WILLOUGHBY CITY COUNCIL – APPLICATION FOR A PERMANENT “ADDITIONAL SPECIAL VARIATION” of 1.3% TO RATES FROM 2022/23

SUMMARY

Extra Information on The need for a 1.3% Permanent Additional Special Variation

Section 2 - The need for a 1.3% Permanent Additional Special Variation

2.1 Background and financial need for a 1.3% Additional Special Rate Variation (ASV)

The Long Term Financial Plan 2021/22 to 2030/31 (LTFP), adopted in July 2021, assumed a 2.1% year on year increase to revenue from rates (being an assumed IPART Rate Cap increase of 2% plus 0.1% population growth). Even with this assumed 2.1% increase, the LTFP forecasted a $1.2 million deficit and a difficult financial year in 2022/23 due to:

- Expiry of Council's 7 year, 7.3% Infrastructure Levy. The cessation of the Infrastructure Levy results in a $2.96 million reduction in rating revenue in 2022/23.
- Revenue streams impacted by COVID were expected to partially recover, but not return to pre-pandemic levels.
- Closure of the Willoughby Leisure Centre for 9 months during 2022/23 for refurbishment at a net cost of $880k.
- Supply side issues increasing the cost of materials and services.

On 13 December 2021, the Independent Pricing and Regulatory Tribunal (IPART) set the 2022/23 Rate Peg (allowable rate increase) for all NSW councils at 0.7%. With a population growth factor of 0.1% for Willoughby City Council, the total allowable increase from IPART for Council is 0.8%. This results in a 1.3% ($666k) gap between the LTFP assumed rate increase of 2.1% and the amount allowed by IPART.

IPART's allowable increase of 0.8% does not recognise the financial pressures we are facing, and the significant worsening of conditions since the adoption of the last LTFP in July 2021. Specifically, the 0.8% IPART mandated increase is inadequate in light of:

- Staff Expenses (39% of Council's total costs) increasing by 2.5% due to Local Government Award increase determination (2%) and the mandated increase to the Federal Government's Superannuation Guarantee rate (a further 0.5% increase). Staff costs will therefore increase by $1.11 million whereas rates are only allowed to increase by $410k under IPART's allowable increase (leading to a $702k shortfall compared to staff cost increases alone).
- An exceptionally tight labour market leading to low supply of labour and wage inflation pressures at all employment levels and employment types.
- Surging inflation on materials and services. Due to supply side issues, inflation has risen sharply on the goods and services most used by councils. The LTFP assumed modest inflation on most goods and services of between 2% and 3%. The reality is that cost increases have surged recently (for example, fuel prices have increased by 35%-40% (prior to the recent Federal government initiative regarding the fuel tax) and building materials and other resource costs have increased between 5% and 20%. This is due to a number of uncontrollable supply factors including:
    - COVID impacting international and domestic supply chains.
    - Global tensions (for example the conflict in Ukraine and deteriorating relationships with some major trading partners) leading to shortages of goods and resulting price increases.
    - World-wide shortages of some essential goods (for example microchips).

- COVID affected revenue streams not recovering as quickly as expected and recent variants affecting confidence and consumer behaviour. The LTFP assumed that major user pays revenue streams would bounce back from the impact of COVID related restrictions impacting the 2019/20 and 2020/21 financial years. The LTFP did not anticipate a further 4-month lockdown between July and October 2021. As revenue streams started to recover after this lockdown, the Omicron variant surged between December 2021 and February 2022, again severely impacting business activity and consumer confidence. Many revenue streams such as paid parking, commercial rentals and leisure centre usage, may not recover if consumer behaviours and the way businesses operate permanently change.
- Increasing incidence of natural disasters and resulting costs for repair, clean up and insurance premiums.

Council has a demonstrable financial need for a Permanent ASV of 1.3% to address the imbalance between the 0.8% allowable increase to rates mandated by IPART and the increasingly difficult financial environment affecting both revenue and costs in Council's business.

2.2 Willoughby City Council meets the Criteria for a Permanent Additional Special Variation

2.2.1 2022/23 ASV Criteria released by IPART on 7 April 2022

On 7 April 2022 the Office of Local Government (OLG) issued a circular providing the revised guidelines for Additional Special Rate Variation (ASV) process for 2022/23. These guidelines apply in place of and supersede the previous ASV issued on 28 March 2022. The new guidelines contained in the circular are as follows:

1 Year ASV Criterion - 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 Act;

Permanent ASV Criterion - Where councils are applying for a permanent special variation, in addition to the above information, the council's 2021-22 IP&R documentation identifying that the council forecast an average Operating Performance Ratio (OPR) of 2% or lower over the next 5 years or, alternatively, evidence of need, for example, but not limited to, that the council needs to maintain a higher OPR so it can meet its capital funding requirements

2.2.2 Willoughby City Council meets the revised ASV Criteria

Willoughby City Council meets the criteria for a permanent Additional Special Variation as it anticipated a higher rate cap of 2,1% in its Long Term Financial Plan for 2022/23 and its average Operating Performance Ratio is less than 2% over the next 5 years.

1 Year Additional Special Variation Criterion

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 Act;

	2022/23 $
2022/23 Rate Revenue Per 2021/22 Long Term Financial Plan	52,307,064
2022/23 Rate Revenue at 0.8% IPART Directive	51,640,963
Difference ($)	666,101
Difference (%)	1.3%
1 Year SRV Criterion Satisfied	

Permanent Additional Special Variation Criterion

Where councils are applying for a permanent special variation, in addition to the above information, the council's 2021-22 IP&R documentation identifying that the council forecast an average Operating Performance Ratio (OPR) of 2% or lower over the next 5 years or, alternatively, evidence of need, for example, but not limited to, that the council needs to maintain a higher OPR so it can meet its capital funding requirements

	2022/23	2023/24	2024/25	2025/26	2026/27
Oerating Performance Ratio Per 2021/22 Long Term Financial Plan	-1.19%	0.09%	0.09%	1.89%	1.63%
5 Year Average Operating Performance Ratio	**0.50%**				
5 Year SRV Criterion Satisfied					

2.3 Foregone Revenue and Implications if IPART do not approve a 1.3% permanent ASV

2.3.1 Cumulative impact to cash and operating position without a 1.3% permanent SRV

The following table shows that the **cumulative 10-year impact of IPART not approving a 1.3% permanent ASV is $7.3 million.** This is direct impact to unrestricted cash holdings, working capital and our operating position. As noted in the following sections, this would force us to release internally restricted cash and would deprive the Willoughby community of infrastructure renewals and other initiatives planned for in the Willoughby City's *Community Strategic Plan: Our Future Willoughby*, the four-year *Delivery Program 2023-2026* and the annual Operational Plans and Budgets and our Local Contributions Plan. This in turn will have a direct impact on our capacity to maintain infrastructure assets in a satisfactory and safe condition.

Figure 1 – Cumulative Revenue and Cash lost without a 1.3% Permanent ASV

	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32	10 Year Total
Foregone Revenue and Cash ($'000)	666	679	693	707	721	735	750	765	780	796	7,293

2.3.2 Willoughby Internally Restricted Cash and purpose

Through prudent financial management we have built Internally Restricted Cash Reserves (Internal Reserves) to fund required infrastructure renewals and specific initiatives into the future. These Internal Reserves are fundamental to ensuring the obligations documented in Willoughby City's *Community Strategic Plan: Our Future Willoughby*, the four-year *Delivery Program 2023-2026* and the annual Operational Plans and Budgets and our Local Contributions Plan. If IPART do not approve a 1.3% permanent ASV, asset renewals and specific initiatives will need to be sacrificed to fund operations. This would result in deteriorating asset conditions and an erosion in service levels overall.

Figure 2 summarises our Internal Reserves, their purpose and recent and future examples of the use of these Internal Reserves.

Figure 2 Willoughby City Council Internal Reserves Summary

Reserve Type	Purpose	Examples of Initiatives Funded
Property Renewal Reserves	• Building sinking funds • To fund known future renewals per asset management plans	*Recent and Current* • The Concourse recladding ($7m) • Willoughby Leisure Centre Pool Hall Upgrade ($5m) *Future* • Rolling roof replacement program • Rolling Floor replacement program • Electrical plant Replacement program • The Concourse floor and seating replacement • Gore Hill Indoor Sporting Complex
Other Asset Improvement Reserves	• To fund safety and amenity upgrades and increases in capacity for recreational Parks and Playgrounds, Open Space sport, footpath, active transport, kerb and gutter, retaining walls etc.	*Recent and Current* • Playground Replacements • Artarmon Streetscape Renewal • Car Park equipment replacement • Sporting field upgrades to increase capacity *Future* • Rolling playground replacements

		• Retaining wall maintenance and safety • Shared pathways • Sporting field resurfacing
Plant and Fleet Replacement Reserves	• To fund ongoing maintenance and replacement of vital operational plant and fleet	• Replacement of street sweepers • Rolling Plant and Fleet replacement program.
Environmental Development Reserves	• Vital Environmental initiatives	• Water Harvesting • Stormwater and pollution prevention • Bushland maintenance • Energy Conservation and emissions reduction.
IT and Innovation Reserves	• To improve customer service • To improve business efficiency • To realise cost savings	• Implementation of Enterprise Resource Planning System • Business Improvement initiatives. • Mobility for business continuity

These reserves are set aside for specific purposes and should not be sacrificed to fund operations.

2.4 Impact on Operating Performance

2.4.1 Impact on 2022/23 Operating Performance without a 1.3% permanent ASV

Even including the 1.3% ASV (a total rate increase of 2.1%), Council is budgeting for a 2022/23 Operational Deficit of $1.7 million. This is predicated upon $500k of unidentified savings by Council, as well as significant savings assumptions on staff vacancies and leave reduction.

If the $666k in additional rates revenue assumed from the 1.3% ASV is not approved by IPART, the 2022/23 Operational deficit would grow to $2.4 million and Council would not return to profitability for at least 3 years. In addition, Council would need to adjust service levels significantly in later years in order to return to profitability. This would create significant risk to Council being able to meet the expectations and obligations set out in the initiatives and works identified in Willoughby City's strategic plans.

2.4.2 Impact on 10 Year Operating Performance without a 1.3% permanent ASV

Figures 3 and 4 indicate the impact to Operating Performance and the Operating Performance Ratio over the ten years of the Long Term Financial Plan under two scenarios:

- Scenario 1 (Base Case) – IPART approve a Permanent 1.3% Additional Special Variation (ASV)
- Scenario 2 – IPART do not approve a Permanent 1.3% ASV

Key Points – Operating Surplus (Deficit) before Capital Grants and Contributions:

- If IPART do not approve a permanent 1.3% Permanent ASV, we will face 3 years of successive Operating Deficits.
- If IPART approve the permanent ASV, we will return to surplus in the 2023/24 Financial Year.
- The cumulative impact on Operating Results **over ten years is $7.9m**, with **$790k being the average annual impact.**

Figure 3 – Operating Surplus (Deficit) before Capital Grants and Contributions with and without 1.3% permanent ASV

Operating Surplus (Deficit) Before Capital Grants and Contributions										
	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32
Scenario 1 (1.3% ASV)	(1,745)	644	650	1,694	1,867	2,749	2,305	3,087	4,063	4,322
Scenario 2 (NO ASV)	(2,411)	(52)	(70)	948	1,089	1,935	1,456	2,200	3,136	3,526

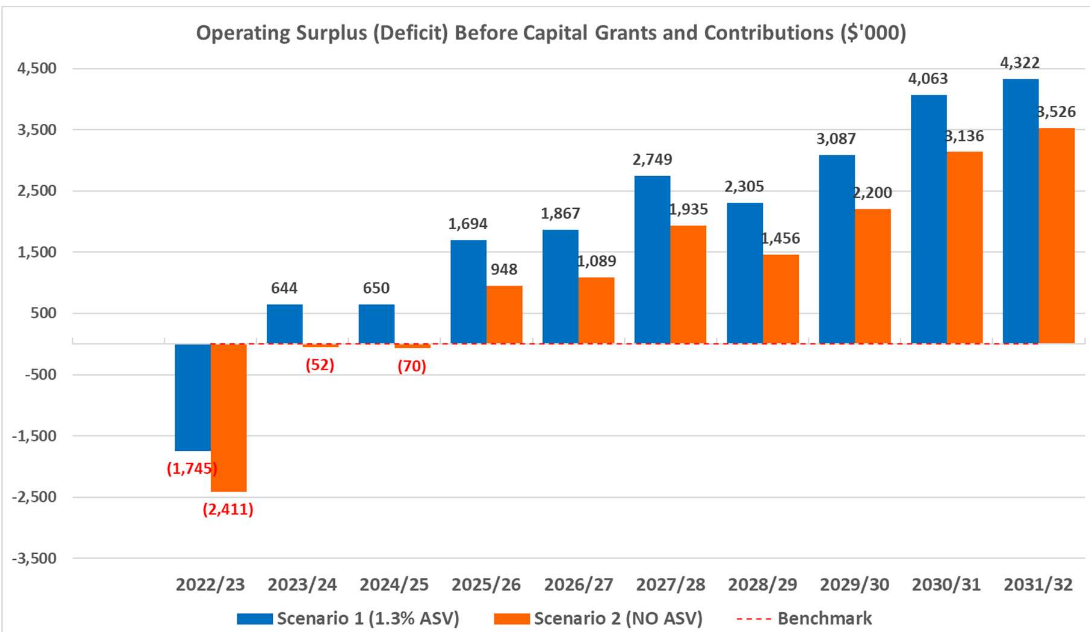
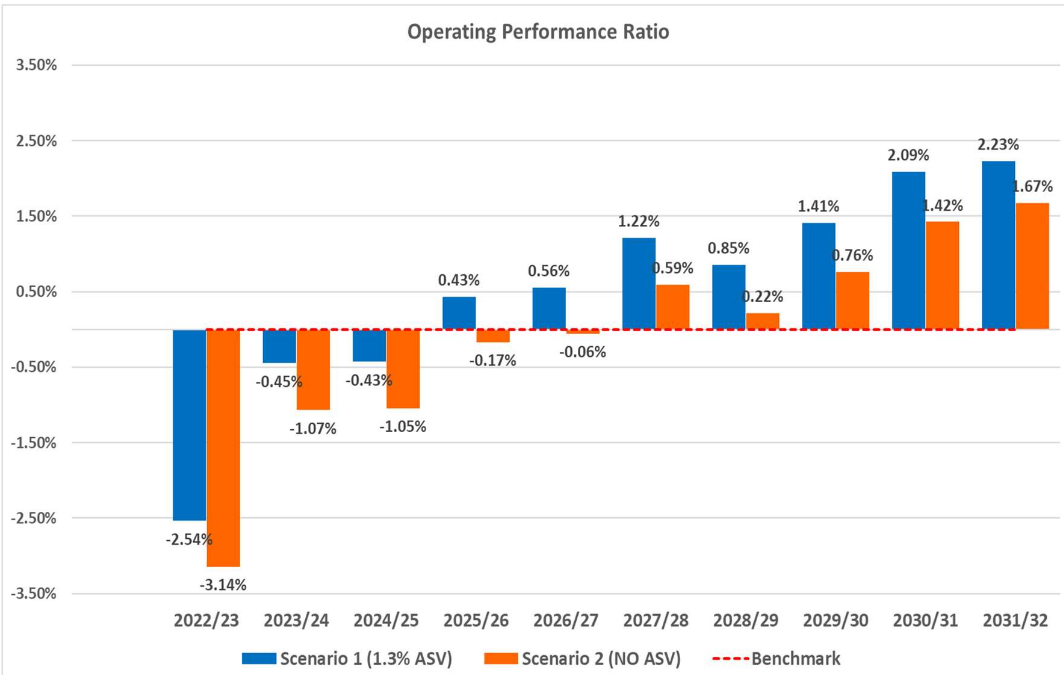


Figure 4 - Operating Performance Ratio with and without 1.3% permanent ASV

Operating Performance Ratio										
	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32
Scenario 1 (1.3% ASV)	-2.54%	-0.45%	-0.43%	0.43%	0.56%	1.22%	0.85%	1.41%	2.09%	2.23%
Scenario 2 (NO ASV)	-3.14%	-1.07%	-1.05%	-0.17%	-0.06%	0.59%	0.22%	0.76%	1.42%	1.67%



2.5 Impact on Cash and Liquidity

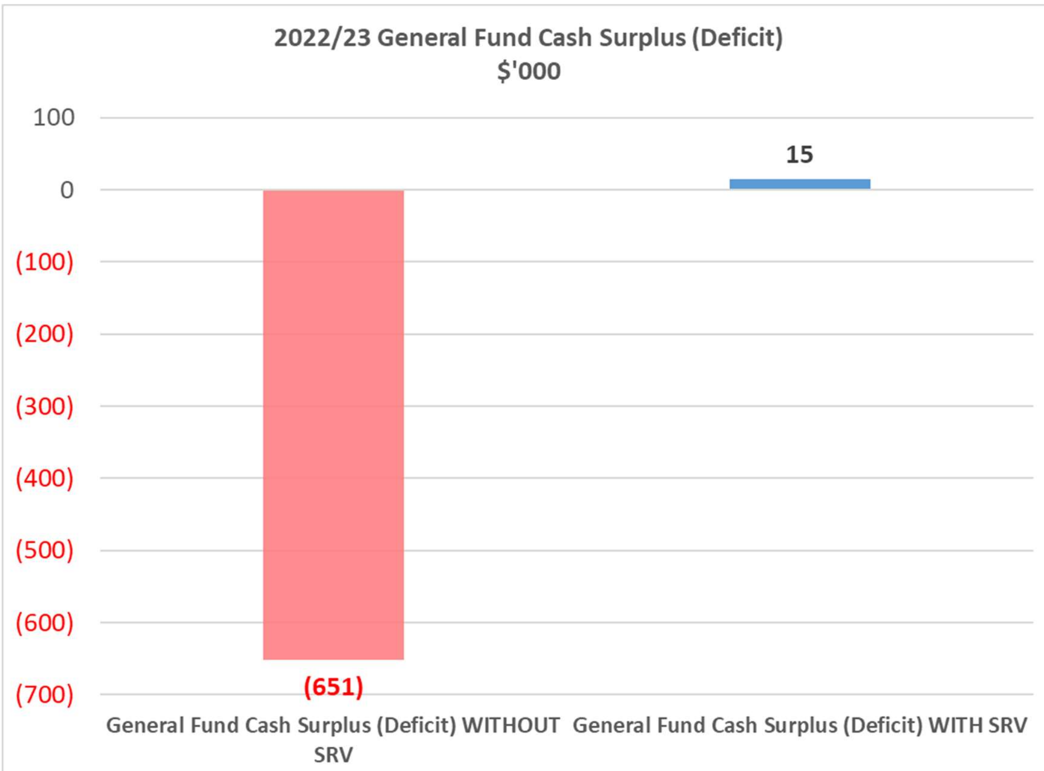
2.5.1 Impact on 2022/23 cash surplus/deficit without a 1.3% permanent ASV

The 1.3% ASV, general fund cash (required to maintain working capital and ensure that obligations are met as and when they fall due) would enable us to break even with a marginal $15k surplus in 2022/23 (notwithstanding the risk to savings). As outlined in section 5.2.2, we believe that Council meets the criteria for the permanent ASV.

If the $666k in additional rates revenue assumed from the 1.3% ASV was not approved by IPART, general fund cash would be $651k in deficit for the 2022/23 financial year. This is a material erosion in Council's capacity to meet obligations and, in addition to the risk of surging inflation, means that without the 1.3% ASV assumed in the 2022/23 budget Council will not have sufficient funds to meet its obligations as identified in the LTFP in 2022/23 and beyond.

Figure 5 indicates the 2022/23 impact on General Fund cash with and without a 1.3% ASV. If the ASV is approved, we will realise a very slim general fund cash surplus. If the 1.3% ASV is not approved, we will realise a $651k general fund cash deficit.

Figure 5 - General Fund Cash Surplus (Deficit) with and without 1.3% Additional Special Variation in 2022/23



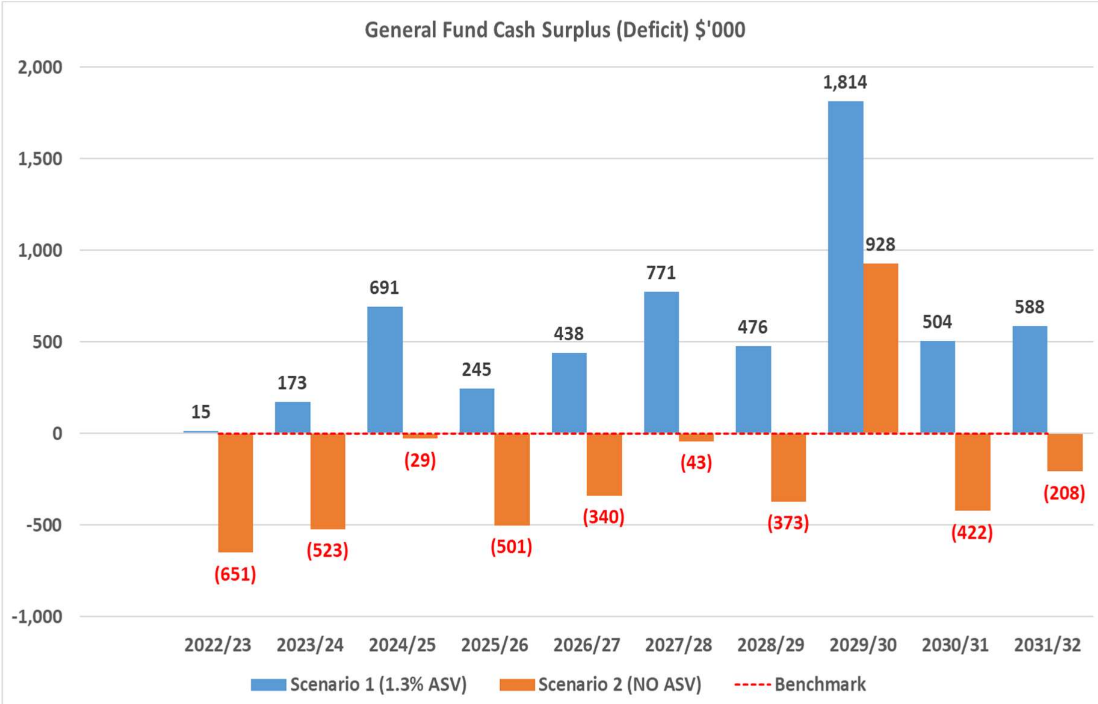
2.5.2 Impact on 10 Year Cash Balances and Ratios without a 1.3% permanent ASV

Figure 6 below show the impact to General fund cash surplus (deficit), and working capital balances and ratios, over the ten years of the Long Term Financial Plan under two scenarios:

- **Scenario 1 (Base Case) – IPART approve a Permanent 1.3% Additional Special Variation (ASV)**
- **Scenario 2 – IPART do not approve a Permanent 1.3% ASV**

Figure 6 – Annual General Fund Cash Surplus (Deficit) with and without 1.3% permanent ASV

General Fund Cash Surplus (Deficit)										
	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32
Scenario 1 (1.3% ASV)	15	173	691	245	438	771	476	1,814	504	588
Scenario 2 (NO ASV)	(651)	(523)	(29)	(501)	(340)	(43)	(373)	928	(422)	(208)



Key Points – General Fund Cash Surplus (Deficit)

- If IPART approve a 1.3% Permanent ASV we can achieve minor cash surpluses throughout the LTFP. This in turn allows us to maintain adequate working capital (ability to pay bills). Internal reserves can be used for the purpose they are held and not diverted to fund operations.
- If IPART do not approve a 1.3% Permanent ASV, the General Fund realises a cash deficit for every year in the LTFP (with the exception of 2029/30). This erodes (and ultimately exhausts) unrestricted cash and forces us to release internally restricted cash to fund operations. The implication of this is that the purpose the cash was held for (for example building renewal) goes unsatisfied. This in turn threatens asset conditions and or delivery of services and infrastructure promised in Willoughby City's *Community Strategic Plan: Our Future Willoughby*, the four-year *Delivery Program 2023-2026* and the annual Operational Plan and Budget 2022/23 and our Local Contributions Plan.
- The cumulative 10-Year General Fund Cash Surplus with a Permanent ASV is $5.7 million.
- The cumulative 10-Year General Fund Cash Deficit without a Permanent ASV is minus $2.2 million.

2.6 Capacity and Willingness to Pay - Rates reduce despite 1.3% SRV

Even with a 1.3% ASV, the 2.1% increase in rating income assumed for 2022/23 is offset by the discontinuation of Council's 7.3% Infrastructure Levy in 2022/23. This means the net reduction in rate income will be 5.2% ($2.95m lower rating income) in 2022/23.

We made a decision at the time of adopting the last Long Term Financial Plan (LTFP) in July 2021 not to apply for an extension of the Infrastructure Levy. This decision was made based on reasonable and conservative assumptions in the LTFP, including reasonable rate peg determinations. The LTFP forecast that despite short term hardship, prudent financial management would allow us to fund future operations and asset renewals without further burdening ratepayers.

Through the duration of the Infrastructure Levy, our rates collection was strong with a rates and annual charges outstanding ratio consistently under 2%. Hardship applications were low. This demonstrates that our community has the capacity and willingness to pay a reasonable level of rates to maintain service levels. Given that net rates will actually decline in 2022/23 despite a 1.3% SRV, the capacity and willingness of ratepayers to meet a reasonable rate increase of 2.1% is not doubted.

2.7 Conclusion – IPART should approve a Permanent 1.3% ASV for 2022/23

IPART should approve a 1.3% Permanent Additional Special Variation for Willoughby City Council for 2022/23. This will allow us to meet the obligations documented in Willoughby City's *Community Strategic Plan: Our Future Willoughby*, the four-year *Delivery Program 2023-2026* and the annual Operational Plan and Budget 2022/23 and Local Contributions Plan.

1.3% only represents the difference between our Long Term Financial Plan assumed rate of a 2.1% rate peg increase in 2022/23 and the 0.8% increase mandated by IPART.

The assumed rate is what we had budgeted for and based our decisions on. Anything less will create a negative and compounding financial impact into the future. If IPART do not approve a 1.3% permanent ASV, asset renewals and specific initiatives will need to be sacrificed to fund operations. This will result in deteriorating asset conditions and an erosion in service levels overall.