New South Wales
Treasury Corporation

Narromine Shire Council

Financial Assessment, Sustainability and Benchmarking Report

05 April 2013

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

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Disclaimer

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

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

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

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

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Section 1 Executive Summary

This report provides an independent assessment of Narromine 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 financial forecasts, with a particular focus on a council's General Fund. Where a council operates a Water or other Fund the financial capacity of these other Funds may be reviewed where considered necessary.

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

- Council has reported an operating surplus, excluding capital grants and contributions, in three of the past four years. The 2012 surplus was achieved as half ($1.8m) of the 2013 Financial Assistance Grant (FAG) was prepaid in 2012
- Council's underlying operating performance (measured using EBITDA) has increased by $3.4m since 2009 to $6.2m in 2012
- The majority of Council's performance indicators have been above benchmark each year of the review period
- However Council's Own Source Operating Revenue Ratio has been below benchmark each year of the review period indicating Council is reliant on external sources of revenue

The Council reported $6.7m of Infrastructure Backlog in 2012 which represents 5.6% of its infrastructure asset value of $120.3m. Other observations include:

- Council's Infrastructure Backlog has remained static over the past three years
- The majority of Council's Backlog is in roads and buildings assets
- Benchmark ratios indicate that in 2012 Council did not spend sufficient amounts on asset maintenance, asset renewal or capital expenditure

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

- Council's LTFP does not include a statement of cashflows therefore the analysis has been completed utilising the forecast income statement and balance sheet
- Council has not reached a developed stage of the IP&R process and there are some reservations in the reasonableness of the assumptions used in the LTFP particularly the underestimation of future expenses
- The forecast shows deficit positions are expected, when capital grants and contributions are excluded, each year of the forecast period
- Council's liquidity is forecast to decrease over the forecast period and falls below benchmark in 2017. The will result in Council having limited resources to deal with unexpected events in future years

We are unable to calculate Council's DSCR in relation to additional borrowings in addition to its existing debt facilities of approximately $1.0m without a statement of cashflow. However continued operating deficits and Cash Expense Ratio well below benchmark are forecast over period indicating there is limited capacity to manage additional borrowings.

Based on our review of the information provided, TCorp believes Council is in a moderate Sustainability position, and based on the current LTFP this position is likely to deteriorate in the medium to long term.

Our key observations are:

- Council has projected increasing operating deficits and decreasing EBITDA over the forecast period
- Since 2010 Council has been unable to spend sufficient funds on asset maintenance, renewal or upgrades when compared to benchmarks and the AMP which indicates that if this continues it will increase Council's Infrastructure Backlog
- Council's Interest Cover Ratio is well above benchmark for the entire forecast period
- Council is reliant on external funding sources as indicated by an Own Source Revenue Ratio that is below benchmark both historically and in the forecast. Any adverse changes in grant funding, in particular the FAG's, could place the Council's financial Sustainability at risk
- Council does not appear to have reached a developed stage of the LTFP and it is important that this is integrated with the AMP, and the LTFP produces an income statement, balance sheet and statement of cashflows

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG group 10. The key observations are:

- Council's financial flexibility is reasonably sound as indicated by the Operating Ratio above benchmark and the group average
- Council's Own Source Operating Revenue Ratio is close to the group average and forecast to improve in the medium term
- Council was in a sufficient liquidity position though it is expected to decline in the medium term
- Council's DSCR and Interest Cover Ratio generally track the group average above benchmark over the review period. The ratios are forecast to decrease in the medium term but remain above benchmark at group level
- Council has a comparatively low level of Infrastructure Backlog. The Asset Maintenance Ratio is at benchmark levels and outperforms the group's average. The Building and Infrastructure Asset Renewal Ratio and Capital Expenditure Ratio have generally tracked the group average. The Capital Expenditure Ratio is forecast to decrease below benchmark and the group average in the medium term

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. Council has provided TCorp with additional information and comments which TCorp has incorporated into the report.

Definition of Sustainability

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

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

Benchmark Ratios

In conducting our review of the Councils' financial performance, forecasts and Sustainability we have measured performance against a set of benchmarks. These benchmarks are listed below.

Benchmarks do not necessarily represent a pass or fail in respect of any particular area. One-off projects or events can impact a council's performance against a benchmark for a short period. Other factors such as the trends in results against the benchmarks are critical as well as the overall performance against all the benchmarks.

As councils can have significant differences in their size and population densities, it is important to note that one benchmark does not fit all. For example, the Cash Expense Ratio should be greater for smaller councils than larger councils as a protection against variation in performance and financial shocks. Therefore these benchmarks are intended as a guide to performance.

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

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

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2.3: Overview of the Local Government Area

Narromine Shire Council LGA	
Locality & Size	
Locality	North West
Area	5,263km²
DLG Group	10
Demographics	
Population as at 2011	6,585
% under 18	30%
% between 18 and 59	46%
% over 60	24%
Expected population 2025	6,651
Operations	
Number of employees (FTE)	89
Annual revenue	$18.8m
Infrastructure	
Roads	1,603km
Bridges	12
Infrastructure Backlog value	$6.7m
Total infrastructure value	$120.3m

Narromine Shire Council Local Government Area (LGA) is located in North Western NSW between Dubbo and Lachlan.

Narromine LGA is a small economy which is heavily dependent on agriculture. Access to irrigation water from the Macquarie River has provided an opportunity for diversification which has included growing of cotton and some specialised intensive production such as a rose propagation nursery.

The current population is anticipated to increase by approximately 1.0% from 6,585 in 2011 to 6,651 in 2025.

Council had 89 fulltime equivalent employees at 30 June 2012.

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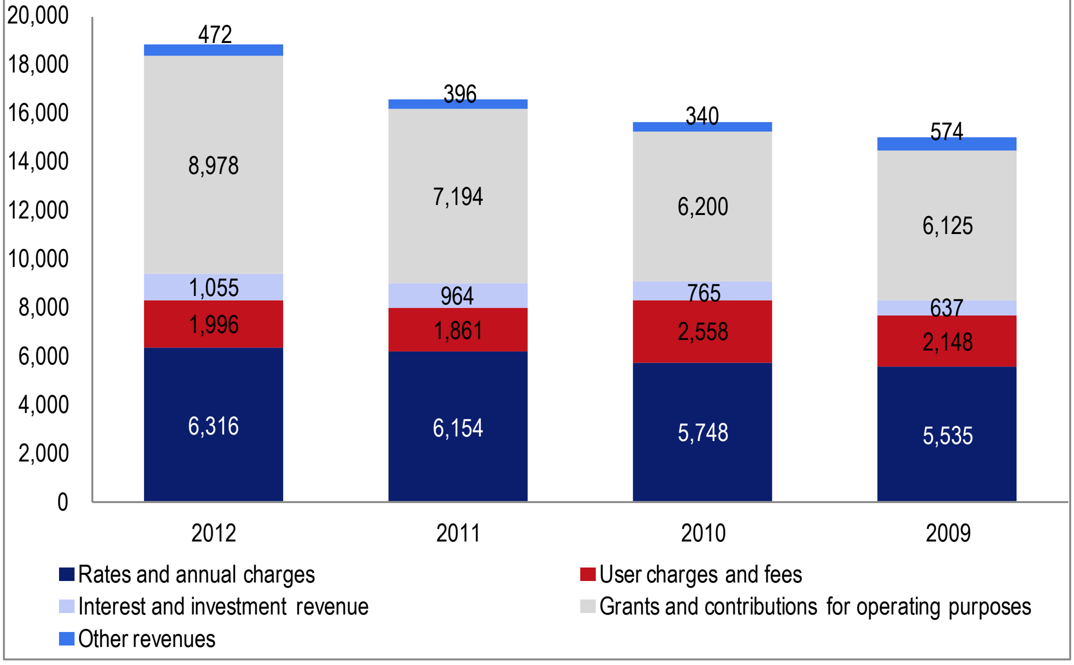
Section 3 Review of Financial Performance and Position

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

3.1: Revenue

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

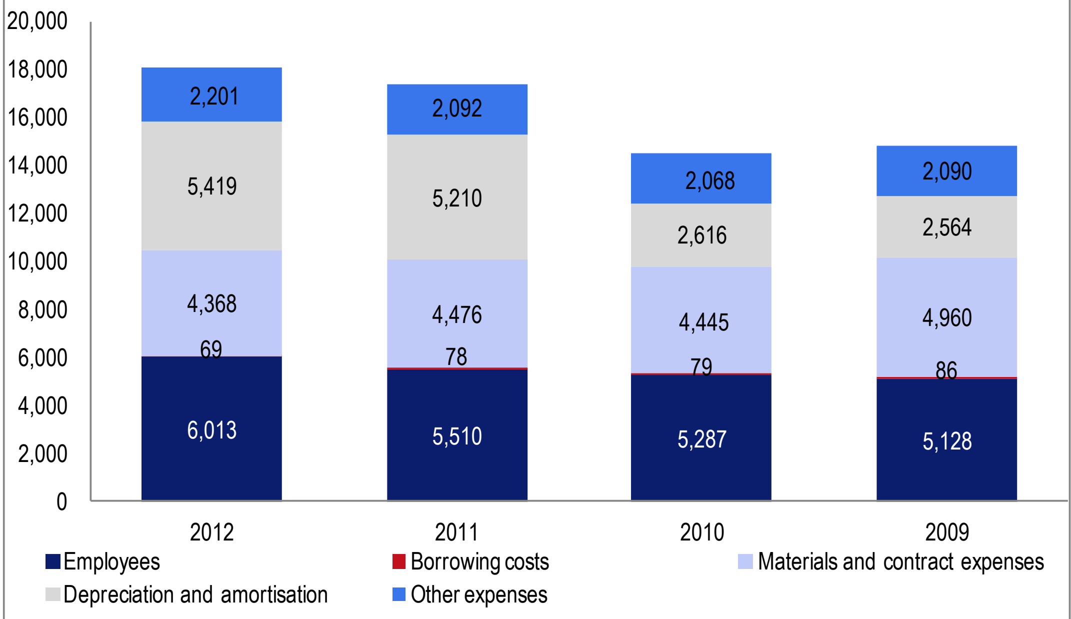


Key Observations

- Council's overall revenue has increased by 25.3% ($3.8m) since 2009 to $18.8m in 2012.
- Rates and annual charges increased in line with the rate peg in 2012 following an increase of 3.8% ($0.2m) in 2010 and 7.1% ($0.4m) in 2011. The 2010 increase was due to an increase in farmland revenue as a result of dryland and irrigable land categories being combined which were previously categorised separately. The increase in 2011 was primarily a result of a $0.3m increase in waste management service charges.
- User fees and charges fluctuated over the period. 2010 saw an increase in RMS income for repair works on the regional roads that Council maintains on behalf of RMS. Following the completion of this project they decreased in 2011. In 2012 RMS charges income increased again following a review of plant hire rates which indicated plant usage had previously been costed incorrectly.
- Operating grants increased by 24.8% ($1.8m) in 2012 as a result of the prepayment of half the 2013 FAG in 2012. In 2011 operating grants increased by 16.0% ($1.0m) as a result of increases in the FAG, Bushfire & Emergency Services grants and transport grants following the December 2010 floods.

3.2: Expenses

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



Key Observations

- Annual expenses increased by 21.8% ($3.2m) from 2009 to $18.0m in 2012.
- Following increases of 3.1% and 4.2% in 2010 and 2011 respectively, employee expenses increased by 9.1% ($0.5m) in 2012. This was primarily due to a $0.3m increase in Employee Leave Entitlements (ELE) due to staff shortages which resulted in increased workloads and more accrued leave.
- Materials and contracts expenses have been maintained at consistent levels over the past two years. 2010 saw a decrease of 10.4% ($0.5m) as a result of a reduction in works carried out due to wet weather.
- Following the revaluation of Council's roads, bridges and footpath assets in 2010, Council's infrastructure assets decreased by $13.5m. However following the revaluation of Council's water and sewer assets in 2012 Council's infrastructure asset value has increased by $7.6m. Overall Council's annual depreciation charge has increased by 111.3% ($2.8m) over the period to $5.4m in 2012 following the revaluation of Council's infrastructure assets
- Other expenses make up 12.2% of Council's overall expenses. The main contributors to other expenses in 2012 were child carers payments $0.8m, electricity and heating $0.3m and insurance $0.2m

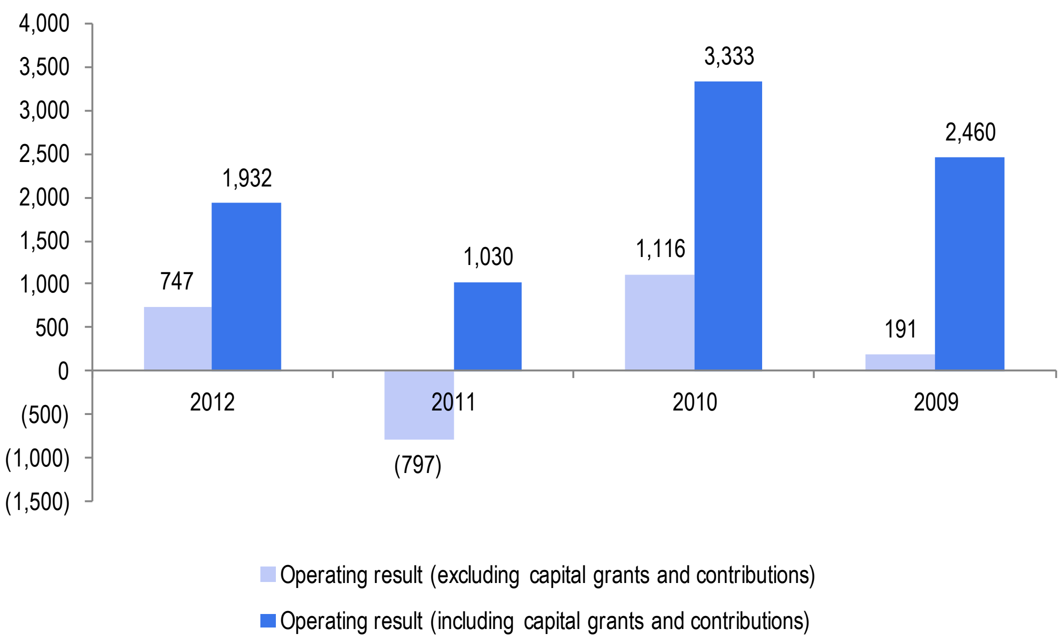
3.3: Operating Results

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

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

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

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



Key Observations

- Council has posted a net operating surplus, excluding capital grants and contributions, in three of the past four years. The 2011 result was adversely affected by increased depreciation expense. The improved result in 2012 was achieved by the prepayment of half the 2013 FAG.
- Council expenses include a non-cash depreciation expense ($5.4m in 2012), which has increased by $2.8m since 2009 following the Asset Revaluations process. Whilst the non-cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

3.4: Financial Management Indicators

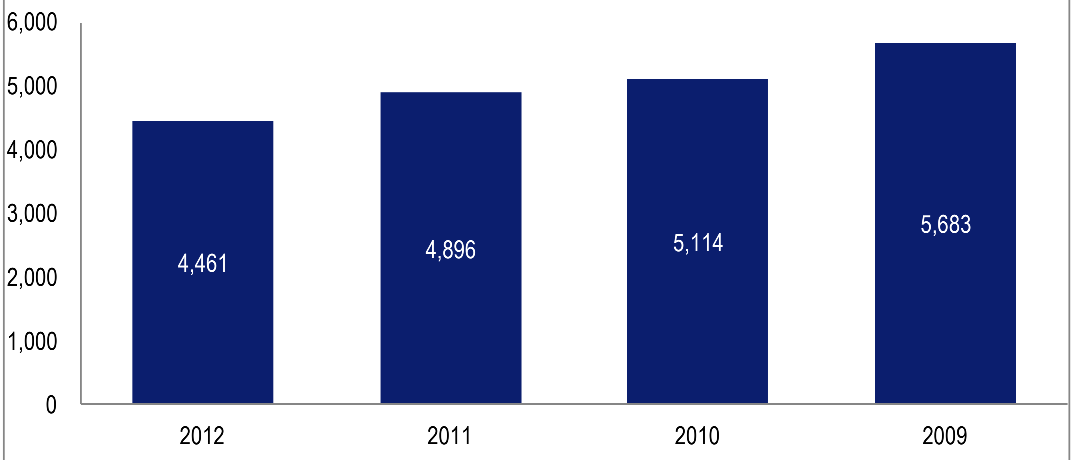
Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA ($'000s)	6,235	4,491	3,811	2,841
Operating Ratio	4.0%	(4.8%)	7.1%	1.3%
Interest Cover Ratio	90.36x	57.58x	48.24x	33.03x
Debt Service Cover Ratio	51.96x	15.59x	28.87x	22.20x
Unrestricted Current Ratio	5.18x	4.95x	4.48x	4.00x
Own Source Operating Revenue Ratio	41.6%	43.6%	46.6%	44.4%
Cash expense ratio	4.3 months	4.9 months	5.2 months	5.6 months
Net assets ($'000s)	154,208	144,946	143,580	145,666

Key Observations

- Council's EBITDA has increased by $3.4m over the period to $6.2m in 2012.
- The Operating Ratio was above benchmark in three of the last four years. The ratio fell marginally below benchmark in 2011 as a result of increased depreciation expense that year. It rebounded to a surplus level due to the prepayment of FAG.
- Council's Interest Cover Ratio and DSCR were well above their respective benchmarks indicating Council currently has sufficient capacity to service their existing debt. DSCR increased in 2012 due to the full repayment of loans for land purchase and the Cale Oval sporting facility in 2011.
- The Unrestricted Current Ratio has been above benchmark each year indicating Council had sufficient liquidity.
- The Own Source Operating Revenue Ratio, while maintained at consistent levels has been below benchmark each year of the review period. This indicates Council does not have a lot of financial flexibility and rely on external sources of funding.
- The Cash Expense Ratio has been above the benchmark of 3.0 months each year however Council also held a substantial amount of cash in term deposits which amounted to $48.4m in 2012.
- Council's Net Assets have increased by $8.5m from 2009 to $154.2m in 2012. When the Asset Revaluations are excluded, the underlying trend in all three years has been an increase in the infrastructure, property, plant and equipment (IPP&E) asset base with asset purchases being greater than the combined value of disposed assets and annual depreciation. Over the review period this amounted to a $1.5m increase in IPP&E assets.
- Council had total borrowings of $1.0m in 2012 representing 0.7% of Net Assets.

3.5: Statement of Cashflows

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



Key Observations

- Cash and cash equivalents have decreased marginally by $1.2m since 2009 to $4.4m in 2012.
- The total cash balances along with the Unrestricted Current Ratio indicate Council had sound liquidity.
- Within Council's current cash, cash equivalents and investments of $18.6m, $9.8m was externally restricted, $7.7m was internally restricted and $1.1m was unrestricted.
- Council's current investment portfolio comprised $1.4m in deposits at call, $3.0m in short term deposits and $14.2m in long term deposits. Council does not hold any CDO's or FRN's.

3.6: Capital Expenditure

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

3.6(a): Infrastructure Backlog

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

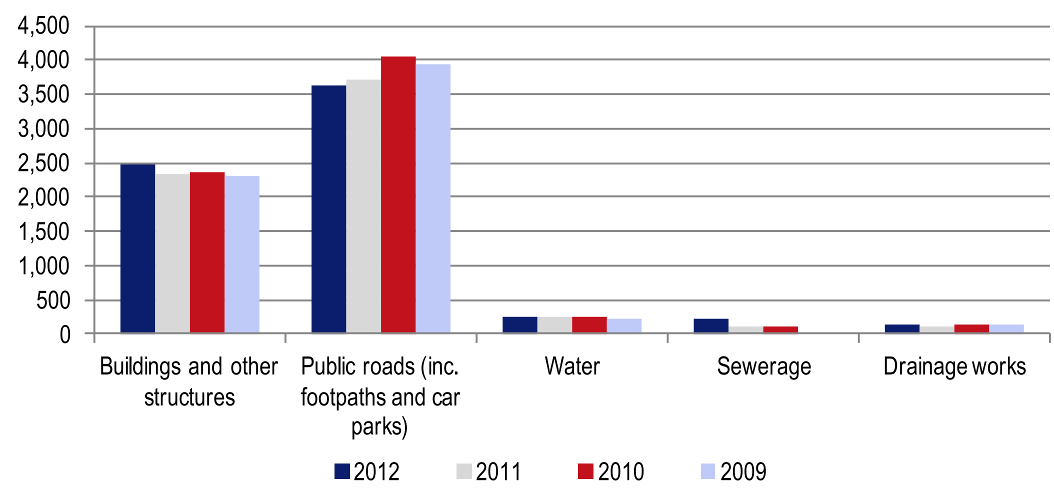
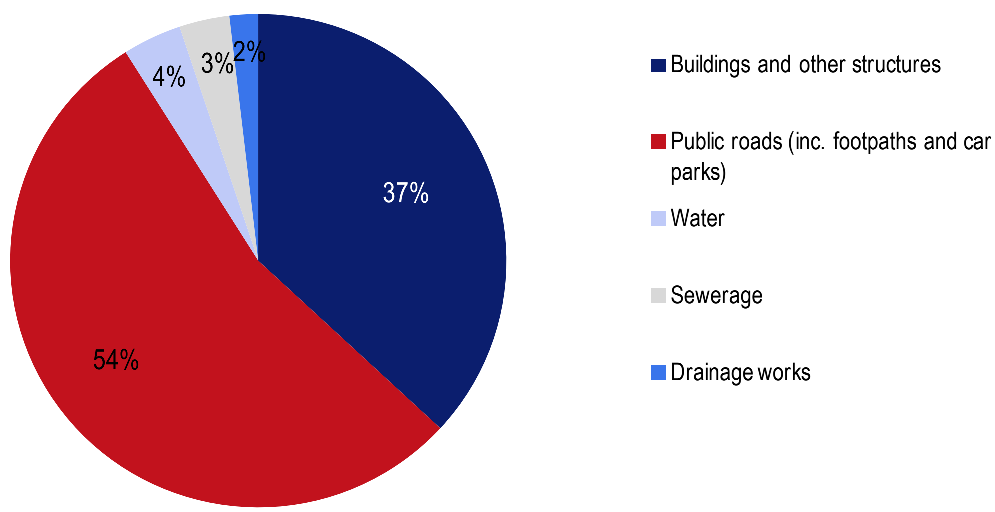


Figure 6 - Infrastructure Backlog Composition for 2011/12



Council reported $6.7m in Infrastructure Backlog in 2012, of which 54.0% ($3.6m) relates to public roads, 37.0% ($2.5m) to buildings, 4.0% ($0.3m) to water assets, 3.0% ($0.2m) to sewerage assets and 2.0% ($0.1m) to drainage assets.

Council advises that prior to 30 June 2012 the Backlog figures were estimates only, provided by the engineering department. As a result of obtaining more accurate data following the development and completion of Council's AMP's the June 2012 Backlog figures are considered to be accurate.

In their Building AMP (2012) Council has recognised that present funding levels are insufficient to continue to provide existing services at current levels in the medium term. Council's Buildings AMP states that there has been an ongoing lack of funding and therefore low level of maintenance which has resulted in premature failures of buildings. Many of these assets are approaching the latter years of their life and require replacement. Services from the assets are decreasing and maintenance costs are increasing.

In their Roads AMP Council states that present funding is sufficient to continue to provide existing services at current levels in the medium term. This does not take into account that many of the road assets are not at an acceptable condition from a road user point of view. Expansion of the transport network or significant upgrading of roads will impact the financial Sustainability of the network.

Water assets for Narromine LGA are considered in good condition however the present programme of asset replacement will need to accelerate in the next few years as the assets need replacement.

Whilst Council has a significant amount of funds reserved for this it is unlikely there will be sufficient funds to fund renewals in the long term.

In relation to their sewerage assets Council's present funding levels are insufficient to continue to provide existing services at current levels in the medium term. Council will need to increase the funding possibly from reserves or loans or by increasing fees and charges to meet the anticipated demand for infrastructure replacement.

Council's operates two aviation facilities which are currently not sustainable without an increase in funding. Council has proposed borrowing funds for infrastructure renewal. An Aerodrome Masterplan is currently under development to research the feasibility of some potential developments at the aerodrome.

It is likely that Council will have to reduce service levels in some areas, unless new sources of revenue are found. For buildings and other equipment, the service level reduction may include, downsizing Council's buildings portfolio.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard ($'000s)	6,686	6,510	6,890	6,610
Required annual maintenance ($'000s)	5,005	5,285	4,779	4,869
Actual annual maintenance ($'000s)	4,394	4,649	4,943	4,871
Total value infrastructure assets ($'000s)	120,273	112,682	110,550	124,053
Total assets ($'000s)	158,467	148,198	147,157	148,922
Infrastructure Backlog Ratio	0.06x	0.06x	0.06x	0.05x
Asset Maintenance Ratio	0.88x	0.88x	1.03x	1.00x
Building and Infrastructure Asset Renewal ratio	0.95x	1.14x	2.33x	1.65x
Capital Expenditure Ratio	0.99x	0.79x	1.62x	1.41x

The Building and Infrastructure Backlog Ratio has been below its benchmark of 0.02x each year of the review period.

The Asset Maintenance Ratio has been below benchmark for the past two years which reflects Council is spending at levels below the required amount to maintain the condition of their assets at satisfactory levels.

Council's Building and Infrastructure Asset Renewals Ratio has been above benchmark in three of the past four years. The ratio peaked in 2010 due to the RMS funded capital renewal of a regional road. The ratio fell in 2011 as a result of the completion of this project, and decreased below benchmark in 2012.

The Capital Expenditure Ratio, which takes into account assets which improve performance or capacity, fell below benchmark in 2011 and 2012 due to increased depreciation following the Revaluation of Council's infrastructure assets and reduced capital works.

Based on the 2011 and 2012 figures Council may see deterioration in the quality of their existing assets and an increase in their 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 ($'000s)	Year ended 30 June			
	2012	2011	2010	2009
New capital works	520	86	823	891
Replacement/refurbishment of existing assets	5,615	4,502	3,771	3,061
Total	**6,135**	**4,588**	**4,594**	**3,952**

Main Capital Projects 2010-2012

Customer Service and Payment Centre Building Purchase	$0.5m
Aerodrome Runway Reseal	$0.2m
Medical Centre Extension	$.01m

Major Capital Works Projects 2012-2022

Roads Renewals and Upgrades	$30.0m
Tomingley Memorial Hall Upgrades	$0.6m
Trangie Girls Guide Hall Upgrades	$0.3m
Trangie Swimming Pool Upgrades	$0.2m
Narromine Council Chambers Upgrades	$0.1m
Narromine Depot Upgrades	$0.1m
Narromine Showgrounds Upgrades	$0.1m
Narromine Rotary Park Upgrades	$0.2m
Trangie Showgrounds Sheep Pavilion	$0.5m

3.7: Specific Risks to Council

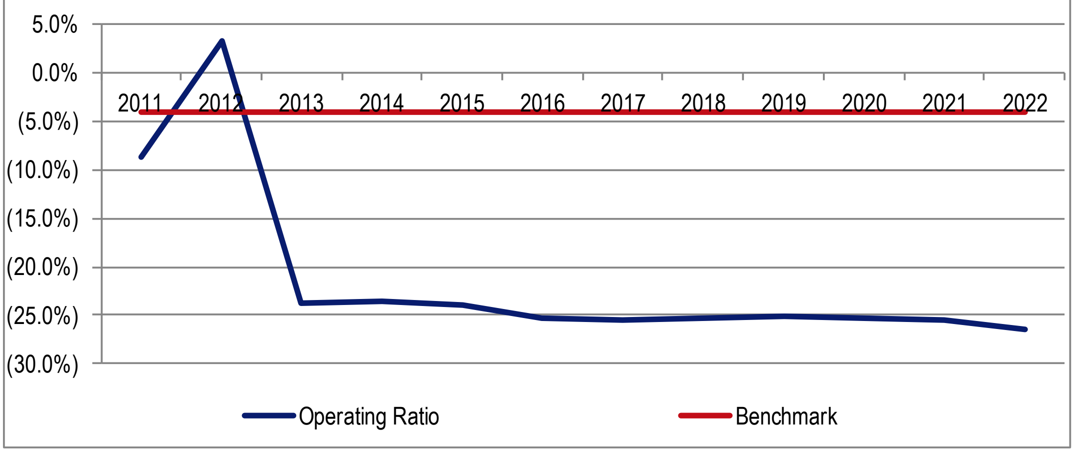
- Climate change. Climate change is considered one of Council's main risks and has caused drought and flooding. Recent flooding has affected water quality as well as Council's ability to complete projects on time. As water is a limited resource Council recognises that it needs to be well managed for immediate needs and long term economic and environmental Sustainability.
- Ageing population. 24.0% of the current population of the LGA is over 60. This trend is likely to continue for the foreseeable future due to Narromine's proximity to Dubbo and good medical facilities. As a result the quality of infrastructure will further deteriorate as fewer ratepayers contribute the funds required to maintain and improve critical infrastructure. The proportion of the population reliant on government subsidies will also increase and appropriate aged care facilities and appropriate health services will be required. Council needs to continue to work with other levels of government and the community and develop appropriate services and facilities to support an ageing population.
- Ageing workforce. The average age of Council employees is 46. It is anticipated that 33.0% of Council's workforce will retire within the next 10 years. Steps must be taken to ensure that Council has processes in place to retain core professionals and give existing employees the opportunity to develop their skills and knowledge within the organisation.
- Operating grants. Grants and contributions for operating purposes remains Council's largest source of revenue at 48.0% of Council's total revenue in 2012, excluding capital grants and contributions. Operating grants revenue is greater than rates revenue, and is forecast to remain at approximately 41% of Council's overall revenue. Any decrease in operating grants will have a significant negative impact on the overall operating result.

Section 4 Review of Financial Forecasts

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

4.1: Operating Results

Figure 7- Operating Ratio for General Fund

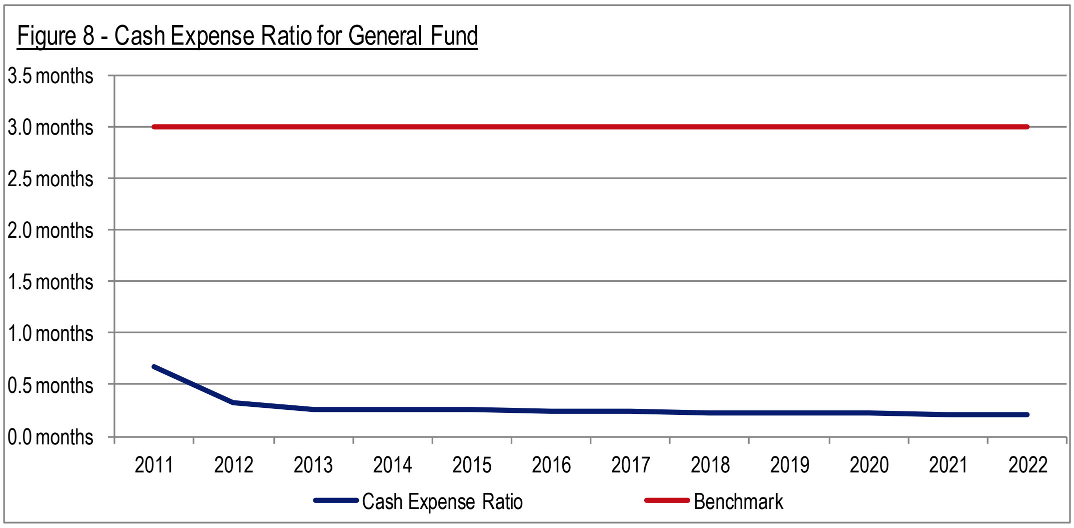


Council has forecast net operating deficits, excluding capital grants and contributions, for the entire forecast period. The ratio decreases significantly in 2013 as a result of a $2.8m decrease forecast in operating grants as a result of the prepayment of half the 2013 FAG in 2012. Council has also forecast a $1.6m increase in materials and contracts expenses due to a number of unfinished works programs in 2012. This will impact the ratio further.

The ratio is maintained at these levels for the remainder of the forecast period.

4.2: Financial Management Indicators

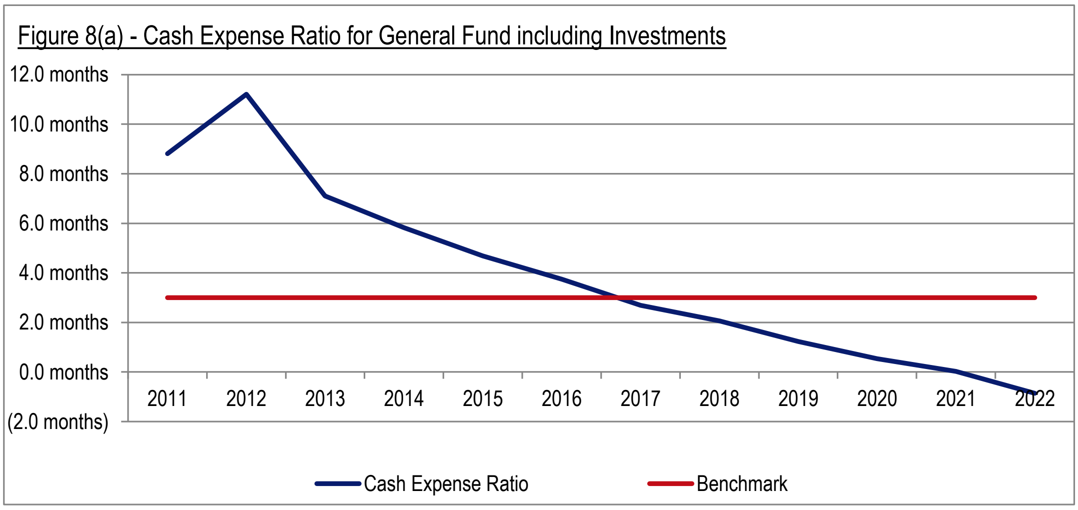
Liquidity Ratios



The Cash Expense Ratio forecast for the General Fund is well below benchmark for the entire forecast period. This is a first draft of Council's LTFP. On completion a more advanced LTFP in the 2013 financial year Council will have a better picture of their cash requirements in the future.

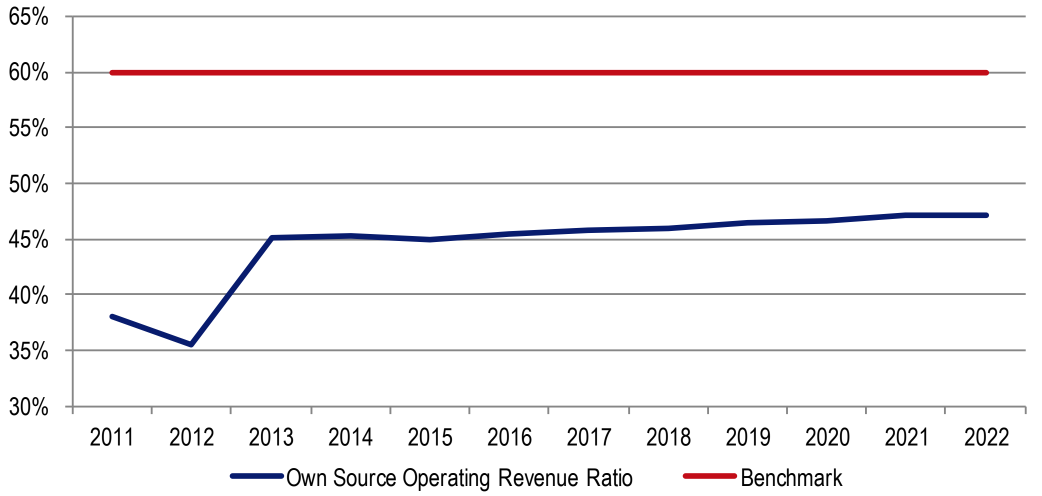
The ratio does not take into account Council's current level of investments. In 2012 Council held $4.4m in short term deposits in their General Fund and $14.2m in long term deposits.

While their investment levels improve Council's liquidity for the General Fund in the short term, as indicated in Figure 8(a) the position deteriorates in the medium to long term as the ratio falls below benchmark in 2017 and continues to decline over the period.



Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio for General Fund



Council's Own Source Operating Revenue Ratio is below benchmark for the entire forecast period. The ratio increases in 2013 due to decreased operating results and a forecast decrease in capital grants.

Council has forecast conservative levels of capital grants as these are not guaranteed as yet.

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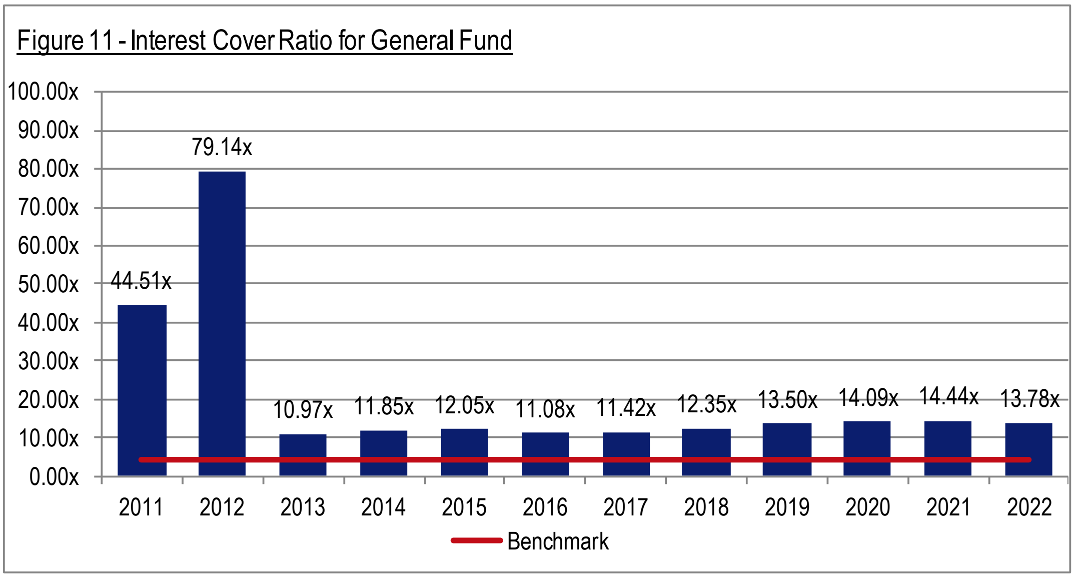

Council's Interest Cover Ratio is well above benchmark for the entire forecast period which shows the Council has sufficient capacity to service scheduled debt commitments

Without a statement of cashflows, we are unable to calculate the DSCR to analyse Council's ability to incorporate further borrowings in addition to the current borrowings of $1.0m in their Consolidated Fund.

4.3: Capital Expenditure

Without a statement of cashflows we are unable to analyse Council's forecast capital expenditure however the balance sheet indicates that Council's net IPP&E is forecast to decrease by $18.5m from 2013 to $99.1m in 2022 within the General Fund.

4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

- Rates and annual charges: TCorp notes that the LGCI increased by 3.4% in the year to September 2011, and in December 2011, IPART announced that the rate peg to apply in the 2012/13 financial year will be 3.6%. Beyond 2013 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%
- Interest and investment revenue: annual return of 5.0%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1.0%)
- All other expenses: the estimated annual CPI increase of 2.5%

<u>Key Observations and Risks</u>

- Council's current LTFP is based on maintaining assets at existing levels of service.
- Rates and annual charges are forecast to increase by 5.6% in 2013 primarily due to a forecast 5.0% increase in water annual charges in 2013. From 2014 rates and annual charges are forecast to increase by approximately 2.5% p.a. with the exception of 2015 which has a forecast increase of 1.6%. Compared to historic increases in the General Fund this forecast would seem conservative.
- User fees and charges are forecast to increase by 51.0% in 2013. They fluctuate significantly over the period. Council has identified issues with the calculation of user fees and charges therefore the user fees and charges income reflected in the current LTFP may not be reliable. More reliable data will be available on the completion of the more advanced LTFP in June 2013.
- Council's operating grants are forecast to decrease in 2013 by $2.8m as a result of prepayments of the FAG in 2011 and 2012. Council has forecast operating grants to increase by approximately 2.0% p.a. for the remainder of the period which is conservative when compared to historic increases.
- Employee expenses are forecast to increase by 10.5% in 2013. As we have used 2012 actual figures and employee expenses were lower than anticipated in 2012 this is resulting in a higher increase than the 6.0% forecast for 2013. For the remainder of the forecast period employee expenses are expected to increase by up to 2.5% p.a. Based on the historic increases in employee expenses in the General Fund we consider this forecast conservative.
- Materials and contracts costs are forecast to increase by 5.1% in 2013 as a result of some unfinished projects in 2012. From 2014 they are forecast to increase by approximately 2.5% p.a. which based on historic performance would seem reasonable.
- Council's depreciation expense is forecast to decrease by 4.2% in 2013 and increase by 2.5% p.a. for the forecast period. The 2012 depreciation expense was marginally higher than

anticipated. As it is unlikely that depreciation expense will decrease in 2013 the forecast depreciation expense is likely to be understated in the LTFP.

4.5: Borrowing Capacity

We are unable to calculate Council's DSCR in relation to additional borrowings in addition to its existing debt facilities of approximately $1.0m without a statement of cashflow. However the continued operating deficits over forecast period and cash expense ratio well below benchmark over period indicates there is limited capacity to manage additional borrowings.

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4.6 Sustainability

TCorp believes Council is in a moderate Sustainability position and based on the current LTFP, this position is likely to deteriorate in the medium to long term.

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

- Council has reported an operating surplus, when capital grants and contributions are excluded, for three of the past four years
- The LTFP shows deficit positions are expected, when capital grants and contributions are excluded, for the entire forecast period. The deficit increases over the period by 35.4% over the period from negative $3.5m in 2013 to negative $4.7m in 2022
- Council's Interest Cover Ratio is well above benchmark for the entire forecast period
- Council has maintained very conservative levels of borrowing. While the use of borrowing may assist Council to reduce its Infrastructure Backlog and to fund asset renewal programs based on the current LTFP there appears to be limited capacity to service additional borrowings due to the large operating deficits
- Operating grants make up approximately 41.0% of Council's operating revenue each year. While no change is anticipated, any adverse change to this revenue source would negatively impact Council's ability to remain Sustainable
- At the time of completing this report Council has not reached a developed stage of the LTFP. It is anticipated this will be completed by June 2013 and it is important that this is integrated with the AMP and that the LTFP produces an income statement, balance sheet and statement of cashflows

Section 5 Benchmarking and Comparisons with Other Councils

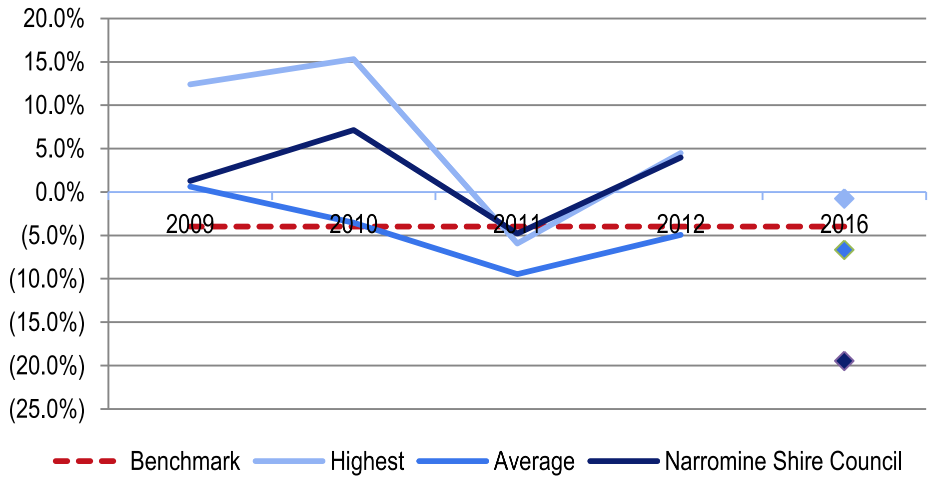
As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis (that is, for councils that operate more than one fund, the results of all funds are included). This section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

In Figure 12 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 20 to 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 skews the ratios.

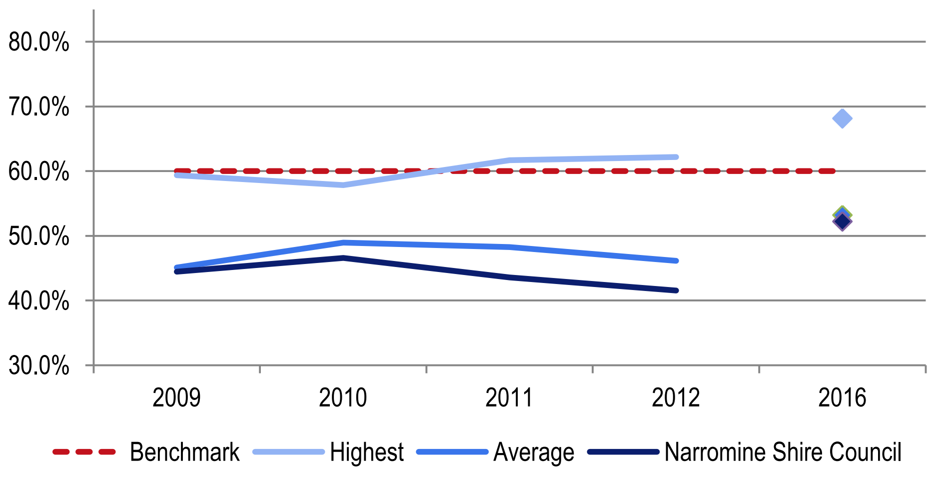
Financial Flexibility

Figure 12 - Operating Ratio Comparison



Council's Operating Ratio has been above benchmark and outperformed the group average for the past four years. The ratio is forecast to decrease well below benchmark and the group average in the medium term.

Figure 13- Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio is below benchmark and the group average over the review period. The ratio is forecast to improve in line with the group average in the medium term but remains below benchmark.

Liquidity

Figure 14 - Cash Expense Ratio Comparison

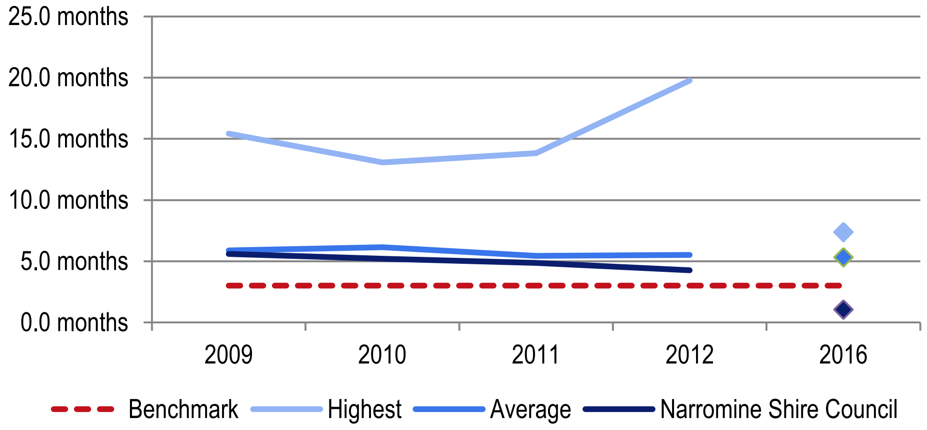
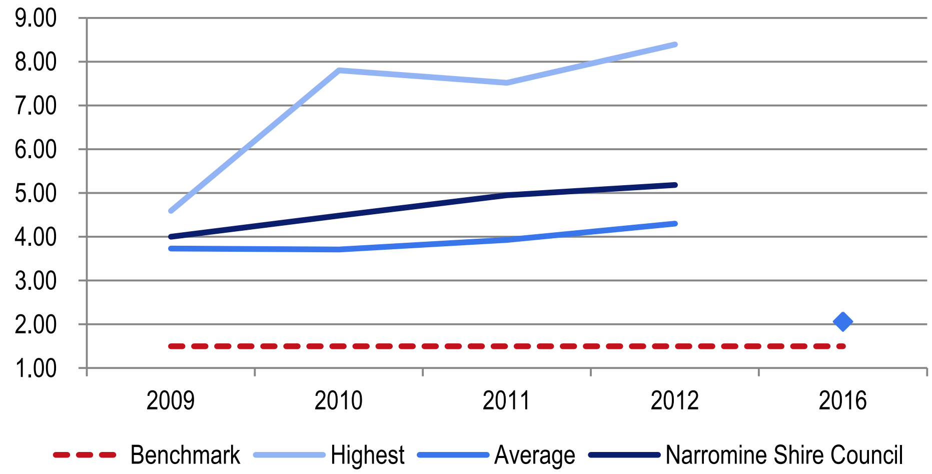


Figure 15 - Unrestricted Current Ratio Comparison



Council's Cash Expense Ratio was above benchmark and in line with the group average over the review period. The ratio is forecast to decrease marginally below benchmark and its peer group in the medium term.

The Unrestricted Current Ratio is above benchmark and outperforms the group average over the review period.

Overall, Council's liquidity position is reasonably sound.

Debt Servicing

Figure 16- Debt Service Cover Ratio Comparison

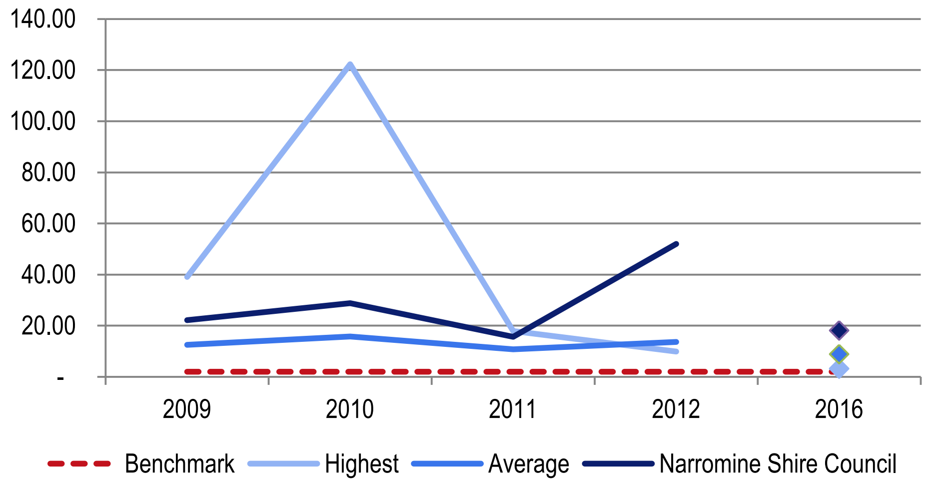
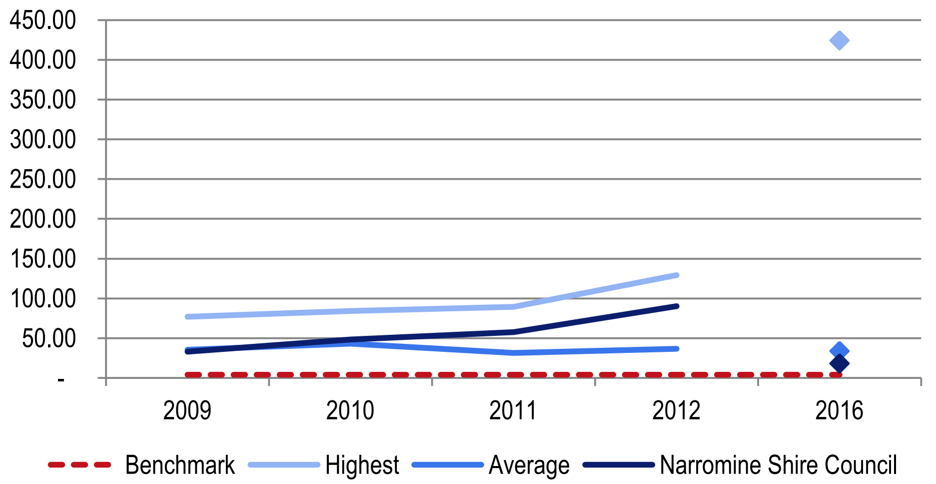


Figure 17 - Interest Cover Ratio Comparison



Council's debt servicing capacity was sound over the review period as indicated by DSCR and Interest Cover Ratio above benchmark and the group average. Overall Council's debt service ratios are forecast to remain acceptable over the medium term.

Figure 18 - Capital Expenditure Ratio Comparison

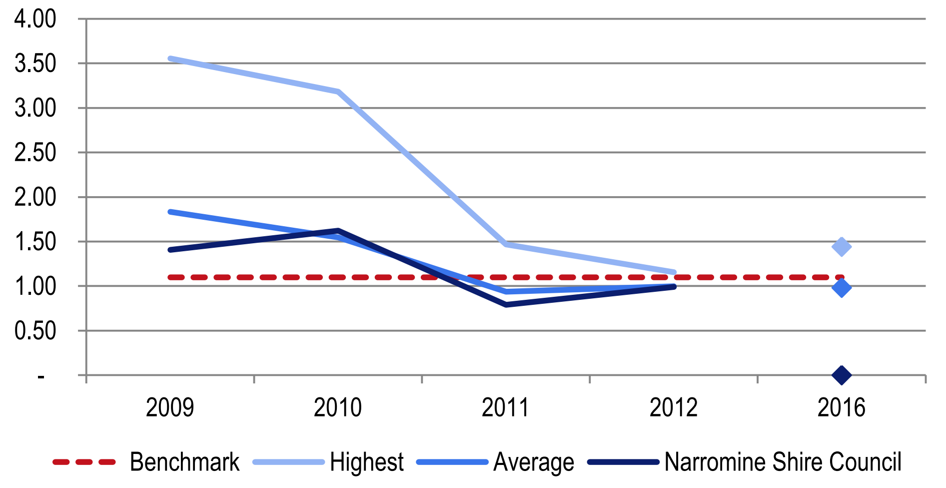


Figure 19 - Asset Maintenance Ratio Comparison

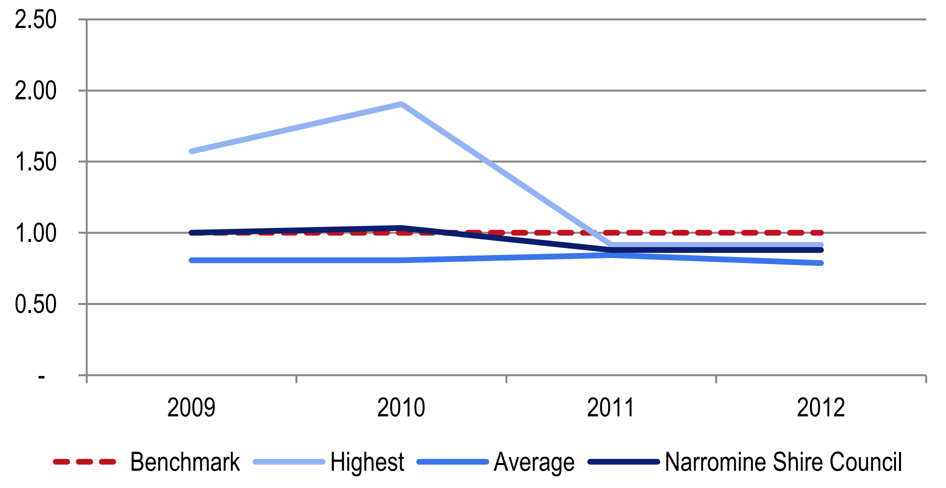


Figure 20 - Infrastructure Backlog Ratio Comparison

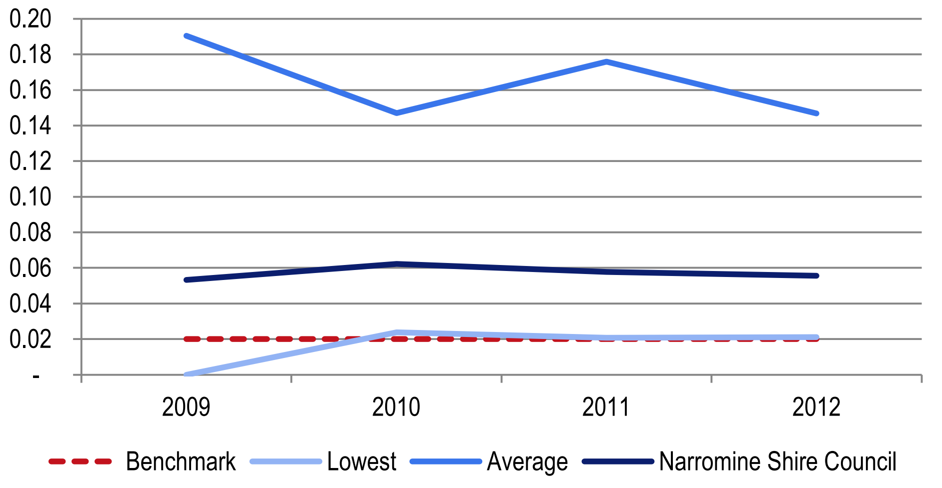
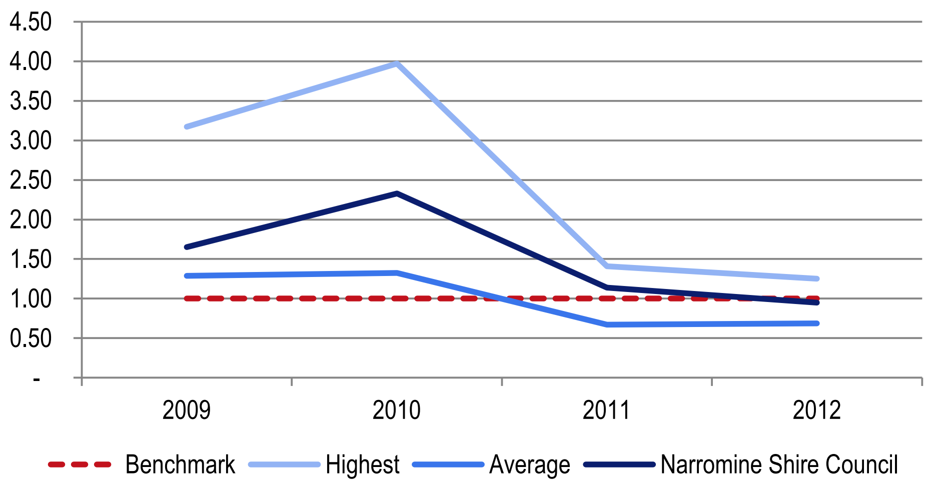


Figure 21 - Building and Infrastructure Asset Renewal Ratio



Council's Infrastructure Backlog has been below the group average in the last four years but has remained above benchmark over the same period. Council's Asset Maintenance Ratio has generally tracked along benchmark levels and has outperformed the group average. The Building and Infrastructure Asset Renewal Ratio and Capital Expenditure Ratio have generally tracked the group average over the review period. The Capital Expenditure Ratio is forecast to decrease below benchmark and the group average in the medium term.

Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's long term financial plan we consider Council to be moderately sustainable, but with a deteriorating forecast position. Council faces risks associated with the ongoing funding of maintenance and renewal of assets.

We base our recommendation on the following key points:

- With the exception of Council's Own Source Operating Revenue Ratio, all of Council's performance indicators were above benchmark for the majority of the review period
- Council's operating result, excluding capital grants and contributions, forecasts a deficit position over the entire LTFP
- The Interest Cover Ratio is well above benchmark for the entire forecast period

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

- Further improvements to the LTFP are required, including completion of the AMP, to get a full understanding of Council's financial position
- Council is aware that if funding levels cannot be increased then reduced service levels will need to be agreed in consultation with the community

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	6,316	6,154	5,748	5,535	2.6%	7.1%	3.8%
User charges and fees	1,996	1,861	2,558	2,148	7.3%	(27.2%)	19.1%
Interest and investment revenue	1,055	964	765	637	9.4%	26.0%	20.1%
Grants and contributions for operating purposes	8,978	7,194	6,200	6,125	24.8%	16.0%	1.2%
Other revenues	472	396	340	574	19.2%	16.5%	(40.8%)
Total revenue	**18,817**	**16,569**	**15,611**	**15,019**	**13.6%**	**6.1%**	**3.9%**
Expenses							
Employees	6,013	5,510	5,287	5,128	9.1%	4.2%	3.1%
Borrowing costs	69	78	79	86	(11.5%)	(1.3%)	(8.1%)
Materials and contract expenses	4,368	4,476	4,445	4,960	(2.4%)	0.7%	(10.4%)
Depreciation and amortisation	5,419	5,210	2,616	2,564	4.0%	99.2%	2.0%
Other expenses	2,201	2,092	2,068	2,090	5.2%	1.2%	(1.1%)
Total expenses	**18,070**	**17,366**	**14,495**	**14,828**	**4.1%**	**19.8%**	**(2.2%)**
Operating result (excluding capital grants and contributions)	**747**	**(797)**	**1,116**	**191**	193.7%	(171.4%)	484.3%
Operating result (including capital grants and contributions)	**1,932**	**1,030**	**3,333**	**2,460**	87.6%	(69.1%)	35.5%

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)				
	2012	2011	2010	2009
Grants and contributions for capital purposes	1,185,	1,827	2,217	2,269
Interest revenue/(losses)	0	0	0	0
Entities using the equities method	0	(21)	(6)	(14)
Revaluation Decrement	0	0	9,487	0
Net gain/(losses) from the disposal of assets	56	82	(32)	55

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Current assets							
Cash and cash equivalents	4,461	4,896	5,114	5,683	(8.9%)	(4.3%)	(10.0%)
Investments	14,200	11,499	9,991	6,955	23.5%	15.1%	43.7%
Receivables	2,588	1,885	1,264	1,673	37.3%	49.1%	(24.4%)
Inventories	585	512	524	625	14.3%	(2.3%)	(16.2%)
Other	4	0	3	0	N/A	N/A	N/A
Non-current assets classified as 'held for sale'	16	16	16	16	0.0%	0.0%	0.0%
Total current assets	21,854	18,808	16,912	14,952	16.2%	11.2%	13.1%
Non-current assets							
Investments	0	0	0	0	N/A	N/A	N/A
Receivables	170	167	176	136	1.8%	(5.1%)	29.4%
Inventories	0	0	0	0	N/A	N/A	N/A
Infrastructure, property, plant & equipment	136,250	129,036	129,861	133,620	5.6%	(0.6%)	(2.8%)
Investnments accounted for using the equity method	193	187	208	214	3.2%	(10.1%)	(2.8%)
Total non-current assets	136,613	129,390	130,245	133,970	5.6%	(0.7%)	(2.8%)
Total assets	**158,467**	**148,198**	**147,157**	**148,922**	**6.9%**	**0.7%**	**(1.2%)**
Current liabilities							
Payables	1,326	753	909	658	76.1%	(17.2%)	38.1%
Borrowings	74	48	140	53	54.2%	(65.7%)	164.2%
Provisions	1,761	1,512	1,377	1,345	16.5%	9.8%	2.4%
Total current liabilities	3,161	2,313	2,426	2,056	36.7%	(4.7%)	18.0%
Non-current liabilities							
Borrowings	993	870	988	1,128	14.1%	(11.9%)	(12.4%)
Provisions	105	69	163	72	52.2%	(57.7%)	126.4%
Total non-current liabilities	1,098	939	1,151	1,200	16.9%	(18.4%)	(4.1%)
Total liabilities	**4,259**	**3,252**	**3,577**	**3,256**	**31.0%**	**(9.1%)**	**9.9%**
Net assets	**154,208**	**144,946**	**143,580**	**145,666**	**6.4%**	**1.0%**	**(1.4%)**

Table 4-Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June			
	2012	2011	2010	2009
Cash flows from operating activities	7,144	5,417	6,671	4,601
Cash flows from investing activities	(7,728)	(5,425)	(7,187)	(8,508)
Proceeds from borrowings and advances	200	0	0	25
Repayment of borrowings and advances	(51)	(210)	(53)	(42)
Cash flows from financing activities	149	(210)	(53)	(17)
Net increase/(decrease) in cash and equivalents	**(435)**	**(218)**	**(569)**	**(3,924)**
Cash and equivalents	4,461	4,896	5,114	5,683

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.

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

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

New South Wales
Treasury Corporation

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.

New South Wales
Treasury Corporation

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.