SUBMISSION 12
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Horsham Rural City Council urban rural balance

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5 September 2016

Executive Officer
Environment, Natural Resources & Regional Development Committee
Parliament House
Spring Street
East Melbourne Vic 3002

Dear Sir/Madam,

SUBMISSION TO THE ENQUIRY INTO SUSTAINABILITY AND OPERATIONAL CHALLENGES OF VICTORIA'S RURAL AND REGIONAL COUNCILS

1. LOCAL GOVERNMENT FUNDING AND BUDGETARY PRESSURES

a) RENEWAL OF AGEING ASSETS

Horsham Rural City Council (HRCC), like most councils, has previously identified a growing gap between the spending required to maintain and renew our existing assets and the available funding for that purpose. As a result, since 2008/09 we have been identifying a component of our rate rises and tagging that to specifically help contribute to this growing gap. HRCC has a network of 2,976 kilometres of road, 32% of which is sealed. This equates to around 7 people per kilometre of road. Soil substrates within the municipality have been identified as some of the most reactive across the state and this reduces the average life of a road. (Council has been unsuccessfully lobbying the Victorian Grants Commission for some years to have this better recognised in the roads component of their grants calculations). Larger vehicles and more frequent road use as farming practices change and evolve is also significantly contributing to the deterioration.

Addressing the renewal gap through targeted rate rises has been a specific strategic objective for many years and needs to continue for a number of years if we are to address the declining condition of our assets.

HRCC regularly engages Moloney Asset Management System to conduct the condition assessment of its entire road network in July 2014 as a part of its three-yearly cycle of condition assessment.

Analysis of current and previous data (degradation curves and asset conditions) was undertaken to do the renewal forecasting for next 20 years. Any impact on the road infrastructure renewal demand impacts heavily on the entire asset renewal program, as roads constitute the largest portion of Council's asset base.

Following are some of the findings and recommendations of the Moloney report:

- The total present renewal shortfall or backlog in over intervention assets for the whole roads group is estimated at $6,524,768 representing 2.41% of the total road asset valuation. This is considered to be reasonable but it should not be allowed to grow.

  Figure 1.2 below, shows that with current renewal expenditure, about 2.41% of road asset stock is over intervention (Approx. $1.0m in 2014 and accumulating each year thereafter), or in simple terms needing some urgent renewal/rehabilitation works. This means that 1 in every 40 roads you come across are close to an unserviceable condition. If the same amount of expenditure is continued for the next 20 years, the percentage of assets over intervention will jump to about 16% which means nearly 1 in every 6 roads are nearing end of their lives.

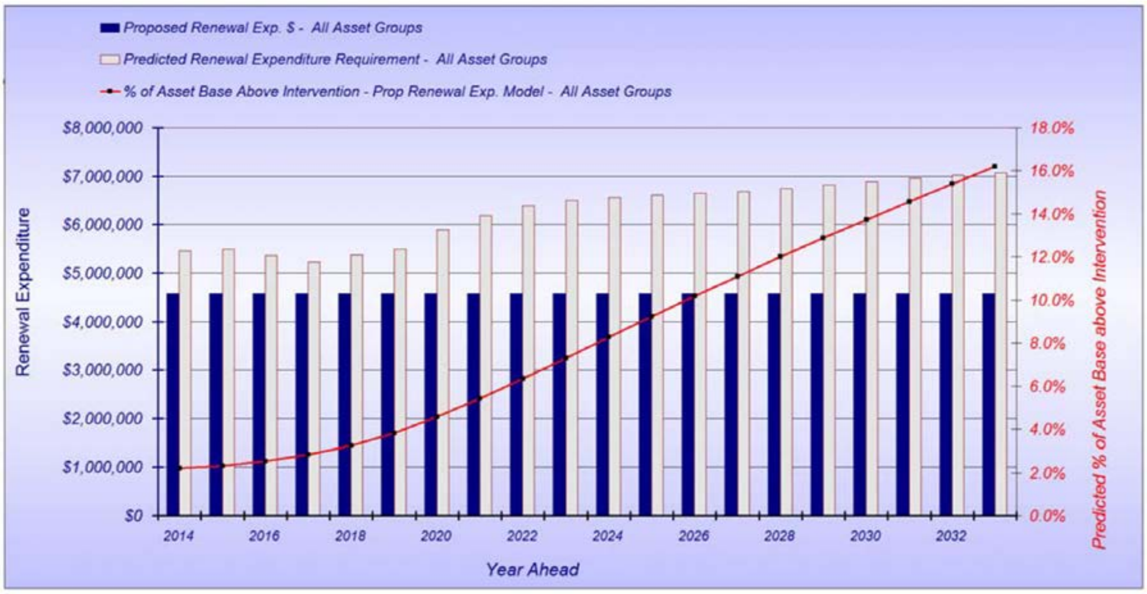

Fig 1.2 Future Predicted Condition Based on Continuation of Present Renewal Expenditure

  Moloney states "Figure 1.2 indicates that if the current total level of renewal expenditure is maintained over the next 20 years, a steady rise in the total extent of over intervention assets will occur to dangerous and unacceptable levels. The upper limit of total assets over intervention on the road network is considered to be around 3.0% - 3.5%. The model predicts that council has 5 years at the current funding levels before this rises above 3.5%."

- Renewal demand is predicted to rise steadily over the next 20 years as the assets age and it was found that at a whole of roads group level council needs to raise its total renewal expenditure by around 3.0% compounding for the next 10 years.

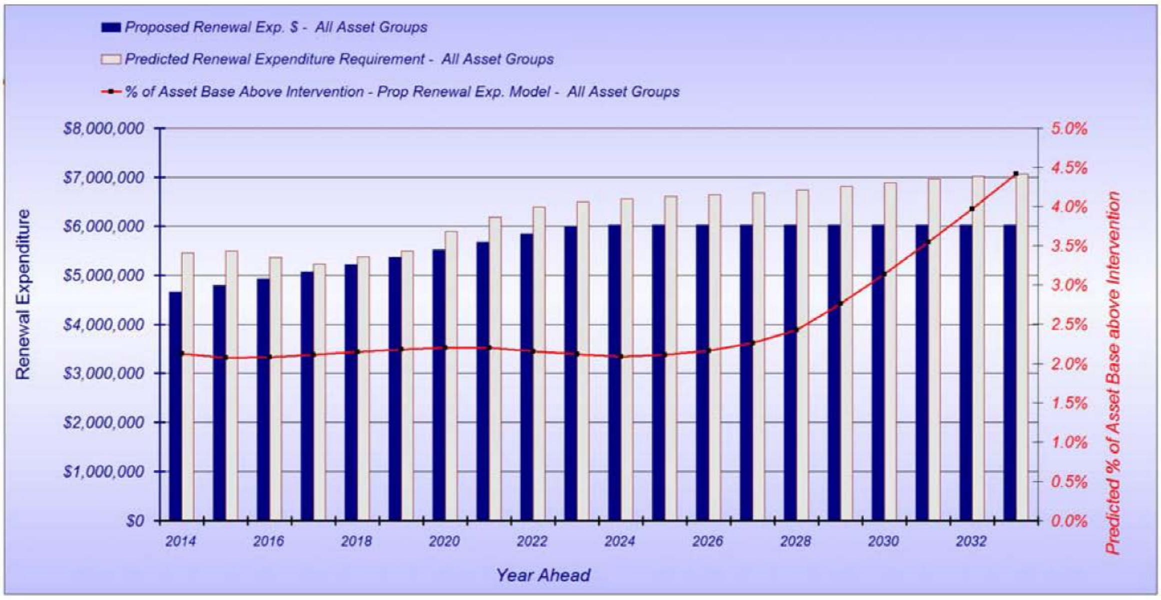

Fig 1.3 Recommended future funding profile with future predicted extent of over intervention assets

- Moloney recommends increasing the current renewal expenditure by around 3% compounding for next 10 years to maintain the current level of service in the road infrastructure (as represented in Fig 1.3 above). This increase will help maintain the % of assets over intervention to about the level of 2.14% (same as current). It can be noticed that the red line (% of asset over intervention) starts rising rapidly after 2026. This implies that the current strategy needs to be revised in about 10 years.

Moloney says "With ageing assets and some of the most difficult subgrades in the state the rising renewal demand should come as no real surprise for HRCC".

A report by VAGO from Feb 2014 – "Asset Management and Maintenance by Councils" highlights the challenge for councils in maintaining and renewing assets. The Auditor General John Doyle in the Executive Summary states "A 1998 report to government warned that unless steps were taken to address councils' asset renewal gaps, the budget councils require for renewal would more than double by 2012. These predictions have materialised despite this warning." He goes on to say further in that summary "Without appropriate and concerted corrective action, the provision of council services to communities is likely to be put at risk. While this may require some hard financial decisions and trade-offs, failure to address this problem now will only lead to more difficult decisions in the future".

b) INDEXATION OF FEDERAL FINANCIAL ASSISTANCE GRANTS

The Federal Government Grants Commission ceased indexation of Financial Assistance Grants in 2014/15 for a 3 year period, which has resulted in a cumulative loss of funding to HRCC of approximately $1.0 million. At the same time they have provided additional, once-off Roads to Recovery funding that will compensate for this in the short term but from 2017/18 the ongoing impact will be around $0.50 million annually.

c) RATE CAPPING

Rate capping has imposed additional pressures on councils - see the item (3 below).

d) GRANTS COMMISSION METHODOLOGY ISSUES

HRCC has for a number of years made submissions to the Victorian Local Government Grants Commission with respect to the methodology used in the calculation of their fiscal equalisation grants. The key matters addressed in these are as follows:

i) MINIMUM GRANT

The national principle requiring all councils to at least receive a 30% minimum grant sees significant, mainly urban, Councils with large and increasing populations grow their share of the overall grant pool thus reducing the balance available for all of the remaining Councils in the state. This principle clearly conflicts with that of horizontal fiscal equalisation and when combined with the Federal Government's freeze on growth of the overall funds, the impact of the 30% minimum becomes more significant. Doing away with the minimum grant and just applying the principles of the remaining Grants Commission methodology would see more grant revenue move to rural councils.

ii) DECLINING POPULATIONS

The current methodology that the Grants Commission uses for calculation of standardised revenue and expenditure uses population as the main basis for a number of the services that it looks at with allowance given to councils with significant population growth. The circumstances of municipalities with declining or relatively static populations, however, are not recognised in the methodology and a cost adjustor for population decline is not considered an issue.

The need to recognise the impact of population decline and its detrimental impact on Council operations is important for all Councils with a declining population base, or with population growth below the state average. It is particularly important for small rural Councils where the impact of such decline is felt the greatest.

Declining populations or populations increasing below average population growth rates greatly impact on a Council's Grants distribution. Of the nine functions included in the calculation of standardised revenue and expenditure, six have total population as the major cost driver; one is based on population but within a narrower age band with the remaining two based on dwelling numbers and the local roads pool.

In municipalities across the state where population is declining or not growing at average rates there is a significant decreasing economies of scale effect. Expectations and sometimes legislation require that service delivery continue to a reduced number of people, who nevertheless have a legitimate expectation or entitlement to those services. For example, road lengths remain the same but cannot easily be reduced just because populations decline. All Councils, regardless of size, must comply with all legislation equally which puts a greater burden on a smaller Council, which any reduction in population only exacerbates.

In other words, there is a significant "fixed" component within the cost structures of all Councils and therefore a declining population means those fixed costs must be spread across fewer and fewer ratepayers. The principles of horizontal fiscal equalisation should see the grants commission methodology compensate for the rising impact of fixed costs as populations decline, but this is not currently the case under present arrangements.

It is our belief that the Grants Commission methodology already greatly compensates councils with expanding populations through the use of population in the major cost driver component of the calculation, and therefore to add a further cost adjustor for population growth is unnecessary. What really should be applied is a cost adjustor for population decline across all functions, to enhance the principle of horizontal equalisation.

There is also a smaller % rate impact for ratepayers in growing Council areas where property values are rising and property numbers increasing compared to rural and regional councils with declining centres.

iii) ROAD SUBSTRATES

The current calculation of the sub-grade factor in the Grants Commission methodology does not pick up on an alternative measure of using degradation curves. Mr Moloney's calculations indicate that roads in HRCC, and others across the Wimmera, are experiencing a road life of only about 40 years. Across the state the average is closer to 80-100 years. The result of this shortened life is that Council spends in the order of $4.7 M per year on road renewals, which is about $2.3 M per year more than an equivalent Council which has average sub-grades.

It is also worth noting that Mr Moloney's report indicates that HRCC has been making a diligent effort to improve the overall condition of its road network, but that this effort has not been rewarded owing to the impact of the 2011 floods which damaged both the visible surfaces of road and the hidden sub-grades. This damage is anticipated to leave a further cost legacy to Council in the years ahead.

iv) MINIMUM SERVICE LEVELS

HRCC recognises the notion of a specific minimum set of services and service levels that should be available to all communities; however we do note that this is a challenge to define, as there is a diverse range of communities in terms of size, distance from service centres and differing needs. We also suggest that there is a need to be as prescriptive as possible when defining service levels so that there are clear and measureable outcomes that can be monitored and defended. The phrase "access to" and "local" can be interpreted in many different ways.

v) WHELAN REPORT

The Whelan Report of 2010 identified 18 councils that were measured as unsustainable. Horsham was not one of these Councils but has many similar characteristics that it must deal with on a regular basis. The 18 Councils will be in a better position to describe the Whelan report findings.

2. FAIRNESS, EQUITY AND ADEQUACY OF THE RATING SYSTEM

a) RATES EFFORT

As mentioned above in point 1(a) above HRCC has been increasing its rates to try and address the growing infrastructure gap however there is a rising issue of "rates affordability" with councils rates currently at the upper level of affordability as measured by the ratio of rates to property values known as "Rates Effort" being 0.67% with state government recommended range from 0.20% to 0.70%. It is unclear how exactly further rate rises will impact on this measure and for how long they can continue to be applied. A comparison of this measure across the state should see that this measure is considerably higher for most rural and regional councils compared to metropolitan municipalities.

b) DIFFERENTIALS

HRCC applies a 20% differential for farming assessments applying principles provided in the Ministerial Guidelines (April 2013) for the use of differentials. These guidelines are helpful but do not provide a definitive way to determine whether a differential should or should not apply. They are also unclear in their reference to what farms should be entitled to a differential with no explanation for this difference. That is, the guidelines say that farm land is an appropriate category for differential rates but that dry land farming and irrigation farming should be "considered carefully" as to whether they are appropriate for differential rates.

c) CONFLICT – TAX ON WEALTH VERSUS PAYMENT FOR SERVICES

There is often confusion and misconception as to why an individual ratepayer's rates bill should increase when nothing has changed from their perspective – no new services to access and no new developments on their properties. It is because every two years valuations are revised to reflect current market evidence. This causes many conflicts within the community as to why certain sectors or individuals should pick up a larger portion of the rate burden.

The issue that is not well understood is that rates are essentially a tax on wealth as measured by property values, they are not a payment for service or a tax based on income. There is a strong correlation between property values and capacity to pay, but it is not always the case and rebates and concessions are then utilised.

d) ALTERNATIVE FUNDING MODEL

Having a tax based on wealth as measured by property values is an important overall tax within the suite of taxes across federal, state and local government. The problem comes in that it is the main tax that local government is left with to raise and fund its services. Local services are easiest for ratepayers to identify whether they use them or not and consequently lead to misconceptions as to what is fair to pay.

There is a good argument for this funding source to be more diverse such that councils have more than just property rates as a source of income i.e. share of GST revenues.

3. IMPACT OF RATE CAPPING POLICIES

The State Government's Fair Go Rates policy will cause significant hardship for Council particularly if other State or Federal Government funding sources are further cut or the State Government continues to move service responsibilities to council without appropriate funding or to increase its own charges to Council by percentages higher than the 2.5% rate cap for things such as audit, election expenses, the fires services levy, Environmental Protection Levies and a range of other charges.

HRCC has been heading downward in general rate increases for a number of years, but given the impacts of ceasing of indexation of FAGS grants for 3 years, then the impact of rate capping is considerable.

As stated in item 2 above rural communities generally are not going to be in a position to impose greater levels of rating on their local communities. There needs to be discussion of alternative income sources or funding options for councils.

4. CAPACITY FOR RURAL AND REGIONAL COUNCILS TO MEET RESPONSIBILITIES FOR FLOOD PLANNING AND PREPARATION, AND MAINTENANCE OF FLOOD MITIGATION INFRASTRUCTURE

Recent changes to the State Government floodplain management policy position are likely to lead to increased costs to Councils. This is an example of cost shifting referred to above. The extent of this cost shift has not yet been determined, but is anticipated to arise in relation to:

- OM&R of river gauging stations used for flood monitoring, which have generally been funded by State Government or its agencies in the past.
- Maintenance and renewal costs of some floodplain infrastructure, which had previously held a range of ownership statuses.

5. MAINTENANCE OF LOCAL ROAD AND BRIDGE NETWORKS

a) SOIL SUBSTRATES

A significant body of work on road conditions across Victoria has highlighted that road sub-grades play a critical factor in influencing the effective lives of roads. It is recognised that much of western Victoria and some other areas incur higher road costs as a result of these poor sub-grades.

Empirical evidence indicates that the range in effective lives of roads could vary between 40 years and 180 years – an effective variation of 450%, having a proportionate impact on the cost of road maintenance and renewal.

HRCC has received a series of reports that now span a period of 13 years, with each report involving the sampling of in excess of 2000 road segments in a road network of about 3300 km.

The condition assessments and reports were prepared by Peter Moloney of Moloney Asset Management Services. Mr Moloney provides similar services for 49 other LGAs across Victoria, hence can be considered to have a high level of expertise in both road asset conditions generally and their relative condition across the State.

Collectively, his work represents a robust dataset for analysis. In his 2012 report to HRCC, Mr Moloney stated "In undertaking this work for many councils over the last 17-years one fact has clearly emerged. Those councils within the state that are on poor subgrades really do have a severe disadvantage that needs to be addressed through the Government funding system."

The condition assessments performed by Mr Moloney allow degradation curves to be developed for classes of road assets. These curves map the condition of roads between inspections, allowing projections of renewal costs to be developed, and importantly determination of the effective (serviceable) life of the assets.

HRCC and other municipalities in the Wimmera Region incur higher costs as a result of these poor sub-grades. For HRCC this additional expenditure is estimated to be about $2.3 M per year on road renewals. This is based on the assumption that extending the useful life of roads from 40 to 80 years would halve the renewal cost, which is currently $4.7 M per year.

b) ASSET RENEWAL GAP

See information provided for item 1 (a) above.

c) ROADS AND BRIDGES FUNDING

For 5 years until 2015/16 HRCC along with other rural councils received $1m per year for the Country Roads and Bridges funding. This was not extended in 2016/17 and as a consequence council's roads and bridges spending have been reduced accordingly. This was a vital component of funding that helped offset some of the infrastructure renewal gap, as described in previous sections. The loss of this funding needs to be offset if Council is to continue to maintain roads and bridges in serviceable condition.

6. WEED AND PEST PLANT CONTROL

Councils have been handed full responsibility for roadside pest and weed control. Currently funding is $65k per annum which was increased from $50k in 2015/16. Council's cost of undertaking this work is estimated at somewhere between $150,000 and $200,000 per annum.

Yours faithfully

[redacted]

PETER F BROWN
Chief Executive