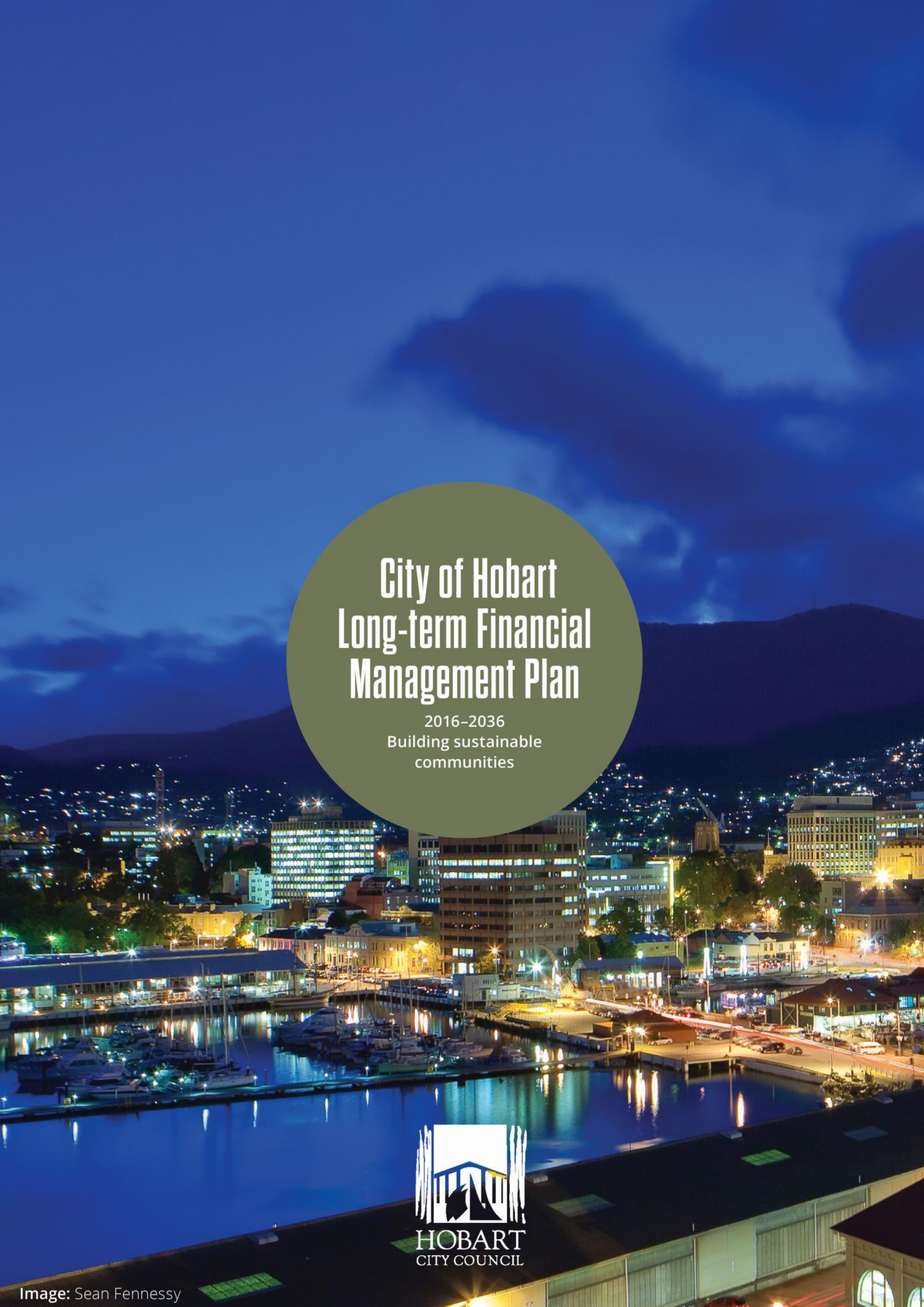

# City of Hobart Long-term Financial Management Plan

2016–2036
Building sustainable communities

HOBART CITY COUNCIL

**Image:** Sean Fennessy

Hobart City Council
GPO Box 503
Hobart, TAS 7001
Tel: 03 – 6238 2711
Fax: 03 – 6234 7109
Email: hcc@hobartcity.com.au
Web: www.hobartcity.com.au

ABN: 39 055 343 428
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## 2. Executive Summary

Council is currently in a strong financial position. It has strongly improved its operating result over recent years toward achieving underlying operating surpluses, has satisfactory liquidity and cash flow, low debt, a low reliance on external funding, and asset renewal requirements are being satisfactorily funded.

Previous versions of this plan have flagged the need for restraint in cost growth in order for forecast rate increases to be moderated. The last three annual budgets, including the 2015/16 budget, have contained an active program of cost reduction. As a result of this, cost growth assumptions for the future have been able to be reduced, thus allowing forecast rate increases to be reduced. Council is confident it now has an embedded cost management ethic.

Other challenges remain including the ongoing funding of asset renewals, and the closure of the McRobies Gully tip site, necessitating both significant rehabilitation costs, as well as changes to the revenue and cost streams associated with Council's waste management services given the requirement for waste to be transported and disposed elsewhere. Council is also committed to the various projects associated with the Inner City Action Plan and to contributing to the Myer site redevelopment.

The forecasts contained within this LTFMP and which are necessarily based upon certain assumptions, produce the following outcomes over the 20-year horizon of this plan:

- The achievement of modest underlying operating surpluses. Council is forecast to achieve surpluses generally in the range of 1.1% of revenue to 2.7% and averaging 2.0%. It is important that Council generates sufficient revenue to cover all of its cash and non-cash costs, with a small buffer. A higher surplus could be targeted annually, consistent with findings of various local government financial sustainability reviews undertaken across the nation.

- A continued low level of indebtedness. Council has a large debt capacity, in the event it needs to fund expenditure.

- 100% funding of forecast asset renewal requirements which is a key financial sustainability indicator. An appropriate benchmark is considered to be 90-100%. Renewal forecasts are continually being refined and the funding level continually monitored.

- Strong cash balances.

These outcomes, together with the underpinning assumptions of revenue and cost growth indicate annual rate increases to the ratepayer in the order of 2.5% in the short term, and then reducing to 2.0%. This is exclusive of the state government fire levy, any redistributive effects of revaluations, AAV indexation or changes to council rating policy.

These outcomes ensure the financial sustainability of Council, thus ensuring the ability to deliver services, at their current levels, into the future. It will ensure that current and future generations pay their fair share.

The LTFMP is based upon Council maintaining existing services at their existing service levels, except for the inclusion of the financial effects of Council's waste disposal strategic plan (closure of McRobies Gully tip site), the Myer site redevelopment and the Inner City Action Plan.

# 3. Background

## *Hobart City Council*

Hobart City Council (Council) is a Capital City council situated in Australia's second oldest city. The Council services an immediate population of 50,078 residents and 640,100 tourists to the city annually. Council offers more than 300 services to the community and the infrastructure required of a Capital City location.

Council has $1.06 billion in gross assets (replacement cost) and in 2015/16 has an operating budget of $119 million, will raise $74 million in rates and charges revenue, and will receive a further $43 million in fees, charges and other income. Council has a workforce of 587 full time equivalent employees.

One of Council's corporate priorities is planning for its financial sustainability. Strategies to achieve this priority include the development of this 20-year Financial Management Plan.

## *What is Financial Sustainability?*

There is not a universally accepted definition of financial sustainability; however, many organisations have defined what financial sustainability means to them.

In order for a situation to be sustainable both present and future needs are required to be met. Extending this definition to financial sustainability requires Council to manage its resources so that its financial commitments can be met both now and in the future. It is designed to ensure equality between generations of ratepayers in that each generation is responsible for the cost of resources they consume.

Financial sustainability can then be taken to mean whether Council can sustain its current practices in financial terms and whether community needs are currently met and will be met in the future. The SA Local Government Financial Sustainability Inquiry of 2005 defined financial sustainability as follows:

> "A Council's long-term financial performance and position is sustainable where planned long-term service and infrastructure levels and standards are met without unplanned increases in rates or disruptive cuts to services."

This definition was endorsed nationally at the National General Assembly of Local Government in Canberra in November 2006. Other financial sustainability reviews have used similar definitions.

## *Importance for Local Government*

Financial sustainability is particularly important for Local Government because councils hold assets worth in the billions of dollars (large relative to revenue base), that have lives of in some cases well over 100 years.

Council has $1.06 billion in physical assets, including buildings, parks infrastructure, plant, vehicles & equipment, playground equipment, road infrastructure, sporting facilities, stormwater infrastructure and The Hobart Aquatic Centre. The expected life of infrastructure assets varies from 10 years for plant and vehicles to 160 years for buildings.

It is important for Council to adequately fund asset management to ensure its assets achieve their full expected service life but can also be renewed without incurring large rates increases in the future.

In addition, councils face continuing expectations and pressures to maintain and increase service levels while at the same time keep rate rises to a minimum and have sound long-term financial management.

In 2007 Local Government Association of Tasmania (LGAT) commissioned an independent review into the financial sustainability in relation to Tasmanian councils. The independent review suggested that most of the challenges facing Councils result from short-term thinking which fails to address the long-term nature of infrastructure.

The Local Government and Planning Ministers' Council at their meeting on 26 March 2007 endorsed three nationally consistent frameworks for assessing financial sustainability, asset planning and management and financial planning and reporting and agreed that each State and Territory governments apply the frameworks by 31 December 2010. The three frameworks are:

- Assessing local government financial sustainability.
- Asset planning and management.
- Financial planning and reporting.

In June 2009 the Prime Minister announced that the Australian Government would provide $25 million to establish a Local Government Reform Fund to:

- Assist councils implement financial and asset planning and management in accordance with the frameworks, and
- Support reforms to council operations through greater regional cooperation and collaboration.

The LGAT commissioned a project to assess the benefits of and barriers to implementing the common specified framework for long-term financial planning and strategic asset management planning in all Tasmanian councils.

Findings from the project have been released in a report *The Framework for Long-term Financial and Asset Management Planning for all Tasmanian Councils*. The Tasmanian Government is seeking funding to implement recommendations from the report. Key recommendations relating to financial sustainability include:

- Agreed sustainability indicators for reporting by all Tasmanian councils.
- An agreed long-term financial plan template.
- Long-term financial plans in place in all councils.

Council has been proactive in both its asset management and financial sustainability pursuits outlined in Council's Asset Management Strategy 2010 to 2015 and this 20-year Financial Management Plan respectively.

# 4. Council's Planning and Reporting Framework

## *Strategic Framework*

Council has worked with the community to establish a 20 year vision for the city and a set of statements that describe what the city will be like if that vision is achieved.

The *Future Direction Statements* have been used as the basis for developing a strategic framework outlining the key strategies that will need to be undertaken by the Council to achieve the community vision.

Hobart's strategic framework identifies the direction needed to continue improving the quality of life of Tasmania's capital city. The future directions statements and key strategies underpin the vision and provide the basis for Council's 5-year Strategic Plan which is implemented through Council's Annual Plan.

Performance in achieving the major actions and initiatives outlined in the Annual Plan are reported to the community through Council's Annual Report.

## *Future Directions Statements*

***Offers opportunities for all ages and a city for life***
In 2025 Hobart will be a city that provides opportunities for education, employment and fulfilling careers. A city that is able to retain its young people and provide a lifestyle that will encourage all ages to see the city as a desirable location and lifelong home.

***Is recognised for its natural beauty and quality of environment***
In 2025 Hobart will be a city that respects the natural beauty of Mount Wellington, the Derwent River, the bushland surrounds and waterfront locations. It has worked to enhance the community connection through the protection of views, vistas, access and linkages and the physical environment has been conserved in a manner that will ensure a healthy and attractive city.

***Is well governed at a regional and community level***
In 2025 Hobart will be a city that works effectively to lead an integrated approach to the planning and development of the metropolitan region. It will create partnerships with governments, the private sector and local communities in achieving significant regional, city and community goals.

***Achieves good quality development and urban management***
In 2025 Hobart will be a city that remains unique in its own right, protecting its built heritage and history while pursuing quality development, the principles of sustainable cities and the reduction of ecological impacts. It will value access to the waterfront, foreshores, public and open spaces and continues to enjoy the benefits of scale and proximity.

***Is highly accessible through efficient transport options***
In 2025 Hobart will be a city that maintains its convenience and accessibility through the greater use of transport alternatives and an effective road and travel network.
Improved public transport options, cycle ways and walking tracks linking open spaces for transport and recreation, the availability of adequate parking for commuters and shoppers,

the take up of sustainable transport options, the reduction of through traffic and the management of an efficient road network are the result of an integrated approach to transport planning within the city and across the metropolitan region.

***Builds strong and healthy communities through diversity, participation and empathy***
In 2025 Hobart will be a city that reflects a spirit of community and tolerance. By valuing diversity and encouraging participation by all ages in the life of their community, a friendly and compassionate society will underpin a safe and healthy city.

***Is dynamic, vibrant and culturally expressive***
In 2025 Hobart will be a city that is a destination of choice and a place for business. Clever thinking and support for creativity will help build a strong economic foundation, and entertainment, arts and cultural activities promote the distinctive character of the city. Lifestyle opportunities and strong communities will ensure a vibrancy and way of life that is Hobart.

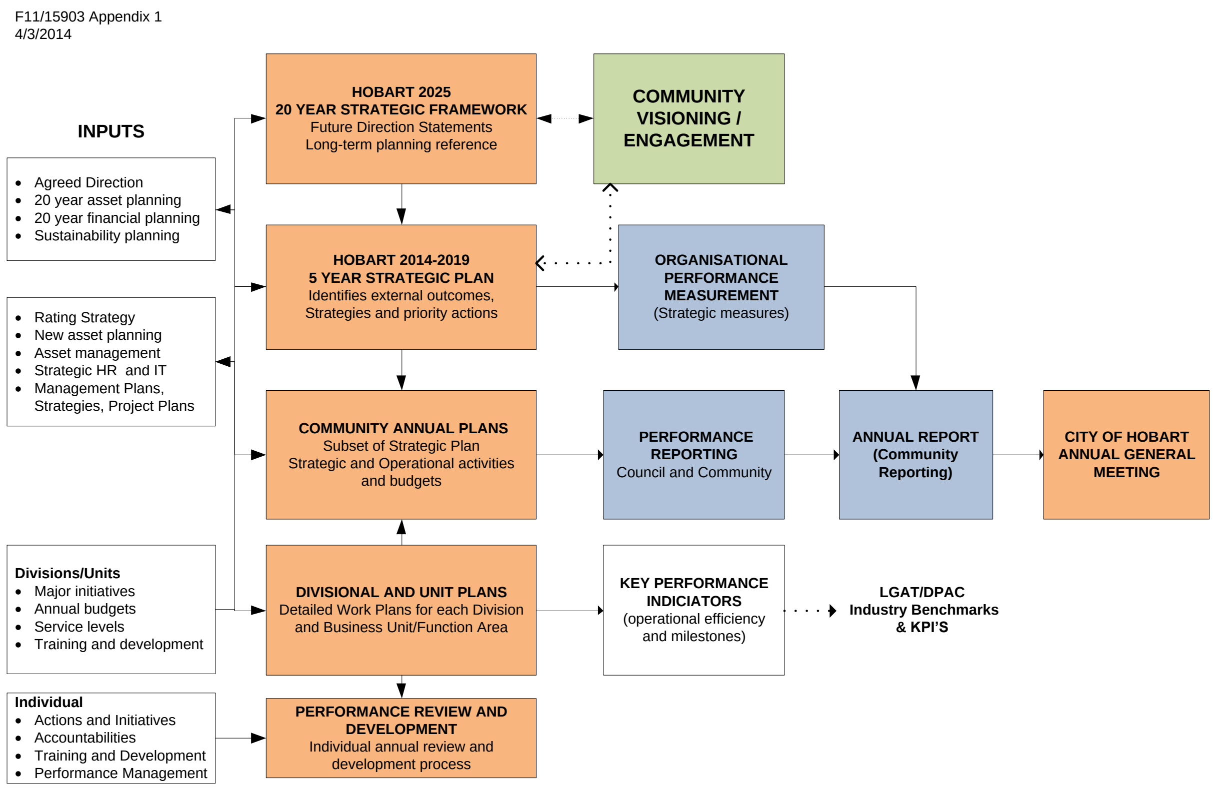
## Linkages with the Strategic Framework

The linkage between long-term financial planning and Council's strategic framework is shown overleaf. Long-term financial planning provides for the optimum allocation of available resources to deliver Council's strategic and corporate objectives. Long-term financial planning supports the delivery of Council's community vision.

Long term financial sustainability can only be said to have been achieved when Council is providing expected services at defined levels to its community that is adequately funded, not only on an annual basis, but in the long term. This includes infrastructure asset renewal funding requirements.

Council's 20-year Financial Management Plan and 20-year Asset Management Plan are integral documents. Council's Asset Management Strategy sets out the most appropriate long term course of action for implementing the asset management policy which aims to forecast long-term asset renewal requirements.

## Council's Planning & Reporting Framework



# 5. Introduction to Long-Term Financial Management Plan

The Long-Term Financial Management Plan (LTFMP) sets out Council's objectives, goals and desired outcomes in financial terms. The purpose of the LTFMP is to express in financial terms the activities that Council proposes to undertake over the medium and longer term to achieve its strategic objectives and community expectations. The key objective of the LTFMP is the achievement of financial sustainability in the medium to long term whilst achieving Council's strategic objectives.

The LTFMP provides a tool for Council to consider the financial impact of its decisions on Council's future financial sustainability. It includes consideration of cost increases: salaries and wages, fire levy, energy costs and other operating costs; and revenue increases: rates, parking fees & charges, rental income, operating grants and other fees and charges.

The LTFMP is aimed at:

- Developing systems to ensure the financial impacts of new initiatives are included in long-term financial planning.
- Developing an appropriate reduction/elimination strategy for Council annual deficits.
- Maintaining stable and predictable rates increases.
- Maintaining and enhancing community service levels.

The LTFMP has been prepared over a rolling 20 year period with the first planning year being 2015/16 and concluding in 2035/36. The LTFMP is a 'living' document and is updated annually as part of Council's annual planning and budget process and on an ongoing basis to reflect changing internal and external circumstances.

## *Measuring Financial Sustainability*

There is not universal agreement on which measures should be used to measure financial sustainability. However, the Report *The Framework for Long-term Financial and Asset Management Planning for all Tasmanian Councils*, recommends a suite of financial sustainability measures identified as key to securing long-term financial sustainability.

The 8 measures have been adopted for the purposes of the LTFMP and are as follows:

- Underlying operating result
- Operating surplus ratio
- Net financial liabilities
- Net financial liabilities ratio
- Interest cover ratio
- Asset sustainability ratio
- Asset consumption ratio
- Asset renewal funding ratio

Appendix 1 provides a full explanation of these indicators. The first two are measures of profitability, the next three measures of indebtedness, and the last three measures of asset management.

# 6. Assumptions and Methodology

The preparation of the LTFMP is underpinned by a 20-year financial model. The financial model allows for analysis and modelling of various financial scenarios. For the purpose of financial modelling the following key assumptions for years beyond 2015/16 have been made:

**General**

- Service delivery will be maintained at existing levels. The LTFMP provides for maintenance of existing services at their existing service levels.
- Council parking operations are self funding in that parking income (fines, on and off-street parking income) exceeds the cost of parking operations. The net surplus contributes to Council's other services and programs.
- Annual asset renewal requirements are based on Council's Asset Management Plans, which set out the forecast capital renewal requirements for the next 100 years. These plans are expressed in today's dollars, but for the financial model have been indexed at 2.5% per annum.
- All maturing debt will be repaid as it falls due.

**Specific**

- The percentage of revenue uncollected on average at year-end is 4.7%.
- The percentage of creditors payable on average at year-end is 14.7%.
- The percentage of commission received for collecting the Tasmanian fire service levy is 4%.
- The percentage of parking fines that result in bad debts is 6.3%.
- The employee on-cost percentage to be applied is 17.6% being payroll tax, contribution scheme superannuation, and workers compensation insurance with employee leave entitlements expense and defined benefit superannuation expense separately shown in the model.
- Costs and capital expenditure arising from the waste disposal strategic plan, costs arising from the Myer site redevelopment, and project costs associated with the Inner City Action Plan have been included – see New Initiatives in Chapter 7.

The specific assumptions have been based on an analysis of recent experience. The variables used in Chapter 7 to underpin Council's long-term financial strategy have been based on a historical analysis of cost and revenue increases over the last four years. These variables are summarised on the following page:

| | | Y/E 30 June | 2016 | 2017-19 | 2020-23 | 2024-27 | 2028-31 | 2032-36 |
|---|---|---|---|---|---|---|---|---|
| | Operating Items | | | | | | | |
| INFLOWS | Rate increase (Council operations) | % change | 0.9 | 2.5 | 2.5 | 2.5 | 2.0 | 2.0 |
| | Rate increase (fire levy) | % change | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 |
| | Rate base growth | % change | 0.4 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| | Parking - car parks | % change | 4.1 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| | Parking - on street | % change | 0.9 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| | Parking - fines | % change | 12.2 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| | Operating grants | % change | -1.2 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| | Other fees and charges | % change | 1.9 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| | Rent | % change | 1.9 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| | Interest revenue rate | % | 2.7 | 3.5 | 3.75 | 4.0 | 4.25 | 4.5 |
| OUTFLOWS | Operating costs | % change | 6.3 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| | Employee salary & wages | % change | -0.30 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| | Fire levy | % change | 5.85 | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 |
| | Energy costs | % change | -13.9 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 |

**What changes have occurred in this version?**

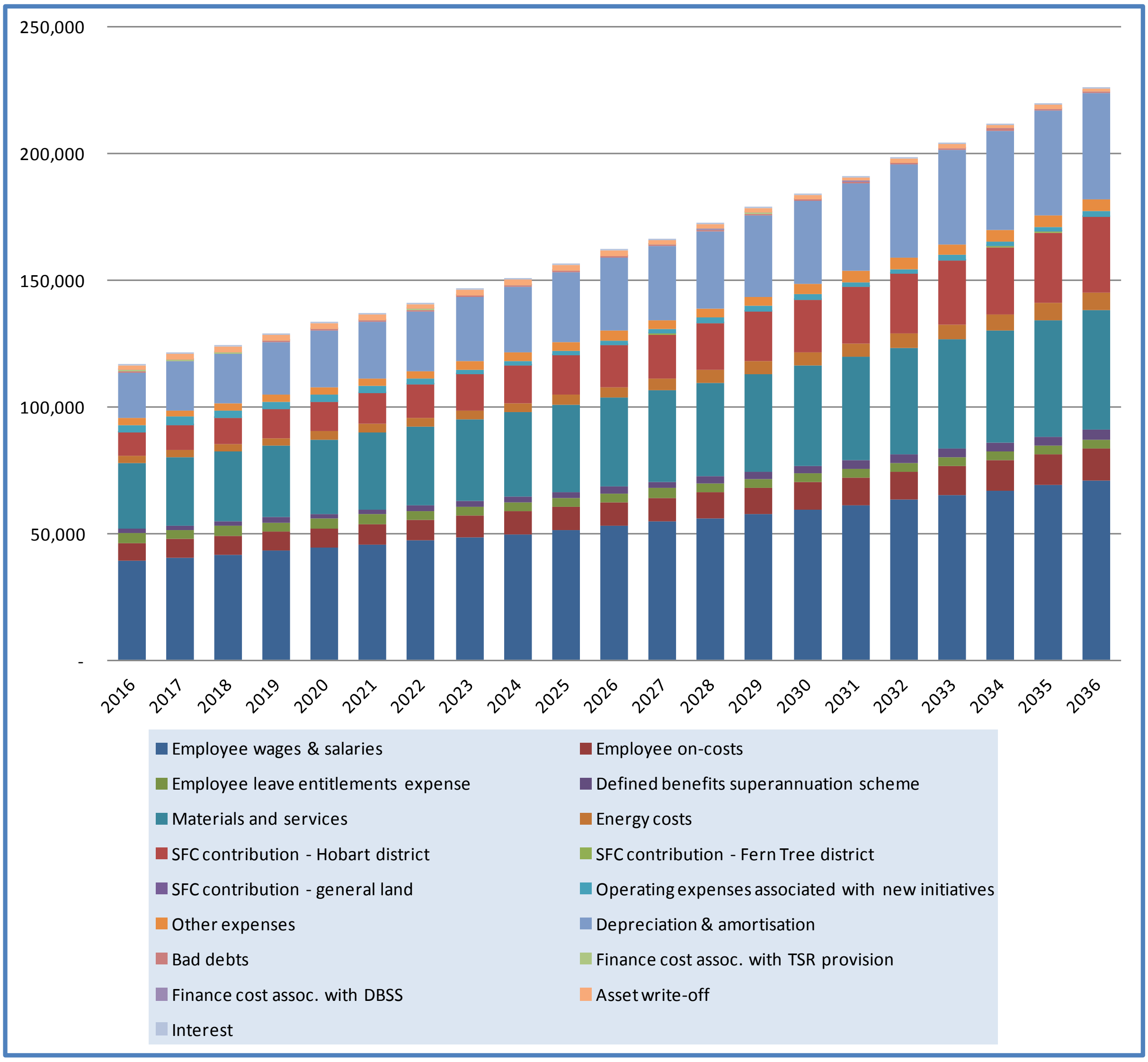
Whilst the LTFMP is updated annually, the underpinning financial model is regularly updated. Revisions have included:

- The inclusion of 2013/14 actual results;
- The inclusion of the 2014/15 budget;
- Revisions to the 2014/15 budget as approved by Council quarterly;
- Updated assumptions;
- Ongoing revisions to the 20 year asset renewal forecasts sourced from the updated asset management plans;
- Forecast distributions as advised by TasWater;
- Decreased interest rates; and
- The inclusion of the effects of the waste disposal strategic plan, and the Inner City Action Plan.

## 7. Key Financial Strategies

In order for Council to remain financially sustainable the following financial strategy has been adopted. The financial strategy reflects an appropriate mix of cost and revenue levels designed to maintain financial stability and, as far as possible, avoid unplanned cuts in services or increases in Council rates whilst ensuring sufficient resources are available to achieve Council's strategic objectives and community expectations.

**Forecast Operating Expenses 2015/16 to 2035/36 ($'000s)**




### *Operating Items - Expenses*

**Salaries and Wages**

Salaries and wages is gross salaries and wages, net of leave amounts paid and amounts capitalised, plus aldermanic allowances and redundancy payments (if any).

Costs have been assumed to increase by 3.0% per annum, inclusive of reclassifications and any new positions. It is inherent in the assumption that leave amounts paid and amounts capitalised will also increase by 3.0% per annum.

### Employee On-costs

Employee on costs includes superannuation (but not including Defined Benefits Superannuation Scheme expense), payroll tax, and workers compensation less labour overheads capitalised. On costs are assumed at 17.6% of salaries and wages, based on the 2015/16 forecast rate.

### Employee Leave Entitlements Expense

Leave entitlements expense is the annual accruals for employee leave. This has been assumed to decrease by 0.3% per annum.

### Defined Benefit Superannuation Expense

Defined benefit (DB) superannuation expense is the annual DB scheme expense, as actuarially determined. It is not annual employer contributions to the scheme. This item is difficult to forecast as it is based on discount rates and interest rates among other things. However, in overall terms it is not material to the long-term financial model. This has been assumed to increase at 4% per annum.

### Materials and Services

Materials and services is all expenditure not included elsewhere. Major items includes subcontractors, communication costs, consultants, licences, external labour, insurance, fuel, advertising and marketing, equipment maintenance, water and sewer charges, printing and stationery costs, and legal costs. This has been assumed to increase at 3% per annum.

### Energy Costs

Annual increases of 5% have been assumed. Council has a target of 30% reduction in electricity use by 2020 based on 2009/10 consumption. This is expected to be achieved by energy efficiency gains, such as with lighting, building services and possible retirement of some assets. Furthermore, streetlighting is being replaced by Aurora with lights which are about 50% more efficient.

### Fire Levy

Pursuant to the *Fire Services Act 1979*, local government acts as a collection agent for this levy, which is paid directly to the State Fire Commission. This item is difficult to forecast as given its method of calculation by the State Fire Commission, is prone to substantial fluctuations, year on year. The average of the last six years has been 6.9%. Annual increases of 6% have been assumed. A 4% commission is received for collecting the levy.

### Operating Expenses associated with New Initiatives

This refers to additional expenditure arising from new initiatives included in the model. Additional expenditure is sourced from the Myer site redevelopment, the closure of McRobies Gully tip site, and projects expensed.

**Other Expenses**

Other expenses include grants and specific purpose benefits, audit fees, fringe benefits tax and land tax. This has been assumed to increase at 3.0% per annum.

**Depreciation and Amortisation**

Depreciation is the financial representation of the annual decrease in the value of, or consumption of the service inherent in, Council's assets. Depreciation thus approximates the funds that will need to be spent at some time in the future to renew assets. This expense increases, on average at 4.3% per annum, due to rising asset valuations and capital expenditure.

**Bad Debts Expense**

This represents parking fines that result in bad debts. 6.3% of parking fines are assumed to result in bad debts.

**Finance Costs of Tip Site Rehabilitation Provision**

This is the annual unwinding of the discount associated with measuring the tip site rehabilitation liability at present value.

**Finance Costs of Defined Benefit Superannuation Scheme**

This is the annual unwinding of the discount associated with measuring the scheme liability at present value.

**Tip Restoration Liability**

This is the increase (if any) in the current forecast cost of rehabilitating the McRobies Gully tip site.

**Asset Write-offs**

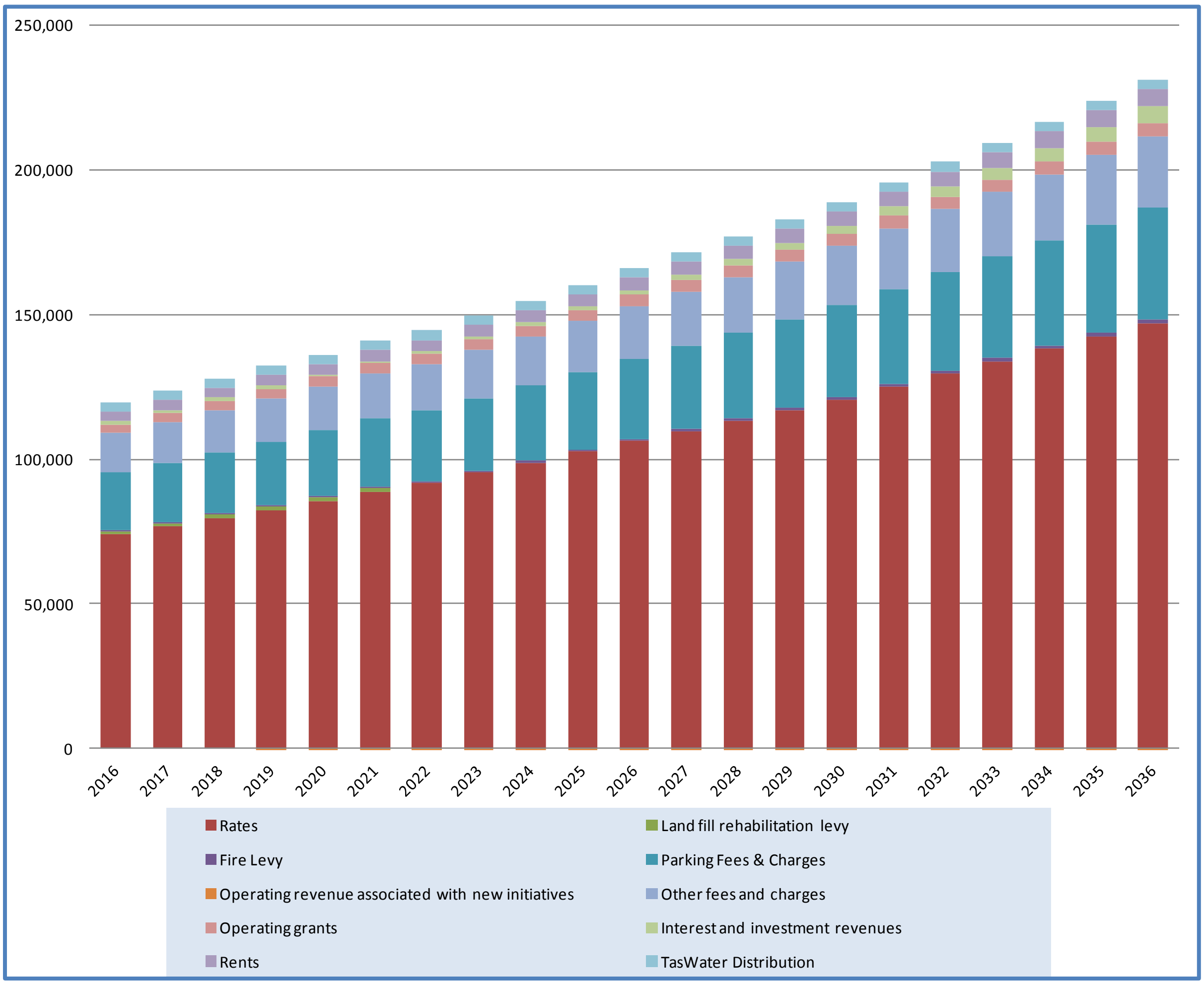
Asset write offs represents the residual value of infrastructure assets replaced. The forecast is difficult to predict.

**Interest Expense**

Interest expense is payable on debt. An interest rate of 5.5% has been assumed for new debt on the basis that interest rates will continue at or around current levels. However at this stage no new borrowings are currently planned.

## *Operating Items – Revenue*

**Forecast Operating Revenue 2015/16 to 2035/36 (‘000s)**




**Rates**

Rates include revenue from General Rates, Service Rates and Charges (stormwater removal, waste management and fire protection) and late payment penalties, interest and supplementaries. Rate increases are forecast to be 2.5% per annum in the short term (plus fire levy estimated at 0.7%), reducing over the forecast period to 2.0% (plus fire levy estimated at 0.7%). If development growth continues at historic levels, annual rate revenue increases will be approximately 0.5% more than the above figures.

Total rate income includes rate and charge income. This plan is not in any way affected by changes in rating strategy – it simply models total rate revenue required per annum irrespective of how that is apportioned to individual properties. For the same reason, the LTFMP is unaffected by periodic revaluations or the application of AAV indexing by the Valuer-General. However, the impact on individual ratepayers may be affected by these matters.

**Fire Levy Commission**

A commission of 4% is earnt for collecting the State Government fire levy.

**Parking Fees & Charges**

Parking revenue from on-street is forecast to increase by 3% per annum, off-street 4%, and fines by 3% per annum.

**Operating Revenues associated with New Initiatives**

This refers to additional revenue arising from new initiatives included in the model. In this case, it is represented by the decrease in revenue associated with the closure of the McRobies Gully tip site in 2017/18.

**Other Fees and Charges**

Other fees and charges is all other fee and charge income including aquatic centre, landfill, external works income, sportsground hire, building and development fees, travel centre income, animal licences, hall hire, Taste Festival income and other amounts.
Annual increases of 3% have been assumed.

**Operating Grants**

Operating grants are predominantly the Commonwealth financial assistance grants and generally minor other operating grants. They are forecast to increase by 2% per annum.

**Interest and Investment Revenue**

Interest revenue is interest earnt on cash investments. An interest rate of 3.5% increasing steadily to 4.5% per annum has been assumed. Interest earnings increase significantly over the term of the LTFMP due to significantly higher cash balances.

**Rental Income**

Rental income is earnt from Council's property portfolio. It is forecast to increase by 3% per annum assuming 100% occupancy of Council's commercial property.

**Distributions from TasWater**

Distributions are received as a result of Council's ownership interest in TasWater. They comprise guarantee fees, tax equivalent payments, and dividends. Forecast amounts are based on advice from TasWater.

## *Non-Operating Items*

**Contributed Assets**

Contributed assets are assets contributed to Council by developers. Council does not budget for these contributions as they cannot be reliably forecast.

**Capital Grants**

Capital grants are grants received for capital purposes. They include Roads to Recovery grants, as well as other specific purpose capital grants. These are also difficult to reliably forecast and are therefore not budgeted for unless specific advice has been received.

**Asset Revaluations**

Asset revaluations are revaluation increments and decrements arising from periodic asset revaluations. Usually these amounts are credited or debited directly to equity but on occasions are accounted for through the income statement. They are not budgeted for.

**Movement in TasWater Investment**

This represents the annual adjustment to the value of Council's ownership interest in TasWater. This cannot be reliably forecasted at this time.

## *Capital Items*

**Asset Replacement**

An integral component of the LTFMP is Council's approach to asset management and in particular to the renewal of assets. Council controls assets worth in excess of $1.06 billion and it is important that each generation pays their way, rather than allowing assets to run down creating a financial impost (or lower service levels) on future generations.

Council discharges its asset management obligations responsibly. As set out in this plan, Council aims to achieve modest underlying operating surpluses. This will ensure that that the current generation is fully paying for the current cost of service provision and asset consumption. In addition, over recent years practices have evolved significantly to the point where council now has well developed asset management plans in place for all asset classes. Council is able to demonstrate this through its involvement in the Municipal Association of Victoria Advanced STEP program where in benchmarking and other reviews, performs at the upper end of participating councils.

These asset management plans will continue to evolve and improve, particularly in the buildings and stormwater asset classes. Further, the plans are based on current service levels but the aim will be, over the medium term, to link the plans with service delivery plans.

The asset renewal requirements contained within the LTFMP are fully sourced from the asset management plans meaning that, based on information currently available, the forecasts are the organisation's best estimate of the quantum, and timing, of the funds required to renew assets for the next 20 years.

**New Assets**

Council has a 10-year new asset capital works program. Originally totalling $1.5 million per annum, the level of funding is declining as funding is diverted to ICDP projects (see below).

**Borrowings**

Council predominantly funds its capital works program from operations. Borrowings are undertaken for specific purposes on a case by case basis. No additional borrowings are presently forecast.

## *New Initiatives*

The financial model and LTFMP are based on existing services at existing service levels. However, new initiatives included are:

- The closure of the McRobies Gully tip site giving rise to reduced revenues and increased net costs to transport waste elsewhere. Capital expenditure of $5.5M was included across 2011/12 and 2012/13 for a new recycling facility and waste transfer station. Also, $10.3 million has been included to rehabilitate the McRobies Gully tip site, the funding for which is being provided by a special rehabilitation levy.

- The financial effects of assistance toward the Myer site redevelopment.

- Projects arising from Council's Inner City Development Plan totalling $36.7M have been included. The quantum and timing of projects will inevitably be varied, however, first consideration costs and timing have been included. Capital grants of $12.3M have also been assumed. Any associated asset write-offs in relation to these projects have not yet been quantified, and thus are not included.

# 8. Long Term Risk, Contingency and Reserves

The LTFMP has included all known variables and has made certain assumptions about the future. However, the future is uncertain. There is an inherent risk that circumstances may change, some of which may be within Council's control (e.g. policy decisions, service delivery decisions) and some which will be outside of Council's control (e.g. legislative change, funding streams, demographics, and macro economic conditions).

Council's three largest expenses categories are employee salaries and wages, materials and services, and depreciation. As such the outcomes of the LTFMP are significantly affected if actual results in these three categories are different to forecast. Chapter 11 sets out a sensitivity analysis of these two largest categories – employee costs, and materials and services, as well as the LTFMP's sensitivity to rates increases being different to those currently assumed. In addition asset management outcomes have a significant impact on the LTFMP. Updates to asset management plans may materially impact on asset valuations, depreciation expense, and forecast asset renewal requirements.

The LTFMP will be reviewed and updated regularly – on at least an annual basis to coincide with the adoption of the Council budget, and more frequently when new information is available which may have an impact on the LTFMP. The underpinning financial model is updated several times throughout the year.

In order to mitigate financial risk, the LTFMP has made provision for contingencies and reserves. These are outlined below. It should be noted these reserves may not necessarily be fully cash backed. Depending on the amount of cash reserves at any point in time, the total balance of reserves may in fact exceed the balance of cash holdings.

**Contributions in Lieu of Public Open Space**

A reserve has been established to separately account for funds provided to Council for the express purpose of providing areas of Public Open Space throughout the city.

**Contributions in Lieu of Parking**

A reserve has been established to separately account for funds provided to Council for the express purpose of providing Parking facilities in the vicinity of developments that have been approved with inadequate on-site parking.

**Heritage Account**

Council has established a Heritage Account as required by the *National Trust Preservation Fund (Winding-up) Act 1999*. Amounts transferred to the account include the initial distribution from the National Trust Preservation Fund, together with interest accruing on the balance of the account.

The Act requires that funds transferred into the Heritage Account be applied for the provision of financial or other assistance in relation to an entry in either the National Trust Register kept by the National Trust of Australia (Tasmania), or the Tasmanian Heritage Register.

**Public Infrastructure Fund**

Council has established a Public Infrastructure Fund for the purpose of identifying funding available for the projects identified in Council's Inner City Action Plan.

**Bushland Fund**

Council established a Bushland Fund for the purpose of purchasing strategic areas of bushland and open space. Up until 2003/04, an annual allocation of $0.15 million was being provided from revenue for this purpose.

During 2003/04, Council resolved to utilise the accumulated balance of the Bushland Fund to provide funding for Mt. Nelson land purchases, and to use $0.10 million of the annual allocation of $0.15 million to assist with servicing of the associated debt.

**McRobies Gully Tip Site Rehabilitation**

Commencing in 2011/12, funding of $1.25 million per annum is being provided by a special levy to meet the cost of rehabilitating the McRobies Gully Tip Site following completion of land filling.

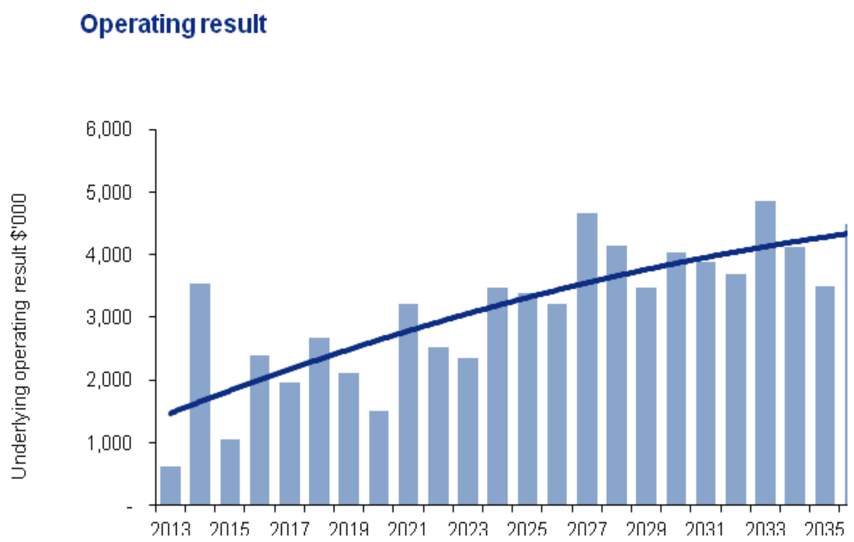
**Other Project Carry-forwards**

This item represents an estimate of the value of unspent projects at the end of each financial year which are carried forward into the following financial year, with capital works representing the majority of the balance.

# 9. Forecast Position and Analysis

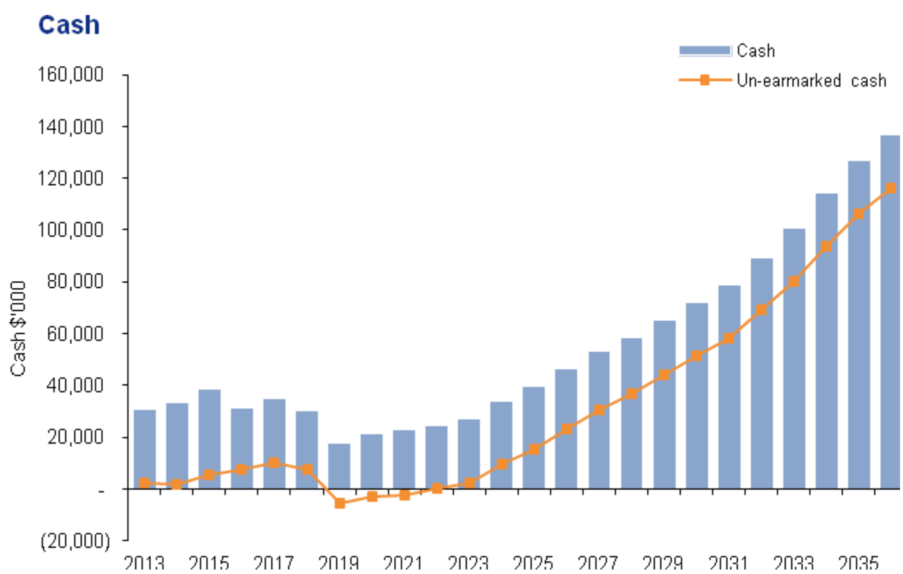
Based on the long-term financial strategy, the following outcomes will be achieved. More detail is provided in the forecast financial statements at Appendix 2.

**Operating Result**



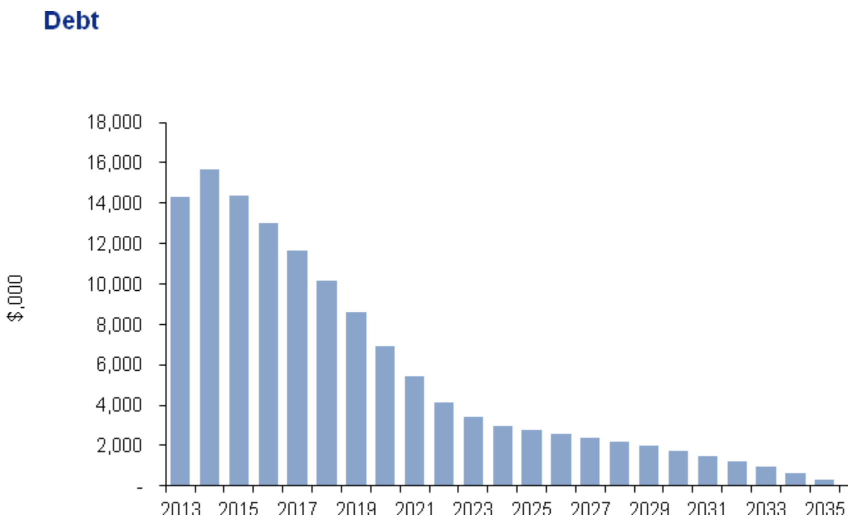

Based on the financial strategy Council will achieve ongoing modest underlying operating surpluses, which is reflective of good practice. This is discussed further in Chapter 10.

**Cash**




Cash balances are currently forecast to increase significantly. As the balance increases, so does the balance of 'unearmarked' cash which will be required for asset renewal purposes – see Indicator 7 – asset sustainability ratio in Chapter 10.

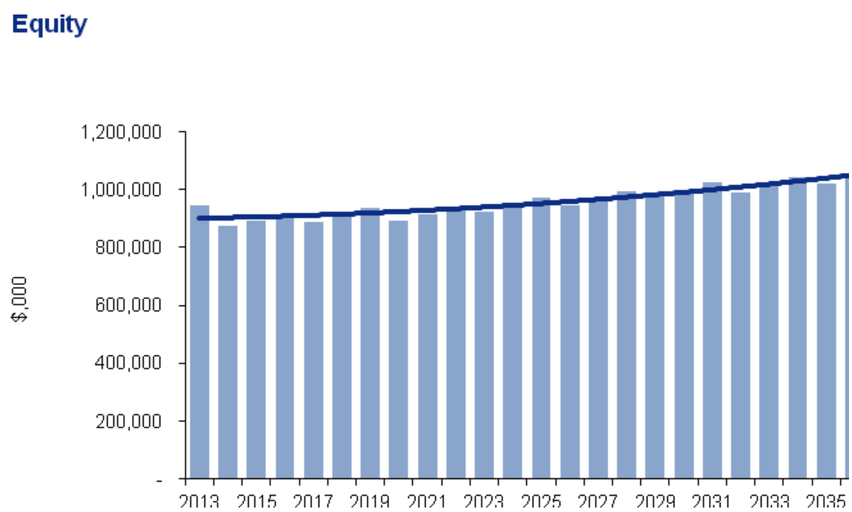
**Debt**




Debt is forecast to decrease over the life of the plan as funds from operations will mean debt financing will generally not be required.

Council has a low level of indebtedness and is well within accepted benchmarks. Indeed, financial sustainability reviews conducted around the nation over recent years have concluded that local government as an industry has low levels of debt. However, properly managed debt is an appropriate and important funding source which spreads the cost of infrastructure over longer periods.

**Equity**




Based on the financial strategy Council’s equity is forecast to increase due to operating surpluses and asset revaluations.

## 10. Financial Sustainability Outcomes

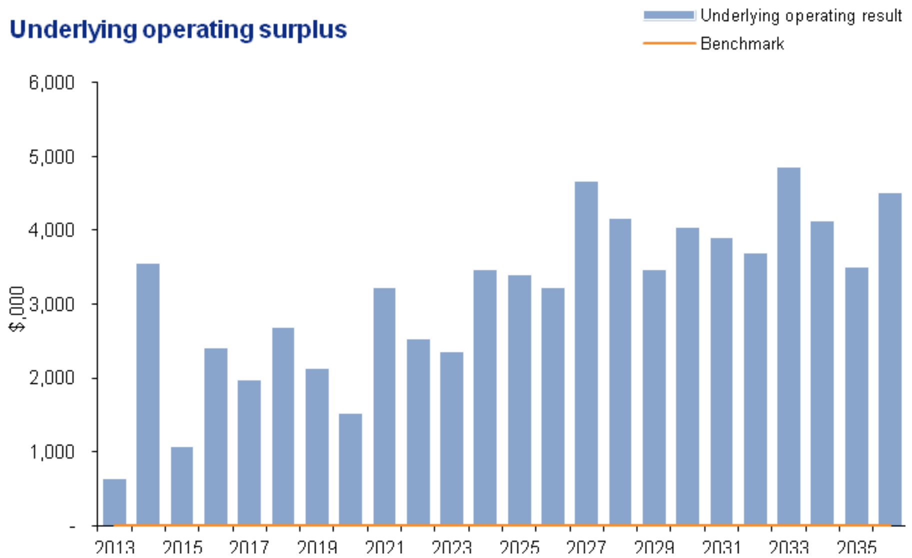
As outlined in Chapter 5, for the purposes of measuring the financial sustainability of Council's LTFMP, eight financial sustainability measures have been adopted.

- Indicators 1 – 2 are measures of profit performance and the extent to which expenses are covered by revenues.
- Indicators 3 – 4 are measures of indebtedness and the amount council owes others (debt, employee provisions, creditors) net of financial assets (cash, investments) and amounts owed to council.
- Indicator 5 measures the proportion of income required to meet net interest costs.
- Indicators 6 – 8 are measures of asset management.

**Indicator 1 – Underlying Operating Result**

The difference between day-to-day income and expenses for the period, adjusted (excluding contributed assets, asset revaluations and capital grants). This indicator is seen as a better indicator of sustainable or recurring operations as it excludes capital grants which can be project specific and thus non-recurring, and other amounts which are recorded as income due to accounting standard requirements.

An operating surplus arises when operating revenue exceeds operating expenses for the period. An operating deficit arises when operating expenses exceed operating revenue for the period. Council's long term financial sustainability is dependent upon ensuring that on average, over time, its expenses are less than associated revenues. This ensures equality between generations of ratepayers in that each generation is responsible for the cost of resources they consume.

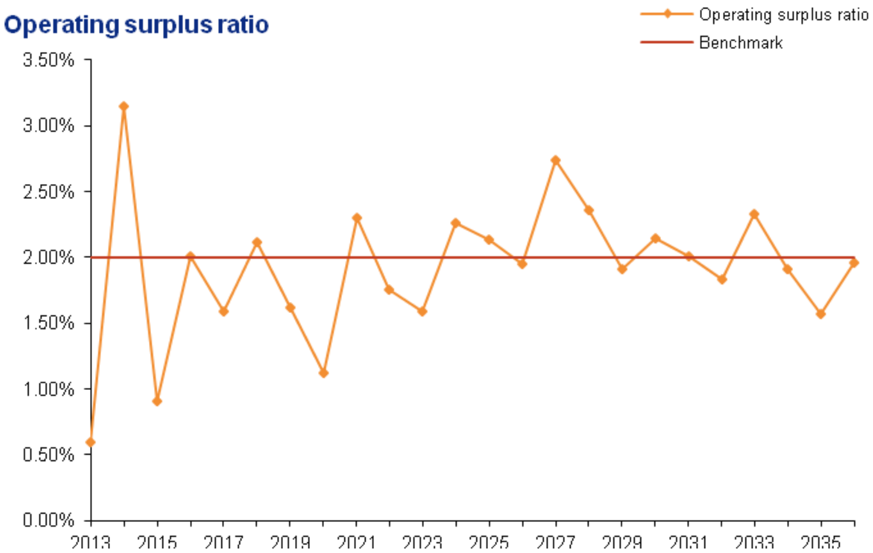



Council's LTFMP indicates through the graph above that modest surpluses will be recorded over the plan period.

Research indicates that there is no clear agreement on what an appropriate target should be. For example, the Victorian Auditor-General recommends generating surpluses consistently, the Tasmanian report "Framework for Long Term Financial and Asset management Planning for all Tasmanian Councils" September 2009 recommends breakeven, or better, on average over medium term, and some state studies recommend sizeable surpluses.

**Indicator 2 – Operating Surplus Ratio**

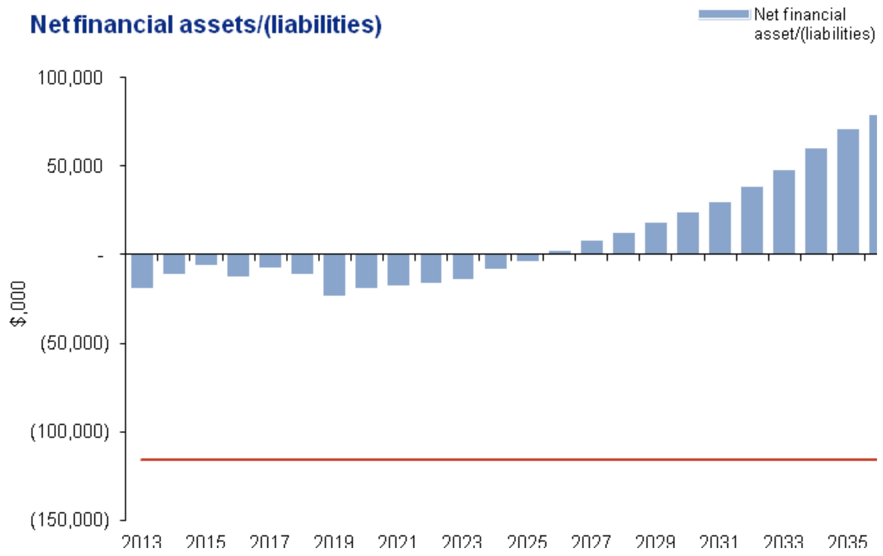
The operating surplus ratio is the operating surplus (deficit) expressed as a percentage of total revenue (adjusted by excluding capital grants, contributed PP&E and asset revaluation increments/decrements). It is a better indicator than the underlying operating result because it expresses that result relative to annual revenue.




Council's LTFMP indicates through the graph above that the operating surplus be a little inconsistent over the short term, but will then settle around the 2.0% mark, on average. Research indicates a wide range of views on appropriate targets. Reviews indicate targets of 0% to 15%, 2.5% to 7.5%, 5% but within the range of 0% to 10% and greater than 0%. A target of 2.0% has been selected which is still modest, but that provides a small margin in the event of unexpected events, however, a higher target could be contemplated. Operating surpluses also generate cash surpluses required to retire debt (principal payments are not recorded in the operating result), and for the defined benefit superannuation scheme where accounting standard requirements can result in actual employer contributions being higher than the expense that appears in the operating result. Differences in the asset valuation rates used for financial reporting purposes and asset renewal purposes also require cash surpluses to be generated.

**Indicator 3 – Net Financial Assets/ (Liabilities)**

What is owed to others less cash held/invested and receivables and is thus a measure of net indebtedness. It is broader than just loan debt, as it includes amounts owed to creditors, employee provisions, amounts held in trust and all other liabilities.

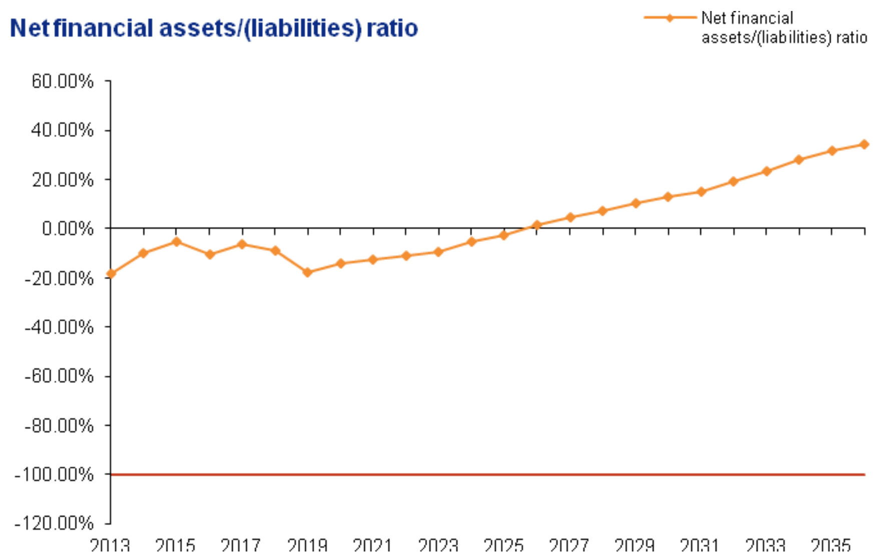



Council's LTFMP indicates through the graph above that it will operate initially in a net financial liability position, peaking at $23.2 million in 2018/19. Council will then move to a net financial asset position due to liabilities decreasing as debt is paid off, the defined benefit superannuation scheme net liability position improves and cash balances increase.

One sustainability report suggests a maximum level of net financial liabilities between nil and total operating income (approx $120 million 2015/16) whereas Council will have a net financial asset position.

**Indicator 4 – Net financial liabilities ratio**

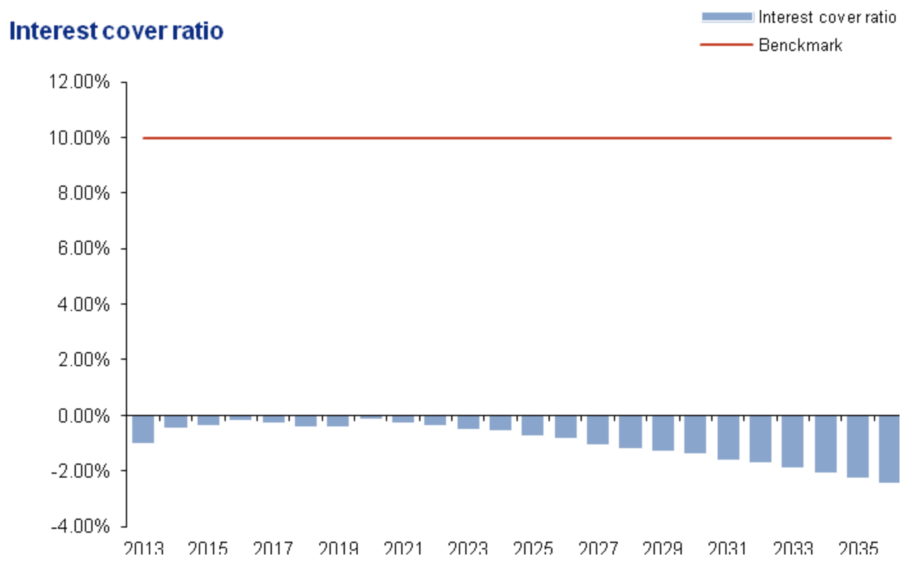
This ratio is net financial liabilities expressed as a percentage of income. It indicates the extent to which net financial liabilities can be met by the Council's income. Where the ratio is increasing it indicates the Council's capacity to meet its financial obligations from income is strengthening.




Council's LTFMP indicates through the graph above that it will operate initially in a net financial liability position, peaking at 17.7% in 2018/19. Council will then move to a net financial asset position from 2025/26. One sustainability report suggests a maximum ratio of 0% to -100%. The Tasmanian Auditor-General suggests a ratio of 0% to -50% represents low risk, -50% to -100% moderate risk, and greater than -100% high risk.

**Indicator 5 – Net interest expense cover ratio**

This ratio is interest expense less interest earnt on investments, expressed as a percentage of income. It measures the proportion of income required to service interest costs.

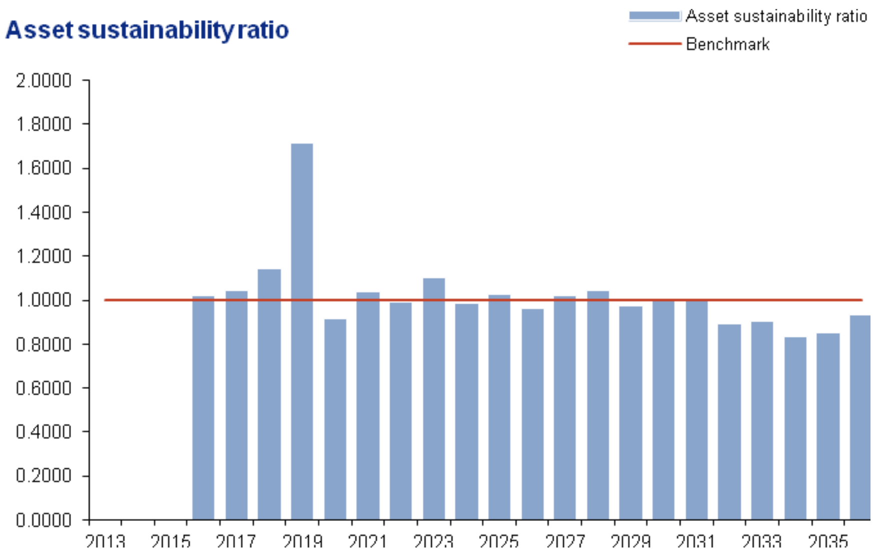



The above graph indicates that Council will operate in a net interest revenue position – that is interest earned on cash investments will exceed interest payable on debt. A variety of targets for net interest expense have been suggested in sustainability reviews, including 0% to 10%, 2% to 5%, and 15% (with a range of 7% to 20%). Tasmanian Treasury adopts 7% when assessing local government loan requests.

Indicators 3, 4, and 5 show Council's low level of indebtedness.

**Indicator 6 – Asset sustainability ratio**

This ratio is asset replacement capital expenditure expressed as a percentage of depreciation expense. It measures whether assets are being replaced at the rate at which they are wearing out. With a young asset portfolio, the target may be quite low. If old, it may be > 100%. Over time, if it averages at or near 100% the service of the asset portfolio is being maintained.

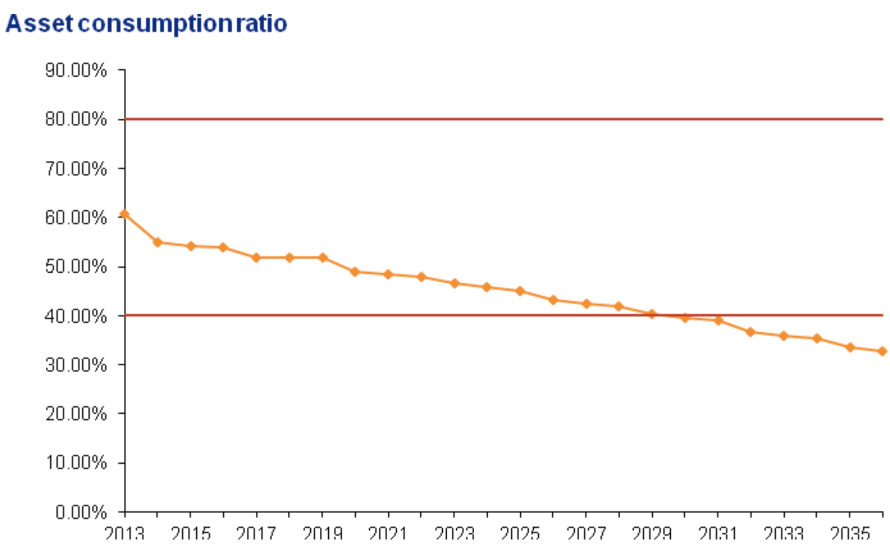



Council's LTFMP indicates through the graph above that it will operate at an average of just under 100% across the plan period. Local government proposed targets are typically set at 100%, however this does not allow for the sometime legitimate periods of less than 100% or more than 100%.

**<u>Indicator 7 – Asset consumption ratio</u>**

This indicator expresses asset written down value as a percentage of replacement cost and thus seeks to measure the proportion of life remaining in assets. A lower measure indicates an older, on average, portfolio of assets and could indicate the potential for large renewal expenditure.

However, a low or declining ratio is not a concern provided assets are being maintained/replaced in accordance with well prepared asset management plans and the organisation is operating sustainably i.e.: recording a breakeven or better underlying operating result. The cash generated by operating sustainably funds the renewal of assets when required.



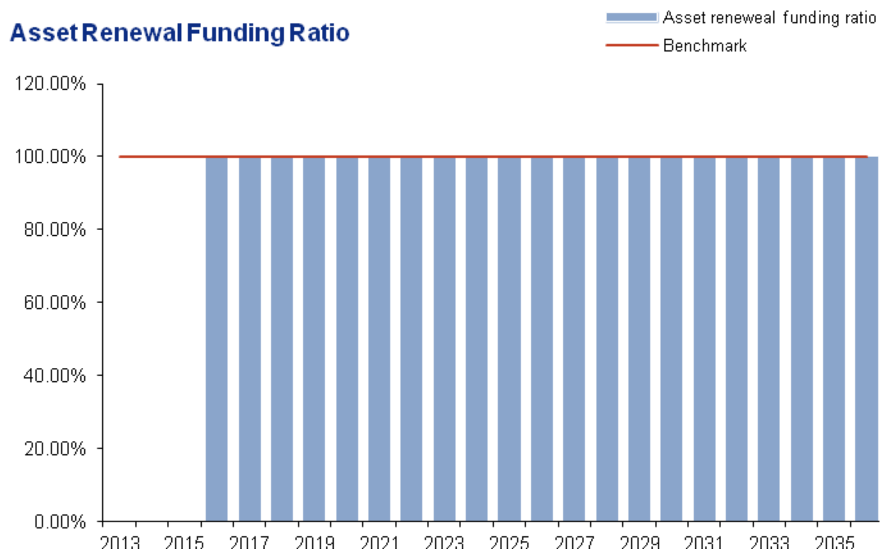
Council's LTFMP indicates through the graph above that the asset consumption ratio will decline over the plan period.

An appropriate target is difficult to define and one source suggests a ratio between 40% and 80%. The Tasmanian Auditor-General considers the road asset class in isolation and suggests a ratio of >60% to represent low risk, 40 to 60% moderate risk and less than 40% high risk. Council's road assets are currently at 48%.

The ratio will increase when, beyond the 20 year plan period, asset renewal expenditure will be greater than depreciation.

**Indicator 8 – Asset renewal funding ratio**

This indicator is the ratio of future asset replacement expenditure as per this plan relative to the future asset replacement expenditure requirement sourced from asset management plans. It therefore measures the capacity to fund asset replacement requirements. An inability to fund future requirements will result in revenue or expense or debt consequences, or a reduction in service levels.




Council's LTFMP indicates through the graph above that known asset replacement requirements will be fully funded. That is, 100% of known asset replacement needs, as identified in Council's asset management plans, will be funded.

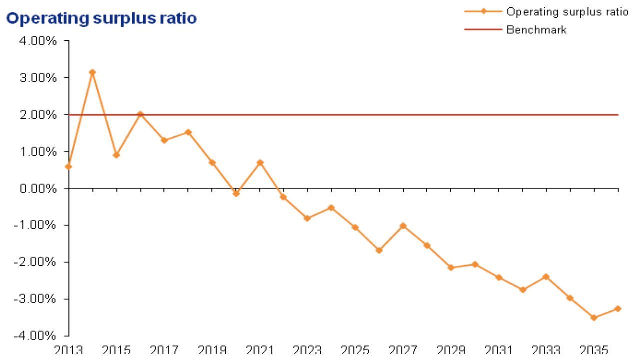
# 11. Sensitivity Analysis

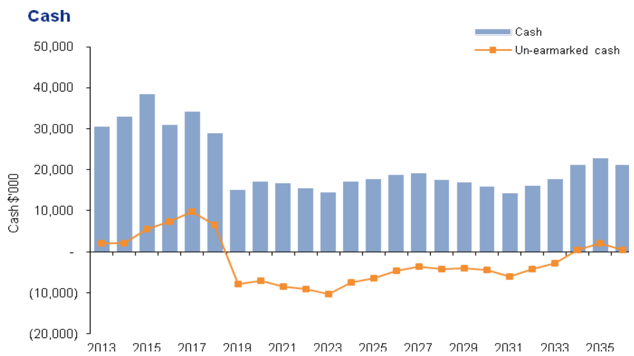
As mentioned in chapter 8, Council's three largest expenses categories are employee salaries and wages, materials and services and depreciation. Council's largest revenue item is rate revenue. The outcomes of the LTFMP are significantly affected if actual results in these three categories are different to forecast.

The analysis below demonstrates the sensitivity of the LTFMP to changes in assumptions for the above categories.

**Rates**

The LTFMP assumes rate increases (for Council operations) of 2.5% for the majority of the plan, reducing to 2.0% in the later years. If these rate increases are 0.5% lower over the next ten years the effect is as shown below.

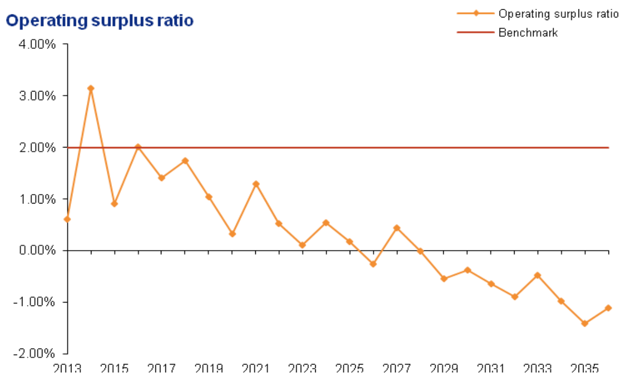


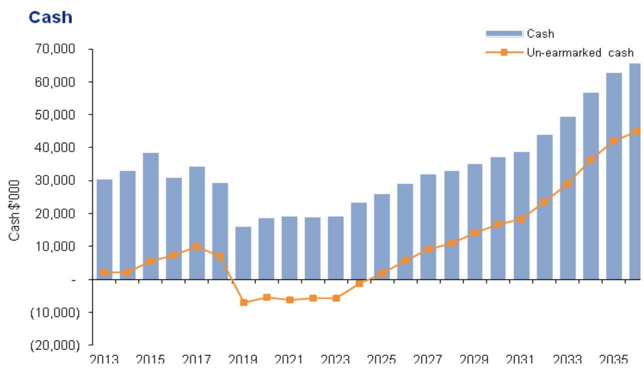




With rate increases 0.5% lower over the next ten years, underlying operating deficits will be recorded in 2020 and 2023 onwards and cash balances reduce by $116M over the life of the Plan.

**Employee Salaries and Wages**

The LTFMP assumes increases in employee salaries and wages of 3% per annum. If employee salaries and wages increases are 0.5% higher over the next ten years the effect is as shown below.

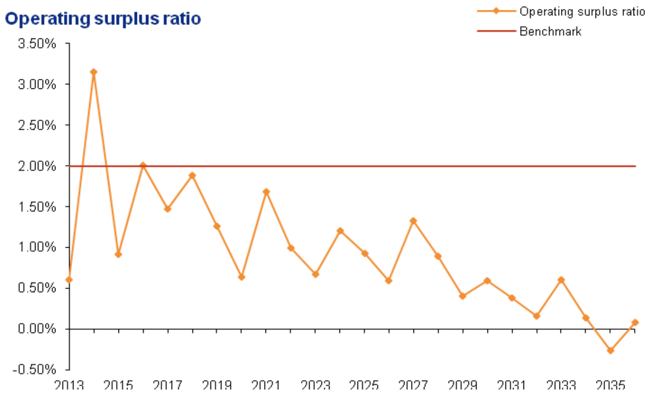


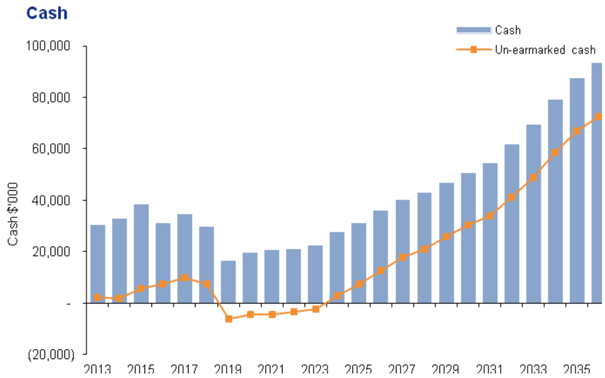



With employee salary and wage increases 0.5% higher over the next ten years, underlying operating deficits will be recorded in 2026 and from 2028 onwards and cash balances reduce by $71M over the life of the Plan.  To restore the status quo, rate increases would need to be approximately 0.3% higher over the next ten years.

**Materials and Services**

The LTFMP assumes increases in materials and services of 3% per annum over the life of the Plan.  If these materials and services increases are 0.5% higher over the next ten years the effect is as shown below.




With materials and services increasing by 3.5% per annum instead of 3% per annum over the next ten years, underlying operating surpluses are still recorded (except for 2035), but cash balances reduce by $43M over the life of the Plan.  To restore the status quo, rate increases would need to be approximately 0.2% higher over the next ten years.

# 12. Conclusions

The purpose of the LTFMP is to express, in financial terms, the activities that Council proposes to undertake over the medium to longer term to achieve its stated objectives. It is a guide for future action. Without a LTFMP Council would have insufficient data to determine sustainable service levels, affordable asset management strategies, appropriate revenue targets or appropriate treasury management.

Council has worked with the community to establish a 20-year vision for the city and a strategic framework outlining the key strategies that will need to be undertaken by the Council to achieve the community vision.

Long-term financial planning provides for the optimum allocation of available resources to deliver Council's strategic and corporate objectives. Long-term financial planning supports the delivery of Council's community vision.

Long term financial sustainability can only be said to have been achieved when Council is providing expected services at defined levels to its community that is adequately funded, not only on an annual basis, but in the long term. This includes infrastructure asset renewal funding requirements.

The achievement of the outcomes in this LTFMP will ensure Council's financial sustainability, thus ensuring the ability to deliver services, at their current levels, into the future while sharing the cost between current and future generations of ratepayers. It will ensure the delivery of Council's community vision.

In financial terms, it will result in:

- Council achieving modest operating surpluses averaging 2.0% of revenue across the plan in line with good practice. Towards the latter half of the plan these surpluses are more in the order of 1.6% to 2.7%;

- A continued low level of indebtedness;

- Funding of 100% of forecast asset renewal requirements demonstrating excellent asset management policy; and

- Strong cash balances.

Council will need to actively monitor revenue and cost growth in order to ensure the assumptions in the LTFMP are achieved.

These outcomes, together with the underpinning assumptions of revenue and cost growth indicate annual rate increases to the ratepayer in the order of 2.5% in the medium term, decreasing in later years to 2% (excluding the fire levy, any redistributive effects of revaluations, AAV indexation or changes to council rating policy).

These outcomes ensure the financial sustainability of Council, thus ensuring the ability to deliver services, at their current levels, into the future. It will ensure that current and future generations pay their fair share.

The LTFMP is based upon Council maintaining existing services at their existing service levels, except for the inclusion of the financial effects of Council's waste disposal strategic plan (closure of McRobies Gully tip site), the Myer site redevelopment and the Inner City Action Plan.

# 13. Appendices

## *Appendix 1 – Financial Sustainability Indicators*

| Financial Indicator | Calculation | Description |
|---|---|---|
| Underlying Operating Result | ($) Operating income (excluding amounts received specifically for new or upgraded assets, physical resources received free of charge and revaluation increments) less operating expenses for the reporting period. | The difference between day-to-day income and expenses for the period. |
| Operating Surplus Ratio | (%) Operating surplus (deficit) divided by total revenue – adjusted (excluding amounts received specifically for new or upgraded assets, physical resources received free of charge and revaluation increments). | The operating surplus ratio is the operating surplus (deficit) expressed as a percentage of total revenue (adjusted by excluding capital grants, contributed PP&E and asset revaluation increments/decrements). |
| Net Financial Liabilities | ($) Total liabilities less financial assets (cash and cash equivalents + trade & other receivables + other financial assets). | What is owed to others less money held, or invested or owed to the entity.<br>Net financial liabilities equals total liabilities less financial assets. |
| Net Financial Liabilities Ratio | (%) Net financial liabilities divided by operating income. | Indicates the extent to which net financial liabilities could be met by operating income. |
| Interest Cover Ratio | (%) Net annual interest expense divided by operating income. | The proportion of day to day income used to pay interest on loans net of interest income.<br>Indicates the extent to which an entity's operating income is committed to meeting interest expense. |
| Asset Sustainability Ratio | (%) Capital expenditure on replacement/renewal of existing plant and equipment and infrastructure assets | The ratio of asset replacement expenditure relative to depreciation for a period. It measures whether assets are being replaced at the rate they are wearing out. |

| Financial Indicator | Calculation | Description |
|---|---|---|
| | divided by their annual depreciation expense. | |
| Asset Consumption Ratio | (%) Depreciated replacement cost of plant and equipment and infrastructure assets divided by current replacement cost of depreciable assets. | Shows the depreciated replacement cost of an entity's depreciable assets relative to their 'as new' (replacement) value. |
| Asset Renewal Funding Ratio | Future asset replacement expenditure as per long term financial plan divided by future asset replacement expenditure requirement as per asset management plans. | Measures the capacity to fund asset replacement requirements. An inability to fund future requirements will result in revenue or expense or debt consequences, or a reduction in service levels. |

## *Appendix 2 – Forecast Financial Statements*

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