



WELLINGTON
SHIRE COUNCIL
The Heart of Gippsland

28 August 2015

Local Government Rates Capping and Variation Framework Review
Essential Services Commission
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ESSENTIAL SERVICES COMMISSION 2015, A BLUEPRINT FOR CHANGE, LOCAL GOVERNMENT RATES CAPPING AND VARIATION FRAMEWORK REVIEW — DRAFT REPORT VOLUME I, JULY 2015

Thank you for the opportunity to provide comment on the Essential Services Commission (ESC) Draft Report Volume I, July 2015.

The Wellington Shire Council (WSC) have referred to the subject report and also the original "Terms of Reference" and on that basis, we have provided comment on the recommendations contained in the subject paper.

THE CAP

Draft Recommendation 1

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

WSC has concerns with the introduction of a Blanket Rate Cap for 3 reasons:

1. A Blanket Rate Cap does not recognise the relative 'starting point' for each Council based on an assessment of financial sustainability and efficiency indicators and the substantial differences between Metropolitan and Regional Councils, for example:
 - *Ease of raising additional revenue* – some Councils have a greater ability than others to raise revenue from sources other than rates, which means the starting base for all Councils is not equal and does not exemplify efficiency, as a Metropolitan Council can easily raise parking fees to cover the majority of expenditure requirements.
 - *Infrastructure maintenance and costs* – unlike Metropolitan Councils, many Regional Councils have significant costs relating to infrastructure maintenance and renewal and they have relatively few revenue sources available to them to meet constantly increasing expectations from their communities. Infrastructure maintenance and renewal requirements for Regional Councils are especially challenging, given factors such as an extensive network of roads, bridges, drainage, walking/cycling paths, sports grounds, pavilions, children's playgrounds etc. that must be managed.



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- *Geographical challenges* - many Regional Councils face challenges resulting from its geography, a history of regular natural disaster events and also the need to provide appropriate infrastructure and services for a number of townships that experience significant population increases during holiday periods.
 - *Disparate communities* - Regional Councils also have many disparate communities and in many cases delivery of services must be duplicated across these communities. This in itself creates challenges when dealing with community expectations regarding both the level and nature of services provided. Regional Councils are also mindful of the need to service the whole municipality regardless of the spread of population and this challenge will become even greater within the confines of rate capping.
 - *Superannuation Shortfalls* - Since 1998 Victorian Local Government have paid approximately \$1.162b into defined benefit superannuation scheme call ups. The structure of the Local Government fund is such that it has to be kept fully funded for future liabilities at all times. This is a financial challenge which for Metropolitan Councils can be easily met given the greater number of rate payers within one district.
2. ESC contends that the application of a Differential Rate Cap across Metropolitan and Regional Councils would be too arduous to administer and would involve a "large degree of judgement".
- Yet the ESC then goes on to recommend the introduction of a Variation Request Process to provide a more "efficient, transparent and participative mechanism to deal with individual council's circumstances". A high level summary of what appears to be onerous guidelines for a Variation application are also provided, which would ultimately require the ESC make a "judgement" on whether a Variation Request should be approved – the ESC's logic as to why they have chosen one process over the other is unclear.
3. WSC is also concerned that the introduction of a Blanket Rate Cap could produce longer term unintended consequences, for example:
- *Increased Borrowings* – Councils that find it difficult to achieve financial sustainability and for political reasons do not want to submit a variation, may instead increase borrowings to fund projects, community services or resource requirements. If not managed properly, especially in a climate of rising interest rates, borrowings could increase substantially which would then see Councils make a Variation Request in order to reduce debt.
 - *Shift to short term Contract Staff* – The motivation for Regional Councils to reduce labour costs could see a shift to a greater reliance on contract / temporary staff. Regional Councils already find it challenging to attract experienced staff for key roles and a revolving door of temporary staff may directly impact on skill retention, compliance and governance requirements. This may also impact on employment opportunities in Regional towns.

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.**

Should a Rate Cap be introduced, WSC agrees that it should apply only to general rates and municipal charge (for those Councils that still have a municipal charge).

It also remains something of a sore point that any Council levy collected on behalf of the state government, is not subject to the same efficiency requirements as the state government sees fit to impose on Councils for their rates.

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 a 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.

In the detail for this recommendation the ESC details that the base indicator in each year is determined by a recalculation of total revenue divided by the number of assessments in each consecutive year compared with the previous year. This is neither rates per assessment, or rates paid on the average valued property.

ESC's wording is confusing as it indicates that "rates per assessment" are the same as "rates paid on the average valuation" however, rates per assessment are gross rates revenue divided by the number of assessments and this does not reflect rates paid on the average valuation.

Rates per assessment reflects rates across the board which arise from the mixing of residential, commercial, industrial, farm and vacant land valuations, their numbers, rate effort and liability for municipal charges – it is therefore highly artificial.

It is arguable therefore that there are few ratepayers, if anybody, paying the "average rate" and that the use of rates per assessment is likely to be more controversial with ratepayers trying to relate things to their own rate bills. The impact of revaluations and the incidence of rates (determined by rating strategies) are also important factors muddying the waters.

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 each year from 2017-18. The Commission will undertake a detailed productivity analysis of the sector to assess the appropriate long-term rate for the efficiency factor.

In previous submissions it has been strenuously argued that the CPI reflects movement in prices paid by household consumers for a weighted basket of goods and services and therefore is not an accurate indicator of production costs that are relevant to Councils. The use of the CPI represents a bias in favour of perceived community expectations about prices rather than the true cost of inputs and it is evident that the ESC has not adequately considered this base factor. Rural and regional councils in particular spend a significant amount of their fixed and variable expenditure on raw materials for road making, which includes oil, bitumen, gravel and cement, hardly items reflected in a consumer price index.

Also the utilisation of WPI only considers "pure" price changes in labour costs and does not consider changes in the age, grade or level of qualifications of the employee and relevant pay. The local government sector is characterised by salary progression via levels within bands. The costs of annual progression for a large number of employees will therefore not be accounted for in the cap which alone may add more than 1% to wage payments especially in councils with low staff turnover.

An Efficiency Factor is also recommended by the ESC to further discount WPI and CPI in order to "address the cost of living pressures faced by ratepayers". It does not however attempt to include any allowance for salary progression and structural changes in labour requirements. Materials and contracts, by far the bulk of *other costs*, are sourced from the wider market and have already been subjected to market forces. It also does not take into account the Regional differences where they have to compete in labour markets where demand is strong in disciplines like planning and environmental health and may need to provide higher rates in order to attract staff to specific locations.

Furthermore, the rate cap is in itself the efficiency measure, to add a further efficiency factor is not based on any evidence, data, or logic and by the ESC Commissioner's own vague comments at a recent MAV presentation on 13 August 2015, where it was stated that the efficiency factor seeks to 'redress the balance of the rates burden back towards the ratepayer.' It was also suggested that most councils adopt an efficiency factor anyway, so this was a more consistent approach across the sector. This view is simply not accurate. Like most Councils, WSC assesses its individual services based on best practice service measurement guidelines issued by the Australian Centre of Excellence in Local Government. WSC have made significant expenditure reductions in services (i.e. crèche operations) while for other services, expenditure has increased (i.e. emergency response and management). The point is, Councils are now far more sophisticated in measuring individual service areas and applying appropriate efficiency savings when they are appropriate.

To suggest a further blanket percentage needs to be applied after many councils have continued to drive the efficient use of rates and resources, is a regressive and unnecessary policy that is not underpinned by any logic, data or evidence. WSC firmly opposes the efficiency factor as it is based on an outdated philosophy of 'driving efficiency' and it fails to recognise far more recent and forensic practices adopted by Councils in service delivery efficiency.

Finally, the ESC's response at the MAV presentation was along the lines of "the efficiency factor is not really that high, so don't be too concerned" then our obvious question is "so why have it at all?"

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.

The ESC's base indicator calculation for each year is determined by a recalculation of total revenue divided by the number of assessments in each consecutive year compared with the previous year. It is neither rates per assessment, or rates paid on the average valued property, successively indexed each year from the base year.

Refer to our comments under "Draft recommendation 3".

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.

The introduction of a Blanket Rate Cap will translate into a large number of councils seeking variations in order to maintain service levels, while dealing with infrastructure renewal and not allowing assets to degrade over time, as has been evident in some NSW jurisdictions.

Despite noting the different capabilities of councils, the ESC maintains that the specific variation material submitted is up to councils to determine. The extensive requirements in arguing the case for a variation are considered likely to dissuade smaller, less-resourced councils, from seeking a variation. A successful request for a variation will be determined entirely by the ESC but despite all the narrative, it is unknown at this stage of the level and depth of the case required to be demonstrated by councils.

The Variation framework appears to be strong on the need for community consultation and involvement however councils are generally on a "hiding to nothing" when this relates to rates. Experience shows that with rating strategies, vocal minorities often attempt to hijack the process and State assessments of whether consultation processes are adequate are often seen through the prism of these minorities rather than the community as a whole. State government is generally never prescriptive in this area which leaves it plenty of room to be critical about consultation. The ESC states that "following on from discussions with councils" that it is "confident that councils with well-established processes for strategic planning and community

consultation will not find these requirements unduly onerous". Community consultation requirements are likely to be influenced heavily by the complexity of business cases, cost-benefit analyses and various options involved in a variation.

Likewise, what constitutes good 'community consultation' varies significantly from larger metro councils where social media and surveys might be appropriate evidence, to small rural councils where 9 councillors living in small towns may have their finger on the pulse of community sentiment a little easier, simply given weight of numbers. How will the ESC assess the appropriateness of consultation in each case?

A consideration of councils using other revenue sources to avoid rate increases as proposed by the ESC is good in theory but many of the councils worst-placed with respect to renewal gap are heavily dependent on government grants with little potential for increasing other own-source revenues. The use of debt to spread costs and hence reduce more immediate rating impacts was also raised by the ESC however for some, would only have the effect of pushing yet higher required rate increases into the future.

Draft Recommendation 7

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

- **The reason 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 funding options have been considered**
- **The proposal is integrated into the council's long-term strategy.**

ESC have only provided a high level overview of what appear to be onerous guidelines for a Variation application, on which they would have to "review and make a judgement" on whether to approve a variation request.

On any objective reading of the document, the requirements being suggested for success point to a huge task and include councils:

- taking account of ratepayers views including the presentation of other realistic options;
- proving that the variation will provide good value for money, including business cases and cost benefit analyses;
- showing service priorities and funding options have been considered including possible reprioritisation of expenditures and financing options;
- considering all other revenue-raising opportunities; and
- demonstrating consistency with councils' long term financial strategies.

It is easy for the ESC to suggest the development of business cases and cost-benefit analyses (incorporating various re-prioritisation and financing options) without fully appreciating the expertise, time and resources required to do this work.

WSC is concerned about:

- the extra resources and cost that would be required by many councils to complete a variation request and
- the ESC resources required to administer the Rate Capping Framework, review the Variation Submissions and maintain the Know your Council Website. This is a State Government initiative that provides no additional benefits to councils but adds a further burden to Councils and the Taxpayer.

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.

- **2016-17 One year (i.e. 2016-17 only)**
- **2017-18 Up to two years (i.e. 2017-18 only 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)**

Should a Rate Cap and Variation process be introduced, WSC agrees with this premise.

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 to vary) an application for variation.

The ESC is experienced at reviewing industries that are providers of few products and WSC is concerned as to whether the ESC has the resources and/or expertise to implement and administer the Framework. Councils are far more complicated in what they deliver and in measuring (impacts on) service delivery. In addition to establishing the cap the ESC has responsibility for considering variations, monitoring associated outcomes and benchmarking council performance and efficiency in order to inform the first two. The ESC has indicated it does not expect large numbers of requests for variations but this seems unlikely, unless councils are discouraged by the task involved.

The ESC also foresees the possibility of extension of its role into garbage charges and statutorily imposed fees. There appears no rationale for the ESC to extend its brief unless it also includes State output purchases from, and specific purpose funding to, the sector.

Some aspects of the Framework and narrative indicate issues concerning impartiality. The ESC reserves a right to unfavourably review requests for variation where it deems uncontrollable budget blow-outs have occurred and there is no avenue for appeal if a council's request for variation is rejected. The question of objectivity is also raised with the ESC stating that it "does not want to err heavily in favour or against councils seeking a variation".

The role of the ESC should be no more than to monitor whether councils have complied with the rate cap variation. There is something inherently wrong with the ESC reviewing the impacts of rate capping decisions and, in particular, reviewing adverse outcomes for councils that have arisen from decisions that it may have made in declining a variation. This broader monitoring should be done by an agency other than the ESC.

Annual information required from councils that do not intend pursuing a variation appear very limited and can largely be satisfied from existing sources. It is unlikely that a request for variation to the cap could be undertaken without councils committing significant resources.

MONITORING

Draft Recommendation 10

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

A high level Rates Comparison report may signal incorrect parallels between Councils and the ESC needs to be able to identify these differences so as not to unduly promote one Council against another.

ESC will require additional resources to undertake this task and also input from Councils to review the report and provide comment regarding differences. This provides yet another level of cost and time for Councils and the ESC. WSC reiterates that this is a State initiative that provides no additional benefits to Council but adds a further burden to the Taxpayer and that the costs for the ESC to administer this process should not be recovered from local Councils.

Draft Recommendation 11

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

ESC will require additional resources to undertake this task and also input from Councils to review the report and provide comment regarding differences. This provides another level of cost and time for Councils and the ESC. WSC reiterates that this is a State initiative that provides no additional benefits to Council but adds a further burden to the Taxpayer and that the costs for the ESC to administer this process should not be recovered from local Councils.

Yours sincerely



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