LOCAL GOVERNMENT NSW

LGNSW Response: IPART Review of the Rate Peg Methodology – Draft Report 2023

JULY 2023

LOCAL
GOVERNMENT
NSW

Local Government NSW (LGNSW) is the peak body for local government in NSW, representing NSW general purpose councils and related entities. LGNSW facilitates the development of an effective community-based system of local government in the State.

OVERVIEW OF THE LOCAL GOVERNMENT SECTOR

Local government in NSW employs more than **55,000 people**

Local government in NSW looks after more than **$136 billion of community assets**

Local government in NSW spends more than **$1.9 billion each year on caring for the environment, including recycling and waste management, stormwater management and preserving and protecting native flora and fauna**

NSW has 450 council-run libraries that attract more than **34.8 million visits each year**

Local government in NSW is responsible for about **90% of the state's roads and bridges**

NSW councils manage an estimated **3.5 million tonnes of waste each year**

NSW councils own and manage more than **600 museums, galleries, theatres and art centres**

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1. Introduction

Local Government NSW (LGNSW) is the peak body for local government in NSW, representing all NSW general purpose councils and related entities. LGNSW facilitates the development of an effective, community based system of local government in the State.

LGNSW commends the Independent Pricing and Regulatory Tribunal (IPART) on the Draft Report of the Review of the Rate Peg Methodology (the Draft report). The Draft Report is clearly the result of a genuine and comprehensive consultation process. It is evident that the concerns of the local government sector have been heard and we are pleased that IPART has been responsive.

LGNSW welcomed the review as a response to the realisation that the current methodology fails to cope with economic volatility or support the financial sustainability of councils.

While LGNSW is disappointed that the Terms of Reference for the review did not extend to the option of removing rate pegging, the Draft Report proposes several significant reforms that will greatly improve the operation of rate pegging system. These reforms include measures that will:

- Provide a more forward facing index, reducing or removing time lags.
- Recognise the differences in cost factors between different groups of councils.
- Allow councils to fully recover the cost of the Emergency Services Levy (ESL).
- Introduce an employee cost factor that more accurately reflects real costs to councils.

LGNSW generally supports the majority of IPART's proposed decisions, recommendations and findings although there are points of difference.

LGNSW commends IPART's recommendation that the NSW Government consider commissioning an independent review of the financial model for councils in NSW. LGNSW expects that any such review will be comprehensive and include the issues for further consideration identified by IPART in the Draft Report and other issues raised by LGNSW and the local government sector.

2. IPART Draft Decisions - LGNSW Response

IPART Decision	LGNSW Response
1. To replace the Local Government Cost Index (LGCI) with a Base Cost Change model with 3 components:	**Supported in Principle:** • LGNSW provides in principle support for the replacement of the LGCI with a new Base Cost Change model.

a. Employee costs **b. Asset costs** **c. Other operating costs.**	• The new model appears to minimise the identified deficiencies of the LGCI, in that the new model is a forward facing and will reduce if not eliminate lags from the determination process. • It is also a simpler model, which will be better understood by councils and ratepayers. • The Base Cost Change Model appears to be a significant step forward.
2. To develop separate Base Cost Change models for 3 council groups: **a. Metropolitan councils (Office of Local Government groups 1,2,3, 6 and 7)** **b. Regional councils (Office of Local Government groups 4 and 5)** **c. Rural councils (Office of Local Government groups 8 to 11).**	**Supported:** • LGNSW's previous submission advocated the need to make provision for adjustments for cohorts/groups of councils and individual councils. • Many councils specifically called for the introduction of different cost indices for different cohorts or categories of councils e.g., metro, rural, regional. IPART's proposal to develop separate Base Cost models for different groups of councils meets this request. • While LGNSW supports the introduction of multiple Base Cost Change Models in principle, groupings should be subject to ongoing review to ensure that the model is reflecting the true cost differences between different regions or groups of councils. There needs to be provision to realign groups or add additional groups if deficiencies are identified.
3. For each council group, calculate the Base Cost Change as follows: **a. 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**	**Supported:** LGNSW supports using wage increases prescribed by the *Local Government (State) Award* ("**Award**") for the year the rate peg applies, with an adjustment to reflect any change in the superannuation guarantee rate and/or other exceptional increases in labour costs beyond the employers' control (e.g., changes to Fringe Benefits Tax legislation). In LGNSW's opinion, prescribed Award wage increases (with an adjustment to reflect any change in the superannuation guarantee rate and/or other exceptional increases in labour costs beyond the employers' control) are likely to provide a more accurate measure of actual increases in an employers' labour costs than the existing measure (WPI, NSW public sector). Further, as the prescribed Award wage increases are forward facing, they are

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. *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.*	less likely to be out-of-date at the time the rate increases apply. Noting that prescribed future Award wage increases may not be available in the year a new Award is made (typically every 3 years), LGNSW supports using the Reserve Bank of Australia's forecast change in the Wage Price Index (Australia, including both public and private sectors) from the most recent Statement on Monetary Policy.
b. 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.	**Supported:** • This mechanism is forward facing and importantly, includes the use of the Producer Price Index (PPI) for Roads and Bridges to supplement the CPI with cost changes relevant to local government that are not captured in the CPI.
c. For other operating costs, we would use the Reserve Bank of Australia's (RBA's) forecast change in the Consumer Price Index from the most recent Statement.	**Supported:** • This is a forward-facing index and greatly simplifies the process by replacing the 26 components included in the CPI that were largely immaterial in themselves.

d. 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.	**Supported:** • LGNSW considers weighting to be vital in determining the differences between groups of councils. • Use of the existing Financial Data Return (FDR) to extract data also simplifies the process for councils as they will not have to do additional reports or returns. • It is also more accurate as it includes all councils.
4. 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.	**Supported:** • The early provision of an indicative rate peg around September each year will provide a higher degree of certainty and assist councils with planning and budgeting. The decision to announce the final rate peg as late as May each year is an important step forward that will help ensure that the model can better deal with economic volatility. This would have avoided the shock 0.7% LGCI determination for the 2022-23 financial year, one of the key triggers for this review. • LGNSW acknowledges the concern raised by some councils in relation to the timing of the final peg in May and how this will impact the exhibition of councils' Statement of Revenue Policy. LGNSW agrees that that there is a need for further consultation on the details. • Some councils have also expressed concerns about the unavailability of up-to-date data for the September indicative peg, meaning lagged data would need to be used. IPART needs to explain how the indicative peg is to be determined. (See further commentary under Seeking Comment (question 3).
5. 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:	**Supported:** • LGNSW considers this to be the most critical reform proposed by IPART for the near term. • LGNSW is pleased that IPART has formally recognised that the current method of including the ESL in the LGCI does not adequately reflect the full cost to councils and that it does not address the fact that changes to the ESL do not fall evenly across councils. LGNSW has long

a. 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. **b. 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.**	argued that the ESL cannot be represented by a one size fits all index. • The proposed adjustment factor will ensure that the full cost increases for individual councils will be included in the determination of the rate peg. • This decision will help provide financial sustainability for councils.
6. 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.	**Supported:** • This is forward facing and will avoid any budgetary shocks arising from the ESL.
7. 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).*	**Support:** • ESL is the major external cost factor imposed on local government. With the ESL now to be dealt with by a new adjustment factor, the existing approach for additional adjustments should be adequate**.**
8. To change the 'change in population' component of the	**Not Supported:**

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.	• LGNSW recommends further consultation with councils that host prison populations. Prison populations do impose costs on councils. For example, increased prison populations generate increased visitation placing additional demand on local infrastructure and services. • It should also be noted that the siting of and expansion of prisons often results in the loss of rateable land for councils and a decline in rate revenue. • It is not clear whether these factors have been adequately considered in the Draft Report.
9. 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.	**Not Supported:** • LGNSW has consistently argued that the Productivity Factor should be permanently removed from the rate peg methodology. • Productivity cannot be accurately measured across the local government sector as councils are too diverse and carry out a wide and unevenly varied range of functions. However, LGNSW welcomes the decision that the Productivity Factor remain as zero by default unless there is evidence to depart from that approach.
10. To review our rate peg methodology every five years, unless there is a material change to the sector or the economy, to ensure it stays fit for purpose.	**Partially supported:** • Given the extent of the changes that would result from IPART's proposed decisions and potential for unintended consequences, LGNSW recommends an initial review after three years and then moving to a 5-year review cycle if performance of the new model is satisfactory.

3. IPART Draft Recommendations

IPART Recommendation	LGNSW Response

1. That a local government reference group is established to advise on the implementation of our new rate peg methodology.	**Supported:** The successful implementation of the proposed reforms will be dependent on engagement and support of the local government sector. LGNSW would be pleased to be represented on this reference group and also recommends that representatives nominated by the NSW Revenue Professionals, Local Government Professionals (Finance Professionals) and the Office of Local Government should be included in the reference group.
2. 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.	**Supported:** • LGNSW has already called on the NSW Government to honour its preelection commitment to commission a review of the financial model for councils in NSW. LGNSW welcomes IPART's support for a review. • LGNSW recommends that IPART be invited to play a lead role in that review given its independence and depth of knowledge of the local government sector.

4. Seeking Comment – LGNSW Responses

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.

LGNSW supports using wage increases prescribed by the *Local Government (State) Award* ("**Award**") for the year the rate peg applies, with an adjustment to reflect any change in the superannuation guarantee rate and/or other exceptional increases in labour costs beyond the employers' control (e.g., changes to Fringe Benefits Tax legislation).

In LGNSW's opinion, prescribed Award wage increases (with an adjustment to reflect any change in the superannuation guarantee rate and/or other exceptional increases in labour costs beyond the employers' control) are likely to provide a more accurate measure of actual increases in an employers' labour costs than the existing measure (WPI, NSW public sector). Further, as the prescribed Award wage increases are forward facing, they're less likely to be out-of-date at the time the rate increases apply.

Noting that prescribed future Award wage increases may not be available in the year a new Award is made (typically every 3 years), LGNSW supports using the Reserve Bank of Australia's forecast change in the Wage Price Index (Australia, including both public and private sectors) 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), with an adjustment to reflect any change in the superannuation guarantee rate and/or other exceptional increases in labour costs beyond the employers' control (e.g. changes to Fringe Benefits Tax legislation), if the Award wage increases are not available.

The Award's wage increases may not be limited to a percentage increase. For example, the *Local Government (State) Award 2023* prescribed in 2024 and 2025 both a percentage increase (3.5% in 2024, and 3% in 2025) plus a lump sum payment for eligible employees equivalent to 0.5% or $1000, whichever is the greater. Where the Award wage increases include a percentage increase and a lump sum payment, IPART should have regard to both payments when measuring the change in employee costs.

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.

As mentioned above, future Award wage increases may not be available in the year a new Award is made (typically every 3 years). Where the Award's wage increases are not available, IPART should use the Reserve Bank of Australia's forecast change in the Wage Price Index (Australia, including both public and private sectors) 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), with an adjustment to reflect any change in the superannuation guarantee rate and/or other exceptional increases in labour costs beyond the employers' control.

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

LGNSW has considered whether increases in award minimum wages, as determined by the Fair Work Commission (FWC) in its Annual Wage Review decisions, would be a suitable alternative source of data on employee costs. On the one hand, the FWC's Annual Wage Reviews have the advantage of being conducted by an independent Expert Panel, which must make sure all interested organisations and individuals have a reasonable opportunity to make submissions. Further, the increases apply to all federal modern awards (including the federal *Local Government Industry Award 2020*), making them a nationally robust indicator which may be less prone to criticism. However, a shortcoming in using Annual Wage Review decisions is that there would be a significant time-lag between the handing down of the FWC's Annual Wage Review decision, and the relevant rate increase. Given the time lag, LGNSW is of the opinion that increases in award minimum wages as determined by the Fair Work Commission (FWC) in its Annual Wage Review decisions, are not a suitable measure of employee costs for IPART's rate peg determinations.

3. 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?

LGNSW supports this proposal, as noted in response to Decision Item 4. The early provision of an indicative rate peg around September each year will provide a higher degree of certainty and assist councils with planning and budgeting. The decision to announce the final rate peg as late as May each year is an important step forward that will help ensure that the model can better deal with economic volatility and prevent shocks. However, as noted above, LGNSW recognises that there are technical details that need to be worked through with the sector, particularly regarding councils' public exhibition and budget setting obligations.

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. 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?

LGNSW does not have further information on individual council arrangements. Refer to LGNSW response to Question 5 for further information.

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 pay.

LGNSW understands that this information should be readily available from councils. The invoices provided by Revenue NSW provide the breakdown of the ESL. Details on cost sharing arrangements may be readily obtained from participating councils. Examples of lead councils in involved in cost sharing arrangements include:

- Riverina Zone, where Coolamon is the lead Council
- New England Zone, where Armidale is the lead Council
- MIA Zone, where Murrumbidgee is the lead Council.

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?

LGNSW supports the introduction of a process to develop timely adjustment factors for groups of councils. However, it would seem that there would need to be an ability to create subgroups, often geographically based as in the case of bushfires, floods and other natural disasters for this purpose. It must also provide for individual council assessments.

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

LGNSW maintains the position expressed in our previous submission, which is to simplify the determination of the factor adjustment and base it solely on population using Estimated Residential Population, removing the adjustment for residential supplementary valuations. A similar view has also been expressed by the Canberra Region Joint Organisation (CRJO) submissions, the NSW Revenue Professionals and several individual councils. which argue that the supplementary valuations should not be deducted from any general rate increase from a population peg.

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

N/A

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

In the absence of any policy or legislative changes to resolve the current ESL dilemma, LGNSW considers it absolutely essential that the new ESL factor be implemented in the 2024-25 year. Councils cannot afford a delay to this, particularly given the costs incurred in 2023-24.

However, it would be preferable if all changes were implemented in 2024-25 as presented below:

- Replace the LGCI with the 3-component BCC model and use 3 council groups
- Implement a separate ESL factor, and
- Include 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 they would have received under the existing methodology for 2024-25.

5. IPART Draft Finding

1. 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.

Noted. (Refer response to Seeking Comment Question 5.)

6. IPART - Further Matters for Consideration

LGNSW agrees that all but one of the issues listed by IPART warrant further consideration either as subjects of separate reviews or more appropriately as part of the recommended independent review of the financial model for councils in NSW raised in this report. Comments on IPART's suggestions are provided below:

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

It is LGNSW's policy position that all land used for commercial (including agricultural) or residential purposes should be subject to rates regardless of tenure. In some cases, rate exemptions should simply be abolished. In other instances, it may be a matter of legislating tighter eligibility criteria and/or introducing a system of partial exemptions as applied in other jurisdictions.

Many current exemptions serve to provide financial benefits to numerous organisations, benevolent institutions, private schools, universities and some government business enterprises that are no longer justified in terms of principles of optimal taxation, particularly principles of equity and efficiency. LGNSW strongly supports a review.

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

LGNSW policy supports the introduction of Capital Improved Value (CIV) to the NSW rating system as an option available to all councils. LGNSW acknowledges that CIV potentially provides the basis for a more equitable rating base and is more easily understood by ratepayers as it more closely reflects market values than the current system of unimproved capital valuations.

Other land valuation methodologies (e.g., Gross Rental Value) and other aspects of the nexus between land valuation and rating should also be considered.

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.

LGNSW does not consider this necessary as the Integrated Planning and Reporting (IP&R) framework and the rate pegging system by its very nature, serve this purpose.

4. Some councils may not have an adequate rate base and a mechanism should be developed to enable councils found to have insufficient base rates income to achieve financial sustainability.

LGNSW strongly agrees, there are a number of councils in NSW who do not have the revenue base or the growth potential to ever achieve financial sustainability under current structural and funding arrangements. The rating system and opportunities to raise other forms of own source revenue cannot deliver financial sustainability. The provision of essential community services is dependent on a new and perhaps unique (in NSW) financial model for application in these areas. There will need to be close engagement between the respective local communities, State and Federal Government in the development of alternative models.

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.

LGNSW has long advocated for the deregulation of fees and charges to enable councils to recover the full cost of service provision.

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 IP&R).

LGNSW agrees practice of IP&R across councils may benefit from a review. The objective should be to improve practice and reduce the reliance on the formulaic rate pegging process.

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.

LGNSW is of the view that questions 6 and 7 are inherently related and need to be considered concurrently. LGNSW has previously suggested that councils that have consistently demonstrated a high level of level of performance (against criteria to be determined) over a period of time should be exempt from the rate peg. This would be focussed on the standard of IP&R. This is consistent with LGNSW's position that the successful implementation of IP&R should make rate pegging redundant. LGNSW agrees that this matter warrants further consideration.

LGNSW maintains that that the independent review of the financial model for councils in NSW needs to examine many other matters beyond those proposed by IPART. These include:

- Streamlining special variation process
- Stronger integration of the rate determination process with IP&R
- Cost shifting
- The regulatory burden on councils

7. Conclusion

LGNSW thanks IPART for the opportunity to constructively contribute to the IPART Review of the Rate Peg Methodology and looks forward to participating in the final stages of the Review and the implementation of the proposed reforms. This review is of great importance to councils, and it is clearly evident that IPART has been receptive and responsive to the views of local government.

It is significant that the draft decisions and recommendations have generally found broad support across the sector. This will assist in delivering vital reforms. LGNSW is also pleased that IPART has also recognised the need for further reforms beyond those contained within this report with its recommendation that the NSW Government consider commissioning an independent review of the financial model for councils in NSW including the broader issues raised in IPART's report.

If you require further clarification of the positions presented in this submission please contact Shaun McBride, Chief Economist at [redacted] or on [redacted]