

Budget 2015-2016

INTRODUCTION

Financial sustainability is a key challenge for all governments.

This Financial Sustainability Plan seeks to identify the specific challenges faced by Nillumbik Shire Council, and set some targets to guide Council's future decisions.

Council manages its finances through an annual Budget, which identifies the expected revenue and expenditure for a year. The Budget is the means by which Council makes a formal commitment of resources to provide funding for services and projects.

A medium-term perspective is provided by the Strategic Resource Plan (SRP), which forms part of the Council Plan. This provides a four-year forecast of revenues and expenditures based on a series of assumptions. It identifies the resources necessary to implement the Council Plan over the next four years.

However, neither the Budget nor the SRP provide targets for Council to achieve financial sustainability over the longer term. Decisions about investment in major projects, funding for renewal of existing infrastructure, management of debt levels, provision of new or expanded services, the level of fees and charges, applications for external grants, and the level of rates are all matters that require a long-term perspective.

Council needs to be able to make decisions for the short-term that are well-informed, and ensure that these decisions do not compromise Council's financial sustainability over the longer term.

The Financial Sustainability Plan provides this context. It begins by identifying the important characteristics of Nillumbik Shire that impact on financial sustainability. It then identifies a series of challenges that are presented to Council. Some of these are structural challenges that relate to the demography and structure of the municipality. Other challenges relate to legacy issues, or the impacts of policies of the State or Commonwealth governments.

The Financial Sustainability Plan then identifies a series of Financial Management Principles which Council will observe when making significant financial decisions. Finally, the plan sets some Financial Sustainability Targets which Council will use to monitor its progress towards sustainability.

The Strategic Resource Plan and the annual Budget will contain information from the Financial Sustainability Plan so that progress towards these targets can be transparently monitored.

NILLUMBIK IN CONTEXT

Nillumbik is an outer-metropolitan municipality located on the urban fringe of Melbourne. While small by metropolitan standards, Nillumbik is a medium-sized municipality in comparison to all Victorian councils.

Known as the 'Green Wedge Shire', Nillumbik comprises 432 square kilometres. It contains a relatively small urban area, where land use is predominantly residential. The other 90% of the shire is rural land located outside the Urban Growth Boundary, where land is used mainly for farming, conservation or rural residential purposes. Commercial and industrial land activity in the shire is very limited. Major activity centres at Eltham and Diamond Creek provide mainly retail services to local markets. Housing is mainly detached dwellings with relatively high numbers of residents per household. Providing a consistent level of service to remote communities in the rural parts of Nillumbik involves additional cost to Council.

Nillumbik has an estimated resident population of 62,724 and 22,881 rate assessments at June 2013. The relationship between these two factors is a critical issue for Council. Across all Victorian municipalities, the average ratio is 1.9 residents per rate assessment. In Nillumbik, there are 2.7 residents per assessment. This ratio is the highest in the state, and it means that each rate assessment in Nillumbik has to fund services for about 50% more residents than the state average. In simple terms, the demand is high (number of residents needing Council services and infrastructure) while the supply is low (number of property assessments from which rates are raised). This situation is essentially attributable to the absence of large scale commercial and industrial land use within the shire, and the predominance of larger family homes rather than smaller dwellings.

Nillumbik's population has a very high socio-economic profile. According to the Socio-Economic Index for Areas (SEIFA) data from the Australian Bureau of Statistics (as per the Victoria Grants Commission 2013-14 Annual Report), Nillumbik has the highest socio-economic ranking of any municipality in Victoria (1098.3). While this is a positive feature of life in Nillumbik, it also means that Council is negatively impacted in terms of entitlements to external grant funding particularly for those grants based on community disadvantage and need.

While Nillumbik has experienced a relatively high level of success in obtaining external grant funding for some specific projects in recent years, constrained budgets at State and Commonwealth government levels mean that Council cannot rely substantially on discretionary grant funding into the future. Recurrent grants have continued to demonstrate a long-term decline in real terms.

Nillumbik is smaller than most neighbouring municipalities and is less able to achieve the economies of scale that larger metropolitan councils enjoy. However Council has undertaken a series of service reviews and benchmarking studies over recent years which have confirmed that Nillumbik is relatively efficient in terms of its costs for service delivery. According to data from the Victoria Grants Commission, Nillumbik is well below the Victorian average for both rates and charges per resident (14% less than average in 2013-14), and expenditure per resident (37% less than average in 2013-14).

Council has an annual turnover of around \$80 million, and owns infrastructure assets valued at more than \$600 million. Apart from land, these assets comprise more than \$60 million in buildings, and around \$300 million in other infrastructure such as roads, bridges, drains and footpaths. Council's assets depreciate at more than \$9 million per annum. Funding the annual cost for renewal of these existing assets is a major issue for Council. Underspending on asset renewal does not represent a saving to Council as it merely defers the expenditure until future years.

Council has increased its loan borrowings in recent years to fund several major projects. This has seen the indebtedness level approach the threshold of the Auditor General's medium-risk range. Some further borrowings are already anticipated for major capital works projects. This means that Council has very little capacity for any further borrowings in the medium term. Sales of surplus assets may provide some funding however this is a non-recurrent source of revenue.

In summary, the characteristics of Nillumbik as outlined above mean that Council needs to rely heavily upon its own resources to fund services, renewal of existing infrastructure, and provision of new assets. A sufficient underlying surplus needs to be achieved after funding of recurrent costs, if Council is to have the resources to implement major infrastructure projects, without compromising asset renewal.

Opportunities to generate a surplus from fees and charges or from productivity savings in operating expenditure are likely to be of marginal impact. The restricted nature of Council's revenue-raising powers in the Local Government Act means that the underlying surplus will need to be funded primarily from rate revenue.

CHALLENGES

Like many Victorian municipalities, Nillumbik faces a number of challenges that require financial discipline and innovation to meet community needs. These include:

Structural and Demographic challenges

- Nillumbik has more residents per rate assessment than any other Victorian council. With 2.7 residents per assessment (compared to a state average of 1.8), Nillumbik rate assessments need to fund services for 50% more residents than the state average. The number of residents is the major factor in determining Council's expenditure needs, which means that rates per assessment in Nillumbik are relatively high, even though rates per resident are lower than the state average.
- Nillumbik is a small municipality by metropolitan standards, and is not able to achieve the economies of scale available to larger metropolitan councils. Despite this, spending per resident in Nillumbik is below state averages.
- Nillumbik is 90% rural by land area, however only a small proportion of the population lives in the rural area. This creates additional costs for servicing residents in the more remote parts of the shire.
- Despite being 90% rural, Nillumbik is designated as a metropolitan municipality and is not eligible for certain government grants that fund programs or projects for rural communities.
- The Nillumbik community has a very high socio-economic status (highest of any Victorian municipality). While this is a positive measure of community wellbeing, it does mean that Council receives a smaller share of government grants.
- An ageing local community will place more demands upon Council services in the years ahead.

Legacy challenges

- Rehabilitation of two former landfill sites at Plenty and Kangaroo Ground is required in accordance with EPA requirements.
- Council is liable to fund shortfalls in the Local Authorities Superannuation Fund Defined Benefit Plan. This was closed to new members in 1993 but all Victorian councils must still contribute if the fund's investment performance is not sufficient to meet entitlements of continuing and former employees.

Infrastructure challenges

- Council needs to address the funding gap for renewal and maintenance of existing infrastructure assets. Currently Council assets depreciate at more than \$9 million per annum. However despite incremental growth in capital works spending in recent years, Council in 2013-14 still only budgeted to spend around \$6 million per annum on renewal of these assets. Underspensing on renewal is not a saving, as higher costs will eventually be borne by future ratepayers.

- A number of Nillumbik's major facilities are quite old and require significant expenditure to upgrade them to contemporary standards, both in terms of community expectations and current design standards. Examples include the Eltham Leisure Centre and the Diamond Creek Community Centre.
- Local conditions present a number of infrastructure challenges for Council. Nillumbik has steep topography and is heavily treed, which both add to infrastructure and maintenance costs. Also, when much of Nillumbik was first subdivided, only low-scale infrastructure was provided. Community expectations for roads, footpaths and drainage are now different, and a higher level of infrastructure is often required.

Service challenges

- Council has increasing responsibilities for emergency management. Natural disaster events such as bushfires and floods have placed significant demands upon Council in recent years, both in terms of prevention measures (tree clearing, drainage improvements) and community recovery programs.
- Climate change adaptation represents a significant challenge in terms of droughts, fires, floods and other extreme weather events. There is also a significant community expectation that Council will take a lead role in environmental sustainability.
- Community expectations about the standard and range of services provided by Council continue to rise, however it is rare for existing service levels to be reduced to offset the cost impacts of new or enhanced service.
- Community expectations about consultation and engagement, and the use of technology to communicate with Council are also increasing.

Cost-shifting challenges

- Nillumbik continues to suffer from long-term declines in government grants for general services, and the erosion in the value of specific service grants. In recent years this cost was more than \$2 million.
- Changes to standards set by government often lead to a higher cost to Council in service delivery. Examples include expansion of preschool services, stricter requirements for power-line tree clearing, and higher standards for rehabilitation of former landfill sites.
- The imposition of state and federal government costs upon councils (e.g. landfill levy) increases costs for Council and ratepayers.

FINANCIAL MANAGEMENT PRINCIPLES

Local Government Act

The Local Government Act (s.136) identifies the following 'Principles of Sound Financial Management':

- Manage financial risks faced by the Council prudently, having regard to economic circumstances. These risks include:
 - The level of Council debt
 - The commercial or entrepreneurial activities of the Council
 - The management and maintenance of assets
 - The management of current and future liabilities
 - Changes in the structure of the rates and charges base
- Pursue spending and rating policies that are consistent with a reasonable degree of stability in the level of the rates burden
- Ensure that decisions are made and actions are taken having regard to their financial effects on future generations
- Ensure full, accurate and timely disclosure of financial information relating to the Council. In addition to these statutory principles, Nillumbik Shire Council will observe the following financial management principles.

Sustainable Budgeting Principle

Council will manage its finances to enable it to meet short-term requirements without compromising its long-term financial sustainability.

Council will budget to achieve both an operating surplus and an underlying surplus in each financial year.

Council will use the Auditor-General's indicators as an independent assessment of Council's financial sustainability, and will seek to maintain an overall low-risk score.

Cash Management Principle

Council will at all times maintain sufficient cash to meet its expenditure requirements, and will prudently invest any surplus cash according to statutory requirements and Council policy.

Asset Renewal Principle

Council will provide well-maintained infrastructure assets that are fit for purpose and provide the required level of service to the community.

Council recognises that the annual depreciation of existing assets represents a significant non-cash cost each year, and that failure to provide sufficient funding for asset renewal will increase the long-term cost to the community.

Council will progressively increase its funding for asset renewal in each budget until the full level of required renewal expenditure is achieved.

Council will prioritise the allocation of additional funding for asset renewal ahead of the creation of new assets. Asset renewal expenditure will be based on sound asset management plans and condition audits which will identify and prioritise works.

New Assets Principle

Council will develop new or upgraded infrastructure assets to meet identified community needs as established through policy, planning, research and consultation.

Council will establish sound cost estimates and project management plans prior to making budget allocations for such projects.

Council will maintain a long-term program for investment in new assets (and upgrades) to facilitate informed decision-making about significant investments and their funding implications. This program will be reviewed on a regular basis.

Loan Borrowings Principle

Council will make prudent use of loan borrowings for investment in new or upgraded assets. Council recognises that infrastructure assets are a long-term investment, and that borrowings enable the cost to be shared over time by current and future users to achieve inter-generational equity.

Council will preserve its borrowing capacity for larger capital works projects. In exceptional circumstances, Council may use borrowings for other significant externally imposed payment obligations (such as superannuation liability) which cannot be funded from rates in a single year.

Council will keep its overall debt at a sustainable level, and will aim to keep this within the Auditor-General's low-risk range. Council may exceed the low-risk threshold for a short period if Council considers that the opportunity to access external grant funding means that additional loan borrowings are justified.

Over the long-term, Council will aim to reduce its overall level of borrowings.

Inter-Government Funding Principle

Council will seek to maximise the level of grants and subsidies received from Victorian and Australian governments to achieve a fair share for the Nillumbik community.

Council will seek and accept external grant funding for projects provided that the acceptance of the funding is consistent with Council's long-term plans and will not compromise Council's principles or objectives.

Council will not seek grant funding for a project if the requirement for Council to provide matching funding would divert funding from Council's higher priorities.

Council supports the Intergovernmental Agreement that requires other levels of government to fully fund those services delivered by Council on their behalf.

Council will transparently report to the community on the level of cost-shifting where Victorian or Commonwealth Government funding is less than the full service cost.

Service Planning and Delivery Principle

Council will deliver high-quality, efficient services that meet contemporary standards and respond to identified needs and priorities for community health and wellbeing.

Council will undertake regular planning for services to ensure that resource levels are adequate to meet identified levels of demand from the community.

User Pays Principle

Council will set user fees and charges for certain services through its annual budget, and will determine movements in fees and charges with reference to changes in the cost of service delivery.

Council will apply competitive neutrality pricing principles to fees and charges for any services that are subject to market competition. Statutory fees determined by other levels of government will be set at that level.

Council will have regard to the following factors when determining the level of other fees and charges – user capacity to pay; equity in the subsidisation of similar services; addressing disadvantage in particular parts of the community; community and environmental benefits; and benchmarking of similar charges by other councils. The key principle that will apply is that the higher the level of private benefit, the higher the proportion that will be paid by the user, and the lower the level of Council subsidy.

Special rates and charges schemes will be used where appropriate and consistent with this principle and the provisions of the Local Government Act.

Property Portfolio Management Principle

Council will regularly review its property portfolio to achieve best fit between the portfolio and the identified current and future needs of the community.

Council will acquire property which is consistent with the objectives and priorities included in adopted Council strategies.

Council will dispose of property that is surplus to identified community needs, subject to a public consultation process prior to a decision.

Council will allocate the net proceeds from sale of public open space to the Public Open Space Reserve. Council will assess on a case by case basis the treatment of proceeds from sale of any land that was originally funded through special rate or special charge programs.

Council will allocate the net proceeds from any other surplus land sales to a reserve account to be spent only on:

- other land acquisitions that are strategically justified; or
- capital works, as identified through the annual budget process;
- capital works to other surplus land in preparation for sale; or
- reduction of debt principal

Reserve Funds Principle

Council maintains several financial reserve funds for specific future expenditure including landfill rehabilitation, development contributions and public open space.

Reserve Funds will be recognised as equity in Council's balance sheet and the cash that backs these reserves will be held as an investment asset in the balance sheet.

The cash within each reserve fund will be available for the purposes for which the reserve was created. Until the funds are used, the cash will be managed in line with Council's Investment Policy.

Budget Year Principle

Council will budget in each financial year for the income and expenditure anticipated to be incurred during that financial year.

If larger projects span two financial years, then Council will budget in each year for that part of the anticipated expenditure that will be incurred in that particular year.

If projects have substantially progressed but are not fully completed at the end of a financial year, the balance of the required funding will be carried forward to the following financial year.

Any other unspent funding at year end will be reviewed and may be reallocated for other purposes.

Transparency Principle

Council will be transparent in the preparation of its financial plans and budgets, and in the reporting of its financial performance through quarterly and annual reports, and through a mid-year budget review.

Council will be transparent in the level of subsidy (i.e. funding from rates) that it provides for different services, and will disclose the true cost of services by charging overhead costs to each service.

When considering new policies or plans, Council will identify the impact of any changes to operating or capital costs arising from this decision.

Productivity and Efficiency Principle

Council will ensure that services are efficient, and will regularly review its services consistent with the Best Value principles contained in the Local Government Act.

Council will maintain an appropriate mix of skills sets through internal staff resources (permanent and temporary) and external contractors for provision of different services.

Council will employ skilled and motivated staff through appropriate remuneration and workplace policies, while ensuring that there is efficient management of staff costs and numbers.

Council will invest in staff training, technology and equipment, to provide ongoing improvements in productivity.

When engaging external contractors, Council will use competitive processes to achieve the best outcome in accordance with Council's Procurement Policy and the tender requirements of the Local Government Act.

Rates and Charges Principle

Council will use rates to fund the balance of its net expenditure requirements after all other income has been applied.

Council recognises that expenditure requirements are primarily determined by the resident population of the municipality, whereas rates income is generated from property assessments. Council also recognises that Nillumbik has a very high level of residents per assessment relative to state averages, which means that rates per assessment are relatively high while rates per resident are relatively low.

Council will therefore manage its finances to keep the level of rates per resident at or below state averages.

Council will use differential rates as appropriate and in an equitable manner pursuant to the provisions of the Local Government Act.

Council will apply a Waste Management Charge as a fixed charge which recovers the full cost of waste and recycling services and landfill rehabilitation.

Council will apply a Municipal Charge to recover some of the administrative costs of Council, as provided in the Local Government Act. However Council will set the level of the Municipal Charge to transparently show the level of cost shifting and grant erosion incurred by Council.

TOWARDS FINANCIAL SUSTAINABILITY

Given the challenges and principles outlined earlier in this plan, the following section considers the issues that Council needs to address to achieve financial sustainability.

Council recognises the need to generate sufficient revenue to:

- Fund recurrent services for the community
- Renew existing infrastructure assets
- Undertake major capital works projects to provide new assets
- Grow services in response to identified community needs

Funding sources

Council's recurrent revenue (primarily rates) is currently sufficient to meet annual operating costs, and to fund part of the renewal needs of existing assets.

Council is therefore relying on other funds (grants, loans and land sales) to supplement its capital works program including renewal works.

Grant funding for capital works is not guaranteed on an ongoing basis, and both State and Commonwealth grant programs are expected to be more limited in future years.

Funding from land sales is an appropriate means of converting surplus assets into more productive assets, however there are only a limited number of properties that Council could potentially sell, so this does not provide an ongoing funding source.

Funding from loan borrowings is an appropriate means of funding investment in significant capital works. Council's current level of indebtedness remains within the Auditor-General's low risk range, however there is very limited capacity for further borrowings within that range. It is also desirable for Council to reduce its overall level of borrowings over the long-term, as this can enable funds to be redirected away from interest payments and instead used for capital works.

A long-term sustainable financial position needs Council to significantly increase the level of recurrent own-source revenue (i.e. rates) that is available for capital works. At a minimum this needs to cover the cost of asset renewal. Ideally, it should be sufficient for Council to also implement an ongoing program of asset upgrades and major capital works projects that meet identified community needs.

Capital works and asset renewal

As noted earlier, the existing level of own-source funding (rates) allocated to capital works on an annual basis (about \$6 million) is substantially less than the annual cost of asset depreciation (about \$9 million). As a result of this historical level of funding, Council has over many years accumulated a 'renewal gap'. The value of this gap is assessed through regular asset management plans and condition audits.

In 2013, it is estimated that Council has a renewal gap over the next ten years of \$10.4 million (being the gap between the required level of spending on existing assets, and the projected level of spending based on Council's existing Strategic Resource Plan).

Therefore, the challenge is for Council to establish a long-term approach that provides sufficient funding to close this renewal gap over the next ten years, so that existing assets are properly maintained, while also generating sufficient funds for new or upgraded assets that are required.

This Financial Sustainability Plan establishes targets for Council to significantly increase capital works funding from rates over the next ten years. Relevant measures are detailed in the following section.

Superannuation liability

In the immediate short-term, Council is constrained by the need to fund a superannuation liability related to the Local Authorities Superannuation Fund Defined Benefit Plan. Like councils throughout Victoria, Nillumbik was required to contribute additional funds to this plan in 2013 to meet a shortfall arising from the Global Financial Crisis.

Council has determined that this liability (\$4.6 million) will be funded in two stages. In 2013-14 Council has budgeted for \$1.9 million for this purpose, and further funding of \$2.7 million is proposed to be budgeted in 2014-15.

After this liability has been fully funded, Council will have capacity to address the issue of additional capital works funding from 2015-16 onwards.

Service levels

Apart from asset renewal and capital works, Council also needs to ensure that adequate funding is available for services to meet changing community needs, population growth and to satisfy statutory requirements. Increases to service levels are transparently identified through the annual budget process as 'New Initiatives' when they are initially funded, and in subsequent years they become part of the Operating Budget and require ongoing annual funding. The New Initiatives budget category also includes non-capital projects such as development of policies and plans that are funded in a specific year, but do not require recurrent funding.

During the period from 2006-07 to 2008-09 Council allocated just over \$1 million each year to New Initiatives. However following the Black Saturday bushfires in early 2009, Council redirected a significant part of the annual New Initiatives budget into bushfire recovery and fire prevention programs. Part of the expenditure for additional fire prevention works is now ongoing, which means that the level of funding available on an annual basis for New Initiatives has now reduced to around \$700,000 per annum. In real terms, this is significantly less than the \$1 million per annum that was historically budgeted for New Initiatives.

In terms of those New Initiatives which involve ongoing services, recurrent funding also needs to be available in subsequent years after they are initially funded. In 2013 the Strategic Resource Plan assumes growth of \$200,000 per annum for this purpose (which is equal to 0.2% of annual operating costs). Given that Nillumbik's population is forecast to grow at around 0.5% per annum, a corresponding level of real growth in service levels would require average funding growth of around \$350,000 per annum rather than the existing \$200,000.

Therefore, Council acknowledges that for financial planning purposes, the appropriate future level of funding for New Initiatives is around \$1 million per annum, with \$350,000 per annum of this to become recurrent in subsequent years.

However the actual level of New Initiatives (whether recurrent or not) that are funded in any particular year is primarily a decision that Council makes in the context of policy priorities for services, rather than an issue of long-term sustainability. It is therefore not proposed to establish a Financial Sustainability Target for New Initiatives. However Council will aim to align the Strategic Resource Plan to the projected level of New Initiatives funding that is required over coming years.

Summary

In summary, progress towards financial sustainability for Nillumbik needs to focus on the following issues:

- Adequate annual funding for ongoing renewal of existing assets
- Adequate funding to upgrade assets and develop new assets
- Minor increases in funding for service growth (New Initiatives)

The next section of this plan identifies measures and targets that Council will use to monitor its progress in addressing these issues.

FINANCIAL SUSTAINABILITY MEASURES AND TARGETS

The measures and targets detailed in the following table have been prepared in the context of the challenges, principles and issues identified in previous sections of this plan.

These provide a basis to plan for Council's progress in terms of financial sustainability, and then to monitor that progress on an ongoing basis.

Some of these targets are used by the Victorian Auditor-General to assess the financial sustainability of each council in Victoria. Further detail on these measures is available in the Auditor-General's annual report on these targets.

Other measures have been included to track Council's progress towards sustainability, particularly in relation to the identified priority issues of asset renewal and capital works funding.

Measure	Target for Nillumbik
Auditor-General Measures	
Overall sustainability assessment	Low risk (green light)
Underlying Result ratio	Low risk (green light)
Liquidity ratio	Low risk (green light)
Self-financing ratio	Low risk (green light)
Indebtedness ratio	Low risk (green light)
Capital replacement ratio	Low risk (green light)
Renewal gap ratio	Low risk (green light)
Other Measures	
Adjusted Underlying Result (excluding capital grants)	Surplus
Budgeted Rate Determination (cash basis) surplus	\$100,000 or higher
Own source (rates) revenue allocated to capital works	>5% higher than previous year
Own source (rates) revenue allocated to capital works	>Depreciation
Renewal gap value (STEP 10 year gap)	Reduce from \$10m to zero
Asset management plans updated and asset condition audits completed each year as per program in Asset Management Strategy	100% of annual program completed

MONITORING, REPORTING AND REVIEW

Successful implementation of this Financial Sustainability Plan will require ongoing monitoring and reporting of progress by Council in meeting the targets.

Some targets are expected to be met every year, while some other targets will take time for Council to achieve over the short or medium term.

It is expected that all targets will be met over the 10 year timeframe of this plan.

Annual Monitoring and Reporting

Council will provide forecasts each year in its Budget and Strategic Resource Plan update regarding the projected performance against the measures and targets. This will commence with the 2014-15 Budget, and will provide 10 year forecasts of projected performance.

Council will then report in each Annual Report on its actual performance against these targets.

Further monitoring will also be provided through the annual Auditor-General's report on financial sustainability for Victorian councils, and through Nillumbik's participation in annual audits as part of the STEP asset management program.

Four Year Review

The overall Financial Sustainability Plan will be reviewed every four years following each general election.

This will provide the opportunity for the newly-elected Council to review the challenges, principles and issues, and update the measures and set targets for the following ten year period, so that these are consistent with the new Council Plan and Strategic Resource Plan.

Victorian Auditor-General's Office
Local Government financial sustainability indicators

Figure 4A
Financial sustainability indicators







Indicator	Formula	Description	Councils
Underlying result (%)	Adjusted net surplus / Total underlying revenue	A positive result indicates a surplus, and the larger the percentage, the stronger the result. A negative result indicates a deficit. Operating deficits cannot be sustained in the long-term. Underlying revenue does not take into account non-cash developer contributions and other one-off (non-recurring) adjustment.	✓
Liquidity	Current assets / Current liabilities	This measures the ability to pay existing liabilities in the next 12 months. A ratio one or more means there is more cash and liquid assets than short-term liabilities.	✓
Self-financing (%)	Net operating cash flows / Underlying revenue	Measures the ability to replace assets using cash generated by their operations. The higher the percentage, the more effectively this can be done.	✓
Indebtedness (%)	Non-current liabilities / Own-sourced revenue	Comparison of non-current liabilities (mainly comprised of borrowings) to own-sourced revenue. The higher the percentage, the less able to cover non-current liabilities from the revenues they generate themselves. Own-sourced revenue is used (rather than total revenue) because it does not include capital grants, which are usually tied to specific projects.	✓
Capital replacement	Capital spend / Depreciation	Comparison of the rate of spending on infrastructure with its depreciation. Ratios higher than 1:1 indicate that spending is faster than the depreciating rate. This is a long-term indicator, as capital expenditure can be deferred in the short-term if there are insufficient funds available from operations, and borrowing is not an option.	✓
Renewal gap	Renewal and upgrade expenditure / Depreciation	Comparison of the rate of spending on existing assets through renewing, restoring, and replacing existing assets with depreciation. Ratios higher than 1:1 indicate that spending on existing assets is greater than the depreciation rate. Similar to the investment gap, this is a long-term indicator, as capital expenditure can be deferred in the short term if there are insufficient funds available from operations, and borrowing is not an option.	✓

Risk assessment criteria for financial sustainability indicators

Risk	Underlying result	Liquidity	Indebtedness	Self-financing	Capital replacement	Renewal gap
High	Negative 10% or less Insufficient revenue is being generated to fund operations and asset renewal.	Equal to or less than 1.0 Insufficient current assets to cover liabilities.	More than 60% Potentially long-term concern over ability to repay debt levels from own-source revenue.	Less than 10% Insufficient cash from operations to fund new assets and asset renewal.	Equal to or less than 1.0 Spending on capital works has not kept pace with consumption of assets.	Equal to or less than 0.5 Spending on existing assets has not kept pace with consumption of these assets.
Medium	Negative 10% to zero A risk of long-term run down to cash reserves and inability to fund asset renewals.	1.0–1.5 Need for caution with cash flow, as issues could arise with meeting obligations as they fall due.	40–60% Some concern over the ability to repay debt from own-source revenue.	10–20% May not be generating sufficient cash from operations to fund new assets.	1.0–1.5 May indicate spending on asset renewal is insufficient.	0.5–1.0 May indicate insufficient spending on renewal of existing assets.
Low	More than zero Generating surpluses consistently.	More than 1.5 No immediate issues with repaying short-term liabilities as they fall due.	40% or less No concern over the ability to repay debt from own-source revenue.	20% or more Generating enough cash from operations to fund assets.	More than 1.5 Low risk of insufficient spending on asset renewal.	More than 1.0 Low risk of insufficient spending on asset base.

The overall financial sustainability risk assessment is calculated using the ratings determined for each indicator is as follows:

Overall financial sustainability risk assessment

	High risk of short-term and immediate sustainability concerns indicated by either: <ul style="list-style-type: none"> • red underlying result indicator or • red liquidity indicator.
	Medium risk of longer-term sustainability concerns indicated by either: <ul style="list-style-type: none"> • red self-financing indicator or • red indebtedness indicator or • red capital replacement indicator or • red renewal gap indicator.
	Low risk of financial sustainability concerns—there are no high-risk indicators.
	An upward trend.
	No substantial trend.
	A downward trend.

Source: Victorian Auditor-General's Office.