CORPORATE & BUSINESS SYSTEMS

ATTACHMENT B

2 BIRIPI WAY, TAREE OFFICE RELOCATION INVESTIGATIONS UPDATE

ORDINARY MEETING

6 FEBRUARY 2019

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25 January 2019

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Dear Steve

REVIEW OF MIDCOAST COUNCIL'S DRAFT FINANCING STRATEGY IN RELATION TO THE PROPOSED OFFICE RELOCATION TO 2 BIRIPI WAY, TAREE

Further to our engagement letter dated 21 December 2018, this letter sets out our comments in relation to our review of MidCoast Council's (Council or the Council) Draft Financing Strategy dated 31 October 2018 prepared in relation to the proposed office relocation to 2 Biripi Way, Taree (the financing strategy).

Background and overview

We understand the Council has been considering the benefits of the centralisation of administrative staff and operations from the three legacy councils which formed the post amalgamation MidCoast Council (the proposed relocation).

Further, we are advised that the building formerly occupied by the Masters hardware store at 2 Biripi Way, Taree was assessed as having geographical and physical attributes which (after certain development) could be suited to becoming the Council's new centralised administrative headquarters. We understand in November 2017, the Council resolved to acquire the former Masters hardware building and site.

The financing strategy document has been prepared to analyse the options for funding the cost of the proposed relocation. According to the financing strategy, Council staff have estimated the likely cost to undertake appropriate development at the 2 Biripi Way property for the proposed relocation (excluding site acquisition or audio visual / IT costs) to be $20 million (including contingency).

Based on the Council's current balance sheet and potential sources of funding, Council staff have identified a range of potential sources of funding to raise the required $20 million as outlined in the table below.

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Funding options	Description
Funds from asset sales	Council has determined that there will be four surplus office buildings upon completion of the proposed relocation which could be sold. Proceeds from their sale can be allocated to this project. The Council has also advised they have a number of other properties which could also be offered for sale.
Rental income from lease of council assets	Some or all of the surplus office buildings set out above may be leased to the public or private sector, with the rental income used to fund repayment of any borrowings.
Re-allocation of existing internal reserves	Council has significant internal reserves for various capital and operating purposes. These reserves have been analysed to identify any balances that can be re-allocated to the proprosed relocation.
Re-allocation of existing budgets	Council can review the current budget for the year ending 30 June 2019 (FY19) to identify savings or excess funds which can be re-allocated. The budget for the year ending 30 June 2020 (FY20) represents a similar opportunity to identify addtional funds that may be re-allocated to the proposed relocation.
Government grants	Council may liaise with both Federal and State Government bodies to identify opportunities for financial contributions to the proposed relocation

After considering the available finding sources, Council has developed three potential funding options for the proposed relocation, as follows:

Option 1

Cash reserves + disposal of surplus properties

- Council will progressively dispose of the four surplus office buildings and [redacted] properties located in [redacted]
- Progressive sale will realise approximately $13 million (as per Knight Frank valuation reports);
- Re-allocation of approximately $7.2 million from existing internal cash reserves; and
- Council will borrow on a short term basis to fund the fit-out. Proceeds from property sales will be allocated as a lump sum, reducing borrowings as each sale occurs.

Option 2

Cash reserves + borrowings + lease existing buildings

- Re-allocation of approximately $7.2 million from existing internal cash reserves;
- Council will source remaining funds (approximately $12.5 to $12.8 million) from external borrowings;
- Repayment of the external borrowings will be funded from rental income generated by the surplus office buildings; and
- Council's operational budget will have to fund repayments until rental income is sufficient to meet repayments or gets generated by each property.

Option 3

Cash reserves + borrowings + property sales and explore options for lease / sale of existing buildings

- Re-allocation of approximately $7.2 million from existing internal cash reserves;
- Properties at [redacted] will be offered for sale, generating approximately $4.5 to $5.5 million (as per Knight Frank valuation reports);
- Council will source remaining funds (approximately $7.0 to $8.0 million) from external borrowings; and
- Repayment of the external borrowings will be from rental income generated by the remaining properties and/or from the Council's general budget.

After analysing the each of the above options, the recommendation put to Council was to proceed with Option 3 as the basis for the financing estimated costs of the proposed relocation.

RSM has been requested to review, analyse and comment on certain aspects of Option 3 as presented in the financing strategy. We have not been requested to, and nor have we, considered options 1,2 or any other potential sources of funding for the proposed relocation. In accordance with our instructions, our work has been limited to comments on the following:

- The funding mix proposed;
- The level of borrowings proposed and the potential impact on the Council's financial position;
- The proposed reduction in the Council's cash reserves and any associated risks; and
- Any other matters contained in the draft financing strategy that warrant comment.

To facilitate our review of the financing strategy we have been provided with the following information by employees of the Council:

- Draft financing strategy document dated 31 October 2018;
- Property valuation reports prepared by Knight Frank for various properties owned by the Council;
- Excel file summarising property valuations, sources of funding and high level debt repayment schedules;
- Detailed information in relation to the internal reserves prepared by Phil Brennan, Manager Finance; and
- Further detail, including historical balances and net movements, in a number of the Council's internal reserves.

Review of the financing strategy Option 3

Funding mix proposed

Under Option 3, the proposed funding mix to raise the $20 million required for the prosed relocation is as set out in the table below.

	Council's proposed funding mix	
Funding source	**Low ($)**	**High ($)**
Internal cash reserves	7,200,000	7,200,000
Proceeds from property sales	4,500,000	5,500,000
External borrowings	8,000,000	7,000,000
Total	**19,700,000**	**19,700,000**

Further analysis of each component of the funding mix is included below.

Internal cash reserves

We have been advised Council has undertaken a process of reviewing existing internal cash reserves to identify any surplus funds which may be re-allocated to contribute to funding the proposed relocation.

According to the Draft Financing Strategy, Council has identified approximately $7.2 million in existing internal reserves which may be re-allocated to partially fund the proposed relocation without adversely impacting existing projects and obligations. The relevant internal reserves and the quantum of the proposed re-allocation are set out in the table below.

Internal reserves		Amount ($)
ELE reserve general purpose		1,000,000
Waste services reserve domestic		1,000,000
Plant reserve		1,000,000
LIRS reserve		480,000
Workers compensation premium reserve		270,000
Swimming pool inspection reserve		80,000
Carry over reserve		200,000
Property reserve		700,000
Water services		2,000,000
Section 94 Admin building funds		470,000
Total		**7,200,000**

We note total internal reserves as at 30 June 2018 (latest available date for this data) were $75.8 million and that the $7.2 million proposed to be re-allocated represents approximately 9.5% of total internal reserves.

Further, the internal reserve balance as at 30 June 2017 was $75.1 million indicating the Council maintains a conservative and consistent reserving regime. Based on our discussions with Council staff, we understand the internal reserves are set at the discretion of Council and can be re-allocated by Council resolution or decision. Accordingly, in cases where a singular reserve is found to be underfunded, excess funds are able to be re-allocated from another internal reserve to fund the shortfall (assuming available surplus).

Based on our analysis of information provided and discussions with Council staff, we have reviewed each internal reserve balance and the proposed reallocation for reasonableness:

Employee leave entitlements (ELE) reserve general purpose: represents a balance of funds set aside to cover a proportion of employees accrued long service leave (LSL).

The quantum of the reserve is re-calculated at year end and is based on an analysis of each employee, their age and the likelihood that the LSL will be paid out in the coming year. At a high level, Council aims to have between 25% and 35% of the accrued LSL liability funded by the internal reserve.

Total leave accruals as at 30 June 2018 were $22.2 million, and we are advised this balance includes LSL for Water and Sewer staff (which is funded out of separate Water and Sewer funds) together with general council staff. The balance also includes a gross up for on-costs (superannuation, workers compensation, etc.) of approximately 16.4%.

After removing entitlements owing to Water and Sewer staff and reversing the on-costs (as these are funded through the general budget when paid), the LSL obligation to be funded through the internal reserve was approximately $13.9 million as at 30 June 2018. According the Council guidelines, the internal reserve should therefore have a balance of approximately $3.48 million to $4.87 million (i.e. 25% to 35% of total LSL obligation).

The balance of the ELE reserve as at 30 June 2018 was $5.29 million. When adjusted for the re-allocation of $1 million to the proposed relocation, the balance of $4.29 million represents 30.9% of entitlements owing to general staff which is within the target range.

Based on the above, the re-allocation of $1 million to the proposed relocation appears reasonable.

Waste services reserve domestic: Council have advised senior Waste staff consider the Waste services reserve to be in a 'healthy' state considering future capital works and remediation projects. Movements in the reserve during FY17 and FY18 have been as follows:

Plant reserve	Contributions	Withdrawals	Closing balance
FY17	2,432,299	-	30,605,000
FY18	2,864,000	(520,000)	32,949,000

The proposed re-allocation of $1 million is also expected to be offset by additional funds to be received from a new revenue stream, the Container Deposit Scheme.

In light of the excess contributions and low expenditure over the past two financial years and Council staff expectations together with an expected new income stream, the re-allocation of $1 million to the proposed relocation appears reasonable.

Plant reserve: represents amounts set aside to fund the annual plant replacement program.

In mid 2016, the Director of Engineering and Infrastructure services conducted a review of the plant reserve and, based on expected plant replacement needs, estimated the Plant Reserve held surplus funds of approximately $1.5 million. Since that time, movements in the reserve during FY17 and FY18 have been as follows:

Plant reserve	Contributions	Withdrawals	Closing balance
FY17	1,486,000	(1,160,000)	5,995,000
FY18	1,852,000	(1,678,000)	6,169,000

The information in the table above indicates Council has contributed net positive cash of around $500k to the plant reserve during FY17 and FY18 and, in light of the earlier analysis may hold an excess of up to $2 million in the Plant Reserve.

Accordingly, the re-allocation of $1 million from the Plant Reserve to the proposed relocation appears reasonable.

LIRS reserve: represents amounts that were set aside to cover repayment of loan funds received under the NSW Government's Local Infrastructure Renewal Scheme (LIRS) for various capital works projects. Council have confirmed they have no plans to seek further funding under the any future rounds of the LIRS .

The balance of the LIRS reserve as at 30 June 2018 was approximately $1.5 million and loan repayments in future years (to repay all outstanding liabilities under the LIRS) are scheduled as follows:

LIRS reserve	Loan repayments ($)
FY19	352,000
FY20	260,000
FY21	201,000
FY22	191,000
Total	**1,004,000**

The repayment schedule results in excess funds of between $480,000 and $490,000 available in the internal reserve which are available to be re-allocated to the cost of the proposed relocation.

Accordingly, the re-allocation of $480,000 from the LIRS reserve to the proposed relocation appears reasonable.

Workers compensation premium reserve: represents a balance of funds which was set aside to allow for unexpected movements in workers compensation insurance premiums (premiums are funded through the general budget).

The balance of the reserve as at 30 June 2018 was $949,000 and Council staff have advised that provisions made in the general budget during FY17 and FY18 have been adequate to fund the premiums and that no movements in or out of the internal reserve have been required over that period.

Further, Council staff have advised they expect premiums to continue to be funded from the general budget into the foreseeable future. Accordingly, Council intends to re-allocate $270,000 or 28.5% of the reserve to the relocation project.

Given the practice of funding of workers compensation premiums through the general budget and the quantum of the balance in the reserve, the reallocation of $270,000 to the relocation project appears reasonable.

Swimming pool inspection reserve: we understand Council was unable to fill a position to carry out swimming pool inspections as required under NSW Government legislation. As a result, it was proposed to outsource the work to a contractor and an internal reserve of $80,000 was established to cover the expected expenditure.

We're advised Council subsequently filled the position and the inspector's salary and related costs are included in the general budget.

Considering the above, the re-allocation of $80,000 from the Swimming Pool inspection reserve to the proposed relocation appears reasonable.

Carry over reserve: represents funds which have been set aside to cover 'carry over' expenditure which has been moved from one year's budget to the following year.

Discussion with Council staff have revealed that in practice, certain expenditure is not always incurred, or funding is provided from the general budget. Council have conducted a review of the reserve and identified approximately $200,000 in funds which have not been expended after several years in the carry over reserve.

Based on the above, the re-allocation of $200,000 to the proposed relocation appears reasonable.

Property reserve: was established with surplus funds from prior property sales for future property acquisitions or opportunities.

We note the balance of the internal reserve was $1.04 million as at 30 June 2018 and there were no transfers into or out of the internal reserve over the past two financial years. The proposed re-allocation amount of $700,000 represents approximately 67% of the total reserve balance.

The utilisation of $700,000 from the Property reserve for the proposed relocation appear reasonable and in line with its stated purpose.

Water Services reserve: the Water Services reserve represents restricted funds which are intended for Water Services division (water and sewer operations) related expenditure and projects.

It was determined by the Council that, as the proposed relocation will house Water Services division staff (approximately 25% of total staff in the building), that is appropriate that the Water Services division should fund approximately 25% of the costs of the proposed relocation (or approximately $5 million). Of the $5 million contribution from the Water Services division, $3 million is to be contributed in the form of real property and the associated rental income with the balance ($2 million) to be re-allocated from reserves.

We note the balance held in the Water Services reserve has increased materially over the past three years as set out in the table below:

Water Services reserve	
FY16	24,659,000
FY17	43,751,000
FY18	61,414,000

Council have advised the Director of the Water Services division has undertaken a review of the Water Services reserve and has estimated, based on expected future capital requirements, the Water Services reserve holds a surplus of at least $2 million which could be contributed to funding of the proposed relocation.

The utilisation of $2 million (representing approximately 3% of the total reserve balance) from the Water Services restricted reserve appears reasonable.

Section 94 Administration Building funds: represents contributions that have been made by developers specifically for funding extensions to, or replacement of, the Councils administration buildings.

Several years ago, Council identified that the continued population growth in the area would lead to growth in the Council employee base and require larger premises to house the administration staff and associated functions. Due to the contribution of the new developments to population growth in the area, Council resolved that developers should be required to fund a portion of these new facilities. The balance of this reserve as at 30 June 2018 was $470,000.

The utilisation of the Section 94 Administration Building funds for the proposed relocation appear reasonable and in line with their stated purpose.

Proceeds from property sales

As noted above, under Option 3, Council has proposed the sale of certain properties at:

We have been provided with Knight Frank property valuations dated 24 September 2018 in relation to each of these properties (amongst others) which set out the following valuation ranges:

Property	Low ($)	High ($)
Total	**4,300,000**	**4,900,000**

We note the Knight Frank valuation reports specify that these valuation opinions have been prepared on a before tax, acquisition and selling cost basis. Accordingly, to estimate the ultimate realisation from the properties (and therefore the balance of funds which may be available for the proposed relocation) we have adjusted the Knight Frank property valuations for estimated selling costs (incorporating commissions, legals, etc.) of 2%, as set out in the table below. We understand the Council is not subject to income or capital gains tax.

	Low ($)	High ($)
Total per valuation report	**4,300,000**	**4,900,000**
Less: selling costs	(86,000)	(98,000)
Expected net proceeds	**4,214,000**	**4,802,000**

The expected net proceeds of between $4.2 million to $4.8 million compares to the estimate used in calculating Option 3 of the proposed funding mix of $4.5 million to $5.5 million. We note the shortfall of $300,000 to $700,000 will be required to be funded from other sources. After discussions with Council staff, and for the purposes of this review, we have assumed the shortfall is likely to be funded from an increase in borrowings (discussed below).

Notwithstanding the above, we note the Knight Frank valuations were prepared as at 24 September 2018 and may be up to six months out of date (assuming a 'normal' sale process) as at the completion of any sale. Accordingly, the ultimate proceeds received from the sale of properties may be different (higher or lower) from the above.

External Borrowings

Under Option 3, Council has estimated external borrowings of between $7.0 and $8.0 million will be required to fund the proposed relocation.

For the purpose of this review we have assumed external borrowings are used to fund the balance of the estimated cost of the proposed relocation ($20 million) after utilising available internal cash reserves and after considering the ultimate proceeds from the sale of the identified properties.

Accordingly, assuming available internal cash reserves available of $7.2 million and the low end of expected proceeds from the sale of property of $4.2 million (discussed above), we have estimated borrowings of approximately $8.3 million will be required to fund the $20 million estimated cost of relocation.

In light of the above, we have recalculated the quarterly and annual principal and interest repayments on borrowings of $7.5 million, $8.0 million and $8.5 million assuming Council will be able to negotiate terms similar to those on the $7.1 million facility used to fund the acquisition of the site at 2 Biripi Way, Taree (NB – the green highlighted row represents the terms closest to the $7.1 million facility).

	$7.5 million borrowing		$8.0 million borrowing		$8.5 million borrowing	
Interest rate	Quarterly ($)	Annual ($)	Quarterly ($)	Annual ($)	Quarterly ($)	Annual ($)
3.00%	126,000	504,000	134,000	536,000	142,000	568,000
3.25%	128,000	512,000	137,000	548,000	145,000	580,000
3.50%	131,000	524,000	140,000	560,000	149,000	596,000
3.75%	134,000	536,000	143,000	572,000	152,000	608,000
4.00%	138,000	552,000	146,000	584,000	155,000	620,000
4.25%	140,000	560,000	149,000	596,000	159,000	636,000
4.50%	143,000	572,000	153,000	612,000	162,000	648,000
4.75%	146,000	584,000	156,000	624,000	166,000	664,000
5.00%	149,000	596,000	159,000	636,000	169,000	676,000

We note repayment of the borrowings is not expected to commence until December 2019.

Funding the external borrowings

Under option 3, Council has proposed that the principal and interest component of any external borrowings related to the proposed relocation are to be funded from the lease proceeds from a selected inventory of buildings currently owned by Council.

The buildings identified by Council for this purpose were subject to the Knight Frank property valuations dated 24 September 2018 wherein the valuer provided the following estimates for the annual rental income for each. A summary of the estimated gross and net annual rental income for the identified properties (extracted from the Knight Frank valuations) is set out in the table below.

Property	Estimated gross annual rental income ($)	Estimated net annual rental income ($)
4-10 Breese Parade, Forster		
16 Breese Parade, Forster		
26 Muldoon Street, Taree		
2 Pulteney Street, Taree (ground floor)		
2 Pulteney Street, Taree (first floor)		
Total	**1,099,000**	**569,065**

We are advised that in addition to the above properties, Council also receives gross rental income of $70,000 (we note there are no outgoings) for the Wallis Lake Motel located at 5 Wallis Street, Forster.

Accordingly, after considering the estimated rental income from yet to be leased properties, together with the income from the Wallis Lake Motel, Council is expected to earn gross annual rental income of $1.17 million. After estimated outgoings (per the Knight Frank valuation report), together with certain Council assumptions in relation to expected lease incentives and provision for a maintenance sinking fund, the estimated net rental income generated in year 1 is approximately $630,000. We note we have assumed 100% occupancy for all properties in preparing the above analysis. Should this assumption not hold true, the Council will be required to fund the repayments on the external borrowings from other sources (i.e. the general budget).

Cost of funding the External Borrowings

Based on the estimated range of borrowings required to fund the proposed relocation discussed above, we have calculated the annual repayments (principal and interest) required over the range of interest rate scenarios and compared to the net rental income expected to be received from property leases (NB – the green highlighted row represents the terms closest to the existing $7.1 million facility).

	$7.5 million borrowing		
Interest rate	**Annual repayments ($)**	**Net rental income ($)**	**Excess / (shortfall) ($)**
3.00%	504,000	630,000	126,000
3.25%	512,000	630,000	118,000
3.50%	524,000	630,000	106,000
3.75%	536,000	630,000	94,000
4.00%	552,000	630,000	78,000
4.25%	560,000	630,000	70,000
4.50%	572,000	630,000	58,000
4.75%	584,000	630,000	46,000
5.00%	596,000	630,000	34,000

$8.0 million borrowing			
Interest rate	Annual repayments ($)	Net rental income ($)	Excess / (shortfall) ($)
3.00%	536,000	630,000	94,000
3.25%	548,000	630,000	82,000
3.50%	560,000	630,000	70,000
3.75%	572,000	630,000	58,000
4.00%	584,000	630,000	46,000
4.25%	596,000	630,000	34,000
4.50%	612,000	630,000	18,000
4.75%	624,000	630,000	6,000
5.00%	636,000	630,000	(6,000)

$8.5 million borrowing			
Interest rate	Annual repayments ($)	Net rental income ($)	Excess / (shortfall) ($)
3.00%	568,000	630,000	62,000
3.25%	580,000	630,000	50,000
3.50%	596,000	630,000	34,000
3.75%	608,000	630,000	22,000
4.00%	620,000	630,000	10,000
4.25%	636,000	630,000	(6,000)
4.50%	648,000	630,000	(18,000)
4.75%	664,000	630,000	(34,000)
5.00%	676,000	630,000	(46,000)

Based on the above calculations, it appears that the expected net rental income is sufficient to service the expected repayments on borrowings (assuming similar terms to the recent $7.1 million CBA loan) in the range of $7.5 million to $8.5 million.

Further, our analysis indicates that Council could fund loans up to approximately $9.0 million (on similar terms to the $7.1 million CBA facility) should the expected net rental income approximate $630,000 per annum.

We note that, assuming borrowings of $8.5 million, an upward movement in interest rates of greater than 0.5% (and consequent increase in repayments) may result in required repayments exceeding the net rental income generated. This risk, however, should be partly mitigated by any annual rent increases incorporated into the lease agreements.

Conclusion on External Borrowings

In reviewing the proposed level of External Borrowings and the ability of Council to fund the repayments (principal and interest), we have considered several scenarios in relation to:

- External Borrowings required (as adjusted for potential property sales shortfalls);
- A range of interest rates on the borrowings; and
- Expected rental income.

Assuming the assumptions made in relation to the above hold for the period of the proposed borrowings, we consider the proposed level of External Borrowings to be reasonable.

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The level of borrowings proposed and the potential impact on Council's financial position

Council has provided a forecast balance sheet as at the end of each financial year for the period FY19 to FY28. Based on the forecast balance sheet information provided, and assuming borrowings of $7.5 million, $8.0 million and $8.5 million at 3.5% interest, we note the following in relation to a number of key performance measures applicable to the Council as set out in their Long Term Financial Plan dated June 2018:

Debt service cover ratio (DSCR) – the DSCR is greater than 2.0, being the Office of Local Government (OLG) benchmark at all times for all levels of borrowings, as set out in the table below:

Debt service cover ratio										
Loan amount @ 3.5% interest	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25**	**FY26**	**FY27**	**FY28**
$7.5 million	2.46	2.41	2.51	2.66	2.94	3.50	3.63	3.90	4.11	4.43
$8.0 million	2.46	2.41	2.51	2.65	2.93	3.49	3.62	3.89	4.10	4.43
$8.5 million	2.46	2.41	2.50	2.65	2.92	3.48	3.61	3.87	4.08	4.41

We note the Council's DSCR for FY17 was 3.4 and for FY18 was 2.8, with the proposed external borrowings causing a slight decrease to the levels set out in the table above (but remaining within OLG benchmarks).

Assuming an $8.5 million loan and a 5.0% interest rate, the FY20 DSCR would decrease slightly to 2.40, and remain between 0.01 and 0.02 below the ratios in the table above for the forecast period (and also above the OLG benchmark).

Our analysis of the DSCR further indicates that the Council would be able to take on external borrowings of approximately $100 million at 3.5% interest before the DSCR would fall below 2.0.

Debt service ratio (DSR) – the DSR is in the satisfactory range (less than 10%) for all years other FY20, when it is at the low end of the fair range (between 10% and 20%) as determined by the OLG and set out in the table below:

Debt service ratio										
Loan amount @ 3.5% interest	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25**	**FY26**	**FY27**	**FY28**
$7.5 million	9.6%	10.4%	10.0%	9.6%	8.5%	6.9%	6.4%	5.9%	5.5%	5.0%
$8.0 million	9.6%	10.4%	10.0%	9.6%	8.5%	6.9%	6.4%	5.9%	5.5%	5.0%
$8.5 million	9.6%	10.4%	10.0%	9.6%	8.5%	7.0%	6.4%	6.0%	5.5%	5.0%

We note the Council's DSR for FY17 was 11.0% and for FY18 was 15.5%. As set out in the table above, the DSR in each forecast period after the proposed external borrowings represents an improvement from historical levels.

Assuming an $8.5 million loan and a 5.0% interest rate, the FY20 DSR would increase slightly to 10.5%, and remain approximately 0.1% higher the ratios in the table above for the forecast period (and also within the OLG's satisfactory range for all years other than FY20).

Whilst the funding mix proposed under Option 3 of the financing strategy will have an impact on the Council's financial position, we note the various ratios and other factors analysed above remain within acceptable ranges and indicate it will be acceptable.

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The proposed reduction in Council's cash reserves and any associated risks

As set out above, total internal reserves as at 30 June 2018 were $75.8 million, with the $7.2 million proposed to be re-allocated representing approximately 9.5% of total internal reserves (and 4.2% of total cash, cash equivalents and investments). We note the balance of the internal reserves as at 30 June 2017 was $75.1 million, indicating the level of internal reserves is relatively consistent and significant funds are not drawn down each year.

Internal reserves are set aside at the discretion of Council and are able to be re-allocated by Council resolution or decision. As a result, should there be a shortfall in a particular internal reserve, excess funds are easily able to be re-allocated from another internal reserve to fund the shortfall.

We note the Council had a net decrease in cash and cash equivalents for FY18 of approximately ($23.3 million) which indicates there is a risk the Council may not have sufficient cash flow available to replenish the reserves after the proposed re-allocation, should this be required. Further, subject to the impact on the Council's borrowing capacity discussed above, and the net decrease in cash and cash equivalents, there may be a risk that Council could have issues in sourcing funding to complete the proposed relocation (should they exceed the initial estimates of $20 million) or for any future projects.

Whilst the reduction in Council's cash reserves will have potentially have an impact on their ability to fund future projects and any unexpected cash requirements, we note the level of cash on hand (and in particular, the internal reserves) is significant and can be re-allocated to satisfy any short term or unexpected requirements.

Conclusion

In accordance with the terms of our engagement, and in relation to Option 3 of the financing strategy, we have provided comment and analysis on the following:

- The funding mix proposed;
- The level of borrowings proposed and the potential impact on the Council's financial position;
- The proposed reduction in the Council's cash reserves and any associated risks; and
- Any other matters contained in the draft financing strategy that warrant comment.

Based on the analysis contained in this report, we have found the funding mix proposed by Council to be reasonable, with minor re-allocations between funds to be realised from property sales and external borrowings. The additional external borrowings should be able to be funded by the expected net rental income to be received from certain properties, assuming the lease and financing terms are as expected (and as set out above).

As a result of implementing the various components of the proposed funding mix, the Council's financial position will be slightly worse in the short term, however still within acceptable metrics determined by the OLG. There is a risk that the decreased cash reserves may impact the Council's ability to fund future projects and unexpected cash flows, however we note a significant balance of cash on hand would remain based on 30 June 2018 balances (approximately $165.4 million, of which only $95.1 million is restricted in its use) to meet any cash requirements.

T Goodman

Tim Goodman
Director