



Local Government Rates Capping and Variation Framework Review

City of Boroondara submission
August 2015



8 Local Government - Rates Capping and Variation Framework submission

In late July the Essential Services Commission (ESC) released a draft report entitled '*A blueprint for change - Local Government Rates Capping and Variation Framework Review*'. The due date for submissions on this framework is 28 August 2015.

The major outcomes for Council arising from the framework are that the ESC agrees with Council's position that Supplementary and Special rates and Charges (waste fees) should not be covered by the proposed rate CAP.

The ESC has also recognised that CPI in itself is not an adequate measure of local government cost increases and responded to that by including a wages price index as part of the CAP calculation.

Whilst the above are positive outcomes there are a number of issues with the ESC's framework which form the basis for Council's submission. Officers have developed a response to the ESC consultation paper which is presented for Council consideration and endorsement.

MOTION

Moved Councillor Healey

Seconded Councillor Kreutz

That Council resolve:

- 1. To endorse the Local Government Rates Capping and Variation Framework Review submission (Attachment B).**
- 2. That the Chief Executive Officer or such other person that the Chief Executive Officer selects for the purpose of giving effect to this resolution, be authorised to make minor amendments as necessary and to submit the City of Boroondara's response to the ESC consultation paper by 28 August 2015.**

CARRIED

Local Government Rates Capping and Variation Framework Review Submission from the City of Boroondara

We appreciate the time taken by the Essential Services Commission (ESC) to understand the complex nature of the legislation under which Councils operate in order to fund Council services through property based taxation.

Boroondara Council also provided a detailed submission to the Rate Capping and Variation Framework Consultation in May 2015.

This submission is in response to the Draft Report Volume 1, issued 31 July 2015.

Which revenues come under the rate CAP (ref 2.2)

The City of Boroondara agrees with the decision to exclude, Supplementary Rates and Special Rates and Charges (waste charges) from the CAP.

Rate revenue per assessment (ref box 2.2)

ESC Box 2.2 explains the relationship between average property value and rate in the dollar.

The assumption made is that the number of rateable properties that will exist at 1 July is known by councils in January of that year. This is not the case.

The mechanisms that allow councils to recognise rateable properties are lengthy and involve an external valuation process, hence new properties' are recognised at several times during the year. This step is dependent upon the volume of new properties and hence occurs at varied times during the year.

The number of new properties change based on the types of development being undertaken. For example at Boroondara the net increase in the number of properties varied between 1,337 in 2011-12, only 123 in 2013-14 but then 996 in 2014-15.

To summarise, by applying the CAP to average rates includes another unknown factor being the estimate of the number of properties at July 1. Therefore the CAP should be applied to the rate in the dollar which is the most fundamental variable and one fully in council's control.

If the ESC uses average rate per property there is an in-built bias for a council to adjust the number of properties that will be in existence on July 1 to provide favourable outcomes.

How should the rate CAP be calculated? (ref 2.4)

The use of CPI as the basis of the CAP fails to recognise and acknowledge the facts already provided to the ESC that CPI is a measure of household expenditure. The ABS itself states that CPI is not a measure of business costs.

The MAV Local Government Cost Index has been developed to monitor a more representative set of local government costs. It has historically demonstrated that local government costs have never been at or even close to CPI levels.

The overwhelming majority of council submissions also stated that CPI is not an adequate basis for the CAP.

Labour costs

The ESC has set the proportion of labour costs to be included in the CAP calculation to be 40%, stating that this represents the average proportion that labour costs represent across the sector.

We challenge this interpretation of the average proportion of costs because it includes depreciation as one of the costs. Depreciation is a non cash item and hence should be excluded from the calculation of employee costs proportion of total costs.

Local government has a disproportionately high asset base compared to its revenue; as a result depreciation becomes a substantial expense line. Therefore this distortion must be removed when calculating the proportion of other expenses.

If the distortion of depreciation is removed, direct labour costs rise to 50% of council expenses on average.

Contract prices are also more directly linked to WPI as in most cases they include a sizeable labour component. Therefore the actual cost of labour in a Councils Income statement is more likely to be in the vicinity of 60%

Therefore the CAP should be based on 50% to 60% WPI forecasts.

Other factors excluded from the CAP

Many submissions to the ESC pointed out the cost of capital works and maintenance costs as being untied to CPI. Our own submission pointed to the Rawlinson's Cost Index for building and construction which is widely used by industry in estimating costs for construction contracts. It is also used by Council when utilising the expertise of quantity surveyors to develop project budgets for capital works. Council believes the imposition of a CAP that does not include capital works and infrastructure renewal and maintenance costs as a factor in the calculation is flawed.

Likewise council funds millions of dollars of utility costs including public lighting in order to deliver services. The proportion of funds allocated in councils budget to utility costs should be automatically increased at the rate of annual cost increases allowed by the ESC for utility providers. At Boroondara utility costs comprise around 4% of expenses.

Efficiency factor

The description of the rationale for an efficiency factor is not based on any evidence provided by the ESC in its draft proposal. The description of the efficiency factor indicates it will start at 0.05% and increment by that amount annually. It has no end date i.e. there is no maximum level of efficiency discount to be applied over time. In

NSW the efficiency discount is 0.04% once only and not cumulative, it remains at 0.04% each year.

At Boroondara Council within 10 years this will reduce the ability to fund services by \$3.72 million and by the 11th year will cost almost \$1 million per annum. By that time services may need to be removed each year to fund this \$1 million cut per annum, or reduce the level of infrastructure maintenance, infrastructure renewal and capital works generally.

The CAP itself is an efficiency driver as it sets rates at lower levels than Councils have historically needed. Hence to maintain some services Councils will need to reduce standards of service delivery or reduce the number of services or remove itself from services to the community all together, exposing the community's most vulnerable, the aged, children and families.

The ESC did not consult on an efficiency dividend hence inclusion in the draft report is inappropriate.

Council rejects an arbitrary reduction in what is already a CAP level that will further diminish the financial position of Council which until this time has been widely supported by its community..

CAP forecasts

The CAP forecast of three years is inadequate.

The *Local Government Act* requires councils to develop a Strategic Resource Plan for a rolling four year period. The forecast should be for a rolling four year period to allow councils to satisfy the current requirements of the *Local Government Act* and to achieve best practice in financial planning. The Commonwealth Government has previously encouraged councils to plan well beyond the mandatory rolling four year financial plan through support and funding of the MAV Step Asset Management programs. Council has invested considerably in this program to maintain, renew and replace assets over the longer term in a financially responsible manner.

The Department of Treasury and Finance (DTF) as an entity under the control of the Victorian Government should not be the source of the forecasts. A level of political influence may be applied to the DTF to ensure their forecasts further the aims of the Victorian Government rather than serving the best interests of the community. Hence, the independence of the forecasts originating from the DTF is in question.

As stated in our May submission an independent economic forecaster such as Access Economics should be commissioned to provide forecast data.

Who decides whether a variation is approved? (ref 3.4)

Boroondara believes that the removal of council's ability to make decisions with respect to revenue raising reduces their capacity to ensure financial decisions are made in the best long term interests of the community. (S 3C and S136). We believe that the *Local Government Act* should be changed to remove the existing requirements on elected Council and to reflect the ESC's control and accountability over Council finances.

Removing elected councillors' ability to decide to fund necessary community infrastructure and programs is a diminution of local democracy.

With respect to community consultation, our previous submission clearly indicated the inherent incongruity of making unelected members of the public who are not accountable for the welfare of the broader community, and in many cases only engage with the process to advocate on personal agendas, being the arbiters of rating decisions. Councillors as the elected representatives of the community are best placed to make decisions on the council budget as they are privy to the intimate detail of budget development processes and communication with the community for all manner of projects, services and infrastructure through master planning, strategic analysis and community engagement.

Council supports and undertakes community consultation at a high level of competency and frequency. It consults on strategy development, service delivery, facility maintenance and upgrade and replacement.

Costs of administering the framework (ref 5.3)

The ESC report does not provide an opinion as to whom should pay for the framework.

Council believes the costs of providing reporting to the ESC will be substantial and will require additional staff, legal, information technology and professional services. As such this should be factored into the CAP. We estimate a minimum of 0.25 % be added to the CAP in the first year to cover these costs annually for a 10 year program.

Evidence of these increased Council costs has been recently experienced due to the introduction of the Local Government Performance Reporting Framework (LGPRF)

Councils have recently experienced the introduction of the LGPRF which according to a regulatory impact statement was to cost around \$2,000 per year. In actuality Boroondara was required to allocate staff resources and technology improvements that have cost in the order of \$100,000. The mandatory budgeting and reporting burden imposed by those regulations has further required system changes to budgeting and reporting practices all of which have required substantial additional time and staffing resources as well as increased external audit costs.

The ESC in its own work on a mandatory reporting system found that local government was already subject to excessive reporting requirements by the Victorian Government. Further, it stated that 30% of current council reporting would be targeted for removal.

Council recommends that this necessary body of work be completed by the ESC prior to the introduction of the CAP.

As to the ESC costs, these should be borne by the Victorian Government as the body introducing this increased level of regulatory burden.

Cost shifting

Council believes the lack of transparency in the report in defining the levels of cost shifting imposed on councils to be a disappointment.

Ample evidence has been received by the ESC that the Victorian Government has since 2009 failed to increase statutory planning fees to reflect the real cost to councils. Yet the ESC Report makes no recommendations with respect to this factor as a means of lowering council's costs and hence reducing the rate level. In contrast the statutory setting of many fees and fines by the Victorian Government has reduced the ability of Council to seek alternative income streams. Therefore table 3.2 which suggests evaluating revenue raising mix as part of a variation application cannot be undertaken.

Boroondara Council is disappointed that the ESC has not been courageous enough to call for immediate increases to the statutory fees and/or removal of statutory controls placed on fee setting for local government.

Ample evidence has also been provided by councils that due to inadequate funding by the Victorian Government to fund services performance by local government on behalf of the state; local government has been required to allocate rate payer funds to maintain service levels. Boroondara Council recommends that in lieu of the ESC requiring the Victorian Government to adequately fund the services delivered on its behalf by local government, that an evaluation of cost shifting amount is included in the CAP.

Financial Sustainability

The report by the Victorian Auditor General for end of year Audits, tabled in parliament in February 2015, indicates for the 2013-14 year that 28% of councils have liquidity risks, 42% have a self-financing risk, 37% have a capital replacement risk and that 33% of councils have a renewal gap.

We submit that a large proportion of councils have not been able to increase rates enough in recent years to maintain financial viability and that the ESC framework will cause many Victorian Councils to further reduce services or become financially unsustainable.

How difficult will it be to have a Variation Approved? (Ref S3.6)

Council does not agree with the ESC's supposition that there will be few variance requests. If this is the case it will be more likely that political factors rather than economic ones are the root cause. We note that in NSW there are few variation applications even though an independent local government review panel stated that 30% of NSW councils had an insufficient and deteriorating operating result and that this trend was unsustainable.

Implementing the Framework (ref table 5.1)

The ESC requirement that a variation request be notified in January does not fit with Council meeting schedules where typically Councils do not meet during late December and all of January.

The ESC has not allowed enough time for councils to comply with the public notice provisions of the *Local Government Act*. The May response by the ESC to councils requesting a variation needs to be concluded in March with mid-April as the absolute final date to allow councils two weeks to finalise their budget document for public notice requirements. Late April early May is the latest that public notice can commence in order to have a council adopt the budget prior to June 30.

Conclusion

In summary, Boroondara Council is disappointed with many aspects of the ESC framework which has to a large extent ignored the opinions of the sector.

The concept of an efficiency dividend was not canvassed in the ESC consultation paper in April. Hence it should not be introduced without further consultation and understanding of the additional impacts to local government finances.

Boroondara Council disagrees with the concept of CPI being the largest factor in the CAP calculation. The products and services measured by CPI bare little relationship to the large majority of the products and services consumed by local governments; hence linking the CAP primarily to CPI is not valid or applicable to our cost structure.

In the absence of true consideration of the cost structures of local government, the absence of review and recommendation to the Victorian Government regarding cost shifting Council at a minimum recommends that the CAP be based on the Local Government Cost Index produced by the Municipal Association of Victorian as it contains the major factors impacting local government cost structures, and is closest to the 'real' financial environment in which Council delivers services to the community.