



Submission to the Essential Services Commission

Local Government Rates Capping and Variation Framework Consultation Paper

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 has 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

The following pages represent Knox City Council's response to the questions and issues raised by the ESC in the consultation paper.

The Form of the Cap

While the Consumer Price Index (CPI) is simple to understand and apply, it is not a relevant basis for setting Council rates as CPI is a consumer price measure made up of a weighted basket of household goods. Council services are made up of salaries, materials, contracts and utilities, all of which generally have little correlation with consumer goods given the nature of the services and infrastructure provided by local government. By way of an example, Knox City Council's employee costs constitute approximately 37% of its total expenditure base, and Construction-type activity represents a further 24% of expenditure. Operating contractors and services represent 21% of expenditure. Typically, Consumer-type spending represents a very small proportion of local government expenditure and CPI therefore is not representative of cost movements for Councils, which include, for example, enterprise agreement and salary progressions, construction cost/materials index and transport index.

A more appropriate index than CPI would be an alternative local government index that more accurately reflects the real costs of delivering Council services and infrastructure, including reference to appropriate wage and construction cost indices.

While councils prepare an annual budget, they undertake their planning including long term financial forecasting over a much longer time frame. Implementing a single year cap would negatively impact local government's ability to plan for long term service delivery and infrastructure. On 19 February 2014 the Victorian Auditor General reported to Parliament that 'Victorian Councils manage around \$73 billion of infrastructure assets. Council spending on renewing or replacing existing assets is not keeping pace with their rate of deterioration, resulting in cumulative renewal gaps that grow each year.' Long term financial challenges such as this will become extremely difficult to address if a rate capping framework provides for single year planning only.

Failure to recognise the impacts of proper asset management in any rates capping framework is likely to lead to reduced investment in asset maintenance and renewal leading to poorer asset outcomes for the community and potential liability exposure for Council.

Knox City Council has undertaken extensive and substantial strategic planning for asset management, and reducing the asset renewal gap. This planning has included significant community consultation and has led to the development of comprehensive asset renewal planning and funding models.

This reflects the duty of care Council owes to the community to effectively manage community assets, and is an appropriate risk and liability management approach to protect both the community from harm and from adverse financial impacts resulting from liability claims. The rates capping framework should take into account this careful planning and analysis and recognise the actual anticipated costs to maintain community assets and infrastructure, recognising that this planning has already included extensive community consultation. Further, there is potential for unintended consequences from an overly-rigid rates capping framework that could see Councils cutting services to communities in order to maintain appropriate levels of asset renewal funding.

It is not appropriate for a single level of rate cap to apply equally to all councils. 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 must 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 must be adequately addressed in any rate cap framework to avoid inequity and disadvantage.

The rate capping framework should also reflect the impact of cost shifting from other levels of government, and circumstances outside the control of Council (e.g. changed legislative obligations or superannuation call-ups). Such external influences that are beyond Council's control should not be subject to capping, or alternatively, should entitle Council to an automatic variation to cover such costs.

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 is not adequately recognised in the starting point against which any future cap will be applied.

The Base to Which the Cap Applies

Any rate cap framework should only apply to rates. Service charges and service rates including special rates and charges are generally set so that Council can recover the cost of that particular service delivery or project.

Service charges are often applied to those services that a rate payer chooses to take up as optional services such as a higher level of waste collection service compared to the base service. For example, Knox Council applies a service charge which covers the cost of an optional green waste service. This charge is set at a rate to recover the direct cost incurred by Council in providing the service. By its nature, residents are exercising choice in taking up this optional service, and therefore such charges should not be subject to rate capping.

It should also be noted that a number of Council's fees and charges are set by legislation, and many of these fees have failed to keep pace with the cost of delivering services. One such example is planning fees, which have not been increased for over six years. This shifts the cost of delivering Council's planning services from applicants to ratepayers, placing greater pressure on rates as a source of revenue. The revaluation of property every two years has the effect of redistributing the rate burden across households. Unlike state based property charges such as land tax, Council's rate (i.e. rate in the \$ CIV) varies annually, based on movement in property valuations. Rates are not a growth tax, unlike State land taxes. The result of this is that ratepayers whose property values have increased at a level greater than the average increase following a revaluation, experience a larger increase in their rate bill compared to other properties in the municipality. This often leads to a distorted and unsubstantiated view by those affected in this way that Council is not effectively controlling its costs. These factors and rate payer reactions are not expected to change under a rate capping regime.

The effect of supplementary valuations in any year should be excluded from any rate cap. Supplementary rates generally reflect development and therefore increased demand on service delivery and infrastructure requirements. Any valuation adjustments arising from supplementary valuations should form part of the valuation base for the following financial year and should be excluded from the calculation for rate capping purposes for that subsequent year.

The Variation Process

Any rate capping variation process should not create an unnecessary administrative burden on already financially constrained Councils. It should be noted that there has been a significant increase in compliance and reporting requirements on local government in recent years which has led to a growth in administrative overheads. Adding a complex and time consuming variation process would inevitably require the diversion of resources from other service delivery, or the addition of resources to meet compliance requirements.

The timing of any variation process must also work within Councils' budget and planning cycles, and not cause unnecessary delay on the finalisation of annual budgets and rate setting.

Any 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).

Clarity would also be required as to the extent of community engagement required post assessment by the ESC of any rate cap variation request. For example, if a Council requests a variation from the rate cap following community consultation on the draft Budget, and the request is denied by the ESC, will further community consultation be required on the modified Budget (to reflect the ESC's/Minister's denial prior to final adoption). If so, the additional round of community consultation will add significant time pressures to the Budget process. If not, the ESC/Minister will effectively be determining the Council's final Budget without due regard to community feedback on the adjusted Budget post ESC/Ministerial direction. This would appear to be at odds with the transparency objective being espoused as a rationale for the rate cap framework.

Community Engagement

Best practice in community engagement depends on both the community, and the subject matter. Local governments experience varying levels of community engagement which often depends on the level of interest in a particular matter.

The City of Knox has recently undertaken an extensive community consultation and engagement program in the development of its City Plan and Vision. In addition, Council actively engages with the community on an annual basis in the preparation of the Budget, Council Plan and Strategic Resource Plan.

Council also actively engages with various community groups and activities throughout the year. Council specifically engages with directly affected communities where service or infrastructure changes are proposed. As previously stated, Knox City Council has undertaken extensive and substantial strategic planning for asset management, and reducing the asset renewal gap. This planning has included significant community consultation and has led to the development of comprehensive asset renewal planning and funding models.

Provided that Council can demonstrate that it has undertaken active and responsive community engagement in its strategic resource planning, an additional, onerous consultation regime ought not be required beyond that already legislatively required in the preparation of Council's annual budget.

Incentives

Knox City Council already undertakes ongoing programs to improve efficiency and effectiveness in responding to community needs. The whole premise of rate capping appears to be based on a mistaken view that Councils are not already pursuing efficiency and effectiveness in service and infrastructure delivery. This misconception should be addressed in the development of any framework.

Knox Council is concerned about potential unintended consequences of a rate capping regime which constricts Council's ability to best 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 reconsider their ability to deliver un(or under) funded services on behalf of state and federal governments e.g. home and community care, school crossing supervision, immunisation, maternal and child health services and libraries.

Timing and Process

Council already extensively engages with its community through the development of Council's Vision and the City Plan, Council's Budget, Annual Plan and Strategic Resource Plan. Adding new consultation arrangements or requirements must be able to be met within existing budget and timeframe requirements to enable Council to effectively plan and deliver services each financial year, noting that the Local Government Act requires the Budget to be completed by 30 June each year.

Transitional arrangements

It is difficult for Council to comment on what transitional arrangements might assist a smooth transition to any rate capping regime without understanding what the quantum impact and consultation and timing impacts are expected to be. It is difficult for Councils to plan without some level of understanding of what the requirements will be.

Other Matters

Knox City Council believes that it is imperative that any rate capping framework be reviewed at least every second year. This will enable an ongoing program of review of the implications and consequences (intended and unintended) of any rate capping program. It is also important that the state government bears the costs of administering the ongoing framework that they have chosen to implement, and that any costs are not passed back to local government.

Council is of the view that local governments ought to be autonomous in making key local decisions including the setting of rates that are in the long-term interests of the community in accordance with the requirements of the Local Government Act 1989.

Knox City Council looks forward to receiving the ESC's draft report in July 2015, and to further contributing thereafter. We look forward to the ESC's consideration of our submission.