4 July 2023

Thank you for the opportunity to provide feedback to IPART on the Draft Report regarding the rate- peg methodology as it is applied to local government in NSW. Overall, the proposed changes are a step in the right direction towards allowing councils to adequately increase their income from rates to support the increases in costs to provide services to the community.

The proposed changes to the current methodology for setting the rate-pegging will align the rate peg amount closer to increases in costs faced by councils. However, whilst there continues to be a limit on the revenue that each respective Council can raise to fund service provision to the community, maintain and renew the vast infrastructure assets, and service growth, financial sustainability will continue to be an issue for most NSW councils.

Although acknowledged in the report, the rate-pegging methodology review does not address the issue of the rating base challenges of some councils and this is a matter that requires consideration.

The Integrated Planning and Reporting Framework allows communities to tell councils how and where expenditure is allocated, and the services and service levels expected. However, with the current rate-pegging income limitation, councils are not able to adequately respond to what their community is asking for.

The draft recommendation to the NSW Government to consider commissioning an independent review of the financial model for councils in NSW is viewed as a positive move towards reviewing the effectiveness of the rate-pegging policy within the context of local government financial sustainability.

It is noted that the proposal has three different council categories and somewhat acknowledges that councils are different, and they face different costs and challenges. However, the categories are very broad, with some councils not clearly in one category or another. Each council's expenditure is different as they provide different services based on their respective Operational Plan.

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Whilst the SRV process provides an avenue for councils to increase rates more than the rate-peg, the process continues to be resource intensive and costly. Further, the process is often played out in the media which naturally limits the amount of information that can be conveyed on what is a highly complex model. The process is also politically challenging as elected Councillors are required to make SRV decisions to ensure long term financial sustainability during what is a relatively short Council term. As can be seen with the significant number of SRV applications in recent years, many councils have only asked for an SRV as a last resort after reducing services and/or after having accumulated a significant backlog in asset renewal. The SRV increases requested are also getting larger, likely to be at least partially driven by councils aiming to minimise the likelihood of being required to undertake the process frequently. This creates a cycle where a long period of asset deterioration or service reduction is necessarily followed by a large increase, rather than a more gradual transition"

Whilst the rate-pegging concept and SRV process are aimed at safeguarding ratepayers from unreasonable increases, the process may, in some instances, create unintended consequences on councils without the desired benefit to the community. For example, a council may wish to remove a fee not being regulated within rate-peg and wants to incorporate in the rates to achieve a more equitable distribution of the burden. Under the current process it must allocate funds and resources to an SRV process, even though the ratepayers will be in the same, or better, position. The rate pegging and associated SRV process should be reviewed to allow an exemption from the process where an increase in the rates is offset by an equivalent decrease in a charge already being paid by ratepayers.

The proposed adjustment in the depreciation change component for population growth (per capita approach) is not supported. Whilst population growth in the rate peg and supplementary valuations provide income for additional infrastructure due to population growth, this additional income does not fully fund the impact of a growing community on the costs to maintain and renew an expanding asset base. Further, based on the current methodology to include a population growth factor in the rate-peg, councils with either low or slow growth, or growth that occurred prior to the growth factor being included in the rate-peg are already disadvantaged when compared to high growth councils. Whilst the introduction of a floor of 0% is noted, the proposed adjustment to depreciation to remove the impact of growth will only be another action to further disadvantage low and slow growth councils.

The proposal to replace the LGCI with a Base Cost Change Model based on Employee Costs, Asset Costs and Other Operating Costs is supported. The proposed model is simpler to explain and likely to be more readily understood by the community. The proposed alignment of Employee Costs to the Local Government (State) Award wage increases is supported. Considering the significant portion of councils' budgets that are attributed to resources, the inclusion of the relevant increase applicable this cost is a long-awaited and logical improvement to the current methodology.

The proposed methodology to capture the impact of increases in the ESL from year to year is a positive move to recognise the impact of cost-shifting on councils. It is suggested that in the next review of the rate-peg methodology IPART expands this approach to other costs shifted on local government from other levels of government. An easier solution to the ESL matter and other cost items shifted, is that the government contributes directly rather than shifting to councils to shift to the community. Another option may be to exclude government charges such as ESL outside the rates cap and have councils collect it on behalf of the NSW State government for a fee, similar to what occurs in other States.

Specifically, regarding the ESL, the proposed approach fails to compensate councils for the significant increases in ESL experienced for 2023/24, as it will only be considering changes from 2023/24 onwards. This approach will not rectify the significant adverse impact experienced by councils in 2023/24.

Regarding the proposed timing of announcing the final rate-peg, whilst acknowledging an indicative rate-peg will be available in September to form the basis of the Draft Operational Plan, announcing a different rate-peg in May is problematic as it does not align with statutory deadlines set by the NSW Government. In May councils would have already publicly exhibited their Operational Plan, which means the impact of the ESL on the rate-peg, even if positive, is not able to be reflected in the exhibited Plan. It is suggested that the increases in the ESL are contemplated by the NSW Government within a timeframe that aligns with statutory deadlines to prepare and exhibit the annual Operational Plan, and to facilitate only one final rate-peg to be announced between September and December each year.

The forward-looking and more agile approach is also supported as it will better reflect the financial reality that councils face and are required to build in their respective Integrated Planning and Reporting documents. This will be a significant improvement on the current 2-year lag between the time that price changes are observed and when councils can recover these price changes by applying the rate peg to their rates income leaving an unrecoverable gap. Whilst volatility creates challenges when preparing forward plans, it is reflective of what happens in practice, as well as expenditure movements.

The transition from a rearward facing LGCI to a forward-facing BCC methodology, whilst supported, needs to consider the impact of volatility experienced over recent years. Councils have had to absorb the significant impact of exceptionally high inflation over the last 12 months with the rates increase being limited to the rate-peg over the same time. Whilst the economy is still impacted by high inflation, the ongoing monetary policy actions are likely to correct the past trend over the coming years. The full transition in one year to a forward-facing methodology is likely to result in the increase in costs experienced in the last two years not being fully addressed if inflation reduces significantly going forward. More importantly it will be difficult to explain to the community a high rate-peg amount during a period where CPI has been low.

Specifically, regarding the four implementation options, it is noted that the option preferred by IPART, that is, using the LGCI excluding the ESL and developing separate ESL factors would allow some changes to take effect sooner and for the recent volatility to be reflected in the cost index. However, this is likely to result in a rate-peg that is higher than the relatively lower CPI that is likely to be experienced during 2025/25. The option to fully implement the new methodology in 2024/25 is likely to result in a rate-peg that is aligned with CPI being experienced by the community. The issue of costs absorbed by councils over the last 12 months will however not be addressed.

Thank you for the opportunity to comment on the draft report, if you have any questions regarding our submission, please do not hesitate to contact us.

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