CITY OF BUNBURY

Financial Trend Analysis

Based on the Annual Financial Report, 30 June 2024

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Executive Summary

This Financial Trend Analysis Report (Report) has been prepared at the request of the Audit Committee and is based on the audited Annual Financial Report to 30 June 2024. It includes the past 5 years financial data and looks forward to the next 12 years based on the adopted 2024/25 Annual Budget and the Long Term Financial Plan (LTFP) 2024/25 – 2035/36. Note: Future year forecasts are shown in today's dollars. CPI increases have been removed, allowing only real increases or decreases in income and expenditure to be reflected. They also do not include budgets for the Ocean Pool, new Regional Art Gallery or future asset renewal projects, as they are still to be finalised.

The Report provides an analysis of the City's financial performance and financial position. It looks at the financial trend for income and expenditure, capital expenditure, loans, reserve funds, and financial ratios. The financial ratios compare how the City is performing to benchmarks set by the Western Australian Department of Local Government, Sport and Cultural Industries. This report focuses on the key aspects to give a high level view and to highlight the major findings from this analysis. The following are the key strengths and concerns:

Strengths:

1. The City is in a good financial position to meet short term financial obligations out of unrestricted current assets.
2. The City has a strong source of own revenue (rates, fees and charges etc.) and can cover operating expenses itself and not rely heavily on external funding such as grants and subsidies.
3. In the long term the City can fund new projects (including asset renewal) from both reserve funds and loan borrowings.

Concerns:

1. Operating deficits. Total expenditure (including depreciation) is greater than total revenue. This is shown in the Statement of Comprehensive Income Statement and in the Operating Surplus Ratio. An operating deficit reduces the City's ability to fund capital works, reduces its loan capacity, and to set aside funds into cash reserves for future projects.
2. The City needs to spend more on capital renewal to avoid the condition of existing assets deteriorating.
3. Loan borrowing will exceed the $20M cap between 2025/26 and 2027/28.
4. Reserve funds have limited capacity to fund new projects until 2028/29.

To address these concerns the City is currently doing the following:

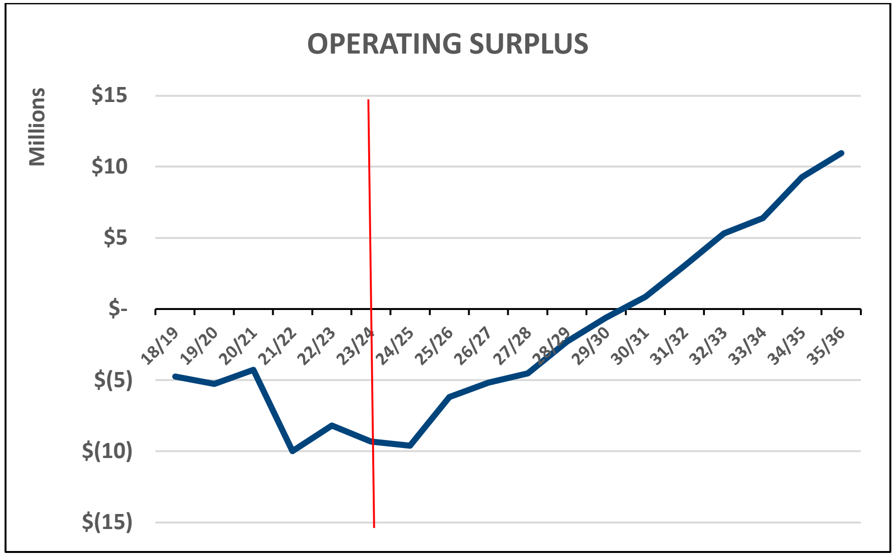
1. Incorporating the above findings into the planning for the 2025/26 Annual budget and LTFP.
2. Identifying operational improvements to increase income and decrease expenditure, as per the CEO KPIs.
3. Economic Development strategies to promote growth in the City's Rate base, including land sales to increase residential construction.
4. Continue to update the City's Asset Management Plans.

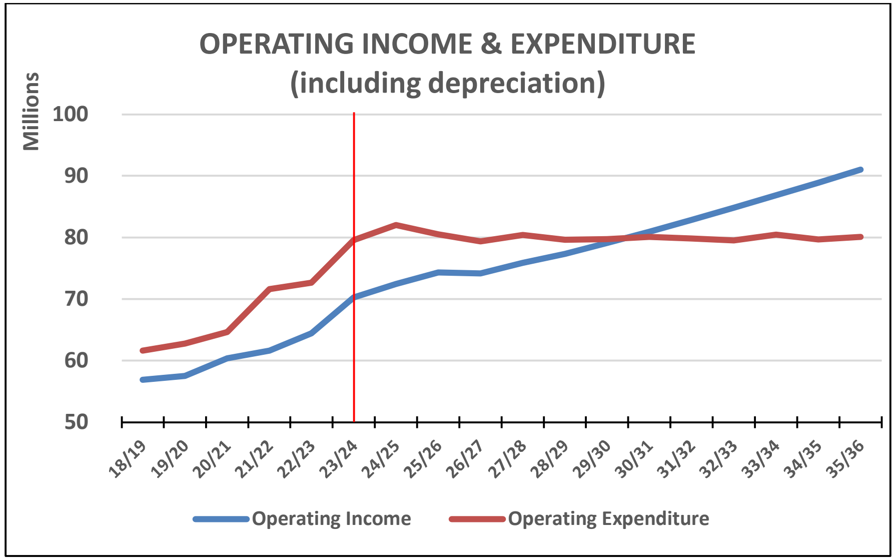
Statement of Comprehensive Income

The Statement of Comprehensive Income includes estimates of all revenues and expenditures that are included in the operating (normal day-to-day) activities of the City and shows the extent to which operating income has exceeded operating expenditure.

Information from the income statement is used to calculate the operating surplus ratio, which is one of the measures of financial sustainability, refer Page12.

An operating deficit has resulted in the past 6 years. Operating revenues are forecast to continue to increase each year mainly due to increases in rate income, while operating expenditure remains steady over the LTFP. In the short to medium term, expenditure will continue to be greater than income resulting in an operating deficit. This improves over the life of the LTFP and by 2030/31 an operating surplus is achieved, which continues for the remainder of the LTFP.





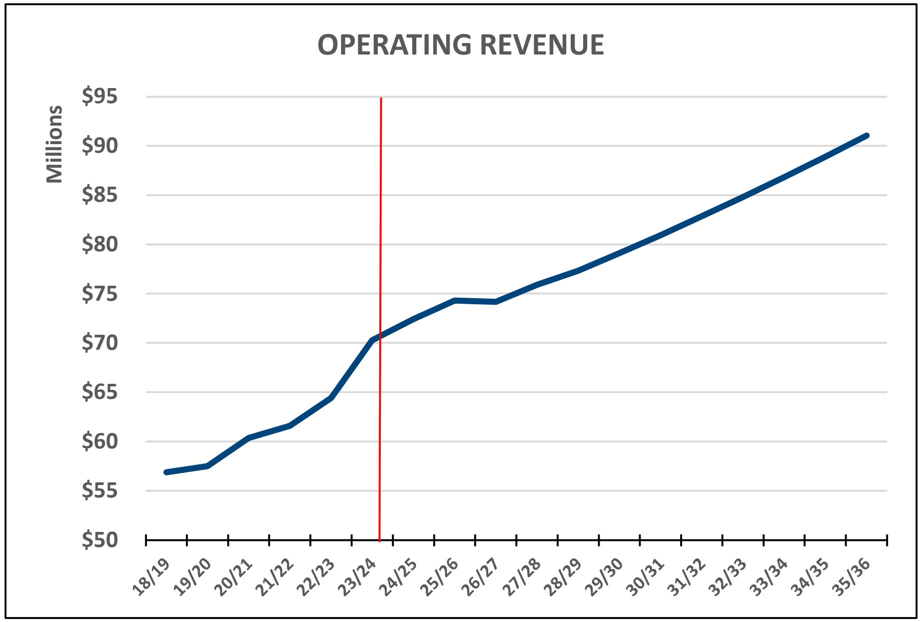
The concern is the time it will take to achieve an operating surplus, i.e. in 7 years' time. The City needs to be committed to increasing revenue and finding operating efficiencies to reduce expenditure and to shorten this time frame.

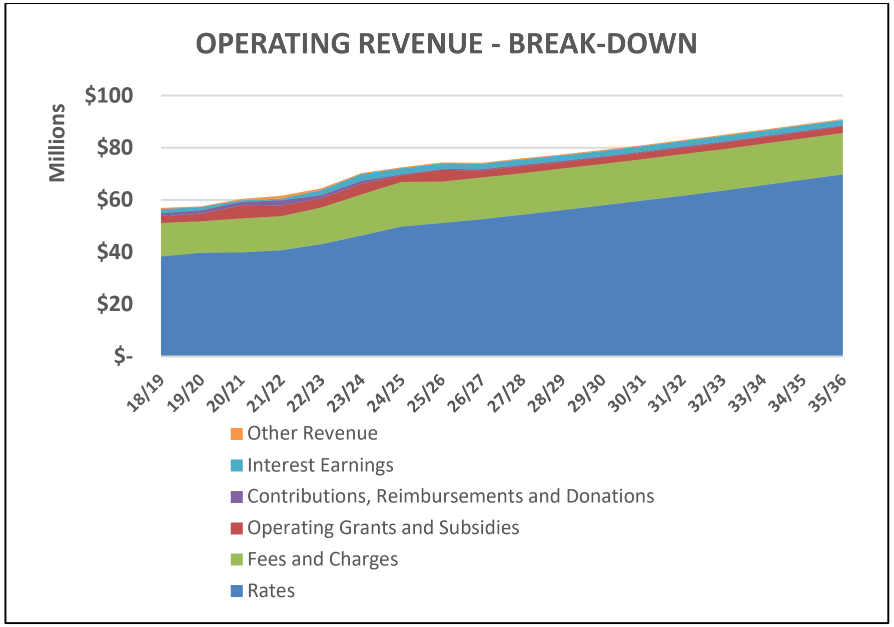
An operating deficit reduces the City's ability to fund capital works, reduces its loan capacity, and to set aside funds into cash reserves for future projects.

Operating Revenue

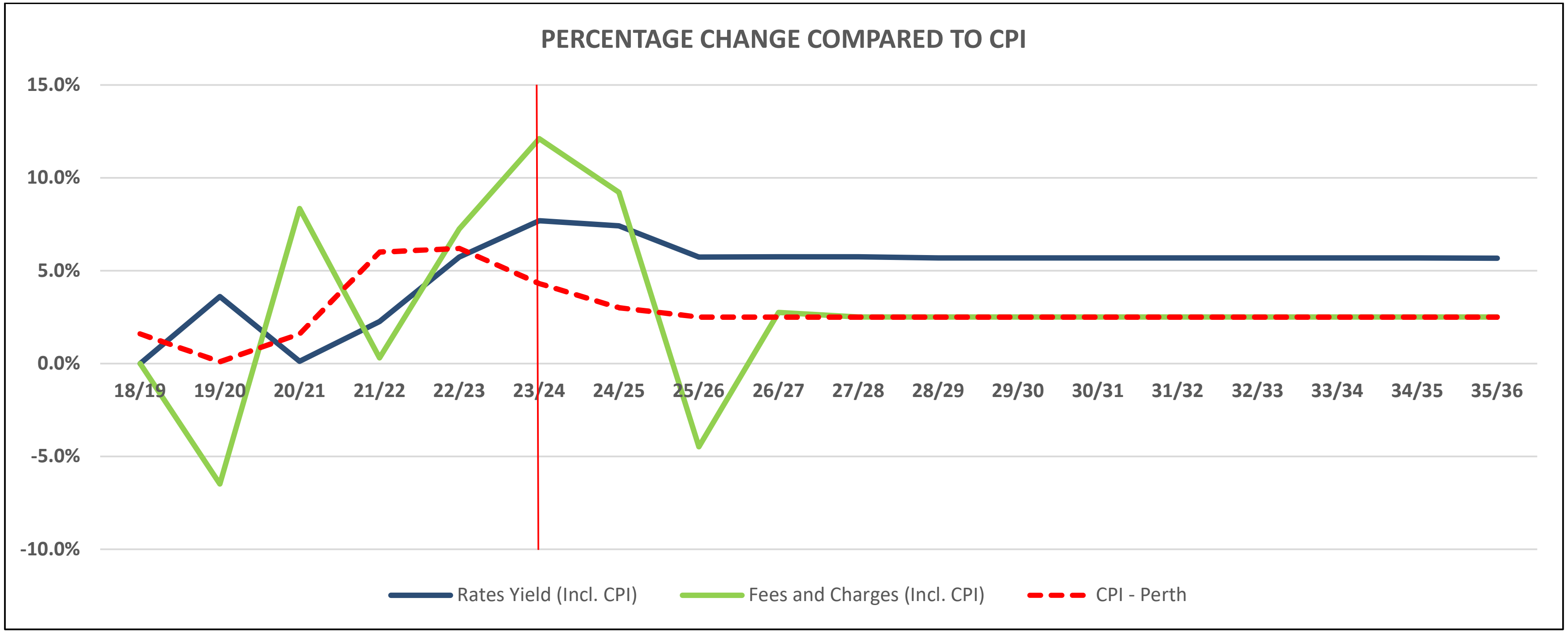
Operating income includes Rate income, Fees and Charges, Operating Grants and Subsidies, Contributions, Reimbursements and Donations, Interest Received and Other Revenue. Non-operating income, such as capital grants are excluded from this total.

The following graphs show that annual operating income continues to increase, and that Rates and Fees & Charges are the largest component.





The following graph shows the percentage changes for Rates and Fees & Charges and compares these to CPI (Perth).



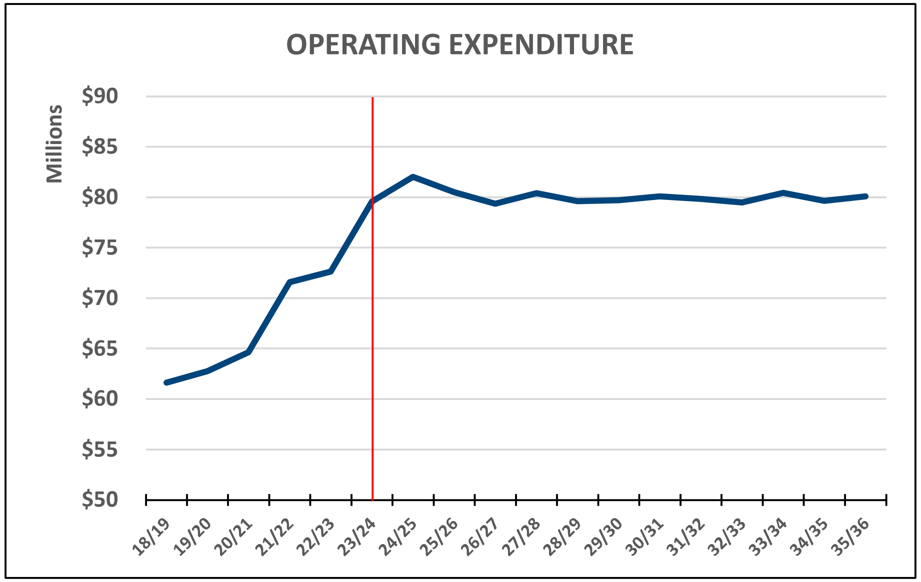
Percentage increases for both Rates and Fees & Charges have both been very volatile compared to CPI in the past due to rapid increases in inflation and the effects of COVID. Rates were increased by zero percentage in 2020/21 and then increased by 7% in both 2023/24 and 2024/25 as the City tried to "catch-up" on lost revenue during this period. The long term Rate increase is forecast at 5.5% which is above the CPI forecast of 2.5%. Fees and Charges have also been affected by COVID with demand reducing for services (e.g. South West Sports Centre), and with raising cost of waste charges which were pasted on to users. In 2025/26 Fees and Charges will decrease due to the removal of the commercial waste services provided by the City. Fees and Charges in the long term are expected to increase in-line with CPI.

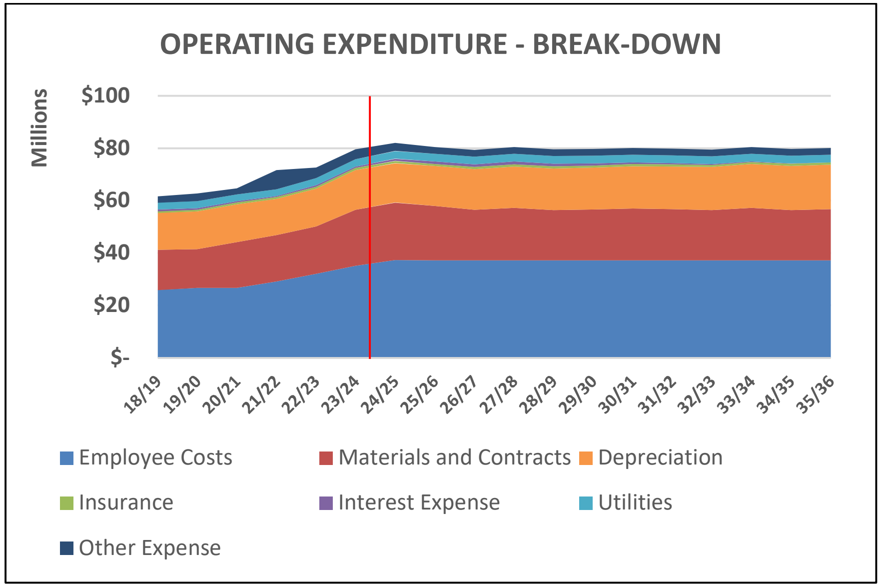
Operating Expenditure

Operating expenditure includes Employee Costs, Materials and Contracts, Utilities, Insurance, Depreciation, Interest on loan borrowings and Other Expenditure.

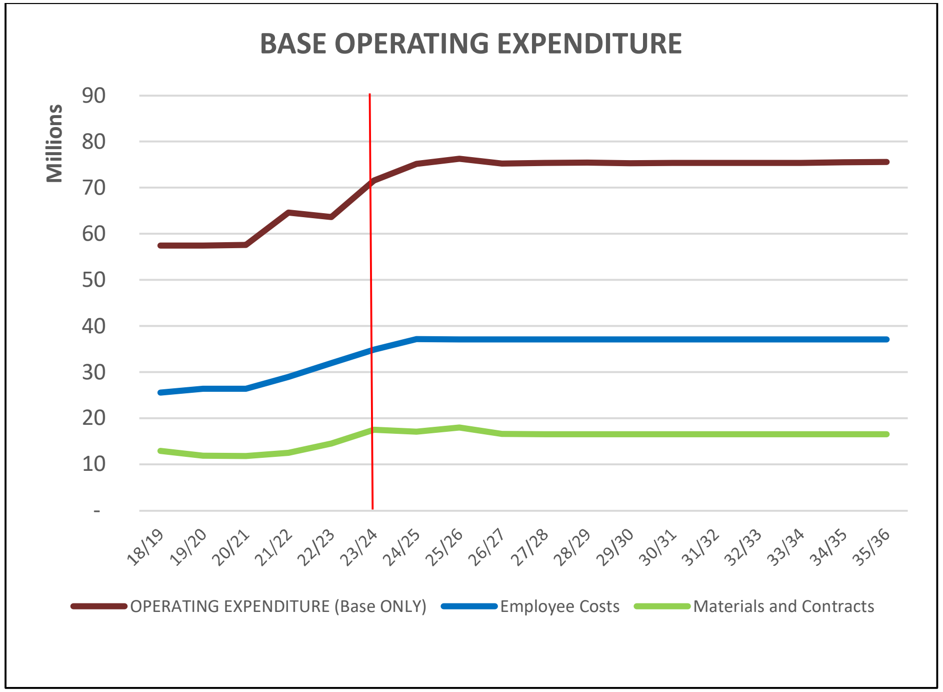
The following graphs shows that operating expenditure has increased significantly in the past, mainly due to increases in both Employee Costs and Materials & Contracts. However, operating expenditure will then remain steady over the LTFP when CPI increases are excluded. Note: CPI forecasts are excluded to show only real increases in expenditure.

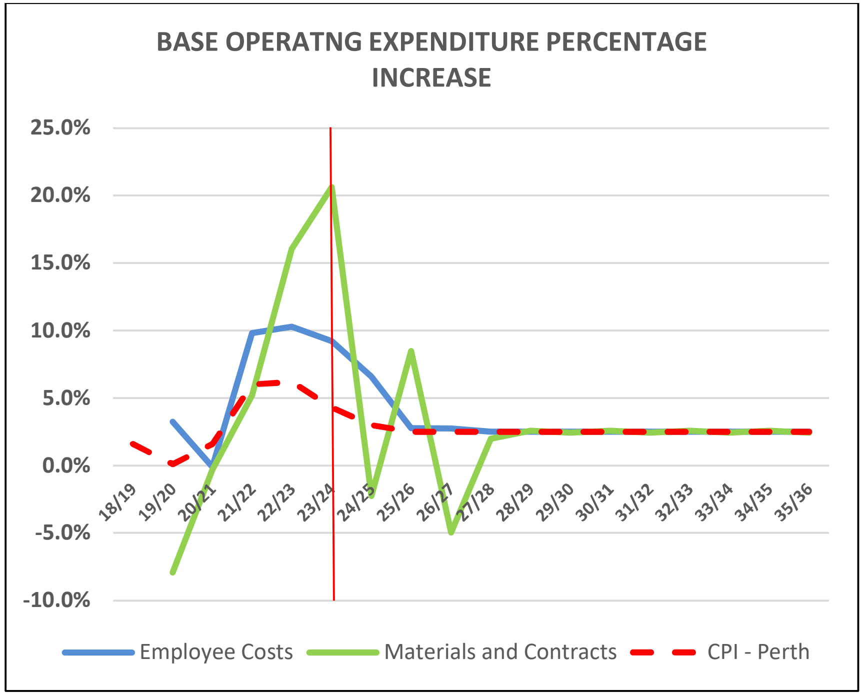
The majority if the operating expenditure is in Employees Costs, Materials & Contracts and Depreciation.





The following graphs shows only base operating expenditure and excludes operating projects that are “one-off” expenditure or discretionary expenditure. When operating projects are excluded the total operating expenditure is substantially reduced.

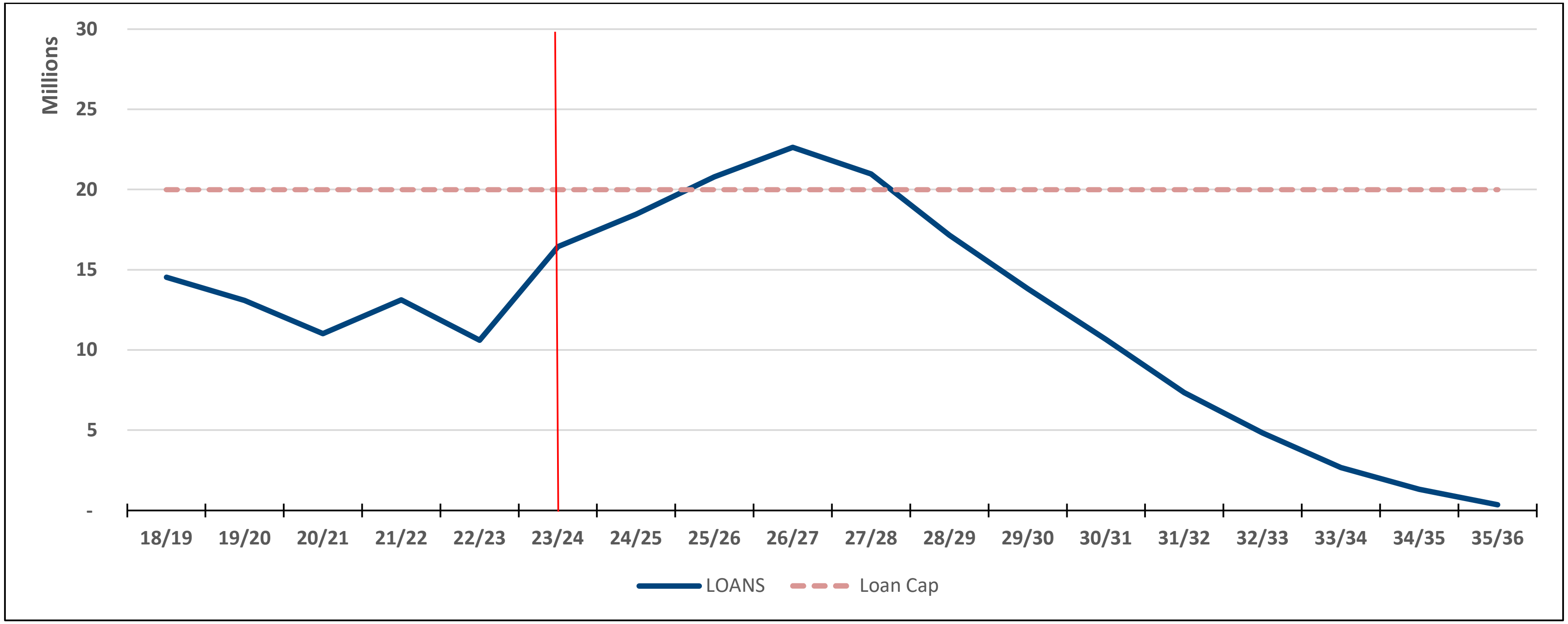




Employee cost increases reflect both the increase in wage rates and increases in employee numbers. Employee Costs and Materials & Contracts expenditure are both forecast to increase by CPI in the long term.

Loans

The LTFP includes new loan borrowings of $4M in 2024/25, $5M in 2025/26, $5M in 2026/27 and $2M in 2027/28. There are no further loans planned after 2027/28 at this stage. The graph shows that total amount of loan borrowings will increase from $16.4M at the beginning of 2024/25 and will peak in 2026/27 at $22.6M. The balance of loans and will then gradually decrease to $363K by 2035/36. The City aims to keep total loan borrowings below $20M if possible.



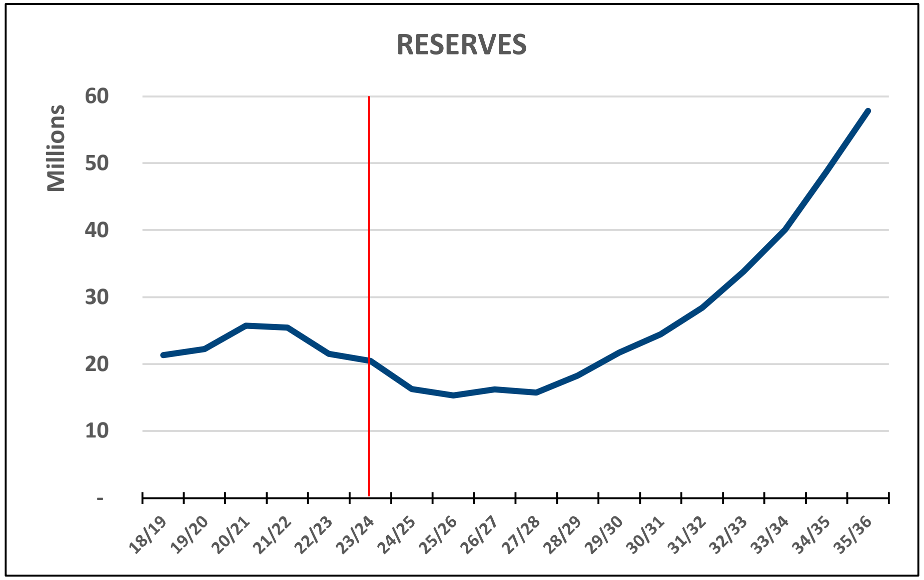
From 2028/29 the loan capacity to borrow new funds for capital projects steadily increases.

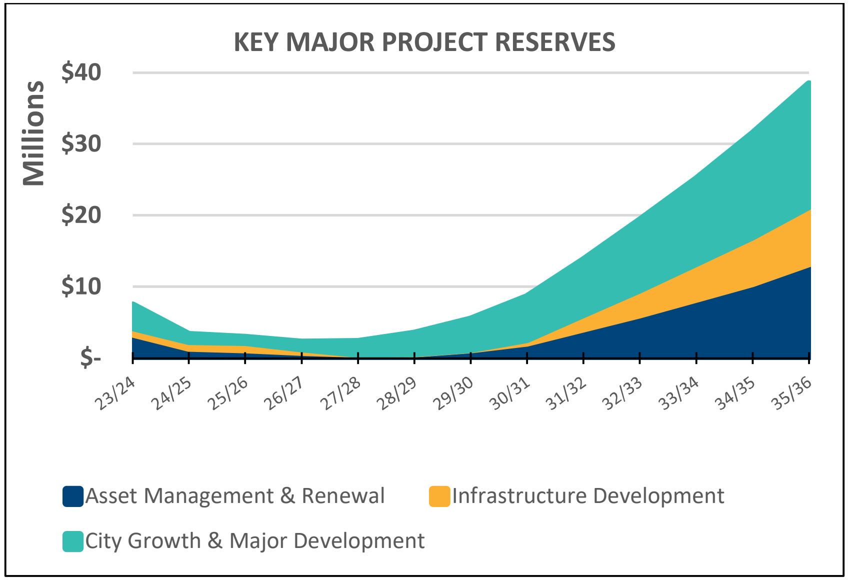
Note: The above loan borrowings do not include budgets for the Ocean Pool, new Regional Art Gallery or future asset renewal projects, as they are still to be finalised.

Reserves

Cash backed reserves are funds set aside for specific purposes and are an essential funding component of the LTFP. The City has 26 different reserves with most funds held in the City Growth and Major Development Reserve, Asset Management and Renewal, Infrastructure Development, Parking Reserve, and Refuse Collection and Waste Minimisation Reserve.

At 30 June 2024 Reserves total $20.4M and then reduce to a low of $15.3M by the end of 2025/26. The total amount of reserves then gradually increases to $64.9M by 2035/36. This increase in reserve funds provides future funding capacity for new projects that may be considered by Council, including the Ocean Pool, new Regional Art Gallery and future asset renewal projects.

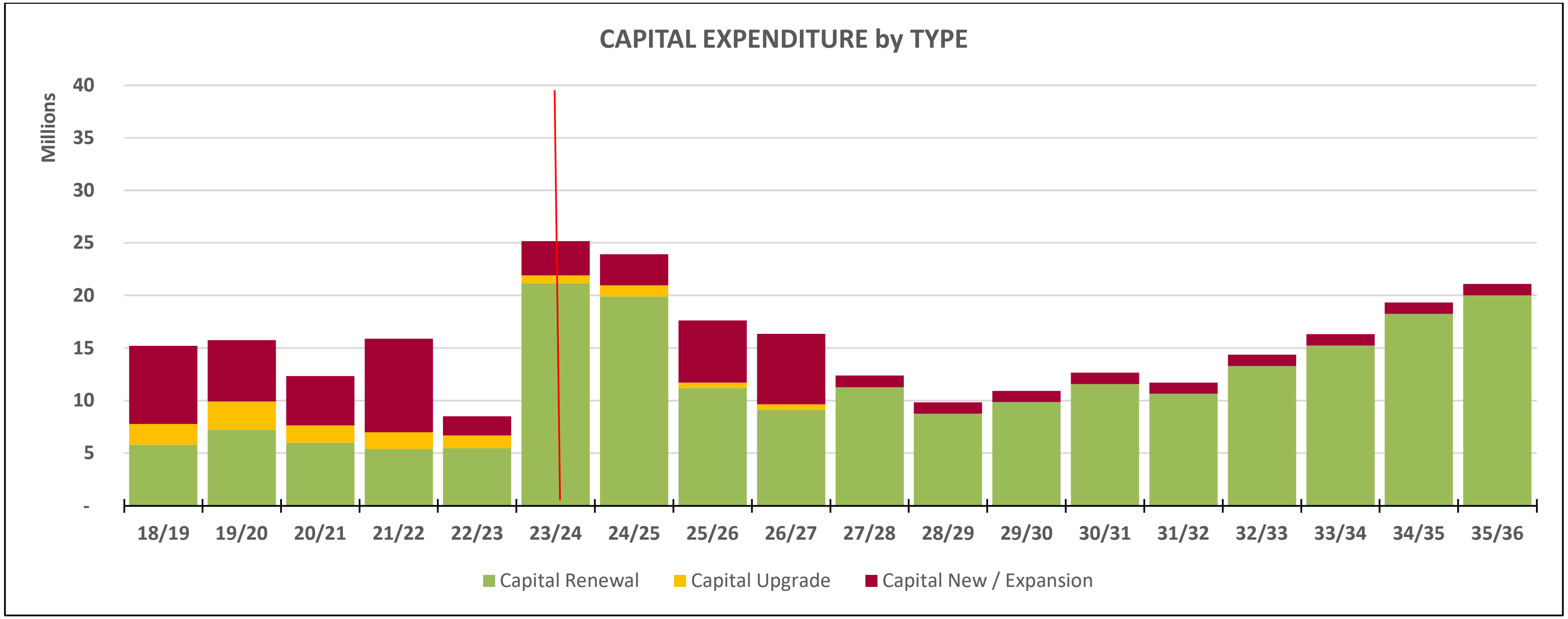




<u>Key major project reserves</u>

From 2024/25 to 2028/29 there is limited capacity to use these reserves for any additional projects that may be considered. However, this significantly improves from 2029/30 to 2035/36 as the reserve balances increase.

Capital Expenditure



The Capital Expenditure graph above shows the total amount spent on capital projects and the type of capital expenditure, i.e. new, update or renewal. Capital 'new' expenditure is greatest between 2018/19 to 2026/27 and then reduces to approximately $1M per annum.

Note: The forecast capital expenditure do not include budgets for the Ocean Pool, new Regional Art Gallery or future asset renewal projects, as they are still to be finalised.

The Asset Sustainability Ratio (Page 17) indicates that capital renewal expenditure needs to increase. It this does not occur the condition of the City's existing assets will deteriorate.

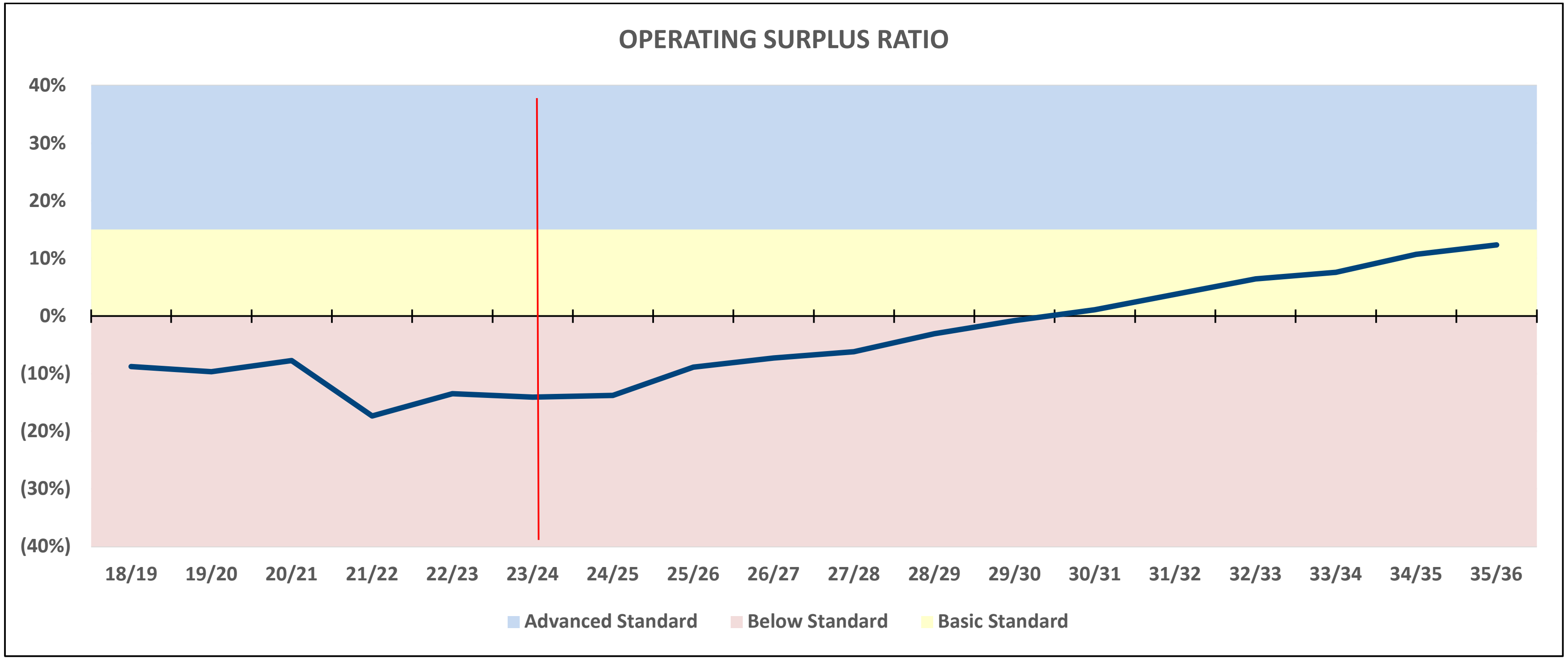
Ratios

Operating Surplus Ratio

Ratio formula: Operating Revenue minus Operating Expenditure as a ratio of own source operating revenue.

The Operating Surplus Ratio measures the City's capacity to meet operational expenses using operational revenues, and the subsequent availability of surplus funds for capital works. The Department of Local Government's basic standard target is met if this ratio is greater than zero.

The City does not meet the basic standard until 2030/31. To improve this result, the City needs to reduce operating expenditure and/or increase operating revenue. Note: A significant operating expense is asset depreciation which is approximately $15M-$17M annually.

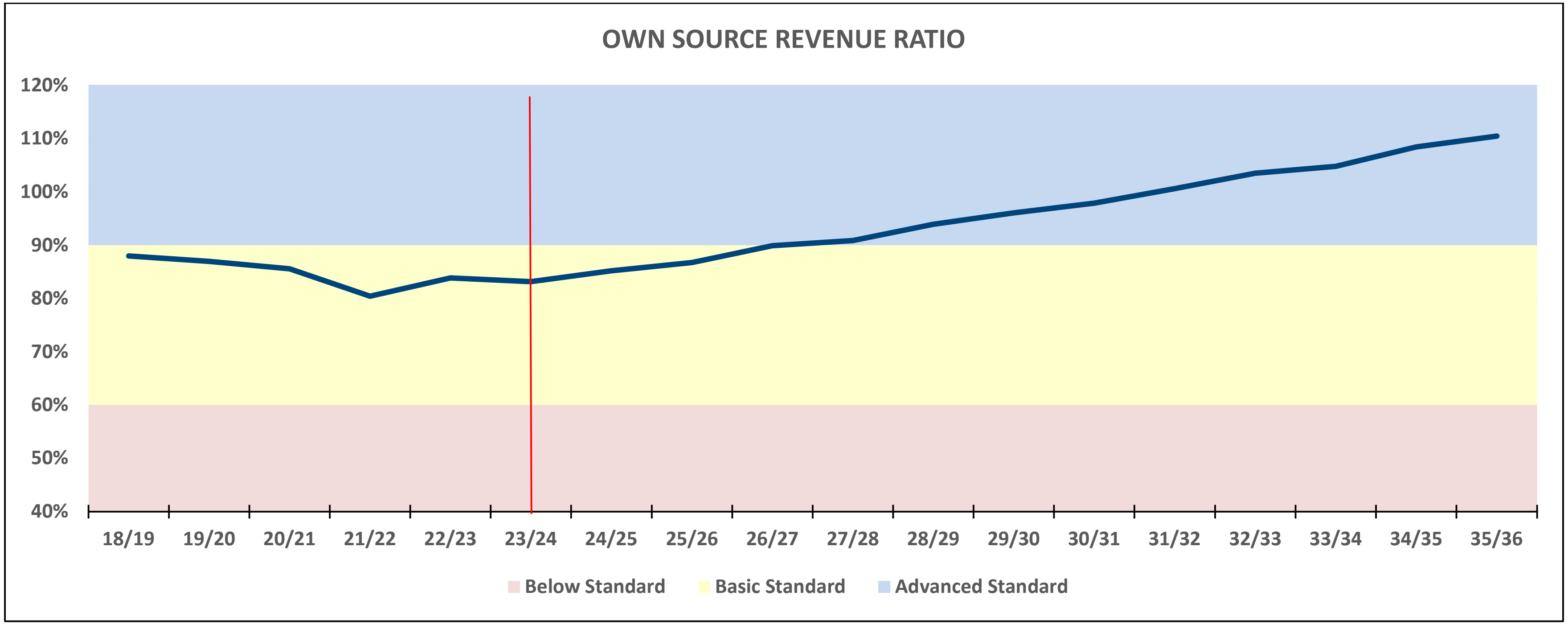


Own Source Revenue Ratio

Ratio formula: Own source operating revenue as a ratio of operating expense.

This ratio measures the City's ability to cover operating expenses from revenues generated directly by the City and does not include external funding such as grants and subsidies. The Department of Local Government indicates that a basic standard is achieved if the ratio is between 40% and 60%, with an advanced standard achieved if greater than 90%.

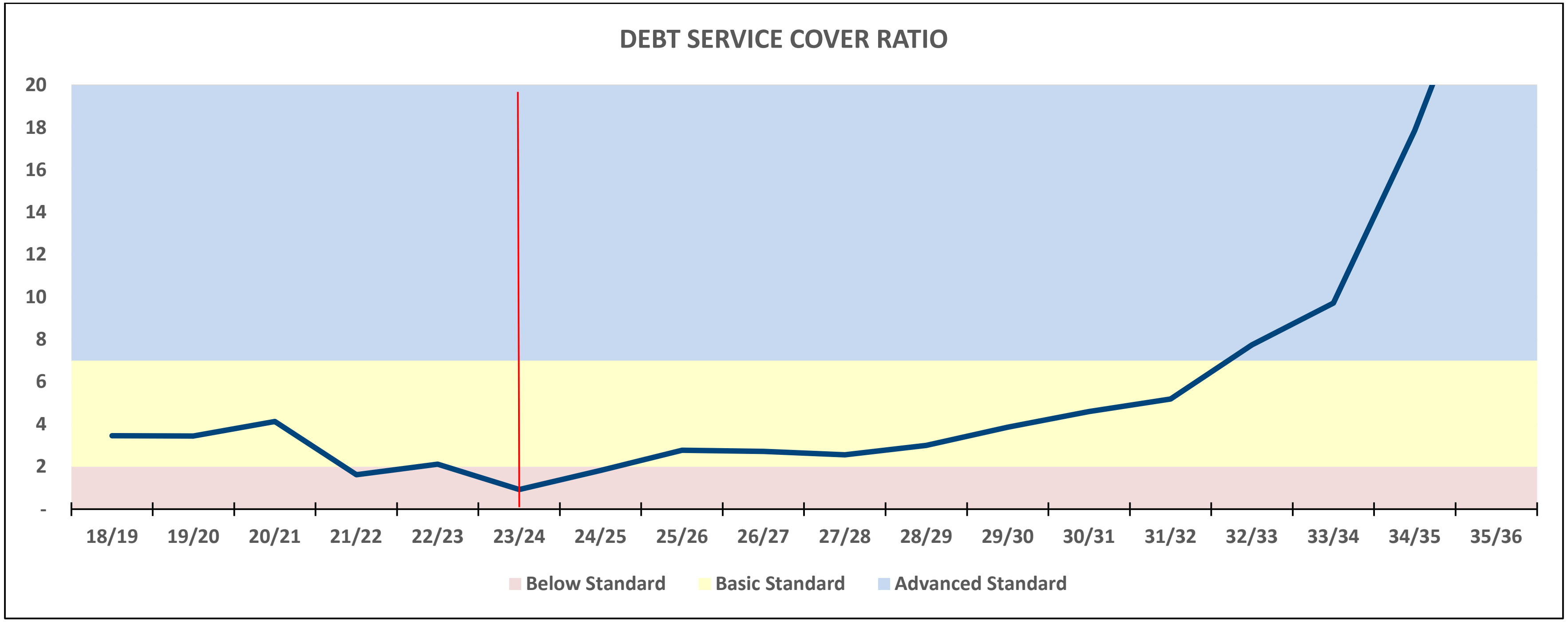
The City meets the basic standard during 2024/25 to 2026/27 and achieves an advanced standard from 2027/28 and steadily continues to improve each year thereafter.



Debt Service Cover Ratio

Ratio formula: Operating Surplus before Interest and Depreciation as a ratio of principal and interest expense for borrowings.

The Debt Service Cover ratio measures the City's ability to repay its debt obligations using uncommitted or general-purpose funds available for its operations. A basic standard is achieved if this ratio is equal to or greater than two, with the Department of Local Government indicating an advanced standard to be greater than five. The higher the ratio is, the easier it is for the City to obtain a loan. The City generally meets this standard and steadily improves its Debt Service Cover ratio each year.

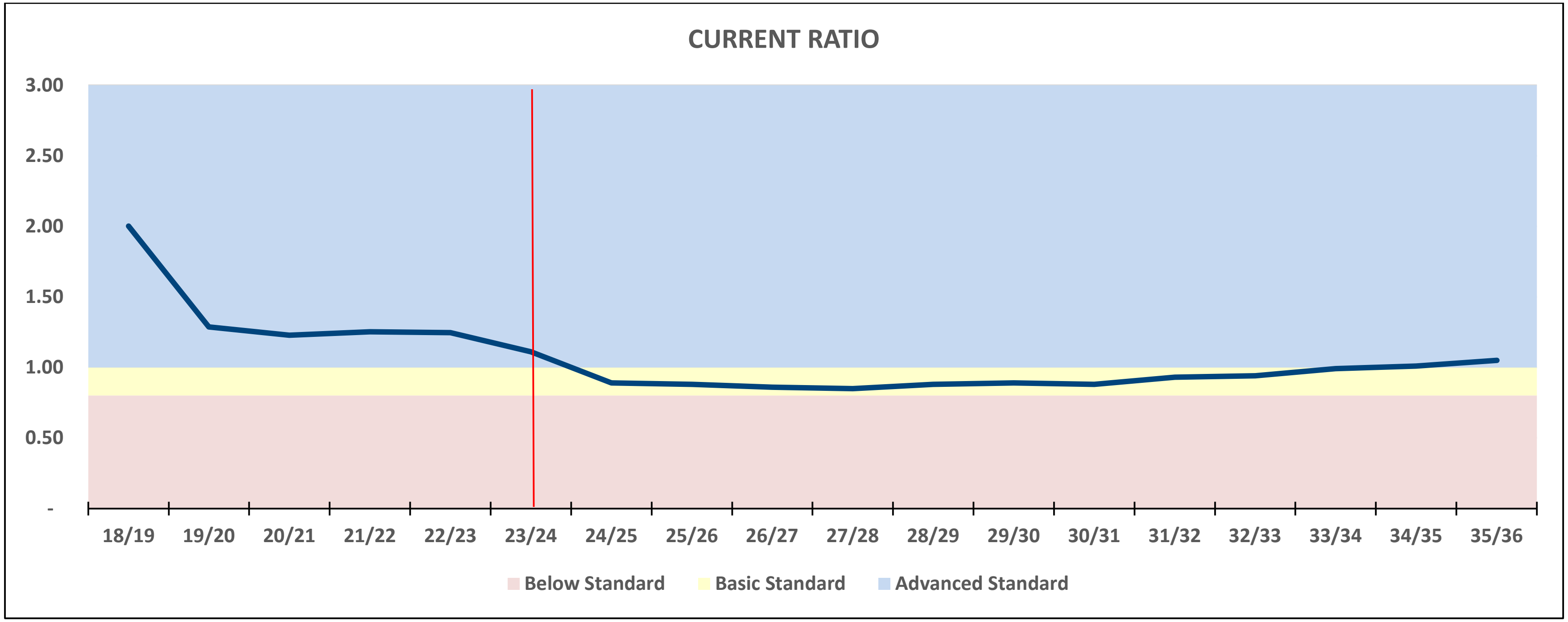


Current Ratio

Ratio formula: Current Assets as a ratio of Current Liabilities.

This ratio measures the City's liquidity and indicates its ability to meet short-term financial obligations out of unrestricted current assets. Liquidity refers to how quickly an asset can be converted into cash. A ratio of greater than 1.0 indicates the City has more current assets than current liabilities.

Although the preferred ratio is a number greater than 1.00, the Department of Local Government indicates that the basic standard is met if the Current Ratio is greater than 0.80. The LTFP meets this standard and gradually improves each year.

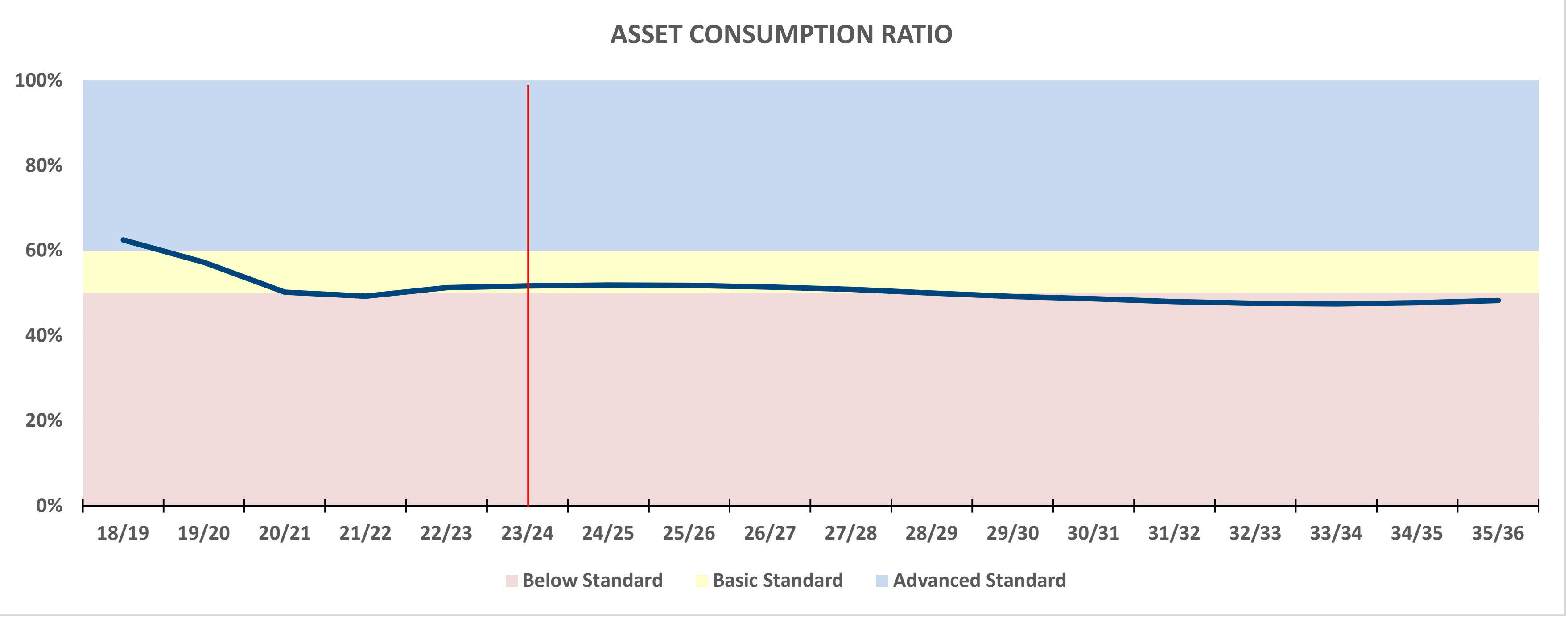


Asset Consumption Ratio

Ratio formula: Depreciated replacement costs of assets as a ratio of current replacement costs of depreciable assets.

This ratio seeks to highlight the aged condition of the City's physical assets and measures the extent to which depreciable assets have been consumed by comparing their written down value to their replacement cost.

The Department of Local Government indicates that the basic standard is met if the ratio is 50% or greater and is improving if the ratio is between 60% and 75%. The LTFP meets the basic standard in the first five years and then falls below 50% for the remaining years of the plan, highlighting the need to allocate more capital expenditure for asset replacement.



Asset Sustainability Ratio

Ratio formula: Capital renewal and replacement expenditure as a ratio of depreciation expense.

The Asset Sustainability Ratio approximates the extent to which assets managed by the City are being replaced as they reach the end of their useful lives. It is calculated by measuring capital expenditure on renewal or replacement of assets, relative to depreciation expense. Expenditure on new or additional assets is excluded.

Depreciation expense represents an estimate of the extent to which the assets have been consumed during that period. Measuring assets at fair value is critical to the calculation of a valid depreciation expense value.

The Department of Local Government indicates that the standard is met if the ratio is 90% and is improving if between 90% and 110%. Apart from the 2023/24 and 2024/25 (due to the replacement of Hands Oval and Forrest Park Pavilion), the City does not meet this standard and will need to allocate more capital expenditure towards the renewal or replacement of existing assets to improve this ratio.