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4 July 2023

Our Ref: 2023/373406-01
File No: S093298.002

Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop
Sydney NSW 1240

Lodged as an online submission.

Dear Tribunal members Carmel Donnelly PSM, Deborah Cope and Sandra Gamble,

Review of the rate peg methodology

Thank you for the opportunity to provide feedback on the draft report.

The draft report is largely a positive reflection of stakeholder feedback, with many of the proposed changes aimed at addressing the numerous concerns raised in the City's and other industry submissions on the issues paper. While further reform is still required, to better understand and improve the financial sustainability of NSW councils, the City believes the proposed changes are a great step forward that will improve the current rate peg methodology and lead to positive outcomes for councils and their communities.

The City's submission of November 2022 noted a preference to remove the rate peg altogether, as it was introduced to protect ratepayers against excessive rate increases. The introduction of the Integrated Planning & Reporting (IP&R) framework now requires councils to develop strategic and operational plans, to regularly consult and engage with the community to ensure these plans satisfy the quantity and quality of the services and infrastructure required to meet those needs, and provides the opportunity for ratepayers to understand, contribute and challenge the rating and financial implications of these plans.

Our submission also noted that if the rate peg were to remain, the current methodology fails to acknowledge NSW councils' financial situation, fails to keep pace with the rising costs being experienced, and fails to adequately forecast and plan for the future financial challenges being faced.

IPART's draft report and proposed changes will address many of these issues, including:

- the inadequacy of a universal local government cost index (LGCI)
- that the LGCI does not reflect council's actual cost experience
- that the LGCI uses historical pricing data to predict future financial needs
- that there is no factor to provide for new or expanding services, including cost shifting.

The City's response below, acknowledges the positive outcomes arising from the recommendations within the report, and provides further comments as requested on the following items:

- Improving the measure of changes in councils' base costs
- Adjusting for the Emergency Services Levy
- Capturing other external changes outside councils' control
- Refining the population factor
- Retaining the productivity factor
- Transitioning arrangements, and
- Improving the broader regulatory framework.

The City supports the introduction of the predominantly forward-looking base cost change to replace the local government cost index. We do note the methodology does not capture depreciation, which is a growing cost for councils, and nor will it cover the currently increasing costs of borrowing. We also support the recognition of the diversity of councils, through the development of separate base cost change models for metropolitan councils, regional councils and rural councils.

The City supports the inclusion of an Emergency Services Levy (ESL) factor to directly offset this significant growing impost from the NSW Government. We do however recommend that the final rate peg be announced by the 31 March each year, if the determination of the ESL could be brought forward, as many councils prepare and publicly exhibit their draft IP&R and budget to their communities in April.

The City also seeks further consideration to be given to our request to adjust the current population factor formula to ensure equitable outcomes for all councils. Councils that experience negative rates growth from supplementary valuations, which does not reflect a similar decline in population, are currently prevented from maintaining their per capita general income. Supplementary valuations are not a true proxy for population growth. The issue impacts more than 10% of councils across NSW and can be easily fixed.

IPART's draft report also acknowledges that many of the other concerns raised in connection with councils' financial sustainability, warrant further investigation, and recommends that the NSW Government consider commissioning an independent review of the broader issues facing the local government financial model. These issues would include, but not be limited to, the following:

- the eligibility for rate exemption
- the use of capital improved valuations
- developing a mechanism to identify and rectify an inadequate rates base, and
- reviewing regulatory processes, fees and charges.

In this review of regulatory frameworks and processes, the City would appreciate consideration also be given to councils' current debt management options for recovering rates. The current NSW government practices hinder efficiencies which result in higher than necessary legal costs to ratepayers.

We look forward to participating in further discussions at the planned public hearings.

Sincerely,

[redacted]

[redacted]

Improving the measure of changes in councils' base costs

1. **The City agrees with the proposal to replace the local government cost index with 3 components of employee costs, asset costs and other operating costs.**

The City supports the proposal to replace the 26 cost component Local Government Cost Index (LGCI) with a simpler three component Base Cost Change model (BCC).

The analysis, in the Draft Report, identified that employee costs and asset cost together represent approximately 60 per cent of total costs for councils, and this aligns with the City's own financial results. The bundling of all other smaller operating cost categories into a single third component, delivers a far simpler calculation mechanism, with none of the individual cost categories sufficiently significant to impact the weighted results.

The use of forward looking publicly available indices is welcomed, as the use of cost data that is two years old under the current LGCI methodology has obviously been problematic, particularly in highly inflationary environments.

2. **The City agrees with the proposal of separate base cost calculations for different groups of councils, and supports the 3 groups being metropolitan, regional and rural.**

The City supports the proposal to recognise the diversity of councils cost experiences by differentiating councils into 3 discrete groups, being metropolitan, regional and rural based on the comparative data groupings by the Office of Local Government (OLG).

The City's cost experience would be considered and modelled within the metropolitan group, which is a reasonable starting proposition as we experience many costs changes that are similar to our metropolitan neighbours. However, as the only global city in NSW, the City is also required to service a much broader community of residents, workers, visitors and tourists. Our cost experience is therefore on a significant breadth and scale, and it includes some unique items that we are required to fund from our revenue base that may not be experienced by all other councils in the group. The OLG recognise these differences by categorising the City separately as the only council within Group 1.

The City therefore also supports IPART's proposal to regularly review the success of the rate peg methodology. This would be a good opportunity for the City to demonstrate the extent to which the its base costs may have moved in line or differently to that of other metropolitan councils, which may identify whether further delineation is warranted.

3. **The City supports the proposed calculation of employee costs, asset costs and other operating costs.**

The City supports the use of the annual increases prescribed by the Local Government Award (the Award), or the use of the Reserve Bank of Australia's (RBA) forecast change in the Wage Price Index (where the Award is not available), adjusted for changes in the superannuation guarantee rate, to determine the base cost changes in employee costs.

The City would also appreciate IPART considering other changes to employee costs that arise from the Award, and in some individual councils, including performance increases or bonuses that may influence employee costs.

The draft report notes a potential risk in the use of the Award in that councils may not always be incentivized to strive for constrained award increases, however as the Award is negotiated as an industry wide agreement, this risk seems unlikely.

The City supports the use of the RBA's forecast change in CPI, adjusted to reflect the differences between movement in CPI and the Producer Price Index (road and bridge construction) to determine the base cost changes in asset costs.

The City supports the use of the RBA's forecast change in CPI to determine the base cost changes in other operating costs.

The City supports the proposal to weight the rate peg for each group, using data on the three components from the last 3 years of data obtained from the Financial Data Returns.

The City would like to note that while supportive of the proposal to adjust the rate peg year by the above base cost change for each of the relevant groups of councils, there are limitations to the use of these indices that will not resolve a number of the current challenges to councils' financial sustainability.

Where a council's 'base' rating revenue is too low, and not representative of the full cost of delivering their communities required services and facilities, indexed increases will at best only maintain the status quo and those councils will never 'catch up'. In fact, the compounding factor will see these councils already under financial stress fall further behind. While the Special Variation (SV) mechanism to address such issues is available, many councils over the years have been unable to overcome the barriers to successfully utilise SV's due to resource and political limitations. Further simplification of the SV methodology would be also welcomed.

The draft report also notes that while the proposed base cost change (BCC) model measures the change in unit cost, it does not reflect changes in the volume, quality or mix of services provided. The operational costs associated with delivering the volume and quality of services required by communities, are not always a linear equation that rise in direct relation to population growth, and there are significant incremental or "step up" costs associated when for instance a new community facility is introduced.

The City notes that IPART have acknowledged that these issues warrant further investigation, and have recommended that the NSW Government consider commissioning an independent review into the broader issues facing the local government financial sustainability.

4. **The City supports the proposal of having an 'indicative rate peg' published annually in September, and publishing a 'final rate peg' later in the financial year, but submits the 'final rate peg' should published no later than the end of March each year.**

The City supports the proposal to release indicative rate pegs for councils in September, and a final rate peg confirmed later in the year when council's Emergency Services Levy contributions are known.

The current process of announcing rate pegs in September is required for councils to commence plans for the following financial year. Issuing an 'indicative rate peg' in September, without the ESL component, provides councils with enough information to move forward with their budgeting and planning processes.

We do however recommend that the final rate peg be announced by 31 March each year, if the determination of the ESL by the NSW Government could be brought forward, as many councils prepare and publicly exhibit their draft IP&R and budget to their communities for comment in the month of April.

Adjusting for the Emergency Services Levy (ESL)

5. **The City supports the proposal to include a separate adjustment factor to reflect the annual change in the ESL.**

The City supports the inclusion of an Emergency Services Levy (ESL) factor to offset this significant and growing impost from the NSW Government.

6. **The City supports the proposal to include the ESL contribution factor within the 'indicative rate peg' and published in the determination of the 'final rate peg'.**

The City supports the proposal to include the ESL contribution factor in the indicative and final rate peg, however again would strongly recommend that this be provided by 31 March each year to allow councils to complete its Integrated Planning and Reporting requirements and commence the public exhibition process with its communities.

The City would recommend that 100% of a council's ESL contribution should be added to its rate peg calculation in the first year, and that the factor should increase in each subsequent year to reflect the mandated increase in their ESL contribution.

The adjustment formula should be simple, transparent and easily understood by all stakeholders, converting the dollar figure required to a percentage of each council's general income.

Capturing external changes outside councils' control

7. **The City supports the proposal that external costs be added as another factor to the rate peg that is set at zero by default, updated for groups of councils on an as-needs basis with the option for further adjustment for individual councils based on an external costs claim. The City supports IPART establishing a process to cover specific external costs.**

The City supports the proposal that IPART make further adjustments to the rate peg on an as-needs basis for new external costs, however would recommend that a separate factor for "external costs" be permanently embedded within the new rate peg methodology to appropriately recognise the prevalence and significance of external costs on local governments and their communities.

IPART and councils should regularly consider new external costs, that may arise from "cost shifts" from different levels of government, that impact local government generally and/or an individual councils financial sustainability and capacity to service their communities. This factor could be set to default to zero, but the presence of a separate permanent factor, ensures that significant external costs are always considered as an area of potential change and not left to fall under the radar.

The City believes the 3 areas of external costs already identified by IPART, being climate change, cyber security and servicing of new community facilities, are good examples of new significant cost pressures that highlight the critical need for external costs factor to be permanently considered within the rate peg methodology.

The City also agrees with IPART that there is a high degree of variability in external costs across councils. Therefore, where IPART can identify common impacts within a group of councils, the City supports that the external costs factor should be determined on an as-needs basis for councils within that group. These groups would not necessarily align to the groups used to determine the base cost changes, and it would be better to allow flexibility for IPART to determine the councils within a group based on the need.

The City also supports the creation of a new and simple process, similar to the Crown Land adjustment process, that would enable individual councils to initiate a claim for significant external costs that would require a variance from the default factor of zero or a variance from the external factor identified for the group within they sit. It would be appreciated if IPART could fast track this process, as the alternative Special Variation process has already proven to be cumbersome, costly and difficult to navigate.

Refining the population factor

8. **IPART needs to adjust its formula for the population factor, to recognise and compensate for negative supplementary valuations, to ensure that all councils per capita income can be maintained.**

The draft report considered the failure of the current population factor formula to acknowledge that supplementary valuations can be negative but proposes that it should not be corrected.

The City recommends that this proposal be reconsidered as it is premised on the belief that supplementary valuations are a true proxy for population growth, whereas that is not always the case, which can lead to dysfunctional and inequitable outcomes for councils.

The current formula is

$$Population\ factor = \max(0, change\ in\ population - supplementary\ valuations\ percentage)$$

where

$$supplementary\ valuations\ percentage = \max\left(0, \frac{supplementary\ valuations}{notional\ general\ income\ yield}\right)$$

And 'supplementary valuations' means the total value of adjustments to a council's general income made by the council under section 509 (2)(b) and (c) of the Local Government Act 1993.

IPART's proposed update to calculate the change in population is

$$Change\ in\ population = max\left(0, \frac{(ERP_{2022} - PP_{2022})}{(ERP_{2021} - PP_{2021})} - 1\right)$$

IPART's Final Report on the Review of the Rate Peg to include Population Growth (issued September 2021) stated "we have recommended a methodology that enables councils to maintain per capita general income over time as their populations grow. Maintaining per capita general income will help councils to maintain existing service levels and provide the services their growing communities expect."

IPART appears to have assumed that income growth through supplementary valuations is a reflection of its population growth, and the current formula for calculating the population factor attempts to prevent a council from benefitting twice from the same population increase. It does this by subtracting the *supplementary valuations percentage* from the *change in population percentage* for the same period. For example, where a council's population increased by 5% but it had already gained an increase of 2% from its supplementary valuations, then its population factor is reduced to 3%. The income change for that council is the supplementary growth of 2% plus the population factor of 3% to ensure council achieves rates growth of 5% to match its population growth.

However, there are instances where a council will experience negative growth from its supplementary valuations even when the development has resulted in an increase to population. This often occurs when the developed land changes its legal description (such as changing from a deposited plan to a strata plan) as well as its land use. Councils are required to process the supplementary valuations across different rating categories as a result of the new development taking on a new land use.

Due to differential rates across rating categories, a parcel of land can be subdivided into multiple dwellings, have the same or similar total land value (due to values being based on the unimproved land), but resulting in less rates being charged on the development overall.

The following table shows examples of how some new residential developments have decreased the City's rates in the last few years.

Suburb	Land value	Business rates	Number of new dwellings	Residential rates	Annual income loss
Zetland	$26 million	$96,000	100	$59,000	($37,000)
Sydney	$46 million	$332,000	80	$71,000	($261,000)
Sydney	$47 million	$340,000	102	$84,000	($256,000)
Sydney	$73 million	$525,000	478	$298,000	($227,000)

In some years, the net result of supplementary valuations may provide a negative total amount, notwithstanding that the council's population has actually increased. In these instances, the current formula does not enable councils with negative supplementary valuations to maintain their per capita general income as their populations grow. This is contradictory to the stated outcome and proves inequitable across NSW councils.

IPART's draft report noted that 14 councils in 2019/20, and 15 councils in 2020/21, were negatively impacted by negative supplementary valuations ranging from 0.2 – 0.29%. This is not insignificant, especially when we factor in the year-on-year compounding effect where to lose access to additional rates of $50,000 in one year represents a cumulative loss of over $500,000 over 10 years.

While this is a real and significant problem for many councils, it could be easily addressed. IPART can change the formula to allow negative supplementary valuation figures for councils that do not have a corresponding decline in population, enabling the actual population increase to be added to the base rating income. For example, where a council had a population increase of 5% and a 1% reduction due to supplementary valuations, it requires a population factor adjustment of 6% to counter the 1% reduction and arrive at the net 5% rates growth to match its growth in population.

The City recommends that IPART should adjust its formula for the population factor to recognise negative supplementary valuations when they occur and allow all councils to at least maintain its per capita general income.

This can be achieved by:

- Not applying a population factor to councils with negative population growth; and
- Allowing for supplementary valuation figures to be negative, and adding the lost income back into the council's base income.

Practically this means removing the "max(0" from the supplementary valuations percentage formula, and adding an "if statement" to the start of the Population factor formula, so the two new formulas are:

Population factor = if(Change in population < 0, 0, max(0, change in population – supplementary valuations percentage))

And

supplementary valuations percentage = supplementary valuations / notional general income yield

IPART can make these changes without risk of deviating from the purpose of the population factor to maintain per capita income, as these changes will not give any councils with declining populations more revenue, but will enable all other councils to maintain their per capita income.

Retaining the productivity factor

9. **The City sees no value in retaining the productivity factor and recommends its removal from the rate peg calculation.**

The City notes the significant number of councils who are trying to remain financially sustainable to continue providing the services and infrastructure that their communities require, and submits that the productivity factor should be removed from the rate peg calculation.

It is acknowledged that ratepayers rightfully expect that their councils will work hard to introduce efficiencies and improve their productivity. However, with expectations of local government services ever increasing, and numerous demands that cannot currently be met, ratepayers would generally expect that councils' productivity savings and resources be reinvested into these new areas of need.

Transitioning arrangements

10. **The City supports the draft decision to review the methodology every 5 years and recommends the new methodology be introduced in full for the 2024/25 rate peg with a one-off true-up adjustment.**

The City supports the proposal to implementing all changes in the 2024/25 rate peg and including a one-off true-up adjustment for the differences between the LGCI and the BCC (excluding the ESL) so that councils would be no worse off under the new methodology compared to what would have been received under the existing methodology for 2024/25.

This will enable Councils to receive the noted benefits from the new approach, in particular a forward projection of indices, while also mitigating any risk of lower rate increases due to the non-inclusion of the impacts of the recent highly inflationary economic environment.

The City also supports the proposed review of the rate peg methodology every five years to ensure it stays fit for purpose, and also provide a mechanism to address unforeseen impacts of the revised methodology.

The City also supports the establishment of a local government reference group and suggests that this group continue to review the new rate peg methodology in the medium term to identify and recommend any necessary amendments.

Improving the broader regulatory framework

11. The City agrees there is merit is further review of the broader regulatory framework.

IPART's draft report identified multiple items that could warrant further investigation and review and the City supports further review of the broader framework.

In particular:

a) the City reiterates its position for council rates to be based on capital improved value
   i) the unimproved land value is currently used as the proxy for determining the liable ratepayer's capacity to pay.
   ii) the unimproved land value is split between strata lot owners within strata plans and does not fairly distribute the rating burden between strata owners and owners of land in deposited plans.
   iii) the unimproved land value does not adequately reflect the ratepayer's capacity to pay.

b) the City reiterates its view that the criteria for rate exemption needs updating, and all land used for residential purposes should be rateable
   i) the shift in the operation of providing social and affordable housing from NSW government to private operators has increased the instances of land that is exempt from rates even though there is an increased need for services.
   ii) the need for services will usually increase when the need for social and affordable housing increases.

c) councils' rates income base and per capita base should be analysed, and changes made to enable a resetting of the base where required
   i) changes to the rate peg methodology cannot fix an already insufficient rating base.
   ii) changes to the rate peg methodology cannot fix an already insufficient per capita rate.
   iii) Councils need the opportunity to reset their rates base or per capita base or both for any rate peg methodology to achieve its goals.

d) insufficient revenue from regulatory services should be reviewed and addressed
   i) many regulatory services are imposed on councils with the fees for service capped at amounts that do not cover the costs of providing the service (e.g. planning assessments).
   ii) future legislative changes may also increase costs or decrease income for regulatory services

e) insufficient debt management options that are hindered by the NSW government practices
   i) Councils’ ability to collect the revenue is limited, with collection avenues generally restricted to costly and uneconomical action through the courts
   ii) Local courts are charging councils the Corporation Fee to lodge small claims for debt recovery making the action unreasonably costly for ratepayers to whom the cost is passed on.
   iii) Poor provision of information by NSW Government (such as the absence of appropriate debtor identification data and lack of contact email or phone details in property transfer information) results in
      (1) difficult and inefficient debt recovery processes,
      (2) unnecessary delays in payment
      (3) interest charges for ratepayers,
      (4) otherwise avoidable legal recovery action,
      (5) unnecessary costs to debtors, and
      (6) avoidable impacts on the credit rating of community members.