FINANCIAL SUSTAINABILITY REVIEW

EDWARD RIVER COUNCIL

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EXECUTIVE SUMMARY

BACKGROUND

This report presents the outcomes of an independent Financial Sustainability Review, commissioned by the Edward River Council (Council), following a strategic objective set by Council to plan for its long term sustainability and to determine whether its current position is appropriate to meet the current and future needs of the organisation and community it serves.

The primary objective of the Financial Sustainability Review is to facilitate sustainable long-term planning and avert potential issues emerging in the future. Although Council's recent financial performance has produced operating surpluses and cash has accumulated, there are apprehensions that an underlying financial or infrastructure deficit could prompt a high reliance on unknown external funding sources, such as grants, in the future.

To address these concerns, Council commissioned AEC Group (AEC) to undertake an independent review of its financial sustainability. This report presents the findings of the review and provides effective strategies to improve Council's financial sustainability and guarantee that they comply with the Local Government Act 1993. The report also analyses the potential impacts of the findings on Council's future financial position, as well as the local community and stakeholders, to ensure Council's sustainable and efficient operation in the future.

PURPOSE & APPROACH

AEC's approach to delivering upon the Terms of Reference is guided by the following definition of financial sustainability:

> *Financial sustainability is the ability of an entity to maintain financial capital and infrastructure capital over the long term. Maintaining financial capital is concerned with the ability to sustain availability of cash into the future to meet the service and infrastructure needs of the entity. Maintaining infrastructure capital is concerned with the entity's ability to provide physical assets over the long term to meet the service requirements and demand.*

Sustainability for local government includes the ability to manage likely developments (built development and socio-demographic development) and unexpected financial shocks in the future.

The AEC approach to assessing financial sustainability includes two fundamental tests:

- Test 1 - **Maintaining Fiscal Capital** - Can Council demonstrate capacity to access cash as required for current and future needs of services and infrastructure?
- Test 2 - **Maintaining Infrastructure Capital** - Can Council demonstrate capacity to provide infrastructure at an acceptable level of performance as required by current and future services?

To be sustainable, Council must satisfy both tests.

KEY FINDINGS

- The Edward River Community Strategic Plan 2022-2050 (CSP) identifies the community's main priorities and aspirations for the future. Council has adopted a Delivery Program which outlines what it intends to do towards achieving the goals as identified in the Community Strategic Plan over the course of its term of office and contains all of the principal activities to be undertaken by Council. Council also has adopted, or is in the process of adopting, strategies that must be funded and included in the Long Term Financial Plan (LTFP). Council's historical financial performance does not reflect the desired operations as outlined in the CSP, the Delivery Program and other adopted plans and strategies.

Maintaining Fiscal Capital – Historical Performance

- Council has reported consolidated operating surpluses for four of the past five financial years and has accumulated cash, cash equivalents and investments. However, if adjustments for asset valuation movements were removed, and other non-recurrent impacts such as prepayment of operating grants are also removed, Council would have reported significant operating deficits in the General Fund.

- Water, sewer and waste management services have historically been profitable, however, there are future risks to profitability and availability of sufficient cash due to the need to increase maintenance and required investments in renewal and replacement of infrastructure (e.g., sewer treatment plant and waste landfill).
- At the end of 2021/22, Council had total cash, cash equivalents and investments of $50.116 million, of which $14.305 million is externally restricted, $7.879 million is internally restricted and a further $5.007 million held in reserve for commitments in reported liabilities (mostly contracted grant liabilities). The residual amount of $22.925M is considered unrestricted.
- Internal reserves have been created by historical Council resolutions. It is AEC's observation that the list of internal reserves have been held with the same balance for many years without any clear, current reason for maintaining them.

Maintaining Infrastructure Capital – Historical Performance

- The replacement cost of assets controlled by Council totals $602.9 million, with the net carrying amount (the written down value) being $428.2 million. Each year, services provided by the Council consume approximately $9.9 million in value of the controlled assets (as indicated by the depreciation expense).
- In the past five financial years Council has generally achieved or exceeded the thresholds for the building and infrastructure renewals ratio, infrastructure backlog ratio and the asset maintenance ratio. However, it should be noted that the infrastructure backlog ratio and asset maintenance ratio are based on targets that Council establishes for itself. This review raises concern with the historical approach to calculating the infrastructure backlog and the maintenance targets.
- As at 30 June 2022, Council estimated that $8.2 million is required to be spent on renewing and replacing assets to bring the assets to a satisfactory standard – often referred to as the value of the infrastructure backlog. The water supply network is estimated to have a backlog of assets of $0.8 million, with backlogs of $0.7 million for the sewerage network and $4.1 million for roads. However, this assessment is based on predominantly qualitative information rather than based on evidence from current condition assessments. Based on financial consumption of assets, there is an indication that the condition of the assets is in a poorer state and that the infrastructure backlog is significantly larger at $22 million.
- The target expenditure on maintenance of assets is $6.1 million compared to actual expenditure in 2021/22 of $5.9 million. However, the target maintenance is set based on historical expenditure on maintenance, not based on a costing of planned maintenance, including a cost estimate of reactive maintenance. Of note, expenditure for water supply network and buildings is significantly below the required maintenance.
- The Asset Management Policy provides Council with the framework to manage assets and enable it to deliver services to the community in an affordable and sustainable manner. The current policy commits Council to a number of actions that are not effective.
- Council's asset management maturity is below the target core maturity for all asset management functions. To ensure financial sustainability, Council needs to improve performance in asset related governance and management, skills and processes, data and systems and asset management strategy.
- Council's Asset Management Steering Committee has not met for an extended length of time and the charter for this internal committee is not clear.

Edward River Village Project

- Construction of the Edward River Village (the Village), a new retirement development in Deniliquin, has been initiated by Council. Stage 1 of the project is scheduled to be completed by August 2023. To understand the impact to Council's financial sustainability, AEC conducted a review of Council's financial planning for the Village.

- At an expected entry price of $485,000 and with 100% occupancy, the Village will be financially independent with the capacity to return a significant dividend to the General Fund in future years.
- The need to reduce the entry price and delays in achieving full occupancy are realistic scenarios that will impact the project's financial assessment, requiring additional borrowings to fund the construction and impacting on the profitability and cash generation in the short to medium term (in the first five to ten years). However, the Village will still be able to operate without subsidy from the General Fund in the medium to long term, as long as near full occupancy is maintained and the operating cost structure of the Village is kept to a minimum.

Forecast Financial Position

- AEC completed a review of the LTFP adopted by Council and prepared an independent forecast of Council's long term projections over the same planning horizon to compare and contrast with the adopted financial position. The forecast position is based on current planned budget for 2023/24, consultation with Council officers on future budget requirements and includes operating costs (and revenue) that AEC could identify from adopted strategies, plans and projects.
- The forecast position includes costs of projected asset renewals based on an assessment completed by AEC, following consultation with Council's relevant officers and modelling based on asset financial data and other asset condition reports as provided by Council.
- The General Fund is projected to produce a net operating deficit (excluding capital grants and contributions) of $2.884 million in 2023/24 which improves across the ten-year period to a $1.411 million loss in 2032/33. While the operating position for the General Fund improves over the ten-year period, the operating loss in 2032/33 of $1.411million is still significant. The operating losses in the General Fund are resulting in cash deficits, which Council will need to address to prevent deterioration of Council's unrestricted cash.
- Available cash in the General Fund is projected to deteriorate across the ten-year period, due to the demand for asset renewals and the operating deficit produced within the General Fund. The General Fund needs to produce approximately $1.788 million more in cash per year to avoid the deterioration of cash balance across the ten years.
- The Water Fund is projected to provide an operating surplus (excluding capital grants and contributions) which improves over the ten-year period.
- The Sewer Fund is projected to provide an operating surplus (excluding capital grants and contributions) which improves over the ten-year period.
- The Water Fund and Sewer Fund continue to increase cash within their respective reserves. However, it should be noted that the renewal of the Sewer Treatment Plant is not projected to occur within the next ten years. If required, a $25 million investment in the renewal of the plant would produce a significantly different scenario.
- The Village Fund produces strong operating surpluses during the first five years from 2023/24 to 2027/28, which includes the revenue received through entry contracts from residents occupying the units. From 2028/29, the Village Fund will produce deficits, indicating insufficient revenue to fund the operating costs and interest payment on borrowings required for Stage One construction. In 2030/31, it is anticipated that revenue will be received through deferred management fees which are projected to increase, resulting in positive net operating result when the village reaches a mature steady state.
- The Village Fund stays in a positive cash position, although this includes borrowings necessary to fund Stage 1 development. The cash position improves in the later years of the forecast period due to the deferred management fees anticipated to begin in 2030/31 which significantly improves the cash generation for the facility.

- The Waste Fund is projected to provide an operating surplus (excluding capital grants and contributions) which improves over the ten-year period. Sufficient cash is generated to address asset requirements based on current planned investments.

Strategies to Achieve a Financially Sustainable Council

AEC recommend the following strategies for improving Council's long-term financial sustainability:

1. Improve the operating position of the general fund, via a Special Rate Variation (SRV) to increase the rate revenue by 7% for six consecutive years and a review of user charges, particularly waste (including the domestic waste charge), to ensure full cost pricing is achieved.
2. Create a Waste Fund to separate the financial planning and reporting for the waste management functions, including the domestic waste collection.
3. Enhance the asset related governance and financial controls to integrate the Project Management Framework, Asset Management Planning and LTFP. The LTFP should be a living resource plan that is adjusted as required to ensure Council decisions are informed by the impact upon the long term financial sustainability.
4. Review of existing cash reserves to assess whether they are still required.
5. Introduce productivity measures to the Operational Plan and Annual Budget (e.g., $/KM graded, $/KM roads resealed, $/KM road re-sheeting, annual food safety inspections completed, hectares of open space maintained, library opening hours, etc.) which can be benchmarked with other comparable Councils and monitored to ensure Council delivery of services and infrastructure is efficient. Council should seek to achieve productivity savings to limit the increase in rates required through the SRV.
6. Introduce a service planning approach as part of the development of Integrated Planning and Reporting Framework, including defining a list of services and development of a Service Review Program targeting services with highest potential for improved productivity and efficiencies. Review and develop defined performance expectations in the Service statements, including the activity able to be achieved with current funding e.g., library opening hours, KMs of road resealed, KMs of road re-sheet, KMs of grading, meters or kerb replaced, operating hours/sessions for swimming pool, etc.
7. Pursue a path of improving the asset management maturity, as outlined in the Asset Management Strategy, in particular improved asset management leadership and governance (including culture), asset condition assessments, improved accuracy, and use of asset registers, whole of life planning and determining the optimal timing for renewal treatments.
8. Market and promote the Village with aim to achieving the target entry price on the Village residential units with aim to fill the units as soon as possible – the realisation of capital revenue through initial contracts and then collection of deferred management fees is essential for the village to establish a stable financial position and to avoid short term impacts that the Village may have on Council's financial position.
9. Seek opportunities to encourage and facilitate economic and population growth to increase the economy of scale in provision of local government services and infrastructure, noting that this requires resourcing.