GWYDIR SHIRE COUNCIL

LONG TERM FINANCIAL PLAN 2016 - 2017

“To be the recognised leader in Local Government through continuous learning and sustainability”

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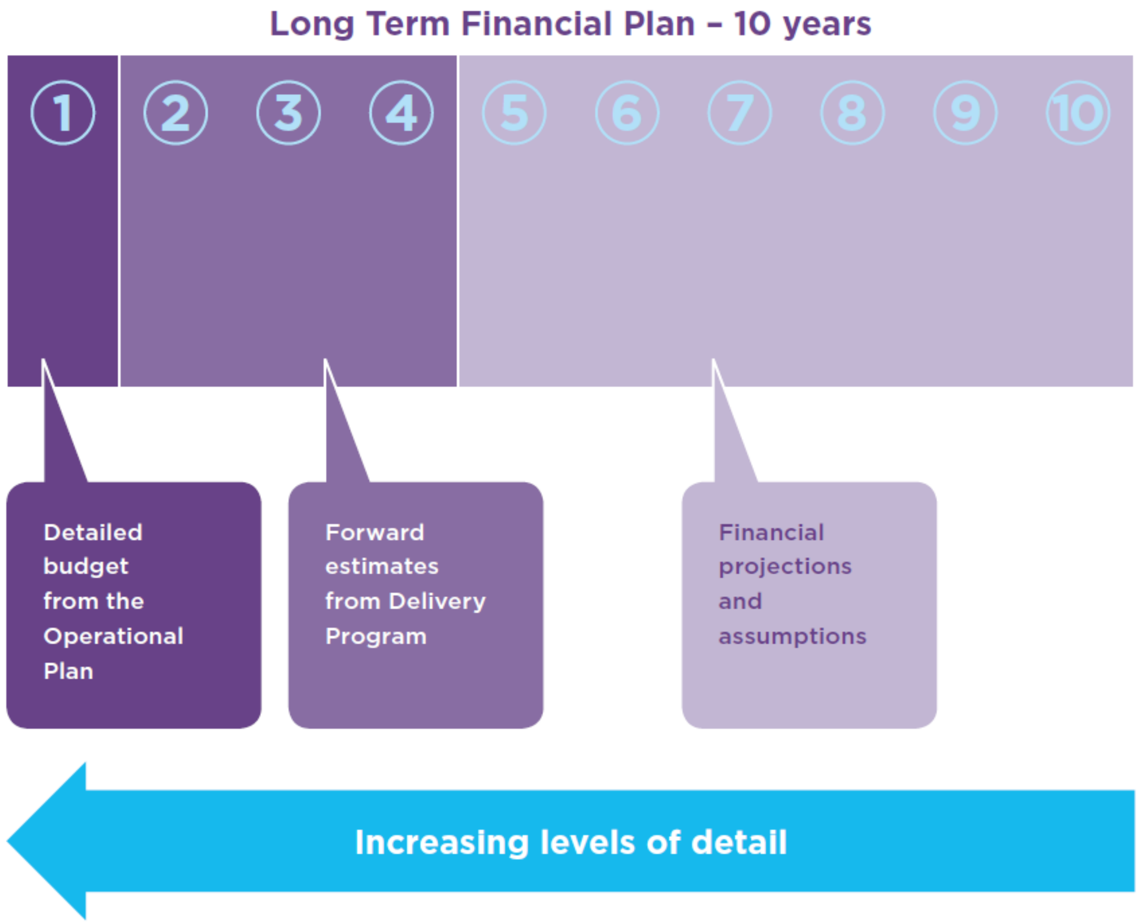
Preamble

Extracts from the 'Integrated Planning and Reporting Manual for local government in NSW – Planning a sustainable future' issued by NSW Office of Local Government in March 2013 are included below to provide some context to this document:

> "Show councillors and the community how the council will achieve financial sustainability over the long term….. The Long Term Financial Plan is an important part of council's strategic planning process. This is the point where long term community aspirations and goals are tested against financial realities."

In other words:

> "Can we afford what the community wants?"
>
> "The Long Term Financial Plan is a decision-making and problem-solving tool. It is not intended that the Long Term Financial Plan is set in concrete – it is a guide for future action. The modelling that occurs as part of the plan will help councils to weather unexpected events. It will also provide an opportunity for the council to identify financial issues at an earlier stage and gauge the effect of these issues in the longer term.
>
> The longer the planning horizon, the more general the plan will be in the later years. For example, it is not expected that the 10th year of a 10 year plan will include specific detail.
>
> As decisions are made, more detail can be added to the Long Term Financial Plan. For example, as the council finalises its Delivery Program, the first four years of the Long Term Financial Plan will become firmer. As the Operational Plan is completed, the detailed budget will form the first year of the Long Term Financial Plan. The diagram following shows the relationships."



Some further cautionary comments regarding the limitations and use of the Long Term Financial Plan (LTFP) seem appropriate.

The LTFP is not designed to give accurate predictions out to ten years or more. There are many factors that influence how accurate the results turn out to be, including inflation forecasts, accuracy of cost estimates, local, state, federal and global economy performance, as well as unforseen legislation and impacts of funding programs by other levels of government.

The LTFP is best used to provide an indication of trends and broad outcomes based upon a set of assumptions and the effects different choices can make on long term outcomes.

Most of the commentary provided in this document will be limited to General Fund performance, as each of the other funds has the freedom to set charges to provide appropriate outcomes and current projections are acceptable for those funds.

Further, the commentary will be limited to the 'Business As Usual' and the proposed '30% Special Rate Variation' scenario. There will be one additional scenario in the final plans adopted – a scenario that brings General Fund to a sustainable position with no Special Rate variation.

The other funds (Water, Sewer & Waste) hold some very expensive, but long lived assets and/or rehabilitation liabilities. The current ten year plans highlight neither the replacement nor maintenance of these long lived assets effectively, as some costs would occur less frequently than the 10 year period covered. These factors do however need to be born in mind in setting appropriate levels of revenue in the current planning period. This is one reason why in any ten year period revenues, operating results and cash reserves may seem unnecessarily high, while renewal ratios will be low in these funds.

The consolidated result is not simply a sum of all of the different funds – under accounting rules internal transactions, for example are excluded from consolidated results. Given the proportional size however of the General Fund component, the consolidated results tend to mimic General Fund results.

The General Fund has some unique challenges. The main thrust of recent Integrated Planning and Reporting legislation and supporting framework is to assist councils achieve long term financial sustainability.

It is quite clear however that continuing on as it has in the past is simply not an option. The attached Business as Usual scenario, which was prepared current using projections of revenues and expenditure to maintain the current levels of service, without speculative sources of revenues for example asset sales. These results show significant shortfalls in General Fund cash and is simply not acceptable and/or sustainable.

Gwydir Shire Council (GSC), like all NSW councils exists solely at the discretion of the NSW State Government. The framework for council operations currently exist in the form of The Local Government Act 1993 (the Act) and associated Local Government Regulations.

The Integrated Planning and Reporting guidelines (IP&R) have now been included within the Act. The key objective related to the Long Term Financial Plan (LTFP) and all related budgets is the requirement that councils work towards financial sustainability as noted in IPR Top Tips – the LTFP will "Show councillors and the community how the council will achieve financial sustainability over the long term". This is supported by the NSW State

Government's initiative, Fit For the Future which is requiring councils to show how they are or can become sustainable.

From an LTFP perspective, this means that GSC needs to work towards attaining a balanced budget. This is a significant challenge and involves many complex issues. Certainly funding shortfalls and associated service level shortfalls remain very important issues that need discussion and lobbying – it is just that these need to be removed from proposed budgets, which need to deal with the reality of current funding limitations.

Vertical fiscal imbalance is one such area – whereas local government has by far the highest level of assets, it has the lowest levels of taxation revenues. This inverse relationship applies to the other levels of government – the federal government has the highest level of taxation revenues, yet has relatively minor levels of assets.

There are several initiatives that the councillors of GSC (Council) have approved recently to start down the path of improved budget results, including service level reviews, some redundancies and a Special Rate Variation application.

All of GSC's operations are being reviewed to determine whether the ongoing provision of the service has ongoing relevance, the level of service that should be provided (and associated budget allocations) and if appropriate, fees for service are set at the right level.

Depending on how you classify them, GSC potentially has over 80 individual service units (let's call them business units). These business units cover an extraordinary range of services covering areas such as social services (preschools to aged care), environmental services (environmental protection, education and weed control), infrastructure services (buildings, roads etc.), regulatory services (building control, food shop inspections etc.), tourism and economic development as well as the services considered more traditional of local government including libraries, water, sewer and waste collection to name a few. Each business unit has its own peculiarities in terms of needs, services, budget requirements and often the legislated framework it operates in (on top of the local government framework).

General Revenues is one of the complex areas subject to much debate by Council. Unlike other funds (Water, Sewer etc.) General Fund has many restrictions placed upon it, for example Rate Pegging, which sets limits on the increase General Rates may be increased each year – this has been in place for many years and has often been set below the rate of cost increases. Any increase above the Rate Peg limit requires a time consuming and difficult application process that is costly – which may in the end not be approved by the State Government. The number of significant (double digit) SRV applications by many councils over the past few years indicates a failure of the rate pegging system.

Further, some other fees are regulated – Council may not charge in excess of the regulated fee, even if costs exceed the associated revenue.

To bring the above into perspective, there are two issues that will briefly be covered to bring these issues into focus.

The first is roads – the single biggest cost centre of GSC and without doubt a subject of focus for the community and Council. Maintaining current levels of service, as well as meeting the requirements of Road to Recovery grant conditions (discussed below) is a contributing factor to the current tough times experience by General Fund operations (GF). The high levels of depreciation in GF are a major impediment in achieving a balanced budget, with road depreciation representing approximately 80% of this amount.

Road depreciation and associated levels of service, has been the subject of intensive work to review methodologies along with improved date and modelling. As a result and in line with road revaluation processes undertaken as at 30 June 2015, depreciation for road infrastructure has decreased from approximately $8m to $3.5m p.a.

Unfortunately, both the State and Federal Governments have, in the past, commenced funding programs that are initially beneficial to local government but over time become liabilities as the initial requirements are modified by the funding body. Roads to Recovery is an example of this type of bureaucratic creep that always seems, in the long run, to the disadvantage of local government. The compliance requirements of the Roads to Recovery are generally high compared to other programs.

Extending these issues across all GSC GF operations, Council is faced with many difficult decisions regarding ongoing viability and funding levels. Whilst the major thrust of the above discussion relates to financial sustainability, Council should take an arm's length view and consider all costs and benefits in relation to service level provision decisions. For example discussions on cost in addition to financial cost should also weigh the other important cost components of social, environmental and even opportunity cost. Opportunity cost relates to opportunities foregone i.e. if $1,000 is not spent in area x then what could be achieved in area y, which may have even greater benefit.

One further issue that must be factored in and could potentially cloud any issue under discussion and must not be underestimated is the support that staff give to the various services they provide. Services are provided for a reason and the Council's staff are passionate and committed about the jobs they do, as you would expect from professionals. In some cases this commitment, although understandable, may be detrimental to undertaking an objective evaluation of the issue at hand.

The above commentary is not designed to push any particular agenda other than financial sustainability. The focus on roads is only provided because roads are the most significant cost centre of GSC. Hopefully the above commentary highlights the difficult task Council faces in trying to determine the best path to take in working towards financial sustainability and engenders open discussion regarding alternative courses of action.

This also does not mean that the Council and community should necessarily remain satisfied with below acceptable levels of service. While Council needs to head towards balanced short and long term budgets that need to reflect the harsh reality of what we can afford with the current revenues, there are many other avenues where the issues should be raised. The Community Strategic Plan, Asset Management Plans, community consultation and Council workshops to name a few where it is appropriate to raise discussions and develop action plans to raise below par service levels to a level that is deemed acceptable by the Council and community are appropriate places to raise these issues, which should be backed by hard evidence. It is likely that at least some grant funding will be tied to this approach.

There are 2 main options available to Council:

1) Increase revenues through increased rates (by special variation above the approved rate pegging limit) and charges and/or
2) Through reduced service levels. Reduced service levels in terms of assets (including our road network) may mean longer effective lives and lower average quality standards as a result of lower maintenance and renewal levels.

Investigations are being undertaken regarding service levels and appropriate levels, in conjunction with appropriate levels of fees and charges where they are at the discretion of Council.

Although Gwydir Shire has a low population density (one of the main contributing factors to revenue problems), it covers a significant area and controls significant assets in terms of size and cost.

Depreciation is seen by many as a nonsense book entry amount that should be disregarded when looking at results, however this is one expenditure item (and associated assumption and related service levels) that significantly affects many sustainability ratios.

A simple explanation of depreciation is the spread of cost of an asset over time in relation to its use – each accounting period is meant to reflect the expired cost of the asset. That is, as an asset is used up (worn out if you like), then how much is used over that time period should be shown as the deprecation dollar value amount for that same period.

Depreciation is the best guide we currently have as to the amounts that should be set aside or used to maintain and renew assets at an acceptable or agreed level of serviceability.

Improved results can be achieved by improved data collection as well as more relevant depreciation methods. For example Water and Sewer funds had significant improvements in depreciation costs.

Council and the Community now face difficult choices for Gwydir to achieve a sustainable position and become ‘fit for the future’.

IPART approved a temporary rate increase of 15% for the 2015-2016 financial year, which expires on 30 June 2015, meaning rate revenues will decrease by $718,783 prior to the approved rate peg increase of 1.8% is applied (which is below many of our cost increases). Council is proposing a permanent Special Rate Variation of 30% effective in the 2016-2017 financial year – this represents retaining the allowable 2015/16 increase and then adding an additional 15%. Effectively this means on average (based on current rate valuations) that ratepayers would pay an average 15% more in general rates than they are in the current financial year.

Even with a 30% rate increase, this will not make General Fund sustainable without an associated reeducation in some service areas. On an operating result basis, General Fund is required to improve in excess of $355k in 2017-2018 up to an improvement of $2,318k in 2025-2026. We should really be aiming for moderate surplus results. On a cash basis even larger improvements should become the objective. Given the fragile cash position of General Fund, a net increase in General Fund cash of $500k per annum would not be seen as unreasonable until such time that General Fund cash reserves are satisfactory, providing a sufficient buffer for unexpected events and reserves for asset renewals.

Executive Overview

We are currently in challenging times where Council must take a fresh look at how it operates if it is to become 'Fit for the Future'.

It is certainly not an option to continue to battle on as it has for the last few years – the current mix of revenues and service levels are certainly not sustainable – even for the short term, as evidenced by the General Fund cash flow issues and unsatisfactory General Fund cash holdings.

It should also be noted that regardless of any other outcome, which because of the relatively low rate base compared to major urban centers and the inverse proportion of assets to ratepayers, Council will remain heavily reliant on grants as a significant source of funding for ongoing operations.

Ideally it will be a mix of solutions that will end up seeing Council as a significantly more robust organization at the end of the day – improvements in revenues (specifically Rates and User Fees and Charges) as well as full reviews of service levels so that ongoing services are funded *within current available resources/revenues*.

Can Council become financially sustainable – certainly? Provided there is the will to do so.

Will this be an easy task? Not at all – there are many difficult and painful decisions that need to be made if Council wishes to meet the majority if not all the benchmarks set by the State Government – or at least show significant improvement towards achieving those benchmarks.

The outcomes outlined in the Special Rate Variation scenario certainly highlight that a lot can be (and has been) achieved, but there is certainly further work required in fine tuning longer term outcomes.

Will this mean that everyone loses out?

No – there may be some services that are no longer deemed fit for purpose or remain linked with the Council's future direction and may be terminated, while some others may be reduced. Other services may remain much the same while others may provide improved services for the same net cost due to efficiencies identified during the review process. In some few areas there may be room to expand expenditures (within the bounds of available funding) to achieve better results.

At the end of the day though, one of the highest priorities will be achieving a small, but consistent General Fund operating surplus i.e. achieving balanced budgets, with some room to spare – as shown in the other fund results.

Service Level Revenues and Improvement Strategies

Service reviews

In the past, there have been service reviews undertaken on an ad hoc basis. Examples include the medical centres, caravan parks, telecommunications, pools and waste collection.

The above reviews have all provided some degree of improved services along with improvements in bottom line results.

Service reviews over the past 2 years have provided significant savings to date, which include:

- Over $1m in savings in employee costs due to a number of positions being made redundant and/or not being filled after being vacated
- Over $100k savings in annual plant depreciation due to disposal of plant items deemed surplus to current requirements
- Approximately $1m in operational savings due to service reviews for example medical centres, waste collection and telecommunications contracts.

The Special Rate Variation

One of the most topical strategies - approval of a Special Rate Variation plays a very important part in Council working towards financial sustainability and maintaining service levels at a level that will be considered appropriate. Without approval, services will need to be cut by significant amounts across Council's operation.

Fees and annual charges

Fees and charges that Council has discretion in setting (there are many that are regulated) will continue to be reviewed to ensure revenues are appropriate for the services provided. Given the sustainability issues and review of service provision, there may be some exemptions that may be removed.

Depreciation

Another very topical area, but as discussed elsewhere in this document, setting depreciation at appropriate levels in line with current capabilities and revenues is an important aspect of achieving sustainability.

Open and frank discussion needs to take place to ensure appropriate outcomes are achieved and associated expectations in relation to associated service levels are managed.

Sensitivity Analysis

Only the very early attempts at any sensitivity analysis have been performed at this time as it is already considered that Council is in a stressed and vulnerable state. Performance is constantly being monitored and remedial action being undertaken as necessary.

Council needs to determine an appropriate path to a future where Council will be far less vulnerable and be in a position to weather reasonable unforeseen shocks. Most likely this will involve significant rate increases (as mentioned above, Council is in the process of applying for a 30% increase) as well as cuts to services and associated budgets.

Scenario Discussion

Only two scenarios will be discussed in detail and commentary will be limited to General Fund operations.

Other fund operations are deemed satisfactory at least in the near term and consolidated results tend to mimic General Fund operations due to proportional size and influence.

The Special Rate variation scenario includes a 30% increase, which would effectively entrench the 15% temporary increase IPART approved for the 2015-2016 financial year and result in an increase of 15% over 2015-2016 rates.

business as usual – this could also be identified as worse case as it leads to continued and significant deterioration.

Special Rates Variation Scenario – Appendix A

This scenario starts down a path that starts to address sustainability in an achievable fashion. Again, the commentary below relates to General Fund outcomes, which also generally carry through to, or are better results on a consolidated basis.

There is a general, across the board improvement in sustainability indicators and there is significant improvement in operating results. A surplus is achieved for each year of the plan. Some further work is required to stabilise results and/or ensure there is a slight upward trend in the surplus. Given prior losses, which have been in the millions, this is a significant turnaround for Council.

Equity in General Fund has stabilised. Further sustainability improvements in operating results will see this figure gradually improve over time.

Under this scenario the Operating Performance Ratio is around benchmark. The own source revenue ratio is close to benchmark for General Fund and over benchmark on a consolidated basis. The asset renewal ratio is above benchmark on average over the ten year period. Finally, the Debt Service ratio is within benchmark results.

While there is certainly work left to do to ensure the long term trends are maintained and improved to ensure benchmark results are achieved in a consistent manner, this provides a significant and important step in the right direction.

Business as Usual – Appendix B

Council's financial position has continued to deteriorate over the past few years to a stage now where significant action needs to be taken to ensure continued viability.

This is the inevitable result of a simple formula – Council has been trying to continue maintain services at a level (with increased costs) that does not match its revenues (reducing in real terms).

One of the outcomes is that General Fund cash has been run down to a level where there is no buffer to weather unexpected events and very tight controls need to be in place to ensure appropriated outcomes.

Almost every single indicator of health continues to deteriorate over time – operating result, net equity reduces from $385m to $349m over the ten year period, capital expenditures are less than half of depreciation and most of the sustainability indicators will weaken.

The only positive spin is that General Fund cash improves, but insufficiently and that the Debt Service Ratio would continue to improve as debt is retired. Further borrowings would however be inadvisable as capacity to maintain the loans would continue to deteriorate.

There has already been a reduction in service levels evident and Council will not be viable, even in the short term without drastic action and further significant reductions in services.

Special Rate Variation not approved

If the special rate variation application is not approved, the following savings have been identified to work towards sustainability:

Description	**No SRV approved**			**Potential ongoing savings annually**
Operational Savings	Expenditure	Income	Net Saving	
Kerb and Guttering	($38,663)		($38,663)	
Car Parks	($22,393)		($22,393)	
Footpaths	($29,946)		($29,946)	
Road Safety Officer	($30,000)		($30,000)	($30,000)
Gwydir RTO	$50,000	($100,000)	($50,000)	($50,000)
Naroo Employee Costs	($50,000)		($50,000)	($50,000)
Training		($100,000)	($100,000)	($100,000)
Private Works		($11,000)	($11,000)	($11,000)
Quarry Operations	($37,207)		($37,207)	
Stormwater Drainage	($47,400)		($47,400)	
Street Lighting	($10,000)		($10,000)	($10,000)

Development and Environmental Services employee costs 3 positions	$91,800	($244,398)	($152,598)	($244,398)
Organisational and Community Development Services employee costs 2 positions	$78,200	($192,591)	($114,391)	($192,591)
Donations	($50,000)		($50,000)	($50,000)
Web presence 1 position	$16,400	($25,100)	($8,700)	($25,100)
Noxious Weeds contract spraying		($30,000)	($30,000)	($30,000)
Libraries	($5,000)		($5,000)	($5,000)
Cranky Rock	($2,000)		($2,000)	($2,000)
Other Buildings	($5,000)		($5,000)	($5,000)
Public Halls	($10,000)		($10,000)	($10,000)
Depot operations	($5,000)		($5,000)	($5,000)
Elected Members	($50,000)		($50,000)	
Executive Services	($10,000)		($10,000)	($10,000)
Plant Replacement	($341,800)		($341,800)	($200,000)
Showground Facilities	($3,000)		($3,000)	($3,000)
Caravan Parks	($5,000)		($5,000)	($5,000)
Roxy	($5,000)		($5,000)	($5,000)
Tourism	($10,000)		($10,000)	($10,000)
Parks and Gardens	($5,000)		($5,000)	($5,000)
Operational sub-totals	($536,009)	($703,089)	($1,239,098)	($1,058,089)

Description	**Option 2 (No SRV approved)**			**Potential ongoing savings annually option 2**
Capital Savings			Net Saving	
Restumping North Star Hall	($50,000)		($50,000)	
Yallaroi Hall sanding floor	($16,000)		($16,000)	
Gravesend Museum paint	($15,000)		($15,000)	
Animal Pound	($50,000)		($50,000)	

Wilby House improvements deferred	($98,095)		($98,095)	
Bingara Civic Centre	($33,500)		($33,500)	
Bingara Scout Hall	($10,000)		($10,000)	
Warialda Hall chairs	($21,400)		($21,400)	
Warialda Rail RFS Shed contract job	$240,000	($240,000)	$0	
Capital sub-totals	($53,995)	($240,000)	($293,995)	$0
Totals	($590,004)	($943,089)	($1,533,093)	($1,058,089)

Possible building and land disposals	Legal/DA costs	Estimate only	Net Saving	
Bingara Civic Centre	$10,000	($180,000)	($170,000)	
Sell Hope Street property with an approved DA for multiple occupancies (Bradburn)	$40,000	($200,000)	($160,000)	
Sell Martin/Bombelli block and Maitland properties with an approved DA for multiple occupancies (includes DCP)	$50,000	($360,000)	($310,000)	
Recoup value of past land transfers to other funds paid off over 10 years		-55,000	-55,000	-55,000
Overall Total	($490,004)	($1,738,089)	($2,228,093)	($1,113,089)

Ratio Performance

Under the Special Rate variation scenario, sustainability ratio results are consistent with benchmarks.

Commentary on proposed outcomes is included in the above discussions and results shown in Appendix C

Assumptions

Current budgets reflect business unit needs for operational purposes. As the service level reviews progress, there may be some changes to gross revenues and/or expenditures and capital expenditures. Adjustments will be made in these cases to ensure operating results and cash forecasts remain consistent. Changes in capital expenditures may also affect operational budgets for employee costs, depending on the makeup of particular capital programs.

For simplicity, all cash and investments are shown as cash to highlight total cash holdings – no cash is transferred to/from investments. Again this highlights the tight starting point that General Fund is currently in. In any case, Council investments are currently limited to bank Term Deposits, which for some ratios are classified as cash in any case.

As cash holdings increase, formal reserves and reserve policies should be established to earmark cash held for appropriate purposes e.g. Plant, Building and Road renewals – after leaving sufficient cash to cover working requirements and sufficient to cover unforeseen emergencies.

Issues related to inadequate or inappropriate service levels, for example as a result of reconciling depreciation to current funding limits, moves from budget projections to more appropriate forums such as the Community Strategic Plan and appropriate sections of Asset Management Plans.

Assumptions common to all scenarios

- Inflation factors as shown in Appendix D for the most part apply to all scenarios – there may be some variation amongst other funds in terms of rates and annual charges.
- No fair value revaluation impacts for Infrastructure assets due on a rolling five year program
- No movements to/from investments. For ease of comparison all cash and investments are shown as cash – this may change in future plans as General Fund cash recovers to acceptable levels.
- Operational budgets are at appropriate levels for current business unit service levels
- The current list of capital expenditure proposed projects is reflective of need. There may be some projects that are currently listed that will not proceed. Further, it is likely there are many proposals not listed as the effort of preparing proposals (even if they may be of benefit) is likely outweighed by the chance they will not proceed due to lack of resources to fund them. As the General Fund position outlook improves this will likely change.
- Populations remain relatively stable.
- Any significant economic growth will be absent.

Assumptions for the Special Rate Variation scenario

- Special Rate Variation increase of 30% in 2017. In the years special rate variations apply, rate pegging increases do not – or if you prefer the rate peg increase is included in the special rate variation increase. In the years after the variations apply, rate pegging increases apply to the new total rate revenues, including the variation which becomes part of the rating base revenue.

Conclusion

Overall, the scenario where a Special Rate Variation of 30% (entrenching the current temporary 15% increase plus an additional 15%) is applied results in a satisfactory outcome in terms of moving towards fully sustainable outcomes.

Further work will be required to fine tune results to further improve these outcomes and to ensure the revenue and expenditure targets are maintained.

If the Special Rate Variation application for the 2016-2017 financial year is not approved, the result will be significant cuts in services and expenditures for Council and would result in major challenges in Council achieving sustainability status.