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Local Government Rates Capping and Variation Framework Review
Essential Services Commission
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LOCAL GOVERNMENT RATES CAPPING AND VARIATION FRAMEWORK REVIEW

Thank you for your invitation to comment on the draft report on the Local Government Rates Capping and Variation Framework Review. We appreciate the time taken by the Essential Services Commission (ESC) to understand the complex nature of the legislation under which Councils operate.

Once again we have canvassed FinPro members across every Victorian Council seeking comments on this review. Some of the comments we have provided may also be seen in submissions from some council's, however, we have also considered them important to restate in the FinPro submission. While there are differing views in some Councils we have taken a middle ground approach on many of the recommendations and have stated where there are concerns in addition to our response. Our comments on the draft report are detailed in the table attached.

FinPro is pleased that many of the draft recommendations included in the ESC's draft report are consistent with the feedback and recommendations of our first submission. There are, however, a number of significant concerns regarding the likely outcomes under a rates capping regime based on the draft recommendations.

We are pleased to have been invited to participate in the technical working group to assist the ESC in detailing the capping and variation process.

With regards to the comments, members of the FinPro Technical Committee would be happy to meet and discuss the points raised.

Yours sincerely

SHANE MARR	MARC GIGLIO
PRESIDENT	**VICE PRESIDENT/ CHAIR TECHNICAL COMMITTEE**

No.	Draft Recommendation	FinPro Response
	THE RATE CAP	
1	The Commission recommends that there should be one rate cap that applies equally to all councils in Victoria.	FinPro is concerned with the impacts of a rate cap with a specific reference to the impact on the Victorian economy through the inevitable reduction in infrastructure spending. If the cap is introduced FinPro endorses the use of a single cap to achieve simplicity with Councils having the ability to submit a variation where required. Some Councils argue, however, that this approach is not fairer. For example where Councils do not charge separate for waste management. This is discussed further in Recommendation 5.
2	The Commission recommends that: • revenue from general rates and municipal charges should be subject to the rate cap • revenue from special rates and charges, 'revenue in lieu of rates' and the fire services levy should not be included in the rate cap • service rates and charges should not be included in the rate cap, but be monitored and benchmarked. •	FinPro are satisfied that the special rates and charges, 'revenue in lieu of rates', the fire services levy, and service rates and charges are excluded from the rate cap. We also support that idea that supplementary rates are proposed to be excluded from the rate cap in the year they occur.
3	The Commission recommends that the cap should be applied to the rates and charges paid by the average ratepayer. This is calculated by dividing a council's total revenue required from rates in a given year by the number of rateable properties in that council area at the start of the rate year.	FinPro support the methodology of applying cap on rate per assessment. The calculation method proposed is easy to understand and simply to verify, however, under this formula there will be some challenges including the accuracy in predicting the number of rateable properties on 1 July each year.
4	The Commission recommends that the annual rate cap should be calculated as: Annual Rate Cap = (0.6 x increase in CPI) + (0.4 x increase in WPI) - (efficiency factor) With: CPI = DTF's forecast published in December each year and WPI = DTF's forecast published in December each year.	While FinPro recognises the ESC's willingness to recognise that CPI is not an adequate measure to base a rate cap, we believe the components that make up the Cap still do not reflect the cost of delivering services and maintaining infrastructure. We would argue that, if used, the weighting of the components should in fact be reversed, i.e. 60%WPI and 40%CPI. We have concerns regarding the timing of the announcement of the rate

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	The efficiency factor will initially be set at zero in 2016-17 but increasing by 0.05 percentage points each year from 2017-18. The Commission will undertake a detailed productivity analysis of the sector to assess the appropriate long-term rate for the efficiency factor.	cap and the link to the DTF release of data. The rate cap should be advised to councils October annually, however with the link to the DTF CPI & WPI indexes we understand this is most likely a lost cause. The inclusion of an efficiency factor comes as a surprise to FinPro. We understood that the ESC were developing a rate capping regime and see this as an attempt to place further pressure on Councils capacity to provide services and maintain infrastructure. Furthermore, imposing an efficiency factor will inevitably force Councils to reduce service and infrastructure levels, causing significant risk for current and future generations. In fact, by introducing a Cap in itself will achieve efficiencies as Councils identify efficiency opportunities across all services An efficiency factor should not be included in the capping mechanism as Local Government is already subject to enforced productivity gains via CPI limits on grant revenues from other levels of government, and rate capping itself is a form of forced productivity improvement. Also the VGC freeze will have a long lasting effect on councils as it has eroded the grant base going forward; FinPro continue to encourage the ESC to develop a formula similar to that of the MAV Local Government Cost Index. The Index has been developed to monitor a more representative set of local government costs. It has historically demonstrated that local government costs have never been at or even close to CPI levels.
5	The Commission recommends that the 2015-16 rates (general rates and municipal charges) levied on an average property should be adopted as the starting base for 2016-17.	FinPro endorses the starting base be the 2015/16 FY, however, we would like to clarify whether or not the base includes supplementary rates for the 2015/16 year. We also acknowledge that six of our member Councils do not levy separate Section 162 Service charges for waste cost recovery. We appreciate that the recovery of waste costs via a service charge is common across the industry however it would be seen, by those six councils, as a regressive step to be forced to introduce these types of charges on ratepayers. We expect that those councils will be treated equally with the opportunity to

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		isolate waste costs from the capping mechanism, without being forced to introduce charges that have previously been collected as part of general rates.
	THE VARIATION PROCESS	
6	The Commission recommends that the framework should not specify individual events that would qualify for a variation. The discretion to apply for a variation should remain with councils.	FinPro agrees that to do so would be unnecessarily restrictive and Councils are best place to assess the circumstances in which a variation is required.
7	The Commission recommends that the following five matters be addressed in each application for a variation: • The reason a variation from the cap is required • The application takes account of ratepayers' and communities' views • The variation represents good value-for-money and is an efficient response to the budgeting need • Service priorities and funding options have been considered • The proposal is integrated into the council's long-term strategy	FinPro endorses the five criteria in the variation application process; however, we do share many Councils concerns on the expectations taking account of its community views. Councillors as the elected representatives of the community are best placed to make decisions on the council budget as they are privy to the intimate detail of budget development processes. If this were to be a requirement, FinPro would expect that there would be a wide variation in the methods and resources dedicated in complying with this requirement.
8	The Commission recommends that in 2016-17, variations for only one year be permitted. Thereafter, councils should be permitted to submit and the Commission approve, variations of the length set out below **First year of variation** — **Length of permissible variation** 2016-17 — One year (i.e. 2016-17 only) 2017-18 — Up to two years (i.e. 2017-18 only or 2017-18 and 2018-19) 2018-19 — Up to three years (i.e. up to 30 June 2021) 2019-20 and beyond — Up to four years (i.e. up to 30 June 2023)	FinPro reiterates its position on the length of the permissible variation which states that indicative capping and lack of certainty may negatively affect community confidence in Council's strategic planning ability. Setting a rate cap level informed only one or two years at a time means that Councils will be unable to fulfil financial planning and management responsibilities currently specified by the Act. The planning cycle for asset renewal and significant capital projects along with borrowing or debt reduction strategies requires at least a four year period of certainty. Councils considering major community infrastructure projects need planning and funding certainty often four to five years into the future Councils Enterprise Bargaining Agreements are negotiated typically for three years also need a known income base to avoid the real risk of a cap determination moving below what has formally been struck for wages growth.

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		We recommend that if a multi-year cap methodology is considered then it should reflect the Strategic Resource Plan (SRP) planning time frame.
9	The Commission recommends that it should be the decision-maker under the framework, but only be empowered to accept or reject (and not to vary) an application for variation	FinPro has heard from many of its members who believe that the removal of council's ability to make decisions with respect to revenue raising reduces their capacity to ensure financial decisions are made in the best long term interests of the community. Should the ESC be the decision maker, FinPro agree that but only be empowered to accept or reject (and not to vary) an application for variation.
	MONITORING AND REPORING	
10	The Commission recommends that it monitor and publish an annual rates report on councils' adherence to the cap and any approved variation conditions.	FinPro share the concerns with many Councils who believe that the costs of providing reporting to the ESC will be substantial and will require additional resources. This will be in addition to the report and regulatory burden already placed on Councils. The danger is that the media will use the information to create league tables as experienced by Councils in the past. An alternative would be to have Councils publish results in their annual reports. While FinPro understands the role of monitoring for compliance we would oppose the framework becoming a vehicle to impose further regulation on the sector.
11	The Commission recommends that it monitor and publish an annual monitoring report on the overall outcomes for ratepayers and communities.	Once again, FinPro share the concerns with many Councils on the report burden that this requirement would place on Local Government.

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	MATTERS FOR CONSIDERATION	
	The Commission recommends that the Government consider making a formal review of the rates capping and variation framework a statutory obligation. The review should draw on any data and trends identified through the ongoing monitoring regime and all interested parties should have an opportunity for the sector to provide input to that review. The Commission considers a review period of 4 years to be appropriate.	FinPro recommends that the review be conducted at the earliest possible interval drawing on the impacts of the capping and variation regime.
	The Commission recommends that the Government consider amending the *Local Government Act 1989* to require that service rates and charges must reflect the efficient costs of providing the underlying service	FinPro believe that this is not necessary as section 136 of the Act ***Principles of sound financial management*** provides the necessary requirement for Councils to manage costs efficiently.
	The Commission recommends that the Government consider initiating a periodic review to ensure that statutory fees continue to reflect councils' efficient cost of providing statutory services.	FinPro agrees with this recommendation with particular note that statutory fee increases have not reflected the actual cost of the service.
	IMPLEMENTING THE FRAMEWORK	
	• ESC announces cap — December 2015 • All councils submit baseline data (budget) — January 2016 • Councils notify ESC of intention to seek a variation — January 2016 • Council applies for variation, submits baseline data (budget) — March 2016 • ESC assesses council variation applications — March-May 2016 • ESC notifies councils of decisions — May 2016 • Councils consult on draft budget — May 2016 • Councils formally adopt budget — June 2016	FinPro believes that the proposed timelines will be challenging and problematic for many Councils. We recommend that this be a focus of discussion with proposed workshops with sector representatives.

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