ESSENTIAL SERVICES COMMISSION

THE DRAFT LOCAL GOVERNMENT RATES CAPPING AND VARIATION FRAMEWORK

QUESTIONS AND ANSWERS - JULY 2015

What has the Commission been asked to do?

In January 2015, the State Government asked the Commission 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 rate increases above the cap. The specific requirements were contained in a Terms of Reference issued by the Minister for Finance and Minister for Local Government.

What will the new framework do?

The framework will promote a transparent and independently verifiable decision-making process in relation to the trade-offs involved in determining council rates.

The framework will be overseen by an independent authority (the ESC) for the benefit of the community and ratepayers who, individually, have limited capacity to engage with these decision-making processes.

In doing so, it seeks to give ratepayers and the broader community confidence that disciplined decision-making is being exercised by their individual councils, and by the sector as a whole.

What is a rates capping and variation framework?

The three elements of the proposed framework are:

1. **The rate cap** — the maximum annual rate of increase that councils can apply to their rates revenue.
2. **The variation process** — a mechanism for councils to apply for increases in rates above the rate cap.
3. **Monitoring and reporting** — a means for verifying and reporting on compliance with the cap or variation conditions and providing accurate and reliable information about overall outcomes for ratepayers and communities under the framework. Monitoring and reporting will also facilitate a process for identifying and addressing unusual or unexplained outcomes.

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THE RATE CAP

How will the rate cap be set?

We are proposing that the rate cap be based on a combination of three items:

- **Consumer Price Index (CPI)** — forecasts published each year by the Victorian Department of Treasury and Finance (DTF)
- **Wage Price Index (WPI)** — forecasts also published each year by DTF
- **An efficiency factor** — that recognises expected productivity gains.

Research suggests that labour costs represent around 40 per cent of the local government sector's overall costs.

The suggested formula for setting the cap is as follows:

Annual Rate Cap = (0.6 x increase in CPI)
+ (0.4 x increase in WPI)
- (efficiency factor)

The Commission is recommending that the efficiency factor be set at zero in the first year to allow for transition to the new framework, 0.05 in the second year, and 0.10 in the third year. The Commission will undertake a detailed productivity analysis of the sector to assess the appropriate long term rate for the efficiency factor.

Table 1 shows indicative forecasts for the annual rate cap (as at July 2015)

TABLE 1 INDICATIVE FORECASTS FOR THE ANNUAL RATE CAP (AS AT JULY 2015)
Per cent

	2016-17	2017-18	2018-19
Underlying CPI forecast (60 per cent weighting)	2.75	2.5	2.5
Plus WPI forecast (40 per cent weighting)	3.5	3.5	3.5
Less Efficiency factor	0	0.05	0.10
FORECAST ANNUAL RATE CAP	**3.05**	**2.85**	**2.80**

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When will the rate cap come into effect?

The rate cap and variation framework will be introduced for the 2016-17 rate year. Increases will be measured against rates in 2015-16.

What is being capped?

The Commission is proposing that the rate cap applies to general rates (levied against each property's valuation) and municipal charges (covering some of councils' administrative costs) only.

It does not include:

- service rates and charges — for services to properties such as waste management and water provision
- special rates and charges — paid by a particular group of property owners for services of special benefit to them
- revenue in lieu of rates — payments received on certain lands
- the fire service levy
- the landfill levy

The general rates and municipal charges to which the cap will apply represent about 88 per cent of the total rate revenue raised by councils in Victoria.

How will the rate cap affect ratepayers?

The cap is focussed on the 'average' or 'typical' ratepayer. Individual rates could still increase by more or less than the capped amount, whether or not a council applies for a variation to the cap.

The average rate is calculated by dividing a council's total rate revenue by the number of rateable properties in the area. This approach is straightforward and maintains council's ability to determine its rates mix within the broader framework.

The cap is the maximum amount the average rate can be increased. It is a matter for individual councils to decide whether to increase the rate by a lesser amount, or apply for a variation to increase rates by more than the cap.

THE VARIATION PROCESS

What does a council need to do to apply for a variation to the cap?

The draft framework does not specify the reasons for which a council may or may not apply for a variation. This will be determined by individual councils.

If a council proceeds to apply for a variation, it will need to address in its application:

- the reason a variation from the cap is required
- how the views of ratepayers' and communities' have been taken into account
- whether the variation represents good value-for-money and is an efficient response to the budgetary need
- service priorities and funding options have been considered
- the proposal is integrated into the council's long term strategy.

The approach we are proposing is not overly burdensome, but it does require councils to present a solid case, engage with communities and consider other options beforehand.

Can the Commission recommend or approve a different increase than the one sought by a council?

When the Commission determines that an application satisfactorily supports the need for the proposed variation, it would approve the variation.

In circumstances where a council's application does not adequately support the rate increase it is seeking, the Commission would only have the power to reject the application. If an application were rejected, the Council's rates would only increase by the rate cap.

Will the results of the Commission's decision on a variation application be public?

Yes — at the conclusion of the rates variation period, the Commission will issue a statement summarising the details of each variation application, its decisions and the basis for those decisions.

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MONITORING AND REPORTING

Why is monitoring important?

A well-designed monitoring and reporting regime can inform ratepayers' assessment of the value-for-money delivered by their councils, as well as how this might change over time.

What will the Commission monitor?

The Commission is proposing to monitor that:

- the relevant council rates and charges are set in accordance with the rate cap or an approved variation above the cap, for the corresponding financial year
- performance outcomes in relation to services, infrastructure and financial sustainability following the implementation of the rates capping framework.

What will the Commission report on?

We are proposing to publish a number of reports in relation to the operation of the framework. These include:

- reports on the annual rate cap, variation applications received and the outcomes of variation applications, including the rationale for the Commission's decision
- an annual rates report detailing council adherence with the rate cap or approved variations above the cap
- an annual monitoring report detailing the findings of the ongoing monitoring regime in relation to performance outcomes under the framework

Public reporting of these outcomes allows ratepayers to verify the linkages between the rates they pay and the outcomes they observe.

Will the framework be reviewed?

We are recommending that there be a formal review of the framework every four years drawing on information collected under the monitoring regime and this review should seek input from all interested parties.