



**INDIGO SHIRE COUNCIL  
OFFICE CONSOLIDATION PROJECT  
FUNDING STRATEGY  
UPDATE 2010**

DRAFT V2.1

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SEPTEMBER 2010**



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## **Executive Summary**

### ***Introduction***

In August 2008, C Kwong & Associates (“CKA”) advised Indigo Shire Council (“Indigo”) that the Office Consolidation Project (“Project”) could only be viable by a combination of risk mitigation measures.

Indigo has requested CKA to “refresh” the advice taking into account the financial performance of the past two years and the position of Indigo as at 30<sup>th</sup> June 2010. This report presents the findings and recommendations arising from our review.

### ***Conclusions***

Over the past two years, Indigo’s holdings of discretionary cash or equivalent have doubled, but may be due to unspent or prepaid grants.

The head room for new borrowings has increased to approximately \$4m due to a reduction in the level of existing borrowings and an increase in the rate base.

However, the sufficiency of recurring surplus for funding asset renewal works and servicing additional borrowing has deteriorated.

The risks of borrowing \$7m - \$8m for the office building have not changed from the initial assessment 2 years ago in that:

- The financial performance of 2009-10 was worse than the previous few years despite the \$5.4m accounting surplus. Both recurring surplus and underlying results appeared declining.
- The risk of “cost blow out” remains should Council embark on a building project of this size.
- Additional borrowing would increase the VAGO indebtedness indicator from 14.32% in 2009, 7% (estimate) in 2010 to 45% if \$8m is borrowed. There would be impact on the other VAGO indicators as well.

### ***Recommendations***

We maintain that the benefits from consolidating the 4 offices are clear. To mitigate the inefficiency of operating over 4 offices by consolidating the office accommodation requirements, Indigo has the option of either to:

- Borrow to build a new office, or



- Rent offices around Beechworth or other options

The option of renting cannot be discounted given that to borrow would further stress the average recurring surplus of \$2m - \$3m that has been generated from the operations, but insufficient for asset renewal.

It should be noted that renting does not need to be a PPP venture, just a normal operating lease for office space around the Beechworth office that represent value for money.

### **BUILD NEW OFFICE**

If to build is the only option, we maintain our recommendation two years ago that the project would have less impact on financial sustainability if contained to \$4m-\$5m.

Notwithstanding, Indigo would need to beef up the recurring surplus by:

- Taking some cost cutting measures including a service review to identify program services no longer relevant to the community needs

Indigo has identified \$670,000 in annual savings from being at the one location that could contribute significantly towards this. There is also the potential to sell two of the three properties that we operate from in Yackandandah. Both properties at High Street and Wellsford Street may fetch around \$0.8m.

- Exploring the potential of obtaining some federal regional development grant to reduce the amount required to borrow and hence to be serviced by the recurring surplus

It may be very difficult to get grant funding for LG Office accommodation unless they are linked to a library, Maternal & Child Health or Indigenous training facilities.

- Using discretionary cash holdings to reduce the amount to borrow, after taking into account the amount that is required for paying for works done or to be done by capital grants

### **OTHER OPTIONS**

Indigo may also wish to explore less expensive options including:

- **Extending the current buildings in Beechworth.** Some of these building are over 150 years old and any extensions would need to be architecturally sympathetic and in keeping to the heritage requirements. The cost may be high.
- **Acquiring existing properties around the current Beechworth office.** There appear some old buildings or vacant land around the current

Beechworth office that may meet the accommodation requirements once refurbished.

Notwithstanding the above, Indigo must prepare a forward financial plan when evaluating those options to provide an indication of where the cuts are coming from, the level of borrowing and hence the recurring amount required for servicing the debt.

### ***Qualifications and Declarations***

In updating the financial sustainability assessment and preparing the funding strategy, all source information was provided by Indigo. The reliability and accuracy of the findings is limited to the accuracy of the source information on which the report is based, and the assumption made as detailed in the report.

The review was conducted by way of enquiries, interviewing senior staff members of Indigo, analysing information made available to C Kwong & Associates and data provided or extracted from the various accounting records and computer systems.

We believe, on reasonable grounds, that the information and documents provided are reliable, complete and not misleading. We have no reasons to believe that any material facts have been withheld. The comments and recommendations in this report are drawn in good faith and without any known conflict of interest. Accordingly, we disclaim any reliance on this report if used for any purpose other than for which it was specifically prepared.

## Detailed Report

### ***Background***

In August 2008, CKA advised that "...Indigo could be financially stressed if it were to undertake more major projects without substantial rate increases because of the following:

- It does not have much discretionary cash or equivalent holdings.
- It has only a head room of \$1.7M for new borrowings before breaching the best practice limit of 60% of total rates and charges.
- Of the recurring surplus of \$3M, revenue from private works had contributed \$4M (50% of rates and charges), which is not as "risk free" as rates and charges.
- Another \$2M-\$3M was required from one-off fund, primarily from grants and contributions that were tied to capital works, to pay for the capital works and loan repayments.
- Although spending on capital works of \$4M-\$5M is comparable to the depreciation charge; Indigo would be stretched to have the financial capacity to maintain its infrastructure without capital works specific grants and contributions..."

CKA further commented that "...there are clear benefits of consolidating the existing offices, but the total amount of potential benefit may not be sufficient to justify the cost of \$8M.

Indigo would be exposed if the Project was to go ahead with the option of borrowing \$8M. Indigo may find LGV reluctant to approve the application for new borrowing as this would place its borrowing/rate revenue ratio above 100%.

The Project could only be viable by a combination of the following risk mitigation measures:

- Reducing the building cost to \$5M or below
- Consider using PPP arrangements to mitigate the potential of cost blow-out
- Adopting a strategy of accelerating the loan repayments in the first five years by making the rate increase higher with a view to reducing the debt/rate revenue ratio to the best practice level of 60%
- Making representation to LGV on the new borrowing that is required for funding the Project and the measures for reducing the debt/rate revenue ratio..."

The business case for office consolidation remains compelling in 2010 as Indigo still operates from the following four offices:

- Main Shire office at Beechworth
- Shire Operations office at Yackandandah
- Service Centre at Chiltern in conjunction with WAW Credit Union
- Service Centre at Rutherglen in conjunction with the Library

The administration has refreshed the benefits estimation and identified \$0.67m in annual savings from being at one location. The net present value of such savings over 25 years at a discount rate of 8% would be \$7.152m, just short of the estimated cost of \$8m for the new office. CKA did not validate the veracity of this figure.

### ***Approach and Method***

This review made a fresh assessment of Indigo with respect to:

- The discretionary cash or equivalent holdings
- The head room for new borrowings before breaching the best practice limit of 60% of total rates and charges
- The adequacy of recurring surplus for funding asset renewal works and servicing additional borrowing

The audited accounts for 2008-09 and 2009-10 (pending official signoff) were used for the analysis, together with other information provided by Indigo.

### ***Findings and Observations***

#### FINANCIAL POSITION

In summary, the audited accounts revealed the following financial position and relevant indicators are as follows:

	30 <sup>th</sup> June 06	30 <sup>th</sup> June 07	30 <sup>th</sup> June 08	30 <sup>th</sup> June 09	30 <sup>th</sup> June 10
	(\$'000)	(\$'000)	(\$'000)	(\$'000)	(\$'000)
<b>Cash Holdings</b>	2,968	3,204	4,085	9,400	5,898
<b>Restricted</b>	3,150	2,698	3,262	1,033	1,181
<b>Discretionary</b>	-182	506	823	8,367	4,717
<b>Borrowings</b>	4,111	3,872	3,214	2,548	1,924
<b>Rate</b>	7,055	7,628	8,272	8,997	9,774
<b>60%</b>	4,233	4,577	4,963	5,398	5,864
<b>(Better practice)</b>					



The financial indicators revealed that Indigo has:

- Improved its discretionary cash or equivalent holdings over the past two years, but this could be due to prepaid VGC grants (\$1m disclosed in the budget) and unspent capital grants (capital work incomplete but tied to a grant).

It is noted that the audited accounts have disclosed restricted cash of \$1.2m in 2009-10, but they are related to LSL (\$1m) and resort and recreation reserve (\$0.2m).

- Reduced its level of borrowings to just under \$2m
- Increased its head room for new borrowings to \$4m and staying within the “borrowing to rate” better practice ratio of 60%, because of an increase in its rate base from \$7m to \$9.8m (over \$10m in 2010-11)

#### FINANCIAL PERFORMANCE

In summary, the audited and unaudited (2009-10) accounts revealed the financial performance and indicators of Indigo over the past 5 years as follows:

	2005-06	2006-07	2007-08	2008-09	**2009-10
	(\$'000)	(\$'000)	(\$'000)	(\$'000)	(\$'000)
<b>Total Revenue++</b>	22,909	22,014	21,668	26,459	28,535
<b>Total Expenses^^</b>	22,597	20,800	20,378	21,665	23,110
<b>Surplus/(Deficit)</b>	312	1,214	1,290	4,794	5,425
<b>Legends:</b> ** 2010 include \$1m prepaid grant		++ include asset sale proceed		^^ include WDV asset sold	
Recurring Surplus	1,531	1,677	2,975	4,322	3,000
One-off Surplus	2,857	4,241	2,854	4,889	7,389
Capital works	-4,006	-5,442	-4,279	-4,933	-13,101
Loan Repaid	-578	-680	-658	-666	-623
Cash Deficit	-196	-204	892	3,612	-3,335
Accounting Surplus	312	1,214	1,290	4,794	5,425
net gain asset disposal	187	5	-11	54	3
one-off grant contribution	3,799	2,761	1,454	3,189	6,181
	730	1,123	1,023	888	848
<b>Underlying results</b>	<b>-4,404</b>	<b>-2,675</b>	<b>-1,176</b>	<b>663</b>	<b>-1,607</b>

More details for the tables above are attached as Appendix A.

It is observed that:

- The \$5.4m surplus of 2009-10 was primarily contributed by the \$7.8m one-off grants and contributions, a portion of which may have an impact on the operating results of 2010-11.
- The recurring surplus for 2009-10 was \$3m, amount available for capital works and loan repayments if there were no one off revenue.
- When the \$1m prepaid grant is excluded, the recurring surplus would be \$2m. This is lower than the average of \$2m - \$3m recurring surplus forecasted in the initial report. It is noted that income from private works was trending downwards. This was primarily caused by the loss of the Falls Creek Waste contract with approximately an impact of \$300,000 in revenue and \$20,000 - \$30,000 in net contribution.
- Under the commonly accepted metric in local government, Indigo do not generate sufficient recurring surplus to fund annual asset renewal needs, approximately \$4.5m (the annual depreciation charge).

## **Conclusion**

Over the past two years, Indigo's holdings of discretionary cash or equivalent have doubled, but may be due to unspent or prepaid grants.

The head room for new borrowings has increased to approximately \$4m due to a reduction in the level of existing borrowings and an increase in the rate base.

However, the sufficiency of recurring surplus for funding asset renewal works and servicing additional borrowing has deteriorated.

The risks of borrowing \$7m - \$8m for the office building have not changed from the initial assessment 2 years ago in that:

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## ***Recommendations for Way Forward***

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- Using discretionary cash holdings to reduce the amount to borrow, after taking into account the amount that is required for paying for works done or to be done by capital grants

## **OTHER OPTIONS**

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- **Acquiring existing properties around the current Beechworth office.** There appear some old buildings or vacant land around the current Beechworth office that may meet the accommodation requirements once refurbished.

Notwithstanding the above, Indigo must prepare a forward financial plan when evaluating those options to provide an indication of where the cuts are coming from, the level of borrowing and hence the recurring amount required for servicing the debt.

## Appendix A

### FINANCIAL POSITION

as at:	30 <sup>th</sup> June 06	30 <sup>th</sup> June 07	30 <sup>th</sup> June 08	30 <sup>th</sup> June 09	30 <sup>th</sup> June 10
	(\$'000)	(\$'000)	(\$'000)	(\$'000)	(\$'000)
Cash Holdings	2,968	3,204	4,085	9,400	5,898
Restricted	3,150	2,698	3,262	1,033	1,181
Discretionary	-182	506	823	8,367	4,717
Borrowings	4,111	3,872	3,214	2,548	1,924
Rate	7,055	7,628	8,272	8,997	9,774
60%	4,233	4,577	4,963	5,398	5,864
Better practice borrowing	4,233	4,577	4,963	5,398	5,864

### FINANCIAL PERFORMANCE

	2005-06	2006-07	2007-08	2008-09	**2009-10
	(\$'000)	(\$'000)	(\$'000)	(\$'000)	(\$'000)
Total Revenue <sup>++</sup>	22,909	22,014	21,668	26,459	28,535
Total Expenses <sup>^^</sup>	22,597	20,800	20,378	21,665	23,110
Surplus/(Deficit)	312	1,214	1,290	4,794	5,425
<u>Legends:</u> ** 2010 include \$1m prepaid grant		<sup>++</sup> include asset sale proceed (from cashflow)		<sup>^^</sup> include WDV asset sold (computed)	
Recurring Surplus	1,531	1,677	2,975	4,322	2,529
One-off Surplus	2,857	4,241	2,854	4,889	7,860
Capital works (ex cflow)	-4,006	-5,442	-4,279	-4,933	-13,101
Loan Repaid (ex cflow)	-578	-680	-658	-666	-623
Cash Deficit	-196	-204	892	3,612	-3,335
Accounting Surplus	312	1,214	1,290	4,794	5,425
net gain asset disposal	187	5	-11	54	3
one-off grant contribution	3,799	2,761	1,454	3,189	6,181
Underlying results	730	1,123	1,023	888	1,172
	-4,404	-2,675	-1,176	663	-1,931

**DISSECTION OF FINANCIAL PERFORMANCE**

<b>2005-06 (\$'000)</b>		<b>Audited</b>	<b>Non Cash</b>	<b>One-Off</b>	<b>Recurring</b>	
Revenue	Rates & Charges	7,055	0	0	7,055	
	Grants	8,607	0	3,799	4,808	
	Fees & Fines	1,118	0	0	1,118	
	Private works	4,312	0	0	4,312	
	Contributions	730	0	730	0	
	Others	1,087	0	659	428	
			22,909	0	5,188	17,721
Expenses	Employee costs	7,789	0	0	7,789	
	Mat & Services	6,295	0	1,750	4,545	
	Private works	1,532	0	0	1,532	
	Depreciation	3,604	3,604	0	0	
	Finance costs	220	0	0	220	
	Others	3,157	472	581	2,104	
			22,597	4,076	2,331	16,190
	Surplus/(Deficit)	312	-4,076	2,857	1,531	
	Recurring Surplus				1,531	
	One-off Fund				2,857	
Capital works (from cash flow statement)				-4,006		
Loan Repaid (from cash flow statement)				-578		
			Cash Deficit	-196		

<b>2006-07 (\$'000)</b>		<b>Audited</b>	<b>Non Cash</b>	<b>One-Off</b>	<b>Recurring</b>	
Revenue	Rates & Charges	7,628	0	0	7,628	
	Grants	7,718	0	2,761	4,957	
	Fees & Fines	1,163	0	0	1,163	
	Private works	3,391	0	0	3,391	
	Contributions	1,123	0	1,123	0	
	Others	991	0	801	190	
			22,014	0	4,685	17,329
Expenses	Employee costs	7,398	0	25	7,373	
	Mat & Services	4,581	0	371	4,210	
	Private works	1,210	0	0	1,210	
	Depreciation	4,230	4,230	0	0	
	Finance costs	234	0	0	234	
	Others	3,147	474	48	2,625	
			20,800	4,704	444	15,652
	Surplus/(Deficit)	1,214	-4,704	4,241	1,677	
Recurring Surplus				1,677		
One-off Fund				4,241		
Capital works from cash flow statement				-5,442		
Loan Repaid from cash flow statement				-680		
			Cash Deficit	-204		



2007-08 (\$'000)		Audited	Non Cash	One-Off	Recurring
Revenue	Rates & Charges	8,272	0	0	8,272
	Grants	6,882	0	1,454	5,428
	Fees & Fines	1,299	0	0	1,299
	Private works	3,548	0	0	3,548
	Contributions	1,023	0	1,023	0
	Others	644	0	395	249
		21,668	0	2,872	18,796
Expenses	Employee costs	7,515	0	18	7,497
	Mat & Services	4,219	0	0	4,219
	Private works	1,414	0	0	1,414
	Depreciation	4,445	4,445	0	0
	Finance costs	223	0	0	223
	Others	2,562	94	0	2,468
		20,378	4,539	18	15,821
	Surplus/(Deficit)	1,290	-4,539	2,854	2,975
	Recurring Surplus				2,975
	One-off Fund				2,854
	Capital works from cash flow statement				-4,279
	Loan Repaid from cash flow statement				-658
	Cash Surplus				892

2009-09 (\$'000)		Audited	Non Cash	One-Off	Recurring
Revenue	Rates & Charges	8,997			8,997
	Grants	10,514		3,189	7,325
	Fees & Fines	1,098			1,098
	Private works	3,807			3,807
	Contributions	931	43	888	0
	Others	1,112		815	297
		26,459	43	4,892	21,524
Expenses	Employee costs	8,261		1	8,260
	Mat & Services	4,558			4,558
	Private works	1,616			1,616
	Depreciation	4,260	4,260		0
	Finance costs	184			184
	Others	2,786	200	2	2,584
		21,665	4,460	3	17,202
	Surplus/(Deficit)	4,794	-4,417	4,889	4,322
	Recurring Surplus				4,322
	One-off Fund				4,889
	Capital works from cash flow statement				-4,933
	Loan Repaid from cash flow statement				-666
	Cash Surplus				3,612



2009-10 (\$'000)		Unaudited	Non Cash	One-Off	Recurring
Revenue	Rates & Charges	9,774			9,774
	Grants	12,319		6,181	6,138
	Fees & Fines	1,278			1,278
	Private works	3,162			3,162
	Contributions	1,172		1,172	0
	Others	830		535	295
		28,535	0	7,888	20,647
Expenses	Employee costs	8,988		17	8,971
	Mat & Services	5,211			5,211
	Private works	1,366			1,366
	Depreciation	4,854	4,854		0
	Finance costs	142			142
	Others	2,549	110	11	2,428
		23,110	4,964	28	18,118
	Surplus/(Deficit)	5,425	-4,964	7,860	2,529
	Recurring Surplus				2,529
	One-off Fund				7,860
	Capital works from cash flow statement				-13,101
	Loan Repaid from cash flow statement				-623
				Cash Surplus	-3,335