Submission by North Sydney Council
to IPART regarding the
Review of Rate Peg Methodology (Issues Paper)

Prepared November 2022

North Sydney Council has long championed for improvements to the NSW rating system. We welcome the opportunity to provide feedback on the first stage of the long-awaited review of the NSW rate peg methodology. Our feedback below is formatted consistent with the online submission form.

Council is pleased that the terms of reference for this Review also include investigation into the recently introduced population growth factor, to determine whether it is achieving its intended purpose.

CURRENT RATE PEG METHODOLOGY

Measuring average annual change in councils' costs

Q1. To what extent does the Local Government Cost Index (LGCI) reflect changes in councils' costs and inflation? Is there a better approach?

The current, rear-looking methodology is not representative of current or future cost pressures. The 2-year lag between the cost change is measured and when the rate increase takes effect does not reflect or compensate councils for current cost pressures, however it is note that this lag has been less of an issue during times of stable inflation. A timelier assessment of current inflation, or a reliable forward-looking measurement of cost changes is needed.

As will be discussed further below, labour costs are known to councils with certainty through the NSW Local Government (State) Award set every 3 years. The forward-looking Award increases, as well as any legislated increases such as the increase in the Superannuation Guarantee rate, as primary input to the rate peg calculation. The rate peg should not be set at a rate that is lower than the known forward-looking Award increases.

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 determination of future rate pegs needs to be based on current forward-looking data if it is to help councils maintain financial sustainability - continuing to deliver current service levels and be able to fund capital works and asset renewals. Historical data does not reflect the current economic conditions that councils are facing. Many related reviews and reforms in recent years have highlighted the importance of councils being financially sustainable. Councils need to build their budgets looking forward. Many councils have been disadvantaged by rate pegging and the recently introduced population factor - the 2022-23 rate peg of 0.7% and the subsequent Application for Special Variation

(ASV) process placed unnecessary burden on councils by way of uncertainty and administrative overhead to achieve a modest indexation to rate revenue.

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

The intention of the LGCI to measure the average change in council costs is supported over the options of a broad economic index e.g. the Consumer Price Index (CPI) or Wage Price Index - NSW Public Sector (WPI), however it is acknowledged that it is not possible to capture the unique circumstances of each council with a single index. The associated lag with the use of the ABS published price index is a downfall. Council awaits the release of proposed alternate (historical and forecast) data sources that could be used to better measure council costs, before commenting on their potential merits.

The use of WPI to gauge labour cost increases in the local government context seems unnecessarily complex and bound to produce anomalies. Amore relevant, and forward-looking source of data is to hand in the NSW Local Government (State) Award. This should be used at a minimum for assessing employee cost movements, as it more closely aligns with the cost increases than the State government sector index currently used. The rate peg should not be set at a rate that is lower than the known forward-looking Award increases. However, it is noted that the Award does not reflect salary step increases, productivity increases nor the current reduced talent pool which are additional costs to each council.

Other forward-looking ABS forecasts and relevant to local government expenditure as well as indexes such as Road and Bridge cost indexes as well as non-residential construction indexes should be considered.

Adjusting for each council's population growth

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 lag in ABS population data currently informing the population factor is problematic. As noted in the *IPART Issues Paper* (September 2021), for 2023-24 this takes into consideration population changes that occurred in 2020 to 2021 during the COVID pandemic which has been impacted by intrastate, interstate, and international migration. Council's realised experience has necessarily not been positive.

Additionally, Council has previously advocated, population growth is not just limited to residential growth. In respect to cost impacts of population, service costs increase directly in relation to population growth due to the need to respond, communicate and service increasing numbers together with increased maintenance associated with increasing use of existing assets. Costs also increase in a stepped fashion as existing community spaces, recreational facilities, libraries, halls etc are overwhelmed and must be supplemented with additional or larger facilities.

This is particularly problematic in inner metropolitan councils were increasing urban density puts increasing reliance on community facilities while concomitantly increasing land prices. The result is councils having to expend significant sums in providing multi-level and multi-purpose community/recreational facilities and maximising usage of existing spaces such as using artificial surfaces (with their higher capital and maintenance cost) rather than grass. In essence, increasing population in dense urban areas has an exponential impact on the cost of provision of community facilities and their ongoing maintenance.

The population factor does not take North Sydney's unique circumstances into account. North Sydney services a large daily transitory worker and student population. North Sydney is home to a "second CBD" of high-rise office towers, multiple large and prominent schools and a university campus. North Sydney's services and infrastructure obligations expand due to population factors that are not captured in its local ABS population data.

Similarly, population density is another issue to be investigated. Population increases are financially rewarded however of equal concern is maintaining and enhancing services and facilities in high density LGAs. While the North Sydney LGA may have a lesser population growth than other areas, it has a very high population density, of 65.7 persons per hectare (PPH) in 2016 compared to 4.2 PPH Greater Sydney and 9.9 PPH NSROC region. In 2021, this increased to 66.2 PPH in North Sydney.

Council supports of the Rating Professionals submission that "the attempt by IPART to prevent councils from 'double-dipping' by subtracting supplementary rates growth from the population increase is flawed because it doesn't account for negative supplementary growth. This means that councils with negative supplementary growth are not afforded their full population increase." North Sydney's 2022/23 rate peg was affected by this. Business properties converted to residential development, leading to a higher number of residents and lower rates. North Sydney's annual rate income was reduced by 0.3% through supplementary changes. The formular does not allow this loss to be regained. This could be addresses by allowing negative supplementary valuation changes to be regained by the population factor.

Adjusting for productivity improvements

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

Council is not able to provide detailed feedback on this matter at this stage of the Review. In the interim, penalising councils for efficiency gains would inhibit innovation.

Adjusting for the impact of other external factors

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

As mentioned elsewhere in this submission, North Sydney Council provides ever increasing services to its large daily transitory population. The extent to which population increases in other LGAs are being funded by "CBD" councils should enter the methodology. Councils like North Sydney have the expense of servicing a larger population but not the income to support the provision and maintenance of the services and facilities demanded by the larger population.

Council supports the removal of external costs that are not subject to local government discretion or decision including the Local Government Election costs, Emergency Service Levy and the Sydney Region Development Fund Levy, regulatory compliance costs (e.g. pool inspections, food shops and other), Valuer General valuation costs, Audit, Risk and Improvement Committees (ARIC) and audit fees - these should be removed from the rate peg pool of funds. These are mandatory costs imposed on councils that are not subject to annual CPI increases.

Additionally, pending Fringe Benefit Tax (FBT) implications for councils e.g. for carparking should be fully investigated. Council supports recognising this impost on other councils, while noting as North Sydney is already close to commercial car parking facilities and therefore has an existing FBT expense.

RATE PEG AND CHANGES IN COUNCILS' INCOME AND EXPENSES SINCE 2011/12

How has the rate peg impacted councils' funding of services?

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

Not necessarily, as in the case of North Sydney, high user pays fees and charges are required to compensate for low rates. For many ratepayers this is means additional annual living or operating costs on top of their rates. Additionally, councils are required through the IP&R process to determine service levels with their communities. Council therefore believes there are additional and/or alternate mechanisms (controlled and implemented by the community) to protect from "unnecessary" rate increases.

Council objects to the use of the term 'unnecessary' as this implies that councils increase rates without reason and without thorough consideration of the implications. The Special Variation process is only necessary because of the limitations of rate pegging.

Communities hold councils accountable for service levels and the efficient use of rates income. Councils produce, exhibit and accept submissions through its Integrated Planning and Reporting (IP&R) plans including the Long Term Financial Plan (LTFP) and the detailed Operational Plan & Budget each year. This framework gives the community visibility into how rates and revenue are being used to realise community aspirations. It also gives the community the opportunity to identify and raise questions on any inefficient use of resources and proposed rates and fees and charges.

The Special Variation process may provide disincentives for councils to apply when income is needed. The process is complicated, resource intensive and subject to politicisation. If necessary Special Variations are delayed, underlying problems of asset renewal and preventive maintenance may be exacerbated, requiring greater increases than if they were applied for in a timely manner.

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

When introduced in 1976, rate pegging allowed for continuation of existing service levels, however currently, with the rate peg falling below cost increases some councils are forced to look at reduce service levels.

Council reiterates that the users of council services are not limited to residents and businesses, and that rates income enables the ongoing provision of existing services, facilities, as well as asset maintenance, but does not necessarily enable significant surplus for the provision of new capital works or the more substantial renewal of existing assets.

Whilst general rates can be supplemented with infrastructure contributions and special variations, these options come with restrictions. Infrastructure contributions are restricted to the capital works or associated land purchases for which they were collected. Special variations (SV) are a costly exercise in applying for permission to increase rates above the rate peg and require demonstration of a community's willingness to pay for the proposed increase - North Sydney Council knows this from experience. Due to rate pegging Council has historically had comparatively low residential rates (plus a significant portion of minimum rates) and over the last 15 years has applied for five special variations, not all successfully (as shown in the table below). Council has also made use of special levies and the introduction of a Stormwater Management Charge.

IPART's records indicate 31 councils have applied for cumulative increases above 30% since 2011-12. Renewal/maintenance of existing assets and the need to improve financial sustainability are frequently cited reasons. This would seem to indicate the rate-peg has not provided sufficient income to many councils.

Special Variations are costly processes that involve large commitment of council resources. The concept is also hard to explain at the commencement of term (and IP&R cycle) to new Councillors and can become political. Most of North Sydney's additional funds realised for the applications in the table below were used to maintain existing service levels or bring existing assets to an acceptable condition. These applications each involved a large commitment of resources and frequently duplicated processes and consultation already undertaken in business-as-usual IP&R.

The *Review of the Local Government Rating System Local Government - Final Report* (December 2016) found "the Special Variation process incurs a significant regulatory burden on councils and the NSW Government, which might have deterred some councils from applying for Special Variations. For example, Wentworth Shire Council noted that the cost of applying for a Special Variation is almost equal to the additional revenue received in the first year of the Special Variation. In its response to the panel, the NSW Government noted that it "supports removing unwarranted complexity, costs and constraints from the rate-peg system."

Year	Outcome
2009	Unsuccessful SV - 11.87% one off increase plus minimum rate increase
2011	Partially successful SV - 7 year increase approved, permanent continuation of existing special levies unsuccessful; ended 2017/18
2012	Successful SV - amendment to previous year's approval, to include permanent continuation of existing special levies following additional community consultation
2019	Partially successful SV - 3 not 5 years plus minimum rate increase approved; ended 2021/22
2023	Successful ASV of 2%

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

The last two rate pegs were significantly below CPI on which many council contracts are based.

In the current rising inflation cycle, lag factors in the the rate peg will add financial pressures to many councils. These will intensify the longer the cycle persists.

Under the rate peg system to maintain sustainability councils, have been obliged to seek income in areas outside their core-capabilities and developed complex fee setting systems via the Fees & Changes Schedule.

As noted in Council's response to Q8 may councils have applied for large rate increases to maintain existing service levels and financial sustainability.

IMPORTANT ISSUES FOR THIS REVIEW

Can we better account for how councils differ from each other?

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

Applying the same rate peg to varying councils does not account for the key differences between local government areas. Councils each have their own individual circumstances, level of service requirements and community aspirations and expectations.

It is recommended that further investigation be given to the option of different rate pegs for metropolitan and regional/rural areas to determine the positives and negatives of this proposal.

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

As noted, consideration should be given to "CBD" councils with high daily transitory worker populations. These councils are providing services to that population without benefiting from the growth factor.

Acknowledgement should also be given to cost differences between council types including population density, asset conditions and volume e.g. length and type of roads, availability of external service providers, customer and ratepayer expectations. Historical modelling may identify material differences between individual councils or groups of councils that may support multiple rate pegs/cost indexes on this basis.

What are stakeholder preferences?

Council questions that consultation IPART is doing with ratepayers (other than calling for submissions) to understand their preferences. If IPART is genuine in wanting to involve all stakeholders in this Review, rather than relying on ratepayers to opt into this consultation, it would be prudent to hear from a representative sample; to test their understanding of the current and proposed rate peg methodology.

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

Yes, volatility in the rate peg in the current economic environment is an issue that needs detailed exploration and further discussion with councils and ratepayers. The current methodology has no allowance to recover the impacts of volatility experienced in recent years due to the release on the rear looking data. IPART is well aware of the challenges facing councils by the 2022-23 LGCI being set at 0.7%.

As noted in the *IPART Issues Paper* (September 2022), the lag in the LGCI remains stable when inflation is relatively stable. However, Australia is currently experiencing record levels of inflation because of knock-on effects from the COVID pandemic, global conflicts, supply side issues and strong consumer demand. According to the ABS, CPI as at the September 2022 Quarter reached 7.3% - the highest recorded since 1990[1] with the official interest rates pushed to their highest level in nine years as at 1 November 2022. Councils and their communities are still recovering from the impacts of the pandemic, and on top of this many also responding to natural disasters. The current increase in CPI is resulting in contractor cost changes for councils, not captured in the current LGCI due to the currently used data lag.

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

As acknowledged in the *IPART Issues Paper* (September 2022), Council appreciates the difficulty in devising a methodology that can simultaneously reduce volatility in the rate peg, allows it to reflect councils' cost changes in real time, and enables it to accurately reflect these cost changes. It also appreciates that the option that may perform best in a high inflationary environment may not be the best option over the long-term, and vice versa. Therefore, it is recommended that IPART should aim

[1] https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation (accessed 25 October 2022)

for a methodology which provides both - more certainty about future rate increased and better alignment with changes in current costs.

Council does not support the use of a rolling-average of cost changes as, while this could reduce volatility it would increase the problems with lag. Council supports use of the most up-to-date information as the basis for setting the rate peg as well as resilience i.e. capacity to positively respond to unforeseen events and climate change as well as changing demographics. Many councils are facing ageing populations and the preference to age in place increases, therefore in turn will require adaption of service provision.

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

Council supports further investigation of the potential option for setting the rate peg at a fixed percentage over 4 years, aligning to the IP&R cycle. This would give councils and ratepayers certainty but would likely create misalignment with changes in costs. This could be done in a manner like the current setting of the NSW Local Government (State) Award inclusive of annual increases set for a 3-year period. However, the last two years, with the unprecedented impacts of COVID pandemic and multiple natural disasters, have highlighted hardships in in setting a multiple year rate peg. Investigation of a “true-up” or averaging mechanisms may be required to capture economic volatility and unforeseen change on a timely basis.

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

Changing the release timing of the rate peg for the next financial year has both positives and negatives. The outcome will affect councils differently, depending on resources available and meeting schedules. It was previously released in November, and this was considered too late to inform preparation or review of the LTFP, especially for councils considering applying for a Special Variation. It is acknowledged that many councils, including North Sydney Council, had long advocated for an earlier release, which gives councils certainty at the time of setting its LTFP.

On the other hand, use of the December quarter CPI may be more relevant to reflect current economic circumstances and announcement of the rate peg in February each year. While this should align to budget preparation cycles, this would shorten the preparation time in the year of the local government election when the LTFP is prepared. The flow in impact could be to the current SRV application timeframes and level of community consultation required.

Can we better capture the change in efficient labour costs?

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

As stated above, the use of WPI to gauge labour cost increases in the index seems unnecessarily complex and bound to produce anomalies. The more relevant source is to hand in the Local Government (State) Award. Additionally, the cost of attracting quality staff should be factored in.

Council also agrees that the 0.5% annual increase to the superannuation guarantee (from 9.5% in 2020-21 to 12% in 2025-26) is a significant additional cost for councils that should be factored into the rate peg methodology. Whilst a welcomed introduction that gives well deserved recognition to councillors, the introduction of (optional) superannuation payments to councillors is a financial impost the council that essentially increases is annual labour costs.

How should new services, activities and external costs be funded?

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

Yes, external costs that apply to all councils should be included in the rate peg methodology, including increase in the Superannuation Guarantee, Local Government Election costs and one off/new taxes. As noted in response to Q6, Council supports the removal of external costs that are not subject to local government discretion or decision. These are mandatory costs imposed on councils that are not subject to annual CPI increases.

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

Yes, as noted in response to Q6 and Q17. Additionally, it is noted that the Stormwater Management Charge has remained unchanged for since 2006-07. However, the difficulties in achieving council-specific adjustments is acknowledged - it may become subjective, political and or inequitable, plus potentially hard for ratepayers to understand.

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

As stated above, costs that apply to all councils should be included in the rate peg methodology. In addition to the increase in labour costs controlled by the NSW Local Government (State) Award and the Superannuation Guarantee, building materials and construction significantly impact councils, as do State Government imposed charges - the impacts of cost shifting be borne by councils. Other costs imposed on councils by the State Government should not be allowed to be higher than the rate peg.

Can we make the rate peg simpler and easier to understand?

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?

Council supports the simplification of the rate peg, however at this stage of the Review cannot provide specific comment on this can could be achieved, other than to reiterate that it should be forward-looking and include reliable cost estimates, and the reliance on Special Variations be reduced.

OTHER FEEDBACK

General Comments

As stated above, whilst this Review is much welcomed, it is noted that the timing of the first stage clashed with the preparation of annual financial statements and the September quarterly budget review statement, and the dates/details of the workshops to be held are not yet available. Similarly, the next stage of the Review is scheduled to clash with the preparation of the annual Operational Plan and Budget. The consultation timings for the Review should be reviewed, and or taken into consideration for future consultations with councils on revenue related matters.

Contact Persons:

Jenny Gleeson, Manager Corporate Planning and Engagement
Christian Menday, Manager Financial Services