

# Setting a local government efficiency factor

Compilation of stakeholder feedback with our draft responses

December 2017



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# Introduction

We received 21 written submissions on the consultation paper. We have provided our draft responses to key issues raised by stakeholders in this document. We engaged Predictive Analytics Group and Applied Econometrics to answer specific comments about the data envelopment analysis in the consultation paper. The reports are attached to the draft proposal.<sup>1</sup>

## Submissions and responses

### Australian Services Union

Issue raised	Commission' draft response
We would like to state from the outset that we do not support the inclusion of an efficiency factor in the rate cap. The ostensible purpose of the rate cap was to impose a fiscal discipline on Local Government, thereby forcing Councils to find efficiencies. What, then, is the purpose of adding an additional discipline to the cap?	Our rate cap formula is based on 60 per cent weighting of CPI and a 40 per cent weighting on WPI to reflect the short term cost pressures faced by councils. On this basis it is reasonable to include an efficiency factor to encourage councils to operate efficiently and share any efficiency gains with ratepayers.  Please refer to page 11 of the draft proposal.

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<sup>1</sup> Applied Econometrics 2017, *Measuring productivity in the local government sector: A reply to stakeholder comments concerning DEA*, October and Predictive Analytics Group 2017, *Local Government – Measuring Productivity using a Direct Method, Final Report – Summary*, November and Predictive Analytics Group 2017, *Local Government – Measuring Productivity Using a Direct Method, Comparison of Alternative Models, Final*, November and Predictive Analytics Group 2017, *Local government measuring productivity using a direct method a comparison of DEA and Bayesian SFA*, November. The reports can be found at <https://www.esc.vic.gov.au/document/local-government/54589-measuring-productivity-local-government-sector/>

## Australian Services Union (continued)

Issue raised	Commission' draft response
<p>We believe the faith placed in the use of data envelopment analytics and the choice of input/output measures contained in the discussion paper are highly problematic, as they do not reflect the highly variable character of those inputs and outputs across Councils. Using measures connected to households, business and length of roads does not provide a proxy for a large range of highly important Council services. A methodology based on the ESC's preference won't reflect how a Council delivers on those outputs. For example, length of road services doesn't seem to distinguish between a Council using a contractor or its own staff. Nor does it reflect the quality of the end product. There also appears to be a tendency to attribute all of a Council's inputs in delivering only a few outputs. This is problematic, as a large percentage of any Council's overall inputs do not get spent on delivering the outputs chosen in the discussion paper. A Council's entire budget is not spent on households, businesses or length of roads – it is also spent on maintaining public places like parks and playgrounds, keeping the community safe via school crossing supervision, offering recreational facilities like leisure services, providing public libraries and so on. None of these services, all of which are commonly identified as services typically provided by Local Government, are reflected in the ESC's preferred methodology. Even if they were found in the ESC methodology, there is no means of measuring their quality and/or community satisfaction.</p>	<p>We note concerns with the inputs and outputs used in the modelling. However, to compare councils consistently it is important to use inputs and outputs that are common to all councils. To help account for some of the differences between councils we also undertook multiple group analysis where councils are only compared against others in their group.</p> <p>The number of households, businesses and length of roads serviced act as proxies for the bundle of services delivered by councils. These services could include public places and school crossing supervisors.</p> <p>The additional modelling by Predictive Analytics Group shows no statistically significant difference between council efficiencies measured at an aggregated (total factor productivity level) or disaggregated (service) level.</p> <p>Predictive Analytics Group originally specified a model that takes into account labour directly employed by council and labour that is out sourced.</p> <p>Predictive Analytics Group undertook additional modelling that incorporated community satisfaction scores to act as a proxy for quality. They found that the results from this analysis were not significantly different from the original models.</p>

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## Australian Services Union (continued)

Issue raised	Commission' draft response
<p>We believe that productivity measurements as they pertain to Local Government, if they are ever going to work, can only work where individual services are assessed in their own right. Factors beyond a crude 'cost \$x amount but delivers x kms of new road' are insufficient in tracing the quality of the work performed and the social dividends quality services yield to the community.</p>	<p>We agree that efficiency could be measured at a service or activity level. The local government performance reporting framework (the framework) goes some way to achieving this.</p> <p>However, we intend that the efficiency factor is applied to the rate cap formula. As rates fund a broad range of council services we consider that an aggregate measure of efficiency is reasonable.</p> <p>Further, we found that while the framework is objective it is not really possible to understand overall council performance or efficiency. And not all individual unit cost measures can be readily incorporated into the rate cap formula without further work. As such we have not been able to calculate an efficiency factor at this stage using the framework.</p> <p>Our response to issues about the service level measures is on pages 13 to 14 of the draft proposal.</p>
<p>In our view, it is impossible for any meaningful single measure of productivity to be devised of any one Council, let alone one productivity measure for all of Victoria's disparate 79 Councils. A 'one size fits all' approach won't work because each Council offers its own service mix and adopts its own service delivery model. Some Councils will better fit the outputs measure in the ESC discussion paper; others simply will not.</p>	<p>We acknowledged in our consultation paper that there were differences between councils and council groups. That's why we also used multiple group analysis to calculate technical efficiencies. In this case councils are only compared councils in their council grouping. This helps to account for differences between groups.</p>

## Borough of Queenscliffe

Issue raised	Commission's draft response
<p>Each input considered in the various models included in this productivity survey has specific issues for our council.</p> <p>Council staff (\$/FTE) – with an FTE of only 43.4 yet the same legislative requirements as for all councils, Queenscliffe operates with an already lean administration team which is necessary regardless of the range of services provided.</p>	<p>We note councils concerns with the inputs used in the modelling. However, to compare councils consistently it is important to use inputs that are common to all councils. To help account for some of the differences between councils we could also undertake multiple group analysis where councils are only compared against others in their group.</p>
<p>Capital (\$) – this has the potential for large variation from one year to the next, with Queenscliffe currently holding funds for a range of capital works project carried forward, coupled with significant government grants council has secured for the 'destination Queenscliff' project to be progressed over the next 2-3 years</p>	<p>Predictive Analytics Group has undertaken additional modelling that includes changing some of the inputs used. They found no significant differences between the results from these models and the original models.</p>
<p>Operating expenses (\$) – a large portion of council's operating expenditures includes additional costs associated with increased service provision for a significant tourist population during the year, and expenditure incurred by council in maintaining and renewing its coastal crown land assets neither of which would be appropriately reflected in the proposed outputs as further detailed at point 2 below.</p>	<p>Further, the results of any future benchmarking could include case studies and commentary from councils which would help explain the factors affecting a particular council.</p> <p>We note council's comments on operating expenditure</p>
<p>Households – while general rates are levied by council on 3,074 rateable properties, Queenscliffe provides services to some of the properties located in Point Lonsdale that are ratepayers to the city of Greater Geelong. Council also enjoys significant tourism with the population increasing to 16,700 over the summer period requiring a much greater level of service provision during part of the year</p>	<p>As with inputs, it is equally important to choose outputs that are common to all councils.</p>

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## Borough of Queenscliffe (continued)

Issue raised	Commission's draft response
<p>Businesses – information on how the number of business will be measured is not evident in this survey and depending on the data source (physical count, rates data or registered ABN numbers) the results could be vastly different, particularly as Queenscliffe has a very small number of commercial ratepayers</p>	<p>Predictive Analytics Group has undertaken additional analysis that includes changing the outputs. So as that they are based on services delivered. They found no significant differences between the results from these models and the original models.</p> <p>Business numbers are drawn from the ABS.</p>
<p>Roads – based on length of roads (kms), this does not consider an assessment of the quality of Council's roads (asset condition) and its commitment to asset renewal.</p>	<p>Predictive Analytics Group undertook additional modelling that incorporated community satisfaction scores to act as a proxy for quality. They found that the results from this analysis were not significantly different from the original models.</p>
<p>It is not reasonable to compare the efficiency or productivity of a council with all other councils across the state in a one size fits all model given the significant differences. It would be more appropriate to consider the five council groupings used by VAGO.</p>	<p>We acknowledged in our consultation paper that there were differences between councils and council groups. That's why we also used multiple group analysis to calculate technical efficiencies. In this case councils are only compared councils in their council grouping. This helps to account for differences between groups.</p>
<p>The models included in this report do not consider unique features of each municipality. The Borough of Queenscliffe plays a significant role in maintaining, developing and protecting coast Crown and land assets in the municipality. It has the higher proportion of land management of any municipality.</p>	<p>Case studies could be developed in future to help explain (and compliment other analysis) some of the reasons for differences between councils and their efficiencies.</p>

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## Borough of Queenscliffe (continued)

Issue raised	Commission's draft response
<p>The conclusion drawn by Predictive Analytics Group that productivity in the Victorian local government sector has declined over the period 2010-11 to 2015-16 needs to be unpacked.</p> <p>The Borough of Queenscliffe's programs and services reflect a lean organisation , which continues to achieve sustainable operational efficiencies to reduce costs and minimise waste and duplication, (e.g. improving financial systems, EBA contained within rate cap, reducing costs by reprioritising some projects and identifying operational savings; shared staffing model; partnering for collaborative shared services funding; negotiating a reduced unit price for replacing existing streetlights with energy efficient LED; joint tender arrangements for the green waste service.</p> <p>Further, previous recommendations by the ESC to the Minister regarding the level of the rate cap to be applied (2.80% in 2016/17 and 2.15% in 2017/18) have not been successful, with the Minister applying a lower rate cap each year which is in effect an efficiency factor.</p> <p>In addition, local government continues to have an efficiency factor built into its operations through a continued cost shift of both services provided and reduced incomes from state and federal governments.</p>	<p>Productivity trends were measured for the sector as a whole (79 councils). Predictive Analytics Group found that the decreases in overall productivity are due to reductions in technological change. While most of the models show that technical efficiency change increased slightly, this is more than outweighed by falls in technological change.</p> <p>In other words, historically councils have improved their efficiency using existing technology (moving closer to the frontier) but their efficiency from utilising new technology declined by a greater amount (a decrease in technological change means the whole frontier has contracted). This results in a decline in overall performance. However, it is important to note that this analysis does not take into account the effects of rate capping.</p> <p>The analysis was done at a whole of sector level because an aggregate measure of total factor productivity change was needed to include in the efficiency factor formula.</p> <p>This analysis could potentially be done at a council level. And councils could see how their productivity levels were trending over time.</p> <p>The analysis of productivity trends ends in 2015-16 – the last year of available data. It does not include the effects of rate capping.</p> <p>Our response to issues about the Minister's cap and cost shifting are on pages 11 and 12 of the draft proposal.</p>
<p>Council appreciates the opportunity to provide feedback to this productivity survey, it is disappointing that a limited consultation period of only 30 calendar days was available in which to consider the productivity survey and make a submission, particularly as part of this timeframe was in the same period during which council have key statutory requirements to meet with respect to the annual financial statements and annual report</p>	<p>We note councils' concerns. We propose to give stakeholders 2 months to respond to this draft proposal and next steps.</p>

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## Borough of Queenscliffe (continued)

Issue raised	Commission's draft response
<p>A fundamental element of consultation is transparency. Council officers requested that we be advised which small rural councils shown in data envelopment analysis (VRS) technical efficiencies for Model 1 chart at page 13 of the productivity survey represents the Borough of Queenscliffe, however this requested was denied, with the advice that the working group would be convened in a couple of weeks to discuss this particular item. This undermines the consultation and does not provide the transparency we seek in being able to provide a complete response by submission to productivity survey.</p>	<p>Our response to this issue is on page 23 of the draft proposal.</p>
<p>Clarification is required with respect to the timing of this productivity study and the outcomes in terms of determining an efficiency factor and including this in the rate cap. The survey indicates that the ESC will release a draft by December 2017 with the final report on the recommended approach to setting the efficiency factor for comment by February 2018.</p>	<p>We will adhere to our normal announcement date will for the rate cap this year. The final proposal on the efficiency factor will feed into our advice for next year's rate cap.</p>
<p>Council recognises that the efficient and effective use of public monies is important and is more than willing to participate in further discussion on this matter. Council does not support the use of an efficiency factor on the assumptions included in this productivity survey. Council urges the ESC to consider undertaking further consultation with the sector over a more reasonable timeframe which involves the consideration of a broad cross-section of councils with different geographic, economic and demographic features.</p>	<p>We began this process in January this year when we asked all councils and peak bodies for nominations to join the working group. All of those who nominated were accepted on the group. This represented a diverse group of councils.</p> <p>We will reconvene the working group when required in future. However, before doing so we will go out to the sector and ask if any other councils are interested in being represented.</p>

Issue raised	Commission's draft response
<p>The premise that a productivity figure reducing the allowable rate cap for local government as an incentive to be more efficient may be seen as disingenuous in light of the introduction of rate capping two years ago. The state government's claims were that local government increased rates by nearly 6% per annum on average over a 10 year period to 2014-15. While in the last two years local government has been limited to CPI increases of around 2.0%. Logically the rate cap in itself is more than sufficient incentive for productivity increases, and a further small productivity percentage removed from the rate cap makes no difference to the level of incentive.</p> <p>Recommendation That the ESC removes reference to any productivity measure until the impact of the rate cap on local government services has been assessed.</p>	<p>Our rate cap formula is based on 60 per cent weighting of CPI and a 40 per cent weighting on WPI to reflect the short term cost pressures faced by councils. On this basis it is reasonable to include an efficiency factor to encourage councils to operate efficiently and share any efficiency gains with ratepayers.</p> <p>We agree that at this point in time the effects of rate capping on council productivity and efficiency are still unknown. This is why for the first year of the rate capping regime (2016-17) we did not include an efficiency factor in our average rate cap advice to the minister. And our consultation paper only proposed modest (small) efficiency factors regardless of the approach chosen to set the factor.</p> <p>We expect to continue to monitor the effects of rate capping to better understand how council productivity and efficiency are affected. And then use the results of this analysis to help inform future efficiency factor.</p>
<p>The ESC has stated that the formulae for the rate cap is 60% CPI + 40% WPI. Since the Minister has not included WPI for the last two years local government has already been forced to endure a significant productivity burden beyond what even the ESC believes is reasonable. The Department of Treasury and Finance's own forecasts demonstrate that wage prices are expected to increase by 0.75% more than CPI each year. Recommendation That all discussion of a productivity figure should be removed until the income lost from the CPI based rate cap over the last two years has been reinstated.</p>	<p>Our response to issues about the Minister's cap is on pages 10 and 11 of the draft proposal.</p>

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## City of Boroondara (continued)

Issue raised	Commission's draft response
<p>The rate cap calculation and productivity figure should also consider revenue sources other than rates for a whole of local government productivity calculation. The specific examples included in the productivity of local government should be the level of grants provided by State and Federal governments particularly the impact of cost shifting borne by local government and the level of annual indexation in payments for services provided. When grants fall as per the freeze on the Financial Assistance Grants (FAGs) over the last four years, local government's ability to deliver services and infrastructure is severely impacted.</p> <p>Recommendation The ESC should have taken these factors into account in determining the overall rate cap and by association the level of any efficiency measure. An evaluation of the rate cap formulae in view of cost shifting and falling levels of government payments to councils be implemented.</p>	<p>Our role is limited to advising on the average rate cap, not other sources of council revenue.</p> <p>Our response to issues about the cost shifting is on page 12 of the draft proposal.</p>
<p>Demonstrated efficiency by the State Government The State Government Budget for 2016-17 included an increase in revenue of 7.2% and increase in total expenditure of 8.2%, this has occurred at the same time it enforced rate caps on local government at CPI. Yet local government faces the same issues as the State with increased population driving the need for increased service provision and infrastructure.</p> <p>Recommendation Local government to have its rate cap set at the same level as the increases in the State Government's budgeted revenue.</p>	<p>This is beyond the commission's role.</p>

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## City of Boroondara (continued)

Issue raised	Commission's draft response
<p>Proxy method We agree that the proxy method is not satisfactory due to the lack of comparability between local government functions and with other sectors of the economy available. However, if this model was chosen we disagree with the treatment of negative productivity Efficiency factor - negative values page 20 We object to the recommendation that negative efficiency outcomes in the economy are ignored. The logic that IPART undertakes this approach is simplistic and as the consultation paper correctly states means that local government is required to be more efficient than the remainder of the economy. We suggest option (1) that negative economic efficiency be added to the rate cap as the only logical, balanced and impartial approach.</p>	<p>We note council's concerns with the proxy value approach.</p> <p>Our response about the proxy value approach is on page 12 of the draft proposal.</p>
<p>We disagree that the PAG model captures the major outputs of local government. When considering the more than 100 services provided by local government and to suggest that this simplistic model measuring productivity merely based on the length of roads and the number of households and businesses is totally inadequate. We note that on page 10 that the PAG stated a decrease in productivity across the sector. This fact should be sufficient to indicate that the model is not capturing the relevant data, or that the variation is due to factors external to the model. One of the factors explaining this stated decrease in productivity reported by this model could be the fact that for most of the last decade councils have been required to increase the capital spend on renewal and replacement of assets as the standards of asset management were eroded due to the last rate cap in the late 1990's. By inference the PAG model should show that councils with run down assets are more efficient than those with higher standards of asset renewal. Surely this is not an outcome that Victorian communities would aspire to. We</p>	<p>We note councils concerns with the outputs used in the modelling. However, to compare councils consistently it is important to use outputs that are common to all councils. To help account for some of the differences between councils we could also undertake multiple group analysis where councils are only compared against others in their group.</p> <p>We have undertaken an analysis to compare technical efficiency and renewals for the year 2015-16. Please contact us if you wish to discuss this further.</p> <p>Predictive Analytics Group undertook additional analysis where it changed the inputs and outputs used in the models. This included developing a model that included community satisfaction scores as a proxy for quality. They found that these changes did not result in efficiency scores that were significantly different from the original models. Our response about additional data envelopment analysis is on pages 14 to 19 of the draft proposal</p>

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Issue raised	Commission's draft response
<p>contest that it is because PAG has used a model which was developed for the sole purpose of measuring technological change in developing and developed countries. We believe that the use of the Malmquist model which measures technological efficiency has been taken out of context in the ESC's report. We ask that the ESC provide objective evidence that council's technological rate of change is the cause of the efficiency outcomes that the PAG model shows. Rather we believe it more likely, as noted above, that the PAG model itself does not adequately explain all the variables associated with measuring productivity in local government. In summary the relevance of the PAG model should be questioned as it is not able to adequately explain the differences between council productivity due to the simplicity of the data examined.</p>	<p>Predictive Analytics Group found that the decreases in overall productivity are due to reductions in technological change. While the models show that technical efficiency change increased slightly, this is more than outweighed by falls in technological change.</p> <p>In other words, historically councils have improved their efficiency using existing technology (moving closer to the frontier) but their efficiency from utilising new technology declined by a greater amount (a decrease in technological change means the whole frontier has contracted). This results in a decline in overall performance. However, it is important to note that this analysis does not take into account the effects of rate capping.</p> <p>We can confirm that Predictive Analytics Group did not use a model for the sole purpose of measuring technological change in developing and developed countries.</p> <p>We have no reason to doubt the independence of Predictive Analytics Group's modelling or results. We have not taken any of Predictive Analytics Group's work out of context.</p>



Issue raised	Commission’s draft response
<p>Applicability of an efficiency factor if the Rate Cap continues to be CPI</p> <p>When the concept of an efficiency factor was incorporated in the ESC's September 2015 Report, it was in the context of the ESC recommended rate cap being a combination of CPI and WPI.</p> <p>The sector advocated for the inclusion of the WPI element — noting that it was traditionally higher than CPI — due to the high proportion of the sector's current cost base that was labour related (reflecting that local government is a service-based industry).</p> <p>The sector's understanding at the time was that the inclusion of an efficiency factor was linked to the inclusion of WPI in the formula to calculate the average rate cap. Put another way, if the rate cap is set at CPI in a particular year, there is already an implicit efficiency factor included.</p> <p>Casey would request more clarity in the upcoming discussion papers on this matter, and recommend that an efficiency factor should not apply if the Minister announced Rate Cap is already CPI or would result in a rate cap lower than CPI.</p>	<p>Our response to issues about the Minister's cap is on pages 11 and 12 of the draft proposal.</p>
<p>Whilst understanding the desire to have a model that is efficient and cost effective to operate and maintain, and which can be readily understood and compared, there are some factors that can impact Councils — including externally imposed requirements — that would not be delineated or excluded in the currently proposed models.</p> <p>More generally, it appears that the measurement of 'outputs' only captures changes in quantity, and would not capture increases in quality of outputs (which, for the same level of inputs, would represent an increase in productivity.)</p> <p>It will be vital that whatever model might be finally adopted here, that it has the ability to take into account externally imposed impacts that increase costs, as well as changes in output quality — whether that be negative or positive.</p>	<p>We acknowledge Casey’s concerns.</p> <p>Predictive Analytics Group undertook additional analysis where it changed the inputs and outputs used in the original models. This included developing models that included community satisfaction scores as a proxy for quality and used service level data for outputs. They found that these changes did not result in efficiency scores that were significantly different from the original models. Our response about additional data envelopment analysis is on pages 14 to 19 of the draft proposal.</p>

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## City of Casey (continued)

Issue raised	Commission's draft response
<p>Casey would recommend that further analysis should be undertaken on the cost impacts of demographic differences beyond just population size, in particular focussing on the proportion of young and old populations that are most linked to key Council services</p>	<p>Further regression analysis could be undertaken to understand whether different demographics drive council productivity and efficiency – positively or negatively.</p>
<p>An interesting issue that arises from the concept of "technically efficient", would be whether the efficiency factor should still apply to those Councils which are already assessed as "fully efficient", as this could be seen to penalising those Councils which have already taken the required steps to be efficient and effective.</p> <p>Casey would request that Councils that are already assessed as being fully efficient should not also be subject to an efficiency factor.</p>	<p>Our response about this issue is on page 23 of the draft proposal.</p>
<p>Consideration is requested for the running of an alternate model — similar to Table 2.1 — with the replacement of "households" with "population", to ascertain if that has a material impact.</p>	<p>Predictive Analytics Group undertook additional analysis where it removed number of households from one of the models and replaced it with population. They found that the change did not result in an efficiency score that was significantly different from the original model.</p>
<p><b>Nominal Value</b> Casey reiterates that the effect of the efficiency factor should not reduce the rate cap below CPI.</p>	<p>Our response about the notional value is on pages 19 to 20 of the draft proposal.</p>
<p><b>Proxy</b> Casey requests more evidence and justification for the ESC recommending the use of the 5-year, 16-industry average, which happens to result in the sole positive proxy number amongst those considered appropriate by Deloitte.</p>	<p>Our response about the proxy value is on page 12 of the draft proposal.</p>
<p><b>Data Envelopment analysis</b> Finally, if the Data envelope analysis is used, Casey supports the multiple group basis, on the basis of the structural differences and different cost structures that different council types face as shown in Appendix A.</p>	<p>We agree that multiple group analysis best accounts for the differences between council groups.</p>



Issue raised	Commission’s draft response
<p>In reviewing what is a complex paper, council remains of the view that the mechanism used to consider local government productivity remain extremely arbitrary and fail to take account of the diverse nature of local government. Using an approach that simply looks at inputs in the form of employee costs, capital investments and operating expenses and assessing these against output such as households, businesses and road lengths provides no consideration to the individual characteristics of each council</p>	<p>Predictive Analytics Group undertook additional analysis where it changed the inputs and outputs used in the original models. This included developing a model that included community satisfaction scores as a proxy for quality. They found that these changes did not result in efficiency scores that were significantly different from the original models. This led us to conclude that the original models are reasonably robust. Our response about additional data envelopment analysis is on pages 14 to 19 of the draft proposal.</p> <p>We acknowledged in our consultation paper that there were differences between councils and council groups. That’s why we also used multiple group analysis to calculate technical efficiencies. In this case councils are only compared councils in their council grouping. This helps to account for differences between groups.</p>
<p>There is already an efficiency factor in place – ESC advice has recognised the key local government cost drivers and equity of applying an approach that recognised the significance of employee costs in drive local government cost indexes The Minister has rejected the ESC’s advice and opted for a CPI only approach. Efficiency factor of 0.4% over two years and more due to the accrual factor.</p>	<p>Our response to issues about the Minister’s cap is on pages 11 and 12 of the draft proposal.</p>
<p>You cannot have an efficiency factor on top of another efficiency factor.</p> <p>It is inequitable for the ESC to be proposing to introduce a further efficiency factor on top of the minister’s cap. Any efficiency factor can only apply where a blended formula is adopted by the Minister.</p>	<p>Our rate cap formula is based on 60 per cent weighting of CPI and a 40 per cent weighting on WPI to reflect the short term cost pressures faced by councils. On this basis it is reasonable to include an efficiency factor to encourage councils to operate efficiently and share any efficiency gains with ratepayers.</p>

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## City of Greater Dandenong (continued)

Issue raised	Commission's draft response
<p>It is premature to apply an efficiency factor. Decreasing productivity in periods measured which is at odd with the broader economy, not including the first year of rate capping. Given the restrictions imposed by rate capping it is highly likely that the trends in the past two years are very different to the proceeding periods.</p>	<p>Our response to measuring productivity trends is discussed on page 22 of the draft proposal.</p>
<p>Is it appropriate to apply a uniform efficiency factor to all? In the case of councils that are fully efficiency is it appropriate that all face the impact of having their rate caps further reduced via an efficiency factor</p>	<p>Our response about this issue is on page 23 of the draft proposal.</p>
<p>Recognising the impacts of the interim Local Government Award as an efficiency factor</p> <p>Although there has been a reduction in the EBA from 3-3.5% to now 2-2.5% however not recognised within this is the fact that within the structure is progression which adds between 0.5-0.7% to costs meaning that it would be a minimum of 3% increase in employee costs year on year. While the ESC recognises this in their WPI recommendation councils will annually need to find efficiencies to fund the gap created by the award structure in to achieve the same outcome as the previous year. This in itself serves as an internal efficiency structure which has not been recognised to this point.</p>	<p>We note the City of Greater Dandenong's concern.</p>

Issue raised	Commission’s draft response
<p>The paper notes the intended aim of the efficiency factor is to “create incentives for Councils to operate more efficiently and ensure that efficiency gains are shared with ratepayers in the form of lower rates”. We believe that it is arguable that the implementation of the rate cap is already providing that incentive in that by the Minister applying the rate cap at the CPI forecast that Councils are only ever-increasing rate income based on inflation. If a Council wishes to implement new initiatives or increase service levels at a higher level than normal growth (i.e. supplementary rates), because of the rate cap, Councils already have an incentive to be more efficient with its existing resources. Furthermore, the onerous requirements of applying for a rate cap variation, in particular demonstrating the support of the community in for a variation, combined with the negative connotation of doing so unnecessarily (until all other options have been explored) places further incentive on councils to be more efficient.</p>	<p>Our rate cap formula is based on 60 per cent weighting of CPI and a 40 per cent weighting on WPI to reflect the short term cost pressures faced by councils. On this basis it is reasonable to include an efficiency factor to encourage councils to operate efficiently and share any efficiency gains with ratepayers.</p> <p>Please refer to our guidance for further information on applying for a rate cap variation.</p>
<p>The paper states that “data showed total factor productivity across the broader economy has increased slightly. Thus productivity in the local government sector is falling behind and going in a different direction to that of the broader economy.” Comparing the local government sector, which operates within the constraints of the Local Government Act 1989, the Local Government Award 2017 and other legislation, to the broader economy that includes private sectors (which would use different inputs and outputs) is short sighted and not a fair comparison. The incentive for efficiency in the private sector/broader economy is profit. The incentive for the local government sector is now the rate cap itself. This is evident, for example, with councils negotiation of enterprise bargaining agreements with the rate cap significantly influencing discussions between councils and unions (i.e. incentive for efficiency). The paper notes that the analysis used to make the assertion of declining productivity “does not take</p>	<p>We respect council’s view however, regardless of whether we compared local government against the boarder economy or not, the analysis showed that local government productivity had declined over the period 2010-11 to 2015-16.</p> <p>Any future monitoring would include using later data from years subject to rate capping. This would enable us see how rate capping has affected efficiency and productivity.</p> <p>Our response to issues about the cost shifting is on page 12 of the draft proposal.</p>

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## City of Greater Shepparton (continued)

Issue raised	Commission's draft response
<p>into account the effects of rate capping" and therefore the statement comparing local government to the broader economy should not be made or relied upon. Further to this the paper does not consider the impact of cost shifting from state government to local government and the impact that this has on productivity measures.</p>	
<p>The consultation paper is lacking in that it has not considered a fifth option of not having an efficiency factor at all.</p>	<p>Our view is that an efficiency factor should be included in the rate capping to encourage councils to operate more efficiently and share the efficiency gains with ratepayers.</p>
<p>The data envelopment approach is noted by the paper as being the best in meeting all criteria yet it scores the lowest in both cost effectiveness and being simple and understandable. Why introduce something like the data envelopment approach to incentivise efficiency that in itself is inefficient? Ratepayers and councils would be better off if the rate cap was left to being just that without the need to further confuse or justify what is essentially an arbitrary figure (as demonstrated in the first two years of its application). The assessment of the data envelopment approach against criteria under table 4.1 shows that it is scored at a 4 (assuming out of 5) for Objectivity. The paper admits that if the data envelopment approach was implemented it "would require a judgement to be made by the commission" on what a reasonable efficiency gain would be and what timeframe should the gain be achieved over". So while the original calculation of the efficiency factor may be objective, its implementation is more subjective which is not reflected in the assessment scoring</p>	<p>Our response to issues about using data envelopment analysis to set the efficiency factor is on pages 14 to 19 of the draft proposal.</p>

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## City of Greater Shepparton (continued)

Issue raised	Commission's draft response
<p>The paper confirms the “minister adopted an average rate cap that was consistent with forecast CPI”. The paper continues “However, for 2016-17 the CPI (and wages growth) was much lower than forecast, meaning that the cap actually enabled an increase in rates above both wages growth and the CPI.” While in some way accurate (the ‘much lower’ part is debatable) this statement implies the support or need for introducing an efficiency factor but should not be as it is out of context. A number of councils would still have EBAs that are higher than the rate cap, agreed at a time when rate capping did not exist. Also, the rate cap is announced December each year which influences the development of the next financial year’s budget (adopted by the June). As such councils have used that as the basis of their budget and allocated for the year ahead. What CPI actually is for the year in question is known well after the rate cap for that year is announced, after the year is finished, and (the actual CPI) has no bearing on resource allocations and financial management decisions made by Council. These financial decisions also assume CPI will increase by the same for existing service levels. This reiterates the argument that the rate cap itself is the incentive for efficiency. Also, it begs the question what statement would have been made if the actual CPI was higher than that of the CPI forecast/rate cap. An alternate view of Table B.1 is that councils have missed out on 0.3 and 0.15 respectively each year of the rate cap set by the Minister instead of using the ESC’s recommended formula.</p>	<p>Our response to issues about the Minister's cap is on pages 11 and 12 of the draft proposal.</p>

Issue raised	Commission’s draft response
<p>Monash City Council does not agree with the notion that Councils need an ‘incentive to operate more efficiently’ or that the sole purpose of efficiency is to lower property rates.</p> <p>Local government has experienced decades of cost shifting and reduced funding from State and Commonwealth Governments whilst introducing new, and enhancing existing, services to meet increasing and changing community expectations. Efficiency has been a necessity to resource relevant local government services. The ability to continue to improve services will be diminished if efficiency gains are simply directed to lower rates.</p>	<p>Our view is that the purpose of the efficiency factor is to create incentives to operate more efficiently and ensure that efficiency gains are shared with ratepayers in the form of lower rates. We add that any efficiency gains beyond the efficiency factor can be used by council in its operations.</p> <p>Our responses to issues about the cost shifting are on page 12 of the draft proposal.</p>
<p>An efficiency factor, on top of rate capping, will disproportionately penalise the Monash community for its ongoing efficiency and low property rates.</p>	<p>We consider that even councils that are performing well should continually look at ways in which they can operate more efficiently.</p>
<p>Whilst applying a simple efficiency factor to local government property rates may appear popular, it ignores the diversity of the local government sector. Municipalities vary widely in the services, and service levels, they provide, the extent to which they are able to draw upon non-rate revenue and importantly their legacy of managing the level of property rates. The imposition of a universal efficiency factor across the local government sector will least impact Councils with high rate levels, and high expenditure, whilst hitting low expenditure and rating Councils the most.</p>	<p>Our response to issues about whether one or more efficiency factors should apply is on page 23 of the draft proposal.</p>

Issue raised	Commission's draft response
<p>As per our previous submission of May 2015 the rate capping framework which includes the efficiency factor does not adequately recognise the significant challenges faced by the City of Port Phillip and poses a significant risk to its financial and service delivery sustainability. These challenges include:</p> <ul style="list-style-type: none"> <li>• maintaining an ageing asset base</li> <li>• the significant growth expected in the municipality, including the development of the Fisherman's Bend Urban Renewal Area, which is expected to have State wide benefits</li> <li>• the impact of climate change, particularly on the City's significant foreshore and marine assets</li> <li>• managing the impact of reduced funding and cost shifting from other levels of Government</li> </ul>	<p>Our response to this issue is on pages 11 and 12 of the draft proposal.</p>
<p>Whilst the City of Port Phillip is committed to deliver best value for the community, improving the efficiency and effectiveness of its service delivery, it does not support the rate capping framework and thus the theoretical efficiency factor. The democratically elected Councillors are best placed to determine the appropriate rates each year in consultation with their community. They are accountable at the ballot box for their decisions.</p>	<p>These matters are outside of the commission's role.</p>
<p>That said if an efficiency factor is unavoidable, the City of Port Phillip prefers approach 1 - a small, notional factor of 0.05 per cent cumulatively but capped in the longer term.</p>	<p>We note Council's preferred position in relation to an efficiency factor.</p>

Issue raised	Commission's draft response
<p>Over the last decade Local government has experienced cost shifting and reduced funding from State and Commonwealth Government whilst responding and meeting increased community expectations, new service demands and financial pressures.</p>	<p>Our responses to issues about the cost shifting are on page 12 of the draft proposal.</p>
<p>Further reduction in rates revenue by the application of an efficiency factor will impede Council's ability to achieve efficiencies through service, technical and technological changes and will detrimentally impact all councils in the long term.</p>	<p>Our response to this issue is on page 9 of the draft proposal.</p>
<p>No model takes into account council or community specific factors (e.g. population, demographic, area, complexity of building infrastructure). Further the consultation paper does not give clear guidance on how to drive efficiencies.</p>	<p>Further regression analysis could be undertaken to understand whether different demographics drive council productivity and efficiency – positively or negatively.</p> <p>Case studies could be developed in future that could give some suggestions about things that could be done to drive efficiencies. This would rely on input from the sector.</p>
<p>All councils are treated equally and there is no incentive to be more efficient, and application of an efficiency factor is more likely to create an environment of cost cutting and service restrictions.</p>	<p>Our view is that even if a council is relatively efficient compared to its peers it can still become more efficient.</p> <p>Savings in excess of the efficiency factor can be used in any way council thinks fit.</p> <p>Our response to issues about one or more efficiency factors is on pages 22 and 23 of the draft proposal.</p>
<p>Efficiency factor be abolished and allow councils to reinvest the equivalent of an efficiency factor into business efficiencies</p> <p>If the efficiency factor proceeds, Method 3 (data envelopment analysis) is preferred on basis that further development of this model is critical to ensure it addresses the diversity and complexity of the sector. However, further work and guidance must be carried out before reaching final a conclusion.</p>	<p>The purpose of the efficiency factor restated is to incentivise councils to invest in business efficiencies that have a longer term benefit.</p> <p>Our response to issues about data envelopment analysis is on pages 14 to 19 of the draft proposal.</p>



Issue raised	Commission’s draft response
<p>Option 1 – Notional efficiency factor — 0.05 per cent City of Whittlesea considers this approach suitable for implementation at a factor of 0.03 per cent per annum over the next four years. The key arguments for this method are its simplicity and low cost for implementation. Process and productivity targets can be more easily communicated internally and are predictable for the period. The factor of 0.03 per cent per annum is more appropriate and sustainable, given the substantial change the sector is facing to adjust to a rate capped environment.</p>	<p>Our response to issues about the notional value is on pages 19 and 20 of the draft proposal.</p>
<p>Option 2 – Proxy measures City of Whittlesea considers this approach not suitable to set the efficiency factor, irrespective of whether three (as per Deloitte’s recommendation) or sixteen industries (as per the ESC’s proposal) are used to calculate the factor. It is problematic to use a market sector benchmark, since local government is subject to a different set of drivers for organisational performance compared to the market sector. These include political and local considerations as well as community benefit. Local government’s role includes intervention to address failures and adverse outcomes of competitive service delivery. The sector would thus provide service activities considered unprofitable in a market environment, which in turn has an adverse effect on the sector’s productivity.</p>	<p>Our response to issues about the proxy value is on page 12 of the draft proposal.</p>
<p>Option 3 – Data envelopment analysis City of Whittlesea considers this approach methodologically appropriate but unsuitable for implementation in the sector. It is too complicated to communicate internally and would introduce unnecessary uncertainty into strategic resource planning. Given the results of the method can be implemented as effectively at lower cost over the long term using the notional method, this method should only be used for long term monitoring at State level.</p>	<p>Our response to issues about data envelopment analysis is on pages 14 to 19 of the draft proposal.</p>

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## City of Whittlesea (continued)

Issue raised	Commission's draft response
Option 4 – Local government performance reporting framework City of Whittlesea considers this approach not suitable to set the efficiency factor, in line with the assertion in the consultation paper that the Essential Services Commission has not yet “been able to calculate an efficiency factor at this stage using this approach.”	Our response to issues about the local government performance reporting approach is on pages 12 to 14 of the draft proposal.

## City of Wodonga

Issue raised	Commission's draft response
This approach indicates a cap be set for a small notional cumulative efficiency factor. What is the cap that is being proposed? Without a proposed cap, we have not been provided with sufficient information to make a full informed assessment of the proposal. In addition, the proposed 4 yearly reviews to consider whether changes need to be made to how efficiency is addressed on the cap is too long. To lock in an efficiency factor that is not due for review for 4 years could severely impact the sector in periods of substantial financial decline, or if the sector was operating at full productivity. The four year review period should be reduced to an annual review to be undertaken alongside the calculation of the rate cap. This methodology will provide the simplest and cost effective solution. However, it could also cause the most damage to councils if it not administered with reasonable parameters, such as the level of the efficiency factor cap and the ability to reset the efficient factor if the economic circumstances of the sector indicate a necessity to so do.	Our proposed draft efficiency factor is discussed on pages 20 to 21 of the draft proposal.

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## City of Wodonga (continued)

Issue raised	Commission's draft response
<p>Suggested approach 2 indicates a proxy value be drawn from historic Australian industry productivity data collated by the ABS. In your report, it is stated that ABS data for the period 2010-11 to 2015-16 show local government productivity has declined and total productivity across the broader economy has increased slightly for the same period. To compare the broader economy performance against local government is unreasonable due to the increasing levels of governance obligations being pushed onto local government that is not required in the broader economy. The increasing level of red tape expected of local government is just not replicated in private enterprise, such as procurement processes, grant acquittals, additional government reporting obligations (performance report, Grant Commission return, ESC return), legislative compliance to the Local Government Act requirements, additional local government legislative obligations for budget and annual reporting requirements are onerous and required by private enterprise). In addition, services are provided by local government that would never be provided by private enterprise due to the cost, however the community benefit to be obtained or legislative obligations require local government to provide those services. Accordingly, many services are provided by local government without the prospect of ever being able to fully recover the cost of provision on a user pays basis. Often many of these services were transferred to local government as part of the cost shifting from state government that has been occurring over many years.</p>	<p>Our response to issues about the proxy value is on page 12 of the draft proposal.</p> <p>Our response to issues about the cost shifting is on page 12 of the draft proposal.</p>
<p>Suggested approach 3 indicates a value calculated from the DEA should be considered. The information provided in the paper is very technical due to the complex nature of this productivity measurement tool. I refer to the submission made by Corangamite Shire Council to the consultation paper and agree with the points they have raised regarding the use of DEA.</p>	<p>Our response to issues about data envelopment analysis is on pages 14 to 19 of the draft proposal.</p>

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## City of Wodonga (continued)

Issue raised	Commission's draft response
<p>Use of the performance data from the local government performance reporting framework set out in suggested approach 4 would not lend itself to an assessment of efficiency. Many of the service performance indicators are influenced by the quality of services provided and may be very expensive to deliver to that standard. There are no financial indicators that would provide a true and comparable reflection of the efficiency of councils across the state. As indicated earlier, there has been insufficient analysis undertaken for this approach to warrant its inclusion in the consultation paper.</p>	<p>Our response to issues about the local government performance reporting approach is on pages 12 to 14 of the draft proposal.</p>
<p>I refer to the submission made by Warrnambool City Council ..... and agree with the points they have made about disparity between councils for comparative purposes and the contribution that councils have already made through the rate cap announced by the Minister for the first two years being below the rate cap being recommended by the ESC.</p>	<p>Our response to issues about the Minister's cap is on pages 11 to 12 of the draft proposal.</p>
<p>This investigation does not properly acknowledge that all councils operate independently, providing a unique set of services to meet the needs and expectations of their individual and diverse communities. Their demographics are different and the size and scale of services differ greatly across the State. Many rural and regional councils will have limited ability to raise alternative income sources that can take the pressure off raising rates to cover the cost of council operations.</p> <p>There will always be a differing level of maturity between councils in the deliver of services to their community. This will fluctuate from year to year and will be somewhat dependent upon the councillors, staff and executive at the council at any point in time.</p>	<p>We acknowledged in our consultation paper that there were differences between councils and council groups. That's why we also used multiple group analysis to calculate technical efficiencies. In this case councils are only compared councils in their council grouping. This helps to account for differences between groups.</p> <p>We acknowledge that productivity may fluctuate over time for the reasons given. This is why we measured productivity over time to help smooth fluctuations and gain an overall trend.</p> <p>In future to complement the analysis described above, we may undertake case studies and seek commentary from councils about productivity trends.</p> <p>Further, Predictive Analytics Group undertook additional analysis where it changed the inputs and outputs used in the original models. This included developing a model that included community satisfaction scores as a proxy for</p>

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## City of Wodonga (continued)

Issue raised	Commission's draft response
	quality. They found that these changes did not result in efficiency scores that were significantly different from the original models. This led us to conclude that the original models are reasonably robust. Our response about additional data envelopment analysis is on pages 14 to 19 of the draft proposal
Wodonga Council would prefer to use a more cost effective notional efficiency factor. A variation on of suggested approach 1 [ notional] would be recommended one that is not cumulative and can be set as low as zero if required, such as when the Minister has declared a lower than recommended rate in the preceding year/s (that has the practical effect of an efficiency factor).	Our response to this issue is on page 11 and 12 of the draft proposal.
The efficiency factor should also be able to vary between council types; for example, to take into account of the much higher ability of larger Metropolitan councils to absorb an efficiency factor in comparison to small rural councils who are operating on a shoestring budget.	Our response to issues about one or more efficiency factors is on page 23 of the draft proposal.

Issue raised	Commission’s draft response
<p><b>Use of Data Envelopment Analysis</b></p> <p>Drew et al (2015) note there is a dearth of empirical literature on the accurate and correct specification of DEA. They further note that “our evidence suggests that incorrect specification may well produce spurious association and lead to poor public policy making”.</p> <p>Allaf (2002), in his analysis of DEA in measuring the performance of American cities, found that “uncontrollable variables such as population density, unemployment and household income suppress the relative efficiency of the local government.</p>	<p>We confirm that a paper by Drew et al (2015) noted that there is a dearth of empirical literature on the accurate and correct specification of DEA. And that incorrect specification may well produce spurious association and lead to poor public policy making.</p> <p>However, the paper goes on to make some other observations including:</p> <p><i>DEA specifications may be driven by the quality and availability of data</i></p> <p><i>Any DEA study will suffer from a degree of incongruence between proxies employed for outputs and actual output data. However, Some specifications of output seem to better reflect service provision than others.</i></p> <p>Drew et al. then prepare four different model specifications to subject to DEA based on a review of models used in other studies of local government efficiency. Their analysis finds the preferred model is:</p> <p>Inputs (staff (\$) + capital (\$) Outputs (roads (km). no. households and no, businesses).</p> <p>All of the models used in Predictive Analytics Groups DEA analysis use roads (km). no. households and no, businesses as outputs.</p> <p>We agree that there are controllable and uncontrollable factors that may affect council efficiency. Further analysis may identify these for the Victorian local government sector.</p>

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Issue raised	Commission's draft response
<p><b>Service or activity level measure of efficiency</b></p> <p>Local councils deliver over 100 different services to residents, businesses and visitors. In this regard, the measurement of efficiency is best applied at service or activity level rather than at an aggregated level.</p>	<p>We agree that efficiency could be measured at a service or activity level. The local government performance reporting framework (the framework) goes some way to achieving this.</p> <p>However, we intend that the efficiency factor is applied to the rate cap formula. As rates fund a broad range of council services we consider that an aggregate measure of efficiency is reasonable.</p> <p>Our response to this issues is on page 13 of the draft proposal.</p> <p>Further, we found that while the local government performance reporting framework is objective it is not really possible to understand overall council performance or efficiency. And not all individual unit cost measures can be readily incorporated into the rate cap formula without further work. As such we have not been able to calculate an efficiency factor at this stage using the framework.</p> <p>Our response to issues about the local government performance reporting approach is on pages 12 to 14 of the draft proposal.</p>
<p><b>Output and input measures</b></p> <p>It is submitted that these (households, businesses and length of road) are poor proxies for the bundle of services delivered by councils. The inputs and outputs used in the models are overly simplistic. Specific issues are:</p> <p>Council staff (\$) and EFT. As the paper notes, these are poor measures as there is significant variation in the sector in the services provided and the extent of contracting versus in house delivery.</p> <p>Capital expenditure is a poor measure given the potential for large variations depending on carry forward projects and grants from other tiers of government</p> <p>Capital operating costs excluding depreciation does not adequately recognise the life cycle cost</p>	<p>Further, Predictive Analytics Group undertook additional analysis where it changed the inputs and outputs used in the original models. This included developing a model that included community satisfaction scores as a proxy for quality. They found that these changes did not result in efficiency scores that were significantly different from the original models. This led us to conclude that the original models are reasonably robust. Our response about additional data envelopment analysis is on pages 14 to 19 of the draft proposal</p> <p>Predictive Analytics Group added good modelling practice indicates that there can be risks of including larger numbers of marginal variables, and this may result in double counting and errors in the analysis.</p>

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## Corangamite Shire Council (continued)

Issue raised	Commission's draft response
<p><b>Output and input measures (continued)</b></p> <p>of an asset. Depreciation is a significant operating cost and councils must be able to fund capital renewal to remain sustainable.</p> <p>Operating expenses (excl. depreciation)(\$) + depreciation (\$). The inclusion of depreciation in the measurement of productivity is important for the reasons above.</p> <p>The number of households does not account for shires with high visitor/tourist numbers</p> <p>It is unclear how business numbers will be measured</p> <p>Roads- it is unclear what is being measured quantity(length) or quality (condition assessment data)</p> <p>Waste collected – it is agreed that this is a very poor measure of output.</p>	<p>Further work could be done to find a variable that accurately reflects visitor or tourist numbers and included in a model.</p> <p>All input data was sourced from the Victoria Grants Commission returns</p> <p>Local road length (in Kilometres) data was sourced from the VGC returns</p> <p>Number of households and businesses were sourced from the ABS</p> <p>Waste collected data was sourced from Sustainability Victoria</p>
<p><b>Large Rural Shires</b></p> <p>The consultation paper indicates that no Large Rural Shire, when assessed using DEA models, is considered to be technically efficient.</p> <p>No consideration is given in the paper that the DEA model might be fundamentally flawed when assessing the efficiency of Large Rural Shires. Again, some cases studies and worked examples would help with analysis and understanding.</p> <p>.... It demonstrates a one size fits all model is not appropriate. For example, it is not reasonable to compare the efficiency of Corangamite Shire with a regional or metropolitan council. Nor is it reasonable to compare the productivity of a Small Rural Shire with Corangamite.</p>	<p>Figure 2.2 in the consultation paper is given as an example of how a benchmarking exercise could be undertaken. It is important to note that efficiencies were measured using one model specification and for one year. It is likely that under different model specifications and for different years the results could be different. Any future benchmarking exercise is likely to benchmark councils using different model specifications and over time.</p> <p>We agree that in some circumstances it may be more appropriate to benchmark councils against other councils in the same group only. This analysis (using DEA) is called multiple group analysis. Generally technical efficiencies are higher when measured this way. This is likely to be because there are relatively fewer differences between councils in the same group.</p> <p>Case studies could be developed in future to help explain (and compliment other analysis) some of the reasons for differences between councils and their efficiencies.</p>

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## Corangamite Shire Council (continued)

Issue raised	Commission's draft response
<p><b>Efficiency Factor</b></p> <p>If an efficiency factor is to be used by the ESC and ultimately the Minister, in setting the rate cap, a more evidence based approach should be used. Based on the assessment of the DEA model in the consultation paper more work is required to find such a tool.</p>	<p>Noted.</p>
<p><b>A way forward</b></p> <p>To progress this matter the following is suggested:</p> <p>More consultation should be undertaken with the sector. This should involve a broad cross section of councils with differing geographic, economic and demographic features.</p> <p>The consultation paper should be rewritten with more case studies, worked examples and consideration of alternative assessment methodology rather than relying just on the potentially flawed DEA model.</p>	<p>We began this process in January this year when we asked all councils and peak bodies for nominations to join the working group. All of those who nominated where accepted on the group. This represented a diverse group of councils.</p> <p>We will reconvene the working group when required in future. However, before doing so we will go out to the sector and ask if any other councils are interested in being represented.</p> <p>Predictive Analytics Group prepared an alternate modelling framework and found that it did not produce significantly different results from the data envelopment analysis.</p> <p>Our response about an alternative modelling framework to DEA is on pages 18 and 19 of the draft proposal.</p>

Issue raised	Commission’s draft response
<p>Our position has not changed since the efficiency factor was first mooted to be included in the rate cap mechanism. We believe that an efficiency factor should not be included in the rate capping mechanism. Local Government is already subject to enforced productivity gains via limits on grant revenues from other levels of government. Most service delivery grants are increased by only CPI (plus a growth factor for any additional services); Councils must therefore bear the increase in the real cost, over and above the CPI. Also, the Federal Government’s freeze on the Victorian Grants Commission (VGC) funding over the past three years will have a long lasting effect on Councils as it has eroded the grant base going forward.</p>	<p>Our rate cap formula is based on 60 per cent weighting of CPI and a 40 per cent weighting on WPI to reflect the short term cost pressures faced by councils. On this basis it is reasonable to include an efficiency factor to encourage councils to operate efficiently and share any efficiency gains with ratepayers.</p>
<p>Furthermore, rate capping, as it has been applied by the Minister over the past two years, by its very nature and application, is a form of forced productivity improvement. We therefore assert that the imposition of an additional efficiency factor is unwarranted.</p>	<p>Our response to issues about the Minister’s cap is on page 11 and 12 of the draft proposal.</p>
<p>An efficiency factor, on top of rate capping, will disproportionately penalise Victorian Councils for their ongoing efficiency and low property rates. Applying an efficiency factor to local government property rates ignores the diversity of the local government sector.</p>	<p>Noted.</p>
<p>The application of efficiency measures should be about each council identifying resources that could be better used for some other application (e.g. improved or higher level of services). It should be about reviewing and using scarce resources in a better way. Applying an efficiency factor, for lower rates sake only, will likely lead to a diminution of services, which disadvantages our communities.</p>	<p>We agree with Finpro’s statement “The application of efficiency measures should be about each council identifying resources that could be better used for some other application (e.g. improved or higher level of services)”. Our response to issues about council efficiency and the purpose of the efficiency factor is on page 9 of the draft proposal.</p>

Issue raised	Commission's draft response
<p>In summary Council supports the following approach to setting the efficiency factor</p> <p>DEA Model 5, Multiple grouping, VRS production frontier, 2.5% gain with a 10 year time frame The use of Model 5 to determine the efficiency factor is encouraged as this can be applied equally to all Councils, irrespective of the level of in-house or contracted-out service delivery and also combines asset management practices through the proxy measure of depreciation. For the 2016/17 Annual Budget (combined 79 Councils), Total Expenses equal \$7.9B, including \$1.4B of Depreciation. Further Council does not support the use of Staff or Capital as inputs. Whilst Staff FTE is a better input than Staff \$, the results shown at Table 2.2 of the Consultation paper show there is only a marginal difference between these input variables. The use of Staff as an input does not adequately represent service delivery at only 42% of Total expenses. Whilst the Total Capital Works budget increases consistently over time, the types of projects vary significantly between years. Further, Capital Works does not include any new assets provided through new subdivision development and the 2016/17 Annual Budget included a total of \$0.4B. These additional assets however will be included in the Depreciation amount in the year following their construction.</p>	<p>Model 5 could be potentially be applied equally across all councils. This is because it accounts for both in house and out sourced service delivery.</p> <p>Council added that capital works does not include new assets constructed for new subdivisions -this is an important consideration for interface councils. Yet these new assets are accounted for in the depreciation amounts for the following year. On this basis model 5 may account for capital inputs more comprehensively.</p> <p>However, it is important to note that our analysis showed that the model specification does not have a significant effect on the efficiency factor. The technical efficiency scores for all models cover a narrow range between 0.79 to 0.82.</p> <p>Predictive Analytics Group undertook additional analysis where it changed the inputs and outputs used in the original models. This included developing a model that included community satisfaction scores as a proxy for quality. They found that these changes did not result in efficiency scores that were significantly different from the original models. This led us to conclude that the original models are reasonably robust. Our response about additional data envelopment analysis is on pages 14 to 19 of the draft proposal</p> <p>The key factors influencing the efficiency factor are the required efficiency gain and the number of years to achieve the gain over.</p> <p>When using data envelopment analysis to set an efficiency factor we may consider the results from several different model specifications. This is to ensure the robustness of our analysis.</p>

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## Hume City Council (continued)

Issue raised	Commission's draft response
<p>Council believes that the assessment of the four options against the five criteria to select an approach to set an efficiency factor is reasonable (Table 4.1), however could be altered to show the DEA approach split into Single Group and Multiple Group analysis. Further, Council believes that the Applicability criteria should be considered higher for multiple group analysis than single group analysis as it takes into account the municipal differences through the grouping of councils as grouped for both VGC returns and the local government performance reporting framework.</p>	<p>We agree that the regulatory criteria used to assess each approach against are well established and robust.</p> <p>We agree that multiple group analysis could be viewed as more applicable because it accounts for some differences between council groups. We would consider using multiple group analysis when setting an efficiency factor using the data envelopment analysis approach.</p>
<p>The use of Variable returns to scale (VRS), which assumes that output does not change in direct proportion to input is considered by Council to be superior to Constant returns to scale (CRS), for the same inherent reasons as outlined in B above.</p>	<p>We agree with council's observations in relation to the use of the variable returns to scale frontier.</p>
<p>Council would further suggest that the required efficiency gain and the timeframe to realise this gain is considered in light of the level of fixed assets that Victorian local Governments own and maintain. For the 2016/17 Annual Budget, Total Local Government assets equalled \$85.74B, with Infrastructure assets totalling \$51.2B and Land assets totalling \$31.4B and in combination represent 96% of all assets. This underlines that the capacity for local government to be agile is limited and a ten-year horizon for an efficiency gain to be realised is appropriate. As can be seen from A above total assets represent 13.2 times total expenses excluding depreciation and demonstrate how fixed asset intensive Victorian local government is.</p> <p>Further Council would suggest that any industry with such a significant level of fixed assets there may be a delay in the time period to realise productivity gains from infrastructure investments.</p>	<p>We agree that a judgement would need to be made about the timeframe to achieve efficiency gains over. We would consider council's arguments in relation to this, when calculating an efficiency factor using the results from data envelopment analysis.</p> <p>We would also take into account the results of any updated productivity study that showed how productivity had trended under rate capping.</p>

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## Hume City Council (continued)

Issue raised	Commission's draft response
<p><b>Notional</b></p> <p>Whilst this approach approximates the mid-point of the results from the DEA approach for the 2010/11 – 2015/16 years, it does not necessarily demonstrate any rigour, applicability or relationship to the level of inputs for Councils to achieve efficiencies for future years. Further it would not be consistent with the existing calculation basis of the Rate Cap, whether that be the Commission's approach of using WPI and CPI or the Minister for Local Government's option of using just CPI.</p>	<p>Our response to issues about the notional value is on pages 19 and 20 of the draft proposal.</p>
<p><b>Proxy</b></p> <p>Council believes that the Proxy approach should not be used as it does not adequately reflect the services provided by Local Government; it is not based on actual Victorian local government data; it is difficult to align the production impact of the significant level of local government fixed assets; and finally is subject to changes or discontinuance in collection of some measures over time by the ABS. It is however recognised that changes in data collection measures could also impact on DEA, due to changes in the VGC questionnaire and also to the LGPRF.</p>	<p>Our response to issues about the proxy value is on page 12 of the draft proposal.</p>
<p><b>LGPRF</b></p> <p>Council believes that with the increasing maturity and longevity of the reporting framework that it has a limited potential, limited to some of the Sustainable Capacity measures, to be utilised as an approach. This is due to the information being based on the same actual data, albeit in a different format, as the VGC questionnaire. Further, as mentioned at B above, the LGPRF is already capable of demonstrating structural differences between groups of Councils.</p>	<p>Our response to issues about the local government performance reporting approach is on pages 12 to 14 of the draft proposal.</p>

## Loddon Shire Council

Issue raised	Commission's draft response
<p>In summary, the rate cap has effectively introduced a substantial efficiency factor on our council. Prior to the introduction of rate capping Loddon Shire Council's rates were significantly below other councils. The introduction of the rate cap, plus our councillors desire to not borrow any money and not apply for any variation, plus a reliance on rates and grants income means that we will continue to struggle to have sufficient income to meet the service and infrastructure expectations of our community. At Loddon Shire, our councillors have introduced an efficiency factor by introducing a wages cap. Responsible representation by councillors would manage efficiency on a council by council basis.</p>	<p>We note Loddon Shire Council's general comments about efficiency and productivity.</p>

## Mansfield Shire Council

Issue raised	Commission's draft response
<p>Mansfield Shire Council supported Corangamite Shire Councils submission</p>	<p>Noted</p>
<p>The only additional suggestion Mansfield Shire Council can make in setting a way forward is to provide identifying information for all Councils listed in Figure 2.2 (page 13) of the report. This is an immediate case study of the entire sector in how the Data Envelope Analysis model is determining the relative effectiveness of Councils in Victoria and we feel will add significantly to the debate and feedback you will receive.</p>	<p>Our response to this issue is on page 23 of the draft proposal.</p>

Issue raised	Commission' s draft response
<p>Rate capping has been recently introduced and its effects on the sector are still being assessed and measured. Is there a need to impose an efficiency factor at this stage?</p>	<p>Our response to this issue is on page 9 of the draft proposal.</p>
<p>Introducing a productivity factor could potentially lead to rate increases below CPI. This will further impact financial sustainability of councils. External expenditure input increases for councils are above CPI. Examples are utility and contractor costs which are increasing at levels well above CPI. Council have limited or no control over these cost increases.</p>	<p>Our response to this issue is on pages 11 and 12 of the draft proposal.</p>
<p>No matter which efficiency factor model is being proposed there will be difficulties in measuring and benchmarking that factor simply, accurately, fairly and in a cost effective manner. Comparing how efficient councils are via complicated matrix/models which are arbitrary and have deficiencies may lead to misinformation and counterproductive behaviour.</p>	<p>Our response to this issue is on page 23 of the draft proposal.</p>
<p>Penalizing council's financially through an efficiency factor will restrict their ability to invest in improved technology and systems to improve efficiencies over the long term. It will also provide a disincentive for councils to invest in technology and systems in the short to medium term which will benefit council in the long term.</p> <p>Councils may need to reduce service levels to meet subjective misleading efficiency targets which will not be in the best interests of the community.</p>	<p>Our response to this issue is on page 9 of the draft proposal.</p>



Issue raised	Commission's draft response
<p>The MAV argues that the existing rates capping framework imposes a significant productivity dividend before any additional discount is identified and imposed. It is the view of MAV that no further productivity dividend is warranted and that no specific allowance should be included in the ESC's recommended cap figure to the Minister.</p>	<p>Our rate cap formula is based on 60 per cent weighting of CPI and a 40 per cent weighting on WPI to reflect the short term cost pressures faced by councils. On this basis it is reasonable to include an efficiency factor to encourage councils to operate efficiently and share any efficiency gains with ratepayers.</p>
<p>We do not support the preferred approach (DEA) for a number of reasons including:</p> <ul style="list-style-type: none"> <li>• problems with its underlying assumptions, particularly as they relate to the services provided by councils and the use of proxies to measure output;</li> <li>• neutrality with respect to structural factors impacting councils' service provision; and</li> <li>• neutrality with respect to quality and other specific objectives around council outputs.</li> </ul> <p>The rationale for a small notional factor being used has not been demonstrated, particularly on the basis that efficiencies can always be realised. This figure is not underpinned by anything, so why have it?</p> <p>We have confidence issues around a suitable wider-economy reference from which to draw because of data issues around relevant industrial sectors and private sector bias.</p> <p>If a factor is to be applied we believe that more work needs to be done with respect to making it more reflective of local government service delivery and actual outputs or cost drivers. To this end further consideration of augmentation of the LGPRF and use of VGC-type approach to establishing relative costs for functions should be considered.</p>	<p>Predictive Analytics Group undertook additional analysis where it changed the inputs and outputs used in the original models. This included developing a model that included community satisfaction scores as a proxy for quality. They found that these changes did not result in efficiency scores that were significantly different from the original models. This led us to conclude that the original models are reasonably robust. Our response about additional data envelopment analysis is on pages 14 to 19 of the draft proposal</p> <p>Further, differences between councils can be accounted for by using multiple group analysis. In this analysis councils are only compared against those in their council group.</p> <p>Our response to issues about the notional value is on page 19 and 20 of the draft proposal.</p> <p>Our response to issues about the proxy value is on page 12 of the draft proposal.</p> <p>Our response to issues about the local government performance reporting approach is on pages 12 to 14 of the draft proposal.</p>



Issue raised	Commission’s draft response
<p>It is important for a ‘simple to understand and apply’ model to be used.</p> <p>Community members, Councillors, Officers and other stakeholders often struggle to understand the technical construction of performance and efficiency measures. Some of the models proposed will cause confusion. This confusion may lead to distrust as to their intent and possible errors in calculation.</p>	<p>Simple and understandable were criteria we assessed each approach against. We considered that the notional approach best met this criterion.</p> <p>However, our decision on the options to set an efficiency factor relied on a balanced assessment against all criteria.</p> <p>While some approaches are more complex than others. Their intent of all, is the same. That is to create incentives to operate more efficiently and share these efficiencies with rate payers.</p>
<p>The application of number of households/businesses and lengths of roads serviced, is a better proxy for technical efficiency than application of population.</p> <p>The application of household/businesses provides a better proxy for rural councils, than population. Many large rural councils have numerous non-resident ratepayers (holiday makers and tourists) requiring services. Population, as a proxy, would underestimate the impact these non-resident ratepayers have on each Council’s service provision. The application of kilometers of road also provides a reasonable proxy that would be useful for large rural councils, as this measure gives a reasonable reflection of the increased extent of infrastructure required in rural areas to service every household with the most basic level of infrastructure – access to property.</p>	<p>Predictive Analytics Group undertook additional analysis where it changed the inputs and outputs used in the original models. This included developing a model that included community satisfaction scores as a proxy for quality. They found that these changes did not result in efficiency scores that were significantly different from the original models. This led us to conclude that the original models are reasonably robust. Our response about additional data envelopment analysis is on pages 14 to 19 of the draft proposal</p>
<p>A level of caution is requested in comparing local government with other industries or all councils as a single group, for benchmarking comparisons.</p> <p>No other industry provides the extensive range of services, particularly not-for-profit services that local government provides. It is also important within the local government sector to compare ‘like for like’ councils, as the variables are extensive across the sector. Using the ‘multiple group mean technical efficiency measures’ would provide better comparisons than the ‘single group mean’ can achieve.</p>	<p>We agree with council’s observation and in some circumstances, it may be more appropriate to benchmark councils against other councils in the same group only. This analysis (using DEA) is called multiple group analysis. Generally technical efficiencies are higher when measured this way. This is likely to be because there are relatively fewer differences between councils in the same group.</p>

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## South Gippsland Shire Council (continued)

Issue raised	Commission's draft response
<p>Consider reducing the Rate Cap earlier than intended, but extend the Notional Efficiency Factor for a longer period.</p> <p>Another approach to be considered by the Technical Group would be to finish the rate cap earlier than intended, but extend the Notional Efficiency Factor for a longer period before capping it. This would provide a more sustainable culture change for councils.</p>	<p>It is unclear what this comment means.</p>
<p>Consider the impact of the cost shift in service provision to Local Government from the State and Federal Government, when determining factors that may have contributed to undermining Local Government productivity trends over the past five or six years.</p>	<p>Our response to issues about the cost shifting is on page 12 of the draft proposal.</p>
<p>The 'curved frontier' representing variable returns to scale, provides a more accurate assumption of changes in proportion with input/output, than the 'straight line frontier'. The curved frontier provides a reasonable guide to monitor how a shift in either input or output can assist in achieving full technical efficiency. Often a change requires a range on inputs, or outputs to see a compounding effect. Often a more substantial investment up front can have longer term productivity outcomes, which the curved frontier may better represent.</p>	<p>We agree with council's observations in relation to the use of the variable returns to scale frontier to measure efficiencies using data envelopment analysis.</p>

Issue raised	Commission's draft response
<p>Councils have already contributed a cumulative efficiency factor in excess of that originally proposed by the ESC on an annual basis.</p> <p>The previous minister has already ignored the ESC recommendations in the application of the previous rate caps with an application of the cap set at the nominal CPI rate of 2.50% in 2016-2017 and 2.0% in 2017-2018 as opposed to recommendations of 2.80% and 2.15% respectively.</p> <p>The cumulative loss in rates and charges income would equate to an efficiency dividend of 0.25% based upon an average rate income equal to 50% of revenue in the two year period well above the nominal 0.05% annually being sought from the commission through this consultation. This efficiency gain has not been recognised in any of the analysis we have seen to date, along with any compounding effects by achieving this forced efficiency upfront.</p>	<p>Our response to issues about the Minister's cap is on page 11 and 12 of the draft proposal.</p> <p>For the foreseeable future we intend to include an efficiency factor in the rate cap advice. This is so as councils continue to receive encouragement to operate efficiently and share the benefits with rate payers.</p>
<p>Disparity in the make-up of councils for comparative purposes</p> <p>Whilst some acknowledgement in the consultation paper goes to the disparate nature of the Regional Cities cohort of councils it does not deal with this disparity and focuses on the fact there are homogenous services all Councils deliver. On face analysis of the 5 models being mooted to determine "Technical Efficiency" there is very little chance that Warrnambool would fit into a positive model of technical efficiency.</p> <p>Over 20% of Warrnambool Councils services are directly related to a regional offering from a regional airport owned by Warrnambool but located in Moyne to regional tourism and economic development spends Warrnambool councils role as capital of the South west comes at a premium for the local community. The cost to the region if Council were to step away from this role to aim for "Technical Efficiency" would be catastrophic to the region's economy.</p>	<p>We agree that in some circumstances it may be more appropriate to benchmark councils against other councils in the same group only. This analysis (using DEA) is called multiple group analysis. Generally technical efficiencies are higher when measured this way. This is likely to be because there are relatively fewer differences between councils in the same group.</p> <p>Further, the results of any potential benchmarking could include case studies and commentary from councils which would help explain the factors affecting a particular council.</p>

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## Warrnambool City Council (continued)

Issue raised	Commission's draft response
<p>Ad hoc and un-restricted efficiency built in via cost shifting</p> <p>Local government has had an ad hoc efficiency factored built into its operations through a continued cost shift of both services and reduced incomes from state and federal authorities. It is incumbent on the ESC to analyse the extent of this cost to Local authorities and factor this as an added component of ad hoc efficiency that has had to be found within the sector during the rate capped period</p>	<p>Our response to issues about the cost shifting is on page 12 of the draft proposal.</p>
<b>Next steps for the ESC</b>	
<p>The ESC has the information to make a more granular assessment both on an individualised rate cap assessment and the merits of local efficiency. Warrnambool encourages the ESC to utilise this information to create a more full review of each Councils relative position and add commentary to the analysis undertaken rather than rely on blunt measures relating to benchmarks at the cohort level.</p>	<p>In future we may investigate ways of presenting data that shows the relative productivity of councils' efficiencies more fully overtime. Particularly as part of outcomes reporting. This may include comments on the analysis which will rely on input from councils.</p>
<p>That the ESC advocate to the State government for fiscal support for Councils where it identifies structural hardship related to the composition of municipalities stemming from the 1994 amalgamations.</p>	<p>This function is outside of the powers of the commission.</p>
<p>Where it identifies Councils that are at future risk of not meeting their service or infrastructure obligations and where an added burden to the rate payers would be inequitable.</p>	
<p>Acknowledgement should also exist where the current service levels of a Council is meeting community expectation and where abnormal imposts exist due to structural conditions established by the State Government.</p>	<p>This last point may be addressed through the proposed case studies and commentary by councils on productivity trends.</p>

Issue raised	Commission’s draft response
<p>Date Envelopment Analysis (DEA): Since DEA deals with the relationships between inputs and outputs, it is important to select the most appropriate inputs and outputs to obtain accurate and relevant results.</p> <ul style="list-style-type: none"> <li>• We do not agree that the model as outlined on captures the major outputs for local government. Given the vast number of services provided by local government, the model is inadequate in its measurement of productivity based simply of households and length of roads. • All five variations of the model estimated a fall in productivity over the period 2010/11 to 2016/17. This in itself suggests that relevant data is not being captured and/or that there are broader economic factors that need to be taken into consideration.</li> <li>• The report suggests that this fall in productivity is due to decline in technological change. Given the limitations of the modelling identified by the Predictive Analytics Group (PAG), we feel that these empirical finding need to be able to be supported by clear objective evidence before its application is considered</li> <li>• Attachment 1 to this submission contains an independent report commissioned by Wyndham from Professor Brian Dollery. Pages 18-19 of this commissioned report clarifies conclusions from Drew, Kortt and Dollery (2015) in terms of population and efficiency outcomes. It stresses that population density and not population size is the key factor in determining service, revenue and infrastructure needs. For Wyndham, a rapidly changing population and thereby population density is a critical factor in determining service and infrastructure needs.</li> </ul>	<p>Predictive Analytics Group undertook additional analysis where it changed the inputs and outputs used in the original models. This included developing a model that included community satisfaction scores as a proxy for quality. They found that these changes did not result in efficiency scores that were significantly different from the original models. This led us to conclude that the original models are reasonably robust. Our response about additional data envelopment analysis is on pages 14 to 19 of the draft proposal</p> <p>We commissioned an expert consultant to respond to Professor Dollery’s paper. Our consultant’s ( by Applied Econometrics) report is attached to the draft proposal.</p>

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## Wyndham City Council (continued)

Issue raised	Commission's draft response
<p>Small Notional Factor of 0.05%: The application of a notational factor cannot be supported. Based on the commentary in the report, it is clear that the 0.05% proposed was chosen in any entirely arbitrary fashion and was also intended to further augment the impact of the rate cap. There is a value judgement being made that 'efficiency' is delivered only through a reduction in rates. This discounts the benefits and future savings from investment in local infrastructure maintenance and asset renewal</p>	<p>Our response to issues about the notional value is on pages 19 and 20 of the draft proposal. Our response to issues about purpose of the efficiency factor is on page 9 of the draft proposal.</p>
<p>Proxy Value from Historic Austrian Industry Productivity Data: As the paper outlines, the proxy method based on ABS data does not include industries which are likely to best reflect the local government sector. Results obtained therefore will be lacking in comparability. In relation to the treatment of negative efficiency values, we do not agree that these should be ignored as proposed under the recommended option 2. Option 2 effectively requires the local government sector to deliver a more efficient outcome than the rest of the economy. If the commission were to proceed with the proxy value approach, our view would be that negative values should be included as under option 1 providing for a more equitable outcome</p>	<p>Our response to issues about the proxy value is on page 12 of the draft proposal.</p>
<p>Victorian Local Government Performance Framework: The paper correctly outlines the deficiency of this approach in that comparisons are largely based on partial productivity measures.</p>	<p>Our response to issues about the local government performance reporting approach is on pages 12 to 14 of the draft proposal.</p>
<p><b>Summary</b></p> <ul style="list-style-type: none"> <li>• We do not support the inclusion of an 'efficiency factor' in setting a rate cap.</li> <li>• Under current legislation, The Minister can set a rate cap based on the projected CPI together with any other desired adjustment.</li> <li>• Each of the models presented in the consultation paper have shortcomings that if adopted would produce suboptimal outcomes for the sector.</li> </ul>	<p>Our rate cap formula is based on 60 per cent weighting of CPI and a 40 per cent weighting on WPI to reflect the short term cost pressures faced by councils. On this basis it is reasonable to include an efficiency factor to encourage councils to operate efficiently and share any efficiency gains with ratepayers.</p> <p>Our response to issues about the Minister's cap is on pages 11 and 12 of the draft proposal.</p>

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## Wyndham City Council (continued)

Issue raised	Commission's draft response
<b>Summary (continued)</b>	
<ul style="list-style-type: none"><li>• It would be more productive to reevaluate the basis for setting the rate cap and establish a Local Government Cost Index based on a basket of goods and services relevant to councils.</li><li>• Any rate cap set needs to reflect the different mix of services and costs of each sub-group of councils in Victoria. It is not a case of 'one size fits all'.</li></ul>	<p>Our response about the strengths and weaknesses of each approach is on pages 12 to 20 of the draft proposal.</p> <p>This is outside of our role.</p> <p>Our response to issues about different rate caps is on pages 22 and 23 of the draft proposal.</p>



