ESSENTIAL SERVICES COMMISSION

A BLUEPRINT FOR CHANGE

Local Government Rate Capping and Variation Framework Review

Final Report

September 2015

An appropriate citation for this paper is:

Essential Services Commission 2015, *A Blueprint for Change, Local Government Rate Capping & Variation Framework Review — Final Report*, September.

MESSAGE FROM THE CHAIRPERSON

This is our final report on the design and implementation of a rate capping and variation framework for local government in Victoria. It follows a draft report released in July and extensive consultation with the local government sector, ratepayers and other interested parties.

From the outset of this review, we committed to developing a framework that did not impose onerous and unnecessary obligations on the local government sector. We have worked to fulfil that commitment by relying on existing arrangements and processes, most notably, the *Best Value Principles*. These principles have been in place for many years. Overall, the framework requires little more of councils than what is already required of them. Its benefit lies in ensuring that adherence with those principles is transparent, inclusive and robust.

As in the draft report, the recommended framework consists of three elements: a state-wide cap on council rates, a variation process for councils who wish to raise rates above the cap, and the public reporting of outcomes under the framework.

We have refined some of the framework's design features in light of the feedback we have received since the draft report. These refinements generally introduce greater flexibility into the framework. For example: through the application requirements for a variation, the timelines for councils to submit an application, and the options available to the Commission when deciding on an application.

We have also used this final report to explain more clearly the rationale and application of our recommendations. In particular, this report explains in significantly greater detail: the design of the rate cap, the base to which the rate cap will apply, our expectations regarding community consultation, and the appeals process available to councils should they consider the Commission to have erred in its decision-making.

Since the inception of this review, we committed to developing a framework that preserved the autonomy of councils. We submit that we have achieved that objective. Under the recommended framework, councils remain responsible for determining their expenditure priorities and consulting with their communities. Councils remain responsible for procuring and delivering services effectively and efficiently, and they remain responsible for their financial performance. Councils remain accountable for the outcomes they achieve and the rates they levy in order to achieve those outcomes.

In other words, councils retain full responsibility for developing and implementing their budgets. The Commission's role is limited to assessing the adequacy of councils' planning and consultation processes against established requirements such as the *Best Value Principles*, and only when a council seeks a rate increase above the cap. At no stage do we limit or intervene in how councils set or alter their priorities. Nor do we create any limits on how councils distribute their revenue raising efforts. Our role is strictly limited to assessing the proposed increase in the overall level of rates and the extent to which the rates payable by the 'average' ratepayer exceed the rate cap.

In the weeks ahead, and with the assistance of technical working groups, we will begin producing guidance notes addressing all relevant requirements under the framework. We will also explore other opportunities to assist councils to familiarise themselves with the framework's requirements.

On behalf of the Commission and its staff, I would like to express our thanks to the hundreds of councillors, council staff, ratepayers and other interested parties who met with us or made written submissions to this review. We are very grateful for your contributions and the generosity you have shown us with your time.

Dr Ron Ben-David
Chairperson

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OVERVIEW

In February 2015, we were asked to design a framework that meets the Government's commitment to cap annual council rate increases as well as to develop a workable process to assess any proposals by councils for above cap increases ('variation process'). This final report concludes our review.

The three main elements of the recommended framework are:

Rate cap — the maximum annual rate of increase that councils can apply to their rate revenue based on the rate of increase in the consumer price index, wage price index and an efficiency factor.

Variation process — a mechanism for councils seeking higher (than cap) increases in their rate revenue to apply to the Commission for approval.

Monitoring and reporting — a means for verifying and reporting on compliance with the cap or variation approvals, as well as providing comprehensive information about overall outcomes for ratepayers and communities under the framework.

In this final report, we describe how each of these elements will work and we make recommendations on each. Our final recommendations have been informed by the feedback we received following the release of the draft report in July.

A complete list of the Commission's recommendations appear at the end of this overview.

THE RATE CAP (CHAPTERS 2 AND 3)

The rate cap is the maximum annual rate of increase that councils can apply to their rate revenue.

First, we consider whether to have one cap or many caps

Our draft report proposed that there be one rate cap that applies to all councils. Some submissions endorsed the simplicity of using a single rate cap while others argued that the framework should allow for different caps based on council characteristics, particularly for rural and regional councils.

While we acknowledge the underlying structural and capacity limitations facing rural and regional councils, these matters lie beyond the scope of this review. To the extent that these councils wish to levy rate increases in excess of the cap, the framework provides scope through the variation process. The Commission's final recommendation is that there should be one rate cap that applies equally to all councils in Victoria. (See section 2.1)

Second, we consider which revenues are to be covered by the rate cap

In the draft report we recommended that the rate cap apply to **general rates and municipal charges** only — noting that these two rate bases account for about 88 per cent of the total rate revenue raised by councils. Many submissions supported our proposed approach.

The Commission confirms its draft recommendation. (See section 2.2)

As a transition measure, Commission staff will meet with the six councils which currently do not levy service charges but collect this revenue as part of their general rates. We will discuss with these councils whether it is necessary for such councils to isolate waste costs from the capping mechanism. (See section 2.2)

Third, we consider whether the cap should be applied to total rate revenue or rate revenue per assessment

Our draft report recommended that the cap be applied to the year-by-year change in the general rates and municipal charges paid by the average ratepayer. We also recommended that any supplementary revenue should be excluded from the rate cap in the year it is received.

Following feedback from submissions and our technical working group, the calculation of the average rates per assessment has been revised to include annualised supplementary rates in the revenue base for 2015-16, and to redefine when the total number of rateable assessments is counted. (See section 2.3)

The revised formula as it applies to 2015-16 is shown in box 1.

BOX 1 CALCULATING THE RATES PAID BY AN AVERAGE RATEPAYER IN 2015-16

The simplest possible approach to calculating the average ratepayer's rates is to divide the total revenue from rateable assessments by the total number of rateable assessments in each council area.

$$\textit{Rates paid by average ratepayer} = \frac{\textit{Total revenue required from rates}}{\textit{Number of rateable assessments}}$$

In the first year of the rate capping framework (2016-17) the rates paid by the average ratepayer in the base year (2015-16) will be calculated as:

Total revenue required from rates = budgeted general rates 2015-16
+ budgeted municipal charges 2015-16
+ annualised supplementary revenue 2015-16

Number of rateable assessments = total number of rateable assessments as at 30 June 2016

Fourth, we consider how the rate cap should be calculated

The terms of reference indicate that the annual rate of change in the Consumer Price Index (CPI) should be the Commission's starting point for setting the cap.

In the draft report, we recommended that the annual rate cap should be calculated based on a 60 per cent weighting applied to the rate of increase in the CPI and a 40 per cent weighting applied to the Wage Price Index (WPI). We also included an efficiency factor to the rate cap (set at zero in 2016-17 but increasing by 0.05 percentage points each year thereafter). We did not consider it appropriate to adjust the rate cap to reflect other cost pressures faced by local councils or structural differences between councils. We considered these matters to be more appropriately dealt with through the variation process.

In this final report we elaborate on the introduction of the WPI, namely, that it does not represent the Commission's views on future labour costs. We have formed no such views. Wage outcomes are a matter for councils and their staff to determine. It was included in acknowledgement that in the short-term, some costs will be fixed or 'locked in'. The efficiency factor would increase in line with our expectation that management of these costs would become flexible with the passage of time.

A number of submissions also argued that inclusion of an efficiency factor was not consistent with the terms of reference issued by the Government. We do not agree with this view. The terms of reference state that the Government's intention in establishing a rate capping and variation framework is to 'promote rates and charges that are efficient'. More specifically, it asks the Commission to identify options to 'improve council incentives for efficiency'. Efficiency factors are a well-established mechanism for providing incentives to drive efficiency.

A number of submissions argued that the cap should include various allowances to reflect the impact of factors outside a council's control. The most common examples of these factors include: construction costs, reduced grant funding, cost shifting, defined benefits superannuation top-ups and the 'renewal gap'. These issues are discussed in this final report. We find no compelling reason to take these factors into account in setting the cap.

We examined the impact of the freeze in Financial Assistance Grants, reducing councils' grant revenue by $133 million between 2013-14 and 2016-17. At the same time, we noted that the additional Roads to Recovery funding grant, announced in June 2015, will provide an extra $225 million between 2015-16 and 2016-17. These offsetting impacts do not fall evenly between councils. The Commission considers that any net adverse impact arising from changes to grants funding can be considered on a case-by-case basis through the variation process.

On this basis, we recommend that the rate cap formula remains as in the draft report. The latest forecasts for the rate cap shown in table 1, have not changed since the draft report was published in July. These figures will be updated in December 2015 following release of the budget update by the Department of Treasury and Finance.

TABLE 1 INDICATIVE FORECASTS FOR THE ANNUAL RATE CAP (AS AT SEPTEMBER 2015)
Per cent

	2016-17	2017-18	2018-19
Underlying CPI forecast[a] (60 per cent weighting)	2.75	2.5	2.5
Plus WPI forecast[a] (40 per cent weighting)	3.5	3.5	3.5
Less Efficiency factor	0	0.05	0.10
FORECAST ANNUAL RATE CAP	**3.05**	**2.85**	**2.80**

[a] We recommend that the forecasts provided by Department of Treasury and Finance in May and December be used to forecast and set the cap.

Over the next two years, we will undertake a detailed productivity analysis of the local government sector to assess whether any refinements are needed in setting the efficiency factor. (See section 2.4)

Finally, we consider how capital projects and asset renewal should be treated under the variation framework

There is considerable debate in local government across Australia about the extent of the asset renewal backlog. There is no consensus around how (or whether) it can be determined objectively and on a consistent basis between councils with different operating environments and service level preferences. Likewise, there is no single accepted measure of how well a council is managing its assets.

Council budgets already include a provision for capital requirements and this provision will be escalated by the rate cap each year once the framework commences. Should these funds be insufficient for a council's infrastructure needs, it will be open to the council to apply for a variation from the rate cap.

We consider better measures of infrastructure needs would assist councils, ratepayers and government agencies to better understand the state of local government assets and the need for new investment. We will work with the Victorian Auditor-General's Office (VAGO), Local Government Victoria (LGV) and the local government sector to develop better measures of councils' capital requirements. (See chapter 3).

VARIATION (CHAPTER 4)

The draft report outlined, that the rate cap cannot, by its nature, take into account the diversity, different needs and legacies faced by the 79 councils across Victoria. Our draft report set out a variation process to provide a mechanism for individual councils to seek a rate increase in excess of the cap if they consider the additional revenue allowed by the annual cap to be insufficient. The draft report proposed that the framework not define situations where a council's application for a variation would be automatically accepted or automatically rejected but that each application be assessed on its individual merits. We also proposed that the Commission be responsible for assessing and determining the response to all applications.

In this final report, the Commission confirms its earlier recommendation that it be responsible for assessing the response to applications. Likewise, we continue to support there being no pre-set thresholds for councils seeking a variation or for the Commission to reject a variation.

The Commission also confirms that councils should be required to address the following five key matters in their application for a variation:

- the reason(s) for the proposed rate increase greater than the cap
- how the application takes account of ratepayers' and communities' views
- how the outcomes being pursued in the variation reflect the efficient use of council resources
- what consideration has been given to reprioritising proposed expenditures and pursuing alternative funding options and
- that the assumptions and proposals in the application are consistent with those in the council's long-term strategic planning and financial management instruments.

Our expectation is that information to support a variation request should be **proportional** to the magnitude of the variation being sought.

In light of the feedback we have received, we also recommend that councils should be able to apply for both temporary and permanent variations from the cap. (See section 4.2.2). In addition, we recommend that the Commission be given limited discretion to accept or reject one-or-more individual components of a variation application. This would be limited to new and stand-alone capital projects or discrete project expenditures. (See section 4.2.2).

The Commission confirms its earlier position that judicial review of a Commission decision on administrative grounds should remain available to councils, without recourse to a merits review. (See section 4.5.2).

COMMUNITY ENGAGEMENT (CHAPTER 5)

The Commission's draft report recommended that councils wishing to increase their rates above the cap must, when applying for a variation, provide evidence of an effective engagement process with their ratepayers and communities. Our draft report did not prescribe specific engagement techniques or standards. Instead, we developed a set of engagement principles that we expect would be reflected in the engagement activities undertaken by councils in support of an application for a variation.

Feedback from submissions to the draft report were overwhelmingly supportive of the key engagement principles and the recommendation that ratepayers' and communities' views should be taken into account in an application for a variation. This final report confirms our principles-based approach to community engagement. While we understand widespread support for a variation will not always be forthcoming, we continue to consider it appropriate for the councils to demonstrate how they have taken the views of their community and ratepayers into account before submitting an application.

To assist councils to describe how they have consulted with their communities, we have devised a tool they can use to describe and discuss the community engagement that has informed their application for a variation. This is a tool only and councils are not obliged to use it. Importantly, we would expect the extent and type of consultation would be in proportion to the scope and scale of the matters addressed in the application. (See section 5.3).

MONITORING AND REPORTING (CHAPTER 6)

In the draft report, we recommended that we:

- monitor and publish an annual rates report on councils' adherence to the cap and any approved variation conditions and
- monitor and publish an annual monitoring report on the overall outcomes for ratepayers and communities.

Most submissions supported the recommendation on monitoring and reporting on council compliance with the cap and variation approvals. The Commission confirms its view that ongoing monitoring and reporting of councils' compliance with the cap or with an approved variation above the cap is crucial to maintaining the integrity of the framework. (See section 6.2). Ready access to transparent, reliable and timely information about the relationship between rates, services delivered and financial performance will allow all parties to draw their own conclusion about the outcomes being achieved by councils. (See section 6.3).

In designing the monitoring and reporting element of the framework, we have attempted to strike a balance between collecting meaningful information without imposing an onerous reporting burden on councils. The information requirements we are proposing are drawn almost entirely from existing council reports, budgets or submissions to the Victoria Grants Commission. Where we have introduced new reporting requirements, such as the baseline information template[1], we have done so in close consultation with the sector. We will continue working with the sector before finalising these requirements in the form of guidance notes. (See sections 6.3 and 7.3).

IMPLEMENTING THE FRAMEWORK (CHAPTER 7)

In developing a timetable for implementing the framework we sought to:

- provide sufficient time for councils to prepare for a variation following the announcement of the cap
- provide time for the Commission to properly consider the applications from councils for variations and
- comply with existing timelines and legislative requirements for councils' budgetary and planning processes.

Many submissions received in response to the draft report raised concerns with the proposed timelines for applying for, and the Commission assessing, variations above the cap.

In light of these concerns, the Commission has sought to provide councils with greater flexibility, including discretion over deciding when they satisfy their current statutory

[1] The latest version of the baseline information template can be found on the ESC's website.

consultation obligations in relation to the budget and how this is integrated into their consultation for a variation application.

Councils will still be required to notify the Commission of their intention to submit a variation application in January, but we will be flexible about when we receive applications and make best endeavours to make a decision within two months of receipt. We also recommend that Government, as part of the broader review of the *Local Government Act 1989*, consider the purpose of the current obligation on councils to place their budgets on public notice for a minimum of 28 days and how this might best be achieved following the introduction of the rate capping framework. (See section 7.1).

In this final report, we also recommend that multi-year variations of up to 4 years in length be allowed from 2017-18 onwards. This will provide councils with greater flexibility and reduce their compliance costs. In making a multi-year application, councils will need to provide considerably more robust information than for a single year application — for example, with regard to forecasts of future expenditures, demand growth and other risk factors. (See section 7.2).

FULL LIST OF THE COMMISSION'S RECOMMENDATIONS

The full list of the Commission's 18 recommendations appears below in the order they appear in this report. They need to be understood in the context of the discussion in the relevant chapter of the report.

THE CAP

Final recommendation 1 (section 2.1)

The Commission recommends that there should be one rate cap that applies equally to all councils in Victoria.

Final recommendation 2 (section 2.2)

The Commission recommends that:

- revenue from general rates and municipal charges should be subject to the rate cap
- revenue from special rates and charges, 'revenue in lieu of rates' and the fire services levy should not be included in the rate cap
- service rates and charges should not be included in the rate cap, but be monitored and benchmarked
- supplementary rates received should be excluded from the rate cap in the year they are received and
- the revenue base for the following year should be adjusted to include the annualised amount of the supplementary revenue received for the current year.

Final recommendation 3 (section 2.3)

The Commission recommends that the rate cap (calculated in recommendation 4) be applied to *average rates per rateable assessment*. For each council, the allowed increase in the *average rates per rateable assessment* in the first year of the framework (2016-17) is given by the formula:

$$\text{Capped average rates per rateable assessment } (2016 - 17)$$

$$= \frac{\text{Total revenue required from rates } (2015 - 16)}{\text{Number of rateable assessments } (2015 - 16)} \;\; \text{X} \;\; (1 + \text{rate cap})$$

where

Total revenue required from rates (2015-16) = budgeted general rates 2015-16
+ budgeted municipal charges 2015-16
+ annualised supplementary revenue 2015-16

Number of rateable assessments (2015-16) = total number of rateable assessments as at 30 June 2016

Rate cap = rate cap as defined in recommendation 4 and as determined in December 2015

The same formula would apply in future years with all shown dates updated accordingly.

Final recommendation 4 (section 2.4)

The Commission recommends that the annual rate cap should be calculated as:

Annual Rate Cap = (0.6 x rate of increase in CPI)
+ (0.4 x rate of increase in WPI)
- (efficiency factor)

where: CPI = DTF's forecast published in December each year

WPI = DTF's forecast published in December each year

The efficiency factor should initially be set at zero in 2016-17 and increase by 0.05 percentage points each year from 2017-18. The Commission will undertake a detailed productivity analysis of the sector to assess the appropriate long-term rate for the efficiency factor.

VARIATION

Final recommendation 5 (section 4.1)

The Commission recommends that the framework should not specify individual events that would qualify for a variation. The discretion to apply for a variation should remain with councils.

Final recommendation 6 (section 4.2)

The Commission recommends that the following five matters be addressed in each application for a variation:

- the reason(s) for the proposed rate increase greater than the cap
- how the application takes account of ratepayers' and communities' views
- how the outcomes being pursued in the variation reflect the efficient use of council resources
- what consideration has been given to reprioritising proposed expenditures and pursuing alternative funding options and
- that the assumptions and proposals in the application are consistent with those in the council's long-term strategic planning and financial management instruments.

Final recommendation 7 (section 4.3)

The Commission recommends that it should be the decision-maker for variation applications under the framework.

Final recommendation 8 (section 4.4)

The Commission should be empowered to accept or reject an application in its entirety. However, where the Commission would otherwise accept (reject) an application but considers the material supporting an individual project within that application to be insufficiently (sufficiently) developed or supported, it may reject (accept) the individual proposal.

MONITORING

Final recommendation 9 (section 6.2)

The Commission recommends that it monitor and publish an annual rates report on council's adherence to the cap and approved variations.

Final recommendation 10 (section 6.3)

The Commission recommends that it monitor and publish an annual monitoring report on the overall outcome under the rate capping and variation framework for ratepayers and communities.

IMPLEMENTATION

Final recommendation 11 (section 7.1)

The Commission recommends that councils notify us of their intention to seek a variation by the end of January of each year and lodge that application by no later than the end of March of each year.

Final recommendation 12 (section 7.1)

The recommended timelines for the 2016-17 rating year are set out below. The Commission will be flexible about when it receives application from councils and will use its best endeavours to make a decision within two months of receipt of a council's application.

RECOMMENDED TIMELINES FOR 2016-17 RATING YEAR

	2015-16
ESC announces cap	December 2015
Councils notify ESC of intention to seek a variation	End January 2016
Council applies for variation	From 1 February 2016
Last date for submission of application	End March 2016
ESC notifies councils of decisions	Within 2 months of receipt
Councils formally adopt budget	June 2016

Final recommendation 13 (section 7.1)

The Commission recommends that the Government, as part of the broader review of the *Local Government Act 1989*, reconsider the purpose of the current obligations on councils to place their budgets on public notice for a minimum of 28 days under sections 129, 130 and 223 and how this might be achieved more efficiently following the introduction of the rate capping framework.

Final recommendation 14 (section 7.2)

The Commission recommends that in 2016-17, variations for only one year be permitted. Thereafter, councils should be permitted to submit and the Commission approve, multi-year variations of up to 4 years in length.

Final recommendation 15 (section 8.1)

The Commission recommends that the Government consider making a formal review of the rate capping and variation framework a statutory obligation. The review should draw on any data and trends identified through ongoing monitoring and all interested parties should have an opportunity to provide input to the review. The Commission considers a review period of 4 years to be appropriate.

Final recommendation 16 (section 8.3)

The Commission recommends that the Government provide councils with guidance on the responsible use of debt, particularly with respect to funding long-lived infrastructure, and greenfield and intergenerational assets.

Final recommendation 17 (section 8.4)

The Commission recommends that the Government consider amending the *Local Government Act 1989* to require that service rates and service charges must reflect the efficient costs of providing the underlying service.

Final recommendation 18 (section 8.4)

The Commission recommends that the Government consider initiating a periodic review to ensure that statutory fees reflect councils' efficient cost of providing statutory services.

GUIDANCE

Throughout this final report we identified that we would develop and provide guidance to assist councils in complying with the framework. This will take the form of written guidance material and will cover areas such as:

- the approach to monitoring, benchmarking and reporting of service rates and service charges (section 2.2)
- the approach to isolating waste related costs from the capping mechanism for councils that do not levy service charges (section 2.2)
- the questions, actions and evidence councils should consider when preparing a variation application (chapter 4)

- guidance on the treatment of discrete project expenditures and new and standalone capital projects, including relevant definition and criteria for projects that would be subject to individual assessment and incremental funding from grants (chapters 3 and 4)
- the baseline information required from councils (chapters 2 and 6)
- requirements related to monitoring compliance with the cap and any approved higher cap (chapters 2 and 6)
- any other relevant matters.

Guidance notes will be developed in consultation with our technical working groups and published on our website. Where appropriate, we will also work with peak bodies and Local Government Victoria to host workshops to promote our guidance material.

1 INTRODUCTION

In January 2015, the Essential Services Commission (the Commission) received terms of reference (see appendix A) from the Minister for Finance (in consultation with the Minister for Local Government) to conduct a review and report on a local government rate capping and variation framework. In conducting the review we have had regard to the matters set out in the terms of reference.

We have been asked to design a framework that meets the Government's commitment to cap annual council rate increases as well as to develop a workable process to assess any proposals by councils for above cap increases ('variation process').

This final report responds to the issues raised in response to our draft report and outlines the details of the recommended framework. Following the release of the final report, and subject to the Government's implementation of our recommended approach we will continue to develop and issue more detailed guidance before the end of November. Where required we will establish working groups and undertake industry workshops to assist the sector in the implementation of the framework.

1.2 WHAT IS A RATE CAPPING AND VARIATION FRAMEWORK?

A rate capping and variation framework should promote a transparent and independently verifiable decision-making process with regards to the trade-offs involved in determining council rates. Independent verification requires that the framework is overseen by an independent authority for the benefit of the community and ratepayers who, individually, have limited capacity to engage with these decision-making processes.

In many ways, the rate capping and variation framework largely relies on the transparent, deliberative and consultative processes that councils advised us they already adopt when setting their budgets and their rates. In this sense, the framework can be viewed as seeking to give ratepayers and the broader community confidence that disciplined decision-making is being exercised by their individual councils and by the sector as a whole.

The three elements of the proposed framework are:

Rate cap — the maximum annual rate of increase that councils can apply to their rate revenue based on the rate of increase in the consumer price index, wage price index and an efficiency factor.

Variation process — a mechanism for councils that are seeking higher (than cap) increases in their rate revenue to apply to the Commission for approval.

Monitoring and reporting — a means for verifying and reporting on compliance with the cap or variation approvals as well as providing accurate and reliable information about overall outcomes for ratepayers and communities under the framework.

Chapters 2 to 7 outline our recommended approach for implementing each of these elements. Chapter 8 discusses some ideas for the longer term.

1.3 WHAT CONSULTATION DID WE UNDERTAKE?

In April 2015, we released a consultation paper which identified some key issues and challenges in designing a rate capping and variation framework and in July we released a draft report which outlined the details of a proposed framework.

The consultation paper outlined the eight principles that would guide us in developing the framework (box 1.1). Our subsequent consultations indicated widespread support for these principles. We are confident that the framework proposed in this final report is consistent with them.

BOX 1.1 PRINCIPLES GUIDING THE FRAMEWORK'S DESIGN

Principle 1 — Local communities differ in their needs, priorities and resources.

Principle 2 — Local communities and ratepayers are entitled to hold their councils to the highest standards of accountability and transparency when setting rates.

Principle 3 — The framework should support the autonomy of councils to make decisions in the long-term interests of their community and ratepayers.

Principle 4 — Councils will need to satisfy the burden of proof outlined in the framework when seeking a variation above the cap.

Principle 5 — Rate increases should be considered only after all other viable options have been explored.

Principle 6 — The framework should support best practice planning, management systems and information sharing to uphold council decision-making.

Principle 7 — The framework should be flexible and adaptable.

Principle 8 — There should be few surprises for ratepayers and councils in the implementation of the framework.

Throughout the review we have consulted widely, including with:

- councils through one-on-one meetings and various broader industry forums
- ratepayer associations and individual ratepayers, including two forums with ratepayer associations
- peak bodies in the local government sector such as Municipal Association of Victoria (MAV), Victorian Local Governance Association (VLGA), Local Government Professionals (LGPro), Local Government Financial Professionals (FinPro) and Institute of Public Works Engineering Australasia (IPWEA)
- unions, private sector representatives and other peak bodies with an interest in local government, and

- with our colleagues in New South Wales at the Office of Local Government, the Independent Pricing and Regulatory Tribunal; and a few NSW councils.

We have also presented to the Fair Go Rates Reference Group established by the Minister for Local Government, as well as the Minister's Local Government Mayoral Advisory Panel.

We received 287 submissions in response to the consultation paper and 116 to the draft report from ratepayers, ratepayer associations, councils, council service providers, sector peak bodies, unions and community organisations. Following the release of the draft report we conducted six public information sessions in Traralgon, Melbourne, Wangaratta, Bendigo, Horsham, and Mildura. While visiting these regions we also met with council staff, councillors and other interested parties. Appendix B provides a summary of our consultation. There were a number of key themes arising from our consultation on the draft report:

- Adequacy and calculation of the cap — a number of issues were raised about the methodology for calculating the cap and the need for the cap to better reflect the diversity of the sector.
- Workability of the framework timelines — issues were raised about the timelines for 2016-17 implementation of the framework. Comments included that the proposed timelines are too tight to meet existing legislative requirements and council practices. Some also noted that the timelines raise the risk of not promoting good community engagement.
- Clarity of variation process requirements — concerns were raised about what needs to be done by councils to successfully apply for a variation. It was suggested that the process will be 'document heavy', or that it will be unwieldy or burdensome for councils to demonstrate the need for a variation above the cap.
- Ratepayers were broadly supportive — ratepayers are generally supportive of a cap on rates and our proposed framework. They expressed that greater attention should be given by councils to improving their community engagement.

As part of our consultation on the draft report we also commissioned two 'deliberative sessions' in Melbourne and in Bendigo with 47 randomly selected and diverse ratepayers (both residential and business) and community members. The sessions allowed us to test our proposed framework with people who might not normally participate in our consultation processes. These discussions demonstrated to us that while many of the participants had little prior knowledge or engagement with council rate setting practices or this review, once they had read the materials, they could participate meaningfully in assessing the usefulness of the draft framework.

Many of the participants in the deliberative sessions viewed rate capping as a positive initiative while others were concerned with the potential impacts on services and the community. The discussions drew out many of the issues we heard elsewhere in relation to the variation process, including concerns about the impact on less well-resourced councils and the need for further clarification around the variation application requirements. The framework's requirements around council engagement with the community were seen as a key strength of the variation process.

1.4 WHAT IS THE STRUCTURE OF THIS REPORT?

Chapters 2 to 6 respond to the major issues raised in response to the draft report and outline our approach for implementing each of the elements of the framework — namely, the design of the rate cap; the variation process if councils wish to raise rates above the cap; and the monitoring and public reporting to be undertaken.

Chapter 7 considers other implementation details not covered in the earlier chapters and chapter 8 discusses some longer term opportunities afforded by the framework.

The full list of our final recommendations appears at the end of the overview.

2 THE RATE CAP

The terms of reference ask us to provide advice on how to implement the Government's commitment to cap annual council rate increases. This includes advice on such matters as: whether any refinements are warranted to a cap based solely on the Consumer Price Index (CPI); as well as the base to which the cap should apply.

This chapter outlines the key elements of the proposed approach to setting the cap in light of comments received since the release of the draft report.

2.1 ONE CAP OR MANY?

There is very significant diversity of circumstances across the 79 councils operating in Victoria. Among other things, councils differ in the services required by their communities, the state of the infrastructure under their management, the cost of delivering services, their reliance on different sources of revenue, their demographics and the economic circumstances of their communities, and the natural environment in which they operate.

In the draft report, we considered whether and how to account for such differences when setting the rate cap. One option we considered was whether separate groupings of councils could be subject to different caps. We also examined the merits of an even more tailored approach whereby each council's rate cap would include adjustments accounting for that council's resource capacity, rating history and control of its costs and revenues.

On balance, in the draft report we decided against these approaches for a number of reasons. Our primary concern is the arbitrariness of such arrangements. The cap adjustments that might be made under these approaches are not self-evident and would involve a large degree of judgement. We expect neither the community nor councils would be well-served by a capping framework that relies extensively on subjective assessments. We were also concerned that any effort to tailor the rate cap would suggest a false degree of precision in setting the cap and may lead to confusion in the community. As such, in the draft report we recommended that there should be only one rate cap that applied equally to all councils in Victoria. We also concluded that the variation process provided a more efficient, transparent and participative mechanism to deal with an individual council's circumstances when the capped increase in rate revenue is considered to be insufficient.

2.1.1 FEEDBACK ON DRAFT REPORT

Following the draft report, we have received a mixed response to our proposed approach. While some submissions endorsed the simplicity of using a single rate cap, a number of submissions continued to argue that the framework should allow for different caps based on council characteristics. The main arguments, particularly for rural and regional councils, are that they have a:

- limited capacity to generate revenue from other sources
- significant road infrastructure network to maintain relative to their size and capacity
- small rate base (and any additional cost of applying for a variation may prove to be prohibitive).

2.1.2 COMMISSION'S RESPONSE

While we acknowledge the underlying structural and capacity limitations facing rural and regional councils, these matters lie beyond the scope of this review. To the extent that these councils wish to levy rate increases in excess of the cap, the framework provides scope through the variation process described in chapter 4.

2.1.3 FINAL RECOMMENDATION 1

The Commission recommends that there should be one rate cap that applies equally to all councils in Victoria.

2.2 WHICH REVENUES COME UNDER THE RATE CAP?

The terms of reference require us to provide advice on the composition of the revenue base to be capped. In the draft report we recommended that the rate cap apply to **general rates and municipal charges** only — noting that these two rate bases account for about 88 per cent of the total rate revenue raised by councils.[2] We recommended that the cap not apply to **special rates and charges** and **revenue in lieu of rates,** because there are adequate checks and balances already in place in the current legislation for these rates and charges.

Most councils told us that their garbage rates and charges are cost reflective and market tested.[3] For these reasons we also recommended that **service rates and charges** (garbage rates and charges) be excluded from the rate cap for now, but that they be monitored and benchmarked. We suggested that if there were unexplained differences across councils, or if we found evidence of councils disproportionately allocating their overhead costs to their service rates and charges, then we would make appropriate recommendations to the Government at that time.

The **fire services levy** was excluded on the grounds that it is not within the control of councils, which are acting only as collection agencies for this state levy. The **landfill levy** was excluded as many councils include it in their garbage rates and charges (which we are excluding from the cap).

Supplementary rates are additional rates collected during the year if the value of a property is altered after rate notices have been issued. Supplementary valuations may be a result of either changes in valuation of existing properties or entry of new properties — for example, due to renovations or subdivisions, respectively.[4] We recommended that supplementary rates be excluded from the rate cap in the year they occur.

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2 Based on 2013-14 rates and charges data collected by the Victorian Grants Commission from councils.

3 38 out of the 62 councils responding to our survey reported that they fully outsource their garbage services through competitive bidding, 19 councils partly outsource this service and 4 councils provide the services in-house (one council did not respond to the question).

4 Some of the examples cited by councils on their websites for undertaking supplementary valuations are when properties are physically changed (e.g. when buildings are altered, erected or demolished), amalgamated, subdivided, portions sold-off, rezoned or are affected by road construction. Supplementary valuations bring the value of the affected property into line with the general valuation of other properties within the municipality. Values are assessed at the date of the general valuation currently in use.

2.2.1 FEEDBACK ON DRAFT REPORT

Many councils, the Local Government Professionals (LGPro), the Local Government Finance Professionals (FinPro)[5] and some ratepayers supported our draft report proposal to limit the base to be capped to general rates and municipal charges and exclude service rates and charges.

For those councils that levy their waste costs through general rates, the FinPro and the City of Monash suggested that they 'be treated equally with the opportunity to isolate waste costs from the capping mechanism, without being forced to introduce charges that have previously been collected as part of general rates'.[6] Likewise, the City of Port Phillip suggested that the 'framework should allow councils to transition future revenue from rates to service charges.'[7]

Wyndham City Council sought clarification on the 'process for monitoring and benchmarking, and the forum for reporting of this data'.[8]

On the approach for accounting for supplementary rates, Surf Coast Shire Council, Frankston City Council and the City of Greater Dandenong noted they adjust the revenue base on the basis of the annualised amount of the supplementary rate revenue received and not the actual supplementary rate revenue received, as recommended by the Commission in the draft report.[9] Surf Coast Shire Council noted that:

> *The treatment of supplementary rates is an essential element in the proposed framework, in particular for growth councils… It is recognised that introducing an annualisation calculation adds some complexity, Council suggests however this is modest and warranted given the magnitude of this matter. Annualisation of supplementary rates is a critical requirement.*[10]

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5 LGPro 2015, *Submission to ESC's draft report*, August and FinPro 2015, *Submission to ESC's draft report*, August.

6 FinPro 2015, *Submission to ESC's draft report*, August and City of Monash 2015, *Submission to ESC's draft report*, August.

7 City of Port Philip 2015, *Submission to ESC's draft report*, August.

8 Wyndham City Council 2015, *Submission to ESC's draft report*, August.

9 Surf Coast Shire Council 2015, Submission *to ESC's draft report*, August, Frankston City Council 2015, *Submission to ESC's draft report*, August and City of Greater Dandenong 2015, *Submission to ESC's draft report*, August.

10 Surfcoast Shire Council 2015, *Submission to the ESC's draft report,* August.

Box 2.1 defines annualised supplementary revenue.

BOX 2.1 ANNUALISED SUPPLEMENTARY REVENUE

Annualising supplementary revenue is a practice used by councils in their budgeting. Supplementary revenue arises because of new valuations of land (due to subdivisions, development of vacant land or land consolidations) during the year. As these new valuations occur, councils issue new (supplementary) rate notices reflecting the new value created since the start of the year. Supplementary revenue is generated on a pro rata basis. For example, if a new property comes into the rate base midway through the year, the council will issue a supplementary rate notice to the owner equivalent to half of the amount that would have been required had that property been rated at the start of the year.

Annualising supplementary revenue is the process by which a council calculates the full year equivalent of the actual supplementary revenue it collected in a given year. In the above example, the annualised supplementary revenue would be double the actual supplementary revenue collected. Alternatively stated, annualised supplementary revenue reflects the additional revenue the council *would have* collected if all the properties that exist at the end of the year *had been* in existence at the start of the year. Annualising supplementary revenue is a notional device used for budgeting. It does not reflect actual revenues collected.

Surf Coast Shire Council also recommended that supplementary rates be monitored by the Commission and should be delineated to show both the received and annualised amount.[11]

[11] Surf Coast Shire Council 2015, *Submission to ESC's draft report*, August.

2.2.2 COMMISSION'S RESPONSE

We confirm our views (as expressed in the draft report) that councils which levy service rates (and those councils which levy part service rates and part service charges) may decide whether they want to start levying service charges or separate their service rates from their total general rates in the future. The Commission will meet with these councils to confirm their plans and discuss the approach for isolating waste costs from the capping mechanism. We will reflect the agreed outcomes from these meetings in guidance material that we will issue in November 2015.

The Commission, with the assistance of a technical working group[12] it established, will provide more details about the monitoring, benchmarking and reporting of service rates and service charges in the same guidance material.

The technical working group has also reviewed the calculation proposed by the Surf Coast Shire Council (and other councils) to annualise the impact of supplementary rate revenue on the rate base. This ensures that the growth in the rates base in the year prior to the capped year is properly considered, and therefore reduces a revenue risk experienced by councils. Section 2.3.2 explains this further.

2.2.3 FINAL RECOMMENDATION 2

The Commission recommends that:

- revenue from general rates and municipal charges should be subject to the rate cap
- revenue from special rates and charges, 'revenue in lieu of rates' and the fire services levy should not be included in the rate cap
- service rates and charges should not be included in the rate cap, but be monitored and benchmarked
- supplementary rates received should be excluded from the rate cap in the year they are received and

[12] The technical working group includes council officers from nine different councils, representing small and large rural, regional centre, interface and metropolitan councils and representatives from FinPro. The working group met in August to refine elements of the proposed rate capping framework and will continue to meet in coming months to refine the information requirements the Commission intends to collect from councils.

- the revenue base for the following year should be adjusted to include the annualised amount of the supplementary revenue received for the current year.

2.3 SHOULD THE CAP BE APPLIED TO TOTAL RATE REVENUE OR RATE REVENUE PER ASSESSMENT?

In our draft report we identified two possible applications for the cap, either a cap on total revenue or a cap on average rates per assessment. We recommended a cap on average rates per assessment as this option better reflects ratepayers' experience with council rates.

The draft report acknowledged that even under a binding rate cap, individual ratepayers will experience rate changes that differ from the capped rate of increase. There are numerous reasons for these differences that are beyond the control of a rate capping and variation framework, including:

- market forces altering the relative value of properties within an individual municipality (and therefore changing final distribution of rates)
- owner actions altering the value of properties, for example, through renovation or subdivision and
- council policies, such as altering the differential rates at which different classes of properties are rated.

In light of these external factors, we suggested that the best option for the rate cap involves applying the rate cap to a 'notional' or 'average' ratepayer — although we recognised that there will be some or many ratepayers who experience higher and lower rate changes than this notional ratepayer. We stressed the importance of councils and the Commission communicating this to ratepayers.

We recommended that the cap should be applied to the year-by-year change in the general rates and municipal charges paid by the average ratepayer. That is, a council's total required general rate and municipal charge revenue in a given year divided by the number of rateable assessments in that council area.

In the draft report, we also concluded that there should be no 'rebalancing constraints' because the expected cost of implementing the required changes to councils' billing systems could outweigh any benefits produced by doing so. These constraints would limit how far above (or below) the cap an individual ratepayer's rates could be increased (or decreased) in a particular year.

2.3.1 FEEDBACK ON DRAFT REPORT

Submissions to the draft report generally supported the cap on average rates per assessment. Of the submissions that commented on the cap, about two thirds supported average rates per assessment, while one third raised some concerns (including possible difficulties in applying the cap).

Some respondents were concerned that the concept of applying the cap to the average ratepayer would be confusing for ratepayers. Wellington Shire Council suggested that due to the uncontrollable influences on ratepayers' rates, such as property revaluations and differential rating:

> *It is arguable... that there are few ratepayers, if anybody, paying the 'average rate' and that the use of rates per assessment is likely to be more controversial with ratepayers trying to relate things to their own rate bills*[13]

Central Goldfields Shire Council voiced similar concerns in its submission stating:

> *The application of the rate needs to be as simple as possible (to apply and to understand). Ratepayers are already confused by the rating process and the concept of an 'average ratepayer' is even more confusing, compounded by a revaluation year where any ratepayer can experience a significant movement.*[14]

Some stakeholders advocated for a very different approach. The Municipal Association of Victoria (MAV) recommended the use of average rates per head of population, as population growth may more closely reflect a council's growth in costs rather than the growth in rateable assessments.[15] The Revenue Management Association recommended the use of 'median' rather than an 'average' rates revenue per assessment, as differential rating means that there are large differences

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[13] Wellington Shire Council 2015, *Submission to the ESC's draft report,* August.

[14] Central Goldfields Shire Council 2015, *Submission to the ESC's draft report,* August.

[15] Municipal Association of Victoria 2015, *Submission to ESC's draft report*, August.

between the rates paid by different assessment classification groups, which distorts average rates when compared to median rates.[16]

The FinPro and some councils including the City of Whitehorse and Moreland City Council raised concerns in their submissions that if the basis for calculating the formula used rateable assessments as at 1 July 2016, this could lead to inaccuracies, as councils would need to use forecasts of additional assessments.[17]

A group of submissions also recommended the inclusion of annualised supplementary rates revenue into the formula as discussed in section 2.2.1.[18]

2.3.2 COMMISSION'S RESPONSE

In light of the concerns raised and following the feedback from our technical working group, the calculation of the average rates per assessment was revised to incorporate two changes:

- the definition of the total rates revenue required includes annualised supplementary revenue for 2015-16
- total number of rateable assessments as at the end of the base year (that is, 30 June 2016).

The revised formula is set out in box 2.2. The detailed formula is set out in appendix C.

16 Revenue Management Association 2015, *Submission to ESC's draft report*, August.

17 FinPro 2015, *Submission to ESC's draft report*, August, City of Whitehorse 2015, *Submission to ESC's draft report*, August and Moreland City Council 2015, *Submission to ESC's draft report*, August.

18 Surf Coast Shire Council 2015, Submission to ESC's draft report, August, Frankston City Council 2015, Submission to ESC's draft report, August and City of Greater Dandenong 2015, Submission to ESC's draft report, August.

BOX 2.2 CALCULATION OF THE CAPPED AVERAGE RATES PER ASSESSMENT

The notional 'average ratepayer' is most simply defined as the ratepayer who owns an average valued property in each local government area. The total rates paid by this ratepayer will be the, so called, 'rate in the dollar' applied by the local council multiplied by the value of the average ratepayer's property. The simplest possible approach to calculating this average ratepayer's rates is to divide the total revenue from rateable assessments by the total number of rateable assessments in each council area.

$$\boldsymbol{Rates\ paid\ by\ average\ ratepayer} = \frac{\boldsymbol{Total\ revenue\ required\ from\ rates}}{\boldsymbol{Number\ of\ rateable\ assessments}}$$

For example, in the first year of the rate capping framework (2016-17) the rates paid by the average ratepayer will be calculated based on:

Total revenue required from rates = *budgeted general rates 2015-16*
+ budgeted municipal charges 2015-16
+ annualised supplementary revenue 2015-16

Number of rateable assessments = *total number of assessments as at 30 June 2016*

Feedback from a number of councils and the deliberations in the technical working group indicate a preference for the revised formula in box 2.2.[19] We have accepted this advice and agree that the revised formula provides a more appropriate basis against which the rate cap should apply for the following year.

We have also examined the merit of using a median assessment calculation, rather than an average assessment calculation. The use of a median valuation calculation has been proposed by a few councils and the Revenue Management Association. A

[19] By not considering the annualised supplementary revenue or additional rateable assessments, the previous draft report formula did not consider the growth in assessments during the year prior to the cap year. Therefore councils would face a revenue risk using the formula, depending on how much growth they experience. The revised formula in box 2.2 considers the additional rateable assessments and annualised supplementary revenue and minimises revenue risk.

number of councils noted that while their systems are capable of producing this information, they are not necessarily configured to report on median values. Further, assessing councils' compliance with a median assessment may be challenging. Councils already report on their total rateable assessments (used to determine average rates per assessment) in their budgets.[20] However, median rates values are not widely reported and are not audited. Nonetheless, this alternative measure may have merit and we will consider collecting data to assess the impact of the cap on the median ratepayers in each council as part of monitoring.

The MAV advocated a rates per head of population approach because it better reflects council service cost growth (that is, based on the number of users of council services, rather than the number of rateable assessments).[21] Such an approach would not sit easily or comfortably with the current practice of levying councils rates based on property values. The MAV did not explain how councils would access up-to-date information on population changes in their municipalities. Nor did the MAV explain how this approach might affect councils with seasonal population fluctuations or councils that have disproportionately high or low representations of commercial, industrial or farming properties in their rate bases.

[20] It is also an audited figure used to produce 'measure 63' in the local government performance reporting framework in council annual reports.

[21] Municipal Association of Victoria 2015, *Submission to ESC's draft report*, August.

2.3.3 FINAL RECOMMENDATION 3

The Commission recommends that the rate cap (as shown in recommendation 4) be applied to *average rates per rateable assessment*. For each council, the allowed increase in the *average rates per rateable assessment* in the first year of the framework (2016-17) is given by the formula:

$$Capped\ average\ rates\ per\ rateable\ assessment\ (2016-17)$$

$$= \frac{Total\ revenue\ required\ from\ rates\ (2015-16)}{Number\ of\ rateable\ assessments\ (2015-16)}\ X\ \ (1 + rate\ cap)$$

where

Total revenue required from rates (2015-16) = budgeted general rates 2015-16

\+ budgeted municipal charges 2015-16

\+ annualised supplementary revenue 2015-16

Number of rateable assessments (2015-16) = total number of rateable assessments as at 30 June 2016

Rate cap = rate cap as defined in recommendation 4 and as determined in December 2015

The same formula would apply in future years with all shown dates updated accordingly.

2.4 HOW SHOULD THE RATE CAP BE CALCULATED?

The terms of reference take increases in the CPI as the starting point for setting the cap on increases in local government rates. That is, if the CPI increased by, say, 2.5 per cent, then increases to rates would be limited to 2.5 per cent.

Our initial consultations revealed numerous concerns with this approach. Councils' predominant concern arose from their view that increases in the CPI did not correlate with increases in the cost of the inputs they required to deliver the services they provide to their communities. More specifically, their input costs were increasing at rates in excess of increases in the CPI. Even more specifically, a cap based purely on the CPI failed to reflect the significance of wage costs in local government budgets.

These comments reflect councils' concerns — as the providers of services — by suggesting that the cap should be calibrated in terms of their actual provision costs. These claims do not take into account that these services are being provided to end-users who have no option but to pay for them through their compulsory council rates. The sole concern is that the cap should reflect councils' provision costs. Our terms of reference require us to consider both 'sides of the equation' — the cost of living pressures faced by ratepayers and the financial sustainability of councils.

The CPI is the most widely accepted measure of the cost of living. It reflects changes to the cost to end-use consumers of purchasing a representative bundle of goods and services. Alternatively stated, the CPI reflects what ratepayers can expect to pay (on average) for the goods and services they consume. It does not measure the costs of producing those goods. Production costs are not the concern of consumers.

We consider the same holds for ratepayers acquiring services from their councils. Ratepayers can be expected to be concerned with what they are required to pay and not with what it costs to produce those services.

In our draft report, we acknowledged that it may take some time for councils to adjust their budgets following the introduction of a cap on rates; for example, because they will have pre-existing financial commitments through fixed price purchasing contracts. In acknowledgement that councils might face some financial inertia, our draft report made an allowance within the proposed cap to reflect that councils could not immediately be expected to reduce their costs in line with the introduction of a CPI-based cap. In other words, we introduced a mechanism that balanced the cost of living concerns of ratepayers with the financial constraints facing councils.

In the draft report, we proposed the cap be set based on the formula:

$$\text{Cap} = (0.6 \times \text{CPI}) + (0.4 \times \text{WPI}) - \text{Efficiency Factor}$$

The introduction of a weighted component based on the Wage Price Index (WPI) sought to accommodate 'locked in' costs that councils faced at the time the cap was introduced.[22] Over time, the effect of these 'locked in' costs would be expected to diminish as councils pursued new opportunities to deliver their services at lower cost. This gradual 'unlocking' of construction costs was built into the cap through the introduction of an efficiency factor which would be set at zero in the first year and then increase modestly by 0.05 per cent each year thereafter. In other sectors, efficiency factors are set at much higher rates ranging up to 2 per cent per annum.

The introduction of a WPI and an efficiency factor are explained below in more detail.

2.4.1 WAGE PRICE INDEX

The introduction of the WPI was intended to serve as a proxy for the limited capacity for councils to adjust their costs immediately. It was not introduced specifically to reflect councils' wage costs. We adopted a WPI as a proxy because of the advice from councils that direct and indirect labour costs reflected the main source of their budgetary inflexibility.

The rationale for introducing a WPI into the cap formulation was not laid out in full in the draft report. This led to considerable confusion with many comments made to us suggesting that respondents had interpreted the WPI as an allowance for councils' *actual* costs of delivery. For example:

- numerous submissions from individual councils and peak bodies submitting that labour costs consisted of more than 40 per cent of total costs (as understood from the cap formula)
- a number of submissions suggested the forecast rise in the WPI (between 3.25 and 3.5 per cent) was too low because it did not account for annual salary progression, with one submission suggesting that an additional allowance of 0.5 per cent be added to the cap
- one council used the WPI to develop a projection of its budget in the years ahead
- a number of respondents interpreted the inclusion of the WPI as the Commission's target outcome for councils' wage negotiations, while others raised concerns that it would become the minimum expectation in employees' wage negotiations.

[22] The constraints imposed by locked in costs were acknowledged in section 2.4 of *Local Government rate capping & variation framework review, Draft report volume I — A Blueprint for Change*, July, p.14.

These comments all misinterpret our intentions behind including the WPI in the cap formula.

We apologise for the lack of clarity in the draft report for the reasons behind the introduction of a WPI into the rate cap formula. We re-emphasise that the allowance made for labour costs in the cap formula serves only as a generalised acknowledgement that some costs are inflexible in the short to medium term. For the avoidance of doubt, the introduction of the WPI does not represent the Commission's views on future labour costs. We have formed no such views. Wage outcomes are a matter for councils and their staff to determine.

2.4.2 EFFICIENCY FACTOR

During our consultations, and in a number of submissions, it was suggested that the inclusion of an efficiency factor was not consistent with the terms of reference issued to us by the Government. We do not agree with this view. The terms of reference state that the Government's intention in establishing a rate capping and variation framework is to 'promote rates and charges that are efficient'. More specifically, it asks the Commission to identify options to 'improve council incentives for efficiency'. Efficiency factors are well-established incentives to drive efficiency, indeed, we would be surprised if they were not used internally by councils for management purposes. The potential benefit of an efficiency factor was acknowledged in some submissions:

> *The use of an efficiency factor is strongly supported by the VFF. It is general good business practice to ensure that an operation is running as efficiency and effectively as possible. Local council operations should be no different. Over time, the efficiency factor should be reviewed and increased where necessary to ensure continued streamlined council budgeting.*[23]

> *The efficiency factor is far too low and again would do nothing to change the existing behaviour in our Council...If you do use the efficiency factor please make it significant.*[24]

23 Victorian Farmers Federation 2015, *Submission to ESC's draft report*, August.

24 Voice and Action G.P.S. Inc 2015, *Submission to ESC's draft report*, August.

The inclusion of an efficiency factor in the rate cap formula ensures that at least some of the benefits of internal efforts to improve efficiency are shared with ratepayers. Councils' internal efficiency targets could well exceed the modest 0.05 per cent returned to ratepayers through the rate cap. Of course, it would be left to individual councils to determine how to use any savings from internal efficiency gains that they achieved in excess of the rate cap (whether in the form of additional services or investments, lower rates, debt repayment or retained savings).

We also do not agree with the claim made in numerous submissions that the imposition of an efficiency factor is superfluous because the CPI and WPI based cap will provide sufficient incentive for councils to operate efficiently. As noted in the preceding discussion, the introduction of the WPI was intended to reflect the inflexibility councils might face in managing their costs in the short to medium term. The efficiency factor was introduced to offset this allowance over time and to ensure those benefits were shared with ratepayers.

Councils also raised concerns about the efficiency factor increasing indefinitely by 0.05 per cent per year. Some councils were concerned that it was unrealistic to expect that they should be expected to pursue increased efficiency indefinitely. The City of Yarra suggested that, 'there is a point of optimum efficiency at which services cannot be delivered more efficiently,'[25] and that the ongoing application of an efficiency factor should be reviewed as part of the four-yearly reviews proposed in the draft report.

It was never our intention that the efficiency factor would increase indefinitely and we had not formed a view about whether there was a time beyond which the efficiency factor would no longer be required. These were matters we expected to address in the detailed productivity analysis we flagged in the draft report. Irrespective of that detailed analysis, we agree with the suggestion that the four-yearly reviews we have proposed should consider whether changes need to be made to how efficiency is addressed in the cap.

Comments were also made in submissions and during our consultations that conveyed a view that the efficiency factor would undermine the integrity of councils. One submission foreshadowed that it would 'prove damaging to the long-term financial viability of local government and the services it is expected to provide to its

[25] The City of Yarra 2015, *Submission to ESC's draft report*, August.

communities.'[26] It seems unlikely that a council's financial viability would be threatened by an efficiency factor that is only 0.05 per cent. If any councils' viability was under pressure, this is more likely to be the result of some other factor that could be addressed through the variation process (see chapter 4).

2.4.3 OTHER SUGGESTED ADJUSTMENTS TO THE CAP

A number of submissions argued that the cap should include various allowances to reflect the impact of factors outside a council's control. The most common examples of these factors include:

- construction costs
- reduced grant funding
- cost shifting
- defined benefits superannuation top-ups.

Another concern raised in submissions pertained to whether an allowance ought to be made in the rate cap to address shortfalls in councils' capital works programs — or more specifically, the 'renewal gap'. One council suggested a 0.5 per cent loading be added to the rate cap for this purpose.[27] We appreciate the concerns that have been raised about capital requirements but consider that the interplay between the rate cap, the renewal gap and councils' capital expenditure programs is more complex than this proposed solution implies. These matters are discussed in more detail in chapter 3.

CONSTRUCTION COSTS

It was suggested that the rate cap be amended to include a weighted component for construction costs (along with CPI and WPI).[28] For example:

> *The CPI reflects movements in the final prices paid by household consumers for a weighted basket of goods and services and therefore is a general indicator of 'prices paid' not of council construction input*

[26] See Inner South Metropolitan Mayors' Forum 2015, *Submission to ESC's draft report*, August.

[27] City of Port Phillip Council 2015, *Submission to ESC's draft report*, August.

[28] Such that: Cap = (A x CPI) + (B x WPI) + (C x Construction index) where A+ B+C=1.

costs... A significant portion of council's spending, around 18% to 19%, is dedicated to building and non-building construction. The contradiction between this and the basis for the CPI are stark.[29]

The cap calculation also ignores the fact that a substantial part of rates income is expended on Capital Works (in Hobsons Bay's case approximately 25%). These works are generally contracted out and there is little in the way of wage costs associated with them so the use of the WPI is not particularly relevant.[30]

There are a number of practical problems with building construction costs into the rate cap. First, we are not aware of any widely accepted forecasts of future construction costs (in our earlier consultation there was a strong view that our measures of CPI and WPI should be forward looking rather than historical)[31]; and second, the available historical indices are not necessarily published regularly or routinely. It is not clear how the cap might be set in the absence of this data.

We modelled how the rate cap might look if construction costs were incorporated using the average of the past three years of Australian Bureau of Statistics (ABS) historical construction cost indexes, to reflect what future costs may be if trends continued.[32] These estimates appear in table 2.1, which shows that the cap would be lower than the estimates derived in the draft report, if construction costs were included in calculating the cap.

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29 City of Wodonga 2015, *Submission to ESC's draft report*, August.

30 Hobsons Bay City Council 2015, *Submission to ESC's draft report*, August.

31 ESC 2015, *Local Government rate capping & variation framework review, Draft report volume I — A Blueprint for Change,* July, p. 13.

32 Such that: Cap = (A x CPI) + (B x WPI) + (C x Construction index) where A= B=C=1/3 and Construction index = (0.5 x Building construction index) + (0.5 x Road and Bridge construction index) using Australian Bureau of Statistics 2015, *Producer Price Indexes*, Australia, 6427.0, June.

TABLE 2.1 ILLUSTRATIVE CAP USING A CONSTRUCTION INDEX

	Cap based on equal shares CPI+WPI+construction costs (per cent)	Forecast cap proposed in draft report (no allowance for construction costs)	Difference (per cent)
2016-17	2.71	3.05	-0.34
2017-18	2.62	2.85	-0.23
2018-19	2.62	2.80	-0.23

Data source: Australian Bureau of Statistics 2015, *Producer Price Indexes*, Australia, 6427.0, June.

Further, as noted in the discussion above regarding the inclusion of the WPI into the rate cap formula, the rate cap is not intended to reflect changes in councils' actual production costs. The Commission therefore does not support including a weighted component for construction costs in the rate cap. Nevertheless, issues associated with capital expenditure warrant further analysis and are discussed in chapter 3.

FINANCIAL ASSISTANCE GRANTS

Some respondents argued that the cap should be adjusted to reflect the freezing, between 2013-14 and 2016-17, of the Federal Government's financial assistance grants. For example, Colac Otway Shire Council recommended that:

> *… the ESC consider the addition of an additional factor to account for the lost revenue to local government as a result of the pause [financial assistance grants paused indexation]. The information on the amounts lost for each municipality would be readily available through the Victorian grants Commission and would assist local government whilst grants are paused.*[33]

Table 2.2 shows the percentage increase in general rate and municipal charges revenue that different council groups would require through 2014-15 to 2016-17, to make up for the loss in financial assistance grant revenue over the same period had there been no additional Roads to Recovery funding. The large differences between

[33] Colac Otway Shire Council 2015, *Submission to ESC's draft report*, August.

council groupings highlight their differing reliance on grants and indicate how difficult it would be to include a factor to account for different councils' loss in grant revenue.

TABLE 2.2 REQUIRED INCREASE IN GENERAL RATE AND MUNICIPAL CHARGES REVENUE TO OFFSET GRANT FREEZE
Between 2014-15 to 2016-17

Council groupings	Percentage increase
Metropolitan	0.4
Interface	0.9
Regional centres	1.4
Large rural	2.3
Small rural	3.7

Data source: Victorian Grants Commission Data and Victorian Grants Commission 2015, *Annual Report*, September.

We also undertook analysis of the impact of the grant freeze taking into account the offsetting impacts of the additional Roads to Recovery funding allocated to councils in 2015-16 and 2016-17. Our analysis suggests that the freeze in financial assistance grants will reduce councils' grant revenue by $133 million between 2013-14 to 2016-17. On the other hand, the additional Roads to Recovery funding grant, announced on 23 June 2015, will provide an extra $225 million between 2015-16 and 2016-17. These offsetting impacts do not fall evenly between councils and so could not be addressed efficiently through the rate cap.

For these reasons we remain of the view that it is more appropriate for councils to address the differential impacts of changes to grant arrangements through the variation process.

COST SHIFTING

The impact of 'cost shifting' has been an ongoing concern for councils. Submissions to the draft report again highlighted concerns that 'cost shifting' is not factored into the cap.[34] For example, Bayside City Council argues that:

> *Whilst underlying CPI and the WPI are better measures of the cost movement of Councils than 'headline' CPI, neither of these indices take into account the cost shifting that occurs from other levels of government or the under indexation or freezing of government grants and regulated fees. The cumulative effect of this cost shifting is considerable and should be factored into the setting of the rate cap.*[35]

While councils could not fully quantify the extent and impact of cost shifting on to local government, many council submissions included examples of cost shifting in health and aged care, libraries, school crossings, maternal and child care, statutory planning, road side weed management, immunisation and preschools. These 'shifts' have occurred incrementally and over many years.

It is worth noting that under the framework the impacts of historical 'cost shifting' will be reflected in councils' base revenue given that they are already incurring and presumably largely meeting these additional costs through rates revenue.

Although we understand the financial impact future 'cost shifting' could have on the sector, it is not feasible to address this issue through the cap, as the type and magnitude will vary from council to council. These impacts are better assessed on an individual basis through the variation process. Moreover, we expect that with the introduction of the framework and the accompanying monitoring arrangements, the impact of 'cost shifting' will be given far more informed consideration than in the past.

DEFINED BENEFITS SUPERANNUATION

Another cost pressure identified by councils pertains to the funding of defined benefit superannuation shortfalls. Local government's defined benefit superannuation fund is

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[34] 'Cost shifting' is a term used by the sector to describe situations where the Commonwealth and State Governments expect or require local government to deliver services, but do not fully fund service delivery. It also covers situations where the State Government sets fees to be charged by local government, but holds the fees below the cost of service delivery (for example, the sector cited planning fees).

[35] Bayside City Council 2015, *Submission to ESC's draft report*, August.

legally required to be ‘fully funded’, meaning that councils must have sufficient funds available to provide the payments that would be required if all members were to withdraw at once. As a result, councils may have to top-up their defined benefits scheme provision to reflect regular actuarial assessments of the expected liability. Currently, Victorian councils are funding a $396.9 million shortfall.[36]

Several submissions suggested that a factor should be included in the cap to take into account the impact of defined benefit superannuation shortfalls. While we understand the required contributions are largely out of councils’ control, the Commission considers that it is not appropriate to automatically adjust the cap to take into account the superannuation top-up.

First, the impact on individual councils can vary even though it is triggered by the same circumstance. Second, councils’ actual costs will always vary from budget estimates. Councils would be expected to manage these fluctuations as ‘business as usual’ without automatically resorting to higher rates. Finally, providing an automatic uplift does not provide the correct incentives for councils to responsibly manage their overall financial exposure. An automatic allowance would simply transfer all financial risk to ratepayers directly.

2.4.4 CONCLUSION

In our draft report, we proposed to include a WPI and efficiency factor into the rate cap formula. We are recommending that the rate cap formula remain as per the draft report. The Commission will complete a detailed productivity analysis within two years and will consult with the sector and other interested parties.

On this basis, the latest forecasts for the rate cap are shown in table 2.3. These forecasts remain unchanged since the draft report published in July. These figures will be updated in December following release of the Budget update by the Department of Treasury and Finance.

[36] Municipal Association of Victoria 2013, *About Defined Benefit Superannuation Shortfall fact sheet*.

TABLE 2.3 INDICATIVE FORECASTS FOR THE ANNUAL RATE CAP (AS AT SEPTEMBER 2015)
Per cent

	2016-17	2017-18	2018-19
Underlying CPI forecast (60 per cent weighting)	2.75	2.5	2.5
Plus WPI forecast (40 per cent weighting)	3.5	3.5	3.5
Less Efficiency factor	0	0.05	0.10
FORECAST ANNUAL RATE CAP	**3.05**	**2.85**	**2.80**

Over the longer term, the four-yearly reviews discussed in section 8.1 should examine whether the rate cap formula continues to provide strong incentives for councils to improve the efficiency of their operations.

2.4.5 FINAL RECOMMENDATION 4

The Commission recommends that the annual rate cap should be calculated as:

Annual Rate Cap = (0.6 x rate of increase in CPI)
+ (0.4 x rate of increase in WPI)
- (efficiency factor)

where: CPI = DTF's forecast published in December each year

WPI = DTF's forecast published in December each year

The efficiency factor should initially be set at zero in 2016-17 and increase by 0.05 percentage points each year from 2017-18. The Commission will undertake a detailed productivity analysis of the sector to assess the appropriate long-term rate for the efficiency factor.

3 CAPITAL PROJECTS AND ASSET RENEWAL

3.1 WHAT WE SAID IN OUR DRAFT REPORT

The terms of reference require the Commission to take into account a number of factors that may impact on local government's short and long-term financial outlook, including any particular service and infrastructure needs. To provide infrastructure, councils acquire new assets or renew, upgrade and expand existing assets. Across Victoria, about half of councils' infrastructure spending is on infrastructure renewal.[37]

In our draft report, we considered that an automatic adjustment factor within the cap to account for infrastructure renewal was not justified. We concluded that due to the variability in requirements across councils, infrastructure renewal that cannot be managed within capped rates should be considered as part of the variation process on a per council basis.[38] Indicative guidance on the matters that we expected would need to be taken into account in a variation application was provided in our draft report.

As a safeguard for unintended consequences, we also recommended monitoring council performance outcomes in relation to service delivery, asset management and financial performance following the introduction of the framework. In light of the feedback we received following the release of our earlier consultation paper, we were cognisant that safeguards needed to be in place to monitor whether councils were under-investing in infrastructure.

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37 LGV 2015, *Local Government Victoria update asset management practice: What's next?*, Presentation to the LGPro's CEO Forum.

38 ESC 2015, *Local Government rate capping & variation framework review, Draft report volume II — Supporting material and analysis*, July, pp. 49-50.

3.2 FEEDBACK ON DRAFT REPORT

A number of submissions from metropolitan councils — including from the Inner South Metropolitan Mayors' Forum (ISMMF), the Eastern Region Mayors and CEOs Group, City of Port Phillip, City of Yarra and Glen Eira City Council — advocated that an uplift factor should be included in the cap to account for infrastructure needs, specifically addressing the asset renewal backlog identified by the Victorian Auditor-General's Office (VAGO).[39] An excerpt from the ISMMF submission sums up these views:

> *We state that there is a clear and evidenced need to incorporate a mechanism to address the infrastructure spending backlog through a transparent and accountable mechanism. CPI/WPI indexes do not adequately address the significant asset renewal backlog that has been identified across the local government sector in Victoria… VAGO identifies the asset renewal gap across the local government sector as $225 million in 2012, double the renewal gap that existed in 1998.*
>
> *Whilst improved asset management practices by the local government sector will assist councils in meeting their requirements, a rate cap that serves to do no more than restrict current levels of expenditure in line with inflationary pressures does nothing to provide councils with genuine scope to address the backlog of asset renewal. To allow for an adequate program of required asset renewal across the sector, the ISMMF proposes that an allowance of 0.5% be added to the annual rate cap as a 'renewal gap factor'.*
>
> *The 'renewal gap factor' would provide councils the means to close the existing renewal gap in approximately 10 years. This is based on the $225 million renewal gap identified by VAGO and total sector rates revenue of $4.0 billion in the same year (refer VAGO report Local Government: Results of the 2011-12 Audits), resulting in a rates funding deficiency of 5.6%. Allocation of the revenues raised through a renewal gap factor to infrastructure spending can be monitored and*

[39] ISMMF 2015, *Submission to ESC's draft report,* August, *Eastern Region Mayors and CEOs Group 2015, Submission to ESC's draft report,* August, *City of Port Phillip 2015, Submission to ESC's draft report,* August, City of Yarra 2015, *Submission to ESC's draft report,* August and Glen Eira City Council 2015, *Submission to ESC's draft report,* August.

verified by the ESC and Government through councils' financial reporting and performance requirements.[40]

Other submissions raising similar concerns had slightly different suggestions:[41]

- Glen Eira City Council argued that capital investment needs a longer lead time than the framework proposes (yearly variation approval initially) and reiterated its view that the variation framework should apply to councils' 4-year strategic resource plans and not annual budgets.
- Gannawarra Shire Council proposed a higher cap for councils with limited sources of revenue and a cap multiplier for all rural councils to account for remoteness.[42]
- Mitchell Shire Council proposed a separately defined cap for councils that have limited access to own-source revenue and a disproportionately long road network to maintain.
- Mount Alexander Shire Council suggested the use of the Victoria Grants Commission's (VGC) grants allocation model to develop different caps for councils.
- The City of Casey supported the single cap model but recommended that the variation framework should explicitly recognise growth and associated services and infrastructure needs and greater weight should be applied to applications for variations on these grounds.
- Banyule City Council proposed 'that where support from other levels of Government for community infrastructure projects and initiatives is evident then there should be an 'as of right' variation process'.

The 'renewal gap' is a measure developed by the VAGO that represents a ratio of council expenditure on renewing, restoring and replacing existing assets to asset depreciation (measured on a straight line basis).[43] It was widely cited in the submissions to our draft report.

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40 ISMMF 2015, *Submission to ESC's draft report*, August. The ISMMF incorporates the Bayside, Boroondara, Glen Eira, Kingston, Port Phillip, Yarra and Stonnington municipalities.

41 Glen Eira City Council 2015, *Submission to ESC's draft report,* August, Gannawarra Shire Council 2015, *Submission to ESC's draft report,* August, Mitchell Shire Council 2015, *Submission to ESC's draft report,* August, Mount Alexander Shire Council 2015, *Submission to ESC's draft report,* August, City of Casey 2015, *Submission to ESC's draft report,* August, Banyule City Council 2015, *Submission to ESC's draft report,* August.

42 According to Gannawarra Shire Council, the cap multiplier for remoteness could reflect 'higher costs in relation to transportation, attracting qualified staff and providing services where a commercial provider is not available'.

43 Depreciation is used as a proxy for the rate at which an asset is consumed.

The premise of the arguments put forward in these submissions is that councils face capital expenditure demands, particularly related to asset renewal, which cannot be met through the cap as currently formulated. They proposed to address this issue either through providing a universal uplift factor in the cap for asset renewal, or the use of more targeted caps (to account for growth, population, dispersion, length of roads, own source revenue) or through an automatic or as-of-right variation.

3.3 A BROADER PERSPECTIVE

Concerns about the effect of the rate cap on councils' capacity to fund the renewal gap appears to be widespread across the sector. Prior to discussing the specific issues raised by the submissions it is useful to see the reported renewal gap in the context of the overall financial status of the sector. Table 3.1 shows the reported renewal gap in the sector relative to total capital, total assets, total income and total borrowings in the sector.

The estimated renewal gap reported by VAGO for 2012 was $225 million.[44] In other words, councils would need to invest $225 million in order to close the renewal gap. While this sum is significant, it compares to councils' total income of around $7.5 billion in 2011-12 (or 3.0 per cent) and an asset base of about $68 billion (or around 0.3 per cent). It is also observed that overall in 2011-12, Victorian councils had low borrowings of less than 1.5 per cent relative to their assets and they held reserves that were more than four times the value of the reported renewal gap.

[44] VAGO 2014, *Asset Management and Maintenance by councils*, February.

TABLE 3.1 KEY FINANCIAL STATISTICS – ALL COUNCILS

	2011-12 $million	2012-13 $million	2013-14 $million	Forecast 2014-15 $million[a]	Budgeted 2015-16 $million[b]
Aggregate renewal gap	225	na	na	na	na
Total capital expenditure	1 980	1 857	1 917	2 276	2 342
New assets				579	629
Asset renewal				1 103	1 115
Asset expansion				159	155
Asset upgrade				434	443
Total assets	67 912	73 006	77 943	na	na
Total rates and charges	4 015	4 301	4 589	4 913	5 208
Total income	7 555	7 930	7 829	8 541	8 730
Total operating expenditure	6 901	7 011	7 198	7 463	7 616
Total currency and deposits held	931	821	993	na	na
Total borrowings	856	999	1 119	1 241	1 311

[a] Data based on actual financial results for the first half of 2014-15 plus forecast results for the second half of 2014-15. [b] Estimated or forecast data for 2015-16. **na** Not available.

Data source: 2011-12 to 2013-14 data sourced from VGC and LGV. Renewal gap data sourced from VAGO.

At a sector-wide level, oft-stated concerns about the renewal gap are somewhat difficult to reconcile with the financial status of the local government sector in Victoria. However, the Commission recognises that statewide figures can belie the distribution of the shortfall in infrastructure spending, and the ability of individual councils to fund those shortfalls. While many councils individually state that they have significant asset renewal backlogs, many councils also have a satisfactory underlying operating result[45] and low debt levels.[46]

Given the very differing circumstances of individual councils, a one-size-fits-all response in the rate cap would be an ineffective and inefficient means for dealing with

45 VAGO (2015), *Local Government: Results of the 2013–14 audits*, February.

46 In 2013-14, councils held borrowings equivalent to 1.5 per cent of their non-financial assets, compared with an average of 3.5 per cent for councils in the other states and territories. Councils do not face any legislative restrictions on their ability to borrow. VAGO's results of audit for 2013-14 shows that overall, indebtedness for all councils was below 40 per cent between 2006-07 and 2012-13, which indicates no concerns about the ability of councils to repay debt from own-source revenue.

the renewal gap. The application of a uniform uplift in the rate cap risks over-compensating those councils that do not face a renewal challenge and under compensating those that do. For councils in genuine need, the renewal gap should be addressed on an individual basis through the variation process described in chapter 4.

3.4 WE NEED BETTER MEASURES OF ASSET NEEDS

To give proper consideration of councils seeking variations to address the renewal gap there needs to be better measures of asset needs than currently exist. The sector mainly uses two measures[47] to assess asset management:

- VAGO's renewal gap
- MAV's STEP program.[48]

While these indicators have shown a general improvement in asset renewal in the sector over recent years, they do not fully show how well the councils manage their assets, namely how much they should spend on assets, on which categories (for example, renewal versus new) and when they should spend it (for example, whether there are corresponding impacts on services).

The MAV has also noted that all councils maintain their own assessment of their renewal gap, which will provide another source of information on an individual council level.

[47] Until 2015, LGV also reported a renewal gap indicator. Going forward it will report a new indicator as part of the LGPRF using a renewal gap calculation similar to VAGO's.

[48] The STEP program was developed by MAV in 2003 and is designed to assist councils improve their asset management and planning. It is built on a continuous improvement model and 'stretch' targets. Since 2010, the STEP program has incorporated the *National Asset Management Assessment Framework* to assist councils in meeting national standards for asset management.

In their submissions, councils claimed that the solution to the renewal gap lay in allowing a higher rate cap — that is, the continuation of the renewal gap is a revenue problem. We find this explanation to be insufficient given the financial measures observed above and highlighted in table 3.1. Moreover, recent VAGO reports have identified significant underspend between councils budgeted and actual capital works programs.[49]

We are therefore coming to the conclusion that others have reached before us, namely, the problem lies in defining a council's true infrastructure needs.

There is still considerable debate in local government across Australia about the extent of the asset renewal backlog. There is no consensus around how (or whether) it can be determined objectively and on a consistent basis between councils with different operating environments and service level preferences. In this debate, there is no single accepted measure of how well a council is managing its assets.

It would appear that councils have gravitated towards VAGO's measure of the renewal gap as evidence of a need for greater investment and a corresponding need for higher rates to fund that investment. While the VAGO measure is useful, for all intents and purposes, it is an accounting device only. It reflects accounting information drawn from councils' financial statements and combines that information into a single measure. In so doing, it relies on a range of implied assumptions about how a council manages its assets, individually and as a portfolio. If those assumptions are not reflected in the operational realities of councils, then additional measures are required beyond just the renewal gap as it is currently applied.

On the other hand, a number of councils use the MAV's STEP program to improve their asset management and to address renewal gaps. STEP uses a renewal gap calculation based on an assessment of the asset's condition, in contrast to the accounting approach based on straight-line asset depreciation. While it is a potentially more robust measure of asset management, it requires time and effort to prepare, report and monitor. Not all councils use the STEP program or apply it consistently.

While councils using STEP generally improved their asset management and planning, progress has been slow. By December 2013, only 23 of the 79 councils had reached a satisfactory level of asset management and renewal, as measured by the STEP

[49] VAGO (2014), *Asset Management and Maintenance by Councils*, February, page 25.

program. Regional councils particularly struggled to improve their asset management performance.[50] While the STEP program provides further insight into the capital expenditure requirements facing councils, it is not directly linked to future demand for the services provided by that infrastructure.

The Commission has initiated talks with VAGO and Local Government Victoria (LGV) on developing agreed and multi-dimensional measures of capital requirements based on well-designed and strategic asset management practices.[51] In doing so, we are seeking to develop measures that reflect a council's intended investments (as they might appear in a variation application) against a long-term view of its asset requirements, and its long-term budget strategy for meeting those requirements.

3.5 ASSESSING APPLICATIONS FOR A VARIATION RELATED TO CAPITAL PROJECTS AND MONITORING THE RENEWAL GAP

The general variation process and monitoring of the outcomes of the framework are discussed in Chapter 4 and 6 respectively. This section discusses specifically how capital requirements will be considered under the variation process and how the renewal gap is monitored.

In making an application for a variation, councils will need to demonstrate the level of capital expenditure historically included in their budgets. The Commission will take as its starting assumption, that this historic capital provision (which will grow each year in line with the cap) should be sufficient for a council to manage its 'rolling' program of capital works without resorting to a rate cap variation. Where a variation is being sought, councils will need to demonstrate why this assumption is invalid. Where a single and large (or 'lumpy') investment is required, councils will need to demonstrate why room for this investment could not be found within the historical provision — that is, why it could not be funded from rate revenue under the cap, including over a number of years. Councils will also be expected to show how capital spending (and its impact on rates) will return to historical levels once the 'lumpy' investment is completed.

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50 VAGO 2014, *Asset Management and Maintenance In Councils*, February, p.xi.

51 A letter has been sent to VAGO seeking its cooperation.

In other words, the Commission will require that a council has had regard to its needs and likely circumstances over the medium to longer term, rather than just over the shorter term. An application will need to be supported by the council's long-term financial plan that highlights capital and operating expenditure, and revenue and cash flow forecasts over the longer term (say, 10 years). Such a plan should be consistent with the council's asset management plan, strategic plans and longer term operational plans. And, as discussed elsewhere in this report, councils will need to ensure they have consulted with their ratepayers about the potential impact on rates from pursuing an expanded program of investment.

In assessing applications for rating variations we would give consideration to the rigour of assumptions and forecasts made by councils in their forward financial plans. For example, we would scrutinise carefully any assumptions that have been made regarding grants from the Federal and State Governments. Further information will be provided on these matters in the guidance material.

To monitor the renewal gap in the short term, the Commission can utilise a combination of an individual council's own assessment and existing indicators. Over the long-term, once a multi-dimensional set of measures is established, this can be incorporated into the baseline information template in order to accurately present renewal gap data at both an individual council level and for the sector.

3.6 CONCLUSION

Concerns about the impact of the rate cap on capital investment were expressed quite broadly in the submissions we received from councils in response to our draft report. Councils were particularly concerned that they are already behind in their investment requirements and they often cited VAGO's measure of the renewal gap as evidence of this shortfall.

We take as our starting position under the framework that council budgets already include a provision for capital requirements and this provision will be escalated by the rate cap each year. Should these funds be insufficient for a council's infrastructure needs it will be open to the council to apply for a variation from the rate cap.

We find that, given the very differing circumstances of individual councils and the existing measures available, a simple uplift to the rate cap would be an ineffective and inefficient means for dealing with the renewal gap. Rather councils that require a rate increase above the cap due to a genuine renewal gap challenge should be assessed on an individual basis through the variation process.

We will work with VAGO, LGV and the local government sector to develop better measures of councils' capital requirements. In the meantime, we will rely on information that should be available through councils' existing planning and budgeting processes.

4 THE VARIATION PROCESS

The terms of reference ask the Commission to ensure that the variation framework:

- provides a mechanism through which councils can submit a proposed rate increase above the cap
- takes into account factors that impact on local government's short-and long-term financial outlook and
- specifies any technical requirements (including information requirements) on councils that request variations from the cap.

This chapter outlines the variation process by which we propose councils will be able to seek an increase in their rates above the rate cap. Our proposals have been informed by comments received since the release of the draft report.

4.1 WHEN CAN COUNCILS SEEK A VARIATION?

In chapter 2, we describe how it is not practical to design a rate cap that takes into account the diversity, different needs and different legacies faced by individual councils. Nevertheless, the increase permitted by the rate cap represents the annual additional revenue requirement typically expected for councils on a state-wide basis. Some councils may consider this additional revenue insufficient in light of their particular circumstances. In our draft report, we set out a variation process to provide a mechanism for individual councils to seek a rate increase in excess of the cap.

Submissions following our draft report emphasised the complexity of local government, with councils often delivering 'over 100' different services to their communities. This clearly involves the need for careful council deliberations when planning, budgeting and setting rates. Service priorities change over time. New services are introduced, while other services are expanded or discontinued. New infrastructure is built and existing infrastructure needs to be maintained. Some infrastructure is retired as it is no longer required. Revenues fluctuate either because of economic circumstances or following policy decisions by other levels of government. And, on occasion, natural disasters happen.

Sometimes budget pressures will arise due to a specific or one-off expenditure requirement. At other times, budgets will struggle with more generalised cost pressures.

When faced with any budget pressures, councils can pursue one or more of the following strategies; and the preferred response is likely to depend on the source of the budget pressure and whether it is momentary or structural. The four broad options facing councils include:

- scrutinising the full suite of their operations and planned investments for opportunities to deliver outcomes more efficiently
- re-examining whether the range of services they are delivering align with their community's highest priorities
- assessing the possibility and merits of alternative funding or financing options for different activities and investments and
- increasing their revenues through higher rates and charges.

The role of representative councils with delegated responsibilities from and accountable to their communities, is to assess how best to manage the trade-offs between these four options.

This responsibility rests inherently with local government. A well-designed variation process will not shift this responsibility away from councils — rather, by promoting transparency and engagement, a variation framework ensures all options are considered in the decision-making process before deciding on pursuing rate increases (above the cap).

The variation process needs to accommodate different sources of cost pressures and it should be able to respond flexibly in different situations. Likewise, councils should be expected to assess all their options before seeking a rate variation. If this were not the case, the rate cap and variation process would be of little benefit.

4.1.1 FEEDBACK ON DRAFT REPORT

The majority of responses to the draft report supported the flexible approach proposed. For example:

> *Council supports the Commission's recommendation that the decision to apply for a variation should be at the sole discretion of each individual council.*[52]

> *We feel this is a very reasonable approach and consistent with the principles that each Council's circumstances will be different and needs to be considered on its merits.*[53]

In the draft report, we concluded that the framework should not include specific triggers or automatic exemptions in light of particular circumstances. Some responses disagreed with this conclusion and argued there should be exemptions or automatic triggers for reasons beyond a council's control. The most commonly cited examples were regarding natural disasters, 'cost shifting', and infrastructure renewal gaps:

> *Council submits that some circumstances should be exempt from the variation process, and a variation should be automatic. These circumstances would include natural disasters and defined benefits superannuation call. The preparation of a Variation application in these situations would be a waste of the ESC's and council resources. Universal or specific variations to the cap should be applied in these circumstances.*[54]

> *Whilst the ERG understand the ESC's desire for a simplified rate cap model, matters such as addressing infrastructure spending would therefore need to be addressed through the variation process. We propose that there is a clear and evidenced need to incorporate a mechanism to address the infrastructure spending backlog currently identified in Victorian local government through a transparent and accountable mechanism. The need to have this backlog addressed, and*

[52] Yarra Ranges Shire Council 2015, *Submission to ESC's draft report*, August.

[53] Wyndham City Council 2015, *Submission to ESC's draft report*, August.

[54] Rural City of Wangaratta 2015, *Submission to ESC's draft report*, August.

> *ensure suitable levels of asset funding are maintained going forward, has been recognized by Government.*[55]

> *A recent example of costs beyond Councils' control is the declaration of a public holiday on 2 October. This would add approximately $250,000 to the wages bill of a large metropolitan Council to cover the leave and the penalty rates for Council services operating on that day. This expenditure was not provided for, nor predicted when budgets were struck earlier this year.*[56]

There was some support for our proposed approach in not specifying automatic triggers, for example:

> *On balance it is considered reasonable that trigger events are not defined. If definitions were included, it is possible that future unforeseen circumstances outside of these or not clearly matching could arise and prompt a reasonable application for a variation.*[57]

4.1.2 COMMISSION'S RESPONSE

We continue to have two concerns about automatic triggers. First, no matter how extensive the list of causes we identify, it will never be exhaustive. Second, even if a list were identified, the inevitable disputes about how the triggers should be defined in practice would be an unhelpful distraction for councils, communities and the Commission. (Our response to concerns about 'cost shifting' and the renewal gap, appears in section 2.3 and chapter 3).

We confirm that we consider that there are no circumstances under which councils should be prohibited from seeking a rate variation above the cap. In other words, we do not propose to define situations (triggers) where a council's application for a variation would be automatically accepted or rejected. We consider that councils should always have the opportunity to apply for a variation and that each application should be assessed on its merits.

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55 Eastern Regional Mayors and CEOs Group (ERG) 2015, *Submission to ESC's draft report*, August.

56 LGPro 2015, *Submission to ESC's draft report*, August.

57 Hobsons Bay City Council, *Submission to ESC's draft report*, August.

That said, we are likely to have an unfavourable disposition towards applications for higher rates due to unbudgeted increases in controllable costs in the past year (more commonly known as 'cost blow outs').

We also recognise that extraordinary circumstances such as disasters can have major financial impacts and that the framework should be flexible to accommodate such unforeseen events (Principle 6). The Commission considers that this is best addressed via the variation process. The Commission, in exercising its professional judgement when assessing variations, will have due regard to the special circumstances and will undertake to make such assessments efficiently and quickly.

4.1.3 FINAL RECOMMENDATION 5

The Commission recommends that the framework should not specify individual events that would qualify for a variation. The discretion to apply for a variation should remain with councils.

4.2 HOW WOULD A COUNCIL DEMONSTRATE THE NEED FOR A VARIATION ABOVE THE RATE CAP?

There are many reasons why a council might consider applying for a variation above the cap. Even applications based on seemingly similar reasons are likely to differ on the facts when scrutinised more closely. Different information will probably be required to assess each application. This makes it impossible to establish a single set of information requirements for all variations. If we attempted to establish a single list of requirements it would probably impose irrelevant (and costly) obligations on most councils seeking a variation above the cap.

A more accommodating and flexible approach involves providing guidance to councils on the subject matter areas that will need to be considered when an application for a variation above the cap is being assessed.

4.2.1 FEEDBACK ON DRAFT REPORT

By proposing this more accommodating and flexible approach, and avoiding a single set of requirements, we sought to provide maximum flexibility for councils to rely on their own processes and systems to inform their application. Respondents raised concerns around the uncertain burden of proof that councils would need to satisfy for a variation above the cap. Further, they were concerned about the subjective nature of the Commission's decisions:

> *Council understands and is generally supportive of the matters to be addressed in each application for a variation however Council notes that the level of detail required in responding to each of the five matters is likely to impose a significant burden on Council and will almost certainly add both costs and time to the budget development process for Council.*[58]

> *A successful request for a variation will be determined entirely by the ESC but despite all the narrative, it is difficult to visualise the level and depth of the case required to be demonstrated by council. On any objective reading of the document, the requirements being suggested for success point to a huge task.*[59]

> *The resourcing required for a variation application will be significant for individual Councils where it is not primarily based on existing processes and documents such as the Council Plan and existing, common, data sets such as LGPRF financial data, Annual Reports and Budgets, and the extensive other reporting to State Government Departments.*[60]

> *The subjective nature of the variation assessment causes a few concerns for us: The framework suggests there will be one process for variations regardless of the size of the variation sought. A more prescriptive, graded approach should be considered to provide Councils with clarity and some level of certainty on the expected outcome.*[61]

[58] Knox City Council 2015, *Submission to ESC's draft report*, August.

[59] City of Wodonga 2015, *Submission to ESC's draft report*, August.

[60] Yarra City Council 2015, *Submission to ESC's draft report*, August.

[61] Wyndham City Council 2015, *Submission to ESC's draft report*, August.

4.2.2 COMMISSION'S RESPONSE

We acknowledge these concerns and emphasise that our expectation is that the information required to support a variation would be proportional to the magnitude of the variation being sought. Can we quantify this expectation in any meaningful way? No. That would be a futile exercise, and none of the submissions we received shed light on how this could be achieved. Commonsense, however, dictates that the burden of proof for a variation of 10 per cent would clearly need to be greater than that for a variation of, say, 1 per cent above the cap.

We contend that councils are experienced decision-makers and would have their own internal standards for the information required to make good decisions. Since 1999, these decision-making standards have been guided by the *Best Value Principles* (see box 4.1). These are now well-established in the sector.

BOX 4.1 BEST VALUE PRINCIPLES

The *Best Value Principles* are:

a. all services provided by a Council must meet the quality and cost standards required by section 208D;
b. subject to sections 3C(2)(b) and 3C(2)(e), all services provided by a Council must be responsive to the needs of its community;
c. each service provided by a Council must be accessible to those members of the community for whom the service is intended;
d. a Council must achieve continuous improvement in the provision of services for its community;
e. a Council must develop a program of regular consultation with its community in relation to the services it provides;
f. a Council must report regularly to its community on its achievements in relation to the principles set out in paragraphs (a), (b), (c), (d) and (e).

Source: *Local Government Act 1989*, part 9, division 3.

It has been no accident, therefore, that the guidance material proposed in the draft report and set out in table 4.1 of this report (see p. 63) draws heavily on these *Best Value Principles*. That being the case, councils could view their variation applications as little more than a public demonstration of their adherence to the *Best Value Principles*.

While few councils acknowledged the alignment between our proposed framework and the *Best Value Principles*, some agreed that the variation process did not impose a considerable or new burden of proof on the local government sector:

> *This is agreed. This Council already takes all these factors into account through its planning and budgetary processes. It is also imperative that one-off factors, such as implementation of major capital works projects and/or programmes are considered valid reasons for a variation.*[62]

> *The matters requiring addressing in the application for variation generally represent good practice and are similar to processes councils go through when preparing annual budgets.*[63]

On balance, the Commission upholds its earlier recommendation that the councils should address the following five matters in each application:

- **The reason(s) for the proposed rate increase greater than the cap.** The reason for the variation will need to be articulated clearly and the amounts involved will need to be quantified. Reasons could include: change in costs, a change in asset management, a change in the services that councils are required to provide, or new projects (see section 4.4). These claims would need to be substantiated.
- **How the application takes account of ratepayers' and communities' views.** The application would need to demonstrate that the views of ratepayers and communities have been identified and describe how their concerns have been addressed. This consultation will need to include the presentation of other realistic options for meeting the funding need, and the trade-offs those options would entail. Importantly, applications will need to account for ratepayers' views on specific expenditure items or cost pressures (where relevant) as well as their impact on the council's overall budget position.

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62 City of Frankston 2015, *Submission to ESC's draft report*, August.

63 Southern Grampians Shire Council 2015, *Submission to ESC's draft report*, August.

The Commission will not prescribe how councils ought to engage with their communities. Such decisions naturally sit with councils rather than the Commission. Nevertheless, we have developed a set of four key engagement principles which we expect to be reflected in the engagement undertaken in support of an application for variation (these are discussed in chapter 5).

- **How the outcomes being pursued in the variation reflect the efficient use of council resources.** This means that, where additional expenditure is involved, any amount proposed to be recovered through higher rates should represent a good value option for achieving the desired outcome. It would be helpful to submit business cases or cost-benefit analyses where higher rates are being proposed in order to fund the delivery of new or expanded services, or new infrastructure.
- **What consideration has been given to reprioritising proposed expenditures and pursuing alternative funding options**. The application will need to demonstrate that councils have considered reprioritising funding from other areas of expenditure; and the reasons for not proceeding with that reprioritisation (in part or in whole). The application will need to demonstrate that councils have considered other suitable funding or financing options and the decision (and reasoning) reached in relation to those options. All these considerations need to bear in mind the long-term interests of the community and ratepayers.
- **That the assumptions and proposals in the application are consistent with those in the council's long-term strategic planning and financial management instruments**. The matters giving rise to the variation application should be consistently represented and addressed in all of the council's relevant financial and planning instruments — for example: its council plan and asset management plan. The assumptions supporting those matters should be transparent and clearly consistent across all relevant instruments (for example: future costs, demand trends, changing community needs, etc).

In table 4.1 (at the end of this chapter), we provide guidance on how we would expect councils to address these five subject matter areas in their application for a variation. Under each heading, the table sets out:

- questions that councils should ask about whether they require a variation, and if so, what form the proposed variation might take
- actions councils should take when they develop a variation application and
- evidence that councils should provide in their variation applications.

This table is for **guidance only** and the ultimate information requirements will depend on the type of variation sought by councils. Councils will be responsible for determining what they consider to be sufficient information to justify a variation application.

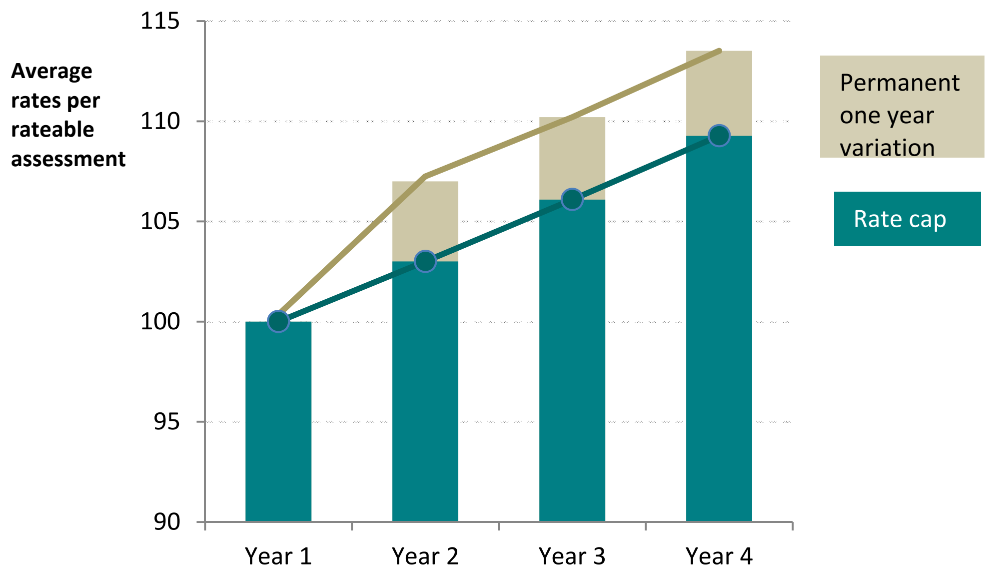
We also propose to allow councils to apply for temporary and permanent variations from the cap.

A temporary variation would enable a council to increase its rates above the rate cap for one year. After that one year, rates would be reduced to the level they would have been if the council had been granted the default rate cap one year earlier. A temporary rate cap increase would enable councils to address costs that arise once and were not expected to recur. An example of this type of expense might be a one-off levy by a council to pay for recovery from an isolated natural event.

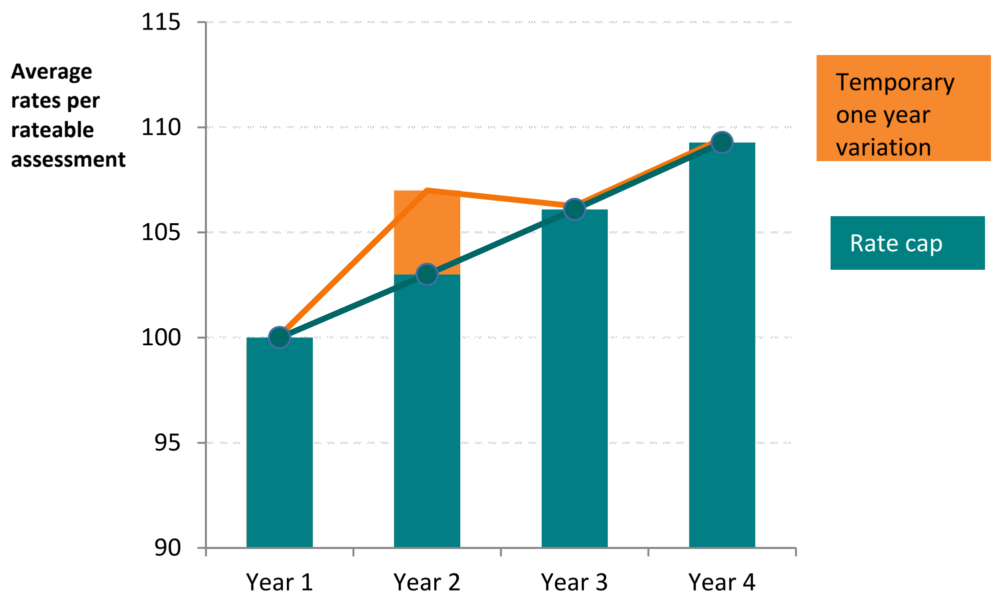
A permanent variation would enable a council to increase its rates above the cap and retain that increase into the future. This might apply in light of a new recurring cost. An example of this might be a variation to account for the operating costs associated with a new facility. These two options are represented in figure 4.1.

FIGURE 4.1 ILLUSTRATION OF PERMANENT VERSUS TEMPORARY VARIATIONS

(a) Permanent variation



(b) Temporary variation



4.2.3 FINAL RECOMMENDATION 6

The Commission recommends that the following five matters be addressed in each application for a variation:

- the reason(s) for the proposed rate increase greater than the cap
- how the application takes account of ratepayers' and communities' views
- how the outcomes being pursued in the variation reflect the efficient use of council resources
- what consideration has been given to reprioritising proposed expenditures and pursuing alternative funding options and
- that the assumptions and proposals in the application are consistent with those in the council's long-term strategic planning and financial management instruments.

4.3 WHO DECIDES WHETHER A VARIATION IS APPROVED?

In the draft report, we outlined three options for who administers the rate variation process. We discussed the merits of each option and proposed that the Commission, as an independent authority, would be responsible for assessing and determining the response to all applications. We also noted that public statements from the State Government were consistent with this proposal.

4.3.1 FEEDBACK ON DRAFT REPORT

Some respondents argued that because the Commission is not elected, it should only have an advisory role. Where this concern was raised, two alternatives were suggested: namely the Minister for Local Government (the Minister), or the council making decisions based on advice from the Commission:

> *Council is also very strongly of the view that it should be the Minister that is responsible for determining on an application for variation. While it is acknowledged that the ESC would appropriately perform an advisory role to the Minister, it is Council's view that the elected politician and not the appointed bureaucrat, that most appropriately perform the role of adjudicator in these matters.*[64]

> *The ESC should advise, not decide, and Council should make the final decision.*[65]

On the other hand, many more submissions supported our proposed role:

> *The City of Port Phillip supports the ESC, as the independent economic regulator, being the decision-maker under the framework.*[66]

> *It is Wodonga Council's view that the ESC, once given the mandate and resources to review a council submission should be given the legislative authority to approve the rate rise it has determined. This avoids the additional administrative delay of the Minister performing another review and possible perception of political influence over a submission already considered by an independent regulator.*[67]

4.3.2 COMMISSION'S RESPONSE

Earlier submissions to the review urged the Commission to learn from the experience of NSW before making recommendations on the design of a Victorian rate capping and variation framework. We have heeded this advice. As discussed in our draft report, the

[64] Shire of Melton 2015, *Submission to the ESC's Draft Report*, August.

[65] Moreland City Council 2015, *Submission to the ESC's Draft Report*, August.

[66] City of Port Phillip 2015, *Submission to the ESC's Draft Report*, August.

[67] City of Wodonga 2015, *Submission to the ESC's Draft Report*, August.

NSW framework is perceived to have operated far more efficiently since decision making was delegated to our counterpart organisation in that state (the Independent Pricing and Regulatory Tribunal (IPART)).

On balance, we believe the concerns raised about the Commission are outweighed by support for our proposal and our position as an independent statutory authority acting on objectives clearly set out in legislation.

4.3.3 FINAL RECOMMENDATION 7

The Commission recommends that it should be the decision-maker for variation applications under the framework.

4.4 WHAT DECISIONS SHOULD BE MADE IN RESPONSE TO AN APPLICATION FOR A VARIATION?

In the draft report, we proposed that the Commission's role in assessing a council's application to vary rates above the cap should be limited only to accepting or rejecting the application in its entirety. In other words, we did not recommend the Commission be given the power to substitute an alternative rate increase to the one proposed. Nor did we suggest the Commission be given the power to negotiate with the council on an alternative rate increase. Our reasoning was that such powers are occasionally given to bodies such as the Commission, but in those instances, the regulator collects detailed information about the costs and revenues of the businesses being regulated (and develops detailed financial models of those businesses). We did not consider such an intrusive and resource intensive approach was appropriate when designing the rate capping and variation framework outlined in the draft report.

4.4.1 FEEDBACK ON DRAFT REPORT

During our consultations, concerns were raised about the proposed limitations on the Commission's decision-making. These concerns were typically raised in the context of individual and readily identifiable capital projects. Concerns were expressed that under the proposed accept-reject model, if an application was required due to a number of cost pressures, the Commission could reject the entire application if the application failed to adequately address just one of those matters. For example, the Australian Service Union wrote:

> *Another scenario where we have little confidence in the variation process is the circumstance where the Commission determines a variation application may be justified in part, but not in whole. It is unclear how the Commission will treat such variation applications. To put it simply, if a Council applies for a variation, but the Commission is satisfied only two-thirds of the variation is 'justifiable,' will the Commission approve the variation or refuse?*[68]

Also during our consultations around the State, councils raised queries about whether the Commission would require them to submit two budget proposals as part of their variation processes — that is, one budget corresponding to the council's proposed variation above the cap; and a second budget corresponding to the capped rate of increase in rates revenues.

In response to these queries, we made it clear that we held no such expectation. As per the guidance provided in the draft report, we would expect a council's application to outline clearly the reasons for rate increases above the cap. Doing so would require the council to first explain what it could achieve within the capped rate of revenue and then the reasons for the additional funding required above the cap. In this sense, the council's incremental requirements above the cap would be made clear to ratepayers and the Commission.

4.4.2 COMMISSION'S RESPONSE

We acknowledge the concerns raised by respondents about our proposed simple accept-reject role for the Commission, which provides the decision-maker with no room for discretion on individual elements of a proposal. This could lead to a situation where the Commission rejected an otherwise convincing application where it found one element of that application to be insufficiently developed or supported.

At the same time, we remain concerned that the Commission should not be placed in a situation where it has effectively become a reviewer of council budgets in their entirety. As noted in the draft report, this would be an extraordinarily intrusive and

[68] Australian Services Union 2015, *Submission to ESC's draft report,* August.

resource-intensive role for the Commission. We continue to maintain that this is not in keeping with the role or the model envisaged in the terms of reference for this inquiry.

If council applications clearly demonstrate why variations above the cap are required, and they highlight the incremental impact on their average rate requirements beyond the rate cap, and they provide supporting documentation for those incremental expenditures, then there may be some opportunity to extend limited discretion to the Commission's decision-making. This information would allow the Commission to assess individual components of an application and then determine whether to accept or reject one-or-more of those individual components.

We propose to limit this discretion to:

- new and standalone capital projects (that is, capital expenditures that are clearly discernible from, and independent of, other capital projects) and
- discrete project expenditures (that is, non-capital projects that are one-off in nature, have a clearly defined and measurable output, and have readily observable start and end points).

We would expect councils' variation applications only to identify individual project proposals for those projects which could not be funded within the cap. Alternatively stated, prior to submitting their applications, councils will need to have prioritised the projects that would only be funded subject to a variation. The Commission will not accept responsibility for prioritising individual expenditures. Where projects are not prioritised, the Commission will only accept or reject the application in its entirety.

Where the Commission rejected an individual project proposal, the council could submit a new and better informed application for that expenditure in a future year.

We will issue guidance material providing relevant definitions and criteria for projects that would be subject to individual assessment.

4.4.3 FINAL RECOMMENDATION 8

The Commission should be empowered to accept or reject an application in its entirety. However, where the Commission would otherwise accept (reject) an application but considers the material supporting an individual project within that application to be insufficiently (sufficiently) developed or supported, it may reject (accept) the individual proposal.

4.5 APPEALING A VARIATION DECISION

In our draft report we outlined that the right of seeking judicial review on administrative law grounds remains available to councils unless legislated otherwise. We supported an ongoing right to judicial review, that is, we did not recommend that this avenue be removed through legislation. Nor did we recommend that the Commission should be subject to an avenue of appeal on merit in response to a variation decision. Box 4.2 explains the different forms of appeal.

While volume I of the draft report did not make any explicit recommendation on appeals, it was understood that the right of judicial review always exists. Volume II provided a more comprehensive discussion and outlined the Commission's rationale for not providing an appeals process based on merit. The following discussion revisits some of these issues in light of respondents' comments.

BOX 4.2 DIFFERENT FORMS OF APPEAL

All the Commission's decisions on variations would be open to judicial review on administrative law grounds. This means a Commission decision could be reviewed by a court if the Commission did not give a council a fair hearing on its variation application or if the Commission made an error of law. If the review by the court found a procedural or legal error, the Commission would be required to make a new decision on the application in a manner consistent with the guidance of the court. The court could not substitute its own decision on the facts before it.

A merits appeal would enable a council to have its application re-examined by another body if its application were rejected by the Commission. Under a merits appeal, if the appeal were successful, that body would 'step into the shoes' of the Commission and reconsider the application as if for the first time.

4.5.1 FEEDBACK ON DRAFT REPORT

Several submissions recommended that councils should have the right to re-examination of a decision made by the Commission in respect of application for a variation above the cap. Most submissions did not specify a preferred process for lodging an 'appeal' and to whom the 'appeal' would be made:

> *Some form of appeal (to the Minister) should be available.*[69]

> *The variation process lacks a process for appeal. A framework underpinned by independence and accountability must have an appeals process.*[70]

> *Council agrees with the ESC's proposal that the Commission approve variations under delegated authority from the Minister, however there should be an appeals or review process.*[71]

> *The MAV has been advised by ESC that it intends to recommend that its decisions will not be subject to a merits judicial review but will be subject to administrative law. The Association seeks the confirmation from ESC that this understanding is correct.*[72]

Some respondents recommend that the appeal should be heard by the Minister. Corangamite Shire Council recommended the right of appeal to the Victorian Civil and Administrative Tribunal.[73]

[69] Central Goldfields Shire Council 2015, *Submission to the ESC's Draft Report*, August.

[70] City of Mooney Valley 2015, *Submission to the ESC's Draft Report*, August.

[71] Mount Alexander Shire Council 2015, *Submission to the ESC's Draft Report*, August.

[72] MAV 2015, *Submission to the ESC's Draft Report*, August.

[73] Corangamite Shire Council 2015, *Submission to the ESC's Draft Report*, August.

Related to the issue of appeal is the transparency of the Commission's decisions. Some submissions raised concerns about whether the Commission would publish its decisions, including the reasons for either accepting or rejecting an application. For example:

> *As a minimum, all applications for a variation should be made public and a report provided back to the council outlining the specific reasons for granting or rejecting a variation. Clarity is sough about the appeal process required as part of the final rate capping framework. This process must be available in a timely and transparent manner, which would accord with basic principles of democratic decision-making.*[74]

4.5.2 COMMISSION'S RESPONSE

We continue to support councils retaining their inherent administrative law rights to seek judicial review of Commission decisions. We believe this is a significant avenue of redress for councils, which should impose an important discipline on the Commission.

Judicial review means taking the Commission to the Supreme Court (the Court) for 'guidance' on the proper exercise of its statutory power. If a council considered that the Commission was incorrectly applying the legislation or failing to take account of a relevant consideration (as examples), the Court could rule and require that the Commission consider the variation application in accordance with the Court's guidance.

However, the Commission is not recommending that the Government consider establishing an avenue for appeal for variation decisions on their merits.

The distinction between 'merits appeal' and 'judicial review' is significant, and is important to the Commission's position as is outlined in box 4.2.

A merits appeal process would add to the time taken and the cost of the framework within an already time-constrained process for annual council rate setting. The costs of pursuing a merits appeal could be significant and, if unsuccessful, these costs would befall councils and their ratepayers.

The appellate decision-maker is unlikely to have significant expertise or a strong understanding of the local government sector, meaning there is limited assurance that

[74] VLGA 2015, *Submission to the ESC's Draft Report*, August.

re-decision will be more rigorous or more satisfying to the appellant. Moreover, a Commission decision to reject an application would not preclude the council from resubmitting an improved application in the following year. The Commission would be required to treat that reapplication solely on the facts before it, without reference to the previous submission.

Introducing a merits review into the rate capping and variation framework is likely to lead to the framework becoming ever more prescriptive, as has occurred in other sectors. We consider this route would not be consistent with either the Government's intentions or the interests of councils as expressed in their submissions and discussions with the Commission.

OTHER RELATED MATTERS

We do not support suggestions that the Minister be required to hear an appeal. The inclusion of a right of appeal to the Minister adds another layer of cost and time to the application process. It potentially places the Minister in an invidious position of being responsible for overseeing the governance of the local government sector and at the same time having to intervene in individual governance matters (namely, budget and rate setting). Further, experience from New South Wales indicates that confidence in the rate capping framework in that State has improved since it was made subject to an impartial and independent process at arm's length from the Minister. Feedback from NSW councils that we have met generally confirmed the positive role of IPART. Further, the NSW Treasury Corporation found that 'the transparency of the rate setting process is improving as IPART continues its work in this area'.[75]

In our draft report we indicated that the Commission would make public its decisions in respect of a variation application and the reasons for our decision. Even so, there appears to be some concern among councils about the Commission publishing its reasons for a decision. For the avoidance of doubt, the Commission will publish a report in support of every decision it makes on a variation application. The Commission will detail the outcome of the application and the basis for its decision.

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75 The New South Wales Division of Local Government (now Office of Local Government) engaged the NSW Treasury Corporation (TCorp) to undertake a review of the financial sustainability of all 152 NSW councils. TCorp's findings and recommendations assisted the NSW's Independent Local Government Review Panel. Source: TCorp, 2013, *Financial sustainability of the New South Wales Local Government Sector: Findings, Recommendations and Analysis*, April, p. 62.

CONCLUSION

There is already scope for judicial review of the Commission's decision on a council's application for a variation to its rate cap. Judicial review provides an important and powerful safeguard for councils. Having another agency re-examining the reasons for a variation under a merits review would not guarantee an improved decision given the necessary expertise involved in assessments of rates. It could potentially introduce greater uncertainty into the framework, at significant cost to ratepayers.

The Commission therefore reaffirms its earlier position that judicial review of a Commission decision on administrative grounds should remain available to councils, without recourse to a merits review.

4.6 HOW DIFFICULT WILL IT BE TO HAVE A VARIATION APPROVED?

In our draft report, we noted that the Commission will need to exercise some degree of judgement when assessing how well an application meets the Commission's expectations as outlined in table 4.1 below.

We noted, that all things being equal, we do not expect a large number of applications each year. We will expect however, that when we receive an application, it will reflect a situation of genuine need and it will demonstrate that need rigorously. If these expectations are not met, and if through the variation process the Commission finds itself routinely becoming involved in councils' rating decisions, we risk becoming a *de facto* regulator of the local government sector. Such an outcome would be contrary to the autonomy of councils — which is something we have endeavoured to preserve in designing the proposed framework.

4.6.1 FEEDBACK ON DRAFT REPORT

Some submissions to the draft report raised concerns with our expectations. In particular:

> *Council notes the views expressed by the ESC that 'we do not expect a large number of applications each year' and is concerned by the position that this comment portrays to the industry – being one of discouraging applications.*[76]

> *We are concerned that the variation process may have undue political influence to avoid the granting of variation applications. For example, if 50 councils made applications that all had valid reasons for increasing above the cap, would applications be approved?*[77]

> *…there should be an acceptance that the number of variations applied for will be many. To suggest that it could be otherwise is painting an inaccurate picture and creating a difficult dynamic between a council with genuine disadvantage factors and its community.*[78]

4.6.2 COMMISSION'S RESPONSE

To be clear, our expectation that the number of applications submitted will be limited has no bearing on how we will deal with whatever number of applications are ultimately received. Our expectation was informed by comments from councils indicating that the commencement of a rate cap would, in all likelihood, force them to 'cut their cloth' to fit within the cap. We took those comments at face value. What eventuates in practice remains to be seen. And when it eventuates, the Commission will treat each application on its merits and without bias or prejudice. The measures outlined in this chapter are designed to ensure rigour and impartiality in the Commission's performance of its duties.

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76 City of Greater Dandenong 2015, *Submission to the ESC's Draft Report*, August.

77 City of Greater Geelong 2015, *Submission to the ESC's Draft Report*, August.

78 Interface Councils 2015, *Submission to the ESC's Draft Report*, August.

TABLE 4.1 QUESTIONS, ACTIONS AND EVIDENCE FOR A VARIATION APPLICATION

Why the Commission needs this information	Questions	Actions	Types of evidence
The reason(s) for the proposed rate increase greater than the cap			
We need to establish whether there is a need for a rate increase greater than the cap.	• What is the underlying driver of the need for an increase in rates above the cap?	• Identify the need for additional revenue. (Is it to meet short-run cash flow needs and/or long-run operating capability?) • Estimate the additional revenue required above the cap. • Determine whether the additional revenue requirements are ongoing or temporary.	• Documents identifying the cause of the variation. • Documents justifying the costs associated with the cause of the variation. • Relevant areas in financial statements showing the council's financial performance and position in previous period.[a] • Relevant areas in budgeted financial statements for current period.[a] • Relevant areas in a strategic resource plan and asset management and/or long-term financial plans.
	• In the event the variation request is for a number of discreet projects, how have these projects been prioritised by council and its ratepayers and what are the incremental expenditure increases of each project?	In the event the variation request is for a number of discreet projects: • identify information regarding how the council and its ratepayers have prioritised these projects; and • highlight the incremental expenditure of these discreet projects.	Documented policies and strategies regarding: • mix of own-source revenue-raising; and • funding and financing (role of debt).
	• Is the proposed rate increase consistent with the council's revenue strategy and policy on funding and financing? • Has the council taken into account whether a staggered increase in rates would be more appropriate? • Has the council considered the funding needs over time by raising the additional expenditure through borrowings and/or by using existing financial assets; or through user charges, rather than general rates?	Review the council's policies and practices: • revenue raising mix (e.g. taxes and user charges); • revenue target; and • role and use of debt.	Documented policies and strategies regarding: • mix of own-source revenue-raising; and • funding and financing (role of debt).

[a] This may be demonstrated through the baseline information.

Continued next page

TABLE 4.1 (CONTINUED)

Why the Commission needs this information	Questions	Actions	Types of evidence
How the application takes account of ratepayers' and communities' views			
We want to be sure that ratepayers and communities are aware of the variation and that their views have been considered.	**All variation applications:** • How has the council engaged with its ratepayers and communities on the requested rate increase? • What information was provided to ratepayers and community members during the engagement? • How has the engagement impacted the council's decision to seek a rate increase? • Is a rate increase the preferred option of the community? If not, why is it the council's preferred option? • Have the Commission's four key engagement principles been incorporated into the engagement? **Major new projects / material increases in service levels:** • Has the community been consulted on the proposal including the implications for the council's overall costs and revenue needs? **Asset management:** • Are asset management activities within community expectations and willingness/capacity to pay? • Are asset management expenditure projections based on reasonable and affordable service levels?	• Assess extent of engagement with ratepayers and the community on the options available and justification for the council's proposed option. • Review modelling of financial impacts on asset management need projections with various options in service level specifications from assets.	• A document setting out the council's consultation/engagement processes with ratepayers and communities including how the council gathers, records and incorporates the views gathered. This should include the council's rating strategy. • Information on results of past consultation/engagement relevant to the variation application. • Information on the engagement consultation on the current variation application. • Evidence of engagement/consultation with the community and community satisfaction with the proposed variation. • Evidence of modelling of the financial impacts of asset management needs, including options for varying service level specifications.

Continued next page

TABLE 4.1 (CONTINUED)

Why the Commission needs this information	Questions	Actions	Types of evidence
How the outcomes being pursued in the variation reflect the efficient use of council resources			
We want to ensure that the change in costs or services proposed by a council represents good value for ratepayers.	• Have sound processes to cost the expenditure been undertaken? • Are there benchmarks from the past or outside the council that demonstrate that costs are good value-for-money?	• Examine processes to ensure optimal cost/service outcomes when costing capital and operational work. • Gather material that can demonstrate that the variation application is funding items that are fit for purpose and the lowest cost for the selected level of service.	• Information on how the costs identified in the variation were incurred including tender documents if relevant.
What consideration has been given to reprioritising proposed expenditures and pursuing alternative funding options			
We want to know that councils have considered the prioritisation of services and different funding options before seeking a variation.[a]	• Why are the existing cost bases increasing? • What other funding options have been considered in addition to a rates increase? • What steps have been pursued to meet preferred expenditure through productivity and efficiency improvements? • Is it appropriate to raise rate revenue rather than reduce other service levels to meet priority needs? • Is the council satisfied the asset management expenditure projections are based on sound (cost-effective and timely) treatments for specified service levels?	• Identify drivers of the need for additional revenue. Are they controllable or non-controllable? • Identify all funding options to deal with the new spending priority. • Identify results from productivity and efficiency improvement programs.	• Information showing how the council has considered the possible reprioritisation of services. • Information showing consideration of differing funding options. • Information on councils' processes for seeking efficiencies and information on efficiencies used to offset increases in costs that have led to the variation. • Information showing drivers of cost increases and the extent to which they are non-controllable. • Community survey results showing community preferences, such as service level changes. • Evidence in asset management plan of rationale for timing and extent of projected asset management outlays (e.g. to minimise whole of lifecycle costs).
That the assumptions and proposals in the application are consistent with those in the council's long-term strategic planning and financial management instruments			
We want to ensure a proposed variation has been incorporated into a council's plans.	• Does the council have an up-to-date strategic resource plan, asset management plan and financial plan? • Is the proposed rate increase consistent with those documents?	• Review the council's strategic resource plan, asset management plan and financial Plan. • Confirm whether the need for additional revenue is identified in the strategic resource plan.	• Demonstrate the variation application is consistent with the council's strategic resource plan and long-term asset management and financial plans.

[a] This may be demonstrated through the baseline information.

5 COMMUNITY ENGAGEMENT

The terms of reference for this review state that the Government intends to promote rates and charges that are efficient, stable and reflective of services that the community needs and demands.

The centrality of ratepayer and community engagement in setting rates is not new.

According to the *Local Government Act 1989* (the LG Act), councils must comply with *Best Value Principles*, which include the need for a council to develop a program of regular engagement with its community in relation to the services it provides and to report regularly (at least once every year) on its achievements in relation to the *Best Value Principles*.[79] In applying *Best Value Principles*, councils may take into account community expectations and values as well as other factors.[80] Councils must also make public their council plans, which includes a strategic resource plan (SRP), and annual budgets for 28 days and receive submissions in that time.[81]

In our draft report, we recommended that councils wishing to increase their rates above the cap must, when applying for a variation, provide evidence of an effective engagement process with their ratepayers and communities. The council engagement process we envisaged would facilitate transparent and participative decision-making. The outcome of which is strategic input to each council's budget.

This chapter reviews the approach outlined in the draft report and in the context of the responses we subsequently received. Much of this concern relates to the Commission's expectations of the way councils report their community engagement around a rate variation. We respond to these concerns by outlining a more detailed mechanism for describing, defining and reporting how councils may demonstrate a case for a variation.

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79 Sections 208B (e) and 208B (f), *The Local Government Act 1989.*

80 Section 208C, *The Local Government Act 1989.*

81 Sections 125, 126, 127, *The Local Government Act 1989.*

5.1 DRAFT REPORT

In the draft report, we proposed that an application for variation would need to demonstrate that the views of ratepayers and communities have been identified and describe how their concerns have been addressed. We noted that this engagement in relation to a case for a variation would need to include the presentation of other realistic options for meeting the funding need and the trade-offs those options would entail. Importantly, applications would need to account for ratepayers' views on specific expenditure items or cost pressures (where relevant), as well as their impact on the council's overall budget position and rate requirements.

As noted in the draft report, where councils are already undertaking good engagement with their ratepayers and communities, we would expect this to be already reflected in their strategic resource plans, budgetary and planning decisions, financial performance, services outcomes and levels of community satisfaction. The proposed framework in the draft report seeks to align the Commission's expectations regarding the content of applications with councils' extant practices. Of course, the diversity in the local government sector means councils will differ in how they engage with their ratepayers and communities. We welcome these differences. Indeed, in recognition of this diversity, our draft report sought to:

- avoid mandating specific engagement techniques or prescriptive standards, as these would not be useful or helpful given the sector's diversity and the different needs of individual councils
- encourage greater sharing amongst councils on good and effective experiences on community engagement
- encourage peak industry bodies (such as the Victoria Local Governance Association (VLGA) and the Municipal Association Victoria (MAV)) to work closely with the sector to enhance the different means to consult and engage effectively with ratepayers and communities
- outline clearly a set of principles that exemplify good practice in community engagement.

We developed a set of four key engagement principles which we expect would be reflected in the engagement activities undertaken by councils in support of an application for a variation from the rate cap. These principles were based on feedback in submissions to our consultation paper. Taking these views into account and testing them against various national and international approaches or standards for engagement,[82] led to the four principles outlined in box 5.1.

BOX 5.1 KEY ENGAGEMENT PRINCIPLES

Principle 1: The engagement program must contain clear, accessible and comprehensive information and follow a timely process to engender feedback from the community

Councils need to provide their ratepayers and communities with clear, accessible and comprehensive information about the need for, and the extent of, proposed rate variations. This should also include information on the major trade-offs involved in the options that the community is being asked to consider.

The community should have adequate opportunities to consider an issue and provide feedback in a timely manner.

Principle 2: The engagement program should be ongoing and tailored to community needs

The program must take into account the characteristics of the community and aim to be as representative of the community's diversity as practicable.

It should be a two way dialogue which occurs on an ongoing process either through regular council planning or designed to address specific issues as they arise.

Its success is measured in how the engagement has impacted the decisions a council has made in regards to setting their rates. Councils should be able to demonstrate how, in making their decisions, they have considered information gathered during the engagement process.

Continued next page

[82] International Association for Public Participation Australasia, 2015, The IAP2 Public Participation Spectrum, http://www.iap2.org.au/resources/iap2s-public-participation-spectrum; *Victorian Auditor-General's Office January 2015,* Public Participation in Government Decision-making, Melbourne, http://www.audit.vic.gov.au/publications/20150130-Public-Participation-BPG/20150130-Public-Participation-BPG.pdf ; IPART, October 2014, Community awareness and engagement for special variation applications, Fact sheet for councils; http://www.ipart.nsw.gov.au

BOX 5.1 CONTINUED

Principle 3: The engagement program should prioritise matters of significance and impact

The engagement program should be fit for purpose, having regard to the significance of the matter at hand, and should demonstrate good value-for-money.

The focus of the engagement program should be on a discussion between councils and their ratepayers and communities about how rate levels impact on services and their prioritisation, as part of the SRP. Engagement with communities in relation to a proposed rate rise should be proportionate to the size and impact of the rise proposed.

Principle 4: The engagement program should lead to communities becoming more informed about council decision-making

Councils should be open and transparent about how rate levels impact on services and about how efficient they are in delivering those services the community needs, and in managing assets necessary for providing those services.

The role of the Commission, in assessing applications for rate variations, will include the consideration of ratepayers' and communities' responses to councils' proposals. The Commission will need to understand whether councils are meeting the reasonable expectations of their ratepayers and communities and how they have considered and responded to issues of common concern to its ratepayers and community.

Source: Essential Services Commission 2015, *Local Government Rates Capping & Variation Framework Review, Draft Report Volume II — Supporting material and analysis*, July, pp. 120-121.

In addition to these principles, the draft report also provided some indicative high-level questions that the Commission would expect councils to explore as part of their engagement processes and that would be discussed in their applications. These were:

- What services does the community value most?

- What services does the community want and how much is it prepared to pay for them?
- Does the community understand the level of services that are available with current rates?
- Does the community understand what the level of services would be with higher rates?
- Does the community understand how much the Council needs to spend to implement the services and why?

The Commission's expectations for community engagement as part of the variation process were captured in its draft recommendation 7:

> *The Commission recommends that the following five matters be addressed in each application for variation:*
>
> - *The reason a variation from the cap is required*
> - *The application takes account of ratepayers' and communities' views*
> - *The variation represents good value-for-money and is an efficient response to the budgeting need*
> - *Service priorities and funding options have been considered*
> - *The proposal is integrated into the council's long-term strategy.* [83]

Further discussion and examples were provided in the draft report and the Commission undertook to issue guidance notes following further consultation with the sector.[84]

83 Essential Services Commission 2015, *A Blueprint for Change, Local Government Rates Capping & Variation Framework Review — Draft Report Volume I*, July, p. 48.

84 See Table 3.2 in Essential Services Commission 2015, *A Blueprint for Change, Local Government Rates Capping & Variation Framework Review — Draft Report Volume I*, July and appendix C of Essential Services Commission 2015, *A Blueprint for Change, Local Government Rates Capping & Variation Framework Review — Draft Report Volume II — Supporting material and analysis*, July.

5.2 FEEDBACK ON DRAFT REPORT

Submissions to the draft report generally supported the recommendation that an application for variation takes account of ratepayers' and communities' views, as well as the key engagement principles outlined in the draft report. There was a notable exception, however. The MAV submitted:[85]

> *The Framework is strong on the need for community consultation and involvement however councils are generally on a 'hiding to nothing' when this relates to rates. As shown with experience with rating strategies vocal minorities often attempt to hijack the process and State assessments of whether consultation processes are adequate are often seen through the prism of these minorities rather than the community as a whole.*[86]

The strategic engagement we are expecting should take into account, and recognise, the diversity of views about rates not just those of the vocal minorities.

Ratepayers expressed their own frustrations with the opportunity to involve themselves in decisions that affect the rates they pay.

> *Few ratepayers take advantage of the chance to gain information from council consultations. I have tried to encourage others to attend these functions but I'm told that it is a waste of time. I must admit I feel that I merely participate in participation.*[87]

Some councils were concerned that the Commission's requirement for community engagement meant that community support was required for the approval of a variation request.

> *It would be entirely reasonable to expect Council to conduct community consultation for a proposed variation and the reasons as to why Council is seeking the variation. It is unreasonable however for the outcome of the variation application to hinge on a Vaux pop outcome of community views. Irrespective of how much a variation may be needed for the*

[85] These sentiments were echoed by the City of Wodonga.

[86] Municipal Association of Victoria 2015, *Submission to ESC's draft report*, August.

[87] Roma Haley 2015, *Submission to ESC's draft report*, August.

> *overall community wellbeing, it is very unlikely to receive popular support from a majority of the community.*[88]

A few submissions were concerned that the approach put forward by the Commission in the draft report may interfere with the decision-making responsibilities of councillors.

> *The current approach put forward by the ESC fails to pay regard to the fact that Councillors are elected under the Local Government Act (1989) to make decisions based on the good governance of the entire Council, and in the best interests of the community. The proposed rate capping and variation framework should not act to fetter these responsibilities.*[89]

> *…we do share many Councils' concerns on the expectations taking account of its community views. 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.*[90]

By far the most prominent concerns raised in submissions related to the burden, cost, and clarity of the Commission's expectations regarding community and ratepayer engagement.

Too onerous

> *It is likely that the resources required to make an application and in particular to effectively seek 'ratepayers and communities' views' will be considerable, adding another resource cost to councils. Resourcing of this requirement is also likely to be more onerous for smaller, less well-resourced councils who may have the greatest need to seek variations.*[91]

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[88] City of Greater Dandenong 2015, *Submission to ESC's draft report*, August.

[89] City of Greater Dandenong 2015, *Submission to ESC's draft report*, August.

[90] FinPro 2015, *Submission to ESC's draft report*, August.

[91] Hobsons Bay City Council 2015, *Submission to ESC's draft report*, August.

The proposed variation framework requires extensive additional documentation, scenario modelling, option considerations and consultation with the community.[92]

At this stage it is unclear how the variation process will impact on council's resourcing. It may be that it requires more resourcing to satisfy the Commission. This is based on the implicit message in the report that the current levels of community engagement around the budgeting process are inadequate to satisfy decision-makers. To counter this criticism, it is likely that we will need to scale up communications and community participation in the budget process.[93]

Cost prohibitive, beyond a council's capacity to meet, or would require additional resources in order to be met

The rate capping process is encouraging a community participatory approach to managing Council business rather than the current representative approach to budgeting. While this has positive benefits, it will most likely impose additional expense to councils to demonstrate sufficient evidence for a variation.[94]

A further layer of administration and cost is now borne by Council through this process. This will include specific consultation activities to ensure the particular variation requirements of the ESC are met, regardless of existing purpose-specific consultation activities and alignment with Council Plans and processes, and will skew diversion of consultation resources from other ongoing planning and performance initiatives.[95]

Moorabool submits that it estimates that it will need to appoint a new community engagement officer to accommodate the engagement requirements required to satisfy the ESC for a cap variation.[96]

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92 Hepburn Shire Council 2015, *Submission to ESC's draft report*, August.

93 Yarra Ranges Shire Council 2015, *Submission to ESC's draft report*, August.

94 Mansfield Shire Council 2015, *Submission to ESC's draft report*, August.

95 Banyule City Council 2015, *Submission to ESC's draft report*, August.

96 Moorabool Shire Council 2015, *Submission to ESC's draft report*, August.

There will be additional costs borne by Council in engaging with its community in a meaningful way to support a variation.[97]

Unclear and further guidance is required about what the Commission expects to see

The Council supports the draft recommendation that ratepayers be made aware of any variations and that their views have been considered, however, is concerned about the ability to appropriately demonstrate this in any application.[98]

…we are keen to better clarify the engagement requirements to support a variation. In particular the intent around demonstrating wide engagement undertaken with community versus a consensus from community supporting the need for a variation.[99]

The ESC will also need to be very clear about what additional engagement processes and evidence base will satisfy their requirements for variation applications.[100]

I note that the commission is not laying down rules how to conduct community consultations. For example, how well will it be advertised, what is the minimum percentage of residents/ratepayers needed to attend such consultations and means of approval of variation request.[101]

A community consultation framework that includes alternate options for meeting Councils funding needs, including the ability to identify trade-offs and project prioritisation, will also require significant resources and staff commitment to develop. Council recommends that the Commission provide guidance with regard to the expected engagement

97 Brimbank City Council 2015, *Submission to ESC's draft report*, August.

98 Greater Shepparton City Council 2015, *Submission to ESC's draft report*, August.

99 Mitchell Shire Council 2015, *Submission to ESC's draft report*, August.

100 Rural Councils Victoria 2015, *Submission to ESC's draft report*, August.

101 Steve Bahlen 2015, *Submission to ESC's draft report*, August.

process to enable Councils to better utilise their limited resources in order to satisfy ESC evaluation criteria.[102]

These concerns about the burden, cost and clarity of the Commission's expectations regarding community and ratepayer engagement also featured prominently in our many meetings and presentations around the state following the release of the draft report.

5.3 COMMISSION'S RESPONSE

We know that community engagement is difficult, time-consuming and that councils' efforts can often go unrequited. We appreciate that if ratepayers are simply asked whether they want higher or lower rates, they will inevitably favour the latter option. We understand that the value proposition that councils need to present to their ratepayers is complicated by the extraordinary array of services they provide. We have taken none of these difficulties for granted in forming our views about the centrality of community and ratepayer engagement in the variation process. Moreover, the overwhelming response from councils confirms the importance they place on involving their communities and ratepayers in important decisions.

Perhaps then, the main challenge we face in this final report is to clarify our expectations regarding the role of engagement in informing a variation application. Before doing so, we respond to two related issues noted above.

Community support as a pre-requisite for approval of a variation request and the role of councillors in decision-making

As the draft report stated, '*the application would need to demonstrate that the views of ratepayers and communities have been identified and describe how their concerns have been addressed.*'[103] Widespread community support is not necessarily required for an approval of a variation request. The Commission understands that the diversity of community and ratepayer views may mean consensus is unlikely to be reached.

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102 Baw Baw Shire Council 2015, *Submission to ESC's draft report*, August.

103 Essential Services Commission 2015, *A Blueprint for Change, Local Government Rates Capping & Variation Framework Review — Draft Report Volume I*, July, p. 20.

Furthermore, councils must weigh up the views of their ratepayers and community members against other relevant factors in their decision-making.

Our terms of reference require us to have regard for the autonomy of councils. We understand the democratic institutions within which they operate. In other words, councils inevitably face the competing priorities of their communities and councillors are elected to make decisions about whether and how to respond to those competing demands. We do not intend for the Commission to inject itself into decisions which are rightfully resolved by councils and their communities.

We are not seeking to interfere in the autonomy of councils and the decisions they seek to make in the best interests of their communities. Our role is limited to reviewing an application for a variation. The framework we have designed deliberately ensures the Commission is not placed in the position of having to represent, or make decisions about, the best interest of ratepayers. Indeed, the framework is predicated entirely on ensuring that the Commission does not usurp this responsibility from councils and councillors.

The suggested engagement process protects the autonomy of councils by providing them with the opportunity to demonstrate that the decisions they have made (and therefore the reasons for their application) have had regard to the interests of their ratepayers and communities. It is for councils, not the Commission, to take those interests into account. It is for councils to demonstrate that they have done so when submitting an application. And if they do so, then the Commission has no role in challenging whether those decisions have indeed been made in the best interests of ratepayers and the community.

Finally, it is worth noting that, in a formal sense, councils are required to demonstrate to the Commission that they have taken the interest of their ratepayers and communities into account when seeking a variation from the rate cap. In performing its duties, the framework requires the Commission to test whether councils have demonstrated this to their ratepayers. In other words, the Commission’s role is limited to assessing whether councils have demonstrated to their ratepayers that their interests have been taken into account when seeking a variation from the rate cap. The framework provides no place for the Commission to interfere in the relationship between councils and their communities.

Our expectations regarding the role of engagement

The second major issue respondents raised with us in submissions, and in our consultations around the state, was that many felt there was a lack of clarity around the requirements of a variation application. In the draft report the Commission highlighted that it was not prepared to prescribe how councils engaged with their communities in order to inform their applications. As described above in section 5.1, the draft report only offered some general principles and some indicative high-level questions that it thought might usefully guide councils' efforts to engage with their communities about rate increases above the rate cap.

The Commission indicated it would not assess a council's engagement program based on a single set of criteria or techniques. We also indicated that effective engagement is not necessarily demonstrated by the absence of community objection to a proposal. The draft report acknowledged councils' existing engagement processes and suggested that, based on the feedback we had received, we considered these existing processes could be sufficient for the engagement requirements of the framework. We did not consider it necessary to prescribe the engagement mechanisms councils should utilise.

We continue to hold that a good case for variation can be built around existing planning and engagement processes. We have designed the variation process to rely as much as possible on existing processes that councils undertake. As mentioned previously, we will be developing guidance materials for councils closer to the framework's implementation, including through working groups.

Despite this, throughout our consultations over the last few months, we continuously received feedback from councils that they already engage with their communities and that the Commission should not tell councils how to engage with their communities. At the same time, councils have sought clarity on how the Commission will assess how they engage with their communities.

From the Commission's perspective, we consider it would be difficult to provide guidance on how we would assess a council's community engagement without this guidance becoming prescriptive — or at least, we anticipate it will be interpreted as being prescriptive. And clearly neither the Commission nor councils want the Commission to be prescribing how community engagement should be conducted.

As such, we have devised a tool to model local government engagement which can help councils describe and discuss their community engagement for the purposes of making an application for variation. At the same time, the tool allows the Commission to describe its expectations *without* prescribing how that engagement is to be conducted. The purpose of **the tool is descriptive, not prescriptive**.

For the avoidance of doubt, this is a tool only. Councils may or may not use it when making an application for variation.

This tool consists of three elements: Form, Content and Timing.

Form: This element of this tool derives from the well-known IAP2 Public Participation Spectrum which defines the public's role in any public participation, or engagement, process.[104] It seeks to demonstrate how ratepayers and community members may participate in council decision-making. The spectrum demonstrates a scale of increasing involvement that ratepayers and community members might have in a decision-making process. The scale consists of five types of participation ranging from 'inform' to 'empower'. According to the IAP2 public participation spectrum, each level involves a 'public participation goal' and a 'promise to the public' (see table 5.1).

104 International Association for Public Participation Australasia, 2015, *The IAP2 Public Participation Spectrum*, http://www.iap2.org.au/resources/iap2s-public-participation-spectrum

TABLE 5.1 IAP2'S PUBLIC PARTICIPATION SPECTRUM

	Public participation goal	Promise to the public
Inform	To provide the public with balanced and objective information to assist them in understanding the problem, alternatives, opportunities and/or solutions.	We will keep you informed.
Consult	To obtain public feedback on analysis, alternatives and/or decisions.	We will keep you informed, listen to and acknowledge concerns and aspirations, and provide feedback on how public input influenced the decision. We will seek your feedback on drafts and proposals.
Involve	To work directly with the public throughout the process to ensure that public concerns and aspirations are consistently understood and considered.	We will work with you to ensure that your concerns and aspirations are directly reflected in the alternatives developed and provide feedback on how public input influenced the decision.
Collaborate	To partner with the public in each aspect of the decision including the development of alternatives and the identification of the preferred solution.	We will work together with you to formulate solutions and incorporate your advice and recommendations into the decisions to the maximum extent possible.
Empower	To place final decision-making in the hands of the public	We will implement what you decide.

Source: International Association for Public Participation Australasia, 2015, *The IAP2 Public Participation Spectrum*, http://www.iap2.org.au/resources/iap2s public participation spectrum

Content: A further element of the descriptive tool relates to what is subject to engagement. The most elemental level involves engagement around a single initiative. That initiative may be small or large in scale. It could involve a specific service, project or investment with an impact that is very local or limited in reach; alternatively the impact could be widespread across the council area and population.

At the next level, the engagement might entail community or ratepayer participation on multiple initiatives; and eventually, it might involve decisions regarding the entire budget. The most expansive level of engagement on content would see ratepayers and communities involved in debating and deciding between different priorities, that is, assessing how to respond to the trade-offs between competing demands (including, for example, more services or lower rates).

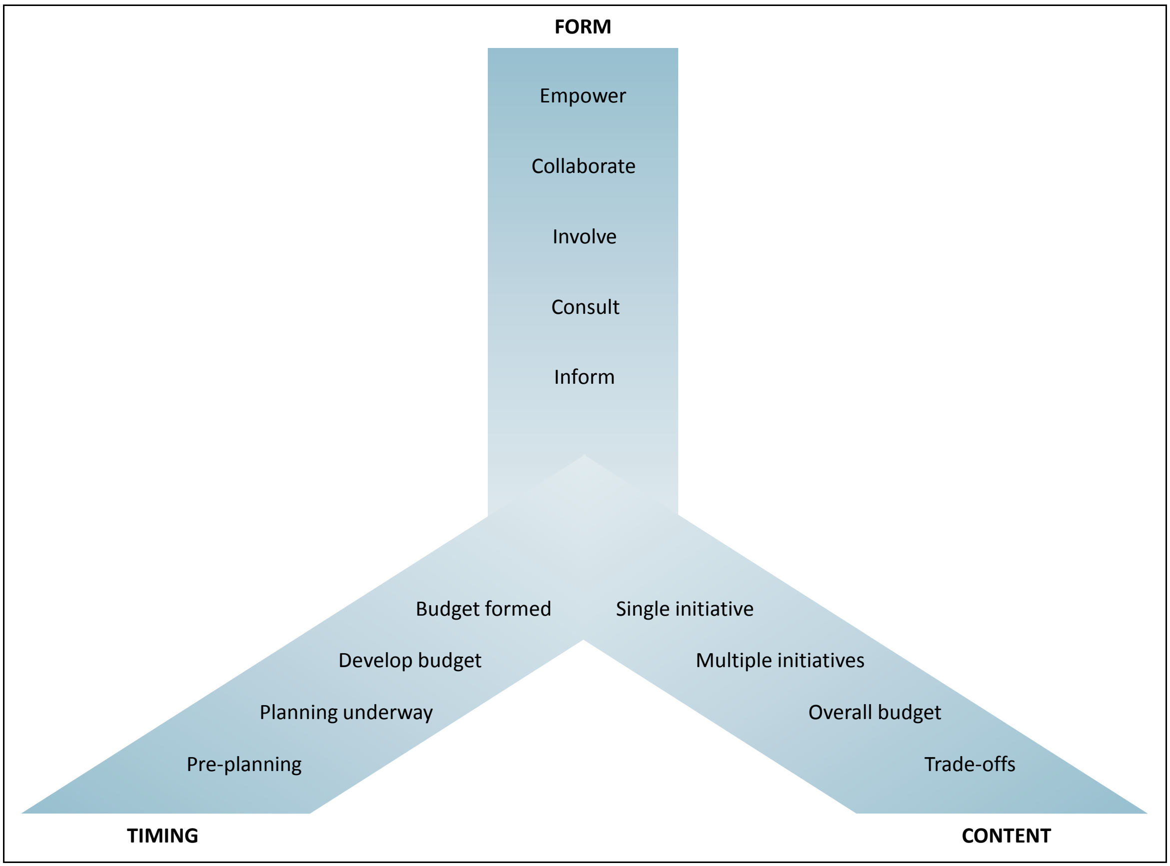
Timing: The third element of this tool relates to <u>when</u> engagement takes place. For this purpose, it is easiest to delineate time in terms of councils' existing planning and budgeting processes. Working backwards: the latest stage at which a council might engage on its rate requirements (that is, to inform its variation application) would be once its budget is fully formed. Earlier engagement could take place during the development:

- of the budget, or earlier still, when councils are undertaking their annual or longer term planning. For example: during the development of the council plan and budget (including the SRP)
- of councils' long-term plans, which then inform councils' SRPs and budgets
- of other specific strategies and policies such as service delivery and infrastructure strategies and key project proposals that then feed into the SRPs, council plans and budgets.

Of course, councils and councillors engage with their communities outside, and prior to these formal planning and budgeting processes.

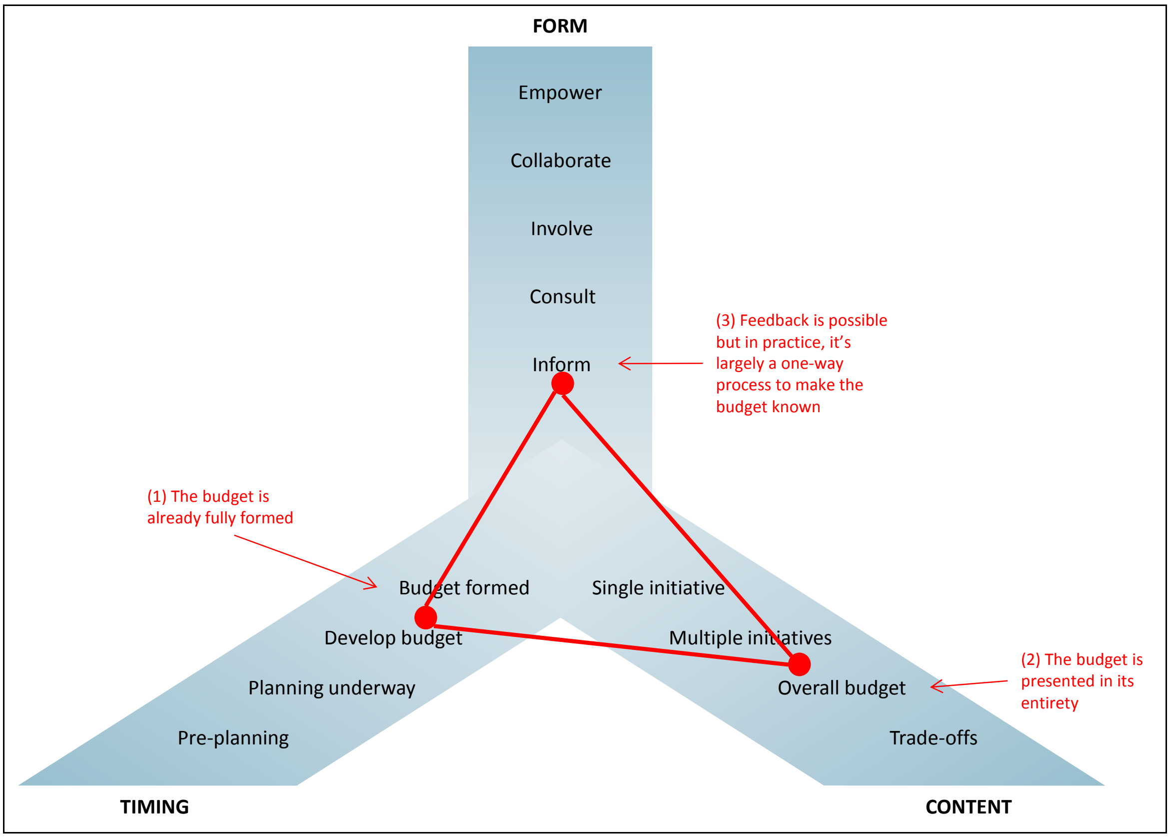
Together, these three elements provide a medium for defining, describing and discussing what councils already do and what the Commission might expect as part of a variation application. The three elements are combined in figure 5.1.

FIGURE 5.1 EXPLANATORY TOOL FOR COMMUNITY AND RATEPAYER ENGAGEMENT



The tool can be used to demonstrate existing consultation activities. For example, Section 223 of the LG Act requires councils to make available to the public their budgets for 28 days prior to council adopting the budget. This legislative obligation is plotted against the tool as shown in figure 5.2.

FIGURE 5.2 SECTION 223 OBLIGATION TO MAKE BUDGET PUBLICLY AVAILABLE

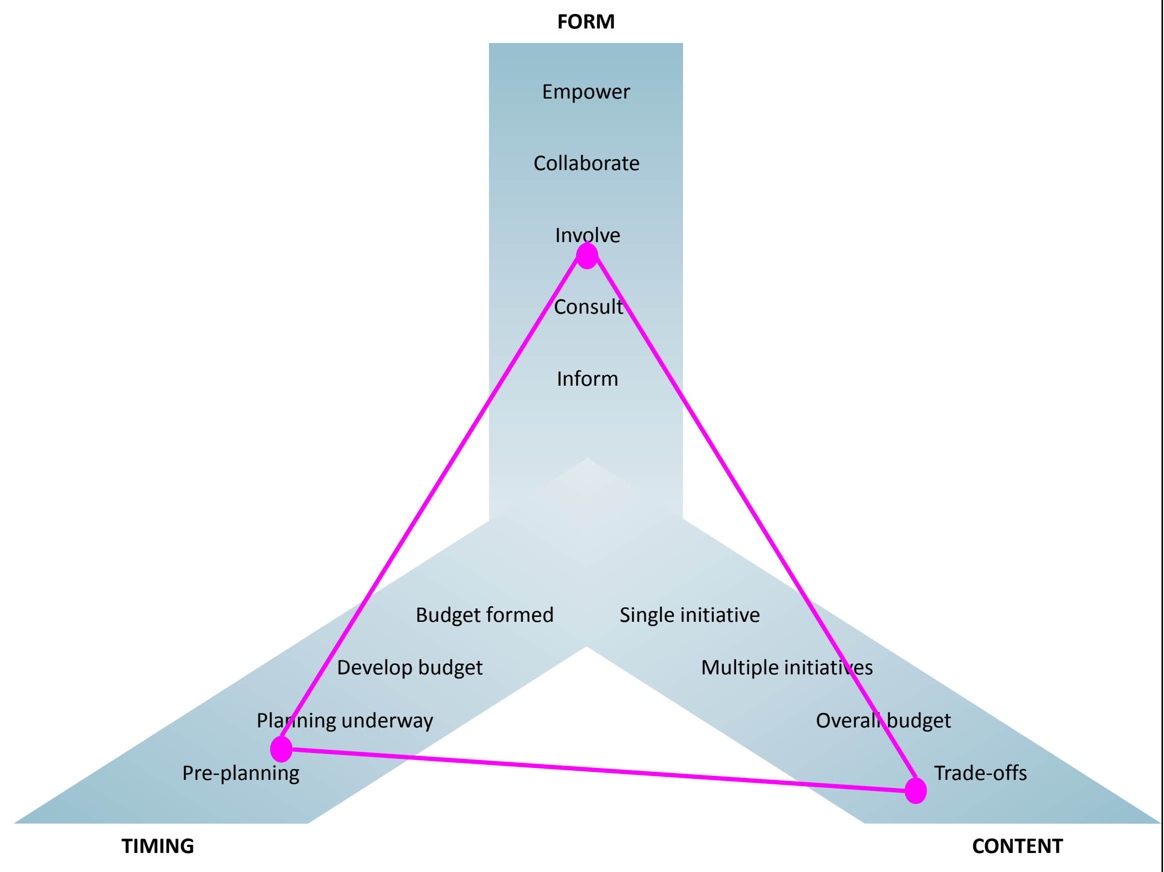


While this example includes one particular consultation activity, we understand other forms of engagement may entail multiple activities. In other words, a triangle plotted on the tool does not necessarily reflect a single activity at a single point in time. It might involve a program of engagement activities over a period of time.

Generally speaking, the more expansive the engagement, the larger the triangle will be (as shown in figure 5.3). That is, ratepayers are brought into the discussions with their council earlier (timing), across a broader suite of decisions (content), and at a level appropriate for their community (form) in terms of their impact on whether the council proceeds with an application for a variation.

Examples such as councils' use of deliberative forums and citizen juries to guide or determine their decision-making regarding budgets would likely encompass almost the entire diagram. Whereas other examples such as the use of surveys or listening posts in the planning of a particular services implementation would encompass smaller areas of diagram.

FIGURE 5.3 MORE EXPANSIVE ENGAGEMENT



Again, and for the avoidance of doubt, the Commission is not requiring that councils must always use an engagement approach akin to the one represented by the pink triangle in figure 5.3. It will always remain with council to determine the most appropriate form of engagement in the circumstances. However, we would expect that where the intended variation is material and its underlying causes are diffuse, then the council would engage with ratepayers in a more expansive manner. Where the cause is less diffuse, or singular, it may be appropriate for the council to adopt a form of engagement represented by a ‘smaller triangle’. Whatever approach is adopted, council will need to describe its engagement strategy (as well as the reasons for adopting that approach) in its application for a variation.

Community engagement in relation to both the basis for council service provision and final budget setting is an important component of considering and demonstrating variation applications. It is appreciated that the activity of engagement generally can vary considerably depending on the engagement topic, stakeholders, depth of need, and resources available, to name just a few. As discussed in chapter 4, the variation process will require information in proportion to the magnitude of proposed variations above the cap. This principle of proportionality also applies to the Commission's expectations for councils around community and ratepayer engagement in relation to a variation application. The design of community engagement **should be proportional to the variation** sought. It is reasonable to expect that councils provide more in-depth and robust evidence to support a higher variation above the approved cap.

5.4 CONCLUSION

The Commission reaffirms its earlier position that councils be required to consult with their ratepayers on the matters relating to their application for a variation. This chapter has sought to address some of the concerns and misunderstandings that arose following the release of our draft report. In keeping with our draft report, we will not prescribe how, when or in what form councils should engage with their communities. The tool described above may assist councils to report on their approach to engagement. It may also assist them to design their approach but it is by no means mandatory.

In assessing applications and in keeping with the principles of good engagement outlined in the earlier section, we will be looking for evidence that councils have:

- developed appropriate engagement programs which will give them the necessary insight to ratepayers' position on their budget and therefore on the elements in the variation they intend to seek
- used that engagement to present relevant options and trade-offs in a transparent and timely manner, and
- had regard to the diversity of ratepayers' views in reaching the variation for which they are applying.

We will continue to consult on the development of relevant guidance material through our technical working groups prior to releasing formal guidance notes by the end of November 2015.

6 MONITORING AND REPORTING

Monitoring outcomes is the necessary third element (in addition to the rate cap and variation process) of the framework the Commission has been asked to develop. The terms of reference ask the Commission to consider the monitoring of council performance so that deteriorations in service delivery, infrastructure or financial position can be identified and addressed promptly. The Commission is also requested to consider any benchmarking or assessment of the effectiveness of the framework.

This chapter outlines the monitoring and reporting element of the proposed rate capping and variation framework in light of comments received since the release of the draft report.

6.1 WHY IS MONITORING SO IMPORTANT?

Without monitoring, the procedural arrangements of the rate capping and variation processes can remain disconnected from the 'real world' outcomes experienced by ratepayers and communities in their daily lives. Public reporting of these outcomes allows ratepayers to verify the linkages between the rates they pay and the outcomes they observe. In other words, well-designed monitoring and reporting can inform ratepayers' assessment of the value-for-money delivered by their councils, as well as how this might change over time. As the framework matures, it should also support comparisons with other councils.

Effective monitoring and reporting can also assist councils to demonstrate the value-for-money they deliver with the resources they have available. Not only can this support how councils communicate with their communities, but it can also assist them to communicate with other levels of government about the trade-offs faced by local government.

Monitoring and reporting will also provide opportunities for additional benchmarking of performance, as the data set becomes more consistent and robust over time.

One of the key concerns identified throughout this review, particularly by councils and peak bodies, was the risk that councils may reduce their expenditures on services, in order to avoid the variation process. Many submissions cited the current financial and infrastructure challenges facing the local government sector in NSW as evidence of the potential impacts and unintended consequences of a rate capping framework. We have noted these concerns. We are confident that our proposed monitoring and reporting arrangements will promote transparency of, and accountability for, rate and service outcomes in Victoria by highlighting unexplained reduced performance.

In the draft report, we made two recommendations with respect to the monitoring and reporting element of the framework. We recommended that we:

- monitor and publish an annual rates report on councils' adherence to the cap and any approved variation conditions (draft recommendation 10)
- monitor and publish an annual monitoring report on the overall outcomes for ratepayers and communities (draft recommendation 11).

In the draft report, we discussed our intention to use existing councils' reports to the Victoria Grants Commission (VCG), annual reports and the Local Government Performance Reporting Framework (LGPRF) to the greatest extent possible as the source of the data to inform our proposed monitoring functions.

We also outlined the development of a 'baseline information' template to assist the councils to demonstrate the need for a variation and to assist the Commission to monitor the broad performance outcomes under the framework.

The draft report also discussed that we could (in consultation with the sector) develop further measures in the future, should we find gaps or weaknesses in the existing data sets.

In the draft report, we also discussed the opportunity to develop sectoral accounts that would include standardised definitions and measures specifically designed for use by local government. We found that currently available data contains numerous limitations, particularly the lack of consistent measures in respect of asset renewal and the lack of consistent service standards and detailed financial information (input costs) disaggregated on a per-service basis. We concluded that addressing these limitations would be an ongoing task and, while important, not a prerequisite for the implementation of the rate capping and variation framework.

We also recommended that the Government consider reviewing the operation and effectiveness of the framework on a 4-yearly basis (see chapter 8).

6.2 COMPLIANCE MONITORING AND REPORTING

The draft report recommended that the Commission monitor and publish an annual rates report on councils' compliance with the cap or any approved variation to the cap. Amongst other things, these reports would address: year-on-year changes in rates, discrepancies between forecast and actual outcomes, and broader trends within and across the local government sector. Councils would be invited to provide comments explaining any unexpected or unusual findings. We noted that non-compliance would be best dealt with through further investigation and referral of our findings to the Minister for Local Government (the Minister).

6.2.1 FEEDBACK ON DRAFT REPORT

The majority of submissions that responded to the Commission's recommendations with regard to monitoring and reporting on council compliance with the rate cap expressed support for what we proposed and recognised that the Commission had a an important role to play. For example, the Victorian Farmers Federation was:

> *supportive of the publication of an annual rates report. Transparency through the application of the rate cap is vital and a compiled document*

> *of the trends across the state will be beneficial information – especially with a review to occur after the first years of the operation of the cap.*[105]

Four councils, FinPro and the Interface Councils provided in principle support but cautioned against the imposition of any further administrative burden on councils.

A few submissions questioned whether this role could be fulfilled by other relevant agencies such as the Auditor-General or whether the LGPRF could be expanded to include compliance with the framework.[106] It was also suggested that compliance with the cap could be reported by councils in their individual annual reports.[107]

Some submissions raised concerns that the rate cap compliance report might be used by the media to publish 'league tables'. For example, FinPro stated:

> *The danger is that the media will use the information to create league tables as experienced by Councils in the past. An alternative would be to have Councils publish results in their annual reports. While FinPro understands the role of monitoring for compliance we would oppose the framework becoming a vehicle to impose further regulation on the sector.*[108]

Greater Shepparton City Council requested further clarity about the consequences for non-compliance and noted what it perceived as a 'subjective' approach.[109] Yarra Ranges Council stated that giving the Commission referral powers in regards to an investigation of non-compliance duplicated existing powers vested in executive government.[110]

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105 Victorian Famers Federation 2015, *Submission to ESC's draft report*, August.

106 Mount Alexander Shire Council 2015, *Submission to ESC's draft report*, August, Murrindindi Shire Council 2015, *Submission to ESC's draft report*, August, Ratepayers Victoria 2015, *Submission to ESC's draft report*, August.

107 FinPro 2015, *Submission to ESC's draft report*, August and Corangamite Shire Council 2015, *Submission to ESC's draft report*, August.

108 FinPro 2015, *Submission to ESC's draft report*, August.

109 Greater Shepparton City Council 2015, *Submission to ESC's draft report*, August.

110 Yarra Ranges Council 2015, *Submission to ESC's draft report*, August.

6.2.2 COMMISSION'S RESPONSE

The Commission remains of the view that ongoing monitoring and reporting of councils' compliance with the cap or an approved variation above the cap is crucial to maintaining the integrity of the framework. The Commission is well placed to undertake this role and to do so impartially and transparently. It would compile its findings on each council in a short report to be published following each rating year. Councils would be given the opportunity to provide an explanation for any non-compliance identified by the Commission, and these comments would be reflected in the public report (with the council's agreement).

While we understand the concerns expressed about the possibility that other parties may use these reports to publish 'league tables', we consider councils will have ample opportunity to explain their rates, rating strategies and any instances of non-compliance with the cap (through their own reporting as well as the Commission's compliance report).

In response to concerns raised about the imposition of additional reporting burden, we confirm our commitment to utilise, to the greatest extent possible, measures already reported by councils. Table 6.1 provides an overview of the data we will be monitoring for the purpose of assessing compliance. The data identified in the table remains largely unchanged from the draft report.[111] The technical working group we have established will continue to refine the specific information we will collect from councils annually to support the proposed rate capping framework.

[111] ESC 2015, *A blueprint for change: Local government rate capping & variation framework review, draft report – volume I*, July, table 2.4, p.16.

TABLE 6.1 INDICATIVE INFORMATION TO BE MONITORED FOR COMPLIANCE WITH THE CAP AND APPROVED VARIATIONS

	Actual (2015-16)	Forecast (2016-17)	Forecast (2017-18)
Total council revenue requirement (all sources)			
General rates			
Municipal charges			
Service rates & charges			
Special rates & charges			
Supplementary rates			
Annualised supplementary revenue			
Statutory fees & fines			
User fees & charges			
Net gain(loss) on disposal of property, infrastructure, plant and property			
Other income			
Grants (all sources)			
Contributions – monetary			
Contributions – non monetary			
Miscellaneous			
Total value of rateable assessments[a]			
Total number of rateable assessments as at 1 July[a] (no.)			
Average rates per assessment			
Breakdown of garbage related costs:			
Council cost			
Landfill levy			

[a] At the commencement of the financial year.

Much of this information is already publicly reported by councils and so does not impose any further burden. All councils will have ready access to this information in their budgets and long-term financial plans. The only new requirement is some additional forecasting of revenue.

Regarding the consequences for non-compliance, the terms of reference for this inquiry do not envisage the Commission playing an enforcement role. Responding to instances of non-compliance with the cap or an approved variation remains the responsibility of the Government or one of its agencies such as Local Government Victorian (LGV) or the Local Government Compliance Inspectorate. The Commission's role would be to gather information on the cause of the non-compliance, in consultation with the council, and report the matter to the Minister. The Commission's report to the Minister would include any commentary submitted by the council.

6.2.3 FINAL RECOMMENDATION 9

The Commission recommends that it monitor and publish an annual rates report on council's adherence to the cap and approved variations.

6.3 MONITORING AND REPORTING OUTCOMES UNDER THE FRAMEWORK

Perhaps the single most important benefit of an effective rate capping and variation framework is the quality assurance mechanism it provides ratepayers and communities by informing their assessment of the value-for-money delivered by their councils. We have found in other sectors that independent scrutiny, analysis and reporting of these outcomes is essential for providing users and providers of services with confidence in the integrity of the overall framework.

Importantly, we consider that this scrutiny over outcomes should be applied to all councils — not just those seeking a variation above the rate cap. Indeed, the problematic consequences attributed to the NSW rate pegging arrangements arose in those councils which did not seek approval for higher rates.

In the draft report we proposed using and consolidating existing performance data from:

- councils' existing reporting instruments — including: annual reports, budgets, council plans and strategic resource plans
- the annual LGPRF to be compiled by LGV and the Community Satisfaction Survey
- data collected by the VGC and financial sustainability indicators compiled by the Auditor-General

- and possibly the asset management data reported by the Municipal Association of Victoria (MAV) through its STEP program.[112]

And using:

- the information that we collect through the rate capping and variation processes described in earlier chapters.

We proposed only developing additional measures of performance with respect to services, infrastructure or financial performance if we found gaps or weaknesses in the existing data sets. And, we committed to working with councils to determine the best approach for defining and collecting the required information.

The first step in this process is the development of a 'baseline information' data template that all councils would complete and submit each year that provides additional asset and financial information in relation to councils' services, in consultation with our technical working group. This information will be used to assist councils and the Commission during the variation process and to monitor changes in services, asset and financial outcomes.

The draft report acknowledged that increasingly sophisticated measures of efficiency will become possible as the data set becomes more robust and consistent. This includes benchmarking opportunities.

[112] The package of asset management tools developed by the MAV known as the STEP program was created to assist councils to improve their planning and asset management. The STEP program utilises a renewal gap calculation based on an assessment of the condition of the asset, in contrast to the accounting approach based on straight-line asset depreciation. The usefulness of the MAV STEP data as a consistent measure of asset management performance will need to be further evaluated.

6.3.1 FEEDBACK ON DRAFT REPORT

Most submissions broadly supported the proposed monitoring role that would support the rate capping and variation framework. Indeed, a number of submissions recommended expanding the Commission's role to look at changes in council costs. Baw Baw Shire Council believed that for councils to adequately demonstrate the impact of rate capping to services there should be a more robust assessment of the current and proposed future services costs in a rate capping environment.[113] Others noted:

> *Council supports the ESC's proposal for an Annual Report on the rate cap and approved variations as well as an Annual Report on the 'overall outcomes for ratepayers and communities'.*[114]

> *It is important that there is transparency and accountability through the process.*[115]

Some councils questioned whether the Commission had overstepped its terms of reference in proposing a monitoring framework, while others objected to the Commission's proposed role in monitoring outcomes under the framework.

> *The report and recommendation equates local government, which supplies hundreds of services, with single business entities such as water corporations and electricity companies, and suggests a role for itself that it is frankly not likely to be able to fairly and impartially perform and which discredits the integrity of local government and its elected representatives. Councils are already subject to the new Local Government Performance Reporting Framework (LGPRF) and financial scrutiny by the Auditor General, as well as a host of other regulatory requirements. In this instance the proposal is considered heavy-handed and inappropriate.*[116]

113 Baw Baw Shire Council 2015, *Submission to ESC's draft report*, August.

114 Yarra City Council 2015, *Submission to ESC's draft report*, August.

115 Colac Otway Shire Council 2015, *Submission to ESC's draft report*, August.

116 Hobsons Bay City Council 2015, *Submission to ESC's draft report*, August.

Similar views were expressed by Whitehorse City Council, which queried the suitability of a monitoring framework when councils are responsible for providing a very broad suite of services to their communities.

> *Councils typically provide more than 100 different services to its community. These require a breadth of activities, inputs and expertise that is unmatched in the private sector or indeed statutory bodies such as water boards which typically specialise in a small number of well-defined core offerings.*[117]

The Australian Services Union (ASU) raised a slightly different concern about the effectiveness of the monitoring framework.

> *ASU is especially concerned that in a local government election year, councillors — and the decision on whether a council applies for a variation will be a political one made by councillors, not an administrative one made by officers — will be extremely reluctant to apply for a rates variation lest they be seen as having failed to adequately manage their council budget, failing to living within the means of the false benchmark set for them by the Commission and it's state-wide, one-size fits all rate cap. And while the Commission asserts that its monitoring process will aid in the endeavour to avoid Councils doing these things, the reality is that no means of compelling Councils to apply for a rates variation is there, either in the framework or the Local Government Act. Thus, and with all due respect, the ASU believes the Commission's proposed safeguard in the form of the monitoring system, will be ineffectual, impotent and ignored by Councils.*[118]

The submission from the Victorian Local Governance Association (VLGA) questioned the value the proposed monitoring and reporting would add in understanding the performance and financial sustainability of the sector, stating:

> *This will not provide any additional value in understanding the performance and financial sustainability of the sector — particularly*

[117] Whitehorse City Council 2015, *Submission to ESC's draft report*, August.

[118] Australian Services Union 2015, *Submission to ESC's draft report*, August.

given that the community will shortly have access to performance reporting data.[119]

The submission recommends that the review of the *Local Government Act 1989* (The Act) provided an opportunity to consider the appropriate roles and responsibilities of relevant agencies.

A small number of submissions, including from the MAV, questioned whether the Commission was the appropriate agency to undertake this role, particularly in regards to monitoring and reporting on broader performance outcomes under the framework. One council suggested that this function should sit with LGV, due to its existing knowledge of the sector. Two submissions recommended that the Auditor-General's role be expanded to encompass this role. Some councils also questioned whether the Commission had exceeded its terms of reference and suggested that the monitoring and reporting elements of the framework were a 'vehicle to impose further regulation on the sector'.

As with the compliance reporting, concerns were raised that outcomes reporting by the Commission would support other parties developing 'league tables' of councils' performance. The Wellington Shire Council was concerned that league tables 'may signal incorrect parallels between Councils'.[120]

A common theme identified in council submissions was the desire for the Commission to make use of existing public reports to the greatest extent possible and that any additional monitoring should not impose excessive administrative burden on councils.

> *Any reporting undertaken by the ESC should leverage existing reporting undertaken by Local Government, ie: the Local Government Performance Reporting Framework, which has commenced for 2014/15 reporting.*[121]

> *Much of the data that is suggested for the monitoring component of the framework is already available and many elements have historical data available. It is therefore recommended that monitoring reports begin with*

119 VLGA 2015, *Submission to ESC's draft report*, August.

120 Wellington Shire Council 2015, *Submission to ESC's draft report*, August.

121 Wyndham City Council 2015, *Submission to ESC's draft report*, August.

some historical figures to allow some degree of pre and post-implementation analysis.[122]

Council agrees with the ESC that adherence should be monitored, however in saying that, any increase on reporting requirements of Council will create further process and lead to increased resource requirements. Therefore the preference is that the ESC remains focused on developing a streamlined approach to monitoring requirements that are consistent with the terms of reference.[123]

6.3.2 COMMISSION'S RESPONSE

These concerns can be grouped into three broad categories relating to:

- the role of the Commission in recommending and overseeing the implementation of outcomes in monitoring and reporting arrangements
- whether our recommended monitoring and reporting framework is adding value to the sector (including concerns that the data collected might be used to make 'league tables' by the media), and
- the level of administrative burden and concerns that what we are proposing might lead to further regulation of the sector in the future.

We respond to each of these concerns below.

The terms of reference explicitly asked the Commission to consider what monitoring and reporting arrangements should be part of the framework, such that any deterioration in performance or sustainability could be identified and promptly addressed.

The terms of reference also asked the Commission to consider any benchmarking of the effectiveness of the framework and council performance. Furthermore, during the first round of consultation, numerous submissions from the sector identified potential risks associated with the framework and actively called for robust monitoring and reporting of outcomes. Indeed, during our consultations we were repeatedly advised of the problems encountered in NSW when a rate capping framework was implemented

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[122] Indigo Shire Council 2015, *Submission to ESC's draft report*, August.

[123] Mitchell Shire Council 2015, *Submission to ESC's draft report*, August.

(37 years ago) without any attention given to monitoring the consequences that ensued.

The Commission remains firmly of the view that a program of ongoing monitoring of performance outcomes in relation to services, infrastructure and financial position is a vital third element of the framework. Reporting these outcomes ensures that communities, councils and the State Government have ready access to transparent, reliable and timely information about the relationship between rates and service outcomes.

The MAV and a small number of councils advanced the argument that the Commission cannot be an impartial observer in monitoring outcomes under the framework because our decisions in respect of variations will impact on those outcomes.

Our proposed role is highly limited. We have sought no powers of enforcement or responsibilities for ensuring broader compliance with the Act. Our proposed powers would be limited to setting the cap, deciding on whether to approve or reject a variation application, and information gathering and reporting.

Any monitoring we undertake would be focused on compliance with, and the outcomes achieved, under the rate capping and variation framework. Agencies such as the Auditor-General and LGV have a role in reporting on financial and broader sector performance. We view our role as adding value to (as opposed to duplicating) the work of these agencies by drawing this information together in a way that can assist communities and ratepayers to make a more informed assessment of the value-for-money received from the rates they pay to their councils.

As matters stand, ratepayers who may be interested in assessing the value-for-money they receive from their council would need to consider numerous council reports, the LGPRF (upcoming), the Council Community Satisfaction Survey as well as reports released by VAGO and the VGC. It would be difficult to be across all of these reports and it is unlikely that more than a handful of engaged ratepayers would ever have the time or resources to embark on such an onerous mission. To suggest otherwise, is to dismiss the barriers that currently exist for ratepayers interested in the effectiveness and efficiency of their council.

That being said, there may be merit (as suggested by LGPro) in the Government considering how the responsibilities of the relevant agencies are defined as part of the broader review of the Act currently underway.

In the design of the monitoring and reporting element of the framework, we have attempted to strike a balance between capturing meaningful information about council performance under the framework and not imposing additional or excessive reporting burden and cost to councils.

The information requirements we are proposing are drawn almost entirely from existing council reports. Where we have introduced new reporting requirements, such as the baseline information template[124], we have done so in close consultation with the sector and have carefully balanced the reporting requirement against any additional cost it imposes. Indeed, much of the data included in the template is drawn from annual reports, budgets and councils' submissions to the VGC. Collated in this way, the baseline template provides a simplified form that will assist councils to demonstrate the need for a variation and for the Commission to monitor outcomes in relation to services and infrastructure. The only additional requirement in the baseline template relates to more detailed information about capital expenditure by asset class and the associated renewal needs. This is information that all councils should have as part of their asset management plans and long-term financial plan.

A number of respondents interpreted our commentary as suggesting that the Commission was seeking to introduce an 'expanded regulatory framework'[125] and that we were equating local government with the energy and water sectors. This was certainly not our intention. Our only purpose in referring to the utility sectors (where we have direct regulatory responsibilities) was to illustrate the importance of compiling information that provides interested parties — whether they be ratepayers or customers — with a holistic view of the value-for-money they are receiving. Indeed, we were seeking to emphasise that the greater challenge for local government in comparison to these sectors arises precisely because of the diversity of services councils provide and the different accounting and reporting practices they adopt. This in no way infers that a similar regulatory approach is appropriate.[126] Nor does it imply that we should avoid making this information available in a useful and comprehensive format simply because it represents a more complicated challenge in local government.

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124 The latest version of the baseline data template can be found on the ESC's website.

125 Whitehorse City Council 2015, *Submission to ESC's draft report*, August.

126 In the discussion of options in Volume II, Chapter 4, the Commission dismisses such an approach as inappropriate for the sector given the existing reporting and accountability provisions in the sector and the level of administrative burden that would be required. See ESC 2015, *Local Government rate capping & variation framework review, Draft report volume II — Supporting material and analysis*, July.

Importantly, throughout our draft report we emphasised our commitment to working with councils and any other interested parties to overcome these complex challenges. For the avoidance of doubt, we confirm that commitment here.

6.3.3 FINAL RECOMMENDATION 10

The Commission recommends that it monitor and publish an annual monitoring report on the overall outcome under the rate capping and variation framework for ratepayers and communities.

6.4 WHAT PUBLIC REPORTS WILL WE RELEASE EACH YEAR?

Regular public reporting is crucial to maintaining transparency and accountability around the impact of the framework, the role of the Commission as the administrator and councils' performance under the framework. Table 6.2 outlines the key reports that the Commission will produce with regard to the rate capping and variation framework. The publication date for most of these reports will depend on the final timelines adopted for the framework (see section 7.1).

TABLE 6.2 FRAMEWORK REPORTING

Key Reports

Report	Description
Setting the rate cap	In May, following the state budget, the Commission will issue a statement with its forecast for the rate cap for the next financial year and the following two years. In December, following release of the state budget update, the next year's rate cap will be finalised and published along with the forecast for the two following years.
Variation Applications	At the conclusion of the application period for rate cap variations, the Commission will issue a statement summarising details of each application received for a rate variation above the cap.
Variation Decision(s)	The Commission will publish reports detailing the outcome of each application for a variation above the rate cap (approval or refusal). Each report will detail the basis for the Commission's decision.
Annual Rates Report	Each year the Commission will publish a report into councils' adherence with the rate cap or relevant variation conditions in the financial year just completed.
Annual Monitoring Report	The Commission will release a report on the performance of the framework. The report will bring together information about the cap and variations, with key findings from our monitoring. We initially expect this report will be available in February each year but will endeavour to bring forward its publication as the framework matures.
One-off reports	From time to time, the Commission may issue one-off reports into matters pertaining to the operation of the framework.

7 IMPLEMENTING THE FRAMEWORK

Previous chapters have described the structural design features of the three elements of the rate capping and variation framework — namely: the rate setting arrangements, the variation process, and the monitoring and reporting of outcomes. This chapter addresses the framework's implementation requirements.

7.1 WHAT WILL BE THE TIMELINES FOR THE CAPPING AND VARIATION PROCESS?

In developing a timetable for the framework we sought to:

- provide sufficient time for councils to prepare for a variation following the announcement of the cap
- provide time for the Commission to properly consider the applications from councils for variations and
- fit into the existing timelines for councils' budgetary and planning processes.

7.1.1 FEEDBACK ON DRAFT REPORT

In the draft report we set out a proposed timeline for 2016-17 implementation year and sought feedback on whether there is merit in allowing for a later adoption of council budgets (August), to provide more time for consultation.

Many submissions received in response to the draft report highlighted problems with the proposed timelines for applying for and the Commission assessing variations above the cap.[127] These concerns commonly related to:

- The ability of councils to meet their statutory obligation to place their draft budgets on public notice for a minimum of 28 days under Sections 129, 130 and 223 of the *Local Government Act 1989*. Concerns were also raised about the need to produce two budgets — one with and one without the variation above the cap.
- Some rural councils advised that council does not meet in January and thus would not be able to approve a notice of intention to apply.
- MAV requested further clarification of the precise dates — e.g. early or later March, early or late May.
- Several councils rejected the idea that budgets could be adopted later than 30 June. This position was strongly expressed in the technical working group on the grounds of the need for budgetary certainty and maintaining good financial management. The exception to this was the Mount Alexander Shire Council which questioned whether an exemption of 1-2 months to adopting the budget by 30 June could be applied in the first year of the framework.[128]

[127] LGPro 2015, *Submission to ESC's draft report*, August, Manningham City Council 2015, *Submission to ESC's draft report*, August, Monash City Council 2015, *Submission to ESC's draft report*, August and Mitchell Shire Council 2015, *Submission to ESC's draft report*, August.

[128] Mount Alexander Shire Council 2015, *Submission to ESC's draft report*, August.

7.1.2 COMMISSION'S RESPONSE

The Commission recognises and is sympathetic to these issues, particularly for the 2016-17 financial year. It is important that the timeline for applying for variation is workable and provides sufficient time for meaningful and targeted community engagement about the need for a variation.

We consider that it would be appropriate to allow councils to have a flexible approach, including discretion over deciding when they satisfy their current statutory consultation obligations in relation to the budget and how this is integrated into their consultation for a variation application. The Commission envisions three main scenarios (see figure 7.1):

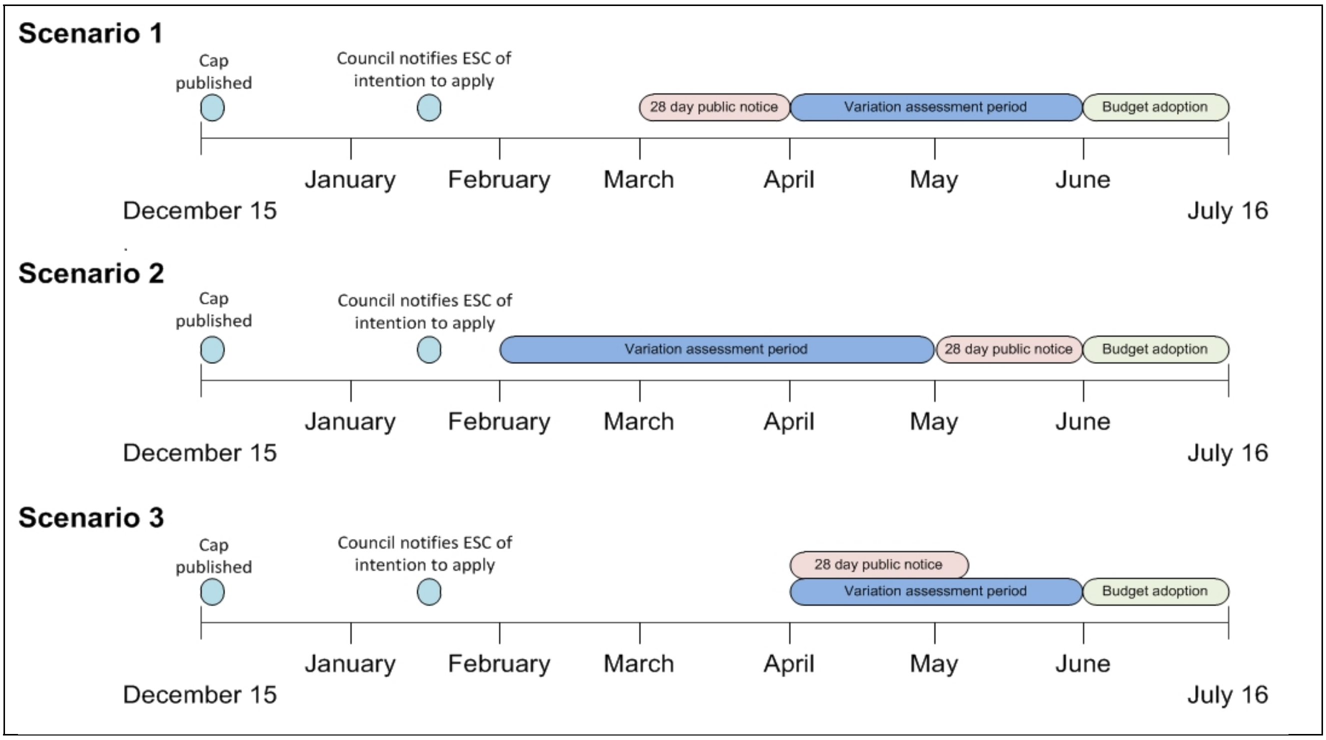
Scenario 1 — Councils may elect to conduct their Section 223 obligations before submitting a variation application to the Commission. This means that councils would be required to prepare a draft budget earlier than in previous years. This would allow for later submission to the Commission as the council would only need to adopt the budget following a decision by the Commission.

Scenario 2 — Councils may submit an application for a variation to the Commission in March or earlier. Community engagement necessary to support the application will need to be completed prior to submission. Councils would conduct their Section 223 obligations after a decision on their variation application was made by the Commission.

Scenario 3 — Councils may elect to place their draft budget on public notice at the same time that an application to the Commission is submitted. Under this scenario, the 28 day requirement could be met concurrently with the assessment of the variation application by the Commission. Councils will still be required to engage with their communities on the proposed variation prior to submitting the application.

It is important to note that the expected community engagement about the need for the variation and the potential trade-offs does not change under any of the above scenarios. Further, councils will still be required to notify the Commission in January of their intention to submit a variation application and the expected date of submission. Under all scenarios, the Commission will be flexible about when it receives applications from councils and will make its best endeavours to make a decision within two months of receipt.

FIGURE 7.1 PROPOSED TIMELINE SCENARIOS FOR MEETING STATUTORY REQUIREMENTS REGARDING THE PUBLIC DISPLAY OF THE BUDGET



Note: In scenario 2, the assessment period (blue) of 3 months reflects the earliest date councils can apply and the latest date the Commission can approve. Within that period, the Commission requires 2 months to complete an assessment.

The broader review of the *Local Government Act 1989* provides an opportunity to reconsider the purpose of the current obligation on councils to place their budgets on public notice for a minimum of 28 days under Sections 129, 130 and 223 and how this might be achieved more efficiently following the introduction of the rate capping framework.

7.1.3 FINAL RECOMMENDATION 11

The Commission recommends that councils notify us of their intention to seek a variation by the end of January of each year and lodge that application by no later than the end of March of each year.

7.1.4 FINAL RECOMMENDATION 12

The recommended timelines for the 2016-17 rating year are set out below. The Commission will be flexible about when it receives application from councils and will use its best endeavours to make a decision within two months of receipt of a council's application.

RECOMMENDED TIMELINES FOR 2016-17 RATING YEAR

	2015-16
ESC announces cap	December 2015
Councils notify ESC of intention to seek a variation	End January 2016
Council applies for variation	From 1 February 2016
Last date for submission of application	End March 2016
ESC notifies councils of decisions	Within 2 months of receipt
Councils formally adopt budget	June 2016

7.1.5 FINAL RECOMMENDATION 13

The Commission recommends that the Government, as part of the broader review of the *Local Government Act 1989*, reconsider the purpose of the current obligations on councils to place their budgets on public notice for a minimum of 28 days under Sections 129, 130 and 223 and how this might be achieved more efficiently following the introduction of the rate capping framework.

7.2 ARE SPECIAL TRANSITIONAL ARRANGEMENTS REQUIRED?

The terms of reference for this review indicate the rate capping and variation framework is to be implemented from the 2016-17 financial year — that is, within 18 months from the time the review was commissioned. Some submissions to our consultation paper urged transitional arrangements in the implementation of the framework. Councils, in particular, were concerned that implementation in 2016-17 would not provide councils with sufficient time to prepare a variation application and to consult with their communities.

A number of councils argued for the full introduction of the framework in 2017-18 to align with new council plans and strategic resource plans following council elections (in October 2016). Many council submissions expressed concern that the property revaluation scheduled for 2016 would mean that ratepayers' rates notices were unlikely to increase in line with the rate cap and that this would cause widespread confusion. Ratepayers generally rejected the idea of a phased or transitional introduction of the framework.

We recognise that there is only a short time between completion of our report and commencement of the framework (and submission of applications for variations). We also note the following:

- The rate cap we are proposing (chapter 2) provides councils leeway by: (i) including a wage price index as a proxy for councils' limited capacity to adjust their wage costs immediately; and (ii) setting the initial efficiency factor at zero and having it increase only very slowly in subsequent years.
- The requirements we proposed for the variation process (chapter 4) have been informed by our discussions with councils. We are confident that councils with well-established processes for strategic planning and community consultation will not find these requirements unduly onerous.
- We recognise that some capacity building will be needed for variation applications (chapter 4). Where possible, we will assist with this capacity building (for example, through guidance and workshops) to ensure councils, the government, ratepayers, the wider community, and we can be confident with the operation of the framework.
- The timelines proposed in the previous section provide flexibility for councils to lodge applications for variations in order to provide councils with discretion to decide when they satisfy their current statutory consultation obligations in relation to

the budget and how this may be integrated into their consultation for a variation application.

- The Government has made its intentions known since late-2014 and our preliminary thoughts about the framework's design were released in April 2015. While the framework's precise details await conclusion of this review, we consider that councils already have enough information to undertake the necessary contingency planning to allow them to respond quickly once arrangements are finalised.

In addition, in our draft report we proposed that in the framework's first year of implementation the Commission should only be authorised to approve variations for one year. Thereafter, it was proposed that councils should be permitted to submit, and the Commission approve variations of length equal to the time the framework has been operating up until four years is reached, at which point, four years would remain the maximum variation length. The rationale for the longer time frames was that this would become feasible as all parties grew more familiar with the process for seeking and approving variations. It was also proposed we could be asked to review this timetable for phasing in the variation process after 2-3 years.

7.2.1 FEEDBACK ON DRAFT REPORT

In the submissions to the draft report, concerns were raised about the proposed restrictions on the length of variation and the proposed associated transitional arrangements. Namely that:

> *Council suggests that the term of permissible variation ought to be articulated in the request for variation from the cap and ought to be supported by evidence which justifies the length or term of the variation being sought, and therefore should not be limited to an arbitrary term. If a case can be demonstrated for a longer period of variation, then this should be assessed on its merit and not restricted to an arbitrary timeframe.*[129]

[129] Knox City Council 2015, *Submission to the ESC's draft report*, August.

Length of permissible variations should be approved on merit as with the quantum.[130]

Council does not support the need to control the length of variations. Councils are appointed for a four year term and it is the responsibility of each elected council to decide whether it wants to apply for a variation up to the length of its own term. [131]

In the draft report it is acknowledged that councils are best placed to decide on the decision to seek a variation or not, it is a contradiction to then take the length of the variation decision from Councils who would be best placed to make this decision.[132]

Some councils expressed concern that these timeframes were inconsistent with their long-term financial plans and long-term strategic resource plans:

…this arrangement is not practical in terms of the timing of Council Elections and the certainty required for good financial, asset management and strategic planning. This Council believes it would be a backward step to improvements in forward planning made in recent years if the ESC were to limit the period for which variations would apply, as proposed in the draft report.[133]

If a Council can demonstrate the need for multi-year approvals it should be considered.[134]

The ESC's proposal to limit future year approvals for rate variation to short periods is likely to erode local government's confidence to plan for and deliver major community projects.[135]

[130] Mount Alexander Shire Council 2015, *Submission to ESC's draft report*, August.

[131] Macedon Ranges Shire Council 2015, *Submission to ESC's draft report*, August.

[132] Mitchell Shire Council 2015, *Submission to ESC's draft report*, August.

[133] Murrundindi Shire Council 2015, *Submission to ESC's draft report*, August.

[134] Bayside City Council 2015, *Submission to ESC's draft report*, August.

[135] Knox City Council 2015, *Submission to ESC's draft report*, August.

Some respondents also argued that our proposed approach would increase costs to undertake more variation applications than required to achieve the same result:

> *The draft report implies an ongoing administrative burden created by the possible need for repeated requests for variations within the next few years due to the proposed transition timelines.*[136]

> *An initial capping mechanism that only allows for a one, two-year, three-year and a maximum of four-year caps will likely force all councils to seek variations on a regular basis. This is not ideal and likely an on-going costly exercise.*[137]

During our consultations it was evident that councils strongly preferred to have the opportunity to align their variation applications with council election terms and the development of new council plans.

7.2.2 COMMISSION'S RESPONSE

Taking into consideration the arguments raised in the responses, we still consider that at this initial stage of operation of the variation framework, it is prudent to ensure that single year caps are functioning smoothly in 2016-17 before we introduce multi-year caps. This is backed up by several responses:

> *It is important that the process with respect to variations is established before multi-year caps are introduced.*[138]

> *Council also believes the transitionary arrangement of the initial variation requests being for one year is appropriate.*[139]

Following the initial year, we propose to allow multi-year variations of up to 4 years in length from 2017-18 onwards. The Commission foreshadowed that the information and consultation required to support a multi-year application will need to be considerably

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[136] City of Wodonga 2015, *Submission to ESC's draft report*, August.

[137] Monash City Council 2015, *Submission to ESC's draft report*, August.

[138] Colac Otway Shire 2015, *Submission to ESC's draft report*, August.

[139] Surf Coast Shire Council 2015, *Submission to ESC's draft report*, August.

more robust than for a single year application — most notably, with regard to forecasts of future expenditures, demand growth and other risk factors.

It is important to note though, if councils seek longer variations in future years, they would be expected to manage budgetary fluctuations within their approved multi-year variation. That is, once approved a variation would not be revisited (or re-opened) other than in the event of material and extenuating circumstances outside the council's control or capacity to manage.

7.2.3 FINAL RECOMMENDATION 14

The Commission recommends that in 2016-17, variations for only one year be permitted. Thereafter, councils should be permitted to submit and the Commission approve, multi-year variations of up to 4 years in length.

7.3 WHAT ABOUT THE COSTS OF ADMINISTERING THE FRAMEWORK?

ADMINISTRATION COSTS

The terms of reference request advice on options for funding the Commission's administration of the rate capping framework, including cost recovery. In broad terms, the Commission's costs will comprise of: (i) a base level of funding to administer the rate capping arrangements and its monitoring and reporting responsibilities; and (ii) a variable funding requirement dependent on the number of applications for variations received each year.

In the draft report we suggested that if some or all of the Commission's costs are to be recovered from local government, then some options for cost recovery include:

- A fixed charge — applied to each council regardless of whether they apply for a variation. The same charge could be levied on each council or it could be apportioned depending on a factor that takes into account councils' ability to pay such as relative size of revenue.
- A variable charge — charges could vary depending on whether councils seek a variation to the rate cap. Costs could be structured equally or apportioned depending on a factor that takes into account of councils' ability to pay.

- A combination — charges to councils could include fixed and variable components.

In response to the draft report, the majority of submissions that responded to the issue of cost recovery did not support these costs being recovered from the local government sector.

In NSW, the State Government funds IPART's costs.[140]

COMPLIANCE COSTS

Although we have been mindful when designing the framework so that it does not impose unnecessarily burdensome requirements on local government, we accept that councils will still incur some compliance costs following introduction of the framework. These costs will have an ongoing component (mainly arising from the requirement for councils to provide information for monitoring and reporting purposes) and an occasional component (associated with preparing an application for a variation).

In the draft report, we suggested that most of these costs will just become the 'cost of doing business' for a council, though we noted that there might be some need for an initial investment in capacity building in the sector.

Responses to the draft report highlighted compliance costs as a significant concern, particularly for small rural councils wishing to make an application for a variation:

> *…preparing a variation request will require additional staff resources. Even if we assumed only a very conservative estimated cost in terms of people and resources of $60,000, this is the equivalent of a 1% rate rise for our council.*[141]

> *Applying for a variation will be a costly exercise in the context of the small budgets of rural councils and self-funded applications will be difficult to justify for small rate base councils.*[142]

[140] IPART administers the rate pegging and special variation framework in NSW.

[141] Hindmarsh Shire Council 2015, *Submission to ESC's draft report*, August.

[142] Rural Councils Victoria 2015, *Submission to ESC's draft report*, August.

> *A small rural Council such as Mansfield, with limited resources is already stretched to meet these legislative requirements. The variation process would further stretch the resources and incur additional costs in the process and in evidence gathering to support the variation application … While we are cognitive that rate capping will be implemented we ask the ESC and Minister to be mindful of the impact on small rural councils, the financial strain on Council's resources and the ability to provide services to the community.*[143]

We expect the ongoing compliance costs for councils will not be significant as the information we are proposing to collect for reporting purposes will be readily available to councils. With regard to the requirements of the application process, we have attempted to design these to reflect councils' existing obligations (most notably, under the *Best Value Principles*). In addition, under final recommendation 14, councils will be able to apply for a four year variation from as early as 2017-18. This will further reduce compliance costs and allow councils to spread the cost of an application over four years.[144]

Nonetheless, some additional costs might arise and while we do not expect these costs to be of particular significance for larger councils, they may represent a barrier for smaller councils wishing to prepare a variation application.

If concerns continue to be voiced regarding the costs of complying with the new framework, two funding options might be considered. These are:

- the Government could provide or coordinate assistance for councils (particularly smaller councils) as they transition to working under the framework

and/or

- providing small councils with a one-off uplift to the rate cap in the framework's first year. The upward adjustment need only be applied in the first year as that financial benefit would then automatically be built into those councils' rate base (and the additional funds would be escalated by the statewide cap each year thereafter).[145]

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143 Mansfield Shire Council 2015, *Submission to ESC's draft report*, August.

144 That is, councils will be able to make one application rather than the two or three that might have been required under our initial proposal.

145 For example, for the smallest councils, a one-off uplift of 1 per cent to the rate cap in 2015-16 would add around $50,000 to their rate base from that year onwards.

GUIDANCE AND SUPPORT

While this document outlines the structural features of the proposed rate capping and variation framework, we appreciate that 'the devil will be in the detail'. For this reason the provision of detailed guidance and support, particularly in preparing a variation application, will be a central focus of the Commission over the coming months. Guidance material will cover areas such as:

- the approach to monitoring, benchmarking and reporting of service rates and service charges (section 2.2)
- the approach to isolating waste related costs from the capping mechanism for councils that do not levy service charges (section 2.2)
- the questions, actions and evidence councils should consider when preparing a variation application (chapter 4)
- guidance on the treatment of discrete project expenditures and new and standalone capital projects, including relevant definition and criteria for projects that would be subject to individual assessment and incremental funding from grants (chapters 3 and 4)
- the baseline information required from councils (chapters 2 and 6)
- requirements related to monitoring compliance with the cap and any approved higher cap (chapters 2 and 6)
- any other relevant matters.

In some cases, the guidance material will be detailed and prescriptive; elsewhere it will be principles-based and provide councils with discretion regarding how they comply. Our 'baseline information' requirement is an example of the former, while our guidance on community consultation adopts the latter approach.

Over the coming months we will continue to develop guidelines in relation to the areas that will be needed most immediately at the commencement of the framework such as the baseline information. We have commenced consultation on some of this guidance material and we will establish additional technical working groups where required.

Support, in the form of workshops, will also be provided. Following the development of guidelines, workshops will be held with councils to assist councils with their understanding of the requirements of the rate capping and variation framework, and in what is involved when making variation applications.

8 OVER THE LONGER TERM

Our experience in establishing related frameworks in other sectors suggest that the rate capping and variation framework proposed in this final report will evolve as experience with the framework matures. As councils, ratepayers and the Commission begin operating under the framework, gaps and ambiguities may become evident. We will work closely with all interested parties to identify and address these concerns.

We also know from experience that with the passage of time, opportunities will emerge to raise the framework's level of ambition. As the parties become more familiar with the framework, they will seek to use it for increasingly sophisticated purposes. Sometimes this will necessitate significant changes to the design of the framework, but often even small modifications will enable significant new opportunities.

It will be important for the long-term success of the framework that it is capable of maturing and evolving to meet changing needs and circumstances.

8.1 WHEN SHOULD A COMPREHENSIVE REVIEW OF THE ENTIRE FRAMEWORK BE UNDERTAKEN?

As with any regulatory arrangements the rate capping and variation framework should be subjected to periodic review. The ongoing monitoring detailed in chapter 6 will provide some assurance that the key elements of the framework are being adhered to. It will also help identify whether features of the framework are responsible for any deterioration or unintended consequences in council performance.

However, there is a need to conduct a more comprehensive review of the framework on a periodic basis in order to assess how effectively it is achieving its intended objectives. Such a review should seek to identify any necessary refinements to the legislative or regulatory architecture so that the framework is capable of meeting relevant policy objectives at that time.

Including a formal review mechanism into the design of the framework is consistent with best practice policy and program delivery principles.

The Commission recommends that the Government consider making a formal review of the rate capping and variation framework a statutory obligation. The review should draw on all relevant information including the data and trends identified through the ongoing monitoring. All interested parties should have an opportunity to provide input to that review. Elsewhere, similar reviews are programmed into legislation for periods of varying length ranging from 3 to 10 years. In our draft report we considered a review period of 4 years to be appropriate.

The majority of submissions expressed support for the recommendation that a formal review of the framework should be conducted on a regular basis.

Eleven councils, Local Government Financial Professionals (FinPro) and the Victorian Farmers Federation provided comments and supported the Commission's recommendation to make the framework review a statutory obligation. Some of them suggested that a review should be made 2 or 3 years after implementation of the framework and that a sunset clause be also included in the *Local Government Act 1989* (the Act). The City of Greater Dandenong argued that:

> *For a period of four years to elapse with no review over something that has the potential to have a very detrimental impact on local government is too long in the initial phase of introduction.*[146]

A small number of other submissions proposed alternative timeframes, varying from every 6 years to within 2 years to better align with council election cycles.

On balance, we consider that a 4-year review cycle is appropriate for the framework. The Government may wish to conduct the first review after 2 years such that future reviews will take place midway between council elections.

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146 City of Greater Dandenong 2015, *Submission to draft report,* August.

8.1.1 FINAL RECOMMENDATION 15

The Commission recommends that the Government consider making a formal review of the rate capping and variation framework a statutory obligation. The review should draw on any data and trends identified through ongoing monitoring and all interested parties should have an opportunity to provide input to the review. The Commission considers a review period of 4 years to be appropriate.

8.2 HOW CAN WE PROMOTE GREATER CONSISTENCY?

The terms of reference emphasise that efficiency is a primary objective of the rate capping and variation framework. Despite some common misconceptions, efficiency is not synonymous with cost cutting. For the purposes of this report, efficiency may be defined as:

> *Delivering the mix, quality and quantity of services wanted by ratepayers, in the way and at the time they want, and at a price they are willing to pay; and doing so at the lowest possible cost. Moreover, it involves adopting new technologies as they become available for producing and delivering these services; and it includes being able to adapt to ratepayers' changing preference in a timely manner.*

Significant sector initiatives (internally and externally driven) have progressed over the past 5 years to promote better resource management and decision-making. These initiatives include:

- improvements in asset management and its integration within broader council planning
- introduction of the Local Government Performance Reporting Framework (LGPRF) as a tool to gather data on a selection of common service areas
- clearer and more expansive guidance from Local Government Victoria on rate setting policies, collaborative procurement and service sharing, budget and financial templates and the LGPRF
- increased used of collaborative tendering and shared services
- more sophisticated approaches to risk management and reporting

- continuous efforts and the use of new media to consult with ratepayers and communities.

These initiatives are welcomed and they should continue, but they are often being pursued on inadequate foundations — meaning that while they may be helpful for councils' management from an administrative perspective, some councils' information management systems remain poorly placed for supporting an assessment of how efficiently they are operating. In our draft report, we suggested that over time council systems should be able to:

- reflect uniform definitions and standard measures for the inputs used and the outputs produced
- identify or measure the resources utilised to produce different outputs
- generate unit costs for the outputs they produce.

Few councils commented on this observation, although the Whitehorse City Council expressed concern about the consequences of such an approach.

> *This implies a manufacturing like cost accounting empire be imposed on broad based service delivery organisations.*[147]

We consider that until this information is available, councils' information management systems will limit their own ability to highlight and drive opportunities for improved efficiency. We consider that a concerted effort is required to standardise the recording of council inputs and outputs across the sector.

We would welcome the opportunity to work with councils and relevant government agencies to develop, and progressively implement, standardised definitions and measures of councils' inputs and outputs. Specific sectoral accounts could be developed that contain financial and resource-use information relevant to assessing how efficiently councils' produce and deliver services to their communities. Sectoral accounts would sit alongside the statutory accounts already produced by local government but they would focus on providing information on costs, revenues, and asset values related to the delivery of relevant services.

[147] Whitehorse City Council 2015, *Submission to the ESC's draft report*, August.

8.3 SHOULD COUNCILS BE GIVEN ANY GUIDANCE ON THEIR FINANCING OPTIONS?

Based on publicly available data, we have observed that councils have generally been averse to debt financing and many have established quite substantial capital reserves. While we note that this is purely within councils' prerogative, we consider there could be benefit in the State Government providing councils with guidance on the responsible use of debt — particularly with respect to funding long-lived infrastructure, and greenfield and intergenerational assets.

In response to the draft report there was broad support for the Government providing guidance on the appropriate use of debt to finance long-lived assets:

> *Mindful of the negative experiences of NSW local governments in terms of debt financing, this council would welcome advice from the state government on Guidelines for the prudent use of debt funding for financing council infrastructure and other priorities as an alternative to rate funding.*[148]

> *Council proposes that the ESC recommend to the State Government that further work be done to investigate other sources of finance for local infrastructure. Opportunities for Councils for a more efficient use of, and access to, borrowings for infrastructure would help to offset the efficiency dividend in the rate cap formula. A sector or partnership approach to accessing borrowings to invest in important community infrastructure is preferable to Councils working on their own solutions.*[149]

> *We encourage the ESC to monitor council indebtedness ratios and the application of loans to fund long-life infrastructure projects to ensure adequate capital renewal investment to sustain existing assets. Further, we are concerned that some Councils may not have access to the commercial skills necessary to negotiate optimal debt-financing arrangements. We encourage the ESC to provide guidance to local government in the area of debt-financing and to provide access to reduced-interest borrowing.*[150]

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[148] Campaspe Shire Council 2015, *Submission to the ESC's draft report*, August.

[149] Yarra City Council 2015, *Submission to the ESC's draft report*, August.

[150] IPWEA 2015, *Submission to the ESC's draft report*, August.

Interface Councils support the proposition that debt should be effectively managed and is a legitimate form of funding for new or upgraded assets which will reap intergenerational benefit. We would be concerned however if the Essential Services Commission is suggesting that debt should be utilised to fund operating expenses or capital works maintenance. This should be clarified in the paper to avoid confusion. Recommended that the ESC provides greater clarity around appropriate use of debt as a financial lever.[151]

8.3.1 FINAL RECOMMENDATION 16

The Commission recommends that the Government provide councils with guidance on the responsible use of debt, particularly with respect to funding long-lived infrastructure, and greenfield and intergenerational assets.

8.4 SHOULD THERE BE GREATER COST REFLECTIVITY IN SOME COUNCIL RATES AND CHARGES?

In section 2.2, we propose that service rates and charges be excluded from the rate cap on the basis of councils' claims that these charges are set on a cost reflective basis. We have not had the opportunity to test these claims. In our draft report we noted that, the *Local Government Act 1989* (the Act) requires that special rates and charges must be cost reflective, but there is no corresponding obligation on service rates and charges. The relevant legislation in NSW requires that waste related charges are not to exceed the reasonable cost of providing the services and that general rates must not be used to fund the cost of providing waste management services.

Six councils agreed with our proposal while Corangamite Shire Council and FinPro did not support it. Corangamite Shire Council argued that 'these costs are driven by commercial agreements established through a competitive tender process' while FinPro believed that legislative amendment 'is not necessary as section 136 of the Act, *Principles of Sound Financial Management*, provides the necessary requirement for councils to manage costs efficiently'.[152]

[151] Interface Councils 2015, *Submission to the ESC's draft report*, August.

[152] Individual submissions from Corangamite Shire Council and FinPro 2015, *Submission to ESC's draft report*, August.

The City of Port Phillip noted that it required further information before it supported our view. It argued that:

> *… there are many pricing and rating principles that councils use to achieve their policy objectives. … These pricing and rating principles may not be consistent with a strict definition of 'economic efficiency' but may be legitimate with respect to achieving community driven policy outcomes.*[153]

If service rates and charges are to be excluded from the cap, we continue to believe there is merit in the Government reviewing the Act provisions regarding service rates and charges to require that these charges must reflect the efficient costs of providing the underlying service.

In our draft report we also noted that in some cases, fees associated with statutory services provided by councils (for example, planning fees) are regulated by the Government. It is not necessarily clear how these fees are determined and some have remained unchanged for a number of years. These fees would not be covered by the rate cap.

Following the introduction of the rate capping framework, we consider that councils should be able to recover the efficient costs of providing these statutory services. There is merit in periodically reviewing fees for statutory services to ensure they reflect the efficient cost of providing those services.

8.4.1 FINAL RECOMMENDATION 17

The Commission recommends that the Government consider amending the *Local Government Act 1989* to require that service rates and service charges must reflect the efficient costs of providing the underlying service.

[153] City of Port Phillip 2015, *Submission to ESC's draft report,* August.

8.4.2 FINAL RECOMMENDATION 18

The Commission recommends that the Government consider initiating a periodic review to ensure that statutory fees reflect councils' efficient cost of providing statutory services.

APPENDIX A — TERMS OF REFERENCE

Local Government Rates Capping Framework

Terms of Reference

I, Robin Scott MP, Minister for Finance, under section 41 of the *Essential Services Commission Act 2001* (the 'ESC Act'), refer to the Essential Services Commission (ESC) the development of a rates capping framework for local government.

As provided for by section 185b of the *Local Government Act 1989,* the Minister for Local Government can cap council general income. The Government has announced a commitment to cap annual council rate increases[1] and has also provided additional guidance on factors to be considered during the implementation of the cap[2].

The State Government's objective is to contain the cost of living in Victoria while supporting council autonomy and ensuring greater accountability and transparency in local government budgeting and service delivery. The Government intends to promote rates and charges that are efficient, stable and reflective of services that the community needs and demands, and set at a level that ensures the sustainability of the councils' financial capacity and council infrastructure, thereby promoting the best outcomes for all Victorians.

The ESC is asked to inquire into and advise the Ministers for Finance and Local Government on options and a recommended approach for a rates capping framework for implementation from the 2016-17 financial year. Advice should include and/or take into account the following matters:

1) Available evidence on the magnitude and impact of successive above-CPI rate increases by Victorian councils on ratepayers.

2) Implementation of the Government's commitment to cap annual council rate increases at the Consumer Price Index (CPI) with councils to justify any proposed increases beyond the cap, including advice on the base to which the cap should apply (e.g. whether to rates or to general income).

3) Any refinements to the nature and application of the cap that could better meet the Government's objectives.

4) Options for the rate capping framework should be simple to understand and administer, and be tailored to the needs of the highly diverse local government sector. The framework should take into account factors that may impact on local governments' short and longer term financial outlook, such as:

    a) actual and projected population growth and any particular service and infrastructure needs;

    b) any relevant Commonwealth Government cuts to Local Government grants;

    c) any additional taxes, levies or increased statutory responsibilities of local governments as required by the State or Commonwealth Governments;

[1] Media release by Daniel Andrews, *Andrew Announces Fair Go for Ratepayers*, 5 May 2014.

[2] ALP's response to MAV's *Local Government Call to Political Parties*, p.1, November 2014.

d) any extraordinary circumstances (such as natural disasters); and

e) other sources of income available to councils (for example, ability to raise user fees and charges from non-residents).

5) Consider how local governments should continue to manage their overall finances on a sustainable basis, including any additional ongoing monitoring of council service and financial performance to ensure that any deterioration in the level, quality or sustainability of services and infrastructure and councils' financial position is identified and addressed promptly.

6) The processes and guidance to best give effect to the recommended approach for the rates capping framework and a practical timetable for implementation, including:

a) the role of councils, the ESC and the Victorian Government and the expected time taken by local governments and by the Victorian Government or its agencies, for each step in the rate capping process;

b) any technical requirements including the information requirements on councils that request exemptions from the cap;

c) any guidance required to give effect to the rate capping options (including in relation to consultation with ratepayers) and to improve accountability and transparency; and

d) any benchmarking or assessment of the effectiveness of the regime, including options to continuously refine the regime and improve council incentives for efficiency.

7) Options for ongoing funding to administer the rate capping framework, including the potential for cost recovery.

In conducting the inquiry and providing its advice, the ESC will have regard to:

- the role of local government in the provision of infrastructure and services to the community and the general efficacy with which they currently perform this task;
- the differences between rural, regional and metropolitan local councils in terms of costs, revenue sources and assets maintained;
- the Revenue and Rating Strategy guide and Local Government Performance Reporting Framework to be administered by the Department of Environment, Land, Water and Planning;
- matters regarding rating practices and asset renewal gap raised by the Victorian Auditor-General's Office (VAGO);
- Department of Treasury and Finance's Victorian Guide to Regulation and Victorian Cost Recovery Guidelines; and

- any relevant insights from the experience of rate pegging in New South Wales, including any reviews or evaluations that can suggest ways to minimise any unintended consequences.

In conducting this independent inquiry, the ESC will be informed by wide consultation. This will include, but is not limited to: councillors and officials from local government; representative bodies such as Municipal Association of Victoria, Victorian Local Government Association and LGPro; unions; VAGO; and relevant government agencies and departments. In addition, the ESC will consult regularly throughout the course of the inquiry with a sector consultative panel established by the Minister for Local Government. The ESC's consultation will be guided by its Charter of Consultation and Regulatory Practice.

The ESC will publish a draft report on the rates capping framework no later than six months after receipt of these terms of reference. The draft report must be made publicly available and invite comments from local governments and other interested parties. A final framework report along with draft guidance material will be provided to the Minister for Finance and Minister for Local Government no later than 31 October 2015.

ROBIN SCOTT
Minister for Finance
Dated: 19 January 2015

APPENDIX B — SUMMARY OF CONSULTATION

B.1 CONSULTATION

The Commission undertook an extensive consultative process with the local government sector and interested parties – councils, ratepayers, ratepayer associations, peak bodies, other council groups, unions and the private sector as a key part in developing our recommendations to the Ministers for Finance and Local Government on a Local Government Rate Capping and Variation Framework (the framework).

The objectives of this consultation process were to:

- engage with stakeholders across the sector and interested members of the broader community to draw on their wealth of knowledge and expertise
- understand the key issues and any major concerns and aspirations, and
- test options with stakeholders to ensure that they are workable in practice.

Throughout this process, the Commission sought to develop a robust and practical framework that was readily understood and fairly balanced the interests of ratepayers and councils. The Commission's consultation process utilised several different methods of consultation with a variety of stakeholders which are detailed below in table B.1.

The engagement program occurred in two parts. The first was to inform the preliminary research period, which led to the release of the draft report (February – July), and the second was the consultation period following the release of the draft framework to receive feedback and then refine its final recommendations (August - early September).

TABLE B.1 ELEMENTS OF THE COMMISSION'S CONSULTATION PROCESS

Element	Timing	Type
Consultation paper	April 2015	Formal milestone
Submissions to the consultation paper	May 2015	Formal milestone
Draft report	July 2015	Formal milestone
An overview – draft local government rate capping & variation framework	July 2015	Communication material (online)
Summary of submissions to the consultation paper	July 2015	Communication material (online)
The Commission's consultation and engagement approach	July 2015	Communication material (online)
Questions and answers	July 2015	Communication material (online)
Newsletters	June, July, September 2015	Communication material (online)
Submissions to the draft report	August 2015	Formal milestone
Website updates	Regularly	Communication material (online)
Public information sessions	August, September 2015	Stakeholder meetings and forums
Meetings with individual stakeholders	Regularly	Stakeholder meetings and forums
Presentations at forums	Regularly	Stakeholder meetings and forums
Deliberative discussions	August 2015	Stakeholder meetings and forums
Technical working group meeting	August 2015	Stakeholder meetings and forums
Newspaper advertisements	August 2015	Media
Media interviews	August 2015	Media
Internal progress reviews	Regularly	Internal planning

B.1.1 INITIAL CONSULTATION

From February to July 2015, the Commission consulted widely with those who will be affected by the introduction of the rate capping and variation framework. The purpose of this initial consultation period was to gather information, data and ideas from the sector, ratepayers and other interested parties. We also used this time to test ideas and options as we were formulating them.

Over this time, each of Victoria's 79 Councils were engaged in some way. This included events and forums held by representative bodies, such as MAV, VLGA, LGPro, FinPro, and groupings of councils such as the Great South Coast Group and the Inner Southern Metropolitan Mayor's Forum. We have also engaged with some councils directly through one-on-one meetings or conversations.

An interactive session was held with six representative ratepayer groups. One-on-one meetings were also held with representatives of the ASU, Professionals Australia and the ANMF. We also met with the VFF, IPWEA, Victorian Civil Construction Industry Alliance and interested parties from the private sector such as CT Management Group. We have met with State Government departments and agencies such as LGV, VGC, VAGO, DTF and DPC. We presented to the Fair Go Rates Reference Group established by the Minister for Local Government, as well as the Minister's Local Government Mayoral Advisory Panel. We also engaged with our colleagues in NSW at the Independent Pricing and Regulatory Tribunal and the Office of Local Government about NSW rate pegging and current reforms.

The number of meetings, forums and presentations we participated in or hosted between February and July was more than 55. We received 287 submissions to the Consultation Paper which was released in April 2015. We also released our first newsletter in June as an update on our review for interested parties.

B.1.2 RELEASE OF DRAFT REPORT AND CONSULTATION

The feedback on issues, suggestions, aspirations and concerns raised throughout the initial period of consultation shaped the Commission's draft report released in July 2015. The report was released in two volumes. *A Blue Print for Change* set out the key design features of the framework, its principles and key elements and the Commission's draft recommendations. *Volume II — Support Material and Analysis* outlined the analysis undertaken by the Commission in reaching its proposed framework, providing greater supporting technical detail. The draft report noted that the Commission brought forward the completion date of its review by one month to the end of September in order to better facilitate the timetable for a 2016-17 implementation.

To accompany the draft report's release, the Commission published supporting material such as an overview of the draft framework, questions and answers, a summary of submissions to the consultation paper, a summary of the Commission's consultation and engagement approach and the second issue of the newsletter *Rates in Review.* All of this material was published on the Commission's website.

With the release of the draft report, the Commission invited further submissions and embarked on another major round of consultation in August and early September. We continued holding stakeholder meetings with individual councils (including both councillors and council staff), State Government departments and agencies such as

LGV, DTF, DPC, VAGO and other interested parties. We also spoke to the Valuer-General to ensure that there were no unintended impacts on their process. We held a second meeting with representatives from twelve ratepayer associations. Public information sessions were held in Traralgon, Melbourne, Wangaratta, Bendigo, Horsham and Mildura and more than 35 people attended. These were supported by advertising and media interviews to promote the public forums, increase community and ratepayer awareness and invite submissions. Whilst in those areas we held meetings with groups of councillors and council staff from councils in those regions. Dr Ron Ben-David and Andrew Chow presented at forums such as the Barwon South West Regional Management Forum, the LGPro CEO forum, the MAV Rural and Regional Mayors' and CEOs' Forum, the second VLGA rate capping forum and the Minister's Fair Go Rates Reference Group meetings 2 and 3. We also held a technical working group meeting with representatives from nine councils. A detailed list of meetings, presentations and forums that the Commission held or attended can be found below in table B.2.

In support of our consultation process, the Commission undertook additional research in the form of deliberative discussion sessions, to engage with people who might not normally participate in the consultation process. Deliberative research is a tool enabling community members to get involved in decision-making and seeks to flesh out participants' viewpoints after they have had the opportunity to deliberate on issues. It differs from the focus group approach in many ways, not least that participants have the full information available and the ability to discuss issues among themselves, rather than simply respond to propositions. Two sessions where held, one in Melbourne and another in Bendigo, with 47 randomly selected ratepayers and community members across a diverse range of demographics. This enabled the Commission to further test the views being presented by interested parties. Given that the participants were unfamiliar with the issues and process prior to the sessions, the Commission also took the opportunity to review the deliberative discussion in terms of implications for the clarity of its proposals.

News stories appeared in metropolitan and regional print and radio.[154] The latter, principally in the areas where forums where held. Items and articles resulting from interviews with Commission representatives tended to, highlight the consultation process, promoted the forums, and explained the key elements of the draft framework.

[154] Dr Ron Ben-David and Andrew Chow were interviewed for print and radio media on six occasions.

This phase of consultation attracted 116 formal submissions from individual councils, local government peak bodies, individual ratepayers, ratepayer associations, unions, community groups and other interested parties. The number of meetings, forums and presentations we participated in or hosted in August and September was more than 40.

Following the closure date for submissions, the Commission released a third issue of its *Rates in Review* newsletter in September. It was published online and included a summary of the key issues raised during the consultation and its preliminary response.

TABLE B.2 MEETINGS, PRESENTATIONS AND FORUMS

November 2014	
Meetings	• DTPLI (now DELWP)
Commencement of the Review	
February 2015	
Meetings	• VLGA • DELWP/LGV • DTF • Randwick City Council (NSW) • Warringah Council (NSW) • IPART (NSW) • Office of Local Government (NSW)
March 2015	
Meetings	• MAV • Strathbogie Shire Council • VAGO • VGC • DELWP/LGV • Hume City Council • LGPro • Wangaratta City Council • Greater Dandenong Shire Council
Presentations/Forums	• LGPro CEO Forum
April 2015	
Meetings	• VFF • Minister for Local Government's Mayoral Advisory Panel • Manningham City Council • DELWP • Professionals Australia • CT Management Group
Presentations/Forums	• Great South Coast Group • VLGA Rate Capping Forum
17 April 2015 — Release of the Consultation Paper	

Continued next page

TABLE B.2 (CONTINUED)

May 2015	

Meetings	• DELWP
	• Trevor Dance (Sunbury Ratepayers)
	• ANMF
	• ASU
	• VLGA
	• Ratepayer Associations Meeting #1 including representatives from:
	  o Ratepayers Victoria
	  o Monash Ratepayers Association
	  o Mornington Peninsula Council Watch
	  o Mornington Peninsula Ratepayers Association
	  o Monash Ratepayers Association
	  o Knox Ratepayers Association
	  o Sunbury Residents Association
	• Baw Baw Shire Council
	• Cardinia Shire Council
	• Kingston City Council
	• VCCIA
	• Strathbogie Shire Council
	• Bayside City Council
	• Glen Eira City Council
	• CT Management Group

Presentations/Forums	• MAV Board Meeting
	• Inner Southern Metropolitan Mayor's Forum including representatives from:
	  o Bayside City Council
	  o City of Boroondara
	  o Glen Eira City Council
	  o Kingston City Council
	  o City of Stonnington
	  o City of Yarra
	• LGPro Corporate Planners Network Special Interest Group
	• RCV Mayors, Councillors and CEOs Forum
	• 2015 ALGWA Conference
	• IPWEA Rate Capping Information Session and Workshop

June 2015	

Meetings	• Fair Go Rates Reference Group Meeting #1
	• Interface Councils Group including representatives from:
	  o Hume City Council
	  o Mitchell Shire Council
	  o City of Whittlesea
	• Baw Baw Shire Council
	• Hume City Council
	• Boroondara City Council
	• LGV

Continued next page

TABLE B.2 (CONTINUED)

June 2015 (continued)	
Meetings (continued)	• Inner Southern Metropolitan Mayor's Forum including representatives from: o Bayside City Council o City of Boroondara o Glen Eira City Council o Kingston City Council o City of Stonnington o City of Yarra • Greater Dandenong City Council • Merv and Rohan Whelan
July 2015	
Meetings	• LGV • IPART (NSW) • VAGO • City of Ballarat Council • RCV • VLGA • Mornington Peninsula Shire Council • DTF • DPC • The Minister for Local Government, Natalie Hutchins • Fair Go Rates Reference Group Meeting #2 • Technical working group meeting including representatives from: o Hume City Council o Strathbogie Shire Council o Baw Baw Shire Council o City of Greater Dandenong o Glen Eira City Council
Presentations/Forums	• LGPro CEO Forum
31 July 2015 — Release of the Draft Report	
August 2015	
Meetings	• LGV • DTF • DPC • VAGO • VLGA • MAV • Knox Council Meeting • City of Yarra • Melbourne City Council • Deliberative discussion group in Melbourne • Deliberative discussion group in Bendigo • Alan Billing, Chris Smith, Leigh Barrett, Cr Michael Delahunty • Buloke Shire Council • City of Greater Bendigo • Cardinia Shire Council

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TABLE B.2 (CONTINUED)

August 2015 (continued)	
Meetings (continued)	• IPWEA • Yarra Ranges Council forum • Baw Baw Shire Council • Hume City Council • Murrindindi Shire Council • West Wimmera Shire Council • Ratepayers Associations Meeting #2 including representatives from: o Ratepayers Victoria o Monash Ratepayers Association o Mornington Peninsula Council Watch o Mornington Peninsula Ratepayers Association o Monash Ratepayers Association o Knox Ratepayers Association o Sunbury Residents Association o Macedon Ranges Residents' Association o Residents of Retirement Villages Victoria Inc. o Whitehorse Ratepayers and Residents Association o Voice & Action Golden Plains Shire Ratepayers Association o Cardinia Ratepayers and Residents Association • Councillors and council officers in Colac including representatives from: o Colac Otway Shire Council o Surf Coast Shire Council o Borough of Queenscliffe o Corangamite Shire Council o Moyne Shire Council o Southern Grampians Shire Council o City of Greater Geelong • Councillors and council officers in Traralgon including representatives from: o Bass Coast Shire Council o Latrobe City Council o South Gippsland Shire Council o East Gippsland Shire Council • Councillors and council officers in Melbourne including representatives from: o Bayside City Council o Maroondah City Council o City of Whittlesea o Stonnington City Council o Hobson Bay City Council o Kingston City Council o Manningham City Council o Mornington Peninsula Shire Council o Banyule City Council o Brimbank City Council o City of Darebin o City of Moonee Valley o Frankston City Council

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TABLE B.2 (CONTINUED)

August 2015 (continued)	
Meetings (continued)	• Councillors and council officers in Wangaratta including representatives from: o Strathbogie Shire Council o Rural City of Wangaratta o Murrindindi Shire Council o City of Wondonga o Towong Shire Council o Mansfield Shire Council o Indigo Shire Council • Councillors and council officers in Bendigo including representatives from: o City of Greater Bendigo o Hepburn Shire Council o Loddon Shire Council o Macedon Shire Council o Mitchell Shire Council o Mount Alexander Shire Council o Strathbogie Shire Council o Pyrenees Shire Council o City of Casey o Buloke Shire Council o Gannawarra Shire Council • Councillors and council officers in Stawell including representatives from: o Northern Grampians Shire Council o Ararat Rural City Council o Pyrenees Shire Council o Glenelg Shire Council • Councillors and council officers in Ballarat including representatives from: o Warrnambool City Council o City of Ballarat o Pyrenees Shire Council • Technical working group meeting including representatives from: o City of Greater Bendigo o Hume City Council o Strathbogie Shire Council o City of Ballarat o Baw Baw Shire Council o City of Whitehorse o City of Greater Dandenong o Glen Eira City Council o Melbourne City Council

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TABLE B.2 (CONTINUED)

August 2015 (continued)	
Presentations/Forums	• Barwon South West Regional Management Forum • LGPro CEO forum • Public Information Session in Traralgon • Public Information Session in Melbourne • Public Information Session inWangaratta • Public Information Session in Bendigo • Public Information Session in Horsham • LGPro Corporate Planners Network Special Interest Group • MAV Rural and Regional Mayors' and CEOs' Forum • VLGA rate capping forum #2
September 2015	
Meetings	• Mildura Rural City Council
Presentations/Forums	• Public Information Session in Mildura • ESC Customer Insight Panel • MAV Metro Forum • Fair Go Rates Reference Group #3

APPENDIX C — DETAILED AVERAGE RATES PER ASSESSMENT FORMULA

The rate cap the ESC will determine will apply to average rates per assessment, as per the following equation:

$$\text{Average rates per assessment (2016-17)} = \frac{\text{Equivalent full year rate revenue (2015-16)}}{\text{Number of rateable assessments as at 30 June 2016}}$$

Calculating average rates per assessment (2015-16) or the 'base':

$$\text{Equivalent full year rate revenue (2015-16)} = \text{budgeted general rates (2015-16) (excluding any allowance for supplementary rates)} + \text{budgeted municipal charges (2015-16)} + \text{annualised supplementary revenue (2015-16)}$$

Note:

- municipal charges revenue will be zero for councils who do not charge any municipal charges
- actual supplementary rates revenue (2015-16) is not considered in the equation
- the revenue outcomes are the same whether councils use Capital Improved Value or Net Annual Value for land valuations

Number of rateable assessments (as at 30 June 2016)	=	Actual number of rateable assessments as at 30 June 2015 (excluding any new rateable assessments assumed for supplementary rates)	+	Forecast number of rateable assessments arising from supplementary valuations between 1 July 2015 and 30 June 2016

Applying the Rate Cap:

Average rates per assessment (2016-17)	=	average rates per assessment (2015-16)	x	(1 + ESC Rate cap percentage)

Estimated total rate revenue under the cap (2016-17)	=	average rates per assessment (2016-17)	x	Number of rateable assessments (as at 30 June 2016)

GLOSSARY

Annual budget	Sets out the services and initiatives to be funded for the financial year and how they will contribute to achieving the strategic objectives specified in the council plan.
Annual report	Contains report of operations, performance and financial statements (including rating outcomes).
Asset renewal expenditure	Expenditure on an existing asset or on replacing an existing asset that returns the service capability of the asset to its original capability.
Capital Improved Value	The total market value of the land plus buildings and other improvements.
Cost shifting	Cost shifting describes a situation where the responsibility for, or the costs of, providing a certain service, or regulatory function are 'shifted' from a higher level of government on to a lower level of government without a commensurate level of funding or the conferral of corresponding and adequate revenue raising capacity.

Council Plan/Community Plan	Sets out the medium-term strategic objectives, strategies, strategic indicators and resources reflecting the vision and aspirations of the community for the next four years. It should reflect the outcome of stakeholder and community engagement.
Council election	A general election of Councillors for all councils held every fourth Saturday in the fourth year after the last general election of Councillors for all councils was held.
Differential rate	A different rate in the dollar is set for different categories of rateable land. For example, a council might have differential rates for farm land, various categories of residential property or commercial/industrial properties – each paying a higher or lower rate in the dollar. Differential rating can only be used by councils using the capital improved value system of valuing land. There is no limit on the number or type of differential rates that can be levied, but the highest differential rate can be no more than four times the lowest differential rate.
Financial assistance grants	General purpose and road grants from the Federal Government allocated to Victorian councils. Both grants are untied, which means that the Federal Government cannot direct how they are spent by councils.

Financial sustainability

The Victorian Auditor-General defines financial sustainability as being able to meet current and future expenditure as it falls due. Councils also need sufficient capacity to absorb certain risks and changes that may materialise without significant change to their revenue or expenditure policies.[155]

A local government will be financially sustainable over the long-term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community.[156]

Freeze of Federal Grants

The national funding pool (for the financial assistance grants) is usually indexed annually in line with population growth and inflation forecasts. The indexation is 'paused' for three years (from 2014-15 to 2016-17).

General rates

Applied as a percentage of each property's valuation; either a uniform rate, or different rates for different property classes, such as residential, farms, commercial and industrial enterprises.

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[155] Victorian Auditor-General's Report, *Local Government: Results of the 2013-14 Audits,* Feb 2015, p. 28.

[156] New South Wales Treasury Corporation (2013), *Financial sustainability of the New South Wales local government sector – Findings, recommendations and analysis*, April, page 5.

Infrastructure	Infrastructure comprises the assets needed to provide people with access to economic and social facilities and services. In general, infrastructure facilities have high capital costs, are time consuming to plan and build, are durable and have low operating costs, and are often networks. They often have environmental and social benefits that are not fully recovered by user charges. For councils, examples of infrastructure may include: roads and bridges, arts and cultural facilities, community centres, early childhood and family support facilities, education facilities, health facilities, justice and emergency services and sport and recreation.
Interface/growth councils	Interface Councils is a group of municipalities that form a ring around metropolitan Melbourne; including Cardinia Shire Council, City of Casey, Hume City Council, Melton City Council, Mitchell Shire Council, Mornington Peninsula Shire Council, Nillumbik Shire Council, City of Whittlesea, Wyndham City Council and Yarra Ranges Council.
Local Government Act 1989	The LG Act governs the operation of local government in Victoria. It outlines councils' purpose to provide for a democratic, efficient and effective system of local government in Victoria, to give councils powers which will enable councils to meet the needs of their communities, to provide for an accountable system of local government and reform the law relating to local government in Victoria.

Municipal charges	To cover some of council's administrative costs. The revenue from the municipal charge can be no more than 20 per cent of the total revenue raised from the combination of the municipal charge and the general rates.
Net Annual Value	The current value of a property's net annual rent (by law, Net Annual Value must be at least five per cent of the Capital Improved Value for commercial property and exactly five percent of Capital Improved Value for residential property).
Property valuation	Property values affect the amount paid in municipal rates. Property values are determined by independent valuers appointed by a council or the Victorian Valuer-General. These valuers assess the market value of each property in line with guidelines issued by Valuer-General. Properties are valued either on the basis of Net Annual Value, Site Value or Capital Improved Value.
Rate in the dollar	Used to calculate a property's rates. Rate in the dollar is multiplied with the value of a ratepayer's property to calculate the property's rates. For a council using only a general rate, the rate in the dollar is calculated as: If council plans to raise the total rate revenue of \$10 million, and the total Capital Improved Value of all rateable properties in the municipality is \$2,380 billion, then the rate in the dollar is calculated by dividing \$10 million by \$2,38 billion = 0.42 cents in the dollar.

Rateable land	Any land that is rateable under section 154. Section 154(1) of the *Local Government Act 1989* defines rateable land as: ‘Except as provided for in this section, all land is rateable.’ Section 154(2) of the Act lists the exemptions to rateable land.
Revenue and rating strategy	A revenue and rating strategy ideally comprises a number of components and may include documents on: a council rationale and objectives discussion including its pricing policy and core components of its rating structure; related research and background discussion on the municipality and past practices; comprehensive rates, fees and charges impact modelling on the municipality; explanatory material and opportunity for public review/consultation.
Regional Cities	Rural hubs, providing administrative and commercial services for the surrounding communities.
Renewal gap	The difference between the funding that councils need to renew their existing assets and the money they actually allocate to this purpose. Can be measured using a number of methodologies.
Revenue in lieu of rates	Payments received on unrateable land such as railway land, State and Commonwealth Government buildings, mining lands, power stations, airports and windfarms.

Service charges/rates (garbage)	For services to properties such as waste management. Can be levied as either a rate (i.e., based on property valuation) or a charge (i.e., per unit) or some combination. A different amount may be charged for different property categories or for different sized bins.
Site Value	The market value of the land only.
Special rates/charges	Are levied on ratepayers specifically benefitting from a service or investment such as footpaths; kerbs and channels; and arrangements for providing services like promotion, marketing or economic development (such as for commercial businesses).
Strategic Resource Plan	Sets out the financial and non-financial resources for the next 4 years to achieve strategic objectives (including rating strategies).
Supplementary rates/charges	Rates assessed/adjusted during the year as a result of supplementary valuations. Reasons for a supplementary valuation include: development of vacant land, change in occupancy, new subdivisions, renovations and extensions, sale of non-rateable properties and consolidation of properties.
Uniform rate	All rateable land in a municipality are charged based on the same rate in the dollar.
Untied grants	General purpose monetary grants not tied to certain terms and conditions (often legislative) that the recipient must adhere to in order to receive the grant.

Victorian Auditor-General's Office	The Auditor-General is an independent officer of the Victorian Parliament, appointed to examine the management of resources within the public sector (including local councils) on behalf of Parliament and Victorians. The Auditor-General conducts and reports on financial and performance audits including local government. The Victorian Auditor-General's Office, supports the Auditor-General.
Victorian Grants Commission	Allocate grants provided by the Commonwealth Government to councils in Victoria according to the *Local Government (Financial Assistance) Act 1995* and a set of national distribution principles. All funds allocated by the Commonwealth are distributed to councils.

ABBREVIATIONS

ABS	Australian Bureau of Statistics
ANMF	Australian Nurses & Midwifery Federation
ASU	Australian Services Union
CIV	Capital Improved Value
CPI	Consumer Price Index
CPN	Corporate Planners Network
DELWP	Department of Environment, Land, Water and Planning
DTF	Department of Treasury and Finance
ESC	Essential Services Commission
FINPRO	Local Government Finance Professionals
ICG	Interface Councils Group
IPART	Independent Pricing and Regulatory Tribunal (NSW)
LGCI	Local Government Cost Index
LGPRF	Local Government Performance Reporting Framework
LGPRo	Local Government Professionals
LGV	Local Government Victoria
NAV	Net Annual Value

MAV	Municipal Association of Victoria
OLG	Office of Local Government (NSW)
PPI	Producer Price Index
RBA	Reserve Bank of Australia
RCV	Regional Cities Victoria
RCV	Rural Councils Victoria
RMA	Revenue Management Association
RV	Ratepayers Victoria
SRP	Strategic Resource Plan
TOR	Terms of Reference
VAGO	Victorian Auditor-General's Office
VFF	Victorian Farmers Federation
VGC	Victorian Grants Commission
VLGA	Victorian Local Governance Association
WPI	Wage Price Index