Local Government Rating System Review

Discussion Paper

VICTORIA State Government

Author

Local Government Rating System Review Ministerial Panel, C/o Department of Environment, Land, Water and Planning, Lvl 35, 2 Lonsdale St, Melbourne VIC 3000. E. Rating.review@delwp.vic.gov.au

Printed by Finsbury Green

ISBN 978-1-76077-737-1 (print)

ISBN 978-1-76077-738-8 (pdf)

Accessibility

If you would like to receive this publication in an alternative format, please telephone the DELWP Customer Service Centre on 136 186, email customer.service@delwp.vic.gov.au, or via the National Relay Service on 133 677 www.relayservice.com.au. This document is also available on the internet at engage.vic.gov.au/rating-review.

Contents

1. Foreword

Over $5 billion will be raised in rates by councils in 2019-20 from over 3 million properties in Victoria.

Our council services and infrastructure are essential to supporting healthy and resilient communities and businesses in Victoria. Equally important is the means to pay for these services and rates provide over half of the revenue for our councils.

Over 3 million rates notices will be opened by Victorian ratepayers this year. Every notice will present detailed information. Many rates notices will have three, four or more different rates and charges, and will include options for payment, ways to appeal the property valuation and how to contact your council for assistance. Over $5 billion will be raised by councils from rates levied on 3 million Victorian properties in 2019-20.

These are big numbers, and they describe a system that is important to all Victorians. Yet it is a system that is applied differently across councils and is often reported by ratepayers, councils and the community to be difficult to navigate.

In the 21st century, councils are complex operations delivering a myriad of services beyond the old view of councils being simply about "roads, rates and rubbish." Each council's current rating arrangements are the result of many adjustments over the decades, making the system far from simple. Changes and successive updates have added requirements and details that can confuse and contradict.

Nevertheless, the rating system also has many strengths and has provided a reliable revenue stream to the third tier of government for well over a century.

In 2018, the Victorian Government committed to a review of the system in recognition that the time for a full review of such an important system was due. In turn, the Government has appointed a Ministerial Panel to lead the work and to make independent recommendations to Government on an optimal rating system. The Panel is required to complete a report, with recommendations to the Minister for Local Government by 31 March 2020.

Fairness and equity are central to the Terms of Reference we have been charged with and are the driving considerations of our deliberations. With this central focus we are determined to ensure the review takes all perspectives into account.

This discussion paper is the first step for the Panel in reviewing the rating system. It aims to stimulate thinking and ideas from all stakeholders of the system and support them to actively participate in the processes available to them for input. Importantly, at this point, the Panel does not have fixed views on how a rating system can best meet the tests of fairness and equity. Our views will be developed over the course of the review through verifying the issues raised through the consultation process and through testing ideas for improvement against evidence and facts.

We are providing a range of ways for people to provide their views on the rating system. The Panel will be making its way around the state from August to October this year to meet with stakeholders, councils, community groups and individuals to listen to and consider their views on local government rating. We are also seeking written submissions and feedback through short surveys to enable the broadest possible engagement with the review of our local government rating system.

We recommend the Review website as an information source both in relation to the issues about rates and the range of opportunities available to the community for providing their views about rating. Additional relevant information and progress updates on the work of the Panel will be added to this website over the coming months.

We look forward to hearing from you.

Ministerial Panel for the Victorian Local Government Rating System Review

- Dr Kathy Alexander (Chair)
- John Tanner AM
- Dr Ron Ben-David

2. Introduction and Ways to Engage with this Review

The Local Government Rating System Review is an opportunity to shape the future of the biggest local government revenue source.

This discussion paper presents an overview of the current rating system. It is designed to present the major system parts, how they work together, a framework for examining rates and a platform for the consultation by the Review Panel.

Chapter 3 presents a short historical summary of the rating system and shows how its origins in the 19th century in Victoria (and much earlier elsewhere) have contributed to the system we have today, with many of its features remaining unchanged.

Chapter 4 provides an overview of the rating system and how it operates. The overview is consistent with the video on the Rating Review website which will help to explain the main parts of the system and how they work together as simply as possible.

Chapter 5 proposes an initial framework for the Review Panel to assess issues of fairness and equity in rating. It will be refined through the Panel's consultation and research over the coming months. This chapter also provides some insight into commonly discussed issues in rating. Initial areas of interest for the Panel include the budget process for councils (including allocation of rates and community engagement), issues of rate exemptions, and the different ways that issues of rating fairness and equity are treated by councils.

The chapter also poses some questions to help readers provide feedback and facilitate broader discussion about fairness and equity in rating. These are presented in separate breakout boxes. We encourage people not to feel limited by these questions if they believe that there are issues that need to be addressed which are additional to the questions raised.

The Panel is seeking to better understand the different practices by councils in dealing with and administering the rating system. We will be consulting directly with councils on some of these detailed issues over the Review.

The Glossary defines some of the important terms used in the rating system. Many of these important terms are also specified in bold text throughout the paper. Appendix I provides a brief discussion on rates in other jurisdictions around the world.

The Paper contains references and links to relevant legislation and documents, and data is drawn from the 2019-20 council adopted budgets.

Finally, the Panel Secretariat has provided further technical and legal information on the Review website, as well as shorter Fact Sheets. These are provided for the interested reader who wants to fully understand the legal and technical complexity of the current system and arrangements, but it is not necessary to read this additional material to engage with the Review.

So, let's begin.

3. The Development of the Rating System in Victoria

Local governments derive their power to levy rates from State legislation via Acts of Parliament.

The taxation of land for government revenue extends back before the colonisation of Australia 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 also 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.

3.1 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.[1] Other metropolitan councils were created in subsequent years.

In addition, the *Roads Act* of 1854 made provision for establishing District Road Boards, which were empowered to levy tolls along with rates on land: a key way to raise revenue for roads.[2] 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, 1958, and the current *Local Government Act 1989.*

The fundamentals of the current rating arrangements are similar in many respects 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.

3.2 Key changes to the rating system since the 19th century

The foundation of a rating system is the 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 of both which was 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 data management techniques 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 early thinking and rules for rates, often 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 some rates. The 1958 Act for example 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 charge to cover some of its administrative costs. This however became optional, lessening the use of a fixed component in rates.

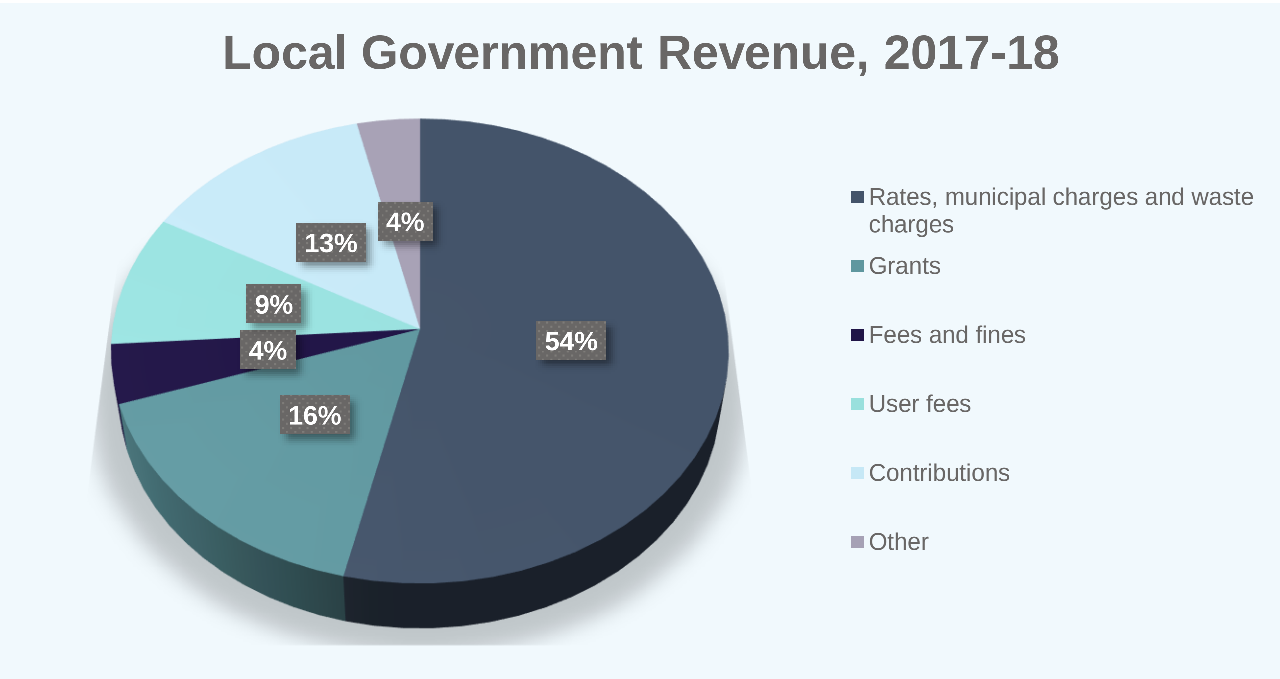
A rate capping system was briefly applied in the early 1990s when Victorian councils underwent amalgamation. In 2016-17, the current rate capping system was introduced and continues today.

Notwithstanding the rate cap, the current system affords councils significant flexibility to raise rates as they see fit. Municipal rates and charges on

1. *Melbourne (Vic.). Council. (1842-),* (2008). In *Trove*, retrieved July 29, 2019, from https://nla.gov.au/nla.party-461954.
2. Board of Inquiry into Local Government Finance in Victoria (1972), *'Report of the Board of Inquiry into Local Government Finance in Victoria'*, Parliament of Victoria, p.7

properties continue to provide the primary revenue source for all councils, accounting for $5.7 billion and 54 per cent of total revenue for Victorian councils in 2017-18. 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 reported revenue sources for 2017-18.

Figure 1: Local Governent revenue 2017-18 (Victorian Auditor General's Office)



4. How do Rates Work?

Councils decide how they calculate and allocate rates across properties as part of their annual budget process. This chapter provides an overview of the rating system. A more detailed discussion of the system is provided in a Supplementary Information Paper on the Review website.

Across Australia, local government rates are primarily based on property values. In Victoria, the State Government's valuation authority, the Victorian Valuer-General, conducts valuations of properties across the state every year.[3] Councils use the most up to date valuations when setting their rates for the forthcoming financial year.

In preparing its annual budget, and before resolving on the rates and charges it will declare for its ratepayers for the forthcoming financial year, a council must determine the total amount of income it needs (including all rates, charges, user fees and other sources of revenue) to deliver services and infrastructure which it resolves as the priorities for its community. Its decisions are made alongside longer-term financial planning for significant spending such as roads and other infrastructure. Considerations of cost reduction and productivity improvements are also important in setting a budget.

The *Local Government Act 1989* (the Act) sets rules around how councils can raise rates. It allows councils to raise rates by using the following:

- **General Rates**, which are raised via:
    - **Uniform Rates;**
    - **Differential Rates;**
    - **Limited Differential Rates;**
    - **Municipal Charges;**
- **Service Rates and Charges**;
- **Special Rates and Charges**.

(Detailed definitions of these terms can be found in the Glossary).

Having reached agreement on the rates and charges, councils then issue rates notices for each rateable **occupancy** in their municipality.

Generally, property owners are responsible for paying rates (whether they are occupying the property or not). An exception to this is commercial leases, where lease contracts specify that the tenant is responsible for paying the outgoing cost on the property, including rates.

4.1 Rateable Land and Exemptions

Rates exemptions allow for some types of property to be exempt from paying rates.

All land is considered rateable in Victoria, except where it is specified as exempt in the Act. Many of the current exemptions are long standing and some can be traced back to the *Local Government Act 1874*, the first specific local government legislation in Victoria.

The current exemptions include:

- State and Commonwealth land (Crown Land), where it is either unoccupied or it is used exclusively for public or municipal purposes;
- Crown land leased to a rail transport operator;
- Land used exclusively for charitable purposes;
- Land used as a residence of ministers of religion;
- Mines;
- Returned Services League (RSL) clubs.

All other land in a municipality is subject to rates.

4.2 General Rates

The amount raised using uniform or differential rates, or a municipal charge, to fund council expenditures.

Councils calculate rates using a property valuation base, which in Victoria is either the **Site Value** (SV), **Net Annual Value** (NAV) or **Capital Improved Value** (CIV) of all properties in the municipality. Property valuations can also be appealed by the ratepayer.

[3] From 1 July 2018 land valuations were centralised under Valuer-General Victoria (VGV), with a new annual cycle of valuations. Prior to that date, valuations in Victoria were generally conducted by councils every two years.

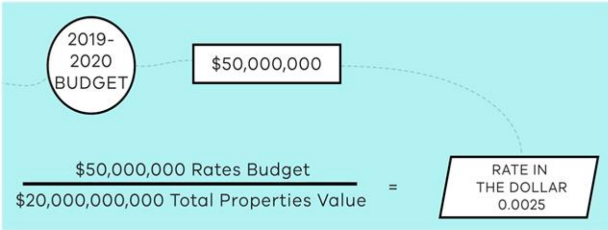
Box 1 – Property Valuation Bases

Site Value (SV) – the value of the land only, not including improvements (such as a building).

Capital Improved Value (CIV) – the value of the land including any improvements (such as a house).

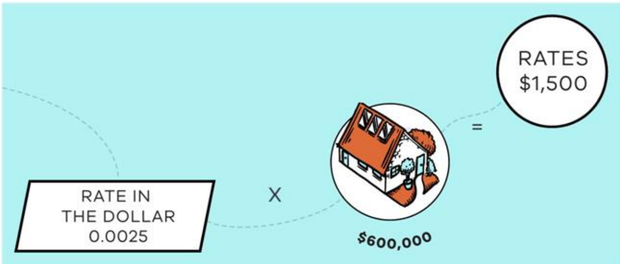
Net Annual Value (NAV) - the estimated annual rent for the land, less some expenses.

A detailed definition of these terms can be found in the Glossary.



In this example, the council's uniform rate in the dollar will be 0.0025. This means that for every dollar of your property's value in the City of Pleasantville, you would pay 0.0025 cents in rates.

So, if you owned a property valued at $600,000, that value would be multiplied by 0.0025, to get $1,500 in rates.



Before allocating rates to individual rateable properties, councils declare if they wish to use a **uniform rate** or **differential rates** and an optional **municipal charge**.

Uniform Rate

Where councils raise rates by applying one rate in the dollar to all properties in a municipality.

If a council chooses to set a uniform rate, the total amount of rates to be collected is divided across the total value of all rateable properties. This results in the **rate in the dollar** which is a percentage amount.

The rate in the dollar is then multiplied by the value of an individual property to calculate the amount to be paid by each ratepayer.

Under a **uniform rate**, all ratepayers pay the same rate in the dollar on their property's value.

In the example below, the City of Pleasantville:

- Seeks to raise $50 million in rates for its budget;
- The value of all the rateable properties in the municipality have been valued at $20 billion (CIV).

Differential Rates

Where councils raise rates by applying different rates in the dollar for certain property categories.

When using **differential rates**, councils must declare the type of property categories and the rate in the dollar for each of these specified categories. Councils are free to declare whatever categories they choose. Some common categories for councils using CIV include Residential, Commercial and Farm Land.[4] Other more specific categories are also used such as Quarrying Land or Vacant Commercial.

[4] If a council uses NAV as their valuation base for rates, they are permitted to use only a few differential rate categories. This is known as 'Limited Differential Rates'.

Each category is assigned a separate rate in the dollar. Once this is determined, differential rates are calculated using the same method as a Uniform Rate. Table 1 below gives a simple example of differential rates and rates payable for three different types of property each equally valued at $600,000.

Table 1. Example Differential Rating Categories

Category	Rate in the Dollar	Rates Payable
Residential Land	0.00250	$1,500
Commercial Land	0.00500	$3,000
Farm Land	0.00125	$750

In the example above, the council has elected to levy the highest rate in the dollar on commercial land and the lowest on farm land. Each property will pay a different amount in rates even though the three properties have been valued equally at $600,000.

There is no limit on the number of differential rates a council may levy in Victoria. However, the highest differential rate is restricted to being no more than 4 times the lowest differential rate in a financial year.

Use of differential rates are further governed by the 2013 Ministerial Guidelines for Differential Rating. The Guidelines set out some suitable and unsuitable uses of differential rates, limit their use in some specific ways and describe instances where councils should consider their use (such as farm land and retirement villages).

4.3 Municipal Charges

A fixed charge declared to cover some of council's administrative costs.

Councils can opt to use a **municipal charge** which applies equally to all properties regardless of their value. Because a municipal charge is a fixed dollar amount, the value of the property has no relationship to the amount charged. The greater the level of a municipal charge, the less the influence of the property's value in determining the total amount levied in general rates and charges.

Using the uniform rates example above, if a council declared that it wanted to raise $10 million (out of the budgeted $50 million in general rates) in municipal charges across the municipality's 50,000 properties then:

- Each property would be levied a fixed amount of $200 in municipal charges;
- The rate in the dollar would be reduced to 0.002 cents in the dollar (as the amount to be raised lowers to $40 million);
- The uniform rates portion for our example property would total $1,200 (0.002 cents in the dollar x $600,000 property value);
- The total rates payable for this example property using this system would be $1,400 (Municipal Charge + Uniform Rates) instead of $1,500.

A municipal charge was levied in 2019-2020 by 39 councils, averaging $194.65 per property. 31 of these 39 councils are rural and regional. The total amount to be raised from a municipal charge must not exceed 20 per cent of the total revenue from general rates and municipal charges. In practice, few councils get close to this ceiling, with the average in 2019-20 at 10.37 per cent for those councils using the municipal charge.[5]

Municipal charges can be used when levying differential rates as well as a uniform rate. The Act also allows an exemption from multiple municipal charges for the same ratepayer if they can show that they are operating a single farm business across multiple properties.

[5] All 2019-20 figures in this Paper are based on the adopted budgets of 78 out of 79 councils. South Gippsland Shire Council received an extension to its 2019-20 budget adoption date. The proposed budget figures in this instance have been used.

The amount a council collects in rates in any year is determined by the council budget process – not property values. The various property values within a municipality determine the *distribution* of rates. Higher valued properties will tend to pay more than lower valued properties in the same municipality.

4.4 Rate Capping

A rate cap is a restriction or limit on the annual increase in rates from a previous year.

A rate cap was applied in Victoria in the 1990s for two years. The current legislative rate cap system commenced in 2016-2017 and operates by limiting the amount of revenue a council can collect in a given year through general rates to a percentage increase from the previous year. This percentage increase is not applied to individual properties, but the overall amount collected in general rates. This limit is determined annually by the Minister for Local Government. The rate capping framework is not being considered by this Review as it will be separately reviewed in 2021.

4.5 Rebates, Discounts and Deferments

Local governments can adjust the impact of rates by applying discounts, rebates, concessions and deferments of payment.

A State-wide concession on rates is provided for eligible pensioners by the State Government. The rate rebate in 2019-20 for eligible pensioners is 50 per cent of the General Rates up to a maximum of $235.15. This amount increases annually in line with inflation. Application of further rebates, discounts and deferments are at the discretion of individual councils.

Some Victorian councils provide an additional rebate on rates for eligible pensioners on top of the Victorian Government rebate. Other rebates are available for:

- Assisting the proper development of the municipal district;
- Preserving or restoring buildings or places of historical or environmental interest;
- The provision of affordable housing to a registered agency.

Councils can also offer incentives for early payments. Deferment schemes, whereby rates owed can be paid upon a specified future date (including upon sale of the property), can also include a discounted interest charge on the deferred rate. Such schemes can temporarily address the affordability issue for some people who own property but do not have a high cash income. They permit individual circumstances to be considered, including financial hardship and long-term illness. Deferment schemes are not in widespread use.

4.6 Hardship Policies and Waivers

All 79 Victorian councils provide for financial hardship considerations by application and many have a published policy for circumstances of financial hardship.

Commonly, councils provide details of the financial hardship assessment process, along with a payment arrangement application form, on the rates and charges section of their website. The Act does not provide a specific definition of financial hardship.

Councils may set up different payment arrangements for people whom they assess as experiencing hardship or waive part of, or even all, unpaid rates and charges.

4.7 Service Rates and Charges

A Service Rate or Charge funds a specific service, commonly used to fund the collection and disposal of waste.

The Act permits councils to levy charges on a property for a specific service, such as:

- Provision of a water supply
- Collection and disposal of refuse
- Provision of sewage services
- Any other prescribed service[6]

Waste charges (collection and disposal of refuse), for providing kerbside waste and recycling services, are in widespread use in Victoria, with just over $695 million to be levied in 2019-20. (It should be noted that waste charges are separate from the State Government landfill levy, which is paid by licenced landfill operators). Water services are no longer provided by Victorian councils, although some still

[6] A prescribed service is one which has been specified in regulations by the Minister via a power in the *Local Government Act 1989.*

provide limited sewage services such as septic tanks.

Even if councils levy a service charge, this amount does not necessarily cover the full costs of providing the service.

4.8 Special Rates and Charges

A Special Rate or Charge funds a specific project that only affects a limited number of ratepayers

Councils can choose to declare a Special Rate or Charge to fund a project that only affects a limited number of ratepayers. This ensures that the ratepayers that benefit from the project contribute to funding it.

These projects can be initiated by councils or by ratepayers petitioning council for the new service. The Special Rate or Charge to be raised also has separate financial accounting requirements, methods of declaration and objection, calculation of amounts due, and public consultation is required for the proposal to be implemented.[7]

Examples of a Special Rate or Charge scheme may include:

- Street beautification works;
- Raising funds for commercial marketing, development and promotion via Business/Trader Associations;
- Creation of car parking to support commercial businesses;
- Infrastructure improvements (such as roads, stormwater drainage, and water and sewer mains) in a limited access street;

Each Special Rate and Charge is calculated and apportioned differently depending on the funding required and number of ratepayers responsible for payment.

4.9 Supplementary Rates and Charges

If a property's valuation changes outside the annual revaluation process, councils issue amended notices updating the rates payable.

These valuation changes can occur for a variety of reasons, some of which are:

- Something occurs to make the land rateable (or exempt from rates) per the rules of the Act;
- The land is subdivided or consolidated;
- A new building is constructed on the land;
- There is an alteration made to an existing construction (such as a renovation or demolition);

When the new valuation is determined, councils then issue revised rates notices to the owner showing the change in valuation and the updated rates and charges. This is called a Supplementary Rates Notice and councils issue thousands of these notices annually as land uses change over time.

4.10 Alternate Rating Agreements

Some ratepayers make payment directly to councils instead of paying rates based on a property's value or can enter into upgrade agreements that only affect their property.

Some specialist property types are subject to different methods of rating under other legislation, allowing councils to raise revenue via rating agreements. These apply to properties such as electricity generators and land used for cultural and recreational activities (such as sporting facilities). In these instances, the rates are calculated quite differently from using the market value of the property. In some instances, land that is exempt from rates altogether may also pay a contribution to the council to fund municipal services.

The recent introduction into State legislation of Environmental Upgrade Agreements and Cladding Rectification Agreements allows councils to help ratepayers obtain finance to alter their properties and pay back their loans via their rates payments. These agreements can reduce the interest rates on the loans as future property rates are used as a financial guarantee. By their nature, these agreements can involve complex methods of calculation which vary across councils.

[7] The use of Special Rates and Charges are governed by the *Special Rates and Special Charges: Calculating Maximum Total Levy Ministerial Guideline*. Available at http://www.gazette.vic.gov.au/gazette/Gazettes2004/GG2004G039.pdf#page=28

4.11 Rate Notices and Payments

Councils are required to issue rates notices which contain significant detail about the ratepayer's property and the dates that payments are due.

The notices that councils issue ratepayers contain a significant amount of detail including the property's various legal descriptions, the assessed value of the property, rates and charges, liability of payment, payment options, ratepayer rights and methods of objection.[8]

Councils are required to allow ratepayers to make payment of the amount due over four instalments over the year and may also choose to offer the ability to pay in a lump sum (in full).

The due dates for these options were set in 1998[9] and are:

Four Instalments

- 30 September
- 30 November
- 28 February
- 31 May

Lump Sum (optional)

- 15 February

Other payment arrangements can be offered by councils.

4.12 The Fire Services Property Levy

Council rate notices also include the Fire Services Property Levy, a State Government charge, to pay for fire services. The inclusion of this levy on the council rates notice will not be covered in this Review.

4.13 Recovery of Unpaid Rates and Charges and Penalty Interest

Councils may charge interest on unpaid rates and charges as well as pursuing legal action which may include sale of the property.

Like taxes at other levels of government, if any rate or charge remains unpaid after its due date, councils can charge the ratepayer interest on these amounts.

Penalty interest rates are set by the State Government.[10] (The current rate is 10 per cent per annum). However, councils have the option to apply either the full amount, a partial amount or not to charge interest at all. Councils do not need to have a policy outlining when they will apply penalty interest, nor are they required to issue new notices once the interest has been applied to the debt. Councils can also choose to recover the unpaid amounts by legal action in the Magistrates' Court.

If rates remain unpaid for over three years, councils can sell the property to recover the outstanding amount, or transfer the land in question to itself, thereby gaining ownership of it.

In some circumstances the occupier of the land may become liable for payment instead of the owner. This may require them to make payment of rent to council instead of the owner, to pay the outstanding debt. In such cases the payments to council cannot exceed the amount of rent owed by the occupier.

[8] S.158 (4) of the *Local Government Act 1989* and S.10 of the Local Government (General) Regulations 2015, set out all details required to be present on a rate notice.

[9] Government Gazette pg. 632 (http://www.gazette.vic.gov.au/gazette/Gazettes1998/GG1998G012.pdf)

[10] The *Local Government Act 1989* requires that penalty interest is to be calculated at the rate fixed under section 2 of the *Penalty Interest Rates Act 1983.* This is currently set at 10 per cent per annum.

5. A Framework for Considering Rating

The scope of this Review requires that the Panel develop ways to consider fairness and equity so the whole rating system can be reviewed, and the key issues brought to the fore.

This chapter outlines a framework that the Panel proposes to use in investigating the rating system. The chapter then discusses some already known issues about the rating system to open the consultation. The Panel is seeking more information on individual councils' rating practices and related issues to better understand how the system is currently working.

Finally, the chapter offers questions for stakeholders to consider as a starting point when providing feedback to the Panel. Nevertheless, these questions should not limit the matters on which stakeholders provide comment.

5.1 A framework to think about rates and other taxes

The main purpose of any government tax system, including council rates, is to raise revenue to fund public services. Sometimes the design of a tax and how it is applied by a government can have unintended consequences and costs on business and the community.

To minimise these unintended consequences and costs, a number of commonly used principles guide good tax design. Those most relevant to rating include **efficiency**, **equity**, **simplicity** and **sustainability** (outlined in Box 2[11]).

An **efficiency cost** occurs when a tax interferes with the decisions of individuals and businesses and prevents them from making choices about work, leisure, consumption of goods and services, investment and savings that would work best for them.

Property values are generally considered an efficient rating base, given that it is difficult to quickly change ownership to avoid paying the annual rates bill. Council property rates also have a broad base because most properties in any given municipality pay rates.

Box 2 - Principles of taxation

Efficiency: Rates should not significantly distort decisions around property ownership, usage and development. For example, stamp duties are often considered *inefficient* as they may prevent property buyers from locating close to work, family, suppliers, or customers.

Equity: The tax burden should fall appropriately across different types of ratepayers.

Benefit principle: Where the distribution of benefits is not uniform, those who benefit more should contribute more.

Capacity to pay (vertical equity): Those ratepayers with greater economic means should contribute more to rates.

Horizontal equity: Taxpayers in similar circumstances should be treated in a similar way.

Simplicity: The system should be practical and cost-effective to administer and enforce. The system should also be simple to understand and comply with.

Sustainability: A key element of the sustainability principle is that the system should generate reliable revenues for councils on an ongoing basis. Rates should be durable and flexible in changing conditions (that is, they can adequately withstand volatility).

If all, or most properties are rated, councils are not creating large incentives for a property buyer or developer to purchase one property over another.

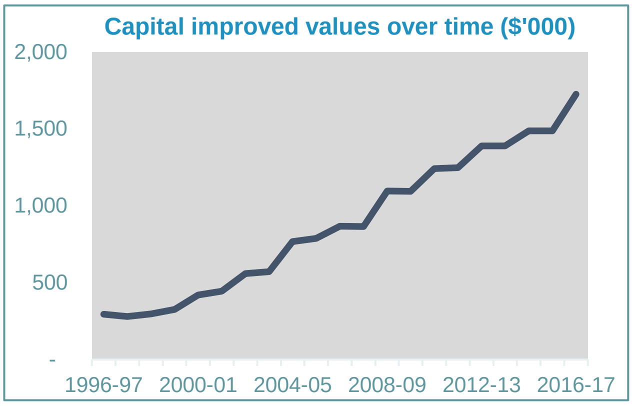
For **simplicity** it should be easy to understand and comply with a tax. Under the simplicity principle taxes should also be easy to administer. When the

[11] These principles are based on *Australia's Future Tax System* (the Henry Review) (2010), Part 1, p.17.

rules around who pays and how to pay a tax are complicated, the system can impose administrative burdens on taxpayers, such as time spent filling out forms, or waiting in line to pay tax. Simplicity can also help the public engage with policy and decision makers in government and discuss the tax and how it is applied.

Councils also have a **sustainable** revenue base in rates. Property values fluctuate over time, especially in the short term, but this does not result in volatility in rates, unlike some other property-based taxes such as those levied on property transactions (i.e. stamp duties). As shown in Figure 2, property values have tended to increase over the long term, providing a reliable and predictable revenue base for councils.

Figure 2 – Property valuations in Victoria since 1996



The central considerations of this review are the concepts of equity and fairness. These are not straightforward and, as discussed below, require some deeper consideration.

5.2 A proposed framework to consider equity and fairness in rates

Equity in taxation is commonly understood as reducing the tax burden on groups with lesser ability to pay. However, this is not the only type of equity that should be considered in setting taxes, including council rates.

Thinking about equity

Equity is a much-discussed topic in tax policy at all levels of government. There is a widespread view that the capacity to pay a tax by an individual or organisation should influence how much tax they should pay. This principle is reflected in many taxes, including income and business taxes. Local government rates attempt to take **capacity to pay** into account in several ways:

- The general rate component of council rates and charges is set as a percentage of property values. Because property values are generally a proxy for wealth, wealthier ratepayers (those with higher valued property) will usually pay more in rates than those with lower valued properties in the same municipality.
- Certain lower-income groups in the community such as pensioners are recognised as having limited or restricted income and therefore receive concessions on rates subsidised by the State (and in some cases by local governments).

However, capacity to pay is not the only type of equity consideration in setting taxes, including local government rates. For services that could be acquired in private markets it may be appropriate that users who benefit more should pay more.[12] Paid parking and swimming pool fees are such examples. Not all ratepayers may use such council services equally. They may, however, benefit from increased property values (and increased wealth) as a direct result of services provided by councils, such as local parks or well-maintained roads.

It is also important to recognise that there are a range of perceptions of equity and inequity which depend on individual perspectives and society's contemporary values around relative fairness and natural justice.

Fundamentally, a discussion about equity in rates must consider both those who gain and those who pay under any decision. In other words, a concession provided to one group or individual must be compensated by an increased payment for others if the same amount of revenue is to be collected in a municipality. Equity considerations should consider the impact on all ratepayers in a community, not just the immediate beneficiaries of a concession.

[12] In contrast to *public goods* – see Supplementary Information Paper 2 on the Review website, at www.engage.vic.gov.au/rating-review for more information.

Thinking about fairness

Questions of fairness often go hand-in-hand with concerns about equity. Fairness tends to be a more subjective concept, informed by individual perceptions and experiences which may be very different over time.

Some initial thinking by the Panel is outlined below as to how fairness in rating may be thought about. In this review we will consider it as a concept referring to the process and *conduct* associated with the rating system and how it is administered. These are presented as follows:

- **Consistency** – A council should administer the rating system the way it says it will administer it and ratepayers in like circumstances should be confident they will be treated on like terms by the council. Public transparency of council policies and application of rates (while not publicising personal information) further supports consistency of practices.
- **Measures of last resort** – The use of a council's coercive powers should only be deployed after the council has made all reasonable efforts to engage (and assist) ratepayers to meet their liabilities.
- **Consideration** – Ratepayers' circumstances differ in innumerable ways. A council should be able to have regard to a ratepayer's circumstances and act reasonably in these circumstances. That is, a 'one size fits all' set of council administrative rules may not work. Consideration of financial hardship circumstances is an example of this.

5.3 Key questions for consultation

While the Panel will conduct an in-depth review into the system over the coming months, there are several questions and issues that are already apparent in the rating system. Many parts of the rating system have not changed greatly over the last century and may no longer be suitable. Other practices have emerged in an unstructured fashion and may have had unintended consequences for fairness and equity.

Some preliminary issues are discussed below. These are framed as broad questions, and the Panel is seeking the community's views during the consultation period. A short discussion of each issue is followed by consultation questions to prompt feedback. These are by no means a full list of issues, and the Panel expects others to be raised and considered during the consultation process.

Should all property owners pay rates?

Victorian legislation allows for a number of exemptions on properties used for specific purposes (as outlined in Chapter 4). Some of these exemptions lack a clear definition. For example, exempting land used for charitable purposes can also provide coverage for the profit-making activities of a charity.

Other exemptions, such as those for mining land, do not appear to have been examined since being put in place in the 19th century. Exemptions from rates for some properties impose a cost on other ratepayers, as exempt properties continue to consume municipal services while not contributing revenue for them. Other ratepayers must therefore contribute more to make up the difference. The Panel is interested in whether the current rate exemptions reflect community values, and how exemptions from rates in the future should be considered.

Consultation Questions:

What types of properties should receive rating exemptions? Why would this be fair?

Does your council report on rate exemptions granted, and/or their estimated value?

Should councils be required to report on rates exemptions? Why?

Should some ratepayers pay lower rates than others?

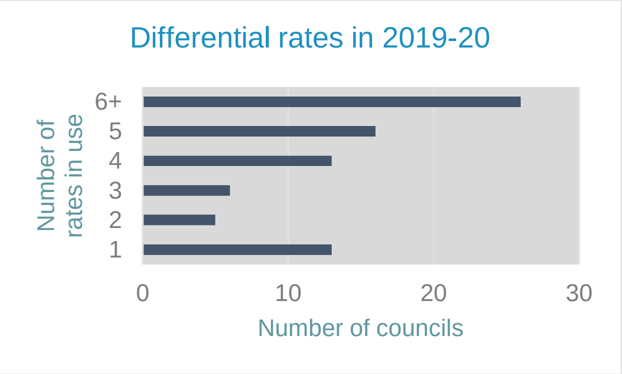
There are several ways councils can reduce (and increase) rates for certain property types and therefore ratepayers.

Many councils use differential rates to support those who are perceived as having a lower capacity to pay, based on the assumption that some types of property are closely associated with a higher or lower capacity to pay by the owners.

The use of differential rates by councils has become widespread. Most common is the use of different rates for 'residential', 'farm', 'commercial', 'vacant' and 'industrial' properties. Differential rates allow councils to provide a discount or increase on a notional 'general' rate in the dollar. This 'general' amount is usually designated to the majority type of property in a municipality, that of ‘residential’ type properties.

The number of differential rates in use (2019-20 budgets) is illustrated in Figure 3 below. In 2019-20, 26 councils will levy 6 or more rates to different property categories.

Figure 3. Number of differential rates in use by councils in 2019-20



Another common method authorised by State law is to set separate rates for land used for cultural and recreational purposes.[13] These do not have to be based on property value, and often provide a large discount compared to the rates levied on most other properties. The occupants of such land are often not-for-profit organisations but may charge entry or membership fees. The Panel is interested in investigating whether these practices reflect current community values and considerations of equity and fairness as framed above.

Another longstanding arrangement is the rating of electricity generators which may opt in to a scheme to pay rates based on energy generation capacity, not property value[14] (More information on specialist rating agreements can be found on the review website).

At an individual level, councils can offer discounts if rate payments are received at an earlier date. Though this may be seen as a reward, it may not assist ratepayers without the capacity to pay, effectively penalising those without the ability to pay a large amount in rates in a lump sum.

Finally, councils may choose to offer waivers (partly or in full) which are commonly used to provide relief to eligible pensioner concession card holders and Department of Veteran’s Affairs card holders

In the interests of transparency and accountability, it is important that rate reductions (and exemptions) are meeting a clear set of criteria and are benefiting those in genuine need. Equally, councils levying higher rates on some properties compared to others should consider the equity issues of doing so. The Panel wishes to consult widely on the many differential rates, discounts, and concessions in use across Victorian councils and how these meet the criteria of equity and fairness.

Consultation Questions:

How does your council allocate differential rates? Why?

What types of properties should pay more through differential rates? Why?

What types of properties should receive rates waivers? Why?

If councils provide rate discounts what criteria should apply?

Should cultural and recreational land and electricity generators have alternative rating arrangements? Why?

Should rates be determined by property values?

As outlined in Chapter 3, property rates are a longstanding method of raising municipal revenue in Victoria and around the world. This is because administering a property tax is relatively low cost given that properties are difficult to hide to avoid tax. In addition, reasonably reliable methods exist for valuing land for rating purposes. Further, as discussed previously, there are a number of economic benefits to property-based rating where all or most properties are rateable.

Nevertheless, as a property’s market value is only a proxy for a ratepayer’s wealth, not an exact measure there are advantages to using other tax bases. For example, when considering equity, a tax on personal income makes it easier to target individuals who may have immediate difficulties paying. The challenge in such an approach is that the information required from a taxpayer can be difficult and expensive to acquire. The Australian Tax

[13] The *Cultural and Recreational Lands Act 1963* allows such designated land to be rated differently.

[14] Section 94 of the *Electricity Industry Act 2000* allows for electricity generators to pay rates under an alternate arrangement.

Office, for example, has significant coercive powers, and a large bureaucracy to administer the personal income and business tax system. Local governments do not have comparable powers or resources.

Should some municipal services be funded by specific service rates or charges?

Council rating revenue is a mix of both rates and charges. **General rates** are set as a percentage of property values while **municipal charges** are a fixed dollar amount for all ratepayers. Around half of council revenue comes from this general rate source. This revenue is further supplemented by service charges and fees.

Service charges for waste are intended to contribute to the cost of providing those particular services. In other words, these services are funded by their users, at least in part. In contrast, other services and goods provided by councils, such as support for new mothers, libraries, and maintaining roads, are primarily funded through general rates. In the case of rates, there is no direct link between the level of service use and the amount paid for those services.

Where a council service has widespread benefits for people other than the individual user[15], funding services through a general property-based rate can be more appropriate. This also applies where it is unfeasible to levy user charges for services. Drains, footpaths and parks are examples of services that are appropriate to fund via rates. In other cases, having specific property-based rates or charges to fund services may be more appropriate.

The Panel is interested in understanding community views about rates and how they should be used in conjunction with other revenue sources by councils.

Consultation Questions:

Should property values determine rates? If not, then what should?

What services should be funded by their users (in line with the user pays principle) rather than through general rates?

When should councils use special rates and charges? Why?

How does your council set charges for waste and other services?

How much oversight of council rates should the State have?

The State Government provides rules about how councils can set rates through legislation such as the *Local Government Act 1989*. To minimise the red tape faced by all 79 councils, these rules should be clear and straightforward. Accordingly, the Panel intends to consult on and understand the level of complexity faced by councils in administering the rating provisions under the Act.

The discretion provided to individual councils by the Act means that there is great diversity in the way the rating system operates across the state. While this allows councils to apply rates in ways that reflect local circumstances, it means ratepayers in otherwise similar situations may be treated differently depending on where they pay rates in Victoria.

Historically, the overarching governance principle has been that democratically elected councils are directly accountable to their ratepayers. As a consequence, there has been limited State Government oversight of rating practices across Victoria.

The Panel is keen to understand how the community views the trade-offs between local discretion (by councils responding to local circumstances) and state-wide inconsistency in rating practices (arising from councils adopting different rating practices).

[15] See the discussion of public goods and externalities in the Supplementary Information Paper – Why do Governments Raise Taxes? on the Review website

Consultation Questions:

Does your council have a clear rating strategy?

Should all councils apply consistent rating practices? Why/why not?

Does the *Local Government Act 1989* (and other requirements) provide clear rules and guidance to councils to set and levy rates? What could be improved?

Is the rating system clear and transparent for ratepayers?

The annual or quarterly rates notices delivered to ratepayers contain a large amount of information. Some of this is required by law, and some is included at the discretion of councils. This review may unearth opportunities for improvements in presenting rates notices, billing practices and customer service for ratepayers. There may also be opportunities to simplify processes for ratepayers to appeal rates and council decisions.

Most councils provide information via their website and distribute information about how rate revenue is spent. Many councils also publish a rating strategy[16] and invite public feedback. However, the rating system can be complex, making it more difficult for the public to engage on long term rating strategies. Rather, the main point of connection for the public is likely to be the rates notice itself.

Consequently, there may be less public awareness of the various factors that influence rate-setting compared to the provision of popular services such as pools and libraries.

The Panel is interested in understanding how the public experiences the rating system and engages with their council on rating issues.

Consultation Questions:

Does your rates notice have the information you want? If not, what would you like to see on your rates notice?

How convenient is it to receive your rates notice and make payments?

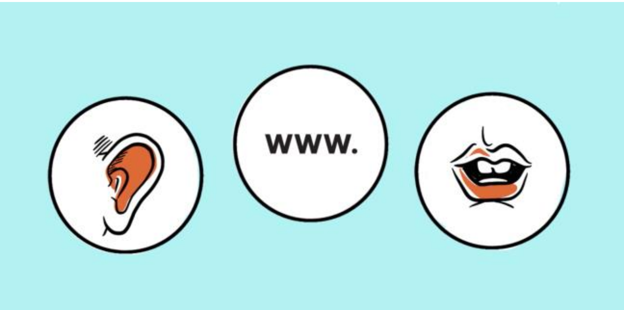
Do you engage with your council in setting rates through the annual budget consultation? If so how easy/difficult is it to do? If not, why not?

5.4 How to Provide Feedback and Engage with the Review

The Minister for Local Government has instructed the Panel to consult widely with councils, peak bodies and the broader community to ensure it identifies the full range of issues before making any recommendations.

This discussion paper has provided an overview of the system and the known issues and is intended to provide one of several platforms for engagement with the community on local government rates.

We encourage all Victorians to engage with the Review by completing the short online survey, providing a formal submission, or attending a public meeting in your area. Public meetings will be held from August to October around Victoria. Those interested in attending may obtain details and register via the Review website.



The online survey and the written submission forms are available at the Review website along with this discussion paper (https://engage.vic.gov.au/rating-review).

The website will be regularly updated on the work of the Panel. You can also write to the Panel at rating.review@delwp.vic.gov.au.

[16] Councils must consult publicly before finalising their budgets, but rating strategies are not mandated by law and there is no requirement to consult on such strategies.

6. Glossary of Key Rating Terms

This section covers common terms used in describing rates. Many of these are explored in detail in Chapter 4 and in a Supplementary Information Paper available on the Review website.

Capital Improved Value (CIV) – the amount that the land and improvements might be expected to sell for, i.e. the value of the land AND all buildings on it. At present, 74 councils use this method of valuation as their rates base.

Differential Rates – councils that use CIV for their rating base can declare any number of rating categories with different rates in the dollar.[17] For each category councils must provide a statement of reasons for its use and the level of that rate, as well as what properties are affected.

General Rates – the amount which the council intends to raise through a proportionate rate on its property valuation base. General rates comprise uniform or differential rates but do not include municipal rates, service rates/charges and special rates/charges.

Limited Differential Rates – a limited set of differential rates that can be used by councils that do not use CIV as their rating base. Limited differential rates can include:

- A Farm Rate
- An Urban Farm Rate
- A Residential Use Rate

Municipal Charge – may be declared as a fixed charge to cover some of the administrative costs of councils. Revenue raised from a municipal charge must not exceed 20 per cent of the council's total revenue from General Rates and Municipal Charges.

Net Annual Value (NAV) -

Either:

- the estimated annual rent for which the land might reasonably be expected to be let, less some expenses; or
- five per cent of the capital improved value (CIV) of the land (whichever is the greater).

For residential properties the NAV is five per cent of the CIV. At present, five councils in Victoria use this method of valuation as their rates base.

Occupancy – If a parcel of land (or a part) is adapted to being separately occupied from other land in the parcel, it is regarded as a separate rateable property and is valued as such. This may also include land used for purposes such as car parks and storage lockers. An occupancy is also sometimes referred to as an **assessment**.

Rate in the Dollar – derived by dividing the revenue to be raised by the relevant property valuation base. The rate in the dollar is applied to individual property values to determine the amount of rates payable for a ratepayer.

Service Rates and Charges – may be declared for any of the following services:

- Provision of a water supply;
- Collection and disposal of refuse;
- Provision of sewage services;
- Any other prescribed services (currently none).

Site Value (SV) - the amount that the land might be expected to sell for if improvements had not been made, i.e. the land only. At present, no council uses this method of valuation as their rates base. This valuation base is used by the State Government to levy land tax.

Special Rates and Charges – Special Rates or Charges fund specific projects that only affect a limited number of ratepayers.

They may be declared for the purposes of:

- Defraying any council expenses; or
- Repaying (with interest) any debt incurred, or loan raised by the council.

Uniform Rates – a proportionate rate set by councils which only declare one Rate in the Dollar that applies to all rateable properties in a municipality. It is the simplest form of rates in the current system.

[17] The exception is under Section 28 of the *City of Melbourne Act 2001,* which allows the City of Melbourne to raise differential rates using any method of valuation.

Appendix I: Rating and Property Taxation in Other Jurisdictions

Property taxes are sometimes known as the tax everyone loves to hate. Yet, despite their lack of popularity, most countries around the world use taxes on property and land, especially to fund public services at the state and municipal levels.

Other Australian Jurisdictions

Municipal governments in all Australian states and territories are funded with property rates. All have been provided by their respective Parliaments with considerable latitude to levy rates in accordance with their own needs and the circumstances of their own community. Rate capping mechanisms, where they are used (including in Victoria and New South Wales, and for a period in the Northern Territory) have placed a limit on overall revenue, while allowing councils significant flexibility to apportion the rating burden as they see fit.

There is considerable variance in the valuation bases used in each Australian state, and different options and restrictions on councils. New South Wales (NSW), Queensland and Western Australia (WA) either fully or partially use unimproved or site value to determine rates. In contrast, Victoria, Tasmania and South Australia (SA) mostly use capital improved value (CIV).

Further, there is disparity in the mix of fixed charges and *ad valorem* rates and the use of differentials which are used widely. Historically, some jurisdictions have used a 'minimum' rate. SA, Tasmania and NSW have the greatest capacity to use this mechanism, allowing up to 50 per cent of the rating burden to be collected via a municipal or fixed charge. All Australian states permit the use of differential rates, but only Victoria and WA place a ratio limit on their use. Some differential rate ratios (highest to lowest rate) in councils in Queensland and Western Australia are extreme; with for example the City of Brisbane's 77 categories resulting in a ratio of 23:1[18] and the Shire of East Pilbara in WA with 12 categories resulting in a ratio of 11:1.[19]

New Zealand and North America

Most Organisation for Economic Cooperation and Development countries have a property tax system in place, or if not, a land tax system (valuing the land only) to raise public revenue. New Zealand's local governments, with similar responsibilities to those in Australia also rely on property rates to raise revenue.

North American municipal governments are heavily funded by property taxes that as a proportion of total taxation in the federal systems of Canada and the United States, are greater than Australia. Local governments in the United States and Canada are responsible for many services, including policing, fire services and education, which are funded by property rates and taxes. There is wide variance in the United States especially, with over 89,000 local and municipal governments and school districts using property taxes. This enormous variance in size, scope and, importantly, levels and apportionment of property taxation, is a reflection of the highly decentralised governance of the United States. Like Australia, municipal level governments are created via statute of the state governments and subject to their control.

Europe

Property taxation is well established in European jurisdictions. Property taxes are often used at a municipal level to fund council services. There are some broad similarities with Australian systems, including centralised valuation processes (at state or Federal level) with some freedom at municipal level to determine rates; rates relief for low-income persons and pensioners; and the use of market value or net annual value as a valuation base for rates.

Councils across the UK levy a "council tax" (on the value of homes) payable by home-owners and renters. Rates follow an increasing scale, with bands and rates varying. A complex system of concessions and exemptions is in place, including exemptions for dwellings that are temporarily unoccupied. Valuations are performed centrally by the national government however with much less frequency than Australian jurisdictions.

18. Each differential rate has a separate "minimum rate", which creates further complexity. https://www.brisbane.qld.gov.au/about-council/council-information-and-rates/rates-and-payments/how-rates-are-calculated

19. East Pilbara utilises two separate methods of valuation, Gross Rental Value and Unimproved Value, making comparison complex. http://www.eastpilbara.wa.gov.au/shireofeastpilbara/media/Documents/Rates/Shire-of-East-Pilbara_Rates-Brochure.pdf

Councils in France levy an annual property ownership tax (partially applicable to vacant land) with a per cent rate based on notional annual rental value (broadly similar to net annual value, with heavy discounting for management costs etc.). Concessions apply for senior and disabled people and there are temporary exemptions for new buildings.

Until recently, France also applied a similar property tax payable by the occupant on residences. This is set to be phased out by 2020. In contrast to the UK, reductions are offered on the basis of the number of occupants. Reductions apply for principal residences of senior and low-income people. Councils apply a separate waste collection tax and also charge separate rates on business premises.

Germany, Austria and Switzerland impose taxes on real property using a combination of a base rate (set by the state level governments) and a "multiplier" that varies by municipality. Rates vary by property type.

In contrast to Australian systems, there is sometimes a relationship between the tax payable to the number of occupants in a residence, with various regions providing reductions or levying increased rates based on occupancy numbers introduces some elements of a poll tax into the system. In addition, unlike Australia, very few European countries or regions to use unimproved land values as a tax valuation base.

Asia

Japan's property taxation system is administered by the central government. Around half the revenue is distributed to municipal governments. Properties are taxed on the basis of value, with an effective uniform rate applied nationwide. Similarly, South Korea levies property taxes for municipal revenue via a nationally consistent percentage rate on the market value of property.

Other Asian countries have varying levels of property taxation. Thailand levies property taxes on commercial and rental properties only, and Indonesia uses a progressive property tax system, with an increasing percentage rate applying to more highly valued property.

Indian states may delegate property taxation to municipal style bodies. Known as the 'house tax', it is levied on annual rental value with progressive rates applying in urbanised areas.

Recent Adopters

Countries that have recently commenced the implementation of a property tax system to fund municipal public services include Chile, Vietnam and Ireland.

Key challenges

The two most consistent arising challenges for municipal level property taxation systems around the world are:

- Accurately calculating and levying the property tax due to inconsistently administered property valuation systems
- Political resistance to levying an unpopular wealth tax.

In relation to the first challenge, Victoria has an established system with annual valuations, a large database of valuation information going back decades and checks and balances in the system, including appeal rights. While rates, like all taxes, have a political element, relative to many state and federal taxes, the public has accepted the existence of rates as a tax to fund municipal services.