De-amalgamation Analysis of Cairns Regional Council

PREPARED BY QUEENSLAND TREASURY CORPORATION

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AUDAX AT FIDELIS

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1 Executive summary

Cairns Regional Council (CRC or Existing Council) was formed in March 2008 following the amalgamation of Cairns City Council and Douglas Shire Council. It covers an area of approximately 4,129 km^2 and has a population of approximately 162,700. Cairns is heavily dependent on tourism which is linked to the Great Barrier Reef and the Wet Tropics World Heritage Area that includes the Kuranda and Daintree rainforests. Cairns also has a seaport primarily used by tour operations servicing the Great Barrier Reef and to host cruise ships. The port is also used to import fuel supplies and export raw sugar and other cargo. The area is the regional centre for far north Queensland where all major educational, health, commercial, government, retail and financial services can be accessed.

A proposal has been lodged by the Friends of Douglas Shire for the de-amalgamation of the former Douglas Shire Council from the Existing Council. If successful, a new Douglas Shire Council would be formed according to the former boundaries, which includes an area of 2,435 km^2 and a population of approximately 11,200.

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 the de-amalgamation proposal. QTC's review includes financial analysis of both the proposed de-amalgamation council (the Proponent Council) and what would become the remaining Cairns City 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 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).

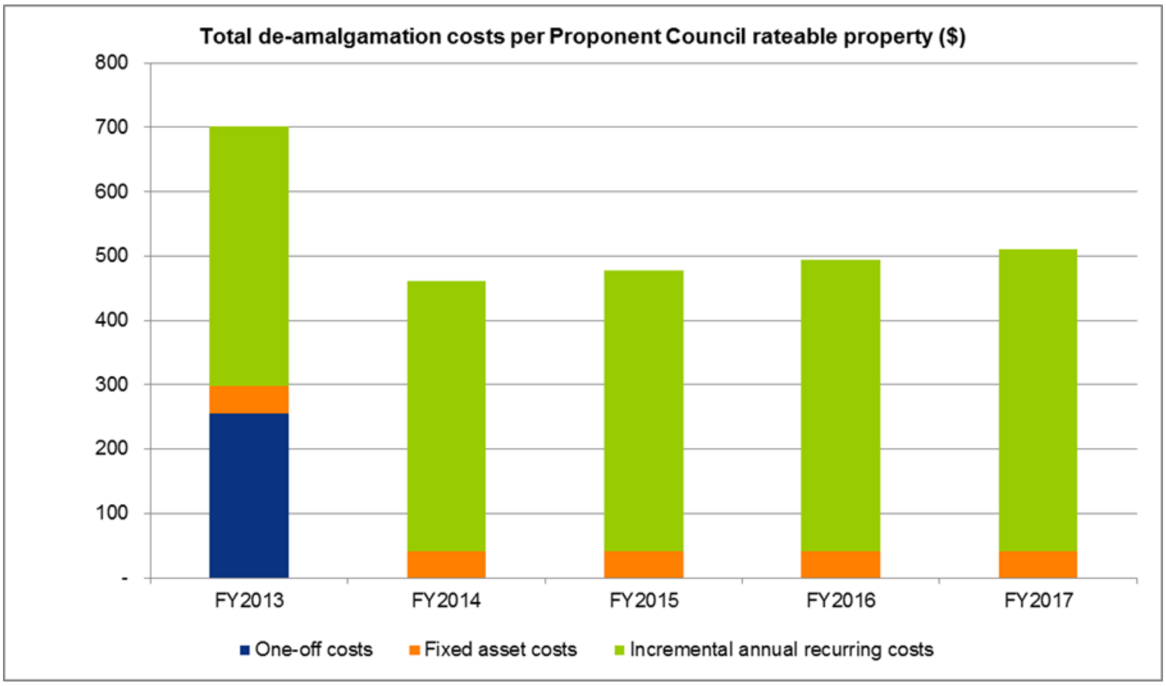
TABLE 1 – SUMMARY OF DE-AMALGAMATION COSTS

	QTC Estimate $	Average Costs $	Annualised Costs $
Total one-off costs	**2,336,000**		
Average one-off costs per Proponent Council rateable property		255.64	
Total one-off fixed asset costs	**2,119,000**		
Average fixed asset costs per Proponent Council rateable property		231.89	
Annualised fixed asset costs per Proponent Council rateable property			41.80
Total incremental annual recurring costs	**3,691,000**		
Total incremental annual recurring costs per Proponent Council rateable property			403.92

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 $256 while the incremental annual recurring costs will be $446.

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 average[1] need to contribute an extra $701 in rates to cover the costs of de-amalgamation. In the second year, the extra contribution will drop to $462 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, and the Existing Council's current five year forecasts as well as five year forecasts for their respective 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 assets existed that 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 Council 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	Sound (neutral)	Very Weak (negative)	Sound (neutral)

Based on the Base Case forecasts, QTC has rated the Existing Council and the Remaining Council as sound and the Proponent Council as very weak.

The Existing Council and Remaining Council ratings are supported by forecasts that indicate that they 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 Proponent Council as very weak. The very weak rating is supported by the following:

- forecast very high and sustained operating deficits, and
- the significant liquidity support (overdraft) required to fund operations in all of the five forecast years.

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 ($)	2,922	3,028	3,137	3,256	3,373
Remaining Council ($)	3,142	3,255	3,372	3,501	3,627

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 – BREAKEVEN CASE INCREMENTAL TO BASE CASE

	FY2013	FY2014	FY2015	FY2016	FY2017
Breakeven case					
Proponent Council ($)	688	556	632	694	678
Change from Base Case (%)	24%	18%	20%	21%	20%
Remaining Council ($)	107	122	120	95	36
Change from Base Case (%)	3%	4%	4%	3%	1%

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 operating efficiencies as a result of the Local Government Reform in 2008 will not be achieved.* CRC has forecast to deliver operating efficiencies during FY2013 and FY2014 as a result of the Local Government Reforms in 2008. If de-amalgamation proceeded these forecast savings may not be realised.
- *Inefficiencies of de-amalgamation.* De-amalgamation is expected to add an additional $56.3m in expenses across the Existing Council region in the period from FY2013 – FY2017. Major contributors to the increased expenses are additional employee and councillor costs of $48.3m, materials and services expenses, including assumed diseconomies of scale of $3.5m, and the upfront and ongoing de-amalgamation costs of $4.5m.
- *Key capital expenditure projects not included in the forecasts.* At this time key decisions required in respect to the Cairns Entertainment Precinct or new Performing Arts Centre and Douglas Foreshore have not been made. Therefore, the costs associated with these projects are not reflected in the forecasts.
- *Scenarios for the reduction of capital expenditure for the Proponent Council would not result in a material improvement in the forecast position.* QTC has relied on the specialist skills and knowledge of CRC for the capital expenditure forecast. The Proponent Council has raised concerns that the capital expenditure forecast by CRC is too high. QTC has considered the impact on the Proponent Council's forecast if new and upgrade capital expenditure in the area was reduced by 50 per cent and concluded that the rating ascribed to the Proponent Council would not change if the forecast capital expenditure was reduced.
- *Landfill provisions of $10.4 million relate to landfills located in the Proponent Council area.* The CRC balance sheet at 30 June 2012 reflects a provision of $10.4m for landfill restorations. CRC advised that this provision relates to landfills located in the Proponent Council area.
- *Forecast rates and utilities charges assumed by CRC for both the Proponent Council and Remaining Council are significantly higher than historical trends.* QTC's forecast assumptions for growth in net rates and utilities differ to the CRC's forecasts. QTC's forecast assumptions reflect historical trends and are lower than CRC's.

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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 Cairns Regional Council (CRC or Existing Council).

TABLE 4 – OVERVIEW

	14 March 2008			2012 Existing Council
	Cairns City	Douglas Shire	Total	
Area covered by region (km^2)	1,694	2,435	4,129	4,129
Population in region #	131,268	11,455	142,723	162,740
No. of rateable properties in region	63,878	8,793	72,671	78,184
No. of voters in region	77,732	8,973	86,705	91,764
Councillors	13	7	20	11
Number of staff	1,130	128	1,258	1,380

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

Key observations since amalgamation:

- Growth in rateable properties in the CRC area since amalgamation has only been 7.6 per cent despite a 14 per cent increase in population.
- The regional economy has slowed as a result of the weak global economic conditions. Unemployment in the region is 7.8 per cent, which is 2.3 per cent higher than the State average.
- Following amalgamation the number of Councillors in the region reduced by 45 per cent.

2.1 Regionally significant assets and services

Water

CRC is responsible for the maintenance and delivery of water operations for the region and is not a party to any specialised water entity arrangements. There is no connecting water pipeline between Cairns and Douglas and as such the water assets and networks are independent.

Sewerage/Wastewater

CRC is responsible for sewerage and wastewater across the region. Council owns and operates the assets and Cairns and Douglas networks are independent.

Waste

CRC has two contracts that deal with waste collection and disposal in the region being:

- Waste collection contract with Cleanaway. The current contract, which commenced on 1 December 2010, is a seven year contract with the option for three, one year extensions. QTC has been advised that the contract allows for CRC to vary the collection area.

- Regional Waste Management contract with SITA. The contract duration is 25 years with 16 years remaining. This contract was negotiated with the then Douglas Shire Council, Mareeba Shire Council and Cairns City Council prior to amalgamation. The waste is delivered to the Bedminster Plant (located in Cairns) for treatment, with disposal to a landfill near Mareeba. This transfer is part of the contract.

Airport

The airport in Cairns is not owned or operated by CRC.

2.2 Financial viability assessment of Existing Council

QTC ratings	**Nov 2012 Cairns Regional Council - Sound (Neutral outlook)** Oct 2011 Cairns Regional Council - Sound rating (Negative outlook) Ratings for the Councils pre-amalgamation: Douglas Shire Council – not previously rated by QTC Cairns City Council – not previously rated by QTC

CRC has been rated by Queensland Treasury Corporation as **sound** with a **neutral** outlook.

In October 2011 Cairns Regional Council's financial viability was rated as **sound** with a **negative** outlook.

A re-affirmed sound rating reflects the view that while CRC reported a minor operating deficit in FY2012 and expect a similar result in FY2013, modest operating surpluses are expected for the remainder of the forecast period. The forecast surpluses are driven by:

- operating efficiencies as a result of the benefits of amalgamation being realised, and
- higher forecast increases in net rates and utilities charges than the past three years.

Over the forecast period CRC expects cash holdings to be greater than outstanding debt. CRC has forecast $525.7m to be spent on capital expenditure with only $61.8m to be funded by debt.

It is recognised that the region has been severely affected over the past few years by the weak regional economy (in particular the retail, tourism and construction sectors) and a high Australian dollar. However, a neutral outlook has been applied to CRC's rating reflecting that these conditions have been managed and that there are no known foreseeable future significant events (within the next two years) that would have a direct impact on CRC'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	77,040	77,902	78,184	78,184	78,575	79,361	80,551	81,759
Growth in rateable properties	n/a	1.1%	0.4%	-%	0.5%	1.0%	1.5%	1.5%
Growth in net rates and utilities revenue	n/a	5.0%	4.7%	3.7%	7.5%	6.0%	6.0%	6.5%
Net rates & utility charges per rateable property ($)	2,774	2,880	3,006	3,116	3,333	3,497	3,651	3,831
Staff numbers (FTE)	1,386	1,394	1,380	1,380	1,380	1,380	1,380	1,380

Key points to note from Table 5 include:

- Forecast growth in rateable properties is less than the forecast population growth published in the Office of Economic and Statistical Research. CRC consider this forecast to be more akin to growth in the area.
- Growth in net rates and utilities charges takes into account assumed growth in rateable properties and real price growth. As seen in Table 5, except for FY2013, this growth is higher than historical growth.
- Economies of scale from amalgamation are expected to result in staff numbers remaining steady during the forecast period.

2.3.2 Forecast financial results

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

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	213,735	224,390	235,031	243,658	261,866	277,526	294,124	313,185
Grants and subsidies	20,136	21,335	12,272	7,797	7,941	7,941	7,941	7,941
Total recurrent revenue	277,362	286,095	285,887	292,720	311,829	329,633	349,406	373,045
Employee expenses	93,427	103,107	107,922	106,463	106,981	110,726	113,901	117,153
Materials and services costs	94,234	94,898	89,361	86,136	92,207	97,002	103,274	108,790
Depreciation	81,609	90,765	86,805	98,549	103,699	110,378	118,165	126,713
Interest expense	6,204	6,486	6,205	5,897	5,597	7,151	7,676	7,692
Total recurrent expenses	276,651	297,387	291,651	298,016	309,454	326,227	343,986	361,318
Operating surplus/(deficit)	710	(11,293)	(5,764)	(5,296)	2,375	3,407	5,420	11,728
Balance Sheet items ($000)								
Cash / (Overdrafts)	137,935	126,281	89,478	106,321	99,281	122,018	158,948	196,583
Property, plant and equipment	2,892,989	3,006,703	3,204,041	3,199,243	3,324,605	3,414,254	3,490,362	3,545,699
Total QTC borrowings	101,582	96,623	92,312	88,753	114,062	123,006	123,663	110,762
Cashflow items ($000)								
Gross capital expenditure	120,871	96,889	129,343	87,714	143,558	105,580	92,997	95,877
New borrowings	9,754	-	-	-	31,048	18,356	12,362	-

Key points to note from Table 6 include:

- CRC has reported operating deficits in FY2011 and FY2012 with a small operating deficit forecast in FY2013. Operating surpluses are expected for the remainder of the forecast period.
- Operating grants and subsidies are forecast to decrease significantly in FY2013 due to the reduction in disaster relief funding.
- Employee expenses are only forecast to increase marginally in FY2014 as the flow on effect of previously implemented efficiencies are realised.
- Materials and services costs are forecast to reduce in FY2013 by 3.6 per cent. This forecast reduction is due to savings strategies implemented by specifically targeting consultancy costs and rationalising corporate purchasing.
- The increase in depreciation over the forecast period is driven by revaluations and capital expenditure.

Note: the impact of the proposed Cairns Entertainment Precinct or new Performing Arts Centre and Douglas Foreshore has not been included in the forecasts.

Table 7 shows a summary of selected 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%	84.7%	85.2%	89.0%	92.4%	93.0%	93.1%	92.9%	92.7%
Operating surplus ratio	0% - 10%	0.3%	(3.9%)	(2.0%)	(1.8%)	0.8%	1.0%	1.6%	3.1%
Interest cover	> 4 times	14.3	13.3	14.1	16.8	20.0	16.9	17.1	19.0
Total debt service cover	> 2 times	n/a	6.7	6.8	11.4	9.8	7.3	6.8	7.1
Cash expense cover	> 3 months	8.8	7.6	5.4	6.6	6.0	7.0	8.7	10.4
Working capital ratio	> 3 times	3.0	2.4	2.8	2.8	2.5	2.7	3.2	3.7
Asset sustainability ratio	> 1.1 times	1.5	1.1	1.5	0.9	1.4	1.0	0.8	0.8
Average useful life of depreciable assets (years)	n/a	n/a	n/a	34.2	30.1	29.8	28.8	27.6	26.1
Net financial liabilities ratio	< 60%	4.0%	4.0%	10.0%	5.5%	15.4%	10.2%	(0.8%)	(14.5%)

Key points to note from Table 7 include:

- Financial ratios are generally within the required benchmarks.
- Own source operating revenue is high, demonstrating a comfortable level of fiscal flexibility.
- Total debt service cover and interest cover ratios are significantly higher than benchmark due to CRC's low gearing. This demonstrates that CRC can service its current debt and potentially could take on additional borrowings (if required) in the future.
- The asset sustainability ratio and average useful life of depreciable assets is declining over the forecast period. This reflects reduced capital expenditure forecast from FY2015 to FY2017.

Contingent liabilities

There are no significant contingent liabilities disclosed in the FY2012 annual financial statements.

3 Proposed de-amalgamation arrangement

The proposed de-amalgamation arrangement involves separating the former Douglas Shire Council (the Proponent Council) from the existing Cairns 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 information of each entity. This information is analysed below.

3.1 Proposed de-amalgamation profile

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

TABLE 8 – PROPOSED DE-AMALGAMATION PROFILE

	Existing Council	Proposed split		
		Remaining Council	Proponent Council	Total
Area covered by region (km^2)	4,129	1,694	2,435	4,129
Population in region #	162,740	151,495	11,245	162,740
No. of rateable properties in region	78,184	69,046	9,138	78,184
No. of voters in region	91,764	82,059	9,705	91,764
Councillors	11	11	5	16
Number of staff (transferring)	1,380	1,260	150	1,410

 # Census 2011 data

Note: the proposed de-amalgamation profile is based on the boundaries of the former Douglas Shire Council, which largely correlates with Division 10 of the current CRC.

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	879,000	1,132,349	300,000
Industrial relations costs	88,000	240,000	500,000
Community & staff engagement costs	371,000	225,091	200,000
Legal due diligence costs	105,000	339,450	300,000
Accounting and finance due diligence costs	60,000	20,000	-
New ICT costs	813,000	24,000	100,000
Reimbursement to Remaining Council for:			
- new ICT equipment	-	-	-
- new property, plant and equipment	-	-	-
- other	20,000	503,500	500,000
Total one-off costs	**2,336,000**	**2,484,390**	**1,900,000**
Averate Cost per Proponent Council rateable property	***$255.64***		

In total, the Existing Council's estimation of one-off costs of de-amalgamation is in-line with QTC's estimate. Significant differences between QTC's one-off cost assumptions and those of CRC and the Proponent Council are discussed below.

- **Governance, planning and implementation costs:** CRC has assumed similar costs to QTC, however CRC included the sunk cost of the existing CEO in the de-amalgamation process. The Proponent Council discussed in their proposal the establishment of a Joint Transfer Board and De-amalgamation Project team, however, these costs do not appear to be included in their submission. 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 relations costs:** QTC estimates are considerably lower than the Existing Council and the Proponent Council. CRC assumes that the recruitment of the executive and other management for the Proponent Council will be done through a recruitment agency. QTC also assumes that a recruitment agency will be utilised, however for a lesser number of senior executives. The Proponent Council assumes a cost of $500,000 however no detail has been provided on this cost.
- **Community and staff engagement costs:** QTC has assumed higher costs than both the Existing Council and the Proponent Council. The primary difference between the assumptions of QTC and CRC is that CRC has not reflected any costs associated with a call centre. The significant differences between estimates of QTC and the Proponent Council are also a result of the Proponent Council not reflecting costs associated with a call centre and community and staff communication.
- **Legal due diligence costs:** QTC's assumed cost for legal due diligence work for the de-amalgamation is less than that assumed by CRC. CRC based their forecast costs on the

report prepared by Deloitte Touche Tohmatsu for the Sunshine Coast Regional Council titled 'De-amalgamation Cost to Create a New Noosa Council[2]'. The Proponent Council appears to have combined accounting due diligence and legal due diligence.

- **Accounting and finance due diligence costs:** QTC has assumed higher costs for accounting due diligence work than those assumed by CRC. The Proponent Council has provided no estimate and appears to have combined accounting due diligence and legal 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. CRC forecast included consultancy services to set up and configure the initial server environment, while the Proponent Council estimated a nominal amount.
- **Reimbursement to remaining council for new property plant and equipment:** CRC has advised that there is no property, plant and equipment located in the Proponent Council's area which the Remaining Council requires in order to maintain services.
- **Other:** Both the CRC and the Proponent Council assumed a contingency for de-amalgamation costs of $500,000. QTC believes it has primarily captured the costs elsewhere. The costs assumed by QTC relate to changes required to the Remaining Council's website.

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	1,699,000	1,080,399	700,000
Additional property, plant and equipment	420,000	350,000	400,000
Total one off fixed asset costs	**2,119,000**	**1,430,399**	**1,100,000**
Depreciation	*382,000*	*251,080*	*180,000*
Cost per Proponent Council rateable property	***$231.89***		
Annualised Cost per rateable property	***$41.80***		

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

- **New ICT assets:** KPMG have estimated the required ICT capital expenditure costs for the Proponent Council, which QTC has adopted. This capital expenditure for the purchase of the new equipment has been reflected in the Proponent Council's forecast and is depreciated over five years.

[2] Deloitte Touche Tohmatsu, *De-amalgamation cost to create a new Noosa Council*, 2012, www.sunshinecoast.qld.gov.au/addfiles/agendaAttachments/om%20140312/Attach7.pdf

- **Additional property, plant and equipment:** QTC has included $420,000 for the acquisition of new property, plant and equipment required as a result of de-amalgamation. This is based on the Proponent Council's submission together with a further $20,000 to upgrade the Proponent Council buildings in Mossman as advised by CRC.

The estimate of Annualised Costs per Proponent Council rateable property 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	306,000	330,699	618,179
Salaries and wages costs	2,774,000	3,519,497	-
ICT Costs	130,000	-	-
Insurance	-	-	-
Service Delivery Costs	-	-	-
Diseconomies of scale for Proponent Council	481,000	-	-
Total annually recurring costs	**3,691,000**	**3,850,196**	**618,179**
Cost per Proponent Council rateable property	***$403.92***		

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 publication[3]. QTC has assumed the Remaining Council will be a category 6 local government and the Proponent Council a category 3.
- **Salaries and wages costs:** Based on discussions with CRC, QTC estimates that 33 staff will be required. This is in addition to the 117 employees who work in the Mossman office and are assumed will transfer to the Proponent Council. This will bring the Proponent Council's staffing levels up to the 30 June 2007 levels[4]. While the Proponent Council's submission indicated an additional 20 senior and middle management employees will be required, QTC was unable to validate if the costs of these staff were included in the forecasts.

[3] Local Government Remuneration Tribunal publication - http://www.dsdip.qld.gov.au/resources/report/local-government/new-remuneration-arrangements-media-release.pdf

[4] CRC advised that the June 2008 staff levels reflect the loss of various key senior staff members in the lead up to the amalgamation and is therefore not an accurate view of the required number of employees (assuming that the previous Douglas Shire Council staff structure is adopted).

- **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 operational costs and/or already included in the forecast.
- **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 the Proponent Council. This also incorporates increased costs related to insurance. Due to its relative large size, the Remaining Council is not expected to experience diseconomies of scale.

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 was to proceed.

TABLE 12 – SUMMARY BALANCE SHEET ALLOCATION

	Existing Council	Remaining Council	Proponent Council
Assets ($000)			
Cash & cash equivalents	89,478	80,391	9,086
Property, plant & equipment	3,204,041	2,812,607	293,333
Other assets	44,953	128,044	15,009
Total assets	**3,338,472**	**3,021,042**	**317,428**
Liabilities ($000)			
Debt	92,312	89,244	3,068
Other liabilities	70,741	52,095	18,646
Total liabilities	**163,053**	**141,339**	**21,714**
Total community equity	**3,175,419**	**2,879,703**	**295,714**

QTC has estimated an opening balance sheet as at 1 July 2012 for the Remaining Council and the Proponent Council based on the FY2012 Balance Sheet for the Existing Council. QTC has referred to information provided by the 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 property, plant and equipment, which has been allocated based on geographic location. Where assets are utilised across the Existing Council area, these assets have been allocated according to the population proportions of the Remaining Council and the Proponent Council.
- **Debt:** Total borrowings for CRC at 30 June 2012 totalled $92.3 million. Debt has been allocated to the Remaining Council and the Proponent Council based on the assets funded since amalgamation plus any residual pre-amalgamation debt. At the time of amalgamation, Douglas Shire Council had $2.7 million and Cairns City Council had $57.6 million in debt with QTC. Since amalgamation the original Douglas Shire Council loans have been fully repaid.
- **Other assets and liabilities:** All other Balance Sheet items, where they are able to be identified as relating to a specific region have been allocated accordingly, otherwise items are generally allocated on the basis of ratepayer or pre-amalgamation proportions.

4 Financial viability assessment of Proponent Council

QTC ratings	**Nov 2012 Proponent Council – Very Weak (negative outlook)**
	Feb 2007 Douglas Shire Council – not previously rated by QTC

Based on information made available QTC has rated the forecast financial profile of the Proponent Council as **very weak** with a **negative** outlook.

The very weak rating reflects the significant and sustained operating deficits that are not expected to improve during the forecast period. Operating deficits lead to liquidity issues and increasing and unsustainable gearing levels.

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 negative outlook has been applied to the Council's rating reflecting the worsening financial profile over the forecast period. The deteriorating financial position will limit the Proponent Council's capacity to meet its future financial commitments.

4.1 Proposed approach for regionally significant assets and services

The CRC does not own any significant regional assets that cut across boundary lines.

Water and Sewerage

The Remaining Council and Proponent Council areas have independent water and sewerage networks.

Waste

The Existing Council holds two significant contracts for the collection and disposal of waste for the region. It should be noted that at this time legal advice has not been sought in relation to the break-up of these contracts and any special conditions they may contain.

QTC has been advised by the Existing Council that the Proponent Council would need to either re-tender for kerb side collection (with Cleanaway) or enter a three way agreement (Cleanaway, the Proponent Council and the Remaining Council) in order for the bin collection service to continue. Prior to amalgamation, Douglas Shire Council's waste collection was contracted out to Adams Waste, which is now Cleanaway.

The Regional Waste Management contract with SITA was negotiated as a tri-party agreement between the former Douglas Shire Council, Cairns City Council and Mareeba Shire Council.

Based on discussions with CRC it has been assumed that this agreement would remain in place, but would be amended to accommodate the Remaining Council and the Proponent Council.

Airport

The airport in Cairns is not owned or operated by Cairns Regional Council and as such there will be no impact to the Proponent Council.

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	9,138	9,257	9,377	9,499	9,623
Growth in rateable properties	n/a	1.3%	1.3%	1.3%	1.3%
Growth in net rates and utilities revenue	n/a	4.9%	5.0%	5.2%	4.9%
Net rates & utility charges per rateable property ($)	2,922	3,028	3,137	3,256	3,373
Staff numbers (FTEs)	150	150	150	150	150

Key points to note from Table 13 include:

- QTC have assumed rateable properties growth in-line with the forecasts set out in the Office of Economic and Statistical Research.
- Total growth in net rates and utilities takes into account growth in rateable properties in addition to real price growth. This overall growth is in-line with historical CRC trends.

4.2.2 Proponent Council financial information

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

TABLE 14 – SUMMARY OF KEY FINANCIAL INFORMATION

	FY2013	FY2014	FY2015	FY2016	FY2017
Income Statement items ($000)					
Net rates and utilities	26,705	28,025	29,413	30,929	32,459
Grants and subsidies	1,037	1,051	1,051	1,051	1,051
Total recurrent revenue	34,092	35,483	37,066	38,796	40,537
Employee expenses	11,985	12,401	12,830	13,275	13,735
Materials and services costs	16,528	17,693	18,614	19,818	20,876
Depreciation	9,447	10,262	10,940	11,571	11,902
Interest expense	189	688	1,351	1,845	2,089
Total recurrent expenses	40,518	41,077	43,768	46,542	48,635
Operating surplus/(deficit)	(6,426)	(5,594)	(6,702)	(7,746)	(8,098)
Balance Sheet items ($000)					
Cash / (Overdrafts)	(1,655)	(14,758)	(26,593)	(33,410)	(35,945)
Property, plant and equipment	298,750	314,511	328,772	337,792	340,669
Total QTC borrowings	2,946	2,816	2,678	2,531	2,373
Cashflow items ($000)					
Gross capital expenditure	14,260	17,734	15,965	10,554	6,214
New borrowings	-	-	-	-	-

Key points to note from Table 14 include:

- Significant and increasing operating deficits are incurred in each year of the forecast.
- QTC has assumed an average growth in net rates and utilities of 5 per cent on average, which is in-line with recent CRC historical increases.
- Employee expenses have been calculated based on 150 employees, which is equivalent to that of Douglas Shire Council prior to amalgamation. A management structure identical to that of the former Douglas Shire Council has been assumed. Growth in employee expenses is based on the current Enterprise Bargaining Agreement for Cairns Regional Council.
- Materials and services expenses exclude any expected operating costs associated with the Douglas Waterfront redevelopment.
- Depreciation expenses have been proportionally allocated between the Proponent Council and Remaining Council based on the allocation of property, plant and equipment assets in the opening balance sheet. Depreciation increases over the forecast period due to capital expenditure and forecast property, plant and equipment asset revaluations.
- The estimated opening balance sheet for the Proponent Council allocated $9 million of cash and equivalents (refer to section 3.3). However, due to operating deficits, the Proponent Council is expected to have a negative cash balance, with an overdraft required from FY2013 onwards.

- QTC has relied on CRC's forecasts for capital expenditure on new and replacement assets required by the Proponent Council.
- The significant capital expenditure increase in FY2014 and FY2015 relates to the design and construction of a full upgrade of the Mossman Wastewater Treatment Plant.

Table 15 provides a summary of the Proponent Council's key ratios used by QTC to assess the financial viability of the Proponent Council.

TABLE 15 – FORECAST FINANCIAL RATIOS

	Benchmark	FY2013	FY2014	FY2015	FY2016	FY2017
Own source operating revenue	> 60%	92.7%	93.2%	93.5%	93.7%	94.0%
Operating surplus ratio	0% - 10%	(18.8%)	(15.8%)	(18.1%)	(20.0%)	(20.0%)
Interest cover	> 4 times	17.0	7.8	4.1	3.1	2.8
Total debt service cover	> 2 times	n/a	6.1	3.7	2.8	2.6
Cash expense cover	> 3 months	-	-	-	-	-
Working capital ratio	> 3 times	0.5	0.2	0.1	0.1	0.1
Asset sustainability ratio	> 1.1 times	1.6	1.9	1.6	1.1	0.7
Average useful life of depreciable assets (years)	n/a	30.4	29.5	28.4	27.1	25.9
Net financial liabilities ratio	< 60%	48.8%	82.4%	110.3%	122.6%	123.1%

Key points to note from Table 15 include:

- Key financial ratios indicate a strong possibility of future financial distress with large and sustained operating deficits, high gearing levels and depleted liquidity.
- The average useful life of depreciable assets appears low at less than 40 years and may indicate a need to invest more heavily in capital expenditure on property, plant and equipment going forward.

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 PROPERTY

	FY2013	FY2014	FY2015	FY2016	FY2017
Proponent Council ($)	2,922	3,028	3,137	3,256	3,373

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 ($)	688	556	632	694	678
Change from Base Case (%)	24%	18%	20%	21%	20%

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.

4.4 Scenario analysis

QTC has relied on the specialist skills and knowledge of CRC as the basis for the capital expenditure forecast. The Proponent Council has raised concerns that the capital expenditure forecast by CRC is too high. QTC has tested the impact on the overall forecast for the Proponent Council by reducing new and upgrade capital expenditure by 50 per cent. The results of the scenario are set out in Table 18 which shows that a reduction in the capital expenditure would not cause a material improvement in the Proponent Council's forecasts. As a result, there would be no change to the rating and outlook ascribed by QTC.

TABLE 18 – SUMMARY OF SCENARIO RESULTS

Scenario Analysis	FY2013	FY2014	FY2015	FY2016	FY2017
Income Statement items ($000)					
Depreciation	9,402	10,078	10,573	11,050	11,287
Interest expense	189	276	502	616	585
Operating surplus/(deficit)	(6,284)	(4,998)	(5,486)	(5,996)	(5,979)
Balance Sheet items ($000)					
Cash / (Overdrafts)	1,971	(2,993)	(6,643)	(7,456)	(5,713)
Property, plant and equipment	295,266	303,407	310,431	314,731	314,980
Cashflow items ($000)					
Gross capital expenditure	10,731	10,007	8,628	5,779	3,439
Key ratios					
Operating surplus ratio	(18.4%)	(14.1%)	(14.8%)	(15.5%)	(14.7%)
Asset sustainability ratio	1.1	1.0	0.8	0.5	0.3

5 Financial viability assessment of Remaining Council

QTC ratings	November 2012 Remaining Council – Sound (Neutral outlook)
	Feb 2007 Cairns City Council – not previously rated by QTC

The Remaining Council has been rated **sound** with a **neutral** outlook.

The sound rating is based on recurring operating deficits over the forecast period and a weak regional economy which is somewhat offset by low gearing levels, a favourable net debt position and ratios which exceed benchmark in all categories with the exception of the operating surplus ratio.

It is recognised that the region has been severely affected over the past few years by the weak regional economy (in particular the retail, tourism and construction sectors) and a high Australian dollar. However, a neutral outlook has been applied to the Remaining Council's rating reflecting that these conditions have been managed and that there are no known foreseeable future significant events (within the next two years) that would have a direct impact on the Remaining Council's capacity to meet its financial commitments.

5.1 Proposed approach for regionally significant assets and services

Water and Sewerage

The Remaining Council and Proponent Council areas have independent water and sewerage networks.

Waste

Existing contracts will continue for the Remaining Council.

Airport

The airport in Cairns is not owned or operated by Cairns Regional Council and therefore no arrangements need to be considered.

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

TABLE 19 – KEY ASSUMPTIONS

Ratio	FY2013	FY2014	FY2015	FY2016	FY2017
Number of rateable properties	69,046	70,220	71,414	72,628	73,862
Growth in rateable properties	n/a	1.7%	1.7%	1.7%	1.7%
Growth in net rates and utilities revenue	n/a	5.4%	5.4%	5.6%	5.4%
Net rates & utility charges per rateable property ($)	3,142	3,255	3,372	3,501	3,627
Staff numbers (FTEs)	1,260	1,260	1,260	1,260	1,260

Key points to note from Table 19 include:

- Total growth in net rates and utilities takes into account growth in rateable properties in addition to real price growth. This overall growth is in-line with historical Cairns Regional Council trends.

5.2.2 Remaining Council financial information

Table 20 provides a summary income statement, balance sheet and cashflow for Remaining Council used by QTC to assess the financial viability of the Proponent Council.

TABLE 20 – SUMMARY OF KEY FINANCIAL INFORMATION

	FY2013	FY2014	FY2015	FY2016	FY2017
Income Statement items ($000)					
Net rates and utilities	216,953	228,584	240,839	254,259	267,890
Grants and subsidies	6,760	6,889	6,889	6,889	6,889
Total recurrent revenue	256,472	267,928	280,731	295,416	310,724
Employee expenses	100,612	104,114	107,737	111,486	115,367
Materials and services costs	70,219	75,169	79,078	84,195	88,691
Depreciation	87,268	92,125	97,290	102,227	105,614
Interest expense	5,497	5,267	5,848	5,564	5,262
Total recurrent expenses	263,998	277,071	290,343	303,856	315,313
Operating surplus/(deficit)	(7,526)	(9,143)	(9,612)	(8,440)	(4,589)
Balance Sheet items ($000)					
Cash	77,464	50,203	48,858	60,265	74,261
Property, plant and equipment	2,806,345	2,917,258	2,994,795	3,066,250	3,127,907
Total QTC borrowings	85,701	96,928	92,481	87,750	82,717
Cashflow items ($000)					
Gross capital expenditure	75,573	125,824	89,616	82,442	89,663
New borrowings	-	15,000	-	-	-

Key points to note from Table 20 include:

- QTC has assumed an average growth in net rates and utilities of 5.4 per cent on average, which is in-line with recent CRC historical increases.
- Growth in employee expenses is based on the current Enterprise Bargaining Agreement for Cairns Regional Council.
- Depreciation expenses have been proportionally allocated between the Proponent Council and Remaining Council based on the allocation of property, plant and equipment assets in the opening balance sheet. Depreciation increases over the forecast period due to capital expenditure and forecast property, plant and equipment asset revaluations.
- QTC has not assumed any diseconomies of scale for the Remaining Council in materials and services expenses as the relative size of the Remaining Council does not significantly differ to that of the Existing Council.
- Operating deficits are forecast for the Remaining Council throughout the forecast period, which are effected by the loss of operational efficiencies that would not be achieved with de-amalgamation.
- New borrowings forecast for the Remaining Council are less than the borrowings forecast for the Existing Council.

Table 21 provides a summary of the Remaining Council's key ratios used by QTC to assess the financial viability of the Proponent Council.

TABLE 21 – FORECAST FINANCIAL RATIOS

Ratio	Benchmark	FY2013	FY2014	FY2015	FY2016	FY2017
Own source operating revenue	> 60%	93.2%	93.8%	94.2%	94.4%	94.4%
Operating surplus ratio	0% - 10%	(2.9%)	(3.4%)	(3.4%)	(2.9%)	(1.5%)
Interest cover	> 4 times	15.5	16.8	16.0	17.9	20.2
Total debt service cover	> 2 times	n/a	9.7	9.0	9.6	10.2
Cash expense cover	> 3 months	5.4	3.4	3.1	3.7	4.4
Working capital ratio	> 3 times	4.0	2.9	2.8	3.2	5.0
Asset sustainability ratio	> 1.1 times	0.9	1.5	1.1	1.0	1.0
Average useful life of depreciable assets (years)	n/a	29.6	29.3	27.9	26.7	25.8
Net financial liabilities ratio	< 60%	5.7%	19.6%	17.2%	10.6%	3.6%

Key points to note from Table 21 include:

- Small operating deficits are expected in all forecast years.
- The working capital ratio is slightly below the benchmark in the forecast period FY2014 and FY2015 as a result of assumptions in respect to funding capital expenditure. If necessary the Remaining Council would be able to remedy this issue through additional borrowings for capital expenditure.
- The asset sustainability ratio is declining over the forecast period. This indicates that Remaining Council may need to invest more in maintaining its asset base.
- The average useful life of depreciable assets appears low at less than 40 years and may indicate a need to invest more heavily in capital expenditure on property, plant and equipment going forward.

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

TABLE 22 – BASE CASE AVERAGE ANNUAL NET RATES AND UTILITIES PER RATEABLE PROPERTY

	FY2013	FY2014	FY2015	FY2016	FY2017
Remaining Council ($)	3,142	3,255	3,372	3,501	3,627

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 23 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 23 – 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 ($)	107	122	120	95	36
Change from Base Case (%)	3%	4%	4%	3%	1%

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.

Appendix 1: Forecast assumptions

Forecast assumptions	Proponent Council's assumptions (avg)	Existing Council's assumptions (forecast avg)	QTC Proponent assumptions (forecast avg)
Population growth - Proponent Council	1.0%	1.0%	1.3%
Population growth - Remaining council	Not provided	1.0%	1.7%
Rateable property growth	1.0%	1.0%	1.3%
LGAQ CCI growth	N/A	N/A	3.6%
Growth in net rates and utilities charges	4.9%	6.5%	5.0%
Growth in wages and salaries - employees	3.9%	2.4%	3.5%
Growth in wages and salaries - Councillors	3.9%	2.4%	2.1%
Growth in materials and services	3.9%	6.0%	6.0%
Interest rate - debt (existing)	8.0%	6.5%	6.1%
Interest rate - debt (new)	8.0%	6.5%	5.5%
Interest rate - cash	Not provided	4.8%	3.7%
Creditor days	Not provided	120 days	60 days
Debtor days	Not provided	45 days	45 days

Appendix 2: Existing Council income statement

Year ended	30-Jun-13	30-Jun-14	30-Jun-15	30-Jun-16	30-Jun-17
	$000	$000	$000	$000	$000
Revenue					
Recurrent revenue:					
Net rates and utility charges	243,658	261,866	277,526	294,124	313,185
Fees and charges	26,938	28,225	29,354	30,352	32,623
Sales - contract and recoverable works	6,281	6,281	6,281	6,281	6,281
Gain on sale of land held as inventory	-	-	-	-	-
Grants, subsidies, contributions and donations	7,797	7,941	7,941	7,941	7,941
Interest received	8,046	7,517	8,532	10,709	13,016
Profit/(loss) from investments	-	-	-	-	-
Rental income	-	-	-	-	-
Other recurrent income	-	-	-	-	-
Total recurrent revenue	292,720	311,829	329,633	349,406	373,045
Capital revenue:					
Total capital revenue	12,252	22,222	22,867	22,699	25,826
Capital income:					
Total capital income	850	-	-	-	-
Total capital revenue and capital income	**13,102**	**22,222**	**22,867**	**22,699**	**25,826**
Total income	**305,822**	**334,051**	**352,500**	**372,105**	**398,871**
Expenses					
Recurrent expenses:					
Employee benefits	106,463	106,981	110,726	113,901	117,153
	-	-	-	-	-
Materials and services	86,136	92,207	97,002	103,274	108,790
Loss on sale of land held as inventory	-	-	-	-	-
Depreciation and amortisation	98,549	103,699	110,378	118,165	126,713
	-	-	-	-	-
Other expenses	333	333	333	333	333
Finance costs	6,534	6,234	7,788	8,313	8,329
Payments	-	-	-	-	-
Total recurrent expenses	298,016	309,454	326,227	343,986	361,318
Capital expenses:					
Total capital expenses	-	-	-	-	-
Total expenses	**298,016**	**309,454**	**326,227**	**343,986**	**361,318**
Result from ordinary activities	**7,807**	**24,597**	**26,273**	**28,119**	**37,554**
Other non-recurrent items	-	-	-	-	-
Net result attributable to Council	**7,807**	**24,597**	**26,273**	**28,119**	**37,554**
OPERATING RESULT					
Operating revenue	292,720	311,829	329,633	349,406	373,045
Operating expense	298,016	309,454	326,227	343,986	361,318
Operating result	(5,296)	2,375	3,407	5,420	11,728

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	26,705	28,025	29,413	30,929	32,459
Fees and charges	4,882	5,058	5,240	5,440	5,635
Sales - contract and recoverable works	1,128	1,128	1,128	1,128	1,128
Gain on sale of land held as inventory	-	-	-	-	-
	-	-	-	-	-
Grants, subsidies, contributions and donations	1,037	1,051	1,051	1,051	1,051
Interest received	340	221	234	248	264
Profit/(loss) from investments	-	-	-	-	-
Rental income	-	-	-	-	-
Other recurrent income	-	-	-	-	-
Total recurrent revenue	34,092	35,483	37,066	38,796	40,537
Capital revenue:					
Total capital revenue	2,627	2,137	1,750	1,763	1,776
Capital income:					
Total capital income	-	-	-	-	-
Total capital revenue and capital income	**2,627**	**2,137**	**1,750**	**1,763**	**1,776**
Total income	**36,719**	**37,620**	**38,816**	**40,559**	**42,313**
Expenses					
Recurrent expenses:					
Employee benefits	11,985	12,401	12,830	13,275	13,735
Materials and services	16,528	17,693	18,614	19,818	20,876
Loss on sale of land held as inventory	-	-	-	-	-
Depreciation and amortisation	9,447	10,262	10,940	11,571	11,902
Other expenses	33	33	33	33	33
Finance costs	189	688	1,351	1,845	2,089
Payments	2,336	-	-	-	-
Total recurrent expenses	40,518	41,077	43,768	46,542	48,635
Capital expenses:					
Total capital expenses	-	-	-	-	-
Total expenses	**40,518**	**41,077**	**43,768**	**46,542**	**48,635**
Result from ordinary activities	**(3,799)**	**(3,457)**	**(4,952)**	**(5,983)**	**(6,322)**
Other non-recurrent items	-	-	-	-	-
Net result attributable to Council	**(3,799)**	**(3,457)**	**(4,952)**	**(5,983)**	**(6,322)**
<u>OPERATING RESULT</u>					
Operating revenue	34,092	35,483	37,066	38,796	40,537
Operating expense	40,518	41,077	43,768	46,542	48,635
Operating result	(6,426)	(5,594)	(6,702)	(7,746)	(8,098)

Appendix 4: Remaining Council income statement

Year ended	30-Jun-13	30-Jun-14	30-Jun-15	30-Jun-16	30-Jun-17
	$000	$000	$000	$000	$000
Revenue					
Recurrent revenue:					
Net rates and utility charges	216,953	228,584	240,839	254,259	267,890
Fees and charges	22,056	22,850	23,672	24,574	25,459
Sales - contract and recoverable works	5,153	5,153	5,153	5,153	5,153
Gain on sale of land held as inventory	-	-	-	-	-
Grants, subsidies, contributions and donations	6,760	6,889	6,889	6,889	6,889
Interest received	5,550	4,452	4,178	4,541	5,333
Profit/(loss) from investments	-	-	-	-	-
Rental income	-	-	-	-	-
Other recurrent income	-	-	-	-	-
Total recurrent revenue	256,472	267,928	280,731	295,416	310,724
Capital revenue:					
Total capital revenue	7,732	20,085	21,117	20,936	24,050
Capital income:					
Total capital income	-	-	-	-	-
Total capital revenue and capital income	**7,732**	**20,085**	**21,117**	**20,936**	**24,050**
Total income	**264,204**	**288,013**	**301,848**	**316,352**	**334,774**
Expenses					
Recurrent expenses:					
Employee benefits	100,612	104,114	107,737	111,486	115,367
Materials and services	70,219	75,169	79,078	84,195	88,691
Loss on sale of land held as inventory	-	-	-	-	-
Depreciation and amortisation	87,268	92,125	97,290	102,227	105,614
Other expenses	300	300	300	300	300
Finance costs	5,599	5,363	5,938	5,648	5,341
Payments	-	-	-	-	-
Total recurrent expenses	263,998	277,071	290,343	303,856	315,313
Capital expenses:					
Total capital expenses	-	-	-	-	-
Total expenses	**263,998**	**277,071**	**290,343**	**303,856**	**315,313**
Result from ordinary activities	**206**	**10,942**	**11,505**	**12,496**	**19,461**
Other non-recurrent items	-	-	-	-	-
Net result attributable to Council	**206**	**10,942**	**11,505**	**12,496**	**19,461**
OPERATING RESULT					
Operating revenue	256,472	267,928	280,731	295,416	310,724
Operating expense	263,998	277,071	290,343	303,856	315,313
Operating result	(7,526)	(9,143)	(9,612)	(8,440)	(4,589)

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.

Ratings

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 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