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WOLLONGONG CITY COUNCIL

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2022-2023 Rate Peg Methodology Review
Independent Pricing and Regulatory Tribunal
PO Box K35
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Sydney NSW 1240

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Dear Sir/Madam

IPART REVIEW OF RATE PEG METHODOLOGY

Wollongong City Council would like to thank IPART for the opportunity to respond to its issues paper relating to the Review of the Rate Peg. It is particularly refreshing to find a set of challenging questions that get to the heart of the issues and challenges faced in setting a Rate Peg and providing outcomes in line with stated objectives.

The core stated objective is to allow councils to vary their general income annually to reflect (as far as possible) changes in the costs of providing local government goods and services due to inflation and other external factors. IPART has been asked to make recommendations on:

- Options to set the rate peg methodology to ensure it is reflective of inflation and costs of providing local government goods and services.
- Options to stabilise volatility in the rate peg and options for capturing more timely changes in council costs and inflation.
- Alternate data sources to measure changes in councils' costs.
- The effectiveness of our current Local Government Cost Index (LGCI).
- Options for capturing changes in councils' costs caused by external factors.
- The effectiveness of the population growth factor in achieving its intended purpose.

While the abolition of the Rate Peg is not within the terms of reference of this review, it becomes clear in Wollongong City Council's response to the specific questions asked that the outcomes sought are not optimally managed through a Rate Peg. On this basis, it is argued that abolition of the Rate Peg and the introduction of other options would be the preferred outcome. It is for this reason that any of the following submission responses that discuss improvement to a mandated Rate Peg methodology, needs to be read in the context of this overarching position that would make much of our response redundant.

IPART note in their issues paper, that one of the reasons for the rate peg relates to importance to ratepayers that councils have incentives to improve their productivity and efficiency in delivering these goods and services. All councils in NSW (other than those under administration) are elected by their communities for a reasonably fixed term. Like all other levels of government, the ultimate existence and power of a council rests in the ballot box. In addition to the ballot box, councils and councillors are held to account on a daily basis by a community that is at close hand, has almost unlimited access to councillors, a council that is available to the public and easy access to council management and staff.

Council is the only level of government that is required to exhibit and consult with its community on its Community Strategic Plan, four year Delivery Plan, one year Operational Plan and annual Revenue Policy. These documents clearly set out a council's direction, operations, actions and capital projects. All of this is costed and supported by a Revenue Policy that outlines the rates and charges to be levied and details the other fees and charges to be applied for the period. With this level of information, engagement, involvement in a council's finances and operations, it is considered councils can clearly be held to account for the productivity, efficiency and delivery by its community without the need for a Rate Peg. The implementation of Performance Audits on local government by the NSW Audit Office is another check and balance on a council's productivity and efficiency.

Response to questions presented in the IPART Issues Paper:

1 To what extent does the Local Government Cost Index reflect changes in councils' costs and inflation? Is there a better approach? (answered in question 2)

Wollongong City Council understands that the Local Government Cost Index has provided a level of transparency in setting the Rate Peg opposed to the decision-making process applied by the Minister for Local Government prior to its commencement. Wollongong also supports the role that IPART has played in trying to develop a clear and transparent process based on external measures.

The role of the Rate Peg in addressing inflationary movements was generally accepted during the benign economic periods experienced as its level of certainty exceeded the prior experience. The rate peg has been exposed and become more detrimental in recent periods, as economic and other external pressures have become stark. It is also argued that the Rate Peg has always failed to address other costs, cost pressures, or local circumstances that impact local governments.

In pure inflationary cost terms, the Local Government Cost Index (LGCI) does not accurately capture the true changes in the cost of services for NSW councils. At the base level, the process of applying historic indexation to future periods cannot match a council's expectation in preparing and consulting with its community on future programs and budgets. Council is required to make estimates based on 'reliable', usually externally sourced, indices into the future and the Rate Peg should reflect these costs.

The application of industry wide cost weightings is not truly reflective of the significant variations in individual council operations and capital programs. Percentages applied to wages, capital expenditures and classification of expenditures are subject to significant variations from one area to another.

The current application of Wage Indexation reflects NSW public sector wage increases to provide for ongoing comparison and cost control/efficiency in local councils. The Award process in local government is determined by LGNSW and the Unions through a negotiation process. While councils may be individually represented in negotiations, the Award is applied unilaterally and becomes a true cost of delivering council services. If a goal of the Rate Peg is to allow 'councils to vary their general income annually to reflect (as far as possible) changes in the costs of providing local government goods and services due to inflation and other external factors', then then this approach is not effective. The application of future Award increases would be preferable, even for councils such as Wollongong, who negotiate an individual Enterprise Agreement.

The application of CPI to insurance, fuel, motor vehicles, electricity etc is significantly flawed due to the substantial size and volatile nature of these costs in local government as opposed to households. There are up to 11 Local Government Cost Index (LGCI) items indexed by CPI. CPI has significant components that are not applicable to local government and make it unrepresentative. The index for electricity, for example, in the 2022-2023 Rate Peg was -4.8% while many councils who are off contract in that year are expecting 35%+ increases in cost. This reflects both volatility and the individual nature of specific council arrangements that cannot be managed with 'one size fits all' of the Rate Peg.

The rates indexation for Emergency Services is not truly representing the increases and variability in increases of this cost across councils.

While there are significant issues in the application of inflationary trends to rates increases, there are potentially more substantial issues with the failure of the Rate Peg to address changing service costs that are not just impacted by price. This would include the impact of government legislation, mandates or cost shifting (outside of the Emergency Services Cost, such as decisions by the state government to require councils to amend land use planning zones, financial accountability of RFS assets, shifting responsibilities for underground petroleum storage from the state to councils, etc), impacts of external conditions such as weather, climate and public health, changes in workers' compensation experiences due to growing psychological injury, reduction to some council's Financial Assistance Grant due to changes in distribution, interest on investments and other revenue impacts. The cost of these externally imposed requirements impacts all councils, albeit that the impact of change can vary significantly from council to council.

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

The application of a universal, 'one size fits all', estimate of all councils' cost and inflation requirements that have a two-year lag is clearly not ideal. The geographical, externally imposed and specific issues that need to be addressed by councils to ensure their revenue is sufficient to meet immediate and future requirements is complex and is best managed at a local level by a council with its community.

Councils are required to provide detailed annual Operating Plans that are consistent with their four-year Delivery Plans, which have already been through an extensive engagement process with their communities. The Operating Plans require a review of the cost and revenue indices from a pricing, or inflationary perspective, as well as a review of other external factors impacting on the delivery of agreed levels of service or the immediate demand for changes to levels of service. Movements in indices and impacts from external influences are clearly articulated within documented Operational Plans. This process is done and exhibited to each community for 28 days or more and adopted following input from the community prior to the new year, which is a timely process.

Wollongong City Council would recommend that an Operating Plan should be the basis for setting a council's costs and revenue requirements. It is acknowledged that this proposal by itself would effectively remove the role of rate pegging, however, it would also remove all the issues with the current process and 'allow councils to vary their general income annually to reflect (as far as possible) changes in the costs of providing local government goods and services due to inflation and other external factors'.

It would be possible, under this proposal, to retain an indexation control process by publishing standard indices that would be applied by all councils to their specific cost categories or, if varied, would require clear articulation of the reasons for variation. The publishing of cost indices would be equally beneficial for councils in providing access to a central source of future indices to be used as a source for forecasting. The Operating Plan could include clear commentary on other variations to input costs that have necessitated further variation. This would include items such as impacts of legislative changes that have added to cost, increased pricing by governments, indexation in existing contracts and other variables that have been discussed previously. While these would normally be included in the assumptions of a council's Operating Plan, they could be structured to be more consistent, transparent and/or measurable by an external organisation such as IPART. It is considered that this process would only be applied to the continuation of existing services or the introduction of those mandated externally and would not be used for the introduction of new service or service levels. The appropriate process for changes to service levels should be through the review and adoption of the Strategic Community Plan and Delivery Plan.

Alternatively, if higher levels of control are to be mandated, IPART could continue to provide indexation (future based) as a baseline to be applied against an individual council Cost Index rather than one Local Government Cost Index. This council Cost Index would reflect the council's cost structure and not an industry average, which would allow for the significant variations in council services and costs. The council Cost Index would be calculated and included in the Draft Operating Plan. Councils should be able to prepare submissions for variation as part of the Operating Plan process that would require community consultation, community submissions and IPART approval if outside an agreed range. It would be anticipated that this should be a relatively simple process based on reasonably straight forward worksheets and explanation. This could be similar to the IPART approval process applied for additional variations for 2022-2023.

At the very lowest level of change and least preferred approach, would be continuation of a Rate Peg based on future cost indices using a revised LGCI. Wages indexation should be based on future Award rates and revised reference rates applied in lieu of CPI where possible. Further allowances should be made for government mandates, legislative change and pricing changes for future years. Using future reference rates would presumably require a correction process in future years to adjust for the variation between actual inflationary costs and the projected levels.

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

The NSW Local Government Award should be used to determine future wage indexation.

More appropriate application of specific indexes to costs items.

Data sources for future indices are reasonably available while offering a degree of variation. Wollongong City Council currently uses the Reserve Bank of Australia, Commonwealth and State Government forecasts, major banks and private research organisation forecasts to determine future indices.

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?

Council has reviewed the issue of accounting for population growth several times through the varying rating reviews and holds the view that having the option of applying a Capital Improved Valuations (CIV), as opposed to the current Unimproved Capital Valuations, would have been an appropriate approach to ensure full growth in all aspects were included in the rate calculations. Council's previously stated view was that growth extends beyond 'population' as it is also linked to the business and employment growth. This is particularly so when considering a regional council such as ours that supports areas and populations outside our Local Government Area. The current proposal will not provide for growth in business properties.

The Population Factor introduced last year was a proxy for the growth factor that is required by Local Government to maintain a council's rates level commensurate to its population and service requirements. Without adjustment for the growth in property rates on average is diminished due to the nature of rate pegging and the application of the Notional Yield.

While Wollongong City Council agrees that the methodology adopted reflects a relationship between population growth and council costs, it still believes that growth and costs to council extend beyond 'population' as they are also linked to the business and employment growth, especially when considering a regional council such as ours that supports areas and populations outside our Local Government Area for lifestyle/recreation, university, medical, professional and similar higher order services. Council is disappointed that the current methodology does not provide for growth in business properties.

Wollongong City Council received a zero population factor for 2022-2023 in the latest IPART Rate Peg. This is not reflective of the actual impact of property increases in 2021-2022 and required further review. The population growth figure for Wollongong was negative for the reporting year used. It is understood that the estimates were adjusted by the Census and potentially reflect impacts of COVID-19 on the student population in Wollongong, which is a 'university town'.

It is clear from property and asset growth that there has been consistent growth within Wollongong over the past three years that reflects on the services and cost of Council. The population estimates used are not adequately reflecting the growth in that period. This is a substantial impact on Wollongong due to the number of new strata title properties that have the highest impact on the diminution of the average rate.

The population growth factor also does not consider the impacts on services and costs to Wollongong Council, which is a key destination for lifestyle/recreation and university activities for residents from the fast growing Western and Southern Sydney regions.

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

Productivity and improvement measures for local councils at a headline level is somewhat problematic due to diversity of operations and the significant shortfall in delivery against demand. With most councils having asset management shortfalls, service gaps and increases in natural environmental issues, any improvements in individual process are immediately redirected to improving these shortfalls. This does not then reflect in the consolidated annual accounts or through reductions in average rates.

The Rate Peg should not be seen as a measure of productivity in the absence of measuring the level of service provided. Productivity is not a single sided measure determined by cost. The underlying role of a sustainable local government is ultimately to provide the level of service agreed to with its community at an agreed price. The community is exceptionally well empowered at the local government level to be engaged in that balance and are provided access to performance measures that should assist in understanding performance improvement.

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

It has been argued above that the costs and cost structures of council vary significantly from council to council. The rates methodology needs to make adjustment for such variation.

The methodology needs to make adjustment for externally imposed service requirements, particularly those imposed by other levels of government.

The methodology needs to consider environmental factors such as natural disasters and the continuing growth in cost of the response to climate change, both mitigation and adaption.

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

The basic premise of this question implies that councils would wilfully impose rate increases unnecessarily. It is Wollongong City Council's view that all decisions made by this Council through its Integrated Planning and Reporting process are made with the community in the best interest of its community.

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

The simple answer to this is no. It is clear from the number of Special Rate Variations and the number of councils who still have non-sustainable financial positions, that Rate Peg alone does not provide sufficient revenues. While it can be argued that Special Rate Variations allow for adjustment from time to time, the substantial investment in time and resources to the application process diverts from the work that is necessary for the community and creates a resistance to sustainable outcomes.

Statistics provided by Bayside Council in support of the above show the level of SRVs and the overwhelming support for council proposals and some indication of the continuing level of financial stress remaining across councils.

In the last 10 years:

- 178 applications for special rate variations (SRVs) were made.
- 165 SRV applications were approved in full or in part.
- 142 SRV applications rationalised based on one or all the following:
  - To address financial sustainability
  - To address existing infrastructure backlogs
  - To address future infrastructure expenditure obligations

In addition to this, in the last three 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%

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

While Rate Peg alone may not be responsible for all sustainability issues, the evidence shown in Question 8 would tend to support such a claim.

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

It is considered that this is an important question as each council is individual in terms or geography, socio-economic conditions, environment, services, community, etc and therefore, need to be managed individually.

One alternate proposal put forward under Question 2 was IPART could provide indexation (future based) as a baseline to be applied against an individual Council Cost Index. This Cost Index would reflect the council's cost structure and not an industry average, which would allow for the significant variations in the way council services and costs are structured.

The Council Cost Index would be calculated and included in the Draft Operating Plan. Councils should be able to prepare submissions for variation as part of the Operating Plan process that would require community consultation, community submissions and IPART approval if outside an agreed range. It would be anticipated that this should be a relatively simple process based on reasonably straight forward worksheets and explanation. This could be similar to the IPART approval process applied for additional variations for 2022-2023.

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

It is considered fundamental to be able to introduce differing cost indexes for individual or smaller groups of councils to ensure a realistic match between cost-of-service delivery and revenue. Matching costs and revenue will assist in financial sustainability.

Dividing the Index into regions or categories of council will still not provide appropriate outcomes.

This submission recommends individual Council Cost Indexes and Indices measured and compared against a set of guidelines set by IPART.

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

Volatility in the Rate Peg is not so much of an issue if it is matched with the cost-of-service delivery. The difficulty or complexity exists in setting four year and annual plans if they are not agile or are difficult to adjust in rapidly changing conditions. Councils are required to set a draft Revenue Policy up to 18 months in advance of the end of period and adopt a final position prior to the start of the year. In volatile times, this may be difficult and may create mismatches between actual cost and revenues.

Stabilisation firstly requires setting the costs and the revenues with estimates and indices for the same period. Fundamentally, the current process fails in this regard. Clearly, councils are setting future budgets based on future cost estimates and stabilisation, in the first instance, requires revenues to be based on the same indices.

Setting Revenue and Costs in the same way through future forecast will undoubtedly require continual adjustment to ensure that forecast versus actual variances are not embedded in future estimates. It is considered that this could be reasonably managed through an adjustment process added to the future year indices. This type of adjustment is applied effectively in the Financial Assistance Grants that make inflationary adjustment, albeit at a simplified CPI level.

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

While it would be administratively beneficial to provide certainty to the future Rate Peg or revenue side of the equation, in the absence of being able to manage and constrain the external costs in a similar fashion, it is considered that this would be a detrimental direction. Effectively, this would be a form of gambling on future revenues against cost indices and would not represent sound financial management.

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

Again, as costs are volatile, a longer-term approach to revenue is not considered the best approach.

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

Historically, it has been argued and requested to provide early release of the Rate Peg has assisted with the development of plans by creating greater certainty during the development phase. This is clearly aligned to periods of benign economic conditions and passive acceptance of the inevitability of the Rate Peg, that meant that variations were easier to manage with more time. The eventual outcome of this approach has arguably been less financially sustainable outcomes.

To be more effective, it is considered that a future model will need to be more flexible and adaptable up to the adoption of an Operating Plan. In an optimised model, this could allow indices to be varied up to and including the final adoption of the Operating Plan, with draft plans being based on existing indices and updated through the process. Undoubtedly, this would require transparent indices and impacts across the budget and the revenue models exhibited.

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

Local Government State Award will reflect the cost. Other methods should be required to measure efficiency.

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

Revenue to pay for all costs are a basic requirement of continuing financial sustainability and is therefore required if external rate pegging is to be applied.

Costs for the following should be included in any Rate Peg:

- Legislative change implications
- Pricing changes from other levels of government
- Shifting of services from other levels of government
- Costs of implementing and operating with government enforced systems such as Planning portal
- Impacts of disaster and climate change implications
- Insurance market change

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

Absolutely, a number of options have been included in the discussion above starting with using the IP&R process to determine individual council revenue needs based on a baseline set of indices applied to a Council Specific Cost Index.

Outside of this, a clearly articulated schedule of additional cost implications of items included in Question 17 could be used to adjust against any baseline indexation methodology. This schedule could be included in the Operating Plan for consultation with the community and simultaneously be reviewed by IPART.

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

As per Question 17.

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 function of a council Revenue Policy and rate variation cannot be responsibly managed through a simplistic index. The function of a council's financial sustainability requires substantial effort by a council and community to balance the appropriate level of community service, legislative compliance and the community's willingness to pay. It is clearly argued that such complexity is well serviced by the comprehensive IP&R process that has been well established across Local Government.

Should you require further information, please contact Brian Jenkins, Chief Financial Officer [redacted]

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