VICTORIA GRANTS COMMISSION

REVIEW OF THE ALLOCATION OF GENERAL PURPOSE GRANTS TO VICTORIAN COUNCILS

Final Report – May 2001

Prepared by
Milbur
&
Spiller Gibbins Swan Pty Ltd

for the
Victoria Grants Commission

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Foreword

To all Victorian Councils

The Victoria Grants Commission wishes to advise that the review of the allocation of General Purpose Grants to Victorian Councils is now complete and that it has adopted the conclusions drawn in the review. The final report and conclusions are presented here for the information of all Councils and interested parties, particularly those who gave of their time and expertise to participate in the process, and without whom this review would not have been such a success.

The report draws together the findings and other information derived from a comprehensive consultation process, which comprised a questionnaire, search conference, key issues seminar, an Issues and Options paper, regional workshops and written submissions from Councils. This final report considers the findings of the Issues and Options paper, summarises the responses received, outlines the further analysis undertaken, and presents conclusions for a new General Purpose Grants methodology for Victoria.

Having accepted the review's conclusions, the Commission will now commence planning for implementation of the new methodology. In line with the Commission's normal approach to the implementation of change, a staged implementation process will be adopted commencing with the allocations for the 2002/03 year.

The Commission advises that this will not see the end of change. It is envisaged that the new methodology will need to continue to evolve and adapt to meet the developing needs of local government. For instance, the final report of the current Commonwealth review of the national grants system is due later this year, and may well have implications for the Victorian methodology. Through the annual submission process, the Commission will continue to provide Councils with the opportunity to highlight their unique characteristics and draw attention to any significant issues that they may be facing.

On behalf of my fellow Commissioners, I wish to express our thanks for your interest and commitment to this Review.

John Lester
Chairperson
Victoria Grants Commission

Contents

Executive Summary

In 2000-01, Councils in Victoria are receiving $228 million in General Purpose Grants – slightly less than 10% of total local government revenues.

The Victoria Grants Commission (VGC) allocates these Grants after taking account of the Commonwealth national principles and after considering the relative needs of Councils – both the demands faced by Councils and their capacity to fund those demands. In doing so, the VGC places a high priority on consultation with Councils, and fine tunes the allocations each year in the light of submissions from Councils.

This Final Report follows a more comprehensive Review than can be encompassed in annual fine-tuning. This Review has also had extensive involvement from Councils, and the recommended changes are aimed at achieving goals seen as important by Councils. The most fundamental of these is fairness, with subsidiary goals being transparency, predictability, and stability.

The following conclusions establish a framework for improvements to the Grants system, to better achieve these goals. Consistent with the VGC's standard approach, it is proposed that the effects of the changes will be phased in over time. This will enable both on-going stability in Council Grants, and the opportunity for Councils and the VGC to assess how the new system is working in practice. The annual process of inviting and considering Council submissions will continue.

Conclusions

Overall Goals

1. General Purpose Grants in Victoria will continue to be allocated through the balanced budget approach, maintaining consistency with the National Principles.
2. Capital expenditure will continue to be excluded from the Grants assessment for the present, but the VGC will review this position as more consistency develops in Councils' treatment of capital items.

Revenue

3. The VGC will continue to use the standardised valuation approach, based on NAV.
4. Valuations will be averaged over two years, rather than the current three.
5. Payments in lieu of rates will be included through a simple addition to standardised revenue.
6. The VGC will recast its formula for calculating discounted standardised expenditure to subtract other grant support after cost adjustors have been applied to standardised expenditure.
7. Revenue assessment will not include parking revenues.
8. While the VGC will consider further ways of including all revenues, it will continue to exclude other revenues in the short term.

Expenditure

9. The VGC will implement a simplified structure of expenditure categories, covering virtually all recurrent expenditure.
10. A revised set of cost adjustors will be used, reflecting the relative needs of Councils.
11. Standard costs will be calculated using mean rather than modal values, and a range for cost adjustors of 0.75 to 1.50 will be used.
12. The categories of Heritage, Culture and Recreation (as a single category), and Roads, will be kept in the calculations of General Purpose Grants.
13. Data from the recent Roads review will be used, in place of the Mulholland methodology, to provide a rigorous basis for updating the cost adjustors for roads.
14. The standardised expenditure approach will be used for sanitation.

Other Issues

15. In view of the importance of both governance and economic development, especially for smaller rural councils, the VGC will adopt a minimum population size in calculating expenditure for these functions.
16. The VGC will not implement a single equation model for expenditure assessment.
17. A suitable transition process will be used in implementing the revised formula.
18. Assistance for natural disasters will continue.
19. The annual data questionnaire will be thoroughly reassessed to simplify the process for councils, while still collecting the key data required for the VGC and other bodies, such as the Australian Bureau of Statistics.

1. Introduction

The Victoria Grants Commission, in establishing this Review, requested a thorough-going examination of the General Purpose Grants process in Victoria. The aim was to identify areas where the grants process could be improved, particularly in terms of transparency and understandability.

This Final Report has developed from an extensive Review process. An Issues and Options paper was published in October last year. A total of 123 Council representatives attended seven workshops in November, and 30 formal submissions were made on the proposals (Appendix A gives a summary of Council comments, and Appendix B lists attendance at the workshops, and submissions received).

Overall, Councils supported the approach and findings of the Issues and Options Paper. However, there was concern at some suggestions, and there was by no means unanimity on the issues.

The VGC has carefully considered the comments from Councils, and in some cases has requested additional analysis to test both the initial suggestions and alternative mechanisms. This report concentrates on those comments and analysis – it does not repeat the detailed discussion and analysis contained in the Issues and Options Paper.

This Report groups the Issues into four broad areas:

- Overall goals
- Revenue capacity
- Expenditure requirements; and
- Other issues.

In each area, the Report considers the findings of the Issues and Options Paper, and summarises Councils' responses. It includes any subsequent analysis, and outlines a new General Purpose Grants methodology.

1.1 Review Objectives

Both the Victorian Grants Commission and the Commonwealth Government have an on-going commitment to improve the allocation of grants to Councils.

In 1998, the VGC foresaw the need to review both the local roads grants formula and the general purpose grants formula. Later that year the VGC commenced the review of Roads Grants. The Final Report was published in July 1999, and the VGC has now released indicative grant estimates based on the new formula.

The methodology for allocating General Purpose Grants had not been comprehensively reviewed in two decades. However, over the years, a large number of changes had been made to the methodology, particularly in the period since local government amalgamation. Nevertheless, the VGC identified a number of issues of concern, including:

- The system is overly complex and hard to understand fully (a very common comment from Councils);
- Local government activities have changed considerably, and the methodology needs to reflect these changes;
- The present process includes elements which may no longer be relevant or appropriate; and
- The VGC analysis covers some 80% of council expenditure, but leaves out some significant expenditures - most notably, capital expenditure.

These views were reinforced by comments from Councils, and in late 1999 the VGC announced that it would conduct a major review of the methodology. Throughout the Review, the VGC emphasised that the Grants system has to meet the legislated objectives of General Purpose Grants, encapsulated in the National Principles of:

- Horizontal Fiscal Equalisation
- Effort Neutrality
- Payment of a Minimum Grant to all Councils
- Adjustments for Other Grant Support; and
- Recognition of the needs of Aboriginal peoples and Torres Strait Islanders[1]

Alongside these National Principles, the Review has asked Councils about desirable goals for the Grants system. The responses have been broadly similar to the goals identified in the recent UK Review of Local Government Grants[2]:

- Fairness
- Stability
- Predictability
- Clarity
- Transparency and
- Responsiveness

The VGC therefore felt it was timely to conduct an overall review to address these issues, while maintaining the central goal of a fair treatment of councils' needs and capacities. This view was amply supported by the findings of the survey of Councils. This survey indicated:

- Only 30% of respondents indicated satisfaction with the current system (with 48% neutral).
- 78% agreed that the system is hard to understand.
- Respondents agreed that the most desirable feature of the system should be fairness, with other important goals predictability, transparency, simplicity and responsiveness.

[1] More detail on the National Principles is given in Appendix H.

[2] See the UK Government September 2000 Green Paper *Modernising Local Government Finance*. This and other reports for this Review were discussed in the Issues and Options Paper.

1.2 Consultation Process

A central part of this review has been consultation with local government. Key events and dates have been:

Commencement	March 2000
Circulation of Questionnaire	End March
Search Conference, Altona	10 April
Key Issues Seminar, Darebin	17 May
Development of Issues and Options	April – September
Release of Issues and Options Paper	mid October
Regional Workshops	7 – 22 November
Council Submissions received	20 December
Assessment of Submissions	January 2001
Release of Final Report	May
Amendments to Data Return	April - May
Implementation (staged)	From October 2001

This consultation process was welcomed by many submissions:

> *"The Board would like to congratulate the Commission on the strength of the consultation process undertaken to date and recognises the Commission's intention to maintain that approach. It is a model that other levels of Government should consider emulating"* (LGPro)

> *"We are encouraged by the scope of the review and in the effort taken to consult with the sector, this is well worthy of congratulation. The review consultation offers evidence to other areas of State Government of a useful model to achieve sector-wide comment on complex matters"* (VLGA)

> *"Thank you for the opportunity to make a submission to the review of allocation of general purpose grants. We would like to support the high level of industry consultation that has gone into conducting the review, and the level of information provided as part of the process."* (Moorabool)

1.3 The Commonwealth Review

The Issues and Options Paper noted, in section 1.3, that in June 2000 the Commonwealth Grants Commission commenced a review of the national local government finance arrangements, to:

- Review certain sections of the Local Government (Financial Assistance) Act 1995;
- Report on the appropriateness of the current National Principles (with a specific mention of the minimum grant allocation); and
- Review the consistency of each State's methodology with the National Principles.

The Terms of Reference of the Review emphasised that the overall principle of horizontal fiscal equalisation will remain central to grants allocation.

The Commonwealth Grants Commission released a discussion paper, followed by formal consultation with the States and Councils in October. In January 2001, the CGC published a Draft Report and a document of supporting information[3]. Submissions were invited on that report by April 2001, so a Final Report can be completed by June 2001.

The Issues and Options Paper noted

> *"While the timing of the Commonwealth Review overlaps the current VGC review, the two processes are complementary rather than conflicting. The central role of horizontal fiscal equalisation in the Commonwealth review also underlines the discussion of principles and goals contained in this Paper."*

The Draft Report, drawing on the UK Grants assessment process which was utilised extensively in the Issues and Options Paper, argued "Best practice funding models are concerned not only with the fairness of the outcomes they produce but with the transparency and accountability of the process." (p 32). The Report suggested that primary aims for the system should be: fairness, transparency, accountability, and predictability. These aims fit well with the methodology adopted for this current Victorian Review.

The Commonwealth Review argued for the continued use of the three major National Principles of:

- Horizontal Fiscal Equalisation (albeit reinterpreted slightly as "relative needs");
- Effort Neutrality; and
- Adjustments for Other Grant Support.

In each case, this approach matches well with the approach taken in the Issues and Options Paper.

3 Commonwealth Grants Commission Draft Report (Discussion Paper LG 2001/1), and Supporting Information (Discussion Paper LG 2001/2)

As it was an issue raised in many Council submissions, a CGC comment on Effort Neutrality in the revenue area, is especially worth noting:

> *"Actual revenues reflect a mixture of policy and non-policy influences. The Effort Neutrality principle says that an individual government's policy choices should not affect its grant allocation. Therefore, the policy contamination means that actual revenue can no longer be used as an accurate measure of revenue capacity."*
> (Supporting Information, p104)

As noted in the Issues and Options paper, one issue fully in the Commonwealth's ambit is that of the Minimum Grant. The CGC agreed that some component of a Minimum Grant is justified – and argued further:

> *"We have found that small reductions in the level of the minimum grant have only a small effect on the grants of 'non-minimum grant' councils . . . we do not think these gains are large enough to justify a decrease in the minimum grant."*
> (Report, p 15)

The Review therefore argued for the retention of the minimum grant for all councils at the present level of 30% of the per capita allocation.

The CGC does suggest some fine-tuning of the current national grants system. In particular, it notes variations between the different state Local Government Grants Commissions in assessment practices, and suggests "We think greater consistency can be achieved and should be required"(p 22). Exactly what this suggestion entails is not spelt out – but in the absence of more detail, comfort can be taken from the alignment of the goals of the Commonwealth Review with those spelt out in the Victorian Issues and Options Paper, and agreed to by most Councils.

On one issue – the formula for calculating Discounted Standardised Expenditure, the CGC has raised some issues with the VGC's current practice. This issue is considered further in section 3.3.4 and in Appendix G, and recommendation 7 above makes an appropriate adjustment to the formula.

The Commonwealth Reports have been published for consultation, with final reports due at the end of June. Depending on the precise form of the final recommendations, there may be some implications for the allocation of General Purpose Grants in Victoria. There will therefore be continuing fine-tuning of the Victorian Grants system over the coming years.

2. Goals and Grant Patterns

2.1 Overview

The Issues and Options Paper presented a broad overview of the goals of the grants system. This drew both on Australian experience, and on the recent review of systems in eight countries, undertaken as part of a comprehensive UK review. This showed a considerable agreement on 'fairness' as the central goal of grants to local government, consistent with the primary Australian goal of Horizontal Fiscal Equalisation. In sum, grants should assist local governments to provide a basic level of service to all, with adjustments made for both areas of high need, and to take account of differences in the resources available to different Councils

From this overview, the paper noted the differing approaches taken by the Local Government Grants Commissions across Australia – with this background experience also being valuable for the discussion of some detailed issues noted below. The discussion suggested the continuance of the current 'balanced budget' approach, which Victorian Councils are familiar with, as there is no other system that is clearly superior.

Two other broad issues were also considered: whether the scope of the VGC analysis should include capital expenditure; and whether the present allocation methodology, especially in the case of smaller rural Councils, really produces 'fair' outcomes.

Ideally, a grants system which purports to examine Councils' needs and resources should consider all aspects of Council operations. As the Issues and Options Paper noted in section 4.1.2, this especially poses challenges for the treatment of capital expenditure, which is currently the major exclusion from the VGC analysis. However, the analysis there (drawing on work undertaken by the NSW Grants Commission) suggested that capital expenditure poses some serious methodological and practical difficulties.

A further general issue was that of the pattern of distribution of Grants across the State – and in particular those allocated to smaller Councils. This issue is discussed in section 5.2.1 below.

2.2 Findings and Responses

2.2.1 Broad Goals

In this report, the discussion in each "Findings and Responses" section starts with the Findings of the Issues and Options Paper, presented in **bold**. The numbering is as used in that Paper.

For broad goals, the findings of the Issues and Options Paper were:

1. The ideal grants system would be one that:
Meets the National Principles set out in the Commonwealth Act and the Commonwealth / State agreement
Achieves the most important goal of fairness; and
Also achieves the other goals which are seen as important by councils: predictability, responsiveness, transparency and stability. (Section 3)

2. In the interests of achieving the goal of fairness, and meeting the National Principle of Horizontal Fiscal Equalisation, the grants allocation process needs to consider both the needs faced by councils, and their capacity to raise revenue. As there is no agreed standard methodology to do this, the goal of transparency suggests Victoria should stay with the existing current balanced budget approach which councils are familiar with. (Section 4.1.1)

Most Councils agreed with the view expressed by the VLGA:

> *"We clearly recognise that the Grants Commission operates within a national framework underpinned by Commonwealth legislation and by national Principles. The VLGA supports the continued application of the Principles and accepts that the goal of fairness in grant distribution is fundamental to both a national approach and to the achievement of broad support for the funding models. The VLGA supports the key requirements of fairness, predictability, responsiveness, transparency and stability and argues that these are critical to the grants calculation processes."*

and Colac Otway:

> *"broadly supports the main thrust of the Review to achieve a more predictable, responsive, transparent and stable system."*

There were some suggestions that grants should recognise council effectiveness. Baw Baw:

> *"believes that whilst many complex problems exist in determining appropriate indicators to reflect effective service delivery, or indeed the services required, the current system should be altered to be output based."*

Nillumbik also noted that the current system is:

> *"input driven rather than output focused . . . with a methodology which has been developed historically from a finance and accounting perspective rather than a balanced scorecard approach. The VGC should continue to refine the current measurements . . . into a more sophisticated approach which addresses all aspects of the local government environment using thorough environment, social and business analysis methodology."*

It is worth noting that views such as Baw Baw and Nillumbik's attracted only minority support in the survey of Councils at the beginning of this Review. The survey asked "Should the system take account of Council performance?" Only 36% of respondents agreed with this view – and this figure fell further, to 21%, if assessment of that performance involved a central agency.

Many Councils noted the analysis in the Issues and Options Paper (p 9) that the goals of fairness and simplicity could come into conflict – and had few doubts about which was the more important:

> *"it is inappropriate to discard new processes [simply] on the basis that any new system would be hard to administer, complex, or difficult to understand. When issues of equity and fairness are involved it behoves the Commission to attempt to address the matters, and make some attempt at addressing known areas of inequity"* (Kingston)

> *"any changes must be fair to all. When in conflict, the matter of fairness should dominate over the desire for simplicity"* (Eastern Region Councils)

There was broad support for the continued use of the balanced budget approach.

2.2.2 Capital

The findings of the Issues and Options Paper were:

3. While infrastructure and other capital issues are clearly a high priority for local government, there are substantial methodological issues involved in attempting to include capital in the General Purpose Grants process. It is therefore recommended that the VGC's current process, of excluding capital items, should continue. (Section 4.1.2)

While noting Councils' increasing focus on infrastructure, the Issues and Options Paper noted both methodological and practical issues in including capital. In general, Councils were not greatly impressed with the methodological argument, but there was strong agreement on the practical problems.

Horsham:

> *"supports the exclusion of capital items from the Victoria Grants Commission calculation at the present time. We believe that on a statewide basis the valuation of infrastructure assets is at an immature stage in its development. Councils only commenced to value infrastructure assets in a systematic way in the early 1990's and we believe there are still a number of data collection issues to be refined over time.*

> *"The Horsham Rural City Council does not consider that its data is sufficiently reliable as it tends to vary from year to year. A more important issue is the variation in valuation methodology used across the state. This was highlighted by the infrastructure review, conducted by the Department of Infrastructure. It was apparent that like councils side by side had very different valuation outcomes. The life of assets and the replacement value of assets differed significantly between councils.*
>
> *"We believe there needs to be a statewide methodology that is adopted by each council before the capital items can be relied upon for the allocation of grants."*

Victorian Local Governance Association:

> *"The VLGA as a matter of first principle would ideally like to see the eventual use of capital expenditure within the assessment process, but supports the Commission's intention to continue with the exclusion of capital expenditure at the time being, given the difficulties and inconsistencies that would occur. We would hope this might be reconsidered at a time when local government capturing and reporting on this data was more comparable"*

East Gippsland:

> *"Referring to your findings on capital expenditure, and infrastructure replacement . . for the sake of this review, the Council accepts the limitations. [However] we note that unless some action is taken to address these issues the continuing problems of asset / infrastructure replacement will plague councils in the future. Therefore 'the capacity of each council in Victoria to provide an average range of services at a standard level' will diminish."*

2.3 Subsequent Analysis

As there was agreement on the overall aims and method, and on the practical reasons for not including capital expenditure in the assessments, no further analysis was required on these recommendations.

2.4 Conclusions

1. General Purpose Grants in Victoria should continue to be allocated through the balanced budget approach, maintaining consistency with the National Principles.

2. Capital expenditure should continue to be excluded from the Grants assessment for the present, but the VGC should review this position as more consistency develops in Councils' treatment of capital items.

3. Revenue

3.1 Overview

As noted above, the overall aim of assessing the different demands on, and capacities of, councils suggests that, ideally, all aspects of revenues should be considered. The Issues and Options Paper noted the main sources of Council recurrent revenue in Victoria:

Council recurrent revenues, 1997-98

	$ million	**%**
Rates	1,249	50%
VGC grants	281	11%
Other government grants	298	12%
Other charges, fees and fines	608	25%
Interest received	53	2%
Total, recurrent revenues	**2,489**	

Source: ABS Local Government Finance Victoria, 1997-98, p12. The table includes only the recurrent revenue items. The largest single item in 'Charges, fees and fines' is parking revenues, which from VGC data total $123 million a year. The remaining $485 million in other charges comes from a variety of sources, including fees such as from HACC services, child care centres, and swimming pools.

As rates comprise 50% of the total, they have traditionally been considered the primary income source in assessing Council revenues, and the Paper discussed a range of issues in that assessment. While noting some strong concerns about the standardised revenue approach, the paper argued it is the most effective way of judging capacity to raise revenue.

The Paper also considered the treatment of two other significant components:

- Other government grants, which have traditionally been treated by the inclusion method, via discount factors on the expenditure assessment; and
- Parking fees and fines, which comprise the most significant component of the "other charges, fees and fines".

The Paper recommended that the treatment of discount factors could be improved by averaging discount factors for all Councils. It also suggested that Parking revenues could be included in the revenue assessment, although noting some methodological issues in this.

3.2 Findings and Responses

3.2.1 Revenue Capacity

The findings of the Issues and Options Paper were:

4. It is clear that revenue capacity does differ between councils, and some effective way of measuring this is needed. While arguments from critics make good points, the most effective (albeit not perfect) way of capturing such differences is to use a standardised valuation approach. (Section 4.2.2)

5. The continued use of NAV as the valuation base is advocated: NAV incorporates both a wealth and an income component, and a shift to CIV would favour councils with strong commercial and industrial property bases. (Section 4.2.5)

6. The move to more frequent revaluations could allow valuations to be averaged over two years rather than the current three. (Section 4.2.5)

7. The most appropriate way to adjust Council rate bases for any payments in lieu of rates appears to be a simple addition to the standardised revenue. (Section 4.2.5)

The Issues and Options Paper noted the views of several critics of the use of standardised valuations. One key point was that the standardised rates calculated by the VGC are in some cases much higher than the actual rates charged by some Councils. Cardinia argued:

> *"There is some merit in the Commission looking at the (constrained) actual rate level rather than a hypothetical standardised rate level, although it is conceded that this conflicts with the principle of effort neutrality, and may be capable of manipulation by Councils who may keep rates low in order to gain an increased grant"*

Similar views were strongly put by the Eastern Region (Metropolitan) Councils:

> *"the present method unfairly overstates the ability of many councils to raise revenue and penalises efficiencies. We see a gathering storm for Metro Councils . . . This is because of the continuing escalation of property values in Melbourne disproportionately to the rest of the State . . grants will continue to be reduced based solely on rising property values, which do not reflect revenue raising capacity."*

The submission suggested two possible approaches to address this situation:

- Discounting of rate revenues, following the New South Wales model (where valuations are discounted to 30%[4]); or
- A differential rating system, separating rates on the three property classes: residential, commercial and industrial, and rural.

[4] The Eastern Councils submission suggested that this discounting affected only councils in Sydney – it is in fact applied to all Councils in New South Wales.

The MAV urged further analysis of the 1991 recommendations of the Commonwealth Grants Commission. That CGC report suggested:

> *"revenue capacities from three classes of ratepayers should be assessed separately:*
> - *Commercial and industrial ratepayers to be assessed with use of property values;*
> - *Residential property to be assessed on the basis of household income; and*
> - *Farming properties on average farm income over a period."*

While the MAV noted the data issues raised in the Issues and Options Paper, it felt "the goal of fairness should be placed ahead of logistical issues related to data collection, which can potentially be rectified."

However, most councils supported the continued use of valuations as the measure of revenue capacity. Horsham commented:

> *"The land valuation systems provide the best long term indicator of capacity to pay of ratepayers and thus the capacity of councils to derive revenue. The use of household incomes to establish revenue capacity has significant flaws.*
>
> *"Under the Best Value valuation methods, valuations will be obtained every two years in future, whereas household income collection is only conducted every five years. The rural sector has the potential for enormous variations in income from year to year and the use of a single year to derive household incomes may work against councils which are predominantly rural based."*

Bass Coast

> *"supports the retention of a standardised valuation approach. The use of other methodologies such as actual rates levied conflicts with the National Principle of Effort Neutrality"*

Swan Hill

> *"With the changes to the Valuation of Land Act requiring a move towards more frequent valuations and a common valuation date, this method will become more responsive and more consistent across Councils in future. Actual rates raised should not be used to determine capacity to raise rates, as clearly this contravenes effort neutrality principles."*

Eighteen submissions commented on the Issues and Options Paper analysis of NAV versus CIV as the valuation base – and 16 supported continued use of NAV.

There was also widespread support for findings 6 and 7, the averaging of valuations over a shorter period, and the treatment of payments in lieu of rates.

3.2.2 Discount Factors

The findings of the Issues and Options Paper were:

8. The continued treatment of other Government grants through discount factors on the expenditure side (ie the inclusion approach) is supported. (Section 4.2.6)

9. An average discount factor for all councils is strongly preferred, rather than the current use of individual council discount factors. If this is done, the discounting system would not rely on the individual (and variable) data from councils. A number of current inappropriate effects would not occur. In addition, the complexity of the system would be reduced significantly. (Section 4.2.6)

While there was general support for the continued use of discount factors, the proposal of State-wide averages created more controversy. Comments ranged from support:

> *"We support the report's suggestion that an average discount factor for all Councils be applied rather than the current use of individual Council discount factors. It is agreed that the system should, where possible, reduce the complexity so that in allocation of grants the system is as transparent as possible." (Whittlesea)*

to the more cautious:

> *"The use of a revised state average discount system would reduce the complexity and assist understanding but its specific individual effects are unknown. We would like to see how this affected our grants before commenting further" (East Gippsland)*

to the downright hostile:

> *"We strongly oppose the averaging of discount factors. We have been staggered at the impact on sealed road expenditure calculations [in the 2000-01 grants]. We do not understand the benefits gained from averaging all discount factors and suggest that the Commission average each council individually" [ie over two or three years] (Eastern Region).*

The Eastern Region submission analysed further the impacts of the average discount factors for roads, and this and the rationale for general averaging of discount factors is investigated in section 3.3.4 below.

3.2.3 Other Revenues

The findings of the Issues and Options Paper were:

10. Parking revenues should be considered in revenue assessment. However, there are some important implementation issues to be addressed. (Section 4.2.7)

11. The complexity and variability of other revenue sources militates against including them in standardised revenue assessment. As their contribution to total revenue is relatively small, their inclusion would increase the system's complexity without greatly improving its performance. (Section 4.2.8)

Opinions were split on parking revenues. Horsham provided a detailed response on parking revenues in principle:

> *"This proposal appears to fly completely in the face of the effort neutrality principle. Considerable caution has to be shown in adopting changes to the methodology which directly conflict with the basic principles of the Grants Commission system."*

Horsham also considered some practicalities (following comments summarised):

a) Net versus gross revenue
Horsham derives approximately $240,000 from parking fees and fines (purely from on-street metering), but has direct costs of some $70,000 and annual depreciation cost in parking meters of $40,000.

b) On and Off Street Carparking
The purpose of on-street parking meters are mainly to control parking activities, to ensure that shopping strips continue to be viable. The operation of off-street carparking has a purpose of maximising revenue.

c) Regional Role
Horsham has a firm policy of returning all parking revenue to improving the amenity of the central business district, for the benefit of all Wimmera residents.

d) Effort Neutrality
Horsham compares itself to Mildura which does not have parking meters. Theoretically Horsham property rating is lower because Council has chosen to install parking meters and collect revenue from that source.

Greater Geelong was also strongly opposed, arguing that it

> *"sets fines to discourage people from illegal parking and maintain safety and control in the municipality. It is not in line with the Grants Commission's agenda of fairness that the City could reduce its fine income, and compromise the safety and street control in the municipality, but maintain the same income level through additional Grants Commission allocations."*

Mitchell was in favour of the principle, but:

> *"The use of parking incomes in revenue assessment would appear to be appropriate, however, averaging the incomes would not seem fair, especially for those councils that do not generate or have the capacity to generate any or substantial income from this source"*

And Moonee Valley:

> *"Council does not support the inclusion of parking revenues in the assessment of revenue as it would be virtually impossible to develop a fair and equitable methodology to determine the average parking revenue."*

Such concerns about parking revenues also influenced views on other revenue sources, with the majority of comments supporting Whittlesea:

> *"We agree that other revenues should not be considered as they are rather small and will only add complexity to a system which needs to be simplified where possible."*

3.3 Subsequent Analysis

In response to these comments, the VGC and the consultants undertook further analysis in four areas:

- Assessing the use of standardised rates;
- Investigating the possibility of assessing revenues separately from the three main property classes: residential, commercial/industrial; and farming;
- Considering the arguments on discount factors, and in particular assessing whether using discount factors for each council averaged over several years would resolve the problems; and
- Considering other revenue sources.

3.3.1 Standardised Rates

As noted above, the strongest arguments against standardised rates came in the Eastern Region submission. This pointed out that a number of Councils have actual rate collections well below the standardised rates calculated by the VGC, and argued that there is a need to change the approach to reflect this situation.

The data presented in the submission indicates that there are nine Councils which have actual rates significantly (ie by 10% or more) below the VGC standardised figure. All of these are in the inner and eastern suburbs of Melbourne, and five are on 'as of right' minimum grants.

The submission suggests that the VGC should consider actual rates raised in assessing capacity to pay. There are two significant problems with this approach:

- The first is that any use of actual rates raised by individual Councils runs into serious problems of effort neutrality, as noted by Cardinia.

- The second extends the analysis from Appendix D of the Issues and Options Paper. That argued that rural Councils need to strike higher than average rates to meet their expenditure requirements. This point was stressed in the submission from Smaller Population Shires, which demonstrated:
  "that other councils . . . are able to spend at above average levels even though they make a much lower rating effort."

This submission drew attention to the key objective of equalisation, to "ensure that each local governing body in a State is able to function, by reasonable effort, at a standard not lower than the average standard of other local governing bodies in the State". It argued that if there is any failure to meet this requirement, it is for smaller Councils that have to strike higher rates in consequence.

The corollary of this argument is that if Councils can spend more than the average (per unit) while striking lower than average rates, they are in a favoured position. It seems strange to suggest adjusting the system to give such favoured Councils a further benefit.

A further suggestion from the Eastern Region Councils, specifically to address the perceived 'gathering storm' was to discount rate revenues, similar to the procedure followed in New South Wales (where valuations are discounted to 30%). However, the New South Wales approach reflects some specific features in that State:

- New South Wales uses land (site) valuations in their calculations – site values differ more between areas than do capital values; and
- Even with the substantial 30% discounting, New South Wales still has more marked variations between Councils on revenue capacity than does Victoria. As a result, many more Councils in New South Wales receive minimum grants.

Nevertheless, this suggestion was tested for Victoria by modeling the effect of discounting all revenues by 50% in the Grants for 2000-2001.

Not surprisingly, the effect of discounting was to increase, in some cases substantially, the grants for metropolitan councils, with the biggest increases for those Councils which are close to being minimum grant Councils. Regional and rural Councils generally saw decreased Grants.

Once again, such a result conflicts with the analysis of Appendix D in the Issues and Options Paper, which showed that the greatest funding gap is for small rural Councils. That analysis lends little support to a proposal to reduce funding to such Councils.

3.3.2 Property Category Analysis

As noted in the comments, several submissions suggested that the current use of total valuations could be improved by considering separately the three main property groups: residential, commercial and industrial, and rural.

It is certainly possible to calculate implicit rates for each property class separately, and this can be done either by using differential rates on valuations, or by using other variables, such as suggested in the 1991 Commonwealth Grants Commission report. The key challenge is how then to combine the three different figures.

This process would be fairly straightforward if there is a stable and common relationship across Councils between the three property classes. Thus, if all (or even most) councils gave a 20% discount on the residential rate to rural properties, and struck a commercial rate 20% higher than the residential rate, some basic rules of thumb could be applied.

To test whether a stable or common relationship exists, information was collected for each Council from the October 2000 data returns. To provide a consistent basis for the calculations, and because the majority of Councils now use CIV valuations, the assessment used CIV valuations for all Councils:

Total CIV valuations of residential properties	Total CIV valuations of commercial and industrial properties	Total CIV valuations of rural properties
1999/2000 rates collected from residential properties	1999/2000 rates collected from commercial and industrial properties	1999/2000 rates collected from rural properties

The following implicit rates were then calculated:

Implicit residential rate (= residential rates divided by residential valuations)	Implicit commercial and industrial rate	Implicit rural rate

The data showed some anomalies – which would have to be audited and rectified if this approach were to be taken further. Notwithstanding this, the calculations show a remarkable range of implicit rates in the dollar across Victorian councils.

While the ratio of NAV:CIV is fixed at 5% for residential and rural properties, for commercial properties the ratio of NAV:CIV valuations is about 9% (this figure was used in the calculations in Appendix E in the Issues and Options Paper). Comparing these two figures for Councils using a standard NAV rate in the $, the commercial implicit rate would be 80% higher than the residential implicit rate (ie 9%:5%).

However, it is very rare for the implicit rates to reflect this figure:

- Some councils, in moving from NAV to CIV, decided to maintain the ratio and so struck a commercial differential at about 80% higher. Thirty four councils have implicit commercial rates higher than the residential rate, with the highest differential at 180% higher.

- Other councils have decided that they will levy just one CIV rate – 14 councils have commercial rates about equal to the residential rate;
- Others have decided to levy a commercial differential which is less than the residential rate. There are a number of possible reasons for this: the Council may recognise that it provides fewer services to commercial ratepayers; or the Council (especially in rural areas) may decide that it wishes to lessen the rate burden on commercial premises in struggling towns. Twenty eight Councils have commercial rates less than the residential rate, with the lowest ratio at 35% lower than the residential rate (that in a site value Council, which complicates the issue further).

Across the State, commercial rates were, on average, 17% higher than residential.[5] However, as indicated in the above description, there is a very high variation around this figure. Statistically, this can be measured by the standard deviation, which is a high 0.42[6].

There is considerable variation both between and within each VGC category:

VGC Category	Commercial: Residential	Average Ratio	Standard Deviation
Metro central	63% higher	1.625	0.61
Metro developed	same	0.994	0.30
Metro fringe	7% higher	1.068	0.25
Regional urban	20% higher	1.197	0.39
Regional centre	63% higher	1.633	0.58
Rural agricultural	same	0.996	0.17

Such wide variations mean there is little basis for deciding on a standard implicit commercial differential rate. Without this, it is extremely difficult to combine standard rates from the two property classes.

A further complication arises with rural rates, which also show wide variation. On average, rural properties pay 80% of the rates of residential properties, but there is a standard deviation of 0.22, and the range is from 0.40 to 1.98 (the latter being again a site value Council).

Thus, there is no common relationship across Councils in their rating treatment of residential, commercial, and rural properties. To establish State-wide implicit differential rates, or to combine other indicators of capacity to pay, it would be necessary for the VGC to apply a common relationship. As a common relationship does not exist in reality, the VGC would have to make an ultimately arbitrary choice – one that would benefit some Councils and impact adversely on others. Not only would the initial choice be arbitrary, but it would also be extremely difficult to handle changes over time. This is not a desirable outcome.

5 These figure is strongly influenced by the large valuations in metro central. If metro central councils are excluded, the average figure was a lower 10% up.

6 There is no established rule as to what represents an acceptable standard deviation. However, to give a reasonable degree of confidence in a common relationship, it would be desirable for the standard deviation to be less than 10% (ie 0.10).

3.3.3 Discounting Other Grants

There are two issues to be considered in this area:

- Whether the VGC should continue with its current methodology, which calculates discounts for each individual council, or move to an averaging approach, discounting for other grants on the basis of the average other grants received by all Councils; and
- What technical formula should be used to incorporate the discounts in DSE. This issue was not raised in the Issues and Options paper, but has subsequently arisen as part of the Commonwealth Grants Commission review.

The second issue is discussed further in section 3.3.4 below, and a technical adjustment to the current formula is recommended. This section concentrates on the first issue.

The Issues and Options Paper argued for a move towards State-wide average discount factors, rather than the current practice of calculating discount factors each year for each Council.

The Issues and Options Paper presented two major arguments for this approach:

- It would reduce significant volatility in the system. The Paper demonstrated on pp 53-6 that there was little or no correlation between the Grants increases Councils saw in 1999-2000 and those they are receiving in 2000-01. A key contributing factor is volatility in Council data returns, which is subsequently reflected in individual discount factors; and
- It would avoid some current inappropriate effects – especially in terms of effort neutrality. One key example noted in the Paper (pp 25-6, and Appendix F) is the case of auspicing services to other organisations. By delivering fewer services directly, Councils can actually increase their discount factor – and the Grant they receive.

Seven submissions supported averaging discount factors, while five opposed. The opponents generally supported averaging the discount factors for individual councils over several years (to reduce volatility) but opposed any averaging between Councils.

The strongest opposition came in the submission from the Eastern Region. This drew attention to what it saw as an alarming effect of the VGC's decision to average the discount factor for roads grants in 2000/01.

The submission argued that in the roads functions the individual discount factor reflects each Council's:

> *"allocation from Local Road Funding (LRF).*
>
> *"If a Council receives a 'good' LRF then this reduces its General Purpose Grant because it receives a 'poor' discount factor of, say, 0.64. On the other hand, if a council receives a 'poor' LRF grant it receives a 'good' discount factor, say 0.90....*

> *"This year the average roads discount factor was 0.78. Therefore the 0.64 is increased to 0.78 increasing the general purpose grant by a large amount. However this is the council already receiving a good LRF grant. Therefore the 'winner' is a 'winner' again.*
>
> *On the other hand the 0.90 is reduced to 0.78, considerably reducing that Council's general purpose grant. This is the council which is receiving a 'low' LRF grant so it is again a 'loser'."*

This argument would be compelling if the sole driver for the results is the level of LRF. The argument effectively assumes that the only substantial difference between the two Councils is in the amount of funding they get from the local roads grant.

However, this is only one possible explanation of the difference – which can be illustrated by the following figures:

Example 1	**Expend**	**Grant**	**Discount Factor**
Council A	10,000	3,600	0.64
Council B	10,000	1,000	0.90
% diff	**0%**	**260%**	

Example 2	**Expend**	**Grant**	**Discount Factor**
Council A	10,000	3,600	0.64
Council B	20,000	2,000	0.90
% diff	**100%**	**80%**	

Example 1 produces the same discount factors as cited in the submission, and in this case the different grant level is the driver (as proposed in the submission).

However, Example 2 produces exactly the same discount factors. In this case, the more important driver of the result is the fact that Council B spends twice as much on its roads as does Council A. In other words, the discount factor is effort positive – if a Council spends more, it will receive a higher grant. This transgresses the National Principle of Effort Neutrality.

To examine which of these is the stronger effect, Appendix C presents for each Council in Victoria their roads expenditure and grants in the 1999/2000 financial year. The figures are presented per km of road[7], and give the following results:

	Average (per km)	**Standard Deviation**	**SD as % of Average**
Road expenditure	$8,756	8,339	95%
Road grants	$1,545	403	26%

7 The road lengths are calculated from actual lengths of sealed roads plus 0.1 times lengths of formed and surfaced roads – reflecting the lower average expenditure Councils have on the latter roads. The results do not change much if a 0.2 factor is used instead.

This shows that there is much greater variation between Councils in what they spend than in what they receive in grants. The same point can be gathered from looking at the Councils with the highest and lowest discount factors in Appendix C. All the Councils with high discount factors spend considerable amounts (all inner Melbourne councils, up to $49,000 per km), while those with low discount factors spend much less (all rural councils, $2,000 to $2,500 per km). It is hard to avoid the conclusion – consistent with the arguments in the Smaller Population Shires submission – that these results reflect ability to fund the works. In fact, comparing the councils at the top and bottom of the discount factor scale, there is very little difference in the size of their grants per km.

The picture is somewhat more complicated in other expenditure areas – the primary reason being that while all councils provide roads, there is some variation in the types and scope of services provided in other areas. Appendix D gives the 1999/2000 figures for Aged Services for all Councils, providing expenditure, grants income and fee income (income from charges to service recipients) figures, all expressed per person aged over 60 years.

This gives the following results:

Aged Services	**Average (per person aged > 60)**	**Standard Deviation**	**SD as % of Average**
Expenditure	$325	132	40%
Grant income	$162	90	55%
Fees charged	$69	38	54%

This also shows considerable variation between Councils. In this case, the variation for grants is slightly higher than the variation for total expenditure. However, the variation for grants is almost identical to the variation in fees charged – suggesting that the variation in grants primarily reflects differences in the programs run by Councils (and hence differences in grants funding, primarily from the Department of Human Services).

Looking at the Councils with, respectively, the highest and lowest discount factors reinforces this conclusion:

- The four Councils with the highest discount factors (all above 0.90) are those which receive minimal grants – and all have very low levels of expenditure. Aged services in these areas are largely auspiced to other organisations. In the current DSE calculations, these Councils receive the maximum DSE benefit, but directly provide minimal services;
- The group of Councils with the next highest discount factors all have fairly high expenditures – between $350 and $500 per head; while
- The group of Councils with the lowest discount factors (with the exception of Wodonga) all have low expenditures – in the $200 to $350 range.

These results, for both roads and aged services, confirm the analysis of Appendix F in the Issues and Options Paper. The use of individual Council discount factors is not effort neutral – Council decisions can affect the calculation of DSE, and therefore the size of Council grants.

While the use of average discount factors is clearly preferable to the use of individual Council discount factors, a modification to that approval is recommended below to address an issue raised by the Commonwealth Grants Commission.

3.3.4 Alternative Mechanism for Discounting Grants

In the process of reviewing this approach, a technical issue on the calculation of Discounted Standardised Expenditure was raised by the Commonwealth Grants Commission from their review of the national systems. This involved the interaction between the discount factors and cost adjustors in the VGC's formula. Appendix G explains the CGC concern in detail, and indicates the difference between the approaches.

For Council i, the current VGC approach for calculating DSE for expenditure function j is

$$\frac{\boldsymbol{DSE_{ij}}}{\boldsymbol{units\ of\ need_{ij}}} = \boldsymbol{standard\ unit\ cost_j * discount\ factor_{ij} * cost\ adjustor_{ij}}$$

The CGC points out that this effectively means the VGC does not apply the cost adjustor to 100% of standardised expenditure. Rather, the cost adjustor is applied to standardised expenditure after the discount factor has been applied – and depending on the discount factor, this could mean that only a small proportion of standardised expenditure is adjusted.

To avoid this problem, the CGC has suggested that the VGC subtract the grant from the standardised expenditure. Appendix G analyses this suggestion, and concludes that the current VGC process does reduce the impact of cost adjustors. It therefore recommends that the VGC should use a formula more consistent with the CGC approach:

$$\frac{\boldsymbol{DSE_{ij}}}{\boldsymbol{units\ of\ need_{ij}}} = \boldsymbol{unit\ cost_j * cost\ adjustor_{ij} - average\ grant_j}$$

As Appendix G shows, there is mathematically only a small difference between the discount factor approach which multiplies the equation by (total expend - ave grant)/total expend) and the direct subtraction approach (- ave grant). While the difference is small, the subtraction method is a preferable mechanism for taking account of other grants.

3.3.5 Other Revenue Sources

As noted above, the Issues and Options Paper recommended that the VGC should continue to exclude other source of revenue in the assessment process. This recommendation was further supported by the analysis of parking revenues presented by several Councils. The information provided there suggested that any system using these revenues would both be complex, and involve considerable arbitrary elements.

This view was also taken in relation to other revenue sources. They vary considerably between Councils, and adopting a standard approach would be extremely difficult. The extent of the variation was further confirmed in subsequent analysis on the Discount Factor issue –discussed in the previous section.

In its current Review, the Commonwealth Grants Commission has argued that the assessment process should consider as many revenue sources as possible. In view of this, it is desirable that the VGC continue to monitor this issue.

3.4 Conclusions

3. The VGC should continue to use the standardised valuation approach, based on NAV.

4. Valuations should be averaged over two years, rather than the current three.

5. Payments in lieu of rates should be included through a simple addition to standardised revenue.

6. The VGC should recast its formula for calculating discounted standardised expenditure to subtract other grant support *after* cost adjustors have been applied to standardised expenditure.

7. Parking revenues should not be included in revenue assessment.

8. While the VGC should consider further ways of including all revenues, it should continue to exclude other revenues in the short term.

4. Expenditure

4.1 Overview

The second step in calculating raw grants is to assess the level of need for each council, and to note how these differ between councils. Calculating standardised expenditure - the costs council face in meeting those needs is considered the best way to achieve this.

Horizontal fiscal equalisation aims at remedying, at least in part, inherent differences between councils in providing services. Such differences can come from:

- The demand side for the services, where population differences lead to differing demands for service; and
- The supply side, where costs differ between councils in providing services.

Since the demand and supply considerations relate to the delivery of specific local government services, the starting point for the analysis is how those services are assessed. The discussion then moves to the differences between councils, which are currently assessed by calculating disability factors.

The aim of calculating standardised expenditure is to cover the range of activities that local government provides. At present, 20 expenditure functions are used. However, the analysis in section 4.3.3 of the Issues and Options Paper suggested that 12 of these functions make little difference to the Grant outcomes. In total, they represent only 12.5% of the aggregated DSE for all Councils in Victoria, and do not produce a strong differential impact between Councils. The Issues and Options Paper therefore suggested that a reduced number of eight expenditure functions could be used. However, it argued against a single expenditure function, on the grounds this would not reflect the diversity between Councils.

As well as improving simplicity, the Paper argued that this move reflects trends amongst Councils in packaging services together. In particular, a number of functions are often combined with sealed roads; footpaths, kerbs and channels, traffic management, street beautification, street cleaning, and drainage.

Within a reduced list of expenditure functions, the Issues and Options Paper made a number of further suggestions to improve the simplicity, transparency, and responsiveness of the Grants system:

- Introduce an ‘Other’ category to give the VGC a greater ability to assess individual Council’s situations;
- Use a reduced number of cost adjustors;
- Apply a standard DSE methodology to all expenditure functions (currently Family Services and Sanitation are treated somewhat differently); and
- In the roads functions, replace the Mulholland approach with data from the recent Roads study.

4.2 Findings and Responses

4.2.1 Expenditure Functions

The findings of the Issues and Options Paper were:

12. The number (20) of expenditure functions contributes to the complexity of the system, while many do not actually make much difference to grants outcomes. A simplified number of eight functions (including a discrete 'other' expenditure function) has advantages, while still reflecting the diversity of local government activities. (Section 4.3.3)

While most submissions supported improving simplicity in the system, many were cautious about the proposal to reduce the number of expenditure functions. Corangamite stated:

> *"it is important that in any attempt to reduce the number of functions that the complexities of Council activities are captured and that differences between different functions are acknowledged."*

The key concern expressed was that the assessment should continue to cover as much of local government expenditure as possible. In fact, it is possible to provide a greater coverage of expenditure with a smaller number of expenditure functions.

Brimbank:

> *"is not outright opposed to reducing the number of cost adjustors, but is wary in the absence of a detailed proposal and financial model. It is agreed that the number of expenditure functions contributes to the complexity of the system. In the absence of detailed financial analysis, Council reserves judgement on the reduction in the number of expenditure items until more information can be provided."*

Eastern Region Councils:

> *"Each time a category is eliminated some councils are disadvantaged. If footpaths are eliminated, as is proposed, then councils in older areas with high costs of maintenance are disadvantaged because their high costs will not be recognised . . The new direction for the Commission should be to provide greater recognition of councils' individual inherent disadvantages as required by the Act by . . . extending the number of categories, not reducing them."*

There was broad support for the flexibility that the VGC would have with the 'Other' category. Maribyrnong argued:

> *"There should be a core formula with the opportunity for local government areas to make a special case over and above the formula where the needs of their communities are not effectively captured"*

And some pertinent comments on individual functions, such as from the Community and Social Planners Network:

> *"Public safety, law and order should be retained as a single expenditure function, rather than grouped into 'other'. This is a significant expenditure function for many councils, particularly for those experiencing increased problems with the use of illicit drugs and gambling."*

4.2.2 Cost Adjustors

The findings of the Issues and Options Paper were:

15. The use of cost adjustors is a common method for distinguishing between councils in assessing needs. Both the Commonwealth and other States use a range of measures - of which a few receive extensive usage. A small number of measures is preferred, concentrating on the most commonly used variables. (Sections 4.4.2 and 4.4.3)

16. The continued use of ranges to measure cost adjustors is favoured. However, ranges between 0.75 and 1.50 may be preferable to the current 1.00 to 2.00 ranges, especially if the VGC calculates standard costs using means rather than modal values. (Section 4.4.4)

There was broad agreement that the VGC should continue to assess cost disabilities between Councils. However, there were some criticisms of the current approach, both in terms of the technique and the particular cost adjustors (disability factors) chosen.

The Eastern Region Councils:

> *"have a concern about the use of most of the present indices because they do not measure the 'differences in the expenditure required to be incurred' by councils. They in fact measure something else ie. index differences and often overstate the significance of the problem they are designed to address . . . [in many cases] actual costs should be used because it is too difficult to measure disability factors by other means."*

These Councils were particularly critical of the use of the socio-economic index (SEIFA) for four expenditure functions:

> *"The concern is that the VGC is using this index as an indicator of council expenditure need. Council costs are not greatly increased by the presence of disadvantaged in the community."*

Other submissions commented on particular cost adjustors. Scale and dispersion were commented on by many rural Councils, such as Indigo:

> *"One of our biggest problems with area is that we have to duplicate facilities across the Shire because of distance that the population has to travel, and, more importantly, lack of available transport for the population to utilise. For example, we have five Senior Citizen Centres spread across the Shire with submissions currently before Council to build a sixth at Kiewa."*

Loddon:

> *"Council finds that servicing the needs of a dispersed small population over a large area is a constant multiplier of necessary expenditure functions"*

Yarra Ranges:

> *"The use of an average SEIFA index for a council disadvantages some councils as the needs of their remote, marginalised and socially disadvantaged communities are masked by the SEIFA results for the urban communities"*

One other cost adjustor issue, which Council submissions have frequently commented on over the years is that of regional groupings of Councils. The VGC currently groups Councils into six groups: Metropolitan Central, Metropolitan Developed, Metropolitan Fringe, Regional Centres, Regional Urban and Rural Agricultural. In a number of current cost adjustors, different indices are applied according to which of these groups Councils are in. The submissions often raise queries about the accuracy of these indices, and/or the appropriateness of certain Councils being allocated into particular groups.

This issue was only raised implicitly in the Issues and Options Paper. The revised listing of cost adjustors did not include the use of regional groupings – with the possible exception of a regional centre variable for Culture and Recreation. As this was an implicit rather than explicit recommendation, it did not attract much comment in submissions. However, there was some comment in the regional workshops – which generally supported the removal of indices based on these groupings.

4.2.3 Specific Functions

The findings of the Issues and Options Paper were:

13. There are strong arguments for continuing to treat Heritage Culture and Recreation as one expenditure function, and also for keeping the roads functions in the calculations of General Purpose Grants. (Section 4.3.3)

17. Some inconsistencies are apparent in the use of the Mulholland methodology, both through changes in local government operations and through clear differences in interpretation between councils. It is recommended that data from the recent Roads review is used, in place of the Mulholland methodology, to provide a rigorous basis for updating the cost adjustors for roads. (Section 4.4.5)

18. There are advantages in using the usual standardised expenditure approach for sanitation - both on consistency and effort neutrality grounds. The issue of externally mandated costs - such as meeting EPA requirements - could be dealt with by recognising such costs in the proposed 'other' expenditure function. (Section 4.4.6)

23. The proposed structure of expenditure functions includes a specific function for services to businesses, which would help recognise the important role councils play in encouraging economic development. It is not easy to see, within the current framework, how the VGC could provide additional resources - or indeed if it should. This is an issue which will clearly benefit from further consideration by councils and the VGC. (Section 4.7.2)

Roads: Cardinia agreed on the need

> *"to reduce the impact of subjective judgements made by Councils by using cost adjusters such as freight loadings, strategic routes, climate. Materials availability and cost, soil conditions. Council supports the increased use of objective data where possible and reliable."*

Economic development

> *"in the areas of economic and tourism development where most non-metropolitan councils would have strategic objectives to ensure these services and opportunities are optimised for the benefit of their communities. In the metropolitan area many of these services are undertaken by the State Government as part of their promotion of Melbourne as a State capital and international city. . . Provincial and rural councils must generally endeavour to fill this gap from their own resources" (Warrnambool)*

Several Councils drew attention to the regional role they play, with consequent costs in providing facilities (especially in the Heritage, Culture and Recreation function).

4.3 Subsequent Analysis

4.3.1 Number of Expenditure Functions

There is clearly some concern among Councils that a reduction in the number of expenditure functions would compromise the VGC's ability to assess differences between Councils. In view of these comments, the proposed functions have been re-examined, and the following list of nine functions is now proposed. This component of each of these are outlined in Appendix F.

Current Proposal	***Proposed in Issues & Options Paper***
Governance	
Family and Community Services	Family and Children
Aged Services	Aged Persons
Recreation and Culture	Heritage, Culture and Recreation
Business Services / Economic Development	Business Services / Economic Development
Roads	Sealed Roads
	Unsealed Roads
Traffic and Street Management	
Other Infrastructure Services	
Waste Management	Sanitation
	Other

As noted above, a smaller number of expenditure functions does not mean that the assessment will reduce its coverage of local government expenditure. Indeed, it is possible to provide a greater coverage of expenditure.

The new list broadly represents fine tuning of the initial proposal, bearing in mind comments from Councils.

The major change from the Issues and Options Paper is the deletion of its suggestion (p 34) that an 'Other' category could be used by the VGC to recognise extraordinary costs above the average. While the overall concept of continued flexibility for the VGC met with approval, the suggestion of a specific 'Other' category was only cautiously supported, with many Councils wanting to see how it might work. In response, it is recommended that the VGC maintain its previous approach, of adjusting the cost adjustors in individual expenditure areas where a Council can demonstrate necessary costs above the average.

4.3.2 Use of Indices

As the Eastern Region Councils noted, the VGC has used indices for the cost adjustors since 1996. The Issues and Options Paper (p 42) noted a number of reasons for this approach:

> *"Frequently, individual councils can have, for a variety of reasons, expenditure that varies significantly more than such scales suggest.*
> *"While scales thus compress the variation between councils, there is a strong argument for their continued use. This centres on the point that there should be consistency between the different expenditure functions, and applies in two ways:*
> - Within *each expenditure function, differing cost adjustments are being combined. If they are not put onto similar scales, then the weighting between the adjustments changes - possibly dramatically;*
> - Between *functions, if one expenditure function has a wider range than another, this directly means that the first expenditure function is playing a larger role in determining the overall pattern of DSE and therefore Grants. This upsets the current weightings, which are determined (reasonably) on each function's percentage of total council expenditure.*

The Eastern Region Councils submission emphasised the point that expenditure can vary much more than the scales suggest:

> *"in most cases, actual expenditure levels would generally be below disability factors. Most councils lack the ability to provide average services over the whole range of activities and need to concentrate spending in areas of their highest priority."*

The alternative suggested by the submission is for the VGC to pay more attention to actual expenditures. There are however some difficulties with this approach:

- As noted in the Issues and Options Paper, it is very difficult to assess from Council data returns whether a reported high expenditure is due to:
  - Inherent cost differences facing that Council;
  - A Council policy decision to spend more in a certain area; or
  - Council accounting practices which record higher expenditure in some areas rather than others.
- To the extent that high expenditure does reflect Council policy decisions, this would conflict with the National Principle of Effort Neutrality. This Commonwealth Grants Commission has especially stressed this point in its current review; and
- As pointed out by the Smaller Population Shires, higher expenditure can also come about through the wealth of a Council – it spends more on services because it is able to (or, conversely for less well-off Councils – they spend less because they simply do not have the resources).

These factors all militate against the use of actual expenditures. The continued use of indices for cost adjustors is therefore supported.

4.3.3 The Socio-Economic Index

The most significant of the current cost adjustors used by the VGC is that for socio-economic status, measured by the SEIFA index compiled by the Australian Bureau of Statistics after each Census.

Until now, the VGC has used the SEIFA index of relative socio-economic disadvantage (as indeed have most other Grants bodies eg NSW, and the Commonwealth Grants Commission until its 1999 review).

This use was criticised in submissions. In particular, the Eastern Region Councils argued:

> *"Council costs are not greatly increased by the presence of disadvantaged in the community . . . with a range of people services which are often free or at minimum charge to the community as a whole".*

Further analysis indicates there are significant differences for 'people' services:

- where there are charges, Councils frequently offer reduced charges for the disadvantaged[8];
- in addition, there is considerable evidence (eg from the Commonwealth Grants Commission – see Issues and Options Paper p 40-41) that low socio-economic status does increase service costs, for two reasons:
  - it can increase demand for services (eg a low income area is less likely to have backyard swimming pools, and thus place a heavier demand on public facilities).
  - it can increase the complexity of delivering a standard service (eg low birth weight infants require more attention from Maternal and Child Health nurses).

Whittlesea noted a further correlation between SEIFA and demands on Councils, with the high level of electronic gaming machines (EGMs) in areas with low SEIFA indices:

> *"The likely economic and social effects associated with the pattern of development of EGMs include:*
> - *possible loss of jobs;*
> - *increased demands for social support services;*
> - *lower levels of local economic activity; and*
> - *reduced local expenditure patterns."*

The Department of Human Resources has recently published a comprehensive study "The Burden of Disease in Local Government Areas of Victoria" (January 2001). This report provides information on life expectancy and disease patterns for each local government area in Victoria.

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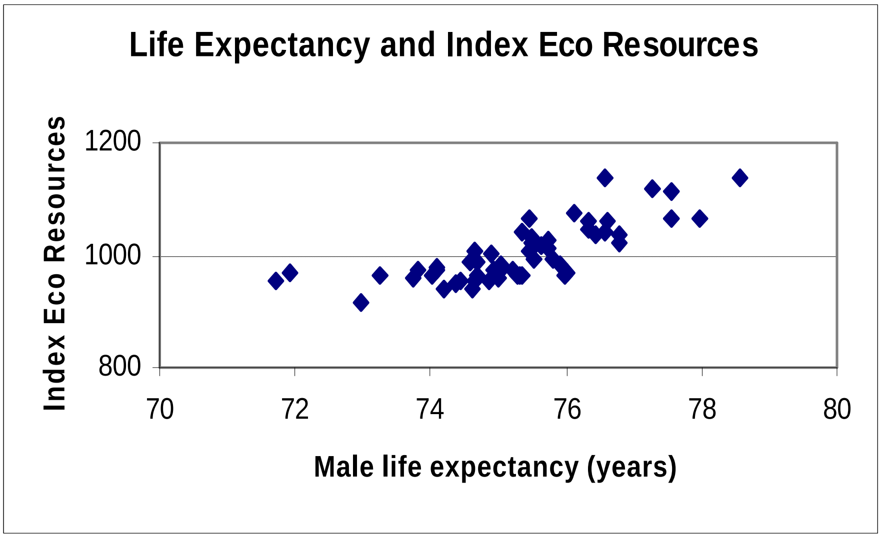
[8] To test the extent of this, eight Councils were surveyed. For both HACC and children's services, all offered discounts on fees either for Health Benefit Card holders or on a means-tested basis. The extent of the discounts varied, with services being provided free in some cases of extreme disadvantage.

The key finding for the current discussion is the correlation between socio-economic status and disease incidence – which impacts on life expectancy. The following graph shows the relationship between the ABS Index of Economic Resources and life expectancy for males.[9]



This relationship does indicate an impact for Council services. An area with higher health problems will have more aged persons who require HACC assistance, and also children with difficulties. Both create greater demands on Council services.

The submission from the Eastern Region Councils also criticised the SEIFA index of relative socio-economic disadvantage because of the components comprising that index.

The Issues and Options Paper indicated that this index was poorly correlated with household income, especially in rural areas. Following the lead of a recent UK initiative, which has combined several different indexes, the paper suggested a composite index, of SEIFA, household income and low English fluency.

Following the submissions, further attention has been paid to the components of the SEIFA index. In fact, the ABS prepares five indices of socio-economic status:

- the index of relative socio-economic disadvantage (IRSED – the index used currently)
- Urban index of relative socio-economic advantage;
- Rural index of relative socio-economic advantage;
- Index of Economic Resources; and
- Index of Education and Occupation.

[9] The Burden of Disease study presents analysis of the correlation between life expectancy and the SEIFA index of socio-economic disadvantage (R2 = 0.32). A better correlation exists between life expectancy and the index of economic resources (R2 = 0.64). There is also a correlation between female life expectancy and the index of economic resources, albeit somewhat weaker (R2= 0.36)

The urban and rural indices of advantage are of little assistance as they do not provide a consistent index covering all of Victoria. It is difficult to see how the Index of Education and Occupation could lead to differences in costs for Councils.

However, it does appear that the Index of Economic Resources will provide a better indicator of Council costs than the current IRSED figures[10]. This can be indicated by the most important components of the two indices[11]:

IRSED Index (currently used)	Economic Resources Index (proposed)
• persons aged 15 and over without qualifications; • families with income less than $15,600; • % unemployed; • % workers classified as 'labourer and related workers'; • persons aged 15 and over who left school at or under 15 years.	• households owning or purchasing dwelling; dwellings with 4 or more bedrooms; • families with income greater than $78,000; single parents with income greater than $31,200; • mortgages greater than $1,300 per month; and rent greater than $249 per week

The IRSED index is more strongly affected by occupational status and educational qualification, while the Economic Resources index is affected by incomes and family type. The above examples of cases in which Council costs will be greater is more likely to be affected by the Economic Resources index than the IRSED. This conclusion is reinforced by the fact that the burden of disease study shows a higher correlation between life expectancy and the Economic Resources index rather than the IRSED.

The Issues and Options Paper suggested a composite socio-economic index, of SEIFA, household income and low English fluency. In fact, the index of Economic Resources is very similar to the combination of the IRSED index and household income. It is therefore recommended that the VGC use the index of Economic Resources as the socio-economic measure, where required.

With the use of this measure, the argument for a composite index weakens considerably. It is therefore recommended that the VGC uses the index of low English fluency as an additional, and separate, cost adjustor for the Aged Services area.

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10 The index figures for each Council on these measures are given in Appendix E. As shown there, the two indices are similar – with the major difference being lower scores for rural councils.

11 Provided in ABS Information Paper "Socio-Economic Indexes for Areas" (1996 Census) catalogue no 2039.0, October 1998

4.3.4 Other Cost Adjustors

As outlined above, there was cautious support in submissions for the other key cost adjustors suggested in the Issues and Options Paper. Most Councils supported concentrating on a limited number of adjustors, with general agreement that the cost adjustors should reflect real cost impacts for Councils. Rural Councils emphasised the issues of Scale and Dispersion, while there was general support for using the more rigorous data from the recent Roads Study in preference to the Mulholland approach.

Many of these submissions were cautious in their support, including requests to see what the effect on Grants of any changes would be.

The following table outlines the cost adjustors proposed for each expenditure function, with discussion of these following.

	Socio-economic	Scale	Isolation/ Dispersion	Others
Governance		✓	✓	Minimum population of 15,000
Family & Community Services	✓		✓	% of population under 5 ATSI population
Aged Services	✓		✓	% of population pensioners Low English proficiency
Recreation & Culture	✓	✓	✓	Regional centres
Business & Economic Services		✓	✓	Tourism Population growth Minimum population of 15,000
Roads				Network costs from roads model
Traffic & Street Management				Population density Regional centres
Other Infrastructure Services		✓	✓	Either fire risk or similar measure
Waste Management			✓	Proportion of population in built-up areas

Governance
This is a new function, reflecting the costs to Councils of operating a Council, supporting councillors, and undertaking other governance functions on behalf of residents and ratepayers. These activities do not vary much with the size of a Council, so a minimum population level is proposed of 15,000. Above that level, costs (eg in running elections) can increase.

Family and Community Services
Broadly speaking, this function combines the current functions of Family Services (which uses SEIFA and single parents as cost adjustors) and Health and Welfare (which uses SEIFA, the number of registered food establishments and Aboriginality).
For the combined function, it is proposed to use the socio-economic index, isolation/dispersion, the proportion of the population under 5 years of age, and Aboriginality.

Aged Services
The current function uses SEIFA, the number of very old persons, isolation, and English proficiency. The recommended new structure is a combination of socio-economic, isolation/dispersion, the % of pensioners, and low English proficiency.

Recreation and Culture
The current function uses SEIFA, scale, isolation, and regional centres. With some changes to the components of these indices, these cost adjustors are used again.

Business and Economic Services
This function would include a number of activities – many of which are now included in the category community services. That function uses as cost adjustors scale, isolation, high population growth, and the numbers of overnight tourists.
The Issues and Options Paper noted that the use of growth as a factor for the business and economic development function could be two-edged:

- on the demand side, a council with a high population growth will face more planning applications than a council with no growth; however
- on the costs side, a council with no growth will have to devote more resources to economic development activities to get similar results to a council which is already in a growth area.

More generally, all Councils are involved in economic development activities – and often such activities require similar resources independent of the size of the Council. In particular, major efforts are made by regional Councils in general economic development, in many regional centre and regional urban councils in running aerodromes, and in many rural councils in running saleyards. In addition, expenditure on tourism related activities seems generally higher in non-metropolitan areas. In contrast, metropolitan Councils spend more on planning and health inspection activities.
It is therefore recommended that, in addition to the cost adjustors, a minimum population size of 15,000 is used for this category.

Roads
As noted above, there was general support for a move away from the Mulholland methodology to use more robust data from the recent Roads review. The proposal is to use the network road cost estimates from that review as the basis of the standardised expenditure.

Traffic and Street Management
This combines a range of previous expenditure functions, which used a variety of cost adjustors, including traffic density, age of infrastructure, population density, regional centres, scale, extent of built up area, and actual expenditure in the case of street lighting. While there may have been some good reasons for each, these adjustors have been the subject of some criticism in Council submissions over the years.

As these services relate primarily to built up areas, it is proposed that a standard cost be applied to the length of built up road in each Council area, with the cost adjustors being population density, and regional centres.

Waste Management

The VGC currently uses Council area and heavy traffic as cost adjustors, but with a control based on actual expenditure. The Issues and Options paper suggested (pp 46-7) there are problems with the control used, and this argument was broadly supported in submissions.

The two major cost impacts on standardised waste collection appear to be the extent of built-up areas (as fewer services are provided for rural residents) and dispersion – reflecting the distance between waste pick-ups.

Other Infrastructure Services

This would include areas such as drainage, and environment protection. Environmental issues vary widely across Victoria – from salination to beach renourishment to stream rehabilitation. As a number of submissions noted, the common thread is that Councils are being asked to do more in this area. The standard cost adjustors of scale and isolation/dispersion seem appropriate here – along with the proposed inclusion of a measure for fire risk.

4.4 Conclusions

9. The VGC should implement a simplified structure of expenditure categories, covering virtually all recurrent expenditure.

10. A revised set of cost adjustors should be used, reflecting the relative needs of Councils.

11. Standard costs should be calculated using mean rather than modal values, and a range for cost adjustors of 0.75 to 1.50 should be used.

12. The categories of Heritage, Culture and Recreation (as a single category), and Roads, should be kept in the calculations of General Purpose Grants.

13. Data from the recent Roads review should be used, in place of the Mulholland methodology, to provide a rigorous basis for updating the cost adjustors for roads.

14. The standardised expenditure approach should be used for sanitation.

5. Other Issues

5.1 Overview

A key goal underpinning many of the findings in this area was the desire to improve the simplicity of the system (subject to the overriding goal of fairness). This was supported by most councils:

> *"The focus on reducing the level of complexity inherent in the current grants allocation process is supported. Any move towards simplification of the system will enhance understanding of the system at individual Council level and reduce resourcing requirements to complete returns." (Moorabool)*

The issue of the 'fairness' of grants is always going to be a complex one. Appendix D of the Issues and Options Paper described the pattern of grants across Victoria. It outlined the gap between Councils' required expenditure and income sources, and suggested that while the grants process significantly ameliorates the disparities, some residual disparities remain – especially for small rural councils. The Paper then considered some suggestions for further assistance for such councils – but found none that were demonstrable improvements on the current system. This issue also raised considerable interest.

5.2 Findings and Responses

5.2.1 Smaller Councils

The findings of the Issues and Options Paper were:

19. While there are arguments that smaller rural councils should receive a 'fairer' share, these arguments are contested, and there is no clear method for resolving them. A number of suggested remedies would create anomalies in the grant system. In any case, different movements in property prices between Melbourne and non-metropolitan Victoria will continue to move grants towards non-metropolitan councils, and the question may not need attention until this process has worked through. (Section 4.5)

20. A scaling adjustment to raw grants has some attractions in terms of dealing with the absolute size of the funding gap. However, such a step is not preferred as the choice of the scaling parameters is arbitrary, and it would make the Grants process more complex and less transparent. (Section 4.6.1)

Horsham argued:

> *"the current review is the proper time for a method of compensating low population councils to be established. There is no doubt the increase in property prices in Melbourne and the relative stability of property prices non-metropolitan Victoria will significantly improve the grant outcomes for rural Victoria.*
>
> *"However, this is not a true answer to the issue of low population councils and a proper nexus between low population and some form of disability factor or other adjustment needs to be given attention. . . the matter cannot be deferred for a number of years.*
>
> *"The present proposal which is being considered is simply to treat councils as having a minimum population of 10,000. This has several flaws which have been identified in the paper. We believe that further efforts and thought should be given to developing a slightly more complex system which can smooth out the flaws that have already been identified.*

Towong drew attention to:

> *"One of the main factors which limits our Council's ability to act equally with other Councils is the issue of resources. . . Despite the small population, many activities are required to be undertaken irrespective of the Council's size, population or budget. In addition, these activities are still required to be managed or provided, even though the population is gradually declining. A declining population reduces the grant but not the basic work. The present methodology does not adequately address these problems."*

Appendix D of the Issues and Options Paper analysed the pattern of Grants across Victoria. The submission from Smaller Population Shires complimented that analysis

> *"First reading of this material is that it is a good analysis of the situation, which leads to a conclusion that smaller councils are being disadvantaged and deserve better grants. However, no such recommendations are made"*

and

> *"There clearly is a need for a redistribution of resources, and the Commission should be using the analysis in the Options Paper to justify action."*

This submission suggested two possible remedies:

- *A scaling of raw grants, to benefit councils below a population of 15,000, and/or*
- *A minimum population level of 20,000 for all expenditure assessments.*

As is perhaps to be expected, such arguments were not always supported by larger Councils:

> *"The proposal to artificially increase grants for smaller rural councils is not supported because this would cause anomalies in the grant system." (Bass Coast)*

Subsequent work on this issue is discussed below.

5.2.2 Single Expenditure Function

The findings of the Issues and Options Paper were:

14. A radically simple proposal, which uses just one expenditure function, is possible. However, there are a number of issues to be addressed, and while such a model would move towards the simplicity goal, it might not help with the transparency or fairness goals. (Section 4.3.4)

There was widespread support for Yarra Ranges' view:

> *"We would not support the concept of a single expenditure model as it cannot reflect the differences between councils. While we support simplifying the system we argue that in doing so the system should not become overly simplistic"*

Cardinia went further, contending that "this proposal would fall into the category of 'brave decision Minister'."

5.2.3 Capping

The findings of the Issues and Options Paper were:

21. The current capping controls on year-to-year movements in grants are well-regarded by councils. With the prospect of significant changes to the methodology coming from this review, it is desirable that such stability be maintained. However, it is also desirable to have some understanding of the road yet to be travelled to reach full horizontal fiscal equalisation. This understanding will help decide whether the current caps should be loosened in future years. (Section 4.6.2)

This provision was strongly supported by Councils

> *"We strongly support the retention of capping controls on changes to grants. This is particularly so for the short term when a change of methodology is implemented. Councils can adjust to changes over time but in the short term it is much more difficult to make the necessary resource adjustments."* (Brimbank)

However, some submissions suggested that there should be a sunset on the phasing in of any new system – so full Horizontal Fiscal Equalisation applies after, say, 5 years.

5.2.4 Natural Disasters

The findings of the Issues and Options Paper were:

22. The VGC assistance for natural disasters is a valued contribution to councils struggling to recover from unforeseen events. If the proposed 'other' expenditure function is adopted, it may be possible over time to develop a mechanism within that function to deal with natural disasters. It is however important that this safety net continue to exist in the interim. (Section 4.7.1)

Councils generally supported this finding.

5.2.5 Data Return

The findings of the Issues and Options Paper were:

24. Following finalisation of the Final Report from this review, it is recommended that the annual data questionnaire be thoroughly reassessed to simplify the process for councils, while still collecting the key data required for the VGC. (Section 4.7.3)

Wellington:

> *"The completion of the annual data return needs to be simplified, ensuring that all functions are clearly defined [and] hopefully eliminating the perceived problems of inconsistent and inappropriate data from Councils."*

Yarra Ranges

> *"We support, in principle, the recommendation to simplify the VGC's data collection processes. However we would not support this if it results in a more simplistic data set and model that does not adequately reflect and cater for the differences between councils"*

Looking forward, LGPro argued:

> *"The Board supports the efforts made by the Commission in reviewing its methodology and researching alternative options. Because of the importance of the Grants Commission allocations and funding support to Council operations, it would be desirable that research at this level be continually undertaken and become more issue specific as determined by the Commission when formulating its annual work plan. To this end, the Board believes that it would be desirable for the Commission to be provided with additional resources by the Government to undertake such a work program"*

5.3 Subsequent Analysis

With the exception of the issue of assistance for smaller Councils, there was general agreement on the suggestions in this area. As a consequence, no further analysis was considered necessary for the other issues.

A number of submissions commented on the revision of the data return. These will be considered in that revision, which will occur in the months following the completion of this report.

The one area where there are still outstanding issues is that of whether small rural Councils should receive additional support – and, if so, how.

The analysis in Appendix D of the Issues and Options Paper indicated that rural agricultural councils have the largest funding gap per head – measured in terms of standardised expenditure and standardised revenues.

As noted above, the submission from the Smaller Population Shires noted this analysis, but expressed concern that no recommendations followed from it. The submission suggested two possible remedies:

- A scaling of raw grants, to benefit councils below a population of 15,000, and/or
- A minimum population level of 20,000 for all expenditure assessments.

A differential scaling of raw grants was considered in the Issues and Options Paper (p 51):

> *"Rather than a standard scaling such as the 0.24 which applied in 1999-2000, the scaling could vary, depending on the size of each Council's Raw grant per head. Thus, for Councils with low raw grants per head, the scaling could be say 0.21, increasing to say 0.42 at the top of range. . . . However, such a step is not preferred as the choice of the scaling parameters is arbitrary, and it would make the Grants process more complex and less transparent."*

While it supported the differential scaling option, the Smaller Population Shires submission did not suggest mechanisms for addressing these arbitrary and complexity concerns.

Further analysis has indicated that Grant results are indeed very sensitive to the scaling chosen – for example, if a range from 0.22 to 0.33 (a 1:1.5 range) were chosen rather than 0.21 to 0.42 (a 1:2.0 range). There is no transparent way of deciding which of these (or, indeed, some other range) should be used.

The second suggestion, of using a minimum population size for all expenditure, was also discussed in the Issues and Options Paper (drawing on previous VGC and MAV work). Modeling of results indicated that this would create strongly differential effects, assisting some Councils but doing little for others.

While these suggestions therefore face problems, the central point made by the submissions from the Smaller Population Shires and others, such as Horsham, is still strong. The analysis of Appendix D does indicate that there is a substantial funding gap for such Councils, and some remedies for this should be considered.

A number of submissions from smaller Councils drew attention to the difficulties posed for services from small scale and dispersed populations. The Issues and Options Paper suggested that such factors could be tackled through use of cost adjustors for scale and isolation/dispersion, and this was considered in more detail in section 4.

In addition to this approach, further analysis has indicated two areas in particular where Councils face similar costs, regardless of population size. These are:

- Governance, where all Councils have to support Council meetings, and assist councillors carry out their functions on behalf of constituents; and
- Business and Economic services, where there is also a significant 'flag fall' in establishing a economic development function – a function that is of major importance in encouraging the economic and social development of regional Victoria in particular.

This Report therefore considered further in section 4 appropriate mechanisms for dealing with these two expenditure areas.

5.4 Conclusions

15. In view of the importance of both governance and economic development, especially for smaller rural councils, the VGC should adopt a minimum population size in calculating expenditure for these functions.

16. The VGC should not implement a single equation model for expenditure assessment.

17. A suitable transition process should be used in implementing the revised formula.

18. The VGC assistance for natural disasters should continue.

19. The annual data questionnaire should be thoroughly reassessed to simplify the process for councils, while still collecting the key data required for the VGC and other bodies, such as the Australian Bureau of Statistics.

6. Where to from Here?

This report has summarised Council responses to the Issues and Options Paper, and has provided additional analysis where required. From this process, it has made a series of conclusions for the future operation of the allocation of General Purpose Grants in Victoria.

The Victoria Grants Commission has adopted these conclusions, and will use them for the allocation of Grants from the 2002-03 financial year onwards.

Following this report, the next step is to finalise the Data Return. It is proposed that this will occur in the next two months.

As has been discussed throughout this report, the fine tuning of the grant system will continue. The Commonwealth Grants Commission's final report will be published in mid-year, and that may occasion some further adjustments to the system. In addition, the VGC will continue its process of discussions with Councils, and the annual opportunity for Councils to present submissions.

Appendices

APPENDIX A: Summary of Council Responses

Finding Number 1

The ideal grants system would be one that:

- **Meets the National Principles set out in the Commonwealth Act and the Commonwealth / State agreement**
- **Achieves the most important goal of fairness; and**
- **Also achieves the other goals which are seen as important by councils: predictability, responsiveness, transparency and stability. (Section 3)**

Agree	*Disagree*	*More info required*
General support	Baw Baw - *output based*	
Eastern Region Councils (ERC)	Nillumbik - *output based*	
Smaller Population Councils (SPC)	Swan Hill - *4 key criteria*	
LGPro		
MAV		
VLGA		

Finding Number 2

In the interests of achieving the goal of fairness, and meeting the National Principle of Horizontal Fiscal Equalisation, the grants allocation process needs to consider both the needs faced by councils, and their capacity to raise revenue. As there is no agreed standard methodology to do this, the goal of transparency suggests Victoria should stay with the existing current balanced budget approach which councils are familiar with. (Section 4.1.1)

Agree	*Disagree*	*More info required*
Cardinia		
Corangamite		
Horsham		
LGPRO		
VLGA		

Finding Number 3

While infrastructure and other capital issues are clearly a high priority for local government, there are substantial methodological issues involved in attempting to include capital in the General Purpose Grants process. It is therefore recommended that the VGC's current process, of excluding capital items, should continue. (Section 4.1.2)

Agree	*Disagree*	*More info required*
ERC	Kingston	Cardinia - *should recognise capital somewhere*
SPC	Nillumbik	Greater Geelong
Bass Coast	Warrnambool - *roads*	
Corangamite		
Horsham		
Swan Hill		
LGPRO		
LGA– *but include eventually*		

Finding Number 4

It is clear that revenue capacity does differ between councils, and some effective way of measuring this is needed. While arguments from critics make good points, the most effective (albeit not perfect) way of capturing such differences is to use a standardised valuation approach. (Section 4.2.2)

Agree	***Disagree***	***More info required***
Bass Coast	ERC – *various issues*	MAV
Cardinia	Moonee Valley	
Colac Otway	Nillumbik	
Horsham	Warrnambool	
Loddon		
Mitchell		
Swan Hill		
Yarra Ranges		
LGPro		
LGA		

Finding Number 5

The continued use of NAV as the valuation base is advocated: NAV incorporates both a wealth and an income component, and a shift to CIV would favour councils with strong commercial and industrial property bases. (Section 4.2.5)

Agree	***Disagree***	***More info required***
ERC	Baw Baw	
SPC	Kingston	
Bass Coast		
Colac Otway		
Corangamite		
East Gippsland		
Horsham		
Loddon		
Maribyrnong		
Mitchell		
Moonee Valley		
Swan Hill		
Whittlesea		
Yarra Ranges		
LGPRO		
LGA		

Finding Number 6

The move to more frequent revaluations could allow valuations to be averaged over two years rather than the current three. (Section 4.2.5)

Agree	***Disagree***	***More info required***
Corangamite	Baw Baw	
Horsham	Kingston	
Mitchell		
Swan Hill		
Yarra Ranges		
LGPRO		

Finding Number 7

The most appropriate way to adjust Council rate bases for any payments in lieu of rates appears to be a simple addition to the standardised revenue. (Section 4.2.5)

Agree	***Disagree***	***More info required***
Loddon		
Mitchell		
Swan Hill		
Yarra Ranges		

Finding Number 8

The continued treatment of other Government grants through discount factors on the expenditure side (ie the inclusion approach) is supported. (Section 4.2.6)

Agree	*Disagree*	*More info required*
SPC		
Cardinia		
Moonee Valley		
Swan Hill		
LGPRO		

Finding Number 9

An average discount factor for all councils is strongly preferred, rather than the current use of individual council discount factors. If this is done, the discounting system would not rely on the individual (and variable) data from councils. A number of current inappropriate effects would not occur. In addition, the complexity of the system would be reduced significantly. (Section 4.2.6)

Agree	*Disagree*	*More info required*
Horsham	ERC - *several reasons*	East Gippsland
Loddon	SPC	MAV- *concern re equity*
Maribyrnong	Wellington	
Mitchell	LGPRO – *consider 3 yr av*.	
Moonee Valley		
Swan Hill		
Whittlesea		

Finding Number 10

Parking revenues should be considered in revenue assessment. However, there are some important implementation issues to be addressed. (Section 4.2.7)

Agree	*Disagree*	*More info required*
Bass Coast	ERC	
Colac Otway	E.Gippsland	
Loddon	*– against effort neutrality*	
Mitchell - *but don't average*	Greater Geelong	
Nillumbik	Horsham –*as E. Gippsland*	
Whittlesea -*but don't average*	Maribyrnong-*as E Gippsland*	
Yarra Ranges	Moonee Valley	
MAV	Swan Hill	
	LGPRO	

Finding Number 11

The complexity and variability of other revenue sources militates against including them in standardised revenue assessment. As their contribution to total revenue is relatively small, their inclusion would increase the system's complexity without greatly improving its performance. (Section 4.2.8)

Agree	*Disagree*	*More info required*
Corangamite	Nillumbik	
Horsham	*– all revenue is important*	
Loddon		
Mitchell		
Swan Hill		
Whittlesea		

Finding Number 12

The number (20) of expenditure functions contributes to the complexity of the system, while many do not actually make much difference to grants outcomes. A simplified number of eight functions (including a discrete 'other' expenditure function) has advantages, while still reflecting the diversity of local government activities. (Section 4.3.3)

Agree	***Disagree***	***More info required***
Cardinia	ERC	Nillumbik - *functions should reflect main LG issue*s
East Gippsland	Baw Baw – *use ABS*	Warnambool -*reflect capacity*
Greater Geelong	Corangamite - *need complex council activities captured*	MAV- *spell out "other" category*
Loddon	Horsham	
Maribynong	Indigo	
Mitchell		
Moonee Valley		
Swan Hill – *but prefer (F1).*		
Whittlesea		
Yarra Ranges		
LGPRO		

Finding Number 13

There are strong arguments for continuing to treat Heritage Culture and Recreation as one expenditure function, and also for keeping the roads functions in the calculations of General Purpose Grants. (Section 4.3.3)

Agree	***Disagree***	***More info required***
East Gippsland		
Greater Geelong		
Horsham		
Maribyrnong		
Mitchell		
Swan Hill		
Whittlesea		

Finding Number 14

A radically simple proposal, which uses just one expenditure function, is possible. However, there are a number of issues to be addressed, and while such a model would move towards the simplicity goal, it might not help with the transparency or fairness goals. (Section 4.3.4)

Agree*(with single equation)*	***Disagree***	***More info required***
Swan Hill	Bass Coast	
	Cardinia	
	Horsham	
	Mitchell	
	Whittlesea	

Finding Number 15

The use of cost adjustors is a common method for distinguishing between councils in assessing needs. Both the Commonwealth and other States use a range of measures - of which a few receive extensive usage. A small number of measures is preferred, concentrating on the most commonly used variables. (Sections 4.4.2 and 4.4.3)

Agree	***Disagree***	***More info required***
Cardinia	ERC – *5 concerns, incl SEIFA, indices, duplication*.	LGPRO – *need more detail on each cost adjustor*.
Corangamite	SPC – *several concerns: SEIFA, indices, two times upper limit, dispersion, metro*	
Greater Geelong	Baw Baw	
Indigo	Horsham	
Loddon	Maribyrnong	
Moonee Valley	Mitchell – *prefer status quo*	
Swan Hill	Nillumbik	
Towong	Warrnambool	
MAV	Wellington	
	Whittlesea	
	Yarra Ranges	

Finding Number 16

The continued use of ranges to measure cost adjustors is favoured. However, ranges between 0.75 and 1.50 may be preferable to the current 1.00 to 2.00 ranges, especially if the VGC calculates standard costs using means rather than modal values. (Section 4.4.4)

Agree	***Disagree***	***More info required***
SPC	Nillumbik – *use actual costs*	MAV- *need clarification*
Mitchell		
Moonee Valley		
Swan Hill		
Whittlesea *– support but prefer status quo*		
Yarra Ranges		

Finding Number 17

Some inconsistencies are apparent in the use of the Mulholland methodology, both through changes in local government operations and through clear differences in interpretation between councils. It is recommended that data from the recent Roads review is used, in place of the Mulholland methodology, to provide a rigorous basis for updating the cost adjustors for roads. (Section 4.4.5)

Agree	***Disagree***	***More info required***
SPC	ERC	ERC & SPC *– clarification of calculation*
Cardinia	Indigo	Swan Hill
Mitchell		
Nillumbik		
Towong		
Yarra Ranges		

Finding Number 18

There are advantages in using the usual standardised expenditure approach for sanitation - both on consistency and effort neutrality grounds. The issue of externally mandated costs - such as meeting EPA requirements - could be dealt with by recognising such costs in the proposed 'other' expenditure function. (Section 4.4.6)

Agree	***Disagree***	***More info required***
East Gippsland	Moonee Valley	
Horsham	Nillumbik	
Mitchell		
Swan Hill		
Yarra Ranges		

Finding Number 19

While there are arguments that smaller rural councils should receive a 'fairer' share, these arguments are contested, and there is no clear method for resolving them. A number of suggested remedies would create anomalies in the grant system. In any case, different movements in property prices between Melbourne and non-metropolitan Victoria will continue to move grants towards non-metropolitan councils, and the question may not need attention until this process has worked through. (Section 4.5)

Agree	***Disagree***	***More info required***
Bass Coast	SPC *(min 20,000)*	Yarra Ranges
Cardinia	Colac Otway	MAV
East Gippsland	Horsham	
Mitchell	Indigo *(min 20,000)*	
Nillumbik	Loddon	
Swan Hill	Towong *(min 20,000)*	
	Jeanette Powell MLC (")	
	Barry Steggal MP	

Finding Number 20

A scaling adjustment to raw grants has some attractions in terms of dealing with the absolute size of the funding gap. However, such a step is not preferred as the choice of the scaling parameters is arbitrary, and it would make the Grants process more complex and less transparent. (Section 4.6.1)

Agree	***Disagree***	***More info required***
Cardinia	SPC *(<15,000)*	
East Gippsland		
Horsham		
Mitchell		
Swan Hill		
Yarra Ranges		
MAV		

Finding Number 21

The current capping controls on year-to-year movements in grants are well-regarded by councils. With the prospect of significant changes to the methodology coming from this review, it is desirable that such stability be maintained. However, it is also desirable to have some understanding of the road yet to be travelled to reach full horizontal fiscal equalisation. This understanding will help decide whether the current caps should be loosened in future years. (Section 4.6.2)

Agree	***Disagree***	***More info required***
ERC	East Gippsland	
SPC	Nillumbik *(reduced range)*	
Cardinia		
Cape Otway		
Corangamite		
Horsham		
Mitchell		
Mooney Valley *(short transition)*		
Swan Hill		
Whittlesea *(3 yr transition)*		
Yarra Ranges		
LGPRO *(5yr max transition)*		
MAV		
LGA *(5yr max transition)*		

Finding Number 22

The VGC assistance for natural disasters is a valued contribution to councils **struggling to recover from unforseen events. If the proposed 'other' expenditure function is adopted, it may be possible over time to develop a mechanism within that function to deal with natural disasters. It is however important that this safety net continue to exist in the interim. (Section 4.7.1)**

Agree	***Disagree***	***More info required***
Horsham	Swan Hill	
Mitchell		
Nillumbik		
Whittlesea		
Yarra Ranges		
MAV		

Finding Number 23

The proposed structure of expenditure functions includes a specific function for services to businesses, which would help recognise the important role councils play in encouraging economic development. It is not easy to see, within the current framework, how the VGC could provide additional resources - or indeed if it should. This is an issue which will clearly benefit from further consideration by councils and the VGC. (Section 4.7.2)

Agree	***Disagree***	***More info required***
Corangamite	Horsham – *against HFE*	East Gippsland
Greater Geelong *– weight regional centers*	Mitchell	
Maribyrnong	Swan Hill – *effort neutrality*	
Nillumbik		
Yarra Ranges		

Finding Number 24

Following finalisation of the Final Report from this review, it is recommended that the annual data questionnaire be thoroughly reassessed to simplify the process for councils, while still collecting the key data required for the VGC. (Section 4.7.3)

Agree	***Disagree***	***More info required***

APPENDIX B: Workshops & Submissions

The Issues and Options Paper was released in mid October, and the VGC subsequently held seven regional seminars in November 2000 to outline the Paper and hear Councils' comments. The seminars were:

Venue	*Date*	*Council Representatives*
Ringwood	8 November	18
Bendigo	9 November	17
Wangaratta	16 November	22
Broadmeadows	20 November	27
Port Fairy	21 November	9
Horsham	22 November	16
Warragul	23 November	14

Following these workshops, Councils prepared submissions to the VGC on the review.

List of Submissions Received

Councils – Group Submissions
Group Submission – Eastern Region Councils
Group Submission – Smaller Population Shires

Councils – Individual Submissions
Ararat Rural City Council
Bass Coast Shire Council
Baw Baw Shire Council
Brimbank City Council
Cardinia Shire Council
Colac Otway Shire Council
Corangamite Shire Council
East Gippsland Shire Council
Greater Geelong City Council
Horsham Rural City Council
Indigo Shire Council
Kingston City Council
Loddon Shire Council
Maribyrnong City Council
Mitchell Shire Council
Moonee Valley City Council
Moorabool Shire Council
Nillumbik Shire Council
Swan Hill Rural City Council
Towong Shire Council
Warrnambool City Council
Wellington Shire Council
Whittlesea City Council
Yarra Ranges Shire Council

Peak Associations
Community and Social Planners Network
Local Government Professionals
Municipal Association of Victoria
Victorian Local Governance Association

Members of Parliament
The Hon. Jeanette Powell, MLC
Mr Barry Steggall, MLA

APPENDIX C: ROADS SPENDING AND FUNDING

Council	Roads - adj km	Expend per km	Funding per km	Discount factor	Council	Roads - adj km	Expend per km	Funding per km	Discount factor
NORTHERN GRAMPIANS(S)	926	$1,915	$1,373	0.28	HORSHAM(RC)	924	$3,820	$1,018	0.73
MACEDON RANGES(S)	793	$2,497	$1,699	0.32	WODONGA(RC)	316	$8,564	$2,255	0.74
GANNAWARRA(S)	595	$2,657	$1,570	0.41	MURRINDINDI(S)	432	$7,233	$1,887	0.74
MOIRA(S)	1,154	$2,457	$1,405	0.43	WELLINGTON(S)	1,411	$5,980	$1,535	0.74
HEPBURN(S)	618	$2,389	$1,314	0.45	SOUTH GIPPSLAND(S)	1,276	$5,136	$1,291	0.75
ARARAT(RC)	787	$2,289	$1,230	0.46	CORANGAMITE(S)	967	$4,839	$1,203	0.75
MOORABOOL(S)	849	$2,534	$1,293	0.49	MITCHELL(S)	562	$7,663	$1,891	0.75
LODDON(S)	1,173	$2,622	$1,276	0.51	BOROONDARA(C)	568	$6,072	$1,493	0.75
MORNINGTON PENINSULA(S)	1,229	$5,275	$2,469	0.53	EAST GIPPSLAND(S)	1,135	$7,999	$1,947	0.76
MOUNT ALEXANDER(S)	567	$3,389	$1,581	0.53	LATROBE(C)	876	$8,531	$2,068	0.76
CENTRAL GOLDFIELDS(S)	560	$2,845	$1,316	0.54	GREATER GEELONG(C)	1,528	$7,922	$1,841	0.77
SOUTHERN GRAMPIANS(S)	1,760	$1,829	$840	0.54	GREATER BENDIGO(C)	1,312	$7,745	$1,800	0.77
WANGARATTA(RC)	739	$3,678	$1,661	0.55	NILLUMBIK(S)	328	$9,194	$1,972	0.79
STRATHBOGIE(S)	846	$2,738	$1,219	0.55	GLENELG(S)	1,248	$5,512	$1,134	0.79
BULOKE(S)	1,155	$2,198	$967	0.56	CARDINIA(S)	357	$18,144	$3,480	0.81
INDIGO(S)	526	$3,762	$1,616	0.57	CASEY(C)	779	$9,267	$1,544	0.83
TOWONG(S)	475	$2,942	$1,247	0.58	WHITTLESEA(C)	514	$9,772	$1,590	0.84
WARRNAMBOOL(C)	255	$5,444	$2,231	0.59	QUEENSCLIFFE(B)	39	$14,822	$2,376	0.84
GOLDEN PLAINS(S)	945	$2,718	$1,066	0.61	GREATER SHEPPARTON(C)	1,104	$10,473	$1,645	0.84
COLAC-OTWAY(S)	693	$4,269	$1,601	0.62	GLEN EIRA(C)	425	$10,261	$1,515	0.85
SWAN HILL(RC)	924	$2,827	$1,004	0.64	KINGSTON(C)	533	$10,216	$1,491	0.85
HUME(C)	731	$3,991	$1,415	0.65	MOONEE VALLEY(C)	433	$10,342	$1,499	0.86
FRANKSTON(C)	523	$4,277	$1,485	0.65	BANYULE(C)	544	$10,237	$1,462	0.86
BASS COAST(S)	545	$4,911	$1,613	0.67	MAROONDAH(C)	459	$10,133	$1,410	0.86
PYRENEES(S)	802	$3,495	$1,146	0.67	MELTON(S)	350	$11,580	$1,578	0.86
SURF COAST(S)	534	$4,624	$1,513	0.67	BAYSIDE(C)	345	$11,217	$1,487	0.87
MONASH(C)	647	$4,586	$1,467	0.68	MANNINGHAM(C)	561	$12,165	$1,409	0.88
GREATER DANDENONG(C)	555	$4,731	$1,512	0.68	DAREBIN(C)	488	$13,590	$1,496	0.89
MILDURA(RC)	1,130	$4,857	$1,549	0.68	HOBSON'S BAY(C)	441	$12,802	$1,402	0.89
HINDMARSH(S)	620	$3,224	$1,017	0.68	BRIMBANK(C)	723	$14,758	$1,444	0.90
BALLARAT(C)	937	$5,684	$1,755	0.69	MORELAND(C)	505	$17,275	$1,521	0.91
ALPINE(S)	293	$6,130	$1,876	0.69	KNOX(C)	626	$17,990	$1,463	0.92
YARRA RANGES(S)	946	$7,524	$2,283	0.70	WHITEHORSE(C)	589	$20,345	$1,474	0.93
YARRIAMBIACK(S)	888	$3,596	$1,057	0.71	WYNDHAM(C)	564	$23,214	$1,396	0.94
MOYNE(S)	1,753	$3,009	$876	0.71	MARIBYRNONG(C)	255	$27,078	$1,540	0.94
WEST WIMMERA(S)	927	$3,191	$917	0.71	MELBOURNE(C)	202	$29,792	$1,653	0.94
CAMPASPE(S)	1,258	$5,134	$1,455	0.72	PORT PHILLIP(C)	205	$31,613	$1,735	0.95
DELATITE(S)	794	$5,162	$1,431	0.72	STONNINGTON(C)	257	$31,518	$1,644	0.95
BAW BAW(S)	805	$7,050	$1,939	0.72	YARRA (C)	217	$49,712	$1,641	0.97

APPENDIX D: Aged Services: Expenditure and Income

Council	No people aged >60	Expend per head	Grants per head	Fees per head	Discount factor	Council	No people aged >60	Expend per head	Grants per head	Fees per head	Discount factor
WODONGA(RC)	3,433	657	678	74	-0.03	YARRIAMBIACK(S)	2,214	334	169	71	0.49
CENTRAL GOLDFIELDS(S)	3,047	292	227	63	0.22	MACEDON RANGES(S)	4,145	440	218	49	0.50
MURRINDINDI(S)	2,227	257	186	85	0.27	STRATHBOGIE(S)	2,258	774	365	245	0.53
WANGARATTA(RC)	4,932	377	262	86	0.30	WHITTLESEA(C)	10,591	208	97	24	0.53
HEPBURN(S)	2,791	308	214	54	0.31	ARARAT(RC)	2,347	245	114	104	0.54
SWAN HILL(RC)	3,706	321	221	62	0.31	MOONEE VALLEY(C)	20,022	264	122	53	0.54
MONASH(C)	29,104	314	214	94	0.32	BALLARAT(C)	13,476	379	172	122	0.55
SURF COAST(S)	3,099	266	178	122	0.33	KINGSTON(C)	24,895	322	146	103	0.55
MOORABOOL(S)	2,916	343	229	83	0.33	CAMPASPE(S)	6,620	361	162	76	0.55
GREATER SHEPPARTON(C)	8,452	231	150	58	0.35	GREATER DANDENONG(C)	19,388	357	156	58	0.56
KNOX(C)	15,172	160	103	34	0.35	YARRA RANGES(S)	15,622	389	169	39	0.56
SOUTHERN GRAMPIANS(S)	3,528	366	236	103	0.36	QUEENSCLIFFE(B)	1,076	413	179	77	0.57
FRANKSTON(C)	16,380	184	117	58	0.36	CASEY(C)	13,827	150	65	33	0.57
GLENELG(S)	3,460	336	208	109	0.38	DELATITE(S)	3,518	360	155	83	0.57
GOLDEN PLAINS(S)	1,496	255	153	42	0.40	MOUNT ALEXANDER(S)	3,520	284	121	53	0.57
CORANGAMITE(S)	3,329	407	242	35	0.41	MAROONDAH(C)	13,815	356	151	42	0.57
WEST WIMMERA(S)	1,068	333	191	82	0.43	MORNINGTON PENINSULA(S)	26,652	216	92	34	0.58
BULOKE(S)	1,748	309	177	96	0.43	MELBOURNE(C)	6,362	401	170	28	0.58
LODDON(S)	2,067	343	196	78	0.43	PYRENEES(S)	1,373	389	161	56	0.59
GANNAWARRA(S)	2,487	343	195	90	0.43	GREATER GEELONG(C)	34,058	355	142	61	0.60
NORTHERN GRAMPIANS(S)	2,630	233	132	80	0.43	SOUTH GIPPSLAND(S)	4,641	378	150	78	0.60
MOIRA(S)	5,507	170	96	49	0.44	GREATER BENDIGO(C)	14,851	431	170	68	0.61
LATROBE(C)	9,867	245	136	64	0.44	MITCHELL(S)	2,979	277	109	38	0.61
MELTON(S)	2,904	756	415	88	0.45	YARRA (C)	9,394	467	180	47	0.61
MANNINGHAM(C)	16,906	213	115	32	0.46	BASS COAST(S)	6,060	307	115	72	0.63
HUME(C)	11,033	223	120	50	0.46	HOBSON'S BAY(C)	13,400	403	149	104	0.63
ALPINE(S)	1,619	409	219	168	0.46	BANYULE(C)	20,542	270	99	49	0.63
WARRNAMBOOL(C)	4,838	511	274	119	0.46	BRIMBANK(C)	17,715	483	173	40	0.64
INDIGO(S)	2,392	346	185	93	0.47	MORELAND(C)	28,280	308	108	49	0.65
GLEN EIRA(C)	26,441	383	204	119	0.47	HORSHAM(RC)	3,390	339	107	67	0.68
COLAC-OTWAY(S)	3,884	204	109	97	0.47	WYNDHAM(C)	6,201	542	170	108	0.69
BAW BAW(S)	5,379	261	138	67	0.47	MARIBYRNONG(C)	11,736	487	151	61	0.69
MOYNE(S)	2,826	348	184	68	0.47	MILDURA(RC)	8,593	415	125	62	0.70
WHITEHORSE(C)	29,596	337	177	83	0.47	DAREBIN(C)	25,950	391	112	57	0.71
NILLUMBIK(S)	4,228	248	129	38	0.48	PORT PHILLIP(C)	13,175	465	119	65	0.74
BOROONDARA(C)	30,779	170	88	47	0.48	WELLINGTON(S)	6,558	55	5	1	0.91
HINDMARSH(S)	1,666	287	148	148	0.48	EAST GIPPSLAND(S)	8,376	40	3	2	0.93
BAYSIDE(C)	19,652	207	106	62	0.49	CARDINIA(S)	5,172	68	3	0	0.95
STONNINGTON(C)	16,389	209	106	52	0.49	TOWONG(S)	1,234	48	0	0	1.00

APPENDIX E: Comparison of SEIFA Indices

This table compares each Council's index figures on two ABS indices:
- the Index of relative socio-economic disadvantage (IRSED, which is currently used by the VGC); and
- the Index of Economic Resources (which this Report prefers)

As shown in the averages, the Eco Resources index figures are generally lower than IRSED in rural, regional urban, and inner Melbourne Councils, and generally higher in other metropolitan Councils.

Averages

	Eco Res	IRSED	+ / -
Metropolitan Central	993	1008	-15
Metropolitan Developed	1052	1039	12
Metropolitan Fringe	1031	1022	9
Regional Centres	977	983	-5
Regional Urban	976	1001	-24
Rural Agricultural	962	997	-35

	IRSED	Eco Res	+ / -
BOROONDARA(C)	1134	1116	-18
DAREBIN(C)	944	953	8
HOBSON'S BAY(C)	980	1007	28
MARIBYRNONG(C)	888	916	28
MELBOURNE(C)	1035	972	-63
MOONEE VALLEY(C)	1012	1014	3
MORELAND(C)	958	966	8
PORT PHILLIP(C)	1043	971	-72
STONNINGTON(C)	1104	1064	-39
YARRA (C)	984	954	-30
BANYULE(C)	1059	1060	1
BAYSIDE(C)	1108	1112	3
BRIMBANK(C)	946	1001	55
FRANKSTON(C)	1005	1017	12
GLEN EIRA(C)	1073	1035	-38
GREATER DANDENONG(C)	921	965	44
KINGSTON(C)	1018	1027	9
KNOX(C)	1057	1074	18
MANNINGHAM(C)	1099	1136	37
MAROONDAH(C)	1059	1061	2
MONASH(C)	1056	1067	10
WHITEHORSE(C)	1073	1065	-7
BASS COAST(S)	965	942	-23
CARDINIA(S)	1028	1038	10
CASEY(C)	1017	1042	25
HUME(C)	976	1022	46
MELTON(S)	1009	1033	25
MORNINGTON PENINSULA(S)	1011	1017	6
NILLUMBIK(S)	1126	1139	13
SURF COAST(S)	1053	1000	-53
WHITTLESEA(C)	983	1023	40
WYNDHAM(C)	1025	1039	14
YARRA RANGES(S)	1047	1047	0
BALLARAT(C)	988	978	-10
GREATER BENDIGO(C)	990	974	-17
GREATER GEELONG(C)	988	992	4
LATROBE(C)	964	966	3

	IRSED	Eco Res	+ / -
BAW BAW(S)	1013	988	-24
CAMPASPE(S)	1000	972	-28
COLAC-OTWAY(S)	992	965	-26
DELATITE(S)	999	960	-39
EAST GIPPSLAND(S)	971	941	-31
GLENELG(S)	980	971	-8
GREATER SHEPPARTON(C)	982	970	-13
MACEDON RANGES(S)	1062	1054	-8
MILDURA(RC)	973	948	-25
MITCHELL(S)	996	995	-1
MOIRA(S)	990	968	-22
MOORABOOL(S)	1016	1012	-3
QUEENSCLIFFE(B)	1055	989	-66
SOUTH GIPPSLAND(S)	1014	979	-35
SWAN HILL(RC)	985	947	-37
WANGARATTA(RC)	1003	982	-21
WARRNAMBOOL(C)	992	963	-30
WELLINGTON(S)	998	972	-26
WODONGA(RC)	992	978	-15
ALPINE(S)	1008	946	-63
ARARAT(RC)	981	957	-24
BULOKE(S)	1017	951	-67
CENTRAL GOLDFIELDS(S)	928	939	12
CORANGAMITE(S)	1015	972	-42
GANNAWARRA(S)	999	965	-34
GOLDEN PLAINS(S)	1007	1008	0
HEPBURN(S)	973	949	-24
HINDMARSH(S)	989	962	-27
HORSHAM(RC)	1013	972	-42
INDIGO(S)	1033	998	-35
LODDON(S)	977	936	-40
MOUNT ALEXANDER(S)	971	964	-7
MOYNE(S)	1019	977	-42
MURRINDINDI(S)	1018	972	-46
NORTHERN GRAMPIANS(S)	995	964	-32
PYRENEES(S)	959	950	-9
SOUTHERN GRAMPIANS(S)	1011	961	-51
STRATHBOGIE(S)	969	938	-30
TOWONG(S)	1030	969	-62
WEST WIMMERA(S)	1008	957	-52
YARRIAMBIACK(S)	1018	958	-60

APPENDIX F: Components of Revised Expenditure Functions

Expenditure Function	Component Functions	Code Numbers	Component items	Total $'s 1998/99 (columns 1+2+4+5)	% of Total
1. Governance	**Council Operations**	**1055**	- Mayor, President, Councillor allowances, CEO salary and reimbursements for out-of-pocket expenses - travel, accommodation, meals, etc - conferences - elections - related insurance - maintenance of furniture and equipment in council chambers and reception areas - cleaning, lighting and heating of council chambers and reception areas - other NEI related to council chambers and reception areas	(Currently fully allocated)	(Currently fully allocated)
	Law Other	**1105**	- local laws and local laws enforcement, rangers - expenses & revenue (registrations & fines) associated with compliance of the Domestic (Feral and Nuisance) Animals Act 1994 - pounds - livestock control (straying livestock) - litter, shopping trolleys - other NEI	34,995,881	1.5
	Total			**34,995,881**	**1.5**
2. Family & Community Services	**Infants & Mothers**	**1110**	- maternal and child health centres - pre-school dental clinics - mothercraft nursing - other NEI	50,744,036	2.1
	Families & Children	**1135**	- play centres (without teachers) - creches & day nurseries (including day care centres) - home care (emergency housekeepers) - family planning - other NEI	130,456,878	5.4
	Preventative Services	**1115**	- immunisation - health inspections - health licences, fees & registrations - pediculosis, head lice - eradication of vermin and pests - other NEI	26,180,282	1.1
	Community Health	**1120**	- health clinics - community health centres - expenses & revenue associated with the compliance with Health Act 1958 and Food Act 1984 - grants and contributions made/received - advances for public purposes - other NEI	14,956,135	0.6
	Community Welfare	**1145**	- youth centres, activities - youth workers/advisers - migrant centres, services	44,154,149	1.8

Expenditure Function	Component Functions	Code Numbers	Component items	Total $'s 1998/99 (columns 1+2+4+5)	% of Total
			- refuges, drop-in centres, neighbourhood houses - welfare administration - grants and contributions made/received - advances for public purposes - other NEI (do NOT include Labour Market Program Funding)		
	Education	**1125**	- pre-school centres - kindergartens - play centres (teacher supervised) - education administration - school prizes, scholarships - grants and contributions made/received - advances for public purposes - other NEI	33,357,206	1.4
	Housing	**1130**	- staff residences - aged persons units/disabled persons units - other residences - aboriginal Housing - grants and contributions made/received - advances for public purposes - other NEI	7,724,747	0.3
	Total			**307,573,433**	**12.8**
3. Aged Services	**Aged & Disabled**	**1140**	- senior citizens - meals-on-wheels - home care senior citizens - home care disabled persons - home care handy man - aged persons hostels - adult/aged day care centres - other NEI	251,843,956	10.5
	Community Transport	**1147**	- Community buses	3,824,446	0.2
	Total			**255,668,402**	**10.7**
4. Recreation & Culture	**Public Halls**	**1200**	- public halls - community centres	30,049,309	1.3
	Libraries	**1205**	- contributions by municipal councils - regional libraries - local libraries - mobile libraries - other NEI	96,374,426	4.0
	Other Culture	**1210**	- museums - art galleries - theatres - historical projects (eg. restoration of statues and monuments) - performing art centres - National Estate program - orchestras, bands - grants and contributions made/received - advances for cultural purposes - other NEI	47,383,709	2.0

Expenditure Function	Component Functions	Code Numbers	Component items	Total $'s 1998/99 (columns 1+2+4+5)	% of Total
	Passive Recreation	**1250**	- parks, gardens, reserves - nature parks, zoos, fauna parks, flora parks - bicycle tracks through parks & gardens - pedestrian tracks through parks & gardens - plant nurseries - subdividers contributions - other NEI	178,780,187	7.4
	Active Recreation	**1255**	- sports complexes (indoor) - outdoor sporting complexes - golf courses - bowling greens - sporting clubs/sporting amenities - recreation officers	125,587,514	5.2
	Swimming Areas & Beaches	**1260**	- swimming pools (exclude sports complexes) - beach cleaning - other NEI	35,266,767	1.5
	Total			**513,441,912**	**21.4**
5. Waste Management	**Sanitation**	**1350**	- garbage rates and charges (exclude interest paid) - garbage collection for households etc, street bins - sale of garbags, garbage bins, compost bins - hard rubbish collection - green waste collection - tip - recycling - kerb side collection - recycling depot - sale of recycled material: eg compost, woodchips - transfer stations - other NEI	251,228,829	10.5
	Trade Waste Disposal	**1365**	- trade waste collection - trade waste disposal	1,814,532	0.1
	Total			**253,043,361**	**10.5**
6. Local Roads & Bridges	**local sealed, local formed & surfaced, local natural surface**	**1305**	- roads and bridges under the control of the municipal council (exclude private streets) - bicycle tracks by roadsides - expenditure on footpaths, kerb & channels and on-street parking areas even though the works undertaken formed an integral component of the road works. Expenditure on these should be shown under the appropriate headings. Where expenditure cannot be separately identified, it may be included under local roads and bridges.	234,017,944	9.8
	Total			**234,017,944**	**9.8**
7. Traffic & Street Management	**Footpaths**	**1310**	- include all expenditure on footpaths even if the works undertaken were an integral component of road works (refer Local Roads & Bridges) - exclude expenditure on footpaths that run through parks or gardens, this should be included under parks and gardens	24,855,130	1.0
	Kerb & Channel	**1315**	- include all expenditure on kerbs and channels even if the works undertaken were an integral component of road works (refer Local Roads & Bridges)	6,413,035	0.3

Expenditure Function	Component Functions	Code Numbers	Component items	Total $'s 1998/99 (columns 1+2+4+5)	% of Total
	Traffic Control	**1320**	- traffic supervision - traffic lights - safety fences, guide posts (exclude those within parking facilities) - road signs, street name signs, road lane markings - supervision of school crossings - traffic calming, eg. roundabouts, speed humps etc. - traffic surveys - traffic strategies	54,152,063	2.3
	Parking Fines	**1325**	- Fines for parking infringements	14,588,194	0.6
	Other Parking	**1330**	- off street car parking facilities - include all expenditure on on-street parking areas even if the works undertaken were an integral component of road works (refer Local Roads & Bridges) - safety fences, guide posts within parking facilities - contributions for car parking facilities - car parking supervision - car park permits, fees - cleaning of car parking facilities - multi-storeyed car parks - other NEI	28,137,031	1.2
	Street Beautification	**1340**	- street beautification - street furniture & bus shelters - other enhancements such as trees planted in the footpath, road sides and road reserves, bunting, fairy lights - other NEI	24,606,163	1.0
	Street Lighting	**1342**	- street lighting - payments to electricity providers	47,200,204	2.0
	Street Cleaning	**1355**	- street cleaning/sweeping, include expenditure on the cleaning of car parking facilities (on-street car parking or car parking adjacent a street) where the street sweeping plant is used. Refer Other Parking.	44,000,734	1.8
	Total			**243,952,554**	**10.2**
8. Other Infrastructure Services	**Fire Protection**	**1100**	- fire brigade training tracks - fire access tracks - fire plugs - eradication of fire hazards - authorised officers under the Country Fire Authority Act 1958 as amended - contributions to Metropolitan Fire Brigade, Country Fire Authority - - other NEI	20,141,969	0.8
	Plant Operating	**1344**	- This is an internal operating account. Refer Column "Plant & Equipment Hire".	29,247,292	1.2
	Other Transport	**1346**	- private streets - road openings - driveway crossings - ferries, marinas, piers & jetties - moorings - boat launching ramps - joint road works with other municipal councils/public bodies - other NEI	22,458,590	0.9
	Other Services	**1348**	- workshops and depots - weighbridges - non-road joint works with other municipal councils/public bodies	38,224,616	1.6

Expenditure Function	Component Functions	Code Numbers	Component items	Total $'s 1998/99 (columns 1+2+4+5)	% of Total
			- other NEI		
	Sewerage	**1360**	- pan services - septic tanks - effluent tanks - other NEI	280,575	0.0
	Environment Protection	**1370**	- flood mitigation - salinity control - beach restoration - foreshore protection - removal of derelict vehicles - noise abatement measures/noise attenuation barriers - other NEI	9,076,980	0.4
	Council Drainage	**1375**	- stormwater drainage (exclude rural drainage schemes) controlled by municipal council - retarding basins - flood control structures and equipment - weirs for controlling and storing runoff - improvement works to natural and artificial waterways	23,450,536	1.0
	Private/Other Drainage	**1380**	- stormwater drainage not controlled by municipal council	1,006,388	0.0
	Agricultural Services	**1385**	- sheep dipping - grazing fees - control of vermin and noxious weeds - rural drainage schemes - disposal of animal carcasses - other NEI	371,573	0.0
	Other	**1390**	- other NEI	6,287,298	0.3
	Other Unclassified	**1410**	- natural disaster relief - natural disaster restitution works - materials account surplus/deficit - contributions to other public bodies - other NEI	41,964,069	1.7
	Total			**192,509,886**	**8.0**
9. Business & Economic Services	**Labour Market Funding Program**	**1146**	- This relates to employment program funding such as Federal programs including Jobskills, Skillshare and New work opportunities.	807,590	0.0
	Community Development	**1150 (a)**	- town planning - urban renewal/rural renewal - subdivisions & sealing - regional economic & planning authorities - petrol pump licences & fees - other NEI	134,646,154	5.6
	Building Control	**1155**	- administration of building and scaffolding standards - building and scaffolding inspections - building and scaffolding fees - other NEI	30,536,816	1.3
	Tourism & Area	**1160**	- information centres, tourist bureaux	48,667,404	2.0

Expenditure Function	Component Functions	Code Numbers	Component items	Total $'s 1998/99 (columns 1+2+4+5)	% of Total
	Promotion		- tourist officers - caravan parks - camping grounds - foreshore reserves - other NEI		
	Community Amenities	**1165**	- public conveniences - rest centres - land for public open spaces - contributions to cemetery maintenance - grants and contributions made/received - advances for public purposes - other NEI	12,692,035	0.5
	Aerodromes	**1335**	- municipal council controlled aerodromes - municipal council contributions - aerodromes fees - Civil Aviation Safety Authority contributions and fees/charges - please record all aerodrome expenditure, even contributions contributions to aerodromes within another municipal boundary.	2,339,562	0.1
	Markets & Saleyards	**1395**	- costs and revenue associated with the operation of markets and saleyards in which the sale of livestock, rural produce and other goods is conducted	8,620,092	0.4
	Other Economic Affairs	**1397**	- other NEI	5,772,718	0.2
	Business Undertakings (Property)	**New (b)**	- industrial estates - commercial properties: eg. shops, office complexes - vacant land for agistment	n.a.	n.a.
	Business Undertakings (Other)	**1460** **1465**	- abattoirs - quarries - historical parks - other	35,575,961	1.5
	Total			**279,658,332**	**11.7**
TOTAL INCLUDED				**2,314,861,705**	**96.5**
EXCLUDED RECURRENT	**Main Roads**	**1300**	- roads & bridges under the control of VicRoads	**84,875,265**	**3.5**
	Total			**84,875,265**	**3.5**
TOTAL RECURRENT				**2,399,736,970**	**100.0**

** Assumes expenditure under code 1405 "Interest Other Than Rates" is fully allocated across relevant functions.*
(a) Industrial estates, commercial properties go to new code "Business Undertakings (Property)"
(b) Replaces Code 1455 "Business Undertakings (Gas)". Includes items currently under code 1150.

APPENDIX G: Changes to the DSE Equation

In its current review, the Commonwealth Grants Commission has expressed some concerns about the way the VGC utilises cost adjustors and discount factors in calculating DSE. This Appendix explains the CGC concern, and indicates the difference between the approaches.

For Council i, the current VGC approach for calculating DSE for expenditure function j is

$$DSE_{ij} = \textit{units of need}_i * \textit{standard unit cost}_j * \textit{discount factor}_{ij} * \textit{cost adjustor}_{ij}$$

Where

$$\textit{discount factor}_{ij} = \frac{(\textit{total expend}_{ij} - \textit{total grants}_{ij})}{\textit{total expend}_{ij}}$$

The CGC points out that this effectively means the VGC does not apply the cost adjustor to 100% of standardised expenditure. Rather, the cost adjustor is applied to standardised expenditure after the discount factor has been applied – and depending on the discount factor, this could mean that only a small proportion of standardised expenditure is adjusted.

This issue remains even after the VGC's decision to apply average discount factors to all expenditure functions. Now,

$$DSE_{ij} = \textit{units of need}_{ij} * \textit{standard unit cost}_j * \textit{discount factor}_j * \textit{cost adjustor}_{ij}$$

Where

$$\textit{discount factor}_j = \frac{(\textit{average expend}_j - \textit{average grants}_j)}{\textit{average expend}_j}$$

Still, the cost adjustor is only applied to a percentage of the standardised expenditure.

The CGC prefers a formula where

$$DSE_{ij} = \textit{units of need}_{ij} * \textit{standard unit cost}_j * \textit{cost adjustor}_{ij} - \textit{grants}_{ij}$$

Here, the expenditure is fully standardised, before grants are subtracted.

What is the difference between the two approaches?

The two approaches, both for an averaged approach, can be readily compared for DSE per unit of need:

$$\textbf{CGC:}\quad \frac{DSE_{ij}}{\text{units of need}_{ij}} = \text{unit cost}_j * \text{cost adjustor}_{ij} - \text{average grant}_j$$

$$\textbf{VGC:}\quad \frac{DSE_{ij}}{\text{units of need}_{ij}} = \text{unit cost}_j * \text{cost adjustor}_{ij} * \frac{(\text{average expend}_j - \text{average grant}_j)}{\text{average expend}_j}$$

But, in the VGC equation, the unit cost_j is effectively the same as the average expenditure_j. Therefore

$$\frac{DSE_{ij}}{\text{units of need}_{ij}} = \text{unit } \cancel{\text{cost}_j * \text{cost ad}}\text{justor}_{ij} * \frac{(\text{average expend}_j - \text{average grant}_j)}{\cancel{\text{average expend}_j}}$$

or

$$\frac{DSE_{ij}}{\text{units of need}_{ij}} = \text{cost adjustor}_{ij} * (\text{average expend}_j - \text{average grant}_j)$$

so

$$\frac{DSE_{ij}}{\text{units of need}_{ij}} = \text{cost adjustor}_{ij} * \text{average expend}_j - \text{cost adjustor}_{ij} * \text{average grant}_j$$

Which is very similar to the CGC formula

$$\frac{DSE_{ij}}{\text{units of need}_{ij}} = \text{unit cost}_j * \text{cost adjustor}_{ij} - \text{average grant}_j$$

Indeed, as unit cost and average expend are the same, the only difference between the two formulae is that the CGC subtracts the average grant, while the VGC subtracts the average grant multiplied by the cost adjustor.

Where the cost adjustor is 1.00 (ie at the bottom of the VGC's current range), there is no difference between these formulae. However, where the cost adjustor is 2.00 (the top of the VGC's current range), the VGC subtracts twice the amount that the CGC formulation does.

This means that the VGC approach effectively gives less impact for the cost adjustors, narrowing the differential between Councils.

It is recommended in section 3.3.4 above that the VGC should follow the CGC suggestion, and apply the cost adjustor to the entire expenditure.

APPENDIX H: The National Principles

The National Principles relating to allocation of general purpose grants payable under section 9 of the *Local Government (Financial Assistance) Act 1995* (the Act) among local governing bodies are as follows:

1. Horizontal Equalisation

General purpose grants will be allocated to local governing bodies, as far as practicable, on a full horizontal equalisation basis as defined by the Act. This is a basis that ensures that each local governing body in the State/Territory is able to function, by reasonable effort, at a standard not lower than the average standard of other local governing bodies in the State/Territory. It takes account of differences in the expenditure required by those local governing bodies in the performance of their functions and in the capacity of those local governing bodies to raise revenue.

2. Effort Neutrality

An effort or policy neutral approach will be used in assessing the expenditure requirements and revenue-raising capacity of each local governing body. This means as far as practicable, that policies of individual local governing bodies in terms of expenditure and revenue effort will not affect grant determination.

3. Minimum Grant

The minimum general purpose grant allocation for a local governing body in a year will be not less than the amount to which the local governing body would be entitled if 30 per cent of the total amount of general purpose grants to which the State/ Territory is entitled under section 9 of the Act in respect of the year were allocated among local governing bodies in the State/Territory on a per capita basis.

4. Other Grant Support

Other relevant grant support provided to local governing bodies to meet any of the expenditure needs assessed should be taken into account using an inclusion approach.

5. Aboriginal Peoples and Torres Strait Islanders

Financial assistance shall be allocated to councils in a way which recognises the needs of Aboriginal peoples and Torres Strait Islanders within their boundaries.

Source: *National Office of Local Government Annual Report 1998/99, Appendix A: National Principles for allocating General Purpose and Local Road Grants p 74*