Submission
No 41

INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Organisation: MidCoast Council

Date Received: 24 April 2024

SUBMISSION

MidCoast Council Submission to the Inquiry into the ability of local governments to fund infrastructure and services.

The Terms of Reference for the Inquiry are broad, and Council submits that the following documents provide the necessary information for the Committee to inquire and report on the ability of local government to fund infrastructure and services:

1. Revitalising Local Government – Final Report of the Independent Local Government Review Panel October 2013

2. IPART Review of the Local Government Rating System – Final Report December 2016

3. LGNSW Submission: IPART Review of the Rate Peg Methodology 2022

4. MidCoast Council Submission to IPART Review of Rate Peg Methodology Issues Paper September 2022 (**Attached** and includes specific challenges MidCoast faces in delivering services and infrastructure)

5. IPART Review of the Rate Peg Methodology Final Report August 2023 (in particular Chapter 9 Review of councils 'financial model)

6. LGNSW Cost Shifting Report for the 2021-2022 Financial Year

In addition, we **attach** a copy of the Report submitted to the 28th September 2022 MidCoast Council Meeting "MidCoast Council Financial Sustainability" which provides some local context to the challenges of Regional Councils in funding infrastructure and services. The Report resulted in an independent review undertaken by AEC which was delivered to Council in December 2023. Council has since prepared a Draft Action Plan in response to the recommendations in the independent review and this is to be considered by Council on 1st May 2024. Following consideration of this report we will be able to provide a copy of the Report and the AEC Independent Review to the Committee.

While Council's submission to IPART on the review of the rate peg methodology is attached some comments from the report are relevant to highlight the difficulty MidCoast Council has in funding infrastructure and services across a large geographic area.

The rate peg which councils have had to manage over a long period has resulted in:

- artificially keeping rates low protecting some ratepayers in the short term which loads the burden onto other ratepayers when councils are forced to apply for large rate increases to address lack of services or unsatisfactory standards of service to the local community.

- ratepayers being led to believe that the rate peg is the true indicator of cost increases so anything above that reflects poorly on the council operations. This creates a false ceiling as ratepayers want costs to be retained within the rate peg but services to increase. This is reflected regularly at community meetings and feedback forums. The rate peg is used as a benchmark when evidence shows it is flawed in reflecting councils cost drivers.

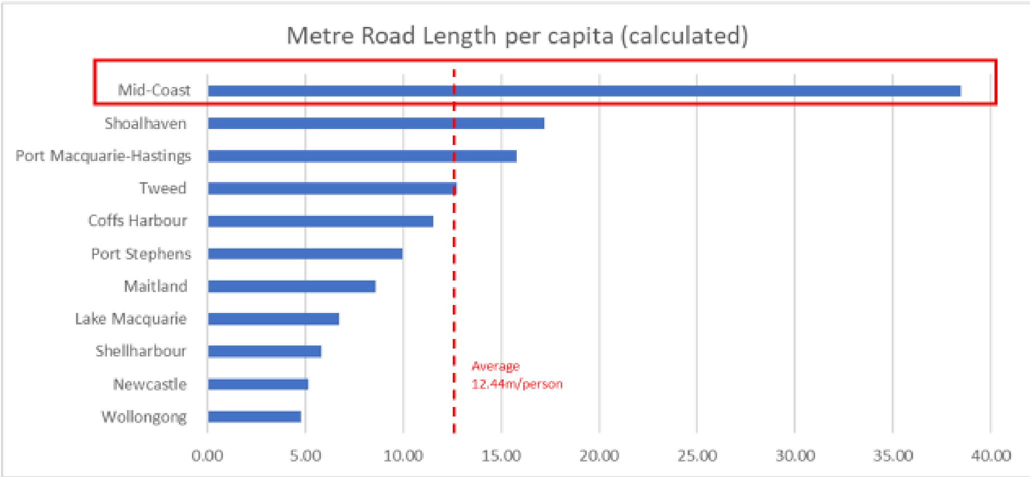
- keeping rates low while creating a divergence between services demanded and the ability to raise funds. It avoids a mature conversation with the community and instead requires councils to argue against the validity of the rate peg. Without the rate peg council can have an open conversation with the community on service provisions and rate levels without the false ceiling of the rate peg.

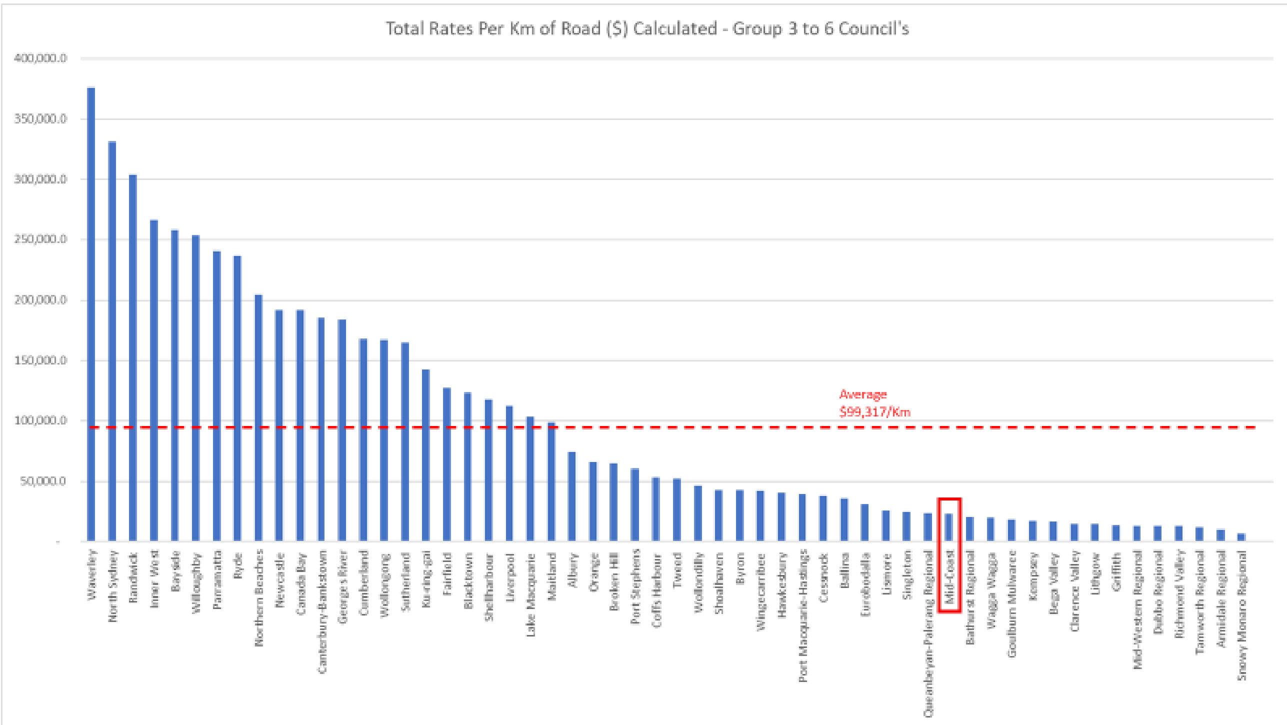
- Councils having to absorb services imposed through cost shifting without sufficient additional funding being provided from various levels of government.

There is evidence available across many reviews to demonstrate that the rate peg does not provide councils with sufficient income. Councils across NSW have vastly different cost drivers depending on whether they are metropolitan or regional/rural and other factors include geographic and demographic features. There is also a large variance in income raising capacity across various councils. For example, many metropolitan councils can raise significant funds through parking revenue. The artificially low rate peg forces councils into large SRV's to compensate and this creates a community impression that the council has been mismanaged when the reality is it is addressing issues relating to an inadequate rate peg being applied over many years.

Additionally, forcing councils into large SRVs has an significant impact on ratepayers capacity to pay, which is particularly relevant having regard to socio economic challenges faced by many rural/regional communities.

The following charts which we have been sharing with our community in our twice yearly community conversation forums (14 to 16 community meetings twice per year to listen to our community) demonstrate the differences between councils on per capita road length and rates collected per km of road. Road maintenance and renewal is a key cost driver for MidCoast Council. Clearly roads are important to other councils also but the driver and challenges to fund are greater in the MidCoast LGA when compared to many other councils.


Metre Road Length per capita (calculated)
Mid-Coast
Shoalhaven
Port Macquarie-Hastings
Tweed
Coffs Harbour
Port Stephens
Maitland
Lake Macquarie
Shellharbour
Newcastle
Wollongong
Average
12.44m/person
0.00
5.00
10.00
15.00
20.00
25.00
30.00
35.00
40.00


Total Rates Per Km of Road ($) Calculated - Group 3 to 6 Council's
400,000.0
350,000.0
300,000.0
250,000.0
200,000.0
150,000.0
100,000.0
50,000.0
-
Average
$99,317/Km
Waverley
North Sydney
Randwick
Inner West
Bayside
Willoughby
Parramatta
Ryde
Northern Beaches
Newcastle
Canada Bay
Canterbury-Bankstown
Georges River
Cumberland
Wollongong
Sutherland
Ku-ring-gai
Fairfield
Blacktown
Shellharbour
Liverpool
Lake Macquarie
Maitland
Albury
Orange
Broken Hill
Port Stephens
Coffs Harbour
Tweed
Wollondilly
Shoalhaven
Byron
Wingecarribee
Hawkesbury
Port Macquarie-Hastings
Cessnock
Ballina
Eurobodalla
Lismore
Singleton
Queanbeyan-Palerang Regional
Mid-Coast
Bathurst Regional
Wagga Wagga
Goulburn Mulwaree
Kempsey
Bega Valley
Clarence Valley
Lithgow
Griffith
Mid-Western Regional
Dubbo Regional
Richmond Valley
Tamworth Regional
Armidale Regional
Snowy Monaro Regional

SUBMISSION

Councils in NSW have many challenges in delivering services and infrastructure to their local communities. These challenges are serious and large and have been well documented in various reports over the past decade. We hope the Committee will review the available information and research which consistently concludes that the funding model for local government needs review and that the solution lies in a partnership between Local and State Government.

Adrian Panuccio

General Manager

23 April 2024

MidCoast Council Submission to IPART

Review of Rate Peg Methodology Issues Paper September 2022

Introduction

The MidCoast is a large and diverse region of 195 towns, villages and localities. The MidCoast ranges from beaches to mountains over an area of 10,000 square kilometres.

The MidCoast is home to the Gathang speaking Aboriginal people, the Biripi and Worimi. We have a population of approximately 93,800 people living in around 40,000 households.

There are two main population centres, Taree and Forster-Tuncurry.

Taree is home to the region's public hospital, airport and train service. It is also a central place for sporting, entertainment and cultural facilities. Large tracts of industrial land support a focus on industry.

Forster-Tuncurry focuses on lifestyle, with tourism and retirement living driving the economy.

Rural and coastal centres include Tea Gardens-Hawks Nest, Gloucester, Wingham, Hallidays Point, Harrington and Old Bar.

The MidCoast is a popular location with retirees from the Central Coast and Sydney.

Most of our population growth has occurred in people aged 60 and over who make up 38.5% of our population.

Important to our community is climate change, Customer Service, Development Assessment, Economic Development, and Local and Regional Roads.

MidCoast Council has 3643 km of transport network assets which are valued at $2.7 Billion. Our total value of assets across all categories is $5 Billion. We are a Group 5 Council (as Classified by the OLG) and the average km of transport network assets of Group 5 Councils is 1283 km. MidCoast Council is 183% above the Group average for km of transport assets. We maintain 38 metres of road per resident compared to the Group average of 9 metres per resident. We would argue these assets are really liabilities, they cannot be sold and they have to be maintained to a satisfactory and safe level to service the local community. This responsibility comes at a considerable cost. Metropolitan Councils maintain around 2.5 to 3 metres of road per resident.

Our population density is 9 residents per km2 compared to the Group average of 229 residents per km2.

18% of MCC is National Park,12% is State Forest and 3.22% is waterways , meaning 33.22% of the area is non rateable.

The above figures are provided to highlight some of the unique characteristics of MidCoast Council and to demonstrate that a state-wide rate peg simply cannot accommodate the diversity of Councils across NSW let alone even within a Group of like Councils. To tinker with the methodology cannot correct a fundamental flaw of having a rate peg apply across all councils in NSW where such a diversity exists.

Summary of Councils Position

Council is aware of the submission lodged by the United Services Union. The submission contains a thorough and evidenced based review of the issues around rate pegging and its inherent limitations. Council supports the primary recommendations in that submission summarised below:

Recommendation 1 – Best approach - Abolish Rate Capping

Recommendation 2 – Second Best – Redesign Rate Capping

The following includes Councils comments on each of the 20 areas IPART has sought feedback on:

1. *To what extent does the Local Government Cost Index reflect changes in councils' costs and inflation? Is there a better approach?*

The LGCI is flawed as it contains too few items to accurately reflect a basket of goods representative of Local Government cost drivers. In addition, it does not take into account the different operating environments which Councils across NSW operate in. For example, Regional Councils have some differences in cost drivers compared to metropolitan councils given the nature of services provided. Also, Councils with large coastal areas such as MCC experience high levels of retiree population growth which creates a different service demand.

The LGCI is also rearward facing which is problematic particularly in high inflationary periods.

It is clear a better approach could be designed with some application of reasonable economic analysis rather than a focus of simplifying the rate peg. It should be accepted that a cost index for local government is not simple and for it to be a valid tool to peg rates it needs to be complex and consider a range of factors which impact the wide variety of councils across NSW. At a basic level the LGCI should consider relevant cost drivers for the various categories of Councils across NSW. A single cost index applicable to all councils has not worked and can never be an effective basis for the rate peg.

2. *What is the best way to measure changes in councils' costs and inflation, and how can this be done in a timely way?*

As mentioned in the response to Question 1 there needs to be differing cost indexes across the range of councils which have a mix of weightings relevant to the cost drivers of the different types of councils.

3. *What alternate data sources could be used to measure the changes in council costs*?

There is a range of actual data that could be used to monitor changes in council costs. Councils have a large labour base so using actual wage increase data for the Local Government industry would be appropriate. As mentioned in 1 and 2 the cost index needs to recognise the different cost drivers across different types of councils. A study of these cost drivers is required and then actual data could be sourced and weighted appropriately.

4. *Last year we included a population factor in our rate peg methodology. Do you have any feedback on how it is operating? What improvements could be made?*

The population factor in our view applies a variable to the rate peg on only one factor which impacts on Councils costs. Councils in regional areas may have moderate or minimal population growth however experience deteriorating infrastructure caused by historical factors including past decisions of local councils and state governments. Applying an indexation based on population factors but no other relevant factors such as significant construction inflationary factors which impact on regional and rural councils is ineffective. The maintenance and renewal of failing infrastructure whose decline has been hastened by climate change impacts (significant weather events) is a more significant driver for many councils than population growth.

5. *How can the rate peg methodology best reflect improvements in productivity and the efficient delivery of services by councils?*

There is sufficient evidence to demonstrate that the productivity factor included in the rate peg does not in fact improve efficiency. If it is designed to improve efficiency it is ineffective. If this was the case NSW councils would be proven to be more efficient that other jurisdictions in Australia which don't have rate pegging. There is academic evidence to demonstrate that that States without rate pegging are equally or more efficient than NSW councils.

By providing Council's with autonomy and accountability in relation to rate setting in their Council area there is incentive to become more efficient. Councils are very good at engaging and interacting with their communities. The IPR framework promotes this and Councils have become very effective at understanding what their communities want. What councils find on the ground is that their communities expect them to provide efficiency in how they operate. The incentive to become efficient comes from the understanding of local communities and responding to their priorities. By becoming more efficient council can more effectively respond to their community. That should be the incentive not providing a broad based productivity factor applied across NSW in a one size fits all rate peg

6. *What other external factors should the rate peg methodology make adjustments for? How should this be do*ne?

The rate peg should consider forward economic projections rather than rearward. These economic projections need to be based on local government specific drivers and some local government expertise being included on a rate peg panel of experts would be supported.

7. *Has the rate peg protected ratepayers from unnecessary rate increases?*

The answer to this question is more complex than the premise of the question asked. It could be argued that the rate peg does protect ratepayers but from what. The rate peg does the following:

- artificially keeps rates low and protects some ratepayers in the short term and then loads the burden onto other ratepayers when councils are forced to apply for large rate increases to address lack of services or unsatisfactory standards of service to the local community.

- leads ratepayers to believe that the rate peg is the true indicator of cost increases so anything above that reflects poorly on the council operations. It creates a false ceiling as ratepayers want costs to be retained within the rate peg but services to increase. This is reflected regularly at community meetings and feedback forums. The rate peg is used as a benchmark when evidence shows it is flawed in reflecting councils cost drivers.

- keeps taxes low while creating a divergence between services demanded and the ability to raise funds. It avoids a mature conversation with the community and instead requires councils to argue against the validity of the rate peg. Without the rate peg council can have an open conversation with the community on service provisions and rate levels without the false ceiling of the rate peg.

8. *Has the rate peg provided councils with sufficient income to deliver services to their communities?*

There is evidence available to demonstrate that the rate peg does not provide councils with sufficient income. The one size fits all rate peg is inadequate as previously mentioned in this submission. Councils across NSW have vastly different cost drivers depending on whether they are metropolitan or regional/rural and other factors include geographic and demographic features. There is also a large variance in income raising capacity across various councils. For example, many metropolitan councils can raise significant funds through parking revenue. The artificially low rate peg forces councils into large SRV's to compensate and this creates a community impression that the council has been mismanaged when the reality is it is addressing issues relating to an inadequate rate peg being applied over many years.

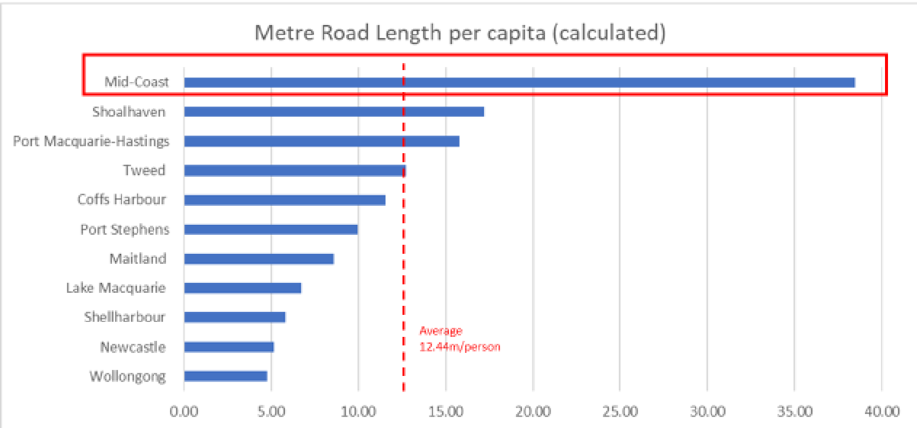
9. *How has the rate peg impacted the financial performance and sustainability of councils?*

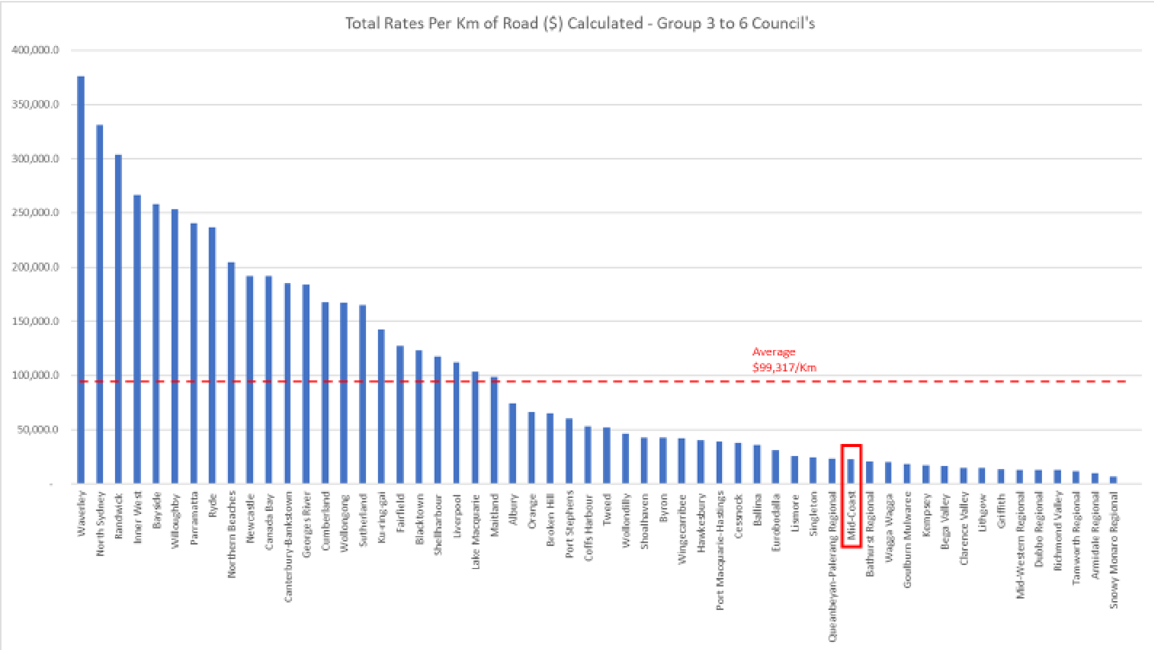
There have been academic studies undertaken to review this question and it is suggested IPART undertake their own research. Our view is that the rate peg has negatively impacted financial performance and sustainability for the reasons set out through this submission.

10. *In what ways could the rate peg methodology better reflect how councils differ from each other?*

As referred to previously in this submission a one size fits all rate peg is flawed and if a rate peg methodology is to continue rather than be abolished it should be reflective of the different types of councils. Unless there can be some equalisation through a systemic review of local government funding the rate peg cannot continue to operate under a blanket methodology across all of NSW.

The following charts which we have been sharing with our community in our twice yearly community conversation forums (14 to 16 community meetings twice per year to listen to our community) demonstrate the differences between councils on per capita road length and rates collected per km of road. Road maintenance and renewal is a key cost driver for MidCoast Council. Clearly roads are important to other councils also but the driver and challenges to fund are greater in our area when compared to many other councils. This is one example of how the rate peg could better reflect the differences between councils.





11. *What are the benefits of introducing different cost indexes for different council types*?

Put simply different cost indexes for different types of councils would provide a more relevant rate peg which would more closely reflect the cost drivers for each different type of council. It would assist further if there was a range within the rate peg to enable some autonomy and accountability to be exercised by Councils within each category.

12. Is volatility in the rate peg a problem? How could it be stabilised?

Rate peg volatility cannot really be avoided particularly in times of economic instability. More problematic is the long term indicative rate peg projection which councils are advised to factor into their LTFP. The actual rate peg does not traditionally track well when compared to this and causes significant variation to the LTFP projections. The long term advice on the LTFP projections should be more regularly reviewed to ensure it is more closely aligned with the actual rate peg. The use of more current forward looking data rather than backward looking would also assist.

13. *Would councils prefer more certainty about the future rate peg, or better alignment with changes in costs?*

Council would prefer a rate peg that was accurate and reflected actual change in costs. Certainty about the rate peg is secondary. While in stable economic conditions there can be a level of certainty that is not the case in volatile times as recently experienced.

14. *Are there benefits in setting a longer term rate peg, say over multiple years*?

Councils need certainty that the rate peg will be relevant to economic conditions at the time. Setting a long term rate peg would not be able to achieve this and therefore would not be supported. There could be an indicative peg over multiple years but this would have to include flexibility to adjust depending on economic conditions.

15. Should the rate peg be released later in the year if this reduced the lag?

In order to accommodate economic volatility, it may be necessary to release the rate peg later in the year. This however needs to be balanced against allowing time for councils to make a decision on special rate variation applications. Reviewing the SRV timeframes and requirements could assist in allowing for a later rate peg announcement.

16. *How should we account for the change in efficient labour costs*?

Efficiency in operations should not be accounted for in the rate peg. Councils should have autonomy to implement and benefit from efficiency in operations. Councils are accountable to their communities through the IPR framework in a more direct way than any other level of Government. It follows that any efficiency gain will be applied to community priorities in accordance with Councils engagement with their community. This could be through service provision or reduction in costs; however it needs to be at the discretion of the elected Council in the preparation of their Delivery Programs and Operational Plans.

17. *Should external costs be reflected in the rate peg methodology and if so, how?*

All relevant costs should be reflected in the rate peg. As mentioned previously an expert panel should be implemented to ensure all relevant cost drivers are reflected in the rate peg and applied to categories of council rather than a state-wide rate peg.

18. *Are council-specific adjustments for external costs needed, and if so, how could this be achieved?*

This is answered in Q 17.

19. *What types of costs which are outside councils' control should be included in the rate peg methodology*?

A relevant basket of costs should be applied as has been outlined in our submission. It is not possible to cater for all variances between councils even within groupings. A Rate Peg Range would provide the flexibility for local councils to reflect external cost impacts and variations.

20. *How can we simplify the rate peg calculation and ensure it reflects, as far as possible, inflation and changes in costs of providing services?*

As mentioned previously in this submission simplifying the rate peg is not the answer. If the rate peg has to remain it has to be reflective of costs and flexible enough to accommodate economic volatility. Simplicity is not the primary objective so shouldn't be a driver.

Concluding Comments

MidCoast Councils position as made clear in this submission is:

1. Rate pegging should be removed and councils accountable to their communities through the Integrated Planning and Reporting Framework. Councils work closely with their communities and have an understanding of community needs and priorities. This should include being able to set appropriate rating levels under the IPR framework. The Governments role should be intervention by exception where councils are either implementing large unjustified rate increases or are keeping rates at very low levels when financial indicators are identifying sustainability issues. A framework could be developed for such an intervention process.
2. Should rate pegging not be removed the current methodology should be redesigned to accommodate the following:
    - A cost index be developed for different categories of councils and then a rate peg be calculated for each category of Councils. The rate peg should include a range so that councils can apply a level of rates within the range after working through community priorities under the IPR framework.
    - An expert rate peg panel should be established to ensure the cost index is reflective of local government costs drivers
    - A review of the SRV timeframes to accommodate the process complexity should be undertaken. Reference is made to the Victorian SRV process for an example of an improved process.

Adrian Panuccio

General Manager

2 November 2022

12. CONSIDERATION OF OFFICERS' REPORTS:

13. GENERAL MANAGER

13.1. MIDCOAST COUNCIL FINANCIAL SUSTAINABILITY

REPORT INFORMATION

Report Author	**Steve Embry, Director Corporate Services**
Date of Meeting	**28 September 2022**
Authorising Director	**Adrian Panuccio, General Manager**

SUMMARY OF REPORT

To report on the establishment of a pathway to financial sustainability for MidCoast Council in response Council's recently adopted resolutions ***174/2022 and 181/2022.***

RECOMMENDATION

1. That Council note the proposal to develop a Financial Sustainability Strategy with the aim of the Strategy being incorporated into Council's Integrated Planning and Reporting documents for 2023-2024.
2. That Council continue the strategic body of work identified in this Report to guide the development of the Financial Sustainability Strategy objectives and actions.
3. That further workshops with Council be scheduled as required to enable the Strategy to be finalised in early 2023 and exhibited for community comment in conjunction with 2023-2024 Integrated Planning and Reporting documents.

FINANCIAL / RESOURCE IMPLICATIONS

Pursuing Financial sustainability is a core Council responsibility and current council resources will be applied to the development of a Financial Sustainability Strategy and its incorporation into Council's broader IP&R plans.

LEGAL IMPLICATIONS

There are no legal implications.

RISK IMPLICATIONS

Risk consideration will be considered in the Financial Sustainability Strategy.

BACKGROUND

Legislative Context

The Local Government Act provides the following financial management principles to guide councils in carrying out their functions.

The principles of sound financial management (Section 8B) are:

a) Council spending should be responsible and sustainable, aligning general revenue and expenses.

b) Councils should invest in responsible and sustainable infrastructure for the benefit of the local community.

c) Councils should have effective financial and asset management, including sound policies and processes for the following—

i. performance management and reporting,

ii. asset maintenance and enhancement,

iii. funding decisions,

iv. risk management practices.

d) Councils should have regard to achieving intergenerational equity, including ensuring the following—

i. policy decisions are made after considering their financial effects on future generations,

ii. the current generation funds the cost of its services.

Local Government Context

As part of the Local Government review process that was undertaken during 2013 to 2015, a number of reports were prepared by various agencies focusing on aspects of Local Government operations.

The NSW Treasury Corporation (TCorp) were commissioned to undertake a review of the financial sustainability of the local government sector and provided their report (Financial Sustainability of the New South Wales Local Government Sector – Findings, Recommendations and Analysis) in April 2013.

In undertaking this work they provided the following definition of financial sustainability:

A local government will be financially sustainable over the long term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community.

The definition brings together what TCorp considers are the key elements of financial strength, service and infrastructure requirements, and needs of the community."

This definition formed the basis on which councils were assessed (at the time) and underpinned the performance measures that were ultimately adopted (and reviewed by both TCorp and IPART) through the Fit for the Future Program.

<u>It is proposed that Council adopt this definition</u> in the development of its Financial Sustainability Strategy given its links to the external measures of financial sustainability that apply to councils and to the Integrated Planning and Reporting (IP&R) Framework under which Council operates.

More broadly, councils across Australia, and particularly those in regional areas, have been grappling with the challenges of financial and asset sustainability. In States where rate pegging applies, significant challenges exist in addressing infrastructure renewal and backlogs across large transport networks while the predominant revenue source is capped at a level generally below inflation.

In NSW the State Government commenced a reform program designed to improve the strength and effectiveness of local government and to drive key strategic directions set out in the Government's Destination 2036 Action Plan.

The Government appointed an Independent Local Government Review Panel in 2012 to investigate and identify options for reform taking into consideration the following items amongst others:

• Ability to support the current and future needs of local communities

• Ability to deliver services and infrastructure efficiently, effectively and in a timely manner

• The financial sustainability of each local government area.

The Independent Local Government Review Panel Report presented its Final Report 'Revitalising Local Government' to the State Government in October 2013.

On page 30 of the Report the Panel commented on 'Building a Sustainable System":

"The Panel's goal is to ensure that every community in NSW has local government that reaches the highest possible standard, and that will be sustainable for several decades to come. This can only be achieved if we look at the system of local government as a whole. Very few challenges can be

addressed or problems 'fixed' in isolation: understanding how the system of local government works is essential to achieve lasting improvements and to avoid the unintended and often adverse consequences of poorly conceived policies and intervention"

The Panel's report was comprehensive and canvassed a broad range of reforms to achieve sustainability and improved services to the community. This included asset management, fiscal management, revenue raising, and governance reforms. Some reforms have been implemented however many more have not. The premise of the Report and its recommendations was that the reform package required all aspects to be implemented as there were significant interdependencies. The State Government at the time implemented selective components of the report including Council boundary reform initiatives. These were addressed separately rather than as part of a broader integrated reform package.

It is worthwhile reflecting on the Panel's introductory comment to Chapter 5 'Fiscal Responsibility'

"Securing local government's financial capacity and sustainability is the fundamental pre-requisite for all other moves to enhance its strength and effectiveness" (Page 34)

and Box 9 - Proposed Requirements for Delivery Programs (included below) as they remain relevant to financial sustainability in the context of Council's recently adopted resolutions:

5.2 Guidelines for Delivery Programs

Soundly-based, long term asset and financial plans are the essential foundations of sustainability. Under IPR, each newly-elected council must prepare a 4-year Delivery Program that gives expression to those plans, and to the Community Strategic Plan. The Panel's investigations suggest that this aspect of IPR needs further attention, so that a council's Delivery Program accurately and fully reflects the provisions of its asset and financial plans, and embeds fiscal responsibility. Proposals for expanded mandatory Guidelines for Delivery Programs to achieve those objectives are set out in Box 9. More rigorous Delivery Programs are also central to the Panel's proposals to replace or streamline rate-pegging (section 6.5).

Box 9: Proposed Requirements for Delivery Programs

A Delivery Program should:

- Give effect to long-term financial and asset management plans prepared fully in accordance with IPR guidelines
- Contribute effectively to progressive elimination of an operating deficit
- Establish a 4-8 year 'revenue path' for all categories of rates linked to specific expenditure proposals for infrastructure and services
- Clearly justify any proposed increases in services or creation of new assets, based on regular service reviews and community consultation to determine appropriate levels of service
- Incorporate substantially increased funding for infrastructure maintenance and renewal (where backlogs have been identified)
- Apply increased borrowing to meet infrastructure needs wherever appropriate and financially responsible
- Ensure a fair and reasonable distribution of the rate burden across categories of ratepayers
- Include measures to bring about ongoing improvements to efficiency, productivity, financial management and governance
- Be certified by the Mayor and General Manager, in their respective capacities, as meeting these requirements.

A further quote from the Panel's report is relevant to the challenge of meeting infrastructure needs – see quote from page 49 below:

"Current estimates of the backlog rely on unaudited data from 'Special Schedule 7' in councils' annual accounts. This data is widely considered to be unreliable and is likely to over-state the real cost of bringing assets to a satisfactory standard. Where councils rigorously review cost estimates and consult their communities to determine realistic, affordable levels of service, the consequence is often very considerable reductions in the estimated backlog. However, this will not lessen the need for additional annual expenditure on maintenance and renewal to ensure that the current condition of assets does not deteriorate and is improved where necessary. Both TCorp and DLG found that existing levels of expenditure on maintenance and renewal are inadequate in most cases.

The measured level of backlogs varies significantly from one part of NSW to another, reflecting differences in environmental conditions, demand pressures and the capacity of councils to undertake necessary works. DLG reports that problems are most acute in the Far West, Mid North Coast, South East, Central West, Murray and Northern Rivers regions. Its audit also found that as a general rule those councils facing the highest per capita cost of bringing assets back to a satisfactory standard (BTS) are amongst those with the weakest TCorp ratings of financial sustainability"

The local government context above demonstrates this is a longstanding sector wide challenge and one not faced by MCC alone (noting however that the Mid North Coast area was identified as a region where the problems are most acute). It is important that MCC review our own unique circumstances and take steps to address what we can control while being cognisant of industry wide initiatives that can support local actions.

DISCUSSION

MCC Current State

MidCoast Council was formed in May 2016 with the amalgamation of Great Lakes Council (GLC), Greater Taree City Council (GTCC), and Gloucester Shire Council (GSC). On 1 July 2017 MidCoast Water was integrated into MidCoast Council. All former entities had infrastructure backlog challenges and MidCoast Water carried significant levels of debt related to major infrastructure projects.

These challenges were understood and both GLC and GTCC had Special Rate Variation (SRV) applications under consideration by the Independent Pricing and Regulatory Tribunal (IPART) at the time of amalgamation while GSC had a continuing SRV (with further increases identified as being required in their Fit for the Future submission). These applications were predominantly to address infrastructure funding requirements.

Each former Council's proposed or continuing SRV is shown below:

- GLC – Proposed from 2016/17 – 6.5% year 1 and 4.25% for the next 3 years (Cumulative increase 20.66%)
- GTCC - Proposed from 2016/17 – 6.9% each year for 6 years. (Cumulative increase 49.23%)
- GSC - Approved 2015/16 – 13% for 3 years (Cumulative increase 44.29%) *Note the final year of the increase was not applied due to a MCC SRV which superseded any ongoing approved SRV's)

In 2017 MidCoast Council was successful with a Special Rate Variation application which provided for the following increases:

- Year One - 10% (6% for Environmental Levy and 2.5% for Roads Program) (noting that this replaced existing special variations that were in place in each of the three previous Local Government Areas – Gloucester Shire (13%), Great Lakes (6% environmental) and Greater Taree (5% environmental)
- Year Two – 5% (2.5% to $100m Roads Program)
- Year Three – 5% (2.5% to $100m Roads Program)
- Year Four – 5% (2.5% to $200m Roads Program)

This was a cumulative increase of 27.3% over the approval period.

Since merger Council has undertaken significant work to integrate systems and asset management data. This work is continuing.

Council has been working through its current and projected financial position and has reviewed current asset information in relation to the transport network. It has noted that there is further work required to verify data within this asset class to a desired level of accuracy.

In reviewing and adopting the Integrated Planning and Reporting (IP&R) documentation for the 2022-2023 financial year, Council adopted the following resolutions:

Council Meeting 11th May 2022 - RESOLUTION 174/2022

(Moved Cr J Miller / Seconded Cr A Tickle)

1. *That Council place the Draft 2022-2026 Delivery Program and 2022-2023 Operational Plan as at Attachment 1, the draft Statement of Revenue Policy as Attachment 2, the Draft 2022-2023 Fees & Charges Schedule as at Attachment 3, and the Draft Detailed Budget 2022-2023 as at Attachment 4 on public exhibition for 28 days to allow consideration of its contents by the public and the lodgement of submissions during the exhibition period.*
2. *That in view of the projected ongoing General Fund deficit position (Operating Result before Capital Grants & Contributions) identified in the Long Term Financial Plan, Management prepare a plan of action for Council consideration so as to return the General Fund to a surplus position within a 4 – 6 year timeframe. This plan of action to consider, but not be limited to, the following matters:*
   - *Completion of works program identified within the Asset Management Strategy (including development of asset management plans) to inform discussion on asset service levels.*
   - *Framework and Program for the conduct of service reviews to inform discussion on services provided by Council and the level / cost of those services.*
   - *Identification of opportunities to achieve operational efficiencies through the Business Transformation Program and other relevant reviews.*
   - *Engagement with the community.*
   - *Timeframes.*
3. *That the plan of action be reported to the September 2022 Ordinary Council Meeting.*

FOR VOTE - Cr A Tickle, Cr J Miller, Cr C Pontin, Cr P Sandilands, Cr D West, Cr K Smith, Cr K Bell
AGAINST VOTE - Nil
ABSENT, DID NOT VOTE – Cr T Fowler, Cr P Howard, Cr D Smith, Cr P Epov

At the next Council Meeting the following resolution was adopted:

Council Meeting 25th May 2022 - RESOLUTION 181/2022

(Moved Cr C Pontin)

That Council notes the Mayor has called on staff to:

1. *Prepare a Transport Asset Strategic Plan that:*
   a. *Describes the current condition of MidCoast transport assets, including roads,*
   b. *Explains the funding since merger to reduce the infrastructure backlog,*
   c. *Identifies the current transport assets (including roads) infrastructure backlog,*
   d. *Projects the changes in asset conditions over time based on the current and projected levels of transport assets funding,*
   e. *Breaks these amounts into operational and capital costs for each of the various categories of roads, separated by funding source,*

f. Proposes options for reverting the roads to a satisfactory standard,

g. Proposes appropriate ongoing road maintenance and renewal budgets to ensure, Council's roads assets do not continue to deteriorate faster than they are renewed, and

h. Identifies possible funding options and timelines for this work.

2. Provide this Report to a Council meeting in December 2022 with an interim report on progress in September 2022, noting the extensive work that will be required to prepare the report,

3. Amend the current budget and expenditure reporting format and timing to enable Council to:

a. approve clearly defined annual budgets for transport assets (including roads), broken down into maintenance, renewal and new capital projects,

b. enable quarterly monitoring of expenditure against those budgets, and

c. provide annual reports of the progress in reducing the transport assets backlog.

4. Commence this budgeting and reporting schedule by December 2022.

FOR VOTE - Cr A Tickle, Cr J Miller, Cr C Pontin, Cr D West, Cr D Smith, Cr K Bell, Cr T Fowler, Cr P Howard
AGAINST VOTE - Nil
ABSENT, DID NOT VOTE - Cr P Epov, Cr K Smith, Cr P Sandilands

A response to these resolutions requires a strategic approach to address financial sustainability across the broad range of factors.

Development of a Financial Sustainability Strategy

Current Budget Position

Council adopted its 2022-2023 budget at the 29 June 2022 Ordinary Meeting. The projected General Fund Net Budget Result was a deficit of $5.5 million while the Net Operating Result from Continuing Operations for General Fund was a projected deficit of $1.2 million. This Net Budget Result (which considers all sources of funding and expenditure) included an additional $7.5 million to address urgent road infrastructure maintenance requirements.

Council has indicated its desire to turn this budget deficit position around over the course of the 2022-2023 financial year.

Restraint will be exercised during 2022-2023 across Council's operations. This will include the following measures:

- all expenditure will be critically considered.
- attention will be given to ensure all income is raised and recovered.
- early notification will be provided where programs will not be delivered as planned so that budget savings can be realised.

Current Long-Term Financial Plan Position

Council considered and adopted an updated Long-Term Financial Plan at the 29 June 2022 Ordinary Meeting. That Plan provided projections of Council's financial position and performance for a 10-year period to 2031-2032 based on a Business as Usual scenario, i.e. ongoing provision of existing services at current service levels.

The current LTFP provides the following projections of Council's Operating Performance Ratio, the key indicator of financial sustainability which measures revenue raised and its coverage of operational expenses, over a 9 year time horizon.

Operating Performance Ratio

	22/23	23/24	24/25	25/26	26/27	27/28	28/29	29/30	30/31
Consoli-dated	-0.07%	-0.17%	-0.85%	0.02%	0.71%	1.20%	1.35%	2.01%	2.40%
General	-7.21%	-8.26%	-10.21%	-9.78%	-9.51%	-9.48%	-9.94%	-9.63%	-9.71%
Water	10.11%	12.13%	14.17%	16.13%	17.95%	19.68%	21.38%	23.08%	24.75%
Sewer	18.88%	20.48%	22.03%	23.49%	24.75%	25.78%	26.76%	27.75%	28.72%

While the Consolidated result indicates that small deficit results for the next 3 years, this is built off projected surpluses within the Water and Sewer Funds. The General Fund is projected to record an ongoing negative Operating Performance Ratio result of approximately 10% across the life of the LTFP.

In dollar terms, the projected deficit results in the Net Operating Result before Capital Grants and Contributions in the General Fund averages approximately $18 million per annum across the life of the LTFP.

These projections have not moved significantly from previous versions of the LTFP which reinforces the need to establish a strategy to return the General Fund to a surplus position.

Council has recently referred the draft 2021-2022 Financial Statements to the NSW Audit Office to commence the audit. Those draft Financial Statements contain the following Operating Performance Ratio results for 2021-2022 (noting that these results are still subject to audit).

Fund	2021-2022 Operating Performance Ratio
Consolidated	4.20%
General	2.15%
Water	1.73%
Sewer	15.31%

Measuring our Financial Performance

Council has considered the development of Financial Goals at several workshops, with the latest being 4 May 2022.

As discussed, there are two main sets of financial ratios that are calculated by Council. The first are the Financial Performance Measures contained within the annual Financial Statements. These Financial Performance Measures have been included as adopted measures within the latest version of the Community Strategic Plan.

The second set of measures are those associated with the Fit for the Future Program, which remain a reporting requirement. Those measures were placed into 3 categories reflecting aspects of overall Council sustainability. They are:

- Sustainability
- Effective Infrastructure and Service Management
- Efficiency

There is commonality between the two sets of measures as can be seen in the following table.

Financial Measure	Financial Statements	Fit for the Future	Category
Operating Performance Ratio	✓	✓	Sustainability
Own Source Operating Revenue	✓	✓	Sustainability
Unrestricted Current Ratio	✓		Effective Infrastructure & Service Management
Debt Service Cover Ratio	✓		Effective Infrastructure & Service Management
Debt Service Ratio		✓	Effective Infrastructure & Service Management
Rates, Annual Charges & Interest Outstanding %	✓		Sustainability
Cash Expense Cover Ratio	✓		Sustainability
Building & Infrastructure Renewals Ratio	✓	✓	Sustainability
Infrastructure Backlog Ratio	✓	✓	Effective Infrastructure & Service Management
Asset Maintenance Ratio	✓	✓	Effective Infrastructure & Service Management
Cost to bring Assets to Agreed Service level	✓		Effective Infrastructure & Service Management
Real Operating Expenditure Ratio		✓	Efficiency

Definitions and benchmarks for those ratios are set out below:

Operating Performance Ratio

This ratio is a core measure of a Council's financial sustainability. It measures Council's ability to contain operating expenditure within operating revenue.

It is important to note that this ratio focusses on operating performance and hence capital grants and contributions, fair value adjustments and reversal of revaluation decrements are excluded.

The ratio is calculated as follows:

(Operating revenue excluding capital grants & contributions - operating expenses) / operating revenue excluding capital grants & contributions

The OLG benchmark is that Council should record a breakeven operating position or better (over 0%).

Own Source Operating Revenue Ratio

This ratio measures fiscal flexibility. It is the degree of reliance on external funding sources such as operating grants and contributions. A council's financial flexibility improves the higher the level of its own source revenue.

The ratio is calculated as follows:

Rates & Annual Charges / Income from Continuing Operations

The OLG benchmark is for own source revenue to be greater than 60%.

Unrestricted Current Ratio

This ratio is a measure of Council’s ability to meet its financial obligations such as paying for goods and services supplied. It assesses the level of liquidity and the ability to satisfy obligations as they fall due in the short term.

The ratio is calculated as follows:

Current assets less all external restrictions / current liabilities less specific purpose liabilities.

The OLG determines that a ratio of greater than 1.5:1 is satisfactory and shows that Council has sufficient liquid assets on hand to meet its short term liabilities.

Debt Service Cover Ratio

This ratio measures the availability of operating cash to service debt including interest, principal and lease payments.

The ratio is calculated as follows:

Operating results before capital excluding interest and depreciation / Principal repayments (source: Statement of Cash Flows) + borrowing costs (source: Income Statement)

The OLG benchmark is greater than 2.

Debt Service Ratio

This ratio assesses the degree to which revenues from continuing operations are committed to the repayment of debt. The ratio is generally higher for councils in growth areas where loans have been required to fund infrastructure such as roads. *The Office of Local Government accepted that a benchmark of <10% is satisfactory, 10% to 20% is fair and >20% is of concern.*

Cash Expense Cover Ratio

This ratio is a measure of Council's liquidity and indicates the number of months that Council can continue to pay its immediate expenses without additional cashflow.

The ratio is calculated as follows:

Current year cash & cash equivalents / monthly average payments for operating and investing activities.

The OLG benchmark is for greater than 3 months.

Building and Infrastructure Renewal Ratio

This ratio assesses that rate at which assets are being renewed against the rate at which they are depreciating.

The ratio is calculated as follows:

Asset renewals / Depreciation, amortisation and impairment

The OLG benchmark is greater than 100%.

Infrastructure Backlog Ratio

This ratio shows what proportion the infrastructure backlog is against the total value of Council's infrastructure.

The ratio is calculated as follows:

Estimated cost to being assets to a satisfactory condition / Carrying value of infrastructure, buildings, other structures and depreciable land improvements

The OLG benchmark is less than 2%.

Asset Maintenance Ratio

This ratio compares actual versus required annual asset maintenance. A ratio above 100% indicates that the Council is investing enough funds that year to halt the infrastructure backlog from growing.

The ratio is calculated as follows:

Actual asset maintenance / Required asset maintenance

The OLG benchmark is greater than 100%.

Cost to bring to Assets to Agreed Service Level

This ratio indicates the proportion of the gross replacement cost of council's assets that have reached the intervention level set by Council based on the condition of the asset. It provides meaningful information of the proportion of outstanding renewal works compared to the total suite of assets that Council has under its care and stewardship.

The ratio is calculated as follows:

Estimated cost to bring assets to an agreed level of service set by Council / Gross Replacement Cost

No benchmark has been set for this ratio.

Real Operating Expenditure Ratio

This ratio indicates how well Council is utilising economies of scale and managing service levels to achieve efficiencies.

The ratio is calculated as follows:

Operating Expenditure / Population (Estimated Resident Population)

The target is a decrease in real operating expenditure over a 3 year rolling average.

All the above measures are relevant and can be reliably calculated. It is recommended that all become part of the suite of measures adopted to measure Council's Financial Sustainability. They should also be calculated and reviewed on both a single point in time and a three year rolling average basis.

<u>Structure of a Financial Sustainability Strategy</u>

Ongoing long-term financial sustainability for Council is an outcome that can be achieved if and when a wide range of separate but inter-related activities are implemented / completed / and operating effectively. These include the large bodies of work and projects identified in the Council resolutions i.e. asset management, service optimisation, business transformation, community engagement, but also less noticeable items such as policy frameworks, staff training, etc.

Current and Proposed Action

As Council is aware there are several actions already underway on a number of fronts that address the themes above and aspects of the various Council resolutions

They include:

Service Optimisation

An approach to the development of a Service Optimisation framework has been agreed.

An initial program plan has been developed with program initiation completed and program set-up and planning in progress.

An external review of Transport Asset service levels has commenced, with findings to inform future financial and service planning.

Future actions during the current financial year include:

- Develop guidelines and template, and undertake a desktop review of services - September 22- March 23 (NB timing dependant on resourcing)
- Review service and, based on initial service costings and community needs, identify priority areas for review (including community consultation) - April - May 23
- Commence service reviews in line with identified priorities - July 23

Strategic Asset Management

The Asset Management Working Group is finalising the 2022-2023 Work Plan for all asset classes. This work is informed by the Asset Management Improvement Plan developed during 2021-2022. A key focus during 2022-2023 will be the finalisation of Asset Management Plans for all asset classes (noting that the water and sewer asset classes are subject to timeframes associated with the development of the Integrated Water Cycle Management Strategy).

The information coming from the Asset Management Plans is required to develop LTFP scenarios and is the basis for conversations with the community on service levels, affordability etc. This is a major consideration and exercise in addressing the financial sustainability challenges facing Council.

The work being conducted on the transport infrastructure asset classes will inform the Transport Assets Strategic Plan requested in Councils resolution.

Business Transformation Program

Council has adopted a Business Transformation Program with a 5-year timeframe. The adopted program provides estimated dollar saving and productivity benefits from year 6.

Program resources will be fully stood up over the remainder of 2022 and the revised schedule of activities based on a 5 year program has been drafted.

Financial and Budget Management

The 2022-2023 Operational Plan highlights that Corporate Overhead Allocation and Service level Costing methodologies will be developed. These support the work that will be undertaken under the Service Optimisation theme and ensure that the true costs of services can be determined. It will also ensure that the appropriate level of corporate overhead is passed on to recognised business activities of Council (Water Fund, Sewer Fund, MCA) and self-funded activities (OSSM, Waste, Environmental Levy).

A body of policy development work will also be undertaken during the next six months to create the budget development and management governance framework. This will guide future budget development processes and financial and management reporting requirements.

Alternate Revenue Streams

Council is currently undertaking a Property Portfolio Review and Strategy Development and will look at other revenue generation activities.

It is proposed to build a Financial Sustainability Strategy using the components listed above and, in the diagram, below:

Under each component (or pillar) of the Financial Sustainability Strategy, a number of objectives, actions and timeframes will need to be developed. Given the requirements of the Council resolutions and the timeframe envisaged to achieve a net Operating Surplus from Operations (4-6 years) these actions will have timeframes that span a number of years. As such there will be a combination of short and long-term actions.

Some of these actions are already incorporated into the 2022-2026 Delivery Program and 2022-2023 Operational Plan. This includes the Service Optimisation Program and the Business Transformation Program. Work in respect of Strategic Asset Management is occurring throughout the organisation via the Asset Management Working Group. The current review of the Community Engagement Strategy and Participation Plan will inform and guide communication / consultation activities that are an essential input to the broader conversation around community expectations of service levels and affordability.

Summary

A pathway to sustainability is required and has clearly been articulated by Council in the adopted resolutions referenced within this paper.

The information provided in this report, and through council workshop discussions will create a platform for the development of a high-level Financial Sustainability Strategy that will guide Council. When finalised it would be appropriate for this Strategy to be included in Council's IP&R documents.

The high-level Financial Sustainability Strategy once adopted by Council can then become a strategy which is under constant review as further information is developed and external factors change.

The Steps to develop the Strategy are set out below:

1. Report to 28th September Council Meeting on the proposal to develop a Financial Sustainability Strategy with the aim of the Strategy being incorporated into Councils Integrated Planning and Reporting documents for 2023-2024.
2. Continue the strategic body of work identified in this report to guide the development of the Financial Sustainability Strategy objectives and actions.
3. Schedule further workshops with Council as required to enable the Strategy to be finalised in early 2023 and exhibited for community comment in conjunction with 2023-2024 IP&R documents.

The above addresses the intent of the Council resolutions to develop a strategic plan to return the General Fund to a sustainable surplus position within a 4-6-year timeframe.

LIST OF ATTACHMENTS

Nil.