GLEN EIRA CITY COUNCIL

Rate Capping and Variation Framework
Draft Report by the Essential Services Commission (ESC)

Response by Glen Eira City Council, August 2015

This submission responds to the Draft Report by the Essential Services Commission (ESC): *Local Government Rate Capping and Variation Framework Review*, 31 July 2015.

It is the third submission by this Council on this subject. It follows

- A Response to the Terms of Reference, March 2015 and
- A Response to the ESC Consultation Paper, May 2015.

This Response should be read in conjunction with Council's two previous submissions.

The proposed "cap and variation" methodology is likely to reduce investment

> "*Victorian councils manage around $73 billion of infrastructure assets. Council spending on renewing or replacing existing assets is not keeping pace with their rate of deterioration, resulting in cumulative renewal gaps that grow each year*".
>
> – Report by the Auditor General, Tabled in Parliament on 19 February 2014.

In addition, on 26 February 2015 the Auditor General Tabled his report on the results of the audits of all local governments for 2013-14. Appendix E of the Auditor-General's report contains forecasts for financial years 2014-15, 15-16 and 16-17 against six indicators of financial sustainability. One of the indicators is "*capital replacement*" it compares the rate of spending on infrastructure with the rate of depreciation of infrastructure. For 2016-17, the forecasts for *capital replacement* for the 79 councils are

- 24 *low risk*
- 43 *insufficient spending* and
- 12 *high risk*.

Victorian Councils currently invest approx. $2 billion pa in asset management.

The single largest use of Rates money is investment.[1]

If Rates are to be indexed, the index should reflect changes in Asset Management costs (eg a Construction Index or an "infrastructure backlog factor" derived from

[1] A significant proportion of wage costs is incurred in delivering programs on behalf of other levels of government and funded by government transfers, not Rates.

Auditor General's work). The ESC Report does not do that. It proposes a hybrid index of 60% Consumer Price Index (CPI) and 40% Wage Price Index (WPI). As argued later, the CPI reflects the costs of consumption, not the costs of investment.

The ESC proposal is not consistent with findings and recommendations of successive Reports by successive Auditors General.

If the ESC Draft is accepted, the Index would not provide adequate funding of infrastructure. Councils would need to address their responsibilities for managing community assets by seeking a Variation.

This would portray asset management as non-core (ie outside the Index).

Some councils may face political pressures not to seek any Variations "*above*" the Index. In these circumstances, to the extent that a Council accepted the cap without variations, it may fail to discharge its responsibilities for infrastructure and community assets.

Investment needs a longer lead time than the cap proposes

Effective asset management requires long term planning and long term Capital works programs.

Section 126 of the Local Government Act requires Councils to develop and approve a Strategic Resource Plan (SRP) each year. The SRP must cover "*at least the next four financial years*" (s126 [2]).

The methodology in the ESC Draft Report does not support that. The Index to apply in a financial year would be notified only seven months before the start of that financial year. That does not provide sufficient lead time or sufficient certainty.

A variation may be approved for one year, increasing to up to four years from 2019-20.

Council's earlier Submission advocated for the Rates framework to apply to Councils' four-year Strategic Resource Plans, not one-year Budgets. Council reaffirms that position.

Major projects often involve expenditure over four years (eg project identification, feasibility, scoping, consultation, concept, business case, costing, detailed design, consultation, contract documentation, tendering, construction and commissioning).

If Rates revenue was subject to greater uncertainty in future years, major projects would assume greater financing risk. This would translate into greater political risk: raising community expectations which could then not be delivered.

It is foreseeable that the composition of the capital works programs would shift with a lower proportion of major projects and a higher proportion of smaller and short-term projects.

An example in this Council would be the Glen Eira Sports and Aquatic Centre (GESAC). The project ran over six years: consultation in 2006, approved in 2008, the construction contract awarded in late 2009 and opened in 2012. GESAC hosts 1.1m visits a year. It has a child care centre and a physio therapy clinic. Membership is 55% female. It has a major partnership with the main local provide of disability services. It is a major contributor to community health and social connectedness. It has been visited by 80 organisations around Australasia.

GESAC cost $40m to build. It turns over $13m pa, covers all its operating costs, all repayment of borrowings and all interest on borrowings. Over a forty year life, it is likely to cost Council nothing.

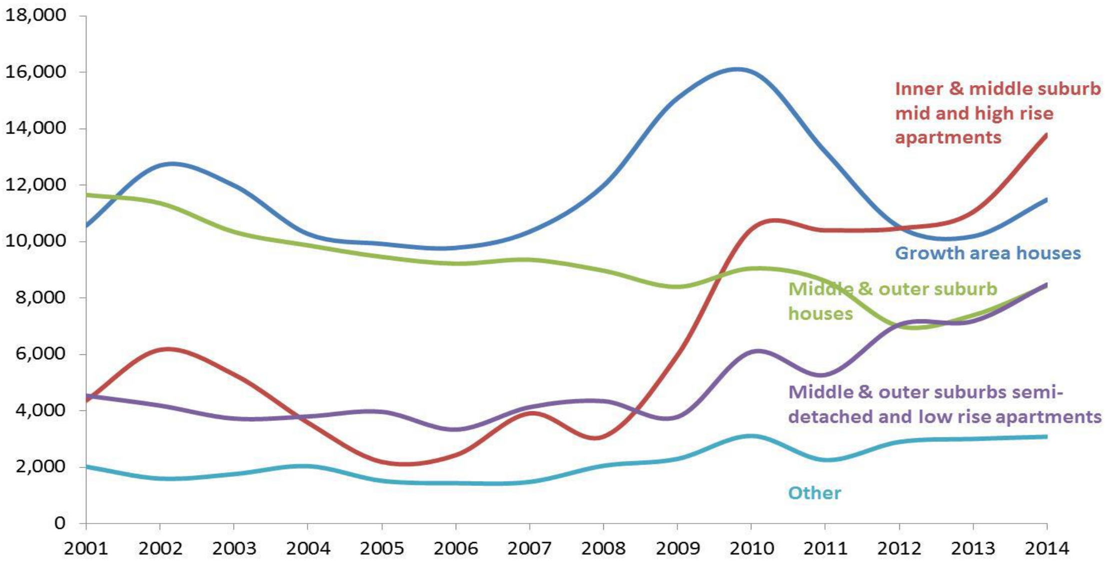
GESAC would not have been attempted if Rates had been capped at CPI and Variations considered on a year-by-year basis.

Capital programs with few major projects would tend to concentrate on managing past assets. It would not do justice to changing or emerging community needs e.g.+

- children's services hubs as a one-stop-shop providing Maternal and Child Health, child care, facilities for networks and groups;
- redeveloping 1960s seasonal pools for young people into all year round recreation centres for all ages and all abilities;
- facilities for both genders to replace facilities disproportionately catering for the sports and activities of one gender;
- transforming book libraries into learning centres.

The cap runs contrary to State policy objectives and future liveability

Victoria, more than any other State, is Australia's growth State. Melbourne alone is forecast to add another three million people in the next thirty years. The main component is apartments in inner and middle Melbourne, including this municipality (see the red line on the following graph).



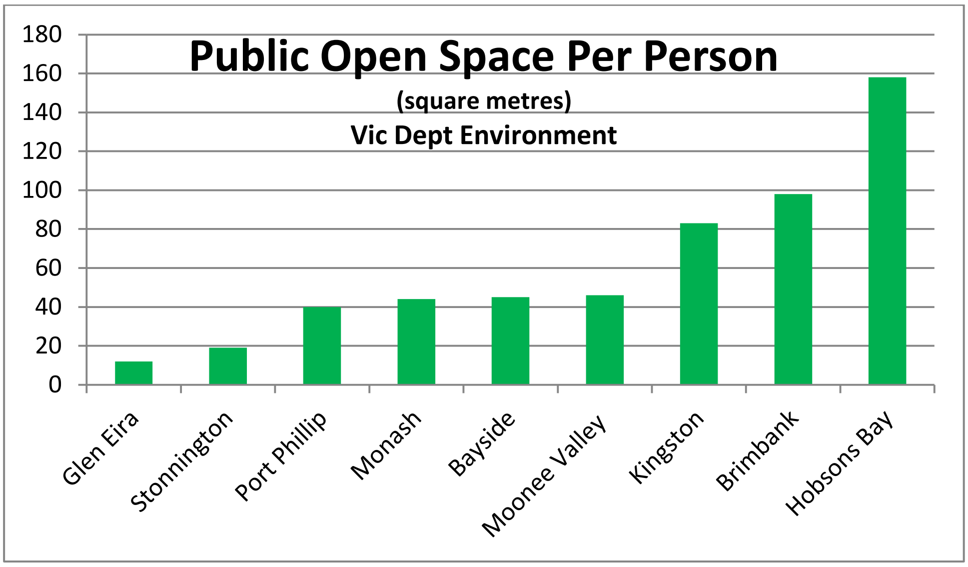
Redirecting Rates investment away from emerging needs and major projects during a period of high growth would detract from State economic performance and future liveability.

It is noteworthy that the State is adjusting its profile of capital works to a larger proportion of major projects (grade separations, new heavy rail lines) and a smaller proportion of small projects. The State's policy on its own capital investment and State policy on Rates investment are not consistent.

Public Open Space

One of the highest needs of apartment dwellers is public open space.

This municipality has the least amount of open space per person of any municipality in Victoria.



Council has adopted a 300 page *Open Space Strategy* following expert analysis and extensive community consultation. Council is implementing the Strategy to the extent that resources allow. Council has secured the highest open space levy rate ever achieved across a whole municipality by any suburban council – a uniform 5.7% of land value. That was supported by an Independent Panel appointed by the Minister for Planning. That is estimated to generate $5m pa but that is not sufficient given the increasing value of property. Increases in population are outpacing increases in public open space. The ratio per person is not improving.

The Open Space Strategy estimates expenditure of $201,296,600 over thirteen years (see Attachment A). This requires significant funding from Rates. The Index will not recognise that. Council will need to seek a Variation.

There are other infrastructure needs that are not recognised in the Index including flood mitigation from lack of capacity in Melbourne Water main drains.

If infrastructure needs are not funded by the Index and Variations, it is foreseeable that Councils will issue Refusals for planning applications on grounds that the infrastructure cannot be provided. In the event that VCAT approves developments notwithstanding lack of funding for infrastructure, it would exacerbate the impact on existing residents and the politics of town planning would become more problematic than they already are.

The Wrong Index

The misalignment is driven by the use of a consumption index for a sector which does not consume.

The CPI is constructed by the Australian Bureau of Statistics (ABS). The CPI:

> "*measures the change in the prices paid by households for goods and services to consume*" (Attachment B).

The main factors in the CPI during 2014 were: *domestic holiday travel, tobacco, fruit, medical and hospital services and pharmaceutical products*.

The proposition that Melbourne's liveability and residents' services should be funded according to changes in the prices of *fruit, tobacco* etc is non-strategic.

The ABS has stated in writing that "*all expenditures by business and expenditures by households for investment purposes, are out of scope of a consumer price index"* (Attachment B).

The Draft Report does not say that CPI is an appropriate Index.

Capacity to Pay

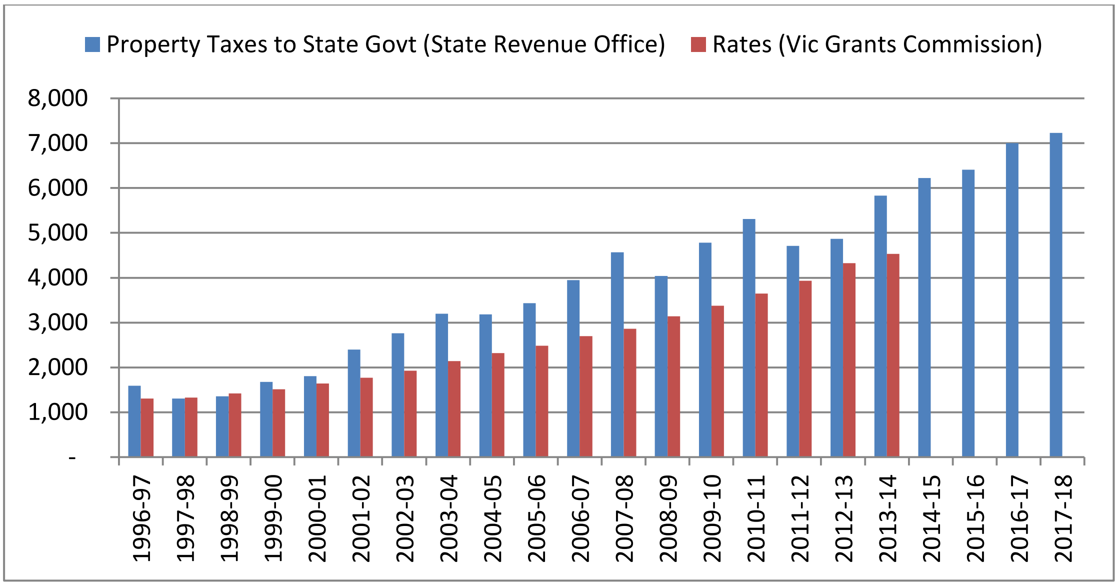
CPI is often used as an indicator of capacity to pay.

If the policy objective was to align Rate increases with capacity to pay, there are more effective methods than capping Rates to CPI.

Firstly, Rates are levied under the Local Government Act. The Act is controlled by the State Government. The Act requires Councils to levy rates on the basis of the value of property, not the capacity to pay of the owners. Councils do not hold any information on owners (eg their income, their age, the number of occupants). The Act could be amended by State government to achieve different objectives or a mix of objectives or to phase changes of Rates over time.

Secondly, the State pays a Rate Rebate to eligible households – currently pensioners. The Rebate was not indexed or increased at all for twenty one years between 1983 and 2004 – see letter from the then Minister for Local Government, Hon. Frank Wilkes MP, 10 October 1983. If the Rebate had been indexed during those twenty-one years, it would now be approximately $512 pa instead of the current $208. Tens of thousands of low income households would be $304 better off each year.

Thirdly, the State's own property taxes (Land Tax, Stamp Duty) have increased by more than Victorian Council Rates and are budgeted to continue to increase by more than Council Rates. State property taxes are paid by the same people who pay Rates.



In 2013 a new property tax was introduced: the Fire Services Property Levy. It increased by approx. 12% in 2014-15. It equates to approx. 16% of Rates.

In 2015 another levy was introduced: the Metropolitan Planning Levy on planning applications of more than $1m. The Levy will raise more than twice the amount Councils receive for actually processing planning applications. The Levy will form part of the cost of new properties.

State Agencies are levying four property taxes which are not linked to capacity to pay.

Fourthly, State Agencies have taken decisions which have significantly added to Council Rates.

- State and Local government operated public sector defined benefit superannuation schemes. Both were adversely affected by the global financial crisis (GFC). The State decided that its own liabilities would be unfunded and the government would make payments only as they were due. The State decided that Councils' liabilities (under the scheme established by State legislation) needed to be fully funded all of the time. That has required Councils to contribute $635,310,000 to the scheme in the last five years. At the same time, the State unfunded liability was increased to $30 billion. The $635m has been passed on in Rates.

- State Agencies have imposed significant levies on Councils. For example, the State Landfill Levy has increased by fifty times inflation since 2009. It would now represent of the order of $90m of total Victorian rates and charges each year.

- State Agencies have shifted significant costs onto Rates by not increasing other sources of revenue. For example, planning application fees are set by State Agencies but paid to Council. They have not been increased at all since 2009. Rates are now paying most of the costs of processing developers' applications. This would now comprise of the order of $100m of total Victorian Rates each year.

The examples set out above account for nearly a billion dollars passed on to Rates and charges (i.e. ratepayers) as a result of decisions made by bodies other than Councils.

If the Rate rebate had been indexed, if the legislation had been modernised and if different decisions had been made by State agencies on the defined benefit superannuation, levies on Rates and Fees payable to Council, the impact of Rates on cost of living would be far lower. The ESC cap and variation process is seeking to contain the consequences of poor decision making by State agencies over a long period of time.

Some Councils will hand back community programs

Council's Response to the Terms of Reference in March 2015 stated:

> *"Up until now, there has been an 'understanding' under which Councils supplement government funding of social programs in order to achieve better outcomes.*
>
> *The most important example is Home and Community Care. In all other states the program is delivered by State governments or their contractors. In Victoria, the program is delivered mainly by Councils. Victorian councils contribute approximately $115m pa to achieve this. It is universally accepted that outcomes are best in Victoria. This council provides care for more than 4,000 elderly and disabled people in their homes.*
>
> *Other important programs (with this council's volumes in brackets) include*
> - *maternal and child health (15,000 consultations pa)*
> - *immunisation (14,000 in 2014-15)*
> - *school crossings (3.4 million crossings pa) including 27 school crossings of roads which are legally the sole responsibility of VicRoads.*
> - *pre schools (10 council provided venues)*
> - *libraries (more than one million loans each year).*
>
> *In each of these areas, the two levels of government have been in a partnership. Rates have been set at a level to supplement government funding of these programs. Rates are higher than they would otherwise be so that outcomes are better than they would otherwise be.*
>
> *The main service beneficiary of this 'partnership' has been the community, notably, the very old, the very young and those participating in education.*

The main financial beneficiary of this 'understanding' has been State agencies.

When one partner puts pressure on the revenue of the other partner, the pressure inevitably comes on the partnership itself. If the partnership is undermined by the capping of rates and if that is initiated by State agencies, the financial benefits which have accrued to State agencies are unlikely to continue. (A council is unlikely to feed the hand that bites it.)

Councils' legal obligations under, amongst others, s136 of the Local Government Act will require priority to be given to Councils' own responsibilities above those of State agencies. It is foreseeable that all these services would move to a fee-for-service basis in which councils:

- *deliver the funding that the State agency provides,*
- *account for their expenditure*
- *and any shortfalls in outcomes would be a matter for the State agency.*

It is foreseeable that waiting lists for these services could blow out and other social outcomes deteriorate before the end of this Parliamentary term."

Council reaffirms this position.

The CPI does not reflect community needs. For example,

- the population does not age by CPI;
- this Council administered 9,000 immunisations in 2010 and 14,000 in 2014-15, an increase of 55%.

In particular, the imposition of a discount of 0.05% in 2017-18, 0.1% in 2018-19, 0.15% in 2019-20 etc on an already inappropriate index would require Councils to make cuts. It would not be rational for Councils to protect State expenditures and cut local expenditures. Some State agency programs in some municipalities would be handed back to the State agency. State agencies would have to provide the services or appoint contractors to provide the services, funded wholly by the State agency. In some cases, this could entail loss of continuity of care, loss of local knowledge and loss of local responsiveness.

In many cases, the current arrangements represent the greatest cost benefit approach and the alternative would be more expensive and less effective. For example, when a Council administers a scheduled vaccination, it gets paid $14.42 by government; when a GP administers the same vaccination to the same child, the GP is paid $43.05 by government. That is not a criticism of GPs. It is an illustration that Councils are the lowest cost provider.

Mass immunisations by Councils at schools will achieve the highest immunisation coverage than if coverage relies on individual families making appointments with GPs.

Earlier this year there was considerable publicity for the Government making Whooping Cough vaccines available for parents free of charge. The publicity omitted to say that Government would pay for the vaccine and that Rates would pay the nurses to administer the vaccines. The program is a highly desirable Public Health initiative and a good example of the sorts of partnership in which Councils may be, reluctantly, unlikely to join in future.

Each Council will need to make its own decisions on where the trade-offs will be made. It is foreseeable that

- some programs will be delivered by Council with the Council adding in its own funds;
- some delivered by Council on a fee-for-service basis, spending whatever funds are allocated by the State agency – no more, no less;
- some programs will be transferred back to the responsible State agency.

In a given Region in Victoria you could readily have a situation in which every Council delivered a different mix of programs, funded to different standards.

(It also illustrates that myriad services do not lend themselves to regulation by a single cap.)

This would affect Council employees who were involved in the affected programs.

Government should legislate now to ensure that affected employees could transfer to the new provider (VPS employment or private contractor) without loss of conditions.

Many people in the community are aware that Rates are a progressive tax. The revenue is raised on the basis of wealth and spent on universal services and facilities. There is a likelihood that future service arrangements will be more costly overall and that the costs will be distributed less progressively.

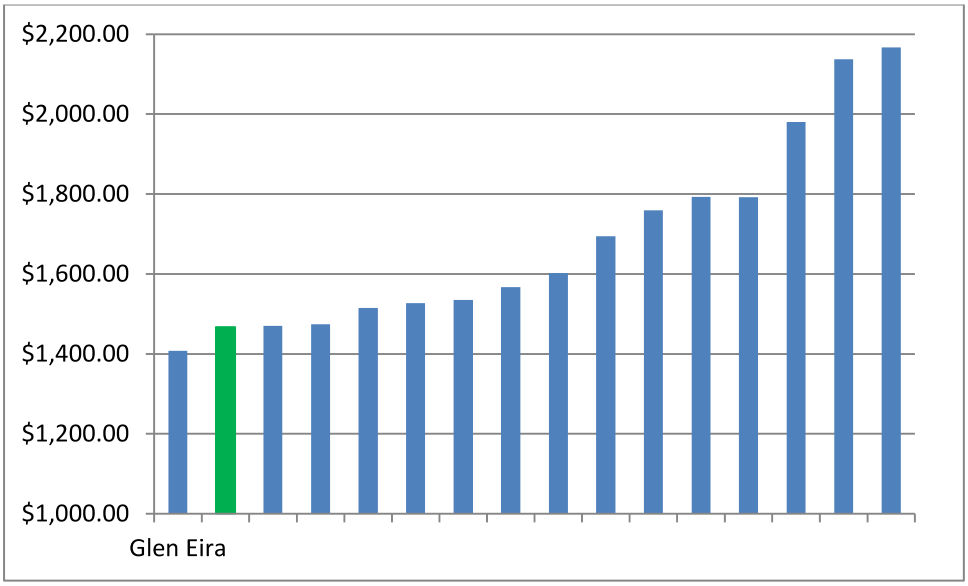
To the extent that Councils were pressured to maintain community services, it would draw more funding away from infrastructure.

The methodology penalises the most economical

Among municipalities, there is about a 50% difference between the highest and lowest average rates and charges per property. The graph below illustrates the range among metropolitan Councils in 2014. This Council is the second-lowest.

A methodology which provides a percentage increase on an existing base will give quite different outcomes. The lowest-cost will be relatively penalised and the highest cost will be relatively rewarded. This approach is unlikely to produce the best results.

Treating all 78 Councils as if they were the same would be like treating all the States and Territories as if they were the same.



Cycle

The Draft proposes that the ESC notifies the % cap in December, Councils notify an intention to seek a Variation in January, lodge variations in March and the ESC determines variations in May.

The effects could include:

- for Rate revenue to be determined separately from other revenue;
- for Rate revenue to be determined separately from expenditure; and
- all to be determined to the exclusion of the community.

There should be an integrated planning process that balances revenue, expenditure and community input.

As previously stated, any regulation should be on the basis of Councils' four year Strategic Resource Plans, not one year Budgets.

If there is to be a Budget focus, the cap and all variations need to be determined in the calendar year prior to the financial year to enable Councils to develop a Budget which integrates revenues with expenditures.

Glen Eira's Performance

Rates in this municipality average $1.60 per person per day. We have the second-lowest average rates and charges per property in metropolitan Melbourne. Council's ten year Strategic Resource Plan projects increases in average rates and charges of between three and four percent per annum over the whole ten years.

In the annual *Community Satisfaction Survey* conducted by an independent market research firm under contract to the State Government in 2015, this Council received an Approval / Disapproval rating of 72 / 4 and a Satisfaction rating of 94%.

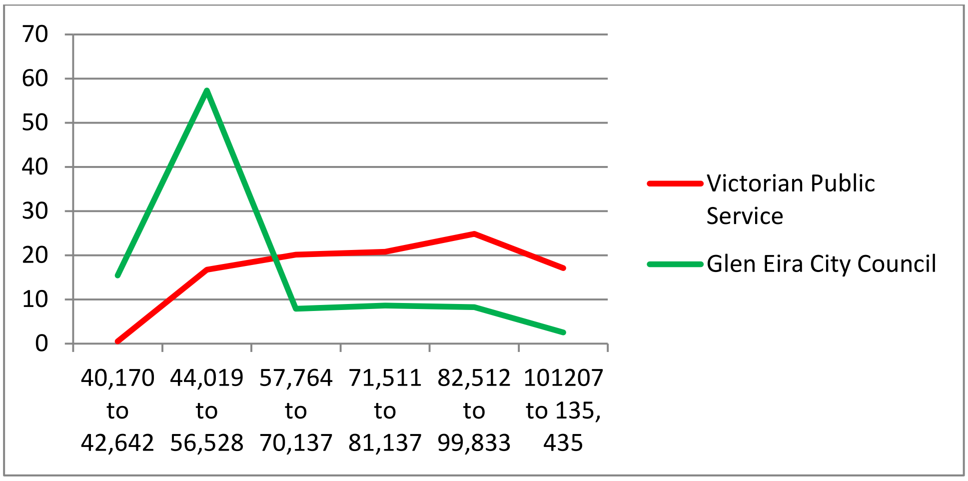
We currently have no waiting list for kindergarten or child care or home care.

This Council's average salary is 14% below Average Australian Earnings and we have one-fifth the proportion of Executives as the Victorian Public Sector.

Council has received favourable assessments in published Reports by the Auditor General and Awards for Governance, major projects, sustainability and customer service.

Wages

There is a lot of ill-informed commentary about labour costs.



In this Council:

- average remuneration is 14% below Australian Average Earnings;
- rates of pay are below the Victorian Public Service – see above graph.[2]
- the proportion of staff paid more than $125,000 at 30 June 2014 was 1.2% in this Council compared with 6% for the Victorian Public Sector;[3]
- all Council CEOs in Victoria are paid less than the Editor of the Herald Sun[4].

There are alternative approaches which would achieve more benefits at less cost.

Concerns have been raised about some expenditures by some Councils. The tabloid media regularly report this pictorially, especially public art. Such examples are usually of relatively low cost.

Ensuring that capital projects are well selected would be better addressed through better *Business Case* processes and requirements for disclosure (e.g. measure and

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[2] *"The State of the Public Sector in Victoria 2013-14"*, Public Service Commission, p32 The Victorian Public Service includes Secretaries, Executive Officers, Grade staff and "*occupation-specific and senior specialist classifications*". No aggregate information is published on occupation-specific and senior specialist classifications. See *"The State of the Public Sector in Victoria 2013-14"*, Public Service Commission, p61.

[3] *"The State of the Public Sector in Victoria 2013-14"*, Public Service Commission, p11

[4] See Guthrie versus News Limited, 2010, Victorian Supreme Court 196, page 46. The Editor of the Herald Sun successfully sued News Limited for damages. Lawyers for the Editor told the Supreme Court that the Editor's remuneration in 2009 was $844,258. Lawyers for News Limited told the Court that the Editor's remuneration in 2009 was only $514,807.

disclose the “renewal gap” in Budgets, Strategic Resource Plans and Annual Reports). That would eliminate inappropriate projects without the imposition of a short term Index based on consumption, not investment.

An effective Policy Framework for Local Government financial management would concentrate, among other things, on the following.

a. Building measurement and disclosure of the state of infrastructure into Council Plans and Budgets.
b. Instituting a Business Case methodology to ensure well-considered expenditures.
c. Transferring good practice from some Councils to all Councils.
d. Providing Councils which are experiencing difficulties with direct assistance to restore performance. This could include attention to Councils proposing increases to their Rates which were out of line with the property taxes of other Councils or other levels of government.
e. Instituting a procedure to identify the impact on ratepayers of decisions by State agencies before those decisions were implemented and with particular regard to the impact on capacity to pay.
f. In many rural Councils, the rate base is smaller than the asset base which precludes them from being financially self-sufficient. Their viability is dependent on financial assistance grants from the Federal and State governments.

Open Space Strategy

Table 1. Total value of the open space projects included in the City of Glen Eira Open Space Strategy 2013 - 2026

City of Glen Eira Open Space Strategy 2013 - 2026 Total value of the 13-Year Open Space Program					
[1] **Value of open space land and capital works projects**	[2] **City of Glen Eira allocation (existing population apportionment)**	[3] **% of total**	[4] **Open space contributions (new population apportionment)**	[5] **% of total**	[6] **Total $ value of the Strategy included in the rate**
Value of land for open space					
Total over 13 years:	$70,507,510	57%	$54,140,990	43%	$124,648,500
Average per year over 13 years:	$5,423,655	57%	$4,164,692	43%	$9,588,347
Value of capital works					
Total over 13 years:	$50,873,485	67%	$25,774,615	33%	$76,648,100
Average per year over 13 years:	$3,913,345	67%	1,982,663	33%	$5,896,008
Total value of all projects					
Total over 13 years:	$121,380,995	60%	$79,915,605	40%	$201,296,600
Average per year over 13 years:	$9,337,000	60%	$6,147,354	40%	$15,484,354

Australian Bureau of Statistics

6461.0 - Consumer Price Index: Concepts, Sources and Methods, 2011

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CHAPTER 2 PURPOSES AND USES OF CONSUMER PRICE INDEXES

WHAT CONSUMER PRICE INDEXES MEASURE

2.1 As the name suggests, a consumer price index measures the change in the prices paid by households for goods and services to consume. All expenditures by businesses, and expenditures by households for investment purposes, are out of scope of a consumer price index. In this regard, expenditure on housing presents particular difficulties as it can be considered as part investment and part purchase of shelter-related services.

2.2 There is currently no single, universally accepted definition of a consumer price index. The often quoted description of a CPI is the following statement from the Resolution concerning consumer price indices released in 2003 by the Seventeenth International Conference of Labour Statisticians convened by the International Labour Organization (ILO) (the Resolution is reproduced in Appendix 4):

"The CPI is a current social and economic indicator that is constructed to measure changes over time in the general level of prices of consumer goods and services that households acquire, use or pay for consumption. The index aims to measure the change in consumer prices over time. This may be done by measuring the cost of purchasing a fixed basket of consumer goods and services of constant quality and similar characteristics, with the products in the basket being selected to be representative of households' expenditure during a year or other specified period."

PRINCIPAL PURPOSES OF A CONSUMER PRICE INDEX

2.3 A consumer price index may serve several purposes. However, three principal purposes are generally recognised, namely to measure:

- changes in the purchasing power of money incomes;
- changes in living standards; and
- price inflation experienced by households.