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INDIGO SHIRE COUNCIL

Wednesday, 13 May 2015

Dr Ron Ben-David
Chairperson
Essential Services Commission
Via email: localgovernment@esc.vic.gov.au

Dear Dr Ben-David

RE: RESPONSES – RATE CAPPING & VARIATION FRAMEWORK

Indigo Shire Council welcomes the Essential Services Commission's Consultation Paper on the proposed rate capping and variation system.

I have enclosed our responses to the questions asked in section 5 of your document and look forward to seeing this feedback included into your proposed model.

I would be happy to discuss our submission with you at any stage.

Yours sincerely

Gerry Smith
CHIEF EXECUTIVE OFFICER

Submission to the "*Local Government – Rates Capping & Variation Framework*" Consultation Paper

Indigo Shire Council

May 2015

This document responds to the specific questions raised by the Essential Services Commission (ESC) in section 5 of the "Local Government – Rates Capping & Variation Framework" consultation paper.

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

Household CPI is a simple and well understood concept that captures the attention of media and the voting public. The reality however is that council's cost increases are higher than household CPI, and capping rates at CPI will require service reductions. The domestic household CPI is not appropriate to the basket of goods that council consume.

Approximately one third of Indigo's budget is costs associated with staffing. This cost increases in accordance with average weekly earnings growth, and market forces. As can be seen by the table below (from the State Government budget 2015-16 Overview) the wage price index is forecast to grow at approximately 1% more than CPI. This gap would be immediately problematic if a CPI rate was used, and councils would therefore need to cut staff numbers each year by 1% in order to keep the total staff budget at CPI. Using the ESC figure of 45,000 people employed in local government this 1% reduction in staff each year would result in a reduction of several thousand people in the next few years, and possibly 10% of the workforce in the next 10 years. This will clearly have impacts on service delivery to the community.

VICTORIA'S ECONOMIC FORECASTS (%)	2013-14 actual	2014-15 forecast	2015-16 forecast	2016-17 forecast	2017-18 projection	2018-19 projection
Real gross state product	1.7	2.25	2.50	2.75	2.75	2.75
Employment	0.6	2.00	1.50	1.50	1.50	1.50
Unemployment rate	6.2	6.50	6.25	6.25	6.00	5.75
Consumer price index	2.8	1.50	2.75	2.75	2.50	2.50
Wage price index	2.7	2.75	3.25	3.50	3.50	3.50
Population	1.9	1.8	1.8	1.8	1.8	1.8

Sources: Australian Bureau of Statistics; Department of Treasury and Finance

Another third of the annual budget is infrastructure projects that are subject to building rates and the supply of products such as bitumen and fuel. Linking council rate increases to household CPI is clearly an inappropriate measure. In the June quarter of 2011 the CPI increased by 0.2% due to the impact that Queensland cyclones had on domestic banana prices. Indigo Shire Council does not purchase bananas and believe that it is not appropriate to link the provision of council services to Queensland banana prices, or other household goods.

Another factor is the rural / metro cost difference. In many cost areas the rural prices are significantly higher – particularly the provision of training, contactors and operational material such as fuel. This is an important context for any rate cap indexation. In addition, rural ratepayers have a much higher infrastructure liability per capita than metro ratepayers. This can be seen in roads (km per head of population) as well as a myriad of other council services (distance travelled per HACC client visit, etc.). In the case of indigo Shire the geographic challenges of having a low population density means that council must maintain 4 permanent service locations for a population of approximately 15,000 people. Compare this to a metro council that may only provide one service location for several hundred thousand people.

The ability of a council to raise income through other sources must be taken into account. Large metro councils have a significant revenue base in local laws (particularly parking). In rural areas this income is not available due to scale and the inefficiencies of managing the enforcement process over large geographical areas. For this reason small rural councils such as Indigo Shire rely much more on grants and rates for basic operation.

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

With the complexities of the cost drivers mentioned above it will be difficult for the ESC to find a workable balance between appropriateness of funding for a very complex industry and the succinct headline figure that the public are expecting.

It is suggested that the MAV LG CPI figure is one avenue worth seriously considering. This index takes into account a number of the unique cost drivers for the sector whilst also remaining roughly in line with CPI (usually averaging ~1% above domestic CPI). The self-referring nature of this index may be problematic and therefore the ESC may consider converting the annual calculation of the MAV LG CPI into a rule of thumb (such as x% above domestic CPI).

The metro / rural cost divide may also be worthy of consideration. Again, this may be solved by a full cost analysis each year (MAV etc.), or this could be analysed and converted to a rule of thumb (i.e. x% over the base cap for rural councils). This tiered approach is the only way to ensure equity across a diverse range of councils.

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?

There is a strong reason for making the capping (and exemption) processes multi year. Councils work to a 4-year strategic resource plan (SRP) that can only be relevant if there is a realistic indication of income. Because rates makes up a large proportion of council's revenue the impact of the cap quantum is a critical consideration for forward planning.

In addition, council work to a 4-year council plan that would become much less meaningful and relevant if there was significant uncertainty about income levels. Because rate increases are cumulative the impact of having an inaccurate projection of future year's income may make a material difference to service provision decisions.

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

Council budgets are currently based on future cost projections – including future cost increase estimates. In this way the use of a future estimate would be appropriate, and maintain the current practice.

A related question is, how the ESC may view cost shocks during a rate capping year. If for instance fuel prices rose rapidly after the rate cap was set (due to supply uncertainty / political instability / etc.) this would significantly increase costs to council. Clearly this would simply be a matter for council's to absorb in the financial year that it happens, but is there scope in the rate capping model for these types of cost increases to be factored into the next year's cap, or would every council need to submit a variation request?

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

No, the rural / metro differences in cost structure is an important consideration. This city / country divide applies to the cost of doing business (unit costs), as well as the per-capita liability for roads and other infrastructure (i.e. ratepayer liability is higher). In addition to this the significant differences in own-source revenue that is available to metro and rural councils (and the relative ability to influence this through enforcement) must be taken into account. These differences must be taken into account in the rate capping and variation models to reduce the risk of creating a significant divide between well-resourced metro councils and small rural councils.

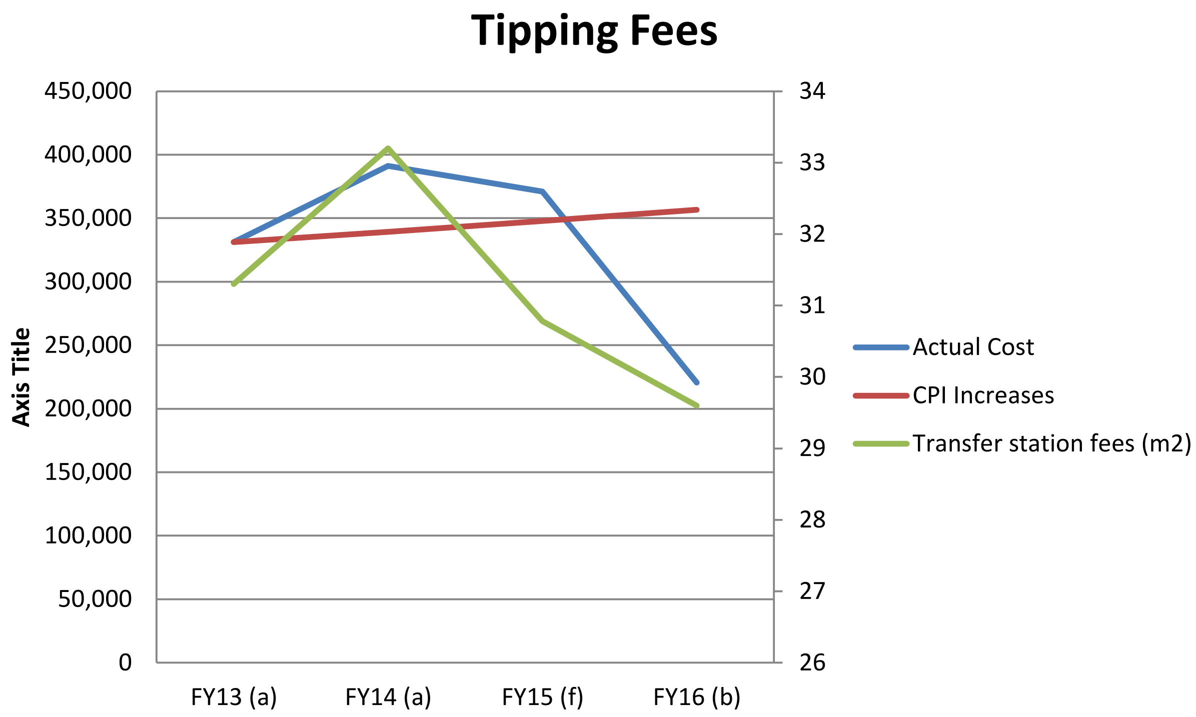
6. What base should the cap apply to? Does it include rates revenue, service rates/charges, municipal charges and special rates/charges?

Rate revenue is the only revenue source that should be capped. Other revenue sources are much more directly linked to particular expenses and must therefore be allowed to be adjusted in line with those expenses.

One important example of this is transfer station charges. These are mostly a reflection of landfill costs that – in the last few years – have varied considerably.

The chart below shows this particular example. The blue line shows actual tipping costs paid by council. This was impacted by carbon tax and the rapidly escalating cost of sending material to landfill. The green line (secondary axis) shows the fee for a single m^2 of general waste to be disposed of at council's landfill provider. As can be seen by the comparison of the blue and green line council has maintained a rough equity over the years and struck a balance between increasing the fee (to accommodate for the increased cost) and reducing the fee due to concerns about illegal dumping and household affordability). This example shows graphically the adjustments made to fees that match the cost pressures faced by council and community expectations.

The red line on the chart shows how fees would have moved if a CPI adjustment was made each year. It is obvious that a CPI adjustment would have had caused a significant financial detriment to council in the first 3 years and then a substantial windfall in the last year. This mismatch may be prevented by multiple submissions for variations from a CPI cap – but at what cost in time and wasted resources. For this reason, fees and charges must be separated from a simple rate cap model.



Indigo Shire gains income from commercial enterprises that provide a supplementary income source. These commercial businesses include the provision of retail gas distribution to the Mt Buller resort village and a quarrying operation that provides road materials for businesses across the region. These businesses are run according to market conditions and are subject to the usual competitive forces. It would be inappropriate for any capping to apply to these revenue sources or any commercial or entrepreneurial activities that Councils are able to undertake under the Local Government Act.

Indigo Shire is currently introducing a new organics collection service that takes a significant step along the path of the Halve Waste initiative. This has required a change to council's kerbside collection fees with some increasing and some decreasing, but overall the revenue will increase by an amount greater than CPI. It would be inappropriate for a capping regime to curtail this type of service introduction as this would be seen by councils as a significant reduction in council's ability to make decisions and implement programs. This is another justification for fees and charges to be excluded from any capping program.

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

The state government's announcement of a rate capping policy was a response to concerns about household affordability. For this reason it makes sense for households to expect that the cap be assessed on a per-household (average) basis.

In addition to creating a clear and simple "average household rates" measure, the capping of average household rates allows for councils experiencing significant growth to gain additional income for the fast growing areas. This mitigates some of the issues associated with capping rates in burgeoning populations.

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

Indigo Shire council has a very low level of supplementary rates due to the slow growth of the townships. However the principle of supplementary rates is an important one. Clearly supplementary rates should not be included in the cap calculation for the reasons mentioned in #7 above. Supplementary rates are due to the expansion of the municipality and the driver of supplementary rates almost always drives increased demands on councils for additional infrastructure and services. Therefore a cap would be best served on the existing ratepayers (by using an average household measure) whilst allowing supplementary valuations to be treated as additional revenue without impacting the cap.

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

Every 2 years the revaluation will cause most rates bills to change by an amount that is different to the published cap percentage, sometimes significant. This is a key reason for recommending that the cap is not implemented in the 2015-16 financial year.

In addition to valuations, changes to council's rating strategy will also change the percentage increase that is seen by residents.

10. What should the base year be?

Indigo Shire Council has no response to this question.

11. How should the variation process work?

It is critical that the variation process be appropriate for the size of the variation and the resources of the council. In this way, a minor variation request from a small council with limited resources should require a significantly simpler process than a large change in a large council. A tiered approach to variation applications is supported.

Variations should be available for multiple years to enable councils to tailor rates increases to expenditure forecasts. This would be relevant for a new service that may start with a small increase in the first (formation) year followed by a year or two of increasing cost. The ability to match rate increases to the program implementation will provide a more transparent and appropriate rating system for ratepayers.

The variation process must be rapid, and efficient to enable it to work within council's time-sensitive budget development process, which commences with the setting of budget parameters early in the year and no later than February. Approvals of variation requests must be determined by this time to prevent unnecessary duplication of effort in budget preparation. Long variation processes with multiple steps will effectively rule out variations for all but the large changes.

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

The ESC document includes some relevant principles for seeking variations however 'lost revenue' is not prominently included in the lists.

As a way of keeping Council rates as low as possible following the Compulsory Competitive Tendering era, Indigo Shire pursued a range of alternate income sources from commercial operations Two of these commercial operations, referred to earlier still remain and produce a positive contribution to Council's net financial position, to the tune of approximately 0.4% of rates. This allows residents in Indigo Shire to enjoy a level of rates that would not have been possible without these enterprises. If either of these sources of 'external' revenue was to be reduced or eliminated then Indigo Shire would require an additional rate increase to fill the gap left by this revenue. The current ESC document does not highlight the loss or reduction of another source of revenue as a reason for requesting a rate cap exemption. Without this change it is likely that a random future event that reduces a 3rd party income source will require a cut in services.

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?

Sustainability of councils should be included as a strong justification for a variation. It appears from the discussion paper that the variation process is likely to be linked to a particular program, cost demand, or responsibility. There should however be an acceptance that a council may simply be in an unsustainable financial position. In this scenario a variation based on long-term financial planning that includes consideration of appropriate austerity measures would be appropriate.

14. What should councils need to demonstrate to get a variation approved? What baseline information should be required for councils to request a variation?

It is critical that the variation requirements be appropriate for the size of the variation and the resources of the council. In this way, a minor change request from a small council with limited resources should require a significantly simpler process than a large change in a large council.

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

It is critical that the community engagement be appropriate for the size of the variation and the resources of the council. In this way, a minor change request from a small council with limited resources should require a significantly simpler process than a large change in a large council.

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?

A few carefully chosen financial KPI's in the Local Government Performance Reporting Framework would provide a meaningful comparison of council's efficiency and cost effectiveness. In addition, the VAGO sustainability indicators would be informative from a long term point of view, although prior to using the VAGO indicators some consideration should be given to adjusting the VAGO "underlying result" measure to better reflect real underlying financial result rather than including one-off abnormal items.

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.

Both the cap and variation process should cover a multiple year timeframe. This will significantly reduce the time pressures on council to fit a variation application into the already tight budget process. By allowing a longer-term strategic view of variations the focus would shift from a year-by-year reactive approach to a multi-year view that could be completed at a more appropriate pace.

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?

Councils all have 4 year strategic resource plans that have been built on strategies that have been through significant community consultation and involvement. Rate capping in the short term would require these strategies to be re-visited and cut back. While Indigo Shire recognise that this is an inevitable and necessary consequence of rate capping it is suggested that a phased implementation is a fairer and more reasonable proposition when compared to a radical reduction in income in one financial year.

In addition, the 2016-17 financial year is an inappropriate year to implement this policy due to the impact of property revaluations (meaning that ratepayers will not easily see a particular percentage rate increase when it is mixed with CIV adjustments). Interim arrangements should stay in place for one more year before moving to the full rate cap.

A further reason for the 2016-17 financial year being sub-optimal is that it is the final budget year of this council term. It seems reasonable to allow the current council to finish their strategic plan under the planned rate levels shown in the SRP, and for any implementation to take affect for the incoming Council (in the 2017-18 financial year. This will mean that Councillors standing for election in 2016 will have full visibility of the environment into which they are being elected and can include the consideration of rate capping in developing the next Council Plan.

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?

Indigo Shire Council has no response to this question.

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

This framework and the variation process must be formally reviewed to ensure that it is not producing deterioration of infrastructure and services. The assessment should be done prior to the next state election to allow voters in Victoria to assess the results of this policy.

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

As with any state government election promise the costs should be fully covered by the state government. Asking another level of government to pay for election commitments would be inappropriate, poor governance, and unfair.

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.**

Cost Shifting

A rate cap assumes that a consistent suite of services will be provided to a consistent standard. This is an ideal situation that is not reflected in reality. Local Government has the unenviable position of being the last stop for federal and state cost-shifting. This issue is very real, and very well understood. Indigo Shire's cost shifting challenges include;

- Roadside management ($35k)
- HACC ($110k)
- Libraries ($330k)
- Septic tanks
- Etc.

In addition to the impact of cost shifting the rapidly escalating cost of governance and reporting requirements arising from state government initiatives and audit reports has a significant detrimental impact on Council resources.

Cost shifting has a significant impact on Councils and any suggestion that Councils must abide to a CPI (or similar) cap must also be made with a commitment that no additional cost or resource requirements will be passed to Councils unless appropriate ongoing resourcing is also given for these services.

Population Growth

The cost of providing a service is a simple formula of;

Unit Cost (of each service) x Population Serviced = Total Cost

Clearly the cost of each service increases over time – leading to increased total cost. It is this cost increase aspect that appears to be the focus of the state government's rate capping policy. The population serviced receives less focus, but is just as important. Because Councils service an increasing population base the total cost will always grow at a rate that is higher than the percentage increase in the unit cost of providing the services, because the number of services increase over time as well.

Therefore a simple "CPI" escalation would be insufficient to account for population increase and the result would be a gradual reduction in service levels. This is particularly noticeable in areas that are experiencing significant growth – such as the provision of services to the elderly. This has been experiencing significant growth and a simple expense capping that does not take into account the increased demand for service will require a reduction in the level of service to the community.

Defined Benefits

Local government is the only level of government that is required to maintain appropriate reserves in the defined benefit superannuation scheme. Whilst this position is financially responsible, it is inequitable with other levels of government, and a relevant consideration in the context of rate capping. The liability that the defined benefit scheme imposes on councils is dependent on investment market conditions and therefore difficult to predict. The last DB call cost Indigo Shire well over $1 million with very little warning or lead time to pay the bill. Many councils are now banking a provision for future calls, and this adds cost to council that – again – is greater than a simple domestic CPI basket of goods.