LOCAL
GOVERNMENT
NSW

Draft LGNSW Submission

Independent Pricing and Regulatory Tribunal (IPART)

Draft Report on the Review of the Rate Peg to Include Population Growth

August 2021

LOCAL GOVERNMENT NSW
GPO BOX 7003 SYDNEY NSW 2001
L8, 28 MARGARET ST SYDNEY NSW 2000
T 02 9242 4000 F 02 9242 4111
LGNSW.ORG.AU LGNSW@LGNSW.ORG.AU
ABN 49 853 913 882

LOCAL GOVERNMENT NSW

Table of Contents

1. Introduction

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

LGNSW welcomes the opportunity to comment on the draft report of the Independent Pricing and Regulatory Tribunal (IPART) Review of the Rate Peg to Include Population Growth.

Rate pegging is a critical issue for local government in NSW and has been since its introduction in 1977. It is encouraging that after over 40 years of denial, we are finally having a serious conversation about the negative consequences of rate pegging and the need for reform.

LGNSW has consistently advocated the removal of rate pegging on the grounds that it was serving to create an ever expanding funding deficit for NSW councils. Something now being recognised by the State Government.

The proposal to allow rates to grow beyond the peg based on population growth represents a significant reform to the rating system. The proposal offers the potential to provide tangible benefits to councils, communities and the State. LGNSW welcomes the proposed reform of the rate peg.

However, it falls short of removing rate pegging - and is but one reform among the many necessary to strengthen the financial sustainability of local government.

LGNSW commends IPART on the model but strongly objects to the Government's decision to tie reform of the rate peg to the reform of infrastructure contributions, specifically, reductions in infrastructure (developer) contributions. The IPART proposal should stand alone.

2. Background

Financial sustainability remains the major challenge facing local government as evidenced by the crippling infrastructure maintenance and renewal backlog of approximately $3.8 billion according to Office of Local Government figures and the operating results of many councils.

Local government is under sustained financial stress. This is a result of the compounding impacts of **rate pegging**, growing populations, increased responsibilities, cost shifting from the Federal and State governments and declining Commonwealth Financial Assistance Grants (in real terms). Cost shifting by the NSW Government onto local government is currently estimated to be around $800 million per annum (representing over 6% of total local government revenue). Rate pegging is foremost among them.

LGNSW is pleased that the Government, in accepting and supporting the findings and recommendations of the Productivity Commission, has finally acknowledged that rate pegging has been damaging NSW since its introduction in 1977. The NSW Productivity Commission, reinforced by IPART who has reached similar conclusions, has confirmed the long held views of local government and the findings of numerous Inquiries over many years. These findings are also accepted by key industry groups and other stakeholders. Both the Productivity Commission and IPART have concluded that rate pegging does not provide councils with adequate revenue to fund the infrastructure and services needed to support communities. This is resulting in declining per capita revenue and a growing revenue gap. NSW per capita rates are lower than any other state and the Productivity Commission estimates that NSW councils have foregone $15 billion in rate revenue over the past 20 years compared to Victorian councils, as the result of rate pegging.

That the Government has finally accepted this after 40 years is a major step forward in itself, and hopefully will open the door to other necessary reforms in future.

While falling short of the removal of rate pegging, LGNSW welcomes the Government's commitment to align rates with population growth as a positive step. Population growth is clearly a major driver of infrastructure and service costs for councils.

3. Proposed Model

LGNSW recognises that developing a model that includes population growth in the rate peg is a challenging brief and commends IPART for listening to local government in the design of a solution. LGNSW and numerous councils made submissions in response to the IPART Issues Paper and it is evident that IPART has taken these views into account in the Draft Report.

LGNSW broadly supports IPART's preferred model and largely agrees with the findings and reasoning behind it.

The preferred model represents a significant improvement to the rate pegging system while noting that it will only deliver modest increases in rate revenue to councils. IPART's modelling indicates that the preferred model would only have delivered an increase of total general income of around $119 million or around 0.7% in the 4th year and a cumulative increase of $262 million.

It is a welcome improvement and will assist councils, particularly those with higher growth, but it is not a game changer when it comes to financial sustainability. Further reforms to the rating system and rate pegging, ideally, the removal of rate pegging, are required if there is to be transformational improvement. Further comments are provided on this later in the submission.

LGNSW is pleased that the preferred model:

- Will maintain per capita rate revenue over time, ending long run decline.
- Recognises the direct linear relationship between population growth and costs.
- Applies to all growth in all councils, not just those whose population growth rates exceed an arbitrary threshold (i.e. high growth councils).
- Ensures that no councils are worse off with IPART modelling indicating that 93 of 129 councils would have received some benefit over the past 4 years, with the balance experiencing no change. It is essential to the sector that no councils are made worse off.
- Is relatively easy to understand and implement.

- Applies to each council individually; it is not a one size fits all model.
- Will provide for a permanent and cumulative expansion of the rate base over time.

These outcomes are all consistent with the positions advocated by LGNSW in our submission on the issues paper.

LGNSW considers the model is deficient in that it:

- Doesn't provide a catch up mechanism for past growth (this still needs to be addressed through Special Variations (SVs).
- Doesn't take into account other cost drivers beyond population growth such as increasing responsibilities, rising community expectations, other revenue constraints, depreciation costs and cost shifting.
- Does not provide any assistance to councils with stable or declining populations.
- Doesn't fully insulate existing ratepayers from growth related rate increases (this will depend on ability to use categorisation options). This is contrary to the objective of reducing existing rate payer resistance to growth.
- Does not recognise the cost impacts of growth in non-residential population influx such centres and popular visitor destinations.

LGNSW acknowledges that these issues are outside of the scope of the Terms of Reference for the IPART Review and may need to be addressed via other reforms.

4. Other Reforms

LGNSW commends IPART's Draft Report for explicitly recognising other areas of rate reform that need to be dealt with that are outside the scope of this review including:

- Emergency services levy
- Cost burden of non-rateable properties (including Community Housing, secondary dwellings and other rate exempt properties)
- Pensioner rebates
- Depreciation costs
- Capital Improved Valuation (CIV).

These are all key areas of reform that will continue to be a focus of LGNSW advocacy to modernise and improve the rating system.

Reform of the emergency services levy is a particularly urgent priority as the rapid escalation of this cost is crippling many rural and regional councils.

5. Rate Reform and Infrastructure Contributions Reforms

LGNSW strongly objects to the Government's decision to tie reform of the rate peg to cater for population growth to reductions in infrastructure (developer) contributions.

Councils overwhelmingly see the decision to link the two as creating a cost shift from developers onto communities.

Both the Productivity Commission and IPART have found that there is an underlying need to reform rate pegging **independently** of reforms to the infrastructure contributions framework.

Furthermore, as noted above, the introduction of the proposed population growth factor will only deliver modest increases in rate revenue. This may help councils address funding deficiencies, but it does not provide capacity to reduce infrastructure contributions.

Reform of the rate peg to include population growth should be about fixing the identified revenue deficiency created by rate pegging, not increasing the profitability of property developers.

LGNSW calls for the review of rate pegging to be decoupled from the reform of infrastructure contributions.

6. Special Variations (SVs).

We commend IPART for committing to review the SV process to simplify and streamline the process. This is desperately required and has long been advocated by LGNSW. Councils advise that the current process is costly, complicated and politically difficult, acting as a deterrent to making applications, even when there are clearly identified needs.

While the adoption of the population growth model should result in a reduction in the number of SVs, it will not eliminate the need. As previously noted, there are many cost drivers other than population growth and many other areas of the rating system that will still require reform (e.g. exemptions, pensioner rate rebates and the ESL). There will also still be a need for catch ups and other adjustments.

The review of the SV process is critical and LGNSW recommends that it be expedited. LGNSW and councils are very keen to participate.

7. PART Review Questions

1. Should our methodology be re-based after the census every five years to reflect actual growth?

Ideally the methodology would be re-based after every census to maintain accuracy. However, LGNSW acknowledges the complexity of doing so. LGNSW supports IPART's proposal to monitor the impact on councils of the re-basing of the ABS population data after the next census. Adjustments should be made where significant changes have been made to ABS estimates that will have a material impact on councils on a case by case basis. The primary objective should be to ensure that no councils have been disadvantaged and only to adjust the population peg upwards for respective councils.

2. In the absence of a true-up, should we impose a materiality threshold to trigger whether an adjustment is needed on a case–by–case basis to reflect actual growth?

Refer to response to Question 1. It would seem that some baseline materiality threshold would be required to identify which councils should be subject to case by case review and upward adjustment. In addition, it is also recommended that councils should be able apply for review and adjustment where they consider it material. This will help build confidence in the model.

3. **Do you have any other comments on our draft methodology or other aspects of this draft report?**

Aligning Estimated Residential Population with Supplementary Valuation data

LGNSW encourages IPART to give consideration to the recommendation made by NSW Revenue Professionals to better align the ERP data with the supplementary valuation growth by;

- Using the ERP data as at 30 June 2020 as supplied by the ABS in March 2021 (as proposed).

- Using the data contained within the 2020-21 Permissible Income for General Rates schedule that is included in the audited Financial Statements for the period ending 30 June 2020 the *"Last year general income yield' and the supplementary growth shown as 'adjustments'*.

Apply to All Councils

LGNSW also agrees with the NSW Revenue Professionals that the population growth factor should apply equally to all councils despite the method of distribution of rates across the rating categories. The component costs measured by the Local Government Cost Index (LGCI) are not aligned this way so we can see no reason why the population growth factor would be treated differently.

In this regard, LGNSW notes with some concern that IPART is considering whether a different approach may be needed for the City of Sydney based on its rating structure and is concerned with singling one council out on a matter of difference. LGNSW does not consider this appropriate and is concerned that this may set a precedent that will allow for other councils to be separated out on matters of difference and potentially denied the full benefit of the population growth factor.

Catch Up

Councils impacted by sustained population growth should be eligible for a one-off population rate peg 'catch-up' without the need for an application for a SV.

Supplementary Valuations

Many councils refute the view that revenue generated by supplementary valuations already covers part of the cost of increased services and should be discounted from the population indexed rate peg. Councils contend that the revenues generated by supplementary valuations barely cover the infrastructure maintenance and depreciation expense associated with new development.

Productivity Factor

LOCAL GOVERNMENT NSW

LGNSW has long advocated for the removal of the productivity factor from the rate peg determination model. Modification of the model to include population growth also provides the opportunity to address this anomaly.

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

The application of the productivity discount is counter-productive as it serves to expand the revenue deficit resulting from rate pegging that has now been recognised by both IPART and the Productivity Commission. It conflicts with the rationale behind the population factor. LGNSW maintains that the application of the productivity discount has no justification in determining council rate increases. There is no basis for determining a productivity factor for complex government bodies delivering a wide range of infrastructure and services, including social services. The fact that IPART has often chose to set the discount at zero on many occasions in recent years, throws even further doubt on its relevance.

LGNSW calls on IPART to take this opportunity to remove the productivity factor.

8. Conclusion

In summary, LGNSW supports the proposal to include population growth in the rate peg and LGNSW supports the adoption of IPARTs proposed model - it will provide significant benefits to many councils while leaving no councils worse off.

Adoption of the proposed model will introduce a progressive reform to the NSW rating system that will help address the systemic revenue deficiency generated by rate pegging.

However additional reforms are also required to respond to other cost drivers, the burden of non-rateable properties, the inequities generated by the use of unimproved capital value (UCV) land valuations and other deficiencies of the rating system.

LGNSW is disappointed that the proposed model only works to preserve existing per capita rates (no matter how deficient) and does not provide for realignment and catch-up within the model. Councils will still need to rely on the existing Special Variation process for this. This makes the need to streamline and simplify the SV process even more urgent and LGNSW calls on IPART to commence the proposed review as a priority.

LGNSW does not accept the Government’s arguments for linking reform of the rate peg with reform of the infrastructure contribution system. These are clearly stand alone issues. LGNSW calls for the IPART rates and growth proposal to be decoupled from the reform of infrastructure contributions.

For further information please contact Shaun McBride on 0438 624 045 or email shaun.mcbride@lgnsw.org.au