13.2	FINANCIAL UPDATE - THIRD QUARTER 2022-23 FINANCIAL REVIEW
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1. PURPOSE

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

2. EXECUTIVE SUMMARY

2.1 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 development of the draft Budget 2023/24 to $7.94 million.

2.2 Consistent with the draft Budget 2022/23, the Third Quarter financial review expects Council to achieve a cumulative cash surplus for 2022/23 of $7.92 million (excluding the additional initiatives subject to Council consideration), an increase of $6.4 million on Budget 2022/23 (see Attachment 1).

2.3 It should be noted that the organisation is facing a higher than the historical average staff vacancy rate, which is placing pressure on the response 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 have been used to offset the net additional enterprise employee costs required based on the new enterprise agreement.

2.4 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 third quarter review (as budgeted).

2.5 That said, there are ongoing risks caused by external and internal factors that may negatively impact our financial performance including high inflation which is increasing the cost base of core services, ongoing challenges 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 the remainder of 2022/23.

2.6 As at 31 March 2023, ongoing efficiency savings of $1.1 million were achieved and $0.91 million one-off additional efficiency savings were achieved across successful capital project tenders (savings ring-fenced in the Asset Renewal Fund).

2.7 The Project Portfolio has reduced from Budget 2022/23 by net $22.4 million to a total of $48.9 million. There are several 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)

3. RECOMMENDATION

That Council:

3.1 Notes that following the third quarter financial review 2022/23 the Council is projecting a full year cumulative cash surplus of $7.92 million which is compares favourably to Budget 2022/23 by $6.4 million and is consistent with the draft Budget 2023/24.

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

3.1.2 Notes Attachment 2 – material portfolio achievements, high risk projects and deferrals including key reasons identified during the Third Quarter.

3.2 Notes that up to $20,000 of additional funding has been allocated to the expansion of the Early Education Grants Program which will result in an updated cash surplus of $7.90 million for 2022/23.

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 third quarter financial 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 third quarter financial review 2022/23 projects Council to achieve a cumulative cash surplus for 2022/23 of $7.92 million (excluding the additional initiatives subject to Council consideration), an increase of $6.4 million on Budget 2022/23 (Attachment 1).

4.5 The improvement in cash surplus is primarily caused by improving interest income because of higher than anticipated cash available for investment, higher investment returns, increased parking income due to improved utilisation at South Melbourne Market and foreshore precincts, and an increase in parking infringement income. This has been partially offset by a reduction in net income due to decreased utilisation in Council managed long day care (Council is mitigating this risk through careful managed of employee costs).

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 have been used to offset the net additional enterprise employee costs (including vacancies) required based on Council's new enterprise agreement.

4.7 As at March 2023, Council forecasts an operating surplus of $8.2 million which is an improvement on budgeted operating deficit of $3.4 million by $11.6 million. Net revenue is favourable by $5.3 million and net expenditure also favourable by $6.3 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.

Net income increased by $5.34 million – key movements include:

4.8 Increase of $3.9 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.

4.9 Increase of $3.0 million across paid parking and parking infringement income. There has been a significant improvement in parking utilisation across the municipality, specifically at the South Melbourne Market and foreshore/tourist areas due to increasing utilisation.

4.10 Net increase of $3.0 million in operating grant income predominately due to additional grants received, offset by additional expenditure including St Kilda Festival, Food Relief Activities, Metro Tunnel 2 for 1 Tree Planting, and Graffiti Mitigation.

4.11 Net decrease of ($3.2) 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.

4.12 Decrease of ($1.6) million in user fee income due to a reduced childcare centre fees due to lower utilisation. Noting that is partially offset by reduced employee costs.

Net expenditure reduced by $6.3 million – key movements include:

4.13 Net decrease of $1.3 million in employee costs due lower employee costs and savings due to enterprise-wide vacancies and low utilisation in long day care. This has offset the additional $1.0 million required to service Council's new Enterprise Agreement. Staff retention and recruitment remains a challenge as was the case in the 2021/22.

4.14 Net loss from forecast property sale and project write-offs increased by ($0.4) million. The cash proceeds will be ring-fenced in the Strategic Property Reserve.

4.15 Increase of ($1.6) 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)

4.16 Increase of ($3.0) 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.

4.17 Net reduction of $3.0 million for capital project operating costs deferred to 2023/24. See capital works statement (attachment 1) for comprehensive details on project deferrals.

4.18 Reduction of $4.7 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).

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

4.20 Reduction of $0.5 million achieved through efficiency savings achieved through banking and valuation tender, software optimisation and procurement savings across operating projects,

Net capital expenditure reduction of $17.1 million mainly due to:

4.21 ($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.

4.22 ($2.5) 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)

4.23 Savings of $0.9 million (ringfenced in Asset Renewal Fund) predominately due to efficiency savings achieved through successful tenders Kerb & Gutter Construction – Wilton Grove, Laneway Construction – Wellington Street, Alma Road/Lansdowne Road Safety Improvements and Standard Drawings – Clever City & FBURA, Local Law Review, St Kilda Town Hall Heritage Fire Sprinkler Upgrade (Savings ringfenced in Asset Renewal Fund)

4.24 $22 million of project deferral to 2023/24 and future years, including key deferrals identified in the third quarter such as Moubray Street Community Park, Palais Theatre and Luna Park Precinct, North St Kilda Childcare Centre Upgrade, Alma Park Amenities Pavilion, Alma Park Playspace Upgrade and South Melbourne Market Cecil Street Essential Services.

4.25 See Attachment 2 – update on portfolio achievements and deferrals identified in March 2023.

Net reserve drawdowns decreased by $22.57 million due to:

4.26 $14.3 million net increase to Contractual Reserves predominantly due to project deferrals reserve due to $15 million project deferrals for 2022/23 offset by $3.2 million deferrals post budget 2022/23.

4.27 $5.1 million increase to Strategic Reserves due to:

- $3.7 million net increase due to project delays for Palais Theatre, St Kilda Marina, Gasworks Park and In Our Back Yard Strategy.
- $1.00 million increase to the Strategic Property Reserve due to forecast property sales.

4.28 $3.5 million increase to Other Reserves, predominately due to capital project savings allocated to the Asset Renewal Reserve.

4.29 ($0.4) 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.

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

Assessment against VAGO Financial Sustainability Indicators

4.31 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.

4.32 The third quarter financial review 2022/23 indicates an overall low risk financial sustainability rating for Council highlighted by the seven VAGO financial indicators below:

Indicator	Forecast 2022/23	Budget 2022/23	Variance	Risk
Net Result %	3.3%	(1.4%)	4.7%	Low
Adjusted Underlying Result %	0.0%	(6.5%)	6.5%	Medium
Working Capital %	374%	344%	30%	Low
Internal Financing %	166%	56%	110%	Low
Indebtedness %	1.3%	1.9%	0.6%	Low
Capital Replacement %	138%	215%	(77.0%)	Medium
Infrastructure Renewal Gap %	116%	177%	(61.0%)	Low
Overall financial sustainability risk rating	**Low**	**Low**	**No Change**	**Low**

4.33 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

Net Result %:

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

4.35 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)

4.36 Net result % is currently projected at 3.3% with a low-risk rating predominately caused by the increase in forecast operating surplus to $8.2 million. This is predominately due to greater investment interest income and improved parking utilisation and revenue.

Adjusted Underlying Result %:

4.37 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.

4.38 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.

4.39 The third quarter review forecasts a medium risk result due to the same factors highlighted in the Net Result ratio. Noting that this is an improvement on Budget 2022/23.

Working Capital %:

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

4.41 Council has no working capital issues at the forecast 374% 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.

Internal Financing %:

4.42 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.

4.43 Internal financing has improved to 166% with a low-risk rating primarily due to improvement in cashflows from operations (collection of prior years’ rates, increased parking and interest income) and reduction in capital spend due to project deferrals to financial year 2023/24.

Indebtedness %:

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

4.45 This indicator shows a low risk for Council as the forecast ratio for 2022/23 of 1.3% which is significantly lower than the target of below 40%.

Capital Replacement %:

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

4.47 Capital replacement % has reduced from budget of 215% to 138% with a medium-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.

Infrastructure Renewal Gap %:

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

4.49 Infrastructure renewal gap % has also reduced from budget of 177% to 116% with a low-risk rating caused by project deferrals identified during 2022/23. 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

4.50 The Project Portfolio has reduced by a net $22.3 million to a total of $48.9 million forecast. Year to date total portfolio spend of $22.8 million with $26.1 million total forecast spend remaining for 2022/23.

4.51 Significant movement in portfolio forecast is caused by timing of delivery across financial years. The 2022/23 portfolio was increased by $4.8 million of deferrals that occurred post budget 2022/23 adoption. A further $4.6m has been added to the portfolio through new projects, bring forwards and additional project costs (noting majority of this has been funded from external grants and reserves). This has however been offset by $29.9 million of deferral to 2023/24 and future years and savings achieved of $1.8 million.

4.52 See both portfolio achievements and March 2022/23 project deferrals outlined in Attachment 2.

Third Quarter Unbudgeted Initiative Requests

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

4.54 As part of the third quarter financial review a request for $20,000 additional funding for the Early Education Grants Program was received. The Early Education Grant Program aims to improve access to early education and care for vulnerable children by funding out-of-pocket expenses to eligible families. The desired outcome is that vulnerable children are accessing quality early childhood education and care for at least 2 days per week.

4.55 The additional funds would allow approximately 8 new children to access the Early Education Grant Program from next month and increase the number of days of care available to families across the program this financial year.

4.56 The Early Education Grant Program is well established and strong relationships with community organisations has ensured families are efficiently referred, resulting in applications ready to be assessed for eligibility and onboarding as soon as the additional funds are approved.

5. CONSULTATION AND STAKEHOLDERS

5.1 The third quarter financial 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 third quarter financial review (as budgeted). However, there are external and internal factors that may negatively impact our financial performance. Some of these key risks include:

6.1.1 Ongoing high inflation which is increasing the cost base of our core services - rising inflationary pressures on goods, services and projects. Budget 22/23 included 4.5% inflation based on March 2022 CPI. However, actual CPI (Melbourne) at June 22 reached 6.1% and then continued to increase to 6.8% in March 2023. With that in mind, we have placed strict financial controls in place to achieve allocated budget.

6.1.2 Ongoing issues with staff retention and recruitment. However, these savings have been used to offset the net additional enterprise employee costs required based on the new enterprise agreement.

6.1.3 Childcare centres experiencing low utilisation. Strategies are being developed and implemented to manage and mitigate the financial impact of these risks for the remainder of 2022/23.

6.1.4 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 $1.55 million. The cash surplus target was revised as part of the Financial Outlook to $2.7 million for the development of Budget 2023/24. Since then, the cash surplus has further improved to $7.9 million 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 Council has directed officers to allocate additional funding for the Early Education Grant program as recommended by the Executive Leadership Team. Noting this change, the cash surplus will reduce by up to $20,000 to $7.9 million.

8. ENVIRONMENTAL IMPACT

8.1 The third quarter financial 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 third quarter financial review including ongoing careful financial management will continue to deliver benefits to the community and support to the local economy.

9.2 The expansion of the Early Education Grant Program will directly benefit the community members who are not eligible for the Commonwealth Childcare Subsidy. The additional funds would allow approximately eight new children to access the Early Education Grants from next month and increase the number of days of care available to families across the program this financial year.

10. ALIGNMENT TO COUNCIL PLAN AND COUNCIL POLICY

10.1 The third quarter financial 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 including the expansion of the Early Education Grants Program 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 March 2023**
2. **Third Quarter 2022-23 Portfolio Achievements and Deferrals**