7063 - Hepburn Shire Council Higher Rate Cap Assessment

April 2025

PREPARED FOR: Essential Services Commission

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1 EXECUTIVE SUMMARY

The *Essential Services Commission* (ESC) engaged *CT Management Group* (CTMG) to assist with the assessment of *Hepburn Shire Council's* rate variation application.

The Victorian Government established the *Fair Go Rates system* (FGRS) in 2015.

The FGRS is established under Part 8A, Section 185A, of the *Local Government Act 1989* (the 1989 Act).

The *Local Government Act 2020* (the 2020 Act) sets out other local government requirements for planning, procurement, community engagement and service delivery.

The FGRS is a framework limiting the amount by which local government councils may increase rates in a year without seeking additional approvals. The purposes of the FGRS are 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
- ensure that a council has the financial capacity to perform its duties and functions and exercise its powers.

Each year the Minister for Local Government sets the rate cap.

The 2025/26 rate cap was set at **3%**.

If the rate cap does not meet a council's needs, the council can submit a higher cap application for up to four years of higher caps at a time.

Hepburn Shire Council has applied to the ESC for a rate cap variation of **7%** above the rate cap of **3%**. The *ESC* has requested *CT Management Group* (CTMG) focus its advice on *Hepburn Shire Council's* current financial position and long-term financial sustainability, with reference to the information provided in Council's application and supporting documents.

Hepburn Shire Council between 2018/19 and 2023/24 increased borrowings, operating costs and capital investment whilst significantly reducing renewal investment, cash and working capital.

These financial decisions between 2018/19 and 2023/24 have established the need for a **7%** rate variation above the 2025/26 mandated **3%** rate cap.

Council was clearly living beyond its means during this period.

CTMG supports the need for a higher rate cap in conjunction with the proposed ongoing expenditure savings targets.

Without the revenue from a higher rate cap, Council would be financially unsustainable due to:

- Insufficient cash balance to fund services and set aside required funds for reserves, trust funds and deposits.
- Consequential unfavorable VAGO financial ratios used to assess financial sustainability.

Generating sufficient operating expenditure savings, in conjunction with the higher rate cap revenue, is necessary for the Council to maintain services as well as deliver the proposed annual capital renewal program of **$9.5m+.**

The **$1.361m** in revenue from the rate cap variation is necessary for the Council to maintain "sufficient cash" and to achieve the Victorin Auditor General Office (VAGO)'s) financial ratios.

"Sufficient cash" – the actual cash is equal to or greater than required cash (required cash = trust funds and deposits, statutory reserves, carried forward capital works, conditional grants unspent)

VAGO financial ratios include:

- Adjusted underlying result – greater than **0%**
- Liquidity ratio (current assets / current liabilities) - greater than **1.0**

- Internal financing (net operating cash flow / net capital expenditure) – greater than **80%**
- Indebtedness (non-current liabilities / own-source revenue) – less than **40%**
- Capital replacement ratio – greater than **1.0**
- Renewal gap ratio – greater than **1.0**

With the additional rate revenue from a higher cap and considering Council's planned operational savings and investment of **$9.5m+** per annum in its capital renewal program, the financial indicators reflect a financially sustainable position notwithstanding:

- a small underlying cash deficit
- the capital replacement and capital renewal ratio of approximately **0.9** that, while less than the preferred **1.0**, is a significant improvement on the prior year result of **0.35**.

We consider that the Council's opening cash balance for 2025/26 is overstated due to an underestimate of rates and charges debtors at June 30, 2025, at **$3.7m.**

We believe the debtor rates and charge balance on 30 June 2025 will be in the vicinity of **$7.7m**. In 2023/24 the 30 June 2024 debtors' rates and charge balance was **$7.7m**.

Historical trends also support an increased amount of rate and charge debtors outstanding at the end of each financial year for the last **7** years. If council's rates and charge debtors balance is understated, it will take longer for council to reach a positive cash position than shown in the projections outlined in council's application.

Council has targeted savings of **$1.5m** in FY2024/25, which we have not confirmed through examination of Council's 2024/25 financial projection, or YTD accounts as at 31 March 2025.

The Council's **$2.53m** ongoing savings target for 2025-26, while supported, is identified as a minimum level of operating expenditure reduction.

We have reviewed opportunities for savings:

- A **5%** saving should be able to be achieved across the range of services without significant service impacts. However, given the **$1.5m** ongoing savings included in the 2024/25 budget further operational savings reductions without service level impacts is unlikely.
- Additional short-term cash saving of **$1.0m** p.a could be achieved by renegotiating and extending the current loan repayment schedules by a further 5 years.

Council will need to seriously examine its service and capital priorities into the future and make difficult reductions in expenditure in expenditure to meet its planned financial sustainability as detailed in its Long-Term Financial Plan (LTFP).

Council could lower expectations on renewal investment for a couple of years (noting that capital works delivery was **82%** of budgeted expenditure in 2023/24) to reduce expenditure and to enable the cash position to restore.

However, given there is a renewal backlog, due to underspend in previous years, we would encourage Council to maintain a robust renewal investment target.

It is important that the Council fully commits to the **$9.5m+** capital renewal program to avoid future decline of Council assets and avoid a further increase in the renewal gap.

The infrastructure gap is measured by the shortfall between the amount of capital renewal necessary to renew infrastructure (often referred to as renewal demand) and the amount of actual capital renewal invested.

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