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A vibrant and sustainable Central Coast

Central
Coast
Council

10 November 2021

Ms Roslyn McCulloch
Commissioner
Office of the Commissioner
Central Coast Council Public Inquiry
Locked Bag 3018
NOWRA NSW 2541

Email: centralcoastcouncil.publicinquiry@olg.nsw.gov.au

Dear Commissioner,

Thank you for providing me with the opportunity to provide a submission-in-reply to the Public Inquiry into Central Coast Council.

INTRODUCTION

The purpose of this submission-in-reply is to provide context and transparency of the reasons driving the decisions made post the appointment of the Administrator in November 2020, which have been questioned throughout the public inquiry. It further provides an outline of the changes required and challenges faced by the Central Coast Council in managing the financial crisis. The timeline details at length the various 'trigger' points of where the organisation had to make key decisions and take action with limited time, constrained by the parameters set to Council by various government agencies. Furthermore, it highlights where the government entities were not working in a collaborative manner to support the Council.

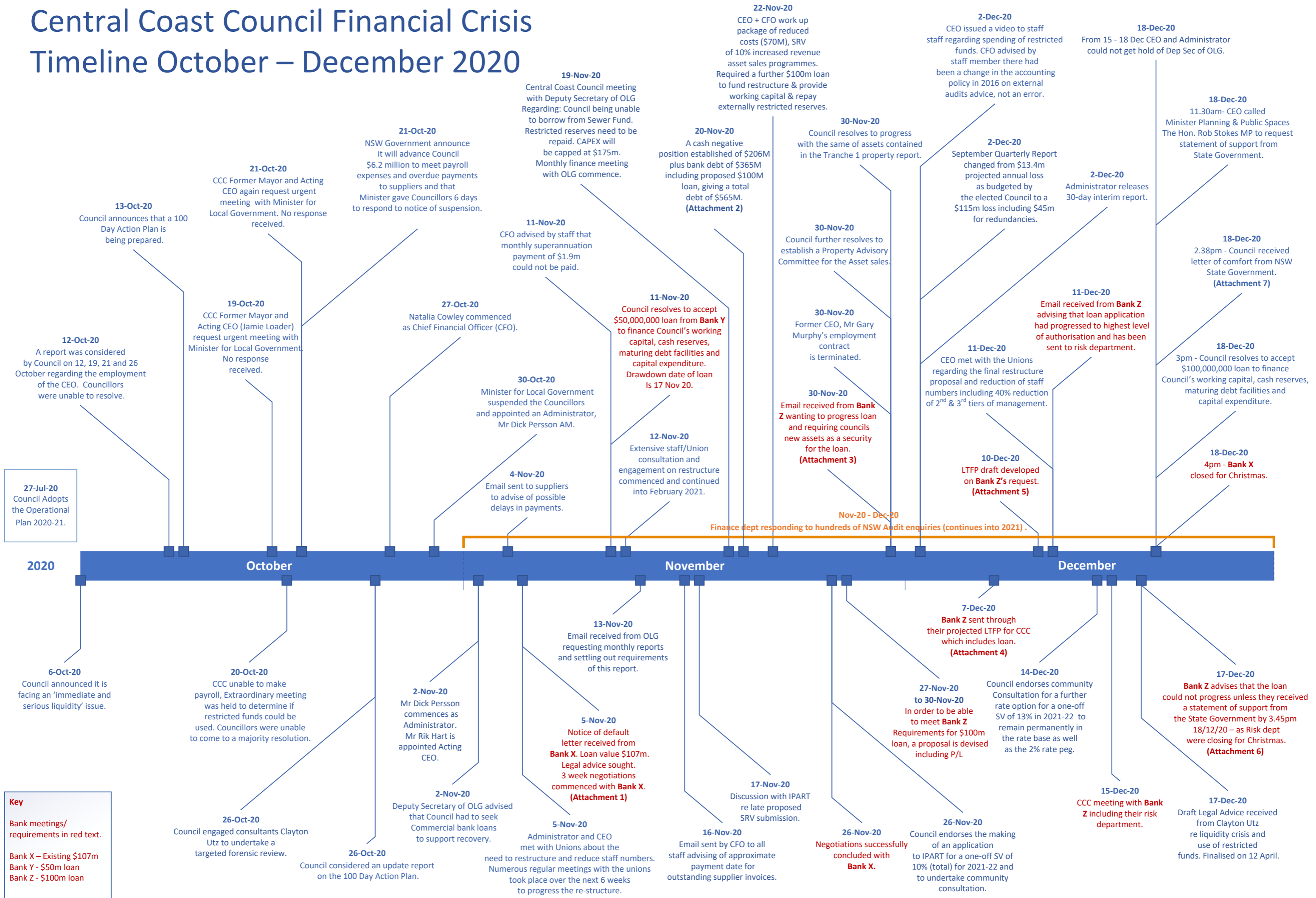


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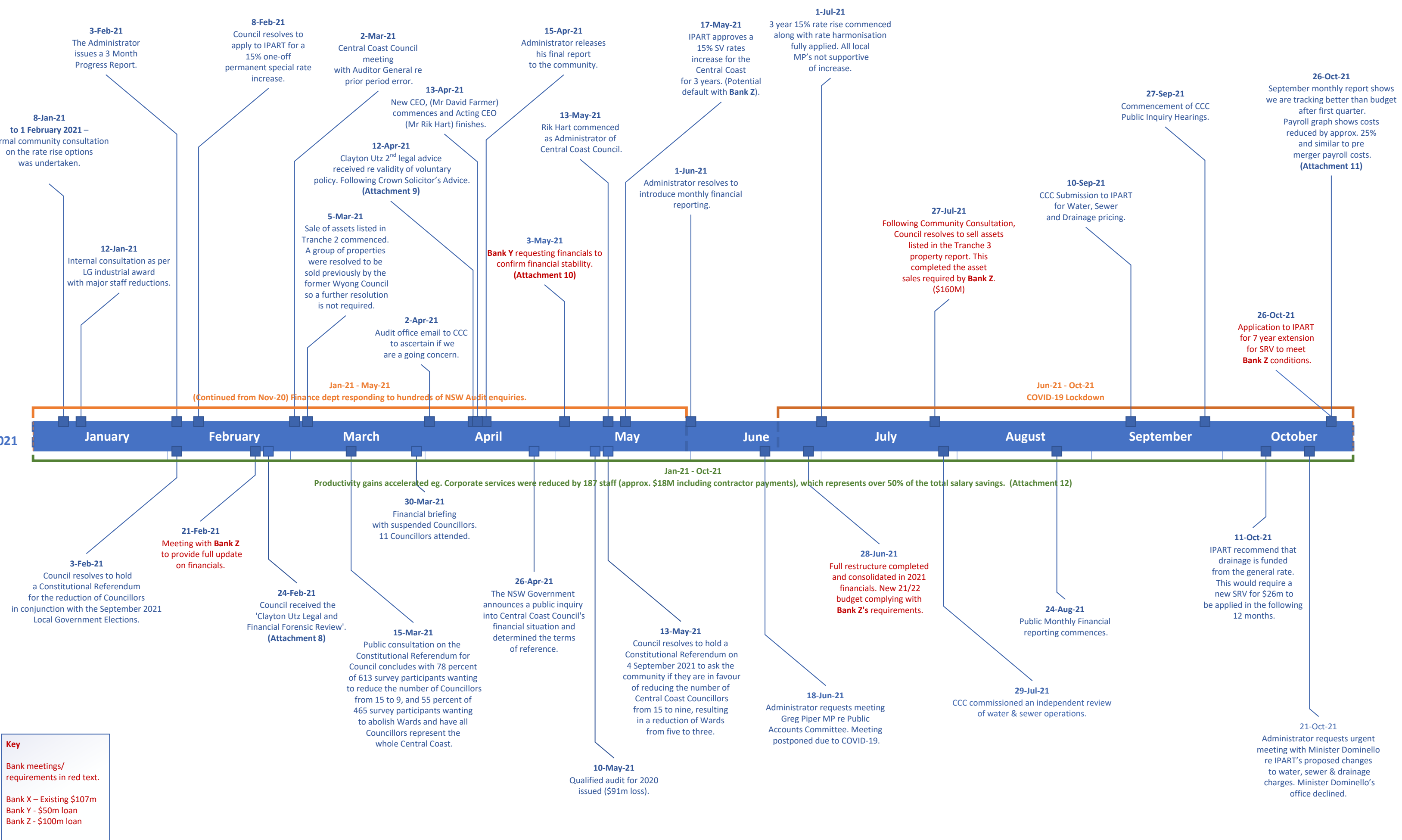
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Central Coast Council Financial Crisis Timeline October – December 2020



Central Coast Council Financial Crisis

Timeline January – October 2021



TIMELINE

This timeline outlines what Central Coast Council has been through in an extremely short timeframe to put Council back into a relatively stable financial position. In reviewing this, I can only hope it can be appreciated the fast-paced environment we were working within, the constraints placed on us, and the hard decisions required. Both the Chief Financial Officer (CFO) and I have previously worked in the private sector, experienced in receiverships and dealing with banks, which is why we knew we had to move very quickly. Fast action and quick decisions needed to occur, and the idea touted that the then leaders and Councillors could have achieved the same results is clearly incorrect based on a comparison between the 100-day plan prepared by the then executive and elected body with support by top tier external consultants, versus the business recovery plan produced by the Administrator and the then A/Chief Executive Officer.

The first two weeks in administration, the current CFO, Natalia Cowley, having arrived four days before me, was able to gain a handle on where Council was financially positioned at Quarter 1, September 30, 2020. At the end of September, the General Fund's cash position was \$206m in deficit. This means that Council had unlawfully used \$206m of restrictions, absorbing the entire internally restricted balance of \$109m and taking a further \$97m from externally restricted cash to fund operational and capital expenditure. The reason why this was unlawful is because the allocation of this funding was not resolved by Council, however there was no corruption in using those funds and the community has received the benefit of that expenditure through \$120m (over 3 years) of water and sewer holiday and the capital investment.

The elected Council had projected an operating loss of \$13m, however in reality this included over \$57m in unallocated targeted savings, which, when including \$45m in projected redundancy costs, led to a revised projected annual operating deficit at the end of Quarter 1 of \$115m, as presented on 2 December 2020.

Four days post commencing in the A/CEO role, Council received a letter of demand from one of Council's bankers to repay a loan book of \$107m. This was only resolved in Council's favour after approximately three weeks' of intense legal discussions.

Concurrently, in an effort to manage the cash flow, the CFO and I wrote to our creditors and made calls to numerous small businesses advising that we would be delaying payment. I had the Unions requesting to meet to receive assurances that Council was going to meet its staff and superannuation obligations following the headlines that Council were unable to pay staff.

It is important to note, that prior to commencing in the role, I was informed by Office of Local Government that Council 'had the powers to tax and therefore [we were] to approach the solution by obtaining commercial loans from the banking industry, as [we are] a good bet'. In addition, post commencement the CFO and I approached the NSW Government seeking permission to borrow from the sewer reserve, but this was declined on numerous occasions. Council was again instructed that the only way forward was to seek external bank loans.

The CFO managed to secure from another bank a \$50m loan, this was received within 10 days which enabled us to pay the creditors run and staff for the next few weeks. Unfortunately, from our cash flow forecasts, we knew we were going to run out of cash again by Christmas. We were limited in which banks we could approach, and no one was prepared to talk to us apart from one bank that showed interest. Council then had to develop a Long-Term Financial Plan (LTFP) which produced the surpluses necessary to repay the loans (both principle and interest), as the bank was demanding we had the ability and capacity to repay back the loan. It was a condition of our discussion with the NSW Government to repay back the unlawfully used funds.

In response to the fact the cashflow forecast projected that Council required a further \$100m, contrary to the usual securities, the bank was insistent upon securing the loan against Council's capital assets. In order to be able to meet its financial obligations including redundancy payments, while also demonstrating a \$50m reduction in employee costs and materials and contracts, and over \$60m in asset sales program to turn this Council around, this was still insufficient for the bank to provide a loan without a statement of support from the NSW Government.

Despite negotiations with the bank and their risk team across two and a half weeks, it came down to the last Friday before Christmas and we still had no loan. We were given the ultimatum by the bank that if we did not have a signed statement of support by 3.45pm on that day, the opportunity would be missed as the risk team were disbanding for the Christmas break. As A/CEO, I was facing the stark reality of closing the doors, informing staff and creditors that we would not be able to meet any financial commitments after 1 January 2021.

Attempts to contact the Office of Local Government and the Minister for Local Government at this time proved fruitless. In desperation, I resorted to placing a call to the Minister for Planning, Rob Stokes MP seeking assistance with securing the signed statement of support. The Minister for Planning responded promptly and at 2.38pm we received a signed statement of support. At 3pm the then Administrator, Dick Persson resolved to accept the offer of the loan of \$100m.

Concurrently with the above we approached IPART with the intent of applying for a permanent 13% SRV plus the 2% rate peg (15%) to deliver the revenue required as per the Long-Term Financial Plan. IPART allowed Council to depart from the normal schedule and truncate the timeframe of putting together an application due in the first week of February. At the same time, we were commencing the consultation process to remove 690 positions and to downsize the second and third management tiers by 40%.

By the time the new CEO, David Farmer arrived in April 2021 we were most of the way through the recovery phase. Whilst the finance team was downsized by approximately 25%, they were now producing monthly accounts well ahead of schedule and were also finalising the 2020 audited financial statements. In May, I took over the role of Administrator. It is worth noting that all the financial information produced from November 2020 onwards was obtained from the current IT and finance systems without any new software adjustments or changes.

Over the 12-month period I've been at the Council, I have formed the view that the State Government did not fully understand the consequences of the initial decision to request that we seek commercial funding to support the business. Our experience to date is that none of the state government agencies - Independent Pricing and Regulatory Tribunal (IPART), Department of Planning, Industry and Environment (DPIE), Office of Local Government (OLG) and NSW Audit Office had any experience in dealing with a local government entity being effectively placed into receivership and being required to seek commercial loans. The following decisions further complicated Council's ability to financially recover, such as:

- the temporary special rate variation instead of the requested permanent one,
- the qualification of Council's opinion despite unequivocal legal advice received, and
- the inability to use Council's sewer reserves.

This showed little regard to the fact that Council has operational constraints driven by the three major Australian banks that are requiring constant financial reporting, clear historical track record proving the achievement of financial sustainability and the contracted repayment of debt. This lack of understanding from these government agencies was evident through lack of responses to meeting requests and phone calls as indicated in the timeline and in addition to the inadequate decisions mentioned above.

Initially, the local politicians behaved similarly to that of the Councillors by actively campaigning against the proposed recovery plan, particularly the asset sales and SRV application, which indicated their sheer lack of understanding of the challenging position Council was placed in. Without the statement of support from NSW Government we would have had to close the doors of Central Coast Council, it was that dire. Meanwhile suspended Councillors continued to blame one another rather than being part of solving the problem, this was evident in briefings undertaken and their response to the issues being managed.

PUBLIC INQUIRY HEARINGS – CLARIFICATION ON RECORD

Following the public inquiry hearings and upon reviewing the transcripts, there is some key information provided by various witnesses that requires correction. In particular is the testimonies of Mr Brian Halstead and Mr Graham Sansom. I believe the below covers the main points and is evidence of the factual inaccuracies in both submissions and testimonies, and are of importance to note.

In addition, at Attachment 13 is a further email between the then CFO, Craig Norman and former CEO, Gary Murphy, and a note from Carlton Oldfield which perhaps provides an insight into the culture existing between finance and the rest of the organisation. The email from Gary Murphy is suggesting seeking further borrowing, cheaper rates and buying time which is pivoted on Carlton Oldfield's statements on 20 April 2020 stating, 'they needed to focus on how they came to be in our current financial position'. This is an unrealistic question to ask if this was all due to COVID as that would clearly give away the answer. This suggests that there was a bigger agenda at play that was being packaged. If there had been unrestricted cash available Gary, Craig and Carlton would not have needed to seek TCorp or buying time for dept refinancing.

For ease, I address each of these statements directly from each respective transcript with the correct information detailed below each statement.

Mr Brian Halsted – 18 October 2021

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21 Depreciation showed increasing - small increases, it
22 was inconsistent with the huge capital expenditure in
23 total. And the depreciation was increasing only slowly.
24 An example of that is that, in the year 2022, the
25 administrator had said the depreciation would be
26 130 million and the last budgets that came out in the July
27 results said the depreciation would be 177 million. Now,

The depreciation amount published in July 2021 is correctly stated at \$177m. The Administrator reported amount is incorrectly stated at \$130m. The Administrator announced a depreciation target of \$170m for FY 20/21, as reported in this article on 25th March 2021

<https://coastcommunitynews.com.au/central-coast/news/2021/03/rik-hart-reveals-the-gritty-detail-of-councils-financial-crisis/>. The amount projected for FY 21/22 was \$175m, which was finalised at \$177m in the Operational Plan for FY 21/22. A year earlier, the audited depreciation for FY 19/20 was \$157m. There was never a discussion about \$130m.

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38 '17, when he showed the restricted cash by fund. This did
39 not appear again until July 2021, and at that stage, he
40 lent out of the general fund \$20 million to the water fund
41 to cover the unrestricted amount.

The statement about lending \$20m to the Water Fund from the General Fund is incorrect. As per the July 21 Investment Report below, the amount was \$10m, which was temporarily allocated to cover the Water Fund's unrestricted cash deficit from the General Fund's internal restrictions – as per the table below:

Background

Council's investments are made in accordance with the Local Government Act 1993, Local Government (General) Regulation 2005, the amended Investment Policy adopted at the Ordinary Council Meeting on 3 February 2021, Ministerial Investment Order issued February 2011 and Division of Local Government (as it was then known) Investment Policy Guidelines published in May 2010.

Current Status

Council's current cash and investment portfolio totals \$464.98 million at 31 July 2021

Council's Cash and Investment Portfolio by Source of Funds

Source of Funds	Value (\$'000) July 2021
Investment Portfolio	\$450,267
Transactional accounts and cash in hand	\$14,712
Total	\$464,979
Restrictions as at 31 July 2021	\$427,114
Unrestricted Funds as at 31 July 2021	\$37,865
Total consolidated Funds	\$464,979

Council's Portfolio is held in separate funds by purpose and is summarised as follows:

Fund	General Fund	Water Fund	Sewer Fund	Drainage Fund	Waste Fund	Total
External Restricted Funds	\$176,650	\$6,308	\$22,249	\$36,235	\$93,026	\$334,468
Internal Restricted Funds	\$90,688	\$1,026	\$877	\$55	-	\$92,646
Total Restricted Funds	\$267,338	\$7,334	\$23,126	\$36,290	\$93,026	\$427,114
Unrestricted Funds	(\$34,209)	(\$10,191)	\$111,981	(\$36,818)	\$7,102	\$37,865
Total funds by Fund	\$233,129	(\$2,857)	\$135,107	(\$528)	\$100,128	\$464,979

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9 \$100 million. It appears, on my review of the accounts,
10 that only in August '20 the externally restricted funds
11 were used, and the maximum I calculated was about
12 30 million.

The above statement is incorrect – both in terms of date and amounts. As you can see from the table below, as at 30 June the General Fund’s unrestricted cash deficit of \$175m not only absorbed the entire \$109m internally restricted balance but also \$66m of external restrictions. As at 30 September, the General Fund’s unrestricted cash deficit of \$206m absorbed the entire \$109m internally restricted balance and also \$97m of external restrictions.

General Fund	30-Jun-20	30-Sep-20
Restricted - external	160,569,234	169,245,562
Restricted - internal	109,199,558	109,106,281
Unrestricted	<u>(175,401,287)</u>	<u>(205,884,851)</u>
Total Funds	<u>94,367,505</u>	<u>72,466,992</u>

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17 \$112 million, to me is not relevant. The council could
18 have an inter-fund loan from sewer to the general fund for
19 that amount. This is the process that the first
20 administrator went through when he lent money out of the
21 general fund to the water fund. So the fact that the money
22 was unrestricted means that it's capable of being lent to
23 another fund.

This statement is incorrect. As per the well documented legal advice (excerpt provided below), all funds within Water and Sewer are externally restricted. An internal loan from the Sewer Fund to the General Fund can only be given through a Ministerial Approval, which **was not** granted to Council – on the advice of the OLG. On the other hand, no Ministerial Approval is needed to lend funds from the General Fund to the Water Fund – so that is not a relevant comparison. In addition, Council could not make use of section (b) in the legal advice below because neither the Water Fund or the Sewer Fund made profits, so no dividends were able to be paid. The **ONLY** option available to Council was an external bank loan. This is also the answer to the same misunderstanding in Mr Samson’s report.

Ministerial approval for limited ulterior uses

- 4.8 There are only two ways that Council can use externally restricted funds levied for sewerage or water services for purposes other than which they were levied:
- (a) by way of internal loan, with approval of the Minister for Local Government. The Minister must impose conditions as to the time for repayment and any interest to be paid (section 410(3) and (4)); or
 - (b) by use of any capital return of investment (dividends) earned on the water and sewerage funds, with approval of the Minister for Water, Property and Housing (section 409(5)-(8)).

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32 The \$86 million in the domestic waste fund is amounts
33 paid by the ratepayers for the service that was greater
34 than the cost of the service, and this could have been lent
35 to avoid the external interest costs.

Most of the cash in the Domestic Waste Fund is externally restricted, so they could not be internally lent out. In addition, as per the above, Ministerial approval was not granted to Council for any inter-fund lending.

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1 Then I would like to go on to the question about the
2 debt that I asked the council to provide information on.
3 It was often quoted that the council had \$565 million worth
4 of debt. I asked the council on a number of occasions how
5 this was calculated and I did not get a satisfactory
6 answer, and I think the size of this figure had an impact
7 on the community's confidence in the council.

Page 2 of the Administrator's 30-day report, clearly sets out that the \$565m amount includes the unrestricted funds debt – which was \$200m. So, the bank borrowings were \$365m. Here's the excerpt from the Administrator's report:

- Accumulated debt [including funds required to be repaid to CCC Restricted Reserves] will be in the order of **\$565m**.

16 It's also interesting to note that the current
17 administrator is saying in the July investment report -
18 where, for the first time since May the unrestricted funds
19 are shown by fund again - he's saying, "Unrestricted funds
20 deficit is being funded through the general fund internally
21 restricted reserves". So what the administrator is saying
22 is that the unrestricted funds are being used. So he's
23 knowingly using the restricted funds, internally restricted
24 funds, to run the business day-to-day, which is similar to
25 what the previous council had been accused of and
26 criticised for doing.

This statement is incorrect. The key problem that made the use of the funds unlawful prior to the Administrator being appointed, was that there was no Council Resolution to allocate any unrestricted cash deficits against internal restrictions and therefore make those uses lawful. It's the act of resolving to use internal restrictions that makes the use lawful. Without those resolutions and allocations, the use of the funds is unlawful.

Mr Graham Sansom – 19 October 2021

Page 3 – Key issues & findings – 7th bullet point

to signs that its financial position was weakening. It appears that the administrative merger was still incomplete, and that financial systems, reporting and budgeting were not fit-for-purpose.

Council did not implement new financial systems or budgeting and yet the outputs were not only fit for purpose for Office of Local Government, the external auditors and the banks, but were also uploaded for public consumption on Council's website.

Page 4 – Key issue & findings – 2nd bullet point

- The claim made in late 2020 that CCC's use of its water and sewer funds was 'unlawful' was central to the case for suspension of the councillors and dismissal of the CEO but has since been placed in doubt by the Solicitor General. CCC's accounting policy may have been contrary to a 'preferred' interpretation of the legislation, but was found to be 'not without merit.' As a result, the Auditor-General has recommended legislative changes and/or policy guidelines to clarify required practice.

This statement is incorrect. The Administrator and Acting CEO were appointed by OLG and OLG instructed Council that if further restricted funds were used, the Administrator and Acting CEO will be dismissed immediately. Council was advised on multiple occasions that the Minister will not consider or grant Council the approval to borrow funds from the Sewer Fund and the only option available to Council was to seek a commercial loan. Whether or not the Crown Solicitor's alternative opinion is "not without merit" is irrelevant when OLG's directed parameters of operation, did not

allow that alternative option. So that alternative option might be of use for an academic admiration point of view, but it's not operationally feasible.

Page 4 – Key issue & findings – 3rd bullet point

- CCC's 'serious financial situation' reported in October 2020 concerned *accounting practice*, not an absolute shortage of funds. At 30 June 2020 the council had reserves of more than \$360m and external borrowings of only \$237m. Its problem was that the reserves were restricted funds and

As explained above, this is not entirely correct. The prohibition of using restricted reserves is an operational restraint imposed by the Local Government Regulator – Office of Local Government and backed by external legal opinion. The greyness introduced by the Crown Solicitor's opinion creates unnecessary confusion as that could not overturn OLG's directive.

Page 4 – Key issue & findings – 5th bullet point

the amount (some \$200m) that should be repaid to restricted funds. However, given the Solicitor General's later advice it may be that the council was never legally obliged to repay some or perhaps any of that amount.

Council was legally obliged to repay all externally restricted funds and it was operationally obliged to repay all internally restricted funds that could not be unrestricted.

CONCLUSION

The two timelines within this submission-in-reply provide a very clear picture of the sheer magnitude and limited timeframe Central Coast Council had in responding to the dire financial situation they found themselves in, contrary to Mr Sansom's opinion that there was time for an alternative approach rather than the one taken.

The vast contrast between the 100-day plan put in place by the suspended elected body prior to Administration, compared to the Business Recovery plan put in place whilst in Administration is evidence of the lack of courage and experience required to get Council back to a financial stable position.

Furthermore, is the initial lack of interest or understanding the State Government had in the issue at hand. As indicated earlier, I was of the view they did not fully understand or appreciate our financial situation, nor did they take the opportunity to completely get across the issues Council were faced with. So again, addressing the point Mr Sansom makes that it's as simple as having the Minister sign off to allow Council to borrow restricted funds, this was not the case. Council was explicitly instructed by OLG numerous times that Ministerial approval would not be forthcoming to allow Council to borrow from its restricted funds.

There are significant broader issues councils are continually faced with. The framework local government operates under is archaic, restrictive and conflicting. There are many examples of this. Particularly affecting Central Coast Council is the issue of funding its capital program from depreciation and contributions. This is further exacerbated by the State / Commonwealth providing capital grants which do not cover the ongoing maintenance of those assets and forces Council to seek additional revenue to cover the increase in operational costs. The net result is Council either applies to IPART for an SRV (revenue increase) in order to fund the depreciation or it essentially reduces its services. If the application is not granted the risk is the increase of backlog due to increased operational load with no extra revenue source. The current infrastructure backlog sits at approximately \$243m which is a clear indication that the two previous Councils were already caught in this cycle. The current Council budgets are not reducing that backlog as the surpluses in the LTFP are directed at repaying the loans over the next 10 years. The backlog will need to be addressed at a later date.

The IPART regulatory impact leads the community to believe that IPART controls councils' expenditure instead of the community understanding their role in holding the governing body (mayor and councillors) and management to account. Ultimately it is the community that ends up penalised, not the organisation.

One of the most confusing aspects in managing local government in NSW is the plethora of externally restricted reserves which cannot be used other than for which the purpose they were collected for, this is completely different to all private sector and federal and state accounting practices. A simpler approach would be to adopt the Queensland model where there are no restricted reserves other than those collected for developer contributions.

The banking industry should play a greater role in when a council applies for a loan in ensuring that the council is performing adequately and within OLG performance metric guidelines. This would be similar to the role Queensland Treasury play as the sole finance provider to local government.

Further to the financial crisis, ongoing challenges continually faced by the organisation is rebuilding the reputation of Council which manifests itself with difficulties in retaining and attracting staff. For example, in recent weeks we have advertised a number of managerial roles with not a single applicant and those roles have not been able to be filled, creating a further burden on existing staff. Potential candidates are concerned about joining the organisation when the imminent threat of impending redundancies is hanging over their head should the current SRV application not be granted.

KEY POINTS

- NSW Government underestimated the challenges Council would face going down the commercial route for lending.

- It is unclear how the NSW Government resolve a situation where a council is directed to go down a commercial route having no other option and yet IPART do not take the financial situation of a council under consideration.
- The banks that lend to councils should be looking closely and taking a greater interest in the financial performance in terms of the loan application.
- Consequences and ongoing challenges faced by the organisation include recruitment, maintaining staff, restoring our reputation within the community, sentiment of local members of parliament for political purposes.
- For consideration, if maintaining the current SRV for a further seven years is refused by IPART, Council will be placed in a position to go for two separate SRVs in the same year and commence service reductions.
- Unaligned government entities and the inability of government at the local and state level to work together.

RECOMMENDATIONS

Recommendation 1

That the Minister for Local Government hold the next general election for the Central Coast LGA in September/October 2022, and in conjunction with the Constitutional Referendum.

Recommendation 2

An independent adjudicator be appointment where the NSW Audit Office and Council have a conflict of legal opinions and reporting. For example, the treatment of restricted cash that led to a qualification and divergence of interpretation of legal opinions between Council and the NSW Audit Office.

Recommendation 3

It is essential that councils and communities are not left worse off by the NSW Government's infrastructure contributions reform agenda, namely the Environmental Planning and Assessment (Infrastructure Contributions) Bill 2021. While the modelling conducted under the NSW Productivity Commission (PC) Review indicates that the reforms will benefit councils, modelling conducted by individual councils and Regional Organisations of Councils (ROCs) refutes this conclusion, instead finding many councils will be negatively affected.

Recommendation 4

There is clear conflict between the Water Management Act and the Local Government Act which needs to be resolved between Central Coast Council and NSW Government. This Council is the only hybrid NSW council reporting under both Acts and this needs to be resolved. Central Coast Council has commenced this work.

Recommendation 5

If a financial crisis was to occur again for a council, NSW Government should ensure that lenders are advised of the imminent suspension of councillors so that a potential breach of the loan conditions is not invoked. Furthermore, government agencies should work closely together to assist the Council

rather than issuing 'demands or directions' which may be contrary to the commercial bank's lending criteria.

Recommendation 6

That the NSW Government reintroduce a financial note of internally and externally restricted and unrestricted funds into the accounting code, including a better definition of restricted funds that can be accounted for in the current ratio. This is to be reported in the quarterly and annual reports (this is under the assumption that the suggestion of removal of externally restricted funds as per the Queensland model is not implemented).

Recommendation 7

NSW Government investigate the Queensland model which does not require maintaining restricted funds other than developer contributions, as well as including the Queensland Treasury model whereby they are the sole provider of finance to councils at attractive interest rates and provide a banker's review of the financial performance of the organisation free of charge on a regular basis.

Recommendation 8

For the larger councils', consideration be given to there being a balance of councillors voted in and representative of the community, and up to 20% appointed based on qualifications and knowledge with voting rights ie. 3 out of 15 councillors would be appointed separately based on qualifications.

Attachments

- Attachment 1 - 5 November 2020 – Letter of default
- Attachment 2 - 20 November 2020 - Financial table
- Attachment 3 - 30 November 2020 – Bank requirements
- Attachment 4 - 7 December 2020 – Bank Z projected LTFP
- Attachment 5 - 10 December 2020 – CCC LTFP
- Attachment 6 - 17 December 2020 – Request from Bank for letter of comfort
- Attachment 7 - 18 December 2020 – Letter of comfort
- Attachment 8 - 24 February 2021 – Clayton Utz advice
- Attachment 9 - 12 April 2021 – Clayton Utz & Crown Solicitor's Advice
- Attachment 10 - 3 May 2021 – Bank Y request financials to confirm stability
- Attachment 11 - 26 October 2021 – Payroll graph
- Attachment 12 - Productivity gains
- Attachment 13 - An email between G Murphy & C Norman, and a meeting note by C Oldfield

Yours sincerely,

A handwritten signature in black ink, appearing to read "Rik Hart". The signature is written in a cursive style with a large initial "R" and a distinct "H".

Rik Hart
Administrator
Central Coast Council