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Hindmarsh
Shire Council

Inquiry into the sustainability and operational challenges of Victoria's rural and regional councils

Submission

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1. General Comments:

1.1 A Definition

Local government financial sustainability has been the subject of enquiries in most States during the past decade by Government Instrumentalities, Local Government Associations and private accounting firms. The Victorian Auditor General (VAGO) refers to financial sustainability in his annual reports and the Local Government Act 1989 contains several provisions relating to council viability and sustainability. Nevertheless, no standard definition has been adopted for the term.

However, the interpretations applied by these sources, taken collectively, mean that a financially sustainable council should be capable of:

- → providing and funding the service needs of its community;
- → meeting contingencies without needing to make radical changes to spending and/or revenue policies;
- → maintaining stability and equity in rating levels; and
- → preserving intergenerational equity.

Assessing Financial Sustainability - the Three Perspectives

A comprehensive assessment of a council's financial sustainability involves analysis from three interrelated perspectives:

(1) Financial performance - the outcome of a council's financial activities: past and projected; measured in financial terms, using indicators devised for the purpose.

(2) Corporate performance - the quality of a council's financial decision making in planning and providing community facilities and services, and in managing resources.

(3) Sustainable (financial) capacity - the impact of inherent structural characteristics (e.g. community income, population etc.) on a council's ability to raise revenue and contain costs.

Performance vs. Capacity

Financial performance and sustainable capacity are distinctly different aspects of financial sustainability, each requiring different means of assessment. VAGO and the MAV use financial indicators to measure financial outcomes.

The Whelan Model *[Merv and Rohan Whelan – "Local Government Financial Sustainability Review" November 2012]* determines the combined impact of inherent factors on the ability of a council to provide required services. These factors include the relative capacity of the community to pay rates, charges and other revenues and the impact of inherent geographic, demographic and financial factors on the ability to provide required services.

The focus is on sustainable capacity. A council's sustainable capacity is not necessarily consistent with its corporate and/or financial performance.

A co-author of the Whelan Report conducted annual appraisals of council financial sustainability for Local Government Victoria for the seven year period to 2009. It became clear during these review processes that financial indicators do not explain the substantial differences between councils in capacity to raise revenues and pay for services, and that these differences are directly related to the impact of the inherent factors identified by the studies.

These factors substantially impact on sustainable capacity and must be quantified and applied to establish an objective, reliable means of determining it.

Inherent Factors
Sustainable capacity is determined by the Whelan Model using a range of inherent factors that impact on revenue raising capacity and cost levels. These are:

- → Capacity of the community to pay;
- → Population size;
- → Population density;
- → Dispersion of the population into townships and rural areas;
- → Remoteness of the municipality from major populations centres;
- → Aged and infant populations;
- → Concentration of service activity;
- → Average traffic volumes;
- → Bridges and other road cost factors; and
- → Tied and untied recurrent government grants.

In short, the Whelan Report noted that there are a range of inherent factors impinging on the financial capacity of all Councils. Since the report was produced, the following external influences have also arisen:

- → Federal and State Government revenues have been affected by the structural changes to the Australian Economy;
- → In response, the Federal Government has frozen Grants Commission indexation of payments;
- → The State Government has, from 2016/17, imposed rate capping limits;
- → Removal by the State Government of local roads funding;
- → On a positive note, interest rates remain at historical low levels;
- → Despite the challenging economy, Victorian councils have not been called upon to “top up” defined benefit superannuation schemes; and
- → Wage rises in the Australian economy have been contained.

1.2 Rural Shires Challenges

The Whelan Report classified Victorian councils. Two of the eight classifications included:

- → Medium Rural (nine councils)
- → Small Rural (nine councils, including Hindmarsh)

It is clear from the Whelan Report that the capacity to pay (C2P) of residents of rural councils is significantly less than residents in other areas, thus affecting the ability of all rural service providers, including local government, to raise revenue to fund services. Some of the factors influencing this conclusion are set out in the following paragraphs taken from the Whelan Report. These are not the only factors analysed by Whelan, but they are the most persuasive and relevant to Hindmarsh.

Capacity to Pay (C2P)
There are two methods consistently proposed for assessing capacity of the community to pay. These are property valuations (CIV) and net disposable community income (NDCI).

The Whelan report concludes that even though councils use Property Valuations to apportion the rate burden among ratepayers, NDCI is arguably the most appropriate measure for determining a community's Capacity To Pay.

The Whelan report concludes that the two smallest rural council categories were at a disadvantage in C2P as follows;

COUNCIL CLASSIFICATION	AVERAGE CAPACITY TO PAY
Small Rural	$33,203
Medium Rural	$43,958
Large Rural	$50,816
Rural Centre	$47,494
Regional City	$64,270
Fringe Metro	$60,632
Low Density Metro	$72,356
High Density Metro	$86,889
	Source: 2012 Whelan Model (2010 Data)

The Whelan Report concluded that Small Rural Shire residents have only a little more than half the C2P of Regional City and Fringe Metro residents. The Whelan Report noted further that –

There is a strong correlation between council population and C2P. Metropolitan and regional councils have the highest relative capacity to raise own source revenue and rural councils, in particular small rural, have the lowest. Further analysis shows that small rural councils have made the greatest relative use of their capacity.

Cost Factors
Many studies have been undertaken to determine the impact of population size on the capacity of councils to achieve economies in service delivery. Perceived gains of larger councils include:

- → Scale - costs per unit reduce as output (population served) increases; and
- → Scope - fixed costs such as administration/capital resources are spread over a range of activities.

(1) Population Size
There is an indisputable relationship between cost per head and size of population. Large populations support the achievement of economies of scale, resulting in lower service costs.

(2) Population Density
Provision of services over larger distances increases service costs. Metropolitan councils have the highest population density (285) and small rural councils the lowest.

(3) Council Remoteness
Remoteness scores for metropolitan councils approximate zero. Small rural councils located farthest from Melbourne and other large population centres, are most negatively impacted.

(4) Road Cost Factors and Bridges
Major factors affecting the cost of constructing and maintaining roads include the availability of suitable road making materials, the stability of sub-grades, climatic conditions and the volume of freight traffic.
Bridges, as part of the local road network and as a function of council geography, add considerably to recurrent costs in certain councils.

(5) Aged and Infant Populations
Provision of aged services, maternal health services and other services for young children have a material impact on service costs per head. The 70+ age group was found to most accurately reflect the impact on aged service costs. Small rural councils have the highest percentage of this group (15.69%) and fringe metropolitan the lowest (7.04%).

(6) Effect on costs
There is a strong correlation between council classification and Nominal Costs, the variation between metropolitan (lowest) and small rural councils (highest) being over $1400 per head. Tests carried out using the Whelan Model suggest that population number has the biggest impact on cost per head.

The described increased service delivery cost in rural municipalities compared to metropolitan councils is further supported by the data available on the knowyourcouncil website.

A comparison of Victoria’s most populous municipality, the City of Casey, and Hindmarsh Shire Council, Victoria’s third smallest, may illustrate this point:

→ Hindmarsh Shire Council’s expenses per property assessment are $3,286.47, compared to Casey’s at $2,358.22.
→ Expenses per head of municipal population in Hindmarsh are $2,890.82, at Casey they are only $849.46.
→ Hindmarsh Shire Council maintains infrastructure per head of municipal population worth $18,805.28, the City of Casey looks after $5,409.67 worth of infrastructure per head of its municipal population.
→ Population density per length of road in Hindmarsh is 1.83, for Casey it is 181.59.
→ Hindmarsh Shire Council has maximised its capacity to raise own source revenue per head of its population with $1,661.26, compared to Casey’s $742.46 own source revenue per head of municipal population.
→ Hindmarsh Shire Council’s rates as a percentage of property values in our municipality are 0.65%, Casey’s are at 0.40%.

2. Local Government Funding and Budgetary Pressures

The three key budgetary pressures experienced not only by Hindmarsh Shire Council but its fellow rural councils are:

- → the Federal Government's freeze on the indexation of Grants Commission payments;
- → the State Government introduction, from 2016/17, of a rate cap; and
- → the removal by the State Government of local roads funding.

The Financial Statements in Council's 2016/17 Budget project expenditure based on Council's long term service, asset and financial planning. The statements project increasing deficits for the years 2017/18 onwards, a reflection of the introduction of rates capping combined with a reduction in state and federal government funding.

Council's medium to long term planning has been based on maintenance of service levels and a continued effort to keep up with the need for renewal of our ageing infrastructure. While the financial statements paint a realistic picture of our service and infrastructure needs, they also reflect that the current financial environment will not allow us to meet these needs into the medium to distant future without additional revenue and funding sources.

If such additional income does not become available, service levels will have to be reduced significantly to maintain a financially sustainable future.

It is worth noting at this point, that the service levels provided to our community are already well below our metropolitan counterparts. To put this into perspective with just a few examples:

As a small rural council, Hindmarsh Shire Council manages assets worth $115m with an operational budget of $18m. Library services in two of our towns are provided for two hours a fortnight via mobile library. Our cinema opens for two shows a week and is only able to do so because our staff volunteer their time to run the shows. Kindergartens in the northern part of our shire are only able to provide 10 hours of four-year-old programs because we have neither the financial nor the human resources to provide 15 hours in each of these small communities.

3. Fairness, Equity and Adequacy of Rating Systems

Hindmarsh Shire Council supports the RURAL LIVING campaign relating to the inequities in services available to rural residents compared to their metropolitan counterparts. The disparity between rural and metropolitan council's capacity to raise revenue, be it from rates or other sources, sees the generation of a two-tier country with those living in small rural shires not able to access a reasonable set of services and continually fighting to remain financially sustainable. This compares markedly with the plethora of services available to those in the cities; for which the ratepayers in those cities pay much less.

I refer again to the comparison above between the City of Casey and the Shire of Hindmarsh to illustrate this point.

While rural people are realistic and do not expect the exact same level of services as those provided in a city, the disparity has a direct impact on our residents' health, wellbeing and prosperity and the liveability of our community. If we are not providing a liveable environment for those working in the country and contributing substantially to our economy, we will see a decline not only of our rural economy but the health of our nation.

4. Impact of Rate-Capping Policies

Council has always considered our community's reduced capacity to pay and been reluctant to increase rates at a high level. However, our inability to raise funds from other sources has meant that Council has been forced to increase rates by more than the current rate cap to maintain services and assets.

While metropolitan councils can minimise the impact of rate capping by increasing their income from other sources such as parking and facility entry fees, rural councils have no such ability.

While Hindmarsh Shire Council is able to maintain service levels for the 2016/17 financial year, we will need to reduce service levels in coming years should not other revenue sources or increased government funding become available.

5. Capacity for Rural and Regional Councils to Meet Responsibilities for Flood Planning and Preparation, and Maintenance of Flood Mitigation Infrastructure

Councils are involved in flood planning and preparation but flood infrastructure and maintenance should be state based responsibilities. Flooding occurs across local government boundaries, is frequently beyond the capacity for Local Government to fund and has state wide impacts. The current funding model does allow for a shared capital cost of flood mitigation infrastructure, however the recurrent cost is borne by local government. Councils are now expected to fund a third of levee capital costs and to also provide the ongoing management and maintenance of infrastructure. Over the life of the infrastructure these costs are typically on a par with the total initial capital cost.

6. Maintenance of Local Road and Bridge Networks

As described previously, the funding and own source revenue at Council's disposal is insufficient to cover the ongoing maintenance and renewal of its local road and bridge network.

The following chart shows the funding required to renew Hindmarsh Shire Council's road infrastructure, as described in our 2016/17 Budget:

Asset Class	Quantity	Approximate Replacement Value	Estimated Useful Life	Annual Funding Target
Footpath	39 km	$3,600,000	40 years	$90,000
Kerb	65 km	$7,000,000	60 years	$90,000
Sealed Pavement	580 km	$63,000,000	70 years	$1,000,000
Sealed Surface	580 km	$16,000,000	20 years	$800,000
Sealed Rural Road Unsealed Shoulders	510 km	$11,000,000	27 years	$220,000
Unsealed Pavement (Hierarchy 3 – 5)	850 km	$17,500,000	27 years	$260,000
Total		**$118,100,000**		**$2,460,000**

Annual funding targets are based on reports and condition assessments by Moloney Asset Management Systems, the last report being issued 20/03/2013.

Moloney concluded that "Hindmarsh Shire has managed its road assets very well since the last condition survey in 2008." and that "The total present renewal shortfall or backlog in over intervention condition assets is estimated at $2,232,527 for the whole road network. The shortfall being mostly associated with the sealed surface assets."

The Moloney report, and Council's own subsequent modelling, project the "required" infrastructure spending over the next 10 years, and beyond.

As part of a long term MAV Asset Renewal Gap survey in 2015, Council's engineering department have undertaken a further calculation of the required expenditure over the next 10 years, considering only at renewal demand expenditure and proposed funding. This calculation shows a renewal shortfall each year averaging $504,500.

It is important to note that this analysis does not take into account that many of Council's buildings were constructed in the post 2nd World War building boom, and the end of their economic life will create an even larger "hump" of renewal expenditure required in the future.

While Hindmarsh Shire Council's financial indicators suggest the Council is slightly better placed than its peers, it still has a significant known infrastructure gap to manage, a clear indicator that Council is not deriving sufficient funds to meet its present capital expenditure needs.

7. Weed and Pest Animal Control

Councils have been handed full responsibility for roadside pest and weed control. Currently funding is $65,000 per annum which was increased from $50,000 in 2015/16. However, Council is responsible for a road network of 3,200km, that is 6,400km of roadside. While the contribution of $65,000 per annum is appreciated, in reality it only provides for a minuscule part of this road network to be controlled.

In closing, on behalf of Hindmarsh Shire Council I appreciate the opportunity to provide a submission.

Yours faithfully,

[redacted]

Anne Champness
Director Corporate & Community Services
Hindmarsh Shire Council