Essential Services Commission Victoria

A Blueprint for Change: Local Government Rates Capping & Variation Framework Review July 2015

Surf Coast Shire Council Submission 25 August 2015

Surf Coast Shire Council acknowledges the Victorian Government's commitment to implementing its rate capping policy. Council seeks to work constructively with the government and the Essential Services Commission (ESC) to establish a workable process and implementation approach that supports the current and future sustainability of Council and its communities.

This submission is complementary to Surf Coast Shire's original submission to the Essential Services Commission (ESC) Local Government – Rates Capping and Variation Framework Consultation Paper of May 2015.

Council believes the Draft Report is thorough and acknowledges the efforts of the ESC and its staff on this challenging issue. Council seeks to provide positive suggestions to assist the best possible implementation of this policy objective.

KEY ISSUES

1. Variation Request Premise

The premise of the proposed system is that councils will request variations to account for individual circumstances. This premise is invalid if councils are not willing or able to request variations, for example due to the cost of preparing requests, the timing of when requests are due, or sensitivity to being criticised for being above the cap.

Councils should be encouraged to request a variation if needed. This is best achieved by enhancing the connection to long term strategic and financial planning rather than an annual cycle.

Additionally, the term "rate cap" could be replaced with "reference rate", making it clearer that the cap is not an absolute and reducing the stigma of requesting a variation. If a long term plan indicates a rate level above the reference rate, a council would be encouraged to consider utilising the variation process if necessary.

Council also suggests that the ESC recommend that all efforts be made to avoid criticising councils that request a variation as being "unable to manage their affairs efficiently". This approach would be consistent with the Minister's emphasis on "making rates fairer" as opposed to a "rates cap".

2. Supplementary Rates – Annualisation

The treatment of supplementary rates is an essential element in the proposed framework, in particular for growth councils.

This importance has been recognised in the Draft Report and Council supports the proposed approach outlined, except for one vital consideration.

On page 8 of the Draft Report it states:

> *"At the end of each financial year, a council will adjust its valuation base and the base for its general rate revenue to include the actual supplementary valuation and supplementary rate revenue <u>received</u>."*

We underlined "received" as this is not the case. Councils actually make the adjustment on the basis of the <u>annualised</u> amount of the supplementary rate revenue received.

The importance of annualisation has been stressed by Surf Coast Council in its original submission, plus by many councils in their submissions. Council anticipates that ESC understands this issue however in preparing the Draft Plan the full detail was not included and this needs to be clarified to remove doubt.

It is useful to note that the supplementary rate received during the year is the pro-rata amount from the date it is raised through to 30 June. In the following year a full year's rates will be levied. This affirms that the annualised amount is the correct base from which to consider a cap.

The annualised amount can therefore be about double the amount received, assuming an even distribution of when supplementary rates are received throughout the year.

Failure to annualise supplementary rates when updating the rate base is calculated to reduce Council's rate revenue in the order of $70 million over 15 years, assuming Council's currently budgeted $500,000 per annum for supplementary rates received, indexed at 3%.

In line with a need for annualisation of supplementary rates, the supplementary rates figure to be monitored as listed in Table 2.4 on page 16 would need to be delineated to show both the received and annualised amount.

It is recognised that introducing an annualisation calculation adds some complexity, Council suggests however this is modest and warranted given the magnitude of this matter. Annualisation of supplementary rates is a critical requirement.

3. Supplementary Rates – Year in Which Received

An additional element regarding supplementary rates is their exclusion from the rate cap in the year in which they are received.

Council wishes to affirm its support for the approach outlined in the Draft Report, where it says on page 8:

"We are proposing that supplementary rates be excluded from the rate cap in the year they occur."

This is a correct and vital element of the rate capping proposal. Failure to exclude supplementary rates from the rate cap in this manner would have the same impact as failing to annualise supplementary rates when recalculating the rate base for the following year, approximately a further $70m in reduced rate revenue over 15 years.

4. Cost Index

Local government has made clear representation that it believes CPI is not reflective of the local government cost mix, however the Draft Report proposes CPI and WPI as the basis for the rate cap.

The Draft Report outlines on page 13:

> *"On the basis of the evidence before us, we consider that any such refinements to the rate cap should be limited to councils' main source of concern, namely, labour costs."*

Council supports the notion of using a wage index, however is not sure if the WPI is sufficiently relevant to local government. For example, if it is influenced by factors other than those being experienced by local government (for example if it relates to "all industries") then it may fail to support Council's reasonable costs.

Local government faces costs such as construction and road maintenance materials for which other indicators such as a Construction Index may be more appropriate. These factors are also addressed within the Local Government Cost Index as proposed by the MAV.

Council agrees that forward looking rather than historical indexes should be used and should be from an objective source. If adequate indexes are not currently produced then the Government could request these to be prepared.

5. Transitionary Period

It is thought likely that councils may not be willing or able to submit variation requests in the first two years. This is due to the compressed timeframe in the first year and the upcoming council election. A newly elected council may also need time to build understanding and develop plans sufficiently to be comfortable to request a variation as needed. This may result in variations being warranted but not achieved, resulting in longer term implications.

This risk could be addressed by allowing a 1% lift in the rate cap for the first two years. This would also allow a council to subsequently request a three year variation, which would align to the council's Strategic Resource Plan and the remainder of the council term. A 1% transition lift in the rate cap would encourage some gain whilst allowing the sector to progress in an orderly manner.

6. Asset Renewal

Local government has for decades been encouraged by the Commonwealth and Victorian Governments to improve asset management practices. Critically this includes providing evidence-based funding of asset renewal, with most councils participating in government sponsored whole-of-sector programs such as Step. Indeed as noted in the Draft Report, this issue has also been considered by the Auditor General; it may be useful to refer readers to the relevant report that can be found at the link:

http://www.audit.vic.gov.au/publications/20140219-Asset-Management/20140219-Asset-Management.pdf

Most councils face asset renewal funding gaps and importantly this is a problem in not only rural and regional councils, but also metropolitan. This gap is also thought to be an increasing issue, with a large portion of the asset base that is currently newer ageing over time.

Required funding cannot be provided to address this issue from business as usual operations, as indicated by using a CPI / WPI cap. The Draft Report proposes that additional asset renewal funding requirements can be achieved through a rate cap variation. Council believes this is not appropriate, with asset renewal being at risk of degrading in favour of new or upgrade proposals. This is the problem that councils have been encouraged to avoid by successive governments.

Council notes that the Draft Report somewhat considers this matter and proposes that only one cap be used. Council suggests that the Draft Report does not give adequate consideration of the importance of asset renewal and this needs to be revisited.

Rather than providing a specific cap to address asset renewal, an alternate proposal may be to provide a delineated stream with supportive templates for asset renewal proposals within the rate cap variation process. This would have many benefits, including allowing for sufficient profile of the need for asset renewal, the development of a standard and best practice approach for asset renewal, and an efficient assessment process of asset renewal variation requests by the ESC. Further, requests under an asset renewal stream could be required to be long term in nature to reflect the evidenced based nature of asset management.

7. Response to an Application for a Variation

Council concurs with the principle that the ESC should accept or reject an application for variation, rather than negotiate an outcome with councils.

This approach could however be complemented with a preliminary step that would assist councils in the preparation of their application and avoid wasted effort. Councils could prepare an overview of their proposed application and receive feedback prior to completing the full application. A recent parallel may be thought of in the Expression of Interest process undertaken by Regional Development Victoria, prior to the completion of a full grant application. The introduction of this step has been a marked improvement for councils.

MATTERS SUPPORTED

8. Inclusions / Exclusions from Rate Cap

Council agrees that the Municipal Charge should be included in the cap along with General Rates, as both are forms of rate revenue.

Council supports the exclusion of a range of items from the rate cap as outlined in the Draft Report, including:

- Service Rates and Charges
- Special Rates and Charges
- Revenue in Lieu of Rates
- Fire Services Levy
- Landfill Levy
- Supplementary rates in year they are received

It is however vital to note that annualised supplementary rates need to be included in the calculation to establish the rate base for the following year on which the rate cap is to apply.

9. Length of Variation Requests

Council believes the ability to seek variations for a period of up to four years is appropriate, particularly given the length of the Council Plan and a Council term. The longer term also is consistent with sound long term financial planning and strategic planning of community service delivery and infrastructure requirements.

Council also believes the transitional arrangement of the initial variation requests being for one year is appropriate.

10. Total Rate Revenue or Rate Revenue per Assessment

The Draft Report describes the different views as to whether the cap should be applied to total rate revenue or rate revenue per assessment.

Council has analysed the two approaches and believes them to have the same impact, so long as supplementary rates are excluded from the rate cap in the year in which they are received (as proposed in the Draft Report). It is likely the differing views across the sector arise from the concern as to the treatment of supplementary rates.

If the ESC is aware of a financial difference between the alternate models, it would be useful for this to be highlighted.

In addition to the exclusion of supplementary rates in the year they are received, it is vital that the supplementary rates are annualised as part of recalculating the rate base from which the rate cap would apply in the following year.

To assist the ESC, Council has prepared a Proposed Rate Cap Formula Presentation that it believes correctly addresses supplementary rates. This has been included as an Appendix at the end of this submission. Council recommends it would be useful for the ESC to review Box 2.2 on page 11 of the Draft Report in this light.

On this basis, Council supports either the total rate revenue or rate revenue per assessment approach.

OTHER MATTERS

11. Use of Debt

It is important that in response to rate revenue restrictions councils don't fall back on debt to fund operating deficits. While the Commonwealth or Victorian Governments may choose to do this for macro-economic factors, this is not the role of local government. Use of debt to fund operating deficits or indeed asset renewal is unsustainable.

The Draft Report gives potentially mixed messages on this matter, where says on page 19:

> *"councils should be required to justify fully any variation and they should not be permitted to circumvent the rate cap by unnecessarily increasing their borrowing"*

Whereas on Table 3.2 it says:

> *"Has the council considered spreading the funding needs over time by raising the additional expenditure through borrowings and/or by using existing financial assets; or through user charges, rather than general rates?"*

Council recommends increased emphasis on not using debt for operating deficits or asset renewal, plus clarification under what circumstances debt may be appropriate.

12. Table 2.4 Information

Council noted above the need to delineate supplementary rates into both the received amount and the annualised amount on Table 2.4.

Council also recommends there is further information necessary to affirm compliance with the rate cap. In particular, these relate to the funding and expenditure of capital works, including:

- Capital Works allocation: delineated into New/ Upgrade and Renewal expenditure
- Borrowings: delineated into purpose categories
- Reserves
- Depreciation

Over time councils have struggled with the importance of ensuring an operating surplus inclusive of depreciation. While depreciation is not an absolute measure of renewal requirement and arguments exist as to why it overstates or understates the funding need, it is nevertheless a broad indicator that is referenced within the Auditor General Sustainability indicators.

Council also recommends the ESC needs to be able to delineate one-off grants, rather than mixing these with "Grants – All Sources". To not do this clouds the true requirement for rates and fees to fund Council operations and projects.

13. Single Cap Across Victoria

Council's original submission did not support a single cap across Victoria due to different circumstances facing each council. Council does however note the ESC's goal to achieve simplicity through a single cap, with differences addressed through rate cap variations. This approach will only work if councils are willing and able to submit variation requests, and that the process adequately acknowledges these characteristics.

Surf Council Shire has a number of characteristics that mean the introduction of rate capping with a single cap will likely cause difficulties, in particular:

- High reliance on rate revenue: currently 70% of total revenue, the highest in Council's peer group of councils
- Limited additional income opportunities: a separate agency (GORRC) has responsibility for areas that may offer traditional "other" income sources, such as parking or caravan parks
- High growth: although this can be better supported with appropriate treatment of supplementary rates
- Large tourism spikes: population quadruples on the Surf Coast at holiday seasons

14. Proposed Annual Timelines

The Draft Report proposes a timeline by which a council is notified of a variation decision by the ESC in May 2016. This does not provide adequate time for councils to complete the budget process and needs to be brought forward to March. Council does not support moving the budget adoption date.

Potentially this timeline is intended only for 2016/17, however the ongoing timeline envisaged is not clear. Council suggests there is no need for applications for multi-year variations to be addressed within a particular annual cycle, rather the workload for both councils and the ESC could be spread to other non-peak times.

15. Efficiency Factor

Council does not support the introduction of a mandatory efficiency factor in local government. It should be noted that in effect the factor is cumulative in nature as it applies each year, which compounds the impact. Council does however strongly support the pursuit of efficiency gains and utilising these gains for the benefit of the community.

Rate capping as proposed will have the effect of removing council discretionary expenditure unless via approved rate cap variations. This will have significant implications for the democratic nature of Councillors seeking to be responsive to often shorter lead time and relatively smaller proposals from constituents.

In this way, local government is different to other sectors regulated by the ESC and the Victorian Public Service that are currently subject to an efficiency factor.

Council already has a Business Improvement program underway with a target set for efficiencies, and utilises these gains to support community initiatives. Removing this flexibility and in effect mandating that such efficiency gains are reduced from rates revenue, removes this important ability for Council.

Councils receive feedback based on perceptions that local constituents are not being fairly treated with budgetary allocations. This problem can be assisted by smaller discretionary allocations that are responsive to genuine constituent feedback. Introducing a mandated efficiency factor will reduce funds that provide this important flexibility and will likely exacerbate this issue.

16. Rebalancing Constraints

Council believes that setting limits on the extent of movement in an individual rate notice is not required. Variation in response to a revaluation is part of the rating system and any cap would simply see the adjustment distributed across all other ratepayers. This would seem inconsistent with the requirement for equity in the rating system given the adjustment would have arisen from a change in valuation of the impacted property.

17. Service Fees and Charges

Council is concerned with the inference of potential further review and regulation of council service charges.

Surf Coast Shire receives a disproportionately high amount of its revenue from rates, in the order of 70%. Given the nature of rates this has historically provided financial stability, however Council will need to further its efforts to increase revenue from service fees and charges.

The level of a number of service fees are currently mandated by the Victorian Government, for example in statutory planning. This is noted in the Draft Report on page 45. It is generally acknowledged (including now by Government) that the level of permitted fee increases has been too low and has fallen well behind the cost of providing these services. This has been an ongoing campaign by the MAV and the sector is now hopeful the issue is being addressed.

Council is concerned that if this experience is replicated across other fee categories through excessively tight regulation, it would restrict Council's ability to shift to a more balance non-rate revenue position and over time degrade Council's financial position.

Alternatively, it would be positive if a framework could be established that assisted Council move to improved cost recovery of services. Council notes the related commentary in Section 6.4 on page 44. To assist in this regard, we highlight for ESC's reference the Auditor General report on this topic from 2009/10, available at the following link:

http://www.audit.vic.gov.au/publications/2009-10/LG-Fees-and-Charges-full-report.pdf

18. Framework Timeframe

Council would like to acknowledge the efforts of the ESC to bring forward the determination of the rate cap outcome by one month to assist councils in preparing the 2016/17 budget. This is valuable and appreciated, although as noted earlier the timeframes for approving variations in May 2016 is too late for budget preparation.

19. Administrative Costs

The Draft Report outlines a number of options for recovery of ESC's costs however does not make recommendations. Council affirms its position that the Victorian Government should fund the operation of this proposed system.

20. Fire Services Levy Increases

It is of note that the Government has announced substantial ongoing Fire Services Levy increases, during a time when rate capping is being introduced. This seems inconsistent, particularly given the confusion experienced by ratepayers regarding the delineation of the Fire Services Levy as it is received on the one bill.

APPENDIX: PROPOSED RATE CAP FORMULA PRESENTATION

Proposed Rate Cap Formula Presentation

Calculating Base

Number of Rateable Properties (Base Year)	=	Budgeted number of rateable properties (excluding any new rateable properties assumed for supplementary rates)	+	Number of rateable properties arising from supplementary rates received during year
Rates paid by average Ratepayer (Base Year)	=	Budgeted total rate revenue raised (excluding any allowance for supplementary rates)	+	Annualised supplementary rates received during year
		Number of Rateable Properties (Base year) (divisor)		

Applying Rate Cap

Rates Paid by Average Ratepayer (Rate Cap Year)	=	Rates Paid by Average Ratepayer (Base Year)	x	(1 + Rate Cap%)
Budgeted Total Rate Revenue (Rate Cap Year) (excluding any allowance for supplementary rates in the Rate Cap Year)	=	Rates paid by averagae Ratepayer (Rate Cap Year)	x	Number of rateable properties (Base Year)