

RATE CAPPING – WHAT CAN WE LEARN FROM THE NSW EXPERIENCE?

John Comrie 28 May 2015 - FinPro Seminar

Disclosure

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- *I have been appointed to NSW Independent Pricing and Regulatory Tribunal to assist in its work assessing NSW councils 'Fit for the Future' submissions*
- *Views expressed in this presentation are those of the author and not necessarily those of IPART or NSW Government*

Political or policy driven?

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- Rate capping is popular in electorate
- Liberal opposition went to 2013 SA election with LG rate-capping proposal
- SA Parliamentary committee recently initiated an Inquiry into merits
- NSW Govt introduced rate capping in 1979 but effectively had 'tiger by tail'
 - IPART now somewhat of a shield
- Are there policy grounds for rate capping?

NSW - Scene setting

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- Currently 152 councils in NSW
- Councils can apply for special rate variations
- Since 2010 decisions re such applications have been determined by IPART
 - ▣ Previously applications determined by Minister
- Currently in NSW 'Fit For the Future' reviews of all councils (by IPART for NSW Govt)
 - ▣ Councils are being encouraged to amalgamate
 - ▣ Need to demonstrate financial sustainability and consider mergers

Basis of rate peg ceiling

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- Rate peg determined by IPART
- Reflects general movements in LG costs (LG Cost Index)
 - discounted for productivity improvement factor (half of 0.4% in 2015/16)

Handwritten mathematical derivations:

$$-\frac{10}{3}x = -\frac{2}{3} - \frac{5}{2} + \frac{1}{2} + \frac{13}{3}$$

$$\frac{15-10}{3}x = \frac{-4-15+3+26}{6} \rightarrow \frac{5}{3}x = \frac{10}{6} \rightarrow x = 1$$

$$2[(x + \frac{1}{4})(x - \frac{1}{4}) - (x + \frac{1}{2})^2] + \frac{35}{24} = x - \frac{2x+1}{3} \quad 2[x^2 - \frac{1}{16} - (x^2 + \frac{1}{4} + x)] + \frac{35}{24} =$$

$$x^2 - \frac{1}{16} - x^2 - \frac{1}{4} - x + \frac{35}{24} = x - \frac{2}{3}x - \frac{1}{3} \quad -\frac{1}{8} - \frac{1}{2} - 2x + \frac{35}{24} = x - \frac{2}{3}x - \frac{1}{3}$$

$$-2x - x + \frac{2}{3}x = -\frac{1}{3} + \frac{1}{8} + \frac{1}{2} - \frac{35}{24} \quad \frac{-6-3+2}{3}x = \frac{-8+3+12-35}{24} \quad (x, y) = \sqrt{(-6, 1)}, (6, 4)$$

$$x = \frac{4-28}{24} \rightarrow x = \frac{1}{2} \quad 3x^2 - 5x - 4$$

$$3x^2 - 2x^2 + 2x - 3 \quad x - 15(4 - \frac{x}{2}) + 1 \rightarrow (x-1) = (5 + \frac{3}{2})x - (-\frac{1}{2})$$

$$x - 60 + \frac{15}{2}x + 1 - 2x + 2 = 5x + \frac{3}{2}x - (-\frac{1}{8}) \quad 5x^2 + 9x - 18 < 0$$

$$x + \frac{15}{2}x - 2x - 5x - \frac{3}{2}x - \frac{1}{8} + 60$$

$$k_p = \frac{1}{2} m U_r^2 \approx \frac{1}{2} \cdot 0.16 \cdot 8000^2 = 2,68 \cdot 10^7$$

$$y = \frac{2\sqrt{4x^2 - 2x} + x}{3\sqrt{4x^2 - 2x} + x}$$

$$y = \frac{(2\sqrt{2} - 1)x - \sqrt{(2\sqrt{2} - 1)^2 + 6}}{\sqrt{(2\sqrt{2} - 1)^2 + 6} + (2\sqrt{2} - 1)x}$$

Other equations and solutions:

$$\begin{cases} x + y = 16 \\ x - 5y = -9 \end{cases} \rightarrow \begin{cases} x + 20y = 80 \\ x - 5y = -9 \end{cases} \rightarrow \begin{cases} x = 4 \\ y = 4 \end{cases}$$

$$\begin{cases} 2x - 5y = 8 \\ x - 2y = 4 \end{cases} \rightarrow \begin{cases} 2(7y - 5) - 5y = 8 \\ 9y - 10 - 5y = 8 \end{cases} \rightarrow \begin{cases} 9y - 10 = 8 \\ 9y = 20 \end{cases} \rightarrow \begin{cases} y = 2 \\ x = 15 \end{cases}$$

$$\begin{cases} 2x + 5y = 28 \\ 5x + 2y = 68 \end{cases} \rightarrow \begin{cases} -9x - 17y + 62 = 0 \\ 5y + 4y - 62 = 0 \end{cases} \rightarrow \begin{cases} -9x - 17y + 62 = 0 \\ -4y - 62 = 0 \end{cases} \rightarrow \begin{cases} -9x - 17y + 62 = 0 \\ -4y = 62 \end{cases} \rightarrow \begin{cases} -9x - 17y + 62 = 0 \\ -4y = 62 \end{cases}$$

Impact of rate pegging

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- over period 2001/2 to 2010/11:
 - ▣ growth in the total revenues of NSW councils was 5.7% per annum
 - average of 8.0% for the other mainland states
 - ▣ Taxation revenue (rates) increased by 4.4% per annum in NSW
 - average of 8.0% elsewhere

Source: NSW Independent LG Review Panel
(quoting IPART)

Can apply for special rate variation

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- Can be for one or more years
- Can be temporary or permanent (built into base)



SRV can be for range of reasons

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such as:

- improving financial position, eg to address financial sustainability issues
- funding the development and/or maintenance community infrastructure or reduce backlogs for asset maintenance and renewal
- funding new or enhanced services to meet growing demand in the community
- funding projects of regional significance
- covering special or unique cost pressures that the council faces

Recent history

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Year	2011/12	2012/13	2013/14	2014/15	15/16
Rate Peg	2.8%	3.6%	3.4%	2.3%	2.4%
No. SRV applications	23	13	23	32	22

- Most SRV applications fully or nearly fully successful
- Many 2015/16 applications were for cumulative increases of 30% - 50% over several years

Unintended consequences?

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- NSW Independent LG Review Panel:
 - Unrealistic community expectations that rates should be contained indefinitely
 - Excessive cuts in expenditure on infrastructure leading to mounting asset renewal & maintenance backlogs
 - Under-utilisation of borrowing due (in part) to uncertainty that increases in rates needed to repay loans will be granted

Unintended consequences? (cont)

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- Independent Panel (cont):
 - Reluctance to apply for SRV
 - Politically risky
 - Process seen as too costly & complex
 - Requiring a disproportionate effort for an uncertain gain
 - Eg many councils had significant operating deficits in 2011/12 but most had not applied for SRV
 - Rate pegging impacts adversely on sound financial management

Integrated planning & reporting

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- IP&R Framework
 - ▣ councils identify & plan for
 - funding priorities
 - asset management
 - service levels
 - ▣ following engagement with their communities
- Develop set of plans & accompanying budgets in consultation with their communities
 - ▣ Community Strategic Plan
 - ▣ Long Term Financial Plan
 - ▣ Asset management Plans
 - ▣ 4-year Delivery Program
 - ▣ Operational Plan

SRV application criteria

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- Need for and purpose of a different revenue path needs to be clearly articulated through IP&R documents
- IP&R docs should canvas alternatives to a rate rise - ie scenarios with and without SRV
- Evidence that the community is aware of the need for and extent of a rate rise
- Explanation of past and proposed future productivity improvements and cost containment strategies

SRV – community engagement

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- Need to have regard to willingness and capacity of community to pay more
- impact on affected ratepayers must be reasonable
- nature and extent of the consultation program should be commensurate with size of SRV sought (and resources of the council)



Independent Panel proposals

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- Favoured abolishing rate pegging
 - ▣ instead recommended rate benchmarking
- Recognised realities and suggested streamlined rate pegging as alternative
 - ▣ eg for modest increases above rate-pegging limit
- Also suggested 'earned exemption' process
 - ▣ for demonstrated consistent high performance in IPR and asset & financial management

NSW Govt response to date

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- *‘Office of Local Govt will work with IPART to amend the guidelines to develop a streamlined and more proportionate process for ‘fit for the future’ councils wanting to increase rates above the rate peg’*



My thoughts

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- In NSW many councils are still coming to grips with
 - ▣ Financial sustainability issues
 - ▣ Preparation of reliable forward plans
 - ▣ Using IPR for determining service level and expenditure decisions
 - ▣ Need & willingness for greater use of debt
 - ▣ Accrual accounting info
 - ▣ Implications of ongoing operating deficits
- Over time there is likely to be greater recognition of need for rate increases

My thoughts (cont)

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- Rate capping not universally unpopular amongst both council members and officers
 - ▣ Can blame State Govt for ills and service level dissatisfaction
 - ▣ Obviates need to determine rate increases
- Councils in Vic & SA have relied too much on rate increases to improve financial sustainability and not enough on reviewing service levels, containing costs, greater use of debt etc
 - ▣ Eg labour costs have increased more in Vic & SA than NSW

VLGA (Sansom) Rate Cap Report

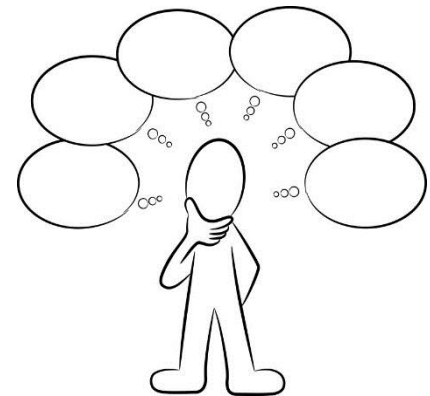
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- NSW situation
 - Rate capping can lead to 'lazy' budgeting and planning
 - System now operating reasonably well because of linkage with IPR
 - Majority of people would rather pay modest increases in rates than see services decline

Key concluding messages

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- Rate capping if well managed is not all bad
- Current NSW system works better now than did
 - Encourages
 - Focus on IPR (better planning re needs, affordability and community engagement) & cost containment
- Don't be scared to apply for increase
 - If can justify
 - But need to consider other options too



Further information

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- See IPART website (Local Government section)
- NSW Independent LG Review Panel Final Report - 'Revitalising Local Government'
- VLGA – 'An Implementation Framework for Rate Capping'

Thank You