Queanbeyan-Palerang Regional Council

QPRC Financial Strategy and Policy

Date policy was adopted:	25 January 2017
Resolution number:	028/17
Next Policy review date:	25 January 2018
Reference number:	C15107905

1. OUTCOMES:

Queanbeyan-Palerang Regional Council commissioned an 'Asset and Financial Sustainability Review' undertaken by Prof Percy Allan and Associates. GHD reviewed the condition and standards associated with the management of Council's infrastructure assets.

2. POLICY:

Background

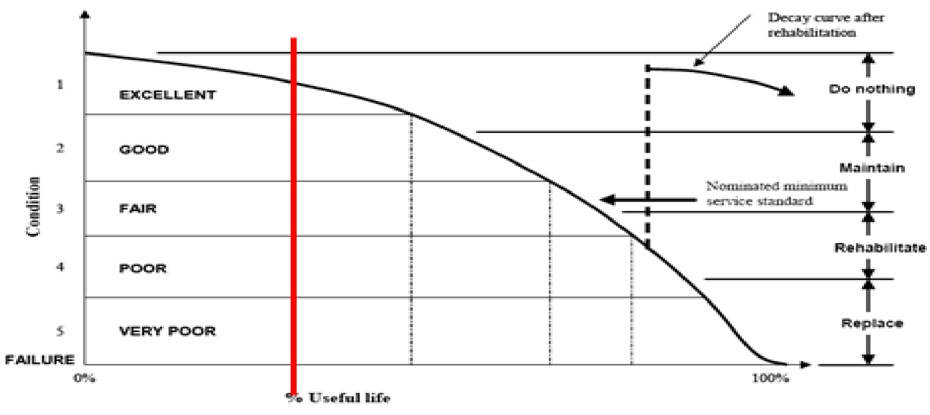
The Asset and Financial Sustainability Review recommended a shift from Existing Policy as outlined in the respective council's Long Term Financial Plan (LTFP), asset management plans (AMP) and revenue policies to a 'Responsible or Optimal Scenario' to achieve an acceptable compromise between Council's obligations to:

- achieve financial sustainability,
- manage the asset backlog to prevent an infrastructure crisis,
- preserve essential public services in line with population growth
- keep rates, fees and charges affordable
- borrow at acceptable levels in line with intergenerational equity and
- meet financial benchmarks to be fit for future (FFF)

A condition and maintenance intervention level scale (1-10) will be used to illustrate asset standards and forecast likely renewal and replacement schedules. Council's Asset Strategy will be updated to consider:

- Infrastructure condition, renewal and capacity needs,
- Rationalising and optimising existing assets,
- Properly size, site and schedule new assets,
- Prioritise assets on the basis of:
  - Asset condition, age, load, local geography,
  - Risks such as climate change, and
  - Demographic changes
- Asset backlog

Ideally infrastructure assets should be renewed at appropriate schedules to preserve their utilisation and ability to support agreed service levels, and to minimise the larger capital cost to replace those assets. The 'degradation curve' chart below illustrates the comparative life cycle of maintaining, renewing and replacing a sample asset.



RE 6: Typical condition decay curve for infrastructure assets

3. DEFINITIONS

Nil.

4. LEGISLATIVE OBLIGATIONS AND/OR RELEVANT STANDARDS

Nil.

5. CONTENT:

The Financial Strategy outlines the elements of the endorsed financial scenario, pricing policies and tools to minimise costs and optimise revenues.

Goals

The key financial sustainability goals for QPRC general operations over 10 years are to meet Fit for Future benchmarks including:

I. a minimum operating surplus ratio of 0%,
II. a maximum infrastructure backlog of 2%
III. a maximum debt services ratio of 20%
IV. a services productivity gain of 2%

The key financial sustainability goals for QPRC water and sewer operations over 10 years is:

V. a minimum annual rate of return on capital of 1½%, a maximum infrastructure backlog of 2% and maximum gearing ratio of 30%.

Assumptions

The Financial Strategy has been drawn from the financial and asset reviews undertaken by Alan Tregiligas (2016) and GHD (2016) respectively, and the analysis of Prof Percy Allan (2016) recommending the Council consider a ‘Responsible or Optimal Scenario’.

The Strategy is modelled on the following growth assumptions over the 10-year projection period:

- the average annual growth in resident population is 1.7%;
- the average annual growth in rateable properties is 1.0%; and
- the average annual growth in Canberra's CPI is 2.4%
- the average interest expense of 3% (using NSW TCorp borrowing rates)
- current service levels
- adopted asset maintenance and renewal intervention levels

Spending on assets is based on the following:

- *Operational expense* is providing the service supported by the assets, such as mowing grass on a sporting field or cleaning public toilets.
- *Maintenance expense* is the expenditure on existing assets which is periodically or regularly required to ensure that a council’s existing assets achieve their economic life or period of service between renewal, such as filling potholes or grinding footpath surfaces.
- *Enhancement capex* is the cost of expanding the service capacity of a council's infrastructure assets beyond their current capacity. It usually involves extending or expanding the council's assets as the service requirements of its community grows, such as the duplication of lanes in an existing road or constructing a new regional sports facility.

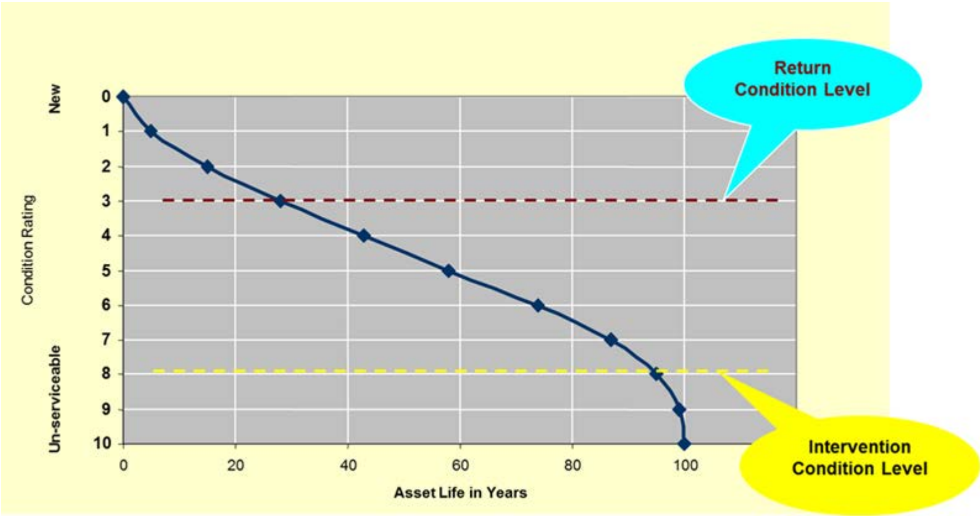
- *Renewals capex* is the cost of restoring the condition (and service capacity) of a council's existing infrastructure assets to 'as new' standard when such restoration falls due at the end of these assets' useful/economic lives, i.e., when an asset degrades to its intervention condition level, being the condition level at which a council's asset managers consider an asset should be renewed/replaced. This includes resealing roads or replacing water mains.
- *Rehabilitation capex* is the cost of restoring the condition (and service capacity) of a council's existing infrastructure assets as a result of past deferrals of programmed maintenance and/or renewals. Rehabilitation capex means capital expenditure aimed specifically at reducing a council's existing infrastructure backlog

Responsible/Optimal Scenario

Council will develop its rolling 10-year Long Term Financial Plan (LTFP) based on a revised version of the Optimal Scenario. The Plan aims to:

- Rehabilitate required infrastructure whose condition has fallen below an acceptable standard (i.e. the 'backlog');
- Renew required infrastructure when it falls below agreed minimum standards in future;
- Align the rate of asset renewal expenditure and/or placement into an infrastructure reserves, to the consumption or degradation of those assets (ie depreciation);
- Expand the total infrastructure stock by enough to cope with residential and business growth as informed by Council's asset strategy and demographic projections;
- Identify those core services that would be quarantined from any cost cuts to help fund infrastructure rehabilitation and renewal, or be subject to specific SRVs;
- Fund these initiatives through adequate revenue measures, operational savings, re-ordering spending priorities, asset leases or disposals and extra borrowings;
- Fund infrastructure maintenance and renewals from operating revenue and rehabilitation and enhancements from budget surpluses, capital revenues and borrowings in accordance with a 'narrowing the gap' strategy;
- Ensure that the outcome by year 10 complies with FFF financial targets (e.g. the LGI recommended minimum surplus ratio and maximum broad debt ratio);
- Borrow sufficiently between now and 2016/27 to help fund infrastructure renewal under the Optimal Scenario;
- Use debt and movements in cash reserves to help 'smooth' large injections of assets renewal or upgrades across several years;
- Place cash surpluses following annual audit into an infrastructure reserve.

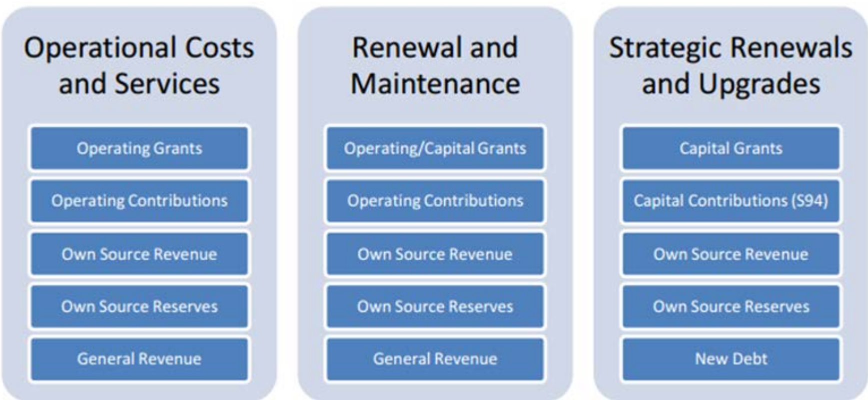
On this basis, asset renewals will be scheduled around the adopted Intervention Condition Levels (eg level 8 for footpaths) to return the assets to good condition and the ability to support agreed service levels.



Narrow the Gap

The ‘Narrow the Gap’ principle aims to progressively map and match asset and service expenses to related revenue sources, and to inform and influence opinion about council funding options, on the premise that:

a) All property taxes (rates, annual charges, development contributions, and asset specific grants) cover the cost of maintenance, renewal, upgrade and debt costs of assets, and the share of corporate attributed costs
b) All usage charges cover the costs of operating and administration costs for water, sewer, waste, and the share of corporate attributed costs
c) Other fees and charges, specific grants and specific SRVs cover the cost of non-infrastructure services (eg planning, environment, community etc), and the share of corporate attributed costs
d) Governance and corporate overhead costs are attributed across those asset and service areas, with balance of cost met by FAG and direct fees



In this way, the gap between those costs and revenues can be identified, and the policy levers to be utilised to have the costs and revenues align through a combination of:

a) Modifying rates, charges and fees revenues
b) Accessing more grants
c) Adjusting asset standards
d) Changing service levels

Financial Principles

The following key fiscal principles are proposed for the General Fund to achieve the fiscal sustainability goals for general operations (i.e., a minimum operating surplus ratio of 0% and a maximum infrastructure backlog of 2%) within 10 years:

- annual maintenance expense would be capped over the 10 years at an average around 85% of the annual required spend identified by GHD;
- annual renewals capex would be capped at 100% of the annual required spend identified by GHD. Renewals capex should be at least equivalent to depreciation expense;
- the average annual rates bill per property may increase by an average of 1.0% in real-terms each year beyond 2016-17;
- the operating fees cost recovery ratio would need to rise slightly more than the increase already planned under continuation of existing policy, to 50%;
- usage-based fees and charges would be increased, in accord with the operating cost recovery ratio increasing;
- dividend payments from W&S activities would need to be introduced, with a 50% dividend payout ratio (against net profit after tax) increasing general operations' revenue;
- annual per-capita spending on services would be cutback by an average of 2% per annum compared with the average cutback of around 1% planned under continuation of existing policy. This will be addressed as an annual efficiency or productivity dividend;
- higher levels of enhancement, renewals and rehabilitation capex over the coming 10 years compared with that proposed under continuation of Existing Policy;
- utilise borrowings to ensure inter-generational equity, and match term of borrowings to accord with expected life of the asset;
- utilise borrowings, reserves and sinking funds to smooth out lumpy capital expenditures; and
- cyclical (as opposed to structural) deficits can be tolerated to ensure that tax smoothing occurs for ratepayers

In order for Water and Sewer Funds to achieve key commercial sustainability goals (of a minimum annual rate of return on capital of 1½%, a maximum infrastructure backlog of 2% and maximum gearing ratio of 30%) within 10 years, the following key policy adjustments are proposed:

- ✓ maintenance spending would be capped over the 10 years at an average around 100% of the required annual level of such spending as assessed by GHD;
- ✓ the annual rehabilitation capex necessary to address the present infrastructure backlog would have to be spread out over 10 years;
- ✓ the annual renewals effort would have to be capped at around 98%;
- ✓ the operating fees cost recovery ratio would need to rise to 100%;
- ✓ revise the portion of governance overhead and direct charges attributed to W&S Funds;
- ✓ the average per-property revenue from usage-based fees and charges needs to be increased by around 1% in real-terms each year for the next 10 years; and
- ✓ the average water and sewerage-related annual charges bill may increase by an average of 1% in real-terms each year for the next 10 years

The rundown in cash reserves (in lieu of borrowings) may be used in part to renew assets that are coming to the end of their useful life and expand the infrastructure stock in line with Council plans.

Further to the Services Review, alternate modes of delivery of services may yield reduced costs or improved levels of investment in services or infrastructure. Those modes may include partnerships with community or business, or third party contracts.

On inter-generational equity grounds, additional borrowings will be used to fund both:

- ✓ enhancement capex, as such capex gives rise to infrastructure services benefiting future (as well as current) residents and ratepayers; and
- ✓ rehabilitation capex, the need for which arises mainly because depreciation has been under-funded in the past and the renewal and replacement of existing assets has been deferred when it fell due because of the lack of finance.

Pricing Principle

Rates and other property related charges will be expended on maintaining, renewing and operating infrastructure assets and the services they support, or paying debt for those assets. Those charges may also be used to match or leverage government grants to be used on those assets and services.

Fees and charges, other than statutory fees, will be moved to recover the real costs of delivering non-infrastructure services. Where a ‘community service obligation (CSO)’ is identified, the value of that subsidy will be disclosed.

Grants will be sought to initiate or continue services to the extent that all costs are recovered from the grant and related fees. Council may choose to subsidise those services up to the value of the organisation overhead attributed to those services.

The costs of supporting services and asset management will be distributed in accord with competitive neutrality principles and be based on a recognised resource effort and transactional drivers.

Commercial property lease returns may be realised (and rebated) in accord with the Rental Policy.

Further information is available in the: Revenue Policy, Pricing Policy, Property and Attribution Policies.

Other Measures

To improve General operations and revenues, Council will take further action including:

- Exploit commercial opportunities;
- Increase operational efficiencies;
- Rationalise non-core services;
- Engage and fund community groups to maintain and service some community assets;
- Sell surplus assets; and
- Obtain extra State or Commonwealth grants

Some of those measures include actions identified in the Property Strategy, including leasing, divestment and strategic acquisition of property.

6. PERFORMANCE INDICATOR:

The following benchmarks are anticipated under the Optimal Scenario:

- Cap the infrastructure backlog at 2% in future,
- Maintain a surplus of not less than 0% of own source operating revenue and keep the net financial liability ratio modest, (ie within the recommended threshold of 40-80%),
- Reduce the real annual change in total service expenditure from an increase 0.5% under Existing policy to 0%, noting that reducing operating expenditure (of which services are the biggest component) is a requirement under Fit for the Future guidelines
- Keep debt services ratio for council's General and Water & Sewerage operations at or below OLG's amber alert level of 10%, let alone Fit for the Future ceiling of 20%.

The table below illustrates the financial and asset sustainability ratios to be pursued in the LTFP.

Council Sustainability Ratios

	LGI Allan Report (2006)	NSW T-Corp Report (2013)	Fit for Future Report (2015)	Proposed QPRC Ratios	Reason for Proposed QPRC Ratios
Operating Balance Ratio	> 0%	< -4%	> 0%	> 0%	To avoid a chronic operating deficit
Own Source Revenue Ratio	NA	> 60%	> 60%	> 60%	To reflect consensus view of the three reports
Net Financial Liabilities Ratio	NA	NA	NA	< 80%	To ensure a credit rating of at least single A minus
Debt Service Ratio	< 20%	< 20%	< 20%	< 20%	To encourage moderate borrowings for infrastructure
Infrastructure Backlog Ratio	< 1%	< 2%	< 2%	< 2%	Consensus view, but uses a correct definition
Infrastructure Renewal Ratio	> 90%	> 100%	> 100%	> 90%	To avoid a big renewals backlog developing
Infrastructure Maintenance Ratio	NA	> 100%	> 100%	> 90%	To avoid a big maintenance backlog developing

Review

The community will be engaged in the preparation of the suite of plans associated with the Community Strategic Plan (asset management plans, workforce plan, long term financial plan) in each council term (ie 4 years), to establish:

- Asset standards
- Levels of service/asset intervention levels.

It is acknowledged that changes above or below those standards and service levels will influence modifications to the asset plans and financial plan, including levels of renewal, borrowings and depreciation.

POLICY:-	
Policy No:	
Policy Title:	QPRC Financial Strategy and Policy
Date Policy was adopted by Council:	25 January 2017
Resolution Number:	028/17
Previous Policy Review Date:	
Next Policy Review Date:	25 February 2018
PROCEDURES/GUIDELINES:-	
Date Procedure/Guideline (if any) was developed:	
RECORDS:-	
Container Reference in TRIM: Policy	SF160365 - C15107905
Container Reference in TRIM: Procedure	
Other locations of Policy:	Intranet (linked to TRIM Container)
Other locations of Procedures/Guidelines:	Intranet (linked to TRIM Container)
DELEGATION (if any):-	
RESPONSIBILITY:-	
Draft Policy developed by:	General Manager
Committees (if any) consulted in the development of the Draft Policy:	
Responsibility for Implementation:	General Manager
Responsibility for Review of Policy:	General Manager

Senior Authorising Officer	**Position**	**Signature/Date**
	General Manager	25 February 2016

ACTION	COUNCIL MEETING DATE	RESOLUTION NUMBER	REPORT ITEM NUMBER
NEW/RECONFIRMED/ AMENDED			

DATE REVIEWED	REVIEWER POSITION	REVIEWER NAME