



LOCAL GOVERNMENT — RATES CAPPING & VARIATION FRAMEWORK

Consultation Paper

April 2015

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MESSAGE FROM THE CHAIRPERSON

In January 2015, the Essential Services Commission of Victoria received terms of reference to consider and report on the development of a state-wide capping and variation framework for council rates. We are required to undertake the review and complete it by October 2015 for implementation in 2016-17.

We have worked with the sector previously, having undertaken an extensive and in-depth consultation process in 2010, when we developed a local government services reporting framework. Similarly, for this review, we will be consulting extensively with all interested parties, recognising the significance the final framework will have for local government and the Victorian community.

Our focus will be on developing an effective framework for capping rates which includes a credible variation process for councils that can clearly demonstrate their need to go above capped increases. While we are very mindful of the need for simplicity when designing the framework, we are also determined that the framework does not inadvertently or partially shift responsibility for rate-setting from councils to the Commission. Councils are responsible for the services they provide and therefore the rates they levy and the legacies they leave. The framework will clearly place the onus on councils to demonstrate that their rates are being set in line with the services they provide to their communities and in line with the long-term interests of their ratepayers.

This consultation paper is the first formal step in our consultation process. To facilitate as much engagement as possible, we have presented the issues using a straightforward format of six questions and answers, covering:

- what are we required to do?
- why is it important to get it right?
- what are some of the key issues?
- what is our approach?

- what are the relevant questions for the review?
- what are our next steps (including how to make a submission)?

We encourage submissions and feedback from all interested parties as they will inform the successful development of an effective rates capping and variation framework.

We look forward to working closely with the sector and the broader community as, together, we develop a well-designed local government rates capping and variation framework that will promote the best outcomes for all Victorians.

Dr Ron Ben-David

Chairperson

CONTENTS

MESSAGE FROM THE CHAIRPERSON	III
1 WHAT ARE WE REQUIRED TO DO?	1
2 WHY IS IT IMPORTANT TO GET IT RIGHT?	3
3 WHAT ARE SOME OF THE KEY ISSUES?	7
4 WHAT IS OUR APPROACH?	15
5 WHAT ARE THE RELEVANT QUESTIONS FOR THE REVIEW?	21
6 WHAT ARE OUR NEXT STEPS?	25
APPENDIX A — TERMS OF REFERENCE	29
APPENDIX B — KEY FEATURES OF THE LOCAL GOVERNMENT SECTOR	33
APPENDIX C — COUNCIL GROUPINGS	43

1 WHAT ARE WE REQUIRED TO DO?

In January 2015, the Essential Services Commission (the Commission) received terms of reference (TOR in Appendix A) from the Minister for Finance (in consultation with the Minister for Local Government) to conduct a review and report on a local government rates capping and variation framework.

The Commission has been asked to design a framework that meets the Government's commitment to cap annual council rate increases as well as to develop a workable process to assess any proposals by councils for above cap increases ("variation process"). The Commission is required to complete its final report by 31 October 2015.

The intended framework will be aligned with the Government's objectives to contain council rates growth and develop greater transparency and accountability in rates setting. It is intended that the proposed framework will lead to future rates that are efficient, stable and reflective of community needs and demands, without compromising councils' autonomy or financial sustainability.

Our key focus will be to develop a simple and effective rates capping and variation framework that will benefit ratepayers and support councils in delivering services to their communities.

We recognise the design of the framework may have considerable impact on ratepayers and councils. We intend to consult widely, with as many interested parties as possible. In accordance with our Charter of Consultation,¹ there will be a number of opportunities for interested parties to provide input and feedback throughout the review. These will be advertised through our website.

¹ Essential Services Commission 2012, *Charter of Consultation and Regulatory Practice*.

Our first consultation milestone is the release of this consultation paper. This paper outlines the review's timelines and process, our approach, and seeks feedback from all interested parties on key matters for the review.

2 WHY IS IT IMPORTANT TO GET IT RIGHT?

In designing an effective rates capping and variation framework, it is essential that we understand the significance, complexity and diversity of the local government sector²:

- Collectively, Victoria's 79 councils have responsibility for \$73 billion of community infrastructure and assets, have an annual revenue of \$7.6 billion and employ 42 500 people across the state.³
- Councils provide 50 to 120 different types of services to a population of around 5.8 million in areas such as social and community services, health, transport and infrastructure, planning and building, environment and emergency services.
- In 2013-14, Victorian councils held \$1.5 billion in debt. Victorian local councils held borrowings equivalent to 1.2 per cent of their non-financial assets in 2012-13, compared to an average of 3.4 per cent for the other states and territories.⁴ Councils do not face any legislative restrictions on their ability to borrow.
- Each council is characterised by its unique mix of community demographics, economic profile, local history, environment, services, infrastructure, and revenue raising capacities.
- Each council has elected local representatives that govern its decision-making.⁵

² Appendix B further outlines key features of the local government sector.

³ Figures are for 2012-13. Municipal Association of Victorian 2014, *Modest rate rise despite funding cuts*, media release 5 July, <http://www.mav.asn.au/news/Pages/modest-rate-rises-despite-funding-cuts-05jul14.aspx>, Accessed 26 March 2015.

⁴ Based on Victorian Grants Commission analysis.

⁵ With the exception of Brimbank City Council and the Rural City of Wangaratta.

While there is commonality across the types of services delivered by local government in Victoria, each municipality is distinct. As such, there is diversity in service delivery across the state reflecting the different composition and priorities of communities. This requires councils to make choices about prioritisation of their limited resources to balance the demands of a range of stakeholder groups. The types, levels, and quality of services councils provide vary depending on the geography of the region they serve, the demographic profile of the community, individual council's financial circumstances, inherited assets and policy decisions. Councils also employ different service delivery models such as service provision being council owned and operated, or outsourced.

Councils raise and receive funds from a variety of sources. Across Victoria, about 56 per cent of councils' revenue was sourced from rates and charges in 2013-14.⁶ The second biggest source of revenue is Federal and State Government grants followed by statutory fees, charges and fines, developer contributions and other sources such as bank interest, asset sales, and earnings from rental properties. The revenue mix for each council varies considerably.

In recent years, the local government sector has experienced major cost pressures. In its 2014-15 budget, the Federal Government announced that the indexation of the Local Government Financial Assistance Grants would be paused for three years (2014-15 to 2016-17). Preliminary estimates by the Victorian Grants Commission (VGC) indicate that this will reduce funding by \$64 million (from the 2013-14 base) for councils by the time indexation resumes in 2017-18.⁷

In our discussions so far, councils have also raised concerns about a number of areas where cost shifting has occurred over the last decade, including in the funding of services such as home and community care, school crossing supervisors, maternal and child health, emergency management and public libraries.⁸

⁶ Victorian Auditor-General's Office 2014, *Local Government Results of the 2013-14 Audits*, p.17.

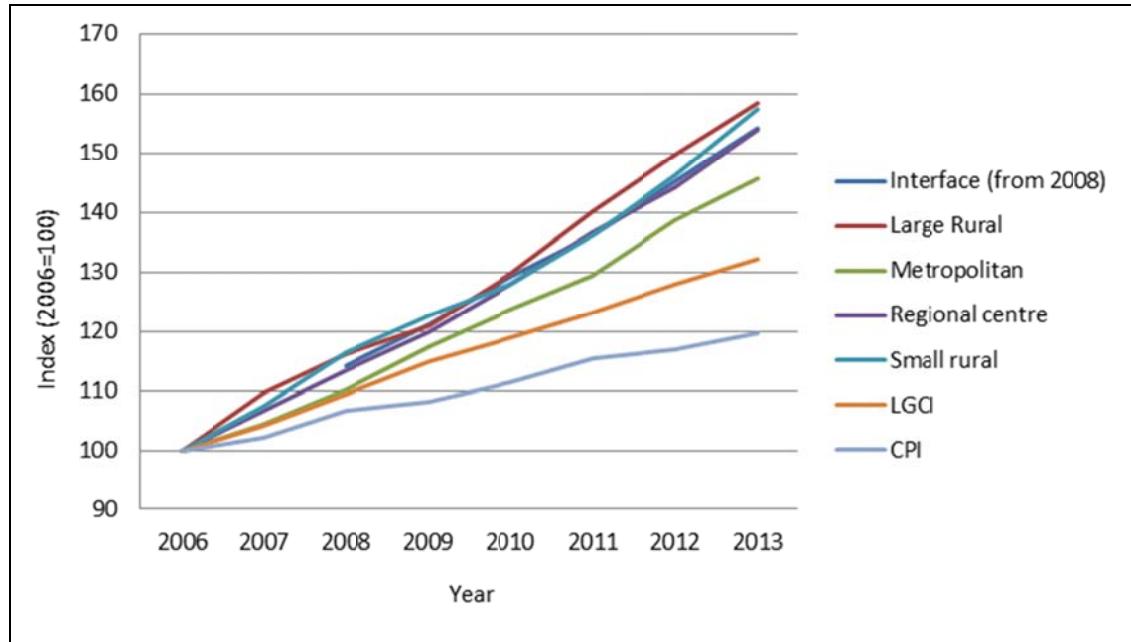
⁷ Based on VGC's analysis comparing funding under a grant freeze to a continued growth in allocations of 4 per cent.

⁸ Cost shifting occurs when Federal or State governments shift service or program delivery responsibility to councils without providing sufficient funding or withdrawing funding for implementation. Councils may then make the decision to keep providing these services using rates to cover funding shortfalls.

Municipal Association of Victoria 2014, Modest rate rise despite funding cuts, media release 5 July, <http://www.mav.asn.au/news/Pages/modest-rate-rises-despite-funding-cuts-05jul14.aspx>, Accessed 26 March 2015.

At the same time, the community in general has been concerned with the pace at which rates have been increasing over recent years.⁹ Based on data drawn from councils' publicly available annual reports, the average rates and charges per assessment have increased by 40 to 60 per cent (cumulative) during the period 2005-06 to 2012-13 (figure 2.1). We are currently in the process of obtaining more accurate and up to date data.

FIGURE 2.1 RATES AND CHARGES PER ASSESSMENT



Note: The figure compares annual changes in council rates and charges per assessment for each council group with annual changes in the CPI and MAV's LGCI. Changes expressed as an index using 2006 as the base year. Data on rates and charges sourced from publicly available council annual reports. As a result, there are a limited number of observations for the earlier years. The council groupings are set out in Appendix C.

Data source: Various council annual reports, Australian Bureau of Statistics and MAV website.

⁹ For example: Various articles from the Ratepayers Association of Victoria website (<http://www.ratepayersvictoria.com.au>); Channel 9's A Current Affair (June 2014); The Herald Sun (2014), *Councils sting Victorians \$2 billion in rate rises above rate of inflation over 10 years*, March; Cardinia Ratepayers & Residents Association Inc, 12 June 2012, Cardinia Shire Council Special Budget Submission Meeting 12th June 2012, http://www.crra.org.au/pdf/CSC_Budget_SpMtg.pdf, Accessed 27 March 2015; Cardinia Shire, *Minutes of Special Council Meeting Tuesday 11 June 2013*, http://www.cardinia.vic.gov.au/files/2013_meetings_agendas/z130611_SCminutes.pdf, Accessed 27 March 2015; Cardinia Shire, *Minutes of General Council Meeting*, Monday 16 June 2014, http://www.cardinia.vic.gov.au/files/2014_meetings_agendas/140616_council_minutes.pdf, Accessed 27 March 2015; Olin, Des, Monash Ratepayers, 11 February 2014, *Sell Underused Assets*, Waverley Leader, p. 25, <https://monashratepayers.wordpress.com/?s=rates>, Accessed 27 March 2015.

As demonstrated in figure 2.1, this is well above the cumulative rate increase in the Consumer Price index(CPI) and the Municipal Association of Victoria's (MAV's) Local Government Cost Index (LGCI) during the same period.

Further, ratepayers have complained about a lack of transparency and accountability by councils in setting rates, especially in relation to service provision and priorities.¹⁰

In its 2013 report on *Local Government Rating Practices in Victoria*, the Victorian Auditor-General' Office (VAGO) also raised concerns about the lack of transparency and accountability of councils in rate setting.¹¹

We also note that as of 1 July 2015, all councils will commence reporting against the Department of Environment, Land, Water and Planning's (DELWP's) Local Government Performance Reporting Framework (LGPRF). We regard this as an important development and will be considering how it might support the rates capping and variation framework, particularly in better defining service outcomes in the future.

It is in this broader environment that this review to develop a rates capping and variation framework was initiated. In undertaking this review, we will carefully consider the competing pressures put on councils with the view to developing an effective rates capping and variation framework that has beneficial outcomes for the sector and community.

¹⁰ For example: Ratepayers Victoria Inc, *The Capping of Rates is for the interest of ratepayers and residents, not institutional beneficiaries!*, http://www.ratepayersvictoria.com.au/?page_id=1461, Accessed 26 March 2015; Knox Ratepayers Association, Newsletter 12 February 2015, <http://www.knoxratepayers.com/newsletters/>, Accessed 26 March 2015.

¹¹ Victorian Auditor-General's Office 2013, *Report on Local Government Rating Practices in Victoria*.

3 WHAT ARE SOME OF THE KEY ISSUES?

In this chapter, we summarise some of the key issues raised during our preliminary consultations including the issues raised by councils and ratepayers in media reports. This is not meant to be an exhaustive account of the issues and we expect to continue to receive further feedback from all interested parties following the release of this consultation paper.

We have outlined our preliminary responses to the issues raised. Our consultation process is designed to further inform our responses to these issues.

1. Autonomy of councils should not be compromised by rates capping

The MAV points out that:

Councils are a distinct tier of government with democratically elected councillors to make decisions on behalf of the community. The autonomy of councils must be respected and councils must retain the flexibility to set appropriate budgets that meet local community priorities and needs. A legislated process already provides that councils make budget decisions in an open, transparent and accountable way that involves community input.¹²

¹² Municipal Association of Victoria, <http://www.mav.asn.au/mediacentre/campaigns/Pages/financial-taskforce.aspx>, Accessed on 25 March 2015.

Our initial response:

We are of the view that councils, in consultation with their communities, remain best placed to make decisions regarding the mix of services and the infrastructure they provide.

We are not seeking to interfere with councils' consultations with their communities on decision-making regarding priorities, resource allocation and service delivery. A cap arrangement recognises that communities and their councils have limited resources and that councils themselves must be disciplined in how they prioritise their activities and pursue efficiently delivered services.

2. CPI is not the appropriate index of council costs

There are three key issues here. First, councils and local government peak bodies argue that the CPI, which measures the price movements of a standard basket of goods and services reflecting household consumption, may not accurately reflect price movements faced by local councils because they have a significantly different composition of expenses compared to households. They believe that a LGCI is a more appropriate cap. Some councils also argue for a different cap for each council group given differences in cost structures.

Second, councils and peak bodies noted that a number of cost and revenue pressures beyond their control have contributed to above CPI increases over the years. These include cost shifting, cuts in government grants, town planning fees which have not increased since 2009,¹³ increases in the landfill levy,¹⁴ and the defined benefit superannuation shortfall.¹⁵ In addition, materials and services costs have increased at significantly higher rates than the CPI — for example, the

¹³ The implications being less of the costs are met by the applicants and with ratepayers subsidising them through higher rates and charges.

¹⁴ The State Government's landfill levy has increased from \$30/tonne in 2010-11 to \$58.50/tonne in 2014-15 for metropolitan municipal waste and from \$15/tonne to \$29.30/tonne for rural municipal waste. Some councils have noted that landfill is a significant proportion of increases in rates and charges.

¹⁵ According to MAV, by 1 July 2013, councils were required to pay a \$396.9 million shortfall to the closed Local Authorities Superannuation Fund Defined Benefit Plan following an actuarial review by the scheme's trustee Vision Super.

Construction Price Index. Councils argue that revenue from rates and charges are usually essential to balance their revenue requirements.

Third, councils noted it would be difficult to plan and budget when the cap is only set for a year and suggest that for council planning purposes, multi-year forecasts of the cap should be adopted.

Our initial response:

We will examine the merits of using an alternative index. The LGCIs separately developed for Victoria (by MAV), NSW and South Australia appear to be between 0.5 to 1.0 percentage point higher than the CPI, on average, over the last five years.¹⁶ We will examine whether these or alternative indices are more reflective of the underlying cost drivers in the Victorian local government sector and we will assess the relative merits of using an index other than CPI. Should our analysis show that it would be beneficial to do so, we will include refinements to the cap that better meet the Government's objectives, as required under the terms of reference (TOR 3).

We will also examine the merits of:

- not being confined to a single cap
- adopting a simpler arrangement during the 2016-17 transition year,
- adopting multi-year forecasts of the cap to better assist council planning.

3. Quality and level of service will deteriorate and infrastructure will run down if rates and charges are capped at CPI

Concerns have been raised about the consequential impact on services if rates and charges are capped. Some councils also cited the Victorian rates reduction and subsequent freeze¹⁷ in the 1990s and NSW's experience with rate pegging

¹⁶ LGCIs developed by the MAV, the Independent Pricing and Regulatory Tribunal (IPART) and the South Australian Centre for Economic Studies for Victoria, New South Wales and South Australia respectively.

¹⁷ This took place as part of a broader reform under different circumstances.

which reportedly resulted in councils deferring capital expenditure on road maintenance and renewal.

Our initial response:

The terms of reference require us, in designing the rates capping and variation framework, to take into account factors that may impact on local governments' short and longer term financial outlook including any particular services and infrastructure needs (TOR 4(a)). We must also take into account the need for any ongoing monitoring to ensure any deterioration in the level and quality of services and infrastructure is identified and addressed promptly (TOR 5).

4. Rates capping may create perverse incentives

Most stakeholders to whom we have spoken have commented that the framework needs to be designed carefully to ensure it reduces any unintended consequences for communities.

Our initial response:

We recognise the limitations of simply imposing an external constraint without having regard to the constantly changing circumstances of councils. We will carefully design a rates capping and variation framework that maximises the incentives for councils to pursue ongoing efficiency and respond to community needs. At the same time, we expect councils will examine their own decision-making and management systems to ensure they support the long term interests of their communities and avoid any unintended consequences under the framework.

Reporting on best practice engagement with communities and their satisfaction levels in regard to service delivery will be another important part of the framework.

5. There are lessons from NSW's rate pegging

We have heard numerous claims that rate pegging in NSW has caused infrastructure backlogs, particularly in circumstances where it was necessary to spend above the rate peg to address those backlogs. According to this view, rate pegging has created a situation where councils are reluctant to apply for a special rate variation, even when necessary, because of political risks.

We have also been advised that some NSW councils have accepted rate pegging and treated it as a useful discipline to operate efficiently and strengthened their systems to make better financial and operating decisions. Other councils have appeared to shy away from applying for special rate variations. Some stakeholders noted that this could be due to a lack of resources and capacity while others indicated it could have been politically motivated. Whatever the reason, it is argued this may have led to service deterioration and a failure to invest in maintaining and creating critical infrastructure.

A few NSW councils commented to us that IPART's application process for special rates variation could be better aligned with council budget setting.

Our initial response:

We will heed these observations and will develop a tailored rates capping and variation framework for Victoria. We will design a framework that seeks to minimise the perverse incentives for councils to run down their critical and productive infrastructure. We are concerned by suggestions that some councils could choose not to apply for a rate variation in order to avoid scrutiny, even if this results in service deterioration and under-investment in critical infrastructure. We will therefore consider building appropriate safeguards into the Victorian local government rates capping and variation framework.

Ultimately, the outcome of rate capping depends on how councils respond to it.

6. An additional layer added to the council budgetary and planning cycle

Stakeholders have suggested that under the current council budgetary cycle there will not be enough time for councils to engage with ratepayers if the Commission requires additional engagement with ratepayers for a rates variation. Concerns have also been raised about whether the Commission will have sufficient time and resources to assess the rates variation applications each year.

Our initial response:

We expect councils to work closely with us to identify the best way in which the new requirements could be integrated into existing arrangements or how existing arrangements could be modified to support the new rates capping and variation framework.

Where benefits outweigh costs, we will recommend changes to the legislation and regulations to accommodate any new timelines for council and Commission processes. At the same time, we will seek to use existing information systems and planning processes to minimise any new requirements on councils for information and process.

7. Ratepayers are concerned with historically high rates and wasteful or unnecessary spending by some councils

A number of ratepayers complained that their rates and charges have been increasing significantly over recent years. A number of ratepayers also argued that capital programs are not prioritised. Their view is that their councils are overspending on non-urgent capital works that could have been delayed. Some ratepayers are even calling for an immediate implementation of a rates cap in 2015-16.

Our initial response:

A well-designed cap and variation process will work as a useful and independent discipline on councils to prioritise and efficiently deliver services, contain rate increases and demonstrate their disciplined approach to ratepayers.

8 VAGO delivered a critical assessment of 12 councils' rating practices

In 2013, VAGO reported, among other conclusions, that there is limited assurance that councils:

- systematically and rigorously consider the information and evidence needed to adequately understand the impact of their rating proposals on their communities,
- consistently calculate, and transparently report, key rates and charges data in a manner that allows scrutiny of decisions, and comparability between councils.

Our initial response:

We will carefully examine these deficiencies and consider how a new rates capping and variation framework may address these issues. In particular, we will issue guidelines and fact sheets to promote greater transparency and consistency for councils to set and report on rates.

CONCLUSION

The Commission recognises the importance of the above issues and will continue to work with key stakeholders to address them and any other major issues emerging from future consultations. In chapter 4, we further articulate our approach and set out principles that will guide us in designing an effective rates capping and variation framework.

4 WHAT IS OUR APPROACH?

Our approach to designing a rates capping and variation framework must align with the Government's objectives.

The terms of reference set out a number of objectives for the framework, including to:

- Contain the cost of living in Victoria while supporting council autonomy and ensuring greater accountability and transparency in local government budgeting and service delivery.
- Promote rates and charges that are efficient, stable and reflective of services that the community needs and demands.
- Promote rates and charges that are set at a level that ensures the sustainability of the councils' financial capacity and council infrastructure.

In applying these objectives, we have developed a set of principles to guide us and the sector in the design and implementation of a workable and effective rates capping and variation framework.

PRINCIPLE 1

Local communities differ in their needs, priorities and resources

- The framework should support individual council diversity and support their ability to deliver different types and levels of services, with limited resources, in response to their community's preferences.
- The framework should take into account distinguishing features such as population growth, any particular service or infrastructure needs, and the sources of income available to councils.

- Councils should be able to show that they have engaged with and considered their community's and ratepayer's views on different rate levels and service priorities.
- The framework should be flexible to respond effectively to any major changes affecting councils and their communities.

PRINCIPLE 2

Local communities and ratepayers are entitled to hold their councils to the highest standards of accountability and transparency when setting rates

- The rates capping regime (together with the variation process) recognises that ratepayers' expectations should be central to councils' consideration of any proposed rate increases.
- Because individual ratepayers often have little 'bargaining power' in councils' rate-setting processes, the framework should provide ratepayers with confidence that proposed variations above the cap are being independently assessed by the Commission.
- We will consider how we can rely on DELWP's LGPRF to so that communities and ratepayers can clearly observe the link between rates and service levels and critical infrastructure investment.

PRINCIPLE 3

The framework should support the autonomy¹⁸ of councils to make decisions in the long term interests of their community and ratepayers

- The autonomy exercised by councils should align with the effective and efficient use of ratepayer funds.
- A cap arrangement recognises that communities and their councils have limited resources and that councils must be disciplined in how they prioritise their activities and pursue efficiently delivered services.

¹⁸ Within a legislative framework.

- Councils, in consultation with their communities, remain best placed to make decisions regarding the mix of services they provide and the service standards they deliver.
- We are not seeking to interfere with councils' consultations with their communities on decision-making regarding priorities, resource allocation and service delivery.

PRINCIPLE 4

Councils will need to satisfy the burden of proof outlined in the framework when seeking a variation above the cap

- When a fully demonstrated case is made by a council and the Commission is satisfied that it meets the framework's requirements, the council should be allowed to increase rates higher than the cap.
- We will, through this review, develop working definitions and criteria to be applied for the exceptional circumstances specified by the Government in our terms of reference.
- We will also publish guidelines and fact sheets on the key requirements of the regime to assist councils in the process.
- Any requirements under the new framework should be proportionate to the expected benefits from its implementation. In designing the rules, we will aim to minimise the burden on councils necessary to comply with the new regime and consider whether any new requirements should be phased in.
- The case for any above cap increases should be justified on the grounds of:
 - more or improved services that the community wants and for which it is willing to pay and/or
 - the closing of any critical infrastructure gap.

PRINCIPLE 5

Rate increases should be considered only after all other viable options have been explored

- The framework should promote the right incentives (and minimise any perverse incentives) for investment in service delivery, maintenance of infrastructure and the pursuit of ongoing efficiencies. The framework should discourage expedient decisions contrary to communities' and ratepayers' long term interests.
- The framework should require councils to demonstrate that they have assessed (and where relevant, consulted on) options other than rate increases. Depending on the circumstances, these other options may include (but are not limited to): cost savings in existing functions; alternative models of service delivery; reprioritisation of expenditures; or alternative funding measures (including fee for service). Any relevant council policies on these matters should be transparent and tested with local communities.

PRINCIPLE 6

The framework should support best practice planning, management systems and information sharing to uphold council decision making

- Relevant information should be provided to ratepayers by councils in an accessible and timely manner to allow discussions and engagement with ratepayers on rate increases, services impacts and financial sustainability.
- The engagement with the community by councils should be an integral part of the councils' annual and long term planning, budgetary and rates setting process. Evidence of effective engagement should form part of the case for seeking rate variations.
- We will provide clear guidance to councils on best practice processes and information for councils to engage meaningfully with their community by drawing on the work and progress already made in these areas by the sector's peak industry bodies (MAV, Victorian Local Governance Association (VLGA), Local Government Professionals (LGPro)), councils and VAGO.

PRINCIPLE 7

The framework should be flexible and adaptable

- We expect the framework will need amendment from time-to-time as councils, communities and the Commission identify opportunities for improvement.
- In light of the available timeframes, it may be necessary to consider a 12-month transition period over which the framework is implemented.
- As councils, communities and the Commission become more familiar with the framework, we expect councils may seek multi-year rate variations (say, for 3-5 years).
- We expect to review the effectiveness and design of the framework within 3 years of its commencement.

PRINCIPLE 8

There should be few surprises for ratepayers and councils in the implementation of the framework

- Roles, responsibilities, information requirements and expectations of councils should be clearly spelled out.
- Councils will need to consult with ratepayers and show the likely impacts on individual rates arising from proposed rate increases.

A well designed framework should deliver positive outcomes for councils and ratepayers (see figure 4.1).

FIGURE 4.1 SUMMARY OF OUR APPROACH



5 WHAT ARE THE RELEVANT QUESTIONS FOR THE REVIEW?

This chapter outlines the relevant questions that will assist this stage of our work in developing the rates capping and variation framework. We are seeking a range of views on these questions that reflect the diversity of the sector.

Figure 5.1 illustrates the major matters that the review should provide advice on.

FIGURE 5.1 MATTERS WE NEED TO PROVIDE ADVICE ON

Cap	Variation
<ul style="list-style-type: none">• Evidence on the magnitude and impact on ratepayers of successive above-CPI rate increases• Application of the cap<ul style="list-style-type: none">– rates, municipal charges, service rates/charges, special rates/charges– treatment of supplementary rates and charges• Any refinements to the cap that could better meet the Government's objectives<ul style="list-style-type: none">– a more cost reflective cap?• Other issues<ul style="list-style-type: none">– cap on revenue or per assessment– initial base year– based on historical movements or forecasts– a single cap only?	<ul style="list-style-type: none">• What are legitimate factors for a variation?<ul style="list-style-type: none">– population growth– decreases in government grants– increased statutory responsibilities– extraordinary circumstances– decreases in other sources of income– other (e.g. community need)• Workable processes and timelines for variation:<ul style="list-style-type: none">– any technical and information requirements– guidance to give effect to the framework and to improve accountability and transparency– benchmarking– any transitional arrangements– assessing the effectiveness of the regime• Any complementary monitoring of service and financial performance?• Cost recovery

THE 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?
- 2.** What are some ways to refine the cap (for example, alternative indices), in line with the Government's objectives?
- 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?
- 4.** Should the cap be based on historical movements or forecasts of CPI?
- 5.** Should a single cap apply equally to all councils?

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?
- 7.** Should the cap apply to total revenue arising from these categories or on average rates and charges per assessment?
- 8.** How should we treat supplementary rates? How do they vary from council to council?
- 9.** What are the challenges arising from the re-valuation of properties every 2 years?
- 10.** What should the base year be?

THE VARIATION PROCESS

- 11.** How should the variation process work?
- 12.** Under what circumstances should councils be able to seek a variation?
- 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,

increased responsibilities, and unexpected incidents such as natural disasters), are there any other circumstances that would justify a case for above cap increases?

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
- 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.

COMMUNITY ENGAGEMENT

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

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?

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.

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?

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?

OTHER MATTERS

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

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

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.

6 WHAT ARE OUR NEXT STEPS?

The next step for the review will be to receive and consider submissions in response to this consultation paper, due on 15 May 2015.

We will engage with the peak industry organisations, such as MAV, VLGA, LGPro (and its Chief Executive Officer group, Financial Professionals group and, Corporate Planners group), unions and ratepayers to receive feedback. We will also regularly consult with the sector consultative panel established by the Minister. We will undertake detailed analysis of the key issues, including those emerging from feedback and submissions. We will also consider options and test them with the sector prior to presenting a preferred option in the draft report.

The draft report will set out our preliminary recommendations on a rates capping and variation framework. It will be released in July and be followed with more consultation, including a number of public meetings to be held in metropolitan Melbourne and regional Victoria. More details on the release of the draft report and public meetings will be published on our website closer to the planned milestones. By 31 October, we will submit the final report to the Minister for Local Government and the Minister for Finance.

The review timelines and milestones are summarised in table 6.1.

TABLE 6.1 REVIEW PROCESS

Activity	Timing
Publication of notice of review	February 2015
Initial consultations	February – March 2015
Consultation paper release	April 2015
First meeting with the sector consultative panel	April/May 2015
Submissions to consultation paper close	15 May 2015
Consultations	April – June 2015
Second meeting with the sector consultative panel	June 2015
Draft report release	July 2015
Consultations and public meetings	July-August 2015
Submissions to draft report close	August 2015
Third meeting with the sector consultative panel	August 2015
Final report to the Ministers	October 2015
Final report public release	November 2015

HOW TO MAKE A SUBMISSION

We invite your feedback and views on matters raised in this consultation paper. You may also wish to provide comment on other issues which we have not covered, but which you believe are relevant to our review and terms of reference.

Interested parties are invited to comment on this paper by sending a written submission. Submissions are due by 15 May 2015. Where relevant, submissions should contain supporting evidence for any claims made.

To promote an open and transparent review process, our normal practice is to make all submissions publicly available on our website. If there is information that you do not wish to be disclosed publicly on the basis that it is confidential or commercially sensitive, this specific information should be clearly identified in the submission.

Any questions about this consultation paper can be directed to Angelina Garces on (03) 9032 1300. Submissions should be emailed to: localgovernment@esc.vic.gov.au

You can also send comments by fax to 03 9032 1303 or by mail marked:

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

APPENDIX A — TERMS OF REFERENCE

Local Government Rates Capping Framework

Terms of Reference

I, Robin Scott MP, Minister for Finance, under section 41 of the *Essential Services Commission Act 2001* (the 'ESC Act'), refer to the Essential Services Commission (ESC) the development of a rates capping framework for local government.

As provided for by section 185b of the *Local Government Act 1989*, the Minister for Local Government can cap council general income. The Government has announced a commitment to cap annual council rate increases¹ and has also provided additional guidance on factors to be considered during the implementation of the cap².

The State Government's objective is to contain the cost of living in Victoria while supporting council autonomy and ensuring greater accountability and transparency in local government budgeting and service delivery. The Government intends to promote rates and charges that are efficient, stable and reflective of services that the community needs and demands, and set at a level that ensures the sustainability of the councils' financial capacity and council infrastructure, thereby promoting the best outcomes for all Victorians.

The ESC is asked to inquire into and advise the Ministers for Finance and Local Government on options and a recommended approach for a rates capping framework for implementation from the 2016-17 financial year. Advice should include and/or take into account the following matters:

- 1) Available evidence on the magnitude and impact of successive above-CPI rate increases by Victorian councils on ratepayers.
- 2) Implementation of the Government's commitment to cap annual council rate increases at the Consumer Price Index (CPI) with councils to justify any proposed increases beyond the cap, including advice on the base to which the cap should apply (e.g. whether to rates or to general income).
- 3) Any refinements to the nature and application of the cap that could better meet the Government's objectives.
- 4) Options for the rate capping framework should be simple to understand and administer, and be tailored to the needs of the highly diverse local government sector. The framework should take into account factors that may impact on local governments' short and longer term financial outlook, such as:
 - a) actual and projected population growth and any particular service and infrastructure needs;
 - b) any relevant Commonwealth Government cuts to Local Government grants;
 - c) any additional taxes, levies or increased statutory responsibilities of local governments as required by the State or Commonwealth Governments;

¹ Media release by Daniel Andrews, *Andrew Announces Fair Go for Ratepayers*, 5 May 2014.

² ALP's response to MAV's *Local Government Call to Political Parties*, p.1, November 2014.

- d) any extraordinary circumstances (such as natural disasters); and
 - e) other sources of income available to councils (for example, ability to raise user fees and charges from non-residents).
- 5) Consider how local governments should continue to manage their overall finances on a sustainable basis, including any additional ongoing monitoring of council service and financial performance to ensure that any deterioration in the level, quality or sustainability of services and infrastructure and councils' financial position is identified and addressed promptly.
 - 6) The processes and guidance to best give effect to the recommended approach for the rates capping framework and a practical timetable for implementation, including:
 - a) the role of councils, the ESC and the Victorian Government and the expected time taken by local governments and by the Victorian Government or its agencies, for each step in the rate capping process;
 - b) any technical requirements including the information requirements on councils that request exemptions from the cap;
 - c) any guidance required to give effect to the rate capping options (including in relation to consultation with ratepayers) and to improve accountability and transparency; and
 - d) any benchmarking or assessment of the effectiveness of the regime, including options to continuously refine the regime and improve council incentives for efficiency.
 - 7) Options for ongoing funding to administer the rate capping framework, including the potential for cost recovery.

In conducting the inquiry and providing its advice, the ESC will have regard to:

- the role of local government in the provision of infrastructure and services to the community and the general efficacy with which they currently perform this task;
- the differences between rural, regional and metropolitan local councils in terms of costs, revenue sources and assets maintained;
- the Revenue and Rating Strategy guide and Local Government Performance Reporting Framework to be administered by the Department of Environment, Land, Water and Planning;
- matters regarding rating practices and asset renewal gap raised by the Victorian Auditor-General's Office (VAGO);
- Department of Treasury and Finance's Victorian Guide to Regulation and Victorian Cost Recovery Guidelines; and

- any relevant insights from the experience of rate pegging in New South Wales, including any reviews or evaluations that can suggest ways to minimise any unintended consequences.

In conducting this independent inquiry, the ESC will be informed by wide consultation. This will include, but is not limited to: councillors and officials from local government; representative bodies such as Municipal Association of Victoria, Victorian Local Government Association and LGPro; unions; VAGO; and relevant government agencies and departments. In addition, the ESC will consult regularly throughout the course of the inquiry with a sector consultative panel established by the Minister for Local Government. The ESC's consultation will be guided by its Charter of Consultation and Regulatory Practice.

The ESC will publish a draft report on the rates capping framework no later than six months after receipt of these terms of reference. The draft report must be made publicly available and invite comments from local governments and other interested parties. A final framework report along with draft guidance material will be provided to the Minister for Finance and Minister for Local Government no later than 31 October 2015.

ROBIN SCOTT
Minister for Finance
Dated: 19 January 2015

APPENDIX B — KEY FEATURES OF THE LOCAL GOVERNMENT SECTOR

Victoria's 79 local government councils deliver and maintain a diverse set of services and infrastructure assets to an estimated population of 5.8 million people.¹⁹ Thirty three cities, 39 shires, six rural cities and one borough make up these 79 councils. Populations range from 3100 (Borough of Queenscliffe) to 280 000 (Casey City Council) and land area ranges from 20 (Yarra City Council) to 22 000 square kilometres (Mildura Rural City Council) (see figures B.1 and B.2). They are very diverse structurally with most rural councils having bigger road networks than metropolitan councils. These differences contribute to differing challenges for councils across Victoria.

¹⁹ DELWP, Victoria in Future 2014, <http://www.dtpli.vic.gov.au/data-and-research/population/census-2011/victoria-in-future-2014?remap=dtpli.vic.gov.au/victoria-in-future-2014>, Accessed on 5 March 2015.

FIGURE B.1 LOCAL GOVERNMENT MAP OF VICTORIA



Source: http://en.wikipedia.org/wiki/Local_government_in_Victoria

FIGURE B.2 LOCAL COUNCILS IN MELBOURNE



Source: http://en.wikipedia.org/wiki/Local_government_in_Victoria

The *Victorian Constitution Act 1975* recognises local government as ‘a distinct and essential tier of government’ consisting of democratically elected councils.²⁰ Local government is made up of democratically elected members and council staff, and the Victorian councils’ governance and operations are governed by the *Local Government Act 1989* (the Act). A council’s primary objective is to endeavour to achieve the best outcomes for the local community having regard to the long term and cumulative effects of decisions (box B.1).

²⁰ Councils have the functions and powers that Parliament considers are necessary to ensure the peace, order and good government of each municipal district (section 74A(1) of the *Constitution Act 1975*).

BOX B.1 OBJECTIVES OF A COUNCIL

- (1) The primary objective of a Council is to endeavour to achieve the best outcomes for the local community having regard to the long term and cumulative effects of decisions.
- (2) In seeking to achieve its primary objective, a Council must have regard to the following facilitating objectives—
 - (a) to promote the social, economic and environmental viability and sustainability of the municipal district;
 - (b) to ensure that resources are used efficiently and effectively and services are provided in accordance with the Best Value Principles to best meet the needs of the local community;
 - (c) to improve the overall quality of life of people in the local community;
 - (d) to promote appropriate business and employment opportunities;
 - (e) to ensure that services and facilities provided by the Council are accessible and equitable;
 - (f) to ensure the equitable imposition of rates and charges;
 - (g) to ensure transparency and accountability in Council decision making.

Source: *Local Government Act 1989*, pp 20-21.

To ensure councils are accountable to their local communities in the performance of their functions they are required to prepare key statutory planning and reporting documents and to consult with the community on them. These reports include:

- **Council plan** — sets out the medium-term strategic objectives, strategies, strategic indicators and resources reflecting the vision and aspirations of the community for the next four years.
- **Strategic resource plan** — sets out the financial and non-financial resources for the next 4 years to achieve strategic objectives (including rating strategies).

- **Annual budget** — sets out the services and initiatives to be funded for the financial year and how they will contribute to achieving the strategic objectives specified in the council plan.
- **Annual report** — contains report of operations, performance and financial statements (including rating outcomes).

Councils are also subject to independent scrutiny in relation to their performance. The Victorian Auditor General's Office (VAGO) undertakes periodic local government audits and reports its findings to the Victorian Parliament.

The Local Government Victoria (LGV) oversees the administration of the Act and provides policy advice to the Minister for Local Government. It is under the Department of Environment, Land, Water and Planning (DELWP).

B.1 COUNCIL SERVICES

Victorian councils provide 50 to 120 different services to their communities. Most services provided by councils are required under programs, policies and regulations set by the State and Federal Governments and councils' respective local laws. Services are also determined by community needs and expectations and councils' capacity to deliver. These services include:

- environment services such as greenhouse gas mitigation, and natural resource and coastal management
- health services such as public health and food regulations
- emergency management services such as response and recovery
- transport and infrastructure services such as roads, footpaths and cycle paths
- planning and building services such as land use planning, economic development and environmental conservation

- social and community services such as disability support, early childhood services, housing and public libraries.²¹

While there is commonality across the types of services delivered by local government in Victoria, each municipality is distinct. As such, there is diversity in service delivery across the state reflecting the different composition and priorities of communities. This creates a level of complexity that requires councils to make choices about prioritisation of resources to balance the demands of a range of stakeholder groups. The types, levels, and quality of services councils provide vary depending on the geography of the region they serve, the demographic profile of the community, individual council's financial circumstances, inherited assets and policy decisions. Councils also employ different service delivery models such as service provision being council owned and operated or outsourced.

DELWP has developed a Local Government Performance Reporting Framework (LGPRF) with the first council reporting starting on the 2014-15 financial year.

Victorian councils also maintain community infrastructure and assets worth \$73 billion which includes buildings, parks and gardens, roads, bridges, council land and drainage networks—which support the delivery of a wide range of important council services.

Councils enforce a number of local laws and policies which operate to protect the amenity of their communities and promote safety. These rules and policies range from addressing practical safety issues to more aesthetic considerations. Councils also undertake advocacy and representation on behalf of their communities.

B.2 COUNCIL FINANCES

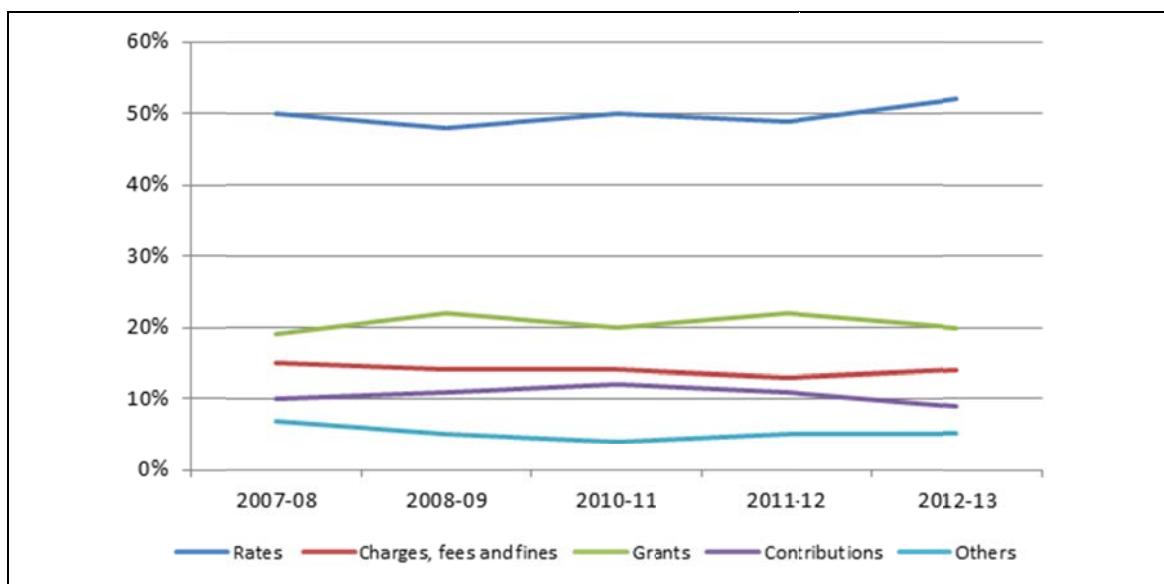
Councils collect revenue from a number of sources. Councils' operating revenue has increased by \$1.16 billion or 16 per cent over the last five years (from \$7.08 billion in 2009-10 to \$8.24 billion in 2013-14). In comparison, councils' operating expenditure

²¹ Municipal Association of Victoria, <http://www.mav.asn.au/about-local-government/local-government-services/Pages/Local-government-services.aspx>, Accessed on 1 November 2014.

increased by \$1.29 billion or 21 per cent over the same period (from \$6.01 billion in 2009-10 to \$7.30 billion in 2013-14).²²

Councils face a complex array of financing arrangements. Across Victoria, about 56 per cent of councils' revenue was sourced from rates and charges in 2013-14.²³ The second biggest source of revenue is Federal and State Government grants followed by: statutory fees, charges and fines; contributions and other sources such as bank interest, asset sales, and earnings from rental properties. The percentage share of each source has been stable over the past few years as shown in figure B.3. Although, in the last two years, increases in rates and charges revenue appears to have made up for decreases in grant revenue.

**FIGURE B.3 SOURCES OF REVENUE – ALL COUNCILS
2007-08 to 2013-14**



Source: Data sourced from VAGO's local government audit reports.

²² Municipal Association of Victoria, <http://www.mav.asn.au/about-local-government/local-government-services/Pages/Local-government-services.aspx>, Accessed on 1 November 2014.

²³ Victorian Auditor-General's Office 2014, *Local Government Results of the 2013-14 Audits*, p.17.

The revenue mix for each council is different. Rural councils with smaller populations and significant road networks generally rely more on grants than rates and charges, while some inner Melbourne and outer fringe councils receive larger amounts in other revenues such as car parking and developer contributions.

Councils prepare their annual budgets by considering community needs in relation to their likely available income from other sources of income other than rates and charges. Rates and charges will then be used to finance the balance. Councils also consider the extent of the rate burden on ratepayers and may decide to forgo some activities and services in order to avoid high rate rises.²⁴

For the period 2006 to 2013, average Victorian council rates and charges per assessment increased by an average of 6.01 per cent per year compared with 4.06 per cent average annual increase in the local government cost index (LGCI) estimated by the Municipal Association of Victoria (MAV) and 2.65 per cent annual increase in Melbourne's Consumer Price Index (CPI).

Over a number of years, ratepayers in various forums have expressed concerns about the increasing rates and charges and questioned councils' spending. In 2013, VAGO audited 12 councils and identified a number of weaknesses in councils' rating practices.²⁵ There are inconsistencies in rating practices as well as the soundness and quality of rating decisions and there is little assurance that councils systematically consider the information needed to adequately understand the impact of rating proposals.²⁶ However, these issues have been contributed to by unclear and undetailed guidelines.

Some councils appear to be experiencing cost pressures associated with cost shifting. Cost shifting occurs when Federal or State governments shift service or program delivery responsibility to councils without providing sufficient funding or withdrawing

²⁴ DEWLP, <http://www.dtpli.vic.gov.au/local-government/guide-to-how-councils-work/planning-and-finance/council-rates-and-charges>. Accessed on 26 February 2015.

²⁵ VAGO has also released other reports on local government recently highlighting deficiencies in council asset management and planning (in *Asset Management and Maintenance by Councils*, February 2012) as well as issues with the governance of councils by the MAV and LGV (in *Effectiveness of Support for Local Government*, February 2015).

²⁶ Victorian Auditor –General's Office 2013, *Rating Practices in Local Government*, page vii.

funding for implementation. Councils may then make the decision to keep providing these services using rates to cover funding shortfalls.

Furthermore, in its 2014-15 budget the Federal Government announced that the indexation applied to the Financial Assistance Grant programme would be paused for three years (2014-15 to 2016-17). The Victoria Grants Commission, the independent statutory body who allocates these grants to local government, has adopted a variable capping arrangement in order to minimise the impact on the councils who most rely on financial assistance grants. However, this freeze on indexation has an impact on all councils across Victoria.

APPENDIX C — COUNCIL GROUPINGS

Metropolitan	Interface	Regional centres	Large rural	Small rural
Banyule	Cardinia	Ballarat	Colac Otway	Bennalla
Bayside	Casey	Greater Geelong	Corangamite	Gannawarra
Boroondara	Hume	Warrnambool	Golden Plains	Hepburn
Brimbank	Mornington	Greater Bendigo	Moira	Mansfield
Darebin	Nillumbik	Greater Shepparton	Moorabool	Murrindindi
Frankston	Whittlesea	Latrobe	Mount Alexander	Strathbogie
Glen Eira	Melton	Mildura	Bass Coast	Alpine
Greater Dandenong	Wyndham	Wodonga	Baw Baw	Ararat
Hobsons Bay	Yarra Ranges		Campaspe	Buloke
Kingston			East Gippsland	Central Goldfields
Knox			Glenelg	Hindmarsh
Manningham			Horsham	Indigo
Maribyrnong			Macedon Ranges	Loddon
Maroondah			Mitchell	Northern Grampians
Melbourne			Moyne	Pyrenees
Monash			South Gippsland	Queenscliffe
Moonee Valley			Southern Grampians	Towong
Moreland			Surf Coast	West Wimmera
Port Phillip			Swan Hill	Yarriambiack
Stonnington			Wangaratta	
Whitehorse			Wellington	
Yarra				
22	9	8	21	19

