Business Paper

Extraordinary Council Meeting

Monday, 26 November 2018

6:30pm

Council Chambers,

Level 2, Administration Building,

4-20 Eton Street, Sutherland

ORDER OF BUSINESS

1. ACKNOWLEDGEMENT OF COUNTRY

2. APOLOGIES

3. DISCLOSURES OF INTEREST

4. MAYORAL MINUTES

5. BUSINESS FOR PURPOSE FOR WHICH THE MEETING WAS CALLED

The business to be transacted at the Meeting will be to consider the following report:

COR043-18 Council Rating for 2019/20

COR043-18 COUNCIL RATING FOR 2019/20

Attachments: Nil

EXECUTIVE SUMMARY

- This report has been reissued for Council's consideration, following the deferral of report COR042-18 at the Council meeting on 19 November 2018.
- Council must adopt a rating model for 2019/20.
- The rating models that are proposed in this report are:
    - Increase Rates by the Rate Pegging Limit only;
    - Increase Minimum Rates and apply the Rate Pegging Limit to Other Properties
    - Increase Minimum Rates and increase all other Properties above the rate peg;
- As a comparison, the minimum rates for apartment units in Sutherland Shire are lower than other similar beach or bay side councils.
- Council must also adopt additional financial strategies to fully address its long term financial position, such as efficiency improvements, user fee and charge review and asset consolidation.
- Council must deal with specific challenges of increased population growth, labour costs, asset renewal and maintenance and external and non-core factors.
- Council currently offers pensioners a voluntary rate rebate, in addition to the mandatory rebate, and has the discretion to offer further rebates to affected pensioners to reduce the impact of any potential rate increase.
- A recent survey of the community found that 76% of respondents believed that the amount of rates paid to Council should be fair between houses and apartments.
- If Council determines to proceed with an application for a special rate variation for 2019/20, it must submit a notice of intention to the Independent Pricing and Regulatory Tribunal (IPART) by 30 November 2018.

REPORT RECOMMENDATION

That Council determine the most appropriate option to be adopted as a rating model in 2019/20.

PURPOSE

The purpose of this report is to seek Council's intention to adopt a rating model for 2019/20, and consider options to increase rates above the 'rate pegging' limit.

BACKGROUND

Over the past several years, there has been much debate in relation to the financial sustainability of local government. Many debate that the rate pegging system limits council's ability to maintain financial strength and sustainability. This is not the case; the rate peg sets an industry minimum for rating increases in the absence of independent review. The rate peg is determined by IPART (Independent Pricing and Regulatory Tribunal of NSW) using a Local Government Cost Index based upon a survey of councils every four years. It is not customised for individual councils. The rate peg does not take into account the range and level of services a community seeks from its local council and the different mix of input costs.

It is the role of an elected council to determine the required rating increases to ensure a financially sustainable position that supports service delivery for its local government area. Despite rate pegging remaining part of the regulatory environment in NSW, this does not prevent councils from actively ensuring adequate levels of revenue to meet their individual needs. To the contrary, through the introduction of the Integrated Planning and Reporting (IPR) Framework, councils are encouraged to take control of their long term resourcing needs.

The Special Rate Variation (SRV) application process for increasing rates above the rate peg has been introduced to assist councils in setting appropriate levels of income. This was first introduced in 2011/12 and provides a transparent and fair review of proposed increases to ensure proposed rate increases are adequately supported by long term planning. Over a hundred applications for increases have been made from across the State since this process was introduced. These have mostly been submitted in order to develop and maintain essential services.

In April 2018, Council adopted through the IPR framework, the Delivery Programme, Operational Plan and Resourcing Strategy, including the Long Term Financial Plan (LTFP) which incorporating a 'Business as Usual' financial model, being an increase by the 'rate pegging' limit only.

The adopted 2018/19 'Business as Usual' model achieved a balanced budget by reducing capital allocations to match the projected level of funds available. The model maintained existing service levels, accounted for the substantial increases in energy costs incurred by Council and allowed for the financial commitment to dredge Sylvania Waters. In essence, the balanced budget was achieved by deferring improvements and renewal to the community's assets and redirecting these funds to meeting increases in cost of existing services.

The outcome of the 2018/19 model included:

- Negative Operating Results from 2019/20 to 2027/28 of an average of $7.07 million;
- Negative Operating Results (excluding Domestic Waste) across all years with an average of $8.90 million from 2019/20 to 2027/28;
- A significant gap between required and actual expenditure on infrastructure renewal;
- An increasing asset backlog, reaching $175.8 million by 30 June 2028, with an associated ratio of 6.12%; and
- Most key performance ratios, against which Councils are measured, failing to meet benchmarks.

In addition to these outcomes, Council's Audit, Risk and Improvement Committee (ARIC) has expressed concerns in relation to the long term financial sustainability:

> *"The Committee expresses concern about Council's financial sustainability and recommends a further report is presented at the Council meeting in April to address the measures being taken in relation to financial sustainability issues"* (ARIC029-18 of 7 March 2018)

This was reiterated by the ARIC again at its meeting of 17 October 2018 (ARIC066-18).

Council, in 2017, did consider a staff recommendation to adopt an LTFP which included raising additional rate revenue through increasing minimum rates (rates applicable to multi-dwelling properties), before adopting the current 'Business as Usual' model.

DISCUSSION

Rating revenue is the primary source of funding for the provision of Council services, facilities, programmes, activities and capital works, and as such Council must set a rating model for 2019/20.

Rating Model Options for 2019/20

Council has a number of options available to it for rating in any given year. These include:

- Maintaining rates at the current level (not applying the rate peg and allowing cost of services to outstrip rates income);
- Applying only the rate peg as determined by IPART; and
- Applying for a Special Rate Variation (SRV) to increase rates above the rate peg.

Should Council not increase rates by at least the IPART rate peg, a portion of potential income will be permanently foregone and total rates income will not keep pace with the cost of provision of services, placing further stress on Council's financial sustainability.

When considering the a Special Rate Variation (SRV) to increase rates above the rate peg option there are a wide range of methods that have been used by the many Councils that have sought and gained approval for this. Councils are guided by the specifics of their respective local areas and community feedback as to what would be the best, least disadvantageous options for their community as a whole.

With this in mind,

- acknowledging that Council does have a very low minimum rate level, at $602.30 is much lower than a majority of other like Councils,
- that research indicates the community would be open to this minimum rate level being raised to achieve a more equal sharing of contribution toward services provided, and
- that operating results between 2019/20 to 2027/28 will be in deficit by an average of $7.07million

The following three options are the most appropriate to be considered for 2019/20:

Option 1 - Increase Rates by the Rate Pegging Limit only
Option 2 - Increase Minimum Rates and apply the Rate Pegging Limit to Other Properties
Option 3 - Increase Minimum Rates and increase all other Properties by 1.55% (above the rate peg)

1. Increase Rates by the Rate Pegging Limit Only

The rate peg determines the maximum percentage amount by which Council may increase its general income for the year. The rate peg is primarily based upon the Local Government Cost Index (LGCI). The LGCI measures price changes over the previous year for the goods and labour an average Council will use and at productivity changes over the same period.

IPART has determined the rate peg for 2019/20 at 2.7%. Council can elect to apply this increase with no requirement to make any submission for a variation and this would continue the current ‘business as usual’ model.

This rating strategy would see a continuation of the declining ratios, particularly in relation to infrastructure, as projected in the LTFP.

Although some additional income would be generated through the separate rating of units in developments across the Shire, this additional income would not meet current service levels.

2. Increase Minimum Rates and Apply the Rate Pegging Limit to Other Properties

Council can apply to IPART for a Special Variation to the rate peg that would increase Council's general income above the rate peg. Such an application be determined based on the guidelines set by the NSW Office of Local Government. It includes aspects such as the level of community awareness and how efficiently the council has been managing its finances.

Council's current rating structure is based upon land value rating with a minimum rate applicable. The minimum rates are currently set at $602.30.

There are 20,531 residential properties paying the $602.30 minimum rate, the majority being units, and 1,494 business properties. On average, two persons reside in this property type.

The average detached house within the LGA pays $1,480 in annual rates. On average, three persons live within this property type. This would suggest a more equitable minimum rate, based on number of residents per household (on average) would be 66.67% of the average detached house, which equates to approximately $986.67.

The unimproved land value does not accurately represent the current market value of units, as can be seen in the example below by the comparisons between a unit and a house in the same suburb.

Some Examples

Example 1

The recent sale price of a detached house in Woolooware was $2.15 million and was subject to $2,186.26 in ordinary rates.

A recent sale price of a unit in the same suburb was $2.175 million and was subject to rate of $602.30 – only contributing 27.55% of the rates of like similar priced house.

Example 2

A detached dwelling in Cronulla sold for $1.7 million, having rates of $2,032.84.
A unit in the same suburb that sold for $1.67 million was only subject to the minimum rate of $602.30 – only contributing 29.63% of the rates of like similar priced house.

In both cases, it would be reasonable to assume that residents were consuming a similar quantum of 'basket of services' provided by Council, with those owning units being subsidised by detached home owners. In these examples, unit owners paying less than a third of those in detached houses.

Should Council resolves to consider increasing the minimum rates, it is recommended, based upon both current market value and comparisons to other councils, that the new minimum should be $900. This would generate an additional $7.255 million per year in rates income.

As a further comparison, minimum rates for apartment units in Sutherland Shire are lower than other similar beach or bay side councils, as listed below:

Councils	Minimum annual rate for apartment units
Sutherland	**$602.30**
Randwick	$805.68
Manly	$816.76
Pittwater	$884.58
Kogarah	$917.47
Warringah	$970.93

If Council increases the minimum rates to $900, the number of properties that would be subject to the new minimum would be 26,948 residential properties (up from 20,531) and 2,033 business properties (up from 1,494). The specific categories of the residential properties are:

Deemed investor properties[1]	30.07%
Department of Housing	0.60%
Pensioner owned properties	12.74%
Other properties	56.60%

Note [1] - *Deemed investor properties have been determined based on ratepayers with postal addresses outside the Shire and real estate agents in the Shire.*

The maximum increase above rate pegging that any one individual property owner would be subjected to is $281.44 for 2019/20 for Option 3.

3. Increase Minimum Rates and Increase all Other Properties by 1.55% (above the rate peg)

Building upon the approach outlined in option 2, Council could also increase all other rates. This is the recommended option for Council to improve its declining long term financial position relating to operational performance and infrastructure assets.

This option would be to apply for an SRV for all other properties of 1.55%, making the cumulative increase for those properties 4.25% for 2019/20, inclusive of the rate pegging increase. This would amount to an increase of $63 per annum for the average ratepayer across the Shire per year ($40 from the rate peg and $23 from the SRV).

This option would increase rates by $1.648 million, in addition to the revenue generated through increasing the minimums, making the total rates revenue increase a year to be $8.903million. This equates to the average Operating Deficit (excluding Domestic Waste) across all years. The increase in revenue would be in perpetuity and would address the financial sustainability issues currently being faced.

Pensioners

The number of properties owned by pensioners that would be on the minimum rate would increase from 2,275 to 3,432 if Option 3 were adopted.

Pensioners are currently entitled to two forms of rebate

i. the mandatory rebate of $250.00, which is subsidised by $137.50 by the State Government, and
ii. a voluntary rebate of $105.00, fully funded by Council.

Council has the discretion to apply a third rebate as it determines, here described as the voluntary rebate, meaning that it can apply an additional rebate to affected pensioners. If it were to apply the voluntary rebate to mitigate the effect of the increase as per Option 3 being recommended in this report, it could either fully rebate the increase above the rate peg, estimated to cost Council $900,000, or partially rebate the increase, the total cost being dependent upon the level of the rebate Council elected to provide.

If Council resolved to apply an additional rebate to buffer any hardship as a consequence of Option 3 may have on ‘at-need’ pensioners, it is proposed the eligibility methodology consider factors that include:

- Application be made by the affected property owner;
- the owner resides in the property;
- open to full pension recipients;
- open to owners who own only one property;
- open to owners whose property valuation (not land value) is below a specified threshold value (yet to be determined).

The assessment for this voluntary rebate would be made based on the individual circumstances.

This methodology would discount the voluntary rebate being accessed in circumstances of properties with substantial value. Council will continue to offer the deferral option to all pensioners regardless of property valuation, providing relief to those pensioners whose properties exceed the threshold property value and are not able to access the voluntary rebate proposed.

Additional Financial Strategies

In conjunction with rate peg increases recommended, Council must also continue to pursue the following strategies, to ensure its long term financial sustainability. These include:

- Efficiency improvements;
- User fee and charge review; and
- Asset consolidation.

These strategies should be considered and incorporated in the LTFP along with the rating model adopted by Council.

Long Term Financial Challenges

Council faces specific challenges in its long term financial planning and its long term financial sustainability and must take these into consideration when deciding the rating model to adopt. These challenges include:

1. Population Growth
2. Asset Renewal and Maintenance
3. Labour Costs
4. External and Non-Core Factors

1. Population Growth

Population growth is a key measurement tool for determining the level of funding required to be invested in our community, both now and for the future. Council must consider the impact of population growth to provide optimum service delivery and must also look outside the IPART rate peg system to do so.

In its ‘Review of the Local Government Rating System’, IPART stated “Under the current unimproved land value methodology, the current ‘growth outside the peg’ process results in an increase in general income from new development that is typically much lower than the increase in costs of servicing new residents and businesses”.

Based upon population forecasts and the 2016 Census, the Sutherland Shire estimated population for 2018 is 228,246. Excluding its Children’s Services Unit and Commercial Waste Unit (as discretionary business units), Council’s expenditure per person was $831.78 for the year ended 30 June 2018.

Council’s demographic data projects an additional 836 dwellings per annum to 2036. Using the current minimum rate and today’s dollars, the increase in rating income outside the peg would be $503,523 each year. Based upon an assumption that each residence has two occupants and apply Council’s expenditure per person, as above, the additional cost of service provision to Council for residents in these additional dwellings would be $1.391 million.

2. Asset Renewal and Maintenance

Council is responsible for maintaining $2 billion worth of infrastructure assets. The on-going renewal and maintenance of these assets is paramount for our community and Council’s ability to deliver services.

Based upon current financial projections, Council has inadequate funds to responsibly maintain its infrastructure assets including roads, footpaths, parks and buildings. The following programmes were excluded from the 2018/19 Capital Program in order to achieve a balanced budget, however their exclusion creates a deferred liability to Council:

- Sporting field surface renovations
- Public Place Presentation program
- Sporting field floodlighting renewals
- Cricket pitch and net renewals
- Netball court surface renewals
- Regional sport facilities signage
- Bushfire readiness and natural areas renewals
- Cronulla and Wanda dune renewals
- Open space furniture renewals
- Skate park renewals
- Community centres play space renewals

Maintenance is deemed to be all routine activities necessary for retaining an asset as near as practicable to its original condition, excluding rehabilitation or renewal. Where a council does not sufficiently fund maintenance, service levels are reduced and/or lifecycle costs of the asset can increase, with the reduced maintenance shortening the asset life through deterioration requiring early renewal. This has an impact on the long term financial position of Council.

Council's estimated asset maintenance ratio for 2018/19 is 94.99% and is expected to decline to 91.45% in 2027/28 assuming the current rating model and other income levels continue as they currently are.

More concerning is the level of funding available for asset renewal. Based upon current financial projections, the building and infrastructure renewals ratio moves from 70.30% in 2018/19 to 48.21% in 2027/28. This has the impact of increasing the infrastructure backlog from 2.33% in 2018/19 to 6.12% in 2027/28.

It should be noted that the various infrastructure managed by Council often have lifecycles extending 20 to 100 years. Infrastructure investment is often uneven and therefore renewal funding requirements should follow the same pattern, with internal reserves used to flatten the financial burden on any one generation.

Risks associated with insufficient renewal funding include increased reactive maintenance costs, public safety, reduced service levels, poor customer satisfaction/experience and intergenerational inequities. Currently 10% of sports assets are in poor and very poor condition. It is estimated 30% of sports assets, including playing surfaces, will fall into poor and very poor condition by 2027/28, whilst over 45% (65) of playgrounds will be in poor or very poor condition by that time, based on estimated useful life, and current level of renewal funding.

3. Labour Costs

Labour costs are another key driver in the service delivery of Council. A comparison with the rate peg set by IPART shows significant variation over the past five years. The increasing gap between labour costs and the rate peg accepted by Council means funding is required to be sourced elsewhere.

As a service based organisation, 46.42% of input costs are employee wages and on costs. This is Council's largest single expense of service delivery. In 2018/19 the projected cost is $106 million to deliver the current level and range of services. Ongoing review of operations and restructuring has limited the level of increase in this cost, however, it remains a significant component of service delivery for Council.

Ordinary rating income, net of pensioner rebates, makes up 50% of Council's total revenue. This is Council's single largest revenue source. In 2018/19 the projected revenue is $116 million.

The table below shows a comparison between award wage increases over the past five years and rate peg limits accepted by Council and its overall impact.

Year	Award Wages increase	Rate peg increases adopted	% Gap between rate peg and Award increase	Percentage of Rate peg to Award increase
2018/19	2.5%	2.3%	-0.20%	92%
2017/18	2.2%	1.5%	-0.70%	68%
2016/17	2.8%	1.8%	-1.00%	64%
2015/16	2.7%	2.4%	-0.30%	88%
2014/15	2.3%	2.3%	0.00%	100%
Cumulative increase	**13.13%**	**10.73%**		**81.72%**

4. External and Non-Core Factors

There are a range of factors beyond Council's control which impact upon its ability to deliver services and fund infrastructure.

Electricity and natural gas are large operational expenditure items for Council. Projections over the term of the LTFP show increases of $38 million above expected CPI, with an average annual increase of 4.64%.

Despite taking a strategic approach to procurement, Council was impacted by volatility in the energy market in recent years. The 200% increase in 2016/17 in the natural gas price for Sutherland Leisure Centre and the forecast 56% increase in 2018/19 in all energy costs focussed Council's attention on the risk of price shocks.

This increase is an example of where the Local Government Cost Index used by IPART as the basis for setting the rate peg may vary for individual councils. In arriving at the rate peg for 2019/20, IPART factored in a 14.4% increase in energy costs, which contributed 0.4% to the determined rate peg of 2.7%. This means that about $464,000 in income from the rate peg can be attributed to energy cost increase, however this compares to a forecast increase of $2.9 million above CPI increases for Council, resulting in Council have to reduce its capital allocations by $2.4 million to meet this obligation.

Another factor requiring funding by Council is the dredging works at Sylvania Waters which is not considered core business. An amount of $3.1 million was originally included in the 2018/19 Budget but has now been partially deferred until 2019/20. To facilitate the ongoing requirement to periodically undertake these works, an amount of $500,000 has been set aside each year. This allocation of funds reduces the amount available for other works and services.

RESOURCING STRATEGY IMPLICATIONS

Council's Long Term Financial Plan provides balanced budgets across each year through the reduction of capital allocations to match the projected level of funds available. The outcome of this is a deteriorating financial position and asset condition.

This report provides rating options for 2019/20, which will address this situation. Council's adoption of the recommended option will be incorporated into the update of the LTFP.

COMMUNITY ENGAGEMENT

Council undertook extensive community engagement in 2017 and the findings were presented to Council. The points relevant to rate increases, as previously identified in this report are:

- 76% of respondents believed that the amount paid to Council should be fair between houses and apartments
- When asked to consider the minimum rates applied by other councils and the average number people residing in different dwelling types, residents felt $955 was a fair annual minimum rate for apartments.

Should Council adopt the recommendation to increase rates, further communication, education and engagement will be undertaken on the rate increase, including the proposed application of the additional income and the reasons behind Council's decision.

STRATEGIC ALIGNMENT

Community Strategic Plan Strategy	Delivery Program (2017-2021) Deliverables
1.4 Ensure community confidence in Sutherland Shire council.	1E Implement the Finance Strategy including the Long Term Financial Plan.

POLICY AND LEGISLATIVE REQUIREMENTS

Council must adopt a Delivery Programme, Operational Plan, Budget and Resourcing Strategy (incorporating a Long Term Financial Plan) each year. This includes a statement of Council's revenue policy and rates for the following year. Council's determination of the rating option for 2019/20 will form the basis for these documents.

If Council determines that it should increase rates above the 'rate pegging' limit, notification of the intention to lodge a Special Rate Variation to IPART by 30 November 2018.

A full submission to IPART is due on the 11 February 2019.

CONCLUSION

Council must adopt a rating model for 2019/20. This report outlines three options that could be applied. The adopted LTFP shows a set of deteriorating financial performance ratios, along with an increasing asset backlog from a lack of available renewal funding.

Should Council apply for a Special Rate Variation, increasing the minimum rates to $900 and all other rates across both residential and business categories and sub-categories by 1.55% above the determined rate pegging limit (Option 3) Council's overall long term financial position will be most improved. Should Council apply the 'business as usual' model, (Option1), Council will continue to maintain its existing levels of service by managing its allocation to asset renewals and upgrades and provision of new assets. Should Council apply for a Special Rate Variation, increasing the minimum rates to $900 (Option 2), Council will substantially improve Council's long term financial position.

RESPONSIBLE OFFICER

The officer responsible for the preparation of this Report is the Manager Finance, Greg Hayes, who can be contacted on 9710 0334.

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