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Treasury Corporation

Mosman Municipal Council

Financial Assessment and Benchmarking Report

26 September 2012

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 Mosman Municipal Council, the LIRS Assessment Panel and the DLG.TCorp shall not be liable to Mosman Municipal 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 Mosman Municipal 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 the renewal of road and marine assets for $2.0m to be repaid over seven years.

TCorp's approach has been to:

- Review the most recent fouryears 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 particular Council fund that was undertaking the proposed debt commitment. As the Council operates only one fund we focused our review on this General Fund.

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

- Council's underlying operating result (measured using EBITDA) has increasedover the review period
- Council's Own Sourced Operating Revenue Ratio has been consistently above benchmark each year
- Council's revenues have been boosted by the introduction of two SRVs which aid infrastructure renewal and a program of environmental works
- Council has sought to generate alternative revenue sources as evidenced by the introduction of parking meters in 2010
- Council has been proactive in seeking cost savings and efficiencies as evidenced through its membership of a regional body of four councilsShore Regional Organisation of Councils ("SHOROC") which is seeking savings through joint tenders and regional purchasing, amongst a range of initiatives

Council's reported Infrastructure Backlog of $25.6m in 2011 represents 11.6% of its infrastructure asset value of $220.7m.Other observations include:

- The backlog has decreased over the four year period due to constant refining of valuation techniques
- The required asset renewal and maintenance benchmarks are not being met to keep the assets in their current condition, therefore the backlog may grow
- Council's capital expenditure priorities in the last four years were influenced by the availability of grant funding
- A new asset valuation was completed in 2010, and a new SHOROC tender for civil works has been entered into resulting in cost efficiencies. These factors combined with a detailed review

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of condition and service intervention levels indicate that the Infrastructure Backlog could be reduced

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

- Council's operating results are forecast to increase over the lifetime of the forecast due to increased own sourced revenue
- Council's level of fiscal flexibility is sound as own source revenue is maintained at levels around 80%
- While Council is service orientated, it needs to balance community needs with sufficient liquidity. Council's liquidity position as indicated by the Unrestricted Current Ratio does not improve above benchmark until 2017
- The key assumptions that underpin the financial forecasts are considered to be reasonable

In our view, the Council has the capacity to undertake the combined additional borrowings of $2.0m for the LIRS project. This is based on the following analysis:

- The DSCR remains above a benchmark of 2.00x each year of the 10 year forecast
- The Interest Cover Ratio remains above the benchmark of 4.00x each year of the 10 year forecast

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG group 2. The key observations are:

- Council's financial flexibility as indicated by the Operating Ratio and Own Source Operating Revenue Ratio are generally below the group's average
- Council's DSCR and Interest Cover Ratio are below the group average and at or below benchmark. In the medium term Council's forecast ratios will improve to be above benchmark
- Council was in a sufficient liquidity position which is expected to improve marginally to be close to the benchmark in the medium term
- Council's performance in terms of its Asset Maintenance Ratio and Building and Infrastructure Asset Renewal Ratio are weaker than its peers. While the Infrastructure Backlog Ratio is lower than the group's average, it would have to reduce significantly to reach the benchmark

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 which will complement their internal due diligence, and 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 fouryears 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 documentsincluding Council's Road Asset Management Plan and the Adopted Marine Asset Management Plan
- 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

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

2.3: Overview of the Local Government Area

Mosman Municipal Council LGA	
Locality & Size	
Locality	Sydney
Area	8.5 km²
DLG Group	2
Demographics	
Population	29,414
% under 18	20.5%
% between 18 and 59	58.6%
% over 60	21.0%
Expected population 2031	30,726
Operations	
Number of employees (FTE)	164
Annual revenue	$34.5m
Infrastructure	
Roads	94 km
Footpaths	175 km
Infrastructure backlog value	$24.1m
Total infrastructure value	$204.8m

Mosman Municipal Council Local Government Area (LGA) is a harbour side suburb located on Sydney's lower north shore. It is bordered by Middle Harbour, Sydney Harbour and Port Jackson. The LGA is approximately 8.5 square kilometres and is home to approximately 29,414 people. The Council forms part of the SHOROC, which also includes Manly, Warringah and Pittwater councils. Matters in which the group gets involved include:

- Waste management
- Joint tenders and resource sharing
- Transport and traffic issues
- Procurement plans

The population is forecast to grow at 0.2% p.a. between 2012 and 2031. In recent years, the LGA has attracted two major housing markets - older families often with teenage children generally from the north shore, and younger adults attracted to the large number of medium density rental dwellings. There are limited opportunities for further residential development in the LGA.

The age group which is forecast to have the largest proportional increase (relative to its population size) by 2021 is 70-74 year olds, who are forecast to increase by 97.6% to 1,569 persons.

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2.4: LIRS Application

Council has made one LIRS application.

Project: Renewal of road and marine assets

Description: The schedule of works program contains more than 120 projects ranging in costs from $0.25m to less than a thousand dollars.

Project cost: $3.3m

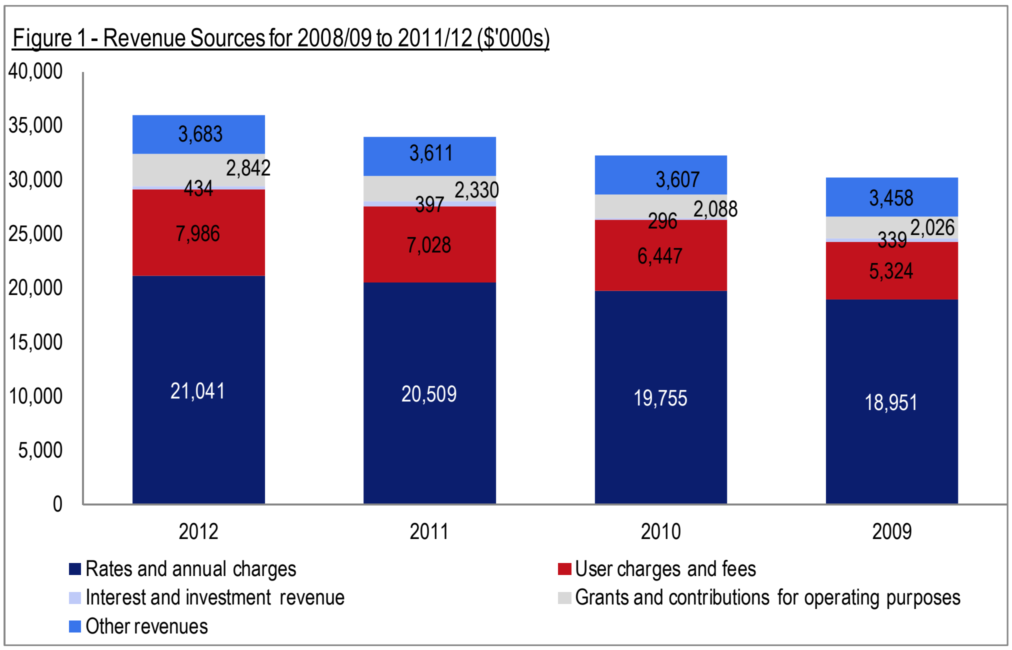
Amount of loan facility: $2.0m

Term of loan facility: Seven years

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

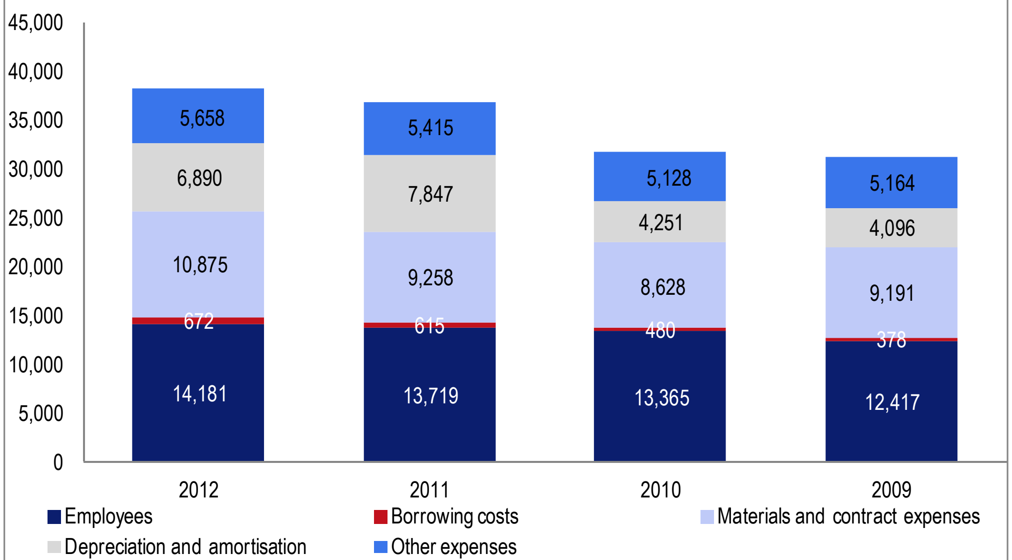


Key Observations

- Rates and annual charges increased by 3.8% in 2011, and 2.6% in 2012 to $21.0m. Council received a 12 year SRV in July 2000 of 5.0% p.a. above the rate peg. The proceeds of the SRV are to fund a program of environmental works to improve the quality of the LGA's bushland, foreshores, and marine habitats by improving stormwater quality, combating bushland degradation, and reconstructing seawalls in an ecologically sensitive manner. The SRV has been extended until 2017. Council received another SRV in 2008 of 6.0% above the rate peg. This levy funds the renewal of infrastructure assets and has no end date. This levy generated $0.8m in 2011.
- Parking fees, property rentals, and restoration charges are the main contributors to user fees and charges. The introduction of on street parking fees in 2010 generated $0.9m in 2010,$1.3m in 2011, and $1.5m in 2012. Rental revenues decreased in 2012, while restoration fees increased by 96.3% to $0.9m.
- Other revenues consist largely of parking fines and rents from investment properties

3.2: Expenses

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



Key Observations

- While full time equivalent employee numbers have remained static over the past four years, employee costs rose by 7.6% in 2010,2.6% in 2011, and 3.4% to $14.2m in 2012. Increased superannuation contributions in 2010 hindered Council's ability to control costs in line with average NSW wage indexation rates.
- Materials and contracts expenses have been volatile. Contractor and consultancy expenditure on infrastructure fell from $1.0m in 2009 to $0.4m in 2010 due to a reduction in restoration revenue together with major road construction projects that were capitalised rather than expensed.The increase in restoration fees in 2012 correlated to an increase in materials and contracts expenses.
- The Asset Revaluations process resulted in the annual depreciation charge increasing, from $4.1m in 2009 to $7.8m in 2011, before decreasing to $6.9m in 2012. Roads, bridges and footpaths were re-valued upwards, so the depreciation charges on these assets increased from $1.6m in 2009 to $3.3m in 2012. A substantial increase in the Council's asset values has directly correlated to a higher depreciation charge. The decrease in 2012 occurred following the continued refinement of Council's asset management planning techniques.

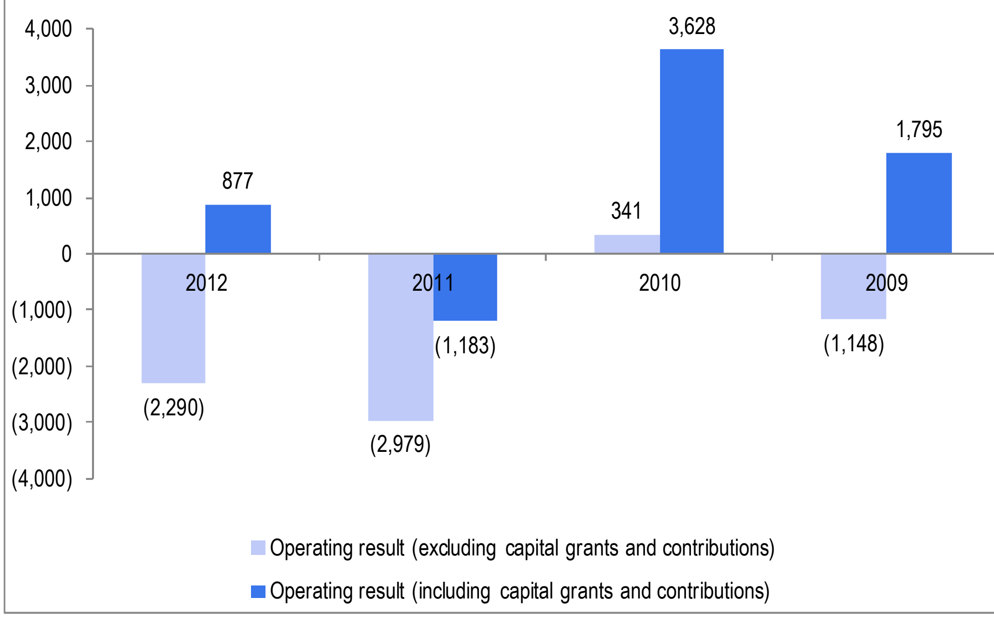
3.3: Operating Results

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 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 posted net operating deficits excluding capital grants and contributions. The operating results started to decline in 2011 due to the increased depreciation charges
- Council expenses include a non-cash depreciation expense, ($6.9m in 2012), which has increased by 68.2% over the past four years following the Asset Revaluationsprocess. While 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.

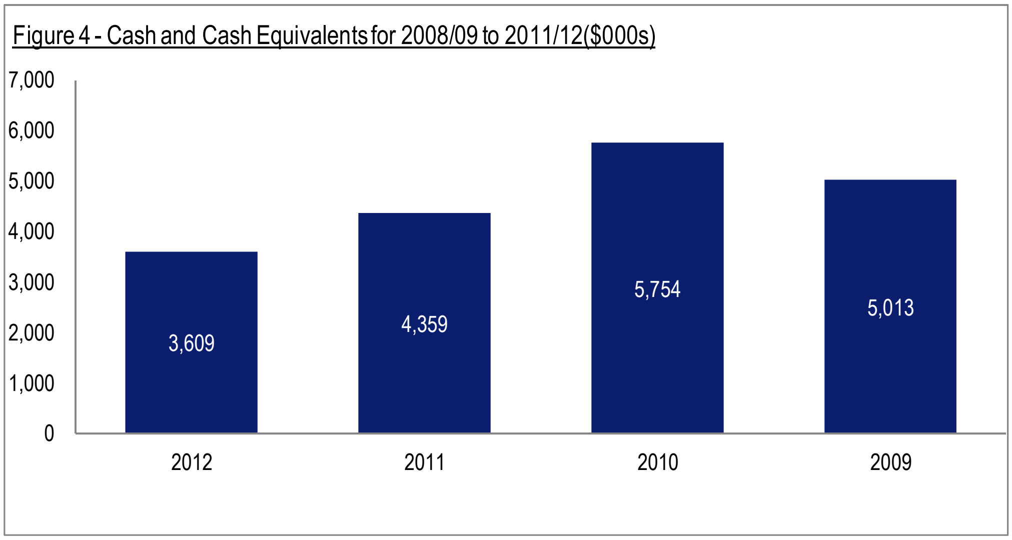
3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA ($'000's)	5,272	5,483	5,072	3,326
Operating Ratio	(6.4%)	(8.8%)	1.1%	(3.8%)
Interest Cover Ratio	7.85x	8.92x	10.57x	8.80x
Debt Service Cover Ratio	2.16x	2.16x	2.07x	1.88x
Unrestricted Current Ratio	1.35x	1.34x	1.52x	1.40x
Own Sourced Operating Revenue Ratio	75.4%	77.2%	73.9%	73.5%
Cash Expense Ratio	1.4 months	1.8 months	2.5 months	2.2 months
Net Assets ($'000's)	462,306	462,117	460,510	492,712

Key Observations

- Council's EBITDA increased over the four year period. Council's Interest Cover Ratio and DSCR indicated that they have flexibility in regard to carrying more debt. The DSCR has been above the benchmark of 2.00x over the past two years. Council had $10.2m in outstanding borrowings in June 2012, being 2.2% of Net Assets.
- The Unrestricted Current Ratio has been on or around the benchmark in all four years indicating liquidity is sufficient.
- Net Assets have decreased by $30.4m between 2009 and 2012 due to the consecutive Asset Revaluations in 2010 and 2011 that increased the value of roads, bridges, and drainage infrastructure, and reduced the value of community land assets. Community land assets decreased by $114.0m, while the value of roads, bridges, and footpaths increased by $72.0m.
- The Asset Revaluations over the last fouryears have resulted in some volatility in Net Assets over this period. Consequently, in the short term, the value of Net Assets is not necessarily an informative indicator of performance. In the medium to long term however, this is a key indicator of a Council's capacity to add value to its operations. Over time, Net Assets should increase at least in line with inflation plus an allowance for increased population and/or improved or increased services. Declining Net Assets is a key indicator of the Council's assets not being able to sustain the ongoing operations of Council.
- When the Asset Revaluations are excluded, the underlying trend in all four years has been an expanding Infrastructure, property, Plant and Equipment (IPP&E) asset base with asset purchases being larger than the combined value of disposed assets and annual depreciation. Over the last four years this amounted to a $7.1m net increase in IPP&E.

3.5: Statement of Cashflows



Key Observations

- Council's cash reserves have decreased marginally over the four years.
- Council current investments comprised $2.8m held in long term deposits at 30 June 2012.
- Council's overall cash, cash equivalent, and investments position has decreased over the past four years, and this correlates directly with increased new capital projects. Examples of capital projects include the construction of a $4.3m sports centre in 2010 and 2011 for which 50.0% federal funding was made available and Council had to match the funding. Council's success in attracting such grants means that its liquidity position can be volatile from time to time.
- Within Councils, cash, cash equivalents, and investments of $6.4m, $1.5m was externally restricted, $3.5m internally restricted, and $1.3m was unrestricted.
- Council did not invest in CDO's so has not been subject to any interest or principal loss.

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 ($'000's)

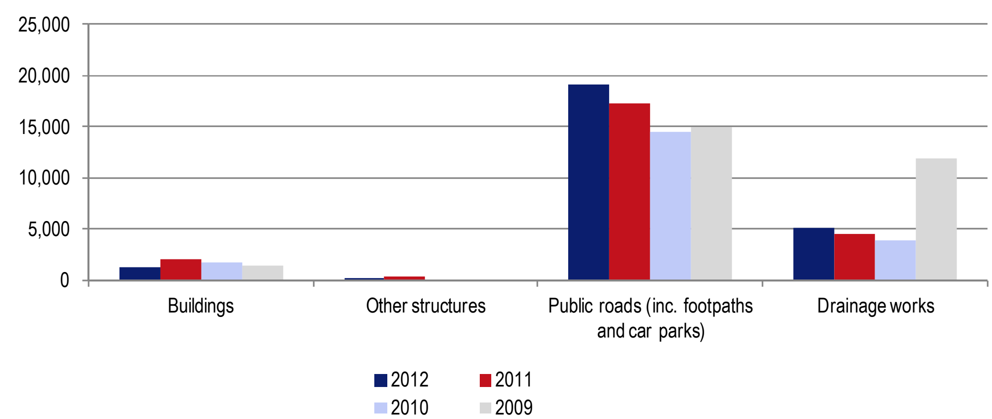
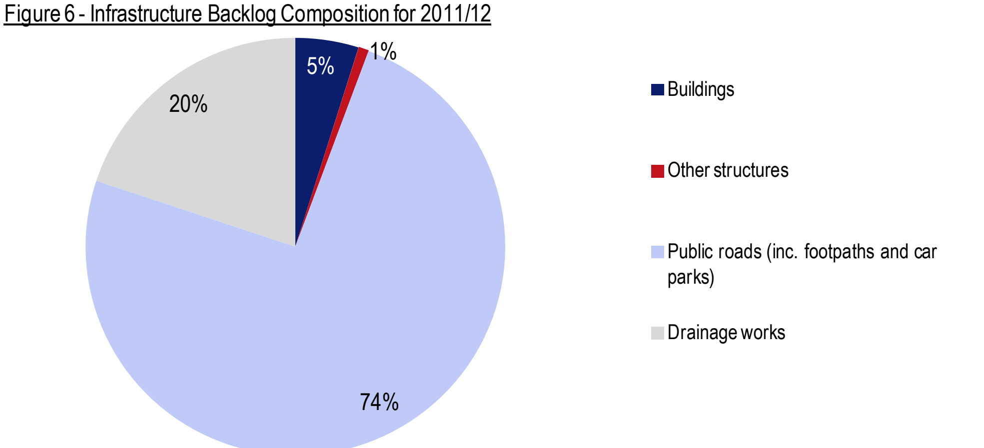


Figure 6 - Infrastructure Backlog Composition for 2011/12



The Council reported a $25.6m backlog in 2012. Consistent with many other councils, the backlog is largely road related, however being an urban council, Council has less kilometres of roads to maintain compared to rural councils.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard ($'000's)	25,630	24,086	20,064	28,282
Required annual maintenance ($'000's)	4,625	4,625	6,780	3,679
Actual annual maintenance ($'000's)	1,823	1,823	2,920	2,617
Total value infrastructure assets ($'000's)	220,663	222,735	218,359	139,929
Total assets ($'000's)	483,818	482,589	480,624	510,358
Infrastructure Backlog Ratio	0.12x	0.11x	0.09x	0.20x
Asset Maintenance Ratio	0.39x	0.39x	0.43x	0.71x
Building and Infrastructure Asset Renewal Ratio	0.80x	0.67x	1.34x	0.98x
Capital Expenditure Ratio	0.92x	1.03x	2.10x	1.66x

The Infrastructure Backlog has marginally decreased between 2009 and 2012aided by increased capital expenditure in 2010, and constant refinement of asset valuation techniques.

Both the Building and Infrastructure Asset Renewal Ratio, and the Asset Maintenance Ratio have not meet the benchmarks in recent years and indicatethat Council is not spending enough on asset renewal and asset maintenance. If these ratios continue to be below benchmark it is likely the Infrastructure Backlog will grow.Council is currently assessing the backlog of works.

The Capital Expenditure Ratio shows that sufficient capital expenditure is occurring, and unlike the Building and Infrastructure Asset Renewal Ratio, this ratio takes into consideration capital expenditure which improves performance or capacity. Council opened a new sporting facility worth $4.3m in 2011 which was 50.0% funded by federal grants and in 2009 Council undertook a $1.2m upgrade of the Drill Hall Common.

According to Council, the local community has not identified the Infrastructure Backlog as a significant issue, with transport and traffic topping the list in community consultation. Marine Structures and their condition has been a recent item discussed in Council and the community due to some damage and deterioration of some assets. Given this, a bulk of the LIRS funding has been identified for work on marine structures.

Council is currently working on a second edition of the roads asset management plan due to be published in November 2012. With the assistance of a community “Asset Management Reference Group”, it is envisaged that the Infrastructure Backlog figure will be refined downwards by agreeing on realistic intervention levels that will be acceptable to the community. Currently Council thinks that the levels of service established are too high a standard, and could be reduced. Further, Council has recently entered into a new SHOROC civil works tender which has indicated a reduction in road asset costs. This too will have an effect in reducing the Infrastructure Backlog.

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 ($'000's)	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
New capital works	0	2,271	5,709	2,409
Replacement/refurbishment of existing assets	6,474	6,126	3,466	4,567
Total	**6,474**	**8,397**	**9,175**	**6,976**

Council has had a diverse mix of capital projects in the last four years for which they have attracted significant Federal and State grant funding.

Council's main area of expenditure has been in its roads and footpaths program in which it invested $6.6m over the last four years. Council also invested $0.3m p.a. in 2009 and 2010 in parking meters, which are now significant revenue generators.

Council's other areas of significant capital expenditure include work on the Clifton Gardens Wharf, Marie Bashir Sports Centre, Bradley Head Road program, and Botanic Road stormwater program. Council attracted funding for these projects from organisations such as the RMS, and the NWS Department of the Environment.

3.7: Specific Risks to Council

- Asset management. Council has indicated that they think their key challenge is determining the appropriate intervention level and the balance between" community" service levels and "engineering" service levels. Council has undertaken significant work over the last 18 months in identifying a complete asset inventory and condition profile. It is now working with a Asset Management Reference Group to determine the appropriate intervention level and define what should and should not be included in the Infrastructure Backlog. This is critical in moving forward as in many cases large asset classes like retaining walls, a change in intervention level can have a significant impact in the funding requirements of the future.
- Ageing workforce. 34.0% of employees are over 50 and 10.0% are over 60. Multiple retirements over the coming years present challenges including the risk of corporate knowledge loss. Strategies developed to combat this include reviewing the recruitment strategy and skill mapping of staff to assist with succession planning.
- Climate change.As a coastal LGA, Council is vulnerable to the effects of climate change, including rising sea levels and changes in rainfall patterns which lead to intense storm events and flooding. The LGA has bushland, seagrass and threatened species which add to the character and value of the LGA and would be vulnerable to the effects of climate change. Council's four year delivery program makes provision for adaption to climate change using

strategies including mitigation, and adaption. For example climate change and rising sea levels are considered in all foreshore works. Council also actively manages 19 of its 22 bushland sites. Between 2001 and 2006 there was an overall increase in the percentage of native vegetation cover across all of the LGA bushland that is currently actively managed.

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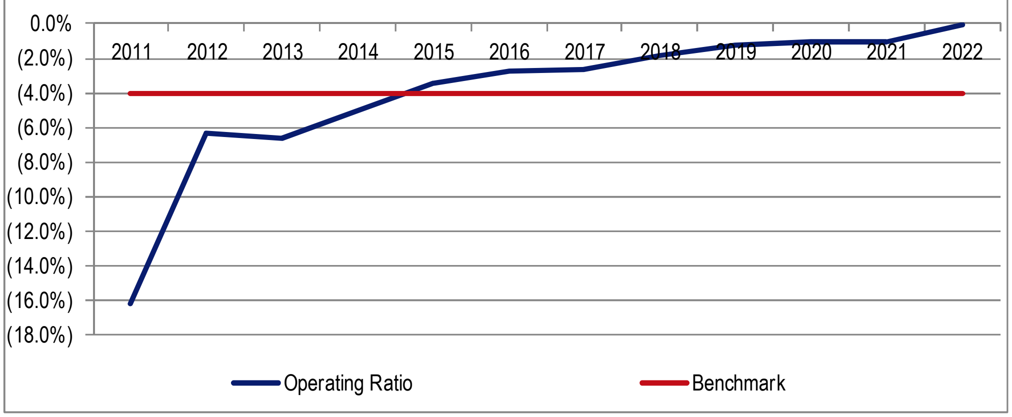
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years, plus the actual results for the past two years. The model includes the $2.0m loan without any LIRS subsidy.

Council operate just one General Fund covering all activities.

4.1: Operating Results

Figure 7 - Operating Ratio for General Fund



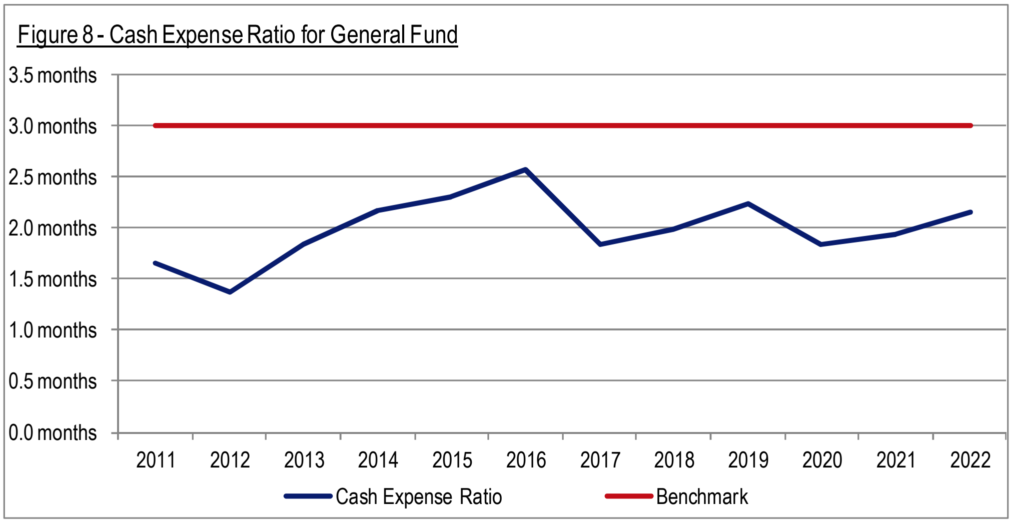
The operating results are forecast to gradually improve over the lifetime of the forecast. Increased revenues in areas such as parking fees in 2013 boost Council revenues for the lifetime of the forecast. Council have also been proactive in generating other revenue sources in areas such as advertising. In May 2012 Council agreed to a 15 year contract to advertise on a pedestrian overpass bridge which will generate $8.0m over 15 years.

Discussions with Council have also revealed how these operating results could improve further. Council has analysed the rate of depreciation charged on assets such as roads versus a sample of 20 other councils and has concluded that the depreciation rates of their roads is deemed too high. Remedial action has been taken in 2012 which has seen a reduction in the depreciation expense on roads of approximately $1.6m. Council has indicated that they will be reviewingthe depreciation expense on some other assets in the near future but this is not reflected in the current LTFP.

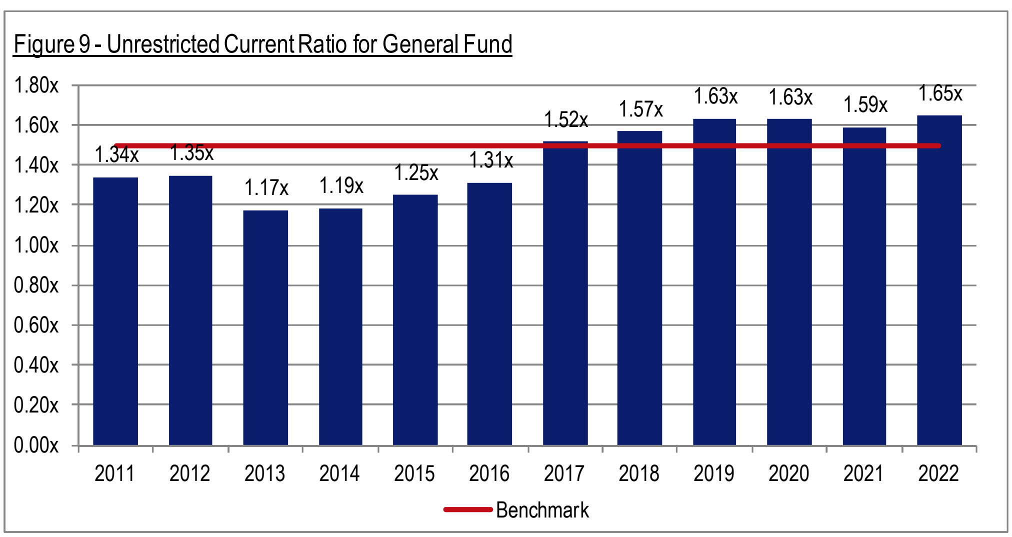
4.2: Financial Management Indicators

The financial management indicators are linked to the utilisation of debt in early years and improve over time as the amortising debt reduces and operating deficits also improve.

Liquidity Ratios

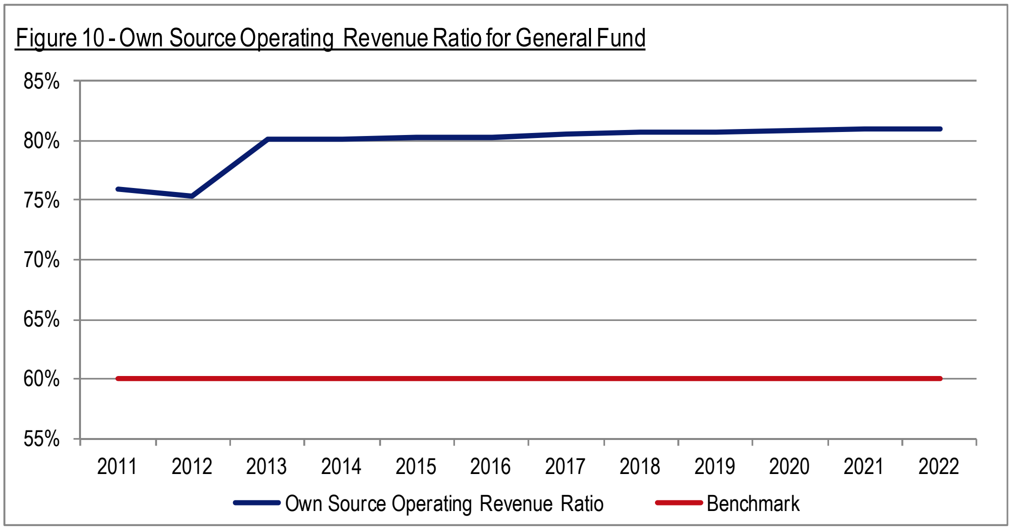


Council's Cash Expense Ratio is consistently below benchmark each year. When Council's investments are included in this ratio ($2.8m in long term deposits in 2012) Council would still not be meeting the benchmark. Council should consider increasing their flexibility in regards to liquidity, as they will not be well positioned if cash reserves were to be called upon in unforeseen circumstances.

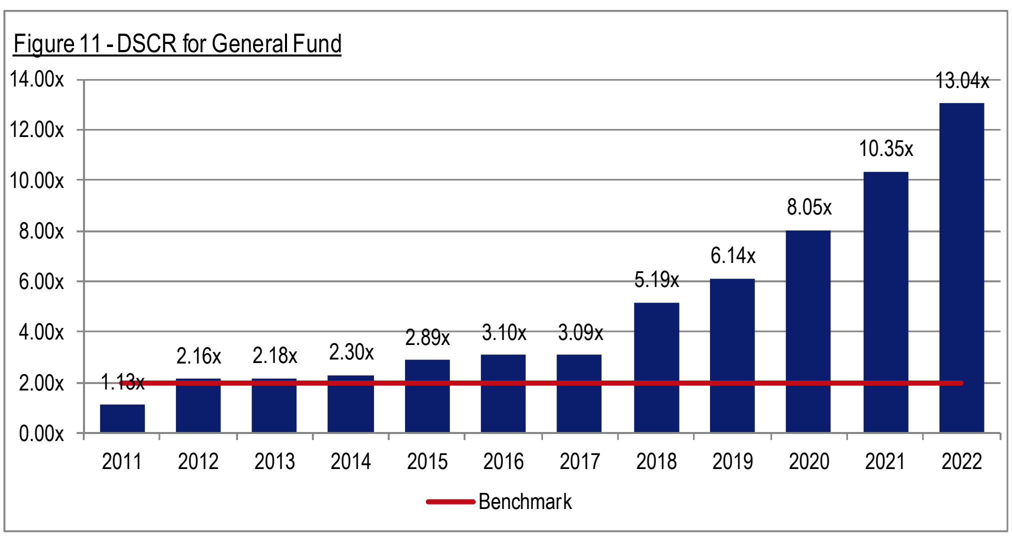


The Unrestricted Current Ratio is not forecast to be above the benchmark until 2017. Council is aware of the DLG benchmark of 1.50x, but being a service orientated Council, it aims to invest as much cash as possible into the community. In Council's community strategic plan Council's 10 year objective is to have an Unrestricted Current Ratio of 2.00x.

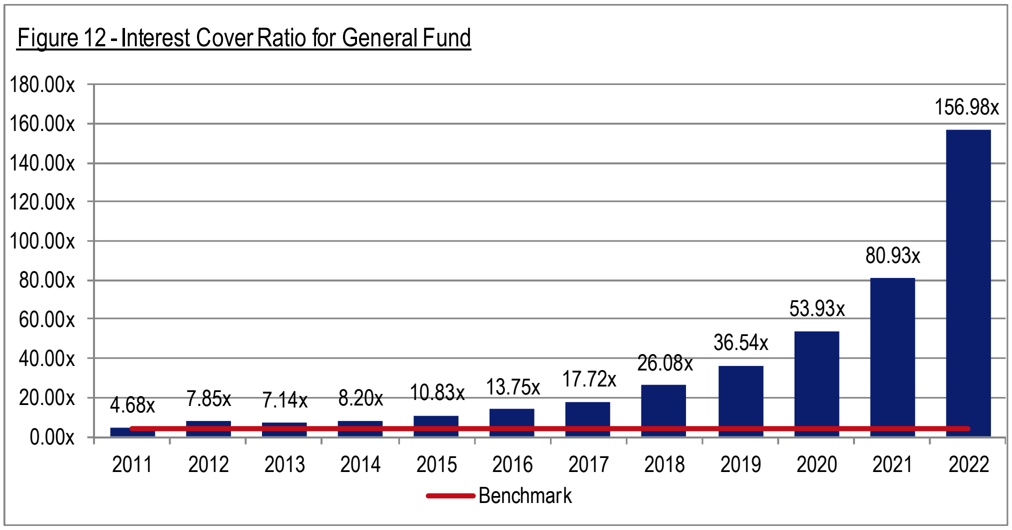
Fiscal Flexibility Ratios



The Own Source Operating Revenue Ratio remains above the benchmark for each year. The ratio is rising over the lifetime of the forecast due to capital grants and contributions forecast being lower than historically received. This skews the proportion of Own Source Revenue Ratio.

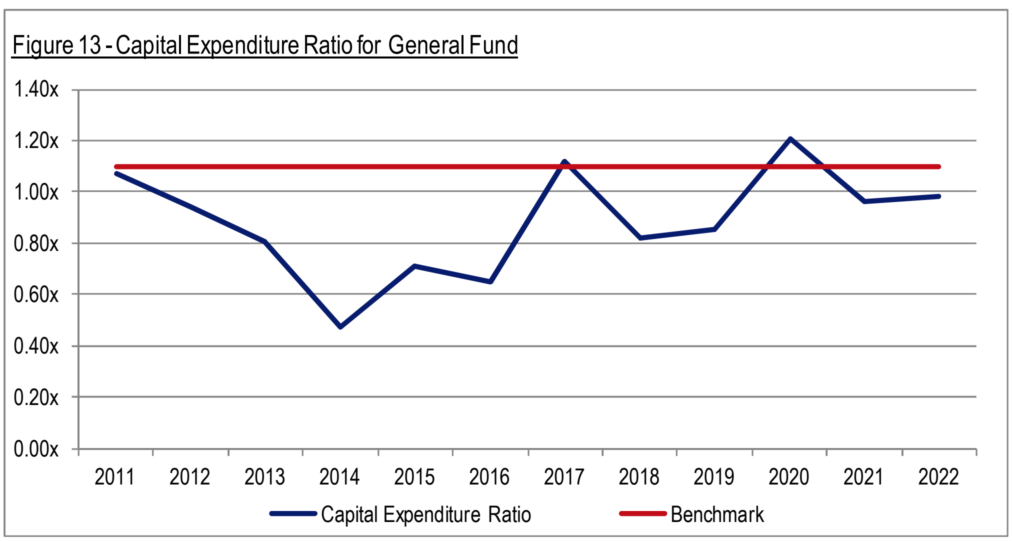


The DSCR shows that Council has the capacity to service the $2.0m loan relating to the LIRS project, and the other planned borrowings of $0.2m in 2013. The DSCR increases over the lifetime of the forecast due to repayments falling from $1.7m in 2014 to $0.5m in 2022. Outstanding borrowings in the General Fund will peak in 2013 at $9.8m reducing to a low of $0.2m in 2022.



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

4.3: Capital Expenditure



There is a gap between asset renewal and depreciation. Despite the infrastructure levy, capital expenditure meets the benchmark in just two of the 10 years of the forecast. The total deficit for capital expenditure versus depreciation across the 10 year period amounts to $9.8m in nominal terms.

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 chargesto increase by mid-range LGCI annual increases of 3%
- 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>

- TCorp find the majority of assumptions reasonable.
- Rates and annual charges are forecast to increase at around 3.0% p.a.
- User fees and charges are boosted in 2013 by increases in parking meter fees.
- Employee costs are forecast to increase by between 3.0% and 8.0% p.a. With rates and annual charges constrained by rate pegging, ever increasing employee costs will threaten the sustainability of the Council.
- Council staff will continue to review depreciation rates which could see operating results further improve over time.

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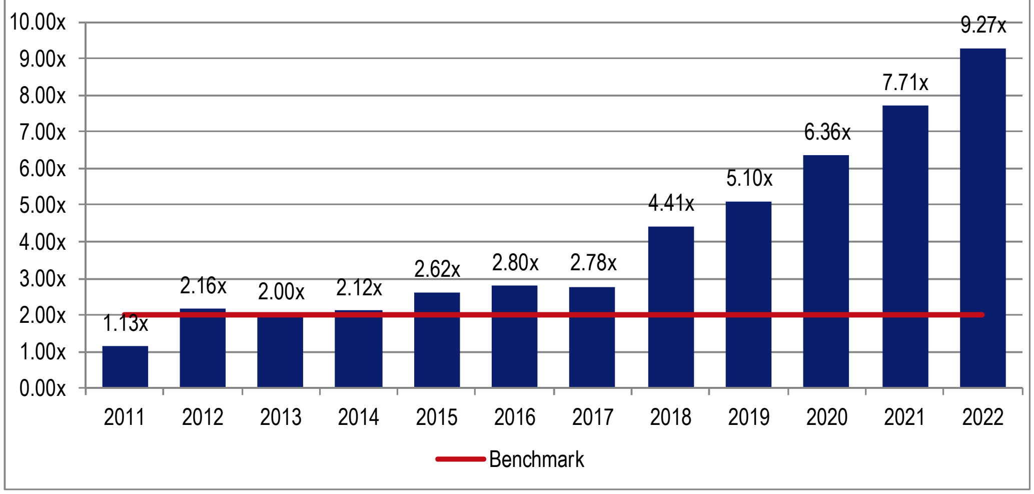
4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will not be able to incorporate additional loan funding in addition to the LIRS loan facilities. Some comments and observations are:

Figure 14 - DSCR for General Fund with an additional $1.5m in borrowings



- Based on a benchmark of DSCR>2.00x, $1.5m could be borrowed in addition to the $2.0m borrowings proposed under LIRS, and the additional forecast borrowings of $0.2m in 2013
- The Interest Cover Ratio will also remain above the benchmark for all years when the additional borrowings are incorporated into the model
- This scenario has been calculated by basing additional borrowing capacity on a 10 year amortising loan with an interest rate of 6.2% p.a.
- However as both the Cash Expense Ratio and Unrestricted Current Ratio are below benchmark TCorp cannot recommend further borrowing beyond the LIRS loan and the other forecast borrowings of $0.2m until these issues are resolved

Section 5 Benchmarking and Comparisons with Other Councils

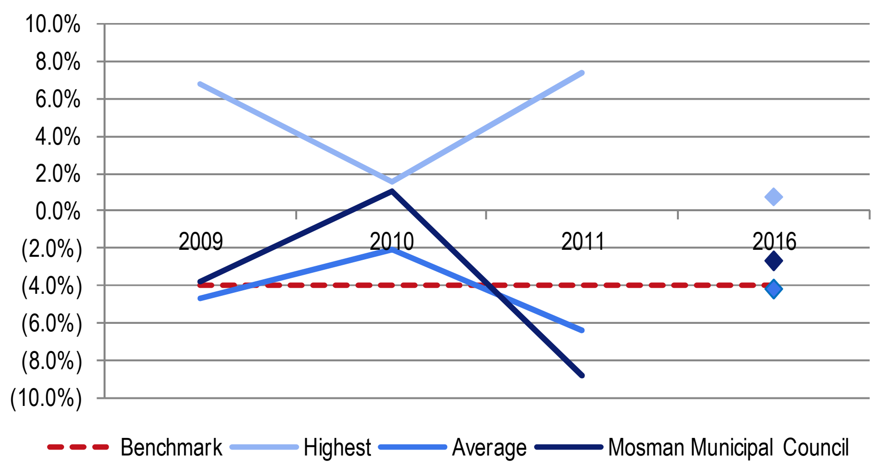
As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 2. There are 15 councils in this group and at the time of preparing this report, we have data for nine of these councils.

In Figure 15 to Figure 21, 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.

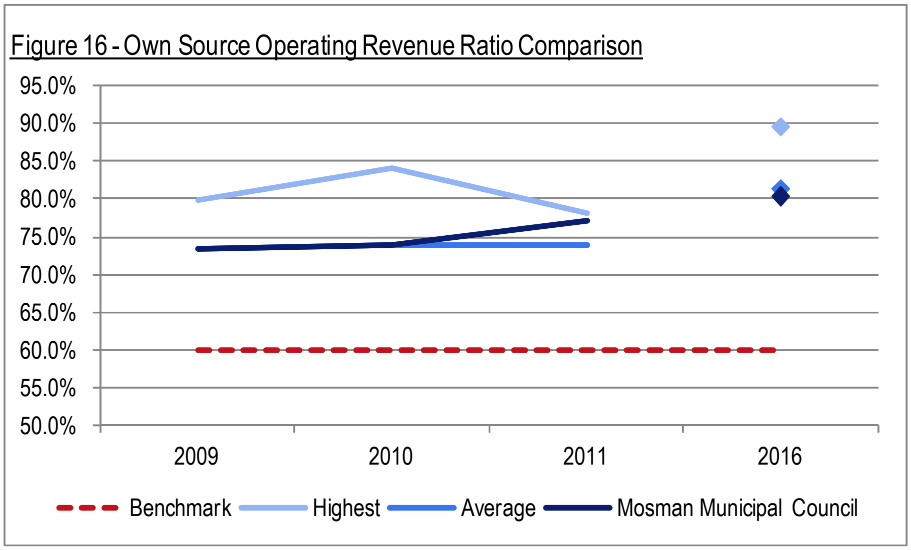
Where no highest line is shown on the graph, this means that Council is the best performer in its group for that Ratio.

Financial Flexibility

Figure 15 - Operating Ratio Comparison



Council's Operating Ratio was above average in two of the past three years. Consistent with other councils in the group, it experienced a decline in operating results in 2011 due to increased depreciation expense. The results are forecast to improve in the medium term to be above the group's average and benchmark.



Council's Own Source Operating Revenue Ratio has improved to be above the group average in 2011 and it is above the benchmark. The ratio has improved over the period and is forecast to improve further in the medium term.

Overall, Council's financial flexibility is around the group's average.

Liquidity

Figure 17 - Cash Expense Ratio Comparison

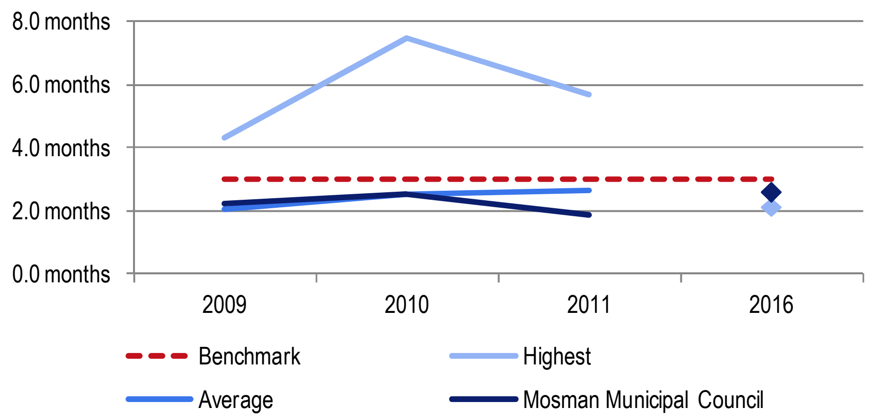
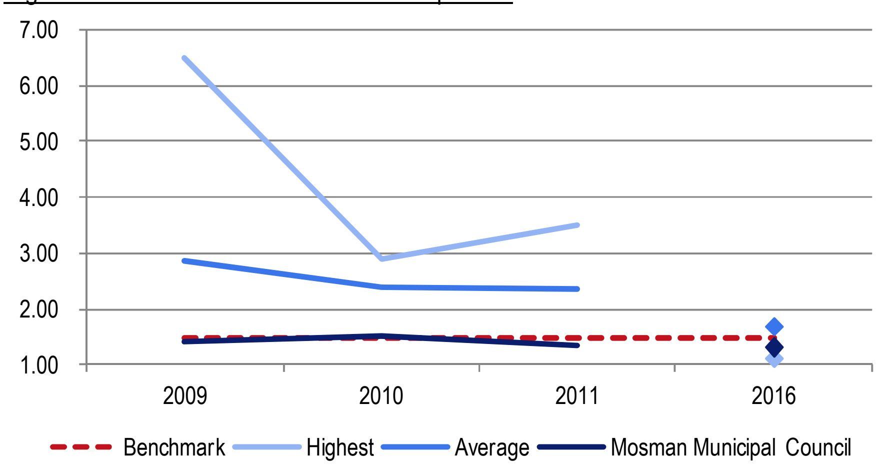


Figure 18 - Unrestricted Current Ratio Comparison



On average over the past three years, the Council's liquidity position has been sufficient and this is forecast to marginally improve.

Debt Servicing

Figure 19 - Debt Service Cover Ratio Comparison

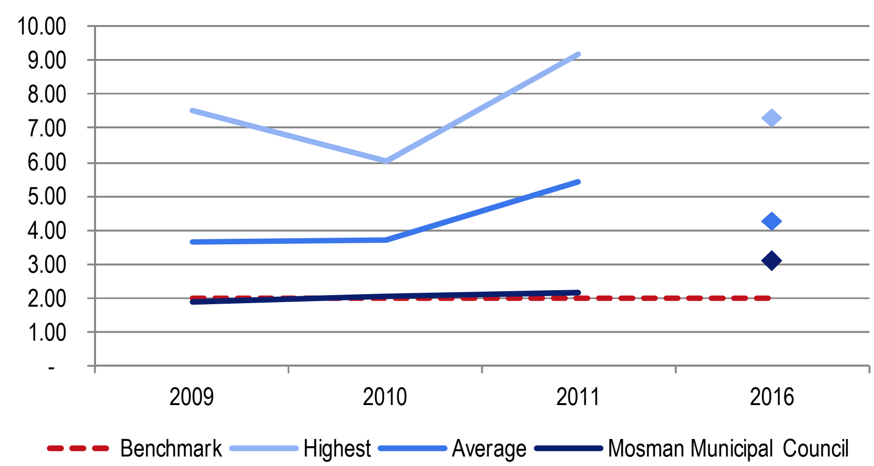
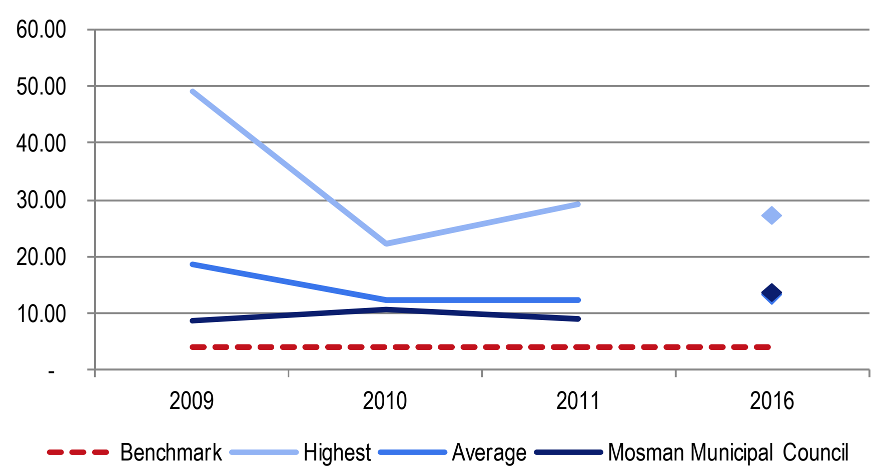


Figure 20 - Interest Cover Ratio Comparison



Over the review period, Council was on or around the benchmark DSCR and above the benchmark for the Interest Cover Ratio and these ratios are forecast to remain in the medium term to be above the benchmark.

Figure 21 - Capital Expenditure Ratio Comparison

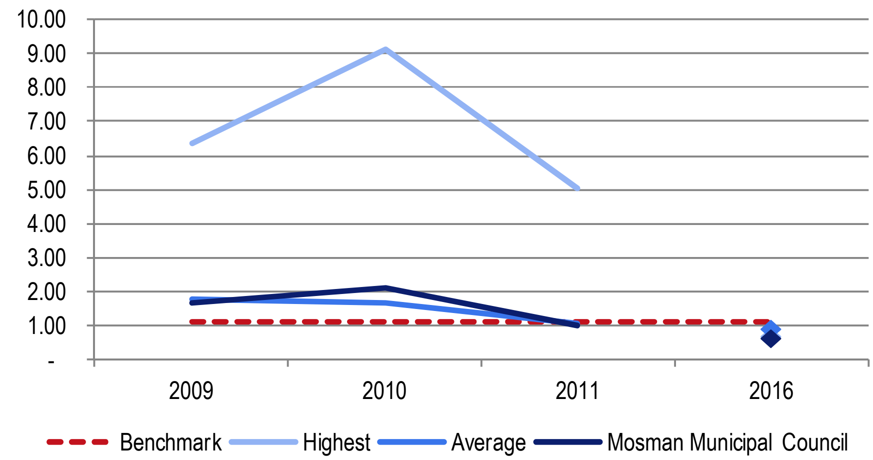
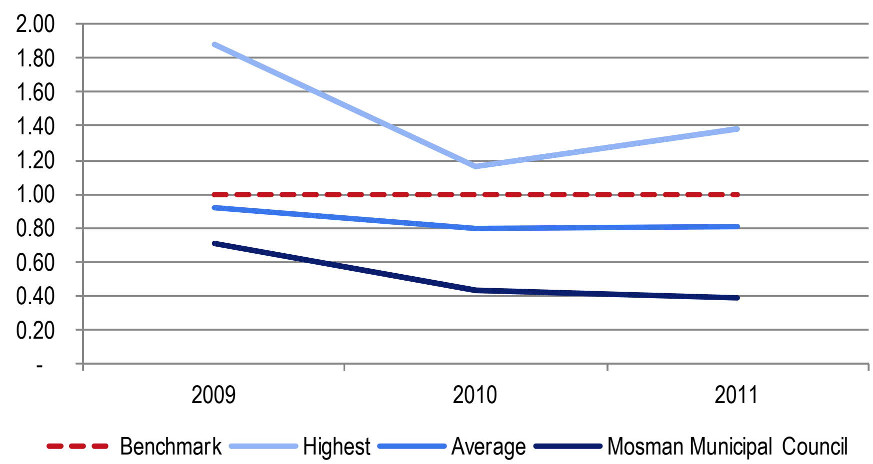
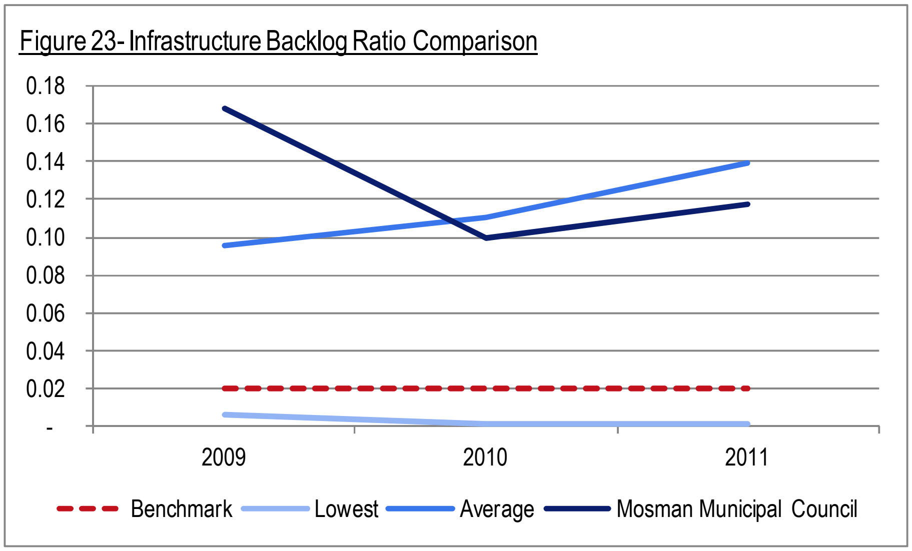
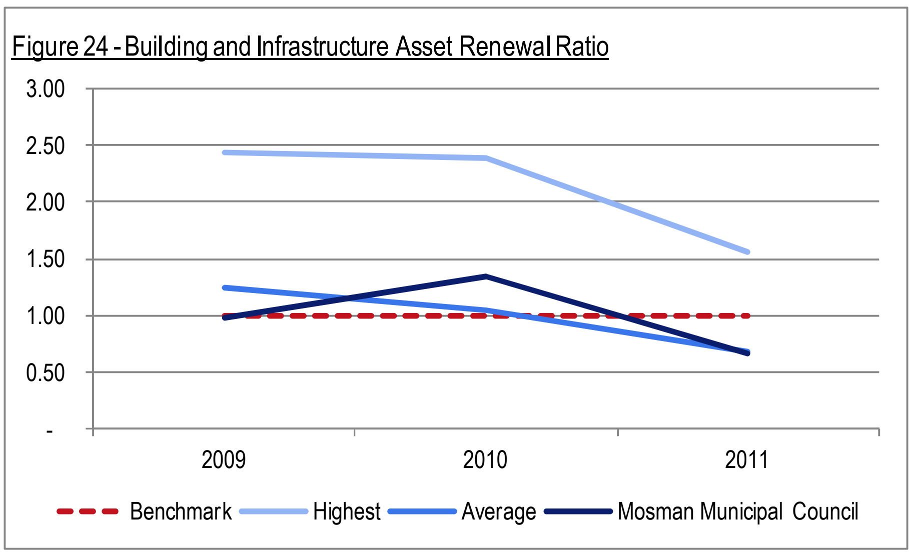


Figure 22 - Asset Maintenance Ratio Comparison







Overall, the Council has a lower Infrastructure Backlog than other councils in the group although the backlog would have to reduce significantly to reach the benchmark. It is below the group average and benchmark in terms of spending on asset maintenance. The Council's Capital Expenditure Ratio and Building and Infrastructure Asset Renewal Ratio have declined against benchmark over the review period.

Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's long term financial plan we consider Council to be in a satisfactory financial position except for its liquidity position. We base our recommendation on the following key points:

- Council's Own Sourced Operating Revenue Ratio has been consistently above benchmark each year
- Council revenues have been boosted by the introduction of two SRVs which aid infrastructure renewal and a program of environmental works
- Council have been proactive in generating alternative revenue sources as evidenced by the introduction of parking meters in 2010
- Council has been proactive in seeking cost savings and efficiencies as evidenced through its membership of SHOROC which is seeking savings through joint tenders, and regional purchasing, amongst a range of methods

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

- Council improves liquidity by continuing to pursue their aim of meeting the Unrestricted Current Ratio benchmark of 1.50x
- Council aims to keep employee salary increases more in line with our benchmark assumption of 3.5%. Ever increasing employee costs represent a threat to Council sustainability. Council's ability to control employee expenses into the future is constrained by the Federal Government increasing the superannuation guarantee levy from 2014 onwards.

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Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000's)	Year ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Revenue							
Rates and annual charges	21,041	20,509	19,755	18,951	2.6%	3.8%	4.2%
User charges and fees	7,986	7,028	6,447	5,324	13.6%	9.0%	21.1%
Interest and investment revenue	434	397	296	339	9.3%	34.1%	(12.7%)
Grants and contributions for operating purposes	2,842	2,330	2,088	2,026	22.0%	11.6%	3.1%
Other revenues	3,683	3,611	3,607	3,458	2.0%	0.1%	4.3%
Total revenue	**35,986**	**33,875**	**32,193**	**30,098**	**6.2%**	**5.2%**	**7.0%**
Expenses							
Employees	14,181	13,719	13,365	12,417	3.4%	2.6%	7.6%
Borrowing costs	672	615	480	378	9.3%	28.1%	27.0%
Materials and contract expenses	10,875	9,258	8,628	9,191	17.5%	7.3%	(6.1%)
Depreciation and amortisation	6,890	7,847	4,251	4,096	(12.2%)	84.6%	3.8%
Other expenses	5,658	5,415	5,128	5,164	4.5%	5.6%	(0.7%)
Total expenses	**38,276**	**36,854**	**31,852**	**31,246**	**3.9%**	**15.7%**	**1.9%**
Operating result (excluding capital grants and contributions)	**(2,290)**	**(2,979)**	**341**	**(1,148)**	**23.1%**	**(973.6%)**	**(129.7%)**
Operating result (including capital grants and contributions)	**877**	**(1,183)**	**3,628**	**1,795**	**174.1%**	**(132.6%)**	**102.1%**

Table 2 - Items excluded from Income Statement

Excluded items ($'000)				
	2012	2011	2010	2009
Grants and contributions for capital purposes	3,167	1,796	3,287	2,943
Fair value adjustments – Investment properties	(631)	618	3,356	(1,650)
Revaluation decrements to infrastructure assets	0	(3,225)	(4,572)	0
Gain/(Loss) on disposal of assets	(57)	(244)	71	(39)

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Table 3 - Balance Sheet

Balance Sheet ($'000's)		Year Ended 30 June				% annual change	
	2012	**2011**	**2010**	**2009**	**2012**	**2011**	**2010**
Current assets							
Cash and equivalents	3,609	4,359	5,754	5,013	(17.2%)	(24.2%)	14.8%
Investments	2,750	1,000	1,000	500	175.0%	0.0%	100.0%
Receivables	3,016	2,461	2,345	2,820	22.6%	4.9%	(16.8%)
Inventories	162	160	139	115	1.3%	15.1%	20.9%
Other	102	87	267	150	17.2%	(67.4%)	78.0%
Total current assets	9,639	8,067	9,505	8,598	19.5%	(15.1%)	10.5%
Non-current assets							
Receivables	49	80	80	101	(38.8%)	0.0%	(20.8%)
Intangible assets	344	360	376	0	(4.4%)	(4.3%)	N/A
Infrastructure, property, plant & equipment	432,073	432,618	429,933	464,627	(0.1%)	0.6%	(7.5%)
Investments accounted for using the equity method	635	555	497	423	14.4%	11.7%	17.5%
Investment property	41,078	40,909	40,233	36,609	0.4%	1.7%	9.9%
Total non-current assets	474,179	474,522	471,119	501,760	(0.1%)	0.7%	(6.1%)
Total assets	**483,818**	**482,589**	**480,624**	**510,358**	**0.3%**	**0.4%**	**(5.8%)**
Current liabilities							
Payables	7,288	6,620	6,846	6,420	10.1%	(3.3%)	6.6%
Borrowings	1,669	1,771	1,919	1,776	(5.8%)	(7.7%)	8.1%
Provisions	3,944	3,538	3,313	3,028	11.5%	6.8%	9.4%
Total current liabilities	12,901	11,929	12,078	11,224	8.1%	(1.2%)	7.6%
Non-current liabilities							
Borrowings	8,496	8,415	7,936	6,306	1.0%	6.0%	25.8%
Provisions	115	128	100	116	(10.2%)	28.0%	(13.8%)
Total non-current liabilities	8,611	8,543	8,036	6,422	0.8%	6.3%	25.1%
Total liabilities	**21,512**	**20,472**	**20,114**	**17,646**	**5.1%**	**1.8%**	**14.0%**
Net assets	**462,306**	**462,117**	**460,510**	**492,712**	**0.0%**	**0.3%**	**(6.5%)**

Table 4-Cashflow

CashFlow Statement ($'000's)	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
Cashflows from operating activities	7,027	6,579	9,026	5,461
Cashflows from investing activities	(7,756)	(8,305)	(10,058)	(6,645)
Proceeds from borrowings and advances	1,750	2,250	3,745	2,990
Repayment of borrowings and advances	(1,771)	(1,919)	(1,972)	(1,394)
Cash flows from financing activities	(21)	331	1,773	1,596
Net increase/(decrease) in cash and equivalents	**(750)**	**(1,395)**	**741**	**412**
Cash and equivalents	3,609	4,359	5,754	5,013

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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.

[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 acouncil 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 building, infrastructure and other structures 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

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.