

BULOKE SHIRE COUNCIL

Decision on application for a higher cap for 2016-17

May 2016



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1. OUR DECISION

The Fair Go Rates System (FGRS), established in the *Local Government Act 1989* (the Act), requires local councils to limit their average annual rate increases to a rate cap, determined annually by the Minister for Local Government (the Minister).¹ For the 2016-17 rating year, the cap has been set at 2.5 per cent.

Councils wishing to increase their average annual rates by more than 2.5 per cent in 2016-17 must first obtain approval from the Essential Services Commission (the Commission). We are responsible for approving, rejecting or approving in part the higher cap sought by a council. This paper outlines our decision in response to an application by Buloke Shire Council (Buloke or Council) for a higher cap of 3.05 per cent (which includes the Minister's rate cap of 2.5 per cent) to apply in 2016-17.

In assessing applications, we are required to have regard to the six legislative matters² and the statutory objectives³ of the FGRS (box 1).

The six legislative matters are:

- the proposed higher cap for each specified financial year
- the reason for which the council seeks the higher cap
- how the views of ratepayers and the community have been taken into account in proposing the higher cap
- how the higher cap is an efficient use of council resources and represents value for money
- whether consideration has been given to reprioritising proposed expenditures and alternative funding options and why those options are not adequate and
- that the assumptions and proposals in the application are consistent with the council's long-term strategy and financial management policies set out in the council's planning documents and annual budget.

¹ Sections 185B and 185C of the *Local Government Act* define rates for the purposes of the cap.

² Section 185E of the *Local Government Act*.

³ Section 10E(7) of the *Essential Services Commission Act 2001* and section 85A of the *Local Government Act*.

BOX 1 OBJECTIVES OF THE FAIR GO RATES SYSTEM

- to promote the long-term interests of ratepayers and the community in relation to sustainable outcomes in the delivery of services and critical infrastructure and
- to ensure that a council has the financial capacity to perform its duties and functions and exercise its powers.

The Act also requires the Commission to have regard to a council's record of compliance with previous years' caps.⁴ However, as this is the first year of the FGRS, this has not been a relevant consideration when assessing applications for higher caps in the 2016-17 rating year.

BOX 2 COMMISSION'S DECISION ON BULOKE SHIRE'S APPLICATION

Buloke has applied for a higher cap of 3.05 per cent, that is, 0.55 per cent higher than the Minister's rate cap for 2016-17.

The Commission has assessed Buloke's application and decided to approve its proposed higher cap of 3.05 per cent for 2016-17.

On balance, the Commission is satisfied that a higher cap is appropriate because Council has clearly identified in its current 4 year Strategic Resource Plan a strategy to repay a \$7 million loan in 2019. The application is consistent with that strategy.

However, the Commission considers Buloke should prioritise the development of a comprehensive long-term financial plan that extends beyond the repayment of the loan and reflects community preferences and affordability, including setting clear targets for key financial indicators to achieve ongoing financial sustainability.

⁴ Section 185E(6)(c) of the Local Government Act.

2. WHAT DID THE COUNCIL APPLY FOR AND WHY?

Buloke sought a higher cap of 3.05 per cent in 2016-17 (inclusive of the Minister's rate cap of 2.5 per cent). Buloke estimated that this would result in additional revenue of \$56 028 for 2016-17.

Buloke advised that the additional revenue will 'continue to deliver Council a surplus in order to repay its borrowings and to provide Council with working capital to remain financially sustainable'.⁵

A copy of Buloke's application and its response to our request for information (RFI) is available on our website (www.esc.vic.gov.au). Appendix A shows the communications between the Commission and Buloke during the assessment period.

⁵ Buloke Shire Council 2016, *Application for a higher cap*, March, p. 2.

3. HOW DID WE REACH OUR DECISION?

Table 1 summarises our observations on each of the relevant matters specified in Buloke's application.

TABLE 1 LEGISLATIVE MATTER SUMMARY

Legislative matter	Summary
185E(3)(a) – proposed higher cap	The Commission verified that the higher cap was appropriately calculated.
185E(3)(b) – reason(s) for which the council seeks the higher cap	<p>In 2014, Buloke took out a \$7 million interest only loan to reduce Council's overdraft interest expenses and improve Council's cash-flow. This loan is due for repayment in November 2019.^a Since the loan was taken out, Council's budget documents and Strategic Resource Plan projections have outlined a plan to accumulate cash reserves and improve Council's working capital ratio to place it in a financially sustainable position when the loan becomes payable.^{b,c,d} Information provided by Buloke is consistent with these goals and indicates that Council will use the additional revenue from the higher cap in 2016-17 to increase its surplus, rather than to increase expenditure.^e</p>
185E(3)(c) – how the views of ratepayers and the community have been taken into account in proposing the higher cap	<p>In developing its 2014-15 Budget, Buloke undertook a roadshow visiting all 10 towns in the shire to inform the community about its financial position and gain support for its plans to improve its financial sustainability going forward (including a plan for 6 per cent per annum rate increases).^a</p> <p>In 2015, Buloke adopted a Community Engagement Strategy, which outlines a range of methods for engaging with the Buloke community, including Council support for a community forum in each of its 10 towns and fire shed meetings in other locations.^{f,g}</p> <p>Prior to the announcement of the 2.5 per cent rate cap, Buloke held a Community Forum Summit attended by representatives from each of its individual town forums.^{a,g,h} Council says its finances were a major focus and Council presented a plan to repay the loan in 2019.ⁱ At the time of this forum, Council was basing its forecasts on an assumption that the rate cap would be set at 3.05 per cent (in line with the Commission's final report to government in 2015). Therefore, Council does not appear to have foreshadowed to the community a possibility of applying for a higher cap.ⁱ</p> <p>Council states in its application that the community was in support of this rate increase.^j This statement appears to have been based on feedback from the Community Forum Summit but the summary note prepared by the Council about the summit does not indicate there was any focused discussion about rate increases, and it is not clear that the 27 attendees (excluding councillors and council staff) at the forum were representative of the views of the broader community.^{h,k} Council's presentation to summit participants also does not appear to have outlined what the consequences would be if it had to stay within a lower rate cap.^l</p>

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TABLE 1 (CONTINUED)

Legislative matter	Summary
185E(3)(c) (continued)	<p>While the Community Forum Summit occurred before the announcement of the Minister's rate cap and Council did not subsequently undertake further consultation to inform its application for a higher cap, we note that Council's application for a higher cap of 3.05 per cent remains consistent with the rate increase it discussed with summit participants in October.</p> <p>We also note that after submitting its application Council held another forum summit in April 2016 to engage with the community prior to the preparation of the draft 2016-17 budget and attendees at this summit are likely to have had an opportunity to provide feedback on Buloke's planned rate increase.^l</p>
185E(3)(d) – how the higher cap is an efficient use of council resources and represents value for money	<p>Across its 2014-15 and 2015-16 budgets, Buloke achieved a \$4 million reduction in its operating expenditure and reduced its workforce from 133 to 115 equivalent full-time through a range of measures including:^{a,m,n}</p> <ul style="list-style-type: none"> • rationalisation of its community support program, including youth services (\$230 000) • discontinuance of community transport (\$30 000) • rationalisation of customer service centres (from 5 to 1) (\$380 000) • rationalisation of road work crews (\$970 000) • implementation of a new road management plan and reclassification of some roads (\$556 000) and • a move to full cost recovery of waste management services (\$431 000). <p>We note this was a substantial reduction in expenditure (around 15 per cent on Council's 2013-14 operating expenditure) and the savings have been ongoing, allowing Council to start building its cash reserves and improving its working capital ratio.</p> <p>Council advised it benchmarks costs, particularly in the area of road maintenance (its biggest area of expenditure).^o The Department of Environment, Land, Water and Planning reports that Buloke's road resealing costs (\$3.86 per square metre) are well below the average for similar councils (\$7.00 per square metre).^p</p>
185E(3)(e) – whether consideration has been given to reprioritising proposed expenditures and alternative funding options and why those options are not adequate	<p>With the community already being impacted by recent substantial service reductions, Buloke does not appear to have explicitly considered further trade-offs in the context of its higher cap application. However, Council has commenced a 3 year program to review all services, including service levels, in a further effort to identify and implement efficiencies and reduce expenditure.</p> <p>Council stated in its application that it is very limited in its ability to raise income and ensures its user fees and charges are reviewed annually and regularly benchmarked with other Councils.^j</p>

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TABLE 1 (CONTINUED)

Legislative matter	Summary
<p>185E(3)(f) – that the assumptions and proposals in the application are consistent with the council's long-term strategy and financial management policies set out in the Council's planning documents and annual budget</p>	<p>Council's reason for applying for the higher cap — to accumulate sufficient cash to repay the loan in 2019 — appears consistent with its short- and medium-term goals as outlined in its Strategic Resource Plan.^{d,j}</p> <p>However, with the additional revenue received through the higher cap to be permanently added to Council's rate base, we found a lack of clarity about Council's longer-term plans for the additional revenue received after the loan is repaid. Council has advised that after the repayment of the loan it will be in a position to invest in its assets to reduce the asset renewal gap.^q However, its longer-term planning has not yet reached a stage where this position is fully substantiated. Council will need to ensure that cash reserves and working capital do not continue to build unnecessarily after the repayment of the loan, such that Council resources are used effectively and directed to where they are most needed and in line with community preferences. The development of a Long-Term Financial Plan, in consultation with the community, will be of central importance.</p>

^a Buloke Shire Council 2016, *Application for a Higher Cap*, March, p. 1. ^b Buloke Shire Council 2016, *Response to Request for Information*, Clarification of points raised by the ESC, 22 April, p.1. ^c Buloke Shire Council 2016, *Response to Request for Information*, Attachment 1, Adopted Budget 2014-15. ^d Buloke Shire Council 2016, *Response to Request for Information*, Attachment 26, Revised Council Plan 2015-19. ^e Buloke Shire Council 2016, *Response to Request for Information*, Budget Baseline Information. ^f Buloke Shire Council 2016, *Response to Request for Information*, Attachment 3, Community Engagement Strategy, February. ^g Buloke Shire Council 2016, *Response to Request for Information*, Clarification of points raised by the ESC, 22 April, pp.3-4. ^h Buloke Shire Council 2016, *Response to Request for Information*, Attachment 9, Register of invitees and attendees to community forum. ⁱ Buloke Shire Council 2016, *Response to Request for Information*, Attachment 7, *Financial Sustainability*, Presentation to Community Forum. ^j Buloke Shire Council 2016, *Application for a Higher Cap*, March, p. 2. ^k Buloke Shire Council 2016, *Response to Request for Information*, Attachment 8, *Community Forum Summit; October 2015*, Summary of discussion points. ^l Buloke Shire Council 2016, *Media Release*, 'Council meets with community on budget', 22 April. ^m See Buloke Shire Council 2016, *Response to Request for Information*, Attachment 1, Adopted Budget 2014-15, pp. 79-83 for a complete list of specific expenditure reductions. At the time of the 2014-15 Budget, only \$3.34 million in savings over a 2 year period had been specifically identified, although the Strategic Resource Plan incorporated the full \$4 million of targeted savings. Council advised the full \$4 million in ongoing savings from its operational expenditure have been realised. ⁿ Buloke Shire Council 2016, *Response to request for information*, Clarification of points raised by the ESC, 22 April, p.4. ^o Buloke Shire Council 2016, *Response to Request for Information*, Clarification of points raised by the ESC, 22 April, p. 5. ^p Department of Environment Land, Water and Planning 2015, *Know Your Council*, <https://knowyourcouncil.vic.gov.au>, accessed on 16 May 2016. ^q Buloke Shire Council 2016, Response to request for further clarification, email dated 28 April.

3.1 ASSESSMENT

As required under the FGRS, we have examined each of the six legislative matters addressed in Buloke's application. The legislation also requires the Commission to (i) promote the long-term interests of ratepayers and the community in relation to sustainable outcomes in the delivery of services and critical infrastructure and (ii) ensure that a council has the financial capacity to perform its duties and functions and exercise its powers.

Taking into account all of the relevant factors above, we consider that the higher cap is appropriate for the following reasons:

- Buloke appears to have focused strongly on improving its financial position in recent years, driving significant efficiencies in expenditure
- Despite significant expenditure reductions, Buloke continues to operate with a small negative adjusted underlying result, suggesting that further budget restraint or more revenue will be needed to operate sustainably on an ongoing basis
- Buloke's Strategic Resource Plan 2015-2019 outlines how sufficient cash reserves will be accumulated to enable repayment of a \$7 million loan in November 2019⁶ and
- Buloke appears to have engaged openly and transparently with its community about its financial challenges.

UNDERLYING FINANCIAL POSITION AND DEMONSTRATED NEED FOR A PERMANENT INCREASE TO THE RATE BASE

To justify a permanent increase to the rate base, Council should demonstrate a long term financial need that is consistent with the long term interests of its ratepayers and community for sustainable outcomes in service delivery and critical infrastructure.

We have examined Buloke's financial position. Buloke has provided forecasts of the impacts on its Local Government Performance Reporting Framework (LGPRF)

⁶ Buloke Shire Council 2016, *Response to request for information, Attachment 26, Revised Council Plan 2015-19* (incorporating the Strategic Resource Plan).

financial indicators (under both 'with' and 'without' higher cap scenarios) (table 2).⁷

These forecasts show that Buloke continues to operate with a small negative adjusted underlying result in the short- and medium-term.⁸ The forecasts also indicate Council's working capital ratio will be higher under the 'with higher cap scenario'.

TABLE 2 LOCAL GOVERNMENT PERFORMANCE REPORTING FRAMEWORK INDICATORS

LGPRF indicator ^a	2014-15 (Actual)	2015-16 (Budget)	2016-17 (Forecast)	2017-18 (Forecast)	2018-19 (Forecast)	2019-20 (Forecast)
Operating position^b						
Adjusted underlying result (%)						
pre FGRS	5.4	-7.4 ^c				
'without' higher cap (a)			9.5 ^d	-2.3	-2.7	-2.3
'with' higher cap (b)			9.7 ^d	-1.8	-2.1	-1.5
difference (b-a)			0.2	0.5	0.6	0.8
Liquidity^b						
Working capital (%)						
pre FGRS	151	194.42				
'without' higher cap (a)			278.4	365.3	151.2	336.6
'with' higher cap (b)			279.9	369.6	153.9	349.4
difference (b-a)			1.5	4.3	2.7	12.8

Note: Under the Local Government Performance Reporting Framework (LGPRF), councils are required to report annually on their performance against a number of financial and output measures. With and without higher cap forecasts assume a rate increase of 2.85 per cent in 2017-18, then 2.8 per cent per year in 2018-19 and 2019-20 (Buloke Shire Council 2016, *Draft Annual Budget 2016-17*, May, p. 44). ^a Table only includes LGPRF indicators considered in making our decision. ^b See Appendix B for definitions of these indicators. ^c Council notes its 2015-16 adjusted underlying result is much lower than the trend due to the early receipt of half of the 2015-16 Victoria Grants Commission (VGC) allocation and the 2015-16 Public Libraries Grant allocation in June 2015 (Buloke Shire Council 2016, *Draft Annual Budget 2016-17*, p. 27). ^d Council explains the 2016-17 adjusted underlying result is higher than the trend due to the additional Roads to Recovery annual allocation (capital recurrent grant) which is part of the underlying revenue. (Buloke Shire Council 2016, *Draft Annual Budget 2016-17*, p. 27).

Data sources: Buloke Shire Council 2016, *Response to request for clarification of LGPRF financial indicators*, May; Buloke Shire Council 2016, *Draft Annual Budget 2016-17*, May, p. 26.

⁷ Buloke Shire Council 2016, *Response to request for information, Reply to 1.1 and 1.7*, 22 April.

⁸ Council notes its 2015-16 adjusted underlying result is much lower than the trend due to the early receipt of half of the 2015-16 Victoria Grants Commission (VGC) allocation and the 2015-16 Public Libraries Grant allocation in June 2015. Council also explains the 2016-17 adjusted underlying result is higher than the trend due to the additional Roads to Recovery annual allocation (capital recurrent grant) which is part of the underlying revenue. (Buloke Shire Council 2016, *Draft Annual Budget 2016-17*, p. 27).

In 2013-14, Buloke was in an unsustainable financial position.⁹ In 2014, a financial monitor was appointed by the State Government to overview Council's finances and a \$7 million interest only loan over a 5 year period was taken out to address Council's cash-flow issues and reduce its overdraft interest expenses.¹⁰

Buloke's focus in the short- to medium-term has been on reducing its operating expenditure and accumulating cash reserves to enable repayment of the loan when it falls due in 2019 and improving its working capital ratio to ensure ongoing sustainability. It appears to have already made substantial progress against its adopted strategy and has reduced its annual operating expenditure by more than \$4 million. It appears to be on track to repay the loan in November 2019.¹¹

While Council has a clear focus in the short-to medium-term, in order to justify a permanent increase to the rate base (which is the effect of a higher cap), Buloke should also be able to demonstrate a long-term financial need that is consistent with the long-term interests of its ratepayers and community for sustainable outcomes in services and infrastructure.

While we remain concerned that Buloke does not have a long-term financial plan extending beyond its loan repayment in 2019, we consider that the ongoing nature of the increase from the higher cap will not be detrimental to the long-term interests of ratepayers in Buloke for the following reasons:

- In successive budget consultations and in its October 2015 Community Forum Summit, Buloke has advised the community about its financial situation and outlined how council will achieve ongoing financial sustainability in the longer-term.
- Buloke is forecasting small negative adjusted underlying results for the period of its Strategic Resource Plan (2015-2019).
- Buloke has already implemented heavy reductions in services and service levels.

On balance, we approved Buloke's higher cap for 2016-17.

⁹ Buloke Shire Council 2016, *Application for a Higher Cap*, March, p. 1.

¹⁰ Ibid.

¹¹ Buloke Shire Council 2016, *Draft Annual Budget 2016-17*.

MONITORING OF OUTCOMES

Under the FGRS framework, we are required to report annually on Buloke's compliance with its rate cap and every two years on outcomes from the FGRS. When doing so, we will monitor and report on whether Buloke has spent the funds from a higher cap in accordance with the expenditure needs cited in its application. While we approve rates and not individual expenditures, it will be important that community and ratepayers receive confirmation that Buloke has fulfilled its expenditure commitments. In the event that those additional funds have been redirected to other areas of expenditure, we will seek and publish Buloke's explanation for the reallocation of those funds.

APPENDIX A: SUMMARY OF COMMUNICATIONS WITH BULOKE

Buloke submitted its application for a higher cap on 31 March 2016. In response to its application the Commission sought additional information from Buloke (table 3). Buloke's application and its response to our request for further information can be found on our website.

TABLE 3 COMMUNICATIONS BETWEEN BULOKE AND THE COMMISSION

Date	Nature of communication
31 March	Buloke submitted its application
14 April	Commission issued to Buloke a request for information (RFI)
18 April	Council contacted Commission to clarify matters in the RFI
22 April	Buloke submitted its response to the RFI
28 April	Commission sought further clarification from Buloke
28 April	Buloke responded to the Commission's further clarification request
16 May	Commission sought clarification of LGPRF financial indicators
17 May	Buloke provided revised LGPRF financial indicators

APPENDIX B: LGPRF INDICATOR DEFINITIONS

- a. **Adjusted underlying result** is adjusted underlying surplus (deficit) as a percentage of adjusted underlying revenue. A surplus or increasing surplus suggests an improvement in the operating position.
- Adjusted underlying revenue** is total income less non-recurrent capital grants used to fund capital expenditure, non-monetary asset contributions and other contributions to fund capital expenditure.
- Adjusted underlying surplus** is adjusted underlying revenue less total expenditure.
- b. **Working capital ratio** is current assets as a percentage of current liabilities. It indicates whether a council has sufficient working capital to pay bills as and when they fall due. High or increasing level of working capital suggests an improvement in liquidity.