Tamworth REGIONAL COUNCIL

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IPART Review of the Rate Peg Methodology 2022

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

The LGCI is with regards to the concept a sound approach to capturing and accommodating the changes in Council's costs and inflations, however the weightings need to be reviewed. In addition, with limited access to the state-wide data it is difficult to suggest a better approach

Better use of the weightings would be recognise that all Councils are not the same. Example a densely populated Council with very few kilometres of roads to maintain does not need as high a weighting as a regional or rural council with an extensive road network. This is especially true when Councils have a duty to provide safe roads regardless of the number of users.

There could even be an argument for multiple rate pegs with some amounts quarantined for specific purposes.

Rate pegs need to look forward and this could be achieved by the use of a rolling 3-year average of the historical LGCI weighted at 50% with a forward-looking forecast projecting inflation weighted at 50%. The estimation uncertainty of the forward forecast will then correct itself by being factored into the next year rolling 3-year average.

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 IPART wish to have a direct link to current inflation movements there is no way that this can be done in a timely manner without it losing relevance. You can't incorporate both timeliness and relevance, you can either have a rate peg with increased relevance or you can have a timely rate peg that potentially looks at say average inflation over a certain time period.

As previously suggested the use of a rolling 3 year average of the historical LGCI weighted at 50% with a forward looking forecast projecting inflation weighted at 50% the onus would then be on Councils to monitor actual inflation and potentially put aside any mismatch to smooth out the peaks and troughs.

It is preferable that the rate peg be released in late November early December each year.

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

If population is to be part of determining rate pegging then as well as population growth IPART should be taking into account population decreases. This is ensure council continues to raise enough revenue to meet costs that do not fluctuate with population levels. If increased population is causing issues with regards to additional costs to provide services this is a strong indication of the inadequacies of rate pegging.

The preference for the rate peg to be forward facing as much as possible, and it is noted that the RBA does also produce forecast CPI figures. Any estimates should be adjusted to reflect actuals.

The Local Government (state) Award provides known increases for a period of three years, this index could be used to forecast future labour costs. Other actual indicators include Emergency Services Levy, better costing for weeds control, cost of audits, cost of compliance, cost of animal control and rehoming, pensioner rebates should be fully funded. There are so many cost shifted activities that eat up resources that should be used for maintaining infrastructure. A lot of this information could be obtained from the numerous returns that are lodged.

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?

An unfortunate issue with lagging indices is the period between when the growth occurred and the year it will be added to the LGCI to determine the rate peg limit. For example, the financial year 2022-2023 the estimated residential population (ERP) used the growth measure between 2019 and 2020. The population growth factors were between 0 & 4.3%.

Part of the calculation is a factor regarding natural growth due supplementary valuations. This growth was a factor allowing councils to grow with the communities they serve. Growth from supplementary valuation changes is deducted from the population factor, but cannot be a negative value.

The attempt by IPART to prevent councils from 'double-dipping' by subtracting supplementary rates growth from the population increase is flawed because it doesn't account for negative supplementary growth. This means that councils with negative supplementary growth are not afforded their full population increase. Also, assuming the population of a subdivision will occur neatly within the same rating year.

Further improvements to consider are;

- Closing the gap between the growth factor and the relevant LGCI year
- Possibilities to relate to changes in demographics
- Identifying any alignment or timing issues between when subdivisions (supplementary values) occur and population increases.
- Large Councils with smaller towns and villages can often have population growth in one area thwarted by decreases in other areas. This is potentially caused by amalgamation of smaller Councils.

TRC maintains our position in regards to population growth aligning with the original IPART recommendation in the Review of the Local Government Rating System for a transition to Capital Improved Values (CIV) as a mechanism to allow councils revenue to grow as the communities they serve grow. We believe that this should be revisited for the following reasons.

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 land 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 improvement in productivity and the efficient delivery of services by councils?

Each council has different service levels and community needs, improvements in productivity are part of our IP&R process. Any productivity gains should be encouraged and allowed as they will surely encourage future productivity gains that will benefit their communities. Penalising councils for efficiency gains is a disincentive for innovation and should be removed. Note efficiencies are also taken into account in SV applications. It is also difficulty in ensure productivity improvements are able to be measured objectively.

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

- Population decreases
- Cost Shifting
- Impact of fixed imposed costs e.g. audit fees.
- Demographics of an area to allow for things such as the need for recreational facilities and playgrounds, the number of pensioners and the impact of pensioner rebates.
- Rating exemptions with regards to land area taken up by entities/organisations such as religious institutions, universities, schools, hospitals, land councils
- Developer contribution levels some councils have very little or none
- Known cost increases such as wage growth and superannuation

The above information is easily captured either through award information or as part of the Permissible Income Return.

Unique costs that have occurred in the last twelve months or that are predicable for the relevant LGCI period. For example, the additional 0.2% added onto the 2021-22 rate peg to account for the costs of conducting council elections, and its subsequent withdrawal in 2022-23 is appropriate. Similar instances of these types of costs should be included in the LGCI methodology.

If a new cost is identified by the IPART or the OLG and it is expected to have a uniform impact on the sector (as with above) then a factor should be applied in the relevant LGCI. The factor may only affect one year and therefore it is reasonable to expect a similar reducing factor in the following year.

The revised LGCI should be agile enough to adapt to the changes to councils' costs driven by external factors.

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

TRC does not believe in the philosophy of unnecessary rates increases. Political pressure to keep land rates low achieves only one result, poor outcomes for the community. Decisions to keep rates low often can lead to the opposite outcome. Councils may delay increases in rates as a pseudo protection only to eventually have no choice but to apply for high percentage increases that have significant impact on the community in particular the vulnerable.

NSW councils adhere to strict IP&R 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.

To this point we encourage IPART to consider some flexibility in the rate peg that would allow for increases above the peg of up to say a factor of 1.5%. The factor should align with the CSP and LTFP rather than the peg itself.

A process should be investigated that enables councils to align their rates with the outcomes from the CSP for the relevant period. This model aligns with question 13 and 14 in the Issues Paper.

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

No. This is why councils seek a Special Variation (SV) from time to time.

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

This is a hard question to answer as not all councils are the same. Historically it is dependent on the decisions made by each council and the rate base the council had when rate pegging was introduced. Moderate and affordable increases over many years must be a preference over sharp increases by way of an SV every 5-10 years. Such moderate/affordable increases would play a significant role in also addressing sustainable intergenerational equity.

Potentially there needs to be a separation between discretionary and non-discretionary council activities. A separation between the provision of non-discretionary infrastructure e.g. roads, water, sewer, waste services, environmental regulatory activities such as animal control and recreational activities would make it more obvious when a Council is unsustainable and community service obligations for certain facilities are too high.

Benchmarks could be set for varying population levels and recreational infrastructure e.g. the number of parks, playgrounds, swimming pools etc for population levels to ensure basic community needs are being met.

By providing a clear delineation between essential and discretionary infrastructure communities and government bodies could make better decisions with regards to the short comings of rate pegging and how much a council's sustainability is being eroded by financially unsustainable projects that will drain council resources for many years to come.

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

- Population density
- Road lengths
- Demographics
- Larger area occupied with rate exempt entities
- Development contributions
- Prevailing weather conditions and their impacts e.g. rural Australia and drought,
- Mining industries. Often mines come to town contribute to facilities that in the long run create a financial liability.
- Parking income – for large city their parking income is more than a small council's total rate revenue
- Apportionment of the more densely populated areas revenue to less populated with regards to additional grant funds being routinely provided
- Introducing a CSO rate peg into rates. So for example if swimming pools, sporting fields, libraries etc a CSO line item being incorporated into the rate pegging. This would stop the community wanting an increased level of service for discretionary items and it might encourage them to accept reduced service levels

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

The LGCI may be more in tune with each council's actual costs of providing services to their communities.

We do not have access to state-wide data that allows us to be better placed to comment, however if there is a material difference between metropolitan council costs and regional council costs (or other cohorts) there may be an argument that supports different cost indexes.

This would be linked to the multiple rate pegs, e.g. road rate peg would be linked to the ABS roads index, CSO index linked to inflation.

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

Yes. IPART will be fully aware of the challenges councils recently presented with the 2022-23 LGCI being released at 0.7%.

To stabilise the LGCI the data used needs to align more closely with the current financial environment and possibly using a period of rolling averages Presently council applications for an SV is assessed on where that council is heading and a proven lineage to the future needs being demonstrated in the council DP as part of the IP&R requirements.

Accordingly, when it comes to the application to go beyond the standard rate peg the IPART looks toward that councils' future costs and future financial position not what the historical costs were. If this principle could be incorporated into the LGCI it would be more easily understood by the community and more closely align the LGCI with the SV process.

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

Predicting future CPI inflation for the long term is difficult and of concern. A better alignment to actual costs is recommended and the use, where possible, of known future costs indexes (e.g. NSW Local Government (State) Award for labour costs) and the RBA forecast CPI. And where estimates were significantly different to actuals adjustments should be made.

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

This is a possible solution; however ratepayers should have a greater say in how their council is operating and to determine the level of services and quality of life that aligns best with their ability to pay for those services. Inflation volatility, pandemics and natural disasters can contribute to the community's ability to pay and also add to the operating costs of individual councils differently.

To avoid volatility in the rate peg the use of a rolling 3-year average of the historical LGCI weighted at 50% with a forward-looking (RBA CPI) forecast projecting inflation weighted at 50%. The estimation uncertainty of the forward forecast will then correct itself by being factored into the next year rolling 3-year average.

This approach can provide stability in smoothing of the long-term revenue to match the growth in long term expenditure and any resulting efficiency gains through economies of scale.

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

No. Councils need to prepare their budget early in the new calendar year to meet exhibition timelines, the current release dates support this outcome. Preferably in November or December at the latest.

Our preference is for forward facing indices wherever possible, above (Q14) we suggest the use historical LGCI indexes weighted at 50% and forecast indexes to accommodate for inflation. If the cost components can be updated through information provided to the OLG the current timeframe should remain achievable.

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

We support the sector and do not believe that productivity factors can be accurately measured in a sector as diverse as local government and once again council's should not be penalised for solid performance.

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

Yes. External costs that apply to all councils uniformly should be included in the rate peg methodology.

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

Council specific adjustments for external costs are needed, examples of external costs include but are not limited to;

- Tracking Federal and State imposed targets, and the cost to achieve them,
- Utilising the IP&R documents to understand any future needs of each council,
- Creating a simple 'council submission' process that enables the exchange of information to enable IPART visibility and approval,
- Audit Risk and Improvement Committee (ARIC),
- Compliance (pool inspections, food shop) and others,
- Stormwater Management Charge – charges set by regulations and unchanged since 2006-07,
- Cost-shifting[1] has an impact on how income from land rates is diverted, we oppose all forms of cost shifting and the imposts on local communities, we provide this data for information purposes only and it should not be included as an adjustment for external costs:
    - The waste levy is the single biggest contributor to cost shifting in NSW, in 2015/16 $305 million was lost because the NSW Government did not fully reinvest the waste levy, paid by councils, back into local government environmental programs.
    - Councils paid $127 million in mandatory local government contributions to fund the state government's emergency service agencies in 2015/16.
    - The NSW Government makes the lowest per capita contribution to public libraries of any state/territory government in Australia at just $3.76 per capita in 2015/16. Councils footed the bill for a $130 million shortfall in funding required to operate the state's 450 public libraries.
    - Councils lost $61 million in 2015/16 through the NSW Government's failure to fully reimburse councils for mandatory pensioner rate rebates, unlike all other state/territory governments in Australia.
    - Councils incur significant costs for activities required to meet regulatory burdens associated with companion animals, noxious weeds, flood controls and other activities.

Councils prepare a lot of public facing information through the IP&R process, Financial Reporting (Statements) and data uploads to the OLG (Financial Data Return – FDR). It may be possible to access relevant information through one or more of these reports without adding something new.

The Local Government Industry needs to look at supplying uniform resources to meet common statutory and industry requirements. For example all Council's need to produce budgets, financial reports and keep track of many funding sources. Instead of 120 Council's trying to source a supplier to provide an appropriate software program why does the industry not have just one central supplier that would be focused on meeting Council's needs at a reasonable price. This would certainly assist Councils of all sizes.

[1] LGNSW Impact of Cost Shifting on Local Government in NSW 2018 page 4

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

Costs that apply to all councils uniformly should be included in the rate peg methodology. These costs should be expanded to include:

- Impact of pensioner rebates
- Impact of rate exempt properties
- Impact of geographical location on the cost of freight and the cost of incentives to attract suitably qualified staff,

Local government has been subject to significant cost shifting from other levels of government and over time these costs have grown as Councils struggle to maintain service levels. Recently we received information showing the mandating of the NSW Audit Office has seen an increase in audit fees of 88% over 9 years.

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?

Where possible the LGCI should be future facing, as is the case with SV applications. Cost components in the LGCI that can be sourced from forward looking known variables, such as labour costs. In question 14 we agree that setting a long-term peg could be a solution, with nearly 40% of the LGCI attributable to labour costs and the Local Government (state) Award being set for 3 years it may be an achievable solution to link the two periods.

Closing the gap in the data used from historical sources needs to be a priority.