



# Revenue Strategy

May 2014

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## Introduction

Good governance requires the Shire of Esperance to provide periodic monitoring and review of the impact of major decisions or legislative change. This includes the way in which Council raises its revenue.

A local government as described in the *Local Government Act 1995* is to “use its best endeavours to meet the needs of current and future generations through the integration of environmental protection, social advancement and economic prosperity”.

With the introduction of the Integrated Planning and Reporting Framework there has been an increased level of interest and scrutiny placed upon local government finances. Asset management has highlighted that a number of local governments including the Shire of Esperance has considerable challenges in ensuring assets are replaced at the optimum time whilst balancing that with an appropriate service level.

This revenue strategy will be used as an informing document to the Corporate Business Plan and the Long Term Financial Plan. The key principle of the planning process is to provide for the future aspirations of the local government and a path to achieve them. Strategic outcomes are supported by the identification and planning of all financial, human resource, asset and infrastructure requirements and income opportunities over the longer term.

In relation to revenue raising, the following facilitating objectives are most applicable:

- Promote the social, economic and environmental viability and sustainability of the district;
- Ensure the equitable imposition of rates and charges; and
- Ensure transparency and accountability in Council decision making.

This revenue strategy will assist the Shire of Esperance in developing longer term revenue streams and ensuring rates and fees are being set in a consistent and clear manner. This strategy will also consider the ongoing support from other levels of government through grant funds which provides significant revenue to support the Shire of Esperance financial performance and capacity.

## Purpose of Strategy

The purpose of this report is to articulate Councils revenue strategy.

Developing a revenue strategy requires Council to strike a balance between competing principles to determine a mixture of rates, grants, fees and charges and other income that provides the income needed for its annual budget and long term financial plan while meeting the tests of equity, efficiency and simplicity.

The diagram below depicts that the development of a long term financial plan has many elements. Whilst the focus to date by the Shire of Esperance has predominately been on improving asset management, looking strategically at a medium to long term revenue strategy is a critical component of a long term financial plan and ultimate financial sustainability.



In developing this document the Council has the following aims:

- Articulating Councils revenue objectives;
- Establishing strategies to achieve its revenue objectives; and
- Improving understanding of the rating system in Western Australia

This revenue strategy will consider the following revenue streams for the Shire of Esperance-

- Rating
- Fees and Charges
- Grants (Non Conditional and Conditional)
- Property Leasing
- Property Development

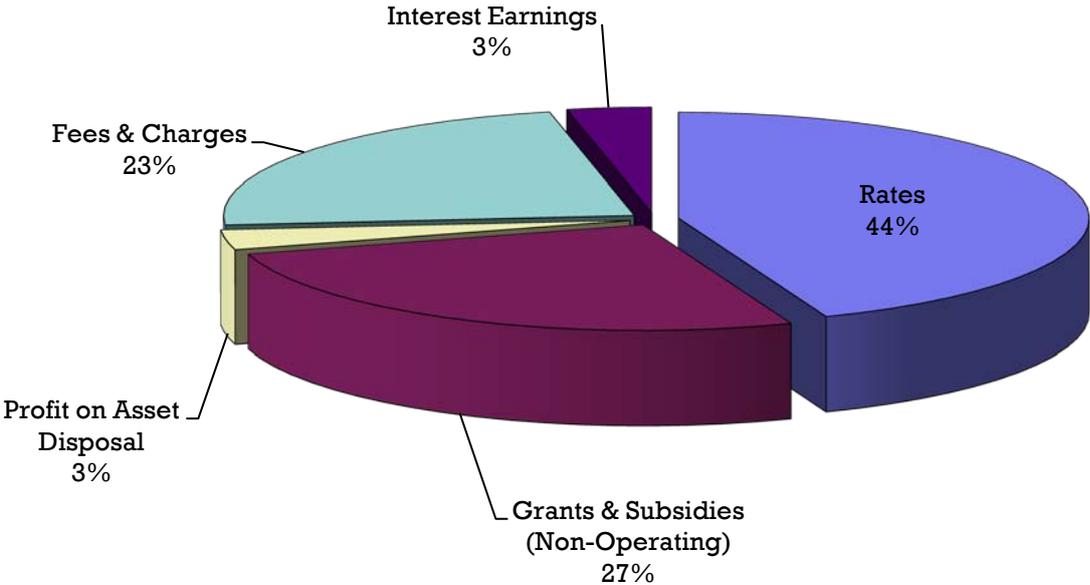
This strategy will be regularly reviewed by Council as an informing strategy for the Shires Corporate Business Plan. Council aspires to balance service levels in accordance with the needs, means and expectations of its community and set revenues to adequately resource its roles, functions and responsibilities.

# BACKGROUND

## Sources of Revenue

The graph below shows the percentage breakdown via the type of revenue that was budgeted within the 2013/14 budget year for the Shire of Esperance.

**Budget Revenue (2013-14) by nature/type**



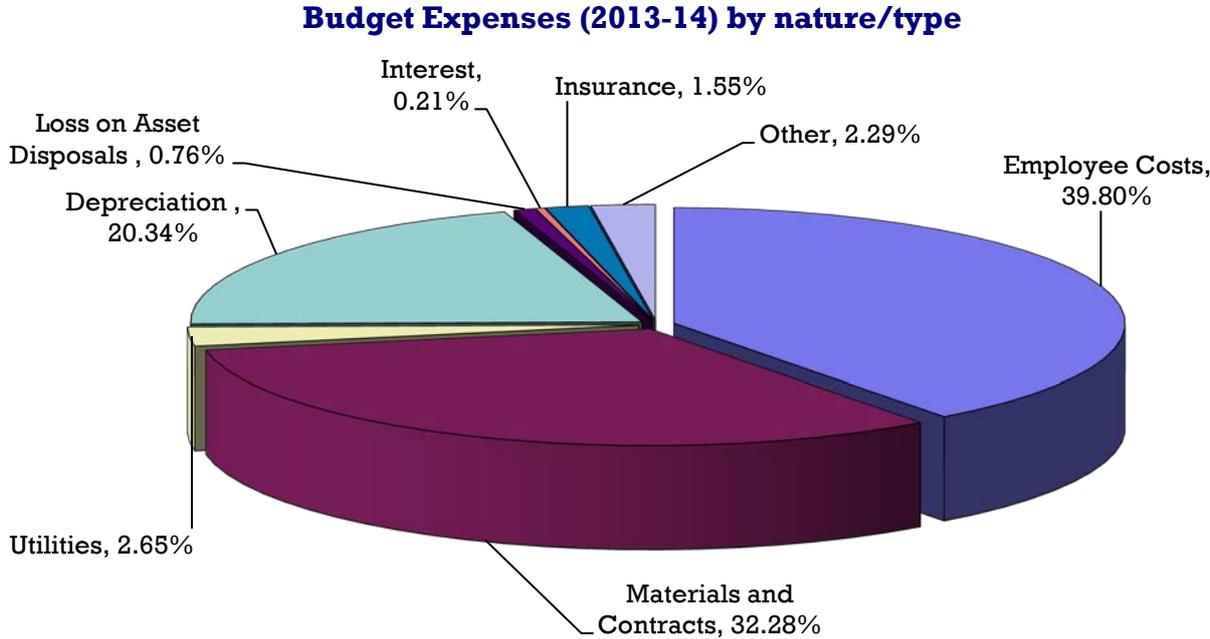
Some key points to note is that the Shire of Esperance is still heavily reliant upon operating Grants & Subsidies accounting for approximately 27% of total revenue. Rates is the most significant income source with 44% of total revenue and fees & charges contributing 23% to total revenue.

Council has a reasonable amount of discretion in determining its level of revenue from its own source income. The combination of rates and fees & charges amount to approximately 67% of total operating revenue.

The source of revenue that is received from commercial lease arrangements amount to less than 1% of the total operating revenue.

**Expenses by Nature or Type**

The graph below shows operating expenditure by nature or type for the 2013/14 financial year.



Depreciation amounted to \$7,088,844 or 20% of total operating expenditure. As Western Australian local governments are currently going through the process of fair value for accounting purposes the true depreciation expense is considered to be understated as it is based upon historical cost of the assets rather than the current replacement cost.

Fair value will be fully implemented at the conclusion of the 2014/15 financial year with depreciation being reported under full fair value basis for the 2015/16 financial year.

## RATING

It is incumbent upon Council to evaluate on a regular basis whether its rating system best satisfies the legislative objectives to which it must have regard and those objectives which Council believe are relevant.

There are a number of generally accepted principles of rating in local government:

- **Simplicity and Efficiency-** The basis for setting of rates should be simple and easily explained to ratepayers. The calculations should be easy to comprehend so not to obscure its rationale and reduce understanding. The rates system also needs to be efficient to administer to reduce costs.
- **Equity-** In theory this would result in each ratepayer being rated fairly in relation to all other ratepayers. The Act has determined that the level of rate contributions will be linked to the ratepayer's property value. The property value is a proxy for wealth and therefore the Act seeks to establish an equitable or fair distribution of the rate burden. The valuation of properties is seen as an equitable way to determine the rate distribution as higher value properties will equally contribute a higher distribution of rates.
- **Capacity to Pay-** The value of property is not always the best indication of the capacity to pay. The value of a ratepayer's property is only a proxy for capacity to pay. Ownership can span over many cycles and well into retirement. Accumulated property values over time can distort the relationship between income and property wealth. In recognition of this, the Act has provided the Council with the ability to grant deferrals e.g. Pensioner rebates and deferrals. Regardless of a ratepayers property ownership level there is a limit on the capacity of most ratepayers to contribute to services through property rates. This limit must be considered when setting the level of rates to meet the community needs and expectations.
- **Compliance-** The Council has an obligation to apply its discretionary rating powers within the framework of the *Local Government Act 1995* to seek to maximise opportunities to derive rates for the benefit of the community.

### Rating Framework

The general rating framework for local government in Western Australia operates under the *Local Government Act 1995*. The provisions contained within the Act govern Council in the raising of rates.

Rates are calculated by multiplying the valuation of a property by the adopted "rate in the dollar". The "rate in the dollar" is a number that is determined by the Council each year and used as a multiplier to calculate the rates payable for each property and the total rates yield.

Property valuations are set by the Valuer Generals Office and will be either the Unimproved Valuation (UV), for properties that are used predominately for rural purposes, or Gross Rental Valuation (GRV) which applies to properties that are used predominately for non-rural purposes.

Under section 6.32 of the *Local Government Act 1995*, when adopting the annual budget a local government is required to impose a general rate on rateable land in the district in order to make up any budget deficiency.

The general rates are determined by Council on the basis of raising the revenue required to meet the deficiency between the total estimated expenditure that is required over the long term to meet the operating needs of the Shire. The operating needs of the Shire utilising full accrual accounting includes an estimate of the use of long lived assets (depreciation).

A balanced operating position or small surplus operating position over the long term will ensure long term sustainability of the Council and the ability to replace its existing assets at the optimal intervention periods.

Financial sustainability of local governments has become a large focus for Western Australian Local Governments in recent time. More importance is being placed on asset management and long term financial sustainability of those assets. The ability for a local government to have the financial capacity to replace or maintain assets at the optimum intervention period to ensure service levels can be maintained will become one of the primary performance indicators for local government. A Long Term Financial Plan over a 10 year timeframe is required to be prepared by local governments. A revenue strategy will assist in ensuring that the local government is sustainable and meeting the objectives of its community.

## **Types of Valuation**

### *Gross Rental Value (GRV)*

The term gross rental value (GRV) is defined in the *Valuation of Land Act 1978* and is simply the gross annual rental that the property might generate on condition that the landlord is liable for all rates, taxes and other charges.

General valuations are revised and provided by the Valuer Generals Office every 3-5 years. Large valuation changes can occur during this period, so an adjustment in the “rate in the dollar” is normally required to ensure the dollar yield is in line with any increase in yield sought by the Council.

### *Unimproved Value (UV)*

Unimproved Value is defined in the *Valuation of Land Act 1978* and is summarised as “value of the land that could be expected to be realised upon its sale whilst not taking into account the value of any improvements (ie. Buildings, structures, landfill, etc)”.

Unimproved Valuations are revised and provided by the Valuer Generals Office annually. This may require an annual adjustment by the local government of the “rate in the dollar” each budget to ensure that actual dollar yield is in line with the increase sought by the Council.

## **Types of Rates**

### *Differential General Rate (Section 6.33)*

Council may wish to apply a different “rate in the dollar” to certain groups of properties. These groups can only be of the following (or groups of) characteristics:

- a) The purpose for which the land is zoned;
- b) Purpose for which the land is held;
- c) Vacant land; and
- d) Any other characteristics or combination of characteristics prescribed.

Differential rating allows Council to have some flexibility in determining rates for properties on the same valuation method. It may be used to encourage certain land use (eg a lower rate in the dollar may be used to encourage commercial development)

### *Minimum Rate (Section 6.35)*

A minimum payment may be determined by Council so that all ratepayers must make a reasonable contribution to the cost of Council’s services and facilities.

### *Specified Area Rate (Section 6.37)*

Council may impose a rate on specific properties in an area for the purpose of meeting the cost of specific work, service or facility. Monies raised are regulated to ensure the funds that are generated by the rate are spent in accordance with the purpose.

*Service Charges (Section 6.38)*

Council may impose a charge on either land owners or occupiers of land within the district or a defined part of the district to meet the cost of providing services in relation to the land. The prescribed services are as follows-

- a) Television and radio rebroadcasting;
- b) Volunteer bush fire brigades;
- c) Underground electricity;
- d) Property surveillance and security; and
- e) Water.

## REVENUE DIRECTIONS

### Rating History

The Shire of Esperance commenced rating with two distinct systems of valuation on the 1<sup>st</sup> July 1994 with the introduction of the GRV system. Previous to that time all properties within the Shire were valued on the UV system. Since 1994 general rate increases have generally been applied equally to both GRV and UV properties. The increases have been applied on existing values as supplied by the Valuer General but there has never been an analysis of rating effort equity between the GRV and UV contribution to the total rate revenue.

The Shire of Esperance has traditionally referenced the current budget deficiency and the Consumer Price Index (CPI) when debating the merits of general rate increases. The CPI is a good indicator of the increase in the cost of household items, however Local Governments are an infrastructure intensive business with significant long lived assets that require a more long term view of the rate revenue that is required. Local Governments have identified the need for an indicator to measure and monitor changes in the cost of goods and services that they purchase. The Local Government Cost Index (LGCI) developed for this purpose in 2006 has been widely and effectively used within the sector.

The LGCI is developed from the weighted average of the following indices published by the Australian Bureau of Statistics (ABS).

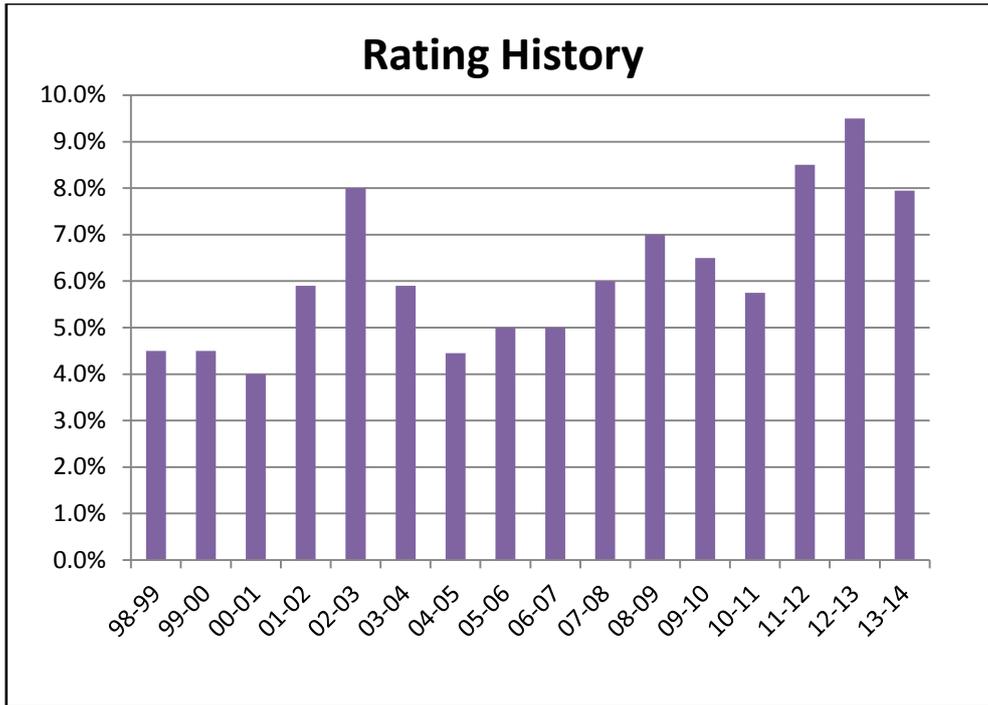
	Weight (%)
Labour Price Index (Public Sector, WA)	35.1
General Construction Cost Index (WA)	20.4
Road and Bridge Construction Cost Index (WA)	20.4
Mining and Construction Machinery Price Index	15.4
Consumer Price Index (Perth, All groups)	8.7

The LGCI addresses changes in the cost of providing existing services. However, it does not address the financial consequences of changes in scope (cost shifting) or any increases in community demand for new or improved services. Equally it does not address underlying operating deficits as faced by the Shire of Esperance. However, neither does it consider efficiency gains which may result from shared resources or new technology, for example or the elimination of services.

To maintain all assets and replace assets at their optimum intervention period, rate increases may be required in the future. Service levels of assets will be reviewed in the future to ensure the correct assets are maintained at the correct level to service the needs of the community.

As many public entities across Australia are discovering, attention has shifted to asset renewal as assets are wearing out. Traditionally the financial planning for the replacement of those assets has been inadequate resulting in unplanned expenditure or loss of service level.

Below is a graph showing rate increases (excluding growth) since the 1998/99 financial year on a year by year basis.



### Budget Considerations

Council is committed to enhancing the quality of life for current and future generations.

Council is however, faced with balancing its service levels, the needs and expectations of the community with the setting of appropriate rates and charges to adequately resource its roles and responsibilities.

Each year Council establishes the maintenance needs of its assets and infrastructure and the community services and facilities that will be provided in the next financial year.

The rate revenue required to meet expenditure needs is calculated taking into account other sources of income. Rate revenue forms an increasingly important part of Councils total revenue. Council currently receives approximately 44% of its total operating revenue by way of property based rates.

### Benefit Principle

Whilst it is acknowledged that not all ratepayers will directly use all of the services provided by Council, the programs and services are provided to deliver an improved quality of life for the whole community.

The application of the benefit principle is difficult in practice because of the complexity and, in some cases, impossibility, of measuring the relative levels of access and consumption across the full range of Shire services.

The analysis of benefit is often reduced to arguments of what services are consumed by town versus rural, commercial versus residential and ratepayers versus non resident ratepayers.

For example it might be argued that rural ratepayers derive less benefit from library services or street lighting than their town counterparts but the reverse argument may be applied with respect to the cost of repairing and maintaining rural roads that are seldom travelled on by residential ratepayers. A non

resident ratepayer may also have no interest in the services that the Shire provides as they cannot access these services.

A simplistic determination of rates based upon where services are located ignores the following points-

- Some services are not location specific
- Access is not synonymous with consumption
- Residents can travel or use technology to access some services
- Service levels provided in different locations within the Shire have different costs

Rates are wealth based, calculated on the valuation of each property. There is a general correlation that all things being equal, property values reflect relative access to municipal services.

## Current Rating Structure

The Shire of Esperance current rating structure is as follows-

Rate Type	Total Number of Properties	Rate in Dollar	Minimum Rates	Number of Properties on Minimums	Valuation \$	Yield \$
GRV- Residential	5,749	8.9932	\$855	2118	64,239,825	6,237,470
GRV- Commercial	454	8.9932	\$855	85	19,701,854	1,797,569
UV- Rural	1,216	0.7262	\$855	98	850,253,900	6,217,081
UV- Mining	128	10.2000	\$427.50	51	1,730,631	189,791
UV- Other	2	0.7262	\$855	1	228,000	1,944
<b>Total</b>	<b>7,549</b>				<b>936,154,210</b>	<b>14,443,855</b>

*Data Source: Shire of Esperance- Statutory Budget 2013-14*

It is estimated within the Long Term Financial Plan that due to the revaluation of assets the depreciation and the corresponding renewal demand of those assets will increase substantially over the next two years. This increase in depreciation as an operating cost will cause the Shire to have substantial underlying operating losses unless this is addressed. The Shire has a number of options to address this issue being-

- reduction in assets therefore reducing the renewal demand
- Increasing operating income
- Decreasing operating expenditure

It is anticipated that all three of the above options will be required in the short to medium term to address the issue. The asset management plans currently identify a significant shortfall of expenditure on asset renewal

The Long Term Financial Plan estimates that to continue 'business as usual' rates will need to increase in the vicinity of 7.5% per year. Any increases over an above that could be used to address the anticipated underlying operating losses and directed towards asset renewal.

**Recommendation 1: That Council work towards closing the asset management gap within a 5 year period.**

**Recommendation 2: That Council set rate increases at 3 percent above the 'business as usual' approach for 5 years with the additional income to be spent on closing the asset management gap and maintaining a small surplus net operating position.**

## **Rating Methods**

### **Uniform General Rates**

The Shire of Esperance currently sets a general rate in the dollar for both the GRV and UV valuation category. This is termed a uniform general rate in the dollar and would apply to all properties within the valuation type regardless of location or land use.

A local government may impose a general minimum payment on each valuation method (and also within each differential category). This results in all properties paying at least the minimum payment regardless of the properties valuation. A lesser minimum may also be imposed on any portion of the district. The Shire of Esperance currently has a lesser minimum for predominately vacant land that receives a lesser service by the provision of roads or other basic services.

The Act restricts the maximum number of properties attracting a minimum payment to no more than 50% of the total rated properties. In addition, the number of properties with a minimum payment within each GRV and UV category cannot be greater than 50% of the number of rated properties within each category. The Shire of Esperance currently sits well within these levels with the total rated properties being 7,549 of which 2,353 or 31% were on a minimum payment. GRV has a total number of rated properties at 6203 of which 2203 or 36% were on minimum payment. UV has a total number of rated properties at 1346 of which 150 or 11% were on minimum payment.

### **Differential Rates**

As an alternative to setting a uniform general rate for each valuation method a local government may apply different rates in the dollar within each category. The Shire of Esperance currently uses differential rates for mining UV properties. The Shire could for example impose differential rates on other rating categories such as Commercial GRV as the land is zoned for commercial purposes whereby the use of the land is different to the predominate residential GRV.

Restrictions apply to ensure that the rate in the dollar which is imposed is not, without the approval of the Minister a rate which is more than twice the lowest differential. In addition the local government is to ensure that no more than 50% of the total rated properties in each differential category are minimum payments.

Before imposing differential rates and differential minimum payments a local government under Section 6.36 of the Act must give local public notice of its intention to do so. Section 6.36(3)(c) of the Act also requires a document describing the objects and reasons for each proposed differential rate to be made available for public inspection.

### **Specified Area Rates**

The Act permits the raising of a specified area rate in addition to a general rate. This type of rate is used to fund specific work undertaken for a specific portion of the district. The funds derived from a specified area rate must be applied to the purpose for which the rate was imposed.

Specified area rates are used as a funding source for defined projects within a limited area. For example, they may be raised to repay a loan for the construction of a barrier fence to prevent wild dogs or used to accumulate funds to meet future maintenance costs.

Many new residential developments constructed with a higher level of amenity than the surrounding suburbs may attract a specified area rate where specific services are provided by the local government to a defined part of the community that are not otherwise available to the wider community.

The Shire of Esperance doesn't currently charge a specified area rate although it has approved the implementation of one for the loan repayment of the wild dog barrier fence. The Shire has applied specified area rates in the past for various purposes.

## Rating Comparison

### Gross Rental Value (GRV)

The effect of rating land on its GRV is that it is rated on its income earning potential, rather than its intrinsic value, although the intrinsic value is invariably linked to its income earning potential. Land classified as GRV is re-valued every 3 to 5 years. This makes comparing the level of the adopted GRV "rate in the dollar" between local governments less reliable than UV which is updated each year. This combined with the fact that the earning potential of properties in different locations can have a large impact on the valuation of each property. An example of this is a 4 x 2 house in Esperance could be valued at \$15,600 and a comparative house in Port Headland could be valued at \$52,000.

A direct comparison table between 'like' Councils in terms of level of rating has been included below. The comparisons are based upon rating that was implemented by local governments during the 2012/13 financial year.

It is difficult to make a direct comparison with the "rate in dollar" as valuations will be based upon the market that is applicable in each region. A far better comparison is the "charge on average residence" which is essentially an average yield per property and is intended to provide a benchmark for GRV rates that an average residential property is levied.

Shire	Valuation Year	Rate in Dollar	Charge on Average Residence	% Plus or Minus Esperance
Esperance	2009	8.33090	\$1,029	
Augusta-Margaret River	2012	9.72260	\$1,366	+33%
Busselton	2012	8.05000	\$1,242	+21%
Broome	2012	7.62820	\$1,944	+89%
Geraldton	2012	10.22280	\$1,530	+49%
Kalgoorlie	2009	5.50720	\$973	-5%
Katanning	2009	8.34670	\$1,019	-1%
Mandurah	2010	8.40000	\$1,185	+15%
Mundaring	2011	8.63600	\$1,327	+29%
Plantagenet	2009	10.92213	\$1,048	+2%
Port Hedland	2012	3.10250	\$2,238	+117%
Roebourne	2012	2.62780	\$1,827	+78%
<i>Average of tabled LG's</i>			\$1,394	+35%

*Data Source: WA Local Government Rates Comparison 2012-13 UHY Haines Norton & Individual Local Government Financial Statements*

### GRV Analysis

From the comparisons to other like local governments contained above it would appear that although Esperance is rating its GRV properties on the lower side of the comparison. The rating effort of each local government is dependant upon the level of service that each local government is providing. It does however provide a reasonable comparison and would appear that there is additional rating capacity within the GRV category compared to other like local governments throughout the State.

A number of local governments are utilising a differential rate for commercial properties as they recognise the higher level of service that is often provided to these properties. For example Augusta-

Margaret River charge a differential rate for commercial/industrial properties that is 5.0% higher than the general rate and Broome is 20% higher. Commercial/Industrial properties also have the added benefit over owner occupied residential property of using rates payments as a tax deduction which lessens the financial burden, although this argument is somewhat diluted as residential ratepayers also have the ability to use rates as a tax deduction if their property is rented.

**Recommendation 3: That Council consider implementing a higher differential rate for Commercial/ Industrial properties.**

**Unimproved Value (UV)**

Comparison to other local governments is easier with UV properties as values are revised annually by the Valuer General. As UV properties are also valued based upon their sale value and therefore their earning capacity, a direct comparison with other local governments on their “rate in the dollar” is a reasonable assessment.

Below is a select group of local governments that have similar characteristics to Esperance in regards to UV property use.

<b>Unimproved Value- Uniform Rate</b>			
<b>Shire</b>	<b>Rate in Dollar</b>	<b>Rates on a Property with a UV of \$500,000</b>	<b>% Plus or Minus Esperance</b>
Esperance	0.67270	\$3,364	
Jerramungup	1.06200	\$5,310	+58%
Kondinin	1.15500	\$5,775	+72%
Koorda	1.84000	\$9,200	+273%
Kulin	0.86560	\$4,328	+29%
Lake Grace	0.75430	\$3,772	+12%
Mingenew	1.16970	\$5,849	+74%
Narembeen	1.07920	\$5,396	+60%
Northampton	0.83850	\$4,193	+25%
Ravensthorpe	0.93350	\$4,668	+39%
<i>State Median</i>	0.97410	\$4,871	+45%

*Data Source: WA Local Government Rates Comparison 2012-13 UHY Haines Norton*

**UV Analysis**

As can be seen in the table above there could well be an argument based purely upon comparisons with other local governments and the State median for an increase in the Shire of Esperance rate in the dollar for Unimproved Properties. For example properties around the area of Munglinup who are situated in the Shire of Ravensthorpe are paying approximately 39% higher rates than those properties that are situated in the Shire of Esperance. Both properties would have similar physical characteristics with a similar ability to generate income. The valuation of each property has taken into account it’s earning potential as valuations are determined predominately on property sales within the district.

A closer analysis of the comparison between the Shire of Esperance and the Shire of Ravensthorpe shows that over the past 12 years the gap between the two Shires in relation to UV properties is increasing. It would appear that the rating effort in UV properties for the Shire of Esperance in relation to its closest neighbour has not kept pace, with the difference in UV “rate in the dollar” increasing from 7% in 2000/01 to 39% in the 2012/13 financial year.

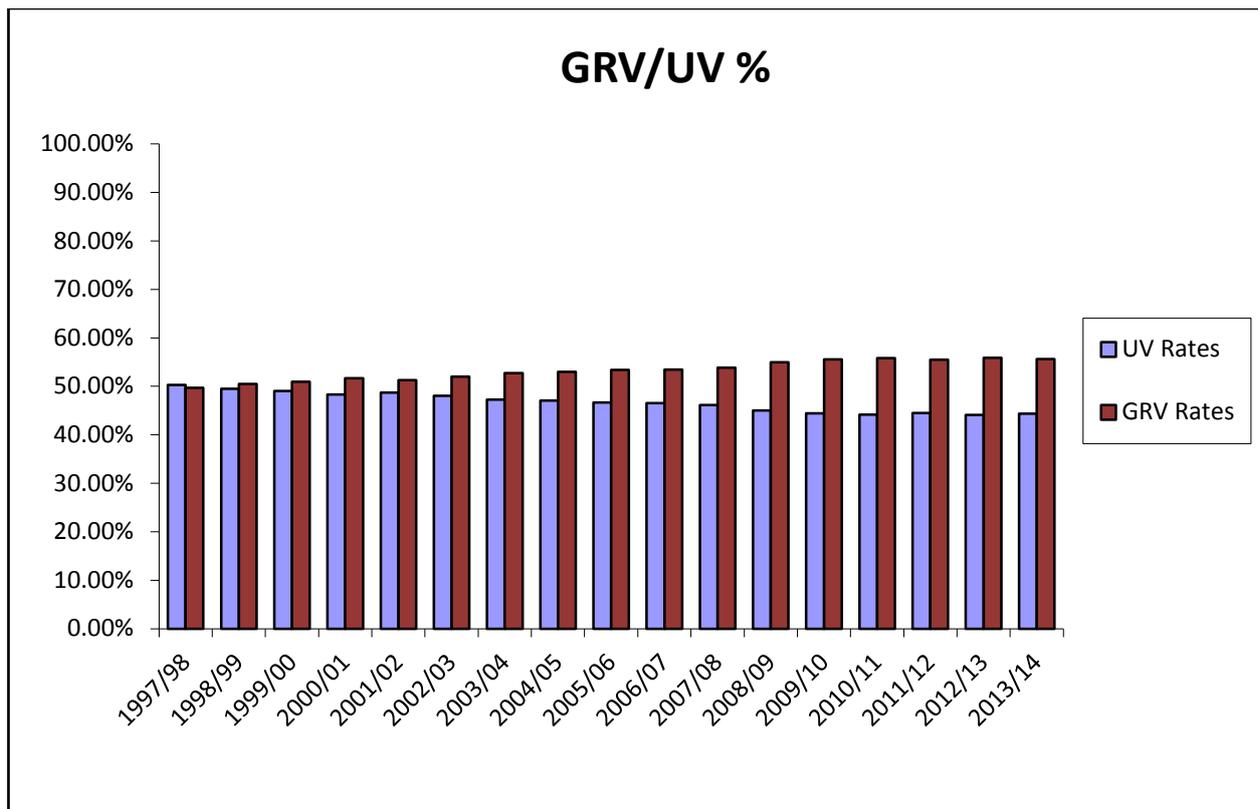
Year	Esperance UV Rate in \$	Ravensthorpe UV Rate in \$	% Difference
2000/01	1.7730	1.9000	7.2%
2004/05	1.8590	2.4150	29.9%
2007/08	1.0118	1.3397	32.4%
2012/13	0.6727	0.9335	38.8%

**Recommendation 4: That Council consider increasing rates for both GRV and UV categories to become closer to the average of rates that are charged by similar local governments in WA.**

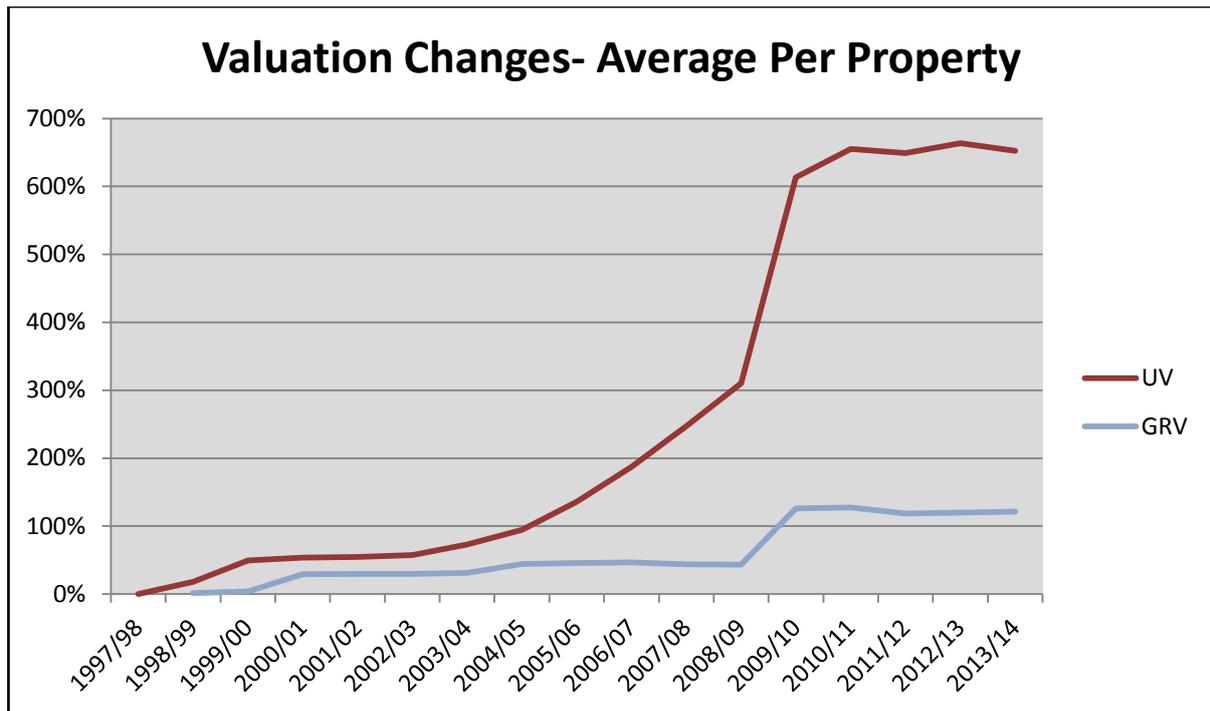
### Comparison between GRV and UV

Since the Shire of Esperance began utilising the GRV system on the 1<sup>st</sup> July 1994 there has never been a comparison made to determine if the rating effort by both the GRV system and the UV system is equitable. Although there is no easy comparison to make, some information has been gathered to show the effort of both GRV and UV properties within the Shire and the changes that have taken place over a period of time.

The graph below shows the yield that is being recovered by both GRV and UV properties. During 1997/98 the yield between both GRV and UV was comparative on a percentage basis. Since that time GRV properties have outpaced the UV properties. During the 2013/14 year GRV property yield amounted to nearly 56% of the total rate income.



The graph below shows the valuation change over the past 15 years as an average per property. As you can see UV properties have increased significantly more compared to GRV properties over the same period. The increase in GRV yield is partly attributable to the increasing number of GRV properties that are created due to subdivisions compared to UV.



In order to try and compare UV properties and GRV properties on an equal comparison, UV valuations were sought from the Valuer General for properties that are currently rated as GRV.

The table below shows that when all properties have a UV valuation basis GRV properties account for 57% of the total valuation amount with UV accounting for 43%. To compare the current rating effort of GRV against UV the current yield percentage for each category was then compared. GRV yield amounts to 56% while being rated as GRV and UV yield accounts for 44% whilst being rated under the UV category.

This analysis shows that the current yield from the UV and GRV properties is nearly the same if both of these categories were rated under the one method being UV.

Rate Type	UV Valuation	Percentage %	Budget Yield \$	Percentage %
GRV Residential	795,570,800	39.89%	5,375,628	37.22%
GRV Commercial/Industrial	148,863,900	7.46%	1,797,569	12.45%
GRV Vacant	197,998,700	9.93%	861,842	5.97%
<b>Sub Total GRV</b>	<b>1,142,433,400</b>	<b>57.27%</b>	<b>8,035,039</b>	<b>55.63%</b>
UV Rural	850,253,900	42.63%	6,217,081	43.04%
UV Mining	1,730,631	0.09%	189,791	1.31%
UV Commercial/Industrial	228,000	0.01%	1,944	0.01%
<b>Sub Total UV</b>	<b>852,212,531</b>	<b>42.73%</b>	<b>6,408,816</b>	<b>44.37%</b>
<b>Total</b>	<b>1,994,645,931</b>		<b>14,443,855</b>	

Data Source: Landgate

## Revenue and Expenditure Analysis

Local governments throughout the State have a responsibility to provide similar levels of services and facilities. The cost of providing services will vary between local governments. The aim of the balanced budget principle through the Local Government Grants Commission is to provide local governments with a General Purpose Grant that allows them to provide services at an average standard.

The equalisation requirements of each local government is calculated by assessing the revenue raising capacity and expenditure needs of each local government. This equalisation requirement forms the basis of a local governments General Purpose Grant. Put simply, the equation is

Equalisation Requirement = Assessed Expenditure – Assessed Revenue

The revenue standards as determined by the Grants Commission are a mathematical formulae used to assess the revenue capacity of each local government. The figures used are averaged over three years to ensure stability in the Standard. A regression formula is created based on the information provided by the Valuer General to assess each local governments rate capacity.

Revenue Area	Actual Revenue	Assessed Revenue	Difference
Residential, Commercial & Industrial	6,239,832	6,284,343	(44,511)
Agriculture	4,875,522	6,182,690	(1,307,168)
Mining	94,505	616,077	(521,572)
Net Investment	480,458	511,323	(30,865)
<b>Total</b>	<b>11,690,317</b>	<b>13,594,433</b>	<b>(1,904,116)</b>

Data Source: WA Local Government Grants Commission- 2013-14 Balanced Budget

The above table clearly shows that the Grants Commission believe that the Shire of Esperance has rating capacity and is raising rates on average less than other local governments. The predominate difference is within the Agriculture area.

The Grants Commission do the above exercise equally for expenditure which shows that the Shire of Esperance should be spending more money within the transport area compared to its assessed needs.

Expenditure Area	Actual Exp	Assessed Exp	Difference
Recreation & Culture	3,824,876	3,957,066	(132,190)
Community Amenities	960,352	907,658	52,694
Governance	864,934	1,133,729	(268,795)
Law, Order & Public Safety	791,268	494,447	296,821
Education Health & Welfare	422,807	645,016	(222,209)
Transport	3,760,924	7,114,784	(3,353,860)
<b>Total</b>	<b>10,625,161</b>	<b>14,252,700</b>	<b>(3,627,539)</b>

Data Source: WA Local Government Grants Commission- 2013-14 Balanced Budget

**Recommendation 5: Council to consider increasing UV rates in a higher proportion than GRV over a number of years.**

**Recommendation 6: Council spend any additional income from the UV rates within the transport area to assist in closing the asset management gap.**

## USER FEES AND CHARGES

Henry (2010, p.690) argues that councils should raise revenue in two main ways: from taxes for services with public goods type characteristics (i.e. services that are generally non- excludable and non-rival in consumption); and from user charges for private goods (those that are generally excludable and rival in consumption).

Sansom (2012) suggests that Councils should try and help communities understand that they provide a range of public goods (roads and related services generally being the most significant) that their general property taxes pay for and charge users for services that have more of a private good characteristic wherever possible.

Broadly speaking where benefits of services do not flow across the whole community a user fee or charge may be more appropriate than an increase in rates.

There are a number of items that Council should consider when determining fees and charges-

- Council should have clear policies in place for charges and concessions.
- Charges can be used to influence behaviour to help meet Councils objectives. They should not be seen solely as a means to generate income.
- Charges should be transparent in how they are set and be able to explain their charging decision to the public
- Charges should form part of overall financial management.
- Many factors are used in setting charges including identifying the charging options, assessing their impact on services and the people that use them, and making comparisons with other providers or local governments.

As a general rule Council will generally seek to recover the full cost of the service from the recipients. Examples of this for the Shire of Esperance is the Airport and Waste Services where long run operating costs need to be factored into the cost of the services. Full cost recovery in some instances is not practical or appropriate. There should be sound and consistent reasons why concessions are granted. Some of the reasons for providing concession may include social benefits, capacity to pay or perceived decline in patronage if the service was at full cost recovery. An example of this may be the Bay of Isles Leisure Centre and the cost of entry to the aquatic facility where entry would be at a level where the facility would be unlikely to be utilised at the same level if entry was at full cost recovery.

The Shire is also responsible for charging fees for services that are prescribed in legislation. This will include fees such as building license fees, development applications and animal registration fees. As this is a prescribed fee, the amount as determined by legislation will apply.

**Recommendation 7: Council will charge full cost recovery on fees and charges where it is considered fair and equitable.**

**Recommendation 8: Council will consider offering concessions only where there are sound and consistent reasons to do so.**

## **BORROWINGS**

Council should be aiming to achieve a small operating surplus on average over time. If this can be achieved then there should be the need for borrowings only to overcome timing mismatches between income and expenditure for asset renewal. Unless the Shire is generating large operating surpluses it will need to raise additional borrowings to purchase new and additional assets.

(Comrie 2013) states that providing the long term financial plan can show that long run revenue exceeds long run costs then there is no reason why debt should not be used if needed to overcome timing imbalances between expenditure outlays and revenue inflows.

Borrowings do not generate revenue and will increase operating expenses through interest repayments. Borrowings should be considered within the context of council's corporate planning, asset planning, budget and long term financial forecasting processes.

Borrowings should also be considered when the long term return to Council is positive. Borrowings for business opportunities should be considered that will assist in cash flow. Business cases will be required for any proposed trading undertaking and should fully consider the impacts if borrowings are proposed.

(Comrie 2013) makes the point that Council should aim not for low levels of debt per se but for responsible use of debt that helps deliver cost-effective and inter-generationally equitable service levels.

**Recommendation 9: Council will consider corporate planning, asset management and long term financial forecasting when considering the use of borrowings to overcome timing imbalances or reduce risk.**

## Other Revenue Sources

### ***Grants and Contributions***

As a local government entity, the Shire has the ability to access grant funding for a range of projects and programs.

Grants are often provided to Local Governments with conditions attached to what, where and how the money may be spent. Grants provided for new infrastructure will have a detrimental long term impact on operating costs through increased depreciation and/or maintenance. The Shire of Esperance needs to carefully consider accepting grants that may add to the long run operating result of the Council unless this has been factored into the Long Term Financial Plan and achieves the strategic outcomes of the Shire.

Operating grants for funded programs may also have detrimental long term effects if grants are provided for a community project. If the funding ceases to be provided in the future, there may be a community demand and expectation upon the Shire for the service to be retained. To ensure cost shifting between levels of government, operational services provided by grant funds will be delivered in comparison to the level of funding provided.

**Recommendation 10: Council will accept conditional capital grants if they contribute to achieving the identified Strategic outcomes of the Shire. The whole of life costs should be closely examined to ensure long term sustainability of the Shire's operating result.**

**Recommendation 11: Services that are funded by operating grants will be delivered in line with the level of funding provided. Any decrease in funding will have an equal decrease in service delivery.**

### ***Interest***

The Shire of Esperance will invest any surplus cash on hand in line with policy CORP 02: Financial Management. The Shire will generally take a conservative approach to investment to ensure the Shire's funds are protected.

**Recommendation 12: Council will invest any surplus funds at the highest available interest rate in line with policy Corp 02: Financial Management.**

### ***Business Activities***

The Shire of Esperance may derive revenue from business activities such as property development, caravan park and commercial leases. In general the conduct of these activities is governed by the principles outlined in section 3.59 of the Local Government Act 1995.

Robust business cases will be developed in line with the requirements of the Act when considering new commercial or business activities. Unless the activity will achieve a strategic outcome, the Shire will look to enter into commercial activities with the view to maximise a return to Council.

Commercial leases will be entered into by Council utilising an independent valuation to determine the consideration. Concessions or a discount may only be considered by Council if the lease will achieve longer term strategic outcomes for the Council.

**Recommendation 13: Council will only enter into new business activities where a robust business case has been developed with a view to maximise returns to Council.**

## **Public Land**

Hester Property Solutions developed a “Public Land Strategy” which reviewed the Shire’s property portfolio and identifies opportunities with respect to these properties. The Shire’s property portfolio comprises approximately 650 properties comprising 423 properties as Crown Land vested to the Shire and 231 freehold properties.

The Public Land Strategy identifies short and medium term opportunities and a corresponding recommendation for each property.

A key principle of the Public Land Strategy is that Council will manage its property assets with the view to:

- (1) Increasing the Shire’s social, economic and environmental sustainability;
- (2) Increasing the Shire’s financial capacity;
- (3) Providing essential services and facilities; and
- (4) Developing an investment portfolio capable of providing income generation.

**Recommendation 14: Council implement key recommendations out of the Public Land Strategy.**

## Conclusion

This revenue strategy will help inform rating and revenue raising opportunities for the Shire of Esperance over a longer timeframe to ensure equity and sustainability. The Shire needs to focus on the long run underlying operating position with the aim to achieve an operating break even position or small operating surplus.

Historically rates have been set with the current budget deficiency in consideration. With the implementation of the Integrated Planning and Reporting Framework, local governments need to consider the long term revenue generation of their local government through the Long Term Financial Plan and the renewal of their infrastructure through the Asset Management Plans. Service levels are a key component of the cost of infrastructure renewal which is then closely tied to its revenue needs and demands.

This revenue strategy not only considers rates as a key revenue source for the Shire but also other revenue streams and options such as fees and charges, grants and contributions, interest and business activities. These alternate revenue sources are an increasingly important part of the Councils revenue stream that will assist in reducing the rate burden and diversify the income opportunities of the Shire.

## Recommendation Summaries

**Recommendation 1:** That Council work towards closing the asset management gap within a 5 year period.

**Recommendation 2:** That Council set rate increases at 3 percent above the 'business as usual' approach for 5 years with the additional income to be spent on closing the asset management gap and maintaining a small surplus net operating position.

**Recommendation 3:** That Council consider implementing a higher differential rate for Commercial/Industrial properties.

**Recommendation 4:** That Council consider increasing rates for both GRV and UV categories to become closer to the average of rates that are charged by similar local governments in WA.

**Recommendation 5:** Council to consider increasing UV rates in a higher proportion than GRV over a number of years.

**Recommendation 6:** Council spend any additional income from the UV rates within the transport area to assist in closing the asset management gap.

**Recommendation 7:** Council will charge full cost recovery on fees and charges where it is considered fair and equitable.

**Recommendation 8:** Council will consider offering concessions only where there are sound and consistent reasons to do so.

**Recommendation 9:** Council will consider corporate planning, asset management and long term financial forecasting when considering the use of borrowings to overcome timing imbalances or reduce risk.

**Recommendation 10:** Council will accept conditional capital grants if they contribute to achieving the identified Strategic outcomes of the Shire. The whole of life costs should be closely examined to ensure long term sustainability of the Shire's operating result.

**Recommendation 11:** Services that are funded by operating grants will be delivered in line with the level of funding provided. Any decrease in funding will have an equal decrease in service delivery.

**Recommendation 12:** Council will invest any surplus funds at the highest available interest rate in line with policy Corp 02: Financial Management.

**Recommendation 13:** Council will only enter into new business activities where a robust business case has been developed with a view to maximise returns to Council.

**Recommendation 14:** Council implement key recommendations out of the Public Land Strategy.