COUNCIL MEETING

ADDITIONAL BUSINESS

7.00 PM, TUESDAY 15 NOVEMBER 2022

Waverley Council
PO Box 9
Bondi Junction NSW 1355
DX 12006 Bondi Junction
Tel. 9083 8000
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ADDITIONAL BUSINESS

CONFIRMATION AND ADOPTION OF MINUTES CM/5.3/22.11

Subject: **Adoption of Minutes - Waverley Traffic Committee Meeting - 27 October 2022**

TRIM No: SF21/6066

Author: Al Johnston, Governance Officer

RECOMMENDATION:

That Part 1 of the minutes of the Waverley Traffic Committee Meeting held on 27 October 2022 be received and noted, and that the recommendations contained therein be adopted.

Introduction/Background

The Waverley Traffic Committee (WTC) is not a committee of Council. The WTC operates under delegation from Transport for NSW (TfNSW), an agency of the NSW Government. It is advisory-only and has no decision-making powers.

The purpose of the WTC is to make recommendations and provide advice to Council on the technical aspects of proposals to regulate traffic on local roads in Waverley. The recommendations of the WTC must be adopted by Council before they can be implemented.

Part 1 of the minutes of WTC meetings must be submitted to Council for adoption in accordance with clause 18 of the Waverley Traffic Committee Charter.

Council has the opportunity to 'save and except' any of the recommendations listed in Part 1 of the minutes for further consideration in accordance with clause 18.1 of the Charter.

Attachments

1. Waverley Traffic Committee Minutes - 27 October 2022 .

MINUTES OF THE WAVERLEY TRAFFIC COMMITTEE MEETING HELD AT WAVERLEY COUNCIL CHAMBERS, CNR PAUL STREET AND BONDI ROAD, BONDI JUNCTION ON THURSDAY, 27 OCTOBER 2022

WAVERLEY COUNCIL

Voting Members Present:

Cr P Masselos	Waverley Council – Chair
Sgt A Leeson	NSW Police – Eastern Suburbs Police Area Command – Traffic Services
Mr V Le	Transport for NSW – Network and Safety Services Manager
Mr P Pearce	Representing Marjorie O'Neill, MP, Member for Coogee
Ms J Zin	Representing Gabrielle Upton, MP, Member for Vaucluse

Also Present:

Mr S Ghosh	Transport for NSW – Network and Safety Officer
Cr L Fabiano	Waverley Council – Deputy Chair
Mr C Hutcheson	Waverley Council – Service Manager, Traffic and Transport
Mr M Almuhanna	Waverley Council – Senior Traffic Engineer
Mr K Magistrado	Waverley Council – Traffic Engineer
Ms B Wang	Waverley Council – Professional Engineer, Traffic and Development
Mr T Williams	Waverley Council – Manager, Urban Design and Heritage

At the commencement of proceedings at 10.05 am, those present were as listed above.

Apologies

Apologies were received from Cr T Kay (Deputy Chair) and Mr N Zervos (Executive Manager, Infrastructure Services).

Declarations of Pecuniary and Non-Pecuniary Interests

The Chair called for declarations of interest and none were received.

Adoption of Previous Minutes by Council - 29 September 2022

The recommendations contained in Part 1 – Matters Proposing that Council Exercise its Delegated Functions – of the minutes of the Waverley Traffic Committee meeting held on 29 September 2022 were adopted by Council at its meeting on 18 October 2022.

ITEMS BY EXCEPTION

The following items on the agenda were dealt with together and the Council Officer's Proposal for each item was unanimously supported by the Committee:

TC/C.01/22.10 27 Salisbury Street, Waverley – Construction Zone.

TC/C.02/22.10 3 Boonara Avenue, Bondi – Construction Zone.

TC/C.03/22.10 1 Belgrave Street, Bronte – Construction Zone

TC/C.04/22.10 Hewlett Street, Bronte Public School - Timed Mobility Parking Space.

TC/C.05/22.10 Busby Lane, Bronte – No Parking Zone.

TC/C.06/22.10 Cuthbert Street and Isabella Street, Queens Park – 'No Stopping' Zone at Intersection.

TC/C.07/22.10 Spring Street, Bondi Junction – Loading and Truck Zone Changes.

TC/V.01/22.10 4 Blake Street, Rose Bay – Construction Zone.

TC/V.02/22.10 40 and 42 Hastings Parade, North Bondi – 'P Motor Bikes Only' Zone.

TC/V.03/22.10 Arthur Street and Military Road, Dover Heights – 'No Stopping' Zones at Intersection.

TC/V.04/22.10 Simpson Street and Hall Street, Bondi Beach – 'No Stopping' Zones.

TC/V.05/22.10 Hardy Street, Rose Bay Secondary College, Rose Bay – Shorten Kiss and Ride Zone (Pick-up/Drop-off Zone).

PART 1 – MATTERS PROPOSING THAT COUNCIL EXERCISE ITS DELEGATED FUNCTIONS

NOTE: The matters listed under this part of the agenda propose that Council either does or does not exercise the traffic related functions delegated to it by TfNSW. The recommendations made by the Committee under this part of the agenda will be submitted to Council for adoption.

TC/C STATE ELECTORATE OF COOGEE

TC/C.01/22.10 27 Salisbury Street, Waverley - Construction Zone (A03/2514-04)

COUNCIL OFFICER'S PROPOSAL:

That Council:

1. Installs a 10 metre 'No Parking 7 am–5 pm Mon–Fri, 8 am–3 pm Saturday Council Authorised Vehicles Excepted' construction zone outside the frontage of 27 and 25 Salisbury Street, Waverley, and part of the frontage of 25A Salisbury Street.

2. Notifies residents in the vicinity of the construction zone prior to it being installed.

3. Delegates authority to the Executive Manager, Infrastructure Services, to adjust the length and duration of, or remove, the construction zone, as necessary.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted.

Voting members present for this item: Representative of the Member for Coogee, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/C.02/22.10 3 Boonara Avenue, Bondi - Construction Zone (A03/2514-04)

COUNCIL OFFICER'S PROPOSAL:

That Council:

1. Installs a 9 metre 'No Parking 7 am–5 pm Mon–Fri, 8 am–3 pm Saturday Council Authorised Vehicles Excepted' construction zone outside the frontage of 3 Boonara Avenue, Bondi.

2. Notifies residents in the vicinity of the construction zone prior to it being installed.

3. Delegates authority to the Executive Manager, Infrastructure Services, to adjust the length and duration of, or remove, the construction zone, as necessary.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted.

Voting members present for this item: Representative of the Member for Coogee, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/C.03/22.10 1 Belgrave Street, Bronte - Construction Zone (A03/2514-04)

COUNCIL OFFICER'S PROPOSAL:

That Council:

1. Installs a 15 metre 'No Parking 7 am–5 pm Mon–Fri, 8 am–3 pm Saturday Council Authorised Vehicles Excepted' construction zone outside 1 Belgrave Street, Bronte, at the street frontage facing Dickson Street.

2. Notifies residents in the vicinity of the construction zone prior to it being installed.

3. Delegates authority to the Executive Manager, Infrastructure Services, to adjust the length and duration of, or remove, the construction zone, as necessary.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted.

Voting members present for this item: Representative of the Member for Coogee, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/C.04/22.10 Hewlett Street, Bronte Public School - Timed Mobility Parking Space (A20/0534)

COUNCIL OFFICER'S PROPOSAL:

That Council installs a mobility parking space (8.30 am–4.00pm School Days Only) in front of Bronte Public School east of 11 Hewlett Street, Bronte.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted.

Voting members present for this item: Representative of the Member for Coogee, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/C.05/22.10 Busby Lane, Bronte - No Parking Zone (A14/0145)

COUNCIL OFFICER'S PROPOSAL:

That Council installs a 12.3 metre 'No Parking' zone on the northern side of Busby Lane, Bronte, south of 33 Chesterfield Parade.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted.

Voting members present for this item: Representative of the Member for Coogee, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/C.06/22.10 Cuthbert Street and Isabella Street, Queens Park - 'No Stopping' Zone at Intersection (A14/0145)

COUNCIL OFFICER'S PROPOSAL:

That Council:

1. Installs a 6.7 metre 'No Stopping' zone on the northern side of Cuthbert Street west of Isabella Street, Queens Park.

2. Reduces the length of the existing 'No Stopping' zone on the northern side of Cuthbert Street east of Isabella Street from 7.4 metres to 4 metres.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted.

Voting members present for this item: Representative of the Member for Coogee, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/C.07/22.10 Spring Street, Bondi Junction - Loading and Truck Zone Changes (A04/0696)

COUNCIL OFFICER'S PROPOSAL:

That Council:

1. Approves a six-month trial replacement of the existing 'Loading Zone' and 'Truck Zone' restrictions on Saturdays and Sundays with '1/2P Meter Registration, 6.30 am–6 pm Sat–Sun' restrictions in Spring Street between Newland Street and Bronte Road, Bondi Junction, as shown in Figures 3–5 of the report.

2. Delegates authority to the Executive Manager, Infrastructure Services, to adjust the length of the proposed '1/2P', reinstating either 'Loading Zones' or 'Truck Zones', as necessary.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted.

Voting members present for this item: Representative of the Member for Coogee, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/V STATE ELECTORATE OF VAUCLUSE

TC/V.01/22.10 4 Blake Street, Rose Bay - Construction Zone (A03/2514-04)

COUNCIL OFFICER'S PROPOSAL:

That Council:

1. Installs a 9 metre 'No Parking 7 am–5 pm Mon–Fri, 8 am–3 pm Saturday Council Authorised Vehicles Excepted' construction zone outside the frontage of 4 Blake Street, Rose Bay.

2. Notifies residents in the vicinity of the construction zone prior to it being installed.

3. Delegates authority to the Executive Manager, Infrastructure Services, to adjust the length and duration of, or remove, the construction zone, as necessary.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted.

Voting members present for this item: Representative of the Member for Vaucluse, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/V.02/22.10 40 and 42 Hastings Parade, North Bondi – 'P Motor Bikes Only' Zone (A21/0065)

COUNCIL OFFICER'S PROPOSAL:

That Council installs a 2.9 metre 'P Motor Bikes Only' zone between the driveways to 40 and 42 Hastings Parade, North Bondi.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted.

Voting members present for this item: Representative of the Member for Vaucluse, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/V.03/22.10 Arthur Street and Military Road, Dover Heights – 'No Stopping' Zones at Intersection (A14/0145)

COUNCIL OFFICER'S PROPOSAL:

That Council:

1. Installs an 11.7 metre 'No Stopping' zone on the western side of Arthur Street, Dover Heights, north of Military Road.

2. Installs a 12 metre 'No Stopping' zone on the eastern side of Arthur Street, north of Military Road.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted.

Voting members present for this item: Representative of the Member for Vaucluse, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/V.04/22.10 Simpson Street and Hall Street, Bondi Beach - 'No Stopping' Zones (A14/0145)

COUNCIL OFFICER'S PROPOSAL:

That Council installs 'No Stopping' signs on all legs to the intersection of Hall Street with Simpson Street, Bondi Beach, to reinforce the existing 'No Stopping' zone that is currently delineated by yellow line marking.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted.

Voting members present for this item: Representative of the Member for Vaucluse, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/V.05/22.10 Hardy Street, Rose Bay Secondary College, Rose Bay - Shorten Kiss and Ride Zone (Pick-up/Drop-off Zone) (A14/0145)

COUNCIL OFFICER'S PROPOSAL:

That Council:

1. Reduces the length of existing 62 metre 'Kiss and Ride, No Parking 8.00 am–9.00 am, 2.30 pm–4.00 pm, School Days Only' zone on the western side of Hardy Street, Rose Bay (outside Rose Bay Secondary College), by 21 metres.

2. Extends the existing 73 metre 'Bus Zone 8.00 am–9.00 am, 2.30 pm–4.00 pm, School Days Only' zone on the western side of Hardy Street (outside Rose Bay Secondary College) by 21 metres.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted.

Voting members present for this item: Representative of the Member for Vaucluse, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/V.06/22.10 Brighton Boulevard, North Bondi - Kerb buildout at Campbell Parade (A20/0069)

COUNCIL OFFICER'S PROPOSAL:

That Council:

1. Installs a kerb buildout on the southern side of Brighton Boulevard, North Bondi, just west of Campbell Parade in accordance with the drawing attached to the report.

2. Delegates authority to the Executive Manager, Infrastructure Services, to modify the design should on-site circumstances warrant changes.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted subject to the addition of a new clause such that the recommendation now reads as follows:

That Council:

1. Installs a kerb buildout on the southern side of Brighton Boulevard, North Bondi, just west of Campbell Parade in accordance with the drawing attached to the report.

2. Retains the parklet in its existing location on Brighton Boulevard.

3. Delegates authority to the Executive Manager, Infrastructure Services, to modify the design should on-site circumstances warrant changes.

Voting members present for this item: Representative of the Member for Vaucluse, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/V.07/22.10 Clyde Street, North Bondi - Angle Parking Review (DA-314/2021)

COUNCIL OFFICER'S PROPOSAL:

That Council:

1. Undertakes a survey of residents in Clyde Street (west of Hardy Street) and Oakes Place, North Bondi, for their views on the angle parking that has recently been installed and provision of passing bays in the narrow section of Clyde Street.

2. Reports the outcomes of the survey with any recommendations to the Waverley Traffic Committee for consideration.

WTC RECOMMENDATION (UNANIMOUS SUPPORT):

That the Council Officer's Proposal be adopted subject to an amendment to clause 1 and the addition of a new clause 3 such that the recommendation now reads as follows:

That Council:

1. Undertakes a survey of residents in Clyde Street (east of Hardy Street) and Oakes Place, North Bondi, for their views on the angle parking that has recently been installed and provision of passing bays in

the narrow section of Clyde Street.

2. Reports the outcomes of the survey with any recommendations to the Waverley Traffic Committee for consideration.

3. Monitors compliance of existing angle parking spaces concerning the length of vehicles parked in those spaces.

Voting members present for this item: Representative of the Member for Vaucluse, NSW Police representative, TfNSW representative and Waverley Council representative (Chair).

TC/CV ELECTORATES OF COOGEE AND VAUCLUSE

Nil.

THE MEETING CLOSED AT 10.27 AM.

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SIGNED AND CONFIRMED
MAYOR
15 NOVEMBER 2022

REPORT
CM/7.13/22.11

Subject: **IPART Rate Peg Methodology Review - Submission**

TRIM No: A08/1245

Author: Tara Czinner, Director, Corporate Services

Director: Tara Czinner, Director, Corporate Services

RECOMMENDATION:

That Council approves the submission to IPART attached to the report (Attachment 1) on the rate peg methodology review.

1. Executive Summary

Earlier this year, the Minister for Local Government asked the Independent Pricing and Regulatory Tribunal (IPART) to review its methodology for setting the annual rate peg for NSW councils. Local Government NSW (LGNSW) will be providing a submission and has asked councils to write to IPART and advise that each council relies upon and supports the LGNSW submission as being the position of its council.

Attached is a draft submission on behalf of Council responding to each of the questions asked by IPART in its Issues Paper, as well as other relevant factors that are important considerations in the context of the rate peg review, generally supporting the view that the current rate peg system and methodology for rate revenue is neither fair nor financially sustainable.

2. Introduction/Background

The rate peg has been set annually by IPART since 2010 and limits the total amount by which councils can increase revenue from rates each year. Under the current methodology, IPART considers annual changes in the average costs faced by an 'average council' in NSW with reference to the most up-to-date ABS data. The main flaw with this method is that there is a two-year lag between the time that price changes are measured over to when councils can recover these price changes by applying the rate peg to their rates income. This lag may not be a significant concern in periods when inflation is relatively stable. However, when inflation is more volatile, the lag leads to material differences between council's general income and cost of providing services. This lag then creates a permanent and growing deviation between council's expenditure profile and its general revenue, which then compounds further in future years. As there is no mechanism under the current methodology for catch-up adjustments, the only option for councils seeking to bridge this gap is through an onerous process of applying to IPART for a 'special rate variation' (SRV).

3. Relevant Council Resolutions

Nil.

4. Discussion

IPART (under instruction from the Minister) is now reviewing their methodology to address this problem and are therefore seeking input from stakeholders during the process. On 29 September 2022, IPART announced the rate peg for the 2023-24 financial year as 3.7% plus a population factor for each council. On

the same day, IPART released its Issues Paper on the Review of the Rate Peg Methodology, seeking feedback and submission from stakeholders.

The issues paper seeks feedback from stakeholder across 20 individual questions addressing a number of concerns that have been raised in respect of the existing rate peg methodology.

Waverley's response was drafted based mostly on the draft submission and position of LGNSW plus additional references from draft submissions from Bayside Council, Albury Council and Canberra Joint Region. Refer to Attachment 2.

Furthermore, the United Services Union (USU) commissioned a report by Professor Brian Dollery (University of New England, Education and Research) regarding assessment of rate peg methodology and responses to questions for review. Refer to Attachment 3.

5. Financial impact statement/Time frame/Consultation

The deadline for submissions was 4 November 2022. However, an extension was sought and granted for Council until Wednesday, 16 November 2022.

6. Conclusion

Waverley welcomes the opportunity to contribute to the Independent Pricing and Regulatory Tribunal (IPART) Review of the Rate Peg Methodology. Waverley welcomes the review as a response to the realisation that the current methodology fails to cope with economic volatility and relies upon and supports the LGNSW submission as being the position of Council.

Council, like all of local government, is under sustained financial stress. This is a result of the compounding impacts of rate pegging, demands on services and infrastructure from communities inside and outside of the local government area (LGA), increased responsibilities, cost-shifting from the Federal and State governments and declining Commonwealth Financial Assistance Grants (in real terms). Waverley welcomes the Government's commitment to review the rate peg methodology.

7. Attachments

1. Rate Peg Methodology Review - Draft Waverley submission ⇩
2. Rate Peg Methodology Review - LGNSW/Bayside/Albury/Canberra Joint Region submission ⇩
3. Professor Brian Dollery, Rate Capping in New South Wales Local Government: Addressing the Questions Raised in the IPART 2022 Review of Rate Peg Methodology - Issues Paper and Further Recommendations for Improvement ⇩ .

IPART RATE REVIEW METHODOLOGY 2022 QUESTIONS – WAVERLEY SUBMISSION

INTRODUCTION

Waverley Council (Waverley) operates within the boundaries of its Local Government Area (LGA), covering 9km2 along Sydney's eastern suburbs of Bronte, Tamarama and Bondi, north to Dover Heights and Rose Bay, west to Queens Park, Bondi Junction and Charing Cross, and south to Bronte. Since 2016, our community has grown from around 72,000 to of 74,280, with annual growth decreasing to under 1% over the last three years. Located on Sydney's eastern seaboard, Waverley is just a few kilometres from the city centre and a must-see destination for visitors and with three famous beaches - Bondi, Bronte and Tamarama attracts visitors in excess of 1.5 million per year.

Waverley welcomes the opportunity to contribute to the Independent Pricing and Regulatory Tribunal (IPART) Review of the Rate Peg Methodology. Waverley welcomes the review as a response to the realisation that the current methodology fails to cope with economic volatility and relies upon and supports the LGNSW submission as being the position of Waverley Council.

This was clearly demonstrated in both the Local Government Cost Index (LGCI) determination of 0.7% for 2022-23, (later adjusted to 2.5% after introduction of a one off Additional Special Variation), but with councils now facing an inflation rate of 8% in the subject year. This shock came after a decade or more of relatively low and stable prices and wages that had not tested the LGCI.

Waverley Council, like all Local Government is under sustained financial stress. This is a result of the compounding impacts of rate pegging, demands on services and infrastructure from communities inside and outside of the LGA, increased responsibilities, cost shifting from the Federal and State governments and declining Commonwealth Financial Assistance Grants (in real terms). Waverley welcomes the Government's commitment to review the Rate Peg methodology.

Cost Index

1. **To what extent does the Local Government Cost Index (LGCI)reflect changes in councils' costs and inflation? Is there a better approach?**

2. **What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?**

WAVERLEY response to Q1 & 2: The Local Government Cost Index (LGCI) does not adequately reflect the actual movements in council costs. The LGCI index is a lagged or "rearward" facing index – whilst other sectors adjust their pricing to reflect the forecasted economic whereas the LGCI uses historical data only. The LGCI is a one size fits all model, applying a standard basket of goods and an average weighting of these items across all councils.

Waverley council supports the view and submission of LGNSW that the LGCI needs to be re-designed as a more forward-facing index – involving the use of more timely data and/or forecast indicators.

3. **What alternate data sources could be used to measure the changes in council cost?**

WAVERLEY response to Q3: Waverley council supports the view and submission of LGNSW that additional accurate data that reflects actual cost movements rather than applying proxy indices. In particular, as wage costs are the single largest component of council expenditure one change would

be to use the NSW Local Government (State) Award as opposed to NSW Public Sector Wage Cost Index. Additionally other examples of actual costs including actual auditing costs and actual audit committee costs.

Population Growth

4. **Last year we included a population factor in our rate peg methodology. Do you have any feedback on how it is operating? What improvements could be made?**

WAVERLEY response to Q4: Waverley council supports the view and submission of LGNSW to improve the population factor may be to base it solely on population and removing the adjustment for supplementary valuations. As Waverley council is 9.2 square kilometres, growth in rateable properties is largely through high/medium density dwellings (i.e., apartment units) which can accommodate 2-4 individuals. Which means that the percentage growth in population does not have a direct correlation to the percentage growth in rates from supplementary valuations. The revenue generated by supplementary valuations should not be discounted from the population indexed rate peg. Furthermore, Waverley has an aging population which generates a higher proportion of pensioner rate rebates and that demographic has increasing demands on council services.

Productivity

5. **How can the rate peg methodology best reflect improvements in productivity and the efficient delivery of services by councils?**

WAVERLEY response to Q5: Waverley council supports the view and submission of LGNSW that productivity improvements should be removed from the rate peg methodology. Any productivity gains made by councils should be retained to invest in maintaining services or infrastructure maintenance and renewal.

External Factors

6. **What other external factors should the rate peg methodology make adjustments for? How should this be done?**

WAVERLEY response to Q6: Waverley council supports the view and submission of LGNSW that predictable costs, that apply to the whole sector such as election expenses and increases in superannuation guarantee contributions should continue. Waverley Council submits that any rate peg calculation method must embody "forward facing" elements, especially with respect to inflationary pressures.

Historical Rate Peg, Cost Increases, Revenue & Expense

7. **Has the rate peg protected ratepayers from unnecessary rate increases?**

WAVERLEY response to Q7: Waverley council supports the view and submission of LGNSW that there is no evidence to suggest the rate peg has protected ratepayers from "unnecessary" rate increases. Electoral accountability protects ratepayers from excessive rate rises. Deferral of needed rate increases, and budgetary constraints can deprive communities of services and infrastructure.

8. **Has the rate peg provided councils with sufficient income to deliver services to their communities?**

WAVERLEY response to Q8: Waverley council supports the view and submission of LGNSW that the number of Special Rate Variations (including by Waverley Council) evidences that the rate peg has been inadequate to provide Councils with sufficient income to deliver services to their communities.

9. **How has the rate peg impacted the financial performance and sustainability of councils?**

WAVERLEY response to Q9: Waverley council supports the view and submission of LGNSW that the rate peg generally undermines financial sustainability. Rate revenue funds approximately 32.7% of Waverley's operating expense or 34.3% of the operating income in 2021-22.

10. **In what ways could the rate peg methodology better reflect how councils differ from each other?**

WAVERLEY response to Q10: Waverley council supports the view and submission of LGNSW that historical modelling be undertaken to establish whether there are significant differences.

11. **What are the benefits of introducing different cost indexes for different council types?**

WAVERLEY response to Q11: Waverley council supports the view and submission of LGNSW that it would improve the cost reflectiveness of the index and improve financial sustainability outcomes.

Volatility and Lags

12. **Is volatility in the rate peg a problem? How could it be stabilised?**

    The initial rate peg determination for 2022-23 of 0.7% clearly demonstrated that the volatility is a major problem where there are significant cost movements.

13. **Would councils prefer more certainty about the future rate peg, or better alignment with changes in costs?**

    In the presence of volatility, the peg needs to better reflect actual cost movements.

14. **Are there benefits in setting a longer term rate peg, say over multiple years?**

WAVERLEY response to Q12, 13 and 14: Waverley council supports the view and submission of LGNSW that the initial rate peg determination for 2022-23 of 0.7% clearly demonstrated that the volatility is a major problem where there are significant cost movements. Additionally, there is volatility between the expected rate cap and actual proclaimed rate cap. A better approach to improving the accuracy of the rate peg to the year it is applied would be to apply a forward-looking forecast.

15. **Should the rate peg be released later in the year if this reduced the lag?**

WAVERLEY response to Q15: There are potential advantages as would better reflect actual costs but then impacts forward planning. Waverley supports the release of an indicative peg and later releases of final peg with further data.

Efficient Labour Costs

16. **How should we account for the change in efficient labour costs?**

WAVERLEY response to Q16: Waverley supports the adoption of the NSW Local Government (State) Award which would be reflective of the minimum labour costs councils face.

Funding New Services & Activities

17. **Should external costs be reflected in the rate peg methodology and if so, how?**

18. **Are council-specific adjustments for external costs needed, and if so, how could this be achieved?**

WAVERLEY response to Q17 and 18: Waverley supports the submission that external costs be reflected in the rate peg methodology. In particular compliance costs such as Audit and ARIC committee costs. Each council has different costs reflected in the community demands for example Waverley includes Bondi Beach and the demands on the infrastructure and services are beyond the demands of the resident community.

19. **What types of costs which are outside councils' control should be included in the rate peg methodology?**

WAVERLEY response to Q19: Waverley supports the position that costs outside control should be considered including the escalating depreciation expenses associated with increasing input costs for renewal and replacement of assets; costs shifting from differing levels of government without compensating funding for example, Waverley has approximately 73,000 residents in its nine square kilometre LGA however with its iconic beaches has numbers exceeding **1.5m (TBC)** visitors placing huge demands on its infrastructure and services including roads; waste; lifeguards and other services.

Simplifying the Rate Peg

20. **How can we simplify the rate peg calculation and ensure it reflects, as far as possible, inflation and changes in costs of providing services?**

WAVERLEY response to Q20: Where possible LGCI should be future facing and using actual data from forward looking known variables.

IPART QUESTIONS – COMBINED RESPONSES LGNSW/BAYSIDE/ALBURY/CANBERRA REGION JOINT

Cost Index

1. **To what extent does the Local Government Cost Index (LGCI)reflect changes in councils' costs and inflation? Is there a better approach?**

The submission concludes that the LGCI in itself does not adequately reflect actual movements in council costs. Additional costs need to be included and there needs to be provision for adjustments for cohorts of councils and individual councils.

- The LGCI index is a one size fits all model, applying a standard basket of goods to all councils and applying an average weighting of these items across all councils. At best this provides an approximate indication of aggregate local government cost movements and there may be large variations between the peg and the actual outcome for individual councils or cohorts of councils. It does not recognise that different councils or council cohorts may have significantly different cost structures or "baskets of goods".
- The LGCI is a lagged or "rearward" facing index. A deficiency that IPART itself acknowledges. Furthermore, it is effectively a two year lag, meaning that there can be a large difference between the LGCI and the actual cost increases councils are facing in the budget year in which it is applied. This is clearly demonstrated in both the LGCI of 0.7% for 2022-23, (later adjusted to 2.5% after introduction of a one off Additional Special Variation), but now facing an inflation rate of over 7% in the subject year.
- LGNSW supports the view that the LGCI needs to re-designed as a more forward facing index. This could involve the use of more timely data and/or forecast indicators. State and Federal Governments use forecasts in developing budgets.
- Many have recommended the introduction of several indexs for different council cohorts or categories e.g,: metro, coastal, regional city, regional, rural remote. LGNSW supports the introduction of multiple indices in principle if it can be demonstrated that there is or can be material differences. This needs to be subjected historical modelling and adopted if material differences are evident.
- LGNSW is open to the view proposed by the NSW Revenue Professionals (FN), along with Dollery & Drew (FN) and others who recommend that the indexes be determined as a 3 year moving average. This would reduce volatility. However, this should again be subject to historical modelling to better understand what impacts this my have.

Bayside Council response to question 1 & 2:

It is widely known and accepted that the current method for calculating the Local Government Cost Index (LGCI) does not accurately capture the true changes in the cost of services for NSW councils let alone being an appropriate gauge in determining the adequacy of revenue. All other major sectors set their pricing to reflect the forecasted economic indexes while and having regard to historical trends whereas the LGCI uses historical data only.

In addition to being a lagging indicator of changes in cost profile, the inputs to the LGCI as are also significant flawed (for example: Instead of factoring in the agreed NSW Local Government award to measure changes to employee costs, the LGCI uses the NSW Public Sector wage index which is almost always lower than the NSW Local Government

Award).
Basing the rate peg on a lagging indicator like the LGCI is problematic in periods where inflation is volatile. The reality is that in periods of large swings in inflation, Council still needs to incur the present-day costs to deliver services which is much higher than the LGCI whereas the rate peg only allows for revenue catch up from changes to costs profiles from previous periods. This creates a revenue shortfall in the present day and consequently constraints the actual growth required for operational expenditure. This then further perpetuates lower LGCI's given that the restrained cost base is then factored into future LGCI calculations and rate pegs.
The current methodology for calculating the LGCI also does not appropriately factor in the true cost of current and future infrastructure renewals and maintenance.
Periodic revaluations and annual indexing of infrastructure assets are required under professional standards to reflect increases in the gross replacement costs of assets. The increased values from revaluations and indexing converts to depreciation expense in councils operating expenditure and broadly represents the rate at which council should be spending to renew (or set funding aside to periodically renew) its existing infrastructure asset portfolio.
The review of the rate peg methodology needs to address two fundamental flaws:
1. The lack of appropriate inputs in calculating the rate peg; and
2. Volatility in the rate peg.
Once the underlying flaws to the inputs to the LGCI is fixed, the volatility in the rate peg could be addressed by use a rolling 3-year average of the historical LGCI weighted at 50% and factoring in a forward-looking forecast for inflation weighted at 50%. The estimation uncertainty of the forward forecast will then correct itself by being factored into the next year rolling 3-year average.

Albury Council response to question 1 & 2:

A better approach would be to utilise the existing NSW Local Government Integrated Planning and Reporting Framework to better effect. The current rate peg methodology is restrictive both on councils and the community, as the current rate peg approach does not support the achievement of the Council's draft four year delivery program and the community strategic plan, although they are both underpinned by a robust community engagement process.

While it is incumbent on councils to demonstrate to our communities that we are effective and efficient in our operations, our experience has been that public submissions received have been focused on requests that councils do more for their community, rather than on limiting rate increases.

Whilst we understand the overall purpose of the rate peg is to prevent what IPART believe are unnecessary excessive rate increases the rate peg is impacting the long-term financial sustainability of councils. The scope of this initiative needs to consider the long-term impact to councils and not just the short-term impact to the ratepayer.

It is widely known and accepted that the current method for calculating the Local Government Cost Index (LGCI) does not accurately capture the true changes in the cost of services for NSW councils let alone being an appropriate gauge in determining the adequacy of revenue. All other major sectors set their pricing to reflect the forecasted economic indexes while and having regard to historical trends whereas the LGCI uses historical data only.

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Basing the rate peg on a lagging indicator like the LGCI is problematic in periods where inflation is volatile. The reality is that in periods of large swings in inflation, councils still need to incur the present-day costs to deliver services which is much higher than the LGCI whereas the rate peg only allows for revenue catch up from changes to costs profiles from previous periods. This creates a revenue shortfall in the present day and consequently constraints the actual growth required for operational expenditure. This then further perpetuates lower LGCI's given that the restrained cost base is then factored
into future LGCI calculations and rate pegs.

There is evidence that the LGCI is not changing to reflect the change in councils costs – and that as a consequence NSW councils are dropping service levels, increasing fees and charges and increasing rates through SRVs to address their immediate financial sustainability.

Across the industry, NSW Council revenue has not been sufficient to keep up with rising costs.

The current methodology for calculating the LGCI also does not appropriately factor in the true cost of current and future infrastructure renewals and maintenance as reflected in the rapidly rising cost of depreciation, which approximates councils annual cost to renew community infrastructure.

Periodic revaluations and annual indexing of infrastructure assets are required under professional standards to reflect increases in the gross replacement costs of assets. The increased values from revaluations and indexing converts to depreciation expense in councils operating expenditure and broadly represents the rate at which council should be spending to renew (or set funding aside to periodically renew) its existing infrastructure asset portfolio.

Councils are using SRVs to 'catch-up' their revenue to meet the cost of service provision. Since IPART took over the rate peg is 2011 there have been 157 SRV applications approved. It has become a part of the normal way that councils manage their business to provide funding for the increasing costs of providing the level of service expected by local communities. As an outcome, while the rates peg has increased rates by 32% over the last 10 years, the average NSW council residential rates have increased by 57%. Indicating the extent of the difference in the LGCI and the required council rates over time.
Even if staggered over several years – the SRV catchup is less equitable and more inefficient than properly levied property tax as it:

- Causes price-shock to ratepayers. The impact on financially disadvantaged ratepayers is compounded because often the same external issues that impact council costs to create the financial urgency required for a decision to apply for an SRV are already affecting household, farming and business budgets.

- Creates inequity for ratepayers in different years. Councils need to be allowed to increase revenue to match costs so that current ratepayers aren't allowed to use up resources and push back the cost of operations to future ratepayers. Ratepayers suffer when price increases are delayed because of decreasing service levels and delayed investment in community services and asset renewal, as well as price rises that affect ratepayers in a different period.

- Makes rates inefficient and increases the administrative cost to council and ratepayers. Taxes should be easily understood, difficult to avoid and have low costs of compliance and enforcement. Property rates are generally one of the most efficient taxes because they are easy to administer compared with other forms of taxation as they rely on a clear information source – property values are hard to avoid because the Government holds comprehensive land ownership records. Conversely, the SRV process is a massive administrative burden and becomes a major job for council at all levels – community, councillors and administration.

There should be an annual performance measure on the LGCI that fails in any year where there are councils that have to apply for an SRV for financial sustainability or to maintain infrastructure or service levels.

The rate peg should be tied to a simple index that can be easily referenced such as the cpi +/- 2%:

- would allow councils to choose to set their rates below the rate peg with flexibility to deal with one-off issues and their own local circumstances,
- would be very efficient to administer, would create a level of accountability through the annual operational plan and revenue strategy setting process already in place
- and would put the decision-making power back with the communities who make decisions to vote in the local council every 4 years.

The timing of the rate peg release is not the issue in question, the inherent challenge is how the rate peg is calculated, that is, on historic inflation rather than forecast inflation. A forecast model would improve the alignment the rate peg with actual inflation experienced by councils.

The rate peg calculation could benefit from using more forward-looking indexes and forecasts such as those available through RBA forecasts. There are many predictive instruments in the marketplace that would help in the calculation of a more relevant rate peg %. Where the predictive measure is found to be inaccurate then the following year could include a revision/correction factor.

It must be accepted that there is no 'one-size fits all' approach for NSW local government, which provides a very broad range of services, and the rate peg must build in a level of flexibility that allows individual councils to do their own cost and revenue analysis based on local circumstances including the cost of inputs and the types of services funded by ratepayers.

Canberra Region Joint Organisation Council response to question 1

- Note approach in Part 2 to separately index the ad valorem component by annualised cost for asset maintenance and renewal, moderated by AO-induced changes in asset valuation
    i. if LGCI does, apply, then civil construction, plant and contract costs should reflect relative council cohort disadvantage in freight, skills and contract supply
    ii. labour costs should reflect known award and super movements in advance

- Note approach in Part 2 to separately index the base/minimum rate component with LGCI
- While the mix of components in the LGCI may be notionally appropriate, it is suggested each should be subject to a discrete moving index (say over three years to smooth out risk of bill shock), and assigned to each council cohort, so that
    i. labour costs reflect known award and super movements in advance
    ii. financial effect of emergency services levy (ESL) is stripped out and separately calculated by council cohort
    iii. movement in insurance costs moderated by advice from local government insurance pools and mutuals
    iv. other indices should reflect the nearest capital city for those council cohorts (eg Sydney, Canberra, Brisbane, Melbourne)

2. What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?

- LGNSW supports the widely held view that the LGCI needs to re-designed as a forward facing index. This could involve the use of more timely data and/or forecast indicators. State and Federal Governments use forecasts in developing budgets.
- Many have recommended the introduction of several indices for different council cohorts or categories e.g,: metro, coastal, regional city, regional, rural remote. LGNSW supports the introduction of multiple indices provided that it can be demonstrated that there is or can be, material differences between the cohorts. This will require detailed historical modelling. If material differences are evident it is imperative the new methodology must be adopted.it must be adopted.

LGNSW also supports the views that the basket of goods for each index needs to be updated more frequently and supports further research on the use of a 3 year rolling average to smooth volatility

Canberra Region Joint Organisation Council response to question 2

- Refer response to Q1
- Three-yearly survey of council cohort costs (perhaps through joint organisations) to record ranges of cost movements for the LGCI major cost components, and recalibrate
- The LGCI point of determination may be June 30 of previous FY to draw on movement in three year average, to apply from 1 July the next FY

3. What alternate data sources could be used to measure the changes in council cost?

One approach involves introducing additional accurate data that reflects actual cost movements rather than applying proxy indices.

- The most obvious example is to use the NSW Local Government (State) Award as opposed to NSW Public Sector Wage Cost Index, LGNSW have long argued for this change. This would provide a significant improvement to accuracy as:
    - wage costs are the single largest component of council expenditure be a significant improvement as wage costs are the single largest component of council costs, representing nearly 40% of the LGCI

  - it is a more accurate reflection of actual cost increases that are faced by councils
  - it is forward looking measure.

- Other examples that would be best applied at an individual council level include:
  - Audit costs (which have escalated rapidly in recent years
  - Audit & Risk Improvement Committees costs (ARICs) which have been imposed on councils in recent years
  - Emergency Services Levy.

- As noted in response to question 2, there is a need to adopt forward facing indicators. The Australian Bureau of Statistics (ABS), Reserve Bank, NSW Treasury provide CPI forecasts that could be substituted for LGCI components based on CPI, making forward determinations rather than lagged determinations.

Bayside Council response to question 3:

The rate peg calculation could benefit from using more forward-looking indexes and forecasts such as those available through RBA forecasts.

Albury Council response to question 3:

The timing of the rate peg release is not the issue in question, the inherent challenge is how the rate peg is calculated, that is, on historic inflation rather than forecast inflation. A forecast model would improve the alignment the rate peg with actual inflation experienced by councils.

The rate peg calculation could benefit from using more forward-looking indexes and forecasts such as those available through RBA forecasts. There are many predictive instruments in the marketplace that would help in the calculation of a more relevant rate peg %. Where the predictive measure is found to be inaccurate then the following year could include a revision/correction factor.

It must be accepted that there is no 'one-size fits all' approach for NSW local government, which provides a very broad range of services, and the rate peg must build in a level of flexibility that allows individual councils to do their own cost and revenue analysis based on local circumstances including the cost of inputs and the types of services funded by ratepayers.

Canberra Region Joint Organisation Council response to question 3

- Refer Part 2 Submission
  i. utilise the annualised renewal and maintenance expense for general assets (derived from asset management plans and financial plans), as reported respectively in Note C1-8 and Special Schedule 7
  ii. consider a weighted LGCI by OLG Group or cohort to reflect a council's
    - freight disadvantage (eg distance from metro or regional city as source of skills, contract and supplies)
    - skills disadvantage (eg access to skills, premiums applicable to short term staff or consultants)
    - rating capacity disadvantage (eg historically low rate base, impacted by demographic change, economic/mining change, rental vacancy)
    - obligations to fill the void (eg providing services and accommodation to house critical public workers eg health)

iii. the above data may be normalised utilising annual LGGC average costs per service, modified to council cohorts rather than state-wide averages

Population Growth

4. **Last year we included a population factor in our rate peg methodology. Do you have any feedback on how it is operating? What improvements could be made?**

LGNSW supports the introduction of a population growth factor in principle. However, the first two years of operation have produced inconsistent and counter intuitive results. (e.g. a fast growing LGA like Blacktown has not earned a growth factor adjustment).

One option to improve the factor may be to simplify the determination of the factor adjustment and base it solely on population and removing the adjustment for supplementary valuations.

The Canberra Region Joint Organisation (CRJO) (FN) submission argues that the discounting of any general rate increase from a population peg through deduction of supplementary levies from new assessment should cease as rate growth by generation of assessments supports the ongoing maintenance and renewal of assets while the population peg supports the extension of services to a growing demographic.
CIV?

Bayside Council response to question 4:

IPART has acknowledged that Councils must be able to scale up and provide additional services as local communities grow and while councils receive supplementary valuations as new rateable properties come online, it often results in councils receiving less income from rates on a per capita basis when compared to the growth in per capita expenditure. It needs to be recognised that supplementary rates do not fully address the issue of additional costs of providing services to a growing population on a per capita basis. This is particularly evident in Councils like Bayside where growth in rateable properties is largely through high/medium density dwellings (i.e., apartment units). In most cases, these new dwellings only attract a minimum rate due to the rating burden being distributed based on unimproved land values. Therefore, while the new dwelling may accommodate average of 2-4 individuals, it still pays a minimum rate which then dilutes the average rates per capita as population on a per head basis grows at a faster rate that the rates collected per new dwelling. This demonstrates that the percentage growth in population does not have a direct correlation to the percentage growth in rates from supplementary valuations.
Therefore, if IPARTs intention for introducing the population growth factor was to allow councils to maintain or increase its rate on a per capita basis, then the current methodology of reducing this factor by the growth in rates from supplementary valuations, fails to achieve that outcome.
It is Councils view that the growth in rates from supplementary valuations should not be used to reduce the population growth factor in the current rate peg methodology.
It should also be noted that there is already an existing gap between per capita rate and per capita costs as a result of the historical rate peg regime and which continues to place stress on council budgets. This is not addressed by the introduction of a population factor or any other review on the rating revenue system. A one-off catch-up adjustment

should be considered through this review to address this historical restriction to Councils general

Albury Council response to question 4:

The population change is an important aspect of the rate peg calculation – where there are high levels of population growth, without the offset of revenue growth in supplementary valuations, it is important that councils can action the needs of the municipality in a timely and proactive manner.

IPART has acknowledged that councils must be able to scale up and provide additional services as local communities grow and while councils receive supplementary valuations as new rateable properties come online, it often results in councils receiving less income from rates on a per capita basis when compared to the growth in per capita expenditure.

It needs to be recognised that supplementary rates do not fully address the issue of additional costs of providing services to a growing population on a per capita basis. This is particularly evident in councils where growth in rateable properties is largely through high/medium density dwellings (i.e., apartment units). In most cases, these new dwellings only attract a minimum rate due to the rating burden being distributed based on unimproved land values. Therefore, while the new dwelling may accommodate average of 2-4 individuals, it still pays a minimum rate which then dilutes the average rates per capita as population on a per head basis grows at a faster rate that the rates collected per new dwelling. This demonstrates that the percentage growth in population does not have a direct correlation to the percentage growth in rates from supplementary valuations.

Therefore, if IPARTs intention for introducing the population growth factor was to allow councils to maintain or increase its rate on a per capita basis, then the current methodology of reducing this factor by the growth in rates from supplementary valuations, fails to achieve that outcome.

It should also be noted that there is already an existing gap between per capita rate and per capita costs as a result of the historical rate peg regime and which continues to place stress on council budgets. This is not addressed by the introduction of a population factor or any other review on the rating revenue system.

The revenue generated by supplementary valuations should not be discounted from the population indexed rate peg.

Canberra Region Joint Organisation Council response to question 4

- Refer Part 2 Submission
- Per findings in IPART Report: councils' costs increase with population growth; rural councils face population related issues that cannot be solved through (that) review; rates revenue has not kept pace with population growth
- The discounting of any general rate increase from a population peg through deduction of supplementary levies from new assessment should cease as

i. rate growth by generation of assessments supports the ongoing maintenance and renewal of assets; while the population peg supports the extension of services to a growing demographic
ii. provides transparency and certainty to councils and community of the nature and value of rate increases

Productivity

5. How can the rate peg methodology best reflect improvements in productivity and the efficient delivery of services by councils?

Productivity improvements should be removed from the rate peg methodology. Productivity cannot be accurately measured across the local government sector as councils are too diverse.

It would need to be conducted on an individual council basis and even then would be complicated by the multifaceted operations of councils. Individual assessments are not consistent with a sector wide peg. It also adds unnecessary complexity of the peg. IPART has set the productivity factor at zero since 2018-19 demonstrating the above and ranged insignificantly between 0.0% to 0.2% when applied. The factor should be removed permanently.

Any productivity gains made by councils should be retained to invest in maintaining services or infrastructure maintenance and renewal. Penalising councils for productivity improvements introduces a perverse disincentive.

Bayside Council response to question 5

It is difficult to measure productivity and efficiency using a singular metric / methodology as there are a number of variables that need to be considered in making the assessment.
Due regard must be given to the following factors:
• Changes to service offerings over time.
• Changes to population (volume and demographics).
• Sufficiency of operating revenue and underlying operating results over time.
• Financial position, liquidity, and cash levels.
• Asset sustainability indicators (i.e., backlogs and asset conditions)
• External factors and cost pressures
• One-off events (e.g., impact of severe weather)
One way to measure efficiency and productivity improvements at a high level could be to measure the changes in per capita expenditure of councils over time having regard to changes in its service profiles.
For instance, if a councils per capita operating expenditure grows at a rate lower than its rate of population growth in an inflationary environment, that could be attributed to efficiency and productivity gains assuming no changes in service offerings.
It should be noted however that per capita expenditure may not be the best indicator of efficiency as a low growth in operating expenditure could be (and often is) attributed to the inadequacy of operating revenue to allow for growth in expenditure (i.e., operating expenditure is being contained due to revenue restrictions).

Ultimately, the best indicator of productivity and efficiency would be where a council is able to generate sufficient revenue to provide the desired levels of service to its community and doing so in a financially sustainable manner without undue financial and operational stress.

Albury Council response to question 5

It is difficult to measure productivity and efficiency using a singular metric / methodology as there are a number of variables that need to be considered in making the assessment. Due regard must be given to the following factors:

- Changes to service offerings over time.
- Changes to population (volume and demographics).
- Sufficiency of operating revenue and underlying operating results over time.
- Financial position, liquidity, and cash levels.
- Asset sustainability indicators (i.e., backlogs and asset conditions)
- External factors and cost pressures
- One-off events (e.g., impact of severe weather)

One way to measure efficiency and productivity improvements at a high level could be to measure the changes in per capita expenditure of councils over time having regard to changes in its service profiles. For instance, if a councils per capita operating expenditure grows at a rate lower than its rate of population growth in an inflationary environment, that could be attributed to efficiency and productivity gains assuming no changes in service offerings.

It should be noted however that per capita expenditure may not be the best indicator of efficiency as a low growth in operating expenditure could be (and often is) attributed to the inadequacy of operating revenue to allow for growth in expenditure (i.e., operating expenditure is being contained due to revenue restrictions).

Ultimately, the best indicator of productivity and efficiency would be where a council is able to generate sufficient revenue to provide the desired levels of service to its community and doing so in a financially sustainable manner without undue financial and operational stress.

We understand that it is challenging in coming up with a sector-wide productivity improvement measure to be considered in setting the rate peg. Councils are best placed to understand the significant financial challenges experienced by the sector and are judged on how they use the scarce resources that they have available by the ratepayer.

The LGCI should be reworked into a performance measure used annually be each council to value the unique mix of services delivered to the local government area. In this way, each council would annually value their outputs (instead of inputs) which would be published at the time of the annual operating plan and linked to the development of the annual revenue strategy.

The local government performance measure would become a reasonable and repeatable way of determining and reviewing the cost of services, that could reported by each council. This would assist councils by providing a reporting framework and methodology to determine the annual rate, within

the rate peg limit. It would create a natural efficiency mechanism because all councils and their communities would be motivated to meet the benchmark, or other target set by Council that takes into account local factors.

This rate peg methodology would have to be auditable to ensure a consistent reporting approach across the sector. It would be used as a basis for each council to review the cost of service provision and community infrastructure, with transparency to report the difference between council costs and an industry benchmark, with an explanation for local factors.

By building flexibility into the rate peg – councils would be able to report on their own service costs for the first time – rather than the current budget method of reducing budgets to match real revenue decreases.

Canberra Region Joint Organisation Council response to question 5

- Refer Part 2 Submission
    i. Councils establish policy decisions identifying certain public services as a CSO, and the nett costs of which are to be recovered by the base rate and supported by relevant grants, noting
        - public and private benefit services are differentiated and published
        - pricing policies articulate the mode of recovery of costs for private benefit services (ie market, full cost recovery, part cost recovery, incentive, regulatory, penalty etc)
        - relevant service statements, recoveries and associated performance measures are published and reported within Integrated Planning and Reporting (IPR), and monitored by Audit Risk and Improvement Committee
- An automatic 0.2% productivity factor discounted from the annual rate peg should be abolished
- A productivity component should be incorporated into SRV applications

External Factors

6. What other external factors should the rate peg methodology make adjustments for? How should this be done?

LGNSW agrees that predictable costs, that apply to the whole sector such as election expenses and increases in superannuation guarantee contributions should continue.

LGNSW also holds the view that the methodology should be modified to allow adjustments for external factors that affect groups of councils, affect councils unevenly or affect individual councils.

For example, the Emergency Services Levy (ESL) that has been included in the peg, does not fall evenly across councils, with the heaviest burden proportionally falling on rural/regional

councils with a high RFS presence. LGNSW maintains that councils should be allowed to adjust rates to recover the full cost of the ESL. This should not require a special variation.

RFS asset depreciation is another factor that should be included.(Expand)

Bayside Council response to question 6:

The revised rate peg methodology needs to take into account the changes to councils' costs profiles driven by the following external factors:

• Global Economic Forecasts and Supply Chain Delays
• Changes in costs and pricing trends of private sector industries that have a high degree of interaction / engagement with the local government sector (e.g., building construction, waste management, specialist contractors, infrastructure, etc.)
• Impact of natural disasters and severe weather events
• Cost of non-value add compliance activities (e.g. detailed data returns, high scrutiny audits, detailed acquittals and increased regularity of reporting on grants,

YoY changes to the LG Code of Accounting Practice, Changes in accounting standards, changes in legislation, etc).

Albury Council response to question 6:

By using an audited local government performance measure reporting framework, IPART would have annual oversight of the cost of service provision and infrastructure for all councils, including narrations and explanations for change. The process would highlight cost pressures that impact individual councils or all councils across the sector. By benchmarking all councils annually, we would have an annual check of the effectiveness of the reporting methodology and be able to moderate back to the real world.

The revised rate peg methodology needs to take into account the changes to councils' costs profiles driven by the following external factors:

- Global Economic Forecasts and Supply Chain Delays
- Changes in costs and pricing trends of private sector industries that have a high degree of interaction / engagement with the local government sector (e.g. building construction, waste management, specialist contractors, infrastructure, etc.)
- Impact of natural disasters and severe weather events
- Cost of non-value add compliance activities (e.g. detailed data returns, high scrutiny audits, detailed acquittals and increased regularity of reporting on grants, YoY changes to the LG Code of Accounting Practice, Changes in accounting standards, changes in legislation, etc).

Other factors may include:

- Lack of understanding of the demand for services delivered by Council for ratepayers, which may be impacted by the increasing financial constraints that a rate peg places on Council.
- Ageing infrastructure assets and the associated asset management plans and requirements
- The escalating depreciation expenses associated with increasing input costs for renewal and replacement of assets

- Changing nature of the workforce, generational change and Pandemic impacts on operational capability
- Climate adaption (as a proactive measure)
- Increasing natural disasters

Canberra Region Joint Organisation Council response to question 6

- Refer Part 2 Submission
    i. Changes in asset maintenance and renewal (ie depreciation) expenses by council cohort, including as consequence of grant funded and development gifted assets
    ii. Changes in Government policy with regard to devolved regulatory or policy agenda programs for delivery by local councils, that are not fully offset by ongoing grant funding or fee recovery
    iii. Nett costs to councils as consequence of cashflowing or underestimating or underfunding reinstatement of assets as part of disaster recovery

Historical Rate Peg, Cost Increases, Revenue & Expense

7. Has the rate peg protected ratepayers from unnecessary rate increases?

There is no evidence to support the conclusion that the rate peg has protected ratepayers from **"unnecessary"** rate increases. Comparisons with other States without rate pegging support the view that electoral accountability protects ratepayers from excessive rate rises.

Rather, rate pegging has been found to deprive communities of services and infrastructure.
ADD material

Bayside Council response to question 7,8, & 9:

In the last 10 years:
• 178 applications for special rate variations (SRVs) were made.
•
• 165 SRV applications were approved in full or in part.
• 142 SRV applications rationalised based on one or all of the following:
o To address financial sustainability.
o To address existing infrastructure backlogs.
o To address future infrastructure expenditure obligations.
In addition to this, the last 3 years:
• 79 councils reported an infrastructure renewal backlog of greater than 2%
• 56 councils consistently reported an infrastructure backlog of greater than 2%
• 99 Councils reported an infrastructure renewal ratio of less than 100%
• 33 Councils consistently (over 3 years) reported an infrastructure renewal ratio of less than 100%
• 74 Councils reported an infrastructure renewal ratio of less than 100% over a 3-year average
The above statistics clearly show that a large majority of NSW councils are balancing their operational budgets by underfunding its capital obligations.
Based on the number and size of Special Rate Variation (SRV) applications in the last 10 years and the deterioration of councils' asset sustainability indicators over the least 3

years, it can be said that the rate peg has prevented necessary rate increases.
The rate peg has been effective to decrease rates and avg rate paid in last 10 years is 2.5%. This policy has resulted in reducing rates collected compared to Victoria of over $1b and been a significant contributor to financial sustainability being the highest risk for NSW Councils for the last 5 years.
As outlined in Q7 the rate cap has created a significant reduction in rates being collected. An example of how this has reduced community services would be the ability to acquire land to invest in land for open space, sporting fields and community buildings. Rates are a levy against land, but the rates have only increased on average of 2.5% in the last 10 years while land has increased at a rate of 10% per year. As a result of this, Councils are no longer able to acquire land and invest in open space, sporting fields and community facilities due to the $1b shortfall in rates across NSW. Therefore, the opportunity costs of rate capping is that income in now lost forever and the ability to purchase land is also now lost, especially as the demand for open space, sporting fields and community facilities is now increasing as housing is now predominately becoming

Albury Council combined response to 7,8 and 9

The implementation of a rate peg has definitely limited rate increases, but this has been at the expense of the financial sustainability of council services.

Under the current rate peg methodology the majority of NSW Councils apply for SRVs, but the SRV process is inefficient, and delays revenue, meaning that services may decline and infrastructure backlogs may develop before additional revenue is sought. These backlogs then require higher rate rises to build services back up to meet community expectations.

The size of the available rate rise has obviously been impacted by the rate peg. However, the impact of the rate peg has meant that councils have been impacted in the ability to generate sufficient income to deliver the services expected of them by their communities. The rate peg also has a significant impact on the long-term financial sustainability of Council, as Council needs to consider the impacts of depreciation and asset replacement, which doesn't appear to be a consideration of IPART in setting the rate peg.

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- 165 SRV applications were approved in full or in part.
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The above statistics clearly show that a large majority of NSW councils are balancing their operational budgets by underfunding its capital obligations.

Based on the number and size of Special Rate Variation (SRV) applications in the last 10 years and the deterioration of councils' asset sustainability indicators over the least 3 years, it can be said that the rate peg has prevented necessary rate increases.

The rate peg has been effective to decrease rates and average rate paid in last 10 years is 2.5%. This policy has resulted in reducing rates collected compared to Victoria of over $1 billion and been a significant contributor to financial sustainability being the highest risk for NSW Councils for the last 5 years.

The rate cap has created a significant reduction in rates being collected. An example of how this has reduced community services would be the ability to acquire land to invest in land for open space, sporting fields and community buildings.

Rates are a levy against land, but the rates have only increased on average of 2.5% in the last 10 years while land has increased at a rate of 10% per year. As a result of this, councils are no longer able to acquire land and invest in open space, sporting fields and community facilities due to the $1b shortfall in rates across NSW. Therefore, the opportunity costs of rate capping is that income in now lost forever and the ability to purchase land is also now lost, especially as the demand for open space, sporting fields and community facilities is now increasing as housing is now predominately becoming multi-unit dwellings.

The rate peg has not provided councils with sufficient income to deliver services to their communities, as it does not take into account the demand for services, ageing infrastructure, escalating depreciation expense and covid operational impacts, inert alia, and therefore places greater strain of the financial sustainability of Council.

The current rate peg has no flexibility for councils where costs increase beyond the 2 year lagging index. There have been numerous financial sustainability reviews on local government over several years that have sited the current rate peg methodology as a major contributing factor.

Most recently, the 2021 NSW Productivity Commission's Paper on Productivity Reform recognised a flexible rating system was the most efficient way of helping councils meet the risings costs of serving their communities. NSW's rate peg is being blamed for councils not having enough money to provide their rapidly growing communities with new infrastructure. The Report signalled NSW councils have foregone about $15 billion in rates compared with Victoria since 2000, and the NSW Productivity Commission says that except for raising user charges or extracting developer contributions, councils don't have alternative funding sources needed to service higher populations or maintain and operate a larger capital stock.

Canberra Region Joint Organisation Council response to question 7

- Refer Part 2 Submission

i. This points to the Accountability and Transparency of councils in profiling assets and services, and setting acceptable rating and pricing paths for their respective maintenance and delivery

8. Has the rate peg provided councils with sufficient income to deliver services to their communities?

The observation that there have been 178 SV applications over 10 years with 165 approved in full or in part provides clear evidence that the rate peg has been inadequate.

Further, IPART itself has have acknowledged the deficiency in advocating the Population Growth Factor. ADD numbers & detail.

Canberra Region Joint Organisation Council response to question 8

- No. Refer Part 2 Submission
  i. Dependent on the foundation of the original general rate base, the imposition of rate pegging, emergency service levies and unsubsidised pension rebates has eroded local government's ability to deliver the gamut of services and assets expected (by community survey and Community Strategic Plan)
  ii. Fundamental to the legislated responsibilities of councils is to match revenues and expenses, be financially sustainable and invest responsibly in infrastructure.
  iii. The evidence of 165 SRV applications over 10 years, with 70% of councils applying more than once, for the purposes of 'financial sustainability' and 'asset backlog' for example, would signal the rate peg is inadequate to provide councils with sufficient income

9. How has the rate peg impacted the financial performance and sustainability of councils?

The rate peg has generally served to undermine financial sustainability. Based on OLG data, the majority of councils are producing consolidated operating deficits, with nearly all producing General Fund annual deficits with deteriorating trend lines.

The fact that the 178 SV applications were overwhelmingly for the purposes of 'financial sustainability' and addressing 'asset backlogs' and funding future 'infrastructure obligations' indicates that the rate peg is inadequate to support financial performance and financial sustainability.

Canberra Region Joint Organisation Council response to question 9

- Refer Part 1 Submission
  i. Based on OLG data, the majority of councils are producing consolidated operating deficits, with nearly all producing General Fund annual deficits, and trend lines deteriorating

ii. The frequency of recent natural disasters has narrowed community focus on the condition of assets, and an expectation of improved maintenance performance
iii. Local government is the nursery of skills in the development and construction sectors. The migration of skilled workers out of local government (and regions) is bearing a higher cost of employment of staff or contractors/consultants
iv. Consequently, council's reputation (in part) plays a part in community views on proposals to increase rates by SRV
v. The size of SRVs are growing towards 100%
vi. Certainty of revenue growth (say through a three year rolling peg average and population peg) smooths out bill shock

Council Differences? revisit

10. In what ways could the rate peg methodology better reflect how councils differ from each other?

The rate peg methodology could potentially determine different pegs for different regions, categories or cohorts of councils. This would be justifiable if there are material differences in the outcomes.DIFFERENT BASKET OF GOODS? COST MOVEMENTS

LGNSW recommends that historical modelling be undertaken to establish whether there are significant differences, and if so, they should be introduced immediately.

11. What are the benefits of introducing different cost indexes for different council types?

It would improve the cost reflectiveness of the index and improve financial sustainability outcomes.

Refer to response to Q.1.

Bayside Council response to question 10 & 11:

While Councils share similarities, each council is different. Rural, Metro, Remote, and Coastal councils all have different challenges and resulting cost implications. The service burden of each council is also different depending on its location, community needs and economic profile. In most cases, there is not a lot of choice or discretion available to Councils.

The figure below shows the categorization of Bayside Councils budgeted operating expenditure (excluding capital expenditure) based on the service rationale for the FY2022/23 financial year.

It can be seen that 76% of Council expenditure is attributable to services / functions that are required due to regulatory or statutory obligations and there is very little allocation available for services that are truly discretionary.

Albury Council response to question 10 & 11:

While Councils share similarities, each council is different. Rural, regional, metro, remote, and coastal councils all have different challenges and resulting cost implications. The service burden of each council is also different depending on its location, community needs and economic profile. In most cases, there is not a lot of choice or discretion available to councils.

Differing cost indexes will recognise that not all councils are alike. IPART has access to existing data collected by IPART to assess expenditure profiles for different categories of councils ie metro, regional, and rural. This information should be considered in assessing the impacts of a 'catch-all' rate peg.

There exists an opportunity to include a factor of relative need, which could be based on the category of council applied by the NSW Grant Commission to recognise the financial sustainability challenges faced by councils.

NSW councils provide hundreds of different services to all types of communities with different service and infrastructure requirements and willingness and capacity to pay for services. There is no one-size fits all. Even councils within a classification (Regional, Rural, Metro) have an enormous amount of diversity because they provide a large range of local services and infrastructure specifically to meet the needs of their local communities.

Any successful rate peg methodology needs to build in sufficient flexibility to allow a council to choose to set a rate lower than the maximum rate peg in any year. Instead of comparing councils and attempting to identify a common level of cost increase across NSW, a local government performance measure could be used to assist councils to value the mix of services they provide to their own local communities.

Canberra Region Joint Organisation Council response to question 10 & 11

- Refer Part 2 Submission
    i. Reimagine council classifications from OLG groups to 'cohorts' that are subject to different growth, distance and cost profiles (metro, coast, regional city, regional, rural, remote)
    ii. Establish an 'asset peg' and 'service peg' by cohort, utilising the metrics outlined in Submission Part 2
    iii. In much the same way, the 'population peg' differentiates councils by growth

2. What are the benefits of introducing different cost indexes for different council types?
    - Refer above

Volatility and Lags

12. Is volatility in the rate peg a problem? How could it be stabilised?

The initial rate peg determination for 2022-23 of 0.7% clearly demonstrated that the volatility is a major problem where there are significant cost movements.

13. Would councils prefer more certainty about the future rate peg, or better alignment with changes in costs?

In the presence of volatility, the peg needs to better reflect actual cost movements.

14. Are there benefits in setting a longer term rate peg, say over multiple years?

Potentially beneficial but only if increases are maintained in real terms. This would require adjustments if there is volatility that increases costs beyond those factored into the longer term peg. It would be difficult to ccurately predict an accurate long term cap.

Bayside Council response for 12, 13 and 14

A better approach to addressing the volatility issues would be to use a rolling 3-year average of the historical LGCI weighted at 50% and factoring in a forward-looking forecast for the current period inflation weighted at 50%.
The estimation uncertainty of the current period forecast will then correct itself by being factored into the next years rolling 3-year average.
This approach can provide stability in smoothing of the long-term revenue to match the growth in long term expenditure and any resulting efficiency gains through economies of scale.
IPART can also remove the volatility by guaranteeing that the rate peg will not drop below the 10-year long term average (i.e. the rate peg should be the higher of, the calculated rate peg under the revised methodology and the 10-year long term average).

Albury Council response for 12, 13 and 14

The priority should be for the rate peg to reflect volatility, rather than leave councils short.

The current rate peg methodology does manage volatility by using an average of two (2) financial years. However, this is an historic average, up to two (2) years prior to the year in which the rate peg is applied, which does not address the issue of long-term sustainability.

A better approach to improving the accuracy of the rate peg to the year it is applied would be to apply a forward-looking forecast. The estimation uncertainty of the current period forecast will then correct itself by being factored into the next years adjusted forecast.

IPART can also remove the volatility by guaranteeing that the rate peg will not drop below the 10-year long term average (i.e. the rate peg should be the higher of, the calculated rate peg under the revised methodology and the 10-year long term average).

The preference should be for the rate peg to support the long-term financial sustainability of councils.

The benefit of a longer term rolling average rate peg is certainty, however, it is likely the risk of this approach would outweigh the benefits. For example, the current inflationary economic environment would see a long-term rate peg having a negative impact on the financial sustainability of councils.

Councils would prefer better alignment with changes in costs over certainty over future rate pegs. However any methodology should be designed with the timing of council integrated planning and reporting as provided by the OLG Guidelines.

Volatility in the rate peg is not a problem – as the rate peg needs to rise and fall to allow councils sufficient revenue to pay for changing costs of infrastructure and services. There is no benefit in setting a long term rate peg – as it would not be able to anticipate the changing needs of councils and their communities.

Canberra Region Joint Organisation Council response to question 12

- Refer response to Q1

Similar volatility in utility markets (particularly sectors subject to carbon or fossil fuel politics) has made a nonsense of modest falls in energy prices in the year of rate peg estimation, only for those values to be blown away by extravagant increases in the year of the rate peg application

Canberra Region Joint Organisation Council response to question 13 & 14

Would councils prefer more certainty about the future rate peg, or better alignment with changes in costs?

- Both. Refer response to Q2, Q3 and Q6

Are there benefits in setting a longer term rate peg, say over multiple years?

- Yes. Councils may prepare their financial plans on 'known' rate peg movements (subject to decisions on setting an asset and service rate peg), and model scenarios with changes to asset standards, public benefit services, and levels of service that may be subject to respective SRVs or pricing paths for private benefit services

15. Should the rate peg be released later in the year if this reduced the lag?

There are potential advantages in that the peg will better reflect actual costs. However, there are disadvantages in terms of certainty and forward planning. An alternative may involve continuing early release, but using forward estimates rather than to better reflect likely movements rather than lagged data.

Alternatively, Dollery & Drew (FN) suggest the release of an indicative peg within the existing timeline to assist with planning and locking in a final peg as late as practical.

Both a potentially workable options that should be further investigated.

Bayside Council response to question 15:

Councils need to commence the preparation of its budgets and long-term financial forecasts early in the new financial year in order to meet public exhibition and council adoption timelines. Thus, a late release of the rate peg may not be beneficial for councils unless IPART can remove the forecasting uncertainty to Councils by guaranteeing that the rate peg will not drop below the 10-year long term average (i.e. the rate peg should be the higher of, the calculated rate peg under the revised methodology and the 10-year long term average). This will allow councils to plan ahead and prepare their budgets with certainty that a late release of the rate peg will not negatively impact their original forecasts.

Albury Council response to question 15:

The volitivity of the rate peg is not a concern when it is done in real-time, or at least close to real-time. A two-year lag means that the volatility is felt by councils two years before it is felt by the ratepayers. Councils subsidise the ratepayer in time of rising inflation and then is seen to raise rates unfairly during times of decreasing inflation. The issue is that the rate peg is determined on historical data/information and the timing of the release of the rate peg.

Councils need to commence the preparation of its budgets and long-term financial forecasts early in the new financial year in order to meet public exhibition and council adoption timelines. Thus, a late release of the rate peg may not be beneficial for councils unless IPART can remove the forecasting uncertainty to councils by guaranteeing that the rate peg will not drop below a pre-determined level (i.e. long term average). This will allow councils to plan ahead and prepare their budgets with certainty that a late release of the rate peg will not negatively impact their original forecasts.

Canberra Region Joint Organisation Council response to question 15

- Yes. Notwithstanding requests in this submission for three rolling rate pegs, advice to councils by March each year may improve the certainty of income and equivalence to most frequent indexed changes to costs

Efficient Labour Costs

16. How should we account for the change in efficient labour costs?

LGNSW strongly supports adoption of the NSW Local Government (State) Award, which would be more reflective of the actual changes in labour costs councils face.

As noted previously in response to Q. 5, LGNSW does not believe that productivity factors can be accurately measured in a sector as diverse as local government.

Albury Council response to question 16:

Any productivity improvements noted in the Award should be taken into account, but it is important to also take into account the increases in the superannuation guarantee and the costs associated with activating different workforce models such as the use of contractors to supplement existing resources due to current workforce resourcing issues experienced.

Canberra Region Joint Organisation Council response to question 16:

- Draw on data available to the sector, including
    i. labour costs reflect known award and super movements
    ii. movement in employment insurance costs moderated by advice from local government insurance pools and mutuals
    iii. skills disadvantage by council cohort (eg access to skills, distance from metro, premiums applicable to short term staff or consultants)

Funding New Services & Activities

1. Should external costs be reflected in the rate peg methodology and if so, how?

LGNSW – Yes

Albury Council response to question 17:

It is noted that adjustments are made by IPART to the rate peg to take into account some external costs outside of the control of councils such as emergency services levy increases by the NSW Government.

However other external costs and examples of cost shifting do not seem to be considered, that increase the financial burden on councils and the community.

Canberra Region Joint Organisation Council response to question 17:

- By survey, council cohorts may elicit the nett cost (through underfunding) of public and private programs devolved by Government, with the change in that annualised cost becoming a feature of the three year rolling average
- Similarly, the nett cost of underfunded projects prompted by grant stimulus or natural disaster grants, may feature as an element in the methodology. In this case 'grant stimulus' means projects and programs that were not proposed within council asset or service plans, or forecast in the financial plans, but were introduced through agency or local member initiative
- Nett costs of maintenance and renewal of assets that are the subject of transfer of ownership to Government (eg regional roads and emergency service facilities)

18. Are council-specific adjustments for external costs needed, and if so, how could this be achieved?

LGNSW – Yes. Refer response to Q.6.

Albury Council response to question 18:

Council-specific adjustments are currently reviewed and assessed under the Special Variation regime. Unfortunately, this is a burdensome, resource-intensive process on Council and an additional financial burden for the community. A Special Variation could also increase rate rise volatility, which seems to be misaligned with the purpose of the implementation of a rate peg.

A change to the process could include the consideration for service demand/ageing infrastructure based on council category (metro, regional, rural) to reduce the need to undertake a Special Variation to rates.

Costs of individual council need to be considered but in a simpler process to enable the revision of the rate peg assigned

Canberra Region Joint Organisation Council response to question 18

- See above

19. What types of costs which are outside councils' control should be included in the rate peg methodology?

LGNSW -As noted previously (Q.6), the ESL and RFS asset depreciations should be included. LGNSW also maintains that the ongoing decline in Financial Assistance Grants in real terms should be included.

Albury Council response to question 19:

Costs that are not in councils control and should be considered when setting the peg include:

1. Aging infrastructure assets and the associated asset management plans and requirements
2. The escalating depreciation expenses associated with increasing input costs for renewal and replacement of assets
3. Changing nature of the workforce, generational change and Pandemic impacts on operational capability
4. Climate adaptation (as a proactive measure)
5. Increasing natural disasters and
6. costs shifting from differing levels of government without compensating funding

There has been significant narrative in the sector on 'cost shifting' - the introduction of legislation or regulation to meet the government's social or environmental policy agenda, then imposing the delivery of those ideals through underfunded or unfunded regulatory services mandated for delivery by local councils. Those nett costs, or annualised change in nett costs, should feature in rate peg calculations.

While both governments bear the broader cost of response and recovery associated with natural disasters, the nett cost (to councils) of those, and other undeclared events that occur (storms, floods) that redirect resources and impede normal asset and service regimes, should also be considered in peg methodology or as a streamlined process for SRV.

Canberra Region Joint Organisation Council response to question 19

- There has been significant narrative in the sector on 'cost shifting' - the introduction of legislation or regulation to meet the government's social or environmental policy agenda, then imposing the delivery of those ideals through underfunded or unfunded regulatory services mandated for delivery by local councils. Those nett costs, or annualised change in nett costs, should feature in rate peg calculations
- While both Governments bear the broader cost of response and recovery associated with natural disasters, the nett cost (to councils) of those, and other undeclared events that occur (storms, floods) that redirect resources and impede normal asset and service regimes, should also be considered in peg methodology or as a streamlined process for SRV.

Simplifying the Rate Peg

20. How can we simplify the rate peg calculation and ensure it reflects, as far as possible, inflation and changes in costs of providing services?

TBA Where possible the LGCI should be future facing, as is the case with SV applications. Cost components in the LGCI that can be sourced from forward looking known variables, such as labour costs should be. In question 14 we agree that setting a long-term peg could be a solution, with nearly 40% of the LGCI attributable to labour costs and the Local Government (state) Award being set for 3 years it may be an achievable solution to link the two periods.
Closing the gap in the data used from historical sources needs to be a priority.

Albury Council response to question 20:

The process could be streamlined by not applying a rate peg. Alternatively, the 26 Local Government Cost Index categories established by IPART could be reduced, especially if there are less material categories that have not significantly varied from CPI over a period of time. It is noted there are at least nine of the categories that are directly attributable to Sydney ratepayers leading to a Sydney-centric calculation so the reduction of Sydney-centric categories could also be considered.

Ideally most taxation systems are premised on simplicity, transparency, ease of administration etc. As councils need to illustrate consideration of the various principles of revenue raising (capacity to pay, beneficiary, intergenerational, community service obligation), perhaps in converse, the rate peg methodology may delineate the metrics used against those principles.

Canberra Region Joint Organisation Council response to question 20

Ideally most taxation systems are remised on simplicity, transparency, ease of administration etc. As councils need to illustrate consideration of the various principles of revenue raising (capacity to pay, beneficiary, intergenerational, community service obligation), perhaps in converse, the rate peg methodology may delineate the metrics used against those principles,

RATE CAPPING IN NEW SOUTH WALES LOCAL GOVERNMENT: ADDRESSING THE QUESTIONS RAISED IN THE IPART (2022) *REVIEW OF RATE PEG METHODOLOGY: ISSUES PAPER* AND FURTHER RECOMMENDATIONS FOR IMPROVEMENT

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Disclaimer

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1. Introduction

Under section 9 of the *Independent Pricing and Regulatory Tribunal Act* 1992, the NSW Minister for Local Government Wendy Tuckerman asked the Independent Pricing and Regulatory Tribunal (IPART) to investigate and report on the current NSW rate peg methodology. In particular, the Minister for Local Government sought IPART to investigate and make recommendations on the following six matters:

1. 'Possible approaches to set the rate peg methodology to ensure it is reflective of inflation and costs of providing local government goods and services';
2. 'Possible approaches to stabilizing volatility in the rate peg, and options for better capturing more timely changes in both councils' costs and inflation movements';
3. 'Alternate data sources to measure changes in councils' costs';
4. 'Options for capturing external changes, outside of councils' control, which are reflected in councils' costs';
5. 'The effectiveness of the current LGCI approach'; and
6. 'Whether the population growth factor is achieving its intended purpose'.

In reviewing these matters, the Minister for Local Government required IPART to have regard for the following factors:

(a) 'The Government's commitment to protect ratepayers from excessive rate increases and to independently set a rate peg that is reflective of inflation and cost and enabling financial sustainability for councils.
(b) The differing needs and circumstances of councils and communities in metropolitan, regional and rural areas of the State.
(c) Ensuring the rate peg is simple to understand and administer'.

Following this request, IPART (2022) published its *Review of Rate Peg Methodology: Issues Paper* on 29 September 2022. In the *Issues Paper*, IPART (2022) identified twenty matters on which it sought input from both the NSW local government sector and the broader general public by 4 November 2022:

1. To what extent does the Local Government Cost Index reflect changes in councils' costs and inflation? Is there a better approach?
2. What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?
3. What alternate data sources could be used to measure the changes in council costs?
4. Last year we included a population factor in our rate peg methodology. Do you have any feedback on how it is operating? What improvements could be made?
5. How can the rate peg methodology best reflect improvements in productivity and the efficient delivery of services by councils?
6. What other external factors should the rate peg methodology make adjustments for? How should this be done?
7. Has the rate peg protected ratepayers from unnecessary rate increases?
8. Has the rate peg provided councils with sufficient income to deliver services to their communities?
9. How has the rate peg impacted the financial performance and sustainability of councils?
10. In what ways could the rate peg methodology better reflect how councils differ from each other?
11. What are the benefits of introducing different cost indexes for different council types?
12. Is volatility in the rate peg a problem? How could it be stabilised?
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15. Should the rate peg be released later in the year if this reduced the lag?
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17. Should external costs be reflected in the rate peg methodology and if so, how?
18. Are council-specific adjustments for external costs needed, and if so, how could this be achieved?
19. What types of costs which are outside councils' control should be included in the rate peg methodology?
20. How can we simplify the rate peg calculation and ensure it reflects, as far as possible, inflation and changes in costs of providing services?

The present Report was prepared in response to the IPART request for comment on its *Review of Rate Peg Methodology: Issues Paper.* By way of background, the Report presents existing international and Australian conceptual and empirical work on municipal property tax limitations, as well as the findings of a number of recent official inquiries and reports into rate-capping in NSW. Drawing on this material, the Report then addresses the twenty questions posed by IPART (2022) in its *Review of Rate Peg Methodology: Issues Paper.*

The Report consists of ten main parts:

- Section 2 briefly summarises the main arguments that have been employed in the debate over rate-pegging in NSW local government by way of institutional background.
- Section 3 provides a synoptic outline of the theoretical literature on property tax limitations, including rate-pegging.
- Section 4 offers a succinct account of the international empirical literature on property tax limitations.
- Section 5 summarizes the extant Australian empirical literature on rate-capping.
- Section 6 considers the findings of a number of recent official reports on the operation of rate-pegging on NSW local government.
- Section 7 briefly outlines the new IPART rate-pegging methodology.
- Section 8 describes the numerous problems with the IPART methodology.
- Section 9 addresses the twenty questions raised by IPART in its *Review of Rate Peg Methodology: Issues Paper.*
- Section 10 concludes the Report by offering two alternative generic recommendations for dealing with the manifold problems besetting the current NSW rate-pegging regime.

2. Genesis and Evolution of Rate Capping in NSW

Legally enforced constraints on increases in property taxes – colloquially known as 'rate capping' or 'rate pegging' in Australia – form part of a broader category of state government imposed limitations on the expenditure and taxation by local government, including property taxation (Dollery and Wijeweera, 2010). Under its longstanding rate capping regime, the NSW Government determines the maximum annual percentage amount by which a local council can increase its rates income for a given financial year. The rate peg does not apply to stormwater, waste collection, water and sewerage charges. Moreover, local authorities enjoy

discretion to determine how to allocate the stipulated rate peg rise between different categories of ratepayer in their respective local government areas.

A rate cap was first introduced in NSW local government in 1901 and it lasted until 1952 (Dollery, Crase and Johnson, 2006), when it was discontinued due to its 'impracticality' (NSW Local Government and Shires Association, 2008, p.16). The modern NSW rate-pegging regime began with the adoption of the 1977 *Local Government (Rating) Further Amendment Bill*, which was subsequently amended to its contemporary form in 1978. The initial motivation for the imposition of the rate peg legislation derived from the period of high inflation in the 1970s. For example, over the period 1973 to 1976, property taxes rose by an average of 188 per cent, while average weekly earnings over the same period increased by only 75 per cent, with the inflation rate at 56 per cent (Johnson, 2001, p.5).

Rate pegging has been controversial in NSW since its inception and it has generated considerable debate (Johnson, 2001). IPART (2008, p.55) has summarised four major arguments that have been proposed in support of the NSW rate-capping regime. Firstly, it has been claimed that municipal revenue regulation through rate pegging prevents the exploitation of monopoly power by local authorities in the provision of local services. Secondly, advocates of rate pegging have argued that it assists in preventing 'cross-subsidisation' and imposes restrictions on the 'provision of non-core services and infrastructure that might prove unsustainable to ratepayers'. Thirdly, proponents contend that rate capping manages governance risk in the local government sector by constraining council income and thereby limiting council expenditure. Finally, it has been argued that rate pegging reduces the ability of local councils to divert funds from essential infrastructure to other projects as well as expenditure on 'marginal services' that are better provided by the private sector or the voluntary sector.

Opponents of rate pegging have contested all of these arguments (Dollery and Wijeweera, 2010). For instance, the claim that rate capping restrains monopoly power and thus increases the supply of municipal services is problematic since rate pegging curtails municipal output by restricting funding. Moreover, the rate peg does not apply to several sources of municipal income, such as water and sewage charges, where monopoly power could also be exploited. Along analogous lines, it is difficult to see how rate capping will dampen cross-subsidisation, given that municipal fees and charges are likely to rise to counteract the negative impact of

rate pegging on municipal revenue. Furthermore, rate pegging has not constrained the provision of 'non-core' local services.

In this regard, Dollery, Wallis and Allan (2006) have demonstrated that an ongoing shift in all Australian state and territory local government systems away from a traditional emphasis on 'services to property' towards 'services to people' has occurred, including in NSW local government. This finding also undermines the claim that rate pegging limits the ability of councils to divert funds from essential infrastructure to other projects as well as the argument that expenditure on local services is better delivered by the private sector and the voluntary sector.

IPART (2008, p.55) has also identified four main arguments against rate capping in the NSW debate. Firstly, it has been claimed that rate pegging constrains the ability of local authorities to provide local services by limiting their financial capacity. Secondly, opponents of rate capping have argued that it has generated a sizeable infrastructure backlog in NSW local government. Thirdly, it is claimed that rate pegging has obliged local councils to impose higher user pays charges to compensate for their loss of revenue from limitations on rate increases. Finally, foes of rate capping have claimed more broadly that the imposition of rate pegging is an attack on local autonomy and the accountability of local government.

Some of these arguments are convincing (Dollery and Wijeweera, 2010). For example, rate pegging clearly constrains the capacity of local councils to provide local services. If the net effect of rate pegging has been to constrain aggregate municipal income, then it must have limited local service provision to some degree. Similarly, the argument that rate capping has stimulated an increase in fees and charges is especially convincing. Indeed, the NSW Treasury (2008, p.14) has itself noted that 'constraints on general revenue distort revenue raising sources and result in higher user charges'.

However, the claim that rate pegging has spawned a local infrastructure backlog is less convincing because it seems that the problem is endemic to the entire country. In its National Financial Sustainability Study of Local Government, PriceWaterhouseCoopers (2006) established that not only was a large number of local councils in all Australian local government jurisdictions financially unsustainable in the long run, but that most local authorities faced a massive local infrastructure backlog, regardless of the rate setting regime in their state. Since this problem is endemic to all Australian jurisdictions and it does not

seem to be more acute in NSW, the NSW local infrastructure backlog cannot thus be solely ascribed to rate pegging.

In addition to these arguments against rate capping in NSW local government, the Local Government and Shires Associations of NSW (2008) proposed a more general argument against rate capping embedded in broader political terms. It claimed that rate pegging has a wider unintended 'dampening' effect on rates than simply the pegged limit. Along these lines, the Association (2008, p.14) contended that 'one likely explanation for the dampening effect is that rate pegging provides a public framework and creates public expectations about maximum rate increases, placing political pressure on councils to stay within the limit and not seek special variations'.

A second element of this argument is that rate capping provides an avenue for local councils to engage in politically expedient 'blame shifting' onto the NSW state government. This phenomenon has also be described as 'learned helplessness' by Drew (2021). The Association (2008, p.15) argued that rate capping 'provides an easy default option from both a political and managerial perspective' since (a) all rate increases can be attributed to the state government; (b) the need for community consultation to justify rate increases is weakened; (c) adhering to the rate peg limit avoids the problems contingent on Special Rate Variation applications; (d) 'councils can blame the state government for their financial deficiencies'; and (e) the existence of rate capping enables councils to avoid long-term planning. The net result of these factors has been the 'under-provision of community infrastructure and services', the emergence of a local infrastructure backlog and an 'undermining' of both the financial sustainability of councils and democratic accountability at the local level.

3. Conceptual Foundations of Rate Capping

A voluminous theoretical and empirical literature has examined central and state government limitations imposed on municipal expenditure and revenue-raising activities, including property taxation or rating (see, for instance, Florestano, 1981; Temple, 1996; Mullins and Wallin, 2004; Anderson, 2006; McCubbins and Moule, 2010). Although the majority of this scholarly effort has focused on American local government, where state-imposed constraints on local fees, charges and taxes are common (Figlio and O'Sullivan, 2001), researchers have also studied other local government systems, including European local government systems (Boadway and Shah, 2009; Blom-Hansen *et al.,* 2014) and Australian state and territory local

government systems (Dollery and Wijeweera, 2010; Drew and Dollery, 2015; Dollery and McQuestin, 2017; Yarram, Tran and Dollery, 2021).

The economic foundations for rate pegging derive from the normative prescriptions of standard neoclassical economic theory: local government enjoys a monopoly in essential local service provision. Consequently, in line with other monopoly suppliers, local government will offer these local services at excessive prices and/or in an inefficient manner. This provides the justification for regulation by higher tiers of government to ensure efficient and equitable outcomes (Bailey, 1999). However, in accordance with economic theory, regulation must be judiciously employed since badly designed and implemented regulation can generate worse outcomes than an absence of any regulation (Hillman, 2005).

To maximise economic efficiency, optimal regulation should seek to achieve (a) allocative efficiency, whereby the composition of local services delivered must correspond with local community preferences, and (b) productive efficiency, where local services must be produced at the lowest possible cost. In addition, optimal regulation should attempt to ensure that equity objectives are achieved. For example, essential local services should be delivered to low income households by local authorities at reasonable prices.

It should be stressed that the effective application of regulation is notoriously difficult in all spheres of economic activity, including in local government systems (Bos, 1994). Moreover, regulation is further complicated in local government since local councils enjoy the legal authority to tax, which is a monopoly power lacking in both the private sector and in most public utilities. In addition, in local municipal revenue regulation through rate pegging, regulatory agencies face additional problems since they cannot regulate the specific prices of particular local services but rather must regulate the 'tax-price' of a whole genre of municipal goods and services that are mostly unpriced.

In the theoretical literature, two conceptual models have attempted to explain property tax limitations, such as rate capping (Drew and Dollery, 2015). In the first place, agency theory (Jensen and Meckling, 1976) holds that local citizens (as principals) fear that 'agency failure' by local councils (as agents) can induce excessive local government outlays. Accordingly, local residents thus seek state government intervention through rate pegging to limit excessive expenditure by local authorities.

Municipal councillors are typically elected every four years in NSW local government and local residents can remove elected representatives who do not embody their best interests.

However, the effectiveness of local elections for minimising 'agency failure' is limited in at least three ways: (a) high information costs mean that local citizens are often ignorant of excessive and/or unwarranted municipal expenditure (hence the suggestion by Drew (2021) for compulsory short financial sustainability statements to be posted to voters prior to elections); (b) the long period between elections allows extensive 'agency failure' to develop; and (c) Cutler *et al.* (1999, p. 320) have argued that 'candidates come as bundles, so that incumbents might be able to spend more and maintain their position if they satisfy people's views along other dimensions'. Dollery *et al.* (2006) have gathered these arguments to develop a public choice approach to rate pegging based on voter scepticism over their ability to exercise control of municipal outlays, which gives rise to a desire for state government intervention.

Secondly, personal finance theory (Cutler *et al.,* 1999) holds that local citizens evaluate the value of the local services they receive from their local authorities relative to their municipal tax burden. Thus, the higher the perceived rate of property tax, the more likely it is that a local resident will support rate pegging. Furthermore, significant rises in property taxes predispose local citizens to support property tax limitations. This argument is especially relevant in NSW local government since municipal rates are highly visible as a result of regular rate bills being sent on a quarterly basis to local residents by local councils (Drew and Dollery, 2015).

4. International Empirical Evidence on Property Tax Limitations

Notwithstanding the substantial empirical literature on the impact of revenue and expenditure limitations on local government, a degree of uncertainty exists over their likely consequences (Dollery and McQuestin, 2017). However, extant empirical evidence has shown that important unanticipated and unintended effects frequently occur (Skidmore, 1999; Mullins and Wallin, 2004). For instance, Temple (1996) demonstrated that rate pegging reduced outlays on local services more than on local administration.

From an Australian local government perspective, the international empirical literature has illuminated two relevant aspects of rate pegging (Dollery and McQuestin, 2010; Yarram, Tran and Dollery, 2021). Firstly, limitations on property tax increases can encourage local authorities to raise income from revenue sources other than property taxes. For instance, in his study of 29 American states, Shadbegian (1999) demonstrated that many local governments substituted foregone property tax income with monies raised under

'miscellaneous revenue'. Along analogous lines, Skidmore (1999) found similar outcomes for 49 American states. In a more recent study, Kousser *et al.* (2008) demonstrated that most US state local government systems increased fees and charges following the application of property tax limitations. Moreover, Mullins and Joyce (1996) examined 48 American states over the period 1970 to 1990 and established that while property tax limitations constrained local taxes, this foregone revenue was replaced by increases in fees and charges. In their study of 1,400 American local governments, Preston and Ichniowski (1991) showed that property tax limitations decreased tax revenue but boosted 'other revenue'.

Secondly, international empirical evidence has demonstrated that property tax limitations do not have a uniform impact across all local councils in a given local government system. By contrast, the impact of rate pegging hinges largely on the characteristics of local authorities. For instance, Brown (2000) showed that in the Colorado local government system the effects of property tax limitations depended on council size by population, with their impact more pronounced in small local authorities. In an analogous study, Mullins (2004) demonstrated that property tax limitations were more potent in poor local authorities.

5. Australian Empirical Evidence on Rate Capping

To date, five scholarly studies have examined the impact of rate pegging in Australian local government. Firstly, Dollery and Wijeweera (2010) investigated rate capping in NSW local government, the conceptual basis for rate capping and the controversy over its desirability, as well as its economic impact on NSW local government financial sustainability compared to other Australian local government systems. Dollery and Wijeweera (2010, p.74) drew two major conclusions from their empirical analysis. Firstly, 'rate-pegging has achieved its basic objective of slowing increases in NSW council rates over time relative to other Australian jurisdictions'. Secondly, 'rate-pegging has enjoyed ongoing and strong public support' that suggests 'the operation of an efficient "political market" in NSW' (Dollery, Crase and Byrnes 2006, p. 397).

Secondly, Drew and Dollery (2015) examined NSW local government with its rate peg compared with (then) uncapped Victorian local government to determine the probable impact of rate capping on Victorian local government. Three dimensions of municipal performance were considered. First, Drew and Dollery (2015) evaluated inter-municipal revenue effort equity by assessing residential tax effort. Residential tax effort measures the proportion of residential rates paid with respect to the total annual incomes accruing to local residents in a

given local government area. Drew and Dollery (2015) found that rate pegging in NSW had significantly *decreased* inter-municipal equity, possibly due to the compounding impact of a rate-cap where initial residential tax effort differed between local councils.

Second, Drew and Dollery (2015) considered the effects of rate capping on financial sustainability by considering local government liabilities per household for NSW and Victorian councils over the period 2009 to 2013. They found that NSW had much greater levels of council debt per household. They also considered the average infrastructure renewal ratio in NSW and Victoria as a measure of the infrastructure backlog and found that NSW had a much larger local infrastructure backlog.

Finally, Drew and Dollery (2015) investigated the claim that rate pegging forced local councils to become more efficient. Using data envelopment analysis (DEA) to study the relationship between inputs and outputs, Drew and Dollery (2015, p. 145) found empirical evidence indicating a 'slightly higher average municipal efficiency for Victorian councils' – a finding starkly at odds with the claims of rate cap proponents.

In a third study, following the approach used by Drew and Dollery (2015), Dollery and McQuestin (2017) empirically investigated the likely impact of the imposition of a rate cap in South Australian (SA) local government by comparing the performance of SA local government with its NSW counterpart using three separate performance indicators (revenue effort, financial sustainability and operational efficiency) for the period 2013 to 2016. Dollery and McQuestin (2017, p.84) found that for revenue effort 'the results from our stratified sample show that rate-capping in NSW has not served to reduce inter-municipal revenue effort inequities'. Furthermore, rate capping is thus 'most unlikely to minimise these inequities in SA local government'. Secondly, they established that the 'claims made by advocates of rate-pegging that it improves financial sustainability are rebutted by our findings'. Employing council debt per capita as a proxy for financial sustainability, Dollery and McQuestin (2017) showed that 'NSW local authorities have much higher debt than their SA counterparts despite the four decade long rate-pegging regime in NSW'. Dollery and McQuestin (2017, p.84) found that the operational efficiency of local councils did not increase under rate capping. Using council expenditure per capita as a measure of the operational efficiency of local authorities, Dollery and McQuestin (2017, p.84) showed that 'rate-pegging does not increase the efficiency of local councils: for each year in our sample, the efficiency of NSW councils falls well below SA councils'.

Dollery and McQuestin (2017, p.84) determined that 'on all three dimensions of local government examined in our empirical analysis, we find SA councils performance better than NSW local government notwithstanding the latter's longstanding rate-pegging policy'. Moreover, relative to NSW, 'SA municipalities exhibit superior performance'. Given these findings, Dollery and McQuestin (2017, p.84) argued that 'the empirical evidence presented in the paper demonstrates that rate-pegging should not be imposed on SA local government and instead other more promising policies [should be] considered'.

In the fourth study, Yarram, Tran and Dollery (2021) employed expenditure data covering the period 2014/15 to 2017/18 to empirically investigate the short-term effects of rate capping on municipal expenditure in the Victorian local government system to determine whether it had differential effects on expenditure by different categories of local council. Yarram, Tran and Dollery (2021, p.11) determined that 'it is clear that the impact of rate capping varies between urban and rural councils'. Moreover, 'rural councils that generally rely more on assessment rates are unsurprisingly unable to incur higher expenditure following a rate-capping'. This contrasts sharply with urban councils 'that are able to increase total expenditure, perhaps through other sources of funding'. Moreover, with respect to the impact of rate capping on different kinds of municipal expenditure, Yarram, Tran and Dollery (2021, p.11) found that 'rate-capping reduces outlays, especially on aged and disabled services, in both rural and urban councils'. Furthermore, they found that 'there is a reduction in expenditure on family and community services in urban councils'.

Yarram, Tran and Dollery (2021, p.17) concluded their study by considering it in the context of the earlier empirical studies on the impact of rate capping on Australian local government. They noted that 'the findings of this study are broadly consistent with previous results of Drew and Dollery (2015) who found that rate-capping in NSW made its local councils more constrained compared to councils in Victoria before the rate-capping'. They noted further that 'our findings are also consistent with Dollery and McQuestin (2017) who established that NSW councils under a rate-capping regime suffered in terms of unsustainable financing and lower operational efficiency compared to councils in SA, which did not have any rate limitations'.

In terms of the international empirical literature on the impact of property tax limitations, Yarram, Tran and Dollery (2021, p.17) noted that 'the findings of this study are also consistent with the findings of Skidmore (1999) and Kousser *et al.* (2008), who established

that limitations on tax and expenditure at the state level are often frustrated by increased user charges'.

Finally, Nahum (2021) considered the impact of the imposition of a rate cap on Victorian local government. Nahum (2021, p.5) argued that 'far from "protecting" ratepayers (that is, residents), rate caps hurt them, in several different ways', including 'compromised service delivery', lower employment levels and/or lower employee wages amongst those local residents employed in local government, higher fees and charges by local councils and 'lower expenditures flowing back into the private sector'.

Nahum (2021) examined the empirical magnitude of some of these negative effects. He found that rate capping reduced aggregate Victorian employment by 7,425 jobs in the 2021/22 financial year. This comprised both local government jobs *per se* and indirect private sector positions. Moreover, rate pegging also reduced state gross income by $890 million in 2021/22. Nahum (2021, p.5) concluded that 'the costs of suppressed local government revenues, and corresponding austerity in the delivery of local government services, will continue to grow with each passing year if the policy is maintained'.

6. New South Wales Official Reports on Rate Pegging

Numerous official inquiries and reports have considered the impact of rate capping on local government in Australia. Given that NSW local government has had a rate cap continuously since 1977, unsurprisingly most of these official documents have focussed on rate capping in NSW local government. In section 6, we briefly consider recent important official reports and their findings on rate capping in NSW.

In May 2006, the Independent Inquiry into the Financial Sustainability of NSW Local Government published its *Are Councils Sustainable? Final Report: Findings and Recommendations* (sometimes known as the Allan Report) that was prepared for the (then) Local Government and Shires Associations of NSW (LGSA). The Allan Report (2006, p.29) adopted Recommendation 21: Rate Pegging which held that 'the State Government free councils to determine their own income by removing statutory limitations on their rates (i.e. rate-pegging) and certain fees (e.g. development application processing fees) in return for councils adopting longer term strategic and financial planning with outcome targets'. The Allan Report (2006, p.29) argued that rate deregulation of this kind would 'bring NSW into line with all other states and territories' and make each local authority 'answerable to its local constituency rather than the state for its taxation policy'.

In support of Recommendation 21, the Allan Report (2006, p.202) argued that 'a sound local government rating system should ideally exhibit four traits; it should be financially adequate, administratively simple, vertically and horizontally equitable and economically efficient'. However, the Allan Report (2006, p.2007) argued that in NSW local government 'rate-pegging had been a major constraint on councils' revenue raising capacity causing it to fall behind other states, notwithstanding NSW's relatively strong property market'. Consequently, in NSW the rating system did not deliver a financially adequate stream of income and hence numerous NSW local authorities could not sustainably finance service provision as well as local infrastructure maintenance and renewal.

In 2015, the NSW Government charged the Independent Pricing and Regulation Tribunal (IPART) with critically examining the municipal rating system in NSW and offering recommendations on how to improve the equity and efficiency of the rating system in order enhance the financial sustainability of NSW local government in the long-run. IPART examined the valuation method used to calculate rates in NSW, exemptions and rating categories, the impact of population growth on council revenue, the distribution of rates across different ratepayers, as well as rate exemptions and concessions. IPART made various recommendations that sought to maintain average rates paid by current ratepayers, but make rate revenue collection more efficient and equitable.

In its 2016 *IPART Review of the Local Government Rating System: Final Report,* IPART offered various recommendations for improving the NSW local government rating system. These recommendations targeted six main aspects of the rating system. Firstly, IPART called for the adoption of the Capital Improved Value (CIV) valuation method to levy local council rates. Secondly, IPART recommended that the rate cap calculation methodology be modified to include population as part of its formula. Thirdly, IPART proposed that local authorities should be accorded greater flexibility in rate setting in their residential areas. Fourthly, IPART argued that rate exemption eligibility should be revised and based on land use rather than land ownership. Fifthly, IPART called for greater rate relief assistance for pensioners. Finally, IPART recommended that local councils enjoy a greater range of options with regard to setting rates within rating categories. These recommendations were designed to mesh with the existing *Local Government Act 1993 (NSW).* Indeed, IPART specified in detail how changes to the Act should be framed to embody its recommendations.

In November 2020, the NSW Productivity Commission published its *Review of Infrastructure Contributions in New South Wales: Final Report.* The NSW Productivity Commission (2020, p.39) argued that in NSW 'local government is constrained in its ability to service growing communities due to the long-standing practice of rate-pegging', especially since the rate capping formula 'does not allow councils to increase their rates revenue with population'. A consequence of this constraint has been 'declining per capita revenue for high growth councils' that has acted as a 'disincentive for councils to accept development'. The NSW Productivity Commission (2020, p.39) argued that reform of the rate cap methodology was required to allow for the inclusion of population growth. It argued that rate cap reform along these lines would increase aggregate council revenue by $18.5 billion over 20 years. This additional revenue could be employed to 'fund local operating and maintenance costs of providing services to a growing population', as well as 'service debt to forward fund infrastructure', thereby enabling local authorities 'to better coordinate infrastructure with development'. It thus recommended that subject to review by IPART, the NSW Government should 'reform the local government rate peg to allow councils' general income to increase with population'.

In December 2020, the NSW Productivity Commission released its *Final Report: Evaluation of Infrastructure Contributions Reform in New South Wales* prepared by the Centre for International Economics. The *Final Report: Evaluation of Infrastructure Contributions Reform in New South Wales* (2020, p.2) held that there should be 'reform of the local government rate peg to enable rates revenue to grow in line with population, removing the existing financial disincentive councils face with respect to growth'. The resultant growth in rates revenue would 'enable councils to recoup the operating and maintenance costs associated with providing services to a larger population'. Moreover, 'extra revenue can help service debt to forward fund infrastructure, improving the coordination of service delivery with development'.

The *Final Report: Evaluation of Infrastructure Contributions Reform in New South Wales* (2020, p.3) further argued that if this was done, then 'we estimate that rates revenue would be around $925 million per year higher'. This additional income could fund 'the operating and maintenance costs of a growing population, to increase borrowing capacity and help finance debt'.

The *Final Report: Evaluation of Infrastructure Contributions Reform in New South Wales* (2020, p.51) argued that the impact of rate capping on NSW local government had been deleterious, particularly on local authorities with high population growth rates. This sub-category of council had experienced 'slower growth in revenue per capita', 'slower growth in expenses per capita' and 'less improvement in their net operating balance'.

Flowing from the earlier reports by IPART and the NSW Productivity Commission, the NSW Government asked IPART to investigate methods of improving the NSW rate cap regime, including explicit incorporation of population growth. On 25 March 2021, IPART released *Issues Paper - Review of the rate peg to include population growth,* followed by its *Draft Report - IPART Review of the rate peg to include population growth* on 29 June 2021 and its *Final Report - Review of the rate peg to include population growth* on 5 October. In these reports, IPART developed a new methodology to enable local councils to maintain per capita general income over time as their local populations grew. This was done on the assumption that maintaining per capita general income would assist local councils to maintain existing service levels, as well as provide those local services their growing local communities required.

On 9 October 2021, (then) Minister for Local Government Shelley Hancock announced that the NSW Government had accepted IPART's recommended rate peg methodology that incorporated population growth. She argued that the new methodology would generate at least $250 million in additional municipal revenue (Hancock, 2021). The new rate peg calculation methodology would operate from July 2022 onwards.

7. IPART Rate Peg Methodology

In its *Review of the Rate Peg to include Population Growth: Final Report,* IPART (2021) outlined its new methodology and then applied it to each NSW local council for the 2022/23 financial year to determine the rate cap for each council. The new formula included a population factor that varied for each local council depending on its rate of population growth (IPART, 2021):

$$Rate\ peg = change\ in\ LGCI - productivity\ factor + other\ adjustments + population\ factor$$

The new formula employs four independent variables as the basis for calculating the annual rate cap for each council:

(a) *Change in LGCI* comprises the annual change in the Local Government Cost Index (LGCI). The LGCI measures price changes over a given year for goods, materials and labour employed by an 'average council'. In particular, the LGCI computes the average change in prices of a fixed 'basket' of goods and services used by councils relative to the prices of the same basket in a base period. The LGCI has 26 cost components, containing *inter alia* employee benefits and on-costs, as well as building materials for bridges, footpaths and roads. These cost components embody the purchases made by an average council to pursue its 'typical activities'. IPART employs ABS price indexes for wage costs, producer prices and consumer prices. In calculating these price indexes, the ABS includes quality adjustments in its price measures to accommodate increases in capital and labour productivity.

(b) Productivity factor is included in the formula since productivity increases offset changes in the LGCI. For example, if labour productivity rises, then this will decrease the net price of labour by the extent of the productivity increase. However, as we have seen, since the ABS price index data has already been adjusted for productivity, in practice IPART sets the productivity factor at zero in the formula.

(c) *Other adjustments* is included in the formula to make provision any additional payments or transfers to local government that may have occurred. For instance, in its 2022/23 rate peg calculations IPART (2021, p.2) included a downward adjustment of 0.2% to remove the additional revenue that was included in the 2021-22 rate peg to meet the costs of the 2021 local government elections.

(d) *Population factor* is calculated for each local council. The population factor is equal to the annual change in residential population adjusted for revenue derived from supplementary valuations. In particular, the population factor equals the maximum change in the residential population less the supplementary valuations percentage or zero. Local authorities with negative population growth receive a population factor of zero. This means that no local council accrues a smaller increase in general income, relative to a rate peg calculated using the LGCI, a productivity factor and any adjustments. Those local councils that accrued more from supplementary valuations than required to maintain per capita general income as their population grows will also have a population factor of zero. The population factor is computed employing the following formula: $Population\ factor = max(0, change\ in\ population - supplementary\ valuations\ percentage)$

The change in population is calculated using the *Estimated* Residential Population (ERP; emphasis added) published by the ABS.

IPART calculated the rate peg for the financial year 2022/23 using the new formula embodying LGCI change, a population factor and an adjustment to remove the costs of the 2021 local government elections that were included in the 2021-22 rate peg. This generated a 2022/23 rate peg for each NSW local authority at between 0.7% and 5.0%, contingent on its population factor. The population factor ranged between 0% and 4.3% (IPART, 2021, p.1).

8. Problems with the IPART Rate Peg Methodology

In addition to the myriad of conceptual and empirical problems with property tax limitations, such as the NSW rate capping regime, identified in the scholarly literature that we considered in sections 2, 3, 4 and 5 of this Report, several analysts have found significant flaws in the new IPART rate peg methodology with its population factor approach. In particular, while acknowledging that the introduction of different rate caps for different local councils represented a significant improvement in NSW rate pegging, Drew (2021; 2022) recognized three major problems with the new IPART rate cap formula.

Firstly, the use of population size in the IPART rate peg methodology is highly problematic for at least three reasons (Drew (2021; 2022). Firstly, given the composition and range of services provided by NSW local councils, which concentrate on 'services to property' rather than 'services to people' (Dollery, Wallis and Allan, 2006), the number of rateable assessments in a given local government area is a much more accurate proxy variable for municipal size than absolute population size (Drew and Dollery, 2014). Secondly, it is universally recognized that population estimates of intercensal years contain significant errors, ranging from 2.4% in large councils to 15.6% in small local authorities (Drew, 2022). Thirdly, given the potential magnitudes involved, annual population changes can generate significant changes in rates under the IPART methodology, which can be highly destabilising to municipal financial planning. It follows that *if*[1] we incorporate a population factor into the rate cap, then it is best to employ a five-year moving average to reduce volatility and partially mitigate the large intercensal errors (give that censes only take place every five years).

Secondly, the LGCI is plagued by a number of problems that render it entirely inappropriate as a reliable index of municipal costs. Drew (2022) has identified six main problems with the

[1] As we will show, there are much more appropriate ways of compensating councils for growth rather than by using a population number known to be both inaccurate and irrelevant.

LGCI. Firstly, the LGCI contains too few items and thus cannot accurately represent the typical 'basket of goods and services' purchased by NSW local councils. Secondly, given the fact that the composition of municipal input consumption changes over time, the weightings embodied in the LGCI should be calculated as a three-year moving average rather than a fixed ratio recalculated every four years (IPART, 2021). The current approach of altering the weightings is too infrequent and accordingly exacerbates volatility. Thirdly, given that the LGCI data employed to calculate rate caps in the forthcoming financial year reflects the previous annual price data, it is 'rearward facing'. This is particularly problematic when cost inflation occurs, as it is at present with all the various supply shocks escalating prices. Fourthly, the LGCI represents a composite of cost indexes derived from different tiers of government - as IPART (2021) itself has conceded - rather than a cost index of NSW local government *per se.* Fifth, the LGCI has no regional weightings for NSW local government despite significant regional cost disparities across NSW (arising from the very disparate municipal service profile between various regions). Finally, the LGCI ignores the operating environment in which local authorities operate, even though this represents a major cost factor for local councils.

Finally, the IPART methodology for annual rate cap determination places two important categories of NSW local council at greater financial risk: rural local authorities and retirement community councils. For example, many rural councils have experienced ongoing population declines, together with an ageing population profile. This not only diminishes their rateable base, but also generates a higher proportion of pensioner rate rebates, which are not fully funded by NSW government grants (Dollery, Johnson and Byrnes, 2008). Similarly, for local councils with growing populations substantially comprised largely of retirees, like Port Stephens Council, a high proportion of older residents typically impose substantial additional service demands on local councils. A rate cap calculation formula that does not recognise the differential demands on different kinds of local council will thus place more councils at risk.

9. Twenty Questions in the IPART *Review of Rate Peg Methodology: Issues Paper*

Before embarking on the journey of answering IPART's twenty questions, it is apposite that we first pose a question of our own:

What is the goal of the NSW Rate Cap regime?

Until IPART and the NSW Government are able to clearly articulate the basic aim of their rate cap regime, it is hard to believe that they will ever experience any success in achieving its unstipulated aim.

Official documentation implies various objectives, including: (a) reduced rates, (b) maintain financial sustainability, (c) simplicity and (d) accuracy. However, most of these implied goals contradict with one another. For instance, it is difficult to see how reducing rates might be expected to result in financial sustainability (without additional measures being implemented). In similar vein, it is clear that a myopic pursuit of simplicity must result in concomitant loss of accuracy (and hence also financial sustainability).

Thus, the most important question that ought to have been posed at the outset has been sadly eschewed and this will likely prove to be the Achilles heal of any review of the rate cap.

1. To what extent does the Local Government Cost Index reflect changes in councils' costs and inflation? Is there a better approach?

As we have seen in section 8 of this Report, the Local Government Cost Index (LGCI) is highly problematic and it is entirely inappropriate as a reliable index of municipal costs in NSW local government. Drew (2022) pinpointed six major deficiencies the IPART LGCI. In the first place, the LGCI comprises too few items and thus does not accurately depict the typical 'basket of goods and services' purchased by NSW local councils. Secondly, given the fact that the composition of municipal input purchases evolves through time, the weightings embodied in the LGCI should be calculated as a three-year moving average rather than a fixed ratio recalculated every four years (IPART, 2021). The present method of changing the weightings is too infrequent and thereby exacerbates the volatility of the LGCI. Thirdly, since the LGCI data employed to calculate rate caps in the forthcoming financial year reflects the previous annual price data, it is 'rearward facing'. This is particularly problematical when cost inflation arises, as it presently has, with various supply shocks escalating prices. Fourthly, the LGCI represents a composite of cost indexes derived from different tiers of government - as IPART (2021) itself has conceded - rather than a cost index of NSW local government *per se.* Fifth, the LGCI has no regional weightings for NSW local government despite significant regional cost disparities across NSW. Finally, the LGCI disregards the operating environment in which local authorities operate, even though this represents a major cost factor for local councils. In other words, the local government taxes in each council area are the price for quite disparate baskets of goods and services: it thus follows that changes to

these prices should vary in response to the different goods and services that make up the particular baskets.

A much better approach can easily be identified. As we have seen, the current LGCI employed by IPART is awash with problems that render it unsuitable as a basis for determining cost increases in operation of NSW local government. Given the spatial variation in municipal costs and municipal resource use across NSW, especially between metropolitan councils and their regional, rural and remote counterparts, Drew (2021) has argued that different cost indexes should be employed for – at a minimum – the four main categories of council (i.e. metropolitan, regional, rural and remote councils). The construction of these indexes should include the use of three-year moving averages of the mix and weighting of the basket of items in the index, a price increase projection for the forthcoming financial year and consideration of the operating environment of the four different categories of council. In particular, the environmental cost factor could be calculated in a precise manner by using econometric techniques on a three-year panel of socio-demographic data along with publicly available financial information. Moreover, using moving averages as suggested would considerably reduce volatility and thereby partially mitigate the problem whereby some local councils find it difficult to predict future rate caps for budgeting purposes.

It is also important to take into account the macro-economic challenges and trends that might face councils in the forthcoming financial year in determining the final rate cap. Put differently, the rate cap cannot entirely comprise an empirical exercise, since judgement must be exercised on future inflationary pressures.

2. What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?

As we have noted under question 1 above, much better approach exists. Given the geographical variation in municipal costs and municipal resource employment across NSW, particularly between metropolitan councils and their regional, rural and remote counterparts, Drew (2021) contended that different cost indexes should be employed for metropolitan, regional, rural and remote councils. These indexes should be constructed on the basis of three-year moving averages of the mix and weighting of the basket of items in the index, a price increase projection for the forthcoming financial year and an assessment of the operating environment of the four different types of council. Moreover, the environmental cost factor could be computed with precision by using econometric techniques and a three-

year panel of socio-demographic data together with publicly available financial information. Furthermore, employing moving averages would substantially reduce volatility and thereby partially mitigate the problem whereby some local councils find it difficult to predict future rate caps for budgeting purposes.

Moreover, if we are truly interested in accuracy then a number of changes to extant practice must follow. First, the rate cap needs to be issued far more precisely – to at least three decimal places – which would be reasonable given that it is multiplied through to millions of dollars of revenue[2]. It is simply not acceptable to have material and avoidable rounding errors given that much more precise figures could easily be generated from index numbers and the like. Second, we need to use far more inputs to mitigate extant extreme synecdoche. We also need to use more precise inputs, rather than relying on known inaccurate proxies (such as wage price indexes[3], CPI, or population estimates that we can be certain do not reflect actual costs). Third, this considerably expanded basket of goods and services purchased by local councils need to be re-priced at least annually and at a time more proximate to the use of the LGCI.

In addition, as we noted under question 1 above, it critical to consider the main macro-economic trends that might face local authorities in the forthcoming financial year in determining the final rate cap. In essence, the rate cap cannot entirely consist of an empirical exercise; judgement must be exercised on future inflationary pressures.

3. What alternate data sources could be used to measure the changes in council costs?

There is a wide range of actual and accurate data that ought to be used in place of the proxies that are currently heavily relied upon. This includes: (i) actual wage increase data for local government employees, (ii) actual auditing costs, (iii) actual audit committee costs, (iv) number of assessment data (that is both more closely related to the cost of local government provision and also far more accurate and timely), (iv) actual remuneration rulings for councillors, (v) the actual costs for hundreds of major items used by local governments on a regular basis, (vi) precise operating environment factors generated econometrically, (vi)

[2] Moreover, it would seem a relatively straight-forward matter to ensure that any rounding error in a given year was mitigated in the next year.

[3] The use of the WPI is particularly perplexing given both the ease of using actual local government wage cost data and the size of this component (about a third of most NSW local council costs).

revaluation adjustment data[4], (vii) precise costs for holding elections and (viii) precise compliance costs.

4. Last year we included a population factor in our rate peg methodology. Do you have any feedback on how it is operating? What improvements could be made?

As we demonstrated in section 8 of this Report, the adoption of population size in the IPART rate peg methodology is highly problematical for three main reasons. In the first place, if we consider the mix of municipal services provided by NSW local authorities, which comprise mainly 'services to property' rather than 'services to people', the number of rateable assessments in a given local government area represents a much more accurate proxy variable for local government size than absolute population size, as demonstrated by Drew and Dollery (2014). Secondly, it is widely agreed that population estimates of intercensal years typically contain substantial errors, ranging from 2.4% in large councils to 15.6% in small local councils (Drew, 2022). Moreover, the ABS population data is often lagged by one or two years. Thus it is known to be inaccurate and irrelevant at the time of its use in the construction of the rate cap. Third, given the population magnitudes involved, annual population changes can produce significant changes in rates under the IPART methodology, which can be highly destabilising to local government financial planning. As we showed in section 8 of this Report, if we incorporate a population factor into the rate cap, then we should use a five-year moving average to reduce rate income volatility and partially alleviate the large intercensal errors (given that censes only take place every five years).

The simplest and most effective way to compensate councils for growth in the local government area – consistent with one of the stated goals of the rate cap (to reduce pressure on the tax liability for the average ratepayer) – is to apply the cap to the average rate for each of the categories. As we have already described in previous submissions, this automatically adjusts for growth in a way that uses reliable and timely data (number of assessments[5]). It also has the benefit of discouraging the use of minimum and base rates that are clearly contrary to another purported goal of the rate cap (distributive justice (Drew (2021)).

[4] The aggressive revaluation of assets by the Auditor-General is significantly affecting the income statements of Councils – if we want local governments to aspire to balanced budgets then these costs ought to be recognised (because it can't be reliably assumed that previous rate caps recognised the costs of these long-lived assets in earlier periods of cost-allocation).

[5] Notably organic growth (for instance births in an existing household) exert very limited cost pressures on councils compared to the subdivision of properties and establishment of new developments. Thus, responding to new assessments is likely to be much more important than responding to additional people.

However, the fact remains that a factor for growth disadvantages most rural and remote communities in a relative sense. These rural and remote councils are the most financially unsustainable category of local governments in NSW. Thus, a factor to compensate for operating environment (as we outlined earlier) is an absolutely essential element of any new rate cap methodology if we are to avoid further financial collapses in NSW local government.

5. How can the rate peg methodology best reflect improvements in productivity and the efficient delivery of services by councils?

If the NSW Government wishes to reflect improvements to efficiency and productivity, then it will be necessary to first accurately measure these constructs. Extant measures – such as operational expenditure per capita – are woefully inadequate as proxies for efficiency (Drew and Dollery, 2015). Instead, intertemporal data envelopment analysis (with appropriate adjustments) would need to be employed. Moreover, it would be essential to have an annual consistent survey of citizen satisfaction (or another reliable proxy for service quality) to ensure that supposed efficiencies were indeed the case (rather than merely reductions to service quality).

However, there is significant potential that policy adjustments to reflect efficiency would have serious, undesirable and unintended consequences. First, it would entirely remove the incentive for local councils to improve efficiency, because doing so would reduce their revenue. Accordingly, an efficiency dividend could well run contrary to the long-run interests of ratepayers. Second, it would further exacerbate the financial sustainability crisis that already grips around two-thirds of NSW local councils. At present, most councils actively seek out efficiencies as a way to partially-mitigate perceived inadequacies in rate cap dictates. If IPART or the NSW Government were to reduce the rate cap according to efficiencies achieved, then this would likely bring forward the time for a looming local government financial crises.

Most councils in NSW are active in pursuing efficiencies to try to maintain a semblance of financial sustainability. It would thus be a grave mistake to do anything to dissuade or punish them for these efforts (especially if we were to use inaccurate measures of efficiency as is currently the case).

6. What other external factors should the rate peg methodology make adjustments for? How should this be done?

As we have noted earlier, any rate peg calculation method must embody 'forward facing' elements, especially with respect to inflationary pressures. This means *inter alia* that the computation of the rate cap will embody forecasts of future cost increases and price rises that NSW local councils will experience. As we have suggested under section 10 of this Report, a rate cap setting panel should be established comprising *bona fide* experts on local government economics who can offer informed judgements on future cost increases and price rises in NSW local government.

Moreover, as the RBA (Lowe, 2021) has graphically illustrated in recent times, making predictions regarding likely inflation outcomes is thwart with danger. For this reason, it is essential that our recommendation for a rate cap range, made in earlier submissions, be adopted. Specifically, offering councils a rate cap range reflective of the uncertainty in both future predictions and past data[6] allows local decision-makers to better tailor their tax increases to their local knowledge regarding the specific challenges emerging in their council area. It also improves democratic accountability and reduces the problem of learned helplessness that has been noted in the literature (Drew, 2021).

7. Has the rate peg protected ratepayers from unnecessary rate increases?

In the short-run a rate peg might protect ratepayers from increases to their tax liability. However, this protection currently comes at significant costs especially to the most vulnerable in the community.

What typically occurs is that councils delay required tax increases because of the expense and political controversy likely to be engendered by a Special Rate Variation (SRV). However, ultimately matters come to a crisis point and then ratepayers are confronted with an extraordinarily large rate increase. It is not hard to find evidence of hefty local rate increases in the IPART determinations, such as 94.787% for Balranald in 2018-19 and 53.5% for Cootamundra-Gundagai in 2021-22. Indeed, there are dozens of SRVs of thirty percent or more. It is hard to believe that residents in these areas would agree that the rate cap saved them from unnecessary rate increases! It is much more likely that they would contend that the rate cap merely spared them a little bit of pain over many years that metastasized into a great burden later because it had been left un-checked.

[6] Able to be precisely quantified using relatively rudimentary statistical measures.

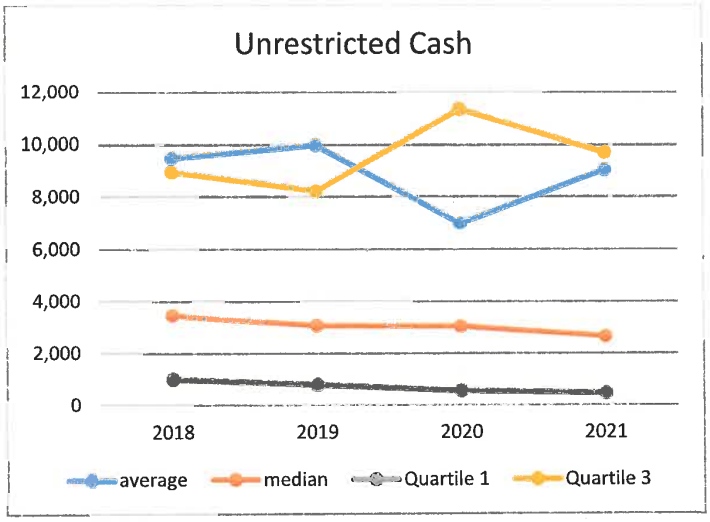
Moreover, deferral of needed rate increases, which is a prominent feature of the rate cap regime, also presents significant intergenerational equity risks. This occurs because existing residents may avoid needed rate increases for a decade or more which are ultimately forced onto contemporary ratepayers who may not have been beneficiaries of past expenditure (for instance if they only recently became homeowners in the local government area).

Furthermore, large and unexpected SRVs needed to mitigate inadequate rate caps over many years tend to disproportionately hurt the most disadvantaged in our communities. These people are the least likely to have savings to draw on to mitigate unexpected rate shocks that accompany SRVs. In addition, the services most likely to be cut by councils to cope with constraints on rate revenue tend to be discretionary projects such as programs tailored to the aged, unemployed, disabled or culturally diverse groups. This is the stark consequence of less-than-competent execution of seeking to reduce 'unnecessary' tax increases.

For all these reasons, in our previous work, we have strongly advocated for automatic triggers linked to a competent financial sustainability monitoring system (which sadly is not our current system). Automatic triggers would force councils to apply for a SRV when data demonstrated that financial sustainability had waned significantly, thus avoiding inappropriate delays to adjust rates which ultimately result in unacceptable large rate shocks.

8. ***Has the rate peg provided councils with sufficient income to deliver services to their communities?***

Financial failures in NSW local government, together with dwindling cash reserves (that have now reached critical levels for median and quartile 1 councils) clearly demonstrate that the rate peg has not delivered sufficient income for councils and their communities. Indeed, frequent approvals of hefty SRVs to address 'financial sustainability' submissions to the IPART, also underline the inadequacy of current practice.



It is unlikely that a 'one-size-fits-all' rate cap will ever be able to provide the disparate NSW cohort of councils and communities with sufficient income to deliver needed services. In accordance with the decentralization theorem, each council provides a different set of goods and services tailored to the particular tastes and preferences of their citizens. This is the whole point of decentralized local government. Furthermore, each community faces different challenges, operating and economic environments. Thus, it follows that each local council needs the flexibility to set the particular rate of the increase to their specific basket of goods provided according to their superior local appreciation of local conditions. This can best be achieved by providing a short range of rate cap for each major category of local government and trusting the democratic accountability and high professionalism of local government decision-makers to make appropriate decisions about the precise price rise required for their specific councils.

9. How has the rate peg impacted the financial performance and sustainability of councils?

As we have seen in section 5 of this Report, Dollery and McQuestin (2017) empirically investigated the likely effects of a rate cap on South Australian (SA) local government by comparing the performance of SA local government with NSW local government employing three performance indicators (revenue effort, financial sustainability and operational efficiency) over the period 2013 to 2016. Dollery and McQuestin (2017, p.84) established that 'rate-capping in NSW has not served to reduce inter-municipal revenue effort inequities'. Moreover, rate capping is thus 'most unlikely to minimise these inequities in SA local government'. In addition, Dollery and McQuestin (2017) found that the 'claims made by proponents of rate-pegging that it improved financial sustainability' were falsified by their

findings. For example, comparing council debt per capita as a proxy for financial sustainability, Dollery and McQuestin (2017) found that 'NSW local authorities have much higher debt than their SA counterparts despite the four decade long rate-pegging regime in NSW'. Furthermore, Dollery and McQuestin (2017, p.84) established that the operational efficiency of local councils did not increase under rate capping. Using council expenditure per capita as a measure of the operational efficiency of local councils, Dollery and McQuestin (2017, p.84) demonstrated that 'rate-pegging does not increase the efficiency of local councils: for each year in our sample, the efficiency of NSW councils falls well below SA councils'.

In sum, Dollery and McQuestin (2017, p.84) found that 'on all three dimensions of local government examined in our empirical analysis, we find SA councils performance better than NSW local government notwithstanding the latter's longstanding rate-pegging policy'. Furthermore, compared to NSW, 'SA municipalities exhibit superior performance'. In light of their findings, Dollery and McQuestin (2017, p.84) concluded that 'the empirical evidence presented in the paper demonstrates that rate-pegging should not be imposed on SA local government and instead other more promising policies [should be] considered'.

10. In what ways could the rate peg methodology better reflect how councils differ from each other?

Following from our observations under question 1 above on regional variations in the LGCI, different rate caps should be calculated for councils falling in (at least) the four main municipal categories in NSW local government (metropolitan, regional, rural and remote councils). This will not only more accurately reflect the different operating environments facing these categories of council, but also facilitate comparisons between the performance of local councils in each category. As a consequence, there will be greater transparency for local residents and more accountability for local councillors.

As noted in this Report as well as in our earlier submission, the rate cap should also be provided as a range for these four main categories of councils. This will allow local government decision-makers to use their superior knowledge of local conditions to set a precise price increase for the basket of goods and services that best reflects their community's specific needs and circumstances. It will also promote democratic accountability and combat learned helplessness.

People outside of Sydney rarely understand the importance of rural councils having the flexibility to tax at higher rates in good agricultural seasons to build up reserves against local economic shocks arising from poor agricultural seasons at other times. Rural economies are very dependent on weather conditions, as well as commodity prices, and a failure to provide the flexibility to properly respond to prevailing conditions has caused much harm to rural communities. Accordingly, a flexible range of rate caps is especially important in rural areas.

11. What are the benefits of introducing different cost indexes for different council types?

As we have observed, given the spatial variation in municipal costs and municipal resource use across NSW local government, especially between metropolitan councils and their regional, rural and remote counterparts, Drew (2021) and others have argued that different cost indexes should be employed for (at a minimum) four main categories of council (metropolitan, regional, rural and remote councils). The construction of these indexes should include the use of three-year moving averages of the mix and weighting of the basket of items in the index, a price increase projection for the forthcoming financial year and consideration of the operating environment of the four different categories of council. In essence, using moving averages as suggested would considerably reduce volatility and thereby partially mitigate the problem whereby some local governments find it difficult to predict future caps for budgeting purposes.

However, if we truly wished a rate cap to be responsive to the particular needs and circumstances of different communities then it would either be: (a) necessary to have a much more carefully assembled LGCI constructed for each individual council, or (b) a rate cap range provided to each category of local government so that relevant decision-makers might use their superior local knowledge of the precise circumstances faced by their communities to set an appropriate price increase.

12. Is volatility in the rate peg a problem? How could it be stabilized?

A certain degree of volatility in the rate cap is to be expected. However, what is problematic is when the volatility is *unanticipated* and out of line with official Australian Bureau of Statistics (ABS) CPI and PPI data. Put differently, it is the volatility between the expected rate cap and the actual rate cap proclaimed that is the real problem for local government. Indeed, current instructions for councils to assume a rate cap of 2.5% (which does not seem to have changed for well over a decade) should be reviewed far more regularly to avoid significant errors creeping into LTFP and thereby exposing communities to fiscal risk.

As we have already detailed, the rate cap can be stabilized by using moving averages. However, it is also important that far more up-to-date data is used in the calculation of the rate cap. Moreover, the gap between expected rate cap and actual rate cap can be redressed by also considering forward-looking indicators when determining the rate, as well as issuing a final cap at a time much closer to when councils might reasonably be expected to be incorporating it into their decision making (i.e. March-May each financial year). In this regard it would seem prudent to provide an indicative rate cap early on for the drafting of budgets, but only proclaim the final rate cap proximate to its final use.

13. Would councils prefer more certainty about the future rate peg, or better alignment with changes in costs?

It should go without saying that local councils and local communities alike would prefer a rate cap that was accurate and adequately met the demands of financial sustainability. Certainty that the rate cap would be appropriate and responsive to actual economic conditions is much preferred to certainty about it being a particular number. At present, there is little confidence in the NSW local government community that future rate caps will be appropriate for the economic conditions that actually prevail at the relevant time. This represents a substantial problem that IPART and the NSW government must respond to.

14. Are there benefits in setting a longer term rate peg, say over multiple years?

Given that the RBA informed us in November 2021 that inflation would be transitory (Lowe, 2021), it is hard to imagine how IPART might think that an accurate long-term rate cap could possibly be divined. As we have already stressed, it is not certainty in a particular number that is at stake here. Rather local councils simply need to be certain that the rate cap will be appropriate for the specific conditions that they face at the relevant time.

15. Should the rate peg be released later in the year if this reduced the lag?

As we have already outlined, an indicative rate cap should be released at around the same time as occurs at present to assist with forward budgeting. However, the final rate cap should certainly be proclaimed as late as practical (i.e. April-May each financial year) in order to ensure that it is sufficiently responsive to prevailing macro-economic conditions. This is particularly important in a high inflation environment where macro-economic forces are volatile and unpredictable. Indeed, had this practice been adopted in the past, local councils

and local communities would have been spared the unnecessary cost and time involved in the recent ASV.

16. How should we account for the change in efficient labour costs?

As we detailed in our response to question 5 it would be a grave mistake to penalize councils for efficiency improvements. First, it would be necessary to measure efficiency correctly (which is presently not done owing to methodological and data problems). Second, it would likely result in deleterious unanticipated consequences.

17. Should external costs be reflected in the rate peg methodology and if so, how?

It is not quite clear what IPART means by 'external costs'. However, certainly all costs must be considered as part of the compilation of a competent rate cap.

At present it appears that many important costs are not considered, such as new compliance costs (like the ARIC committees and the significantly higher audit costs after central auditing), cost-shifting and aggressive revaluations of existing assets pursued by auditors (that should have been reflected in past rate caps but certainly have a large bearing on current bottom lines).

Moreover, sensible adjustments need to be made to the permissible general income calculation to account for the portion of the pensioner rebates *not* refunded by the NSW Government (i.e. the notional general income should be increased by the amount of the rebates *not* received back as a subsidy). This simple change would mean that rural and fringe councils, which are often in the most precarious financial position, would no longer be penalised by the higher and increasing proportion of pensioners that choose to live in their areas.

In addition to calculating the rate cap so as to minimise uncertainty and reduce income volatility, it is also important to take into account the macro-economic challenges and trends that might face councils in the forthcoming financial year(s) under the stipulated rate cap. Put differently, the rate cap cannot be a purely empirical exercise; judgements must also be made about future inflationary pressures and other external forces that will impinge upon council costs.

18. Are council-specific adjustments for external costs needed, and if so, how could this be achieved? Please see our response to question 17.

19. What types of costs which are outside councils' control should be included in the rate peg methodology?

As detailed in our response to previous questions, adjustments must be made for a range of compliance, audit revaluation, cost-shifting and pensioner-discount costs. Indeed, adjustments should have been made for the substantial direct and indirect costs associated with COVID requirements and it would be appropriate to include a catch-up factor for this in the next rate cap.

Given the problem with sourcing appropriately trained staff, especially in rural and remote areas, it would also be appropriate to adjust rate caps for staff training and relocation expenses (or alternatively these costs could be reflected in the notional general income calculation).

In addition, it is absolutely essential that costs associated with local economic shocks are reflected in rates. This is particularly important in rural areas where climatic conditions and changes to commodity prices can have large effects on both 'capacity to pay' and 'need' for local government services (and hardship provisions).

As we have suggested a number of times, a rate cap range will often be the best way to reflect external costs that are specific to particular councils. Often it would not be possible for IPART to understand or quantify the myriad of specific external costs faced by various local communities at particular times. We need to trust to the superior local knowledge of local decision-makers to do so. Moreover, the democratic process has a built-in accountability mechanism to ensure that a rate cap range would not be exploited (although we note that simple reporting by IPART, along with pre-election fiscal statements long championed by scholars such as Drew (2021), could also act as an effective check on opportunistic behavior).

20. How can we simplify the rate peg calculation and ensure it reflects, as far as possible, inflation and changes in costs of providing services?

As we laid bare at the outset, a competent rate cap needs to have a clearly articulated purpose. We do not believe that simplicity ought to be the primary purpose of a rate cap. Indeed, most of the inaccuracy and subsequent fiscal damage caused by the rate cap has come about because of a desire to make things simple (often through the inappropriate use of indexes).

The costs of getting rate caps wrong are substantial, both in terms of financial sustainability as well as the broader social costs to the most vulnerable in our communities. We suspect that simplicity is a goal motivated in part by the desire to keep IPART/NSW government costs down. However, there is clearly a multiplier effect on the costs of inaccurate rate caps. Thus, it should be clear that the prudent course of action would be to invest more adequately in an accurate rate cap, better tailored to the needs of particular communities. To borrow a phrase from Bird et al. (2015): 'to buy cheap methodology is to buy dear in the longer term'.

10. Recommendations

In this Report, we have (a) considered the major arguments in the ongoing debate in NSW local government over the impact of rate capping; (b) we examined the various theoretical considerations on the nature of property tax limitations and their regulation; (c) we surveyed the international empirical literature on the impact of property tax limitations; (d) we discussed the Australian empirical literature on the impact of rate pegging in local government; (e) we considered the findings of recent inquiries and official reports on rate capping in NSW local government; (f) we outlined the new IPART methodology for calculating the annual rate cap that includes a population growth factor; (g) we examined various problems inherent in the IPART methodology; and (h) we provided answers to the twenty questions provided by IPART (2022) in its *Issues Paper.* We now offer several recommendations for improving the municipal rating system in NSW local government.

As we have demonstrated in this Report, the longstanding rate cap regime in NSW local government has had a damaging impact on municipal performance, especially the continuing inadequacy of income from rates, related ongoing problems with the financial sustainability of NSW local government and associated inadequate infrastructure maintenance and renewal (Dollery, Johnson and Crase, 2006). Moreover, as we have shown in the Report, the new IPART rate cap methodology is seriously deficient and it will accordingly further damage the financial sustainability of NSW local government (Drew 2021; 2022).

Two alternative generic approaches of improving the NSW local government rating system exist:

RECOMMENDATION 1: 'FIRST-BEST' APPROACH ABOLISH RATE CAPPING

A 'first-best' approach would be for the NSW Government to simply abolish rate pegging and grant local councils the freedom to strike their own rates and be held accountable by their

own local residents. As we have demonstrated in this Report, this approach accords with both economic theory on optimal municipal property taxation an local democratic accountability, as well as the weight of international and Australian empirical evidence on property tax limitations.

However, this optimal approach involving the abolition the rate cap in NSW local government faces the harsh political reality that it is politically extremely difficult to remove rate pegging from NSW local government. In this regard, Drew (2021, p.111) observed that 'no political party is likely to voluntarily remove existing tax limitation regimes because there is a considerable risk that taxes would be increased soon after, and the party facilitating this would be greeted with the displeasure of voters at the next higher tier election'. Moreover, 'because taxation limitations are a politically popular way of responding to cost of living pressures – at no immediate cost to the instigator – their incidence is only likely to increase in future'.

RECOMMENDATION 2: 'SECOND-BEST' APPROACH REDESIGN RATE CAPPING

A 'second-best' pragmatic approach must accept that rate capping will remain an unassailable feature of NSW local government, regardless of the political complexion of the state government. We thus contend that reform should instead focus on removing the worst features of the NSW local government rate pegging regime. Put differently, a 'second-best' approach should concentrate on improving the IPART rate cap methodology.

Drew (2021, pp.111-114; 2022) has advanced several recommendations for reforming rate caps which we have augmented with additional suggestions. Firstly, as noted earlier, we recommend different cost indexes be employed for metropolitan, regional, rural and remote councils. As we have seen, the current LGCI employed by IPART is awash with problems that render it unsuitable as a basis for determining cost increases in operation of NSW local government. Given the spatial variation in municipal costs and municipal resource use across NSW, especially between metropolitan councils and their regional, rural and remote counterparts, Drew (2021) argues that different cost indexes should be employed for – at a minimum – the four main categories of council (metropolitan, regional, rural and remote councils). The construction of these indexes should include the use of three-year moving averages of the mix and weighting of the basket of items in the index, a price increase projection for the forthcoming financial year and consideration of the operating environment

of the four different categories of council. In essence, using moving averages as suggested would considerably reduce volatility and thereby partially mitigate the problem whereby some local governments find it difficult to predict future caps for budgeting purposes.

It is also important to take into account the macro-economic challenges and trends that might face councils in the next year when determining the final cap. Put differently, the rate cap cannot be a purely empirical exercise; judgements must also be made about future inflationary pressures and the like.

Secondly – and following from our first recommendation - we contend that different rate caps be calculated for councils falling in the four main municipal categories in NSW local government (metropolitan, regional, rural and remote councils). This will not only more accurately reflect the different operating environments facing these categories of council, but it will also facilitate comparisons between local council outcomes in each category. Accordingly, there will be greater transparency for local residents and more accountability for local councillors.

Thirdly, we recommend that a rate cap setting panel, as well as the SRV assessment panel, should include at least one scholarly local government expert. Scholarly knowledge of rate cap theory and sophisticated empirical techniques are clearly important for the development of a sound cap. Moreover, scholars are perceived to have greater independence (thus strengthening perceptions for a range of rate cap stakeholders) and can bring new insights to deliberations. Many of the problems associated with the recent changes would have been avoided if a suitably credentialed person was on the deliberative panels. It is thus wise to address this gap to avoid problems in the future.

Fourthly, we recommend that the rate cap should be based on the average rate for each category of property. As we have seen, the IPART rate cap methodology calculates the annual rate cap for each council based on its total property tax revenue from the previous financial year. Changing to a calculation based on typical (mean) rate impost will have significant benefits for local authorities. For instance, it will mean that the construction of new dwellings and businesses in a given local government area will increase the total tax intake. This will better enable local councils to absorb the costs of growth, including the need for additional local infrastructure investment. It would also mean that the inaccurate and controversial population growth factor would be rendered redundant.

To calculate the cap, the average of each category (from the previous period) would need to be inflated by the specific cap for the particular type of council, then multiplied by the number of assessments in the given category as at the most recent record date. The total tax take would then be equal to the sum of the various category calculations.

A rate cap based on the averages for each category will also encourage more prudent use of minimum rates and base rates. This implies that it will thus contribute to greater distributive justice. Furthermore, an approach based on averages is more consistent with the objectives of a rate cap; that is, to avoid rate shock for the typical resident. By setting rate caps on the foundation of the typical rate imposed on each category of ratepayer we are much more likely to avoid rate shock for the typical ratepayer.

Fifthly, we recommend that the rate cap should be provided within a small range rather than as a single set number. A rate cap should not be a single figure for each council, but instead encompass a small range of potential rate increases (thus, for instance, a rate cap can be expressed as 2.4 to 3.0% rather than simply 2.7%). This would have a number of advantages. Firstly, it would diminish much of the 'learned helplessness' and 'blame shifting' inherent in the current rate cap regime. Second, it would enable councillors to lessen any error in the calculation or calculation methodology. Third, it would allow for local councils to adjust to changes in conditions that occur in the long time-span between promulgation of the rate cap and the start of the new financial year. Fourth, it would empower regulators to explicitly include the statistical error term associated with any empirical calculation. Fifth, it would reassert democratic accountability and would give councillors greater opportunity to respond to community circumstances and community preferences. A rate cap incorporating a small range would still reduce the potential for monopolistic excesses, but it would do so in a manner that respects both the uncertainty of the rate cap construction as well as local democratic principles.

Sixthly, we recommend more sensible timelines should be established for SRV nominations and applications. The current timeline for SRVs in NSW could hardly be worse and contribute to a range of avoidable costs (see Table 1 below). In practice, it often means that local councils are breaking bad news to their local communities immediately prior to Christmas. In the most recent year of delayed elections, the early nomination date meant that

many councils delayed their SRV by an additional year which may well have caused serious financial sustainability problems. Moreover, it increases stress on council staff who often have to give up customary extended periods of leave typically taken over the festive season. In addition, it adds to consultant costs because companies are often forced to pay premiums to staff to work over the festive season.

In Victoria much more reasonable date are employed, as we can see from Table 1. Intent to apply is purely optional, as it should be. Moreover, the applications roll in over a long period which allows for much better assessment turnaround times. In addition, it also makes it much more likely that applications get assessed on their own merits rather than being sub-consciously compared to other applications.

Table 1: Special Rate Variation Key Dates for NSW and Victoria

Event	NSW Date	Victorian Date	Recommendation
Notification of Intent to apply for a SRV	26 November	31 January*	End of January (optional)
SRV application due date	7 February	1 February until 31 March	Should be submitted any time prior to mid-April
Determinations announced	May 2022	Within two months of receiving the application	Within six weeks of application

* Note this is only an option in Victoria. It is not mandatory to give notice of intent.

Our seventh recommendation suggests automatic triggers should be employed. One of the significant problems associated with a rate cap regime is that it is associated with steep political costs. This explains why many local councils are hesitant to indicate intent to apply for an SRV in election years. The problem with delaying SRVs is that a council may fail financially in the interim. Moreover, it also tends to mean that increases need to be higher to make up for foregone rate revenue for the year(s) deferred.

Political costs could be reduced substantially by making SRVs mandatory when certain triggers are met. This would indicate that the local community in question would perceive the SRV as an act required from fiscal prudence rather than political choice. It would also mean

that the rate cap regime would not add further to the already deplorable record of local government financial failures in the NSW local government system (Drew et al., 2021).

Triggers should include standard ratios already in use. However, they would require the NSW OLG to employ more reasonable benchmarks based on empirical evidence (rather than the current apparently arbitrary numbers). In particular, the following ratios represent excellent candidates:

- Operating ratio (over *three* years)
- Unrestricted Current ratio (with a more appropriate benchmark)
- Debt ratio (with more suitable benchmark)
- Cash expense ratio (using a more appropriate benchmark)
- Rates outstanding (currently there is no benchmark and it should be noted that a ceiling - rather than a floor - would be most appropriate here to protect ratepayers).

We have specifically excluded the asset maintenance ratios because they are typically too unreliable at present. Moreover, their use may exacerbate the already high levels of distortion to these numbers.

Regulators might also consider introducing a trigger whereby a certain turnover in councillors following elections would establish a presumption that a new rating policy should be constructed, where a new rating policy might result in a reduction to total tax take, different categories, changes to minimum and base rates and hence greater distributive justice (Drew, 2021). This would be consistent with calls for greater political accountability with respect to municipal finance.

In addition, given the extreme fiscal distress currently experienced by forcibly amalgamated councils as a result of the disastrous NSW local government *Fit for the Future Program* (Drew et al., 2021), it should be considered essential that all compulsorily consolidated councils submit an SRV application as a matter of urgency.

Our eighth and final recommendation prescribes that the burden of proof should rest with the assessing panel or those who object to the proposed rate cap to offer sound reasons for why it should be rejected or reduced. Given that SRV applications are publicly available, and should also be based on thorough and robust proof of need according to prescribed criteria, the burden of proof should rest with the SRV assessment panel or those who object to the proposal to provide compelling reasons for why the SRV should be rejected or reduced. This

is especially the case when local councils have availed themselves of suitably qualified experts to assist in the preparation of the SRV and where they have provided robust empirical evidence in support their claims. In essence, reversing the burden of proof along the lines we suggest would more appropriately respect the efforts of council staff and the deliberations of politically accountable councillors.

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