



Victorian Local Governance  
Association

15 May 2015

Dr Ron Ben-David  
Chairperson  
Essential Services Commission  
c/o localgovernment@esc.vic.gov.au

Dear Dr Ben-David,

On behalf of the Victorian Local Governance Association (VLGA), I welcome an opportunity to respond to the Essential Services Commission's review of a rates capping and variation framework for local government.

Following the then-opposition's announcement of an intention to implement rates capping in May 2014, the VLGA has continually expressed our concern and opposition to this policy.

Fundamentally, based on the evidence available from Victoria and other jurisdictions, we consider rates capping to be an ineffective tool. Our member councils and others are completing forward analyses of the impacts of rate capping in their individual municipalities and are best placed to provide details of these consequences.

We acknowledge that the State Government has a mandate to implement rate capping and, given this, we consider the most productive task to be to seek to ensure that the design of the framework minimises potential threats to local government's financial sustainability and the wellbeing of local communities.

Our considerations in this regard are described further in two papers we have commissioned, authored by Peter McKinley (Executive Director of McKinley Douglas Ltd) and Graham Sansom (Adjunct Professor of the University of Technology Sydney). We have also developed a rate capping Principles document that expresses key touch-points. All papers have been made publically available on our website and I have included a copy for your reference.

In this brief submission I would like to highlight three key points.

Firstly, rather than introducing more regulation and restrictive requirements on local government, **a rates capping framework should look to build on the existing process of rate setting.** Working with, and improving on, the current arrangements (which include Best Value and the new Performance Reporting Framework) and supporting local government's work engaging with communities can promote a fair rates culture that renders the need for the blanket imposition of a rates cap unnecessary. The Minister's power to cap rates, which already exists, could be held in reserve.

Linked to this point is our second argument that **the centre point of a rates capping framework should be process of rate setting** and the promotion of transparency, use of good data and close community engagement, not a specific and arbitrary rate increase figure. Rather than being prescribed at the outset, an acceptable level of rate increase should be the end point of the rate setting process.

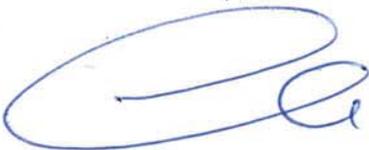
The diversity of the sector and the multiplicity of factors that impinge on the level of funding needed to ensure good community outcomes, varies so significantly across local government areas that trying to determine a one size 'rates cap' is ineffectual. Moreover, focusing attention on a single figure, or a set of figures, has the potential to drive perverse outcomes, including setting up community (and council) expectations that might be unrealistic. Again, this would not be in the long term interest of communities.

Finally, **rate capping should apply only to revenue from general rates**. Other charges including those for waste, are a return on cost of service and applying a rates cap to these would force local government to conduct activities at a loss. The Minister's current legislative powers apply to 'general income', provisions that include such service charges and are therefore unacceptably broad, cutting across sound financial management.

In closing, the VLGA would like to underscore the importance of considering the issue of rates generally in the context of the wider financial environment for local government. Rate setting cannot be distinguished from issues such as cost shifting and unfunded liabilities. Nor can it be separated from the fact that local governments, especially those in rural areas, have relatively few revenue sources available to them to meet constantly increasing expectations from their communities and from other levels of government.

The VLGA looks forward to working with the Essential Services Commission in ensuring a rates capping and variation framework works with local government, respects its status as democratically legitimate and secures the level of investment required of councils to support the wellbeing of their local community.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'A. Hollows', enclosed within a large, loopy blue oval.

**Dr Andrew Hollows**  
**Chief Executive Officer**

## RATE CAPPING PRINCIPLES

The following 12 principles have been developed by the Victorian Local Governance Association (VLGA) to guide the debate around the State Government's rate capping policy. They have been informed by the advice and the experiences of Victorian councils, complemented by our commissioned research and an analysis of practice locally and in other jurisdictions.

**We encourage councils to consider these principles and include them in responses to the Minister for Local Government and the review by the Essential Services Commission (ESC).**

In addition to these principles, the VLGA will release an implementation guide that deals with the process of rate capping and will continue to provide practical advice and support to members.

### BACKGROUND

The VLGA opposes the introduction of rate capping to Victorian local government for two key reasons:

First, the introduction of rate capping risks prejudicing the sound, long-term financial management of local government, in turn threatening the overall sustainability of the sector. Indeed, the State Government may be introducing a potentially significant restraint on the ability of councils to raise 'own revenue' at the very same time as local government is facing additional service demands which it may be unable to meet within a rate capped environment.

Second, and fundamentally, the mandatory imposition of rates restriction infringes on local governments' constitutionally established status as a distinct and essential tier of government, democratically elected and responsible to the communities it represents.

The State Government has expressed its intentions in proposing rate capping as ensuring rate rises are affordable and that councils are made more accountable for their actions in setting rates.

The VLGA has commissioned two key pieces of work – [Towards a Workable Rate Capping Regime](#) and [An Implementation Framework for Rate Capping](#) – the findings of which reinforce the messages coming from the local government sector. These include that rate capping may see rate rises reduced but at the expense of critical community infrastructure. It may also see accountability shift away from the community as local government seeks to comply with a state mandated cap, over locally expressed wishes.

In noting the clear evidence, the VLGA acknowledges the State Governments' electoral mandate to proceed with a rates capping policy. Given this circumstance the key task for the VLGA and for the local government sector is to work with the State Government to shape the design of the rates capping framework. This would have the task, as captured in the following principles, to ensure that potential damage to councils and communities is minimised, to look for opportunities to enhance local government's role and to raise the all-important issue of resources.

## **PRINCIPLE 1 – FOCUS ON INVESTING IN COMMUNITIES**

Rates are ultimately raised by councils to raise revenue for services to meet the identified needs of communities in all their diversity – growing, ageing, declining, or simply changing. Any approach to adjusting rates revenue should support this general capacity of councils and enable and support adequate investment by local government to meet community needs.

## **PRINCIPLE 2 – SUPPORT LOCAL DEMOCRACY**

In relation to other levels of government, local government has an important role in expressing the needs and preferences of local people through a range of mechanisms. The health of the democratic relationship between councils and communities depends on the capacity of local government to seek out and respond to local priorities. A key part of this response is expenditure, funded by local rates.

The increased desire of communities to have greater say in budgetary and strategic decisions should be one that causes a renewed interest in shaping the respective roles of councils and communities within the Local Government Act, rather than a paternalistic response to limit councils' capacity.

The Essential Services Commission has noted its support for the continued capacity of local government to make decisions in the interests of its community. Any regulation of rate setting should reflect this support and minimise negative interference in the relationship between councils and communities.

This extends to the types and levels of services in each municipality. It is not the role of the State Government or of any other body to define the mix of services provided. The diversity of each local government area should be respected, as should the ability of each local government to respond to their community's preference with regards to service mix.

## **PRINCIPLE 3 – SECURE THE SUSTAINABILITY OF THE LOCAL GOVERNMENT SECTOR**

The collective local government sector is confronting a constrained fiscal environment, defined by reductions in external financial assistance from other levels of governments which will see rates revenue become more important for continued local government sustainability, not less. Any arrangements for adjusting rates revenue should be fit for purpose in the context of this environment.

Within the local government sector, individual councils are diverse - some rely on rates revenue much more than others for a range of factors, some of which are inherent and beyond local governments' control. Any restrictions on rates revenue needs to account for this diversity and be accompanied by measures to particularly protect those councils that will be substantially affected.

## **PRINCIPLE 4 – SUPPORT SIMPLICITY, CLARITY AND THE MINIMISATION OF ANY COMPLIANCE BURDEN**

Local government is the subject of numerous regulatory requirements, with responsibilities to report to numerous different agencies. A rate setting framework should work to minimise any additional layer of complexity imposed on local government. A key means to achieve this is through utilisation of existing council process.

As outlined in work commissioned by the VLGA, the planning and reporting processes already in place can deliver the State Government's election mandate on rate restrictions. Recasting the emphasis on Council Plans, Strategic Resource Plans, Performance Reporting arrangements, Best Value Principles, and the role of the Auditor General would obviate the need for additional regulatory layers and minimise the costs to local government.

## **PRINCIPLE 5 – FOSTER A SHARED APPROACH BETWEEN LOCAL AND STATE GOVERNMENT**

Meeting the needs of communities is a common concern of both local and state governments. Local government needs to be understood as part of the wider public sector, involved in the achievement of policy objectives that resonate with those of the State Government. Impairment of local government's capacity to meet its objectives, therefore inevitably involves impairment of the State's capacity to meet its own.

In the context of rate raising restrictions, an opportunity exists to open up a conversation about the distribution of roles and responsibilities between communities, local government and State Government. The development of a rate capping framework should support this discussion, encompassing the question of cost shifting and supporting the goal that any additional responsibilities required of local government be transparently negotiated and reimbursed at a cost recovery level.

## **PRINCIPLE 6 – MAKE BEST USE OF COMMUNITY RESOURCES**

A rate restriction policy recognises that community resources are limited, but it does not, in itself, support the best use of these resources. There is a key difference between rates 'savings' and rates 'efficiencies'. In requiring councils to limit rate increases, a rate restriction framework should also work to support councils to develop ways to use rates revenue in the most efficient way, both in terms of productive efficiency but also with regard to equity. The need for efficiency incentives is recognised by the ESC, but this recognition needs to be accompanied by further details, guidance and potentially resourcing.

## **PRINCIPLE 7 – CONSIDER WAYS TO STRENGTHEN THE INVOLVEMENT OF COMMUNITIES IN LOCAL GOVERNMENT DECISION MAKING**

Rates restrictions focus attention on the involvement of communities in resourcing decisions of local government. Community engagement around the question of how much money is raised and where it is spent is an important tool in managing revenue/expenditure trade-offs in conditions where money available is scarce. In addition, a key part of the ESC's approach is its position that councils must be able to show that they have engaged with and considered their community's views on different rate levels and service priorities.

In this context, consideration needs to be given to how councils can be supported to engage their communities more, and more effectively, on the question of rates and priorities. The NSW experience highlights the importance of community-led planning as one means to achieve this. In the context of rate capping, the VLGA is advocating for thought to be given to the potential of better community planning to support councils in engaging with their communities.

## **PRINCIPLE 8 - DISTINGUISH BETWEEN GENERAL REVENUE AND COST RECOVERY**

Good public financial governance requires the appropriate use of rates and other sources of revenue for local government. Council rates and charges income includes a mix of general rates, municipal charges and service charges, including waste and resource recovery charges. Municipal charges and service charges need to be seen as the recovery of cost for service. General rates need to be seen as a local tax which funds general local government activity and expenditure.

It is not appropriate to restrict local government cost recovery which would force councils to undertake activities at a loss. Rate revenue restriction should only apply to general rates. This would require re-interpretation of current provisions in the Local Government Act which enable the restrictions of local government 'general income', encompassing both rates and charges. This broad power cuts across sound financial management.

## **PRINCIPLE 9 – FACILITATE CREDIBLE, UNCOMPLICATED AND COST MINIMAL ARRANGEMENTS FOR RATES CAP VARIATIONS**

The Government has stated its intent to set a rate cap at the level of the Consumer Price Index (CPI). CPI has been demonstrated to be an inappropriate indicator of local government costs. But evidence from other examples of rate capping systems shows that any indicator is likely to also be inadequate. There is enormous variation in the circumstances of each local government area, encompassing different levels of needs, across different levels and types of services experiencing different degrees of demand. The complexity at stake effectively rules out the possibility of an index able to capture the cost factors relevant to all local governments.

Given this reality, the critical question becomes to what degree the cost cited by each local government is explained and justified, including by financial modelling and by reference to local community preferences.

For the VLGA the substantive issue is the regime for granting variations. A rate cap must constitute a baseline only, with increases to be granted 'as of course' where a council

can make a reasonable case in terms of need, community support and evidence of moves toward efficiency of operation. It should be simple to apply, and councils should have access to the option of multi-year variations which support financial certainty and good financial management.

### **PRINCIPLE 10 – REDUCE BUREAUCRATIC OVERSIGHT**

The ESC has a role to play as an independent arbiter in a rate restriction arrangement. However, it is critically important to minimise further regulation to local government and its attendant costs. The most effective role for the ESC would therefore be one of monitor of existing performance and financial data and of adviser to the Minister on cases for potential intervention.

### **PRINCIPLE 11 – SUPPORT THE RIGHT REVENUE MIX**

The ESC has suggested that a rates capping framework should require local government to demonstrate that they have assessed (and where relevant, consulted on) alternative funding options for services.

Consideration of the relative mix of rates, fees and charges is an important part of good financial management. Rate capping provides an opportunity to consider the revenue mix and to give thought to the potential development of a revenue policy which sets out how services could and should be funded and how to distribute cost impacts across the community.

This opportunity needs to be framed however, by attention to the relative capacities of different local government and the options for revenue-raising available which among some local governments are much more circumscribed than among others.

### **PRINCIPLE 12 – ENSURE OPPORTUNITIES FOR OPEN, PUBLIC SCRUTINY, INDEPENDENT REVIEW AND FULL EVALUATION**

Rates restriction arrangements will involve the making of decisions, including by the ESC and the Minister for Local Government. These decisions and their rationale should be publically available and accessible.

The NSW experience highlights the long-term nature of the resultant effects of rate capping, and the importance of evaluation and review to ensure these effects are known, and any degradation in the financial status on local government addressed. The ESC has stated its intent to review the effectiveness of the framework within three years of its commencement. In the interests of transparency, local government should be fully engaged in this process and any findings should be made public and openly available.



# TOWARDS A WORKABLE RATE CAPPING REGIME

A paper prepared for the Victorian Local  
Governance Association



Peter McKinlay, Research Associate, Institute for Governance and Policy Studies, Victoria  
University of Wellington and Executive Director, McKinlay Douglas Ltd

When referencing this work, it is appropriate to list:  
Victorian Local Governance Association, *Towards a Workable Rate  
Capping Regime*, by Peter McKinlay, 2015

## **Towards a Workable Rate Capping Regime**

### **Introduction**

The purpose of this paper is to assist the Victorian Local Governance Association (VLGA) determine how it should propose working with the State Government in the development and implementation of its rate capping policy. The paper starts with the basic assumption that the state government will not resile from its decision to cap rates (it clearly believes that this is a major election promise on which it is required to deliver). Accordingly, and despite strong opposition within the local government sector to the concept of rate capping, the task now for the sector and especially its peak organisations is to work with the state government so as to minimise the potential negative impacts, and look for opportunities to enhance local government's role.

The paper sets out (in the appendix) and briefly comments on the terms of reference which the state government has given the Essential Services Commission for the development of the rate capping regime. Next, it provides an overview of the way in which different jurisdictions have approached issues of local government autonomy and the relationship between local government and higher tiers of government.

It then looks at the experience in a number of jurisdictions with restrictions on rates (council tax, property tax) drawing out lessons for the development of the state government's policy.

The discussion then shifts to the changing context for the respective roles of local government and higher tiers of government including the increasing blurring of the boundary between the responsibilities of different levels of government, especially in relation to services to people as opposed to services to property.

Finally the paper discusses possible options for the development and implementation of a Victorian rate capping regime designed to minimise negative impacts on the activities of both state government and local government.

### *Comment on Terms of Reference*

The terms of reference require the ESC to take into account "Available evidence on the magnitude and impact of successive above-CPI rate increases by Victorian councils on ratepayers". Such evidence may be limited. In 2008 the Australian Productivity Commission released its report *Assessing Local Government Revenue Raising Capability* which included the following:

The Commission has been asked to examine the impacts on individuals, organisations and businesses of rates, user charges and other revenue sources available to local governments. Developing indicators that can be used to provide insights into the impacts of rates, and fees and charges on individuals, businesses and organisations has been difficult, given the limitations of the data sources available at the local government level.

It has not been possible to develop indicators of the impact of rates, and fees and charges for individuals, organisations, and business *within* councils, because of a lack of data. Such indicators are required to make inferences about how the burden of financing local government expenditure is shared between and among individuals, organisations and businesses.

The State's overarching objective as set out in the terms of reference is:

The Government intends to promote rates and charges that are efficient, stable and reflective of services that the community needs and demands, and set at a level that ensures the sustainability of the councils' financial capacity and council infrastructure, thereby promoting the best outcomes for all Victorians.

There is a necessary implication the government believes councils should be able to deliver "services that the community needs and demands" and remain financially sustainable within a regime which caps rates (and potentially fees and charges) to the CPI. This interpretation admittedly depends on the relative weight which the state attaches to the CPI cap as such, and how it expects the process of applying for increases above the cap to operate in practice. Possible interpretations range from increases being granted only in exceptional circumstances, to the cap constituting a baseline with increases to be granted "as of course" provided that the council can make a reasonable case in terms of need, community support and efficient operation (that is, the council is already operating in a way which meets industry good practice standards for efficient performance).

The difference is palpable. It is between a situation in which Victorian councils could move relatively quickly into a situation which combines a measure of financial unsustainability with significant deterioration in service quality and infrastructure and a situation in which councils **working with their communities** could expect to be sustainable in the medium to long term. This can be illustrated by extrapolating from the following paragraph from the Victorian Auditor-General's February 2013 report Ratings Practices in Local Government, and considering how rates would have increased over the period had they been capped at CPI instead of increasing as they did:

Between 2001–02 and 2009–10, mean rates per property assessment in Victoria increased by an average of 6.3 per cent each year. This exceeded the average 2.9 per cent per year growth in the Consumer Price Index and the average 4.8 per cent per year growth in the Local Government Cost Index, which the Municipal Association of Victoria (MAV) uses to forecast the movement of council costs associated with wages and construction.

The following table, using a base of 100, compares actual average council rate increases against what they would have been if CPI capped

Average Victorian rate increases 2001/02-2009/10 actual and if CPI capped		
Year	Actual	CPI capped
2001-02	100	100
2002-03	106.3	102.9
2003-04	113	105.88
2004-05	120.12	108.95
2005-06	127.68	112.11
2006-07	135.73	115.36
2007-08	144.28	118.71
2008-09	153.37	122.15
2009-10	163.03	125.70

If rates had been CPI capped and had no exemptions been granted, at the end of the eight year period covered by the table average rates across Victoria would have been 22.9% lower than they actually were<sup>1</sup>. This emphasises the implications for the sector of imposing a cap if that cap is not directly related to **the needs of individual councils and the preferences of the communities they serve.**

### **Local government autonomy**

In Australia it is common to think of local government as 'a creature of statute' with the implication state governments naturally have both the power and the right to intervene to shape the role, function and structure of local government as they see fit.

Taking an international perspective suggests that, in practice, Australia and similar jurisdictions (United Kingdom, Canada, New Zealand) are in a relative minority and that it is more common to treat local government as having a significant measure of autonomy. It is a distinction which has very real implications for the revenue raising powers of local government, including the power of local government to choose which revenue sources it should utilise, and the discretion it has on how it utilises them.

Martin and Loughlin (2003) undertook a substantial review of local government funding practices across Europe as part of a major study undertaken for the English government on "balance of funding" - the way in which revenue raising powers were distributed between different tiers of government.

They argue that underpinning the degree of local fiscal autonomy of local government "are two contrasting models of central-local relationships: (i) a principal/agent model and (ii) a 'choice' model. The 'principal agent' approach envisages local government primarily as an agent of delivery of priorities and objectives that are determined by 'higher' tiers of government – the region, Land<sup>2</sup>, province or national government – and relies on bureaucratic/legal controls. A 'choice' model emphasises the needs and preferences of local people – service users, citizens, local business etc. –and depends on mechanisms by which local stakeholders express their priorities – for example through voting or public engagement and stakeholder engagement/consultation." (P4).

More recently, a yet to be published piece of work being undertaken for the European Union makes a distinction between "managerial" and "governmental" local government. Broadly, the distinction is between local government as an instrument of central government to implement national policies, or as an expression of a local political community developing and implementing local policies in response to the demands of the community.

These distinctions concern more than just local fiscal autonomy, they are pervasive in terms of the role, structure and function of local government. Among other things this reflects the different understandings of the nature of local government. Within the principal/agent model there has in recent years been a dominance of insights from public choice theory and new public management, including to various degrees embedding a separation between governance and management broadly imitating practice in the corporate sector (Boston et al 1991; Connoley 2007). This contrasts with the greater emphasis on public

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<sup>1</sup> This implies an average reduction in total revenue over the period of something in the order of 11% as rates revenue represents approximately half of council revenue.

<sup>2</sup> The term used in Germany for the equivalent of a state.

involvement and various forms of direct democracy characteristic of the 'choice' model and can be seen reflected in the different sizes of local governments from within the two different approaches. The following table illustrates this, contrasting 10 European countries which broadly follow the choice model with the United Kingdom and Victoria:

Average populations of the basic unit of local government	
Finland	16,187
France	1,800
Germany	7,010
Italy	7,391
Netherlands	40,191
Norway	12,013
Poland	15,542
Spain	5,823
Sweden	33,448
United Kingdom	137,553
Victoria	67,772

In jurisdictions where the perceived role of local government is the efficient delivery of services as determined by a higher tier of government, there is a natural bias towards the 'efficiency' of larger units of local government with governance itself being seen as one cost which should be minimised. In jurisdictions where the emphasis is much more on the role of local government as driven by the choices made by the communities it serves, there is a contrasting emphasis on smaller scale facilitating better and more direct engagement between councils and their communities with governance being treated as a core role including easy citizen access to elected representatives.

The European Charter of Local-Government provides perhaps the best known example of a statement of the principles which should underpin autonomous local government. The charter has been ratified by 44 of the 47 member states of the Council of Europe. In respect of local government finance, and in marked contrast to this the approach underpinning the state government's commitment to rate capping, the following is the charter's statement of principles in respect of the financial resources of local authorities.

### **Article 9 – Financial resources of local authorities**

1. Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.
2. Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law.
3. Part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.
4. The financial systems on which resources available to local authorities are based shall be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.
5. The protection of financially weaker local authorities calls for the institution of financial equalisation procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support. Such procedures or measures shall not diminish the discretion local authorities may exercise within their own sphere

of responsibility.

6. Local authorities shall be consulted, in an appropriate manner, on the way in which redistributed resources are to be allocated to them.

7. As far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction.

8. For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law.

Next, the principal/agent model with its assumption that the state has discretion to intervene in the role, structure and function of local government to suit its own purposes has given rise to another and significant issue. This is the extent to which higher tiers of government have the knowledge, incentives and understandings to intervene in ways which are efficiency promoting, and result in better outcomes for the citizens served by different tiers of government.

There is evidence that, on the whole, higher tiers of government lack both the internal coordination, and the detailed knowledge of local government, especially of the differing circumstances of different councils and their communities, for their interventions to be as effective as they need to be in what are now typically very resource constrained environments.

The Australian Productivity Commission in its report on the regulatory role of local government observes:

The number of state agencies that have regulatory dealings with local government under these laws ranges from 17 in Victoria to only 4 in Queensland. The more numerous the number of state agencies delegating regulatory roles, the greater is the task of coordination between state and local governments. For example, a larger number of state government bodies will have more difficulty in reaching agreement on a consistent and comprehensive ranking of the state government's priorities for local government regulation and in coordinating consistent support to local government. (Australian Productivity Commission 2012) (p10).

Essentially the Productivity Commission is saying that, at least in the regulatory environment, what we are witnessing is not so much state intervention in directing the activities of local government, as the intervention of a series of relatively uncoordinated agencies within state governments. There is an implication that states (state agencies) are acting without properly understanding the broader implications of their actions because there are no effective constraints on their ability to intervene. State agencies themselves lack the necessary incentives to ensure that their interventions are soundly based and effective to produce the desired outcomes without significant unintended consequences. To put this another way, it is easy for state agencies to focus on agency goals rather than overall 'whole of public sector' outcomes.

The same theme is picked up in other jurisdictions. The New Zealand Productivity Commission in its 2013 report on the regulatory role of local government, *Towards Better Regulation*, observed:

It is important to note that, while local authorities were created by statute, they are not, as sometimes characterised, 'agents' of central government that are required to implement national priorities, and be accountable to central government for operational performance. This agency characterisation seems to reflect a misunderstanding of the respective

roles of, and relationship between, local and central government. Local authorities exercise a range of types of powers and have varying degrees of discretion and autonomy, depending upon the specific regulatory context (p3).

In England the office of the Comptroller and Auditor-General has recently completed the report *Financial Sustainability of Local Authorities 2014* which has included a review of the role of the Department for Communities and Local Government (DCLG), as the principal adviser to government on local government, in reviewing the impact of proposed funding reductions on local government services (in England local government undertakes a substantial range of services on behalf of different central government departments. It is the individual departments which hold the knowledge at central government level of the adequacy of funding to meet service delivery requirements). The report says of DCLG's performance:

The Department does not monitor the impact of funding reductions on services in a coordinated way. The Department is reliant on other departments and inspectorates to alert it to individual service failures. It prioritises its interest in service delivery on services where local authorities spend the most money, engaging more closely with relevant departments. However, its reliance on other departments, and selective focus on services, means it risks only becoming aware of serious problems with the financial sustainability of local authorities after they have occurred. The Department is the single point within government that should monitor the impact of funding reductions across the full range of local authority services on an on-going basis, but does not do so robustly enough (p9)

### **Restrictions on rates**

The Australian Productivity Commission's report *Assessing Local Government Revenue Raising Capacity* includes a discussion of restrictions on local government revenue raising, focusing primarily on experience with rate capping in NSW. After a somewhat equivocal discussion of the experience, the Commission's finding in respect of the NSW experience is:

*Rate pegging has dampened the revenue raised from rates in New South Wales relative to other States and there seems to have been little offset from non-rates revenue sources in recent years. (P154)*

The final report of the NSW Independent Local Government Review Panel, *Revitalising Local Government* (released publicly in early 2014) painted a much more negative picture of the impact of rate pegging observing that among the significant unintended consequences of the policy were:

- Unrealistic expectations in the community (and on the part of some councillors) that somehow rates should be contained indefinitely, even though other household expenditures are rising.
- Excessive cuts in expenditure on infrastructure maintenance and renewal, leading to a mounting infrastructure backlog.
- Under-utilisation of borrowing due (in part) to uncertainty that increases in rates needed to repay loans will be granted.
- Reluctance to apply for Special Rate Variations (SRVs) even when clearly necessary, because exceeding the rate peg is considered politically risky, or because the process is seen as too complex and requiring a disproportionate effort for an uncertain gain.

The last point is clearly significant. Discussion with a number of NSW councils suggests that the perceived compliance requirements for a special rate variation are both time-consuming and expensive, and it's only worthwhile putting in an application if it is for a very significant increase.

The Panel's report urged councils to make greater use of the special rate variation procedure in order to address the significant problems of financial sustainability identified in many councils. Despite this, the authority responsible for administering rate pegging, the Independent Pricing and Regulatory Tribunal, reports that only 19 councils out of 152 had applied for a special rate variation in the current round (applications closed at the end of February).

In 2009 the New Zealand Institute of Economic Research undertook a literature research/review for Local Government New Zealand on international experience with rate capping, concentrating on experience in the United Kingdom, NSW and selected states in the United States.

The review concluded that rates capping was effective to cap rates in the sense of slowing growth from what would otherwise have been. It then considered the question does rate capping improve outcomes and observed:

This is the harder and more crucial question. Is the result closer to an optimal package of services and taxes than would otherwise be the case? Do the restrictions prevent waste? Do they prevent funding of non-core activities or investments that the citizenry can't really afford? Or do they prevent sensible decisions on local priorities by local communities and risk cutting core expenditure (eg infrastructure maintenance) into the bone?

The evidence in New Zealand and internationally is that local government is now highly conscious of the need to be efficient and keep costs to citizens as low as possible – without formal restrictions. The evidence from the US, and New South Wales in particular, points to the conclusion that rates capping has cut core expenditure into the bone, that a large infrastructure backlog has been created, that local circumstances have not been adequately catered for and that local communities are being denied local choice.

Hay & Martin (2014) provide an overview of experience with local government revenue capping in the United Kingdom since capping (of council tax) was first introduced in 1985, with the Minister having the power to cap individual authorities whose growth in expenditure was considered to be excessive. With approximately 350 local authorities, 18, 13 and 19 councils respectively were capped in the first three years.

The article provides an overview both of the complexities of local government financing in the United Kingdom, and of the way in which devolution to the Scottish and Welsh assemblies has changed the nature of the relationship between local government and the responsible higher tier. Hay & Martin report that a much more collaborative approach has emerged in both Wales and Scotland with the relationship between the two tiers of government being seen by both sides as more in the nature of a partnership whereas in England it remains much more confrontational.

Despite the significant difference, they find that:

Between 1993–1994 and 2008–2009 average expenditure by English authorities rose by 136% compared to 119.4% in Wales and 105.7% in Scotland (HM Treasury 2009, 2010b). It appears then that capping in England has not delivered a materially different outcome in terms of council tax rises and limiting local government expenditure when compared with the more informal and collaborative approaches adopted in Scotland and Wales over the last decade.

Finally, they note that the Localism Act is partly shifting the power to restrict local government expenditure in England (through controlling Council tax increases) from government to local communities. The act includes a provision for a local authority to hold a referendum if it is determined that its council tax rise is “excessive”. For the 2015-2016 year the Secretary of State has set the threshold as 2%. The logic is that local communities should have a greater say although Hay and Martin doubt that local electorates will have the detailed knowledge of the financial circumstances of their local authority to make a sufficiently informed decision.

Victorian experience has been primarily with the Kennett government reforms in the late 1990s which included a legislated reduction of 20% in local government rates. There is a widespread view that a principal result of this reduction was to encourage local authorities to minimise expenditure on asset maintenance and renewal, draw the down reserves, and develop other devices for minimising the impact on what they regarded as necessary on-going spending.

The Australian Productivity Commission in its report assessing the revenue raising capacity of local government identified from the literature a number of justifications which could support a higher tier of government restricting the revenue raising powers of local government:

- It has been argued that because local governments are monopoly suppliers of some basic community services, their rates, fees and charges should be regulated to prevent misuse of monopoly power.
- Governments at higher levels might consider that the governance challenges in the local government sector are best overcome by direct regulation.
- Voters, if aware of the limitations of council governance, might prefer that other spheres of government impose legislative and regulatory constraints on councils’ revenue-raising capacity.

Ironically, each of these arguments could apply equally well to higher tiers of government, including tiers which have no tier above them which could enforce any kind of constraint.

#### *Lessons for the development of the state’s policy*

For each of these arguments there is a strong case that imposing a revenue restriction is a second-best solution if that. Alternative approaches include addressing directly how councils determine what services should be provided with their communities, including a much stronger emphasis on community involvement, and addressing the limitations on governance within local government.

More generally, the evidence from experience with rate capping policies, and other restrictions on the ability of local authorities to raise revenue, suggests that the unintended consequences will often outweigh the intended benefits. Currently New South Wales provides a good example with a number of councils facing

relatively high infrastructure backlogs combined with relatively poor financial outlooks, a combination which can in large part be attributed to the inability of councils to raise the revenue required to maintain infrastructure and services at acceptable levels.

At the heart of this is a combination of:

- The necessarily “blunt instrument” character of a blanket restriction applied across an entire sector, rather than designed to reflect the different circumstances of each individual local authority - what may be a perfectly manageable restriction for one authority may render another unsustainable because of differences such as the relative state of infrastructure, the level of growth being experienced within the authority, the extent of borrowing, the demographic mix, population density, the activity mix in the local economy and much more.
- The barriers in the way of seeking an exemption as often the process is seen as being politically fraught (the assumption there is something inherently wrong in seeking to breach a revenue limiting measure seemingly intended to protect the public interest) and both time-consuming and expensive.

At the same time it must be acknowledged that rate capping is not just a technical exercise but an understandable political response to apparently ‘excessive’ rates increases especially in times of relative economic constraint and low inflation. It does need to be remembered that resort to political intervention from a higher tier of government is often the only practical option for ratepayers concerned at the level of rates. Councils are monopoly providers of local government services, there is no way a ratepayer can avoid payment of the levy which the council has decided the ratepayer should meet, and nor is there any way in which a ratepayer can reduce the impact by limiting use of the service (in contrast, say, to the ability of the consumer to reduce charges by a metropolitan water authority simply by turning off the tap). From a local government perspective this suggests paying more attention to measures which might make their current and intended rating levels acceptable and minimise the risk that individual ratepayers will seek political intervention from a higher tier of government.

These matters are touched on below in the section on options for developing and implementing a rate capping regime in Victoria.

### **The blurring boundary between different tiers of government**

The days are long gone when the role of local government could be described as “rates, roads and rubbish” - basically a relatively narrow range of services to property.

Part of the change has been driven by community expectations for a broader range of services. As the Australian Productivity Commission observed in its report *Assessing Local Government Revenue Raising Capacity* “Local governments have increasingly been providing services beyond their traditional roles of the provision of local roads and other services to property. Many councils now have a substantial involvement in the delivery of human services, and in planning and regulatory functions.”

Part of the change has been driven by cost shifting from higher tiers of government - often without making equivalent resources available (see the 2003

Senate committee report Inquiry into Local Government and Cost Shifting - Rates and Taxes: a Fair Share for Responsible Local Government otherwise known as the Hawker report).

Both these trends have been features of the local government environment for a number of years. Both, and especially the first, reflect a blurring of the boundaries between local government role and function, and the role and function of other tiers of government especially as communities turn naturally to their councils for assistance when there are real needs which need to be addressed - greater involvement of local government in a range of health related services, and in areas such as child care services and services to older people have been one natural result.

In overall terms so far the impact of this blurring on the overall expenditure of local government has been relatively minor. As the Productivity Commission observed "Local government spending, however, still is mainly on community amenities (including water and sewerage in some States) and local roads".

There is a good case to believe that the situation is in the process of changing for at least two reasons:

- The fiscal outlook for higher tiers of government and more particularly the response of higher tiers of government to the changing fiscal situation points to a very significant diminution in the willingness of higher tiers of government to incur additional expenditure or for that matter to continue existing discretionary support for local government at current levels.
- The impact of trends such as demographic change is likely to result in a much greater need for support services at a community level for groups whose support needs have traditionally been seen as primarily the responsibility of higher tiers of government. The most obvious group is older people, but there is increasing evidence that a range of other needs are best addressed at a community level, with the increased involvement of local government as one possible result.

This suggests that the state government may be introducing a potentially significant restraint on the ability of councils to raise 'own revenue' at the very same time as:

- The willingness of higher tiers of government, especially the Federal government, to provide revenue support for local government may be diminishing, perhaps significantly.
- Local government will face additional service demands which it may be unable to meet within a rate capped environment.

The first of these trends is already evident with measures such as withdrawing the indexing of Financial Assistance Grants, something which has been seen as a major negative impact for local government.

The second is more likely to be seen by local government as providing a defence to demands from within its communities for additional services, and support a local government response which says in effect "we can't help you as we are not allowed to raise the revenue required - go and talk to state."

On this issue there is an argument that the state government should consider seriously the risk which rate capping may pose to achieving objectives which are

important for the state itself. Apart from the likelihood that local government will be looked to across a range of services for more involvement than is currently the case, there are some very specific state objectives whose achievement will require significant local government involvement which could be placed at risk if rate capping is implemented. One example is the ability to deliver on the objectives of the Melbourne Plan where local government is clearly seen as playing an important role as can be seen from the following extract from the summary version of the plan:

**Places of Local-significance** include activity centres, neighbourhood centres, other industrial land and other urban renewal sites. Local governments are primarily responsible for the planning and delivery of these places because of their importance to local communities in terms of access to services, employment opportunities and the liveability of their neighbourhoods. A network of diverse and vibrant activity centres is important to the city structure. Local governments are encouraged to plan and support local urban-renewal and transit-oriented development sites to better use existing and planned infrastructure for housing and employment opportunities.

It is not difficult to envisage a serious conflict between the evolving role of local government both generally and in specific areas such as Plan Melbourne, and the impact of rate capping. It poses a double risk for the state government. The first flows from the reduced ability of local government to deliver on a range of demands including the objectives of the Melbourne Plan so that objectives important for the state may simply not be met or met to the desired extent. The second is the increased pressure on the state government itself to step in and provide the investment which its rate capping policy will have prevented or discouraged local government from providing.

### **Possible Options for the development and implementation of a rate capping regime**

The state government has given the Essential Services Commission (ESC) an extremely difficult task if it is to deliver a single formula for a rate cap, linked to the CPI, which achieves all of the state's apparent objectives simply because of the very great differences between different councils, the communities they serve, the relative state of each council's infrastructure, the service demands they face and so on.

As the Australian Productivity Commission observed in its work on the revenue raising capacity of local government, local governments exhibit considerable diversity for reasons including:

- aggregate community income per resident in their local area and grants per resident received from other spheres of government
- demographic and geographic attributes of their local area
- extent and nature of economic activity in their area and surrounding areas

- preferences and expectations of their local communities
- management capacity and skill base of their councillors and staff.

These, and other factors, impact on the level and composition of both their expenditure and revenue.

The challenge which the ESC will face in preparing its report, and the state government in turn will face in determining its response to the report, is how to manage the variable impact of a standard cap across local government because of the inherent diversity of the councils to which it would apply.

As noted above in the comment on the terms of reference, responding to this challenge will depend very much on the relative weightings which the ESC and the state government give to the impact of the cap on the one hand, and the exemption regime on the other. The government's stated objective it "intends to promote rates and charges that are efficient, stable and reflective of services that the community needs and demands, and set at a level that ensures the sustainability of the councils' financial capacity and council infrastructure" strongly suggests that the relative weighting will be towards the working of the exemption regime to ensure that the cap which finally applies to each council recognises the unique nature of each council's circumstances.

Before considering this further, it is useful to reflect on what lies behind much public opposition to rates as a tax. There is good and increasing evidence that one of the principal reasons for public opposition is the lack of engagement which ratepayers have in council decisions about which services to provide, to what level, and how those services should be funded including what mix of revenue/borrowing, and how to distribute the cost impacts across the community. In this respect, the Victorian Auditor-General in his report on the rating practices of local government had this to say about the quality of information made available by councils, and of their engagement strategies:

Council engagement and communication with ratepayers on rating decisions and rate matters varied significantly in depth and quality. Councils do not provide sufficient or consistent information to ratepayers about their rating decisions. While there are some examples of good practice in this area, there are opportunities for improvement.

Accordingly, the Auditor-General recommended that local government develop and implement comprehensive ratepayer communication and engagement strategies that include:

- Information and reporting on how rating decisions are made, their implications for ratepayers, and the expected outcomes.
- The use of a range of communication tools appropriate to the local community .
- Details of how the effectiveness of their ratepayer engagement and communication activities will be assessed and reported.

What the Auditor-General recommends would be a significant improvement on what currently takes place but even this falls well behind what would now be seen as good practice in engagement, especially if the objective is to gain public support for local government rating decisions and what lies behind them.

It's instructive to note the contrast between current Victorian practice for developing and seeking public input on the Council Plan, the Strategic Resource Plan, and the Council's annual budget, and the practice for the equivalent plans in New South Wales through its statutory Integrated Planning and Reporting framework. The New South Wales equivalent of the Council Plan is the Community Strategic Plan, a document with a 10 year time frame to be "developed and delivered as a partnership between the council, state agencies, community groups and individuals. It should address a broad range of issues that are relevant to the whole community."

This is in marked contrast to conventional statutory consultation requirements which involve the preparation of a document or proposal, a period of public exhibition/consultation (typically one month), council hearings on submissions and then a council decision. Instead NSW practice through Integrated Planning and Reporting, and good practice with community engagement generally, involves processes which emphasise bringing in the community before a council's preferred proposals are developed. The overwhelming conclusion is that the standard 'prepare and then consult' approach is inherently dysfunctional and not 'fit for purpose' in delivering either effective engagement, or public acceptance of council proposals (see, for example, Lenihan 2012).

The growing evidence that public resistance to rates, especially rates increases, is grounded at least partly in a relative lack of engagement with and 'ownership' of council decisions suggests an opportunity for using the development and implementation of a rates capping regime to address this problem directly.

This places the focus squarely on the relative significance of the way the cap itself is determined, and the approach which is taken to considering exemptions to the cap. Currently it looks as though the local government sector in Victoria may be focused on the nature of the formula with the objective of ensuring that the annual cap is set at as high a level as possible consistent with the objective of linking it to the CPI, an objective which in practice is likely to leave very little room for recognising the inherent differences between the councils to which a single cap would apply.

A better approach may be to regard the formula itself as relatively unimportant as compared with the regime for granting exemptions. At most, success in fine tuning the formula may see a rate cap 0.25%-0.5% per annum higher than it might otherwise be. In contrast getting the exemption regime right will be critical for achieving long term financial sustainability, especially for councils which need to invest significantly in infrastructure or other areas of activity. To be that New South Wales experience points the way to a process which could actually work to the benefit of both the state government and local government and its communities.

The New South Wales rate capping regime is administered by the Independent Pricing and Regulatory Tribunal (IPART) which each year sets the rate cap (known as the rate peg) in accordance with a formula which combines the New South Wales local government cost index with a productivity factor as a deduction intended to allow ratepayers to share in council productivity gains.

It also administers an exemption regime the critical elements of which are evidence of community engagement and understanding of the need for a rate rise, and demonstration that the council has explained what it is doing in terms of productivity improvements and cost containment. The specific criteria are:

Evidence that the community is aware of the need for and extent of a rate rise. The IP&R documentation should clearly set out the extent of the General Fund rate rise under the special variation. The council's community engagement strategy for the special variation must demonstrate an appropriate variety of engagement methods to ensure an opportunity for community awareness and input to occur.

The council's IP&R documents or the application must explain the productivity improvements and cost containment strategies the council has realised in past years and plans to realise over the proposed special variation period.

In practice, the regime can be seen as saying to local government provided you have engaged with your communities so that they are aware of and understand the need for a rate rise, and you are making good progress on productivity improvement and cost containment, then in principle you should be entitled to an exemption from the rates increase reflecting the level recognised through your engagement process.

There is evidence that, despite the almost universal view that ratepayers will invariably be opposed to significant rates increases, this process can result in community support for very substantial increases indeed. As an example, one City Council in the Sydney metropolitan area was able to demonstrate to IPART that its residents would accept a rates increase of 11.7% per annum for seven years in a row. The Council had achieved this outcome through effective engagement on options for rating and service levels which resulted in demonstrated ratepayer support for a mix of services and service levels and acceptance of the associated rating decisions.

It seems reasonable to assume the state government will have no quarrel with an exemption process which would allow quite significant rates increases above a rate cap so long as a council is able to demonstrate both community support and an acceptable performance on productivity improvement and cost reduction. This assumption is based on the judgement the state is responding to ratepayer concerns at least some rates rises are inherently unjustified in the belief that the state has an obligation to protect ratepayers when they have no other means available to them. From this it follows that gaining ratepayer acceptance an increase is justified should satisfy the state's concerns as well as those of ratepayers themselves.

For this approach to managing an exemption regime to be applied in Victoria some significant change will be required over and above what is specifically contemplated by the terms of reference.

First, the legislative provisions regarding the Council Plan, Strategic Resource Plan, and Council budget would need to be rewritten to create for Victorian councils an equivalent of the Independent Planning and Reporting (IP & R) framework in NSW to bring the whole process back to the fundamental principle that council planning for the future nature and cost of services is inherently a partnership approach with the council's community and other stakeholders. This is necessary among other reasons in order to provide an adequate statutory basis for engagement with communities in a way which results in them sharing a sense of ownership of the resultant decisions, something which is an increasing feature of IP & R in NSW.

Next, it may also be necessary to review the purpose and approach which the ESC would apply in undertaking the role of managing applications for exemption. Currently, the ESC act states its purpose as:

The purpose of this Act is to enable the Essential Services Commission to perform the regulatory and advisory functions that are conferred on the Commission in a manner that provides incentives for dynamic, productive and allocative efficiency and promotes the long term interests of Victorian consumers.

It is a purpose written to support a role in which the ESC acts as the regulator in situations where inherently the parties involved have different and normally conflicting interests - the overarching purpose is to balance the presumed interest of (often monopoly) utilities in maximising return and minimising cost with the interest of consumers in obtaining reliable services at a reasonable cost.

The role of administering an exemption regime in an environment in which, as a prerequisite to any application, a council had gone through a process of in-depth engagement with its communities resulting in broad acceptance of its proposals is a very different one. It needs an approach which recognises that the interests of councils and their communities, especially in the medium to longer term, are much more closely aligned. In this situation the role of the ESC becomes much more one of acting as a facilitator bringing together parties around a common objective than one of putting in place an imposed solution to resolve an issue between adversarial parties.

If this approach to managing a rate capping/exemption regime, including the proposed statutory changes, can be put in place, then paradoxically implementing the state government's rate capping strategy should offer local government some very real benefits including, over time, reducing the political profile of the rate setting process and hence the risk of arbitrary intervention. It should also help address the pressures which are likely to come to bear on local government as a result of the trends discussed in the section of this paper dealing with the fuzzy boundary between the responsibilities of different tiers of government. A more broadly based long-term strategic planning process for local government would provide a natural venue in which to have a dialogue about the respective responsibilities of the council, the community and other tiers of government.

In conclusion, the argument in this paper suggests the local government sector should see the state government commitment to introducing a rate capping regime as an opportunity rather than a threat - and in practice an opportunity for both the state and local government to start de-politicising rate setting, and improving understandings of who should be responsible for funding what activities and how.

## Appendix: Terms of Reference

The State Government's objective is to contain the cost of living in Victoria while supporting council autonomy and ensuring greater accountability and transparency in local government budgeting and service delivery. The Government intends to promote rates and charges that are efficient, stable and reflective of services that the community needs and demands, and set at a level that ensures the sustainability of the councils' financial capacity and council infrastructure, thereby promoting the best outcomes for all Victorians.

The ESC is asked to inquire into and advise the Ministers for Finance and Local Government on options and a recommended approach for a rates capping framework for implementation from the 2016-17 financial year. Advice should include and/or take into account the following matters:

- 1) Available evidence on the magnitude and impact of successive above-CPI rate increases by Victorian councils on ratepayers.
- 2) Implementation of the Government's commitment to cap annual council rate increases at the Consumer Price Index (CPI) with councils to justify any proposed increases beyond the cap, including advice on the base to which the cap should apply (e.g. whether to rates or to general income).
- 3) Any refinements to the nature and application of the cap that could better meet the Government's objectives.
- 4) Options for the rate capping framework should be simple to understand and administer, and be tailored to the needs of the highly diverse local government sector. The framework should take into account factors that may impact on local governments' short and longer term financial outlook, such as:
  - a) actual and projected population growth and any particular service and infrastructure needs;
  - b) any relevant Commonwealth Government cuts to Local Government grants;
  - c) any additional taxes, levies or increased statutory responsibilities of local governments as required by the State or Commonwealth Governments;
  - d) any extraordinary circumstances (such as natural disasters); and
  - e) other sources of income available to councils (for example, ability to raise user fees and charges from non-residents).
- 5) Consider how local governments should continue to manage their overall finances on a sustainable basis, including any additional ongoing monitoring of council service and financial performance to ensure that any deterioration in the level, quality or sustainability of services and infrastructure and councils' financial position is identified and addressed promptly.
- 6) The processes and guidance to best give effect to the recommended approach for the rates capping framework and a practical timetable for implementation, including:
  - a) the role of councils, the ESC and the Victorian Government and the expected time taken by local governments and by the Victorian Government or its agencies, for each step in the rate capping process;
  - b) any technical requirements including the information requirements on councils that request exemptions from the cap;
  - c) any guidance required to give effect to the rate capping options (including in relation to consultation with ratepayers) and to improve accountability and transparency; and
  - d) any benchmarking or assessment of the effectiveness of the regime, including options to continuously refine the regime and improve council incentives for efficiency.
- 7) Options for ongoing funding to administer the rate capping framework, including the potential for cost recovery.

In conducting the inquiry and providing its advice, the ESC will have regard to:

- the role of local government in the provision of infrastructure and services to the community and the general efficacy with which they currently perform this task;
- the differences between rural, regional and metropolitan local councils in terms of costs, revenue sources and assets maintained;
- the Revenue and Rating Strategy guide and Local Government Performance Reporting Framework to be administered by the Department of Environment, Land, Water and Planning;
- matters regarding rating practices and asset renewal gap raised by the Victorian Auditor-General's Office (VAGO);
- Department of Treasury and Finance's Victorian Guide to Regulation and Victorian Cost Recovery Guidelines; and
- any relevant insights from the experience of rate pegging in New South Wales, including any reviews or evaluations that can suggest ways to minimise any unintended consequences.

In conducting this independent inquiry, the ESC will be informed by wide consultation. This will include, but is not limited to: councillors and officials from local government; representative bodies such as Municipal Association of Victoria, Victorian Local Government Association and LGPro; unions; VAGO; and relevant government agencies and departments. In addition, the ESC will consult regularly throughout the course of the inquiry with a sector consultative panel established by the Minister for Local Government. The ESC's consultation will be guided by its Charter of Consultation and Regulatory Practice.

The ESC will publish a draft report on the rates capping framework no later than six months after receipt of these terms of reference. The draft report must be made publicly available and invite comments from local governments and other interested parties. A final framework report along with draft guidance material will be provided to the Minister for Finance and Minister for Local Government no later than 31 October 2015.

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Victorian Local Governance  
Association

# AN IMPLEMENTATION FRAMEWORK FOR RATE- CAPPING

**Prepared for the Victorian Local Governance Association by Graham Sansom, Adjunct Professor, University of Technology, Sydney. Formerly Director of the Australian Centre of Excellence for Local Government and Chair of the NSW Independent Local Government Review Panel**

When referencing this work, it is appropriate to list:  
Victorian Local Governance Association, *An Implementation Framework for Rate-Capping*,  
by Graham Sansom, 2015

# Victorian Local Governance Association

## An Implementation Framework for Rate-Capping

Graham Sansom<sup>1</sup>

This paper sets out a framework for ‘productive’ rate-capping in Victoria – a set of arrangements that could achieve the State government’s policy objective whilst respecting the role and integrity of local government, as well as avoiding unnecessary costs and the imposition of a further layer of ‘red tape’ and bureaucracy. The centrepiece of the proposed approach is to focus on using existing legislation to reinforce a ‘fair rates’ culture and, most importantly, to make councils more accountable to their communities for the way in which they budget and set rates.

In principle, the Victorian Local Governance Association (VLGA) opposes rate-capping on the grounds that it infringes local government’s constitutional status as a ‘distinct and essential tier of government’, and – on the basis of past experience in New South Wales and Victoria itself – may well prejudice sound longer-term financial management. Moreover, local government needs to be seen as part of the wider Victorian public sector: any excessive restriction of local councils’ capacity to fund essential services and infrastructure would have adverse implications not only for the affected communities, but also for the achievement of broader State policy objectives.

Nevertheless, given the Government’s electoral mandate for rate-capping, the VLGA believes that the best course of action is constructive engagement in the work now being undertaken by the Essential Services Commission (ESC) to design an appropriate implementation framework . Accordingly, VLGA wishes to advance a set of proposals that could transform what most in local government regard as a serious threat, into an opportunity for productive improvements to local governance and State-local relations.

The framework for rate-capping advanced in this paper therefore seeks to increase transparency and accountability in rate-setting; promote effective strategic planning and community engagement; ensure efficient use of public resources and productivity gains; and build on existing processes set out in the Local Government Act, plus the important role of the Auditor General.

### 1. Context

The State Government’s proposal to introduce rate-capping comes at a difficult time:

- All levels of government are facing severe fiscal constraints due to broader economic conditions and, in particular, the seemingly intractable federal budget deficit.
- Federal funding to State and local governments may well be further reduced – Victorian local government will lose \$124m in federal financial assistance grants over three years

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<sup>1</sup> Adjunct Professor, University of Technology, Sydney. Formerly Director of the Australian Centre of Excellence for Local Government and Chair of the NSW Independent Local Government Review Panel

due to freezing of indexation, and is facing a permanent 13% cut in those grants ***even if indexation is restored after the current freeze***; whilst the State government itself faces massive cuts in health and education, plus a possible redistribution of GST revenues.

- For local government, the likely implication is that rates will need to do more of the 'heavy lifting' on the revenue side, not less.
- Major reviews are underway into the future of the federation, inter-government financial relations and the taxation system, with outcomes unlikely to be clear until well into 2016 – but again with potentially significant implications for local government's dependence on rate revenue.

Councils are facing an increasingly difficult fiscal environment in which rates revenue will most likely become more, not less, important. Any arrangements for rate-capping must be 'fit for purpose' in terms of that environment: they should continue to focus on sound financial management in order to meet community needs.

## 2. Rates are a Tax

It is also important to reflect on the nature of council rates:

- The Local Government Act clearly differentiates between general rates, special rates and fees and charges. The latter three are means to recover the costs of specific services or facilities that benefit identifiable groups of ratepayers or service users, and need to be treated quite differently to general rates.
- However, it is now widely accepted that general rates are a tax, not a fee for service. This was the view taken in the 'Henry' tax review and is echoed in the federal government's recent tax discussion paper.
- Rates and land tax are very efficient taxes and were identified in the Henry tax review as potentially a more prominent source of revenue within the overall taxation system – a finding that may well be endorsed by the current review.
- Accepted principles of taxation (defined by the Henry review as equity, efficiency, simplicity, sustainability and policy consistency) should apply to general rates, and any system of rate capping should avoid undermining the application of those principles.
- Rates are a tax on the ***value of property*** – one of few taxes in Australia on wealth, rather than income or expenditure. Substantial increases in property values are therefore a legitimate consideration in judging 'affordability', as in most cases this wealth can sooner or later be translated into cash assets (eg by those inheriting property). The equity principle is important in this regard.

It is essential to distinguish between the taxation and 'service charges' components of councils' revenues. Sound taxation principles – especially equity – should apply to general rates and any form of rate-capping should respect those principles.

## 3. What Exactly is the State Government's Objective?

Recent statements by the Premier and the Minister for Local Government suggest that the Government's focus is on ensuring that rate increases are affordable and that councils are made more accountable for their actions in setting rates.

News.com.au on 9 January reported the Premier saying:

"We made a commitment that we would cap rates at the inflation rate unless a local council can demonstrate where the money is going ... Any council that can't demonstrate why they are charging more than the inflation rate, has no business charging more."

However, the Premier reportedly went on to say that those councils able to demonstrate a need to charge higher rates would be given permission to do so by an independent umpire.

Adding to those comments, the Minister was quoted by ABC News on 3 March as follows:

"We want to make sure that local councils stay accountable to their residents that are paying rates and we want to put an end to the rate hikes of eight, nine, 10 per cent and we want to make sure that they are prioritising local services and infrastructure before spending on silly projects ... People want to know where their rates are going and look, if they've got community support for a particular ... project that the community is behind and they can demonstrate that, then obviously the Essential Services Commission will look at that."

All this suggests that the government's objective (correctly) is NOT simply to suppress rate increases and enforce a rigid CPI-based cap, but rather to keep increases ***as close as possible to the CPI*** consistent with sound financial management and efficient delivery of the infrastructure and services that local communities need and want.

Such an approach would also be consistent with the parallel need to maintain an effective and sustainable system of local government that can partner the State government in achieving its objectives for the wellbeing of all Victorians. Unwarranted limitations on local government rates constitute revenue lost to the State's public sector as a whole.

#### **4. Risk of Unintended Consequences**

NSW has had a system of 'rate-pegging' for over 35 years. It was introduced for reasons very similar to those advanced by the Victorian government, and is now working quite well, primarily because in recent years it has been linked to the broader Integrated planning and Reporting Framework that promotes effective community engagement in long-term planning, coupled with rigorous financial and asset management.

The NSW system has had to evolve to address a range of unforeseen problems. These have included:

- Creation of unrealistic expectations in the community (and on the part of some councillors) that somehow rates should be contained indefinitely, even though other taxes and household expenditures are rising more rapidly.
- Excessive cuts in expenditure on infrastructure maintenance and renewal, leading to a mounting infrastructure backlog.
- Under-utilisation of borrowing (with implications for inter-generational equity) due (in part) to uncertainty that increases in rates needed to repay loans will be granted.

- Reluctance by councils to apply for Special Rate Variations (SRVs) even when clearly necessary, because exceeding the nominal rate peg is considered politically risky, or because the process is seen as too complex and costly, requiring a disproportionate effort for an uncertain gain.
- Generally poor financial management across much of local government – rate-pegging can lead to ‘lazy’ budgeting and planning, as well as entrenching a mendicant mentality (dependence on grant funding), with a tendency to ‘learned helplessness’ and blaming others for the sector’s financial problems.

The NSW experience highlights the need for very careful design of rate-capping arrangements, and flexible implementation, in order to avoid potentially severe unintended consequences. It also highlights the value of implementing rate-capping as part of a broader framework for strategic planning, community engagement and financial and asset management.

## 5. What is to be Capped?

This is a critical issue that will have a major bearing on the outcomes of rate-capping. The Minister’s current power under section 185A to limit rates and charges applies to a council’s ‘general income’. This is defined as ‘general rates, municipal charges, service rates and service charges’ such that only special rates are excluded.

As noted earlier, fees and charges, together with service and special rates, should all be seen as means to recover costs of services and infrastructure of particular benefit to specific groups of ratepayers or service users. Responsible financial management demands that those rates, fees and charges be set at levels that reflect the true cost of providing the services, infrastructure or facility involved – subject to any community service obligation (subsidy) the council might be willing to accept. Provided the cost is calculated and justified in a way that is transparent and accountable to ratepayers and service users, there can be no justification for imposing an arbitrary cap on cost recovery. If necessary, an independent body such as the ESC can assess whether the calculations are reasonable and provide advice on how to go about setting special rates, fees and charges.

In the case of special rates, the Act already details the process by which they should be considered, justified and implemented, including extensive consultation with those affected. Suitably modified, those provisions could be extended to all service rates, fees and charges aimed at recovering readily specified costs. Any restrictions imposed by other legislation would need to be considered and where necessary amended.

NSW experience also suggests that:

- On no account should a blanket cap be applied to rate increases faced by individual ratepayers (assessments) – that approach can only lock-in or generate inequities and is contrary to taxation principles and sound financial management.
- A majority of people would rather pay modest increases in rates than see services decline.
- Rate increases should be calculated, discussed and assessed in actual dollars as well as percentages – there is considerable evidence to show that annual rate increases of \$1-2

per week are not generally regarded as excessive, irrespective of the percentage that constitutes, provided the need for the increase is explained.

- Increased revenue resulting from new or re-development should be excluded from rate-capping – those additional funds will be required to provide expanded services and infrastructure.
- Allowance must be made for expected movements in grant funding and other sources of revenue, as well as increased responsibilities or functions devolved to councils (often called ‘cost-shifting’).

Rate-capping *per se* should apply only to total revenue from general rates. The Minister’s current power under s185A to limit ‘general income’ is too broad and cuts across sound financial management.

## 6. How Important is the Cost Index?

The Victorian government has identified the CPI as a ‘starting point’ index for rate-capping. This has been strongly opposed by local government on the grounds that the CPI does not reflect accurately many of the costs incurred by councils in delivering essential services. In NSW the Independent Pricing and Regulatory Tribunal (IPART – ESC’s equivalent) now uses a specially calculated cost index for rate-pegging purposes, but its methodology has also been challenged. Importantly, in its 2013 report on the financial sustainability of local government, the NSW Treasury Corporation highlighted the need for rate increases to reflect ‘underlying costs’ (eg infrastructure backlogs) as well as recurrent increases.

Experience across several states shows that a generally agreed standard measure of council cost increases is likely to prove elusive. Indeed, the current system of federal financial assistance grants and their distribution to councils through the Victorian Local Government Grants Commission is predicated on the assumption that circumstances and needs differ considerably from place to place and community to community. The question therefore arises: is there any point in expending considerable resources on researching local government costs and developing a special index for rate-capping?

The Premier and Minister have made it clear that they want to introduce rate-capping in a flexible way that can respond to the differing needs and wishes of local communities. The danger with a ‘definitive’ index is that councils will focus on limiting rate increases to that level, rather than on sound financial management and effective community consultation about local needs and hence the appropriate level of rates.

Moreover, **multi-year rate-setting** (at least the span of the Council Plan) is essential to facilitate sound financial management. Therefore a rate-capping process needs to take a medium-longer term perspective, making it that much harder to produce a definitive index.

If the **process** of rate-capping is designed well, the index should become irrelevant. The critical question to be asked in assessing a proposed rate increase is simply whether it is justified in the circumstances of the case, whether that case has been adequately researched and documented, based on sound medium-longer term plans, and whether there has been adequate community engagement to explain why the increase is necessary and to maximize local support.

## 7. Towards 'Productive' Rate-Capping for Victoria

Reflecting the various points made in sections 1-6, the rest of this paper suggests how a process for rate-capping in Victoria could use existing provisions of the Local Government Act (with some minor amendments) and build productively on established processes such as Council Plans, Strategic Resource Plans, Best Value, Performance Reporting and the role of the Auditor General. This would entrench a 'fair rates' culture.

### 7.1 Basic Principles

At the outset, it is important to set out a number of basic principles that should apply to rate-capping.

- The 'headline' and underlying objective should be widely discussed, clearly articulated and generally agreed as a starting point.<sup>2</sup>
- The focus should be on establishing a sound process that achieves the agreed objective whilst respecting local government's integrity and its duty to respond to differing community needs and wishes, as set out in the Constitution and Local Government Act.
- A primary consideration should be to maintain a sustainable system of local government – unsustainable low rates are as much a problem as excessive rate increases.
- The revenue-raising needs of councils should also be considered in the broader context of funding the State's public sector and achieving the Government's wider objectives, rather than solely in terms of 'core' local service provision.
- Trying to formulate a definitive cost index and means of determining what constitutes 'efficient' service delivery or 'acceptable' rate increases is ultimately pointless and will detract from, rather than support, a sound process.
- A firm distinction must be drawn between general rate revenue on the one hand, and special rates, fees and charges on the other – the latter being seen as mechanisms to recover specific costs attributable to identified beneficiaries of particular services, infrastructure or facilities.<sup>3</sup>
- Potential adverse unintended consequences must be understood, carefully monitored and avoided.
- Expectations must be managed carefully from the outset – councillors and communities need to understand that rate-capping cannot involve deferring rate increases indefinitely or imposing unrealistic limits on councils' revenue and expenditure.
- Rate-capping arrangements should be overseen by an independent agency at arms-length from Government, with no arbitrary political intervention in individual cases.

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<sup>2</sup> The Government's formal objective, as state in the terms of reference for the current ESC review, offers a useful basis for discussions. It reads: The State Government's objective is to contain the cost of living in Victoria while supporting council autonomy and ensuring greater accountability and transparency in local government budgeting and service delivery. The Government intends to promote rates and charges that are efficient, stable and reflective of services that the community needs and demands, and set at a level that ensures the sustainability of the councils' financial capacity and council infrastructure, thereby promoting the best outcomes for all Victorians.

<sup>3</sup> In this regard, it would be appropriate for all councils to separately identify domestic waste charges, which are a fee-for-service not a general rate

## 7.2 Key Elements of Current Legislation

Figure 1 below shows elements of current legislation of particular relevance to the Government’s proposals for rate-capping. Attachment A provides related extracts from the Local Government Act.

**Figure 1: Existing Legislative Framework in Victoria**

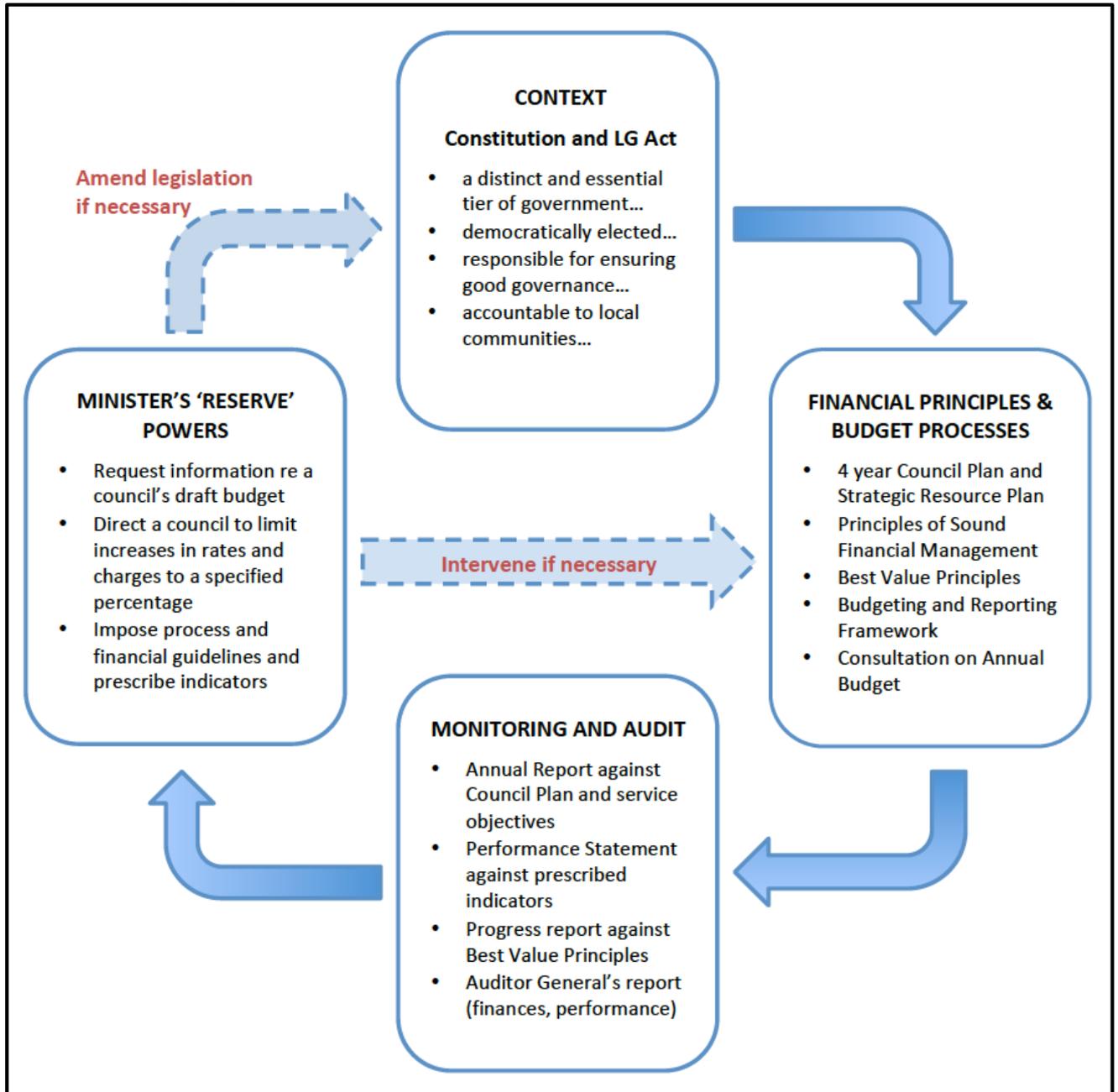


Figure 1 and the extracts from the Act make three things very clear:

- Victoria already has the equivalent of the IPR requirements that now provide the framework for rate-pegging in NSW
- The Local Government Act already provides for rate-capping

- If rate-capping is now to proceed along the lines foreshadowed by the Premier and Minister, there is no need for any major or disruptive changes to current legislation, policies or processes.

There are four key elements of current legislation:

1. The **context** established by the State Constitution and Local Government Act – namely that local government is to be treated as *a distinct, democratic tier of government accountable to local communities*.
2. The extensive **strategic planning requirements, financial principles and budget processes** already detailed in the Local Government Act, including in particular the Best Value Principles introduced by the Bracks government in 1999. Fully implemented, this framework is actually more demanding than the NSW IPR provisions. It should mean that councils set their rates only after careful and detailed analysis of community needs and wishes, their medium-term financial position, and the scope to contain the costs of service provision through efficiency and productivity improvements.
3. Demanding provisions for **performance monitoring, reporting and audit** under both the Local Government Act and the Audit Act, with the Auditor General providing independent oversight. Performance and financial statements based on prescribed indicators already offer a wealth of information on what councils do and the costs involved, and can point to areas for improvement.
4. The **Minister’s considerable powers to intervene where necessary**, by setting guidelines, by prescribing indicators and processes, by requiring provision of information on council budgets, and ultimately, by capping rate increases.

Viewed as a package, these existing provisions offer ample scope to ensure that councils make well-informed, fair and reasonable decisions when setting rates. The Minister can already provide detailed guidance on how councils should act, and can intervene if individual councils clearly fail to maintain required standards. Why, then, is there seen to be a need for further measures?

### **7.3 Areas for Improvement**

Anecdotal evidence suggests the answer may be that in practice not enough councils are applying the current framework in a sufficiently rigorous and transparent manner, and that as a consequence more could be done to contain costs; to respond efficiently and effectively to community priorities; and to ensure councils are fully accountable for their decisions. In particular, it is debatable whether the Best Value Principles are being implemented effectively (see section 7.4).

Of particular importance, as emphasized in the Minister’s recent statement, is the need for councils to engage effectively with their communities and other key stakeholders when preparing Council Plans and setting rates. Rates are a ‘high profile’ tax and any substantial increases need to be carefully explained. This is discussed in section 7.5.

Another apparent weakness is the lack of guidance in the Local Government Act and Regulations as to what should be included in a council's Budgeting and Reporting Framework, other than a reference to the very general Principles of Sound Financial Management. Nor are there any principles relating specifically to the setting of rates (such as the principles of taxation discussed in section 2).

In its recent report<sup>4</sup> the NSW Independent Local Government Review Panel (ILGRP) pointed to a similar deficiency in that state. It commented as follows:

In most cases, rating systems appear to be the result of an accumulation of pragmatic decisions taken over many years, focused simply on raising as much revenue as possible within legal limits and in a manner acceptable to the majority of ratepayers. This approach is unlikely to reflect sound fiscal policies or to lay a solid foundation for long-term sustainability.

The Panel thus sees a need for preparation and adoption by councils of more rigorous Revenue Policies that set out a clear rationale for the way their rating systems are structured, precisely what they are designed to achieve, and how taxation principles have been applied. This would enhance transparency and accountability to the community, and encourage councils to avoid both arbitrary imposition of rates and unnecessary complexity. Revenue Policies should be updated as part of each new 4-year Delivery Program ...

The NSW Delivery Program is equivalent to a Council Plan in Victoria.

A related concern, raised earlier in section 4, is that the Minister's current power to limit a council's 'general income' – including fees and charges – goes too far and may cut across sound financial management by limiting councils' ability to apply full cost recovery where appropriate to specific services, facilities and infrastructure provision. As a general rule, achieving appropriate cost recovery ought to be a matter for resolution by councils with those affected, having regard to their particular circumstances, rather than by intervention from the State.

The following improvements to the current framework for financial management and budgeting therefore warrant consideration, as set out below.

1. Require rigorous application by councils of the Principles of Sound Financial Management and Best Value Principles, together with defined processes for strategic planning and budgeting.
2. Set firmer guidelines – and if necessary amend the Local Government Act – to promote effective community engagement in the implementation of the Best Value Principles and strategic planning and budgeting processes.

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<sup>4</sup> Independent Local Government Review Panel *Revitalising Local Government: Final Report*, October 2013

3. Clarify the key components of a Budgeting and Reporting Framework and include a Revenue Policy along the lines proposed by the NSW ILGRP.
4. Ensure that decisions to levy special rates, fees and charges follow due process, including adequate community consultation, and that those sources of revenue are used solely for specific cost recovery.
5. Increase the capacity of Local Government Victoria (or the Essential Services Commission – see section 7.7) to analyse the annual performance and financial data generated by councils with a view to identifying and pursuing potential cases of poor performance or unwarranted rate increases.
6. Limit the Minister's rate-capping power to income from general rates.

#### **7.4 Best Value Principles**

The Best Value Principles enacted by the Bracks government in 1999 sought to replace the former government's rate-capping and compulsory competitive tendering arrangements with a self-regulating approach to reviewing services, containing costs and productivity improvement. Attention to those principles appears to have waned in recent years and this seems to be the right moment to revive them as a key plank in achieving the new government's objective of minimising rate increases.

Rigorous review of service provision is essential in a climate of scarce resources, changing community needs and an increased focus on containing costs. This is an area where the expertise of the ESC could be of great value to councils, and where much more could be done across local government to share performance data, undertake comparative benchmarking and exchange examples of good practice.

Renewed attention to the Best Value Principles and associated efforts to promote regular and rigorous reviews of service provision could offer a productive alternative to more 'heavy handed' approaches to rate-capping.

#### **7.5 Community Strategic Planning**

As noted above, the Minister is clearly concerned that there should be closer engagement with communities and stakeholders in the budget and rate-setting process. For such engagement to be effective, it needs to extend also to prior processes of strategic and financial planning – preparation of the Council Plan and the Strategic Resource Plan.

In NSW, the IPR framework has introduced a new element in the form of a rolling 10-year Community Strategic Plan (CSP). This is intended to be a central point of reference for the activities of councils and their working relationships with community organisations, State agencies and other partners. It should thus be a 'whole of council, whole of community' plan, prepared only after extensive consultations with all concerned. Councils' 4-year Delivery Programs and annual Operational Plans (including budgets and rates) should flow from the CSP. The ILGRP argued that the CSP process could also be aligned with implementation of the NSW State Plan to foster improved cooperation between local and

State governments, including setting shared objectives (but this is very much a work in progress).

A number of Victorian councils are already acknowledged leaders in the field of local community planning and their experience could inform strengthening of strategic planning and community engagement either by expanding the scope of Council Plans or by introducing a NSW-style community strategic plan.

### 7.6 A 'Light-Touch' Approach to Rate Capping

The evidence is overwhelming that **there is no need to introduce a wholly new process** or to create a substantial additional bureaucracy in order to achieve the government's stated objectives. Rate-capping can be implemented – and the Government can honour its election commitment – through a series of improvements to existing arrangements.

Figure 2 shows how rate-pegging in NSW is now enmeshed with Integrated Planning and Reporting. There are clear parallels with the current Victorian provisions shown in Figure 1.

**Figure 2: Strategic Planning, Budgeting and Rate-Pegging in NSW**



*Community Strategic Plan is a 10-year 'whole of community' strategy; Delivery Program is a 4-year plan for the council's term; Resourcing Strategy includes financial, asset management and workforce plans; Operational Plan is updated each year and includes the budget.*

In NSW there is still an 'application and exemption' process for councils wishing to exceed the rate peg. However, the strong message to councils from IPART is that they should complete their planning and community engagement processes first, **then** decide whether they need a 'Special Variation' rate increase (ie in excess of the current annual index) and for how many years (up to the legislated maximum of seven).

The 'application and exemption' system in NSW has been costly for both councils and the State government. But now that rate-pegging is being based on the IPR process, this can be changed. Both IPART and the NSW ILGRP have proposed that – subject to councils properly

implementing IPR requirements, including adequate community consultation – rate increases to a certain level above the annual peg (an additional 3-5%) could be ‘automatically’ approved or ‘ticked and flicked’ on the basis of the IPR documentation alone ie without preparing a separate application.

There are three critically important reasons for advocating this ‘light touch’ approach:

- It focuses councils’ attention on their fundamental responsibilities to ensure sound financial management and provide their communities with needed services and infrastructure as efficiently and effectively as possible.
- Consequently, it minimizes the adverse unintended consequences of councils becoming overly concerned with conforming to an index, such as making ‘lazy’ cuts to maintenance of infrastructure and facilities.
- It minimizes costs and administrative complexity, and avoids introducing another layer of controls.

In the Victorian context a ‘light touch’ approach could be taken still further. If the current legislative framework is applied more rigorously as outlined in sections 7.2-7.5, **there should be no need for ‘application and exemption’ arrangements at all.** Instead, rate-capping arrangements would simply comprise:

1. Strengthened strategic planning and community engagement through revised guidelines for the Council Plan and Strategic Resource Plan and perhaps introduction of a NSW-style community strategic plan
2. More rigorous implementation of the Principles of Sound Financial Management and Best Value, plus a supplementary requirement for a Revenue Policy as proposed by the NSW ILGRP
3. Careful monitoring of councils’ performance in applying the framework, formulating budgets and setting rates and budgets, using existing reporting and audit processes
4. Intervention by the Minister (or an agency acting on the Minister’s behalf) where a council needs to provide additional information to justify its budget and rate increases, and where imposing a specific cap is warranted.

The combination of better planning and community engagement, more rigorous guidelines for financial management and rate-setting, performance monitoring and the Minister’s power to intervene will be more than sufficient to ensure that councils cannot substantially exceed CPI-based rate increases unless those increases are fully justified. By the same token, NSW experience shows that effective community consultation can engender support for very substantial rate increases – at least in percentage terms, and provided that the additional revenue is clearly allocated to specific services and projects that the community sees as important.

## **7.7 Role of the Essential Services Commission**

The Government has indicated that it wishes to engage the ESC both to develop the rate-capping framework and to provide ongoing independent oversight of rate increases.

Introduction of another agency overseeing local government's financial and governance performance runs the risk of 'bureaucratic creep'. NSW experience shows that rate-capping can all too easily become complex and costly, and that under an 'application and exemption' system the cost to councils (and hence their communities) can outweigh the benefits.

The 'light touch' approach proposed in section 7.6 seeks to minimize costs while maximising benefits (which accrue not only in terms of the level of rates but also better governance). In particular, there would be no need to expend time and money on formulating an inevitably controversial annual index, nor on complex calculations of appropriate costs of service delivery, nor on processing dozens of applications every year.

Having said that, there is undoubted value in having an arms-length agency oversee rate-capping, and in tapping the relevant expertise of the ESC. It is therefore proposed that consideration be given to defining the ESC's role as follows:

1. Monitor the operation of the overall framework for financial management and rate-setting, as described in Figure 1 and section 7.2, and advise on any necessary strengthening of guidelines and procedures.
2. Assist councils with methodologies for applying the Best Value Principles and for setting appropriate rates, fees and charges.
3. Cooperate with LGV and the Auditor General to ensure that the performance monitoring processes are operating effectively and actually deliver the information required to assess local government costs and the validity of rate increases.
4. Review that data in order to assess and benchmark rate increases across the board, and to identify apparent cases of poorly documented and/or unjustified increases.
5. Advise the Minister on those cases where additional information and investigation is required and application of a specific rate-cap may be warranted; act on the Minister's behalf to undertake necessary investigations; and recommend an appropriate cap.
6. Liaise with LGV and the Auditor General to identify and correct any adverse unintended consequences of rate-capping.

## Attachment A: Edited Extracts from Local Government Act

### Principles

#### SECTION 3C: Objectives of a Council

- (1) The primary objective of a Council is to endeavour to achieve the best outcomes for the local community having regard to the long term and cumulative effects of decisions.
- (2) In seeking to achieve its primary objective, a Council must have regard to the following facilitating objectives—
  - (a) to promote the social, economic and environmental viability and sustainability of the municipal district;
  - (b) 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;
  - (f) to ensure the equitable imposition of rates and charges;
  - (g) to ensure transparency and accountability in Council decision making.

#### SECTION 3D: What is the role of a Council?

- (2) The role of a Council includes—
  - (c) maintaining the viability of the Council by ensuring that resources are managed in a responsible and accountable manner;

#### SECTIONION 136: Principles of sound financial management

- (2) ...a Council must—
  - (a) manage financial risks faced by the Council prudently, having regard to economic circumstances;
  - (b) pursue spending and rating policies that are consistent with a reasonable degree of stability in the level of the rates burden;
  - (c) ensure that decisions are made and actions are taken having regard to their financial effects on future generations;
  - (d) ensure full, accurate and timely disclosure of financial information relating to the Council.

### Strategic Planning

#### SECTION 125: Council Plan

- (1) A Council must prepare and approve a Council Plan within the period of 6 months after each general election or by the next 30 June, whichever is later.
- (2) A Council Plan must include—
  - (a) the strategic objectives of the Council;
  - (b) strategies for achieving the objectives for at least the next 4 years;
  - (c) strategic indicators for monitoring the achievement of the objectives;
  - (d) a Strategic Resource Plan containing the matters specified in section 126;
  - (e) any other matters which are prescribed by the regulations.
- (3) A person has a right to make a submission under section 223 on the proposed Council Plan.

#### SECTION 126: Strategic Resource Plan

- (1) The Strategic Resource Plan is a resource plan of the resources required to achieve the strategic objectives.
- (2) The Strategic Resource Plan must include in respect of at least the next 4 financial years—
  - (a) financial statements describing the required financial resources in the form and containing the information required by the regulations;
  - (b) statements describing the required non-financial resources, including human resources, in the form and containing the information required by the regulations.
- (2B) A Council that proposes to adopt a plan to provide services or take initiatives must ensure that the resources required for the plan are consistent with the Strategic Resource Plan (so far as the plan relates to the period covered by the Strategic Resource Plan).

- (3) A Council must—
- (a) review the Strategic Resource Plan during the preparation of the Council Plan; and
  - (b) adopt the Strategic Resource Plan not later than 30 June each year.

## Best Value

### SECTION 208B: Best Value Principles

The Best Value Principles are—

- (a) all services provided by a Council must meet the quality and cost standards [determined by the Council];
- (b) ... all services provided by a Council must be responsive to the needs of its community;
- (c) each service provided by a Council must be accessible to those members of the community for whom the service is intended;
- (d) a Council must achieve continuous improvement in the provision of services for its community;
- (e) a Council must develop a program of regular consultation with its community in relation to the services it provides;
- (f) a Council must report regularly to its community on its achievements in relation to the principles set out in paragraphs (a), (b), (c), (d) and (e).

### SECTION 208C: Factors that may be looked at in applying the Principles

In applying the Best Value Principles, a Council may take into account, among other factors—

- (a) the need to review services against the best on offer in both the public and private sectors; and
- (b) an assessment of value for money in service delivery; and
- (c) community expectations and values; and
- (d) the balance of affordability and accessibility of services to the community ...

### SECTION 208G: Report on Best Value Principles compliance

At least once every year a [Council](#) must report to its community on what it has done to ensure that it has given effect to the Best Value Principles.

### SECTION 208H: Ministerial Codes

- (1) The Minister may publish in the Government Gazette one or more Codes in relation to how Councils are to give effect to the Best Value Principles.

### SECTION 208I: Ministerial guidelines

- (1) The Minister may publish in the Government Gazette guidelines for Councils in relation to the Best Value Principles.

## Budgeting and Reporting

### SECTION 137: Budgeting and reporting framework

A Council must establish and maintain a budgeting and reporting framework that is consistent with the principles of sound financial management.

### SECTION 127: Council must prepare a budget

- (2) The Council must ensure that the budget contains—
  - (a) Financial statements in the form and containing the information required by the regulations;
  - (b) a description of the services and initiatives to be funded in the budget;
  - (c) a statement as to how the services and initiatives described under paragraph (b) will contribute to achieving the strategic objectives specified in the [Council](#) Plan;
  - (da) for services to be funded in the budget, the prescribed indicators of service performance that are required to be reported against in the performance statement under section 131;
  - (db) the prescribed measures relating to those indicators;

- (e) any other information required by the regulations.

#### **SECTION 129: Public notice**

- (1) As soon as practicable after a Council has prepared a proposed budget or revised budget, the Council must give public notice.
- (2) A person has a right to make a submission ... on any proposal contained in the proposed budget or revised budget.
- (3) In addition to any other requirements specified by this Act, the notice referred to in subsection (1) must ... contain any information required by the regulations;

#### **SECTION 130: Adoption of budget or revised budget**

- (1) A Council may adopt a budget or revised budget if it has complied with all of the relevant requirements of this Act relating to budgets and revised budgets.
- (4) The Council must submit a copy of the budget or revised budget to the Minister within 28 days after adopting the budget ...
- (7) A Council must give the Minister any information concerning its budget or revised budget that the Minister requests.

#### **SECTION 131: Annual report—contents**

- (2) An annual report must contain the following, in respect of the financial year reported on—
  - (b) an audited performance statement;
  - (c) audited financial statements;
  - (d) a copy of the auditor's report ... under Part 3 of the Audit Act 1994;
  - (f) any other matter required by the regulations.

#### **SECTION 139: Audit committee**

- (3) An audit committee must be constituted in the prescribed manner.
- (4) An audit committee has the functions and responsibilities prescribed for the purposes of this section.
- (5) The Minister may make guidelines for the purposes of this section.

#### **SECTION 140: Accounts and records**

- (1) A Council has a duty to ensure that there are kept in accordance with the regulations—
  - (a) proper accounts and records of the transactions and affairs of the Council; and
  - (b) such other records as will sufficiently explain the financial operations and financial position of the Council.
- (2) A Council has a duty to do all things necessary to—
  - (f) ensure efficiency and economy of operations and the avoidance of waste and extravagance;

## **Special Rates**

#### **SECTION 163: Special rate and special charge**

- (1) A Council may declare a special rate, a special charge or a combination of both only for the purposes of—
  - (a) defraying any expenses; or
  - (b) repaying (with interest) any advance made to or debt incurred or loan raised by the Council—in relation to the performance of a function or the exercise of a power [that] is or will be of special benefit to the persons required to pay the special rate or special charge.
- (1A) A Council must not make a declaration under subsection (1) unless it has given public notice of its intention to make the declaration at least 28 days before making the declaration.
- (1C) A Council must send a copy of the public notice to each person who will be liable to pay the special rate or special charge within 3 working days of the day on which the public notice is published.
- (2C) The Minister may make guidelines for the purposes of [determining the amount of special rates and charges].
- (3) The Council must specify in the declaration—

- (ad) the total amount of the special rates and special charges to be levied; and
- (b) the land in relation to which the special rate or special charge is declared; and
- (c) the manner in which the special rate or special charge will be assessed and levied; and
- (d) details of the period for which the special rate or special charge remains in force.

## Rate-Capping

### **SECTION 185A: Definition**

In this Part—

"general income" means the amount declared by a Council under section 158 to be the amount which the Council intends to raise by general rates, municipal charges, service rates and service charges.

### **SECTION 185B: Minister may give directions concerning rates and charges**

(1) The Minister may, by Order published in the Government Gazette, direct a Council specified in the Order that the Council's general income in respect of a financial year—

- (a) is not to exceed the Council's general income in respect of a specified previous financial year; or
- (b) is not to exceed a specified percentage of the Council's general income in respect of a specified previous financial year.