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ITEM 16 IPART REVIEW OF RATE PEG TO INCLUDE POPULATION GROWTH

This report presents a draft submission from Council in response to a request from IPART relating to its review of the inclusion of rates growth within its Rate Peg. The current legislation for rates does not fully allow Council's rates revenue to increase proportionally with population growth, thereby reducing the average rate per head of population and property as population increases. The draft submission supports the proposed variations included in IPART's review, although Council has previously maintained that changes to property valuation using Capital Improved Valuations (CIV) remains Council's preferred approach.

RECOMMENDATION

Council make submission as attached to the **IPART Review of the Rate Peg to include Population Growth**, draft Report June 21.

REPORT AUTHORISATIONS

Report of: Brian Jenkins, Chief Financial Officer
Authorised by: Renee Campbell, Director Corporate Services - Connected + Engaged City

ATTACHMENTS

1 Draft IPART Submission
2 IPART Review of the Rate Peg to include Population Growth - Draft Report

BACKGROUND

IPART has been involved in several Local Government rating reviews over time. The latest review is at the request of the Minister for Local Government to recommend a rate peg methodology that allows the general income of councils to be varied annually in a way that accounts for population growth. Council has reviewed this issue several times through the varying rating reviews and has previously held that the application of Capital Improved Valuations (CIV), as opposed to the current Unimproved Capital Valuations, would have been an appropriate approach to ensure full growth in all aspects were included in the rate calculations. While a change to CIV was proposed by IPART in its Review of the Local Government Rating System – Final Report in December 2016, the NSW Government did not support that approach at the time when it introduced changes to Legislation. There was acknowledgement that growth was not being captured in the rating calculations that led to this current proposal.

The current proposal by IPART is based on calculating population growth. Council's previously stated view was that growth extends beyond 'population' as it is also linked to the business and employment growth. This is particularly so when considering a regional council such as ours that supports areas and populations outside our Local Government Area. The current proposal will not provide for growth in business properties.

IPARTS's recommendation is that 'each council's general income on a per capita basis should be maintained as its population grows. The rate peg for each council should be increased by a population factor equal to the annual change in its residential population, using Australian Bureau of Statistics data, with an adjustment for income derived through supplementary valuations.' Their proposed method is provided below.

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

LGCI is the Local Government Cost index currently used to represent the changes in cost of council's goods and services or our industry inflation rate. Other adjustments are not defined.

The population factor proposed to be used is based on the change in estimated residential population for the local government area (ERP) specified by the Australian Bureau of Statistics (ABS). These statistics are proposed to be applied in arrears so that for the 2022-2023 rate year, the population increase from calendar years 2019 to 2020 would be applied. The population estimates are published in the March following the end of year, while IPART publish the Rate Peg in the December prior to a rating period resulting in the proposed two year lag.

As councils do achieve a level of growth due to increases in rateable properties (supplementary valuations), the population factor proposed makes adjustment for that growth to ensure it is not double counted, as follows:

$Population\ factor = \max(0, change\ in\ population - supplementary\ valuations\ percentage)$

$Change\ in\ population = \max(0, ERP\ 2020/ERP\ 2019 - 1)$

$Supplementary\ valuations\ percentage$ = max (0, $supplementary\ valuations\ notional\ general\ income\ yield$)

Effectively for Council, this should result in the increase allowed in Council General Income to be equal to the Population Factor, as the already applied Supplementary Valuation Percentage would presumably always be lower than the Population Factor. Albeit with the lag in application of the population growth, there may be anomalies in some periods.

To understand the potential financial and rating impacts of this approach, a notional calculation based on the proposed formula has been applied at a high level to the past five years (since the last year of the special rate variation in 2015). The actual notional yield calculation against the potential results with the applied formula are summarised below.

	2021-22	2020-21	2019-20	2018-19	2017-18
Actual Notional Yeild	180,267,266	175,581,733	170,303,044	165,085,380	160,551,320
Revised Notional Yeild	186,262,035	181,014,232	174,086,696	166,843,680	161,334,502
Variance	**5,994,769**	**5,432,499**	**3,783,652**	**1,758,300**	**783,182**

This notional increase in the annual rate levy is calculated to have increased by almost $6M over the five year period. This increase is consistent with the notion that the full impacts of rates growth is not currently been recognised through the current notional yield or General Revenue calculation. Population growth over the period (applied two years in arrears) compared to the value of supplementary rates growth (currently allowed) is represented below.

	2021-22	2020-21	2019-20	2018-19	2017-18
Poulation Growth	1.390%	1.207%	1.372%	0.999%	0.920%
Suplementary Valuation Growth	0.657%	0.485%	0.441%	0.532%	0.424%

This table shows the shortfall between the rates growth currently being applied (supplementary valuation growth) and the proposed population growth figure that is understood to be applied to the Rate Peg under the proposed formula.

While the IPART proposed approach will potentially lead to higher growth in rates revenue that better represents the increase in population and will allow Council to better meet the costs of increased service, how the rates will be allocated is an important consideration. IPART has suggested in their review that 'while the impact on individual ratepayers may vary, on average new ratepayers will pay most of the additional rates revenue. Given this, our view is additional protections for existing ratepayers are not necessary at this stage'. This is considered correct, although due to the nature of Council's rates structure that applies a 50% Base charge (fixed amount) and an ad valorem amount (percentage of valuation), the percentage increases will be higher for higher valued properties and lower for lower valued properties.

IPART has also recognised that their proposal does not address all issues or stakeholder concerns. This includes, Capital Improved Valuations, Emergency Services Levy, Stormwater Management Charges, cost burden of non-rateable property, rating categorisation flexibility, or pensioner rebates. Council has made submission seeking variation on a number of these issues including the current exemptions legislation (non-rateable properties) that was broadly argued on a principle that residential properties should incur rates. This is consistent with a population based approach that increases revenue requirements in line with population growth. The proposed IPART methodology would, for example, increase rates revenue based on population growth in community housing, housing owned by benevolent institutions or charities and other non-rateable residential property. While the rate income would increase, that increased amount must be applied to existing ratepayers who would bear the burden of increased population living in non-rateable property. While this is not preferable, it is consistent with what happens with existing properties when they convert from rateable to non-rateable and is considered to be best addressed through further consideration of exemptions by the State Government.

There are three specific questions asked by IPART in relation to their review:

- Should our methodology be re-based after the census every five years to reflect actual growth?
- In the absence of a true-up, should we impose a materiality threshold to trigger whether an adjustment is needed on a case–by–case basis to reflect actual growth?
- Do you have any other comments on our draft methodology or other aspects of this draft report?

The proposal includes the application of estimated residential population (ERP) specified by the Australian Bureau of Statistics (ABS). These data sets appear to be published each March for the periods from 2000 to the previous year. It is noted that the population figures provided are estimates and appear to allow for retrospective adjustment each year and more accurate figures following each census. It has been identified that there have been changes to Wollongong's estimates from year to year retrospectively, which may have implications on the applied formula. Three data sets for the preceding year show this.

	2020	2019	2018	2017	2016	2015	2014
2001-2018 ABS			216,071	213,281	210,394	208,313	206,415
2001-2019 ABS		218,114	215,856	213,281	210,394	208,313	206,415
2001-2020 ABS	219,798	218,856	215,856	213,281	210,394	208,313	206,415

It can be seen in these numbers that the 2001-2018 estimate population for 2018 of 216,071 was revised downwards in the 2001-2019 statistics to 215,856, and the 2001-2019 figure for 2019 was revised upwards from 218,114 in the 2001-2020 estimates to 218,856. The impact of applying the calculation for the change in population from a single set of numbers would produce inconsistencies and potentially higher or lower rate variations. The cumulative effect of such changes could be significant if correction is not applied or calculations are not based on the numbers provided and applied in the first instance for each year. By applying the numbers reported each year, the system would true itself up each year based on the latest estimate of population and the movement from estimate used in prior years. The table below shows the varying population indexes and cumulative effect where the first line is derived by applying the numbers published in a single year and the second variation (2) based on the numbers as first published in each year.

	2019-20	2018-19	2017-18	2016-17	2015-16	2014-15	2013-14
Change in Population	0.430%	1.046%	1.308%	1.372%	0.999%	0.920%	0.834%
Change in Population 2	0.772%	0.946%	1.308%	1.372%	0.999%	0.920%	0.834%
Cumulative PopN Index	106.228	105.773	104.678	103.326	101.928	100.920	100.000
Cumulative PopN Index 2	106.484	105.668	104.678	103.326	101.928	100.920	100.000

The variations in the prior years based on using a single year's numbers would have reduced income indexation from 6.484% to 6.228% (0.256% variation). This would equate to a variation of approximately $460K in rates revenue.

In considering the impacts of IPART's Rate Peg and its proposals, it is always relevant to consider that the Rate Peg remains the maximum increase allowed to be applied the following years' General Income. Councils retain its control over the application of all or part of the increase. Council will also retain the existing controls over allocations of its rates, with limitations, through rating structure and pricing policy determined through its Revenue Policy each year.

PROPOSAL

It is proposed to make the submission as attached to support the introduction of an adjustment to the Rate Peg for population growth, with clarification on the application of population estimates as described.

PLANNING AND POLICY IMPACT

This report contributes to the delivery of Our Wollongong 2028 goal "We are a Connected Engaged Community". It specifically delivers on the following:

Community Strategic Plan	Delivery Program 2018-2022	Operational Plan 2021-22
Strategy	4 Year Action	Operational Plan Actions
4.3.2 Resources (finance, technology, assets and people) are effectively managed to ensure long term financial sustainability	4.3.2.2 Continue to pursue alternative funding options to deliver financially sustainable services and facilities	Implement approved rating structures Commence the review of the rating structure to align to legislative changes

CONCLUSION

While the proposed methodology is not Council's preferred outcome for accurately reflecting the impacts of growth in its rates, the proposal does provide a reasonable estimate of at least part of the growth impact. The proposal would provide a closer alignment between Council's increasing cost and the rates collected and would provide more options for Council in its collection and distribution of rates. It is considered that the proposal should be supported.

wollongong
city of innovation

WOLLONGONG CITY COUNCIL

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Our Ref:	Z21/154495
File:	FI-002.10.1.1.006
Date:	16 July 2021

SUBMISSION TO THE DRAFT REPORT JUNE 2021 – REVIEW OF THE RATE PEG TO INCLUDE POPULATION GROWTH

Wollongong City Council (Council) would like to thank IPART for the opportunity to respond to its review and draft report on the inclusion of population growth into the Rate Peg. While your direct questions relate primarily to the method of calculation of population growth, Council would like to reiterate that its preferred approach to effectively and equitably managing growth in a local government area would be through the application of Capital Improved Valuation (CIV) as an option for rating. Council would urge the continued pursuit of this outcome through IPART and the State Government in the future.

Council does acknowledge that the proposed methodology for the inclusion of growth in the Rate Peg calculation would provide a reasonable representation of the residential growth of the City and would provide better alignment between Council's increased costs incurred through residential growth and the revenue received to support services for that community. Like IPART, Council is aware that the current calculation does not fully represent the increased population growth or costs incurred and has supported reform that would support such a change.

Council also agrees that the methodology needs to include a net growth result that is inclusive of the portion of growth that is already achieved through the supplementary valuations process. Council's analysis of recent years indicates that on average about 50% of the growth has been achieved through supplementary valuations.

Council also agrees with IPART that the proposed system should provide outcomes that:

- maintains total per capita general income over time;
- reflects a linear relationship between population growth and council costs;
- is based on the change in residential population for each council, and
- applies to all councils, including those experiencing low growth.

While Wollongong City Council agrees that the methodology proposed reflects relationship between population growth and Council costs, it still believes that growth and costs to Council extend beyond 'population'. Cost is are also linked to the business and employment growth, especially when considering a regional council such as ours that supports areas and populations outside our Local Government Area. Council is disappointed that the current proposal will not provide for growth in business properties.

While the IPART proposed approach will lead to higher growth in rates revenue that better represents the increase in population and will allow Council to better meet the costs of increased service, the allocation of rates will remain an important consideration. We understand IPART has suggested that 'while the impact on individual ratepayers may vary, on average new ratepayers will pay most of the additional rates revenue' and 'given this…additional protections for existing ratepayers are not necessary at this stage'. We would argue that due to the nature of Council's rates structure that applies a 50% Base charge (fixed amount) and an ad valorem amount (percentage of valuation), the percentage increases will be higher for higher valued properties and lower for lower valued properties, while all properties will pay more.

Wollongong City Council also remains concerned particularly with previous decisions not to address the cost burden of non-rateable property and pensioner rebates. Council has made submission seeking variation on a number of these issues including the current exemptions legislation (non-rateable properties) that was broadly argued on a principle that residential properties should incur rates. This is consistent with a population based approach that increases revenue requirements in line with population growth. The proposed IPART methodology would, for example, increase rates revenue based on population growth in non-rateable residential property. While the rate income would increase, that increased amount must be applied to existing ratepayers who would bear the burden of increased population living in non-rateable property. While this is not preferable, it is consistent with what happens with existing properties when they convert from rateable to non-rateable and would be best addressed through further consideration of exemptions.

In terms of the specific questions ask by IPART the following is provided.

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

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

There are undoubtedly numerous methods for calculating population growth and presumably each will have specific issues. The use of local government area (ERP) specified by the Australian Bureau of Statistics (ABS) appears to be a valid source, although there is potentially some concern with the lag between actual growth and its application. The proposed source will effectively be applied to a rating year that commences two years after the period of estimated growth. This lag may, at times, have impact on the rates and their distribution of rates that will be reflected in changes to the average rate that theoretically should be maintained in real terms.

In reviewing the estimated residential population (ERP) for Wollongong over recent publications, it has been identified that there have been retrospective changes to estimates from year to year. These changes may have implications on the applied formula. Three data sets for the preceding year show this.

	2020	2019	2018	2017	2016	2015	2014
2001-2018 ABS			216,071	213,281	210,394	208,313	206,415
2001-2019 ABS		218,114	215,856	213,281	210,394	208,313	206,415
2001-2020 ABS	219,798	218,856	215,856	213,281	210,394	208,313	206,415

It can be seen in these numbers that the 2001-2018 estimated population for 2018 of 216,071 was revised downwards in the 2001-2019 statistics to 215,856 and the 2001-2019 figure for 2019 was revised upwards from 218,114 in the 2001-2020 estimates to 218,856. The impact of applying the calculation for the change in population from a single data set, therefore, would produce inconsistencies and potentially higher or lower rate variation percentages. The cumulative effect of such changes could be significant.

It is contended that the formula should be based on the estimates provided and applied in the first instance for each year. By applying the numbers reported each year, the system would true itself up each year based on the latest estimate of population against the previously applied estimate. The table below shows the varying population indexes and cumulative effect for Wollongong City Council, where the first line is derived by applying the numbers published in a single year and the second variation (2) based on the numbers as first published in each year.

	2019-20	2018-19	2017-18	2016-17	2015-16	2014-15	2013-14
Change in Population	0.430%	1.046%	1.308%	1.372%	0.999%	0.920%	0.834%
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Cumulative PopN Index	106.228	105.773	104.678	103.326	101.928	100.920	100.000
Cumulative PopN Index 2	106.484	105.668	104.678	103.326	101.928	100.920	100.000

The variations in the prior years based on using a single year's numbers would have reduced income indexation from 6.484% to 6.228% (0.256% variation).

Presuming that the ABS consider census data as it becomes available in its estimates, it is considered that the linear application of the estimated growth based on information applied in the first instance will provide a reasonably sound progression without the need for 'true-up' of information external to the ABS process.

Please contact me should you require further information.

This letter is authorised by

Brian Jenkins
Chief Financial Officer
Wollongong City Council
Telephone (02) 4227 7111

IPART Independent Pricing and Regulatory Tribunal | NSW

Review of the rate peg to include population growth

Draft Report

June 2021

Local Government »

Tribunal Members

The Tribunal members for this review are:
Ms Deborah Cope, Acting Chair
Ms Sandra Gamble
Mr Mike Smart

Enquiries regarding this document should be directed to a staff member:
Cameron Shields (02) 9019 1901
Sheridan Rapmund (02) 9290 8430

Invitation for submissions

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

Submissions are due by Friday, 6 August 2021

We would prefer to receive them electronically via our online submission form Lodge a submission

You can also send comments by mail to:

Review of the rate peg to include population growth
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop, Sydney NSW 1240

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 choose not to publish a submission - for example, if it contains confidential or commercially sensitive information. If your submission contains information that you do not wish to be publicly disclosed, please indicate this clearly at the time of making 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)

We make the people of NSW better off through independent decisions and advice. IPART's independence is underpinned by an Act of Parliament. Further information on IPART can be obtained from IPART's website.

Contents

1 Our draft methodology allows councils' rates revenue to rise with population growth

Councils are not adequately compensated for population growth under the current rating system, which disincentivises them from accepting development and population growth.

We have proposed a draft methodology that will enable councils to maintain per capita general income over time as their populations grow. We found that existing service levels, represented by the amount of general income per capita, is the best indicator of the future costs of servicing population growth. Maintaining per capita general income will help councils to maintain existing service levels and provide the services their growing communities expect.

The draft methodology includes a population factor based on the percentage change in residential population in each council area. This approach reflects our findings of a mostly linear relationship between council costs and population growth.

We propose using population data from the Australian Bureau of Statistics (ABS) to determine the change in residential population. While many stakeholders expressed a preference for using population projections rather than the ABS historical estimates, our view is that the ABS data is more accurate than projections and will reduce the need for a true-up.

Councils already receive some revenue outside the rate peg from population growth through supplementary valuations, but the amount varies depending on the type of development and the underlying rate structure in a council area. Our proposed population factor would act as a 'top-up' to the revenue that councils already receive through supplementary valuations.

Our draft methodology applies to all councils experiencing population growth, even at low levels. We modelled the impact our draft methodology would have had on councils over the past 4 years and found it would have increased the total general income of the sector by 0.6%, which amounts to $116 million.

Our draft methodology will allow rates revenue to increase to better cover the costs of population growth from 2022-23. Councils may need to apply for special variations to catch-up on historic shortfalls in revenue. Rates revenue is one funding source available to councils; there are others including grants and developer contributions that are beyond the scope of this review. We note that there are also reforms proposed to the developer contributions system, and the impact of the changes to the rate peg and infrastructure contributions will be different for each council.

The impact of our draft methodology on ratepayers will also vary from council to council. Councils in NSW have autonomy to set rates and ultimately each council's ratings structure will determine who pays towards growth. While the impact on individual ratepayers may vary, on average new ratepayers will pay most of the additional rates revenue. Given this, our view is additional protections for existing ratepayers are not necessary at this stage.

Our analysis indicates that the relationship between costs and population growth for City of Sydney is not linear and a different approach may be necessary to account for this. We will consult with City of Sydney to better understand the issues.

We plan to review the performance of our draft methodology within 5 years to ensure it remains appropriate and consistent with its intended purpose to compensate councils for population growth.

Draft Recommendation

1. Each council's general income on a per capita basis should be maintained as its population grows. The rate peg for each council should be increased by a population factor equal to the annual change in its residential population, using Australian Bureau of Statistics data, with an adjustment for income derived through supplementary valuations. Our proposed method is provided below.

1.1 Proposed adjustment to the rate reg for population growth

We propose to maintain each Council's general income on a per capita basis as its population grows as set out below

Draft rate peg methodology

In November each year, we will publish a rate peg methodology that will apply to NSW local governments based on the following formula:

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

In this formula:

change in LGCI means the change in the local government cost index (LGCI).

More information on the LGCI, productivity factor and other adjustments we may make in determining the rate peg is set out in Information Paper 3: The context of our review. We are not considering other changes to the rate peg as part of this review.

Population factor for 2022–23:

Each year, each council will have a population factor equal to the annual change in its residential population, adjusted for revenue received from supplementary valuations in the previous year.

The population factor is equal to the maximum of zero or the change in residential population less the supplementary valuations percentage. Councils with negative population growth will have a population factor of zero, ensuring they are no worse off under our methodology. Councils that have recovered more from supplementary valuations than is required to maintain per capita general income as their population grows will also have a population factor of zero. The population factor will be calculated using the following formula:

$$Population\ factor = \max(0, change\ in\ population - supplementary\ valuations\ percentage)$$

Change in population for 2022–23:

We will publish the change in population for each council on our website. The change in population will be calculated using the estimated residential population (ERP) for 2020 and 2019 specified in the Australian Bureau of Statistics (ABS) 'ERP by LGA (ASGS 2020), 2001 to 2020', released March 2021.[1]

The calculation is shown in the following formula:

$$change\ in\ population = \max\left(0, \frac{ERP\ 2020}{ERP\ 2019} - 1\right)$$

Each year we will update the formula. For example, for the 2023-24 rate peg methodology we will calculate the change in population using ABS data for 2020 and 2021.

Supplementary valuations percentage for 2022–23:

The supplementary valuations percentage will be calculated by councils. The calculation is shown in the following formula:

$$supplementary\ valuations\ percentage = \max\left(0, \frac{supplementary\ valuations}{notional\ general\ income\ yield}\right)$$

In this formula:

supplementary valuations means the total value of adjustments to council's general income for the previous year (2021–22) that the council made under paragraphs 509(2)(b) and (c) of the *Local Government Act 1993* (LG Act)

notional general income yield means the general income of the council for the previous year (2021–22) prior to making adjustment under paragraphs 509(2)(b) and (c) of the LG Act.

Each year we will update the formula. For example, for the 2023-24 rate peg methodology councils will calculate their supplementary valuations percentage based on their supplementary valuations revenue and notional general income yield for 2022-23.

Explanatory notes

Important features of the draft methodology include:

- The population factor reflects a linear relationship between population growth and council costs.

- The change in population for each council is calculated using ABS estimated residential population data.
- Councils with negative growth will have a population factor of zero. Such councils will receive a rate peg that is determined in same manner as it is now.
- If a council's supplementary valuations percentage exceeds its change in population, indicating the council has recovered more revenue through supplementary valuations than is necessary to maintain per capita general income, the population factor will be zero.

The draft methodology does not change the operation of the supplementary valuation process under the *Valuation of Land Act 1916* or the calculation of notional general income under section 509(2) of the LG Act. Councils will still calculate their notional general income in the same way as they do now. The rate peg methodology will, however, account for the value of supplementary valuations when determining the population factor to be applied.

2 Councils currently are not adequately compensated for population growth

2.1 The population in NSW is growing

The population in NSW is growing and is expected to continue to grow, but the amount of growth varies across the state.[2] Growth is concentrated in metropolitan areas, although some regional areas are also growing.[3] Information Paper 3: The context for our review provides more information about NSW's population growth, including the impact of COVID-19.

As local communities grow, councils need to provide infrastructure and services to new residents and businesses.

Councils source revenue in a variety of ways

Council revenue sources include:

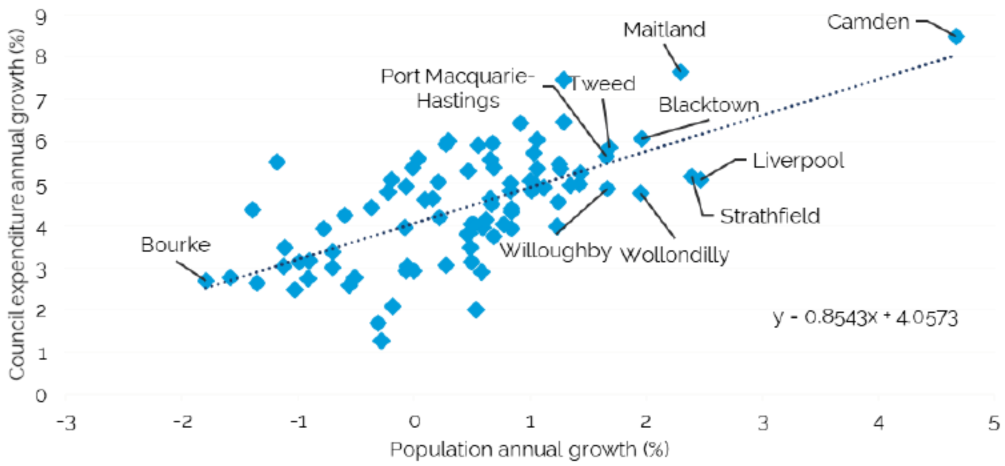
- property rates
- sale of goods and services, which includes fees and charges for services such as waste management, water and wastewater, recreation, building approvals and parking
- grants from the Australian Government administered through the NSW Grants Commission, and other grants such as capital grants
- other revenue, including levying developer contributions
- interest income.

2.2 Council costs increase as population grows

Our analysis shows the main driver of a council's costs is the size of its population or number of ratepayers in the area.

Historically, council costs have increased with population growth. For every 1% increase in population, we estimate NSW councils' expenditure increases by 0.85%. Figure 1 shows the relationship between councils' expenditure and population growth.

Figure 1 Population and council expenditure growth in NSW (1999-2019)



a. Excludes LGAs that did not exist for the entire sample period. Excludes Albury, Lithgow and Oberon, whose borders changed in 2004. Excludes The Hills Shire and Hornsby, whose borders changed in 2016.

Source: The CIE, Analysis of rate peg options to account for population growth, 19 May 2021, p.15.

Increased costs are driven by extra people, extra rateable and non-rateable properties, and the increase in community expectations of the functions and services councils provide.

The impact on council costs from population growth varies depending on:

- whether the council is a metropolitan, regional or rural council
- the demographics of the population in the council area
- the type of development that occurs with population growth; that is, greenfield or infill development or an increase in secondary dwellings (such as granny flats)
- the cost mix; that is, whether there is an increase in capital or operating costs.

> We found existing service levels, represented by the amount of general income per capita, is likely to be the best indicator of the cost of servicing an additional person. This reflects our findings of a mostly linear relationship between costs and population growth.[4]

We worked with councils to understand how council costs and revenue are impacted by population growth:

01	**Regional issues** We developed a case study showing the issues regional councils face. The case study was based on interviews with Byron Shire Council, Wagga Wagga City Council and Cessnock City Council; and issues raised through stakeholder submissions.
02	**Greenfield development** We worked with Blacktown City Council to understand the costs of servicing a new greenfield development and the associated increase in revenue they receive from new development.
03	**Infill development** We also worked with Bayside Council to understand the costs of servicing infill development. The case study also highlights issues with the ratings system.

These case studies are set out in Information Paper 1: The impact of population growth on council costs and revenue.

2.3 Funding the costs of population growth outside the rate peg

Rate pegging has been in place in NSW since 1977. The rate peg is the maximum percentage by which a council may increase its general income for the year. General income is predominantly revenue from rates. The rate peg applies to councils' total income from rates, rather than to individual rates.

Historically the rate peg has not included any adjustment for population growth, meaning the additional costs of population growth have been funded within existing rates revenue or by other means.

Councils may be able to increase their revenue outside the rate peg by:

Special variations	Supplementary valuations	Infrastructure contributions	Government grants
Councils can apply to IPART for a special variation to increase their general income above the rate peg	When the Valuer General issues a supplementary valuation due to changes in land value (e.g. when land is rezoned or subdivided)	Contributions from developers to fund infrastructure necessary to serve the needs of the development	Councils can apply for federal and state government grants

Councils are partly compensated for higher population growth through higher rates revenue, mainly from the supplementary valuations process.

Our analysis indicates councils are currently recovering about 60% of the costs of population growth through supplementary valuations. The amount recovered varies between councils, depending on rate structure, land values and the type of development.

2.4 General income may be insufficient to service the costs of population growth

Our analysis shows the costs of growth are not being fully met for NSW councils in general, with faster growing councils tending to be unable to recover additional revenue through general income in proportion to their growth.[5] The outcome is an expenditure gap between the cost of growth and what councils spend.

Councils with fast growing populations have had slower growth in total revenue per capita. We expect councils experiencing high population growth will consequently observe a reduction in rates per capita as their population grows.

Submissions from councils supported our finding, indicating the costs of servicing growth outstrip the revenue that councils can recover through rates to service growth.

We expect under-recovery of the costs of growth will mean growing councils will be unable to maintain their service levels. This may result in councils relying on special variations to fund growth or exploring other forms of revenue raising.

3 We propose to maintain Councils' general income on a per capita basis

3.1 We propose to add a population factor to the rate peg to adjust for population growth

We examined councils' revenue and costs to investigate options to maintain councils' general income on a capita basis. The two options we considered in developing our draft methodology to adjust the rate peg for population growth involve either:

- **Option 1**: using the percentage change in population or rateable properties to determine the population factor, or
- **Option 2**: applying the percentage change in population or rateable properties to a per capita cost variable to determine the population factor.

These options are described in more detail in Information Paper 2: How we propose to adjust the rate peg for population growth.

Although both options are viable, we prefer option 1 as:

- It recognises service levels and costs are different across councils. Option 1 accounts for population growth by referring to the current costs per capita in each council.
- Our analysis found a largely linear relationship between council costs and population growth. This relationship suggests the added complexity of implementing option 2 may be unnecessary.
- Option 2 may be difficult to implement on a council-by-council basis.

Our preferred approach is summarised in Box 1.

Box 1 Our proposed adjustment to the rate peg for population growth

Our preferred approach is to implement a methodology that:

- maintains total per capita general income over time
- reflects a linear relationship between population growth and council costs
- is based on the change in residential population for each council
- applies to all councils, including those experiencing low growth.

3.2 Our draft methodology maintains per capita general income

Our draft methodology has been designed to maintain per capita general income. This approach reflects our findings of:

- a mostly linear relationship between council costs and population growth
- that existing service levels, represented by the amount of general income per capita, is the best indicator of the cost of servicing an additional person.

3.3 We have used residential population rather than service population

Many submissions to our Issues Paper highlighted the costs incurred by councils where their serviceable population is higher than their residential population. Councils may have larger service populations due to tourism or because they are employment, business or cultural hubs.

We concluded it would not be appropriate to include service populations within a population factor as:

- It is challenging to accurately measure service populations.
- There is some benefit to business ratepayers from a larger serviceable population. However, ultimately ratepayers across all rating categories, including residential ratepayers, would pay for the additional costs to councils.
- Where practical, councils should make use of user pays approaches to collect additional revenue from service populations.

Councils can come to IPART for a special variation if they require additional revenue to increase rates to accommodate their service populations. We discuss the use of special variations for population related issues in section 4.3.1 of this Draft Report.

3.4 Using ABS data to measure changes in residential population

Although there was support in submissions and at council workshops for using population projections to measure population growth, our view is that the ABS estimated residential population data is the best data source for measuring changes in population.

We found the ABS data, which is a backward-looking estimate, to be more accurate than the Department of Planning, Industry and Environment's (DPIE) population projections, reducing the need for a true-up in our draft methodology. The ABS data is also easy to understand and publicly available.

We also considered using third party population projections, but concluded this is not appropriate because the relationship between third party providers and councils is not independent. We prefer an estimate that is derived at 'arm's length' from councils' processes.

3.5 Adjusting for revenue from supplementary valuations

Councils are currently able to increase general income up to a maximum amount (called councils' notional general income) that is adjusted for supplementary valuations issued by the Valuer General. The Valuer General issues supplementary valuations when there are changes in land value outside the usual 3 to 4-year general valuation cycle (e.g. where land has been rezoned or subdivided).

Our analysis indicates councils are recovering about 60% of the costs of population growth from increases in general income due to supplementary valuations, although the amount recovered does vary between councils.[6]

Our preferred option includes an adjustment to the population factor to account for the increase in rates revenue already obtained by councils from supplementary valuations.

> Our proposed adjustment for supplementary valuations will maintain per capita general income as councils' populations grow

Without this adjustment, some councils would be overcompensated for population growth (up to double in some cases).[7]

3.6 Our draft methodology is forward-looking

Many council submissions referred to councils needing to 'catch up' on past growth. We recognise that some councils may need additional revenue to address the impact of past population growth.

Our proposed adjustment to the rate peg for population growth does not include an adjustment for past growth. We have taken this approach because the need for and quantum of any catch up would need to be determined on a case-by-case basis to consider each council's:

- financial sustainability
- past income from supplementary valuations
- productivity and operating environment
- impact of any special variations.

Our view is this assessment is best undertaken through the special variations process (see section 4.3.1). We expect use of the special variations process for this purpose would be most suited to councils that have experienced high population growth that has caused per capita general income to decline.

3.7 Councils general income will change in line with population growth

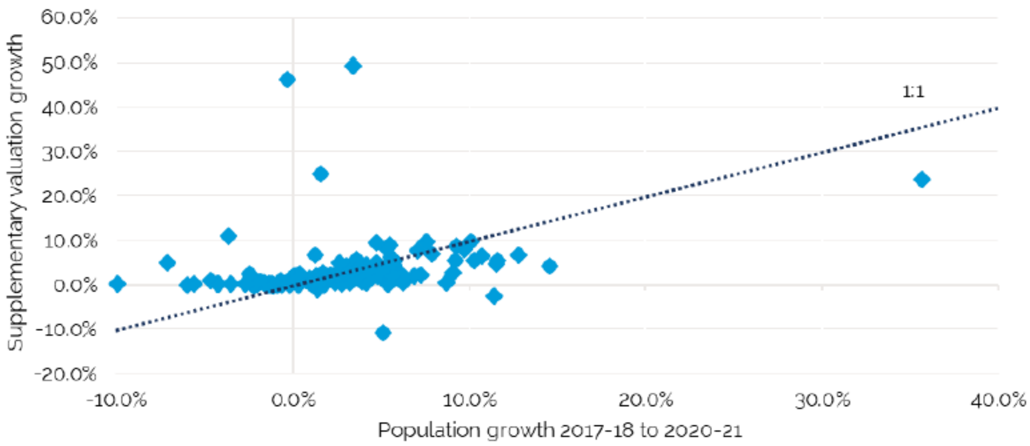
To estimate the impact on councils of our draft methodology to adjust the rate peg for population growth we modelled the outcomes if the proposed adjustment to the rate peg had been implemented for the past four years (2017-18 to 2020-21). We do not have reliable forecasts of the additional revenue councils receive through supplementary valuations to model the impact of our draft methodology going forward.

We found that our draft methodology would have:

- Increased the total general income of 96 of the 129 NSW councils
- increased the total general income of the local government sector by 0.6%, that is an additional $116 million.[a]

The impact of our draft methodology is shown in the following figures. Figure 2 shows the percentage increase in councils' revenue per person from supplementary valuations against population growth over the past four years. Figure 3 shows the percentage increase in councils' revenue, after adjusting for our draft methodology, against population growth over the past four years. Our proposed methodology ensures councils can at least maintain general income on a per capita basis over time.

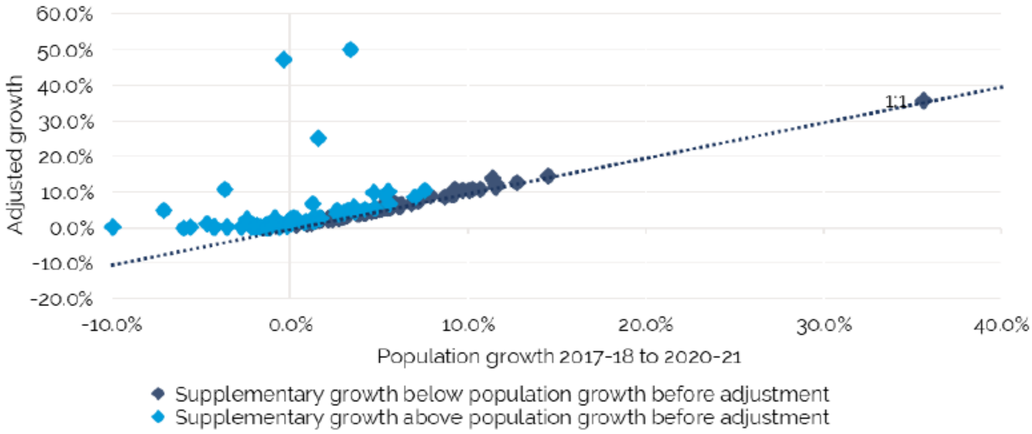
Figure 2 Percentage increase in councils' revenue per person from supplementary valuations versus population growth (2017-18 to 2020-21)



Source: OLG data and IPART analysis.

[a] Our estimate of $116 excludes the impact of special variations over this time period, which increased councils' general income by about $20 million over the four years.

Figure 3 Percentage increase in councils' revenue per person from adjusted growth in revenue versus population growth (2017-18 to 2020-21)



Source: OLG data and IPART analysis.

3.8 Council rating structures determines who pays for population growth

Our draft methodology maintains per capita general income as population grows. While the impact on individual ratepayers may vary, on average rates will stay the same. We considered if we could implement a draft methodology and ensure the additional revenue that councils receive is paid for by new ratepayers. We found:

- **Who pays for population growth will vary from council to council**: The structure of a council's rates and the type of development that occurs with population growth will ultimately determine how much new ratepayers pay. Illustrative worked examples are set out in Information Paper 2: How we propose to adjust the rate peg for population growth.
- **Councils have limited ability to impose different rates for new ratepayers**: Generally, new ratepayers will pay the same rates as existing ratepayers in the relevant rating category or subcategory. Recent legislative changes to rating subcategories will provide some additional flexibility for councils to set rates to ensure new ratepayers pay their fair share, but only in limited circumstances.

If councils were only able to obtain revenue from new ratepayers, there would be a shortfall in revenue to meet the costs of growth. This shortfall would perpetuate the under-recovery of the costs of growth that our draft methodology has been designed to address. Councils would likely continue to rely on special variations to fund growth.

Existing ratepayers will also likely benefit from improvements to services and infrastructure to service population growth.

3.9 Our methodology should be reviewed within 5 years

We plan to review the performance of our draft methodology within 5 years to ensure it remains appropriate and consistent with its intended purpose to align councils' general income with population growth. Reviewing the methodology again within 5 years will allow us to analyse its impact and make changes if necessary.

3.10 We propose to monitor the impact on councils to determine whether a 'true-up' is needed to reflect actual population growth

ABS population data, although backward looking, is an estimate. The data is updated to reflect actual growth after the census every 5 years. We are considering whether it would be appropriate to re-base the population factor in the rate peg every 5 years following the census to reflect actual growth.

Councils, in their submissions and at the workshops, supported a true-up mechanism in the methodology. Some councils argued existing estimates are inaccurate and under-report population growth. This was more common for regional councils than metropolitan councils.

The census data does result in a re-basing of past population estimates, to reflect actual growth. However, for most councils we found the impact is minimal. Given this, our draft methodology does not provide for any 'true-up' or re-basing of population estimates. The added complexity of doing this may outweigh any benefit from increased accuracy. However, we are open to hearing from stakeholders about our proposed approach.

In the absence of a true-up, we propose to monitor the impact on councils of the re-basing of the ABS population data after the next census. Where there is a material impact on a council because actual population growth was significantly different to the ABS estimate, we may consider on a case-by-case basis whether an adjustment to the council's population factor is required.

We seek stakeholder feedback

1. Should our methodology be re-based after the census every five years to reflect actual growth?
2. In the absence of a true-up, should we impose a materiality threshold to trigger whether an adjustment is needed on a case-by-case basis to reflect actual growth?

3.11 We are consulting with City of Sydney

Our analysis shows that City of Sydney's rates income is largely from business rates rather than residential rates. Varying its total general income to account for population growth may overstate the additional revenue it needs to service any increase in population.

We are considering whether a different approach may be needed for City of Sydney. We are consulting with City of Sydney to better understand their cost drivers.

4 Our draft methodology will not address all stakeholder concerns

4.1 Changes to the statutory minimum rate amount may be needed

Councils told us they need more flexibility in setting higher minimum rates[8]

Currently, councils wishing to set minimum rates higher than the statutory minimum rate amount[9] must obtain approval from IPART. Councils with minimum rates already above the statutory minimum amount may increase minimum rates by an amount equivalent to their rate peg percentage or special variation percentage.

The statutory minimum rate amount is updated annually. In the past, the statutory minimum rate amount has been increased annually in line with the rate peg. We are considering whether a different approach may be needed in the future for minimum rates given our draft methodology would result in each council having a different rate peg. Stakeholders will be consulted on this issue as part of our review of the special variation process (see section 4.3.1).

4.2 Some issues raised by stakeholders are outside the scope of this review

Stakeholders raised a range of concerns about important issues that are outside the scope of this review. These issues include:

- **Ad valorem rates should be based on capital improved value (CIV)**: In our 2016 review of the local government rating system, we recommended CIV be mandated as the basis for setting ad valorem rates in metropolitan areas. The NSW Government did not accept this recommendation. Many submissions to our Issues Paper expressed a preference for using CIV. Regional councils generally only supported a move to CIV if it was optional for regional councils.
- **Emergency services levy:** At both workshops councils raised the issue of whether the emergency services levy should be funded from general income. This levy is a significant cost for some councils, particularly regional councils.
- **Stormwater management charges**: Councils commented that stormwater management charges have not changed since 2007 and do not reflect the costs to councils of providing those services.
- **Depreciation costs**: Councils have significant depreciation costs associated with ageing assets, such as buildings, roads, footpaths and parks. Some councils suggested linking a population factor with depreciation costs.

- **Cost burden of non-rateable properties**: Many stakeholders were concerned about the cost burden on ratepayers from non-rateable properties. These can take many forms:
  - secondary dwellings, such as granny flats or short-term holiday lets being built on farmland
  - community housing
  - retirement properties, which may fall under a single title.

  The burden of funding service provision for these properties falls on other ratepayers.
- **Rating categories are not sufficiently flexible to account for different uses**: Several councils told us they have significant numbers of residential properties in their area used for Airbnb and other holiday lettings. Although these properties are operated as a business, they are charged residential rates. Councils indicated they need flexibility to charge business rates for these properties.
- **Pensioner rebates**: Many councils have older populations and consequently have higher cost burdens associated with funding councils' portion of the pensioner rebate. The burden of paying for the rebate falls on other ratepayers.

4.3 Other funding sources remain important for councils to fund growth

Our draft methodology will not solve all issues raised by councils. Other funding sources will therefore remain important for councils to fund growth.

4.3.1 Using special variations for population-growth related issues

We expect our draft methodology will reduce, but not eliminate, the need for special variations. We expect councils will continue to use the special variation process to address some population growth-related issues including:

- to 'catch up' on past population growth, where this is significant and has reduced per capita general income over time
- where per capita general income does not accurately reflect the costs of servicing the population and a one-off adjustment to the rate base is required
- to fund capital costs of infrastructure to service population growth that cannot be met while maintaining per capita general income or through other revenue sources (such as infrastructure contributions)
- where increases in general income are needed to accommodate a large service population.

IPART is reviewing its special variation process to simplify and streamline the process. We will be consulting with stakeholders as part of the review of the special variations process.

4.3.2 Making effective use of infrastructure contributions

Councils should use infrastructure contributions to fund infrastructure needed to service development. To ensure contributions plans are used most effectively, councils should regularly review and update their contributions plans.

The NSW Government has developed a roadmap to implement reforms to the infrastructure contributions system in NSW.[10] The proposed reforms are based on recommendations made by the NSW Productivity Commissioner following his review of the infrastructure contributions system in NSW. The NSW Government's proposed reforms aim to, among other things, enhance the capacity of councils to support growth and better align infrastructure contributions and strategic planning and delivery.[11]

4.3.3 Role of state and federal government grants

We expect that some councils will remain reliant on state and federal government grants, such as those with declining populations and those with populations less able to afford rate increases.[12] Where government funding is intended to fund capital or operating costs associated with population growth, funding should remain targeted to those councils that need it most.

5 How to provide your feedback

We welcome feedback on all aspects of this report and our draft methodology. You can provide feedback through written submissions and/or by attending the public hearing.

We seek your written feedback on the following questions:

1. Should our methodology be re-based after the census every five years to reflect actual growth?
2. In the absence of a true-up, should we impose a materiality threshold to trigger whether an adjustment is needed on a case-by-case basis to reflect actual growth?
3. Do you have any other comments on our draft methodology or other aspects of this draft report?

Have your say

We are holding a public hearing on Tuesday 20 July 2021.

We are accepting written submissions until Friday 6 August 2021.

You can submit your feedback or register for the public hearing using the links.

Submit feedback »

Attend the public hearing »

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1 Australian Bureau of Statistics (ABS), ERP by LGA (ASGS 2020), 2001 to 2020, March 2021.
2 ABS, National, state and territory population, December 2020.
3 ABS, National, state and territory population, December 2020; DPIE, NSW population projections, December 2019.
4 The CIE, *Analysis of rate peg options to account for population growth*, 19 May 2021, p 15.
5 The CIE, *Analysis of rate peg options to account for population growth*, 19 May 2021, pp 23 and 30-31.
6 IPART analysis of council financial statements (data provided by OLG)
7 IPART analysis of council financial statements (data provided by OLG)
8 Workshop with metropolitan councils on 28 May 2021; council submissions.
9 This amount is the amount specified in section 126 of the *Local Government (General) Regulation 2005* for the purposes of section 548(3)(a) of the *Local Government Act 1993*.
10 DPIE, *NSW Government Response to NSW Productivity Commission's Review of Infrastructure Contributions in NSW*, March 2021.
11 DPIE, Infrastructure contributions reform webpage, accessed 22 June 2021.
12 NSW Productivity Commission, *Review of infrastructure contributions in New South Wales*, p 42.