ruralcouncilsvictoria

Dr Ron Ben-David
Chairperson
Essential Services Commission
Level 37 / 2 Lonsdale Street
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Dear Dr Ben-David

RESPONSE TO THE DRAFT *BLUEPRINT FOR CHANGE, LOCAL GOVERNMENT RATES CAPPING AND VARIATION FRAMEWORK REVIEW*

Thank you for the opportunity to make a submission on the *draft Blueprint for Change, Local Government Rates Capping and Variation Framework Review*.

Rural Councils Victoria (RCV) is the alliance of Victoria's 38 rural councils. It supports and promotes sustainable, liveable and prosperous rural communities, including a program of activities and advocacy focussed on issues shared by the State's rural councils and communities.

The priorty concerns of rural councils in relation to the proposals set out in the draft *Blueprint* are summarised below.

'One size fits all' approach disadvantages rural communities

Regional cities and metropolitan councils are better placed to respond to constraints on rate revenue by utilising other own source revenue streams including user charges, parking fees and fines. There is very little scope for this in rural areas where there is a significant reliance on financial assistance and other grant revenues.

The ESC's recommendation that there should be one rate cap that applies equally to all councils in Victoria fails to recognise the financial sustainability challenges facing rural councils and their limited capacity to raise revenue from sources other than rates. The fact that rural communities and smaller councils have relatively high levels of asset management responsibilities is not recognised in the ESC draft report.

The attached table contrasts rural councils with metro and all councils showing:

- rates accounting from 17% and averaging of 45% of recurrent revenues in rural councils compared with 54% for metro councils and 51% for all councils;
- rates on average equal to 3.5 times FAGs in rural councils, but 24 times in metro councils and 10 times for all councils;
- rates representing on average 6.6% of the value of buildings and infrastructure in rural councils with respective figures of 14.2% and 9.3% for metro and all councils;depreciation

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expense accounting on average for 45% of rates in rural councils compared with 19% in metro councils and 34% for all councils;

- five year average annual growth to 2013-14 in capital outlays on non-building construction of 10% in rural councils, 3.8% in metro councils and 7.3% in all councils;
- across affected councils – a five year average annual renewal gap at end of 2011-12 accounting for an average of 13% of rates in rural councils, 7% in metro councils and 9.6% in all councils; and
- across affected councils - net debt, inclusive of renewal gap, at end of 2011-12 representing on average 44% of rates in rural councils compared with 23% for metro councils and 35% overall.

These data provide evidence in support of the more complex financial position seen in rural councils through the combined effect of greater reliance on grants (over which we have no or little control), high levels of capital expenditure and renewal gaps.

Analysis has also suggests that rural councils have particular sensitivities to financial distress – smaller financial shocks can have a substantial effect on small rural shires and their capacity to 'rebalance' the organisation and stabilise its financial position. This increases the probability that a rate cap that is not attuned to the needs of rural councils will have a long-term and catastrophic effect on these councils and their communities.

RCV therefore recommends that ESC looks at the position of 'at risk' Councils right now to determine that they will need to have increases above the cap. This would alleviate the pressure on these councils in seeking a variation.

Underpinning cost indexation is flawed

RCV supports a cap that takes into account both supply side cost pressures and ability to pay.

The proposed cost indices used in the formula are not appropriate. A significant proportion of rural council costs relate to construction, asset maintenance and waste management , and RCV is concerned that any index is reflective of this. The level of discretion with respect to many costs incurred by rural councils is limited given that rural ratepayers should be entitled to expect minimum levels of service provision in the face of scale diseconomies and other cost disadvantages.

As can be seen in the data appended to this submission, there are considerable systemic differnences between councils and council cohorts, which undermines the application of a standard cost index based solely on prices and broader consumer prices. The absence of capital expenses from the index is particularly problematic and will present an ongoing and persistent requirement for variations above the proposed cap.

Responsible use of available funds

In Section 6.3 the *Blueprint* infers that councils should use debt to offset the impact of rate capping and before applying for a variation. This would effectively shift the cost burden to future generations and could possibly result in Councils raising and using debt to provide services or projects. Borrowing is part of prudential economic management but only considered appropriate to fund the acquisition, expansion, upgrade, or renewal of major capital assets or upgrade the technology of obsolete physical assets. Rural councils may also have more limited capacity to repay borrowings or to generate revenues from infrastructure funded from borrowings.

Proposed implementation timeline is unworkable and will create confusion

The proposed timelines, including assessment of council variation requests to ESC from March to May, will require councils to place their draft budget on public exhibition and approve the budget within 4 to 8 weeks. The model proposed by the ESC would therefore undermine the trust between councils and their local communities by compromising the consultation process and timing , necessitating that the consultation is in effect cursory and token.

In year one, RCV suggests it would be more cost effective if the variation process allowed for a two year variation. Some rural Councils have very mature, robust long term financial plans and a very clear understanding of what the rate increase needs to be.

Community engagement

The timeline proposed by the ESC would prevent councils from meeting the legislated requirements in relation to budget preparation and adoption.

The ESC will also need to be very clear about what additional engagement processes and evidence base will satisfy their requirements for variation applications.

'Best value' is the role of local government

A number of mechanisms already exist that impose discipline upon councils in achieveing efficient outcomes for ratepayers. It is the role of councils to define, measure, consult and report on the assessment of value for money in service delivery as defined by the best value principles in the *Local Government Act* (1989 s.208B/208C). The ESC proposal also flags additional performance reporting outside of existing requirements, on top of new measures such as the LGPRF which already imposes a significant administrative and cost burden on small rural councils.The Blueprint also adds a reporting burden starting in January 2016, when all councils must provide baseline data. There has been incremental growth in the reporting burden on councils, accelerating over recent years and it is hard to argue that this has not been at the expense of efficiency. The rather involved requirements foreshadowed with respect to the variation process proposed in the Blueprint will not be without considerable cost. Applying for a variation will be a costly exercise in the context of the small budgets of rural councils and self -funded applications will be difficult to justify for small rate base councils.

For example, for a small North Eastern council, a one percent increase of rates brings in approx $50,000. If Council has to carry the cost of preparing a request for variation, it may choose not to proceed. The outcome would be a reduction of services or infrastructure maintenance or alternatively a bigger underlying deficit.

It is therefore expected that Rural Councils will require assistance to prepare exemption applications.

Funding the new model

The State Government should fund the operations of the Essential Services Commission.

State wide Rates Equity

The current difference in rate levels across the State means that the base to which the rates cap is applied will provide for substantial variations between councils in the dollar amounts of rate increases allowable under the cap.

Public messaging

RCV asks ESC to recommend to the State that it is careful with its messaging. There are many small, lean and efficient Councils who struggle because of external factors out of their control (see *Financial Sustainability Overview*, M. & R. Whelan, May 2015). Telling our communities that councils are wasteful is not helpful, particularly when we need to seek a rate increase above the cap.

Rural councils have been assured many times that the implementation of a rate capping and variation framework is not about rectifying the actions of small rural councils, but those of large urban councils. We therefore wish to draw to your attention the fact that all aspects of the proposed framework will impact rural councils most.

Acknowledging the concerns summarised in this submission, it is RCV's firm view that the 38 rural councils comprise a 'natural' grouping for which a strong case for differentiation can be made. We therefore propose it would be fair and reasonable for ESC to recommend two classifications within the rate capping and variation framework – one for rural councils and one for urban councils (including metropolitan and regional city councils) – each category having its own rate capping methodology and variation process.

Thank you again for the opportunity to make this submission. For further information or to discuss this matter further, please dont hesitate to contact me on 0427600122 or e-mail me at RCVCHAIR@mav.asn.au.

Yours sincerely

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	Depreciation Expense on Buildings & Infrastructure as % Rates 2013-14				
	Average	**Median**	**Stdev**	**Low**	**High**
Metro	19.3%	19.1%	4.2%	12.3%	27.9%
RCV	45.0%	40.6%	21.4%	13.3%	104.7%
All	33.6%	27.9%	18.7%	12.3%	104.7%

	Five Year Average Annual Renewal Gap at End 2011-12 as % Rates Revenue 2011-12				
	Average	**Median**	**Stdev**	**Low**	**High**
Metro	6.9%	6.5%	6.0%	0.3%	21.0%
RCV	12.8%	8.5%	12.4%	0.1%	44.9%
All	9.6%	7.7%	10.0%	0.1%	44.9%

	Rates as % Value of Buildings & Infrastructure 2013-14				
	Average	**Median**	**Stdev**	**Low**	**High**
Metro	14.2%	14.1%	3.6%	8.9%	21.8%
RCV	6.6%	6.2%	3.0%	2.4%	18.6%
All	9.3%	7.8%	4.5%	2.4%	21.8%

	Rates as % Underlying Operating Revenues 2013-14				
	Average	**Median**	**Stdev**	**Low**	**High**
Metro	57.3%	58.3%	7.9%	36.1%	68.3%
RCV	44.1%	45.0%	8.7%	16.8%	58.1%
All	49.2%	49.3%	10.0%	16.8%	68.3%

	Net Debt as % Rates 2011-12				
	Average	**Median**	**Stdev**	**Low**	**High**
Metro	22.6%	17.7%	16.2%	7.1%	60.7%
RCV	44.2%	31.0%	38.4%	2.7%	169.0%
All	35.2%	27.8%	28.6%	2.7%	169.0%

	Ratio of Rates to FAGs 2013-14				
	Average	**Median**	**Stdev**	**Low**	**High**
Metro	23.9	21.6	14.5	7.5	74.4
RCV	3.5	2.7	3.7	1.0	23.0
All	10.1	4.8	12.0	1.0	74.4

	5 Year Average Annual Growth in Capital Outlay on Non-Building Construction				
	Average	**Median**	**Stdev**	**Low**	**High**
Metro	3.8%	3.6%	6.7%	-6.1%	18.9%
RCV	10.0%	7.0%	14.1%	-9.2%	61.8%
All	7.3%	5.3%	11.4%	-13.4%	61.8%

Notes:

Metro excludes interface

Rates are municipal charge and general rates

Renewal Gap Based on STEP data

Renewal Gap and Net Debt tables only include affected councils

Infrastructure figures include land improvements

Net Debt includes Renewal Gap