NSW GOVERNMENT | Treasury

Contact: Dominica Nelson
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Independent Pricing and Regulatory Tribunal
Via online submission

Dear panel members,

Review of the rate peg to include population growth

The NSW Productivity Commission appreciates the opportunity to provide a submission to the Independent Pricing and Regulatory Tribunal's (IPART) Issues Paper: *Review of the rate peg to include population growth.*

In March 2021, the NSW Government accepted all 29 recommendations of my *Review of Infrastructure Contributions in New South Wales* (the Review) for implementation. Among recommendations aimed at fixing the local infrastructure funding system was reforming the local government rate peg to reflect population growth.

The Review recognised the existing rate peg methodology is penalising councils for accommodating an increased population because it does not allow for commensurate increase in the volume of services demanded. This weakness was also previously acknowledged by IPART in its *Review of the Local Government Rating System – Final Report.* That review found, over the previous 5–10 years, councils' general income grew by 0.2 per cent annually compared to population growth of 1.3 per cent, on average.

The Issues Paper asked a number of questions relating to costs faced by local government. Issues with councils' costs, including impacts from population growth, have already be explored in my 2020 *Review of Infrastructure Contributions* and IPART's *Review of the Local Government Rating System*. The Commission submits that IPART should develop a simple and robust methodology for councils' rates to adjust with population.

Reform to the rate peg is a necessary condition for successful implementation of the broader reform package for infrastructure contributions. Stakeholders hope to have the new rating arrangements in place from 1 July 2022, enabling other reforms contingent on the change to be progressed.

In response to specific discussion questions posed in the Issues Paper, the Commission provides its feedback in **Attachment A** for your consideration.

The Productivity Commission and NSW Treasury are available to offer further advice on design and implementation of the rate peg reform. Please contact Dominica Nelson on dominica.nelson@treasury.nsw.gov.au or 08 6768 4201 if we can be of further assistance.

Yours sincerely,

Peter Achterstraat

Peter Achterstraat AM
NSW Productivity Commissioner

3 May 2021

Attachment A – Submission to IPART's Issues Paper
Attachment B – NSW Productivity Commission's Review of Infrastructure Contributions (Final Report)

NSW Productivity Commission's submission to the Issues Paper

Discussion Questions	Responses
1. What council costs increase as a result of population growth? How much do these costs increase with additional population growth?	The impact on council costs from population growth have been explored previously by two reviews for NSW Government—the IPART's *Review of the Local Government Rating System* (December 2016) and the NSW Productivity Commissioner's *Review of Infrastructure Contributions* (December 2020). This review should refer to these previous reports for answers to this question and the issues it poses.
2. How do council costs change with different types of population growth?	Refer to the answer for Discussion Question 1.
3. What costs of population growth are not currently funded through the rate peg or developer contributions? How are they currently recovered?	Refer to the answer for Discussion Question 1.
4. Do you have any views on the use of the supplementary valuation process to increase income for growth, and whether this needs to be accounted for when incorporating population growth in the rate peg?	Presently, councils can increase their general income above the rate peg through the existing supplementary valuation process. When changes to a property are recorded, a Supplementary Notice of Valuation is issued to determine a new land value, outside of the usual three to four-year valuation cycle. Supplementary valuations can occur due to: • newly created parcels of land in subdivisions • the transfer of part of land that is included in an existing valuation (e.g. through strata division of an existing block) • the amalgamation of parcels of land into a single valuation • changes to zoning, or • an error being detected in the valuation process. Consideration should be given to abolishing the supplementary valuation process, as a reformed rate peg that accounts for population growth will provide a simpler and more transparent methodology. The special variation process should continue where councils must demonstrate to IPART the need for additional revenue over the rate peg within the guidelines set by the Office of Local Government.
5. Are there sources of population data we should consider, other than the ABS historical growth and DPIE projected growth data?	Population forecasts and projections (as endorsed by the Common Planning Assumptions Group) and Australian Bureau of Statistics (ABS) actuals are used across NSW Government. These are the preferred datasets unless a strong case can be made for using an alternative source.

6. Is population data the best way to measure the population growth councils are experiencing, or are there better alternatives (number of rateable properties or development applications, or other)?	Rates are used to provide services to the community, so population data is the preferred way to measure population growth. In addition, it is the residents that pay the rate base that provides councils with their income (not rateable properties or development applications) providing another justification for population data being preferred.
7. Do you think the population growth factor should be set for each council, or for groups of councils with similar characteristics? How should these groups be defined?	Ideally, the population growth factor should be set for each council to reflect the specific growth characteristics of the council. Detailed data is available for local government area (LGA) geographies, so there are no impediments to implementing this. Grouping LGAs with similar characteristics—either by geographical location or by growth bands—is not supported. Besides the complexity of administering annual growth bands, it would distort the revenue-raising capacity of councils by rewarding low-growth councils (and penalising high-growth councils) based on location. For example, applying a single population growth factor to councils within the lower north shore area will see both Mosman (low-growth) and North Sydney (high-growth) councils raise their rates revenue by the same percentage despite facing different servicing requirements. Any issues with developing LGA-specific population indices should be raised with the Common Planning Assumptions Group, chaired by the NSW Chief Economist.
8. Should we set a minimum threshold for including population growth in the rate peg?	A minimum threshold of zero should be set to ensure councils experiencing declining population growth are not negatively impacted under the rate peg reform. Any other amounts are discouraged as this is likely to lead to perverse outcomes in councils' acceptance of growth.
9. What is your view on the calculation of the growth factor – should we consider historical, projected, projected with true-up, a blended factor or another option?	Projected growth with true-up is the preferred option, as it would better reflect future demand for council services. Reasons for why the remaining options are not considered are outlined below: • Historical growth – councils face a 2-year lag before they can raise revenue to match actual growth. • Projected growth – projections may result in under or over recovery of revenue and are based on assumptions of growth expectations. • Blended factor – there is still some risk of under or over recovery of revenue. A formula should be developed to ensure that, over time, council rates increase with the size of the population within their LGA.
10. How should the population growth factor account for council costs?	In conjunction with the rate peg reform, IPART should review the essential works list (Recommendation 4.6 of the *Review of Infrastructure Contributions)* to:

	- determine the development-contingent items (that should be funded from infrastructure contributions) - remove general population items (that should be funded from rates revenue). Subject to review of the essential works list, the rate peg methodology should be revised, to reflect an adjusted local government cost index (LGCI) and inclusion of a population growth factor. The LGCI accounts for changes in prices for a fixed basket of inputs used by an average council, while the population growth factor reflects changes in input quantities used by individual councils (which vary due to differences in expectations and growth). Adjustments must be made to the LGCI to remove development-contingent costs from the content of the basket of inputs so that they are not funded twice (by both ratepayers and developers).
11. Do you have any other comments on how population growth could be accounted for?	The infrastructure contribution reforms are dependent on successful implementation of the rate peg reform. Allowing councils' general income to grow with population will rebalance local infrastructure funding arrangements. It reduces councils' dependence on contributions to fund general population costs, ensuring industry is charged only for the costs incurred from their developments proceeding (development-contingent costs). This allows for unjustified items to be removed from local contributions plans, reducing industry costs, and improving development feasibility. Importantly, the rate peg reform removes an important disincentive for councils to accept development and growth, paving the way for more housing supply and improved affordability.
12. Do you have any comments on our proposed review process and timeline?	To guide implementation of all 29 recommendations from the *Review of Infrastructure Contributions*, the Department of Planning, Industry and Environment has released an implementation roadmap. The rate peg reform is a necessary condition for successful reform of the infrastructure contributions system that needs to be introduced by 1 July 2022 so that they apply from 2023-24 onwards. This proposed timeline reconciles with the overall implementation timeframe adopted by the *Review of Infrastructure Contributions* (see Table 7.1 of Attachment B). It is essential for implementation there be no impediment to delivery of this review within the agreed timeline.