Review of Council's Strategies for Financial Sustainability

September 2017

Document status

Ref	Approving director	Date
7276		September 2017

Contents

Introduction

During the 2015 Fit for the Future process Hawkesbury City Council was assessed by IPART as 'Unfit' on the basis that it failed to meet the sustainability criteria. Specifically, that it did not meet the Operating Performance Ratio *"based on its forecast for a negative operating performance ratio by 2019-20"*.

In December 2015, Council was the subject of a merger proposal with part of the Hills Shire Council. In March 2016, the delegate recommended that the proposal not be implemented and in May 2016 the Government announced that the proposal would not proceed.

Council was provided an opportunity to submit a reassessment proposal in late 2016. Council advises that it has recently been assessed by the Office of Local Government as 'Fit' based on a series of strategies which included increases in revenue and decreasing costs, and a focus on renewal expenditure on assets over maintenance.

Throughout the Fit for the Future reform period Council was working to determine its path to long term financial sustainability. This has included reviewing expenditure and revenue as well as working with the community to determine desired levels of service and community expectations. Council has now developed a plan that is encapsulated within the Community Strategic Plan and the 2017 – 2027 Resourcing Strategy. The Resourcing Strategy has three scenarios.

- Deteriorate
- Stabilise
- Improve

Implementing measures to reduce costs and increase revenue is built into all three scenarios. The Stabilise and Improve scenarios then have additional increases in rates revenue through Special Rate Variations and borrowing programs to fund renewal and new capital works.

In October 2016 Council resolved that

> *"Council engage a suitably qualified consultant to review Council's current financial position, Delivery Program and Operational Plan with the objective of finding new solutions and strategies not already explored.*
>
> *The consultant to have access to all information held by Council that they feel they require from Council.*
>
> *The process for selecting the consultant to be completed in consultation with the Mayor and Deputy Mayor and reported to Council for a final decision."*[1]

Morrison Low was appointed to undertake take this review and in carrying out the review we have drawn on our experience from

- Our work with over 40 councils during the Fit for the Future process
- The assistance we provided to many of the councils with their Fit for the Future submissions to IPART and subsequently to the OLG for reassessment

[1] Council Resolution on 11 October 2016

- Our understanding of what creates financial sustainability (strategies and operational initiatives)
- Our knowledge of driving performance against the Fit for the Future benchmarks; and
- Our experience of good practice and ideas that we have observed across the State.

Approach to the Review

Morrison Low conducted a desktop review of key Council information, had discussions and correspondence with Council staff to query a number of points, and we compared Council's strategies to those developed in other Fit for the Future Improvement Plans and reassessment proposals that we have worked on across NSW.

Key documents that we have been provided with or sourced copies ourselves include Council's:

- Resourcing Strategy 2017-2027
- Long Term Financial Plan and various spreadsheets supporting the calculations of the Fit for the Future Ratios
- October 2016 Council report on outcome of Service Level Review
- Presentation used during the community engagement process in July/August 2017
- Hawkesbury City Council Fit for the Future Proposal and IPART determination 2015
- Hawkesbury City Council Fit for the Future Draft Reassessment Proposal dated November 2016 and supporting information
- Council's Draft Resourcing Strategy 2015-2025
- Infrastructure Assessment Report by JRA dated June 2015
- Hawkesbury Residential Land Strategy 2011
- Delegates Report on the Merger Proposal of Hawkesbury City and the Hills Shire (part) Councils, March 2016
- In addition, we were able to discuss the 2016/17 Draft Financial Statements which had just been prepared

Council officers provided us with all the information we requested and assisted us with promptly answering all questions and enquiries.

It was also necessary to review and where practical and possible test the financial and asset related information and assumptions that underpin Council's current position and forecast performance against the Fit for the Future benchmarks in order to review Council's strategies to reduce costs and increase revenue.

The review team included an accountant and engineer and drew on our collective experiences of working with over 40 councils during the Fit for the Future process. In accordance with Council's resolution we have;

- Reviewed Council's Fit for the Future re-assessment proposal and supporting documentation
- Checked forecast performance against the benchmarks in the re-assessment proposal and 2017-2027 Resourcing Strategy
- Checked the validity of the supporting data e.g. required asset expenditure, depreciation and methodology of calculating the benchmarks

Current Position

Financial sustainability

The Council failed four of the seven Fit for the Future benchmarks for 2015/16 including key benchmarks around Operating Performance and Asset Renewal. We note that this reflects a trend whereby Council has not met these important ratios for some time.

The 2017-2027 Resourcing Strategy describes a requirement to address an infrastructure backlog by increasing expenditure on asset renewal and asset maintenance, meeting an upcoming short to medium term wave of asset renewal, and satisfying rising community expectations of service levels. At the same time Council seeks to operate more and more efficiently year on year, meaning a requirement to deliver increased service levels with fewer resources. We understand that the community feedback during the recent Special Rate consultation process has been in favour of increasing expenditure rather than reducing services to meet the current funding. This contrasts with some other local government areas where constraining or even reducing services and service levels was the preferred approach to reach financial sustainability.

The Resourcing Strategy sets out three scenarios for the future of the Council and its communities.

- **Deteriorate**

  This scenario requires Council to implement a range of initiatives to reduce costs and increase revenue[2]. Efficiencies will be directed to increased renewal and maintenance of existing assets.

  Asset condition is forecast to deteriorate and Council will not meet the Fit for the Future benchmarks at 2027.

- **Stabilise**

  This scenario requires Council to implement a range of initiatives to reduce costs and increase revenue. Additionally, revenue is increased through a permanent Special Rate Variation where rates rise 7% over the rate peg each year for two years (14% cumulative) and Council initiates a borrowing program of $25 million over five years.

  Efficiencies and funds will be directed to increased renewal and maintenance of existing assets with some expenditure on new assets.

  Asset condition is forecast to stabilise and Council will meet all Fit for the Future benchmarks at 2027.

- **Improve**

  This scenario requires Council to implement a range of initiatives to reduce costs and increase revenue. Additionally, revenue is increased through a permanent Special Rate Variation where rates rise 7% over the rate peg each year for three years (21% cumulative) and Council initiates a borrowing program of $40 million over seven years.

  Efficiencies and funds will be directed to increased renewal and maintenance of existing assets as well as expenditure on new assets and new services.

  Asset condition is forecast to improve and Council will meet all Fit for the Future benchmarks at 2027.

2 These are attached as Appendix A

Figure 1 Explanation of Council's scenarios (Source: 2017 - 2027 Delivery Program)

Rate option (impact on service levels)	Rating Increase*	Funding Impact	Asset Condition	New Assets	FFTF Benchmarks
1 Deteriorate	Increase of 7.5% over three years in line with rate peg amount. Cumulative increase of 7.69% over three years.	Generate $7.8M over 10 years which will not be sufficient to fund the increasing cost of Council operations.	Decline in condition of assets with a focus on managing risk, including the possible closure and removal of unsafe assets.	No capacity for new capital works apart from those funded by grants and developer contributions.	Will not meet benchmarks unless substantial service reductions are implemented.
2 Stabilise	Increase of 14% over the rate peg amount. Cumulative increase of 22.9% over three years (including the rate peg amount).	Generate $42.7M over 10 years which together with a borrowings program would allow an additional spend of: • $40.2M on roads • $2.6M on public domain • $1.1M on buildings.	Condition of assets would stabilise and increase capacity to fund preventative maintenance and renewal.	Limited program of asset upgrades to augment works funded from by grants and developer contributions.	Will meet Fit For The Future benchmarks.
3 Improve	Increase of 21% over the rate peg amount. Cumulative increase of 31.29% over three years (including the rate peg amount)	Generate $62.5M over 10 years which together with a borrowings program would allow an additional spend of: • $46.7M on roads • $21.4M on public domain • $7.2M on buildings.	Condition of assets would stabilise and improve over time.	Able to fund new infrastructure & increase gravel road sealing, road rehabilitation and public domain programs.	Will meet Fit For The Future benchmarks.

Performance against the benchmarks

Table 1 Current and forecast performance[3]

Indicator[4]	Current[5]	Deteriorate	Stabilise	Improve
Operating Performance	×	×	✓	✓
Own Source Revenue	✓	✓	✓	✓
Debt Service	✓	✓	✓	✓
Asset Maintenance	×	✓	✓	✓
Asset Renewal	×	×	✓	✓
Infrastructure Backlog	×	×	✓	✓
Real Operating Expenditure	✓	✓	✓	✓

3 Refer to Figure 1 for the implications of each scenario
4 Performance is assessed as at the end of the LTFP period rather than 2020/21 as in the Fit for the Future reassessment
5 Report 2015/16 performance against the benchmarks

Council Improvement Strategies

Council identified a large number and range of improvement opportunities in their Fit for the Future action plan. Twenty strategies were originally submitted to IPART; subsequently twelve of these were amended for the Council reassessment process.

These form the basis of the Council's improvement strategies which are summarised below. For the purpose of assessing these we have separated out the applications for an SRV and Council's proposed borrowing programs contained in scenarios 2 and 3.

In reviewing the strategies, we have concentrated on the approach Council has used to estimate the value, considered whether that is reasonable and realistic and, for example, includes implementation costs. We have also considered whether, in our experience, implementing the efficiency is realistic and achievable.

Finally, we have considered whether, from our experience, there are other efficiency or revenue generating opportunities that other councils have implemented.

Operational efficiencies

- Review of road operations
- Review of service delivery models
- Review of plant/fleet management
- Property and asset review
- Review of insurance cover and self-insurer model
- Adoption of new technology and on-line business platforms
- Regional Strategic Alliance

General comments

Council has confirmed that there is no double counting: that the value of each individual initiative is separate and distinct, including ones that see efficiencies generated in the 'back of house' functions.

There are a number of differences in the values of the savings submitted as part of the Fit for the Future reassessment and now set out in Council's Resourcing Strategy. Council has confirmed that the forecasts in the Long Term Financial Plan incorporate the latest estimates.

We note that Council recognises the differences between efficiency savings that must be realised by reducing costs and those that can be realised by purchasing less materials or goods or seeking alternative suppliers. Council advises that it is developing plans to realise the efficiency savings in the corporate services area which is highlighted in a number of initiatives by ongoing review and refinement, analysing work practices, improving workflows, removing duplication and working regionally. Achieving these savings will require diligence and ongoing monitoring to ensure they are realised.

Comments about specific strategies

The disposal of under-utilised assets, particularly parks and open space assets, is generally problematic. There are community and political issues that will need to be addressed, and the community perception of the sale of assets is usually negative. We are also aware of other councils whose Fit for the Future strategies were predicated on sales of land and assets who have encountered difficulties in re-classifying land as operational. Council should be careful not to overstate the value of this initiative. Council advises that it has previously sold over $9M of excess property which demonstrates a track record of being able to achieve this strategy. It has also already undertaken significant work in identifying possible surplus or underutilised assets, some of which have now been sold. Our enquiries indicate that Council has taken a prudent and practical approach to estimating the further value of this initiative. For example, that pocket parks are not included within the expected $1.5M and that Council has already realised $350,000 this year which exceeds the budgeted amount for the year. We note that the timeframe for disposing of the assets is reasonable (2021) and that minor implementation costs have been allowed for as the majority of the work will be done inhouse.

The review of road operations is estimated to create efficiencies of $150K per annum for four years to create a total ongoing annual savings of $600K that will be reinvested into asset renewal. We are advised that 'road operations' covers the depot, workshop, stores, plant, materials, contractors and staff and we would expect that Council should be able to achieve the savings targets. We understand that Council is considering a 'spend to save' approach to implementing the savings and will use part of the total efficiencies generated to employ a resource to drive the change. We would support that approach.

Many councils have used the Fit for the Future process to embed a program of ongoing service reviews into their organisation. Council appears to have adopted a similar approach with the service delivery model review strategy. This is estimated to achieve annual savings of $860K over five years as opportunities are investigated and implemented.

The Regional Strategic Alliance is estimated to deliver modest savings for Council of $146K per annum by 2020/21. In our view, this timeframe provides sufficient time to investigate, agree and then begin to deliver shared services efficiencies. The estimated savings should easily be achievable if aggregation of contracts and resources is taken into account. We note that savings in this order will mean Council's internal resource or contracts dealing directly with Hawkesbury are reduced in favour of a shared resource or joint contract. The expected savings in comparison to what other councils expect to achieve from shared services are conservative but we note that the savings are expect to be realised in a reduction of corporate costs where other strategies already apply. A conservative approach is therefore prudent.

Review of approach to capitalisation

One area we identified that was not set out in the strategies but is common for councils is a review of capitalisation policies and processes. We were advised that processes had been reviewed and changed within the last three years to ensure that reseal work was being capitalised (estimated $1.5M per annum) and a more recent process had been put in place around building renewal (estimated $200K per annum).

While there is no impact on the asset itself, the different accounting treatment of capital and operational expenditure means a change from classification of maintenance work to capital

- has a positive impact on the operating performance ratio
- has a positive impact on the renewal ratio
- should lead to a positive impact on the infrastructure backlog ratio.

Given one of Council's strategies is to identify savings for reinvesting in asset renewal, Council should document that as part of meeting the Fit for the Future plan compliance with its Asset Capitalisation Policy is adhered to and it ensures it has processes in place that support that.

Benefits realisation

Implementing efficiency programs requires relentless discipline and oversight. Our advice is always that councils should take a formal project management approach to implementation. There should be a designated group or senior officer responsible for ensuring the projected savings are achieved (project governance) who should get regular updates from the individuals responsible for implementing each strategy (project management).

We understand that Council has put in place such a structure through the 'Fit for the Future Strategies Implementation Team' which is made up of:

- Executive Manager Community Partnerships
- Chief Financial Officer
- Deputy Chief Financial Officer
- Manager Design and mapping
- Manager Strategic Planning
- Manager Corporate Communications
- Manager Human Resources
- Administration Support

We are advised that the initial focus of the Fit for the Future Strategies Implementation Team has been on the SRV and once a decision on the SRV has been made attention will turn to implementing all the strategies. Each strategy has a Responsible Officer allocated with progress reporting quarterly (MANEX) and six monthly (Council).

Generate additional revenue

- Stormwater management charge
- Special rate for new residential development
- Review of waste management and sewer business units
- Review of pricing structures for business units
- Lobbying for increased regional road funding
- Integrated Capital Works Program
- Sinking fund for community facilities
- Energy Efficiency Borrowings Program
- Sustainable population growth

General comments

These are the typical strategies we would expect to see. Targeting increased revenue from assets and services where particular users or groups of users get the majority of the benefit has been used in most Fit for the Future improvement plans we have worked on.

Many councils' Fit for the Future improvement plans forecast an increase in parking revenue (e.g. fines and payment for parking). Discussions with Council staff indicate that there is little prospect for an increase in parking revenue for Hawkesbury.

Reviewing the overhead allocation from the waste, water and/or sewer funds is another typical area councils have included in their plans. However, we are advised that a review of the allocation of overheads was undertaken and the changes implemented in 2016/17 prior to the development of these strategies. This resulted in an estimated additional $500K per annum being calculated as the true overhead cost which is now accounted for.

The most significant revenue increase relates to the Special Rate Variation.

Comments about specific strategies

The description of the pricing structures for business unit's strategy indicates a desire to achieve a break-even result for these assets/services. In our experience of working with other councils, it is unlikely that some of these facilities will achieve that given the nature of the services provided, especially the pool. The estimated benefits of the strategy are modest ($160K per annum) and failing to achieve breakeven across all the assets is unlikely to significantly affect Council's performance. We also understand that setting the target is an important signal of Council's expectations.

We note that the strategy around increasing the contribution to building renewal and maintenance from childcare providers is now based on seeking to achieving recovery of up to 50% of depreciation. We would caution over-estimating the value of the increased revenue as achieving increases in charges for childcare providers can be problematic.

The costs and revenue associated with growth have a major impact on Council's financial sustainability. It is vitally important that Council continues to plan for, monitor and allow for growth. We are advised that the timing of the Special Rates for Redbank North Richmond and Jacaranda Ponds Glossodia remain on track as forecast. Reviewing expected timeframes for particular developments and growth forecasts will need to be an ongoing process.

We note the progress that has been made towards obtaining a dividend from the Waste Management Fund and the Sewerage Fund. While the future dividend is estimated to increase, no provision is yet made for the Sewerage Fund dividend (2020/21) as there is a need to comply with the relevant requirements first including making a surplus for 3 years in a row. It is important to note that the performance of the Sewer fund itself is not part of a Fit for the Future assessment of financial sustainability or included in the calculation of the Fit for the Future benchmarks. Payment of a dividend from the Sewer fund to the General fund will however make a positive contribute to council's financial sustainability.

Council's Integrated Capital Works Program strategy of using the funds from VPAs and section 94 contributions is sensible.

In our view, it is clear that Council needs a substantial Special Rate Variation. Hawkesbury has consistently reported operating deficits and under investment in renewals. Fit for the Future has created a change in NSW local government and it is no longer acceptable for councils to run ongoing operating deficits.

We understand that the community has clearly indicated a desire for improvements to existing assets and services and the provision of new assets and services. Council's costs and revenue strategies, as forecast in the Deteriorate scenario, are unable to satisfy the Fit for the Future benchmarks let alone deliver new assets and services.

There are always ways for an organisation to become more efficient or for a council to seek to increase its non-rates revenue. However, having considered Council's various strategies and initiatives and the planned expenditure within scenarios 2 and 3 of the Resourcing Strategy, we do not believe there are alternative strategies and initiatives that would provide anywhere near the level of revenue/savings that the SRV provides.

Table 2 below highlights the typical high-level strategies that in our experience NSW councils have used to meet the Fit for the Future benchmarks and indicates those that our review has determined council has used.

Table 2 - Typical Financial Sustainability Strategies

Strategy	Hawkesbury City Council
Efficiency programs	✓
Service Reviews	✓
Review of financial and asset management practices	✓
Increased fees, charges & cost recovery	✓
Special Rate Variations	✓
Reduce services & service levels	×

Financial and Asset Issues

Debt

Borrowing to fund assets is a well-established approach to create intergenerational equity for councils who invest in long lived community assets.

Prudent financial management should mean that overtime Council's depreciation cost and renewal expenditure balance out. However, Council advises that such is the need to renew assets that in this case debt funding of renewals will bring forward the renewal program and deliver on the community expectations for improvements in assets and services. Council's intention is to ensure that the community can see immediate benefits from any increases in rates.

Council advises that, in respect of each borrowing program, the $25M and $40M respectively will be borrowed over a period of 15 years

- Scenario 2: 49% will be used for Renewal and 51% for New Capital
- Scenario 3: 46% will be used for Renewal and 54% for New Capital

In our view, based on the information contained within the Long-Term Financial Plan, Council could fund the asset works within scenario 2 without resorting to borrowing. Council has sufficient net operating cashflows to cover both the renewal and new capital over the ten years of the LTFP. While Council may not be able to schedule the works in the way currently programmed the same work should be able to be delivered within the 10-year period.

Depreciation

Depreciation is a complex issue involving many calculations, multiple inputs and data sets from across difference asset categories. In this regard, we have not undertaken a detailed review of depreciation. However, we note that Council's overall rate of depreciation is within the range we would expect when compared to other similar councils. The only area that raised questions was Council's specialised buildings, and Council advises that this category includes sewerage and waste management facility assets. These are no t typical assets and could explain the variation.

We would expect depreciation to be indexed or cost escalations allowed for over the ten years of the LTFP. We found that this was not Council's practice but we understand that following our advice this has now been included and updated forecasts made. As well as needing to be being accurate in the forecast depreciation costs, depreciation is the denominator in the Asset Renewal Ratio. If the forecast cost for depreciation is not accurate then the Renewal Ratio will also be inaccurate.

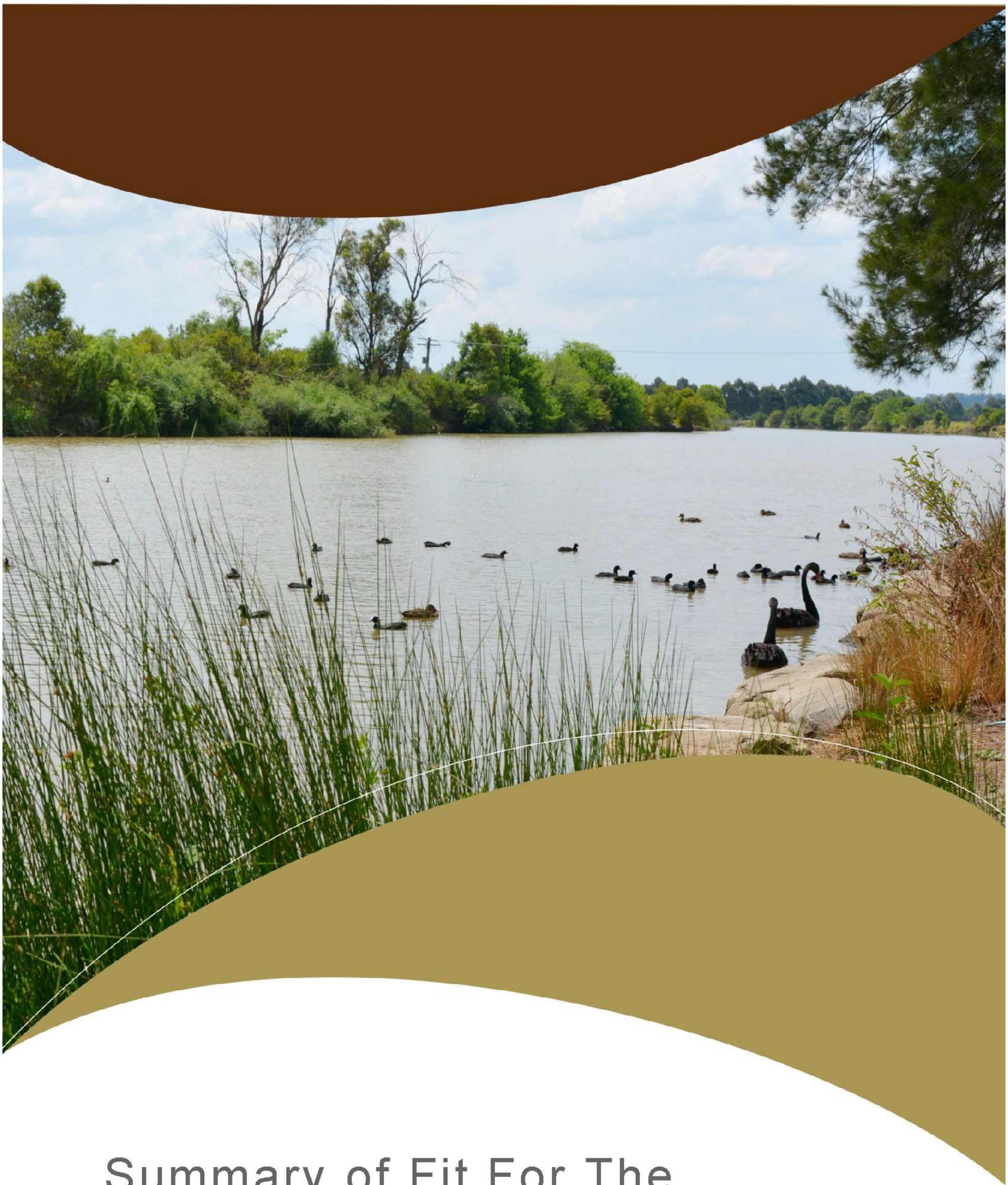
Infrastructure backlog ratio

Morison Low has a different, condition based, approach to calculating the estimated cost to satisfactory from JRA. There are many interpretations and methodologies to calculating the estimated cost to satisfactory and an absence of clear guidelines and it is open to Council to select an appropriate methodology.

We have not enquired as to the validity of the data which the methodology uses or the calculation itself. What is key in our view is that Council adopts a methodology that is consistent across asset classes and is repeatable from year to year.

We do note that, in our view, it is important that Council's reporting is consistent as the community can become confused when there are mixed messages. Council's infrastructure backlog ratio has reduced in recent years and is forecast to be less than 3%, even under the Deteriorate scenario. While we are advised that the JRA methodology is based on only including high-risk assets in the calculation, the current infrastructure backlog ratio does not seem consistent with the narrative that a substantial SRV and borrowing program are required to arrest declining infrastructure.

Appendix A Council Improvement Strategies



Summary of Fit For The Future Strategies

Delivery Program 2017-2021

Fit For The Future Proposal - Summary of Strategies		
1.1	Review of Road Operations	An annual 1% efficiency target applied to Councils yearly $14 million spend on road works operating costs (excluding ordinary wages and overheads).
1.2	Review of Service Delivery Models	An annual 1% to 2.5% efficiency target applied to Corporate Support and Discretionary Services (excluding employee costs and overheads).
1.3	Review of Plant and Fleet Management	Review of plant/fleet vehicles and accessories, ownership and maintenance models to achieve annual saving on net cost of operating leaseback fleet.
1.4	Property and Asset Review	Rate of return review to identify non-performing and surplus properties for sale or disposal.
1.5	Review of Insurance Coverage and Self-Insurer Model	Review self-insurer model to enable comparison with alternate funding and provisioning arrangements for workers compensation and other insurances. Review to include assessment of impact of self-insurer requirements on procurement costs and staff productivity.
2.1	Special Rate Variation	Notional SRV of 14.49% (excluding rate peg) over two years commencing in 2018/2019 to generate additional rating revenue to meet loan repayments for $25 million infrastructure borrowings program, with balance of revenue directed to asset renewal and maintenance and budget repair.
2.2	Stormwater Management Charge	$25 annual levy for stormwater management services against properties connected to the stormwater drainage network - commencing in 2017/2018.
2.3	Special Rate for New Residential Development	Special Rate applied from 2019/2020 to developments at Redbank, North Richmond and Jacaranda Ponds, Glossodia to generate additional revenue to fund asset maintenance requirements which will not covered by ordinary rating revenue due to the particular characteristics of the environmental and heritage assets within these developments.
2.4	Waste Management and Sewer Dividend	A 12% rate of return on the value of assets within Waste Management Facility and Sewerage Schemes.
2.5	Review of Pricing Structures	Review operations of income generating 'non-core' business units – Cemeteries, Companion Animal Shelter, Richmond Pool, Upper Colo Reserve so that pricing structures can be geared to achieve break-even operating position over medium term.
2.6	Lobbying for increased regional road funding	Council receives RMS funding as a contribution to the costs of maintaining regional roads. It is proposed that Council lobby government to have additional roads placed on the regional roads network and seek contribution to costs of maintaining these roads.

Delivery Program 2017-2021

Fit For The Future Proposal - Summary of Strategies		
3.1	Completion of Asset Management Plans	Completion of asset management plans to provide a sound platform for long-term financial forecasting and the validation of infrastructure backlog values. To be undertaken in conjunction with the review and consolidation of Council's asset management planning framework.
3.2	Service Level Review	Community engagement strategy to determine safe, affordable and agreed levels of service for all asset classes.
3.3	Integrated Capital Works Program	Establish parameters for capital works investment with a clear priority on asset renewal to address infrastructure backlogs and upgrading existing assets. Strategy is intended to minimise future exposure to increased asset maintenance costs and annual depreciation charges.
4.2	Sinking Fund for Community Facilities	Building Maintenance and Renewal Levy applied to community facilities used to deliver fee-paying and/or funded child care services based on 50% of the annual depreciation charges for these facilities as a contribution to the maintenance and renewal of these assets.
4.3a	Infrastructure Borrowings Program	$25 million loan facility to fund accelerated five year works program focused on road upgrades and renewals, renewal of park assets and community buildings, in response to documented community priorities.
4.3b	Energy Efficiency Borrowings Program	Loan facility to invest in energy efficiency infrastructure. Costs recovered through energy savings would be used to fund loan borrowings.
5.1	OPEX Expenditure Reduction	Projected savings to be achieved through the adoption of new technology, online service delivery platforms and a review of opening hours.
5.2	Regional Strategic Alliance	Formal partnership with Blue Mountains and Penrith City Councils to implement regional joint projects to increase operating efficiencies through the aggregation of service contracts and the sharing of resources and corporate costs across the three councils.
5.3	Sustainable Population Growth	Continued implementation of Hawkesbury Residential Land Strategy to concentrate new residential development around existing urban centres and villages.