

SURF COAST SHIRE COUNCIL

Our Financial Story

JUNE 2024

Winchelsea Common

Our Financial Story

Surf Coast Shire Council is a regional local government authority, located an hour south-west of Melbourne. The municipality has an approximate population of 41,000 in 2024, a mix of coastal and hinterland communities and has experienced strong overall population growth over recent decades.

Council provides 100+ services to the local community and maintains over one billion worth of community assets to support both the local population and the 2.5 million people who visit the area on an annual basis.

The purpose of this document is to share the financial challenges faced by Council and to outline the important principles that underpin the development of its annual budgets and financial plans. By sharing these challenges and principles with the community, Council hopes to inform and engage its most critical stakeholders in finding solutions to Council's financial challenges.

The Challenge

Council has a responsibility to current and future communities that leads to significant demands on its finances, in particular:

- The reality of responding and adapting to the changing climate;
- Costs associated with maintaining our existing assets (asset renewal) and new assets;
- The expectations of a growing community, with diverse interests, compounded by a continuing growth in visitors; and
- The growing costs of managing the shire's waste and recycling including transitioning away from the Anglesea Landfill.

These demands are set in the context of revenue structures constraining Council's capacity to support the community:

- The State Government's "Fair Go Rates" legislation, introduced in 2016, has capped rate revenue increases below inflation;
- In 2024, the State Government introduced changes that prevent councils from fully recovering the costs of all waste and recycling costs through a waste service charge;
- The State Government's debt levels are forecast to increase from 5% of nominal gsp (net debt to gross state product) pre-covid to 25% in 2026-27, restricting its ability to provide local government financial support;
- The Federal Government's financial assistance grant which accounts for more than half of Council's operating grants, has not increased in real terms on a per capita basis since 1995; and

- The challenge of fully recovering our costs for our services.

Whilst acknowledging that household affordability is important, particularly with the current cost-of-living crisis, the introduction of rate capping has significantly constrained revenue for local government authorities. Council must carefully consider the allocation of its financial resources in this environment and continue to pursue important efficiency reforms. This can be difficult at times with the burden of extra responsibilities being placed on Council by State and Federal Governments without sufficient compensation.

Climate Change

All councils are required to mitigate and plan for climate change risks under the *Local Government Act 2020*. In 2019 Surf Coast Shire Council declared a climate emergency acknowledging the need for more urgent and extensive action to reduce emissions and increase resilience to local climate change impacts.

Climate change is a significant challenge for all levels of government – with its impacts felt acutely at the local level, particularly in rural and regional areas. Council is responsible for managing over \$1 billion of community assets and infrastructure, including roads, community buildings and open space, all of which are impacted by climate events and have a high cost for repair and maintenance.

Conservative economic assessments of the direct risks to Victorian council assets indicate that annual damages will increase significantly due to climate change in a business as usual scenario (without adaptation) as hazardous events become more frequent and as more assets become exposed.

All levels of government, including Council, are now bearing the costs of climate change and the financial pressure to both recover and adapt will grow. This is an evolving environment that needs to be evaluated and understood so that decisions in the 10-Year Financial Plan can factor climate change in managing long term sustainability.

Asset Renewal

Council's delivery of services significantly depends on maintaining its assets in good condition for as long as the community needs them.

Council's asset management practices are mature and incorporate infrastructure and financial elements of the asset base. This includes thorough and extensive asset condition reviews that feed into detailed asset modelling. This modelling ensures that Council has a forward plan for renewing its assets, so they remain in a safe useable condition for the community.

The asset modelling projects the asset renewal demand over the coming 10 years and calculates an allocation for asset renewal that increases each year at a steady rate (to avoid annual fluctuations that are difficult to manage). This has been formally documented in

Council's Asset Renewal Funding Strategy and is considered a foundation for the 10-Year Financial Plan.

When assets have reached a condition where renewal is desired, but funding cannot be allocated at that time, they are referred to as Council's "Asset Renewal Backlog". Council has acknowledged that with all the demands on its finances, it is not feasible to reduce the backlog to zero. Over the last five years Council's asset renewal backlog has grown.

Consecutive councils have recognised the growing financial commitment to maintain its ageing assets and have increased the annual allocation to asset renewal from \$5.5 million in 2015-16 to \$10.6 million in 2024-25. Under Council's current Asset Renewal Funding Strategy, the annual allocation will nearly double to reach \$20.4 million in 2033-34. Council has mostly offset the recent jump in construction costs by improving asset renewal practices. This will remain a focus in coming years.

Council continues to find it challenging to de-commission assets, even if they are used infrequently. Community reluctance to see a reduction in the number of facilities means Council's funds are stretched more thinly across a larger number of assets.

The growing need for asset renewal expenditure, in the context of more extreme weather events, presents a significant challenge for Council. Without major reform to Council's services and operations it will mean less money is available to fund new initiatives and for existing services to keep pace with community expectations.

New Initiatives

Council's 10-Year Financial Plan in 2024/25 has \$6.7 million of funding allocations to provide for new initiatives that are important to support a growing and changing community, including:

- Projects identified within Development and Infrastructure plans,
- Loan principal and interest costs, noting loans have been used to fund generational assets as Council is a growing municipality, it's rate-base cannot afford to fund the level of infrastructure required to provide those services to the community, and
- Annual allocations towards new discretionary initiatives, which are important projects that respond to current issues and demands.

Council's allocations to new initiatives are declining as more funds are required to renew existing assets.

Council does have some funding sources that assist with new initiatives, including:

- Development and Infrastructure plans are strategically important because they ensure developer contributions are committed with certainty, however these also create long-term commitments from Council.

- Council has been successful at attracting grants from other levels of government to help fund new projects. This partnership funding remains essential however it is important to note that the operating and future renewal costs will still fall to Council and must be considered, as does any co-contributions required under any funding agreements. Grant funding is also impacted by financial pressures being experienced by other levels of government.
- New residential developments in the Shire do provide increased rate revenue for Council which can help fund new items, and these supplementary rates are important. However, the growing community also needs Council to deliver new services, and maintain and renew new assets when necessary, so the supplementary rates do not solve Council's financial challenges.

Infrastructure Special Rate or Charge Schemes can finance new or improved infrastructure with financial contributions from property owners that stand to benefit.

Council needs to consider the level of discretionary funding it wishes to have available as discretionary funding is used for a variety of things including new pathways, drainage, beautification works, recreation facilities and other community assets. Council's capacity to provide this funding is reducing over time and this may lead to community expectations not being met.

Waste and Recycling

Council will face several significant costs associated with waste management during coming years, including the rehabilitation of Anglesea landfill as well as upgrades to waste facilities necessary to meet community needs and cater for a growing population. The Anglesea Landfill is predicted to reach the end of its life in 2027. The current estimated cost to complete rehabilitation works at the landfill is \$12 million, a cost that has increased significantly from the 2022-23 estimation of \$7.1 million.

Successive councils have been planning for the closure of the Anglesea landfill with cash reserves being built up in a Waste Reserve. Significant cost increases associated with waste management disposal, including increases to the State Government's municipal waste levy, and cost escalations for rehabilitation works, mean the reserve will not have sufficient funds to cover the rehabilitation works when they are required. Council will need to borrow funds to deliver the rehabilitation works which cannot be deferred.

A Plan to Manage the Challenge

Council's challenging financial situation means that over the Ten-Year Plan there is a declining capacity to fund new initiatives as obligations to manage existing assets is increasing. Contributing to this are the construction cost escalations exceeding 6% over the two years post COVID, and a prediction of over 4% for 2023/24. This has significantly reduced the value

for money obtainable from Council's available cash allocations. These cost pressures are within a constrained revenue environment. Whilst Council acknowledges that rate increases are not the sole solution, rate revenue is Council's largest source of revenue. Rate increases Under the State Government's Fair Go Rates System have not kept up with cost escalations experienced by Council.

Council is managing the forecast cash deficits expected over the Long-Term Financial Plan by drawing on reserves. There is no capacity to respond beyond that to new challenges or opportunities, or to maintain the current levels of new initiative.

To maintain Council's capacity over the Ten-Year Plan to fund new initiatives, and to factor in the costs to manage climate change, Council's operations need to generate higher surpluses. To do this, Council needs to review what it delivers to the community and at what cost. Council's Business Reform Program needs to be ramped up with further business improvements and efficiencies. Council will also need to explore alternative income streams, efficiencies and what is an affordable standard of service. For example, adjusting cleaning and maintenance schedules.

The changes needed to create greater financial capacity will require assistance and input from the community and other partners. This takes time and so it is important that Council continues to work on this challenge, identify solutions and make the necessary changes.

Financial Principles

Long Term Financial Plan

1. The 10-Year Financial Plan will be updated and endorsed as part of the annual budget process.
2. An unallocated cash deficit in any year must be funded by a reserve allocation; however, this is only an interim solution with a strategy required to return to an ongoing surplus.
3. A minimum balance forecast over the life of the 10-Year Financial plan of \$250,000 must be retained in the Accumulated Unallocated Cash Reserve to provide for unexpected demands. A plan to replenish the reserve must be made when an unexpected demand reduces the balance to below \$250,000.
4. Borrowings are an effective way to fund Council priorities that are otherwise not affordable within Council's rate base. They can spread the burden of large investments across the generations that will benefit from those investments. New borrowings will only be taken where there is capacity to fund debt servicing costs for every year of the loan and will not be taken out to fund deficits or asset renewal requirements.
5. Proceeds from asset sales will be allocated to the Accumulated Unallocated Cash Reserve unless related to the sale of open space (i.e. must be allocated to the Open Space Reserve).

Recurrent EBITDA¹

6. Focus on operational performance by budgeting and reporting against Recurrent EBITDA, as this provides the funding for funding allocations.
7. Recurrent EBITDA must include allowances for growth (both discretionary and non-discretionary) and compliance costs.
8. Growth in Recurrent EBITDA is required to fund increases in obligations and discretionary allocations.
9. Setting user fees and charges should be done with a view to minimising Council subsidy and to provide equity across user groups.
10. Projected Recurrent EBITDA savings must be realistic and driven by identified and funded initiatives.
11. Proposed discretionary projects that create new or improved assets must be assessed for the impact on Council's future Recurrent EBITDA and renewal requirements, and the ability for this to be afforded in the 10-Year Financial Plan.

Allocations

12. Council must fund obligations before allocating funds for discretionary purposes.
13. Asset renewal is fundamental to Council's service and financial sustainability; the asset renewal allocation is derived from formal assessments and is one of Council's most important commitments.
14. Council's contribution to Developer and Infrastructure Plans and debt principal and interest form part of its allocation to new projects.
15. A consistent level of discretionary allocation should be provided across all years of the 10-Year Financial Plan.

¹ Recurrent EBITDA Definition: earnings before interest, tax, depreciation and amortisation, excluding project revenue and expenditure