LITCHFIELD COUNCIL

Community effort is essential

Long Term Financial Plan

2017/18 to 2026/27

Executive Summary

This Long Term Financial Plan is designed to ensure that the financial sustainability of Litchfield Council continues to improve over the next 10 Years by supporting sound financial decision making.

Sustainability in the context of Litchfield means the community has well maintained facilities and infrastructure and receives good quality services at an affordable level of property rates both now and into the future.

Council currently has strong cash reserves and no debt which provides a good foundation in the short term. In the long term however, Council faces several challenges including:

- very large operating deficits
- inadequate funding for capital expenditure to maintain the existing asset base.

These challenges are not easily resolved and can only be addressed through a long term, disciplined approach to the allocation of financial resources.

The Long Term Financial Plan is based on the following strategies:

- Constrain growth in operating costs
- Explore opportunities for increased income from sources other than Property Rates
- Advocate strongly for grants from other levels of Government
- Improve the approach to Asset Management
- Use discretionary Reserves to increase capital spend in the short term
- Increase rate income to fund an increase in capital spend

The combination of these strategies will improve the sustainability of Litchfield gradually over time with the key objective of increasing the level of capital expenditure which is currently inadequate.

A ten year Operating Statement and Cash Flow Statement has been prepared based on a series of assumptions about the movement of each income and expenditure type. This ten-year view provides the context for the annual Municipal Plan and budget process and is a key input into the development of the 4-year Strategic Plan.

Introduction

The Local Government Act requires Council to prepare and maintain a Long Term Financial Plan (LTFP). The Plan must cover a minimum period of four years however, many of the decisions that Council makes have impacts that go well beyond this time horizon. Litchfield Council has therefore developed a ten-year plan to ensure that the decisions made today are truly sustainable in the long term.

A long-term financial plan provides a framework to consider:

- The level of funding required to deliver essential services required by the community
- Is the current condition of assets providing an acceptable level of service?
- Are new or upgraded assets required and how can they be funded?
- What income sources are available and how can these be maximised?
- What property rating strategy should be adopted?

The goal of the LTFP is to ensure financial sustainability which can be defined as:

'…a government's ability to manage its finances so it can meet its spending commitments, both now and in the future. It ensures future generations of taxpayers do not face an unmanageable bill for government services provided to the current generation.' (Commonwealth Government, Intergenerational Report, May 2002)

Sustainability in the context of Litchfield means the community has well maintained facilities and infrastructure and receives good quality services at an affordable level of property rates both now and into the future.

The directions of the LTFP are informed by Council's Strategic Plan and Asset Management Plan. The LTFP also provides the context and financial limits that need to be considered in the development of long term plans and the management of expectations about what can be achieved.

The LTFP is developed using a series of assumptions about future growth in income and expenses. These assumptions have been based on the best available information and will be reviewed on an annual basis in the lead up to the development of the Municipal Plan. The strategies contained in the Plan will help set the parameters for the development of the annual budget.

Current Financial Position

The following section of the Plan provides analysis of Council's current financial situation based on a set of criteria that are generally accepted measures of sustainability. These measures were used in a report by the accounting firm Deloitte in its Review of Councils Financial Sustainability in the Northern Territory (May 2012). Litchfield Council was not included in that review but the measures are highly relevant.

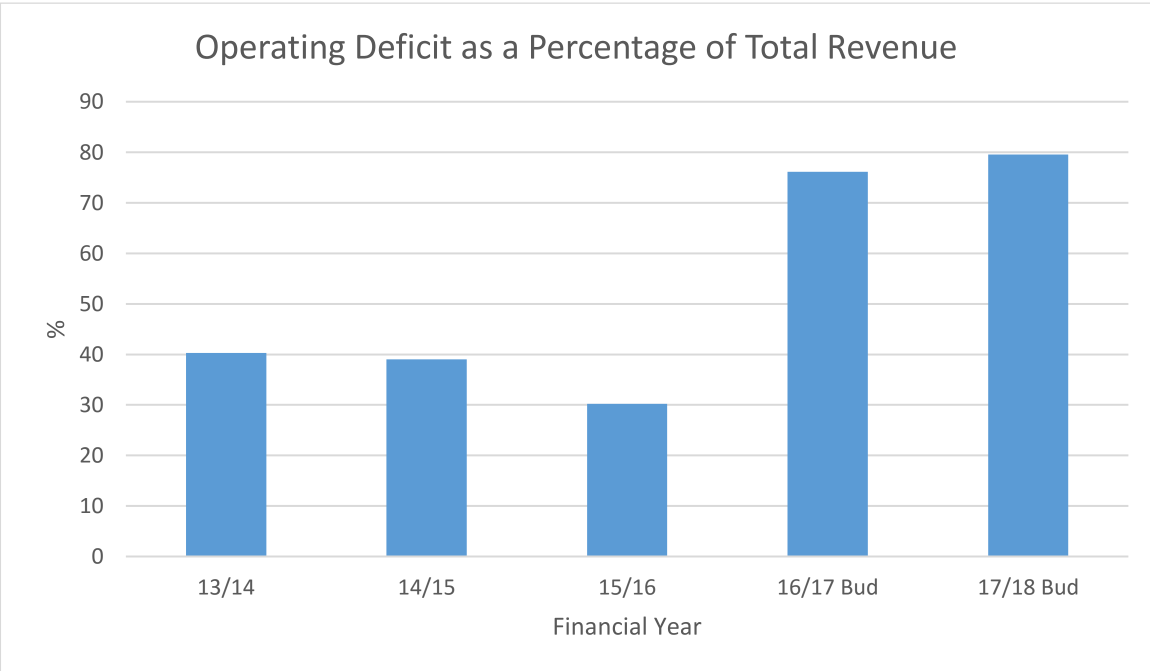
Operating Surplus/Deficit Ratio

This ratio expresses the Operating result as published in the annual financial statements as a percentage of total revenue. Ideally, Councils should run modest operating surpluses as this ensures that sufficient revenue is being generated to meet the costs of delivering services and to maintain the value of its assets over time. Large operating deficits indicate that long term sustainability is at risk as there is insufficient funds to maintain assets and infrastructure in an acceptable condition.

The graph below sets out the ratio for Litchfield Council in recent years. The result for 2015/16 is artificially low as total revenue for the year was substantially increased by large government grants. This masked the impact of the revaluation of assets and other changes to the calculation of depreciation that occurred in that year. The depreciation expense increased from $8.9 million in 2014/15 to $16.8 million in 2015/16.

Further work will be undertaken to ensure the depreciation calculation is as accurate and robust as possible.

The full impact of the increase in depreciation can be seen in the 2016/17 budgeted result.



Depreciation is a non cash item in the Operating statement but that does not mean it is irrelevant.

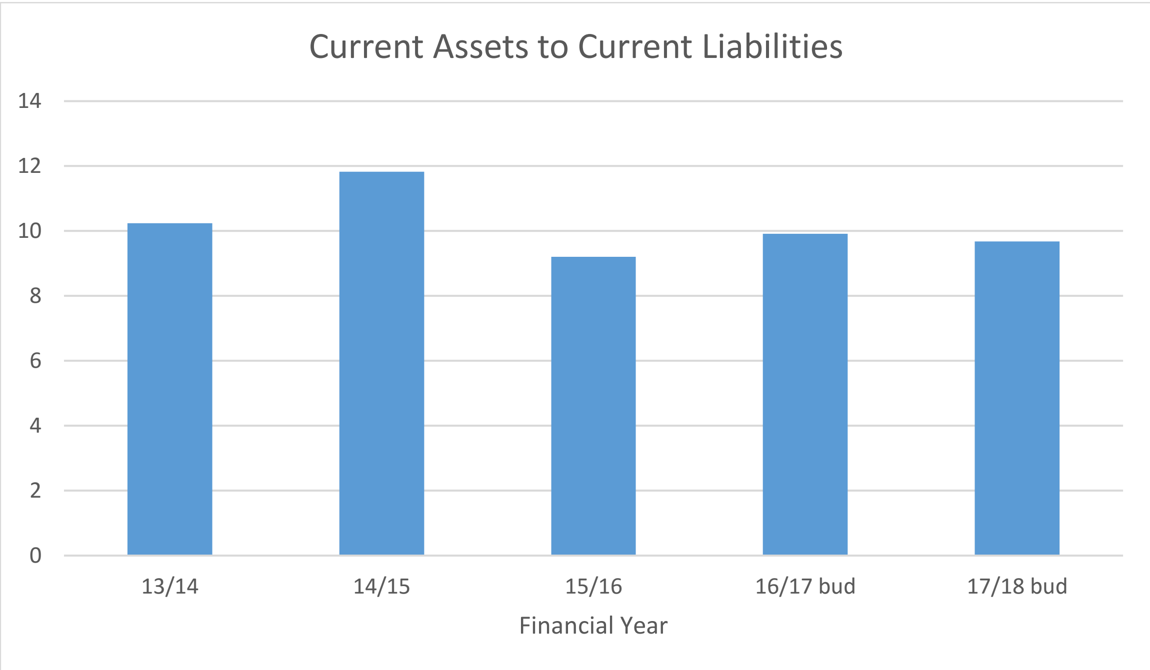
Depreciation is a measure of the deterioration of the Council's asset stock during the year. An Operating deficit implies that Council is not raising sufficient revenue to fund the renewal of existing assets.

Litchfield is consistently running large operating deficits and the recent change to the calculation of depreciation has worsened the situation substantially. The size of the operating deficit does raise concerns about long term sustainability and the ability of Council to adequately fund the renewal of its infrastructure in the future.

Current Ratio

The current ratio compares current assets to current liabilities and is an indicator of Council's capacity to meet its short term financial obligations. The ratio should be greater than 1 to provide assurance that Council has sufficient funds to meet short term debts.

Council has strong cash reserves and minimal short term liabilities. This is represented in the graph below which shows that Litchfield Council has current ratio in excess of 10.



Debt

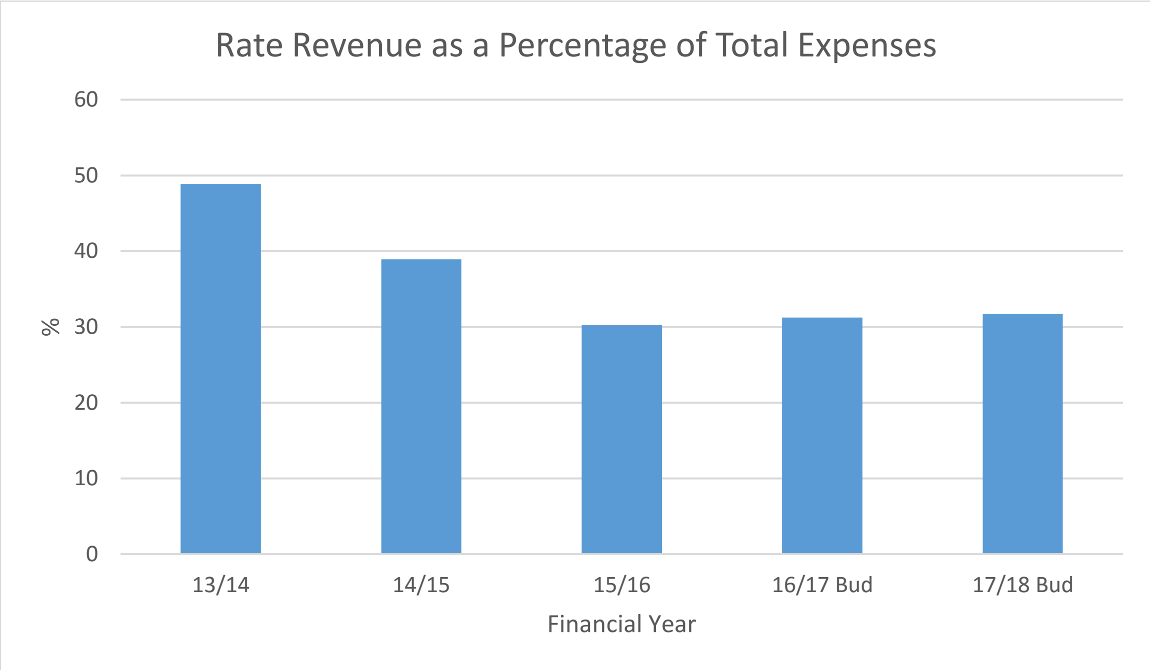
To assess an organisation's exposure to interest on debt the Interest Coverage Ratio would normally be used. Council currently has no debt and therefore no interest expense.

There is a role for debt in financing large, long lasting community assets as the repayments spread the cost to ratepayers both now and in the future who will enjoy the benefits of the asset created by the debt. However, loans need to be repaid with interest and this has an impact on Council's operating result which must be funded.

The debt free positon of Litchfield does provide flexibility to allow for future borrowings for critical community infrastructure.

Rates Coverage Ratio

The Rates Coverage Ratio measures the percentage of total expenses that is met by rates revenue. The higher the percentage, the more self-reliant Council is and the lower the risk is of external impacts on revenue. A ratio of greater than 40% is considered low risk.

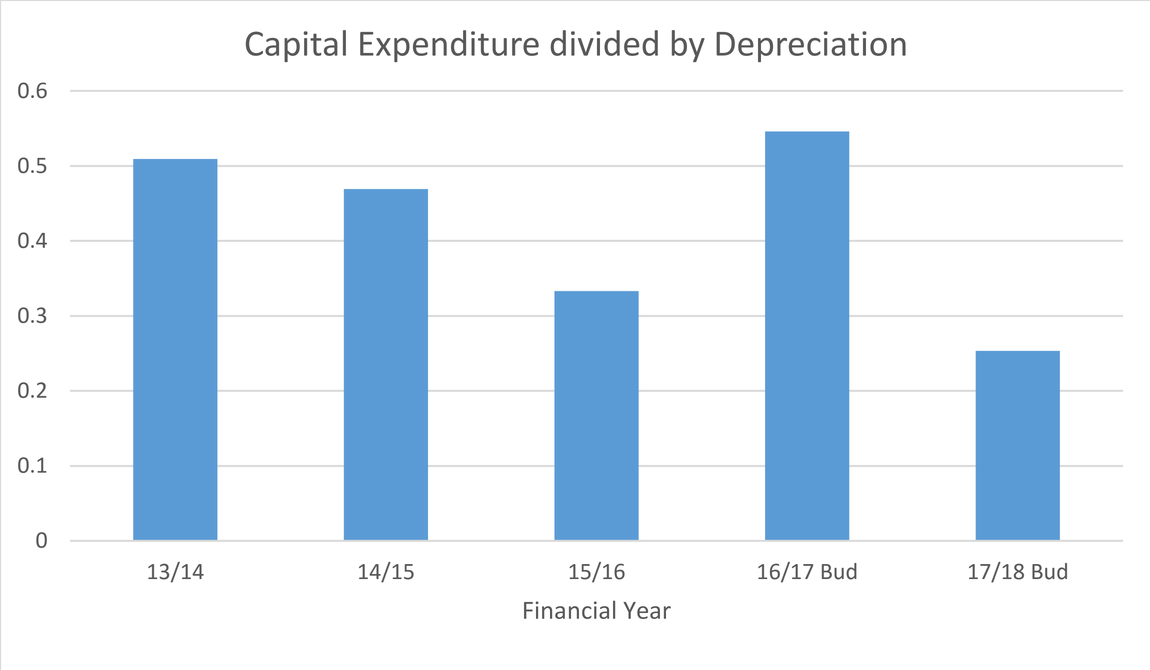


The reduction in this ratio in 15/16 and 16/17 relates to the large increase in the depreciation expense in these years. The ratio is currently sitting at around 30% which indicates that Council is quite dependent on external sources of revenue, mainly government grants. This does present some risks as Governments can reduce or freeze grants with little regard to the financial impact on councils.

Sustainability Ratio

The Sustainability ratio compares the level of capital works expenditure to depreciation. A ratio of greater than 1 means that Council is increasing the value of its asset base. A ratio of less than 1 means that Council's asset stock is losing value as it is deteriorating more quickly than it is being renewed.

Council is spending substantially less on capital works than the depreciation expense and the sustainability ratio is around 0.5. This is a concern as over time the quality and value of Council's assets will continue to decline.



Summary of Financial Position

Litchfield Council has strong cash reserves and no debt which means in the short term it will be able to continue to deliver services and a limited amount of capital works to its community.

In the long term however, Litchfield faces several challenges including very large operating deficits and inadequate funding for capital expenditure to maintain the existing asset base.

Emerging Issues

The Impact of Growth

Litchfield municipality has experienced substantial growth in population over the last 10 years with the addition of 6,500 new residents which represents a 47% increase. Accurate population growth numbers are not available for the next 10 years although it is anticipated that Litchfield will continue to grow at a moderate pace.

The Greater Darwin Land Use Plan estimates that 500 dwellings will be required to meet likely growth in population in Litchfield over the next 5-10 years.

Population growth can impact on the financial position of Council in a number of ways. Additional properties provide more income to Council through property rates and waste management charges. Whilst there are also costs in providing services to an expanding population, there are economy of scale benefits for some services particularly if the new dwellings are in an urban area.

Another potential impact of growth is that community expectations for an expanded range and quality of services may emerge, for example library services or an aquatic facility. Managing these expectations can be challenging as funding new service standards may be beyond the financial capacity of Council despite the additional rate income generated.

The rate of growth in the number of new assessments created for rating purposes has only been around 30 per annum.

The Long Term Financial Plan has factored in growth in rateable properties of $25,000 per annum with the additional revenue and expense implications included in the forward projections.

Maintaining and Renewing Assets

Council has an extensive network of infrastructure assets with a current value of approximately $238.14 million. Sealed roads account for the vast bulk of this amount with road culverts and unsealed roads being the next largest categories. Maintaining these assets in good order and renewing them as they approach the end of their useful life requires substantial expenditure each year.

The 2017/18 Budget provides for $2.2 million in expenditure on infrastructure maintenance and this is considered sufficient to maintain the road network in an acceptable condition. In addition, the Capital Expenditure program for 2016/17 is $4.2 million of which $3.05 million relates to roads and related infrastructure.

In the 2014/15 year a revaluation of Council's infrastructure assets was undertaken along with a review of the useful life of each asset type. The outcome of this revaluation was that the depreciation expense for 2015/16 increased by $7.9 million to a total of $16.79 million.

Depreciation is designed to be an estimate of the value of assets consumed during each financial year. It is calculated on a straight line basis linked to the useful life of the assets. Many assets do not deteriorate in a straight line way so the depreciation charge may not align to changes in the condition of assets on the ground on a year to year basis. However, provided the useful life and asset values used in the depreciation calculation are correct, over time the accumulated depreciation should give a reasonable approximation of the condition of the asset.

This is why depreciation is included in the financial statements as an expense and over time capital expenditure on asset renewal should match the annual rate of depreciation. This ensures that the asset base maintains its value and assets remain in an acceptable condition.

This issue creates long term sustainability challenges for Litchfield Council and many other councils in the Northern Territory.

Other Potential Pressures

The financial performance of **Thorak Regional Cemetery** has deteriorated over the last few years due to a reduction in income from cremations, burials etc. The forecast for the 2017/18 year is that the Cemetery will make an operating loss of $66,530. The Cemetery financial reserve is expected to have a balance of $12,241 at 30 June 2018.

On the current trajectory, the Cemetery reserve will be completely exhausted in 2018/19 and the Cemetery will become a financial drain on Litchfield Council. Given the other pressures on Council's budget, it does not have the capacity to support ongoing financial losses at the Cemetery.

Ongoing advocacy to the Northern Territory Government is being undertaken to ensure a more equitable funding model for the cemetery given the majority of burials and cremations are for people from outside the Litchfield municipal district.

The LTFP assumes that this issue will be resolved in the 2017/18 year and that from 2018 the Cemetery will not have an impact on Council's financial position.

An **Aquatic Facility Community Needs Analysis** has highlighted a community need for an aquatic facility in the Litchfield municipality. This Needs Analysis is Step One in Planning a Community Facility process and although the report will include reference to the cost of running aquatic facilities, the detailed financial implications of building and operating the facility are part of a feasibility study (Stage 2). The capital cost of building even a relatively small scale aquatic complex will be substantial. In addition, the ongoing operating costs would need to be funded and the capacity to do that within the existing financial settings of Council is quite limited.

The Northern Territory Government has unilaterally determined to transfer responsibility for **street lighting infrastructure** to local councils, effective from 1 January 2018. The estimated cost to Litchfield of this decision is $130,000 per annum. This type of cost shifting adds to the pressures being faced by all councils in the Territory and ultimately the costs will be borne by ratepayers.

The Way Ahead – Improving Long Term Sustainability

As indicted in the section of this Long Term Financial Plan relating to the current financial position, Council has strong cash reserves and no debt which means in the short term it will be able to continue to deliver services and a limited amount of capital works to its community.

In the long term however, Litchfield faces several challenges including very large operating deficits and inadequate funding for capital expenditure to maintain the existing asset base. These long term challenges will require a concerted and disciplined approach to the management of financial resources so that sustainability can be improved.

The aim of the Long Term Financial Plan is to improve sustainability by:

1. Decreasing the size of the operating deficit
2. Increasing the funding available for capital expenditure

The following strategies are designed to address both of these challenges.

Constrain Growth in Operating Costs

The major expenditure categories to which this strategy applies are Employee costs, Contractors and Materials. The Northern Territory is experiencing negative inflation and in fact there was -0.4% movement in the Consumer Price Index for the year to December 2016. The low levels of price movements are forecast to remain the case for some time.

The movements in the Wage Price index published by the Australian Bureau of Statistics also points to slow growth in wages in the broader Northern Territory economy. In the latest published data, wages in the Northern Territory have increased by 2.9% in the 2016 year.

The LTFP assumptions reflect these trends and growth in operating costs are expected to be much lower in the coming years than has historically been the case. The LTFP allows for 2.1 to 2.7%% growth in employee costs and 1.5% growth in contractors and materials.

The LTFP provides for a small pool of New Initiative funds to be allocated to high priority one-off projects and activities each year. Whilst the amount is modest, it does provide a small amount of flexibility in what will otherwise be a constrained budget. It is important that these funds not be allocated to recurrent programs as this will reduce the amount available in future years. Recurrent increases in operating expenditure must be funded from matching income sources or reductions in expenditure in another part of the budget.

Explore Opportunities to Increase Income from sources other than Rates

Council receives income from a range of user fees and charges. A comprehensive review of the adequacy of these charges will be undertaken to identify areas where users should be making a greater contribution to the cost of delivering some of these services.

Increases for all fees and charges set by Council will increase by a minimum of 5% for 2017/18, with increases in future years to be determined following the outcome of the review.

Advocate Strongly for Grants from other levels of Government

Council has received substantial grants for one-off capital projects in recent years and continuing to advocate strongly for grants relating to road works, in particular, will be an important part of bridging the gap between the amount that is currently spent on infrastructure renewal and what should be spent to maintain asset condition.

Given the uncertainty about the allocation of grant funding, the LTFP has taken a conservative approach to forecasting future grant income. However, advocacy efforts and grant applications will be stepped-up to ensure that any available funding that is consistent with meeting Council's strategic objectives is targeted.

Improve the Approach to Asset Management

Council has an extensive network of infrastructure assets and the ongoing maintenance and renewal of these assets is one of its biggest challenges. To ensure that decisions about the allocation of funding to infrastructure works is sustainable, further work is required to continue to improve the data and analysis of asset condition, valuation and useful life.

Based on the work done to date, it is clear that the current level of capital expenditure is inadequate to maintain the condition of roads, in particular and the Long Term Financial Plan seeks to allocate an increased level of funding for capital expenditure. This is very challenging to achieve in the current context and it will take many years of disciplined decision making to reach a point where the level of capital expenditure is adequate.

Use Discretionary Reserves to Increase Capital Spend in the Short Term

Council has very strong cash reserves made up of a number of specific purpose reserves and a significant amount of unallocated cash. The discretionary reserves and unallocated cash balance as at 30 June 2016 was approximately $14.1 million. These reserves provide a short term opportunity to deliver a higher level of capital works but do not represent a long term solution as once they are spent, they are spent.

The current use of a large number of very specific purpose reserves is of little value and it is intended they be reviewed. Funds in the Infrastructure reserve will be used to reduce the pressure on the assets and will be drawn down at the rate of $1million per annum for the next 5 years. This will support the capital works program until some of the longer term solutions start to take effect.

The Waste Management Reserve will remain separate as these funds were raised specifically for waste management purposes.

There will still be sufficient cash reserves remaining after this draw down to meet ongoing working capital requirements and provide a buffer for unforeseen events.

Increase Rate Income to fund Increased Levels of Capital Expenditure

Rates and the waste management charge provide approximately 50% of the total revenue for Council and is the most stable and predictable source of revenue for Council.

The growth in the number of properties will generate some additional revenue over the coming years and a review of the rating system is currently underway to ensure that the rating system is structured in a fair and equitable manner.

This Review presents potential opportunities to create a more sustainable rate base. The current level of rates is insufficient to fund the level of capital expenditure required to maintain the condition of existing assets and over time this will lead to noticeable deterioration of the asset stock, particularly roads.

All new dwellings created must be captured and rated separately to ensure the owners of these dwellings are contributing to Council services.

There is also a strong case to move to a valuation based rating system and to introduce a minimum rate to ensure low value properties continue to make a reasonable contribution and high value properties contribute more. Without a fundamental change to the rating system long term financial sustainability will be a very difficult outcome to achieve.

The LTFP has been based on annual increase in Rates of 5% on existing properties, with an allowance for growth in the number of rateable assessments. The waste charge has been indexed to reflect the full recovery of the costs of maintaining waste management services.

Attachments

1 Assumptions for 10 year Operating Statement
2 10 Year Operating Statement

Assumptions for 10 year Operating Statement

The Litchfield Council Long Term Financial Plan ("The Plan") is prepared in accordance with Section 126 of the Local Government Act. The Plan details the expected activities over the duration of the plan from the year ended 2017/18 to the year ended 2026/2027.

Long Term Financial Plan Assumptions

ITEM	INCREMENT 2017/18 to 2020/21	INCREMENT 2021/22 to 2026/27
INCOME		
General Rates	5.0% + $25,000 growth	5.0% + $25,000 growth
Waste Charge	3.0% + $10,000 growth	3.0% + $10,000 growth
Statutory Charges	0.0%	0.0%
User Charges	5.0%	5.0%
Grants, subsidies and contributions	1.5%	1.5%
Investment Income	-3.0%	-3.0%
Other Income	Thorak Cemetery Assistance	Thorak Cemetery Assistance
EXPENSES		
Total Employee Costs	2.1 – 2.7%	2.4%
Auditor Fees	1.0%	1.0%
Elected Member Expense	2.0%	2.0%
Election Expenses	10% growth every 3 years	10% growth every 3 years
Cemetery Operations	1.5%	2.0%
Contractors	1.5%	2.0%
Energy	2.0%	2.5%
Insurance	2.0%	2.5%
Maintenance	1.5%	2.0%
Legal Expenses	0.0%	0.0%
Donations and Community Services	1.5%	2.0%
Computer / IT Costs	1.5%	2.0%
Parts, accessories and consumables	1.5%	2.0%
Professional Services	1.5%	2.0%
Sundry Expenses	1.5%	2.0%
New Initiatives	0.0%	0.0%

	2016/2017	2017/2018	2018/2019	2019/2020	2020/2021	2021/2022	2022/2023	2023/2024	2024/2025	2025/2026	2026/2027
Income	**Budget**	**Budget**	**Plan**	**Plan**	**Plan**	**Plan**	**Plan**	**Plan**	**Plan**	**Plan**	**Plan**
Rates											
General Rates	6,442,326	6,953,357	7,323,025	7,714,176	8,124,885	8,556,129	9,008,936	9,484,382	9,983,601	10,507,782	11,058,171
Waste Charge	2,642,844	2,743,838	2,836,153	2,931,238	3,029,175	3,130,050	3,233,952	3,340,970	3,451,199	3,564,735	3,681,677
Waste Levy	407,200	-	-	-	-	-	-	-	-	-	-
Statutory Charges	41,500	33,500	33,500	33,500	33,500	33,500	33,500	33,500	33,500	33,500	33,500
User charges	1,192,859	1,217,955	1,278,853	1,342,795	1,409,935	1,480,432	1,554,454	1,632,176	1,713,785	1,799,474	1,889,448
Grants, subsidies and cont	3,977,099	5,294,974	4,168,498	4,171,881	4,215,976	4,260,071	4,304,167	4,348,262	4,392,357	4,436,453	4,480,548
Investment Income	505,000	725,000	703,883	683,382	663,478	644,153	625,391	607,176	589,491	572,322	555,652
Reimbursements	-	-	-	-	-	-	-	-	-	-	-
Other Income	-	43,000.00	70,000.00	70,000.00	70,000.00	70,000.00	70,000.00	70,000.00	70,000.00	70,000.00	70,000.00
Total Income	**15,208,828**	**17,011,624**	**16,413,913**	**16,946,972**	**17,546,949**	**18,174,336**	**18,830,399**	**19,516,467**	**20,233,935**	**20,984,266**	**21,768,996**
Expenses											
Total Employee Costs	5,650,888	5,973,624	6,136,102	6,294,948	6,426,178	6,582,370	6,742,467	6,906,566	7,074,768	7,247,174	7,423,891
- Salaries	4,880,142	5,174,390	5,320,308	5,462,892	5,580,344	5,719,853	5,862,849	6,009,420	6,159,656	6,313,647	6,471,488
- Superannuation	492,695	519,188	533,829	548,136	559,921	573,919	588,267	602,973	618,048	633,499	649,336
- Workers Compensation Insurance	121,551	101,546	103,465	105,421	107,413	110,098	112,851	115,672	118,564	121,528	124,566
- Fringe Benefit Tax	24,900	24,300	24,300	24,300	24,300	24,300	24,300	24,300	24,300	24,300	24,300
- Other	131,600	154,200	154,200	154,200	154,200	154,200	154,200	154,200	154,200	154,200	154,200
Prescribed Expenses											
- Auditor Fees	39,000	41,000	41,410	41,824	42,242	42,665	43,091	43,522	43,958	44,397	44,841
- Bad and doubtful Debts	-	-	-	-	-	-	-	-	-	-	-
- Elected Member Expenses	250,691	242,787	247,643	252,596	257,648	262,800	268,056	273,418	278,886	284,464	290,153
- Election Expenses	-	136,710	-			150,381	-			165,419	-
Other Materials, Contracts and Expenses											
- Cemetery Operations	309,600	266,500	270,498	274,555	278,673	284,247	289,932	295,730	301,645	307,678	313,831

	2016/2017	2017/2018	2018/2019	2019/2020	2020/2021	2021/2022	2022/2023	2023/2024	2024/2025	2025/2026	2026/2027
- Contractors	4,887,650	4,447,358	4,579,068	4,647,754	4,717,471	4,811,820	4,908,057	5,006,218	5,106,342	5,208,469	5,312,638
- Energy	192,800	231,600	236,232	240,957	245,776	251,920	258,218	264,674	271,290	278,073	285,025
- Insurance	226,633	223,599	228,071	232,632	237,285	243,217	249,298	255,530	261,918	268,466	275,178
- Maintenance	486,950	522,628	530,467	538,424	546,501	557,431	568,579	579,951	591,550	603,381	615,449
- Legal Expenses	138,000	173,000	130,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000	70,000
- Donations and Community Support	96,000	116,250	117,994	119,764	121,560	123,991	126,471	129,001	131,581	134,212	136,896
- Computer / IT Costs	272,500	281,290	285,509	289,792	294,139	300,022	306,022	312,143	318,385	324,753	331,248
- Parts, accessories and consumables	209,500	188,000	190,820	193,682	196,588	200,519	204,530	208,620	212,793	217,049	221,389
- Professional Services	228,700	343,070	348,216	353,439	358,741	365,916	373,234	380,699	388,313	396,079	404,000
- Sundry	367,330	374,357	379,972	385,672	391,457	399,286	407,272	415,417	423,726	432,200	440,844
- New Initiatives	503,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000
Depreciation	16,787,411	16,787,411	16,787,411	16,787,411	16,787,411	16,787,411	16,787,411	16,787,411	16,787,411	16,787,411	16,787,411
Total Expenses	**30,646,653**	**30,549,184**	**30,709,414**	**30,923,451**	**31,171,669**	**31,633,996**	**31,802,638**	**32,128,899**	**32,462,565**	**32,969,225**	**33,152,796**
Underlying Operating Result	- 15,437,825	- 13,537,560	- 14,295,501	- 13,976,479	- 13,624,720	- 13,459,661	- 12,972,239	- 12,612,432	- 12,228,630	- 11,984,959	- 11,383,799
One off Capital grants	3,858,656	-	600,000	600,000	600,000	600,000	600,000	600,000	600,000	600,000	600,000
Operating Deficit	**- 11,579,169**	**- 13,537,560**	**- 13,695,501**	**- 13,376,479**	**- 13,024,720**	**- 12,859,661**	**- 12,372,239**	**- 12,012,432**	**- 11,628,630**	**- 11,384,959**	**- 10,783,799**
Operating Surplus / (Deficit) less Depreciation	5,208,242	3,249,851	3,091,910	3,410,932	3,762,691	3,927,750	4,415,172	4,774,979	5,158,781	5,402,452	6,003,612
Capital Spend											
Operating	1,349,586	3,249,851	2,491,910	2,810,932	3,162,691	3,327,750	3,815,172	4,174,979	4,558,781	4,802,452	5,403,612
Capital Grants	3,858,656	-	600,000	600,000	600,000	600,000	600,000	600,000	600,000	600,000	600,000
Reserve	3,954,386	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000					
Funds available for renewal and replacement of assets	9,162,628	4,249,851	4,091,910	4,410,932	4,762,691	4,927,750	4,415,172	4,774,979	5,158,781	5,402,452	6,003,612
Financial Reserve Prediction	8,997,281.00	8,075,901.00	7,075,901.00	6,075,901.00	5,075,901.00	4,075,901.00	4,075,901.00	4,075,901.00	4,075,901.00	4,075,901.00	4,075,901.00