30 June 2015

Mr Keir Delaney
Secretary
Environment & Planning Committee
Legislative Council Parliament House
Spring Street
EAST MELBOURNE  VIC  3002

Dear Mr Delaney

INQUIRY INTO LOCAL GOVERNMENT RATE CAPPING POLICY

Thank you for the opportunity to provide feedback to the Environment & Planning Committee’s inquiry into Local Government Rate Capping Policy.

We have referred to both the "Terms of Reference" and the "Local Government – Rates Capping & Variation Framework Consultation Paper" and on that basis, we have detailed some of our key concerns with Rate Capping and have also included our Recommendation.

KEY RATE CAPPING CONCERNS

1. Rate Capping does not fully address the State Government’s Terms of Reference

Terms of Reference - The development of a Rates Capping framework for local government, has been referred to the Essential Services Commission (ESC) by Robin Scott MP, Minister for Finance, under section 41 of the Essential Services Commission Act 2001 (the ‘ESC Act’). The State Government’s objective is to develop a Rates Capping framework for local government in order to:

- contain the cost of living in Victoria,
- support council autonomy and ensure greater accountability and transparency in local government budgeting and service delivery,
- promote rates and charges that are efficient, stable and reflective of services that the community needs and demands, and set at a level that ensures the sustainability of the councils’ financial capacity and council infrastructure, thereby promoting the best outcomes for all Victorians.

Contain the Cost of Living - The fundamental tenent of the Terms of Reference is to contain the cost of living in Victoria and given that Council Rates comprise approximately 1.4 per cent of the cost of living for Victorians, any cap on rates will have minimal impact on containing living costs.
There are other, more substantial levers that State Government can and should be manoeuvring to contain the cost of living, in particular the myriad of State and Federal Taxes and excises. The other major living expenses that impact Victorian residents are food, increasing utility costs (electricity, gas and water) and annual Health Insurance premium increases.

*Transparency* - Local Government is the most transparent level of government as budgets have to be available for review by the community prior to their adoption. Councils already utilise many ways and processes to engage the community in a range of budget and service delivery matters thereby meeting the requirements in the abovementioned terms of reference.

*Lack of Community Understanding* - There is a lack of Community understanding when it comes to the methodology of raising and applying rates and also why this third tier Government is so important to ensure the best outcomes for communities. It is important to recognise that there may always be projects/works that arise unexpectedly and that result in a change to priorities. Also, because Councils are making decisions with the best interests of the wider community in mind, they will not always be judged by individual communities as having made the correct decision / prioritised appropriately as ratepayer sentiment can be very fickle. Nevertheless a 2013 Independent Local Government Review Panel (ILGRP) survey showed that Council rates are seen as “fairly Good Value” and most respondents would rather see rates rise than have cuts to services.

However, given the Terms of Reference details “...the development of a rate cap” it appears evident that the State Government has a mandate to implement rate capping in some guise as a way of controlling Local Government in driving efficiencies. We believe however that this is misguided and that the cost of living is a much broader issue than Council Rates, as stated above. Also if a rate cap is to be developed it should be flexible and take into account the many differences between Metropolitan and Rural Councils.

2. **A Simple Rate Capping Framework / Methodology is required**

Whatever the framework, it must be simple, clear, the process timely and current legislative and logistical requirements taken into account.

It would ideally be aligned to the Performance Reporting Framework thereby lending itself to measuring or limiting rate rises depending on the workings for each particular council.

*Budget Adoption Cycle* - Councils have a requirement to adopt the budget by 30 June each year. The existing statutory timeframe allows sufficient time to manage factors such as:

- the complex process required to be undertaken as part of robust budget development,
- the statutory requirement to undertake community consultation in accordance with Section 223 of the *Local Government Act 1989,*
- timelines for Council agendas to be prepared and made available to the public in advance of Council meetings at which budgetary matters are considered; and
- other administrative processes that surround budget development.
Therefore any Rate Capping framework needs to meet the current budget timeframes, have the flexibility to adapt and improve while still affording Councils some certainty over future planning of service delivery and financial sustainability.

Variations - Any request for a rate cap variation will also require a process that can meet the current budget timeframes, without the need to increase staff numbers to meet a long form process.

While a transition period of twelve months to allow a short-term review of the implementation of rate capping and allow feedback and potential amendments to be made is supported, a period of two years would be preferred.

3. Rate Variations

As detailed in point 2 above, we suggest that under the current budgetary cycle there will be insufficient time for Councils to engage with ratepayers if the ESC requires additional engagement with ratepayers for a rate variation.

We are also concerned as to whether the ESC will have sufficient time and resources to assess rate variation applications each year. If the timing of consideration of variations is outside the legislative timeframes, then process/guidelines would need to be in place to determine how Councils would manage this (e.g. application to the Minister for Local Government for an extension of time for budget adoption / readvertising of their budget?).

Rate Variation Process - The process for applying for a rate variation and the associated information requirements should be clearly set out and defined and not be so arduous as to actively deter legitimate applications for rate variations.

Multi Year Variations - The ability for Councils to seek multi-year variations is supported on the basis of good financial planning, particularly to manage exceptional circumstances such as a significant call for a top up payment for the defined benefits superannuation scheme or a natural disaster. A multi-year variation would allow such impacts to be managed financially over multiple years and diffuse the annual impact on ratepayers.

Impact of Superannuation Top Ups - Since 1998 Victorian Local Government has paid $1.162b in calls into a defined benefit superannuation scheme. All levels of government operated Defined Benefit Superannuation Schemes. The benefits were defined and, as a result, employer governments need to fund them. The Local Government scheme was established by State legislation and closed to new members in 1993. Although new members were not able to access the scheme after that time, the liabilities to existing members continue to grow.

The structure of the Local Government fund is such that it has to be kept fully funded for future liabilities at all times. This is in distinct contrast to the funds operated by the Victorian State Government and Commonwealth Government, each of which currently have substantial unfunded liabilities. If the same rules of operation were applied to the Local Government fund, $1,162b in calls and contributions tax would not have needed to be funded across the 17 years since 1998. This requirement, that is unique to Local Government, places significant and often unplanned upwards pressure on rates. It could be stated that the State and Federal governments are not transparent around this issue, as most taxpayers would have no idea they are paying for these schemes through state and federal taxes.
4. **Should a single Rate Cap apply equally to all councils?**

Provided the "Variation" element of the framework is sufficiently flexible to meet the diverse needs and circumstances of member Councils, then a single framework that addresses the variability of a Local Government area’s needs and its community’s capacity to pay, would be the simplest to administer.

**Multi Cap Model** - If, through consultation, the ESC determines that a multiple cap model should be introduced, then consideration should be given to determining appropriate caps based on the following categories:

- Inner city
- Middle suburbs
- Interface areas (Growth)
- Interface areas (Green wedge)
- Peri-urban areas
- Regional centres
- Rural

Alternatively, a more sophisticated multiple cap model would recognise the relative ‘starting point’ for each Council based on an assessment of financial sustainability indicators.

5. **Consumer Price Index (CPI) should not be used as a baseline**

*CPI is not the correct baseline* – CPI is not an acceptable basis for setting a cap on rate increases, as CPI does not demonstrate relevance to the calculation of rate increases.

The most significant limitation on the use of CPI for setting rates is that the basket of goods used to calculate CPI does not include the main cost drivers associated with the services provided by a local government. The CPI measures non-local government costs such as domestic and international holiday travel and accommodation, the price of fruit and vegetables and the price of tobacco. Councils do not buy tobacco, fruit or vegetables. The Australian Bureau of Statistics CPI also states that “All expenditures by businesses, and expenditures by households for investment purposes, are out of scope of a Consumer Price Index.”

A Council basket of goods is the price of asphalt, building materials and labour costs. These do not increase at the rate of the CPI basket. For example, Council must pay for its utility services, however, none of these services, electricity for street lighting, gas for Council buildings or water for parks and ovals are limited to increases by CPI.

Research and analysis undertaken by the MAV indicates that, as a result of these issues, Local Government costs typically increase by around one per cent above the CPI. In rural, regional and remote areas, transportation costs and reduced supplier competition means this cost can be much higher. These councils are also constrained by the inability to charge higher levels of user fees given the low and fixed income base of many communities. The impact of using CPI alone as the cap would mean that, in real terms, Council revenue available to fund services and capital infrastructure would go backwards year on year. This would likely result in nearly all Councils needing to make a business case for a variation to the framework, creating unnecessary levels of bureaucracy.
**Consistent and Stable Rate increases** - S 136 (b) of the Act requires Council to pursue rating policies that are consistent with a reasonable degree of stability in the level of the rates burden. CPI is not a stable measure and is subject to sudden fluctuations, examples include the introduction of the GST, changes in prices due to the rise and fall of the Australian dollar, storm events or droughts in other states which affect the market price of fresh fruit and vegetables and other food.

Also the requirement for a Strategic Resource Plan as per section 126 of the Act is that Councils ensure their financial sustainability and manage responsibly by planning resource allocation over a four year period. This will be impossible to do if revenue fluctuates as widely and unpredictably as CPI.

**Ideal Baseline** - Rather than being prescribed at the outset an acceptable level of rate increase should be the end point of the rate setting process. The diversity of factors that impinge on the level of funding needed to ensure good community outcomes, varies so significantly across local government areas that trying to determine a one size fits all rate cap is ineffectual and will not be in the long term interest of communities.

The merits of using an alternative index to better reflect the underlying cost drivers in the Victorian Local Government sector need to be explored and considered by the ESC.

We recommend the development of an independently verified and validated Local Government Cost Index, which could form the basis for a more relevant starting point (refer to the Recommendation in this paper).

**Lack of Community Understanding** - The premise that CPI is simple to understand as opposed to simple to report is not correct. Each quarter the “headline” CPI rate is reported by the Australian Bureau of Statistics and is reported widely. However we would argue that the level of understanding broadly held in the community is questionable.

In summary, the centre point of a rates capping framework should be the process of setting rates, the promotion of transparency, use of good data and close community engagement - not an arbitrary figure such as CPI.

6. **Rate Capping should only apply to revenue from general rates.**

It is our view that the cap should apply only to general rates and the municipal charge (for those Councils that still have a municipal charge).

Applying the Rate Cap to total revenue would also be disadvantageous to those Councils experiencing growth or significant change.

**Other Charges** - Charges for waste are a return on cost for service and applying rates cap to these would force local government to conduct activities at a loss. These charges are operated on a fee for service or contracting basis and may be subject to cost escalations as outlined in negotiated contracts.

**Fires services levy** - The Fire Services Levy should also be excluded from the cap as that is a tax that is merely collected by Local Government on State Government’s behalf.

**Exclude Supplementary rates** - Supplementary rates should be excluded from the rate cap. Supplementary rates are an indicator of growth, which leads to increased service delivery and infrastructure requirements. Councils need to respond to
these increased requirements often, in the case of service delivery, as population or participation meets certain triggers.

Supplementary rates also become part of the base for the following financial year so a process to ensure consistency in the treatment of supplementary valuations for determining the rate base should be established for all Councils.

*Exclude Service Charges and Special Rates and Charges* – Increases should already be based on the direct cost of those services and may have inputs into the cost of delivery that are outside of the control of Councils. For example, EPA Victoria levies that may impact on the cost of waste collection may increase at significantly greater rates than CPI and Councils should be able to determine what the required charge should be on a cost recovery basis.

7. What should the base year be?

New Base Year 2017 / 2018 – Given that 2016/17 is a revaluation year and in addition, 2016 is a council election year, the commencement of rate capping in 2017/18 would be ideal as it would ideally sit alongside a new council planning cycle.

8. Distinction between Metropolitan and Rural Councils

Some Councils have greater ability than others to raise revenue from sources other than rates. For example substantial revenues from parking meters and parking related fines.

Many rural Councils have significant costs relating to infrastructure maintenance and renewal that many Metropolitan Councils do not and have relatively few revenue sources available to them to meet constantly increasing expectations from their communities.

Consideration needs to be given to how this will be factored into a rate capping framework and whether there will need to be different rate caps for different types of Councils.

Councils should have the autonomy to make service type and level decisions in consultation with their communities in response to specific needs and therefore, the ESC will need to be cautious in how the LGPRF is used to make links between rates and service levels.

The reporting that will result from the new LGPRF must be viewed in the context of the diversity and range of Councils and the services each provides to its community. Service levels may vary between Councils as a result of many factors, such as different population demographics, remoteness, community expectations, exposure to natural emergencies, etc.

Council such as Wellington Shire, face many challenges resulting from its geography, a history of regular natural disaster events and the need to provide appropriate infrastructure and services for a number of townships that experience significant population increases during holiday periods.

It has many disparate communities and delivery of services must be duplicated across these. This in itself creates challenges when dealing with community expectations regarding both the level and nature of services provided.
Infrastructure maintenance and renewal requirements are especially challenging, given factors such as those mentioned above and the extensive network of roads, bridges, drainage, walking/cycling paths, etc. that must be managed.

Council is mindful of the need to service the whole municipality regardless of the spread of population and this challenge will become even greater within the confines of rate capping.

9. Consequences of Blanket Rate Capping

There should not be any introduction of rate capping without due consideration for the difference in councils and also some unintended consequences.

**Asset Renewals** - It is essential that any rate capping framework has as a core principle, that the potential impacts on Local Government do not include deterioration in existing levels of service delivery and renewal/maintenance of assets, to the detriment of the communities they serve.

Appropriate asset renewal should continue to be required, but consideration must be given within the framework to how the differing costs that will be incurred by different Councils are to be accommodated.

Monitoring of Councils’ ability to meet their infrastructure requirements will be important to the longer term sustainability of Councils. A process to monitor and review Councils’ ability to undertake the appropriate level of infrastructure works, both operating and capital, will be important to ensure appropriate levels of service to the community are provided within the confines of the advised rate cap.

Councils should have robust asset management plans that identify and prioritise capital works required to be delivered each financial year. As part of developing the annual budget, the capital works program is already clearly articulated and made available to the community for review and comment.

**Unintended Consequences** – Apart from impacts on asset renewal funding and programs, there may also be some other impacts that could affect councils for example:

- **Increased Borrowings** – an annual increase in borrowings to fund projects or community requirements. If not managed properly, especially in a climate of rising interest rates, borrowing could eventually turn into hard core debt where only the interest is serviced.

- **Shift to Contract Staff** – The motivation to reduce labour costs could see a greater ongoing reliance on contract/temporary staff. Rural Councils already find it challenging to attract staff for key roles and a revolving door of temporary staff may directly impact on skill retention, compliance and governance requirements.

RECOMMENDATION

Rate-pegging should be reviewed in the context of a wider effort to address infrastructure backlogs, ensure financial sustainability and provide communities and regions more options for the way Local Government operates. It is recommended therefore that:
1. A blanket CPI based Rate Cap not apply

Rather than a blanket solution that may have unintended consequences, a rate capping methodology needs to be established that can be equitably applied to all councils and minimises potential threats to Local Government’s financial sustainability and the wellbeing of local communities.

2. An LG Cost Index should be developed

We support a recent LGPro proposal to develop an independently verified and validated Local Government cost index. LGPro detailed how this LG Cost Index could be determined through an independent assessment made by the Australian Bureau of Statistics or similar and should incorporate the following three components:

a) Core Local Government Cost Index (i.e. the LG equivalent to CPI)

b) Adjustment Factor – which would automatically account for industry-wide impacts, but be calculated specific to that Council – these adjustments would include cost impacts of items such as a Defined Benefits Superannuation Call; imposition of costs by State Government e.g. their wish for a Council to maintain a bike path or CCTV cameras; or new regulatory statutory costs imposed on Councils.

c) Infrastructure Renewal Factor – this would recognise the relative starting point for a council, whereby some councils have a low average rate – this focus on infrastructure renewal would ensure that Victorian Councils do not fall into the same financial non-viability trap that has occurred in NSW.

3. A longer term Valuation cycle be introduced

Setting a cap on individual rate assessments is considered problematic given revaluations every two years. In a revaluation year, valuation movements will vary between geographic locations and between different property classes. To apply a cap to assessments would provide no certainty for future financial and budgetary planning and create a significant administrative burden for Councils.

A better option would be to introduce three-yearly valuation cycles. This would provide three years of clarity for the community and result in a significant cost reduction to both Councils and the State Government who pay councils for their valuation data.

Yours sincerely

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ECM: