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CITY OF WODONGA VIC

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Enquiries: Trevor Ierino
Reference:R20.0034

Dr Ron Ben-David
Local Government Rates Capping and Variation Framework Review
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne VIC 3000

Dear Mr Ben-David

Re: Rate Capping - Submission on Essential Services Commission draft report – Wodonga City Council

I write in response to the recently issued Essential Services Commission (ESC) report, "*A Blueprint for Change, Local Government Rates Capping & Variation Framework Review – Draft Report Volume 1, July*".

While Wodonga did not make a separate submission as part of the input process to this report, it supported the Municipal Association Victoria's submission, with a Wodonga Council officer being a member of its task force set up for such purpose.

It is disappointing to observe that many of the observations made in that submission appear not to have had influence with the ESC in the development of the draft report.

The framework needs to take account of long term structural adjustments, not just annual explanations for above CPI rate variations.

Council understands and notes the preference of the communities in general for rate increases at or below CPI. The difficulty faced by many councils, however, is the need for structural change and reform to address a backlog of underspending on key infrastructure, and to strengthen their balance sheets to put them on a more sustainable footing.

Dealing with aging infrastructure and a growing infrastructure needs gap is an issue for all councils as confirmed by the recent Auditor General's report *Asset Management and Maintenance by Councils – February 2014*;

Such reform can take place as a "big bang" approach, or introduced slowly over time.

Wodonga has taken a long term approach to financial sustainability. It has a clearly defined long term vision, developed through a long and extensive community consultation process. It has a plan to ensure all its infrastructure assets are renewed as and when required, it is strengthening its balance sheet, as recommended by the Auditor General to make provision for possible future superannuation shortfall call-ups, and continually reviews its services to ensure they are meeting the wants and needs of the community.

Wodonga is also in a period of rapid growth, being Victoria's fastest growing regional city. This situation can be compared to that experienced by peri-urban councils on the fringe of the Melbourne metropolitan areas. This can't be supported without significant upfront investment.

The Australian Local Government Association's (ALGA's) definition of financial sustainability is worth noting:

"A council's long-term financial performance and position is sustainable where planned long-term service and infrastructure levels and standards are met without unplanned increases in rates or disruptive cuts to services."

It is against this definition that Wodonga develops its long term financial planning.

Wodonga has a prudent financial plan to address the challenges above and ensure it remains financially sustainable.

In addition to this, a range of issues confront councils, often on a yearly basis, that are both outside the scope of a CPI, and beyond the control of councils. These include but are not limited to the following:

1. Ongoing cost shifting from both federal and state government to councils;

2. Increased compliance and enforcement obligations placed on councils by new or amended legislation (rate capping will further increase these requirements);

3. Inadequate indexation of ongoing federal and state government funded programs (the recent three year freezing of the Financial Assistance Grants to councils in the federal budget is an example);

4. Defined Benefit Superannuation scheme call ups (some $4m recently in Wodonga's case and around $0.6 billion across all councils in Victoria);

5. Inadequate, or nil over many years of indexing of State Government controlled fees for services provided by councils. An example of this being Land Information Certificates ($20) which has remained unchanged since 1992! Statutory planning fees (set by the State) have also remained unchanged for many years. Presently Wodonga ratepayers cross subsidise developers to the tune of $0.4 million annually as a result.

6. Funding for programs discontinued by federal and state governments, but not before communities have come to expect their ongoing service provision by councils;

7. Federal and state government funded projects having funding pulled at short notice or prior to their expected completion dates, results in councils having to redeploy (inefficiently) or cover redundancy costs;

8. The obligation to enforce State law which at times can be less that satisfactorily drafted. For example restricted dog laws have cost some councils up to $0.2 million in legal costs for a single dog case, only to lose due to difficulty complying and enforcing the letter of the law. Wodonga has also had its difficulties in this regard.

Such goals, issues and challenges cannot be achieved or addressed without a modest increase over and above CPI, unless services levels are adversely impacted. Council has tested this plan through its budget consultation process, with very few adverse objections received by comparison with its ratepayer base.

What is the cumulative impact on Wodonga's forward budgets?

Under a CPI (or equivalent) limited rate increase council's forecast revenue will be well below that forecast in the 2015-2016 Budget. The following table provides an indication of the impact of this.

The table assumes no other changes are made to operating and capital expenditure.

$ mils	16/17	17/18	18/19	19/20	20/21	21/22	22/23	23/24
Rate increase proposed per 2014/15 Budget	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%
Rate increase under rate capping (est.)	3.05%	2.85%`	2.80%	2.75%	2.70%	2.65%`	2.60%	2.55%
Revenue Shortfall – per year	$(0.5)	$(1.1)	$(1.7)	$(2.4)	$(3.2)	$(4.1)	$(5.0)	$(6.0)
Revenue Shortfall - cumulative	$(0.5)	$(1.5)	$(3.2)	$(5.7)	$(8.9)	$(12.9)	$(17.9)	(23.9)
Possible job losses*	8	18	28	40	53	68	83	100

**Assuming shortfall made up of reduced services @ $60k annual salary. Note, does not take account of redundancy payments.*

The above analysis indicates, all else being equal, the revenue reduction under rate capping amounts to some $8.9 million over the next five years, and up to $23.9 million by the year 2023-2024.

Depending on how such reduction is covered these figures would mean a reduction of the capital program of up to $8.9 million over the next five years; or a reduction in services up to the value of $3.2 million per year along with the associated job losses of up to 53 staff by 2020-2021, or some combination of both measures.

Councils should not have to bear the cost of a rates variation submission

The very introduction of rate capping itself is an example of costs shifting or added cost burdens placed on councils by the decisions of state and federal governments, and beyond the control of councils.

Costs include developing a submission, the ESC's costs in reviewing the submission and making its decision, and further ongoing council reporting requirements. This question is particularly important if the ESC determines the request for a variation was justified.

It is unlikely that a request for variation to the cap could be undertaken without councils' committing significant resources.

In addition the draft report implies an ongoing administrative burden created by the possible need for repeated requests for variations within the next few years due to the proposed transition time frames. The report proposes a 1 year variation in the first instance, transitioning then to 2 years, then 3 years, and so on. Further administrative burden is already required in ongoing reporting and monitoring regimes envisaged by the draft report.

This doesn't take account of duplicate budgets needing to be developed in 2016/17 due to timing of ESC determinations being May. This allows no time for development of various budget reporting requirements (2-4 weeks workload) and leaves no option other than to develop 2 sets of documentation, one based on a "yes" and from the ESC and one based on the "no" answer.

It is the view of this council that the costs of the ESC should not be recovered from councils. This is a State initiative that provides no additional benefits to councils, therefore these added cost burdens should be covered by the Victorian Government

The introduction of the rate capping regime by 2016/17 is not feasible under current legislation.

The current timelines proposed by the ESC appear unachievable unless prior year data is used. That is, it will not be possible to develop current data attributable to developing next year's budget, and meet all the requirements of developing a submission, consulting with the community, allowing time for the ESC to review the submission and make its decision, then to develop a final budget and re-consult with the community on that budget, within current legislative timeframes.

The current legislative timeframes for budget development are extremely tight and do not allow for a reasonable timeframe for an ESC submission process in the interim.

The report envisages a determination by the ESC in May of 2016. Under current legislation requiring budgets to be submitted to the Minister by end June, and working backwards to include a public consultation process under s223 of the Local Government Act (it takes around **6 weeks** to fully satisfy a s223 process, allowing for submissions to be heard and so on) means that councils **must submit their draft budgets to the public in early May.**

The development of all of the required compliance documents and statutory disclosures supporting the public release of a council budget, related commentaries, media releases and information packages is conservatively estimated to take most councils **3 to weeks to complete.**

This means the **latest** a council could await the determination by the ESC and still meet its statutory obligations is **mid-April 2016**.

The current timeframes proposed by the ESC render this unachievable unless the ESC is suggesting that councils go through the inefficient process of developing duplicated budget documentation. One set based on a successful variation application, and one set based on an unsuccessful application. In other words that each council dedicate multiple staff for 3 to 4 weeks to develop a "dead" budget.

Two alternates suggested by this council are as follows:

1. The ESC committs to providing councils is determination by no later than mid April of 2016; or

2. The ESC recommends to government that transitional arrangements be made to allow councils up to 10 weeks (4 weeks preparation plus 6 weeks for a s223 process), after the date upon which makes its determination, to deliver its budget to the Minister. This should still allow sufficient time to send rates notices to the community for 2016/17 (say late August) prior to the first instalment date of September 30, 2016.

The ESC should be given legislative authority to make a decision on a rate capping variation.

The ESC report also does not make a clear recommendation on who will have the authority to make a decision on the rate variation request, ie. the ESC or the Victorian Government.

Currently the ESC has no legislated power to make such a decision. It is Wodonga Council's view that the Essential Services Commission, once given the mandate and resources to review a council submission should be given the legislative authority to approve the rate rise it has determined. This avoids the additional administrative delay of a Minister performing another review and the possible perception of political influence over a submission already considered by an independent regulator.

Two tiered regime

In various forums and dialogues between the state government and local governments regarding the impending introduction of rate capping various comments and assertions were made that the government was specifically targeting those councils in the upper echelon of rate increases (say 10% and above), and not those councils with more reasonable increases (say 1 to 2% above CPI).

This submission acknowledges that such rhetoric did not form part of the terms of reference for the ESC in developing its framework. It does raise however the possibility of a 2-tiered regulatory regime with a "light handed" approach being taken for those councils in the 1 to 2% above CPI zone.

This could include for example those councils who are able to demonstrate a prudent long term plan, with support of the community through existing budget processes, who are attempting to deliver structural adjustments to its financial and asset management positions to be subjected to a lower level "review and confirmation" process rather than a full rate capping variation submission process.

Such an approach would seem reasonable and would deliver great efficiencies to both the ESC and to councils whilst councils would still be exposed to the scrutiny of an independent regulator.

This submission recommends that a 2-tiered approach to regulation be strongly considered by the ESC.

Other matters

In addition to the issues raised above council also supports a separate submission it anticipates will be made by the Municipal Association Victoria. Some items expected to be raised in that submission are again repeated below and re-iterated in our submission.

Monitoring regime not to be onerous or an additional burden to councils

Councils are already subject to a litany of reporting requirements through various state and federal agencies. Further duplication of reporting obligations are to be avoided at all costs. Council suggest any reporting regime by the ESC should be provided via existing documents submitted such as the newly introduced Local Government Performance Reporting Framework, or the pre-existing Grants Commission reporting requirements.

Reduced Independence of Local Government

Rate capping hamstrings the independent operation of democratically representative governments. Councils should have the freedom to make autonomous decisions around levels of own-source taxes and charges.

The proposed Framework has the potential to adversely impact the longer-term sustainability of councils and places a great deal of responsibility about the future of the sector out of the hands of community elected representatives and into the hands of the ESC.

Relevance of Consumer Price Index (CPI)

The CPI reflects movement in the final prices paid by household consumers for a weighted basket of goods and services and therefore is a general indicator of "prices paid" not of council construction input costs.

The selection of the CPI represents a bias in favour of perceived community expectations about prices rather than any consideration of the cost of inputs. No consideration is given, in any case, whether the basket items, or their weightings, reasonably reflects the inputs for local government service provision.

Weightings of costs within the CPI indicate that the CPI has little relevance to local government inputs. For example, approaching one third of the weighted change in costs is attributable to food, beverages and tobacco and 19% to housing costs excluding utilities and 3% to education costs. Utilities (excluding water) account on average for around 8% or more of councils' recurrent costs although the weighted change in the CPI incorporates a figure of less than 4%.

A significant proportion of councils' spending, around 18% to 19%, is dedicated to building and non-building construction. The contradiction between this and the basis of the CPI are stark.

Additionally smaller regional locations don't always have sufficient scale to attract multiple tenderers and therefore guarantee city-equivalent competitive tender pricing. Fluctuations in pricing between some years can be quite stark. Some projects are stalled when this occurs. It is not always possible to delay projects and sometimes must proceed at unavoidably higher costs.

The extent of any consideration of any existing production cost indices or their possible development has not been adequately discussed by the ESC. The MAV develops alternate indices that are closer aligned to the cost pressures facing councils. A similar methodology could be considered by the ESC.

Limitations of Wages Price Index (WPI)

WPI only considers "pure" price changes in labour costs and does not consider changes in the age, grade or level of qualification of the occupant and relevant pay. The local government sector is characterised highly 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 in councils with low staff turnover.

While opposition may be taken to any claim local government labour market conditions are different from those generally prevailing, councils are not like private sector providers that can just "close shop" or drastically change product lines – they have to keep providing services and often have to pay premium prices for labour. For example, 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.

Efficiency Factors

The Framework discounts the product of weighted WPI and CPI for an *efficiency factor* in order to "address the cost of living pressures faced by ratepayers".

The proposed cap does not 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.

The application of an efficiency factor is therefore considered inappropriate.
The assumption that efficiency gains can be made *ad infinitum* without impacting service effectiveness takes no account of current levels of council productivity.

Factors to be taken into Account by Councils

A successful request for a variation will be determined entirely by the ESC but despite all the narrative, it is difficult to visualise the level and depth of the case required to be demonstrated by councils.

On any objective reading of the Framework 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 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.

In response to concerns about smaller councils' ability to be successful in the variation process, the ESC indicated that the burden of proof that will need to be met may differ depending on the type of council involved. This raises concerns about the objectivity of the process and the need to clearly indicate the task involved.

Despite noting the different capabilities of councils, the ESC maintains that the specific material submitted is up to councils to determine.

Councils should not feel pressured to take on additional risk in the form of less effective but lower cost suppliers/contractors in order to be successful in obtaining a variation

(The ESC states councils should "Gather material that can demonstrate that the variation application is funding items that are fit for purpose and *the lowest cost for the selected level of service*").

There are questions regarding sources, sometimes conflicted, on which the ESC will rely to form opinions about efficiency and need e.g. levels of cost-shifting and renewal gap. Relevant data are disputed by responsible State Government agencies and there are inherent problems expected with the LGPRF.

The Framework is strong on the need for community consultation and involvement however councils are generally on a "hiding to nothing" when this relates to rates. As shown with experience 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.

Need for Exactness

The ESC Framework argues that requests for variation will need to be substantiated and the amounts required quantified. It states that councils will need to be very precise about the rate outcome they are seeking through the variation process and ESC will decline to partially accede to any increase requested. In other words, councils will have to get their sums exact or they get nothing extra. If a strong case is made, or parts of the rationale are substantiated, it is not clear why some level of additional increase should not be approved.

As an example, should 3 out of 4 elements be considered reasonable by the ESC, it would seem very unfair for an entire application be denied for the sake of one of the elements being rejected. The ESC report does not adequately argue the case for why this unfair approach is justified.

Impartiality

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.

In closing thank you for the opportunity to make this submission which I trust will be given full and fair consideration in your final report.

Please feel free to contact our Director Business Services, Trevor Ierino, on 02 6022 9266, or email tierino@wodonga.vic.gov.au should you need to clarify any elements of this submission.

Yours faithfully

Patience Harrington
Chief Executive Officer