

3. Borrowing Strategy

Loan borrowing is a legitimate and responsible financial management tool and the use of loans to fund capital projects can be an effective mechanism of linking the payment for the assets (via debt payments) to the successive rate-paying populations who receive benefits over the life of those assets. This matching concept is frequently referred to as 'inter-generational equity'.

Borrowings are considered as a source of funding in the following circumstances:

- Capital projects that deliver long term benefit to the community
- Building or purchase of assets where a detailed cash flow analysis shows that full funding costs can be recovered over the life of the asset
- Economic investments where a new asset or service decreases existing costs or provides new revenue in excess of their funding costs (positive NPV)

As borrowings are usually the highest cost source of funds:

- Internal funding sources are considered and used first (including possible re-allocation of funds from lower priority projects or operating items)
- The proposed project may be re-timed to match internal funds availability

SCENARIO PLANNING

The LTFP is a model to consider scenarios for the funding of operating and capital expenditure. Detailed forecasts of all sources of operating revenue and expenditure are utilised to derive the maximum surplus available to apply to Council's rolling program of capital investments in new or refurbished infrastructure. These forecasts consider both changes in price levels for individual items as well as the benefits of ongoing productivity improvements.

Scenario 1 - Base Case Scenario without the Special Rate Variation for Infrastructure

Scenario 2 - Continuation of the Special Rate Variation for Infrastructure

Scenario 3 - Continuation of the Special Rate Variation for Infrastructure plus additional funding to Close the Infrastructure Gap

Both Scenario 1 and 2 are financially sustainable in terms of maintaining a balanced budget, sufficient unrestricted cash and available working capital, sufficient cash reserves and a permissible debt service ratio over the medium term.

Council's optimal scenario is Scenario 2, which assumes continuation of the SRV for Infrastructure as this will help address the asset renewal backlog. As this requires approval from an external authority, the Independent Pricing and Regulatory Tribunal (IPART), it cannot be the Base Case scenario. The Base Case scenario is non-optimal, but is the only one that can be delivered without external approval. Council has resolved to apply to IPART under Section 508(2) of the Local Government Act to continue this SRV permanently.

Both scenarios are modelled for a period of 10 years. Each of them considers the impact on key financial indicators in the LTFP, current service levels and asset management. The forecast income statement, balance sheet and cash flow statement for the scenarios are provided in appendices to this report.

Scenario 3 requires funding, in addition to the Special Variation for Infrastructure, in order to meet the identified target renewal expenditure levels. This level of funding is not achievable without significant additional revenue or reduction in operational services.

Scenario 1 – Base Case Scenario without continuation of the SRV for Infrastructure

The base scenario of the LTFP shows the financial results of delivering the current level of service as per the 2013/14 budget expanded out over 10 years and adjusted by various price forecast indexes as detailed in the financial assumptions section of this document. As with other scenarios, this scenario is modelled to address Council's renewal assets gap as much as possible. The adopted principle under this scenario is that all available surplus funds will be diverted towards Council's assets renewal as a priority.

This scenario is sustainable according to the recognised financial sustainability measures and can be delivered, however, it does not address the asset renewal backlog and community concerns about the roads network. This scenario identifies the impact of not receiving the continuation of the SRV for Infrastructure starting from 2014/15 onwards. The associated road works that this levy will fund is also eliminated.

Council's revised Asset Management Strategy and the updated Roads and Transport Asset Management Plan confirm the need to increase the level of funding for roads to address the backlog. Several research surveys have also been undertaken with the Community to identify the service level requirements. These surveys confirmed that roads represented the highest concern in the community. If Council does not get an approval for the continuation of the Special Rate Variation, it will not be possible to maintain Council's roads to this service level standard in the future.

Capital expenditure

Capital expenditure is based on the current and projected capital works program and Council's Asset Management Strategy (AMS). Council's AMS outlines the renewal strategies for each assets class. These include Roads and Transport, Buildings, Drainage and Recreational Facilities. The AMS also provides and quantifies the required renewal expenditure to close the assets renewal gap. As indicated above, all available surplus funds have been allocated towards partially funding this gap for the next 10 to 20 years. The required renewal funding is based on the cost to renew assets currently in a poor condition.

The required renewal expenditure as per the AMS is displayed below.

Required Renewal Expenditure Asset Classes	Current prices (\$M)		Future prices (\$M)	
	1 Year	10 Year	1 Year	10 Year
Roads and Transport	12,151	121,510	12,151	140,213
Drainage	1,500	15,000	1,500	17,309
Buildings	2,398	23,980	2,398	27,671
Recreational facilities	467	4,670	467	5,389
Total	16,516	165,160	16,516	190,581

The base scenario allocates capital funding as follows:

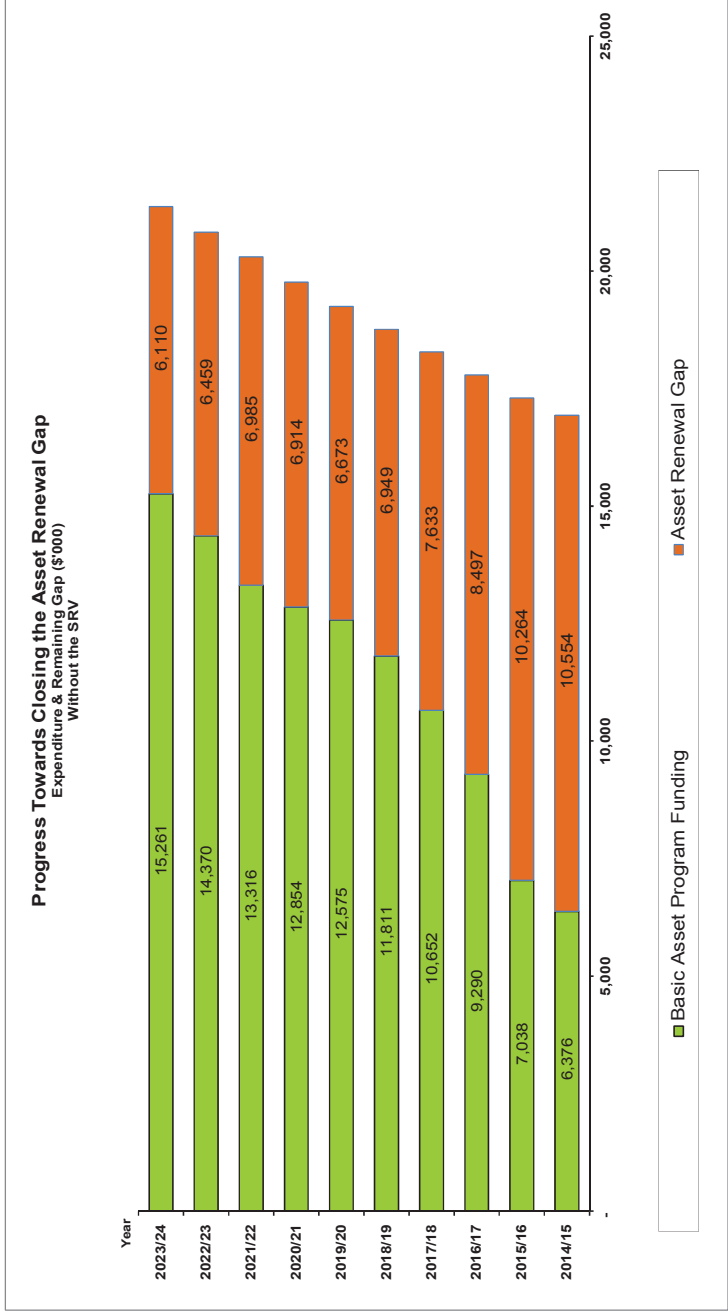
Projected Capital Expenditure

Scenario 1 - Without the SRV

Capital expenditure by category	Budget	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
\$'000											
Planning, Community & Other	3,623	2,266	2,202	2,346	2,415	2,504	2,569	2,651	2,780	2,898	
Roads & Transport	8,502	15,070	13,408	19,725	10,807	20,242	15,636	18,863	16,660	23,673	
Streetscape & Public Domain	286	469	1,037	534	256	603	270	277	782	292	
Parks & Recreation	14,301	27,047	15,425	21,860	12,406	31,199	15,595	7,418	5,036	7,036	
Stormwater Drainage	455	620	774	902	1,568	1,659	1,700	1,771	1,937	2,078	
Council Buildings	1,660	770	1,056	18,438	1,758	11,871	1,978	2,069	2,303	22,633	
Trees & Natural Environment	1,110	901	1,215	1,646	923	-	-	-	-	-	
Total	29,937	47,143	35,117	65,451	30,133	68,078	37,748	33,049	29,498	58,610	

Table below displays the Asset renewal gap after additional funds from cash reserves (subject to maintaining target KPI's for liquidity/reserves) allocated towards assets renewal, but without the SRV. Even with the investment of additional funds from cash reserves, the renewal gap remains significant. The loss of funding from the SRV would also have a negative impact on the funding shortfall, as this will grow in a compound way over time as shown below.

Assets Renewal Funding (\$M)	10 Year
Future Prices	Total
Required Renewal Funding	190,581
Standard Expenditure	113,543
Projects funded by SRV	-
Asset Renewal Gap	77,038



The total length of each individual bar in the chart above shows the estimated expenditure required each year to adequately maintain and renew Council's community assets. This grows into the future with inflation of the cost of the works required. The components of the bar chart are divided into:

- (green section) - The amount met from Council's traditional level of asset renewal expenditure programs
- (red section) - The remaining asset renewal gap (funding shortfall)

Table below displays the balances of internal and external cash reserves under the Scenario 1.

Projected Internal Cash Balance Reserves

Scenario 1 - Without the SRV

Cash Reserve Balances	Budget	Projected	Projected	Projected	Projected	Projected	Projected	Projected	Projected	Projected	Projected
\$'000	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	Projected
Internal Liability Reserves	4,050	4,250	3,800	4,010	4,230	4,450	3,950	4,180	4,420	4,670	4,670
Internal Project Reserves	10,810	11,220	11,860	12,440	12,830	13,180	13,510	13,980	14,490	14,640	14,640
Total Internal Reserves	14,860	15,470	15,660	16,450	17,060	17,630	17,460	18,160	18,910	19,310	19,310

Scenario 2: Continuation of the SRV for Infrastructure

This Scenario represents the base case scenario plus additional income from the SRV for Infrastructure and increased expenditure on Infrastructure assets funded by this income.

This scenario is Council's preferred one and is also considered sustainable. The LTFP has assumed in this scenario that the levy will be continued permanently. Council considers that this increase in funding is necessary to address the current renewal backlog and meet community expectations in regard to service levels and the management of essential community assets.

Income from the continuation to the Infrastructure Levy will be used entirely to fund Council's road works.

It is estimated that the special rates variation will produce the following increase in Council revenue over the next 10 years to 2023/24.

\$M	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Special Rate Variation	2,752	2,851	2,965	3,083	3,200	3,319	3,445	3,576	3,708	3,845
Less: Pensioner Rebates	-	24	-	24	-	25	-	26	-	27
Levy available for Infrastructure Projects	2,728	2,827	2,941	3,058	3,175	3,293	3,419	3,550	3,681	3,818

Pending approval for an ongoing levy Council will receive approximately \$32.5 million in total over a 10-year period. If continuation of the special rate variation is not approved, the roads program will need to be reduced by eliminating levy funded projects, so that the total program value each year equals only the funding available from other sources, as factored into the Base Scenario above. The levy ensures that Council has the capacity to provide additional funding to reduce the infrastructure gap, and continue to bring Council's roads to a fair standard within an

established time frame. The benefits of bringing Council's roads to a satisfactory standard will help reduce the annual maintenance requirements as well as the cost of future road works.

Scenario 2 allocates capital funding as follows (note that these figures include expenditure on some new assets, largely funded from Development Contributions):

Projected Capital Expenditure
Scenario 2 - With the SRV

Capital expenditure by category	Budget	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
\$'000											
Planning, Community & Other		3,611	2,265	2,201	2,347	2,415	2,504	2,569	2,652	2,781	2,898
Roads & Transport		11,133	17,892	16,339	22,791	13,976	23,536	19,050	22,418	20,345	27,491
Streetscape & Public Domain		286	469	1,037	534	256	603	270	277	782	292
Parks & Recreation		14,236	27,045	15,420	21,867	12,403	31,201	15,594	7,424	5,042	7,039
Stormwater Drainage		432	619	772	904	1,567	1,660	1,700	1,773	1,939	2,079
Council Buildings		1,625	768	1,053	18,441	1,756	11,872	1,978	2,072	2,306	22,635
Trees & Natural Environment		1,110	901	1,215	1,646	923	-	-	-	-	-
Total		32,433	49,959	38,037	68,530	33,296	71,376	41,161	36,616	33,195	62,434

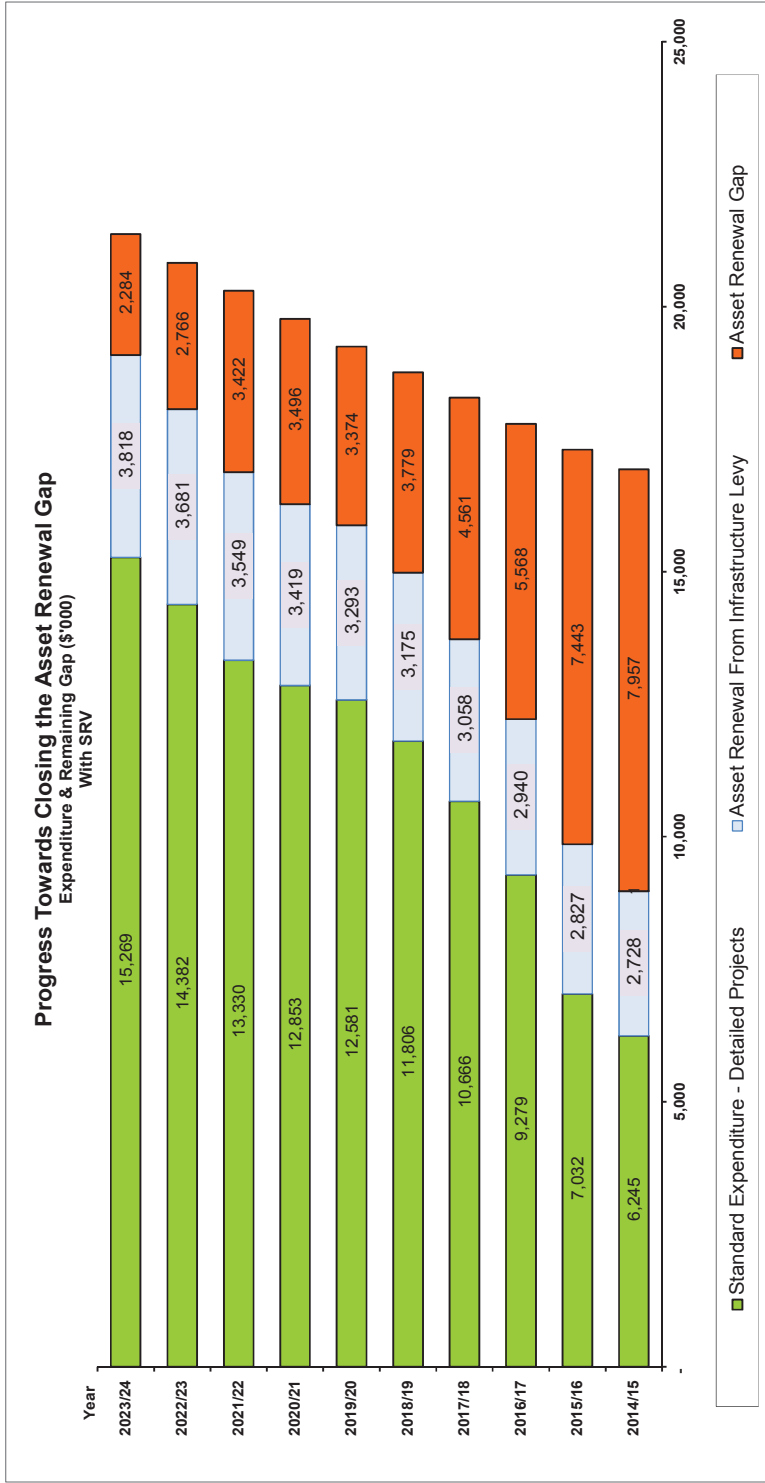
The balances of internal and external cash reserves under Scenario 2 are shown below:

Projected Internal Cash Balance Reserves
Scenario 2 - With the SRV

Cash Reserve Balances	Budget	Projected	Projected	Projected	Projected	Projected	Projected	Projected	Projected	Projected	Projected	Projected
\$'000	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2023/24	2023/24
Internal Liability Reserves	4,050	4,250	3,800	4,010	4,230	4,450	3,950	4,180	4,420	4,670		4,670
Internal Project Reserves	11,080	11,500	12,180	12,740	13,150	13,510	13,870	14,340	14,860	15,010		15,010
Total Internal Reserves	15,130	15,750	15,980	16,750	17,380	17,960	17,820	18,520	19,280	19,680		19,680

The table and chart below displays the Asset renewal gap after additional funds allocated towards assets renewal (with SRV). The additional income from the SRV has a positive impact on the size of the future asset renewal gap, reducing it by the amount of the levy. The chart is similar to the chart in Scenario 1 but shows the additional reduction in the asset renewal gap caused by the levy.

Assets Renewal Funding (\$M)	10 Year	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Future Prices	Total										
Required Renewal Funding	190,581	16,930	17,302	17,787	18,285	18,760	19,248	19,768	20,301	20,829	21,371
Standard Expenditure	113,443	6,245	7,032	9,279	10,666	11,806	12,581	12,853	13,330	14,382	15,269
Special Rate Variation	32,488	2,728	2,827	2,940	3,058	3,175	3,293	3,419	3,549	3,681	3,818
Asset Renewal Gap	44,650	7,957	7,443	5,568	4,561	3,779	3,374	3,496	3,422	2,766	2,284



Scenario 3: Continuation of the Special Rate Variation for Infrastructure plus additional funding to Close the Infrastructure Gap

The “Closing the Gap” Scenario represents Scenario 2 (the base case scenario plus additional income from the SRV for Infrastructure), and an additional \$44.650 million over 10 years capital investment required to renew our infrastructure assets to service levels identified in recent community consultation. This scenario seeks to develop an adequate infrastructure renewal program to ensure that the community continues to be served by its assets at their desired level.

If Council was to close the annual asset renewal gap over the 10 years of this LTFP, additional funds of \$44.650 million will need to be found on top of the proposed special rate variation for Infrastructure. If additional revenues cannot be raised an option would be to reduce operational costs, however this will require significant cuts to existing services. Another option available to Council would be to borrow the funds with the resulting impact on debt levels and operational cost. As all revenues are committed to fund existing operational expenditure plus asset renewals the actual amount borrowed would be much higher as Council would also need to borrow to fund the interest costs on the loans. The extra borrowing will also be in contravention of Council's borrowing strategy in that it has no significant future cash flow benefit and the debt could only be serviced by eliminating or curtailing other capital works projects. In the long term borrowing for infrastructure renewal is not sustainable.

Projected financial statements have not been produced for this scenario, as this is currently unfunded and does not meet most of the financial sustainability tests identified in the LTFP. The scenario is work in progress and requires significant financial analysis and modelling to determine future revenue streams and funding sources to address the shortfall between required expenditure and current affordable expenditure. Council is not prepared to consider borrowing for this shortfall until it can be assured that it will only be addressing a short-term requirement and that there would be future asset renewal reductions to enable the debt to be repaid.

The table below shows that Council requires funding of \$44.650 million from unidentified sources to close the assets renewal gap.

Assets Renewal Funding (\$M)	10 Year Total	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Required Renewal Funding	190,581	16,930	17,302	17,787	18,285	18,760	19,248	19,768	20,301	20,829	21,371
Standard Expenditure - Detailed Projects	113,443	6,245	7,032	9,279	10,666	11,806	12,581	12,853	13,330	14,382	15,269
Infrastructure Levy (SRV)	32,488	2,728	2,827	2,940	3,058	3,175	3,293	3,419	3,549	3,681	3,818
Closing the Gap - unidentified funding	44,650	7,957	7,443	5,568	4,561	3,779	3,374	3,496	3,422	2,766	2,284
Asset Renewal Gap	-	-	-	-	-	-	-	-	-	-	-

LTFP ASSUMPTIONS & SENSITIVITY ANALYSIS

The Long Term Financial Plan contains a wide range of assumptions, including assumptions about interest rates, potential effect of inflation on revenues and expenditures, current service levels and others. Major assumptions in the current version of the LTFP are listed below and a detailed list is attached to this report.