Level 12, 60 Collins Street
Melbourne, VIC 3000

GPO Box 4326
Melbourne, VIC 3001

Ph: 03 9667 5555
Fax: 03 9667 5550

MUNICIPAL ASSOCIATION OF VICTORIA

29 July 2016

The Secretary
Environment and Planning Committee
Parliament House, Spring Street
EAST MELBOURNE VIC 3002

Dear Mr Delaney

Rate Capping Inquiry

The Municipal Association of Victoria (MAV) welcomes the opportunity to provide a submission to the Environment and Planning Committee's inquiry into rate capping. This submission provides relevant information for the Committee on two main issues: firstly, the emerging consequences arising from the rate capping policy on councils' service and infrastructure provisions, and secondly, some observations from the first iteration of the variation process undertaken by the Essential Services Commission (ESC).

Emerging consequences of rate capping

The MAV has hypothesised that the full consequences of rate capping will not become apparent until the system has been in place for several years. As indicated in its previous evidence to the Committee, the Association believes that the long-term consequences of the framework will be a reduction in the quality of the sector's infrastructure, a narrowing of its service responsibilities and a reduction of its innovation to fill community needs.

Despite expecting most major consequences to be as a result of the application of the policy over time, the first year of the framework has led to several interesting consequences that are relevant to the Committee's terms of reference. As expected, there is some evidence of some councils reducing their support for the following services as a direct consequence of rate capping:

- SES unit funding
- School crossing supervisor program
- Home and Community Care program

These services have several common features such as being the responsibility of the Victorian Government (except for the HACC program, which is the responsibility of the Commonwealth), despite local government being increasingly required to fund a greater proportion of the service over time.

The rate capping framework has effectively crystallised the concern of many councils in being asked to continually fund the State's responsibilities while having its primary revenue source constrained significantly. It reflects an unwillingness to continue to fund state responsibilities while operating under a state-imposed revenue constraint.

Additional publicly reported effects of the rate cap have been reductions in service levels for public libraries (opening hours cut or mobile service schedules reduced), staff job losses and cuts to kindergarten operations. The MAV is also aware that capital projects (such as sporting club pavilions construction) have also been delayed in response to rejected applications to the ESC for cap variations.

Variation process

The first iteration of the variation process has now been completed, with the ESC having made rating determinations on nine of the 10 applications originally received (with the City of Greater Geelong's application withdrawn before determination). The MAV acknowledges that the variation process is likely to evolve as the ESC and councils develop a more mature framework for considering the variations and to this end, we welcome the appointment of Peter Brown to undertake a review of the variation method.

However, we have significant concerns about the experience of the variation process, primarily concerning the high costs borne by councils in the application process and the basis and consistency on the decision-making by the ESC.

Despite the view expressed at previous Environment and Planning Committee hearings by State officials that the costs of applications would be trivial, the experience of councils making applications suggested that the cost of preparing an application was significant. Casey City Council has indicated that the marginal cost of the application was $250k, with additional expenses incurred through the reallocation of internal staff time to prepare the application. While the cost to Casey City Council is at the upper end of applications, it is clear that other councils incurred significant costs in preparing its supporting material for the application. Other councils indicated they did not allocate specific new resources to prepare an application, but took senior staff offline to manage the application process. The opportunity cost of the variation application is considered to be significant for these councils.

The ESC's decision-making process was unclear and apparently inconsistent across the councils that applied for a rating variation. There appeared to be different standards applied to different applicants depending on whether they were rural, or regional city or metropolitan. The basis for their decision-making was not clear based on the guidance material issued in advance of the variation process. While the MAV supports the apparent willingness to provide rating variations to the rural councils that made applications in recognition of their limited resources, it raises concerning questions about how the ESC goes about its decision-making and the administrative fairness of the process.

The first variation process does not provide any real guidance to councils of the likelihood of success in any future application. Given the apparent high cost of compiling a variation application, this lack of clarity around the operation of the process will undermine the capacity of councils to plan whether to apply for a variation in subsequent years. This is particularly problematic given the scope of planning work that councils will undertake following the 2016 election cycle, including the development of Council Plans, strategic resource plans, road management plans, among others. A council's intention to apply for a variation must be considered when considering these planning documents and ongoing uncertainty into 2017 is untenable.

Other observations relevant to the first year of the variation process include the ESC's commissioning of Deloitte Access Economics during the process to provide advice on the optimal underlying surplus position for a council in April 2016. It is apparent that this work informed the ESC's rejection at least one variation, but it effectively 'moved the goal posts' after applications had been made.

Similarly, the experience of the first round of variation suggests the ESC is more likely to support an application if it required resources for general expenditure (such as road renewals) rather than specific projects. While the ESC's stated reason for rejecting applications for funding of individual projects (which can be summarised as questioning why a permanent increase in rates is required for specific and time-bounded projects) may appear reasonable, there is little doubt that these councils are able to provide an investment pipeline arising from a decision to grant a variation about the cap. These councils appear to have been disadvantaged by a lack of clarity in the guidance material around the application process.

The ESC's decision-making also seemed to lack understanding of the local government financial context. Councils will typically have revenue streams (such as developer contributions paid as cash) that are hypothecated to particular projects. Including these funds in assessment of councils' underling financial result or free cash flows shows a lack of understanding of the true financial capacity of the sector. This is particularly the case for councils experiencing significant growth.

Key outstanding issues

The sector does not have any information yet on whether the Victorian Government will fund the application processes to the ESC for 2017-18 and beyond. The experience of the first round of applications demonstrated the costs of preparing an application are significant and potentially could be a barrier for small rural councils. The sector requires the Victorian Government to clarify whether it will continue to fund the variation process before council elections. The MAV believes that the State has a responsibility to fund the costs of the ESC in fulfilling its role under the State-imposed policy of rate capping.

I would welcome the opportunity to meet with the Committee to further discuss these points.

Yours sincerely

ROB SPENCE
Chief Executive Officer