Baw Baw Shire Council
Submission to Essential Services Commission

Baw Baw Shire Council is a **Peri-Urban** municipality located approximately 100 kilometres east of the Melbourne CBD, the Shire is experiencing rapid residential expansion. It is expected Baw Baw Shire will have 71,683 residents by 2036, having grown at a rate of 1.7 per cent annually over the previous decade.

Rapid population growth increases the demand for residential land, community services and infrastructure. A predominantly rural shire, the rate at which growth is presently occurring is unsustainable in the medium-to-long term. Residential growth cannot continue without the timely provision of sustainable employment and infrastructure, in particular:

- Roads and public transport, telecommunications and energy;
- Health, education, leisure, commercial and community services.

As with other peri-urban councils, Baw Baw Shire is struggling to find an appropriate balance between managed settlements (growth) and protecting and enhancing rural economic activities and the shire's natural resources, biological diversity and quality landscapes. Further to this, Baw Baw Shire is the largest peri-urban shire in Australia with a vibrant and successful dairy industry.

Baw Baw Shire's challenge (and opportunity) is to manage the growth, protect and increase the agricultural pursuits that have underpinned the local economy and create local employment for its growing community in a financially constrained environment.

FORM OF THE CAP

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

Baw Baw Shire Council shares the view of the MAV as reflected in the Consultation Paper that while CPI is simple and easy to understand, it is not the appropriate indicator for local government cost escalation. The use of CPI as a reasonable benchmark for Local Government cost escalation has always been problematic. While the CPI is a weighted basket of household goods, council services are predominantly made up of salaries, materials, contracts and utilities, all of which generally exceed other cost increases in the economy.

Other cost inputs into local services are grants from other tiers of government that often provide less than inflation indexation, thereby increasing the local government financial contribution.

Research and analysis undertaken by the MAV indicates that local government costs therefore typically increase by around one per cent above the consumer price index (CPI). In rural, regional and remote areas, this cost can be much higher because of distance to transport goods and materials, and lack of competitive suppliers. An additional revenue impact on these councils is the lack of capacity to charge higher levels of user fees given the low and fixed income base of many communities.

The impact of using CPI alone as the cap would mean that in real terms, Council revenue available to fund services and capital infrastructure would be going backwards year on year. This would likely result in nearly all Councils needing to make a business case for a variation to the framework, creating unnecessary levels of bureaucracy.

An ongoing review is particularly important in light of the NSW experience where rate pegging resulted in the deterioration of community infrastructure and the financial sustainability of some Councils.

By contrast Victorian Councils were able to introduce a long term financial planning framework that delivers on community expectations as well demonstrating a commitment to address the asset investment backlog and reduce the infrastructure gap.

It is important that any cap is not counterproductive by resulting in a short-sighted view of Local Government sustainability and a repeat of the NSW experience.

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

While Baw Baw Shire Council supports a proposal to develop an independently verified and validated local government cost index, setting an upper limit by which Local Government could set a rate up to could also enable LG to remain autonomous. Setting an upper limit, say up to 5 per cent would enable Councils to formulate their budgets based on the service and infrastructure needs of their community. It would enable LG to remain accountable to their community through the Council Plan and Budget process already enshrined in the Local Government Act and avoid unnecessary bureaucracy.

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

Baw Baw Shire Council believes that whilst there is merit in providing an annual cap or 'Upper Limit' plus indicative limits for forward planning, how is the ESC any better at determining the long term CPI than Councils? Enterprise Agreements vary between Councils and the LG Award see salary escalation beyond CPI and must be taken into account. Setting an 'Upper Limit' will enable each Council to manage their Council Plan and Budget in line with their community expectations and consultation.

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

As outlined in our response to Questions 1 and 2 above, Baw Baw Shire Council advocates that CPI is not used as an indicator and that a more appropriate indicator is developed or an 'Upper Limit' set that enable Councils to work with their communities through the current legislative requirements.

Additionally, the model needs to incorporate into its formulae the impact of cost shifting [estimated at about 6 per cent of LG budgets] in the current revenue framework for Local Government. An example is that Local Government partly funds rate rebates for pensioners. Addressing social impact issues through welfare and income support is the responsibility of higher levels of government that are able to spread the cost of such assistance more equitably and efficiently over a broader revenue base.

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

The response to this question needs to be considered in terms of the totality of the rate capping and variation framework. It is Baw Baw Shire Council's view that providing the Variation element of the framework are sufficiently flexible to meet the diverse needs and circumstances of each Council, then a single cap or 'Upper Limit' would be the simplest to administer. Any rate chosen should address the variability of needs and communities' capacity to pay across the State.

The introduction of single rate cap does not recognise the financial challenges including impact of natural disasters faced by rural and peri-urban councils as compared to metropolitan councils. As noted in Principle 1 of ESC Consultation Paper, the local communities differ in their needs, priorities and resources and as such it is important that framework around rate capping should support special consideration for such councils and facilitate ESC approval for higher rate than CPI in a simple, judicious and less onerous administrative process.

THE BASE TO WHICH THE CAP APPLIES

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

It is Baw Baw Shire Council's view that the cap should apply only to general rates and the municipal charge (for those Councils that still have a municipal charge), and not those charges such as waste which are operated on a fee for service or contracting basis. These latter services are a) market tested b) subject to cost escalations as outlined in negotiated contracts and c) often provided on an opt-in or out basis in those municipalities where population density is sufficient to provide economies of scale.

The Fire Services Levy should also be excluded from the cap as that is a tax that is merely collected by local government on State Government's behalf.

It is also important to note that there is no uniformity of the starting position across Councils. The average rates and charges per assessment varies widely across municipalities and is based on historical decisions from Council to Council. It would not be safe to assume that the current levels are an appropriate base from which to assess or cap future movements.

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

A cap should apply to total rates and total municipal charges rather than average rates and charges per assessment. Applying the cap to average rates and charges would be grossly disadvantageous to those Councils experiencing growth or significant change.

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

Supplementary rates should be excluded from any rate cap. Supplementary rates are an indicator of growth which leads to increased service delivery and infrastructure requirements which need to be responded to, often, in the case of service delivery, as population or participation meets certain triggers. Supplementary rates become part of the base for the following financial year. The response to this question should be read in conjunction with that to Question 7 above.

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

The methodology of the local government rating model and how valuations impact the rates paid per property is widely misunderstood in the community. Trying to explain Councils' rate increases are on the total rate revenue and spread across all the various property classes, as opposed to individual assessments, is consistently misunderstood.

A comprehensive community information campaign will be necessary to ensure that the benefit is understood.

10. What should the base year be?
The base year should be the 2015/16 year as per adopted budgets and Council plans.

THE VARIATION PROCESS

11. How should the variation process work?

It is important that the variation process does not create unnecessary levels of bureaucracy for already financially constrained Councils.

It is proposed that

- The cap should form the maximum rate increase that could be struck without mandatory referral to the Essential Services Commission for review and authorisation. Councils proposing increases to rates and charges at or below the cap should be exempt from the ESC process.

- Councils proposing to apply rate increases in excess of the cap (Upper Limit) would need to prepare a Business Case for consideration of the Essential Services Commission. A standard template should be established to minimise the cost and administrative burden of production for Councils, and to ensure that the ESC has the necessary information to inform their review.

- A two-tier Business Case process should be adopted. For those Councils who are seeking to apply a rating increase of the cap plus say up to 2 per cent a 'light touch' Business Case should be required. For those Councils seeking to apply a rating increase in excess of the Cap plus 2 per cent a more comprehensive Business Case and Financial Assessment would be required. This should reduce the number of Business Cases requiring substantial review effort, minimising the cost of implementation to Councils and the ESC.

- In reviewing each Council's Business Case, the Essential Services Commission would give consideration to the following factors:
    - The Council has a robust 10 year Long Term Financial Plan and 4 year Strategic Resourcing Plan in place;
    - The Council can demonstrate clear and transparent communication and consultation with their community in the development of their annual budget and/or 4 year SRP;
    - AND : The Council is subject to extraordinary financial drivers that are outside of their control which may include such factors as :
        - Implications of State or Federal Government policy changes;
        - Recovery from emergency or other disaster;
        - Legacy asset management concerns;

- Shifts in global money markets affecting superannuation calls or other linked investments.

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

Councils should be able to seek a variation where, following a robust assessment of their financial circumstance, community ambition, and consultation it is determined that a rate rise in excess of the cap is warranted.

Councils should be able to seek a variation from the ESC without the need to demonstrate community support when a variation is sought as a result of changes to external factors such as natural disasters, changes to statutory fee and charges and/or external funding available to Council through State or Commonwealth Government grants is altered.

13. Apart from the exceptions identified by the Government (namely, new infrastructure needs from a growing population, changes in funding levels from the Commonwealth Government, changes in State Government taxes and levies) what other exceptions need to be considered?

- Overall financial position at the commencement of the framework's implementation (i.e. some Councils are already experiencing financial challenge);
- State Government cuts to grants;
- Cost shifting by other statutory agencies;
- Prevention, mitigation and response to natural disasters;
- Inability to generate self-sourced revenue;
- Community asset stewardship (including lack of viable alternatives to Council ownership and management);
- Proportion of rate base that is exempt from rates in accordance with Section 154 of the Local Government Act;
- Growth;
- Other extraordinary circumstances outside of local government's control.

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

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

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

It is Baw Baw Shire Council's view that these requirements are appropriate; however, service charges should be exempt from the Cap or 'Upper Limit'.

COMMUNITY ENGAGEMENT

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

Baw Baw Shire Council has adopted and implemented a minor modified version of the IAP2 Framework for community consultation and engagement.

INCENTIVES

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

The assumption here is that Councils don't do this already! Councils are constantly reviewing service delivery methods and standards, looking for ways to improve and collaborate with other similar service providers.

We agree with others in that the language needs to shift to one of financial sustainability and value for money, rather than the current economic rationalist focus which is at odds with other government messaging regarding local employment protection.

The sector has always welcomed opportunities to review its operations and taken on challenges provided by other tiers of government, including cost shifting. The sector welcomes the opportunity to be seen and respected for the manner in which it delivers its services now and into the future as an equal and legitimate government partner. Local Government, in the main, 'punches above its weight.'

Unintended consequences can be minimised by ensuring a planned and staged implementation in partnership with the sector. A fast tracked process will undoubtedly result in unintended consequences which may reflect badly on not only Local Government but also the State. An appropriately comprehensive risk assessment should be commissioned before implementation.

TIMING AND PROCESS

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

Councils' budget timeframes are established after taking into consideration the requirements of the Local Government Act. Authorisation of Variations would need to be complete by no later than 30th March to enable statutory consultation of 4 weeks to occur during April/May, consideration of submissions, and endorsement by 30th June.

TRANSITIONAL ARRANGEMENTS

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

The ESC should take into consideration that:

- 2015/16 is a revaluation year and therefore the perception of benefit from the wider community will be diluted by the shifts in rates associated with the revaluation; and
- 2016 is a Council election year and the commencement of a new Council four-year budgeting and planning cycle. It makes sense to coordinate the introduction of a new framework with the wider council planning and budgeting cycle.

ROLES

19. What are stakeholders' views on the respective roles of the key participants? Should the Commission's assessment of rates variations be advisory or determinative?

Baw Baw Shire Council agrees that there is benefit in having an independent arbiter such as the Essential Services Commission have oversight over the implementation of any rate capping framework. The role of the Essential Services Commission would be to:

- Monitor the success of the implementation of the Rate Capping and Variation Framework and provide advice to the Minister on any review, taking into consideration feedback from the Sector.
- Review Council Budgets and variation submissions for those where mandatory referral is required;
- Authorise rate increases in excess of the baseline where Business Cases have sufficient merit in accordance with the established criteria;
- Provide advice to the Minister for Local Government in circumstances where Business Cases are seen to have insufficient merit and other intervention may be required.

Local Government Victoria should have a role in providing direct support to Councils in reconsidering their financial strategy where Business Cases are deemed by the ESC to have insufficient merit.

It will be important to ensure that over time the policy parameters to support rate capping are integrated across VAGO, LGV and the Essential Services Commission to ensure maximum public transparency for Councils and for Government. This should also be reflected in the Local Government Performance Reporting Framework.

OTHER MATTERS

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

Yes. It is Baw Baw Shire Council 's view that a regular cycle of review is imperative, and should take into consideration not only feedback from the Sector and the community but also include a full assessment of the economic impact on the impact on Councils' financial sustainability and ability to meet asset renewal requirements pre- and post-rate capping implementation.

An ongoing review is particularly important in light of the NSW experience where rate pegging resulted in the deterioration of community infrastructure and the financial sustainability of some Councils.

By contrast Victorian Councils were able to introduce a long term financial planning framework that delivers on community expectations as well demonstrating a commitment to address the asset investment backlog and reduce the infrastructure gap.

It is important that any rate cap is not counterproductive by resulting in a short-sighted view of Local Government sustainability and a repeat of the NSW experience.

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

Under no circumstances should the cost of applying the framework be applied to local governments. As a State Government policy position it should be fully funded by State Government. Any attempt to operate the framework on a cost recovery basis from the sector would ironically further disadvantage those Councils that have the most pressing financial need. It is nonsensical that Councils would have to levy their community to pay the State to administer a process that is supposed to relieve financial pressure on the community.

The cost of administering the framework to the State can be minimised through ensuring that the process is non-bureaucratic, simple to navigate and based on appropriate templates etc.

OTHER MATTERS RAISED IN EARLIER CHAPTERS

22. We are interested in hearing from stakeholders on:

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

Baw Baw Shire is generally in agreement with the principles for the review set out in Section 4 of the Consultation Paper. The exceptions to this are outlined below:

- Principle 4 – we agree with this principle, however suggest that the burden of proof should be variable, depending on the level of increase that is sought above the cap. There would be benefit in establishing a framework that required a less onerous burden of proof where the level of increase sought above the cap (Upper Limit) is, for example, up to 2 per cent above the cap. This would also reduce the expectation on the ESC and reduce the costs of implementation.
- Principle 5 – should be re-worded to reflect Rate increases above the cap should be considered only after all other viable options have been explored. Rate increases that keep pace with reasonable levels of cost escalation are responsible financial management. The current wording infers that any rate increase, even at CPI, is a last resort.
- Principle 7 – suggest that a further dot point is added under this principle to reflect that the framework should not apply unnecessary levels of bureaucracy or administrative burden on either the ESC or Councils.

Other factors for the consideration of the Commission that have an impact on the overall financial sustainability of the sector and have put upwards pressure on rates include:

- **Responsible stewardship of local assets**

Local government has a key role in establishing and maintaining local assets which make a very real contribution to delivering economic, social and environmental outcomes at local, state, and regional levels. A 2014 report by the Auditor General identified that Local Government is responsible for $73 billion of community assets.

It is well understood that investment in these important assets has not been able to be sustained at required levels, even with current income and revenue strategies. While some good progress has been made, there is still a pressing need for many Councils to address growing asset renewal gaps. The same 2014 Auditor General report found that Councils are generally budgeting less than is required to renew their assets and consequently the funding needed for asset renewal continues to grow each year. The Auditor General went on to assert that without appropriate and concerted corrective action, the provision of Council services to communities is likely to be put at risk, and that while this may require some hard financial decisions and trade-offs, failure to address this problem now will only lead to more difficult decisions in the future.

An assessment of rate capping outcomes in NSW undertaken by NSW Treasury Corporation in 2013 (as reported by VLGA) identified critical under investment in asset maintenance and deteriorating financial sustainability had arisen during their own rate pegging regime. Its report found that revenue needed to grow to cover not only annual cost increases but the underlying cost of service delivery including progressive elimination of deficits and infrastructure funding needs. This meant that in most cases rates need to rise by substantially more than the current annual peg if Councils were to achieve sustainability.

As a general concept, initiatives that enhance transparency, accountability and efficiency of local government are welcomed. It is important however that policy shift such as rate capping is not implemented without consideration to the wider macro-economic issues impacting local government financial sustainability. Key to this are the following considerations:

a) Growth

Accommodating Melbourne's and Victoria's growth creates enormous financial strain on Council resources. Multiple, concurrent growth fronts and lack of existing infrastructure in greenfield growth areas make it difficult to achieve unit cost efficiencies, meaning that growth costs more in some areas than in others. Government funding has traditionally not necessarily followed growth, meaning that many Councils have been left to carry the burden. By way of example, a 2013 report by Essential Economics assessed that significant infrastructure and resources – totalling the equivalent of $9.8 billion by 2026 (expressed in 2011 constant prices) – will be required to ensure that Councils in the interface areas are adequately provided with facilities and services to assist in closing the gap with Melbourne's inner and middle suburbs, and to ensure improved economic, social and liveability outcomes are achieved.

This report doesn't include those **Peri-Urban Councils** that are: predominantly rural; provide significant farming enterprises; and try to manage growth in urbanised areas without any support from State and Federal Governments.

Growth comes at a cost and these costs need to be funded – if not through rates, through some other means. It should be noted that currently, developer contributions only cover approximately 25 per cent of the infrastructure costs incurred for new residents. An unintended consequence of the foreshadowed changes to the Development Contributions legislation will be a further reduction of the share of infrastructure costs paid for by Development Contributions with a greater share to be funded by ratepayers in general – this should not be the case.

b) Defined benefit superannuation liabilities that are not equally applied to State and Commonwealth government schemes

Since 1998 Victorian local government has paid $1.162b in calls into a defined benefit superannuation scheme. All levels of government operated Defined Benefit Superannuation Schemes. The benefits were defined and as a result employer governments need to fund them. The local government scheme was established by State legislation and closed to new members in 1993. Although new members were not able to access the scheme after that time, the liabilities to existing members continue to grow.

The structure of the local government fund is such that it has to be kept fully funded for future liabilities at all times. This is in distinct contrast to the funds operated by the Victorian State Government and Commonwealth Government each of which currently have substantial unfunded liabilities. If the same rules of operation were applied to the local government fund, $1,162b in calls and contributions tax would not have needed to be funded across the 17 years since 1998. This requirement that is unique to local government places significant and often unplanned upwards pressure on rates.

c) Lack of escalation of local government fees regulated by the State Government

Many fees which fund Council services are set by State agencies. While State agencies have over the years applied regular escalation to fees that benefit the State, they have not applied the same level of rigour to fees that benefit local government. Despite advocacy on this matter, Local Government has been unable to directly influence these fees and charges that are set on its behalf. A lack of annual indexation on these charges puts pressure on other areas of Council budgets. Between 2000 and 2013 successive State Governments have increased fees by less than half the CPI. Examples of charges that fall into this category include: planning permits, development plan permits, applications to re-zone land. Less and less of the real cost of delivering the service are therefore met by the applicant, shifting the burden to fund the gap to rates, and therefore all ratepayers. The result is that residents across the wider municipality are subsidising developers through increases in the general rate.

d) Changing State or Federal Government policy positions which have flow on cost impacts for local government and increases in government charges that are in excess of CPI

From time to time State and Federal Governments introduce changed policy objectives which have flow on implications for local government. A recent example is the 4 year old preschool universal access policy which has involved considerable expenditure by Councils. Revised emergency management arrangements following the Bushfires Royal Commission have also resulted in substantial additional costs for many rural, **Peri-Urban** and interface municipalities.

Over the last five years there has also been a number of increases in government charges paid by Councils which have increased by more than CPI. Recent examples include the landfill levy and the fire services levy (which had a much higher impact in CFA Councils (including Interface) than it did in MFB areas).

e) Services that councils deliver on behalf of the State Government which are not fully funded through grants

The successful implementation of a rate capping framework must recognise the interdependent financial relationship between all levels of Government, but in particular that of State and Local Governments. A cut or a restriction in one area can have flow on implications for others.

Local Governments typically provide a number of services on behalf of, or in partnership with, State and or Federal Governments which are funded through grant programs. There is evidence that over time grants have not kept pace with the true cost of service delivery. Restricting the ability of Councils to generate revenue through rates will bring increased focus and scrutiny on those areas where Local Government receives less funding than the cost of delivery of such services. The most significant example of this is HACC services, where it is estimated that Victorian Councils currently contribute approximately $115m per annum above grant funding levels. Other examples include School Crossing Supervisors, Library Services and Youth Services, Immunisation, Maternal Child Health services. An unintended consequence of rate capping may be a reduction in Local Government's ability to subsidise declining real contributions from other levels of government for these services. In this scenario, Councils would deliver services to the level of funding provided, rather than to the true cost of the service.