Recommendations for Improvement* prepared by Emeritus Professor Brian Dollery, an expert on the finance, performance and structure of Australian local government, and particularly to the the first recommendation for "the NSW Government to simply abolish rate pegging and grant local councils the freedom to strike their own rates and be held accountable by their own local residents." We strongly support this recommendation.

The paper sets out robust arguments for the removal of the rate peg (consistent with the overwhelming majority of other Australian jurisdictions), which we will direct the reader to rather than replicate here.

Questions

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

We agree with the current use of a local government-specific cost index rather than a broad economic index to better reflect the composition of councils' costs.

We have concerns regarding the 'one size fits all' approach and support IPART's stated intention to investigate the degree of variability in cost profiles across different councils and council types in NSW.

The Issues Paper notes that there is a two-year lag in the LGCI. However, we believe the lag has been further exacerbated by the fact that the LGCI is calculated on an annual average basis by comparing the average level of the index for the latest four quarters with the average of the index for the preceding 4 quarters.

For example, consider the *ABS 3101 Road and bridge construction New South Wales* index produced by the Australian Bureau of Statistics, which comprises 27% of the weight of the index as at 30 June 2021[1]: the index released by the ABS shows quarter-on-quarter inflation between June 2021 and June 2022 to be 7.7%[2] however the 'annual average' rate of only 5.2% is used in the LGCI calculation.

In practice, this means that significant movement in the indices takes even longer to be reflected in the rate peg.

Particularly in light of the already-acknowledged 2-year lag, we believe it would be appropriate to reflect the full amount of the year-on-year increase in the LGCI calculation and assume that input price levels at the end of one year will be maintained, if not increased, by the time the rate peg is applied. (To take the most recent year as an example, we believe it would be reasonable to assume that road costs will remain 7.7% higher than June 2021 levels over the course of the 2024 financial year.)

Should the methodology change, we also believe it would be appropriate to consider a one-time 'reset' of the rate peg to ensure that any cost increases that have been incurred to the date of change (but not yet reflected in the rate peg) have been considered.

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

Acknowledging the challenges associated with using historical data, Murrumbidgee Council would support a forward-looking estimate of costs and inflation.

If the rate peg cannot be abolished, one possible approach for consideration might be:
1. Having regard to forecast costs and inflation, a minimum rate peg(s) for the next four years is set in line with the Council term. This could be used by Councils and relied upon for certainty in planning and developing resourcing plans to support the CSP, Delivery Program, and Operational Plan.
2. Each year, the rate peg (and forecast for coming years) is confirmed and, if necessary, adjusted *upwards* to reflect any changes to the forecast and/or 'catch-up' any unanticipated cost increases such as those seen in recent years. The rate peg should not be adjusted below the minimum rate peg set at (1), because this would undermine Councils' resourcing strategies and introduce an unacceptable level of volatility.

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

In general, we believe the data sources used in the calculation of the LGCI are reputable and reasonable. However, we would advocate for the use of the NSW Local Government (State) Award as an alternative to the NSW public sector wage price index, as set out at #16.

We would also like to see a review of the Sydney-specific indices used. We know, for example, that electricity prices in Sydney are not equivalent to those in our regional areas.

If appropriate forward-looking data can be sourced, then we would support that as an alternative to the historical data.

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[1] Table A.1, IPART *Review of rate peg methodology Issues Paper*.
[2] Indexes were 120.9 for June 2021 and 130.2 for June 2022. i.e. (130.2 – 120.9)/120.9 = 0.077

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?

Murrumbidgee Council has had a population factor of 0.0% for each of the two years since its introduction. There are concerns in the community regarding the integrity of the data collection process undertaken at the last census, and hence the population data used in the rate peg calculations.

The issues paper also identifies that a 3-year lag is an issue, and we agree.

One observation is that the historically-driven methodology does not provide for community facilities and services to be funded that may accommodate any expected or desired population growth into the future.

It also does not consider any additional services or facilities that may be required to support a stable population whose demographics are changing: for example, many communities across NSW have ageing populations that may require additional services or support from councils.

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

The issue paper suggests that "it is also important to ratepayers that councils have incentives to improve their productivity and efficiency in delivering these goods and services". We agree, and continuously strive for productivity and efficiency improvements: we have no option but to do so given the severe resourcing constraints faced by our small rural council; the rate peg does not cover existing cost increases.

We would also urge IPART to be cautious not to misidentify under-resourcing and overworked staff as "productivity improvements". Although these may appear from a purely financial perspective to be a more efficient allocation of resources, we must be mindful of the health and wellbeing of our staff and the sustainability of such sacrifices in the long term: one person doing the work of two may act as a temporary contingency measure when faced with a labour shortage but it should certainly not be expected to carry on indefinitely or lauded as an "improvement". Such an arrangement would be detrimental to both Councils and their workers and we would hope that, under such circumstances, Councils would not be subject to a productivity factor adjustment which would further constrain already-limited resources.

We would support the removal of the productivity factor from the rate peg calculation. We note that it has already been set at zero since 2018-19 to recognise that improvements in productivity are already reflected, to an extent, in the ABS price indices.

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

The issues paper states that on average, income from rates represents around one third of NSW councils' combined total income. For Murrumbidgee Council this figure is around 24%. This means that we are heavily reliant on other sources of funding, particularly grants and contributions, to remain sustainable.

Although other funding sources are themselves not part of this review, we believe that changes to the revenue base in its entirety should be considered when determining the rate peg. If revenue, particularly untied revenue, from these other sources declines (noting, for instance, that the value of Financial Assistance Grants provided to local government has declined over the past three decades from around 1% of Commonwealth taxation revenue to around 0.55%) then it follows that Councils will need to replace some of that lost income from other sources – and this may include income from rates.

A Council such as Murrumbidgee Council has limited opportunities to increase revenue from other sources (such as user fees and charges); and special variation applications are both onerous and negatively perceived. Therefore, although these other avenues exist, we believe it would be appropriate to offer councils the flexibility and autonomy within the rate peg to manage these challenges, trusting that we live and work in our local communities and have their best interests in mind.

We also refer to #19 concerning cost shifting from the NSW Government which believe also ought to be considered and adjusted for.

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

We believe that ratepayers have not been subject to unnecessary rate increases. However, we contend that rate pegging is an unnecessary mechanism in curtailing these increases: ratepayers choose their elected representatives and hold their Council accountable for rate increases they deem inappropriate or unnecessary.

We are concerned that the rate peg may eventually also shield ratepayers from *necessary* rate increases and in the long term threaten the financial sustainability of NSW Councils.

The aforementioned report also points out that this perceived "protection" may be short-lived, noting significant rate increases once local councils reached the point of applying for an SRV. We refer to the analysis in that paper for discussion of the intergenerational equity risks, disproportionate impact on disadvantaged community members and other unintended consequences arising from the rate peg.

We note that other states and territories other than Victoria do not regulate rates income and would support investigation into other means of protecting ratepayers from unnecessary rate increases that are less restrictive to Councils.

It is our belief that the alignment between operating expenditure and movements in the rate peg identified at section 3.2 of the issues paper is indeed a result of councils developing their budgets with reference to the rate peg. Applying for special rate variations is seen as onerous and undesirable and it is our belief that, in general, councils would cut expenditure to the bare minimum rather than proceed down that path.

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

No. RAMJO's submission gives a number of examples where expected wage increases alone outpace the increases in the rate peg year-on-year, before even considering other costs. It also refers to pressure on aging infrastructure which may require increased maintenance above that which has been completed in the past (and the associated increase in costs).

As identified in the issues paper, one of the aims is "enabling councils to continue delivering their existing services to households, businesses, and the broader community." We do not believe that the rate peg supports this aim, and would encourage measures that provided councils with greater autonomy and flexibility in managing their rates income.

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

The existence of the rate peg curtails Councils' flexibility and autonomy in raising revenue to maintain services and infrastructure to the standards expected by the community.

The volatility and historically-centred approached, discussed elsewhere in the paper and this response, exacerbate this issue.

We refer to #6 regarding the limitations on other revenue-raising opportunities.

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

We strongly support investigation of the degree of variability in cost profiles across different councils and council types in NSW and consideration of the ways in which the methodology could better reflect differences between councils. The length of the road network has already been identified in the issues paper as a key driver of Council's cost profile, and we believe that this, along with other factors that may determine cost discrepancies between Councils, warrants further investigation.

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

Introducing different cost indexes for different council types may enable the rate peg to be based off a more accurate reflection of the costs incurred by councils, in turn allowing for increased financial sustainability across the sector.

We understand that this may result in some additional complexity in the methodology, however we would accept this trade-off as Council's sustainability is our priority.

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

Volatility in the rate peg is a major problem when it results in the rate peg being set *lower* than expected, as was the case when the 2022-23 rate peg was set at 0.7%. A volatile rate peg is less of an issue when the changes are known in advance and can be planned for, or when there is an unexpected *increase* in the rate peg.

We believe that an approach similar to that set out at #2, that provides Councils with certainty in the form of a minimum rate peg for coming years, may be an option. This would enable appropriate planning and budgeting decisions to be made, with sufficient time to make any necessary adaptions to Council's services.

In addition, we note that the current LGCI methodology attempts to stabilise volatility by using an 'average annual basis' for its calculation as set out at #1. As set out at that item, we believe that this should be reviewed.

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

Ideally, Council needs both certainty and alignment to support its long-term financial sustainability. We refer again to the proposed methodology at #2 which would provide a degree of certainty to Councils but also the flexibility to shift the rate peg upwards in the case of unforeseen upwards movement in cost indices as has been seen in recent years.

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

Yes. The benefit of this would be to provide certainty in budgetary and planning processes and hence support the long-term sustainability of Councils.

However, it needs to be ensured that the ability to react to unforeseen changes (such as the high inflation seen in 2021-22) is not lost, whether this is by the methodology suggested at #2, a simplified rate variation process, or some other mechanism.

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

We would support a later rate peg release that better captured the cost increases faced by Council, provided that the release was no later than November of the year prior to the application of the rate peg. Any later than that would impede on the efficiency of the budgeting and planning process for the following year.

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

We would support the use of the NSW Local Government (State) Award as an alternative to the NSW public sector wage price index in the LGCI. We agree that this would be more reflective of the actual changes in labour costs councils face, with almost all of our staff employed under this Award.

We also believe that rises in superannuation guarantee rates should continue to be reflected in the calculation, whether it be via the adjustment mechanism used in 2023-24 or via the LGCI calculation.

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

Yes. To the maximum extent possible, external costs should be reflected in the rate peg methodology. We expect that the method by which external costs are included may vary depending on the nature of the cost.

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

We would support a mechanism that allowed councils to request adjustments for council-specific external costs. We believe that this may provide a more streamlined alternative to the existing special rate variation process for relevant costs that are not otherwise already considered in the rate peg process, particularly where these costs are mandatory or unavoidable.

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

We believe that cost-shifting from the NSW Government has not been addressed in determining the rate peg. For example, in October 2018 LGNSW released a survey report titled *Impact of cost shifting on local government in NSW: a survey of councils*[3] estimating that the accumulated total cost shifting burden since the survey began in 2005/06 was an estimated $6.2 billion. We do not believe that these additional costs are reflected in the rate peg methodology.

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?

Murrumbidgee Council is willing to accept complexity in the rate peg calculation, noting that the maintenance of Council's financial sustainability is our priority, followed by a desire for certainty to facilitate better planning and budgeting processes. We understand that simplification will likely not be possible while maintaining an accurate reflection of inflation and changes in costs of providing services.

[3] https://www.lgnsw.org.au/common/Uploaded%20files/PDF/Cost_Shifting_Report_FINAL.pdf