

# Local Government - Rates Capping & Variation Framework

## Response

### General Comments

Boroondara Council is opposed to the imposition of a rate cap for the following reasons:

- Local Government is a legitimate level of Government with elected Councillors accountable to the community through the electoral process. As such they must be empowered to decide upon the level of taxation for their communities. S 3 E (e) of the *Local Government Act 1989* (the Act) empowers Council to “raise revenue to enable the Council to perform its functions.”
- The imposition of a state wide rate cap does not take into account the needs, aspirations and demand for services of each local community.
- Local Governments have had to subsidise programs they deliver on behalf of the State Government to an increasing degree. The lack of adequate State funding, the imposition of increased charges, and the freezing of user pay fees are some of the major reasons that rates have increased.
- Many Councils have large backlogs in infrastructure renewal due to aging community infrastructure. The imposition of rate capping has the effect of transferring the costs of infrastructure renewal to future generations.

### THE FORM OF THE CAP

1. *While a cap based on CPI is simple to understand and apply, are there any issues that we should be aware of?*

CPI is not a satisfactory index for rate capping. See response to question 2.

Other issues are discussed within the subsequent responses.

2. *What are some ways to refine the cap (for example, alternative indices), in line with the Government’s objectives?*

CPI is not a satisfactory index for business or local government as is stated by the Australian Bureau of Statistics. Below is a quote from their website.

“All expenditures by businesses, and expenditures by households for investment purposes, are out of scope of a consumer price index.” - 6461.0 - *Consumer Price Index: Concepts, Sources and Methods*.

The most significant limitation on the use of CPI for setting rates is that the basket of goods used to calculate CPI does not include the main cost drivers associated with the services provided by a local government. The CPI measures non-local

government costs such as domestic and international holiday travel and accommodation, the price of fruit and vegetables and the price of tobacco. Councils do not buy tobacco, fruit or vegetables. A Council basket of goods is the price of asphalt, building materials and labour costs. These do not increase at the rate of the CPI basket. For example, Council must pay for its utility services, however, none of these services, electricity for street lighting, gas for Council buildings or water for parks and ovals are limited to increases by CPI.

S 136 (b) of the Act requires Council to pursue rating policies that are consistent with a reasonable degree of stability in the level of the rates burden.

CPI is not a stable measure and is subject to sudden fluctuations, examples include the introduction of the GST, changes in prices due to the rise and fall of the Australian dollar, storm events or droughts in other states which affect the market price of fresh fruit and vegetables and other food.

The requirement for a Strategic Resource Plan as per section 126 of the Act is that Councils ensure their financial sustainability and manage responsibly by planning resource allocation over a four year period. This will be impossible to do if revenue fluctuates as widely and unpredictably as CPI.

### Rate Cap Index Inclusions

Boroondara Council recommends that additional factors should be included in any index and not merely be the subject for a variation request, as follows;

Local Governments are primarily service organisations. Services are provided through the employment of people. The cost of the labour impacts Council whether through contracted service providers or through direct employment by Council. The largest single expense line for all Councils is employment costs. Therefore any index should include Average Weekly Earnings (AWOTE) ABS 6302.

Other factors to include in an alternative index would be data received from publications like Rawlinson's Construction cost index which, at Boroondara, is used to inform escalation factors for future capital works in our Long Term Financial Strategy.

Councils unlike the State and Federal government are required to fully fund the defined benefit superannuation scheme. Under the conditions which this fund operates, a vested benefit index must meet required levels at each actuarial review. There have been a number of calls on Councils to fund shortfalls over the last decade. The last call required Boroondara Council to fund more than \$14 million dollars.

A Defined Benefit Superannuation funding allowance is required to be included in the rate capping index. The Vision Super is recommending that all Councils create a contingency fund of 1 % of rates annually. Therefore this increment should be included in the annual rate capping index.

Inner metropolitan Councils are faced with increased population density because of the requirement from the State Government to cater for thousands of new residential dwellings. As a result Council is required to provide more open space for the wellbeing of its community. Boroondara has one of the lowest ratios of open space to total area of all metro Councils.

Therefore Council must acquire land to use as open space. Hence, Boroondara Council believes that an allowance of 0.5% to 1 % of rates should be added to the index for Councils in order to acquire land. This would allow a small parcel of land to be acquired every three to four years in areas of high open space need.

The federal Government freezing of the Federal Assistance Grants has placed further pressure on rates for many Councils. The impacts of freezing, decreasing or diversion of funding programs or freezing of statutory fees charged by local government for services needs to be included in the index.

The effect of legislative changes needs to be taken into account when developing the index. For example, the introduction of Universal Access requiring 15 hours of 4 year old kindergarten in 2011. Council provides more than 30 buildings for use by community groups to provide kindergarten services. As a result of this Federal initiative Council was required to expend significant funds on the expansion of these buildings to cater for the additional hours.

The City of Boroondara requests that the impact of all legislative changes to Councils be assessed and included in the index to determine the cap.

While not a comprehensive measure of the real costs to Councils, the Municipal Association of Victoria has over many years published a local Government Cost Index which incorporates some of these cost movements. It could be used as the basis for the development of a more realistic cost index for rate capping.

3. *Should the cap be set on a single year basis? Is there any merit in providing an annual cap plus indicative caps for the next two to three years to assist councils to adopt a longer term view in their budgeting and planning, particularly when maintaining and investing in infrastructure often takes a longer term perspective? How should such a multi-year cap work in practice?*

By definition, CPI is an historical measure bearing no relationship to future CPI levels or actual costs borne in a given year.

It is necessary for any index to be available for a minimum of a four year period. Having a rate cap level informed only one or two years at a time means that Council will be unable to fulfil financial planning and management responsibilities currently specified by the Act. The planning cycle for asset renewal and significant capital projects along with borrowing or debt reduction strategies requires at least a four year period of certainty.

***Section 3C (1) Objectives of a Council***

*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.*

S126 of the Act requires Councils to adopt a Strategic Resource Plan for four years.

Therefore the minimum level of certainty provided should be for a rolling four year period.

Most Councils undertake longer term planning. For example Boroondara's Long Term Financial Strategy plans for 10 years in order to truly assess the effect of financial decisions on the future financial capacity of Council. Our published new and renewal capital program is for 5 years.

Having variable income increases based on an annually announced index introduces uncertainty to communities and increased financial risk to Councils.

*4. Should the cap be based on historical movements or forecasts of CPI?*

Neither measure is suitable. Historical movements are irrelevant from the moment it is published and forecasts are notoriously unbelievable.

If historical movements are used to set the cap, during a period of short term inflation then Council funding will be tied to an historical inflator that will negatively impact on Council financial capacity and hence services

Where a forecast inflation rate is used the unreliability of the forecast would require some form of compensation. This may involve use of a range rather than a fixed rate or the use of a variation margin to be added to the CPI based on historical gaps between forecast and actual CPI levels.

The cap level should be developed by an independent body such as Deloitte Access Economics for a rolling 4 year period.

*5. Should a single cap apply equally to all councils?*

Yes. If a single cap is introduced, ratepayers across the state should be treated equally. They should receive the same level of rate rises and the same level of impact to service delivery and maintenance of community assets.

The reasons to support this include simplicity and ease of community understanding.

If a different approach is taken based on different groups of Councils the rationale for the differences should be made clear and consider factors such as State and Federal Grants and the reliance of each Council on rate revenue as the source of income.

Creating differences based upon capacity to raise revenue or current financial position simply penalises those Councils who have been managing responsibly.

## THE BASE TO WHICH THE CAP APPLIES

6. *What base should the cap apply to? Does it include rates revenue, service rates/charges, municipal charges and special rates/charges?*

### Operating Expense Cap

An alternative to an income level cap could be to apply the cap to increases in operating expenditure. This would allow Councils to maintain capital expenditure for asset renewal or new projects while at the same time generating the need for efficiencies to be obtained through limiting the growth in the cost of service delivery.

By applying the cap and hence limiting the cost increases to operating expenses the need for increases in rate incomes would be significantly reduced. Therefore a general lowering of rate increases would be achieved without impacting on future generations through reducing Council's ability to undertake asset renewal works.

Therefore Boroondara Council would prefer an expense cap rather than income cap to be actively considered by the ESC.

### Income Cap

If a decision is made to introduce a cap on income it should be on the increase in the rate in the dollar for general rates.

### Service Charges

The cap should not apply to service rates and charges which are generally calculated as a fee for service.

For example at Boroondara service charges are carefully calculated as a cost recovery for Waste services. If for example, the State Government increases the landfill levy the costs can be passed onto residents through the service charge rather than being cost shifted to rates. Note the land fill levy has increased from \$9 per tonne in 2008-09 to \$58.50 in 2014-15 and by a further 3.45% to \$60.52 in 2015-16 and will cost ratepayers in Boroondara \$2.36 million in the coming year. All of these increases have exceeded CPI levels.

If service charges were included in the rate cap then cost increases such as the above would need to be taken from the funds available for community services.

This is an example of one of the many cost pressures forced onto local government that has resulted in Councils increasing rates.

### Special Rates

Special rates should not be covered by the cap as these rates are for a special benefit to a particular set of rate payers. In Boroondara these are for trader associations where the whole balance is returned to the traders in the form of funds for marketing and other expenses designed to promote business at shopping centres in the city. These funds are not used by Council.

If Special rates are included in the overall cap then, under certain scenarios there will be an incentive to discontinue these programs which would allow increasing of general rates but still comply within the cap rules.

#### Supplementary Rates

The effect of supplementary valuations should also be excluded from the cap. (See response to question 8)

We recommend that if a cap was introduced in a non-revaluation year that the cap increase be applied to the general rate in the dollar.

In a revaluation year the effect of an increased CIV should be incorporated into the calculation.

**7. *Should the cap apply to total revenue arising from these categories or on average rates and charges per assessment?***

The cap should only be introduced for general rate in the dollar excluding special rates, service charges and supplementary rates.

If the cap is applied to total revenue the effect would be to reduce the general rate because of the effect of supplementary property valuations.

Due to the revaluation every two years the cap cannot apply to average rates and charges per assessment. In a revaluation year the change in rate levels historically varies dependent on the suburb and property type. (See response to question 9)

**8. *How should we treat supplementary rates? How do they vary from council to council?***

Supplementary rates recognise new properties or increases to a property's CIV between biennial revaluations. Hence they represent increases in service demand due to additional population and or properties in the municipality. For example, an increase in population requires additional services, e.g. more Immunisation programs, higher Maternal & Child health services, additional library facilities and materials. Higher property numbers drives the need for more and better open space and recreation opportunities and to other services such as traffic treatments to cater for higher vehicle density. Higher density property development also generates demand for planning, building, local laws and asset protection services.

Therefore supplementary rates must fall outside of any rate cap regime.

**9. *What are the challenges arising from the re-valuation of properties every 2 years?***

Rates are levied on the individual property based on its proportion of the total municipal CIV. Therefore when a revaluation occurs the rate levied will usually not be the same as the general rate increase for the municipality.

In 2014-15 Boroondara increased the general rate by 4.6%.

The average property value in Boroondara increased by 9.7% hence Council created a reduction in the rate in the dollar from 0.001693 in 2013-14 to 0.001615 in 2014-15. The rate in the dollar (tax rate) decreased by 4.8%.

The below table which illustrates the potential for public confusion over actual rate increases is based on revaluation. It shows that despite the rate rise being only 4.6% a number of properties had increases of up to 30% due to change in CIV and alternatively a number of properties had rate decreases of more than 20%

**2014 Boroondara Revaluation - Rate Percentage Change  
All Property Types - Uses Adopted Rate of 0.1615 Cents in Dollar**

**BASED ON FINAL VALUATIONS APPROVED BY THE VALUER  
GENERAL**

<b>% Change Rates</b>	<b>Total Assessments</b>	<b>No. Residential</b>	<b>No. Commercial</b>
<-20%	453	245	208
-15% to -20%	957	727	230
-10% to -15%	1,081	663	418
-5% to -10%	3,540	2,690	850
0% to -5%	11,439	9,325	2,114
>0% to 5%	20,516	19,198	1,318
>5% to 10%	20,598	20,105	493
>10% to 15%	9,116	8,981	135
>15% to 20%	2,725	2,682	43
>20% to 25%	1,730	1,656	74
>25% to 30%	308	281	27
>30%	370	302	68
<b>TOTALS</b>	<b>72,833</b>	<b>66,855</b>	<b>5,978</b>

The outcome of revaluations every two years is that rate increases for individual properties will be higher or lower than the cap due to redistribution.

**10. What should the base year be?**

The base year should be 2015-16 or later if a transition period was to be introduced.

## THE VARIATION PROCESS

### 11. How should the variation process work?

The main concern for Councils with any variation process is that the response from the ESC be early enough for Councils to complete their budget processes.

### 12. Under what circumstances should councils be able to seek a variation?

Council's position is that all of the issues identified in responses 12 and 13, where known, should be included in the cap index. In the event that the index does not reflect these costs to Council the valid reasons for seeking a variation include the issues discussed below.

Aside from external impacts discussed in question 13 there are a number of valid reasons why a cap exemption should be pursued as follows;

- Withdrawal or redirection in funding by State or Federal governments
- Independent financial indicators such as the current risk ratings of the Auditor General as per the 'Local Government Results of the 2013-14 Audit' report tabled in a parliament in February 2015, - where a council is not in the low risk category is a sound reason to apply for cap variations.
- Failure by State or Federal Governments to increase funding by the actual costs of providing services or at least by CPI. As an example successive governments have failed to increase fees charges for the processing of planning applications since 2009.
- Planning for the future - A Council may plan to build financial reserves for identified future major capital works projects or likely financial impacts such as the defined benefit superannuation call.
- Newly adopted Council service strategies based on identified community need may indicate the requirement for expanded or additional services.
- The early repayment of debt where economic conditions favour such a decision.
- Where there is community support for initiatives which require that the rate cap be exceeded.

### 13. Apart from the exceptions identified by the Government (namely, new infrastructure needs from a growing population, changes in funding levels from the Commonwealth Government, changes in State Government taxes and levies, increased responsibilities, and unexpected incidents such as natural disasters), are there any other circumstances that would justify a case for above cap increases?

Community support for increases above CPI following an extensive community engagement process should be a sufficient basis for exemptions if we are to respect the democratic process.



Councils face a range of external influences which impact on the development of the budget. Given that these factors are largely outside Council control it would be appropriate that the impact of these factors be included in the range of variations to the cap.

Examples of these factors outside Council control include:

- Bridging asset renewal gaps
- Continued freezing of statutory fees.
- Ongoing Cost Shifting by State or Federal government
- Higher than CPI increases in Utility charges
- Changes in legislation requiring Councils to undertake extensive works to prepare, e.g., recent changes to Residential Zones, Local Government Performance Reporting Framework, Universal Access etc..
- Legal costs due to unpopular and unacceptable planning applications
- Constraints on non-rate revenue raising through legislation e.g, Subdivision Act
- Defined Benefit Superannuation Calls
- Increases in Workcover insurance premiums
- Cessation or redirection of annual Grant programs e.g. Living Libraries, Community Infrastructure Fund etc.
- Increased property density leading to open space requirements and/or increased demand for services and impacts to assets
- Changes in the rate of payment for valuations by the SRO.
- Council elections

**14.** *What should councils need to demonstrate to get a variation approved? What baseline information should be required for councils to request a variation? A possible set of requirements could include:*

- the council has effectively engaged with its community*
- there is a legitimate case for additional funds by the council*
- the proposed increase in rates and charges is reasonable to meet the need*
- the proposed increase in rates and charges fits into its longer term plan for funding and services*
- the council has made continuous efforts to keep costs down.*

*We would like stakeholders' views on whether the above requirements are adequate.*

In broad principle these elements are satisfactory; however the exact requirements in order to meet these broad criteria will determine whether the variation scheme is workable.

In order for a Council to minimise the costs and time associated with a cap variation submission. The ESC should clearly identify what are the detailed elements that a Council needs to provide to meet the requirements of a submission for example;

- Is compliance with S129 of the act a demonstration of effective rate level consultation?
- Is the existence of a process improvement program a sufficient indication that Council has made efforts to keep its costs down?
- What form of financial analysis is required to indicate the increase in rate and charges is reasonable to meet the need?
- What are the criteria to determine if a case for additional funds is legitimate?

Boroondara Council would like to be a party to future consultation that clarifies and provides a specific framework with respect to the above requirements.

## COMMUNITY ENGAGEMENT

*15. What does best practice in community engagement, process and information look like? Are there examples that we can draw from?*

The City of Boroondara has a comprehensive program of community engagement which is informed by the International Association of Public Participation (IAP2) spectrum and IAP2 Core Values.

Community engagement is undertaken on a regular basis and within a strategic framework, permitting multiple opportunities for community members to shape specific Council plans and strategies over the short and longer term. Community members' long and short term interests are hence known to Councillors who then make balanced decisions that reflect community needs and demands.

Council is faced with the challenge of finding a balance between the competing demands placed on the annual budget. For example, Council may engage with sports clubs or park users who wish to improve facilities in their local area and during the same period with local business who require additional public car parking to be provided to enhance economic viability. What role should the broader community have in deciding which of these two issues, or both, is to be funded in a budget, or whether they agree to pay for higher rates for the benefit of these groups?

In reality each Council budget has hundreds of these complex decisions being made. Boroondara Council has considered this type of issue and has determined that they, as elected representatives, are the best placed to make these decisions.

While community members may be passionately interested in particular projects, policies or services that affect them there is not a high level of interest in rates as a topic. For the 2014-15 Council Budget there was only one submission that mentioned rate levels. Most submissions were requests for reallocation or additional expenditure by Council around service delivery

At Boroondara engagement occurs with the development of every policy, strategy and plan which Council prepares. These initiatives inform the allocation of resources. One of the key strengths of a democratic system is the check and balance which arises from decisions being made by those accountable to the people impacted by decisions. This is the role of elected representatives. Those who choose to participate in budgeting or other strategic initiatives do not have this vitally important element of accountability. However, no constraints are imposed upon the ability of any member of the community to make any submission they like about Council's budget. Unlike other levels of government, Council will hear submissions regarding its budget prior to adoption.

## INCENTIVES

- 16. How should the framework be designed to provide councils with incentives to pursue ongoing efficiencies and respond to community needs? How could any unintended consequences be minimised?*

S 3C (2b) of the Act already requires council 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

Councils do not need "incentives" to respond to community needs. That what they do - the reason they exist. It is matter for elected representation to determine how they wish to balance efficiency against effectiveness and service quality having regard for community needs.

## TIMING AND PROCESS

- 17. A rates capping and variation process should ensure there is enough time for councils to consult with their ratepayers and for ratepayers to provide feedback, and for us to review councils' applications. To ensure the smooth functioning of the rates capping and variation framework, it is particularly important that it aligns with councils' budget processes. We are interested in stakeholders' views on how this can be achieved.*

In order for a Council to have adequate direction for its budget planning process it would be necessary for the ESC to provide a response to a cap variation submission by the end of February.

## TRANSITIONAL ARRANGEMENTS

- 18. What transitional arrangements are necessary to move to the new rates capping and variation framework? Is there merit in phasing in implementation over a two year period to allow for a smooth transition?*

A transition year would be useful where the index used to cap rates was determined and consulted with the sector. In 2016-17 the ESC could publish proposed rate caps for 2017-18 to 2019-20 to allow Councils to review the financial implications and any required reduction in services or adjustments to capital works that arise from the proposed rate cap.

## ROLES

**19.** *What are stakeholders' views on the respective roles of the key participants?*

*Should the Commission's assessment of rates variations be advisory or determinative?*

In the situation where the ESC granted a rate cap variation and subsequently the Minister overturned its ruling Councils would not have confidence in the system. Therefore when the ESC grants a rate variation it should be determinative.

However, in the situation where a cap variation was not approved through a lack of Council resources to submit appropriate documentation or fully execute the requirements for a variation, the determination of the ESC could place the Council in financial difficulty. As a result of this type of situation S 136 of the Act, "Principles of Sound Financial Management" may have to be considered to determine whether a Council now has the power to fully discharge their obligations under this section of the Act.

## OTHER MATTERS

**20.** *Is there a need for the framework to be reviewed to assess its effectiveness within three years time?*

The framework should be reassessed every year for the first 3-5 years. This is to ensure that public services are not affected and the financial viability indicators are not decreasing as outlined in the annual VAGO report "Local Government Results of the 2013-14 audits" tabled in parliament in February 2015.

**21.** *How should the costs of administering an ongoing framework be recovered?*

This is a State Government initiative, the State Government should pay for any costs incurred by Council and the ESC in delivering this framework.

The Council costs of preparing submissions for cap variations including external expertise and community consultation could be included in the rate cap variation.

## OTHER MATTERS RAISED IN EARLIER CHAPTERS

### 22. We are interested in hearing from stakeholders on:

- *whether we have developed appropriate principles for this review*

The principals do not specifically consider whether the imposition of rate capping is financially sustainable for Councils and the communities they serve.

The principals do not consider intergenerational shifting of costs through insufficient capital renewal of Council assets.

- *whether there are other issues related to the design or implementation of the rates capping and variation framework that stakeholders think are important*

As noted previously a review of the Act may need to occur to determine if a Council submission for variation to the cap is rejected by the ESC whether Councils have adequate powers to comply with their obligations under the Act.

- *supporting information on the major cost pressures faced by councils that are beyond their control and the impact on council rates and charges.*

Local governments across Australia gather 3 % of the total taxation that is levied by all levels of government. Yet they are responsible for more than 30% of the assets held by government on behalf of the community.

The report on end of year Audits by the Victorian Auditor General 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.

#### State Government Impacts

- Freeze on planning application fees since 2009.
- Maximum levels of open space contributions set at 5 % of site value under the Subdivision Act S18.
- Some examples of the extent to which Boroondara Council subsidises State Government services as budgeted for 2015-16
  - Home and Community Care                      \$3.53 million
  - Meals on Wheels                                      \$0.25 million
  - Libraries (50/50 Funding model)              \$3.05 million
  - Immunisation                                         \$0.40 million
  - Maternal and Child Health                      \$1.27 million
  - School Crossing supervision                      \$0.81 million

The above are operating costs only excluding the provision of buildings and overheads required to deliver these services.

## Attachment B

- Removal or retargeting of grants such as the Living Libraries or Community Infrastructure Fund to selected Council groups.
- EPA waste to land fill levy at \$2.4 million per annum
- Fire Services levy
- Restrictions on rating certain property types yet these property types are included in the fire services levy.
- New legislation requiring large effort and expense on behalf of Councils to prepare. e.g., Residential Zones.

### Federal Government Impacts

- Freezing of FAGS grants for 3 years produces a reduction in income of \$3.5 million over the 10 years of Council's financial plan.