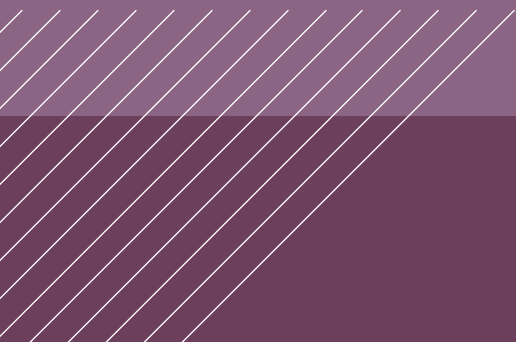


Victorian Fire Services Property Levy

Options Paper

June 2011



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1. Treasurer's foreword

In February 2009, Victoria was devastated by bushfires. At this time, concerns were raised about the operation of the Fire Services Levy (FSL). The Victorian Bushfires Royal Commission (the Royal Commission) subsequently recommended that 'the State replace the Fire Services Levy with a property-based levy and introduce concessions for low-income earners' (Recommendation 64).

The Victorian Government will introduce a fairer and more equitable new property-based levy to replace the existing Fire Services Levy. The current insurance-based model is inequitable and lacks transparency. The new levy will ensure that all Victorian property owners pay a fair contribution to our fire services.

Ensuring Victoria's fire services continue to operate equitably and with sufficient resources will be the focus of the design of the new levy.

This options paper outlines a range of levy design and implementation issues - from the most appropriate tax base on which to apply the property levy, to the most effective and efficient method to transition from the insurance-based model to a property-based model.

The Government offers all Victorians the opportunity to comment on the options for the design of the new fire services levy. A public consultation process will be undertaken to seek feedback, and responses will be considered in finalising the design and implementation of the new levy and transition process.

This options paper is the first stage in delivering this significant reform of the funding of Victoria's fire services.

KIM WELLS MP

Treasurer

2. Executive Summary

The annual budgets of Victoria's fire services are mainly funded by financial contributions from insurance companies, the State Government and metropolitan councils. The State and Commonwealth Governments provide additional funding in the event of major fires. Insurance companies recover the cost of their contributions by imposing a Fire Services Levy (FSL) on insurance premiums.

This options paper sets out the Government's proposal to replace the current funding model with a new property-based fire services levy, and invites community input regarding key elements of the new property levy. The Government welcomes views on the following proposals for the design of the new levy:

- Impose the levy on real property, including non-rateable property, property owned by local councils and potentially the State Government.
- Set the fire services property levy annually to ensure the fire services are adequately funded.
- The fire services property levy be comprised of a fixed component and an ad valorem charge assessed on the value of property.
- A concession be provided to Health Care Card holders, Department of Veterans Affairs gold card holders and Pensioner Concession Card holders.
- The fire services property levy be collected by local councils, with support for implementation and administration.
- The tapering approach be adopted to phase out the insurance contributions prior to the introduction of the property levy.
- The Essential Services Commission be appointed to independently monitor the FSL transition process and release a report on whether or not insurance companies have passed on savings to policy holders.

In a number of other areas there is a need to choose between different options for key elements of the levy. The Government seeks feedback on the following issues:

- Which components of the statutory contributions model should be replaced by a property levy.
- Whether the property levy should be assessed on the site value, improvements value of real property or on the capital improved value.
- The respective costs and benefits of a single statewide levy and separate levies for areas served by the CFA and MFESB.
- The potential for different property levy rates for different property types.
- How the amount of any concession should be determined.

3. Introduction

3.1 Previous reviews

Victoria's move to a property-based levy is consistent with recent reform in other states and territories. The Australian Capital Territory (2006–07), Western Australia (2003), South Australia (1999) and Queensland (1985) have introduced funding systems for fire services that require property owners to contribute via a levy on property. Tasmania levies residential property owners, while retaining an insurance-based levy on businesses.

In 2003, DTF released *A Review of Victorian Fire Services Funding Arrangements* comparing and evaluating various funding options. The Government of the day decided to retain the current fire services funding model, subject to some minor changes.

In 2009, the *Fire services and the non-insured* Green Paper was released, inviting public comment regarding the funding of Victoria's fire services and proposing a DTF pilot study into the level of insurance in Victoria. Public submissions overwhelmingly supported a property-based funding model.

In May 2010, the *Australia's Future Tax System* review was released. It recommended that all specific taxes on insurance products, including the FSL imposed by insurance companies, should be abolished, advising that insurance products should be treated like most other services consumed within Australia and be subject to only one broad-based tax on consumption.

In July 2010, the Royal Commission recommended that the current insurance-based funding model be replaced, on the grounds that it:

- is inequitable since the community-wide benefits provided by the fire services are funded by insured property owners only; and
- lacks transparency, as there is no direct or well understood link between insurance company contributions to the fire brigades and the FSL paid by insured property owners.

The Royal Commission did not prescribe the design of the property-based funding model but suggested that the State could benefit from the experience of other states and territories.

The Royal Commission was concerned that changing to a property-based model might create problems for some uninsured property owners with low incomes. This group would find themselves paying the new levy, without a compensating reduction in their insurance costs. As such, the Royal Commission recommended concessions for low-income earners.

3.2 The fire services

There are three authorities responsible for the provision of fire services throughout Victoria, the Metropolitan Fire and Emergency Services Board (MFESB), the Country Fire Authority (CFA) and the Department of Sustainability and Environment (DSE).

The MFESB and CFA undertake a range of activities that support three main objectives:

- fire or hazard prevention;
- fire or hazard extinguishment; and
- fire or hazard containment.

The MFESB and CFA also respond to a myriad of other emergency incidents including:

- floods;
- search and rescue;
- road accident rescue;
- emergency medical response; and
- industrial and hazardous materials incidents.

The MFESB and CFA also develop fire safety procedures and counter-terrorism strategies, provide community safety programs, conduct fire safety building inspections and inspect and maintain equipment.

DSE has statutory responsibility to prevent and suppress fire in every State forest, national park and on all public land in Victoria. DSE in partnership with Parks Victoria provides a significant fire fighting effort during events such as large bushfires and is entirely government funded.

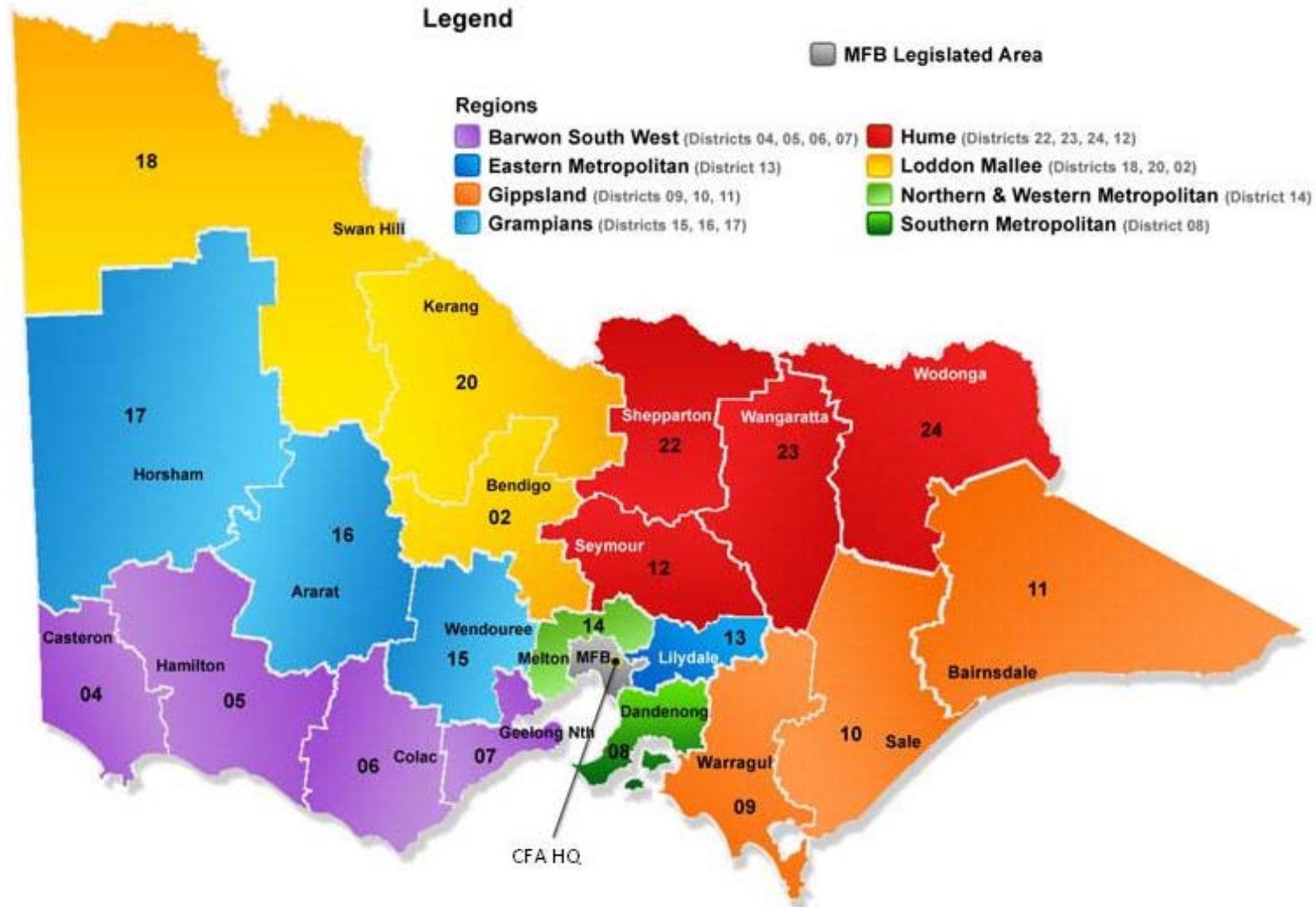
3.2.1 MFESB and CFA geographical coverage

While the MFESB and CFA are each responsible for distinct geographic areas (see Figure 1), they extend their services across regional boundaries in response to specific emergencies.

The MFESB provides fire service coverage in metropolitan Melbourne. The Melbourne Metropolitan Fire District (MFD) covers approximately 1 096 square kilometres, containing almost four million residents, workers and visitors and billions of dollars of assets and infrastructure. The MFESB employs more than 1 700 fire fighters in 54 fire stations and specialist departments.

The CFA is one of the world's largest volunteer emergency service and community safety organisations. The CFA is based on community involvement and gains its strength from the commitment of its volunteers and staff. There are over 58 000 CFA volunteers, including more than 35 000 trained volunteer fire fighters and 23 000 involved in non fire fighting roles. The authority is supported by over 1 400 paid staff, including over 500 career fire fighters, providing emergency response and community safety programs throughout Victoria. The CFA provides fire services to all parts of Victoria other than the Melbourne MFD. This covers 150 182 square kilometres, and with the expansion of the urban fringe requires the CFA to provide services with a greater urban focus.

Figure 1: Areas serviced by the CFA and the MFESB



Source: Country Fire Authority

4. Fire services funding arrangements

4.1 Current funding arrangements

The MFESB and CFA are largely funded by statutory contributions from the insurance industry, metropolitan municipal councils and the State Government in proportions determined by Section 77A of the *Country Fire Authority Act 1958* (CFA Act) and Section 37 of the *Metropolitan Fire Brigades Act 1958* (MFB Act).

As illustrated in Table 1, insurance companies are required to contribute 75 per cent of the statutory contributions to MFESB annual expenditure and 77.5 per cent of the statutory contributions to CFA annual expenditure. The State Government contributes 12.5 and 22.5 per cent respectively. Local governments located wholly or partly within the MFD are required to contribute 12.5 per cent of the statutory contributions to the annual expenditure of the MFESB. Local councils outside the MFD are not required to contribute to CFA annual expenditure.

Table 1: Statutory contributions (per cent)

	MFESB	CFA
Insurance companies	75.00	77.50
Local government	12.50	-
State Government	12.50	22.50
Total	100.00	100.00

Source: Section 77A of the Country Fire Authority Act 1958 and Section 37 of the Metropolitan Fire Brigades Act 1958

In addition to the statutory contributions set out in Table 1, the fire services receive funding from a range of other sources. This additional funding is provided by the Commonwealth Government, insurance brokers (and property owners who insure with a company not required to make a contribution), user charges (including attendance at false alarms), the sale of goods and services and income from investments. The State Government provides further funding for catastrophic fire events. (Table 6 on page 14 provides a full summary of MFESB and CFA funding.)

4.2 The insurance Fire Services Levy

Insurance companies have had an evolving role in funding Victoria's fire brigades since their inception in 1845. Under the current statutory contributions model, the fire brigades provide the Government with an estimate of expenditure likely to be incurred during each financial year. The Minister determines the total statutory contributions, and the insurance industry statutory contribution is distributed between individual insurance companies. The distribution is based on the insurance companies' annual gross premium income for each dedicated class of insurance.

Insurance companies pass on their contribution costs to policy holders as an FSL on insurance premiums. The Insurance Council of Australia (ICA) provides their members with quarterly advisory rates to add to premiums. The rates are advisory in nature and members are recommended to make their own determination of the FSL having regard to their estimated premium movements. The ICA has no legislative or statutory power to set rates

and insurance companies are not obliged to recover the costs in this way. Similarly, there is no role for the Government to determine how insurance companies should recover their costs.

The recent ICA advisory rates for Victoria are illustrated in Table 2.

Table 2: ICA advisory rates (per cent)

Victoria metro	May-11	Feb-11	Dec-10	Sep-10	Jun-10	Mar-10	Dec-09	Sep-09	Jun-09	Mar-09	Dec-08	Sep-08	Jun-08
Commercial	45	44	44	46	46	46	47	50	51	48	48	48	48
Householders/homeowners	18	17	17	18	18	18	19	20	21	20	20	20	20
Victoria country													
Commercial	65	64	64	66	72	72	80	84	68	63	63	58	58
Householders/homeowners	24	23	23	24	26	26	28	31	26	24	24	24	24

Source: Insurance Council of Australia

Most ICA members apply rates similar to the advisory rates to all home and contents policies. To calculate the FSL liability, the insurer will multiply the cost of the insurance policy by the advisory rate. For example, a residential building insurance policy of \$400 a year will be multiplied by the relevant rate (18 per cent in the metropolitan area) to determine a FSL liability of \$72.

4.3 Problems with the current funding model

Following the 2009 bushfires a number of questions were raised regarding the equity and efficiency of the statutory contributions funding model.

4.3.1 Over collection

The 2003 review highlighted concerns that insurance companies were collecting more FSL than the amount they were required to contribute to the MFESB and CFA.

It is estimated that from 1998-99 to 2001-02 the FSL revenue collected by the insurance industry was \$47 million greater than the statutory contribution the insurance industry was required to make to fund Victoria's fire services. While these excess amounts were retained by the insurance industry at that time, the Government introduced improved reporting measures to increase transparency in the insurance industry's collection of the FSL. Insurers must now report the contributions made to the fire services and the amount of the FSL collected each year.

From July 2006 to June 2009, the insurance industry collected \$17 million less in FSL than the required statutory contribution to the CFA and \$12 million more than the required statutory contribution to the MFESB. These discrepancies are likely to be the result of estimating premium income in advance of revenue collections.

4.3.2 Under-insurance and non-insurance

Insurance taxes are among the most inefficient taxes levied in Australia and there is significant potential for reform. The combination of state and Commonwealth taxes on insurance reduces transparency and increases the cost of insurance.

One of the primary concerns with the insurance-based model is that non-insured property owners do not contribute to funding the fire services. As a result, owners of insured buildings and contents are over-contributing to funding the fire services and cross subsidising the non-insured.

In 2010, DTF and the State Revenue Office (SRO) undertook a study to assess the level of non-insurance in Victoria. This study involved collecting information from insurance

companies on insured properties in 10 local authority areas and matching this to the SRO's property database.

In Victoria, there is a low level of building non-insurance both in absolute terms and when compared to other Australian states and territories (including those that do not use an insurance-based funding model). The estimated range for non-insured residential properties is between 3 and 9 per cent for buildings, with the most reliable estimate indicating that 4 per cent of Victorian households do not have building insurance. Approximately 26 per cent of Victorian households do not insure their contents.

A second equity concern is the incidence of under-insurance, where property owners insure their property for less than its value and therefore pay lower premiums and a reduced FSL. There are two possible measures of property value for insurance purposes, replacement cost and market value. Replacement cost refers to the cost of rebuilding the home, while market value is the differential between the likely sale price of the land (in the event of the home being destroyed) and the cost of purchasing an equivalent property.

Under-insuring a property for its replacement cost is prevalent and likely to be caused by:

- the intrinsically difficult task of estimating rebuilding costs;
- failure to update policies as circumstances change; and
- a deliberate tendency to insure only the dwelling and not other items such as fences and water tanks, which is a positive choice to partially self-insure.

Conversely, only a small percentage of domestic buildings are insured for less than market value. Many property owners are significantly 'overinsured' in respect of the market value of their home.

4.3.3 Owners of similar assets can make significantly different contributions

Insurance premiums for similar properties can vary significantly. The price of insurance varies due to deductibles and differential products, such as new-for-old replacement and reimbursement if building costs exceed the sum insured. Some property owners renew insurance policies with existing insurers without comparing premiums, or accurately estimating the value of their home and contents. These factors contribute to owners of similar assets paying considerably different premiums and therefore different FSL contributions.

A 2010 analysis of online insurance premium calculators found that a residential property with a sum insured of \$200 000 and a deductible of \$500 could pay an insurance premium of between \$296 and \$544. When the ICA advisory rates are applied to these premiums, the FSL payable varies from \$53.28 to \$130.56 per annum (see Table 3).

In addition, owners of similar properties choose to insure their property for different amounts. For example, the DTF and SRO study showed that the owners of properties with improvements valued at \$155 000 insured their properties for between \$148 800 and \$548 700. Substantial differences in the sum insured for similar properties will be reflected in differences in insurance premiums and FSL contributions.

4.3.4 Some asset owners pay too much for fire services

The DTF and SRO study found that those with contents insurance significantly over-contribute to funding Victoria's fire services relative to the benefits that they receive. In 2008-09, this over-contribution from insured contents owners was estimated to be between \$46 and \$54 million and is due to:

- insurance premium rates (as a percentage of the sum insured) being much higher for residential contents than for buildings, largely due to the risk of burglary and theft; and
- insurers applying the ICA-recommended rates to insurance premiums, which are the same for both building and contents premiums, to determine the FSL paid by individual policy holders.

Analysis of domestic contents insurance data indicates that the average FSL payable in respect of a contents policy is \$52.71. This is in addition to the FSL paid in respect of building insurance.

4.3.5 Fire risk and residential insurance premiums

Insurance premiums in the household sector are influenced by a number of risk factors. While fire risk is one, arguably weather damage and loss attributed to theft/burglary are greater determinants of insurance premiums and the FSL.

Research undertaken by DTF found a lack of consistent variation in the premiums charged by insurance companies for equivalent properties based on location in selected low or high fire risk areas (based on MFESB and CFA advice, see Table 3). As the FSL is calculated as a percentage of the total insurance premium, some property owners pay a higher FSL as a result of a risk profile which does not necessarily reflect fire risk.

Table 3: Insurance premiums for timber house, selected insurers and locations

	Low fire risk areas	High fire risk areas
Insurer A	\$351 - \$440	\$351 - \$470
Insurer B	\$376 - \$436	\$406 - \$436
Insurer C	\$391 - \$412	\$367 - \$390
Insurer D	\$296 - \$307	\$320 - \$352
Insurer E	\$450 - \$486	\$443 - \$544
Insurer F	\$475 - \$516	\$473 - \$483
Insurer G	\$318 - \$339	\$326 - \$377
Summary	\$296 - \$516	\$320 - \$544

Source: 2010 DTF and SRO study using online insurance calculators

The lack of variation is due largely to the relative importance of other risks (e.g. burglary) in determining premiums and the cost to insurers of undertaking fire risk assessments.

4.4 Alternate funding models

In recent years there has been a substantial change in the mechanisms used to fund the provision of fire services across Australia and New Zealand. As recently as 1998-99, insurance-based funding models were predominant across Australia and New Zealand. At that time four states used an insurance-based model (New South Wales, Victoria, Western Australia, South Australia), as did New Zealand, while Tasmania used a hybrid model containing both property-based and insurance-based funding elements. Only Queensland adopted a property-based model, with the ACT and Northern Territory funding services

from consolidated revenue. Queensland's property-based model was adopted in 1985, prior to which it also used an insurance-based model.

Since that time, three jurisdictions (Western Australia, South Australia and the ACT) have moved to a property-based model. In New South Wales and Victoria recommendations have been made to government to move to property-based models.

A high-level comparison of funding models by jurisdiction is provided at Table 4. Further information on the design of the fire services levy in other jurisdictions is set out at Table 5.

Table 4: Funding models by jurisdiction

Jurisdiction	Fire services contribution for residential property	Fire services contribution for non-residential property
Victoria	Insurance-based model	
New South Wales	Insurance-based model	
Queensland	Property-based model	
Western Australia	Property-based model	
South Australia	Property-based model	
Tasmania	Local council levies	Insurance-based model
Australian Capital Territory	Fixed charge	Property-based model
Northern Territory	Consolidated revenue	
New Zealand	Insurance-based model	

Source: Department of Treasury and Finance, Fire and Rescue NSW, Queensland Fire and Rescue Service, Fire and Emergency Services Authority of Western Australia, RevenueSA, Tasmania Fire Service, ACT Revenue Office, Northern Territory Treasury and the New Zealand Fire Service

In addition to the models used in other jurisdictions, the following have been raised as possible alternatives to Victoria's funding arrangements:

- enhancing the current insurance-based model;
- introducing compulsory insurance; and
- mandating recovery of fire service costs.

Upon analysis, these options were found to be impractical and unlikely to deliver significant improvements in efficiency and simplicity.

Table 5: Fire services levy in other jurisdictions

Jurisdiction	Fire services funding model	Collection agency	Tax base and levy structure	Concessions	Motor vehicles included	Property type classification	Area classification	Exemptions
Victoria (current)	Insurance-based model	Insurance industry	Insurance contribution passed on to policy holders	No	No	Different ICA advisory rates for residential and commercial property	Different ICA advisory rates for properties located in MFESB and CFA areas	Infrastructure insured by the State Government and some property insured with the VMIA by statutory authorities
New South Wales	Insurance-based model	Insurance industry	Insurance contribution passed on to policy holders	No	Yes	Unknown	Unknown	Unknown
Queensland	Property-based model	Local government	Fixed charge determined by the size and nature of any improvements on the land	Pensioners	No	17 risk weighted categories	Area classifications reflect quality of services delivery as measured by response time	State and Commonwealth property
Western Australia	Property-based model	Local government	Rate multiplied by Gross Rental Value (rental value of land and buildings)	Pensioner concession cards, state concession cards, Commonwealth Seniors Health Card and WA seniors cards.	No	Three property classifications: Vacant, residential and farming; commercial, industrial and miscellaneous; and mining (extraction) tenements. Different maximums apply depending on property classification	Five area classifications to reflect quality of service	Commonwealth property, some local government properties, mining (prospecting) tenements, Wittenoom township (which is contaminated by asbestos)
South Australia	Property-based model	RevenueSA	Fixed charge plus variable charge calculated using the capital value of the property (valuation based on the market value of the property). A fixed charge is applied to motor vehicles.	Pensioners, self-funded retirees, people receiving eligible Centrelink benefits	Yes	Six land use categories: residential; commercial; industrial; rural/vacant; other; and special community use	Four regions	No
Tasmania	Local council levies for residential property and an insurance-based model for non-residential property	Local government, insurance industry	Legal liability to residential contribution rests with the local council. Councils are permitted to pass the cost on to ratepayers in the form of a levy. Commercial property owners pay an insurance levy and motor vehicles owners pay a levy on registration.	Unknown	Yes	Residential and non residential property contributions are collected using different funding models	Unknown	Crown land, council land, State forests, the town of Savage River, a jetty or slipway, unimproved land not exceeding 10 square metres and Aboriginal land
Australian Capital Territory	Property-based model	Revenue Office	A fixed charge is imposed on residential and rural properties. Valuation-based charges, assessed on the Average Unimproved Value of land, apply to commercial properties. The Average Unimproved Value of land is the average value of the land for the 3 preceding years.	Pensioners	No	Two property classifications: residential and rural properties; and commercial properties	Unknown	Unknown
Northern Territory	Consolidated revenue							
New Zealand	Insurance-based model	Insurance industry	Variable rate applied to the insured replacement value of property and a fixed charge for motor vehicles	No	Yes	Rates are consistent for all property types (excl motor vehicles). Maximums only apply in respect of residential and personal property. No maximums apply to other property types.	No	Unknown

5. Property-based fire services levy

5.1 Property charge

Implementing a property-based charge to fund Victoria's fire services has several advantages. A property-based levy would have a broad tax base and ensure that all property owners make a financial contribution to the fire services. A levy calculated with reference to property value would be more equitable, and the owners of similar properties would make similar funding contributions that reflect the underlying costs of providing fire services.

Removing the insurance statutory contribution will also remove the FSL from insurance premiums and could lead to an increase in the take up of building and contents insurance. Evidence indicates that the levels of insurance increased when Western Australia replaced its insurance-based model with a property charge.

A property charge will directly and transparently link the financial contributions paid by individual property owners with the expected costs of providing fire services and provide a stable and predictable revenue source to fund the fire services over time.

5.2 Principles

The following principles have guided the design of a property-based fire services funding model:

- efficiency;
- equity;
- sustainability and stability of the revenue base;
- simplicity and transparency; and
- minimising administration and compliance costs.

5.2.1 Efficiency

The new property-based fire services levy should be charged on a broad base, and at a low rate that minimises distortions to decision making. Taxes that impose a significant burden may alter behaviour, such as discouraging consumption of a good or service.

5.2.2 Equity

All beneficiaries of the fire services should contribute to MFESB and CFA funding in proportion to the benefits they receive. As all property owners benefit from Victoria's fire services, a minimum contribution should be made by all property owners. Equally, property owners in similar circumstances should make similar contributions and consideration should be given to their ability to pay.

5.2.3 Sustainability and revenue stability

Funding should be derived from a reliable and stable source. The revenue base needs to grow over time in line with demand and the cost of providing the services. The amount of revenue received should be predictable to allow for service planning and minimise the need for adjustments to the levy.

5.2.4 Transparency and simplicity

A fire services funding model should allow property owners to identify what they are contributing to and how much they are contributing. The system should also ensure accountability for revenue and expenditure decisions.

5.2.5 Administration and compliance costs

The costs to the Government to administer the scheme and ensure property owner compliance should be minimised. Property owners should also be able to comply with their obligations without incurring significant time, resource and financial costs.

6. Levy design

6.1 Funding requirements

The intention of this reform is to maintain existing funding levels. In general, this implies that the new property levy will replace existing statutory contributions, while other sources of revenue to the fire services will remain in place.

To maintain current funding levels, the property-based funding model will need to replace all funding sources that will cease when the property levy is implemented.

Table 6 summarises the 2009-10 budget for the MFESB and CFA. The highlighted values represent the revenue sources which could potentially be replaced by the property-based levy following the cessation of the insurance model.

Table 6: 2009-10 Revenue

Funding Source	CFA 2009-10	MFEB 2009-10
Insurance Contributions	\$ 303 170 000	\$ 206 136 000
Local Government	-	\$ 34 356 000
State Government	\$ 71 554 000	\$ 34 356 000
Commonwealth Government	\$ 576 000	\$ 3 049 000
Major incident funding	\$ 4 389 000	
Contributions from brokers and owners	\$ 20 670 000	\$ 8 086 000
Provision of Goods and Services	\$ 13 701 000	\$ 27 214 000
Interest and dividends	\$ 4 544 000	\$ 8 072 000
Other Income*	\$ 14 252 000	\$ 4 288 000
- Uninsured fire fees	<i>a component of other income</i>	
Total Income	\$ 432 856 000	\$ 325 557 000

* Other income includes public donations, contributions from the Transport Accident Commission and income from investments.

Source: CFA and MFESB

Statutory contributions come from three sources: the insurance industry, local government and state government. There is a strong case for the new property levy to replace all existing insurance and local government contributions, and a question as to whether it should also replace state contributions.

Local councils currently contribute to the fire services to the extent that they insure their buildings and contents with private insurance companies. In addition, councils either wholly or partly within the Metropolitan Fire District (MFD) make statutory contributions to the MFESB. These costs are passed on to residents through local council rates. If the metropolitan municipal council statutory contribution was to cease following the introduction of the property-based levy, there would not be an increase in the overall burden on ratepayers as a result of a property levy on local council property. Similarly, the State Government statutory contribution could also be replaced by a levy on State Government property, subject to the development of a robust and transparent methodology for determining the levy. This could however, give rise to some administrative complexity.

In summary, there are significant distinctions between the situations in relation to local government contributions compared with state government contributions. In particular:

- Local councils currently pay the FSL when they insure their assets privately; state owned land and buildings are insured through the Victorian Managed Insurance Authority (VMIA).
- Existing local government statutory contributions are passed on (through rates); whereas state contributions are sourced from consolidated revenue.

These factors raise a question as to whether the new property levy should replace all existing statutory contributions, or insurance and local government contributions only.

Question

- Which components of the statutory contributions model should be replaced by a property levy?
 - All statutory contributions from insurers and state and local governments?
 - Statutory contributions from insurers and local government only, with existing state government contributions continuing on the basis of the current model?

6.2 Tax base

Since all property owners benefit from the availability of fire services, the levy should be imposed on real property (i.e. land and improvements).

6.2.1 Personal property and motor vehicles

The owners of personal property and motor vehicles receive significant benefits from the fire services. Approximately 12 per cent of incidents to which the CFA responds are mobile vehicle related, while a total of 9.1 per cent of MFESB incident response time relates to mobile vehicles. However, this includes rescue activities and the Transport Accident Commission (TAC) currently makes an annual contribution towards the cost of the MFESB and CFA providing road accident rescue services. The TAC contribution will continue following the implementation of the property-based funding model.

While South Australia, Tasmania and New Zealand impose a levy on motor vehicles, studies conducted by the Fire and Emergency Services Authority of Western Australian indicated that a levy on motor vehicles would add little value to the design of a fire services property levy. Western Australia, Queensland and the Australian Capital Territory have property-based funding models but do not impose that levy on motor vehicles. A motor vehicle fire services levy for Victoria will increase collection costs and duplicate collection of the levy from owners of both real property and motor vehicles.

There is also no existing valuation process or comprehensive valuation base upon which to impose a property levy on motor vehicles or personal property. As a result of the impediments to imposing the levy on motor vehicles and personal property, the property levy will not be extended beyond real property.

6.2.2 Non-rateable property

Given their use of Victoria's fire services, there is a case on equity, efficiency, competitive neutrality and transparency grounds for a fire services property charge to be levied on local government property and properties that currently receive exemptions from other property taxes in Victoria. This is consistent with the arrangements in Western Australia and South Australia.

This approach reflects the fact that owners of property used for charitable purposes, infrastructure and other currently tax-exempt purposes already make a financial contribution to the fire services through their insurance premiums. The property levy would replace this insurance contribution.

Proposal

- Impose a property levy on real property, including non-rateable property, property owned by local councils and potentially the State Government.

6.3 Valuation base

There are three main property valuation options for a property levy:

- site value, which is the value of land only;
- improved value, which is the value of buildings only; and
- capital improved value, which includes the value of both land and buildings.

Table 7 illustrates the value of the different tax bases. All Victorian properties are valued biennially, with supplementary valuations where new properties are developed or following a change in property use (i.e. from commercial to residential).

Table 7: Value of the tax base

Tax base	Value of tax base
Site value	\$776 billion
Improved values	\$486 billion
Capital improved value	\$1.3 trillion

Source: Valuer-General Victoria

Site (land) value is an economically efficient tax base and a levy on site value has the benefit of not affecting incentives to invest in improvements. Site value is however less representative of the value of assets protected by the fire services. A levy on the site value of a property could impose more heavily on property owners with low improved values relative to land value, such as farms and low density residential properties in metropolitan areas.

A property levy based on improved values (i.e. the value of buildings) would reflect the benefits received from fire services, as the owners of higher value assets receive a greater potential benefit from the availability of these services. Although a levy on improved values

would also have a higher impact on properties with high improved values relative to land value, such as high density office and apartment buildings and retail complexes. A levy on improved values may result in the owners of vacant lots not making a contribution to the fire services even where they represent a fire risk. This issue could be mitigated by including a fixed levy component on all properties (discussed further in section 6.5).

A property levy assessed on capital improved value would partly apply to a broad and immobile tax base (land). As the value of improvements is included in the tax base, the levy would partly reflect the benefits received from the protection of assets. Imposing the levy on capital improved value, however, would not identify whether the majority of the property's value (and therefore the benefit derived from fire services) was in the land or the improvements (buildings). A capital improved valuation base would be more consistent with local councils existing practice levying rates, which may reduce administration costs.

Question

- What is the most appropriate valuation base?
 - Site value (i.e. the value of land only)?
 - Improved value (i.e. the value of buildings only)?
 - Capital improved value (i.e. the value of land and buildings)?

6.4 Revision of the funding requirement and levy

A revision mechanism is required to ensure the fire services property levy raises adequate revenue in future years while providing a stable and transparent levy for property owners.

There are three main options for revising the revenue raised and property levy in the years following implementation:

- continue to set MFESB and CFA budgets annually and derive the property levy rate from the funding requirement;
- determine a levy rate at the time of implementation and maintain that fixed levy rate in future years (subject to periodic review); or
- derive the property levy rate from the funding requirement, subject to a cap on total revenue growth.

There has been strong growth in revenue directed to the fire services in recent years. If MFESB and CFA budgets continue to be set annually and the property levy rates are derived from the funding requirement, the levy rates will change each year. To calculate levy rates the total revenue requirements would be divided by aggregate property values, taking into account levy areas and property types. A change in revenue requirements, or a change in aggregate property values, would have an impact on the levy rate. Variable levy rates provide flexibility to ensure revenue collections match funding requirements, but may reduce certainty for property owners about future levy charges. However, variable levy rates will ensure Victoria's fire services are adequately funded into the future.

Alternatively, the property levy rate could be determined at the time of implementation and fixed, subject to periodic review. In practice, a biennial review would be most appropriate to ensure that the revenue raised using revised property values is equivalent to the cost of providing fire services. A fixed levy rate would result in small revenue adjustments during

non-valuation years due to newly developed properties, and allow for larger variations following each review when new valuations are used to calculate the levy.

Fixed levy rates provide certainty and administrative simplicity but remove flexibility. This limitation may cause budgetary pressure in non-valuation years if there is little revenue growth. Growth in property numbers reflects an increase in demand for services, but due to the largely fixed nature of MFESB and CFA costs, revenue requirements may not increase until a capacity constraint is reached. Similarly, growth in property values is not necessarily related to growth in MFESB and CFA budgeting requirements.

As an alternative to the above options, the levy rate could be altered annually, subject to restrictions on the growth of overall revenue. Increases to fire services revenue and the resulting levy rate would be capped to promote prudent financial management and prevent an increased financial burden being passed on to property owners. Capped variations provide certainty but remove flexibility in the revenue raising capacity of the property levy.

Proposal

- Set the property levy annually to ensure the fire services are adequately funded.

6.5 Fixed and variable charge

The expected benefits of the fire services to a property are affected by two factors: the risk of a fire occurring and the value of the property to be protected. The fire services also provide broader public benefits, such as fire prevention, which cannot be readily linked to specific properties.

A fixed component or a minimum payment would reflect broader community benefits, while an ad valorem property rate (a charge calculated as a percentage of property value) would reflect the benefits to individual property owners. The structure of the emergency services property levy in South Australia includes both a fixed component and an ad valorem levy.

The fire services provide an on-call fire fighting capacity and undertake fire prevention activities that benefit the community as a whole. The cost of these prevention and preparedness services can be considered broadly equivalent across a given class of properties. The cost of responding to fire or emergency incidents is also likely to be similar for many sectors of the community. For example, the MFESB will send two fire appliances to most residential property fires irrespective of the value of the property. However, the costs will be greater for high value properties such as multilevel office, retail or apartment buildings. This additional cost would be reflected in the ad valorem component of the levy.

As alternatives to a fixed component and variable charge, a flat per property charge could be applied to property owners or a simple ad valorem rate could be applied to the value of each property. These alternatives are efficient and administratively simple to collect.

However, a flat charge per property may be inequitable as the same contribution is expected from owners of high value and low value properties with no consideration given to their ability to pay. A flat per property charge also does not reflect the value of assets protected. Alternatively, if a single ad valorem levy rate were applied, the levy would not reflect the benefits derived from on-call fighting capacity and fire prevention activities. In addition, the collection costs associated with a single ad valorem levy rate could be disproportionate relative to revenue collected from low value properties.

Proposal

- The fire services property levy include a fixed component and an ad valorem charge assessed on the capital improved value of property.

6.6 MFESB and CFA

Under the current insurance-based arrangements, policy holders contribute to the fire service for the area in which their property is located. As a result, the owners of property outside the MFD area (serviced by the CFA) pay a higher rate of FSL than those inside the MFD (serviced by the MFESB), as reflected in the current ICA advisory rates (see Table 2). This difference arises because the relatively larger budget of the CFA (Table 6) is spread over a smaller pool of insurance premiums in the CFA area, although there are a similar number of properties in each area (Table 8).

Maintaining separate levy rates for properties within the MFD and properties outside the MFD would be consistent with the existing funding arrangements. While the MFESB and CFA extend their services across regional boundaries in response to specific emergencies, property owners within the MFD largely benefit from services provided by the MFESB and property owners outside the MFD largely benefit from services provided by the CFA. Separate levy rates mean that property owners contribute to their local fire service. Due to significant differences in the cost of providing fire services to different geographical areas, separate levy rates reflect the cost and quality of fire services provided within and outside the MFD.

Under a separate levy rate structure, similar properties within each region would pay the same levy rate, but properties in the MFD would pay a lower levy rate compared to properties of similar properties value outside the MFD. As a result, and particularly in areas close to the boundary of the MFD, property owners in relatively close proximity may make quite different contributions to the provision of fire services.

While the Royal Commission noted that the fundamental problem with the current arrangements arises from its imposition on insurance, it also raised the possibility of establishing a single fund for CFA and MFESB services. While a single fund could imply a single state-wide levy, it could also involve differential levy rates determined on some basis other than the CFA and MFESB budgets.

A single levy rate is likely to be more economically efficient as it would spread the cost of funding both fire services over the broadest possibly property base (particularly when imposed on the capital improved value of property). A single rate would also mean that property owners in Victoria would all contribute to funding the fire services on similar terms, relative to the value of their property. However, it would necessarily re-distribute some of the costs of funding the CFA to metropolitan property owners.

Table 8: Property count by location

Within the Metropolitan Fire District (approx.)	
Residential property	988 000
Non-residential property	122 000
Outside the Metropolitan Fire District (approx.)	
Residential property	1 266 000
Non-residential property	216 000

Source: Valuer-General Victoria

The choice of single or separate levy rates will involve a tradeoff between economic efficiency, equity and the principle of user pays. As such, DTF welcomes submissions in response to the following questions.

Questions

- Should the property levy be set at single statewide rate, or should separate property levies be imposed within and outside the MFD?
- Are there alternative ways of sharing the cost of funding fire services across the boundary of the MFD?

6.7 Differential rates by property type

In forming its recommendations, the Royal Commission noted that there is potential to adjust the rate of the fire services property levy to reflect risk. Developing and applying a comprehensive risk rating to scale a property levy for individual properties is unlikely to be feasible, as the costs of doing so would be very high relative to the amount of the levy collected. However, it is feasible to apply different rates to different property types.

Applying differential rates by broad property type would be desirable on equity grounds if the use of fire services differs across property types (for example, commercial, industrial, residential, primary production land and public benefit). With differential rates, a \$1 million residential property and a \$1 million commercial property, both located in the same area, would make different annual contributions to the fire services.

Developing a robust methodology for classifying property types by fire risk will be key to implementing differential levy rates in a fair and transparent manner. As DTF further examines approaches to risk classification, the following questions are posed for consultation.

Questions

- Should different levy rates apply to different properties classifications?
- How should the total funding burden be distributed between property classifications?
- Should the total budget be allocated according to a measure other than the fire risk of broad property classifications?

6.8 Concessions

The Royal Commission recommended that the fire services property levy include a concession for low income earners. However, the recommendations did not provide any direction on how a concession should be implemented or appropriately targeted.

6.8.1 Eligibility for a concession

Eligibility based on Commonwealth concession cards would allow for an individual's status to be easily verified and subject to Commonwealth income and asset thresholds. This would be consistent with the approach taken in other jurisdictions.

Accordingly, the simplest and most equitable way to provide a concession is to grant a concession to holders of Commonwealth:

- Health Care Cards; and/or
- Pensioner Concession Cards; and/or
- Department of Veterans Affairs gold cards.

It is considered that Commonwealth Seniors Health Care card and Victorian Seniors card holders should not be entitled to a fire services property levy concession. This is due to the eligibility requirements for these cards allowing individuals not generally considered low income to be eligible.

6.8.2 Rate of concession

State concessions can be delivered in a variety of ways. For example:

- The local council rates concession is effectively a fixed discount, with a nominal 50 per cent discount subject to a cap (\$187.60 for 2010-11). Approximately 98 per cent of concession households receive the capped discount amount.
- The Annual Electricity Concession provides a 17.5 per cent discount off the electricity bills of eligible customers.

The fire services levy concession could take the form of a percentage discount on the levy payable, a percentage discount with a cap, or a fixed dollar amount discount.

6.8.3 Targeting the concession

The Royal Commission recommended a concession due to its concerns about uninsured low income earners becoming liable for a fire services property levy, without an offsetting reduction in fire services insurance levy.

The fire services property levy concession will need to be appropriately designed and targeted to ensure it is available to low income property owners, without significantly increasing the fire services property levy for non-concessional levy payers. In addition to concession card eligibility criteria, it may be possible to target the concession to those who need it most by setting a property value threshold.

6.8.4 Interaction of concession and collection agency

The choice of collection agency interacts with the choice of concessions eligibility.

If local councils are the collection agency, the fire services property levy would likely be issued as part of rates notices. In that case, it would be most simple administratively to align the concession with the existing local government rates concession, which is available to Pensioner Concession Card and Department of Veterans Affairs gold card holders.

Collection by the SRO would allow more flexibility in choosing the concessions policy. The SRO currently administers a range of concessions for stamp duty, including the pensioner stamp duty concession, which is available to pensioners who hold a Health Care Card, Pensioner Concession card and Department of Veterans Affairs repatriation health cards and pensioner cards.

Proposal

- A concession should be given to holders of Health Care Cards, Pensioner Concession Cards and Department of Veterans Affairs gold cards on their principal place of residence.

Questions

- Should eligibility for a concession be subject to a property value threshold?
- How should a concession be calculated?
 - Percentage discount?
 - Percentage discount with a cap?
 - A fixed dollar amount discount?

6.9 Collection agency

Local councils and the SRO are both feasible options for collecting the fire services property levy based on the recommended revenue base. DTF estimates that the administration costs of either option would be broadly similar. These costs could be recovered from the levy.

6.9.1 Local council

Local councils have an established legislative framework and established procedures for billing, collection, pensioner concession card verification, objections to property valuations, and debt collection. These could be extended to the fire services property levy, which would simplify compliance for residential owner-occupiers.

Implementation in any one local council will not be complex, but the involvement of 79 local councils significantly adds to the complexity of implementation and ongoing administration.

Collection by local councils could create the potential for differential treatment of taxpayers (e.g. different collection and enforcement arrangements in different councils), and would require a new mechanism for non-rateable property. It would also require more complex legislation, because of the need to provide for tax administration powers and governance arrangements in addition to the levy design.

Implementation will require a lead time of at least 12 months to develop suitable agreements with local government. Ensuring the smooth development and implementation of collection arrangements will also require being mindful of peak workloads for local government, such as flood recovery. The Government would need to agree with councils on suitable arrangements to support them to implement and administer the property levy.

6.9.2 State Revenue Office

The SRO has specialised knowledge and expertise in tax administration. The SRO's established processes for education, compliance, enforcement and existing avenues of review and appeal could be extended to the fire services property levy by amending the *Taxation Administration Act 1997* (TAA).

A single collection agency has lower complexity relative to the local government option. Collection by the SRO would also allow greater flexibility in levy design, greater direct control by government, a sophisticated capacity for compliance activity and lower risk to implementation timelines. Additionally, the SRO would provide uniform service and is already subject to existing supervision and accountability mechanisms that would apply to the property-based levy.

However, the SRO would need to implement a new collection system to issue an assessment to most households. This would increase household compliance costs. If there is low household compliance with fire services property levy payment, the additional cost of SRO debt collection may not be justified by the expected low fire services property levy assessments. This could be an ongoing risk to revenue, although this could be mitigated by other factors.

Proposal

- That the fire services property levy be collected by local councils, with support for implementation and administration.

6.10 Transitional arrangements

The existing fire service statutory contributions from insurers can be phased out relatively easily. The Government can declare a final statutory contribution to be paid by insurers for the 2012-13 financial year and property owners will then be liable for the property levy from 1 July 2013.

However, there are several associated risks which must be carefully managed. If insurers continue to collect the FSL in full until 30 June 2013, this may create an incentive for property owners to defer taking out or renewing insurance in the months immediately prior to 30 June in order to avoid the FSL. Those property owners who choose to remain insured and pay the full FSL may consider that they have contributed 'twice' to the fire services in the first year of the property levy.

The insurance industry will receive significant long-term financial and economic benefits following the abolition of the statutory contributions model and face some incentives to ensure the FSL is removed from insurance policies (including the risk of customer switching, price competition and reputational risk). However, it is preferable that the Government actively manage the transition process to ensure the interests of policy holders are protected.

6.10.1 Tapering model

Under a 'tapering' model, insurers would reduce the FSL paid on insurance premiums in the 2012-13 financial year on a pro-rata basis (for example, by 1/365th for each successive day in which an insurance policy is renewed or taken out during the year). By phasing out the FSL in this way, the incentive and equity impacts identified above are avoided.

Western Australia adopted a tapering approach as part of their transition model, which proved to be feasible and easy to communicate to stakeholders.

6.10.2 Decoupling model

The alternative approach is a 'decoupling' model, where insurers would pay a final discounted statutory contribution with the balance of the funding requirement met through a discounted property levy. In this case, the discounted FSL would apply to the full term of the insurance policy. For example, with a 50 per cent discount to the statutory contribution all policy holders (including those taking out insurance immediately prior to the end of the financial year) would pay an FSL equivalent to 50 per cent of the FSL normally applying to the full policy.

The main advantages of this option are that it staggers the introduction of the property levy for non-insured property owners (50 per cent in year one and 100 per cent in the second year), and is simpler to implement (a simple 50 per cent discount rather than a pro rata reduction).

However, this model only partially addresses the incentive and equity impacts on property owners through a partial discount. This option has not been successfully implemented in other jurisdictions.

Proposal

- The tapering approach be adopted to phase out the insurance contributions prior to the introduction of the property levy.

6.11 Monitoring

The abolition of statutory contributions from insurance companies will remove the FSL from insurance premiums. However, the nature of the insurance industry and significant events such as the recent floods may make it difficult to identify savings to insurance policy holders, particularly in the residential sector.

An independent review of the impact of abolishing the insurance-based funding model will be implemented to strengthen the incentives for insurance companies to fully pass on premium reductions and demonstrate premium reductions.

There are two main options for an independent monitoring authority: the Essential Services Commission (ESC) or an appropriate accounting, actuarial or consulting firm.

The ESC is Victoria's independent economic regulator of essential services and also provides advice to the Victorian Government on a range of regulatory and other matters. The ESC has the relevant skills and experience in data collection and analysis, performance monitoring, and the provision of independent advice. The ESC will adopt a cooperative approach with insurers but also has the statutory power to compel insurance companies to provide data for analysis should this become necessary.

The alternative is to appoint an accounting, actuarial or consulting firm to undertake this monitoring role. However, there may be concerns regarding the independence and transparency – and hence credibility – of the analysis undertaken by an external firm, particularly where it may have a previous or ongoing relationship with clients in the insurance industry.

The monitoring agency would review industry and company-specific data to investigate whether insurance companies have passed on savings to policy holders. The monitor would produce a public report detailing compliance or non-compliance on an industry wide level as well as for specific insurers if necessary.

Proposal

- The Essential Services Commission be appointed to independently monitor the FSL transition process. A public report on whether or not insurance companies have passed on savings to policy holders is to be produced as part of the monitoring role.

7. Next steps

7.1 Consultation

The Government offers all Victorians the opportunity to comment on the options for the design and implementation of the new fire services property levy in Victoria, and will conduct a rigorous public consultation process.

All written submissions will be treated as public documents unless individuals or organisations request otherwise. Please note that freedom of information access requirements will apply to all submissions including those treated as confidential.

The closing date for written submissions is 30 September 2011.

Submissions can be sent:

By post:

Fire Services Project
Department of Treasury and Finance
1 Treasury Place
East Melbourne
Vic 3002

By email:

fireservicesproject@dtf.vic.gov.au

7.2 Timeline

Consultation period	From June 2011
Written submissions close	30 September 2011
Legislation introduced	Early 2012
Transition period commences	1 July 2012
Implementation	1 July 2013
Independent review of insurance prices following the removal of the FSL	July 2013 – June 2014

