Item:	**9.4**	**Ref: AINT/2021/00909**
Title:	**Special Rate Variation Application**	**Container: ARC17/2315**
Responsible Officer	**Acting Director Organisational and Corporate Services**	
Author:	**Kelly Stidworthy, Manager Financial Services**	
Attachments:	1. Community Engagement Summary Report 2. 2021-22 Special Rate Variation Application - Written Submissions Part A 3. 2021-22 Special Rate Variation Application - Written Submissions - Part B	

ADOPTED RECOMMENDATION

1/21 **Moved Cr O'Connor Seconded Cr Robinson**

That Council:

a. Proceed with a section 508(2) (permanent) Special Rate Variation option in order to address Armidale Regional Council's financial sustainability and maintain essential community infrastructure including Council's road network, footpaths and community buildings.

b. Make application to the NSW Independent Pricing and Regulatory Tribunal for Option 2 being a permanent Special Rate Variation of 8.5% plus 2.0% rate peg (total 10.5%) commencing in 2021-22.

c. Acknowledge the feedback received from the community during the community engagement and public exhibition process and provide this to the NSW Independent Pricing and Regulatory Tribunal as part of the Special Rate Variation application by Armidale Regional Council.

d. Receive a report outlining an improvement program to be implemented in the 2021/22 budget in order to:

   I. Eliminate the unfavourable gap between operating income and expenditure.

   II. Create the financial capacity needed to undertake the actions required under the mandatory Performance Improvement Order.

   III. Improve key asset management indicators.

The Motion on being put to the vote was CARRIED.

1. Purpose

To present Council with the community feedback provided during the Special Rate Variation consultation period and recommend that Council proceed with application for a section 508(2) (permanent) Special Rate Variation commencing in the 2021-22 financial year to support the provision of ongoing services, renewal of infrastructure and achieve compliance with section 8b of the *Local Government Act 1993*.

For the reasons outlined in this report, Option 1 provides Council the greatest opportunity to secure its longer term financial sustainability while at the same time seeking to review and improve its own service level commitments to enhance community outcomes.

Option 1 would also enable Council to meet the requirements of the Performance Improvement Order issued to Council on 9 December 2020 by the Hon. Shelley Hancock MP, Minister for Local Government.

Option 1 is a permanent Special Rate Variation of 18.5% plus 2.0% rate peg (total 20.5%) commencing in 2021-22.

Option 1 would result in the average Armidale Residential ratepayer paying an additional $2.48 per week and the average Guyra Residential ratepayer paying an additional $1.16 per week including the 2% rate peg.

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2. OFFICERS' RECOMMENDATION:

That Council:

a. Proceed with a section 508(2) (permanent) Special Rate Variation option in order to address Armidale Regional Council's financial sustainability and maintain essential community infrastructure including Council's road network, footpaths and community buildings.

b. Make application to the NSW Independent Pricing and Regulatory Tribunal for Option 1 being a permanent Special Rate Variation of 18.5% plus 2.0% rate peg (total 20.5%) commencing in 2021-22.

c. Acknowledge the feedback received from the community during the community engagement and public exhibition process and provide this to the NSW Independent Pricing and Regulatory Tribunal as part of the Special Rate Variation application by Armidale Regional Council.

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3. Background

History of Special Rate Variations

In comparison with other NSW councils, Armidale-Dumaresq and Guyra Shire Councils used the Special Rate Variation (SRV) process minimally over the past decades. Compared with other NSW councils, ratepayers in this region have experienced modest rates increases over 20 years+.

It can be seen from the table below that temporary SRVs have been used as an additional source of funding by both the Armidale Dumaresq and Guyra Shire Councils for at least the last 15 years. The percentage increases shown in the table include the SRV and the annual rate peg. The temporary nature of previous SRVs applied for has created a perception that Council is continually seeking additional SRV funding when in reality previous SRV applications have in part been made to replace existing SRV funding.

Council	2005 /06	2006 /07	2007 /08	2008 /09	2009 /10	2010 /11	2011 /12	2012 /13	2013 /14	2014 /15
Rate Peg	*3.50%*	*3.60%*	*3.40%*	*3.20%*	*3.50%*	*2.60%*	*2.80%*	*3.60%*	*3.40%*	*2.30%*
Armidale Dumaresq	5.78% (expired 2011/12)									12.30% (expires 2020/21)
Guyra Shire					8.43% (expired 2013/14)					8.00% permanent

Armidale Dumaresq Council

In 2021 a temporary SRV of 10% (above the rate peg) applied by the former Armidale Dumaresq Council over a seven year period will expire, reducing Council's overall rates income by $1.5 million annually. Funding generated from the temporary SRV has paid for key asset renewal programs including the maintenance and renewal of community assets including roads, bridges, storm water drainage and facilities.

The need to, at a minimum, replace the funding generated from the temporary SRV has been known for some time. The consultation undertaken by Armidale Dumaresq Council in 2014/15 was on the basis of a 20% SRV under two different scenarios, however, application was made for a 10% SRV plus the rate peg in response to community concerns about affordability expressed during the consultation period.

The NSW Independent Pricing and Regulatory Tribunal's (IPART) determination of Armidale Dumaresq Council's 2014/15 SRV application, approved in June 2014, considered that the Council would need to seek a further special variation following cessation of the temporary SRV. Financial modelling performed for the 2014/15 SRV application showed that the General Fund operating performance would consistently remain in deficit even with the inclusion of the additional SRV revenue.

Guyra Shire Council

Guyra Shire Council applied for a permanent 8% SRV in 2014/15 including the rate peg. As the rate peg was 2.3% the SRV component was 5.7%. This replaced a previous temporary SRV of 8.43% including the rate peg and resulted in Guyra Shire Council's ordinary rate income increasing by $58,275. The application for the permanent SRV only increased Guyra Shire Council's income minimally and was made for the purpose of retaining the temporary SRV permanently.

Financial modelling performed for the 2014/15 SRV application showed that the General Fund operating performance would consistently remain in deficit even with the inclusion of the permanent SRV.

The submission made by Guyra Shire Council in 2015 to IPART in response to the proposed mergers showed that the Council required a permanent special rate variation of 30% (27.5% above the rate peg) in 2016-17 as well as an overall 15% decrease in depreciation expense in order to reach a neutral operating position over ten years. IPART considered these assumptions to be unreasonable although the Council did undertake community consultation on the special rate variation proposal and advised that 70% of respondents would accept a 30% rate rise if Guyra was able to be considered a Rural Council.

Former Council Outlook at Merger

Including the above SRV funding, the General Fund forecast net operating result before capital grants and contributions forecast for the former councils and submitted with the 2014/15 SRV applications was:

Council $'000	**2014 /15**	**2015 /16**	**2016 /17**	**2017 /18**	**2018 /19**	**2019 /20**	**2020 /21**	**2021 /22**	**2022 /23**	**2023 /24**
Armidale Dumaresq	(1,303)	(1,790)	(1,934)	(698)	(310)	(82)	334	(830)	(449)	(371)
Guyra Shire	(1,036)	(1,110)	(1,092)	(1,050)	(1,006)	(977)	(976)	(953)	(950)	(968)
Combined	(2,339)	(2,900)	(3,026)	(1,748)	(1,316)	(1,059)	(642)	(1,783)	(1,399)	(1,339)

The above table demonstrates that, despite the addition of SRV funding to the former councils revenue bases, significant General Fund operating deficits continued to be forecast.

Current Council Outlook

Council has faced some significant financial challenges since merger. The recently considered report entitled “Review of Council Finances” by Finch Consulting highlighted the deterioration in Council’s net working capital and reserves since merger from $29.8m at 12 May 2016 to $18.2m as at 30 June 2019. The report stated “The decline in Net Current Assets by $11.6m in the first three years since merger is due in part to Council adopting operating budget deficits and actual operating expenditure substantially exceeding budget, thus exacerbating the deficits, and major project expenditure overruns.”

The net working capital and reserves position has since improved through a focus on minimising budget deficits and closely managing expenditure to remain with budget and stood at $24.5m at 30 June 2020 with unrestricted cash of $2.14m.

An improvement in unrestricted cash is currently forecast in the 2020/21 budget; however, is subject to the budget position withstanding negative impacts from the downturn in revenue resulting from Covid-19, which has proved much worse than anticipated when the original 2020/21 budget was developed. A key reason for the improved cash position is a significant reduction in the level of funding directed to infrastructure renewal in the 2020/21 budget but this cannot be sustained.

Implementation of the recommendations from the Review of Council Finances has been included as a mandatory action required to improve performance under section 438A(3)(b) of the Act in the Performance Improvement Order issued to Council on 9 December 2020 by the Hon. Shelley Hancock MP, Minister for Local Government. These recommendations are:

a) Council should adopt surplus budgets that ensure financial sustainability over the longer term.
b) Council should adopt a Reserves policy that ensures a minimum of $4-5m is available as unrestricted cash to fund working capital requirements before setting aside funds as Internal Restrictions.
c) Establishment and funding of Reserves should be supported by Council resolutions.
d) Council should request a fourth quarter budget review report to ensure that Councils financial position and performance is sound and that the budget for the ensuing year is based on current information.
e) Council and the Audit and Risk Committee should ensure appropriate governance oversight and risk monitoring of major projects and budget reporting.
f) Council should ensure that the budget approval and monitoring process incorporates detailed information in relation to major capital projects and funding sources.
g) Management should establish an appropriate Project Management framework that is best practice, together with a reporting architecture that ensures accountability for budget variances.
h) Management should ensure that quarterly budget reviews are complete, timely and accurate and reflect any adverse trends known to management.
i) Projects should not be initiated in the Projects Ledger unless there is a fully funded budget allocation. The Project Ledger should be regularly reconciled with the General Ledger and adopted budget.
j) Office of Local Government guidelines pertaining to Capital Expenditure Reviews should be applied to relevant projects.
k) Council should ensure that sufficient resources are provided within the organisation to address the above recommendations.

These recommendations are in addition to the Performance Improvement Order requirements to:

- Implement the recommendations from the Governance Arrangements Review under oversight of the Audit, Risk and Improvement Committee;
- Implement the recommendations from the Land Management Practices Review;
- Ensure that resources are provided to the General Manager so that adequate funds are provided for:
    - Governance standards to be maintained;
    - The delivery of the Operational Plan;
    - Infrastructure maintenance;
    - The improvement of financial ratios; and
- Implement improvements to Council's financial monitoring and reporting.

These recommendations are required to be implemented by 4 September 2021.

<u>New Special Rate Variation Application</u>

The process for consideration of making an application for a new SRV is supported by the following Council resolutions:

- 28 August 2019

That Council resolves to pursue the application of a Special Rate Variation effective 1 July 2021.

- 29 July 2020

That Council commence investigation and an analysis of options for a Special Rate Variation, with the purpose of considering an application for a Special Rate Variation effective 1 July 2021, *with a minimum outcome being retention of funding provided by the current temporary Special Rate Variation.*

- 28 October 2020

That Council:

a) Commence community engagement on the following Special Rate Variation (SRV) options:
   1. *A permanent SRV of 18.5% plus 2.0% rate peg (total 20.5%) commencing in 2021-22;*
   2. *A permanent SRV of 8.5% plus 2.0% rate peg (total 10.5%) commencing in 2021-22; and*
   3. *Discontinuation of the temporary SRV of 10% (above the rate peg) applied by the former Armidale Dumaresq Council and ending on 30 June 2021;*

b) On or before 27 November 2020, formally notify IPART that Council intends to submit a Special Rate Variation application;

c) Note that the community engagement will also cover rates harmonisation impacts effective 1 July 2021; and

d) Note that the Special Rate Variation and Rates Harmonisation community engagement period runs from Monday, 2 November 2020 through to Thursday, 10 December 2020.

In accordance with the resolution made 28 October 2020, Council notified IPART of its intention to apply for a SRV on 18 November 2020.

During November and December 2020 Council conducted an extensive community consultation process to determine the community's views on the preferred SRV option.

Should Council wish to make application to IPART for a SRV it must do so by 8 February 2021.

4. Discussion

SRV Options

Armidale Regional Council is considering making an application to the IPART for a SRV to be retained permanently in the rate base.

The SRV funding would be used to fund asset renewals with a focus on roads, footpaths, community buildings and facilities. This would also support improved outcomes in terms of financial sustainability, maintaining service levels and the infrastructure backlog.

The SRV options presented to the community for feedback included:

Option 1 **Improve Services** Continuation of the temporary SRV plus an additional SRV increase	Council will apply for a permanent Special Rate Variation of 18.5% plus the 2.0% rate peg (total of 20.5%). This will replace the funding currently provided by the temporary SRV and increase total rate revenue by $1.8 million per annum. This option will result in the current level of assets and services maintained and Council will also be able to fund additional asset renewals and reduce the medium to long term financial risk. Roads, bridges, buildings and community facilities maintenance and renewal will be the focus of additional funds raised. This option provides Council the greatest opportunity to secure its longer term financial sustainability while at the same time seeking to review and improve its own service level commitments to enhance community outcomes.
Option 2 **Maintain Services** Continuation of the temporary SRV (Does not address future growth)	Council will apply for a permanent Special Rate Variation of 8.5% plus the 2.0% rate peg (total of 10.5%). This will replace the loss of the current SRV which is due to stop in 2021. This option will result in current levels of service maintained in the short term; however the asset renewal backlog will increase. This will increase costs in the medium to long term placing a financial burden on future generations. Council will have limited options to fund new assets as the region grows.
Option 3 **Decrease Services** Discontinuation of the temporary SRV (Financially unsustainable)	Council will not apply for a Special Rate Variation and revenue from ordinary rates will drop by $1.5 million per annum. This option will bring a significant reduction in the services provided by Council and the asset renewal backlog will increase. Roads, buildings and public spaces will deteriorate placing a significant financial burden on future generations and threaten Council's medium and long-term financial sustainability.

<u>Integrated Planning & Reporting Framework</u>
In conjunction with the SRV process, Council's Integrated Planning & Reporting (IP&R) documents have been updated including the:

- Community Strategic Plan 2017-2027
- Delivery Program 2018-2022
- Resourcing Strategy 2020-2021

A number of Delivery Program outcomes will not be possible to achieve without a SRV. These specifically include:

- Leadership for the Region

COMMUNITY OUTCOME - Council exceeds community expectations when managing its budget and operations

L2.1 Financial Sustainability

Maintain financial sustainability through effective short, medium, and long-term financial management. That includes an application to IPART for a Special Rate Variation at a rate determined through community consultation – and in line with Council resources and viability - for the specific purpose of creating revenue to fund asset maintenance and renewals.

- Environment & Infrastructure

COMMUNITY OUTCOME - The community has access to transport which enables connectivity both locally and outside of the region

E4.1 Roads and Bridges

Maintain safe and effective traffic facilities on the road network, through appropriate resourcing, including applying for a Special Rate Variation to maintain and renew roads and bridges to expected service levels.

Under a scenario of no SRV and an associated drop in rate revenue of $1.5 million per annum, it would be necessary to comprehensively reduce service levels and further community consultation would be needed on which service levels would reduce.

<u>IPART Assessment Criteria</u>

The criteria against which IPART is to assess SRV applications is based on what councils are required to do under IP&R. These criteria are:

Criteria	Council's Application
• The need for, and purpose of, a different revenue path for the council's General Fund (as requested through the special variation) is clearly articulated and identified in the council's IP&R documents • The relevant IP&R documents must be exhibited (where required), approved and adopted by the council before the council applies to IPART for a special variation to its general income	Council's: • Community Strategic Plan 2017-2027 • Delivery Program 2018-2022 • Resourcing Strategy 2020-2021 Have been updated to include provision for the application of a SRV and placed on public exhibition.

Criteria	Council's Application
Evidence that the community is aware of the need for and extent of a rate rise	Council's SRV community engagement period ran from Monday, 2 November 2020 through to Thursday, 10 December 2020 and included a letter being mailed to every ratepayer to inform them of the need for the SRV and potential rating impacts of each SRV option. The potential rating impacts of rates harmonisation was also considered and included in the community engagement material.
The impact on affected ratepayers must be reasonable, having regard to both the current rate levels, existing ratepayer base and the proposed purpose of the variation	Council's Delivery Program 2018-2022 has been updated to include a new section "Impacts on Ratepayers". IPART found that Armidale Dumaresq's 2014/15 SRV application for 12.3% had a moderate impact on ratepayers and Guyra Shire's previous SRV application for 8% was reasonable. This is in part due to the lower rating levels in the former GSC area compared to the former ADC area.
The IP&R documents or the council's application must explain the productivity improvements and cost containment strategies the council has realised in past years, and plans to realise over the proposed special variation period	Council's Delivery Program 2018-2022 has been updated to include a new section "Productivity Improvements".
Any other matter that IPART considers relevant	

SRV Rating Impacts

A breakdown of ratepayer impacts based on a harmonised rating structure is shown below.

Rating Category (Harmonised)	No Rate-payers	Average 2020/21	Average 2021/22			Per Week Increase/(Decrease)		
			Option 1	Option 2	Option 3	Option 1	Option 2	Option 3
Residential - Armidale	8,225	$1,126	$1,255	$1,148	$1,059	$2.48	$0.43	($1.29)
Residential - Guyra	942	$529	$589	$539	$497	$1.16	$0.20	($0.61)
Residential - Ebor	53	$425	$473	$433	$400	$0.93	$0.16	($0.49)
Residential - Hillgrove	96	$602	$671	$614	$566	$1.32	$0.23	($0.69)
Residential - Wollomombi	16	$576	$642	$588	$542	$1.27	$0.22	($0.66)
Residential - Village	104	$380	$423	$387	$357	$0.84	$0.15	($0.43)
Residential Non-Urban	1,226	$1,082	$1,206	$1,104	$1,018	$2.38	$0.42	($1.24)
Business - Armidale	390	$4,501	$5,016	$4,591	$4,233	$9.90	$1.73	($5.16)
Business - Armidale Industrial	157	$4,863	$5,420	$4,961	$4,574	$10.70	$1.87	($5.57)
Business - Guyra	99	$915	$1,020	$933	$861	$2.01	$0.35	($1.05)
Business - Non-Urban	44	$1,141	$1,271	$1,163	$1,073	$2.51	$0.44	($1.31)
Farmland	1,510	$3,228	$3,597	$3,292	$3,035	$7.10	$1.24	($3.70)
Farmland - Intensive	2	$6,285	$7,004	$6,411	$5,911	$13.83	$2.42	($7.20)
Mining	11	$5,925	$6,603	$6,044	$5,572	$13.04	$2.28	($6.79)
Total Assessments / Total Average	**12,875**	**$1,462**	**$1,629**	**$1,491**	**$1,375**	**$3.22**	**$0.56**	**($1.67)**

Rates Harmonisation

Council also consulted the community on the impacts of rates harmonisation during the SRV consultation process. This was because it was anticipated to have a significant impact on some categories of ratepayers in addition to any impact that may arise due to the proposed SRV.

It was identified that the Guyra Farmland rating category would be the most significantly impacted category due to rates harmonisation. This is because the Guyra Farmland unimproved land value is approximately $1 billion with rate revenue of $1.9 million versus the Armidale Farmland unimproved land value of approximately $0.9 billion with rate revenue of $2.9 million.

The large difference in rate revenue versus the close underlying land values for each category would result in a significant shift of the rate burden from the Armidale Farmland to the Guyra Farmland category if harmonisation was undertaken at 1 July 2021.

There were some other impacted rating categories identified but these had much smaller numbers of ratepayers and lower financial impacts.

The recently released Exposure Draft Bill *Local Government Amendment (Rates) Bill 2021* provides for further options for rates harmonisation than are available under current legislation. These include:

a) by the levying of a new rate for the category of land, with effect from 1 July 2021,
b) by the use of sub-categorisation of the category of land, or
c) by gradual harmonisation of rates for the category over no more than 4 years.

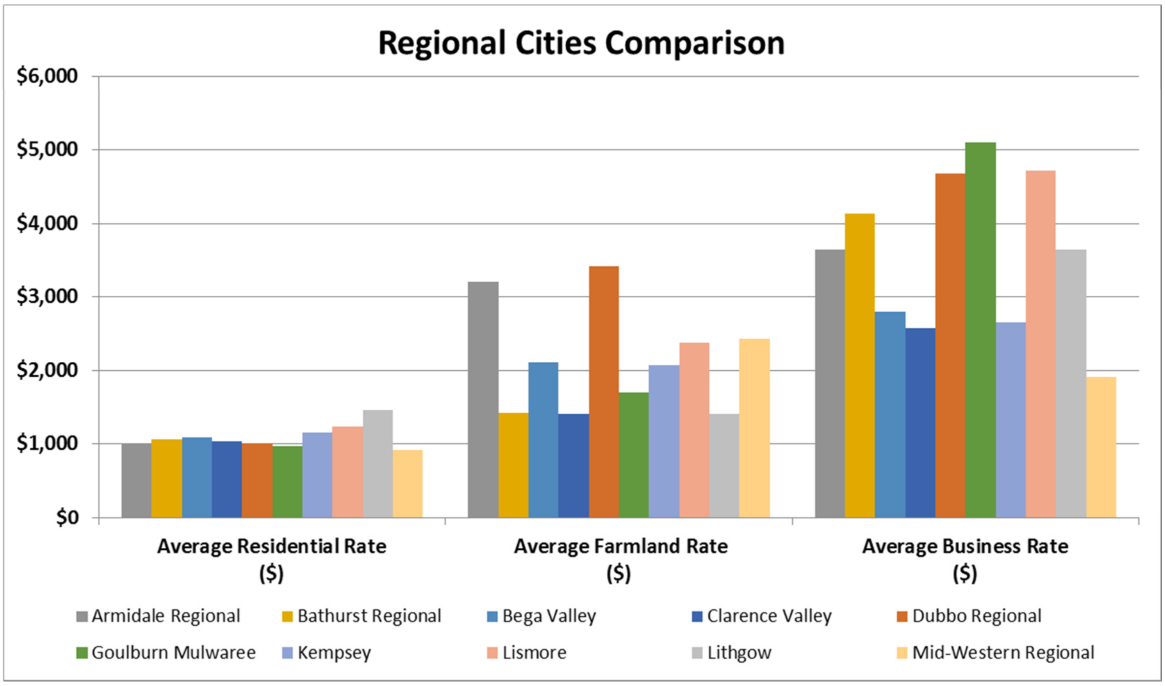
At a minimum, a four year gradual harmonisation of rates would smooth the transitional increases in rates between rate categories.

The provisions of the Exposure Draft Bill are subject to a separate report. However, it is anticipated that Council will consider the provisions in the revised legislation as part of the final rates harmonisation strategy determined and implemented from 1 July 2021. It should be noted that the Exposure Draft Bill is currently available for consultation and this legislation is not yet final.

Rating Comparisons

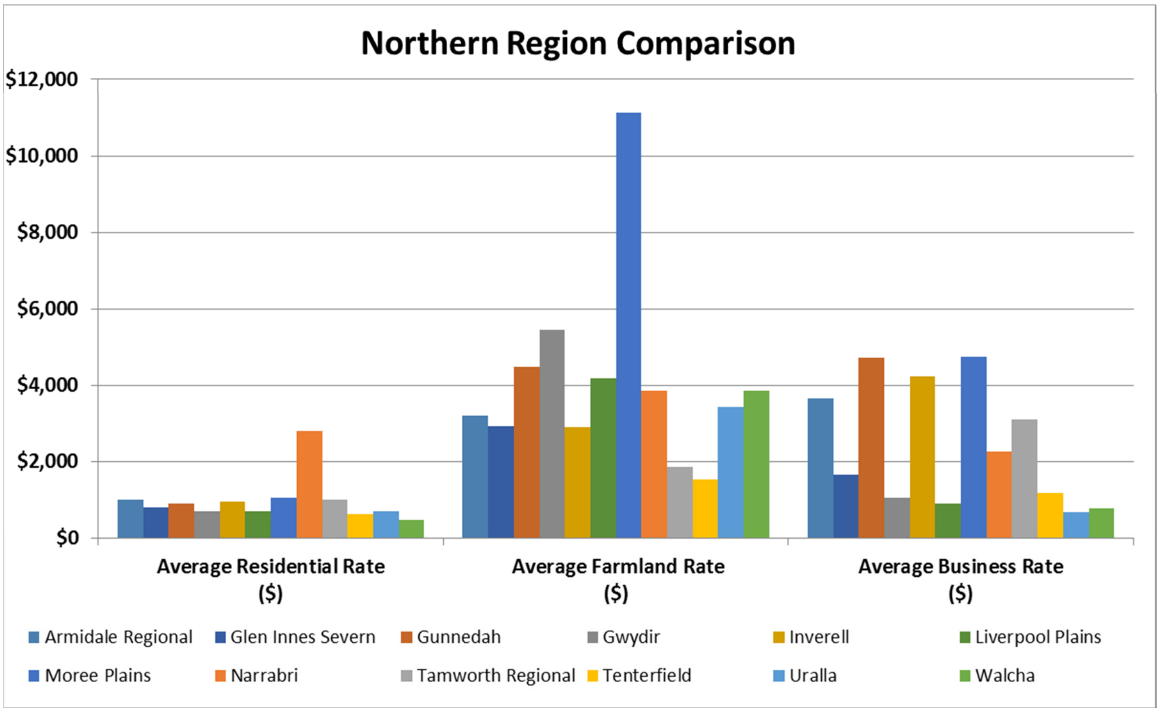
Comparisons are difficult to make to other councils because of a range of factors, including the area of land in the local government area, population density and the associated number of rateable assessments, the number and types of services provided and types of industry. Comparisons with financially-stressed councils are also problematic because it might seem they are more efficient but, in fact, they have many challenges ahead of them.

Council has compared its average rates with 10 ‘Regional Cities’ group councils with relatively similar population size. The data is based on 2018/19 comparisons because this is the latest data available from the Office of Local Government’s *Comparative Council Information*.



In this comparison, Council's average residential rate is the third lowest in the group, average farmland rate is the second highest and the average business rate is the fifth highest.

It is also worth comparing the Northern Region group of councils because they have large rural areas. In this comparative group, Council has the fourth highest average residential rate, the fifth lowest farmland rate and the fourth highest business rate.



Capacity to Pay

Socio-Economic Indexes for Areas (SEIFA), produced by the Australian Bureau of Statics, are an assessment of the welfare of Australian communities. The index of Advantage / Disadvantage is a composite index in which lower scores indicate more disadvantaged areas and higher scores indicate more advantaged areas.

When compared to same local government areas in the rating comparison graphs above, Council's SEIFA ranking is the highest at 87. Council engaged Morrison Low to conduct a Capacity to Pay review in 2019. It found the Armidale Regional Council area has lower disadvantage and greater advantage than regional NSW but is below the state wide averages. The review also noted there are greater levels of wealth inequality within the Armidale Region local government area compared to regional NSW.

Key findings from the review:

<table>
<tr><td colspan="4">Areas of Advantage</td></tr>
<tr><td>Non - Urban and Rural Regions</td><td colspan="3">There was a wealth and advantage bias towards the rural communities in council's LGA</td></tr>
<tr><td>Former Armidale Dumaresq Shire</td><td colspan="3">There was a wealth and advantage bias towards areas from the former Armidale and Dumaresq Shire in the same category</td></tr>
<tr><td>Areas of Advantage</td><td>• Rural Armidale
• NEGS</td><td colspan="2">• Rural East
• North Hill</td></tr>
<tr><td colspan="4">Areas of Disadvantage</td></tr>
<tr><td>Common Characteristics</td><td colspan="3">Regions of significant disadvantage had very low household incomes, high unemployment, a younger demographic profile, high levels of housing stress and a significant proportion of lone individual households</td></tr>
<tr><td>Areas of Disadvantage</td><td>• Central Armidale
• South Hill</td><td>• University
• Guyra</td><td>• Rural North West</td></tr>
</table>

The average taxable income (excluding government pensions and allowances) in the Armidale Regional Council area in 2017 was $50,884. The NSW average for the same period was $65,196 and the New England and North West group was $52,194.

Council has a hardship policy that aims to provide options for ratepayers deemed to be in genuine financial hardship and to provide equitable access to relief measures for all ratepayers.

The recommended benchmark for outstanding rates and charges for rural councils is less than 10%. The ratios below demonstrate that Council is generally able to recover its rates and annual charges within the year they are rated. Council's level of outstanding rates and charges indicates ratepayers have historically been able to consistently pay rates and annual charges.

Outstanding rates and charges		
2019-20	2018-19	2017-18
5.74%	5.46%	6.86%

Council has 1638 ratepayers eligible for the pension rebate. The highest proportion is in the residential rating categories. Pensioners comprise 22.6% of residential ratepayers in Guyra and 14.6% in Armidale.

In addition to pension rebate concessions provided by the NSW Government, Council also grants a pension rebate of up to $25 on ordinary rates, $25 on annual water charges and $25 on annual sewerage charges to eligible pensioners.

Category of property	Number of pensioners	% of rateable assessments
Residential	1,585	14.9%
Farmland	53	3.5%

5. Implications

5.1. Policy

The determination by Council on a position regarding the SRV application may impact a number of policy positions due to the differing levels of funding that would result under each option.

5.2. Risk

The decision to proceed or not with an application for a SRV contains various risk considerations. A drop in the level of funding available to the Council at the current time would present significant legislative, financial, operational and political/reputational risks as funding would not be available to meet legislative compliance obligations including the performance improvement order. Service levels would drop almost immediately and this would result in issues becoming prevalent in areas such as the condition of the road network.

If a decision to apply for a new SRV is made, the outcome will not be known until very late in the 2021/22 budget development process. This would require the preparation of at least two Operational Plan and Budget scenarios to accommodate the risk of a SRV application not being successful.

5.3. Sustainability

The decision to proceed or not with an application for a SRV contains various sustainability considerations. A drop in the level of funding available to the Council would negatively impact it’s ability to consider how services could be delivered more sustainably into the future and to undertake sustainability initiatives contained in the Operational Plan.

The financial sustainability considerations are contained in the next section.

5.4. Financial

<u>Local Government Act Requirements</u>

Section 8b of the *Local Government Act 1993* (the Act) requires Council to apply principles of sound financial management including:

(a) Council spending should be responsible and sustainable, aligning general revenue and expenses.

(b) Councils should invest in responsible and sustainable infrastructure for the benefit of the local community.

(c) Councils should have effective financial and asset management, including sound policies and processes for the following:

(i) performance management and reporting,

(ii) asset maintenance and enhancement,

(iii) funding decisions,

(iv) risk management practices.

(d) Councils should have regard to achieving intergenerational equity, including ensuring the following:

(i) policy decisions are made after considering their financial effects on future generations,

(ii) the current generation funds the cost of its services.

All NSW councils are required under the Act to apply these principles in order to ultimately achieve a financially sustainable position.

Application of these principles means:

- Council must achieve a fully funded operating position.
- Council must maintain sufficient cash reserves.
- Council must have an appropriately funded capital program.
- Council must maintain its asset base ‘fit for purpose’.
- Council must have adequate resources to meet ongoing compliance obligations.

Fit For The Future Framework

To measure financially sustainability and provide a consistent method of comparing council performance, in 2014 the NSW Government decided to reform local government by creating a ‘Fit For The Future’ framework and assess councils against that framework. The assessment is based on a series of Key Performance Indicators (KPIs) including:

KPI	Description of Fit For The Future Targets
Operating Performance	This measures a council’s achievement of containing operating expenditure within operating revenue.
Own Source Operating Revenue	This measures fiscal flexibility. It is the degree of reliance on external funding sources such as grants and contributions.
Building and Infrastructure Asset Renewal	Measures the rate at which infrastructure assets are being renewed relative to the rate at which they are depreciating.
Infrastructure Backlog	Measures the annual assessment of what one off spend is required to bring all infrastructure assets to a satisfactory condition relative to their total written down value.
Asset Maintenance Ratio	Compares actual versus required maintenance. A ratio above 1.0 indicates that Council is investing in enough funds to stop the infrastructure backlog figure from growing.
Debt Service Ratio	Measures the cost of debt servicing (principal and interest) against total operating revenue (excluding capital grants and

	contributions).

If a council is able to demonstrate that it is able to meet the Office of Local Government (OLG) benchmarks set for the above KPIs this would effectively mean the council was financially sustainable. Financial sustainability is defined as when councils can generate sufficient funds over the long term to provide the planned level and scope of services and infrastructure for communities as identified through the IP&R process.

These KPIs continue to be used to measure financial sustainability in NSW local government and similar financial indicators are commonly used in all States to measure and compare local government performance.

SRV Option Financial Outcomes

Financial modelling undertaken on the SRV options has demonstrated that they produce very different impacts on the Fit For The Future KPIs used to measure financial sustainability in NSW local government. The impact of the different SRV options on the KPIs for the **General Fund** only is shown in the tables below.

Option 1 – Improve Services

Continuation of the temporary SRV plus an additional SRV increase.

Fit for the Future	KPI	OLG Benchmark	2021/22	2025/26	2030/31
Financial Sustainability	Operating Performance Ratio	>0%	(0.31%)	1.73%	2.79%
	Own Source Operating Revenue Ratio	>60%	71.30%	78.91%	80.88%
	Building and Infrastructure Asset Renewal Ratio	>100%	81.3%	85.6%	68.2%
Effective Infrastructure & Service Management	Infrastructure Backlog Ratio	<2%	2.27%	2.61%	3.09%
	Asset Maintenance Ratio	>100%	84%	84%	84%
	Debt Service Ratio	>0 <20%	6.80%	4.28%	0.13%
Efficiency	Real Operating Expenditure per capita over time	Decreasing Trend	$1,623	$1,563	$1,518
Other (not FFF)	Amount available for Infrastructure Asset Renewal		$8.02M	$9.32M	$8.40M

The above table demonstrates that Option 1 produces an operating surplus meaning that a sufficient level of revenue is generated to cover depreciation expense. This funding is then diverted to the capital program to fund capital renewal programs. The modelling demonstrates that an increase in revenue alone is not sufficient to increase the asset renewal ratio to a sufficient level over time, however, on average it is significantly improved over the other SRV Options. Under Option 1, consideration would still be required in terms of prioritisation of spend on asset renewal over new assets and levels of service. However, this Option does enable financial capacity to be generated and unrestricted cash significantly improves in the later years of the forecast period.

The debt service ratio improves in all SRV Options as current debt is paid down over time. However, the generation of an operating surplus under Option 1 indicates that there is a greater capacity to take on new debt and meet repayments.

The level of infrastructure asset renewal funding under Option 1 is $1.8 million per annum higher than Option 2 and $3.3 million per annum higher than Option 3.

Option 2 – Maintain Services

Continuation of the temporary SRV.

Fit for the Future	KPI	Benchmark	2021/22	2025/26	2030/31
Financial Sustainability	Operating Performance Ratio	>0%	(3.71%)	(1.71%)	(0.78%)
	Own Source Operating Revenue Ratio	>60%	70.45%	78.19%	80.19%
	Building and Infrastructure Asset Renewal Ratio	>100%	63.1%	69.1%	53.6%
Effective Infrastructure & Service Management	Infrastructure Backlog Ratio	<2%	2.34%	3.01%	3.92%
	Asset Maintenance Ratio	>100%	84%	84%	84%
	Debt Service Ratio	>0 <20%	7.05%	4.45%	0.14%
Efficiency	Real Operating Expenditure per capita over time	Decreasing Trend	$1,623	$1,563	$1,518
Other (not FFF)	Amount available for Infrastructure Asset Renewal		$6.22M	$7.52M	$6.60M

The above table demonstrates that Option 2 does not produce an operating surplus and this has detrimental flow on impacts to the amount of asset renewal funding available to the capital program. The asset renewal ratio under Option 2 is 65% on average compared to 81% under Option 1 measured over a ten year timeframe.

Under this Option, prioritisation of spend on asset renewal over new assets would be necessary and levels of service would need to be reviewed and changed or reduced in some areas in order to improve the operating result and increase the level of funding available to renew assets.

The debt service ratio improves in all SRV Options as current debt is paid down over time. However, without generation of an operating surplus under this Option there is a lower capacity to take on new debt and meet repayments without creating further negative impacts to the asset renewal ratio and the cash position than Option 1.

The level of infrastructure asset renewal funding under Option 2 is $1.5 million per annum higher than the Option 3.

Option 3 – Decrease Services

Discontinuation of the temporary SRV.

Fit for the Future	KPI	Benchmark	2021/22	2025/26	2030/31
Financial Sustainability	Operating Performance Ratio	>0%	(6.59%)	(4.63%)	(3.81%)
	Own Source Operating Revenue Ratio	>60%	69.73%	77.59%	79.60%
	Building and Infrastructure Asset Renewal Ratio	>100%	47.9%	55.3%	41.4%
Effective Infrastructure & Service Management	Infrastructure Backlog Ratio	<2%	2.41%	3.35%	4.67%
	Asset Maintenance Ratio	>100%	84%	84%	84%
	Debt Service Ratio	>0 <20%	7.26%	4.58%	0.14%
Efficiency	Real Operating Expenditure per capita over time	Decreasing Trend	$1,623	$1,563	$1,518
Other (not FFF)	Amount available for Infrastructure Asset Renewal		$4.72M	$6.02M	$5.10M

The above table demonstrates that Option 3 produces a significant operating deficit and this has significant detrimental flow on impacts to the amount of asset renewal funding available to the capital program. The asset renewal ratio under Option 3 is 51% on average compared to 65% under the Option 2 scenario measured over a ten year timeframe.

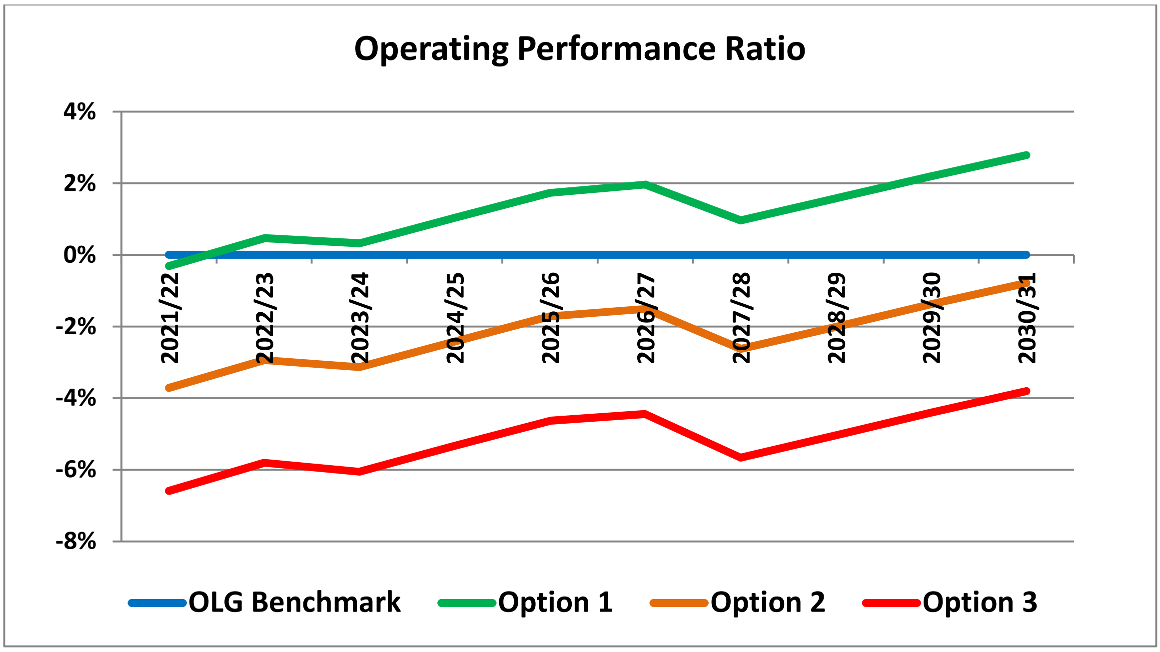
Under this Option, prioritisation of spend on asset renewal over new assets would be necessary and levels of service would need to be significantly reduced in order to increase the level of funding available to renew assets.

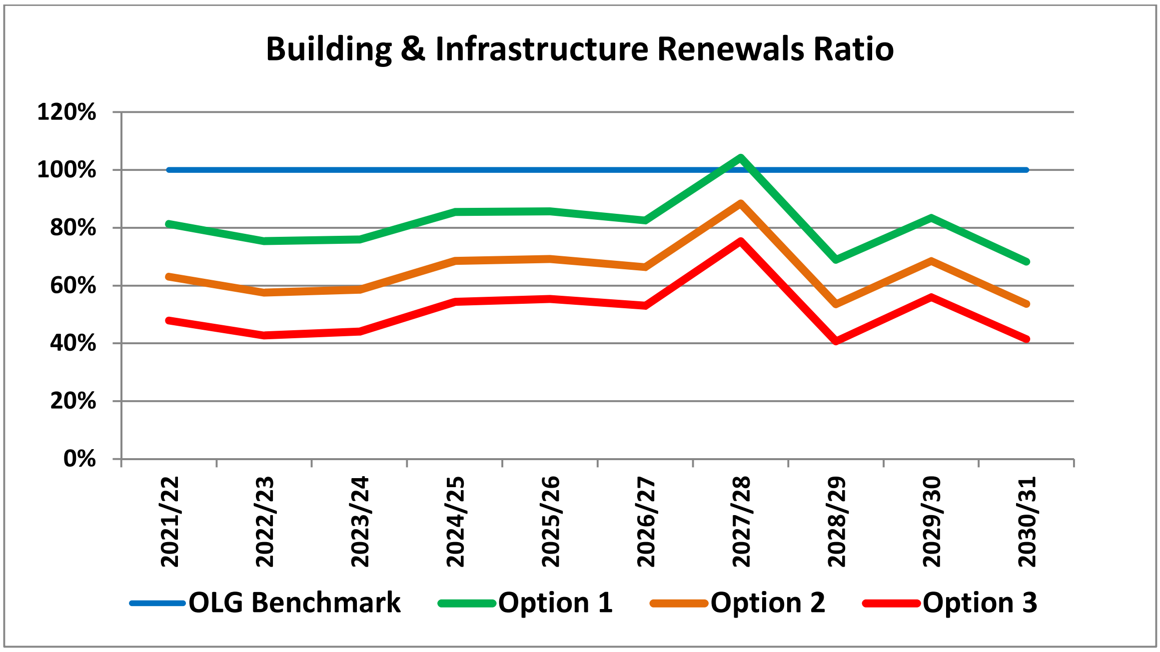
The debt service ratio improves in all SRV Options as current debt is paid down over time. However, without generation of an operating surplus under this scenario there is no capacity to take on new debt and meet repayments without creating further negative impacts to the asset renewal ratio and the cash position than Option 1 or 2.

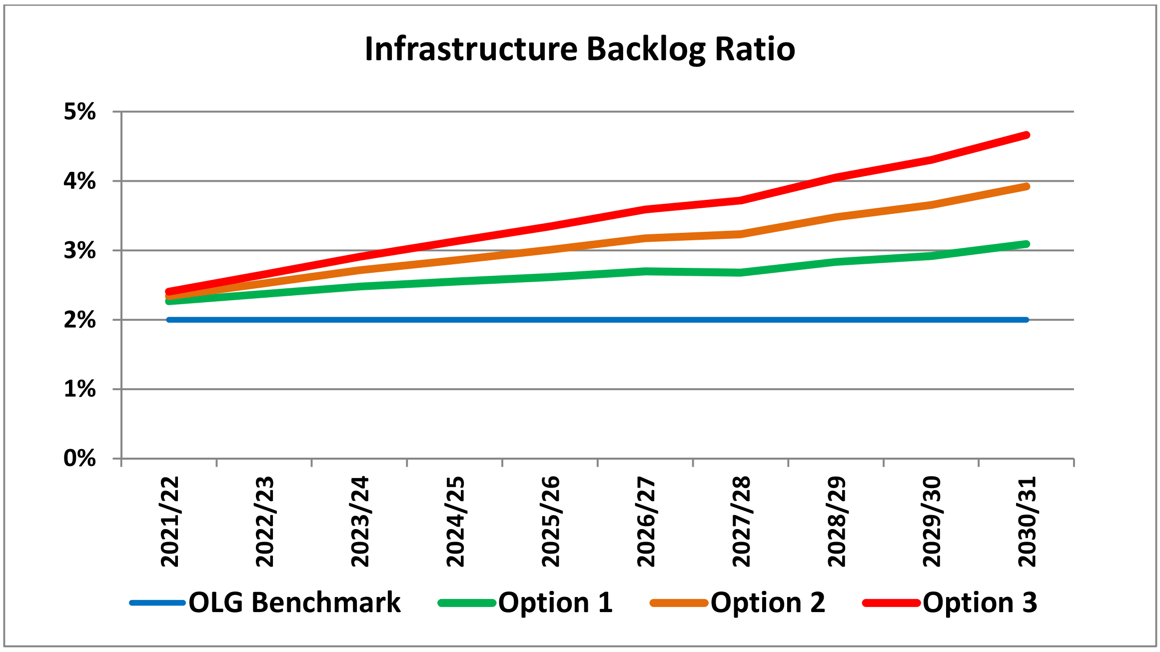
The level of infrastructure asset renewal funding under Option 3 is $1.5 million per annum lower than Option 2.

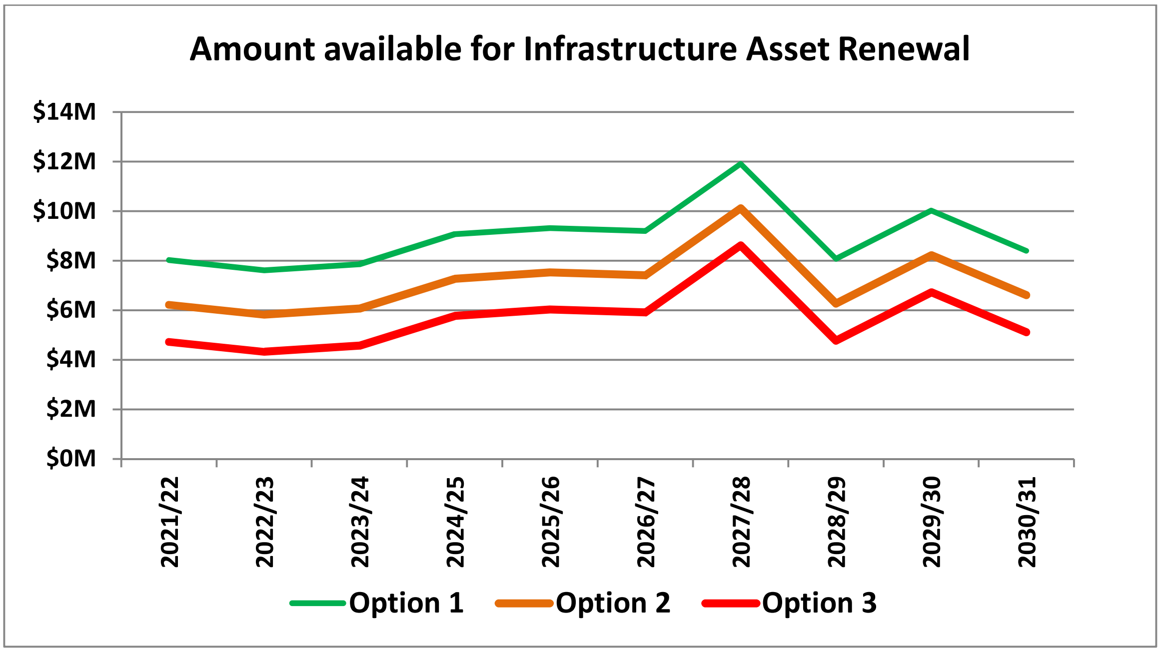
Comparison of SRV Options

Comparisons of the KPIs that produce the most variation under each SRV Option are shown below.









6. Consultation and Communication

The community engagement period ran from Monday, 2 November 2020 through to Thursday, 10 December 2020. A report covering the community consultation process and all submissions received is contained at the Attachment.

The community engagement process included the following mechanisms for the dissemination of information and to gather community feedback:

- A letter and brochure was mailed to every ratepayer to inform them of the need for the SRV and potential rating impacts of each SRV option.
- Face to face presentations and community feedback sessions were held in Armidale and Guyra.

- Face to face presentations and community feedback sessions were held in Ben Lomond, Wollomombi, Hillgrove, Wards Mistake (Guyra Chambers), Black Mountain, Ebor and Lower Creek.
- Separate presentations and feedback sessions were held with the Armidale Ratepayers Association and NSW Farmers.
- Pop up stalls were held in Guyra Main Street, Armidale Farmer's Market and Armidale Markets in the Mall.
- Webinar presentation and community feedback session.
- A dedicated page was created on Council's Your Say Armidale website.
- Additional advertising included social media posts, media releases, newspaper ads, radio ads and Council e-news.
- Council also held a random phone survey between 23 November 2020 and 2 December 2020.

The community feedback is summarised in the attached report; however, some of the frequently raised issues included:

- Council does not listen to community views
- There is decreased community capacity to pay due to COVID, bush fires and drought
- Council needs to identify more efficiencies, cost savings and trim costs to fit budget
- Many questioned Council's financial management track record and capability if an SRV is granted

Apart from feedback provided at the meetings outlined above, there were 247 written submissions received during the consultation period and these are contained at the Attachment.

The written submissions received supported the following SRV options:

SRV Option	No Submissions	% Submissions
Option 1 – Improve Services	22	9%
Option 2 – Maintain Services	53	21%
Option 3 – Decrease Services	116	47%
Unsure	56	23%
Total	**247**	

Within the category of "unsure" no SRV option was identified in the submission; however, most submissions in this category made mention of 'no rate increase' so it could be presumed they supported Option 2 or Option 3.

The phone survey results yielded a slightly different outcome to the written submissions. 405 residents were contacted as part of the phone survey with a split of 75% to the former Armidale Dumaresq LGA and 25% to the former Guyra Shire LGA. Questions were also included on the level of satisfaction with community facilities and services.

The key findings from the phone survey are:

- Satisfaction was highest with libraries, parks and gardens and recreation and sporting facilities – all of which enjoyed healthy mean (average ratings) well above "par" on a 1-5 satisfaction scale. Satisfaction was lowest with maintenance of local roads and bridges (2.83 mean) and maintenance of footpaths, kerbs and gutters.

- 68% of residents recalled receiving a letter from Council regarding the proposed SRVs. Of these, 78% had read it either in detail (34%) or by skimming it (44%). Other ways of finding out about the SRV were social media (37%), word-of-mouth (29%), local newspaper (16%) and local radio (12%).
- 57% of residents supported retaining the existing 8.5% SRV (with 31% opposed and 12% unsure). The major reason for support was an understanding that the major purposes of the SRV – maintenance and renewal of local roads, footpaths and community facilities – was a valid use of such funds.
- 28% of Armidale residents, and 26% of residents from the former Guyra Shire supported the additional 10% SRV (with opposition of 63% and 69% respectively). Major concerns included a lack of trust in Council and/or perceived wastefulness (raised by 29% of respondents), a perception that rates are already too high (1%) and that Council should “live within its means” (10%). Offsetting this, 14% felt rate increases were necessary to fund improvements to services and infrastructure, and 7% believed the amount proposed was affordable.

In terms of response numbers to compare with written responses received, the survey results can be broken down as follows:

Option 1 – Improve Services

	Support	Oppose	Unsure/No Opinion
All Respondents	110	261	34
%	27%	64%	8%
Ratepayers Only	77	235	26
%	23%	69%	8%

Option 2 – Maintain Services

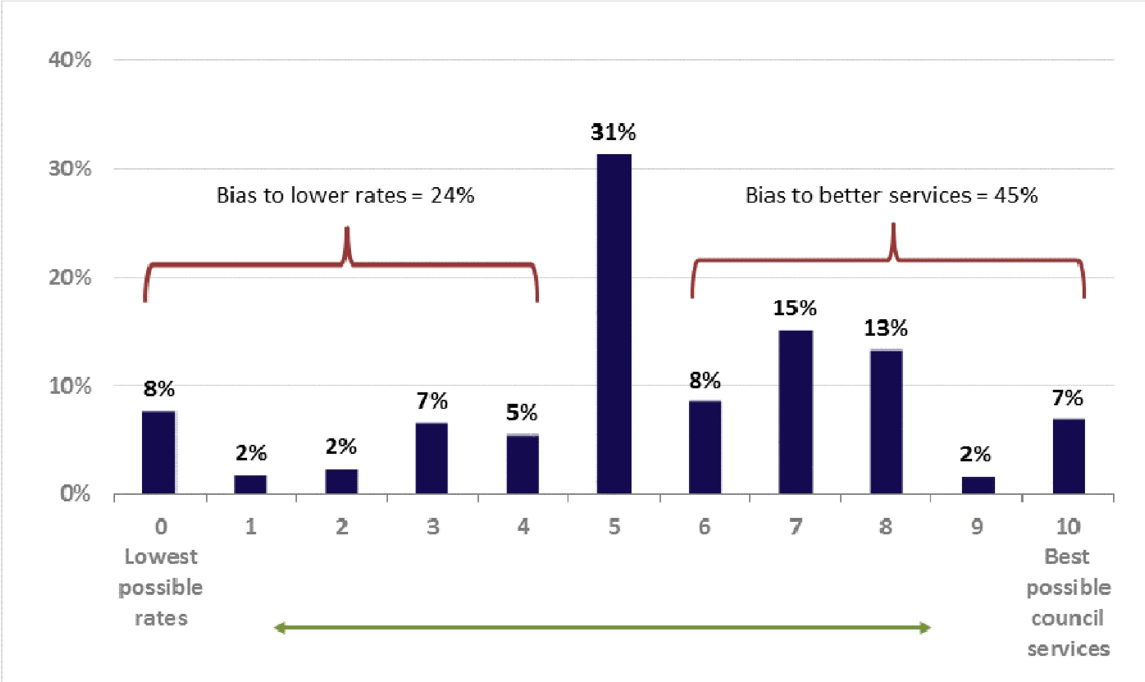
	Support	Oppose	Unsure/No Opinion
All Respondents	231	124	50
%	57%	31%	12%
Ratepayers Only	187	113	38
%	55%	33%	11%

The above tables show that in contrast to the written responses received, the majority of residents who were surveyed by phone were of the view that service standards should be maintained rather than decrease as would be the outcome under Option 3.

There was also a higher level of support for Option 1 from residents who were surveyed by phone than through the written submissions received.

A question at the end of the survey was included to try and gauge whether residents valued lower rates more highly than the services they receive. This question was:

> *And where would you sit on a sliding scale of 0-10, where 0 means you only want to pay the lowest possible rates, and 10 means you only want the best possible Council services?*



The response received to this question showed a bias towards better services with 45% on this side of the scale against 24% on the "lowest rates" side.

A wide range of issues and matters were raised as part of the public consultation process. The issue of lack of trust was a common denominator across all forums. It is clear from the feedback received that Council will need to put mechanisms in place to ensure greater transparency and accountability around financial performance and to ensure prudent management of public funds. For the next few months this will occur as part of the requirements of the Performance Improvement Order Council must operate under but it will need to continue beyond that. Building the community's trust back up in the Council is going to take many years of maintaining a disciplined approach to management of the budget, finding ways of delivering services more efficiently and sound management of capital project development, funding and delivery.

7. Conclusion

This report provides Council with information pertaining to the need for a 508(2) (permanent) Special Rate Variation option in order to address Armidale Regional Council's financial sustainability and maintain essential community infrastructure including Council's road network, footpaths and community buildings.

<u>Option 1 – Improve Services</u>

Council will apply for a permanent Special Rate Variation of 18.5% plus the 2.0% rate peg (total of 20.5%). This will replace the funding currently provided by the temporary SRV and increase total rate revenue by $1.8 million per annum.

Option 1 would result in the average Armidale Residential ratepayer paying an additional $2.48 per week. The average Guyra Residential ratepayer would pay an additional $1.16 per week. The average Armidale Business ratepayer would pay an additional $9.90 per week and the average Farmland ratepayer would pay an additional $7.10 per week. These amounts <u>include</u> the 2% rate peg, which is applicable for all Options.

Mainly due to the impacts on ratepayers, Option 1 was predominantly negatively perceived by the community through the process for written submissions and feedback provided at community meetings also did not demonstrate support for this Option. Community feedback from the phone survey indicated a higher level of support for Option 1 than written submissions.

The additional impact of rates harmonisation on some rating categories may have also contributed to the level of negative feedback received on this Option from the community and there will now be some further options to mitigate the impacts of rates harmonisation through the recently released Exposure Draft Bill *Local Government Amendment (Rates) Bill 2021*.

Option 1 provides for the best outlook in terms of meeting the Fit for the Future key performance indicators, including a consistently higher level of funding available for infrastructure asset renewal expenditure. It is noted that even with the higher level of funding assumed, Council would still not consistently achieve the target benchmarks for the Building and Infrastructure Renewals Ratio or the Infrastructure Backlog Ratio, however, there would be opportunity to refine service levels and review the mix of funding options to improve these ratios.

Under this Option a General Fund operating surplus is generated. In the long term financial modelling, this is initially a modest surplus position and improves in later years of the forecast. As Council would be fully funding depreciation under this Option, the generation of an operating surplus would indicate there would be funding available to improve service levels over time and also address the infrastructure challenges that will result from increased population growth.

An important consideration is that Option 1 will enable Council to meet the requirements of the Performance Improvement Order issued to Council on 9 December 2020 by the Hon. Shelley Hancock MP, Minister for Local Government. This includes a requirement for Council to adopt surplus budgets that ensure financial sustainability over the longer term and adopt a Reserves policy that ensures a minimum of $4-5m is available as unrestricted cash to fund working capital requirements before setting aside funds as Internal Restrictions.

Another advantage from the generation of an operating surplus is that it is an important indicator of Council's capacity to take on new debt without creating further negative impacts to the asset renewal ratio and the cash position.

<u>Option 2 – Maintain Services</u>

Council will apply for a permanent Special Rate Variation of 8.5% plus the 2.0% rate peg (total of 10.5%). This will replace the loss of the current SRV which is due to stop in 2021.

Option 2 would result in all categories of ratepayers being subject to the 2% rate peg increase.

Due the minimal impact on ratepayers and that many residents do not want a decrease in services, Option 2 received a higher level of support than Option 1 from the community through the process for written submissions and it also received majority support from the phone survey responses. It is noted that 23% of the written submissions were classified as identifying no option i.e. "unsure". Many of these mention 'no rate increase' and it is likely that a reasonable number of these submissions could be associated with Option 2.

The General Fund operating position under Option 2 is forecast to be a significant cumulative deficit in the long term financial modelling. This in turn impacts the amount of funding available for infrastructure asset renewal and the Building and Infrastructure Renewals Ratio and Infrastructure Backlog Ratio are negatively impacted as a result.

Without generation of an operating surplus, there is a lower capacity to take on new debt and meet repayments without creating further negative impacts to the asset renewal ratio and the cash position.

As the forecast financial position under Option 2 is not financially sustainable, if Council were to instead recommend and support this Option, it could not do so without also resolving to implement a plan to review the organisation's service levels to eliminate the unfavourable gap between operating income and expenditure.

Option 3 – Decrease Services

Council will not apply for a Special Rate Variation and revenue from ordinary rates will drop by $1.5 million per annum.

Option 3 would result in the average Armidale Residential ratepayer receiving a decrease of $1.29 reduction per week and the average Guyra Residential ratepayer a decrease of $0.61 per week. The average Armidale Business ratepayer would receive a decrease of $5.16 per week and the average Farmland ratepayer a decrease of $3.70 per week. These amounts include the 2% rate peg.

Due to the favourable impact on ratepayers and the perceived negative views of Council, Option 3 received a high level of support from the community through the process for written responses but a lower level of support from the phone survey responses.

The General Fund operating position under Option 3 is forecast to be a significant cumulative deficit in the long term financial modelling. This in turn impacts the amount of funding available for infrastructure asset renewal and the Building and Infrastructure Renewals Ratio and Infrastructure Backlog Ratio are negatively impacted as a result.

Without generation of an operating surplus, there is no capacity to take on new debt and meet repayments.

Service levels would drop almost immediately and this would result in issues becoming prevalent in areas such as the condition of the road network. Community satisfaction with services would drop and Council would become at risk of failing to meeting compliance obligations.

Under a scenario of no SRV and an associated drop in rate revenue of $1.5 million per annum, it would be necessary to comprehensively reduce service levels and further community consultation would be needed on which service levels would reduce.

Recommended Option

Option 1 provides Council the greatest opportunity to secure its longer term financial sustainability while at the same time seeking to review and improve its own service level commitments to enhance community outcomes.

Option 1 would also enable Council to meet the requirements of the Performance Improvement Order issued to Council on 9 December 2020 by the Hon. Shelley Hancock MP, Minister for Local Government.

While rate increases under Option 1 are moderate, the longer term costs of not maintaining infrastructure to the required standard will result in more significant costs to the community. Option 1 also provides financial capacity to address infrastructure challenges that will result from increased population growth and to take on new debt without creating further negative impacts to the asset renewal ratio and the cash position.

For these reasons and due to the need to achieve financial sustainability and effective infrastructure management as required under section8b of the *Local Government Act 1993* and the Fit for the Future framework, Option 1 Improve Services requiring a permanent Special Rate Variation of 18.5% plus 2.0% rate peg (total 20.5%) commencing in 2021-22 is recommended.