



# TOWONG 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).<sup>1</sup> 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 Towong Shire Council (Towong) for a higher cap of 6.34 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 matters<sup>2</sup> and the statutory objectives<sup>3</sup> of the FGRS (box 1).

The six legislative matters are:

- the proposed higher cap for each specified financial year
- the reasons 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.

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

<sup>2</sup> Section 185E of the *Local Government Act*.

<sup>3</sup> Section 10E(7) of the *Essential Services Commission Act 2001* and section 185A 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
- 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.<sup>4</sup> 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 TOWONG SHIRE'S APPLICATION**

Towong has applied for a higher cap of 6.34 per cent, that is, 3.84 per cent higher the Minister's rate cap for 2016-17.

The Commission has assessed Towong's application and approves its proposed higher cap of 6.34 per cent for 2016-17.

The Commission is satisfied that the higher cap is consistent with Towong's well developed long-term financial plan to deliver sustainable outcomes in services and critical infrastructure in the long-term interests of its community. We find Towong's application and long-term financial plan to be consistent with the requirements of the Fair Go Rates System.

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<sup>4</sup> Section 185E(6)(c) of the Local Government Act.

## 2. WHAT DID THE COUNCIL APPLY FOR AND WHY?

Towong sought a 6.34 per cent rate cap for 2016-17 (inclusive of the Minister's rate cap of 2.5 per cent). Towong estimated that this would result in additional revenue of \$242 860.

Towong submitted that the purpose of the higher cap is to enable Council to continue to provide day-to-day services and infrastructure maintenance and renewal at the modest level required by its residents and ratepayers. The higher cap assumed Towong's long-term financial plan to enable it to be financially sustainable in the short to medium-term.

Towong's application also stated that its long-term financial outlook has been negatively affected by major decisions outside of its control including the freeze of the Federal Government Financial Assistance Grants. This has caused a revenue shortfall of \$658 000 over three financial years 2014-15 to 2016-17.

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

### 3. HOW DID WE REACH OUR DECISION?

Table 1 summarises our observations on each of the relevant matters specified in Towong'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. <sup>a,b</sup>
185E(3)(b) — reason(s) for which the council seeks the higher cap	<p>Towong's application stated that the funds will be used to provide day to day services and infrastructure renewals at levels required by residents and ratepayers and to ensure financial sustainability in the short to medium-term.<sup>b</sup></p> <p>Council provided sufficient evidence to support its reasons for a higher cap. Council provided financial analysis that suggests its financial position will deteriorate in the medium-term (liquidity will fall into VAGO's high risk band in 2023) without an increase in revenues.<sup>c,d</sup></p>
185E(3)(c) — how the views of ratepayers and the community have been taken into account in proposing the higher cap	<p>Towong's application and supporting documents show that Council appears to have consulted adequately with its community and ratepayers about service levels and its financial situation. This assumed the need for rate rises of around 6 per cent on average annually over the longer term.<sup>e</sup> Towong's application explains that it:</p> <ul style="list-style-type: none"> <li>• Provided a public notice and the opportunity to make submissions (in writing or verbally) about the Council Plan, Budget, Strategic Resource Plan, Long-term Financial Plan, and Asset Management Plan.<sup>f</sup> The Council Plan, Budget, Strategic Resource Plan and Long-term Financial Plan all forecast that rates will increase annually by about 6 per cent over future years.<sup>e,g</sup></li> <li>• Consulted widely with the community prior to the 2015-16 budget about its difficult financial situation and service delivery implications under a cap environment. Council was able to produce consultation outcomes indicating general community acceptance for rate rises of about 6 per cent per year to maintain services at current levels.<sup>h</sup></li> <li>• Used a continuum of engagement methods to consult with the community including workshops, focus groups, one on one meetings, information stands, surveys, web pages, local radio and newspaper and newsletters.<sup>i</sup></li> <li>• Engaged with communities and developed a number of community master plans including "Our Bellbridge", "Tallangatta Tomorrow", "Our Valley Our Future" and "Upper Murray 2030 Vision Plan". The master plans represent the views of the ratepayers and communities about services required. The plans have been used to formulate the 2013-2017 Council Plan and annual budgets.<sup>j</sup></li> </ul>

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**TABLE 1 (CONTINUED)**

Legislative matter	Summary
185E(3)(c) (continued)	<ul style="list-style-type: none"> <li>• Used the audit committee to review all longer term planning documents and provide Council with community views.<sup>j</sup></li> <li>• Conducted 'Road Shows' where the Director Technical Services and Asset Engineer visited local communities and spoke to residents about road and related infrastructure. The views obtained from residents have been used to inform the development of asset management plans and intervention levels for assets.<sup>j</sup></li> </ul> <p>We note that Council indicated that it did not consult specifically on its intention to apply for a higher cap in 2016-17. While Towong identified a list of services that could be reduced or ceased to allow it to operate under the Minister's cap, it stated it was unable to consult fully prior to its application. However, Council subsequently indicated that it is willing to consult more on such matters in the future.<sup>k</sup></p>
185E(3)(d) — how the higher cap is an efficient use of council resources and represents value for money	<p>Towong's application indicated that Council performs well against its peers in terms of unit costs to deliver a range of services (data from Know Your Council website) as well as showing higher community satisfaction (State wide community satisfaction survey) more generally.<sup>l</sup> Council has also provided information regarding its initiatives to reduce costs across a range of services and identified efficiency savings of \$145 800 (or 1.1 per cent of total expenditure) in 2015-16.<sup>m</sup></p> <p>Prior to this Towong has achieved other major cost savings over the past six years including:</p> <ul style="list-style-type: none"> <li>• bringing kerbside waste collection back in-house is estimated to save \$1 million over a 7 year period</li> <li>• motor vehicle policy changes and fleet reduction is estimated to save \$130 000 per year</li> <li>• organisational restructure is estimated to save \$250 000 per year and</li> <li>• shared service arrangements between Towong and Indigo Shire Council for rates and property services is estimated to save \$25 000 per year.<sup>n</sup></li> </ul>
185E(3)(e) — whether consideration has been given to reprioritising proposed expenditures and alternative funding options and why those options are not adequate	<p>Towong's application shows that it has considered alternate funding options and service trade-offs. It has considered:</p> <ul style="list-style-type: none"> <li>• borrowing, leasing and special charges</li> <li>• reducing expenditure on roads renewals</li> <li>• reducing expenditure on certain services so as to meet the Minister's cap of 2.5 per cent and</li> <li>• utilising cash reserves to fund an increasing underlying deficit</li> </ul> <p>Council also provided reasons about why these options are not suitable:</p> <ul style="list-style-type: none"> <li>• under the current circumstances borrowing, leasing, and special charges are not suitable ways to fund service delivery. Council uses borrowings for projects with intergenerational benefits and not to fund day to day operational needs. There are no major plant or equipment purchases planned in 2015-16 so consequently there is no need for lease arrangements. There are no projects planned in 2016-17 that meet the criteria for a special charge under the Local Government Act</li> </ul>

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**TABLE 1 (CONTINUED)**

Legislative matter	Summary
185E(3)(e) (continued)	<ul style="list-style-type: none"> <li>• reducing expenditure on roads renewals to a level that can be accommodated under the cap results in road conditions that are unacceptable to the community</li> <li>• reducing expenditure on some services to levels that can be accommodated under the cap may be of concern to both staff and the community and</li> <li>• utilising cash reserves is expected to cause financial sustainability concerns in the short-term.</li> </ul> <p>We consider the reasons given by Council for not adopting these options appears to be reasonable.</p> <p>As noted earlier Towong identified a list of services that may be reduced or ceased to allow it to operate under the Minister's cap.</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>Towong's application included:</p> <ul style="list-style-type: none"> <li>• a range of masterplans for some communities</li> <li>• strategies to promote tourism and agriculture</li> <li>• Road Management Plan</li> <li>• Council's Plan</li> <li>• Council's Budget</li> <li>• Annual Report (2014-15)</li> <li>• Long-term Financial Plan.</li> </ul> <p>The masterplans, strategies and road management plan inform the planning documents that are based on an annual rate rises of about 6 per cent.<sup>i</sup></p>

<sup>a</sup> Towong Shire Council 2016, *Budget Baseline Template*, March. <sup>b</sup> Towong Shire Council 2016, *Application for a higher cap, the statement*, March, p. 1. <sup>c</sup> The Victorian Auditor-General's Office (VAGO) define the liquidity ratio as current assets divided by current liabilities. <sup>d</sup> Towong Shire Council 2016, *Application for a higher cap, the statement*, March, pp. 5-6. <sup>e</sup> Towong Shire Council 2016, *2015-16 Budget*, p. 6. <sup>f</sup> Towong Shire Council 2016, *Application for a higher cap, the statement*, March p. 8. <sup>g</sup> Towong Shire Council 2016, *Application for a higher cap, Towong Shire Council LTFP - Budget 2016-17 - FINAL @ 6.34%*, March. <sup>h</sup> Towong Shire Council 2016, *Response to Request for Information — Essential Services Commission*, April p. 3. <sup>i</sup> Towong Shire Council 2016, *Application for a higher cap, the statement*, March. <sup>j</sup> Towong Shire Council 2016, *Application for a higher cap, the statement*, March, pp. 8-10. <sup>k</sup> Towong Shire Council 2016, *Response to Request for Information — Essential Services Commission*, April, p. 5. <sup>l</sup> Towong Shire Council 2016, *Application for a higher cap, the statement*, March, pp. 11-12. <sup>m</sup> Towong Shire Council 2016, *Application for a higher cap, the statement*, March, p. 5. <sup>n</sup> Towong Shire Council 2016, *Application for a higher cap, the statement*, March, pp. 4,12-13. <sup>o</sup> Towong Shire Council 2016, *Application for a higher cap, the statement*, March, pp. 15-19.

### 3.1 ASSESSMENT

As required under the FGRS, we have examined each of the six legislative matters addressed in Towong'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 reasons discussed below.

#### **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 Towong's underlying financial position. Towong's forecasts of the effects on its Local Government Performance Reporting Framework (LGPRF) financial indicators (under both 'with' and 'without' higher cap scenarios) show that Towong operates with a negative adjusted underlying result in the short and medium-term (table 2).

Towong has shown through its long-term financial planning (covering the period 2017 to 2032) that it will need to increase rates by about 6 per cent per year to remain financially sustainable and continue to deliver services at current levels. Towong's application supported its claim that if it fails to generate sufficient revenue to offset operating expenses over the longer term, this may lead to a reduction in service levels. Council may also not be in a position to undertake major asset renewal and replacement when required. Towong consulted on the higher rate increase prior to adopting its 2015-16 budget and its application indicated that there was general acceptance among the community.

Our analysis shows that Towong has pursued and achieved savings from a range of initiatives. LGPRF indicators show that Towong has lower unit costs to deliver a range of services than the average of comparable councils.

**TABLE 2 LOCAL GOVERNMENT PERFORMANCE REPORTING FRAMEWORK INDICATORS**

LGPRF indicator <sup>a</sup>	2014-15 (Actual)	2015-16 (Forecast Actual)	2016-17 (Forecast)	2017-18 (Forecast)	2018-19 (Forecast)
<b>Operating position</b>					
<b>Adjusted underlying result<sup>b</sup> (%)</b>					
pre-FGRS	26.57	-13.29			
'without' higher cap (a)			-3.69	-7.06	-4.20
'with' higher cap (b)			-3.13	-5.03	-0.79
difference (b-a)			0.56	2.03	3.41

**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. <sup>a</sup> Table only includes LGPRF indicators considered in making our decision. <sup>b</sup> See Appendix B for definition of this indicator.

Data source: Towong Shire Council 2016, *Response to request for further information*, April.

Towong's application showed that Council is pursuing a broad range of actions within its control in order to deliver services that meet community expectations. Towong's application included:

- its long-term financial model that shows how its financial position is affected by different revenue and expenditure scenarios
- a range of initiatives it has undertaken to reduce costs
- a number of alternative funding arrangements that were considered and provided reasons why these were not appropriate and
- a number of engagement forums with the community on its financial situation and how different rating scenarios would affect service delivery.

Based on our analysis of Towong's application, we consider that Council has demonstrated a need for a higher cap in 2016-17 to maintain financial sustainability in the longer term.

## **MONITORING OF OUTCOMES**

Under the FGRS framework, we are required to report annually on Towong'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 Towong 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 Towong 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 Towong's explanation for the reallocation of those funds.

## APPENDIX A: SUMMARY OF COMMUNICATIONS WITH TOWONG

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

**TABLE 3 COMMUNICATIONS BETWEEN TOWONG AND THE COMMISSION**

Date	Nature of communication
31 March	Towong submitted its application
4 April	Towong amended cover sheet and forwarded to the Commission
8 April	Towong and the Commission met to have a preliminary discussion about the application
15 April	Commission issued Towong a request for information (RFI)
19 April	Towong contacted Commission to clarify questions in RFI
19 April	Commission responded to Council query on RFI
29 April	Towong submitted its response to the RFI
2 May	Towong submitted an updated baseline information template to the Commission
5 May	Commission contacted Towong to clarify calculation of higher cap related figures
5 May	Commission sent follow-up questions related to Towong's response to the RFI
6 May	Towong responded and clarified the higher cap calculation query
6 May	Towong responded to the Commission's 5 May request for some clarifications
9 May	Commission sent query to Towong in relation to its capital expenditure
11 May	Towong responded to the Commission's request in relation to its capital expenditure

## 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.