

Quote No L22/824 - 22/65
SB:JB

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29 April 2022

Dear Sir/Madam

Application for Additional Special Variation - Additional Information

Broken Hill City Council wishes to apply for a permanent additional special variation for rates for 2022/23. This application is for a permanent 1.6% variation above the rate peg of 0.7% for a total rate peg of 2.3% for 2022/23, in line with Council's 2021/22 Operational Plan and Long Term Financial Plan (LTFP).

Broken Hill City Council has a demonstrable financial need for the permanent variation due to several factors as detailed below.

Council's un-adjusted LTFP extract shows an average operating performance ratio (OPR) of 3.1% over the next 5 years. The LTFP is prepared based on several assumptions using professional judgement and the best information to hand at the time.

In the 10 months since adoption, several factors and assumptions have changed and as such, we ask that our application be assessed against the adjusted OPR included in the application which shows an average OPR of 1.9%, over the next 5 years. This adjusted OPR falls to 1.1% in the event of a temporary adjustment.

Several assumptions included in Council's 2021/22 Operational Plan and Long Term Financial Plan have been reassessed and require adjustment which in turn changes the projected OPR for Council.

Inflation

Council's 2022-2031 LTFP assumed general inflation to be 2.5%. The latest all groups annual CPI percentage change was 5.1%, with the previous 3 quarters being 3.5%, 3.0% and 3.8%. The adjusted OPR section of our application has been adjusted with an assumed 3.5% inflation over the next 5 years. Council has also factored in a 2% efficiency gain on materials and contracts over that time as in our original 2022-2031 LTFP.

Ongoing supply chain issues due to the ongoing COVID-19 pandemic and the war in Ukraine (increasing gas/energy prices) are primary factors fuelling inflation increases. The road to recovery for regional and rural communities as we emerge from the pandemic will continue to be tough, not keeping funding from rates revenue at the level determined in the 2022-2031 Long Term Financial Plan would significantly jeopardise Council's return to surplus and lead to the worsening of key financial ratios.

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Wages

Council's 2021/22 assumed employee cost index to be 2.0% ongoing. Council is currently in the early stages of negotiations to renew our consent award which expires at the end of this financial year. The assumption of a 2.0% employee cost index has been revised as employee award increases are now predicted to be 2.5 - 2.75% percent. The adjusted OPR in Council's application has been adjusted for a 2.5% employee cost index.

Increasing rates revenue by the current rate peg of 0.7% rather than a permanent ASV of 2.3% would require choosing between cuts to jobs, roads maintenance, parks, libraries, and other community services due to lack of available funding.

Investment Returns

Council's 2021/22 assumed an investment rate of return of 3.0% over the next 5 years. This forecast has been adjusted to 2.0% due to the current rates on offer for Term deposits and Cash accounts and the volatility in the market due to the Ukraine war and the ongoing effects of COVID-19 and supply chain disruption.

Forecast Rates Peg

Council's 2021/22 LTFP assumed a rate peg of 2.3% for the 2023 and then 2.6% in the year following. While future rate pegs remain unknown, if they are below 2.6% this will have further detrimental effects to Council's OPR.

Financial Need

Council, as one of the City's largest employers, plays an integral role in the City's recovery from the effects of the pandemic. Increasing rates revenue by the current rate peg of 0.7% rather than a permanent ASV of 2.3%, would require choosing between cuts to jobs, roads maintenance, parks, libraries, and other community services due to lack of available funding. An increase of 0.7% or a temporary ASV for 2022/23 also has flow on effects into future years, as a permanent ASV becomes part of Council's ongoing permissible income and without it will reduce overall 'real' income.

Rates increase of 2.3% through a permanent ASV is still less than inflation but is in line with budget forecasts and community consultation conducted last year and the adopted Long Term Financial Plan. An increase of 0.7% in no way covers expenditure increases due to wages costs and high prices currently being experienced for materials and services. Examples of increased materials costs being experienced now are fuel, with diesel costs increasing approximately 26% between July 2021 – February 2022 and continuing to rise since. Bitumen, timber, steel, concrete, and other construction materials have all also risen sharply in cost in recent times.

Broken Hill City Council has faced a number of challenges in terms of its financial sustainability over the previous 10 years. In 2013, a report by New South Wales Treasury Corporation (T-Corp), on behalf of the division of Local Government, which considered both historic and a 10-year financial forecast, determined Council to be in a very unstable financial position and unsustainable.

Overall, the financial sustainability of Council was assessed as 'very weak', one of only five NSW Councils to receive this rating.

A rating of very weak can be described as a council that:

- Has limited capacity to meet its financial commitments in the short to medium term and has very limited capacity in the long term
- Has a record of significant operating deficits and is unlikely to be able to address its operating deficits and manage unforeseen financial shocks without the need for structural reform and major revenue/expense adjustments

- Expense adjustments are likely to result in significant changes to the range and/or quality of services offered
- Has difficulty managing its core business risks

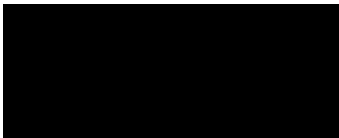
Council has since achieved significant improvement and taken steps in the right direction towards becoming financially sustainable. T-Corp have since assessed Council as 'weak with a positive outlook', with further improvements likely based on key assumptions.

While Council has made significant improvements, Council still has a lot of hard work and tough decisions ahead of it before it can be deemed financially sustainable. Council's operating performance ratio has still been negative over the previous 3 years and was as low as -20.38% in 2020. The effects of the COVID-19 pandemic have impacted Council's finances significantly and proved the need for Council to continue to work towards improved financial sustainability to enhance Council's ability to withstand future financial shocks or adverse events.

The cumulative effects of not having a permanent special variation of 2.3% would have a real and long-term negative impact on the City of Broken Hill and its residents. The impacts equate to around \$2.7 million dollars over 10 years, this is a significant figure which would seriously affect service delivery and capital works programs. Council has been working hard to reduce its infrastructure backlog ratio which is 7.83% as of 30 June 2021, well short of the benchmark of <2.0%

As outlined above, a permanent ASV of 2.3% is needed to continue to fund crucial community services and infrastructure and enable Broken Hill City Council to continue its return to surplus and improve key financial ratios for ongoing financial sustainability.

Yours faithfully



SIMON BROWN
ACTING CHIEF FINANCIAL OFFICER