



14 May 2015

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Dear Dr Ben-David

Local Government Rates Capping and Variation Framework Review

Thank you for the opportunity to comment on the Essential Services Commission Local Government – Rates Capping and Variation Framework Consultation Paper. Please find attached Hobsons Bay's submission.

Council notes that the issue of rate setting is a complex one and that across the sector there is a wide range of application of rates and charges as permitted by the Local Government Act. Accordingly the establishment of a framework under which rate-capping and potential variations will be applied will also have the potential to be complex.

Council therefore looks forward to further opportunities for consultation over the next few months.

If you require further information please contact David Anderson, Director Corporate Services on 9932 1012.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Chris Eddy', written over a horizontal line.

Chris Eddy
Chief Executive Officer

Local Government - Rates Capping & Variation Framework

Response

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?

Rate capping at CPI may lead to large number of councils needing to apply for increases through the variation process.

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

It is pleasing to note that consideration is being given to examine the use of an alternative index rather than CPI, such as the Local Government Cost Index (LGCI). This would be a far better basis for the cap to be applied as it considers the major cost pressures experienced by the local government sector, which are acknowledged in the consultation paper.

Whatever the indicator, it is important that it is released early in the budget process so that council's can determine their rate income.

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?

The cap should be set on a single year basis to ensure that the most up to date index (whether it is CPI or LGVI) is applied and takes into account the most recent cost factors.

There is some merit (although not vital), to include indicative caps for a further two to three years in an effort to assist councils to adopt a longer term view in their budgeting and financial planning. These factors could be applied in council's long term financial plans when calculating future rate income.

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

Historical movements are definitive and remove uncertainty. Forecasts of CPI are subjective and open to debate.

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

A single cap applied to all councils would be simpler and avoid debate.

It would be interesting to consider how councils are grouped. Application of varying caps to each group of councils would also be an interesting discussion, in particular the groups of councils that may receive a higher cap and those that may receive a lower cap.

For example, Hobsons Bay is considered as one of the 17 inner metropolitan councils within the Victorian Auditor General's Office (VAGO) report on local government audit results. It would be an interesting argument to determine whether these councils may receive a higher or lower rate cap. Many will argue that inner metropolitan councils do not need a higher rate cap due to their higher rate base and greater income generating capacity. The counter argument is that these councils are more dependent upon rates as a source of income as they receive less financial support from other levels of government.

As stated on page 40 of the discussion paper, 'the revenue mix for each council is different.' Hobsons Bay City Council is in a unique situation when discussing its revenue and is disadvantaged in its revenue earning capacity in that it is:

- Not a rural council, who generally receive more grants than rates and charges;
- Not like many other inner metropolitan councils that receive larger amounts in other revenues such as car parking fees and fines; and
- Not an outer metropolitan fringe council that is expanding and receiving large amounts of developer contributions.

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?

Total rates revenue - The rate cap should not be based solely on total rate revenue from the prior year, as this does not fully take into account growth from supplementary rates. At the extreme, are significant population growth councils, where a rate cap based on total rate income would not be realistic. If exceptions were given to growth councils, those who do receive a relatively small amount of supplementary rates would be disadvantaged. The most appropriate solution is for the cap to apply to the rates (and possibly charges), but allowance should be made for total rates income to grow above the cap, as a result of supplementary rate income.

General rates – must be included in the rate cap, otherwise there is no real point in having a cap. Consideration does need to be given to the impact of rate capping on differential rates as per section 161 of the Local Government Act 1989 (LGA). Councils (such as Hobsons Bay) with a differential rating structure should be able to continue to adjust their differential rates, as long as the overall change complies with the rate cap.

Service charges – as per section 162 of the LGA should not be included in the cap. Hobsons Bay City Council has a waste service charge under section 162 and ensures that this charge is based on the cost of providing the service, which is addressed in Council's Waste and Service Charge Policy. The cost of providing waste management (and therefore the waste service charge) has fluctuated greatly over the past few years. This is largely due to the introduction (and subsequent removal) of the carbon price, significant increases to the Victorian Government's landfill levy, increased collection service costs, and the cost of reducing waste to landfill through resource recovery. It is also likely that the cost of future opportunities to recover waste and avoid landfill will increase. These opportunities include food waste recovery, which align with the Victorian Government's *Getting Full Value* policy. The potential introduction of a Victorian Government waste recovery target may also have implications for costs on Local Government.

Municipal charges – as per section 159 of the LGA must be included in the rate cap or councils will be able to introduce or increase municipal charges, effectively removing the rate cap.

Special rate and charges – as per section 163 of the LGA should not be included in the cap. The Act states that these can only be considered 'if the Council considers

that the performance of the function or the exercise of the power is or will be of special benefit to the persons required to pay the special rate or special charge.' Such charges should be treated independently of the rates cap.

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

The cap should be applied so that an allowance is included to account for growth from supplementary rates.

The process should be that each council needs to determine what they would earn under their existing rating structure. This is achieved by multiplying current CIVs (including a full year of supplementary growth) by the current rate in the dollars (and any other charges included in the cap). The rate cap can then be applied to determine the total rates income that can be budgeted for.

Under this scenario, in a non-revaluation year, a council will simply be able to change their rate in the dollars and other charges (included in the cap) by the rate cap. The majority of ratepayers (who have not had their Capital Improved Value increased due to a supplementary valuation) will get a rate rise exactly as per the rate cap. If a council wants to adjust their rating structure they should be allowed to do so, as long as the rates income budgeted to be earned does not exceed the capped rate income initially calculated.

Under this scenario, in a revaluation year, councils will again need to determine what they would earn under their existing rating structure by multiplying their existing CIVs by the existing rate in the dollars. Again, they then apply the rate cap to determine the total rates income that can be budgeted for. In a revaluation year the new (revalued) CIVs will need to be applied and new rates in the dollar calculated to achieve the same amount of rate income (including the increase as a result of the cap) that can be budgeted for.

In both instances, due to supplementary growth, total revenue from rates will increase by above the rate cap.

If the rate rise were to apply to total rate revenue, assumptions and estimations would need to be made regarding supplementary income to determine a new rate in the dollar. This would lead to complications and an opportunity for manipulation. As stated earlier (question 6), the cap applying to total revenue is not plausible, particularly for councils that receive supplementary rate revenue.

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

The treatment of supplementary rates should not vary between councils.

As mentioned previously, allowances to total rate income should be made for increases as a result of supplementary rates. The rate (and whatever charges are included) increases should be based on the rate cap, whilst total rates income should be allowed to increase, due to CIV growth from supplementary rates, above the cap.

Supplementary rates can be considered as necessary to provide the additional revenue to councils for the additional demands on services as new housing and further development is constructed and occupied.

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

The challenge is to ensure that any rate capping system implemented works in both a non-revaluation and revaluation year.

In a simplistic example, for a non-revaluation year, councils simply change their rates in the dollar and other rate charges (included in the cap) by the rate cap.

This will not work in a revaluation year, as changing rates in the dollar by the rate cap, combined with increased valuations will lead to large rate increases well above the rate cap.

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

2015-16

THE VARIATION PROCESS

11. How should the variation process work?

The rate cap should be set at a reasonable level so that councils seek a variation under exceptional circumstances, particular to their own circumstance, rather than all councils seeking variations for the same reasons. This would be a very inefficient and timely process and councils would have great difficulty in meeting their budget setting deadlines.

Councils would need to apply for a variation during their financial planning phase very early in the budget process. Whilst the discussion paper provides some guidance as to the circumstances which councils may seek a variation it does not appear to address the level of evidence that would need to be produced by a council to support its application.

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

The circumstances to seek a variation are dependent upon the index selected.

If the cap is purely based on CPI and does not take into account sector wide circumstances that apply to every council (i.e. funding level changes, increased responsibility, cost shifting) then all councils are likely to be applying for variations for the same reasons. This creates an inefficient and timely variation process.

The rate cap should be set at a reasonable level so that councils seek a variation under exceptional circumstances, generally specific to their own situation. There is no point having rate capping if every council ends up applying for a variation. Using an index such as the LGCI takes into account general local government sector cost issues, which will provide councils with a better opportunity to adhere to.

If a council has developed its long term financial plan and budget based on the following, yet can not remain financially sustainable, then it should be able to seek a rate cap variation if it is:

- Containing operational expenditure to minor increases;
- Generally maintaining service levels with the aim to use fewer resources and an emphasis on innovation and efficiency.
- Addressing significant capital works renewal expenditure requirements based on asset management plans.

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?

In relation to infrastructure, it is not only 'new infrastructure needs from a growing population' that should justify a case for above cap increases. Many councils have put considerable resources into identifying their infrastructure renewal gap (particularly due to ageing infrastructure and changing community needs) and have only just started addressing the issue through their capital works program. Many of Hobsons Bay's building and facilities were constructed in the 1960s and 1970s and need substantial renewal while emerging issues such as greater involvement of women in active sport has resulted in demand for appropriate facilities.

Any rate cap and variation criteria needs to carefully consider these factors and weight should be given to councils who are focusing on reducing their asset renewal gap and responding to community expectations.

Any council that has developed its long term financial plan and budget based on the factors outlined in our response to question 12 and continues to have financial sustainability concerns should be eligible to apply for an variation.

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.

Hobsons Bay generally agrees with the above requirements, although they do seem to be quite broad and subjective.

In addition, support needs to be provided to councils who apply for a variation as a result of addressing significant capital works renewal expenditure requirements, based on asset management plans.

COMMUNITY ENGAGEMENT

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

Community perspectives, gained through an objective and unbiased community engagement process, along with expert advice, strategic considerations and legal and legislative requirements are valuable and important considerations when making decisions regarding Council business.

Community engagement processes need to be unique for each Council and in turn for each differing opportunity, ensuring they are open, flexible and responsive. Best practice community engagement processes are well planned and provide sufficient time for both Council and our community to be able to understand the issues and non negotiable elements of often complex problems and opportunities presented. There also needs to be consideration to the time required to appropriately analyse the contribution received and feed into the decision making process. In order to successfully achieve best practice community engagement Council needs to be committed to the set framework and resource it appropriately in order for it to be sustainable and meet community's ongoing and changing needs.

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 minimized?

Councils will need to pursue ongoing efficiencies to remain financially sustainable under rate capping, so that is incentive in itself.

Further incentives can be provided by ensuring that variations are granted, when required, to financially responsible councils, which are providing efficiencies, consulting with their community, strategically planning and focusing on asset renewal expenditure.

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.

This is extremely difficult and needs to be addressed as early in the budget process as possible.

An important factor will be the timeliness in responding to rate capping variation requests. Some important determining factors in relation to this will be resources as well as the amount of variation requests received. Again, we emphasise that the index for which the rates cap is based is extremely important.

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?

There may be some merit in a phased implementation as it will potentially give councils more opportunity to prepare for the full impact of a rate cap. Additional time to prepare would ensure that councils are not disadvantaged if they have not been able to provide the necessary evidence in support of a variation.

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?

The Commission's assessment being purely advisory may not be effective as there are some differences in the ways that councils calculate their rate increases. The cost pressures faced by local government are also significant, so 'self' rate capping may not be effective.

OTHER MATTERS

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

There will definitely be a need for the framework to be reviewed, in particular:

- The number of variation applications and variations granted as well as the time taken to analyse those applications.
- The appropriateness of the index being used will need to be constantly monitored.
- The impact of the rate cap on the financial sustainability of councils and the impact on council's asset renewal gaps.

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

The state government should bear the cost of administering the framework and there should be no charge by the ESC for a variation application, otherwise this just becomes another cost shifting exercise.

OTHER MATTERS RAISED IN EARLIER CHAPTERS

22. We are interested in hearing from stakeholders on:

- whether we have developed appropriate principles for this review
- whether there are other issues related to the design or implementation of the rates capping and variation framework that stakeholders think are important
- supporting information on the major cost pressures faced by councils that are beyond their control and the impact on council rates and charges.

Hobsons Bay City Council generally agrees with the principles outlined in [The Essential Services Commission 2015, Local Government — Rates Capping and Variation Framework Consultation Paper](#), April.

The principles highlight the importance of the variation process in the rate capping regime. Despite this, it is important that sector wide financial implications and issues are taken into account when determining the rate cap. This would allow variation applications to focus on exceptional circumstances, particular to a council's specific issue, rather than all councils seeking variations for the same local government sector wide issue. This would assist in developing a variation application process that is efficient, where outcomes can be determined in a timely manner, providing councils with an opportunity to meet their budget setting deadlines.

The complex nature of council rating systems and rate modeling has not really been addressed within the paper. Councils can calculate their rate increases in slightly different ways, so the application of rate capping will need to be uniform, if it is to be fair and equitable between councils.

Many things need to be determined to outline how the cap is to be applied and calculated. Total rate income, general rates, service charges, municipal charges, differential rating structures, supplementary rates (initially applied over part of the year then converted to a full year), average rates and differences between revaluation and non-revaluation years all need to be taken into account. The devil is in the detail, so experienced officers, with substantial rating, rate modeling and long term financial planning experience will need to be consulted to ensure an appropriate methodology is adopted.