ATTACHMENT B

T Corp assessment of Temora Shire Council

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Temora Shire Council

Financial Assessment and Benchmarking Report

21 March 2013

Prepared by NSW Treasury Corporation as part of the Local Infrastructure Renewal Scheme

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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 as part of the Local Infrastructure Renewal Scheme (LIRS) announced by the NSW Government.

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 within prudent risk parameters and the limits of its financial projections.

The report has been prepared for Temora Shire Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Temora 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 Temora Shire Council's (the Council) financial capacity and its ability to undertake additional borrowings. 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.

The report is primarily focused on the financial capacity of the Council to undertake additional borrowings as part of the Local Infrastructure Renewal Scheme (LIRS).

Council has made one application for Temora Medical Complex for $1.7m of borrowings to be repaid over six years.

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. The review of the financial forecasts focused on the consolidated position. Although the project is being funded from the General Fund given the level of revenue generated from Council's Sewerage Fund we have focused our review on the Consolidated Fund

The Council has been reasonably managed over the review period based on the following observations:

- Council reported minor operating deficits in the last two years having previously reported surpluses, when capital grants and contributions are excluded
- Council's underlying cash result (measured using EBITDA) has increased since 2009 and is on an upward trend
- Council's Unrestricted Current Ratio has been above benchmark each year indicating Council had sufficient liquidity
- Council's Interest Cover Ratio and DSCR have been well above benchmark over the review period

Council's reported Infrastructure Backlog of $4.4m in 2012 represents 3.2% of its infrastructure asset value of $136.0m. Other observations include:

- Council's Infrastructure Backlog has increased by $2.0m since 2009 to $4.3m in 2012
- Public road assets made up 83.0% of the Infrastructure Backlog
- Compared to benchmark ratios, Council appears to have underspent on asset renewal in the past two years and it is likely that the backlog valuation will grow

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

- The forecast shows surplus positions are expected each year from 2013 when capital grants and contributions are excluded
- Council's Capital Expenditure Ratio is above benchmark for the entire forecast period

In our view, the Council has the capacity to undertake the combined additional borrowings of $1.7m for the LIRS project. This is based on the following analysis:

- The DSCR remains above the benchmark of 2.00x in the 10 year forecast
- The Interest Cover Ratio is above the benchmark of 4.00x for the entire forecast period
- In addition, Council has sufficient capacity to manage additional borrowings from 2012 of up to $12.2m based on TCorp's calculations and the existing financial forecasts

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios, on a consolidated basis, with other councils in DLG Group 10. The key observations are:

- Council's financial flexibility is moderate. While the Operating Ratio is above benchmark and forecast to increase further in the medium term Council's Own Source Operating Revenue Ratio is below benchmark and forecast to decline in the medium term
- Council was in a sufficiently liquid position which is forecast to be above the group's average liquidity level over the medium term
- Council's DSCR and Interest Cover Ratio were above benchmark and the group average over the review period. The ratios are forecast to decline in line with the group average in the medium term but remain above benchmark
- Council has a comparatively low level of Infrastructure Backlog
- The Asset Maintenance Ratio tracks benchmark level above the group average. It's Building and Infrastructure Asset Renewal Ratio falls below benchmark in 2011 and remains at this level in line with the group average. The Capital Expenditure Ratio broadly tracks the group average. Following a decrease in 2011 the ratio improves in 2012 however it is forecast to decrease in the medium term below benchmark and its peer group

Section 2 Introduction

2.1: Purpose of Report

This report provides the Council with an independent assessment of their financial capacity and performance measured against a peer group of councils. It will complement Council's internal due diligence, the IP&R system of the Council and the DLG.

The report is to be provided to the LIRS Assessment Panel for its use in considering applications received under the LIRS.

The key areas focused on are:

- The financial capacity of the Council to undertake additional borrowings
- 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 particular Council fund that was undertaking the proposed debt commitment. For example where a project is being funded from the General fund we focussed our review on the General fund
- Identify significant changes to future financial forecasts from existing financial performance and highlight risks associated with such forecasts
- 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
- Conduct a high level review of the Council's IP&R documents for factors which could impact the Council's financial capacity and performance

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
- Council's submissions to the DLG as part of their LIRS application
- Other publicly available information such as information published on the IPART website

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Benchmark Ratios

In conducting our review of the Councils' financial performance and forecasts 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
Infrastructure Backlog Ratio	< 0.02x
Asset Maintenance Ratio	> 1.00x
Building and Infrastructure Asset Renewal Ratio	> 1.00x
Capital Expenditure Ratio	> 1.10x

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2.3: Overview of the Local Government Area

Temora Shire Council LGA	
Locality & Size	
Locality	Riverina
Area	2,802 km²
DLG Group	10
Demographics	
Population as at 2011	5,776
% under 18	27%
% between 18 and 59	45%
% over 60	28%
Expected population 2025	6,353
Operations	
Number of employees (FTE)	85
Annual revenue	$15.5m
Infrastructure	
Roads	1330km
Bridges	6
Infrastructure backlog value	$4.4m
Total infrastructure value	$136.1m

Temora Shire Council Local Government Area (LGA) is located approximately 518km from Melbourne, 410km from Sydney and 88km from Wagga Wagga.

Temora Shire is in the heart of the productive southern wheat and sheep area of the state. The towns and villages are home to about two thirds of the Shire's residents.

Sheep production for wool and meat are the main agricultural activities

The current population of 5,776 is expected to increase by 10.0% to 6,353 in 2021.

Council had 85 equivalent full time employees at the end of the 2012 financial year.

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2.4: LIRS Application

Council has made one LIRS application.

Project: Temora Medical Project

Description: The construction of a purpose built medical complex. The building is designed to accommodate a wide range of health and allied health professionals and will be fitted with a range of modern high quality equipment to support the professionals'.

Amount of loan facility: $1.7m

Term of loan facility: 6 years

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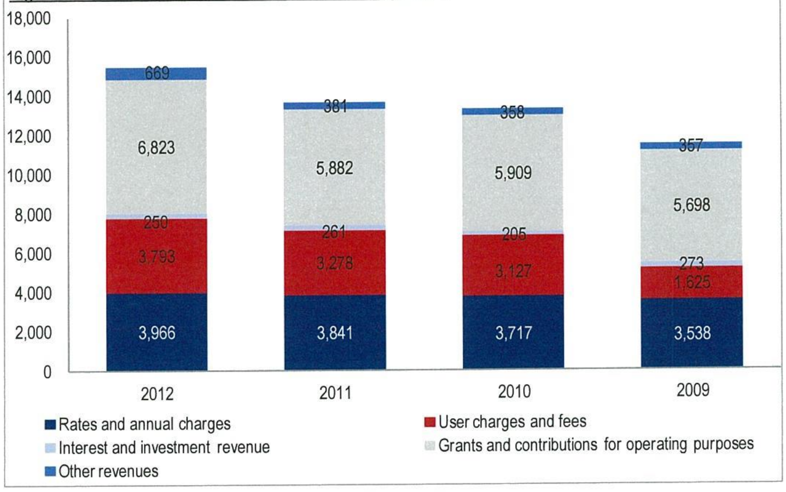
Section 3 Review of Financial Performance and Position

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: Revenue

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

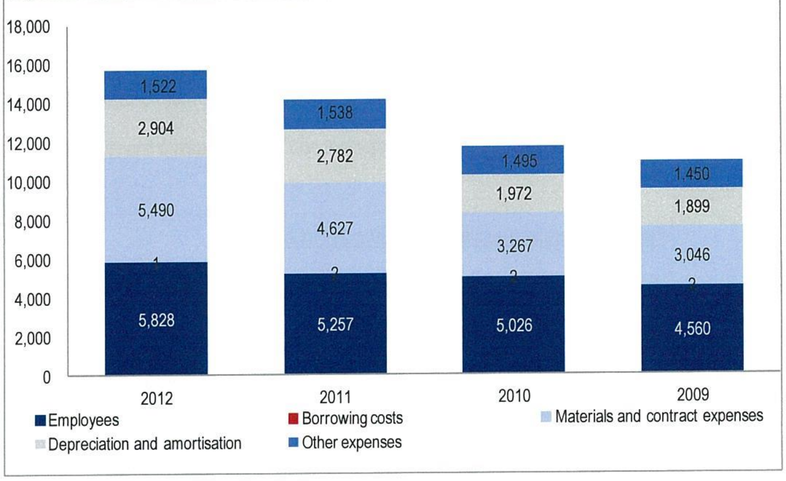


Key Observations

- Council's total revenue, excluding capital grants and contributions, has increased 34.9% ($4.0m) since 2009 to $15.5m in 2012.
- Rates and annual charges have increased in line with rate peg over the past two years. In 2010 they increased by 5.1% due to an increase in the number of assessments and increases in annual sewage domestic waste management charges.
- User fees and charges remained static between 2010 and 2011. In 2012 they increased by 15.7% ($0.5m) due to increased RMS charges revenue. 2010 also saw an increase of $1.0m in RMS (formerly RTA) revenue and private works revenue. RMS charges are Council's largest revenue source in this category and generated $3.0m in 2012.
- Grants and contributions for operating purposes increased by 16.0% ($1.0m) due to half of the Financial Assistance Grant for 2013 being paid in advance in June 2012.

3.2: Expenses

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



Key Observations

- Council's total expenses increased by 43.7% ($4.8m) since 2009 to $15.7m in 2012.
- Employee expenses increased by 10.9% ($0.6m) in 2012 due to increased employee leave entitlements (ELE) following a decrease in the discount rate set for ELE. 2010 saw an increase of 10.2% ($0.5m) driven by an increase in the number of full time equivalent employees from 74 in 2009 to 78 in 2010.
- Materials and contracts expenses have increased by 80.2% ($2.4m) since 2009 to $5.5m in 21012. 2011 saw an increase of 41.6% due to increased maintenance on Council's roads network. In 2012 materials and contracts expenses increased by 18.7% ($0.8m) primarily in response to increased works undertaken for RMS and flood damage repairs.
- The Asset Revaluations process resulted in the value of Council's infrastructure assets increasing by $69.4m since 2009 to $136.0m in 2012. This resulted in the depreciation charge increasing $1.0m since 2009 to $2.9m in 2012.

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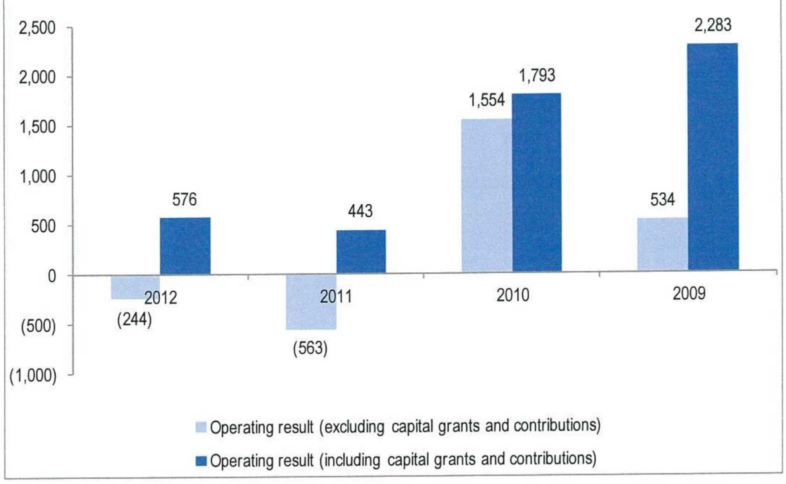
3.3: Operating Results

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 net operating deficits, excluding capital grants and contributions, in 2011 and 2012. Increased materials and contracts expenses and depreciation expense had a negative impact on the result in 2011. Increased user fees and charges and advanced payment of operating grants impacted the result favourably in 2012.
- Council's expenses include a non-cash depreciation expense of $2.9m in 2012. Whilst the non-cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

3.4: Financial Management Indicators

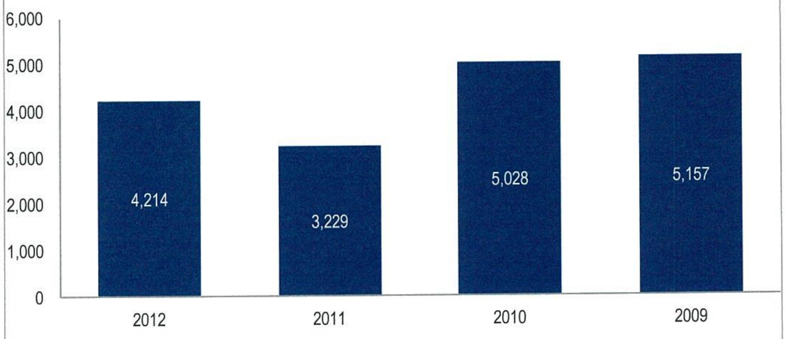
Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA ($'000s)	2,661	2,221	3,528	2,435
Operating Ratio	(1.6%)	(4.1%)	11.7%	4.6%
Interest Cover Ratio	2,661.00x	1,110.50x	1,764.00x	1,217.50x
Debt Service Cover Ratio	204.69x	277.63x	525.00x	173.93x
Unrestricted Current Ratio	2.98x	3.90x	3.04x	3.55x
Own Source Operating Revenue Ratio	47.5%	48.6%	50.5%	39.0%
Cash Expense Ratio	3.9 months	3.4 months	6.2 months	6.8 months
Net assets ($'000s)	216,109	213,239	213,508	77,724

Key Observations

- Council's underlying operating performance (measured using EBITDA) is on an upward trend and has increased $0.2m since 2009. Increased revenue from user fees and charges combined with lower depreciation charges caused EBITDA to peak in 2011.
- Council's Operating Ratio was above benchmark in three of the four year period. The ratio fell marginally below benchmark of negative 4.0% in 2011 reflecting the increased materials and contracts and depreciation expenses that year.
- Council's Interest Cover Ratio and DSCR were well above their respective benchmarks indicating Council had flexibility in regard to carrying more debt, but is also reflective of a small amount of debt held.
- The Unrestricted Current Ratio was above benchmark each year indicating Council had sound liquidity.
- The Own Source Revenue Ratio is below the 60% benchmark in all four years. This indicates that Council did not have sufficient financial flexibility, and rely on revenue streams outside of their control, in particular operating grants. 2009 saw an increase of $1.5m in Capital Grants compared to 2010, which included an increase in the Federal Stimulus Package Grant, Transport grants and a contribution for the Morangarell Bridge.
- The Cash Expense Ratio was above benchmark in all four years indicating Council had sound liquidity. The ratio decreased in 2011 due to increased materials and contracts costs resulting in a decrease in Council's cash balance.
- Council's Net Assets have increased by approximately $138.4m since 2009 due to asset revaluations which increased the value of roads, bridges and drainage infrastructure.
- When asset revaluations are excluded the underlying trend in all four years has been an increase in the infrastructure, property, plant and equipment (IPP&E) asset base with asset purchases being greater than the combined value of disposed assets and annual depreciation. Over the four years this amounted to a $6.0m increase in IPP&E assets.
- Council has borrowings of $0.003m representing 0.001% of Net Assets.

3.5: Statement of Cashflows

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



Key Observations

- Cash and cash equivalents have decreased by $0.9m since 2009. Increased materials and contracts expenses caused a decrease in Council's cash balance in 2011. The sale of investment securities resulted in an increase in the cash balance in 2012.
- The cash balances along with the Unrestricted Current Ratio indicate Council had sound liquidity.
- Of the $4.7m in cash, cash equivalents and investments, $2.1m is externally restricted and $2.6m is internally restricted. Council do not have any unrestricted cash.
- In 2012 Council's investments comprised of $0.5m in long term deposits. Council do not have any CDO's or FRN's.

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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)

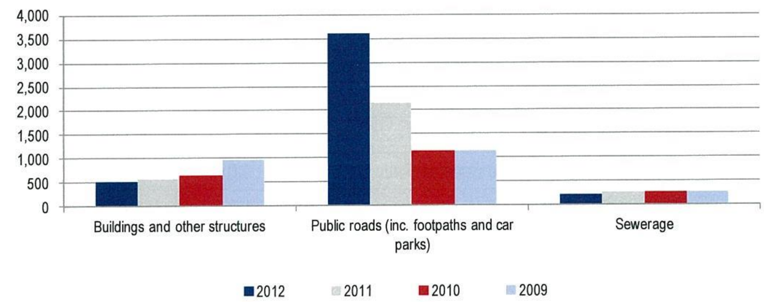
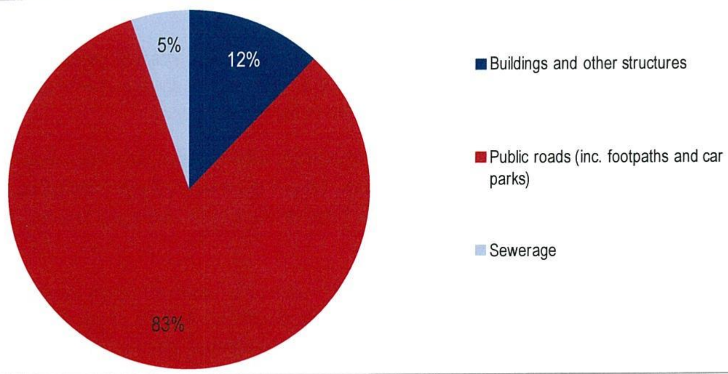


Figure 6 - Infrastructure Backog Composition for 2011/12



Council reported $4.4m in Infrastructure Backlog in 2012, of which 83.0% ($3.6m) relates to roads, 12.0% ($0.5m) relates to buildings and 5.0% ($0.2m) relates to sewerage. Council's roads backlog increased in 2011 and 2012 as Council continue to update their asset data with current figures. Council are happy that these figures best reflect the backlog position in 2012. Council do not have any water infrastructure. Water is supplied by Goldenfields Water County Council.

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Council do not have any drainage backlog. Council has revalued their drainage infrastructure and are currently preparing a Drainage Plan as well as an Integrated Water Cycle Management Plan which will clarify and value future requirements

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard ($'000s)	4,360	2,995	2,080	2,386
Required annual maintenance ($'000s)	3,050	3,589	1,501	1,429
Actual annual maintenance ($'000s)	4,186	3,589	1,501	1,429
Total value of infrastructure assets ($'000s)	136,078	134,494	134,590	66,633
Total assets ($'000s)	221,400	217,560	217,974	81,970
Building and Infrastructure Backlog Ratio	0.03x	0.02x	0.02x	0.04x
Asset Maintenance Ratio	1.37x	1.00x	1.00x	1.00x
Building and Infrastructure Renewals Ratio	0.85x	0.52x	2.03x	2.33x
Capital Expenditure Ratio	1.54x	0.88x	1.98x	2.42x

The Building and Infrastructure Backlog Ratio was marginally above the benchmark of less than 0.02x in two years of the four year period.

The Asset Maintenance Ratio increased above the benchmark of greater than 1.0x in 2012 due to increased road maintenance in 2012 as a result of flood damage maintenance. This ratio indicates Council is spending at the required level on asset maintenance.

The Building and Infrastructure Asset Renewal Ratio has been below benchmark for the past two years as a result of increased depreciation. Council also made a decision to reduce capital works in 2011 and 2012 to enable necessary maintenance works to be carried out following a number of years of extensive capital works. .

The Capital Expenditure Ratio which takes into account capital expenditure which improves performance or capacity has been above benchmark in three of the four year period. The ratio decreased below benchmark in 2011 due to decreased spending on Council's roads, bridges and footpaths.

Based on these figures Council is spending at the required level to maintain their existing assets and meet current service levels however they are not spending sufficiently to enhance their asset base or performance.

In their Asset Management Plan 2011 (AMP) Council state that their goal is to manage their infrastructure assets to meet required levels of service in the most cost effective manner for present and future residents. Council also recognise that further work is required on condition rating and methodology for their unsealed roads network.

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	1,280	772	845	372
Replacement/refurbishment of existing assets	3,471	1,994	3,419	4,635
Total	**4,751**	**2,766**	**4,264**	**5,007**

Major Capital Works Projects

The Temora Medical Project is Council's main capital works project. This project involves the construction of a new medical facility for Temora. The new facility will feature modern architecture and facilities including 12 consultation rooms, specialists' rooms, minor procedure areas and on-site pathology.

Major Capital Projects 2010-2012

- Medical Centre Construction $2.5m
- Roads Upgrades and Renewals $1.7m
- Bundawarrah Centre (Rural Museum/Visitor Information Centre) $0.8m
- Bob Aldridge Park Club rooms $0.1m
- Ariah Park Multi Sport Complex $0.7m
- Reseal/Line mark runway at airport $0.7m

Major Capital Works Projects 2013-2017

- Roads Upgrades and Renewals $10.5m
- 18/36 Runway Upgrade $1.6m
- Town Hall Upgrade $0.3m
- Heated Pool contribution $0.2m
- Grogan Bridge upgrade $0.2m

3.7: Specific Risks to Council

- Local Economy: The past decade has been challenging for families in farming communities as well as those businesses reliant on this sector. The LGA has suffered the loss of tradespeople, families and individuals who have moved from the area to seek better job opportunities allied to the mining industry. Council is planning for its future economy through tourism initiatives and economic development strategies. Population growth is predicted at 10.0% over the next 10 years and this will require a change of focus on the type of facilities provided and promotion of improved lifestyle to attract young skilled people to relocate to the smaller rural towns and villages.
- Ageing Population: Council has a significant ageing population with the over 60's representing approximately 28% of Council's population. This will place additional pressure on existing infrastructure and services, and increase demand for infrastructure to meet the needs of an ageing population. While Council does not have a specific policy on supporting the ageing population within the community, it provides many meaningful activities for older people in the community. The development of a formal Ageing Population policy and plan would provide a more structured approach to its ageing population and identify skill sets that would be of benefit to the overall community.

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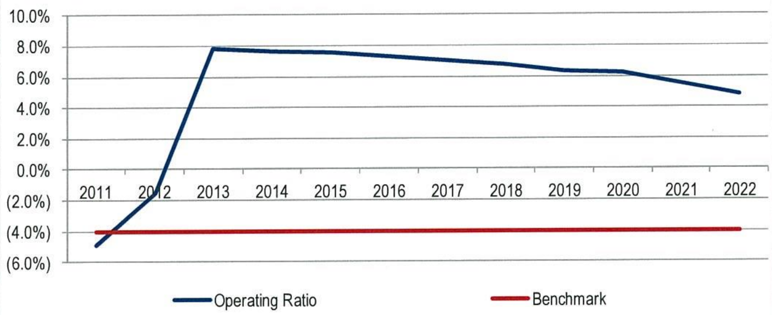
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $1.7m loan without any LIRS subsidy.

The LIRS loan relates to the General Fund, however Council also operate a small Sewer Fund and so we have focused our financial analysis on Council's Consolidated position.

4.1: Operating Results

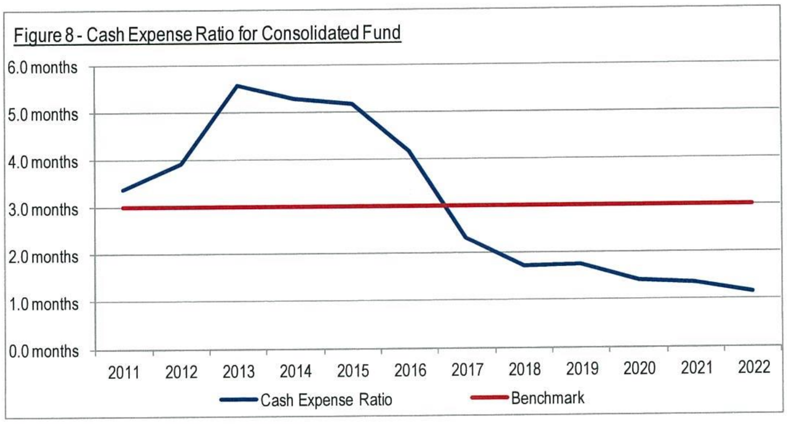
Figure 7- Operating Ratio for Consolidated Fund



The Operating Ratio shows surplus positions are expected, when capital grants and contributions are excluded, each year from 2012 for the remainder of the forecast. Increased operating grants in 2012 and decreased materials and contracts expenses in 2013 are causing the ratio to remain well above benchmark.

4.2: Financial Management Indicators

Liquidity Ratios



The Cash Expense Ratio is above benchmark until 2017. Council has not included any funds for RMS works from 2017. Council has recognised this anomaly and plan to remedy this in their next LTFP.

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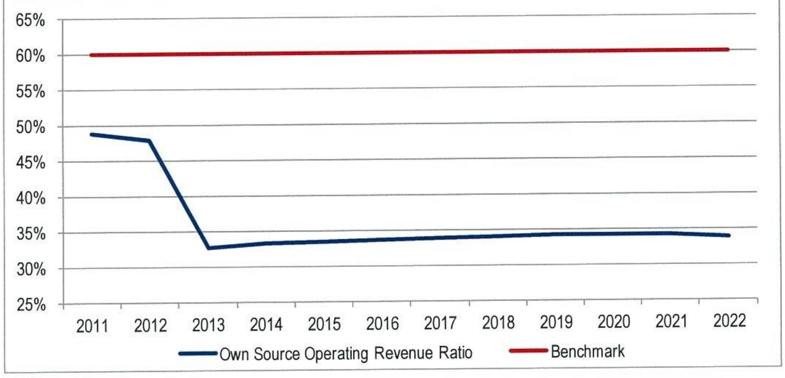
Fiscal Flexibility Ratios

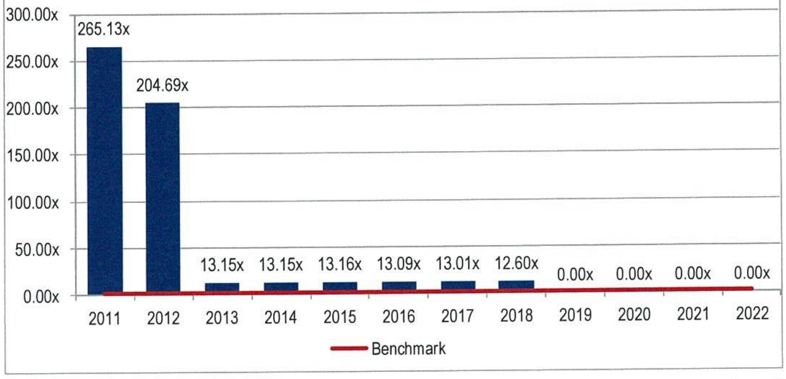
Figure 9 - Own Source Operating Revenue Ratio for Consolidated Fund



Council's Own Source Operating Revenue Ratio is well below benchmark for the entire forecast period. This indicates Council is highly reliant on external revenue sources, primarily operating grants, which make up over 40.0% of Council's overall revenue.

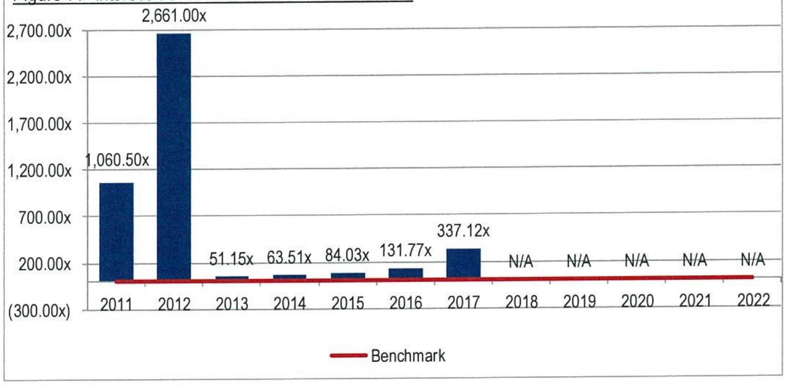
The ratio decreases in 2013 as Council's user fees and charges are forecast to decrease significantly. Council has removed RMS fees revenue from their user fees and charges revenue in the LTFP as this revenue is not guaranteed. Therefore this ratio may not be an accurate reflection of Council's future Own Source Operating Revenue.

Figure 10 - DSCR for Consolidated Fund



Council's DSCR is well above benchmark of 2.00x until 2018. From 2019 there is no result as Council will have paid down all their debt and have not forecast any additional borrowings

Figure 11 - Interest Cover Ratio for Consolidated Fund



The Interest Cover Ratio, similarly to the DSCR, shows Council has sufficient capacity to service scheduled debt commitments with no ratio shown from 2018 as Council has forecast no additional borrowings.

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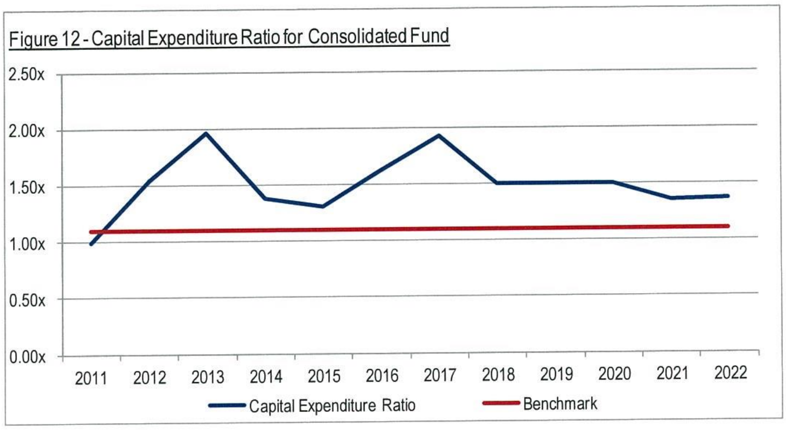
4.3: Capital Expenditure



The Capital Expenditure Ratio is above benchmark for the entire forecast period. The ratio peaks in 2013 due to the LIRS project and roads upgrade, and again in 2017 driven by increased spending on Town Hall upgrades and airport runway upgrades.

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 the LGCI 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%

<u>Key Observations and Risks</u>

- Rates revenue has been forecast to increase by 6.9% in 2013. In 2013 Council plans to increase sewerage charges by 5.0% and waste charges by 7.9%. From 2014 rates revenue is assumed to increase by 2.8% p.a. which is considered conservative given the recent rate peg increases
- Council has forecast user fees and charges to decrease by almost $3.0m from 2013 and increase approximately 1.6% p.a. for the remainder of the forecast. Council has taken a very conservative approach in their user fees and charges forecast. They have removed the RMS charges income which cannot be guaranteed each year and maintained conservative increases for the remainder of the forecast. If in fact no income is to be received, Council should amend its LTFP to reduce expected forecast expenses so that the forecast provides a more accurate estimate of Council's operating result.
- Employee expenses are forecast to decrease by 11.0% in 2013. This is a result of the 2012 actual figures being used for our assessment. From 2014 they increase by 4.0% p.a. which we consider reasonable.
- Materials and contracts expenses are forecast to decrease by 47.3% in 2013 following a one off increase in 2012 for flood damage repair work. From 2014 they are forecast to increase by 3.9% p.a. This is considerably lower than historic increases in materials and contracts expenses and Council will need to monitor this carefully to maintain these forecast levels.

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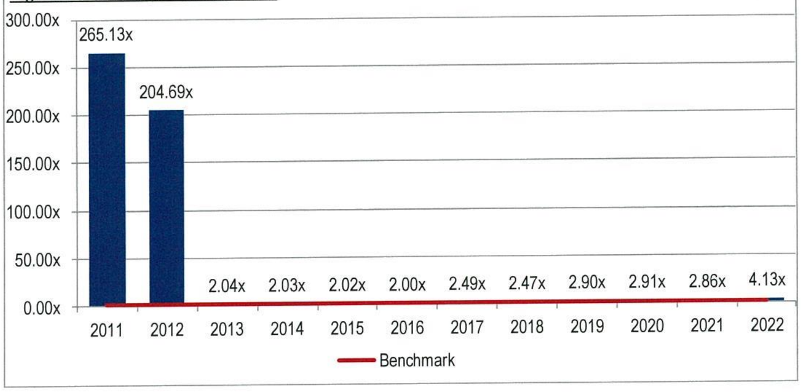
4.5: Borrowing Capacity

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

- Based on a benchmark of DSCR>2x, $12.2m could be borrowed in addition to the $1.7m borrowings proposed under LIRS in 2013
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at a rate of 7.5% p.a.

Figure 14 - DSCR for General Fund



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Section 5 Benchmarking and Comparisons with Other Councils

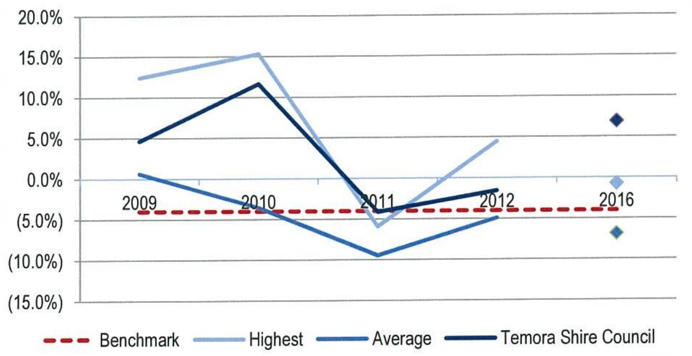
As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis (that is, for councils that operate more than one fund, the results of all funds are included). This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 10. There are 25 councils in this group and at the time of preparing this report, we have data for 19 of these councils.

In Figure 15 to Figure 23, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 21 to 23 do not include the 2016 forecast position as those numbers are not available.

Where no highest line is shown on the graph, this means that Council is the best performer in its group for that Ratio.

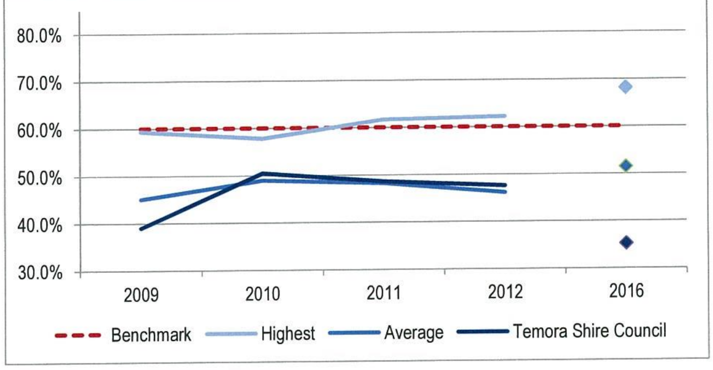
<u>Financial Flexibility</u>

Figure 15 - Operating Ratio Comparison



Council's Operating Ratio decreased significantly in 2011 however remained above benchmark and the group average. The ratio improved slightly in 2012 and Council is forecast to maintain its strong operating results over the medium term, in contrast to its peer group which is forecast to deteriorate.

Figure 16 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio was in line with the group's average and below benchmark over the review period. It is forecast to decrease in the medium term in contrast to its peer group which is forecast to increase slightly.

Overall, Council's financial flexibility is moderate.

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Liquidity

Figure 17 - Cash Expense Ratio Comparison

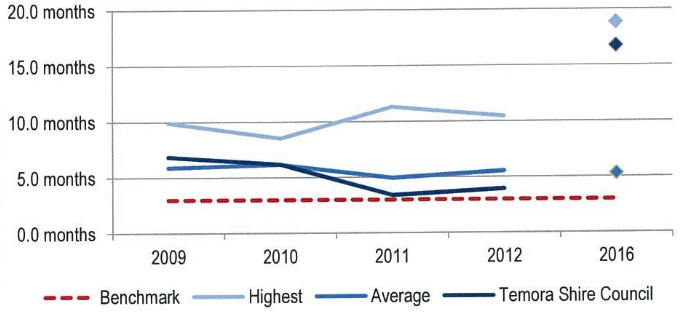
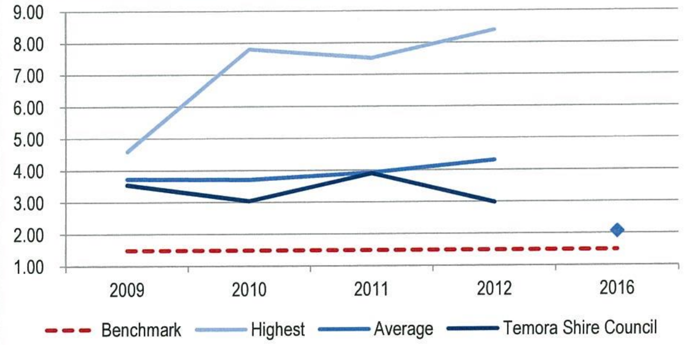


Figure 18 - Unrestricted Current Ratio Comparison



Council's Cash Expense Ratio generally tracked the group average but remained above benchmark over the review period. The ratio is forecast to increase well above benchmark and its peer group in the medium term.

The Unrestricted Current Ratio was above benchmark and broadly tracked the group's average until 2012. In 2012 the ratio decreases below the group average but remained above benchmark. Council did not provide sufficient data to calculate the ratio over the medium term.

Overall, Council's liquidity position is sound.

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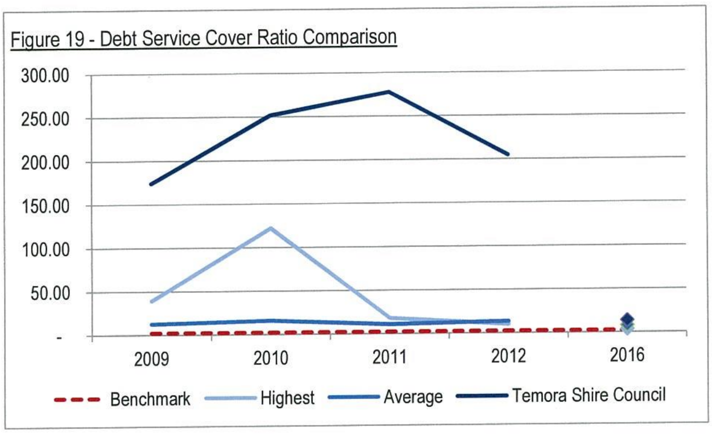
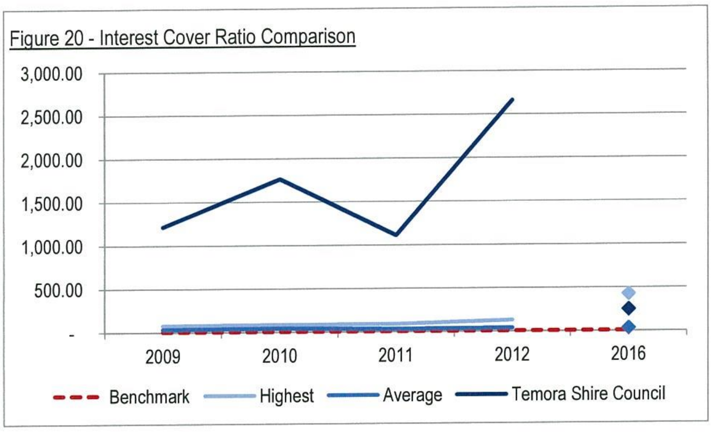
Debt Servicing





Over the review period, Council was the strongest in the group in terms of DSCR and Interest Cover Ratio indicating that its gearing levels are lower than other councils in the group. Council's debt service ratios are forecast to decrease in the medium term in line with the group average but remain well above benchmark.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

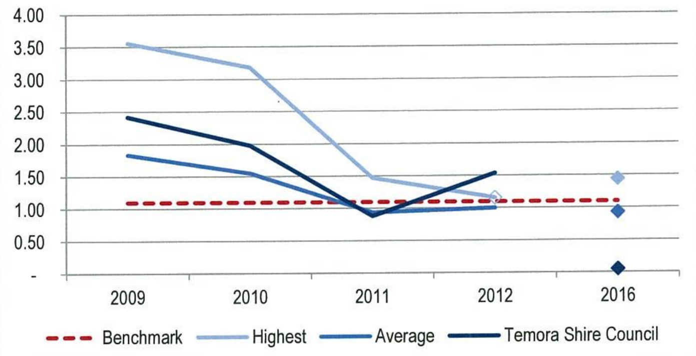


Figure 22 - Asset Maintenance Ratio Comparison

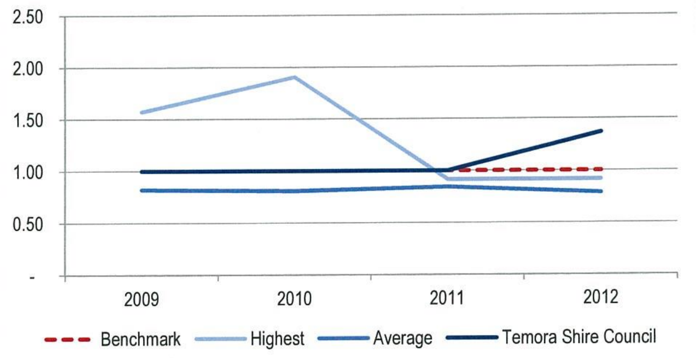


Figure 23 - Infrastructure Backlog Ratio Comparison

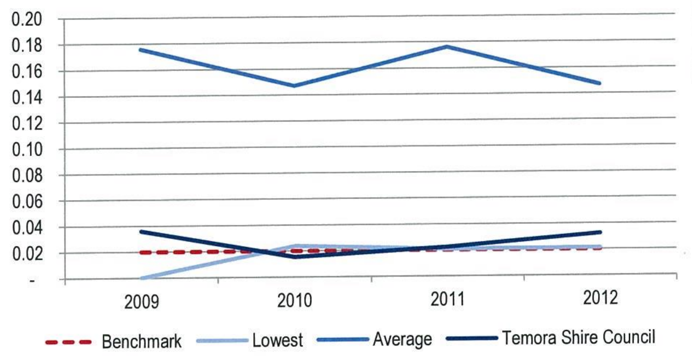
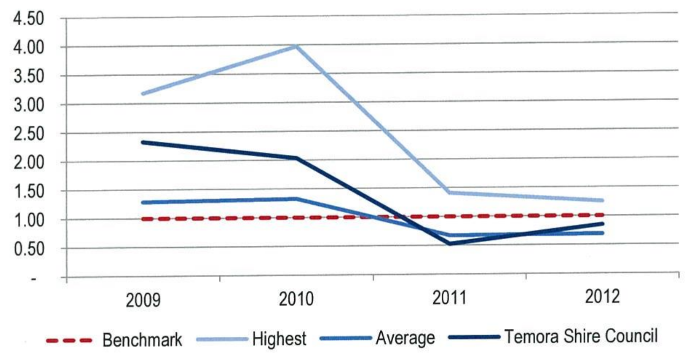


Figure 24 - Building and Infrastructure Asset Renewal Ratio



Council's Infrastructure Backlog has been well below the group's average in the past four years, and has remained at or close to benchmark over the same period.

The Asset Maintenance Ratio has also tracked benchmark levels but remained above the group average. The Building and Infrastructure Asset Renewal Ratio was above benchmark until 2011 when it fell below benchmark to the group level as a result of a reduction in capital works.

The Capital Expenditure Ratio decreased below benchmark in 2011 due to decreased spending on Council's roads, bridges and footpaths. The ratio improved in 2012 but is forecast to decrease below benchmark and its peer group in the medium term.

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Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's LTFP we consider Council to be in a satisfactory financial position in terms of their operating performance. Both past performance and the financial forecasts support our findings that Council has sufficient financial capacity to service the additional borrowings proposed under its LIRS application.

We base our recommendation on the following key points:

- Council has sufficient financial capacity to manage the additional $1.7m debt highlighted by a DSCR and Interest Cover Ratio well above the benchmark in all 10 years of its financial forecast
- Council has incurred operating deficits for the past two years however the LTFP forecasts operating surplus (excluding grants and contributions for capital purposes) each year of the review period. While Council has forecast conservative increases in materials and contracts expenses they have also forecast very conservative increases in some revenue areas, and indeed some reductions (RMS)
- Council's Capital Expenditure Ratio has been forecast above benchmark for the entire period

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

- Council is heavily reliant on operating grants which made up approximately over 45% of Council's revenue for the last four years. Any decrease in this revenue stream will have a significant negative impact on Council's overall operating performance. Council needs to improve revenue in other areas where possible, and reduce reliance on operating grants.
- Council has based their forecast on conservative levels of growth. We recommend Council reviews some of its assumptions in its LTFP so that a more accurate financial forecast is available.

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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	3,966	3,841	3,717	3,538	3.3%	3.3%	5.1%
User charges and fees	3,793	3,278	3,127	1,625	15.7%	4.8%	92.4%
Interest and investment revenue	250	261	205	273	(4.2%)	27.3%	(24.9%)
Grants and contributions for operating purposes	6,823	5,882	5,909	5,698	16.0%	(0.5%)	3.7%
Other revenues	669	381	358	357	75.6%	6.4%	0.3%
Total revenue	**15,501**	**13,643**	**13,316**	**11,491**	**13.6%**	**2.5%**	**15.9%**
Expenses							
Employees	5,828	5,257	5,026	4,560	10.9%	4.6%	10.2%
Borrowing costs	1	2	2	2	(50.0%)	0.0%	0.0%
Materials and contract expenses	5,490	4,627	3,267	3,046	18.7%	41.6%	7.3%
Depreciation and amortisation	2,904	2,782	1,972	1,899	4.4%	41.1%	3.8%
Other expenses	1,522	1,538	1,495	1,450	(1.0%)	2.9%	3.1%
Total expenses	**15,745**	**14,206**	**11,762**	**10,957**	**10.8%**	**20.8%**	**7.3%**
Operating result (excluding capital grants and contributions)	**(244)**	**(563)**	**1,554**	**534**	**56.7%**	**(136.2%)**	**191.0%**
Operating result (including capital grants and contributions)	**576**	**443**	**1,793**	**2,283**	**30.0%**	**(75.3%)**	**(21.5%)**

Table 2 - Items excluded from Income Statement

Excluded items				
Grants and contributions for capital purposes	820	1,006	239	1,749
Net gain from the disposal of assets	N/A	120	11	334

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Current assets							
Cash and cash equivalents	4,214	3,229	5,028	5,157	30.5%	(35.8%)	(2.5%)
Investments	500	2,103	0	0	(76.2%)	#DIV/0!	#DIV/0!
Receivables	2,495	1,201	1,968	836	107.7%	(39.0%)	135.4%
Inventories	971	1,826	1,968	1,937	(46.8%)	(7.2%)	1.6%
Other	101	124	89	201	(18.5%)	39.3%	(55.7%)
Total current assets	8,281	8,483	9,053	8,131	(2.4%)	(6.3%)	11.3%
Non-current assets							
Investments	0	0	0	0	N/A	N/A	N/A
Receivables	66	79	34	43	(16.5%)	132.4%	(20.9%)
Inventories	0	0	0	0	N/A	N/A	N/A
Infrastructure, property, plant & equipment	213,053	208,998	208,887	73,796	1.9%	0.1%	183.1%
Investment property	0	0	0	0	N/A	N/A	N/A
Total non-current assets	213,119	209,077	208,921	73,839	1.9%	0.1%	182.9%
Total assets	**221,400**	**217,560**	**217,974**	**81,970**	**1.8%**	**(0.2%)**	**165.9%**
Current liabilities							
Payables	1,338	800	965	909	67.3%	(17.1%)	6.2%
Borrowings	0	12	12	12	(100.0%)	0.0%	0.0%
Provisions	3,885	3,474	3,455	3,251	11.8%	0.5%	6.3%
Total current liabilities	5,223	4,286	4,432	4,172	21.9%	(3.3%)	6.2%
Non-current liabilities							
Borrowings	3	0	6	18	0.0%	(100.0%)	(66.7%)
Provisions	65	35	28	56	85.7%	25.0%	(50.0%)
Total non-current liabilities	68	35	34	74	94.3%	2.9%	(54.1%)
Total liabilities	**5,291**	**4,321**	**4,466**	**4,246**	**22.4%**	**(3.2%)**	**5.2%**
Net assets	**216,109**	**213,239**	**213,508**	**77,724**	**1.3%**	**(0.1%)**	**174.7%**

Table 4-Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
Cash flows from operating activities	3,329	2,429	3,669	4,779
Cash flows from investing activities	(2,332)	(4,222)	(3,786)	(4,285)
Proceeds from borrowings and advances	0	0	0	0
Repayment of borrowings and advances	(12)	(6)	(12)	(12)
Cash flows from financing activities	(12)	(6)	(12)	(12)
Net increase/(decrease) in cash and equivalents	**985**	**(1,799)**	**(129)**	**482**
Cash and equivalents	4,214	3,229	5,028	5,157

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

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.

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.

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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, building, other structures and depreciable land improvement assets (from note 9a)

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.