

De-amalgamation Analysis of Rockhampton Regional Council

PREPARED BY QUEENSLAND TREASURY CORPORATION
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1 Executive summary

Rockhampton Regional Council (RRC or the Existing Council) was formed in March 2008 following the amalgamation of the Rockhampton City, Livingstone Shire, Fitzroy Shire and Mount Morgan Shire Councils. It covers an area of approximately 18,300 km² and has a current population of approximately 112,000. Prominent industries in the region include agriculture (particularly beef), military (facilities and staff), education (Central Queensland University), retail and support services to the Bowen Basin mining sector.

A proposal has been lodged by the Capricorn Coast Independent Movement (the Proponent) for the de-amalgamation of the former Livingstone Shire Council (Proponent Council). If successful, a new Livingstone Shire Council would be formed along its former boundaries, which includes an area of approximately 11,800 km² and a population of 33,000.

QTC has been engaged by the Department of Local Government to provide advice and assistance to the Queensland Boundaries Commission (the Commission) about the financial aspects of this de-amalgamation proposal. QTC's review includes a financial analysis of both the proposed de-amalgamating council (the Proponent Council) and what would become the remaining Rockhampton Regional Council (the Remaining Council) to:

- determine the costs of de-amalgamation for both the Proponent Council and the Remaining Council, and
- assess the financial viability of the Proponent Council and the Remaining Council on the basis that de-amalgamation was successful, and compare this to the financial viability of the Existing Council.

1.1 Financial impact of de-amalgamation

1.1.1 De-amalgamation costs

De-amalgamation costs include all costs incurred from the date of a successful poll for de-amalgamation of the Proponent from an Existing Council to the date of de-amalgamation (ie, election of Proponent councillors, which is likely to be approximately 12 months after the poll). QTC has identified the costs of de-amalgamation to include:

- **one-off costs.** These relate to implementation and due diligence, community and staff engagement, and information and communication and technology (ICT). They will have the greatest direct impact on the cost to ratepayers because they will be expensed in full during the first year of de-amalgamation, and
- **fixed asset costs.** These relate to the cost of purchasing new ICT equipment and any other new plant and equipment required for the Proponent Council to maintain service delivery standards. These assets will be expensed over the term of their useful life, therefore impacting ratepayers more subtly over time than one-off costs.

Successful Proponent Councils will be required to pay their own de-amalgamation costs as well as the de-amalgamation costs of the Remaining Council.

1.1.2 Incremental annual recurring costs

Incremental annual recurring costs incurred by either the Proponent Council or the Remaining Council are not considered a cost of de-amalgamation. QTC has identified these for the Proponent Council in order to highlight the ongoing extra costs associated with operating as a separate council.

Successful Proponent Councils will be required to pay their own incremental annual recurring costs but will *not* be responsible for paying costs of this nature for the Remaining Council. Incremental annual recurring costs incurred by the Remaining Council should be small in comparison to those of the Proponent Council, but may include costs associated with lower purchasing power and other operating inefficiencies. These costs, where applicable, have been considered by QTC in the forecasts determined for the Remaining Council. To the extent that they exist, these costs may impact QTC's sustainability rating for the Remaining Council when compared to the Existing Council and the average rates per rateable property of the Remaining Council when compared to the Existing Council.

1.1.3 Summary of Proponent Council costs

Table 1 shows the estimated cost of de-amalgamation, including incremental annual recurring costs, to the Proponent Council (column 1). It also shows how these costs translate into a cost per rateable property (columns 2 and 3).

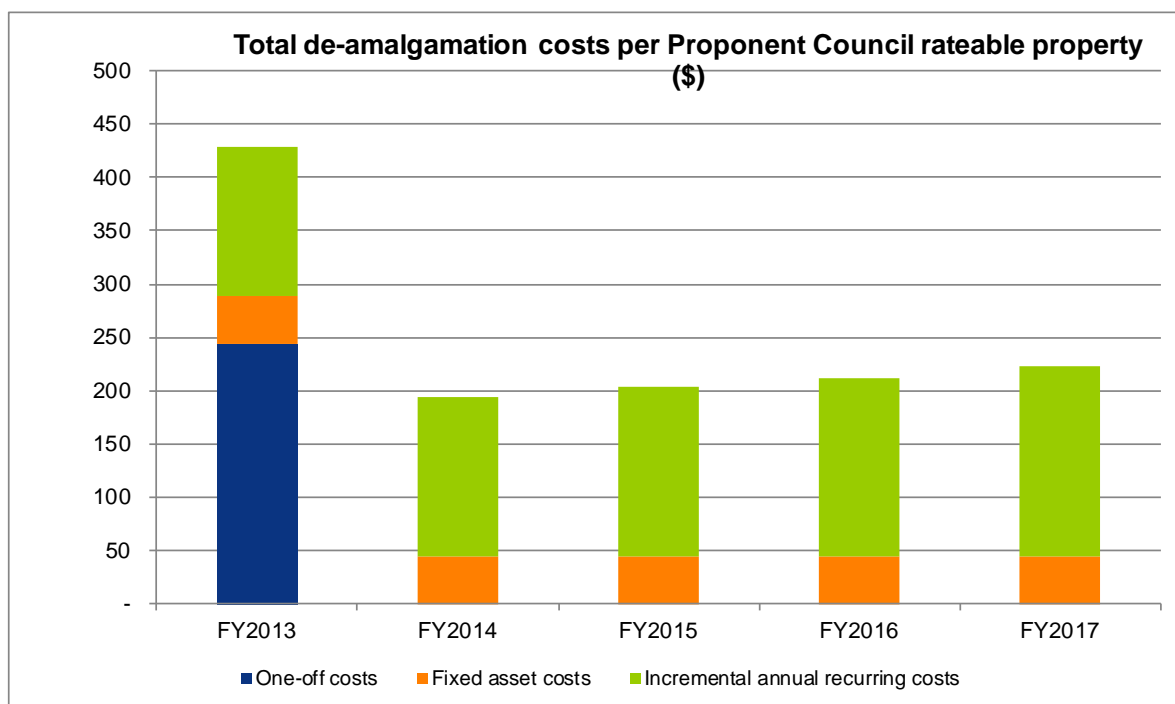
TABLE 1 - SUMMARY OF DE-AMALGAMATION COSTS

	QTC Estimate \$	Average Costs \$	Annualised Costs \$
Total one-off costs	3,900,000		
Average one-off costs per Proponent Council rateable property		243.23	
Total one-off fixed asset costs	3,823,000		
Average fixed costs per Proponent Council rateable property		238.43	
Annualised fixed costs per Proponent Council rateable property			44.91
Total incremental annual recurring costs	2,260,000		
Incremental annual recurring costs per Proponent Council rateable property			140.95

Annualised fixed asset costs demonstrate the financial effect of spreading the cost of the asset over their useful life (ie depreciation expense)

Table 1 indicates that the one-off costs of de-amalgamation per rateable property will be \$243 while the incremental annual recurring costs will be \$186.

The following graph shows the financial impact of de-amalgamation, including incremental recurring costs, per rateable property over five years.



In the first year, each rateable property in the Proponent Council area will on average¹ need to contribute an extra \$429 in rates to cover the costs of de-amalgamation. In the second year, the extra contribution will drop to \$194 and is then expected to increase each year based on inflation.

1.2 Assessment of financial viability – using QTC’s Base Case

The financial viability of the Existing Council, Proponent Council and Remaining Council was assessed by QTC with reference to financial information provided by the Proponent, the Existing Council’s current five year forecasts as well as RRC’s five year forecasts for the Proponent Council and Remaining Council.

In order to derive its own Base Case set of 5 year financial forecasts for the Proponent and Remaining Councils, QTC made adjustments to the assumptions of the Proponent Council and Existing Council where they were not considered to be complete and/or reasonable.

QTC’s Base Case financial forecasts for the Proponent Council and Remaining Council included a cost allocation that might occur because of decreased purchasing power with suppliers including insurance, waste management, fleet leasing and other expenses, as well as other inefficiencies.

¹ Rates per rateable property may bear no direct comparison to actual rates paid by some ratepayers because it is an average figure calculated using total rateable properties. It does not take into consideration that some residential, commercial and industrial rateable properties attract a higher portion of the base rate than others.

QTC's financial forecasts for the Proponent Council also included the items identified in its assessment of de-amalgamation costs. That is:

- the one-off costs of de-amalgamation for itself and the Existing Council
- the additional fixed asset costs, and
- the incremental annual recurring costs of de-amalgamation where they were not already considered to be included.

QTC's financial forecasts were based on a standard delivery model. However, where existing assets were shared across a region (ie, landfills), QTC assumed that a commercial arrangement would be negotiated between the councils to continue to share the asset. This was thought to be a more practical assumption than including the cost of replacing the asset.

1.2.1 Sustainability ratings – Base Case forecasts

QTC's assessment of financial viability involved determining a sustainability rating for the Existing Council, Proponent Council and Remaining Council. This rating considers each council's five year forecasts against sustainability ratios and benchmarks referred to by both QTC and the Department of Local Government (DLG).

A summary of the sustainability rating assigned by QTC to the Existing, Proponent and Remaining Councils is shown below. It should be noted that these sustainability ratings have been determined based on information and assumptions contained in the Base Case forecasts estimated by QTC.

Sustainability Rating	Existing Council	Proponent Council	Remaining Council
QTC rating (and outlook) – Base Case	Moderate (neutral)	Moderate (neutral)	Weak (negative)

Based on the Base Case forecasts, QTC has rated the Existing Council and Proponent Council as moderate, while the Remaining Council was rated as weak.

The moderate ratings are supported by the forecasts that indicate that the Existing and Proponent Councils will satisfy most of QTC's sustainability benchmarks over the forecast period. Both Councils will however experience small operating deficits in some or all of the five forecast years.

QTC has rated the Remaining Council as weak. The weak rating is supported by the following observations:

- The Remaining Council is expected to have sustained operating deficits from FY2013 to FY2015 and a level of debt that, while able to be serviced at present, impacts its level of financial flexibility and corresponding ability to respond to unexpected financial shocks.
- Forecasts also show that cash holdings are expected to be severely constrained by FY2017.

1.3 Financial effect per rateable property – Base Case versus Breakeven Case

QTC undertook an assessment of the impact to ratepayers of de-amalgamation by comparing the average net rates and utilities per rateable property that would apply under the Base Case for the Proponent and Remaining Councils, to the average net rates and utilities per rateable property that would apply for the Proponent and Remaining Councils to achieve a balanced operating result (ie, the Breakeven Case).

1.3.1 Base Case average annual rates per rateable property

Table 2 shows the average net rates and utilities per rateable property that would apply using QTC's Base Case for the Proponent and Remaining Councils.

TABLE 2 – BASE CASE AVERAGE ANNUAL NET RATES AND UTILITIES PER RATEABLE PROPERTY

	FY2013	FY2014	FY2015	FY2016	FY2017
Proponent Council (\$)	2,929	3,087	3,255	3,414	3,554
Remaining Council (\$)	3,182	3,372	3,594	3,780	3,937

1.3.2 Breakeven average annual rates per rateable property

QTC considers that a balanced operating result is essential to a council's long term financial sustainability. Table 3 shows the estimated incremental increase / (decrease) in net rates and utilities per rateable property that would apply if de-amalgamation was successful and the Proponent and Remaining Councils were to achieve a balanced operating result (ie, the breakeven rates).

TABLE 3 – CHANGE IN AVERAGE ANNUAL NET RATES AND UTILITIES PER RATEABLE PROPERTY – BREAK-EVEN CASE INCREMENTAL TO BASE CASE

	FY2013	FY2014	FY2015	FY2016	FY2017
Breakeven case					
Proponent Council (\$)	464	96	86	47	13
Change from Base Case (%)	16%	3%	3%	1%	0%
Remaining Council (\$)	306	153	27	1	-
Change from Base Case (%)	10%	5%	1%	0%	0%

The required increases per rateable property in the Breakeven Case when compared to the Base Case forecasts reflect:

- the elimination of operating deficits in the current five year forecasts where they existed
- the cost increases attributable to the impact of de-amalgamation, with the upfront costs being incurred in FY2013 and other costs expensed in future years, and
- the impact of increased operating expenses associated with a reduction in economies of scale and efficiency.

1.4 Key issues for consideration

- *Forecast rates and utilities charges are above projected CPI.* While the Proponent Council and Existing Council have both proposed rate increases of this size, it is noted that the community may not be able or willing to absorb these increases over a sustained period.
- *Debt levels for Remaining Council are very high.* The net financial liabilities and interest cover ratios fail to meet benchmark requirements in most years of the forecast. This indicates that, while the current level of debt is able to be serviced by Council, its ability to take on additional debt is limited.
- *Proponent Council is forecasting operating deficits over the forecast period.* A balanced or surplus operating result is essential to long term financial sustainability. Current forecasts for the Proponent Council do not achieve a balanced or surplus operating result in any of the forecast years, with deficits averaging 5.2 per cent per annum.
- *Remaining council demonstrates emerging liquidity issues:* QTC has assessed the Remaining Council as weak with a negative outlook. While the Proponent Council has been rated as moderate as a separate council, the Remaining Council has and will continue to be impacted by the previously weak and very weak QTC rated shire councils of Fitzroy and Mount Morgan, respectively. In addition, the capital program over the last four years has contributed to significantly increased debt levels. While a portion of this debt has been allocated to the Proponent Council, the Remaining Council's debt level remains high.
- *Significant future capital expenditure program:* The forecast capital expenditure program further contributes to declining liquidity and increasing debt for the Remaining Council. If the capital program could be reduced or postponed, this situation may be alleviated.
- *Investigation of regional waste disposal options:* The Existing Council continues to explore suitable regional options for waste disposal. Regional collaboration on waste solutions could be adversely impacted if the Existing Council was to de-amalgamate.
- *Negotiation of terms for the supply of water to Proponent Council.* The Proponent Council will need to negotiate terms for the supply of water for the Yeppoon pipeline. It is expected that the contract would be based on take-or-pay terms and a commercial price. The take-or-pay terms would mean that the Proponent Council would still be required to pay the Remaining Council in years where their primary water source was sufficient to supply all of their needs.

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2 Existing Council profile

Table 4 sets out selected demographics of the amalgamating local governments in 2008 and the current profile for Rockhampton Regional Council (RRC or Existing Council).

TABLE 4 – OVERVIEW

	14 March 2008					2012 Existing Council
	Rockhampton City	Livingstone Shire	Fitzroy Shire	Mt Morgan Shire	Total	
Area covered by region (km2)	188	11,775	5,901	492	18,356	18,356
Population in region #	62,565	30,616	11,183	3,153	107,517	112,383
No. of rateable properties in region	24,243	14,058	5,116	1,636	45,053	49,019
No. of voters in region	39,095	19,307	6,850	2,049	67,301	71,430
Councillors	12	9	9	7	37	11
Number of staff	650	293	82	21	1,046	1,208

Census 2006 data used for 14 March 2008 figures and Census 2011 data was used for 2012 figures.

Key observations since amalgamation:

- Growth in rateable properties has been approximately 9 per cent over the four years since amalgamation, with most growth centred upon Gracemere and Yeppoon.
- Population growth over the period was approximately 4.5 per cent.
- Staff numbers have increased over this period by 162 or approximately 15 per cent.
- Amalgamation led to a significant decrease in the number of Councillors across the region.

2.1 Regionally significant assets and services

Water and Sewerage

Fitzroy River Water, a commercial business unit of Rockhampton Regional Council, is responsible for the operation and maintenance of all water and sewerage assets in the region. Major assets in the region include the Fitzroy River Barrage, which is the main supply source for Rockhampton, and the recently completed pipeline to Yeppoon which transports treated water and safeguards the supply in coastal areas.

Waste

Waste sourced from coastal areas is currently deposited at Yeppoon, while the remainder of the region utilises the existing landfill at Lakes Creek, which is expected to reach capacity in the next few years. A recent \$3.0 million upgrade to the Yeppoon landfill has seen an extension of its useful life, although this site is not being used as the regional landfill.

RRC is currently searching for a new landfill site, including an option for a regional partnership to develop a joint facility with neighbouring councils (eg, Gladstone Regional Council). This facility may not be located in the Rockhampton Regional Council area.

Waste and recyclable material collections are carried out by RRC and JJ Richards respectively under a regional contract negotiated by the Central Queensland Local Government Association.

Airport

RRC owns and operates the Rockhampton Airport, which is used by both domestic airlines, Qantas and Virgin Australia, and military aircraft. Total passenger numbers are approximately 750,000 per annum. There has not been any significant development since amalgamation, but some repairs were needed following the flood event in 2011. The airport did not qualify for disaster relief funding, being a commercial enterprise, however, RRC received special assistance from the Federal Government to cover some of the repair costs.

2.2 Financial viability assessment of Existing Council

QTC ratings	Nov 2012 Rockhampton Regional Council: Moderate (Neutral outlook)
	Oct 2011 Rockhampton Regional Council: Moderate (Neutral outlook)

RRC has been rated by Queensland Treasury Corporation as **moderate** with a **neutral** outlook.

RRC's balance sheet has a moderate level of debt that has been used to fund its capital program over recent years. This debt is able to be adequately serviced, however RRC's forecast operating result indicates that it has limited capacity to take on any further debt without significant adverse impact to its forecasts.

RRC has displayed some willingness to increase rates and utilities charges above the Consumer Price Index (CPI) over recent years. Despite this, the last 4 years have been characterised by continuous operating deficits, indicating that this level of increase is still not sufficient to cover current operating expenditure. This trend is not sustainable in the long-term.

RRC's current rating of moderate is based on a forecast return to operating surplus by 2015. The achievement of an operating surplus is based on a continuation of above CPI increases in rates and utility charges and containment of growth in employee costs and materials and services costs.

A neutral outlook has been applied to the Existing Council's rating, reflecting that there are no known foreseeable significant events within the next two years that would have a direct impact on Council's capacity to meet its financial commitments.

2.3 Financial analysis

2.3.1 Key assumptions

Table 5 outlines key assumptions applied to the financial forecasts used by QTC to determine the financial viability of the Existing Council.

TABLE 5 – KEY ASSUMPTIONS

	Actual FY2010	Actual FY2011	Actual FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Number of rateable properties	n/a	n/a	49,019	49,852	50,700	51,562	52,438	53,330
Growth in rateable properties	n/a	n/a	n/a	1.7%	1.7%	1.7%	1.7%	1.7%
Growth in net rates and utilities revenue	8.4%	1.2%	9.6%	9.6%	7.4%	7.3%	6.8%	5.8%
Net rates & utility charges per rateable property (\$)	n/a	n/a	2,879	3,103	3,276	3,456	3,629	3,776
Staff numbers (FTE)	1,185	1,211	1,208	1,229	1,249	1,271	1,292	1,314

Key points to note from Table 5:

- Forecast growth in rateable properties of 1.7 per cent per annum is consistent with the view of population growth by the Office of Economic and Statistical Research.
- Growth in net rates and utilities revenue, not attributable to the growth in rateable properties, is above CPI in each year of the forecast.

2.3.2 Forecast financial results

Table 6 provides a summary income statement, balance sheet and cashflow for RRC.

TABLE 6 – SUMMARY OF KEY FINANCIAL INFORMATION

	Actual FY2010	Actual FY2011	Actual FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Income Statement items (\$000)								
Net rates and utilities	127,248	128,759	141,150	154,672	166,100	178,186	190,308	201,391
Grants and subsidies	15,442	25,201	24,154	19,214	25,354	26,596	27,899	29,266
Total recurrent revenue	181,907	196,986	218,222	225,660	245,543	261,525	277,261	292,253
Employee expenses	80,833	88,370	94,914	95,804	97,991	102,273	107,242	112,454
Materials and services costs	53,610	61,116	60,395	67,238	70,676	74,846	79,824	83,938
Depreciation	49,387	50,592	53,363	59,000	61,886	63,915	67,007	70,236
Interest expense	7,815	9,447	11,754	13,092	14,452	15,326	15,463	15,611
Total recurrent expenses	192,180	210,170	221,076	237,298	245,316	256,682	269,974	282,687
Operating surplus/(deficit)	(10,273)	(13,184)	(2,854)	(11,637)	227	4,844	7,287	9,566
Balance Sheet items (\$000)								
Cash / (Overdrafts)	84,461	94,289	104,292	75,517	78,328	74,794	73,595	71,841
Property, plant and equipment	2,242,415	2,300,885	2,488,468	2,644,768	2,747,119	2,851,769	2,960,277	3,072,345
Total QTC borrowings	153,504	195,128	220,091	240,091	253,238	253,918	255,067	254,093
Cashflow items (\$000)								
Gross capital expenditure	112,625	95,314	99,853	127,024	84,609	87,218	90,908	94,718
New borrowings	40,771	56,301	41,500	38,400	32,400	22,000	22,000	20,000

Key points to note from Table 6:

- RRC is forecasting rates and utilities price increases above current CPI over the forecast period. The return to operating surplus is dependent on these increases being successfully delivered.
- In FY2013, a significant portion of the capital program is funded by cash.

Table 7 provides a summary of RRC's key historical and forecast financial ratios for the FY2010 to FY2017 period.

TABLE 7 – HISTORICAL AND FORECAST FINANCIAL RATIOS

	Benchmark	Actual FY2010	Actual FY2011	Actual FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Own source operating revenue	> 60%	83.0%	78.4%	78.3%	80.7%	79.5%	79.8%	80.2%	80.5%
Operating surplus ratio	0% - 10%	(5.6%)	(6.7%)	(1.3%)	(5.2%)	0.1%	1.9%	2.6%	3.3%
Interest cover	> 4 times	6.0	5.0	5.3	4.6	5.3	5.5	5.8	6.1
Total debt service cover	> 2 times	n/a	1.8	2.5	1.8	2.2	2.3	2.5	2.6
Cash expense cover	> 3 months	7.5	7.5	8.0	5.5	5.6	5.1	4.7	4.4
Working capital ratio	> 3 times	2.9	3.1	3.2	2.6	2.5	2.4	2.4	2.3
Asset sustainability ratio	> 1.1 times	2.2	1.8	1.8	2.1	1.4	1.4	1.3	1.3
Average useful life of depreciable assets (years)	n/a	n/a	n/a	44.7	42.9	41.3	39.9	38.5	37.3
Net financial liabilities ratio	< 60%	47.6%	58.2%	60.5%	78.1%	75.6%	72.7%	69.7%	66.5%

Key points to note from Table 7:

- RRC derives the majority of its revenue from sources over which it has some influence and control, such as general rates and utility charges, with an own source revenue ratio of greater than 60 per cent over the forecast period. This provides a degree of financial flexibility and some protection against adverse financial shocks.
- The net financial liabilities and debt service cover ratios fail to meet benchmark requirements in some years of the forecast. This indicates that, while the current level of debt is able to be serviced by RRC, a focus on maintaining or reducing debt levels is warranted.
- The asset sustainability ratio indicates adequate investment in RRC's asset base to maintain service capacity. The capital program is being financed with a combination of operating cashflow and debt.

Contingent Liabilities

The only significant contingent liability disclosed in the FY2012 financial statements is a \$6.2 million claim lodged in the Supreme Court by a contractor in relation to an alleged breach of contract on the recently completed Rockhampton to Yeppoon pipeline. The claim is being vigorously defended by RRC.

3 Proposed de-amalgamation arrangement

The proposed de-amalgamation arrangement involves separating the former Livingstone Shire Council (the Proponent Council) from the existing Rockhampton Regional Council. QTC has received information from the Proponent Council and Existing Council in relation to the cost of de-amalgamation and the initial financial position of each entity. This information is analysed below.

3.1 Proposed de-amalgamation profile

Table 8 outlines selected demographics of RRC, together with the proposed compositions of the Proponent Council and Remaining Council.

TABLE 8 – PROPOSED DE-AMALGAMATION PROFILE

	Existing Council	Proposed split		Total
		Remaining Council	Proponent Council	
Area covered by region (km2)	18,356	6,581	11,775	18,356
Population in region #	112,383	79,034	33,349	112,383
No. of rateable properties in region	49,019	32,985	16,034	49,019
No. of voters in region	71,430	49,682	21,748	71,430
Councillors	11	8	7	15
Number of staff (transferring)	1,208	846	362	1,208

Census 2011 data.

Note that the proposed de-amalgamation profile is based on the boundaries of the former Livingstone Shire Council.

3.2 Proposed de-amalgamation and incremental annual recurring costs

Outlined below is QTC's estimate of the cost of de-amalgamation to the Proponent Council, and some discussion on where this estimate differs from that of the Proponent Council and Existing Council.

3.2.1 One-off costs of de-amalgamation proposal

Table 9 outlines the estimates of the one-off costs of de-amalgamation.

TABLE 9 – ONE-OFF DE-AMALGAMATION COSTS

	QTC Estimate \$	Existing Council Estimate \$	Proponent Council Estimate \$
Governance, planning and implementation costs	1,091,000	727,794	521,500
Industrial relations costs	1,063,000	1,000,000	100,000
Community & staff engagement costs	482,000	300,000	168,000
Legal due diligence costs	100,000	100,000	40,000
Accounting and finance due diligence costs	60,000	300,000	20,000
New ICT costs	1,084,000	-	-
Reimbursement to Remaining Council for:			
- website	20,000	-	-
Total one-off costs	3,900,000	2,427,794	849,500
Average cost per Proponent Council rateable property	\$243.23		

Generally, QTC's estimates of one-off costs of de-amalgamation exceed both the Proponent Council and Existing Council. Significant differences between QTC's one-off cost assumptions and those of RRC and the Proponent Council are discussed below.

- Governance, planning and implementation costs:** QTC assumed higher costs than the RRC and the Proponent Council. The major cost components under this category relate to the De-amalgamation Project Team, Joint Transfer Board and election costs. The Proponent Council's submission discussed the establishment of a Joint Transfer Board and De-amalgamation Project Team, however, it assumed lower staffing levels existed in the project team than QTC expects will be required. The Existing Council provided an estimate of the costs of transitional activities, but did not provide a break-down of the components of their estimate. It should be noted that QTC considers its cost estimate as being conservative. It does not reflect the costs of preparing new planning schemes, disaster management schemes and other required policies and plans for either the Remaining Council or the Proponent Council. QTC's experience at the time of amalgamation was that these costs were incurred after the establishment of the new council.
- Industrial relation costs:** QTC assumed much higher costs than the Proponent Council, however, its costs were similar to those of the Existing Council. The Proponent Council assumed \$100,000 for this category, which was allocated entirely for redundancies. No recruitment costs were forecast.
- Community and staff engagement costs:** QTC assumed higher costs than the RRC and the Proponent Council. The variance between QTC's estimate and that of the Proponent Council is largely due to the Proponent Council not reflecting costs associated with a call centre and estimating a smaller cost for uniforms. The difference between the estimate of QTC and the Existing Council is that the latter has not reflected any costs for a call centre and staff and community consultation.

- **Legal due diligence costs:** QTC's estimate of costs are in-line with Existing Council estimates and higher than the Proponent Council's. The Proponent Council assumes that the legal process associated with de-amalgamation would be less complex than the original amalgamation.
- **Accounting and finance due diligence costs:** QTC assumed costs are lower than the RRC and marginally higher than the Proponent Council. QTC has assumed that the project team will undertake some of the accounting due diligence.
- **New ICT costs:** QTC engaged KPMG to estimate the information and communication technology costs of de-amalgamation. These costs relate to the one-off costs associated with the establishment of data and voice systems and the IT transition project team. The IT Transition Project Team is additional to the Joint Transfer Board and the De-Amalgamation Project Team. The Remaining Council and Proponent Council did not forecast these one-off costs.
- **Reimbursement to remaining council for new property plant and equipment:** QTC has determined that the Remaining Council would not require any property, plant and equipment that is located in the Proponent Council's boundary in order to maintain services in the Remaining Council.

3.2.2 Property, plant and equipment costs

Table 10 outlines the estimate of property, plant and equipment purchases required by the Proponent Council as a result of de-amalgamation.

TABLE 10 – PROPERTY, PLANT AND EQUIPMENT DE-AMALGAMATION COSTS

	QTC Estimate \$	Existing Council Estimate \$	Proponent Council Estimate \$
New ICT assets	3,323,000	3,145,000	630,000
Additional property, plant and equipment	500,000	500,000	-
Total one-off fixed asset costs	3,823,000	3,645,000	630,000
<i>Depreciation</i>	<i>720,156</i>	<i>684,556</i>	<i>126,000</i>
Cost per Proponent Council rateable property	\$238.43		
Annualised cost per Proponent Council rateable property	\$44.91		

Significant differences between the estimates of QTC, RRC and the Proponent Council are:

- **New ICT assets:** KPMG has estimated the required ICT capital expenditure requirements for the Proponent Council, which QTC has adopted. This capital expenditure has been reflected in the Proponent Council forecast as depreciation expense over 5 years.
- **Additional property, plant and equipment:** QTC has included \$500,000 for the refurbishment of the former Livingstone Shire Council chambers and administration building on Anzac Parade. The Proponent Council has not assumed any cost for this refurbishment.

The estimate of Annualised Costs per Proponent Council ratepayer in Table 10 reflects the total fixed asset costs depreciated over the average useful lives of the assets concerned.

3.2.3 Incremental annual recurring costs

Table 11 shows the incremental annual cost associated with administering the proposed de-amalgamated council. Ratepayers of the Proponent Council would bear these incremental costs post-de-amalgamation.

TABLE 11 - INCREMENTAL ANNUAL RECURRING COSTS

	QTC Estimate \$	Existing Council Estimate \$	Proponent Council Estimate \$
Councillor Remuneration	525,000	659,976	490,000
Salaries and wages costs	632,000	594,020	700,000
ICT Costs	517,000	560,910	608,750
Insurance	-	100,000	115,000
Service Delivery Costs			-
Diseconomies of scale for Proponent Council	586,000	630,000	-
Total incremental annual recurring costs	2,260,000	2,544,906	1,913,750
Cost per Proponent Council rateable property	\$140.95		

Key points to note from Table 11:

- **Councillor Remuneration:** QTC has estimated councillor remuneration based on information in the most recent Local Government Remuneration Tribunal publication². QTC has assumed that the Remaining Council will be a category 6 local government and the Proponent Council a category 4 local government.
- **Salaries and wages costs:** QTC's estimate of incremental costs reflects an additional six administrative employees that would be required by the Proponent Council. These employees would be required because it would not be possible to split the roles they currently complete in the Existing Council's corporate services division.
- **ICT costs:** KPMG has estimated the ICT recurring cost requirements for the Proponent Council, which QTC has considered and adjusted for those costs it believes are not incremental to ongoing operations.
- **Diseconomies of scale for Proponent Council:** It is assumed that the smaller de-amalgamated entities would be subject to reduced economies of scale compared to the Existing Council. QTC has included a recurring cost relating to diseconomies of scale equal to 3 per cent of the annual materials and services expense for both the Remaining Council and the Proponent Council. This also incorporates increased costs related to insurance.

² Local Government Remuneration Tribunal publication – <http://www.dsdip.qld.gov.au/resources/report/local-government/new-remuneration-arrangements-media-release.pdf>

3.3 Proposed balance sheet separation

Table 12 shows the opening balance sheet for the Existing Council, and estimates of what would become the opening balance sheet for the Proponent Council and Remaining Council if de-amalgamation were to proceed.

TABLE 12 – SUMMARY BALANCE SHEET ALLOCATION

	Existing Council	Remaining Council	Proponent Council
Assets (\$000)			
Cash & cash equivalents	104,292	51,728	52,564
Property, plant & equipment	2,488,468	1,707,293	781,175
Other assets	110,505	78,885	31,620
Total assets	2,703,265	1,837,906	865,360
Liabilities (\$000)			
Debt	220,091	146,483	73,608
Other liabilities	50,875	35,901	14,974
Total liabilities	270,966	182,384	88,582
Total community equity	2,432,299	1,655,522	776,778

QTC has estimated an opening balance sheet as at 1 July 2012 for the Remaining Council and Proponent Council based on the FY2012 unaudited Balance Sheet for the Existing Council. QTC has referenced information provided by both the Proponent Council and Existing Council to determine the estimated opening Balance Sheet.

Discussion on key Balance Sheet items follows.

- **Cash and cash equivalents:** QTC estimated the opening cash balances of the Remaining Council and the Proponent Council based on a reconstruction of the cash flows during the period since amalgamation. This involved assumptions around receipts from customers, payments to suppliers and employees, payments for property, plant and equipment including subsidies, donations and contributions for new capital expenditure, and proceeds from and repayments of borrowings.
- **Property, plant and equipment:** QTC has relied on information from the Existing Council for the allocation of the property, plant and equipment, which have been allocated on geographic location. Where assets are utilised across the Existing Council area, these assets has been allocated according to the population proportions of the Remaining Council and the Proponent Council.
- **Debt:** At the time of amalgamation, the Proponent Council had \$29.6 million, and the remaining Councils a total of \$54.0 million in debt with QTC. Since amalgamation RRC has drawn down \$189.4 million in new loans and had \$220.1 million in outstanding debt as at 30 June 2012. QTC has allocated borrowings since amalgamation in the same proportion as the capital expenditure in their respective regions. Redemptions over the same period are assumed to have occurred in the same proportion as the opening debt balances.

- **Other Balance Sheet items:** All other balance sheet items, where they are unable to be identified as relating to a specific region they have been allocated accordingly, otherwise items have generally been allocated on the basis of proportion of population or pre-amalgamation proportions.

4 Financial viability assessment of Proponent Council

QTC ratings

Nov 2012 Proponent Council - Moderate (Neutral outlook)

Feb 2007 Livingstone Shire Council - Moderate (Developing outlook)

Based on the information made available, QTC has rated the forecast financial profile of the Proponent Council as **moderate** with a **neutral** outlook.

The moderate rating is primarily reflective of the fact that key financial ratios are generally within acceptable benchmarks, with the exception of the operating surplus ratio, throughout the forecast period. The operating surplus ratio is negative, reflecting the small operating deficits forecast each year. One-off costs of de-amalgamation and incremental recurring costs, together with diseconomies of scale contribute to these forecast operating deficits.

On average, a balanced or surplus operating result is essential to long term financial sustainability. Rates and utility charges will need to increase at levels greater than those forecast to achieve a break-even operating result.

A neutral outlook has been applied to the Proponent Council's rating, reflecting that there are no known foreseeable significant events within the next 24 months that would have a direct impact on Council's capacity to meet its financial commitments.

4.1 Proposed approach for regionally significant assets and services

Water and Sewerage

QTC's forecasts assume the Proponent Council will take ownership of all water and waste water assets in their region, including the Rockhampton to Yeppoon water pipeline (the pipeline), and will operate and maintain them under an 'in-house' delivery model as specified by the Boundaries Commission.

The Proponent Council will be dependent on the Remaining Council for water that is required to ensure that water flows continuously through the pipeline to prevent corrosion and maintain water quality. The Proponent Council may also be dependent on the Remaining Council for additional water supplies when not available from Water Park Creek, which is the primary source of water for the coastal area from Yeppoon to Emu Park.

These additional water requirements of the Proponent Council would need to be sourced from a high priority water allocation from the Fitzroy Barrage storage. It is likely that the supply contract would be under take-or-pay conditions.

The Proponent Council intends to explore the option of Fitzroy River Water continuing to provide water and sewerage services to their region post de-amalgamation. This arrangement should be negotiated on commercial terms.

Waste

The Existing Council has recently upgraded the Yeppoon landfill to extend its useful life. This site now has sufficient capacity to cater exclusively for the Proponent Council's needs for in excess of a further 15 years.

QTC has assumed that the waste and recyclable material collections and processing would continue to fall under the provisions of the regional contract negotiated by the Central Queensland Local Government Association.

Airport

The Proponent Council will have no involvement in the ownership or management of the airport following any de-amalgamation.

4.2 Financial analysis

QTC derived a set of financial forecasts for the Proponent Council after considering the financial information provided by the Existing Council and the Proponent Council.

In order to derive its own Base Case set of 5 year financial forecasts for the Proponent, QTC made adjustments to the assumptions where they were not considered complete and/or reasonable.

4.2.1 Key Assumptions

Table 13 outlines key assumptions applied to the financial forecasts used by QTC to determine the financial viability of the Proponent Council.

TABLE 13 – KEY ASSUMPTIONS

	FY2013	FY2014	FY2015	FY2016	FY2017
Number of rateable properties	16,515	17,010	17,521	18,046	18,534
Growth in rateable properties	n/a	3.0%	3.0%	3.0%	2.7%
Growth in net rates and utilities revenue	n/a	8.6%	8.6%	8.0%	6.9%
Net rates & utility charges per rateable property (\$)	2,929	3,087	3,255	3,414	3,554
Staff numbers (FTEs)	368	379	390	402	413

Key points to note from Table 13 include:

- Growth in rateable properties is consistent with OESR estimates of population growth.
- FTEs are assumed to grow in-line with rateable properties to maintain service standards.

4.2.2 Proponent Council financial information

Table 14 provides a summary income statement, balance sheet and cashflow used by QTC for the Proponent Council.

TABLE 14 - SUMMARY OF KEY FINANCIAL INFORMATION

	FY2013	FY2014	FY2015	FY2016	FY2017
Income Statement items (\$000)					
Net rates and utilities	48,366	52,506	57,022	61,610	65,860
Grants and subsidies	5,668	4,425	4,699	4,991	5,285
Total recurrent revenue	65,630	68,972	74,326	79,800	84,915
Employee expenses	28,891	30,524	32,251	34,233	36,238
Materials and services costs	20,191	18,792	20,145	21,861	23,149
Depreciation	15,739	16,862	17,770	18,717	19,743
Interest expense	4,004	4,070	4,256	4,361	4,502
Total recurrent expenses	73,330	70,901	76,220	81,082	85,624
Operating surplus/(deficit)	(7,700)	(1,930)	(1,894)	(1,282)	(709)
Balance Sheet items (\$000)					
Cash / (Overdrafts)	50,875	48,041	49,557	48,007	46,867
Property, plant and equipment	818,437	850,095	878,719	912,452	947,058
Total QTC borrowings	73,636	75,877	76,224	77,430	78,468
Cashflow items (\$000)					
Gross capital expenditure	29,978	24,301	21,361	26,420	27,403
New borrowings	6,608	8,608	7,310	7,310	6,720

Key points to note from Table 14:

- Yeppoon has traditionally been a high growth area, which slowed during the recent financial downturn. The forecast growth in rateable properties is expected to be driven by improved financial conditions, developments in the region (including Great Keppel Island) and the areas appeal as a lifestyle destination for mining workers.
- Rates and utilities revenue is a product of assumed growth in rateable properties and price increases. Rates and utility charges are forecast to increase in-line with the price increases being proposed by the Existing Council, which are above current CPI in all years.
- Grants and subsidies are forecast to decline in FY2014 as the impact of NDRRA funding for regional flood reconstruction works finalises. Associated NDRRA materials and services expenditure also declines in FY2014.
- Forecasts show operating deficits in all years. The major contributors to the significant operating deficit in FY2013 are one-off de-amalgamation costs. Annual incremental

recurring costs of de-amalgamation are a significant component of the operating deficits in later years.

- The Proponent Council's declining cash balance and increasing debt balance is largely attributable to the assumed capital program. If the Proponent Council's capital program could be reduced or postponed, this situation may be alleviated.

Table 15 provides a summary of QTC's view of the Proponent Council's key ratios for the FY2013 to FY2017 period.

TABLE 15 - FORECAST FINANCIAL RATIOS

	Benchmark	FY2013	FY2014	FY2015	FY2016	FY2017
Own source operating revenue	> 60%	80.8%	83.4%	83.9%	84.3%	84.7%
Operating surplus ratio	0% - 10%	(11.7%)	(2.8%)	(2.5%)	(1.6%)	(0.8%)
Interest cover	> 4 times	3.0	4.7	4.7	5.0	5.2
Total debt service cover	> 2 times	n/a	1.6	1.8	2.1	2.3
Cash expense cover	> 3 months	11.4	11.5	11.0	9.9	9.2
Working capital ratio	> 3 times	3.9	4.1	4.2	4.1	3.8
Asset sustainability ratio	> 1.1 times	1.8	1.4	1.2	1.4	1.4
Average useful life of depreciable assets (years)	n/a	48.7	45.9	43.9	42.2	40.5
Net financial liabilities ratio	< 60%	46.0%	48.4%	44.0%	44.7%	44.7%

Key points to note from Table 15 include:

- Key financial ratios are generally within acceptable benchmarks with the exception of the operating surplus ratio, which reflects the forecast operating deficits. On average, a balanced or surplus operating result is essential to long term financial sustainability.
- Forecast growth in net rates and utilities charges is above the current CPI and may be difficult to achieve. Any shortfall in achieving these increases will result in a deteriorating financial position.
- The interest cover and debt service cover ratios indicate very little capacity for the Proponent Council to take on debt to respond to an unexpected financial shock.

4.3 Financial effect per rateable property – Base Case versus Breakeven Case

QTC undertook an assessment of the impact to ratepayers of de-amalgamation by comparing the average net rates and utilities per rateable property that would apply under the Base Case for the Proponent Council to the average net rates and utilities per rateable property that would apply for the Proponent Council to achieve a balanced operating result (ie, the **breakeven case**).

4.3.1 Base Case average annual rates per rateable property

Table 16 shows the average net rates and utilities per rateable property that would apply using QTC's Base Case for the Proponent Council.

TABLE 16 – BASE CASE AVERAGE ANNUAL NET RATES AND UTILITIES PER RATEABLE PROPERTIES

	FY2013	FY2014	FY2015	FY2016	FY2017
Proponent Council (\$)	2,929	3,087	3,255	3,414	3,554

4.3.2 Breakeven average annual rates per rateable property

QTC considers that a balanced operating result is essential to a council's long term financial sustainability. Table 17 shows the estimated incremental increase / (decrease) in net rates and utilities per rateable property that would apply if de-amalgamation was successful and the Proponent Council was to achieve a balanced operating result (ie, the breakeven rates).

TABLE 17 - CHANGE IN AVERAGE ANNUAL NET RATES AND UTILITIES PER RATEABLE PROPERTY – BREAKEVEN CASE INCREMENTAL TO BASE CASE

	FY2013	FY2014	FY2015	FY2016	FY2017
Breakeven case					
Proponent Council (\$)	464	96	86	47	13
Change from Base Case (%)	16%	3%	3%	1%	0%

The required increases per rateable property in the Breakeven Case when compared to the Base Case five year forecasts reflect:

- the elimination of operating deficits in the Base Case
- the cost increases attributable to the impact of de-amalgamation, with the upfront costs being incurred in FY2013 and other costs expensed in future years, and
- the impact of increased operating expenses associated with a reduction in economies of scale and efficiency.

5 Financial viability assessment of Remaining Council

QTC ratings

Nov 2012 Remaining Council – Weak (Negative outlook)

The Remaining Council has been rated as **weak** with a **negative** outlook.

The rating of weak is based on forecast operating deficits until FY2016 and very high levels of borrowings relative to revenue. The Remaining Council has displayed a willingness to increase rates and utilities charges above CPI over recent years and it will be necessary to continue in this manner for the foreseeable future to maintain required liquidity. This however, may lead to ratepayer rating stress.

The Remaining Council will retain a significant level of debt associated with the capital expenditure program over recent years that pertained to the Remaining Council area. These borrowings are able to be serviced at present. As the Remaining Council has little capacity to increase long term debt, it may need to reduce its future capital expenditure program.

A return to an operating surplus will require limiting increases in employee expenses as well materials and services expenses.

The Remaining Council has limited capacity to respond to an unexpected financial shock and may need to seek support from the State.

The negative outlook indicates that there is a foreseeable event or circumstance occurring that has the potential to deteriorate the Remaining Council's capacity to meet its financial commitments in the short term, resulting in a change to its rating. It does not necessarily indicate that a rating change may be forthcoming.

5.1 Proposed approach for regionally significant assets and services

Water and Sewerage

Fitzroy River Water will continue to provide all water and sewerage services to the Remaining Council area. The Remaining Council will retain ownership of the Rockhampton Barrage and its water allocations. An agreement will need to be finalised with the Proponent Council to supply potable water to several of the Proponent Council's suburbs (Nerimbra and Caves areas) and for the Yeppoon pipeline. This water (assumed 2.5ML) is part of the Existing Council's High Priority allocation from the barrage, and will be charged to the Proponent Council at close to a full cost price.

Waste

The Remaining Council will initially use the Lakes Creek landfill, which will reach capacity around 2016. This landfill is the only landfill in the Remaining Council area to incur carbon tax. Following the closure of the Lakes Creek facility, the Remaining Council will either be part of a Central Queensland regional solution, which is currently out for tender, or will need to develop a new landfill site by 2016. The latter possibility has not been factored into forecasts.

QTC has assumed that the waste and recyclable material collections and processing would continue to fall under the provisions of the regional contract negotiated by the Central Queensland Local Government Association.

Airport

Rockhampton Regional Council will retain full ownership and control of the airport. The airport is currently on a price path to full cost pricing. No major capital upgrades are required or planned for the airport in the near future.

5.2 Financial analysis

QTC derived a set of financial forecasts for the Remaining Council after considering the financial information provided by the Existing Council and the Proponent Council.

In order to derive its own Base Case set of 5 year financial forecasts for the Remaining Council, QTC made adjustments to the assumptions where they were not considered complete and/or reasonable.

5.2.1 Key Assumptions

Table 18 outlines key assumptions applied to the financial forecasts used by QTC to determine the financial viability of the Remaining Council.

TABLE 18 – KEY ASSUMPTIONS

Ratio	FY2013	FY2014	FY2015	FY2016	FY2017
Number of rateable properties	33,381	33,781	34,187	34,597	35,047
Growth in rateable properties	n/a	1.2%	1.2%	1.2%	1.3%
Growth in net rates and utilities revenue	n/a	7.2%	7.9%	6.4%	5.5%
Net rates & utility charges per rateable property (\$)	3,182	3,372	3,594	3,780	3,937
Staff numbers (FTEs)	846	856	866	877	888

Key points to note from Table 18 include:

- Growth in rateable properties is consistent with OESR estimates of population growth.
- Staff numbers are assumed to grow with the increase in rateable properties over the forecast period. The Existing Council has recently undertaken an internal restructure to streamline processes and reduce staff requirements so that the eventual increase in FTE numbers may be less than estimated.

5.2.2 Remaining Council financial information

Table 19 provides a summary income statement, balance sheet and cashflow for Remaining Council.

TABLE 19 – SUMMARY OF KEY FINANCIAL INFORMATION

	FY2013	FY2014	FY2015	FY2016	FY2017
Income Statement items (\$000)					
Net rates and utilities	106,228	113,899	122,875	130,784	137,963
Grants and subsidies	13,546	11,956	12,482	13,031	13,617
Total recurrent revenue	157,914	165,455	176,774	187,137	196,899
Employee expenses	67,465	70,090	72,817	76,010	79,418
Materials and services costs	49,056	45,003	47,433	50,310	52,696
Depreciation	43,463	45,895	47,005	49,247	51,555
Interest expense	8,158	10,181	11,245	12,426	13,514
Total recurrent expenses	168,355	171,389	178,773	188,348	197,547
Operating surplus/(deficit)	(10,441)	(5,934)	(1,998)	(1,211)	(649)
Balance Sheet items (\$000)					
Cash	15,423	12,932	2,248	(4,893)	(12,399)
Property, plant and equipment	1,828,832	1,897,434	1,970,907	2,054,494	2,129,623
Total QTC borrowings	165,813	178,276	180,171	192,757	194,036
Cashflow items (\$000)					
Gross capital expenditure	100,870	60,244	65,357	75,488	67,314
New borrowings	31,792	25,792	16,690	27,690	17,280

Key points to note from Table 19 include:

- Rates and utilities revenue is a product of assumed growth in rateable properties and price increases. Rates and utility charges are forecast to increase in-line with the price increases being proposed by the Existing Council, which are above current CPI in all years.
- Grants and subsidies are forecast to decline in FY2014 as the impact of NDRRA funding for regional flood reconstruction works finalises. Associated NDRRA Materials and Services expenditure also declines in FY2014.
- Forecasts show the Remaining Council will experience operating deficits over the entire forecast period. These deficits place financial pressure on the Remaining Council and reduce flexibility to deal with unexpected financial shocks. The Existing Council was already forecasting a significant operating deficit in FY2013 but the assumed diseconomies of scale exacerbate the position.

- Cash is being depleted, which is unsustainable.

Table 20 provides a summary of the Remaining Council's key ratios for the FY2013 to FY2017 period.

TABLE 20 –FORECAST FINANCIAL RATIOS

Ratio	Benchmark	FY2013	FY2014	FY2015	FY2016	FY2017
Own source operating revenue	> 60%	81.7%	83.4%	83.8%	84.1%	84.3%
Operating surplus ratio	0% - 10%	(6.6%)	(3.6%)	(1.1%)	(0.6%)	(0.3%)
Interest cover	> 4 times	5.0	4.9	5.0	4.9	4.8
Total debt service cover	> 2 times	n/a	2.1	2.2	2.2	2.2
Cash expense cover	> 3 months	1.6	1.3	0.2	-	-
Working capital ratio	> 3 times	1.5	1.4	1.1	0.9	0.7
Asset sustainability ratio	> 1.1 times	2.3	1.3	1.4	1.5	1.3
Average useful life of depreciable assets (years)	n/a	40.6	38.9	37.7	36.6	35.4
Net financial liabilities ratio	< 60%	98.9%	102.4%	103.0%	108.1%	107.3%

Key points to note from Table 20 include:

- Key financial ratios are generally not within acceptable benchmarks, with the exception of debt servicing, interest cover and asset sustainability ratios.
- The net financial liabilities to revenue ratio indicates no capacity to take on debt to respond to an unexpected financial shock.
- Forecast growth in net rates and utilities is above the current CPI and may be difficult to achieve. Any shortfall in achieving these increases will result in a further deterioration of their financial profile.
- Forecasts show the Remaining Council will experience liquidity issues (Cash expense cover ratio is well below the benchmark). This may require the Remaining Council to reduce its future capital expenditure program as it has little or no capacity to increase long term debt.

5.3 Financial effect per rateable property – Base Case versus Breakeven Case

QTC undertook an assessment of the impact to ratepayers of de-amalgamation by comparing the average net rates and utilities per rateable property that would apply under the Base Case for the Existing Council to the average net rates and utilities per rateable property that would apply for the Existing Council to achieve a balanced operating result (ie, the breakeven rates).

5.3.1 Base Case average annual rates per rateable property

Table 21 shows the average net rates and utilities per rateable property that would apply using QTC's Base Case for the Remaining Council.

TABLE 21 – BASE CASE AVERAGE ANNUAL NET RATES AND UTILITIES PER RATEABLE PROPERTY

	FY2013	FY2014	FY2015	FY2016	FY2017
Remaining Council (\$)	3,182	3,372	3,594	3,780	3,937

5.3.2 Breakeven average annual rates per rateable property

QTC considers that a balanced operating result is essential to a council's long term financial sustainability. Table 22 shows the estimated incremental increase / (decrease) in net rates and utilities per rateable property that would apply if de-amalgamation was successful and the Remaining Council was to achieve a balanced operating result (ie, the breakeven rates).

TABLE 22 - CHANGE IN AVERAGE ANNUAL NET RATES AND UTILITIES PER RATEABLE PROPERTY – BREAKEVEN CASE INCREMENTAL TO BASE CASE

	FY2013	FY2014	FY2015	FY2016	FY2017
Breakeven case					
Remaining Council (\$)	306	153	27	1	-
Change from Base Case (%)	10%	5%	1%	0%	0%

The required increases per rateable property in the breakeven case when compared to the Base Case five year forecasts reflect:

- the elimination of operating deficits in the Base Case
- the cost increases attributable to the impact of de-amalgamation, with the upfront costs being incurred in FY2013 and other costs expensed in future years, and
- the impact of increased operating expenses associated with a reduction in economies of scale and efficiency.

Disclaimer

Department of Local Government and Queensland Boundaries Commission: Local Government De-amalgamation

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The Department and the Commission acknowledge that QTC is not a legal, tax or accounting advisor and that independent expert advice from practitioners in the relevant disciplines should be obtained on those matters before acting upon the information contained in this Report.

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Appendix 1: Forecast assumptions

Forecast assumptions	Proponent Council's assumptions (avg)	Existing Council assumptions - Proponent Council (avg)	QTC assumptions - Proponent Council (forecast avg)
Population growth - Proponent	2.6%	3.0%	3.0%
Population growth - Remaining council	1.2%	1.2%	1.2%
Rateable property growth	2.6%	1.7%	2.6%
LGAQ CCI growth	3.6%	3.6%	3.6%
Growth in net rates and utilities charges	6.2%	8.0%	8.0%
Growth in wages and salaries - employees	5.6%	6.1%	5.8%
Growth in wages and salaries - Councillors	3.2%	3.2%	3.2%
Growth in materials and services	6.2%	7.2%	7.2%
Interest rate - debt (existing)	6.5%	6.2%	6.1%
Interest rate - debt (new)	6.5%	6.5%	5.5%
Interest rate - cash	5.0%	5.5%	3.7%
Creditor days	n.a.	120 days	60 days
Debtor days	n.a.	43 days	45 days

Appendix 2: Existing Council income statement

Year ended	30-Jun-13 \$'000	30-Jun-14 \$'000	30-Jun-15 \$'000	30-Jun-16 \$'000	30-Jun-17 \$'000
INCOME STATEMENT					
Revenue					
Recurrent revenue:					
Net rates and utility charges	154,672	166,100	178,186	190,308	201,391
Fees and charges	27,481	29,077	30,590	32,184	33,860
Sales - contract and recoverable works	12,799	13,336	13,896	14,480	15,088
Gain on sale of land held as inventory					
Grants, subsidies, contributions and donations	19,214	25,354	26,596	27,899	29,266
Interest received	5,058	5,033	5,401	5,315	5,346
Profit/(loss) from investments					
Rental income	2,441	2,519	2,600	2,683	2,769
Other recurrent income	3,996	4,124	4,256	4,392	4,533
Total recurrent revenue	225,660	245,543	261,525	277,261	292,253
Capital revenue:					
Total capital revenue	29,214	10,381	11,120	11,337	11,563
Capital income:					
Total capital income	4,599				
Total capital revenue and capital income	33,813	10,381	11,120	11,337	11,563
Total income	259,474	255,924	272,646	288,598	303,816
Expenses					
Recurrent expenses:					
Employee benefits	95,804	97,991	102,273	107,242	112,454
Materials and services	67,238	70,676	74,846	79,824	83,938
Loss on sale of land held as inventory					
Depreciation and amortisation	59,000	61,886	63,915	67,007	70,236
Other expenses				105	105
Finance costs	15,255	14,763	15,648	15,795	15,954
Payments					
Total recurrent expenses	237,298	245,316	256,682	269,974	282,687
Capital expenses:					
Total capital expenses					
Total expenses	237,298	245,316	256,682	269,974	282,687
Result from ordinary activities	22,176	10,608	15,964	18,625	21,130
Other non-recurrent items					
Net result attributable to Council	22,176	10,608	15,964	18,625	21,130
OPERATING RESULT					
Operating revenue	225,660	245,543	261,525	277,261	292,253
Operating expense	237,298	245,316	256,682	269,974	282,687
Operating result	(11,637)	227	4,844	7,287	9,566

Appendix 3: Proponent Council income statement

Year ended	30-Jun-13 \$'000	30-Jun-14 \$'000	30-Jun-15 \$'000	30-Jun-16 \$'000	30-Jun-17 \$'000
Revenue					
Recurrent revenue:					
Net rates and utility charges	48,366	52,506	57,022	61,610	65,860
Fees and charges	4,658	5,004	5,341	5,700	6,067
Sales - contract and recoverable works	3,776	3,934	4,099	4,272	4,451
Gain on sale of land held as inventory					
Grants, subsidies, contributions and donations	5,668	4,425	4,699	4,991	5,285
Interest received	2,194	2,103	2,133	2,163	2,154
Profit/(loss) from investments					
Rental income	221	228	235	243	251
Other recurrent income	747	771	796	821	848
Total recurrent revenue	65,630	68,972	74,326	79,800	84,915
Capital revenue:					
Total capital revenue	10,784	5,294	5,332	5,282	5,397
Capital income:					
Total capital income	928				
Total capital revenue and capital income	11,711	5,294	5,332	5,282	5,397
Total income	77,341	74,266	79,658	85,082	90,312
Expenses					
Recurrent expenses:					
Employee benefits	28,891	30,524	32,251	34,233	36,238
Materials and services	20,191	18,792	20,145	21,861	23,149
Loss on sale of land held as inventory					
Depreciation and amortisation	15,739	16,862	17,770	18,717	19,743
Other expenses				31	31
Finance costs	4,093	4,180	4,369	4,479	4,624
Payments	4,416	542	1,685	1,761	1,839
Total recurrent expenses	73,330	70,901	76,220	81,082	85,624
Capital expenses:					
Total capital expenses					
Total expenses	73,330	70,901	76,220	81,082	85,624
Result from ordinary activities	4,011	3,365	3,438	4,000	4,688
Other non-recurrent items					
Net result attributable to Council	4,011	3,365	3,438	4,000	4,688
<u>OPERATING RESULT</u>					
Operating revenue	65,630	68,972	74,326	79,800	84,915
Operating expense	73,330	70,901	76,220	81,082	85,624
Operating result	(7,700)	(1,930)	(1,894)	(1,282)	(709)

Appendix 4: Remaining Council income statement

Year ended	30-Jun-13 \$'000	30-Jun-14 \$'000	30-Jun-15 \$'000	30-Jun-16 \$'000	30-Jun-17 \$'000
Revenue					
Recurrent revenue:					
Net rates and utility charges	106,228	113,899	122,875	130,784	137,963
Fees and charges	22,823	24,117	25,346	26,638	27,999
Sales - contract and recoverable works	9,023	9,402	9,797	10,208	10,637
Gain on sale of land held as inventory					
Grants, subsidies, contributions and donations	13,546	11,956	12,482	13,031	13,617
Interest received	825	437	451	465	480
Profit/(loss) from investments					
Rental income	2,220	2,291	2,364	2,440	2,518
Other recurrent income	3,249	3,353	3,460	3,571	3,685
Total recurrent revenue	157,914	165,455	176,774	187,137	196,899
Capital revenue:					
Total capital revenue	18,431	5,087	5,788	5,805	5,916
Capital income:					
Total capital income	3,671				
Total capital revenue and capital income	22,102	5,087	5,788	5,805	5,916
Total income	180,016	170,542	182,562	192,942	202,815
Expenses					
Recurrent expenses:					
Employee benefits	67,465	70,090	72,817	76,010	79,418
Materials and services	49,056	45,003	47,433	50,310	52,696
Loss on sale of land held as inventory					
Depreciation and amortisation	43,463	45,895	47,005	49,247	51,555
Other expenses				74	74
Finance costs	8,371	10,401	11,517	12,707	13,804
Payments					
Total recurrent expenses	168,355	171,389	178,773	188,348	197,547
Capital expenses:					
Total capital expenses					
Total expenses	168,355	171,389	178,773	188,348	197,547
Result from ordinary activities	11,661	(847)	3,790	4,594	5,267
Other non-recurrent items					
Net result attributable to Council	11,661	(847)	3,790	4,594	5,267
OPERATING RESULT					
Operating revenue	157,914	165,455	176,774	187,137	196,899
Operating expense	168,355	171,389	178,773	188,348	197,547
Operating result	(10,441)	(5,934)	(1,998)	(1,211)	(649)

Appendix 5: QTC's sustainability rating definitions

Ratings

Very Strong	A local government with a very strong capacity to meet its financial commitments in the short, medium and long-term. It has a record of reporting operating surpluses and is highly likely to be able to manage major unforeseen financial shocks and any adverse changes in its business without revenue and/or expense adjustments. Its capacity to manage core business risks is very strong.
Strong	A local government with a strong capacity to meet its financial commitments in the short, medium and long-term. It generally has a record of operating surpluses and may occasionally report minor operating deficits. It is able to address its operating deficits, manage major unforeseen financial shocks and any adverse changes in its business, with minor revenue and/or expense adjustments. The expense adjustments are likely to result in only minor changes to the range of and/or quality of services offered. Its capacity to manage core business risks is strong.
Sound	A local government with an adequate capacity to meet its financial commitments in the short, medium and long-term. While it is likely that it may have a record of minor to moderate operating deficits, the local government is expected to regularly report operating surpluses. It is likely able to address its operating deficits, manage major unforeseen financial shocks and any adverse changes in its business, with minor or moderate revenue and/or expense adjustments. The expense adjustments are likely to result in some changes to the range of and/or quality of services offered. Its capacity to manage core business risks is sound.
Moderate	A local government with an adequate capacity to meet its financial commitments in the short to medium-term and an acceptable capacity in the long-term. While it has some record of reporting minor to moderate operating deficits, the local government may also have recently reported a significant operating deficit. It is likely able to address its operating deficits, manage unforeseen financial shocks and any adverse changes in its business, with moderate revenue and/or expense adjustments. The expense adjustments are likely to result in a number of changes to the range of and/or quality of services offered. Its capacity to manage core business risks is moderate.
Weak	A local government with an acceptable capacity to meet its financial commitments in the short to medium-term and a limited capacity in the long-term. It has a record of reporting moderate to significant operating deficits with a recent operating deficit being significant. It is unlikely to be able to address its operating deficits, manage unforeseen financial shocks, and any adverse changes in its business, without the need for significant revenue and/or expense adjustments. The expense adjustments would result in significant

Ratings

	changes to the range of and/or quality of services offered. It may experience difficulty in managing core business risks.
Very Weak	A local government with a limited capacity to meet its financial commitments in the short and medium-term, and a very limited capacity long-term. It has a record of reporting significant operating deficits. It is highly unlikely to be able to address its operating deficits, manage unforeseen financial shocks and any adverse changes in its business without the need for structural reform and major revenue and/or expense adjustments. The expense adjustments are likely to result in significant changes to the range and/or quality of services offered and it may need the assistance from higher levels of government. It will have difficulty in managing its core business risks.
Distressed	A local government with a very limited capacity to meet its short-term financial commitments and no capacity to meet its medium to long-term financial commitments. It has a record of reporting significant operating deficits. To be able to address its operating deficits, meet its medium and long-term obligations, manage unforeseen financial shocks and any adverse changes in its business, major revenue and expense adjustments and structural reform will be required. The local government is unlikely to have the capacity to manage core business risks and may need assistance from higher levels of government.

Outlooks

A ratings outlook generally focuses on the potential movement in an entity's rating in the short-term (ie, less than 24 months). Outlooks may be positive, neutral or negative.

Positive/Negative	As a result of a foreseeable event or circumstance occurring, there is the potential for enhancement/deterioration in the local government's capacity to meet its financial commitments (short and/or long-term) and resultant change in its rating. However, it does not necessarily indicate that a rating change may be forthcoming.
Neutral	There are no known foreseeable events that would have a direct impact on the local government's capacity to meet its financial commitments. It may be possible for a rating upgrade or downgrade to occur from a neutral outlook, if such an event or circumstance warranted as such.

Appendix 6: Key financial ratios definitions and benchmarks

Indicator	Calculation and definition	Target benchmark
Own Source Operating Revenue	Net rates and utilities and fees and charges / total operating revenue This indicates the level of Council's fiscal flexibility. It is the degree of reliance on external funding sources such as operating subsidies, donations and contributions. Council's financial flexibility improves the higher the level of its own source revenue.	Greater than 60%
Operating Surplus Ratio	Operating result (excluding capital items) as a percentage of operating revenue This is an indicator of the extent to which revenues raised cover operational expenses only or are available for capital funding purposes. A positive ratio indicates the percentage of total rates available to help fund proposed capital expenditure.	Between 0% and 10%
Interest Cover Ratio	Operating result before gross interest expense and depreciation / gross interest expense This ratio indicates the extent to which Council can service its interest bearing debt and take on additional borrowings. It measures the burden of the current interest expense upon Council's operating cash.	Greater than 4 times
Total Debt Service Cover	Net operating cash flow + gross interest expense / gross interest expense + prior year current interest bearing liabilities This ratio indicates Council's ability to repay loan funds. If cover drops below benchmark, this may indicate periods of higher risk for Council with constrained flexibility and limited capacity to take on higher levels of debt to manage unforeseen financial shocks.	Greater than 2 times
Cash Expense Cover	Current year's cash and cash equivalents balance / (total operating expenses – depreciation and amortisations – finance costs charged by QTC – interest paid on overdraft) *12 This liquidity ratio indicates the number of months Council can continue paying for its immediate expenses without additional cash inflow.	Greater than 3 months
Asset Sustainability Ratio	Capital expenditure divided by depreciation expense (expressed as a percentage) This is an approximation of the extent to which the infrastructure assets managed by a local government are being replaced as these reach the end of their useful lives.	Greater than 1.1 times
Net Financial Liability	Total liabilities less current assets divided by total operating revenues (expressed as a per cent) This is an indicator of the extent to which the net financial liabilities of a local government can be serviced by its operating revenues. A ratio greater than zero implies that total liabilities exceed current assets.	Not greater than 60%
Working Capital Ratio	Current assets divided by current liabilities This is an indicator of the management of working capital and measures the extent to which a local government has liquid assets available to meet short term financial obligations.	Greater than 3 times
Average Useful Life Property, Plant & Equipment	Total assets (or asset class) divided by total depreciation (or depreciation on asset class) This is an indicator of asset management planning and asset renewal and or maintenance of the asset base of Council.	Greater than 35 years

QTC may use additional sustainability ratios where required