



Submission to the Essential Services Commission

Local Government Rates Capping and Variation Framework Review A Blueprint for Change

INTRODUCTION

In January 2015, the Victorian Minister for Finance issued a terms of reference to the Essential Services Commission of Victoria (ESC) to consider and report on the development of a state-wide capping and variation framework for Council rates. The ESC is required to undertake and complete the review by October 2015 for implementation in 2016-17.

In April 2015, the ESC issued a Consultation Paper seeking submissions on their proposed approach, and any identified issues, to the design of a rate capping and variation framework.

The terms of reference set out a number of objectives for the framework, including to:

- *contain the cost of living in Victoria while supporting Council autonomy and ensuring 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.*
- *promote rates and charges that are set at a level that ensure the sustainability of the Council's financial capacity and Council infrastructure.¹*

The ESC developed a set of principles to guide it and the sector in the design and implementation of a workable and effective rates capping and variation framework. The principles are;

- Local communities differ in their needs, priorities and resources
- Local communities and ratepayers are entitled to hold their council to the highest standards of accountability and transparency when setting rates
- The framework should support the autonomy of Councils to make decisions in the long term interests of their community and ratepayers
- Councils will need to satisfy the burden of proof outlined in the framework when seeking a variation above the cap
- Rate increases should be considered only after all other viable options have been explored
- The framework should support best practice planning, management systems and information sharing to uphold council decision making
- The framework should be flexible and adaptable
- There should be few surprises for ratepayers and councils in the implementation of the framework.

Council is broadly supportive of the principles outlined above.

¹ Essential Services Commission, Local Government- Rates Capping and Variation Framework Consultation Paper, p15

In July 2015, the ESC released its draft report entitled *A Blueprint for Change* which proposes a framework to meet the Government's commitment to generally cap annual Council rate increases to CPI, as well as to develop a workable process to assess any proposals by Councils for above cap rate increases.

The following represents Knox City Council's response to the draft recommendations proposed by the ESC in its report *A Blueprint for Change*.

The Cap

Draft Recommendation 1

The Commission recommends there should be one rate cap that applies equally to all Councils in Victoria.

Response

Council reiterates the points made in its submission to the consultation paper. Councils are diverse organisations serving diverse communities, providing a wide range of services to their communities in response to community demands. Councils have diverse geographic and physical characteristics that determine the infrastructure requirements of those municipalities. An effective cap framework should recognise these differences.

For the City of Knox, rates constitute 66% of Council's income. Similarly to like Councils, Knox City Council's reliance on rate income is higher than the Victorian average of around 56%. Therefore the impact of rate capping on Knox will be proportionally greater than on those Councils with a lower reliance on rate revenue (for example, with large parking revenue sources). This is a significant structural difference that should be adequately addressed in any rate cap framework to avoid inequity and disadvantage. A single, uniform rate cap that applies to all Councils fails to recognise fundamental differences in the structural characteristics of Victoria's 79 Councils.

Any rate capping framework also needs to provide a level of sophistication that recognises the relative starting point and operating context for each Council to ensure significant disadvantage is not incurred. For example, those Councils with current lower rating levels (relative to others) will be significantly disadvantaged if relative rating efficiency effort is not adequately recognised in the starting point against which any future cap will be applied.

Draft Recommendation 2

The Commission recommends that:

- Revenue from general rates and municipal charges should be subject to the rate cap;
- Revenue from special rates and charges, revenue 'in lieu of rates' and the Fire Services Levy should not be included in the rate cap; and
- Service rates and charges should not be included in the rate cap but be monitored and benchmarked.

Response

Council generally supports this recommendation, however it should be noted that Knox is one of a small number of Councils that includes its base garbage collection costs as part of Council rates. The exclusion of service rates and charges from the proposed rate cap is likely to incentivise those Councils that currently do not apply a service charge for waste collection and disposal, to do so. The consequence of this will be a re-distribution of the rates and charges burden in the first year of operation towards lower valued properties (i.e. the effect of a flat charge relative to an ad valorem rate). This, in turn, will have the effect of distorting perceived benefits from a rate cap for those lower valued properties who will incur a disproportionately greater share of the rates and charges burden when a service charge is first introduced.

Draft Recommendation 3

The Commission recommends that the cap should be applied to the rates and charges paid by the average ratepayer. This is calculated by dividing Council's total revenue required from rates in a given year by the number of rateable properties in that Council area at the start of the rate year.

Response

Council is supportive of this recommendation.

Draft Recommendation 4

The Commission recommends that the annual rate cap should be calculated as:

$$\begin{aligned} \text{Annual rate cap} &= (0.6 \times \text{increase in CPI}) \\ &+ (0.4 \times \text{increase in WPI}) \\ &- (\text{Efficiency factor}) \end{aligned}$$

With: CPI = DTF's forecast published in December each year

WPI = DTF's forecast published in December each year

The efficiency factor will initially be set at zero in 2016-17 but increasing by 0.05 percentage points in each year from 2017-18. The Commission will undertake a productivity analysis of the sector to assess the appropriate rate for the efficiency factor.

Response

Council reiterates its response to the consultation paper. Knox City Council already undertakes programs to improve efficiency and effectiveness in services and in responding to community needs. Council continues to be concerned that a rate capping regime constricts Council's ability to make its own judgements in conjunction with its community to deliver the services and infrastructure both required and expected by the community. In an environment of cost shifting from Federal and State Governments to Local Government, it is inevitable that Councils will need to reconsider their ability to continue to deliver services on behalf of State and Federal Governments.

Knox City Council, in its Long Term Financial Forecast, has forecast rate rises at 5% each year over the ten year forecast period. These forecasts have taken into account Council's calculated cost escalation factor as well as creating surpluses to enable Council to deliver new capital and operating services, as well as planned major community projects over this forecast period.

Capping rates at a combination of DTF's forecast CPI figure and the WPI figure already introduces an inherent efficiency factor on Council's rate revenue when compared to the actual cost to deliver services. That is it has been long established that the actual costs incurred by Councils are not accurately measured by CPI (being a basket of consumer items) and that a rate cap that ties to CPI, by default, results in an efficiency factor. To add a further efficiency requirement beyond Treasury's CPI and WPI, creates a further compounding efficiency 'dividend' effect.

To Include an additional efficiency factor of .05 percentage points each year from 2017-18 and increasing every year thereafter is effectively compounding an efficiency factor that will already exist, and is an additional needless constriction on local government rate revenue.

Council is generally supportive of including a weighted wage cost (WPI) in the proposed cap. Council continues to argue that the cap should be based on a more relevant local government price index rather than the proposed CPI. Nonetheless, noting the government's public commitment to capping rates to a CPI figure, Council would support the projected CPI rather than historical CPI as a more accurate reflection of future budget cost.

Draft Recommendation 5

The Commission recommends that the 2015-16 rates (general rates and municipal charges) levied on an average property should be adopted as the starting base for 2016-17.

Response

Council understands that the State Government has indicated its intent that the cap commence from the 2016-17 financial year, and therefore applying 2015-16 rates as the base appears appropriate.

Variation

Draft Recommendation 6

The Commission recommends that the framework should not specify individual events that would qualify for a variation. The discretion to apply for a variation should remain with Councils.

Response

Council agrees with this recommendation.

Draft Recommendation 7

The Commission recommends that the following five matters be addressed in each application for a variation:

- The reason for a variation from the cap is required.
- The application takes account of ratepayers and communities views.

- The variation represents good value for money and is an efficient response to the budgeting need.
- Service priorities and other funding options have been considered.
- The proposal is integrated into the Council’s Long Term Financial Strategy.

Response

Council understands and is generally supportive of the matters to be addressed in each application for a variation however Council notes that the level of detail required in responding to each of the five matters is likely to impose a significant burden on Council and will almost certainly add both costs and time to the budget development process for Council. Given the SC’s proposed budget (and variation) timeframe, Council would effectively need to develop two annual draft budgets in readiness for community consultation so that it would be in a position to immediately proceed with the relevant budget depending on the outcome of the rate cap variation decision of the ESC. Insufficient time has been allocated in the ESC’s proposed budget timetable to enable a draft budget to be re-worked following the ESC’s decision, and then to achieve final budget approval by 30 June.

Council reiterates its submission to the consultation paper - any rate variation framework must be administratively efficient. The process for variation from any predetermined cap should be aligned to relative effort. For example, a minor variation from the predetermined cap should only require a base level of demonstrated evidence to constitute an as of right approval, graduating to higher levels of demonstrated evidence to substantiate higher levels of requested variation from the predetermined rate cap.

The variation process should also contemplate an automatic variation where external influences occur that are beyond Council’s control (e.g. changed legislative obligations or superannuation call-ups).

Draft Recommendation 8

The Commission recommends that in 2016-17, variations for only one year be permitted. Thereafter Councils should be permitted to submit and the Commission approve, variations of the length set out below:

First year of variation	Length of permissible variation
2016-17	One year (i.e. 2016-17 only)
2017-18	Up to two years (i.e. 2017-18 or 2017-18 and 2018-19)
2018-19	Up to three years (i.e. up to 30 June 2021)
2019-20 and beyond	Up to four years (i.e. up to 30 June 2023)

Response

Many Councils undertake extensive community planning and consultation and develop budgets over much longer term periods than outlined in the above draft recommendation. Indeed, Knox Council has developed a detailed rolling long term financial forecast covering a 10-year forward period and has a plan to deliver major community projects over this time. The ESC's proposal to limit future year approvals for rate variation to short periods is likely to erode local government's confidence to plan for and deliver major community projects. Council suggests that the term of permissible variation ought to be articulated in the request for variation from the cap and ought to be supported by evidence which justifies the length or term of the variation being sought, and therefore should not be limited to an arbitrary term. If a case can be demonstrated for a longer period of variation, then this should be assessed on its merit and not restricted to an arbitrary timeframe.

Draft Recommendation 9

The Commission recommends that it should be the decision maker under the framework, but only be empowered to accept or reject (and not vary) an application for variation.

Response

Council is generally supportive of this Draft Recommendation, however, approval or refusal is a relatively blunt mechanism. A more efficient and workable mechanism may be to allow Councils to submit an alternative or revised submission as part of the variation process.

Monitoring**Draft Recommendation 10**

The Commission recommends that it monitor and publish an annual rates report on Council's adherence to the cap and any approved variation conditions.

Response

While Council does not generally oppose the Commission publishing an annual rates report as a means of accountability, the report should not impose any further administrative burden on Council other than that already imposed through financial and annual reports and existing reporting frameworks.

Draft Recommendation 11

The Commission recommends that it monitor and publish an annual monitoring report on the overall outcomes for ratepayers and communities.

Response

While Council has no general objection to the Commission publishing such a report, it is concerned that additional Council resources will be required to gather the data that the Commission wishes to report on. Councils already have significant reporting requirements including through their Annual Reports, Audited Financial Statements and the Local Government Performance Framework, and these existing reports should be sufficient to meet annual reporting requirements without placing additional administrative burdens on Councils.

Matters for Further Consideration

The Commission recommends a number of other matters for consideration including a regular formal review of the capping and variation framework process, of which Council is generally supportive.

The Commission also recommends that the Government consider amending the Local Government Act 1989 to require that Service Rates and Charges must reflect the efficient costs of providing the underlying service.

Council is generally supportive of this recommendation, however further or additional cost constraints on service rates and charges by way of legislation would not be supported.

The Commission also recommends that the State Government consider initiating a periodic review to ensure that statutory fees continue to reflect Council's efficient cost of providing statutory services. Council strongly supports this recommendation. Statutory fees and charges must be set in a way that reflects the Council's true cost of providing such services, otherwise ratepayers are effectively subsidising the provision of these services. Council believes that these reviews should be conducted on an annual basis.

Costs of Administering the Framework

The Commission has noted a number of options to cover the costs of the Commission administering the Framework. Council reiterates its initial submission that, as in New South Wales, the State Government must fund the cost of its scheme.

Council would not be supportive of the Government or Commission imposing any additional costs on Local Government for administering the scheme.

Guidance and Support

Council acknowledges the ESC's note that it would provide more detailed guidance and support over the coming months. Council asks that the Commission be mindful that any such guidance and support not increase the administrative burden for Councils to comply, nor any additional community burden in undertaking community engagement.