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Scott Chapman
Independent Pricing and Regulatory Tribunal
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sent by email: ipart@ipart.nsw.gov.au

Dear Scott,

QPRC Submission to the IPART Review of the Rate Peg Methodology

QPRC has considered the IPART issues paper and the questions raised and submits the following feedback for inclusion in this review.

QPRC acknowledges the broader context of taxation in Australia, with local government rates being one tax of many taxes on Australian people. Collectively, Australian taxes have become less progressive in recent decades with Australians paying a higher rate of tax on stagnant earnings over recent decades. Whilst these are not IPART's problems to solve, it is our view that all taxes should be designed to be equitable for all Australians.

The rate peg methodology must support the following clear overriding principles, and the outcomes of the rate peg methodology should be assessed against these principles over time, and adjustments made if the rate peg is not meeting it's designed purpose.

Principle 1. The objectives of the rate peg methodology must include, at a minimum, for all Councils to be financially sustainable.

Principle 2. The general rate of each Council must at least be sufficient to adequately fund the community service obligation (CSO).

Principle 3. The rate peg methodology must demonstrably support property rates that are equitable, simple and efficient.

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

There is evidence that the LGCI is not changing to reflect the change in Council's costs – and that as a consequence NSW Council's are dropping service levels, increasing fees and charges and increasing rates through SRVs to address their immediate financial sustainability.

QPRC uses the LGCI cost items to factor its expense budget increases and tracks the change in actual vs budget cost rises over time. A quick sample of actual cost rises for our council is provided in the table below and indicates that some components of the LGCI are reasonable, and some have been significantly low, averaged over 5 years.

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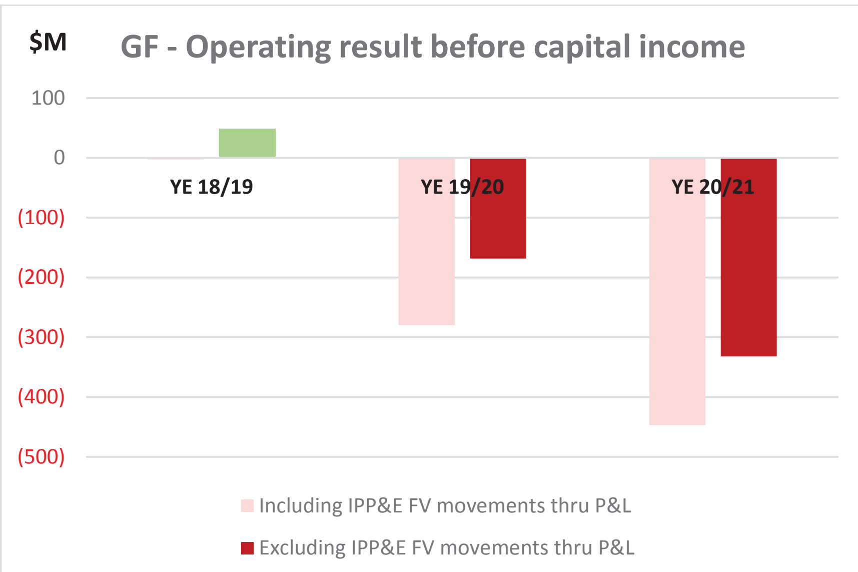
Table 1: Actual Cost increases for QPRC

Trends	2017-18	2018-19	2019-20	2020-21	2021-22	Actual Average	LGCI Average
Insurances	1,219,476	1,335,836	1,395,119	1,636,194	1,795,436	10.2%	2.4%
Electricity	1,663,207	1,709,296	1,861,407	2,028,551	1,967,949	4.4%	5.5%
Street lighting	998,612	1,134,054	1,104,828	2,855,494	722,282	23.7%	na
Petrol	1,288,043	1,423,971	1,595,229	1,418,462	1,661,397	7.2%	5.0%
Telephone	820,922	698,109	845,712	728,197	734,256	-1.7%	-4.4%
Legal Costs	462,738	447,008	668,532	836,070	886,427	19.3%	2.4%
Depreciation	22,167,513	24,908,935	26,553,651	29,464,536	34,734,324	12.0%	2.0%

One of the critical differences for QPRC is the rapidly rising cost of depreciation, which approximates Council's annual cost to renew community infrastructure.

Across the industry, NSW Council revenue has not been sufficient to keep up with rising costs. The following analysis by LG Solutions shows the general fund operating result (excluding water, sewer and other Council businesses) of all NSW Councils over 3 years.



As can be seen above the state wide operating result (before capital income) has dropped from a $49M surplus to a $332M deficit.

This shows that collectively, NSW Councils are financially unsustainable and the 3 year trend indicates that it may not improve. What the year-end 20/21 results mean (Council by Council) is that:

- Overall there are now more Councils with a general fund deficit (58%) than a surplus.
- 20 x general fund Councils went from a surplus last year to a deficit this year.
- While 27 x general fund Councils reported even larger deficits this year than last year.

Councils are using SRVs to 'catch-up' their revenue to meet the cost of service provision. Since IPART took over the rate peg is 2011 there have been 168 SRV applications approved. It has become a part of the normal way that Councils manage their business to provide funding for the increasing costs of providing the level of service expected by local communities. As an outcome, while the rates peg has increased rates by 31.8% over the last 10 years, the average NSW Council residential rates have increased by 57%. Indicating the extent of the difference in the LGCI and the required Council rates over time.

Even if staggered over several years – the SRV catchup is less equitable and more inefficient than properly levied property tax as it:

- Causes price-shock to ratepayers. The impact on financially disadvantaged ratepayers is compounded because often the same external issues that impact Council costs to create the financial urgency required for a decision to apply for an SRV are already affecting household, farming and business budgets.
- Creates inequity for ratepayers in different years. Council's need to be allowed to increase revenue to match costs so that current ratepayers aren't allowed to use up resources and push back the cost of operations to future ratepayers. Ratepayers suffer when price increases are delayed because of decreasing service levels and delayed investment in community services and asset renewal, as well as price rises that affect ratepayers in a different period.
- Makes rates inefficient and increases the administrative cost to Council and ratepayers. Taxes should be easily understood, difficult to avoid and have low costs of compliance and enforcement. Property rates are generally one of the most efficient taxes because they are easy to administer compared with other forms of taxation as they rely on a clear information source – property values are hard to avoid because the Government holds comprehensive land ownership records. Conversely, the SRV process is a massive administrative burden and becomes a major job for Council at all levels – community, councillors and administration.

There should be an annual performance measure on the LGCI that fails in any year where there are councils that have to apply for an SRV for financial sustainability or to maintain infrastructure or service levels.

Is there a better approach?

Yes. The rate peg should be tied to a simple index that can be easily referenced and understood and be provided as a range to accommodate relevant local decision making. For example this might be a much simplified version of the current LGCI that references no more than 3-5 relevant ABS indexes such as the road and bridge construction index +/- 2%. In this way the rate peg range:

- would allow councils' to choose to set their rates below the rate peg with flexibility to deal with one-off issues and their own local circumstances,
- would be very efficient to administer, would create a level of accountability through the annual operational plan and revenue strategy setting process already in place
- and would put the decision-making power back with the communities in line with the local government Integrated Planning and Reporting framework (IP&R).

2) *What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?*
3) *What alternate data sources could be used to measure the changes in council costs?*

The following relevant information should be considering when checking and testing any proposed NSW LG rate peg to ensure it will not undermine the financial sustainability principles, before being released. The industry should be canvassed for a complete list that is specific to the local government:

- LG Award
- Statewide Mutual and Statecover insurance costs
- Total gross assets x required maintenance factor from the NSW LG consolidated Infrastructure note from the audited financial statements
- Any relevant taxation changes – eg the increase in compulsory superannuation
- Building and Construction Index NSW
- Road and Bridge Construction Index NSW
- TCorp interest rates
- NSW wholesale forward market electricity prices

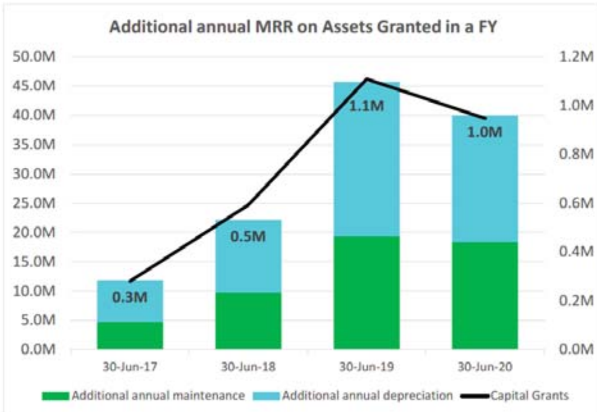
It must be accepted that there is no 'one-size fits all' for NSW LG, which provides a very broad and diverse range of services to local communities. The rate peg must build in a level of flexibility that allows individual Councils to develop their own cost and revenue analysis and appropriate resourcing strategies based on local circumstances including the cost of inputs and the types of services funded by ratepayers.

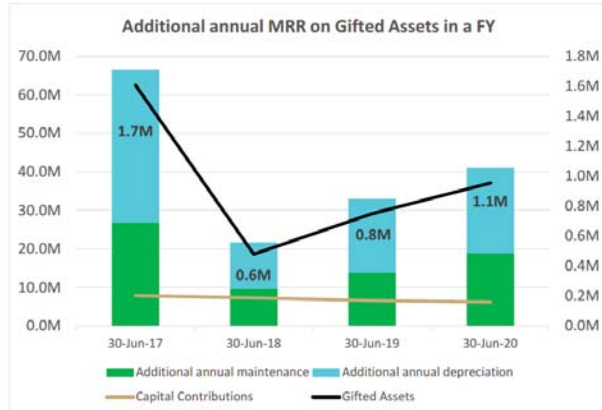
4) *Last year we included a population factor in our rate peg methodology. Do you have any feedback on how it is operating? What improvements could be made?*

QPRC is a high growth Council and the cost of population growth has been built into our long term forecasts. We have planned to reinvest increased revenue from growth into service expansion to provide for the expanding population and new areas of development. The adopted financial strategy also considered the expansion of Council's asset base to provide additional community infrastructure to cope with the service demands of the growing population. Council has so far invested $486M in a program of compressed capital works over 5 years, comprising asset renewal and asset expansion and funded through capital grants and new loans. Our LTFPs had been relying (in-part) on the population factor review, to capture additional revenue for growth.

There have now been 2 rate pegs announced with a population factor, and QPRC received nil additional income in year 1 and 0.9% in year 2. We have annual population growth of 2% and our council's required asset maintenance and renewal costs are increasing exponentially on a growing asset base.

The following charts indicate the estimated additional required annual expenditure on asset maintenance and renewal for new assets that have been contributed by developers as part of new development, or assets that have been contributed by the government for our developing LGA in just the previous 4 years.





The revenue generated by supplementary valuations should not be discounted from the population indexed rate peg.

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

A better approach would be to utilise the existing NSW Local Government Integrated Planning and Reporting Framework (I&PR) to better effect. The current rate peg methodology is restrictive both on councils and the community, as the current rate peg approach does not support the achievement of the Council's draft four year delivery program and the community strategic plan, although they are both underpinned by a robust community engagement process.

The LGCI should be reworked into a performance measure used annually be each Council to value the unique mix of services delivered to the local government area.

In this way, each Council would annually value their outputs (instead of inputs) which would be published at the time of the draft annual operating plan (in March each year) and linked to the development of the annual revenue strategy.

The LG performance measure would become a reasonable and repeatable way of determining and reviewing the cost of services, that would be reported by each Council. This would assist Councils by providing a reporting framework and methodology to determine the annual rate, within the rate peg range – that would directly link with the services prioritised by each local community. It would create a natural efficiency mechanism because it fits with existing council planning, reporting and community engagement frameworks.

This rate peg methodology would have to be designed sensibly and be auditable to ensure a consistent reporting approach across the sector. It would be used as a basis for each Council to review the cost of service provision and community infrastructure, with transparency to report the difference between Council costs and an industry benchmark, with an explanation for local factors.

By building flexibility into the rate peg range – Councils would be able to report on their own service costs for the first time – rather than the current budget method of reducing budgets and service levels over time - to match real revenue decreases.

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

By using an audited LG performance measure reporting framework, IPART would have annual oversight of the cost of service provision and infrastructure for all Councils, including narrations and explanations for change. The process would highlight cost pressures that impact individual councils or all Councils across the sector. By benchmarking all councils annually, we would have an annual check of the effectiveness of the reporting methodology and be able to moderate back to the real world.

Council's currently report to the Local Governments Grants Commission on local cost factors and service levels, and local disadvantages, for example travel / freight distances, skills shortages, relative local petrol prices and cross-border / regulatory costs. The existing local government grants commission reporting and assessment should be utilised as part of the annual assessment of cost of services for each Council.

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

No. Under the current rate peg methodology the majority of NSW Councils apply for SRVs, but the SRV process is inefficient and delays revenue, meaning that services may decline and infrastructure backlogs may develop before additional revenue is sought. These backlogs then ultimately require larger rate rises to rebuild degraded assets and failing services back up to the level required by the community.

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

No. QPRC has been discussing the need for an SRV with its community in order to be financially sustainable.

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

The current rate peg has no flexibility for councils where costs increase beyond the 2 year lagging index. There have been numerous financial sustainability reviews on local government over several years that have sited the current rate peg methodology as a major contributing factor.

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

NSW Councils provide hundreds of different services to all types of communities with different service and infrastructure requirements and willingness and capacity to pay for services. There is no one-size fits all. Even Councils within a classification (Regional, Rural, Metro) have enormous diversity because they provide a large range of local services and infrastructure specifically to meet the needs of their local communities.

Any successful rate peg methodology needs to build in sufficient flexibility to allow an individual council to choose to set a rate lower than the maximum rate peg in any year.

Instead of comparing Councils and attempting to identify a common level of cost increase across NSW, the LG performance measure should be used to assist councils to value the mix of services they provide to their local communities.

The LG performance measure reporting must become a data set that is publicly available for download to allow cross-comparison and full transparency.

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

Councils would prefer better alignment with changes in costs over certainty over future rate pegs and the methodology should be designed with the timing of council IP&R as provided by the OLG Guidelines. Council's advertise their operational plans from March / April every year and therefore the rate peg should be released after the December ABS publication.

13) Is volatility in the rate peg a problem? How could it be stabilised?

Volatility in the rate peg can be managed if the rate peg range allows councils' some flexibility to plan ahead. The rate peg needs to rise and fall to allow councils sufficient revenue to pay for changing costs of infrastructure and services – and councils will need to balance that with the impact on ratepayers caused by sudden rates increases.

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

There is no benefit in setting a long term rate peg – as it would not be able to anticipate the changing needs of councils and their communities.

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

Yes. The rate peg range should be released by early March each year to allow time to be incorporated into council operational plans, budgets and revenue strategies that are generally put on public exhibition in April for June adoption. The December ABS indexes should be used for the calculation.

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

The Local Government Award must be taken into account when testing the adequacy of the annual rate peg range. The award is a negotiation process, includes considerable stakeholder involvement from a number of parties and includes consideration of a wide range of relevant issues. It should not be automatically dismissed as being an inefficient process – and equally should not be automatically accepted as producing the best value result for ratepayers without additional accountabilities. It is not in the ratepayers interest to underpay local government employees.

(There could be a separate analysis performed on the relative wages of local government employees and their State and Federal government counterparts across a wide range of professions if that was thought to be relevant to the discussion on the rate peg methodology. This analysis would need to consider the different professions and productivity of different levels of government, and weigh up the importance of attracting skilled employees to the sector.)

Use of the public sector wages index should immediately be stopped and is patently irrelevant to the LGCI.

The test of efficiency for local government wages must come back to the value received by the ratepayer relative to the services they receive. Councils should be transparent in their reporting to ratepayers on the cost of services provided. Each Council makes its decision on how to resource those services based on providing the best value to ratepayers.

17) *Should external costs be reflected in the rate peg methodology and if so, how?*
18) *Are council-specific adjustments for external costs needed, and if so, how could this be achieved?*
    i. *In regards to the Emergency Services Levy:*

The Emergency Services Levy sits outside this discussion on the rate peg methodology. The rate peg range should not be designed as a 'loop-hole' that allows other levels of government to shift costs directly to the ratepayer.

Council's should report annually on the amount of costs imposed by other levels of government as part of their LG performance measure report and the total amount should be reported to all NSW taxpayers and ratepayers.

Direct cost shifting is an unfunded cost and could be the subject of Council SRVs which would maximise the opportunity for community feedback on the practice. And, in any year when there is a such a significant increase caused by cost-shifting across all NSW Councils, an additional % allowance for the cost could be added on to the rate peg range – as long as there is full transparency and the cause and value of the rate rise is reported to ratepayers.

ii. *In regards to changes in services and service levels and reprioritisation of services.*

Communities should be allowed to ask their councils for changes in services and service levels and reprioritisation of services through the existing integrated planning and reporting process. Councils can manage their resourcing strategies and associated revenue strategies if the rate peg range builds in sufficient flexibility. However more expense changes requested by the community or planned by council that would require additional rates revenue above the rate peg range could be accommodated through the SRV process.

In this way – SRVs would become more targeted to service increases as opposed to financial sustainability, and the IP&R process would be able to be used to its potential.

iii. *Other external costs such as election costs.*

Councils provide a wide range of services including substantial compliance activities required to be provided by legislation or government direction. These should not be individually accounted for in a rate peg calculation (as this would be inefficient) and the rate peg should not be set at such low levels that one-off costs can't be otherwise allowed for within the rate peg range.

It is expected that other external costs relating to compliance would be captured and reported LG performance measure report that would assist with transparency to ratepayers over what is driving changes in the cost of local government services and rates over time.

19) *What types of costs which are outside council's control should be included in the rate peg methodology?*

Costs that are not in councils control and should be considered when testing the adequacy of the rate peg range prior to its announcement include:

- Changing nature of the workforce, generational change and pandemic impacts on operational capability
- Climate adaptation (as a proactive measure)
- Increasing natural disasters
- Insurance impacts, electricity market costs, borrowing costs
- costs shifting from differing levels of government without compensating funding.

20) *How can we simplify the ratepeg calculation and ensure it reflects, as far as possible, inflation and changes in costs of providing services?*

Ideally, property taxes should be premised on simplicity, transparency, ease of administration and equality including intergenerational equity. Each year when the rate peg range is announced, there should be a report that demonstrates how the rate peg methodology and outcomes meets its objectives.

There should be an opportunity for continued stakeholder comment on the methodology and outcomes, and an ongoing process that continues to drive improvements to the ratepeg based on its performance against meeting its objectives.

Council's submission has outlined an alternative ratepeg methodology that utilises and enhances the existing successful IP&R process, that allows local flexibility and local decision making to meet ratepayer priorities, and that builds in additional transparency over the value for money that ratepayers receive and the cost of services.

Thank you for the opportunity to contribute to this important discussion. Please contact me on [redacted] if you require any additional information.

Yours sincerely,

[redacted]

Kate Monaghan
Director Corporate Services
Queanbeyan-Palerang Regional Council