New South Wales
Treasury Corporation

# Greater Hume Shire Council

## Financial Assessment and Benchmarking Report

**Non - LIRS Applicants Only**

**13 November 2012**

**Prepared by NSW Treasury Corporation for Greater Hume Shire Council, the Division of Local Government and the Independent Local Government Review Panel.**

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## Disclaimer

This report has been prepared by New South Wales Treasury Corporation (TCorp) in accordance with the appointment of TCorp by the Division of Local Government (DLG) as detailed in TCorp's letters of 22 December 2011 and 28 May 2012. The report has been prepared to assist the DLG and the Independent Local Government Review Panel in its consideration of the Sustainability of each local government area in NSW.

The report has been prepared based on information provided to TCorp as set out in Section 2.2 of this report. TCorp has relied on this information and has not verified or audited the accuracy, reliability or currency of the information provided to it for the purpose of preparation of the report. TCorp and its directors, officers and employees make no representation as to the accuracy, reliability or completeness of the information contained in the report.

In addition, TCorp does not warrant or guarantee the outcomes or projections contained in this report. The projections and outcomes contained in the report do not necessarily take into consideration the commercial risks, various external factors or the possibility of poor performance by the Council all of which may negatively impact the financial capability and sustainability of the Council. The TCorp report focuses on whether the Council has reasonable capacity, based on the information provided to TCorp, to take on additional borrowings, and Council's future Sustainability, within prudent risk parameters and the limits of its financial projections.

The report has been prepared for Greater Hume Shire Council the DLG and the Independent Review Panel. TCorp shall not be liable to Greater Hume Shire Council or have any liability to any third party under the law of contract, tort and the principles of restitution or unjust enrichment or otherwise for any loss, expense or damage which may arise from or be incurred or suffered as a result of reliance on anything contained in this report.

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## Section 1 Executive Summary

This report provides an independent assessment of Greater Hume Shire Council's (the Council) financial capacity, its ability to undertake additional borrowings, and its future Sustainability. The analysis is based on a review of the historical performance, current financial position, and long term financial forecasts. It also benchmarks the Council against its peers using key ratios.

TCorp's approach has been to:

- Review the most recent four years of Council's consolidated financial results
- Conduct a detailed review of the Council's 10 year financial forecasts, with a particular focus on a council's General Fund although where a council operates a Water or other Fund the financial capacity of these other funds may be reviewed where considered necessary

The Council has been managed in a satisfactory manner over the review period based on the following observations:

- Council's Unrestricted Current Ratio has been above benchmark in each of the past four years indicating Council had sufficient liquidity
- Over the review period, Council had a moderate level of borrowings (borrowings being 0.7% of Net Assets in 2012) and had therefore flexibility in regard to carrying more long term debt

Areas of concern are that:

- Council's underlying operating results (measured using EBITDA) have declined marginally over the past four years due to the negative effect of the flood events in the recent years.
- Approximately 37.0% of Council's revenue base is derived from own sourced revenue (annual charges, and user charges and fees) compared to a benchmark of 60.0%. The LGA is heavily dependent on external sources of funding.

The Council reported $102.6m of Infrastructure Backlog in 2012, which represents 47.3% of its infrastructure asset value of $217.0m. Other observations include:

- Council's Infrastructure Backlog increased by $77.3m between 2011 and 2012 as a result of the development of formal asset management plans that provide a more accurate valuation of the backlog
- A significant portion of the backlog (90.0%) is related to public roads
- As the required maintenance amounts are not being spent to keep the assets in their current condition, it is likely that the backlog may grow in the upcoming years

The key observations from our review of Council's 10 year forecasts for its General Fund are:

- The LTFP assumes existing service levels to the community are maintained
- The forecast show consistent operating deficits excluding capital grants and contributions all 10 years, however the operating performance is expected to slightly improve over time
- Overall it appears that Council will have sufficient liquidity throughout the next 10 year period to service all short term liabilities, currently scheduled capital expenditure and related long term liabilities
- Council's level of fiscal flexibility will continue to be limited as Council will continue to rely on external funding sources such as operating grants and contributions
- Council's forecast capital works program is mainly related to public roads, which matches the profile of the existing Infrastructure Backlog
- Key assumptions within the financial forecasts are considered to be reasonable

In our view, the Council has the capacity to undertake additional borrowings of up to $9.6m in 2013, subject to considering any restrictions that Council has in respect of its cash resources, such as providing for a specific capital project. This is based on the following analysis:

- The forecast DSCR remains at a level consistently above the benchmark of 2.00x for all the forecast period

In respect of the long term sustainability of the Council our key observations are:

- Overall Council is not spending sufficient amounts on asset maintenance and in the long term this could lead to an increasing backlog
- Overall Council is not spending sufficient amounts on asset renewal and in the long term this could lead to a declining asset base
- The flood events in recent years have negatively affected Council's capacity to invest in capital expenditure
- Council maintained a moderate level of borrowings over time and has further borrowing capacity to fund its capital projects on the long term
- Council's long term operating performance will depend on Council's ability to control key expenses such as employee costs, and materials and contracts, and to diversify its revenue sources

[To insert summary comments about the benchmarking.]

# Section 2 Introduction

## 2.1: Purpose of Report

This report provides the Council with an independent assessment of their financial capacity, Sustainability and performance measured against a peer group of councils which will complement their internal due diligence, and the IP&R system of the Council and the DLG, together with the work being undertaken by the Independent Local Government Review Panel.

The report is to be provided to the DLG and the Independent Local Government Review Panel.

The key areas focused on are:

- The financial capacity of the Council to undertake additional borrowings
- The long term Sustainability of the Council
- The financial performance of the Council in comparison to a range of similar councils and measured against prudent benchmarks

## 2.2: Scope and Methodology

TCorp's approach was to:

- Review the most recent four years of the Council's consolidated audited accounts using financial ratio analysis. In undertaking the ratio analysis TCorp has utilised ratio's substantially consistent with those used by Queensland Treasury Corporation (QTC) initially in its review of Queensland Local Government (2008), and subsequently updated in 2011
- Conduct a detailed review of the Council's 10 year financial forecasts including a review of the key assumptions that underpin the financial forecasts. The review of the financial forecasts focused on the Council's General Fund
- Identify significant changes to future financial forecasts from existing financial performance and highlight risks associated with such forecasts, including those that could impact Council's Sustainability
- Conduct a benchmark review of a Council's performance against its peer group
- Prepare a report that provides an overview of the Council's existing and forecast financial position and its capacity to meet increased debt commitments and achieve long term Sustainability
- Conduct a high level review of the Council's IP&R documents for factors which could impact the Council's financial capacity, performance and Sustainability

In undertaking its work, TCorp relied on:

- Council's audited financial statements (2008/09 to 2011/12)
- Council's financial forecast model
- Council's IP&R documents
- Discussions with Council officers
- Other publicly available information such as information published on the IPART website

Definition of Sustainability

In conducting our reviews, TCorp has relied upon the following definition of Sustainability to provide guidance:

"A local government will be financially sustainable over the long term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community."

Benchmark Ratios

In conducting our review of the Councils' financial performance, forecasts and Sustainability we have measured performance against a set of benchmarks. These benchmarks are listed below. Benchmarks do not necessarily represent a pass or fail in respect of any particular area. One-off projects or events can impact a council's performance against a benchmark for a short period. Other factors such as the trends in results against the benchmarks are critical as well as the overall performance against all the benchmarks. As councils can have significant differences in their size and population densities, it is important to note that one benchmark does not fit all.

For example, the Cash Expense Ratio should be greater for smaller councils than larger councils as a protection against variation in performance and financial shocks.

Therefore these benchmarks are intended as a guide to performance.

The Glossary attached to this report explains how each ratio is calculated.

| Ratio | Benchmark |
|---|---|
| Operating Ratio | > (4.0%) |
| Cash Expense Ratio | > 3.0 months |
| Unrestricted Current Ratio | > 1.50x |
| Own Source Operating Revenue Ratio | > 60.0% |
| Debt Service Cover Ratio (DSCR) | > 2.00x |
| Interest Cover Ratio | > 4.00x |
| Building and Infrastructure Backlog Ratio | < 0.02x |
| Asset Maintenance Ratio | > 1.00x |
| Building and Infrastructure Asset Renewal Ratio | > 1.00x |
| Capital Expenditure Ratio | > 1.10x |

## 2.3: Overview of the Local Government Area

| Greater Hume Shire Council LGA | |
|---|---|
| Locality & Size | |
| Locality | Murray |
| Area | 5,939 $km^2$ |
| DLG Group | 11 |
| Demographics | |
| Population in 2011 | 9,815 |
| % under 18 | 28.3% |
| % between 18 and 59 | 46.7% |
| % over 60 | 25.0% |
| Expected population 2031 | 10,900 |
| Operations | |
| Number of employees (FTE) | 144 |
| Annual revenue | $30.6m |
| Infrastructure | |
| Roads | 2,072 km |
| Bridges | 64 |
| Infrastructure backlog value | $102.6m |
| Total infrastructure value | $217.0m |

Greater Hume Shire Council Local Government Area (LGA) is located in southern New South Wales on the Victorian border and shares a border with the municipalities of Wagga Wagga, Urana, Lockhart, Corowa, Tumbarumba and Albury.

Council was formed on 26 May 2004 through the amalgamation of three existing LGAs: Hume Shire, Holbrook Shire and Culcairn.

The LGA includes many agricultural districts primarily for the production of wool, wheat and other grains, lucerne, and for the raising of cattle and sheep.

The region is characterised by relatively low population growth. In line with the national trend, Council has an aging population. Council's median age has increased from 35 to 43 years over the last decade. There is also an outflow of young people from the area, mainly due to university attendance in nearby LGAs and capital cities.

Council is involved in two co-operative arrangements with other Councils concerning the provision of library services with Riverina Regional Library and Upper Murray Regional Library.

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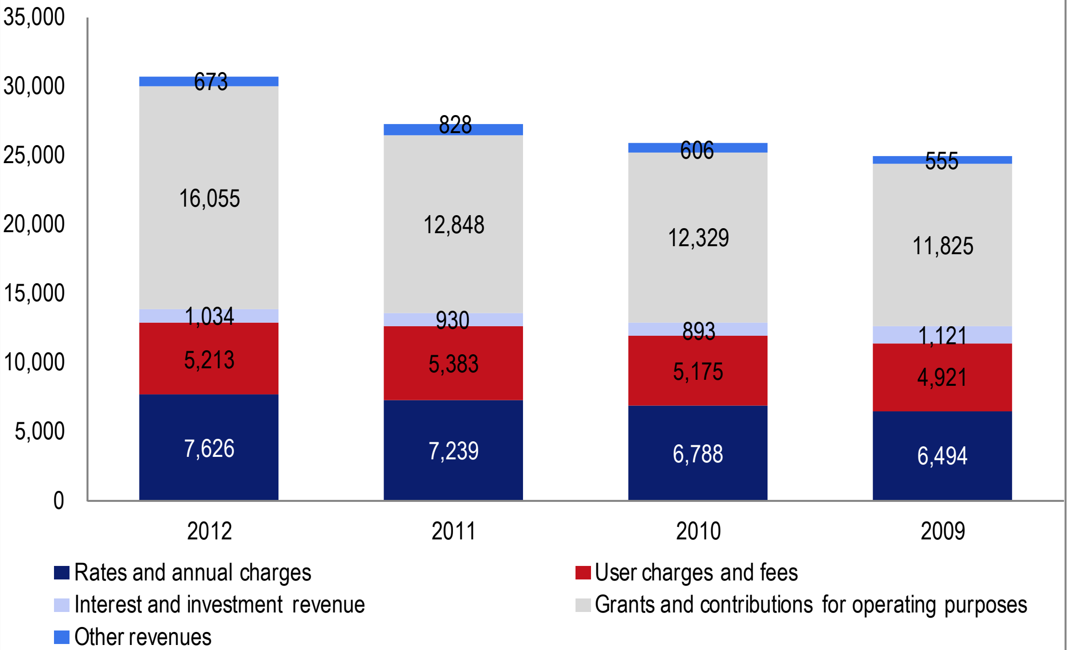
## Section 3 Review of Financial Performance and Position

In reviewing the financial performance of the Council, TCorp has based its review on the annual audited accounts of the Council unless otherwise stated.

### 3.1: Revenues

Figure 1 - Revenue Sources for 2008/09 to 2011/12 ($'000s)




Key Observations

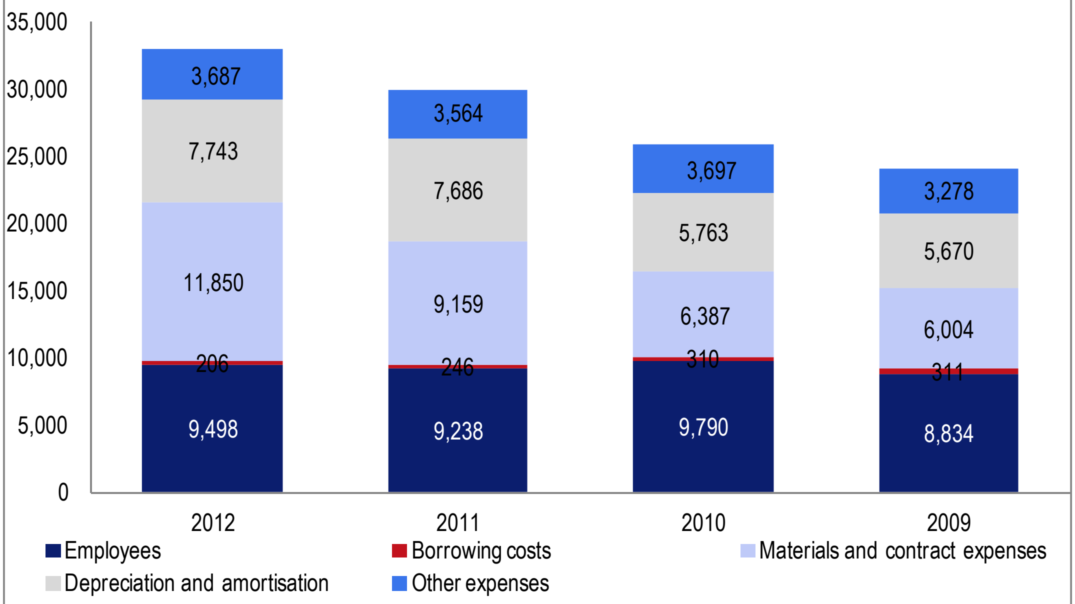
- Rates and annual charges increased by 4.5% in 2010, 6.6% in 2011, and 5.3% in 2012 up to $7.6m. In 2011, rates and annual charges included a rate peg increase of 2.6%, and a farmland rate revenue adjustment for farmland rate revenue foregone from 2010. Farmland rate revenue was adjusted in order to reflect the increase in land rates levied following the change in the land value as determined by the Valuer General. Council has seven residential categories and uses base rates in order to ensure equitable distribution of the rate burden across the Shire. Farmland ordinary rates were the main contributors each year, contributing $3.9m in 2012. In 2012, the increase in rates and annual charges was mainly driven by increases in domestic waste management, water supply, and sewerage charges.
- User charges and fees increased by 5.9% over the review period, up to $5.2m in 2012. RMS fees and private works charges were the main contributors. Council generated $2.1m and $1.3m respectively from these sources in 2012.
- Council generated a $0.9m surplus from aged care hostels activity in 2011, whereas it incurred deficits in 2010 and 2012.
- Grants and contributions for operating purposes increased by 4.3% in 2010, 4.2% in 2011, and 25.0% in 2012 up to $16.1m. Following the damage caused by floods, Council received operating grants for natural disaster relief which amounted to $3.0m in 2011 and $4.2m in 2012. Council also received less operating grants and contributions for community care

services and from RMS in 2011. In 2011, community care grants decreased by $1.4m to $1.9m while RMS contributions declined by $1.2m to $1.5m

- Insurance claim recoveries and rental revenue were the main contributors to other revenues in 2012, contributing $0.2m each.

### 3.2: Expenses

Figure 2 - Expenses for 2008/09 to 2011/12 ($'000s)




Key Observations

- Employee expenses increased by 7.5% over the review period, up to $9.5m. The number of equivalent full time staff remained static over the review period.
- Material and contract expenses increased by 6.4% in 2010, 43.4% in 2011, and 29.4% in 2012 up to $11.9m. In particular, raw materials and consumables increased by $2.7m in 2012 and were related to flood restoration works.
- Due to the Asset Revaluations process the annual depreciation expense increased by 36.6% over the review period, up to $7.7m.
- Insurance and family day care centre expenses were the main contributors to other expenses, amounting to $0.7m and $0.5m respectively in 2012.

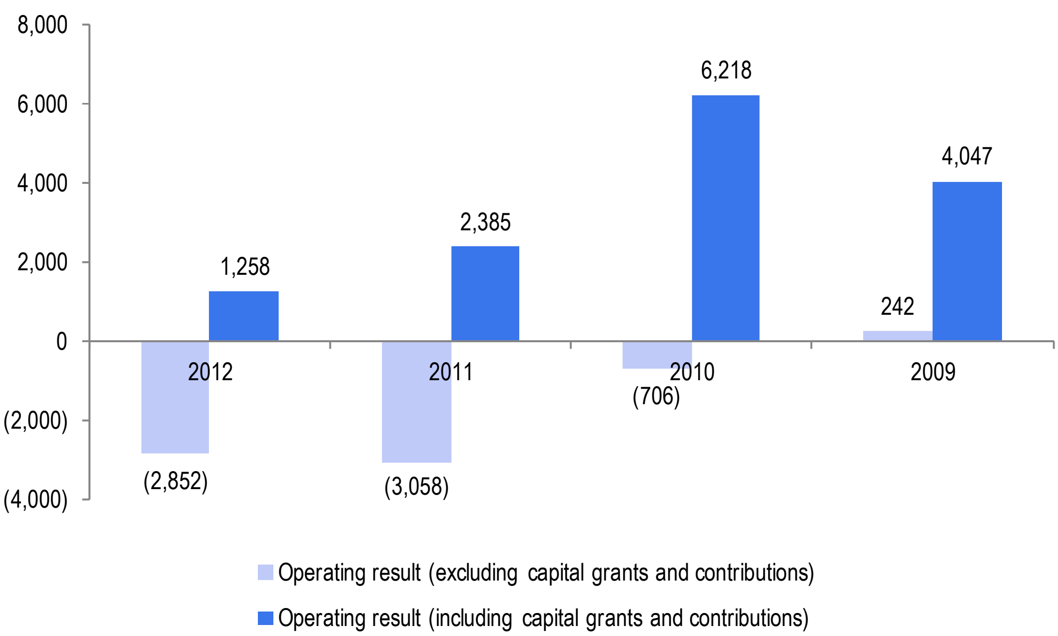
### 3.3: Operating Results

TCorp has made some standard adjustments to focus the analysis on core operating council results. Grants and Contributions for Capital Purposes, realised and unrealised gains on investments and other assets are excluded, as well as one-off items which Council have no control over (e.g. impairments).

TCorp believes that the exclusion of these items will assist in normalising the measurement of key performance indicators, and the measurement of Council's performance against its peers.

All items excluded from the income statement and further historical financial information is detailed in Appendix A.

Figure 3 - Operating Results for 2008/09 to 2011/12 ($'000s)




Key Observations

- Council reported operating deficits excluding capital grants and contributions each year since 2010 as a result of the increase in expenses following the flood renovation works, and the increased depreciation charge.
- Council expenses include a non-cash depreciation expense ($7.7m in 2012), which has increased over the past four years following the Asset Revaluations process. Whilst the non cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense at it represents the allocation of the value of an asset over its useful life.

## 3.4: Financial Management Indicators

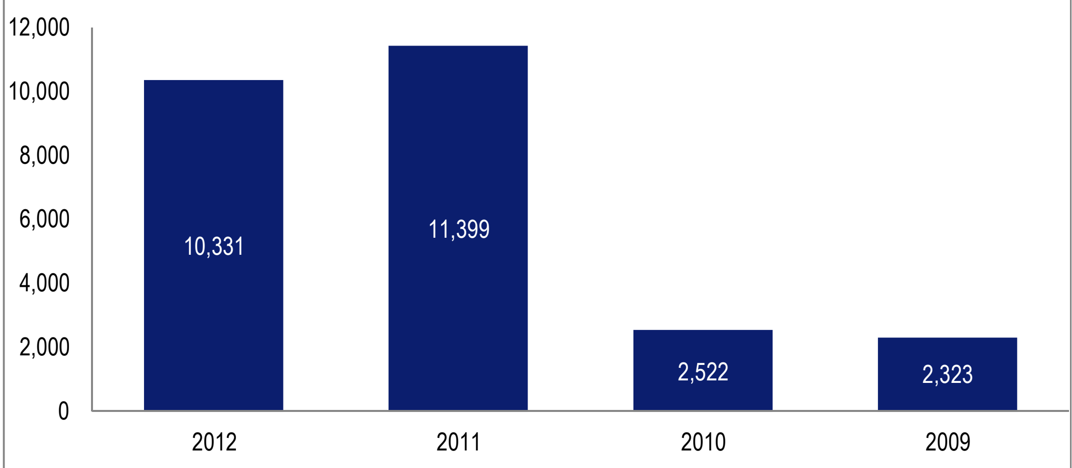
| Performance Indicators | Year ended 30 June | | | |
|---|---|---|---|---|
| | **2012** | **2011** | **2010** | **2009** |
| EBITDA ($'000s) | 5,566 | 5,267 | 5,917 | 6,800 |
| Operating Ratio | (7.8%) | (9.8%) | (0.6%) | 3.3% |
| Interest Cover Ratio | 27.02x | 21.41x | 19.09x | 21.86x |
| Debt Service Cover Ratio | 8.66x | 7.79x | 8.46x | 9.51x |
| Unrestricted Current Ratio | 6.09x | 5.84x | 6.90x | 4.88x |
| Own Source Operating Revenue Ratio | 37.0% | 38.6% | 36.6% | 39.7% |
| Cash Expense Ratio | 5.0 months | 6.2 months | 1.5 months | 1.5 months |
| Net Assets ($'000s) | 381,776 | 365,427 | 359,303 | 244,499 |

Key Observations

- Council's EBITDA decreased by 18.1% over the review period, down to $5.6m in 2012. The Operating Ratio was consistently below the benchmark since 2011.
- The Operating Ratio in particular has been negatively affected by low annual charges levied by the Water and Sewer Fund. Council has acknowledged that its annual water and sewerage charges are insufficient, and has introduced a pricing regime that will provide a sustainable revenue base for the Water and Sewer Funds within the next few years.
- The Unrestricted Current Ratio has been above the benchmark of 1.50x over the past four years indicating Council had sufficient liquidity to meet its short term liabilities.
- The Cash Expense Ratio has been above the benchmark since 2011 following Council transferring a substantial part of its investments into cash and equivalents. This indicates Council had sufficient liquidity.
- Council's Interest Cover Ratio and DSCR indicate that Council had some capacity to carry more debt. The DSCR has been above the benchmark of 2.00x over the past four years.
- Council had total borrowings of $2.7m in 2012, being 0.7% of the Net Assets.
- The Own Source Operating Revenue Ratio was significantly below the benchmark of 60.0% over the review period indicating Council did not have sufficient financial flexibility. Council was consistently relying on external funding sources over the review period.
- Net Assets increased by $137.3m between 2009 and 2012 due to the Asset Revaluations process that increased the value of roads, bridges, footpaths, and drainage assets, and reduced the value of community land assets.
- The Asset Revaluations over the last four years have resulted in a high level of volatility in Net Assets over this period. Consequently, in the short term the value of Net Assets is not necessarily an informative indicator of performance. In the medium to long term however, this is a key indicator of a Council's capacity to add value to its operations. Over time, Net Assets should increase at least in line with inflation plus an allowance for increased population and/or improved or increased services.
- When the Asset Revaluations are excluded, the underlying trend in all four years has been an expanding infrastructure, property, plant, and equipment (IPP&E) asset base with asset purchases being larger than the combined value of disposed assets and annual depreciation. Over the four years this amounted to a $9.3m increase in IPP&E assets.

## 3.5: Statement of Cashflows

Figure 4 - Cash and Cash Equivalents for 2008/09 to 2011/12 ($'000s)




Key Observations

- Total cash and investments increased by $3.9m between 2009 and 2012, up to $22.1m.
- Council had cash and investments amounting to $22.1m in 2012, including $10.3m in cash. The investment portfolio was comprised of term deposits amounting to $11.8m.
- In 2012, $7.7m of cash and investments was externally restricted, $12.1m was internally restricted, and $2.3m was unrestricted.
- Cash and equivalents increased significantly between 2010 and 2011 following Council transferring a substantial part of its investments from long term to short term deposits.
- Council does not have any CDOs or other forms of investment securities.

### 3.6: Capital Expenditure

The following section predominantly relies on information obtained from Special Schedules 7 and 8 that accompany the annual financial statements. These figures are unaudited and are therefore Council's estimated figures.

### 3.6(a): Infrastructure Backlog

Figure 5 - Infrastructure Backlog for 2008/09 to 2011/12($'000s)

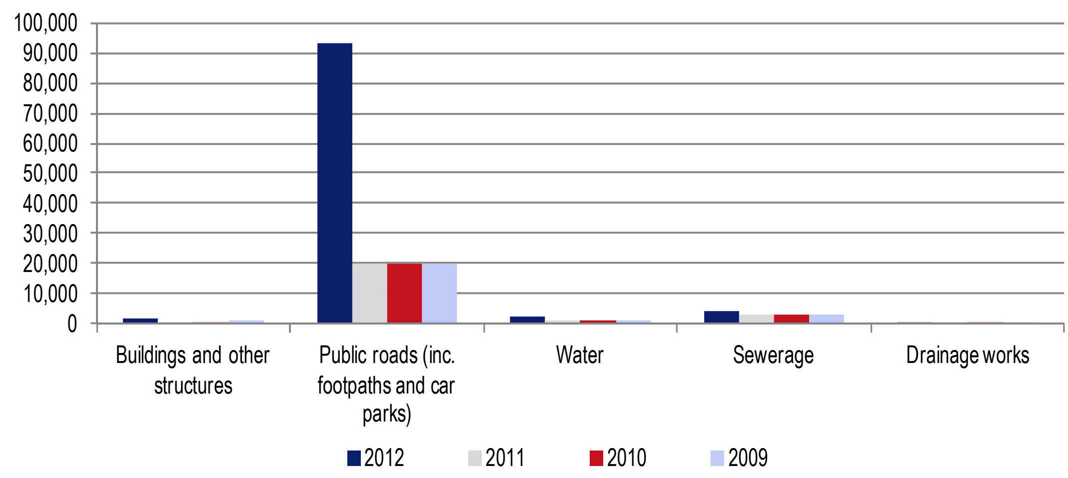
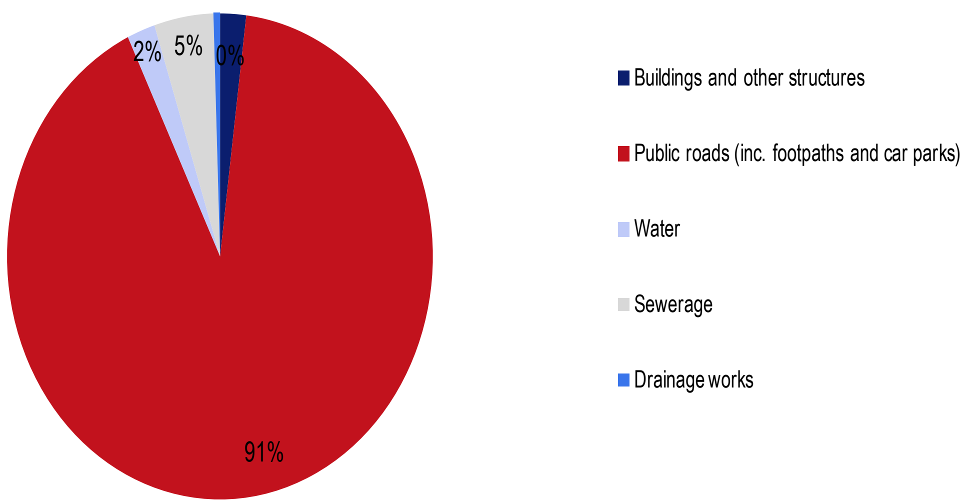



Figure 6 - Infrastructure Backlog Composition for 2011/12




Council reported an Infrastructure Backlog of $102.6m in 2012, with 90.9% related to public roads. Following the recent development of formal asset management plans, the backlog valuation has increased by $77.3m between 2011 and 2012. Prior to that, the backlog value was based on Council's best estimates. In discussions with Council officers, they have indicated that Council is currently examining various options to reduce the backlog including the possibility of applying for a SRV.

### 3.6(b): Infrastructure Status

| Infrastructure Status | Year ended 30 June | | | |
|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 |
| Bring to satisfactory standard ($'000s) | 102,591 | 25,236 | 25,234 | 25,794 |
| Required annual maintenance ($'000s) | 7,892 | 9,719 | 9,717 | 9,717 |
| Actual annual maintenance ($'000s) | 5,090 | 7,516 | 6,994 | 7,140 |
| Total value of infrastructure assets ($'000s) | 217,035 | 205,277 | 204,284 | 219,357 |
| Total assets ($'000s) | 390,305 | 375,252 | 369,629 | 255,188 |
| Building and Infrastructure Backlog Ratio | 0.47x | 0.12x | 0.12x | 0.12x |
| Asset Maintenance Ratio | 0.64x | 0.77x | 0.72x | 0.73x |
| Building and Infrastructure Renewals Ratio | 0.70x | 0.68x | 1.02x | 0.84x |
| Capital Expenditure Ratio | 1.25x | 0.94x | 1.99x | 1.38x |

- The Asset Maintenance Ratio was consistently below the benchmark over the review period, indicating spending on asset maintenance has not been sufficient. If this trend continues, it is likely that the Infrastructure Backlog may grow.
- The Building and Infrastructure Renewals Ratio was consistently below the benchmark, with the exception of 2010. Council acknowledges that funding asset renewals and generally maintaining an ageing asset base to a standard acceptable to the community is one of its key challenges.
- The Capital Expenditure Ratio was consistently above the benchmark of 1.10x with the exception of 2011. In 2011, Council prioritised flood related repair and maintenance works over capital works. In February 2011, Council sold one of its aged care facilities (Howlong Hostel) for $1.4m to a specialist aged care provider and generated a $0.3m net gain on disposal of assets. Two other facilities (Jindera and Holbrook Hostels) were sold in January 2012 for $5.2m and Council generated a gain on sale of $0.8m through this transaction. Council generated an operating surplus from aged care activity in only one year over the past three years. Post these sales, Council has no further involvement in residential aged care facilities.
- Council completed Asset Management Plans for transport, water supply and sewer assets. The completion of Asset Management Plans for plant and fleet, storm water asset, and land and community is currently in progress.
- Council has undertaken a community survey in 2012. The results indicate that the residents were dissatisfied with the maintenance of the roads and the provision of services and facilities for youth.

### 3.6(c): Capital Program

The following figures are sourced from the Council's Annual Financial Statements at Special Schedule No. 8 and are not audited. New capital works are major non-recurrent projects.

| Capital Program ($'000s) | Year ended 30 June | | | |
|---|---|---|---|---|
| | **2012** | **2011** | **2010** | **2009** |
| New capital works | 9,990 | 8,682 | 11,675 | 8,205 |
| Replacement/refurbishment of existing assets | 357 | 1,384 | 242 | 379 |
| **Total** | **7,733** | **7,775** | **5,753** | **5,662** |

From 2010 to 2013, major capital works have mainly been road related and include:

- Regional road program ($6.5m)
- Road construction program- rural and urban ($4.2m)
- Gravel resheeting program ($1.6m)
- Bitumen resealing program- urban and rural ($1.7m)

In total, Council budgeted $16.0m for the capital works of the 2010 to 2013 period. Council will borrow $3.1m in 2013 in order to complete the following projects:

- Coppabella Road reconstruction ($1.8m loan). This project includes widening, realigning and reconstructing four kilometres of road and the installation of five drainage structures.
- Holbrook Depot ($0.4m loan)
- Jindera Multi Service Outlet Centre ($0.3m loan)
- Streetscape works in Culcairn and Jindera ($0.5m loan)
- Upgrade amenities in Culcairn Caravan Park ($0.1m loan)

### 3.7: Specific Risks to Council

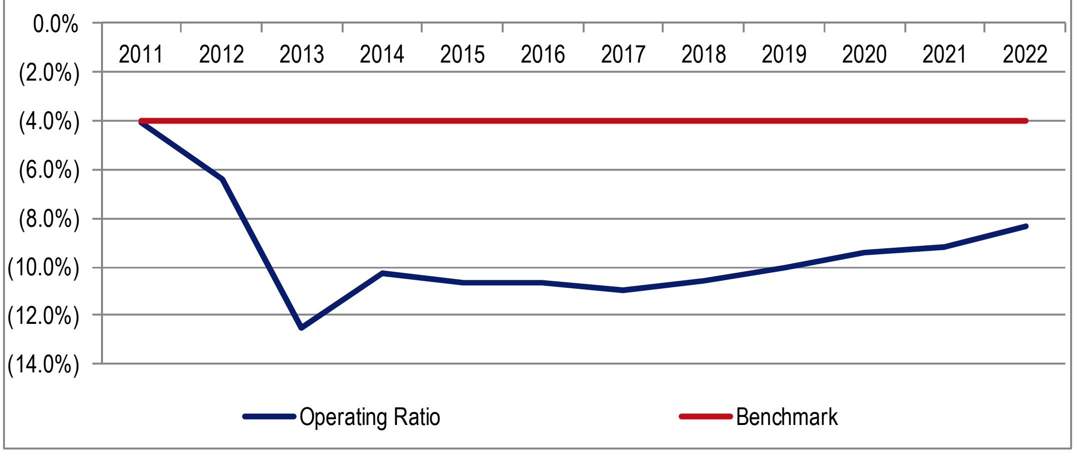
- Water shortage. With Council's population expected to grow marginally, Council has to consider water security for residents and farmers. At the moment, water supply seems to be secure, in particular following the significant rainfall in the later part of 2010. However, farmers have struggled through many years of drought prior to 2010. Therefore, Council has implemented private water supply guidelines and regulated the use of water filing stations.
- Road works. The LGA is currently experiencing various road changes, such as the construction of new bypasses, in order to reduce the commuting time to Albury and Wodonga. The LGA was a popular stopover for travellers along the Hume Highway. The bypasses will impact Council as they will reduce the stopovers in the LGA and decrease the number of visitors.
- Retention of younger people. Council faces a lack of public transportation and facilities for young people. As a consequence, Council is losing a lot of young people to larger cities. Council is focusing on developing entertainment facilities and creating jobs to retain younger people through Council Youth Services. Being located near Albury, to a lesser extent, Wagga presents many economic opportunities to increase employment locally.
- Ageing population. Council is predicted to have over 29% of the population aged over 60 by 2025. This will increase demand for senior health and residential facilities. Council will continue to focus on increasing the level of services in this area.

# Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. We have focused our financial analysis upon the General Fund as although some Council's consolidated position includes both a Water and Sewer Fund these are operated as independent entities, which unlike the General Fund are more able to adjust the appropriate fees and charges to meet all future operating and investing expenses.

## 4.1: Operating Results

Figure 7- Operating Ratio for General Fund




Council's Operating Ratio remains well below the benchmark for each year of the forecast, but is forecast to marginally improve over time.

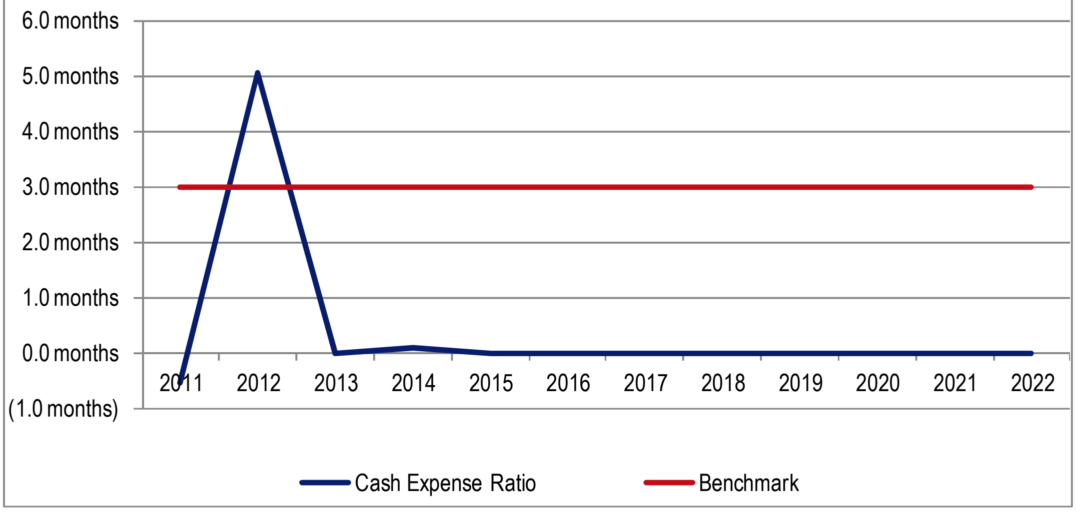
The ratio is skewed downwards in 2013 due to a decrease of $2.6m in user fees and charges (following the sale of residential aged care facilities in 2012), and a decrease of $4.2m in operating grants and contributions. The ratio is lower from 2013 to 2022 compared to 2012 as a result of the significant decrease in the forecast operating revenue excluding capital grants and contributions between 2012 and 2013.

The ratio is forecast to improve slightly from 2014 onwards due to increases in Council's own revenue sources, combined with controlled expenses.

## 4.2: Financial Management Indicators

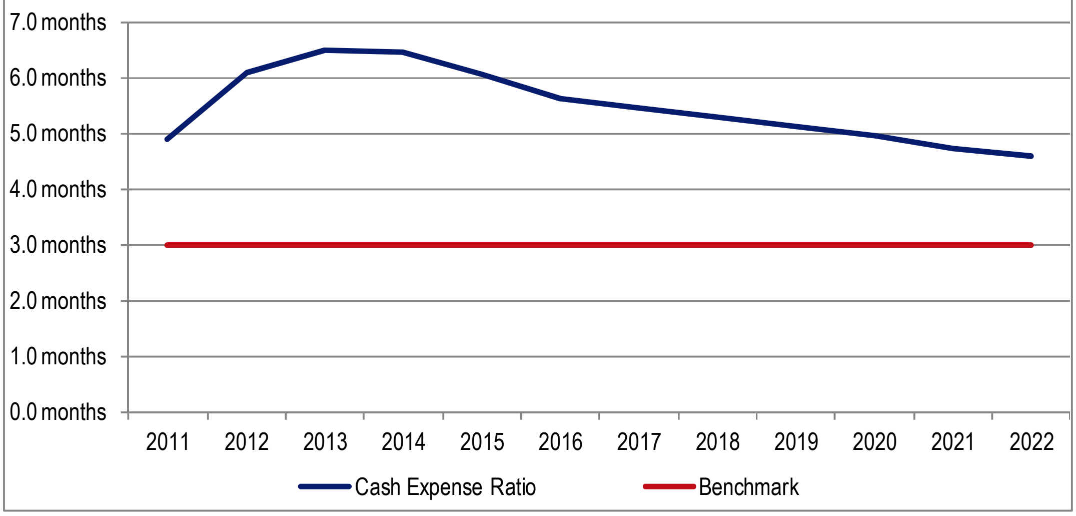
Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund



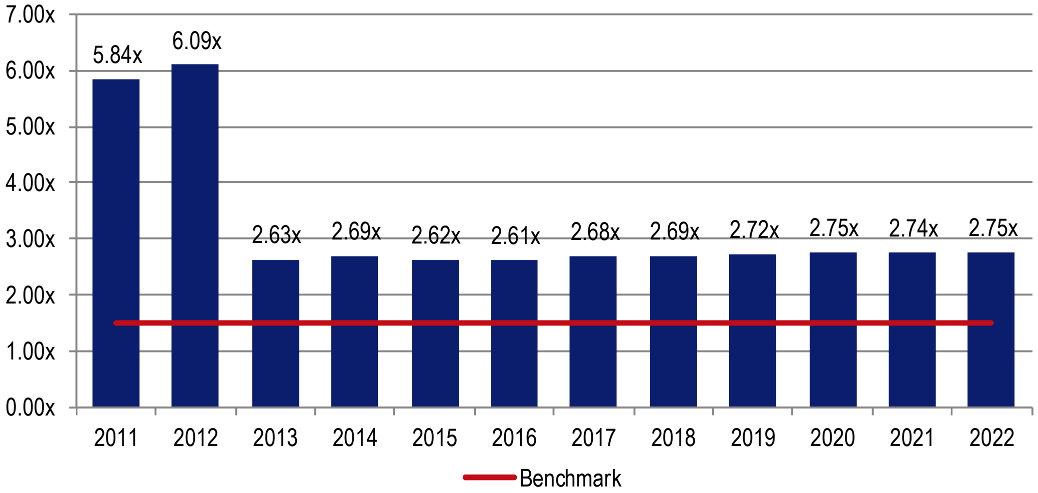

Council forecast a Cash Expense Ratio of approximately nil for the 10 upcoming years, due to Council maintaining the majority of its liquid assets in its investments from 2013 onwards.

Figure 8a - Cash Expense Ratio for General Fund (including Investments)




When investments are included in the Cash Expense Ratio, the ratio is above the benchmark for the review period, indicating Council will have sufficient liquidity. The ratio is declining from 2014 onwards as a result of a decrease in cash and investments due to increased purchases of IPP&E over time.

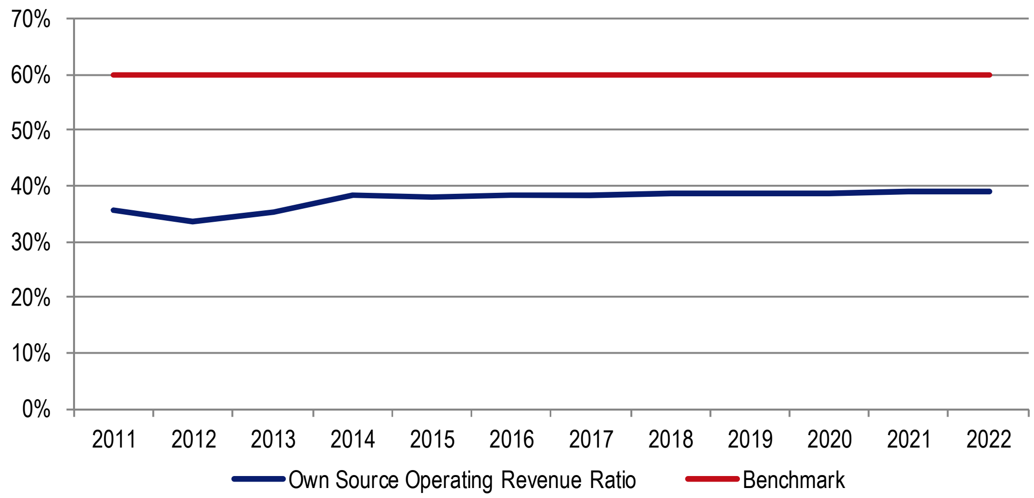
Figure 9 - Unrestricted Current Ratio for General Fund



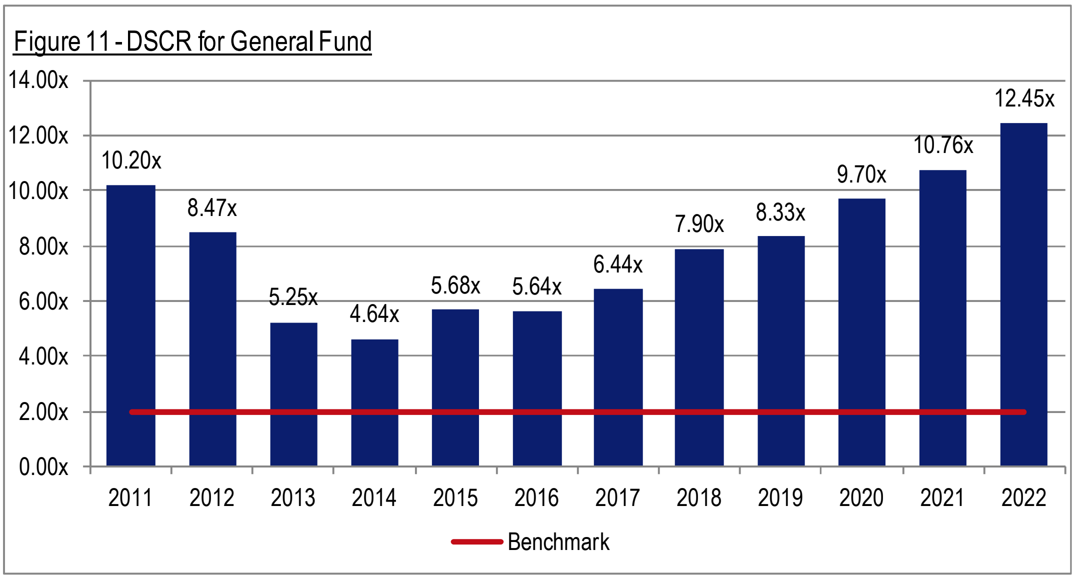

The Unrestricted Current Ratio is expected to be above the benchmark for all the forecast years indicating Council will have sufficient liquidity to meet its short term liabilities. The ratio drops in 2013 as a result of a decrease in current cash and investments following the road related projects forecast for 2013.

Fiscal Flexibility Ratios

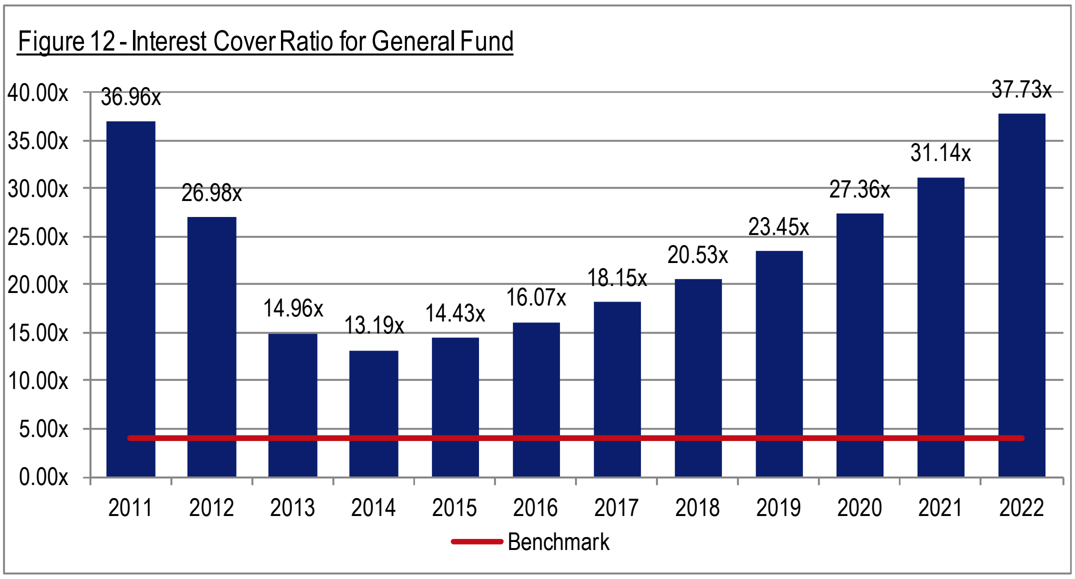
Figure 10 - Own Source Operating Revenue Ratio for General Fund




The Own Source Operating Ratio remains below the benchmark for all of the forecast period. Council depends on grants and contributions for operating purposes that represent approximately 50.0% of its total revenue.



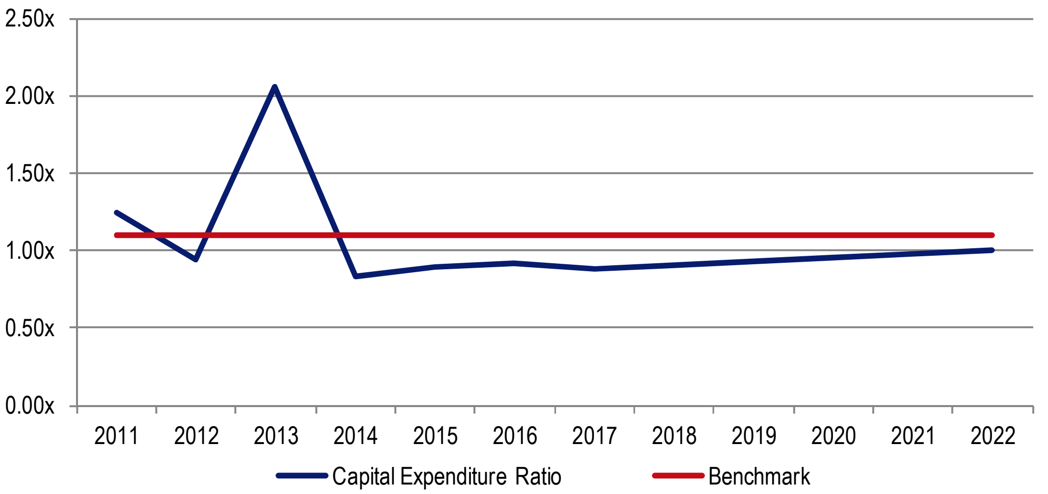

The DSCR is above the benchmark each year indicating that Council has the capacity to service its existing loans and an additional $3.1m in borrowings scheduled in 2013.




The Interest Cover Ratio, similar to the DSCR, shows the Council has sufficient capacity to service scheduled debt commitments. There is capacity to service further debt interest costs before the Council's ratio decreases to the 4.00x benchmark.

## 4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund




Capital expenditure peaks in 2013 due a $9.9m forecast expenditure in new plant and equipment and the road related projects.

From 2014 onwards, the ratio is below the benchmark indicating a funding gap between asset renewal and depreciation. However, the total value of capital expenditure ($72.3m) forecast for the 10 upcoming years is greater than the accumulated depreciation ($69.7m), indicating that Council is expected to marginally expand its asset base.

### 4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

In order to evaluate the validity of the Council's forecast model, TCorp has compared the model assumptions versus TCorp's benchmarks for annual increases in the various revenue and expenditure items. Any material differences from these benchmarks should be explained through the LTFP.

TCorp's benchmarks:

- Rates and annual charges: TCorp notes that rates increased by 3.4% in the year to September 2011, and in December 2011, IPART announced that the rate peg to apply in the 2012/13 financial year will be 3.6%. Beyond 2013 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%
- Interest and investment revenue: annual return of 5%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

Key Observations and Risks

- The LTFP is a "base case" scenario where existing service levels are maintained
- Annual rates and fees are forecast to increase by at an average rate of 3.5 % p.a each year of the forecast.
- Council forecasts a $2.6m decrease in user fees and charges in 2013 down to $2.0m as the result of the sale of three aged care facilities in 2011 and 2012. User charges and fees are forecast to increase by 7.0% in 2014 following an increase in rental fees related to the Jindera Multi Service Outlet Centre project which is one of Council's major projects forecast in the upcoming years. User fees and charges are then forecast to be flat from 2015 to 2017 then a 2.7% p.a. increase from 2018 to 2022
- Council forecasts a $0.8m decrease in employee costs in 2013 down to $7.9m following former aged care staff being transferred to the new provider. Employee expenses are forecast to increase at an average rate of 4.0% p.a. for the remainder of the forecast which is considered reasonable
- Council forecast a decrease of $7.7m in materials and contracts expense between 2012 and 2013, down to $3.7m. In 2012, expenditure was exceptionally high due to important flood repair works caused by three separate floods events. Material and contracts expenditure for 2013 are based on a "normal" operating period. Materials and contracts expenses are forecast to increase at average rate of 1.7% p.a. from 2014 to 2022 which is lower than benchmark
- Depreciation expense is forecast to be static and does not fluctuate with changes in capital expenditure. This forecast is not realistic and is likely to be understated
- TCorp consider the other assumptions behind the LTFP reasonable.

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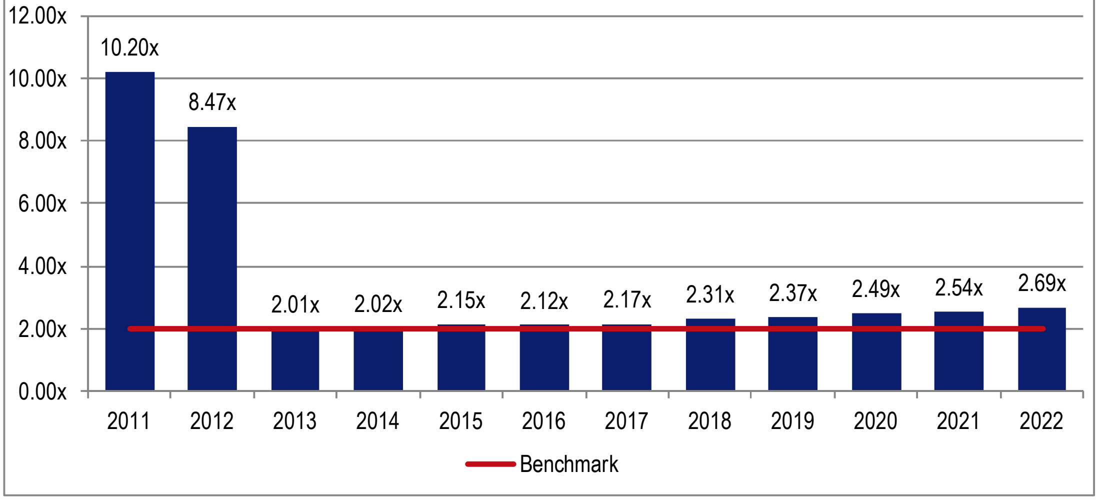
## 4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council could be able to incorporate additional loan funding in addition to its existing debt facilities. Some comments and observations are:

Figure 14 - DSCR for General Fund with an additional $9.6m in borrowings




- Based on a benchmark of DSCR>2.00x, $9.6m could be borrowed in 2013 in addition to the existing borrowings already incorporated into the LTFP
- The DSCR will remain above the benchmark each year of the forecast
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan with an interest rate of 7.5%

## 4.6: Sustainability

TCorp believes Council to be in a deteriorating financial position. Whilst Council's historical results over the review period have been reasonable, the recent completion of the Asset Revaluations process and preparation of Asset Management Plans has highlighted a significant gap in available funding required to maintain Council's assets.

The limited size of the rate base makes it extremely difficult to address its forecast operating deficits, manage unforseen financial shocks or any adverse changes in its business.

In considering the longer term financial Sustainability of the Council we make the following comments:

- The recent development of formal assets management plans has highlighted the widening gap between the required level of maintenance expenditure and the actual expenditure. In the long term, if Council is not spending sufficient amounts on asset maintenance, the backlog will continue to grow and Council does not have the financial resources to address this expanding gap without external funding assistance to bring it back to a satisfactory level
- In the long term, Council is not spending sufficient amounts on asset renewal and this could lead to a reduction in service levels
- The floods in recent years have increased the challenge for Council of maintaining a sustainable LGA. Widespread destruction of key assets such as roads has deferred other capital projects
- Council has maintained a moderate level of borrowings over time, and has further borrowing capacity. In the long term, Council has capacity to add debt to fund capital projects
- Council's long term Sustainability is dependent on reducing expenses, which may require reviewing service levels. If savings are not achieved, it is doubtful that the forecast level of capital expenditure will proceed, leading to a declining asset base.
- Council's long term Sustainability would be aided by a diversification of its revenue sources in order to decrease its reliance on operating grants and contributions.

## Section 5 Benchmarking and Comparisons with Other Councils

[This section still being finalised]

## Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's long term financial plan we consider Council to be moderately sustainable. The continued operating deficits forecast could eventually have a negative effect on Council's ability to replace key infrastructure assets as they become due for renewal.

We base our recommendation on the following key points:

- Council have kept employee expense increases below historic NSW wage indexation rates
- Council's Unrestricted Current Ratio has been well above benchmark the past four years indicating Council had sufficient liquidity
- Council has a moderate level of borrowings at $2.7m, 0.7% of net assets
- Council has sufficient capacity to repay the additional $3.1m forecast to be borrowed in 2013 to fund its capital projects

However we would also recommend that the following points be considered:

- Council is not spending sufficient amounts on asset renewal and in the long term this could lead to a reduction in service levels
- Council forecasts continuing operating deficits. While sustainable in the short to medium term, Council may be unsustainable in the longer term unless additional revenues can be sourced, further efficiencies found, or service levels reviewed
- In addition, Council is highly dependent on external revenue sources such as State and Federal grants. Any material adverse change to the levels of grants receivable would severely weaken Council finances

# Appendix A Historical Financial Information Tables

Table 1- Income Statement

| Income Statement ($'000s) | Year ended 30 June | | | | % annual change | | |
|---|---|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 | 2012 | 2011 | 2010 |
| **Revenue** | | | | | | | |
| Rates and annual charges | 7,626 | 7,239 | 6,788 | 6,494 | 5.3% | 6.6% | 4.5% |
| User charges and fees | 5,213 | 5,383 | 5,175 | 4,921 | (3.2%) | 4.0% | 5.2% |
| Interest and investment revenue | 1,034 | 930 | 893 | 1,121 | 11.2% | 4.1% | (20.3%) |
| Grants and contributions for operating purposes | 16,055 | 12,848 | 12,329 | 11,825 | 25.0% | 4.2% | 4.3% |
| Other revenues | 673 | 828 | 606 | 555 | (18.7%) | 36.6% | 9.2% |
| **Total revenue** | **30,601** | **27,228** | **25,791** | **24,916** | **12.4%** | **5.6%** | **3.5%** |
| **Expenses** | | | | | | | |
| Employees | 9,498 | 9,238 | 9,790 | 8,834 | 2.8% | (5.6%) | 10.8% |
| Borrowing costs | 206 | 246 | 310 | 311 | (16.3%) | (20.6%) | (0.3%) |
| Materials and contract expenses | 11,850 | 9,159 | 6,387 | 6,004 | 29.4% | 43.4% | 6.4% |
| Depreciation and amortisation | 7,743 | 7,686 | 5,763 | 5,670 | 0.7% | 33.4% | 1.6% |
| Other expenses | 3,687 | 3,564 | 3,697 | 3,278 | 3.5% | (3.6%) | 12.8% |
| **Total expenses** | **32,984** | **29,893** | **25,947** | **24,097** | **10.3%** | **15.2%** | **7.7%** |
| **Operating result (excluding capital grants and contributions)** | **(2,383)** | **(2,665)** | **(156)** | **819** | 10.6% | (1608.3%) | (119.0%) |
| **Operating result (including capital grants and contributions)** | **1,727** | **2,778** | **6,768** | **4,624** | (37.8%) | (59.0%) | 46.4% |

Table 2 - Items excluded from Income Statement

| Excluded items ($'000s) | | | | |
|---|---|---|---|---|
| | **2012** | **2011** | **2010** | **2009** |
| Grants and contributions for capital purposes | 4,110 | 5,443 | 6,924 | 3,805 |
| Net gain from the disposal of assets | 220 | 387 | 0 | 0 |
| Net losses from the disposal of assets | 0 | 0 | 45 | 13 |

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Table 3 - Balance Sheet

| Balance Sheet ($'000s) | Year Ended 30 June | | | | % annual change | | |
|---|---|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 | 2012 | 2011 | 2010 |
| **Current assets** | | | | | | | |
| Cash and equivalents | 10,331 | 11,399 | 2,522 | 2,323 | (9.4%) | 352.0% | 8.6% |
| Investments | 11,801 | 6,698 | 15,100 | 15,950 | 76.2% | (55.6%) | (5.3%) |
| Receivables | 4,889 | 6,573 | 2,701 | 2,671 | (25.6%) | 143.4% | 1.1% |
| Inventories | 116 | 180 | 145 | 114 | (35.6%) | 24.1% | 27.2% |
| Other | 187 | 0 | 0 | 0 | N/A | N/A | N/A |
| Total current assets | 27,324 | 24,850 | 20,468 | 21,058 | 10.0% | 21.4% | (2.8%) |
| **Non-current assets** | | | | | | | |
| Receivables | 91 | 74 | 97 | 113 | 23.0% | (23.7%) | (14.2%) |
| Inventories | 2,019 | 1,941 | 1,928 | 564 | 4.0% | 0.7% | 241.8% |
| Infrastructure, property, plant & equipment | 360,850 | 348,356 | 347,095 | 233,402 | 3.6% | 0.4% | 48.7% |
| Intangible assets | 21 | 31 | 41 | 51 | (32.3%) | (24.4%) | (19.6%) |
| Total non-current assets | 362,981 | 350,402 | 349,161 | 234,130 | 3.6% | 0.4% | 49.1% |
| **Total assets** | **390,305** | **375,252** | **369,629** | **255,188** | **4.0%** | **1.5%** | **44.8%** |
| **Current liabilities** | | | | | | | |
| Payables | 2,899 | 3,876 | 3,118 | 3,727 | (25.2%) | 24.3% | (16.3%) |
| Borrowings | 458 | 628 | 440 | 496 | (27.1%) | 42.7% | (11.3%) |
| Provisions | 2,479 | 2,382 | 2,426 | 2,229 | 4.1% | (1.8%) | 8.8% |
| Total current liabilities | 5,836 | 6,886 | 5,984 | 6,452 | (15.2%) | 15.1% | (7.3%) |
| **Non-current liabilities** | | | | | | | |
| Payables | 0 | 0 | 800 | 800 | N/A | (100.0%) | 0.0% |
| Borrowings | 2,261 | 2,528 | 3,140 | 2,973 | (10.6%) | (19.5%) | 5.6% |
| Provisions | 432 | 411 | 402 | 464 | 5.1% | 2.2% | (13.4%) |
| Total non-current liabilities | 2,693 | 2,939 | 4,342 | 4,237 | (8.4%) | (32.3%) | 2.5% |
| **Total liabilities** | **8,529** | **9,825** | **10,326** | **10,689** | **(13.2%)** | **(4.9%)** | **(3.4%)** |
| **Net assets** | **381,776** | **365,427** | **359,303** | **244,499** | **4.5%** | **1.7%** | **47.0%** |

Table 4-Cashflow

| Cashflow Statement ($'000s) | Year ended 30 June | | | |
|---|---|---|---|---|
| | **2012** | **2011** | **2010** | **2009** |
| Cashflows from operating activities | 8,614 | 7,891 | 7,408 | 10,246 |
| Cashflows from investing activities | (9,245) | (8,376) | (7,320) | (10,181) |
| Proceeds from borrowings and advances | 0 | 6 | 500 | 0 |
| Repayment of borrowings and advances | (437) | (430) | (389) | (404) |
| Cashflows from financing activities | (437) | (424) | 111 | (404) |
| **Net increase/(decrease) in cash and equivalents** | **(1,068)** | **(909)** | **199** | **(339)** |
| Cash and equivalents | 10,331 | 11,399 | 2,522 | 2,323 |

# Appendix B Glossary

Asset Revaluations

In assessing the financial sustainability of NSW councils, IPART found that not all councils reported assets at fair value.[1] In a circular to all councils in March 2009[2], DLG required all NSW councils to revalue their infrastructure assets to recognise the fair value of these assets by the end of the 2009/10 financial year.

Collateralised Debt Obligation (CDO)

CDOs are structured financial securities that banks use to repackage individual loans into a product that can be sold to investors on the secondary market.

In 2007 concerns were heightened in relation to the decline in the "sub-prime" mortgage market in the USA and possible exposure of some NSW councils, holding CDOs and other structured investment products, to losses.

In order to clarify the exposure of NSW councils to any losses, a review was conducted by the DLG with representatives from the Department of Premier and Cabinet and NSW Treasury.

A revised Ministerial investment Order was released by the DLG on 18 August 2008 in response to the review, suspending investments in CDOs, with transitional provisions to provide for existing investments.

Division of Local Government (DLG)

DLG is a division of the NSW Department of Premier and Cabinet and is responsible for local government across NSW. DLG's organisational purpose is "to strengthen the local government sector" and its organisational outcome is "successful councils engaging and supporting their communities". Operating within several strategic objectives DLG has a policy, legislative, investigative and program focus in matters ranging from local government finance, infrastructure, governance, performance, collaboration and community engagement. DLG strives to work collaboratively with the local government sector and is the key adviser to the NSW Government on local government matters.

Depreciation of Infrastructure Assets

Linked to the asset revaluations process stated above, IPART's analysis of case study councils found that this revaluation process resulted in sharp increases in the value of some council's assets. In some cases this has led to significantly higher depreciation charges, and will contribute to higher reported operating deficits.

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[1] IPART "Revenue Framework for Local Government" December 2009 p.83

[2] DLG "Recognition of certain assets at fair value" March 2009

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## EBITDA

EBITDA is an acronym for "earnings before interest, taxes, depreciation, and amortisation". It is often used to measure the cash earnings that can be used to pay interest and repay principal.

## Grants and Contributions for Capital Purposes

Councils receive various capital grants and contributions that are nearly always 100% specific in nature. Due to the fact that they are specifically allocated in respect of capital expenditure they are excluded from the operational result for a council in TCorp's analysis of a council's financial position.

## Grants and Contributions for Operating Purposes

General purpose grants are distributed through the NSW Local Government Grants Commission. When distributing the general component each council receives a minimum amount, which would be the amount if 30% of all funds were allocated on a per capita basis. When distributing the other 70%, the Grants Commission attempts to assess the extent of relative disadvantage between councils. The approach taken considers cost disadvantage in the provision of services on the one hand and an assessment of revenue raising capacity on the other.

Councils also receive specific operating grants for one-off specific projects that are distributed to be spent directly on the project that the funding was allocated to.

## Independent Commission Against Corruption (ICAC)

ICAC was established by the NSW Government in 1989 in response to growing community concern about the integrity of public administration in NSW.

The jurisdiction of the ICAC extends to all NSW public sector agencies (except the NSW Police Force) and employees, including government departments, local councils, members of Parliament, ministers, the judiciary and the governor. The ICAC's jurisdiction also extends to those performing public official functions.

## Independent Pricing and Regulatory Tribunal (IPART)

IPART has four main functions relating to the 152 local councils in NSW. Each year, IPART determines the rate peg, or the allowable annual increase in general income for councils. They also review and determine council applications for increases in general income above the rate peg, known as "Special Rate Variations". They approve increases in council minimum rates. They also review council development contributions plans that propose contribution levels that exceed caps set by the Government.

## Infrastructure Backlog

Infrastructure backlog is defined as the estimated cost to bring infrastructure, building, other structures and depreciable land improvements to a satisfactory standard, measured at a particular point in time. It is unaudited and stated within Special Schedule 7 that accompanies the council's audited annual financial statements.

Integrated Planning and Reporting (IP&R) Framework

As part of the NSW Government's commitment to a strong and sustainable local government system, the *Local Government Amendment (Planning and Reporting) Act 2009* was assented on 1 October 2009. From this legislative reform the IP&R framework was devised to replace the former Management Plan and Social Plan with an integrated framework. It also includes a new requirement to prepare a long-term Community Strategic Plan and Resourcing Strategy. The other essential elements of the new framework are a Long-Term Financial Plan (LTFP), Operational Plan and Delivery Program and an Asset Management Plan.

Local Government Cost Index (LGCI)

The LGCI is a measure of movements in the unit costs incurred by NSW councils for ordinary council activities funded from general rate revenue. The LGCI is designed to measure how much the price of a fixed "basket" of inputs acquired by councils in a given period compares with the price of the same set of inputs in the base period. The LGCI is measured by IPART.

Net Assets

Net Assets is measured as total assets less total liabilities. The Asset Revaluations over the past years have resulted in a high level of volatility in many councils' Net Assets figure. Consequently, in the short term the value of Net Assets is not necessarily an informative indicator of performance. In the medium to long term however, this is a key indicator of a council's capacity to add value to its operations. Over time, Net Assets should increase at least in line with inflation plus an allowance for increased population and/or improved or increased services. Declining Net Assets is a key indicator of the council's assets not being able to sustain ongoing operations.

Roads and Maritime Services (RMS)

The NSW State Government agency with responsibility for roads and maritime services, formerly the Roads and Traffic Authority (RTA).

Section 64 Contribution

Development Servicing Plans (DSPs) are made under the provisions of Section 64 of the Local Government Act 1993 and Sections 305 to 307 of the Water Management Act 2000.

DSPs outline the developer charges applicable to developments for Water, Sewer and Stormwater within each Local Government Area.

Section 94 Contribution

Section 94 of the Environmental Planning and Assessment Act 1979 allows councils to collect contributions from the development of land in order to help meet the additional demand for community and open space facilities generated by that development.

It is a monetary contribution levied on developers at the development application stage to help pay for additional community facilities and/or infrastructure such as provision of libraries; community facilities; open space; roads; drainage; and the provision of car parking in commercial areas.

The contribution is determined based on a formula which should be contained in each council's Section 94 Contribution Plan, which also identifies the basis for levying the contributions and the works to be undertaken with the funds raised.

Special Rate Variation (SRV)

A SRV allows councils to increase general income above the rate peg, under the provisions of the Local Government Act 1993. There are two types of special rate variations that a council may apply for:

- a single year variation (section 508(2)) or
- a multi-year variation for between two to seven years (section 508A).

The applications are reviewed and approved by IPART.

Sustainability

A local government will be financially sustainable over the long term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community

**Ratio Explanations**

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

This ratio compares actual versus required annual asset maintenance, as detailed in Special Schedule 7. A ratio of above 1.0x indicates that the council is investing enough funds within the year to stop the infrastructure backlog from growing.

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

This ratio compares the proportion spent on infrastructure asset renewals and the asset's deterioration measured by its accounting depreciation. Asset renewal represents the replacement or refurbishment of existing assets to an equivalent capacity or performance as opposed to the acquisition of new assets or the refurbishment of old assets that increase capacity or performance.

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

Ratio = current year's cash and cash equivalents / (total expenses – depreciation – interest costs)*12

This liquidity ratio indicates the number of months a council can continue paying for its immediate expenses without additional cash inflow.

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

This indicates the extent to which a council is forecasting to expand its asset base with capital expenditure spent on both new assets, and replacement and renewal of existing assets.

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

Ratio = operating results before interest and depreciation (EBITDA) / principal repayments (from the statement of cash flows) + borrowing interest costs (from the income statement)

This ratio measures the availability of cash to service debt including interest, principal and lease payments

Building and Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

Ratio = estimated cost to bring assets to a satisfactory condition (from Special Schedule 7) / total infrastructure assets (from Special Schedule 7)

This ratio shows what proportion the backlog is against total value of a council's infrastructure.

Interest Cover Ratio

Benchmark = Greater than 4.0x

Ratio = EBITDA / interest expense (from the income statement)

This ratio indicates the extent to which a council can service its interest bearing debt and take on additional borrowings. It measures the burden of the current interest expense upon a council's operating cash.

Operating Ratio

Benchmark = Better than negative 4%

Ratio = (operating revenue excluding capital grants and contributions – operating expenses) / operating revenue excluding capital grants and contributions

This ratio measures a council's ability to contain operating expenditure within operating revenue.

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

Ratio = rates, utilities and charges / total operating revenue (inclusive of capital grants and contributions)

This ratio measures the level of a council's fiscal flexibility. It is the degree of reliance on external funding sources such as operating grants and contributions. A council's financial flexibility improves the higher the level of its own source revenue.

Unrestricted Current Ratio

Benchmark = 1.5x (taken from the IPART December 2009 Revenue Framework for Local Government report)

Ratio = Current assets less all external restrictions / current liabilities less specific purpose liabilities

Restrictions placed on various funding sources (e.g. Section 94 developer contributions, RMS contributions) complicate the traditional current ratio because cash allocated to specific projects are restricted and cannot be used to meet a council's other operating and borrowing costs. The Unrestricted Current Ratio is specific to local government and is designed to represent a council's ability to meet debt payments as they fall due.