



Independent Pricing and Regulatory Tribunal  
New South Wales

# Special variation increase

## Kempsey Shire Council 2018-19

Determination  
Local Government

May 2018

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# 1 Executive summary

The Independent Pricing and Regulatory Tribunal of NSW (IPART) has set the rate peg for 2018-19 at 2.3%. Councils may apply to increase their general income above the rate peg. For most councils, general income consists entirely of rates revenue.

Kempsey Shire Council (Kempsey Council) applied for a single-year special variation to:

- ▼ increase its general income by 6.5% in 2018-19, which represents a 4.2% increase above the rate peg, to continue an expiring environmental levy, and
- ▼ retain this increase in its rate base for 10 years.<sup>1</sup>

IPART has assessed the council's application against the criteria in the Office of Local Government (OLG) Guidelines. This report sets out our decision, and explains how and why we reached that decision. Box 1.1 outlines the context for this process.

## 1.1 We have approved Kempsey Council's application for a special variation

We decided to allow the special variation as requested.

Our decision means that Kempsey Council may increase its general income in 2018-19 by 6.5%, including the rate peg of 2.3% that is available to all councils (see Table 1.1). This increase may be retained in the council's general income base for 10 years and is to be removed from the council's rate base after 2027-28.

The purpose of the special variation is to renew Kempsey Council's environmental levy which has been applied across the shire for the past 10 years and is due to expire on 30 June 2018. As the application renews an expiring special variation, rate payers on average will only experience an increase in rates equivalent to the rate peg in 2018-19.

**Table 1.1 IPART's decision on Kempsey Shire Council's application for a special variation in 2018-19**

	2018-19 (%)
Increase to continue environmental levy	4.2
Rate peg	2.3
<b>Total increase approved</b>	<b>6.5</b>

This special variation will allow the council to continue to fund environmental restoration projects across the shire including bush regeneration, repair to local creeks and waterways, weed control, restoration of wildlife habitats and corridors and flood mitigation works.<sup>2</sup>

<sup>1</sup> Kempsey Council, *Special Variation Application Form Part A 2018-19*, Worksheet 1.

<sup>2</sup> Kempsey Council, *Application Part A*, Worksheet 6 and *Application Part B*, p 10.

### **Box 1.1 Context for IPART's decision**

Each year, IPART sets the rate peg, which is the maximum amount by which councils can increase their general income in that year.

Councils may apply for a special variation that allows them to increase their general income by more than the rate peg. For a single year increase, they apply under section 508(2) of the *Local Government Act 1993* (the Act). For successive year increases (up to a maximum of seven years), they apply under section 508A of the Act.

IPART assesses these applications against the criteria set by the Office of Local Government (OLG) in its *Guidelines for the preparation of an application for a special variation to general income* (OLG Guidelines).

The OLG Guidelines emphasise the importance of the council's Integrated Planning and Reporting (IP&R) processes and documents to the special variation process. The IP&R documents, in particular the Delivery Program and Long Term Financial Plan (LTFP), must contain evidence that supports a council's application for a special variation.

The criteria for assessing applications for special variations are listed in Appendix A.






## **1.2 The council's application meets the criteria**

Our decision reflects our finding that the council's application meets the requirements in the OLG criteria.

Our assessment against the criteria is summarised in Table 1.2.



**Table 1.2 Assessment of Kempsey Shire Council's special variation application**

<b>1. Financial Need</b>	
	<p>The council demonstrated the financial need for the special variation (SV):</p> <ul style="list-style-type: none"> <li>▼ Community feedback suggests it wants spending on environmental projects to continue.</li> <li>▼ Operating Performance Ratio (average 2017-18 to 2026-27) is <ul style="list-style-type: none"> <li>– -0.54% with SV</li> <li>– -2.12% without SV revenue and assuming SV expenditure</li> </ul> </li> <li>▼ Infrastructure backlog of \$15.4 million in 2017-18; infrastructure backlog ratio of 4.0% which does not meet the benchmark of 2.0%</li> <li>▼ Asset maintenance ratio of 0.78 in 2017-18 which does not meet the benchmark of 1.00.</li> </ul>
<b>2. Community awareness</b>	
	<p>The council demonstrated the community is aware of the rate rise. It:</p> <ul style="list-style-type: none"> <li>▼ used a range of engagement methods to make the community aware of the need for and extent of the rate increase</li> <li>▼ provided adequate explanation about the purpose and impact of the SV and sought feedback, and</li> <li>▼ satisfactorily considered community feedback on the rate increase.</li> </ul>
<b>3. Impact on ratepayers</b>	
	<p>Impact on ratepayers will be low and reasonable:</p> <ul style="list-style-type: none"> <li>▼ the SV renews an expiring SV, so rates will on average only rise by the rate peg</li> <li>▼ current residential rates are lower than Group 4 and most neighbouring councils</li> <li>▼ rates to income ratio is comparable to other councils, and</li> <li>▼ outstanding rates ratio comparable with neighbouring councils.</li> </ul>
<b>4. IP&amp;R documents exhibited</b>	
	<p>The council adopted its Community Strategic Plan in 2017. It:</p> <ul style="list-style-type: none"> <li>▼ exhibited its IP&amp;R documents during May and June and adopted them on 27 June</li> <li>▼ adopted the Long Term Financial Plan setting out the SV scenarios in 2017, and</li> <li>▼ adopted the Delivery Program which referenced the SV but did not clearly present the rate increases.</li> </ul>
<b>5. Productivity improvements and cost containment</b>	
	<p>Over the past four years, the council has realised savings of \$3 million per annum in operating expenditure and is forecasting further savings of \$1.5 million. Initiatives included:</p> <ul style="list-style-type: none"> <li>▼ changing how the road and bridge network is managed, and</li> <li>▼ reducing salary costs after a management restructure (\$350,000 pa).</li> </ul>

### 1.3 We have attached conditions on how the council can spend its extra revenue

We have attached conditions to this decision, including that the council uses the income raised from the special variation for purposes consistent with those set out in its application. Box 1.2 summarises these conditions.

#### **Box 1.2 Conditions attached to Kempsey Shire Council's approved special variation**

IPART's approval of Kempsey Shire Council's application for a special variation over the period 2018-19 to 2027-28 is subject to the following conditions:

- ▼ The council uses the additional income from the special variation for the purposes of environmental restoration projects as outlined in the council's application and listed in Appendix B.
- ▼ The council reports in its annual report for each year from 2018-19 to 2027-28 on:
  - expenditure consistent with the council's application and listed in Appendix B, and the reasons for any significant differences from the proposed expenditure, and
  - the outcomes achieved as a result of the actual program of expenditure.
- ▼ On 1 July 2028, the council is to reduce its general income to what it would have been without the special variation.

The council is to reduce its general income for 2018-19 by \$764,935 (the value of the expiring special variation) before its general income is increased in 2018-19 in accordance with IPART's determination.

### 1.4 Structure of this report

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

- ▼ Chapter 2 outlines the council's application for the special variation
- ▼ Chapter 3 explains our assessment of the council's application against each criterion
- ▼ Chapters 4 and 5 discuss how our decision will impact the council and its ratepayers.

## 2 Kempsey Council's application

Kempsey Council applied for a special variation to increase its general income by 6.5% in 2018-19 consisting of:

- ▼ a 4.2% increase to renew the council's expiring environmental levy to provide the funds to continue further environmental projects within the shire, and
- ▼ the rate peg of 2.3%

and to retain this increase in its general income base for 10 years.<sup>3</sup>

Kempsey Council's environmental levy was first introduced as a special variation in 2003-04 at a rate of 4.7% for a 5-year period. In 2008-09 it was renewed and approved at a rate of 4.5% for a ten year period. This application seeks to extend this expiring environmental levy temporarily for a further ten years.<sup>4</sup>

The expiring special variation reduces the council's general income at the end of 2017-18<sup>5</sup>. Applying the proposed special variation of 6.5% to this reduced base provides a net increase to general income of 2.3% in 2018-19 over 2017-18, which is equal to the rate peg.

The council estimates its permissible general income would increase from \$19.52 million in 2017-18 to \$20.01 million in 2018-19 if the requested special variation is approved.<sup>6</sup> Over the 10-year period of the special variation to 2027-28, this would generate additional revenue of \$8.8 million compared to rate increases at the assumed rate peg (after adjusting for the expiring special variation).

The council indicated it intends to use the additional revenue to continue to fund environmental restoration projects across the shire including bush regeneration, repair to local creeks and waterways, weed control, restoration of wildlife habitats and corridors, flood mitigation works and environmental education.<sup>7</sup>

More detail on the council's proposed program of expenditure is provided in Appendix B.

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<sup>3</sup> Kempsey Council, *Application Part A*, Worksheet 4.

<sup>4</sup> Kempsey Council, *Application Part B*, p 10.

<sup>5</sup> The council has a special variation for 4.4% above the rate peg which will expire 30 June 2018, reducing the council's general income by \$764,935. As a result, the actual increase in the council's general income is estimated to be 2.3% in 2018-19: see *Application Part A*, Worksheet 1.

<sup>6</sup> Kempsey Council, *Application Part A*, Worksheet 1.

<sup>7</sup> Kempsey Shire Council, *Application Part B*, p 10.

## 3 IPART's assessment

To make our decision, we assessed Kempsey Council's application against the criteria in the OLG Guidelines. We also considered the council's most recent IP&R documents, its FFTF proposal, and a range of comparative data about the council set out in Appendix C.<sup>8</sup>

We found that Kempsey Shire Council's application met the requirements of the criteria.

Our assessment of the council's application against the criteria is summarised in Table 1.2 and discussed in more detail in the sections below.

### 3.1 The council demonstrated financial need for the special variation

Kempsey Council has demonstrated a financial need for the requested special variation, which is to continue the existing environmental levy that funds environmental restoration works throughout the shire. This is consistent with the priority the community places on the environment identified in the Community Strategic Plan.

We found that Kempsey Council's IP&R documents adequately set out the need for, and purpose of the requested special variation.

The council also analysed the financial impact of the special variation on its operating performance and infrastructure backlog, and canvassed alternative funding strategies.

#### 3.1.1 Impact on council's operating performance

The operating performance ratio (OPR) measures whether a council's revenues fund its costs. The OPR is defined as:

$$OPR^9 = \frac{\text{Total operating revenue} - \text{operating expenses}}{\text{Total operating revenue}}$$

The additional special variation expenditure is allocated to environmental works. The council forecasts the special variation would enable continued funding of environmental projects at current levels.

Without the special variation and assuming the council's expenditure is the same as under the special variation scenario, the council forecasts consistent operating deficits, as shown in Figure 3.1 and Table 3.1. The cumulative value of these forecast deficits (before capital grants and contributions) is \$9.2 million to 2027-28. Hence, without the special variation, and

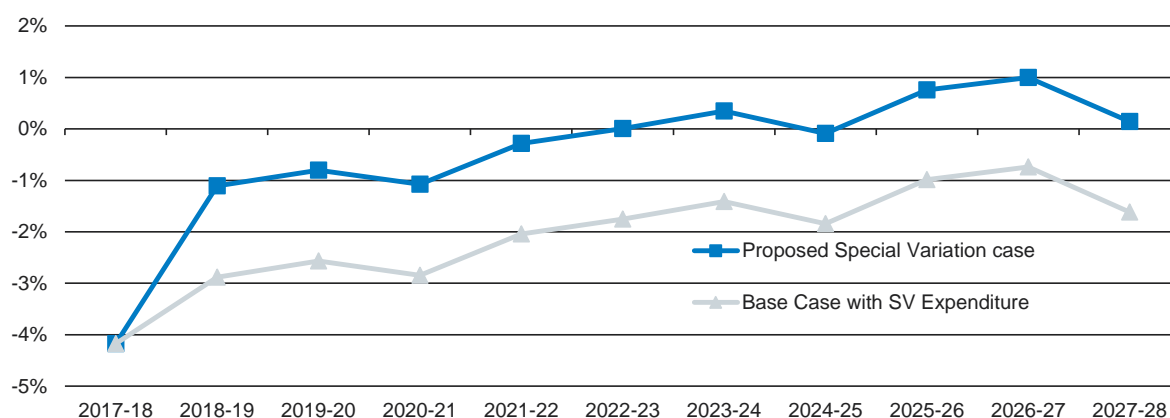
<sup>8</sup> Kempsey Council is in OLG Group 4, which is classified as small to medium regional town that is predominantly urban in nature. The group comprises 28 councils, including Ballina, Byron, Port Stephens and Lismore.

<sup>9</sup> Expenditure and revenue in the OPR measure are exclusive of capital grants and contributions, and net gain/loss on sale of assets.

with the special variation expenditure, the council's financial sustainability would deteriorate.

Under the special variation scenario, the operating deficits are reduced, and the council begins generating surpluses from 2022-23 onwards. The cumulative value of these forecast operating results is a net deficit of only \$0.4 million to 2027-28.

**Figure 3.1 Kempsey Shire Council's Operating Performance Ratio (%) excluding capital grants and contributions (2017-18 to 2027-28)**



**Note:** The base case with SV expenditure scenario shows the impact on the council's operating position if the special variation projects were to go ahead without the special variation revenue.

**Source:** Kempsey Council, *Annual Financial Statements*, various; Kempsey Council, *Application Part A*, Worksheet 7 and IPART calculations.

**Table 3.1 Projected operating performance ratio (%) for Kempsey Council's special variation application**

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Application - including SV	-1.1	-0.8	-1.1	-0.3	0.0	0.3	-0.1	0.8	1.0	0.1
Base Case with SV expenditure	-2.9	-2.6	-2.8	-2.0	-1.8	-1.4	-1.8	-1.0	-0.7	-1.6

**Source:** IPART calculations based on Kempsey Council, *Application Part A*, Worksheet 7.

### 3.1.2 Impact on the council's infrastructure backlog

The council estimates that it would cost \$15 million to bring its assets to a satisfactory standard, eliminating its infrastructure backlog.<sup>10</sup> Measured as a percentage of the written down value of infrastructure assets,<sup>11</sup> the infrastructure backlog ratio for 2016-17 was 4.5% for the general fund. This is higher than the FFTF benchmark of 2%. The council may have less scope to reduce this backlog if it decided to continue with its environmental expenditures without the special variation revenue.

<sup>10</sup> Kempsey Council, *General Purpose Financial Statements, 2016-17*, Special Schedule 7.

<sup>11</sup> Historical cost less accumulated depreciation.

Our conclusion that Kempsey Council has a financial need for the special variation revenue to undertake environmental restoration works is consistent with our FFTF assessment of the council summarised in Box 3.1.

### Box 3.1 FFTF Assessment

IPART's Fit for the Future assessment in 2015 found that Kempsey Council:

- ▼ Did not meet the criterion for financial sustainability based on its forecast operating performance ratio not meeting the benchmarks. The council's operating performance ratio was -40.4% in 2014-15 and was forecast to reach -3.5% by 2019-20, which was still below the benchmark. In its proposal the council relied on successfully applying for a special variation from 2017-18 of 36% cumulative over four years.
- ▼ Did not meet the criterion for infrastructure and service management as its forecast infrastructure backlog and asset maintenance ratios did not meet the benchmarks by 2019-20.
- ▼ Met the efficiency criterion based on a forecast decline in real operating expenditure per capita from \$2,055 in 2014-15 to \$1,467 in 2019-20.

TCorp observed in 2013 the council's financial position was 'weak' and its outlook was 'negative'. This assessment was made largely because of consecutive operating deficits.

**Source:** Kempsey Council, *Council Improvement Proposal*, October 2015; IPART, *Assessment of Council Fit for the Future Proposals*, October 2015, and NSW Treasury Corporation (TCorp), *Financial Sustainability of the New South Wales Local Government Sector*, April 2013.

### 3.1.3 Alternative funding strategies

The council has considered a number of alternative revenue options such as user fees and charges, borrowing, and funding expenditure from reserves:

- ▼ In the case of user charges and fees, the council concluded this was not feasible and introducing user fees would be impractical. As the environmental projects being undertaken have the characteristics of public goods, the council considers the use of rates to be a more appropriate funding source.
- ▼ Borrowing was ruled out as an alternative funding source due to the ongoing and recurrent nature of the environmental expenditure.
- ▼ Whilst the council holds \$41.9 million in cash and reserves, it noted 62.5% of these reserves must only be used for the purpose for which they were collected (eg, water and sewer) and the remaining reserves are also predominantly held for specific purposes (eg, employee leave liabilities).<sup>12</sup>

## 3.2 The council demonstrated community engagement and awareness

We found that Kempsey Council has demonstrated adequate community engagement and awareness.

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<sup>12</sup> Kempsey Council, *Application Part B*, p 22.

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In 2017, the council reviewed its IP&R documents in consultation with the community. The Long Term Financial Plan (LTFP) incorporates several scenarios that model the requested special variation.

The Delivery Program references the council's intent to apply to retain the existing environmental levy, and articulates the need for and purpose of the special variation. However, it did not clearly set out the extent of the rate rise under the special variation. The Delivery Program also canvassed an additional 4% special variation for which the council subsequently decided not to apply.

### **Public Consultation**

In addition to consulting on the IP&R documents, the council also undertook community consultation specifically relating to the special variation. This consultation process used a variety of methods to engage with the community including:

- ▼ Social media posts on Facebook that reached 1081 people
- ▼ A dedicated engagement website
- ▼ Community surveys (online and hard-copy)
- ▼ A media release seeking feedback on the proposed special variation
- ▼ Advertisements in local newspapers and mayoral column in local newspapers
- ▼ A direct email newsletter to ratepayers
- ▼ Posters in public buildings, libraries, council chambers
- ▼ Face to face engagement at market stalls and other community events

Through these channels the council communicated the extent of the special variation in terms of the average rate rise and total funds generated, the 10-year duration proposed and also provided a breakdown of where the levy funds have been spent to date.

While the council clearly communicated the average contribution towards the environmental levy in dollar terms across all ratepayers, it omitted the average contribution by rating category. However, as the special variation is renewing an expiring special variation, rates will on average only rise by the rate peg. This levy has been in place for 14 years so the council considers it is well understood by the community.

A community engagement survey ('Have your say on funding environmental projects') was undertaken in 2017 to inform the community of the special variation costs, the impact and the intended use, and to gauge community support for the environmental levy.

### **3.2.2 Outcome of consultation with community**

Although this criterion does not require councils to demonstrate community support for the special variation, they are required to consider the results of their community consultation in preparing their application. Kempsey Council's consultation indicated its community's preference was to extend the environmental levy through a special variation for a further 10 years. This is evidenced by the survey in which:



- ▼ 75% of respondents expressed a preference for the council applying for a 10-year extension to the existing environmental levy at the current rate of \$53 per household per year, and
- ▼ 9% of respondents favoured discontinuing the environmental levy.<sup>13</sup>

### 3.2.3 Submissions from the community

The council received three written submissions in relation to its application for the special variation, including one opposing the application and two in favour. The submission that opposed the environmental levy did so on the basis that existing programs and works funded by the levy are not best practice.

The council has considered its community's feedback and provided individual responses to concerns that were raised.<sup>14</sup>

IPART received five submissions opposing the application on the grounds that rates have increased substantially over the past three years and the council has demonstrated it does not need additional funds through its recent \$2 million contribution towards the Kempsey cinema project.<sup>15</sup>

## 3.3 The impact on ratepayers is reasonable

We found that the impact of these increases on ratepayers will be small and reasonable, given:

- ▼ this special variation replaces an expiring special variation which means rates will on average only increase by the rate peg of 2.3%
- ▼ the community is already paying the levy that this special variation seeks to renew, and
- ▼ community acceptance and support for the environmental levy that is being collected through the special variation.

### 3.3.1 Council's consideration of impact on ratepayers

The council considers the community has the capacity and willingness to pay. The approval of the special variation will result in the average residential rate increasing by approximately \$17.60<sup>16</sup>, which is a 1.55% increase in 2018-19 and below the rate peg increase of 2.3%.<sup>17</sup> If the special variation is not approved the average residential rate would decrease because of the expiring special variation currently funding the environmental levy.

The rates and annual charges outstanding ratio is an indication of ratepayers' ability to pay. In 2016-17 Kempsey Council achieved a rates and annual charges outstanding ratio of

<sup>13</sup> Kempsey Council, *Application Part B*, pp 43-44.

<sup>14</sup> Kempsey Council, *Application Part B*, p 45.

<sup>15</sup> Submissions received can be accessed on the IPART website.

<sup>16</sup> Kempsey is proposing a rebalancing of rates across rating categories which will result in the increase to residential rates being lower than the average increase to general income.

<sup>17</sup> This is partly because Kempsey Council intends to restructure its rating categories as outlined in Chapter 5.



5.95%.<sup>18</sup> This ratio has consistently remained below the OLG benchmark for rural areas of less than 10%.

Kempsey Council submitted that it has adopted a Rates and Charges Hardship Assistance Policy. The council states this hardship policy demonstrates Kempsey Council's commitment to aiding ratepayers who display a genuine inability to pay their rates and charges in a timely manner and provides a framework to provide assistance to those ratepayers who are suffering genuine financial hardship. This policy allows ratepayers to enter into payment arrangements with the council in cases of demonstrated financial difficulty.<sup>19</sup>

### **3.3.2 IPART's assessment of impact on ratepayers**

To assess the reasonableness of the impact of the special variation on ratepayers, we examined the council's special variation history and the average annual growth of rates in various rating categories. We found that since 2007-08:

- ▼ the council has applied for and been granted three special variations:
  - 2008-09: 7.7% temporary environmental levy for 10 years (the expiring special variation being replaced)
  - 2012-13: 11.37% permanent increase to fund road works and maintenance
  - 2014-15: 37.54% permanent increase over four years to fund road and bridge works
- ▼ the average annual growth in residential rates was 6.9%, which compares with the average annual growth in the rate peg of 2.7% over the same period.

We also compared current rates and socio economic indicators in Kempsey with neighbouring councils and OLG Group 4 councils as shown in Table 3.2.

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<sup>18</sup> Outstanding rates ratio for the General Fund. Kempsey Council, *Application Part B*, p 51.

<sup>19</sup> Kempsey Council, *Application Part B*, p 52.

**Table 3.2 Kempsey Shire Council - comparison of rates and socio-economic indicators with neighbouring councils and Group 4 averages (2015-16)**

Council (OLG Group)	Average residential rate (\$) <sup>a</sup>	Average business rate (\$)	Median annual household income (2016) <sup>b</sup>	Average rate to median income ratio (%)	Outstanding rates ratio (%)	SEIFA Index NSW Rank <sup>c</sup>
Bellingen Shire (11)	986	927	51,844	1.9	2.5	63
Coffs Harbour City (5)	1,070	4,327	57,564	1.9	6.2	61
Nambucca Shire (11)	912	1,782	43,420	2.1	5.6	9
Port Macquarie-Hastings (5)	1,067	3,453	54,184	2.0	5.1	68
<b>Kempsey Shire (4)</b>	<b>938</b>	<b>2,132</b>	<b>46,488</b>	<b>2.0</b>	<b>5.5</b>	<b>4</b>
OLG Group 4 average	1,013	3,619	62,656	1.6	4.5	

**a** The average residential rate (ordinary and special) is calculated by dividing total Ordinary Rates revenue by the number of assessments in the category.

**b** Based on the 2016 Census data on median household income.

**c** The highest possible ranking is 130 which denotes a council that is least disadvantaged in NSW.

**Source:** OLG, Time Series Data 2015-2016; ABS, *Socio-Economic Indexes for Areas (SEIFA) 2016*, March 2018; ABS, 2016 Census DataPacks, General Community Profile, Local Government Areas, NSW, *Median Weekly Household Income* and IPART calculations.

Based on 2015-16 data, we found that Kempsey Council's:

- ▼ average residential rate (\$938) was 7.4% lower than the average for Group 4 councils and lower than most neighbouring councils
- ▼ average business rate (\$2,132) was 41% lower than the average for Group 4 councils and considerably lower than some neighbouring councils
- ▼ average rate to income ratio was higher than the average for Group 4 councils but comparable with neighbouring councils
- ▼ outstanding rates ratio was broadly in line with neighbouring councils, and
- ▼ SEIFA ranking of 4 indicates a significant level of disadvantage.

We conclude the impact of the increase is small and reasonable taking into account the above factors, community support for spending on the environment, and that rates on average would only increase by the rate peg.

### 3.4 The council's IP&R documents were exhibited

We consider that, on balance, and taking into account that this special variation renews an expiring special variation, this criterion has been sufficiently met.

#### 3.4.1 Exhibition, approval and adoption of IP&R documents

The council adopted its Community Strategic Plan, Delivery Program 2017-2021 and Long Term Financial Plan (LTFP) on 27 June 2017. This followed public exhibition of these documents from 26 May 2017 to 22 June 2017. The council advertised the availability of these documents for public comment, promoted them in local media and social media, placed

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copies on the council's website, and invited face to face comment on the documents at its stall at the Riverside markets.

### **3.4.2 Content of IP&R documents**

While this criterion focuses on the exhibition and adoption of the IP&R documents rather than the content of the IP&R documents, criteria 1 to 3 of the OLG Guidelines include mention of specific attributes the suite of IP&R documents should include which we assess in conjunction with this criterion.

#### **The need for, and purpose of the requested special variation (criterion 1)**

The council presented the need for, and purpose of the requested special variation in both the Long Term Financial Plan and the Delivery Program. The LTFP noted that it included the continuation of the environmental levy to support services in estuary management, noxious weeds, developing long-term plans for environmental management and flood mitigation. The Delivery Program indicated the council would apply to retain the existing environmental levy to continue funding rehabilitation projects to improve the health of waterways, the weed program and other restoration projects.

#### **The extent of the general fund rate rise under the special variation (criterion 2)**

The LTFP incorporates several scenarios that model the requested special variation. These scenarios present the extent of the general fund rate rise and the duration of the rate rise.

#### **The impact of any rate rises upon the community (criterion 3)**

This special variation renews an expiring special variation of the same magnitude so rates will increase by the rate peg on average. The Delivery Program references the council's intent to apply to retain the existing environmental levy, which was characterised as being the same environmental levy that had been in place for the past 14 years. However, it did not mention the size of the current levy.

The Delivery Program also discussed a potential 4% special variation, for which the council subsequently decided not to apply.<sup>20</sup>

Specific special variation consultation material also communicated continuing the levy would, on average, cost households \$53 per year.<sup>21</sup>

### **3.5 The council explained its productivity improvements and cost containment strategies**

Kempsey Council's application sets out the productivity improvement and cost containment initiatives it has undertaken in recent years and plans to implement in the future.

In particular, it submitted that it had implemented a long-term productivity review aiming to identify and realise financial savings through improving efficiency. Through this

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<sup>20</sup> Kempsey Council, *Delivery Program 2017-2021*, p 15.

<sup>21</sup> Kempsey Council, *Application Part B*, p 39.

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productivity review the council has identified a series of cost-cutting exercises. These include:

- ▼ re-tendering for electricity and telecommunications providers at a lower cost
- ▼ renegotiating insurance agreements (reduced premiums for public liability insurance and property insurance)
- ▼ significant changes to how the road and bridge network is managed, and
- ▼ the council stopped taking on new debt for minor improvement works, and is paying down existing debt to release a further \$2.5 million per annum (in interest payments) over time.<sup>22</sup>

In March 2017 the council also commenced an Organisation Culture and Structure Review which is designed to identify and implement several productivity improvements. Initiatives include:

- ▼ human resource efficiencies, which have resulted in a flatter structure that will provide more efficient and flexible work practices, and
- ▼ a move from a four-director structure to a two-director structure, which has provided annual savings in the order of \$350,000 per annum.

When this review is finalised the council anticipates ongoing net operational savings of approximately \$1.5 million per annum.

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<sup>22</sup> Kempsey Council, *Application Part B*, p 57.

## 4 Our decision's impact on the council

Our decision means Kempsey Council may increase its general income in 2018-19 by 6.5%, an estimated \$750,284 above the rate peg as indicated in Table 4.1. After 2018-19, the council's general income can increase up to the annual rate peg unless we approve further special variations.<sup>23</sup>

**Table 4.1 Permissible general income of Kempsey Shire Council in 2018-19 arising from the special variation approved by IPART**

Notional general income 2017-18 (\$)	Adjustment: expiring special variation <sup>a</sup> (\$)	Increase approved (%)	Annual increase in general income (\$)	Adjustments: Catch-ups, valuations <sup>b</sup> (\$)	Permissible general income 2018-19 (\$)
19,518,580	764,935	6.5	1,218,987	37,369	20,010,001

<sup>a</sup> Includes adjustment of -\$764,935 for a special variation that expires on 30 June 2018.

<sup>b</sup> A prior catch-up of \$37,369 that had not been recouped by the time of the application was submitted to IPART is to be recouped in 2018-19.

**Note:** The above information is correct at the time of the council's application (February 2018).

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

The council estimates that over the 10 years to 2027-28 it will collect, in total, an additional \$8.8 million of rate revenue compared to rate increases that are limited to the assumed rate peg.<sup>24</sup>

This extra income is the amount the council requested to enable it to continue to fund environmental restoration projects across the shire.

The approved special variation is temporary for 10-years. Hence, on 1 July 2028, the council is to reduce its general income to what it would have been without the special variation.

<sup>23</sup> General income in future years cannot be determined with precision, as it will be influenced by several factors in addition to the rate peg. These factors include changes in the number of rateable properties and adjustments for previous under- or over-collection of rates. The Office of Local Government is responsible for monitoring and ensuring compliance.

<sup>24</sup> Kempsey Council, *Application Part B*, p 6.

## 5 Our decision's impact on ratepayers

IPART sets the allowable increase in general income, but it is a matter for each council to determine how it allocates any increase across different categories of ratepayer, consistent with our determination.

Kempsey Council indicated that while it will increase rates uniformly across rating categories, it intends to vary the percentage of rates collected from each rating category between 2017-18 and 2018-19 as follows:

- ▼ Residential 72.70% in 2017-18 to 72.01% in 2018-19
- ▼ Business 11.31% in 2017-18 to 12.33% in 2018-19
- ▼ Farmland 15.99% in 2017-18 to 15.66% in 2018-19.<sup>25</sup>

The council has calculated, taking into account both the 2.30% rate peg increase and the rebalancing of rating categories:

- ▼ the average residential rate would increase by 1.55% or by \$17.60
- ▼ the average business rate would increase by 11.78% or by \$323.25
- ▼ the average farmland rate would increase by 0.37% or by \$8.00.<sup>26</sup>

Table 5.1 sets out Kempsey Council's estimates of the expected increase in average rate in each ratepayer category.

**Table 5.1 Indicative annual increases in average rates under Kempsey Shire Council's approved special variation for 2018-19**

Rating category	Average rate 2017-18 (\$)	Increase (%)	Increase (\$)	Average rate 2018-19 (\$)
Residential average	1,138	1.55	17.60	1,155
Business average	2,745	11.78	323.25	3,068
Farmland average	2,154	0.37	8.00	2,162

**Note:** The increase to average business rates is due to the transfer of a substantial number of properties from the 'other' sub-category to the higher rated CBD sub-category as part of Kempsey Council's rebalancing of rating categories.

The average increase in rates is 2.3% because the special variation renews an expiring special variation to fund environmental works.

<sup>25</sup> Kempsey Council, *Application Part B*, p 26.

<sup>26</sup> Kempsey Council, *Application Part B*, p 26.



## Appendices





## A Assessment criteria for special variation applications

**Table A.1 Assessment criteria for special variation applications**

Assessment criteria
<p><b>Criterion 1 – Financial need</b></p> <p>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&amp;R documents, in particular its Delivery Program, Long Term Financial Plan and Asset Management Plan where appropriate.</p> <p>In establishing need for the special variation, the relevant IP&amp;R documents should canvas alternatives to the rate rise. In demonstrating this need councils must indicate the financial impact in their Long Term Financial Plan applying the following two scenarios:</p> <ul style="list-style-type: none"> <li>▼ Baseline scenario – General Fund revenue and expenditure forecasts which reflect the business as usual model, and exclude the special variation, and</li> <li>▼ Special variation scenario – the result of implementing the special variation in full is shown and reflected in the General Fund revenue forecast with the additional expenditure levels intended to be funded by the special variation.</li> </ul> <p>Evidence to establish this criterion could include evidence of community need/desire for service levels/project and limited council resourcing alternatives. Evidence could also include analysis of council's financial sustainability conducted by Government agencies.</p>
<p><b>Criterion 2 – Community awareness</b></p> <p>Evidence that the community is aware of the need for and extent of a rate rise. The Delivery Program and Long Term Financial Plan should clearly set out the extent of the General Fund rate rise under the special variation. The council's community engagement strategy for the special variation must demonstrate an appropriate variety of engagement methods to ensure community awareness and input occur. The IPART fact sheet includes guidance to councils on the community awareness and engagement criterion for special variations. In particular, councils need to communicate the full cumulative increase of the proposed SV in percentage terms, and the total increase in dollar terms for the average ratepayer, by rating category.</p>
<p><b>Criterion 3 – Impact on ratepayers is reasonable</b></p> <p>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. The Delivery Program and Long Term Financial Plan should:</p> <ul style="list-style-type: none"> <li>▼ clearly show the impact of any rate rises upon the community</li> <li>▼ include the council's consideration of the community's capacity and willingness to pay rates, and</li> <li>▼ establish that the proposed rate increases are affordable having regard to the community's capacity to pay.</li> </ul>
<p><b>Criterion 4 – IP&amp;R documents are exhibited</b></p> <p>The relevant IP&amp;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.</p>
<p><b>Criterion 5 – Productivity improvements and cost containment strategies</b></p> <p>The IP&amp;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.</p>
<p><b>Criterion 6 – Additional matters</b></p> <p>IPART's assessment of the size and resources of the council, the size of the increase requested, current rate levels and previous rate rises, the purpose of the special variation and other relevant matters.</p>

Source: OLG Guidelines, November 2017, pp 7-9.

## B Expenditures to be funded from the special variation above the rate peg

Table B.1 shows Kempsey Council's proposed expenditure of the special variation funds over the next 10 years.

The council will use the additional special variation revenue, above the rate peg, of \$8.8 million over 10 years to fund the following projects (indicative costings in brackets):

- ▼ Flood mitigation works (\$520,000)
- ▼ Weed control (\$100,000)
- ▼ Coastal management (\$460,000)
- ▼ Estuary management (\$48,000)
- ▼ River management (\$190,000).<sup>27</sup>

The special variation revenue will also fund other environmental projects.

As a condition of IPART's approval, the council will indicate in its Annual Reports how its actual expenditure compares with this proposed program of expenditure.

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<sup>27</sup> Kempsey Shire Council, *Application Part A*, Worksheet 6, and Kempsey Shire Council, *Application Part B*, pp 39-40.

**Table B.1 Kempsey Shire Council – Income and proposed expenditure over 10-years related to the special variation**

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>Special variation income above assumed rate peg</b>	787,653	807,344	827,528	848,216	869,422	891,157	913,436	936,272	959,679	983,671	8,824,378
Funding for increased operating expenditures	590,740	605,508	620,646	636,162	652,066	668,368	685,077	702,204	719,759	737,753	6,618,284
Funding for capital expenditure	196,913	201,836	206,882	212,054	217,355	222,789	228,359	234,068	239,920	245,918	2,206,095
<b>Total expenditure</b>	787,653	807,344	827,528	848,216	869,422	891,157	913,436	936,272	959,679	983,671	8,824,378

**Note:** Numbers may not add due to rounding. Total special variation expenditure equals funding for increased operating expenditures plus funding for capital expenditure.

**Source:** Kempsey Shire Council, *Application Part A*, Worksheet 6.

## C Comparative indicators

### Performance indicators

Indicators of council performance may be considered across time, either for one council or for a group of similar councils, or by comparing similar councils at a point in time.

Table C.1 shows how selected performance indicators for Kempsey Council have changed over the four years to 2015-16. Table C.2 compares selected published and unpublished data about Kempsey Council with the averages for the councils in its OLG Group, and for NSW councils as a whole.

The tables below show that:

- ▼ both Full-Time Equivalent (FTE) staff and the average cost per FTE for Kempsey Council have risen since 2012-13 but remain below the OLG Group 4 and NSW average figures, and
- ▼ Kempsey's employee costs as a proportion of operating expenditure has risen since 2012-13 but is below the OLG Group 4 and NSW average figures.

**Table C.1 Trends in selected performance indicators for Kempsey Shire Council, 2012-13 to 2015-16**

Performance indicator	2012-13	2013-14	2014-15	2015-16	Average Annual change (%)
FTE staff (number)	302	286	298	307	0.5
Ratio of population to FTE	97	102	99	96	-0.3
Average cost per FTE (\$)	64,123	72,392	68,097	67,179	1.6
Employee costs as % operating expenditure (General Fund only)	30.5	29.3	30.3	35.7	N/A

**Note:** Except as noted, data is based upon total council operations that include General Fund, Water & Sewer and other funds, if applicable.

**Source:** OLG, unpublished data.

**Table C.2 Select comparative indicators for Kempsey Shire Council, 2015-16**

	Kempsey Council	OLG Group 4 average	NSW average
<b>General profile</b>			
Area (km <sup>2</sup> )	3,376	-	-
Population	29,454	-	-
General Fund operating expenditure (\$m)	47.7	63.1	70.2
General Fund operating revenue per capita (\$)	1,728	-	-
Rates revenue as % General Fund income	41.6	39.5	43.6
Own-source revenue ratio (%)	66.2	65.8	67.3
<b>Average rate indicators<sup>a</sup></b>			
Average rate – residential (\$)	938	1,013	1,017
Average rate – business (\$)	2,132	3,619	5,118
Average rate – farmland (\$)	1,865	2,029	2,366
<b>Socio-economic/capacity to pay indicators</b>			
Median annual household income (\$) <sup>b</sup>	46,488	62,656	77,272
Average residential rate to median income ratio (%)	2.0	1.6	1.3
SEIFA, 2016 (NSW rank: 130 is least disadvantaged)	4	-	-
Outstanding rates and annual charges ratio (%)	5.5	4.4	3.6
<b>Productivity (labour input) indicators<sup>c</sup></b>			
FTE staff (number)	307	343	354
Ratio of population to FTE	95.9	-	-
Average cost per FTE (\$)	67,179	79,862	83,193
Employee costs as % operating expenditure (General Fund only)	35.7	38.4	39.7

**a** Average rates equal total ordinary rates revenue divided by the number of assessments in each category.

**b** Median annual household income is based on 2016 ABS Census data.

**c** Data includes General Fund, Water & Sewer and other funds, if applicable (unless noted otherwise). There are difficulties in comparing councils using this data because councils' activities differ widely in scope and they may be defined and measured differently between councils.

**Note:** Except as noted, data is based upon total council operations for General Fund only.

**Source:** OLG, *Time Series Data 2015-2016*, OLG, unpublished data; ABS, *Socio-Economic Indexes for Areas (SEIFA) 2016*, March 2018, ABS, 2016 Census DataPacks, General Community Profile, Local Government Areas, NSW, *Median Weekly Household Income* and IPART calculations.