Snowy Valleys Council
Background Paper - Financial Situation

Morrison Low Consultants has been engaged by Snowy Valleys Council's ('Council') to:

- review Council's current baseline budget and financial forecasts
- assess the contributors to Council's financial sustainability challenges
- independently assess and provide independent advice on the long-term financial sustainability of Council
- provide advice on options to close any financial sustainability gap
- provide information to the Snowy Valleys community and facilitate the community engagement process, so that Council can make an informed decision on the options to become financially sustainable.

Morrison Low has relied on a publicly available information and information provided by Council in its analysis, assessment of Council position and in developing a series of background papers. This background paper covers our assessment of the financial situation.

The Council's financial position is unsustainable at the current levels of expenditure and income. This has occurred for a number of reasons and most of these reasons are unrelated to the 2016 merger and would have challenged the former councils at some point in the future regardless.

Council has been making changes to become more sustainable, but these alone will not be sufficient. Apart from an internal continuous improvement journey, no decisions have been made around how to close this gap, as there are a number of options that could be adopted that singularly or jointly will ensure that Council becomes sustainable.

The Local Government Act requires councils to apply sound financial management principles of being responsible and sustainable in aligning income and expenses, infrastructure investment, with effective financial and asset management performance management. The objectives are to:

- achieve a **fully funded operating position**
- **maintain sufficient cash reserves**
- have an appropriately **funded capital program**
- **maintain its asset base** 'fit for purpose'
- have adequate resources to meet ongoing **compliance obligations**.

These objectives are the foundation for sound financial management and a financially sustainable Council that has the financial capacity to deliver the services to its community over the long term.

Current situation

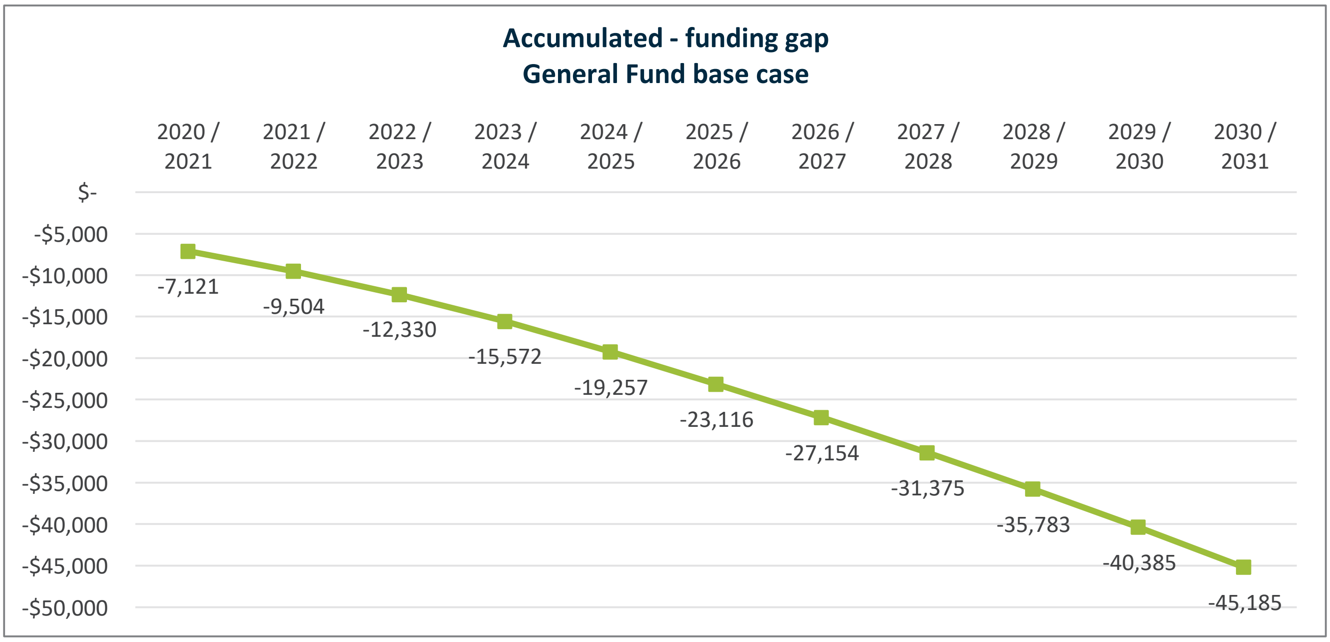
The Council is producing deficit net operating results whilst maintaining, and in a lot of instances, expanding and improving services. Despite delivering efficiencies, Council has continued to produce significant operating losses. Contributing factors to this are detailed in the next section. In the previous two financial years, Council posted a net consolidated (General, Water, Sewer and Domestic Waste Funds) operating deficit of $7.7 million and $1.6 million respectively. For General Fund operations[1] only, the net operating deficits were $7.7 million and $2.9 million. Repetitive operating deficits are unsustainable and lead to a cash deficit and depleted assets. Doing nothing is not an option.

The Office of Local Government require councils to meet an operating performance benchmark for spending within their income base, that is operating income equals operating expenses. It should be noted that grants and contributions for capital projects are excluded. Council's consolidated operating results, excluding capital grants and contributions, have not met the Office of Local Government benchmark and have resulted in a cumulative consolidated operating deficit of $21 million since 2016.

In 2019/20 general rates contributed 18% of Snowy Valleys General Fund total revenue, which is significantly lower than similar regional merged councils at 24%. The other major income streams for Council are user charges and fees at 24% and operating grants at 29%. With general rates income at a relatively low level, as a percentage of Council's General Fund revenue, with no change to service delivery, a rates increase is necessary to help mitigate budget imbalances.

In 2020 the Boundaries Commission engaged Deloitte to undertake a financial analysis of Council. The published summary findings concluded that Council was not financially sustainable in the medium- to long-term and suggested a range of strategies to address Council's financial sustainability issue.

A financial analysis of Council's General Fund operation's current position is illustrated in the following graph.



[1] General Fund operations, which are all Council operations excluding water, sewer and domestic waste, are funded from the general rates and other income. Water, sewer and domestic waste are funded from a combination of annual charges and user fees and can only be used for the specific operational purpose.

This analysis indicates a ten-year funding gap in the order of $45 million. This is a result of year-on-year net operating deficits for General Fund, without any initiatives to improve the financial situation. As a result, it does not achieve a **fully funded operating position.**

To fund the ongoing operating deficits, there is a need to use Council's cash reserves to enable the delivery of services and management of assets. From the current financial analysis, the total cash reserves are estimated to decrease by some 65%, $29.2 million, over ten years, placing further financial pressure on Council to **maintain sufficient cash reserves.**

Council has a good infrastructure backlog at 0.23% (*2019/20 Financial Statements*), bettering the target of 2%. This means that Council has been able to maintain its assets at the agreed level over the years **and maintain its asset base** 'fit for purpose'.

This has been achieved through a combination of external funds, grants and internal funding. Deloitte, in their report to the Boundaries Commission, noted that since 2016 approximately $62 million has been invested in capital projects, including new infrastructure, asset renewal and maintenance. As a result, Council's infrastructure backlog ratio has reduced to minimal levels and the average quality rating for assets across the region has improved.[2]

This has allowed Council to renew its asset base in a timely manner by having an appropriately **funded capital program.**

Council has received significant grant funding for new and upgrade assets, which increases the costs to the community to maintain and renew these assets over their lifetime. Recently Council has been advised they were successful in obtaining an additional $14 million in grants for new assets and upgrades to assets, namely a new emergency evacuation centre and upgrades to three swimming pools. To keep these assets fit for purpose, there will be an estimated increase in costs of $460,000 per year for asset maintenance and depreciation and decreased investment income, which have been included in the financial modelling.

Other factors that will constrain Council's ability to achieve financial sustainability are:

- the minimum full-time equivalent (FTE) requirements in place for Tumbarumba, Adelong and Batlow due to merger obligations for a rural centre
- community expectations of consistent service levels across the towns and villages in the LGA
- due to the geography and LGA size limit, asset and service consolidation opportunities
- the current level of spending on asset renewal given the good condition of Council's asset base.

The key challenge for Council is to implement its current sustainability plan, which aims to deliver efficiency improvements within Council of over the next three to four years. To become fully sustainable, Council will need to explore a range of further options for consideration by the community. By way of illustration, should Council not implement any sustainability improvements, then a one-off special rate variation (SRV) increase of 37% would be required.

[2] Local Government Boundaries Commission and Deloitte, 'Proposal To "Demerge" the Existing Snowy Valleys Council - Summary of Key Findings Report', October 2020, p.4.

Closing the gap

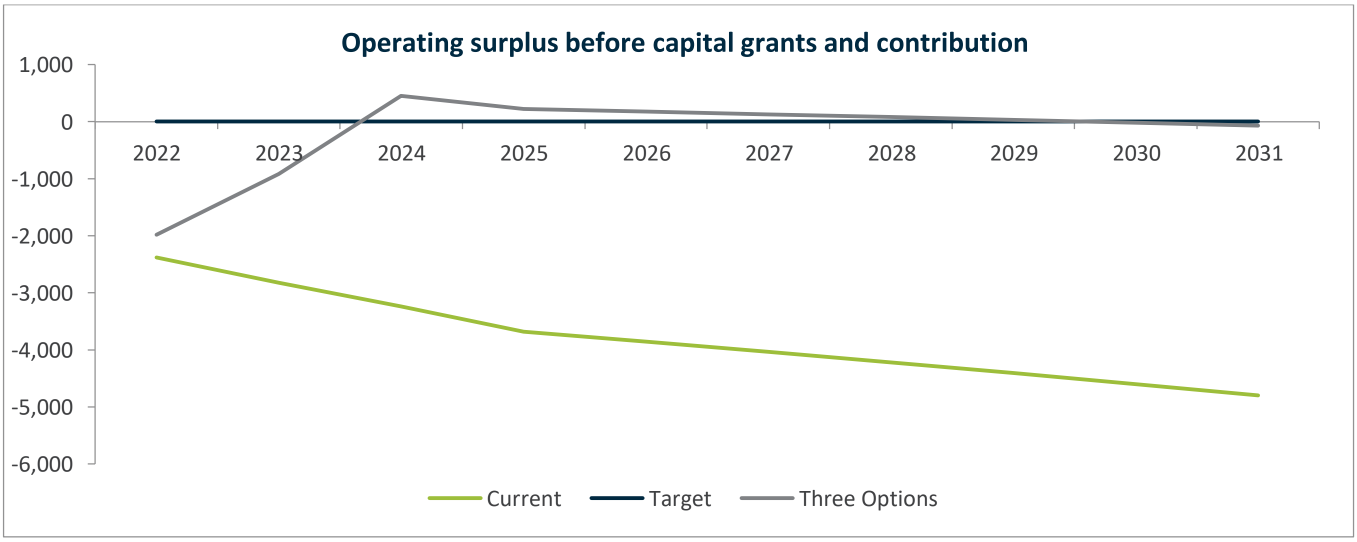
Currently the General Fund operation has an estimated ten-year financial gap of $45 million. For 2021/21 there is an estimated operating deficit of $2.4 million, increasing to $4.8 million in 2030/31, with each year having a deficit result. The likelihood is that this position could get worse, with the impact of grant funded new assets and increases in service costs and/or levels, without any actions to improve Council's financial performance.

Given the current circumstances, three options have been developed for community consideration, being:

1. Option A - 30% SRV over two years (15%, 15%) = $3.1 million (is the compounded amount ~32.25%) + implementing the productivity gains[3] of $600,000 over three years.
2. Option B - 25% SRV over two years (12.5%, 12.5%) = $2.5 million (is the compounded amount ~ 26.66%) + productivity gains $600k over three years + $700,000 service savings over three years.
3. Option C - 15% SRV over two years (7.5%, 7.5%) = $1.5 million (is the compounded amount ~ 15.56%) + productivity gains $600,000 over three years + $1.7 million service savings over three years.

Noting the rate peg increase needs to be added to the SRV percentage increase. For example, if the rate peg increase was 2.1% for 2022/23, this would need to be added to the first year SRV percentages for the options above, i.e. option B year 1 - 12.5% + 2.1% = total increase of 14.6%.

The following graph shows the outcomes of the three options compared to the current situation and includes an estimated rate peg increase.



As detailed above, Council's assets are in a good condition, however there is significant pressure on the cash reserves of Council.

An SRV is a viable solution to the Council's financial sustainability challenges, however there are other options that Council can consider, to reduce the amount of any SRV. The options and choices that Morrison Low considers most suitable for consideration are listed on the following page. It is most likely that no single option will provide the solution.

[3] Productivity gains will result in a $600,000 saving in staff costs.

These options are:

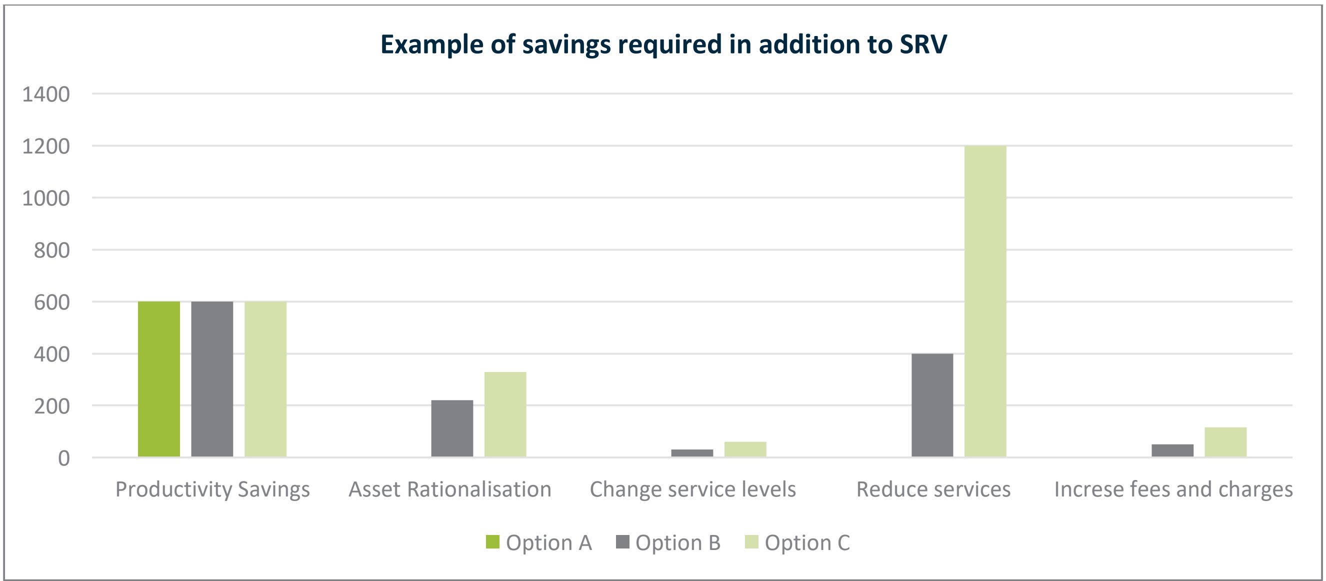
1. Asset rationalisation - selling or disposing of underutilised/redundant building assets will avoid ongoing maintenance and depreciation costs. Council has identified a range of underutilised or redundant building assets with a value of $9.7 million. If Council disposed of $2.25 million of assets it would save $100,000 per annum.
2. Transfer or cease services - this entails someone else providing the services or stopping services altogether. Services that could be considered for exit are non-core services and include some community services activities, community grants and donations, saleyards, events and promotions, and community development. Council currently spends $2.5 million of general rates delivering discretionary services that could be transferred or closed. Transferring or ceasing 20% of these services would save $500,000.
3. Reduce service levels - unlike transferring or ceasing services, under this option, Council would still deliver the service but reduce the amount of service it provides. It could reduce the operating hours for some services like libraries, swimming pools and customer service centres, etc. A reduction in service hours of 12 per week, on average, across a range of services would save an estimated $60,000 per annum. The types of services where hours could be reduced include:
    - community services - 155 hours per week across all services
    - visitor information centre - 43 hours per week
    - libraries - 118 hours per week across all libraries
    - customer centres - 64 hours per week across both centres
    - swimming pools – Council's five swimming pools' hours vary seasonally.
4. Increase fees and charges - this approach enables a larger recovery of the costs paid by the direct users/beneficiaries rather than general ratepayers. For example, a 2% increase in fees and charges would generate an addition $260,000 in income. This could include reintroduction of user charges for swimming pools and sporting facilities.
5. Apply for a special rate variation to cover all or part of the funding gap.

Council has identified three possible options, with option A requiring productivity savings within Council operations and options B and C requiring, in addition to productivity savings, increasing amounts of service savings and/or additional revenue to reduce the amount of any SRV.

Following are the options for consideration:

	Option A	Option B	Option C
Closing the gap through: • asset rationalisation • change service levels • reduced services • increased fees and charges.	No service changes, with a productivity saving of $600,000. See example of apportionment for option A in the chart below	$600,000 productivity savings + savings of $700,000 over three years from a combination of closing the gap options. See example of apportionment for option B in the chart below.	$600,000 productivity savings + savings of $1.7 million over three years from a combination of closing the gap options. See example of apportionment for option C in the chart below.
Special rate variation	An SRV of 30% spread over two years (32.25% compounded).	An SRV of 25% spread over two years (26.66% compounded).	An SRV of 15% spread over two years (15.56% compounded).

Asset rationalisation and increasing fees and charges are most likely to be the first levers used to close the gap, but realistically provide the smallest impact. Changing service levels and reducing services are normally the last levers used because they are the least acceptable, but they do provide the largest impact. The following chart is indicative of where the source of funding to close the gap may need to come from in options A, B and C. As the amount of savings required increases, the impact on services must increase.



Illustrated in the above chart following is an indication of where the source of funding to close the gaps may need to come from for each option.

Option A - example comprises:

- the proposed SRV, plus $600,000 of productivity savings.

Option B - example comprises:

- the proposed SRV, plus $600,000 of productivity savings, plus $700,000 of savings/increased revenue made up of:
    - rationalising $4.8 million of underutilised asset to reduce costs by $220,000
    - six hours per week of service reductions to reduce costs by approximately $30,000
    - transfer/cease services to reduce net costs by $400,000
    - an 8% additional increase in fees and charges to generate a further $50,000 in revenue.

Option C - example comprises:

- the proposed SRV, plus $600,000 of productivity savings, plus $1.7 million of savings/increased revenue made up of:
    - rationalising $7.3 million of underutilised asset to reduce costs by $330,000
    - 12 hours per week of service reductions to reduce costs by approximately $60,000
    - transfer/cease services to reduce net costs by approximately $1.2 million
    - an 18% additional increase in fees and charges to generate a further $110,000 in revenue.

The impact on ratepayers will vary, depending upon the level of savings generated from the options detailed above. The following graph illustrates the change in Council's average rate and, as you would expect, the higher the SRV the greater the increase in the average rate.