City of
KINGSTON

15 May 2015

Mr Ron Ben-David
Chairperson
Essential Services Commission
Level 37
2 Lonsdale Street
MELBOURNE VIC 3000

Dear Mr Ben-David

Re: Local Government Rates Capping and Variation Framework Review

Please find attached Kingston City Council's submission in response to the Local Government Rates Capping and Variation Framework Consultation Paper.

Council welcomes both the opportunity to put forward a submission and your commitment to consulting throughout the development of the rate capping and variation framework.

Council appreciates the Commission's recognition and understanding of the significant task it has been asked to deliver - which is articulately captured in the breadth and depth of issues represented throughout the consultation paper.

For many years Kingston Council has worked hard to deliver financially responsible and balanced budgets, that keep rates low while delivering high-quality services and maintaining valuable community infrastructure.

Due to our strong focus on sound financial management, Council is well prepared to respond to the Victorian Government's rate-capping policy and we intend to continue to deliver quality community services and infrastructure.

If you have any queries in relation to our submission, please contact our General Manager, Corporate Services, Paul Franklin on 9581 4704 or via e-mail on paul.franklin@kingston.vic.gov.au

Yours sincerely

John Nevins
CHIEF EXECUTIVE OFFICER

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Essential Services Commission – Rate Capping Consultation Questions

Introduction

In response to your request for advice on the magnitude and impact on ratepayers of above CPI rate increases (page 21) it is important to consider their "capacity to pay". During the same period of time cited in your Consultation Paper of 2005/06 to 2012/13 Average Weekly Earnings (AWE) (ABS 6302 – Table 3) increased by 35%.

The proportion of Annualised Average Weekly Earnings required to pay the Average Rates/ assessment in Kingston was 2.28% in 2005/06. The comparable proportion of annualised Average Weekly Earnings to pay the average rates charge in 2012/13 was 2.67%.

	2005/06		2012/13
KCC Average Rates/ Assessment	$973.41		$1,536.50
AWE May 2006 *	$819.70	May 2013	$1,105.00

*Source: * ABS 6302 Table 3*

Annualised AWE	$42,626.40	$57,460.00
Average Rates/ Assessment Annualised AWE	2.28%	2.67%

Allowing for the change net in income is a more balanced reflection of capacity to pay rates, not merely the gross 40% to 60% increase in rates identified in your paper.

During this time substantial cost increases were imposed on Local Government including:

- Sector wide defined benefits superannuation calls of $524M of which Kingston was required to fund $12.4M.
- Landfill levies increasing the cost of Waste Disposal from $9/tonne in 2009/10 to $58.50/tonne in 2014/15. Kingston places 30,000 tonnes of waste in landfill per annum. The change in Government levy has added $1.5M per annum to the costs borne by ratepayers through the Waste Service Charge on our rate notices.

These and other costs have generally not been able to be absorbed by local governments in Victoria.

Specific Questions asked in the consultation paper.

THE FORM OF THE CAP

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

A cap more reflective of cost changes that apply to local government is required.

CPI, while it is simple to understand and apply does not reflect the basket of goods and services purchased by a Council. The goods and services included in the CPI basket typically comprise approximately 3% of the total spend by Councils. The main cost elements purchased by Kingston Council in 2014/15 that are within the CPI basket are:

- Fuel $0.4M
- Food (Meals on Wheels) $1.2M
- Utilities (Gas, Electricity and Water) $2.6M
- Communications (Voice and Data) $1.2M; and
- Insurances $1.1M

A total of $6.5M. This compares to a total spend by Council of $185.6M in 2014/15.

In short, the CPI basket of over 100,000 consumer goods and services is simply not representative of a Council's spending.

A typical spend profile for a Council is:

- Labour 40%
- Goods and Services 40% e.g. home and community services, contract payments for services such as waste collection and disposal; civil infrastructure minor maintenance works; and open space mowing etc
- Civil and Building Capital Works 20% eg typical pavilion and community centre building projects and road/footpath/drainage reconstruction works.

An appropriate index should reflect movements in these cost types, such as a combination of a:

- Labour Price Index;
- Construction Price Index; and/or
- General Price Index

would better reflect the cost drivers of a Council.

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

If an index is to be utilised it should be more representative of the price changes that Councils are subject to.

The Victorian Auditor-General in February 2013 reported to Parliament on Rating Practices in Local Government.

Recommendation 2 in that report was for DPCD (as it then was) to:

"In consultation with the Municipal Association of Victoria, review the adequacy of the Local Government Cost Index and encourage the use of an agreed benchmark by councils in the annual reporting of their rates and charges."

The Auditor General commented that:

"Many Councils are dissatisfied with both CPI and LGCI as benchmarks. They argue that the scale of rate increases needs to be understood in the context of large, externally imposed costs, and factors over which Councils have little control, that are currently not reflected in the construction of the LGCI.

More specifically, they suggest the LGCI does not adequately reflect actual wage costs for Councils, external market forces, and the actions of the Victorian and Australian governments, which combines to increase service delivery and infrastructure costs, while diminishing external funding."

The Local Government Cost Index was developed by the MAV to identify the forecast increase in costs to deliver the same level and range of services as the previous year – or the change in costs to maintain that status quo. The index is a calculated weighted index encompassing both employment costs (80%) and construction price movements (20%).

The limitations inherent in the MAV Local Government Cost Index is that it makes no allowance for:

- Growth in service demand;
- Addressing the infrastructure renewal gap;
- Declining levels of grant funding from other levels of Government in absolute and real terms;
- Expansion of Council responsibilities;
- Increases levels of regulatory compliance;
- Levies imposed by other levels of government;
- Level of debt;
- Unexpected cost impositions e.g. Unfunded Superannuation Call, natural disasters and cost shifting by other levels of government etc.; and
- Decisions to expand services or assets for the community.

Unquestionably, a comprehensive and validly measured index would be an important metric by which Councils could judge, and be judged. Implicit in formulating a Council Plan that is responsive to the community are Council considerations about the resourcing required via rate revenue, other funding options; prioritisation of services as well as the community's capacity to pay.

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?

Councils are required under the *Local Government Act 1989* (the Act) to produce a Council Plan (S125) that includes the strategic objectives of the Council and Strategies for achieving the objectives for at least the next four years. Council is also required to develop a Strategic Resource Plan (S126) to achieve those strategic objectives including financial statements for at least the next four years.

This section of the Act requires a Council to ensure that the resources required are consistent with the objectives of the Council Plan.

For Councils to comply with those obligations it will be necessary for the annual cap and an indicative cap for at least three further years on a rolling basis be provided to Councils. Otherwise Council will be reduced to only being able to commit to services and asset renewal or upgrade plans 12 months in advance or to make their own assessment of the cap in future years, potentially resulting in inconsistency across local governments and an over or under commitment of services or works. The lack of certainty will not be satisfactory to the community nor is it a responsible way to plan an organisation's future strategic activities.

In addition, a responsible Council will typically prepare at least a 10 year financial plan to provide insight into whether the Council can adequately resource its operations and capital works program in the medium term and to provide high level guidance to the community on timing of capital works programs etc.

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

The cap should be based on a forecast of whatever index is determined to be used. This will minimise any mismatch between price changes being experienced as they are being incurred and not what has happened in the prior year.

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

It would not be easily understood by the community (or Councils) if different caps were applied to different Council areas; conversely the services and communities Council's provide very widely and therefore a single cap may be too simplistic.

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?

Part 8A of the Act gave the Minister the power to limit income from rates and charges and was utilised in the mid to late 1990s.

S185A defines General Income as: General Rates; Municipal Charges; Service Rates; and Service Charges. Each requires separate consideration of whether it should be included in a cap.

General Rates) Municipal Charge))	These two should be within the cap. This represents the discretionary revenue that is raised by Council to fund Operating and Capital expenditures.
Service Charge/Rates	These should be outside any cap as they relate to specific service provision where the relationship between the services being provided and the beneficiary (the ratepayer) is clear and unambiguous. The cost of service delivery is clearly defined, simple and efficient to allocate. Equally costs in this area are generally beyond Council's control eg landfill levy which is set by the EPA/State Government; waste disposal fees which are increasing as landfills in Melbourne rapidly close and environmental rehabilitation costs increase. In 2005/06 the total direct cost to deliver Kingston's waste services was \$8.3M. In 2012/13 the cost to deliver this service was \$10.3M (excluding carbon tax) and in 2015/16 this has risen to \$12.1M. This equates to a 45% increase in direct costs to Council that have been recouped by way of the Waste Service Charge with no charge in the attributes or characteristics of the service. During this time the number of properties receiving this service rose from 56,423 to 61,734. This growth accounts for less than 10% of the above 45% increase in direct costs. To include Waste Service Charges in the proposed cap would impose a down side on Council's other service delivery and capital works plans. It is noteworthy that service charge is used for Waste Collection/Disposal by all sixteen inner metropolitan councils.

Inclusion of the special rates and special charge extends the range of items that have previously been included in the calculation of a capped general income.

Special Rates & Special Charge	Should not be in the cap as the special rate/charge is in place as it has been determined that a special benefit to the persons required to pay rate/charge exits. This is consistent with the user pays principle. In order to apply special rates and charges Councils need to go through a separate statutory process for them to be established.

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

Cap should apply to total annualised rate revenue (see 8 below). This ensures that relative valuation movements between properties continues to drive the apportionment of total rate revenue among all rate payers.

A cap per assessment would render the valuation process redundant and over time increase inequities between individual properties as valuations change at different rates and between classes of properties (eg residential compared to industrial/commercial) currently subject to differential rating strategies by Councils.

A method to rate new or changed properties would also be required to ensure the contribution to total rate revenue was fair. Being brought in at a current valuation date would be inequitable when compared to properties that had previously been subject to capping. It is the valuation and the revaluation process that delivers ongoing equity in sharing the rate burden among all rate payers. To move to a cap per assessment would defeat this principle of equity.

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

The calculation of the next year's rates and charges (general income as defined in Section 185A) needs to be based on an annualised current year rates and charges revenue calculation, that is the amount of rate revenue, inclusive of service (waste) and municipal charges that would have been raised had all properties been in their current status for the full year. The use of an annualised general income is necessary to ensure that Council has adequate/fair resources to support all properties and rate payers, as reflected by their final capital improved value and number, for the new year in full.

By way of example, the addition of one additional property valued at $500,000 as at 1 January being added to the rate base of a city and the base used in subsequent years can have a significant effect if incorrectly determined for the sector. Noting that Kingston adds approximately 500 new assessments and $300M of additional property value to the rates database.

Year 1

		Rates Raised	**Annualised Rates**
	1 July Budget Estimate Year 1	**1 January Actual Year 1**	**30 June * Budget Base Year 2**
CIV	$10,000,000	$10,500,000	$10,500,000
Number of Assessments	20	21	21
Rate in $	0.20000	0.20000	0.20000
Rates	**$20,000**	**$20,000**	**$21,000**
Supplementary Rate @		$500	
Total Rate Revenue Raised	**$20,000**	**$20,500**	**$21,000**
Rates/Assessment	$1,000		$1,000

* Annualised based on year end CIV
@ Represents 6 months rates pro rata for 6 months service

Year 2

		Current and Preferred Option
	Rates Raised Base Actual Year 1	**Annualised Rates Budget Base Year 2**
Year 1 Base	$20,500	$21,000
CPI +2% #	$410	$420
Year 2 Rate Revenue Target	$20,910	$21,420
CIV	$10,500,000	$10,500,000
Number of Assessments	21	21
Rate in $	0.19914	0.20400
Rate Revenue Year 2	$20,910	$21,420
Rates/Assessment	**$996**	**$1,020**

CPI assumed to be 2%

Supplementary rate income for the prospective year should be outside of the budgeted (and capped) general income to allow for new properties that come on stream through the year with related service delivery and potentially capital costs to Council. Supplementary Rates ensure that all properties contribute an equitable share of rates (general income) during each year.

If Council were to use actual revenue for the base Council's revenue per assessment will decrease each year in real terms.

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

There are no issues from the current revaluation process being completed every two years. This cycle ensures valuations used to apportion rates are current thus ensuring equity among ratepayers.

10. What should the base year be?
The base year should be the year prior to the introduction of rate capping.

THE VARIATION PROCESS

11. How should the variation process work?

Sequencing is critical for the variation process to be credible with the community. If a Council wishes to apply for a variation to the cap; whether for one year or more than one year, the Council should first have complied with the requirements for consulting on the Budget and/or Council Plan & Strategic Resource Plan of the Act. This will require a Council to have considered the need, or not, to apply for a variation to the cap well in advance of the current budgeting cycle which commences internally to Council usually in the November/December timeframe of the prior year.

This will ensure that the ESC considers the submission in the context of having heard what the community thinks of the proposal. Of course, the challenge is for the Council to run a consultation process that engages the community and draws comments/submissions on the proposal for a variation to the cap. Despite running a public engagement process as described in our response in 14. below, typically, very few submissions are received on the budget, with most feedback provided following the issue of the Rates Notice. Over the last five years Kingston has averaged eight formal submissions on its budget every year. Kingston issues approximately 71,000 rates notices a year.

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

Council have a Statutory obligation to achieve the best outcomes for their local community. Their primary objectives are to efficiently and effectively promote the social, economic and environmental viability and sustainability of the municipality. Therefore, there should be no limitation in the circumstances under which a Council could seek a variation to the cap provided there is strong support from the community.

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

Consideration should be given to including the following exceptions:

- Unfunded Defined Benefits Superannuation Calls. Legislation dictates that, unlike State and Federal Governments, Local Government's closed defined benefits superannuation fund must comply with APRA legislation and be fully funded at all times. In the last 10 years unbudgeted calls totalling in excess of $500m have been contributed by Local Government.
- Waste Collection/Disposal Costs – see earlier discussion on service charges/service rates in item 6 above.
- Closed Landfill Remediation and monitoring costs imposed by EPA/VCAT orders.

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.

These are fine if you accept that raising rates is the only funding source. It would be appropriate for Councils to also demonstrate that additional funds could not be raised/sourced from:

- Accumulated Cash Reserves;
- Government Grants;
- Borrowings – note need to repay in future periods;
- User Fees and Charges;
- Joint Venture Partnerships; or
- A mix of the above.

COMMUNITY ENGAGEMENT

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

Better practice budget engagement would include:

1. Budget Information Sessions (including visual presentation with content about rates and how to make a submission);
2. Face to face communication with ratepayers effected by significant increases in rates; and
3. Direct communication of information provided through a range of channels including web, social media, information brochure and engagement with the local media.

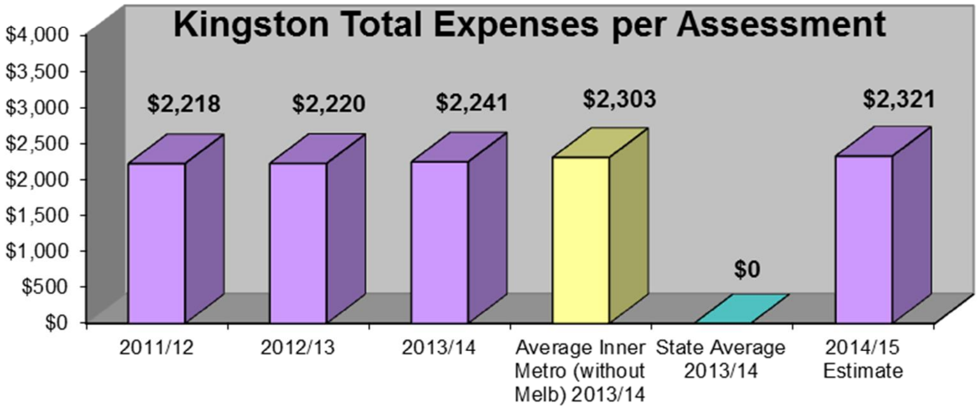
When consulting the conduct of a representative sample survey of resident ratepayers has provided Kingston with a deep insight into the views of the silent majority. It was particularly insightful to compare the representative survey results with those who "self selected" into a concurrent electronic survey process. This technique enabled Kingston Councillors to understand the objective views of its ratepayers when developing its current rating strategy. When recently posed the question "what would you prefer rate rises or service cuts?", the representative sample found it difficult to respond. In essence they responded by saying "it depends on what service you wanted to cut" or "just be more efficient".

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?

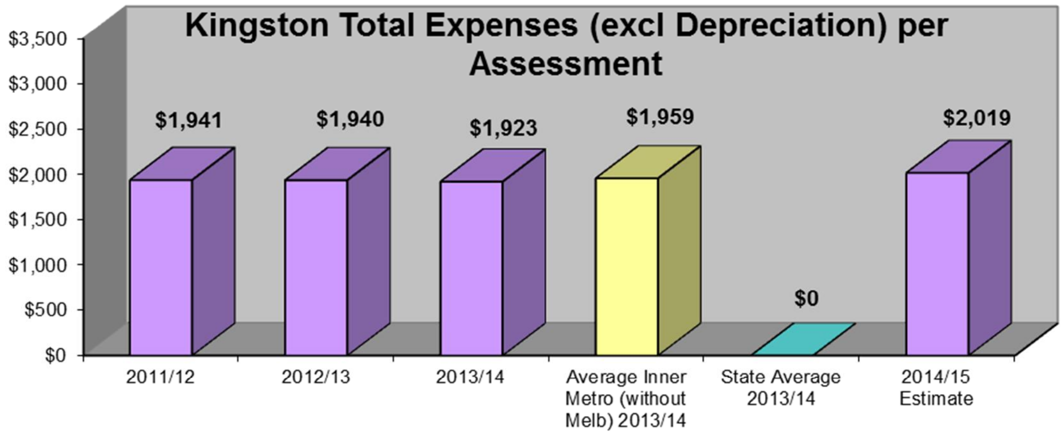
Councils walk a fine line between raising income from rates and charges to meet increasing community demands in terms of quantity and quality of services and the impact that action may have on all classes (residential, industrial, commercial, rural) of ratepayers and their capacity to pay. However, Council has a responsibility to ensure that sufficient income is generated from all sources (grants, user fees, rates) to ensure both continuity of services provided, the renewal of existing assets and the provision of new assets. Councillors and officers spend a great deal of time to ensure that operations are efficient and effective and that the rate rises required are as low as possible for the services and capital projects that are delivered.

Kingston focus on cost containment is demonstrated below:

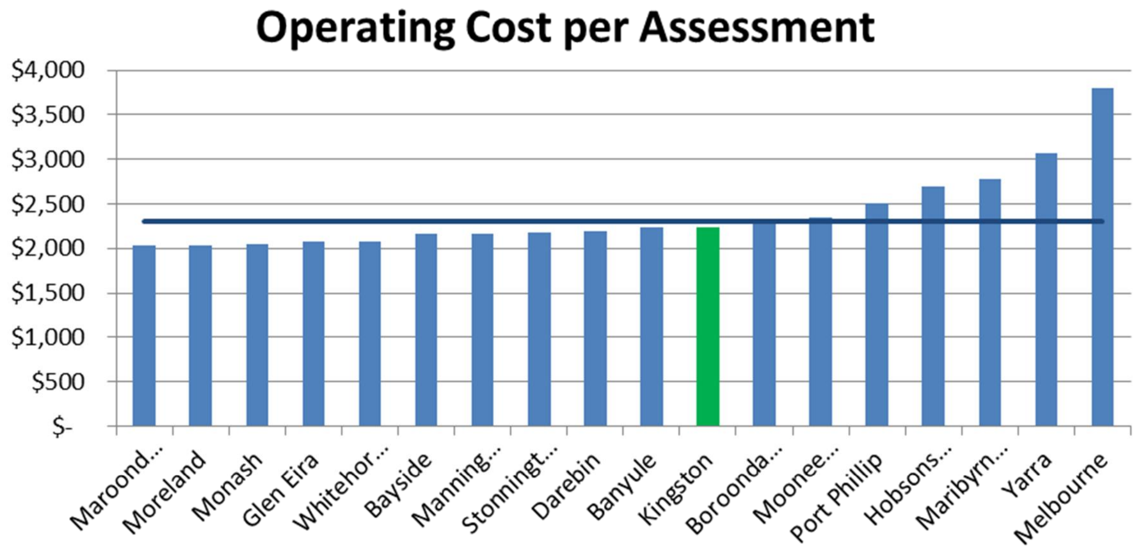


The graph above demonstrates the cost containment that Kingston Council has delivered for many years. In 2011/12 the operating cost per assessment was $2,218 per assessment. In 2013/14 it was $2,241 per assessment. This is an increase of only 1.04% in costs in the two year period in nominal terms. Taking into account CPI of 5.48% over this two year period, this equates to 4.44% real decrease in the operating expenditure per assessment.

If you exclude non cash depreciation and focus purely on cash outflows Kingston has reduced its operating cost per assessment from $1941 in 2011/12 to $1,923 per assessment a decrease of 0.93% in the two year period in normal terms. Taking into account CPI of 5.48% over this two year period this equates to a 6.41% real decrease.

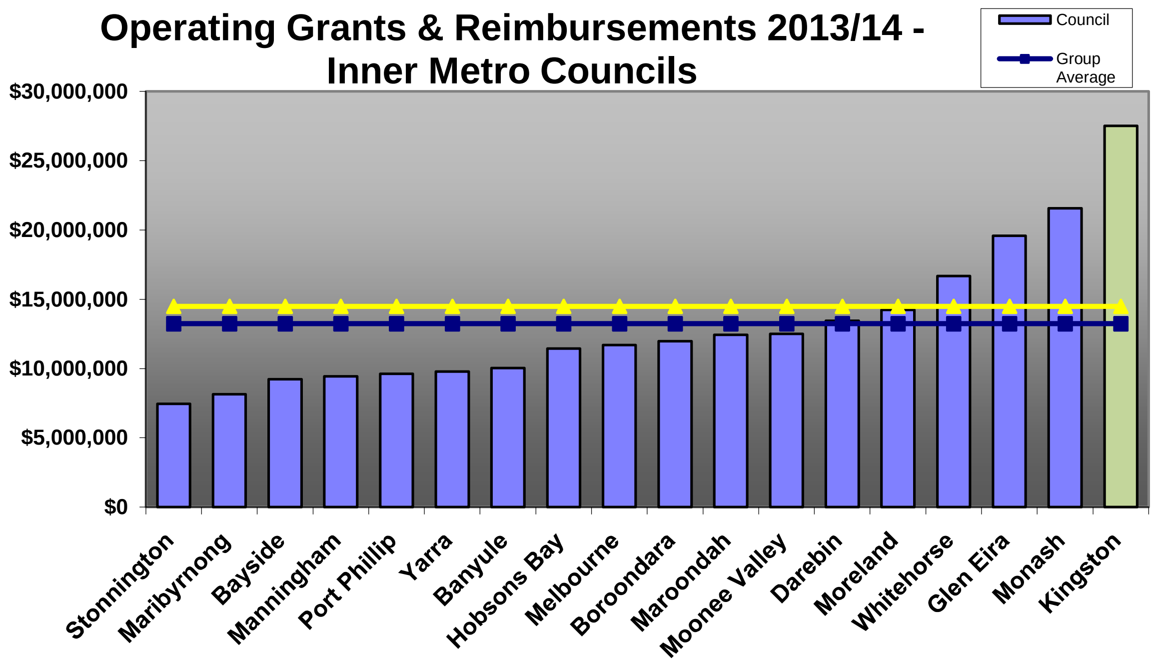


Note: the State Average has been listed as $0 as we are unable to confirm value.

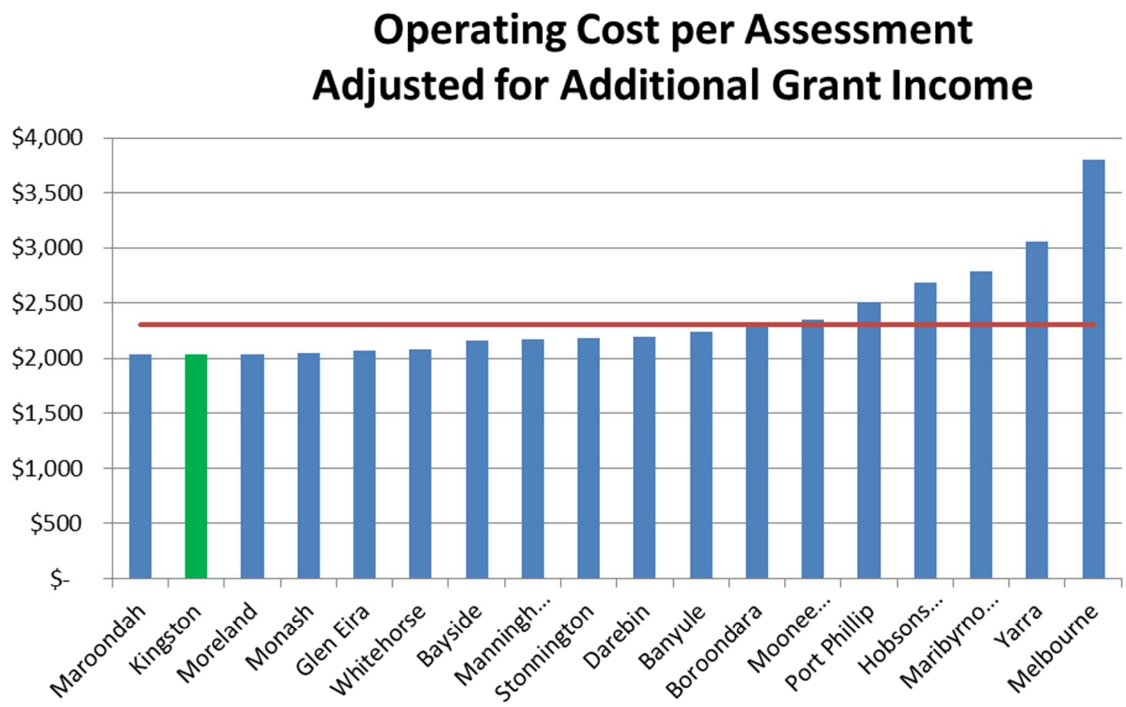


The average operating cost per assessment for inner metropolitan councils is $2303 per assessment (see above graph). Kingston is $62 (or 2.7%) per assessment below the average at $2241 even when taking into account Kingston receiving significantly above the average Metropolitan operating grants of $27.5M.

The Commission is asked to note that the level of operating grants received by Kingston is more than twice the average amount of operating grants received by Inner Metropolitan Councils where the average is only $13.2M (see graph below). This adds an additional $14.3M to the total cost of running Council, as all grants are spent in accordance with the funding agreement. If Kingston received only the average amount of grant revenue this would reduce our Operating Cost per assessment by a minimum of $202; but Council would subsequently be reducing services to the community.



Kingston's $14.3M of above average level of operating grant funding adds an additional $202 per assessment which, when adjusted to exclude above average Operating Grant Income, results in Kingston having the equal lowest operating cost per assessment (equal with Maroondah), for inner metropolitan councils.



However, it is only after consideration of all of the interlocking aspect of a Council's finances and the outputs delivered and/or outcomes achieved can a true assessment be made of whether efficiencies are being achieved. The comparative reporting provided by the Local Government Reporting Framework will be insightful in this regard.

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.

Council elections are held on the last Saturday in October every four years; immediately upon election new Councils are required to consider their Council and Strategic Resource Plans. To facilitate this process Councils need to know the rate caps that are to apply for their four year term.

And on an annual basis, it is preferable the rate cap value is known well in advance so Councils consult with their communities on a budget that is accurately based on the determined capped rate.

Knowledge of the rate cap should also allow a Council the opportunity to consult with their community on a budget that can deliver additional services if an exemption to the rate cap is allowed. Once community consultation is complete, and in the event a community is comfortable with a different rate, this could then be presented to the ESC via the determined application process.

As previously discussed, all Councils are required to have four year strategic and financial plans in place; relying on CPI as the rate cap value, a figure which varies year on year, will add complexity to determining long term Council plans.

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 transitional/implementation arrangements must allow sufficient time for Councils, should they wish, to make an application for a variation in the first year that the cap applies.

ROLES

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

The decision to allow a variation should be made by the Minister on the advice of the Essential Services Commission. This process of approval needs to be completed to allow Councils to adopt their Budget by the 30 June Statutory deadline required by the Act.

OTHER MATTERS

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

The framework for the administration of variations to the cap should be subject to review within the suggested three year timeframe.

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

The cost of administrating the framework should not be passed to local government or those applying for a variation. The cost should be recovered from the State Government.

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.**

All comments are included in above responses.