

4 July 2023

Ms Carmel Donnelly PSM
Chairperson
Independent Pricing and Regulatory Tribunal
PO Box K35 Haymarket Post Shop
Sydney NSW 1240

Dear Ms Donnelly

Review of the Rate Peg Methodology

Thank you for the opportunity to comment on IPART's June 2023 Draft Report titled "Review of the rate peg methodology" which was finalised by IPART after wide consultation with ratepayers, councillors, council staff and other stakeholders across NSW.

In its submission, Council has taken the opportunity to comment on the questions raised by IPART in Chapters 3 to 9 of the Draft Report as well as the Draft Decisions, Draft Findings, Draft Recommendations and Matters for Further Consideration contained in those Chapters.

The Questions, Draft Decisions, Draft Findings, Draft Recommendations and Matters for Further Consideration are shown in **bold** in the attached document and are followed by Council's Comments in respect of each matter.

If you have any questions or require further information, please do not hesitate to contact Council's Director, Corporate Support (Mr Glen Magus) on [REDACTED] or Chief Financial Officer (Mr Duncan Chell) on [REDACTED]

Yours faithfully [REDACTED]

Steven Head
General Manager

TRIM Reference: F2013/00751

IPART'S REVIEW OF THE RATE PEG **METHODOLOGY**

Chapter 3 - Improving how we measure changes in councils' base costs

IPART's Draft Decisions

- **To replace the LGCI with a Base Cost Change model with 3 components:**
 - *employee costs*
 - *asset costs*
 - *other operating costs.*

Council Comment - Supported

- **To develop separate Base Cost Change models for 3 council groups:**
 - *metropolitan councils (Office of Local Government groups 1,2,3, 6 and 7)*
 - *regional councils (Office of Local Government groups 4 and 5)*
 - *rural councils (Office of Local Government groups 8 to 11).*

Council Comment - Supported

- **For each council group, calculate the Base Cost Change as follows:**
 - *For employee costs, we would use the annual wage increases prescribed by the Local Government (State) Award for the year the rate peg applies, or the Reserve Bank of Australia's forecast change in the Wage Price Index from the most recent Statement on Monetary Policy (averaging the changes over the year to June and December for the year the rate peg applies). We would adjust for changes in the superannuation guarantee in both cases. We are currently consulting on the best approach to measure changes in employee costs (see Seek Comment 1).*
 - *For asset costs, we would use the Reserve Bank of Australia's forecast change in the Consumer Price Index from the most recent Statement on Monetary Policy (averaging the changes over the year to June and December for the year the rate peg applies), adjusted to reflect the average difference between changes in the Producer Price Index (Road and bridge construction, NSW) and changes in the Consumer Price Index (All groups, Sydney) over the most recent 5-year period for which data is available. Improving how we measure changes in councils' base costs*
 - *For other operating costs, we would use the Reserve Bank of Australia's forecast change in the Consumer Price Index from the most recent Statement on Monetary Policy (averaging the changes over the year to June and December for the year the rate peg applies).*
 - *Weight the 3 components using the latest 3 years of data obtained from the Financial Data Returns of councils in that group, and update the weights annually.*

Council Comment - Supported

- **To publish indicative rate pegs for councils around September each year (unless input data is not available) and final rate pegs around May each year.**

Council Comment - Supported

IPART's Draft Recommendation

- ***That a local government reference group is established to advise on the implementation of our new rate peg methodology.***

Council Comment - Supported

Questions on which comments are sought by IPART

- **What are your views on using one of the following options to measure changes in employee costs in our Base Cost Change model? How can we manage the risks associated with each option when setting the rate peg?**
 - **Use annual wage increases prescribed by the Local Government (State) Award for the year the rate peg applies, adjusted to reflect any change in the superannuation guarantee rate.**
 - **Use the Reserve Bank of Australia's forecast change in the Wage Price Index from the most recent Statement on Monetary Policy (averaging the changes over the year to June and December for the year the rate peg applies), adjusted to reflect any change in the superannuation guarantee rate.**

Council Comment

Council's preferred option is to use the annual wage increase prescribed by the Local Government (State) Award to measure changes in employee costs, adjusted to reflect any change in the superannuation guarantee rate. This will reflect the actual increase in Council's recurrent payroll costs for each year, noting that this comprises most of the expenditure within the Employee Costs category.

In years where the Award is still under negotiation, it is suggested that the forecast Wage Price Index be used to calculate the draft rate peg. Once the Award increase is finalised, the rate peg should then be adjusted to reflect the actual increase agreed by the parties to the Award. Such adjustment could be made at the same time the draft rate peg is reviewed to include increases in the Emergency Services Levy. It is noted that Award negotiations are typically finalised in June which is around the time Council receives notification from Revenue NSW of the Emergency Services Levy to be charged in the next financial year.

Council believes the Wages Price Index is a better measure of expenditure compared to the current method used within the Local Government Cost Index. However, the Award is the most accurate and is therefore the most suitable option available above the Wages Price Index.

- **How can we manage the risks associated with each option when setting the rate peg?**
 - **Use annual wage increases prescribed by the Local Government (State) Award for the year the rate peg applies, adjusted to reflect any change in the superannuation guarantee rate.**
 - **Use the Reserve Bank of Australia's forecast change in the Wage Price Index from the most recent Statement on Monetary Policy (averaging the changes over the year to June and December for the year the rate peg applies), adjusted to reflect any change in the superannuation guarantee rate.**

Council Comment

Council believes the risk of using the Local Government (State) Award, adjusted to reflect any change in the superannuation guarantee rate, is very low as it reflects the actual increase in cost that will be incurred. No risk mitigation measures are, therefore, suggested.

- **Are there any alternative sources of data on employee costs we should further explore?**

Council Comment

After payroll related costs (for which the Award is the preferred measure), workers compensation insurance costs are the next largest component within the Employee Costs expenditure category. They comprise approximately 2% of Council's Employee Costs.

Over recent years, Council's workers compensation insurance premium has increased exponentially e.g. the increase from 2022/23 to 2023/24 was \$350,000 or 58%. Such increases are understood to be in response to the impact of psychological claims which is a national matter impacting the workers compensation insurance industry. Should the cost of insurance continue to increase at this rate, it may be appropriate that the rate peg be adjusted each year by a suitable price index that best reflects workers compensation insurance cost increases.

All other costs within the Employee Costs category are minor for Council and, therefore, do not require further consideration.

- **Do you support releasing indicative rate pegs for councils in September, and final rate pegs that are updated for councils' Emergency Services Levy contributions in May?**

Council Comment

Council is supportive of IPART releasing indicative rate pegs for councils in September, and for final rate pegs to be updated in May to reflect councils' Emergency Services Levy contributions. Hornsby Shire Council's Emergency Levy has almost doubled over recent years from \$2.3 million in 2018/19 to \$4.1 million in 2023/24. This was one of several major cost drivers that led to Council applying for its now approved four-year Special Rate Variation (SRV) commencing in 2023/24.

The preparation of Council's SRV application was a resource intensive project that for many months directed staff time and cost away from core community priorities. The proposed SRV was met with significant angst from a portion of the community that were unsympathetic of Council's financial need for the increase. Ensuring that the rate peg reflects the additional Emergency Service Levy expenditure incurred each year will result in incremental increases to rates and charges that may reduce the likelihood of Council needing to apply for SRV's in the future.

Chapter 4 - Adjusting for the Emergency Services Levy

IPART's Draft Decisions

- **To include a separate adjustment factor in our rate peg methodology that reflects the annual change in each council's Emergency Services Levy (ESL) contribution. This factor will reflect:**
 - **an individual council's contribution, for councils:**
 - **that are not part of a rural fire district, or**
 - **that are part of a rural fire district but do not engage in ESL contribution cost sharing arrangements, or**
 - **are the only council in their rural fire district, or**
 - **that are part of a rural fire district and engage in ESL contribution cost sharing where we have accurate information about what the council pays.**
 - **the weighted average change for each rural fire district, for councils that are part of a rural fire district and engage in ESL contribution cost sharing arrangements where we do not have accurate information about what they pay.**
- **To set Emergency Services Levy (ESL) factors and a final rate peg for each council in May after ESL contributions for the year the rate peg is to apply are known, so that councils can recover changes in ESL contributions in the year contributions are to be paid.**

Council Comment - Supported

IPART's Draft Finding

- **Some councils that are part of rural fire districts have entered arrangements with other councils to share the costs of the Rural Fire Service component of the Emergency Services Levy (ESL). They may therefore pay an amount that is different to the ESL contribution set out in their assessment notice.**

Council Comment – Not applicable to Hornsby

Questions on which comments are sought by IPART

- **Do you have further information on arrangements between councils to share Emergency Services Levy (ESL) contribution bills including:**
 - **what these arrangements cover (including whether they cover matters other than ESL contributions), and**
 - **whether they apply to Rural Fire Service, Fire and Rescue NSW and NSW State Emergency Service ESL contributions, or contributions for only some of those services?**

Council Comment

Council receives an annual Contribution Assessment Notice from Revenue NSW each year. The Notice provides the total annual contribution payable and the amount to be charged to Council for each service i.e. the NSW Rural Fire Service, NSW State Emergency Service and Fire and Rescue NSW. Council can provide this information and/or a copy of the Assessment Notice to IPART each year if IPART is unable to obtain this data directly from Revenue NSW.

- **Would councils be able to provide us with timely information on the actual ESL contribution amounts they pay including contribution amounts paid to the:**

- **Rural Fire Service**
- **Fire and Rescue NSW**
- **NSW State Emergency Service?**

For example, by providing us with a copy of any cost sharing agreement that sets out the proportion that each council pays.

Council Comment – As above

Chapter 5 - Capturing external changes outside councils' control

IPART's Draft Decision

- *To maintain our current approach and make additional adjustments to the rate peg on an as needs basis for external costs (For the Emergency Services Levy, we have made a separate decision - see Draft Decision 5)*

Council Comment - Supported

Question on which comments are sought by IPART

- **Would you support IPART establishing a process to develop adjustment factors for groups of councils to increase the rate peg to cover specific external costs?**

Council Comment

Council is supportive of a process to develop adjustment factors for groups of councils to increase the rate peg as this will achieve a rate peg that caters better for various incremental costs incurred by the sector and will increase alignment between the rate peg and a council's cost base.

Given the broad range of services that councils provide and ongoing changes in the external environment, it is considered likely that part of the cost base of the sector will experience significant price growth in the future, as has occurred for the Emergency Services levy over recent years. Developing adjustment factors for cost increases of this nature will allow the rate peg to be adjusted in a more agile manner than has previously been the case and this will increase the alignment between the rate peg and the actual costs being incurred by Council.

In terms of potential future adjustment factors, it may be appropriate for IPART to monitor workers compensation insurance premium costs, as noted in Council's response to an earlier question. Other insurance premiums such as for motor vehicles and property may also warrant future consideration as these insurances have also recently been impacted by external factors such as ongoing natural disasters that have contributed to annual increases far greater than CPI.

Chapter 6 - Refining the population factor

IPART's Draft Decision

- *To change the 'change in population' component of the population factor to deduct prison populations from the residential population in a council area and then calculate the growth in the non-prisoner residential population of a council area for the relevant year. We would not make retrospective adjustments for previous population factors.*

Council Comment – Not applicable to Hornsby

Questions on which comments are sought by IPART

- **Would you support measuring only residential supplementary valuations for the population factor?**

Council Comment

Council supports the measurement of supplementary valuations for part of the population, but it should not be the only measure. Business populations also have a significant impact on the provision of Council assets, services, and costs, particularly for most metropolitan councils that have one or more business centres. The population factor should also include a measure to take account of business population growth, even if this growth is transient inside of business hours as Council must provide services for this population regardless or not of whether the population resides on Council land outside of business hours.

The impact of business populations on costs is even more pronounced for Sydney councils with central business districts who experience a large influx of people during business hours that must be catered for. Ignoring growth in this area, which for some councils has been significant as high-density CBD's have been built over recent years erodes the alignment between the rate peg and the cost base of the sector.

- **If you supported using residential supplementary valuations, what data sources would you suggest using?**

Council Comment

Council supports IPART's current approach of using data from the ABS.

Chapter 7 - Retaining the productivity factor

IPART's Draft Decision

- *To retain the productivity factor in the rate peg methodology and for it to remain as zero by default unless there is evidence to depart from that approach.*

Council Comment

Council does not support the retention of the productivity factor in the rate peg as it is biased towards non-price driven metrics that may result in an efficiency saving yet it ignores non price-based metrics that will likely cause cost increases. For example, applying a productivity factor to account for a potential reduction in headcount from an efficiency measure ignores the reality of many councils that increasing community aspirations incrementally lead to an increase in services each year above core business.

It is noted that headcount typically increases gradually over time to deliver the growing needs of the community. In this scenario, applying a reduction in income when councils are grappling with the opposite challenge of funding additional headcount would reduce the alignment between the rate peg and the council's cost base. Furthermore, In the case of headcount reduction it is also noted that whilst efficiency measures can save staff time, this time is often redirected to an expansion of services elsewhere in Council's operations, largely due to the complexities and cost of realising headcount reduction under the Local Government Award, and because there are typically a large number of existing demands that require resources.

Chapter 8 - Transition arrangements

IPART's Draft Decision

- *To review our rate peg methodology every five years, unless there is a material change to the sector or the economy, to ensure its stays fit for purpose.*

Council Comment - Supported

Question on which comments are sought by IPART

- **What implementation option would you prefer for the changes to the rate peg methodology?**

Council Comment

Council supports the suggestion that new methodology should commence two years after significant volatility caused by the high inflationary environment has ended to ensure that councils do not lose income from omitting inflationary years where the current LGCI methodology will account for the high inflationary environment.

However, Council notes that should the inflationary environment continue into 2023/24, which now appears likely, the new methodology should be delayed for another year (e.g. until 2026/27 instead of until 2025/26) so that councils do not lose essential additional income that is required from the prolonged inflationary period.

Only when inflation is back within the RBA's target range should the change to the new methodology occur as only then will it be fair for two years of cost growth data to be omitted by changing to a forward-looking measure.

Council agrees that the adjustment factor for the ESL should commence immediately from 2024/25. Given the significant increases incurred by councils in 2023/24, it is also suggested that ESL cost increases for both years (2023/24 and 2024/25) should be taken account of in the 2024/25 rate peg and SRV approvals covering that period.

Chapter 9 - Improving the broader regulatory framework

IPART's Draft Recommendation

- *That the NSW Government consider commissioning an independent review of the financial model for councils in NSW including the broader issues raised in this report.*

Council Comment - Supported

IPART's Recommended Matters for Further Consideration

- *The eligibility of current rate exemptions could be better targeted to improve outcomes for ratepayers and councils.*
- *The use of the Capital Improved Valuation method to levy local council rates could improve the efficiency and equity of rates.*
- *There could be merit in considering whether to introduce an additional constraint (i.e. conditions) on the rate peg to provide confidence to ratepayers that increases are reasonable.*
- *Some councils may not have an adequate rates base and a mechanism should be developed to enable councils found to have insufficient base rates income to achieve financial sustainability.*
- *Statutory charges for services provided by councils may not be recovering the full cost of service provision, such as for development approval fees and stormwater management service charges.*
- *Councils could be better supported to serve their communities more effectively to build community trust in councils. This could include improvements in how councils undertake and implement their integrated planning and reporting.*
- *There are opportunities to strengthen council incentives to improve their performance, including considering whether there is merit in a model that would exempt councils that demonstrate an agreed level of performance and consultation with ratepayers from the rate peg.*

Council Comment

Council does not support the proposal for an additional constraint on the rate peg. The detail of the current review has been largely logical with IPART's suggested changes increasing the alignment between the rate peg and a council's costs. Adding additional constraints to appease a vocal section of the community that do not have access to the detailed finances of councils potentially removes the benefits made from the various improvements suggested throughout IPART's review.

Council supports the suggestion that councils who can demonstrate an agreed level of performance and consultation with ratepayers may be exempt from the rate peg and notes that this would assist with addressing the current challenges of meeting growing community expectations with limited income. Like community consultation undertaken throughout the process to apply for an SRV, it would make sense for councils to be able to increase rates incrementally above the rate peg when the community have been comprehensively consulted with on matters related to increasing the provision of services, such as through adopted strategies. Allowing councils to increment rates from year to year, subject to this work being undertaken requires less resources than applying for larger SRV's and assists the community by incrementing rate increases gradually over time.