

Review of the Rate Peg Methodology  
Independent Pricing and Regulatory Tribunal  
PO Box K35  
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SYDNEY NSW 1240

Our Ref:  
Date:

24367361  
4 July 2023

Dear Tribunal Members

## IPART REVIEW OF THE RATE PEG METHODOLOGY – DRAFT REPORT JUNE 2023

Wollongong City Council would like to thank IPART for the opportunity to respond to its Draft Report relating to the Review of the Rate Peg Methodology. Council acknowledges the work being done to consult with Local Government, ratepayers, citizens and other stakeholders to consider the balance and conflicts between financial management responsibilities, sustainability and the impacts on our ratepayers. It is clear that IPART has consulted broadly and listened to all stakeholders and has represented what has been heard, attempted to provide options to progress outcomes within the scope of the review and provided pathways for future considerations.

Wollongong City Council is broadly supportive of IPART's 'draft decisions', although consider that there is opportunity for further refinement or change to aspects of some decisions, including:

- 1 – Base Charge Model (Asset weighting)
- 2 – Three Council Groups Model
- 3 – Base Cost Indexation

Council is strongly supportive of IPART's 'draft recommendations' and 'matters for further consideration'. We appreciate the willingness of IPART to advance these learnings from the consultation process to assist in moving Local Government to a more balanced and achievable financial model. Council has argued strongly for many of these actions in our past submissions. This would particularly include better targeting residential rates exemptions, the option for councils to apply Capital Improved Values for rating, appropriate cost recovery for statutory charges and ensuring councils are able to plan for and maintain financial sustainability through their Integrated Planning and Reporting (IP&R) Framework in concert with their community.

### Response to draft decisions presented in the Draft Report:

- 1 To replace the LGCI with a Base Cost Change model with three components:
  - a employee costs
  - b asset costs
  - c other operating costs.

**QUALIFIED SUPPORT** - Wollongong City Council supports the simplified approach to determining the cost structure of Local Government. This approach will be easier to understand by councils and the community. The Base Cost Model should be able to be included in councils' budget assumptions as part of the IP&R process. This simplification should allow greater use of forward looking indices that are reasonably well understood and available for budgeting and rate setting purposes.

While generally agreeing with the inclusion of 'Assets Cost' as a component for indexation calculations, Council's issue with the cost base is the measurement of the component in the model. The proposed model would use depreciation cost adjusted for population growth. Depreciation is an accounting estimate based on an assets fair value and remaining life. This measurement does not represent the actual expenditure (cash) required to be expended in a particular year on a council's assets renewals and, therefore, doesn't measure the appropriate base for indexation required. Nor does the measure include costs for annual maintenance of assets required to ensure that they are fit for purpose over their life. Depending on asset accounting policies, asset maintenance



could include reasonably substantial asset construction such as roofing, drainage, painting of buildings, spray seals and heavy patching of roads or, in some cases, relining of pipes or replacement of grates in drainage. All these costs that would not be included in the asset base component but should have a cost index based on asset construction. We contend that the Asset component should be broader than depreciation.

We understand the visual simplicity of measuring costs in line with the Income Statements expenses but consider using this long term accrual accounting measurement inclusive of accounting estimates as the base for annual pricing variance can be misleading. We also understand that an alternate base for indexation may be difficult to establish without a significant departure from use of the Income Statement to assess cost structures. Unfortunately, NSW financial reporting does not adequately disclose asset costs separately.

Wollongong City Council will also argue that the application of CPI to 'Other Operating Costs' is not the most accurate indexation for items that would be assessed under the asset component. Council argues that PPI would be a better measure across the 'non-employee' components of the base model. It is difficult to see any correlation between household expenditure measured through CPI and the expenses incurred by councils. Should PPI be used for non-employee costs, the question of appropriate measurement would not be a significant issue on implementation and could be improved over time.

- 2 To develop separate Base Cost Change models for three 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)

**NOT SUPPORTED:** Council understands that costs of councils vary significantly between councils and agreed in our last submission that it was considered fundamental to be able to introduce differing cost indexes for individual or smaller groups of councils to ensure a realistic match between cost-of-service delivery and revenue. Matching costs and revenue will assist in financial sustainability. We also argued that dividing the Index into regions or categories of council will still not provide appropriate outcomes and suggested that individual Council Cost Indexes should be established.

It is difficult for us to assess the level of consistency of cost structure within the groupings advocated in the Draft Report but consider the inclusion of Wollongong City Council in the Regional group with councils such as Broken Hill, Cessnock, Singleton, Kiama and Snowy Monaro would suggest very little commonality. This group includes councils with coastal issues and others inland, has populations from 17K to 219K and densities from 3.4 capita/Km<sup>2</sup> to 895 capita/Km<sup>2</sup>, indicating a high level of diversity and one would imagine very different cost structures. If smaller groupings such as Local Government Group 5 was proposed, that are reasonably large coastal councils, there may be more commonality but still reasonable levels of variability.

It remains important that the rates indexation applied to all councils best reflects their individual cost structures to allow an appropriate match between costs and revenue.

- 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 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).

**SUPPORT (LOCAL GOVERNMENT (STATE) AWARD)** - Council supports the use of the Local Government (State) Award as a reasonable reflection of the changing costs incurred by councils for employment. While Wollongong City Council has its own Enterprise Agreement, it understands the broader application of the Award and the role of LGNSW as a central party rather than an individual council to the negotiation process of the Award.



- 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 five year period for which data is available.

**SUPPORTED** - Council agrees that an RBA CPI forecast adjusted to PPI would be a reasonable index to apply to an Asset Category for calculation of the Rate Peg.

- c 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).

**NOT SUPPORTED** - The CPI is a measure of the change in a basket of household goods that has very little if any correlation to the costs incurred by councils. As argued in the comments to draft decision 1 above, the costs incurred by Council in the current 'Other Expenses' category would include a large portion of asset related costs that would tend to move in concert with the PPI. It would also include large purchases such as waste contracts, plant costs, Insurances, IT Licences and maintenance, street lighting and utility charges, and others that bear very little resemblance to household goods.

Council is of the view that indexation, other than CPI, would best represent Council's other costs and would be preferred. We understand and support the desire to use readily available forward looking estimates from reliable sources such as the RBA. In the absence of another directly related and forecast index, we would argue that the same indexation to be applied to asset costs would be more equally applicable to most of the cost base and a better reflection of the remainder than the CPI.

The application of the same indexation as the Asset category would remove any of the issues associated with calculation of the weighting of that category and allow the introduction of the Base Cost Change Model without great concern regarding the weightings now. It would then be possible to continue to refine and define the Asset category over time.

- d Weight the three components using the latest three years of data obtained from the Financial Data Returns of councils in that group and update the weights Annually

**SUPPORTED** - Council agrees that approach is reasonable and retains a level of consistency.

- 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

**QUALIFIED SUPPORT** - Council agrees that approach provides the best option to provide for a reasonable match between indexation of costs and revenues. OLG, IPART and councils will be required to communicate this approach to communities and continue to build a high level of trust and transparency through the IP&R process.

With this process in place, councils should have clearly defined cost indexes built into their budget assumptions that can be easily explained when variations occur.

The timing of the indicative rates may be better issued in October of each year to avoid conflict with the election cycle in those years.

- 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.

**SUPPORTED** – Council continues to support an end state where the costs of the State Government Emergency Services are funded through the taxes and other revenues of the State Government and not passed on to council ratepayers as an indirect tax. While awaiting such change, Council agrees that a specific adjustment is required to manage the continuing impacts of higher than Rate Peg costs changes associated with the ESL.

The calculation as drafted in this review is supported.



- 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** – Council supports this change in conjunction with draft decision 4 that would require adjustments during the IP&R exhibition period.

In addition to reduce the impacts of variations in the exhibited budgets, it is considered that State Government could be requested to improve the timing of the ESL accounts or be requested to provide indicative estimates in September/October in line with other IPART indicative cost changes.

- 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

**SUPPORTED** – Council agrees that external costs in addition to the ESL that impact on councils require adjustment in the rate peg methodology, however, concur that the methodology to include such costs cannot reasonably be a broad brush approach. The process and allocation of such allowances should be made as separate decisions in line with principles to ensure councils can match expenses and revenues to maintain financial sustainability.

- 8 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.

**SUPPORTED** – Council continues to support a broadening of growth concepts to include non-residential growth. In the absence of this, Council supports the concept of removing non-residential growth earned from supplementary rates from the Population Formula. This will provide a better estimation of residential growth in rates in line with the original intent.

- 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.

**SUPPORTED**

- 10 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

**SUPPORTED** – The review of policy and methodology is reasonable reviewed on a regular basis as good governance. It is considered that the timing of review should be ‘at least every five years’ and this should not limit earlier review if necessary. Reviews should be able to include structure, measures, indexation and/or any other aspect of the process.

**Response to draft recommendations presented in the Draft Report:**

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

**SUPPORTED** - Council agrees that the establishment of a reference group would be of assistance in supporting the implementation principles of changes to the Rate Peg methodology. It is considered that the implementation issues will need to be carefully considered to ensure further and unintended consequences of the improvements do not affect future financial sustainability.

While the principles of the changes espoused are broadly supported, it will be difficult to ensure that the change process is cognisant of the potential impacts that timing will affect. As we move from indexation that reflects backward facing measures with considerable lag, to ones that are estimates of future results, the possibility of missing the substantial impacts of an inflated economy present a high risk to financial sustainability in the longer term.

Council would be confident that with suitable representation on the working party the measures can be transitioned without negative impacts.



- 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**

Response to matters for further consideration:

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

**SUPPORTED** – Council supports a change to Sections 555 and 556 of the Local Government Act 1993 NSW to:

- exempt land on the basis of use rather than ownership and to directly link the exemption to the use of the land, and
- ensure land used for residential and commercial purposes is rateable unless explicitly exempted.

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

**SUPPORTED** - Councils should be able to choose between the Capital Improved Value (CIV) and Unimproved Value (UV) methods as the basis for setting rates at the rating category level. A council's maximum general income should not change as a result of the valuation method they choose.

- 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.

**NOT SUPPORTED** – It is considered that the discretion as to how councils apportion rate increase across different rating categories should remain with the relevant council and its community. The role of IPART and the Rate Peg process is effectively to determine the increase in the General Income allowed under the Local Government Act. While Council is generally in agreement with most of the IPART proposals it is considered that this proposal for further consideration significantly changes the independence of councils in establishing their rating structure and pricing mix through their Revenue Policies. It is not evidenced that actions taken by councils other than in relation to harmonisation after forced mergers have created ratepayer complaints.

- 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.

**SUPPORTED** – It is considered that the SRV process has a significant cost and requires substantial resourcing and consultation capacity to enable positive outcomes. It is reasonable to expect that councils with insufficient rate base and financial sustainability issues may not be well placed to execute an SRV. While it is not envisaged that this would be a broad brush approach, it is considered that a mechanism that is simpler than the SRV process would assist some councils in beginning to address their financial sustainability issues.

- 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.

**SUPPORTED** – Council is aware and has argued for full cost recovery of statutory services obligations across several reviews and directly to State Government. There are a substantial number of statutory fees that are not assessed as recovering the cost of delivery and this comes at the expense of community subsidisation of service through rates.

The balance between user pays and broad property tax needs to be measured against the purpose and drivers for statutory cost that councils incur. A clear articulation of the pricing strategy of legislative imposed or restricted pricing would be the starting point to ensure appropriate and full cost recovery, where assessed as appropriate, is achieved. It is argued that this should be articulated in legislation and pricing should be assessed in consultation with councils to ensure equitable service and the appropriate level of cost recovery is achieved.

Any new services required to be delivered by councils as a result of future government decisions should consider this upfront.

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.

**SUPPORTED** – Wollongong City Council believes that the current IP&R process is sound and creates a high level of trust between us and our community. Continued review, improvement and support to the IP&R process is always welcomed and considered good governance.

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.

**SUPPORTED** – Council supports the development of processes that would allow greater levels of autonomy in managing council and community affairs more holistically through the IP&R process at a local level. We agree that there would be merit in considering whether to develop a mechanism where councils could be provided with the autonomy to set their own rate increases, subject to certain conditions such as a medium-term plan, a record of strong financial management, a clear plan for ongoing productivity improvements and community support.

Thank you again for the opportunity to provide feedback.

Should you require further information, please contact [redacted], [redacted], on [redacted] or [redacted]

Yours faithfully

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Wollongong City Council

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