Randwick City Council
a sense of community

Randwick City Council
30 Frances Street
Randwick NSW 2031

**Phone** 1300 722 542
ABN: 77 362 844 121

**council@randwick.nsw.gov.au**
**www.randwick.nsw.gov.au**

**Follow us here**

**2022-23 Rate peg methodology review**
**Independent Pricing and Regulatory Tribunal**

04 November 2022

**Ref No:** F2004/07049

**PO Box K35**
**HAYMARKET POST SHOP SYDNEY NSW**
**1240**

Dear Sir / Madam,

## 2022-23 Rate peg methodology review

## Response to IPART Issues Paper – September 2022

Thank you for the opportunity to respond to the review of rate peg methodology issues paper. Please find below Randwick City Council's feedback to the questions raised throughout the paper.

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

The LGCI measures the changes in prices of a fixed "basket" of goods and services purchased by the average Council. The basket has too few items and the weightings lack evidence, with changes to weightings being too infrequent. Using moving averages over a 3-year period adjusted yearly would be more accurate in reflecting costs. The LGCI does not consider the differences between Councils, with no regional weightings. Across NSW (New South Wales) Councils there is a wide range of demographics, and geographic and economic differences, none of which are currently considered.

The LCGI is a basket of rear-facing indexes that are not suited to high inflationary environments as they do not consider the time lag of cost changes. Using moving averages would reduce volatility and help councils to predict future rate caps that are used in planning and preparing budgets.

Rate increases need to be in line with current CPI (Consumer Price Index) levels otherwise ratepayers are effectively getting a tax cut, while Councils fund the cost of goods and services at current inflationary levels. As the producer price index (PPI) serves as an indicator for the CPI, IPART (Independent Pricing and Regulatory Tribunal) should consider increasing the weighting of the PPI cost components of the LGCI. Updating these weightings on a yearly basis, using data from the Annual Financial Statements and Financial Data Return would be of greater value than using data that is 4–5-years out of date.

Alternatively, IPART may consider:

- removing the rate peg altogether and allowing individual councils to determine increases on a cost basis like other service charges; or
- use cost indexes that take into consideration the demographics, geographic and economic variances between the 5 council types

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

If there is no appetite to remove the rate peg, then the best measure of changes in council's costs and inflation would be:

- the use of actual cost data as per the Financial Statements and other data returns made available to the Office of Local Government (OLG) each year.
- use cost indexes that consider new LGCI factors such as council size, location, and population demographics and applying theses LGCI factors to the actual expense. This would provide, more accurate future costs than using 4-5-year-old data.
- new LGCI to be introduced that closely align to council types and the demographics, geographics and economics of individual council areas. Councils have unique sets of challenges such as the recent floodings experienced by many regional councils.

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

CPI forecasts would provide the best indication of future costs, together with an expanded basket of LGCI applied to individual councils' actual costs from previous years.

Actual data is currently available through the many returns and Financial Statements submitted to the Office of Local Government (OLG) each year.

**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?**

Population growth is not the correct functional unit as it does not measure the demand for new services, and the pressures for new expenditure as well as other factors would. A more accurate indicator of growth would be the number of rateable assessments in each local government area. Annual population changes can generate significant changes in rates under the IPART methodology which can be problematic to council's financial planning. The population factor is a poor estimate, open to large errors between census years that result in sudden shifts, that can only be avoided using 3 year rolling averages.

This lag between the growth period and the year it will be added to the LGCI to determine the rate peg limit needs to be addressed. For the financial year 2022-23 the Estimated Residential Population (ERP) used was the growth measure between 2019 and 2020. ERP is backward-looking, and projections are forward-looking and prone to fluctuation. Councils of course use projections in their strategic planning including Long Term Financial Plan modelling and modelling that underpins our informing strategies, e.g., Housing Strategy. Hence, on face value the proposed methodology appears misaligned with our strategic planning.

In place of population growth (or in conjunction with it), the rate peg could consider factors that are more closely aligned to the demographics, geographics, and economics of council areas. E.G. IPART could consider: - age of the population (number of residents receiving concessions), number of employed residents, number of disabled residents and income levels.

Another important consideration is the population growth factor is reduced by the growth from supplementary valuation changes. This is flawed as it does not account for negative supplementary growth. What is considered is the net effect of supplementary valuations taken up during the year. What is not shown for example is the losses that a council may have incurred where a highly rated business property is developed and subdivided for residential development. Income is reduced and there is no provision for a catch up of this lost valuation. This supports the notion that growth would be better measured by assessment numbers.

Council supports a transition to Capital Improved Values (CIV) as a mechanism, to allow councils revenue to grow as the communities they serve do. This is also the view of the NSW Revenue Professionals Group.

CIV is efficient:

- Easily understood, landowners are more likely to know the value of their ‘property’ than the value of the land that their house sits on.
- The Premier requested IPART review the rating system to be ‘easily understood.’ The IPART delivered on this in the 2016 Review.
- High values contribute more; low values contribute less.

CIV enables immediate effect due to population growth:

- Councils receive supplementary rate income and grow as they do now due to subdivisions;
- Growth in vacant land (same as now) = uplift in rates
- Growth in value and population once building complete = uplift in rates
- Minimal lag between subdivision (new plan) and rate income
- Rates are paid as growth occurs.
- Minor growth due to increased capacity (e.g., secondary dwellings) is identified.

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

Improvements in productivity and efficiency do not need to be included in the methodology. Deducting a productivity factor where there is evidence of productivity improvements would only serve to discourage councils from striving to achieve future productivity gains that would serve the community. Services which cannot be funded, are generally funded out of productivity gains to the benefit of the community.

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

The rate peg methodology should continue to include the unique cost factors adjustments for costs considered to impact Councils, such as the temporary upwards adjustment in 2021-22 to assist with meeting the additional costs of the local government elections and the adjustment in the 2023-24 rate peg to cover the increased super guarantee cost.

Other external factors that should be adjusted for are those factors that put cost pressures on councils. Proactive planning and post event remedial costs for natural disasters and severe weather events. While funding is made available for natural disasters it is not always sufficient to meet the costs required to repair the damage experienced. In addition to this, mandatory legislative and technology compliance such as NSW Cyber Security Policy, building and specialised contracting costs.

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

Rate pegs using the current LGCI have given ratepayers tax relief and protected them to an extent far greater than inflationary pressures. This year Council faces current inflationary costs around 7.3% with the rate peg for 2023-24 of only 3.7%

Rate pegging on this basis can lead to unsustainability for councils, with more councils across NSW struggling financially. When councils are underfunded and unable to meet service level requirements, this can result in future SV’s being sought for significant amounts. Such significant rate hikes end up working against the principal purpose of the rate peg which is to protect ratepayers from significant increases.

Importantly, NSW councils adhere to strict IP&R (Integrated Planning and Report) (Integrated Planning and Report) frameworks that require extensive community consultation that allows for intervention by the community and mandates numerous consultation steps. It is important to note that the IP&R framework was not in place when rate pegging/capping was introduced in 1977 yet the NSW Government has made no concessions to allow the ratepayers of NSW more choices in how the community can be better funded.

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

No. Therefore councils seek SVs from time to time. Without SVs many councils would have become unsustainable and would fail to deliver the services the community expects.

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

The rate peg alone has limited the projects and capital works that council is able to fund, requiring councils to apply for SVs to ensure financial sustainability and meet community expectations regarding service delivery. Many councils have had to rely on significant SV to remain financially sustainable, exasperating intergenerational inequity.

In the last 10 years:

- 178 councils applied for an SV
- 165 applications were approved in full or in part
- 142 applications were justified based on one or all the following:
    - to address financial sustainability,
    - existing infrastructure backlogs, and
    - future infrastructure expenditure obligations.

In addition to this, the last 3 years:

- 79 councils reported an infrastructure renewal backlog of greater than 2%
- 56 councils consistently reported an infrastructure backlog of greater than 2%
- 99 Councils reported an infrastructure renewal ratio of less than 100%
- 33 Councils consistently (over 3 years) reported an infrastructure renewal ratio of less than 100%
- 74 Councils reported an infrastructure renewal ratio of less than 100% over a 3-year average.

The above statistics clearly show that a large majority of NSW councils are balancing their operational budgets by underfunding capital obligations, indicating that the rate peg alone has not been sufficient to meet the growing expectations of communities.

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

All councils are different, operating under different environments and different conditions. IPART should consider additional data such as geographics (climate, location, size), demographics (population size, age, employment, homeownership, education levels) and economics (income levels, tourism, business investment, interest rates). Political and community involvement also reflect how councils differ. Location and size impact service levels, and infrastructure where there is a greater tourism demand or greater business concentration. Tourism and areas of high business concentration place an additional burden on council's assets above usual levels. This additional burden is in the form of the costs associated from pressure on infrastructure, the environment, local communities.

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

The benefits of introducing different cost indexes for different councils would mean that costs would realistically represent the demand for new expenditures for councils. Service levels, volume, and type vary between council types, of metropolitan and regional councils. There are even significant differences between councils of the same type.

Employee benefits and on-costs was higher for metropolitan councils (40.7%), compared to regional and rural councils (36.2% and 34.6% respectively). The cost share of Construction works

– roads, drains, footpaths, kerbing, bridges was higher for regional and rural councils (27.0% and 23.9% respectively), compared to metropolitan councils (18.2%).

(https://www.ipart.nsw.gov.au/sites/default/files/documents/fact-sheet-reweighting-of-local-government-cost-index-12-may-2020_0.pdf)

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

Yes, after the 2022/23 rate peg, of just 0.7% councils were given the option to apply for an SV without the need to follow the usual process. The volatility in determining the rate peg was clearly indicative of a need to align the LGCI to the current financial environment and the need to alter weightings to assist in containing this volatility. This needs to be addressed by using forward - facing indexes relevant to individual councils, based on rolling averages. When making an application for SV, councils consider future expenses and financial position and do not refer to historical costs. This same principle could be applied to the LGCI, aligning the rate peg and SV methodology.

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

Better alignment with changes in cost would support financial sustainability. This could be achieved as mentioned above using a rolling average of LGCI and increasing the “basket” of indexes. Certainty around a future rate peg does not necessarily guarantee that it would align with costs and inflation.

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

As in Q13, it would be preferable to better align with changes in costs than set a longer-term rate peg over multiple years. While setting a longer-term rate peg over multiple years would provide some certainty, it would not address inflation volatility or unexpected events such as natural disasters. It could impact financial sustainability in high inflation environments unless a 3-year rolling average of weighted LGCI was introduced.

Setting a longer-term rate peg could also restrict community initiatives for new projects or services as expenditure would be locked into the future rate peg limits and may not align with the community's ability to pay.

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

A later release date for the rate peg could only be accommodated if the exhibition timelines for the Operational Plan (budget) were also adjusted. Using a December quarter CPI against the LGCI factors could work.

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

To reflect efficient labour costs, alignment to the NSW Local Government Award and factoring in current markets costs would more accurately reflect Council’s costs. Labour costs need to reflect current market conditions, which include employment conditions to retain and attract skilled employees to the industry. Labour costs also differ significantly between regional and metropolitan councils.

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

Yes, any costs that apply to all councils should be reflected in the methodology. These should include compliance costs, asset revaluation costs, and audits. Rebate entitlements not subject to the government subsidy should also be considered for inclusion, so Councils with older demographics are not being financially disadvantaged.

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

Council-specific cost adjustments are needed, allowing for a more accurate cost reflection in the Rate Peg. The rate peg however needs to be applied on an individual council basis to be fit for purpose. Details of specific adjustments could be obtained through the Financial Reporting and FDR (Financial Data Return) that are already submitted to the OLG each year.

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

Only costs that apply to all councils uniformly should be included in the rate peg methodology such as the cost of legislative compliance, audit, and revaluation fees. Cost shifting from other levels of government continues to be an issue for local councils, with no regional-specific weightings. Some examples include Fire Service Levy, State Emergency Services Levy and Planning Levies which is more than $5M annually. The NSW Audit Office has been responsible for council audits fees have also increased significantly. For example, Randwick City Councils audit fees increased 16% from 2021 to 2022 and is expected to increase further beyond the current rate peg.

**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 use of historical data needs to be removed and replaced with the use of future- facing forecasts on an individual council basis. If the rate peg is to remain the LGCI needs to be reviewed to use local government-specific indexes, as well as operating environment factors that are the cost drivers for councils. These include council demographics, geographics and economic factors. Alternatively, the rate peg be removed, and control of rate increases is returned to local government councils, as occurs in other states. This will better equip councils to take control and ensure financial sustainability.

Kind Regards,

[redacted]

**Stephen Wong**
Chief Financial Officer
Randwick City Council