ATTACHMENT 2

Willoughby City Council Submission

IPART - Review of the Rate Peg Methodology

4 November 2022

About Willoughby City

The City of Willoughby occupies 23 square kilometres on the lower north shore of Sydney, with its own CBD of Chatswood and a large part of St Leonards. Located 8.5 kilometres north of the Sydney CBD, Willoughby City incorporates the suburbs of Artarmon, Castle Cove, Castlecrag, Chatswood, Middle Cove, Naremburn, Northbridge and Willoughby, as well as parts of Gore Hill, Lane Cove North, St Leonards and Roseville.

The Lane Cove River and the foreshore of Middle Harbour feature treasured bushland, while our City's residential areas are home to more than 83,000 people in 2022. Industrial and commercial zones support approximately 78,000 jobs and a gross regional product of $13.04 billion. The City of Willoughby's population is forecast to grow to 91,848 by 2036.

Council is the custodian of a diverse portfolio of community infrastructure assets, including 21 sports fields, 17 public halls, seven libraries, a regional performing arts centre, two visual arts spaces, three public swim centres, 425 hectares of open space, 330 hectares of bushland, 60,000 street trees, 288 kilometres of roads, and much more. Those infrastructure assets are the foundation of an even more diverse array of services highly valued by local communities. 96% of Willoughby City residents somewhat satisfied, satisfied, or very satisfied with Council, which compares positively to a benchmark for metropolitan councils of 89%[1].

Overall Feedback

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

The current methodology is rear looking and not representative of current or future cost pressures. The reliance on historical data and the resulting two year lag between when cost change is measured and when the rate increase takes effect means that the current Local Government Cost Index (LGCI) does not reflect or compensate councils for current cost pressures. The two-year lag has been a lesser issue during times of relatively stable inflation.

However recently, where the economy has moved from very low to very high inflation, this time lag has left councils with inadequate levels of funding. The impact of this lag became apparent in 2021 when, despite high inflation in the wake of COVID, global conflicts and supply side issues, IPART issued a rate peg of 0.7% for the 2022/23 financial year. This was clearly inadequate in light of the cost presures being experienced by Councils. Following significant industry lobbying, IPART announced an Application for Special Variation (ASV) process for councils to secure an increase above 0.7%. This caused significant uncertainty and administration overhead simply so councils could achieve a modest cost of living adjustment to rate revenue.

To improve the alignment of current cost pressure with rate increases, there needs to be a more timely assessment of current inflation, or ideally a reliable forward looking measurement of cost changes.

Labour comprises 38.6% of the weighting in the current LGCI. Forward looking labour increases are known with certainty through the Award increases negotiated at the time of each new Local Government Award. We believe the rate peg should use the forward looking Award increases (and any legislated increases such as the increase in the Superannuation Guarantee rate) as a primary input to the Rate Peg calculation. The Rate Peg should be set at a rate that is not lower than the known forward looking Award increases.

[1] Micromex Research. (2020). *Willoughby City Council community perception research 2020*.

Other forward looking forecasts or projections should be used for the other cost components. These may include Australian Bureau of Statistics (ABS) or other reputable economic forecasts of price movements/inflation. These estimates are used for important decisions such as the Reserve Bank making interest rate decisions. Other published data (such as statements made by utility companies on future price increases or analyst predictions of fuel costs) could also supplement and refine this forward looking analysis.

To adjust for any error inherent in using forward looking data, a true up or averaging process could occur in the following year or years, to ensure that rate increases align with actual cost movements over the medium term (i.e. this process would ensure councils were not under compensated if the forecasts were wrong). This true up concept is already contemplated with the recent changes to the population growth factor.

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

It is not possible to capture the unique circumstances of each council within a single index. However, we believe the current cost components and weightings in the Local Government Cost Index (LGCI) are reasonably suitable to capture the major costs borne by all councils. The issue is therefore the lag between when inflation is measured and the two year lag between when cost change is measured and when the rate increase takes effect.

At the very least this time lag needs to be significantly reduced or removed, but preferably, a reliable forward looking measurement of actual cost changes should be used.

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

Labour comprises 38.6% of the weighting in the current LGCI (and in Willoughby City Council's case, 39% of total Operating Expenditure). Forward looking labour increases are known with certainty through the Award increases negotiated at the time of each new Local Government Award. We believe the rate peg should use the forward looking award increases (and any legislated increases such as the increase in the Superannuation Guarantee rate) as a primary input to the Rate Peg calculation. Further, the Rate Peg should be set at a rate that is not lower than the known forward looking staff increases.

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Forward looking estimates (from reliable sources such as analysist or the ABS) should be relevant to local government expenditure types and should incorporate indexes such as Road and Bridge cost indexes and non-residential construction indexes.

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?

We continue to support the inclusion of a population growth factor in the calculation of rate pegs for individual councils. This ensures councils are appropriately compensated for the cost of growing populations. We do think there could be improvements such as:

- Closing the gap between the growth factor and the relevant LGCI year. For the financial year 2022-23 the Estimated Residential Population (ERP) used was the growth measure between 2019 and 2020. This lag needs to be reduced.
- Including growth not captured in residential population measures, such as growth in local working or visitor population. This growth also increases cost pressures and gives rise to the need for infrastructure provision and maintenance. Chatswood CBD, its shopping, transport interchange, events all provide a drawcard for a significant numbers of visitors and workers into the area that Council is required to support.

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

Penalising councils for efficiency gains may inhibit innovation and should be removed. Councils should be compensated for growth in costs through the rate peg. Productivity gains and efficient delivery of services should benefit the community through either increased levels of service, or through lower rates or other charges.

The significant divergence between rate growth and much higher cost growth over the years since the rate peg was introduced has meant councils have had to innovate and create efficiencies simply to maintain services (albeit in some cases reduced service levels) or stay financially sustainable. This diminishes what efficiencies councils have left to give and given the current and projected economic forecasts additional pressure is likely to impact service levels or the mix of services offered by Council.

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

It is not possible to forecast all external factors to answer this question definitively. The general principle (as with the current methodology) is that if IPART or the OLG identify a specific external factor that has an impact on all councils, then that factor should be applied within the relevant rate peg calculation (as was the case with increased election costs in 2021-22).

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

We do not agree with the notion of unnecessary rate increases. The community holds councils accountable for levels of service and also for the efficient use of rates they pay.

In addition, Councils produce, exhibit and accept submissions on Integrated Planning and Reporting (IP&R) documents each year. This framework gives the community visibility into how rates and revenue are being used to realise community aspirations. It also gives the community the opportunity to identify and raise questions on any inefficient use of resources and proposed rates and fees and charges.

The current rate peg methodology (and the productivity factor included in the rate peg) has created a significant disparity between revenue growth and the much higher actual cost growth borne by councils. This has affected levels of service and in numerous cases has led councils to seek Special Rate Variations (SRV). In most cases the SRV is simply a catch up of under-funding in previous years and results in “bill shock” for ratepayers (large one off increases instead of having regular incremental increases).

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

No. This is evidenced by the number of councils who seek a Special Rate Variation every year and the disparity between the rate peg, employee costs and inflation.

In addition, all councils rely heavily on income sources outside of rates (user charges and fees and varying levels of reliance on grant funding). In the case of user charges and fees, Councils pass on the cost of services to customers, many of whom are ratepayers.

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

The current rate peg methodology (and the productivity factor included in the rate peg) has created a significant disparity between revenue growth and the much higher actual cost growth borne by councils over a number of years.

This has affected levels of service and made the business extremely marginal and reliant on other revenue sources to compensate for this disparity and inadequate compensation. This reliance on other revenue streams has in most cases been adequate through normal times, but the COVID pandemic showed the risk to sustainability when these other revenue streams are significantly impaired.

Further, the prevalence of councils seeking Special Rate Variations indicates that the current methodology has not resulted in a financially sustainable model for councils.

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

All councils have their own individual circumstances, levels of service requirements and community aspirations and expectations. As such it is difficult to envisage how any methodology (or methodologies) would individually cater for differences between councils, apart from removing the rate peg and allowing councils and their community to determine the rates.

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

If the cost elements of different types of councils can be reliably measured, there may be some merit in using different cost indexes for different councils (for example rural versus metropolitan). This would mean rate increases would be more tailored to the costs they are intended to compensate for.

However, the current methodology which focusses on the cost changes experienced by the average council is adequate and less complex.

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

Volatility is not a problem if the rate peg is suitably aligned to the current or future financial environment and cost escalation. The volatility has been an issue due to the lag in measurement and the significant changes to the inflation environment in recent years (i.e. where the rate peg is not aligned to the current cost environment).
Rate peg volatility does not appear to be a significant issue for ratepayers. Conversely, the distortion/volatility caused by periodic Special Rate Variations does appear to be an issue for ratepayers.

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

The IPART should be aiming for a methodology which provides both, more certainty about future rate increases and better alignment with changes in current costs.

If achieving both is not a possible outcome, we have a preference for ensuring that the rate peg aligns with current changes in cost as this is essential to financial sustainability.

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

Yes. A longer term horizon for a rate peg would provide a valuable input into long term financial planning. However, any long term rate peg would need to be flexible and changeable as it could not possibly capture rapid, unpredicted changes in costs that were not captured in the original long term rate peg. As seen in recent years, costs can increase or decrease significantly as a result of global and local events.

A long term rate peg would be very useful for long term planning but would need to have a “true up” or averaging mechanism to ensure it captured inherent economic volatility and unforeseen change on a timely basis.

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

No. We acknowledge that a later release may provide time to be more accurate with more current data. However, the statutory IP&R timeframes for annual budgeting and update of Long Term Financial Plans means it is not possible to issue the rate peg later. The rate peg is a vital input into an extensive and time bound budgeting process and is required to be publicly exhibited prior to adoption by Council.

One option may be to release the rate peg at the same time (or even earlier), with a high/low range to cater for volatility between the issue of the rate peg and price movements after that.

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

The Rate Peg calculation should use the actual cost increase that will be borne by local governments. The current use of the NSW public sector wage price index (WPI) should be discontinued and replaced with the known forward looking increase in the Local Government State Award. Other known labour cost increments (for example increases in Superannuation Guarantee Rates) should also be factored into the forward looking calculation.

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

Yes. Material one off costs impacting all councils, such as new taxes, increased election costs or increases in the superannuation guarantee contributions 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?

No. We think this would be too difficult to achieve, may become subjective, political, and inequitable and may not be easily understood by ratepayers.

One off external costs for specific councils should be addressed via funding form other levels of government (grants and disaster relief funding), or through a more simplified Special Rate Variation process.

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

Costs that apply to all councils should be included in the rate peg methodology.

The current mix of min cost components in the Local Government Cost Index (LGCI) appear appropriate. However, given the number of uncontrollable State Government levies and charges imposed on Local Government, all State Government charges (including but not limited to the Waste Levy, Parking Space Levy, planning fees etc.) should be included in the new rate peg methodology. In addition, increases to those State Government charges should not be allowed to be higher than the local government rate peg.

Other uncontrollable costs for specific councils should be addressed via funding from other levels of government (grants and disaster relief funding), or through the existing Special Rate Variation process.

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 rate peg calculation should be forward looking and include reliable forward looking estimates instead of data on cost movements that are two years old.