

FACT SHEET

Rate peg for NSW councils for 2015/16

2 December 2014

IPART is responsible for setting the rate peg for NSW councils each year. For 2015/16, we have set the rate peg at 2.4% based on the change in the Local Government Cost Index and an adjustment for a productivity factor.

What is the rate peg?

The rate peg determines the maximum percentage amount by which a council may increase its general income for the year. For almost all councils general income consists entirely of rates income. For a small number of councils, general income also includes some annual charges such as drainage levies. The rate peg does not apply to stormwater, waste collection, water and sewerage charges.

The rate peg is mainly based on the Local Government Cost Index (LGCI), which measures price changes over the past year for goods, materials and labour used by an average council. We deduct a productivity factor from the LGCI to strike a balance between ensuring that councils can meet the increased costs of delivering services resulting from price changes and ensuring that councils share productivity gains with ratepayers.

How did we set the rate peg for 2015/16?

We calculated the rate peg for 2015/16 by:

- ▼ taking the increase in the LGCI for the year to September 2014 of 2.47%
- ▼ deducting a productivity factor of 0.04%.

This resulted in a rate peg of 2.43% which we rounded to 2.4% for 2015/16.

What is the LGCI and how do we measure change?

The LGCI is a price index for councils in NSW. It is similar to the Local Government Price Index used in South Australia and similar in principle to the Consumer Price Index (CPI), which is used to measure changes in prices for a typical household.

The LGCI is designed to measure the average change in prices of a fixed 'basket' of goods and services that are purchased by councils, relative to the prices of the same basket in a base period. The index has 26 cost components, such as employee benefits and on-costs, and building materials for roads, bridges and footpaths. The cost components represent the purchases made by an average council to undertake its typical activities. We constructed the index in 2010 based on a survey we undertook of NSW councils' expenditure in 2008/09 and 2009/10.



We use the change in the LGCI in the year to September 2014 to inform the rate peg for 2015/16. This is the latest available information at the time we set the rate peg. The change in the LGCI in the year to September 2014 was 2.47%.

The main contributors to the change in the index were:

- ▼ an increase of 2.7% in employee benefits and on-costs, measured by the ABS wage price index for the NSW public sector
- ▼ an increase of 3.2% in construction costs for works, measured by the ABS producer price series for Road and Bridge Construction in NSW.

Offsetting these increases were decreases of:

- ▼ 1.9% in plant and equipment leasing prices
- ▼ 2.8% in motor vehicle repairs prices
- ▼ 3.0% in information technology and software prices.

There was an increase of 10.2% in gas prices, measured by the ABS consumer price series for gas and other household fuels. However, with a small weighting in the index, this resulted in a small impact on the LGCI.

The increase of 1% in electricity costs reflects the net effect of large price increases in 2013/14 off-set by a significant decrease in the September 2014 quarter as a result of the carbon price repeal. The impact on the LGCI (0.04 percentage points) was therefore lower than in previous years.

For more detail on the increase in the LGCI to September 2014, see Table 1 on page 5.

How did we determine the productivity factor for the 2015/16 rate peg?

The rate peg includes a productivity factor to allow ratepayers to share in council productivity gains. In the last four years, we applied a productivity factor of 0.2% in each of our rate peg determinations.

This year we reviewed our methodology for determining a long term productivity factor. We investigated a measure for determining a productivity factor that would be appropriate for all the industries we regulate. We decided to use the ABS market-sector value added multifactor productivity, based on quality adjusted hours worked. We have continued to use a long term (15-year) average as it smooths out short-term volatility in the index and therefore allows for a more consistent estimation of productivity over time.

Based on this methodology, we determined a productivity factor of 0.04% for the 2015/16 rate peg.

For more information on the productivity factor see the Fact Sheet – Productivity factor for cost indices – October 2014.

http://www.ipart.nsw.gov.au/Home/Industries/Research/Fact_Sheets_Information_Papers/Fact_Sheet_-_Productivity_factor_for_cost_indices_-_October_2014

How have we approached the carbon price repeal?

The Federal Government has repealed the carbon price effective 1 July 2014. We considered whether to adjust the rate peg for the carbon price removal and noted that:

- ▼ Due to the way the LGCI is constructed, the impact of the carbon price removal would be captured in the rate pegs of 2015/16 and 2016/17 (assuming input prices adjust within 15 months).
- ▼ When we applied an adjustment to the 2012/13 rate peg, it was in advance of the carbon price introduction and was based on Federal Treasury estimates of the prices.
- ▼ The timing of the carbon price removal (July 2014) means that we would be considering an adjustment after the removal is underway and with no published estimates of the effect on prices.

For these reasons we have decided to make no formal adjustment to the 2015/16 rate peg for the carbon price removal. Instead, we will allow its impact to work through the movements in the LGCI in the normal way. We consider that this approach is consistent with our usual approach in the calculation of the LGCI as it allows price effects to flow through to the rate peg in the same way as any other changes in prices.

How does the carbon price repeal affect councils' waste management charges?

Domestic waste management charges are set by councils and are outside the rate peg.

Under the Local Government Act, councils are required to calculate the domestic waste management charge so that they do not exceed the reasonable cost of providing these services.

We expect that as the impact of the carbon price removal will gradually flow through to councils' waste management costs, this will be reflected in the domestic waste management charges set by councils.

What does the rate peg mean for ratepayers?

The rate peg sets the maximum increase in each council's general income for the 2015/16 financial year. Because the rate peg applies to general income in total, and not to individual ratepayers' rates, councils have significant discretion to determine how to allocate this increase between different ratepayer categories. Individual rates are also affected by other factors, such as land valuations.

As an indication, the average residential rate per assessment in NSW in 2014/15 is around \$923. The rate peg decision implies an average rate increase of around \$22 in 2015/16. However, an individual ratepayer's rates may increase by more or less than the rate peg amount.

What does the rate peg mean for councils?

Councils must not increase general income by more than the rate peg. Councils requiring additional general revenue may apply to IPART for a special variation.

Councils applying for a special variation must satisfy the criteria listed in the Office of Local Government's Guidelines. The Guidelines require that councils must:

- ▼ establish a need for a special variation through the Integrated Planning and Reporting (IP&R) process, including through undertaking long term financial planning
- ▼ ensure community awareness of the need for and extent of the rate rise and giving the community an opportunity for input
- ▼ consider the impact on ratepayers and the community's capacity and willingness to pay
- ▼ exhibit and adopt the relevant IP&R documents
- ▼ explain productivity improvements and cost containment strategies it has realised or proposes in the future.

See the IPART website for information on the special variation requirements and councils that have applied in recent years.

http://www.ipart.nsw.gov.au/Home/Industries/Local_Govt/Special_Variations_and_Minimum_Rates

Want more information?

For more detail on the Local Government Cost Index see our Information Paper, *Local Government Cost Index* published in December 2010. This is also available on our website.

www.ipart.nsw.gov.au/Local_Govt/local-government-cost-index

Table 1 The increase in the LGCI for the year ended September 2014

Cost items	Effective weights as at end Sep 2013 (%)	Price change to end Sep 2014 (% annual average)	Contribution to index change (percentage points)
Operating costs			
Employee benefits and on-costs	41.7	2.7	1.14
Plant & equipment leasing	0.4	-1.9	-0.01
Operating contracts	1.3	1.8	0.02
Legal & accounting services	1.1	3.1	0.03
Office & building cleaning services	0.2	2.0	0.00
Other business services	5.9	2.3	0.13
Insurance	1.9	0.3	0.01
Telecommunications, telephone & internet services	0.5	0.1	0.00
Printing publishing & advertising	0.5	8.6	0.04
Motor vehicle parts	0.5	2.3	0.01
Motor vehicle repairs & servicing	0.7	-2.8	-0.02
Automotive fuel	1.2	3.8	0.05
Electricity	3.8	1.0	0.04
Gas	0.1	10.2	0.01
Water & sewerage	0.5	2.8	0.01
Road, footpath, kerbing, bridge & drain building materials	3.1	3.2	0.10
Other building & construction materials	0.8	1.9	0.01
Office supplies	0.3	1.3	0.00
Emergency services levies	1.4	2.5	0.03
Other expenses ^a	8.6	2.6	0.22
Capital costs			
Buildings – non-dwelling	6.1	1.9	0.11
Construction works - road, drains, footpaths, kerbing, bridges	13.9	3.2	0.45
Construction works - other	1.4	3.2	0.04
Plant & equipment – machinery	3.7	0.3	0.01
Plant & equipment – furniture etc	0.2	1.6	0.00
Information technology & software	0.3	-3.0	-0.01
Total change in LGCI	100.0		2.47

^a Includes miscellaneous expenses with low weights in the Index, eg, councillor and mayoral fees.

Notes: Figures may not add due to rounding. Percentage changes are calculated from unrounded numbers.