13.2	FINANCIAL UPDATE MID-YEAR 2022-23 FINANCIAL REVIEW
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1. PURPOSE

1.1 To provide Council with an overview of the results of the second quarter 2022/23 performance to budget and seek approval for one unbudgeted item to be funded from the surplus.

2. EXECUTIVE SUMMARY

2.1 A fiscal budget is adopted by Council for the following financial year by June 30 each year. The budget is prepared between February through June using information and estimates available at the time.

2.2 Budget 2022/23 was adopted at the 29 June 2022 Special Council meeting with a cash surplus of $1.55 million. The cash surplus target was revised as part of the 10-year Financial Outlook to $2.7m for the development of Budget 2023/24.

2.3 Since then, the cash surplus has further improved to $5.79m as the Reserve Bank has increased interest rates several times resulted in higher investment income and Council has seen significant improvements in parking utilisation and revenue.

2.4 The mid-year Budget 2022/23 review expects Council to achieve a cumulative cash surplus for 2022/23 of $5.79 million (excluding the additional initiatives subject to Council consideration), an increase of $4.2 million on Budget 2022/23 (see Attachment 1).

2.5 It should be noted that the organisation is facing a higher than the historical average staff vacancy rate, which is placing pressure on existing staff to respond to increased service volumes and backlogs to meet service levels and project delivery. Some roles are very difficult to recruit in the current market resulting in salaries and wages underspends. However, these savings will be used to offset the net additional enterprise employee costs (including vacancies) required based on the in principle enterprise agreement subject to Fair Work Australia ratification.

As outlined in section four, Council's financial sustainability risk is expected to achieve an overall low risk rating based on projections resulting from the mid-year quarter review (as budgeted).

That said, there are external and internal factors that may negatively impact our financial performance including high inflation which is increasing the cost base of core services, an in-principle Enterprise Agreement (subject to a vote over January and February and subsequent approval), ongoing issues with staff retention and recruitment and childcare centres experiencing low utilisation. Strategies are being developed to manage and mitigate the financial impact of these risks for the remainder of 2022/23.

2.6 As at 31 December 2022, ongoing efficiency savings of $0.66 million were achieved and $0.58 million one-off additional efficiency savings were achieved across successful capital project tenders (savings ring-fenced in the Asset Renewal Fund).

The Project Portfolio has reduced from Budget 2022/23 by net $14.4 million to a total of $56.8 million. This is $11.9 million less than what was forecast in the 10-year financial outlook. There are a number of key reasons causing the delays in delivering the portfolio including resourcing and recruitment, procurement challenges, external dependencies (such as utility connections, private developments, tenants, etc.) and external approvals (see both portfolio achievements and deferrals outlined in Attachments 2)

2.7 As part of the mid-year budget review, authorisation is requested for Officers to develop a package of maintenance works (mainly grass and planting) with the Department of Transport (DoT) on state infrastructure at Council's current service level. The estimate value of works is approximately $500,000 and DoT is to provide the majority of funding.

3. RECOMMENDATION

That Council:

3.1 Notes that following the mid-year budget review 2022/23 the Council is projecting a full year cumulative cash surplus of $5.79 million which compares favourably to the 10-year Financial Outlook by $3.2 million and Budget 2022/23 by $4.2 million.

3.2 Notes attachment 1 – Financial Statements with accompanying explanatory notes.

3.3 Notes Attachment 2 – material portfolio achievements, high risk projects and deferrals including key reasons identified as part of the mid-year budget review 2022/23.

3.4 Notes Budget 2023/24 development will take into consideration the updated forecast cash surplus, the increased project portfolio deferrals to 2023/24, as well as the economic environment that Council is operating in.

3.5 Approves the CEO to work with the Department of Transport to develop a package of maintenance works on state infrastructure at Council's current service level. The package is estimated at up to $500,000 which the Department of Transport is to provide the majority of the funding. The outcome of the agreement will be presented in the CEO report.

4. KEY POINTS/ISSUES

4.1 The organisation carries out a monthly review of all operating revenue and expenditure as well as the project portfolio.

4.2 The results of the mid-year 2022/23 review are presented to Council using two sets of performance reporting instruments:

4.2.1 The Comprehensive Income Statement Converted to Cash.

4.2.2 The Victorian Auditor General Office's (VAGO) Financial Sustainability Indicators.

Comprehensive Income Statement Converted to Cash

4.3 We use the Comprehensive Income Statement Converted to Cash to ensure prudent financial management by maintaining a modest cumulative cash surplus.

4.4 The mid-year budget review 2022/23 projects Council to achieve a cumulative cash surplus for 2022/23 of $5.79 million (excluding the additional initiatives subject to Council consideration), an increase of $4.2 million on Budget 2022/23 (Attachment 1).

4.5 The improvement in cash surplus is primarily caused by improving interest income as a result of higher than anticipated cash available for investment, higher investment returns (average of 4.23%), increased parking income due to improved utilisation at South Melbourne Market and foreshore precincts, and an increase in parking infringement income.

4.6 It should be noted that the organisation is facing a higher than the historical average staff vacancy rate, which is placing pressure on existing resources to respond to increased service volumes and backlogs to meet service levels and project delivery. Some roles are hard to recruit. However, these savings will be used to offset the net additional enterprise employee costs (including vacancies) required based on in principle enterprise agreement (subject to voting and Fair Work Australia approval)

4.7 As at December 2022, an operating surplus forecast of $1.15 million which is an improvement on budgeted operating deficit of $3.38 million. Net revenue is favourable by $3.68 million and net expenditure also favourable by $0.86 million. Full details are contained in Attachment 1 for financial statements including full commentary on variances. The following section provides a high-level overview of key movements.

4.8 Net income increases of $3.68 million mainly due to:

4.8.1 Net increase of $3.1 million in other income predominately due to increasing interest income due to favourable cash holdings and increasing investment yields from recent Reserve Bank increases to the cash rate.

4.8.2 Net increase of $1.86 million in operating grant income predominately due to additional grants received (offset by additional expenditure) for St Kilda Festival, Food Relief Activities, Metro Tunnel 2 for 1 Tree Planting, and Graffiti Mitigation.

4.8.3 Net increase of $0.8 million in statutory fees related to parking infringement income due to full complement of parking enforcement officers and increased activities in the foreshore/tourist area.

4.8.4 Net decrease of ($1.99) million in capital grant income (timing only) predominately to project delays to future years delaying receipt of grant income. This includes funding for Park Street Bike Link, Moubray Street Community Park, Palais Theatre and Luna Park Precinct, Elder Smith Netball Courts and Pavilion, Blackspot Inkerman Street Westbury and Alma Park Play Space Upgrade.

4.8.5 Net decrease of ($0.12) million in user fee income due to a reduced childcare centre fees due to lower utilisation (partially offset by reduced expenditure) and the cancellation of South Melbourne Market Direct program (offset by reduced expenditure). This is offset by an increase in paid parking at the South Melbourne Market and foreshore/tourist areas due to increasing utilisation.

4.9 Net expenditure reduction of $0.86 million mainly due to:

4.9.1 Net increase of ($0.3) million in employee costs due $1.0 million additional employee costs required based on in principle Enterprise Agreement offset by $0.7 million lower employee costs and savings due to enterprise wide vacancies. Staff retention and recruitment remains a challenge as was the case in the 2021/22.

4.9.2 Net loss from forecast property sale and project write-offs increased by ($0.25) million. The cash proceeds will be ring-fenced in the Strategic Property Reserve.

4.9.3 Increase of ($1.65) million for operating project deferrals post budget adoption. Key deferrals include Department of Transport Pop Up Bike Lanes, COVID Safe Outdoor Activation Fund, Customer Experience Program, Electrical Line Clearance, and Carlisle St Carparks Strategy Execution (offset by reserves)

4.9.4 Increase of ($1.9) million for additional grant funded expenditure for St Kilda Festival, Food Relief, Graffiti Mitigation and Urban Canvas Program and Metro Tunnel 2 for 1 Tree Planting and reserve funded expenditure at the St Kilda Marina.

4.9.5 Reduction of $3.5 million operating project deferrals to 2023/24 and future years including In Our Back Yard, St Kilda Marina, Fishermans Bend Program and Temporary Park Lansdowne Road (offset by reserves)

4.9.6 Reduction of $1.0 million in depreciation due to lower capital delivery than initial budget portfolio.

4.10 Net capital expenditure reduction of $12.73 million mainly due to:

4.10.1 ($3.3) million of capital expenditure deferred from 2021/22 post budget adoption including Public Toilet Program across various sites, Childcare Centre Fence Compliance, Bubup Nairm Cladding Rectification Works, Fleet Renewal Program, South Melbourne Market - The Courtyard, New Dog Park Moran Reserve and other minor deferrals.

4.10.2 ($2.6) million of additional expenditure predominantly due to the purchase of land for the expansion of Pakington Street Reserve and other minor cost escalations for HVAC, Air and Energy Improvement Program and South Melbourne Town Hall Renewal and Upgrade (reserve funded)

4.10.3 Savings of $0.51 million (ringfenced in Asset Renewal Fund) predominately due to efficiency savings achieved through successful tenders Kerb & Gutter Construction – Wilton Grove, Laneway Construction – Wellington Street and Alma Road/Lansdowne Road Safety Improvements.

4.10.4 $18.1 million of project deferral to 2023/24 and future years, including key deferrals identified in the second quarter such as Palais Theatre Tunnels Rectification, Public Space Lighting – Elwood Foreshore, EcoCentre Redevelopment, In Our Backyard, Elder Smith Netball Courts and Pavilion, South Melbourne Market Amenities Upgrades and Regrading, South Melbourne Town Hall Renewal and Upgrade and Park Street Bike Link.

4.10.5 See Attachment 2 – for a full list of portfolio achievements and deferrals identified in the second quarter including commentary.

4.11 Net reserve drawdowns decreased by $13.25 million due to:

4.11.1 $8.6 million net increase to Contractual Reserves predominantly due to project deferrals reserve due to $11.2 million project deferrals for 2022/23 offset by $3.2 million deferrals post budget 2022/23.

4.11.2 $4.8 million increase to Strategic Reserves due to:

- $2.8 million net increase due to project delays for Palais Theatre, St Kilda Marina and In Our Back Yard Strategy.

- $1.00 million increase to the Strategic Property Reserve due to forecast property sales.

4.11.3 ($1.37) million net reductions to Statutory Reserves (Open Space Contributions) predominantly due to deferrals post budget 2022/23 including New Dog Park MO Moran Reserve and land purchase for expansion of Pakington Street Reserve.

4.12 Comprehensive details of forecast updates that impact the current financial year are set out in Attachment 1.

Assessment against VAGO Financial Sustainability Indicators

4.13 Council's decision-making is guided by the principles of sound financial management, to ensure our financial position is sustainable. We assess our financial performance using the VAGO financial sustainability indicators.

4.14 The mid-year budget 2022/23 review indicates an overall low risk financial sustainability rating for Council highlighted by the seven VAGO financial indicators below:

Indicator	Latest Forecast	Budget 2022/23	Variance	Risk
Net Result %	0.5%	(1.4%)	1.9%	Low
Adjusted Underlying Result %	(3.7%)	(6.5%)	2.8%	High
Working Capital %	348%	344%	4%	Low
Internal Financing %	123%	56%	67%	Low
Indebtedness %	1.2%	1.9%	0.7%	Low
Capital Replacement %	159%	215%	(56%)	Low
Infrastructure Renewal Gap %	128%	177%	(49%)	Low
Overall financial sustainability risk rating	**Low**	**Low**	**No Change**	**Low**

4.15 The indicators generally need to be considered from a medium-term trend perspective rather than annual basis. A medium rating over one or two years is acceptable particularly in response to an event such as COVID-19 but over the medium to long-term, Council aims to achieve and maintain a low-risk rating overall

4.16 Net Result %:

4.16.1 The net result ratio assesses Council's ability to generate enough funds for asset renewals.

4.16.2 A $3.38 million operating deficit was budgeted for 2022/23 which assumed a business-as-usual approach on a path to recovery from COVID pandemic, however included significant operating project deferrals from 2022/23 (despite being reserve funded)

4.16.3 Net result % is currently projected at 0.5% with a low-risk rating predominately caused by the increase in forecast operating surplus to $1.2 million. This is predominately due to greater investment interest income and improved parking utilisation and revenue.

4.17 Adjusted Underlying Result %:

4.17.1 This assesses our ability to generate surplus in the ordinary course of business excluding non-recurrent capital grants and contributions to fund capital expenditure from net result.

4.17.2 An underlying deficit is normally budgeted due to the reliance on external funding/contributions to fund our infrastructure assets works. For instance, Open Space Contributions are collected, held in reserve to fund upgrades, expansion and new of public space.

4.17.3 The mid-year review forecasts a marginal high risk result due to the same factors highlighted in the Net Result ratio. Noting that this is an improvement on Budget 2022/23.

4.18 Working Capital %:

4.18.1 This working capital ratio assesses Council's ability to pay short-term liabilities as they fall due (current assets/ current liabilities).

4.18.2 Council has no working capital issues at the forecast 348% with a low-risk rating. This has improved slightly due to increased holdings of non-current financial assets including term deposits due to delayed portfolio delivery.

4.19 Internal Financing %:

4.19.1 The internal financial ratio assesses Council's ability to finance capital works using cash generated from its operations. A ratio below 100 means cash reserves or borrowing are being used to fund capital works, which is acceptable on occasions.

4.19.2 Internal financing has improved to 123% with a low-risk rating primarily due to improvement in cashflows from operations (collection of prior years' rates) and reduction in capital spend due to project deferrals to financial year 2023/24.

4.20 Indebtedness %:

4.20.1 The indebtedness ratio assesses Council's ability to repay its non-current debt from its own source revenue.

4.20.2 This indicator shows a low risk for Council as the forecast ratio for 2022/23 of 1.2% which is significantly lower than the target of below 40%.

4.21 Capital Replacement %:

4.21.1 The capital replacement ratio assesses whether Council's overall cash spend in renewing, growing, and improving its asset base is enough.

4.21.2 Capital replacement % has reduced from budget of 215% to 159% with a low-risk rating caused by project deferrals identified in the first half of the financial year. Factors contributing to deferrals include internal resourcing and vacancies, additional design considerations, material shortages and the impact of pandemic in the construction sector.

4.22 Infrastructure Renewal Gap %:

4.22.1 The infrastructure renewal gap ratio assesses Council's spend on its asset base is keeping up with the rate of asset depletion (depreciation).

4.22.2 Infrastructure renewal gap % has also reduced from budget of 177% to 128% with a low-risk rating caused by project deferrals identified during the mid-year 2022/23 review process. Factors contributing to deferrals include internal resourcing and vacancies, additional design considerations, material shortages and the impact of pandemic in the construction sector.

Project Portfolio Update

4.23 The Project Portfolio has reduced by a net $14.1 million to a total of $56.8 million forecast. Year to date total portfolio spend of $15.8m, $0.9m less than year to date forecast with 72% of total forecast spend remaining for 2022/23.

4.24 Significant movement in portfolio forecast is caused by timing of delivery across financial years. The 2022/23 portfolio was increased by $4.87 million of deferrals that occurred post budget 2022/23 adoption. A further $4.11m has been added to the portfolio through new projects, bring forwards and additional project costs. This has however been offset by $22.67 million of deferral to 2023/24 and future years identified over the first half of the year.

4.25 See both portfolio achievements and second quarter 2022/23 project deferrals outlined in Attachment 2.

Mid-year Unbudgeted Initiative Requests

4.26 The quarterly review process is also used to identify and assess urgent and unbudgeted expenditure proposals or in the CEO report.

4.27 As part of the mid-year review a request for authorisation for Officers to work with the Department of Transport to develop a package of maintenance works on State infrastructure at, or near, Council's current service level for other assets (such as roadsides, parks, etc.). Majority of the cost estimated at $500,000 is to be funded by DoT. Council will contribute to this program to ensure the service standards are consistent with Council's current service provisions.

5. CONSULTATION AND STAKEHOLDERS

5.1 The mid-year 2022/23 budget review and consideration of unbudgeted initiatives has been conducted after engagement with relevant stakeholders from across the business as required.

6. LEGAL AND RISK IMPLICATIONS

6.1 As outlined in section 4, the Council's financial sustainability risk is considered low based on projections resulting from the mid-year review (as budgeted). However, there are external and internal factors that may negatively impact our financial performance.

6.1.1 These risks include including high inflation which is increasing the cost base of our core services, an in-principle Enterprise Agreement (subject to majority voting over January and February), ongoing issues with staff retention and recruitment and childcare centres experiencing low utilisation. Strategies are being developed and implemented to manage and mitigate the financial impact of these risks for 2022/23.

6.2 A key financial risk is the rising inflationary pressures on goods, services and projects. Budget 22/23 included 4.5% inflation based on March 2022 CPI. However, actual CPI at June 22 reached 6.1% and then continued to increase to 8.0% in December 2022. With that in mind, we have placed strict financial controls in place to achieve allocated budget.

6.3 Project portfolio (including both capital and operating programs) continues to experience increasing delivery risks increased due to issues such as internal staff resourcing, contractor availability, material shortages, external dependencies, and external approvals.

7. FINANCIAL IMPACT

7.1 Budget 2022/23 was adopted in June 2022 with a surplus of $1.55m. The cash surplus target was revised as part of the Financial Outlook to $2.7m for the development of Budget 2023/24. Since then, the cash surplus has further improved to $5.79m as the Reserve Bank have increased interest rates several times resulted in higher investment income and an improvement in parking utilisation and revenue.

7.2 If Council approves the additional item recommended by the Executive Leadership Team, then the cash surplus will reduce by up to $0.19 million (early estimates) to $5.60 million.

8. ENVIRONMENTAL IMPACT

8.1 The mid-year review includes adjustments to Council's project portfolio and considers delivery and environmental impacts.

9. COMMUNITY IMPACT

9.1 The updated financial information presented as part of the mid-year budget 2022/23 review including ongoing careful financial management will continue to deliver benefits to the community and support to the local economy.

9.2 The unbudgeted initiatives requested in section 4 will directly benefit the community members through improvement amenity and safety of our public open spaces.

10. ALIGNMENT TO COUNCIL PLAN AND COUNCIL POLICY

10.1 The mid-year Budget 2022/23 review supports strategic direction 5 – "Well Governed Port Phillip" as a city that is a leading local government authority, where our community and our organisation are in a better place as a result of our collective efforts. This review helps to ensure that Port Phillip Council is cost-effective, efficient and delivers with speed, simplicity, and confidence.

11. IMPLEMENTATION STRATEGY

11.1 TIMELINE

11.1.1 The initiatives proposed can commence immediately if approved by Council.

11.2 COMMUNICATION

11.2.1 Since the Budget was set new information on the costs of initiatives and accuracy of forecasts has been received. These changes are reflected in updated forecasts in the monthly CEO report.

12. OFFICER DIRECT OR INDIRECT INTEREST

12.1 No officers involved in the preparation of this report have any material or general interest in the matter.

ATTACHMENTS

1. **Financial Statements December 2022**
2. **Mid Year 2022-23 Portfolio Achievements and Deferrals**