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INSTITUTE FOR REGIONAL FUTURES

Cessnock City Council Financial Sustainability Review

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Document preparation

This report was prepared on Awabakal, Worimi and Wonnarua Land by the Institute for Regional Futures for Cessnock City Council.

The University of Newcastle acknowledges the traditional custodians of the lands within our footprint areas: Awabakal, Darkinjung, Biripai, Worimi, Wonnarua, Gomeroi and Eora Nations.

We also pay respect to the wisdom of our Elders past, present and emerging.

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Executive Summary

This report presents a picture of a community clearly struggling with financial sustainability challenges that have emerged over many years. Explanations include severe revenue constraints exacerbated by cost pressures associated with growth, state government policies, and an ageing base of infrastructure. We suspect that Council executive have been aware of the issue for some time but that the Council as a whole has delayed action in an effort to be kind to the ratepayers. However, as this report will make clear, delay is no longer an option – it is also extremely unlikely to manifest as a kindness in the long-run. We thus commend this report to both Council and the community that it serves and encourage all stakeholders to read it in full and with a receptive mind.

1. Introduction

Financial sustainability is best defined as the ability to meet the needs of the current residents without putting at risk the capacity of the next generation to meet their own needs (Drew and Dollery, 2020). It is essentially a moral endeavour which revolves around protecting the most vulnerable in our community, as well as assuring intergenerational equity. The latter is a particular concern, because if current residents don't at least fully fund operational expenditure now (as well as paying their share of capital spending), then a future voiceless generation will be forced to pick up the tab. This is, of course, is a grave moral hazard that must be confronted (Buchanan, 1997; Drew, 2021).

Assuring financial sustainability is also important because a failure to do so in the past has resulted in some quite disagreeable interventions which have had catastrophic impacts on communities (Boundary Commission, 2022). Of particular note is the enduring risk of amalgamation which will inevitably arise again as a potential threat given both the state government's own fiscal distress, and the inability of regulators and politicians to learn from the mistakes of their last foray into boundary reform (see, Drew et al., 2021; McQuestin et al, 2020; Drew et al., 2023). Another intervention employed in the past has been to appoint an administrator, and the potential damage of such a move has been further heightened by recent legislative changes. We are not suggesting that either intervention is imminent for Cessnock, but given the disastrous history of public policy in NSW it might be seen as reckless to discount these possibilities.

Local government is responsible for most of the essential services and infrastructure that Australians use on a daily basis. Yet, local government only extracts around 2.9 percent of taxation revenue in this country according to the most recent Australian Bureau of Statistics (2025) *Government Finance Data*. Clearly the value that citizens routinely derive from their tax dollar at the local government level is far superior to that derived from state or federal spheres. Moreover, higher tiers of government have been encroaching on the single tax base (land rates) available to local government. Indeed, they have also increasingly been shifting costs onto councils to

alleviate state fiscal difficulties, all the while employing blame games in the media around cost-of-living pressures.

Notably, local government is the only tier of government in this country that has to be transparent and accountable for its taxation increases. Most state and federal taxes grow in line with inflation – often exceeding this by a large margin. For instance, goods and services tax (GST) liabilities automatically increase as prices of relevant goods go up – yet most people don't acknowledge this increasing burden and the pressure it places on the cost-of-living. Similarly, income tax liabilities increase as wages try to keep apace with inflation, often by more than the nominal percentage wage increase because of bracket creep. But, once again, this is rarely acknowledged by citizens. Indeed, few people stop to contemplate that local government tax (rates) is by far the smallest tax burden in the typical family budget.

Notably local government is also the tier of government that takes the greatest care to protect vulnerable citizens from tax imposts. Consider the GST, for instance – whether one is the Prime Minister of Australia or a homeless person, everyone is required to pay precisely the same tax for a given item. There are no hardship provisions at this tier of taxation. Yet, local government does typically have comprehensive hardship provisions, as well as discounts on the tax liability for pensioners.

Despite all of the aforementioned extraordinary circumstances of local governments a special rate variation (SRV) often presents as a politically challenging exercise. Because local government tax is more obvious (being billed quarterly instead of deducted before one receives one's pay, or simply included in the price of purchases) it garners much attention from citizens. Few welcome the prospect of paying additional tax, when they become aware of it. Additionally, media often misrepresents the matter, apparently encouraged by people intent on political mischief-making. Furthermore, the way the Office of Local Government (OLG) requires councils to communicate the size of the increase also frequently and profoundly misleads people. Yet despite all these difficulties many councils do indeed apply for an SRV most years. For instance, in the 2024-25 round nine applications were made (five approved); in 2023-24 seventeen applications were actioned (fourteen approvals) (IPART, 2025).

If done rigorously, in the spirit of the Act (NSW, 1993), an SRV has the potential to transform organisations and assure intergenerational equity. It is also an important opportunity to educate members of the community and galvanise enduring co-operation. Part of a rigorous SRV is a strictly independent assessment of matters by bona fide experts using sophisticated empirical techniques and theory. The second part of a rigorous SRV is the interrogation of the application by the Independent Pricing and Regulatory Tribunal (IPART) according to the OLG Guidelines. Councillors and community must understand that it is not Cessnock that will ultimately decide whether a tax increase occurs – this decision is entirely the purview of the IPART under Ministerial delegation according to the Act (NSW, 1993). Otherwise stated, council and community are not agreeing to any tax increase – they

are merely putting a brief of evidence together with a recommendation for the independent adjudication of the Ministerially appointed umpire (IPART).

An SRV application is in no way indicative of managerial or Councillor shortcomings. Nor is it a reflection of the dedication and efforts of council staff. In large part, it is simply a function of costs increasing at a rate that exceeds the anaemic movements in heavily constrained revenues.

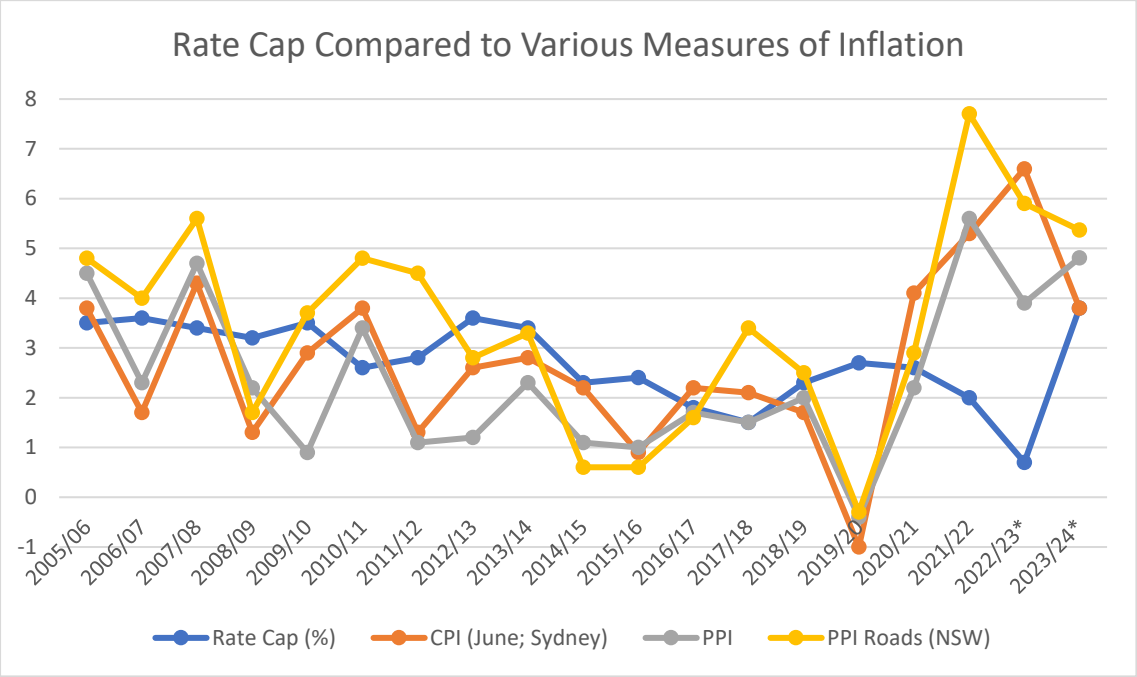
Most people will be aware that Australia has experienced unusually strong rates of inflation since the federal and state government COVID policy interventions (see Drew, 2025 for a thorough discussion of the causes of inflation). Indeed, most people will appreciate that official inflation figures often fail to represent the actual cost-of-living increases felt (see, for example: https://www.youtube.com/watch?v=g4kJsDMglSU).

Moreover, inflation remains a particular concern for most in the community. However, it is also a cause of much confusion in the community: and it seems, amongst some state and federal government decision-makers. There are, in fact, a number of measures of inflation produced by the Australian Bureau of Statistics. The Consumer Price Index (CPI) – the inflation measure most people implicitly refer to – is by definition, a measure of the change in a basket of *household* goods and services. It therefore has limited relevance to local government, although it might tangentially measure changes in capacity to pay of *some* residents[1]. The Producer Price Index (PPI) is arguably more relevant to local government – it measures the change in prices for business. Even more informative is the PPI (roads) which is specific to the single largest cost for local governments.

The local government cost index (LGCI) is supposed to measure the increases to costs faced by local governments which have been immense because inflation has thus far disproportionately affected energy and materials (local government is obliged to make considerable use of these resources to fulfil its remit: for example, the expenditure on fuel in 2023/24 was $1.555 million, having risen from just $1.261 million just two years earlier). The local government cost index is used to guide decisions around the IPART rate cap which is the maximum percentage that a council can ordinarily increase its total tax take in a given year, in the absence of a special rate variation. Unfortunately, the LGCI does not measure cost pressures accurately – recent changes have improved matters a little, but it is still far from precise. As a result, the allowable tax increases for NSW local governments have largely lagged actual cost pressures over many years according to Australian Bureau of Statistics data (Figure 1 below). This gap has been slowly compounding and explains some of the financial sustainability predicaments faced by local governments across the state.

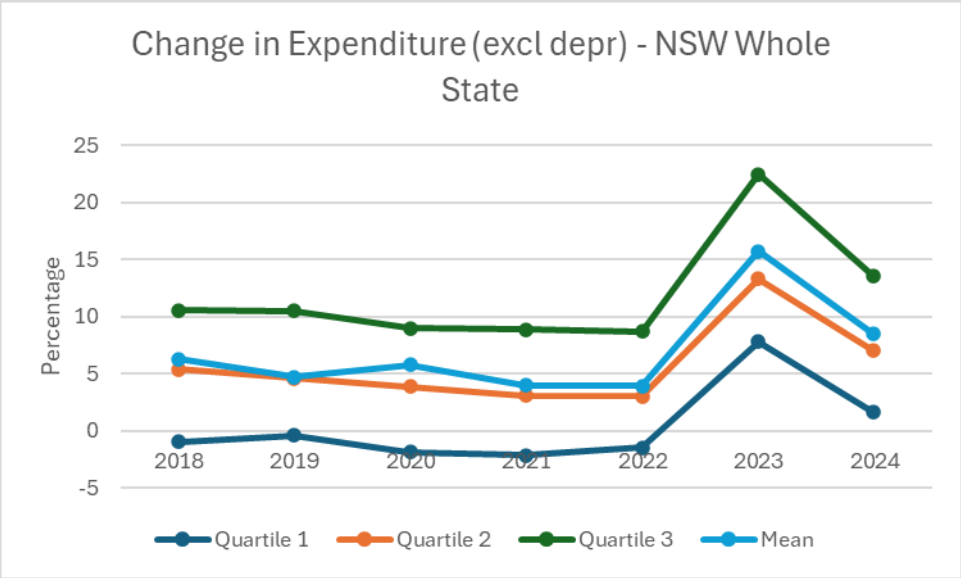
[1] It is important to remember that people on welfare have their incomes adjusted to CPI twice per year. Employees, often have to wait for an Enterprise Bargaining agreement to be executed and may suffer a significant lag in trying to maintain real incomes.

Figure 1. A Comparison of the Rate Cap Against Various Measures of Inflation.



Clearly, the inability of a rate cap to keep apace with cost increases faced by local government will make it inevitable that councils will need to apply for SRVs from time to time. This insufficiency is further exacerbated by the extraordinary increases to operational expenditure that most local governments in the state have been obliged to absorb to meet their obligations to communities (as well as the national housing crisis) in the last few years. It should be clear that rate increases in the last two financial years have lagged expenditure obligations by a considerable margin (see Figure 2). {Matters are further inflamed by the fact that crucial grant receipts are linked to CPI (an inappropriate index which is typically lower than local government cost pressures)}. Notably, Figure 2 excludes depreciation which has typically been increasing at a very fast pace because of Auditor General misapprehensions around the AASB116 requirements (such as efforts to standardise depreciation accruals and also include assets that are clearly not under the control of council). Further exacerbating matters are new regulatory costs such as the aforementioned central auditors (in truth, a cost-shift with relatively little value; see McQuestin et al., 2021), ARIC committees, and new training requirements.

Figure 2. Changes to Operational Expenditure (excluding depreciation), NSW.



For the particular case of Cessnock, matters are even more troublesome. As we have already noted, central auditing has posed some challenges for all local governments. However, given Cessnock's traditionally low rates of accruals, the risk to future operating results seems much more pronounced. Cessnock is also exposed to considerable risk associated with movements aimed at reducing carbon outputs. It is likely that many more mines will be forced to close because of an increasingly difficult operating environment. With each closure there is a strong potential for residual tax burdens to be shifted to the remaining body of ratepayers. This particular issue has already caused a revenue crunch at one other local government in the jurisdiction (hit harder by closures) and given the problems this caused there it would seem prudent to get on the front foot now. Furthermore, as we will demonstrate later in this report with reference to the scholarly literature, residential growth also poses an acute risk to sustainability.

One of the key learnings that we have taken away from the councils we have previously helped is that delay inevitably results in greater pain down the track. Every year that a council puts off collecting a reasonable quantum of taxation, is a year that ultimately will have to be caught up on. That is why one can all too regularly see headlines about councils applying for SRVs of eighty percent or more (see for example Tenterfield or North Sydney). Usually, these councils delayed for many years after problems first came into view – they did so for putatively good reasons and as a kindness to ratepayers – however, arithmetic will always have the final say. There is never a good time for a rate increase and waiting often becomes a vain hope that merely compounds problems. Indeed, there is no good reason why people might expect there to be a better time in the future (in fact, many economists would point to good reasons for why matters are likely to continue to deteriorate).

In addition, the way implicit liabilities tend to manifest further augurs against better outcomes at an ill-defined future moment. Implicit liabilities are monies that we know

will need to be spent in the future – they are an even greater risk than explicit liabilities that one finds on the Balance Sheet of financial statements. A salient example of implicit liabilities are road seals. When seals are reapplied in a timely manner one might expect a cost in the order of $8 per square metre. If roads are left to deteriorate and the entire substrate needs to be dug up and re-limed this cost typically sits at around $60 per square metre. Unfortunately, one of the first things to be delayed when a council is under strain is road maintenance. Given the figures cited above, it is easy to understand how delays to maintenance might lead to catastrophic outcomes for financial sustainability.

It would thus be prudent for council to get on the front foot and take appropriate action to permanently alter its revenue path as soon as possible. Delays will only increase the pain and costs down the track. Should Council commit to making reasonable adjustments to its rate path then it would be necessary to complete more detailed independent studies of efficiency, liability capacity, and capacity to pay – as well as a rigorous interrogation of the LTFP. This would all be in accordance with the spirit of the process as articulated in the Act (NSW, 1993), OLG Guidelines, and IPART interpretation of OLG Guidelines. It is also what the community will likely demand. The community should be made aware that Council has embarked on a rigorous independent evaluation by three professors (this should also be signalled in IP&R processes). Work should then be conducted with a view to present to the community in early November. A number of other tasks would also be necessary, including review of hardship policy, surveying of staff, surveying of community, councillor briefings & training, staff briefings and the like. An SRV is an intensive exercise that requires dedication and thoroughness. With the right commitment and perspective the process can work to the betterment of all stakeholders and result in new levels of understanding that might previously have eluded the various parties.

We reiterate that many people frequently misconceive who will make the decisions around an SRV. For the case of financial sustainability, the Guidelines do not require that the community agrees to the tax increase – merely that they have been made aware and that they have had a real chance to influence the design of the proposal in a reasonable way that acknowledges financial imperatives. The Councillors will then need to vote on a motion to forward the proposal to IPART. But this alone is no guarantee that the tax increase will occur – after all, in the last two rounds over a quarter of applications have been rejected by IPART. The final decision is made by IPART around May each year, under delegation of the Minister for Local Government. IPART are quite thorough in their work – therefore only a comprehensive brief of sophisticated evidence and a demonstration of a real willingness to make changes and respond to community feedback can be assured of success. Indeed, one of the key tasks here is an independent interrogation of the LTFP and efficiency measures proposed to support the SRV application.

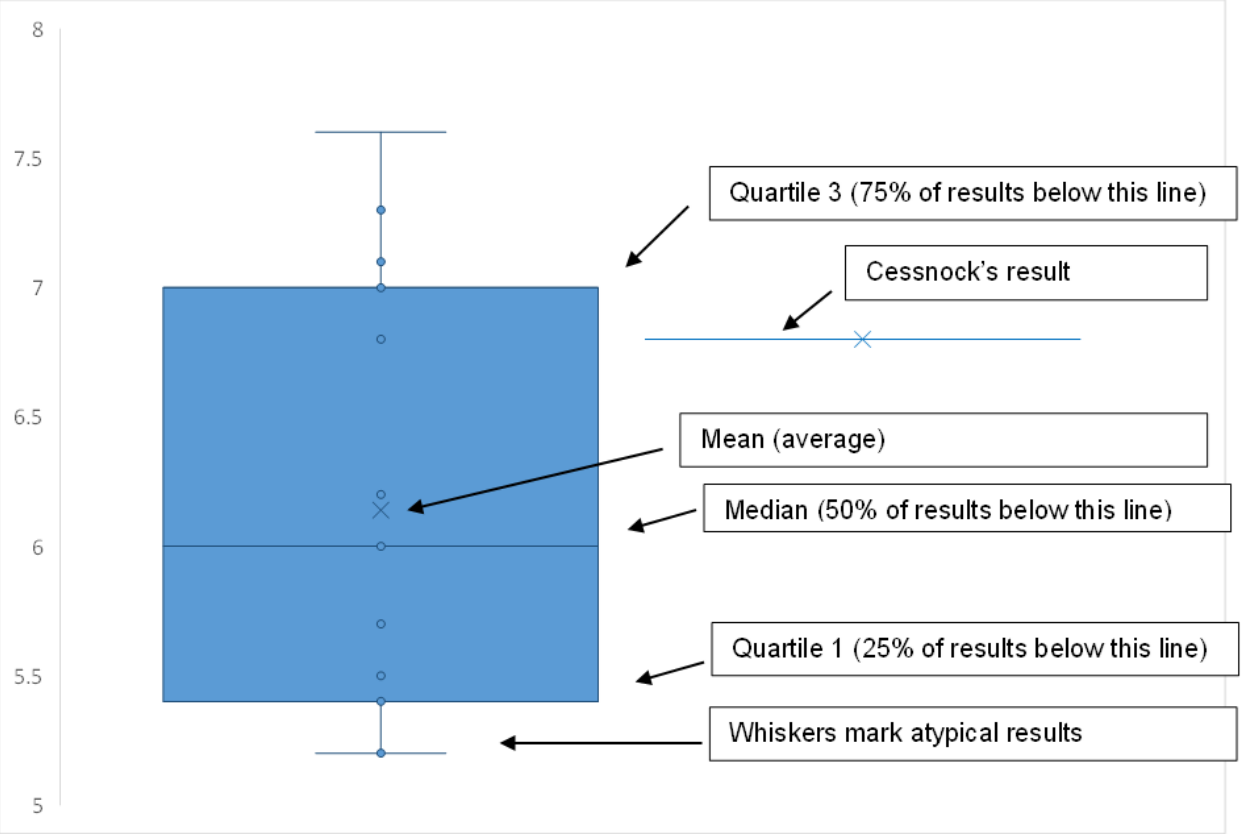
The remainder of the report presents a number of simple ratios whereby comparisons are made to a group of peer councils derived from the appropriate OLG group and assisted by Euclidian cluster analysis (for similarity). Table 1 lists the peers used.

Table 1. Peers Used in Comparisons

Bathurst	Kempsey	Singleton
Dubbo	Lismore	Tamworth
Eurobodalla	Mid-Western	Wagga Wagga
Goulburn Mulwaree	Queanbeyan-Palerang	Wingecarribee
Griffith	Richmond Valley	

Comparative data is presented in box and whisker plots which are the best way to illustrate a particular council's performance relative to its peer group. Figure 3 explains how best to interpret such a plot.

Figure 3. Interpreting Box and Whisker Plots



We also conducted a cross-section regression to derive a benchmark for capacity to pay. The panel regression and other tasks that we will do in a potential Capacity to Pay report will be more thorough, but likely yield consistent answers. Notably this latter work is conducted with reference to all peer councils in NSW (those designated 'urban' (which is Cessnock's classification) according to the Australian Classification of Local Government). This was a cohort of sixty-eight NSW local governments.

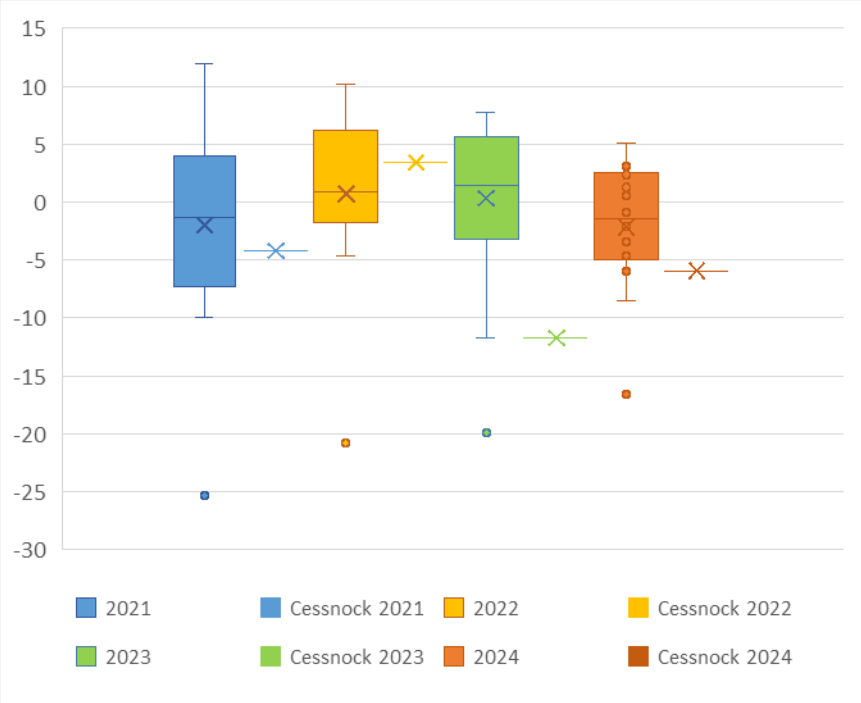
We also formulated a sustainability index based on rigorous mathematical techniques for all urban councils for the 2024 financial year. We graphed Cessnock's relative position with respect to its peers towards the end of this report.

We conclude with our recommendations regarding the next steps for Council.

Analysis

In this part of the report we will look at around fifty metrics to get a feel for the need and practicality of permanently changing Cessnock's rate path (SRV). As a general rule, it is important to consider all metrics together and not myopically focus on any single number. Nevertheless, it would be reasonable to place more emphasis on the sophisticated regression and financial sustainability indexes, because these techniques are more rigorous, and are also based on a larger group of peers (an additional fifty or so councils). Furthermore, numbers alone will never tell the whole story – it is also critical to understand matters in terms of the specific context of the council, economic theory, experiences derived from other councils, as well as the prevailing local and state political environments. This is the reason why we conduct site visits and survey staff and community. It is also the reason why our team of distinguished scholars discuss the matter at length, between themselves, before coming to a consensus recommendation.

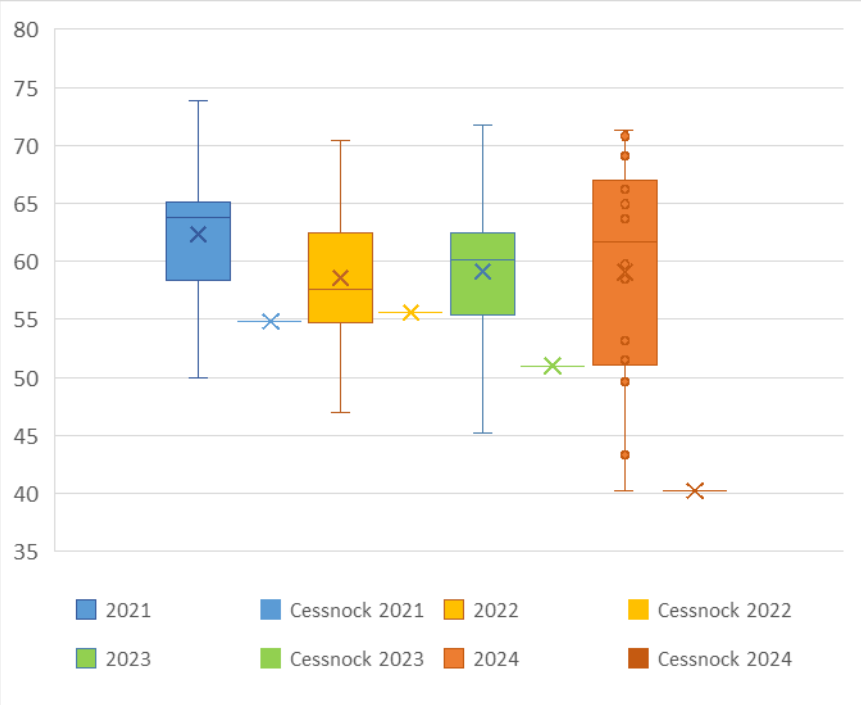
Figure 4. Operating Performance Ratio



Perhaps the key ratio employed for decision making by councils and regulators alike is the operating ratio. It is important to not get fixated on any particular year as expenditures are often lumpy – instead we need to look at matters over a longer term. In the past the benchmark was break even over three years and we consider this far more reasonable than the current OLG requirement. Clearly if a local government consistently fails to break even then they will have great difficulty in maintaining and replacing assets when required. This is particularly problematic given our earlier comments around the threats posed by implicit liabilities.

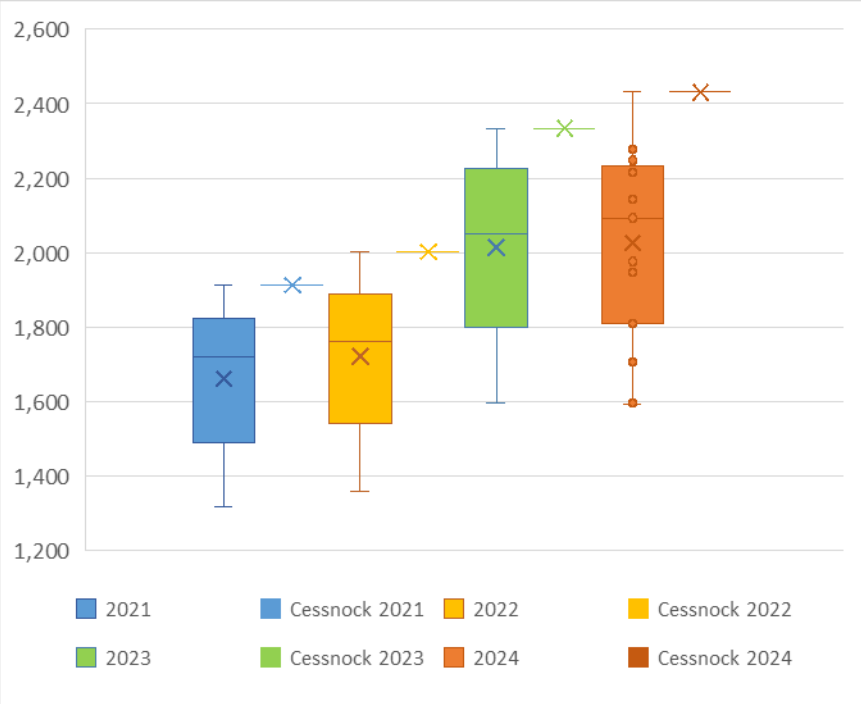
Figure 4 compares the operating ratio of Cessnock to the fourteen peer councils that the OLG tell us are similar. In three of the years the operating ratio for Cessnock was firmly in the negative range. Moreover, in a comparative sense Cessnock has been in the bottom quartile (lowest 25%). Clearly this is not a sustainable situation.

Figure 5. Own Source Ratio



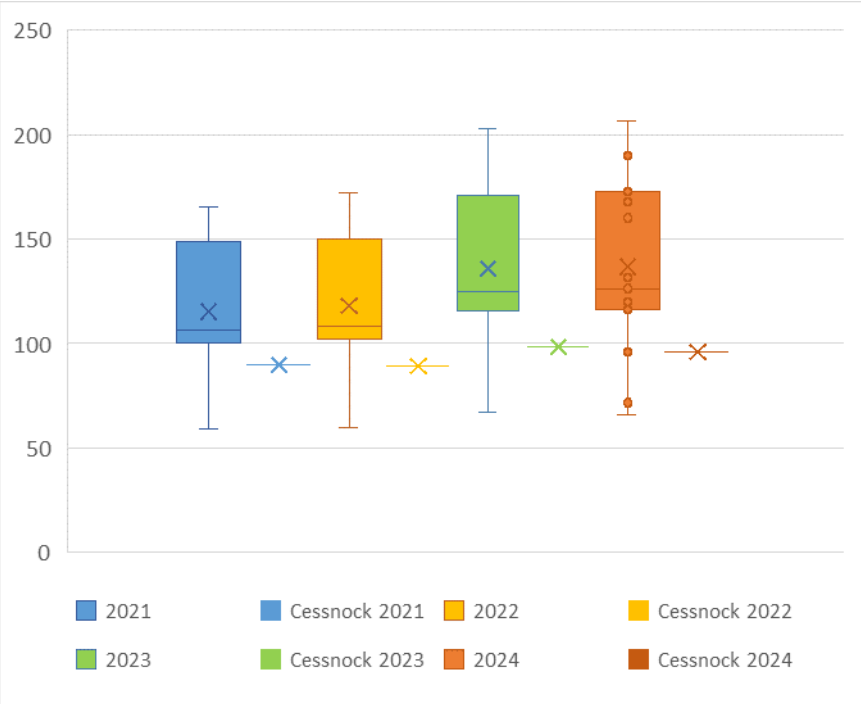
The own source ratio is a regulatory benchmark arbitrarily set at sixty percent in apparent ignorance of both our Local Government Financial Assistance Act 1995 (CTH) and the very disparate goods and services provided by local governments across the state. End users of this report should absolutely ignore the *benchmark* as otherwise they might be inclined to make poor decisions that expose the community to risk. Nevertheless, the ratio does have a little value when considered over time with reference to peers. This is because it clearly shows that own source monies – such as fees, and rates – are not commensurate with other councils and are declining in a relative sense. This observation leads one to suspect that there may well be a need for more accurate pricing of goods and services at Cessnock (for non-regulated fees) and also potentially higher taxes.

Figure 6. Road Grant per Kilometre ($)



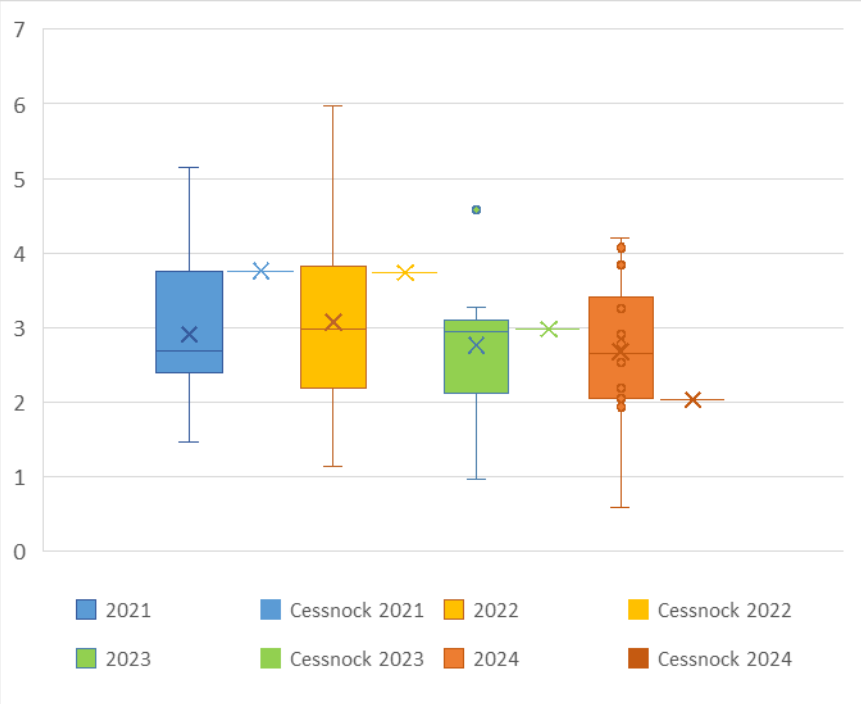
Grants are also important to consider as they clearly have an impact on the aforementioned metric. In Figure 6 we plot road grants as per allocations made by the NSW Local Government Grants Commission (NSWLGGC) which are supposed to be made according to national principles articulated in the Act (1995, CTH). It appears that Cessnock is getting a good allocation. Given heavy vehicle usage of council roads this might be appropriate.

Figure 7. General Component of Financial Assistance Grant per Person ($)



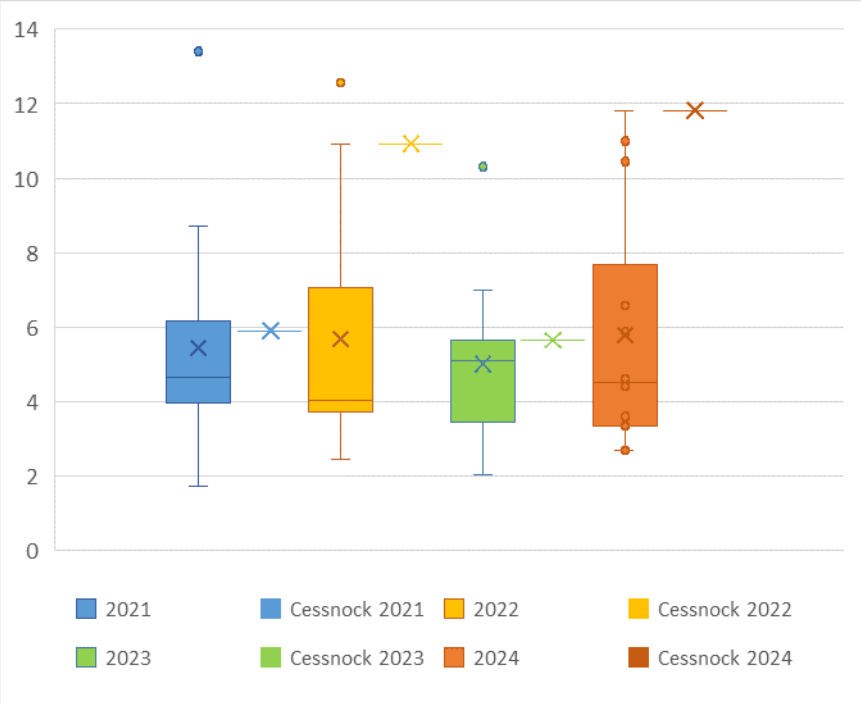
The general component of grant allocations are supposed to be allocated by the NSWLGGC according to the principle of horizontal fiscal equalisation (HFE), as per the Act (1995, CTH). At a recent conference the Head of the OLG declared that he did not want to talk about HFE, despite the fact that it is carefully articulated in section 6(2)(a) of the enabling legislation and defined quite clearly in s6(2)(3) (Local Government (Financial Assistance) Act (1995, CTH). HFE means that every Australian ought to be able to access basic government goods and services at a reasonable price. We remind readers that financial assistance grants are federal government money that must be allocated by states according to the federal law. We also note that the aforementioned Act (1995, CTH) also requires transparency and accountability under s3(4)(a) – something that the NSWLGGC seems reticent to fully embrace. It is hard to understand allocations in the lowest quartile for Cessnock, given that the demographic data that we present later in this report is typically average. It would be helpful if the NSWLGGC would provide full details of their methodology and release all materials associated with their recent review of the FAG allocations (including the consultant reports) – this might allow the community to better understand matters.

Figure 8. Unrestricted Current Ratio



The unrestricted current ratio is a measure of liquidity. We don't believe that liquidity is a pressing concern for Cessnock in the short-run. Rather, sustainability is the issue at hand. Nonetheless, there is a distinct downward trend in both absolute and comparative terms and this will clearly need to be arrested.

Figure 9. Debt Service Ratio

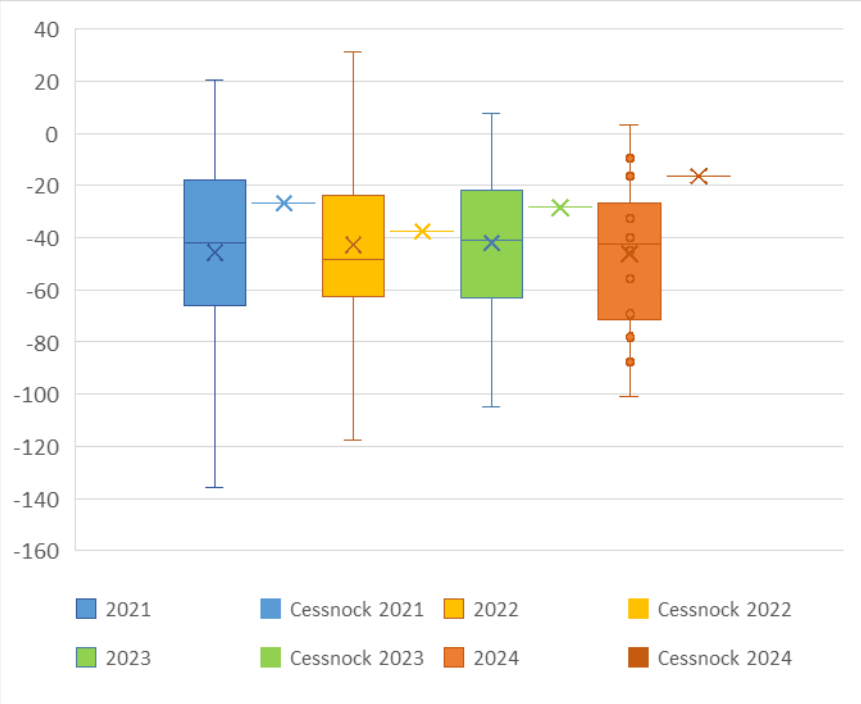


The debt service ratio is an extremely misleading metric mandated by the state government, with an apparently arbitrary and inappropriate benchmark. Moreover, the OLG SRV Guidelines suggest that council needs to investigate other options such as debt, apparently unaware of the moral hazard and also how this might relate to financial sustainability. These matters will be dealt with in far greater detail should Council proceed further, in the *Debt Report*.

Observance of the aforementioned debt ratio could easily result in poor cash management and unsustainable practices. It should thus be largely ignored.

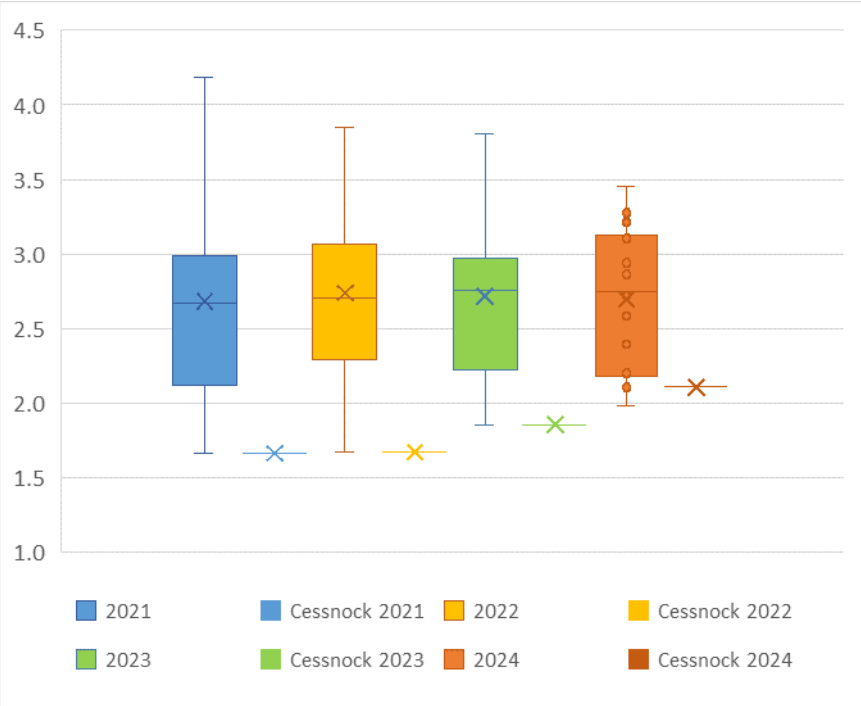
One of the other serious problems with this particular metric is that it ignores other important explicit liabilities such as staff entitlements. The next metric that we will survey corrects matters a little, but it is still inferior to multiple regression analysis that we typically conduct in a more comprehensive *Debt Report*.

Figure 10. Nett Financial Liabilities



The nett financial liabilities ratio is a little more comprehensive and hence a more defensible ratio, which probably explains why it is the preferred metric employed in various guises in other states. The numerator is liabilities less current assets; the denominator revenue less capital grants. Therefore, a more negative result is a relatively better outcome. Notably, the result for this metric stands in stark contrast to Figure 9 and suggests that Cessnock has relatively little capacity for more explicit debt. Nevertheless, we remind readers that it will be important to understand the situation for total liabilities which is a much more complex matter that can only be dealt with thoroughly in a separate study.

Figure 11. Total Depreciation of Infrastructure, Property, Plant and Equipment Deflated by Carrying Amount



Depreciation accruals have been a source of ongoing difficulties for all local governments in Australia. It has become a particular problem in recent years in NSW in the wake of the appointment of a central auditor which seems to have a unique interpretation of AASB116 and its associated international accounting standard. It is a grave mistake to require absolute consistency in depreciation accruals or to insist that councils accrue depreciation expense for items that they clearly do not control. No reputable scholar of accounting would say otherwise.

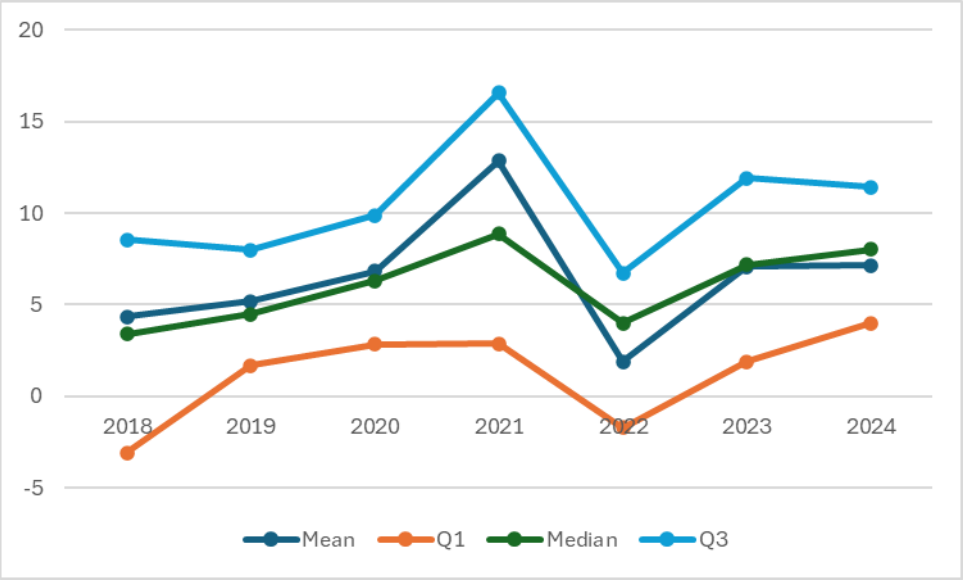
Nonetheless, the Auditor General has considerable power to enforce its novel interpretation of matters irrespective of the effect that this will have on the usefulness of accounting statements. Accordingly, Cessnock's depreciation expense has been increasing in recent years. Given Figure 11, it would be reasonable to expect even further significant increases in the future. This will be exacerbated by any new capital works that council might undertake. Additional revenues would be necessary to cover these additional expenses.

Council might also expect a continuation of significant increases to audit fees now that the state government has abandoned market principles in favour of an economically inefficient monopoly (for audit services). This will also need to be met with additional revenues if we do not wish for sustainability to suffer.

On a slightly different note, we would encourage the CFO to start listing non-depreciable earthworks as a separate item in Note C1-6 in the financial statements. We imagine these items are being accounted for appropriately, but it would help comparisons if the Notes were more clear and consistent with most other local governments in the state (notably auditors are charged with ensuring comparability in line with Australian Accounting Standards). For the purposes of interpreting Figure

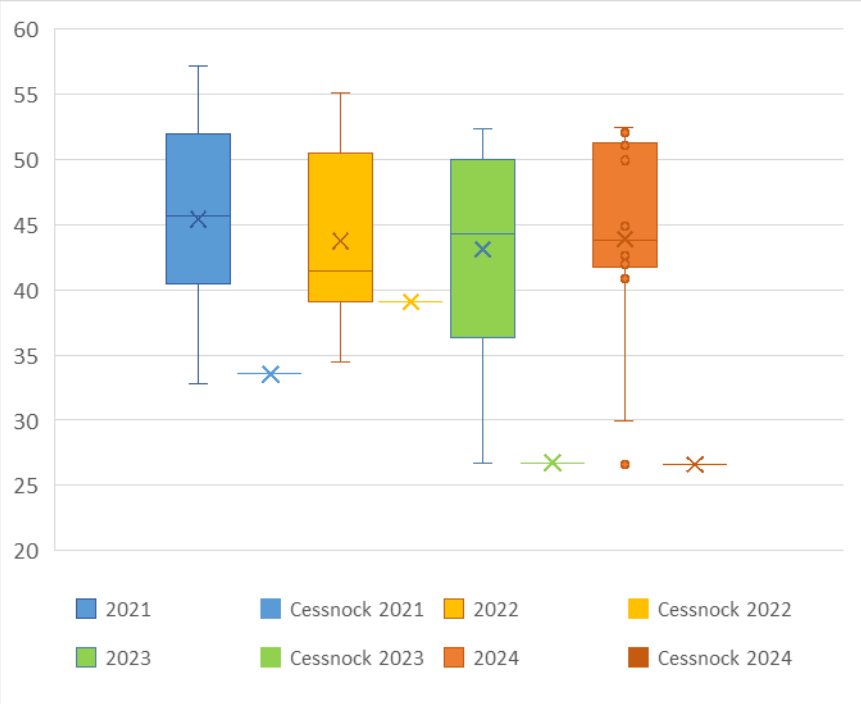
11 accurately, end-users of this report ought to know that bulk earthworks typically account for 0.4 percentage points with respect to the depreciation rate under consideration.

Figure 12. Percentage Change in Depreciation Expense, all NSW Councils Classified "U".



Moreover, the experience of Cessnock has not been unique with respect to other NSW local governments. In Figure 12 we provide the year-on-year percentage change summary statistics for depreciation expense derived from the audited financial statements of all NSW councils in the same national classification code ('urban' councils). It is clear that typical increases to depreciation expense have far exceeded CPI, the rate cap, as well as increases to grants for most of the last seven years. Indeed, a quarter of the relevant councils have had increases to depreciation expense exceeding ten percent in recent times. If these increases continue to outpace changes to revenue, then it would be reasonable to expect that many metrics of sustainability would deteriorate accordingly.

Figure 13. Nexus



A nexus ratio is designed to measure how much of operational expenditure is covered by fees and charges. As such, it is a good indicator of whether Council is charging sufficient prices for goods and services subject to fees, and also sufficient rates.

For most of the time period under consideration Cessnock has had an extremely low nexus result. Indeed, for the last two years it has had the absolute lowest rate in the peer group. This is problematic because if Council does not collect sufficient fees to cover its' cost of production, then either ratepayers will be forced to subsidise the cost or the next generation will be required to pick up the tab for items already fully consumed by individuals. This would be completely inequitable. Economic theory, and common experience, also lead to the conclusion that inappropriately low fees also result in inefficient levels of consumption. Often Councillors are reticent to charge a fee that fully covers councils' cost as a kindness to those availing themselves of the good or service. However, there is no escaping the fact that if the resident consumer doesn't pay the full price for what they consume, then others will ultimately be forced to do so.

For this reason, we strongly encourage council to start working through the task of setting non-regulated fees and charges at long run marginal cost. In simple terms this means that we should price things at the cost of producing one more unit taking into account all future knowable capital investments. Our suggestion is to divide fees charged by the local government into equal groups and redress each group, each year on a rotating cycle. Most extant fees are probably a combination of a historical judgement when the good or service was first introduced (which may or may not have reflected actual cost at the time) indexed by CPI (which as we have already shown is usually completely the wrong foundation for local government decision

making). This typical approach – probably employed by almost every local government in the state – is not conducive to financial sustainability, nor equity. Once fees have been re-based it might be possible to use a rough-and-ready index some years, but they really should be reviewed in depth at least every Council term.

Next, we will look at various crude metrics which the OLG supposes might provide insights into capacity to pay. The fact is that averages will be misleading when there is skewing of data – this is simply an arithmetic reality. Land size and values are quite disparate within a local government area, therefore skewing is almost certain. This effect is even more pronounced when some local government areas host mining operations, as does Cessnock. Furthermore, average rates do not measure capacity to pay, because rates are paid out of incomes. One can see this easily from a simple thought experiment: if two adjoining local government areas had precisely the same average rates (ignoring the significant problem of skewing for a moment) but completely disparate resident incomes then it is a matter of formal logic that they could not possibly have the same capacity to pay. Thus, the OLG Guidelines are completely in error and represent a flawed basis, *ab initio*, for decision making.

Later in this report we will conduct a more sensible exercise and should council proceed with a SRV we will perform even more comprehensive analysis.

Nevertheless, the OLG Guidelines are the basis on which IPART must make its decisions, therefore it behove us to review these flawed metrics.

Figure 14. Rates, Fees and Annual Charges per Assessment ($000)

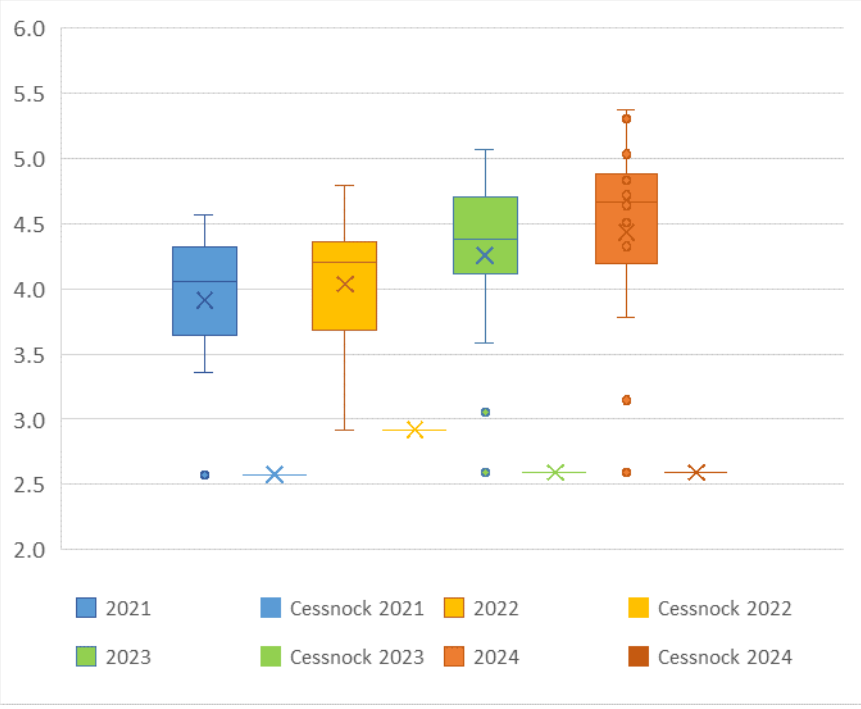
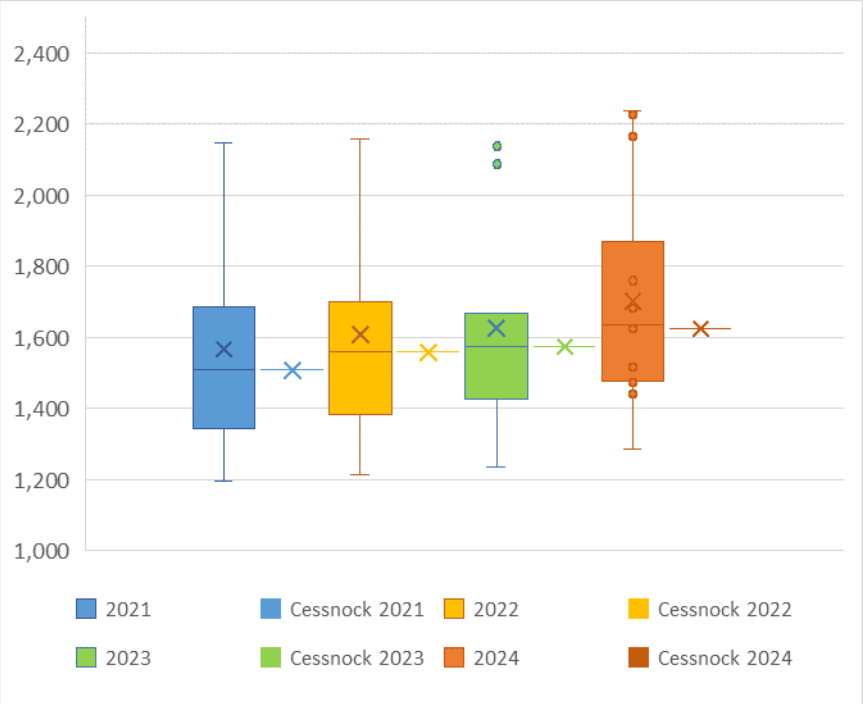


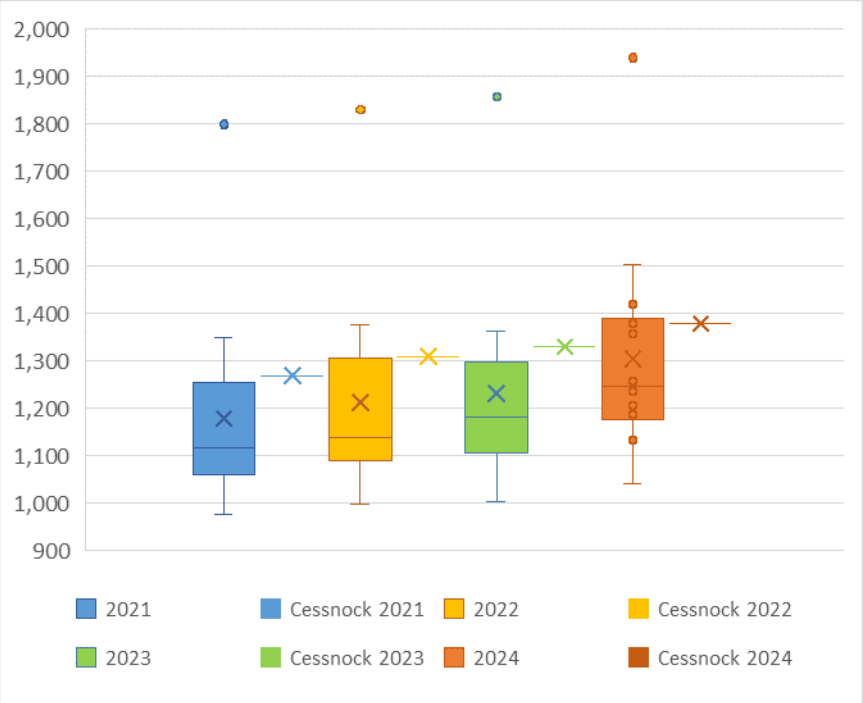
Figure 14 suggests that Cessnock is routinely collecting the lowest rates, fees and charges on a per assessment basis, compared to OLG peers. Indeed, Cessnock is an extreme outlier (in a statistical sense). This certainly seems to suggest that there is a revenue problem.

Figure 15. Total Rates per Property Assessment ($)



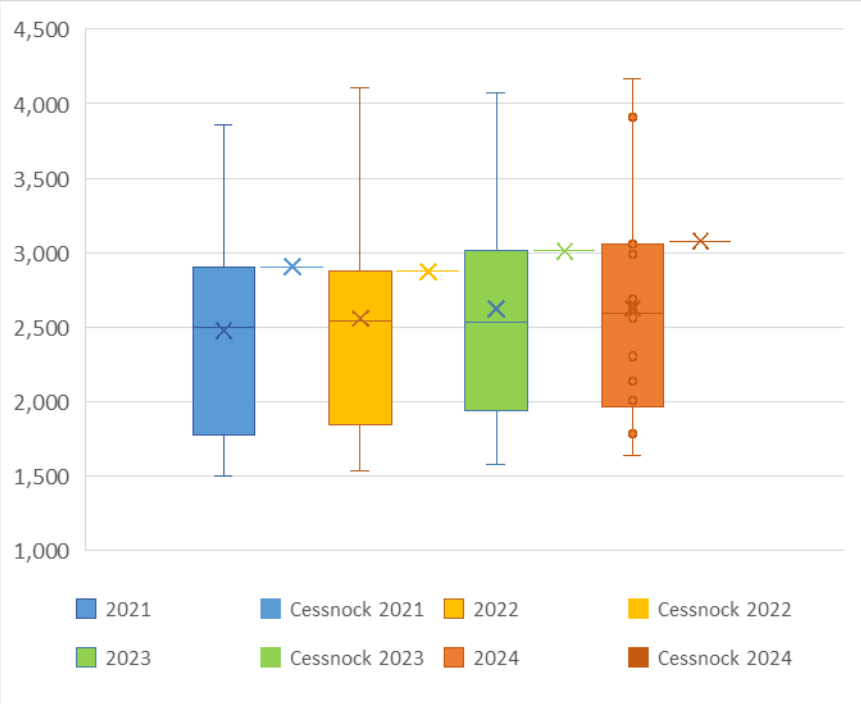
If we just look at total rates per property assessment, Cessnock appears to be close to the median, but below average. End-users should remember that Cessnock has big mining operations and that this will inevitably distort comparisons based on average rates.

Figure 16. Residential Rates per Assessment ($)



Average rates per residential assessment would at first glance appear high. However, as we have already plainly stated comparisons of averages are meaningless with skewed data, in the absence of a consideration of incomes. Later in this report we will provide a competent analysis that may well contrast starkly to this flawed OLG methodology.

Figure 17. Farm Rates per Assessment ($)



Average farm rates also appear to be *prima facie* high. However, without knowing the incomes associated with farming ventures in these locations, comparisons are pretty meaningless. It would be heroic in the extreme to expect the value of agricultural product from diverse activities such as wool, fat lamb, cattle, cropping, or irrigated fruit – represented in the peer group – to be in any way comparable. Furthermore, agricultural data is always heavily skewed because the size of ventures are heavily skewed – from mum and dad operations, to international mega-corporations such as the Australian Agricultural Company. It would therefore be somewhat reckless to put any emphasis on the aforementioned data required by the OLG. If Council proceeds with work we will investigate these and other matters correctly using ABARES census year data and other sources (for example, agricultural commodity prices and projections).

Figure 18. Business Rates per Assessment ($)

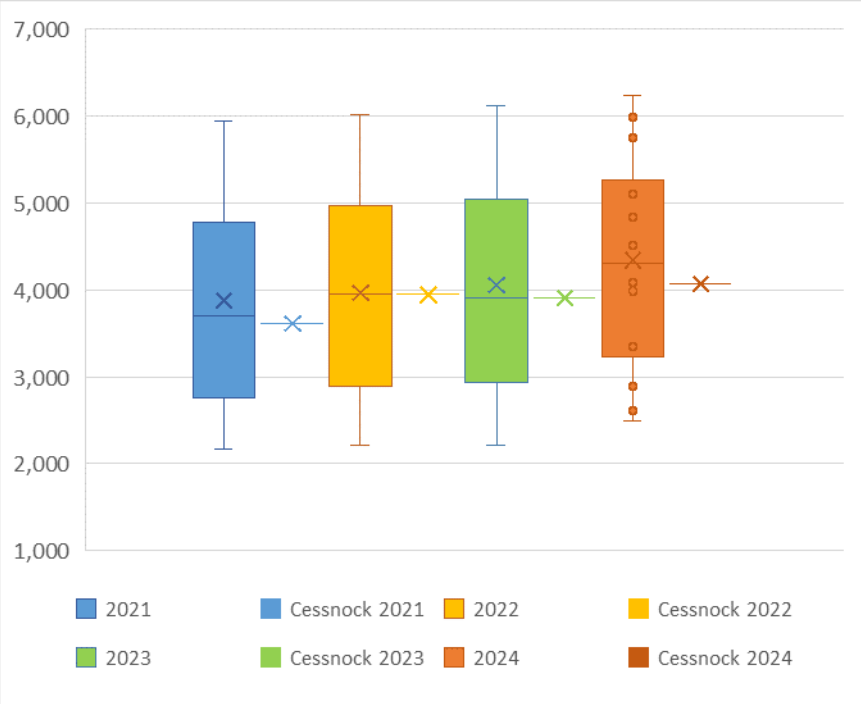
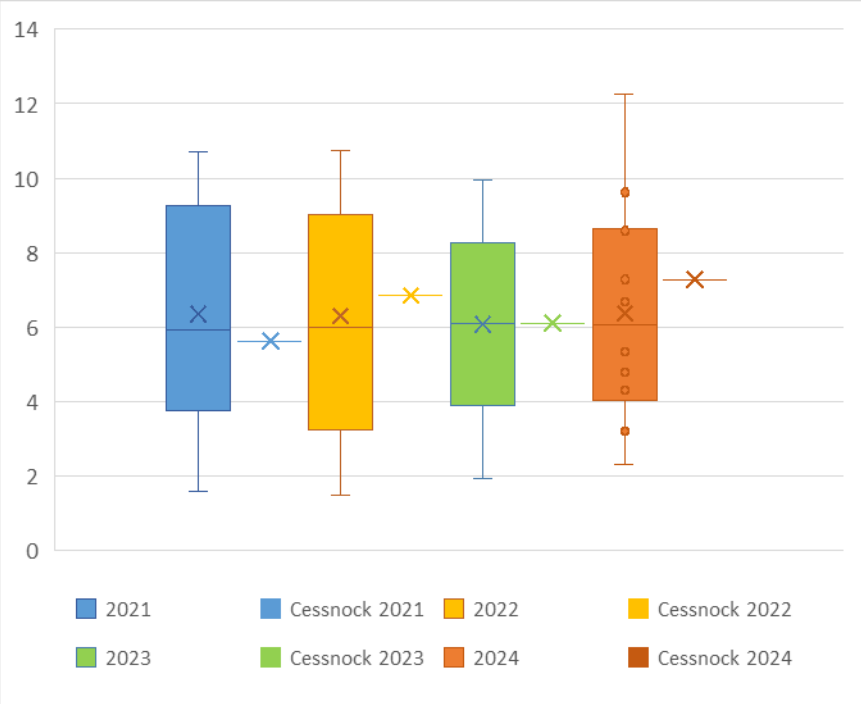


Figure 18 suggests that average business rates are a little below typical levels of the peer group. However, once again, significant skewing in the data both within and between local government areas makes this kind of metric pretty unhelpful. Moreover, different business ventures are clearly likely to have different land intensities, orientations and associated incomes. For these reasons, end users would do better to place greater emphasis on the regression results that we will present shortly, as well as a more detailed analysis (in the potential *Capacity to Pay Report should* council proceed with stage two).

Figure 19. Rates and Charges Outstanding (%)



One final simple metric that is worth considering – with caveats – is the rates and charges outstanding data as recorded in the notes of the audited financial statements. In a comparative sense Cessnock is more or less typical of the peer group for most years. It is important to contextualise this to specific local economic circumstances as well as the level of focus that any given council might put into following up arrears (there may be good reason to think that efforts might be increased in this latter regard).

We have noted that Cessnock has an unusual rate structure (as well as non-mandatory pensioner rebates) and that this might be optimised to improve capacity to pay as well as distributional equity (especially given the potential of some ratepayers to export part of their local government tax expense). This is a matter that we will discuss in workshops with council should they elect to proceed with Stage 2. We will also need to discuss the Hardship Policy in view of this result, and we will provide council with copies of exemplars from other local governments that IPART has expressed approval of, as a guide.

In the following exercise we conduct a cross-section regression to get a more defensible estimate of capacity to pay. We caution that a cross-section (just one year, as opposed to a panel that looks at several years) is not the gold standard (panel regression is better because it smooths out any local distortions in a given year). However, it is a good guide which we believe will likely be close to the more robust estimate that a panel regression would provide, should Council proceed to Stage 2.

Regression has a number of advantages over other potential methods. First, it allows us to take account of *all* of the important variables known to affect capacity to pay simultaneously. As we have noted, capacity to pay is a function of incomes, so in a regression we include details of the number of various taxpayers, their wages, various welfare benefits, and also (unincorporated) business[2] incomes. In addition, regression allows economists to make *ceteris paribus* claims – that is, precisely understand statistical associations between the regressand and regressors, holding all other things constant.

Readers should be aware that the two professors who have authored this report are extremely experienced scholars, with a combined output of hundreds of works, which have been approvingly cited thousands of times by their scholarly peers. Indeed, one is the editor at a highly esteemed academic journal. Otherwise stated, they are world-class in this field and routinely conduct sophisticated empirical analyses.

Econometrics is based on a strong body of theory developed over centuries and is something that students study at both the undergraduate and graduate levels. Typically, to become an econometrician one studies at least a bachelor's degree (three years), followed by a two-year master's. All three of the professors involved in this present work hold doctorates in the field (the highest qualification available from universities), and all have successfully taught postgraduates at the highest level. For readers interested in further information on econometrics, we refer them to the introductory works of Wooldridge (2006) or Kennedy (2003).

Our regressions were conducted on the entire cohort of sixty-eight urban councils within NSW, over the 2024 financial year using data that was laboriously assembled from audited financial statements, Australian Bureau of Statistics data, as well as Office of Local Government data. The regression is thus considerably broader than the earlier ratio work which mostly refers to just the cohort of councils in the same Office of Local Government category as Cessnock.

The final model specification that we employ in our analysis can be expressed as follows:

$$\mathbf{T}_i = \alpha_i + \beta_1 \mathbf{A} + \beta_2 \mathbf{I} + \mu$$

Where **T** is the total tax take (that is the sum of all categories of taxation) reasonably expected of a local government, **A** is the disaggregated assessment data, **I** is a

[2] Incorporated data at the local government area level is, of course, not available. It is reasonable to assume that corporate activity is a function of the incomes in a local government area – if this is indeed the case, then regression remains very robust (certainly far more sensible than the average rate data).

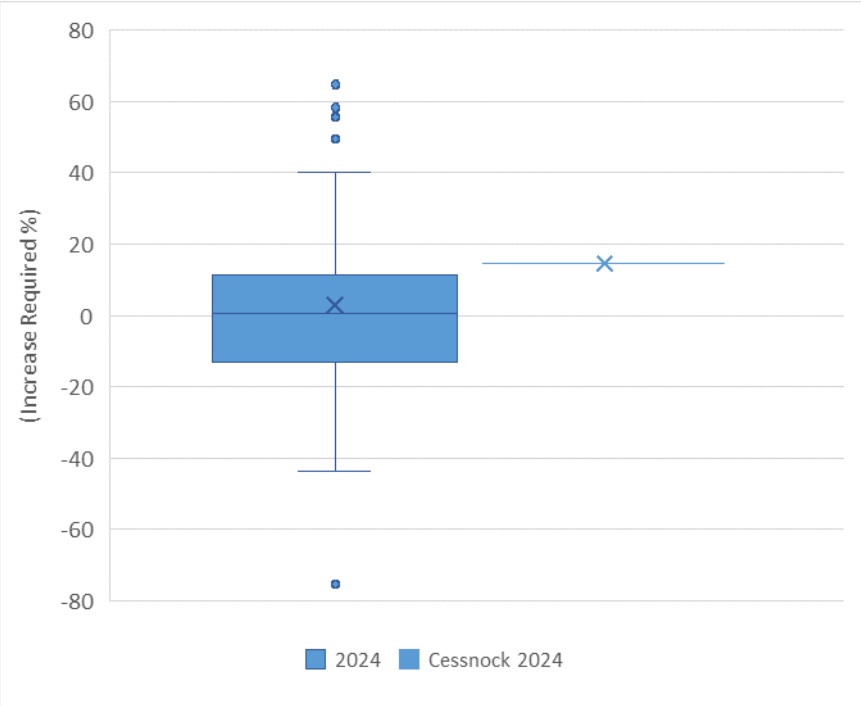
vector of relevant income data for particular local government areas at a specific time and μ is an idiosyncratic error term. Here we included all sixty-eight councils categorised as broadly similar under the extant federal government classification system[3]. Log transformations were employed to counter skewness when econometric diagnostics tests revealed the need to do so. We also conducted and satisfied all other relevant diagnostic tests.

Notably, the coefficient of determination for the regression was 0.9561 – which is extremely high and means that the function specified explained most of the tax take outcomes for urban councils in 2024.

Following the establishment of a function to describe total tax take we then inserted the specific variables for Cessnock for the financial year. By this robust estimate – based on a specification of the numbers of each type of property assessment as well as the incomes (welfare, wage and unincorporated business income) – it would have been reasonable to expect Cessnock to have taken in some $55.057 million in 2024, as opposed to the $47.183 million actually collected. Otherwise stated, Cessnock extracted some 16.68% less local government taxation than might have reasonably been expected from a council with its specific socio-economic profile. Clearly, exerting less than an average revenue effort is not sustainable – if this has occurred for multiple years in the past (a suspicion that can only be confirmed through panel regression analysis), then this would suggest an urgent need to quickly remedy the revenue insufficiency. It would be unreasonable for the Council or its community to believe that they could provide even average levels of services in a financially sustainable way unless they were prepared to at least extract an average level of local government taxation from ratepayers.

[3] We were missing data for a few of the councils for the 2024 financial year, owing to audit delays.

Figure 20. Indicative Percentage Additional Tax Capacity, All Relevant NSW Peers, 2024 Only.



In Figure 20 we graph the additional tax capacity of urban councils in NSW in 2024 derived from our econometric exercise. To understand this graph one must remember that it refers to *additional capacity* – otherwise stated, in this case a higher result suggests a financial sustainability risk. Cessnock is in the top quartile compared to other relevant councils in NSW, suggesting a particularly acute insufficiency.

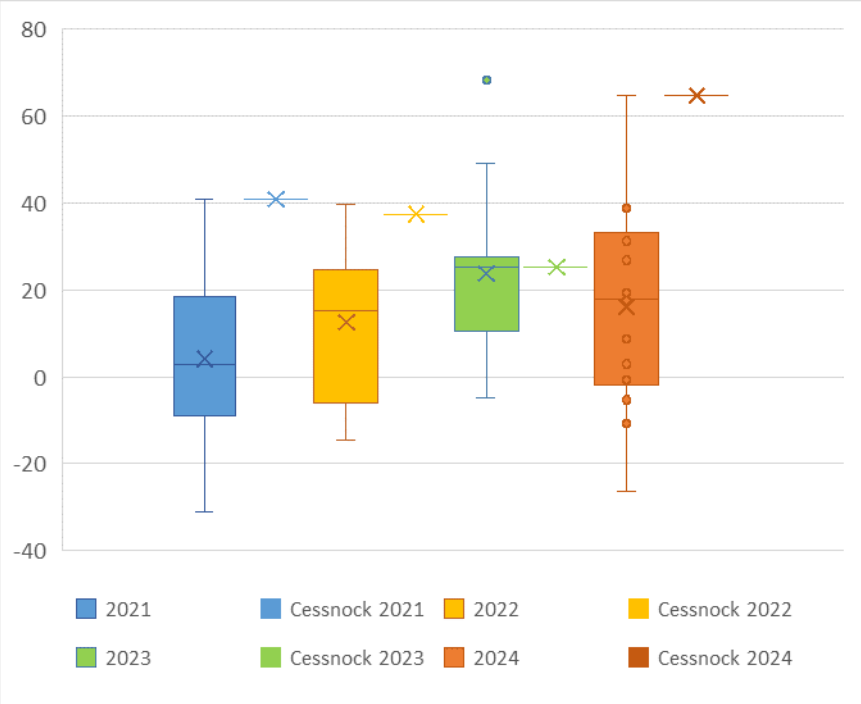
We note that this regression result is consistent with much of the ratio data viewed to-date in this report – we imagine that if Council moves to Stage 2 that the *Capacity to Pay* work will further attest to these matters.

Deviation from budget matters for a number of reasons. First, scholarly research has proven beyond reasonable doubt that deviations from budget have a deleterious effect on efficiency – to be precise a one percent deviation could reduce technical efficiency by up to 0.6 percent (McQuestin et al., 2020). Second, the SRV process is about changing revenue paths to meet future needs. To make good decisions people need to have confidence in the projections.

There are many reasons for why budgets might be inaccurate: (i) poor methodology, (ii) Councillor decisions for new spending, (iii) unexpected state government priorities and directives, (iv) quarterly budget review (QBR) processes that are less than ideal, (v) insufficient accountability, (vi) unexpected emergency spending (such as floods), and (vii) a failure to locate decision-making within the budget and LTFP. With respect to the latter, we suggest that all council workshops and meetings take place with reference to printed copies of the budget and LTFP.

Notably, the research under citation explored the reasons for budget deviance with recourse to the notes for all NSW local governments over a number of years and found that state government policy/directives was the single largest cause of deviation. This explains why most councils fall short of ideal performance in this area.

Figure 21. Deviation from Budgeted Revenue



It should be observed that the budget deviations for revenue were positive. This means that the actual exceeded the budget and was therefore a good thing with respect to sustainability. Furthermore, when actual revenue exceeds budgets, this can point to the likelihood that much of the discrepancy was caused by unexpected capital grants.

In view of past large discrepancies, should Council proceed to Stage 2 of the project our team of scholars would invest considerable time into interrogating the long-term financial plan (LTFP) to ensure that it is as reliable as it can be.

Figure 22. Deviation from Budgeted Expenditure

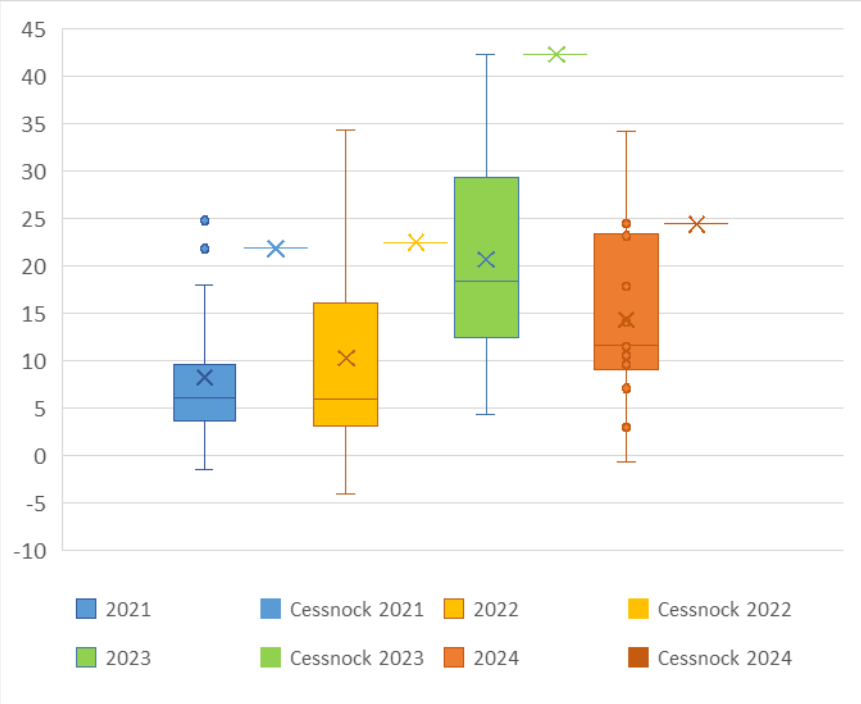


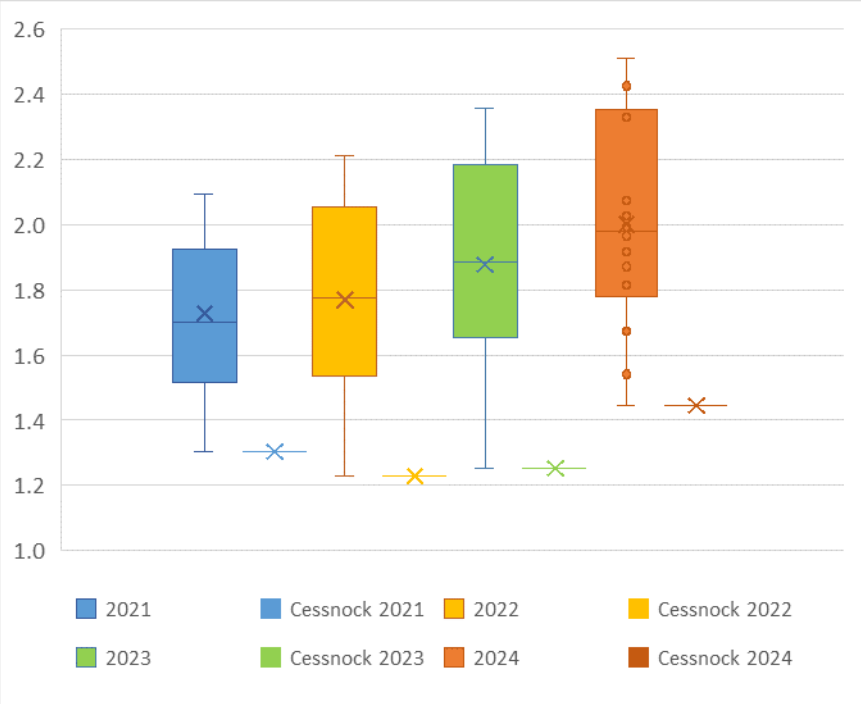
Figure 22 demonstrates that deviations from budgeted expenditure were also disappointing. A positive result here exacerbates the financial sustainability position. Notably, in most years the deviation is considerably less than the deviation for revenue which is a nett positive result.

One of the criteria of the OLG, and hence IPART, is the efficiency of council. It is not unreasonable for regulators and residents to wish to see tax and grant monies spent as efficiently as possible.

Technical efficiency is the conversion of inputs (money and staff) into outputs (generally proxied by the disaggregated assessments, length of sealed roads, and length of unsealed roads). It is important to understand that scale and density can also act as important environmental constraints with respect to efficiency.

To measure efficiency precisely one would need to do data envelopment (DEA) and full disposal hull (FDH) analyses, usually in a local intertemporal sense. This is a significant task that can be undertaken in the efficiency report should council elect to proceed to Stage 2.

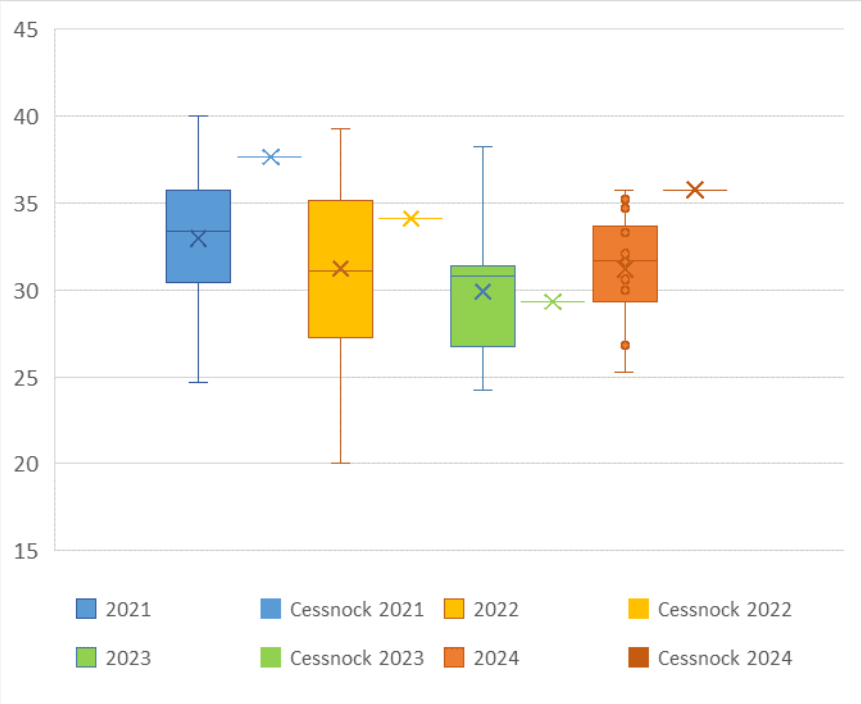
Figure 23. Staff Expenditure per Assessment



For now, some crude ratio analysis will likely suffice. In Figure 23 we present staff expenditure on a per assessment basis for Cessnock and its comparative peers. This is an important thing to do because a common refrain in communities faced by necessary tax increases is that council should cut staff to become efficient. We are quite sure that people making these assertions are likely not conscious of what this would mean in a practical sense for the lives of their 'efficiencies' and the families that rely on them. Nor do we think that people always understand the link between staff levels and service levels – a call for reduced staff will result in reduced service levels (including maintenance) in the absence of higher contract expenses (which would defeat the whole purpose of the reductions anyhow).

As it turns out, a claim of this kind could not be substantiated with the evidence before us in any event. For the last four years, Cessnock has had the absolute lowest staff expenditure per assessment out of the peer group. This is an impressive result that *prima facie* suggests exceptional cost management.

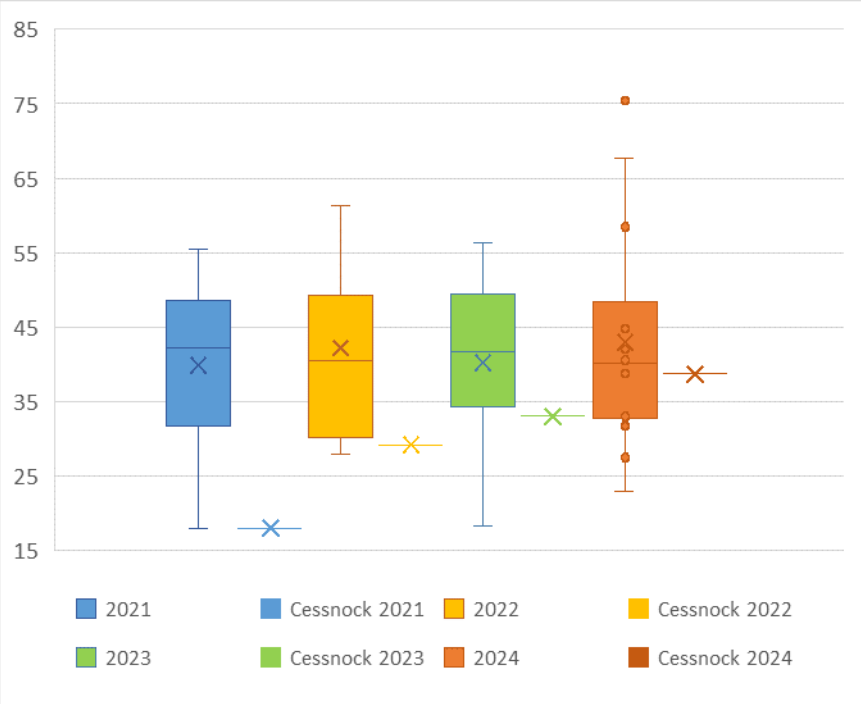
Figure 24. Proportion of Expenditure on Staff



It is also sometimes helpful to look at the proportion of expenditure devoted to staff costs. However, people need to be careful not to get confused on this matter. Technical efficiency is a reflection of the particular mix of factors of production (staff and money) used by the management team. A high proportion of staff expenditure simply means that council elects to do more in-house and less as contracted work. Scholarly research suggests that this is often a prudent course to take (see, for example, Brown and Potoski, 2003). We will be able to provide more commentary on this matter should council proceed to Stage 2 and its associated *Efficiency Report*.

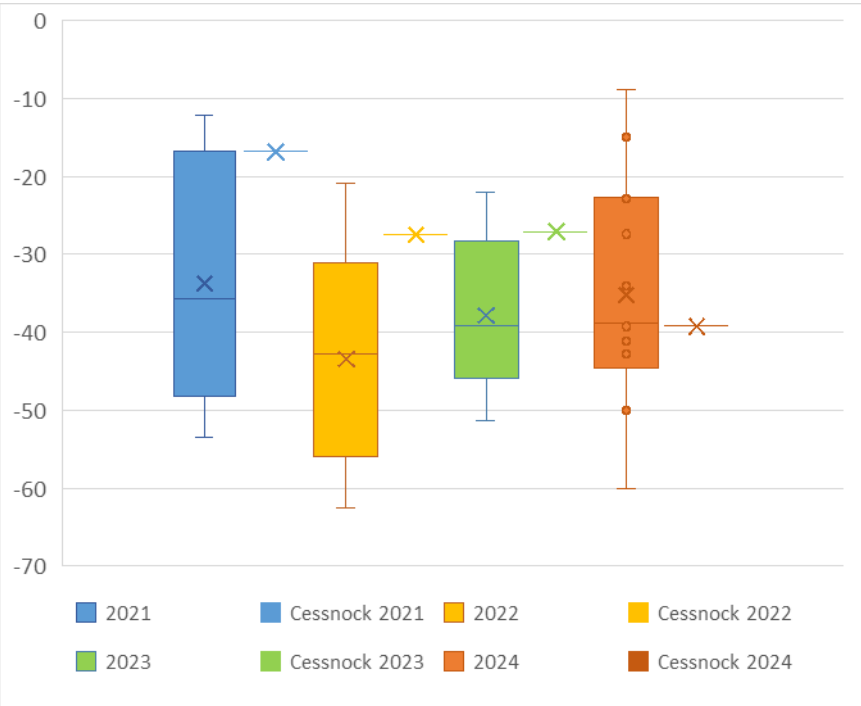
In our opinion too little focus is placed on the Cash Flow statements by Councillors and Regulators alike. Accordingly, in the next three metrics we provide comparative data on the three kind of cash flows.

Figure 25. Operating Cash Flows (deflated by revenue)



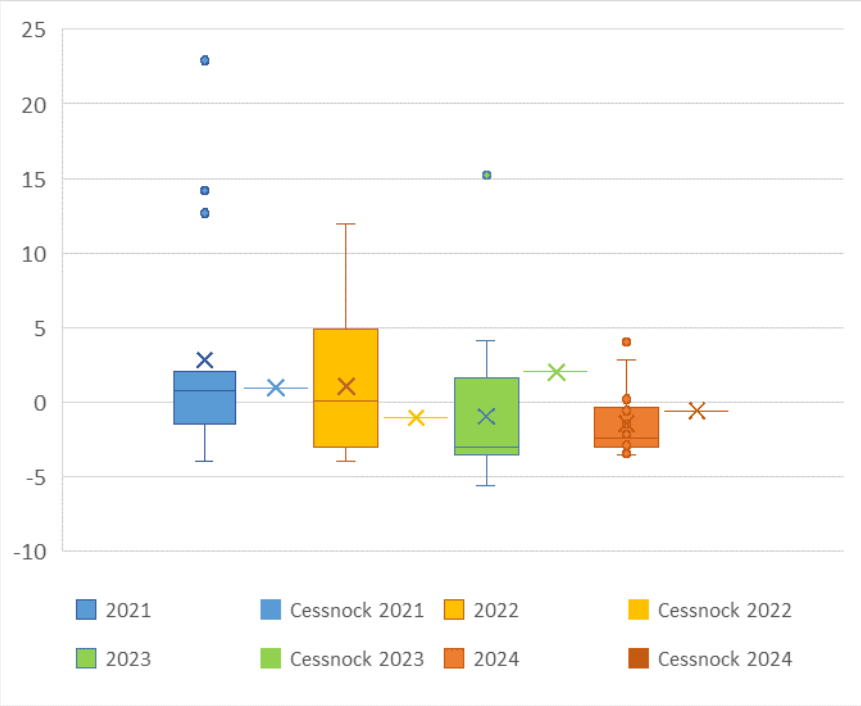
Operating Cash Flow measures how receipts (such as rates, user charges, and grants) are directed towards payments (such as employee expense, materials and borrowing costs). Because of the nature of local government in Australia, operating cash flows are always positive. What is notable from Figure 25 is that this kind of cash flow at Cessnock has been typically in the lowest quartile with respect to the peer group. This further underlines both the insufficiency of rate revenue and the extraordinary low staff expenses, observed earlier, for Cessnock.

Figure 26. Investing Cash Flows (Deflated by Revenue)



Investing cash flows measure the relationship between receipts from the sale of investments and infrastructure, property, plant and equipment (IPPE) and payments for new investments and IPPE. It is sometimes conflated by movements of money in and out of term deposits and the like. Because of the nature of NSW local government investing cash flows tend to be negative and a financially sustainable council will typically be at least as negative (if not more so) as its peer group over the medium-term. As can be seen from Figure 26 Cessnock is often in the least negative quartile with respect to its' peers. This is indicative of a council that is under-investing probably because of insufficient revenue. This interpretation of the data would be consistent with what we have seen in the other metrics.

Figure 27. Financing Cash Flows (Deflated by Revenue)



Financing cash flows measure the balance between receipts from borrowings and payments relating to the repayment of borrowings. For intergenerational equity reasons we would like to see this cash flow approach neutral over the long-run. Cessnock is slightly more positive than its peers and may be drawing on debt slightly more frequently than ideal. This cash flow should be monitored carefully over coming years, and is a further pointer to likely revenue insufficiency.

We will now look at the infrastructure ratios mandated by the OLG. These ratios have a chequered past and there has been much scholarly research casting doubt on their reliability (see, for example, Drew, 2017). We also note that the Auditor-General takes care to place their assurance statement before Special Schedule 7 (where the asset ratios are to be found) – it seems the central auditor may share our doubts.

Furthermore, we understand that Cessnock has only recently reviewed its asset management data and plans. We therefore expect significant revisions to these metrics in the next set of financial statements. Indeed, our own inspection of asset

conditions suggests that more realistic data will likely be reported at the completion of the 2025 financial year.

Figure 28. Buildings and Infrastructure Renewal Ratio

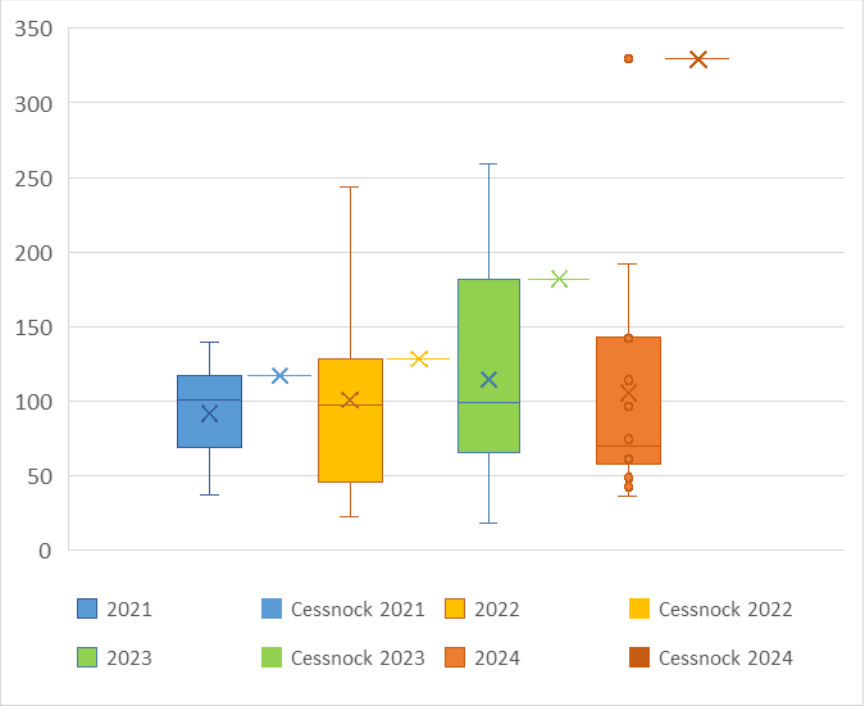


Figure 29. Infrastructure Backlog Ratio

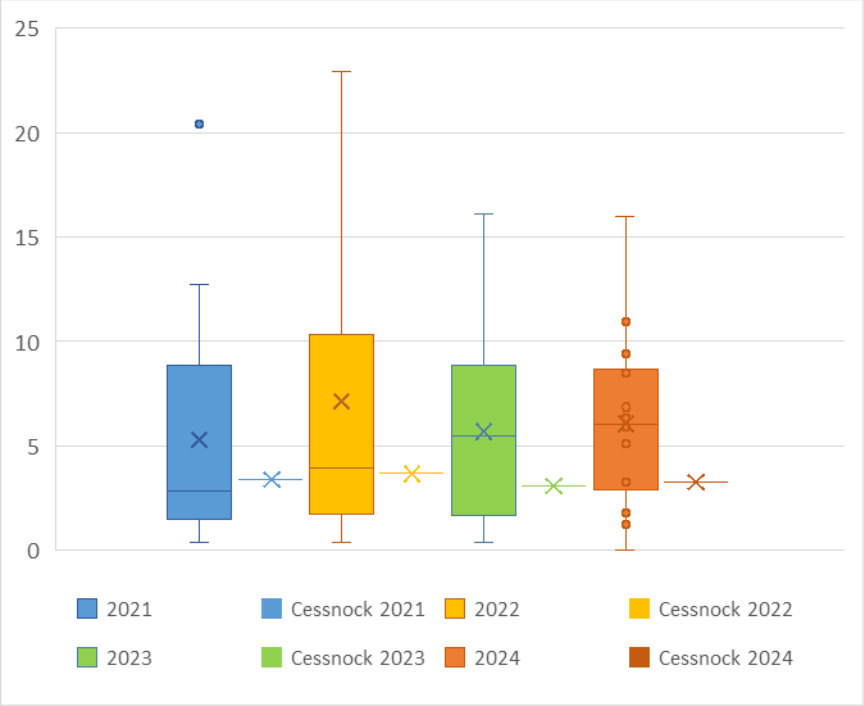
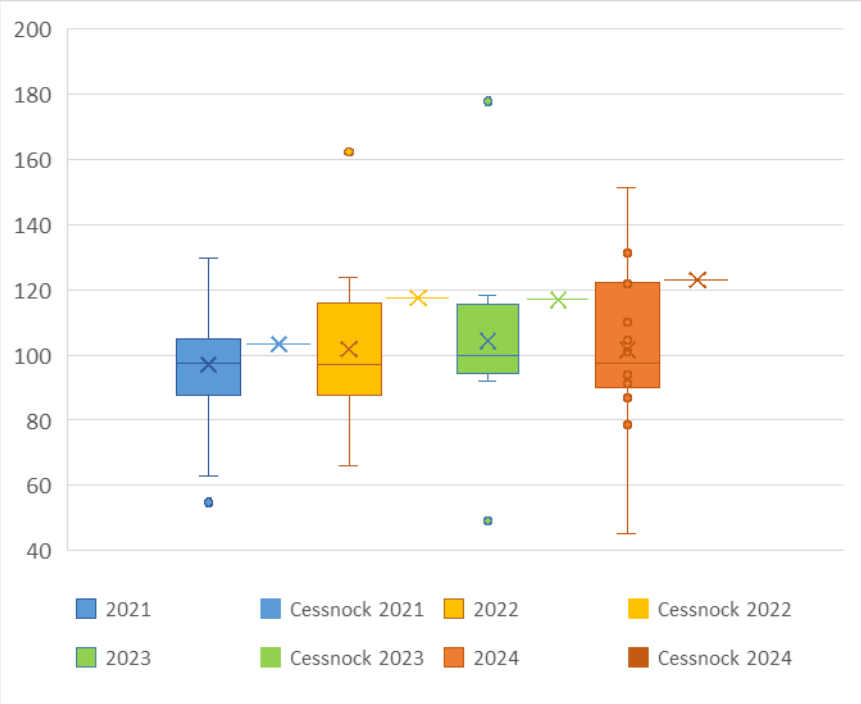


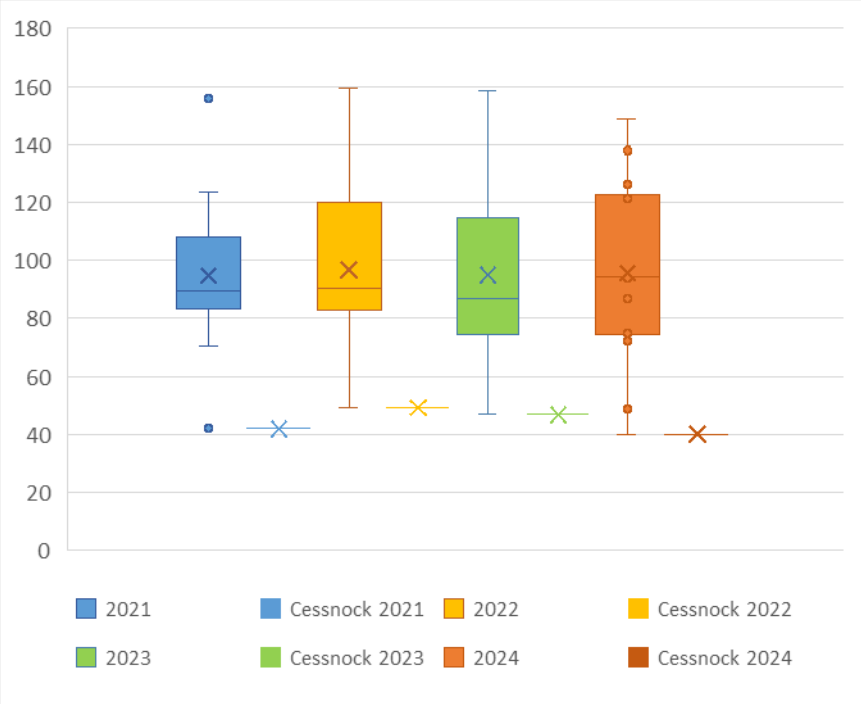
Figure 30. Asset Maintenance Ratio



Accordingly, while the next three ratios appear to show that Council's asset renewals, maintenance and backlogs are relatively good, we do not feel that end users should place much emphasis on Figures 28-30. Accordingly, we have not provided commentary on each metric.

We will now look at the cash situation for Cessnock. Cash held is generally a function of the relationship between revenues and expenditures over a considerable period of time. Moreover, it is important for end-users to appreciate that not all cash is accessible to Council (for instance, external reserves), and that furthermore what is accessible is often put away for essential obligations (for example, internal reserves).

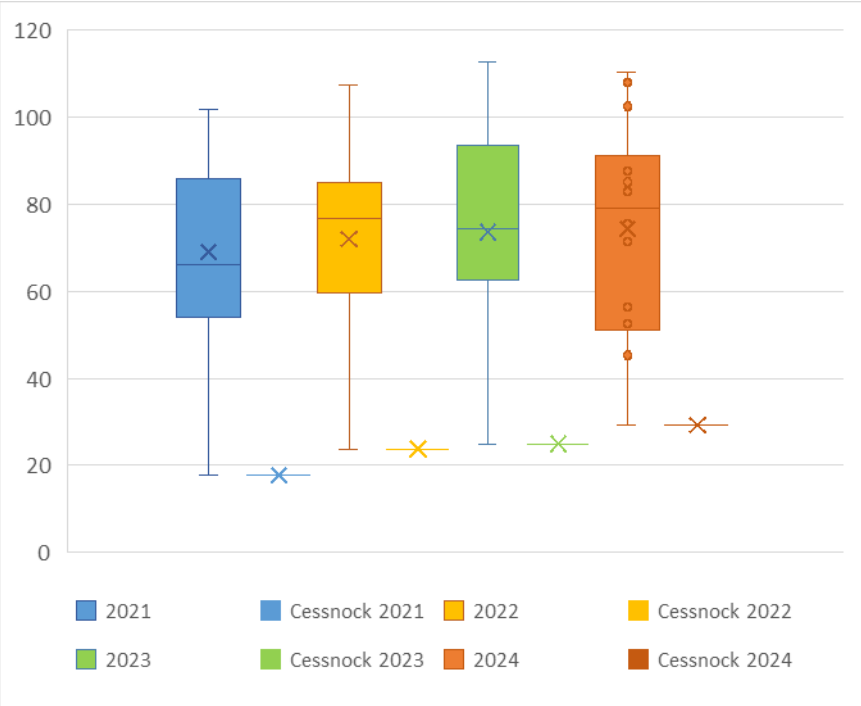
Figure 31. Total Cash, Cash Equivalents and Investments Deflated by Revenue



We start with Figure 31 which details all cash and equivalents (including external reserves which often can't legally be used for purposes other than those for which they were collected). We have deflated these numbers by revenue, so that like-for-like comparisons can be made across time and between peers.

In a comparative sense, Cessnock has had very low levels of cash reserves across time, relative to the peer groups. This likely further attests to chronic revenue insufficiency over many years (a fact that we will only be able to confirm in the panel regressions in a potential *Capacity to Pay* report).

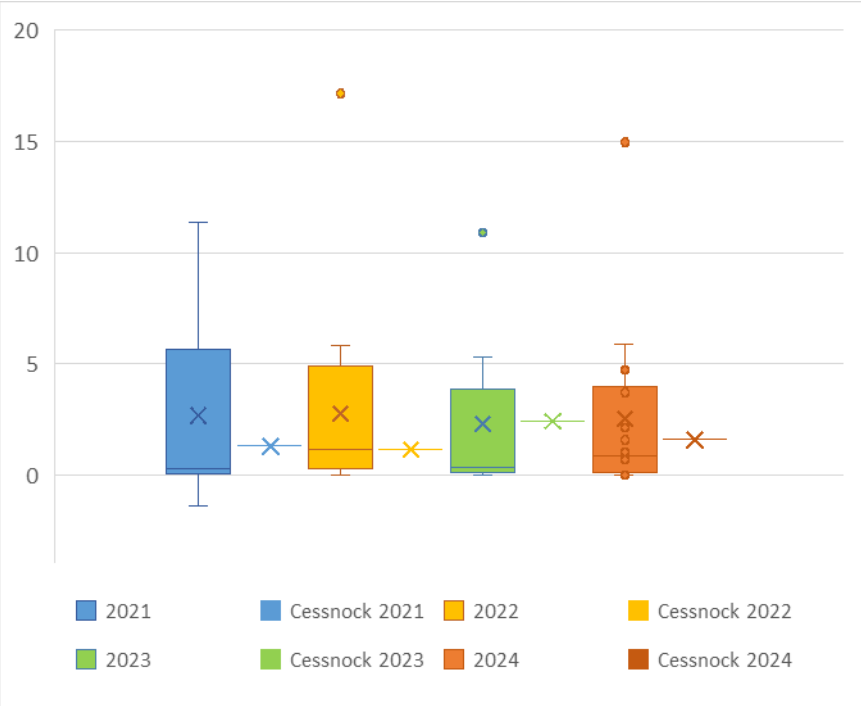
Figure 32. Total Externally Restricted Cash, Cash Equivalents and Investments Deflated by Revenue



Generally, the largest component of cash reserves for most Councils are the externally restricted funds. These are mostly derived from capital grants and developer contributions for a local government area like Cessnock. As Figure 32 demonstrates, Cessnock's externally restricted funds are consistently the lowest in the peer group.

We note that Cessnock is in a high growth area, which are typically the urban councils that struggle the most in this country. Often capital grants and developer contributions fail to keep apace with the substantial costs of building new capital infrastructure (such as roads) to facilitate development. There seems to be a good case that state and federal governments may not always be playing their part in supporting Council to help mitigate our chronic national housing shortage. If higher tiers of government fail to sufficiently support Council, then the burden may, unfortunately, fall to existing ratepayers (in addition to the new entrants). We would encourage Council to continue to advocate for appropriate support from state and federal governments so that existing ratepayers are not unfairly burdened by state and federal policies and goals. In this regard council staff can assist by ensuring that they have a shovel ready prioritised list of capital works required to support housing stock growth.

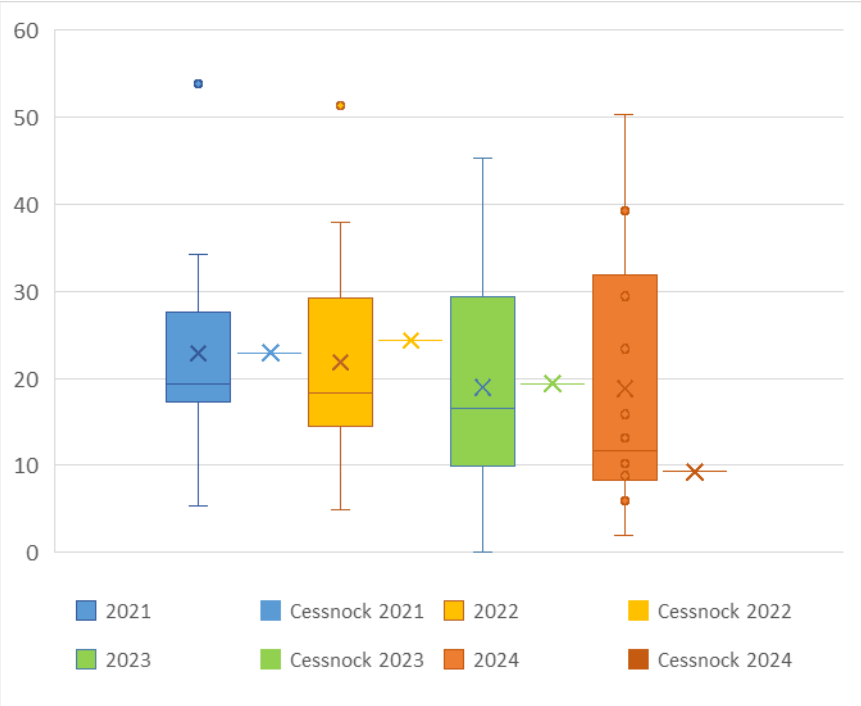
Figure 33. Total Unrestricted Cash, Cash Equivalents and Investments Deflated by Revenue



Unrestricted cash is monies that council can draw on to plug cash deficits and meet unanticipated costs (such as natural disasters pending insurance claims or new state government cost-shifting efforts).

As Figure 33 demonstrates, Cessnock is below average in a relative sense for three of the four financial years. Moreover, it is abundantly clear that almost all the peer group have insufficient unrestricted monies. Generally, the combined unrestricted and internal restricted cash should run at twenty-five percent or so (subject to context including the other metrics and operating environment). The goal for unrestricted cash should typically be around eight percent (subject to context as we have already noted) – and this is especially important for a high growth council like Cessnock with some distressed infrastructure. Clearly additional revenues will be necessary to allow Council to accrue adequate reserves over time.

Figure 34. Total Internally Restricted Cash, Cash Equivalents and Investments Deflated by Revenue



Internally restricted cash can be used in emergencies, but generally should not be used because it is usually set aside for important things such as employee leave entitlements and IPPE replacements. Figure 34, at first glance, suggests that Cessnock council is in a relatively satisfactory condition with respect to internal reserves. However, unlike many of its peers, Cessnock has not been internally restricting pre-paid financial assistance grants. This has confounded comparisons because pre-paid FAGS amounted to some $8 million for Cessnock.

Ideally the Auditor-General would perform their function with respect to the accounting standards and international reporting framework, especially as it relates to comparability. If this had indeed been done, then Cessnock would have been consistent with most of its' peers for comparison purposes.

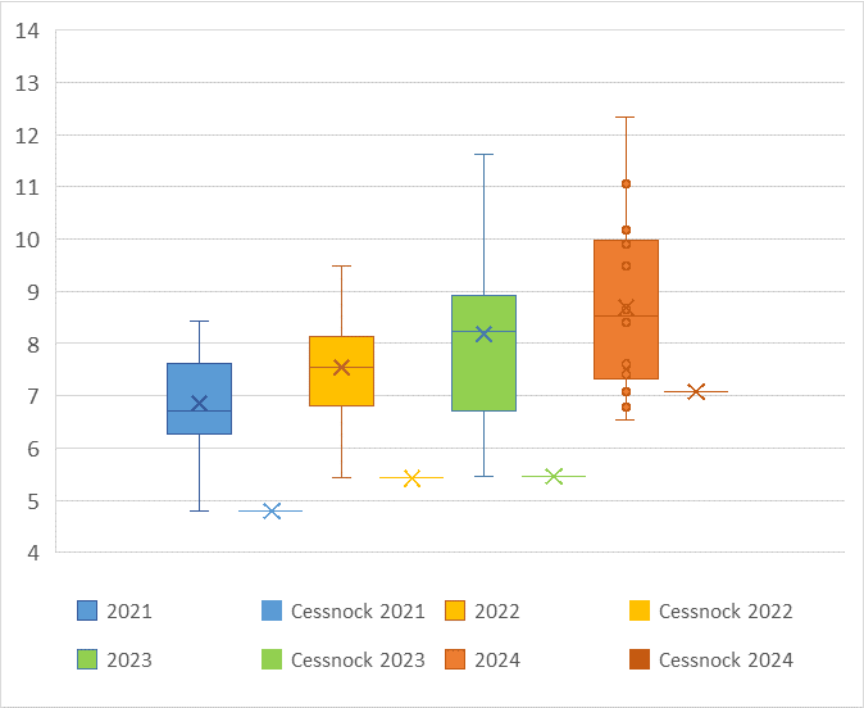
In the absence of appropriate auditor focus we would instead encourage Council to make its own decision to internally restrict pre-paid FAGs in the 2025 financial years' statements. This will give Councillors, community and IPART a more realistic view of Cessnock's predicament. Indeed, the time may come when pre-payments cease to happen as the federal government tries to redress its own budget difficulties – if pre-paid FAGs have not been internally restricted then Cessnock could find itself in a very uncomfortable position.

When adjustments are made for pre-paid FAGs, it is clear that Cessnock is in a serious situation and urgently needs to increase revenues so that it can set aside sufficient reserves. This is especially the case given that the internal reserves (such as those for waste remediation) appear to be on the light side for a council of Cessnock's profile. It thus underscores the importance of making a prudent and

prompt decision around redressing the revenue insufficiency for the local government area.

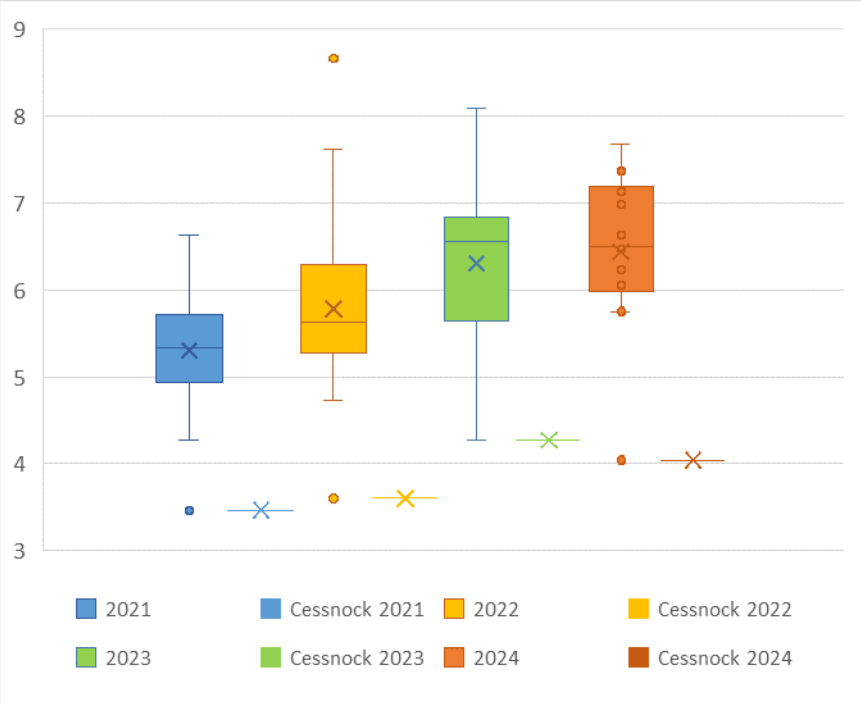
Nett operating results are the outcome of the difference between revenues and expenditure. Accordingly, it is useful to examine each of the aforementioned components in turn, before considering the nett outcome.

Figure 35. Total Income per Assessment ($000)



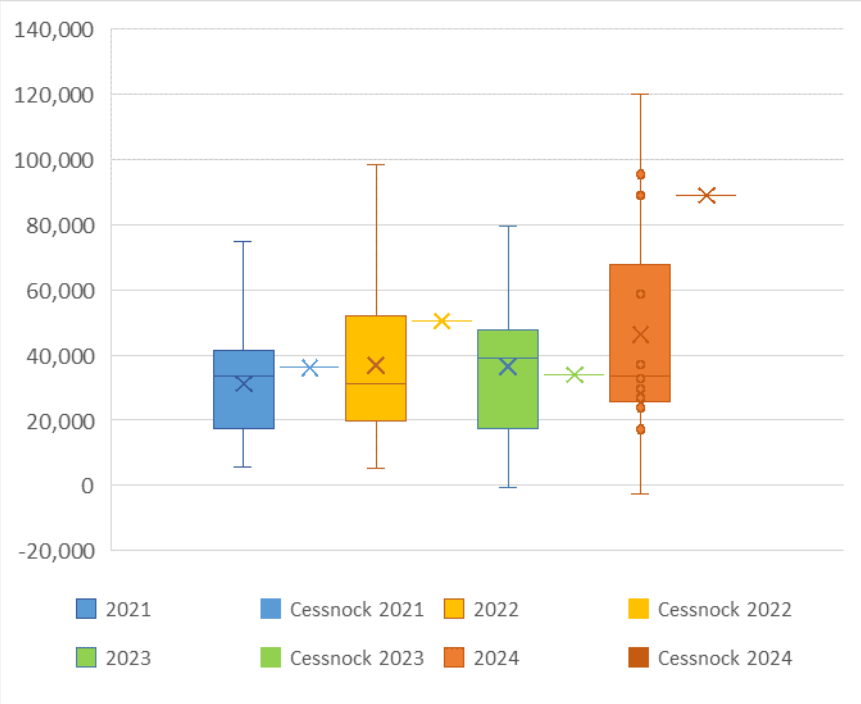
On an income per assessment basis Cessnock had the lowest recorded result for the first three years under consideration. In 2024 things improved in a relative sense – albeit still recorded in the lowest quartile – mostly as a result of a one-off large capital grant. Low income levels do not bode well for financial sustainability, all things being equal.

Figure 36. Total Expenditure per Assessment ($000)



In Figure 36 we look at total expenditure on a per assessment basis also. Notably, Cessnock was the lowest expenditure council in each and every year, and for three of these years the result was as an extreme outlier. Moreover, the expenditure on a per assessment basis was far below that of the revenue (but recall, the revenue is significantly higher because of capital grants which can only lawfully be spent on the purpose for which they were provided). Readers should be mindful that the expenditure results presented in Figure 36 including depreciation expense and that the dependent axis is presented in thousands of dollars as per the financial statements and most of our data.

Figure 37. Nett Operating Result ($000)

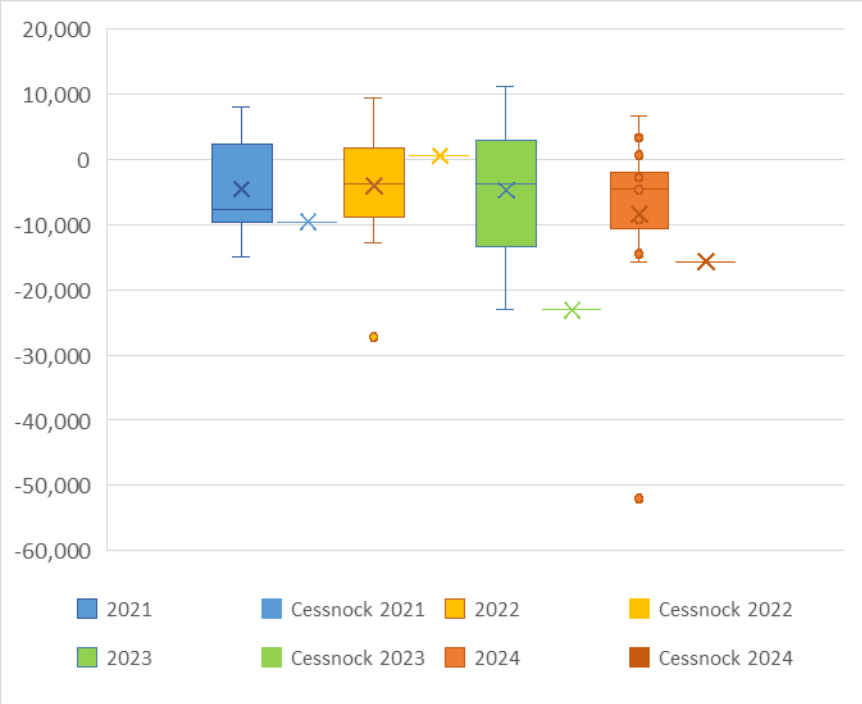


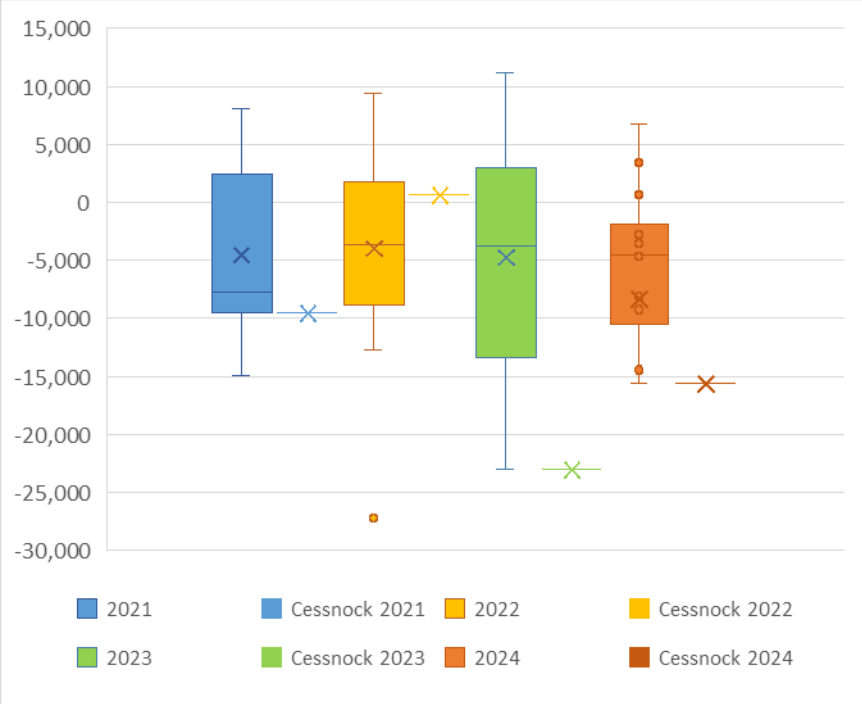
The difference between revenues and expenses is the nett operating result. However, as illustrated by 2024 (which included an unusually high capital grant component), this figure can be somewhat misleading in the local government sector. Readers should be mindful that capital grants can only be spent on the purposes for which they were provided – therefore the nominal surplus of almost $89 million doesn't really tell the true story of how the council improved or deteriorated (in an accessible income sense) for 2024.

The NSW preferred measure is thus nett operating result excluding capital grants. Whilst at odds with double-entry book keeping principles, excluding capital grants does indeed better reflect realities facing financial managers and Councillors.

We said earlier that a local government ought to strive to break even over three years. For the past four years Cessnock has averaged a deficit of a little over twelve million (excluding capital grants). Clearly this is not sustainable and cannot be allowed to continue. Moreover, matters seem to be deteriorating with time, and this does not augur well.

Figure 38. Nett Operating Result Without Capital Grants ($000)





For Figure 38 we provide two graphs, wherein the second has been truncated so that end-users can better focus on what has been happening at Cessnock.

Figure 39. Cessnock Revenue Breakdown, 2023 Financial Year.

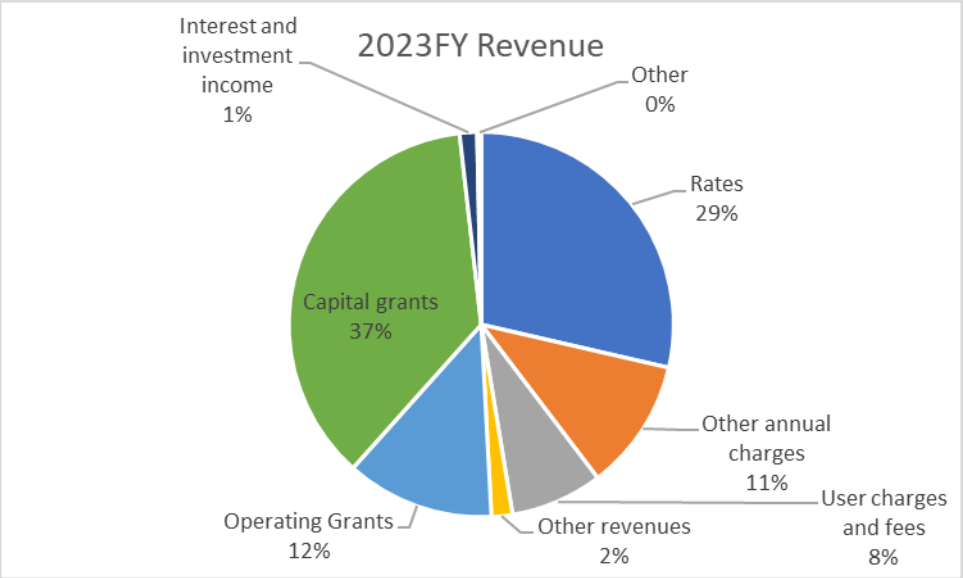
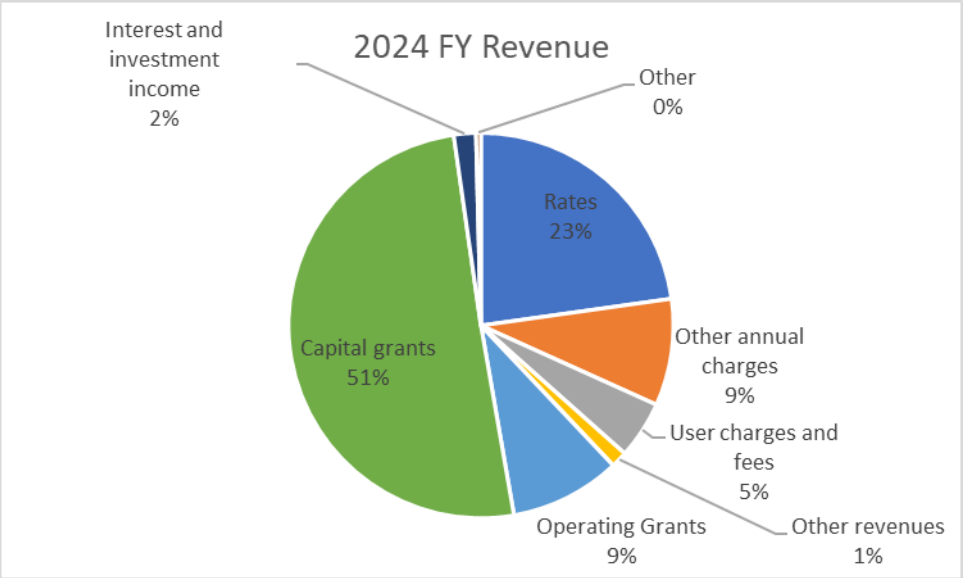


Figure 40. Cessnock Revenue Breakdown, 2024 Financial Year.



It is important to also understand the typical make-up of revenue at Cessnock. Because 2024 contained unusually large capital grants we have presented data for both the 2023 and 2024 financial year.

It is a common misconception amongst ratepayers that their local government taxes fund most of the local government expenditure. As these charts make clear, this is simply not true.

Rates typically account for less than a third of the revenue at Cessnock. This is particularly low in our experience for a non-rural council. Given that we have largely established that revenues are chronically insufficient Figures 39 and 40 point to some noteworthy challenges.

First, because grants are mostly beyond the control of Council, the heavy lifting will need to be done by fees and charges, as well as rates. Second, because rates are less than a third of the revenue, relatively large increases will need to be made to bring in sufficient revenue to redress shortfalls. The longer Council delays, the larger the increases will ultimately need to be. Third, Cessnock seems particularly exposed to state and federal government risk – when the unusually high grant flows of the last five years or so start to get turned back down, a real budget squeeze is likely. The condition of the state and federal budgets means that a significant slowdown in grants is highly likely.

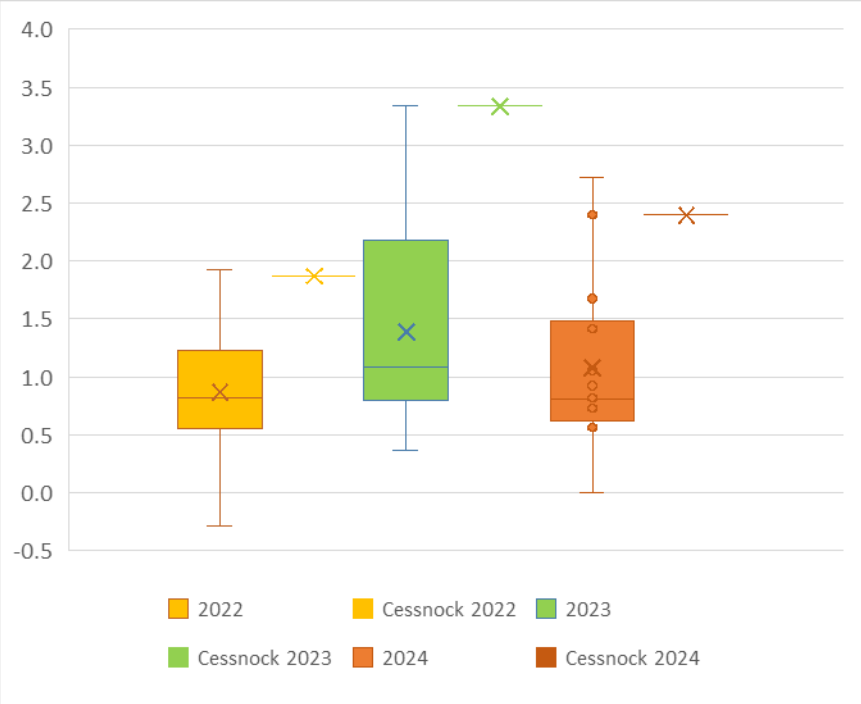
All of the aforementioned observations weighted heavily in our recommendation at the end of this report.

As preparation for the formulation of our recommendation we need to briefly survey the demographic data for Cessnock. This is the main component of the operating environment which has long been considered by scholars to be an essential determinant of financial sustainability. Sadly, Councils and decision-makers sometimes fail to fully appreciate the significance of these matters.

The first few metrics that we shall examine relate to growth. We strongly prefer growth in assessment data (rather than the population data that follows) for two main reasons: (i) population growth data from the ABS is little more than an educated guess in intercensal years with typical errors of 8.9 percent at the SA2 level, and (ii) most services are still better associated with assessments rather than population (for example, rubbish or roads).

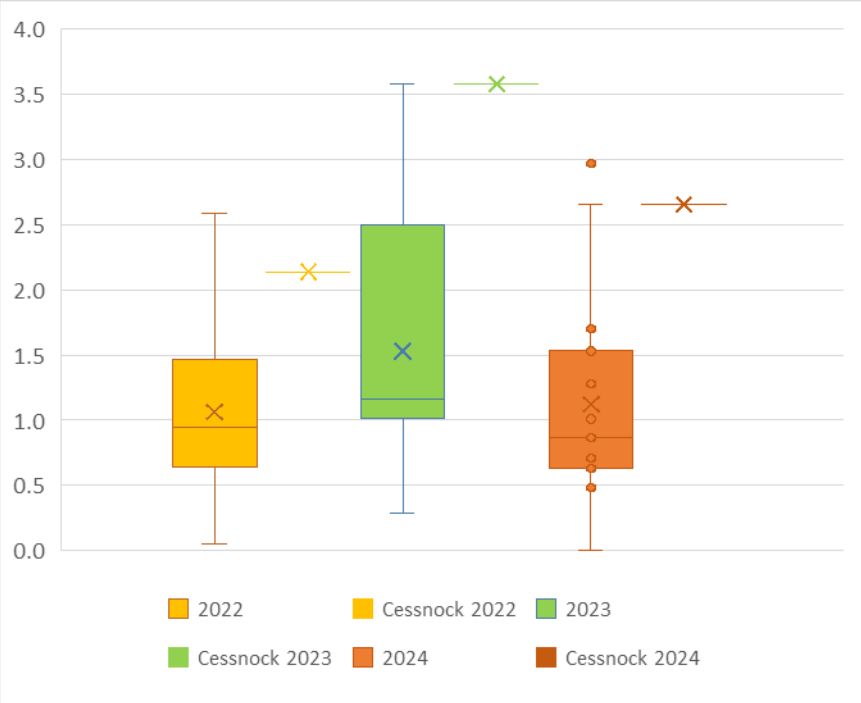
Many local governments are confused about what growth means for financial sustainability, following the opinions expressed sans evidence by the former Independent Local Government Review Panel (2015). Growth does not make a local government area more sustainable – indeed the opposite is usually the case. This is immediately clear when one considers that rates typically account for only a third of revenue, and that grants are very slow to respond to marginal changes to demographics (if at all). Furthermore, many fees do not cover actual costs and are also for the most part merely access charges. In addition, new entrants to a local government area usually bring with them new tastes for local goods and services – often tastes for the higher quality services experienced in capital cities, that are quite unrealistic elsewhere (Ladd, 1994). This puts upwards pressure on local government unit costs. For all these reasons, it is not surprising to find that the Councils most at risk in this country tend to be located in the growth ‘fringe’ areas (Drew and Dollery, 2020).

Figure 41. Growth in Number of Assessments (percent)



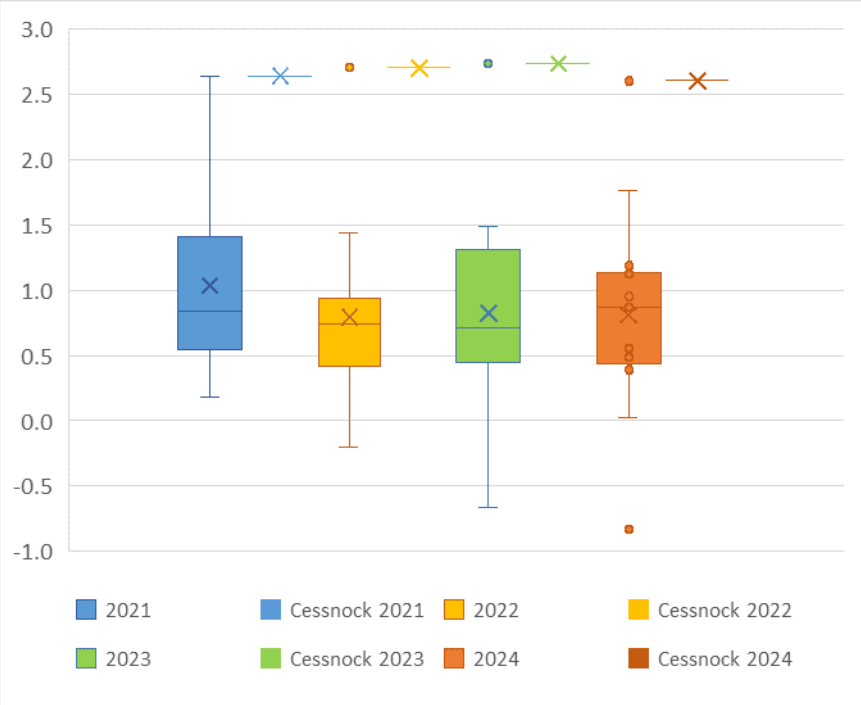
Thus, Figure 41 confirms our earlier comments around the significant challenges facing Cessnock. Notably, growth for Cessnock is consistently far in excess of what it is for the peer group – which means that the risks to financial sustainability stemming from this determinant, are higher accordingly.

Figure 42. Growth in Number of Residential Assessments (percent)



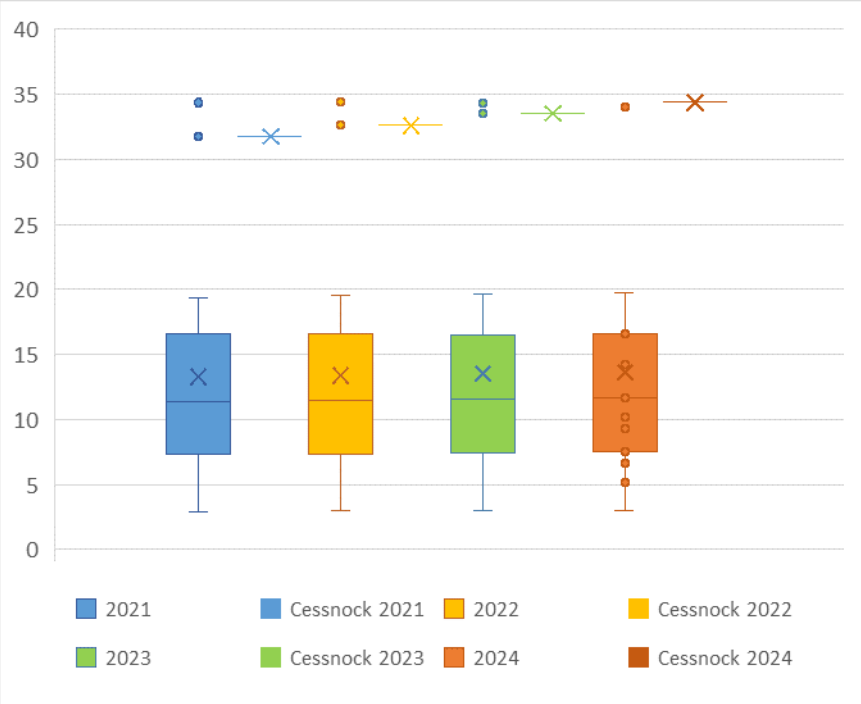
Furthermore, growth has mostly been driven by residential assessments (see both Figure 42 and Figure 43). This is the kind of growth that poses the most significant risk for financial sustainability, as reflected in a number of the metrics that we reviewed earlier.

Figure 43. Population Growth (percent)



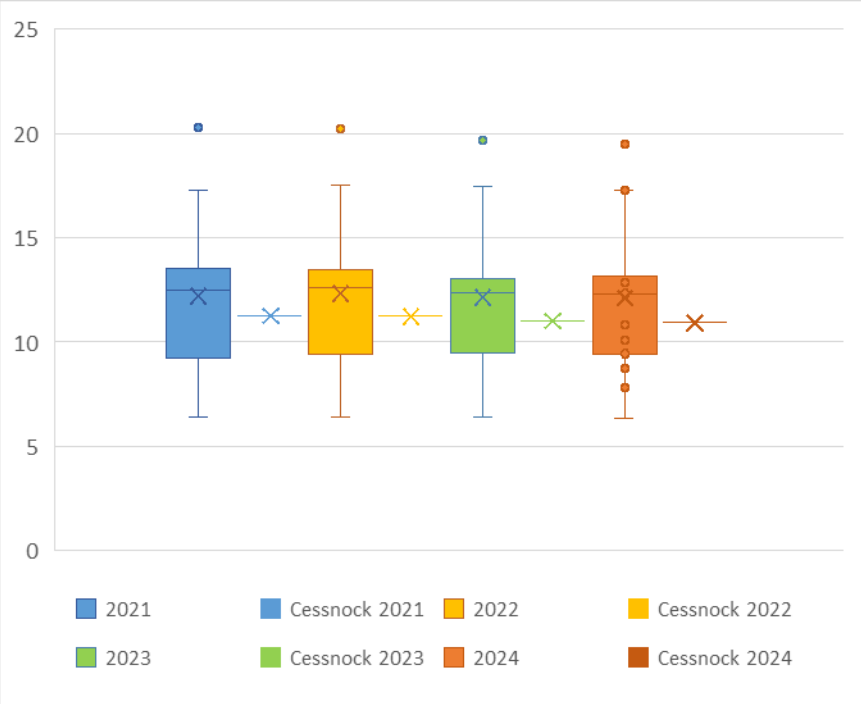
It thus comes as no surprise that population growth for Cessnock is higher than all other peers – indeed, it is an extreme outlier in most years. We caution again that population data in intercensal years can be subject to very large errors however, the results are consistent with assessment growth data. Clearly, growth of this kind poses a pronounced risk to the future financial sustainability of this local government area.

Figure 44. Population Density



Population density is important because of the economic concept of economies of density. With most service provision still best associated with assessments, clearly the closer these properties are to one another, the lower the unit cost is likely to be. However, it is important to be mindful that diseconomies of density might also emerge, due to congestion effects if too many high-rises and the like are built – however this does not appear to be a problem yet. As it stands at present, the relatively high population density at Cessnock helps to partly offset the earlier problems identified with respect to growth.

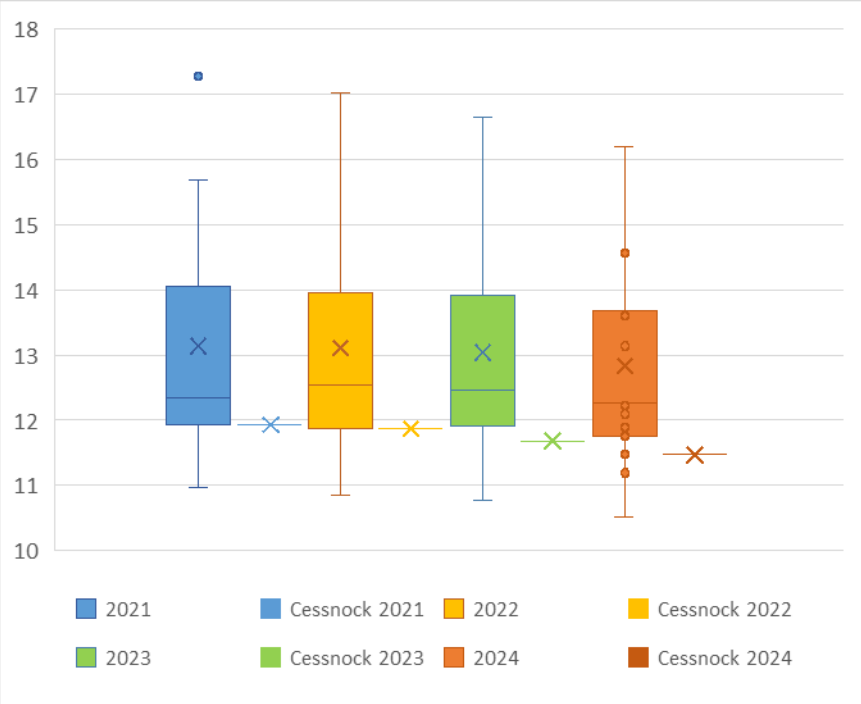
Figure 45. Aged Pension



The proportion of people on an aged pension poses a risk to the financial sustainability of local governments because of the various mandated rebates Council is required to provide, as well as the high level of goods and services demanded by this demographic (as proven in countless econometric analyses). Matters are further exacerbated in Cessnock because of the additional rebate provided to pensioners beyond the mandated discount. People must understand that providing any rebate inevitably means that the remaining ratepayers have to pay more – it is an arithmetic certainty which is determinative despite any feelings one might have on the matter. Moreover, discounts also undermine the moral foundation of a land-based tax oriented towards capturing unrealised capital gains. Indeed, it is not at all certain that pensioners are the group that most struggles in a community – young families on low or casual incomes might reasonably be harder hit (especially if they have a mortgage). People often forget that pensions are indexed twice annually to the higher of CPI or the bespoke living index. We are not recommending that the additional pensioner discount be eliminated at this stage, however, it will need to be discussed in relation to capacity to pay requirements outlined in the OLG guidelines.

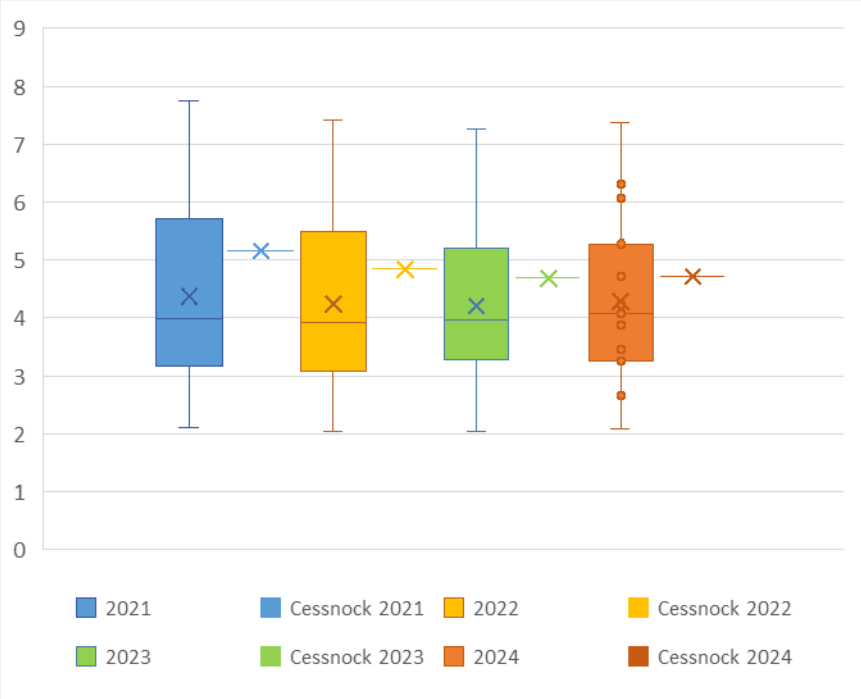
On a positive note, the proportion of aged pensioners at Cessnock are a little less than typical.

Figure 46. Percentage of Population Aged 55-64



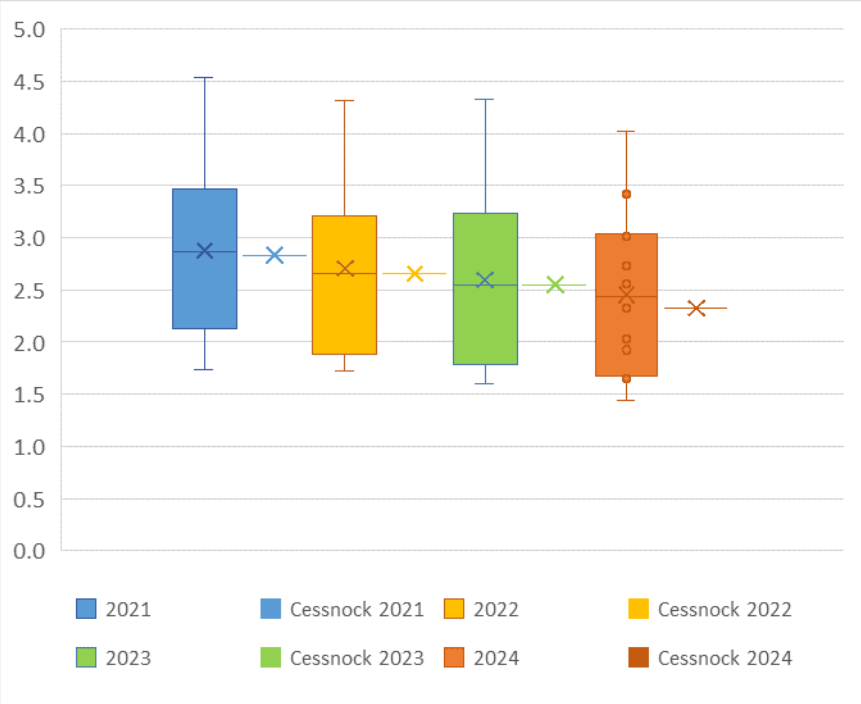
Perhaps even more important – from a financial sustainability perspective – the proportion of people in an age group likely to become pensioners during the term of the LTFP is also relatively low. This reduces the severity of the threat to financial sustainability from this particular driver.

Figure 47. Disability Support Pension



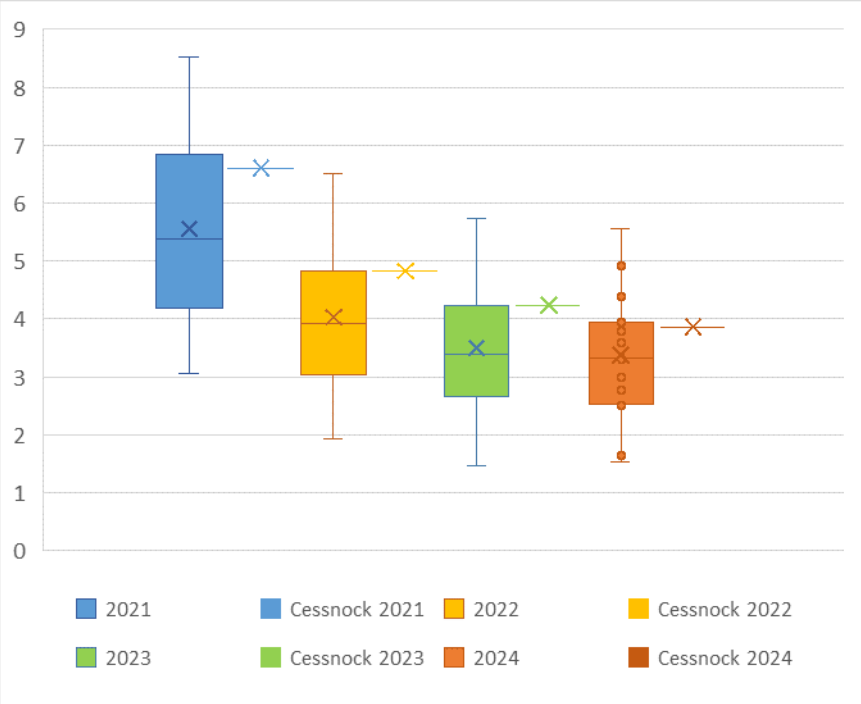
In view of the recent growth to disability support pensions (DSP), it is also important to augment aged pension data with DSP data. Figure 48 shows that Cessnock has a higher than typical proportion of DSP recipients. This is likely to have eliminated most of the aforementioned comparative advantage in the relative levels of aged pensions.

Figure 48. Pensioner Discount (as a Proportion of Residential Rate Revenue)



By way of a summary of this aspect of risk we have charted the pensioner rebate as a proportion of revenue below. Cessnock is pretty typical of the cohort – which is reflective of lower than typical proportions of aged pensioners augmented by higher than typical levels of DSP.

Figure 49. Newstart Allowance/ Jobseeker

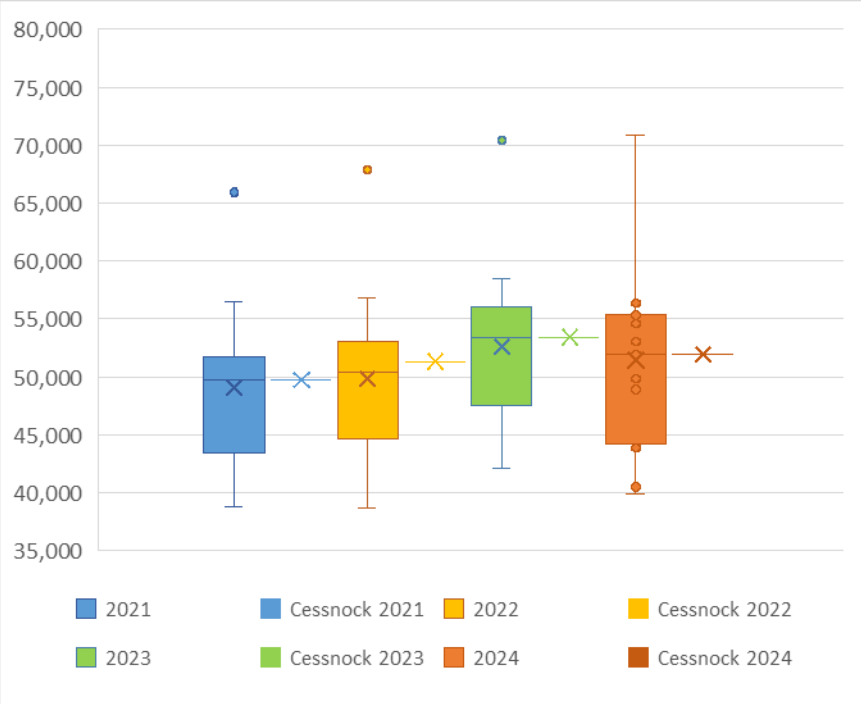


The proportion of people unemployed is also pertinent to capacity to pay and financial sustainability considerations. Generally, unemployed persons tend not to be home-owners, but instead renters. Part of any increase to rates *may* be passed on by landlords when rental agreements are renewed. However, it is important for all to be mindful that there is generally no justification for passing on the entire increase – because landlords typically receive a generous federal tax deduction on the rates that they pay. Moreover, the entire annual rates paid by a landlord is usually a tiny fraction of the typical rents charged – perhaps a few weeks at most. The effect of any potential rate increase would be even more marginal, especially if the tax export component was properly acknowledged.

Figure 49 illustrates that Cessnock typically has relatively high rates of unemployed persons compared to OLG peers. However, it is important to also note that unemployment has been trending down of late (in an absolute sense) and now sits at less than four percent.

Should Council decide to investigate an SRV then it will be important to clearly articulate that there is no justification for putting up rents by the amount of any local government tax increase. Furthermore, it will also be essential to ensure that hardship provisions cover the relatively rare instances of unemployed home-owners.

Figure 50. Median Employee Income



The vast majority of rates are paid by income earners. It is therefore apposite to examine this data. Since the extraordinary policy interventions associated with COVID-19, it is no longer sensible to look at average incomes. We therefore present median employee income data in Figure 50.

As can be clearly seen, Cessnock has quite typical employee income levels. This is suggestive of the capacity to pay at least typical rates – something that seems to currently not be occurring.

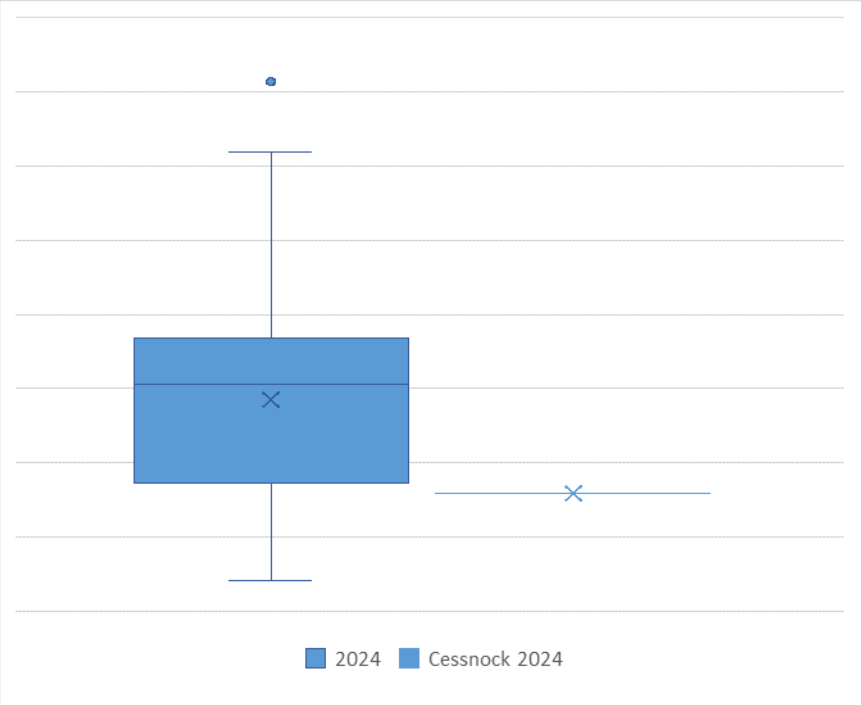
Notably in our Capacity to Pay report we will canvass an even broader array of socio-economic and demographic variables.

One final matter before we present our recommendation is to try to summarise the financial sustainability data. In particular, the NSW state government mandated ratios would seem especially important because these are the metrics upon which decision-making is usually conducted.

Accordingly, we collated the nine mandatory metrics for all sixty-eight NSW local governments which sit in the same Australian classification category as Cessnock. We then conducted a principal components analysis (PCA) on these metrics. PCA is a well-established rigorous technique for reducing several pieces of data into a single number for each local government area (see, for example, Dunteman, 1979). It does so through linear projections arranged upon a set of axes constructed in such a way that variance is maximised.

PCA has significant advantages for our task because it minimises the leverage of any single metric. Recent scholarly research has shown that it is also robust to alternate specifications (Drew et al., 2025).

Figure 51. PCA of Financial Sustainability Ratios – Overall Sustainability Score Relative to Peers



After conducting the PCA on 2024 financial year data, we charted the result for Cessnock against the broad peer group of sixty-eight councils. As Figure 51 demonstrates, Cessnock is in the *lowest quartile* of financial sustainability relative to the broad peer group, using OLG financial sustainability metrics. When considered with respect to our earlier comments regarding the likely inaccurate asset metrics, the outcome is quite serious. This exercise thus underlines the case for timely and prudent action.

Recommendation

Our recommendation is based on the consensus view of Professor Joseph Drew and Professor Masato Miyazaki. The work upon which it has been based has been assured by Professor Yunji Kim.

In view of the metrics surveyed, our knowledge of the council's context, higher tier government political context, macro-economic forces, and economic theory we have no choice other than to make a strong recommendation for Council to engage on the work required to put forward an SRV proposal for the round closing February 2026. Cessnock faces a serious financial sustainability challenge, and the community simply cannot afford for any further delay. We remind end-users of this report that whilst the next round for SRVs closes in February 2026, a decision will only be expected around May 2026, and that the first instalment of rates subject to the decision would not occur until August 2026. It is a long process with significant lags, which need to be understood in terms of the acute need for additional funds to mitigate implicit liabilities and also provide a safe level of reserves for Cessnock.

We remind Council that significant work is required before a full proposal can be put together. This includes, *inter alia*, a more thorough interrogation of the LTFP, surveys of staff and community (Council to issue based on our advice), detailed discussion and workshops with Councillors, studies of efficiency, debt and capacity to pay, as well as community presentations.

We remind everybody involved that this needs to be a team effort to get the best proposal to put forward for the independent adjudication of IPART. Councillors, community, staff and scholars will all need to make important contributions. However, it is imperative that everyone understands that the actual decision will be made by IPART under Ministerial delegation according to the Act (1993, NSW). We thus encourage all parties to work together to put the best brief of evidence forward for IPART to deliberate upon.

Until further important work has been done it is impossible to be definitive about the size of a potential SRV. However, we are prepared to guide stakeholders to expect an increase of somewhere between twenty-five and thirty-five percent (excluding the rate cap). {Initial review of physical asset conditions suggests that it is possible that our final recommendation is likely to sit towards the upper end of this range (although further investigation remains to be done)}. A more precise recommendation will be put to Council prior to the community engagement, but it may still be subject to change in response to community input.

Should we be selected to help conduct the process it is important to understand that our work is strictly independent. Certain empirical facts are clearly beyond dispute. However, how these facts might be interpreted is open for some debate. We will provide the community with a single recommendation for what we feel is in their long-run best interest. Nonetheless, we will be open to good reasons and evidence to support alternative interpretations of the facts. In past engagements we have been ready to alter our recommendations in response to good reasons, and we will

continue to do so because we believe the community has a right to expect that any final application to IPART will be based on sound reasoning and good evidence.

We stand ready to assist the community should Council elect to proceed with Stage 2 of the proposed work.

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