

10.8 Policy (Draft) Entrepreneurial Property Activities & Financial Reserve

POLICY NAME: DRAFT REVIEW
ENTREPRENEURIAL PROPERTY ACTIVITIES
AND FINANCIAL RESERVE

POLICY REF: TBA

MEETING ADOPTED: TBA

POLICY HISTORY: 23 February 2006
Resolution No. 230206(065)



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OBJECTIVE

To provide guidelines for the management of Council's Entrepreneurial Property Activities and Financial Reserve that has been created and funded through Council's long term entrepreneurial activities in respect to land and property development.

BACKGROUND

Council, through a long history of pro-active land and property development, has managed to raise a significant amount of funds which have been set-aside in an internal reserve to assist with funding both further entrepreneurial activities and community infrastructure. The funds from these activities have been used to finance major community assets such as Angels Beach Drive, Prospect Bridge, Lennox Head by-pass, Northern Rivers Community Gallery, the Ballina Community Services Centre and the Lennox Head Community Centre.

The retention of this reserve is critical to the on-going financial viability of the Council as Council does not generate adequate revenue from its traditional income sources such as rates, fees and charges to satisfy the community demand for new and replacement infrastructure.

Therefore it is important that the funds held in this reserve are carefully managed within a clear set of guidelines. This policy provides those guidelines.

This policy was formerly the L01 - Land Development Reserve Management Policy.

DEFINITIONS

Entrepreneurial Property Activities and Financial Reserve Council holds a number of smaller property related reserves, however this reserve refers to the funding generated from Council's industrial, residential and commercial land development activities

SCOPE OF POLICY

This policy applies to:

- Council employees
- Councillors
- Committees of Council

RELATED DOCUMENTATION

Related documents, policies and legislation:

- Local Government Act
- Council's Operational Plan

POLICY

1. Council will retain an internal reserve titled "Entrepreneurial Property Activities" the purpose of which will be to finance land and property development activities, to assist in financing community infrastructure and to provide a contingency for any unforeseen financial shocks that may impact on Council's financial situation.
2. Council will aim to retain a minimum balance of \$1 million in this reserve to protect against unforeseen financial shocks.
3. This reserve will be segmented into three sub-categories being:

a) Industrial Land

The purpose of this portion of the reserve is to finance the on-going operation and development of Council industrial land with the shire. Proceeds and expenses associated with industrial land development will be transferred to and from this sub-category of the reserve.

This section of the reserve will aim to pay a dividend to Council, based on 50% of net profits on any land release. The payment of any dividend is determined after consideration is given by Council as to whether adequate funds are retained to ensure that Council's future industrial land activities can be financed.

Any dividend paid will take the form of a transfer to the Community Infrastructure portion of this reserve, as per sub-category c.

b) Commercial Opportunities

The purpose of this portion of the reserve is to finance commercial development opportunities as they arise. Any commercial development should be the subject of a detailed financial analysis before funds are expended on that development.

This section of the reserve will pay a dividend to Council, based on 50% of net profits or 50% of any net income stream (after depreciation). The payment of any dividend is determined after consideration is given by Council as to whether adequate funds are retained to ensure further commercial activities can be financed, as opportunities arise.

Any dividend paid will take the form of a transfer to the community infrastructure portion of this reserve, as per sub-category c.

c) Sub-category c) Community Infrastructure

This section of the reserve will finance community infrastructure projects as determined by the Council. The financing may be either by a direct cash contribution or by using the interest generated on the reserve to finance loan principal and interest repayments. The method of financing will be a matter for Council to determine.

REVIEW

This policy is to be reviewed every four years.

The General Manager
Ballina Shire Council

13 June 2011

Dear Sir

Policy Review - Land Development Revenue - Management.

This email represents a submission in respect to the review of the Land Development Revenue - Management Policy.

At the February 2011 Finance Committee meeting Council resolved:

"2. That Council receive a further report on the implications of creating a 'Budget Shocks' reserve of \$1 million sourced equally from the Community Infrastructure and Commercial Opportunities reserves."

The Finance Committee report dated 7 April 2011 does not cover all the implications. Other relevant issues are as follows:

1. Council has a responsibility to optimise the use of resources. The allocation of money to a budget shocks reserve is an inefficient use of capital. Given the demand for infrastructure the allocation of funds to something that may not even happen is a very low priority. There are more deserving infrastructure projects for which the funding could be used.
2. In assessing the ability of Council to absorb financial shocks a holistic approach is required. Table 1 - Consolidated Property Reserves shown in the Finance Committee Paper dated 7 April 2011 is not an appropriate guide as to the ability of Council to absorb financial shocks. The table is simply a statement of source and application of funds (cash) relative to one specific Council activity i.e. property. The reserve balance is dependent upon discretionary decisions and property activity budgeting of Council.

Contrary to statements in the 7 April 2011 business paper Table 1 does not reflect project profitability as the table does not include non cash capital contributions which need to be taken into account when determining profitability. The table represents the cash surplus/deficit on projects (excluding non cash capital contributions). Distributions of these are not dividends as claimed as generally dividends are paid out of profits. The cash distributions simply represent a return of capital such as in the case of the Harvey Norman project. When the land value, holding and subdivision cost are taken into account this project did not make a profit. The cash surplus of \$2.16 million calculable from Table 1 is a return of capital.

The Simpson legal case has been cited as an example of budget shock. This is a questionable analogy. The Simpson issue was around for a long time. From an operational risk management perspective the outcome should have been a predictable scenario. It could have been covered by the budgeting for a specific provision over a number of budget periods.

3. A recognised Financial Asset benchmark for a council is 2.5% to 5% of total assets. Based on Ballina Council's 2010 financial statements 2.5% of total assets is \$20.6 million and 5% is \$41.3 million. Council's actual Financial Assets were \$58.7 million which represents 7.11% of total assets; a surplus of \$17.4 million to \$38.1 million. This does not include the value of subdivision land banks relative to Council's development activities, which also represents a source of funds in the event of need.

Note:

Financial Assets are: (Current Assets + Non Current Investments + Investment Properties - Externally Restricted Cash/Investments).

4. Based on Council's 2010 Unrestricted Current Ratio of 2.07:1 Council's liquidity position has tightened in recent years. I note that further tightening is expected to the extent that the ratio may fall below 1:1 and current liabilities may exceed current assets. However in the event that Council needed to make a large unbudgeted payment at short notice it should have little difficulty raising additional debt on the basis that it could repay the borrowings in the medium term by meeting the market with the sale of surplus assets.

There are also governance issues in respect to the proposed policy.

- There is no definition as to what constitutes 'budget shocks' and consequently the circumstances under which the reserve will be drawn down are not known.
- The policy does not state whether drawings on the reserve will be a first or last resort or whether the budget shocks reserve will be used only after all other funding avenues have been exhausted.
- The reserve top up provisions mean that once there is a draw down a further allocation of funds is required. Consequently there is no limit as to the amounts or frequencies of allocations to the reserve as the policy requires a

balance of \$1 million to be maintained.

- The policy does not provide for community consultation as to what any reserve draw down will be spent on nor does it stipulate the approval process for any draw down of the reserve.
- The policy exposes Council to the risk of budget manipulation through the omission of expenditure from budgets and subsequent drawdown of the budget shocks reserve.

In summary:

1. A plausible business case has not been made for a budget shocks reserve.
2. Council has a capacity to cover a budget shock of \$1 million from existing resources without undue financial strain.
3. A more efficient capital allocation of the \$1 million would be to infrastructure funding.
4. From a governance perspective the proposed policy does not contain adequate protective covenants.

Under the circumstances it is considered that Council should not proceed with the establishment of a budget shocks reserve. Instead Council should look mitigate the risk of budget shocks through astute operational risk management, prudent budgeting and specific provisioning for identified risks.

Yours faithfully,

Vince Kelly