New South Wales
Treasury Corporation

Oberon Council

Financial Assessment, Sustainability and Benchmarking Report

22 March 2013

Prepared by NSW Treasury Corporation for Oberon Council, the Division of Local Government and the Independent Local Government Review Panel.

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 Oberon Council, the DLG and the Independent Local Government Review Panel. TCorp shall not be liable to Oberon 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 Oberon Council's (the Council) financial capacity, 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. Council operates three funds and for the purposes of our report we have used the Consolidated Fund as the Water and Sewer Funds do not have a significant impact on Council's overall operating result.

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

- Council has reported marginal operating deficits, excluding capital grants and contributions, in three of the past four years
- Council's underlying operating performance (measured using EBITDA) has increased by $2.1m since 2009 to $3.3m in 2012
- The majority of Council's performance indicators were above benchmark over the review period and improved in 2012
- Council's Own Source Operating Revenue Ratio has been slightly below benchmark each year of the review period indicating Council is reliant on external sources of revenue

The Council reported $16.1m of Infrastructure Backlog in 2012 which represents 13.3% of its infrastructure asset value of $120.9m. Other observations include:

- Council's Infrastructure Backlog value has increased by $9.7m from 2009 to $16.1m in 2012
- The majority of Council's Backlog (87.0%) relates to public roads infrastructure which has increased in Backlog value from $5.2m in 2009 to $14.0m in 2012 following the Asset Revaluations process
- Based on benchmark ratios Council appear to be underspending the required amount to maintain their existing assets at a satisfactory level

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

- The forecast contains optimistic assumptions in respect of the level of rates and annual charges increases which Council is unlikely to achieve
- Based on the current LTFP, the forecast shows minor surplus positions are expected in all 10 years when capital grants and contributions are excluded
- All Council's benchmark ratios are above benchmark for the forecast period
- By 2016 Council will have paid down their existing debt and has not forecast any additional borrowings

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In our view, the Council has the capacity to undertake additional borrowings of up to $11.9m. This is based on the following analysis:

- Based on a benchmark of DSCR>2x, up to $11.9m could be borrowed in addition to the existing borrowings of $0.3m
- This is dependent on Council achieving the operating results in the current LTFP

Based on our review, Council is currently in a sound Sustainability position. This assessment is based on Council achieving the operating results indicated in their current LTFP. Council also has a comparatively high level of Infrastructure Backlog and this needs to be addressed or Council's infrastructure assets may deteriorate, placing pressure on Council's future Sustainability. Other key observations include:

- Council's current LTFP forecasts an operating surplus for the entire forecast period
- Council's Interest Cover and DSCR is above benchmark for the entire forecast period indicating they have the capacity to service their current borrowings
- Council's Own Source Operating Revenue Ratio is above benchmark for the entire forecast period indicating Council do not rely heavily on revenue streams outside their control
- Council Capital Expenditure Ratio has been forecast above benchmark indicating Council will be spending at levels required to improve their existing infrastructure assets

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 reasonably sound as indicated by the Own Source Operating Revenue Ratio and Operating Ratio being above the group average and improving above benchmark in the medium term
- Council was in a sound liquidity position indicated by the Cash Expense Ratio tracking at benchmark levels and improving in the medium term and the Unrestricted Current Ratio above benchmark and outperforming the group average in 2012
- Council's DSCR and Interest Cover Ratio were above benchmark and the group average over the review period. However the ratios are forecast to decline to benchmark levels in the medium term
- Council has a comparatively high level of Infrastructure Backlog. The Asset Maintenance Ratio is below benchmark and the group average. However its Building and Infrastructure Asset Renewal and Capital Expenditure Ratios have been above benchmark and outperformed the group average over the review period.

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. It will complement Council's internal due diligence, 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
- 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

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In completing the report, TCorp worked closely with Council management to analyse and understand the information gathered. The Council was given a draft copy of the report for their review and comment. Based on our discussions with Council:

- Council agrees with the findings of the report

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

Oberon Council LGA	
Locality & Size	
Locality	Central West
Area	3,628km²
DLG Group	10
Demographics	
Population as at 2011	5,040
% under 18	26%
% between 18 and 59	49%
% over 60	25%
Expected population 2025	5,342
Operations	
Number of employees (FTE)	79
Annual revenue	$13.4m
Infrastructure	
Roads	966km
Bridges	29
Infrastructure Backlog value	$16.1m
Total infrastructure value	$120.9m

Oberon Council Local Government Area (LGA) is located in Central West NSW approximately 180km west of Sydney and 40km southeast of Bathurst.

The LGA contains the town of Oberon and the villages of Black Springs, Burraga, Edith, Mount David, O'Connell, and Shooters Hill. The Jenolan Caves are also located in the Oberon LGA.

The principal industries in the region are agriculture, timber and tourism.

The current population of 5,040 is expected to grow by 0.6% p.a. to 5,342 in 2021.

Council had 79 full time equivalent employees at 30 June 2012.

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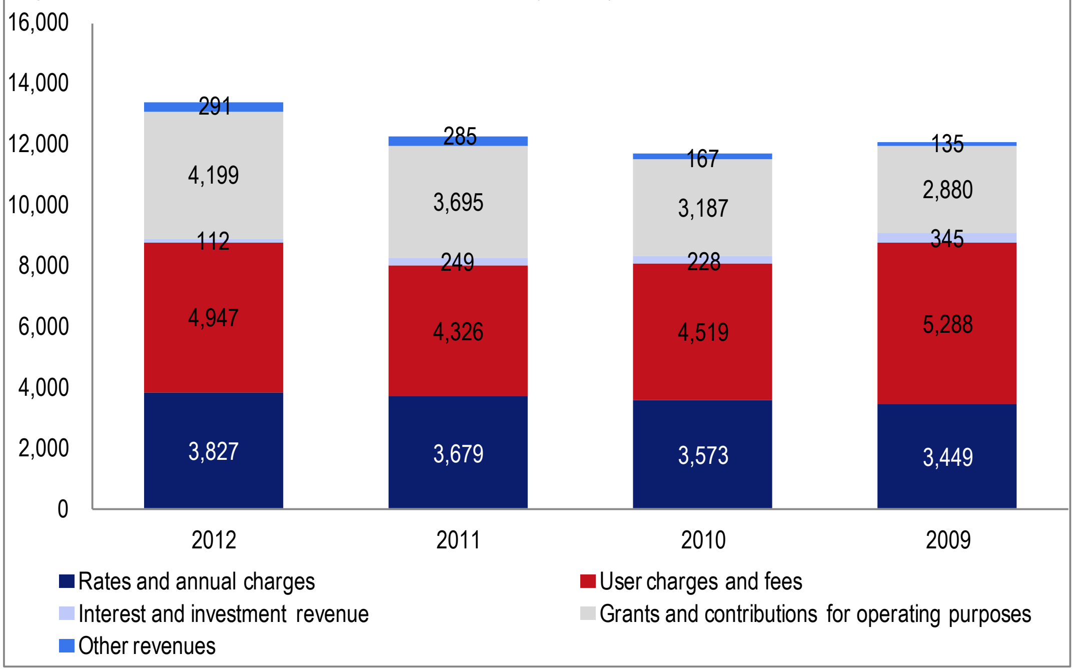
Section 3 Review of Financial Performance and Position

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)

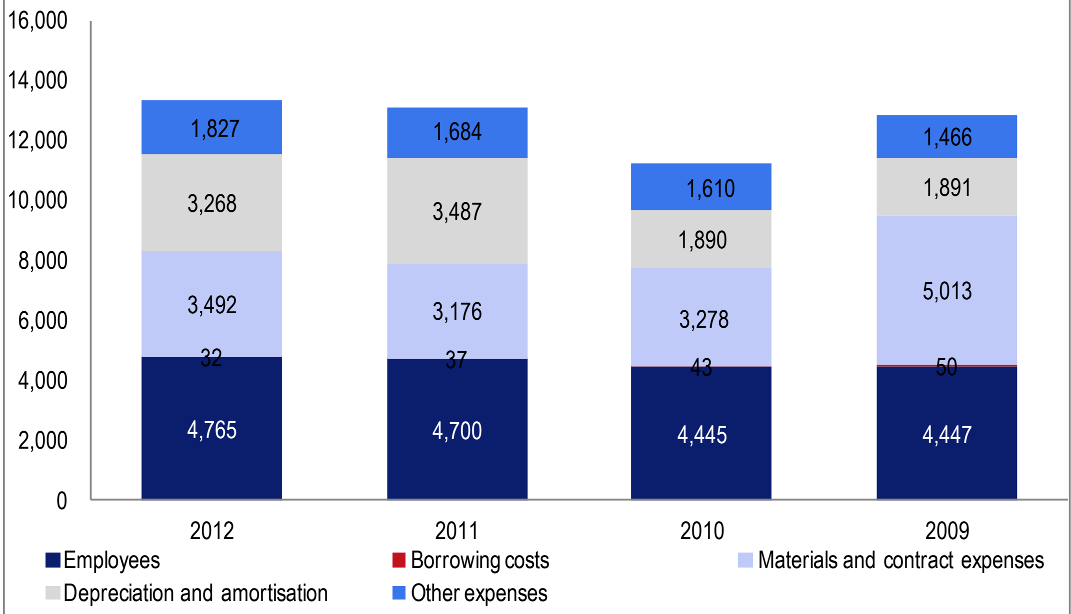


Key Observations

- Council's overall revenue has increased by 10.6% ($1.3m) since 2009 to $13.4m in 2012.
- Rates and annual charges have been increasing at consistent levels over the review period. As well as rate peg increase, 2012 also had a slight increase in waste management services charge.
- User fees and charges decreased by 14.5% in 2010 and 4.3% in 2011 as a result of decreased private works in both years. In 2012 user fees and charges increased by 14.4% due to a $0.6m increase in RMS charges as a result of works conducted at O'Connell Avenue.
- Grants and contributions for operating purposes have been increasing consistently over the review period. 2012 saw an increase of $0.5m as a result of the prepayment of half the 2013 Financial Assistance Grant (FAG) in 2012.
- Council's sewer fund has operated a surplus position over the review period. Their water fund had a surplus position in three of the past four years. 2012 reported a marginal deficit $0.03m as a result of an increase in water purchase charges.

3.2: Expenses

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



Key Observations

- Council's expenses increased by 4.0% ($0.5m) from 2009 to $13.3m in 2012.
- Employee costs were maintained at consistent levels for the past two years. They increased by 5.7% ($0.3m) in 2011 driven by increases in employee leave entitlement and workers compensation insurance.
- Materials and contracts expenses decreased in 2010 and 2011 in line with the decreases in private works. In 2012 materials and contracts increased by 9.9% ($0.3m) as a result of a reconstruction project undertaken for RMS on O'Connell Avenue. This is offset by the additional fees income.
- The Asset Revaluations process has increased the value of Council's infrastructure assets by $49.3m from 2009 to $120.9m in 2012. This resulted in the annual depreciation charge increasing by 73.0% ($1.4m) from 2010 to $3.3m in 2012.

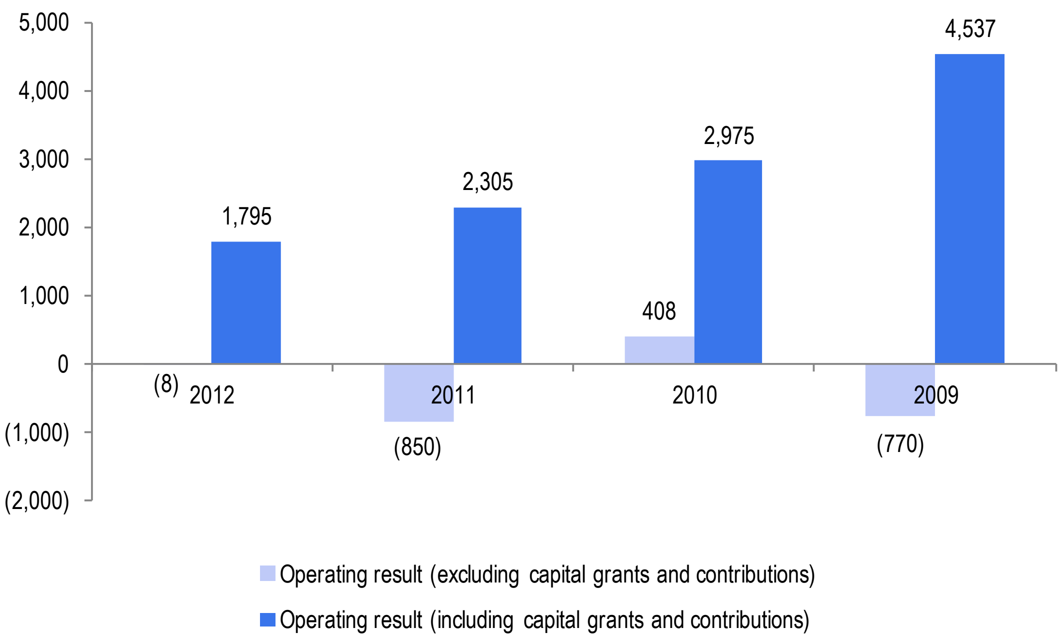
3.3: Operating Results

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 has reported marginal operating deficits, excluding capital grants and contributions, in three of the last four years. The decrease in 2011 was due to increased depreciation expense while the result improved in 2012 due to increased operating grants following the prepayment of half the 2013 FAG in 2012.
- Council expenses include a non-cash depreciation expense of $3.3m in 2012 which is an increase of $1.4m from 2010 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 as it represents the allocation of the value of an asset over its useful life.

3.4: Financial Management Indicators

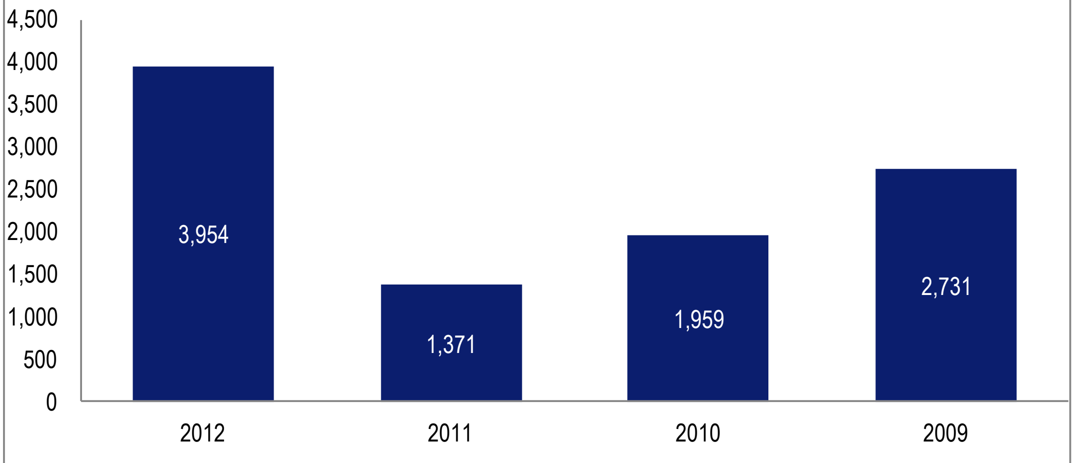
Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA ($'000s)	3,292	2,674	2,341	1,171
Operating Ratio	(0.1%)	(6.9%)	3.5%	(6.4%)
Interest Cover Ratio	102.88x	72.27x	54.44x	23.42x
Debt Service Cover Ratio	27.66x	22.66x	19.84x	9.76x
Unrestricted Current Ratio	5.75x	3.30x	3.88x	5.51x
Own Sourced Operating Revenue Ratio	57.8%	52.0%	56.8%	50.2%
Cash Expense Ratio	4.7 months	1.7 months	2.5 months	3.0 months
Net Assets ($'000s)	180,245	170,785	167,505	132,615

Key Observations

- Council's EBITDA is on an upward trend and has increased by $2.1m since 2009 to $3.3m in 2012. The 2012 result was mainly due to the prepaid FAG.
- The Operating Ratio has been below the benchmark of negative 4.0% in two of the four years reviewed. The improved result in 2010 was primarily as a result of the decrease in materials and contracts expenses that year while increased operating grants assisted the result in 2012.
- Council's Interest Cover Ratio and DSCR were well above their respective benchmarks indicating Council currently has sufficient capacity to service their existing debt.
- The Unrestricted Current Ratio has been above benchmark each year indicating Council had sufficient liquidity.
- The Own Source Operating Revenue Ratio has been below benchmark each year of the review period. This indicates that Council does not have sufficient financial flexibility and rely on revenue streams outside their control as is indicated by the improved result in 2012 following the increase in the FAG.
- The Cash Expense Ratio has been below benchmark in two of the past four years. The ratio increased in 2012 primarily as a result of the increase in the sale of investment securities.
- Council's Net Assets have increased by $47.6m from 2009 to $180.2m in 2012 due to Asset Revaluations which increased the value of roads, bridges and drainage infrastructure.
- When the Asset Revaluations are excluded, the underlying trend in all three 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 three years this amounted to an $11.0m increase in IPP&E assets.
- Council had total borrowings of $.3m in 2012 representing 0.2% 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 were on a downward trend until 2012. The improved result in 2012 was as a result of a $1.0m increase in the sale of investment securities as well as a $1.8m decrease in IPP&E and investment securities purchases.
- The cash balances along with the Unrestricted Current Ratio indicate Council had sound liquidity.
- Within Council's current cash and equivalents of $4.0m, $1.6m was externally restricted, $1.9m was internally restricted and $0.4m was unrestricted.
- Council held $0.1m in cash, $1.8m in deposits on call and $2.0m in short term deposits. Council held $0.7m in non-current investments but did not hold any current investments.

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.

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

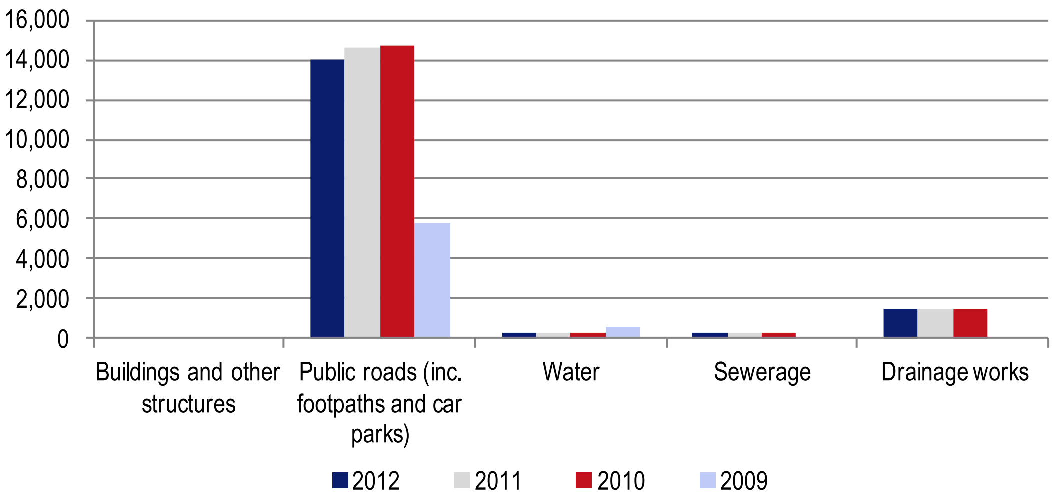
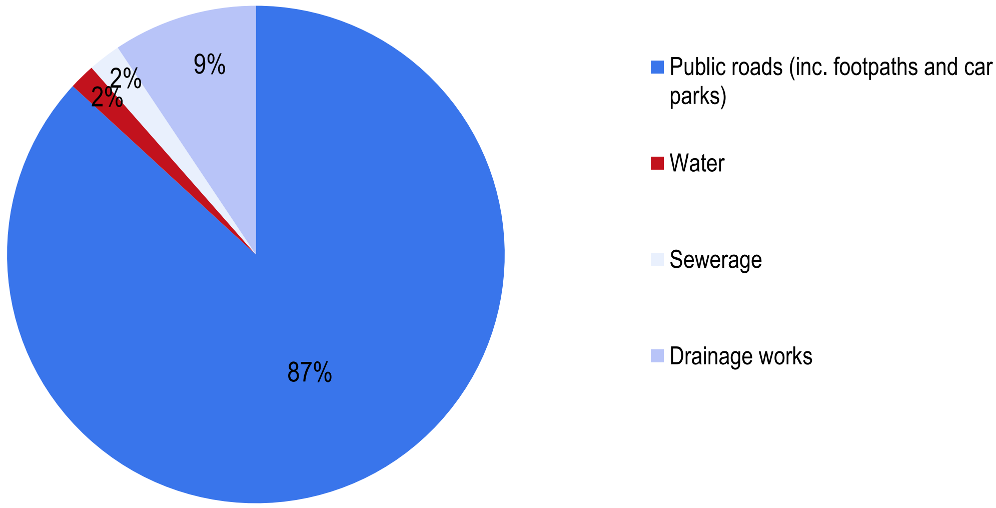


Figure 6 - Infrastructure Backlog Composition for 2011/12



Council reported $16.1m in Infrastructure Backlog in 2012, of which 87.0% ($14.0m) relates to public roads, 9.0% ($1.5m) to drainage works, and 2.0% ($0.3m) each relate to water and sewerage infrastructure assets. Council has not reported any buildings infrastructure asset backlog. Council has advised that they have relatively few public buildings with no public halls and only one swimming pool. Over the past few years Council has completed renovations or extensions on the most significant of their buildings including the Community Centre, the Indoor Sports Centre, the Works Depot and the Rural Fire

Service Headquarters. The remainder of their buildings are comparatively new and do not require substantial works therefore no buildings backlog has been reported.

Council has completed their Asset Revaluations and their first AMP and it is intended that future AMP's will be more advanced as Council improve their information gathering techniques. Council is also currently developing their risk management plans for the delivery of asset management services.

In their AMP Council advise they will need to place a continuing emphasis on road upgrades if it intends to bring its road network up to a satisfactory standard. Council is also aware they need to source new funding in order to continue to maintain their assets at the desired standard for future generations.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard ($'000s)	16,141	16,660	16,797	6,390
Required annual maintenance ($'000s)	1,913	1,828	2,037	2,102
Actual annual maintenance ($'000s)	1,122	1,507	1,174	1,106
Total value infrastructure assets ($'000s)	120,891	112,763	111,098	71,577
Total assets ($'000s)	182,711	173,743	170,527	135,460
Building and Infrastructure Backlog Ratio	0.13x	0.15x	0.15x	0.09x
Asset Maintenance Ratio	0.59x	0.82x	0.58x	0.53x
Building and Infrastructure Asset Renewal Ratio	1.25x	1.41x	3.97x	3.17x
Capital Expenditure Ratio	1.15x	1.47x	3.18x	3.56x

Council's Building and Infrastructure Backlog Ratio has been above its benchmark of <0.02x each year of the review period.

The Asset Maintenance Ratio has been well below benchmark for the past four years indicating Council is spending at below required levels to maintain their assets at satisfactory levels.

The Building and Infrastructure Asset Renewals Ratio and Capital Expenditure Ratio have both been above benchmark for the past four years however both ratios decreased in 2011 as a result of increased depreciation expense.

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	785	960	1,502	0
Replacement/refurbishment of existing assets	3,609	4,865	4,782	6,524
Total	**4,394**	**5,825**	**6,285**	**6,524**

Major Projects 2011-2012

Regional Roads Upgrades	$2.7m
Local Sealed Roads Upgrades	$2.3m
Local Unsealed Roads Upgrades	$1.2m
Indoor Tennis and Sports Complex Extensions	$0.5m
Stormwater Drainage Upgrades	$0.4m
Community Centre Renovations	$0.2m
Gravel Pit Purchase	$0.1m

Major Projects 2013-2022

Roads Rehabilitation and Upgrades	$15.0m
Oberon Water Mains Replacement	$0.8m
Stormwater Drainage Projects	$0.4m

3.7: Specific Risks to Council

Ageing Population. The LGA has an increasing ageing population and this places pressure on existing services and increase demand for aged care and community health facilities. Council has been pro-active by negotiating with a private provider to construct and operate a 66 bed aged care facility within the township of Oberon. Construction will commence in the 2013-2014 financial year following liaison between Council, the provider, local health services and relevant Commonwealth and State Government agencies. Council needs to continue to monitor the provision and level of service for aged care facilities and their health services must continue to respond to the changing community needs.

Technology. The terrain of Oberon LGA makes it difficult to achieve comprehensive communication technology coverage. To ensure that the entire LGA has the opportunity to be connected to the world, full coverage and access to wireless and mobile communication technology needs to be assured. This is also a key issue in the LGA's ability to present itself as an attractive alternative for new business and people relocating. Council has been supportive of the Commonwealth Government's move to introduce the National Broadband Network (NBN).

Agriculture and forestry are the predominant industries and employers in the community and as such are integral to the prosperity of the community. While it is anticipated that the logging industry will continue to grow, agriculture will likely decline as land used for agriculture is taken over for the timber industry. Council recognises the need to implement industrial zoning in the LGA to ensure the level of agricultural land remains stable and there is suitable land available for forestry and commercial opportunities including retail and hospitality services.

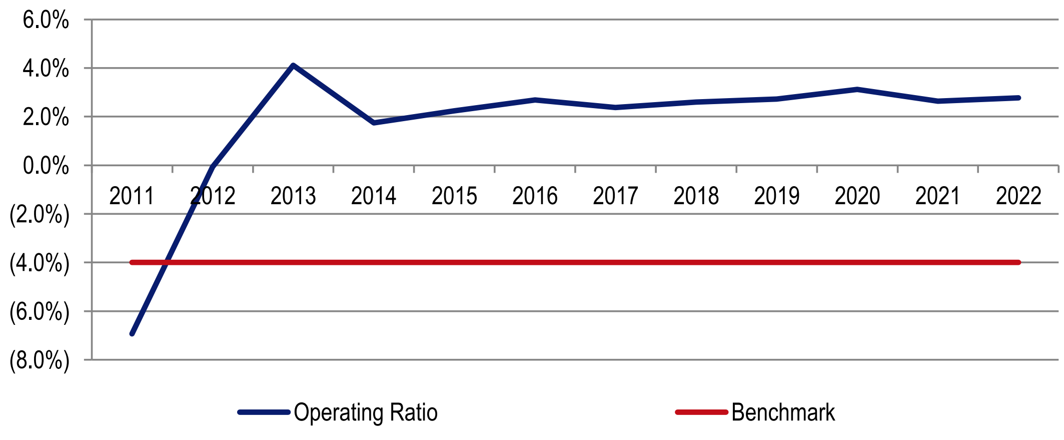
Infrastructure Backlog. At 13.3% of their infrastructure asset value Council has a relatively high level of Infrastructure Backlog. Without funding to decrease the current Backlog Council's assets will deteriorate, Backlog may increase and as a result service levels may need to be reduced.

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 Consolidated Fund as although Council's consolidated position includes a Water and Sewer Fund which are operated as independent entities, the income generated does not have a significant impact on Council's overall position.

4.1: Operating Results

Figure 7- Operating Ratio for Consolidated Fund



Council has projected a net operating surplus, excluding capital grants and contributions, each year of the forecast period. The ratio increases significantly in 2013. Although user fees and charges are forecast to decrease by 10.2% in 2013, rates and annual charges have been forecast to increase by 8.2%. The LTFP submitted was based on 2012 budget figures and as the 2012 actual figure for rates and annual charges was lower than anticipated, the increase reflected is higher than the 3.7% budgeted by Council. However based on their Quarterly Budget Review Council anticipates the $4.1m budgeted for rates and annual charges will be achieved through rates peg and additional levies as a result of revaluation of land after subdivision.

Council has also forecast a decrease in materials and contracts expenses in 2013 which also assists the ratio that year. However Council has not reduced their operating grants in 2013 following the prepayment of half the 2013 FAG in 2012, and therefore Council's operating grants may be overstated. As Council's operating surplus is marginal any reduction in revenue stated in their current LTFP may cause an operating deficit.

The ratio decreases slightly in 2014 as a result of a forecast decrease in operating grants and user fees and charges which is partly offset by a further increase forecast in rates and annual charges. In 2014 Council has included an increase of 10.0% above rate peg for their ordinary rates in their LTFP however Council now plans to postpone this increase until further analysis of future road requirements is completed and following community consultation. This may cause the ratio to decrease further. The decrease in user fees and charges in 2013 and 2014 is due to a forecast reduction in reconstruction works for the RMS. As a result Council has also decreased materials and contracts expenses forecast over the same period.

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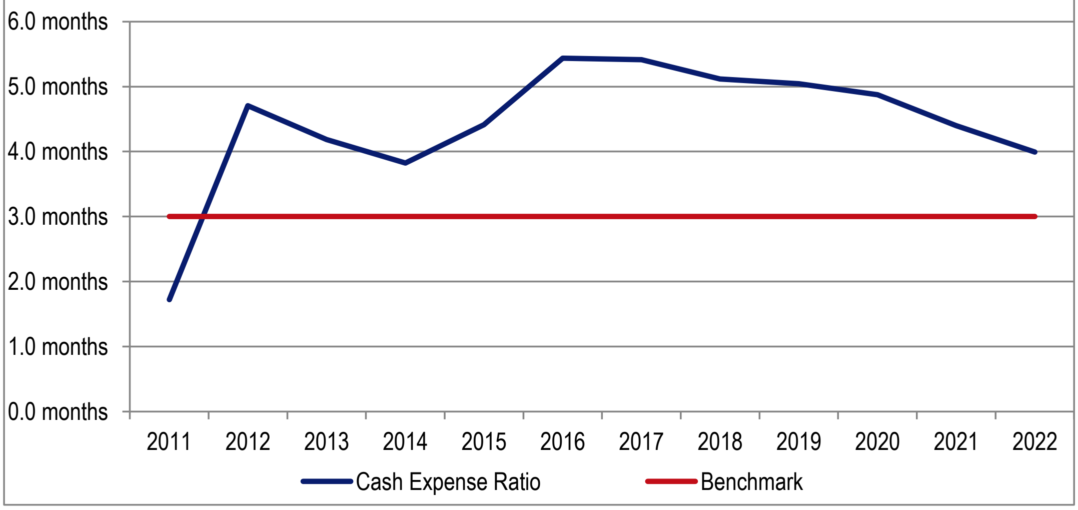
4.2: Financial Management Indicators

Liquidity Ratios

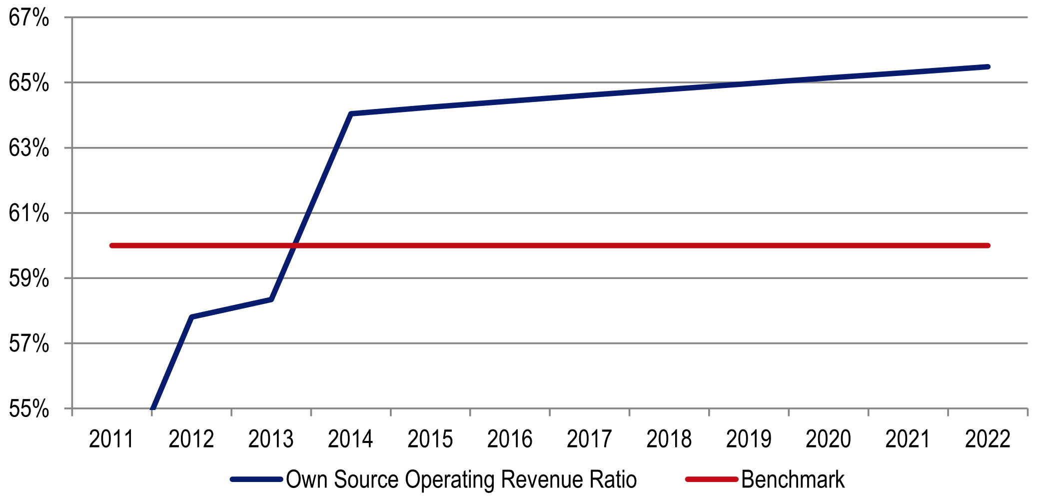
Figure 8 - Cash Expense Ratio for Consolidated Fund



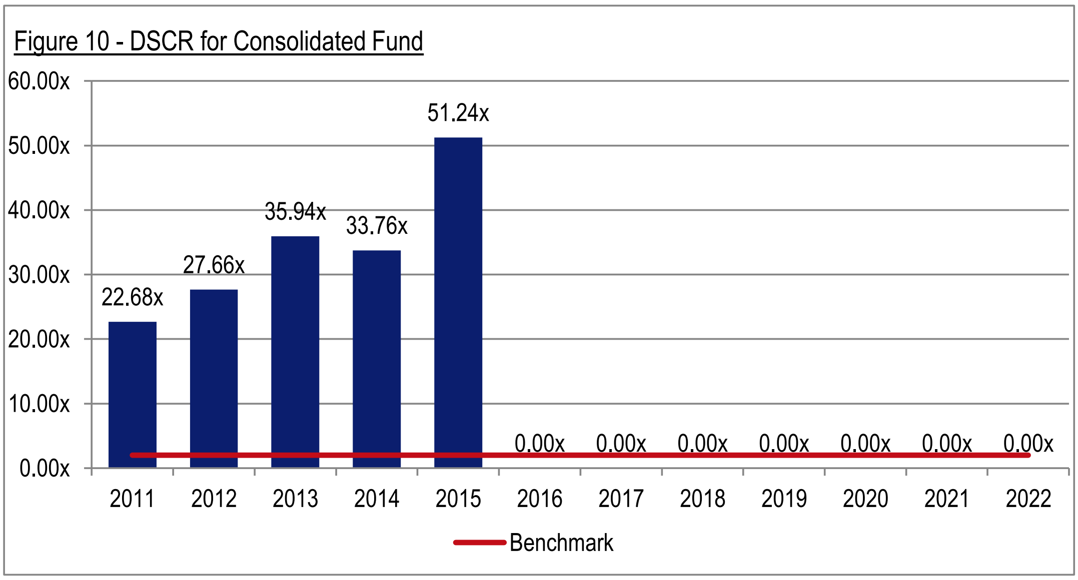
Council's Cash Expense Ratio is above benchmark for the entire forecast period. The ratio decreases in 2014 as a result of a decrease in operating grants. The ratio improved in 2016 as a result of the long term investments being transferred to short term investments upon maturity.

Fiscal Flexibility Ratios

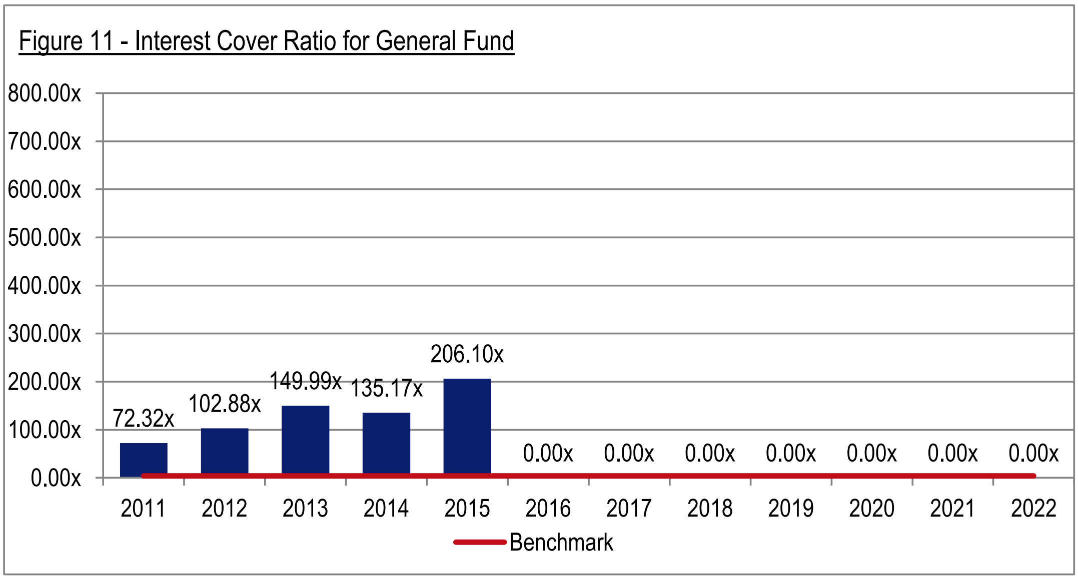
Figure 9 - Own Source Operating Revenue Ratio for Consolidated Fund



Council's Own Source Operating Ratio increases well above benchmark in 2014 where it remains for the forecast period. This is a result of capital grants being forecast at much lower than historic levels. In 2012 and 2013 Council received a grant of $0.2m p.a. for the reconstruction and sealing of Dog Rocks Roads which is not repeated. Council has also forecast conservative levels of capital grants for the Rural Fire Service, as they fluctuate each year.



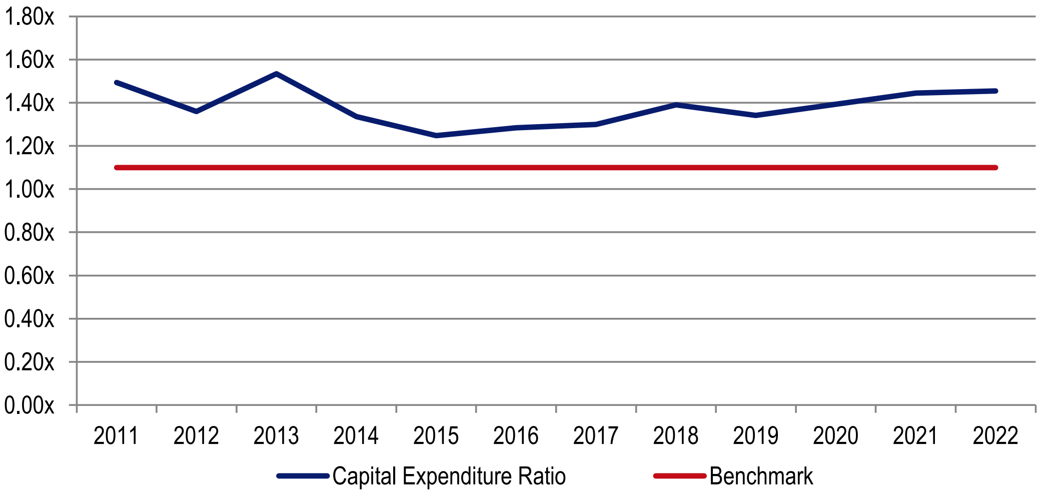
Council's DSCR is well above benchmark of 2.00x until 2015 reflecting Council's low levels of borrowings. From 2016 there is no DSCR result as Council will have paid down all their debt and has not forecast any further borrowings.



Council's Interest Cover Ratio, similarly to the DSCR is above benchmark for the forecast period indicating that Council has the capacity to service more debt.

4.3: Capital Expenditure

Figure 12 - Capital Expenditure Ratio for Consoliadted Fund



The Capital Expenditure Ratio is above benchmark for the entire forecast period. The ratio peaks in 2013 due to $0.4m in additional roads infrastructure works and $0.6m in Rural Fire Service plant and buildings acquisitions.

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 5.0%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1.0%)
- All other expenses: the estimated annual CPI increase of 2.5%

<u>Key Observations and Risks</u>

- Council's LTFP has been based on maintaining existing services at current levels
- Rates and annual charges are forecast to increase by 8.2% in 2013. As previously discussed actual rates and annual charges did not increase at the level budgeted in 2012 therefore the percentage increase is higher, however Council anticipates they will meet the budgeted level. Rates and annual charges are forecast to increase by 10.7% in 2014 as Council has included an increase of 10.0% above rate peg for their ordinary rates. Following a Council meeting in February 2013 Council now plan to postpone this increase until further analysis of future road requirements is completed and following community consultation. From 2015 they are forecast to increase by 3.0% p.a. for the remainder of the forecast period which is considered reasonable, however given that the 10.0% increase will not happen in 2014, rates and annual charges are now overstated in the current LTFP.
- User fees and charges are forecast to decrease in 2013 and 2014 due to an anticipated decrease in private works for RMS on state roads. From 2015 Council has forecast an increase of approximately 1.7% p.a. for the remainder of the period which we consider conservative.
- Employee expenses are forecast to increase by 5.7% in 2013 and 4.4% p.a. for the remainder of the forecast period. Based on increases of 5.7% and 1.4% in 2011 and 2012 respectively and our benchmark, we consider this forecast to be at a level higher than our benchmark and should be reviewed. Council has advised that these increases will be reviewed in conjunction with the review of its Operational Plan, Delivery Program and LTFP.
- Materials and contracts costs are forecast to decrease in 2013 and 2014 in line with anticipated decreases in contract works for the RMS. Materials and contracts expenses have been forecast at conservative levels, when compared with historic results, for the remainder of the forecast period however this may be partially offset by the conservative levels of user fees and charges forecast
- With the exception of rates and annual charges and forecast employee expense growth, we consider the forecast reasonable.

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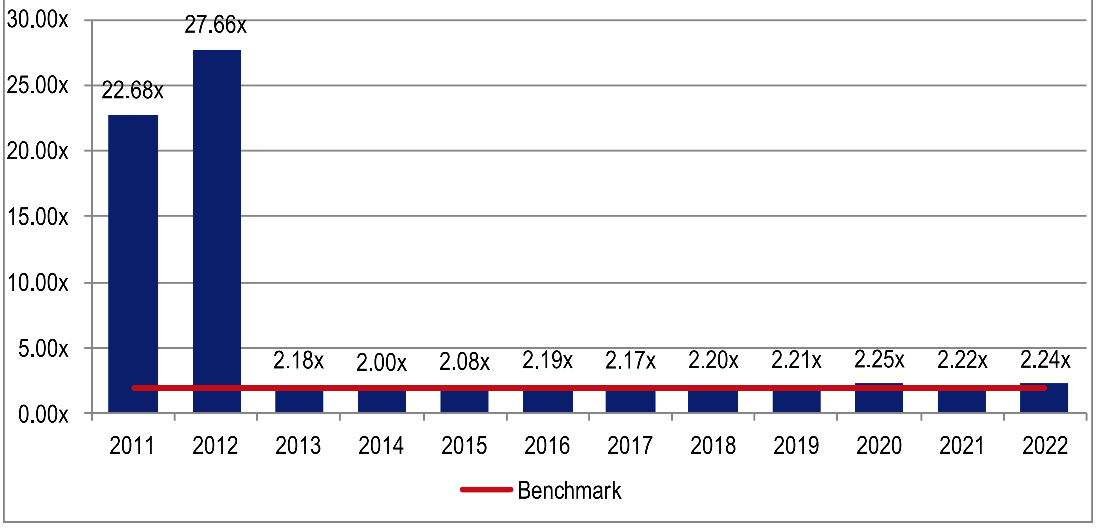
4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will be able to incorporate additional loan funding, in addition to its existing debt facilities of $0.3m. Some comments and observations are:

- Based on a benchmark of DSCR>2x, up to $11.9m could be borrowed in addition to their existing borrowings of $0.3m
- 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



4.6 Sustainability

TCorp believes Council is in a sound Sustainability position. Council has reported a marginal deficit position for three of the past four years and has forecast surplus positions for the entire forecast period. Our assessment is based on Council achieving the improved forecast operating results in their LTFP. Council also need to address their Backlog and increase their expenditure on asset maintenance.

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

- Council's current LTFP shows marginal surplus positions are expected over the entire forecast period. However this is based on Council achieving operating results and maintaining expenses at the levels forecast in their LTFP. As rates and annual charges will not increase at the level stated in 2014 and Council has not forecast any decrease in operating grants for 2013 the operating result is likely to be overstated and the LTFP will need to be amended to reflect the expected future forecasts.
- Council's DSCR and Interest Cover Ratio are well above benchmark for the entire forecast period which indicates Council has the capacity to take on additional borrowings
- Capital expenditure is forecast at levels above what is required to maintain assets at an acceptable standard over the forecast period
- Council has maintained very conservative levels of borrowing. By 2016 Council will have paid down their existing borrowings and has not forecast any additional borrowing for the next 10 years. The use of borrowing may assist Council to reduce its Infrastructure Backlog and to fund asset renewal programs

Section 5 Benchmarking and Comparisons with Other Councils

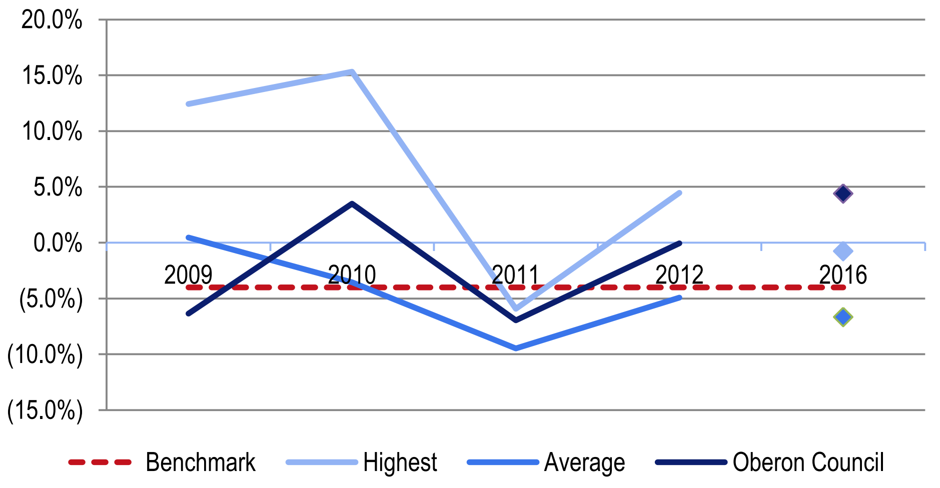
As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis (that is, for councils that operate more than one fund, the results of all funds are included). This section 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 all of these councils.

In Figure 15 to Figure 24, 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 22 to 24 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. For the Interest Cover Ratio and Debt Service Cover Ratio, we have excluded the highest Councils because very low debt levels have resulted in very high ratios which are a result of low debt levels that skew the ratios.

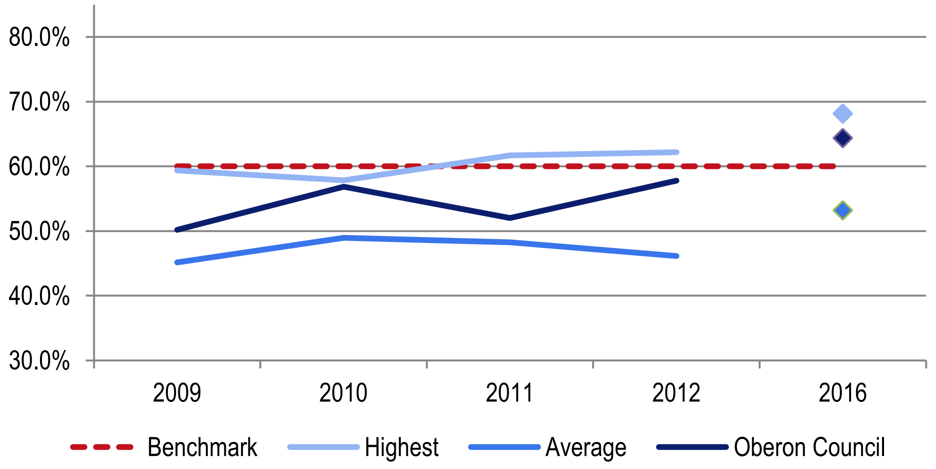
<u>Financial Flexibility</u>

<u>Figure 15 - Operating Ratio Comparison</u>



Council's Operating Ratio has fluctuated over the period but has remained above the group average. Following a decrease in 2011 the ratio increased above benchmark in 2012 and is forecast to improve further in the medium term and to outperform its peer group.

Figure 16- Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio was below benchmark but above the group average over the review period. Council is forecast to remain above the group average and improve above benchmark over the medium term.

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Figure 17 - Cash Expense Ratio Comparison

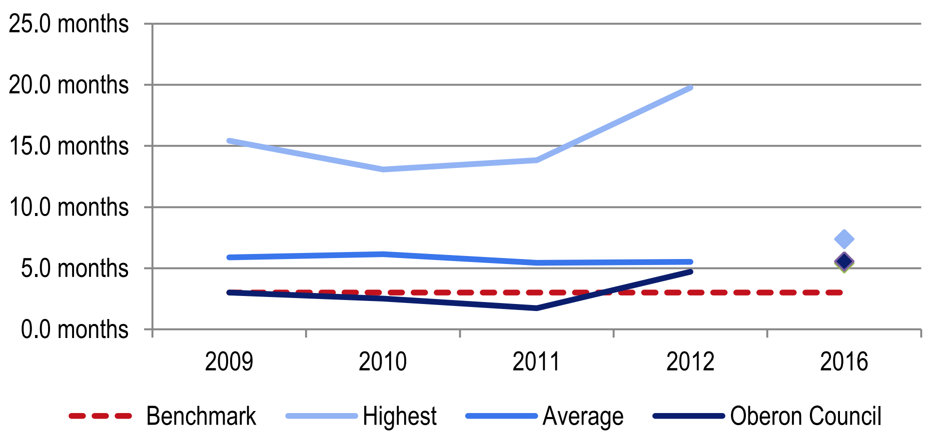
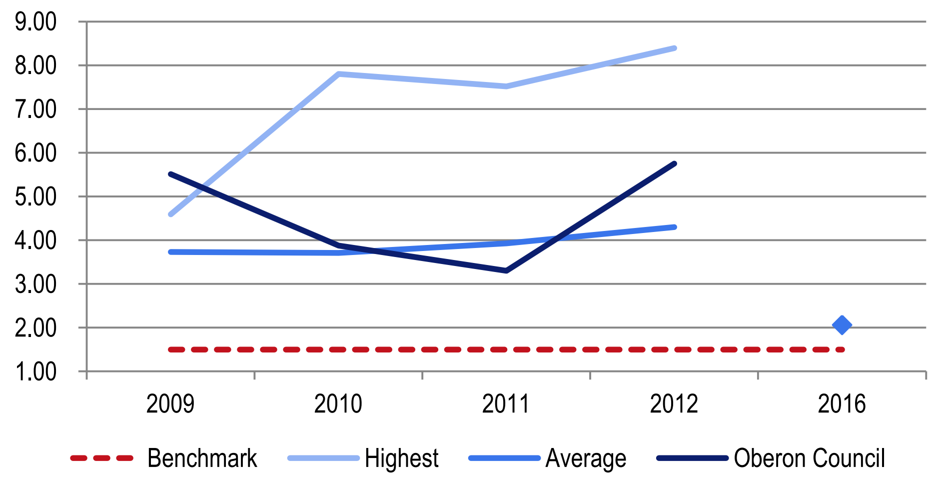


Figure 18 - Unrestricted Current Ratio Comparison



Council's Cash Expense Ratio was below the group average but generally tracked benchmark levels until 2011. The ratio improved in 2012 and is forecast to maintain this performance in the medium term in line with the group average.

The Unrestricted Current Ratio was above benchmark for the review period and outperformed the group average in 2012. Council has not provided data for a forecast over the medium term.

Overall, Council's liquidity position is sound.

Debt Servicing

Figure 19- Debt Service Cover Ratio Comparison

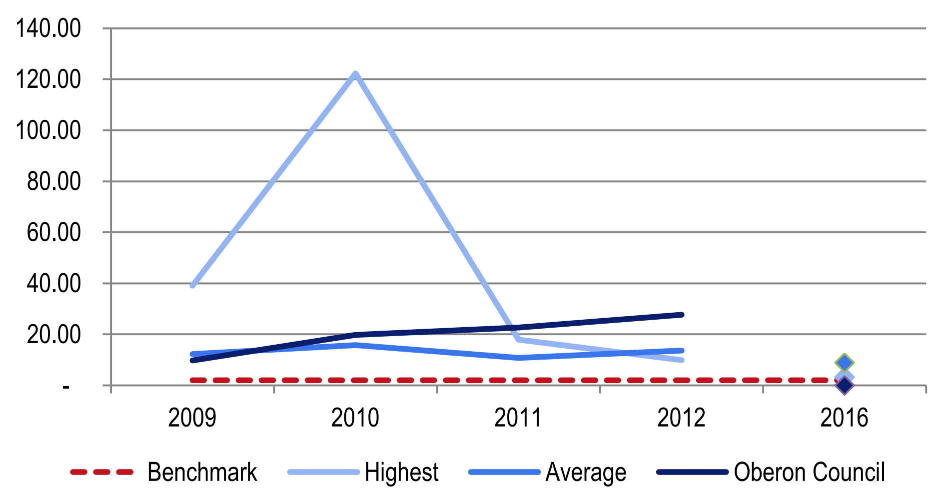
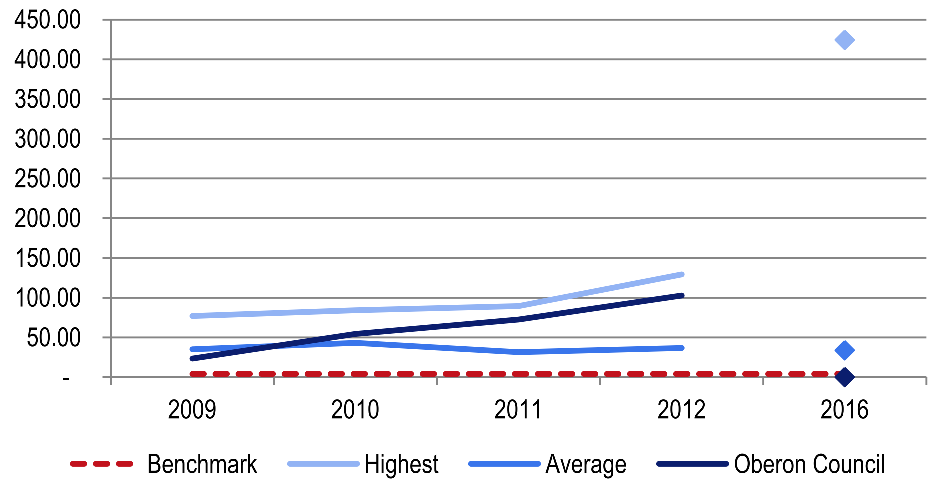


Figure 20 - Interest Cover Ratio Comparison



Council's debt servicing capacity was sound over the review period, as indicated by both the DSCR and Interest Cover Ratio being above benchmark and outperforming the group average over the review period. While the ratios are forecast to decrease to benchmark level in the medium term, overall Councils debt servicing ratios are forecast to remain acceptable.

Asset Renewal and Capital Works

Figure 20 - Capital Expenditure Ratio Comparison

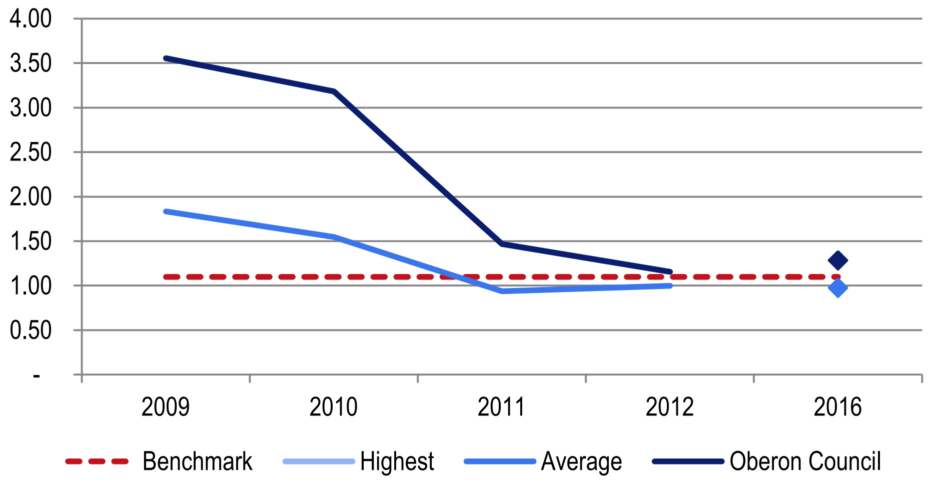


Figure 21 - Asset Maintenance Ratio Comparison

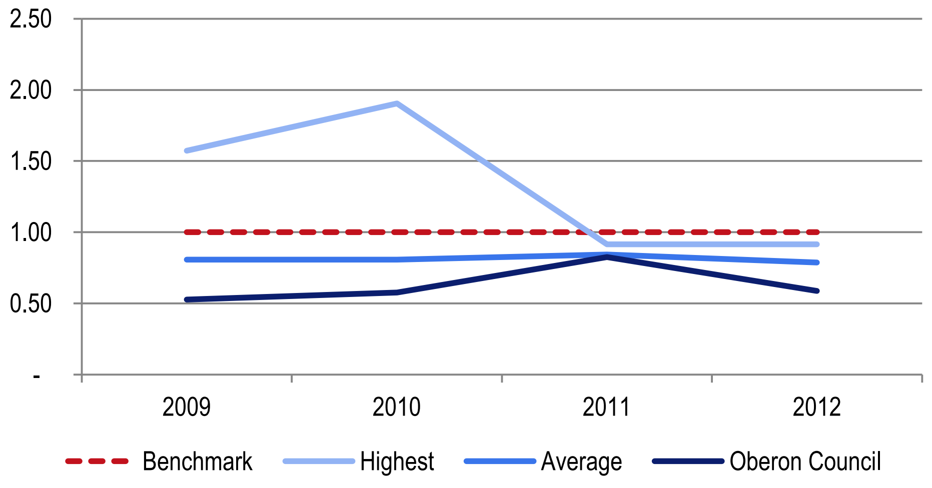


Figure 22 - Infrastructure Backlog Ratio Comparison

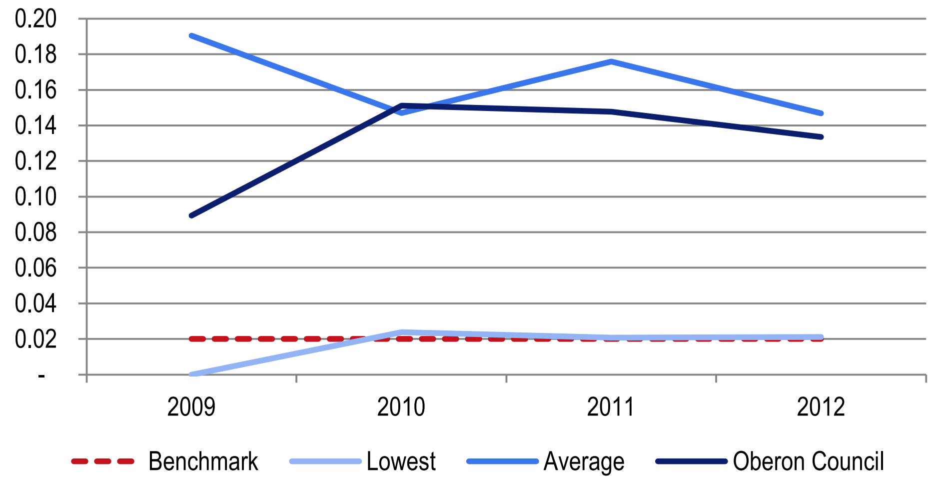
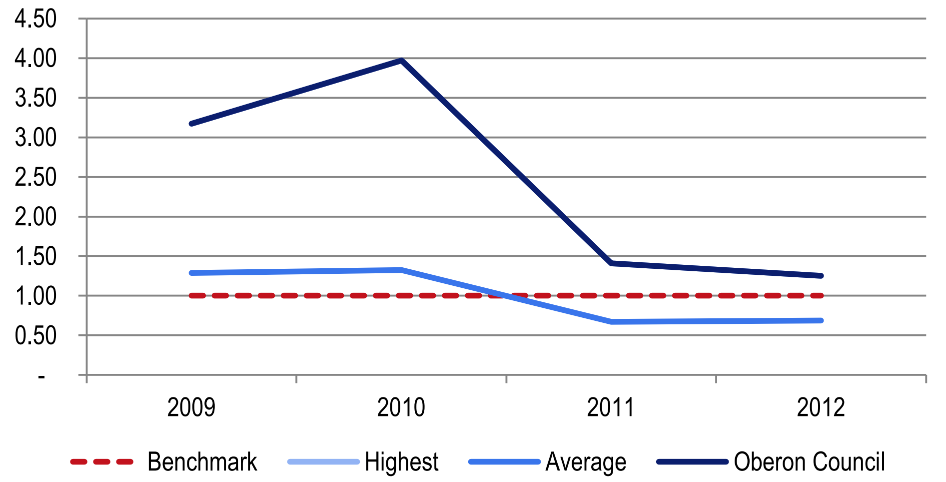


Figure 23 - Building and Infrastructure Asset Renewal Ratio



Council's Infrastructure Backlog Ratio has been well above benchmark but marginally below the group average in the past four years . Council's Asset Maintenance Ratio has been below benchmark and the groups average over the review period. The Building and Infrastructure Asset Renewal Ratio decreased in 2011 but remained above benchmark and the groups average.

Council's Capital Expenditure Ratio was well above benchmark and outperformed the group's average until 2012. The ratio fell to benchmark level in 2012 following an increase in depreciation expense. Council's Capital Expenditure Ratio is forecast to remain at this level in the medium term.

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 currently in a sound Sustainability position.

We base our recommendation on the following key points:

- Council has incurred marginal operating deficits, excluding capital grants and contributions, in three of the past four years
- Council's operating result, excluding capital grants and contributions, forecasts a surplus position over the entire LTFP
- All Council's ratios are above benchmark for the entire forecast period

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

- Council has a comparatively high level of Infrastructure Backlog. Council needs to address this and allocate funding to reduce their current Backlog
- In their LTFP, Council has forecast rates and annual charges to increase by over 10.0% in 2014 however Council has since deferred the proposed increase to 2015 pending further consultation with the community and a review of service levels for roads infrastructure maintenance. As a result the forecast operating result may be overstated. Following the service levels review Council will review its LTFP to provide a more certain picture of its forecast financials

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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	3,827	3,679	3,573	3,449	4.0%	3.0%	3.6%
User charges and fees	4,947	4,326	4,519	5,288	14.4%	(4.3%)	(14.5%)
Interest and investment revenue	112	249	228	345	(55.0%)	9.2%	(33.9%)
Grants and contributions for operating purposes	4,199	3,695	3,187	2,880	13.6%	15.9%	10.7%
Other revenues	291	285	167	135	2.1%	70.7%	23.7%
Total revenue	**13,376**	**12,234**	**11,674**	**12,097**	**9.3%**	**4.8%**	**(3.5%)**
Expenses							
Employees	4,765	4,700	4,445	4,447	1.4%	5.7%	(0.0%)
Borrowing costs	32	37	43	50	(13.5%)	(14.0%)	(14.0%)
Materials and contract expenses	3,492	3,176	3,278	5,013	9.9%	(3.1%)	(34.6%)
Depreciation and amortisation	3,268	3,487	1,890	1,891	(6.3%)	84.5%	(0.1%)
Other expenses	1,827	1,684	1,610	1,466	8.5%	4.6%	9.8%
Total expenses	**13,384**	**13,084**	**11,266**	**12,867**	**2.3%**	**16.1%**	**(12.4%)**
Operating result (excluding capital grants and contributions)	**(8)**	**(850)**	**408**	**(770)**	99.1%	(308.3%)	153.0%
Operating result (including capital grants and contributions)	**1,795**	**2,305**	**2,975**	**4,537**	(22.1%)	(22.5%)	(34.4%)

Table 2 - Items excluded from Income Statement

Excluded items				
Grants and contributions for capital purposes	1,803	3,155	2,567	5,307
Fair Value Adjustments on Investments	(141)	88	64	541
Net gain/(loss) from the disposal of assets	(321)	(500)	224	(37)

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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 cash equivalents	3,954	1,371	1,959	2,731	188.4%	(30.0%)	(28.3%)
Investments	0	1,000	0	0	(100.0%)	N/A	N/A
Receivables	1,782	2,383	1,958	1,438	(25.2%)	21.7%	36.2%
Inventories	1,514	1,504	1,529	1,082	0.7%	(1.6%)	41.3%
Other	188	10	204	160	1780.0%	(95.1%)	27.5%
Total current assets	7,438	6,268	5,650	5,411	18.7%	10.9%	4.4%
Non-current assets							
Investments	736	1,426	1,840	2,785	(48.4%)	(22.5%)	(33.9%)
Receivables	0	0	0	0	N/A	N/A	N/A
Inventories	316	313	313	310	1.0%	N/A	N/A
Infrastructure, property, plant & equipment	174,221	165,736	162,724	126,954	5.1%	1.9%	28.2%
Investment property	0	0	0	0	N/A	N/A	N/A
Total non-current assets	175,273	167,475	164,877	130,049	4.7%	1.6%	26.8%
Total assets	**182,711**	**173,743**	**170,527**	**135,460**	**5.2%**	**1.9%**	**25.9%**
Current liabilities							
Payables	737	1,019	749	759	(27.7%)	36.0%	(1.3%)
Borrowings	92	87	118	75	5.7%	(26.3%)	57.3%
Provisions	1,344	1,413	1,606	1,471	(4.9%)	(12.0%)	9.2%
Total current liabilities	2,173	2,519	2,473	2,305	(13.7%)	1.9%	7.3%
Non-current liabilities							
Payables	0	50	100	0	(100.0%)	(50.0%)	N/A
Borrowings	179	271	358	439	(33.9%)	(24.3%)	(18.5%)
Provisions	114	118	91	101	(3.4%)	29.7%	(9.9%)
Total non-current liabilities	293	439	549	540	(33.3%)	(20.0%)	1.7%
Total liabilities	**2,466**	**2,958**	**3,022**	**2,845**	**(16.6%)**	**(2.1%)**	**6.2%**
Net assets	**180,245**	**170,785**	**167,505**	**132,615**	**5.5%**	**2.0%**	**26.3%**

Table 4-Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
Cash flows from operating activities	5,267	5,018	3,971	5,818
Cash flows from investing activities	(2,597)	(5,488)	(4,705)	(6,052)
Proceeds from borrowings and advances	0	0	0	0
Repayment of borrowings and advances	(87)	(81)	(75)	(70)
Cash flows from financing activities	(87)	(81)	(75)	(70)
Net increase/(decrease) in cash and equivalents	**2,583**	**(551)**	**(809)**	**(304)**
Cash and equivalents	3,954	1,371	1,959	2,731

New South Wales Treasury Corporation

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.

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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

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.

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.