



Attachment C

**November 2013 Resolution,
Report and Annexures (3)
Presentation of Scenarios for LTFP
(Including Discussion Paper)**

9.6 Finance: Financial Assistance Grant Calculations – 2013-14 Details

REPORT FROM: DIRECTOR OF CORPORATE AND COMMUNITY SERVICES
Author: Anna Watt – Director of Corporate and Community Services

Moved: Cr Newman Seconded: Cr Scherf

8.11/13 RESOLUTION

That Council notes the information in this report.

CARRIED

9.7 Finance: Presentation of Scenarios for Long Term Financial Plan

REPORT FROM: DIRECTOR OF CORPORATE AND COMMUNITY SERVICES
Authors: Hein Basson – General Manager, Anna Watt – Director of Corporate and Community Services and Eric Brown - Manager of Finance

Moved: Cr Scherf Seconded: Cr Schumacher

9.11/13 RESOLUTION

1. That Council notes the information in the body of this report, in conjunction with Annexures E, F and G, and in particular the effect on the TCORP financial and infrastructure ratios of the five (5) different scenarios discussed.
2. That Council, in principle, adopts Scenario 5 as its preferred option for consultation with the Community.
3. That Council notes the deadlines to IPART for the notification and application of a Special Rates Variation; being 13 December 2013 and 24 February 2014 respectively.
4. That Council requests the General Manager to notify IPART of the intent to apply for a Special Rates Variation by 13 December 2013; recognising that a process of Community consultation will follow after this mentioned date.
5. That Council requests the Director of Corporate and Community Services to make the necessary arrangements for Community consultation sessions throughout the Local Government Area towards the end of January and beginning of February 2014, to properly inform the Community of the effect and extent of the proposed Special Rates Variation.
6. That Council requests the Director of Corporate and Community Services to amend Council's Delivery Program in order to reflect the effect of the proposed Special Rates Variation in this document.
7. That Council requests the Director of Infrastructure Services to revisit and revise Council's Road Infrastructure Asset Management Plans for the December 2013 Ordinary Council Meeting – identifying the effect of the proposed Special Rates Variation on these Plans.

8. That Council approves for an Extraordinary Meeting to be held on 20 February 2014 to consider the revised Long Term Financial Plan, including a Special Rates Variation, in its final format.
9. That Council requests the Director of Infrastructure Services to prepare an application for round three (3) of the Local Infrastructure Renewal Program for \$4 million to address the state of Council's local bridge infrastructure.

CARRIED

9.8 Finance: Quarterly Budget Review – September 2013

REPORT FROM: DIRECTOR OF CORPORATE AND COMMUNITY SERVICES
Author: Eric Brown – Manager of Finance

Moved: Cr Schumacher

Seconded: Cr Newman

10.11/13 RESOLUTION

That Council notes and adopts the information in this report, with the estimated annual Operational Surplus of \$3million being the result of the September 2013 Quarterly Budget Review.

CARRIED

9.9 Financial Management: Finance Report – October 2013

REPORT FROM: DIRECTOR OF CORPORATE AND COMMUNITY SERVICES
Author: Eric Brown – Manager of Finance

Moved: Cr Scherf

Seconded: Cr Schumacher

11.11/13 RESOLUTION

That Council notes the following information:

1. The cash book report disclosing total reconciled cash balance of \$592,355.77;
2. The investment report disclosing total invested funds of \$12,822,137.05 with total cash and investments of \$13,414,492.82 (compared with \$11,306,404.64 in November 2012); and
3. The loan liability report showing a total loan liability of \$12,674,545.79 (compared with \$10,572,342.08 in November 2012).

CARRIED

9.7 Finance: Presentation of Scenarios for Long Term Financial Plan

REPORT FROM: DIRECTOR OF CORPORATE AND COMMUNITY SERVICES

Authors: Hein Basson – General Manager, Anna Watt – Director of Corporate and Community Services and Eric Brown - Manager of Finance

ANNEXURES E, F AND G

PURPOSE

The purpose of this report is to present Councillors with a discussion paper in respect of the Long Term Financial Plan. The purpose of this discussion paper is to provide Councillors with their annual opportunity to revise the financial plan for the next ten (10) years. The attached discussion paper has a particular focus on ensuring Council's financial sustainability into the future, achieving an operating surplus within three (3) years as requested by Council at its Ordinary Council Meeting in May this year. The plan also addresses the current state of road infrastructure.

EXECUTIVE SUMMARY

Council's Long Term Financial Plan (LTFP) is in the process of being reviewed. Since the previous LTFP was approved, Council has received information regarding the variability of Grant Funding into the future, met with the NSW Grant Commission, been reviewed by NSW Treasury (TCorp) and requested that the reviewed plan achieves an operating surplus within three (3) years.

The discussion paper attached to this report presents five (5) scenarios for Council to consider. Only two (2) of these scenarios will (in part) address the concerns that have been raised, namely scenario 2 and scenario 5. Both of these options include a section 508(A) Special Rates Variation, resulting in a stepped increase that remains in the rate base. The suggested variation would be over three (3) years for farmland and one (1) year for residential properties.

The additional money that would be raised is aimed firstly at balancing the budget and secondly assisting Council to not fall further behind with its infrastructure backlog (\$29.5 million as at 30 June 2012), which in the past it has been unable to do due to insufficient revenue. That, along with the resultant improvement in the TCORP identified financial and infrastructure ratios, is its sole purpose.

The recommended scenario 5 also includes Council applying for a further Local Infrastructure Renewal Scheme (LIRS) loan of four million dollars (\$4 million). This will enable large projects that have previously been too costly to be approved, and other major road infrastructure projects that are scheduled into the future to be brought forward; examples include replacing bridges in urgent need of repair, and larger road works projects.

BACKGROUND

The LTFP is an important document for Council; it identifies how much can be spent where and when major projects can be undertaken (if at all). With the new focus on financial sustainability this document has become ever more important.

The *Local Government Amendment (Planning and Reporting) Act 2009*, (the Act) was approved on 9 October 2009 and commenced on and from that date. The amendments

to the Act give effect to the Integrated Planning and Reporting framework, which includes a Community Strategic Plan and a four (4) year Delivery Program with the associated Resourcing Strategy documents, which comprise the Asset Management Plans, Work Force Plan and LTFP.

The budgeting process flows from the LTFP, and each year of budgeting must be continually compared with the underlying indicators in the LTFP to ensure Council is on track. Where a variation of the LTFP is proved or expected, the Plan must be reviewed to address the issue. In this review of the LTFP, Council will need to make some very difficult decisions. These decisions will have a significant impact on how Council will operate in the next ten (10) years.

The difficulty with developing a LTFP (and in particular for the Glen Innes Severn Council) is that, due to the breakdown of Council's revenue sources Council is heavily reliant on grant revenue. Around 30% of Council's revenue is sourced from Rates and Annual Charges. Grant revenue is by its very nature uncertain and at least in part is subject to an application and approval process. This makes the preparation and assumptions of a LTFP more subjective. Further, the grant revenue that is not subject to an application process is reliant on both the State and Federal Government, which can at times be unpredictable and subject to political influence. This unpredictability is one (1) of the primary reasons the LTFP needs to be reviewed. The second significant 'pressure' on this review is the need to address the financial sustainability indicators identified by TCORP for NSW Local Government. Both reasons are discussed further below:

1) Variability of Grant Funding and the Long Term Financial Plan:

The most significant variant in the newly suggested scenarios for the LTFP is the exclusion of the 'above trend' increases in both the Financial Assistance Grant and the Roads to Recovery Grant. The removal of these increases (identified on page 5 of Annexure E) will result in a deterioration of approximately \$866,500 in grant revenue per annum (which is budgeted to increase by approximately 4% per annum thereafter). Therefore the decrease is significant.

This is not to say that there may not be smaller increases in the Financial Assistance Grant or the Roads to Recovery Grant. Council's meeting with the NSW Grant Commission indicated that there was a possibility of a removal of the minimum grant component of \$20.81 per capita.

The Commission indicated that this may result in an increase of grant funding to the Glen Innes Severn Council of approximately \$308,000 per annum. However, the removal of this minimum grant component is unlikely at this stage, as the 'Metropolitan Councils' which benefit from this minimum amount are asking for a removal of the rate peg. Further, the minimum per capita amount was Commonwealth legislation not NSW legislation; therefore it would require an amendment in the State Legislation to remove the rate peg, as well as the change in Commonwealth legislation, to remove the minimum per capita amount. This seems very unlikely.

Based on this information, Council staff have excluded 'above trend' increases in the Financial Assistance Grant and the Roads to Recovery grant, which were

included in the previous Long Term Financial Plan. This impact has been discussed further on page 5 of Annexure E.

2) TCORP Sustainability and the Independent Local Government Review Panel:

In December 2011, the Division of Local Government (DLG) appointed TCORP and the NSW Treasury to assist in the analysis of the State Government's Local Infrastructure Renewal Scheme (LIRS) initiative. This initiative sought to address the state wide infrastructure backlog by providing Councils with an interest rate subsidy on loans to fund infrastructure projects. TCORP's role in this process was to undertake a financial assessment for each Council seeking assistance under the LIRS scheme.

After the establishment of the Independent Local Government Review Panel in March 2012, the DLG expanded the scope of TCORP's work to include a financial sustainability and benchmarking assessment of all 152 New South Wales (NSW) Councils.

In April 2013 TCORP released the Report titled; "Financial Sustainability of the New South Wales Local Government Sector – Findings, Recommendations and Analysis".

The findings and recommendations of the aforementioned report were summarised in Report 9.4 to Council at the May Ordinary Council Meeting. The report identified the 'TCORP financial sustainability ratios' which a Council's financial sustainability is to be measured against.

A further report of significance was the *"New Direction for Local Government: Independent Local Government Review Panel: Future Directions for NSW Local Government: Twenty Essential Steps Document (April 2013)"*, prepared by the Local Government Review Panel. This report was presented to Council at the May Ordinary Council meeting (Report 9.1). It suggested a merger of the Glen Innes Severn and Tenterfield Shire Councils be considered in 2020 if both Councils were unable to show a financially sustainable position.

The discussion paper attached to this report details the scenarios that Council staff have prepared for Council's consideration based on the aforementioned factors. The discussion paper also identifies a number of other adjustments that have been made as a result of Council decisions since the original LTFP was approved, along with updated data where available.

Five (5) scenarios have been prepared and they are discussed in detail in Annexure E. Only two (2) of these scenarios will (in part) address the concerns identified by the recently released TCORP report, in particular Council's infrastructure renewal ratios.

(a) Relevance to Integrated Planning and Reporting Framework

This item links to Council's Operational Plan Objective GCL 3.1 "To be recognised as a well managed Council and an employer of choice" and also Objective GCL 2.1 "Glen Innes Severn LGA will keep its local autonomy and Local Government has achieved Constitutional Recognition".

(b) Financial Considerations

The financial considerations are significant, and will largely dictate the course of Council for the next number of years. It is critical for Councillors to therefore fully digest the information presented in the attached report, and to fully consider and question the options presented.

COMMENTARY

Council staff have prepared five (5) scenarios for discussion. These scenarios have been prepared based on the same base case scenario which has refined the adopted Long Term Financial Plan (from June 2012).

The previous LTFP was adjusted to account for a number of variations which arose after its preparation. The variability of the plan is understandable given the fluctuations that naturally arise in the public sector (primarily in grants and contributions). Therefore, it is common practice to review the plan on an annual basis. However, in this particular case the review of the plan is of even more importance, given the release of the various reports on financial sustainability in Local Government and the recommendations associated with these reports.

These adjustments are discussed on page 5 of Annexure E.

The five (5) scenarios that have been prepared and discussed in Annexure E are as follows:






- Scenario 1 –** Base Case Scenario
- Scenario 2 –** Implementation of a Special Rate Variation for three (3) years
- Scenario 3 –** Special Rates Variation and Local Infrastructure Renewal Scheme (LIRS) Loan
- Scenario 4 –** Special Rates Variation and Unsubsidised Loan
- Scenario 5 –** Special Rates Variation and Local Infrastructure Renewal Scheme (LIRS) Loan and Reduced Capital Expenditure

These scenarios have been developed to address the TCORP ratios identified in the TCORP report titled “Financial Sustainability of the New South Wales Local Government Sector – Findings, Recommendations and Analysis”. The current position of Council and the financial position in preceding years are illustrated below:

TCORP RATIOS		Year ended 30 June			
	Bench	Council			
		2013	2012	2011	2010
Financial Ratios					
Operating Ratio	> (4.0%)	(4.53%)	(0.27%)	(12.1%)	(5.4%)
Interest Cover Ratio	> 4.00x	5.58x	7.46x	8.42x	7.02x
Debt Service Cover Ratio	> 2.00x	3.34x	4.78x	5.13x	4.44x
Unrestricted Current Ratio	> 1.50x	4.78x	3.46x	2.40x	2.83x
Own Source Operating Revenue Ratio	> 60.0%	44.68%	39.65%	31.5%	32.2%
Cash Expense Ratio	> 3.0 months	8.64 months	6.98 months	6.8 months	7.0 months
Infrastructure Ratios					
Infrastructure Backlog Ratio	< 0.02x	0.12x	0.14x	0.17x	0.16x
Asset Maintenance Ratio	> 1.00x	0.74x	0.63x	0.62x	0.62x
Building and Infrastructure Renewals Ratio	> 1.00x	0.89x	0.55x	0.57x	0.07x
Capital Expenditure Ratio	> 1.10x	0.87x	1.37x	1.10x	0.51x

In accordance with the attached discussion paper, the TCORP ratios indicate the need to address the infrastructure side of Council's financial balance (the infrastructure ratios). The development of the LTFP has been targeted at addressing these, while maintaining the Financial Ratios above benchmark. The scenarios identified above are expected to have the following impact on the LTFP:

ESTIMATED	TCORP Bench.	Year ended 30 June 2023				
		Scenario				
		1	2	3	4	5
Operating Ratio	> (4.0%)					
Interest Cover Ratio	> 4.00x					
Debt Service Cover Ratio	> 2.00x					
Unrestricted Current Ratio	> 1.50x					
Own Source Operating Revenue Ratio	> 60.0%					
Cash Expense Ratio	> 3.0 months					
Infrastructure Backlog Ratio	< 0.02x					
Asset Maintenance Ratio	> 1.00x					
Building and Infrastructure Renewals Ratio	> 1.00x					
Capital Expenditure Ratio	> 1.10x					

	<i>Good</i>	<i>Above TCORP Ratio</i>
		<i>Close to achieving Ratio or above ratio and deteriorating slowly</i>
	<i>Average</i>	<i>Reasonable but short of TCORP ratio.</i>
		<i>Improving but still of concern.</i>
	<i>Poor</i>	<i>Below TCORP ratio with no chance of achieving required ratio possibly deteriorating.</i>

Scenario 2 and 5 are expected to bring Council to a sustainable position, based on the TCORP measure of on average meeting the benchmarks identified. Scenario 1 will have few above benchmark ratios, suggesting a deteriorating position that will not meet the TCORP requirements identified. Therefore the status quo is not suggested as a preferred course of action.

The financial indicators of each scenario are discussed in more detail in the discussion paper.

Scenario 1 – Base Case Scenario

This is discussed on page 11 of Annexure E and indicates:

This scenario can be adopted by Council with an adjustment in total capital expenditure. This adjustment will reduce capital expenditure to approximately what was identified in the original Long Term Financial Plan. This capital expenditure is not sufficient to meet the requirements identified by TCORP in regard to asset renewal. The plan will also not achieve Council's adopted goal of achieving an operating surplus within three (3) years. Therefore, further scenarios have been developed, investigating the possibility of a special rates variation.

Scenario 2 – Implementation of a Special Rate Variation for three (3) years

This is discussed on page 15 of Annexure E and indicates:

This scenario indicates an improved cash position, a satisfactory operating position, and a balance between the general fund and the remaining funds, combined with a good asset renewal ratio. This scenario is a significant improvement on the Base Case Scenario, and will put Council in a very progressive situation in respect of asset renewal.

It should be noted that this scenario has a few weaknesses; it still does not address the infrastructure backlog (or deferred asset renewals), nor does it deal adequately with the infrastructure items (such as bridges) which are in a poor state and need to be renewed as a matter of urgency.

This scenario is certainly an improvement on both the previous LTFP and the Base Case Scenario. This option is a good scenario for Council to consider.

Scenario 3 – Special Rates Variation and Local Infrastructure Renewal Scheme (LIRS) Loan

This is discussed on page 29 of Annexure E and indicates:

This scenario indicates a deteriorating cash position, a satisfactory operating position, and a balance between the general fund and the remaining funds, combined with a good asset renewal ratio. This scenario will address a number of critical infrastructure projects, which are of present concern. The only concern with this scenario is the fact that the cash position is deteriorating, due to the increased loan repayments.

This is a reasonable scenario apart from the reduction in cash and cash equivalents. This decrease can be addressed by a reduction in annual capital expenditure, to match the loan repayments and additional interest expense on the loan.

Based on scenario two (2), additional scenarios were developed. The first was to answer the question of what impact an unsubsidised loan of the same amount would have on Council (Scenario 4 – Unsubsidised Loan \$4million), and the second what impact the four million dollar LIRS loan with reduced capital expenditure in future years would have (Scenario 5 – Local Infrastructure Renewal Scheme (LIRS) Loan and Reduced Capital Expenditure).

Scenario 4 – Special Rates Variation and Unsubsidised Loan

This is discussed on page 38 of Annexure E and indicates:

This scenario has been prepared in case Council adopts Scenario 3, but is not successful in obtaining the LIRS loan. This is a reasonable possibility, but should only be considered if Council's application for LIRS funding is not successful. Further, the scenario would need to be modified to reduce capital expenditure, to ensure that Council is in a satisfactory cash position. This would lead to a reduced capital renewal ratio, which is not ideal. It may be more suitable to delay some urgent works and reduce the extent (or value) of the loan.

Scenario 5 – Special Rates Variation and Local Infrastructure Renewal Scheme (LIRS) Loan and Reduced Capital Expenditure

This is discussed on page 40 of Annexure E and indicates:

This scenario indicates a stable cash position, a satisfactory operating position, and a balance between the general fund and the remaining funds, combined with an acceptable asset renewal ratio. This scenario will address a number of critical infrastructure projects which are of present concern.

This scenario is an improvement on earlier scenarios, in that it addresses all of the key concerns raised. It would be ideal to meet the required renewal ratio; however, this should be balanced with the additional benefit of bringing forward urgent works.

This scenario is suggested as the preferred and therefore recommended option.

Suggested Special Rate Variation:

Both Scenario 2 and 5 are suggested as good options for Council's adoption. The difficulty with this is that both of these options include a Special Rate Variation. This can be an unpopular suggestion to make and must be properly justified.

Special Rate Variations and the Rate Peg:

The rate peg is a percentage increase limit on increases in Rates revenue in NSW, set with the idea of matching the increase in the cost of goods specific to Local Government. In principle this is an excellent idea, particularly if the rate peg is set to keep track with the increases in the cost of road works. Based on the large number of Councils applying for Special Rate Variations this does not appear to be the case – particularly for Councils with significant road networks. This may have to do with the breakdown of a Council's expenditure types and the increases in the Consumer Price Index (CPI) per category. Therefore a Council with more road works per capita would be in a worse position than a Council with less road works per capita if the road works CPI increased more than the Local Government Rate Peg. This makes it difficult to set a flat rate across NSW for a rate peg.

The rate peg cap is set annually by the Independent Pricing and Regulatory Tribunal (IPART), and limits the increase for all Councils in NSW apart from those who have been granted an exemption. For an increase above the rate peg to be approved, Council must undertake the Special Rate Variation process which requires the Council to:

- 1) Properly plan in the longer term by implementing the Integrated Planning and Reporting Framework (IP&R), which comprises the Long Term Financial Plan, Asset Management Plans, a Delivery Programme and the Community Strategic Plan. Once these documents are completed and if they indicate that Council will require additional revenue to pay for the services required, Council is able to apply for a Special Rates Variation. These planning documents must also demonstrate the need for, and include, a Special Rate Variation;
- 2) Consult with the Community – Council must consult with the Community as part of the IP&R Framework, as well as consulting in respect of the Special Rate Variation process.

IPART does an independent assessment of the information supplied to it and then approves the application if all the requirements have been met. Further information in this regard is included in Annexure F.

As part of the process, it is also necessary for a Council to match the need for the special rates variation with the form of the variation. Due to the ongoing need to address the operating deficit, Council staff members have suggested the following increase:

The Special Rate Variation suggested would be a section 508(A) variation, resulting in a stepped increase that remains in the rate base. The suggested variation would be over three (3) years for farmland and one (1) year for residential properties. Two (2) options for 'phasing in' the Special Rates Variation are identified on page 25 of Annexure E. In saying that, Council should discuss these options and, if appropriate, identify new options or more appropriate options based on the community's ability and willingness to

pay, balanced with the looming 2020 deadline for Financial Sustainability and Amalgamation. The suggested special rates built into each of the scenarios from two (2) to five (5) include a 30% increase above the rate peg spread over three (3) years for farmland, and a 10% increase above the rate peg for Residential properties. The estimated average impact on rate payers is as follows:

Rates category	YEAR					
	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Residential (RATE PEG)	545.63	565.27	584.49	604.36	624.91	646.16
(SRV)	545.63	565.27	584.49	662.81	685.35	708.65
Variance	-	-	-	58.45	60.44	62.49
Average \$/day	0.00	0.00	0.00	\$0.16/day	\$0.17/day	\$0.17/day
Assessments	3,636	3,636	3,636	3,636	3,636	3,636
Revenue Raised	0	0	0	212,524.20	219,759.84	227,213.64
Farmland (RATE PEG)	1,875.85	1,943.38	2,009.45	2,077.78	2,148.42	2,221.47
(SRV)	1,875.85	1,943.38	2,009.45	2,278.72	2,584.06	2,930.33
Variance	0.00	0.00	0.00	200.94	435.64	708.86
Average \$/day	0.00	0.00	0.00	\$0.55/day	\$1.19/day	\$1.94/day
Assessments	1,016.00	1,016.00	1,016.00	1,016.00	1,016.00	1,016.00
Revenue Raised	0.00	0.00	0.00	204,151.28	442,614.59	720,200.64
TOTAL ADDITIONAL REVENUE RAISED				416,675.48	662,374.43	947,414.28

The increase on the average farmland assessment would be in the order of \$1.94 per day (approximately \$709 per annum) and residential around 17 cents per day (approximately \$63 per annum). As with all expenses, breaking down the increase per day does not truly reflect the imposition on ratepayers and this is appreciated. However, even the annual amounts are arguably reasonable when broken down into quarterly instalments.

The suggested increases have been balanced with the regional average as identified in Annexure E, and this does suggest some level of fairness. Council should discuss and consider the affordability of this increase and the quantum of the variation. The variation amount has been identified primarily on the grounds of financial sustainability and achieving a balanced budget within three (3) years.

Quantum of the Special Rates Variation:

To arrive at the suggested Special Rates Variation percentages, Council's staff members have reviewed the Long Term Financial Plan and have attempted to "balance the budget". To do so, based on the current projections, Council would require between \$800,000 and \$1 million per annum.

Council staff then reviewed what may be affordable based on the latest (2011/12) average Division of Local Government rating comparative information, as well as the regional average, which identified that bringing rates to the regional average would raise in the order of \$800,000 in additional rates:

Regional Average		(2011/12)						
	Guyra	Inverell	Walcha	Bingara	Uralla	Kyogle	Armidale	Total Average
Residential Business Rate LGA	409.28	821.70	383.07	381.07	473.09	647.86	827.01	3,943.08
	612.24	3,009.17	620.25	344.34	472.05	965.52	3,046.79	9,070.36
								1,295.77
Farmland Rate	2,103.45	2,253.56	3,131.75	3,759.73	3,404.84	1,228.50	2,312.22	18,194.05
								2,599.15
	Glen Innes	Regional Average	Variation	Assessments	Variation X No. of Assessments			
Residential Business Rate LGA	545.63	563.30	17.67	3,636	64,237.73			
	1,247.45	1,295.77	48.32	390	18,843.13			
Farmland Rate	1,875.85	2,599.15	723.30	1,016	734,872.80			
					817,953.66	Rate Variation (to balance to Average)		

The figure of \$800,000 to \$900,000 (at today's values) has been identified as the suggested amount for which a Special Rate Variation should be applied. This amount is significant in respect of Council's current rating base, and therefore it is suggested that this increase be implemented over a few years.

The main goal here is to balance the budget. A balanced budget will result in the order of \$1,000,000 in additional Capital Works per annum. This will require a Capital Works Plan that clearly identifies the benefit the Community will receive from this increase.

This amount is significant and is not suggested lightly. However, if Council were to attempt to address the infrastructure backlog, an even more significant Special Rate Variation would be required. For this reason, Council staff members have not suggested this as an option at present.

The amount has been identified to address the further deterioration in Council roads.

Why should the Community pay for a Special Rates Variation? Where will the Community see the funds being spent?

The additional money that will be raised is aimed firstly at balancing the budget and secondly assisting Council to not fall further behind with its infrastructure backlog (\$29.5 million as at 30 June 2012), which in the past it has been unable to do due to insufficient revenue. That, along with the resultant improvement in TCORP ratios is its sole purpose. Therefore, if successful, the revenue raised will be spent on infrastructure maintenance and renewal – primarily 'road infrastructure'.

If Council is successful in receiving a further LIRS loan of four million dollars (\$4 million), it will enable larger projects that have previously been too costly be approved, and other major road infrastructure projects, such as replacing bridges in urgent need or repair and large road works projects that are scheduled into the future to be brought forward. Annexure G identifies the possible additional capital works that could be achieved based on this increase in revenue.

What happens if Council doesn't adopt a Special Rates Variation?

Apart from the deteriorating financial position (which can be clearly seen in the above TCORP ratio chart), the effect on the ground will need to be a reduction in service levels. This entails a review of the level of service provided, for example, revisiting what size or height a particular bridge is, and reducing the bridge to a causeway if a bridge is higher than the particular service level. This process is difficult and will require sacrifice, particularly for rural residents. If this does not happen, Council will find itself in a position where the backlog grows and the quality of the average asset will deteriorate (as is already starting to become evident). The Asset Management Plans also identify this trend.

Why should Council apply for a Special Rates Variation now?

The IP&R framework, as well as the TCORP and the Independent Review Panel reports, have come as a big shock to the majority of Councils, and have resulted in a realisation across the industry that Councils are in a poor and deteriorating position. This has been exacerbated by a number of factors outside of a Council's individual control but will, with all probability, be left up to individual Councils to resolve. It would

be unwise to continue to argue that the industry, State Government or the Commonwealth Government should intervene. The industry trend appears to be to push Councils that are unsustainable (particularly in Queensland) to amalgamate. Therefore, it is important for this Council to act to address its financial sustainability. If amalgamated, it is likely that a rate increase would follow regardless, but in that instance the likelihood of ratepayers' money being spent in this Local Government Area is reduced.

Combination of Special Rates Variation and LIRS loan;

Scenario 5 includes an application for a LIRS loan of \$4 million dollars. The reason for this suggestion is that the additional loan funding (if successful) will be subsidised at 3%, resulting in an effective interest rate of around 2%. This will allow Council to address (bring forward) a number of critical infrastructure projects, which would otherwise have been completed in future years.

A particular focus suggested by Council staff would be the Nine Mile Bridge and a number of other timber bridges in a deteriorating state (bearing in mind a bridge can cost in the order of \$500,000 to \$600,000 to construct).

Adopting a Special Rates Variation:

The intention of this business paper report and the attached Annexures is to address the request by Council in May 2012 (RESOLUTION 5.05/13) to investigate the possibility of a special rates variation.

It is suggested that Council digests the information in this report and adopts the suggested Scenario 5 and the associated Special Rates Variation for Community Consultation. This would allow the Community to provide feedback regarding the possible increase, and Council to adjust or modify the scenarios to account for those suggestions, if appropriate.

It is further suggested that Council notifies IPART of its intent to apply for a Special Rates Variation by 13 December 2013. Then, subject to Community Consultation, a final LTFP will be adopted at an Extraordinary Meeting to be held in late February 2014. This is necessary to approve the possible application prior to the closure of the Special Rates Variation applications on 24 February 2014.

Therefore, it is suggested that Council approves this above-explained process to allow Community Consultation to progress, and that the various deadlines be met. The approval of a Special Rates Variation would require the review of Council's Asset Management Plans, as well as the Delivery Program.

It should be noted that the application process involves a significant amount of work, and will involve Councillors and Council staff dealing with the difficult questions from Community members. It is appreciated that this will be the case, and from various sources it has been made clear that this is a heart wrenching process. Therefore, Council staff only make this recommendation based on the longer-term good of the community. Reasonable alternatives have been considered, and the suggestion is not made lightly.

(a) Governance/Policy Implications

Nil.

(b) Legal Implications

Nil.

(c) Social Implications

The ability for the community to pay for a Special Rates Variation should be considered. The imposition has been spread over three (3) years for farmland. However, it is for Council to consult with the Community regarding its ability to pay, the need for improved roads, and the longer term financial sustainability of this currently autonomous Council.

(d) Environmental Implications

Nil.

(e) Economic/Asset Management Implications

The asset management implications combined with the Community's ability to pay, are the key concerns. The need for additional revenue to maintain Council's infrastructure is evident. The implications of the additional funding will be further discussed in the reviewed Asset Management Plans to Council. The possible implications are identified in Annexure E. However, these works are reliant on the allocation of funds and therefore will be subject to Council's review of works, both in the annual budgets and the reviewed Asset Management Plans.

CONCLUSION

In the attached discussion paper Council has been presented with five (5) scenarios, that are aimed at addressing the poor TCORP ratios identified in Council's TCORP review released in March this year. These ratios identify the need for Council to increase its funding to renew and properly maintain its infrastructure assets, and this has been the primary goal of the reviewed LTFP scenarios, along with achieving an operating surplus.

Each of the five (5) scenarios has its merits. However, Scenario Five (5) is the recommended option, based on the ability to bring forward capital works while maintaining strong ratios throughout the life of the plan. This recommended scenario includes a Special Rates Variation.

Council requested Council staff to investigate the impact of a special rates variation on its longer term financial sustainability. Community consultation is an important next step as part of the IPART approval process. Ultimately, Councillors are in the best position to develop an appropriate understanding of the issues at stake, and to make the required decisions.

RECOMMENDATION

- 1. That Council notes the information in the body of this report, in conjunction with Annexures E, F and G, and in particular the effect on the TCORP financial and infrastructure ratios of the five (5) different scenarios discussed.***
- 2. That Council, in principle, adopts Scenario 5 as its preferred option for consultation with the Community.***

3. *That Council notes the deadlines to IPART for the notification and application of a Special Rates Variation; being 13 December 2013 and 24 February 2014 respectively.*
4. *That Council requests the General Manager to notify IPART of the intent to apply for a Special Rates Variation by 13 December 2013; recognising that a process of Community consultation will follow after this mentioned date.*
5. *That Council requests the Director of Corporate and Community Services to make the necessary arrangements for Community consultation sessions throughout the Local Government Area towards the end of January and beginning of February 2014, to properly inform the Community of the effect and extent of the proposed Special Rates Variation.*
6. *That Council requests the Director of Corporate and Community Services to amend Council's Delivery Program in order to reflect the effect of the proposed Special Rates Variation in this document.*
7. *That Council requests the Director of Infrastructure Services to revisit and revise Council's Road Infrastructure Asset Management Plans for the December 2013 Ordinary Council Meeting – identifying the effect of the proposed Special Rates Variation on these Plans.*
8. *That Council approves for an Extraordinary Meeting to be held on 20 February 2014 to consider the revised Long Term Financial Plan, including a Special Rates Variation, in its final format.*
9. *That Council requests the Director of Infrastructure Services to prepare an application for round three (3) of the Local Infrastructure Renewal Program for \$4 million to address the state of Council's local bridge infrastructure.*

Annexure E

Glen Innes Severn Council Meeting

28 NOVEMBER 2013

2013

Long Term Financial Plan - Discussion Paper

Councillor Workshop – 14 November 2013



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SCENARIO PLANNING / DISCUSSION PAPER

The Long Term Financial Plan (LTFP) is continually updated to consider numerous scenarios for the funding of operating and capital expenditure. This requires detailed forecasts of all sources of operating revenue and expenditure, to derive the maximum surplus available to fund Council's rolling program of capital investments in new or refurbished infrastructure. These forecasts consider changes in price levels for individual items, as well as the benefits of ongoing productivity improvements.

In this scenario development process, assumptions are based on forecasts of inflation, rates revenue, labour award increases and workforce planning assumptions, timing and value of major assets sales, major projects and policy changes.

All scenarios are assessed using the objective tests of financial sustainability, and a conclusion reached after wide consultation with senior management, Councillors and the public as to the optimal LTFP proposal. In the current LTFP planning process, these considerations have resulted in five (5) scenarios being considered. These are:

- Scenario 1 – Base Case Scenario
- Scenario 2 – Implementation of a Special Rate Variation for three (3) years
- Scenario 3 – Special Rates Variation and Local Infrastructure Renewal Scheme (LIRS) Loan
- Scenario 4 – Special Rates Variation and Unsubsidised Loan
- Scenario 5 – Special Rates Variation and Local Infrastructure Renewal Scheme (LIRS) Loan and Reduced Capital Expenditure

Scenario 1: Base Case

Introduction

The base case scenario identifies the expected position adopting the current revenue and expenditure projections only. It should be noted that the current "base case" scenario has changed when compared with the current adopted LTFP Scenario 3 – which was adopted on 28 June 2012.¹

¹ Adopted by Council at the June 2012 ordinary meeting

The adjustments of note are as follows:

- 1) It is no longer expected that the Financial Assistance Grant (FAG) and the Roads to Recovery (R2R) grant revenue will increase any more than the Consumer Price Index. In the original plan, an increase of 25% in R2R funding was expected in the 2014/15 financial year, and the Financial Assistance Grant was expected to increase by 4%, with a 20% increase in the 2014-15 financial year.² This adjustment has been reviewed and, after meeting with the NSW Grants Commission, it is not expected that significant grant increases are likely to materialise. This represents a deterioration of approximately \$866,500 per annum;³
- 2) In regard to capital expenditure, \$1 million in capital expenditure was originally budgeted for the Swimming Pool Infrastructure Renewal. This estimate has been increased to \$1.5 million. The Central Business District infrastructure upgrade budget of \$1.8 million, as well as the accelerated road funding of \$2 million, has also been left in the base scenario. In saying that, the associated interest rates and loan terms have been adjusted to reflect the approval of the LIRS projects;
- 3) The 2012/13 and 2013/14 actual and budgeted figures have been included in the new long term financial plan;
- 4) The basic assumptions (such as expenditure increases and revenue increases) have been reviewed based on an additional year's worth of results;
- 5) The effect of the aerodrome and the associated capital works and grant revenues have been consolidated into the plan – These arose after the original adoption of the plan;
- 6) The effect of the closure of the Long Day Care Service at Gum Tree Glen and the associated changes have been accounted for in this plan;
- 7) Council has identified the actual required capital works for infrastructure assets, and these have been included in the LTFP to identify the true funding position for infrastructure assets.

These adjustments, in particular the reduction in the FAGS and the R2R funding, have made a significant difference to Council's projected position. The net result was a deterioration in Council's operating position, which will have a significant impact on Council's ability to meet the goal of a sustainable operating surplus within the next three (3) years.

A reduction in the Financial Assistance Grant and Road to Recovery Grant Increases

The reason for the removal of the FAGS and the R2R increases are largely due to a meeting between Council and the NSW Grants Commission on 21 October 2013. In this meeting it was identified that there is unlikely to be any significant increase in

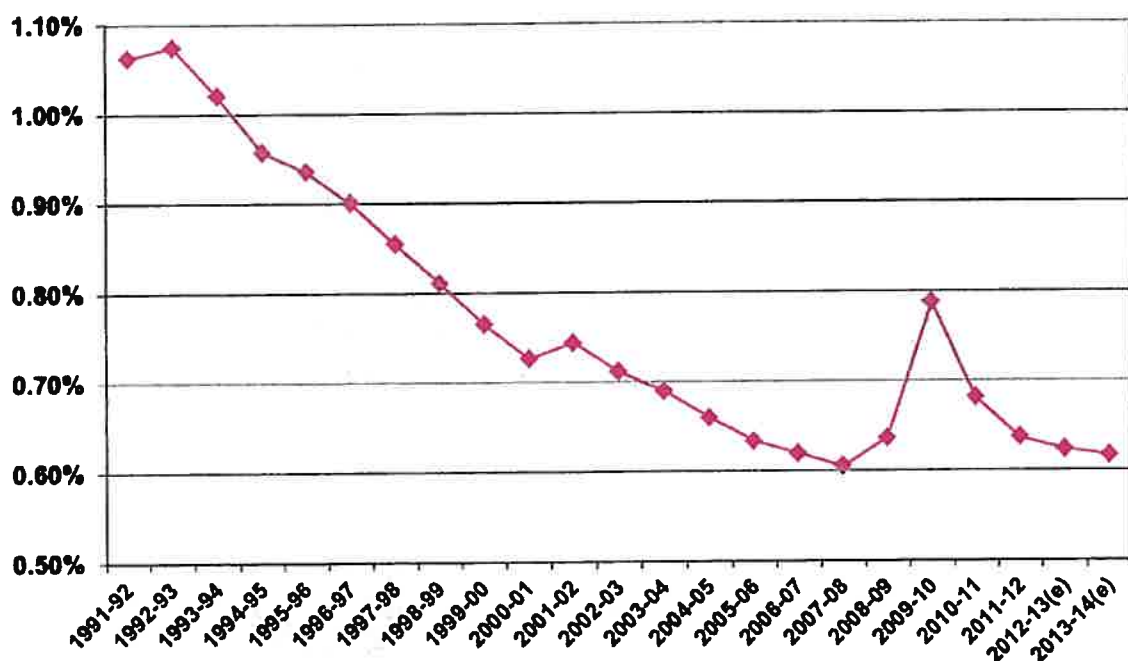
² The Financial Assistance Grant represents \$3,575,000 in grant funding per annum. The Road to Recovery Grant represents \$606,000 in grant funding per annum.

³ The NSW Grants Commission does not administer the Roads to Recovery Grant. However, at this stage it is unlikely that there will be any significant increases associated with this programme.

grant funding in future years. Further, if an increase does materialise, it is likely to be the removal of the minimum per capita rate from the Financial Assistance Grant calculation. A removal of the minimum per capita rate would see a reduction in grant revenue to city councils, with an increase in funding to rural councils such as Glen Innes Severn Council. However, this would require a Commonwealth law change, which is unlikely. If the law change does materialise, the increase is expected to be in the order of \$300,000. This would still not provide a balanced budget, and therefore relying on an increase in grant revenue to 'save' Council would be unproductive and unrealistic.

A copy of the presentation made to Council by the Grants Commission is attached as Annexure A.

Of particular note is a graph from the presentation indicating the proportion of Commonwealth revenue that the FAG represents. The spike in the graph in 2009/10 and 2010/11 was due to a significant decrease in Commonwealth revenues in the Global Financial Crisis, not due to a significant increase in funding.

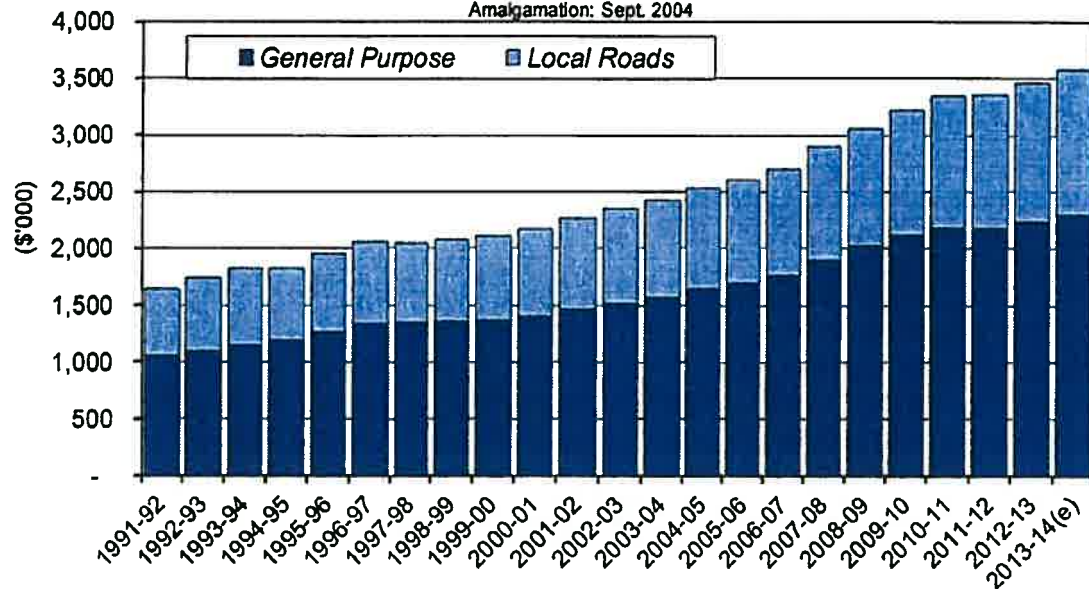


A further graph of note is the comparison of the Financial Assistance Grant entitlement for Glen Innes Severn Council from 1991-92 to 2013-14. It is assumed that the earlier years would include the consolidated amount received for the Severn Shire and Glen Innes Municipal Councils. The Graph shows a gradual increase, suggesting that it is unlikely that there would be any sudden or significant increases. In fact, it should be noted, that due to low population growth, the increase in FAGs for the current financial year is less than the State average. Therefore, on this basis it is argued that the increases in this grant are likely to continue at a similar rate to the Consumer Price Index.

FAGs: Glen Innes Severn

Estimated Entitlement for 2013-14: \$3,575,261

Amalgamation: Sept. 2004



A change in the estimate for the Glen Innes Swimming Pool

The estimate for the swimming pool upgrade, as well as the loan to fund the swimming pool improvements, has been increased from \$1 million to \$1.5 million. This estimate is based on the interim reports provided regarding the swimming pool. It should be noted that this expenditure will largely represent a renewal of the infrastructure (operating room, pool lining etc) rather than enclosing the pool. In addition, further improvements are proposed, such as a wet deck for children. However, the exact details will be confirmed once the proper investigations have been completed.

At this stage, there is no suggestion to enclose the Glen Innes Swim Centre for year round operation. To do so would significantly increase the capital outlay (in the order of an additional \$2.5 million to \$4.5 million would be required to enclose the pool).⁴ It should also be noted that enclosing the Glen Innes Swim Centre would increase the number of people attending. However, as the pool is currently operating at a loss in the summer months, it is expected that enclosing the pool would result in an increased operating loss. In this regard, it should also be noted that the operating cost (the difference between operating revenue of \$85,000 and the operational expenditure of \$598,974) for both the Emmaville and Glen Innes Swimming pool is budgeted this financial year at \$513,974. Although the Emmaville Pool represents in the order of \$120,000 of this loss, extending the swimming season for the Glen Innes Swim Centre is likely to result in a significant increase in operational costs.⁵

⁴ This estimate has been established by researching nine (9) aquatic centre feasibility studies across Australia.

⁵ At this stage it is hard to estimate a change in operating expenditure, as any improvements are only at a preliminary planning stage.

Therefore the idea of enclosing the swimming pool would require not only a significant initial capital outlay (which would need to be funded from loan funds), but also a significant increase in operational costs.

The current capital expenditure will also be targeted to reduce water wastage and electricity costs, which will hopefully result in other operational savings. These are hard to quantify at this stage.

The effect of the aerodrome and the associated capital works and grant revenues have been consolidated into the plan

At around \$3.5 million, the grant and contribution revenue associated with the aerodrome development is significant. The development will also save in the order of \$120,000 per annum in reduced operational costs (excluding depreciation of \$120,000 per annum), due to the day to day management being handed over to the Australia Asia Flight Training group (AAFT). There is also likely to be additional revenue in user charges for the Water and Sewer fund, but these are hard to quantify at this stage.

This grant revenue is budgeted to be received in the current financial year and, as can be seen from all the prospective scenarios, the expected increase in grant revenue is very significant. However, one should realise that this is a one off transaction, and will only have reasonably minor ongoing impacts in regard to Council's operating position. It should also be noted that the expected revenues are spent on capital expenditure; therefore the financial benefits at this stage are limited to a minor annual improvement in the operating position.

Estimates have been made to incorporate the impact of the Aerodrome development into all proposed scenarios. The wider economic effect has not been considered in this LTFP.

The impact of the closure of Gum Tree Glen and the associated changes have been accounted for in this plan

At the time of the previous Long Term Financial Plan no suggestions to close Gum Tree Glen had been costed into the adopted scenario. The savings identified in the original reports and the cost of the operation of the Out of School Hours Service and Early Intervention Centre have been included in this plan.⁶

⁶ As adopted by Council in the April 2013 Ordinary Council meeting (Resolution 5.04/13).

Council has identified the actual required capital works for infrastructure assets and these have been included in the LTFP to identify the true funding position for infrastructure assets

One of the more significant changes in this reviewed plan is the change in projected capital expenditure. The capital expenditure identified in this plan exceeds that of the original plan, which included a reasonably conservative capital expenditure schedule.

The total capital expenditure can be compared as follows:

	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)
ORIGINAL PLAN	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23		
Total Capital Expenditure	3,640	5,861	3,301	4,337	3,903	4,442	3,490	3,533	3,588	N/A		
Loan Funding		2,000		1,000		1,000				N/A		
Base Capital Expenditure	3,640	3,861	3,301	3,337	3,903	3,442	3,490	3,533	3,588	N/A		
SCENARIO 1: BASE CASE												
Total Capital Expenditure	7,407	5,777	4,310	4,447	5,102	4,749	4,905	5,064	5,235	5,372		
Loan Funding		2,500										
Base Capital Expenditure	7,407	3,277	4,310	4,447	5,102	4,749	4,905	5,064	5,235	5,372		
VARIANCE	3,767	(584)	1,009	1,110	1,199	1,307	1,415	1,531	1,647	N/A		
Adjustment for Shortfall in Cash Year on Year	N/A	(1,000)	(1,034)	(1,069)	(1,105)	(1,143)	(1,182)	(1,222)	(1,264)	N/A		
Actual Affordable Capital Expenditure	N/A	2,277	3,276	3,378	3,996	3,606	3,723	3,842	3,971	N/A		
Depreciation												
Expected Asset Expenditure Ratio (taking into account shortfall in cash)	N/A	5,140	5,167	5,196	5,227	5,258	5,291	5,326	5,362	N/A		
	N/A	44%	63%	65%	76%	69%	70%	72%	74%	N/A		

The vast majority of these capital increases are in respect of road and road related infrastructure, which has been identified as an area of particular focus. The amounts required for road infrastructure, drainage works, water and sewer related infrastructure are derived from the required annual capital expenditure, as well as the asset management plans. The aim of Council is to achieve asset renewal ratio of 1:1 (or 100%), thereby ensuring that Council renews all of its critical infrastructure assets. The impact of the increased capital expenditure is discussed further below. It is appreciated that the asset renewal ratio and asset expenditure ratio are separate ratios. However, as new asset expenditure has not been identified for the life of the plan, Council should target an asset expenditure ratio of 1:1 with all capital works being renewals of existing assets. This would also equate to a 1:1 asset renewal ratio. It should be noted that the TCORP ratio's for asset renewal and asset expenditure are different (1:1.1 for asset expenditure and 1:1 for asset renewal).⁷ In our particular case, it is not suggested that a 1:1.1 ratio is appropriate as population growth, and therefore demand growth is much lower than 10% per annum. One would expect that the appropriate asset expenditure ratio would be 100%, to ensure that all assets are renewed, while a premium for population and demand growth would be in the order of one to three percent (1 – 3%) in this Local Government Area.

In regard to the shortfall in cash per annum, this amount has been estimated based on the reduction in cash on the balance sheet for the base case scenario. It is only an estimate, but will be reasonably accurate in terms of what is affordable. The same capital expenditure (apart from major projects) has been used between all the scenarios, to ensure that senior staff/Councillors are "comparing apples with apples." Comparing scenarios where different base line capital expenditure amounts are used will not accurately reflect our true position. The capital expenditure amounts between the Base Case Scenario and the Special Rates Variation with LIRS Scenario are further considered below.

⁷ Page 7, Treasury Corporation New South Wales, Glen Innes Severn Council – Financial Assessment Benchmarking Report, release 21 March 2013, available at <http://www.dlg.nsw.gov.au/dlg/dlghome/documents/tcorp/Glen%20Innes%20Severn%20Financial%20Assessment%20Report.pdf>

Please review the "Base Case" scenario Income Statement and Balance Sheet attached as Annexure B.

Please note in particular:

Income Statement

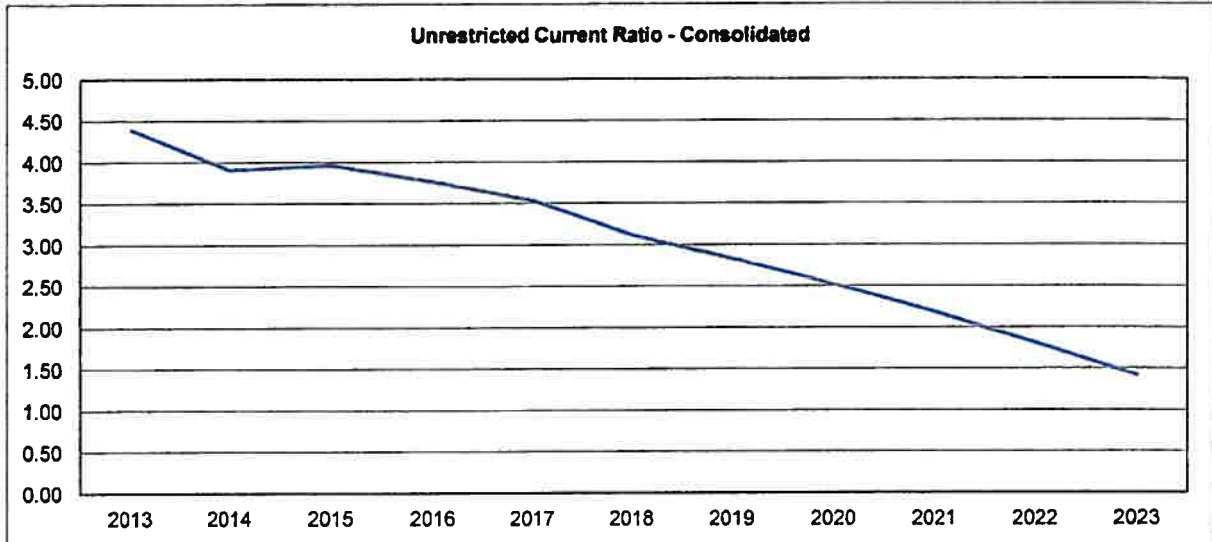
- 1) Poor operating position – Council will not achieve an operating surplus within three (3) years. The Income Statement (consolidated) identifies a continuing deficit in the order of (\$500,000) to (\$700,000) per annum. This is comprised of a water fund surplus of around \$120,000, a sewer fund surplus of \$80,000, the quarry fund (Glen Innes Aggregates) at around \$150,000 and the general fund at a deficit of around (\$1 million).**
- 2) The imbalance between the profitable water, sewer and quarry fund when compared with the unprofitable general fund indicates that additional revenue streams should be sourced for the general fund.**
- 3) The risk of 'losing' the water and sewer fund to a County Council would result in this position deteriorating significantly.**
- 4) The overall position suggests that Council is not funding its depreciation.**

Balance Sheet

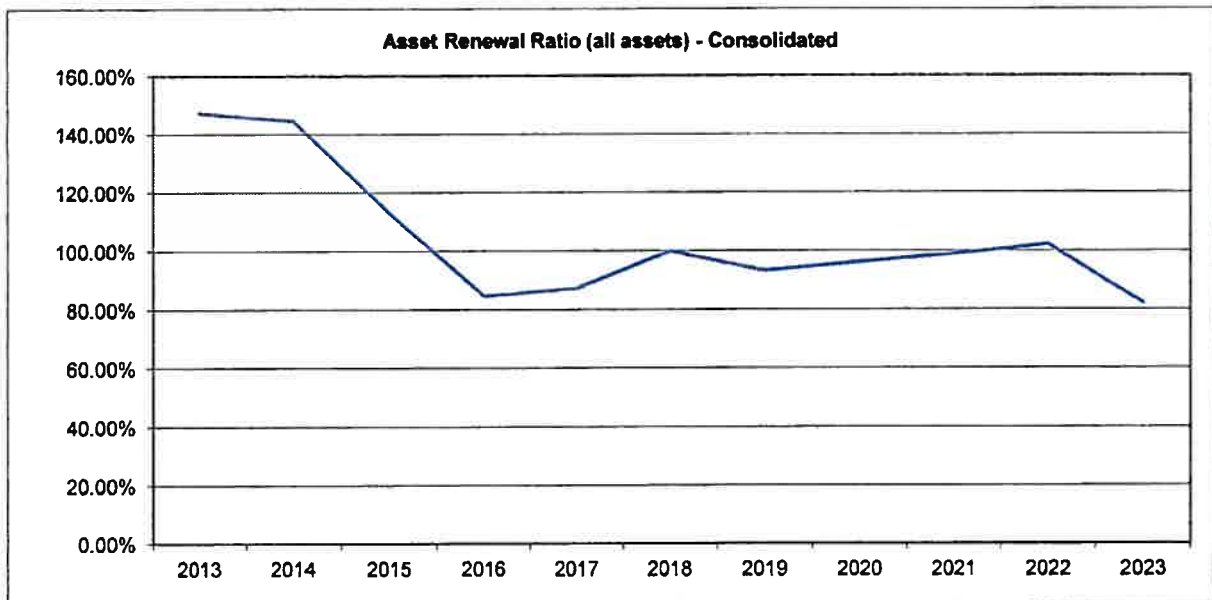
- 1) Deteriorating cash position – the consolidated balance sheet shows a reduction in Cash and Cash Equivalents from \$13.687 million this financial year to \$5.801 million in the 2022/23 financial year. This is a greater concern than the operating position, and would forecast shortfalls of cash well below a reasonable limit. Therefore Council would need to reduce capital expenditure in the order of \$1 million per annum to address this deterioration. This would effectively require returning to the original capital works schedule, which would not address the required capital works for road infrastructure and will result in an increasing roads backlog.**
- 2) Therefore, Council could maintain the status quo and adopt the base case scenario, but it would not address any of the significant concerns regarding asset conditions, particularly roads.**

Key Ratios and Graphs

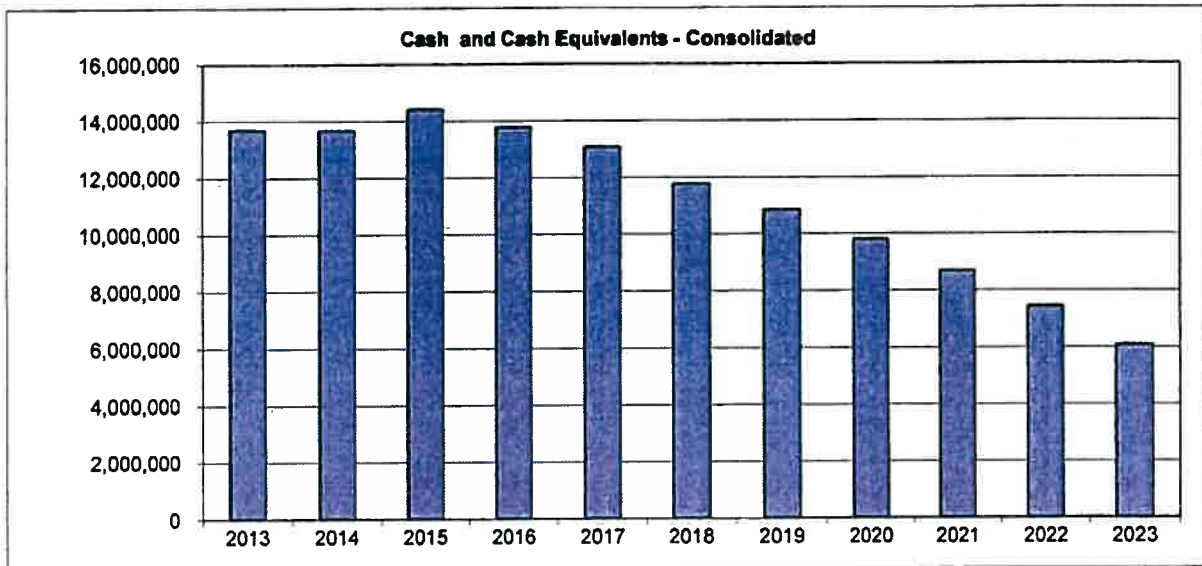
- 1) The deteriorating cash position suggests that Council's cash expenditure is too high to be sustainable on this basis. The reason for this, as indicated above, is the higher capital expenditure programme. The Unrestricted Current Ratio identifies this trend well:



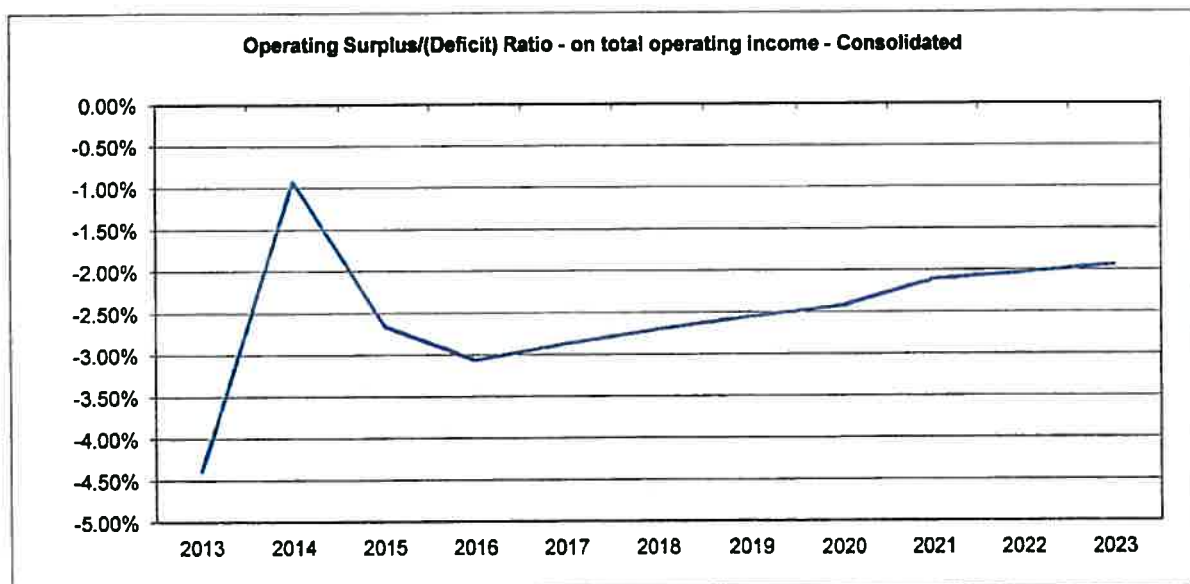
- 2) As indicated above, due to the increased capital works programme, the Asset Renewal Ratio is sitting at a reasonably healthy position (between 80% and 100% for future years). As also indicated above, due to the deteriorating cash position, this capital expenditure will need to be reduced by approximately \$1 million per annum. Therefore, this ratio would reduce by approximately 20% and would sit between 60% and 80%. The required TCORP ratio for asset renewal is 100%.



- 3) The Cash and Cash Equivalents – Consolidated Graph also indicates a decrease in the cash position:



- 4) The Operating Surplus/Deficit Ratio Graph indicates that although the position improves slowly, Council would not reach a break even operating position for the life of the plan:⁸



⁸ Interestingly, the TCORP ratio identified for the operating Surplus/Deficit is greater than (4%). Therefore, in the latter part of the plan, Council would achieve this position. Realistically, an operating position of (4) % would not allow sufficient asset renewals, nor would it address the infrastructure backlog. A recent IPWEA conference identified that an operating ratio of around 5% would be optimal.

Revenue Forecasts

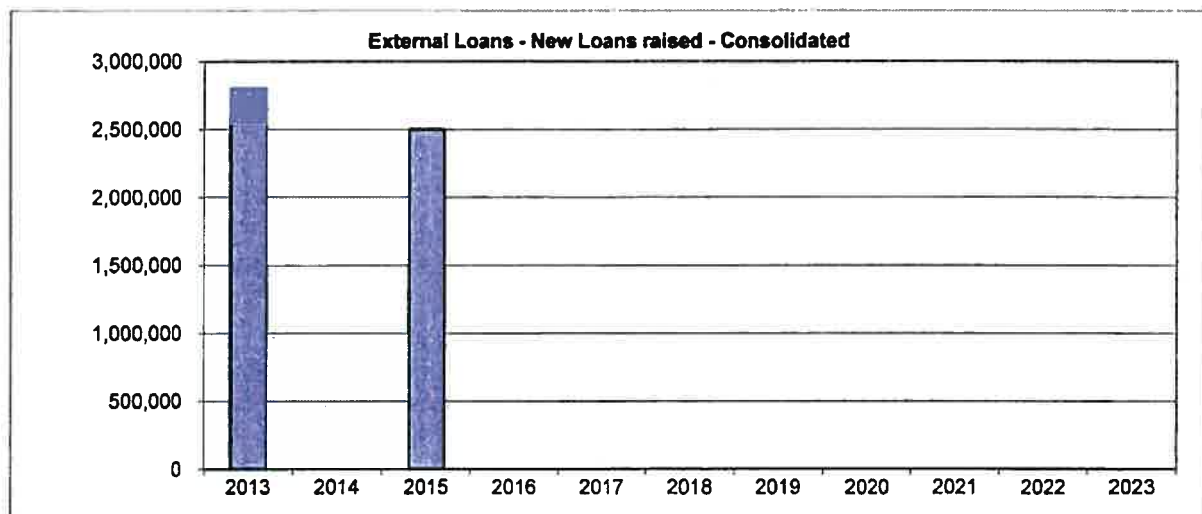
Rates and Annual Charges

No changes – only increases in the Rate Peg amount are recognised.

Loans and Major Projects⁹

As indicated above, the swimming pool projection has been increased from \$1million to \$1.5million. The renovations are to be paid from \$1.5million in loan funding, identified in the 2014/15 financial year. A further \$1million (for which Council has received LIRS funding) will also be drawn in the 2014/15 financial year for the acceleration of various critical road projects.¹⁰

No further loans have been incorporated into the equation as was done in the original plan, which had a further \$1million in road projects every second year.



Conclusion

This scenario can be adopted by Council with an adjustment in total capital expenditure. This adjustment will reduce capital expenditure to approximately what was identified in the original Long Term Financial Plan. This capital expenditure is not sufficient to meet the requirements identified by TCORP in regard to asset renewal.¹¹ The plan will also not achieve Council's adopted goal of achieving an operating surplus within three (3) years. Therefore, further scenarios have been developed, investigating the possibility of a special rates variation.¹²

⁹ The \$2.8million identified in 2013 was in respect of the two LIRS projects (the CBD infrastructure upgrade at \$1.8million and the Accelerated Road Programme at \$1million).

¹⁰ Council adopted a resolution approving the execution of an Agreement for the \$1million Accelerated Roads LIRS programme (resolution 25.09/13).

¹¹ As indicated above, TCORP has identified an Asset Renewal Ratio of 100% and an Asset Expenditure Ratio of 110%.

¹² As requested by Council (Resolution 5.05/13); "That Council requests that the Director of Corporate and Community Services to research and present a report to Council by November 2013; exploring options and identifying the benefits of implementing a Special Rate Variation for the 2014/15 Financial Year."

Scenario 2: Special Rate Variation Scenario

Introduction

This Special Rate Variation Scenario represents the base case scenario with additional revenue from a suggested special rate variation. The suggested special variation breakdown is identified below. An increase in annual service charges for the Water and Sewer Fund has also been identified, to match revenue with the required capital expenditure and loan repayments of both the water and sewer fund.

This scenario was developed because it is of paramount importance to find additional funding, in order to maintain Council infrastructure assets to service levels identified in earlier 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 its desired level.

The Special Rate Variation Scenario of the LTFP shows the financial results of increasing rates above the rate peg limit in years 1, 2 and 3 which remain permanently in the rate base.

Special Rate Variations¹³

Special variations provide an opportunity for councils to vary their general income by an amount greater than the annual rate peg.

The Independent Pricing and Regulatory Tribunal (IPART) will assess and determine special variation applications by councils under powers delegated by the Minister for Local Government. These powers include:

- setting the annual rate peg based upon an IPART-published Local Government Cost Index and productivity factor; and
- assessing and determining applications for special variations.

Special variations are an important means of providing additional funding to councils to deliver services and infrastructure that the community has requested and the council is unable to fund within its existing revenue.

The reasons why an individual council may require a special variation are wide and varied. Special variations do not have to be tied to a particular project or series of projects.

There are two special variation options under the *Local Government Act*. When seeking a special variation, councils may apply for:

- a one-off percentage increase under section 508(2); or

¹³ Information sourced from NSW Government, Division of Local Government; "Guidelines for the Preparation of an application for a special variation to general income for 2014/15". Available at: <http://www.dlg.nsw.gov.au/>

- multi-year percentage increases (of between two and seven years) under section 508A.

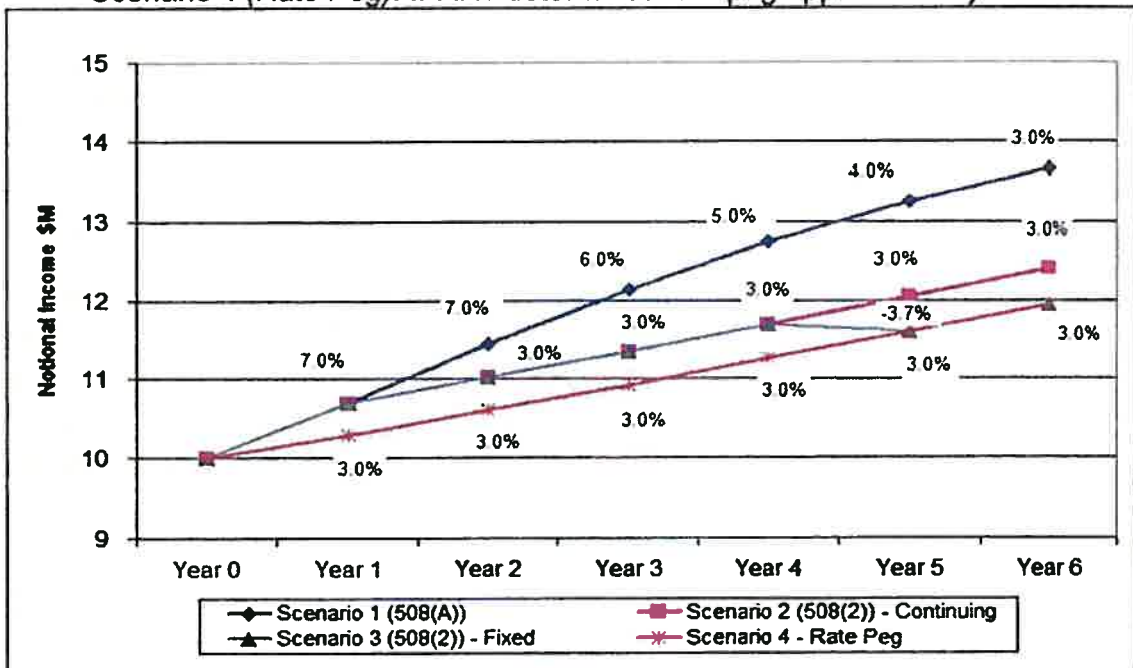
The type of special variation that is appropriate for each council will be determined by the revenue requirements of the council, as outlined in the adopted Long Term Financial Plan. This will depend on a number of factors including:

- the size of the variation required;
- the reason for the variation;
- the need for the increase to be ongoing or for a fixed term;
- the 'lumpiness' of expenditure over time;
- the financial objectives of the council;
- the rate at which council wishes to recover its costs.

It is important to understand the difference between each type of variation and the impact each will have on a council's financial position, the provision of services and the ability of ratepayers to pay the additional rates.

In general, a council's general income could follow one of four paths:

- Scenario 1 (*s508A of the Local Government Act*): Successive annual percentage increases (for between 2 and 7 years), which remain permanently in the rate base;
- Scenario 2 (*508(2) continuing*): a one-off (single year) percentage increase that remains permanently in the rate base;
- Scenario 3 (*508(2) fixed for x years*): a one-off (single year) percentage increase that remains in the rate base for x years. At the end of the fixed period the rate base is adjusted to match the rate peg path; or
- Scenario 4 (*Rate Peg*): IPART determined rate peg applies each year.



Suggested format of a Special Rates Variation:

The suggested special rate variation would follow Scenario 1 as described above, and therefore section 508(A) of the Act. The reason for this suggestion is that for Council to arrive at the suggested quantum of the special rates variation (as identified below) the increase in the farmland rate class would be significant. Where increases are significant it is not prudent to increase rates in one (1) year only, as this tends to make the increase harder to adjust to for ratepayers.

For this reason the suggested variation has been made over three (3) years for farmland.

It is also suggested that the amount is retained in the rate base indefinitely, as the entire aim of this variation is to balance the budget (and thereby ensure financial sustainability). If Council were to seek the variation for a particular project or series of projects it should only apply for a temporary rate variation. This is not the aim of this suggested variation; therefore a temporary rate variation is not suggested.

However, one could argue that if Scenario 3 or 4 from the LTFP were adopted (which include a \$4million loan) that this should be funded by a temporary rate increase. This is a valid argument, but in truth, when considering the other aim of balancing the operational budget, the rate variation serves a dual purpose. The reason for bringing forward the \$4million in capital works is to address the critical infrastructure, such as bridges and roads, which are a risk to Council. After the repayment of this loan, the additional funds that are freed from loan repayments will be spent on addressing renewals and perhaps even a portion of the infrastructure backlog.

Two (2) options for 'phasing in' the Special Rates Variation are identified below. In saying that, Council should discuss these options and, if appropriate, identify new options or more appropriate options based on the community's ability and willingness to pay, balanced with the looming 2020 deadline for Financial Sustainability and Amalgamation.

Suggested Quantum of a Special Rates Variation;

To arrive at the suggested special rates variation percentages, Council's staff have reviewed has reviewed the Long Term Financial Plan and have attempted to "balance the budget". To do so based on the current projections Council would require between \$800,000 and \$1 million per annum. Council staff then reviewed what would be affordable based on the latest (2011/12) average Division of Local Government rating comparative information, as well as the district average which identified (as per the attached Annexure C) that bringing rates to the regional average would raise in the order of \$800,000 in additional rates.

The figure of \$800,000 to \$900,000 (at today's values) has been identified as the suggested amount for which a special rate variation should be applied. This amount

is significant in respect of Council's current rating base, and therefore it is suggested that this increase be implemented over a few years.

The main goal here is to balance the budget. A balanced budget will result in the order of \$1,000,000 in additional Capital Works per annum. This will require a Capital Works Plan that clearly identifies the benefit the Community will receive from this increase.

This amount is significant and is not suggested lightly.

Ability to pay;

The ability of the Community to pay for a special rates variation is an important consideration. This is very difficult to measure. The increased suggested rates are identified in the table (Page 23 below). Option 1 has been costed into the Long Term Financial Plan. The increase per day for Farmland is on average \$1.94 in the 2016/17 financial year, whilst the increase on Residential properties will be around 17 cents per day. This amount is spread in quarterly instalments as with all rates, and will assist to some extent in making the amount affordable.

The suggested increases have been balanced with the regional average as identified in the attached annexure, and this does suggest some level of fairness. However, Council should discuss and consider the affordability of this increase and the quantum of the variation. The variation amount has been identified primarily on the grounds of financial sustainability and achieving a balanced budget within three (3) years.

Increase in Water and Sewer Annual Charges;

In conjunction with the suggested increase in rates, the financial modelling has identified that additional revenue would be required for both the water and sewer fund to break even on a cash in/cash out basis.

Clearly, the Income Statement projections for the water and sewer fund indicate that the funds will make operating surpluses. Even so, due to recent significant loan funding, additional funds are required to offset the loan repayments, while ensuring that capital renewal remains at the 1:1 ratio or better.

This increase is suggested, as reducing infrastructure renewal would be counterproductive particularly where a significant backlog exists (\$6.3 million in deferred renewals). The suggested increases are identified (Page 25 and 26 below) and are spread over three (3) years at 4%, 3% and 3% respectively above the Consumer Price Index. If the fees are not increased, capital works should be reduced by approximately \$100,000 per fund.

Capital Expenditure in this Scenario:

Apart from having a balanced budget, the major benefit of the Special Rate Variation Scenario is the increased capital expenditure associated with the Scenario.

The total capital expenditure can be compared as follows;

	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23		
SCENARIO 1: BASE CASE	N/A	2,277	3,276	3,378	3,996	3,606	3,723	3,842	3,971	N/A		
Depreciation	N/A	5,140	5,167	5,196	5,227	5,258	5,291	5,326	5,362	N/A		
Expected Asset Expenditure Ratio	N/A	44%	63%	65%	76%	69%	70%	72%	74%	N/A		
SCENARIO 2: SRV	7,407	3,277	4,310	4,447	5,102	4,749	4,905	5,064	5,235	5,372		
Depreciation	N/A	5,140	5,167	5,196	5,227	5,258	5,291	5,326	5,362	N/A		
Expected Asset Expenditure Ratio	N/A	64%	83%	86%	98%	90%	93%	95%	98%	N/A		
Variance	N/A	20%	20%	21%	22%	21%	23%	23%	24%	N/A		

The vast majority of these capital increases are in respect of road and road related infrastructure, which has been identified as an area of particular focus. As indicated by the expected Asset Expenditure Ratio, the Special Rates Variation Scenario is very close to meeting the required renewal ratio of 100%. This would be a very healthy ratio for Council to maintain. With the projected sale of other Council properties' it is possible that Council will in future years meet the targeted 100% renewal ratio.

Why the sudden focus on sustainability and asset renewal?

Council aims to spend its depreciation amount every year in capital expenditure. This (as can be seen from the TCORP ratios) is accepted practice, and is how asset renewal is measured. It is a difficult concept to understand, particularly due to the common tax concept of depreciation, which is simply a tax write off and increasing depreciation results in reduced tax. Council does not pay income tax, and increasing depreciation means that Council's operating position will deteriorate. The depreciation concept in Local

Government is an estimate of the actual cost of Council's total assets that are consumed in each financial year. Therefore, if one was to spend that amount each and every year (or on average) one would achieve a stationary position in respect of asset deterioration. In the past Council has struggled to maintain a satisfactory ratio, simply because of insufficient money to do so. The aim of this scenario is to bring Council closer to this required ratio. Hand in hand with this additional funding, it is also imperative that hard decisions are made on service levels and which assets Council should maintain. Therefore, the basic idea is that Council should only use as many assets as are absolutely necessary for proper operation and to cater for future population growth.

The entire notion of cash funded depreciation is relatively recent in NSW Local Government Circles. In past years, Councils across the State did not accurately reflect the cost of such assets, nor did they consider the cost of maintaining them (the lifecycle cost). The process only truly commenced in full swing in July 2006, when the former Department of Local Government mandated that NSW Councils commence valuing infrastructure, property, plant and equipment at fair value, in accordance with Australian Accounting Standard AASB 116, "Property, Plant and Equipment".¹⁴

This valuation requirement was introduced using a staged approach. The first asset class to be re-valued at fair value was water supply and sewerage services assets. This was required by 30 June 2007. The 'fair valuation of assets' is basically the practice of stating an asset at its depreciated replacement cost. Therefore, the recognised cost of assets on the balance sheet should be representative of today's cost (to construct the asset again) less the depreciation amount (an estimate of the true reduction in value or the deterioration to date) rather than the historic cost (what Council paid for it at the time of construction in 1900).¹⁵ This is amazing, particularly given the fact that Local Councils are very asset 'heavy' compared with any other industry. Perhaps one of the more comparable industries would be farming, where farmers have significant assets (are asset rich) but are cash poor, as the return on the significant assets is low. Therefore, a large portion of 'profit' relates to the underlying increase in the farmers' land, not necessarily to the immediate cash return.

Therefore Council's true position (or at least more representative position) only became apparent in the 2012 financial year. After this point, Council has been reducing expenditure and reviewing what its core functions are. This has led to difficult decisions, not only for the Glen Innes Severn Council but for all Councils in NSW. The revaluations also identified that the industry was in poor shape, and this realisation later triggered the TCORP review and the various investigations and inquiries into NSW Councils' sustainability.

¹⁴ See Division of Local Government Circular No. 12-09.

¹⁵ This is the basic practice for infrastructure assets where there is no active market. This represents the majority of Council's assets.

Please review the "Special Rates Variation" scenario Income Statement and Balance Sheet attached as Annexure D.

Please note in particular:

Income Statement

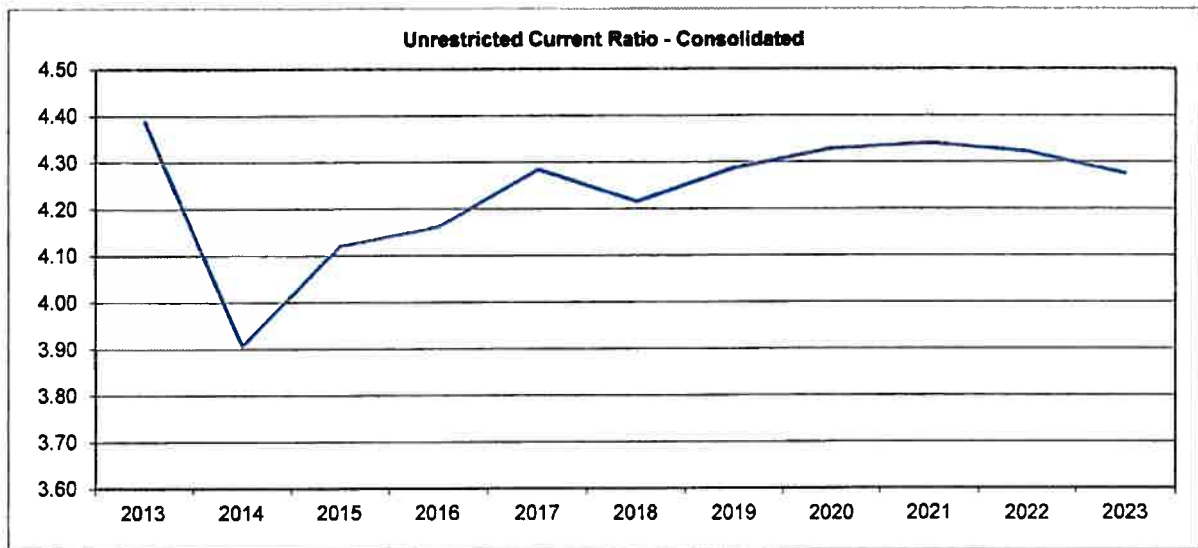
- 1) Reasonable operating position – is likely to achieve an operating surplus within three (3) years. The Income Statement (consolidated) identifies an operating surplus from year three (3) onwards, increasing over the life of the plan. This is comprised of a water fund surplus of around \$200,000, a sewer fund surplus increasing to around \$200,000, the quarry fund (Glen Innes Aggregates) at around \$150,000 and the general fund breaking even in the 2017/18/ or 2018/19 financial year.
- 2) The break even general fund indicates that Council will achieve a more balanced position. This should be compared with the imbalance between the profitable water, sewer and quarry fund and the unprofitable general fund in the Base Case scenario.
- 3) The risk of 'losing' the water and sewer fund to a County Council would result in a deteriorated position. However, the result of this loss would now not be as significant as in the Base Case scenario, because the General Fund itself is also balanced.
- 4) The overall position suggests that Council is funding its depreciation, but is still not providing sufficient funding to address the infrastructure backlog (or the deferred infrastructure renewals).

Balance Sheet

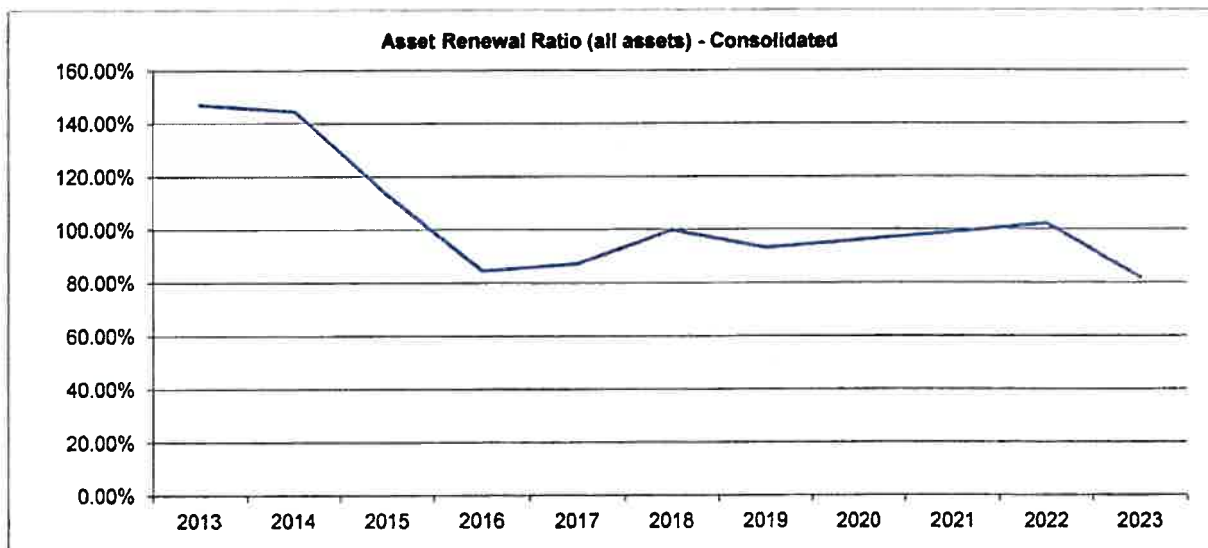
- 1) Improving cash position – the consolidated balance sheet shows an increase in Cash and Cash Equivalents from \$13.687 million this financial year to \$16.152 million in the 2022/23 financial year. This suggests that the capital expenditure identified is affordable, and sits in stark contrast to the Base Case scenario.
- 2) Therefore, Council could adopt this scenario but it would still require additional funding to address the identified infrastructure backlog of \$29.5 million in the 2011/12 financial year.

Key Ratios and Graphs

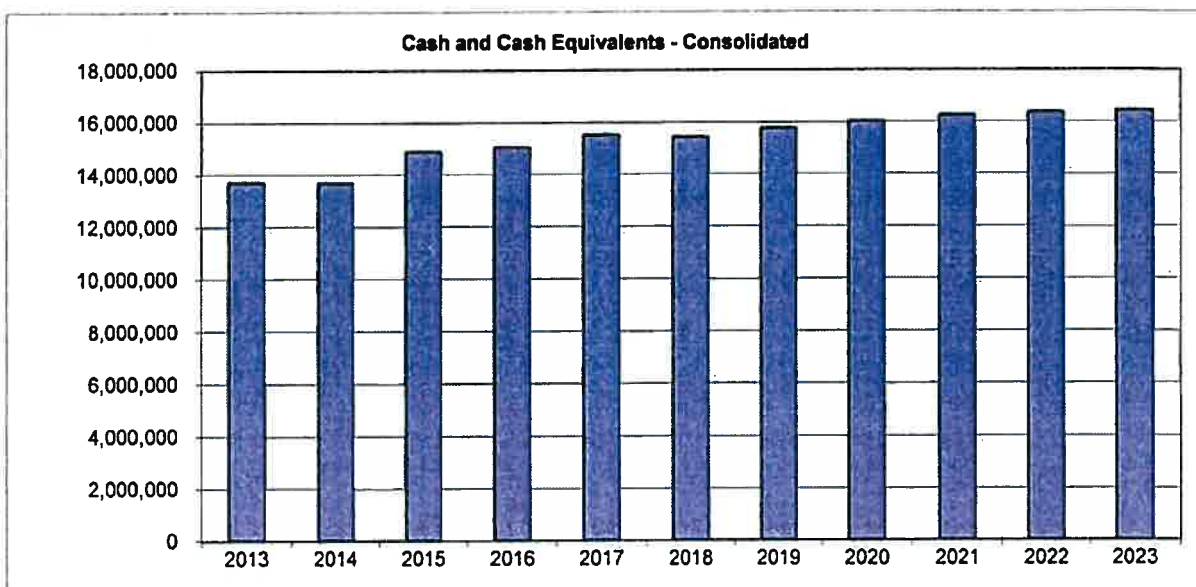
- 1) The improving cash position suggests that Council's capital expenditure programme would be affordable with this Scenario. The Unrestricted Current Ratio identifies this trend well:



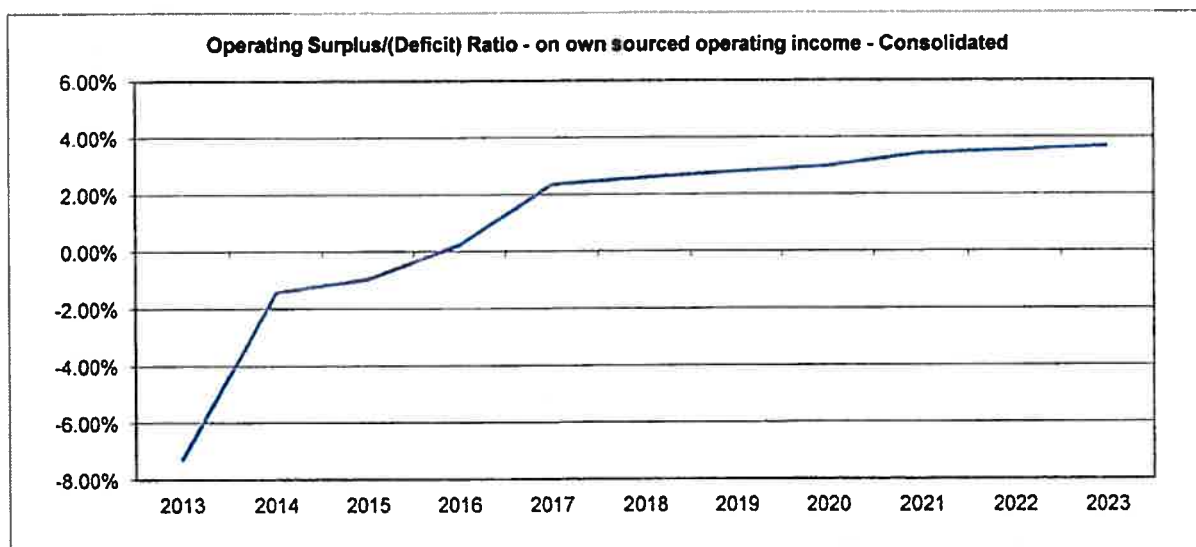
- 2) Due to the increased capital works programme, the Asset Renewal Ratio is sitting at a reasonably healthy position (between 80% and 100% for future years). The required TCORP ratio for asset renewal is 100%.



- 3) The Cash and Cash Equivalents – Consolidated Graph below indicates an improvement in the overall cash position:



- 4) The Operating Surplus/Deficit Ratio Graph indicates that the operating position improves quickly in the years that are affected by the Special Rate Variation,(SRV) and that an operating break even position is achieved in three (3) years:



Revenue Forecasts

Rating Revenue and a Special Rate Variation

The primary target for rate increases is farmland rates. The reason for this is that the Glen Innes Severn Local Government Area enjoys some of the best farmland and climatic conditions in the northern regional area (Bingara, Walcha, Uralla, Kyogle, Armidale, Guyra and Inverell), and therefore it is reasonable to bring farmland rates to the regional average.

The current lower than average farmland rates are also partly due to rate increases below the rate peg amount for the Severn Shire Council in earlier years. These reduced increases, which were arguably justifiable at the time, have compounded over the years and in part have exacerbated the infrastructure backlog.

The second suggested increase would target residential properties to bring them to the regional average.

General rates categories (Residential/Farmland) have been increased above the rate peg limit by the following amounts:

Rates category	YEAR		
	2014/15	2015/16	2016/17
Residential	10.00%	0%	0%
Business	0%	0%	0%
Farmland	10.00%	10.00%	10.00%
Mining	0%	0%	0%
Rates category - Residential			
Year	Rate Peg	Special Variation	Increase in Rates
2013/14	3.4%	0%	3.4%
2014/15	3.4%	10.00%	13.40%
2015/16	3.4%	0%	3.4%
2016/17	3.4%	0%	3.4%
2017/18	3.4%	0%	3.4%
2018/19	3.4%	0%	3.4%
2019/20	3.4%	0%	3.4%
2020/21	3.4%	0%	3.4%
2021/22	3.4%	0%	3.4%
2022/23	3.4%	0%	3.4%
Rates category - Farmland			
Year	Rate Peg	Special Variation	Increase in Rates
2013/14	3.4%	0%	3.40%
2014/15	3.4%	10.00%	13.40%
2015/16	3.4%	10.00%	13.40%
2016/17	3.4%	10.00%	13.40%
2017/18	3.4%	0%	3.40%
2018/19	3.4%	0%	3.40%
2019/20	3.4%	0%	3.40%
2020/21	3.4%	0%	3.40%
2021/22	3.4%	0%	3.40%
2022/23	3.4%	0%	3.40%

The average rate payable per assessment, depending on the rate peg amount, is estimated to be as follows:

Option 1 – as suggested above

Rates category	YEAR					
	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Residential (RATE PEG)	545.63	565.27	584.49	604.36	624.91	646.16
(SRV)	545.63	565.27	584.49	662.81	685.35	708.65
Variance	-	-	-	58.45	60.44	62.49
Average \$/day	0.00	0.00	0.00	\$0.16/day	\$0.17/day	\$0.17/day
Assessments	3,636	3,636	3,636	3,636	3,636	3,636
Revenue Raised	0	0	0	212,524.20	219,759.84	227,213.64
Farmland (RATE PEG)	1,875.85	1,943.38	2,009.45	2,077.78	2,148.42	2,221.47
(SRV)	1,875.85	1,943.38	2,009.45	2,278.72	2,584.06	2,930.33
Variance	0.00	0.00	0.00	200.94	435.64	708.86
Average \$/day	0.00	0.00	0.00	\$0.55/day	\$1.19/day	\$1.94/day
Assessments	1,016.00	1,016.00	1,016.00	1,016.00	1,016.00	1,016.00
Revenue Raised	0.00	0.00	0.00	204,151.28	442,614.59	720,200.64
TOTAL ADDITIONAL REVENUE RAISED				416,675.48	662,374.43	947,414.28

This option is suggested, as the increases are implemented relatively slowly across the Farmland rating base. This has been balanced with the need to achieve an operating break even position in three (3) years. In saying that, if Council were to entertain the idea of a SRV, Council should discuss and approve the quantum of the variation, the extent of the increases and the year in which those increases take effect.

The amount identified here has been calculated based on a break even position, balanced with bringing the rating categories up to the regional average.

Option 2 – Other option 15%, 10%, 5%

Rates category	YEAR					
	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Residential (RATE PEG)	545.63	565.27	584.49	604.36	624.91	646.16
(SRV)	545.63	565.27	584.49	682.81	685.35	708.65
Variance	-	-	-	58.45	60.44	62.49
Assessments	3,636	3,636	3,636	3,636	3,636	3,636
Revenue Raised	0	0	0	212,524.20	219,759.84	227,213.64
Farmland (RATE PEG)	1,875.85	1,943.38	2,009.45	2,077.78	2,148.42	2,221.47
(SRV)	1,875.85	1,943.38	2,009.45	2,379.19	2,698.00	2,924.63
Variance	0.00	0.00	0.00	301.41	549.58	703.16
Assessments	1,016.00	1,016.00	1,016.00	1,016.00	1,016.00	1,016.00
Revenue Raised	0.00	0.00	0.00	306,232.56	558,373.28	714,410.56
TOTAL ADDITIONAL REVENUE RAISED				518,756.76	778,133.12	941,624.20

It is possible to bring forward the increase in rates to ensure that Council has a better chance of achieving an operating surplus. Therefore this option (15% year 1, 10% year 2, 5% year 3 for farmland and 10% in year 1 for residential) could also be considered.

Water and Sewer Annual Charges

Water and Sewerage services charges have been increased by 4% in 2014/15, 3% in 2015/16, and 3% in 2016/17, over the standard CPI (3%) increase. Thereafter, a 3% (CPI) increase has been assumed for the term of the plan.

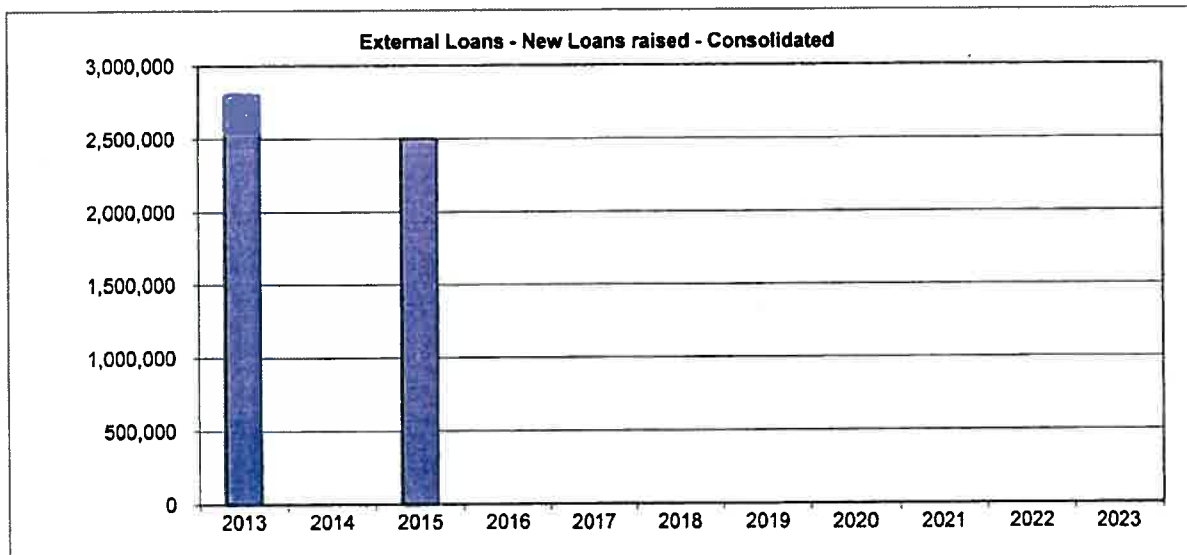
Service category	YEAR		
	2014/15	2015/16	2016/17
Water	4.0%	3.0%	3.0%
Sewer	4.0%	3.0%	3.0%
Service category - Water			
Year	CPI	LTFP Increase	Total Increase
2013/14	3.0%	0%	3.0%
2014/15	3.0%	4.0%	7.0%
2015/16	3.0%	3.0%	6.0%
2016/17	3.0%	3.0%	6.0%
2017/18	3.0%	0%	3.0%

2018/19	3.0%	0%	3.0%
2019/20	3.0%	0%	3.0%
2020/21	3.0%	0%	3.0%
2021/22	3.0%	0%	3.0%
2022/23	3.0%	0%	3.0%
Service category - Sewer			
Year	CPI	LTFP Increase	Total Increase
2013/14	3.0%	0%	3.0%
2014/15	3.0%	4.0%	7.0%
2015/16	3.0%	3.0%	6.0%
2016/17	3.0%	3.0%	6.0%
2017/18	3.0%	0%	3.0%
2018/19	3.0%	0%	3.0%
2019/20	3.0%	0%	3.0%
2020/21	3.0%	0%	3.0%
2021/22	3.0%	0%	3.0%
2022/23	3.0%	0%	3.0%

Loans and Major Projects¹⁶

As indicated in the Base Case Scenario, the swimming pool projection has been increased from \$1million to \$1.5million. The renovations are to be paid from \$1.5million in loan funding identified in the 2014/15 financial year. A further \$1million (which Council has received in LIRS funding) will also be drawn in the 2014/15 financial year for the acceleration of various critical road projects.¹⁷ The major projects are identical between the Base Case and Special Variation Scenarios.

No further loans have been incorporated into the equation, as had been done in the original plan, which had a further \$1million in road projects every second year.



¹⁶ The \$2.8million identified in 2013 was in respect of the two LIRS projects (the CBD infrastructure upgrade at \$1.8million and the Accelerated Road Programme at \$1million).

¹⁷ Council adopted a resolution approving the execution of an Agreement for the \$1million Accelerated Roads LIRS programme (Resolution 25.09/13).

Conclusion

This scenario indicates an improved cash position, a satisfactory operating position, and a balance between the general fund and the remaining funds, combined with a good asset renewal ratio. This scenario is a significant improvement on the Base Case Scenario, and will put Council in a very progressive situation in respect of asset renewal.

It should be noted that this scenario has a few weaknesses – it still does not address the infrastructure backlog (or deferred asset renewals), nor does it deal adequately with the infrastructure items (such as bridges) which are in a poor state and need to be renewed as a matter of urgency.

However, this scenario is definitely an improvement on both the previous Long Term Financial Plan and the Base Case Scenario.

Therefore, this option is a good scenario for Council to consider in its own right.

Scenario 3: Special Rate Variation Scenario and LIRS Loan

Introduction

This Local Infrastructure Renewal Scheme (LIRS) Loan Scenario combines the Special Rates Variation Scenario plus an additional \$ 4 Million loan drawn from the State Government's Local Infrastructure Renewal Scheme (LIRS). The reason this scenario has been prepared is to address any urgent backlog of works that have been identified as critical (such as the bridges in a poor state of repair). Therefore this scenario attempts to address this weakness in Scenario 2 - Special Rates Variation Scenario.

This plan also recognises the opportunity provided by the LIRS programme.

This scenario seeks to develop an adequate infrastructure maintenance and renewal program, to ensure that the community continues to be served by its assets at their desired level.

Why use LIRS funding?

The Infrastructure Backlog Audit recently completed by the Division of Local Government estimated that the infrastructure backlog in local communities in NSW is in excess of \$7billion. In recognising this increasing backlog in infrastructure renewal needs, the NSW Government is committing significant funding to help councils meet the cost of borrowing to fund the required works. The Local Infrastructure Renewal Scheme (LIRS) provides councils with a subsidy in interest costs, to make it affordable to take out major bank loans to fund their projects. This investment in debt funding has been proven to be far less expensive than paying for the long-term recurring maintenance requirements of deteriorating assets.¹⁸

The balance is easy to justify:

- 1) The interest rate subsidised at 3% would equate to around 2% in interest per annum. This is less than the Consumer Price Index for roads and road infrastructure. Therefore moving the work forward at that interest rate means Council is paying less to get the work done than if it had waited until the funds were available;
- 2) Not only does the work get more expensive, the requisite amount of maintenance for assets that are in this condition class is significantly more than would be for a new asset. Therefore Council is paying less in maintenance for the new asset.

However, the following must also be considered:

¹⁸ Division of Local Government Website, 'NSW Local Infrastructure Renewal Scheme' accessed at http://www.dlg.nsw.gov.au/dlg/dlghome/dlg_generalindex.asp?sectionid=1&mi=6&ml=22&AreaIndex=LIRS on 11 November 2013.

- 1) Only assets that are in advanced state of deterioration should be targeted, particularly those assets such as bridges where a failure or collapse could trigger a significant impact on the affected residents;
- 2) Assets should be replaced at an appropriate level of service – which is affordable as a whole. Therefore Council should not replace an asset where the overall maintenance cost of that service level exceeds Council's foreseeable affordable maintenance allowance. Therefore a bridge should be replaced with a causeway where a causeway would suffice in meeting the affordable service level;
- 3) Loan money is not free money, so the repayment of such will affect the availability of funds in future years.

LIRS funding quantum

Clearly bringing forward these works is a reasonable idea, and this funding will allow Council to address a large number of projects, in particular bridges, which are of concern. Bridges and other road projects are inherently expensive, and this necessitates the need for a reasonably significant loan. Based on the projects identified (which will require further investigation and approval by Council), a four million dollar loan has been costed into this scenario.

This should allow a large portion, if not all, of the most critical bridges to be repaired or replaced. There are 43 remaining timber bridges. Of these, the longer bridges present the largest dilemma in terms of replacement or rehabilitation, due to the extremely high costs associated with these works. For instance, to renew one (1) long 60 metre bridge can cost more than \$500,000 just for replacement of the superstructure. In comparison, Council's total R2R income is \$604,459 per annum. It is estimated that around ten (10) bridges will require substantial remediation or replacement within the next few years.

Four million dollars is a significant amount of money. However, this is relative to the size of the organisation. A four million dollar loan is approximately 17% of Council's annual revenue of \$24million. Therefore this would be equivalent to a person earning \$60,000 per year taking a loan of \$10,000. Therefore the amount in the scheme of things is not as significant as would first be thought. However, it is critical to realise that a ten (10) year loan of four million dollars will have a significant impact on Council's cash position, which must be monitored closely in this plan. It is also important to realise that this will have an impact on Council's debt service ratios. In this regard, the initial TCORP report indicated Council could borrow an additional \$4.8 million on top of the original \$2.8million LIRS loans for the CBD revitalisation and the \$1million accelerated road programme. An additional \$1million was approved above this amount for the next round of LIRS funding, and has also been costed into the plan. Therefore, the remaining available loan balance is approximately \$3.8million.

For obvious reasons, the initial Long Term Financial Plan that this amount was derived from has now been reviewed significantly. The amount of four million dollars would only be affordable in conjunction with a Special Rates Variation of the quantum identified in Scenario 2 above. It is expected that this amount will be affordable based on the reviewed plan. The reason Council is attempting to draw such a significant amount is due to the need to address a significant number of bridges of concern. The other reason is that aggregating the projects should allow Council to attract more (and perhaps more cost effective) tenders for the work identified.

Capital Expenditure in this Scenario

As with the Special Rate Variation Scenario, the major benefit of this scenario is the increased capital expenditure, which results in an improved renewal ratio.

The total capital expenditure (excluding loan funding expenditure) can be compared as follows;

	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)	\$ (000)
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	
SCENARIO 1: BASE CASE	N/A	2,277	3,276	3,378	3,996	3,606	3,723	3,842	3,971	N/A	
Depreciation	N/A	5,140	5,167	5,196	5,227	5,258	5,291	5,326	5,362	N/A	
Expected Asset Expenditure Ratio	N/A	44%	63%	65%	76%	69%	70%	72%	74%	N/A	
SCENARIO 3: SRV and LIRS	N/A	3,277	4,310	4,447	5,102	4,749	4,905	5,064	5,235	N/A	
Depreciation	N/A	5,140	5,167	5,196	5,227	5,258	5,291	5,326	5,362	N/A	
Expected Asset Expenditure Ratio	N/A	64%	83%	86%	98%	90%	93%	95%	98%	N/A	
Variance	N/A	20%	20%	21%	22%	21%	23%	23%	24%	N/A	

The vast majority of these capital increases are in respect of road and road related infrastructure, which has been identified as an area of particular focus. As indicated by the expected Asset Expenditure Ratio, the Special Rates Variation Scenario is very close to meeting the required renewal ratio of 100%. This would be a very healthy ratio for Council to maintain. With the projected sale of other Council properties, it is possible that Council will, in future years, meet the targeted 100% renewal ratio.

Revenue Forecasts

Rating Revenue and a SRV

As per Special Rates Variation scenario above.

Water and Sewer Annual Charges

As per Special Rates Variation scenario above.

Please review the "Local Infrastructure Renewal" Scenario Income Statement and Balance Sheet attached as Annexure E.

Please note in particular:

Income Statement

- 1) Reasonable operating position – Council is likely to achieve an operating surplus within three (3) years. However, the surplus would be less than the Special Rates Variation Scenario. The Income Statement (consolidated) identifies an operating surplus from year three (3) onwards, increasing over the life of the plan. This is comprised of a water fund surplus of around \$200,000, a sewer fund surplus increasing to around \$200,000, the quarry fund (Glen Innes Aggregates) at around \$150,000 and the general fund breaking even in the 2018/19 or 2019/20 financial year. Therefore the operating position is very similar to that of the Special Rates Variation Scenario, apart from the additional interest payable at 2% on the LIRS loan.
- 2) The break even general fund indicates that Council will achieve a more balanced position. This should be compared with the imbalance between the profitable water, sewer and quarry fund and the unprofitable general fund in the Base Case Scenario.
- 3) The risk of 'losing' the water and sewer fund to a County Council would result in a deteriorated position. However, the result of this loss would now not be as significant as in the Base Case Scenario, since the General Fund itself is also balanced.
- 4) The overall position suggests that Council is funding its depreciation, but is still not providing sufficient funding to address the infrastructure backlog (or the deferred infrastructure renewals).

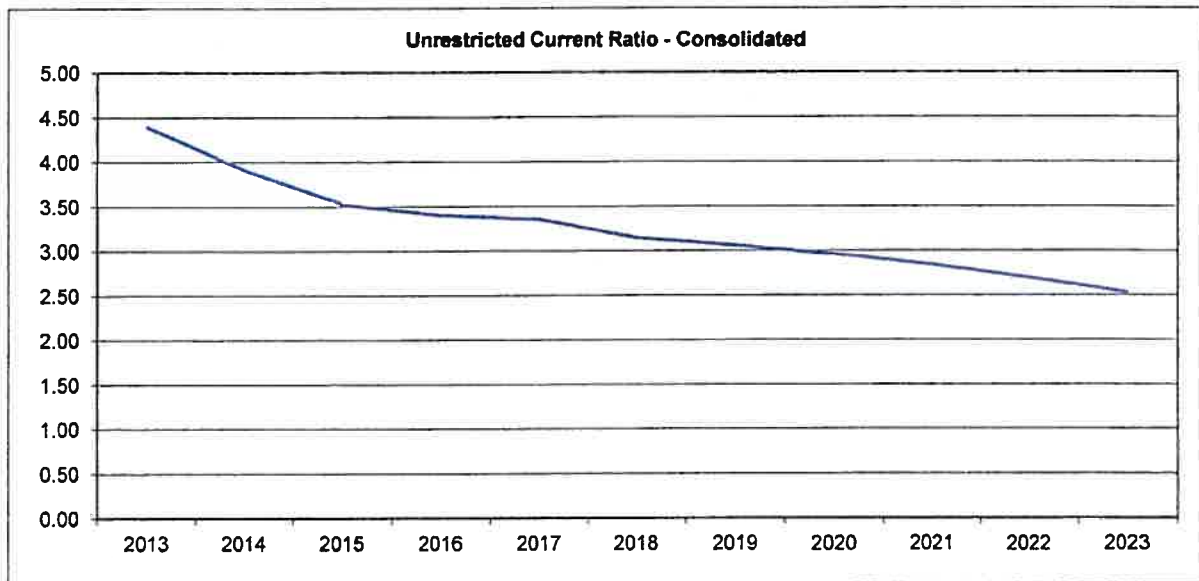
Balance Sheet

- 1) Deteriorating cash position – the consolidated balance sheet shows a decrease in Cash and Cash Equivalents from \$13.687 million this financial year to \$12.320 million in the 2022/23 financial year. This suggests that when compared with the Special Rates Variation Scenario identified above, the capital expenditure would need to be decreased to match the loan repayments and interest on the \$4million LIRS loan.
- 2) Therefore, Council could adopt this scenario, but it would still require additional funding to address the identified infrastructure backlog of \$29.5

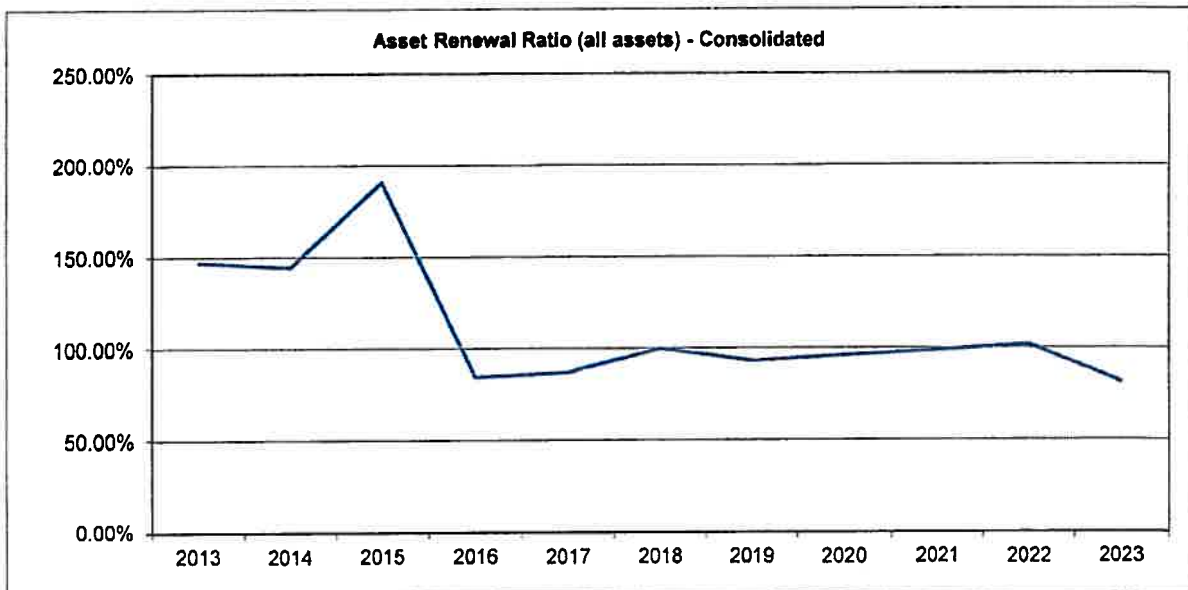
million in the 2011/12 financial year. The brought forward \$4million in capital works will address a portion of the infrastructure backlog. However, as Council's cash balance is decreasing, the scenario should really be amended to reduce capital expenditure.

Key Ratios and Graphs

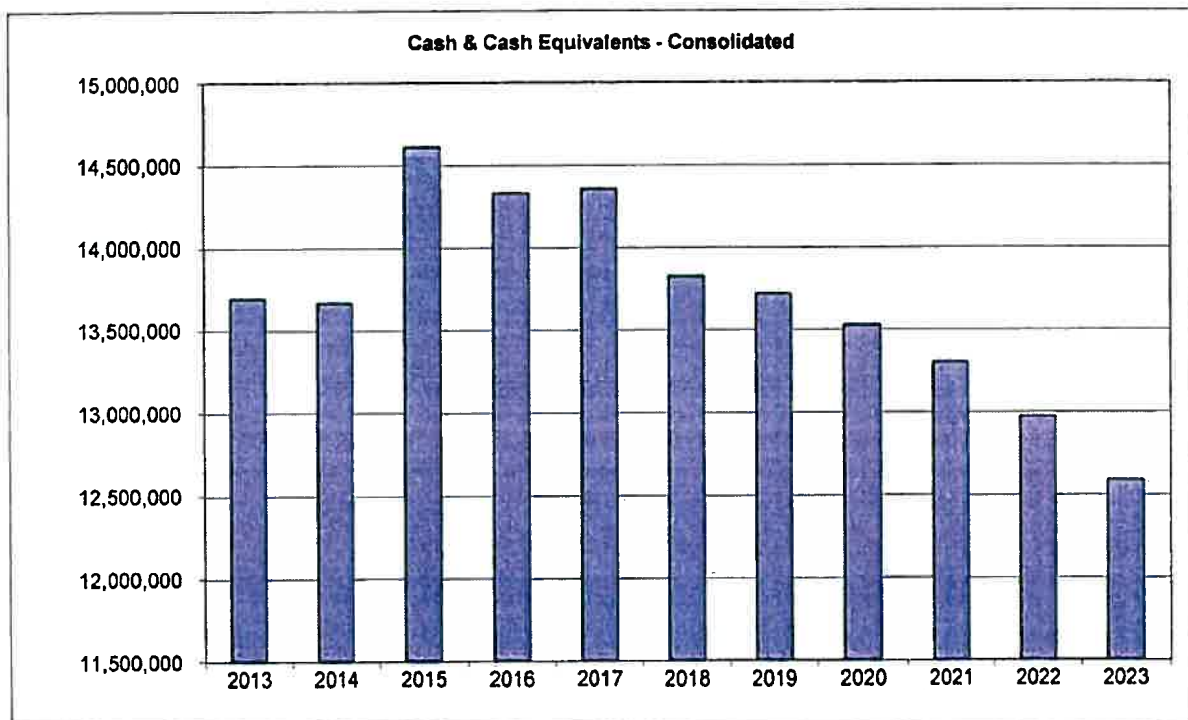
- 1) The deteriorating cash position suggests that Council's capital expenditure programme is too high combined with the additional loan repayments of the \$4million LIRS loan. The Unrestricted Current Ratio identifies this trend well:



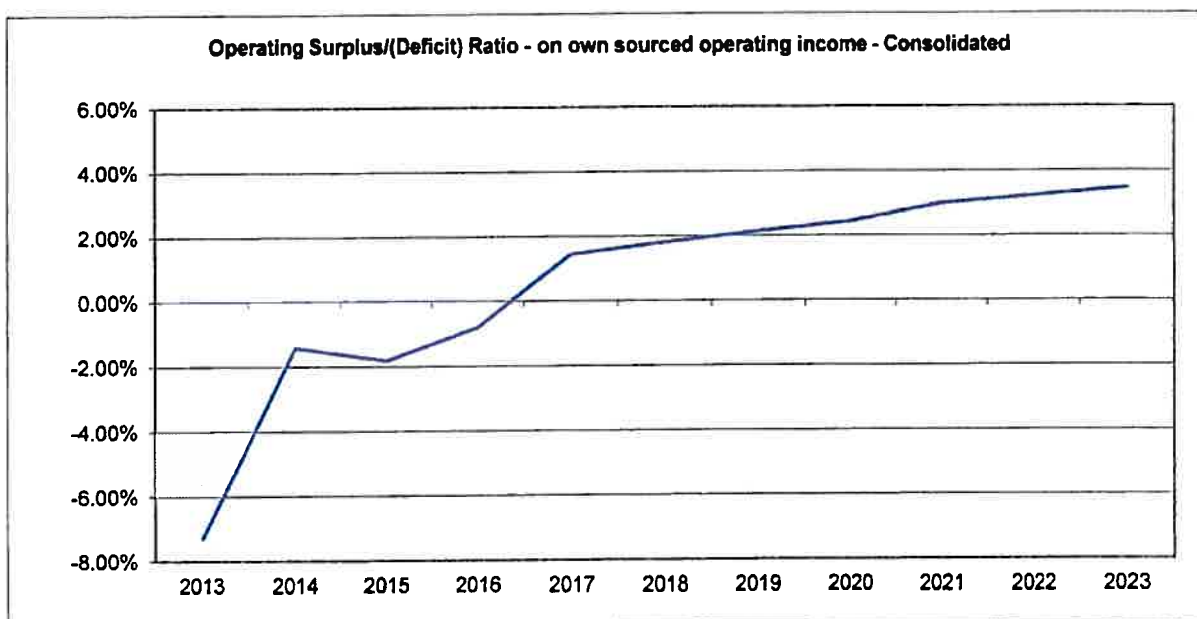
- 2) Due to the increased capital works programme the Asset Renewal Ratio is sitting at a reasonably healthy position (between 80% and 100% for future years). Due to loan funded works, the renewals in the first few years are well above the required TCORP ratio of 100%:



- 3) The Cash and Cash Equivalents – Consolidated Graph indicates a slow deterioration in the overall cash position (please note Y axis variance is less than other graphs):



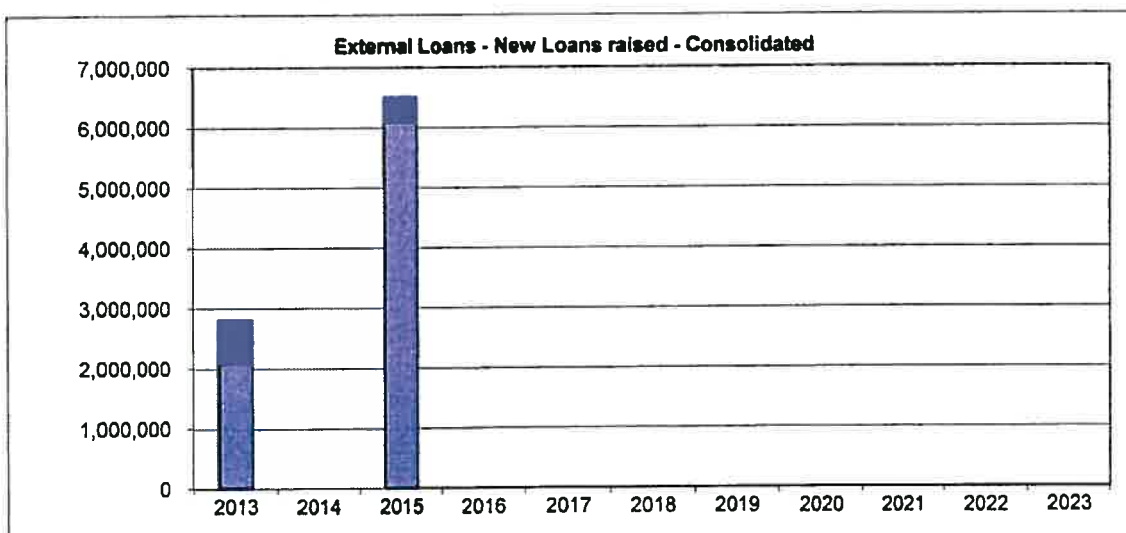
- 4) The Operating Surplus/Deficit Ratio Graph indicates that the operating position improves quickly in the years that are affected by the SRV, and that an operating break even position is achieved in three years:



Loans and Major Projects¹⁹

As indicated in the Base Case Scenario, the swimming pool projection has been increased from \$1million to \$1.5million. The renovations are to be paid from \$1.5million in loan funding identified in the 2014/15 financial year. A further \$1million (for which Council has received LIRS funding) will also be drawn in the 2014/15 financial year for the acceleration of various critical road projects.²⁰ The only difference between the Special Rates Variation (Scenario 2) and this scenario is the additional \$4million in loan funding for road projects in the 2014/15 financial year.

No further loans have been incorporated into the equation as had been done in the original plan, which had a further \$1million in road projects every second year.



¹⁹ The \$2.8million identified in 2013 was in respect of the two LIRS projects (the CBD infrastructure upgrade at \$1.8million and the Accelerated Road Programme at \$1million).

²⁰ Council adopted a resolution approving the execution of an Agreement for the \$1million Accelerated Roads LIRS programme (Resolution 25.09/13).

Conclusion

This scenario indicates a deteriorating cash position, a satisfactory operating position, and a balance between the general fund and the remaining funds, combined with a good asset renewal ratio. This scenario will address a number of critical infrastructure projects, which are of present concern. The only concern with this scenario is the fact that the cash position is deteriorating, due to the increased loan repayments.

This is a reasonable scenario apart from the reduction in cash and cash equivalents. This decrease can be addressed by a reduction in annual capital expenditure, to match the loan repayments and additional interest expense on the loan.

Based on this scenario two (2) additional scenarios were developed. The first was to answer the question of what impact an unsubsidised loan of the same amount would have on Council (Scenario 4 – Unsubsidised Loan \$4million), and the second what impact the four million dollar LIRS loan with reduced capital expenditure in future years would have (Scenario 5 – Local Infrastructure Renewal Scheme (LIRS) Loan and Reduced Capital Expenditure).

Scenario 4: Special Rate Variation Scenario and Unsubsidised Loan

Commentary

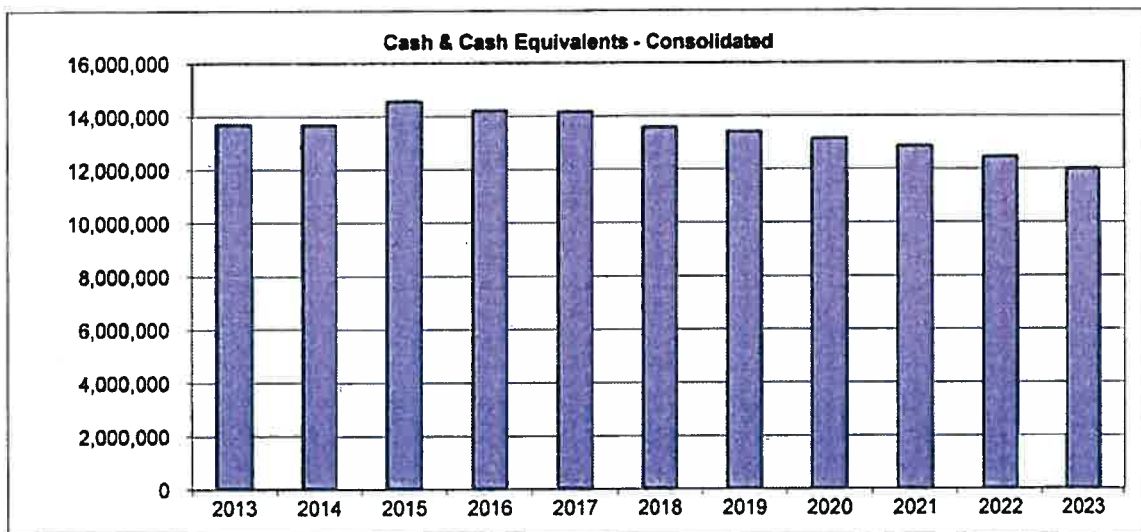
This scenario is identical to Scenario 3 (Special Rates Variation plus LIRS loan) except that the loan is unsubsidised, and therefore incurs interest at the estimated rate of 5% over ten (10) years. This should be compared with the estimated 2% of the LIRS loan. As the loan is for \$4million, this has a negative impact on the operating position. Further, the loan repayments, as well as the additional interest, also have a negative impact on cash flow.

This scenario has not been considered further, as even the subsidised loan will require modification to arrive at a realistic and healthy cash position. The projections associated with this scenario are attached as Annexure F.

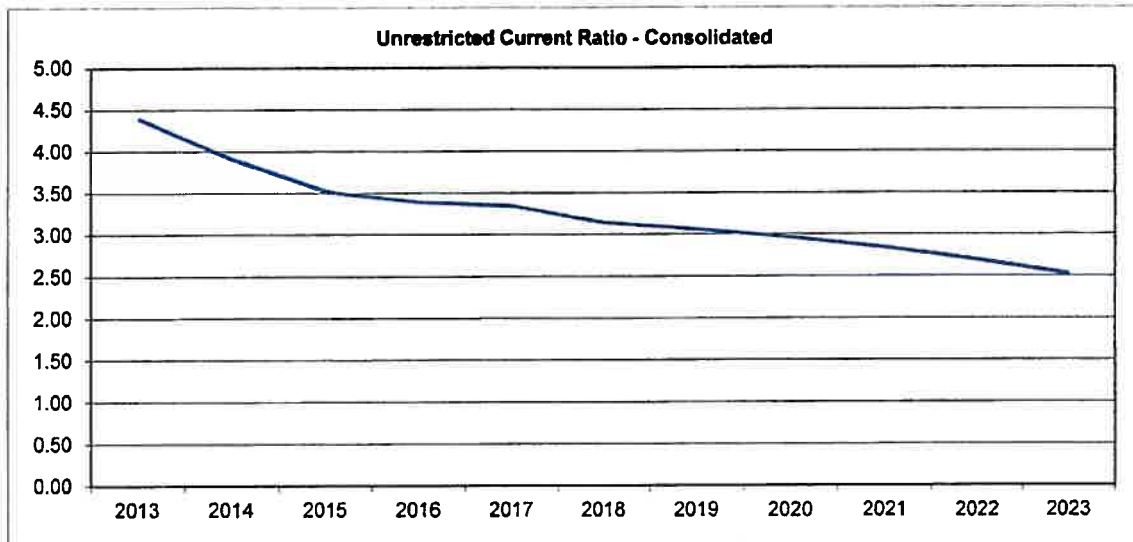
This scenario would need to be adjusted to reduce capital expenditure by the interest and principal repayments on the loan which, based on a \$4million loan for 10 years at 5%, would equate to approximately \$600,000 in the first year.

Please note the following:

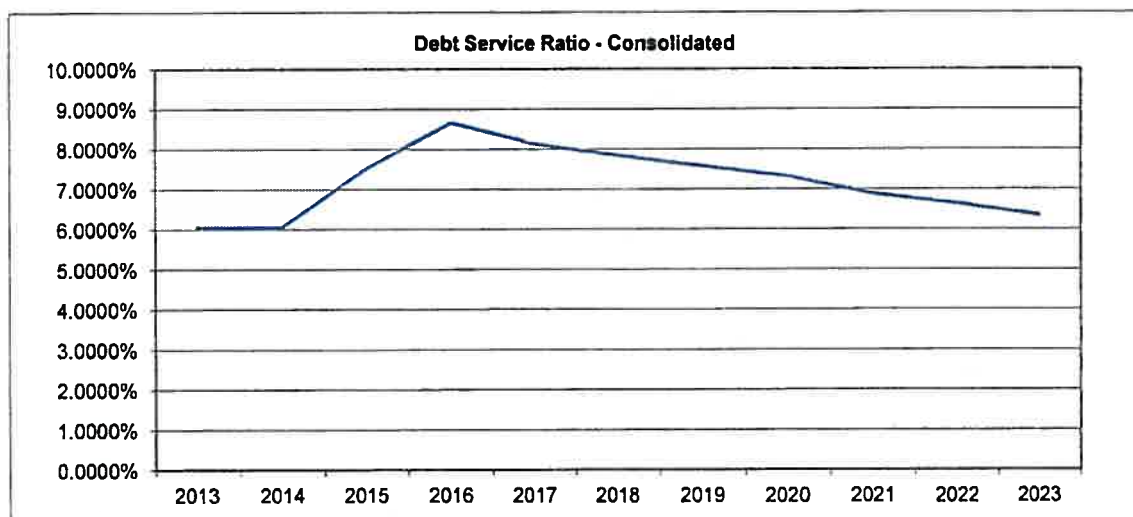
- 1) The cash position deteriorates over the life of the plan. This is not satisfactory, and capital expenditure would need to be adjusted to compensate.



- 2) The unrestricted current ratio deteriorates over the life of the plan – suggesting a reduction in liquidity.



- 3) The debt service ratio increases, but is still reasonable. Therefore the loan is affordable, but when combined with significant capital expenditure the combination of 'expenditure' is too high.



Conclusion

This scenario has been prepared in case Council adopts Scenario 3, but is not successful in obtaining the LIRS loan. This is a reasonable possibility, but should only be considered if Council's application for LIRS funding is not successful. Further, the scenario would need to be modified to reduce capital expenditure to ensure that Council is in a satisfactory cash position. This would lead to a reduced capital renewal ratio, which is not ideal. It may be more suitable to delay some urgent works and reduce the extent (or value) of the loan.

Scenario 5: SRV and Local Infrastructure Renewal Scheme (LIRS) Loan and Reduced Capital Expenditure

Introduction

This scenario is based on "Scenario 3 – Special Rates Variation and Local Infrastructure Renewal Scheme (LIRS) Loan", except the amount of capital expenditure allocated on an annual basis is reduced. The amount of capital expenditure has been reduced to compensate for the deterioration in the cash position associated with that scenario. The capital expenditure has been reduced by the amount of the loan and interest repayments on the four million dollar loan, to ensure that the loan has less impact on the cash position of Council.

Capital Expenditure in this Scenario

As with the Special Rate Variation Scenario, the major benefit of this scenario is the increased capital expenditure, which results in an improved renewal ratio. This is not as pronounced as Scenario 2, 3 and 4, but will ensure that the cash position for Council remains satisfactory while addressing the \$4million in bridgework required urgently.

The total capital expenditure (excluding loan funded expenditure) can be compared as follows:

	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23		
SCENARIO 1: BASE CASE											
Depreciation	2,277	3,276	3,378	3,996	3,606	3,723	3,842	3,971	N/A		
Expected Asset Expenditure Ratio	5,140	5,167	5,196	5,227	5,258	5,291	5,326	5,362	N/A		
	44%	63%	65%	76%	68%	70%	72%	74%	N/A		
SCENARIO 3: SRV and LIRS											
Depreciation	3,277	4,310	4,447	5,102	4,749	4,905	5,064	5,235	5,372		
Expected Asset Expenditure Ratio	5,140	5,167	5,196	5,227	5,258	5,291	5,326	5,362	N/A		
	64%	83%	86%	98%	90%	93%	95%	98%	N/A		
SCENARIO 5: SRV and LIRS reduced capital expenditure											
Depreciation	2,835	3,868	4,005	4,660	4,307	4,463	4,622	4,793	4,930		
Expected Asset Expenditure Ratio	5,140	5,167	5,196	5,227	5,258	5,291	5,326	5,362	N/A		
	55%	75%	77%	89%	82%	84%	87%	89%	N/A		

As indicated, in Scenario 5 the Asset Expenditure Ratio is lower than Scenario 3. However, the ratio is still strong compared with earlier years.²¹ However, it should be noted that the TCORP ratio for asset renewal is 100%.

²¹ Asset Renewal Ratios for earlier year are as follows: 2008 – 84.67%, 2009 – 39.54%, 2010 – 7.37%, 2011 – 56.67%, 2012 – 55.09%, 2013 – 89.24%