

2019 Local Government (LG) Rating System Review

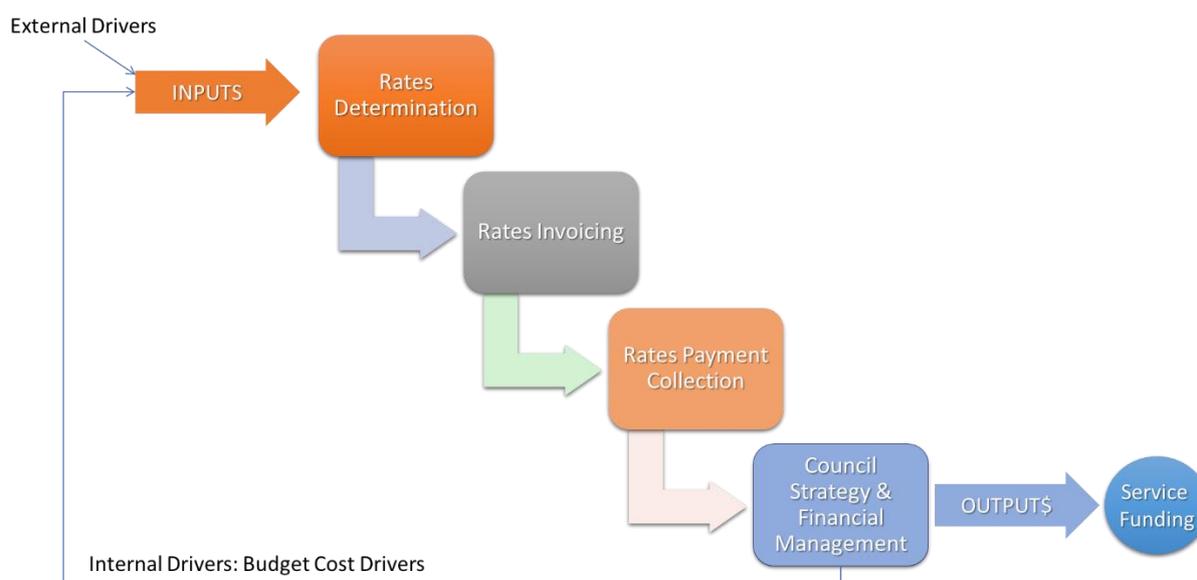
Background

Following up your recent 23 Oct 2019 engagement with ratepayers (at the Windsor Hotel), Ratepayers Australia would like to submit additional information to the review panel.

The Rating System's Operating Model

What is not clear in the LG Rating Review Discussion Paper is the scope of the rating system's operating model. From the 23 Oct forum's questions and discussions, we envisage the following diagram conceptualises the scope of this rating system, based on the user experiences (UX) of ratepayers interacting with it, to be informed and invoiced; pay for money owing to council and including having a say in councils' 4 year's strategic and annual budget planning that projects cost drivers that influence the determination of rates fundraising value.

This is the first gap, i.e. the operating scope of the rating system is NOT clearly understood. The 23 Oct Forum's dismal of council budgeting issues raised by participants, is a result of this lacking understanding of system scope.



Only with this clarity of the scope of the rating system, we can more effectively share our evaluation insights to assist the panel better understand improvement opportunities that not only better strengthen the fairness and equity of the system, but also identify governance overlays that ensure the rating system is not just economically sustainable for councils, but is also socially responsible to the ratepayers and other users who pay for municipal services and infrastructures.

Rates Determination User Experiences

The heart of this rating system phase is about calculating each property's annual rates payable.



[Prosperous Australia](#) has [researched](#) extensively on local government rating approaches and recommends for the Site Value (SV) approach and against the current CIV, which is adopted by most councils and is included in the 2019 LG Bill to be a possible state-wide rating methodology.

Our concerns with the CIV approach is underpinned by:

1. **Inefficient and transparency lacking councils' budget management:** Annual councils' budgets do not align to track the financial performance of councils 4 years strategic plans and long-term assets management (if not lacking or do not exist). The rates capping policy was legislated with the intent to increase council efficiency and productivity, which are still lacking in progress development today, concluding there is continuing high inefficiencies and lacking transparency in councils' budget management. Until this financial management inefficiency is fixed, rates determination would continue to yield inflated rates.
2. **External factors inflating the capital values of properties:** 2 factors were discussed during the forum:
 - a. Ratepayers are asked to pay notional tax (via rates) on properties they reside in, and developers transfer this tax obligation to purchasers. Other investments' taxation follows ATO rulings, that the investors pay for realised capital gains when investments are sold or if the investor is a speculative trader. Residential ratepayers have not sold their properties or are negative gearing the properties they live in and they pay tax (rates) on dynamic notional market value of their homes. The no brainer is that councils gets more rates income; developers have more access to supply of properties when selling owners are attracted by high market values, or force-sell because rates are increasingly unaffordable and adding to higher cost of living; and affluent international investors can outbid local buyers. The CIV system also penalises ratepayers (through higher rates) when they or their neighbours improve their properties.
 - b. Many properties in some metro areas were/are increasingly funded by money laundering (ML) schemes, which are currently unaddressed, because of lack of money laundering legislation imposition on real estates, accounting and legal professional service providers. Furthermore, councils (unlike their UK counterparts) have no money laundering detection obligations, hence policies. The sophistication of high-end ML schemes can involve complicated and often transnational networks of real-estate agents, accounting and legal firms, the use of multiple shelf and established companies, securitisation investment and banking institutions and even council planning decision makers. These schemes often use local developers, local companies, international students and individual investors as front end covers to

acquire properties in targeted areas. Complicated and multi layering concealment tactics, such as buying and reselling several times among and between developers and company and individual investors, also help to effectively whitewash local and international dirty money. As there is no prudent and effective anti ML and corruption oversight of planning decisions made by councils, especially when council sells their own lands with lacking business cases and decisions are made behind closed doors ([Casey](#) is the first public detection of this concealed issue already arising in many councils)

Changes to the current rating system should include better state-wide risk management, hence governance oversight legislation, to address these external factors.

Rates Invoicing User Experiences

79 councils have their own rates invoicing and payment systems. There is an immediate efficiency improvement opportunity to consolidate these 79 different rates invoicing and payment systems into one shared model, and redesign a state-wide format for rate invoicing, by involving ratepayers in the process and ensure statements' information makes lay sense. Currently, councils are not familiar with design thinking approaches in their service improvement and development capabilities.

Rates Payments Collection User Experiences

79 councils have varying methods of collecting rates and arrears payments. The paperwork of each method supported often get mixed up across methods, causing waste in issuing unneeded paper notifications/mailouts, causes confusion among ratepayers and takes time to resolve. These payment collection and administration variations are creating unneeded and preventable cost waste.

The forum discussions also noted the special powers of councils to confiscate properties when ratepayers are unable to pay their rates and the lack of social responsibility in consistently supporting ratepayers with genuine financial difficulties. To worsen this matter, the 2019 LG Bill is proposing to legislate the provision of Environmental Update Agreement (EUA) loans¹ to residential owners. The EUA loan repayments will appear in rate invoices. This green loan service leverages councils' rating powers to collect loan repayments; confiscate and sell properties and transfer credit risk to future borrowers in situations of loan defaults. It also enables the financing agency (Sustainable Australia Fund, underwritten by Bank Australia) to create portfolio funds of highly secured loan assets for securitisation and trading in financial and investment markets (also often used in sophisticated money laundering schemes).

It is bizarre that the 2019 LG Bill legislate a new financial service, without proper due diligence and overarching governance guidelines, to be potentially legislated as a revenue- fee raising municipal service, breaking away from councils' core business lines.

¹ Further information (including ratepayer concerns) about this new green financial service is in Appendix 1.

Council Strategy & Financial Management User Experiences

Community engagement in annual budgeting is often tokenistic and many local constituents lack the knowledge and/or time to analyse council budgets and ask the right scrutiny questions. Most engagement often involve small groups wanting community grants. The effectiveness of the few participatory budgeting programs that are practiced by some councils, is not widely known and the knowledge shared. Further to that, there is no evaluation measures by the community to assess how well these public engagement programs are conducted and ensures transparency and accountability in rates-funded council strategic and operating budgets.

Council strategy planning only involved a selected few of public participants. The accepted council plan projects 4 years budgets, which annual budgets and long-term assets management plans are not effectively aligned with. As a result, the financial cost of a strategy plan is not effectively managed, often changed by annual budgets without meaningful variation highlights and explanations. Ratepayers trying to scrutinise the service performance and financial management of longer-term council plans against rolling annual budgets by strategy cycle, are strongly challenged by the complexity of financial indicators reconciliation and laboriously lengthy effort involved.

A state-wide training program for ratepayers to understand and participate in council strategy and budget planning, can also be socially beneficial and also offers economies of scale in increasing public participation in council strategic and operating financial planning and performance oversight. Provision of a community engagement evaluation and performance management system can also ensure good governance practice in councils' decision making and implementation concerning both financial and service management matters.

Rating System Fit for Purpose (Service Management) User Experiences

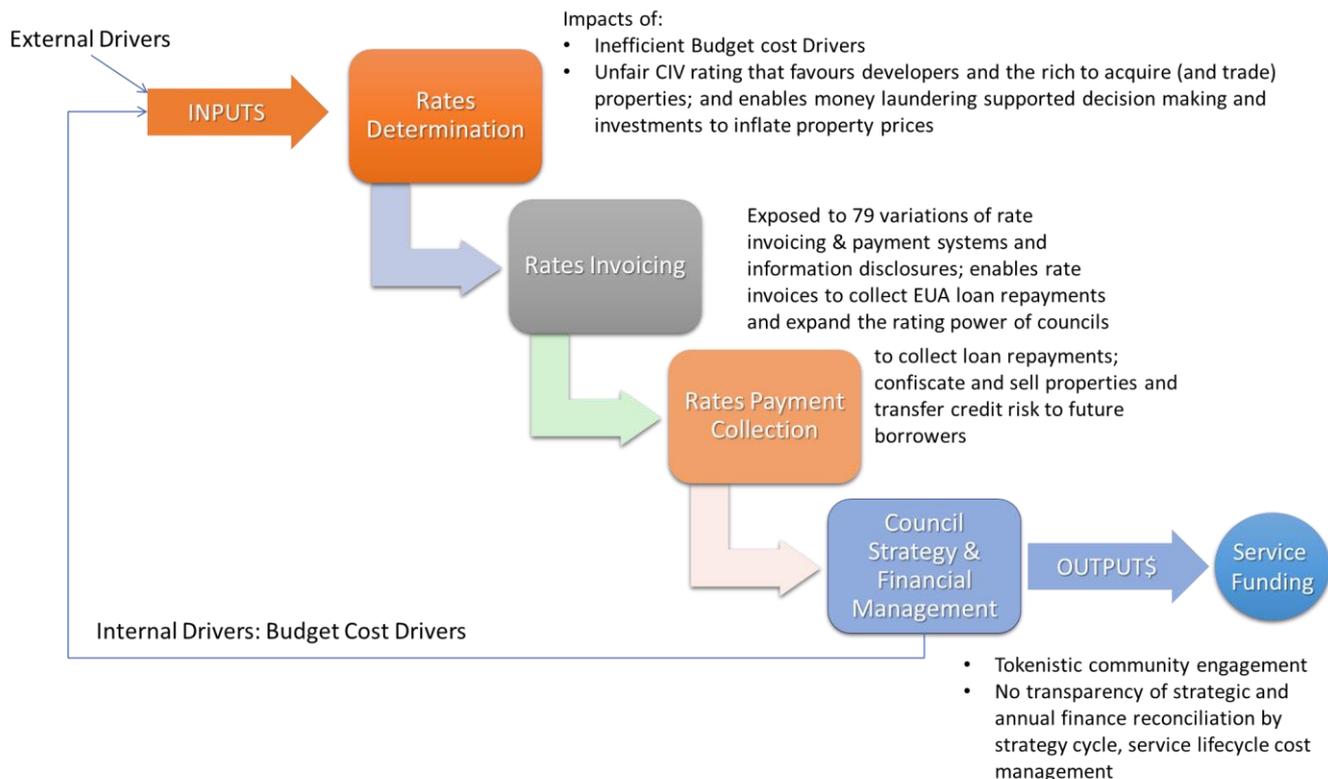
The ultimate goal of the LG rating system is to deliver partial funds for councils to finance their expenditures in providing council services. Efficacious service management in councils is very lacking and no ratepayers can understand the activity costs of service provisioning, from new service / project development to on-going maintenance. The lifecycle management of new services funded by higher government grants does not exist, often resulting in originally short term or once off new service provisioning to continue without further grants support and no business case evaluation to continue them or otherwise. As a result, there is no public visibility of service costs management reporting and ratepayers are kept in the dark about the total and breakdown costs of service management in councils.

The rate in the dollar explanation of how rates are spent is based on historical trends or budgets already inheriting many inefficiencies in their estimations.

The Panel needs to acknowledge that the fit for purpose of the current rating system is not working efficaciously. There is a need to understand and agreed what constitute the process phases of the rating system and applying a system thinking approach to identify the flaws and improve the current system, including providing a community engagement performance management (governance) overlay that can integrate into the LG Performance Reporting Framework.

Summary of User Concerns

We have highlighted concerns about the rating system in terms of its process phases, summarised as follows:



Conclusion

As a result of this analysis of the forum discussions and our contributions to the 2019 LG Bill review, we can conclude that we support the notions that:

1. All property owners should pay rates, including interim owners, such as developers, and the rates valuation approach should change to an income/affordability based methodology.
2. All ratepayers should pay the same percentage of rates, to optimise consistency and efficiency, however councils can offer discretionary subsidies or grants to disadvantaged or special consideration parties.
3. Rates should be determined by a fair and equitable state-wide Site Valuation approach, not the CIV model currently adopted by almost all councils. We also recommend that the panel take into consideration the solution options communicated by a representative from Prosperous Australia.
4. The State should provide an overarching governance framework (which includes a risk management outline) in directing how councils localise and manage the LG rating system phases and ensuring the rating system is fit for purpose, i.e. the rates financed funds are efficiently and effectively managed, together with visible/ transparent service cost breakdown and quality management.
5. The current rating system is NOT clear and transparent as there are internal inefficient cost drivers and external influencers that increasingly inflate property value, which have not been understood and given public scrutiny and priority attention within the sector, including the LG Rating System panel.

The current rating system is inefficient, unfair and inequitable, favouring councils, developers and investors at the expense of ratepayers, especially residential ones. Additionally, it also lacks fit for purpose transparency and accountability in council financial and service management, diluting all *good governance* core principles. It is high time the panel recommends consistent and state-wide reforms to correct these systematic operating and governance deficiencies currently in the Victorian LG Rating System.

Appendix 1 – EUA Product Analysis

The Governance Issue

Victoria’s 2019 Local Government (LG) Bill includes amending the LG Act (1989) to provide environmental upgrade agreements (UAE) to residential ratepayers. Currently EUA loans are offered to commercial and other incorporated ratepayers, including body corporates, who can claim EUA expenses in their income tax returns. However the equity sharing of benefits and governance effectiveness are unclear. Melbourne City Council was the first Victorian council to experiment with EUA financing for commercial property owners. In 2015, the LG Act (1989) was amended to allow all councils to enter EUA with their incorporated ratepayers.

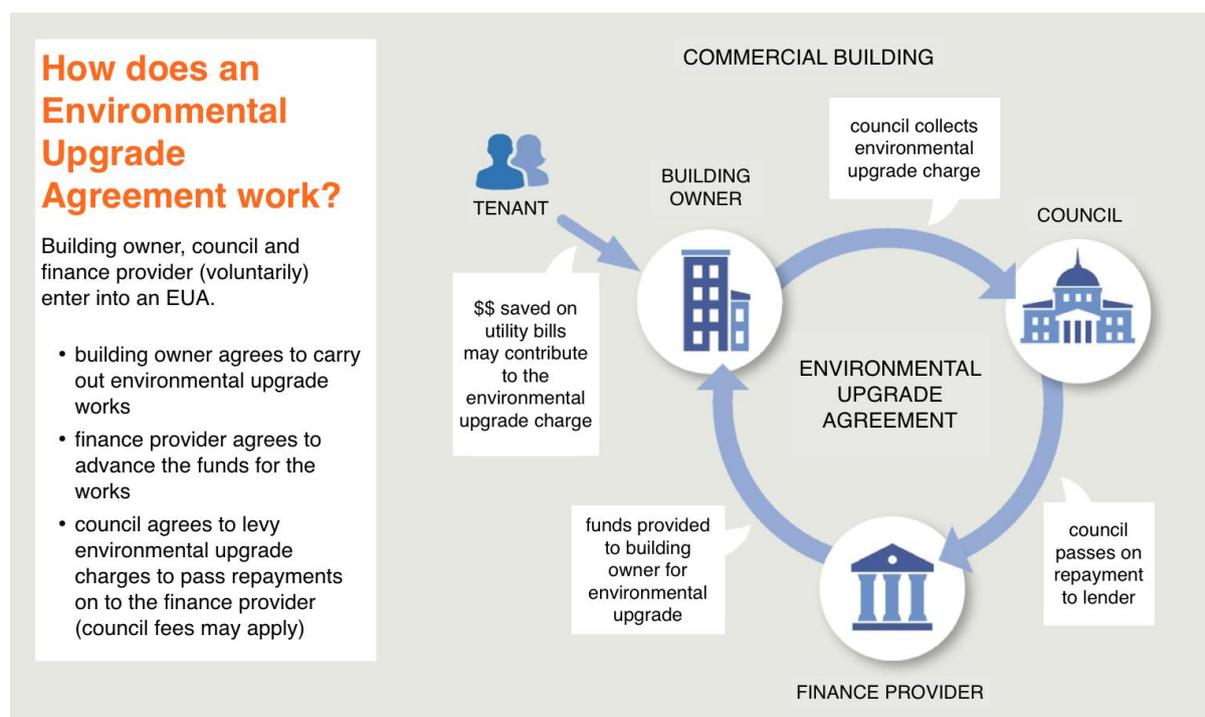
To shed some insights into understand the equity sharing of benefits and governance risks of EUA, we conducted a high-level research and product analysis of EUA. The analysis findings are as follows.

What is an Environmental Upgrade Agreement (EUA)?

“Environmental Upgrade Finance (EUF) is a new and growing form of finance designed to make existing buildings better. It enables businesses and building owners to borrow money with very favourable terms so they can upgrade their buildings to save on energy, water and waste. It involves an **Environmental Upgrade Agreement (EUA)** between the building owner, financier, and local council” ([Better Building Finance, 2019](#)).

How EUA Works?

Many marketing collaterals clearly explained how EUA works, such as the one below.



([Efficiency Matters, 2017](#))

Who are the partnering organisational service providers?

- | | |
|---|---|
| 1) Councils | Act as EUA retail channels & loan payment collection Intermediaries |
| 2) Better Building Finance: <ul style="list-style-type: none"> • Established by Melb City Council in 2015² • Managed by Sustainable Australian Fund | Backoffice service provider for servicing loan principle deposit and repayment transfers and other back-office administration |
| 3) Sustainable Australia Fund <ul style="list-style-type: none"> • A commercial and independently unit trust established by Melb City Council in 2002, to “progress sustainable development in greater Melbourne.” • Recapitalised & scaled by Bank Australia in 2019³ to reach out a national market. | Manages the EUA loan mortgage fund portfolios. |
| 4) Other state and development peak-bodies, such as the Australia Government Department of Industry, Innovation and Science (grant provider) and WA Property Council (lobbying WA Parliament to legislate EUA in their LG Act. | Provide a variety of financial and in-kind resources for the development of EUA financing to promote & support their green policies and initiatives; lobbying for LG legislative adoptions of EUA |

What is innovative about EUA financing?

EUA’s underpinning financial structure:

1. Leverages councils’ rating powers to collect loan repayments; confiscate and sell properties and transfer credit risk to future borrowers in situations of loan defaults;
2. Creates portfolio funds of highly secured loan assets for securitisation and trading in financial and investment markets;
3. Allows councils to access consistent back-office administration support through Better Building Finance.

Stakeholders’ Cost-Benefits Analysis

Councils	+ New, long-term, guaranteed and default risk-free net revenue streams from Sustainable Australia Fund. + Facilitate more existing property owners to (notionally)	- As new intermediaries in financial provisioning, councils have not publicized confirmation of their likely APRA, AUSTRAC, SOX and other market governance obligations. - Councils have no quantifiable environmental sustainability
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² The same year the LG Act (1989) was amended to allow councils and incorporated ratepayers to enter EUAs.

³ The same year the 2019 LG Bill proposed to allow EUA to be available to residential ratepayers.

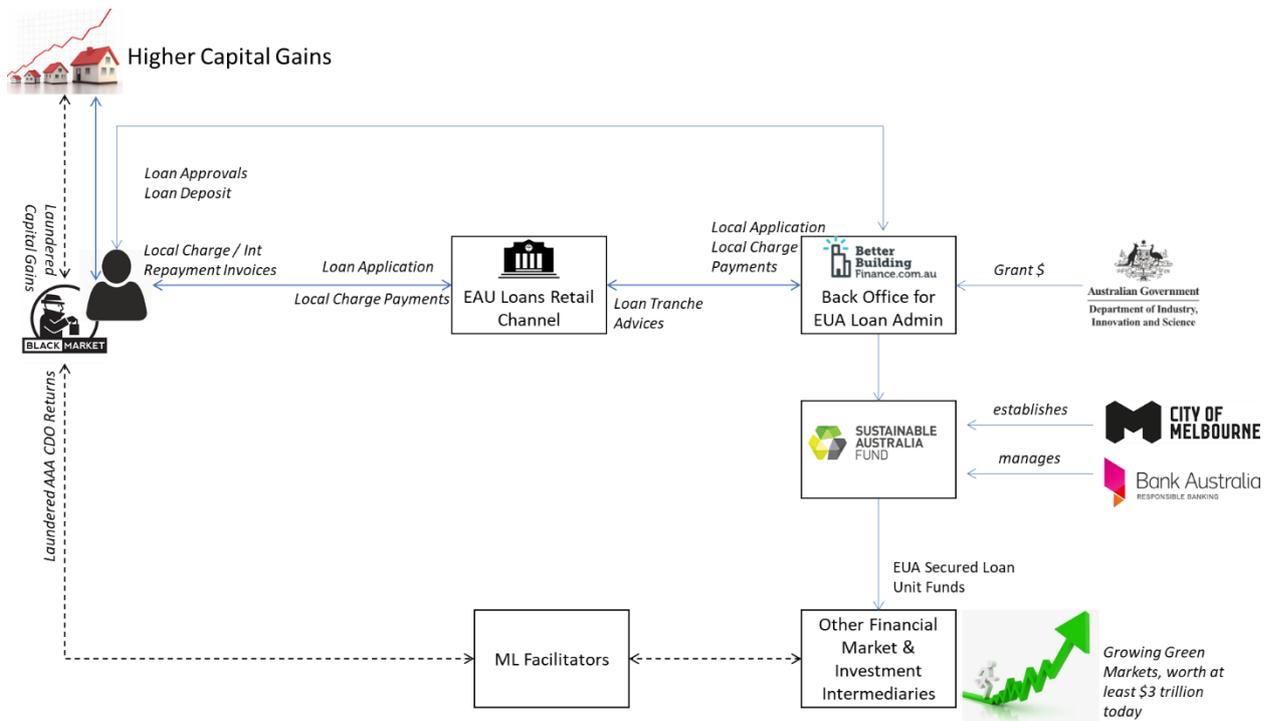
	<p>contribute to environmental sustainability via their EUA financed property upgrades.</p>	<p>objectives and associated KPIs, to measure the environmental value enabled by EUA financed upgrades. Without these KPI measures, there is no clear alignment of real outcomes to state's carbon emission targets, etc → exposing councils to greenwash participation risks.</p>
Ratepayers & Tenants	<ul style="list-style-type: none"> + Benefit increased capital value of their existing properties, especially good for developers and investment speculators, not so for residential homeowners & tenants who are exposed to higher CIV rates + may enjoy cheaper utility costs, after local charge offsets, depending on term of outstanding debt repayments 	<ul style="list-style-type: none"> - Credit risks are transferred to future ratepayers and tenants inheriting previously defaulted and long-term debt with no access to, or constrained exit and take-up of cheaper financing alternatives
Sustainable Australia Fund (SAF) & its EUA back-office admin company (Better Building Finance)	<ul style="list-style-type: none"> + Revenue from loan interests and fees, back-office service fees; trading profits from EUA securities – from low risk & security backed primary CDO issues and possible CDO-derivatives' trading. + No credit risk liability, hence lesser prudential/governance costs + <i>Early to market</i> opportunities in developing Australia's green financial markets 	<ul style="list-style-type: none"> - Due to joint ownership holding with Melbourne City Council and that SAF's business will increase as the council promotes and progresses sustainable development in greater Melbourne, there may be risks of collusion than conflict of interest.
Other Government Agencies and Property Development peak bodies like Property Councils	<ul style="list-style-type: none"> + Perceive EUA financing can foster greater community contributions to environmental sustainability policies and initiatives + Business/political propaganda branding & green populist appeal to customers/voters e.g. recent declaration of climate change emergencies in local areas 	

<p>Money Launderers</p>	<ul style="list-style-type: none"> + Very profitable and new ML scheme across Australia, in a poorly regulated property market and lacking governance local government environments. + ML scheme offers capital gains and safe primary EUA security investments and access to derivatives trading, complicating/concealing visibility of ML channels. 	
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Risk Analysis

Lucrative Money Laundering Scheme/Topology

EUA loans and securitisation may likely offer a new and lucrative; highly secured and long-term revenue generating retail and institutional ML investment products in Australia, the most preferred place for money laundering ([ABC News, 2017](#), [Transparency International, 2017](#)), because of its poorly regulated property markets and governance lacking local councils with no money laundering policies (unlike their UK counterparts). If and when EUA securities are offered in international derivative markets, transnational money laundering becomes more easily accessible. Without access to streamlined EUA front and back office transaction data, currently widely distributed and fragmented across different company structures and council channels across Australia, the capacity of AUSTRAC to data mine ML activities would be very challenging, if not untimely or even impossible.



Green Loans Oligopoly and Market Inefficiencies

The joint ownership structure of Sustainable Australia Fund, and its ownership of Better Building Finance, may implicate risks of collusion and oligopoly control of a niche green loans market. The fair competition of green loans is at risk. EUA oligopoly is easily viable, enabled by strategic cross company holdings; the legislated control of council retail channels; and creating competition barriers through a diversity of partnership-forms with various state and federal government agencies across the nation. Oligopoly creates market inefficiencies; reduces competition and innovation in the emerging green financial markets, which is currently estimated to be worth \$3 trillion worldwide ([Bloomberg, 2019](#)). This form of market control can also encourage price fixing and higher service prices, which are market conditions that offer more attractive revenue for councils and higher tax claims for businesses, but not benefiting residential ratepayers.

States' property industry leaders and peak bodies (e.g. property councils) have successfully lobbied or are currently urging their states' parliaments to change their local government acts to include EUAs, which further increase this oligopoly risk and its occurrence coverage nationally.

Council Risks & Domino Consequences

As councils are involved in the EUA contracts, they are intermediaries in financial service provisioning, notably being EUA retailing channels; risk transferring and debt payment collection intermediaries for Sustainable Australia Fund. Financial service provisioning is not a municipal service by legislation and the 2019 Local Government Bill legislating the extension of EUA to also cover residential ratepayers will make Local Government become the new *boy-in-town* in the financial services sector. This means councils will have to oblige and meet AUSTRAC, APRA and other financial market regulations, however, currently they are not. Councils, as new entrants, will contribute to and be affected by the systematic market risks, which APRA may not be aware, including **the future impacts of councils on the stability of the Australian Financial system**.

Councils' environmental sustainability policies and initiatives are considered to be at capability maturity level 1, hence there is absence and inconsistency of reliable KPI measures, such as those of the Global Reporting Initiative (GRI) standard. Without KPI measures, councils are unable to quantify and prove their performance in responsible environmental sustainability and validate their contributions to Victoria's environmental sustainability targets (which are still unclear and in development). Ultimately, councils cannot show the transparency of and hence cannot commit accountability for the real environmental value of EUA financed property upgrades. Current EUA marketing collaterals only quantify illustrated financial returns. These governance issues create a very precarious public perception that views councils are involving in greenwashing activities.

These ethics and governance issues, when not mitigated and effectively managed, would result in non-compliance sanctions and new regulatory compliance setup and reporting costs, which can only mean much higher future council rates and local charges to support EUA service provisioning.

Closing Note

The product analysis identified there is inequity in benefits sharing and the prevalence of many ethics and governance issues involved in EUA service provisioning. Continuing a complete legislation of allow all ratepayers to enter EUAs with their councils will erode the integrity and governance objectives of the 2019 Bill's reforms, ultimately affecting the community confidence and trust in local government. There are also other flow-on impacts associated with enabling more complex and concealing money laundering layers, and offering more and secured returns for ratepayers linked to the black market. Until the management frameworks of these governance and compliance issues are clear, the 2019 LG Bill should seriously reconsider legislating EUA to become a mainstream municipal service in Victoria's local government.