

## 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.