Grant Thornton

Central Coast Council - Phase 1

Financial Capacity Review - Phase 1

4 June 2020

Contents

Grant Thornton

Level 17, 383 Kent Street

Sydney, NSW, 2000
PO Locked Bag Q800
QVB Post Office
Sydney, NSW, 1230

T +61 2 8297 2400
F +61 2 9299 4445
E info.nsw@au.gt.com
W www.granthornton.com.au

Mr. Gary Murphy
Chief Executive Officer
Central Coast Council
P.O. Box 20
WYONG NSW 2259

4 June 2020

Dear Sir

Central Coast Council – Financial Capacity Review – Phase 1

We refer to our engagement letter dated 14 April 2020. We have pleasure in enclosing our report and will be pleased to provide hardcopies on request.

Our conclusions and recommendations are included within the Executive Summary, but stress that for a full understanding it is necessary to read this in conjunction with our detailed commentary set out in sections 2 to 4.

Your attention is drawn to Appendix A which defines the scope of our work. This report is confidential and has been prepared exclusively for the Council. Whilst other parties may be interested in receiving a copy of this report we stress that, to the fullest extent permitted by law, we cannot accept any responsibility whatsoever in respect of any reliance that these parties may place on our report in any decision that they may make in relation to the Council.

We do not accept any responsibility for any loss or damages arising out of the use of the report by the addressee(s) for any purpose other than in connection with the Financial Capacity Review.

We reiterate, therefore, that this report should not be used, reproduced or circulated to any other party in whole or in part, without our prior written consent.

If there are any matters upon which you require clarification or further information please contact me on +61 2 8297 2501.

Yours sincerely

Philip Campbell-Wilson
Partner – Financial Advisory

If you have any questions in respect of this report or its contents, please contact:

Philip Campbell-Wilson
Partner
T +61 8297 2501 or +61 408 757 245
E philip.campbell-wilson@au.gt.com

01

Executive summary

Executive Summary

Area	Observation	Recommendation
Revenue and Rates Arrears Analysis	• To obtain a timely assessment of the potential impact on revenue and cash collections as a result of COVID-19, we developed a high level Revenue and Collections model. The model estimates that revenue and cash collections will reduce by $86.1 million to $117.2 million in 2020/21. • Rates, annual charges and water and sewer usage comprise approximately 70% of Council's total budgeted revenue for 2020/21. While the revenue is not expected to be impacted, there is a real risk that the collection of rates and charges will be materially impacted as both business and household income is reduced during the economic crisis. As such, available cash will be severely impacted. Every 1% increase in the arrears rates equates to c. $4.1 million of reduced cash. We have assumed an arrears rate as high as 30% in one quarter in the 'high' scenario.	• With revenue and cash collections estimated to be reduced by $86.1 million to $117.2 million in 2020/21, it will be necessary to immediately reduce operational and capital expenditure where available. • The budgeted level of spend is not possible in an environment where cash receipts are materially impacted, and where there was already a cash outflow forecast for the period. At the upper end of our modelling, it may be necessary to reduce spending by up to $153.3 million for the year in the event additional and material grant funding is not available. • The impact on revenue and cash should be monitored on an ongoing basis. In the event actual outcomes are not as detrimental as forecast, it may be possible to release certain capital projects placed on hold.
Interim Measures	• We recommended that the below interim measures be explored to immediately preserve cash while the impact of COVID-19 is further assessed: – Placing a freeze on new recruitment; – Limiting Overtime; – Limiting the use of contract and temporary labour; and – Enforcing leave to reduce excess leave accruals. • Lead by Krystie Bryant and the P&C directorate, the ELT has assessed the initiatives and identified potential savings of c. $17.8 million over 12 months.	• Now that the cost savings have been identified, it will be important that the initiatives are implemented immediately to ensure the benefits are realised in a timely manner. • The P&C directorate are currently developing a communication plan which will address the execution of the plan. • It is recommended that there is ongoing monitoring of these interim initiatives to ensure all directorates remain on track to realise the benefits identified. The targets should also be reassessed in due course to determine whether additional savings are available. • We will consider additional operational and capital opportunities in Phase 2 of our review.
Finalising 2020/21 Budget	• The Draft Operational Plan 2020-21 and 2020-21 Proposed Budget were prepared prior to the outbreak of COVID-19. As a result, they do not factor in any potential impact to the financial performance or service delivery as a result of COVID-19. • The ELT and Councillors have made the decision not to utilise the one month extension of time to finalise the 2020/21 Operational Plan and budget to address the impact of COVID-19. Instead, the budget will be amended via Q1 adjustments once there is more visibility on the financial impact.	• As the Council have agreed to proceed to finalise and adopt the Operational Plan and budget in June 2020, in the event the Council has not already done so, we recommend that Council: – Ensure that there are adequate disclosures to note that it has not been adjusted to reflect the potential impact from COVID-19 which is currently being quantified; and – Obtain legal advice to ensure there are adequate caveats.

Solvency: The Council needs to be able to operate as going concern moving forward, anticipating material revenue losses over an unknown time period.

Minimise Job Losses: The assumption is that the COVID-19 crisis is temporary and Council will ramp back up. Therefore, Council will need staff to deliver perhaps a new set of services as defined by the Services Review.

Services: The Council need to maintain its ability to deliver essential services, at the very least, to the community.

Local Economy Stimulus: As a level of government, Council has an obligation to play their part in getting the economy moving again and especially supporting local businesses

02

Revenue Analysis

Revenue and Collections Modelling

COVID-19 Impact on Revenue and Cash Flow

- COVID-19 is not only having devastating consequences on people's health, but it is having a severe impact on the global economy. The local economy has not been immune with public health orders issued and restrictions being in place resulting in the economy contracting.
- Whilst restrictions are gradually easing, the lock down and period of closure for many services and businesses will have a long lasting impact. Ongoing social distancing requirements will also impact the ability of businesses and services to ramp up trading their operations.
- The peak economic impact of COVID-19 on the local business community is potentially yet to play out. Particularly as Jobkeeper, the Mandatory Code of Conduct (tenant rent relief program) and certain regulatory relief is wound back and businesses need to fund re-mobilisation costs, pay rent plus deferred rent repayments and fund employee costs. This re-mobilization is to occur during an environment of disrupted and uncertain consumer spending habits.
- The impact on the business community has a flow on effect to the personal finances of the population with many people currently being supported by the stimulus measures including Jobkeeper and Jobseeker.
- With both business and personal finances under strain, it can be expected that there will be a reduced level of revenue generated by the Council for a period of time, and cash collections will reduce. It is necessary to understand the potential impact this may have, particularly on the main revenue source of rates and annual charges which are required to enable Council to continuing delivering services to the community, many of which are essential services.

Revenue and Collections Model

- We have developed a high level model to assist in estimating the revenue loss and impact of rate arrears for the 2020/21 year.
- The purpose of the model is to provide a high level estimate only which can then be used to drive change elsewhere within the Council. For example, the forecast impact on rates and revenue will drive the need for operational efficiencies to be identified and provide guidance for the level of capital projects which may need to be deferred or modified.
- Given the number of revenue streams within Council, the number of variables impacting revenue, the short timeframe we are working within and the uncertain environment, it was necessary for the model to be high level. As the business units complete and cost their 'Return to Services' plans, we will override the model with the more detailed analysis. Further, as actual trends start to emerge we will be able to revisit the initial assumptions adopted. As such, the model will need to be updated and the forecast impact on revenue and rates collection assessed on an ongoing basis.
- Given the unprecedented nature of the COVID-19 pandemic, it is noted that there is no precedent and as such we have had to rely heavily on judgement and estimates.
- While it is noted that the Council has security against the rate payer's property for any arrears, the model focuses on the immediate cash flow impact from non-collection. There could be significant delays in full recovery of unpaid rates.
- A more detailed overview of the model is included in **Appendix B.**

Caveat

- As noted throughout this report, there is no precedent upon which we can base our assessment of arrears and revenue loss. We have set out our assumptions and note:
  - We have had to make assumptions based on judgment and limited known information given the unprecedented nature of COVID-19;
  - Our assumptions are based on known conditions as at 1 June 2020;
  - While stimulus package and relief measures which commenced in March and April 2020 are due to cease in September and October 2020, these programs may be extended or amended going forward. Further, alternate and targeted stimulus measures are likely to be announced going forward in an attempt to revitalise the economy which may impact the assessments made within this report
- Given the lack of certainty, it will be necessary to monitor cash, actual results and forecasts on a regular basis.

Estimated Revenue Impact and Rates Arrears

Estimated Revenue and Cash Flow Impact

	Low ($'000)	High ($'000)
Q4 2019/20		
Rates Arrears[1]	(15,000)	(20,000)
Revenue Loss[2]	(4,298)	(4,298)
Capital Contributions[2]	(5,681)	(5,681)
Total Q4 2019/20	**(24,978)**	**(29,978)**
2020/21 (Full Year)		
Rates Arrears[3]	(70,976)	(102,015)
Revenue Loss[3]	(8,483)	(8,483)
Capital Contributions[3]	(6,659)	(6,659)
Total 2020/21	**(86,117)**	**(117,157)**
Grand Total	**(111,096)**	**(147,135)**

Notes: 1. Annual rate arrears estimated based on current receivables projections as at 2 June 2020 which consider current payment profile and 2018-19 payment profile.
2. Adopted from Council's assessment of loss for the period April 2020 to 30 June 2020.
3. Incorporates outcomes from Revenue and model.

2020/21 Budgeted Revenue and Estimated Impact (High Scenario)

	Proposed Budget (2020/21) ('$000)	Est. Arrears / Cash Flow ('$000)	Est. Revenue Reduct'n ('$000)	Est. Contrib'n Reduct'n ('$000)	Est. Total Cash Flow & Revenue ('$000)	Est. Reduct'n as % of Budget Revenue
Rates & Annual Charges	335,480	(83,882)	-	-	(83,882)	25%
User Charges & Fees	148,754	(18,133)	(6,428)	-	(24,561)	17%
Interest & Investment Revenue	11,100	-	(781)	-	(781)	7%
Other Revenues	13,568	-	(1,273)	-	(1,273)	9%
Grants & Contrib. - Operating	40,218	-	-	-	-	0%
Grants & Contrib. - Capital	45,946	-	-	(6,659)	(6,659)	14%
Total Revenue	**595,066**	**(102,015)**	**(8,483)**	**(6,659)**	**(117,157)**	**20%**

Notes: User Charges & Fees and Other Revenues per 'GT Information Revenue'. Other revenue categories in line with 2020/21 budget per Draft Operational Plan.
Sources: 'LTFP – Consolidated Workfile' and 'GT Revenue Information.xls provided on 25 May 2020

Outcomes

- Based on the assumptions adopted and set out on the following page, we estimate that the total impact of rate arrears and lost revenue and contributions will be in the range of $86.1 million to $117.2 million for the 2020/21 financial year, plus a further $15.0 million to $20.0 million for the last quarter of 2019/20.
- As the largest driver is the collection of rates, annual charges and water and sewer usage, noting a 1% movement in the collection of these items equates to a cash flow impact of c. $4.1 million for 2020/21.
- As a result of the estimated cash flow impact, it will be necessary to immediately identify areas of operational and capital expenditure which can be reduced or deferred. While we have begun discussions in this regard, this will form the basis of Phase 2 of our review.
- As more detailed information becomes available such as actual results and detailed and costed Return to Service plans, the estimated impact can be reconsidered. Should the impact be less than initially forecast, it may be possible to commence certain capital projects that were initially deferred. It would be a more prudent approach to release additional projects should the position not be as detrimental as opposed to having to scale back projects once commenced as a result of an unfavourable result.

Collections and Hardship

- At the Council meeting on 23 March 2020, the Councillors passed a motion to defer further recovery action on outstanding rates and charges for the quarter and to extend hardship provisions to businesses which have closed. Further, no interest can be charged on overdue rates and charges until at least 31 December 2020.
- Should the Councillors not extend this period, and given the expected increase in arrears, we recommend that a 'soft' approach to debt collection be recommenced. As is being undertaken at other councils, contact should be made with rate payers who are in arrears to remind them of their obligation. In the event that the rate payer raises issues which suggest they are experiencing hardship, a hardship application should be made and assessed in accordance with the Debt Recovery and Hardship Policy.
- While acknowledging genuine cases of financial hardship, this soft approach should result in increased recoveries by identifying parties who are being opportunistic as opposed to experiencing hardship, and also result in some payment plans being put in place to try and prevent the arrears growing each quarter.

Model and Key Drivers

Key Assumptions and Drivers for 2020/21

Rate and Annual Charges Arrears

- The largest driver within the model is the assumption with respect to the arrears rates which have been applied to rates, annual charges and water and sewage usage (i.e. $408 million of the total budgeted revenue of $595 million, or c. 70%).
- For the purpose of the model, we have adopted the following assumptions:

Rates Arrears Assumptions

2020/21	Low %	High %
Q1	15%	20%
Q2	20%	25%
Q3	20%	30%
Q4	15%	25%

- While there are no strong guiding principles given the unprecedented nature of COVID-19, in adopting these assumptions we have considered the following, with further commentary in **Appendix C**:
  - The socio-economic index for the region;
  - The national and local unemployment rates (excluding under-employment);
  - The primary industries/employers of the region;
  - The national level of mortgages which have been deferred since March 2020; and
  - Comments received from other Councils with respect to their forecasts.
- Although it is anticipated that the economy will improve as the restrictions are lifted, Q4 2019/20 is not expected be the peak in arrears as the Federal Government is providing support via various stimulus packages including Jobkeeper and the increased Jobseeker payment, plus some households may have savings that have not yet been eroded. Subject to any further initiatives from the Government, once Jobkeeper is removed in September 2020 (at the same time that the Bank's support with respect to mortgage deferral is to conclude and the rent relief Mandatory Code of Conduct ends), there may be an increase in arrears with a peak seen in Q2 2020/21, particularly if the rate of underemployment remains high.

With rates, annual charges, water and sewer usage being the largest component of revenue for the Council, any impact on collection rates will have a detrimental effect on council. A 1% increase in arrears will reduce available cash by c. $4.1 million.

User Charges and Other Revenue

- We have worked with the Finance team and Business Partners to receive their estimates of future lost revenue from operating revenue sources. These are high level estimates only based on the drivers within the model and not detailed analysis. Once the more detailed Return to Services plans are developed and costed, the initial estimates should be revised.
- As set out in **Appendix B**, revenue was categorised according to one of the below categories:
  - N/A – no change expected;
  - Operational Flat – reduced demand is expected; and
  - Operational Ramp Up – A period of time will be required for the service to return to pre-COVID levels as a result of closures and ongoing restrictions.
- The assumptions were provided as at 25 May 2020. As restrictions are changing regularly, this will impact the assumptions adopted.

Interest and Investment Revenue

- As a result of no interest being charged on rate arrears until at least 31 December 2020, interest revenue is estimated to fall by at least $781,000.
- We have assumed there are no other impacts on forecast interest and investment revenue

Grants and Contributions

- With respect to Grants and contributions, a 20% reduction has been applied against the budgeted level of Developer Contributions. This assumption is in line with the estimate provided for the impact on development assessment revenue reflecting a slowdown in the building and construction industry. This equates to a total reduction in develop contributions of c. $6.7 million.
- We have assumed there will be no detrimental impact on grant funding. Given the onus on Federal and State Government to play a key role in stimulating the economy, we do not foresee a reduction in grants. We would expect the level of grants to increase, however, the initial $395 million package announced by the State Government in April 2020 is expected to have negligible impact on the Council. We will consider this further in Phase 2 of our review.

Estimated Cash Flow Impact

Historical Cash Flow Statement (per 2020/21 Budget Model)

($'000)	Actual 2018/19	Projected 2019/20	Projected 2020/21
Cash Flows from Operating Activities			
Receipts:	676,861	586,258	600,359
Payments:	(472,611)	(420,052)	(450,353)
Net Cash provided (or used in) Operating	**204,250**	**166,206**	**150,005**
Cash Flows from Investing Activities			
Receipts:	283,545	84,184	90,887
Payments:	(471,534)	(248,355)	(248,261)
Net Cash provided (or used in) Investing	**(187,989)**	**(164,171)**	**(157,374)**
Cash Flows from Financing Activities			
Receipts:	-	30,000	50,000
Payments:	(31,704)	(46,574)	(45,247)
Net Cash Flow provided (used in) Financing	**(31,704)**	**(16,574)**	**4,753**
Net Increase/(Decrease) in Cash & Cash	**(15,443)**	**(14,539)**	**(2,616)**
plus: Cash, Cash Equivalents & Investments - beginning	59,502	44,059	29,520
Cash & Cash Equivalents - end of the year	**44,059**	**29,520**	**26,904**
COVID Adjustments			
Estimated Collection Arrears (2020/21 only)			(102,015)
Estimated Revenue lost (2020/21 only)			(8,483)
Estimated reduction in Contributions (2020/21 only)			(6,659)
Sale of securities (restriucted funds) to fund Capex (excl $27.8m allocated to capital projects)			(63,066)
Adjusted Cash & Cash Equivalents - end of the year			**(153,319)**

Sources: 'LTFP – Consolidated Workfile' (2020/21 Draft Budget work papers). 2019/20 closing cash has not been adjusted to reflect COVID impact although the figure aligns to the 'Executive Cash Flow'

A negative cash flow of $2.6 million was forecast prior to COVID-19. This will be heavily impacted by COVID-19 ($117.2 million) and the use of restricted funds ($63.0 million). The total cash impact of $180.2 million compares to only c. $29.5 million of available cash. As such, it is necessary to immediately reduce operational and capital expenditure by c. $153.3 million. We will consider this further in Phase 2 of our review.

High Level Cash Flow Analysis

- We have conducted a high level analysis on the impact the lost revenue and reduced rate collections will have on Council's available cash for 2020/21. The purpose of the analysis is illustrate at a high level the likely cash impact on the budget should urgent measures not be taken to reduce capital and operational expenditure.
- We need to work further with the Finance Team to:
  - Consider the revised forecast closing cash balance for 2019/20, noting the cash flow analysis presented opposite is from the draft 2020/21 budget and does not consider recent run rate and the projected COVID-19 impact for the last quarter of the 2019/20 year; and
  - Better analyse the utilisation of available cash and restricted funds.

While an operating loss of $32.5 million (before capital grants and contributions) is budgeted, positive cash from operating activities is forecast as a result of depreciation being a 'non-cash' item. Despite this, the operating budget should be break even as a minimum.

The original budget includes the sale of $90.9 million of securities. This essentially assumes that $90.9 million of restricted funds will be accessed to fund Capex despite only $27.8 million of contributions being earmarked for capital projects listed in the Operational Plan for 2020/21.

Of the Capital Expenditure Budget of $248 million, only $42.7 million was initially forecast to be funded via grants and restricted funds. As such, $205.5 million is to be funded from operational funds and general funds. This is not sustainable, especially given prior year's performance and now the impact of COVID-19.

As a result of the poor operating performance of the Council, it is not possible to access debt from TCorp. As such, debt is only available from Banks which charge a higher, commercial rate. Actual borrowings for 2019/20 are likely to be $20 million higher than budgeted with the funds proposed to be used to retire old debt and reimburse restricted funds that were accessed. A further $50 million is budgeted to be borrowed in 2020/21 with the majority budgeted to be used to replace existing debt.

Restricted funds should not be used to fund general capex. As such, in addition to the cash impact forecast from COVID-19, it will be necessary to further reduce spending so that restricted funds are not used to fund projects that are to be funded from general revenue.

The impact on revenue and collections, plus other adjustments, is expected to result in cash shortage of up to $153.3 million. It is essential that operational efficiencies are gained and expenses reduced, and that capital projects are deferred to preserve cash.

We will consider initiatives with respect to operational and capital expenditure in Phase 2 of our review.

03

Interim Measures

Interim Measures

With the benefit of time as we progress Phase 2 of our scope, we will aim to identify further measures to consider (including with respect to capital expenditure) to assist in managing the anticipated revenue and cash flow impact. In the interim, we note the below measures were discussed with Krystie Bryant who has lead a project with all directorates to identify savings. Initial savings of c. $17.8 million have been identified with communications now being developed to assist in realising the savings .

Issue	Recommended Action	Estimated Saving (2020/21)
Freeze on new hires	• The practice of filling vacant positions needs to be revisited during the COVID-19 period and in light of reduced income and cash flow. • Prior to automatically filling any vacant position, there needs to be an assessment of whether a replacement is required to be obtained and whether the impact on service levels is tolerable. The assessment will also need to include a number of factors which will vary based on the role.	$8.4 million
Reduce Excess Leave	• The organisation has a significant level of excess leave totalling more than $17 million. The current period can be used as a time to reset the culture with respect to excess leave and reducing the leave accrual. Council is looking to set targets for those with excess leave to reduce their balance within a set period. • While there is no immediate cash flow benefit from employees taking leave, the leave accrual balance will reduce therefore having a future benefit for the organisation. It is also beneficial to enforce leave during quieter periods. • There are a number of instances where there will be a detrimental impact in the current climate to enforce leave, which cannot be sustained from a cash perspective. This includes where a replacement is required to cover the employee on leave, where the employee seeks to 'cash out' their leave or other employee favourable incentives such taking leave at double pay. • We understand that there is discretion allowed with respect to some of these initiatives. In the event it is possible, we recommend not allowing employees to 'cash out' leave or be paid at double rate. In the event it is not possible to manage the position with employees within reason, it may be necessary to take a soft approach with respect to enforcing leave so as not to erode cash.	$4.4 million
Reduce Overtime	• With overtime costing the organisation in excess of $10 million per year, it is necessary to reduce this. The organisation is looking to introduce new business rules and targets which would reduce overtime by $3.2 million during the year. • This excludes the benefit to be obtained from introducing an afternoon shift for Water & Sewer which is estimated to further reduce overtime costs by c. $2 million. A more detailed review of overtime by the Council in due course may identify additional savings.	$3.2 million
Review Necessity of Temporary Labour	• A review of temporary labour and contractors have been undertaken to determine possible cost savings. As a result of ceasing some positions, there may be a delay in project delivery. However, of the savings identified, it has been commented on that the disruption to services is tolerable and there is the ability to quickly scale up in due course if needed.	$1.8 million
Lowing the Decision Tree Threshold	• We understand that the Spend Prioritisation Decision Tree was initially used to assess entering of contracts or obtaining services in excess of $250,000. The threshold has subsequently been reduced to $150,000 which should assist in identifying further non-essential spend.	TBC

04

Budget Finalisation Process

2020/21 Draft Operational Plan

Finalising 2020/21 Operational Plan / Budget

- At the Council meeting on 23 March 2020, the Councillors:
  - Endorsed the Draft Operational Plan for 2020-21 for the purpose of public exhibition from 31 March 2020 to 27 April 2020; and
  - Passed a motion to consider adopting the draft Operational Plan 2020-21 by the end of June 2020.
- The Councillors noted that the draft Operational Plan was developed prior to the quantification of the impacts likely to result from COVID-19 and as such pressure would be placed on the revenue base and cost of operations set out in the draft Operational Plan.
- On 17 April 2020 a one month extension was announced meaning Operational Plans were now to be adopted by 1 August 2020.
- We understand that the Council has made the decision to proceed to adopt the existing Operational Plan in June 2020 and not utilise the extension of time. This decision is advised to have been driven by:
  - The additional time is not sufficient to fully assess the potential impact of COVID-19 given its unprecedented nature;
  - Even upon assessment of the revenue impact, it will take additional time to assess and implement measures to constrain expenses and reallocated capital projects; and
  - 2019/20 would result in a 13 month year for reporting purposes which would create reporting issues in future years.
- These concerns need to be balanced against not promising the community certain services and projects which cannot be delivered upon.
- We have not investigated this further noting the comments provided by various employees. As such, it is expected that adjustments will be processed in Q1 at which time further actual information will be available.
- Noting this decision by Council, we highlight the need for appropriate caveats to be included to note the budget was prepared prior to COVID-19 and as a result revenue will not be met and reductions will be required with respect to expenses and capex. Legal advice should also be sought if not already provided as to how the caveat is expressed appropriately.

Appendices

Glossary

2019/20	Financial year ended 30 June 2020
2020/21	Financial year ended 30 June 2021
Capex	Capital expenditure
Council	Central Coast Council
Councillors	The elected Councillors of Central Coast Council
COVID-19	2019 novel coronavirus disease
ELT	Executive Leadership Team
P&C	People and Culture
Q1	Quarter 1 of the financial year, being 1 July to 30 September
Q2	Quarter 2 of the financial year, being 1 October to 31 December
Q3	Quarter 3 of the financial year, being 1 January to 31 March
Q4	Quarter 4 of the financial year, being 1 April to 30 June

Appendix B – Model Methodology and Overview

Model Methodology

- The Model was developed for the purpose of estimating, at a high level, the impact that COVID-19 may have on forecast revenue and cash flow for the 2020/21 year.
- One of the key objectives was to obtain an estimate within a short period of time so that it can be used as a driver for other initiatives within the organisation. Given the uncertainty created by the situation and the number of variables with respect to the revenue drivers, the model attempts to simplify the process by limiting the number of variables/drivers. By being user friendly and requiring minimal input, the model aims to produce an outcome in a short period of time and provide a focus on the potential impact cash to the Council.
- We understand that 'Return to Services' plans are being prepared and the financial impact will be considered by the Business Partners once the plan is complete for each service. Once this more detailed estimate is available, we will override any high level assumptions with the detailed modelling.

Model Drivers

- The model commences with the budgeted revenue for the 2020/21 year.
- Each revenue line is then sensitised based on one of four revenue categories:
  - N/A: Applies to revenue where there is expected to be no impact as a result of COVID-19. As such, forecast revenue will remain unchanged.
  - Operational Flat: Is applied to revenue sources that are ongoing (i.e. have not had to close or be materially altered as a result of COVID-19), however, there is expected to be a reduction in demand. For example, it may be assumed that only 90% revenue will be generated during the year due to reduced demand for a service such as development applications.
  - Operational Ramp Up: Applies to revenue sources that have been interrupted by COVID-19 (i.e. closed or scaled back). Forecast revenue is then driven by an estimated re-opening date and ramp-up period.
  - Rates and Annual Charges: Used for revenue that is still levied/charged at the same rate, however, collection is expected to be impacted
- With the 'Operational Flat' category, the Business Partner is required to nominate the estimated % of the reduced demand/revenue.
- With the 'Operational Ramp Up' category, the Business Partners need to input the below assumptions which then drive a gradual increase/lineal ramp up of the revenue for the service:
  - The month of commencement or reopening;
  - The % at which demand/trading/capacity is estimated upon reopening (e.g. Theatres may only be able to seat 50% of patrons due to social distancing measures); and
  - The number of months in which the service is expected to take to return to pre-COVID-19 levels.
- There are instances where revenue streams were grouped due to the number of revenue lines within the organisation (e.g. all leisure centers and pools were grouped). In instances where there may be different revenue drivers within a stream in the model, the Business Partners engineered an outcome using the variables to ensure that the estimated outcome is in line with their expectations.
- The outcome of the model has been reviewed for reasonableness by both the Business Partners and Vivienne Louie, Unit Manager Financial Performance.

Appendix C – Collection/Arrears Assumptions

Collection Assumption

- As set out on Page 9, we have assumed the following level of arrears for each quarter:

Rates Arrears Assumptions

2020/21	Low %	High %
Q1	15%	20%
Q2	20%	25%
Q3	20%	30%
Q4	15%	25%

- As a result of the significant impact the collection of rates, annual charges and water and sewer usage has on cash flow, the actual level of arrears rates should be monitored on an ongoing basis.
- Given the unprecedented nature of COVID-19, there are no historical trends in which we can rely on to forecast the arrears levels. As such, the above rates are a best estimates based on a number of factors discussed below.
- Considerations in our estimated arrears rates include:
  - Prior to COVID-19, the historical level of arrears with respect to collections was c. 6%. This is in an environment where unemployment for the region had been c. 5.4% against a national unemployment rate of 5.2% for 2019.
  - In April 2020, post COVID-19, the reported national unemployment rate increased to 6.2%. Based on figures that there are 12,293 job losses in April 2020 within the region, this would result in a local unemployment rate of 9.0%. There were a further 11,577 job losses covered by Jobkeeper which would see the local unemployment rate or 12.4% if Jobkeeper recipients were included.
  - Underemployment is a key issue at present with a number of people working fewer hours and/or having voluntarily reduced their hours and wage. Approximately 20% of local residents are estimated to be currently underemployed.
  - The Australian Banking Association reported that as at 16 May 2020, 1 in 14 (or 7.1%) of mortgages have been deferred for up to six months as a result of COVID-19.
  - While the Health Care and Social Assistance industry is the largest employer in the region and is not expected to be materially impacted, the second to fourth largest employing industries are all likely to be severely impacted by COVID-19. 32.6% of the local population are employed in Retail Trade, Construction and Accommodation and Food Services compared to 26.7% within the broader NSW population.
  - Income of retirees is expected to be negatively impacted by reduced dividend declared by listed companies as a result of the pandemic.
  - Payment of rates generally receives a lower priority for payment within households during times of distress. This is in part to rates not being considered 'essential' from an individual households perspective, and also the knowledge that Councils are not aggressive in their recovery strategies.
- The arrears level is likely to increase in Q2 when Jobkeeper ends. The current mortgage deferral assistance provided by banks is also set to conclude at this time as does the moratorium on insolvent trading. Tenants will also need to meet rent deferral repayments plus return to normal lease obligations with the Mandatory Code of Conduct ends in NSW on 24 October 2020. As such, the position may deteriorate even further as the economy appears to reopen.

Caveat

- As noted throughout this report, there is no precedent upon which we can base our assessment of arrears and revenue loss. We have set out our assumptions and note we have had to make assumptions based on judgment and limited known information given the nature of COVID-19.
- Our assumptions are based on conditions known as at 1 June 2020 and may change as additional stimulus and relief measures are announced in the future.
- Given the lack of certainty, it will be necessary to monitor cash, actual results and forecasts on a regular basis.

Grant Thornton

granthornton.com.au