

Fair Go Rates system

Guidance for councils 2018–19

14 November 2017 (amended January 2018)



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About this document

The Victorian Government's Fair Go Rates system establishes rate caps to limit the amount by which Victorian councils can increase rates in a year without seeking additional approval.¹ Each year, the Minister for Local Government sets the average rate cap — that is, the maximum percentage increase in councils' average rates for the forthcoming financial year. The minister can set a cap for all councils, a group of councils or a single council. If any council considers the average rate cap increase to be insufficient for its needs, the council can apply to the Essential Services Commission for a higher percentage.

We are publishing this guidance to help councils plan for and make such applications. The guidance also aims to help councils meet other requirements of the system. These include complying with the average rate cap set by the minister — or any higher cap approved by us — and reporting to us on their compliance.

The current version of this guidance document reflects what we have learnt from assessing applications over the first two years, along with feedback from the sector, our technical working groups and ratepayers. The underlying principles and our approach to assessment are unchanged. To make it easier to refer to the guidance, some material may appear in more than one place.

This document provides general advice or guidance only.² It aims to help councils understand how commission staff interpret relevant regulatory requirements. By following this advice or guidance, councils may be better able to present the information to support their applications.

However, councils should not read this document as a set of fixed rules that would secure the approval of an application in all circumstances. As the Fair Go Rates system matures, we will update and refine this guidance as necessary. Readers' feedback on the document will be most welcome and will help us to improve the guidance.

¹ In references to capping in this document, unless otherwise stated, 'rates' should be understood to mean average rates including general rates and municipal charges and any other prescribed rates or charges on rateable properties. Also, see Footnote 3.

² This document is issued under s. 11 of the *Essential Service Commission Act 2001* in connection with the commission's functions under s. 10E of that Act and s. 185E(5)(c) of the *Local Government Act 1989*. This document is not intended to be a final statement. The commission may provide further directions, advice and guidance in relation to particular applications or issue guidelines under the Local Government Act.

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1. Purpose and timelines

Overview

This chapter provides readers (councillors, council staff and interested stakeholders) with an overview of the Fair Go Rates system. In particular, it explains our role, key timelines and processes in the system. It is important to note that references in this document to ‘rates’ should be understood to mean general rates, municipal charges and any other prescribed rates or charges on rateable properties, unless otherwise stated.³

1.1. Background and role of the commission

The Victorian Government established the Fair Go Rates system in December 2015. This legislative framework limits the annual increases in Victorian local government rates.

In this system, Victorian councils cannot increase average rates by more than the average rate cap set for them by the Minister for Local Government, unless we approve their application for a higher cap.⁴ In the past two years, the minister has set a single rate cap for all councils, but can set different rate caps for councils, individually or by class. For simplicity, we refer to this as the minister’s cap.

We also have a role in monitoring and reporting.⁵ We report annually on councils’ compliance with the rate cap (unless the context requires otherwise, this refers to their compliance with the minister’s cap or a higher cap we approved). We also report on outcomes associated with the Fair Go Rates system every two years, starting in December 2018.

In performing our statutory responsibilities under the *Local Government Act 1989* (the Act), we have the following objectives:

- to promote the long term interests of ratepayers and the community in relation to sustainable outcomes in the delivery of services and critical infrastructure
- to ensure that a council has the financial capacity to perform its duties and functions and exercise its powers.⁶

³ Sections 185B and 185C of the *Local Government Act 1989* provide the formal definition.

⁴ ‘Average rates’ refers to the rates paid by the notional average ratepayer. This is calculated by dividing total revenue required from rates by total number of rateable properties in each local government area.

⁵ Section 10E, *Essential Services Commission Act 2001*.

⁶ Section 185A, *Local Government Act 1989*.

Victoria's 79 councils reflect the very diverse geographic and socioeconomic circumstances of the people they represent. The reasons why councils seek higher caps are accordingly diverse. We are keen to help councils understand the system and its requirements. The following chapters provide guidance on the key elements of the Fair Go Rates system:

- how to meet the reporting requirements
- how to apply for a higher cap
- how we assess the content of an application
- how to comply with the rate cap.

To support this guidance, our website also contains reference information about community engagement.⁷

1.2. The rate cap

The minister is required to seek and have regard to advice from the commission before setting the average rate cap that will have effect in a given financial year. There may be a single cap for all 79 councils, or separate caps for individual councils or classes of council.

The minister's cap is based on the forecast change in the consumer price index⁸ over the financial year in which the cap will take effect, plus or minus any adjustment. The legislation would allow, for instance, an adjustment for wage pressure or an efficiency factor.

The rate cap means that the average rates a council levies cannot increase by a percentage greater than the rate cap in force in a particular financial year.⁹ It does not mean that no individual ratepayer will face a percentage increase higher than the rate cap — only that the 'average ratepayer' will not. Many factors determine the distribution of rates within a municipality and the rates an individual pays.¹⁰

The rate cap currently covers only general rates and municipal charges, but not various levies (such as the fire services levy) passed on to the state government or other bodies. At present, the rate cap excludes other revenue that the councils control — such as service rates and service

⁷ At <https://www.esc.vic.gov.au/project/local-government/55520-community-engagement-resources/>

⁸ Under the Act, the consumer price index is defined as the forecast Melbourne consumer price index, as published in the budget update prepared (in December) under the *Financial Management Act 1994*.

⁹ That is, the cap set by the minister, or a higher cap approved by us.

¹⁰ The rates billed to individual ratepayers may increase or decrease by a percentage amount that is different from the rate cap, due to any of several reasons. These include a change in valuation of their properties relative to the valuation of other properties in the local government area, a change in any differential rate, and the inclusion in the bill of other rates and charges (such as waste collection charge and the fire services levy) that are not covered by the rate cap.

charges for waste collection, special rates and charges, and revenue in lieu of rates. Under the legislation, the minister has powers to cap other rates or charges in the future.

Chapter 5 contains more information about complying with the rate cap.

1.3. Applying for a higher cap

The Fair Go Rates system allows Victorian councils to apply to us for a higher cap above the cap set by the minister. In considering whether to approve a higher cap, we must have regard to six matters set out in the legislation ('legislative matters'):

- the proposed higher cap and the specified year(s) in which it would apply
- the reasons for which the council seeks the higher cap
- how the views of ratepayers and the community have been taken into account in proposing the higher cap
- how the higher cap is an efficient use of council resources and represents value for money
- whether consideration has been given to reprioritising proposed expenditures and alternative funding options and why the council does not consider those options to be adequate
- that the assumptions and proposals in the application are consistent with the council's long-term strategy and financial management policies set out in the council's planning documents and annual budget.

A council seeking to increase rates above the minister's cap has to demonstrate a long-term funding need supported by good long-term financial planning. Establishing a long-term funding need is particularly important. This is because an approval can allow up to four annual higher caps in succession, each increasing the rate base permanently.

A council can best establish it has a long-term funding need through good long-term financial planning. Box 1.1 gives a more detailed description of such planning. In summary, applications will need to demonstrate that the council has done the following.

- It engaged effectively with ratepayers and communities about its services, infrastructure needs, rate levels, financial outcomes and trade-offs (see Box 1.2). It must also show how the outcomes of this engagement influenced its decision to apply for a higher cap
- It developed and applied rigorous and consistent internal policies, plans and processes to ensure efficiency and value for money
- It considered options to reduce or re-prioritise expenditure, and explored alternative funding, financing and revenue sources. If it rejected any options, it should demonstrate why those options were not adequate or appropriate.

We also have regard to a council's record of compliance with any previous rate cap.

Box 1.1 Features of good financial planning

Central to the Fair Go Rate system and a key emphasis in the current review of the *Local Government Act 1989* is the promotion of good long-term financial planning. Throughout this guidance, we have emphasised that applications for a higher cap must demonstrate that the need for additional funds is based on and supported by rigorous and robust long-term financial planning.

A simple description of good long-term financial planning includes:

- Ensuring that the assumptions in a council's long-term plans and financial strategies are based on reasonable and reliable information, by having best-practice processes, plans and policies in place that include:
 - sound policies and practices to manage cash resources and debt
 - good asset-management plans, to identify cost-effective outlays based on properly considered and documented risk management
 - performance monitoring and reporting.
- Effectively managing areas within the council's control, to deliver services and fulfil its functions cost-effectively, through methods that include:
 - undertaking programs of continuous improvement and efficiency
 - considering options and trade-offs for different models of funding, finance and service delivery
 - seeking opportunities to collaborate with other councils in shared services, etc.
- Undertaking regular service reviews to plan and prioritise service delivery, using effective engagement practices to identify community preferences while maintaining financial sustainability.
- Providing a stable and predictable rating burden on ratepayers to avoid rate shocks.
- Updating financial plans regularly, to reflect best-available information.

Having these elements in place helps a council ensure it bases its projections of long-term revenue and expenditure on robust and timely information. Good long-term financial planning can also identify potential opportunities and constraints, to aid good decision-making.

Box 1.2 Trade-offs

There will inevitably be 'trade-offs' between different options that a council can take into account to determine the most appropriate approach to meet its long-term funding need and the long-term interests of the community.

'Trade-offs' is a term that appears a number of times in this document, particularly in the context of choices presented in community engagement (Section 4.3), and when council is examining expenditure proposals or funding options (Section 4.5). When an application describes the trade-offs that were considered, we expect a clear statement that compares the financial impacts, service impacts and infrastructure impacts that arise from the choice of pursuing different options.

A council's strategic approach to considering alternative options and their potential impacts on ratepayers and the community is a key element of sound long-term financial planning.

1.4. Monitoring compliance and reporting

Monitoring and reporting are important for ensuring transparency and accountability. We therefore provide information about councils' rating practices and broader performance outcomes under the Fair Go Rates system. The intention is to help ratepayers and communities assess value for money in the rates they pay and the services they receive.

We must monitor and report councils' compliance with the minister's cap or any higher cap we approved, every year. We also report on outcomes in relation to council services, asset maintenance and financial sustainability, every two years starting from December 2018. That report would also identify any impacts or trends within and across councils. Chapter 2 outlines the information that we require councils to provide for our reports.

A council's compliance record under the Fair Go Rates system may affect the rate cap the minister sets for that council. We also consider it when assessing any future application for a higher cap. Failure to comply with the cap *in a single year* does not affect the validity of any rates or charges that the council levies in that financial year. However, the minister may determine that a council *repeatedly and substantially* failed to comply with a rate cap, and may declare rates or charges collected in a financial year to be invalid. Repeated noncompliance may also be grounds for a council's suspension by the minister.

1.5. Key dates for the 2018-19 rating year

Table 1.1 shows the key dates and timelines for the operation of the Fair Go Rates system for the 2018-19 rating year.

Table 1.1 Timelines for the 2018-19 rating year

Fair Go Rates system — key dates	Timeframe
Base year	1 July 2017 – 30 June 2018
The minister announces the rate cap	By 31 December 2017 ^a
A council seeking approval for a higher cap notifies the commission of intention to apply	By 31 January 2018
A council sends application for a higher cap, with budget baseline information	1 February – 31 March 2018
The commission assesses council applications	February – May 2018
The commission notifies councils of decisions	Within two months of receipt of application
Capped year	1 July 2018 – 30 June 2019
Councils formally adopt budget no later than	June 2018
All councils send annual compliance information	By 30 September 2018
The commission publishes compliance report	November 2018

^a Unless an alternative date is determined by the minister and published in the Government Gazette.

We previously noted the importance of providing further flexibility in the timeframes for when councils can apply for a higher cap, particularly in the face of events such as council elections. With the sector, we explored the option of a September application, in addition to the regular March application date. The matter is still under consideration; we will incorporate any detailed process changes (as identified through consultation) in a future update of this guidance.

1.6. Communicating with councils

All councils can expect to receive general information, enquiries and instructions from the commission, about applying for a higher cap and complying with the minister's cap or an approved higher cap. We ask councils to nominate and maintain a key contact for these communications. We will also copy communications to the chief executive officer and the records area of each council.

2. Reporting requirements

Overview

This chapter provides Victorian councils with guidance on their data and information reporting obligations in the Fair Go Rates system. Specifically, it aims to clarify:

- what information the system requires councils to provide
- why we ask for the information and how we use it
- when and how councils are required to provide this information.

2.1. What information do we require from councils?

We require councils to provide two main datasets, for which we set up separate spreadsheets.

Only a council applying to us for a higher cap must provide the **budget baseline information**. This is consolidated financial information on services and assets, including forecast actuals for the base year and forecasts for the year(s) in which the cap or caps will have effect.

All councils must provide us with their **annual compliance information**. This is a summary of value of land, number of rateable properties, rate(s) in the dollar, municipal charges and average rates. We use this in our assessment of councils' compliance with the rate caps.

2.2. Why do we ask for this information and how do we use it?

The Fair Go Rates system gives us several statutory functions. These include advising the Minister for Local Government on the rate cap or caps, and assessing applications for higher caps from councils. We also monitor and report on councils' compliance with the rate caps, and on outcomes of rate capping. In identifying the information required for these responsibilities, we worked closely with the sector and with our financial technical working group.¹¹

We focused on ensuring that any reporting requirements:

- integrated with the information that councils already reported, or were based on information that was readily accessible to them
- imposed minimal administrative burden
- requested only information we require to fulfil our statutory responsibilities.

¹¹ The technical working group comprised senior financial officers from nine councils, with representatives from small and large rural, regional city, interface and metropolitan councils, and the Local Government Finance Professionals (FinPro).

To meet our statutory responsibilities, we rely where possible on existing data sources. These include a council's annual report(s), council plan, strategic resource plan and budget; data from the Victoria Grants Commission; local government performance reporting framework indicators; and the Victorian Auditor General's financial sustainability indicators. But the current suite of datasets available has limitations. We use the data provided in the annual compliance information template and the budget baseline information template to address these limitations and thus fulfil our responsibilities.

Councils that are concerned about their capacity to meet the reporting requirements set out in this guidance should contact us.

How will we use the Information?

The **budget baseline information** is important for assessing a council's application for a higher cap or caps. The information should identify the services and assets most affected by a decision to apply for a higher cap, and the overall impact on a council's financial performance. It should also show if circumstances have changed such that the council needs a higher cap, and identify the outcomes that the additional revenue would achieve. The budget baseline information should also disclose and support the council's assumptions — in forecasting grants and growth in rateable properties, for example — and show whether they help to justify a proposed rate increase.

In this way, the data provides much of the information we require to assess the council's stated financial position, its calculation of the proposed higher cap, and its reasons for applying. Section 2.3 gives more information about completing this template. Sections 4.6 and 4.7 explain the way we assess a council's long-term financial planning and its funding need.

The **annual compliance information** shows whether a council's capped average rate exceeds the base average rate by more than the minister's cap or higher cap, and forms the basis of our annual assessment. We report on councils' compliance with the rate caps in November each year. Section 2.4 gives more information about completing this template. Section 5.8 explains how we assess councils' compliance with the rate caps.

Table 2.1 summarises these two reporting requirements.

Table 2.1 Reporting requirements

Reporting requirement	Who must report	When it must be reported
Budget Baseline Information	Only councils applying for a higher cap	With applications for a higher cap (no later than 31 March 2018)
Annual Compliance Information	All councils	By 30 September 2018

The next two sections give further details of the two templates.

2.3. Budget baseline information

We require a budget baseline information template **only** from councils that apply for a higher cap. It captures budget information about the impact of a higher cap or caps.

2.3.1. What is required?

The budget baseline information template focuses on the outlook for the period of the proposed higher cap and the change relative to the base year. It requires a council to report on the forecast actuals in the base year and to present two scenarios for the years for which it seeks a higher cap. The first scenario assumes we approve the higher cap; the second assumes the council stays operating under the minister's cap. This comparison will display the impact of the proposed rate increase on services, assets and financial position, relative to the base year. Strategic resource plan information, including the proposed higher cap, is also required.

A council should provide information (income statements, balance sheets and capital works statements), for up to ten years, to complete the template. It should show both 'with' and 'without' higher cap scenarios, and do this for the budget year, three years of the strategic resource plan, and as many years as are supported by the council's long-term financial plan. This requirement is discussed further, below.

Box 2.1 How many years of data are required?

We have received many requests to clarify the preferred period of time that councils should cover in the long-term financial plan that supports their higher cap application.

We understand that, as part of the Local Government Act review, there is a clear emphasis on progressively requiring ten-year financial plans. We support such a move, as it allows councils to plan more effectively in providing community services as well as maintaining and investing in long-lived infrastructure. We are also aware that councils are at different stages of readiness to undertake such long-term financial planning. Some councils may require a transition period to meet the proposed legislative requirement.

Recognising this transition, we do not mandate a fixed period that councils applying for a higher cap must cover in their long-term financial plans. The minimum should at least align with the four-year strategic resource plan. This corresponds to existing statutory requirements and does not represent any additional burden on councils. Councils should use the information in their long-term financial plans to complete the budget baseline information template in their higher cap application.

Continued next page

Box 2.1 (continued)

There is an important caveat. As reasons for a higher cap, a council may cite underlying factors that will impact on its finances over the longer term; a four-year financial plan may not adequately capture these impacts. This is especially the case for a council applying for multi-year caps, where a four-year financial plan is unlikely to capture the long-term effects of the proposal and demonstrate the underlying financial need. A council submitting a four-year financial plan runs the risk of failing to demonstrate the need for a higher cap because of insufficient information. The same may be true where a council seeks a higher cap significantly above the minister's cap, with potential impact on its finances over an extended period.

In these circumstances, we expect councils applying for multi-year or substantial higher caps to submit a long-term financial plan to support their applications. The outlook of the financial plan should capture the long-term effects of the proposal and demonstrate the underlying financial need. Where necessary, we may request a longer plan than the council has provided (or additional information) to assist us to better assess the underlying need. Failure to provide such financial information may limit our ability to be satisfied that a higher cap is appropriate.

Based on the strategic resource plan and the long-term financial plan information provided, the template will automatically calculate relevant financial indicators, as used in the local government performance reporting framework.¹² We will use these indicators (in addition to other information provided in the council's application) to assess a council's financial capacity and long-term funding need. The council should also show the assumptions it has incorporated in its long-term financial plan.

A council is required to give forecasts of annualised supplementary general rate and municipal charge revenue and the growth in rateable properties over the course of the strategic resource plan and long-term financial plan. These forecasts are important for calculating the required higher rates and the rate revenue that a council expects to receive in the following years with a higher cap. The onus is on councils to make the most reasonable forecasts of this growth, and to explain their assumptions in the budget baseline information template. Section 5.7 describes how we will monitor the reporting of annualised supplementary revenue and rateable assessments.

¹² The template calculates indicators of Liquidity (Working capital; Unrestricted cash), Obligations (Asset renewal; Loans and borrowings; Indebtedness) and Operating position (Adjusted underlying result).

The budget baseline information template provides detailed instructions and definitions to help council staff complete it. The information is important for demonstrating the reasons for a higher cap. It captures whether the council's circumstances may have changed, affecting its financial position. The more detailed the information provided, the easier it will be for the council to demonstrate why it seeks the higher cap.

2.3.2. Where can councils find the budget baseline information template?

Our website has a copy of the template for the 2018-19 financial year.

2.3.3. When and how must councils report the budget baseline information?

Councils should send their completed templates **with their applications for a higher cap**. Chapter 3 contains further guidance on applying for a higher cap.

2.4. Annual compliance information

We require **all** councils to send us annual compliance information, to report on their compliance with the rate cap.

2.4.1. What is required?

The annual compliance information template requires councils to enter valuations, number of rateable properties, rate(s) in the dollar and municipal charges for the base year and the capped year. These figures should be readily available from the council's rating system.

The template provides detailed definitions and instructions to help council officers complete it. We report each year on councils' compliance with the rate caps.

2.4.2. Where can councils find the annual compliance information template?

Our website has a copy of the template for the 2018-19 financial year.

2.4.3. When and how must councils report the annual compliance information?

All councils will need to download the 2018-19 template from our website and complete it by 30 September 2018.

Councils should send completed templates by email to localgovernment@esc.vic.gov.au.

2.5. Questions about our information requirements

If councils or other stakeholders have questions about our information requirements they may email us at localgovernment@esc.vic.gov.au or call 03 9032 1300.

3. Applying for a higher cap

Overview

This chapter deals with processes: for the council applying for a higher cap and for the commission arriving at a decision. While the following chapter deals with the material we expect to find in an application and how we would assess it, this chapter covers:

- *Purposes* — what a higher cap should accomplish, what our statutory role is, and what an application should demonstrate
- *The application process* — how and when a council can apply
- *Our response to an application* — requesting further information, making and publishing a decision, and how a council may contest a decision.

3.1. Purposes

A council with a long-term financial need may wish to increase its average rates above the cap set by the Minister for Local Government. If so, the Fair Go Rates system provides for the council to apply to us for a higher cap.¹³ We expect the application to tell us how the council has identified and managed its financial needs.

3.1.1. Purpose of multi-year caps

A higher cap (which subsumes the minister's cap) sets an allowable percentage increase in average rates for a council. A council can apply to us for a higher cap for a period of up to four financial years.¹⁴ It can specify different higher caps each year for a multi-year application (for example 4 per cent to take effect in the first year, then 5 per cent and 3 per cent).

However, to provide greater certainty to ratepayers and smooth the rate path, we encourage councils to adopt a uniform annual rate of increase (a rate that is equivalent to the average annual increase over the period specified). If a council chooses not to smooth the rate path, it will need to explain why a varying annual rate of increase is more appropriate. The budget baseline information template provides guidance on how a council can smooth its rate path.

¹³ Section 185E, *Local Government Act 1989*.

¹⁴ Technically this would be a higher cap in each of (up to) four successive years. Each higher cap creates an ongoing permanent increase in the rate base.

3.1.2. What is the role of the commission?

Our role is to assess any application for a higher cap and to decide whether the proposed higher cap is appropriate.¹⁵ We base our assessment of an application on all of the following:

- our statutory objectives to promote the purposes set out in s. 185A of the *Local Government Act 1989* (the Act) (see Box 3.1)
- the six matters specified in s. 185E(3) of the Act (see Box 3.2)
- the council's compliance history
- the council's compliance with any commission directions on the manner and form of an application.

When the assessment is finished, we publish our decision and reasons on our website and, if we approve a higher cap, we do so through a special Order published in the Government Gazette. The Order sets out the permissible percentage increase in average rates for the years specified.

3.1.3. What should an application demonstrate?

An application should demonstrate to us that, by approving it, we will achieve our statutory objective, which is to promote the purposes of the Fair Go Rates system, as set out in Box 3.1.¹⁶

Box 3.1 The purposes of the Fair Go Rates system

The purposes of this Part are—

- (a) to promote the long term interests of ratepayers and the community in relation to sustainable outcomes in the delivery of services and critical infrastructure; and
- (b) to ensure that a Council has the financial capacity to perform its duties and functions and exercise its powers.

Source: s. 185A, *Local Government Act 1989*.

A later section of the Act sets out six legislative matters that an application must address. These largely reflect or reinforce existing council obligations around planning, budgeting, financial management and community engagement. Compliance with these obligations should ensure councils are efficient and sustainable and provide good value for money to ratepayers for the services that councils deliver. The process for applying for a higher cap provides additional

¹⁵ Section 185E(6), *Local Government Act 1989*.

¹⁶ Section 10E(7) of the *Essential Services Commission Act 2001* states our objective is to promote these purposes in the *Local Government Act 1989*.

independent scrutiny to ensure councils, when levying higher rates on their ratepayers, adhere to those statutory obligations. Box 3.2 sets out these legislative matters.

Box 3.2 Six matters an application for a higher cap must specify

An application under this section of the Act must specify —

- (a) a proposed higher cap for each specified financial year; and
- (b) the reasons for which the Council seeks the higher cap; and
- (c) how the views of ratepayers and the community have been taken into account in proposing the higher cap; and
- (d) how the higher cap is an efficient use of Council resources and represents value for money; and
- (e) whether consideration has been given to reprioritising proposed expenditure and alternative funding options and why those options are not adequate; and
- (f) that the assumptions and proposals in the application are consistent with the Council's long-term strategy and financial management policies set out in the Council's planning documents and annual budget.

Source: section 185E(3) *Local Government Act 1989*.

As we interpret the purposes and legislative matters of the Fair Go Rate system, we should approve a higher cap only when a council can demonstrate a long-term funding need that justifies a higher cap. We define a long-term funding need as a situation in which, as projected, a council's adjusted long-term revenue is less than the adjusted long-term expenditure it will need to perform its duties and functions efficiently, including some capacity to accommodate unforeseen events.

Conversely, a council that projects an adjusted underlying operating surplus is generating sufficient revenue to offset the cost of its current service provision.¹⁷ In this situation, residents paying rates and fees for service in any year are collectively 'paying their way'. Revenue generated to cover depreciation expense should help ensure, on average and over time, the council generates sufficient net cash flow to cover its asset-renewal needs.

¹⁷ The adjusted underlying result, a financial indicator in the local government performance reporting framework, is defined as the surplus (or deficit) of *adjusted underlying revenue* less total expenditure, expressed as a percentage of *adjusted underlying revenue*, where this in turn is defined as total income other than non-recurrent capital grants for capital expenditure, non-monetary asset contributions and other contributions to capital expenditure.

3.2. The application process

3.2.1. How does a council apply?

Notification of intent

Before applying to us for a higher cap, we ask that a council provide notification of its intention to do so. As in past years, we encourage councils to notify us no later than 31 January 2018 and include an estimated date of application. We can then estimate the resources we require to assess all applications properly in a timely manner.

To notify us, the council (or its chief executive officer) can send an email advising us of its intention and nominating a contact officer. We will confirm receipt of the notification and publish a list of councils that give notice. We will provide notifying councils with an embargoed copy of any media release before its publication.

The notification does not oblige a council to send an application. If a council subsequently decides not to apply, it should tell us (by email) of the change at the earliest possible time. We will publish this updated information on our website.

The notification of intent should specify the:

- indicative higher cap that the council is seeking
- number of years (maximum of four financial years)
- indicative reasons for seeking a higher cap
- expected date of sending
- details of the nominated contact for future communications (see Section 1.6).

Pre-application meeting

Once we receive a notification of intent, we will contact the council to arrange a time for a pre-application meeting. The meeting is a chance to discuss the application and to clarify as necessary the information that the council should provide.

The application

An application for a higher cap must be in writing, with the council's approval and sign-off, and sent to us electronically. We will discuss with each council as necessary the most appropriate format and delivery method for the application and supporting documentation. A council should also clearly indicate any confidential information in its application. We will confirm receipt of each application and place it on our website (excluding any confidential information). We will publish a list of the councils that applied for a higher cap, with the size of the increases they seek and the number of years over which they would have effect. We will also provide applicant councils with an embargoed copy of any related media release.

File size restrictions may mean a council has to divide attachments across a number of emails. In this case, the council should ensure each attachment is numbered and clearly listed on the application cover sheet.

Where to send notifications and applications

Send electronic copies (required) to: localgovernment@esc.vic.gov.au

Send hard copies (at own discretion) to:

*The Local Government Team, Essential Services Commission,
Level 37, 2 Lonsdale Street, Melbourne, 3000.*

3.2.2. How do we respond to ratepayer and stakeholder submissions?

At any time — but particularly after ratepayers become aware that their council is considering a higher cap application — we might receive submissions from the public or other stakeholders. The Fair Go Rates system does not prescribe a process for the commission to respond to submissions.

We encourage ratepayers and members of the community to engage actively with the council on planning and budgetary questions. If community members have concerns about a proposed higher cap, then they should raise their concerns with the council. The council should then discuss those concerns in its application to the commission.

However, concerned individuals or groups can also make a submission to us at any stage, by email to localgovernment@esc.vic.gov.au. If we receive uninvited submissions that are relevant to the six matters set out in s. 185E(3) of the Act (as shown in Box 3.2), then we will consider those submissions, to the extent possible, depending on the stage that an application has reached.

Before council applications are received

Before we receive a council's application, we will refer to the council any person or organisation making an uninvited submission on a possible higher cap. If the council does then apply for a higher cap, we will assess how the council sought and responded to the views of ratepayers and the community, in proposing the higher cap.

After council applications are received

When we have an application from a council, we will consider an uninvited submission only if it is relevant to purposes of the Fair Go Rates system and the six matters set out in s. 185E(3) of the Act (as shown in Box 3.2). With the sender's consent, we will forward the submission to the relevant council for its response. But we cannot facilitate a dialogue between the submitter and the council or continue a dialogue with the submitter.

3.2.3. When should the council complete its application?

A council can send us its application for a higher cap at any time between 1 February 2018 and 31 March 2018.¹⁸ This application period provides councils with flexible timing to accommodate their different circumstances.

If a council cannot apply before 31 March, the minister may set a new application date in the Government Gazette.¹⁹ A council should not assume the minister will do so other than in exceptional circumstances.

A council can apply for higher caps to take effect over one to four financial years. Once we approve an application, we expect the council to manage budgetary fluctuations for the duration of the approved higher cap or caps. However, in the context of multi-year approvals, the council can apply for an alternative higher cap by sending a new application. The council should consider doing so, only if it can demonstrate a significant change in circumstances that was unforeseeable at the time of the initial multi-year application.

3.2.4. What does the council have to send?

An application must include:

- an application cover sheet (the cover sheet)
- a statement addressing the six legislative matters (the statement).

These two documents must be supported by:

- the budget baseline information (described in Section 2.3)
- any other necessary supporting documentation including (but not limited to) records of engagement plans, tools and outcomes, key strategic planning and budgetary documents and relevant policies and procedures.

The following sections set out the basic data requirements and expected information in the application cover sheet and the statement.

Application cover sheet

Each application must include a completed application cover sheet. This template (which will be available on our website) captures high-level information about the application. The cover sheet includes:

- the nominated contact for future communications (see Section 1.6)

¹⁸ Section 185E(2), *Local Government Act 1989*.

¹⁹ Section 185E(2)(b), *Local Government Act 1989*.

- the proposed higher cap or caps, in dollar and percentage terms
- the financial years (no more than four) in which a proposed higher cap would have effect
- a brief summary of the reasons for the application
- a list of attachments that include the necessary evidence to support the application.

We expect these components to be consistent with the application statement, the budget baseline information and any other supporting documentation.

Statement addressing the six matters

After the cover sheet, the second component of an application is a statement addressing the six legislative matters that the council is required to specify in seeking a higher cap (Box 3.2).

The statement forms the basis of the application for a higher cap. A council should use the statement, together with any supporting evidence, to demonstrate that it has a long-term funding need that justifies a higher cap, and that approval is in the interests of ratepayers and the community. In Sections 4.1 to 4.6, we explain what we look for in an application, as the council addresses each of the legislative matters, identifying the kinds of information we expect to find. In Section 4.7, we explain how we assess whether what we find adequately demonstrates the fundamental features of good financial planning and management, and the need for a higher cap.

In addressing the six legislative matters satisfactorily, a council can show its community and the commission that a higher cap may meet the purposes of the Fair Go Rates system, because:

- there is a long-term need for additional funding
- council took appropriate steps to ensure its plans were robust, efficient and reflected outcomes from community engagement.

The Fair Go Rates system requires councils to demonstrate publicly their adherence to the best practice planning and budgetary process requirements in the Act, before applying for a higher cap. The Best Value Principles and the principles of sound financial management are particularly relevant.²⁰ The Best Value Principles also require councils to engage with the ratepayers and the community, and so develop their understanding of the trade-offs needed for strong financial outcomes. The conversation is not about what is wanted but about moving towards what is needed — and about ratepayers' willingness to pay for it.

If a council seeks a higher cap for more than one year, or for a percentage well above the minister's rate cap, we look for greater substantiation than for a minor increase for a single year. The greater the potential burden on ratepayers that a higher cap application represents, the

²⁰ Section 136 and ss. 208A – 208J of the *Local Government Act 1989*

greater is the effort we expect in preparing (and assessing) the application. A council is responsible for determining what it considers sufficient demonstration to support its application.

Supporting material

A clearly stated application can demonstrate these key matters with supporting detail. For instance, a discussion of community engagement will be easier to understand and assess, if the application includes material such as:

- records of meetings and attendance
- the degree of involvement sought from participants
- samples of the material provided
- notes and analysis of participants' views.

We wish to minimise the need for a council to generate *new* accounting records, analyses and reports, purely to support an application. Rather, using *existing* detailed material can help to show the council identified a financial need through established and robust financial and planning processes. However, councils should cross-reference such material and explain its significance in sufficient detail to support the application.

Supporting documents prepared for different purposes at different dates may present different versions of what is essentially the same information. A council should therefore clearly explain how the supporting documents strengthen its overall case for a higher cap. Further, where there are any significant inconsistencies, the council should identify and explain them.

3.3. Our response to an application

3.3.1. How do we make requests for information?

Once we receive an application, we may need to clarify issues or seek additional information from the council, to understand its application better. We will send a written request to the council as soon as possible: probably within two or three weeks of receiving the application. Other informal contacts for minor clarifications may continue as needed while we assess the application.

We will place the council's formal response to our request alongside the council's original application on our website. We will include any supporting documents provided, unless marked as confidential.

3.3.2. How will we assess the application?

It takes considerable time to assess an application properly. We will use our best efforts to finish each assessment and publish the decision within two months of receiving an application. During this time, commission staff will be in touch with council contacts as necessary.

Expert advice

If appropriate, we may engage external expertise to assist our analysis and understanding of key aspects of higher cap applications. This expertise may include financial and accounting analysis, infrastructure maintenance and planning, corporate planning, and community engagement. Our use of this expertise does not represent an additional requirement or criterion, but simply helps us understand a council's application and the implications of our decisions. We will publish any external advice that is directly relevant to an application, together with our decision report in response to that council's application.

3.3.3. How will the council receive our response?

We will approve, approve in part, or not approve, the higher cap proposed by the council. In deciding on an application for a higher cap, we must have regard to:

- the purposes of the Fair Go Rates system
- whether the application satisfies the legislative matters
- whether the council has complied with directions, advice and guidance in relation to a particular application under s. 185E(5)
- the council's record of compliance with the rate cap.

We will publish a decision report that details the higher cap approved (or not approved), the years for which it will have effect, and the reasons for our decision. We will also make all decisions publicly available on our website after notifying the relevant council of the decision. Further, any approved higher cap will appear in the Victorian Government Gazette.

We will provide a council with an embargoed copy of the decision report before its public release. We will also invite the council for a formal meeting to discuss the reasons for our decision.

Approved

Approval means a council can increase its capped average rate by no more than the percentage amount of the higher cap proposed in its application for the specified period.

Approved in part

Under s. 185E(6) of the Act, the commission has authority to set a lower rate cap than the one that the council proposed. Approval in part means a council can increase its capped average rate, but only by the lower percentage that we set.

Not approved

A 'not approved' response means a council cannot increase its capped average rate by more than the average rate cap set by the minister.

3.3.4. How can a council contest a decision?

A council can seek a judicial review by the Supreme Court, on administrative law grounds, of a commission decision on an application for a higher cap. This means the court could set aside our decision if we do not give a council a fair hearing on its application or if we make an error of law. If the court finds a procedural or legal error, then we can be required to make a fresh decision on the application in a manner consistent with the court's guidance. The court could not substitute its own decision based on the facts before it.

4. Assessing an application

Overview

Chapter 3 described the mechanics of an application. That is, the processes for the council applying for a higher cap and for the commission arriving at a decision and publishing it. This chapter deals with the substance of an application and, in particular:

- the guiding principles we follow when assessing each of the legislative matters
- the nature of the material we expect to find when a council is responding to each of these matters
- the documents that the council should provide to support its case.

The chapter finishes by summarising our assessment approach and the likely circumstances in which we could be satisfied that our approval of a higher cap is in the long-term interests of the community and ratepayers.

The six matters that must be addressed

All applications — whether for one year or for several — must cover the core subject matter. That is, they should consider the six legislative matters as the means by which they demonstrate a long-term funding need, established through robust financial planning and engagement with the community.

Sections 4.1 to 4.6 give further guidance on the information we consider will assist a council addressing the six legislative matters, namely:

1. Proposed higher cap
2. Reasons
3. Engagement
4. Efficiency and value for money
5. Alternative funding and offsets
6. Long-term planning

Section 4.7 describes our approach to combining our assessments of a council's responses to each of the six legislative matters, into an overall decision on the council's application for a higher cap.

4.1. Proposed higher cap

*An application must specify a proposed higher cap for each specified financial year.*²¹

4.1.1. Purpose

The purpose of this legislative matter is to detail the magnitude of the rate increase(s) being sought and the year(s) in which the increase will have effect.

4.1.2. Guiding principles

We will verify that the proposed higher cap is:

- correctly expressed as the total percentage increase above the base average rate, inclusive of the minister's cap for 2018-19
- consistently stated in the budget baseline information template and elsewhere in the application.

4.1.3. General and specific expectations

A council can address this matter by accurately completing the application cover sheet template (a Microsoft Word form) and the budget baseline information template (a Microsoft Excel spreadsheet that itself contains detailed Instructions on how to enter the required data).²² These documents will cover:

- the higher cap or caps being sought
- the years to which the higher cap or caps will have effect (maximum of four years)

The requested higher cap should be expressed as the total percentage increase from the base average rate. Any approved cap is inclusive of the average rate cap that the minister sets. For multi-year applications, we recognise that the average rate cap will not be known for the years beyond the immediate budget year. Councils may want to use the Department of Treasury and Finance forecasts for estimating average rate caps to help in planning and budgeting.²³ However, the increase the council seeks should reflect its long-term funding need and should be the outcome of rigorous long-term planning. It should not be just an add-on to the minister's rate cap but should be inclusive of that rate cap when known, or of the council's own forecast of consumer price index.

A council should ensure the application cover sheet, the statement and the Budget Baseline information are consistent in stating both the amount of revenue applied for, and the corresponding percentage increase in average rates.

²¹ Section 185E(3)(a), *Local Government Act 1989*.

²² Both templates are available on our website at <https://www.esc.vic.gov.au/project/local-government/29079-fair-go-rates-system-guidance-material/>

²³ See <http://www.dtf.vic.gov.au/Publications/Victoria-Economy-publications/Macroeconomic-indicators>

4.1.4. Supporting evidence

As above, a council must provide the completed application cover sheet template and budget baseline information template. The template requires the council to provide 'with higher cap' and 'without higher cap' forecasts of selected financial indicators in the local government performance-reporting framework.

As Section 4.6.3 explains, we expect the budget baseline information template to show results with and without a higher cap for the budget year and the three following years of the strategic resource plan, and up to ten years of the long-term financial plan.

4.2. Reasons

*The reasons for which the council seeks the higher cap.*²⁴

4.2.1. Purpose

The purpose here is to specify the immediate and underlying reasons for the application — reasons that the application and supporting documentation should consistently reflect throughout. This should explain whether the council is seeking a higher cap to address a material change in financial circumstances; a change to the services that the council provides; particular infrastructure needs; to ensure long-term financial sustainability; or some other factor or combination of factors.

Applications can specify more than one reason in one year — or in different years of a multi-year application. If different reasons are specified, then applications should demonstrate and quantify the funding requirements for each reason.

4.2.2. Guiding principles

The commission will consider whether the reasons for seeking the increased revenue are consistent with the long-term funding need of the council.

4.2.3. General and specific expectations

We expect councils to quantify the amount(s) that make up their funding need, and identify the purpose(s) for which the funding is required. An application must always demonstrate a long-term funding need.

As part of its normal planning and budgeting process, a council is expected to model the services and service levels that it can provide in different revenue scenarios. We therefore expect that, before seeking a higher cap for 2018-19, the council prioritised the services and expenditures that made up its revenue requirement under the rate cap in the base year 2017-18.

If a council now seeks a higher cap to fund a service or expenditure that it previously funded from revenue in the base year, it needs to demonstrate why it can no longer do so within the revenue generated by the average rate cap.

A council should also demonstrate the need for this funding change to its community. Further, it should include evidence of this community engagement in the application. Section 4.3 discusses this in detail.

Most reasons put forward by a council will likely fit into one or more of the following categories.

²⁴ Section 185E(3)(b), *Local Government Act 1989*.

- The council faces sustained underlying operating deficits, possibly following a material change in revenue or costs. The deficits cannot be managed by trade-offs or alternative funding, such as internal savings, the use of other revenues, or by an operational change to minimise the impact in the short term. The application must make this point clear in the response to the fifth legislative matter. We expect a council to manage one-off or immaterial short-term variations in its liquidity through day-to-day financial management.²⁵ When a council faces major increases in its long-term funding requirements it should give clearly identified and quantified reasons.
- The council, in consultation with its community, prioritised the provision of a new service or higher standard of service but does not have corresponding funding from other sources.
- The council is increasing its effort to address asset renewal requirements, consistent with its long-term strategy and asset-management plans.
- The council wants to fund significant investments in new infrastructure, which it prioritised in its plan and long-term strategy, developed through engagement with the community. The funding requirements (and corresponding revenue needs) should be calculated according to the whole-of-life cost of the project. A council should not seek higher caps to fund specific small, short-term capital projects that form part of its regular capital-works plan.

A higher cap represents a permanent increase in a council's rate base that will continue to compound every year thereafter. For this reason, we do not expect to receive applications that aim to fund short-term expenditure or cash-flow requirements. It is not in the interests of ratepayers and the community to approve higher caps on this basis.

There are no reasons that automatically ensure the approval of a higher cap.

4.2.4. Supporting evidence

We expect a council to provide documentation that supports the council's reasoning. The documentation needs to show how circumstances might have changed, or whether the council has an existing funding need, such as a renewal backlog or a long-term adjusted underlying deficit. This evidence may refer to previous financial statements, long-term financial plans, council plans, strategic resource plans or asset-management plans. If the increase is required to fund a specific action, such as repairing council-owned building infrastructure, then the council needs to explain how in future years it will continue using the higher revenue included in the rate base.

We expect a council to explain clearly any material differences between past budget and actual expenditure (particularly underspends) for services or infrastructure. This explanation will give us confidence that funds budgeted will be appropriately spent in the interests of ratepayers.

²⁵ 'Liquidity' here meaning the council's ability to generate sufficient cash to pay its bills on time.

The budget baseline information template (see Section 2.3) is an essential part of the evidence that demonstrates the council's reasons.

4.3. Engagement

*How the views of the ratepayers and the community have been taken into account in proposing the higher cap.*²⁶

4.3.1. Purpose

The purpose of this legislative matter is to ensure a council demonstrates it considered the views of ratepayers and the community in relation to a higher cap.

Engagement on a higher cap should be part of a council's long-term planning. This front-end engagement could feed into the development of a four-year council plan, the annual budget, or be part of broader community engagement on key issues affecting the local government area.

The more a council integrates engagement on a higher cap into its formal planning process, including the consideration of key budget trade-offs, the easier it will be to address this legislative matter.

4.3.2. Guiding principles

The commission's consideration of this matter is guided by our key engagement principles (Box 4.1) and the Best Value Principles (e) and (f) on engagement (Box 4.2)²⁷ in the Act.

Box 4.1 Key engagement principles

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

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

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

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

Essential Services Commission 2015, *A Blueprint for Change*, pp. 69 70.

²⁶ Section 185E(3)(c), *Local Government Act 1989*.

²⁷ Sections 208B (e) and 208B (f), *Local Government Act 1989*.

4.3.3. General and specific expectations

General expectations

As a minimum, a council's engagement on higher caps should meet our key engagement principles.

Councils will differ in how they engage with ratepayers and communities. We do not prescribe how councils should do this; such decisions sit with councils. But applications should clearly explain how the council engaged with its community and why it chose this approach, what information it provided to the community and how this was provided. Applications should also explain what the council learnt about the views of its ratepayers and the community, and how the council took these views into account in deciding to seek a higher cap.

We recognise that effective community engagement can be challenging. Whether or not a certain method is appropriate will depend on the demographic, geographic and financial characteristics of each council.

We expect that councils will increasingly integrate engagement on a higher cap application into their existing planning and budgetary processes. If records show that a council's engagement on its budget or long-term plan adequately covered its funding needs, service levels, trade-offs and the other Fair Go Rates system legislative matters, then we do not expect to see a separate engagement program for a higher cap application.

A council will need to show that it has engaged openly and effectively, and in ways that draw out community views. Community members and ratepayers should understand that the higher cap represents good value for money, that trade-offs have been considered, and that a higher cap fits into the council's long-term strategy. Over time, the community should become better informed of the trade-offs required for a council to achieve long-term financial stability.

An application should show the efforts that the council made to engage effectively with its ratepayers and community members to obtain a representative view. The council should actively seek the views of a sufficient number of people, reflecting diverse groups in the municipality.

Specific expectations

We expect the council to provide a narrative describing and demonstrating:

- what it did to engage with ratepayers and community members (outlining who was approached and in what way, when and where) and why the selected methods were chosen
- what information the council gave ratepayers and community members about issues that could include:
 - the scale of the higher cap
 - whether the higher cap addresses a short-term or long-term need
 - details of the options, trade-offs and different rate-increase scenarios
- what the outcomes of the engagement program were (documentation and analysis of the responses of ratepayers and community members)
- how the council took into account the views of ratepayers and the community in seeking a higher cap. Although not bound to accept those views even if expressed by a majority, the council must explain how it weighed up and considered those views and how they influenced its decision, by describing:
 - what it learnt through the engagement process
 - how it is responding to the issues raised during the engagement and why it is responding that way
 - what the council is doing about unmet expectations arising from the engagement undertaken.

We note in particular that, based on the documentation provided by some councils in previous applications, it has not always been sufficiently clear:

- whether councils engaged with ratepayers and the community and presented adequate information to them, on trade-offs and the potential effects on rates, services and service levels
- how the council considered ratepayer and community views, and how it gave feedback on those views, particularly when it received mixed (or largely negative) responses to its engagement.

4.3.4. Supporting evidence

To support its narrative describing community engagement, the council must provide evidence. This should demonstrate the thinking at each stage of the engagement program — from planning through to evaluation. This evidence might include:

- an engagement plan
- agendas, material and information provided to community members during the engagement processes
- documents that capture and analyse the views expressed during the engagement processes (such as survey results, comments from community meetings or listening posts, or submissions)
- council analyses of community and ratepayer views
- council meeting reports, minutes or records of discussions where the council considered the outputs of the engagement process (i.e. the views of ratepayers and the community)
- material provided to community members reporting back and explaining how the engagement process informed the council's higher cap application.

Community engagement resources available on our website

In consultation with the commission's engagement technical working group, we have developed resources to assist councils planning, undertaking and reporting on their engagement. These resources are available on our website.²⁸

²⁸ Refer <http://www.esc.vic.gov.au/project/local-government/29079-fair-go-rates-system-guidance-material/>

4.4. Efficiency and value for money

*How the higher cap is an efficient use of council resources and represents value for money.*²⁹

4.4.1. Purpose

The purpose of this legislative matter is to ensure an applicant council can demonstrate it has sufficient policies and processes in place (and has taken specific actions) to ensure the additional revenue raised would be used efficiently, and the outcomes being pursued represent value for money for ratepayers. In many ways, this matter represents a public demonstration of the council's adherence to the Best Value Principles that councils are obliged to meet in their service provision.³⁰

4.4.2. Guiding principles

The commission's consideration of this matter is consistent with the Best Value Principles (a)-(d) (Box 4.2).

Box 4.2 Best Value Principles

The Best Value Principles are —

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

Source: section 208B(a)–(e), *Local Government Act 1989*.

²⁹ Section 185E(3)(d), *Local Government Act 1989*.

³⁰ Section 208B, *Local Government Act 1989*. Changes to the Act foreshadowed in the Victorian Government review may remove the requirement to adhere to the Best Value Principles. But the proposed changes are consistent with the desired outcomes of efficiency and value for ratepayers. Until the Act is amended, the commission will continue to cite the Best Value Principles.

We consider these principles cover expenditure that councils may not traditionally classify as a 'service', including capital works and expenditure that is not directly related to the *Reasons* for the application. This is because a council's failure to follow these principles in other areas of its operations will ultimately affect its capacity to deliver services. It will also affect ratepayers' value for money from the rates that are paid.

4.4.3. General and specific expectations

The application should show how the amount of any additional revenue the council proposes to receive through a higher cap represents a good value option for achieving the desired outcome.

We expect applications to demonstrate that the council has sound processes, policies and initiatives to ensure it uses resources efficiently, and that it followed these processes and policies in determining the need for a higher cap.

When proposing to fund the delivery of new or expanded services, or new infrastructure, a council should show it took appropriate steps to ensure the planned expenditure would represent value for money for ratepayers. This may include service reviews, business cases and/or cost benefit analyses (when appropriate), and consideration of whole of life project costs. A council should demonstrate the desired objectives and outcomes of the proposed changes to services or infrastructure, and the options considered for delivering those objectives and outcomes.

The council should quantify any efficiency savings gained and explain how forward expenditure projections reflect those savings.

4.4.4. Supporting evidence

To support its application, the council may refer to or describe relevant sections of internal policies and processes for ensuring efficiency and value for money. This evidence might include tendering or procurement policies; policies for reprioritising capital expenditure; service reviews and their outcomes; internal efficiency initiatives; business cases; cost benefit analyses (where appropriate); and assessment of alternative delivery options. The council should also explain how it has followed these policies/processes.

Further, if applicable, the council should provide the results of any benchmarking studies that compared the council's unit costs with its peers' unit costs. For instance, information at the *Know Your Council* website can support an application effectively. This can be particularly helpful if the website shows performance measures related to the *Reasons* that the council identified in its application.

4.5. Alternative funding and offsets

*What consideration has been given to reprioritising proposed expenditures and pursuing alternative funding options and why those funding options are not adequate.*³¹

4.5.1. Purpose

The purpose of this legislative matter is to ensure a council considered the prioritisation of services and different funding and financing options before seeking a higher cap. This matter requires the council to demonstrate that it considered other feasible options, and to explain why it judged those options inadequate. The application should show that the council's engagement program sought community views on the issues.

4.5.2. Guiding principles

The commission's assessment of this matter is based on evidence about whether:

- the council considered alternative budget scenarios, in conjunction with its ratepayers and community
- the council's decision to apply for a higher cap is the most appropriate funding option to meet the stated *Reasons*.

4.5.3. General and specific expectations

We expect a council to show how it came to prefer raising additional revenue through a higher cap to other options, and how it considered any trade-offs (see Box 4.3).

Councils should not simply resort to increase their revenues through higher rates when faced with budget pressures. We expect a council to have also considered one or more of the following areas in addressing its funding need:

- scrutinising the full suite of its operations and its planned investments for opportunities to deliver outcomes more efficiently
- re-examining whether the range of services and service standards delivered align with the community's highest priorities
- assessing the possibility and merits of alternative funding or financing options for different activities and investments
- examining cash-flow options that are available to manage short-term funding needs, having regard to its long-term revenue and cost trends.

³¹ Section 185E(3)(e), *Local Government Act 1989*.

We do not advocate that the sector increase or reduce its debt level. Whether it is prudent or responsible to use debt finance depends on the circumstances of each municipality and the judgment of the council. But debt finance is an option available to councils as part of their financial toolkit and it can form a key element in a responsible long-term financial plan. In particular, debt finance can be useful when a council seeks to provide long-lived infrastructure that is likely to provide inter-generational benefits to the community.

We expect a council applying for a higher cap to show it has a well-considered debt policy (preferably consulted on with the community) that guides its decision whether to use debt to reduce the need for additional funding in the short-term through increased rate revenues. If the council adopts a debt position that is not consistent with its debt policy, then the application should clearly explain why. In other words, as required by the legislation, a council's application must demonstrate it considered the option of debt and the reasons for adopting or not adopting it.

The application needs to demonstrate that the council considered other suitable funding or financing options. It also needs to outline the decision reached (and reasoning for the decision) on those options, which could include different rate increase scenarios. In demonstrating the preferred option, the council should consider how a higher cap is in the long-term interests of the community and ratepayers. The council, in consultation with the community, must decide priorities and desired outcomes; this decision is not our role.

Box 4.3 Trade-offs

There will inevitably be 'trade-offs' between different options that a council can take into account to determine the most appropriate approach to meet its long-term funding need and the long-term interests of the community.

'Trade-offs' is a term that appears a number of times in this document, particularly in the context of choices presented in community engagement (Section 4.3), and when council is examining expenditure proposals or funding options (this Section 4.5). When an application describes the trade-offs that were considered, we expect a clear statement that compares the financial impacts, service impacts or infrastructure impacts that arise from the choice of pursuing different options.

A council's strategic approach to considering alternative options and their potential impacts on ratepayers and the community is a key element of sound long-term financial planning.

4.5.4. Supporting evidence

Where relevant, an application should show how the council considered reprioritising services and changing service levels. It should show that the council considered using alternative revenue sources such as its current financial reserves or debt financing for the proposed expenditure. The application has to describe the engagement undertaken to identify the community's service preferences, with council's consideration of these preferences. Where relevant, an application should provide asset-management plans that support the timing of proposed works and the whole-of-life project costs for capital projects.

Key supporting documents should include long-term financial plans, revenue and rating policies, and debt financing policies. The budget baseline information will also help provide evidence. In particular, it will show how service review and/or reprioritisation might have affected, or are likely to affect, the revenue and expenditure profiles of services.

4.6. Long-term planning

*That the assumptions and proposals in the application are consistent with those in the council's long-term strategy and financial management policies set out in the council's planning documents and annual budget.*³²

4.6.1. Purpose

The purpose of this legislative matter is to show the reasons for the application are consistent with the council's long-term strategy and financial management plans, policies and other key planning documents. Our assessment will follow the council's summary of its recent, current and projected financial position, its relevant policies and the way that the higher cap links to longer-term strategies. This information will frame and support the council's reasons for seeking a higher cap and help us understand the council's financial position.

4.6.2. Guiding principles

The commission's consideration of this matter is guided by the council's demonstration whether:

- its reasons for seeking a higher cap are consistent with and supported by the council's key financial management and other strategic and planning documents
- in seeking a higher cap, the council adhered to the principles of sound financial management required by s. 136 of the Act (Box 4.4).

³² Section 185E(3)(f), *Local Government Act 1989*.

Box 4.4 Principles of sound financial management

- (1) A Council must implement the principles of sound financial management.
- (2) The principles of sound financial management are that a Council must—
 - (a) manage financial risks faced by the Council prudently, having regard to economic circumstances;
 - (b) pursue spending and rating policies that are consistent with a reasonable degree of stability in the level of the rates burden;
 - (c) ensure that decisions are made and actions are taken having regard to their financial effects on future generations;
 - (d) ensure full, accurate and timely disclosure of financial information relating to the Council.
- (3) The risks referred to in subsection (2)(a) include risks relating to—
 - (a) the level of Council debt;
 - (b) the commercial or entrepreneurial activities of the Council;
 - (c) the management and maintenance of assets;
 - (d) the management of current and future liabilities;
 - (e) changes in the structure of the rates and charges base.

Source: s. 136(1)-(3), *Local Government Act 1989*.

4.6.3. General and specific expectations

We expect a council to demonstrate that the reasons for its application (and underlying need) are consistently represented in, and supported by, its relevant financial and planning policies and documentation. Accounting records and projections should be reconciled to operational programs and asset-management records.

The budget baseline information template described in Section 2.3 shows an appropriate level of detail. Section 2.3.1 explains the period that we would expect the long-term plans to cover. The council should use the minister's cap to show results with and without a higher cap for the budget year. It could extend the Department of Treasury and Finance forecast of consumer price index to show similar results for the years of the strategic resource plan. It should explain the basis of any critical assumptions it makes for the later years of the long-term financial plan.

In previous applications, not all councils have ensured their financial plans were clear and consistent with other supporting material such as corporate plans, financial strategies and policies, and asset-management plans. For instance, for a higher cap intended to close an asset-renewal gap, we would expect to see the purpose, monetary amounts and timescale reflected in an asset condition report and financial plans attached to the application.

We also expect an application to consider the council's major financial challenges systematically and reflect them in the financial plans. The plans should deal with major trade-offs, and model alternative scenarios that align with good policies and financial sustainability.

The council will have used certain assumptions to quantify the higher cap that it seeks. For example, these assumptions might relate to future costs, demand trends, changing community needs and appropriateness of funding source. All relevant planning documents should state these assumptions consistently; when this is not the case, we expect the application to highlight and explain differences. We also expect a council to demonstrate that it reviews the assumptions underpinning its long-term financial plans annually, and to explain the reasons for changes to key assumptions in these plans.

We expect that the council adheres to the principles of sound financial management and that the application and supporting documentation reflect this.

4.6.4. Supporting evidence

As evidence, a council may provide its council plan, strategic resource plans and long-term financial plan, annual budgets, asset-management plans, revenue and rating policies, and debt policy. The budget baseline information should also provide supporting evidence. We expect a council's application to direct us to the relevant sections of the plans and policies.

4.7. What is our assessment approach?

Integrating the six legislative matters and our statutory objectives

As the Fair Go Rates system requires, we examine each of the six legislative matters that a council addresses in its application. Further, the Act requires us to have regard to a council's record of compliance with previous years' caps.

Our assessment takes into account the statutory objectives and legislative matters that applications must address. This approach ensures that the assessment includes all relevant factors covered by the legislation that impact on whether the application demonstrates a long-term financial need that should be funded through a higher cap.

To assist our assessment we may seek external consultants' advice (which we publish on our website with our decision in due course). The advice covers technical areas of financial capacity and community engagement.

Our assessment approach is set out below

4.7.1. Integrated approach

The way in which a council establishes its long-term funding need, and the rigour with which it does so, are both important. Applications must address each of the six legislative matters listed in Box 3.2. An application should demonstrate the magnitude of funds needed, the reasons for that need, and the actions that the council took to minimise the overall need. The more comprehensive and robust a council's long-term planning, and the better its engagement with the community, the simpler it will be for the council to demonstrate a long-term need for funds.

When assessing an application and determining whether a higher cap is appropriate, we depend largely on the information that the council provides in its application addressing the six legislative matters. However, data in the budget baseline information template also provides insights to guide our decision, as do key indicators in the local government performance-reporting framework. We examine the information provided in the whole application, and seek to answer four basic questions.

1. What is the underlying financial position?

We look at the way the council has responded to the first two legislative matters: the *Proposed higher cap* and the *Reasons* for which it is required. They should be consistently stated and clearly explained throughout the application. We also look at the council's financial capacity, as shown by the current values and the past and forecast trends of financial indicators used in the local government performance-reporting framework. We focus on the adjusted underlying result (as well as other key financial indicators such as the working capital ratio, unrestricted cash position and asset renewal ratio). We also take into account specific council characteristics such as road length, and trends such as population and dependence on grant revenue, to understand the financial pressures faced by the council.

2. What has been done to manage the underlying position?

We look at the council's response to the fourth and fifth legislative matters: *Efficiency and value for money*, and *Alternative funding and offsets*. We consider other supporting information the council provides. We look at indicators and trends in the local government performance-reporting framework, particularly those showing the council's costs to provide services. We make comparisons with other councils, using unit costs of service delivery and similar benchmarks. We consider records of service reviews that are completed, and of planned and historical savings that the council can quantify. We consider processes for asset review and disposal. We look for any other cost saving initiatives the council has pursued — within its own organisation and in cooperation with neighbouring councils.

We look at the council's management of cash including discretionary reserves, and its use of debt in the context of the council's policy on borrowing and the mandatory principles of sound financial management.

3. How were ratepayer and community views taken into account?

We look at the council's response to the third legislative matter, *Engagement*, and the content and the manner in which it was undertaken. We expect that the council openly and actively discusses with ratepayers and the community all issues of substance covered in the other legislative matters. We take into account measures of community satisfaction.

Beyond this, we also consider whether the council seeks views on how it can best conduct the engagement program. We assess whether the council monitors its success in reaching people and adjusts its program accordingly. We look for records showing the council considers participants' views and reflects them in its application. We consider how the council provides feedback to the community and addresses any unmet expectation.

4. Are the plans, policies and processes in place sufficient to demonstrate a long-term funding need?

Our focus is on the sixth legislative matter, *Long-term planning*, and its integration with the other matters and its consistency with the supporting financial information. A council can establish its long-term funding need most clearly through good long-term financial planning. We consider the following features (Box 4.5) are fundamental to good financial planning and management, and we shall look for them in a council's higher cap application.

Box 4.5 Features of good financial planning

- Ensuring that the assumptions in a council's long-term plans and financial strategies are based on reasonable and reliable information, by having best-practice processes, plans and policies in place that include:
 - sound policies and practices to manage cash holdings and debt
 - good asset-management plans, to identify cost-effective outlays based on properly considered and documented risk management
 - performance monitoring and reporting.
- Effectively managing areas within the council's control, to deliver services and fulfil its functions cost-effectively, through methods that include:
 - undertaking programs of continuous improvement and efficiency
 - considering options and trade-offs for different models of funding, finance and service delivery
 - seeking opportunities to collaborate with other councils in shared services, etc.
- Undertaking regular service reviews to plan and prioritise service delivery, using effective engagement practices to identify community preferences while maintaining financial sustainability.
- Providing a stable and predictable rating burden on ratepayers to avoid rate shocks.
- Updating financial plans regularly, to reflect best-available information.

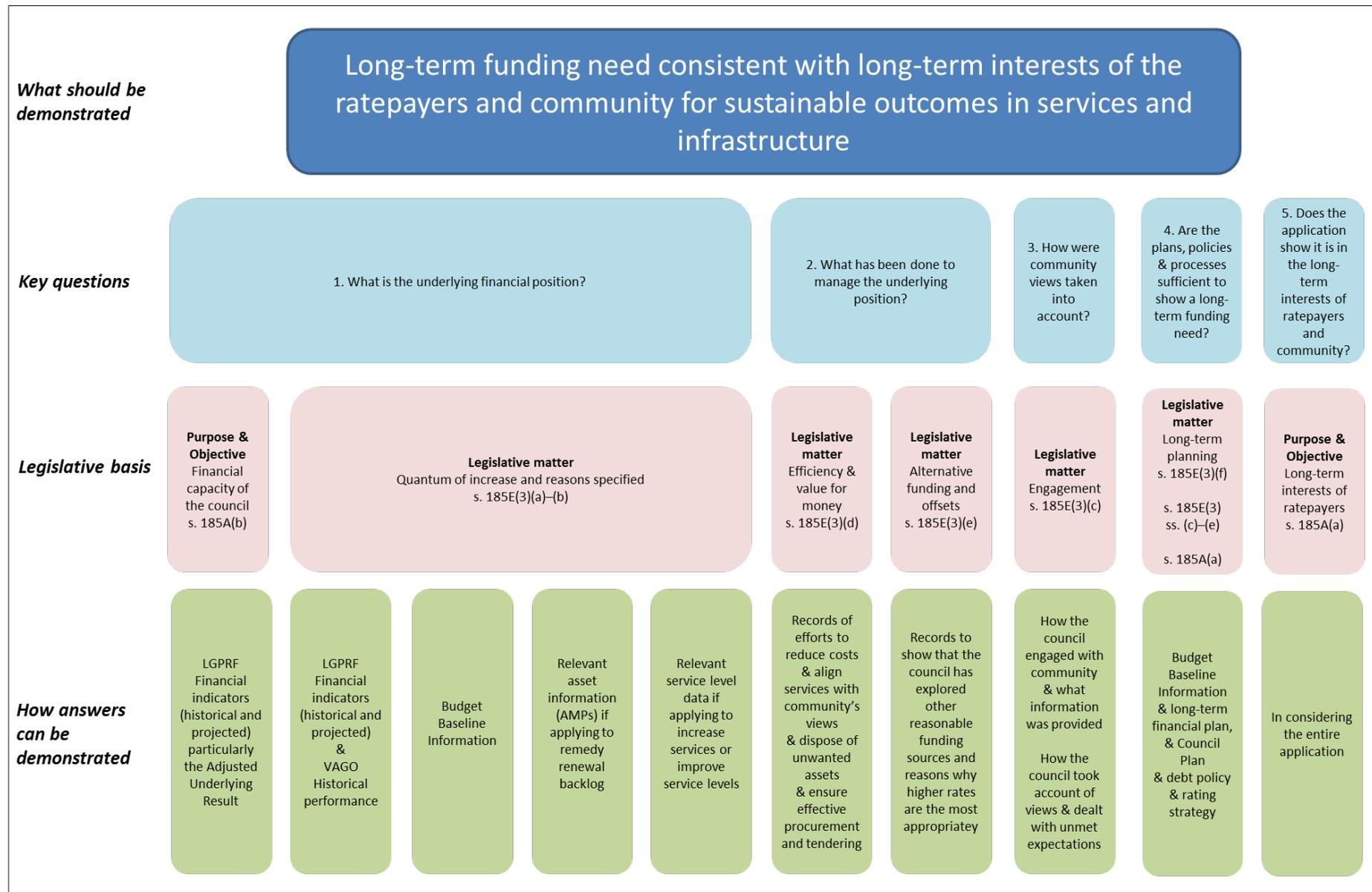
We consider these are distinguishing features that identify good planning. They help the council ensure it bases its projected long-term revenue and expenditure trends on robust and timely information. In this way, the council can also identify long-term funding need with sufficient confidence for good decision-making.

5. Does the application demonstrate that it is in the long-term interests of ratepayers and the community?

To justify a permanent increase in the rate base and meet the statutory objectives, we must be satisfied that the application adequately demonstrates a long-term funding need. We must also be satisfied that a higher cap is consistent with the long-term interests of the council's ratepayers and community for sustainable outcomes in services delivery and critical infrastructure.

Figure 4.1 outlines how our assessment approach sits within the legislative framework.

Figure 4.1 Assessment approach



4.7.2. Other considerations

Need for greater demonstration for a multi-year cap

An application for a higher cap that will take effect over two to four years is not significantly different, in form and presentation, from a single-year cap. But if approved, it is different in one key respect: compared to a single year's higher cap, it can increase the council's revenue — and the community's rate burden — to a greater degree.

Because of this, we expect and require a multi-year application to show a higher standard of consistency and attention to detail. In documenting its plans, we would expect the council to demonstrate that it:

- considers whether trade-offs — such as different service, infrastructure and financial options that might not exist in the short term — may become available over two to four years
- models alternative scenarios (not limiting these to a single with/without higher cap comparison)
- outlines the key operating and financial assumptions in the long-term financial plan, ensuring these are consistently stated (or adequately reconciled) in the narrative statement, formal budgets and plans, and the budget baseline information template.

Engagement is particularly important for multi-year applications — and it must be clear how the views of ratepayers and the community informed the council's plans. We expect an application to show that the council engages effectively, securing adequate representation and involvement of the people it represents. Its engagement program must make clear the options under consideration and the impact of a multi-year cap. The application must also show how the council responded to the views that it gathered through engagement, and dealt with unmet expectations.

Because circumstances may change significantly during the timespan of a multi-year cap, we expect a council to commit to continuing this engagement and reviewing its priorities, as part of its normal planning and budget processes, as stated in Sections 4.3 and 4.5.

The affordability of a higher cap

Affordability is an important consideration for a council when setting its rates. We encourage councils to take this into account when they make their decisions about whether to apply for a higher cap.

We do not assess affordability in councils' higher cap applications. The legislation does not require us to do so, nor is it appropriate.³³ Councils are best placed to determine their community's capacity to pay after taking into account all major factors that may affect their communities. The decision on the appropriate trade-off between service impacts and the level of rates rightly sits within the council's jurisdiction.

Our role, as defined in legislation, is limited to ensuring that the higher cap application process undertaken by councils is robust and transparent.

Long-term and short-term need

A council with a well-developed long-term financial plan should not have to resort to a higher cap, simply to balance any net cash needs in its budget from year to year. It should be able to meet any short-term cash needs from available resources, including its existing unrestricted cash holdings. Seeking ongoing higher rates to fund year-to-year fluctuations in cash flow would be inconsistent with the long-term interests of ratepayers and communities.

Generally, we consider a higher cap is not appropriate when an application:

- does not demonstrate a long-term funding need
- proposes to apply the higher cap to fund short-term needs
- is not supported by adequate long-term financial planning
- does not demonstrate that the council accounted for the views of the community and ratepayers
- is inconsistent with the council's internal plans and policies, and conflicts with information provided to the community and the commission
- is not supported by our analysis of the council's financial capacity and overall flexibility to manage its short-term needs.

³³ Affordability is not one of the matters listed in the legislation that councils must address in their applications — section 185E(3).

5. Complying with the rate cap

Overview

This chapter provides guidance to councils on how to calculate the base average rate and capped average rate. Our guidance follows the requirements of the Act. The document also explains how we will monitor and report on council compliance with the rate caps.

A council should use this guidance to ensure it uses the correct information to calculate its base average rate and capped average rate. A council must comply with the rate cap set by the Minister for Local Government unless we set a higher cap by special Order for that council. A council may also use this guidance to help assess whether it will need to apply for a higher cap in a later year.

5.1. Key terms

Councils need to understand a number of terms to ensure they comply with the rate cap.

Base average rate

The base average rate is a council's average rates as at 30 June in the base year.

Capped average rate

The capped average rate is a council's average rates as at 1 July in the capped year.

The average rate cap

In December of each year, the minister sets the average rate cap, or caps, for the following financial year by general Order. The average rate cap is based on the forecast change in the consumer price index over the financial year to which the rate cap relates, plus or minus any adjustment. The average rate cap sets the maximum percentage by which Victorian councils can increase its average rates from the base year to the capped year.³⁴ The minister must seek, and have regard to, the advice of the commission in setting the average rate cap each year. The average rate cap includes general rates and municipal charges and any other prescribed rates and charges.

³⁴ Section 185D, *Local Government Act 1989*.

A higher cap

A council seeking a higher cap than the minister's rate cap can apply to us for approval.³⁵ If we approve an application, we set by special Order a higher cap as the total percentage (inclusive of the minister's rate cap) by which a council can increase its average rates from the base year to the capped year. If we do not approve a higher cap, the council must comply with the minister's rate cap. Councils can apply for up to four years of higher caps. Chapter 3 explains how councils can apply for a higher cap.

What is not currently subject to the rate cap

Unless prescribed by the minister, the following sources of revenue are not currently capped and not included in the calculation of the base average rate or capped average rate:

- service rates and service charges³⁶
- rates and charges from cultural and recreational land³⁷
- revenue in lieu of rates
- special rates and charges
- the fire services levy
- actual supplementary revenue (from general rates and municipal charges).

Any actual supplementary revenue received in the base year and capped year is not to be included. Instead, the annualised supplementary revenue related to the base year is included in the calculation of the base average rate because it most closely reflects the contribution of valuation changes in a municipal district and a council's rate base. Section 5.3 discusses annualised supplementary revenue in more detail.

Note that the rate cap applies to **gross** general rates and municipal charges revenue.

5.2. What are councils expected to comply with?

All councils are expected to comply with the rate cap set by general Order by the minister, or a higher cap or caps set by special Order by the commission. To comply with the rate cap, a

³⁵ Section 185E, *Local Government Act 1989*.

³⁶ While councils' service rates and service charges are not capped, we will monitor them. See Section 5.10 for information on how we will monitor service rates and service charges and waste costs.

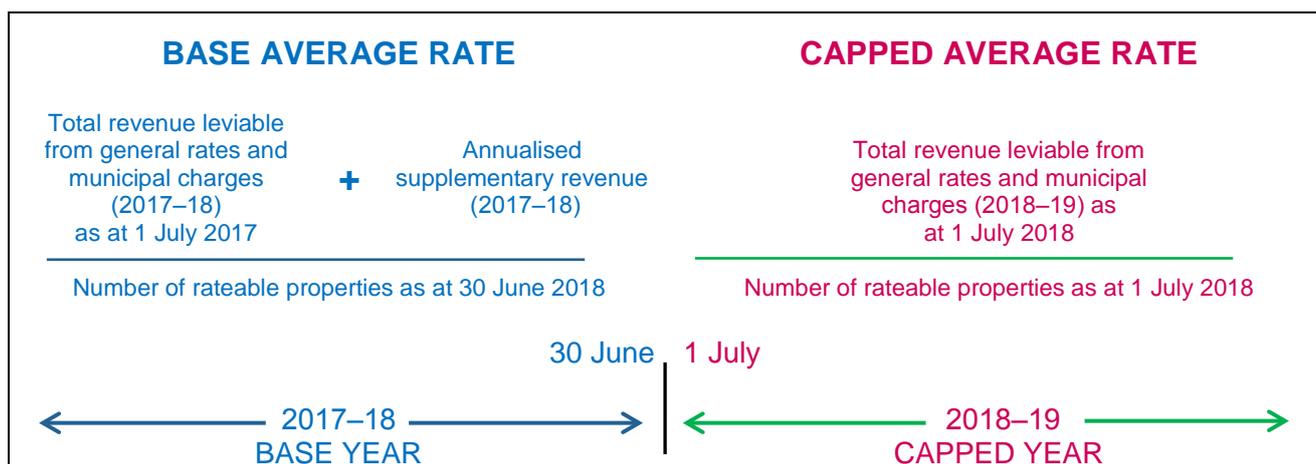
³⁷ This includes properties that are defined as cultural and recreational properties in accordance with the *Cultural and Recreational Lands Act 1963*.

We note that the Local Government Bill Exposure Draft proposes to include cultural and recreational land in the rate cap. We will update our guidance to reflect any changes as necessary.

council's capped average rate must not exceed the base average rate by more than the rate cap in effect.

Compliance with the rate cap in the capped year is always calculated in relation to the base average rate in the preceding financial year. For the 2018-19 rating year, the base year is 2017-18 and the capped year is 2018-19. Figure 5.1 summarises the calculation of the base average rate and capped average rate for the 2018-19 rating year.

Figure 5.1 Calculating the base average rate and capped average rate



5.3. Calculating the base average rate

The base average rate is the total annualised revenue leviable from general rates, municipal charges and any other prescribed rates or charges on rateable properties within the council's municipal district as at 30 June in the base year divided by the number of rateable properties within the council's municipal district as at 30 June in the base year. This calculation is shown below.

Box 5.1 Base average rate

$$\text{Base average rate} = \frac{Rb}{L}$$

Rb = total annualised revenue leviable from general rates, municipal charges and any other prescribed rates or charges on rateable properties within the council's municipal district as at 30 June in the base year³⁸

L = number of rateable properties as at 30 June in the base year

where:

Rb = total revenue leviable from general rates as at 1 July 2017
(excluding any allowance for supplementary general rates revenue)

+

total revenue leviable from municipal charges as at 1 July 2017
(excluding any allowance for supplementary municipal charges revenue)

+

annualised supplementary general rates revenue as at 30 June 2018

+

annualised supplementary municipal charges revenue as at 30 June 2018

and

L = number of rateable properties as at 30 June 2018

Note: cultural and recreational land is excluded from the calculation of the base average rate.

³⁸ In other words, *Rb* is the original amount of rates and charges levied at the commencement of the financial year + the annualised amount of supplementary rates and charges raised.

Annualised supplementary revenue

Annualised supplementary revenue from general rates and municipal charges can be calculated using value of land, number of rateable properties, rate(s) in the dollar and municipal charge per property.³⁹ These calculations are shown below.

Annualised supplementary general rates revenue

= (total value of land as at 30 June in the base year – total value of land as at 1 July in the base year)

x rate in the dollar

= (total value of land as at 30 June 2018 – total value of land as at 1 July 2017)

x rate in the dollar (2017-18)

Annualised supplementary municipal charges revenue

= (number of rateable properties on which municipal charge is leviable as at 30 June in the base year – number of rateable properties on which municipal charge is leviable as at 1 July in the base year)

x municipal charge per property

= (number of rateable properties on which municipal charge is leviable as at 30 June 2018 – number of rateable properties on which municipal charge is leviable as at 1 July 2017)

x municipal charge per property (2017-18)

Table 5.1 shows how **Council A** would calculate its base average rate for the 2018-19 rating year. Assume Council A has no differential rates and a municipal charge is leviable on all rateable properties. Council A does not intend to apply for a higher cap.

³⁹ The annualised supplementary rates and charges is the amount of rates and charges that would have been raised had all of the supplementary rates and charges been levied for the full 12 month period and not for the varying pro-rata portions of the financial year.

Table 5.1 Calculating the base average rate

Council A	
Total value of land as at 1 July 2017	\$20,000,000,000
Total value of land as at 30 June 2018	\$20,600,000,000
Number of rateable properties as at 1 July 2017	43,000
Number of rateable properties as at 30 June 2018	43,600
Rate in the dollar (2017-18)	\$0.0035
Municipal charge per property (2017-18)	\$110
Total revenue leviable from general rates as at 1 July 2017	
= total value of land as at 1 July 2017 * rate in the dollar (2017-18)	
= \$20,000,000,000 * \$0.0035	
= \$70,000,000	
Total revenue leviable from municipal charges as at 1 July 2017	
= number of rateable properties as at 1 July 2017 * municipal charge per property (2017-18)	
= 43,000 * \$110	
= \$4,730,000	
Annualised supplementary general rates revenue	
= (total value of land as at 30 June 2018 – total value of land as at 1 July 2017) * rate in the dollar	
= (\$20,600,000,000 - \$20,000,000,000) * \$0.0035	
= \$2,100,000	
Annualised supplementary municipal charges revenue	
= (number of rateable properties as at 30 June 2018 – number of rateable properties as at 1 July 2017) * municipal charge per property	
= (43,600 – 43,000) * \$110	
= \$66,000	

Continued next page

Table 5.1 (continued)

Council A	
Base average rate	
=	total revenue leviable from general rates as at 1 July 2017
+	total revenue leviable from municipal charges as at 1 July 2017
+	annualised supplementary general rates revenue as at 30 June 2018
+	annualised supplementary municipal charges revenue as at 30 June 2018
/	number of rateable properties as at 30 June 2018
=	\$70,000,000 + \$4,730,000 + \$2,100,000 + \$66,000 / 43,600
=	\$1,763.67

A council should estimate its base average rate early in the base year. When the minister announces the rate cap for the coming year, each council can then estimate its capped average rate under the minister’s cap, and determine whether it needs to apply for a higher cap.

5.4. The effect of the minister’s rate cap or higher cap

The minister's cap or an approved higher cap sets the limit for the percentage increase in average rates from the base year to the capped year. Each year, during the budget and planning process, a council should determine its maximum allowable capped average rate, using its base average rate, and whichever rate cap will be in effect.

This approach ensures the council knows ahead of time whether it is likely to comply with the rate cap. In determining its revenue from general rates and municipal charges, the council should ensure it does not set a capped average rate that exceeds the base average rate by more than the rate cap in effect.

In the simplest terms, whether considering the minister’s rate cap or an approved higher cap:

$$\text{Maximum allowable capped average rate} = \text{Base average rate} \times (1 + \text{rate cap})$$

where the rate cap is expressed as a decimal, not the equivalent percentage (e.g. **0.025** not **2.5%**)

To comply with the Fair Go Rates system, the capped average rate must not exceed the base average rate by more than the rate cap, as calculated using this equation. In practice, a council will have to forecast its base average rate and capped average rate in advance of the capped year.

Table 5.2 shows how Council A would apply the rate cap to its base average rate to determine its maximum allowable capped average rate for the 2018-19 rating year.

Table 5.2 Applying the rate cap

Council A	
Minister's rate cap 2018-19	2.25%
Maximum allowable capped average rate	
= base average rate * (1 + rate cap)	
= \$1,763.67 * (1 + 0.0225)	
= \$1,803.35	
Maximum allowable revenue from general rates and municipal charges	
= maximum allowable capped average rate * number of rateable properties as at 1 July 2018	
= \$1,803.35 * 43,600	
= \$78,626,160	

In this example, Council A's maximum allowable capped average rate is \$1,803.35.⁴⁰ This represents total revenue of \$78,626,160 that Council A may levy from general rates and municipal charges in the capped year.

5.5. Calculating the capped average rate

The capped average rate is the total revenue leviable from general rates, municipal charges and any other prescribed rates or charges on rateable properties within the council's municipal district as at 1 July in the capped year divided by the number of rateable properties within the council's municipal district as at 1 July in the capped year. This calculation is shown below.

⁴⁰ For the capped year, councils may apportion the additional amount they can receive between general rates and municipal charges in any way they wish, so long as they meet the requirements of s. 159 of the Local Government Act 1989.

Councils will raise the same revenue, regardless of whether they use capital improved value or net annual value for their property valuations.

Box 5.2 Capped average rate

$$\text{Capped average rate} = \frac{Rc}{L}$$

Rc = total revenue leviable from general rates, municipal charges and any other prescribed rates or charges on rateable properties within the council's municipal district as at 1 July in the capped year

L = number of rateable properties as at 1 July in the capped year

where:

Rc = + total revenue leviable from general rates as at 1 July 2018
(excluding any estimate for supplementary general rates revenue)

+ total revenue leviable from municipal charges as at 1 July 2018
(excluding any estimate for supplementary municipal charges revenue)

and

L = number of rateable properties as at 1 July 2018

Note: cultural and recreational land is excluded from the calculation of capped average rate.

Table 5.3 shows how Council A would calculate its capped average rate for the 2018-19 rating year. In this example, Council A decides to increase its revenue from general rates and municipal charges to the maximum allowable revenue in table 5.2 (\$78,626,160).

Table 5.3 Calculating the capped average rate

Council A	
Total value of land as at 1 July 2018	\$20,600,000,000
Number of rateable properties as at 1 July 2018	43,600
Rate in the dollar (2018-19)	\$0.003579
Municipal charge per property (2018-19)	\$112.50
Total revenue leviable from general rates as at 1 July 2018	
= total value of land as at 1 July 2018 * rate in the dollar (2018-19)	
= \$20,600,000,000 * \$0.003579	
= \$73,721,160	
Total revenue leviable from municipal charges as at 1 July 2018	
= number of rateable properties as at 1 July 2018 * municipal charge per property (2018-19)	
= 43,600 * \$112.50	
= \$4,905,000	
Capped average rate	
= total revenue leviable from general rates as at 1 July 2018	
+ total revenue leviable from municipal charges as at 1 July 2018	
/ number of rateable properties as at 1 July 2018	
= \$73,721,160 + \$4,905,000 / 43,600	
= \$1,803.35	

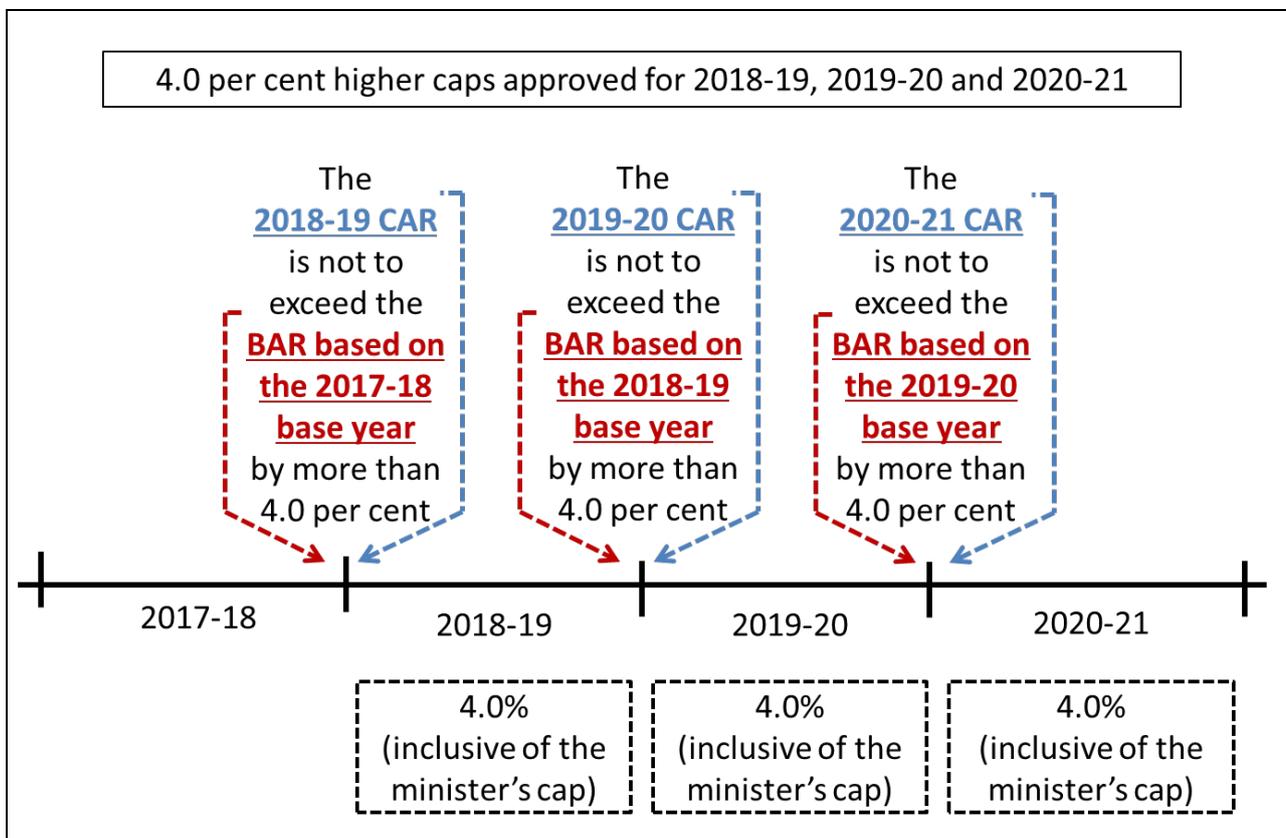
5.6. Multi-year higher caps

In 2018-19, councils can apply for higher caps for a period up to four years. In any relevant year, the higher cap is inclusive of the minister's cap. That is, if the minister's cap is 2.25 per cent in one year, and we approve a higher cap of 4.0 per cent, the council can increase its average rates by 4.0 per cent.

Assume Council B's application is approved for three years of higher caps of 4.0 per cent (inclusive of the minister's cap) starting from 2018-19. The 4.0 per cent higher cap will have effect in each year of the three years. That is, Council B's capped average rate, for each year from 2018-19 for

three years, must not exceed the corresponding base average rate by more than 4.0 per cent. Figure 5.2 shows how Council B would apply multi-year higher caps to calculate its average rates.

Figure 5.2 Applying multi-year higher caps to calculate average rates



Note: BAR = base average rate; CAR = capped average rate.

See Appendix A for detailed scenarios of a multi-year higher cap with different assumptions.

5.7. What are the implications of forecasting?

Given the timing of when councils develop and adopt their budgets, they will need to forecast the base average rate and capped average rate.⁴¹

Our consultation with our financial technical working group⁴² found all councils should have reasonably accurate information by April, enabling councils to make credible forecasts of base average rate and capped average rate. Councils are responsible for ensuring their forecasts are as accurate as possible.

⁴¹ That is, forecasts have to be made of the annualised effect of supplementary revenue raised through general rates and municipal charges, and of the number of rateable properties at 30 June.

⁴² The technical working group comprised senior financial officers from nine councils, with representatives from small and large rural, regional city, interface and metropolitan councils, and the Local Government Finance Professionals (FinPro).

We will also monitor rateable assessments and annualised supplementary revenue of councils with approved higher caps. It will be important to monitor a council's actual growth, to ensure it is in line with the forecasts in the council's applications. We acknowledge that forecasts of rateable assessments and annualised supplementary growth may not turn out to be exactly as forecasted. Factors outside the council's control can affect the actual growth. However, we expect a council to make estimates as accurately as possible. Systemic underestimation or overestimation of supplementary revenue may be identified and reported, and can affect how we consider future applications for higher cap from these councils.

5.8. Monitoring compliance with the rate caps

5.8.1. How do we monitor compliance with the rate caps?

1. All councils must submit the annual compliance information template to us by 30 September 2018.⁴³ As part of the annual compliance information template, a council reports its base average rate and capped average rate.
2. We verify the calculation of the base average rate and capped average rate, including that the figures in the annual compliance information template are consistent with the rating system reports.
3. We verify whether the capped average rate does or does not exceed the base average rate by more than the rate cap.
 - A council is compliant if the capped average rate does not exceed the base average rate by more than the rate cap.
 - A council is non-compliant if the capped average rate does exceed the base average rate by more than the rate cap.
4. We report each council as compliant or non-compliant in our annual compliance report. We may report non-compliance as material or immaterial.

Note that we assess a council's average rate increase rounded to **two decimal places** consistent with the gazetted average rate cap decision.

Annual compliance information template

A council must provide the following figures in the annual compliance information template:

- value of land as at 1 July 2017, 30 June 2018 and 1 July 2018
- number of rateable properties as at 1 July 2017, 30 June 2018 and 1 July 2018
- rate(s) in the dollar for 2017-18 and 2018-19

⁴³ The annual compliance information template can be found on our website.

- municipal charge per property for 2017-18 and 2018-19.

The council should provide these figures from its **rating system**⁴⁴. These figures should be auditable.

The annual compliance information template will automatically calculate:

- general rates revenue as at 1 July 2017 and 1 July 2018
- municipal charges revenue as at 1 July 2017 and 1 July 2018
- annualised supplementary general rates revenue as at 30 June 2018
- annualised supplementary municipal charges revenue as at 30 June 2018
- base average rate
- capped average rate.

The template provides detailed instructions to help council officers complete it.

Rating system reports

A council must submit rating system reports as at 1 July 2017, 30 June 2018 and 1 July 2018 to support the figures in the annual compliance information template. Each rating system report must be signed by the chief executive officer. A rating system report is not required for waste monitoring information.

Random audits

From 2018, we will undertake random audits of the data provided by councils in the annual compliance information template.

5.8.2. What happens if a council is non-compliant?

If a council is non-compliant, we will ask the council to provide a short **statement of explanation**. The statement should explain why the council is non-compliant. We will publish the statement in our annual compliance report.

If a council fails to comply with the rate cap, then we may refer the matter to the minister. Further, we will consider that council's non-compliance when assessing any subsequent application for a higher cap.

5.8.3. What happens if rates are below the maximum allowable capped average rate?

A council's annual compliance information may show that its capped average rate is below the maximum allowable capped average rate. This means the council has complied with the cap, which is the expected outcome and does not require an explanation.

⁴⁴ For example, rating systems include Technology One, Pathway and Civica.

However, a council will need to provide reasonable explanations if it chooses to levy rates *significantly* below the maximum allowable capped average rate for one year, and then applies for a higher cap in the following year.

5.9. Monitoring when councils introduce new service rates and charges

In the Fair Go Rates system, the capped revenue base currently excludes service rates and service charges. Most councils use service rates and service charges to recover waste management costs, at least in part. The rate cap has potential implications for those councils that recover waste costs either fully or partially through general rates, as they are therefore subject to the cap. The impact on councils will vary, depending on the rating and revenue policies of each council and the extent to which they recover waste costs through general rates.

We will adopt the following approach to monitor councils' new service rates and service charges:

1. A council should inform us as soon as practicable if it is changing its rating strategy on waste cost recovery.⁴⁵
2. A council should provide us supporting documentation showing that the change has a neutral impact for the council and its community. That is, in aggregate terms, the increase in revenue from service rates and service charges should match the reduction in general rates revenue and does not result in a windfall gain. The council may make further adjustments to make the change more attractive to their ratepayers. Such differences will need explaining, to account for possible changes in outputs, price, and the quantity and quality of service levels between years. The council will have to provide supporting information to us.
3. Any changes in the council's rating strategies for waste management should be reflected in its rating strategy document and adopted formally by the council. Council should provide us with a copy of the revised rating strategy document.
4. A council should provide us with information on its engagement about the new rating strategies, and the engagement outcomes. It should clearly explain how it accounted for ratepayers and the community's views. The former Department of Transport, Planning and Local Infrastructure (now Department of Energy, Land, Water and Planning), in its 2014 *Better Practice Guide: Revenue and Rating Strategy*, advised councils: 'public consultation is an important part of the revenue and rating strategy. Such an undertaking and its importance warrants a council engaging with their community about the revenue picture, its aims and its impact upon the municipality.'⁴⁶

⁴⁵ Any new rating strategies for service rates and service charges is preferably adopted at the start of a financial year for ease of implementation. Also, gradual transitions from recovering waste costs through general rates to levying service charges are encouraged.

⁴⁶ Department of Transport, Planning and Local Infrastructure, *Local Government Better Practice Guide Revenue and Rating Strategy*, Local Government Victoria, 2014

5. If we find no issues with a council's new service rates and service charges, then we expect the council, in the immediate rating year following the adoption of the new rating strategies, to adjust its general rates to reflect the additional revenue collected through the new service rates and service charges.
6. Where it is clear that the new service rates and service charges may disadvantage ratepayers as a whole, and the council cannot explain the apparent windfall gain that results, we will report the matter to the minister. The minister may then request us to advise on an alternative rate cap for the council concerned, in accordance with clause 185D(3) of the *Local Government Act 1989* (the Act), taking into account a waste adjustment.

Overall, we will continue to monitor and assess the base average rate and capped average rate resulting from the change in rating strategies, as described in Section 5.8. Similarly, we will monitor service rates and service charges (and waste management costs); the requirements are discussed in Section 5.10.

Councils are encouraged to meet with us if they have any questions about this approach.

5.10. Monitoring service rates and service charges more broadly

Although the capped revenue base currently excludes service rates and service charges, we will monitor and benchmark them across all councils.

Councils provide different waste management services at different levels of performance, depending on community requirements and the council's own policies and priorities. Councils also allocate and recover their waste management costs in different ways, usually from one or more of these sources:

- general rates
- service rates and service charges under s. 162 of the Act
- user fees
- government grants
- other recurrent fees.

Analysis shows that councils classify and recover their waste management costs in different ways. Most councils recover these costs through service rates and service charges, which are excluded from rate capping. However, a small number do so exclusively through general rates, while other councils use a combination of these sources.

Some councils also collect revenue for related services through user fees, rather than service rates and service charges. Examples of waste services where user-pays policies operate are the optional green waste, large commercial bins, additional bins requested by residents (to discourage generation of more waste) and landfills. These user fees are also excluded from capping.

5.10.1. How will we monitor service rates and service charges?

We will monitor service rates and service charges for increases that are unexplained or cause concern. We will report on councils' waste management costs as part of our biennial outcomes report in 2018.

The Victoria Grants Commission already gathers some data on council revenue and costs associated with waste management services, and council annual reports give service rates and service charges information. However, there is no other publicly available information on the level of waste costs recovered by councils, either partially or fully, through general rates. We therefore collect information on waste costs and related revenues, through the annual compliance information each year (see Section 2.4 of this document).

The information we gather will help us monitor service rates and service charges, and we will use it for the following:

- to validate councils' submissions to us when they propose to change service rates and service charges in their rating strategy
- to validate councils' applications for higher caps, if they choose to keep waste management costs in the general rates, and make a higher cap application where waste costs have increased above the relevant rate cap
- to establish benchmarks for waste management costs in the future
- to make any future recommendations to the minister on waste costs recovery, if necessary.

Appendix A – calculating average rates

Scenario 1 – with growth in rateable properties

Council B's application is approved for **three** years of higher caps of 4.0 per cent (inclusive of the minister's cap), starting from 2018-19. The 4.0 per cent higher cap will have effect in each of the three years. That is, Council B's capped average rate for each year from 2018-19 for three years must not exceed the corresponding base average rate by more than 4.0 per cent.

Table A.1 shows how the base average rate and capped average rate would change based on a higher cap of 4.0 per cent for 2018-19, 2019-20 and 2020-21 and the following assumptions:

- Council B has no differential rates.
- Council B does not levy a municipal charge.
- The annual growth in number of rateable properties is **2.50 per cent**.
- The annual growth in value of rateable properties (due to growth in number of rateable properties) is 3.00 per cent.
- A general valuation of all properties within Council B's municipal district will be carried out in 2017-18 and will take effect from 1 July 2018 for the 2018-19 year. Overall, property valuations will increase by 7.50 per cent as a result. Similarly, there will be another revaluation in 2019-20 that will take effect from 1 July 2020 for the 2020-21 year.

Table A.1 Multi-year higher cap
With growth in rateable properties

	2017-18	2018-19	2019-20	2020-21
Value of land as at 1 July	\$5,150,000,000	\$5,702,337,500	\$5,873,407,625	\$6,503,330,593
Value of land as at 30 June	\$5,304,500,000	\$5,873,407,625	\$6,049,609,854	\$6,698,430,511
Rate in the dollar	\$0.00426400	\$0.00412517	\$0.00429018	\$0.00415050
Number of rateable properties as at 1 July	14,863	15,235	15,615	16,006
Number of rateable properties as at 30 June	15,235	15,615	16,006	16,406
General rates as at 1 July	\$21,959,000	\$23,523,125	\$25,197,970	\$26,992,065
Annualised supplementary general rates as at 30 June	\$658,788	\$705,694	\$755,939	\$809,762
Base average rate	\$1,484.67	\$1,551.59	\$1,621.53	\$1,694.62
Maximum allowable capped average rate	\$1,544.06	\$1,613.66	\$1,686.39	^a
Maximum allowable revenue	\$23,523,124	\$25,197,970	\$26,992,065	^a

^a Depends on applicable rate cap, as yet undetermined, for the **fourth** year

Scenario 2 – with no growth in rateable properties

As before, Council B is approved for **three** years of higher caps of 4.0 per cent (inclusive of the minister's cap) starting from 2018-19. The 4.0 per cent higher cap will have effect each year of the three years. That is, Council B's capped average rate for each year from 2018-19 for three years must not exceed the corresponding base average rate by more than 4.0 per cent.

Table A.2 shows how the base average rate and capped average rate would change based on a higher cap of 4.0 per cent for 2018-19, 2019-20 and 2020-21 and the following assumptions.

- Council B has no differential rates.
- Council B does not levy a municipal charge.
- The annual growth in number of rateable properties **is 0 per cent**.
- A general valuation of all properties within Council B's municipal district will happen in 2017-18 and will take effect from 1 July 2018 for the 2018-19 year. Overall, property valuations will increase by 7.50 per cent as a result. Similarly, there will be another revaluation in 2019-20 that will take effect from 1 July 2020 for the 2020-21 year.

Table A.2 Multi-year higher cap
With no growth in rateable properties

	2017-18	2018-19	2019-20	2020-21
Value of land as at 1 July	\$5,150,000,000	\$5,536,250,000	\$5,536,250,000	\$5,951,468,750
Value of land as at 30 June	\$5,150,000,000	\$5,536,250,000	\$5,536,250,000	\$5,951,468,750
Rate in the dollar	\$0.00426400	\$0.00412517	\$0.00429018	\$0.00415050
Number of rateable properties as at 1 July	14,863	14,863	14,863	14,863
Number of rateable properties as at 30 June	14,863	14,863	14,863	14,863
General rates as at 1 July	\$21,959,000	\$22,837,984	\$23,751,503	\$24,701,563
Annualised supplementary general rates as at 30 June	\$0	\$0	\$0	\$0
Base average rate	\$1,477.47	\$1,536.57	\$1,598.03	\$1,661.95
Maximum allowable capped average rate	\$1,536.57	\$1,598.03	\$1,661.95	^a
Maximum allowable revenue	\$22,837,984	\$23,751,503	\$24,701,563	^a

^a Depends on applicable rate cap, as yet undetermined, for the **fourth** year

