Independent Pricing and Regulatory Tribunal

Kempsey Shire Council's application for a special variation 2012/13

Local Government — Determination
June 2012

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Mr James Cox PSM, Chief Executive Officer and Full Time Member

Ms Sibylle Krieger, Part Time Member

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1 Determination

The Independent Pricing and Regulatory Tribunal of NSW (IPART) is responsible for setting the amount by which councils may increase their general income, which mainly includes rates income. Each year, we determine a standard increase that applies to all NSW councils, based on our assessment of the annual change in their costs and other factors. This increase is known as the rate peg.

However, councils may apply to us for a special variation that allows them to increase their general income by more than the rate peg. We are required to assess these applications against criteria in the Guidelines provided by the Division of Local Government (DLG),[1] and may allow special variations under either section 508A or 508(2) of the *Local Government Act 1993* (the Act).

Kempsey Shire Council applied for a multi-year special variation under section 508A, and requested increases of 16.05% in 2012/13, 14.33% in 2013/14 and 8.29% in 2014/15. After assessing the council's application, we decided to allow part of the requested increase, and for 2012/13 only, on a permanent basis. We have made this decision under section 508(2) of the Act.

1.1 Our decision

IPART decided that Kempsey Shire Council can increase its general income by 11.37% in 2012/13. This increase includes the rate peg of 3.6% that is available to all councils, and will be retained permanently in the council's income base. It reflects the proposed first-year increase under an alternative 5-year funding option that the council presented to its community.

Table 1.1 sets out the decision, and Box 1.1 lists the conditions we have attached to our decision.

1 *Guidelines for the preparation of an application for a special variation to general income in 2012/2013* were issued by Division of Local Government, Department of Premier and Cabinet, September 2011.

Table 1.1 IPART's decision on Kempsey Shire Council's application for a special variation in 2012/13 (%)

Component	Amount
Increase to fund road works and maintenance	7.77
Rate peg	3.60
Total increase	**11.37**

Box 1.1 Conditions attached to IPART's decision

IPART's decision on Kempsey Shire Council's application for a special variation in 2012/13 is subject to the following conditions:

- The council uses the additional income from the special variation for the purposes of funding part of the expenditures included in the works program outlined in the council's application, and listed in Appendix A.
- The council reports in its annual report for each rating year over the period 2012/13 to 2020/21:
  - the expenditure on the works program listed in Appendix A that was funded from the additional income in that year
  - the outcomes achieved as a result of the special variation
  - its asset renewal and maintenance expenditure
  - its productivity savings achieved, and
  - any significant variations from its financial results as forecast in its Long Term Financial Plan and any corrective action taken or to be taken.

1.2 What did the council request and why?

The council applied to increase its general income by a cumulative 43.7% over the 3 years from 2012/13 to 2014/15, to be permanently retained in its income base.[2] As Table 1.2 notes, the requested special variation included increases to fund road works and maintenance, as well as the rate peg increases available to all councils.

Table 1.2 Components of Kempsey Shire Council's requested special variation (%)

	2012/13	2013/14	2014/15
Increase to fund road works and maintenance	12.45	11.33	5.29
Rate peg increase[a]	3.6	3.0	3.0
Total increase	**16.05**	**14.33**	**8.29**

[a] In 2012/13, the rate peg reflects IPART's determination; in the following years it is an assumed increase.

Source: Kempsey Shire Council Application Part A, Worksheets 1 and 4.

2 Kempsey Shire Council, *Application for a section 508A special variation –Part A* (Kempsey Application Part A) Worksheet 1 and IPART calculations.

The council estimated that the requested special variation would increase its revenue by $5.2 million over the 3 years from 2012/13 to 2014/15.

This represents around $4.1 million above the increase that would be generated by rate peg increases alone.[3] Over 10 years, it would be around $40.7 million more than that generated by rate peg increases alone.[4]

The council indicated that it would use the income raised by the special variation to fund a $66.2m program to maintain roads and bridges and complete bypass works as part of the Pacific Highway upgrade.[5] Specifically, it proposed to spend:

- $37.3m on maintaining the sealed road network
- $22.4m on maintaining the unsealed road network
- $2.6m on maintaining bridges
- $4.0m on bypass works.[6]

1.3 How did we reach our decision?

We assessed Kempsey Shire Council's application against the criteria in the Guidelines for special variations under section 508A of the Act. We found that it did not satisfactorily meet these criteria. In particular, the council did not meet:

- Criterion 6 'Implementation of Integrated Planning and Reporting Framework (IPRF)'. The DLG reviewed the council's IPRF documents and advised that they did not yet meet the legislative requirements of the criterion.
- Criterion 2 'Demonstrated community support'. While the council undertook extensive community consultation, the feedback from this consultation does not provide clear evidence of broad community support for the proposed rate increases and expenditure program.
- Criterion 3 'Reasonable impact on ratepayers'. We found that the level of the proposed multi-year rates increases was significant, and the cumulative impact on ratepayers would be substantial. We also note that available data suggest the Kempsey community has a lower than average capacity to pay than other comparable councils and across NSW councils as a whole.

In addition, the council's policy of not taking on new debt and funding capital expenditure from recurrent revenues[7] places an additional burden on current ratepayers.

3 Kempsey Application Part A, Worksheets 1 and 4. It is not possible to determine the council's future general income with precision. A council's actual general income is affected by many other factors, including the number of rateable properties and adjustments for previous under- or over-collection of rates. The DLG is responsible for monitoring and ensuring compliance.

4 Kempsey Application Part A, Worksheet 1 and IPART calculations.

5 Kempsey Shire Council, *Application for a section 508A special variation –Part B* (Kempsey Application Part B), p 6.

6 Kempsey Application, *Road Capital Ten Year Financial Data*.

However, we found that the council's application did partially meet the less stringent criteria in the Guidelines for a single-year special variation under section 508(2) of the Act. Most importantly, it demonstrated that there is a need for the road works and maintenance program, and that it had consulted its community adequately on the proposed rate increases.

Therefore, we decided to allow a single-year special variation of 11.37% in 2012/13, to be incorporated permanently into the council's general income base. The 11.37% increase reflects the first-year increase proposed in an alternative 5-year funding option which the council presented to its community. It will have a more reasonable impact on ratepayers than the requested increase of 16.05% in 2012/13.

We note that this decision does not preclude the council from applying for a further special variation in 2013/14. However, prior to doing so, we consider that it should:

- update and revise its planning and reporting documentation to reflect the advice provided by DLG
- consult with, and obtain the support of, the broader community on its proposals
- consider reviewing its financing strategy in light of the impact on ratepayers and the principles of intergenerational equity.

Table 1.4 summarises our findings against each of the criteria for special variation applications under section 508A.

1.4 What does our decision mean for the council?

Our decision means that Kempsey Shire Council can increase its general income by an estimated $1.4m in 2012/13.[8] This will be permanently incorporated into the council's revenue base. After this year, this income will increase by the annual rate peg unless we approve further special variations.[9]

Table 1.3 Impact of approved special variation on the council's income in 2012/13

Adjusted notional general income 2011/12 ($)	Annual increase in general income (%)	Annual increase in general income ($)	Permissible general income 2012/13 ($)[a]
12,017,379[b]	11.37	1,366,376	13,383,755

a Permissible general income refers to the maximum general income that the council can generate in the year. It equals the previous year's notional general income level adjusted for any expiring special variation, other adjustments (prior year catch ups, excesses, valuation objections and income adjustments for Crown land) plus the annual dollar increase permitted by the proposed special variation percentage.
b The 2011/12 adjusted notional general income level is not part of the council's application and is only included for comparative purposes.

7 Kempsey Application, Part B, p 106.
8 Kempsey Application, *Delayed 5 year scenario s508 Application,* Worksheet 1.
9 As stated in footnote 3, the actual general income in future years will be influenced by a range of factors apart from the rate peg.

Table 1.4 Summary of IPART's assessment against the criteria in the Guidelines

Criterion	IPART findings
1. Demonstrated need for the rate increases derived from the council's Integrated Planning and Reporting Framework	The application demonstrated the need for rate increases: ▾ it reflects community priorities as outlined in the Community Strategic Plan ▾ it incorporates alternative revenue sources ▾ rates are an appropriate source of expenditure for renewals and rates revenue is currently low ▾ the additional funding would improve the council's financial sustainability.
2. Demonstrated community support for the special variation	The council provided evidence of extensive consultation through workshops, media releases and an independent phone survey. The results of the survey (29% supportive, 30% somewhat supportive, 41% opposed) and the views expressed in written submissions did not show convincing evidence of broad community support for the rate increase.
3. Reasonable impact on ratepayers	The proposed rate increases would have increased the average residential rate by $352 over 3 years. This may not be reasonable, given the relatively low average income levels in the LGA. In support of a partial approval, the council has a low outstanding rates ratio, low rates and a hardship policy in place to assist pensioners and those in financial hardship.
4. Sustainable financing strategy consistent with the principles of intergenerational equity	The council's debt service ratio is currently within DLG's monitoring range of 10% to 20%. However, the council's strategy of not taking on any new debt and funding capital expenditure from recurrent revenue increases the reliance on current ratepayers to fund capital works. The cost of long-lived assets should be distributed over the generations that benefit from them. It may be appropriate for the council to review its strategy in light of the community's capacity to pay and the principles of intergenerational equity.
5. An explanation of the productivity improvements and cost containment strategies the council has implemented in past years, and is planning over the requested special variation period	The council has achieved productivity savings in the past and aims to do so in the future. It is appropriate to continue exploring opportunities for further productivity improvements and cost containment. The council may wish to consider its communications to residents on the nature and value of productivity improvements.
6. Implementation of Integrated Planning and Reporting Framework (IPRF)	DLG has advised that the council's implementation of the IPRF has not yet met the legislative requirements. The currency of the council's Community Strategic Plan and the quality and integration of its Asset Management Policy, Resourcing Strategy and Delivery Plan were cited as concerns.

Note: In accordance with the Guidelines, IPART may also consider any other matters it considers relevant in assessing a council's application for a special variation. In the case of Kempsey Shire Council's application, no other matters were identified.

1.5 What does our decision mean for ratepayers?

The council provided us with supplementary information that outlined how rates would change if the proposed increase were spread over 5 years, including a first-year increase of 11.37%.

If the council changes its rates according to this scenario, the average residential rate will increase by 12.6% or $91 in 2012/13 ($65 above the rate peg). The average business rate will increase by 7.6% or $124 ($65 above the rate peg), while the average farmland rate will increase by 8.4% or $114 ($65 above the rate peg).[10]

However, these rises are indicative only and the actual impact on rates is a matter for the council to decide, consistent with our determination.

1.6 What does the rest of this report cover?

The rest of this report discusses the council's application and our assessment and findings in making our decision in more detail:

- Chapter 2 focuses on the council's application
- Chapter 3 discusses our assessment against the criteria.

The appendices provide the council's proposed program of expenditure, and a summary of the comparative data we considered in our assessment.

10 Kempsey Application, *Delayed 5 year Scenario s508 Application*, Worksheet 5; IPART calculations.

2 Kempsey Shire Council's application

Kempsey Shire Council applied to increase its general income by:

- 16.05% in 2012/13
- 14.33% in 2013/14
- 8.29% in 2014/15.[11]

These increases include the rate peg increases, and represent a cumulative increase of 43.7% (or 33.8% above the rate peg increase) for these 3 years.

The sections below provide some brief background information on the council and its history of special variations. The subsequent sections outline its application for a special variation in 2012/13, how the council proposes to use the additional income it would raise, and how the necessary rate increases would affect different ratepayers.

2.1 About the council

Kempsey Shire Council serves an area located on the mid-north coast of NSW, approximately halfway between Sydney and Brisbane. This area has a road network of around 1,000km. It comprises rural, semi-rural, residential, commercial and industrial land, and has a population of approximately 29,000 residents.[12]

The council is in DLG Group 4 indicating it is classified as an "urban, small to medium-sized regional town or city".[13] IPART considers that this group is the most suitable peer grouping for the purpose of comparing it with other councils.

11 Kempsey Application Part A, Worksheet 1.

12 Kempsey Application, Part B, p 3.

13 DLG, *Snapshot of NSW Councils: Comparative Information on NSW Local Government Councils 2008/09*, p 11-17. The Australian Classification of Local Governments (ACLG) system classifies councils into 22 categories according to their socio-economic characteristics and their capacity to deliver a range of services to the community. The DLG has reduced this to 11 groups because some ACLG categories contained few or no councils in NSW. There are 32 councils in DLG Group 4 including, for example, Port Macquarie-Hastings Council and Albury City Council.

The Kempsey Shire LGA has a SEIFA ranking of 6, positioning it among the most disadvantaged councils in the state.[14] Average residential rates in this LGA are relatively low. In 2010/11, they were $649 compared with an average of $806 for all DLG Group 4 councils, and $659 for all NSW councils.[15]

The council raises a lower than average proportion of its revenue through rates, annual charges and user fees. In 2010/11, 37.0% of its total revenue came from rates and annual charges compared with an average of 39.9% for DLG Group 4 councils, and 46.7%for NSW councils.[16]

It also receives a significant amount of funding from grants. In 2010/11, this source contributed 31.8% of its revenue, compared to an average of 20.5% for DLG Group 4 councils and 16.1% for NSW councils. This indicates that the council is relatively reliant on external sources of funding, such as grants from other levels of government.

2.2 History of special variations

The council has sought 10 special variations since 1994/95, of which 4 have been approved under section 508(2). Most recently:

- In 2003/04, an environmental levy was approved for 5 years and continued for another 5 years in 2008/09.
- In 2009/10, a requested special variation of 11.5% to fund road maintenance and renewal expenditure was not approved.

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14 SEIFA is the Socio-Economic Index for Areas published by the Australian Bureau of Statistics. It ranks LGAs from 1 to 153 (includes 1 ranking for "unincorporated NSW"). A ranking of 1 means the council is least advantaged relative to all the other councils in NSW. A ranking of 153 means it is least disadvantaged relative to all the other councils in NSW.

15 DLG, unpublished comparative data, 2010/11.

16 DLG, unpublished comparative data, 2010/11.

2.3 Requested special variation in 2012/13

The council applied to increase its general income by a cumulative 43.7% over the 3 years to 2014/15 or $5.2m (Table 2.1.)[17] The estimate has been verified by DLG.[18]

The council indicated that the requested special variation comprises:

- a cumulative increase of 33.8% to fund road works and maintenance
- a cumulative rate peg increase of 9.9%. This includes the rate peg of 3.6% IPART has set for 2012/13 and an assumed rate peg of 3.0% in each of the following years.[19]

Table 2.1 Kempsey Shire Council's requested special variation and estimated impact on its general income

	Year	Annual increase in general income (%)	Cumulative increase in general income (%)	Annual increase in general income ($)	Cumulative increase in general income ($)	Permissible general income ($)[a]
Y0	2011/12					12,017,379[b]
Y1	2012/13	16.05	16.05	1,928,432	1,928,432	13,946,134
Y2	2013/14	14.33	32.67	1,997,798	3,926,230	15,943,931
Y3	2014/15	8.29	43.67	1,321,832	5,248,062	17,265,763

a Permissible general income refers to the maximum general income that the council can generate in the year. It equals the previous year's notional general income level adjusted for any expiring special variation, other adjustments (prior year catch ups, excesses, valuation objections and income adjustments for Crown land) plus the annual dollar increase permitted by the proposed special variation percentage.

b This income level is the 2011/12 adjusted notional general income level, not the permissible general income level. It is not part of the council's application and is only included for comparative purposes.

Source: Kempsey Application Part A, Worksheet 1.

17 It is not possible to determine the council's future general income with precision. A council's actual general income is affected by many factors, including the number of rateable properties and adjustments for previous under- or over-collection of rates made by councils. The DLG is responsible for monitoring and ensuring compliance.

18 DLG, *Assessment of Kempsey Shire Council's s508A Special Variation Application – Part A*, March 2012.

19 From 2013/14, we will set the rate peg increases in December of the preceding year. If the rate peg is higher or lower than the 3% assumed, this is unlikely to have an impact on the council's future general income, as the special variation percentage will apply in the period specified. Under the Act, a council may apply to IPART to vary or revoke a special variation made under Section 508A. Any application will be assessed against any applicable Guidelines. However IPART considers that a request to vary or revoke a special variation would be an exception or due to special circumstances eg, as a result of the carbon price adjustment in the 2012/13 rate peg decision.

In setting the rate peg for 2012/13, we included a carbon price advance of 0.4% to assist councils to meet higher prices arising from the introduction of the carbon price from 1 July 2012.[20] We will set future rate pegs in the December prior to the start of the financial year to which each rate peg applies.

Table 2.2 shows the components of the requested special variation for each of the 3 years.

Table 2.2 Components of Kempsey Shire Council's requested special variation (%)

	2012/13	2013/14	2014/15
Increase for road works and maintenance	12.45	11.33	5.29
Rate peg	3.6	3.0	3.0
Total increase	**16.05**	**14.33**	**8.29**

Note: The council has assumed the rate peg will be 3.0% in 2013/14 and 2014/15.

Source: Kempsey Shire Council Application Part A, Worksheets 1 and 4.

2.4 How the council proposes to use the income raised

The council indicated that it would use the income raised by the special variation above the rate peg to contribute towards a $66.2m program of road and bridge works and maintenance, including bypass works as part of the Pacific Highway upgrade.[21] Specifically, it would spend:

- $37.3m on maintaining the sealed road network
- $22.4m on maintaining the unsealed road network
- $2.6m on maintaining bridges
- $4.0m on bypass works.[22]

Appendix A sets out details of Kempsey Shire Council's works program.

20 Given that the effects of the carbon price will eventually be captured in the Local Government Cost Index (LGCI), we will reverse the upfront adjustment we have made in the 2012/13 rate peg over 2 years. We will deduct 0.1% in 2013/14 and 0.3% in 2014/15 from the rate pegs in these years. See IPART, *Effects of the carbon price on local councils*, *Local Government – Information Paper*, December 2011 for more information.

21 Kempsey Application Part B, p 6.

22 Kempsey Application, *Road Capital Ten Year Financial Data*.

2.5 How the council proposes to allocate the special variation among ratepayers

Kempsey Shire Council proposed to allocate the rate increases associated with its requested special variation differentially among ratepayers, with residential rates increasing proportionally more than business and farmland rates. It indicated that residential rates would increase by a total of 49% (or $352) over the 3 years.

Table 2.3 sets out the impact of the council's proposed rate increases on the average rate in each rate category.

Table 2.3 Impact of the requested special variation on average rates in each category

	2011/12	2012/13	2013/14	2014/15
Average residential rates($)	**721**	**851**	**986**	**1,073**
$ Increase		130	135	87
% Increase		18.0	15.8	8.9
Average business rates($)	**1,637**	**1,800**	**1,969**	**2,092**
$ Increase		163	169	123
% Increase		9.9	9.4	6.2
Average farmland rates ($)	**1,365**	**1,518**	**1,677**	**1,789**
$ Increase		153	159	112
% Increase		11.2	10.4	6.7

Source: Kempsey Application Part A, Worksheet 5 and IPART calculations.

3 IPART's assessment

We assessed Kempsey Shire Council's application against criteria included in the Guidelines. We found that this application did not satisfactorily meet the criteria for a special variation under section 508A of the Act. Most importantly, it has not yet met the requirements for Criterion 6, 'Implementation of Integrated Planning and Reporting Framework (IPRF).' We also had concerns in relation to Criterion 2, 'Demonstrated community support' and Criterion 3, 'Reasonable Impact on ratepayers.'

We considered that the cumulative impact of the multi-year rate increase on ratepayers are substantial and a lower increase is more reasonable. In addition, we found that the council's financing strategy of not taking on new debt and funding capital expenditures from recurrent revenue would place additional pressure on current ratepayers.

However, the council's application did partially meet the less stringent criteria in the Guidelines for single-year special variations under section 508(2) of the Act. In particular, it demonstrated that there is a need for the proposed road works and maintenance program, and that it had consulted its community adequately on this program and the associated rate increases.

Therefore, we decided to allow a single-year special variation of 11.37% in 2012/13, to be incorporated permanently into the council's general income base. Before applying for a further special variation under section 508A, we expect that the council will complete its planning and consultation process under the IPRF. It may also wish to consider reviewing its financing strategy of eliminating debt to ensure that the impact on current ratepayers is balanced with the impact on future ratepayers.

Table 1.3 (in Chapter 1) summarised our findings in relation to each of the criteria. The sections below discuss our assessment of each criterion in more detail.

3.1 Criterion 1 - Demonstrated need for the rate increases derived from the council's Integrated Planning and Reporting Framework

Councils seeking special variations must demonstrate that their requested increase in general income is necessary. This includes:

- supporting their application with relevant strategic, asset management and long-term financial planning information
- providing evidence that the income raised by the special variation will be used to fund an efficient and feasible program of expenditure, and
- if possible, providing evidence that the special variation will improve their financial sustainability.

Kempsey Shire Council requested the special variation to help fund a program that includes around $66.2m of capital works over 10 years (described in section 2.4).[23] The council proposes to also employ higher user fees, charges, grants and other income to fund this program.

We are satisfied that the purpose of the special variation is consistent with the community's objectives and priorities as outlined in the council's Community Strategic Plan and identified through an extensive community consultation process. We are also satisfied that the council has demonstrated that it needs to generate the additional revenue it requires for the program through rate increases, and that it has considered and made use of alternative revenue sources as part of its funding proposal. For example, the council indicated that it has secured continued grants funding for the program. It has also outlined options for diverting existing funds away from services towards funding maintenance; increasing user charges for sporting facilities; and removing non-essential services or infrastructure if required.[24]

While we have not undertaken a detailed evaluation of the council's expenditure items, we note the proposed expenditure estimates are based on current industry standards for road work cost estimates. The council's application indicates that its works program has been informed by independent structural assessments, including condition assessments.[25]

The council has also shown how the special variation will have a positive effect on its financial sustainability. In its application, the council indicated that:

- It would have an operating surplus before capital grants and contributions of around $1,044,855 in 2014/15 with the special rate variation, rather than a deficit of $206,695m without it.[26]

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23 Kempsey Application, *Road Capital Ten Year Financial Data*.

24 Kempsey Application, Part B, pp 16-17 and 23-29.

25 Kempsey Application, Part B, p 4.

26 Kempsey Application, Part B, pp 38 and 62.

- Its asset renewal ratio of 73.4 in 2012/13 would improve to 102.8 in 2014/15 with the special variation, rather than remaining at 91.0 (which is outside the DLG benchmark levels of 100.0) without it.[27]

On balance, we have assessed that Kempsey Shire Council has demonstrated a need for the rate increases implied by the special variation.

3.2 Criterion 2 - Demonstrated community support

Councils seeking special variations must demonstrate that they have undertaken extensive community consultation and obtained community support for the special variation and the associated program of expenditure. The consultation material should be clear and accurate, and explain what the rate increase will be used for and its impact on ratepayers.

We found that Kempsey Shire Council has engaged extensively with the community to determine expenditure priorities, and whether there is support for the requested rate increases. However, the community feedback suggests it is divided on the special variation. The results of an independently conducted survey, online survey and written submissions indicate some support for increased rates, but it is difficult to determine whether there is broad community support.

The council's community consultation strategy included community workshops, media releases and an independent telephone survey. The results of its workshops and the phone survey provide an indication of the level of community support for the requested special variation.

The council's telephone survey of 400 respondents found that:

- 29% indicated they supported for the proposed rate over 3 years.
- 30% were "somewhat supportive" of the works program. Of these, 17% were concerned that no improvements would be made, and 16% stated they could not afford the increase. The other 67% did not express these concerns.
- 41% of respondents opposed the proposed special variation.[28]

A second question asked whether respondents would support a special variation over 5 years:

- 31% supported this option
- 25% were somewhat supportive. Of these, 10% stated it was more affordable spread over a longer time period.
- 44% were not supportive. Of these, 16% preferred the 3-year special variation.[29]

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27 Kempsey Application, Part B, pp 75-76.
28 Micromex Research, *Special Rate Variation Kempsey Shire Council*, March 2012, p 19.
29 Micromex Research, *Special Rate Variation Kempsey Shire Council*, March 2012, p 23.

A further question asked if respondents felt it was important to have a special variation of some form to fund the Delivery Plan – 49% were supportive, a further 29% were "somewhat supportive".[30]

Over the period of its consultation process (October 2010 to April 2011), the council also received submissions and survey responses from the public about the requested special variation and rate rises:[31]

- Following the first round of consultation, 58% of responses from the public preferred service cuts, 43% preferred a combined rate increase with service cuts, and 14% preferred a rate increase alone to fund maintenance. Amongst these submissions, an overall average rate increase of around $110 a year was supported.
- Following the second round of consultation, the council received 27 letters supporting the rate increase and 13 opposed to it.[32]

IPART received 16 direct representations from the public in response to the council's requested special variation, including a petition with 351 signatures. We considered these as part of our assessment. The concerns raised included the size of the rate increases and how the additional funds would be spent. One of the conditions applied to our approval of the special variation is that the council clearly reports, over the period to 2020/21, on its program of expenditure and outcomes achieved as a result of the special variation in its annual report.

Given the above results, our assessment was that the council had consulted adequately on its special variation (as required for special variations under section 508(2)). However, it did not provide evidence of broad community support for the full special variation amount (as required for special variations under section 508A).

In addition, in relation to the council's consultation approach, we noted that in some of the material it provided to the community, it did not present the total proposed rates increase, as the figures excluded the estimated impact of inflation. In future, we would like the council to present the total increase in rates, including assumed rate peg increases and inflation, in all documents. Further, in surveying community support, we suggest the council avoid including vague response options such as 'somewhat supportive' in its survey. Instead, it should ask whether respondents are 'supportive' and 'not supportive' of a range of alternative scenarios. This will more clearly indicate the level of community support for its proposals.

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30 Micromex Research, *Special Rate Variation Kempsey Shire Council*, March 2012, p 28.

31 Kempsey Application Part B, p 75.

32 Kempsey Application Part B, pp 83-84.

3.3 Criterion 3 - Reasonable impact on ratepayers

This criterion is important, given that the primary purpose of regulating council revenues is to protect ratepayers from unreasonable increases in rates. To assess whether a council's application meets the criterion, we considered the magnitude of the impact of rate rises resulting from the requested special variation, the ratepayers' capacity to pay the increased rates, and evidence of community support for the requested special variation.

Table 2.3 in Chapter 2 showed the impact of Kempsey Shire Council's proposed rates increases on average rates for each category. On average, residential rates would increase by $352 over 3 years, including $130 in 2012/13.

We consider that these increases would have a large impact on ratepayers. We made this assessment in the light of capacity to pay indicators for the LGA such as the SEIFA index and average income levels.

Kempsey's SEIFA ranking of 6 places it among the most disadvantaged LGAs in NSW. In 2009, the average household income in the LGA was $30,938, which was significantly lower than the average for all DLG Group 4 councils ($38,502) and all NSW councils ($41,376).

On the other hand, the council has an outstanding rates ratio of 5.1%, which is lower than the average for DLG Group 4 (6.0%) and all NSW councils (7.3%) and suggests that a high proportion of ratepayers pay their bills on time. The council also has a hardship policy in place.

Overall, we assessed that the council's proposal would have a high impact on ratepayers. Our decision to approve a lower, single-year increase is therefore a lower impost on ratepayers.

3.4 Criterion 4 - Sustainable financing strategy consistent with the principles of intergenerational equity

Councils seeking special variations must demonstrate that they have considered the use of all available financing options to address their capital expenditure requirements. Their financing strategy must be both sustainable and ensure intergenerational equity. The concept of intergenerational equity means that the costs of long lived assets (such as roads and bridges) are shared between current and future users, based on their share of the use of these assets over their life. For example, this may be achieved by council borrowings, which spread the financing costs of infrastructure over a long period, rather than meeting these costs through large rate increases in the short to medium term.

Overall, we found that council's financing strategy relies on current rate payers to fund new capital investment through higher rates, as it does not intend to take on new debt.[33] However, the beneficiaries of new infrastructure will include future ratepayers. This imbalance can be addressed through the use of debt to partly contribute to the cost of new long life assets. While the use of debt to partly fund capital assets will increase the council's borrowing expenses, the principles of intergenerational equity indicate these costs should be shared across current and future ratepayers that derive benefit from these assets.

In contrast, fully funding infrastructure investment through current ratepayers, as proposed by the council, will result in current ratepayers paying higher rates than otherwise necessary and/or reduced service levels from other areas of council's operations. Further, we found that the council has the financial capacity to use debt to contribute partly to the cost of infrastructure assets. The council's debt service ratio of 13.5% is currently within the DLG monitoring range of less than 20%.[34]

It may be appropriate for the council to review its debt strategy in light of the community's capacity to pay and the principle of sharing the cost of long-lived assets between the current and future ratepayers who benefit from them.

3.5 Criterion 5 - Productivity improvements and cost containment strategies

Councils seeking special variations must demonstrate that they have implemented a program of productivity or efficiency improvements and cost containment strategies to ease expenditure pressures before considering an increase in rates. In particular, they need to provide details of the productivity improvements, efficiencies and cost containment strategies that they have implemented over the past 2 or more years, and details of those that they propose to realise over the period of the special variation.

In its application, the council indicated that it has achieved productivity savings in the past and has plans in place to do so in the future. It has also undertaken a number of cost containment strategies over the past 2 years that have generated further savings for the council. The council indicated that:

- it has achieved productivity improvements through a budget review that converted $1m per annum from operations into meeting the ongoing replacement of assets, which was achieved without a reduction of service to the public
- it has identified the potential for a further redirection of $1.5m per annum (approximately 4% of operating expenditure).[35]

33 Kempsey Application Part B, pp 75-76.
34 Kempsey Application Part B, p 39.
35 Kempsey Application Part B, p 107.

As a cost containment strategy, the council has also indicated that it aims to shift from using debt towards funding asset replenishment from ongoing revenue. The council's application stated that this represents a net saving of 14% on the cost of providing services.[36] As indicated above, we consider that it may be appropriate for this financing strategy to be revised.

As part of our assessment, we examined comparative data on productivity from the DLG for 2010/11 as presented in Appendix B. These data indicated that Kempsey Shire Council had:

- a lower number of staff (265) relative to the average for DLG Group 4 councils (313) and the NSW average (294)[37]
- lower average staff costs ($68,355) compared to the Group 4 average ($72,277) and NSW average ($71,155)
- zero contractor/consultancy costs compared to an average of $4.6m for Group 4 councils and $6.2m for NSW.

However, the council had a lower ratio of population to staff (111) compared with the average for DLG Group 4 (127) and NSW (126).[38]

We encourage the council to communicate its productivity improvements and cost containment strategies to its community in future.

3.6 Criterion 6 - Implementation of Integrated Planning and Reporting Framework

To qualify for a special variation under section 508A of the Act, councils must have implemented the Integrated Planning and Reporting Framework (IPRF), including developing a 10-year community strategic plan, a 4-year delivery program, an annual operational plan and a detailed resourcing strategy.

The DLG has reviewed Kempsey Shire Council's IPRF documents and advised that the council has not yet met the legislative requirements of the IPRF. We note that the DLG has suggested that the council could improve its strategic planning documents by:

- updating its Community Strategic Plan
- more clearly linking its Resourcing Strategy with its Asset Management Plan
- demonstrating how its community consultation informed the Community Strategic Plan and Long Term Financial Plan.

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36 Kempsey Application Part B, p 108.

37 The council has advised IPART that comparisons between councils with and without water and sewer services may not provide an accurate comparison to the council.

38 The council suggested that amongst rural councils, a ratio of length of road network maintained to staff may provide a more useful comparison than using population.

Appendices

A Kempsey Shire Council's Expenditure Program

The following table summarises the council's proposed expenditure program on maintenance and bypass works from 2012/13 to 2021/22.

It includes:

- $37.2m for sealed roads
- $22.4m for unsealed roads
- $2.6m for bridges
- $4.0m for bypass works.

Table A.1 Kempsey Shire Council's works program summary ($ '000)

	12/13	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	21/22
Sealed roads	2,556	2,578	2,141	2,376	3,882	3,364	4,676	4,412	5,018	6,220
Unsealed road	803	1,356	1,817	1,924	2,556	3,615	2,575	2,891	2,735	2,106
Bridges	199	207	314	92	99	350	460	380	250	250
Bypass works	0	0	1,000	2,500	500	0	0	0	0	0

Source: Kempsey Application, *Road Capital Ten Year Financial Data*; and IPART calculations.

B Comparative indicators

Table B.1 Kempsey Shire Council's comparative performance against selected indicators, 2010/11

	Kempsey Council	DLG Group 4 average	NSW average[e]
General profile indicators			
Area (km^2)	3,371		
Population	29,331		
General Fund operating expenditure ($m)	35.2		
General Fund revenue per capita ($)	1,303	1,484	2,006
Rates revenue % total general income	37.0	39.9	46.7
Average rate indicators[a]			
Average rate level – residential ($)	649	806	659
Average rate level – business ($)	1,441	2,894	2,450
Average rate level - farmland ($)	1,273	1,702	2,121
LGA socio-economic/capacity to pay indicators			
Average annual income, 2009 ($)	30,938	38,502	41,376
Growth in average annual income, 2006-2009 (%)	4.6	4.6	4.4
Ratio of average residential rates (2010/11) to average annual income, 2009 (%)	1.9	2.0	1.5
SEIFA, 2006 (NSW rank)[b]	6		
Outstanding rates ratio (%)	5.1	6.0	7.3
Productivity indicators			
FTE staff (no)[c,d]	265	313	294
Ratio of population to FTEs[c,d]	111	127	126
Average cost per FTE ($)	68,355	72,277	71,155
Employee costs as % ordinary expenditure	42.7	38.3	37.3
Contractor expenses ($)[c]	0	4,584,370	6,238,288
Contractor expenses as % ordinary expenditure	0	5.9	8.0

a Average rates equal the rates revenue in each category divided by the number of assessments in that category.
b See footnote 14 for SEIFA index.
c Based upon total council finances and operations ie, General Fund and Waste and if applicable, Water and Sewer and other funds (eg, Airport).
d Total number of FTEs is at 30 June 2010, which was reported in council's consolidated financial reports.
e NSW averages exclude Snowy River Shire Council because data were not yet available.
Note: General Fund refers to all council activities except Water and Sewer.
Source: DLG, unpublished comparative data, 2010/11 and ABS, National Regional Profiles, NSW, November 2011.