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Essential Services Commission
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Dear Dr Ben-David,

LOCAL GOVERNMENT RATES CAPPING AND VARIATION FRAMEWORK REVIEW

Thank you for your invitation to comment on the Local Government Rates Capping and Variation Framework Review. One of the key objectives of FinPro is to provide advocacy for local government practitioners on issues, which affect the industry as a whole, and to act as the focal point of reference by regulatory bodies on financial issues affecting the sector.

In this process 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 and other Local Government peak bodies, however, we have also considered them important to restate in the FinPro submission. Comments addressing the 22 questions outlined in the consultation paper are listed in the table attached.

In general we:

- Don't support a rate cap based on CPI and recommend development of an independently verified and validated local government cost index.
- Recommend the base to which the cap applies be carefully considered.
- Recommend that the variation process does not create unnecessary burden for already financially constrained Councils and that the criteria are clear and known in advance.
- Recommend a comprehensive community information campaign will be necessary to ensure that the methodology is and benefits are easily understood.

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
PRESIDENT

MARC GIGLIO
VICE PRESIDENT/ CHAIR TECHNICAL COMMITTEE

No.	Question	FinPro Response
	THE FORM OF THE CAP	
1	While a cap based on CPI is simple to understand and apply, are there any issues that we should be aware of?	The rate cap should not be based on CPI or have CPI as the major influence in the calculation of the proposed cap (see Response 2). Cost increases will vary for local councils from region to region. Costs for materials in remote areas or communities that have significant cost such as transport will not be reflected in CPI movements.
2	What are some ways to refine the cap (for example, alternative indices), in line with the Government's objectives?	FinPro recommends development of an independently verified and validated local government cost index which could form the basis for a more relevant starting point than CPI. We suggest that the cap should be based on a Victorian Local Government Cost Index (VLGCI), which measures price movements over the past year for goods, materials and labour used by an average council. We recommend the ESC work closely with the MAV and look closely at their LGCI model and consider it as a base for the ESC model. The proposed index should take into account: • new regulatory and statutory obligations imposed on Councils • Further cost shifting from other level o government. • Geographical location, e.g. rural, regional, inner metro, outer metro, growth fringe metro. • Average Weekly Earnings for the Public Sector in Victoria. • The impact of Superannuation defined benefits unfunded liability calls. • Capital Building cost indices • Reliance on rates as a proportion of income. Therefore, we recommend a Local Government cost index be developed with additional adjustment mechanisms for the above outlined change drivers.

No.	Question	FinPro Response
3	Should the cap be set on a single year basis? Is there any merit in providing an annual cap plus indicative caps for the next two to three years to assist councils to adopt a longer term view in their budgeting and planning, particularly when maintaining and investing in infrastructure often takes a longer term perspective? How should such a multi-year cap work in practice?	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. We recommend that if a multi-year cap methodology is considered then it should reflect the Strategic Resource Plan (SRP) planning time frame.
4	Should the cap be based on historical movements or forecasts of CPI?	As outlined in our response to Questions 1 and 2 above, FinPro strongly recommends that CPI is not used as an indicator and that a more appropriate indicator is developed. Most indicators provide a historical perspective that may bear no relationship to future cost pressures outlined in the response to question 2.
5	Should a single cap apply equally to all councils?	If a single cap is introduced, ratepayers across the state should be treated equally. They should receive the same level of rate rises and the same level of impact to service delivery and maintenance of community assets. The reasons to support this include simplicity and ease of community understanding. This approach, however, would not align with Principle 1 in the consultation paper. If an alternative method is adopted, for example, a state wide Local Government cost index plus adjustment factor (e.g. infrastructure levy) the rationale for the differences should be made clear to the community.

No.	Question	FinPro Response
	THE BASE TO WHICH THE CAP APPLIES	
6	What base should the cap apply to? Does it include rates revenue, service rates/charges, municipal charges and special rates/charges?	A cap should only apply to rates as described in the ***Local Government Act* 1989 Part 8**, including**:** • Rates and charges on each occupancy S.158A: • Uniform S.160 • Differential rates S.161 • Limited differential rates S.161A • Municipal Charge S.159 We recommend that the cap should not be applied to Service Rate or Charge S.162 e.g. waste, rubbish or recycling charges and S.163 Special Rates and Charges. These rates and charges are generally specified to defray the costs of specific purpose and set at specified amounts (usually for a small number of residents/ratepayers). FinPro notes that Councils without service charges such as separate waste charges would be disadvantaged. Applying the cap to the uniform rate does not account for significant shifts in environmental costs which are commonly recovered through higher adjustments to waste charges that apply at various councils. *We would advocate for the cap to not be applied to the proportion of waste and environmental management costs for those councils that have not declared a service rate or charge under S.162.*
7	Should the cap apply to total revenue arising from these categories or on average rates and charges per assessment?	The issues in relation this question are extremely complex. We urge the ESC to give careful consideration when designing the methodology. We firmly believe that the rate cap increase should apply to the total estimated rate base at the end of the previous financial year to which the cap will apply (i.e. total rate income at 30 June of the previous financial year) not the budgeted or declared rate base in the previous budget document. This will ensure that rate growth from supplementary or new rates (especially for growth Councils) is included in the starting base from which the cap will apply.

No.	Question	FinPro Response
8	How should we treat supplementary rates? How do they vary from council to council?	Supplementary rates recognise new properties or increases to a property's CIV between biennial revaluations. Hence they represent increases in service demand due to additional population and or properties in the municipality. For example, an increase in population requires additional services, e.g. more Immunisation programs, higher Maternal & Child health services, additional library facilities and materials. Higher property numbers drives the need for more and better open space and recreation opportunities and to other services such as traffic treatments to cater for higher vehicle density. Higher density property development also generates demand for planning, building, local laws and asset protection services. *<u>Therefore, supplementary rates must fall outside of any rate cap regime</u>*.
9	What are the challenges arising from the re-valuation of properties every 2 years?	Councils set rates by determining the level of rate revenue required to fund existing services, required capital works each year and provision for new or expand services and works. The valuation of each property and subsequent two-yearly revaluation process determine how the rate burden is distributed, not the level of rate revenue required. The rate cap should be applied in a consistent manner year-on-year. So to minimise confusion, with biennial revaluations and rate setting with variable rates in the dollar, the cap should apply to total rate revenues (including items detailed in Question 7 i.e. rates, municipal charges). This of course will mean that in revaluation years all ratepayers will experience different levels of rate increase (or decrease) compared to the previous year, as individual property valuation movements are applied. This will no doubt cause confusion amongst ratepayers, who will be expecting a CPI rate increase each year. This will be particularly problematic in the first year of implementation with the impact of valuation shifts masking the real benefit for the average ratepayer. *<u>A comprehensive community information campaign will be necessary to ensure that the methodology is and benefits are understood.</u>*
10	What should the base year be?	The base year should be the forecasted result for 2015/16 or later if a transition period was to be introduced.

No.	Question	FinPro Response
	THE VARIATION PROCESS	
11	How should the variation process work?	It is important that the variation process does not create unnecessary levels of bureaucracy for already financially constrained Councils and that the criteria are clear and known in advance. A template for variation requests should be developed in advance as should definition of what is best practice community consultation that would underpin any variation request. FinPro request that a variation process that is administered by the ESC provides for: • an equitable consideration of bids from all councils, regardless of the size of council, recognising that smaller councils may have limited resources to prepare and submit bids • Independent financial indicators such as the current risk ratings of the Auditor General as per the annual report for 'Local Government Results' where a council is deemed not to be in the low financial sustainability risk category and therefore is a sound reason to apply for cap variations • a process to be facilitated several months prior to councils advertising draft budgets (variation/submission decisions by end of January each year) • recognition of councils' requirements to maintain infrastructure renewal expenditure at a rate higher than the rate cap • recognition of councils' desires to expand/increase service delivery with new initiatives • a variation/submission process that does not incorporate onerous or cost prohibitive deterrents to each council submitting a bid.
12	Under what circumstances should councils be able to seek a variation?	Councils should be able to submit a bid when seeking additional funding for: • Increased renewal gap funding in line with STEP program identified requirements • major new infrastructure; or the ability to service loan funding for such infrastructure • increased/expanded services e.g. new initiatives • servicing the cost shifting associated with managing other levels of government services

No.	Question	FinPro Response
		• maintaining financial sustainability according to VAGO indicators, particularly working capital ratio (greater than 150%) • implementing Council adopted strategic plans e.g. Asset Management Plans.
13	Apart from the exceptions identified by the Government (namely, new infrastructure needs from a growing population, changes in funding levels from the Commonwealth Government, changes in State Government taxes and levies, increased responsibilities, and unexpected incidents such as natural disasters), are there any other circumstances that would justify a case for above cap increases?	See response to Q12. Also, if the local community supported a proposal from their Council to invest in community infrastructure or some other initiative, this should be grounds for an additional rate increase beyond the cap. Councils face a range of external influences which impact on the development of the budget. Given that these factors are largely outside Council control it would be appropriate that the impact of these factors be included in the range of variations to the cap. Examples of these factors outside Council control include: • Bridging asset renewal gaps • Continued freezing of statutory fees. • Ongoing Cost Shifting by State or Federal government • Higher than CPI increases in Utility charges • Changes in legislation requiring Councils to undertake extensive works to prepare, e.g., recent changes to Residential Zones, Local Government Performance Reporting Framework, Emergency Management obligations and the pending Energy Safe Victoria tree pruning regulations resource implications. • Legal costs due to unpopular and unacceptable planning applications and other examples of legal issues such as dangerous dog cases. • Constraints on non-rate revenue raising through legislation e.g. Subdivision Act

No.	Question	FinPro Response
		• Defined Benefit Unfunded Superannuation Calls • Increases in Workcover insurance premiums • Cessation or redirection of annual Grant programs e.g. Living Libraries, Community Infrastructure Fund etc. • Increased property density leading to open space requirements and/or increased demand for services and impacts to assets • Changes in the rate of payment for valuations by the SRO. • Council elections
14	What should councils need to demonstrate to get a variation approved? What baseline information should be required for councils to request a variation? A possible set of requirements could include: • the council has effectively engaged with its community; • there is a legitimate case for additional funds by the council; • the proposed increase in rates and charges is reasonable to meet the need; • the proposed increase in rates and charges fits into its longer term plan for funding and services; • the council has made continuous efforts to keep costs down. We would like stakeholders' views on whether the above requirements are adequate.	All of the items listed are relevant and adequate requirements for councils to demonstrate as part of the submission process: • The council has effectively engaged with its community. **Agree** (please refer to Response 15 on Community Engagement); • there is a legitimate case for additional funds by the council – **Agree** • the proposed increase in rates and charges is reasonable to meet the need – **Agree** • the proposed increase in rates and charges fits into its longer term plan for funding and services – **Agree** • the council has made continuous efforts to keep costs down – **Agree**.
	COMMUNITY ENGAGEMENT	
15	What does best practice in community engagement, process and information look like? Are there examples that we can draw from?	At the majority of Councils, Community engagement is undertaken on a regular basis and within a strategic framework, permitting multiple opportunities for community members to shape specific Council plans and strategies over the short and longer term. Community members' long and short term interests are hence known to Councillors who then make balanced decisions that reflect community needs and demands. Councils are faced with the challenge of finding a balance between the competing

No.	Question	FinPro Response
		demands placed on the annual budget. For example, Council may engage with sports clubs or park users who wish to improve facilities in their local area and during the same period with local business that require additional public car parking to be provided to enhance economic viability. In reality each Council budget has hundreds of these complex decisions being made. Many Councils have considered these types of issues annually and have determined that elected representatives, are the best placed to make these decisions. While community members may be passionately interested in particular projects, policies or services that affect them there is not a high level of interest in rates as a topic. At all Councils' engagement occurs with the development of every policy, strategy and plan which Council prepares. These initiatives inform the allocation of resources. One of the key strengths of a democratic system is the check and balance which arises from decisions being made by those accountable to the people impacted by decisions. This is the role of elected representatives. Those who choose to participate in budgeting or other strategic initiatives do not have this vitally important element of accountability. However, no constraints are imposed upon the ability of any member of the community to make any submission they like about Council's budget. Unlike other levels of government, Council will hear submissions regarding its budget prior to adoption.
	INCENTIVES	
16	How should the framework be designed to provide councils with incentives to pursue ongoing efficiencies and respond to community needs? How could any unintended consequences be minimised?	The Local Government Act currently requires Councils to ensure that resources are used efficiently and effectively and services are provided in accordance with the Best Value Principles to best meet the needs of the local community. The MAV step program now includes a third dimension focused on 'Service Planning' which aims to assist councils with a framework for long term service delivery. This incorporates evaluating current service levels, the efficiency and effectiveness of the service and the level of service the community is prepared to pay for. FinPro see this dimension as critically important to the long term sustainability of Councils which requires adequate resourcing and skills capacity building. FinPro does not support the concept of offering incentives to Councils to respond to community needs. To maintain autonomy Councils need to determine how they wish to

No.	Question	FinPro Response
		balance efficiency against effectiveness and service quality having regard for community needs and the level of subsidy provided.
	TIMING AND PROCESS	
17	A rates capping and variation process should ensure there is enough time for councils to consult with their ratepayers and for ratepayers to provide feedback, and for us to review councils' applications. To ensure the smooth functioning of the rates capping and variation framework, it is particularly important that it aligns with councils' budget processes. We are interested in stakeholders' views on how this can be achieved.	The timing and timeliness of the variation application consideration will be important if not to de-rail the smooth running of a Council's budget preparation and consultation process in accordance with the timeframes established in the Local Government Act. Authorisation of variations would need to be complete by end of February to enable preparation of budget documents and statutory consultation of 4 weeks to occur during April/May, consideration of S223 submissions, and Council adoption by 30 June. Announcement of the years cap and forecast guidance should be by December (latest) to allow Council assessment and planning of non-capped income and setting of capital and operation priorities to form a draft budget by April for community review and comment. We recommend that the consultation process that councils undertake on a proposed variation would need to take place in October each year with the expectation that a council would: • undertake community consultation in October; • submit a variation to ESC in November; • receive advice (ESC) on the success or failure of the bid in December and proceed with the completion of the budget process.
	TRANSITIONAL ARRANGEMENTS	
18	What transitional arrangements are necessary to move to the new rates capping and variation framework? Is there merit in phasing in implementation over a two year period to allow for a smooth transition?	We recommend a transition year that allows councils to prepare the 2016/17 draft budgets in-line with their pre-rate capping announced SRPs. If they require a variation then the ESC will need to give some concession regarding the consultative process that might be expected in future (post 2016/17) variation. Other factors that need to be considered include: • 2015/16 is a revaluation year and therefore the perception of benefit from the wider community will be diluted by the shifts in rates associated with the re-

No.	Question	FinPro Response
		valuation • 2016 is a Council election year and the commencement of a new Council 4 year budgeting and planning cycle. An effective approach would be to coordinate the introduction of a new cost containment framework with the wider council planning (which includes significant community engagement). In 2016-17 the ESC could publish proposed rate caps for 2017-18 to 2019-20 to allow Councils to review the financial implications and any required reduction in services or adjustments to infrastructure renewal and appropriately incorporate in the Council planning process i.e. 4 year SRP.
	ROLES	
19	What are stakeholders' views on the respective roles of the key participants? Should the Commission's assessment of rates variations be advisory or determinative?	FinPro agrees that there is benefit in an independent arbiter, such as the Essential Services Commission, overseeing the implementation of any rate-capping framework. The role of the Essential Services Commission would be to: • Review Council Budgets and variation submissions for those where mandatory referral is required; • Authorise rate increases in excess of the baseline where Business Cases have sufficient merit in accordance with the established criteria; • Provide advice to the Minister for Local Government in circumstances where Business Cases are seen to have insufficient merit and other intervention may be required. • Monitor the success of the implementation of the Rate Capping and Variation Framework and provide advice to the Minister on any review, taking into consideration feedback from the Sector. Importantly, FinPro recommends that the ESC be the final arbiter regarding rate variations to remove any perceptions of political interference. Local Government Victoria's role should be to provide direct support to Councils in reconsidering their financial strategy where Business Cases are deemed by the ESC to have insufficient merit. It will be important to ensure that over time the policy parameters to support rate capping are integrated across VAGO, LGV and the Essential Services Commission to

No.	Question	FinPro Response
		ensure maximum public transparency for Councils and for Government. This should also be reflected in the Local Government Performance Reporting Framework
	OTHER MATTERS	
20	Is there a need for the framework to be reviewed to assess its effectiveness within three years' time?	Yes. It is FinPro's view that a regular cycle of review is imperative, and should take into consideration not only feedback from the Sector and the community but also include a full assessment of the economic impact on the impact on Councils' financial sustainability (changes to sectors VAGO financial sustainability measures) and particularly ability to meet asset renewal requirements pre and post rate capping implementation. It should also include movement in Councils resident satisfaction survey results pre and post rate capping with focus on changes in resident assessment of quality of services and infrastructure condition.
21	How should the costs of administrating an ongoing framework be recovered?	As a State Government policy position it should be fully funded by State Government. Any attempt to operate the framework on a cost recovery basis from the sector would ironically further disadvantage those Councils who have the most pressing financial need The cost of administering the framework to the State can be minimised through ensuring that the process is non-bureaucratic, simple to navigate and based on appropriate templates etc. Should Local Government be required to fund the administration and compliance of rate capping framework then an automatic funding adjustment is required when setting the rate cap.
	OTHER MATTERS RAISED IN EARLIER CHAPTERS	
22	We are interested in hearing from stakeholders on **whether we have developed appropriate principles for this review**: • PRINCIPLE 1 - Local communities differ in their needs, priorities and resources; • PRINCIPLE 2 - Local communities and ratepayers are entitled to hold their councils to the highest standards of accountability and transparency when setting rates;	FinPro is generally in agreement with the principles for the review set out in Section 4 of the Consultation Paper. The exceptions to this are outlined below : • Principle 4 – we agree with this principle, however suggest that the burden of proof should be variable, depending on the level of increase that is sought above the cap. There would be benefit in establishing a framework that required a less onerous burden of proof where the level of increase sought above the cap is, for example, up to 2% above the cap. This would also reduce

No.	Question	FinPro Response
	• PRINCIPLE 3 - The framework should support the autonomy of councils to make decisions in the long term interests of their community and ratepayers; • PRINCIPLE 4 - Councils will need to satisfy the burden of proof outlined in the framework when seeking a variation above the cap; • PRINCIPLE 5 - Rate increases should be considered only after all other viable options have been explored; • PRINCIPLE 6 - The framework should support best practice planning, management systems and information sharing to uphold council decision making; • PRINCIPLE 7 - The framework should be flexible and adaptable; and • PRINCIPLE 8 - There should be few surprises for ratepayers and councils in the implementation of the framework.	the expectation on the ESC and reduce the costs of implementation. • Principle 5 – should be re-worded to reflect Rate increases **above the cap** should be considered only after all other viable options have been explored. Rate increases that keep pace with reasonable levels of cost escalation are responsible financial management. The current wording infers that any rate increase, even at CPI, is a last resort. • Principle 7 – suggest that a further dot point is added under this principle to reflect that the framework should not apply unnecessary levels of bureaucracy or administrative burden on either the ESC or Councils.
	• whether there are other issues related to the design or implementation of the rates capping and variation framework that stakeholders think are important	Refer previous comments
	• supporting information on the major cost pressures faced by councils that are beyond their control and the impact on council rates and charges.	Other factors for the consideration include: • A narrow cost only focus does not evaluate or acknowledge Councils contribution to resident's quality of life though in home support services, open space and sport and leisure facilities, child immunisation and family services, library and meals on wheels to name some. Value for money and contribution to quality of life has been ignored. Council acknowledges the financial pressures notably on pensions and self-funded retirees but advocates for equal recognition for the services and role Councils play in delivery on the ground to this section of the community. • As forward capital programs are reprioritised and scaled back over time there is an unintended negative consequence to construction industry employment as well as an economic multiplier effect across business in general. While on a council by council basis this may reach $10m or $15m over a ten year long term financial plan horizon, the aggregate of this amount by 79 Victorian Councils could readily reach $1b over a decade. FinPro supports the following points made by LGPRO in its submission as many of our members have contributed to the LGPro submission.

No.	Question	FinPro Response
		• **Defined benefit superannuation liabilities that are not equally applied to State and Commonwealth government schemes** Since 1998 Victorian local government has paid $1.162b in calls into a defined benefit superannuation scheme. All levels of government operate Defined Benefit Superannuation Schemes. However while there is complete transparency in relation to Local Government defined schemes by contrast the State and Federal schemes no transparency with rate payers who all unknowingly contribute. The benefits were defined and as a result employer governments need to fund them. The local government scheme was established by State legislation and closed to new members in 1993. Although new members were not able to access the scheme after that time, the liabilities to existing members continue to grow. The structure of the local government fund is such that it has to be kept fully funded for future liabilities at all times. This is in distinct contrast to the funds operated by the Victorian State Government and Commonwealth Government each of which currently has tens of billions of unfunded of unfunded liabilities. If the same rules of operation were applied to the local government fund, $1,162b in calls and contributions tax would not have needed to be funded across the 17 years since 1998. This requirement that is unique to local government places significant and often unplanned upwards pressure on rates. • **Lack of escalation of local government fees regulated by the State Government** Many fees which fund Council services are set by State agencies. While State agencies have over the years applied regular escalation to fees that benefit the State, they have not applied the same level of rigour to fees that benefit local government. Despite advocacy on this matter, Local Government has been unable to directly influence these fees and charges that are set on its behalf. A lack of annual indexation on these charges puts pressure on other areas of council budgets. Between 2000 and 2013 successive State governments have increased fees by less than half the CPI. Examples of charges that fall into this category include: planning permits, development plan permits, applications to re-zone land. Less and less of the real cost of delivering the service are therefore met by the applicant, shifting the burden to fund the gap to rates, and therefore all ratepayers.

No.	Question	FinPro Response
		The result is that residents across the wider municipality are subsidising developers through increases in the general rate. • **Changing State or Federal Government policy positions which have flow on cost impacts for local government and increases in government charges that are in excess of CPI** From time to time State and Federal Governments introduce changed policy objectives which have flow on implications for local government. A recent example is the 4 year old preschool universal access policy which has involved considerable operational expenditure by councils and capital works to maintain preschool infrastructure. Revised emergency management arrangements following the Bushfires Royal Commission have also resulted in substantial additional costs for many rural and interface municipalities. Over the last 5 years there have also been a number of increases in government charges paid by councils which have increased by more than CPI. Recent examples include the landfill levy and the fire services levy • **Services that councils deliver on behalf of the State Government which are not fully funded through grants** The successful implementation of a rate capping framework must recognise the interdependent financial relationship between all levels of Government, but in particular that of State and Local Governments. A cut or a restriction in one area can have flow on implications for others. Local Governments typically provide a number of services on behalf of, or in partnership with, State and or Federal Governments which are funded through grant programs. There is evidence that over time grants have not kept pace with the true cost of service delivery. Restricting the ability of Councils to generate revenue through rates will bring increased focus and scrutiny on those areas where Local Government receives less funding than the cost of delivery of such services. The most significant example of this is HACC services, where it is estimated that Victorian Councils currently contribute approximately $115m per annum above grant funding levels. Other examples include School Crossing Supervisors, Library Services and Youth Services, immunisation, maternal child

No.	Question	FinPro Response
		health services. An unintended consequence of rate capping may be a reduction in Local Government's ability to subsidise declining real contributions from other levels of government for these services. In this scenario, Councils would deliver services to the level of funding provided, rather than to the true cost of the service.