

Local Government – Current State and Federal Inquiries

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AEC GROUP

- AEC has been in operation since 1993.
- Originally operated as “Australian Economic Consultants” before being incorporated as the AEC Group Pty Ltd in 1999.
- AEC has been providing evidenced based insight to public, private and not for profit clients for over 30 years.
- Strategic Finance team comprised of ex-local government CFOs – insights and advice enabled by our local government experience and expertise is our key value we provide.
- Provide a large range of financial and economic support to local government, including financial sustainability reviews, long term financial plans, rating strategy reviews, full cost recovery assessments and pricing, strategic asset management, business cases/feasibility studies and service reviews.

Overview of Presentation

- **Overview of State and Federal Inquiries**
- **Assessment Framework for Financial Sustainability**
- **What is the financial position of local government in Victoria?**
- **Case Study – Brent Quill - City of Wodonga**
- **Revenue Structures for Local Government**
- **Cost Shifting**
- **FinPro Recommendations**

OVERVIEW OF STATE AND FEDERAL INQUIRIES

State and Federal Inquiries

VICTORIA

Committee inquiring into, consider and report, on **local government funding and service delivery in Victoria**, including but not limited to:

- The **effects of cost shifting** from the state and federal governments to local councils in an **examination of vertical and horizontal fiscal imbalances**;
- Whether local councils are **adequately delivering on their core service delivery objectives**;
- The overall **revenue structure of local government**;
- Whether the **existing revenue structure is sustainable and appropriate** or if **alternative models of funding** would be more sustainable and appropriate; and
- Any other related matters.

NSW

Committee inquiring into and report on the ability of local governments to fund infrastructure and services, and in particular:

- **Level of income councils require** to adequately meet needs of their communities
- If **past rate pegs have matched increase in costs**
- **Levels of service and financial sustainability**, including **cost shifting**
- **Social and economic impacts of rate peg** in NSW, for ratepayers, councils and council staff
- **Compare the rate peg** as it exists to **alternative approaches**
- Operation of the **special rate variation process and its effectiveness in providing the level of income** Councils require
- Any other relevant matters.

FEDERAL

Committee is inquiring into, and will report on, **local government matters**, with a particular focus on the following inclusions in the terms of reference:

- The **financial sustainability and funding** of local government
- The **changing infrastructure and service delivery obligations** of local government
- Any **structural impediments to security for local government workers and infrastructure and service delivery**
- Trends in the **attraction and retention of a skilled workforce** in the local government sector, including **impacts of labour hire practices**
- The **role of the Australian Government in addressing issues** raised in relation to the above
- Other relevant issues.



NEED FOR A MORE SUSTAINABLE FUTURE FOR LOCAL GOVERNMENT

Submission to Legislative Council Economy and
Infrastructure Committee Inquiry into Local Government
Funding and Service Delivery in Victoria

MAY 2024

Prepared by the AEC Group

ASSESSMENT FRAMEWORK FOR FINANCIAL SUSTAINABILITY

Framework for Assessing Financial Sustainability

Without an established and appropriate framework to measure and assess financial sustainability, **differing interpretations and opinion prevail.**

Indicators alone do not provide guidance on whether local government is sustainable and **measure risk of financial sustainability.**

Without an **established target range for indicators**, there is no guidance on what the risk is to long term sustainability. **Councils in different cohorts should have different targets established.**

Different **financial indicators impact upon financial sustainability in different ways** and the **weighting of the impact is different across the cohorts** of councils.

In absence of an established sustainability framework, **different indicators can be used from year to year, resulting in inconsistency** in applying and interpreting indicators.

Local Government Victoria, 2023-24 Council Budgets Summary

“Overall council finances remain sound.

*A large majority of councils are budgeting for **operating surpluses**, most have **substantial cash and investments and debt levels remain low**. **70 of 79 councils adopted a 3.5 per cent rate rise in line with the rate cap** and all councils now **have separate rates or charges for kerbside waste collection**. **Capital expenditure levels are consistent with the previous budget year.** “*

*“Based on 2023-24 adopted budgets 70 of 79 Victorian councils have adopted a 3.50 per cent rate rise in line with the rate cap ... **No councils applied to the ESC for a higher cap for 2023-24 and no councils have applied for a higher cap since the 2019-20 budget year.**”*

*“Collectively, Victorian councils are budgeting to hold cash and investments worth **\$5.99 billion as at 30 June 2024 (increased from \$5.28 billion as at 30 June 2023)**. The budgeted cash and investments position largely reflects the accumulation of rates and charges, user fees and bank interest.”*

*This is slightly offset by the decision of the Commonwealth Government to bring forward payment of 100 per cent of the 2023-24 estimated financial assistance grant allocations into the 2022-23 financial year ... However the estimated collective impact of the brought forward payment is approximately **\$235 million – only a small percentage of the \$5.99 billion total.**”*

Victoria Auditor General Office (VAGO), Results of 2022–23 Audits: Local Government

“The sector’s financial performance improved slightly. A number of revenue and income streams increased, but growth in councils’ expenses outpaced this for another year. Financial performance would have declined had the Australian Government not advanced 100 per cent of the 2023–24 financial assistance grants in 2022–23.”

“Councils’ balance sheets remain strong and over the short term their financial health is fine. They face longer-term challenges that require sound financial planning and management to maintain this financial health.”

*“The adjusted underlying result indicator measures a council’s ability to generate a surplus from its ordinary course of business (excluding capital receipts) to fund its capital spending. It is important that councils generate enough money to deliver community services. **A longer-term negative trend in this indicator could force councils to reduce the services they offer their communities.**”*

“In 2022–23 the sector’s adjusted underlying result deteriorated to 0.15 per cent, compared to 1.41 per cent in 2021–22. The adjusted underlying result before the pandemic was greater than 4 per cent.”

Essential Services Commission advice on rate cap for 2024-25

*“While council **cash reserves are declining**, the sector maintains **low levels of debt and stable borrowing levels.**”*

*“Council costs increased at a slower rate than inflation during 2022-23 but as a **higher rate than the current rate cap of 3.5%.**”*

*“**Construction costs continued to rise** but at a slower pace than last year.”*

*“**Expected future wage increases have the potential to raise council costs in the future.**”*

*“**Major driving factors of the overall increase in CPI are not key council cost components.**”*

*“**While most councils working capital ratios are still in an appropriate range, the downward trend may not be sustainable in the longer term.**”*

*“**While lower rate caps can decrease the overall rate burden on a community, it is a blunt tool and must also be balanced against the long term sustainability of councils. In our view, well-functioning hardship policies and programs can be effective in supporting ratepayers experiencing vulnerability.**”*

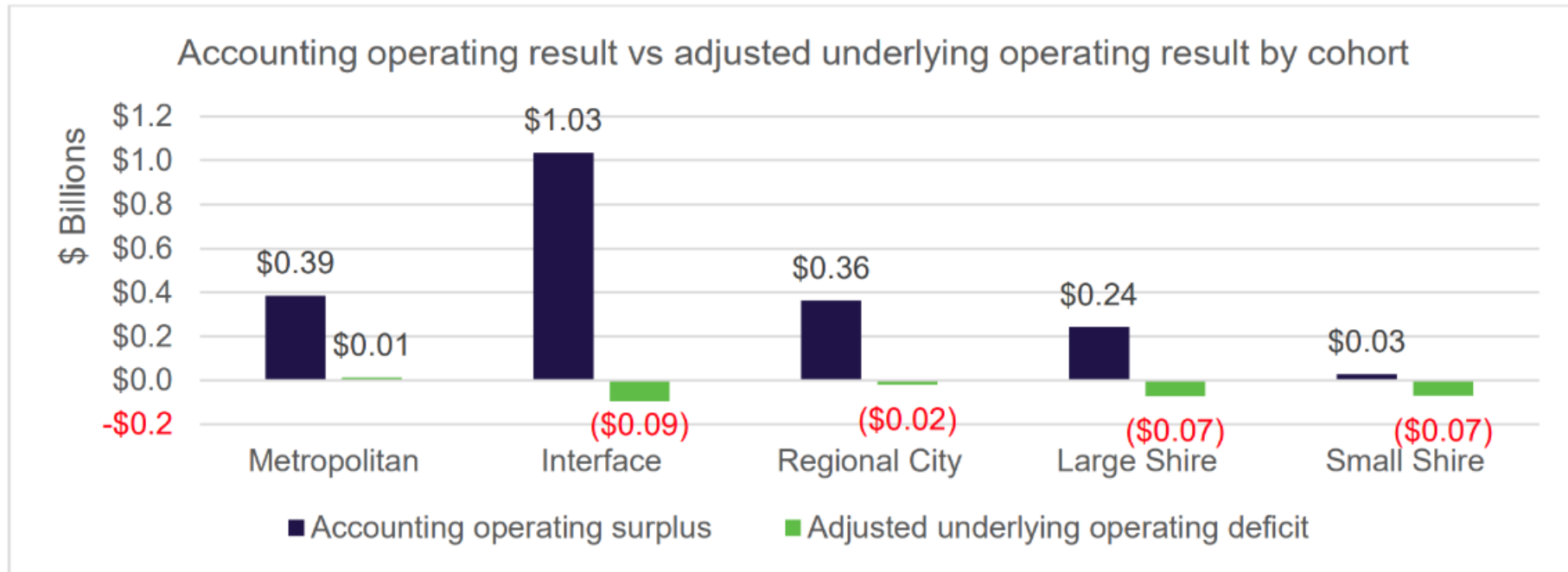
However, ESC provided advice to the Minister that:

- The average rate cap be set equal to the 2024-25 CPI forecast by the Department of Treasury and Finance,
- No adjustment be made, and
- A uniform cap continues across all councils.

Consistency in use and application of indicators is important.

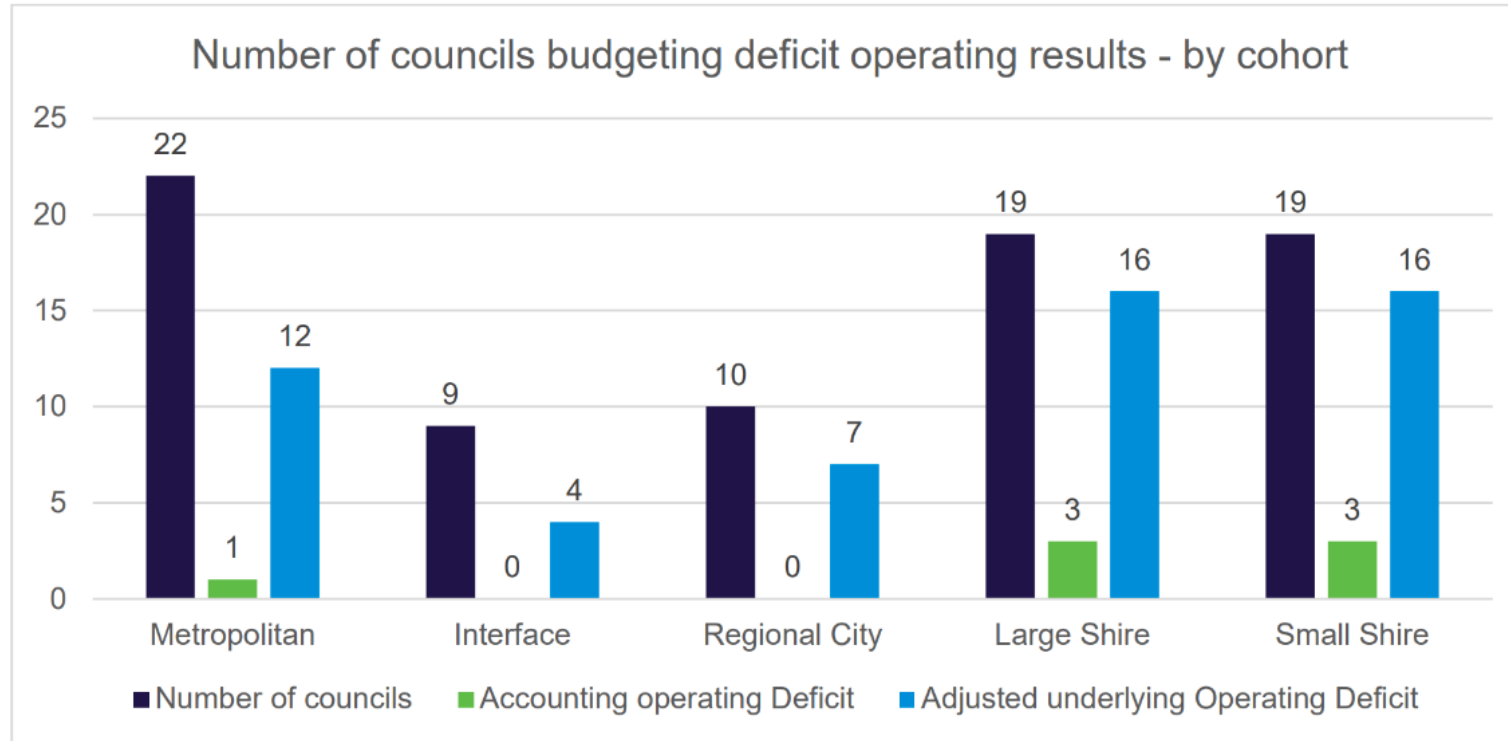
For example, the analysis of the operating result by LGV in the summary of the 2022-23 budgets is very different to the summary provided for the 2023-24 budgets.

Figure 33 Budgeted accounting operating result (surpluses) & adjusted underlying operating result (deficits) by cohort



Source: 2022-23 adopted budgets

Figure 34 Number of councils reporting accounting operating deficit and adjusted underlying operating deficit by cohort 2022-23



Source: 2022-23 adopted budgets

Overall, 55 out of 79 councils are projecting an adjusted underlying operating deficit. The total cumulative adjusted underlying operating deficit for the sector amounts to \$241.42 Million (\$242.86 million in FY 2021-22 Adopted Budgets). In VAGO’s most recent report on 2020-21 local government audits the small, large and interface council cohorts all reported negative adjusted underlying results of below zero (a deficit). This indicates a greater risk to a council’s ability to generate a surplus in the ordinary course of business. The metropolitan and regional city cohorts recorded small positive adjusted underlying results (a surplus). **To remain financially sustainable councils ideally need to record small adjusted underlying surpluses over the medium to long term.**

In the below commentary by LGV the assessment is based on “accounting operating surplus” for 2023-24 council budgets which is in contrast and inconsistent to the previous year’s approach.

Operating results

To remain financially sustainable councils should aim for small operating surpluses on average over multiple years. This is because continued operating deficits consume and reduce council financial resources over time, resulting in an unsustainable financial position. 71 of 79 Victorian councils are budgeting for an accounting operating surplus in 2023-24, while the remaining 8 councils are budgeting for an accounting operating deficit.

Financial Performance Measures

Expected Range

Efficiency		
E2	Expenses per property assessment	\$2,000 to \$5,000
E4	Average rate per property assessment	\$700 to \$2,000
Liquidity		
L1	Current assets compared to current liabilities	100% to 400%
L2	Unrestricted cash compared to current liabilities	10% to 300%
Obligations		
O2	Loans and borrowings compared to rates	0% to 70%
O3	Loans and borrowings repayments compared to rates	0% to 20%
O4	Non-current liabilities compared to own source revenue	2% to 70%
O5	Asset renewal and upgrade compared to depreciation	40% to 130%
Operating position		
OP1	Adjusted underlying surplus (or deficit)	-20% to 20%
Stability		
S1	Rates compared to adjusted underlying revenue	30% to 80%
S2	Rates compared to property values	0.15% to 0.75%

Local Government Better Practice Guide

Expected ranges include results that would indicate very poor to very good financial sustainability.

There is no guidance to what range is necessary to be sustainable.

Framework for Assessing Financial Sustainability (cont'd)

VAGO historically published a criteria-based assessment – last used for the report on 2019/20 audits

Risk	Net Result	Adjusted underlying result	Liquidity	Indebtedness	Internal financing	Capital replacement	Renewal gap
High	Less than Negative 10% Insufficient revenue is being generated to fund operations and asset renewal.	Less than 0% Insufficient surplus is being generated to fund operations.	Less than 0.75 Immediate sustainability issues with insufficient current assets to cover liabilities.	More than 60% Potentially long-term concern over an entity's ability to repay debt levels from own-source revenue.	Less than 75% Limited cash generated from operations to fund new assets and asset renewal.	Less than 1.0 Spending on capital works has not kept pace with consumption of assets.	Less than 0.5 Spending on existing assets has not kept pace with consumption of these assets.
Medium	Negative 10% to 0% A risk of long-term run down to cash reserves and inability to fund asset renewals.	0% to 5% Surplus being generated to fund operations.	0.75 to 1.0 Need for caution with cashflow, as issues could arise with meeting obligations as they fall due.	40% to 60% Some concern over the ability to repay debt from own-source revenue.	75% to 100% May not be generating sufficient cash from operations to fund new assets.	1.0 to 1.5 May indicate spending on asset renewal is insufficient.	0.5 to 1.0 May indicate insufficient spending on renewal of existing assets.
Low	More than 0% Generating surpluses consistently.	More than 5% Generating strong surpluses to fund operations.	More than 1.0 No immediate issues with repaying short-term liabilities as they fall due.	40% or less No concern over the ability to repay debt from own-source revenue.	More than 100% Generating enough cash from operations to fund new assets.	More than 1.5 Low risk of insufficient spending on asset renewal.	More than 1.0 Low risk of insufficient spending on asset base.

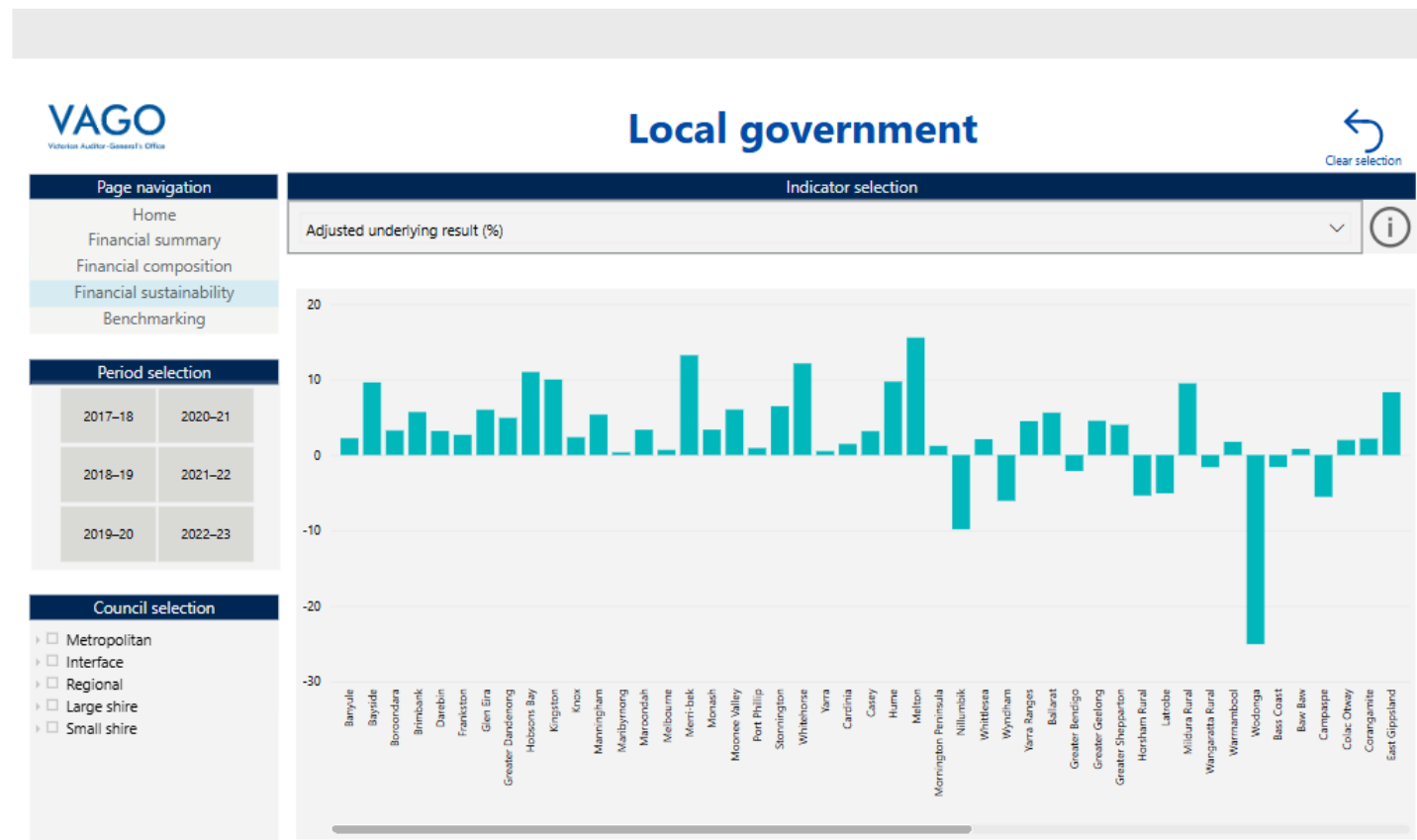
Source: VAGO Results of 2019-20 Audits: Local Government

Framework for Assessing Financial Sustainability (cont'd)

VAGO Data Dashboard – financial sustainability indicators


Results of 2022–23 Audits: Local Government

Tabled: 7 March 2024



Framework for Assessing Financial Sustainability (cont'd)

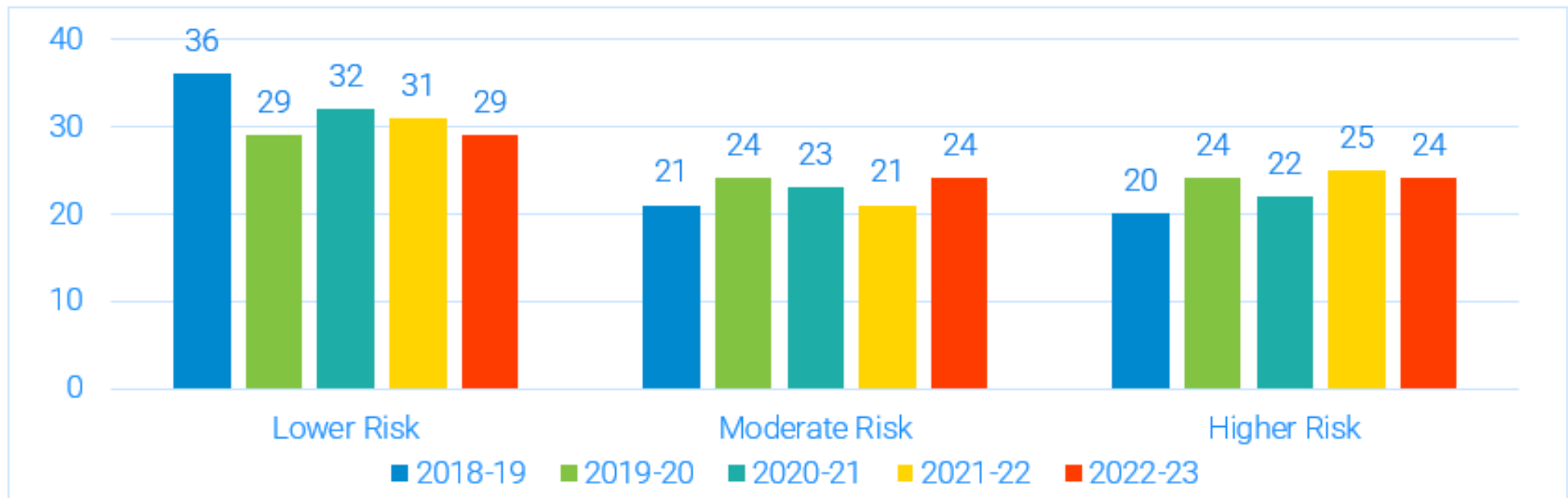
Example of a criteria-based Sustainability Framework – Queensland Audit Office (QAO) financial sustainability risk criteria

Risk level	Risk criteria
Higher risk 	There is a higher risk of sustainability issues arising in the short to medium term if current operating income and expenses policies continue, as indicated by average operating deficits (losses) of more than 10 per cent of operating revenue.
Moderate risk 	There is a moderate risk of sustainability issues over the longer term if current debt financing and capital investment policies continue, as indicated by: <ul style="list-style-type: none"> • a current net financial liabilities ratio of more than 80 per cent of operating revenue, or • an average asset sustainability ratio of less than 50 per cent, or • average operating deficits (losses) of between 2 per cent and 10 per cent of operating revenue, or • having 2 or more of the ratios assessed as moderate risk (see Figure I2).
Lower risk 	There is a lower risk of concerns about financial sustainability based on current income, expenses, asset investment, and debt financing policies.

Source: Queensland Audit Office.

Framework for Assessing Financial Sustainability (cont'd)

Example of a criteria-based Sustainability Framework – LGAQ Submission to the Federal Inquiry included Queensland Audit Office risk assessment for financial sustainability of all Queensland councils.

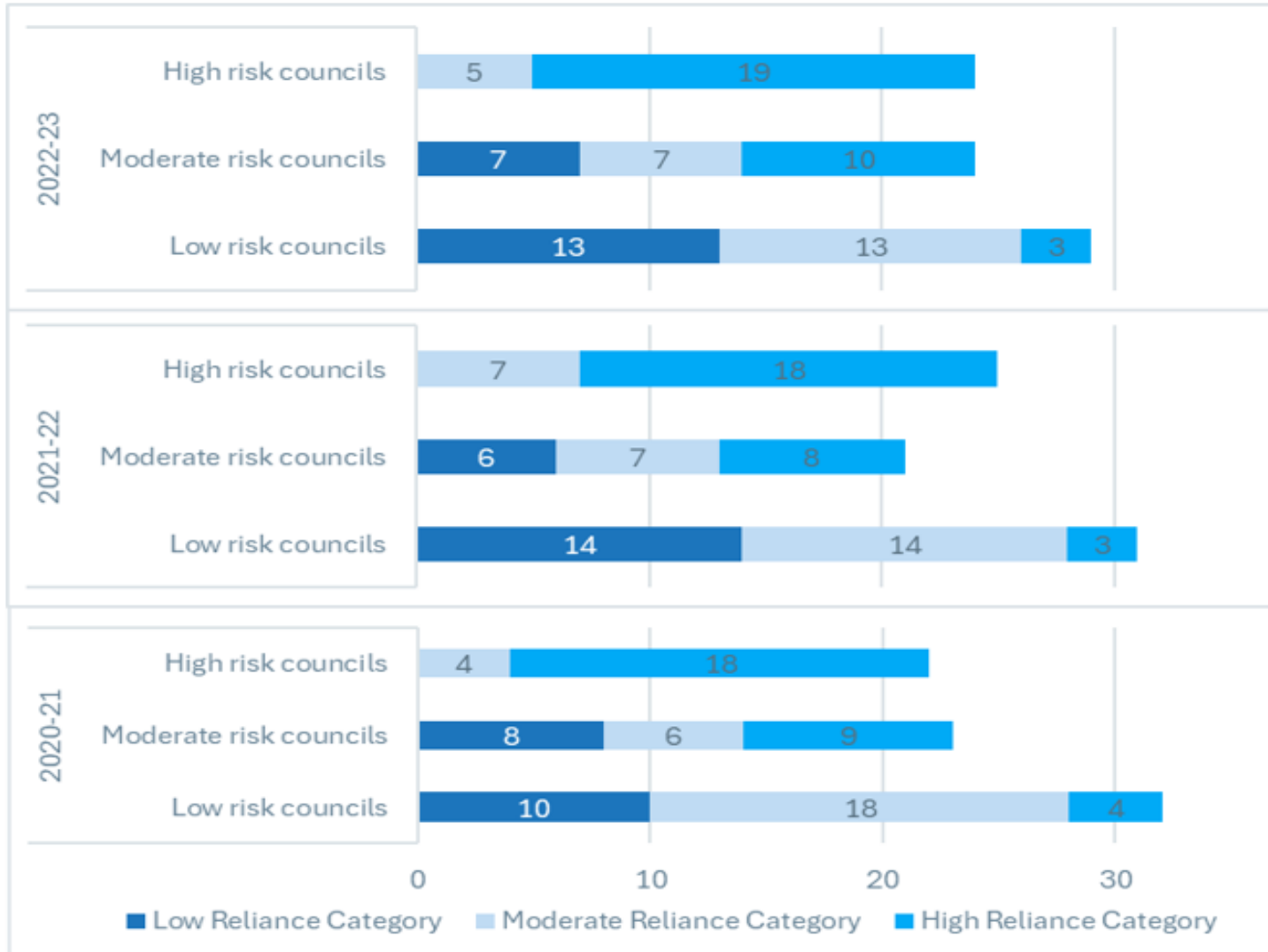


Source – Queensland Audit Office, Local Government 2023 (Report 8: 2023-24)

The QAO has highlighted that, as at 30 June 2023, 48 councils are at either a moderate or a high risk of not being financially sustainable – which is an increase from the 46 councils reported as at 30 June 2022. LGAQ Submission to Federal Inquiry

Framework for Assessing Financial Sustainability (cont'd)

Example – LGAQ Submission to the Federal Inquiry



Analysis by QAO of councils by risk outcome and reliance upon grants funding highlights that a large majority of councils in the high reliance category were also assessed by QAO as having a high financial sustainability risk – see Figure 4 below that indicates a deterioration in the risk of sustainability for councils with a high reliance upon grant funding.

LGAQ Submission to Federal Inquiry

Source – Queensland Audit Office, Local Government 2023 (Report 8: 2023-24)

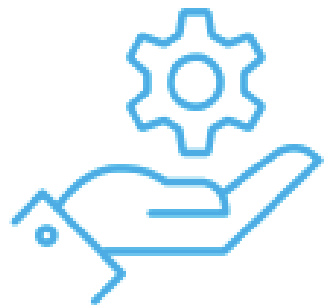
WHAT IS THE FINANCIAL POSITION OF LOCAL GOVERNMENT IN VICTORIA?

AEC Approach to Assessing Financial Sustainability



TEST 1 **MAINTAINING FISCAL CAPITAL**

Can Council demonstrate capacity to access cash as required for current and future needs of services and infrastructure?



TEST 2 **MAINTAINING INFRASTRUCTURE CAPITAL**

Can Council demonstrate capacity to provide infrastructure at an acceptable level of performance as required by current and future services?

FinPro Submission

In the absence of an established definition, and for the purposes of the Committee’s consideration, FinPro suggests to the Committee that the definition for financial sustainability should be:

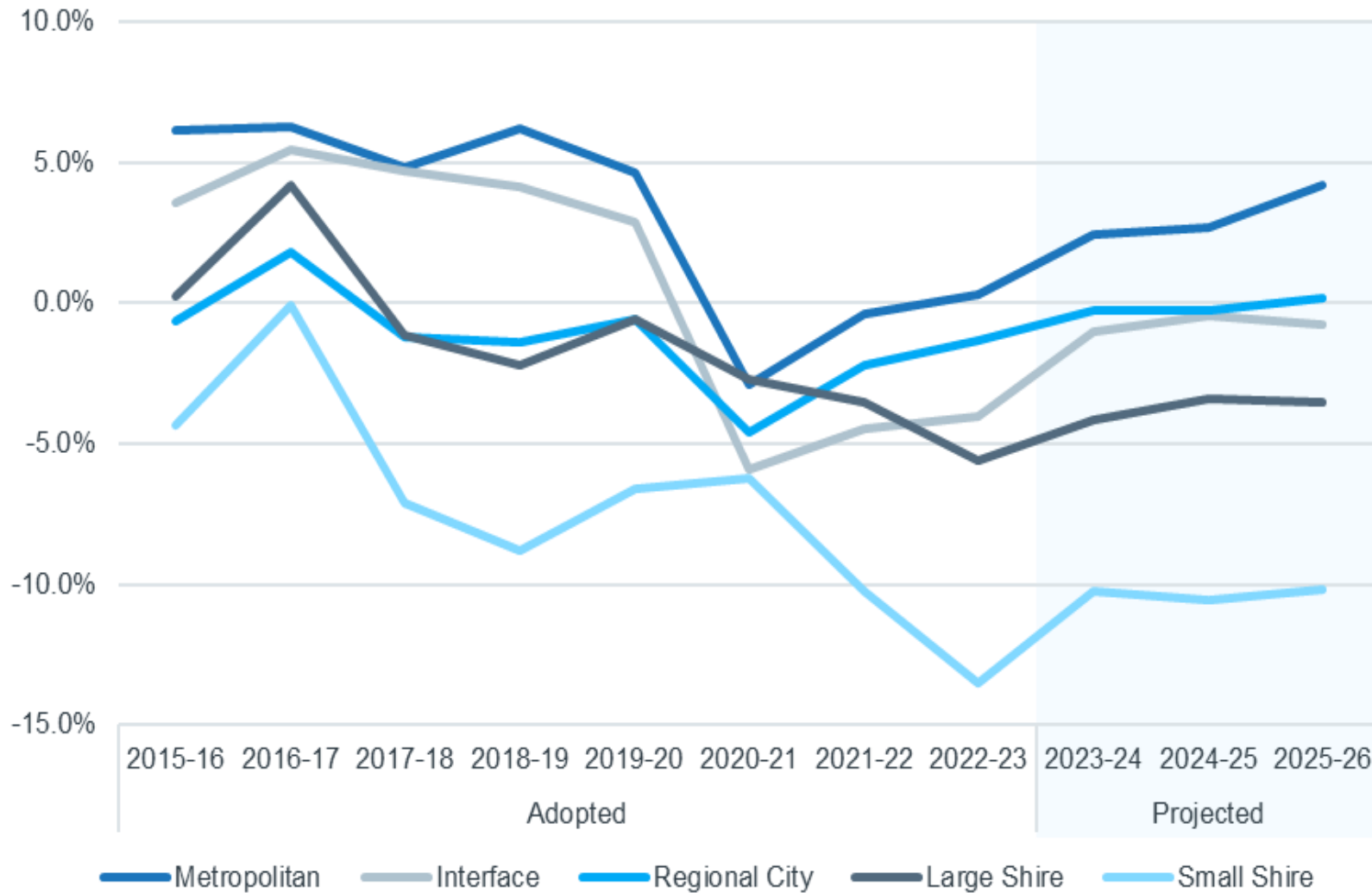
Demonstrated capability to deliver on required levels of service while maintaining fiscal capital and infrastructure capital over the long term.

Assessment	Indicator
Maintaining fiscal capital	Net result margin (%)
	Adjusted underlying result (%) NEW
	Liquidity (ratio)
	Internal financing (%)
	Indebtedness (%)
	Unrestricted cash ratio NEW
Maintaining infrastructure capital	Capital replacement ratio
	Renewal funding ratio NEW
	Asset renewal ratio NEW
	Renewal gap ratio

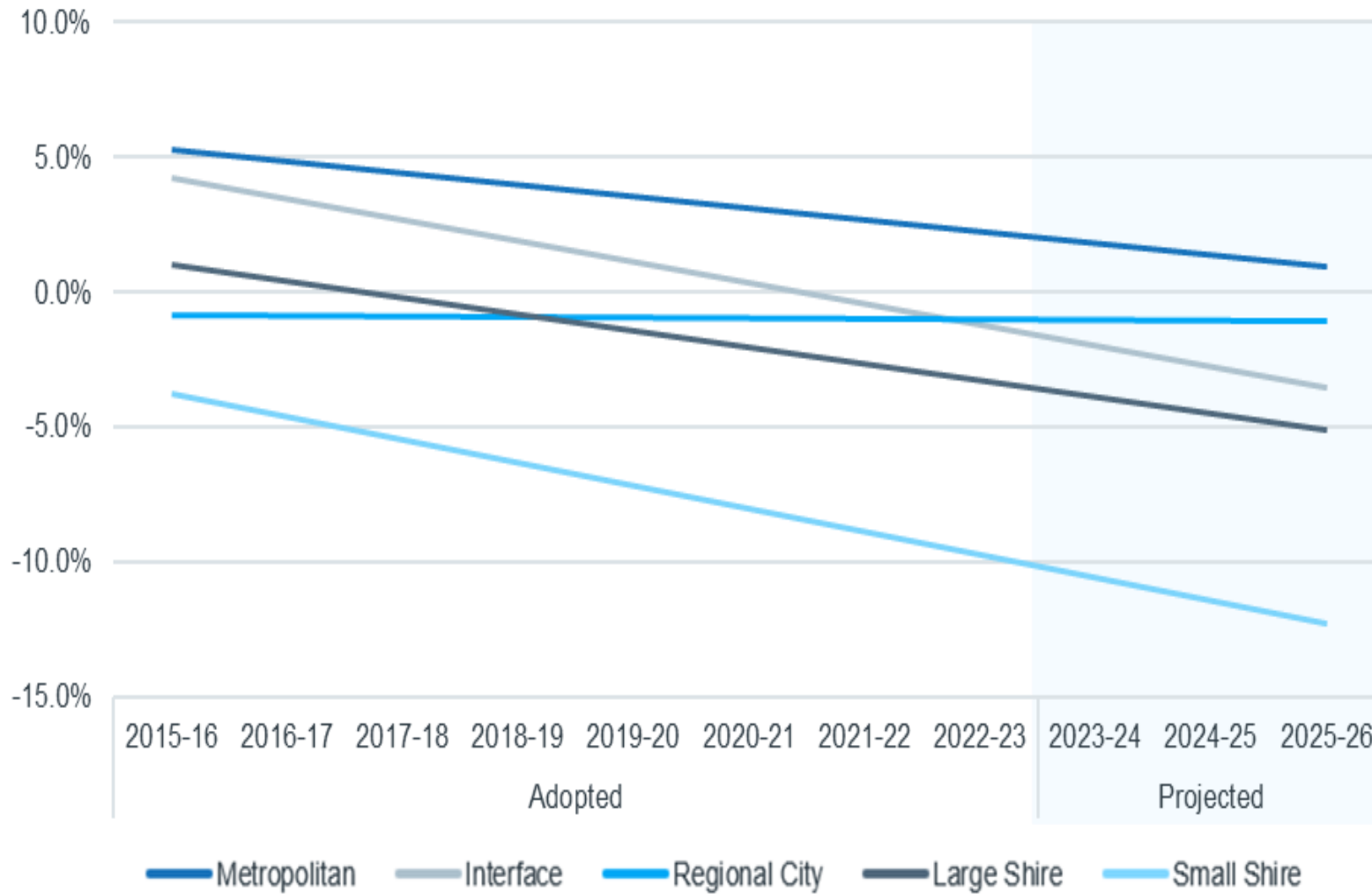
Relevant indicators should be monitored for trend over time, and measured as a 3-5 year average.

Source: AEC

Adjusted Underlying Result

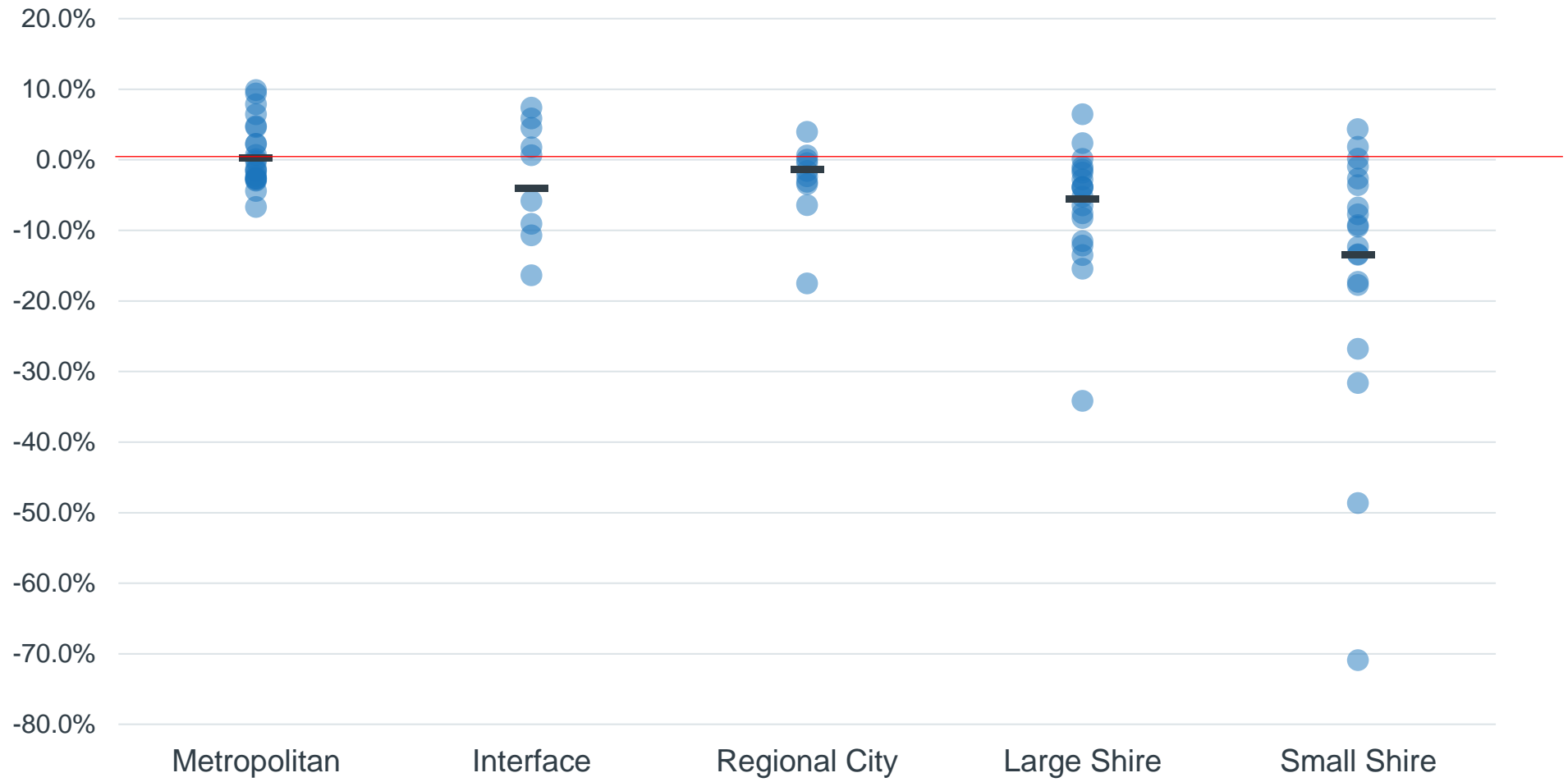


Adjusted Underlying Result



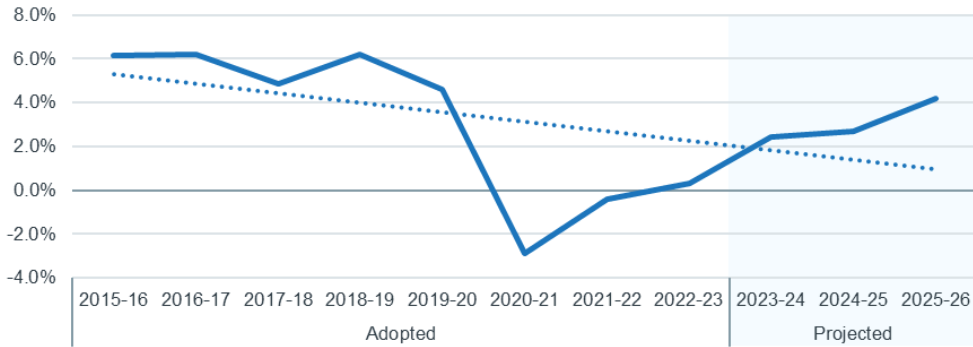
Source: AEC Analysis (unpublished), LGV Budget Summary Report data (various years)

Adjusted Underlying Result

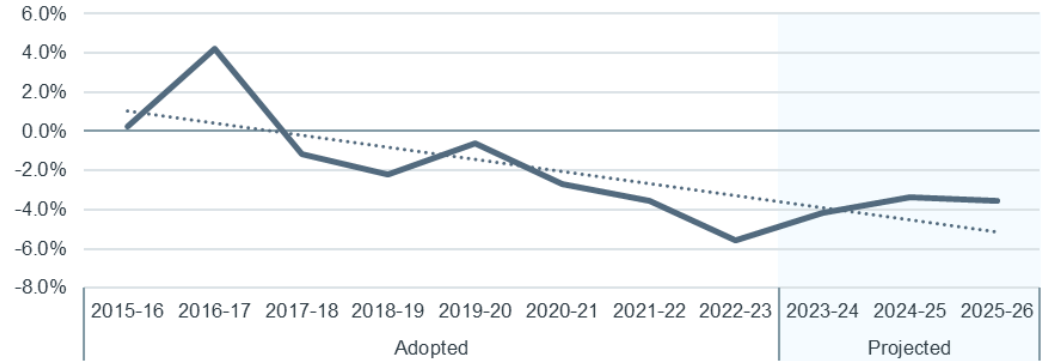


Source: AEC Analysis (unpublished), LGV Budget Summary Report data (2023-24)

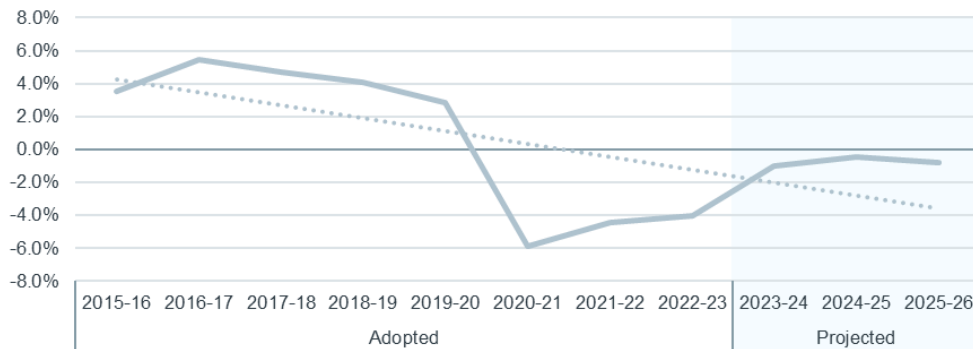
Metropolitan



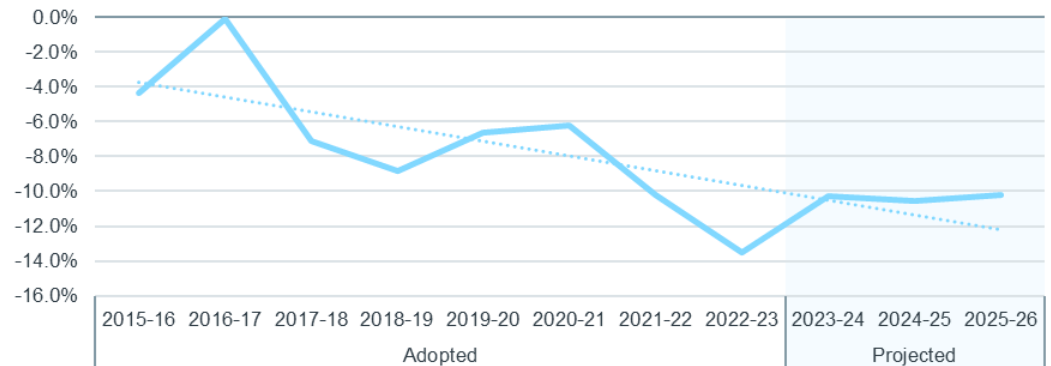
Large Shire



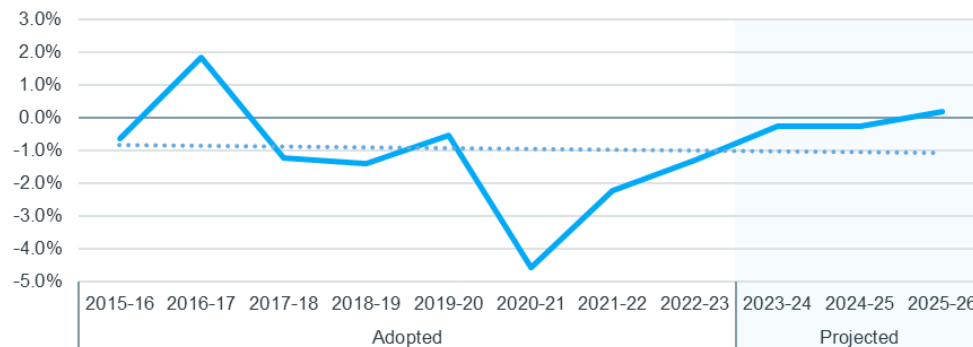
Interface



Small Shire



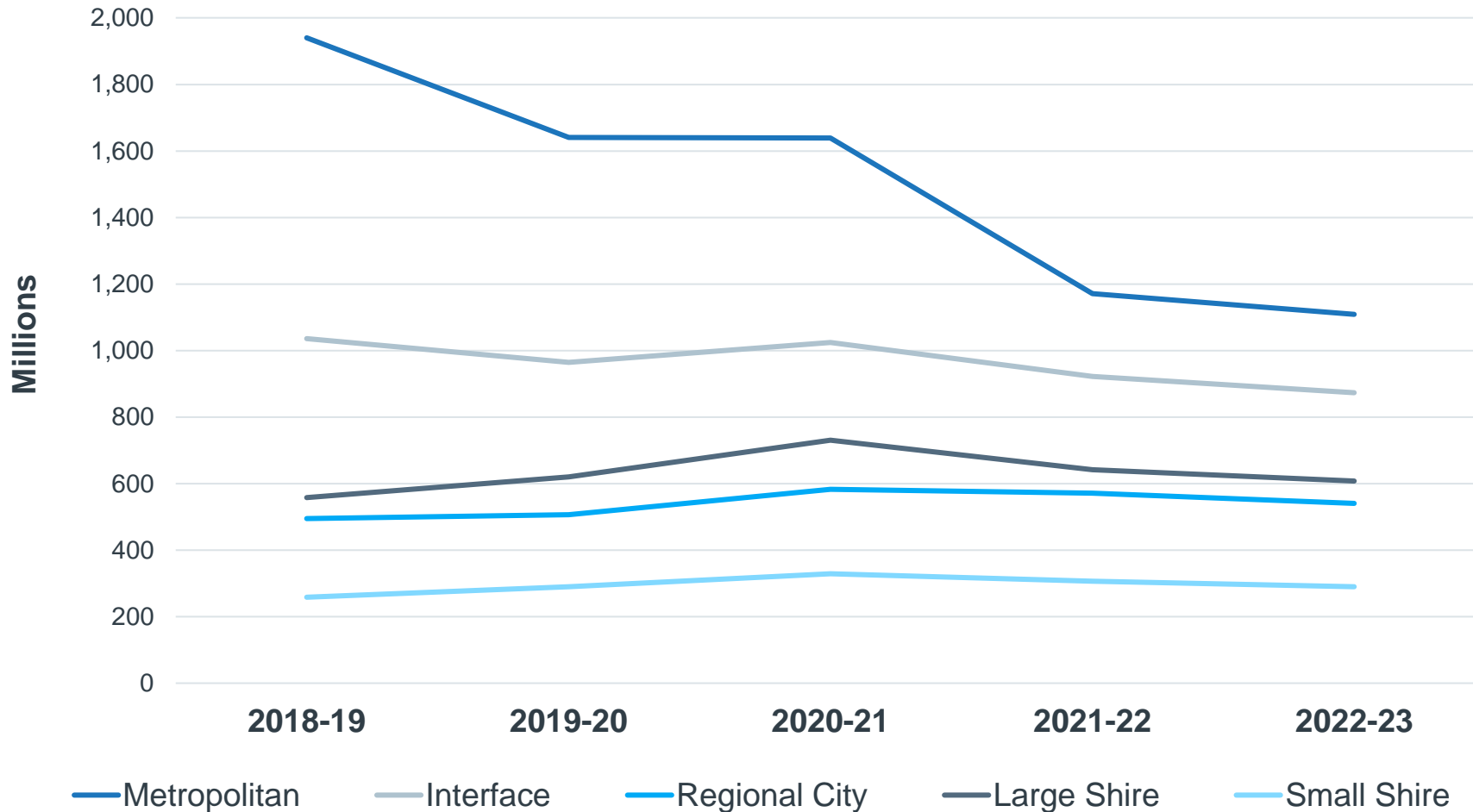
Regional City



- AEC applied criteria to the adjusted underlying result as reported by VAGO to assess whether Victorian councils were deteriorating, stable, improving or fluctuating
- 50% of all councils were deteriorating with only 12% improving
- 18 of 22 metropolitan councils were deteriorating
- While small shire councils were often reporting poor adjusted underlying result, the result fluctuated too significantly to determine whether the result was deteriorating, stable or improving

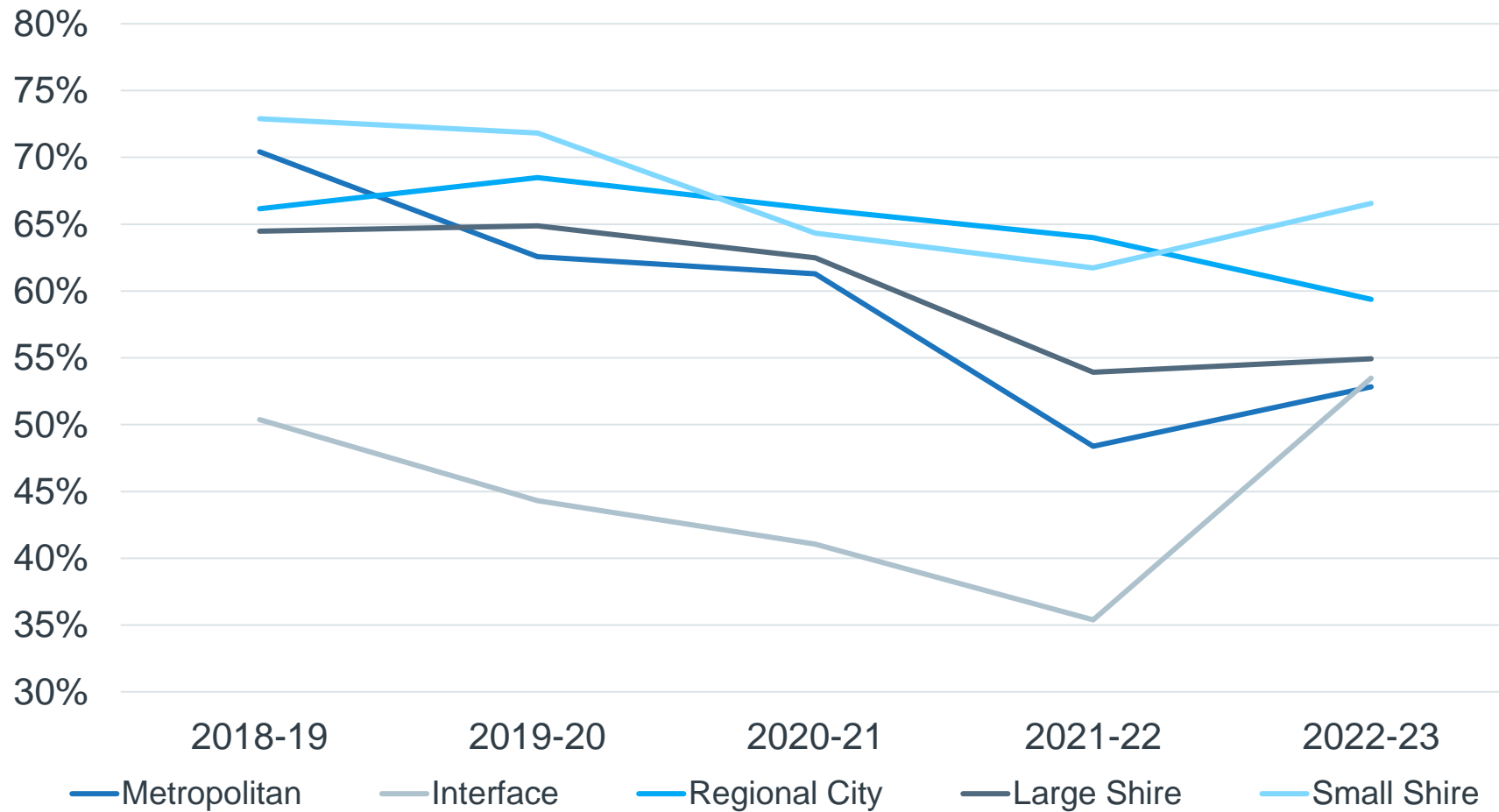
Council	Deteriorating	Stable	Improving	Fluctuating
Metropolitan	18	3	1	
Interface	7	1	1	
Regional	5	1	3	1
Large Shire	8	4	1	5
Small Shire	1	1	3	14
Total	39	10	9	20
Percentage	50%	13%	12%	26%

Unrestricted Cash and Other Financial Assets



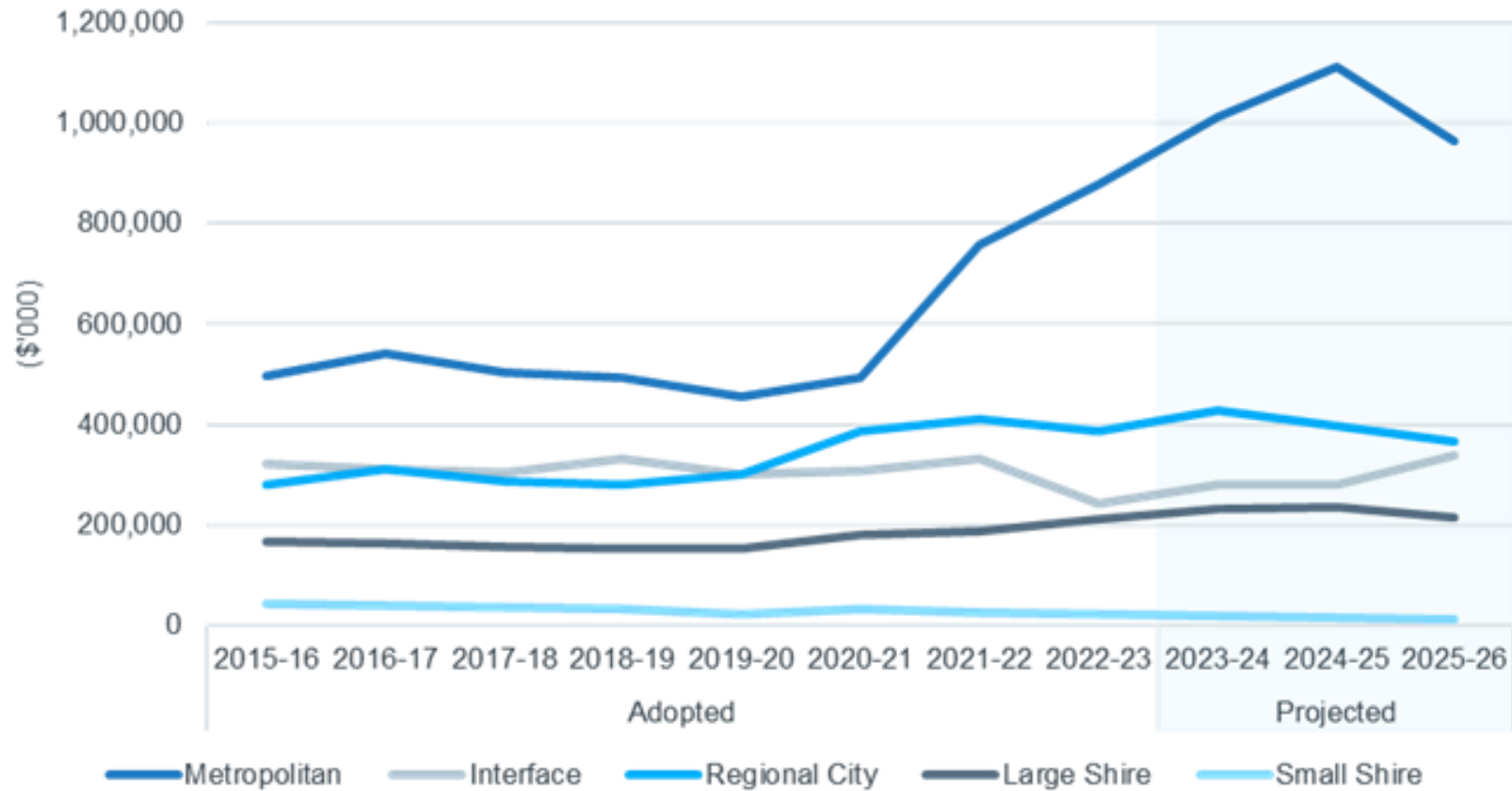
Source: AEC Analysis (unpublished), LGV Local Government Performance Reporting Framework, VAGO

Proportion of Cash and Other Financial Assets Unrestricted



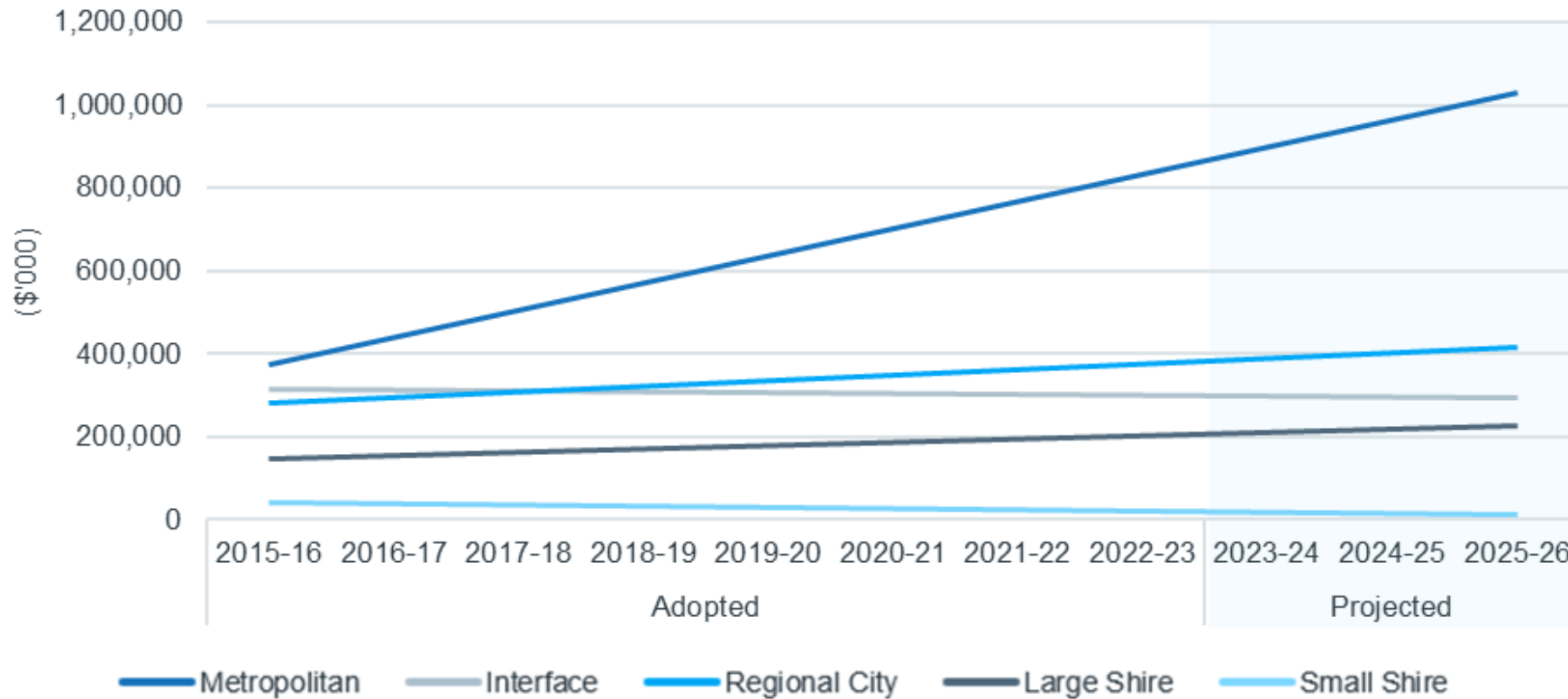
Source: AEC Analysis (unpublished), LGV Local Government Performance Reporting Framework, VAGO

Total Budgeted Borrowings



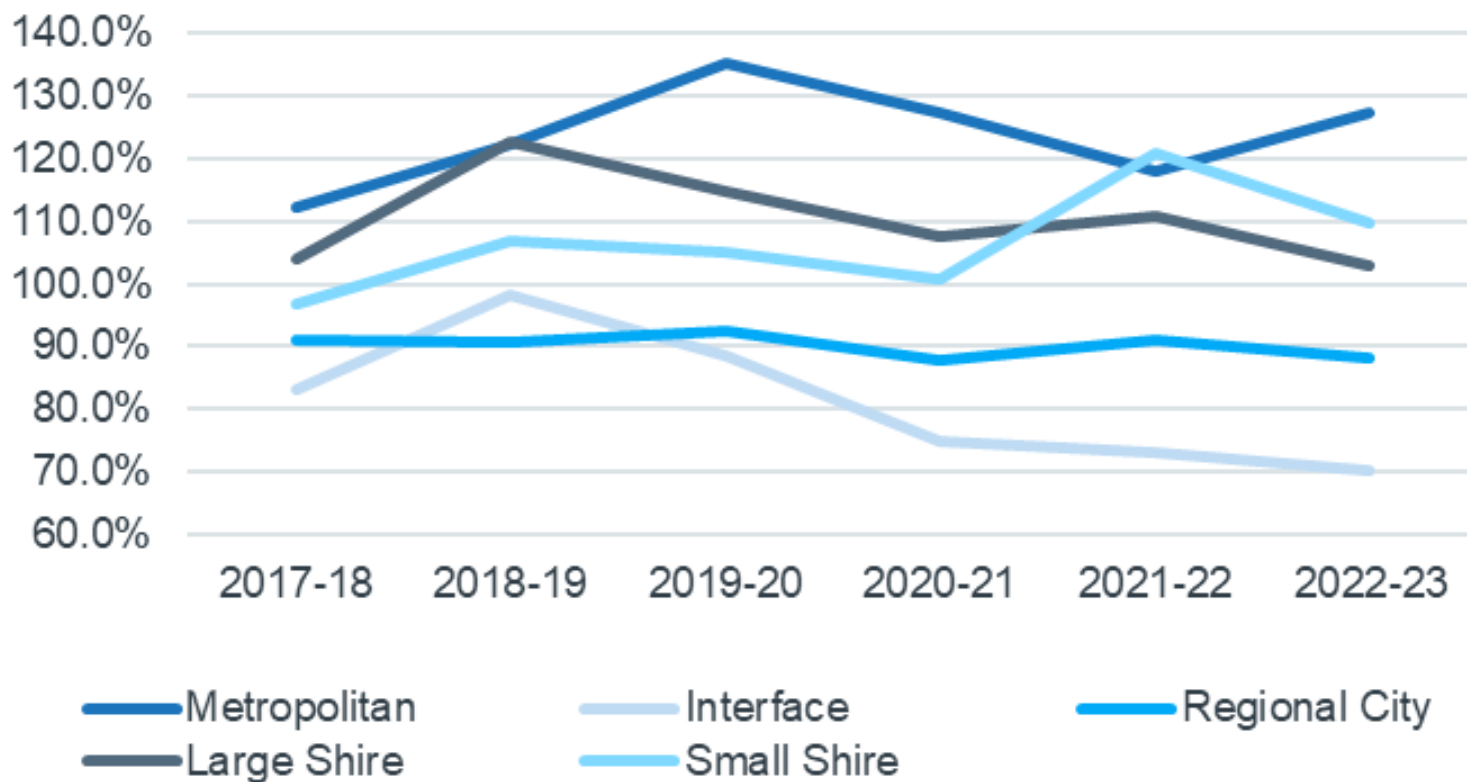
Source: AEC Analysis (unpublished), LGV Budget Summary Report data (Various Years)

Total Budgeted Borrowings Trendline



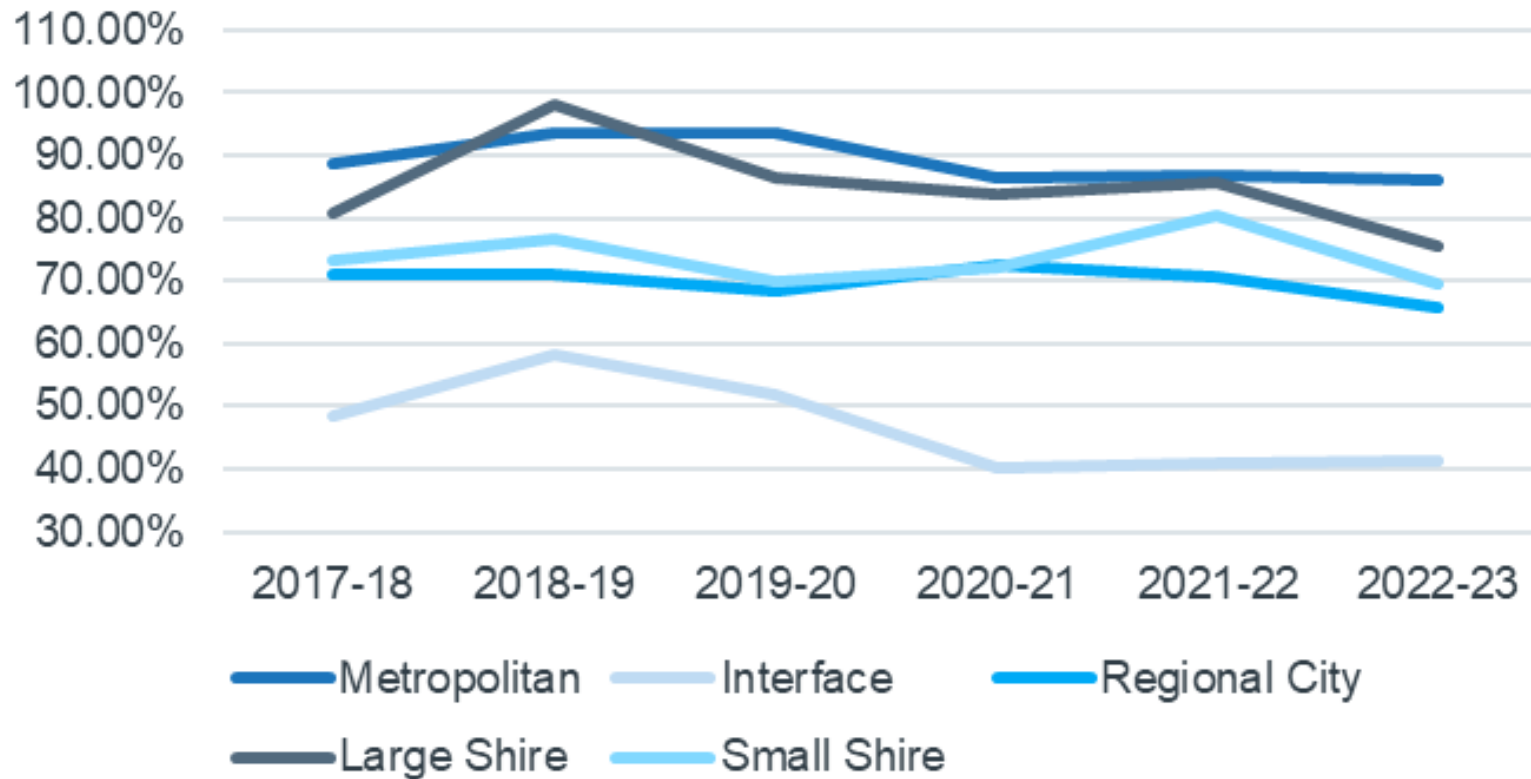
Source: AEC Analysis (unpublished), LGV Budget Summary Report data (Various Years)

Renewal and Upgrade Ratio



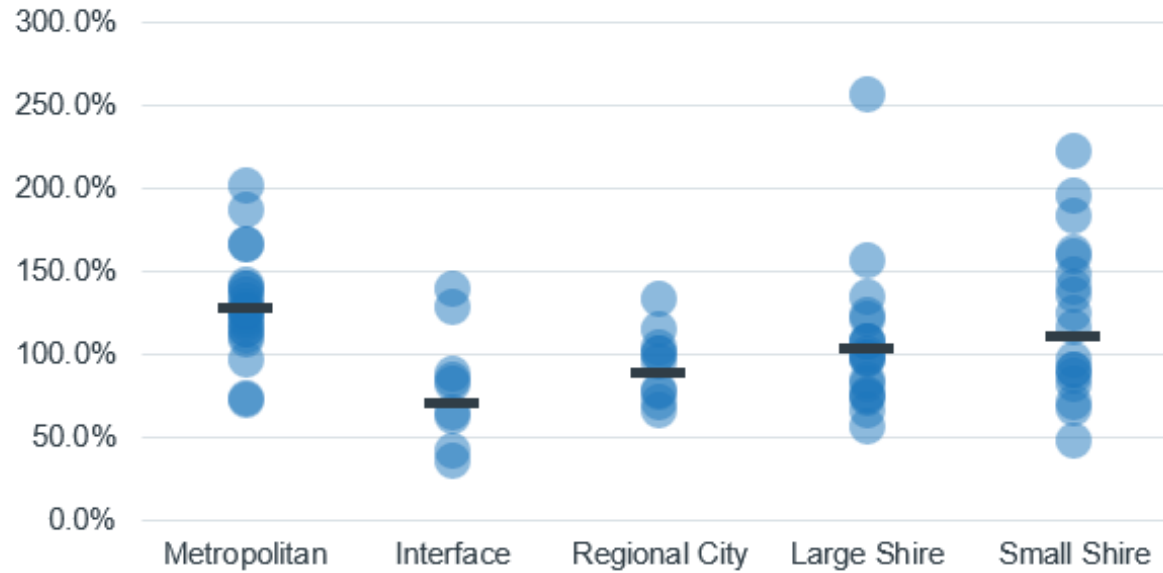
Source: Source: AEC Analysis (unpublished), VAGO data

Renewal Ratio (Excluding upgrades)



Source: Source: AEC Analysis (unpublished), VAGO data

Renewal and Upgrade Ratio



Source: AEC Analysis (unpublished), VAGO data

Renewal Ratio (Excluding upgrades)



Source: AEC Analysis (unpublished), VAGO data

- Lack of integration between financial and asset planning is a weakness in local governments across all jurisdictions.
- NSW Councils are required to prepare a Report on Infrastructure Assets as a special schedule in the annual financial statements. This may assist Victorian Councils in improving the reporting on asset management activities.

NSW Report on Infrastructure Assets by class:

- Estimated cost to bring assets to satisfactory standard
- Estimated cost to bring to the agreed level of service set by Council
- Required maintenance and actual maintenance
- Net carrying amount and gross replacement cost
- Assets in condition as a percentage of gross replacement cost (Condition 1 – 5)

Report on Infrastructure Assets

as at 30 June 2023

Asset Class	Asset Category	Estimated cost to bring assets to satisfactory standard ^a		Estimated cost to bring to agreed level of service set by Council ^{b, c}		2022/23 Required maintenance ^c	2022/23 Actual maintenance	Net carrying amount	Gross replacement cost (GRC)	Assets in condition as a percentage of gross replacement cost				
		\$ '000	\$ '000	\$ '000	\$ '000					1 ¹	2 ²	3 ³	4 ⁴	5 ⁵
Buildings	Buildings	6,845	3,574	11,206	9,585	372,845	516,869	25.0%	37.0%	33.0%	4.0%	1.0%		
	Sub-total	6,845	3,574	11,206	9,585	372,845	516,869	25.0%	37.0%	33.0%	4.0%	1.0%		
Other structures	Other structures	8,297	1,065	476	313	83,530	140,159	20.0%	29.0%	27.0%	22.0%	2.0%		
	Sub-total	8,297	1,065	476	313	83,530	140,159	20.0%	29.0%	27.0%	22.0%	2.0%		
Roads	Sealed roads	105,136	42,837	11,859	10,585	870,953	1,282,543	4.0%	29.0%	38.0%	26.0%	3.0%		
	Unsealed roads	3,436	2,695	2,869	2,621	9,067	26,952	2.0%	10.0%	47.0%	31.0%	10.0%		
	Bridges	3,876	3,907	381	234	82,679	140,545	41.0%	26.0%	25.0%	5.0%	3.0%		
	Footpaths	659	265	827	429	86,463	120,367	30.0%	43.0%	25.0%	2.0%	0.0%		
	Other road assets	1,358	1,119	4,276	3,825	296,855	399,539	80.0%	8.0%	11.0%	1.0%	0.0%		
	Bulk earthworks	–	–	–	–	336,117	337,481	100.0%	0.0%	0.0%	0.0%	0.0%		
	Other road assets (incl. bulk earth works)	–	–	–	–	–	–	0.0%	0.0%	0.0%	0.0%	0.0%		
	Sub-total	114,465	50,823	20,212	17,694	1,682,134	2,307,427	34.8%	21.4%	26.4%	15.4%	2.0%		
Water supply network	Water supply network	28,302	7,436	9,703	9,531	482,494	929,471	3.0%	26.0%	59.0%	11.0%	1.0%		
	Sub-total	28,302	7,436	9,703	9,531	482,494	929,471	3.0%	26.0%	59.0%	11.0%	1.0%		
Sewerage network	Sewerage network	14,812	13,349	15,699	15,227	719,798	1,026,823	17.0%	37.0%	42.0%	3.0%	1.0%		
	Sub-total	14,812	13,349	15,699	15,227	719,798	1,026,823	17.0%	37.0%	42.0%	3.0%	1.0%		
Stormwater drainage	Stormwater drainage	9,432	7,795	1,213	1,319	196,893	311,812	4.0%	62.0%	24.0%	7.0%	3.0%		
	Sub-total	9,432	7,795	1,213	1,319	196,893	311,812	4.0%	62.0%	24.0%	7.0%	3.0%		
Open space / recreational assets	Swimming pools	1,762	–	3,372	5,986	20,836	39,305	8.0%	10.0%	64.0%	18.0%	0.0%		
	Other open space / Recreational Assets	1,692	871	2,603	9,973	58,536	87,102	27.0%	17.0%	49.0%	6.0%	1.0%		
	Sub-total	3,454	871	5,975	15,959	79,372	126,407	21.1%	14.8%	53.7%	9.7%	0.7%		
Other infrastructure assets	Other infrastructure assets	3,112	3,206	800	530	36,452	63,863	14.0%	22.0%	50.0%	9.0%	5.0%		
	Sub-total	3,112	3,206	800	530	36,452	63,863	14.0%	22.0%	50.0%	9.0%	5.0%		
Total – all assets		188,719	88,119	65,284	70,158	3,653,518	5,422,831	22.3%	29.0%	36.4%	10.7%	1.6%		

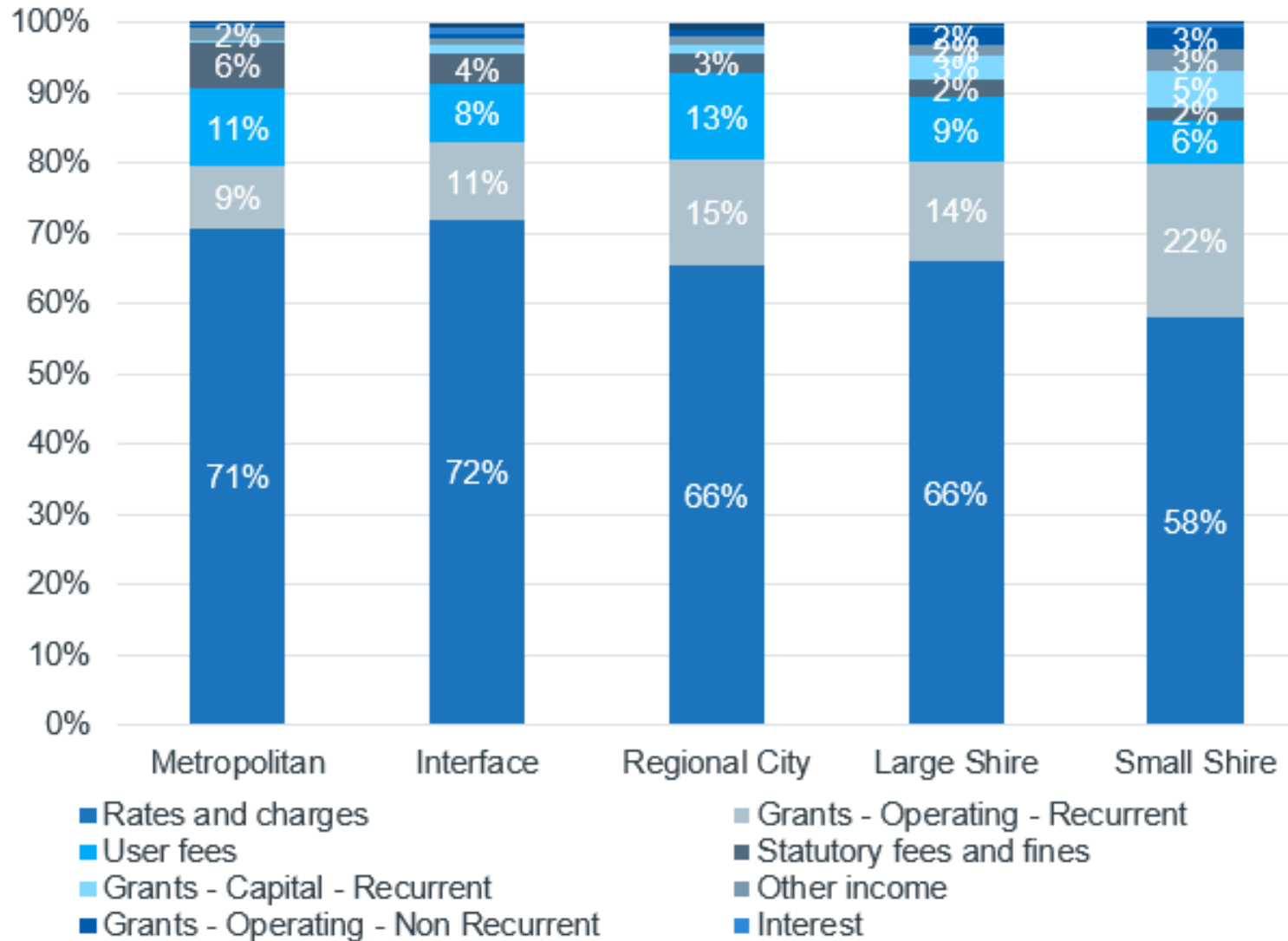
CASE STUDY – BRENT QUILL – City of Wodonga

Brent Quill – Manager Finance – City of Wodonga

- Can you outline why City of Wodonga undertook a financial sustainability review?
- What were the key challenges that Council faced to being sustainable?
- What has Council decided to do to improve the future sustainability of the council?
- As a financial professional, what did you personally learn through the project?

REVENUE STRUCTURES FOR LOCAL GOVERNMENT

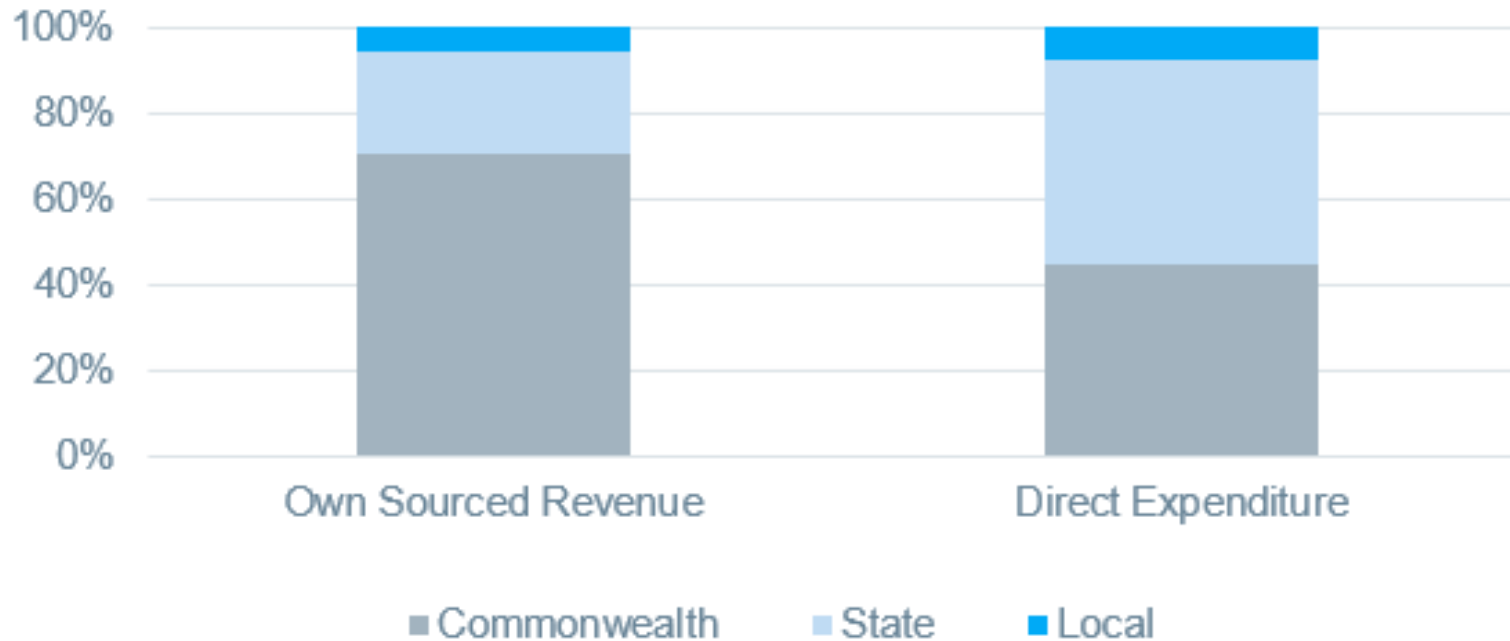
2022-23 Budget - Revenue Categories as a % of Adjusted Underlying Revenue



Source: AEC Analysis (unpublished), LGV 2022-23 Budget Summary Report data

Vertical Fiscal Imbalance

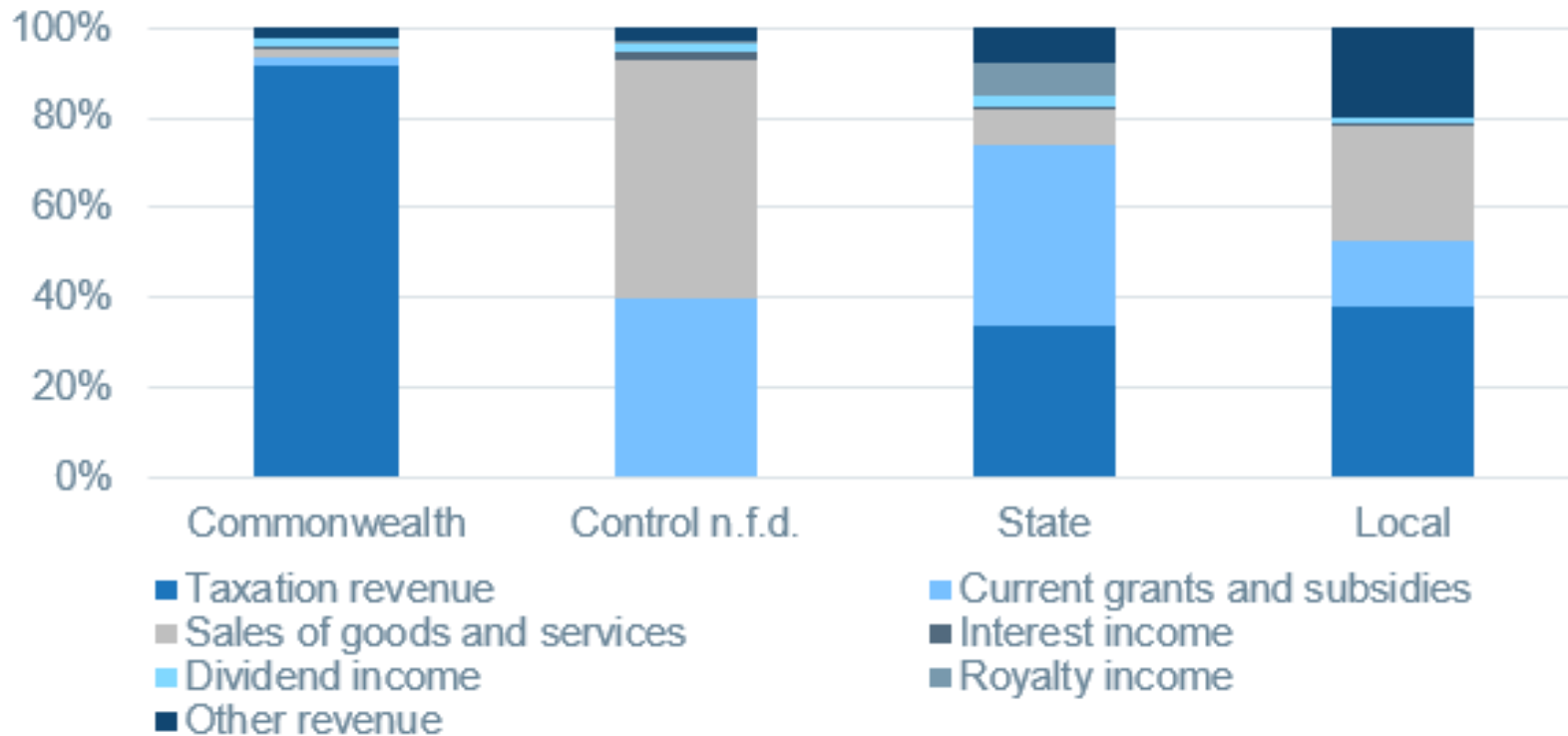
Own Sourced Revenue and Spending – By level of government



Source – Australian Bureau of Statistics 55120DO001_202122 Government Finance Statistics, Australia, 2021-22

Vertical Fiscal Imbalance

All Levels of Government – Sources of Revenue



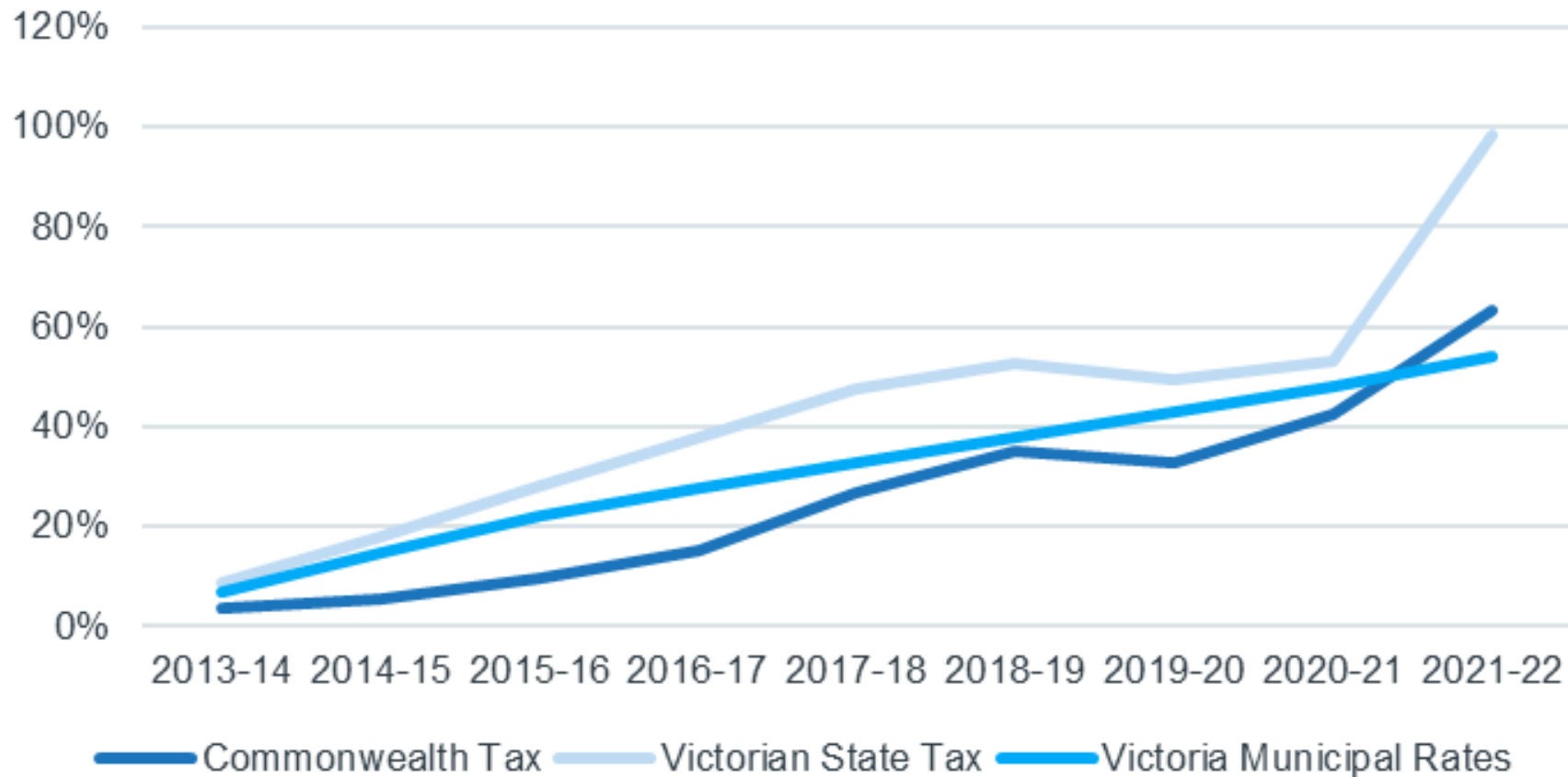
Source – Australian Bureau of Statistics 55120DO001_202122 Government Finance Statistics, Australia, 2021-22

Note – Control not further defined (n.f.d) contains units where jurisdiction is shared or unclear e.g. Universities

Effects of Vertical Fiscal Imbalance

- **Weakens government accountability to the public by breaking the nexus between a government's decisions on the level of service provision and the revenue raised to fund it.**
- **Reduces transparency regarding who is responsible** for which government services, **allowing governments to avoid responsibility by shifting blame** for funding and operational shortfalls to other spheres of government, resulting in **public confusion and blame-shifting.**
- **Creates inefficiencies**, including through **bureaucratic overlap, duplication and excess** and the **cost of administering grants between governments.**
- **Misallocates resources**, including the **inadequate or inappropriate funding of services and infrastructure.**
- **Slows the responsiveness of governments** to the needs of their communities

Comparison of Commonwealth, State and Local Government Taxation Revenue



Source: ABS 55060DO001_202122 Taxation Revenue, Australia, 2021-22

Rate Capping

Rate Cap, CPI, Cost Indices and Forecasts (%) (report extract)

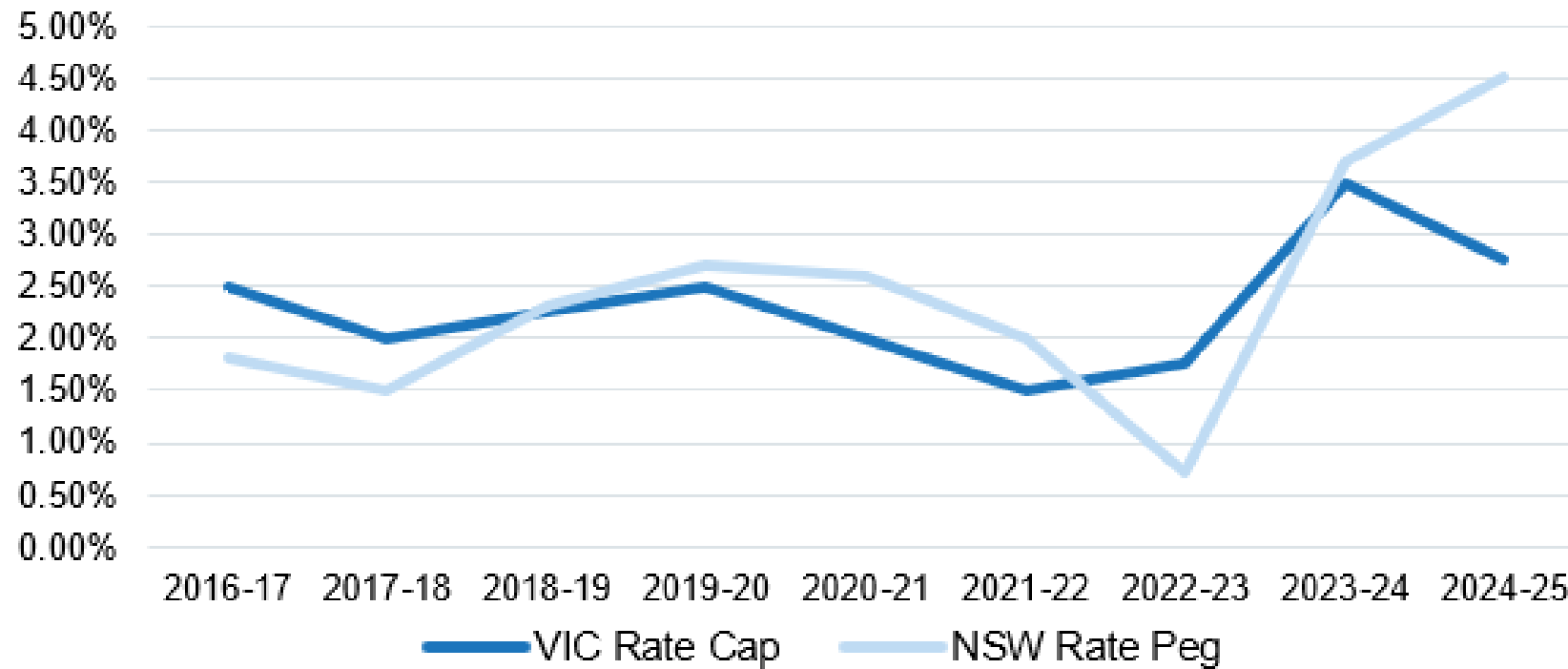
Measure	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Rate Cap	2.25	2.5	2.0	1.5	1.75	3.5	2.75 ^f	TBD
CPI Melbourne (a)	1.7	1.7	1.4	4.0	7.0	4.9	-	-
Cost Indices (b)	2.6 to 2.7	0.3 to 1.2	1.6 to 2.0	4.7 to 6.1	4.2 to 4.7	3.9 to 4.3	-	-
DTF CPI Forecast (c)			2.25	1.5	1.75	4.0	2.75	2.5
RBA CPI Forecast (d)			1.85	1.1	2.25	4.45	3.4	2.9
DTF WPI Forecast (c)			3.25	1.75	2.0	3.5	3.5	3.25
RBA WPI Forecast (d)			2.3	1.4	2.5	3.9	3.7	2.9

Source: Essential Services Commission – The Outcomes of Rate Capping

- (a) ABS as of September 2023
- (b) Recalculated Local Government cost indices from New South Wales, South Australia and Tasmania
- (c) Melbourne CPI and WPI Victoria sourced from Department of Treasury and Finance Budget Update
- (d) Australia CPI and WPI sources from RBA Forecast Tables – Statement on Monetary Policy
- (e) Rate Cap for 2024-25 has been determined at 2.75 in line with the DTF CPI forecast without adjustment
- (f) In the ESC report, the 2024-25 was “TBD” – now that the Minister has approved the rate cap for 2024-25 AEC has updated this in the table.

Rate Capping

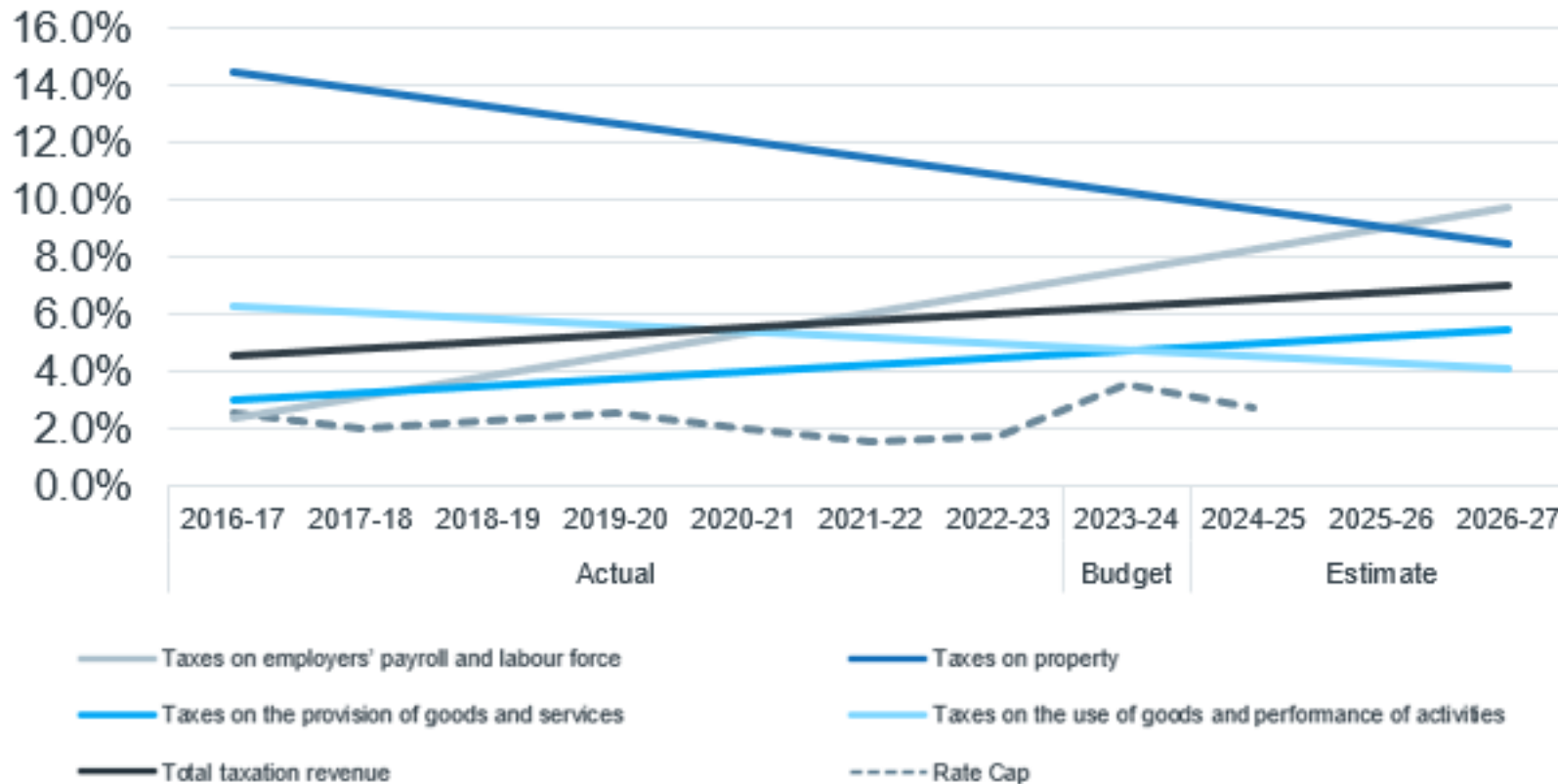
Comparison of the NSW Rate Peg and VIC Rate Cap



Source: Essential Services Commission (website) and C and IPART NSW (website)

Rate Capping

Annual Victorian Tax Revenue increase trendline (adjusted for growth) and Annual Rate Cap Increase



Source: Department of Treasury and Finance (website) Essential Services Commission (website)

Rate Capping

Estimated impact of Rate Peg set below the actual increase in costs

Rate cap set by the Minister has been significantly below the actual cost escalation for the previous two financial years, estimated to have impacted the operating position of Mildura Rural City Council by \$4.5 million recurrently.

Higher Rate Cap Applications

ESC and LGV have referred to the ability for local government to apply for a higher rate cap as a suitable mechanism to protect the financial sustainability of councils that require a larger increase in rate revenue.

*FinPro is of the view that the Fair Go Rating System in Victoria needs to learn from the impact rate pegging has had in NSW, which has seen a deterioration in the financial sustainability of local government. This is evidenced by the high number of councils applying for a special variation and the significant quantum of increases approved – resulting in large rate shocks to local communities. The same outcome is highly likely to occur in Victoria due to the current Fair Go Rating System. **FinPro Submission***

Higher Rate Cap Applications

*Recent approved special variations for councils in NSW include cumulative rate increased in excess of a 65% increase in the general rate. This is a situation that can be avoided in Victoria by correcting the impact the Fair Go Rating System is having on local government in Victoria. **FinPro Submission***

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Victoria	6	4	4	4	3	0	0	0
% of Councils	7.6%	5.1%	5.1%	5.1%	3.8%	0.0%	0.0%	0.0%
NSW	13	11	18	24	12	12	11	23
% of Councils	10.2%	8.6%	14.1%	18.8%	9.4%	9.4%	8.6%	18.0%

Source: Essential Services Commission (website) and IPART NSW (website)

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Victoria	4.1%	4.1%	3.8%	6.9%	4.5%	0.0%	0.0%	0.0%
NSW	6.0%	5.9%	7.3%	7.1%	7.5%	8.3%	9.3%	16.3%

Source: Essential Services Commission (website) and IPART NSW (website)

Higher Rate Cap Applications

Submissions to the NSW Inquiry ...

From 2011-12 to 2022-23, IPART approved 168 applications for special variations, skewed toward metropolitan and regional councils. Typically, rural and large rural councils are less likely to apply for special variations.

... metropolitan councils represent 19.5% of all councils in NSW, but account for 25.3% of all SV applications, whereas regional councils represent 28.9% of all councils, but 40.7% of all SV applications. In contrast, together rural and large rural councils represent 44.5% of all councils, but only 26.9% of SV applications.
NSW Office of Local Government

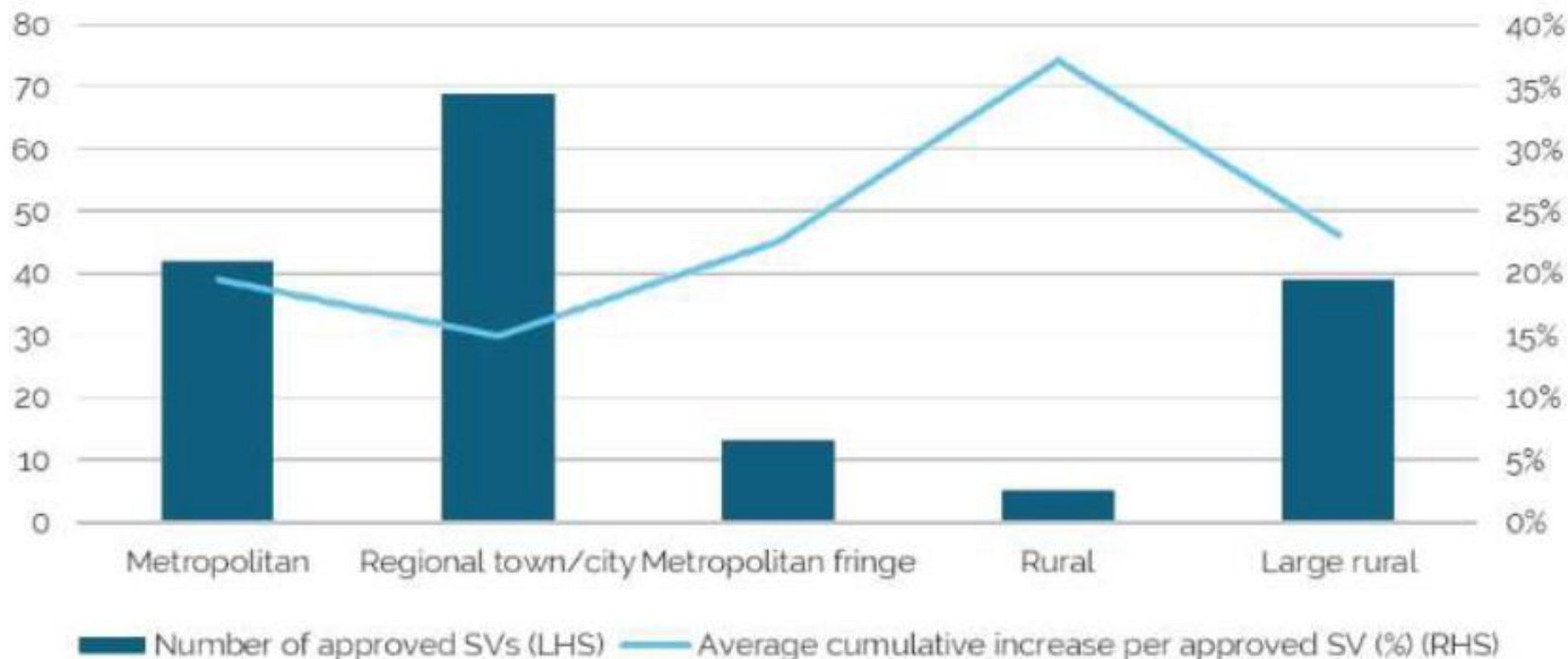
Council type	Councils in NSW		SV applications	
	Number of councils	Proportion of councils	Number of applications	Proportion of applications
Metropolitan	25	19.5%	46	25.3%
Regional town/city	37	28.9%	74	40.7%
Metropolitan fringe	9	7.0%	13	7.1%
Rural	15	11.7%	7	3.8%
Large rural	42	32.8%	42	23.1%
Total	128	100%	182	100%

Higher Rate Cap Applications

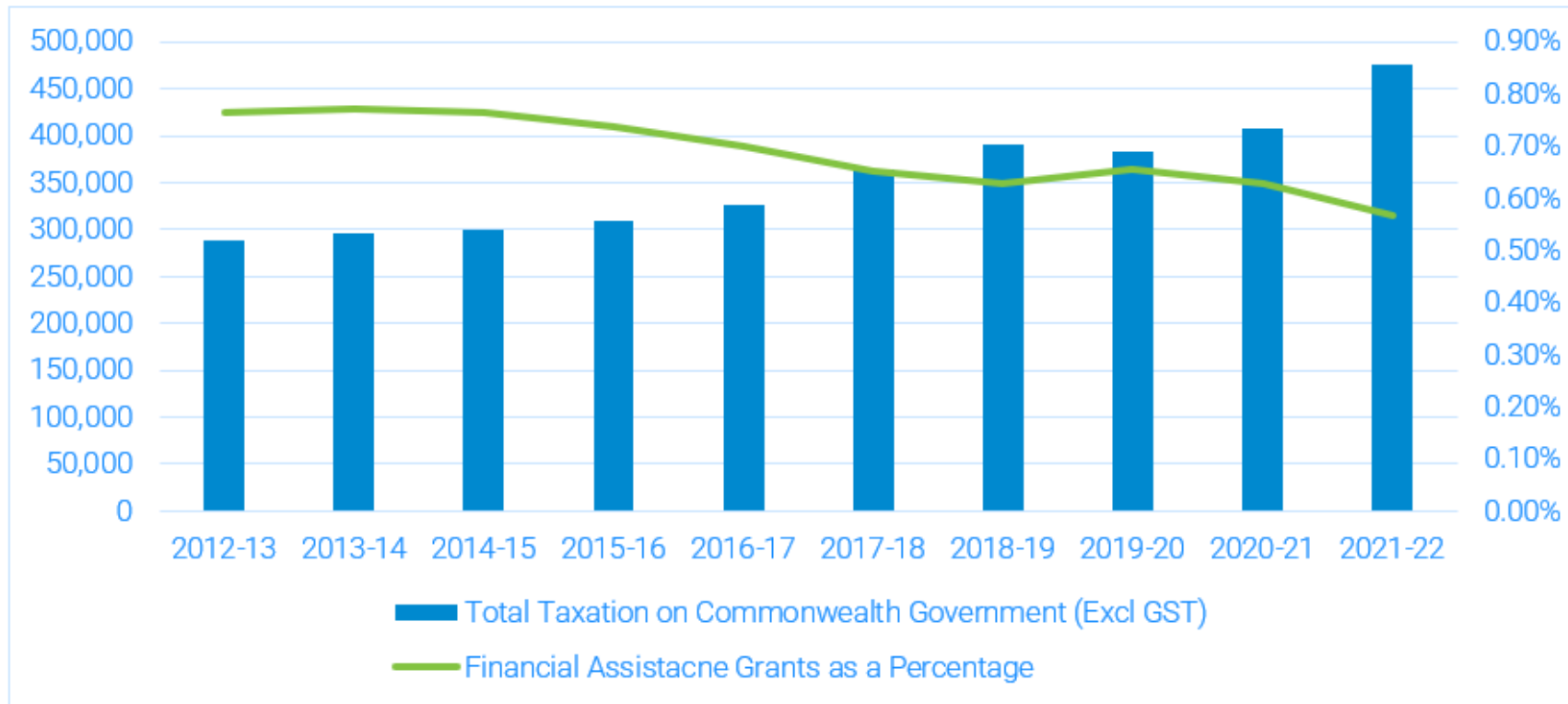
Submissions to the NSW Inquiry ...

... while rural councils had the lowest number of approved special variation applications, rural councils also had the highest cumulative increase.

NSW Office of Local Government



Financial Assistance Grants



Source: ABS Taxation Revenue – Australia – 2021-22

	General Purpose	Local Roads	General Purpose Per Capita	Local Roads Per Capita
Metropolitan	19%	12%	\$33.44	\$7.89
Interface	23%	14%	\$73.19	\$16.13
Regional City	21%	16%	\$141.92	\$39.90
Large Shire	24%	35%	\$223.03	\$117.97
Small Shire	14%	22%	\$409.56	\$238.97

Source: Department of Infrastructure, Transport, Regional Development, Communications and Arts, VAGO

Constitutional Recognition of Local Government and Direct Funding of Local Government

- The **recognition of local government in the Commonwealth Constitution** has long been called for.
- The call for constitutional recognition has **largely concerned the method of funding of local government** and enabling the **Commonwealth to make payments to any local government body** formed by State or Territory.
- The current dualist federal system allocates powers and functions to Commonwealth and State, with **local government “being creatures” of States**, results in local government **having no independent relations with the Commonwealth government**.
- Furthermore, **powers for taxation by local government lies with the State that can only be exercised by local government if delegated to it by the State**.
- Therefore, **local government has no status or power of its own, creating a depowered position to address vertical fiscal imbalance and sufficiency of funding**.
- Local government should be **subject to minimum intervention from other spheres of government** with respect to its legitimate interests and jurisdictional responsibilities (including revenue raising, local laws and land use planning).

COST SHIFTING

2014 Victorian State-Local Government Agreement

- A Victorian State-Local Government Agreement (VSLGA) was established in response to the Federal Inquiry into cost shifting to build collaborative working relationships between state and local government. The VSLGA was most recently revised and agreed to by the parties in 2014: <https://www.localgovernment.vic.gov.au/our-partnerships/victorian-state-local-government-agreement>
- It was agreed that the implementation would result in the following outcome (amongst a longer list):
 - Where the Victorian Government intends for local government to administer or enforce new primary legislation, or new or revised regulation, the relevant lead department shall, subject to exceptional circumstances, consult with local government in accordance with the Victorian Guide to Regulation.
 - The Victorian Government commits to consultation other than in exceptional circumstances with local government on any material change to funding agreements that impact on local government.
 - The introduction and application of a new Cabinet process to assess local government impacts of policy, as appropriate, to ensure consistent consideration and appropriate processes for consultation with local government on issues that may impact on local government.
 - Continue to streamline state regulatory and reporting requirements on local government.



Challenge for Victorian councils is lack of reporting on cost shifting – this limits capacity to report to the Inquiries.

LGAQ published a report in 2023 – **LGAQ Cost Shifting Report** – reported **\$360 million annually** in cost shifting – with some councils reporting up to **35% of general rate income used on cost shifting**.

LGNSW publish a biannually report on cost shifting, with surveys provided to all councils to complete. LGNSW's latest cost shifting report was released in November 2023, highlighting a total cost shift to councils of **\$1.36 billion in 2021-22**, which is the equivalent of more than **\$460 per ratepayer annually**

378%

Increase in reported cost shifting in Queensland (after factoring in indexation since 2002)

Victorian Councils that have completed recent research to identify and quantify the impact of cost shifting:

- Mornington Peninsula Shire Council
- City of Glen Eira
- City of Boroondara
- City of Greater Bendigo
- City of Yarra
- Mildura Rural City Council (currently)

- Libraries
- Maternal and child health services
- Local emergency relief services
- Immunisation
- School crossing supervisors
- Fire hydrant plug maintenance
- Public safety (CCTV)
- Urban stormwater
- Transfer of leisure facilities
- Management of state owned land as committee of management
- Social housing
- Rate exemptions
- Planning compliance on State owned land
- Environmental health
- Biodiversity
- Electrical line clearance
- Landfill levy
- Planning Scheme amendments
- Glass recycling stream
- Bin lid standardisation
- Building services and VBA requirements
- Climate change response and mitigations
- Pool fence compliance
- Accreditation requirements for Family Support Program
- Psychological safety legislation
- Cladding
- Community satisfaction survey
- Community engagement requirements
- Gender equality legislation
- Council involvement in planning approvals where the Minister is the decision maker
- Statutory planning
- Inspection and reactive pruning
- State road maintenance
- Medically supervised injecting rooms
- Child safe legislation
- Citizenship ceremonies

FINPRO RECOMMENDATIONS

The following recommendations are made for the sector to work collaboratively with the State Government to implement:

1. That **LGV engages with the sector and establishes a risk-based assessment framework for financial sustainability of local government**, including criteria set for different council cohorts, to assist both the state government, Councillors and local governments officers to take action to manage risks to sustainability.
2. That **ESC be required to calculate and have regard in advice provided to the Minister to a local government cost index for the Victorian local government** when considering advice to the minister on setting the rate cap each year.
3. That **ESC be required to consider adjustments to correct historically set rate caps that were insufficient to meet the indexation** of local government costs.
4. That **LGV engages with the sector and establishes a more detailed report on assets**, similar to the required schedule Report on Infrastructure Assets for NSW councils, to **ensure transparency in reporting of assets and the capacity of councils to fund the necessary maintenance and capital investments**.
5. That the **Minister Local Government, LGV and local government peak bodies reengage with a model like the Victorian State-Local Government Agreement**

The following recommendations and specific notifications for the Committee to consider:

1. That the Committee notes the **FinPro analysis of the financial position of local government which is in contrast to other assessments** outlined in this report that local government is in a sound financial position.
2. That the Committee notes the **analysis provided by FinPro that a majority of councils have a deteriorating underlying adjusted deficit, deteriorating unrestricted cash and investing insufficient cash to asset renewals**, resulting in an increased risk to financial sustainability of the local government sector.
3. That the Committee notes the **combination of a deteriorating financial position and cost shifting is impacting on the capacity of local government sector to deliver core services**
4. That the Committee notes that the **vertical fiscal imbalance that exists results in the local government sector being vulnerable to policy settings of other levels of government**, including the allocation of grant funding, **which is exacerbated in Victoria by the further restriction placed on local government** by the Victorian Government through the rate capping system.
5. That the Committee notes there is a **significant difference in the rate cap calculated for Victorian councils compared to NSW councils for 2024/25**. The rate peg set for NSW councils will be 4.5%, while the rate cap set for Victorian councils will be 2.75%. Applied across the total rate revenue base for Victorian councils, the difference equates to over \$138 million in lost rate revenue for local government in Victoria. FinPro requests the Committee to recommend to the Minister for Local Government to seek the development of a Local Government Cost Index, for use in the annual rate cap calculation.

6. That the Committee notes the **administrative and in particular the political challenges faced by councils seeking a higher rate cap under the Fair Go Rate System** and the likely outcome that **Victorian communities will experience significant rate shocks in future years** when significant rate increases will be required.
7. That the Committee notes that, **unlike the Commonwealth and Victorian governments, the revenue base of local government does not grow in line with economic growth, due to the impact of rate capping and the Financial Assistance Grant funding model** – due to rates and operating grants contributing 80% of revenue in the local government sector. This means while the Commonwealth and Victorian Governments can respond to demands for higher living standards as the economy grows (e.g., additional funding for better health services and better education), the local government sector is significantly constrained to meet the demand of the community for higher living standards.
8. That the Committee notes that, between 2011/12 and 2021/22, **Commonwealth Government taxation revenue (excluding GST) increased by 65%** (or 31% in the five years to 2021/22) and **Victorian Government taxation revenue increased by 98%** (or 34% in the five years to 2021/22) yet Victorian **local government taxation revenue (municipal rates) only increased by 54%** (or 16% in the five years to 2021/22).
9. That the Committee notes that as a **percentage of total Commonwealth Government taxation revenue (excluding GST), the amount of Financial Assistance Grants made available to local government decreased from 0.76% to 0.57% from 2011/12 to 2021/22.**