

28 April 2022

The Chair
Independent Pricing and Regulatory Tribunal
PO Box K35
HAYMARKET POST SHOP NSW 1240

Dear Ms Donnelly

Supplementary Information – Additional Special Variation – Ongoing – 2022/23 Rating Year

Council has reviewed the NSW Office of Local Government's (OLG) Circular No. 22-07 and the Independent Pricing and Regulatory Tribunal's (IPART) Information Paper dealing with the process for Council to make an Additional Special Variation (ASV) application for the 2022/23 financial year. Council has noted that:

- The Guidelines set out in Circular No. 22-07 apply in place of the "Guidelines for the Preparation of an Application for a Special Variation to General Income" issued by the OLG in 2020.
- The Guidelines set out in Circular No. 22-07 apply in place of, and supersede, the ASV Guidelines issued in Circular No. 22-03.
- The one-off ASV is available for the 2022/23 financial year only and is for councils that can show that the special variation will enable them to meet the obligations they set for 2022/23 in their 2021/22 Integrated Planning and Reporting (IP&R) documentation.
- Councils seeking a permanent special variation will also need to demonstrate the need for the special variation to be included in their rate base on an ongoing basis.

On the basis that Council has decided to make application for a permanent special variation for 2022/23 and beyond, Council is aware that it needs to provide IPART with the following information for assessment as part of its application:

- Council's 2021/22 IP&R documentation identifying that Council budgeted for an income increase above the percentage specified for the Council for 2022/23 under section 506 of the Local Government Act.
- Council's 2021/22 IP&R documentation identifying that Council forecast an average Operating Performance Ratio (OPR) of 2% or lower over the next five years or, alternatively, evidence of need, for example but not limited to Council needing to maintain a higher OPR so it can meet its capital funding requirements.
- A Council resolution to apply for the ASV under section 508(2) of the Act which clearly states:

- Whether the resolution is for a temporary or permanent variation under section 508(2) of the Act.
- The additional income that Council will receive if the ASV is approved
- Why the ASV is required
- Council has considered the impact on ratepayers and the community in 2022/23 and, if permanent, in future years if the ASV is approved and considers that it is reasonable

Council is appreciative that the ASV application process is a simpler more targeted application process and that IPART will not require councils to demonstrate community consultation or criteria outside of the above processes. In this regard, IPART will consider the consultation undertaken through the IP&R process and consider the resolution to apply for a ASV meets the above requirements.

Council's 2022-26 Delivery Program and 2022/23 Budget

At its 13 April 2022 General Meeting, Council considered General Manager's Report No. GM13/22 – Draft 2022-26 Delivery Program Including the Operational Plan, Budget and Fees and Charges 2022/23 – Adoption for Public Exhibition – and resolved that (***bolding added for emphasis***):

1. *Council adopt for public exhibition the draft 2022-2026 Delivery Program and Operational Plan 2022/23 which includes the draft Budget, Fees and Charges and Rating Structure for 2022/23 and make available for public comment from 14 April to 16 May 2022.*
2. *Council note the rating information contained in the draft 2022-2026 Delivery Program and Operational Plan 2022/26 aligns with the Independent Pricing and Regulatory Tribunal's (IPART's) rate increase approval for NSW councils (i.e., a 0.7% rate increase for 2022/23).*
3. ***In line with recently published IPART Guidelines, Council apply for a permanent Additional Special Variation (ASV) to General Income (i.e. from 0.7% to 2.28% for 2022/23) on the following basis:***
 - a) ***The additional general income to be received by Council for the 2022/23 financial year as a result of such an ASV would be \$1.1 million.***
 - b) ***The additional income is required to ensure the financial sustainability of Council's services and projects as detailed in General Manager's Report No. GM13/22 and Council's Long Term Financial Plan.***
 - c) ***Council has considered the impact of an ASV on ratepayers and the community in 2022/23 and future years and considers such impact to be reasonable in the circumstances.***
4. ***Following public exhibition, and before 30 June 2022, a report be prepared which outlines any submissions received and recommends the adoption of the 2022-2026 Delivery Program and Operational Plan 2022/23, including Budget, Fees and Charges and Rating Structure which takes into account IPART's decision in respect of Council's ASV application.***

Most of the information contained in General Manager's Report No. 13/22 is relevant to Council's ASV application. As such, it is repeated below to assist IPART's assessment (***bolding added for emphasis***):

The draft 2022/23 Budget

Council staff commenced the preparation of the draft 2022/23 Budget in December 2021. To minimise some of the financial constraints and considerations impacting local government generally and Council specifically, and to avoid excessive bids for funding which could not be met, the draft 2022/23 budget parameters included:

- **Alignment with the parameters and projects identified in the Long-Term Financial Plan (LTFP) adopted by Council at the 13 March 2019 General Meeting. Further revisions of this LTFP have been endorsed by Councillors at various briefing workshops held during November 2020, February 2021, and March 2022. These briefing workshops were held to advise Councillors of revisions required to the LTFP due to changed economic conditions impacting Council's financial position, reaffirm priorities, provide updated asset management requirements and to plan for any necessary budget adjustments in future annual budgets.**
- *The adopted LTFP underpins the development of the Operational Plan each year and is the minimum needed to maintain service delivery. It is artificially set lower to reflect IPART's usual approach, not specifically set to deliver the full suite of community expectations. Given the critical need to maintain Council's financial position any other course of action would have been inappropriate.*
- *Subsequent revenue declines over the last three years (predominantly due to COVID) and the IPART determined maximum rate pegs restricting our capacity to deliver projects and initiatives that meet community expectations has resulted in a number of projects and initiatives have had to be postponed or cancelled.*
- *The main LTFP projects for inclusion in the annual 2022/23 budget include: Asquith to Mount Colah public domain of \$3.5 million (part allocation) funded from development contributions, Footpath budget of \$500K and Heritage Planning Study of \$425K funded from general funds and major project budget allocations for 2022/23 (part allocations) of Hornsby Park Redevelopment at \$21.9 million, Westleigh Park Redevelopment at \$1.7 million and Mark Taylor Redevelopment of \$4.5 million funded from external grants from the NSW State Government.*
- **A general rate peg increase of 0.7% for 2022/23 – i.e., the allowable percentage approved by the IPART that a Council can increase its rate revenue. The rate peg has increased the base amount of Council's general income from rates by \$500K, which is less than Council's forecast labour cost increase for the 2022/23 financial year let alone other non-labour related expenses. It is noted that this general rate peg increase issued by the IPART for 2022/23 is significantly below the 10-year historical average that was determined in the LTFP at 2.28%.**
- *Zero external loan borrowing and the continuation of prudent financial management.*
- *A nil increase to Divisional expenditure (net of direct labour) for material and contract expenditure – this is despite substantial price increases, particularly for construction materials. Any increase has been required to be offset by productivity improvements or reviewing service provision.*
- *Direct salaries and wages to include provision for the Local Government (State) Award increase of 2% calculated on 50 pay weeks. The two-week reduction from a full year represents organisational savings which occur as a result of the average delay in replacing staff members who retire/resign/etc. and/or productivity improvements that are required.*

- *The use of Council staff where possible to undertake grant funded projects and Section 7.11 and 7.12 Development Contributions projects.*
- *An increase in superannuation from 10% to 10.5% in line with statutory requirements which is estimated at \$300K.*
- *Allowable insurance premium increase ranging from 9% to 15% based on quotes received.*
- *Following discussions with Councillors during an informal workshop in March 2022 a project to develop a master plan for Beecroft Village Green was included for 2022/23. The aim of the Masterplan is to provide a vision for the Village Green, assess existing trees (and planned replacements), illustrate an appropriate renewal of the play space, public toilets and consider suggestions from the community. The masterplan is expected to cost \$30K which is proposed to be funded from the internally restricted asset referred to as 179 Beecroft Road.*

The draft 2022/23 budgeted cash surplus after applying the parameters above and priorities identified in the revised LTFP is \$1.8 million. Whilst this forecasted surplus is a satisfactory amount for Council to respond to budget shocks (such as storm events, infrastructure failure and/or capital projects increases) that may occur over the financial year, there are several significant challenges that may place pressure on this surplus. Some of these challenges are not fully known at the time of writing this report and are explained below in more detail.

Budget Challenges

- *Revised Asset Management Plans have been determined on current service levels provided to the community for each of Council's major asset classes being Roads, Drainage, Buildings and Open Space. An external independent assessment was undertaken in determining the condition of the assets and the resulting ten-year forecast requirements for maintenance and renewal expenditure compared to existing budgets. **Based on this latest assessment it indicates that there is an average funding gap of \$3 million per year over the next ten years. This asset management funding gap has not been included in the draft 2022/23 forecast surplus which is insufficient to address this requirement. This matter will be considered by Councillors during an upcoming informal workshop on Council's Revised LTFP in April 2022 including discussion around meeting critical infrastructure requirements.***
- *The Independent Pricing and Regulatory Tribunal (IPART) have released a draft report into the review of Domestic Waste Management services particularly in respect to pricing and expenses included in this service. The consequence of these potential changes, if approved, may result in a significant financial impost on Council's budget estimated at \$2.3 million. **The current forecasted 2022/23 surplus does not have the capacity to fund these proposed changes. This issue is subject to a separate report at this General Meeting of 13 April 2022 as noted in Director's Report CE6/22 – IPART Domestic Waste Management Charge Review.***
- *Capital projects detailed in the Operational Plan 2022/23 total \$66 million and are largely funded from external grants and development contributions. There is a level of unavoidable financial risk from major capital expenditure budgets of this size and the use of general funds may be required if unexpected cost escalations occur that cannot be offset through project scope reductions or funded from external sources. Current external economic forecasts indicate that the cost of raw materials and contracts will increase in line with rising inflation this year, which will place pressure on these budgets. **It is noted that due to supply chain***

issues being experienced in the construction sector has seen material costs rising by at least 15%.

- **The Hornsby Shire Local Government Area has been impacted by multiple severe weather events that were declared Natural Disasters by the NSW State Government between 2018 and 2022. Each of these events typically costs Council several hundred thousand dollars in clean-up costs that are not always able to be recouped from the NSW State Government. A cost estimate to rectify damaged Council Infrastructure (i.e., roads) from the February 2022 floods is currently being prepared, which is expected to be larger in cost than the previous years' events, and which will require funding in the 2022/23 Annual Budget. The funding requirements from the most recent event as well as the possibility of further disasters in 2022/23 is a risk to the budget.**
- **Council's LTFP had forecast a rate peg of 2.28% for the 2022/23 Annual Budget that was based on the average 10-year historical rate peg. A 2.28% rate increase would have provided in total \$1.6 million in income from rates, which is \$1.1 million more than the increase provided by the 0.7% rate peg of \$500K in 2022/23. The significance of the 0.7% rate peg set by the IPART for the 2022/23 budget year will have an ongoing financial detriment estimated at \$11 million over the next 10 years exclusive of the compound effect of further rate peg increases. This has been reflected in the draft LTFP which will be considered by Council at its May 2022 General Meeting. It is noted that this most likely will result in budget deficits in 5 out of the 10 years in the LTFP exclusive of the asset management funding gap and IPART proposed Domestic Waste Service changes.**

The identified budget challenges above demonstrate the need for prudent financial management over the 2020/23 financial year and the financial risk to the forecasted surplus from a natural disaster, changes to the Domestic Waste Management arrangements by the IPART, project cost escalation above planned increases and revised asset management plan requirements need to be addressed. A number of Councillor requests were unable to be funded due to the likelihood of some of the constraints stated above.

Additional Special Rate Variation

The Minister for Local Government in response to financial sustainability concerns raised by the Local Government sector from this historical low rate-peg has announced a one-off opportunity for the 2022/23 financial year. This opportunity is an additional special rate variation for 2022/23 which:

- *Is the lower of 2.5% or what is in a Councils published LTFP (inclusive of the 0.7% rate peg)*
- *Can be applied to the 2022/23 rate base then reversed in 2023/24*
- *Can be applied to the 2022/23 rate base and remain as a permanent increase*

Council as part of this process will have to be able to demonstrate financial need such that, in the absence of a special variation, Council would not have sufficient funds to meet its obligations as identified in its LTFP as and when they fall due in 2022-23 and beyond if seeking a permanent retention to its rate base. The challenges section above clearly demonstrates this financial need and the fact that over the next 10 years in the LTFP it has been estimated that Council will be in deficit 50% of the time. It is noted that this is before considering the financial impact of asset management plan requirements and IPART changes to the Domestic Waste Management service on the operating budget result.

Given the financial deterioration in Council's financial capacity from the challenges identified above it would be fiscally responsible to apply for the additional special rate variation at 2.28% as listed in Councils published LTFP as a permanent increase. Applications are due to be submitted to the IPART by 29 April 2022 and should Council's application be successful the average residential rate will increase by \$19.64 from \$1,252.31 (inclusive of the 0.7% rate peg) to \$1,271.95 with a 2.28% total rate increase (also inclusive of the 0.7% rate peg).

Council's 2019/20 – 2028/29 Long Term Financial Plan

Council's current Long Term Financial Plan (LTFP) was adopted on 13 March 2019 and covers the period 2019/20 to 2028/29. The Plan was reviewed by Councillors at workshops and briefing sessions during November 2020, February 2021 and March 2022 and was used to inform and support the creation of Council's Integrated Planning and Reporting documents for 2019/20, 2020/21, 2021/22 and 2022/23.

The LTFP was initially drafted to guide decision making in respect to Council's financial sustainability following the transfer on 12 May 2016 (the proclamation date) of the Hornsby Shire Council area south of the M2 Motorway to the City of Parramatta Council. The financial impact of that transfer was significant to Hornsby Shire Council and resulted in the following being transferred to the City of Parramatta:

- Net recurrent revenue of \$9.1 million per annum. Over the period of the LTFP, with projected rate increases applied, this equated to a net loss of \$99.6 million for Hornsby for the 10-year period
- Foregone growth in rates income (estimated at a minimum of \$2.4 million) which would have been achieved from development in the transferred area over the 10-year period
- Assets that had been identified (valued in excess of \$50 million) which were to be used towards funding the development of the Hornsby Quarry and Westleigh sites
- Section 711 Development Contribution funds collected prior to the proclamation date
- Significant foregone Section 711 and 712 Development Contribution funds (tens of millions of dollars) from projected future development in the area transferred to the City of Parramatta

The LTFP included a number of assumptions and calculations which have particular relevance to IPART's assessment of Council's 2022/23 ASV application e.g.,

- The LTFP was forecast on the basis of a continuance of "normal operations" – this was defined as the provision of services to stakeholders at levels of service they had come to expect on a regular basis in the years leading up to the adoption of the LTFP
- An annual rate peg increase of 2.28% was allowed for each year of the Plan period – this increase was based on a calculation of the Government's average rate peg increase for the five-year period to 2018/19
- The forecast Net Operating Results before Grants and Contributions provided for Capital Purposes were \$5.5 million (2019/20), \$4.7 million (2020/21), \$3.7 million (2021/22), \$2.0 million (2022/23), \$2.0 million (2023/24), \$0.2 million (2024/25), \$0.7 million (2025/26), \$0.5 million (2026/27), \$0.3 million (2027/28) and -\$0.7 million (2028/29)
- The forecast Operating Performance Ratios (OPR) were 4.17% (2019/20), 3.47% (2020/21), 2.73% (2021/22), 1.43% (2022/23), 1.40% (2023/24), 0.13% (2024/25), 0.48% (2025/26), 0.35% (2026/27), 0.22% (2027/28) and -0.41% (2028/29)

It is noted that the average OPR for the period 2022/23 to 2026/27, which is the subject period for this ASV application, is 0.76% and that this figure is well below the 2% average figure required to justify the ASV application.

It is also noted that the actual OPRs for 2019/20 and 2020/21, as shown in the Annual Financial Statements for those years, are 5.32% and 3.82% respectively. The actual results indicate that the forecasts in Council's current LTFP are reasonable and could be relied upon for financial planning purposes. They also reflect that the OPRs are on a downward trend (as forecast) and will average out at under 2% for the period of the LTFP.

Council's 2022/23 to 2031/32 Long Term Financial Plan

A report is currently being prepared for submission to Council's 11 May 2022 General Meeting recommending that Council adopt for the purpose of public exhibition a draft 2022/23 to 2031/32 LTFP. The draft Plan (copy attached) has regard to the issues discussed in General Manager's Report No. 13/22 (referred to above) as well as providing for the maintenance of Council's recurrent services over the period of the Plan.

The Plan forecasts that the Income Statement Result before Capital Items (assuming a 0.7% rate increase) will be in deficit for eight out of the 10 years with an average deficit of \$3.266 million per year. This would see Council needing to utilise Council's unrestricted cash balances and/or the repurposing of internally restricted assets to fund recurrent operations, which is financially unsustainable.

It is noted that the forecast OPRs for the 2022/23 to 2026/27 financial years with a 0.7% rate increase would be -0.62%, 2.03%, -0.84%, -1.49% and -2.10%. The average OPR for the five-year period would be -0.6% which is well below the 2% average figure required to justify the ASV application.

The Plan also forecasts that the Income Statement Result before Capital Items (assuming a 2.28% rate increase as allowed in the current LTFP) will still be in deficit for seven out of the 10 years with an average deficit of \$1.967 million per year. This would again see Council needing to utilise Council's unrestricted cash balances and/or the repurposing of internally restricted assets to fund recurrent operations, which is unsustainable in the longer term.

It is noted that the forecast OPRs for the 2022/23 to 2026/27 financial years with a 2.28% rate increase would be -1.41%, 2.81%, -0.04%, -0.68% and -1.28%. The average OPR for the five-year period would be -0.1% which again is well below the 2% average figure required to justify the ASV application.

Conclusion

The above information (summarised against the relevant criteria below) demonstrates that Council has fully met the requirements of the Guidelines set out in Circular No. 22-07. As such, its ASV application for a 2.28% increase in rates for 2022/23, and for the extra income to be included in Council's rate base on an ongoing basis, should be approved by IPART.

Council's 2021/22 IP&R documentation identifies that Council budgeted for an income increase above the percentage specified for the Council for 2022/23 under section 506 of the Local Government Act.

- Council's 2019/20 – 2028/29 LTFP, which was part of its 2021/22 IP&R documentation, identified a rate increase of 2.28% for the 2022/23 financial year and beyond.
- That rate increase was based on the average 5-year historical rate peg at the time the LTFP was adopted.

- It will provide additional rate income of \$11 million over the next 10 years (compared to a 0.7% rate increase recommended by IPART), exclusive of the compound effect of further rate peg increases
- The LTFP confirms that income is required to meet Council's ongoing commitments over that period
- A new draft 2022/23 – 2031/32 LTFP also confirms the need for the rate increase and notes that Council will still be in deficit for seven out of the 10 years (with an average deficit of \$1.967 million per year)

Council's 2021/22 IP&R documentation identified that Council forecast an average Operating Performance Ratio (OPR) of 2% or lower over the next five years.

- Council's 2019/20 – 2028/29 LTFP, which was part of its 2021/22 IP&R documentation, forecast OPRs of 1.43% (for 2022/23), 1.40% (for 2023/24), 0.13% (for 2024/25), 0.48% (for 2025/26) and 0.35% (for 2026/27).
- The average of those OPRs is 0.76% per annum, well below the benchmark of 2% set by Circular No. 22-07.
- The new draft 2022/23 – 2031/32 LTFP forecasts OPRs of -1.41% (for 2022/23), 2.81% for (2023/24), -0.04% (for 2024/25), -0.68% (for 2025/26) and -1.28% (for 2026/27) on the basis of a 2.28% rate increase.
- The average of those OPRs is -0.12% per annum, well below the benchmark of 2% set by Circular No. 22-07.

A Council resolution to apply for the ASV under section 508(2) of the Act which clearly states whether the resolution is for a temporary or permanent variation under section 508(2) of the Act; the additional income that Council will receive if the ASV is approved; why the ASV is required; and that Council has considered the impact on ratepayers and the community in 2022/23 and, if permanent, in future years if the ASV is approved and considers that it is reasonable.

- Council's 13 April 2022 resolution in respect of the adoption of its draft 2022-26 Delivery Program and 2022/23 Budget states in part that:

In line with recently published IPART Guidelines, Council apply for a permanent Additional Special Variation (ASV) to General Income (i.e. from 0.7% to 2.28% for 2022/23) on the following basis:

- The additional general income to be received by Council for the 2022/23 financial year as a result of such an ASV would be \$1.1 million.*
- The additional income is required to ensure the financial sustainability of Council's services and projects as detailed in General Manager's Report No. GM13/22 and Council's Long Term Financial Plan.*
- Council has considered the impact of an ASV on ratepayers and the community in 2022/23 and future years and considers such impact to be reasonable in the circumstances.*

If IPART has any questions or requires any further information about Council's ASV application, please do not hesitate to contact me on [REDACTED] or Council's Director, Corporate Support - Mr Glen Magus on [REDACTED]

Yours faithfully

[REDACTED]

Steven Head
General Manager

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