CAMPBELLTOWN CITY COUNCIL

2 November 2022

Review of the rate peg methodology – Issues Paper
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop
SYDNEY NSW 1240

Dear Tribunal

Submission: Review of the rate peg methodology – Issues Paper

Thank you for the opportunity to comment on the issues paper on behalf of Campbelltown City Council.

Campbelltown City Centre is identified in the Greater Sydney Region Plan as a Metropolitan Cluster Centre that, together with the centres of Liverpool, Penrith and the emerging Aerotropolis, will support the growth of the Western Parkland City to a region that will be home to in excess of 1.5 million people by 2036.

Campbelltown City Centre is in a unique position as a Metropolitan Cluster Centre at the 'Southern Gateway to Sydney' serving regional and metropolitan communities that often extend outside our rate base.

The main points in our submission are:

1. Rate peg should be forward looking not backwards.
2. Should use award outcomes as a key input into the formula calculation given staff labour costs are a key cost driver.
3. Allow for greater flexibility for local context and to consider commitments outlined and developed using the IPR framework.
4. Consider rolling averages to smooth out lumpiness or one off distortions.

Yours sincerely

[redacted]

Phu Nguyen
Director City Governance

EXECUTIVE SUMMARY

The current Local Government Cost Index (LGCI) generally achieves what it is designed to do during stable inflation. The 26 cost components are not reflective of all council costs or all types of council costs and the 2 year lag needs to be addressed to align more closely with the current financial climate.

The local government state award provides councils with a clear future facing pathway for wages growth. This in connection with each council's 10 year Long Term Financial Plan (LTFP) and 4 year Delivery Program (DP) as part of the Integrated Planning and Reporting (IPR) framework significant and objective data is available to align the peg with a future facing LGCI. Up to date data that closes the gap in the lag and aligns more closely with the financial situation at the time should be part of future determinations.

We do not believe that the LGCI is allowing councils to keep pace with their costs which is demonstrated by the number of Special Variation (SV) applications applied for from year to year. Past expenditure patterns is not considered an appropriate indicator of future expenditure. Every year there's another need, another function to perform without any additional funds unless council applies for a SV, which is an intense, costly and protracted process.

The IPR framework was introduced by the NSW Government in 2009 with a suite of documents that inform our community on Council's financial position to provide works, services, facilities and activities identified in the Community Strategic Plan (CSP). Accordingly the IPR framework needs to have some influence on the government's rate pegging policy.

In essence the rate peg needs to:

- be future facing as much as possible
- acknowledge IPR and allow flexibility
- avoid assumptions that past expenditure will be the future expenditure
- address volatility:
  - if using retrospective data points through rolling averages
  - if future facing estimates with a true-up
- account for diminishing income streams (eg Financial Assistance Grants (FAG))
- account for compliance costs.

In this submission we have responded to each of the 20 items on which you are seeking feedback. The responses are provided below.

RESPONSE TO QUESTIONS PRESENTED IN THE IPART ISSUES PAPER

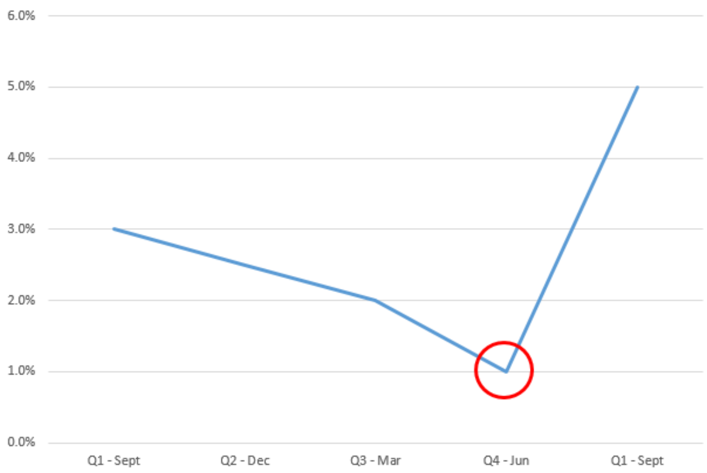
1. To what extent does the Local Government Cost Index reflect changes in councils' costs and inflation? Is there a better approach?

The LGCI achieves what it is designed to do, which is to reflect the average costs across all NSW councils based on 26 cost components. Where it fails is to reflect the individual movements of each council and one off project based expenditure.

Material changes or movements in revenue sources are not captured. As a recent example, the dramatic decrease in parking fines (during COVID), diminishing FAG and interest on investments.

The 2 year lag has not been an issue during times of relatively stable inflation. If inflation is consistently running at say 2 per cent per year, give or take between 0.5 per cent and 1 per cent movement, the LGCI calculation would expectedly remain just as stable. In times of volatile and somewhat unpredictable inflation, the effect can be (and has been) very dramatic and does not align with community expectations.

The current methodology uses CPI for 11 of the 26 cost components selected at a single point in time, this practice does not account for any anomalies. In the example below the situation can occur where the CPI is 3 per cent in Q1, then 2.5 per cent in Q2 then 2 per cent in Q3 then 1 per cent in Q4 followed by a steep rise to 5 per cent in Q1 of the next year. The current IPART model uses the Q4 CPI to predict the cost increases for councils in the LGCI. This is graphically illustrated below.



Council is required to prepare a 10 year LTFP as part of the IPR process and place this on public exhibition for a period of at least 28 days. The LTFP is future facing and includes all of the council costs including individual nuances. Our preference is for the revised LGCI to be future facing and information from each councils LTFP may be of assistance in achieving this outcome.

To avoid volatility in the rate peg, the use of a rolling 3 year average of the historical LGCI weighted at 50 per cent with a forward-looking forecast projecting inflation weighted at 50 per cent. 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?

There is significant data collected and publicly available, the number of cost components could be increased to better measure overarching costs but as each council is significantly different in the way it services its community it is not considered possible to capture everything.

The 2 year lag needs to be significantly reduced or removed, but preferably, a reliable forward looking measurement of actual cost changes should be used.

IPART should incorporate the anticipated costs for councils to meet targets set by other levels of government. There are many currently in place that we would encourage IPART to accommodate. We also suggest having a mechanism that can monitor and account for new targets as they arise.

We suggest the peg include a component for councils to address resilience and climate change. This is a known need across every council, however the type of work to be costed may differ between councils. A resilience factor should incorporate pro-active work and maintenance, as well as immediate costs to deal with catastrophic events such as bushfires and floods. Our communities expect their local government to be undertaking this work, but they are not adequately resourced or financed to achieve what is required of them.

In addition, we ask for a simple mechanism to be introduced for councils to annually notify IPART of known and evidenced additional factors that need to be incorporated into their rate peg.

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

Our preference is for the rate peg to be forward facing as much as possible. We are not familiar with all the possible indices that may allow for this to be achieved and speculate that any estimates would be coupled with a true-up to align those estimates with actual results.

The Local Government (State) Award provides known increases for a period of 3 years. This index is recommended to forecast future labour costs. Council data may also assist the IPART with wages growth and any additional costs associated with attracting quality staff.

The Reserve Bank of Australia (RBA) produces forecast CPI.

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?

The unfortunate issue with tangible indices is the lag between the growth period and the year it will be added to the LGCI to determine the rate peg limit. For the financial year 2022-23 the Estimated Residential Population (ERP) used was the growth measure between 2019 and 2020. The range of population growth factors was between 0 and 4.3 per cent.

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.

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.

5. How can the rate peg methodology best reflect improvements 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 IPR process. Any productivity gains should be encouraged and allowed as they will surely encourage future productivity gains that will benefit our community.

Penalising councils for efficiency gains is a disincentive for innovation and should be removed.

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

Unique costs that have occurred in the last 12 months or that are predicable for the relevant LGCI period. For example, the additional 0.2 per cent 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. If the impact is permanent, ie, the costs are going to have an effect infinitum the factor should not be removed in the following LGCI.

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

- Global Economic Forecasts and delays in the Supply Chain
- Changes in private sector costs and pricing trend where local government has a high degree of interaction or engagement (eg, IT, building construction, waste management, specialist contractors, infrastructure, design etc.)
- Impact of natural disasters and severe weather events
- Resilience – cost in identifying how local government can support its community to be more resilient and how local government can itself be resilient. Cost to implement identified resilience outcomes.

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

We do not believe in this philosophy of unnecessary rate increases. Council strives to provide the best possible works, services, facilities and infrastructure to its community. To keep land rates low and running with a vernacular of protection is fictitious at best.

Moreover decisions to keep rates low can lead to opposite outcomes. The choice to delay necessary rate increases as a pseudo protection may eventually lead to no choice but to apply for high percentage increase that has significant impact on the community in particular the vulnerable.

Importantly, NSW councils adhere to strict IPR framework that requires extensive community consultation and allows for intervention by the community and mandates numerous consultation steps. It is important to note that the IPR framework was not in place when rate pegging/capping was introduced in 1977 yet the NSW Government has made no concessions to allow the ratepayers of NSW more choices in how the community can be better funded.

Instead, we see the same rhetoric around protecting ratepayers from excessive raises.

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 per cent. The factor should align with the CSP, DP (DP), Operational Plan (OP) and LTFP rather than the peg itself.

Accordingly, a process should be investigated that enables councils to align their rates with the outcomes from the CSP for the relevant period. For example, if the community identifies a need (in the CSP) for funding that results in increase variations each year that exceeds the IPART peg limit. The IPR process starts with the CSP, resourcing of the plan is determined in the DP which is funded annually by the OP. This model aligns with question 13 and 14 in the Issues Paper.

A mechanism of recommending a factor for councils that have a financial need to remain sustainable should be included.

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

No. This is why councils seek a SV from time to time.

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

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.

Following on from the NSW Governments 'Fit for the Future' investigation, a number of councils found it necessary to apply for significant rate increases to remain financially sustainable. Essentially, this situation leads to injustices in intergenerational equity as the current and future ratepayers are playing catch-up to pay the gap not funded through appropriate, fair and equitable land rates.

In the last 10 years:

- 178 councils applied for a SV
- 165 applications were approved in full or in part
- 142 applications rationalised based on one or all of the following to address:
    - financial sustainability,
    - existing infrastructure backlogs,
    - future infrastructure expenditure obligations.

In addition to this, the last 3 years:

- 79 Councils reported an infrastructure renewal backlog of greater than 2 per cent
- 56 Councils consistently reported an infrastructure backlog of greater than 2 per cent
- 99 Councils reported an infrastructure renewal ratio of less than 100 per cent
- 33 Councils consistently (over 3 years) reported an infrastructure renewal ratio of less than 100 per cent
- 74 Councils reported an infrastructure renewal ratio of less than 100 per cent over a 3 year average

The above statistics clearly show that a large majority of NSW councils are balancing their operational budgets by underfunding its capital obligations.

Based on the number and size of SV applications in the last 10 years and the deterioration of councils' asset sustainability indicators over the least 3 years, it can be said that the rate peg has prevented necessary rate increases.

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

We do not have access to state-wide data that allows us to determine if there are material differences between cohorts of council's or individual councils.

Historical modelling may identify material differences and if this occurs there may be an argument that supports multiple pegs on this basis.

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.

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

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

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. It would preferably be based on the future landscape rather than historical. Presently council applications for a 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 IPR requirements.

Accordingly, when it comes to the bespoke 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 special variation 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 (eg, NSW Local Government (State) Award for labour costs) and the RBA forecast CPI.

14. Are there 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 per cent with a forward-looking (RBA CPI) forecast projecting inflation weighted at 50 per cent. 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 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 OP (budget) early in the new calendar year to meet exhibition timelines, the current release dates support this outcome.

Our preference is for forward facing indices wherever possible, above (Q14) we suggest the use of historical LGCI indexes weighted at 50 per cent 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 believe accounting for actual labour costs should be aligned with changes in the NSW Local Government (State) Award to be more reflective of council's costs. The cost of attracting quality staff should also be factored in. These costs may be identified through sector based advertising agencies.

We support the sector and do not believe that productivity factors can be accurately measured in a sector as diverse as local government.

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 IPR 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.

Council prepare a lot of public facing information through the IPR 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 or by simply modifying current requirements without adding something new.

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.

Local government has been subject to significant cost shifting from other levels of government. Recently we received information showing the mandating of the NSW Audit Office has seen an increase in audit fees of 88 per cent over 9 years. Specifically for us audit fees have increased by 161% from $66,000 in 2015-16 to $172,000 in 2021-22.

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

Changes to legislation that affect all councils, often result in additional costs to the local community, examples include but are not limited to the mandating of the audit office, rather than competitive tendering and superannuation payments for elected councillors.

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 Q14 above we agree that setting a long-term peg could be a solution, with nearly 40 per cent 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 2 periods.

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