

# TRANSCRIPT

## STANDING COMMITTEE ON THE ENVIRONMENT AND PLANNING

### Inquiry into rate capping policy

Melbourne — 22 March 2016

#### Members

Mr David Davis — Chair

Ms Samantha Dunn

Ms Harriet Shing — Deputy Chair

Mr Shaun Leane

Ms Melina Bath

Mr Adem Somyurek

Mr Richard Dalla-Riva

Mr Daniel Young

#### Participating Members

Mr Jeff Bourman

Mr James Purcell

Ms Colleen Hartland

Mr Simon Ramsay

#### Staff

Secretary: Mr Keir Delaney

Research assistants: Ms Annemarie Burt and Ms Kim Martinow

#### Witnesses

Dr Ron Ben-David, Chairperson,

Dr John Hamill, Chief Executive Officer and

Mr Andrew Chow, Director Regulation, Essential Services Commission.

**The CHAIR** — I welcome people to the hearing of the Standing Committee on the Environment and Planning. This is a public hearing. We would like mobile telephones off, if possible. All evidence taken is protected by parliamentary privilege provided by the Constitution Act 1975 and subject to the standing orders of the Legislative Council. Information you give here today is protected by law; however, any comment repeated outside this hearing may not be protected. All evidence is being recorded by Hansard, and there will be proof copies provided within a small number of days.

I welcome again and thank the chairman of the Essential Services Commission, Dr Ron Ben-David, and his executive officer, Dr John Hamill, and Andrew Chow, the director of regulation. Obviously we have an inquiry on rate capping and its impacts and you have a central role in that, so we are appreciative of you returning to give further evidence now that the process has taken a further few steps. What I might ask for is a very brief introduction that would explain the steps that have been taken since we last met, and then we will ask some questions.

**Dr BEN-DAVID** — Actually we have not prepared an opening statement because we thought we would just jump straight into questions.

**The CHAIR** — I thought you might want to say something briefly, that was all.

**Dr BEN-DAVID** — Since we last presented, we have submitted a report to the government. The government released the report with its own response, accepting by and large the tenor of our report with a couple of small changes, particularly around the rate cap. Whereas we proposed a rate cap formula, the government chose a different path. Also in some of the reporting requirements there was a slight change. Where we suggested there be two annual reports — one on the outcome of the rate capping each year and a second report focusing on council outcomes in terms of services, infrastructure and financial performance — the government made that a two-year report, so we will be producing that every second year.

Since that time we have been working assiduously. The team has been working on developing our own internal process as to how we are going to deal with applications when they come in, and at the same time they have been working, particularly Andrew here, and talking to councils around the state about any issues they may have in their understanding of the framework and in their consideration of whether to make an application or not. Andrew has also presented at a number of forums with hundreds of attendees from the local government sector.

I do not remember the exact date, but in the first couple of days of February we put out just a very up-and-down statement about the number of councils that had indicated to us by 31 January, as required, that they might be making an application. The purpose of that was really in order to make sure that, one, they were thinking about it in a timely way, and two, that they allowed us to prepare ourselves.

We put out a statement just identifying the 21 councils. We made it very clear in that statement — in fact I think it was in the second paragraph — that there was no obligation on these councils to proceed to a full application but that it would be up to those councils to decide. At the moment we are waiting to hear which councils will proceed to a full application. The next step is that by the end of this month, 31 March, they will have to submit those applications. So we are basically in a waiting game at the moment to see how many will proceed.

**The CHAIR** — I am appreciative of that. I guess there are a couple of baseline questions that would be worth asking and would be helpful to the committee. The first is: have you received applications now, and if so, how many? The second is: what was your advice to the minister late last year and can we have a copy of that, please? Finally, the one issue that comes directly from that is the issue of the financial status of a number of the rural councils. It is my understanding you made a recommendation that there be some differential arrangements for rural councils and that was not a recommendation accepted, as I understand it, by the minister. I am happy to be corrected on any of that if that is not the case. I will leave it at that, and then I have a further question about some specifics.

**Dr BEN-DAVID** — How many have we received? At this stage, we have received just the one.

**The CHAIR** — From?

**Dr BEN-DAVID** — From Ballarat City Council. And we believe another four at this stage have committed to making an application; they are Wyndham, Murrindindi, Pyrenees and Casey — all for slightly different amounts. Those other four have not formally notified us. This is from our monitoring of their council minutes. Then there are, as of this morning, seven in the ‘maybe’ basket; they are Geelong, Horsham, Moorabool, Buloke, Latrobe, Toowong and Yarriambiack. Then of the 21 that remained, 9 have withdrawn, so I can name them or just leave it at that.

**The CHAIR** — So is that available in a list or something of that nature?

**Dr BEN-DAVID** — We can provide that. Yes, that is fine.

**The CHAIR** — Thank you.

**Dr BEN-DAVID** — So that is where we are. It will be basically somewhere between 5 and 12 — that is the best that we can say. There may be another surprise out there that we do not know of, but I guess we will find out in a couple of weeks.

Now, on our advice to the minister regarding the rate cap, that advice is, to the best of my knowledge, confidential advice, and the act does not refer to us making that publicly available. It belongs to the minister, if you like; we made the advice, and it is hers. So I really have to defer to her to indicate whether she is willing to release that advice. What I can say though is that you have seen our final report and you are familiar with the formula that we recommended, and that is probably a fairly good indication of the sort of direction we would be taking and the advice we would be providing.

In terms of the small councils, the rural councils, we certainly did not recommend a differential rate capping framework; we recommended a single rate cap, and in doing so there were a number of — —

**The CHAIR** — Which was 3.05 or somewhere in that — —

**Dr BEN-DAVID** — That was in the draft report. That was based on the formula, and it was based on the May Treasury estimates of the CPI and of the wage price index.

**The CHAIR** — Projected.

**Dr BEN-DAVID** — Yes, they are forward-looking; that is right. They are forecasts. In December, Treasury would have released its updates with its MYEFO — the midyear financial outlook — and we would have updated the results.

**The CHAIR** — So we are not privy to that number either?

**Dr BEN-DAVID** — That was advice that went to the minister. I would feel more comfortable if the minister was to authorise the release of the advice.

**The CHAIR** — If I can perhaps indicate as a committee member that I would like to see that advice and will seek to have my committee members request it formally from you. I do believe that it ought to be in the public domain. It is a document that forms a significant basis for the minister’s decision-making, it would seem to me, and I think the community has a right to know. So I will seek to have my committee members formally support that position.

On the rural councils, your information is that you did not recommend a differential rate. Did you recommend a different regime for those rural councils?

**Dr BEN-DAVID** — No, we did not. So in the final report we set a single cap statewide for a number of reasons. We felt that the differences between the different councils were best addressed through the variation process, where they were able to air why they felt they needed different caps rather than us trying to, if you like, second-guess how different councils might be grouped and how different factors might be taken into calculation. What we did highlight in our report — and I honestly do not recall if it was a recommendation or not — was that there was a need for some capacity-building around the sector to help them deal with the new framework and there were clearly some resourcing issues that might affect smaller councils more than larger

councils, but that was very much in the domain of government to deal with rather than us through the rate capping framework itself.

**The CHAIR** — So in terms of specific areas and specific outcomes in terms of councils, a number of councils have said that their cost structures are such that unless there is a variation, they will have to defer capital expenditure or, in some cases, cut services of some type. For example, in Casey it seems likely that the Hunt Club football and cricket recreation facility and the Autumn Place family and community centre would be put on the backburner as capital infrastructure unless a variation were successful. I wonder if you might outline in a case of that nature how you will go about assessing that variation.

**Dr BEN-DAVID** — That is not an easy question to answer in the absence of the application itself, which has not been received, so we will await their submission. We have provided quite detailed guidelines or guidance material to councils. We provided that in either November or December last year. It was shortly after the report. As I said, Andrew has been working with councils. What we have said all along is that the onus is on councils to make their case and that the act requires certain matters to be presented as part of their applications. There are six matters that need to be presented, and our guidance material explores what that means. It is not prescriptive. We felt, and I think councils were generally in agreement, that given the wide array of circumstances across the sector — across the 79 councils — and given the many different reasons that they would be coming forward with an application for a variation, it really would not be helpful for us to become overly prescriptive in the way we requested information.

The basic principle, though, that we have tried repeatedly to ingrain in the way that they think about this is to say, ‘Don’t think that you’re trying to convince us bunch of people sitting up in an office in Lonsdale Street. Think of this as an argument that you are putting to your own communities, to your own ratepayers, about why they should be paying higher rates’. In the case of Casey I think they would be asking for just under 3.5 per cent. Really the onus is on the councils to put the argument to us and then for us to assess whether the case is made.

**The CHAIR** — One further point. I think the evidence — and this is by way of feedback in a sense — that we received from the MAV and the VLGA leads a little to the conclusion that councils are not clear about the variation process, and I think there may be further work required to assist them in that process.

**Dr BEN-DAVID** — We have brought in the guidance material. We should have a copy for everyone, which we can leave with you.

**The CHAIR** — We would certainly appreciate a copy of that.

**Dr BEN-DAVID** — We have tried to tread that fine line. As I said, we want to give them some guidance about what is expected, but we do not want to be locking them into a cookie-cutter approach, because we have got 79 sets of circumstances out there. To say, ‘You must do it in this particular way’ might not serve their individual needs and individual purposes. So that is guidance material, and we certainly welcome any feedback on whether that can be improved. Certainly after this first round of somewhere between 5 and 12 applications we will go back, we will review how those councils found making an application and we will use that to update the guidance material. If you want Andrew to take you through the guidance material, we can do that.

**The CHAIR** — We are happy to look at that, but I think you will find the transcript of our previous hearing of interest in that respect.

**Ms SHING** — I might actually segue directly on from that most recent comment that you made in relation to the engagement with councils and also with stakeholder groups about the way in which the process would operate and the intentions behind developing the regulatory framework in the way that you have, as far as what is in the final report. To that end, firstly, thank you for answering those questions to date and also for providing this additional material.

Andrew, my question is to you, and it relates specifically to the work that you have done with individual councils, whether they are within that group of between 5 and 12 on the one hand or more broadly as part of the 21, or more broadly beyond that. But I also note in addition to that, to follow on from some of the comments made by the chair, that we heard evidence from some representatives from the sector a couple of weeks ago in hearings that they believed that the obligations were in fact onerous and unwieldy, and in the final report you

actually indicate that you are in fact committed to developing a framework that does not impose onerous and unnecessary obligations on the local government sector. So what I suppose I would like you to address in that answer is how you reconcile those two views and how it is that those key representatives might have that view when you in fact hold another.

**Mr CHOW** — At a practical level we have been talking to those councils who have notified us that they intend to seek a higher cap. So out of the 21 we have actually spoken to more than 10 of them, and in most of the cases they actually did not come back to suggest that the requirements were onerous. In fact one of the notions which surprised us was that the smaller councils were actually quite prepared in terms of meeting our requirements. They are far more rigorous in terms of the way that they have to look after the finances. They are far more rigorous in the way in which they have to look after their assets.

So relative to some of the bigger metro councils that we have spoken to, some of the smaller rural councils actually have good asset management plans, and they are the ones who have been telling us, 'We can actually come back to you', in addressing the steps that we want them to take as part of our guidance in submitting an application. I think it is fair to say that while there is a view at a general level about the level of how onerous it is in terms of the requirements, the ones who are actually preparing them — the practitioners who come in — actually have not raised that.

Previously our chairperson mentioned that we had spoken to a number of conference groups, so we have spoken to over 200 people attending, say, the FinPro. They are the people who will be compiling the planning documents and the budgets. It was not raised in any of those meetings that the requirements were onerous or complex.

**Ms SHING** — Were you given other feedback in relation to the framework in the course of those meetings and conversations?

**Mr CHOW** — In terms of the overall framework, again, this is the first time we are doing it, so we like to go through the whole process before we actually capture those learnings, and if there are improvements that we can make to the guidance material, we will surely do that.

**Ms SHING** — As a follow-on question from that, if I may, we have heard evidence in the last couple of weeks, and again from council stakeholder groups and peak bodies, that in fact the resourcing requirements would speculatively — because of course we have not yet concluded the process that remains open as at today's date — involve taking somebody offline in fact to work on a proposal to the extent that that might translate to approximately \$40 000. What is your view in relation to the resourcing required, particularly for smaller councils and regional and rural councils to assist them in preparing an application in the experience that you have had with a group of 21-plus?

**Mr CHOW** — To date we actually have not had any direct feedback on the cost to councils of submitting and preparing an application. I suspect the figure would vary. It depends on the state in which the council has its processes and systems in place. To the extent that they have good policies, systems and processes in place, we would think that the additional effort would be marginal, and this is actually confirmed with some of the meetings we had with the councils who are seeking to apply. In fact this came out in this morning's *Ballarat Courier* whereby the Pyrenees shire was actually reported to have spent over \$10 000 putting together an application — so this was reported by the media. We have not had any direct feedback yet from councils regarding the cost of submitting an application.

**Ms SHING** — My final request for comment or response would then relate to what you have just alluded to, namely that if councils have the appropriate regulatory systems in place to determine and understand their asset base, their revenue streams and their capital and recurrent expenditure into the forward period, then the notion of making an application could relatively readily be drawn from that material in order to make an application for variation if they are functioning well and if they are doing things in a way that means data is up to date as they go.

**Mr CHOW** — There is no reason for us not to expect that would be the case, but this is not to understate that the councils still would have to gather it together, integrate it and put in a clear and concise case to substantiate the need for additional funds under the higher cap.

**Ms SHING** — As is the case with any application for a regulatory determination of funding or any sort of go-ahead for a request from government.

**Mr CHOW** — That is right.

**Mr LEANE** — I have just one question around the clear and concise case that you just mentioned. The evidence we have had from representatives of the smaller rural councils has been that those councils have very similar challenges. Their challenges are almost all the same. So with the smaller rural councils putting in applications, I suppose we would not be surprised if, with those applications and the case for a variation, you got 10 or so more cases that are exactly the same. Is that going to be a problem for those councils? I would have thought that the smaller councils all work in clusters anyway; they all interact; they all work together. Is that going to be a problem for their applications if their applications are very similar to another nine or almost exactly the same as another nine?

**Dr BEN-DAVID** — One of the design principles of the framework that we made a case for in the final report was that each council would be considered on its merits. So each application will be considered completely in isolation of any other application. We would actually encourage them to work together to think about how to present, but whether they do or do not of course is up to them.

**Ms DUNN** — Thank you, gentlemen, for your submission so far. It is my understanding that there will be a productivity review undertaken by the commission and that that productivity review will look at the efficiency factors. I am just wondering at this stage if the commission has any views or thoughts on what that looks like.

**Dr BEN-DAVID** — If I could just give a little bit of context to where the idea of the study came from, in the draft and final report we had a formula around how the rate cap should be set, and you will recall there was a 60 per cent weighting on CPI, a 40 per cent weighting on wage price index and then less an efficiency factor. We say that efficiency factor should start off at zero and then increase by 0.05 per cent per year over the first couple of years, while we would undertake a much more detailed study into the efficiency or productivity of local government so we knew where to cap that efficiency factor. That was the reason behind having the productivity study. In the first year that did not bite because the efficiency factor would have been zero, and even in the second year it would have only been 0.05 per cent, but by the time we get to the second, third or fourth year it starts to bite, which is why we were keen to get the study done in the first couple of years of the framework.

The honest truth is we have not turned our minds in any great detail to the productivity study. All our energies have gone into getting the sector and ourselves ready to deal with the first round of applications. That really has been where all our effort has gone. What we anticipate is, once we get the first round of applications completed, we will then turn our minds to the productivity study. So I would say probably in July or August we would start to scope that out. We would be talking to the sector and we would be talking to the peak bodies about how we might do that.

The biggest challenge there will be data, and good reliable data. These studies are very much a case of junk in, junk out, so we have got to find good sources of data to use and then develop an appropriate methodology. My rough guess would be a study of that magnitude would take probably about a year to run, and I say that because there is the data gathering, there is the number crunching, there is writing it up. We would then put it out to the sector in a draft form and let them test the assumptions. Then we would go back and finalise the report. So what that would mean is that it would inform our advice to the minister at the earliest in December 17 for the 2018–19 rate capping year. In the meantime, at least, our advice would be based on the existing 0.05 per cent. So it is predictable.

**Ms DUNN** — I wanted to go back. There was some discussion about cost to council in seeking a variation and that the commission to date is not familiar with those costs. I take your point, we are still in the middle of a process, so it is pretty hard to determine what they are. But I am just wondering, is the commission, when the process is finally completed, actually going to go back to those councils who have applied to seek detail from it of the cost, the time and the energy involved in the variation process with a view to making that a better process?

**Dr BEN-DAVID** — The short answer is yes. We would go back to them, and not just the cost and the effort but also the frustrations. We would want to know from them where we were unclear, where we were ambiguous

and where we could be clearer. For us this is a learning exercise. It always will be. We will never stop trying to think about how to make the framework work better for councils and indeed for ratepayers in the community. We have got frameworks in place in other sectors that have been there for almost 20 years — in fact over 20 years. We are still reviewing them. It is just a commitment to continually improving the way we do what we do.

**Ms DUNN** — In terms of the variation, do you envisage into the future that there will be a fee attached to councils wanting to apply for a variation?

**Dr BEN-DAVID** — I think it was in the draft report, maybe the final report, we said there are different ways this could be funded, but in the end it is a government policy call. It is not up to us.

**The CHAIR** — The government said that in the first year they are paying the costs for the variation process. Is that correct?

**Ms DUNN** — I am sure that came up in a past hearing.

**Ms SHING** — Are you inviting the speaker to give an opinion?

**Dr BEN-DAVID** — I cannot speak on that.

**Ms DUNN** — I think you answered the question. You said it was a government decision.

**Dr BEN-DAVID** — It is a government decision. One thing, just so you understand the way we are funded, even if there were some sort of arrangement whereby councils contributed, those funds would not be paid directly to us. They would be paid into consolidated revenue, and then we would get a grant from across the road, from Treasury.

**The CHAIR** — It is not a cost recovery type of system?

**Dr BEN-DAVID** — Well, it depends on how the government goes about designing it.

**Ms SHING** — The independence of the ESC has got a lot to do with the way in which this particular model is run.

**Dr BEN-DAVID** — Yes, but we do not have a bank account, so we cannot collect the money.

**Ms DUNN** — Just one more, and it is still on the variation process, because one of the criteria or measures in terms of the commission evaluating that variation application is around how the views of ratepayers and the community have been taken into account in proposing the higher cap. I am just interested in, I guess, the transparency around that process, taking into account that councils are all very different in the way they approach consultation and engagement, and a lot of that is to do with the shape of those municipalities. You might find that a citizens jury might exist in an inner city council, you might find that there is quite a different approach in a rural area and a different approach again in an interface council area, whether that be a growth or a green-wedge council. I am just wondering how you maintain consistency in evaluating that particular element of the criteria, given the nature of engagement can be so different but still be a genuine process for the community and a genuine conversation that achieves those key engagement principles that are in this guideline here?

**Dr BEN-DAVID** — Funnily enough, of all the issues it is probably one of the most vexed ones that we have had in our discussions with councils over the last year and a half or so, because we have been loath to tell them, for the exact reasons you highlighted, how they ought be consulting their own consumers. It seems pretty weird that a regulator sitting up here would be telling them how to be doing what is really their fundamental duty, which is to understand and represent the views of their communities. So we have laid out some principles about how we think that should be done, but we certainly have not tried to dictate in any way how it should be done, because you are absolutely right, for some it is going to be a good old town hall meeting, for others it will be the — —

**Ms DUNN** — It will be an online platform.

**Dr BEN-DAVID** — Online surveys, focus groups, the citizens juries — those sorts of things; it will be horses for courses. The challenge though for them is in the words that you read out, which is the ‘take into account’. A lot of councils, when we were discussing this, what they heard was that you have to get the support of your community. And they are saying to us, ‘But we will never get unanimous support for anything we want to do’, which I am sure is true. And we said, ‘No, this has got nothing to do with support. This is taking into account’. So what we are looking for in the submissions that they make to us — the variation applications — is that they have presented information to their communities in whichever form, whether it be a survey or another form, that they have harvested the views of the community and they have taken them into account. So they have heard them and have responded in a conscious, knowing and transparent way. How they respond is completely up to them. What we want to see is that they are doing it openly and transparently. So even if the community was to say, ‘No, we absolutely don’t want that to happen’, but the council comes back and says, ‘Look, we have heard the community. We appreciate their concerns, but our reasons for proceeding are this, this and this’, then we will certainly take that into account. It does not say ‘support of communities’.

**Mr RAMSAY** — Thank you for the opportunity to ask a couple of questions. I am a state member for Western Victoria, so I have the second largest city in the state as a constituent, as a council, but I have also lots and lots of, 17 in fact, very small rural councils.

The data you have provided in relation to councils seeking variation anywhere between 5 and 12 is certainly not consistent with the discussions I have had with certain councils about their ability to meet the cap without significantly increasing their debt portfolio, so my question is more about your view about councils increasing debt rather than seeking variation in relation to meeting the cap and whether part of your brief is actually to have councils demonstrate what sort of debt policies they will be seeking to meet the cap.

And just by the by, a number of councils indicated significant increases in costs to host the local government elections this year. If I can quote, Golden Plains indicate a 47 per cent increase in expenditure to host local council elections; Surf Coast more than 50 per cent; the City of Greater Geelong, which I understand is one of yours seeking a variation, is telling me that they are having to find an increase of \$200 000 to meet their local council election commitments. Postage: obviously the cost of postage is a significant cost to local councils.

So there are those expenses that come before councils and others where they really have no wriggle room, and for only five councils, at this stage, to indicate a potential variation means, to me that many, many small councils must be seeking increases in debt, and Golden Plains indicates anywhere from \$8 million to \$13 million in debt over the next 10 years to meet the rate cap. Could you perhaps indicate whether you have had the discussion with councils in relation to their debt portfolios to meet the rate caps?

**Dr BEN-DAVID** — Maybe I will just make one very small comment on the local government election costs because I have seen no information; I do not know about Andrew. But certainly that is clearly a cost on councils. But I think it is worth remembering that while those costs are incurred in the one year, they do relate to effectively a four-year period. A good council should be spreading those costs over at least four years.

**The CHAIR** — I think it is the surprise increase that has shocked many.

**Dr BEN-DAVID** — Honestly, I cannot comment there, I am just saying that as a general accounting principle you would smooth the cost out over the four-year period.

Look, that is a very interesting question. We were not asked for our views on whether councils should or should not be turning to debt financing, and so we did not provide advice in that regard. What we did recommend is that the government produce a guideline on the appropriate use of debt by local governments to give councils some clarity around what is expected from government, from Treasury, in that regard.

Certainly the use of debt: debt can be a useful instrument, particularly where assets that are long lived are being built. I do not think that there should be a flat rejection of debt. I am now expressing a personal view, but the appropriate use of debt — when it is used, to what extent it is used — that ought to be something that government gives guidance on.

If a council, though, turns to us and says, ‘We need a rate increase because we are not prepared to borrow’ that is completely the prerogative of that council. We are not going to override that prerogative. What we would be looking for, though, is where does that statement come from — that we are not prepared to borrow? Do they

have an internal policy, have they consulted with their own communities, have they done their own financial modelling et cetera to support that position? If they can demonstrate that support for that position — —

**The CHAIR** — A debt reduction strategy, for example?

**Dr BEN-DAVID** — Debt reduction or not just no debt borrowing — then we would accept that, just the way we would accept any other part of their application if it was properly supported. We do not go into this with a position on whether there should be debt or what the appropriate level of debt is or whether different councils should have different debt profiles. We do not have any of that.

**Mr DALLA-RIVA** — In your initial presentation, although it was not a presentation, you mentioned that government chose a different path — whether that is quoted directly or not, but that was what I picked up and I have written down — so I was trying to work it out, in terms of the rate cap formula, because in the last presentation I asked a range of questions about the rate cap formula, about the use of the 0.6 times the rate of increase of CPI; the WPI 0.4, and then there was the productivity which you spoke about earlier being zero in the early days. So you have put together a process, you have come up with a figure, you have recommended that figure to the government, and then you said in the presentation the government chose a different path. What did you mean by ‘the government chose a different path’?

**Dr BEN-DAVID** — We recommend a formulaic approach. The government, at least as I have understood it, chose simply the CPI element of the formula.

**The CHAIR** — Estimated or forecast CPI.

**Dr BEN-DAVID** — The Treasury forecast of underlying CPI, yes. So that was only one element of our overall formula.

**Mr DALLA-RIVA** — So your formula was to recommend with the WPI and the productivity improvements. The government has come back with just the CPI forecast.

**Dr BEN-DAVID** — Forecast.

**Mr DALLA-RIVA** — So I just want to get on the record, what was the forecast and what was the amended? Can you recall what the forecast was?

**Dr BEN-DAVID** — I am pretty sure, we can check, but I am pretty sure the Treasury December forecast for CPI for the coming year was 2.5 per cent.

**Mr DALLA-RIVA** — Prior to December?

**Dr BEN-DAVID** — In its December update.

**Mr DALLA-RIVA** — Yes, but the one prior, because we last spoke to you — —

**Dr BEN-DAVID** — The Treasurer’s CPI figure in December 2015 was 2.5 per cent. I honestly do not remember what it was in our draft report, so I do not remember what it was in May the year before. I do not have it.

**Mr DALLA-RIVA** — I could not see it in the — —

**Dr BEN-DAVID** — Sorry. It will be in here. Can you just bear with me for 2 minutes?

**Mr DALLA-RIVA** — Yes.

**Dr BEN-DAVID** — The forecast for 2016–17 as at May 2015 for CPI was 2.75 per cent. Treasury then lowered it in December to 2.5 per cent.

**Mr DALLA-RIVA** — Based on the 2.75, the WPI, the productivity, what was your recommendation, what percentage?

**Dr BEN-DAVID** — Bottom line, 3.05 per cent. That was based on the May figures.

**Mr DALLA-RIVA** — And if you put the amended CPI at December 2015, what would have been your amended rate cap?

**Dr BEN-DAVID** — At what date, sorry?

**Mr DALLA-RIVA** — With the new CPI adjusted rate in December 2015, what was the calculation from the ESC?

**Dr BEN-DAVID** — Treasury's forecast at the time was 2.5 per cent for CPI and 3.25 per cent for the wage price index. If you pump those into the formula, you get around 2.8 per cent.

**Mr DALLA-RIVA** — The advice provided to the minister concerning the recommendations on the rate capping that you have got, you cannot provide information on that; is that — —

**Dr BEN-DAVID** — Regarding the advice we provided to the minister, as I said, I would prefer it if the minister authorised the release of that advice.

**Mr DALLA-RIVA** — Was it advice provided under cabinet, or was it advice provided — —

**Dr BEN-DAVID** — It is advice provided under the act. All the act says is that we are to provide advice to the minister. It is silent on what happens after that in terms of the ownership of that advice, if you like.

**The CHAIR** — It is the minister's decision.

**Dr BEN-DAVID** — Yes. That is all I am trying to say.

**The CHAIR** — No, no. It is the minister's decision on what she decided to do with your advice.

**Dr BEN-DAVID** — Yes. Our advice is purely that, advice only.

**The CHAIR** — Under the act — —

**Ms SHING** — It is advice to the minister.

**Dr BEN-DAVID** — Yes.

**Ms SHING** — As opposed to the committee.

**Mr DALLA-RIVA** — So it was not advice to go to cabinet; it was just advice to the minister.

**Dr BEN-DAVID** — I believe that is correct.

**Ms BATH** — With respect, earlier on you mentioned that rural and regional councils are good asset managers by and large. You made some commentary around that — good at managing their assets. I note in the course of our inquiry we have heard from a number of rural and regional councils and, in the last sitting week, from MAV and LGPro about the benefits of the country roads and bridges program, which supplied rural and regional councils with \$1 million per year to use as they saw fit for local bridges and roads, and I note that this program has been cut. My comment is: as you have gone around to the forums — and I understand you have had about 200 representatives from councils — I would like you to comment on (a) the themes that were raised at those forums by council personnel and (b) did they raise the loss of country roads and bridges as an ongoing concern to how they would manage those assets in the future?

**Mr CHOW** — I presented at two forums at the FinPro, one last December and one in February this year, and they were attended by over 200 finance people from the councils. In neither of the two meetings was the funding raised. They tended to go to the more general question about the councils having to look at all their operations and how they deal with the budget. But in the conferences themselves that I attended none of them raised the specific funding in relation to roads.

**Ms BATH** — Could you tell us where the forums were?

**Mr CHOW** — One of them was held in Torquay; the second one was held in Melbourne.

**Ms BATH** — So there were none in the easterly direction, in Gippsland or the Latrobe Valley, in that space.

**Mr CHOW** — I understand that out of the people who attended they came from all the different councils.

**Ms BATH** — Could I then ask: what were the themes that were raised? If there were some general themes, what were the themes raised by the financiers?

**Mr CHOW** — I would have to go back to look at the detailed notes, but from memory they did ask a couple of questions regarding compliance, how the cap was calculated, the formula. They did ask about how we consider good community engagement. So the response that our chairperson gave was the one that I gave at the presentation as well. Those were the two key themes: the items of a specific compliance nature and, secondly, about community engagement.

**Ms BATH** — With respect, when councils have put in their applications for variation, they will be assessed. What is the process from that point on? Do you communicate your decision with the minister? Do you seek advice from the minister before going back to council? Could you take us through those steps, please?

**Dr BEN-DAVID** — The decision is our own, purely our own, so the minister is not involved in the decision. If the minister wishes to be briefed, then I would brief her. As a matter of course I try to meet with all the ministers for whom we have some portfolio responsibility. For example, the energy minister I meet quarterly, the finance minister I meet quarterly, the water minister probably a little less frequently. The local government minister I have not met yet this year, but last year I was meeting her probably every two months. It really depends on the work program. So I would expect to be briefing the minister as to where we are in the process and maybe some of the tricky issues we are dealing with. If we were doing a water price determination, I would be discussing it with the water minister. But I certainly would not be asking the minister's thoughts on how we should proceed in terms of the decision itself, nor would I expect the minister to offer those thoughts.

**Ms SHING** — On the basis that that would be inappropriate.

**Dr BEN-DAVID** — Completely, yes. In my experience in this job for seven years now I have had those discussions over and over again with many ministers over many years, and they have all respected the independence of the commission. I would not expect that to change.

**Ms BATH** — So for councils, once you have assessed the variations, what is the process that you would give back to them?

**Dr BEN-DAVID** — For every decision we make we will put out a formal statement of decision and reasons, and that will be a public document. I presume we would give it to the affected council first for a couple of days and then we would make it public. The reason for making it public is an important one, and that is so that the sector as a whole can learn what has worked here and what has not worked there as part of the learning process. And we are actually giving a bit of thought as to how we capture that information internally as well in terms of developing precedents.

There will be that formal path of a decision and reasons document. That will not be a huge long document, but it will be a concise explanation of why we have made the decision we have. Then I presume the councils would want to talk to us and follow up with us and we will do that, but that will be a more informal interaction.

**Ms BATH** — Thank you.

**The CHAIR** — My question is: in the process of calculating the recommended rate cap did you quantify or seek to quantify the cost shifting that may have occurred from the state government and seek to put some numeric value or impact value on councils' position?

**Ms SHING** — Just with state or with state and federal?

**The CHAIR** — Either. I do not mind, but I am trying to seek these both. In the case of the state it has also cut funding, but that is a point. I am just seeking a response by Dr Ben-David.

**Ms SHING** — So did the federal government, which is why — —

**The CHAIR** — It actually froze funding as opposed to cutting funding, but either way it is a big difference.

**Ms SHING** — Thank you, Sir Humphrey. That is terrific!

**Dr BEN-DAVID** — On the cost shifting, we certainly had a lot of discussions with councils around cost shifting. As you would expect, it was raised often. The more we delved, the murkier it became as to what really is the cost — a lot of claims but not a lot of facts, if you like. That is not to say that there are not costs, but no-one could quantify them for us. However, in terms of thinking about the cap itself, we did not take into account cost shifting, and I think it is important that I spend 30 seconds explaining why.

The cap applies from a point in time — let us say 1 July in whatever year — and at least when the first year comes around all the cost shifting that has occurred has already occurred. It is already in the base of the council's finances; they are already covering those costs, so they are already paying for the school crossings — —

**The CHAIR** — Or not, as the case may be.

**Dr BEN-DAVID** — That is right, but to the extent that they are, it is already in the base, so it gets escalated along with the cap, whatever the cap may be. So we do not have to do a second adjustment for the cost shifting. If in the future there is a further transfer of responsibilities between different levels of government to local government, then that would be a matter that would be taken into account through the variation process.

**The CHAIR** — So any cost shifting that actually occurred this year that we are coming into where the so-called cap will apply, that is not incorporated in the calculation? For example — let me give you a very concrete example — the disappearance of the country roads and bridges program, a straight drop of \$1 million from state government — —

**Ms SHING** — It is not.

**The CHAIR** — It is a straight drop. It is from \$1 million a year to small councils to zero. In that case that is not incorporated in any way in the calculations?

**Dr BEN-DAVID** — I would need to think a little bit about the answer to that, because one is a grant versus a cost shift. It is slightly different. I just have to think about it, because a grant is usually for just one-off funding, as opposed to a cost shift, which is usually an ongoing responsibility. I am not — —

**The CHAIR** — 'Effective cost shift' you might want to call it.

**Dr BEN-DAVID** — I am not shirking the answer. I am just saying I need to think about it, because a grant is a little bit different to a transfer of responsibility.

**The CHAIR** — But my essential point is that in the year that we are going into, with the first year of the so-called cap, there is no allowance made for cost shifting by the state government.

**Dr BEN-DAVID** — Not in the cap, but it would be picked up in the variation process for those councils who are applying to us.

**The CHAIR** — They would have to apply for a variation to deal with that.

**Dr BEN-DAVID** — Should they choose to apply for a variation and that was one of the reasons for doing so, they would have to explain that, yes.

**Mr RAMSAY** — Going back to the debt issue which we briefly discussed, I am still of the view that particularly rural councils — and there is no provision in the rate capping policy to support the councils — do not have means to increase income. Metro-based councils have a greater capacity, whether it is through parking fees or other things, to raise the gap in funding. We have already heard about the loss of very significant programs from government to local councils in relation to country roads and some of the federal grants that trickle down, so my view is there needs to be a watching brief on how some of these more sensitive rural councils adapt to the cap and their lack of capacity to raise revenue to meet their core services.

We talked about, I thought originally as part of the discussion, having a rate policy for those rural councils, particularly those disadvantaged ones which were identified in the country roads and bridges program. I guess

this year we will see how they are able to cope — whether their debt levels are rising, whether they are able to meet their core responsibilities in service provision — and perhaps re-look at that next year, because, I mean, your answer was, ‘Well, you know, the government may give some guidelines in relation to debt loads in relation to councils having to meet these restrictions’. A watching brief from the Essential Services Commission might be in order to make sure — —

**Dr BEN-DAVIS** — So the answer is: we will have a watching brief. Remember how I said today there would be a report every two years on performance — —

**Mr RAMSAY** — They are extended at two years. I mean, it really needs to be within 12 months of introduction.

**The CHAIR** — Okay, I will take that as a comment, I think. I thank you, Dr Ben-David, and your officers for your evidence. We may well want to come back to you again on some of these matters and specifically seek some further information as well.

**Ms SHING** — We will pick your brain next time, Dr Hamill.

**The CHAIR** — I will flag that we will seek that information regarding the advice that you gave the minister. Thank you.

**Committee adjourned.**