2022

Response to the IPART Rate Peg Methodology Review

RIVERINA JO
JOINT ORGANISATION

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RESPONSE TO THE
RATE PEG METHODOLOGY REVEW

Introduction

This submission is lodged on behalf of the Riverina Joint Organisation, our Members are the councils of Bland, Coolamon, Cootamundra-Gundagai, Greater Hume, Junee, Lockhart, Temora and Wagga Wagga.

At the outset our Members want to make it very clear that they do not support the rate peg. The argument that the rate peg "protects" ratepayers is offensive. Local Government is government at the grassroots, it is the government that is held to the highest accountability because of its daily front-facing interactions with its constituency. Councillors are held to account at the ballot box just as State and Federal politicians are, and we maintain that this is where councils should be held to account for the decisions made in relation to the rates they charge and the services and facilities they provide.

We welcomed IPART's recent decision not to move forward with setting a Domestic Waste Charge peg. We believe that some of the reasons provided for not proceeding with that peg apply to the Rate Peg:

- It does not reflect cost increases beyond council control.
- There are methodology and data limitations making it difficult to find one rate for all.
- It limits councils' ability to provide what the community wants.

If a new methodology is adopted then it must address the above limitations that undermine the validity of the current methodology.

Our Members welcomed the introduction of the Population Growth factor into the rate peg calculation because it recognised that lumping 128 councils together to find a one-size-fits-all increase in rates does not work. We believe that if the methodology for creating the peg is to improve, then underpinning the approach must be recognition that the services, facilities and staffing issues for a council in the centre of Sydney are vastly different to one in the Riverina or Far western NSW.

Is it any wonder that rate pegging has not worked when the same weightings and indices are used to calculate the peg for a council with no rural roads and a population density of 8,040 people per square kilometre[1] as it is for one with hundreds of kilometres of unsealed roads and a population density of 1 person per square kilometre[2]?

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[1] City of Sydney: https://profile.id.com.au/ssroc/about?WebID=180#:~:text=The%202021%20Estimated%20Resident%20Population,8%2C040%20persons%20per%20square%20km.

[2] Bland Shire Council: https://www.yourcouncil.nsw.gov.au/wp-admin/admin-ajax.php

In addition, the inability of the current approach to factor in the cost of enhancing, increasing or introducing new services undermines the ability of councils to effectively deliver the commitments made to their communities through the Integrated Planning and Reporting regime. Councils are forced to reduce one service in order to increase another in a no-win scenario where the rate peg insists it is supporting a Business-As-Usual regime.

Our Members recognise the need for IPART to have a robust and transparent methodology to calculate the rate peg. A methodology that can be interrogated to provide answers that are supported by independently verifiable indices. In order to achieve this, we believe that IPART should construct a Character Matrix that is used along with the Local Government Cost Index (LGCI) to determine a rate peg that reflects the specific characteristics for groups of councils.

In much the same way as Disability Factors inform the calculation of the Financial Assistance Grants, the Character Matrix could address the unique factors that each council is required to address in order to deliver a rate peg that more closely meets the actual costs incurred by council. Just as the Grants' Commission calculates a minimum grant across all councils and then tops-up the grant using Disability Factors, we suggest that IPART could calculate a base rate peg and then adjust it using the Character Matrix.

Below we address each of the questions asked by IPART in its Issues Paper.

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

Our Members do not believe the LGCI adequately reflects councils' real costs. For example, despite numerous approaches to IPART requesting that it cease using the NSW Public Service Wage Index as the indicia for wage increases and instead rely on the Local Government Award wage increase the practice has continued. The Public Service Wage Index is consistently 1-1.5% below the actual wage increase imposed on councils through the NSW Local Government Award. Given that around 40% of a council's total expenditure is on wages the financial impact of this one decision is substantial.

In previous conversations with IPART about this issue we have been advised that the discounted approach is indicative of productivity gains upon which the increase is based. This is an economic fiction, the industry wide bargaining that is undertaken to achieve the annual wage increase means that productivity gains are unlikely to be achieved at an individual council level, particularly as most councils have stretched their workforces as far as they can in order to balance budgets.

The failing to address wage increases appropriately is further exacerbated by the skills shortages that most councils in regional and rural NSW are facing and have faced for some considerable time. This has resulted in many of our Members being forced to offer over-Award wages in order to remain competitive in a very tight jobs market. Not only is LGCI not recognising the full extent of mandated wage increases, but it is also not accommodating the supply driven labour market.

There is also an inherent problem with the way that the Emergency Services Levy (ESL) is handled. The ESL costs are pooled and then attributed to every council. However, the economic burden does not fall equally with rural councils meeting the full cost of the Rural Fire Service (RFS) contributions.

The RFS contributions should be ring-fenced and only applied to the calculation of the LGCI for the councils that pay it.

As mentioned above a major cost item is the implementation of council Community Strategic Plans (CSP). Councils are required to produce and deliver on their CSP; however, the rate peg makes no provision for this. The delivery of the CSP is a core activity and consequently a Business-As-Usual requirement, it is not appropriate that councils should have to seek a Special Rate Variation in order to deliver on a mandated activity for which they are measured. There should be provision in the rate peg calculation for the delivery of the CSP.

The calculation of the rate peg fails to consider policy changes or additional regulatory burdens which create additional cost burdens for councils. Where councils are required to deliver new regulatory functions, the State will often advise that the council can set charges to recoup the attendant costs. While this might work for councils with large population bases operating over a small landmass, for small councils the quantity of transactions undertaken rarely cover the actual costs in delivery. There is simply not the volume of work available to generate sufficient income to cover the costs unless councils make the decision to charge substantially for the regulatory service. However, revenue can be limited either by the State setting a ceiling fee for the service or the council deciding the cost-recovery fee would be prohibitive.

Additional regulatory or reporting requirements introduced by the State are likely to lead to either the recruitment of new staff or the engagement of specialist consultants to fill knowledge and skills gaps in councils. Again, this is an increase in costs beyond council control, which is not currently factored into setting the rate peg.

The introduction by the OLG of the Audit, Risk and Improvement Committees (ARIC) is yet another example of a cost impost that is beyond councils' control. We estimate that the cost of an ARIC for most councils will be at least $50,000 per year, for most of our councils to 0.7% rate peg that was calculated by IPART for 22-23 would not have raised sufficient funds to cover this cost.

We would therefore suggest that prior to setting the rate peg that IPART should contact all State government departments and agencies to determine what new regulatory activities and policies have been introduced or will be introduced that are likely to have a cost impact on councils. The additional costs of delivering on the State imposed activities should be accommodated in the rate peg.

Our Members agree that IPART should consider emulating the process used to calculate the Local Government Financial Assistance Grants (FAGs) whereby Disability Factors that impact on individual councils are added to a base grant amount to provide an uplift in funding that recognises the unique factors that individual councils face. The Grants' Commission utilise the following factors to determine the final FAGs grant amount:

- Population – total for the LGA
- Aboriginal and Torres Strait Islands (% of population
- Local road length (in kilometres)

- Environment (hectares of environmental land) rainfall, topography and drainage.[3]

Our Members suggest that the above factors could be incorporated into the proposed Character Matrix.

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

Our Members agree the measurements that are currently in use are not of a sufficiently timely nature to inform good outcomes for the rate peg. The data is just not current enough.

Our Members agree that using the Financial Data Returns (FDRs) that councils submit by the end of October each year would provide far more up-to-date information that would better inform decision-making. Our Members suggest that if IPART were to work with the OLG and councils, the FDRs could be amended to capture additional information that would support the calculation of the rate peg. For example, if the FDR also captured staff vacancies in additional to staff numbers and costs this would provide a true indicator of labour costs.

In addition, because FDRs are lodged annually it is more likely to capture inflation costs, although we recognise that increases in expenses can also be the result of volume and service level increases.

We also suggest that IPART consider a "smoothing" approach to inflation, perhaps adjusting for inflation using the immediate past 3 quarters and the projected forward quarter to create an inflation rate that can be used in the rate peg calculation.

Again, we believe that it is important that IPART contact all State agencies to determine what new policies and regulations are being introduced or have been implemented that are or will have cost implications for councils. Local Government across NSW bemoans "cost-shifting" for the imposts that it creates and the impacts it makes on the financial operations of councils. However, this could be mitigated if IPART took the additional work into account when calculating the rate peg.

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

As stated above we believe that council Financial Data Returns (FDRs) would provide a robust data source that IPART could use to calculate the rate peg.

We have in the past expressed our concerns that IPART does not appear to "ground-truth" the rate peg to determine whether or not it will provide sufficient revenue uplift to cover costs. We believe that one way this could be addressed is by IPART incorporating a review of council operating statements to determine whether the proposed rate peg will allow a council to run in a financially viable manner.

As suggested above we believe the Grants' Commission's Disability Factors could be used to inform the rate peg and recognise the unique factors that impact on council operations. Our Members

[3] https://www.olg.nsw.gov.au/wp-content/uploads/2022/04/Financial-Assistance-Grants-2022-23-Fact-Sheet-2022.pdf

recommend applying the ABS' SEIFA Index[4] as this would allow incorporation of the socio-economic issues in relation to each LGA. This is important because generally the SEIFA Index is reflective of the types of services that are needed within a community.

A further factor that our Members would like to see incorporated into the calculation is the geographic area that the council covers. The reason for this is that councils and rural and regional areas usually cover large land areas, with low population density. Councils that service LGAs covering large landmasses are usually required to provide multiple service points and community infrastructure and facilities for their communities. The demand for duplicated service delivery is compounded by a complete lack of a viable public transport system that would underpin the ability of councils to centralise services and facilities.

As a consequence of this issue, we have Member Councils that have multiple swimming pools, libraries and customer service points. Every time a council is required to duplicate a service or facility this adds to council operating costs. However, the rate peg does not take this into consideration.

Finally, we believe that the rate peg should factor in the quantum of local roads (on a per kilometre basis) in the calculation of the rate peg. This could also include the number of kilometres of sealed and unsealed roads because this reflects the costs involved in maintaining the infrastructure.

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?

Our Members agree that the application of the population factor needs refining. This is because of the lag in the population numbers and the projection's reliance on past performance being an indicator of future outcomes.

Our Members suggest that the population projections be further informed with the data being lodged through NSW Planning's Planning Portal on residential DAs which would show possible increases in population through increased housing and DAs for industrial developments which could show projected increase in employment which would translate to increases in population.

For example, NSW Planning's population projection for Bland Shire Council is for an increase of 12 people between now and 2040. However, Evolution Mining, the Shire's largest employer has an approval to expand its operations which will require an additional 200-250 staff. Council needs to prepare for the increase in population but this need will not be recognised in the rate peg under the population factor as it is currently applied.

IPART is already aware that the population factor only considers permanent population increases not temporary increases caused by holidaymakers, which can double the size of a population for months on end. There should be a mechanism within the rate peg methodology that recognises the increased demand on infrastructure and services created by tourists.

[4] https://www.abs.gov.au/websitedbs/censushome.nsf/home/seifa

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

Our Members are very concerned that IPART has failed to recognise that any improvements in productivity are used by councils to deliver additional services for the community. As stated above there is no provision within the rate peg for councils to fund the delivery of their CSPs. Consequently the only way CSPs can be delivered is either through productivity and delivery efficiencies or by cutting existing services and delaying maintenance activities.

Local Government's primary goal is to create community dividends through the delivery of services and facilities that meet community needs as identified though the CSP process. Therefore, any gains in productivity are converted into service provision for the community.

Our Members also argue that if there is a chance that councils will be penalised for implementing efficiencies, through the loss of rates' revenue, then this could act as a disincentive to more efficient operations for some councils.

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

Our Members agree that adjustments should be made for external factors and that these would include costs such as:

- The Rural Fire Service Contribution
- The introduction of new regulations or policy changes that create an additional financial or resourcing impost on councils such as the introduction of the ARIC regime, or the requirement to account for Rural Fire Service Equipment
- Natural disasters
- Population Density
- Aboriginal & Torres Strait Islanders
- Aged Population
- Environment (ABS - ha environmental land) Rainfall, topography and drainage
- Tourism Influx – population growth that must be serviced to accommodate a regular influx of tourists
- Remoteness.

As suggested above these factors could form part of the Character Matrix for a council.

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

There is absolutely no objective way that this assumption can be tested as NSW councils have not been permitted to set their own rates for over 40 years. However, looking at what has happened in other States where there is no rate peg, the answer is likely to be no. There is nothing to indicate that in States where councils set their own rates that they have imposed rate increases that would be deemed to be unnecessary.

The underlying issue that this question raises is whether the NSW rate peg is set to ensure councils stay financially viable or is it set to keep rates as low as possible. A mindset that dictates that the setting of the rate peg is to avoid rate rises, inevitably results in rate pegs that do not cover council costs. This then results in councils being forced to play "catch-up" either through a Special Rate Variation or delays in vital infrastructure maintenance or the reduction of services.

Notwithstanding the above, our Members suggest that IPART consider setting a minimum and maximum rate peg, with councils being able to set their own peg within the range. We believe that this type of approach would allow councils to better match the rate peg to their costs while still working within an independently determined range.

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

Our Member Councils agreed that the rate peg has failed to provide sufficient income to deliver services to their communities.

What has resulted is councils being forced to make decisions to push liabilities further down the line, delay the maintenance of community infrastructure, cutback on service or a combination of all three. Increasingly, it is resulting in the inability to attract skilled workers because councils cannot compete in a highly competitive labour market environment. Our inability to attract skilled workers has resulted in an increasing reliance on third-party providers which inevitably increases costs.

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

Our Member Councils agree that the rate peg has impacted on councils in the following ways:

- Required councils to find efficiencies – however efficiencies are finite in nature and eventually manifest themselves in maintenance and service cuts.
- Reduction in services and reduced and delayed maintenance on infrastructure
- Undermining service provision
- Increased the pressure on staff to continually deliver more with less
- Reduced the attractiveness of local government as an employer of choice
- Reduced the financial viability of councils
- Impacted on the ability of councils to deliver on their CSPs.

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

We have suggested that the methodology make use of a Character Matrix that reflects the differences between councils. The matrix could utilise as a starting point, the Australian Classification of Local Government whereby the OLG has previously divided councils into 22 categories dependent on their location and population size (**Attachment One**).

In addition, the Matrix could introduce percentage weightings that addressed issues such as the SEIFA Index for the LGA, the population density, the need for multiple delivery points for community infrastructure and services, the kilometres of sealed and unsealed roads, the demographics that might reflect additional service needs, such as an aged population, aboriginal population or the numbers of Culturally and Linguistically Diverse people.

A co-design approach to the development of the Matrix is supported by our Members, to ensure that it covers the diversity of challenges that councils face.

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

Our Members agree that the benefit of introducing different cost indexes is that it would better reflect the costs that different councils face. We have mentioned above that the way that IPART's current approach to the ESL does not accurately reflect the way that the costs impact on different councils, introducing different cost indexes for different council types would address this.

The OLG already has categorised council by type dividing councils into 22 categories using the Australian Classification of Local Governments. This could be used to factor in population size, remoteness etc. to determine different rate pegs for different council types. In addition, our suggestion of incorporating a Character Matrix would further refine the rate peg by capturing unique differences between council types.

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

The rate peg's volatility was certainly demonstrated when councils saw it drop for 22-23 to 0.7% for most councils from 2.0% in 21-22.

As suggested above we believe that the adoption of a rate peg range, setting a minimum and maximum peg would assist in addressing volatility issues. The other approach that could be utilised is setting a benchmark rate peg and allowing councils to set their own rate peg either above or below the benchmark. Where a council sets a rate peg well above the benchmark, the council could be asked to explain why the higher rate was used. This is the approach that was canvassed when IPART considered setting a Domestic Waste Management Charge peg, we believe it could also work for the general rate peg.

Finally, we believe that the rate peg should be benchmarked against other indexes that measure growth in costs like the CPI or inflation rate.

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

Our Member Councils strongly support a better alignment with changes in costs. We are concerned that certainty will mean the release of the rate peg too early or perhaps for a period of years, meaning that it will not capture recent, significant cost changes.
The lag time relating to the indicia that is currently used has been identified as an issue, this would be exacerbated if the peg was either released earlier or released for a period of years.

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

While there may be some merit in a longer-term rate peg, our Members are concerned that the approach will fail to reflect sudden, unexpected changes that impact on costs, for example the war in Ukraine.

If IPART was to move to setting a longer-term rate peg then it must have the capacity for an uplift that responds to significant cost changes.

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

As stated above our Members believe that the FDRs should be used to inform the rate peg calculations. The FDRs are submitted by councils at the end of October; therefore, our Members would support a later release of the rate peg, but no later than the end of December.

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

Our Members do not believe that this should be a variable in the rate peg. As stated above any efficiencies achieved translate directly into services for the community.

In addition, in a skills shortages environment where councils are struggling to fill positions and are being forced to pay a premium on wages any efficiency in labour costs is consumed by increases in wages far and beyond the Award increases.

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

Our Members agree that external costs should be reflected in the rate peg methodology. This could be achieved by calculating the LGCI in the normal way and then adding the additional factors based on applicability.

This would require that a profile be established for each LGA in consultation with the council that flagged the specific costs that applied for the council, perhaps using the same Disability Factors as the FAGs uses as well as other factors that have been agreed on for example: size of the LGA and population density, kilometres of roads and SEIFA index. This information would be used to inform the Character Matrix that has been suggested above as a way to recognise unique internal and external costs faced by councils.

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

As suggested above there should be a Character Matrix developed that can be incorporated into the rate peg calculation

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

We have mentioned many of these above, however we would like to raise the issue of natural disasters and the immediate costs that result during and following a disaster. For example, during the bushfires in 2020 one of our Member Councils was forced to purchase satellite phones to ensure their staff could communicate with each other when the mobile phone system crashed.

In the instance of floods, the additional burden of immediate clean-ups from a public health perspective generates immediate additional costs for councils. There is a time lag between a disaster and the distribution of grants to meet the costs that arise from those disasters, in the interim councils need to start repairs and clean-ups.

We believe that the addition of a resilience factor to the rate peg would allow councils to build a specific reserve to address the immediate financial resourcing required to deal with natural disasters including bushfires.

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?

It is more likely that in order to reflect inflation and changing costs that the rate peg will need to become more complex not simplified. There are 128 councils in the State and each one has different cost pressures. The current way of calculating the rate peg is probably the most simplified approach because it results in one-size-fits-all outcome (excluding the population growth variable).

Our Members agree that the rate peg does not need to be simplified it needs to more accurately reflect the costs borne by councils to provide the communities they represent with services and infrastructure. This is likely to require a more in-depth approach to the calculation of the rate peg that captures appropriate and relevant information on council costs.

Conclusion

Our Members welcome the opportunity to provide this feedback on the rate peg methodology, however as stated earlier, this does not mean that our Members support the continuation of the rate peg.

However, if the rate peg is to remain then it needs to better reflect the unique characteristics of the 128 councils that represent communities stretching from the metropolitan Sydney to outback NSW. The one-size-fits-all approach does not result in a rate peg that adequately supports council operations, nor does it allow councils to grow the services they provide to meet the demands of their communities.

If councils are to remain financially viable and successfully deliver on their Community Strategic Plans then the calculation of the rate peg must change substantially, working together with councils in a genuine co-design approach our Members believe that this can be achieved.

ATTACHMENT ONE

Australian Classification of Local Government and OLG group numbers

Step 1	***Step 2***	**Step 3**		**Category**	**Alpha**	**DLG group No.**
URBAN (U)						
	Capital City (CC)	Not applicable		1	UCC	1
Pop. > 20,000	***Metropolitan Developed (D)***	Small (S)	up to 30,000	2	UDS	2
	Part of an urban centre > 1,000,000 and pop. density > 600/sq km.	Medium (M)	30,001-70,000	3	UDM	
		Large (L)	70,001-120,000	4	UDL	3
or		Very large (VL)	> 120,000	5	UDV	
Pop. density > 30 persons per sq km	***Regional Town/City (R)***	Small	up to 30,000	6	URS	4
	Part of an urban centre with population <1,000,000 and predominantly urban in nature.	Medium	30,001-70,000	7	URM	
		Large	70,001-120,000	8	URL	5
or		Very large	>120,001	9	URV	
>90% of LGA population is urban	***Fringe (F)***	Small	up to 30,000	10	UFS	6
	A developing LGA on the margin of a developed or regional urban centre.	Medium	30,001-70,000	11	UFM	
		Large	70,001-120,000	12	UFL	7
		Very large	>120,001	13	UFV	
RURAL (R)						
	Significant Growth (SG) *Average annual Population growth > 3%, population > 5,000 and not remote.*	Not applicable		14	RSG	N/A
	Agricultural (A)	Small	Up to 2,000	15	RAS	8
		Medium	2,001-5,000	16	RAM	9
		Large	5,001,-10,000	17	RAL	10
		Very large	10,001 to 20,000	18	RAV	11
	Remote (T)	Extra small	Up to 400	19	RTX	N/A
	Situated in a remote locality.	Small	401-1,000	20	RTS	N/A
		Medium	1,001–3,000	21	RTM	9
		Large	3,001 to 20,000	22	RTL	10

Note: For "Rural Agricultural Very Large" (RAV), "Rural Remote Large" (RTL), and "Rural Significant Growth" (RSG), 20,000 is the upper limit because beyond this number all local governments are deemed "Urban".