4 July 2023

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

Via email: ipart@ipart.nsw.gov.au

Subject: Submission - Draft Report - Review of the rate peg methodology

Introduction

Thank you for the opportunity to comment on the Draft Report on IPART's review of the rate peg methodology (the Draft Report).

Lake Macquarie City Council (Council) is the largest local government area by population in the Hunter region, with 217,000 residents across 95 communities within an area of 757 square kilometres. The wide geographical spread of communities across the Local Government Area, as well as the existence of significant inland and coastal waterway assets, and an expansive road network, poses significant service delivery challenges and cost pressures on Council which must be largely met through expenditure of rates revenue.

As noted in our previous submission to this review process, Council believes the rate peg system is by nature problematic and argues that councils with a demonstrated track record of good financial management, planning and reporting should have the capacity to set rates in accordance with the revenue and expenditure choices of their communities – consistent with the principle of 'earned autonomy' articulated in IPART's 2009 Revenue Framework for Local Government report.

Council acknowledges and appreciates that IPART has taken into consideration many of the comments made in our initial submission in relation to the rate peg methodology and has included many of our suggestions and recommendations in the proposed changes referenced in the Draft Report.

We support the proposal to replace the Local Government Cost Index (LGCI) with a Base Cost Change (BCC) model, measuring the base cost change for three groupings of councils – metropolitan, regional and rural – each year. We support the overall proposal for the BCC to include only three components – employee costs, asset costs and all other operating costs (excluding the Emergency Services Levy (ESL).

IPART's intention to produce, through the BCC model, a timelier measure of changes in councils' base costs – by referring to forward-looking measures of changes in council costs – is consistent with the recommendation made in our original submission. While no single approach is likely to equally suit all councils, this change provides a more balanced and nuanced method of calculating cost changes across the spectrum.

Council staff have reviewed the Draft Report and prepared the following responses to select discussion points in the executive summary.

FROM THE SECTION HEADED 'WE ARE SEEKING COMMENT ON'

1. 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?

a. 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.

Council favours using the award to measure changes in employee costs as it is better aligned than the Wage Price Index (WPI) index for this purpose, based on historical outcomes as highlighted in the IPART report. The main advantage of this approach is that the award provides real data highly relevant to councils and is locked in for several years.

It is not a perfect approach, however, as the BCC will not capture the first-year increase in any new award due to timing. As the first year of any new award usually has the highest increase, a method of capturing this potentially significant increase should also be considered, including but not limited to a "true-up" mechanism.

Another factor to consider is that many councils have individual Enterprise Agreements in place that may have a higher rate of pay increase as well as higher superannuation contributions. Many councils are also paying market premiums to attract staff. These factors should be considered, if not already considered within the proposed model.

b. 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.

Using the Wage Price Index is not Council's preferred option. There are some potential benefits to the approach in that the forecast WPI has compared well to actuals from June 2019 to 2022 - the accumulated actual WPI increases are only 0.2 per cent higher than WPI predictions. The WPI may also better account for labour market conditions, particularly in areas where councils are facing challenges in attracting and retaining staff. In addition, Reserve Bank of Australia (RBA) forecasts are timelier, with four forecasts made per year.

The negative aspects of this approach are outlined in the IPART draft, with historical outcomes showing that the award cumulative five-year increase was 12.2 per cent, versus WPI public sector 11.4 per cent, and the 10-year increase was 29.3 per cent versus 27.1 per cent. Again, as above, a "true-up" mechanism may be appropriate for these variances.

Council notes that operating costs under this model would be forecast using the RBA CPI forecast. There have been significant variations on actual CPI versus the RBA CPI forecast between 2017 and 2022 – the accumulated actual CPI increases are 2.6 per cent higher than CPI predictions. This difference is a multi-million-dollar detriment to all councils.

Council believes consideration should be given to a true-up mechanism if cost increases have come in higher than expected – for example in recent times where CPI increases have substantially exceeded forecasts due to factors such as COVID-19 supply chain impacts, and significant rises in fuel costs.

2. Are there any alternative sources of data on employee costs we should further explore?

Another potential approach could be weighting these proposed information sources and trends. The weighting of historical and forecast data could be calculated so that the most recent actuals and predictions are weighted more heavily than older information.

3. Do you support releasing indicative rate pegs for councils in September, and final rate pegs that are updated for councils' Emergency Services Levy (ESL) contributions in May?

Council supports releasing indicative rate pegs around September to support the Integrated Planning and Reporting (IP&R) process. Lake Macquarie currently has IP&R documents adopted by Council in May so an adjustment in May is impractical for the timing of exhibition and adoption by Council. Even should this extend to a June adoption, an adjustment in May for ESL would be impractical to implement.

We also support updating individual council rate pegs to reflect the individual council ESL contributions, which will eliminate the lag within the current methodology and better reflect individual council circumstances than using the average weight of the ESL as a share of total costs. There was a previous commitment made to the local government sector for earlier notification of ESL contribution assessment notices. This would assist in better informing the preparation of documents to align with the IP&R cycle.

4. Do you have further information on arrangements between councils to share Emergency Services Levy (ESL) contribution bills including:

a. what these arrangements cover (including whether they cover matters other than ESL contributions), and

b. 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?

We do not have comment to add to this section.

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

a. Rural Fire Service
b. Fire and Rescue NSW
c. 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.

We do not have comment to add to this section.

6. 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 supports this proposal, as noted in our previous submission:

"There are many factors that differentiate councils, including metropolitan and regional categorisations, which take land mass and population into account, and whether councils manage water and sewer. Other factors that differentiate councils, and can have a significant impact on costs, include vulnerability to natural disasters, kilometres of road per capita, topography, and the presence of waterways (lakes, beaches etc) that require management, infrastructure and staff resources."

The recognition of the differentiation between metropolitan, regional and rural councils in calculating the BCC is an improvement as it begins to recognise the differing cost pressures each type of council incurs.

7. Would you support measuring only residential supplementary valuations for the population factor?

Council supports the continued inclusion of a population growth factor but has concerns about the way it is currently applied and the extent to which it is reflective of the actual growth and demands on councils. In the 2022-2023 financial year, Lake Macquarie Council received zero per cent increase for the population factor, which does not reflect the rate at which our city is growing. Lake Macquarie's population increased from 197,371 in the 2016 Census to 213,967 in the 2021 Census (8.4 per cent growth).

Council receives supplementary valuations during the financial year, however these are insufficient to cover the increased demands on our city. There can be other circumstances, such as paper subdivisions being formalised into subdivisions, that require significant council expense outlay for no additional population factor.

In circumstances where the ABS information highlights sustained growth, a true-up may be required. We note that the 2024-25 rate peg will include a Census true-up for the population factor. This was a decision from the IPART 2021 Review of the rate peg to include population growth.

Using population changes versus rateable properties does appear to be a better methodology. There are scenarios where rateable property does drive costs, for instance with the provision of roads and other infrastructure, whereas the population measure is more relevant to the delivery of council services.

8. If you supported using residential supplementary valuations, what data sources would you suggest using?

As noted previously in this submission, Council has concerns about the time lag of population information. However, we acknowledge the issue of data independence is important. Council would like to see some kind of true-up if there have been significant changes, however use of Australian Bureau of Statistics (ABS) data is considered most appropriate at this time.

9. What implementation option would you prefer for the changes to the rate peg methodology?

The most pressing issue for councils when it comes to the transition of the rate peg methodology is to ensure we do not change methodology at a time that results in councils being worse off from the transition to forecasted versus historical movements in costs.

The preferred option of staging the changes between the 2024-2025 and 2025-2026 rate pegs is considered optimal. Using the LGCI for 2024-2025 will ensure that the 2022-2023 cost increases are incorporated in the rates peg. Separating the ESL component better reflects individual council circumstances and will cover the increasing cost for those councils experiencing increases above the weighted average. As the 2023-2024 rate peg did not capture the increases in the ESL contributions, as it was assumed that the NSW Government would continue to subsidise these increases, this additional cost needs to be factored into the implementation of a change in rate peg methodology. Separating the ESL component will only capture the 2024-2025 impact.

It is Council's view that a five-year review cycle is positive, however regular changing of the methodology is not ideal either – we need to have a robust methodology and stick with it, so that the ups and downs are balanced out over the longer term.

<u>FROM THE SECTION HEADED 'MATTERS FOR FURTHER CONSIDERATION</u>

1. The eligibility of current rate exemptions could be better targeted to improve outcomes for ratepayers and councils.

Council supports IPART's proposal that the NSW Government should review the recommendations of the 2016 IPART review of the rating system on reforming the provisions for rates exemptions in the Local Government Act.

This would address issues such as when a significant proportion of land is rating-exempt, leaving a council's rate base too narrow to raise enough income to cover the costs of the services its community needs. There are also inequities associated with rating-exempt land. This becomes an issue when development of rating-exempt land causes population growth – for example, it is used to build retirement villages, social and community housing, or aged care facilities. This puts a disproportionate burden on existing ratepayers to bear the cost of providing services to a growing population.

2. The use of the Capital Improved Valuation method to levy local council rates could improve the efficiency and equity of rates.

Council supports IPART's proposal that the NSW Government should review the recommendations of the 2016 IPART review of the local government rating system on use of the Capital Improved Value (CIV) method to levy local council rates.

While it supports the review, it notes the introduction of a CIV will see an administration burden to the Valuer General department, which would have a flow-on effect to councils through the Valuer General fees. This increased cost would need to be factored into the rate peg methodology. While the change in rating system from UV to CIV maybe more equitable, ultimately the rate payer will pay more to cover the increased cost in service.

3. 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.

The view of reduction of volatility for residents is one that assumes volatility is something councils should bear, which is flawed when there are limited mechanisms for councils to use to protect against these fluctuations.

4. 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.

Council acknowledges the difficulty in addressing financial sustainability and supports consideration of a mechanism to address this issue. However, we agree this would not be straightforward, and Council is concerned that the outcome would result in an administration burden which would increase costs, with the rate payer ultimately paying more to cover this additional cost.

5. 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.

Council agrees with this proposition and supports IPART's recommendation that the NSW Government should review the amounts councils can charge for statutory services to ensure these amounts reflect the full cost of providing these services.

6. 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.

We do not have comment to add to this section.

7. 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.

Agree, and this would be consistent with the principle of 'earned economy' articulated in IPART's 2009 Revenue Framework for Local Government report.

Council appreciates the opportunity to provide this feedback. Should you require further information on matters included in this submission, please contact our [redacted] Bjorn Lategan at [redacted]akemac.nsw.gov.au or on 02 [redacted].

Yours sincerely

[redacted]

Morven Cameron
Chief Executive Officer