



Financial Sustainability Analysis

Kyogle Council
April 2014

Summary of findings and assessment

This report provides Review Today's assessment of Kyogle Council's financial sustainability under continuation of existing policy assumptions. It is based on the latest available 10-year financial projections.

Financial sustainability

The Commonwealth Government defines financial sustainability as:

...a government's ability to manage its finances so it can meet its spending commitments, both now and in the future. It ensures future generations of taxpayers do not face an unmanageable bill for government services provided to the current generation.¹

The Australian Local Government Association's definition is:

A Council's long-term financial performance and position is sustainable where planned long-term service and infrastructure levels and standards are met without unplanned increases in rates or disruptive cuts to services.²

Both these definitions address the core local government goals of:

- program sustainability - ensuring the maintenance of a Council's high priority expenditure programs, both operating and capital;
- rate stability - ensuring a reasonable degree of stability and predictability in the overall rate burden; and
- intergenerational equity - promoting a fair sharing in the distribution of Council resources and the attendant taxation between current and future ratepayers.

For a Council considering its financial sustainability the question is:

Can we continue the sort of revenue and expenditure patterns of recent years while maintaining the levels of service expected by our community?

Overview

Under continuation of existing policy, the Council's financial outlook is rated as financially unsustainable.

Table 1 summarises the key financial ratios from Review Today's perspective.

Table 1: Key performance indicators – continuation of existing policy

Indicator	Prudent Limit	2012/13 Actual	2013/14 Estimate	2014/15 Projection	2015/16 Projection	2016/17 Projection	2022/23 Projection
Total debt ratio	50% max	5.3%	6.8%	17.3%	15.6%	14.0%	4.3%
Debt service ratio	10% max	0.5%	0.6%	0.7%	0.8%	0.7%	0.1%
Infrastructure backlog ratio*	5% max	7.8%	8.8%	9.7%	10.7%	11.6%	17.1%
Annual renewals gap ratio*	5% max	39.9%	51.8%	51.8%	51.8%	51.8%	51.8%
Operating balance ratio**	2½% min	-19.4%	-25.9%	-22.6%	-21.6%	-20.4%	-12.7%

Source: Review Today's preferred financial ratios applied to the Council's own financial projections unless otherwise stated.

The key financial indicators, and associated benchmark values, used by Review Today are detailed in the Appendix.

* Review Today estimate. ** Excludes the impact of any extraordinary items as assessed by Review Today.

While the Council's **total debt** ratio is comfortable, the outlook under continuation of existing policy conditions is for a burgeoning **infrastructure backlog** ratio and ongoing large annual **operating deficits**.

¹ Commonwealth of Australia, *Intergenerational Report 2002/03, Overview – Fiscal Sustainability*, Budget Paper No 5, May 2003.

² Australian Local Government Association National General Assembly Resolution of December 2006.

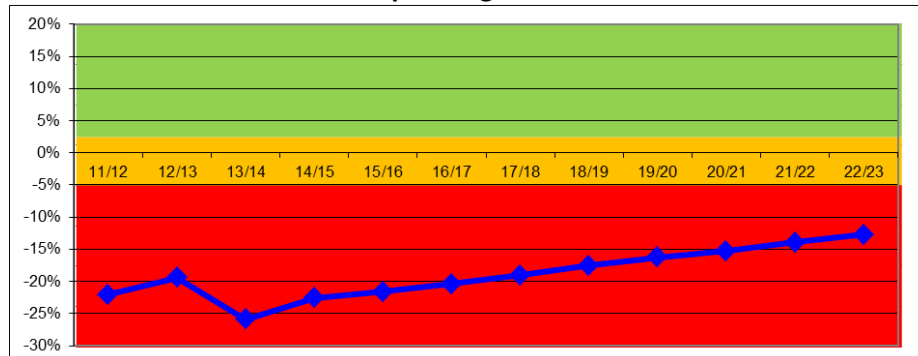
Council-in-confidence

Operating balance

The primary indicator of a council's operating financial performance is its operating surplus/(deficit) *before* capital amounts. When measured in this way, any operating deficits are indicative of services being consumed by current ratepayers but which will be funded – one way or the other – by future ratepayers.

The Council's latest financial projections indicate that, without any change to existing policy, the outlook is for ongoing large annual operating deficits although those deficits are expected to gradually diminish. This forecast trend improvement is not significant enough to see the Council exit the unsustainable red zone in the next 10 years (see Chart 1).

Chart 1: Operating balance ratio



As a general principle, operating expenses plus a fair measure of annual depreciation represent spending on outputs the consumption of which give rise to benefits derived wholly in the current period. Capital spending results in benefits largely beyond the current period. When the operating surplus – appropriately measured – is positive, operating revenue is more than sufficient to fund current operations. When the operating surplus is negative (indicating an operating deficit), operating revenue is insufficient to fully fund current operations. In general, operating deficits should be avoided over the medium term.

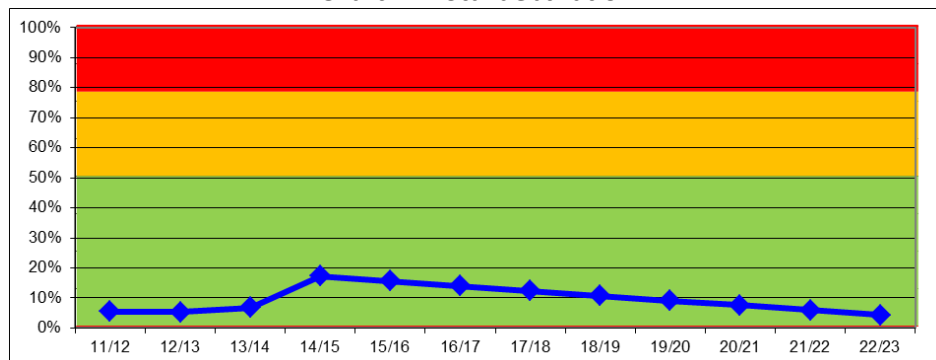
Moreover, if annual depreciation is not being funded (as indicated by an operating deficit), it is inevitable that a council cannot generate sufficient funds to internally finance its asset renewal and replacement requirements. The result is either greater reliance on debt or an increasing infrastructure backlog.

Total debt ratio

The total debt ratio provides an indication of a council's reliance on (repayable) financial resources provided by other sectors of the economy relative to the council's annual revenue or income. Maintaining solvency requires debt to remain at moderate levels relative to annual revenue.

The Council's latest financial projections indicate that, without any change to existing policy, it will continue to place minimal reliance on external financial resources such as borrowings. The Council is well within the sustainable green zone in this respect (see Chart 2).

Chart 2: Total debt ratio

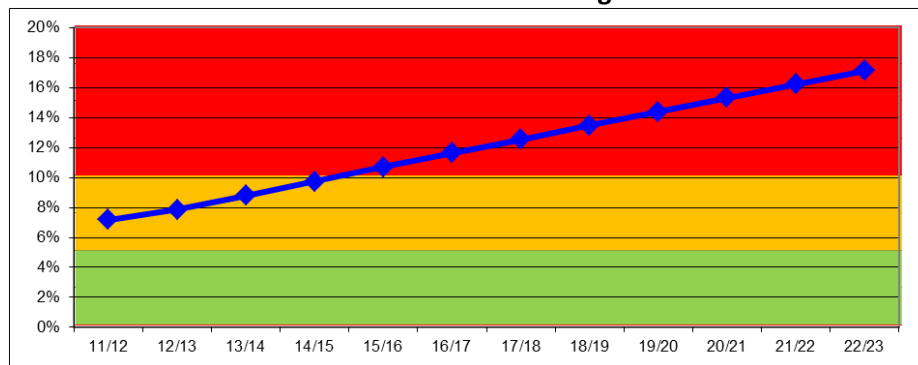


Infrastructure backlog ratio

A council's infrastructure backlog is the estimated total cost of overdue maintenance and renewal of its buildings, roads and all other infrastructure assets (including stormwater assets, recreational assets and natural assets). Such an infrastructure backlog in effect is a 'liability' facing a council much like borrowings but one that does not show up on its balance sheet. An annual renewals gap directly adds to an existing backlog.

The Council's latest financial projections imply that, without any change to existing policy, its infrastructure backlog is set to inexorably rise over the next 10 years as forecasts of actual annual capital expenditure on asset renewal and replacement falls well short of the annual spend required to maintain the existing service capacity of the Council's infrastructure and building assets. This will see the Council move out of the cautionary amber zone into the unsustainable red zone in the next 10 years (see Chart 3).

Chart 3: Infrastructure backlog ratio*



* In the absence of the Council's own backlog forecasts, Review Today has projected forward the Council's current backlog estimate using the annual gap between projections of 'required' and 'actual' renewals capex.

Consistent with its practice for councils relying on their own backlog estimates rather than estimates based on IPWEA consistent modelling, Review Today has opted to use the higher set of limits identified in the Appendix for Kyogle Council.

Review Today
March 2014

Key Ratios (%)

All projections shown are based on the continuation of existing policy. All data is sourced from the Council's published financial statements and latest projections.

Kyogle Council	Prudent Limit (a)	2011/12 actual	2012/13 actual	2013/14 estimate	2014/15 projection	2015/16 projection	2016/17 projection	2017/18 projection	2018/19 projection	2019/20 projection	2020/21 projection	2021/22 projection	2022/23 projection
<u>Total debt ratio</u>													
> % total debt / total op. revenue	50% max	5.5%	5.3%	6.8%	17.3%	15.6%	14.0%	12.4%	10.8%	9.1%	7.5%	5.9%	4.3%
<u>Debt service ratio</u>													
> % Borrowing costs / total operating revenue	10% max	0.8%	0.5%	0.6%	0.7%	0.8%	0.7%	0.6%	0.5%	0.4%	0.3%	0.2%	0.1%
<u>Infrastructure backlog ratio</u>													
> % Infrastructure backlog / infrastructure replace cost	5% max	7.2%	7.8%	8.8%	9.7%	10.7%	11.6%	12.5%	13.5%	14.4%	15.3%	16.2%	17.1%
<u>Annual renewals gap ratio</u>													
> % Actual - required / required renewals capex	10% max	32.9%	39.9%	51.8%	51.8%	51.8%	51.8%	51.8%	51.8%	51.8%	51.8%	51.8%	51.8%
<u>Operating balance ratio*</u>													
> % Operating surplus/ rates, fees & charges	2½% min	-22.1%	-19.4%	-25.9%	-22.6%	-21.6%	-20.4%	-19.0%	-17.5%	-16.3%	-15.2%	-13.9%	-12.7%
<u>RELATED RATIOS AND MEMO ITEMS</u>													
<u>Services provision per resident</u>													
> % Real per capita cost of services growth index		100.0%	99.9%	64.2%	60.6%	61.1%	61.6%	62.0%	62.6%	63.0%	64.0%	64.7%	65.4%
<u>Infrastructure provision per resident</u>													
> % Real per capita infrastructure growth index		100.0%	99.6%	96.9%	93.3%	89.9%	87.5%	85.2%	83.4%	81.1%	79.4%	77.7%	76.0%
<u>Annual percentage growth in:</u>													
> Estimated resident population		n/a	1.7%	0.1%	1.1%	1.1%	0.0%	0.0%	-0.5%	0.0%	-0.5%	-0.5%	-0.5%
> Number of ratings assessments		n/a	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
> CPI		3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
> Council employment (FTEs)				0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
> Wages & salaries				3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%

(a) Prudent Limit represents minimum or maximum limit beyond which the ratio is at risk of becoming unsustainable (i.e., enter the "amber" or "red" zones referred to in the Appendix)

* Excludes the impact of any extraordinary items as assessed by Review Today

Key Financial Aggregates (\$ million)

All projections shown are based on the continuation of existing policy. All data is sourced from the Council's published financial statements and latest financial projections.

Kyogle Council (all projections include allowance for inflation)	2011/12 actual \$M	2012/13 actual \$M	2013/14 estimate \$M	2014/15 projection \$M	2015/16 projection \$M	2016/17 projection \$M	2017/18 projection \$M	2018/19 projection \$M	2019/20 projection \$M	2020/21 projection \$M	2021/22 projection \$M	2022/23 projection \$M
Operating Budget*												
Rates & annual charges	6.772	7.038	7.360	7.581	7.808	8.042	8.283	8.531	8.787	9.050	9.321	9.600
User charges & fees	6.129	7.575	4.311	4.440	4.573	4.710	4.851	4.997	5.146	5.300	5.459	5.622
Operating grants & contributions	8.600	7.277	4.601	4.739	4.881	5.027	5.178	5.333	5.493	5.658	5.828	6.002
All other operating revenue	1.045	0.823	1.171	0.926	1.003	0.984	0.997	1.012	1.035	1.059	1.084	1.112
Total Operating Revenue	22.546	22.713	17.443	17.686	18.265	18.763	19.309	19.873	20.461	21.067	21.692	22.336
Cost of services (excl int & depn)	14.936	15.636	10.368	10.186	10.691	11.097	11.497	11.892	12.338	12.847	13.299	13.778
Borrowing costs	0.183	0.121	0.104	0.129	0.153	0.139	0.124	0.107	0.089	0.071	0.052	0.031
Maintenance expense	4.748	3.771	3.771	3.771	3.771	3.771	3.771	3.771	3.771	3.771	3.771	3.771
Depreciation expense	7.658	7.589	7.721	7.589	7.589	7.589	7.589	7.589	7.589	7.589	7.589	7.589
Total Expenses	27.525	27.117	21.964	21.675	22.204	22.596	22.981	23.359	23.787	24.278	24.711	25.169
Operating Surplus/ (Deficit)	-4.979	-4.404	-4.521	-3.989	-3.939	-3.833	-3.672	-3.486	-3.326	-3.211	-3.019	-2.833
Capital Budget												
Capital grants & contributions	4.582	4.839	2.579	4.317	1.295	1.435	1.437	1.450	1.608	1.466	1.474	1.632
Receipts from asset sales	0.608	0.569	0.621	0.511	0.526	0.542	0.558	0.575	0.592	0.610	0.628	0.647
Cashflow generated by annual depreciation charge	7.658	7.589	7.721	7.589	7.589	7.589	7.589	7.589	7.589	7.589	7.589	7.589
Total Receipts	12.848	12.997	10.921	12.417	9.410	9.566	9.584	9.614	9.789	9.665	9.691	9.868
Rehabilitation capex	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Renewals capex	5.607	5.173	4.147	4.147	4.147	4.147	4.147	4.147	4.147	4.147	4.147	4.147
Enhancements capex	2.216	2.275	1.240	1.240	1.240	1.240	1.240	1.240	1.240	1.240	1.240	1.240
Acquisition of non-infrastructure assets	-0.396	0.470	4.956	4.970	-0.288	0.057	0.045	0.369	0.599	0.484	0.681	0.925
Total Payments	7.427	7.918	10.343	10.357	5.099	5.444	5.432	5.756	5.986	5.871	6.068	6.312
Capital Surplus/(Deficit)	5.421	5.079	0.578	2.060	4.311	4.122	4.152	3.858	3.803	3.794	3.623	3.556
OVERALL SURPLUS/(DEFICIT)	0.442	0.675	-3.943	-1.929	0.372	0.289	0.480	0.372	0.477	0.583	0.604	0.723
Balance sheet and related items (at year's end)												
Total debt	1.241	1.210	1.178	3.056	2.849	2.628	2.393	2.141	1.872	1.585	1.279	0.952
Infrastructure backlog	31.518	35.894	40.351	44.808	49.265	53.722	58.179	62.636	67.093	71.550	76.007	80.464
Infrastructure assets incl buildings (at replace cost)	438.171	457.428	458.668	459.908	461.148	462.388	463.628	464.868	466.108	467.348	468.588	469.828

* Excludes the impact of any extraordinary items as assessed by Review Today

Appendix: Assessing Financial Sustainability

Review Today's full assessment of a council's 'sustainability' position typically involves distinct assessments of the council's capital sustainability and its operating sustainability. By contrast, the financial sustainability assessment made for the purposes of this report does not encompass a specific assessment of either the 'infrastructure sustainability' dimension of the council's capital sustainability or the 'service sustainability' and 'community affordability' dimensions of the council's operating sustainability. As the focus in this report on financial sustainability, the emphasis here is on the following strategic questions and key ratios:

STRATEGIC QUESTIONS		KEY RATIOS	GREEN ZONE ^(a)	RED ZONE ^(b)
① Current position	② Prospective position			
Are the council's debt obligations presently at prudent levels?	Do the council's debt levels stay within (or return to) prudent levels in the initial years under its long-term financial plan ("LTFP"), and remain there over the remainder of the planning period?	Total Debt Ratio = total debt as a % of operating revenue*	<50%	>125%
Are the council's debt servicing obligations at manageable levels relative to its income?	Do the council's debt servicing obligations stay within (or return to) manageable levels in the initial years under its LTFP, and remain there over the remainder of the planning period?	Debt Service Ratio = net debt service cost as % of operating revenue	<10%	>20%
Is all of the council's infrastructure presently in an acceptable condition, with no overdue maintenance or replacement?	Does the council's LTFP target the (near) elimination of any current infrastructure backlog by the end of the planning period?	Infrastructure Backlog Ratio = infrastructure backlog* as % of total replacement value of infrastructure assets	<2% or <5%**	>5% or >10%**
Does the council have a recent track record of ensuring that its infrastructure assets are renewed or replaced as soon as that falls due?	Is the infrastructure renewals program in the council's LTFP on average equal to the renewals requirement identified in the accompanying asset management plan?	Annual Renewals Gap = required annual renewals* capex <u>less</u> actual annual renewals* capex as a % of required annual renewals capex	<10%pa (3yr avg)	>25% pa (3yr avg)
Does the council's annual income from all sources presently at least meet all of its annual expenses?	Does the council's annual income as projected under its LTFP at least fund all of its projected annual expenses?	Operating Balance Ratio = net operating result as % of operating revenue (both excluding capital items)	0-2½%	<-5%
Does the council's real operating service expenditure (excluding depreciation and interest payments) keep pace with its population growth.	Will the council's real operating service expenditure (excluding depreciation and interest payments) in future keep pace with its projected population growth.	Services Provision per Resident = operating expenditure (excluding interest and depreciation) expressed in constant prices per head of population converted to an annual index commencing at 100%	>100%	<90%
Does the council's real infrastructure stock keep pace with its population growth.	Will the council's real infrastructure stock in future keep pace with its projected population growth.	Infrastructure Provision per Resident = infrastructure stock (at replacement cost) expressed in constant prices per head of population converted to an annual index commencing at 100%	>80%	<60%

* all terms so marked (initial reference only) are defined in the attached glossary ** the higher limits are used when a council relies on its own estimates rather than using an IPWEA consistent method

(a) the ratio ranges given for the "green zone" indicate an outcome that is considered fully sustainable and which provides a reasonable margin of safety in case of unexpected developments

(b) the ratio ranges given for the "red zone" indicate an outcome that is considered not to be sustainable over the medium term; the gap between the green and red zones is the "amber zone" where some caution is warranted and some policy adjustment on the part of the council may be prudent

Glossary

All financial terms used in this report have the meaning given in the NSW Department of Local Government, *Local Government Code of Accounting Practice and Financial Reporting*, with the following additions and exceptions. All *italicised terms* below are defined elsewhere in this Glossary.

actual renewals capex	means the actual (or planned) amount of <i>renewals</i> capex in a particular year
cost of services, or operating expenditure	means total expenses before depreciation, interest, statutory contributions and maintenance
enhancement	means increasing an asset's service capacity beyond that which existed originally; includes extension and expansion
existing policy	means the situation where a council's key spending and revenue policy settings continue on in future in line with present settings
infrastructure	includes buildings
infrastructure backlog	means the estimated total cost of undertaking the required asset <i>renewal</i> that the council's asset managers had programmed to occur prior to a year's end, but which had not been carried out by then (due to a lack of finance or other reasons) and is still required to be done is measured preferably by the "Total Value in \$ Above Intervention Condition" amount estimated when using the Moloney model and by the "Cumulative Renewal Funding Shortfall" when using the NAMS.PLUS model; in the absence of estimates like these consistent with IPWEA principles, Review Today uses the SS7's "estimated cost to bring to a satisfactory standard" as a proxy; in all cases, the latest available estimate/proxy of a council's existing infrastructure backlog is extrapolated forward using the annual gap between projections of 'required' and 'actual' renewals capex
operating revenue	means income from continuing operations excluding (i) any capital grants and contributions, and (ii) any large 'net gain from the disposal of assets' amounts
rehabilitation	means addressing any <i>infrastructure backlog</i> , and occurs whenever a council's actual renewals capex exceeds required levels
renewal(s)	means restoring an asset's service capacity to that which existed originally, applying current construction standards and technology, once an asset has reached (i) the end of its economic or useful life or (ii) because it no longer provides an acceptable level of service and cannot be restored by the regular repair and upkeep of assets
required renewals capex	means the amount of <i>renewals</i> capex required in a particular year (in addition to required maintenance) in order to keep the service capacity of an asset at a satisfactory level; in the absence of estimates consistent with IPWEA principles, Review Today uses the annual depreciation of the relevant assets as a proxy

Acronyms

AM	Asset Management
DLG	Division of Local Government (previously Department of Local Government)
IP&R	Integrated Planning and Reporting [Framework]
IPWEA	Institute of Public Works Engineering Australia
LTFP	Long-Term Financial Plan
NAMS.PLUS	the asset management system sponsored by IPWEA
SS7	Special Schedule 7

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Note all assessments in this report are based on the council's own financial projections

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