REGIONAL CITIES NSW

IPART Rate Methodology Submission

REGIONAL CITIES NSW

Table of Contents

Overview

Regional Cities New South Wales (RCNSW) is an alliance of 15 regional cities from across the state. The alliance aims to grow regional cities in New South Wales (NSW) through increased investment that will build productive, liveable and connected regions.

RCNSW welcomes the opportunity to make a submission to the NSW Independent Pricing and Regulatory Tribunal's Draft Report of its Review of the Rate Peg Methodology.

IPART has asked for written feedback on twenty questions. We have provided detailed answers below.

RCNSW believes that this review is an opportunity to consider the rate peg issue in a more holistic fashion with a view to addressing past failings of the rate peg system and place local councils on a more sustainable financial footing.

There is consensus that the current framework around the rating system and other local government revenue sources has created an environment where councils are falling further and further behind in their capacity to provide and maintain services and infrastructure for their populations.

Since the introduction of the rate peg, councils been forced to defer infrastructure construction and maintenance because revenue is simply not sufficient to meet council costs. This has led to significant backlogs in council infrastructure plans.

This situation has been exacerbated by the pandemic, which has brought about material and labour shortages, and has been worsened by an economic environment of high inflation, rising interest rates and rising costs.

This has resulted in the use of Special Rating Variations (SRVs) by councils to meet immediate cost pressures. RCNSW believes that SRVs should be focussed on council proposals to expand, renew or upgrade infrastructure or services, rather than for the purpose of financial sustainability.

Responses to IPARTs Questions

The following outlines RCNSW's responses to the individual questions posed by IPART.

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

The best way to measure changes in councils' costs and inflation is through accurate reflection of population pressures, application of Australian Bureau of Statistics (ABS) Census data to reflect actual growth of regional communities, recognition of the ongoing operating and maintenance costs, impact of population growth and analysis of the impact of reform measures.

Accurate Reflection of Population Pressures

RCNSW believes the rate peg methodology needs to accurately measure changes to costs resulting from population growth, the impact of transient, service and tourist populations and the particular demands of dispersed populations and large geographical areas experienced by regional councils.

RCNSW welcome IPART's recognition that there is a linear relationship between population growth and council costs[1], while emphasising that this relationship is different for each LGA cohort (metro, coastal, regional city, regional, rural, merged). RCNSW maintains that ongoing recognition of the relationship between population growth and council costs must be included in any future reform of the rate peg.

RCNSW also welcome IPART'S recognition of the infrastructure and service demands created by transient, service and tourist populations and the potentially significant burden that these can impose on councils[2]. Regional cities are without the capacity to recover these infrastructure and service establishment, maintenance or servicing costs effectively through a user pays approach, compared to their metropolitan counterparts.

[1] IPART, Review of the rate peg to include population growth. Final Report (September 2021), 9
[2] *Ibid*, 10

The removal of IPART's recommendation to discount the value of SRVs when assessing the increase in the rate peg for population would allow for some recognition of, and support for, the infrastructure and service demands created by transient, service and tourist populations. The Special Variations[3] are interim measures and a methodology should be developed to recognise these ongoing circumstances and work towards a financially sustainable future for councils where such costs are factored in to the rate peg, thus reducing the need for SRV applications.

RCNSW also welcomes recognition of the infrastructure and service demands created by the greater areas covered by regional LGAs and the dispersed nature of their populations.

IPART has noted that council costs have historically increased with population growth. Council expenditure increases 0.85 percent for every one percent increase in population, while councils' general income increases by only approximately one-quarter of a percentage point.

Therefore, it would be useful for IPART to reassess council expenditure, inclusive of depreciation, to ascertain whether this 0.85 percent coefficient is consistent across LGA cohorts (metro, coastal, regional city, regional, rural, merged) or whether adjustments need to be made to account for the experience of different cohorts. RCNSW has found, for example, that the growth in infrastructure depreciation itself, engulfs much of the value of supplementary levies.

Accurate Measurement of Population Growth

RCNSW supports the application of ABS Census data to reflect actual growth of regional communities. The ABS Estimated Residential Population (ERP) data is an acceptable source of measuring change in population.

RCNSW welcomes IPART's proposed recommendation that the level of population growth should be re-based every five years after the census to reflect actual growth[4], provided that the true-up does not negatively impact the population rate peg granted from the previous year's ERP.

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[3] *Ibid*, 10
[4] *Ibid*, 10

Recognition of the Ongoing Operating and Maintenance Costs Impact of Population Growth, in Addition to Capital Costs

The inclusion of population in the rate peg methodology should address the cost of the recurrent and operating component of population growth, as well as the capital component. That growth is reflected in growth in new or upgraded asset depreciation.

In relation to new developments, the rate peg methodology should take account of the ongoing operating and maintenance costs to council of the development, as well as the potential requirement for provision of additional services and amenities.

IPART has recognised that the supplementary valuations process partially compensates councils for the operating and maintenance costs of higher population growth through higher rates revenue.

IPART has also recognised that, historically, supplementary valuations have not fully compensated councils for increased costs due to population growth[5] and that the supplementary valuation process usually results in most councils receiving less income from rates for each new resident, compared with existing residents.

RCNSW suggests that IPART should consider a methodology that addresses this revenue shortfall and that recognises that rural and regional councils have less capacity to recover these costs from user-pays mechanisms.

Impact of Reforms

Many components of council costs are potentially impacted by reforms or land transformation including:

- reform to developer contributions;
- the development of Renewable Energy Zones;

[5] *Ibid*, 38-40

- the installation of renewable energy facilities infrastructure on farmland; and
- changes in the use of rental housing from long-term to short-term on the categories of the rating structure.

Careful and full analysis of every proposed reform should be undertaken to understand the financial implications of each reform on councils' costs and incomes. It is essential that the impact of multiple reforms maintains total per capita general income over time.

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

RCNSW believes alternate data sources that could be used to measure the changes in council costs are the ***ABS Census and estimated residential population (ERP) data***. We welcome the inclusion of these sources in the recommended methodology[6].

In addition, RCNSW believes that the proposed adjustment to the rate peg for population growth should include an ***adjustment for past growth***. This would provide accurate data to measure the changes in council needs and costs through use of council services.

This adjustment for past growth should also take into account the backlog of infrastructure and maintenance and operational costs created by the underfunding caused by the current rate peg.

Compared to councils in other states, NSW councils are falling behind in their capacity to deliver infrastructure and services. ***The NSW Productivity Commission estimated that NSW rates are around 30 per cent below the national average, with NSW councils having foregone $15 billion over the past 20 years when compared to Victorian councils[7].***

As IPART itself has observed, "We expect under-recovery of the costs of growth will mean growing councils will be unable to maintain their service levels." This is exacerbated by councils' inability to meet Office of Local Government asset ratios

[6] Ibid, 3
[7] Bathurst Regional Council Submission to IPART, 7 November 2022

benchmarks. This leads to a downward spiral due to councils' inability to borrow and therefore inability to maintain, repair and replace their assets.

RCNSW believes that this adjustment for past growth should be determined on a case–by–case basis, considering each council's financial sustainability, its past income from supplementary valuations, its productivity and operating environment, and the impact of any special variations. Alternatively, it could be determined by cohorts of councils. Up to a five-year catch-up should be considered, without a Special Rate Variation.

This will allow regional Councils to accurately fund the services needed by member communities, taking into account the costs of operation and maintenance of services needed for development.

RCNSW acknowledges that this is contrary to IPART's recommendation in its Final Report. However, in our view, it is a necessary step to support the financial sustainability of councils and to assist in the task of removing the infrastructure backlogs and implementing an effective maintenance, repair and renewal (MRR) program to remediate condition 4 and 5 assets.

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?

RCNSW welcomes the inclusion of a population factor in the rate peg methodology however, we believe the rate peg does not accurately reflect the pressures of, and the needed response to, population growth in regional NSW communities.

It should be noted that even councils with no or minimal growth or even declining populations require the ability to increase income simply to maintain current levels of service.

RCNSW believes IPART's population growth approach appears not to take into account the ongoing maintenance, repair and renewal or depreciation of new and existing assets; and, does not provide any mechanisms to give councils the capacity to do this important and necessary work without sacrificing other needed works or services.

RCNSW welcomes IPART's recommendation to include ABS census population data and that the methodology be rebased every five years to reflect actual population growth. RCNSW recommends that any consideration of population growth address the recurrent and operating components of that growth as well as the capital component, in order to reflect actual costs.

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

RCNSW believes that councils should be rewarded rather than punished for increased efficiencies at a time when the gap between demand for service provision and the capacity to provide those services is widening.

RCNSW welcomes the continued suspension of any additional deductions in the rate peg because of increased efficiencies. The continuation of the suspension would remove a disincentive for councils to pursue additional efficiency measures.

RCNSW recommends IPART include ABS Census population data in the rate peg methodology. Further, that the methodology be rebased every five years to reflect actual population growth to accurately address the recurrent and operating components of that growth, as well as the capital component, in order to reflect actual costs.

This rebasing should also include an adjustment to the rate peg for past population growth, as a catch up over five years. This is discussed in greater detail in our response to question 2 above.

With regard to efficient delivery of services by councils, RCNSW is concerned that other reform proposals outside of IPART's population reforms may inhibit, rather than increase councils' efficient delivery of services.

For example, some reforms have proposed the exclusion of community facilities from the essential works list, therefore requiring current and future ratepayers to forward-fund the capital and subsequent maintenance of those facilities, the scale and siting of which responds to the rate and cohorts of population growth. This inhibits rather than increases councils' efficient delivery of services as well as the ability to deliver these services.

Further, in an effort to increase efficient and timely delivery of services, the IPART review may contemplate assigning contributions to new and renewed capital (through debt and depreciation), rather than await the aggregation of sufficient funds to undertake projects identified in the works list, by which time escalated costs have outstripped contribution indexation. This has acquired increased significance in times of high inflation, and builder and supply shortages.

The past few years and the current environment have put additional pressures on the capacity of councils to maintain local infrastructure and amenity and to deliver the services their residents expect. Our members have stated through a survey that pressures include:

- staff shortages;
- external contracts well beyond budget estimates, sometimes as much as 40 per cent higher than the original estimate;
- uncertainty about, and delay in the delivery of necessary building supplies, as well as substantial increases in costs; and
- delays in the commencement of projects.

The substantial increase in project costs has led to:

- the indefinite deferral of projects and the return of external grant monies attached to them; and
- the downsizing of the scope of, and deferral of, road and bridge works [8].

In the rate peg context, the financial circumstances of many councils mean there is no ability for other capital programs to fund the shortfall because all capital works have had substantial cost increases.

Assigning contributions to new and renewed capital (through debt and depreciation), rather than awaiting the aggregation of sufficient funds to undertake projects, would help to reduce these pressures.

[8] RCNSW, Survey of Members, November 2022

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

RCNSW welcomes IPART's consideration of external factors, such as ABS Census population data, to make accurate adjustments to the rate peg methodology.

RCNSW also welcomes the recommended 5-year review to reflect actual population growth. RCNSW recommends the rebasing take into account the recurrent and operating components of growth as well as the capital component, in order to reflect actual costs.

In addition, IPART and councils need to consider the demographic profiles of regional councils. Account needs to be taken of the age of new residents who have relocated to regional cities, while continuing to address the long-term issue of ageing regional populations.

RCNSW recommends a detailed analysis of:

- the quantum of population shifts from metropolitan to regional areas;
- the demography of those migratory populations;
- the housing and service requirements of this population shift; and
- the more extensive use of communications technology to enable more people to work from home.

RCNSW also believes consideration needs to be given to the cost impacts of natural disasters on regional and rural councils.

More frequent natural disasters, such as floods and bushfires, impose a disproportional financial burden on regional and rural councils and their ratepayers when compared to unanticipated costs faced by their metropolitan counterparts.

Not only do natural disasters impose significant additional infrastructure repair costs on councils, but there are times when council assets needed to perform repair tasks have been damaged or destroyed. The destruction of property and livelihoods by disasters also significantly impacts the financial viability of councils' ratepayers and their ability to meet rates costs and insurance and other levies.

These factors need to be considered to assess and respond to the financial impact of increasing infrastructure and service demands on councils.

Has the rate peg protected ratepayers from unnecessary rate increases?

More than 60 per cent of RCNSW members agree the rate peg has not protected rate payers from unnecessary rate increases[9].

However, RCNSW members also assert that increasing the rate peg to adequately fund regional councils to allow for the provision of services to better serve their communities, should not be considered an "unnecessary" rise in the rate peg.

While more than 60 per cent of RCNSW members have experienced a rate rise in the last three years (in line with IPART's recommendations), these rate rises have failed to address the viability of regional Councils. Some examples of councils' lack of capacity to meet these needs, such as deferring or downsizing of projects, is discussed in our response to question 4.

In the last three years, some RCNSW members have applied for a Special Rate Variation to address long term financial sustainability and enable service levels to be maintained in the face of significant population growth.

RCNSW is gathering further data on this issue and will provide that information to IPART once it is collated.

[9] *Ibid*

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

The rate peg has failed to provide NSW regional councils with sufficient income to deliver services to their communities.

As discussed in Question 2, NSW councils have fallen behind in their capacity to deliver infrastructure and services when compared to councils in other states. The implication of this growing gap on the ability to maintain service levels and to maintain, repair and replace assets, must be addressed.

The structural problem of population growth with respect to council costs bears repeating.

As noted by IPART in Review of the Rate Peg to include Population Growth, and Information Paper No 1[10], council costs have historically increased with population growth. Council expenditure increases 0.85 percent for every one percent increase in population, while councils' general income increases by only approximately one-quarter of a percentage point.

It would be useful for IPART to reassess council expenditure, inclusive of depreciation, to ascertain whether this 0.85 per cent coefficient is consistent across LGA cohorts (metro, coastal, regional city, regional, rural, merged) or whether adjustments need to be made to account for the experience of different cohorts. RCNSW has found, for example, that the growth in infrastructure depreciation itself, engulfs much of the value of supplementary levies.

NSW regional councils also face cost pressures which metropolitan councils do not have to account for, including:

- duplication of services because of the councils' geographic extent;
- the provision of services like aged care;
- the extensive local road network area;
- the costs of natural disasters such as floods and bushfires; and
- cost pressures from dealing with a greater transient population.

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[10] IPART, *op.cit.*, 9, IPART Information Paper1. The impact of population growth on council costs and revenues, 29 June 2021, 21

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

Put simply, the rate peg system has limited the capacity of New South Wales councils to raise the revenue needed to provide the required services and infrastructure for their communities.

RCNSW member councils are under financial strain and continuing to fall behind in their capacity to deliver infrastructure and services when compared to councils in other states.

RCNSW also maintains another failing of the rate peg is that there is no 'one size fits all' approach to financing the service provision and infrastructure needs of regional, rural and metropolitan councils. The nature of regional LGAs means that while their rate base is smaller and less capable of generating the revenue needed, compared with their metropolitan counterparts. They are also managing the impacts of natural disasters and servicing much larger geographic areas and larger road networks.

The current IPART review presents an opportunity to recast the framework of local government rates and revenues to ensure the future sustainability of council finances.

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

RCNSW maintains NSW regional council are significantly different from their metropolitan counterparts, with different populations and different service and maintenance needs and costs.

As stated in Question 8, the nature of regional LGAs means that while their rate base is smaller and less capable of generating the revenue needed compared with their metropolitan counterparts, they are also servicing much larger geographic areas and larger road networks and managing the impacts of natural disasters.

Any changes to the rate peg methodology must take into consideration the different needs of council areas, reflecting the linear relationship between population growth and council costs, differentiated by LGA cohort (metro, coastal, regional city, regional, rural, merged).

In this context and as discussed more fully in our response to question 7, it might be useful for IPART to reassess council expenditure, inclusive of depreciation, to ascertain whether this 0.85 per cent coefficient is consistent across LGA cohorts (metro, coastal, regional city, regional, rural, merged) or whether adjustments need to be made to account for the experience of different cohorts. RCNSW has found, for example, that the growth in infrastructure depreciation itself, engulfs much of the value of supplementary levies.

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

RCNSW believes the benefit of introducing different cost indices for different council types will recognise their differing demographics, geography and consequent financial pressures, and provide a more sustainable foundation for councils to provide infrastructure and services to their communities.

RCNSW recommends the introduction of cost indices differentiated by LGA cohort (metro, coastal, regional city, regional, rural, merged).

The characteristics of regional councils which support the creation of different cost indices for different council types are discussed throughout this paper including:

- the greater geographic area of the local councils which sometimes demands the duplication of services and facilities;
- the need to supply particular services like aged care, an obligation that metropolitan councils do not share;
- the greater extent of the local road network;
- the disproportional cost burden imposed by increasingly frequent natural disasters; and
- the more limited capacity for cost recovery, either from local residents or transient populations.

The application of differentiated cost indices would help address some of the economic, demographic and geographic differences between urban and regional LGAs and help restore regional councils to a more sustainable financial basis.

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

All RCNSW members agree changes to the rate peg are needed to ensure the future viability of regional councils, either through better alignment with councils' expenses or through increased certainty of the future of the rate peg.

A majority of RCNSW members have indicated they would prefer a combination of certainty about the future rate peg and a better alignment with changes in costs. Two-thirds of RCNSW members have indicated a combination of certainty about the future rate peg and better alignment with changes in costs is preferable, while one-third of members are supportive of the rate peg reflecting better alignment with changes in costs.

To provide greater certainty and better reflect the changes in costs, RCNSW believe the rate peg needs to take into account population growth within councils, because this significantly impacts their ability to meet the needs of growing populations.

There is a need to reduce the 'lag-effect' of the data used now to produce the rate peg, which could be achieved by using 'forward-facing' data and predictions, rather than using out of date 'rear-facing' data.

There also needs to be better alignment of the rate peg to actual costs incurred by councils. This includes taking into account asset depreciation costs and those costs particular to non-metro councils such as duplication of services, more extensive road networks, and the provision of local services not provided by other councils.

When future increases to the rate peg are considered, greater use of known future costs indices, such as the NSW Local Government (State) Award for labour costs, will improve the accuracy of the rate peg[11].

[11] Tamworth Regional Council, Submission. IPART review of the rate peg methodology 2022

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

There is interest from some councils in setting a longer-term rate peg, but also concerns about the implications of such a framework.

The attraction of a longer-term rate peg centres around certainty:

- certainty on the level of rate peg increases available to councils, which could provide better alignment with long term financial plans, and greater confidence about service delivery and asset renewals; and
- a greater degree of certainty for rate payers about the year-on-year increases in their rates.

However, councils also expressed concerns about whether setting a longer-term rate peg would provide the necessary flexibility to adapt to changing circumstances. Concerns were specifically expressed about inflation, awards salary increases, and the need for and timing of true ups to respond to unanticipated circumstances. Councils noted that pandemics and natural disasters can add to the operating costs of individual councils and affect the community's ability to pay.

It is clear that there is no "one size fits all" solution because increases in costs and the community's ability to pay will be different for different councils.

With respect to a longer-term rate peg, there are suggestions about the data that might be considered for its preparation. These include using three-year rolling averages which can be adjusted over time. The value in using 'forward-facing' data and then re-adjusting at an agreed later date based on real figures seems to be preferred. There is also interest in using CPI figures in the preparation of the rate peg.

RCNSW endorses a review of the rate peg in accordance with ABS Census data to ensure the needs of the community and the funding provided is an accurate reflection of the population in regional communities.

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

The great majority of RCNSW members agree the rate peg should not be released later in the year[12].

Most councils see any change to a later date as detrimental to budget planning processes.

There is strong interest in the 'lag-effect' being removed from the preparation of the rate peg, and it is acknowledged that releasing the rate peg later in the year is one way that could reduce the lag.

However, in the view of many councils, the current timing ties in with the budget preparation process and timeline followed by most councils.

Councils need to prepare their budgets early in the new calendar year to meet exhibition timelines and the current release dates support this outcome. Council staff needs an appropriate period of time to determine the rate structure to ensure compliance with the rate peg and prepare accurate budgets for the next financial year.

The early release of the rate peg allows councils to prepare their annual operation plan based on actual rate income and better inform the community. In accordance with the Integrated Planning and Reporting framework, Councils need to adopt a draft operational plan incorporating the Revenue Policy, advertise for 28 days (typically May) and consider submissions prior to adoption in June[13].

If there was to be a delay in release of the rate peg, then a release no later than November or December is preferred.

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[12] RCNSW Survey of Members November 2022

[13] Dubbo Regional Council, Submission. IPART review of the rate peg methodology September 2022, 3 November 2022

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

More than 80 per cent of RCNSW members agree the rate peg should account for the change in efficient labour costs and incentivise councils to seek further efficiencies[14].

There is no question that councils try to operate as efficiently as possible in order to maximise their ability to deliver infrastructure and services to their communities. Labour is one of their most significant costs. In the Local Government Cost Index salary/wages carry a 38.6 percent weighting of total costs.

There is a view that councils achieving efficient labour costs should not be penalised for achieving these efficiencies. The current system is not necessarily equitable in this respect.

Finalising award negotiations to an earlier time frame, and a sufficient delay between the award determination and its implementation, could also assist councils to incorporate the new award in their budget preparations.

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

Since these three questions are interrelated, RCNSW has decided to answer them together to avoid repetition.

External costs and the rate peg

All RCNSW members agree external costs should be reflected in the rate peg methodology, including:

- operational and maintenance costs of infrastructure;
- inflation costs;
- the costs of implementing and monitoring new regulations and targets imposed by state and federal governments; and

[14] RCNSW Survey of Members November 2022

- the cost of maintaining services that have been cost-shifted by other levels of government to councils.

Council specific adjustments

There is also agreement that there are costs unique to individual councils and that IPART should retain the current ability to apply council specific adjustments where necessary. Eighty per cent of RCNSW members agree council specific adjustments on external costs to the rate peg should be implemented. Unforeseen costs and those outside of the 'measured cost' considerations need to be included as well.

While council-specific adjustments are currently reviewed and assessed under the Special Variation regime, this resource-intensive process imposes an additional financial burden on councils and ultimately the community. A Special Variation could also increase rate rise volatility, which seems to be contrary to the purpose of a rate peg.

The methodology should work to minimise these Special Variation adjustments by creating a mechanism which recognises and incorporates external and uncontrolled costs into council budgets through the rate peg process.

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.

Costs beyond councils' control, especially in the post-pandemic world of labour shortages and supply change disruptions, include:

- climate change and the response to natural disasters;
- increases in superannuation guarantee contributions;
- the changing nature of the skills required by council employees, especially with the continued transition to digital services; and
- the escalating depreciation expenses associated with increasing input costs for renewal and replacement of assets.

Whether anticipated or unanticipated, all of these add to the financial pressure on councils.

Council costs that are not uniform

The methodology should be modified to allow adjustments for external cost factors that affect groups of councils, affect councils unevenly or affect individual councils.

For example, the Emergency Services Levy (ESL), which IPART has acknowledged as a significant cost factor and included in the peg, does not fall evenly across councils, with the heaviest burden proportionally falling on rural and regional councils with a high RFS presence. Under the current methodology, the cost is averaged and diluted and therefore does not adequately compensate those most affected. Individual councils should be allowed to adjust rates to recover the full cost of the ESL and this should not require a special variation.

In a similar fashion, the impact of the portion of pensioner rebates not refunded by the NSW Government imposes a greater penalty on rural and fringe councils because of the higher proportion of pensioners who choose to live in their areas.

The impact of transport costs illustrates another cost divide between metropolitan and rural and regional councils. While the steep rise in these costs in recent months have affected metropolitan councils somewhat, it is a major cost for regional and rural councils, where the cost of fuel is higher than in the metropolitan area and also results in freight costs for the same materials being much greater.

Community expectations and non-traditional costs

Any methodology must take into account the changing expectations by our residents about what issues councils should address.

For example, there is an expectation that all levels of government address risks associated with environmental sustainability and climate change. In turn, these changing expectations are reinforced through legislation from departments such as the NSW EPA.

Councils more responsive to community sentiment might implement proactive climate adaption measures. The rate peg methodology needs to be responsive to cost challenges such as these that are outside of traditional council services.

With respect to climate change, NSW Government targets, including the reduction of carbon net emissions to zero by 2050, impose additional financial burdens on councils.

The target requires councils to respond with measures such as the transition to electric vehicles, by way of example. This imposes significant upfront costs, not just in terms of the capital cost, but also the upskilling of existing staff and the creation and the creation and maintenance of new infrastructure to support the effectiveness of the fleet. A rate peg that provides cost increases, but assumes a 'like for like' asset replacement will be inadequate in these instances.

Cost shifting to councils

Cost shifting to local government from both federal and state governments is an issue of significant concern to all NSW councils. Examples of cost shifting include:

- local government election costs;
- contributions to the NSW Rural Fire Service;
- contributions to NSW State Emergency Service, Fire and Rescue NSW;
- lack of adequate funding for public libraries;
- the cost of implementing regulations, for example companion animals, noxious weeds, flood controls, pools and shops etc.

These cost shifts impose considerable burdens on NSW councils, as illustrated by the lack of full reimbursement of the waste levy and the pensioner rebate, as well as the underfunding of public libraries:

- The waste levy is the single biggest contributor to cost shifting in NSW, in 2015/16 $305 million was lost to councils because the NSW Government did not fully reinvest the waste levy, paid by councils, back into local government environmental programs.
- Councils lost $61 million in 2015/16 through the NSW Government's failure to fully reimburse councils for mandatory pensioner rate rebates, unlike all other state/territory governments in Australia.
- The NSW Government makes the lowest per capita contribution to public libraries of any state/territory government in Australia at just $3.76 per capita in 2015/16,

resulting in a $130 million shortfall in funding required to operate the state's 450 public libraries[15].

Decisions by other levels of government also have ongoing implications for local government finances. For example, the Federal Government's three-year freeze on increases to Commonwealth Financial Assistance Grants (FAGs) had immediate and ongoing impacts. This directly cost NSW councils around $300 million and reduced the base on which future adjustments are made. Councils are still bearing the compounding effect of the freeze[16].

Any reduction in Commonwealth Financial Assistance Grants (FAGs) in real terms should be included in the rate peg index.

Changes to legislation that affect all councils, also often results in additional costs to the local community. The mandating of the NSW Audit Office as the supplier of audit services for example, has resulted in an increase in audit fees of 88 percent over nine years[17].

Failure to address the continuation of cost shifting will only further deteriorate councils' financial position

External costs summary

Many councils feel that every year there is another need or another function to perform without any additional funds unless Council applies for a SRV, which is an intense, costly and protracted process.

These external costs, including those out of councils' control, need to be addressed in the rate peg methodology rather than through SRV applications. To achieve this, council specific and cohort specific adjustments will be needed. The methodology needs to recognise that there is no "one size fits all" model to reflect these costs.

The methodology should be forward looking and willing to account for non-traditional programs and costs that the community now expects. It should also incorporate anticipated

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[15] Bathurst Regional Council, *op.cit.*
[16] Local Government NSW, Draft Submission. IPART review of the rate peg methodology September 2022, 3 November 2022, 13
[17] Bathurst, *op.cit.*

costs to meet targets, implement and oversee regulations set by other levels of government. The methodology also needs to address the infrastructure and facilities backlog.

In accounting for these external costs, the rate peg methodology should minimise the need for costly Special Variation Applications.

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

Ninety per cent of RCNSW members agree IPART should simplify the rate peg calculation and ensure it reflects inflation and changes in the costs of providing services[18].

The need for the rate peg calculation to be based on 'forward-facing' not 'rear-facing' data is seen as a critical change that needs to be made. There are also suggestions about including CPI in the calculations throughout the year with critical points established to 'check' the figures before the rate eg is finalised.

Taking account of population growth with accurate and agreed predictive and actual figures must be included in the calculation of the Rate Peg. Councils strongly expressed a view around the inclusion of population estimates and actuals using ABS data as the source.

Conclusion

RCNSW believes the current rate peg system is not working and failing our communities. This IPART review is an important opportunity to address the inadequacies and ensure that NSW councils are put on a long-term, sustainable financial footing.

For More Information

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[18] RCNSW Member Survey