Review of rate peg methodology

Issues Paper

September 2022

Local Government

Tribunal Members

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Invitation for submissions

IPART invites comment on this document and encourages all interested parties to provide submissions addressing the matters discussed.

Submissions are due by Friday, 4 November 2022

We prefer to receive them electronically via our online submission form.

You can also send comments by mail to:

2022-23 Rate peg methodology review
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop, Sydney NSW 1240

If you require assistance to make a submission (for example, if you would like to make a verbal submission) please contact one of the staff members listed above.

Late submissions may not be accepted at the discretion of the Tribunal. Our normal practice is to make submissions publicly available on our website as soon as possible after the closing date for submissions. If you wish to view copies of submissions but do not have access to the website, you can make alternative arrangements by telephoning one of the staff members listed above.

We may decide not to publish a submission, for example, if we consider it contains offensive or potentially defamatory information. We generally do not publish sensitive information. If your submission contains information that you do not wish to be publicly disclosed, please let us know when you make the submission. However, it could be disclosed under the *Government Information (Public Access) Act 2009* (NSW) or the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW), or where otherwise required by law.

If you would like further information on making a submission, IPART's submission policy is available on our website.

The Independent Pricing and Regulatory Tribunal

IPART's independence is underpinned by an Act of Parliament. Further information on IPART can be obtained from IPART's website.

Acknowledgment of Country

IPART acknowledges the Traditional Custodians of the lands where we work and live. We pay respect to Elders, past, present and emerging.

We recognise the unique cultural and spiritual relationship and celebrate the contributions of First Nations peoples.

Contents

1 We want to work with stakeholders to improve our rate peg methodology

The rate peg is the maximum amount in percentage terms by which a council may increase its general income for the year.[a] IPART sets a new rate peg every year and has done so since 2010. The role of the rate peg is to protect ratepayers from unnecessary rate rises, while enabling councils to continue delivering their existing services to households, businesses, and the broader community.

Across the state, 128 councils provide important goods and services to their local communities, including roads, bridges and footpaths, and facilities such as parks, libraries, and swimming pools. As the costs of providing these goods and services increase over time, councils need to be able to increase their income to continue providing the services that their communities need and want. However, it is also important to ratepayers that councils have incentives to improve their productivity and efficiency in delivering these goods and services.

Income from rates represents one of the main sources of income for councils. The importance of this income source varies across councils but, on average, it represents around one third of NSW councils' combined total income. Councils' other sources of income include grants and contributions, and fees and charges for goods and services they deliver. The rate peg does not constrain income from these other sources which are not part of this review.

Our rate peg methodology is currently designed to allow councils to increase their rates income each year by an amount that reflects inflation and changes in the types of costs a typical council would incur. Councils may also need to increase the quantity of services they provide as their local communities grow. We have accounted for this by introducing a population growth factor to the rate peg methodology from 2022-23 onwards.

Councils can choose to increase their rates income by the rate peg, by less than the rate peg, or not at all. The rate peg applies to rates income in total, and not to individual ratepayers' rates. This means that councils can increase rates for some rating categories by more than the rate peg, and others by less than the rate peg, as long as the overall increase in their rates income does not exceed this percentage.

Councils may want or need to increase their rates income by more than the rate peg in some years – for example, so they can introduce new services or improve service quality. To do this, they must consult with their communities, and then apply to IPART for a 'special variation' (SV). If approved, the SV allows the council to increase their rates income by a specified percentage above the rate peg. This is a separate process and is not a matter for this review.

Our rate peg methodology uses independent measures of price changes published by the Australian Bureau of Statistics (ABS) to produce an objective measure of inflation and changes in relevant costs.

[a] For almost all councils, general income consists entirely of rates income. For a small number of councils, general income also includes some annual charges such as drainage levies. In our Issues Paper we use "rates income" to describe general income.

Although we use the most up-to-date ABS data available, there is a 2-year lag between the time period that price changes are measured over and when councils can recover these price changes by applying the rate peg to their rates income. The lag may not be a significant concern in periods when inflation is relatively stable. However, when inflation is more volatile, the lag may lead to material differences between what councils receive under the rate peg and how their costs have actually changed. This may temporarily impact councils' funding of the quality and range of services their communities need.

Currently, we refer to inflation and changes in costs incurred by the average council in NSW when we calculate the rate peg. We recognise that councils and communities across NSW have differing needs and circumstances and understand that each council faces a unique set of challenges. These include the impacts of natural disasters such as bushfires, droughts and floods and more broadly addressing climate change. This means that some councils may experience higher cost increases than the annual rate peg.

More recently, the impacts of COVID and inflation on council costs and services have prompted us to review our rate peg methodology. The Premier and Minister for Local Government have also asked us to undertake a review and issued us with a terms of reference. This review will help to enable the rate peg to meet the needs of ratepayers and councils in the years ahead.

1.1 Our review of the rate peg methodology

IPART has been asked to recommend a rate peg methodology that:

- allows councils to vary their general income[b] annually to reflect (as far as possible) changes in the costs of providing local government goods and services due to inflation and other external factors
- continues to include a population growth factor.[c]

We have been asked to investigate and make recommendations on:

- options to set the rate peg methodology to ensure it is reflective of inflation and costs of providing local government goods and services
- options to stabilise volatility in the rate peg, and options for capturing more timely changes in council costs and inflation
- alternate data sources to measure changes in councils' costs
- the effectiveness of our current Local Government Cost Index (LGCI)
- options for capturing changes in councils' costs caused by external factors
- the effectiveness of the population growth factor in achieving its intended purpose.

[b] In our Issues Paper we use "rates income" to describe general income.

[c] The terms of reference for this review are available on our website.

This Issues Paper outlines the current rate peg methodology, its performance since 2011-12, and the key issues we are considering. It also sets out the questions we are seeking stakeholder comment on.

1.2 We want to hear from you

We are keen to hear what you think about the IPART's rate peg methodology.

We are seeking feedback on the questions raised throughout our Issues Paper (and listed below). We are also interested in hearing about other issues in addition to those raised in this paper.

Tell us what you think

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We will engage with councils, ratepayers, and other stakeholders throughout our review. To have your say, you can:

- provide a submission to this Issues Paper by 4 November 2022
- participate in our workshops in November 2022.

We will consider all the feedback we receive through this engagement, as well as the results of our analysis, in forming our draft recommendations. We will release our Draft Report that explains those recommendations in February 2023. You will then have further opportunities to comment by:

- providing a submission to our Draft Report
- attending our public hearing, which is planned for March 2023.

We will provide our Final Report and recommendations to the Minister for Local Government in May 2023.

Have your say

Your input is critical to our review process.

You can get involved by making a submission, submitting feedback, or attending a public hearing.

We are seeking feedback on our Issues Paper by 4 November 2022.

Submit feedback »

Register for the workshop »

Attend the public hearing »

2 Current rate peg methodology

The rate peg is one of several ways that councils can increase their rates income each year. They can also raise additional income from SVs and supplementary valuations. More generally, councils can also receive income through grants and contributions, and user fees and charges for goods and services they provide.

The Minister for Local Government has delegated to IPART the task of setting the rate peg. Each year, we apply the rate peg methodology to determine the maximum amount in percentage terms by which councils can increase their rates income in that year.

The rate peg applies to total rates income rather than to individual rates. Councils are responsible for setting individual rates for residential, business, farmland, and mining rating categories. This means that individual rates may increase by more or less than the rate peg.

One way that the rate peg affects rates directly is through the minimum rate. Most councils have a minimum rate that applies to all ratepayers, regardless of their land value or the ad valorem rate that the councils apply to that land value. While the minimum rate varies between councils, where councils have set minimum rates at the limit imposed by legislation or where IPART has approved a higher minimum rate, the rate peg affects how much this minimum rate can be increased by each year.[d]

2.1 Role of the rate peg

The role of the rate peg is to protect ratepayers from excessive rate increases, and to create a financial incentive for councils to improve their productivity and efficiency. However, it also needs to allow councils' rates income to vary annually to reflect, as far as possible, changes in the cost of providing services due to factors such as inflation and population growth. Otherwise, they may have to reduce the quality or scope of their services to their communities or seek other sources of income.

To balance these interests, our current rate peg methodology involves measuring the average annual change in costs faced by NSW councils, then adjusting this percentage to account for the annual change in each council's population. We can also make further adjustments to account for productivity improvements in the local government sector, and other external factors likely to affect councils' costs, where we consider this is appropriate.

[d] A council can vary its minimum rate by more than the rate peg if IPART has approved an application for a special variation or minimum rate increase, or if its minimum rate is below the statutory minimum set out in the *Local Government (General) Regulation 2021*.

What else can councils do to vary their income?

Individual councils may experience changes in costs greater or less than the rate peg. Or they may want to increase the quantity or quality of services they provide to their communities. Councils that require additional increases in rates income above the rate peg on a temporary or permanent basis can apply to IPART for an SV. If approved, the SV allows the council to increase their rates income by a specified percentage above the rate peg. Councils can also apply to IPART to increase their minimum rates above the statutory limit (MR increase).

Councils applying for an SV or MR increase must consult with their communities and satisfy the criteria listed in the Office of Local Government's (OLG's) SV/MR increase guidelines. These are available on IPART's website.[e] IPART's website also includes general information on the requirements and recent applications from councils.

Councils can also raise additional income by applying for grants and through their user fees and charges.

2.2 Measuring average annual change in councils' costs

We measure the average annual change in councils' costs using the Local Government Cost Index (LGCI). This index measures the change in prices of a fixed 'basket' of goods and services purchased by the average council relative to the prices of the same basket in a base period. It is similar in principle to the Consumer Price Index (CPI) used to measure changes in prices for a typical household.

We developed the LGCI for use in setting the rate peg in 2010, following a review of the revenue framework for the local government sector.[f] We made the decision to set the rate peg with reference to a local government-specific cost index rather than a broad economic index (such as CPI or the Wage Price Index) to better reflect the composition of councils' costs and the relative importance of individual costs. We considered that this would provide more accurate estimates.

The LGCI is designed to reflect the costs that councils incur when providing goods and services to their communities, including labour, construction, and administration costs. It currently includes 26 cost components, each of which is weighted to reflect its relative contribution to councils' total costs.[1] We maintain the accuracy of the index by collecting data on councils' expenditure every 4-5 years and using this data to update the weights of the cost components.

Figure 2.1 shows the main cost components in the LGCI and their weightings. Further detail on the LGCI cost components and weightings are available in Appendix A – Performance of the rate peg since 2011-12.

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e See IPART's website for OLG's Guidelines for preparation of an application for an SV and further information on MR increases.

f See IPART, Local Government Cost Index – Information Paper, December 2010 and IPART, Revenue Framework for Local Government – Final Report, December 2009.

Figure 2.1 Main cost components in the LGCI and weights as at end June 2021

38.6%	Labour
26.9%	Road and bridge construction
6.2%	Business services, including administrative services
4.9%	Non-residential building construction
3.0%	Plant and equipment – machinery
2.3%	Utilities (electricity, gas, and water)
2.1%	Operating contracts
1.5%	Emergency services levy
1.2%	Insurance

To measure the annual change in each cost component, we use an appropriate inflator. In most cases, this is a price index published by the ABS. This is intended to provide transparency and independence in estimating cost changes. However, as we rely on historical data to set the rate peg, there is a 2-year lag associated with this method. We discuss the issue of lag in further detail in section 4 of this Issues Paper.

Our terms of reference require us to investigate alternate data sources to measure councils' costs. We will assess the merit of using alternate data sources, including both historical and forecast data, for measuring changes in councils' costs as part of this review.

Seek comment

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?

2.3 Adjusting for each council's population growth

When the population a council serves grows, the costs of delivering local government services in the council's area also grow. Before the 2022-23 rate peg, there was no explicit allowance in the rate peg methodology to account for the increase in the volume of services that need to be provided to service population growth or to maintain new local infrastructure. Historically, councils have funded these additional costs through supplementary valuations where land had been rezoned or subdivided to accommodate the growing population,[g] other income sources (such as grants or SVs) or within existing rates income.

In our 2021 review of population growth and the rate peg,[h] we introduced a population factor to the rate peg methodology so that councils can increase their rates income in line with the annual change in the residential population in their area (minus any supplementary valuations they receive). This council-specific percentage is then added to the average annual change in councils' costs (as measured by the LGCI) to determine each council's rate peg.

Our terms of reference ask us to investigate and report on whether the population growth factor is achieving its intended purpose. However, as 2022-23 was the first year that councils received a population growth factor in their rate peg, there is only limited information to analyse. We are keen to hear stakeholders' views on this issue.

Further detail on how we calculate the population factor is provided in Appendix A – Performance of the rate peg since 2011-12.

Seek comment

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?

2.4 Adjusting for productivity improvements

Our current rate peg methodology includes a productivity factor to account for productivity gains in the local government sector.

From 2011-12 to 2017-18, we calculated the productivity factor using information published by the ABS on market sector value-added multifactor productivity.[2] The productivity factors we applied ranged from 0.0% to 0.2%.

[g] Supplementary valuations are issued outside the usual 3-to-4-year general valuation cycle when changes to property are recorded on the Register of Land Values. Supplementary valuations can result in land values increasing or decreasing, impact the rates income received for the affected properties, and lead to a permanent change in a council's rates income.

[h] The outcomes of this review are available on our website.

Since 2018-19, the productivity factor has been set at zero as a default to recognise that improvements in productivity are already reflected, to an extent, in the ABS price indexes we use to measure price changes in LGCI cost categories. However, we retain discretion to deduct a productivity factor if there is evidence of productivity improvements in the local government sector that have not been fully incorporated in the LGCI.[3]

The productivity of councils and the efficient delivery of services is a key concern for ratepayers.

Seek comment

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

2.5 Adjusting for the impact of other external factors

IPART has discretion when setting the rate peg. We have previously adjusted it for factors we considered would impact councils' costs and would not be captured or reflected in a timely manner through the existing rate peg methodology. These adjustments can be upwards or downwards.

Specific adjustments we have made to the rate peg include:

- An upward adjustment in 2012-13 to cover the introduction of a carbon price.[4] Downward adjustments were made in 2013-14 and 2014-15 following the removal of the carbon price.[5]
- A temporary upward adjustment in the 2021-22 rate peg to assist councils to meet additional costs associated with the 2021 local government elections.[6] A corresponding downwards adjustment was made to the 2022-23 rate peg to remove these costs.[7]
- An upward adjustment in 2023-24 to include the costs of an increase in superannuation guarantee contributions.[8]

We have also made adjustments to our LGCI methodology, including changing the way we measure council costs associated with the Emergency Services Levy from the 2020-21 rate peg onwards.[9]

Details of adjustments we have made to the rate peg since 2011-12 are available in section 3 of Appendix A – Performance of the rate peg since 2011-12.

Seek comment

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

3 Rate peg and changes in councils' income and expenses since 2011-12

In reviewing the rate peg methodology and other potential approaches, it is important to understand how the rate peg has performed, and how councils' revenue has changed, since IPART started setting the rate peg in 2011-12.

Councils in NSW receive most of their income from 3 main sources:

Rates and annual charges
This includes residential, business, farming and mining rates, plus any special rates charged by councils, as well as annual charges such as domestic waste management charges.

Grants and contributions
Councils can apply for state and federal government grants.

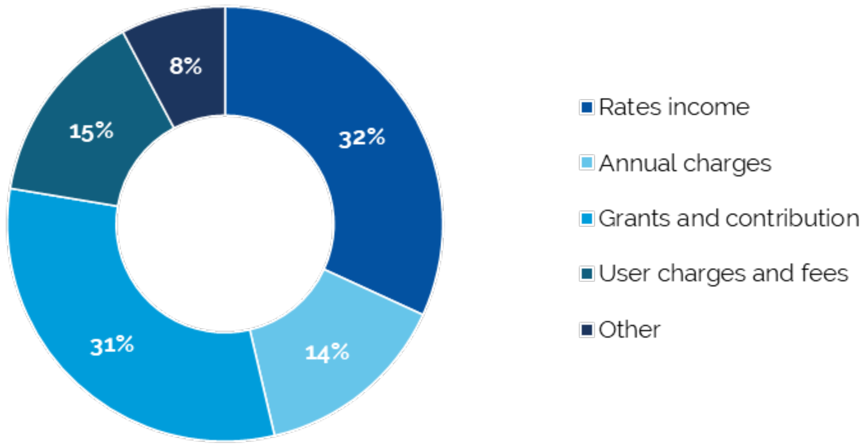
Councils may receive developer contributions to fund infrastructure necessary to serve the needs of the development.

User fees and charges
Councils can charge for the sale of goods and services, such as parking, child and aged care services, building and regulatory services and private works.

Source: Office of Local Government, NSW Overview – Finances.

Figure 3.1 shows that in 2020-21, income from rates represented 32% of combined total operating income for all councils in NSW, followed by grants and contributions and user fees and charges, which accounted for 31% and 15% of total operating income respectively. Annual charges such as domestic waste management charges represented 14% of councils' total operating income.

Figure 3.1 Councils' sources of income (2020-21)



Source: Email to IPART, Office of Local Government, 25 August 2022 and Office of Local Government, Times Series Data 2020/2021.

IPART's rate peg represents the maximum percentage amount by which councils can increase income from rates each year. However, councils may increase their rates income by more than the rate peg by if IPART has approved an application for an SV, or through supplementary valuations when land is rezoned or subdivided.

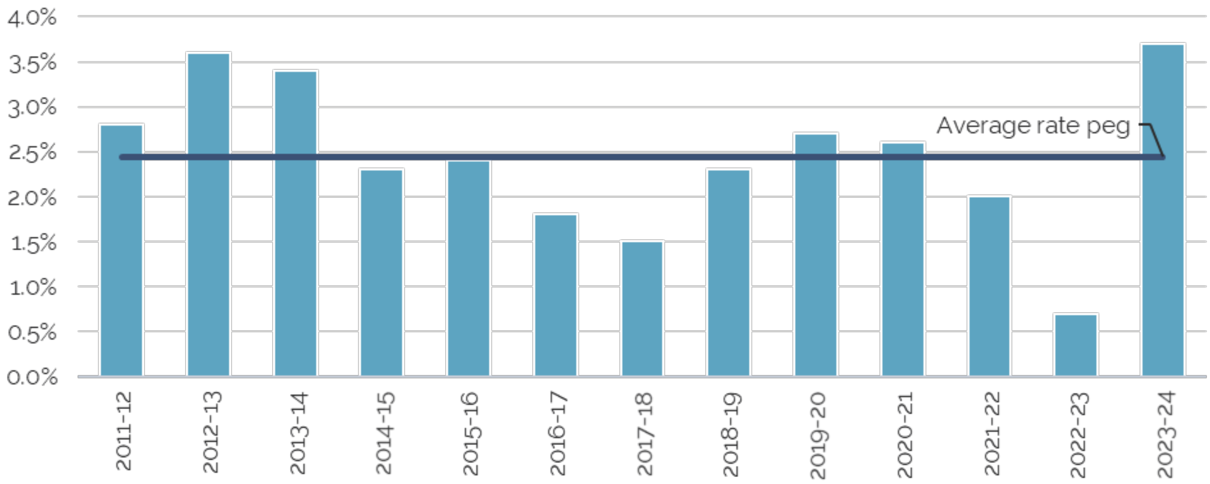
The sections below summarise IPART's decisions on the rate peg since 2011-12 and compare the cumulative increase in the rate peg over this period to the increases in councils' combined total operating income and expenses.

3.1 Rate peg over time

Figure 3.2 shows that from 2011-12 to 2023-24, the rate peg has ranged from 0.7% to 3.7 %, with an average of around 2.4%.[i]

[i] Councils' population factors have been excluded for 2022-23 and 2023-34. Councils' rate pegs for those years ranged up to 5.0% for 2022-23 and 6.8% for 2023-24.

Figure 3.2 Rate peg since 2011-12

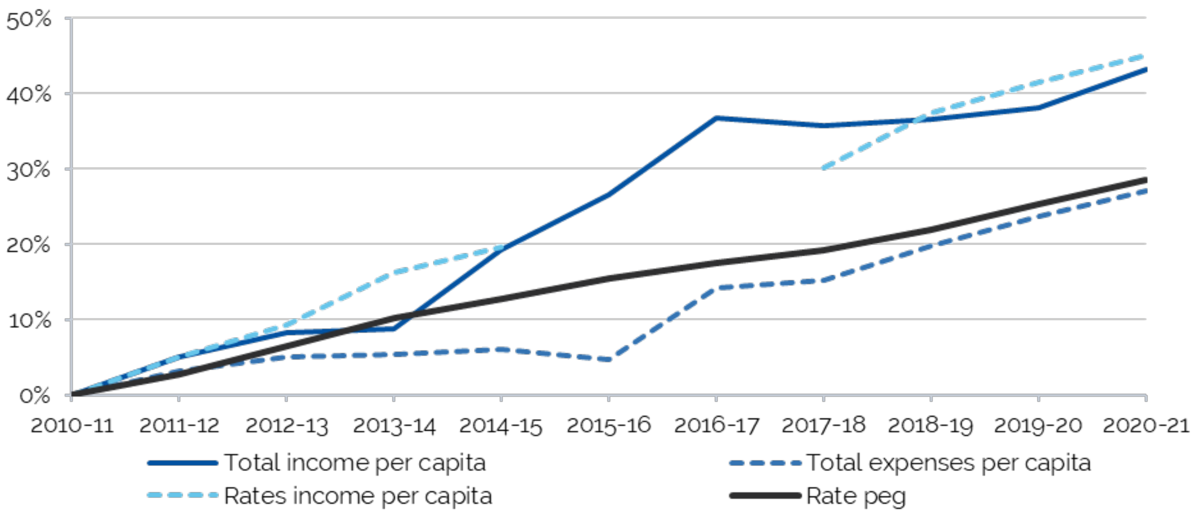


Note: Excludes councils' population factors for 2022-23 and 2023-34.

3.2 How has councils' income changed?

To understand how NSW councils' income has changed since we started setting the rate peg from 2011-12, we compared the relative growth in their total income, expenses, and rates income and the cumulative increase in the rate peg (Figure 3.3).

Figure 3.3 Growth in NSW councils' income, expenses, and rates income per capita compared to cumulative increases in the rate peg



a. 2010-11 included as the base year.
b. We adjusted figures for total income, expenses, and rates income for population growth.
c. Figures for total income and expenses from continuing operations are based on councils' general funds.
d. We excluded rates revenue for 2015-16 and 2016-17 as the dataset does not contain councils impacted by amalgamations.
e. We estimated values for a small number of councils that did not report data to OLG based on the aggregate percentage change for other councils over the same period.

Source: Email to IPART, Office of Local Government, 25 August 2022, and Office of Local Government, Times Series Data.

Figure 3.3 presents councils' total income, expenses, and rates income on a per capita basis. It shows that from 2010-11 to 2020-21:

- councils' operating income per capita grew by around 43%
- councils' operating expenses per capita grew by around 27%
- councils' rates income per capita grew by around 45%
- the cumulative increase in the rate peg was 28%.

In addition to higher rates revenue, other drivers of the 43% increase in councils' total operating income per capita included:

- higher grants and contributions per capita, which grew by 65%
- higher user charges and fees per capita, which grew by 29%.

The 45% increase in total rates income per capita is equivalent to an average increase of around 3.8% per year, which is around 50% higher than the average rate peg of 2.5% per year over this period. This can mainly be attributed to SVs and additional income received through supplementary valuations.

Our preliminary state-wide analysis suggests that on a per capita basis, movements in the rate peg appear to be similar to councils' combined total operating expenses. We intend to undertake further analysis to understand if this varies depending on a council's circumstances and location. It is also possible that councils have referred to the rate peg when setting their budgets and planning their expenditure, which would explain why councils' total expenses per capita and the rate peg have grown at a similar rate.

Appendix B – Councils' income since 2011-12 provides more detailed analysis on councils' total operating income.

3.3 Why did we introduce the population factor?

In our 2021 review of the rate peg to include population growth, we recognised that councils must provide additional services as their local communities grow. While councils receive supplementary valuations to fund the costs of these additional services, we found that most councils receive less income from rates for each new resident compared to existing residents.

In response to this finding, we adjusted our rate peg methodology to include a population factor from 2022-23. The population factor is intended to enable councils to maintain per capita rates income over time as their populations grow.

This means that from the 2022-23 rate peg onwards, councils' rate pegs account for higher costs incurred as a result of population growth. However, these population adjustments did not compensate councils that experienced population growth prior to the recent introduction of the population factor.

Figure A.1 in Appendix A shows the population factors we set for the 2022-23 rate peg, which range from 0% to 3.1%.

3.4 How has the rate peg impacted councils' funding of services?

Some councils have told us that the rate peg is putting them under increasing financial pressure.

We welcome stakeholder views (and evidence) on how the rate peg has impacted councils' quality and range of services. We are also seeking information on how the rate peg has affected the ability of councils to maintain levels of existing services (in terms of both quantity and quality) to their communities.

We will also undertake analysis of NSW councils' financial data from 2011-12 to help support our understanding of this issue.

Seek comment

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?

4 Important issues for this review

To meet our terms of reference, and respond to concerns that stakeholders have raised with us, we have identified 5 key issues for this review:

- Can we better account for the differences between councils?
- Are volatility and lag in the rate peg problems?
- Can we better capture the change in efficient labour costs?
- How should new services, activities or external costs be funded?
- Can we improve simplicity and understandability?

Each of these issues relate to how well the rate peg reflects costs and are discussed below.

4.1 Can we better account for how councils differ from each other?

Our terms of reference ask us to have regard to the differing needs and circumstances of councils and communities in metropolitan, regional and rural areas. These councils differ widely in terms of the characteristics of the areas and the populations they serve. These differences mean that their costs in providing local government goods and services and their scope to raise revenue to cover these costs also vary.

Table 4.1 highlights the differences in some key characteristics of councils across the state, including area size, population, and length of roads they are responsible for maintaining.

Table 4.1 Characteristics of councils in different parts of NSW

Council type	Average council area (km^2)	Average population changes over 5 years (%)	Average population density (population /km^2)	Average total road length (km)	Average residential rate ($)
Metropolitan	77	5.9%	3,825.7	439	1,186
Regional town/city	3,688	3.6%	93.2	1,363	1,222
Metropolitan fringe	1,134	8.9%	305.2	1,032	1,400
Rural	15,213	-2.8%	0.5	1,608	454
Large rural	7,881	-0.2%	2.6	1,725	863
All councils	**5,530**	**2.4%**	**796.5**	**1,307**	**1,024**

a. Figures in this table are based on data for 2020-21.
b. We separated metropolitan councils into 2 types – Metropolitan to describe those part of a developed urban centre; and Metropolitan Fringe to describe those on the margin of a developed urban centre. We also separated rural councils in 2 types – Rural to describe those with population up to 5,000; and Large Rural to describe those with population above 5,000.
c. Figures in the population changes over 5 years column represent the population changes from 2015-16 to 2020-21.

Source: Office of Local Government, Times Series Data 2020/2021.

We have observed that different council types rely on a different mix of income sources to fund their expenditure. For example, metropolitan and regional councils tend to receive a higher share of income from rates, and rural councils generally source a higher share of income from grants and contributions. More information on the role of the rate peg in the revenue framework for different councils is available in Appendix B – Councils' income since 2011-12.

Some councils have previously argued that the LGCI is too broad and that its components are not individualised enough for councils. As Section 2 discussed, the LGCI is designed to measure cost changes experienced by the average council in NSW, and as a result probably does not reflect the exact actual cost changes of any individual council. Every council is different, with different communities, services, and costs.

The addition of the population growth factor from the 2022-23 rate peg means the current methodology captures the differing rates of population growth, and the costs associated with this, for individual councils. As part of this review, we plan to investigate the degree of variability in cost profiles across different councils and council types in NSW and consider ways in which the rate peg methodology could better reflect council differences.

For example, it may be that councils of the same type – e.g. rural councils or metropolitan councils – have similar cost structures. If we find evidence that this is the case, we will consider whether there is merit in introducing separate cost indexes for different council types.[j]

We support changing the rate peg methodology to account for material differences in inflation and costs incurred by different council types. However, changes to improve accuracy and cost-reflectivity can also result in greater complexity. We will take this into account when considering changes to the rate peg methodology as part of this review.

Seek comment

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?

[j] For instance, if large metropolitan councils tend to have a certain mix of cost inputs, which differed markedly from any cost mix that small rural councils may tend to have.

4.2 Are volatility and lag in the rate peg problems?

As previously noted, our terms of reference ask us to set a rate peg methodology that is reflective, as far as possible, of inflation and the costs of providing local government goods and services. At the same time, we have also been asked to recommend options for addressing lag and volatility in the rate peg.

Under the current methodology, this lag and volatility stem from:

- **The 2-year lag in the LGCI.** The rate peg for a financial year is published in September of the previous year. To determine this percentage, we measure the change in the LGCI using the latest available ABS information on prices, which relates to the previous financial year. As a result, there is a 2-year lag between when councils experienced cost changes and when the rate peg reflects those changes. For example, to set the rate peg for 2022-23, we measured the change in the LGCI in the year July 2020 to June 2021, relative to July 2019 to June 2020. This rate peg then came into effect in July 2022.
- **Volatility in prices.** When inflation is volatile, this is reflected in the change in the LGCI and thus the rate peg.

The sections below discuss why lag and volatility in the rate peg may be problems for councils and ratepayers, some options for addressing these issues, and the role of the SV process.

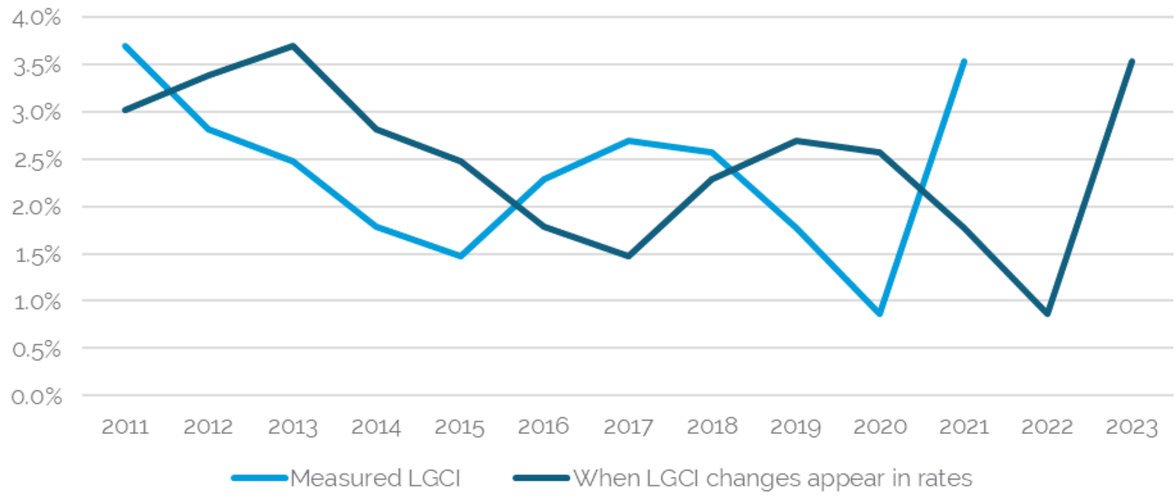
Why lag and volatility may be problems

When inflation[k] is relatively stable from one year to the next, the lag in the LGCI (and therefore the rate peg) does not cause a problem in and of itself. In this stable environment, the changes in councils' costs from year to year are relatively even, so there is little difference between the change in the LGCI when councils get that increase through the rate peg 2 years later.

However, the lag is more of an issue when inflation is volatile. When inflation increases sharply in one year, councils' actual cost changes are also likely to increase sharply in that year. However, the lag means that the cost change measured by the LGCI in that year will be significantly lower than these actual cost changes, and it will take 2 years for these actual changes to 'show up' in the LGCI. This is shown in Figure 4.1 below.

[k] And/or public sector wages as measured by the NSW public sector wage price index (WPI).

Figure 4.1 When LGCI changes are measured versus when they apply to rates income



Source: IPART analysis

Volatility in the rate peg makes it more difficult for councils to plan and budget. This problem occurred recently, when we set the 2022-23 rate peg at 0.7% (excluding the population factor). Recent high inflation and price volatility, combined with the lag in the LGCI, meant that this increase was lower than most councils had factored into their 2022-23 budgets and Long-Term Financial Plans. In response to this, councils were allowed to apply for an Additional Special Variation (ASV) to make up the shortfall.[l]

But would volatility be less of a problem for councils if we could:

- reduce the lag in the LGCI?
- improve the predictability of the changes measured by the LGCI?

We are keen to hear councils' views on these questions.

Volatility may also be an issue for ratepayers because it might make budgeting for future years more difficult. Overall, ratepayers may prefer stability over cost-reflectivity. However, creating a stable rate peg instead of a cost-reflective one may result in a growing divergence between councils' costs and rates income. We would like to hear from ratepayers on this issue.

[l] We assessed councils' ASV applications based on guidelines from the Office of Local Government. The ASV they could seek was capped at the lower of 2.5% (including the population factor) or the council's assumed 2022-23 rate peg based on its 2021-22 Integrated Planning and Reporting documentation (including the population factor). Councils had to demonstrate why the ASV was required and that they had considered the impact on ratepayers and the community. We approved ASV applications for 86 councils, with increases ranging from 1.6% to 2.5%.

How could we address some of these volatility problems?

There are a number of changes we could make to the current methodology to reduce the impact of volatility, but each has some potential drawbacks.

For instance, we could use forecasts of cost changes rather than lagged actual data on cost changes to set the rate peg each year. This would eliminate the lag, and potentially enable more timely changes in the rate peg to match changes in costs. However, even the most sophisticated forecasts can be inaccurate. This means this approach would create a risk of long-term divergence between councils' costs and rates income.

Another option might be to use a rolling-average of cost changes. This would reduce volatility in the rate peg but increase the lag. It could also result in the rate peg being less cost-reflective than under the current methodology.

There might be other options that we could consider, such as setting the rate peg at a fixed percentage over a longer period, say 4 years. This gives councils and ratepayers more certainty but may turn out to be significantly out of alignment with changes in costs.

What are stakeholder preferences?

It will be difficult to devise a methodology that can simultaneously reduce volatility in the rate peg, allow it to reflect councils' cost changes in real time, and enable it to accurately reflect these costs changes. Determining the most appropriate rate peg methodology is a balancing act. Each option has benefits and risks associated with it. To find the right balance, we will carefully consider what stakeholders tell us is more important to them:

- short-term fluctuations in the rate peg are minimised to support councils' long-term planning processes
- the rate peg compensates councils for changes in the costs of providing local government goods and services in a timely manner, or
- the rate peg accurately reflects changes in the costs of providing local government goods and services.

We also note that the option which performs best in a high inflationary environment may not be the best option over the long-term, and vice versa.

Seek comment

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

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

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

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

4.3 Can we better capture the change in efficient labour costs?

As Figure 2.1 indicated, labour costs are the largest single cost component included in the LGCI, with a weighting of 38.6%. While we intend to review all 26 components of the index, we are particularly interested in whether we can better capture changes in efficient labour costs.

We recognise that councils need to pay staff salaries and maintain conditions that retain and attract people with appropriate skills. The measure of labour costs in the rate peg methodology needs to reflect labour market conditions, but also make allowance for appropriate labour productivity gains.

We currently use the NSW public sector wage price index (WPI) in the LGCI. This reflects the change in total hourly rates of pay for NSW public sector workers.[m] We are seeking comment from councils, ratepayers, and other stakeholders about whether this remains the most appropriate way to account for changes in councils' labour costs.

Some alternatives we could consider instead of the WPI include using:

- the NSW Local Government (State) Award, which may be more reflective of the actual changes in labour costs councils face
- specific enterprise bargaining agreements, or changes in NSW councils' total employee costs.

However, we may also need to consider expected labour productivity improvements, depending on the approach taken.

We note that the WPI does not include changes in the superannuation guarantee. From July 2021 to July 2025, it is increasing by 0.5% each year (from 9.5% in 2020-21 to 12% in 2025-26). This may be a significant additional cost for councils that is not currently captured in the rate peg methodology.[n]

Seek comment

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

[m] Excluding bonuses and superannuation contributions.

[n] We included an explicit adjustment for the 2021-22 superannuation guarantee in our calculation of the 2023-24 rate peg.

4.4 How should new services, activities and external costs be funded?

Over time councils may need or want to provide new services to their local communities or undertake new activities to deliver existing services. These may be discretionary new services the community wants, existing services that require more effort to deliver, or additional costs or services the council has been compelled to fund. Where this is the case, councils need to meet the costs of those new services or activities.

The rate peg methodology does not account for changes in service provision.[o] The LGCI is calculated based on the change in unit costs of doing business, not how much business council does.[p]

Currently councils can fund new services in several ways, including:

- re-prioritising services or finding efficiencies in their expenditure
- levying fees or charges for a service in some cases
- applying to IPART for an SV to their rates income above the rate peg
- seeking operating or capital grants.

We are interested in hearing from stakeholders about whether and how the rate peg methodology should account for additional costs associated with new services, activities or costs outside councils' control, while still providing appropriate checks and balances to allow ratepayer interests to be protected.

Councils can face changes in their costs that are outside their control (external costs). Some of the adjustments we currently make to the rate peg to account for these kinds of external costs, such as the emergency services levy, are added to the LGCI. Others, such as the costs of local government elections in 2021-22, are made as a separate adjustment to the rate peg directly. One of the options we may consider is whether adjustments for changes in other external costs should be included in the rate peg methodology.

We would also like to hear stakeholders' views on what types of external costs they face and if and how these costs should be reflected in the rate peg methodology.

Seek comment

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?

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o An exception to this is our approach to factoring the emergency services levy (ESL) into the LGCI. We use forecasts to determine the change in councils' ESL costs.

p There is now a population growth factor that provides more income as population grows, but rates do not rise as more services are provided on a per capita basis.

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

4.5 Can we make the rate peg simpler and easier to understand?

The current rate peg is a relatively complex calculation, with multiple inputs and steps. For example, as section 2.1 noted, the LGCI includes 26 cost components, each of which is separately inflated using an ABS index. Simplifying our methodology would make it easier for councils to apply the method themselves to predict the likely rate peg when they are planning.

However, in general, the simpler we attempt to make the rate peg, the less accurate it will become in reflecting cost changes. On the other hand, it may also be the case (for example) that the relative materiality of using many different ABS indexes is negligible, and it might be preferable to reduce some of that complexity for a simpler method.

In this review, we will look for opportunities to simplify the methodology and improve the predictability of the rate peg without sacrificing much accuracy.

Seek comment

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?

Appendices

A Performance of the rate peg since 2011-12

A.1 History of the rate peg in NSW

First introduced in NSW in 1977, the rate peg represents the maximum percentage amount by which councils may increase their rates income for a given year. Councils that wish to increase their rates income by an amount above the rate peg must consult with their communities and apply to IPART for approval of an SV.

In 2008, the NSW Government asked IPART to review the framework for regulating council rates and charges.[q] The review identified that stakeholders were concerned about the transparency of the approach for setting the rate peg, given the methodology had never been clearly explained. The review recommended using a new local government-specific cost index that is calculated transparently and designed to reflect movements in councils' costs to determine the rate peg. A productivity adjustment factor would be added to account for councils' productivity gains.

In 2010, the NSW Government announced that from 2011-12 the amount by which councils could increase their rates income would be determined by IPART, having regard to the movements of the LGCI and productivity factor. IPART exercises this power under delegation from the Minister for Local Government.[10]

In 2021, the NSW Government asked us to recommend a rate peg methodology that allows councils' rates income to vary in a way that accounts for population growth. We recommended a methodology that enables councils to maintain their per capita income as their population grows. We first applied this new methodology in our decisions on councils' 2022-23 rate pegs.[r]

A.2 How does IPART calculate the rate peg?

Our current rate peg methodology has 4 key steps:

- measuring the average annual change in costs faced by NSW councils using the LGCI
- applying a council-specific population growth factor to account for the annual change in each council's population
- considering whether we need to apply a productivity factor to account for productivity improvements in the local government sector
- considering whether we need to adjust the rate peg above or below the percentage produced by the LGCI, population growth factor and productivity factor, for any other external factors likely to impact on councils' costs.

Each of these steps is discussed below.

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[q] See our terms of reference for our review of the revenue framework for local government.

[r] See our terms of reference for our review of the rate peg to include population growth.

A.2.1 Measuring the annual change in the Local Government Cost Index

The LGCI is designed to measure how much the price of a fixed basket of inputs acquired by councils in a given period compares with the price of the same set of inputs in a base period. That is, the LGCI does not measure costs directly, but how the prices of goods and services in the basket change over time. Measures of cost changes are mainly sourced from ABS price indexes for wages, consumer prices, and producer prices.

The LGCI was first developed by IPART in 2010 following a survey of councils to determine appropriate cost categories and weightings.[s] IPART surveys councils on costs for the LGCI every 4-5 years and uses this data to reweight the LGCI to maintain the appropriateness of the cost categories and their weightings. The last reweight of the LGCI was completed in May 2020, based on results from our 2019 cost survey of councils.[11]

Table A.1 shows the 26 cost components in the LGCI, the inflators we use to measure changes in each component, and their current weights.

[s] See IPART's Information Paper on the Local Government Cost Index, released December 2010.

Table A.1 LGCI cost components, inflators, and weightings

Cost component	Inflator	Weight as at end June 2021 (%)
Operating costs		
Employee benefits and on-cost	Wage Price Index (WPI) – Public sector, NSW	38.6
Plant and equipment leasing	Producer Price Index (PPI) – 663 Other goods and equipment rental and hiring	0.3
Operating contracts	PPI – 729 Other administrative services	2.1
Legal and accounting services	PPI – 693 Legal and accounting services	0.8
Office and building cleaning services	PPI – 7311 Building and other industrial cleaning services	0.3
Other business services	PPI – 7299 Other administrative services (not elsewhere classified)	6.2
Insurance	Consumer Price Index (CPI) – Insurance, Sydney	1.2
Telecommunications, telephone and internet services	CPI – Telecommunication equipment and services, Sydney	0.4
Printing, publishing and advertising	PPI – 16 Printing (including the reproduction of recorded media)	0.6
Motor vehicle parts	CPI – Spare parts of accessories for motor vehicles, Sydney	0.3
Motor vehicle repairs and servicing	CPI – Maintenance and repair of motor vehicles, Sydney	0.4
Automotive fuel	CPI – Automotive fuel, Sydney	0.7
Electricity	CPI – Electricity, Sydney	1.9
Gas	CPI – Gas and other household fuels, Sydney	0.1
Water and sewerage	CPI – Water and sewerage, Sydney	0.4
Road, footpath, kerbing, bridge and drain building materials	PPI – 3101 Road and bridge construction, NSW	2.5
Other building and construction materials	PPI – 3020 Non-residential building construction, NSW	0.7
Office supplies	CPI – Audio, visual and computing media and services, Sydney	0.3
Emergency services levy	IPART index based on data provided by NSW Treasury	1.5
Other expenses	CPI – All groups CPI, Sydney	8.4
Capital costs		
Building – non-dwelling	PPI – 3020 Non-residential building construction, NSW	4.2
Construction works – road, drains, footpaths, kerbing, bridges	PPI – 3101 Road and bridge construction, NSW	22.0
Construction works – other	PPI – 3101 Road and bridge construction, NSW	2.5
Plant and equipment – machinery, etc.	PPI – 231 Motor vehicle and motor vehicle part manufacturing	3.0
Plant and equipment – furniture, etc.	PPI – 24 Machinery and equipment manufacturing	0.1
Information technology (hardware and software)	CPI – Audio, visual and computing equipment and services, Sydney	0.6

A.2.2 Apply a council-specific population factor

From 2022-23, we introduced in the rate peg methodology a population factor for each council in NSW based on how fast its population is growing. The population factor is designed to compensate councils for population growth from 2021-22 onwards.

The population factor is equal to the maximum of the change in residential population in the council area less the supplementary valuations percentage or zero (see Box A.1 for more detail). Councils with negative population growth will have a factor of zero, ensuring no council receives a lower increase in rates income, relative to a rate peg calculated using the LGCI, productivity factor and any adjustments. Councils that have recovered more from supplementary valuations than is required to maintain per capita rates income as their population grows will also have a population factor of zero.

Box A.1 How the population factor works

When the population grows, land is sometimes rezoned or subdivided to provide more housing or businesses. When this happens, councils can generate additional income (over and above the rate peg) through supplementary valuations in a given year. In our review of the rate peg to include population growth we found that supplementary valuations only partly compensated councils for population growth.

The population factor enables councils to maintain per capita rates income as their populations grow, in instances where the rate of growth in income from supplementary valuations does not keep pace with the rate of growth of the population.[a]

$$\begin{aligned} &Population\ factor \\ &\qquad = \max(0, change\ in\ population \\ &\qquad - supplementary\ valuations\ percentage)^{b} \end{aligned}$$

a. We calculate a separate population factor for each council. This means a fast-growing council is likely to receive a higher population factor (and hence rate peg) than a slowly growing one.
b. Without this adjustment for supplementary valuations, some councils would be overcompensated for population growth at the expense of ratepayers (up to double in some cases).

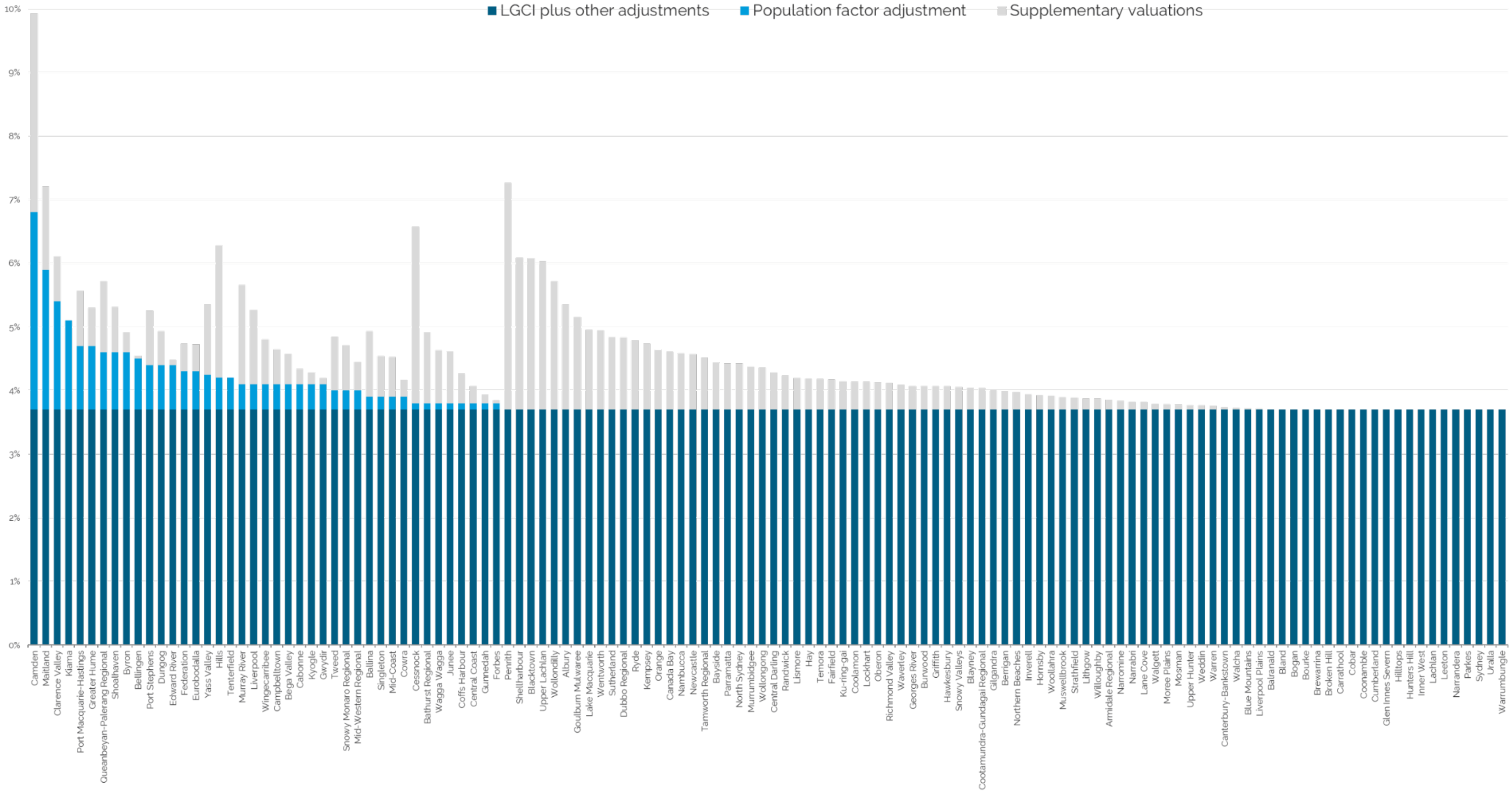
Source: IPART, Review of the rate peg to include population growth, September 2021, pp 2,3, 8 and 11.

Our terms of reference for this review require us to consider whether the population factor is achieving its intended purpose. We will review the effectiveness of the population factor, but this will be limited as we have only 2 years of data.

Figure A.1 shows the allowed change in each council's rates income in 2023-24 due to the rate peg (change in the LGCI and other adjustments we make plus its council-specific population factor) as well as any supplementary valuations it receives.[t]

[t] Supplementary valuations are provided through a process outside of the rate peg but do provide councils with additional revenue.

Figure A.1 2023-24 rate peg, population adjustments and supplementary valuations by council



The figure shows that each council will receive a minimum rate peg of 3.7%. Around one third will receive a higher rate peg due to their population factor. The remainder have a population factor set to 0%. This occurs because, either the council recorded no population growth in its area, or the population growth was less than the supplementary valuation increases they received.

The population factor in our rate peg methodology is based on the most up to date ABS population data, but this is lagged by 3 years. This lag means that the population changes captured in the population factors we applied for the 2023-24 rate peg reflect changes that occurred in 2020 to 2021, during the COVID-19 pandemic. We expect the pandemic would have impacted on levels of intrastate and interstate migration, and suppressed levels of net overseas migration.

A.2.3 Consider applying a productivity factor

Our rate peg methodology also includes a factor to account for productivity changes in the local government sector.

From 2011-12 to 2017-18, we calculated the factor using the ABS market sector value-added multifactor productivity based on quality adjusted hours worked. Productivity factors we applied ranged from 0.0% to 0.2%.

Since 2017-18, our productivity factor has been set at 0% as a default to recognise that improvements in productivity are already reflected, to an extent, in the ABS price indexes we use to measure price changes in LGCI cost categories. However, we retain discretion to apply a productivity factor if there is evidence of productivity improvements in the local government sector that have not been fully incorporated in the LGCI.

A.2.4 Make other adjustments

IPART has discretion when setting the rate peg, and we have previously adjusted for factors we considered would impact councils' costs that would not be captured or reflected in a timely manner through the existing rate peg methodology. These adjustments can be upwards or downwards. We are interested in your views on whether the adjustments we have previously made are sufficient.

As an example, in the 2012-13 rate peg we included a carbon price advance to allow councils to recover higher costs associated with introduction of the carbon price, which was not captured in the price data we used to calculate the rate peg.[12] This adjustment was reversed in the following 2 years to avoid double counting the impact of the carbon price as it flowed through to the LGCI.[13]

More recently, we introduced a temporary upward adjustment in the 2021-22 rate peg to assist councils to meet additional costs associated with the 2021 local government elections.[14] This adjustment was reversed in 2022-23.

Figure A.2 shows the different adjustments we have made to the rate peg percentage since 2011-12.

Figure A.2 IPART adjustments to rate peg percentage, 2011-12 to 2023-24

2011-12	**Rate peg set** - With productivity adjustment
2012-13	**0.4% increase** – Carbon price advance to offset introduction of carbon price
2013-14	**0.1% decrease** - Carbon price advance partially withdrawn to avoid double counting the impact of the carbon price
2014-15	**0.3% decrease** - Carbon price advance withdrawn to avoid double counting the impact of the carbon price
2018-19	**0% productivity adjustment** - IPART decided to set the productivity adjustment to 0% by default
2020-21	**Change in Emergency Services Levy** - IPART used forecast ESL contributions instead of actual figures. This helped reduce the lag from two years to one
2021-22	**0.2% increase** – Adjustment for local government election costs
2022-23	**0.2% decrease** - Adjustment for local government election costs removed **Population growth factor** - Introduced
2023-24	**0.2% increase** - Superannuation guarantee

Source: Adjustments for each year are available on our website.

A.3 How other states and territories regulate rates income

Apart from Victoria, the other states and territories do not regulate rates income. Rather, councils are permitted to adjust the level of their rates income to align with their prepared budget for each financial year.

However, these councils do need to meet specified requirements before raising rates. For example, several jurisdictions require councils to publish a public notice of rates and an explanation for the rate increases and, in some cases, to consult with the public.

Table A.2 provides an overview of the legal mechanisms that allow rates income to increase in each jurisdiction.

Table A.2 Methods of increasing rates in other states and territories

Jurisdiction	Method
Victoria	• Uses a rate cap method, similar to NSW. The rate cap is set equal to the December forecast of the CPI from the Victorian Department of Treasury and Finance. • The Essential Services Commission (ESC) is responsible for recommending rate cap increases to the Minister for Local Government. • The Victorian method is flexible, as shown in 2022-23 when the ESC recommended that the rate cap should not be set outside of the historical range of 1.50% to 2.50%.[a] • Councils can seek approval for a higher rate cap from the ESC, if the rate cap decision does not meet their needs. • The rate cap for 2022-2023 was set at 1.75%.[b]
Western Australia, Queensland, South Australia, Tasmania and Northern Territory	• In these jurisdictions councils have the autonomy to set their rates at the level needed to achieve the required income in their budgets.[c] • Each jurisdiction has varying legislative requirements and restrictions on councils, but broadly councils have authority to independently set rates. • An example of a restriction is that in Western Australia, a council's income from general rates is limited, such that income from rates cannot exceed 110% of the budget deficit or be less than 90% of the budget deficit.[d]
ACT	• The ACT does not have local governments and instead land rates are set by the ACT government.

a. Essential Services Commission, Advice on the average rate cap for 2022-23, November 2021, p 1.
b. Essential Services Commission, Average annual rate caps.
c. Productivity Commission, 5 Year Productivity Review - Supporting Paper No. 16 – Local Government, August 2017, p 10.
d. *Local Government Act 1995* (WA), s 6.34.

A.4 How municipal rates have changed in NSW compared to other states and territories

Figure A.3 shows how municipal rates have changed in all states and territories (other than the ACT[u]) and compares this to the NSW rate peg and inflation.[v] The difference between the NSW changes in municipal rates and the rate peg changes likely reflect this difference. The difference is also likely due to SVs, which allow NSW councils to raise their rates above the amount allowed by the rate peg.

Figure A.3 shows that the rate peg and NSW rates have been relatively stable, compared to other jurisdictions. However, there are numerous and varied factors that may drive changes in rates. The higher and less stable rates of change in other jurisdictions could be due to faster growing populations, or volatility in prices. Because of this, it is difficult to compare the impacts of the rate peg to other jurisdictions due to the wide ranging geographic, demographic, and economic differences between them.

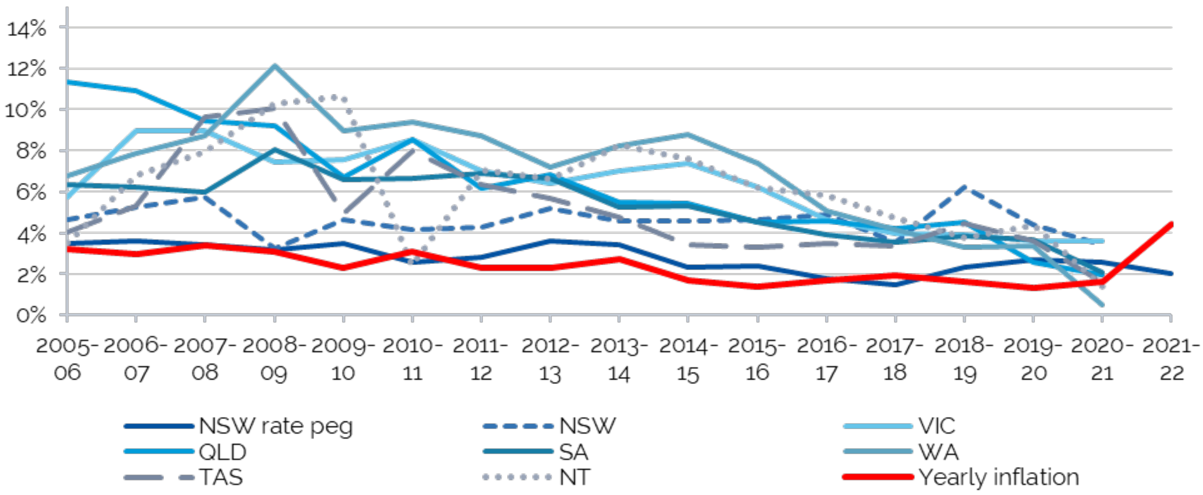
It is important that we examine the changes in rates from other jurisdictions as a comparison for the performance of the rate peg. However, we note that such comparisons are not perfect and that the differences between jurisdictions create a significant number of variables.

u We did not compare the ACT with other states and territories for two reasons. Firstly, there are no local governments in the ACT, rates are set by the Territory Government. Secondly, rates in the ACT grew at approximately 10% annually over the same period, almost double the Australian average (Taxation Revenue, Australia Methodology, 2020-21 financial year).

v Municipal rates are used for this analysis due to the data from the ABS using this categorisation. Municipal rates include rates and charges beyond those that form part of NSW councils' rates income (and therefore subject to the rate peg) – that is, water, wastewater and garbage.

We also note that the changes in municipal rates represent total rates income across each jurisdiction. They do not provide an accurate depiction of the changes experienced in each council, or the experience of individual ratepayers.

Figure A.3 Changes in municipal rates in Australian jurisdictions and the NSW rate peg



Note: Annual change in municipal rates raised in each jurisdiction. IPART first set the rate peg in 2011-12. The ESC first set the rate peg for Victoria in 2015-16.

Source: Australian Bureau of Statistics: Taxation Revenue, Australia Methodology, 2020-21 financial year.

B Councils' income since 2011-12

B.1 How councils and their income sources vary

Under the current rate peg methodology, we set a rate peg for each of the 128 councils across NSW each year. NSW councils differ widely in terms of the characteristics of the areas and the populations they serve. These differences mean that councils' costs of providing goods and services and their scope to raise income to cover these costs also vary.

As part of this review, we will consider the extent to which differences between councils leads to differences in how councils' costs change over time due to inflation and other external factors.

To start exploring this issue, we used OLG's council classifications to identify the key differences between councils' characteristics and sources of income.[15] OLG classifies councils by 5 council types:

1. Metropolitan
2. Regional town/city
3. Metropolitan fringe
4. Rural
5. Large rural.

The council types are based on broad demographic variables, specifically whether the council is part of an urban centre, on the margin of an urban centre, or agricultural in nature and the population size. We recognise that there are also differences between councils of the same type that may influence their cost changes, including geography, socio-economic index rating and demographic factors.

B.1.1 Key differences in council sources of income

In 2020-21, the main source of income for NSW councils was rates income (32% of combined total operating income), followed by grants and contribution (31% of combined total operating income) then user fees and charges (15% of combined total operating income).

However, this varies by council type. As shown in Table B.1, for rural and large rural councils, grants and contributions were the highest source of income (62% and 48% respectively) and the contribution of rates income was much lower than average.

Table B.1 Source of income as a percentage of total income, 2020-21

Council type	Rates income (%)	Grants and contributions (%)	User fees and charges (%)	Annual charges (%)	Other (%)
Metropolitan	41%	23%	11%	13%	12%
Regional town/city	28%	31%	18%	17%	6%
Metropolitan fringe	34%	34%	12%	15%	5%
Rural	11%	62%	18%	6%	3%
Large rural	20%	48%	16%	11%	5%
Total	**32%**	**31%**	**15%**	**14%**	**8%**

a. Other sources of income include interest and investment revenue, net gain from the disposal of assets, and other revenues and income.
b. Based on total income from continuing operations for councils' general funds.

Source: Email to IPART, Office of Local Government, 25 August 2022 and Office of Local Government, Times Series Data 2020/2021.

As part of the next stage of this review we will consult with councils and develop case studies to better understand how different council types use elements of the revenue framework to raise income to fund expenditure. We are also seeking to better understand any differences in inflation and costs incurred by different council types.

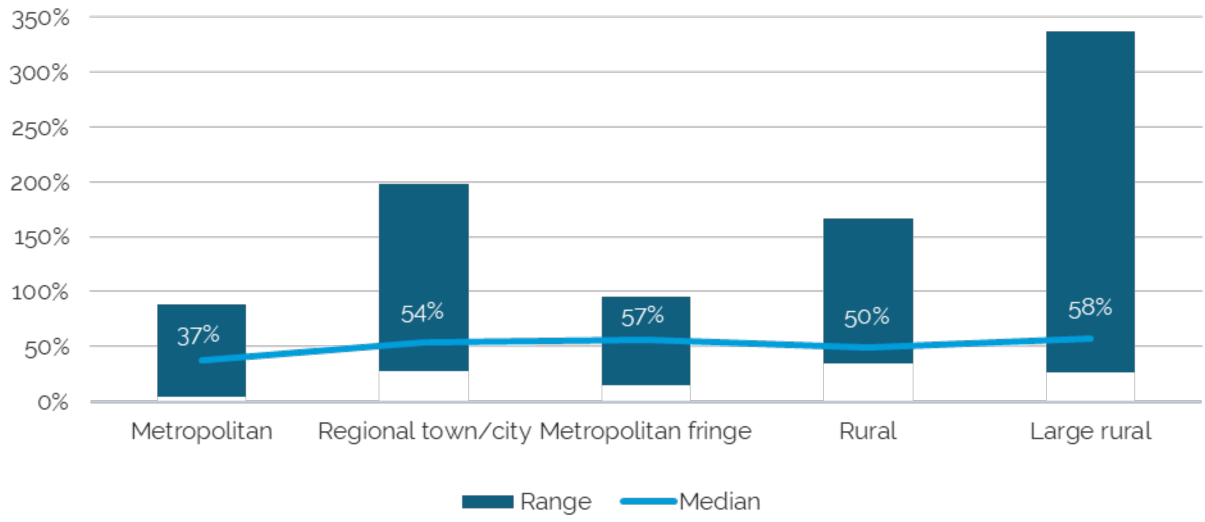
B.2 How councils' income has changed

B.2.1 Rates income per capita increased by 45% from 2010-11 to 2020-21

As we discuss in section 3, rates income per capita increased by 45% from 2010-11 to 2020-21. This is equivalent to an average increase of around 3.8% per year, which is around 50% higher than the average rate peg of 2.5% per year. over this period.

To determine whether particular council types are more likely to require higher increases in total rates income, we compared the percentage change in rates income per capita by council type. Figure B.1 shows the median change, as well as the top and bottom of the range for each council type.

Figure B.1 Change in rates income per capita by council type, 2010-11 to 2020-21



Note: Excludes councils impacted by amalgamations.

Source: Office of Local Government, Time Series Data

All council types recorded medians above the cumulative increase in the rate peg over this period. Large rural councils had the highest median percentage increase (58%), and metropolitan councils had the lowest median percentage increase (37%). We expect that increases above the rate peg are mainly due to SVs and supplementary valuations.

Special variations

From 2011-12 to 2022-23 we approved 168 applications for SVs.

To explore whether particular council types are more likely to apply for an SV, we compared the proportion of councils in each council type to the proportion of SV applications we received from each council type since 2011-12. As Table B.2 shows, we found that metropolitan councils and regional councils were more likely to apply for an SV than other council types:

- metropolitan councils represent 19.5% of all councils in NSW, but account for 25.3% of all SV applications
- regional councils represent 28.9% of all councils, but 40.7% of all SV applications.

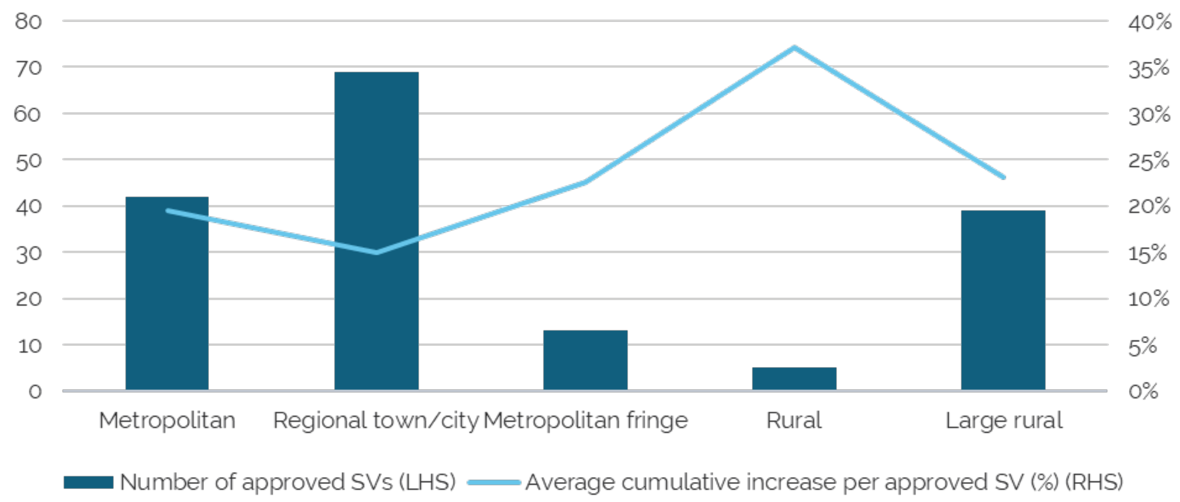
In contrast, together rural and large rural councils represent 44.5% of all councils, but only 26.9% of SV applications.

Table B.2 Proportion of councils and SV applications by type

	Councils in NSW		SV applications	
Council type	**Number of councils**	**Proportion of councils**	**Number of applications**	**Proportion of applications**
Metropolitan	25	19.5%	46	25.3%
Regional town/city	37	28.9%	74	40.7%
Metropolitan fringe	9	7.0%	13	7.1%
Rural	15	11.7%	7	3.8%
Large rural	42	32.8%	42	23.1%
Total	**128**	**100%**	**182**	**100%**

Figure B.2 shows the number of SV applications we approved, and the average cumulative increase per SV by council type from 2011-12 to 2022-23.[w] We note that while rural councils had the lowest number of approved SV applications, they also had the highest average cumulative increase.

Figure B.2 Number of approved SVs and average cumulative increase



Supplementary valuations

Councils are also able to increase rates income outside the rate peg when the Valuer General issues supplementary valuations due to changes in land value (e.g. when land is rezoned or subdivided). We determined that councils received around $286 million in supplementary valuations from 2014-15 to 2020-21.[x, 16]

[w] SVs can be approved for multiple years. The cumulative increase represents the increase over the SV period, and accounts for the effect of compounding. As an example, if we approved a 2-year SV for 10% increases in each year, this would be a cumulative increase of 21% due to compounding.

[x] OLG did not collect information on supplementary valuations prior to this.

B.2.2 Grants and contributions increased by 65%

Operating and capital grants and contributions per capita grew by 65% from 2010-11 to 2020-21.

The key driver of this overall increase was a 130% increase in grants and contributions per capita for capital purposes. In comparison, grants and contributions per capita for operating purposes grew by just 7% over the same period.

We are aware that sometimes a grant for capital purposes might lead to ongoing operating expenses, or deprecation costs which are not captured in our existing rate peg methodology. This is because the LGCI measures the cost of direct acquisitions of goods and services rather than their financing.

We will consider the impact of grants on councils' financials as part of this review.

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