IPART Rate Peg Review

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

The Local Government Cost Index (LGCI) was used to set the rate peg of 0.7% for 2022-2023. The LGCI measured price changes between June 2020 and June 2021. If there were no macroeconomic forces at play and price changes were relatively constant then historical costs would be appropriate. The current financial year commencing July 2022 has demonstrated that this approach may not be appropriate when there is emerging inflationary pressure. The LGCI doesn't take into account anticipated price increases, perhaps a better approach might be to make provision for this. IPART and NSW Treasury employ economists who may be able to make reasonable estimates and propose a suitable approach.

The LGCI survey is voluntary and only represents the cost weightings for those councils which have resources available to answer. IPART aims to survey councils only every 4 years to arrive at an average weighting. Average weightings mean that there is potential for some advantage or disadvantage to individual councils with cost weightings that depart from the average, although IPART has previously identified that differences between council types would not result in a material difference in cost change percentages. If an individual council is more highly exposed to an individual cost component than the average and that cost component is experiencing substantial price rises then that council might be disadvantaged.

If the LGCI was forecast instead of using historical data then councils may have the funds needed to meet costs during rising inflation.

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

Using historical cost alone is not agile enough to provide the necessary increased income in times of increasing inflation. This is because councils need adequate income to continue to fund facilities and services in the year that is subject to inflationary pressure. It may be better to estimate likely inflation on the individual cost components and make an adjustment in a future year for any variance to the actual cost changes in components. The variation might be measured once the relevant indexes are updated and an adjustment factor is added or subtracted in a future year. A worked example where the forecast LGCI percentage exceeds the actual by 2% in the financial year 2023-2024 and is recovered in the financial year 2025-2026:

September 2022 announce rate peg for 2023-2024 using forecast LGCI		6%	(a)
June 2022 – June 2023 actual LGCI		5%	
September 2023 announce rate peg for 2024-2025 using forecast LGCI		5%	
June 2023 – June 2024 actual LGCI		4%	(b)
September 2024 announce rate peg for 2025-2026 using forecast LGCI		4%	(d)
June 2023 – June 2024 LGCI estimate adjustment factor	(b) – (a)	-2%	(c)
September 2024 adjusted rate peg for 2025-2026	(d) + (c)	2%	(e)

The requirement to adjust council notional general income through shortfall provisions and expiring temporary special variations is already contained within Part 2 of Chapter 15 of the Local Government Act 1993, so the concept of making an appropriate increase or reduction to rate income in a subsequent year is not foreign to councils. The proposed method may continue to protect ratepayers from unnecessary rate increases while ensuring councils have rate income to meet forecast rising costs, rather than absorbing those costs and potentially impacting service provision for up to two years while awaiting lag data to be confirmed.

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

The LGCI data sources referencing the ABS producer price indexes are sound. Wages increase data might be more meaningfully sourced by reference to the Local Government State Award or annual survey of individual council enterprise agreements. Individual rate pegs could accurately include a component for individual councils by reference to their proposed award or enterprise agreement increase for the coming financial year. Refer to discussion at the answer to question 2 about incorporating a forecasting element to LGCI as an alternative to relying on historical data alone.

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?

The population factor adjustment is welcomed as it recognises a one-size-fits-all approach to setting an income increase for each council is not appropriate. Recognition of other factors financially impacting on individual councils additional to population growth may have merit. Individual councils are subject to an array of different factors that impact their financial sustainability. IPART might review a more comprehensive set of key financial and sustainability measures for each council annually and set an adjustment factor that reflects the financial needs of the council. This would continue to protect ratepayers from 'unnecessary' rate rises.

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

A productivity factor discount is possibly an outdated concept that imagines local government provides a finite set of facilities and services; that local government is not subject to an increased scope of responsibilities placed on it by higher levels of government; and that councils are not faced with increased customer expectations. Ratepayer, resident and customer surveys could be utilised to best reflect satisfaction with individual council productivity and service delivery, either collected by councils or independently.

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

As IPART has pointed out at page 16 'Every council is different, with different communities, services and costs.' Councils also have different histories and that includes different historical capacities to successfully apply for grants and special variations. Port Stephens Council has had two unsuccessful special variations in the last twelve years. Residential rates have declined from being comparable with surrounding councils to be being substantially lower. The rate peg for individual councils should reflect their score in key financial indicators and their existing rate burden for ratepayers relative to comparable councils. Comparability could be determined by reference to OLG group, size, population, geographic location and SEIFA index score for example. This would ensure that the individual rate peg was both necessary and relatively affordable.

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

The rate peg has insulated ratepayers from rate increases whether necessary or unnecessary. The rate peg makes no assessment of the financial capacity of a council area, whether the rate peg is adequate, excessive or inadequate for a particular council to achieve or maintain financial sustainability. If a council is financially compromised the special variation process creates additional costs and consumes additional resources and puts those costs and resources at risk of wastage should the process be poorly executed by the financially compromised council. The more a council is struggling to manage limited financial and staff resources, the less likely it is to have adequate and competent resources to successfully execute the onerous special variation process. This forces the council to make a choice as to whether to postpone or abandon applying for a special variation and continue to struggle financially, or make the significant decision to redirect resources, almost without exception including the engagement of consultants, to attempt a special variation. The special variation process consumes significant resources due to the level of engagement with the community that is required. The special variation application process is usually funded out of the operational budget and as such costs ratepayers.

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

Not for Port Stephens Council. The constraints of rate pegging are cumulative and will ultimately result in a lower standard of living for residents through a reduction in services in order to balance the operational budget which may include a reduction in maintenance of roads and roadsides, public spaces, parks and a reduction in the scope and quantity of services. Council's residents consistently tell us they desire more services not less, and recently Council has received feedback from the community that they value maintenance expenditure, however, there are little to no government grants available for these ongoing services.

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

Council is in the process of consulting on another special variation application as it is struggling to meet the community's service level expectations within current budget constraints. Council engaged independent experts from the Centre for Local Government at the University of New England who have determined that Council's rate receipts have been inadequate and Council's financial situation under rate pegging is unsustainable. Through its Long Term Financial Plan Council is currently predicting year-on-year deficits, the focal reasoning for this is Council's income is capped whilst inflation and external costs pressures are increasing.

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

In addition to population growth, a comprehensive set of key financial and sustainability measures for each council should be assessed annually and an adjustment factor set that reflects the financial needs of the council. This would ensure that the rate peg increase is 'necessary'. Refer to discussion and suggestions in answers at questions 2 to 6 which detail: a process to forecast LGCI; make adjustments after LGCI lag data is received; make individual rate pegs for councils that take into account the proposed wage increases for individual councils, whether that be Award or enterprise agreement increases; reflect individual comprehensive financial and sustainability data; take into account the historical rate context of the council in terms of rate burden comparables; and an individual assessment as to affordability.

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

IPART has already determined that different weightings of cost indexes for different councils is not material. The concept of individual rate pegs has been introduced whereas in prior years such an option was not available and possibly considered inefficient for IPART to administer. In the same manner the use of forecast costs and a more comprehensive analysis of the financial needs of individual councils, beyond population growth is proposed in answers to questions 2 to 6.

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

It is clear that volatility in the rate peg is a problem, evidence of this is the 2022-2023 additional special variation process undertaken this year to rectify the lower-than-anticipated and needed rate peg. A forecast and subsequent adjustment methodology is proposed in the answer at question 2.

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

Better alignment with costs, using a combination of forecasting and subsequent adjustment as proposed in the answer at question 2.

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

No, better cost alignment is preferred .

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

A forecasting and subsequent adjustment methodology as proposed in the answer at question 2 may resolve this issue. The announcement of the rate peg when not closely aligned with the assumed 2.5% has a material impact on councils budgeting and as a result, the services delivered and outlined within the Integrated Planning and Reporting (IP&R) documents. If the rate peg was to be released later in the year this would need to be considered along with current IP&R processes and timeline, ensuring councils had sufficient time to prepare, inform and engage on the IP&R documents before formal adoption.

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

Councils should submit to IPART the future percentage increases outlined in their enterprise agreements. For those councils reliant on the Local Government State Award information may be submitted by Local Government NSW.

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

External costs are captured through appropriate indexes already. The methodology should be modified to reflect forecast cost changes as proposed in the answer at question 2.

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

Local government specific costs are captured through appropriate indexes already. The rate peg methodology should be modified to reflect council specific financial needs as proposed in the answers at questions 3 to 6. This might enable councils and their communities to achieve a more financially sustainable outlook. Councils would be able to deliver on their plans and priorities as outlined in their IP&R documents with more assurances that their income will relatively keep up with its costs. As such councils will be able to better plan and deliver for their community.

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

Local government specific costs are captured through appropriate indexes already. The methodology should be modified to reflect forecast cost changes as proposed in the answer at question 2.

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 most appropriate way to simplify the process is to leave budget setting and income determination to individual democratically elected and accountable councils. If that is politically unpalatable then simplification of the rate peg calculation should not be an objective of the rate peg process. Port Stephens Council does not receive enquiries from ratepayers asking for it to explain the rate peg calculation, so simplification would not appear to meet ratepayer needs. A more comprehensive analysis of individual council financial and sustainability needs is required and where rate peg is preferred this may necessitate more complex methodology to achieve a fair outcome.