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

Dear Dr Ben-David

RE: COMMENTS ON DRAFT RATES CAPPING & VARIATION FRAMEWORK REVIEW

Thank you for providing the Draft Report – Volume 1, A Blueprint for Change, Local Government Rates Capping & Variation Framework Review on 31 July 2015 and for inviting written submissions.

Indigo Shire Council welcomes the Commission's recommended framework and believes that this is a significant step towards an acceptable solution to the State Government's policy position. There are however a number of areas that warrant some adjustments, particularly in relation to the sustainability issues faced by small rural Councils.

The Indigo Shire Council response to the Draft Report follows;

The Rate Cap

The framework suggested in the Draft Report is clearly an interdependent system of three elements (the cap, the variation process and the reporting regime). It is pointed out in the Draft Report that the individual differences in Councils (rural challenges, interface, etc.) is best handled by the variation process, and not the cap.

This seems like an appropriate solution to the issue of individual Council differences; however the success of the program requires an assumption that Councils have full and free access to the variation process as required. The ESC has made this assumption because the Terms of Reference for this work does not indicate any restrictions.

With the recent statements by the Minister for Local Government that she sees variations as a rare exception to the rate cap, it is suggested that this adds a degree of clarification to the expectations behind the terms of reference for this work.

It seems reasonable to now reassess the ESC's proposed rate capping framework in the light of the Government's expectation that the variation process will be the rare exception to the rule.

- Is it still appropriate to rely on this rare exception to deal with the multitude of differences that exist in Victorian Councils?

- Will the proposed framework really allow Councils to account for differences if they are expected to use the variation framework as a rare exception?
- Is the ESC's Terms of Reference assumption of a free access to the variation process still valid in light of the recent statements?
- Should the cap be amended to allow for some degree of differences for some Council categories that are well understood to have higher cost pressures.

Wages Proportion

All Councils are required to perform the same level of administration and governance. This is seen in several back-office areas such as the annual planning and reporting cycle. All Councils are required to comply with the same regulation in regards to annual reports, LGPRF reporting, Long-term financial (and non-financial) planning, etc. The examples are numerous across all of Council's core functions.

This creates a significant inequity in the proportion of staff that are required in small Councils when compared to large Councils. Smaller Councils are regularly required to have a greater than 40% proportion of staff to meet the Council requirements.

Therefore, the 40% weighting of staff costs in the calculation of the cap discriminates against small (mainly rural) Councils and advantages large (mainly metropolitan) Councils.

This staff weighting in the rate cap calculation should be increased for smaller Council's.

Rate Cap Proportions

The Commission is clearly attempting to balance the complexity of the cap (i.e. allowing for sector-specific costs) compared to simplify and transparency. This appears to be the reason for including only two components of the cap (a wages component and a household CPI component).

This does not reflect the true costs faced by Councils and it is suggested that a third component be added to account for the capital works expenditure that Councils make.

Capital works is a significant cost for Councils and represents a large part of the annual budget. If this is not recognised in the capping calculation it will force Councils to constrain capital works expenditure to the level of household CPI.

It is suggested that a formula that includes 3 components be developed that includes;

- Wage growth (currently 40%)
- Capital works (based on an appropriate measure such as the ABS Roads & Bridges Construction Index)
- Household CPI

Cost Shifting / Additional Services and Requirements/ Fixed Income

The cap assumes that there will be no increase in the requirements of Councils in the future. It is a 'maintenance' system that takes no account of;

- Cost shifting from other levels of Government,

- Increases to services (septic tanks, roadside management, etc.) or additional reporting requirements (such as the LGPRF or even the increase in workload due to the proposed rate capping framework).
- The proportions of Council's income (fees) that are set by regulation and are either not increasing, or increasing at a rate that is inadequate to cover cost increases.

All of these factors are certainties of Council's existence and the additional requirements that are placed on Council's is relentless.

The ESC Draft Report suggests that the variation framework would be the appropriate method to address these changes. This is an expensive, time consuming, and uncertain method of addressing these challenges.

Own-Source Funding

The single cap assumes universal access to own-source funding options. This is clearly incorrect and the differences in the Local Government sector are significant. A cap on a small rural shire with limited own-source revenue is a solid cap. A cap on a large metropolitan Council with significant own source revenue will have a far lower impact.

This increases the divide between large metropolitan Councils and small rural Councils and will require small Councils (with limited resources) to submit more variation requests.

Efficiency Factor

The inclusion of an efficiency factor is a very broad interpretation of the terms of reference, and goes beyond the original promise to keep Council rates within CPI.

To introduce an arbitrary further efficiency (bringing Council's target below household CPI) without solid evidence, analysis, and a clear Ministerial direction goes beyond the reasonable scope of the terms of reference and would require Councils to curtail costs at a rate that is LOWER than the average basket of household goods. This will require services to be reduced.

The efficiency factor should be removed. The requirement for Council's to meet a household CPI measure more than adequately drives cost reduction in the sector.

If it is to remain, there must be an upper limit set for the efficiency factor. For a meaningful analysis of the proposed framework this is required to give the proposed calculation some context.

Variation Cost to Council

The suggested variation process appears to be appropriate for strategic projects. However it also appears to be very involved and expensive to complete, for more simple / routine applications. The impost on (particularly) small Councils is very high and will require significant work to prepare the submission. This is especially problematic for small Councils that are required to comply with the same governance and legislative requirements as large Councils, but with significantly lower resources.

It is suggested that the variation process be modified to take into account the size of the Council and the level of variation requested.

Program (ESC) Cost Allocation

The Rate Capping and variation Framework is an initiative of State Government, and is being driven and implemented by State Government. It appears to be logical that State Government fund the process. The ESC is silent on this and have merely included a number of self-evident options for Ministerial consideration.

It is recommended that this State Government program be funded by the State Government. Any exception to this would result in an additional cost shift to Local Government. It is the Commission's role to provide a clear recommendation in this regard.

Variation Evaluation Methodology

The ESC proposes that a procedural evaluation will be undertaken and there appears to be no intent to assess the merits of the business case itself – merely that the Commission will provide approval based on evidence that the consultation and governance steps have been followed in the appropriate way.

This seems to open the door for valid (and possibly urgent) requests (perhaps as a result of a natural disaster) to be rejected due to an administrative step. Take for example a fire or other natural disaster that requires Council to embark on an additional prevention / mitigation program. It is entirely possible for this to occur in the second half of the financial year (causing Council to miss the variation deadline) and without notice (meaning that this work is unlikely to be included in the various strategic documentation). This sort of compressed timeframe may make a valid variation impossible to achieve. In this situation a Council is likely to either borrow to fund the required program or reduce spending in areas such as infrastructure (the NSW experience).

Variation Feedback

Feedback to Councils is required for all unsuccessful variation applications.

Monitoring

Much of the data that is suggested for the monitoring component of the framework is already available and many elements have historical data available. It is therefore recommended that monitoring reports begin with some historical figures to allow some degree of pre and post implementation analysis.

Appeal Process

The Draft Report is silent on the appeal process that may be available to Councils. This needs to be clarified.

Variation Timeframe

The variation timeframe is impractical and will require significantly higher workloads (and cost) for Councils.

Due to the late notification of the outcome of the variation application Council's will need to create a budget with 2 scenarios – one for an approved variation and one for a rejected variation. The approval is too late in the budget process to await the ESC outcome before creating an alternate budget.

This will add significant complexity to Council's budget process, add additional confusion to the community consultation process, and delay the adoption of the budget.

It is recommended that the variation outcome be provided earlier to allow Councils time to consult with the community if the variation is rejected and to prepare an alternate budget prior to the start of the financial year.

Multiple Year Variations

In 2016 new Councils will be elected and will then set about the usual process of creating a 4-year Council Plan and other long-term strategic documents. The current proposal from the Commission is to limit variations in 2017-18 to only 2 years.

This will prevent some strategic work from being planned. It is therefore recommended that the length of variation be set to 4 years from the start of the Rate Capping Framework. This will allow Council to plan adequately from the start.

Council Elections

Each 4 years, following elections, Councils will be required to create a new Council Plan, consider the Long Term Financial Plan (SRP) and adopt a Budget within the first 6 months of their tenure. This is in addition to all the other requirements at this time (Code of Conduct, induction, etc.).

The addition of a rate capping submission into this mix makes it very difficult to conduct all of these processes AND provide a variation application in the first year of a Council term.

It is recommended that the variance submission timelines be extended – for all years – but particularly for an election year.

Ratepayer Perspective on Capping

The Terms of Reference specifically asks the ESC to consider the impact of the capping framework on the cost of living for ratepayers. There are two pieces of analysis that are missing from the Draft Report that will assist the Commission in acquitting its responsibilities;

1. The expected impact on the average ratepayer on their cost of living once this framework is in place. This could be achieved with a calculation similar to; If an average ratepayer has a rates bill of \$1,500 the difference between a 6% increase and a 3.05% increase is \$37.5 per year. On an average household expenditure of \$36,348 PA (ABS data) this is a saving of 0.1% for the average ratepayer. Without this type of analysis it is not possible for the ESC to demonstrate how this framework will "contain the cost of living" (from page 1 of Terms of Reference).
2. The rates bill is seen by the Ratepayer as a combined bill, and ratepayers generally do not see the difference between the State Government charge (FSPL) and the Local Government Charge. It is therefore suggested that the Commission include a recommendation that the FSPL also be capped at the same level as the Council rates.

The Commission has already seen fit to consider wider Terms of Reference that is in keeping with the intent of the Government's policy (by including an efficiency factor). It is therefore unusual that the commission has not considered these additional 2 aspects that would take into account the ratepayer's perspective.

Conclusion

In summary, the Draft Report offers a (generally) reasonable framework design and some sensible suggestions regarding implementation. Unfortunately the plight of small rural shires is not adequately addressed and it is important that this be reviewed prior to the final recommendation being made to the State Government. In summary, the Rate Capping and Variation Framework should be amended to include a number of changes, including;

- A rate cap that includes an additional component that takes into account the cost of construction.
- A different cap tier (or additional weighting percentage) for small rural shires that accounts for a/ the different staffing proportion in these Councils and b/ the sustainability challenges faced by these locations.
- The efficiency factor should be removed.
- The variation application should be simplified to a standard template.
- Variation applications should be fast-tracked for clearly identifiable needs (natural disasters, etc.) to avoid unnecessary delays and uncertainty.
- The timing of the variation process should be altered to be more suitable for Councils.
- The monitoring should include retrospective measures and should also include analysis on the impact of this framework on the average Victorian household budget.
- Costs of this program should be covered by the State Government.

Thank you again for this opportunity to provide input into the Rate Capping and Variation Framework. Indigo Shire Council keenly await the updated framework and look forward to seeing some revisions to make this a fairer and more practical solution.

Yours sincerely



Gerry Smith
CHIEF EXECUTIVE OFFICER

CC: MUNICIPAL ASSOCIATION OF VICTORIA
RURAL COUNCIL'S VICTORIA