

# Local Government Better Practice Guide

Revenue and Rating Plan

Book 1: Introduction

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The Local Government Better Practice Guide: Revenue and Rating Plans was compiled by a working group comprising:



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# Introduction to the Third Edition

The Local Government Revenue and Rating Plan Best Practice Guide 2022 (the Guide) has been developed by the Department of Government Services, the Municipal Association of Victoria, Revenue Management Association and FinPro. The Guide supports an integrated approach to developing their Revenue and Rating Plan<sup>1</sup> that considers each revenue components as a part of an overall financial structure.

Based on feedback from local governments and the recent review of the Victorian local government rating system, this edition guides the reader through all the building blocks of revenue and rating.

The new edition now offers sections for the public as well as councillors to assist in setting the course for how rates and other revenue will be raised to pay for services and infrastructure.

The Guide discusses all the major considerations in revenue and rating, methods for councils to take up an integrated approach and practical examples of how these may be applied. The Guide addresses technical and detailed aspects of revenue, rating, costing and pricing, and specific points of interest that councils may consider.

The emphasises of the third edition is:

- Revenue components of government grants, fees, charges, and rates should be considered in conjunction with each other;
- Knowing the full cost of council services is important when creating, setting, and reviewing user fees and charges; and
- Rating arrangements adopted by a council should address good taxation principles (which include equity, efficiency, simplicity, and sustainability).

## Ministerial Guidelines

Appendix One of this Guide incorporates *Ministerial Guidelines relating to payment of rates and charges* issued under section 181AA of the *Local Government Act 1989*.

## Ministerial Good Practice Guidelines

Appendix Two of this Guide incorporates *Ministerial Good Practice Guidelines for Service Rates and Charges* issued under section 87 of the *Local Government Act 2020*.

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<sup>1</sup> Section 93, *Local Government Act 2020*

## Revenue and Rating Plans

A Revenue and Rating Plan should provide clear explanations of all decisions made by a council in implementing their revenue and rating practices, including:

Clear links under the *Local Government Act 2020* to a Council's -

- Community Vision (Section 88);
- Strategic Planning Principles (Section 89);
- Council Plan (Section 90);
- Financial Plan (Section 91);
- Asset Plan (Section 92).

Adherence to requirements under the -

- Financial Management Principles (section 101); and
- Service Performance Principles (section 106).

And -

- Information on the rating framework employed by council and justification for the basis of the framework, including the rationale and objective behind these decisions; and
- Clear references to relevant council policies, such as waste services, pricing and cost recovery, financial hardship, advocacy, and service provision.

### What does Best Practice look like?

This Guide is not prescriptive. It does not dictate what optimal rating arrangements should be. It is not a requirement that councils levy rates and beyond the requirements of the legislation, the system affords significant flexibility for councils to levy rates in a wide range of ways. Best practice for the purposes of this Guide is:

Everyone involved in council revenue and rate setting fully understands the impacts of their decisions and can explain and justify them to the public.

## How to use this Guide

This edition of the Guide contains multiple sections:

Book 1: Introduction to the Guide

Book 2: Councillor Guide

Book 3: Council Employee Guide

Book 4: Public Guide

Appendix One: Ministerial Guidelines Relating to Payment of Rates and Charges

Appendix Two: Ministerial Good Practice Guidelines Relating to Service Rates and Charges

Appendix Three: Supporting Documents

Though the entirety of the Guide may be used by any reader, the following sections can be collated for specific audiences for more direct reference:

<b>Audience</b>	<b>Documents</b>
Councillors	Book 2: Councillor Guide Appendix Three: Supporting Documents
Council Employees	Book 3: Council Employee Guide Appendix One: Ministerial Guidelines Relating to Payment of Rates and Charges Appendix Two: Ministerial Good Practice Guidelines Relating to Service Rates and Charges Appendix Three: Supporting Documents
The Public	Book 4: Public Guide Appendix Three: Supporting Documents



## Spotlight On: The City of Pleasantville

This Guide provides examples of how the content can be applied. Where breakout boxes discuss content further, they will be applied to the 'City of Pleasantville', a fictional council in Victoria.

To give context to council decisions made for the City of Pleasantville, the following statistics<sup>2</sup> have been created:

Estimated Resident Population	100,000
Working Age Population (%)	65%
Children Enrolled in Preschool	1,800
Aged Pensioners	12,500
Number of Businesses	9,000
Number of Jobs	80,000
Wards & Councillors	3 wards with 3 councillors each

The City of Pleasantville is positioned in key freight, tourist and commuter transport routes and hosts manufacturing, tourism, health, education, government services and retailing industries.

Recently council elections resulted in four newly elected Councillors. All councillors have completed comprehensive Councillor Induction Training and are now required to develop a new Revenue and Rating Plan.

Rates and charges were a popular topic during the election. The previous Pleasantville Council had experienced criticism about its rates and the cost and provision of various council services.

This new Council immediately began a lengthy community engagement process, setting dedicated meetings with community members, providing surveys to the public and collating data on service use by ratepayers and their associated costs.



As you proceed through this Guide, 'Spotlight On' sections and breakout boxes will discuss some of the topics considered by the new council as well as the experiences of a local resident, Jenny who owns a property located in Flores Avenue, Pleasantville.

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<sup>2</sup> Several key statistics have been by selected from descriptions used in Region Summaries by the Australian Bureau of Statistics.

# Revenue and Rating in Local Government – An Overview

## Local Government Service Provision

A council's infrastructure and the services are essential to supporting healthy and resilient communities and businesses. An equally important factor is how these services are paid for.

A council's Annual Budget provides a public statement of priorities. The budget describes services that a council intends to provide, as well as what funds will be allocated to deliver them.

Regardless of the services provided, the revenue required to meet their costs is a basic requirement of council planning and decision making. Service decisions can be the result of community demand, identified need, legislative and regulatory requirements and historical decision making.

Two focus areas of a council's revenue are:

- The appropriate, desirable, and feasible cost of services (expenditure); and
- The appropriate mix of revenue required to pay for these services.

## A Brief History of Local Government Rates

The taxation of land for government revenue extends back to the early 16th century in England. The appeal of rates (as a type of land tax) is attributed to its close alignment with municipal government services which, among other things, directly influence the value of land.

Quality municipal services increase the value of land in their vicinity and revenue raised from the owners of this land contributes to paying for the services. The amount raised from each property (the 'rates') is primarily determined from each property's monetary value.

The taxation of land is administratively simple and transparent, as title and rating liability records are maintained and readily available. Furthermore, land, unlike many other financial assets, is also impossible to conceal. For these reasons, property-based taxation has great appeal for governments around the world and began to be used to fund councils in Victoria from the mid-19th century. In the early 21st century, property and land taxation for sub-national and municipal level government revenue is in widespread use in the developed world and is increasingly being applied in middle income countries.

## The Beginnings of Rating in Victoria

The Town Council of Melbourne was incorporated and empowered to levy rates on land in legislation passed in 1842. Other metropolitan councils were created in subsequent years.

Around the same time the Roads Act of 1854 made provision for establishing District Road Boards, which were empowered to levy tolls, along with rates on land to fund road construction. These district boards were precursors to regional shires.

Following these initial steps, Victorian councils' power to levy rates has been granted by Parliament and governed in Victoria through the Local Government Acts of 1874, 1903, 1910, 1958, and the current Local Government Acts of 1989 and 2020.

The fundamentals of the current rating arrangements are similar to those established in the 19th century. In the intervening period, several important changes have occurred in line with contemporary ideas about fair and equitable taxation and modern administrative practices.

## Key Changes to the Rating System since the 19<sup>th</sup> Century

The foundation of a property rating system is a system of property valuation which has developed over the past century in Victoria.

A rental return value (now known as Net Annual Value) was the common valuation base in Victoria for the late 19th and most of the 20th century, with site value also used. Before the 1989 Act, councils levied rates on either Site Value (SV), Net Annual Value (NAV) or a mixture known as the 'shandy' system.

The 1989 Act introduced a third option: Capital Improved Value (CIV), and, in the 1990s, most councils opted to move away from SV or NAV to CIV. CIV as a valuation system began to be used in Victoria in the 1960s as new technologies and records management allowed its collection. The 1989 Act gave councils powers to freely determine their own property categories under which differential rates could be levied if using the CIV base.

19th century ideas about taxation fairness shaped the rules for rates, typically setting a maximum ceiling rate that favoured large or highly valued land holdings by limiting the amount they would be liable for. A minimum rate also ensured that even the lowest value land would pay.

The 1958 Act included a minimum rate of 5 shillings per property and a maximum rate of four shillings in the pound of NAV. Upper and lower limits were also in place in earlier Acts. The minimum and maximum rate concepts were abolished by an amendment to the 1989 Act in 1996, given that the 1989 Act offered councils the option to raise a municipal (fixed) charge to cover some of its administrative costs. This however became optional, lessening the use of a fixed component in rates.

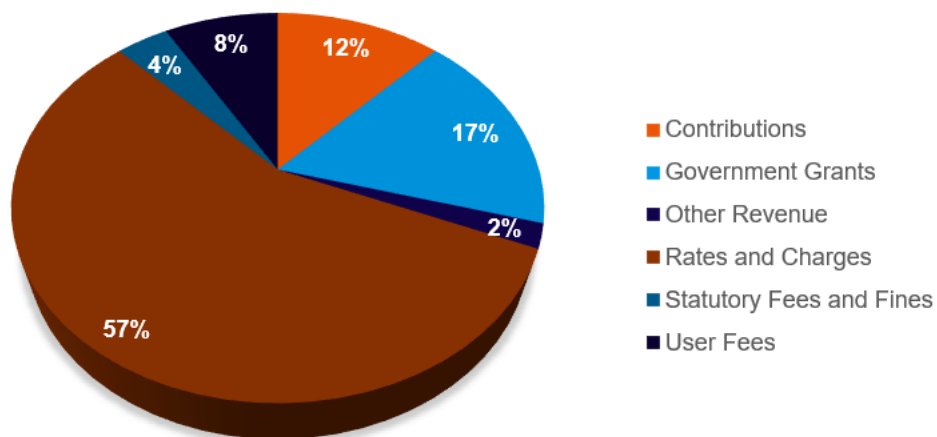
A rate capping system was briefly applied in the early 1990s when Victorian councils underwent amalgamation. In 2016-17, the current rate capping system was introduced and continues today.



Notwithstanding the rate cap, the current system affords councils significant flexibility to collect rates as they see fit. Municipal rates and charges on properties continue to provide the primary revenue source for all councils, accounting for \$7 billion and 56 per cent of total revenue for Victorian councils in 2022-23.

This revenue is supplemented by a wide range of other charges and user fees, along with government grants, notably the Commonwealth Government's Financial Assistance Grants to councils. The chart below shows all Victorian councils budgeted revenue sources for 2022-23.

## Local Government Budgeted Revenue 2022-23



## Council Rates: The Tax Base for Local Government

Council rates are a legally recognised form of property tax on the 'stored wealth' or unrealised capital gains,<sup>3</sup> inherent in land and buildings. Rates are a form of tax and no less legitimate than taxes levied by the Commonwealth or State Governments.

Rates are determined by the value of a ratepayer's property. They have no direct correlation to an individual ratepayer's income, consumption of services, or any perceived benefits derived from these services.<sup>4</sup>

As a type of wealth tax, it is also important to recognise that rates are not equivalent to income taxes, corporate taxes, or consumption taxes. A popular complaint heard is that *"...the rates I pay have no correlation with the services I use"* or *"...rates don't reflect my income and capacity to pay"*. While Councils may be tempted to consider rates in these ways, it is often leads to perverse outcomes and inequitable results in their communities.

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<sup>3</sup> The increase in the property's valuation which has yet to be sold.

<sup>4</sup> A comparable form of tax is the State Revenue Office's collection of Land Tax on behalf of the Victorian Government.

# Common Myths about Council Rates

## **Myth #1 – Councils automatically collect a windfall gain because of valuation increases**

**FACT:** The amount a council collects in rates in any year is determined by the council budget process – not property values. Under an *ad valorem* system (i.e., where the payable rate is proportionate to the value of the property) property values within a local government area determine the distribution of the rate burden across properties. Higher valued properties will tend to pay more in rates than lower valued properties in the same municipality.

## **Myth #2 – The valuation of properties in Victoria is decided by councils**

**FACT:** The annual valuation process is centrally managed by the Valuer-General of Victoria and independent of councils. Valuations are also subjected to audits. If you are dissatisfied with the valuation of your property on your rates notice, you may appeal the valuation by either contacting your council or through the Valuer-General Victoria's website.

## **Myth #3 – Councils enjoy revenue windfall from new properties created during the financial year**

**FACT:** New subdivisions create new assessments which are valued (outside of the annual valuation cycle) in a process called supplementary valuation. These new assessments generate new revenue, which then pays for the additional services required for the new properties and the people that live and work in them. The rate capping system takes this into account.

## **Myth #4 – Rates paid reflect the use or availability of council services consumed, not the value of the property**

**FACT:** Councils receive many applications by property owners to be considered for rate reductions, and a common ground for such applications is the claim that the owner does not benefit from council services to the same extent as other owners in the municipality, or some services may be difficult to access.

All ratepayers are required to contribute to the total pool of revenue, according to the value of their property. As with income tax, it would be practically impossible for specific individuals to be rated in accordance with the level of services which they use, or purport to use, at any given time, such as walking on a footpath or using a municipal bin in a park.

## Myth #5 – Individual rates automatically go up every year

**FACT:** The amount paid by individual properties is influenced by the relative movements of other property values in a local government area. Changes in property values will vary across a municipality according to many factors including sale of similar properties in the area and any improvements to the building(s) on the land.

A revaluation may result in the rates for some properties going up while others go down and rate capping directly effects the total amount that councils may collect from ratepayers.

## Myth #6 – Property valuation movements are uniform and can be addressed with differential rates

**FACT:** Individual property values shift up and down and movements can be highly localised. It is a common by councils to highlight movements (i.e., 'farm values have increased by x percent') as applying to a broad property category, when it is citing an average only.

This movement in average values – while a useful indicative measure – has serious implications for equity if councils adjust differential rates on the basis of the average valuation movement of a broad property category such as farm land, ostensibly to reduce perceived 'rates shock'.

Valuation data proves that individual property movements are highly localised and variable, thus making rating decisions on the basis of property category average valuation movements is at best a blunt instrument and almost certain to have erratic and inequitable effects.

# Property Valuations – Facts

Valuations provided to councils are determined by the Valuer-General Victoria who is responsible for the standards, quality and compliance of these valuations. The Valuer-General's responsibilities comprise:

- Setting and maintaining valuation standards and quality to protect the probity of government property transactions;
- Managing and auditing contract valuation panels for consistency and compliance with standards;
- Improving and monitoring standards of rating authority valuation practice and methodologies; and
- Auditing performance of municipal valuation contracts through the certification process<sup>5</sup> following the requirements of the *Valuation of Land Act 1960*.

Property sales and rental agreement data is used to determine values. Detailed information on recent sales such as land size, soil type and quality, aspect and position, building information, number of rooms, planning schemes and overlays and more is used to determine a property's value. In the case of leases, in most cases the amount in the rental contract itself determines the value.

Valuers use this information to estimate the value of a property that is similar and proximate to the recent sales. The sale of a four-bedroom house will influence the values of similar houses in the vicinity but may have little effect on the two bedroom units in nearby streets.

A commonly heard criticism of property valuations is that owners don't like the effect that a neighbouring sale has on their property in that it affects rates (and other taxes) on both properties. These owners are oft heard to claim that the valuation system is '*wrong*', '*made up*', '*it's not worth that much*' or '*it's not fair*'.

The *Valuation of Land Act 1960* requires that land must be valued at its highest and best use – not what the owner thinks it should be valued at or what they paid for it 17 years ago. Based on the principle of horizontal equity this is precisely how the system does and should work, so similar properties are treated in a similar way at the same point in time. It is rare to hear complaints from property owners when they benefit from the sale of their property for similar amounts.

Additionally, the valuation system allows for appeals to be made to the Valuer-General Victoria and in VCAT. This provides the system with independent oversight to ensure fairness and transparency applies to all property owners.

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<sup>5</sup> s7A, *Valuation of Land Act 1960*

