Mildura Rural City Council

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Dr Rob Ben-David
Chair
Essential Services Commission
Level 37, 2 Lonsdale Street
MELBOURNE VIC 3000

Dear Dr Ben-David

DISCUSSION PAPER "LOCAL GOVERNMENT – RATES CAPPING & VARIATION FRAMEWORK"

Responsible governments welcome initiatives that enhance transparency, accountability and efficiency. It is important however that policy shifts such as rate capping are not implemented without consideration of the wider macro-economic issues that impact the financial sustainability of local government.

Mildura Rural City Council (MRCC) is one of 10 Victorian regional cities that is dedicated to providing services and infrastructure to maintain quality of life for residents and visitors, and being an economically attractive region for business. MRCC comprises nearly 10% of the geographic area of Victoria, with associated high levels of infrastructure and regional city standard facilities necessary to meet expectations.

A more detailed response to the Essential Services Commission paper questions is attached, and is based upon work undertaken with Regional Cities Victoria, LGPro and the MAV.

Given that there is insufficient time for a formal resolution by Council, please note that these responses are mine on behalf of Council and I will utilise reference to MRCC throughout.

MRCC believes that rate capping should not be introduced without a detailed understanding of the current financial sustainability of each local government area. A decline in revenue will result over time in a reduction of expenditure on essential infrastructure maintenance and renewal, as well a reduction in services and community facilities.

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Other aspects that should be considered include:

- A rate capping framework must recognise the interdependent financial relationship between all levels of Government, but in particular that of State and Local Governments. A cut or a restriction in one area can have flow on implications for other areas. Many fees that fund Council services are set by State agencies. While State agencies have over the years applied regular escalation to fees that benefit the State, they have not applied the same level of rigour to fees that benefit Local Government. Despite advocacy on this matter, Local Government has been unable to directly influence these fees and charges that are set on its behalf and a lack of annual indexation on charges puts pressure on the budgets of other areas of Council. Between 2000 and 2013, successive State Governments have increased fees by less than half the CPI.

  Local Governments typically provide an extensive array of services on behalf of, or in partnership with State and or Federal Governments, that are funded through grant programs. There is evidence that over time grants have not kept pace with the true cost of service delivery. Restricting the ability of Councils to generate revenue through rates will bring increased focus and scrutiny on those areas where Local Government receives less funding than the cost of delivering such services.

  The most significant example of this is HACC services, where it is estimated that Victorian Councils currently contribute approximately $115m per annum above grant funding levels. Other examples include school crossing supervisors, library services, youth services, immunisation and maternal child health services. An unintended consequence of rate capping may be a reduction in Local Government's ability to subsidise declining real contributions from other levels of government for these services. In this scenario, Councils would deliver services to the level of funding provided, rather than to the true cost of the service. Revised emergency management arrangements following the Bushfire's Royal Commission have also resulted in substantial additional costs to many rural and interface municipalities.

  Over the last five years there has also been a number of increases in Government taxes paid by Councils which have risen higher than CPI. Recent examples include the Landfill Levy and the Fire Services Levy.

- **Defined benefit superannuation liabilities that are not equally applied to State and Commonwealth Government schemes.**

  Since 1998 Victorian Local Government has paid $1.162b in calls into a defined benefit superannuation scheme. 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 in distinct contrast to the funds operated by the Victorian State Government and Commonwealth Government, each of which currently have substantial unfunded liabilities. If the same rules of operation were applied to the Local Government fund, $1,162b in calls and contributions tax would not have needed to be funded across the 17 years since 1998. This requirement that is unique to Local Government, places significant and often unplanned upwards pressure on rates.

- **Changing State or Federal Government policy positions which have flow-on cost impacts for Local Government and increases in government charges that are in excess of CPI.**

  From time to time State and Federal Governments introduce changed policy objectives which have flow-on implications for Local Government. A recent example is the Four Year Old Preschool Universal Access Policy which has incurred considerable costs to Councils.

As demonstrated in NSW, the cumulative outcome of Rate Pegging and decline in real grant support from State and Commonwealth Governments has resulted in:

- 25% of NSW Councils are now not financially sustainable under current policy settings.
- 50% are vulnerable.
- Only 25% are in a relatively strong financial position (a number of high income, low infrastructure mainly metropolitan Councils).

MRCC endorses the position that Councils are best placed to consult with the local community and seek agreement on addressing local needs and priorities. The current Council and Community Planning process, integrated with developing long term financial and asset management plans allows the community and Council to appreciate how to meet current and future requirements.

As such, MRCC does not agree with both the Rate Capping Framework and utilising the Consumer Price Index (CPI) as the measure for determining rate cap levels. It is our view that CPI is not a realistic measure of the costs associated with the operational and capital needs of local government, and an alternative cost index should be explored.

MRCC is currently undertaking detailed service reviews of all areas across Council, and as the impact of rate capping, cost shifting and reductions in real grants increases, there will be a risk to the capacity of Council to maintain current service levels and employment in our isolated regional area.

MRCC looks forward to future consultation on this matter across the sector.

Yours sincerely

GERARD JOSÉ
CHIEF EXECUTIVE OFFICER

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Mildura Rural City Council
Submission to Essential Services Commission

FORM OF THE CAP

1. **While a cap based on CPI is simple to understand and apply, are there any issues that we should be aware of?**

   Mildura Rural City Council (MRCC) shares the view of the Municipal Association Victoria (MAV), Regional Cities Victoria and LGPro as reflected in the Consultation Paper, that while CPI is simple and easy to understand, it is not the appropriate indicator for local government cost escalation. The use of CPI as a reasonable benchmark for Local Government cost escalation has always been problematic as the CPI is a weighted basket of household goods; Council services are predominantly made up of salaries, materials, contracts and utilities, all of which generally exceed other cost increases in the economy.

   Other cost inputs into local services include grants from other tiers of Government; these grants often provide less than inflation indexation, thereby increasing the Local Government financial contribution. Research and analysis undertaken by the MAV indicates that Local Government costs therefore typically increase by around one per cent above the consumer price index (CPI). In rural, regional and remote areas such as Mildura, this cost can be much higher because of distance to transport goods and materials, and lack of competitive suppliers. An additional impact on revenue for rural Councils is the inability to charge higher levels of user fees, given the low and fixed income base of many communities.

   The consequence of using CPI alone as the cap would mean that in real terms, Council revenue available to fund services and capital infrastructure would go backwards year-on-year. This would likely result in nearly all Councils needing to make a business case for a variation to the framework, creating unnecessary levels of bureaucracy.

2. **What are some ways to refine the cap (for example, alternative indices), in line with the Government's objectives?**

   MRCC would support the development of an independently verified and validated Local Gvernment cost index which could form the basis for a more relevant starting point (as opposed to CPI). The LG Cost Index would be determined through an independent assessment made by the Australian Bureau of Statistics or similar and MRCC would welcome further discussion on a model that utilises this as a base.

A starting point would also be beneficial in allowing differential models, addressing whether a Council and its community was demonstrating that it needed a variation to meet essential community infrastructure renewal and/or a special rate variations that allowed for specific projects that the community endorsed, such as significant capital works or a series of environmental activates that have been agreed within the Council and Community Plan.

3. **Should the cap be set on a single year basis? Is there any merit in providing an annual cap plus indicative caps for the next two to three years to assist councils to adopt a longer term view in their budgeting and planning, particularly when maintaining and investing in infrastructure often takes a longer term perspective? How should such a multi-year cap work in practice?**

MRCC undertakes longer-term planning for both operational and capital works, and given this, there should be capacity in providing an annual cap plus indicative caps over outlying years. This would both minimise bureaucracy and give greater medium-term clarity to Council's financial planning. Major capital works projects normally have a multi-year horizon therefore having a long-term outlook on Council's anticipated income would be beneficial.

Councils are required, under legislation, to develop a four year Strategic Resource Plan and four year Council Plan in line with the elected Council's terms. It would make sense that any approach to rate capping took that timeframe into consideration.

4. **Should the cap be based on historical movements or forecasts of CPI?**

As outlined in our response to Questions 1 and 2 above, MRCC is of the view that CPI is not a definitive indicator and that a more appropriate collection of indicators be developed.

The central issues that need to be addressed prior to establishing a model is to define Local Government's role, the establishment of a mechanism to allocate functions and associated revenue raising powers to support Local government and improve the adequacy and flexibility of Local Government's revenue base to meet the demands being placed on it.

Any revenue framework needs to recognise Local Government's role as the third level of Government responsible for all local matters and that it can only function effectively if a mechanism is in place to appropriately share public functions and correspondingly allocate funding or revenue raising powers between Local Government and other levels of government. Any 'capping' mechanism needs to be established with the capacity to introduce other revenue streams to meet agreed functions.

Additionally, the model needs to incorporate into its formulae the impact of cost shifting (estimated at about 6% of LG budgets) in the current revenue framework for Local Government. An example is that Local Government partly funds rate rebates for pensioners. Addressing social impact issues through welfare and income support is the responsibility of higher levels of government who are able to spread the cost of such assistance more equitably and efficiently over a broader revenue base.

5. Should a single cap apply equally to all councils?

The response to this question needs to be considered in terms of the totality of the rate capping and variation framework. It is the view of MRCC that any cap chosen should address the variability of needs and communities' capacity to pay across the State. If there was identified variation elements within the framework that are sufficiently flexible to meet the diverse needs and circumstances of member Councils, then a single cap may be the simplest to administer.

If through consultation, the ESC determines that a multiple cap model should be introduced, then consideration should be given to determining appropriate caps based on the following categories:

- Inner city
- Middle suburbs
- Interface areas (growth)
- Interface areas (green wedge)
- Peri-urban areas
- Regional centres
- Rural

Alternatively, a more sophisticated multiple cap model could be developed that recognises the relative ‘starting point’ for each Council based on an assessment of financial sustainability indicators and then look at a range of social and economic indicators (population density, distance from capital centres, SEIFA rating, infrastructure per capita, per capita share of State expenditure on public infrastructure, etc).

THE BASE TO WHICH THE CAP APPLIES

6. **What base should the cap apply to? Does it include rates revenue, service rates/charges, municipal charges and special rates/charges?**

It is MRCC’s view that the cap should apply only to general rates and the municipal charge (for those Councils that still have a municipal charge), and not those charges such as waste which are operated on a fee for service or contracting basis. These latter services are a) market tested, b) subject to cost escalations as outlined in negotiated contracts, and c) often provided on an opt-in or out-basis in those municipalities where population density is sufficient to provide economies of scale.

It is also important to note that there is no uniformity of the starting position across Councils. The average rates and charges per assessment varies widely across municipalities and is based on historical decisions from Council to Council. It would not be safe to assume that the current levels are an appropriate base on which to assess or cap future movements. Applying a percentage in such circumstances could disadvantage those who have kept rates and charges reasonably low.

Specific levies such as the Fire Services Levy should also be excluded from the cap as that is a tax that is merely collected by Local Government on the State Government’s behalf.

7. **Should the cap apply to total revenue arising from these categories or on average rates and charges per assessment?**

The cap should apply to average rates and municipal charges per assessment; not to the total revenue. Applying the cap to total revenue would be grossly disadvantageous to those Councils experiencing growth or significant change. For example, Councils facing declining population or rapidly ageing communities actually require increases in revenue capacity to address higher service demand, changing facilities and infrastructure provision.

8. How should we treat supplementary rates? How do they vary from council to council?

Supplementary rates should be excluded from the rate cap. Supplementary rates are an indicator of growth which leads to increased service delivery and infrastructure requirements which need to be responded to, often in the case of service delivery, as population or participation meets certain triggers. Supplementary rates become part of the base for the following financial year. The response to this question should be read in conjunction to that of Question 7 above.

9. What are the challenges arising from the re-valuation of properties every 2 years?

The challenge will be more significant in the first year of implementation and the perception of benefit gained by the community. By implementing the framework in a revaluation year, the natural shift in relative values, and therefore rates, will mask the real benefit for the average ratepayer.

The methodology of the Local Government rating model and how valuations impact the rates paid per property is widely misunderstood in the community. In simple terms, when Council sets its budget it determines the amount of rates and charges that it needs to generate in order to meet business needs. That figure is then divided up across the rateable properties in the municipality on the basis of 1) capital improved value relative to all other rateable properties, and 2), any differential rating scheme that the Council has approved (such as for industrial or vacant land). What this means is that while a property may increase in value, it does not necessarily mean that the rates will increase by the same percentage.

A comprehensive community information campaign will be necessary to ensure that the benefit is understood.

10. What should the base year be?

Not being an economist, I believe that the base year should deliver enough trend data to ‘even’ out highs and lows in inflation rates. Therefore, I would suggest an averaging model that had 10 years of data built in to establish a base year or commencement rate.

THE VARIATION PROCESS

11. How should the variation process work?

It is important that the variation process does not create unnecessary levels of bureaucracy for already financially constrained Councils.

MRCC supports the position of LGPro that:

- The cap should form the **maximum** rate increase that could be struck without mandatory referral to the Essential Services Commission for review and authorisation. Councils proposing increases to rates and charges at or below the cap should be exempt from the ESC process.

- Councils proposing to apply rate increases in excess of the cap would need to prepare a Business Case for consideration of the Essential Services Commission. A standard template should be established to minimise the cost and administrative burden of production for councils, and to ensure that the ESC has the necessary information to inform their review.

- A two tier Business Case process should be adopted. For those Councils who are seeking to apply a rating increase of the cap plus say up to 2% a 'light touch' Business Case should be required. For those Councils seeking to apply a rating increase in excess of the Cap plus 2% a more comprehensive Business Case and Financial Assessment would be required. This should reduce the number of Business Cases requiring substantial review effort, minimising the cost of implementation to Councils and the ESC.

- In reviewing each Council's Business Case, the Essential Services Commission would give consideration to the following factors:
  - The Council has a robust 10 year Long Term Financial Plan and 4 year Strategic Resourcing Plan in place.
  - The Council has a clear plan to bring rating increases back in line with the appropriate cap within a reasonable timeframe.
  - The Council can demonstrate clear and transparent communication and consultation with their community in the development of their annual budget and/or 4 year SRP.
  - AND, The Council is subject to extraordinary financial drivers that are outside of their control which may include such factors as:

    - Implications of State or Federal Government policy changes;
    - Recovery from emergency or other disaster;
    - Legacy asset management concerns;
    - Shifts in global money markets affecting superannuation calls or other linked investments.
  - OR, where rate increases are in direct relationship to increased service provision (eg the introduction of a new Green Waste Service), the Council can demonstrate community consultation and preparedness to pay.

12. Under what circumstances should councils be able to seek a variation?

Councils should be able to seek a variation where, following a robust assessment of their financial circumstance, community ambition and consultation, it is determined that a rate rise in excess of the cap is warranted / required.

13. Apart from the exceptions identified by the Government (namely, new infrastructure needs from a growing population, changes in funding levels from the Commonwealth Government, changes in State Government taxes and levies.

- Overall financial position at the commencement of the framework's implementation (ie some Councils are already experiencing financial challenge).
- State Government cuts to grants.
- Cost shifting by other statutory agencies.
- Prevention, mitigation and response to natural disasters.
- Inability to generate self-sourced revenue.
- Community asset stewardship (including lack of viable alternatives to Council ownership and management).
- Proportion of rate base that is exempt from rates in accordance with Section 154 of the Local Government Act.
- Stewardship of green wedges.
- Growth.
- Other extraordinary circumstances outside of Local Government's control.

14. What should councils need to demonstrate to get a variation approved? What baseline information should be required for councils to request a variation? A possible set of requirements could include:

- The Council has effectively engaged with its community.
- There is a legitimate case for additional funds by the Council.
- The proposed increase in rates and charges is reasonable to meet the need/s.
- The proposed increase in rates and charges fits into its longer term plan for funding and services.
- The Council has made continuous efforts to keep costs down.
- We would like stakeholders' views on whether the above requirements are adequate.

MRCC supports this view that these requirements are appropriate.

COMMUNITY ENGAGEMENT

15. What does best practice in community engagement, process and information look like? Are there examples that we can draw from?

MRCC undertakes significant engagement to develop its long-term plan and resourcing strategy. It is more appropriate to strengthen the integrated community engagement process to ascertain whether the community has been consulted.

INCENTIVES

16. How should the framework be designed to provide councils with incentives to pursue ongoing efficiencies and respond to community needs? How could any unintended consequences be minimised?

Pursuing ongoing efficiencies and responding to community needs could, for some Councils, be mutually exclusive under a rate capping framework. The language needs to shift to one of financial sustainability and value for money, rather than the current economic rationalist focus which is at odds with other government messaging regarding local employment protection.

Rate capping should not be seen as a punitive tool, yet unfortunately recent press reporting from the Minister for Local Government's office is represented as if rate capping is to be the Government's tool to 'bring Local Government under control'. The sector welcomes measures to enhance transparency, accountability and community engagement and ownership, however those same principles should apply equally to the State Government and their own financial processes. It is important that the sector perceives that there is a level playing field.

Unintended consequences can be minimised by ensuring a planned and staged implementation in partnership with the sector. A fast tracked process will undoubtedly result in unintended consequences which may reflect badly on not only Local Government, but also the State. An appropriately comprehensive risk assessment should be commissioned before implementation.

TIMING AND PROCESS

17. A rates capping and variation process should ensure there is enough time for councils to consult with their ratepayers and for ratepayers to provide feedback, and for us to review councils' applications. To ensure the smooth functioning of the rates capping and variation framework, it is particularly important that it aligns with councils' budget processes. We are interested in stakeholders' views on how this can be achieved.

The timing and timeliness of the Variation application consideration will be important if not to de-rail the smooth running of a Council's budget preparation and consultation process in accordance with the timeframes established in the Local Government Act. Authorisation of Variations would need to be complete by 30th March to enable statutory consultation of four weeks to occur during April/May, consideration of submissions and endorsement by 30th June.

TRANSITIONAL ARRANGEMENTS

18. What transitional arrangements are necessary to move to the new rates capping and variation framework? Is there merit in phasing in implementation over a two year period to allow for a smooth transition?

MRCC supports LGPro's view that the framework should commence from the 2016/17 financial year. This view is offered on the basis that:

- Councils will have already commenced the development of their 2015/16 budgets by the time that the ESC has had the opportunity to finalise its review.
- 2015/16 is a revaluation year and therefore the perception of benefit from the wider community will be diluted by the shifts in rates associated with the re-valuation.
- 2016 is a Council election year and the commencement of a new Council four year budgeting and planning cycle. It makes sense to coordinate the introduction of a new cost containment framework with the wider council planning and budgeting cycle.

ROLES

19. What are stakeholders' views on the respective roles of the key participants? Should the Commission's assessment of rates variations be advisory or determinative?

There is benefit in having an independent arbiter such as the Essential Services Commission oversee the implementation of any rate capping framework, rather than a political decision making process. The role of the Essential Services Commission could be:

- Review the Council planning and consultation process as part of reviewing long term plans that lead to a request for a rate cap variation.
- Authorise rate increases in excess of the baseline where business cases have sufficient merit in accordance with the established criteria.
- Provide advice to the Minister for Local Government in circumstances where business cases are seen to have insufficient merit and other intervention may be required.
- Monitor the success of the implementation of the Rate Capping and Variation Framework and provide advice to the Minister on any review; taking into consideration feedback from the sector.

Local Government Victoria should have a role in providing direct support to Councils in reconsidering their long term strategies (financial, assets, capital works, etc), where business cases are deemed by the ESC to have insufficient merit.

It will be important to ensure that over time the policy parameters to support rate capping are integrated across VAGO, LGV and the Essential Services Commission to ensure maximum public transparency for Councils and for Government. This should also be reflected in the Local Government Performance Reporting Framework.

OTHER MATTERS

20. Is there a need for the framework to be reviewed to assess its effectiveness within three years' time?

Yes. It is MRCC's view that a regular cycle of review is imperative, and should take into consideration not only feedback from the sector and the community, but also include a full assessment of the economic impact on Councils' financial sustainability and the ability to meet asset renewal requirements pre and post-rate capping implementation.

21. How should the costs of administrating an ongoing framework be recovered?

Under no circumstances should the cost of applying the framework be applied to Local Governments. As it is a State Government policy position, it should be fully funded by the State Government. Any attempt to operate the framework on a cost recovery basis from the sector would further disadvantage those Councils who have the most pressing financial needs. The cost of administering the framework to the State can be minimised through ensuring that the process is non-bureaucratic, simple to navigate and based on appropriate templates, etc.

OTHER MATTERS RAISED IN EARLIER CHAPTERS

22. We are interested in hearing from stakeholders on:

- Whether we have developed appropriate principles for this review?
- Whether there are other issues related to the design or implementation of the rates capping and variation framework that stakeholders think are important?
- Supporting information on the major cost pressures faced by Councils that are beyond their control and the impact on Council rates and charges.

MRCC is broadly in agreement with the principles for the review set out in Section 4 of the Consultation Paper. The exceptions to this are outlined below:

- Principle 4 – we agree with this principle, however suggest that the burden of proof should be variable, depending on the level of increase that is sought above the cap. There would be benefit in establishing a framework that requires a less onerous burden of proof where the level of increase sought above the cap is, for example, up to 1% above the cap. This would also reduce the expectation on the ESC and reduce the costs of implementation.
- Principle 5 – should be re-worded to reflect rate increases **above the cap** should be considered only after all other viable options have been explored. Rate increases that keep pace with reasonable levels of cost escalation are responsible financial management. The current wording infers that any rate increase, even at CPI, is a last resort.
- Principle 7 – suggest that a further dot point is added under this principle to reflect that the framework should not apply unnecessary levels of bureaucracy or administrative burden on either the ESC or Councils.

Other factors for the consideration of the Commission that have an impact on the overall financial sustainability of the sector and have put upwards pressure on rates include:

Responsible stewardship of local assets
Local Government has a key role in establishing and maintaining local assets which make a very real contribution to delivering economic, social and environmental outcomes at local, state, and regional levels. A 2014 report by the Auditor General identified that Local Government is responsible for $73 billion of community assets.

It is well understood that investment in these important assets has not been able to be sustained at required levels, even with current income and revenue strategies, and while some good progress has been made, there is still a pressing need for many Councils to address growing asset renewal gaps. The same 2014 Auditor General report found that Councils are generally budgeting less than is required to renew their assets and consequently the funding needed for asset renewal continues to grow each year. The Auditor General went on to assert that without appropriate and concerted corrective action, the provision of Council services to communities is likely to be put at risk, and that while this may require some hard financial decisions and trade-offs, failure to address this problem now will only lead to more difficult decisions in the future.

An assessment of rate capping outcomes in NSW undertaken by NSW Treasury Corporation in 2013 (as reported by VLGA) identified critical under investment in asset maintenance and deteriorating financial sustainability had arisen during their own rate pegging regime. Their report found that revenue needed to grow to cover not only annual cost increases but the underlying cost of service delivery including progressive elimination of deficits and infrastructure funding needs. This meant that in most cases rates need to rise by substantially more than the current annual peg if Councils were to achieve sustainability.