

10.2 Special Rate Variation Investigation

Officer Lyndal Harper, Group Manager Corporate Strategy

File Number F19/2091

PURPOSE

Since the 2019 adoption of the Financial Sustainability Strategy and Roadmap, Council has indicated significant long term financial sustainability challenges. Forecasting required for the Long-Term Financial Plan, within the Integrated Planning and Reporting (IP&R) document suite, has modelled multiple years of ongoing operating deficit budgets when capital grants and contributions are excluded. Alternative budget scenarios, with and without a special rate variation (SRV) have been published throughout this time, aiming at raising awareness and reflecting the challenge in obtaining a sustainable budget position.

This paper seeks Council's endorsement to carry out a formal investigation of the need for a SRV and dedicate resources to considering detailed financial modelling, asset management planning and levels of capital spending. The investigation would also include significant community engagement and information sharing so that the community is informed and has a say on the difficult decisions required.

It is intended that the investigation will result in a further report to Council in November 2023 recommending whether an application for a Special Rate Variation is required to address Council's financial viability.

RECOMMENDATION

That Council:

- 1. requests the General Manager to conduct a detailed investigation into options for achieving financial sustainability including a review of asset management plans, proposed capital programs, possible service level reductions, assessing capacity to pay and conducting community engagement; and**
- 2. receives a further report in November 2023 recommending whether a Special Rate Variation application should be submitted with the intention of implementing a rate increase from the 2024-25 financial year, including consideration of the viability of service reductions.**

BACKGROUND

Council's financial results have fluctuated over the last five years due to implementing significant organisational and systems change, injections of sizeable grant funding following natural disasters and the COVID-19 pandemic and increased expenditure to address legacy issues such as salaries not appropriately reflecting staff competency levels and critical functions, particularly from a strategic planning and governance perspective, not being adequately resourced.

Consistently achieving a positive operating performance result is not possible given the current sources of income, reliance on grant funding and level of asset maintenance and improvement required.

Significant financial improvements are needed in the future to ensure Council is financially sustainable on a longer-term basis. Current long-term forecasts indicate operating expenditure

exceeds operating revenue in the General Fund, and when capital grants and contributions from other levels of government are excluded, Council is facing ongoing operating deficit budgets. Net operating results (excluding capital grants and contributions) for the next 10 years from 2023-24 to 2032-33 indicate a cumulative \$62 million deficit. A situation that is not sustainable.

The challenge of managing rising costs, meeting community expectations and having government restrictions on generating income from rates is not a new issue for this Council or any across NSW.

Financial results have deteriorated across the sector over the past three years with 38% of Council's across NSW reporting deficits in the 2021-22 financial year. Seventeen NSW Councils have made an application to the NSW Independent Pricing and Regulatory Tribunal (IPART) seeking approval to increase rates in 2023-24.

Examples of the level of rate increase being sought from similar Councils are in the table below.

Council	Level of rate increase sought	Other actions
Armidale Regional Council	Cumulative increase of 50% over three years	n/a
Bega Valley Council	43% increase in 2023-24 permanently retained in rate base	Reduce service levels by \$138 million over 10 years
Federation Council	Cumulative increase of 74.59% over four years	n/a
Lithgow City Council	45.7% increase in 2023-24	Create a future fund from rate rise levied against power, mining, and quarrying businesses.

Kempsey Shire Council must implement a holistic improvement program to meet its stated financial goals of:

- Modest operating surpluses to insulate Council from unforeseen events.
- The provision of current service levels and where appropriate increased service levels to meet community expectations.
- Reduce or eliminate the infrastructure backlog.
- Maintain adequate levels of debt/equity funding.
- A program of activity that see Council's assets appropriately leveraged for the long-term benefit of the Macleay Valley community.
- Ensure appropriate levels of cash reserves are maintained for future projects and asset renewal management.
- Ensure appropriate investment in the maintenance of assets.

In 2019 Kempsey Shire Council adopted a Financial Sustainability Strategy and Roadmap, taking a proactive approach to addressing productivity, systems and budget issues that had been emerging for some time.

The Strategy identified that to achieve financial sustainability Council should:

- Continue to integrate and align the service delivery and financial outcomes through the Integrated Planning and Reporting document suite including Long-Term Financial Plan, the Community Strategic Plan and Delivery Program
- Enable a culture of innovation, financial literacy and accountability to ensure decision making at every level is aligned to positive community outcomes
- Work with the community on determining service level expectations and agreed associated funding sources
- Develop better practices, enabling systems and processes.

Progress on the implementation of the Strategy has been reported quarterly since adoption and the program of work is now incorporated into the Long Term Financial Plan, redeveloped as the Financial Sustainability Program. The revised Financial Sustainability Program is largely focused on the General Fund given the large operating deficits forecast for that fund in the future.

The Long Term Financial Plan, a 10 year financial forecast updated annually and adopted as part of the IP&R suite, has since 2019 indicated the severity of Council's financial position.

Each year Council has placed on public exhibition and adopted a LTFP that includes the strategies and actions identified to address financial sustainability. Each year for the past five years the LTFP has included scenarios for possible Special Rate Variations to increase revenue and return Council to a balanced budget position.

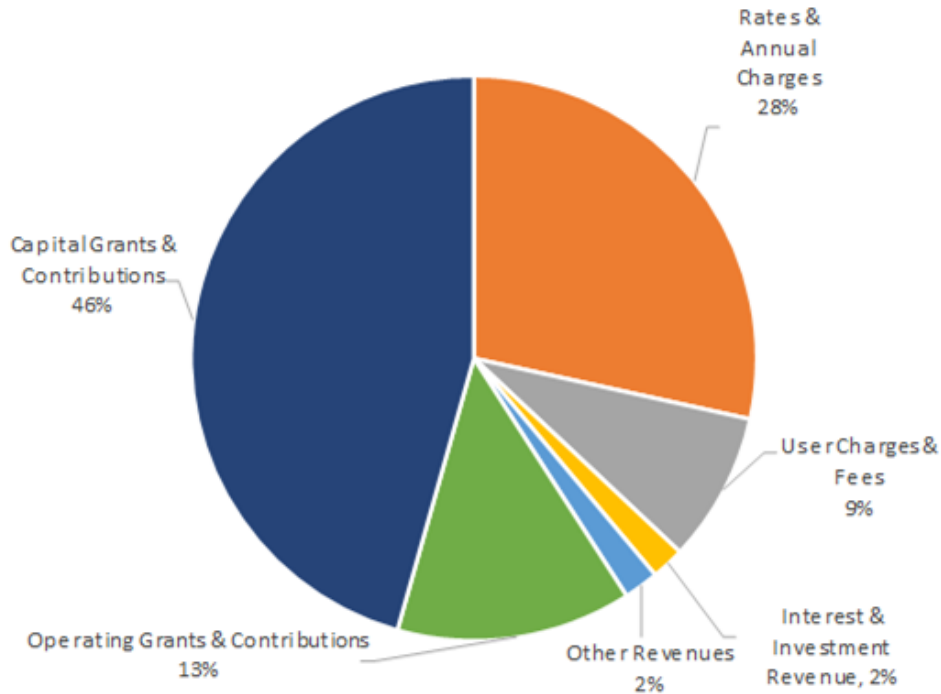
Subsequent disaster events, COVID-19 and significant grant funding has meant that in previous years Council has not had adequate capacity to conduct a detailed investigation of a SRV including community engagement and education.

It is no longer sustainable for Council to assume that grant funding will continue at the levels experienced over the last 3-5 years and containing expenditure can prevent realisation of ongoing deficit positions.

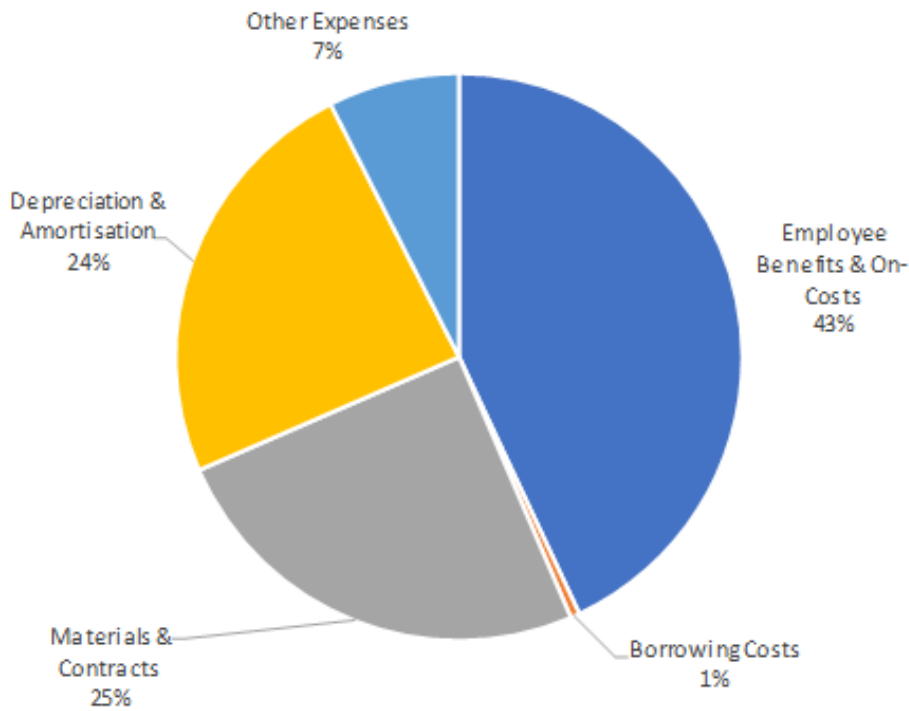
The following graphs provide a summary of Council's financial position, with a particular focus on the General Fund. The IP&R report at agenda item 10.1 and associated attachments include significant further detail.

2023-24 General Fund Forecasts – Revenue and Expenditure

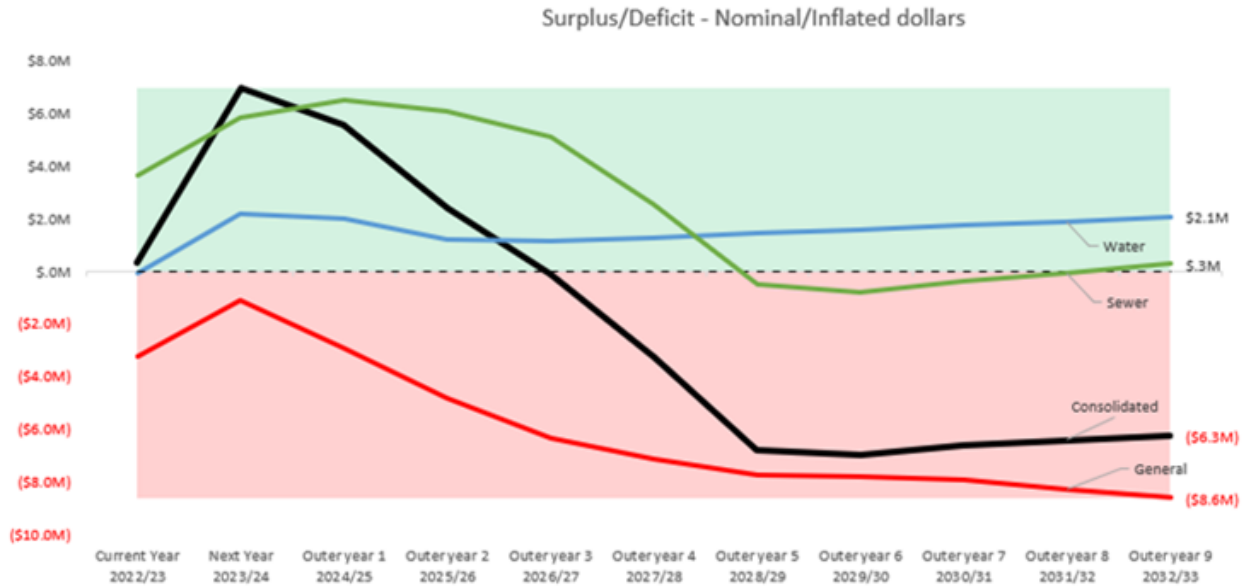
Revenue Forecasts



Expenditure Forecasts



10-year Long Term Financial Plan Forecasts by Fund



Fund	10-year totals
Consolidated	(\$21M)
General	(\$62M)
Water	\$17M
Sewer	\$25M

The above charts and table illustrate the challenges facing Council’s General Fund.

The work of creating a long-term financial forecast relies on making a series of assumptions. Key assumptions and facts that have contributed to the forecast of ongoing deficits in the general fund include:

- Rising costs of materials and contractors that are necessary to deliver maintenance and renewal programs.
- Implications of a low unemployment market making it difficult for Council to secure available, suitably experienced, and qualified staff employed within the parameters of the Local Government Award.
- Significant proportion of Council’s capital expenditure in recent years has been grant funded. This has delivered critical works such a replacement of timber bridges, road upgrades and construction of new sports and community facilities. In forecasting spend for future years Council must assume that other levels of government won’t continue the multimillion-dollar grant programs that have been available after natural disasters and the COVID-19 pandemic.

- Over the last three years Council has continued to deliver record levels of investment in capital improvements and new projects, many funded with contributions from grants. To ensure this infrastructure can be maintained and eventually replaced, future years budgets must include an appropriate allocation for depreciation (i.e., future asset replacement) and asset maintenance. Current financial modelling indicates that depreciation after 2025 represents almost half the income from rates.
- While borrowing funds for capital investment is a recommended financial management practice and achieves intergenerational equity, borrowing to fund ongoing operating costs without a plan for increasing revenue streams is not sustainable. The impact of rising interest rates has also contributed to the significant increase in borrowing costs.

KEY CONSIDERATIONS

Conducting the proposed investigation and making further recommendations on financial sustainability is intrinsically linked to Council meeting the obligations of the IP&R framework.

According to the Guidelines published by the Office of Local Government, IP&R provides a pathway for Council's to:

- Work directly with their community to identify long-term priorities for local identity, growth and lifestyle.
- Understand the range of services the community wants, the service standards they expect and the infrastructure that will be required.
- Have meaningful conversations about the cost of meeting community expectations.
- Allocate resources within Council's means and map out a 4-year strategy to deliver key priorities, projects and services.
- Set appropriate rates, fees and charges and monitor the Council's progress in delivering priorities, projects and services through the Operational Plan.
- Report to the community on their success in achieving these goals.
- Be assured that their Council is meeting planning, consulting and reporting requirements under other laws.

Significant community engagement was undertaken to support the development and adoption of two primary documents in the IP&R framework, the Community Strategic Plan: Your Future 2024 and Delivery Program 2022-2026.

There are two primary actions in the adopted Delivery Program that underpin the need for this investigation project:

- LE.DP3: Deliver and improve corporate performance, assets, risk and management systems
- LE.DP4: Manage our money and assets to be sustainable now and in the future

The community's support for prioritising the financial management of Council and its operations is demonstrated in the results of quantitative community survey data collected through a biennial telephone survey.

- 2020 survey results identified Financial Management as the highest ranked driver of community satisfaction. The data shows a significant gap between the respondents ranking of importance of financial management and level of satisfaction.

- Indicative results from the 2023 Survey conducted in March 2023, show that Financial Management and Sustainability is the second highest priority ranked service after Bridges.
- 2023 results also show that the highest ranked services that the community expects Council to invest more in are Roads, Bridges and Transport followed by Stormwater and Drainage. These are services that require multimillion dollar expenditure to make a discernible difference to the residents lived experience.

Council's ongoing investment in high quality planning documents that integrate community engagement outcomes with true costings and data have created a strong foundation for the proposed investigation and subsequent decision making.

Policy and Legislation

The investigation and any related decisions of Council would be undertaken as per Section 508 of the Local Government Act and according to the relevant IPART guidelines and reference material.

Strategic Alignment

This investigation and related financial modelling, community engagement and future recommendations align with the themes outlined in Council's Financial Sustainability Strategy and Roadmap, adopted in 2019.

10-year financial forecasts, as included in the Long Term Financial Plan are a legislative requirement of the Integrated Planning and Reporting Framework that applies to all Council's in NSW.

Impact on Financial Sustainability

The financial impact of carrying out a detailed investigation and potential subsequent application for a special rate variation is minimal;

- Resourced using existing salary allocations for vacant positions in Council's Corporate Performance department.
- Estimated \$30,000 budget for community engagement and community survey activities, funded from General Manager and Director Corporate & Commercial existing budget allocations.
- Potential expenditure of up to \$25,000 for additional consultants to evaluate capacity to pay and associated financial modelling, funded from existing budget allocations.

The impact on financial sustainability of not carrying out this investigation and forming a recommendation for future years is a forecast cumulative operating deficit of \$62 million over the next ten years.

Stakeholder Engagement

Analysis of potential stakeholders shows that those critical in guiding the investigation work and providing key insights include:

- IPART
- Micromex Research
- Other Councils who have made recent SRV applications
- Office of Local Government
- Local State and Federal MP's in relation to potential future grant funding
- Council Staff (as service delivery experts and ratepayers)

An essential part of the investigation and legislated component of any potential application for a Special Rate Variation is engagement with the community and local ratepayers. A detailed engagement plan will be prepared if Council resolve to undertake the investigation, as recommended in this report.

Criteria 2 in the guidelines for the preparation of a Special Rate Variation as issued by the Office of Local Government state that Council's must provide evidence that the community is aware of the need for and extent of a rate rise.

Creating genuine awareness requires a focus on communicating several key messages to the community such as:

- Significant measures have been taken over the last five years to address Council's financial sustainability
- A false security has been created by delivering millions of dollars in grant funded projects
- Maintaining the network of essential assets such as roads, bridges and public reserves comes at a large cost
- Council will continue working to ensure further efficiency and operational cost savings
- Rising costs of materials, labour and interest rates impact the financial forecasts
- Consideration will be given to reducing services as part of the action plan to achieve financial sustainability

Once modelling and scenarios have been further developed the engagement will clearly identify the proposed level of rate rise, the average impact in dollar terms on rating categories and expected outcomes for ratepayers.

A range of communication and engagement methods, aligned with the Inform and Consult levels of the IAP2 engagement spectrum and Council's adopted Community Engagement Strategy, will be used.

Proposed engagement methodology and tools include:

- Education resources such as webinar and slide shows
- Focus on staff being informed to help ensure factual correctness in the community
- Engage where people are already gathered i.e., groups and clubs meeting, events, markets
- Development and distribution of plain English fact sheets, info graphics and detailed financial data
- Consider education materials being mailed to all ratepayers
- Listening posts where Managers, Executive and Councillors are available to listen and explain

CONCLUSION

This report, to be read in conjunction with Council's Long Term Financial Plan and Delivery Program, highlights the severity of Council's long term financial position.

Over several years, financial modelling has publicly identified that a Special Rate Variation may be required to address the forecast budget deficit.

It is now critical that the detailed investigation and community engagement outlined in this report is carried out so that Council can make an informed, evidence-based decision on what action is required ahead of the 2024-25 financial year.

ATTACHMENTS

Nil.