New South Wales
Treasury Corporation

# Weddin Shire Council

## Financial Assessment, Sustainability and Benchmarking Report

**8 March 2013**

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

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## Disclaimer

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

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

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

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# Index

# Section 1 Executive Summary

This report provides an independent assessment of Weddin Shire 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 consolidated financial forecasts

The Council's financial results have been satisfactory in some areas over the review period based on the following observations:

- Council's underlying results (measured using EBITDA) increased by $1.0m over the past four years to $3.1m
- Council's Unrestricted Current Ratio has been above benchmark in each of the past four years indicating Council had sufficient liquidity to meet its short term liabilities
- Over the review period, Council has operated debt free. With a positive EBITDA, Council has had the capacity to use borrowings to fund capital projects if required

Areas of concern are that:

- Approximately 45.5% of the Council's revenue base is derived from own sourced revenue (rates and annual charges, and user charges and fees). As a rural Council, he LGA's is dependent on external sources of funding to meet its operating expenses
- Over the review period, spending on renewal and addition of assets was consistently below the benchmark levels as Council prioritised flood damage works over its scheduled capital work program due to limited timing to spend the grant funding for the flood repairs. If this trend continues, it is likely that the quality of Council's asset base will decline in future years

The Council reported $9.6m of Infrastructure Backlog in 2012 which represents 8.6% of its infrastructure asset value of $112.8m. Other observations include:

- Over the review period, the Infrastructure Backlog has remained relatively static. The total nominal value has increased by $0.1m due to rising costs associated with upgrading roads and sewer assets
- The Backlog is mainly road related (63.7% of the total Backlog value in 2012)
- Over the past four years, spending on maintenance of assets has consistently been insufficient due to Council's limited funding resources. Council could only spend approximately 80.0% of the total maintenance expenditure requirements in each of the past four years. If this trend continues, it is likely that the Backlog will grow in future years
- Council's Asset Management Plans (AMP) have highlighted that Council's actual levels of funding are insufficient to maintain the current service levels in the short to medium term in most areas including transport, buildings, parks and recreation, stormwater drainage and sewerage services

The key observations from our review of Council's 10 year forecasts are:

- The current LTFP needs further refinement as the requirements of the AMP have not been incorporated.
- Some of the assumptions are generic straight line assumptions that are not consistent with past trends as well as the existing and forecast declining population trend. The LTFP may need to be reviewed to reflect Council's forecast position
- The LTFP assumes that service levels to the community are being maintained, although with a declining population, this level of service may not be required
- The forecasts show that substantial operating deficit positions are expected in all 10 years when capital grants and contributions are excluded
- Council's level of fiscal flexibility will continue to be limited as Council will continue to rely on external funding sources such as operating grants and contributions
- Overall it appears that Council will have sufficient liquidity throughout the next 10 year period to service all short term liabilities and currently scheduled capital expenditure
- The total capital expenditure is forecast at below the required levels, indicating Council's asset base is likely to decline over time

In our view, based on its credit metrics of DSCR and Interest Cover Ratio, the Council has the capacity to undertake additional borrowings. However, the forecasts show consistent operating deficits between 2013 and 2022. TCorp considers that it would be prudent for Council to develop strategies to improve its operating position prior to undertaking any borrowings.

Based on historical performance, TCorp believes Council to be moderately Sustainable in the short to medium term. Over the past four years, Council consistently recorded operating deficits when capital grants and contributions are excluded. In addition, Council did not spend the required amounts on maintenance, renewal and addition of assets and based on the findings of the AMP and on the current version of the LTFP, this trend will continue in future years. As a consequence, Council's asset base is likely to decline in a short to medium term.

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

- Based on the information provided to TCorp, Council's financial position appears to be deteriorating. However, the assumptions underpinning the current LTFP need to be reviewed so that more definitive conclusions can be drawn about Council's long term Sustainability
- Council forecasts continuous operating deficits (excluding capital grants and contributions) that will make it difficult to maintain service levels
- Council's long term Sustainability would be aided by a diversification of its revenue sources in order to decrease its reliance on operating grants and contributions. It is recognised that this might be difficult to achieve due to the Council's limited rating base and declining population trend
- The flood events in recent years have negatively affected Council's capacity to invest in its assets
- Council is not spending sufficient amounts on maintenance, renewal and addition of assets and in the long term this is likely to lead to an increased Infrastructure Backlog and to a deteriorating asset base

In respect of our Benchmarking analysis we have compared the Council's key ratios with other councils in DLG Group 9. Our key observations are:

- Council's financial flexibility is low compared to the benchmark but mixed compared to the peer group with a below average Operating Ratio but an above average Own Source Operating Revenue Ratio.
- Council's liquidity position has been sound and was generally above the peer group. Over the medium term, Council is forecast to utilise borrowings to fund its capital projects. Council's debt servicing capacity is forecast to be sound and on par with the group average.
- On average, Council outperformed the peer group in terms of levels of Infrastructure Backlog. Council's performance in terms of spending on maintenance of assets, capital expenditure and infrastructure assets renewal was generally lower than the peer group. Over the medium term, Council's Capital Expenditure Ratio is forecast to remain below the group average.

# 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

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.
- They have provided clarifying comments that we included in the report
- Council have noted that the Backlog valuation derived from the AMP provide more accurate estimates than the data provided by Special Schedules 7 (unaudited documents)

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

| Weddin Shire Council LGA | |
|---|---|
| Locality & Size | |
| Locality | Central West |
| Area | 3,410km$^2$ |
| DLG Group | 9 |
| Demographics | |
| Population as at 2011 | 3,665 |
| % under 18 | 24.3% |
| % between 18 and 59 | 43.5% |
| % over 60 | 32.2% |
| Expected population 2025 | 3,113 |
| Operations | |
| Number of employees (FTE) | 56 |
| Annual revenue | $10.8m |
| Infrastructure | |
| Roads | 968.0km |
| Bridges and major culverts | 14 |
| Infrastructure backlog value | $9.6m |
| Total infrastructure value | $112.8m |

Weddin Shire Council Local Government Area (LGA) is located in the Central West region of NSW, at the crossroads of the major thoroughfares from Sydney to Adelaide and Brisbane to Melbourne. 94.0% of the land area is devoted to dry-land agriculture, 3.0% to national parks and 3.0% to state forests. Ample land is also zoned ready for new industry, as well as residential housing and hobby-farms.

The LGA's population has been declining over the past decades and based on the current projections of the Department of Planning (NSW Government), this trend is likely to continue in future years. The median age is 47 years old against 37 years old in all persons in Australia, supporting a focus on retaining and attracting younger people and also providing retirement facilities.

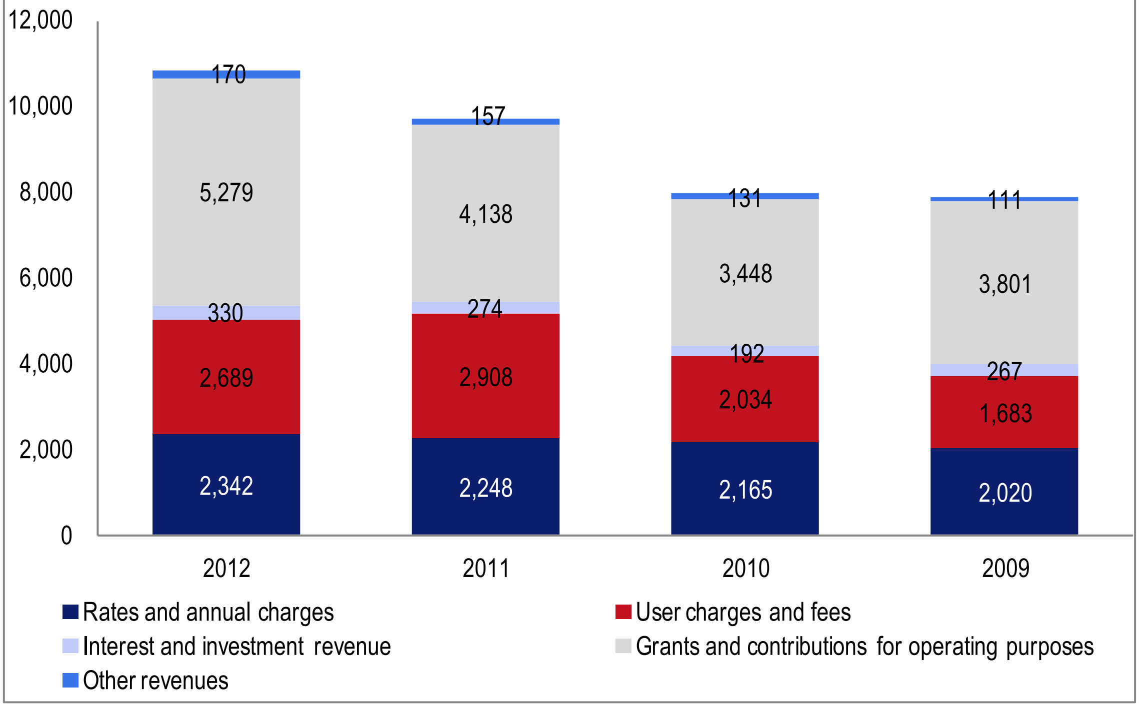
Over the past four years, Council has experienced two major flood events in December 2010 and March 2012 that have substantially impacted Council's infrastructure assets such as roads. In April 2012, repairs to flood damaged roads have been estimated at $1.5m, which is mostly grant funded. These events affected Council's work program as Council had to prioritise repairs and reschedule other works.

# 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)

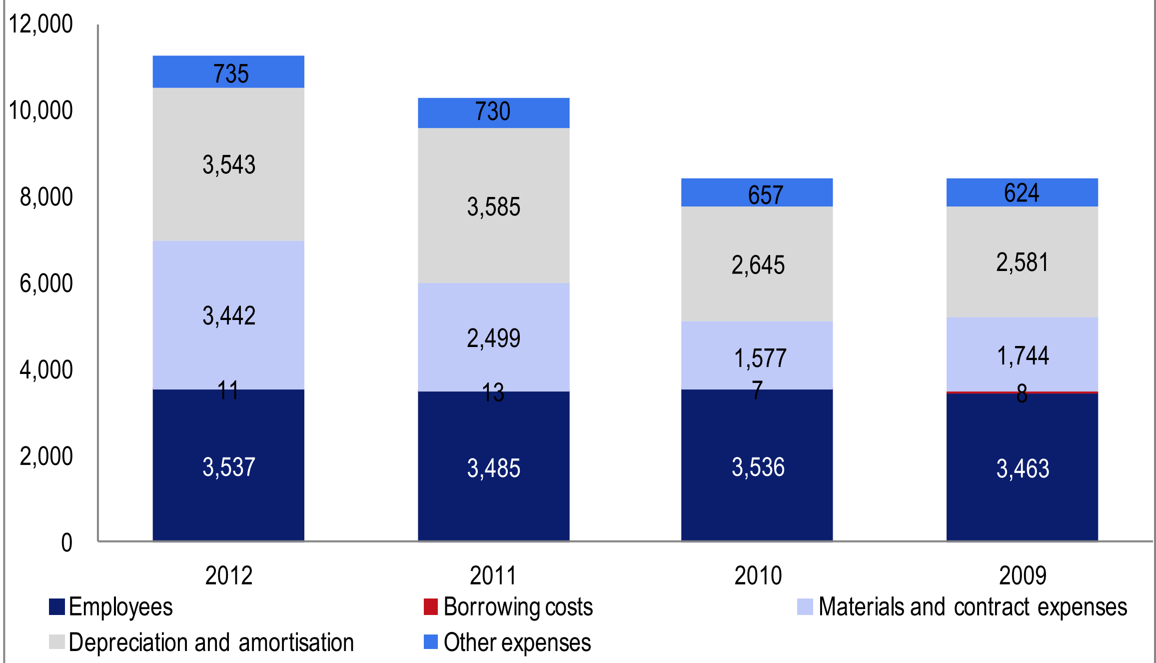



Key Observations

- Rates and annual charges increased by 7.2% ($0.1m) in 2010, 3.8% ($0.1m) in 2011 and 4.2% ($0.1m) in 2012 to $2.3m. Over the review period, farmland rates and sewerage charges both increased by $0.1m, amounting to $1.1m and $0.2m respectively in 2012.
- User charges and fees increased by 59.8% ($1.0m) over the review period to $2.7m, peaking at $2.9m in 2011 due to increased RMS charges. RMS charges were consistently the main contributor to user charges and fees, amounting to $1.3m in 2009, $1.8m in 2010, $2.6m in 2011 and $2.3m in 2012.
- Operating grants and contributions increased by 38.9% ($1.5m) over the review period to $5.3m. Since 2011, Council has been in receipt of natural disaster funding for the floods that occurred in December 2010 and March 2012 ($0.5m in 2011, $0.9m in 2012). In 2012, Council received the prepayment of half ($0.6m) of the 2013 Financial Assistance Grants (FAG).
- Other revenues remained relatively static over the past four years, amounting to $0.2m in 2012. In 2012, commissions and agency fees as well as rental income were the main contributors.

## 3.2: Expenses

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




Key Observations

- Over the past four years, the number of employees has decreased from 65 to 56. Employee costs increased by 2.1% ($0.1m) between 2009 and 2012 to $3.5m. This was mainly due to increases in employee entitlement provisions and in superannuation which rose by $0.2m and $0.1m respectively over the review period while salaries and wages decreased by $0.1m.
- Materials and contracts costs increased by 97.4% ($1.7m) over the past four years to $3.4m. Since 2011, they have substantially increased as Council has been performing additional works on the state highways as well as repairs to flood damaged local roads. These additional costs were covered by additional revenues for flood and by charges and contributions from the RMS.
- Due to the Asset Revaluations, annual depreciation expense increased by 37.3% ($1.0m) over the review period to $3.5m. Council officers have indicated that Council had to value its assets on the basis of wholesale replacement where Council is bearing the full costs of depreciation for assets such as Regional Roads owned by the State Government or 'gifted' to Council (for which the construction was therefore not fully funded by Council). In addition, annual depreciation expense is required to be based on complete replacement of assets, however in reality, these costs are often remediated (for instance re-lining of sewer mains) for a smaller cost. Council officers believe that as the AMP are refined, the gap between reported depreciation and actual costs to restore service potential of the assets will be bridged through better recognition of residual values.

- Other expenses increased by $0.1m over the review period to $0.7m. In 2012, insurance costs and Councillor's fees and allowances were the main contributors amounting to $0.2m and $0.1m respectively.

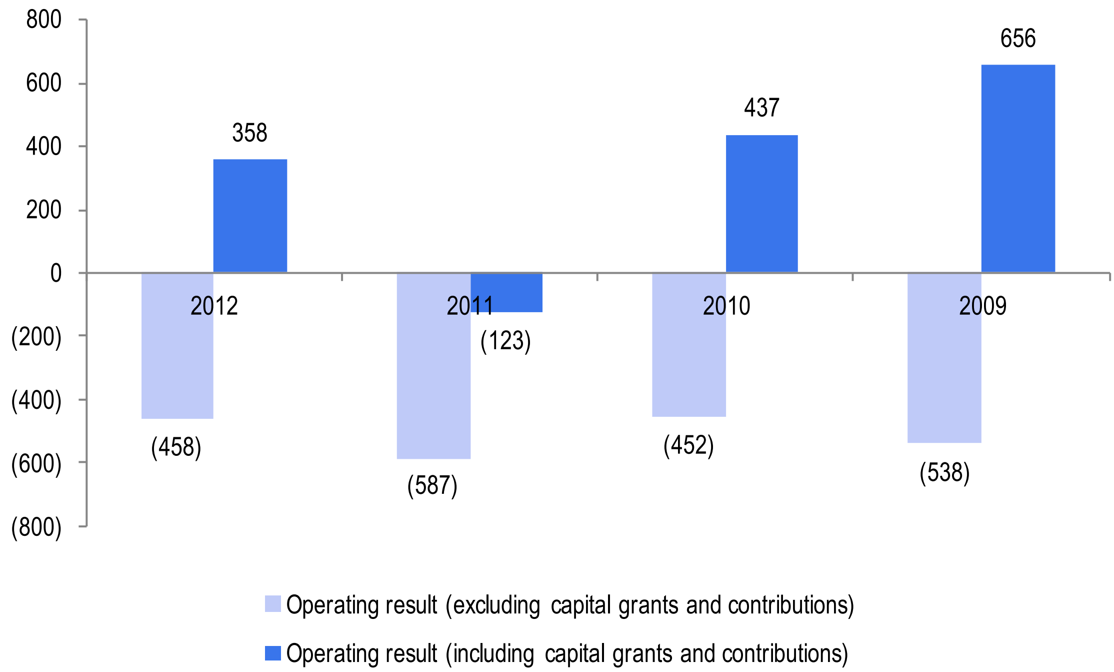
### 3.3: Operating Results

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

- Over the review period, Council has consistently reported operating deficits of around $0.5m per annum, excluding capital grants and contributions.
- Council expenses include a non-cash depreciation expense, ($3.5m in 2012), which has substantially increased since 2009. 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.
- Over the review period, Council consistently reported operating surpluses when capital grants and contributions are included, with the exception of 2011 where Council received less

amounts for bushfire and emergency services compared to the other years ($0.2m in 2009, $0.6m in 2010, $50,000 in 2011, $0.3m in 2012).

- Between 2009 and 2011, the sewerage business generated operating deficits ($0.2m in 2009, $28,000 in 2010, $20,000 in 2011). In 2012, it generated a $23,000 operating surplus.

### 3.4: Financial Management Indicators

| Performance Indicators | Year ended 30 June | | | |
|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 |
| EBITDA ($'000s) | 3,096 | 3,011 | 2,200 | 2,051 |
| Operating Ratio | (4.2%) | (6.0%) | (5.7%) | (6.8%) |
| Interest Cover Ratio | N/A | N/A | N/A | N/A |
| Debt Service Cover Ratio | N/A | N/A | N/A | N/A |
| Unrestricted Current Ratio | 8.10x | 4.69x | 5.49x | 4.40x |
| Own Source Operating Revenue Ratio | 43.3% | 50.6% | 47.4% | 40.8% |
| Cash Expense Ratio | 11.5 months | 10.3 months | 8.4 months | 8.7 months |
| Net assets ($'000s) | 149,293 | 145,896 | 145,768 | 124,248 |

Key Observations

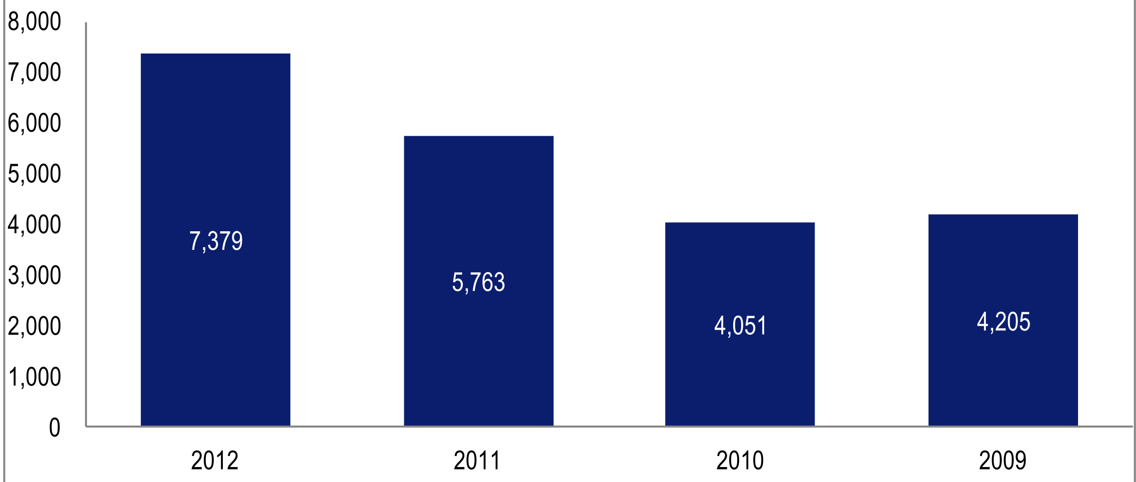
- Council's operating performance has marginally improved over the review period. The Operating Ratio was consistently below the benchmark but improved marginally over the past four years. The EBITDA increased by $1.0m over the past four years to $3.1m.
- Council has operated debt free over the past four years. With a positive EBITDA, Council had some flexibility in regard to carrying debt if required.
- The Unrestricted Current Ratio has been above the benchmark of 1.50x over the past four years indicating Council had sufficient liquidity to meet its short term liabilities.
- The Own Source Operating Revenue Ratio was consistently below the benchmark of 60.0%, indicating Council had limited financial flexibility. Over the review period, Council was dependent on external sources of funding such as operating grants and contributions.
- The Cash Expense Ratio was consistently above the benchmark over the review period indicating Council had sufficient liquidity. The ratio was consistently much higher than the benchmark of three months indicating Council could have invested its cash reserves in term deposits with more favourable interest rates.
- Net Assets increased by $25.0m between 2009 and 2012 due to the Asset Revaluations that increased the value of stormwater drainage and sewerage assets, and reduced the value of operational land assets, buildings, roads, bridges and footpaths
- The Asset Revaluations over the last four years have resulted in a high level of volatility in Net Assets over this period. Consequently, in the short term the value of Net Assets is not necessarily an informative indicator of performance. In the medium to long term however, this is a key indicator of a Council's capacity to add value to its operations. Over time, Net Assets should increase at least in line with inflation plus an allowance for increased population and/or

improved or increased services. Declining Net Assets is a key indicator of the Council's assets not being able to sustain the ongoing operations of a Council.

- When the Asset Revaluations are excluded, the underlying trend in all four years has been a marginal decline in infrastructure, property, plant, and equipment (IPP&E) asset base with asset purchases being marginally lower than the combined value of disposed assets and annual depreciation. Over the four years, this amounted to a $0.4m decrease in IPP&E assets.

### 3.5: Statement of Cashflows

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




Key Observations

- Over the past four years, Council consistently maintained all of its reserves in cash and cash equivalents, and these increased by $3.2m between 2009 and 2012 to $7.4m.
- In 2012, of Council's cash and cash equivalents (including $7.0m in term deposits), $0.8m was externally restricted, $6.4m was internally restricted and $0.2m was unrestricted.
- Over the review period, Council did not have any CDO's or any other forms of investment securities.

## 3.6: Capital Expenditure

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

### 3.6(a): Infrastructure Backlog

Figure 5 - Infrastructure Backlog for 2009/10 to 2011/12($'000s)

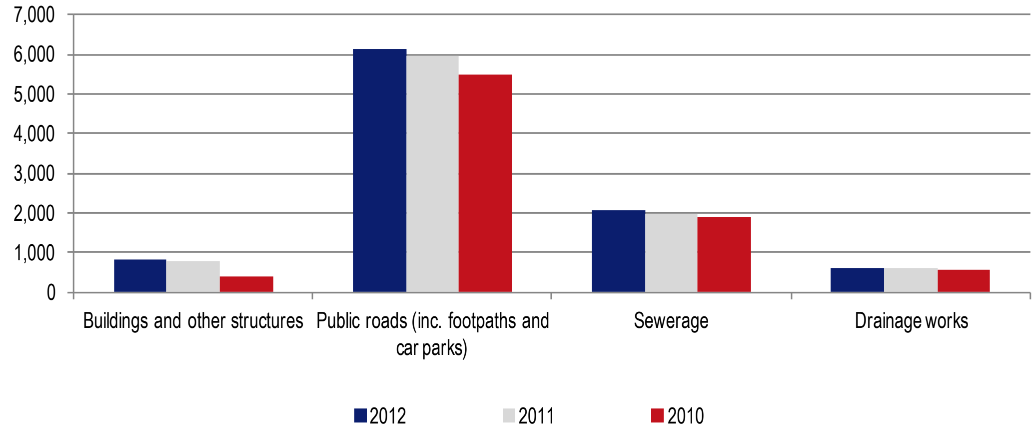
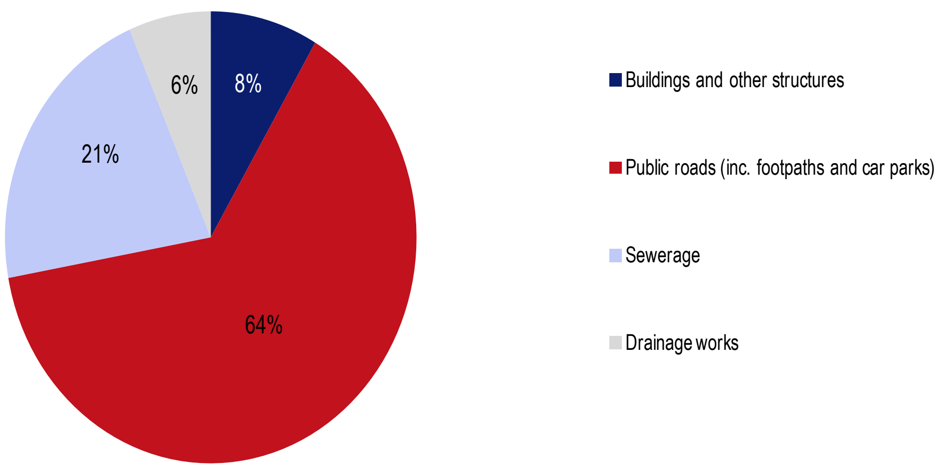



Figure 6 - Infrastructure Backlog Composition for 2011/12




Council could not provide the entire Special Schedule 7 for 2009. As a consequence, we do not have the detail of the Backlog for buildings and other structures as well as public roads for that year. The total value of the Backlog as well as the required and actual maintenance amounts were available, and were used in this analysis.

In 2012, Council reported an Infrastructure Backlog of $9.6m, of which 63.7% was related to public roads. Over the review period, the Infrastructure Backlog value has increased by $0.2m due to rising costs associated with upgrading roads and sewer assets.

Council officers have indicated that they believed that the Backlog could be reduced to a lower level provided that Council manages to source additional funding such as the Roads to Recovery funding for instance. In addition, they mentioned that the development of the AMP have provided better estimates of the Infrastructure Backlog.

### 3.6(b): Infrastructure Status

| Infrastructure Status | Year ended 30 June | | | |
|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 |
| Bring to satisfactory standard ($'000s) | 9,645 | 9,340 | 8,370 | 9,460 |
| Required annual maintenance ($'000s) | 2,656 | 2,565 | 2,405 | 2,310 |
| Actual annual maintenance ($'000s) | 2,211 | 2,145 | 1,930 | 1,870 |
| Total value of infrastructure assets ($'000s) | 112,806 | 110,640 | 111,931 | 116,509 |
| Total assets ($'000s) | 151,636 | 148,363 | 147,720 | 126,292 |
| Building and Infrastructure Backlog Ratio | 0.09x | 0.08x | 0.07x | 0.08x |
| Asset Maintenance Ratio | 0.83x | 0.84x | 0.80x | 0.81x |
| Building and Infrastructure Renewals Ratio | 0.34x | 0.60x | 0.10x | 0.44x |
| Capital Expenditure Ratio | 0.84x | 0.60x | 0.96x | 1.66x |

- The Building and Infrastructure Backlog Ratio was consistently above the benchmark of 0.02x over the past four years.
- The Asset Maintenance Ratio was consistently below the benchmark of 1.00x over the review period, indicating spending on maintenance of assets was insufficient due to Council's limited financial resources. Prioritisation of flood repairs over other capital and maintenance projects has adversely affected this ratio over the past few years. If this trend continues, it is likely that the Infrastructure Backlog will continue to grow in future years.
- The Building and Infrastructure Renewals Ratio was consistently below the benchmark of1.00x over the past four years, indicating spending on renewals of assets was insufficient.
- The Capital Expenditure Ratio was consistently below the benchmark of 1.10x over the past four years, with the exception of 2009.
- Council's infrastructure ratios indicate that spending on maintenance, renewal and addition of assets has generally been below the required levels over the past four years. If this trend continues, it is likely that Council will not be able to maintain its current service levels while its asset base is likely to decline in the short to medium term. In recent years, Council prioritised flood repair works due to limited timing to spend the grant funding for the flood repairs. Council officers have indicated that Council is now returning to its scheduled capital works program which will increase the quality of Councils assert base in future years.
- Council has completed its AMP and is now working towards incorporating the requirements into the LTFP which is scheduled to be achieved in 2014. Overall, the AMP have highlighted that Council's present funding levels are insufficient to continue to provide existing services at current levels in the short to medium term. This is the case for all classes of assets, with the exception of waste assets for which it appears that Council has sufficient resources to maintain the level of services but only in the short term. The main needs in terms of maintenance and renewal expenditure are related to transport assets for which the required level of expenditure has been estimated at $3.4m p.a. in the next 10- year period. Council's available funding for this period is estimated at $2.1m p.a. (61% of the total requirements). The Asset Maintenance Ratios reported above are likely to have been understated because it does not reflect the latest understanding of asset maintenance requirements.

### 3.6(c): Capital Program

Council did not publish Special Schedule 8 which would have detailed their capital expenditure spending levels.

Over the past four years, Council completed a number of capital projects, including:

- Construction of the doctor's residence
- Road works to Martin Lane and Pinnacle Road
- Flood repairs (including replacement of the footbridge in Melyra Street and of a bridge on Millars Lane, widening, heavy patching and resealing of roads)
- Drainage improvements in Bimbi township
- Sewer mains relining

The total estimated cost of these projects is $3.7m.

### 3.7: Specific Risks to Council

Declining population. The LGA's population has substantially declined over the past decades. In 1976, the population was 4,750 while at 2011 it was 3,665. The drivers of this decline are shared with most of the smaller rural communities in NSW and include influences such as limited employment for local youth, years of drought impacting severely on farm production, impact of the global economy on farm product prices, and the attraction of larger centres and mining activities. Council needs to implement strategies to attract more people through increased employment opportunities in order to reverse the declining population trend.

Infrastructure maintenance funding shortfall. The recent development of AMP has highlighted the extent of funding shortfall in the short to medium term in relation to maintenance and renewal of assets. Council needs to source additional funding in order to tackle this issue or to review its service levels.

Natural disaster/flooding. The floods in recent years have increased the challenge for Council of completing additional renewal works in a short amount of time. Widespread destruction of assets such as roads has required high levels of repair works. Council had to prioritise flood repair works over renewal and addition of assets.

# Section 4 Review of Financial Forecasts

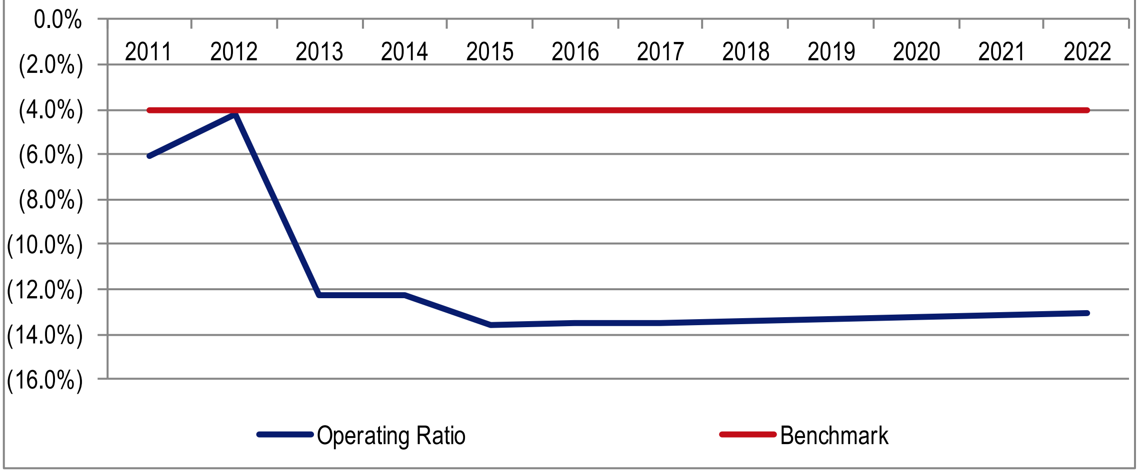
The financial forecast model shows the projected financial statements and assumptions for the next 10 years. Council's consolidated position includes a Sewer Fund, which unlike the General Fund is more able to adjust the appropriate fees and charges to meet all future operating and investing expenses.

In 2012, the revenue generated from the sewer business represented 2.7% of Council's total consolidated operating revenue while Net Assets related to the sewer activity amounted to 4.3% of Council's Net Assets.

As Council have been unable to provide us with detailed projections for the General Fund, we have focused our analysis upon the Consolidated LTFP.

## 4.1: Operating Results

Figure 7 - Operating Ratio




The Operating Ratio is below the benchmark throughout the forecast. The results show that significant deficit positions are expected each year when capital grants and contributions are excluded ($1.2m in 2013, $1.8m in 2022).

The ratio is skewed downwards in 2013 due to a decrease of $0.7m in operating revenue while operating expenses are forecast to increase by $0.1m. In particular, operating grants and contributions are forecast to decline by $1.5m in 2013 due to adjusting for the prepayment in 2012 of half ($0.6m) of the 2013 FAG as well as no flood restoration grant forecast to be received that year.

The Operating Ratio is forecast to remain static in 2014 and to decline slightly in 2015 due to Council starting to pay interest in relation to a new loan forecast to commence in that year to pay for the upgrade of Grenfell Main Street.

From 2015 onwards, the ratio remains relatively static as the main items of revenue and expenses are forecast to increase by 3.5% p.a.

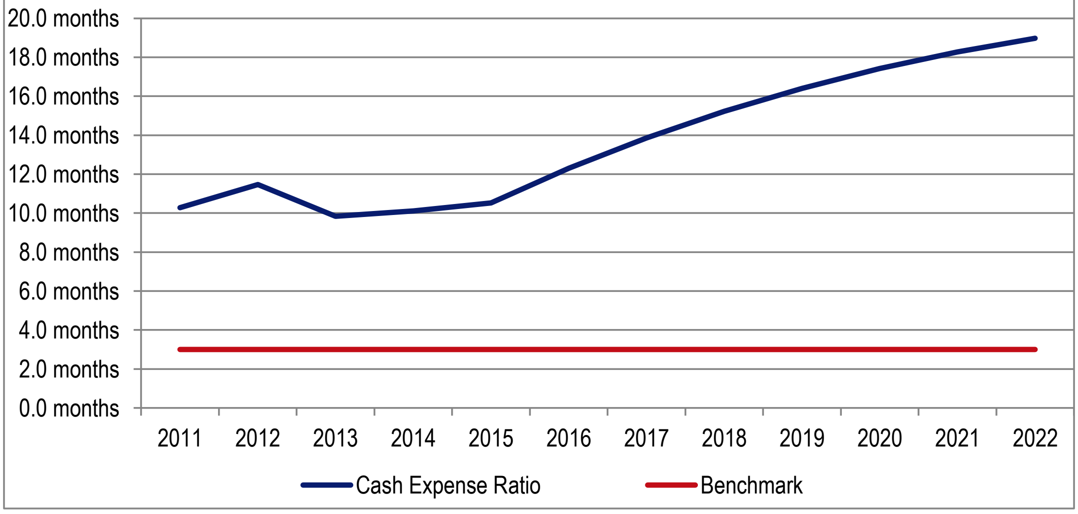
These forecasts indicate Council faces pressures on its Sustainability unless additional revenue sources are found, services are reviewed, or other expenses are reduced.

Though Council's LTFP required further refinement: the level of operating deficits in particular is likely to be reduced.  Council officers have indicated the possibility of applying for an SRV or seeking additional external revenue sources as well as reviewing the service levels and the depreciation expense to align with the actual costs.

## 4.2: Financial Management Indicators

Liquidity Ratios

Figure 8 - Cash Expense Ratio



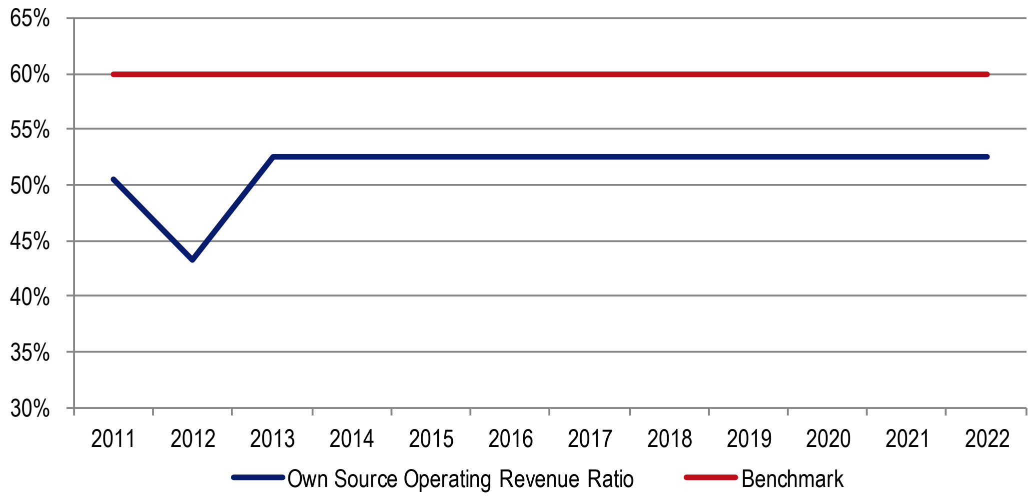

The Cash Expense Ratio is consistently above the benchmark, indicating Council has sufficient liquidity. The ratio is higher than the benchmark of three months each year of the forecast indicating Council does not forecast to invest its cash reserves in term deposits which could have more favourable interest rates.

The ratio increases over time as Council's cash reserves are forecast to improve over time, rising from $6.4m in 2013 to $16.8m in 2022. Once the AMP requirements are built into the LTFP, it is likely that the cash reserves will decrease to lower levels to fund capital expenditure.

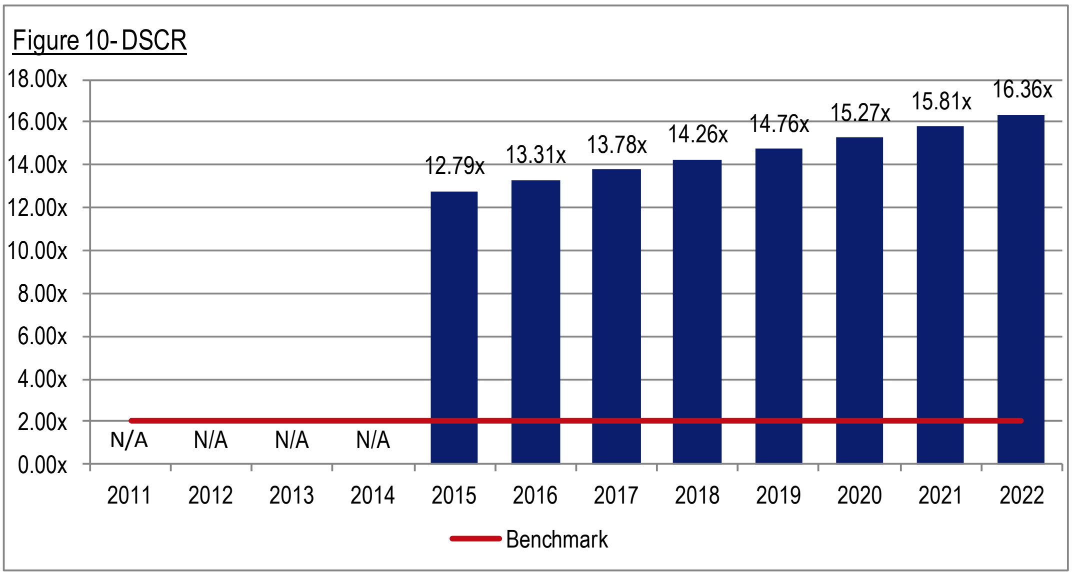
While preparing the current version of the LTFP, Council officers could not provide 10- year projections of the Unrestricted Current Ratio. When analysing the 10- year projections of the current assets and current liabilities, we note that cash and cash equivalents are forecast to increase substantially over the review period.

Fiscal Flexibility Ratios

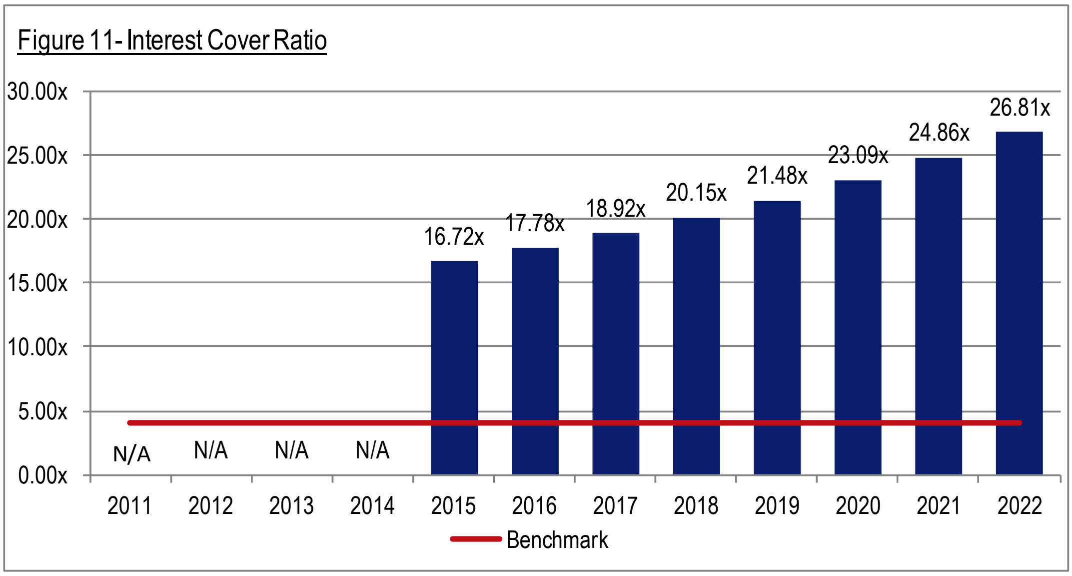
Figure 9 - Own Source Operating Revenue Ratio




The Own Source Operating Ratio is consistently below the benchmark of 60.0%, indicating Council will continue to be dependent on operating grants and contributions that will represent more than 37.0% of its total operating revenue (excluding capital grants and contributions).



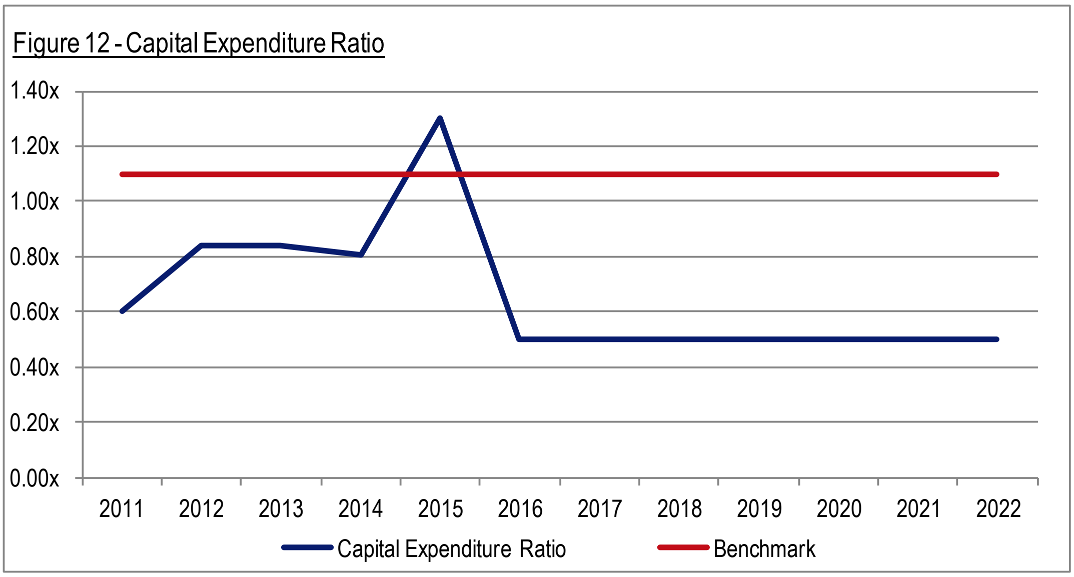

The DSCR is forecast to be above the benchmark of 2.00x from 2015 onwards, indicating that Council has the capacity to service its scheduled loans. Over the past four years, Council has operated debt free. In the current version of the LTFP, it is forecast that Council will borrow $2.0m in 2015 for the upgrade of Grenfell Main Street.




From 2015 onwards, the Interest Cover Ratio is consistently above the benchmark of 4.00x indicating Council will have sufficient capacity to service its scheduled interest payment commitments.

New South Wales
Treasury Corporation

### 4.3: Capital Expenditure




The Capital Expenditure Ratio is below the benchmark of 1.10x each year of the forecast with the exception of 2015 where high levels of capital expenditure are forecast ($5.0m).

We note that these projections do not take into account the AMP requirements which have not as yet been incorporated into the LTFP. In upcoming years, the main projects that will be conducted include the upgrade of the Grenfell Main Street as well as the upgrade of the swimming pool and the continuation of the construction of a new doctor surgery.

Overall, the total capital expenditure ($26.6m) is forecast to be lower than the accumulated depreciation ($42.0m), indicating that Council's asset base is likely to decline over time.

### 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>

- The LTFP assumes that the current service levels are being maintained.
- TCorp has based its analysis on the actual figures for 2011 and 2012 as well as the projections for the period between 2013 and 2022.
- From 2014, onwards, all items (with the exception of borrowing costs), are forecast to increase by 3.5% p.a.
- Rates and annual charges are forecast to increase by 2.1% in 2013.
- User charges and fees are forecast to increase by 25.3% ($0.7m) in 2013 due to additional contract work on state highways being performed for the RMS.
- Operating grants and contributions are forecast to decrease by 28.6% ($1.5m) in 2013 partly due to an adjustment to the prepayment in 2012 of half ($0.6m) of the 2013 FAG as well as no grant for flood restoration forecast to be received (in 2012, Council received a one-off grant for flood restoration amounting to $0.9m).
- Capital grants and contributions are forecast to remain static in 2013 amounting to $0.8m
- Employee costs are forecast to increase by 4.6% ($0.2m) in 2013.
- Materials and contracts costs are forecast to decrease by 2.7% ($0.1m) in 2013.
- Annual depreciation expense is forecast to increase by 1.1% in 2013.
- Overall, TCorp considers the assumptions behind the LTFP need to be reviewed. The use of constant growth numbers of 3.5% for revenues and expenses is of some concern as a declining population together with past trends indicate that forecast future movements in expenses and revenues may not be realistic.

### 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 its existing debt facilities. Some comments and observations are:

- Based on its credit metrics of DSCR and Interest Cover Ratio, Council has the capacity to undertake additional borrowings.
- However, as noted in our comments in section 4.1, the forecast shows that consistent operating deficits are expected each year when capital grants and contributions are excluded. In TCorp's view, it would be prudent for Council to develop strategies to improve its operating position prior to proceeding with any further borrowings in addition to those already included in its LTFP
- Council will also need to review and update its LTFP using more precise assumptions and updated depreciation expense

### 4.6 Sustainability

TCorp believes Council to be moderately Sustainable in the short to medium term. Council has consistently recorded operating deficits when capital grants and contributions are excluded over the past four years. In addition, Council did not spend the required amounts on maintenance, renewal and addition of assets. The AMP have highlighted that, based on the current levels of resources, Council is likely to face a funding shortfall for maintenance, renewal and upgrade for each class of assets (with the exception of waste assets). Council may therefore be unable to maintain the current service levels in these areas.

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

- Council forecasts continuous operating deficits (excluding capital grants and contributions) that will make it difficult to maintain existing service levels.
- Council population has declined over the past decade and this trend is forecast to continue. As a consequence, Council's rating base will remain limited. It is unlikely that Council will manage to decrease its reliance on operating grants and contributions. Council officers have indicated that Council will consider applying for an SRV to increase its revenue and address its reliance on external funding sources.
- Council has operated debt free over the past four years. In the medium term, Council may have capacity to take on debt to fund capital projects. However, consistent operating deficits may prevent Council from adding further borrowings.
- The floods in recent years have increased the challenge for Council of maintaining a Sustainable LGA. Widespread destruction of key assets such as roads has deferred other capital projects
- Over the past four years, spending on maintenance, renewal and addition of assets was insufficient. The AMP has highlighted the widening gap between the required level of maintenance, renewal and upgrade expenditure and the actual expenditure. In the long term, if Council is not spending sufficient amounts on asset maintenance, the Backlog may grow and the quality of Council's assets is likely to decline. Ultimately, this could impact service standards. It appears that the widening funding shortfall could only be reduced with external funding assistance

## Section 5 Benchmarking and Comparisons with Other Councils

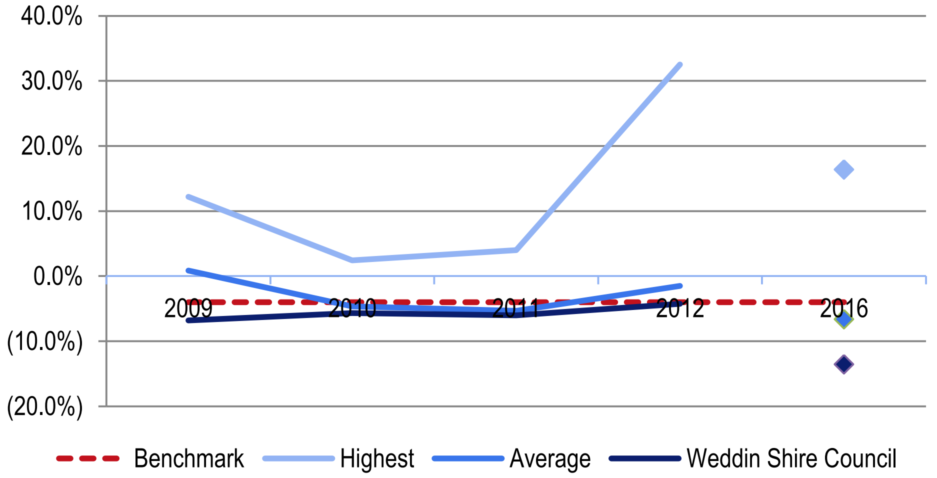
Each council's performance has been assessed against ten key benchmark ratios. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 9. There are 21 councils in this group and at the time of preparing this report, we have data for all of these councils.

In Figure 13 to Figure 22, 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 16, 20, 21 and 22 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 from the calculations, councils with very high ratios which are a result of low debt levels that skew the ratios.

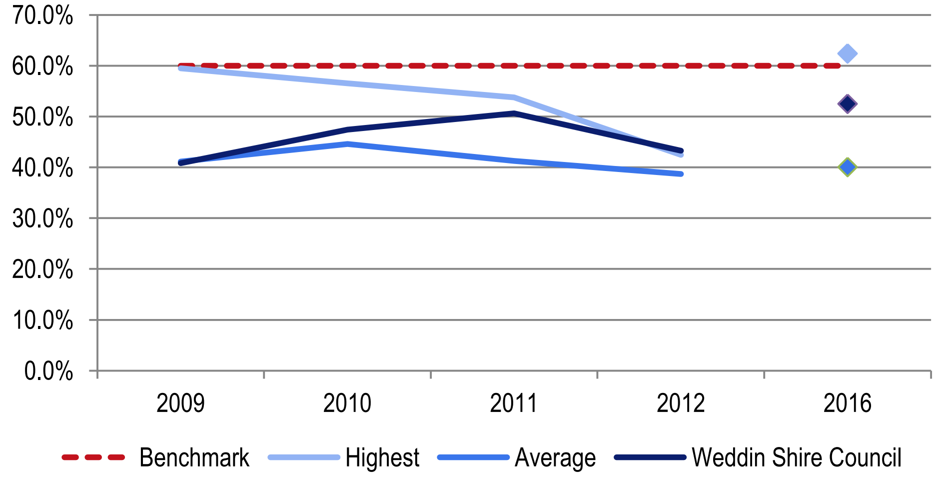
Financial Flexibility

Figure 13 - Operating Ratio Comparison



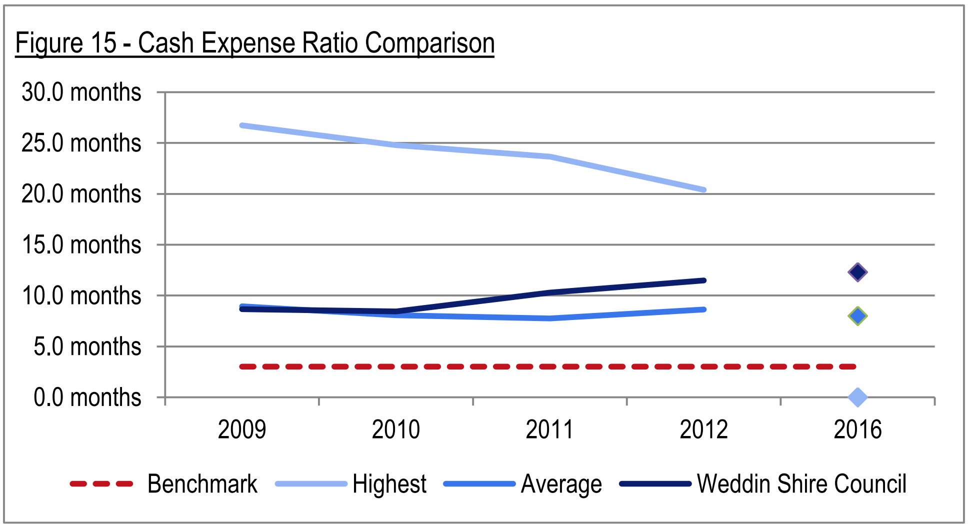

Over the review period, Council's Operating Ratio was consistently below the benchmark and the group average. Over the medium term, Council's ratio is forecast to deteriorate and remain below the peer group.

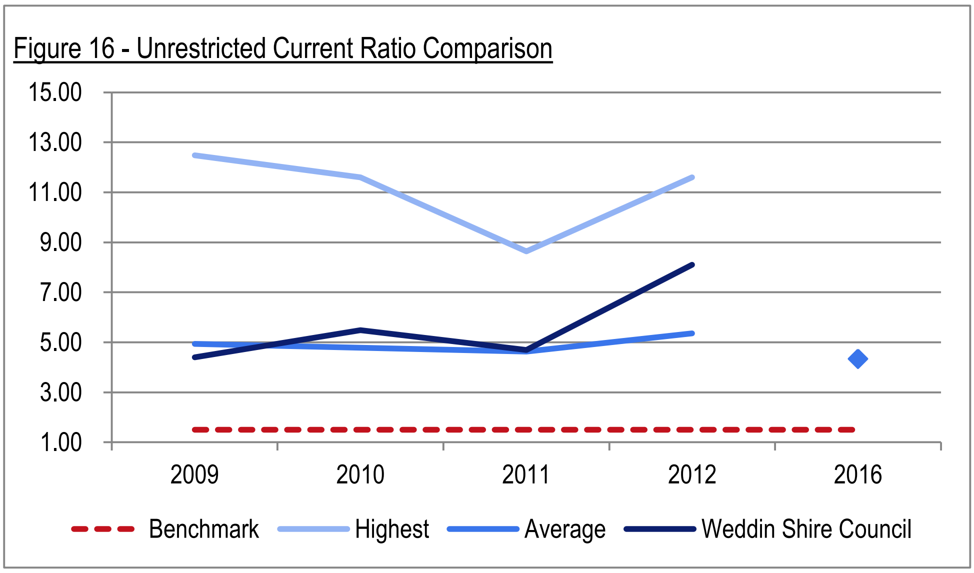
Figure 14 - Own Source Operating Revenue Ratio Comparison




Council's Own Source Operating Revenue Ratio was consistently below the benchmark, though it outperformed the group average in three of the past four years. In the medium term, Council's ratio is forecast to improve but it will remain below the benchmark and above the peer group.

## Liquidity




Council's liquidity position has been sound, with both of Council's liquidity ratios being above their respective benchmarks. Council's Cash Expense Ratio and Unrestricted Current Ratio were consistently near or above the group average.

Debt Servicing

Figure 17 - Debt Service Cover Ratio Comparison

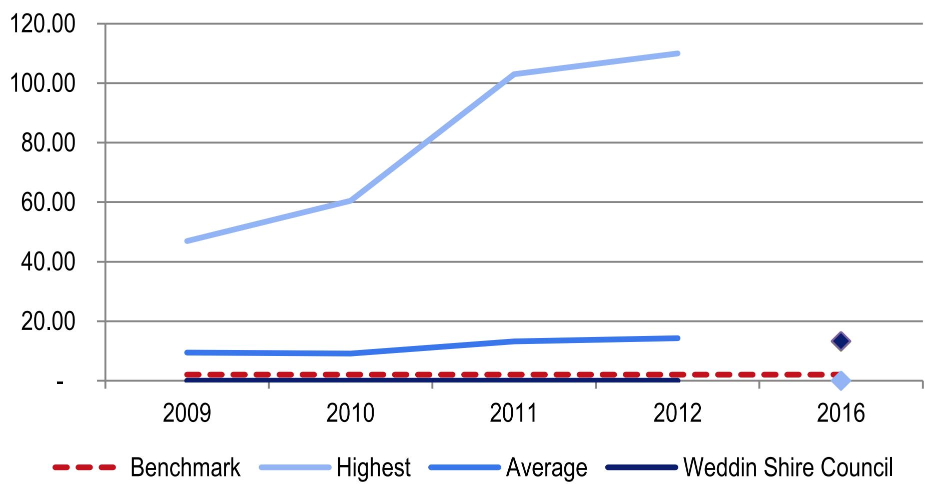
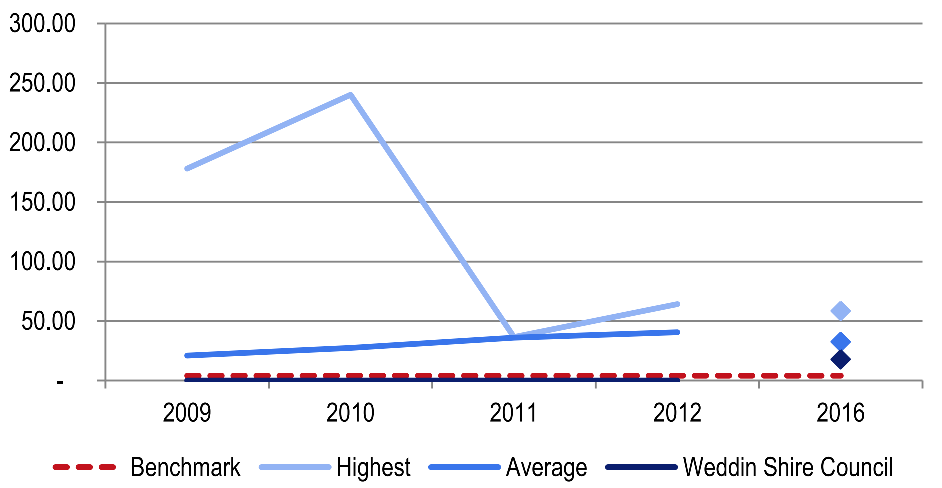



Figure 18 - Interest Cover Ratio Comparison




Council has operated debt free over the past four years. On average, councils from the group have utilised debt over the review period and had sufficient capacity to service their debt commitments. In the medium term, Council is forecast to utilise borrowings to fund its capital projects. Council's DSCR and Interest Cover Ratio are forecast to outperform the benchmark and to be on par with the peer group.

## Asset Renewal and Capital Works

Figure 19 - Capital Expenditure Ratio Comparison

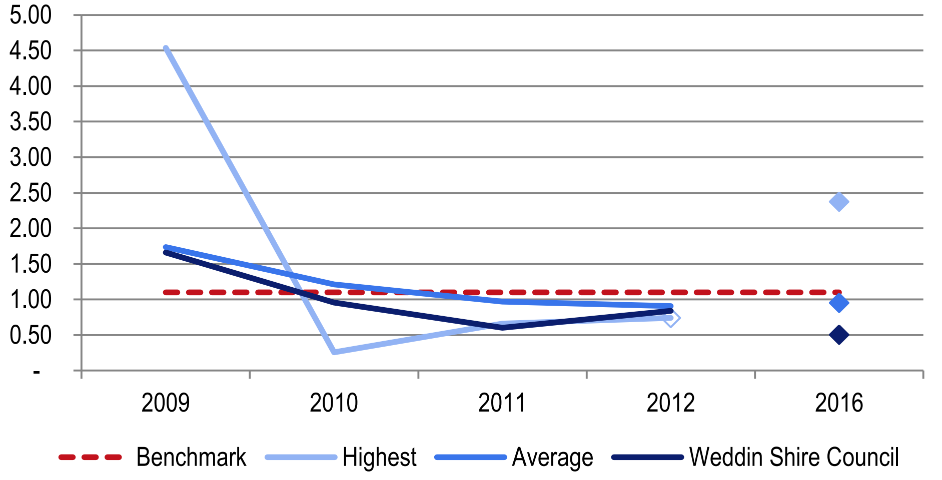
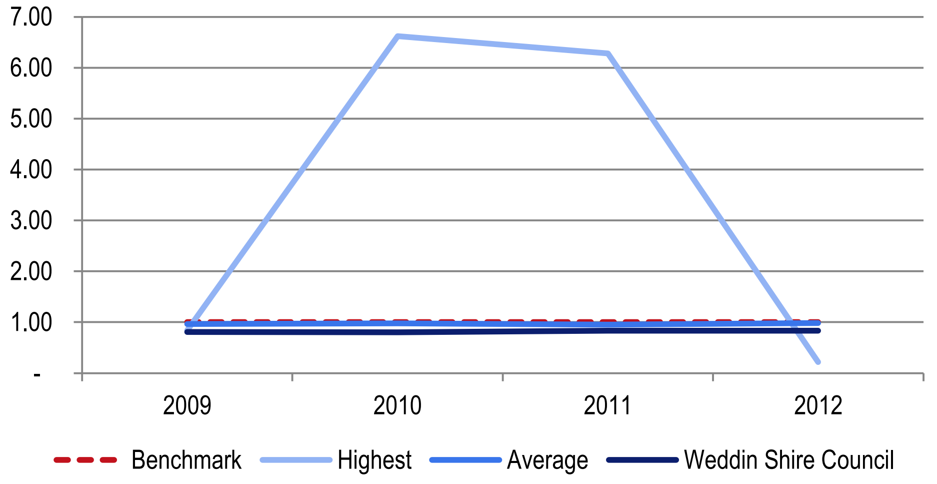
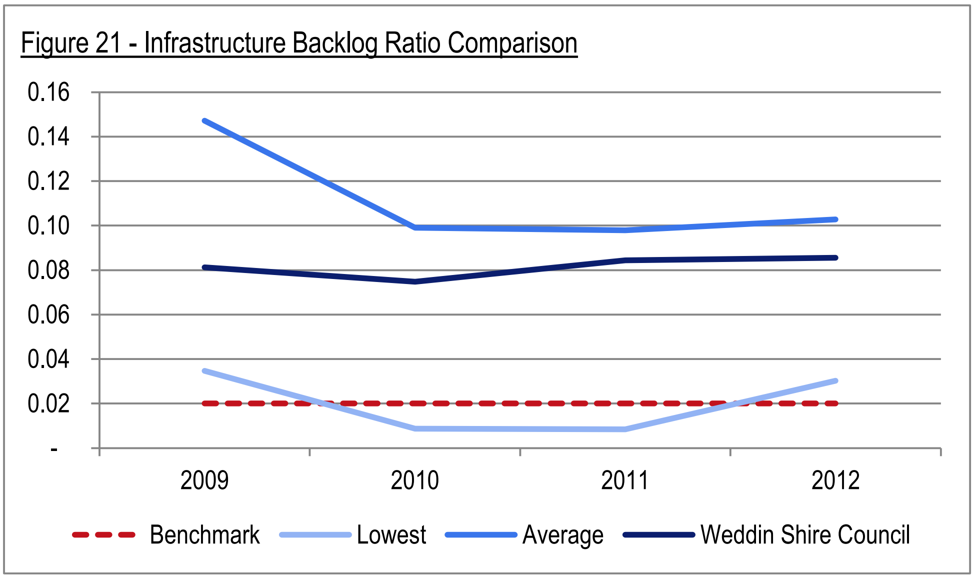
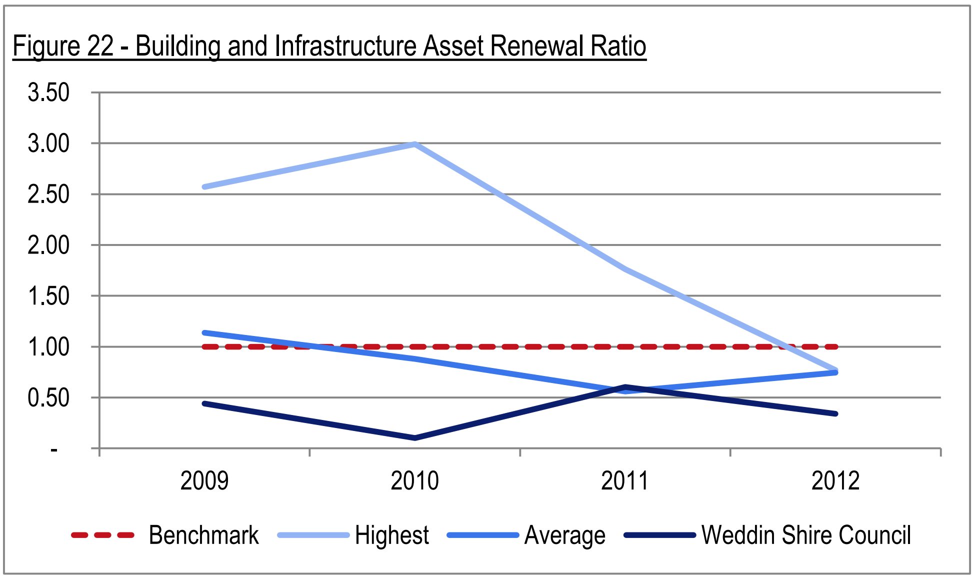



Figure 20 - Asset Maintenance Ratio Comparison






Over the review period, Council's level of Infrastructure Backlog was consistently above the benchmark but below the group's average levels of Backlog. Council's spending on maintenance of assets was consistently below the benchmark and the peer group's average spending.

Council's performance in terms of capital expenditure and infrastructure assets renewal was generally lower than the peer group. In particular, Council's Building and Infrastructure Asset Renewal Ratio was generally weak compared to the group average.

Over the medium term, Council's Capital Expenditure Ratio is forecast to remain below the benchmark and the group average.

## 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 moderately Sustainable in the short to medium term. The forecast declining population, and the continued operating deficits forecast will eventually have a negative effect on Council's ability to replace key infrastructure assets as they become due for renewal.

Based on the information provided to TCorp, Council's financial position appears to be deteriorating. However, the assumptions underpinning the current LTFP need to be reviewed so that more definitive conclusions can be drawn about Council's long term Sustainability

We base our recommendation on the following key points:

- Over the past four years, Council had sufficient liquidity to meet its short term liabilities
- Council operated debt free over the past four years and had capacity to add borrowings

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

- Council forecasts continuing operating deficits when capital grants and contributions are excluded. While Sustainable in the short to medium term, Council may become unsustainable in the longer term unless additional revenues can be sourced, further efficiencies found, or service levels reviewed
- Council is dependent on external revenue sources such as State and Federal grants. Any material adverse change to the levels of grants receivable would severely weaken Council finances
- Council population has declined over the past decade. If this trend continues, it is unlikely that Council will manage to decrease its reliance on operating grants and contributions
- Council is not spending sufficient amounts on maintenance, renewal and addition of assets and in the long term this could lead to a reduction in asset quality and service levels. Council does not have sufficient funds to meet its future funding requirements for asset renewals
- Council needs to review its LTFP and update the underlying assumptions to appropriate levels before any further definitive conclusions can be made about long term Sustainability

New South Wales Treasury Corporation

# 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 | 2,342 | 2,248 | 2,165 | 2,020 | 4.2% | 3.8% | 7.2% |
| User charges and fees | 2,689 | 2,908 | 2,034 | 1,683 | (7.5%) | 43.0% | 20.9% |
| Interest and investment revenue | 330 | 274 | 192 | 267 | 20.4% | 42.7% | (28.1%) |
| Grants and contributions for operating purposes | 5,279 | 4,138 | 3,448 | 3,801 | 27.6% | 20.0% | (9.3%) |
| Other revenues | 170 | 157 | 131 | 111 | 8.3% | 19.8% | 18.0% |
| **Total revenue** | **10,810** | **9,725** | **7,970** | **7,882** | **11.2%** | **22.0%** | **1.1%** |
| **Expenses** | | | | | | | |
| Employees | 3,537 | 3,485 | 3,536 | 3,463 | 1.5% | (1.4%) | 2.1% |
| Borrowing costs | 11 | 13 | 7 | 8 | (15.4%) | 85.7% | (12.5%) |
| Materials and contract expenses | 3,442 | 2,499 | 1,577 | 1,744 | 37.7% | 58.5% | (9.6%) |
| Depreciation and amortisation | 3,543 | 3,585 | 2,645 | 2,581 | (1.2%) | 35.5% | 2.5% |
| Other expenses | 735 | 730 | 657 | 624 | 0.7% | 11.1% | 5.3% |
| **Total expenses** | **11,268** | **10,312** | **8,422** | **8,420** | **9.3%** | **22.4%** | **0.0%** |
| **Operating result (excluding capital grants and contributions)** | **(458)** | **(587)** | **(452)** | **(538)** | 22.0% | (29.9%) | 16.0% |
| **Operating result (including capital grants and contributions)** | **358** | **(123)** | **437** | **656** | 391.1% | (128.1%) | (33.4%) |

Table 2 - Items excluded from Income Statement

| Excluded items ($'000s) | | | | |
|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 |
| Grants and contributions for capital purposes | 816 | 464 | 889 | 1,194 |
| Net gain from the disposal of assets | 14 | 144 | 56 | 148 |

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 | 7,379 | 5,763 | 4,051 | 4,205 | 28.0% | 42.3% | (3.7%) |
| Receivables | 684 | 1,359 | 1,195 | 517 | (49.7%) | 13.7% | 131.1% |
| Inventories | 156 | 210 | 143 | 175 | (25.7%) | 46.9% | (18.3%) |
| Other | 4 | 3 | 3 | 11 | 33.3% | 0.0% | (72.7%) |
| Total current assets | 8,223 | 7,335 | 5,392 | 4,908 | 12.1% | 36.0% | 9.9% |
| **Non-current assets** | | | | | | | |
| Receivables | 9 | 72 | 45 | 14 | (87.5%) | 60.0% | 221.4% |
| Infrastructure, property, plant & equipment | 143,404 | 140,956 | 142,283 | 121,370 | 1.7% | (0.9%) | 17.2% |
| Total non-current assets | 143,413 | 141,028 | 142,328 | 121,384 | 1.7% | (0.9%) | 17.3% |
| **Total assets** | **151,636** | **148,363** | **147,720** | **126,292** | **2.2%** | **0.4%** | **17.0%** |
| **Current liabilities** | | | | | | | |
| Payables | 355 | 845 | 315 | 388 | (58.0%) | 168.3% | (18.8%) |
| Provisions | 1,458 | 1,284 | 1,305 | 1,400 | 13.6% | (1.6%) | (6.8%) |
| Total current liabilities | 1,813 | 2,129 | 1,620 | 1,788 | (14.8%) | 31.4% | (9.4%) |
| **Non-current liabilities** | | | | | | | |
| Provisions | 530 | 338 | 332 | 256 | 56.8% | 1.8% | 29.7% |
| Total non-current liabilities | 530 | 338 | 332 | 256 | 56.8% | 1.8% | 29.7% |
| **Total liabilities** | **2,343** | **2,467** | **1,952** | **2,044** | **(5.0%)** | **26.4%** | **(4.5%)** |
| **Net assets** | **149,293** | **145,896** | **145,768** | **124,248** | **2.3%** | **0.1%** | **17.3%** |

Table 4-Cashflow

| Cashflow Statement ($'000s) | Year ended 30 June | | | |
|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 |
| Cashflows from operating activities | 4,649 | 3,272 | 2,296 | 3,857 |
| Cashflows from investing activities | (3,033) | (1,560) | (2,450) | (4,008) |
| Proceeds from borrowings and advances | 0 | 0 | 0 | 0 |
| Repayment of borrowings and advances | 0 | 0 | 0 | 0 |
| Cashflows from financing activities | 0 | 0 | 0 | 0 |
| **Net increase/(decrease) in cash and equivalents** | **1,616** | **1,712** | **(154)** | **(151)** |
| Cash and equivalents | 7,379 | 5,763 | 4,051 | 4,205 |

# Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

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.