ESSENTIAL SERVICES COMMISSION

Release of Arup's growth study report

Overview

September 2017

An appropriate citation for this paper is:

Essential Services Commission 2017*, Release of Arup's growth study report*, September

Contents

Background

The local government sector in Victoria comprises 79 councils. These councils invest and maintain infrastructure to provide a wide range of services to their community.

In 2015, the Victorian Government introduced the Fair Go Rates system (FGRS) which caps the annual amount that councils can increase their average rates without seeking approval for a higher cap. The commission has a number of roles under the FGRS including assessing higher cap applications from councils.

Why we commissioned an independent growth study

Currently there are 10 interface councils – Cardinia, Casey, Hume, Melton, Mitchell, Mornington Peninsula, Nillumbik, Whittlesea, Wyndham and Yarra Ranges. These interface councils have experienced significant growth over the last decade and this is expected to continue. A number of other councils are also experiencing significant growth, including infill growth.

In 2016, three councils (Ballarat, Casey and Wyndham) submitted higher cap applications that specified growth as a key reason for requiring additional revenue above the average rate cap. In assessing these applications, we were careful to ensure that any rejection of a higher cap did not compromise the council's ability to service growth particularly over the longer term. We indicated the need to better understand the major financial issues associated with growth area councils.

Subsequent to our 2016 higher cap application process, we appointed Peter Brown to undertake an independent review of our first year implementation of the FGRS. In the review, Brown also recommended:

> *A review is undertaken into any special financial issues associated with growth area councils.*

In light of Brown's recommendation, and our undertaking that the higher cap assessment process should address growth more comprehensively, we appointed Arup to undertake an independent growth study and prepare a report on its findings. A copy of the scope is attached at appendix A.

The key objective of the growth study was to gain an independent view of the impact of population growth on the capacity of councils to provide services and infrastructure to the community over time.

Arup's growth study report

Arup's consultation

During the study, Arup consulted with eight interface councils (Cardinia, Casey, Hume, Melton, Mitchell, Mornington Peninsula, Whittlesea and Wyndham), Local Government Victoria, Victoria Grants Commission, Victorian Planning Authority, Municipal Association of Victoria and National

Growth Areas Alliance. Arup also conducted an online survey of all Victorian councils to inform its understanding of broader issues relating to growth. 21 councils responded to the survey.

Arup's questions

Arup's report is structured around four key questions:

- Are councils required to spend more when they are growing in population terms, compared to when population is stable?
- Are growth area councils managing their resources efficiently?
- Are councils using debt effectively?
- Under what circumstances might it be appropriate for growth area councils to increase their rates income beyond the cap?

Arup's findings

Arup's report makes a number of findings:

- Arup found that councils are required to spend more when they are growing compared to when population is stable, primarily due to costs associated with infrastructure delivery.
- Arup found that councils still have room to increase the efficiency and effectiveness of their organisations, particularly in asset management.
- Arup found no evidence that a community's own current and future income is insufficient to fund its local infrastructure (based on the data gathered to date).
  - Arup considers that it is possible to use debt financing to bridge the gap between capital expenditure today and the income from rates and charges in the future.

We have found Arup's findings useful in helping us to understand more about growth and its impact on councils. In particular, where we have previously heard from the sector that growth does not pay for itself over time, Arup found no evidence that this is necessarily the case. Further, Arup appears to have also identified that there are a range of measures that councils can explore to improve the efficiency and effectiveness in managing their infrastructure for growth. This may assist in alleviating the immediate pressure on councils to apply for a higher cap. We will be interested in hearing stakeholder feedback on Arup's findings.

Arup's report also provides a list of possible questions to facilitate our discussion with councils that are seeking a higher cap because of growth:

- What is the forecast rate of growth in your municipality over the next four years?
- What percentage of your expenditure is related to the delivery of new infrastructure for (a) capital works and (b) salary for staff in primarily asset management and delivery functions?
- What is your approach to asset management and delivery?
- What alternative infrastructure delivery models have you considered?
- Have you made full use of the available income?

- What is your approach to debt? How much and what type of debt have you considered?
- Have you had a robust consultation process that sets out to the community the trade-offs between facilities/services, charges, rates and debt?

A copy of Arup's report is attached and is available on our website (www.esc.vic.gov.au).

Next steps

We welcome stakeholder feedback on Arup's report. Following stakeholder feedback, we will consider how to best use the findings and recommended questions to inform our higher cap application assessment process and whether amendments to our guidance material are required.

We also believe that Arup's report will promote greater discussion and sharing of ideas about best practice approaches to managing growth in the sector.

Responding to Arup's report

Questions for stakeholders

1. Are there any gaps or weaknesses in Arup's findings?

2. Are the questions proposed by Arup to assist the commission in assessing higher cap applications relevant and reasonable?

Feedback on Arup's report closes on **18 October 2017**.

Please email any feedback to localgovernment@esc.vic.gov.au with subject title: Feedback on Arup's growth study report.

You may also send feedback by mail marked:

Attention: Local Government Division
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne VIC 3000

Any questions regarding the growth study may be directed to:

Andrew Chow
Director, Local Government Division
03 9032 1300

Please note that your feedback may be published on our website. Please mark clearly if you do not wish your feedback to be published.

Appendix A

A. Understand the extent and nature of population growth and councils' current processes in addressing or managing growth related needs and issues
B. Understand the short- and long-term impacts of population growth on services, infrastructure and overall financial position of councils.
C. What is best practice in terms of addressing/managing growth-related needs and issues?
D. How are participating councils faring against best practice approaches?
E. Taking into account the findings from the above, what are the key questions or considerations ESC should make when assessing higher cap applications (with growth as key reason) to ensure decisions on higher cap applications will not create adverse impacts on council and the community? Are there any suitable key performance indicators which might be useful for both the Commission and councils experiencing significant growth?

We have listed some of the questions we are interested to learn more about growth below. The consultant should not be limited by this list.

In assessing any historical information, data should cover the last ten years. In assessing future information, data should be for the next 10 years (if available).

Comparisons should be made with other councils from other council groups which are also experiencing significant growth in population (either from greenfield or brownfield development).

The consultant should map out its findings and conclusions and make some recommendations for the Commission to consider in assessing higher cap applications due to growth. The consultant should also make recommendations to the participating councils about best practice in managing growth.

Commission's questions

A. Understanding the extent and nature of population growth and councils' current processes in addressing growth related needs and issues:

1. Analyse growth in population (including demographic changes) and rateable properties.
2. Analyse the different drivers of growth of population and rateable properties
3. How do councils account for growth in population and rateable properties in developing their council plans (long-term financial plans and strategic resource plans), asset management plans and capital works programs for the Long-Term Financial Plan (LTFP) and Strategic Resource Plan (SRP) period?
4. What are some of the factors that impact on the capacity of councils to fund their infrastructure needs and obligations arising from growth? These may include:

    i. Phase of growth, the quality and capacity and use of existing infrastructure
    ii. Legacy of past planning decisions
    iii. Sufficiency of other sources of funds such as user charges, government grants (and developer contributions which is discussed in more detail in 6 below)

iv. Accuracy of council projections of growth and their assumptions about when infrastructure will be needed.
v. Type, location and timing need for new infrastructure (greenfield, brownfield, urban, interface, peri-urban)
vi. Council decisions about the scope of works – e.g. additional capacity, service levels decisions above standardised levels
vii. Relative efficiency of procurement and tendering practices.

5. What different levers within their control can a council utilise to manage and provide for growth and how are these utilised by the sector? Are there any identifiable trends in growth councils?

   i. Means of funding: developer contributions, rates revenue, operational savings, efficiencies and expenditure reductions, user fees
   ii. Use of debt: what are the current debt levels of interface councils experiencing rapid growth (vis a vis other council groups) and what impact might increased use of debt finance have on the capacity of growth councils to meet future infrastructure obligations?
   iii. Other levers: may include delaying or altering scope of works, use of reserves or internal borrowing from reserves

6. Understanding contributions of State and Federal Grants in addressing growth over the last 10 years.

   i. At a high level, what is the nature and magnitude of grants received to address growth
   ii. Any costs shifting issue related to addressing growth requirements

7. What is the whole process of developer contribution plan (DCP), and what are the associated issues related to DCPs in addressing growth?:

   i. Explain the process and associated issues.
   ii. All councils using DCPs? Why, why not?
   iii. What percentage of councils' total annual capital spending over the last 10 years is funded from developer contributions; specifically from DCPs? Have the costs of growth related infrastructure provided in the last decade matched the projections of expenditure on infrastructure made in DCPs?
   iv. To what extent does funding from DCPs offset the cost of providing the infrastructure agreed within the DCP? If there is a gap, to what extent is this gap off-set over time by an expanded rate base resulting from the growth?
   v. Compare councils' marginal cost of providing DCP-related infrastructure and services. Explain the reasons for the differences among councils.

vi. Are there circumstances where developer cash contributions which have been received but are not yet needed (as per the DCP milestone) were used for other purposes to help with short term funding requirements and get replaced/repaid later? If no, why not?

vii. Are there any other issues council related to developer contributions and DCPs that the Commission should take into account?

B. Understanding the short- and long-term impacts of population growth on services, infrastructure and overall financial position.

1. Understand the impact of population growth on council services and infrastructure.

i. Which key services have changed over time and are they correlated with demographic changes identified in A.1 above?

ii. What new additional services were introduced resulting from high population growth over the last 10 years?

iii. What has been the council's level of capital expenditure over the last 10 years, including comparison of expenditure on renewals vs new capital projects and comparison of expenditure per type of services?

iv. What has been the trend in councils' capital expenditure per assessment and per population and operating expenditure per assessment and per population?

v. For items 1.i to 1.iv are there any identifiable trends in growth councils?

2. Understand the impact of population growth on councils' level and sources of revenue over time.

i. What is the trend in the level of revenue including the different sources of revenue and how they have changed over time? Are there any identifiable trends in growth councils?

ii. What has been the trend in the level of supplementary rates revenue and cash contributions received over time? Are there any identifiable trends in growth councils?

iii. Are there other potential sources of revenue currently available to councils that they don't use? Why not?

C. What is best practice in terms of addressing growth-related needs and issues?

D. How are participating councils faring against best practice approaches?

E. Taking into account the findings from the above, what are the key questions or considerations ESC should make when assessing higher cap applications (with growth as key reason)? Are there any suitable key performance indicators which might be useful for both the Commission and councils experiencing significant growth?