northern beaches council

3 November 2022

Tribunal Members
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop
SYDNEY NSW 1240

Our Ref: 2022/647103

Via online submission form

Dear Sir / Madam

Review of Rate Peg Methodology

Northern Beaches Council welcomes the opportunity to provide feedback on IPART's 'Review of Rate Peg Methodology' (our reference 2022/647103).

Council's responses to the specific questions posed by IPART in the Issues Paper are provided below.

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

   For the following reasons in our opinion, it is highly unlikely that the Local Government Cost Index adequately reflects changes in an individual Council's costs and inflation.

   The Local Government Cost Index (LGCI) is intended to measure, in percentage terms, how much the overall cost of providing local government services changes each year. It consists of a basket of cost items, each of which is weighted according to its importance to local government as determined by IPART. The current methodology uses CPI for 11 of the 26 cost components selected at a single point in time, this practice does not account for any anomalies. As noted by the Australia Bureau of Statistics in relation to the Consumer Price Index (CPI) as expenditure patterns change over time in a dynamic economy, the fixed basket used runs the risk of becoming unrepresentative and can lead to bias. In this regard the question must be asked, how can a cost index use a fixed basket to measure costs changes and at the same time remain both contemporary and representative of local government operations. In a rapidly changing economy, the structure of any index is liable to become seriously out of date unless there is frequent revision of items and weights. The 26 cost components are not reflective of all council's costs or all types of council costs and these issues are compounded by the 2 year time lag in its application to the rate peg and the index only being reviewed every 5 years.

   We support the contention that the Local Government Cost Index (LGCI) is too broad and that its components are not individualised enough for councils. The rate peg should be calculated separately at a minimum by council type, with cohorts within the type to reflect geography, socio-economic index rating, demographic factors and similarities in the services provided. A coastal council has a different cost structure to an inner city council, a rural council and so forth.

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If the Local Government Cost Index was reflective of changes in councils' costs and inflation you would not expect to see the large number of Special Variations which have been approved since 2011-12, the large number of New South Wales Councils currently experiencing deficits and issues with long term sustainability, nor the disparities in the level of New South Wales rates compared to other States and Territories as noted Figure A-3 of the Issues Paper.

The most significant component of a council's costs is those related to employees. As noted in the Issues paper the measure of labour costs in the rate peg methodology needs to reflect labour market conditions. IPART currently uses the NSW public sector wage price index (WPI) in the LGCI which reflects the change in total hourly rates of pay for NSW public sector workers. This is not and never has been the appropriate way to account for changes in councils' labour costs. The Local Government (State) Award provides councils with a clear future facing pathway for wages growth.

A further component of a better approach would be to give greater emphasis on the capital component of a Council's costs. As part of the services and facilities provided by councils there is a significant investment in a vast range of infrastructure. This infrastructure is required to be maintained at a standard satisfactory to the community's expectations. The LGCI does not currently consider the impact of asset inflation and the direct impact on a council's costs. Likewise, while IPART has indicated that it is "aware that sometimes a grant for capital purposes might lead to ongoing operating expenses, or deprecation costs which are not captured in our existing rate peg methodology" and that "this is because the LGCI measures the cost of direct acquisitions of goods and services rather than their financing" this shortcoming needs to be addressed

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

In the first instance the rate peg should be forward facing and represent an estimate for the relevant rating year. This could then be trued up in future rate pegs by an adjustment to represent the difference between estimated and actual cost increases.

If consideration is given to making the move to a forward facing rate peg, it is of utmost importance that transitional arrangements effectively take account of costs and inflation between the dates used in the current methodology and those used in a new methodology. This is exceptionally important as the current inflation numbers being experienced in the range of 7-8% would be included in the rate peg for 2024/25 based on the current methodology and it would not be appropriate for this not to be taken into account in a change to a forward facing rate peg, if this were to occur.

As noted in question one, the most significant component of a council's costs are its employees. The NSW public sector wage price index (WPI) is not the appropriate measure of employee cost increases and the Local Government (State) Award should be used for this purpose.

The best measure of actual costs are the annual financial statements of New South Wales councils and these should be used as a significant part of the determination of actual costs.

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

As noted in Question 2 the best measure of actual costs are the annual financial statements of New South Wales councils and these should be used as a significant part of the determination of actual costs.

The rate peg calculation would benefit from using more forward-looking indexes and forecasts such as those available through RBA forecasts, subject to the transitional considerations noted in Question 2.

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?***

As noted by IPART in the Issues Paper there are limitations with the Supplementary Valuations system which result in most councils receiving less income from rates for each new resident compared to existing residents. There are also some types of development such as granny flats which result in increases to a council's population but do not trigger supplementary valuations, and therefore councils do not receive additional income to service the additional residents.

IPART uses residential population rather than service population to calculate the population factor. Councils may have larger service populations due to tourism or because they are employment, business or cultural hubs.

Backward-looking ABS data is used to measure changes in residential populations rather than the Department of Planning, Industry and Environment (DPIE) population projections. IPART considered that using third party population projections were not appropriate because the relationship between third party providers and councils is not independent.

ABS data is updated after a census every five years. IPART has considered it is appropriate to re-base the population factor every 5 years following the census. We believe this is too long a time lag.

IPART has acknowledged that Councils must be able to scale up and provide additional services as local communities grow and while councils receive supplementary valuations as new rateable properties come online, it often results in councils receiving less income from rates on a per capita basis when compared to the growth in per capita expenditure.

It needs to be recognised that supplementary rates do not fully address the issue of additional costs of providing services to a growing population on a per capita basis. Often new dwellings only attract a minimum rate due to the rating burden being distributed based on unimproved land values. Therefore, while new apartment dwelling may accommodate from 2 to 4 individuals, it still pays a minimum rate which then dilutes the average rates per capita as population on a per head basis grows at a faster rate that the rates collected per new dwelling. This demonstrates that the percentage growth in population does not have a direct correlation to the percentage growth in rates from supplementary valuations.

Therefore, if IPARTs intention for introducing the population growth factor was to allow councils to maintain or increase its rate on a per capita basis, then the current methodology of reducing this factor by the growth in rates from supplementary valuations, fails to achieve that outcome.

It is Councils view that the growth in rates from supplementary valuations should not be used to reduce the population growth factor in the current rate peg methodology.

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

We don't agree that an additional productivity/efficiency factor be included in the rate peg as:

- cost indexes globally already include these
- the funds generated from efficiencies should be available for the community to determine how they are distributed (service improvements, reduced rates, etc).

In the first instance if improvements in productivity and the efficient delivery of services by councils are to be reflected in the rate peg methodology then they must be clearly defined and means developed for them to be accurately measured.

In this regard it is difficult to measure productivity and efficiency using a singular metric or methodology as there are a number of variables that need to be considered in making the assessment. In general terms efficiency is quality, and productivity is quantity. This is the biggest difference between the two and both are necessary for the success of any operation.

We note from the Deloitte Access report in relation to efficient costs of interment services - IPART 2020, that efficient costs were referred to as the minimum costs required to achieve a given set of services or outputs. In this respect, it was noted that efficient costs may vary depending on the quality of services provided or the types of services provided. For example, in the context of cemeteries efficient costs may vary even for a defined product such as an adult lawn burial depending on area in which the interment is situated, the maintenance required for the gardens surrounding the site and the quality of visitor infrastructure provided.

It should not be assumed that ratepayers or the community would either expect or want efficiencies returned to them in the way of lower rates as generally these efficiencies relate to how ratepayers and the community interact with council whether in requesting a service or paying an account as there is a general assumption that standards will improve as technology and other factors with drive efficiency and productivity improve. If it is to occur one method to measure efficiency and productivity improvements at a high level could be to measure the changes in per capita expenditure of councils over time having regard to changes in its service profiles.

Therefore, consideration should be given to the following factors:

- Changes to service levels.
- Changes to population (including socio-economic index ratings and demographics).
- Underlying operating results over time.
- Financial position, liquidity, and levels of working capital.
- Asset sustainability including the state of backlogs and the sufficiency of asset condition
- External factors and cost pressures
- The impact of isolated events such as natural disasters and public health events.

For instance, if a councils per capita operating expenditure grows at a rate lower than its rate of population growth in an inflationary environment, that could be attributed to efficiency and productivity gains assuming no changes in service offerings.

It should be noted however that per capita expenditure may not be the best indicator of efficiency as a low growth in operating expenditure could be (and often is) attributed to the inadequacy of operating revenue to allow for growth in expenditure (i.e., operating expenditure is being contained due to revenue restrictions).

Ultimately, the best indicator of productivity and efficiency would be where a council is able to generate sufficient revenue to provide the desired levels of service to its community and doing so in a financially sustainable manner without undue financial and operational stress.

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

As noted earlier the rate peg methodology should be forward facing and represent an estimate for the relevant rating year.

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

- external costs in the form of additional costs associated with legislated requirements relating to planning, compliance and reporting changes
- shortfalls in the Local Government Defined Benefits Superannuation Scheme
- additional expenditure related to cost shifting
- the cost of natural disasters

- the cost of public health events such as the COVID-19 pandemic, and
- the costs associated with full the ranges of services provided by Council.

The following external factors should have adjustments made for them in the rate peg methodology in a forward-facing outlook:

- costs profiles by council type, with cohorts within the type to reflect geography, socio-economic index rating, demographic factors and similarities in the services provided.
- economic forecasts for all council costs
- the impact of supply change delays
- changes in costs and prices of private sector industries that have a high degree of engagement by the local government sector

As recognised in the Integrated Planning and Reporting Guidelines, Councils operate in a complex environment, with responsibilities under some 67 different Acts, and direct relationships with more than 20 state and commonwealth agencies.

While the IP&R framework is prescribed by the Act, other Acts and state agencies require additional strategic planning from councils such as those relating to land use planning and community inclusion (Disability Inclusion Action Plans).

The Act makes it clear that IP&R is designed to cover all of a council's activities and all plans and strategies must be connected in some way to the framework

IP&R provides a pathway for elected representatives to:

- work directly with their community to identify long-term priorities for local identity, growth and lifestyle
- understand the range of services the community wants, the service standards they expect and the infrastructure that will be required
- have meaningful conversations about the cost of meeting community expectations. Allocate resources within council's means and map out a 4-year strategy to deliver key priorities, projects and services
- set appropriate rates, fees and charges and monitor the council's progress in delivering priorities, projects and services through the Operational Plan
- report to the community on their success in achieving these goals
- be assured that their council is meeting planning, consulting and reporting requirements under other laws.

All of the factors built into the IP&R framework should have the provision for adjustments in the rate peg methodology.

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

The rate peg limits rate increases in the short term but does not necessarily protect ratepayers from unnecessary rate increases. As noted in the Issues Paper from 2011-12 to 2022-23 IPART approved 168 applications for special variations excluding the 86 NSW local councils approved for 2022-23 Additional Special Variation. The question needs to be asked as to whether the rate peg leads to unnecessary lumpy rate increases and much more impactful and stressful increases for the more vulnerable in the community through the Special Variation process.

As noted in the Review of the Local Government Rating System Local Government – Final Report from December 2016 "the Special Variation process incurs a significant regulatory burden on councils and the NSW Government, which might have deterred some councils from applying for SVs. For example, Wentworth Shire Council noted that the cost of applying for an SV is almost equal to the additional revenue received in the first year of the SV. In its response to the panel, the

NSW Government noted that it “supports removing unwarranted complexity, costs and constraints from the rate-peg system.”

The following is a summary of the cumulative increases above 30% since 2011-12:

<u>2013</u>

- Wyong – 30.6% cumulative increase to improve financial sustainability so as to be able to reduce infrastructure backlogs.
- Shellharbour – 43% cumulative increase to improve financial sustainability, to maintain current levels of service and to improve infrastructure.
- Parkes – 43% cumulative increase to improve financial sustainability so the council can maintain and renew assets and increase spending on assets.
- Gunnedah 39.7% cumulative increase to fund debt servicing costs associated with a capital works program, and to improve its financial sustainability.

<u>2014</u>

- Burwood – 69.6% cumulative increase to improve the operating balance, increase capital spending and reduce the infrastructure backlog.
- Corowa – 31.8% cumulative increase to maintain current service levels, long term financial sustainability and containment of infrastructure backlog.
- Holroyd – 44.22% cumulative increase to fund maintenance and renewal of key assets and improve financial sustainability.
- Junee – 33.56% cumulative increase to improve the council’s financial sustainability, retain funding for basic services and road renewal works.
- Kempsey – 37.54% cumulative increase to adequately finance infrastructure maintenance programs and retain existing services to the community.
- Maitland – 63.22% cumulative increase to increase capital expenditure and to ensure future financial sustainability.
- Tenterfield – 53.07% cumulative increase for asset renewal and improved financial sustainability.

<u>2015</u>

- Ashfield – 38.45% cumulative increase for infrastructure renewal and maintenance including the aquatic centre.
- Blue Mountains – 40.34% cumulative increase for renewal and maintenance of built infrastructure and assets; environmental protection; improved services and financial sustainability.
- Gloucester – 38.94% cumulative increase for roads and bridges infrastructure backlog.
- Kyogle – 33.56% cumulative increase for financial sustainability, infrastructure expenditure for roads, bridges and stormwater assets.
- Newcastle – 46.93% cumulative increase for financial sustainability, maintain and enhance existing services, infrastructure backlogs, asset renewal and new capital expenditure.
- Oberon – 39.4% cumulative increase for Road maintenance and backlogs and improve financial sustainability. Fund interest payments on a LIRS loan and upgrade to freight roads.
- Weddin – 30.34% cumulative increase for asset renewal and improved financial sustainability.
- Wollondilly – 50.72% cumulative increase for reducing the infrastructure maintenance backlog and financial sustainability.

<u>2016</u>

- Gwydir Shire – 30% cumulative increase for financial sustainability and continuation of an expiring special variation.
- Lachlan Shire – 45.1% cumulative increase for financial sustainability and asset maintenance, renewal and upgrading of infrastructure.

- Singleton – 39.4% cumulative increase for Asset renewals (includes an expiring special variation).
- Wingecarribee Shire – 45.3% cumulative increase for financial sustainability, asset maintenance, renewals and upgrades, and to continue expiring special variation for Environmental Levy.
- Yass Valley – 38.6% cumulative increase for financial sustainability and infrastructure renewals and upgrades.

<u>2017</u>

- Byron Shire – 33.55% cumulative increase to reduce the infrastructure backlog and improve financial sustainability.

<u>2018</u>

- Balranald Shire – 94.87% cumulative increase to fund asset maintenance and renewal, reduce the infrastructure backlog and improve financial sustainability.
- Hawkesbury City – 31.29% cumulative increase to fund asset maintenance and renewals and improve financial sustainability.

<u>2019</u>

- Dungog Shire – 76.02% cumulative increase to fund operations such as infrastructure maintenance and renewal, reduce infrastructure backlog, maintain existing services and enhance financial sustainability.

<u>2021</u>

- Cootamundra-Gundagai Regional – 53.5% cumulative increase to maintain service levels, fund asset renewals and improve financial sustainability.
- Georges River – 32.6% cumulative increase to maintain service levels, deliver key priorities in the Community Strategic Plan and Delivery Program, fund infrastructure maintenance and renewals, and improve financial sustainability.

<u>2022</u>

- Snowy Valleys – 35.95% cumulative increase to Continue delivering existing service
- levels without a significant reduction, manage a range of financial impacts (e.g., maintenance of grant-funded new assets and natural disasters) and ensure long-term financial sustainability.

Based on the above, it is highly unlikely that the rate peg has protected ratepayers from unnecessary rate increases.

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

The rate peg has not provided councils with sufficient income to deliver services to their communities evidenced the number of Special Variations and the size of some of those increases.

The impact of the rate peg has limited a council's ability to generate sufficient income to deliver the services expected of them by their communities, maintain infrastructure to a satisfactory standard and maintain long term financial sustainability.

The rate peg has had a significant impact on the long term financial sustainability of councils and in this regard the current rate peg methodology has not adequately reflected the impact of costs related to the diverse and substantial infrastructure maintained by councils for their communities. The nature of depreciation in particular seems to be neglected. In essence depreciation is an estimate over time for the decrease in an asset's value due to use, wear and tear or obsolescence. In the first instance depreciation is a non-cash cost in the Income Statement when it is expensed. However, it is a cash cost once it is expended for the purpose of funding the renewal of infrastructure which has depreciated over time. Capital renewals and upgrades are significant component of all council operations and needs to be a consideration of IPART in setting the rate peg.

The following is a summary of IPART's approval of Special Variations since 2011/12.

Year	Applications	Full Approval	Part Approval	Declined	No Determination
2011-12	23	9	10	4	0
2012-13	16	10	6	0	0
2013-14	24	21	3	0	0
2014-15	34	30	3	1	0
2015-16	23	22	1	0	0
2016-17	13	9	1	0	*3
2017-18	8	4	2	2	0
2018-19	13	8	3	2	0
2019-20	13	13	0	0	0
2020-21	1	0	0	0	**1
2021-22	8	7	1	0	0
2022-23	5	5	0	0	0
Total	181	138	30	9	4

* No determination was made by IPART because the 3 councils were dissolved under an amalgamation.

** Withdrawn

Excluding applications where there was no determination 95% of all Special Variation applications have been approved by IPART.

The majority of these applications have been to address financial sustainability, existing infrastructure backlogs future infrastructure expenditure obligations which highlights that the rate peg alone has not provided councils with sufficient income to deliver services to their communities

Developer contributions alone are not sufficient for councils to acquire land and invest in open space, sporting fields and community facilities to the extent required as their community grows. Rates are required to fund this shortfall. As a consequence of rate capping particularly in a period of high asset inflation, the opportunity costs are that that income is forgone as well as the ability to purchase land and build appropriate infrastructure assets especially as the demand for open space, sporting fields and community facilities increases with higher density housing.

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

Financial performance and sustainability are significant issues for NSW Councils. For the year ended 30 June 2021 the combined Operating Result before grants and contributions for operating purposes was a deficit of $332m. Between the 2020 and 2021 financial years 47 NSW councils moved from a surplus position to a deficit or increased their deficit. In the 2021 financial year 58% of all NSW Councils recorded a deficit.

A full analysis of Council results is required to identify the extent of financial performance and sustainability issues as it is likely to be much worse than that highlighted by the Operating Result before grants and contributions for operating purposes alone. The extent of increases in the level of loan borrowing, decreases in available working capital, increases in infrastructure backlogs and the impact of inflation on unspent reserves such as developer contributions must also be considered.

There are many factors such as the COVID-19 pandemic that have affected the financial performance and sustainability of councils in recent years, however the impact of the rate peg should not be underestimated.

The Issues Paper notes that IPART's preliminary state-wide analysis suggests that on a per capita basis, movements in the rate peg appear to be similar to councils combined total operating expenses. It also notes that the other drivers for the 43% increase in councils' total operating income per capita include higher grants and contributions per capita, which grew by 65% higher user charges and fees per capita, which grew by 29%. To this point operating and capital grants and contributions per capita grew by 65% from 2010-11 to 2020-21 with the key driver of this overall increase being a 130% increase in grants and contributions per capita for capital purposes while grants and contributions per capita for operating purposes grew by just 7% over the same period. What this point fails to highlight is the effective decrease in operating grants over this time and the extent to which this relates to unfunded cost shifting.

There were significant capital grants provided to Councils that were amalgamated in 2016 and while IPART has indicated that it is "aware that sometimes a grant for capital purposes might lead to ongoing operating expenses, or deprecation costs which are not captured in our existing rate peg methodology" and that his is because the LGCI measures the cost of direct acquisitions of goods and services rather than their financing, it fails to address ongoing operating expenses and deprecation costs.

It is important that we examine the changes in rates from other jurisdictions as a comparison for the performance of the rate peg. While IPART has noted that such comparisons are not perfect and that the differences between jurisdictions create a significant number of variables this should not inhibit this occurring.

Most recently, the 2021 NSW Productivity Commission's Paper on Productivity Reform recognised a flexible rating system was the most efficient way of helping councils meet the risings costs of serving their communities. NSW's rate peg is being blamed for councils not having enough money to provide their rapidly growing communities with new infrastructure. The Report signalled NSW councils have foregone about $15 billion in rates compared with Victoria since 2000, and the NSW Productivity Commission says that except for raising user charges or extracting developer contributions, councils don't have alternative funding sources needed to service higher populations or maintain and operate a larger capital stock.

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

Currently, the rate peg methodology does not reflect how councils differ from each other. Rather it uses a broad averaging approach to set a rate peg for what is termed a typical council. While Councils share similarities, each council is different. Metropolitan, regional town/city, metropolitan fringe, rural and large rural each share similarities within their grouping however, there are differences between councils within these groupings that may influence their cost changes, including geography, socio-economic index rating and demographic factors as well as the range of services the community wants, the service standards they expect and the infrastructure that will be required.

We support the contention that the Local Government Cost Index (LGCI) is too broad and that its components are not individualised enough for councils. The rate peg should be calculated separately at a minimum by council type, with cohorts within the type to reflect geography, socio-economic index rating, demographic factors and similarities in the services provided. A coastal council has a different cost structure to an inner city council, a rural council and so forth.

It should be noted that the Office of Local Government also groups councils based on the Australian Classification of Local Governments (ACLG) determined by the Australian Bureau of

Statistics (ABS). New South Wales councils have been condensed from 22 ACLG categories into 11 groups, to better reflect the councils in New South Wales and consideration should be given to this as a starting point.

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

The principal benefit of introducing different cost indexes for different council types would be to enhance the likelihood that the rate peg actually reflects inflation and changes in the types of costs a council incurs.

Again, we note in the Issues Paper that it is stated that the importance of this income source varies across councils but, on average, it represents around one third of NSW councils combined total income. In the case of Northern Beaches Council, it represents 43% of total income.

The Office of Local Government classifies councils by 5 council types, metropolitan, regional town/city, metropolitan fringe, rural and large rural and there are differences between councils of the same type that may influence their cost changes, including geography, socio-economic index rating and demographic factors.

We support the contention that the LGCI is too broad and that its components are not individualised enough for councils. The rate peg should be calculated separately by council type, with cohorts within the type to reflect geography, socio-economic index rating and demographic factors. A coastal council has a different cost structure to an inner city councils and so forth.

Based on the factors above there is merit in introducing separate cost indexes for different council types and would encourage IPART to exercise its support for changing the rate peg methodology to account for material differences in inflation and costs incurred by different council types. Naturally, changes to improve accuracy and cost-reflectivity may result in greater complexity, however, this should not inhibit IPART’s need to ensure the rate peg adequately reflects inflation and changes in the types of costs a council incurs.

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

Volatility in the rate peg is an issue in the present economic conditions as it is currently being determined on historical data with a 2-year lag between the time period that price changes are measured over and when councils can recover these price changes by applying the rate peg to their rates income.

While the Issues Paper states the lag may lead to material differences between what councils receive under the rate peg and how their costs have actually changed and that this may only temporarily impact councils’ funding of the quality and range of services their communities need, we would contend that this is not the case.

The volatility in the rate peg creates issues in the development of an achievable LTFP, however, it is only one of many factors that is subject to volatility and the LTFP needs to be agile to account for these differences.

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

We must look at this question based on the principles of sound financial management (section 8B) and integrated planning and reporting (section 8C) in the Local Government Act, 1993 - Chapter 3

The following principles of sound financial management apply to councils:

(a) Council spending should be responsible and sustainable, aligning general revenue and expenses.
(b) Councils should invest in responsible and sustainable infrastructure for the benefit of the local community.

(c) Councils should have effective financial and asset management, including sound policies and processes for the following:

  (i) performance management and reporting,

  (ii) asset maintenance and enhancement,

  (iii) funding decisions,

  (iv) risk management practices.

(d) Councils should have regard to achieving intergenerational equity, including ensuring the following:

  (i) policy decisions are made after considering their financial effects on future generations,

  (ii) the current generation funds the cost of its services.

While a rate peg which gave more certainty about future increase would be advantageous, councils require appropriate alignment with changes in costs to be able to satisfy the above principles, so it is not about what councils prefer but what they need to satisfy the requirements of the Act.

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

As far as possible, the rate peg as well as a Council's budget and Long Term Financial Plan should reflect expected economic conditions. Setting a longer term rate peg over multiple years would not assist councils in achieving this objective and would make councils less agile during periods of economic volatility. Maintaining service levels determined in consultation with the community requires a council to meet the current costs of those service levels. Setting a longer term rate peg over multiple years would not ensure that a council had sufficient revenue to meet costs for agreed service levels at times such as we have experienced over the past 12 months.

As we can see in the past 12 months it is not always possible to anticipate when these periods of volatility will occur. Indeed, our most respected financial institution, the Reserve Bank of Australia had not anticipated the changes in economic conditions we are currently experiencing.

In his October 2021 speech the Governor of the Reserve Bank, Philip Lowe stated:

- Underlying inflation is expected to be 2¼ per cent over 2022 and 2½ per cent over 2023
- The Wage Price Index to increase by 2½ per cent over 2022 and 3 per cent over 2023 (although overall labour costs are expected to increase somewhat faster than this).
- The latest data and forecasts do not warrant an increase in the cash rate in 2022. The economy and inflation would have to turn out very differently from our central scenario for the Board to consider an increase in interest rates next year. It is likely to take time to meet the condition we have set for an increase in the cash rate and the Board is prepared to be patient.

In order to improve the accuracy of the rate peg for the year to which it is being applied and to build in an appropriate allowance for volatility, it should be based on the best available forecast of the movement in costs and other adjustments for that year. This forecast should then be adjusted by a factor to take account of the difference between the previous rate peg and actual cost movements/inflation in that period. The estimation uncertainty of the rate peg will then largely correct itself by the use of this factor.

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

In order to meet the Integrated Planning and Reporting (IP&R) requirements including the completion of budgets as part of the Operational Plan and outer year forecasts as part of the Long Term Financial Plan Council commences this process in October each year. This enables a robust bottom-up process to be undertaken in the preparation of budgets and review of fees and charges prior to a rigorous management review as well as allowing appropriate time for staff to work with Councillors and undertake appropriate levels of public consultation.

As such, releasing the rate peg later in the year does not assist in ensuring budgets are both rigorous and robust. Budgets should be based on a clear understanding of the range of services the community wants, the service standards they expect and the infrastructure that will be required.

There are already significant issues for councils in the preparation of their budgets related to the timing of relevant information being made available as many statutory fees are not determined until around April or May and often these fees will increase by less than cost/inflation increases.

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

As noted in the Issues paper the measure of labour costs in the rate peg methodology needs to reflect labour market conditions. IPART currently uses the NSW public sector wage price index (WPI) in the LGCI which reflects the change in total hourly rates of pay for NSW public sector workers. This is not and never has been the appropriate way to account for changes in councils' labour costs.

The NSW Local Government (State) Award (Award) is more reflective of the actual changes in labour costs councils face and enables the use of increases applicable to year to which the rate peg applies. It is imperative that IPART has a clear understanding of all the provisions of the Award that relate to increases including those related to progression through the salary system. These entitle employees to an increase over and above the Award increase in circumstances such as the achievement of performance objectives relating to the position and are generally referred to as step increases.

As with the NSW public sector wage price index (WPI) the Award does not include changes in the superannuation guarantee which is increasing by 0.5% each year (from 10.5% in 2022-23 to 12% in 2025-26) and this must be included as it is a significant cost to Council. IPART should also account for any significant increases in contributions to the Local Government Defined Benefits Superannuation Scheme where the employer contributions significantly exceed the contributions for employees subject to the Superannuation Guarantee Levy. It should be noted that extra contributions provided for under the Superannuation Deed due to shortfalls in the Local Government Defined Benefits Superannuation Scheme Council, Northern Beaches Council has been required to make further additional contributions of approximately $1 million a year over the past 14 years.

The Issue Paper notes that IPART may need to consider expected labour productivity improvements, depending on the approach taken. If this is to occur IPART must clearly identify how it proposes to measure productivity/efficiency improvements and ensure that these are not already offset by Award based salary increases provided where such improvements occur.

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

All costs should be included in the rate cap methodology. This includes external costs in the form of additional costs associated with legislated requirements relating to planning, compliance and reporting changes, shortfalls in the Local Government Defined Benefits Superannuation Scheme, additional expenditure related to cost shifting and the cost of natural disasters, the cost of public health events such as the COVID-19 pandemic and the costs associated with full the ranges of services provided by Council.

As IPART has not identified the nature of external costs as it sees them in the context of this Review, it is difficult to provide a more definitive answer to this question. We note that in its new methodology for setting public transport fares in Sydney, that external costs included congestion, emissions and accident externalities where considered. In respect of IPART's Review of Domestic

Waste Management Charges, it was noted that external factors likely to be putting upward pressure on DWM costs, included the change in the market for recyclables, the Federal Government's export ban on waste and recyclable, increases in the waste levy, the lack of investment in waste recycling and disposal infrastructure, market concentration in the waste services industry and shortages in landfills.

As noted earlier, Councils operate in a complex environment, with responsibilities under some 67 different Acts, and direct relationships with more than 20 state and commonwealth agencies. Councils provide a diverse range of services

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

All costs should be included in the rate cap methodology. As noted earlier in this submission all councils are subject to the Integrated Planning and Reporting (IP&R) requirements under the Local Government Act, 1993 (Act). The IP&R Framework begins with the community's, not councils, aspirations for a period of at least 10 years. It includes a suite of integrated plans that set out a vision and goals and strategic actions to achieve them. It involves a reporting structure to communicate progress to council and the community as well as a structured timeline for review to ensure the goals and actions are still relevant.

IP&R framework recognises that most communities share similar aspirations a safe, healthy and vibrant place to live, a sustainable environment, a caring and engaged community, opportunities for employment, reliable infrastructure, etc. The difference lies in how each community responds to these needs. That is what shapes the character of each local government area. IP&R also recognises that council plans and policies should not exist in isolation and are connected on many levels.

There is a direct link from the Community Strategic Plan to the Delivery Program and Operational Plan, this must be informed and supported by the financial, asset and workforce planning undertaken by council as part of the Resourcing Strategy. Any community endorsed changes to council's strategic direction and priorities should be reflected in resource planning and allocation.

The IP&R provides a pathway for elected representatives to:

- work directly with their community to identify long-term priorities for local identity, growth and lifestyle
- understand the range of services the community wants, the service standards they expect and the infrastructure that will be required
- have meaningful conversations about the cost of meeting community expectations. Allocate resources within council's means and map out a 4-year strategy to deliver key priorities, projects and services
- set appropriate rates, fees and charges and monitor the council's progress in delivering priorities, projects and services through the Operational Plan
- report to the community on their success in achieving these goals
- be assured that their council is meeting planning, consulting and reporting requirements under other laws.

Based on the comprehensive nature of IP&R and the underlying consultation process with the community, the council-specific adjustments for external costs identified in the Resourcing Strategy including the Long Term Financial Plan, Operational Plan and Delivery Program should be included to allow councils to meet community expectations for ongoing changes in services.

This could be best achieved by implementing a recommendation in the Revitalising Local Government – Independent Local Government Review Panel's Final Report (p 44) to provide a small add-on percentage to the rate peg to fund priorities identified in IP&R documents without the need for a Special Variation process.

In this regard we note IPART suggested increased flexibility for councils to set rates within a margin of 3% above the rate pegging limit. At the time it was noted that would add around 60 cents per week to the average residential rate (over and above the typical rate-pegging increase). Further based on TCorp's assessments, the Panel considers that a margin of up to 5% would be more realistic where councils need to make significant short-medium term inroads into infrastructure backlogs and correct operating deficits. At the time it was noted "this would result in a total increase for the average residential ratepayer of around $1.70 per week, which is well within the range of affordable and acceptable increases indicated by survey data."

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

There are vast range of costs current outside of Council's control that should be included in the rate peg methodology. However, it is also necessary to consider the impact of a range of revenue limitations including those associated with legislated fees and charges and the decline in operating grants and contributions such those associated with the freezing of the financial assistance grants from 2014 to 2016 and the use of indices which do not reflect costs increases. Northern Beaches Council is responsible for the management of over $5 billion in assets, the infrastructure is ageing and requires timely renewal. If roads, stormwater, community buildings and other infrastructure is not adequately maintained, the replacement costs will be much higher, so deferring the problem of maintaining assets to future generations of ratepayers, when assets will become more costly to replace, as a result of a council's limited capacity to raise this additional revenue is highly inappropriate.

The vast range of costs currently outside of Council's control include additional costs associated with legislated requirements relating to planning, compliance and reporting changes, shortfalls in the Local Government Defined Benefits Superannuation Scheme, additional expenditure related to cost shifting and the cost of natural disasters and the cost of public health events such as the COVID-19 pandemic.

Cost shifting occurs when program or service responsibilities are transferred to Council with insufficient funding or grants that don't keep pace with the actual delivery costs incurred. Rates revenue must be used to cover funding shortfalls and meet increasing service demands, new government policy, rising costs and community expectations.

While all levels of Governments cover the broader cost of response and recovery associated with natural disasters, the cost to councils is significant. Northern Beaches Council has been subject to an increasing incidence of East Coast Lows which has resulted in both declared and undeclared events that redirect resources and impede normal asset and service regimes. In declared events the NSW Government provides financial relief and support services for eligible local councils following a natural disaster however, this funding is limited to the restoration of essential public assets that have been damaged as a direct result of the natural disaster and a reduction in the waste levy which is well short of the actual costs incurred.

Over the past 3 years the COVID-19 pandemic has impacted revenue streams for services and resulted in additional costs to support the community and businesses. Recovery was stronger than expected towards the end of the 2021/22 financial year, with an overall cost of $12.0 million (2021: $17.9 million, 2020: $11.2 million). The overall net cost of the pandemic is now $41.1 million including losses due to the impact on services along with small business and community support packages.

Likewise, there are significant costs outside of Council's control related to movements in energy prices and while Council has been responsive in minimising the impact of these increases to some degree, this has required considerable capital expenditure to take advantage of technological changes.

As everyone is well aware we have an aging population and the costs of pensioner rebates/subsidies are not currently considered in the rate peg methodology.

The current rate peg methodology fails to take account of the differences in costs associated with new capital works and capital renewals, the need to upgrade infrastructure and facilities to modern standards associated with legislative requirements as well of the costs of inflation associated with holding developer contributions until sufficient funds have been collected to commence works related to growth.

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?

The underlying issue is that the current rate peg calculation is overly simplistic and further simplification would not ensure that it reflects inflation and changes in costs of providing services. Indeed, additional simplification may further distort the rate peg calculation, impacting on a Council's ability to maintain long term financial sustainability, maintain intergenerational equity for future ratepayers, meet community expectations for the ongoing movement in services, maintain infrastructure assets in a satisfactory condition and ensure it has the agility to meet the needs of the community at difficult times such as those experienced during the COVID-19 pandemic as well as recent, storm, flood and bushfire emergencies.

As noted in the Issues Paper, the terms of reference asked IPART to have regard to the differing needs and circumstances of councils and communities in metropolitan, regional and rural areas. These councils differ widely in terms of the characteristics of the areas and the populations they serve. These differences mean that their costs in providing local government goods and services and their scope to raise revenue to cover these costs also vary.

As also noted in the Issues Paper OLG classifies councils by 5 council types, metropolitan, regional town/city, metropolitan fringe, rural and large rural and there are differences between councils of the same type that may influence their cost changes, including geography, socio-economic index rating and demographic factors.

We support the contention that the LGCI is too broad and that its components are not individualised enough for councils. The rate peg should be calculated separately by council type, with cohorts within the type to reflect geography, socio-economic index rating and demographic factors. A coastal council has a different cost structure to an inner city councils and so forth.

We would also argue that that adjustments for changes in other external costs should be included in the rate peg methodology including those to meet community expectations for the ongoing movement in services as detailed in a Council's IP&R documentation, those experienced during events such as the COVID-19 pandemic as those related to natural disasters.

We would also argue that the rate peg calculation should be based on economic forecasts for the rating period with future adjustments to take account of differences in the actual increase in prices and inflation.

Should you require any further information or assistance in this matter, please contact my office on [redacted]

Yours faithfully

[redacted]

David Walsh
Chief Financial Officer