



Special variation increase

Upper Hunter 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.

Upper Hunter Shire Council applied for a multi-year special variation to:

- ▼ increase its general income by 6.3% in each year for 2018-19, 2019-20 and 2020-21, a cumulative increase of 20.1%, and
- ▼ retain this increase in its rate base permanently.¹

Under the council's application, minimum rates would increase by the rate peg.²

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 not approved Upper Hunter Shire Council's application for a special variation

We decided not to approve the special variation. Our decision means that the council may only raise its general income by the rate peg of 2.3% in 2018-19.

The council proposed to use the special variation revenue to repay long term loans to fund its town revitalisation projects, projects to increase and enhance community and family facilities and improve roads.³

If the council wishes to use additional rate revenue provided by a special variation to fund these projects, it could apply to IPART for a special variation in future years.

¹ Upper Hunter Shire Council, *Special Variation Application Form Part A 2018-19* (Upper Hunter Shire Council Application Part A), Worksheet 1.

² Upper Hunter Shire Council, *Special Variation Application Form – Part B for 2018-19* (Upper Hunter Shire Council, Application Part B), p 32.

³ Upper Hunter Shire Council, *Application Part B*, pp 8 and 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 does not meet all the criteria

Our decision reflects our finding that the council's application does not meet the requirements in the OLG criteria.

Our assessment against each criterion is summarised in Table 1.1.

Table 1.1 Assessment of Upper Hunter Shire Council's special variation application

1. Financial Need	
	<p>The council demonstrated the financial need for the special variation (SV):</p> <ul style="list-style-type: none"> Operating Performance Ratio (average 2018-19 to 2027-28) is: <ul style="list-style-type: none"> 2.5% with SV revenue, or -0.8% base case with SV expenditure. Net debt of \$4 million or 12.0% of income in 2017-18. This would increase to \$16.5 million or 47.4% of income by 2020-21 without the SV revenue and assuming SV expenditure proceeds. Infrastructure Renewal Ratio (average 2018-19 to 2026-27) is: <ul style="list-style-type: none"> 141.7% with SV revenue, or 114.7% base case without SV expenditure. Spending on infrastructure renewals is consistent with community priorities.
2. Community awareness	
	<p>The council's community consultation and IP&R documentation did not make clear the extent and impact of the rate increases. The council did not communicate:</p> <ul style="list-style-type: none"> the full cumulative impact of the rate rise over the three years in percentage terms, and the dollar impact on average ratepayers, by rating category. <p>Additionally, the:</p> <ul style="list-style-type: none"> delivery program did not mention the SV long term financial plan setting out the proposed SV was adopted in late January 2018 after the community consultation period had ended, which did not allow reasonable time for the community to provide meaningful feedback prior to the council making its special variation application. It did not mention the total cumulative increase nor the impact on ratepayers, and the public consultation materials did not disclose the total rate increase. Ratepayers had to put in a request to council to find out the expected rate impact.
3. Impact on ratepayers	
	<p>Impact on ratepayers will be substantial, but reasonable given:</p> <ul style="list-style-type: none"> average residential and business rates were lower than Group 11 and neighbouring councils median household incomes was higher than Group 11 and most neighbouring councils, and the rate to income ratio is lower than both Group 11 and neighbouring councils. <p>The council concluded the rate rise was affordable based on:</p> <ul style="list-style-type: none"> 2011 SEIFA ranking is average compared to other regions in NSW 44.6% residential and 44.4% business ratepayers pay the minimum rate, which will increase by the rate peg under the council's application, and lower average residential and business rates compared to Group 11 average.
4. IP&R documents exhibited	
	<ul style="list-style-type: none"> The Delivery Program did not refer to the SV nor identify the requested SV. The council did not adequately update its IP&R documentation to communicate the full impact and extent of the proposed SV and allow for community feedback.
5. Productivity improvements and cost containment	
	<p>Over the past three years, the council has realised annual savings from initiatives including:</p> <ul style="list-style-type: none"> realigning the council's organisational structure (\$250,000), and environmental sustainability projects for solar energy (\$34,000). <p>The council also estimates annual cost savings from future initiatives including:</p> <ul style="list-style-type: none"> a productivity and service review (\$280,000), and further solar energy projects (\$100,000).

1.3 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.
- ▼ Chapter 4 discusses how our decision will impact the council and ratepayers.

2 Upper Hunter Shire Council's application

Upper Hunter Shire Council applied for a special variation to increase its general income by a cumulative 20.1%, or 12.6% above the assumed rate peg, over the 3-year period from 2018-19 to 2020-21, and to permanently retain this increase in its general income base.⁴ As required under the OLG Guidelines,⁵ the council applied for the special variation on the basis of its most recent, adopted Integrated Planning and Reporting (IP&R) documents, in particular the:

- ▼ Community Strategic Plan 2027 (Community Strategic Plan)
- ▼ Delivery Program 2017/18 – 2020/21 and Operational Plan 2017/18 (Delivery Program), and
- ▼ Long Term Financial Plan 2017/18- 2026/27 (LTFP).

More detail relating to the IP&R documentation is provided in Sections 3.2 and 3.4.

The council estimated if the requested special variation were approved, its permissible general income would increase from \$10.55 million in 2017-18 to \$12.67 million in 2020-21. Over the 3-year period of the special variation to 2020-21, this would generate additional revenue of \$2.61 million compared to rate increases at the assumed rate peg. This figure would increase to \$12.93 million over a 10-year period, as the additional revenue raised would remain permanently in the council's rate base.⁶

The council indicated it intended to use the additional revenue to fund principal and interest repayments on a \$15 million loan facility to be repaid over 15 years. The council indicated the loan facility is to fund specific projects to revitalise town centres, enhance community and family facilities, improve roads, and improve financial sustainability. The council's LTFP indicates that over the period 2018-19 to 2027-28 it proposes to spend the additional \$12.93 million special variation revenue as follows:

- ▼ \$3.95 million on loan interest payments, and
- ▼ \$8.97 million on loan principal repayments.⁷

The council's LTFP and Special Rate Variation Potential Projects list indicate it proposes to spend the \$15 million in borrowings for:

- ▼ \$10.21 million on revitalising Murrurundi, Scone, Aberdeen and Merriwa
- ▼ \$2.03 million on community and family infrastructure, and
- ▼ \$3.00 million on renewing roads and causeways.⁸


⁴ Upper Hunter Shire Council, *Application Part A*, Worksheet 1.

⁵ OLG Guidelines, November 2017, p 6.

⁶ Upper Hunter Shire Council, *Application Part A*, Worksheet 1 and Worksheet 7.

⁷ Upper Hunter Shire Council, *Application Part A*, Worksheet 6 and Upper Hunter Shire Council, *Application Part B*, pp 7, 10 and 17.

⁸ Upper Hunter Shire Council, *Long Term Financial Plan 2017/18- 2026/27*, p 16 and Upper Hunter Shire Council, *Attachment 6 – Community Engagement Strategy Proposed Special Rate Variation (SRV) 2018/19* (Attachment 6 – SRV Community Engagement Information), pp 15-16.



More detail on the council's proposed program of expenditure to 2027-28 is provided in Appendix B.

3 IPART's assessment

To make our decision, we assessed Upper Hunter Shire Council's application against the criteria in the OLG Guidelines. We also considered the council's most recent IP&R documents and a range of comparative data about the council set out in Appendix C.⁹

We found that Upper Hunter Shire Council's application did not fully meet the requirements of the criteria. We were not satisfied that the council demonstrated community engagement and awareness of the rate rise, nor were the council's IP&R documents adequately exhibited. In particular, the council did not adequately communicate the full extent and impact of the special variation.

Our assessment of the council's application against the criteria is summarised in Table 1.1 and discussed in more detail in the sections below.

3.1 The council demonstrated financial need for the special variation

We found that Upper Hunter Shire Council's LTFP clearly set out the need for, and purpose of the requested special variation, which is to achieve the Upper Hunter Shire 'Community Priorities' detailed in the council's Community Strategic Plan and Delivery Program and Operational Plan.

The council's IP&R documents indicate the community's priorities were for Upper Hunter Shire Council to work on:

- ▼ revitalising town centres
- ▼ improving and maintaining roads and bridges
- ▼ adding family and community infrastructure such as sporting fields and parks
- ▼ maintaining community facilities at a safe and reliable standard, and
- ▼ meeting the Fit For the Future benchmarks for financial sustainability.¹⁰

More detail on the IP&R documentation is available in Section 3.4.

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

⁹ See Appendix C. Upper Hunter Shire Council is in OLG Group 11, which is classified as Rural Very Large. The group comprises councils such as Bellingen Shire, Muswellbrook Shire, Inverell Shire and Gunnedah Shire.

¹⁰ Upper Hunter Shire Council, *Community Strategic Plan 2027*, p 21.

3.1.1 Impact on council's operating performance

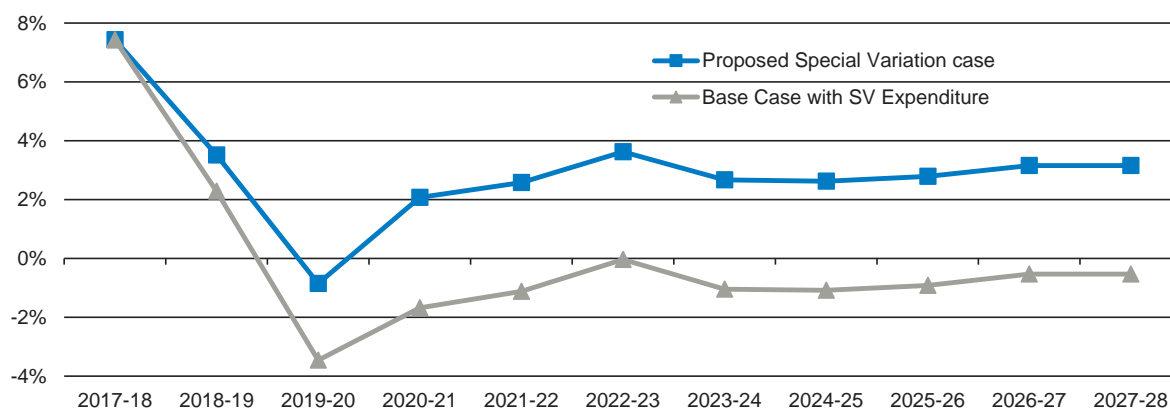
The operating performance ratio (OPR) measures whether a council's revenues fund its costs. The OPR is defined as:

$$OPR^{11} = \frac{\text{Total operating revenue} - \text{operating expenses}}{\text{Total operating revenue}}$$

Under the special variation scenario, the council forecasts continuing operating surpluses, growing to 3.2% by 2027-28. The cumulative value of these forecast surpluses is \$9.92 million to 2027-28.¹² These surpluses would allow the council to make loan repayments to fund its proposed expenditure, and provide more infrastructure to service the community.

Without the special variation and assuming the council's expenditure is the same as under the special variation scenario, it forecasts consistent operating deficits, as shown by the 'Base case with SV expenditure' scenario in Figure 3.1 and Table 3.1. The cumulative value of these forecast deficits (before capital grants and contributions) is \$3.00 million to 2027-28.¹³ As discussed in Section 2, the council estimates loan principal and interest payments of \$12.93 million over the 10-year period to 2027-28 to fund its proposed expenditure. Hence, without the special variation, the council's sustainability would deteriorate, and the council may not generate sufficient funds to repay its loans whilst also improving infrastructure and services over the long term.

Figure 3.1 Upper Hunter 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: Upper Hunter Shire Council, *Application Part A*, Worksheet 7 and IPART calculations.

¹¹ Expenditure and revenue in the OPR measure are exclusive of capital grants and contributions. This OPR calculation includes net losses from infrastructure disposals arising from road resealing works.

¹² Upper Hunter Shire Council, *Application Part A*, Worksheet 7.

¹³ Upper Hunter Shire Council, *Application Part A*, Worksheet 7.

Table 3.1 Projected operating performance ratio (%) for Upper Hunter Shire 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	3.5	-0.9	2.1	2.6	3.6	2.7	2.6	2.8	3.2	3.2
Base case with SV expenditure	2.3	-3.5	-1.7	-1.1	0.0	-1.0	-1.1	-0.9	-0.5	-0.5

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. This OPR calculation includes net losses from infrastructure disposals arising from road resealing works.

Source: IPART calculations based on Upper Hunter Shire Council, *Application Part A*, Worksheet 7.

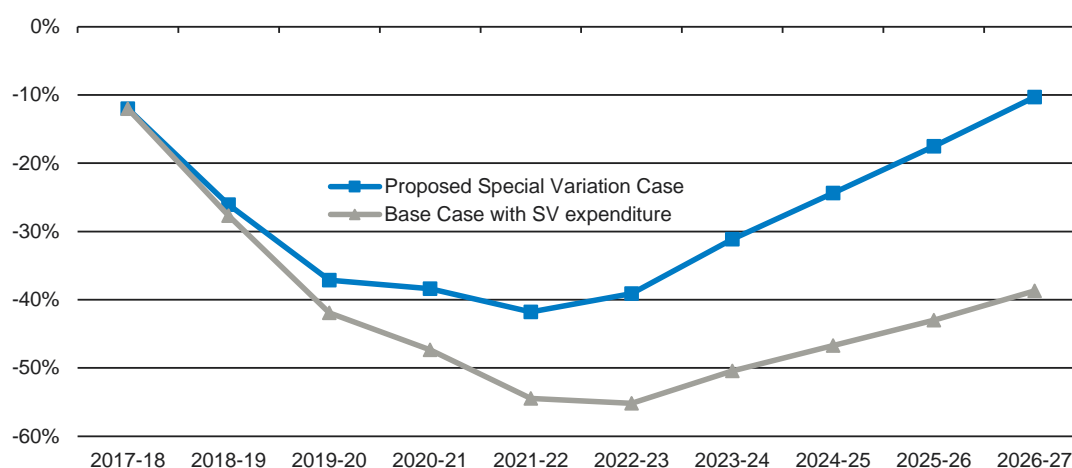
3.1.2 Impact on council's net debt

Net debt is the book value of the council's gross debt less any cash and cash-like assets on the balance sheet. Net debt shows how much debt the council has on its balance sheet if it pays all its debt obligations within its existing cash balances. Over time, a change in net debt is an indicator of council's financial performance and sustainability on a cash basis.

Figure 3.2 shows the council's net debt position, as a percentage of total income over the next 10 years assuming:

- ▼ special variation expenditure and revenue (Proposed Special Variation Case), and
- ▼ special variation expenditure, but without the additional special variation revenue (Base Case with SV expenditure).

Figure 3.2 Upper Hunter Shire Council's Net Debt^a to Income Ratio (%) (2017-18 to 2026-27)



a Net debt is the book value of the council's gross debt less any cash and cash-like assets on the balance sheet. Cash includes cash, cash equivalents and current investments. Total cash includes externally restricted, internally restricted and unrestricted funds.

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

Source: Upper Hunter Shire Council, *Application Part A*, Worksheet 7; Email to IPART, Upper Hunter Shire Council, 19 February 2018 and IPART calculations.

We calculate the council's net debt¹⁴ is \$4.25 million or 12% of income in 2017-18.¹⁵ With the special variation revenue, net debt would be \$13.86 million or 38% of income by 2020-21. Over the longer term, with the special variation revenue, net debt would decrease to \$4.33 million and net debt to income would return to 10% of income by 2026-27 as the council repays its loan and builds cash reserves.¹⁶

Without the special variation, and assuming the council's expenditure is the same as under the special variation scenario, we calculate that net debt would grow to \$16.47 million or 47% of income by 2020-21. By 2026-27, net debt is forecast to be \$15.67 million or 39% of income as shown in Figure 3.2.¹⁷ Hence, without the special variation revenue, the council's net debt levels will increase over the medium term and gradually increase over the longer term, but at a slower rate than with the special variation revenue.

3.1.3 Impact on council's infrastructure renewal

The council estimates it will spend \$10.65 million on infrastructure renewals in 2017-18.¹⁸ Measured against the rate at which infrastructure is depreciating, the infrastructure renewal ratio¹⁹ for 2017-18 is 240.5%.²⁰ This is above the FFTF benchmark of greater than 100%. However, the council forecasts spending on renewals will fall.

With the special variation the council meets the benchmark, averaging at 141.7% to 2026-27. Without the special variation the council forecasts it will still meet the benchmark, averaging at 114.7% over the same period.²¹

However, with the special variation, the council forecasts it will be able to undertake a higher level of renewals. Based on the feedback obtained during community consultation, the council concluded the community would not want a lowering in the standard of public infrastructure and would, in fact, like to see asset quality increased.²² Hence, spending more on infrastructure renewals is consistent with the community's priorities. Without the special variation revenue, the council may be less able to meet those priorities over the long term.

Table 3.2 below shows the projected infrastructure renewal ratio including and excluding the special variation.

¹⁴ Net debt equals cash plus cash equivalents less borrowings. A net debt position means that the council has more debt than cash and cash-like investments.

¹⁵ This analysis includes current investments. Of the \$28.21 million in cash, cash equivalents and investments: \$18.21 million is externally restricted, \$9.95 million is internally restricted and \$0.06 million is unrestricted for 2016-17. See: Upper Hunter Shire Council, *General Purpose Financial Statements for the year ended 30 June 2017*.

¹⁶ Upper Hunter Shire Council, *Application Part A*, Worksheet 7 and Email to IPART, Upper Hunter Shire Council, 19 February 2018.

¹⁷ Upper Hunter Shire Council, *Application Part A*, Worksheet 7 and Email to IPART, Upper Hunter Shire Council, 19 February 2018.

¹⁸ Asset renewals represent the replacement and/or refurbishment of existing assets to an equivalent capacity/performance as opposed to the acquisition of new assets (or refurbishment of old assets) that increases capacity/performance.

¹⁹ The asset renewal ratio is defined as spending on asset renewals divided by depreciation, amortisation and impairment.

²⁰ Email to IPART, Upper Hunter Shire Council, 19 February 2018.

²¹ Email to IPART, Upper Hunter Shire Council, 19 February 2018.

²² Upper Hunter Shire Council, *Application Part B*, p 18.

Table 3.2 Projected infrastructure renewal ratio (%) for Upper Hunter Shire Council's special variation application

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	Average
Application including SV	214.4	244.5	144.8	161.7	131.8	86.9	99.5	88.1	103.7	141.7
Excluding SV	182.6	165.0	83.8	99.3	102.5	92.1	105.0	92.9	109.1	114.7

Source: Email to IPART, Upper Hunter Shire Council, 19 February 2018.

3.1.4 Alternative funding strategies

In recent years, the council has implemented a number of alternative revenue raising and cost containment strategies to improve financial sustainability. Key strategies include:

- ▼ reviewing its loan portfolios annually against prevailing market conditions,²³ and
- ▼ planning for town revitalisation projects to improve property values across Upper Hunter Shire.²⁴

The council is also undertaking reviews of its operations and management on an ongoing basis in an effort to achieve further operational efficiencies and savings in service delivery. Future initiatives include:

- ▼ a productivity improvement and service review to be completed for projects relating to the maintenance of open space and roads,²⁵ and
- ▼ consulting with the community, through council committees to determine the right mix of council services.²⁶

The council considered grant funding as an alternative funding option to the \$15 million loan and concluded that grant funding is uncertain. It further concluded:

- ▼ borrowing is the only assured funding option to undertake major projects, and
- ▼ since it is a small council with a limited revenue base, the only way to repay loan borrowings is through revenue derived from a special rate variation.²⁷

Refer to Section 3.5 for more details on the council's productivity improvements and cost containment strategies.

²³ Upper Hunter Shire Council, *Application Part B*, p 43.

²⁴ Upper Hunter Shire Council, *Application Part B*, p 17.

²⁵ Upper Hunter Shire Council, *Application Part B*, p 43.

²⁶ Upper Hunter Shire Council, *Application Part B*, p 44.

²⁷ Upper Hunter Shire Council, *Application Part B*, p 16.

3.2 The council did not demonstrate community engagement and awareness

We found that Upper Hunter Shire Council did not demonstrate that its community is aware of the need for and extent of the proposed rate increase.

In IPART's fact sheet on the community engagement and awareness criterion,²⁸ we indicate that councils should clearly communicate the **full impact** of the proposed rate increases to ratepayers. In particular, councils need to show:

- ▼ the cumulative percentage impact of the special variation on rates, and
- ▼ the total rate increase in dollar terms and on an annual basis.

Upper Hunter Shire Council's IP&R documentation and public materials did not meet these requirements in detailing the full impact of the rate rise under the proposed special variation. In particular, the council did not show:

- ▼ the 20.1% cumulative percentage impact of the special variation on rates, and
- ▼ the 6.3% rate increases on an annual basis in a consistent manner.

For these reasons we consider the council has not satisfied this criterion.

3.2.1 IP&R documents did not clearly disclose the total cumulative rate increase nor the impact on ratepayer categories

The OLG guidelines²⁹ require councils to engage the community regarding the special variation through its IP&R documents. Upper Hunter Shire Council sought community feedback on the proposed special variation during its consultation period from November 2017 up to 15 January 2018. The council's IP&R documents over this period did not disclose the impact of the special variation in percentage terms, nor the total increase in dollar terms for the average ratepayer, by rating category.

The council's Delivery Program did not discuss its special variation application.

The council adopted and exhibited its LTFP with the proposed special variation on 29 January 2018 after its public consultation period had ended.³⁰ However, this timing would not have allowed the community the opportunity to provide meaningful feedback to the council prior to it applying for the special variation.

In addition, the exhibited LTFP does not disclose the size nor the cumulative impact of the rate rise. In the first instance, the council's LTFP refers to the proposed special variation as:

"Permanent SRV for 6.30% cumulative over 3 years".³¹

²⁸ IPART Fact Sheet, *Community awareness and engagement for special variations*, November 2017, pp 2-5. The content in this document is the same as the fact sheet for the 2017-18 special variations, which was also available as guidance material on our website during Upper Hunter Shire Council's period of community consultation with its ratepayers. Further, the OLG guidelines specifically direct councils to the IPART fact sheet (see page 8 of the OLG Guidelines).

²⁹ OLG Guidelines, pp 6-9.

³⁰ Upper Hunter Shire Council, *Application Part B*, p 40.

³¹ Upper Hunter Shire Council, *Long Term Financial Plan 2017/18- 2026/27*, p 2.

Based on this, ratepayers could have inferred that Upper Hunter Shire Council was applying for a special variation of 6.3% cumulative over a 3-year period, rather than three years of increasing rates by 6.3% annually (or 20.1% cumulative).

In the second instance, the council's LTFP refers to the proposed special variation as:

IPART rate pegging plus SRV at 4.0% for 3 years with a low farmland SRV of 1.25% under the LTFP assumption of 2.30% rate pegging³²

Again, this did not disclose the 20.1% total cumulative increase, nor the total increase or dollar impact on ratepayers.

3.2.2 Public materials did not clearly disclose the per year rate increase, total cumulative rate increase nor impact on ratepayer categories

The council used a variety of methods to engage with its community on the proposed special variation, and provided reasonable opportunities for community feedback, including:

- ▼ the council website
- ▼ media releases including press releases, advertisements, a council newsletter and radio
- ▼ a 'Have Your Say' resident brochure distributed to every household, and
- ▼ community pop-up stalls.³³

However, the council's public material during its consultation period consistently proposed it may apply for a 3-year period "SRV at 4% plus rate pegging".³⁴ Based on this, ratepayers may not have clearly determined this would mean its proposal was for a special variation of 6.3% per year for 3 years; or 20.1% in total. In addition, the public materials did not clearly communicate the average dollar impact for the ratepayer, by rating category.

The council developed a spreadsheet calculator to estimate the impact of the special variation options proposed during its consultation period. We note it advertised for ratepayers to contact the council for an individual assessment of the impact on their rates. The "Potential Special Rate Variation for 2018/2019" survey and media releases encouraged residents to provide their address and contact details for the council to respond with an estimate. Residents were able to access the survey at community pop-up stalls, on the council's website and at council customer service centres.³⁵ However, the annual increases for the average ratepayer were not clearly communicated. Under this method, ratepayers are responsible for obtaining the impact on their rates directly from the council.

³² Upper Hunter Shire Council, *Long Term Financial Plan 2017/18- 2026/27*, p 15.

³³ Upper Hunter Shire Council, *Application Part B*, pp 24-25.

³⁴ For example, see Upper Hunter Shire Council, *Attachment 6 – SRV Community Engagement Information*, p 20.

³⁵ Upper Hunter Shire Council, *Application Part B*, p 25 and Upper Hunter Shire Council, *Attachment 6 – SRV Community Engagement Information*, p 21.

3.2.3 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. Upper Hunter Shire Council's consultation indicated its community's preference was for it to focus on revitalising town centres, family and community facilities projects, including improving sporting facilities and major roads.³⁶

Based on this outcome, the council decided to apply for the special variation.

3.2.4 Submissions from the community

The council received 126 written submissions in relation to the special variation application, including 46 opposing the application and 65 in favour (with the remaining submissions related to general comments).³⁷

The main reasons for opposition were:

- ▼ unwillingness to pay above the current rates
- ▼ concern related to affordability of paying rate increases
- ▼ views that the council should reassess its spending, and
- ▼ disagreement on the proposed projects to be undertaken with the special variation revenue.

The main reasons for support expressed:

- ▼ support for town revitalisation
- ▼ improvements to sporting and community facilities were highly valued, and
- ▼ upgrades to roads were a priority.

The council considered its community's feedback by responding to these concerns during the community consultation process.³⁸

IPART received 158 submissions (mostly opposing the application),³⁹ mainly on the grounds that:

- ▼ the rate increases would be unaffordable
- ▼ the council should more effectively manage their spending and be more cost efficient
- ▼ there was inadequate community consultation, and
- ▼ the projects proposed to be undertaken with a loan and repaid by the additional special variation revenue were not considered important.

³⁶ Upper Hunter Shire Council, *Application Part B*, p 13.

³⁷ Upper Hunter Shire Council, *Application Part B*, pp 11-12 and Email to IPART, Upper Hunter Shire Council, 12 March 2018.

³⁸ Upper Hunter Shire Council, *Application Part B*, p 10.

³⁹ We also received some submissions outside our consultation period.

3.3 The impact on ratepayers is reasonable

As Chapter 2 discussed, Upper Hunter Shire Council requested a 3-year cumulative increase of 20.1% that will remain permanently in the rate base.

We found the impact of these increases on ratepayers would be substantial but reasonable, given the:

- ▼ average residential and business rates were lower than the OLG Group 11 average
- ▼ median annual household income was higher than the OLG Group 11 average
- ▼ average rate to median income was lower than the OLG Group 11 average, and
- ▼ the council's financial sustainability.

3.3.1 Council's consideration of impact on ratepayers

The council considers the existing community has the willingness and capacity to pay. It examined socio-economic indicators to assess the impact on ratepayers such as:

- ▼ the 2011 SEIFA (index 967)⁴⁰ suggests Upper Hunter is not an unduly disadvantaged area, and
- ▼ an average rates comparison performed by the Office of Local Government's 2012/13 Councils Comparative Information. This showed that Upper Hunter had lower average residential (\$610) and lower business (\$960) rates than the OLG Group 11 average rates for residential (\$653) and business (\$1,891).⁴¹

The council also indicated the majority of ratepayers with less capacity to pay the rates rise may be on the minimum rate, which will increase by the rate peg under its proposal.⁴² Approximately 44% of residential and business rates are on minimum rates.⁴³

The council also noted the impact of a past special variation has been more significant on farmland ratepayers due to the higher value of their land. Therefore, it has included a further measure to reduce the impact of the proposed special variation, by only applying a 1.25% increase above the rate peg for the farmland category.⁴⁴

The council submitted it also has a hardship policy that may assist ratepayers with:

- ▼ reducing interest charges applied to outstanding rate payments, and
- ▼ writing off rates for pensioners in particular circumstances.⁴⁵

Based on the socio-economic indicators and additional considerations, the council concluded the community has the willingness and capacity to pay.

⁴⁰ Upper Hunter Shire Council, *Application Part B*, p 33. The council's SEIFA Index NSW rank was 86, where 153 was the highest rank in 2011.

⁴¹ Upper Hunter Shire Council, *Application Part B*, p 33.

⁴² Upper Hunter Shire Council, *Application Part B*, p 33.

⁴³ Upper Hunter Shire Council, *Application Part B*, p 32.

⁴⁴ Upper Hunter Shire Council, *Application Part B*, p 35.

⁴⁵ Upper Hunter Shire Council, *Application Part B*, p 34.

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 successfully applied for one special variation in 2013-14 over 3-years, a cumulative increase of 17.9%, retained in its rate base permanently. This was used to fund loan repayments for a program of upgrades to road and bridge infrastructure, and
- ▼ the average annual growth in residential rates is 5.16%, 1.84% for business rates and 4.21% for farmland rates, which compares with the average annual growth in the rate peg of 2.71% over the same period.

We also compared current rates and socio economic indicators in Upper Hunter with neighbouring councils and OLG Group 11 councils as shown in Table 3.3.

Table 3.3 Upper Hunter Shire Council - comparison of rates and socio-economic indicators with neighbouring councils and Group 11 averages (2015-16)

Council (OLG Group)	Average residential rate (\$) ^a	Average business rate (\$)	Median annual household income 2016 ^b	Average rate to median income ratio (%)	Outstanding rates ratio (%)	SEIFA Index NSW Rank ^c
Dungog Shire (10)	794	866	63,752	1.2	3.6	83
Liverpool Plains Shire (10)	624	1,294	53,664	1.2	7.5	15
Mid-Western Regional (4)	820	1,793	58,812	1.4	3.6	44
Muswellbrook Shire (11)	722	1,859	69,992	1.0	5.3	22
Upper Hunter Shire (11)	714	863	64,584	1.1	6.5	67
OLG Group 11	720	1,863	60,274	1.2	4.7	-

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

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.

We found that Upper Hunter Shire Council's:

- ▼ average residential rate was lower than the average for Group 11 councils and also below most neighbouring councils
- ▼ average business rate was substantially lower than the average for Group 11 councils and also below its neighbouring councils
- ▼ ratepayers had higher median household incomes in 2016 than the average for Group 11 councils and higher than most neighbouring councils, and

- ▼ average rate to income ratio was lower than the average for Group 11 councils and lower than most neighbouring councils.

Taking all these factors into account, we consider the impact of the increases is substantial, but reasonable.

3.4 The council's IP&R documents were not adequately exhibited

The council exhibited its Community Strategic Plan, Delivery Program and Operational Plan on 27 April 2017 and adopted the documents in June 2017.⁴⁶ It sought community feedback on the proposed special variation during its consultation period from November 2017 up to 15 January 2018.⁴⁷

Under the IP&R framework, the Delivery Program and Long Term Financial Plan are key documents. Given the importance of the Delivery Program and LTFP under the IP&R documents, criterion 4 of the special variation guidelines published by OLG⁴⁸ requires:

The relevant IP&R documents⁴⁹ 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.

Additionally, criteria 1 to 3 in the OLG Guidelines make specific reference to requirements of the Delivery Program and LTFP. More detail on the criteria in the Guidelines is available in Appendix A.

Upper Hunter Shire Council's Delivery Program did not discuss its special variation application. We note that the Delivery Program refers to the council's objective to translate the community's priorities and strategies from the Community Strategic Plan into actions. However, based on the Delivery Program alone, the council's intention to apply for the special variation is not clearly identified. Specifically, the Delivery Program did not clearly set out:

- ▼ the need for, and purpose of the requested special variation (criterion 1)
- ▼ extent of the rate rise under the special variation (criterion 2), and
- ▼ the impact on affected ratepayers of the special variation (criterion 3).

In addition, the council's LTFP disclosing the special variation was adopted and exhibited on 29 January 2018 after the community consultation period had ended.⁵⁰ This would not have allowed the community reasonable time to provide meaningful feedback prior to the council making its special variation application.

Although the special variation was disclosed in the LTFP (criterion 1), it did not clearly communicate the full impact of the proposed rate increases to ratepayers. As discussed in

⁴⁶ Upper Hunter Shire Council, *Application Part B*, pp 38-39.

⁴⁷ Upper Hunter Shire Council, *Attachment 6 – SRV Community Engagement Information*, pp 9 and 18-19.

⁴⁸ Office of Local Government, *Guidelines for the preparation of an application for a special variation to general income*, November 2017 (the Guidelines), p 9.

⁴⁹ The relevant documents are the Community Strategic Plan, Delivery Program, and Long Term Financial Plan and where applicable, Asset Management Plan. Of these, the Community Strategic Plan and Delivery Program require (if amended) public exhibition for 28 days. It would also be expected that the Long Term Financial Plan (General Fund) be posted on the council's web site.

⁵⁰ Upper Hunter Shire Council, *Application Part B*, p 40.

Section 3.2, the LTFP did not disclose the 20.1% total cumulative increase nor did it set out the impact on ratepayers in dollar or percentage terms. In particular, it did not show the:

- ▼ extent of the rate rise under the special variation (criterion 2), and
- ▼ impact on affected ratepayers of the special variation (criterion 3).

For these reasons we consider the council has not satisfied this criterion.

3.5 The council explained its productivity improvements and cost containment strategies

Upper Hunter Shire 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 cost savings and cost containment initiatives undertaken in the past few years have generated savings for the council. Some of the examples provided include:

- ▼ realignment of the council's organisational structure to establish refocused and more cost effective business units with annual costs savings of \$250,000⁵¹
- ▼ establishing a Sustainability Advisory Committee for environmental initiatives relating to installing solar panels with annual costs savings of \$34,000,⁵² and
- ▼ planning for town revitalisation projects to improve property values across the Upper Hunter Shire.⁵³

In addition, it has identified some additional future cost savings strategies including:

- ▼ a productivity improvement and service review to be completed in 2018 for projects relating to maintenance of open space and roads with annual savings of \$280,000⁵⁴
- ▼ reviewing major energy sites to install solar power with annual cost savings of \$100,000,⁵⁵ and
- ▼ potentially disposing excess operational land for proceeds of \$750,000 with annual cost savings of \$30,000.⁵⁶

⁵¹ Upper Hunter Shire Council, *Application Part B*, p 41 and Email to IPART, Upper Hunter Shire Council, 9 March 2018.

⁵² Upper Hunter Shire Council, *Application Part B*, p 43 and Email to IPART, Upper Hunter Shire Council, 9 March 2018.

⁵³ Upper Hunter Shire Council, *Application Part B*, p 17.

⁵⁴ Upper Hunter Shire Council, *Application Part B*, p 43 and Email to IPART, Upper Hunter Shire Council, 9 March 2018.

⁵⁵ Email to IPART, Upper Hunter Shire Council, 9 March 2018.

⁵⁶ Email to IPART, Upper Hunter Shire Council, 9 March 2018.

4 Our decision's impact on the council and ratepayers

Our decision means that Upper Hunter Shire Council may increase its general income up to the rate peg (2.3%) in 2018-19. It is to determine how the rate peg increase will be distributed among ratepayer categories.

If the council wishes to use additional rates revenue provided by a special variation to fund future projects, it could apply to IPART for a special variation in future years.



Appendices



A Assessment criteria for special variation applications

Table A.1 Assessment criteria for special variation applications

Assessment criteria
<p>Criterion 1 – Financial need</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&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&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"> ▼ Baseline scenario – General Fund revenue and expenditure forecasts which reflect the business as usual model, and exclude the special variation, and ▼ 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. <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>Criterion 2 – Community awareness</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>Criterion 3 – Impact on ratepayers is reasonable</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"> ▼ clearly show the impact of any rate rises upon the community ▼ include the council's consideration of the community's capacity and willingness to pay rates, and ▼ establish that the proposed rate increases are affordable having regard to the community's capacity to pay.
<p>Criterion 4 – IP&R documents are exhibited</p> <p>The relevant IP&R documents must be exhibited (where required), approved and adopted by the council before the council applies to IPART for a special variation to its general income.</p>
<p>Criterion 5 – Productivity improvements and cost containment strategies</p> <p>The IP&R documents or the council's application must explain the productivity improvements and cost containment strategies the council has realised in past years, and plans to realise over the proposed special variation period.</p>
<p>Criterion 6 – Additional matters</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 Upper Hunter Shire Council's proposed expenditure of the special variation funds over the next 10 years.

The council would have used the additional special variation revenue, above the rate peg, of \$12.93 million, over 10 years to:

- ▼ make principal and interest loan repayments of \$12.93 million for \$15.00 million of borrowing facilities taken to fund specific projects to revitalise town centres, increase and enhance community and family facilities, and improve roads.⁵⁷

The council endorsed a Special Rate Variation Potential Projects list on 30 October 2017.⁵⁸ The council indicated that if Upper Hunter Shire were successful in obtaining a special variation, further community engagement would be carried out to finalise the special rate variation projects list to ensure the community's priorities for each town centre and the shire are reflected.⁵⁹ The \$15.00 million of proposed projects from the loan facility are:

- ▼ \$10.21 million on revitalising Murrurundi, Scone, Aberdeen and Merriwa by improving public toilets, shop front awnings, street furniture and constructing footpaths, roundabouts, kerb returns, street banners and signs
- ▼ \$2.03 million on community and family infrastructure including upgrading dog off-leash areas, improving cycleway, fencing of playground and picnic areas and improving bike and skate parks, and
- ▼ \$3.00 million on renewing roads in Moonan Brook, and concreting causeways in Upper Rouchel, Merriwa and Dry Creek.⁶⁰

⁵⁷ Upper Hunter Shire Council, *Application Part A*, Worksheet 6 and Upper Hunter Shire Council, *Application Part B*, p 16.

⁵⁸ Upper Hunter Shire Council, *Application Part B*, p 10.

⁵⁹ Upper Hunter Shire Council, *Application Part B*, p 13.

⁶⁰ Upper Hunter Shire Council, *Attachment 6 - SRV Community Engagement Information*, pp 14-16. See Special Rate Variation – Potential Projects.

Table B.1 Upper Hunter Shire Council – Income and proposed expenditure over 10 years related to the special variation (\$000)

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Special variation income above assumed rate peg	422	859	1,333	1,366	1,400	1,435	1,471	1,508	1,546	1,585	12,926
Funding for new/enhanced service levels - loan interest	178	349	512	493	472	449	422	393	360	324	3,951
Loan principal repayments	244	510	821	873	928	987	1,049	1,115	1,186	1,261	8,974
Total expenditure	422	859	1,333	1,366	1,400	1,436	1,471	1,508	1,546	1,585	12,925

Note: Numbers may not add due to rounding.

Source: Upper Hunter 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 Upper Hunter Shire Council have changed over the four years to 2015-16. Table C.2 compares selected published and unpublished data about Upper Hunter Shire Council with the averages for the councils in its OLG group, and for NSW councils as a whole.

Overall, the tables below show that:

- ▼ average costs per full-time equivalent (FTE) staff at Upper Hunter were lower than both the OLG Group 11 average and NSW average in 2015-16, and
- ▼ while the council's average staff cost per FTE has increased by 4% since 2012-13, the employee costs as a percentage of operating expenditure were on par with the OLG group average and lower than the NSW average in 2015-16.

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

Performance indicator	2012-13	2013-14	2014-15	2015-16	Average annual change (%)
FTE staff (number)	192	193	198	202	1.7
Ratio of population to FTE	75	75	74	71	-1.7
Average cost per FTE (\$)	64,307	70,549	72,101	72,426	4.0
Employee costs as % of operating expenditure (General Fund only)	33.9	34.8	38.2	38.0	N/A

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

Source: OLG, unpublished data and IPART calculations.

Table C.2 Select comparative indicators for Upper Hunter Shire Council, 2015-16

	Upper Hunter Shire Council	OLG Group 11 average	NSW average
General profile			
Area (km ²)	8,096	-	-
Population	14,409	-	-
General Fund operating expenditure (\$m)	30.5	28.0	70.2
General Fund operating revenue per capita (\$)	2,307	-	-
Rates revenue as % of General Fund income	37.3	33.7	43.6
Own-source revenue ratio (%)	62.0	57.2	67.3
Average rate indicators^a			
Average rate – residential (\$)	714	720	1,017
Average rate – business (\$)	863	1,863	5,118
Average rate – farmland (\$)	3,356	2,871	2,366
Socio-economic/capacity to pay indicators			
Median annual household income, 2016 (\$) ^b	64,584	60,274	77,272
Average residential rate to median income ratio (%)	1.1	1.2	1.3
SEIFA, 2016 (NSW rank: 130 is least disadvantaged)	67	-	-
Outstanding rates and annual charges ratio (%)	6.5	4.8	3.6
Productivity (labour input) indicators^c			
FTE staff (number)	202	165	354
Ratio of population to FTE	71.3	-	-
Average cost per FTE (\$)	72,426	74,013	83,193
Employee costs as of % operating expenditure (General Fund only)	38.0	38.0	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.