



IPART Independent
Pricing and Regulatory
Tribunal | NSW

Rate peg methodology review

Workshop presentation

Agenda

Session 1: Review background and introductions

Session 2: Base costs and Local Govt Cost Index

01 Volatility, lag and cost reflectivity

02 Differences in base costs including labour

Session 3: Costs of new activities and services

03 Population growth factor

04 New services, activities and external costs

05 Adjustments including the productivity factor



Session 1: Review background and introductions

Terms of reference

We have been asked to investigate and make recommendations on:

1. options to set the rate peg methodology to ensure it is reflective of inflation and costs of providing local government goods and services
2. options to stabilise volatility in the rate peg and options for capturing more timely changes in council costs and inflation
3. alternate data sources to measure changes in councils' costs
4. the effectiveness of current LGCI approach
5. options for capturing changes in councils' costs caused by external factors outside councils' control
6. the effectiveness of the population growth factor in achieving its intended purpose.

Review timeline



Funding framework and role of the rate peg

Funding framework for councils

- Income from rates is an important source of funding for councils at about 32%
- Grants and contributions make up 31% and user fees and charges about 15%
- Additional income can be raised from special variations and supplementary valuations

Role of the rate peg

- Protect ratepayers from excessive or unnecessary rate increases
- Enable councils to continue delivering their existing services to ratepayers and the community. Creates a financial incentive to improve productivity and efficiency.

The rate peg is part of the funding solution.

Rate peg components



Characteristics of councils in different areas of NSW

Council type	Average council area (km ²)	Average population changes over 5 years (%)	Average population density (population/km ²)	Average total road length (km)	Average residential rate (\$)
Metropolitan	77	5.9%	3,825.7	439	1,186
Regional town/city	3,688	3.6%	93.2	1,363	1,222
Metropolitan fringe	1,134	8.9%	305.2	1,032	1,400
Rural	15,213	-2.8%	0.5	1,608	454
Large rural	7,881	-0.2%	2.6	1,725	863
All councils	5,530	2.4%	796.5	1,307	1,024

Key themes from submissions

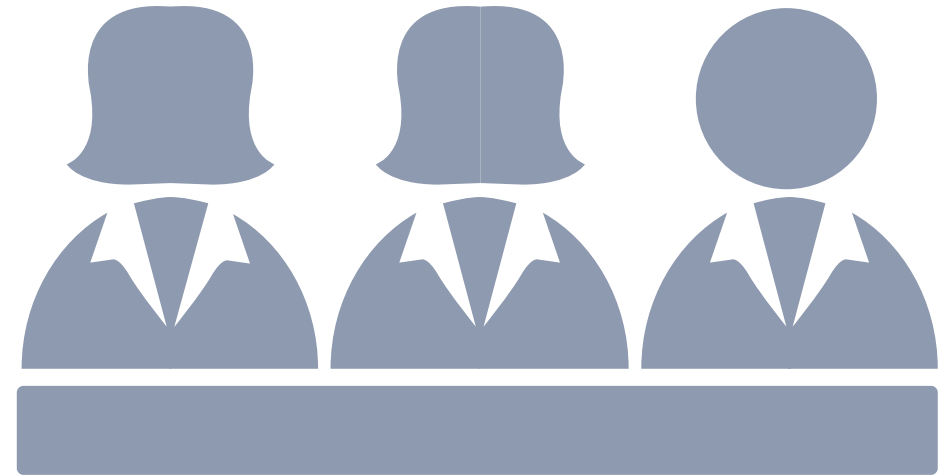
• **Base costs and the cost index**

- Some councils are struggling to meet costs and are using Special Variations
- Ratepayers consider their rates are unaffordable
- The LGCI is too blunt and needs to account for council diversity
- Rear-facing indicators are a problem and lag is an issue when inflation is volatile

• **Costs of new activities and services**

- The population growth factor should remain but needs revision
- Councils consider the productivity factor is not practical
- Costs driven by external requirements that impact councils unevenly must be accounted for
- The rate peg must consider costs outside of councils' control: environment, regulatory, "shifted" costs, COVID.

Introductions and comments from workshop participants



Session 2: Base costs and the Local Government Cost Index (LGCI)



Volatility, lag and cost reflectivity



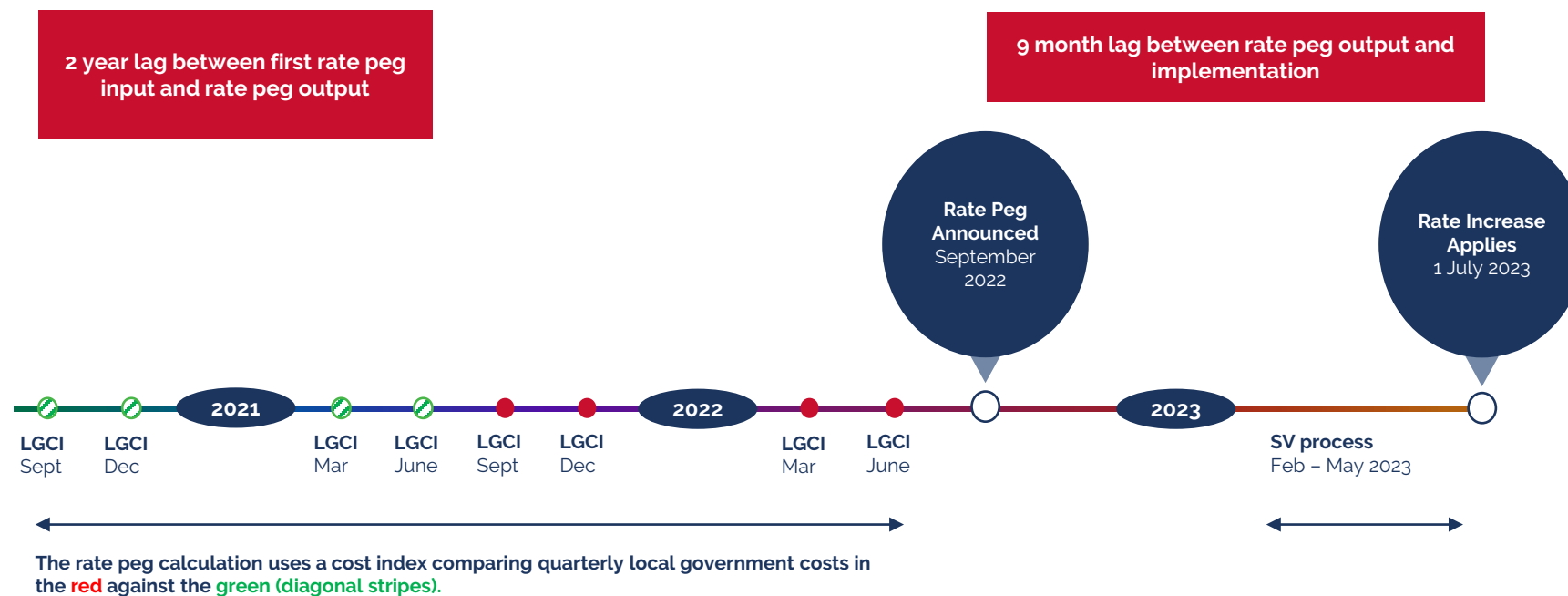
Differences in base costs including labour

Lag, volatility and cost reflectivity

- There is a 2-year lag between when councils experience cost changes and when the rate peg reflects these changes.
- When inflation is **stable**, the lag may not be a significant concern for councils. This is because the changes in costs from year to year are relatively even, so there is little difference between how costs changed 2 years ago, and how costs are changing now.
- When inflation is **volatile**, the lag may lead to material differences between what councils receive through the rate peg, and how their costs actually change. This may temporarily impact councils' ability to provide services.

2-year lag in the LGCI

We measure the change in the cost index using the latest available ABS information. To set the rate peg for 2023-24, we measured the change in the LGCI in the year July 2021 to June 2022, relative to July 2019 to June 2020. This rate peg will come into effect in July 2023.



How could we address some of these problems?

Option



Use forecasts

Eliminates lag

Even the most sophisticated forecasts can be inaccurate

Use a rolling-average

Reduces volatility

Increases lag
Could also result in the rate peg being less cost-reflective

Set the rate peg at a fixed percentage over a longer period

Provides certainty

May turn out to be significantly out of alignment with changes in costs



Differences in base costs
including labour

Local Government Cost Index



Cost components and weightings determined by survey of councils



26 cost components: Top 2: labour (39%), roads and bridges construction (22%)



Mainly use Australian Bureau of Statistics prices indexes (CPI, PPI and WPI) to measure changes in costs

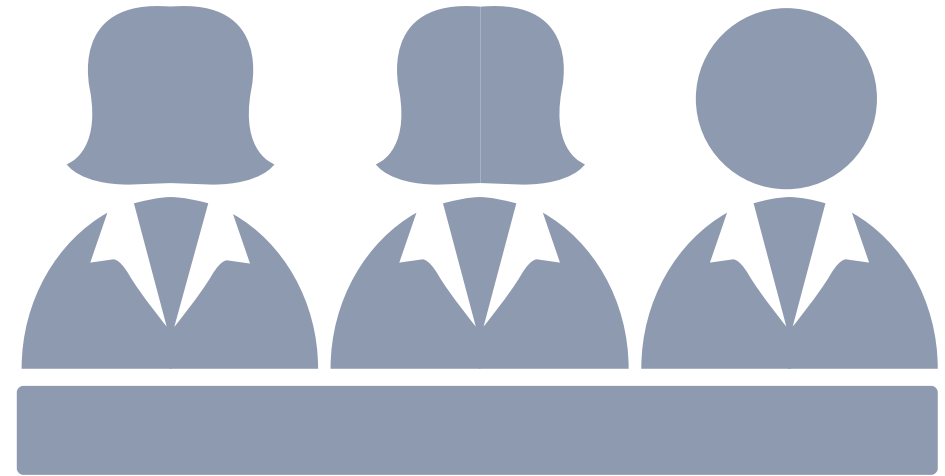
Funding services ratepayers need

- Some councils have told us that rates revenue does not cover the efficient costs of services ratepayers need.
- Other councils have a revenue base that allows them to provide a range of services, including discretionary activities.
- Councils may have other revenue options to pay for services. Given these differences, making adjustments to the rate peg is not straightforward.
- For councils with very low rates or rates income, are there other avenues to increase rates income, such as a one-off special variation to rates?

Efficient labour costs

- Labour costs are the largest single cost component in the LGCI, with a weighting of 39%
- We currently use the NSW public sector wage price index (WPI) to measure changes in labour costs. We are seeking comment about whether this remains appropriate.
- Some alternatives we could consider include:
 - the NSW Local Government (State) Award
 - specific enterprise bargaining agreements, or changes in NSW councils' total employee costs.
- We may also need to consider expected labour productivity improvements, depending on the approach taken.

Feedback and questions



Rate peg methodology workshop



Short break
20 minutes

Session 3: Costs of new activities and services



Population growth factor



New services, activities and externally driven costs



Other issues

Population factor

Previously, there was no explicit allowance in the rate peg to account for the increase in services that need to be provided to service population growth.

We introduced a population factor from the 2022-23 rate peg.

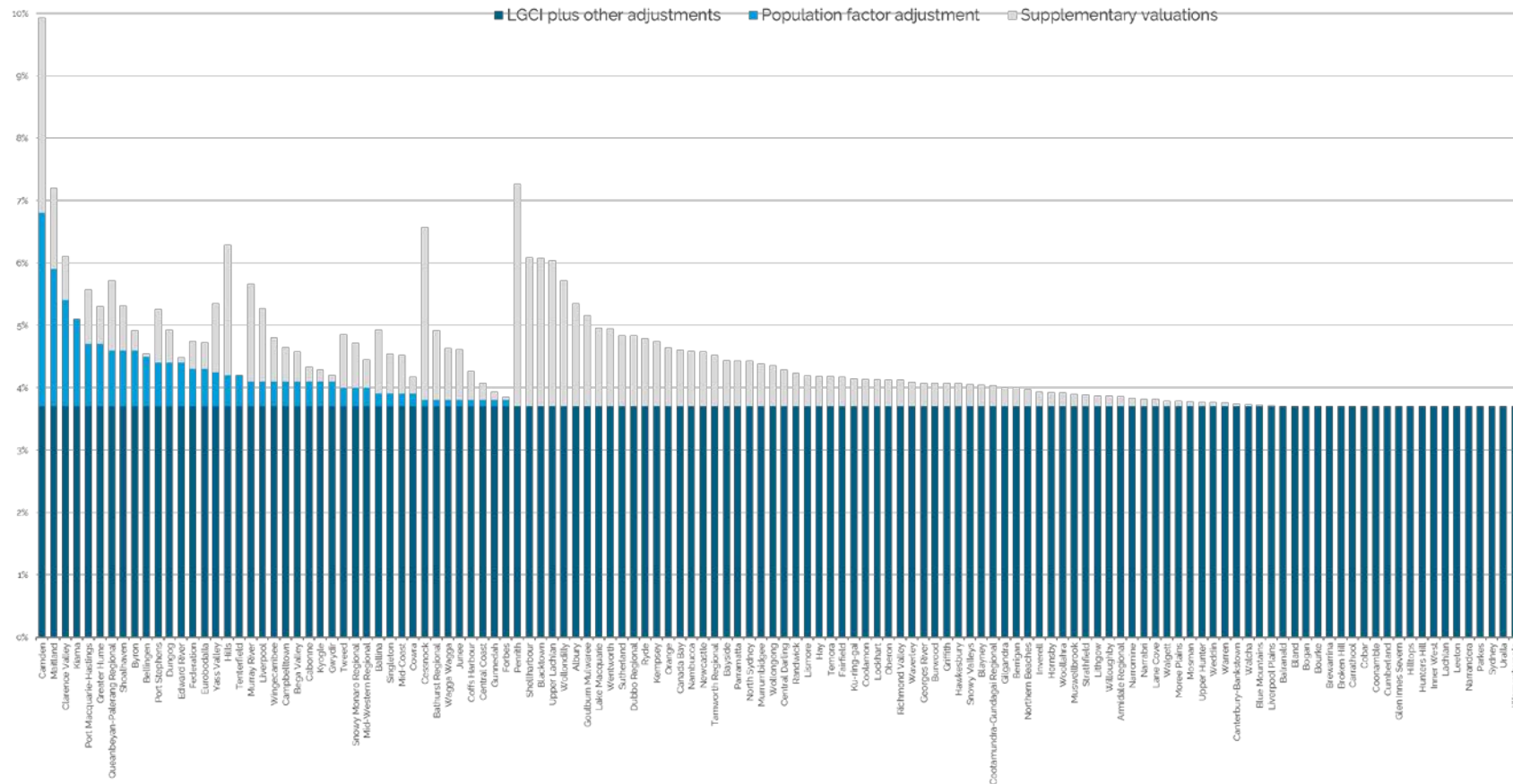
- Councils can increase their rates income in line with the annual change in the residential population in their area, less any supplementary valuations they receive.
- This council-specific percentage is then added to the average annual change in councils' costs (as measured by the LGCI) to determine each council's rate peg.

We are seeking feedback on how the population factor is operating and what improvements could be made.

Population factor and supplementary valuations

- Our 2021 review of the rate peg to include population growth found that as the population a council serves grows, the costs of delivering local government services also grow
- From the 2022-23 rate peg we introduced a population factor based on the percentage change in residential population in each council area
- However, councils are already compensated for population growth, to an extent, through supplementary valuations
- To ensure that councils only recover necessary costs, and ratepayers do not pay more than what is necessary, we subtract the amount of additional income received through supplementary valuations from the population factor

Population growth and supplementary valuations



Funding new services, activities and external costs

- Councils may not be adequately compensated when their scope of services increases
- We are seeking feedback on how the rate peg methodology could account for additional costs, while still providing appropriate checks and balances

New services

Over time councils need or want to provide new services to their community.

These can be:

- discretionary services driven by community wants
- existing services requiring more effort to deliver, or
- additional services council has been asked to fund

Funding options

The LGCI does not account for these changes

Current funding options are:

- re-prioritising services or finding efficiencies
- increasing/establishing fees or charges
- seek approval for a Special Variation to rates income
- seek operating or capital grants

Other adjustments to the rate peg

2011-12	Rate peg set with productivity adjustment
2012-13	0.4% increase – carbon price advance to offset introduction of carbon price
2013-14	0.1% decrease – carbon price advance partially withdrawn to avoid double counting
2014-15	0.3% decrease – remaining portion of the carbon price advance withdrawn
2018-19	0% productivity factor – IPART sets the productivity factor to 0% as a default
2020-21	Change in ESL – IPART changed its approach to measuring ESL contributions, to reduce the lag from 2 years to one
2021-22	0.2% increase – adjustment for local government election costs
2022-23	0.2% decrease – adjustment for local government election costs removed Population growth factor introduced
2023-24	0.2% increase – superannuation guarantee

Productivity factor

Our rate peg methodology includes a productivity factor.

- Prior to the 2018-19 rate peg, we set the productivity factor in the rate peg with reference to estimates of multifactor productivity published by the ABS and adjusted for relevant industry specific factors.

The productivity factor is set at zero as a default.

- This recognises that improvements in productivity are already reflected, to an extent, through the indexation of the input costs in the LGCI.

We are seeking feedback on how can the rate peg methodology best reflect improvements in productivity and the efficient delivery of services by councils.

Climate change costs

Councils play an important role in tackling climate change and must address climate change risks

Mitigation

Reduce emissions that cause climate change

- installing solar panels
- switching to electric vehicles
- using LED lights

Adaptation

Managing or reducing the negative effects of climate change

- flood mitigation
- coastal management
- protection from heat

Climate change is likely to drive higher costs

Climate change costs

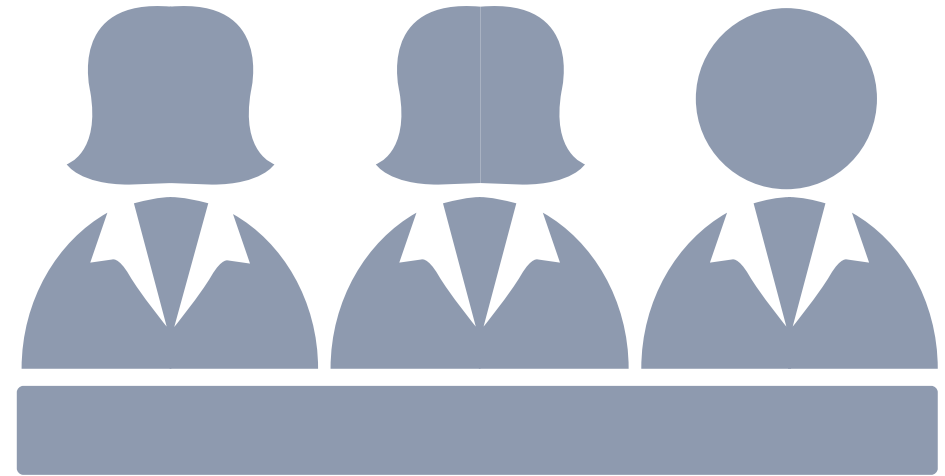
If included in the rate-peg? How?

- Climate change cost allowance factor to capture increases to costs due to climate change
- Should it be uniform across all councils or vary across councils?

Challenge

- Need to understand costs and how they vary across activities and councils
- Define climate change-related costs and what to include
- Ratepayer response

Feedback and questions



Review timeline

