Local government rates capping and variation framework

Submission by Nillumbik Shire Council in response to the Essential Services Commission's Consultation Paper

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LOCAL GOVERNMENT RATES CAPPING AND VARIATION FRAMEWORK

ESSENTIAL SERVICES COMMISSION CONSULTATION PAPER APRIL 2015

SUBMISSION BY NILLUMBIK SHIRE COUNCIL

Introduction

This submission responds to the Consultation Paper released by the Essential Services Commission (ESC) in April 2015 regarding the proposed Rates Capping and Variation Framework for Victorian Local Government. The framework proposes that increases in Council rates be capped at the Consumer Price Index (CPI).

This response by Nillumbik Shire Council makes various recommendations that, if implemented, would enable the framework to be implemented without adversely impacting on the capacity of Council to provide services and infrastructure to meet community needs.

As an Interface council, Nillumbik faces a range of issues that are different to those faced by established metropolitan municipalities. Nillumbik's issues include:

- Responsibility for conservation and management of the Nillumbik Green Wedge, which is widely recognised for its environmental significance to wider Melbourne, along with responsibilities for fire prevention and emergency management.
- Nillumbik has a large geographic area to service (which involves additional cost)
- Nillumbik has more residents per property than any other Victorian municipality (and 50% more residents per property than the average municipality).
- Despite the fact that 90% of Nillumbik is rural land (outside the Urban Growth Boundary), Council is not eligible for rural grant programs, which impacts on the level of rates.
- Interface councils, such as Nillumbik, tend to have a higher proportion of local infrastructure (particularly roads) than state infrastructure, when compared to inner/middle metropolitan councils where a greater proportion of the road network is arterial roads which are funded by the state. This higher proportion of local infrastructure places an additional burden on Interface council budgets.
- Nillumbik does not have significant non-rate revenue sources (such as car parking fees and fines) that are available to metropolitan councils.
- Although Nillumbik's rates-per-property are above the state average, the levels of rates-per-resident and expenditure-per-resident are both below state averages.

While rate increases in recent years have been above CPI, this has to a large degree been attributable to factors outside of Council's control. These include the recent $4.6 million statutory liability for defined benefit superannuation; natural disaster responses; higher regulatory standards imposed by governments; and cost shifting by State and Commonwealth Governments (in the form of grants erosion or additional charges on Council).

If a rate cap is to be introduced, then Council considers that this must:

- Be confined to rate increases that arise from Council spending decisions, with automatic exemptions for any additional costs arising from external impacts; and

- Provide sufficient capacity for Council's responsible stewardship of Nillumbik's natural assets (the Green Wedge) and built assets (community infrastructure).

Responses are provided according to the issues as listed in the Consultation Paper.

Key recommendations are shown in bold.

1. THE FORM OF THE CAP

Selection of an appropriate index

- A cap based on the Consumer Price Index (CPI) is out of scope and has little relevance to the costs of local government.

- According to the Australian Bureau of Statistics, the CPI measures price movements of the following items:
    - Food and non-alcoholic beverages
    - Alcohol and tobacco
    - Clothing and footwear
    - Housing
    - Furnishings, household equipment and services
    - Health
    - Transport
    - Communication
    - Recreation and culture
    - Education
    - Insurance and financial services

- The majority of these items are not used by local government in delivering its services to the community, and are irrelevant to the level of rates.

- As the Australian Bureau of Statistics has noted, "*A consumer price index measures the change in prices paid by households for goods and services to consume. All expenditures by businesses, and expenditures by households for investment purposes, are out of scope of a consumer price index*".

- Key drivers of local government costs are building materials prices and labour prices. An appropriate index would focus on these determinants, not consumer prices.

- If CPI is to be used, then short-term fluctuations will be problematic, as these will undermine longer-term financial planning by local government.

- The CPI can fluctuate considerably each quarter. According to the ABS, the annual CPI for the year ended June 2014 was 3.0%. However six months later, the annual CPI for the year ended December 2014 was 1.7%.

- Such significant changes over a short period of time would make it difficult for councils to maintain stable long-term financial plans.

- If it is determined that CPI is to be used as the index for rate capping, then the best approach would be to set a fixed index of 3% p.a. rather than using actual results. This is consistent with the long-standing and widely accepted CPI target range of 2% to 3% used by the Reserve Bank of Australia to determine monetary policy over the long-term.

- This approach would avoid the impact of short-term volatility and provide certainty for local government in setting rates and making long-term contractual and investment decisions.

- If this cap was set at the upper end of the target range (3%) then this approach would also be likely to reduce the frequency of applications for exemptions or variations by local government. It would also be consistent with the State Government's stated objective of capping rates at CPI.

- **In summary, Council considers that an appropriate index for local government would be based on building materials and labour costs. However if a CPI based cap is to be used, then 3% is an appropriate cap.**

<u>Single-year or multi-year cap</u>

- The framework should support councils to take a long-term perspective for financial planning. Decisions regarding infrastructure investment, multi-year contracts and borrowings need to be taken in a long-term context.

- **A cap should be fixed for several years in advance to provide councils with certainty. It should be set at a fixed figure (as suggested above) rather than being based on historical actual results.**

Application of the cap to different councils

- A different cap should be applied for different groups of councils.

- The Consultation Paper identifies different council groupings, and Nillumbik is included in the Interface group.

- The Interface group includes a combination of councils with high levels of growth and development, along with councils with significant responsibility for green wedge conservation and management (particularly Nillumbik, Yarra Ranges and Mornington Peninsula).

- Interface councils are quite different to established metropolitan municipalities.

- The Interface councils do not have access to the same non-rate revenue sources as inner/middle metropolitan councils (such as parking fees and fines).

- Interface councils have much larger geographic areas to service than inner/middle metropolitan councils, resulting in additional costs for servicing the more remote parts of their municipalities.

- Interface councils tend to have a higher ratio of local infrastructure assets to state infrastructure assets. Interface councils have to maintain this higher proportion of local assets. For example, Interface municipalities typically have a higher proportion of local roads (sealed and unsealed) and a lower proportion of arterial/main roads, when compared to inner/middle metropolitan municipalities. This places extra demands on Interface councils' finances, relative to the demands placed on inner/middle metropolitan councils.

- Unlike rural councils, Interface councils are not eligible for rural grant programs even though much of their land area is zoned for rural purposes.

- **Therefore, in recognition of the particular needs and challenges facing Interface councils, any rate capping framework should provide a higher cap for the Interface group. This cap should be set at 1.5% above the standard cap.**

- **If an Interface council proposed to increase rates by more than the standard cap plus 1.5%, then ESC approval would be required.**

2. THE BASE TO WHICH THE CAP APPLIES

- The cap should be applied to existing rate revenue while also taking account of growth in the municipality's rate base. This can be achieved in two ways.

- Firstly, the cap could be applied based on the prior year's rate revenue, plus any additional rate revenue attributable to the growth in the rateable value of the municipality from supplementary valuations during each year.

- Alternatively, the cap could be applied to the average rate per assessment in the municipality. This would account for growth via the increase in the number of assessments from one year to the next.

- **The cap should be applied to general rates, service rates/charges and the municipal charge. The base should be determined according to the prior year's declared rates and charges, plus any growth due to supplementary valuations or changes in assessment numbers during that year.**

- The cap should not apply to special rates and charges. These are used primarily for road construction schemes, and are subject to their own statutory consultation and objection process. As funds from special rates and charges can only be used for the designated purpose, and are applied only to a small proportion of properties in the municipality, special rates/charges should be excluded from the cap.

3. THE VARIATION PROCESS

- Councils should be able to seek a variation for any purpose. The framework should provide guidance about the reasons for variation that are eligible to be approved. However other circumstances may arise which are not anticipated by the framework, and it should be open to councils to seek variations for such other reasons.

- Councils should be able to seek variations (exemptions from the cap) if they wish to raise rates/charges by an amount greater than the cap that applies to that council's group.

- **Variations should be classified into two categories as follows:**
    - **Variations caused by external factors**
    - **Variations arising from Council decisions**

- **The variation application should be approved <u>automatically</u> by the ESC for any rate increases above the relevant cap that are caused by external factors (i.e. not arising from Council decisions).**

- Variations caused by external factors would include:
    - Real terms declines in State or Commonwealth Government recurrent grants
    - Real terms declines in statutory fees and charges that are set by State or Commonwealth Government but are collected as Council revenue
    - Increases in State or Commonwealth Government taxes or levies paid by Councils
    - Increases in Council responsibilities arising from changes in State or Commonwealth legislation or policy
    - Statutory requirements to fund superannuation shortfalls or increases in the level of the superannuation guarantee
    - Natural disasters

- Assessment of real terms impacts on the above factors should be made by reference to the same cost index that is used for rate capping purposes. In other words, if the standard rate cap is set at 3% then the expectation will be that the State or Commonwealth Government will index their grants and fees at this level, otherwise Council will be entitled to a variation to offset the difference.

- **The above factors should not require councils to demonstrate community support for a variation, as these factors are not caused by a council decision. Councils should only need to provide evidence of these factors to the ESC in order to receive an automatic approval of a variation.**

- For any matters arising from Council decisions that require rate increases above the relevant cap, the variation application should be assessed and determined by the ESC. Such matters would include:
    - Increased investment in renewal of existing infrastructure to maintain existing service levels (renewal gap closure)
    - Provision of new or upgraded infrastructure to meet community needs
    - Provision of new or expanded services to meet community needs

- **Councils should demonstrate that community consultation and engagement about these matters (including the need and the cost) has been undertaken and that there is community support for a variation.**

- The consultation paper identifies that one factor in determining a variation application could be whether "*the council has made continuous efforts to keep costs down*".

- Councils with a low level of existing expenditure should be more readily granted a variation than those councils where existing levels of expenditure are already higher than average. This assessment should not be based on existing levels of rates, as rates are a revenue source and the level of rates is a function of the other (non-rate) revenues available to each council. Rates do not reflect the level of expenditure or the level of a council's efficiency. The most appropriate measure of efficiency is expenditure per capita.

- **Therefore the assessment of a variation application should consider the relative level of existing Council expenditure on a per capita basis.**

4. TIMING AND PROCESS

- There are several aspects to the issues of timing and process.

- Firstly, it is important that the variation process aligns with the annual budget process and the statutory requirements and deadlines for budget preparation. These include the requirement for public exhibition of the draft budget for one month, consideration of public submissions, and adoption of the budget (with any changes arising from the consultation process) by 30 June each year.

- This requires a council to resolve to exhibit its draft budget by April each year. Council needs to prepare the draft budget and associated documentation during February and March in order to meet the April deadline.

- Secondly, better practice in this regard should involve a focus on the medium to long term, rather than only the short-term annual budget. As noted earlier, decisions regarding infrastructure investment, multi-year contracts and borrowings need to be taken in a long-term context.

- **A council seeking a variation should be able to demonstrate how this aligns to its medium-long term plans, particularly the Strategic Resource Plan (SRP).**

- Thirdly, there is added complexity due to the timing of council budgets which are prepared in advance of the State and Commonwealth budgets each year. This can mean that councils are often setting budgets without knowing the extent of any changes to State and Commonwealth funding and grants for the coming year. A recent example of this was the Commonwealth's decision in 2014 to freeze Financial Assistance Grants to local government for three years.

- This issue means that there needs to be capacity for councils to seek variations in the following year, if a State or Commonwealth funding decision has impacted on the council budget for the previous year.

- **Councils should be able to seek variations to offset any shortfall arising from State or Commonwealth funding decisions, in respect of the impact in the previous year and the coming year.**

- **Councils should be able to seek variations for one year, or for multiple years (up to the 4 year period of the statutory SRP) in a single application.**

- If a Council is seeking a variation solely because of the impact of external factors (not Council decisions) then the process of ESC approval should be automatic. Councils should not be required to provide any justification for such variations, apart from evidence of the magnitude of these impacts.

- If a Council is seeking a variation because of the impact of Council decisions, then the Council would need to provide some justification in terms of evidence of need and the outcome of community consultation.

- **A tiered approach would be useful, where the extent of evidence and justification required would be proportional to the extent of the variation being sought.**

- **In order to achieve the statutory deadlines, Council would need to be advised of the ESC decision on a variation application by the end of January.**

- **To provide the ESC with sufficient time to consider the variation application, Councils should lodge any variation application by the end of December in respect of the following financial year.**

- Variation applications should be able to be lodged at any time prior to these deadlines, and Councils should be able to receive a response from the ESC within one month. This would enable Councils that are more advanced with their financial planning processes to seek approval in advance of the deadlines.

5. TRANSITIONAL ARRANGEMENTS

- The proposed rate capping framework represents a significant change in local government financial planning. The transition to the framework is an important consideration, particularly in terms of any matters that preceded the announcement of the introduction of the framework, but which will have impacts in the years following the framework's introduction.

- At Nillumbik, there are two such matters of significance, and these are outlined below as examples of how transitional issues need to be considered.

<u>Eltham Leisure Centre – SRV grant conditions</u>

- The first of these relates to a proposed redevelopment of the Eltham Leisure Centre. This project has been several years in the planning, and addresses the single largest infrastructure renewal issue identified in asset condition audits.

- The project is estimated to cost $15.8 million and is to be undertaken over three years, commencing in 2015-16. Council applied for a Sport and Recreation Victoria grant of $3 million during 2014, and the grant application was approved and the grant agreement was signed prior to the 2014 Victorian state election. Therefore, Council had entered into the grant agreement prior to the formal announcement of rate capping by the now Minister for Local Government.

- This project involves a funding commitment from Council over three years at a total value of $12.8 million. Council is obliged to deliver the project within specified timelines as per the agreement with Sport and Recreation Victoria.

- Council had the capacity to fund this project over that three year period (2015-2018) within its Strategic Resource Plan (refer 2014-15 Nillumbik Budget) however this involved rate increases over that three year period which were higher than CPI. Under a rate cap, Council would be unable to fund its commitment to the State Government to deliver this project over that three year period, unless Council reduced other expenditure.

- **The transitional arrangements should therefore provide exemptions for matters where Councils have entered into funding agreements that pre-date the new Victorian Government's announcement of a rate capping framework.**

Landfill Rehabilitation regulatory requirements

- The second example relates to the cost to Council to rehabilitate former landfill sites and meet the regulatory requirements of the Environmental Protection Authority (EPA).

- Council owns two former landfill sites – one in Plenty, and one in Kangaroo Ground. The Plenty landfill was closed in 2006, and the Kangaroo Ground landfill was closed in 1995. Since closure, both sites have been managed in accordance with Environment Protection Authority (EPA) requirements under the relevant licences and pollution abatement notices. These requirements involve site monitoring for pollution to air, land and water. Council has an agreement with the EPA to rehabilitate both sites over the next eight years to mitigate and manage pollution risks.

- The landfill rehabilitation program is expensive, and will require Council to invest $12.4 million over the next eight years to 2022-23. Council has been aware for many years that this process will be costly, and has taken the responsible approach by establishing a financial reserve to gradually accumulate funds for this purpose. Funding has been collected via the Waste Management Charge, and allocated into this reserve at a level of $500,000 per annum. As at 30 June 2014 this reserve held $3.9 million, and a further $500,000 will be added during 2014-15. By maintaining this approach over the next eight years, Council would have $8.4 million available to meet the EPA deadline of 2022-23.

- However based on the latest information regarding EPA standards and technical requirements, the most recent cost estimate for the required works is $12.4 million, meaning that Council requires an extra $4 million over the next eight years.

- Council has no objection to meeting the EPA requirements, and recognises that landfill rehabilitation is an important environmental and public health issue. However the EPA technical standards have been increased significantly over recent years (particularly since the Cranbourne landfill incident). The increased costs of these higher standards, and the specific timeframe for rehabilitation, both place extra pressure on Council’s finances.

- To generate the extra $4 million over the next eight years, Council had been proposing to make a series of gradual increases to the Waste Management Charge each year. This will require compounding increases of around $110,000 each year, equivalent to approximately 0.2% of rates and charges, which would be applied each year for eight years.

- In terms of rate capping, this compounding extra cost for landfill rehabilitation would consume a significant share of each year's rate increases before Council covers any other cost increases. It is therefore likely that this approach would require Council to seek rate cap exemptions each year for eight years for this purpose, even though this cost relates to increased State Government regulatory standards.

- Alternatively, Council could add $500,000 to the Waste Management Charge in the first year, and then maintain this level of funding over an eight year period. This would represent a once-off increase equivalent to 0.8% of rates and charges in that first year (in addition to any other increases related to the rest of Council's budget). Again, under a rate capping framework, an increase of 0.8% would represent a significant share of the annual increase in rates, before Council funds any other cost increases.

- As stated above, Council recognises the importance of landfill rehabilitation in terms of protecting the environment and public health. Council has no objection to meeting the EPA requirements. However the contemporary standards for landfill rehabilitation represent an increase above historical standards, and Council now faces a higher cost to meet these new regulatory requirements. Council cannot realistically be expected to meet these new higher standards by reducing existing services to the community, and yet the capacity to fund the landfill rehabilitation program will be constrained in future by rate capping.

- **Therefore in terms of transitional issues, the rate capping framework needs to provide sufficient flexibility for councils to fund any regulatory requirements imposed by the State Government (such as landfill rehabilitation) where the funding to meet those requirements is beyond the existing level of rates and charges.**

- **A transitional year for application of the framework in 2016-17 would provide scope for councils to address some of these historical issues with a full understanding of how the future framework will operate. Councils have not been in a position to address these issues in 2015-16 as the framework is not yet clearly defined. Partial commencement of the framework in 2016-17 (e.g. an extra 2% above the cap) would help to address this problem and smooth the introduction of rate capping.**

6. ROLES

- The ESC should determine any applications by councils for variations in accordance with the framework.

7. OTHER MATTERS

- In terms of periodic review, Council supports the suggestion that the framework be reviewed within the first three years of operation.

- In regard to the costs of administering the framework, these should be borne by the State Government as the framework is a policy of the State Government.