

With respect to the submission to Ipart by Muswelbrook Council for a Special Rate Variation (“SRV”) I express serious concerns as to the proposed asset acquisitions and method of funding, based on:

1. Reliance on grant funding, increased debt and increased rates to fund projects with poor revenue prospects
2. The Future Fund has undergone rapid expansion with a reliance on debt funding for properties below investment grade
3. Non-disclosure of planned asset purchases as already described in Council minutes
4. A high level of senior staff turnover has been experienced and there has been the recent departure of a senior finance staff member

I will now provide further detail on each of the above matters.

1. PROPOSED ASSET ACQUISITIONS

Council issued to ratepayers a document of ‘Proposed Special Rate Variation FAQs’. This included a statement concerning the “Implementation of Olympic Park Precinct Master Plan upgrade and Entertainment and Conference Centre with a combined value of \$M26.01”. This would involve an annual operational maintenance and net yearly operational contributions of \$700,000.

Council failed to advise the individual amounts to be expended on the construction of the two items.

An examination of the figures provided to Ipart for the operation of the Entertainment and Conference Centre reveals an annual cash deficit (excluding depreciation) of \$M1.258 on an asset costing \$M15. This proposed return is grossly unacceptable from a financial perspective.

2. THE FUTURE FUND

An early description of the objectives of this fund, by the Council, stated:

“Commercial activities. Council is involved in a number of commercial activities related to the provision of residential and commercial properties for lease and sale of both development ready and surplus vacant land. Since July 2010, Council has created a commercial buildings business activity (reported in the special schedules of the annual financial statements) in order to dissociate from Council's normal activities (and from its General Fund) a number of buildings and land that have been acquired in order to provide revenue from rentals and sales. Council generated a deficit after tax of \$0.1m in 2011 and a surplus after tax of \$0.6m in 2012 from its commercial buildings activity. Council has prepared a separate LTFP for this Fund. The projections show an operating result between \$0.6m to \$0.8m each year between 2013 and 2022. The surpluses generated in the Commercial Property fund to date have been reinvested in the fund, allowing it to become established and expand to a point where it can generate significant ongoing dividends. From 2013/14, an annual dividend of \$0.5m will be paid to the General Fund and it is expected that this should increase to \$1.0m by 2016/17.

These dividends will be used to fund increased renewal and replacement of assets and infrastructure in the General Fund.”

On page 148 of Council Financial Statements 2016/17 it is disclosed that investment properties had grown from \$M8.861 (opening balance 2016) to \$M21.915 (closing balance 2017) with an outstanding commitment of \$M35.209 for additional purchases. The fund was supposed to provide an ongoing dividend of \$M1.0 per annum to the General Fund. However, the results provided were (after fair value movement):

	2017	2016
Total income attributable	\$M1.823	(\$M1.244)
Fair value movement	\$M0.545	(\$M1.967)

In contrast, on page 18 of the Agenda for the Extraordinary Meeting of Council on 31/01/2018, it is revealed that net profit attributable to Council from the Future Fund was \$M0.472 for the year to June 2017.

Future operation of the fund will now be impacted by total existing debt of \$M53.6, although this does not appear to have been included in the present submission to Ipart. Council has demonstrated the sensitivity of higher interest rates on the proposed debt to be taken on in funding the asset acquisitions in the current Ipart proposal, but has not demonstrated any impact from interest rate charges on Future Fund debt.

3. OTHER PLANNED ASSET PURCHASES BY COUNCIL

Council failed to disclose, in the previous Ipart submission, that it was about to conclude negotiations for the purchase of Muswellbrook Marketplace for over \$M33. In recent Council minutes it is disclosed that:

31/01/2018 at Item 9.2

Council authorises the General Manager to execute all relevant documentation relating to the purchase of the option of the subject property by Council.

and

12/12/2017 at Item 19.5

160 RESOLVED on the motion of Crs [REDACTED] that: Council: 1. Proceed with the purchase of the property as identified in the report. 2. Authorise the General Manager to negotiate and execute all other relevant documentation relating to the purchase of the subject property by Council. 3. Authorise if necessary for the Council Seal to be affixed to the Contract of Sale and Transfer document relating to the purchase by Council of the subject property. 4. The subject property be classified as “Operational” land within the meaning of Division 1, Part 2 of the Local Government Act 1993. 5. such funds to be sourced from the Future fund in diminution of the amount set aside for loan repayment.

4. HIGH LEVEL OF STAFF TURNOVER

In recent years there has been high turnover of staff employed at the Director level of Council, and senior staff immediately below this level. The General Manager also resigned recently. Minutes of the Council meeting on 31/01/2018 at Item 9.3 refer to “delivery of planning and regulatory service – personnel matters concerning particular individuals”.

The matter was discussed in Closed Council with the result:

9.3 DELIVERY OF PLANNING AND REGULATORY SERVICES. Disclosure of Interest [REDACTED] declared a pecuniary interest in this item. [REDACTED] advised that [REDACTED] works in the Department that the report is about. At 6:40pm [REDACTED] left the Council Chambers and therefore took no part in discussion or voting on this item. 178 RESOLVED on the motion of [REDACTED] that: Council endorse the proposal in the report.

It is my understanding that this involved a senior staff member, closely involved in the preparation of financial plans submitted to Ipart, who has since left employment at Council.

SUMMARY

In the TCorp report enclosed with the submission are the following comments:

4.5: **Borrowing Capacity** Based on the current version of the LTFP and when analysing the financial capacity of the Council, we believe that Council should not incorporate additional loan funding in addition to its existing debt facilities where those borrowings are serviced from operating revenues. Council has advised TCorp that Council has access to substantial and recurrent capital planning contributions connected with infrastructure renewal on its mining affected road network. Bringing forward the renewal of its mining affected road network is the subject of Council's proposed borrowings. Council proposes to fund its borrowings for the mining affected road renewal from that recurrent capital source. TCorp considers that borrowing for capital renewal for that purpose may be appropriate. Some comments and observations are:

As noted in our comments in section 4.1, the forecast shows that substantial deficit positions are expected each year when capital grants and contributions are excluded. Despite favourable forecasts for the credit metrics (DSCR and Interest Cover Ratio) in the 10-year forecast, TCorp considers that it would be prudent for Council to develop strategies to improve its operating position prior to proceeding with further borrowings other than those mentioned above.

I believe that Muswellbrook Council is attempting to expand its asset base at an inappropriate rate with a reliance on capital grants and debt which is increasing interest rate risk in an environment where rates could ultimately move substantially higher. Recently acquired assets (in the Future Fund) will fall in value and it is unlikely that any revenue increases will offset this. The SRV by Muswellbrook Council should be refused.