

4 May 2017

Our ref: C/17/7386

The Hon Natalie Hutchins MP
Minister for Local Government
Level 27, 1 Spring Street
Melbourne VIC 3000

Dear Minister

YARRA CITY COUNCIL - PROPOSED WASTE CHARGE

I refer to your letter of 21 April 2017 seeking advice from the Essential Services Commission on whether Yarra City Council's (Yarra) proposal to introduce a new waste service charge as part of its 2017-18 budget complies with the Local Government Act 1989 (the Act) as well as relevant guidelines issued by the Commission.

As we understand it, Yarra's proposal:

- will generate an additional \$8.5 million in revenue to fully recover the cost of delivering waste services¹
- is not offset by an equivalent reduction in general rates (i.e. is not revenue neutral).

As a result, Yarra will make available \$8.5 million of general rate revenue for other purposes. Yarra has stated that this is part of the council's new long term financial strategy aimed at ensuring it can 'continue to fund services at the high levels the Yarra community currently values' and 'remain financially sustainable into the future'.²

Under the Fair Go Rates System, service charges, including waste charges, are outside the definition of the base and capped average rates, meaning they are not subject to the annual rate cap set by you or a higher cap approved by the Commission.

¹ Yarra City Council – Draft Budget 2017-18.

² <http://www.yarracity.vic.gov.au/hot-topics/exploring-a-new-funding-option-for-waste-services/>

This position was taken to reflect the view that such service charges are typically market tested. Being outside the rate cap also means councils can align charges with the cost of providing the service. Unlike special charges, the Act does not require councils to notify and engage with relevant ratepayers and demonstrate cost reflectivity when introducing or setting service charges.³ The absence of any legislative guidance on the setting of service charges provides councils with very broad discretion when creating and setting service charges.

Despite this very broad discretion, our understanding of the policy intention of the Fair Go Rates System led us to issue guidance on this matter. Our guidance states that we expect a council proposing to introduce new service charges to explain clearly the financial and service impacts associated with such a change to their community:

A council should provide the Commission supporting documentation showing that the change has a neutral impact for the council and its community. That is, in aggregate terms, the increase in revenue from service rates and service charges should match the reduction in general rates revenue and does not result in a windfall gain. The council may make further adjustments to make the change more attractive to their ratepayers. Such differences will need to be explained, accounting for possible changes in outputs, price, and the quantity and quality of service levels between years. The council will have to provide supporting information to the Commission.⁴

Even though we have no role in approving service charges, this guidance is aimed at maintaining the integrity of the capping framework. It is intended to discourage councils from converting otherwise capped revenue into an uncapped source of funds, to the overall detriment of ratepayers consistent with the purpose of the Fair Go Rates System as set out in legislation.⁵

The reason for including this in our guidance derives from our role in monitoring compliance with the rate cap rather than our role in approving rate cap variations. Under the Local Government Act, the Commission is required to report each year on

³ Sections 163 to 166 of the *Local Government Act 1989*.

⁴ Essential Services Commission 2016, *Fair Go Rates System — Guidance for Councils (2017-18)*, October [Amended March 2017].

⁵ Section 185A sets out the purpose as being to promote the long term interests of ratepayers and the community in relation to sustainable outcomes in the delivery of services and critical infrastructure; and ensure that a Council has the financial capacity to perform its duties and functions and exercise its powers.

whether councils have complied with the Minister's rate cap or otherwise, a rate cap approved by the Commission. Every two years, we are also required to produce an 'outcomes report' that examines broader financial, service and infrastructure performance measures. The purpose of the outcomes report is to monitor for unintended consequences arising from the rate capping framework. Our first outcomes report is due in late 2018. An overall surge in revenue, such as the one expected by Yarra, would be highlighted in the outcomes report.

In our first compliance report released in November 2016, we noted that Mornington Peninsula Shire and the Borough of Queenscliffe introduced new service charges to recover waste costs for the 2016-17 rating year. We were satisfied that both these councils introduced their new service charges on a revenue neutral basis. In addition, Knox City Council has recently advised the Commission that its proposed residential garbage charge in 2017-18 generates no additional net revenue (i.e. revenue neutral).

Under Yarra's proposal, the average rate for 2017-18 is estimated to be \$1950. Based on publicly available information, this is \$159 higher than it would be if the new charge is introduced on a revenue neutral basis in 2017-18 (ie \$1791). In other words, Yarra will be collecting an additional \$159 per property (on average) compared to what it would have been collecting had it not introduced this new service charge.

Were Yarra to raise an equivalent \$8.5 million through a higher cap application that variation would have seen rates increase by around 10.3 per cent.

Had Yarra sought this additional revenue through a higher rate cap, the Commission would have required Yarra to consult with its community in accordance with section 185E(3)(c) of the Local Government Act. Indeed, given the magnitude of the proposed increase, we would have expected to have seen a very extensive application from the council. That application would have required both consultation on the magnitude of the increased revenue but more importantly, we would have expected to see extensive consultation on the reason that additional revenue was required. In other words, what additional expenditures was council planning or anticipating to justify the additional revenue and how informed was the community of those expenditures.

It is worth considering how those expectations compare to the circumstances surrounding Yarra's proposal to introduce the new waste charge.

Based on publicly available information, it appears that Yarra has engaged with its community about the introduction of the new waste charge. We welcome Council's efforts. However, it appears Yarra has not fully explained to its community how they propose to use the additional \$8.5 million to be collected under general rates as a result of the introduction of a new charge without a corresponding reduction in general rates.

In summary, it is necessary to distinguish between Yarra's compliance with the letter of the law versus whether its actions are within the spirit of the law. We believe that our guidance reflects the 'spirit of the law'.

We now turn to a discussion of Yarra's new waste charge.

Yarra proposes to collect \$8.5 million in 2017-18 from its new waste charge. Council has proposed that charges vary depending on size of the bin with an 80 litre bin paying \$165 per year, a 120 litre bin paying \$247.50 per year and a 240 litre bin paying \$800 per year. This will see customers paying \$2.06 per litre of bin space for the first 120 litres, but \$4.60 per litre for the next 120 litres.

We are not in a position to confirm whether Yarra's proposed charges do, in fact, produce revenue that is equivalent to the cost of delivering the service. Likewise we do not know how Council has defined the services covered by this new charge. For example, we do not know whether the proposed waste charges deals only with the cost of collecting and disposing of waste from bins or whether it also includes other waste related-costs (such as street cleaning). We are also unable to confirm whether the claimed revenue requirement of \$8.5 million reflects an efficient cost for the service being delivered; and we are not in a position to comment on the efficiency of the proposed scale of charges.

These are all important matters but they largely sit beyond the powers and functions provided to the Commission by the Local Government Act and the Essential Services Commission Act 2001 as part of the Fair Go Rates System.

Were the Government inclined to consider amendments to those Acts, some options that might be considered could include:

- requiring councils to demonstrate cost reflectivity and that they have undertaken community engagement (as already required for special charges) when setting service charges
- requiring that service charges can only be introduced on a revenue-neutral basis (unless, of course, council seeks a rate cap variation)
- requiring councils to describe transparently the precise nature of the service covered by a service charge (for example, explain what services are included in 'waste collection'). Alternatively, the Government could prescribe the definition of these services through regulation or some other instrument.

Other amendments could be considered regarding the remit of the Commission. For example:

- requiring councils to seek approval from the Commission to introduce a new service charge (which would involve confirming its introduction on a revenue-neutral basis)
- providing the Commission with scope to assess the efficiency of service charges where it has reason to believe they may not have been set in an efficient manner.

A further option might involve bringing service charges under the rate cap. We would advise caution before pursuing this option. We believe a better approach is to require the services covered by the charge to be defined very specifically and to then require councils to demonstrate that their proposed service charge reflects the efficient cost of delivering that service. The above suggestions could be further explored as part of the current Local Government Act review.

Although we do not have full information from Yarra to assess the impact of the proposed new charge, based on publicly available information, it appears the concept of revenue neutrality, as outlined in our published guidance, has not been taken into account in Yarra's proposal. It also appears that Council has not fully demonstrated or consulted with its community about the need for the additional \$8.5 million in its total revenue. We understand that Yarra is currently consulting with its ratepayers on the

proposed waste charge and a recommendation to include the waste charge as part of its final adopted budget is yet to be made by the council.

Should Yarra proceed with this proposal, the Commission will seek relevant information to complete its assessment as part of the 2017-18 compliance report to be published in November 2017. At which time, we will also need to assess Yarra's main reason for requiring the additional \$8.5 million for long term financial sustainability.

I would welcome the opportunity to brief you further on these matters if that would be of assistance. Alternatively, your staff or department may want to contact Andrew Chow, our Director for Local Government, on 9032 1323.

Yours sincerely



Dr Ron Ben-David
Chairperson