



ATTACHMENT 4

TCorp Financial Assessment Report on BMCC

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New South Wales
Treasury Corporation

Blue Mountains City Council

Financial Assessment and Benchmarking Report

27 March 2013

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



Disclaimer

This report has been prepared by New South Wales Treasury Corporation (TCorp) in accordance with the appointment of TCorp by the Division of Local Government (DLG) as detailed in TCorp's letters of 22 December 2011 and 28 May 2012. The report has been prepared as part of the Local Infrastructure Renewal Scheme (LIRS) announced by the NSW Government.

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

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Section 1 Executive Summary

This report provides an independent assessment of Blue Mountains City Council's (the Council) financial capacity, and its ability to undertake additional borrowings. The analysis is based on a review of the historical performance, current financial position, and long term financial forecasts. It also benchmarks the Council against its peers using key ratios.

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

Council has made two applications, firstly for the Blaxland Waste Management Facility Resource Recovery Centre, and secondly the Springwood Community and Cultural Facilities Upgrade, with loan facilities of \$4.9m and \$6.0m respectively.

TCorp's approach has been to:

- Review the most recent three years of Council's consolidated financial results
- Conduct a detailed review of the Council's 10 year financial forecasts. The review of the financial forecasts focused on the particular Council fund that was undertaking the proposed debt commitment. As the Council operates only one fund we focused our review on this General Fund

Historical financial results indicate that the Council has been well managed in most areas over the review period based on the following observations:

- Revenue in 2011 has increased by 10% over 2009 levels mainly due to the SRV and the approved Environmental Levy
- Expenses have been well managed although depreciation expense has increased as a result of the Asset Revaluation process
- Liquidity and financial flexibility is sound with Council's Unrestricted Current Ratio, Cash Expense Ratio and Own Source Operating Revenue Ratio all above benchmark in the review period
- Council has maintained its DSCR and Interest Cover Ratio above benchmark in the review period

The Council reported \$34.9m of infrastructure backlog in 2011 which represents 5.8% of its infrastructure asset value of \$605.0m. Other observations include:

- Infrastructure backlog has decreased primarily due to more detailed asset condition assessments and valuations
- The largest category of backlog is in buildings which represent 60.8% of the backlog in 2011. One of Council's LIRS applications is building related
- Council has been spending less on maintenance than required. The shortfall in annual maintenance was \$3.9m in 2011
- Council's Capital Expenditure Ratio is above benchmark, on average over the three years to 2011. This indicates that the Council has invested sufficiently in capital expenditure over the review period but is underspending on maintenance of existing assets. Council's capital expenditure has focussed on renewal and upgrade of existing assets

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

- In the current LTFP, the forecast capital expenditure is significantly below the levels required to maintain an acceptable asset base because of insufficient funds. Net assets are forecast to decline over the forecast period indicating a deterioration in the Council's asset base
- Operating Ratio is far below benchmark in all forecast years and is not expected to improve substantially if current trends continue. Council management is working on strategies to improve the operating position in the long term. Liquidity ratios are at benchmark in most of the forecast years but are particularly weak in the short term to 2015
- Council's DSCR and Interest Cover Ratio are below benchmark in all forecast years due to a higher amount of borrowings forecast in 2012 and 2013. Increased borrowings are forecast in 2012 and 2013 to complete major works
- Discussions with Council management reveal that a Strategic LTFP Case has been developed which seeks to provide options to improve Council's forecast financial position

In our view, the Council would only have the capacity to undertake the additional borrowings of \$10.9m for the LIRS projects if the following actions are undertaken:

- Council to consider this report and support a program of community consultation and seek to identify the opportunities for expenses reduction and/or additional revenue raising sources. The aim of this program should be to achieve improvements in the forecast Operating Ratio and EBITDA
- Council to consider seeking extensions of the SRV and Environmental Levy which are critical to the Council's debt repayment abilities
- Council to reassess its LTFP forecasts to ensure that future asset renewal and replacement funding requirements are correctly included and supported by Council's AMP

Postscript on Council's latest financial position:

Council has confirmed to TCorp that it is actively addressing each of the actions outlined above and that it is committed to operating within its financial means and strengthening its financial position. TCorp's Financial Assessment and Benchmarking Report was prepared based on an earlier LTFP which has now been superseded. The revised LTFP, only recently adopted by Council, has been based on six key financial strategies that together address the key issues raised by TCorp. These strategies include renewing existing and seeking additional special variations for infrastructure and environment works, ceasing future loan borrowings subject to annual reviews of borrowing capacity, continuing the program of engaging the community on achievement of affordable and acceptable levels of service, implementing service level reviews and adjustments to ensure value for money, and an updated and adopted Asset Management Strategy (including a review of depreciation in light of improved asset planning data). Council's latest LTFP addresses the three TCorp actions outlined above with the expectation being that Council will achieve a projected surplus operating result (excluding capital items) by 2023 of \$500,000.

In respect of the Benchmarking analysis, TCorp has compared the Council's key ratios, on a consolidated basis, with other councils in DLG Group 7. The key observations are:

- Council's financial flexibility was mixed, as indicated by the Operating Ratio which underperformed the group's average and the benchmark, and the Own Source Operating Revenue Ratio which outperformed the group's average and the benchmark.
- Council's liquidity position was sound over the review period and similar to that of other councils in the group.
- Council's debt servicing capacity was above benchmark but lower than other councils over the review period.
- Council's Infrastructure Backlog Ratio was lower than other councils in the past three years), however its Capital Expenditure, Asset Maintenance and Asset Renewal Ratios were largely below the group's average and benchmark over the same period.

Section 2 Introduction

2.1: Purpose of Report

This report provides the Council with an independent assessment of their financial capacity, Sustainability and performance measured against a peer group of councils which will complement their internal due diligence, and 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 LIRS Assessment Panel for its use in considering applications received under the LIRS.

The key areas focused on are:

- The financial capacity of the Council to undertake additional borrowings
- The 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 three years of the Council's consolidated audited accounts using financial ratio analysis. In undertaking the ratio analysis TCorp has utilised ratio's substantially consistent with those used by Queensland Treasury Corporation (QTC) initially in its review of Queensland Local Government (2008), and subsequently updated in 2011
- Conduct a detailed review of the Council's 10 year financial forecasts including a review of the key assumptions that underpin the financial forecasts. The review of the financial forecasts focused on the particular Council fund that was undertaking the proposed debt commitment. For example where a project is being funded from the General fund we focussed our review on the General fund
- Identify significant changes to future financial forecasts from existing financial performance and highlight risks associated with such forecasts, 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 2010/11)
- Council's financial forecast model
- Council's IP&R documents
- Discussions with Council officers

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

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
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

Blue Mountains City Council LGA	
Locality & Size	
Locality	Sydney Surrounds
Area	1,432km ²
DLG Group	7
Demographics	
Population	75,942
% under 18	25%
% between 18 and 59	52%
% over 60	23%
Expected population 2025	78,000
Operations	
Number of employees (FTE)	490
Annual revenue	\$95.7m
Infrastructure	
Roads	637km
Bridges	34
Infrastructure backlog value	\$34.9m
Total infrastructure value	\$605.0m

The Council Local Government Area (LGA) is located in the greater Sydney area. It attracts over 3m visitors a year making it one of the top three most visited tourist destinations in Australia. Tourism accounts for about 40% of total employment in the LGA.

After a small decline in population in 2006, the population growth has been at a very low rate. The LGA's demographic is older than the state average. The LGA's median age is 42 compared to the state average of 38. 15.7% of the population is over 65 compared to a state average of 14.7%.

The LGA covers 143,000 hectares, 70% of which are incorporated in the World Heritage Blue Mountains National Park.

The Council was granted a SRV of 7% increase (inclusive of the 2.8% rate pegging) in 2011. The Council can then apply the rate pegging percentage increase to the SRV inflated amount for the next two years. The SRV is used for asset renewal and maintenance works.

2.4: LIRS Application

Council has made two LIRS applications.

Project 1: Blaxland Waste Management Facility Resource Recovery Centre

Description: The project will provide a new Resource Recovery Centre which will include a small vehicle drop off and sorting area, recycling shed and re-use shed. The project aims to minimise what needs to be buried in landfill. The recycling shed will provide facilities for the community to drop off recyclable materials for free. The re-use shed will provide facilities for the community to drop off a range of items that could be used again and for others in the community to take away for free.

Amount of loan facility: \$4.9m

Term of loan facility: 10 years

Project 2: Springwood Community and Cultural Facilities Upgrade

Description: The \$15.5m project includes upgraded accommodation for the Library headquarters and Springwood library branch, Council district offices and customer service centre, community services offices and activity rooms including a 500 seat community theatre/ hall, Civic open space and children's playground.

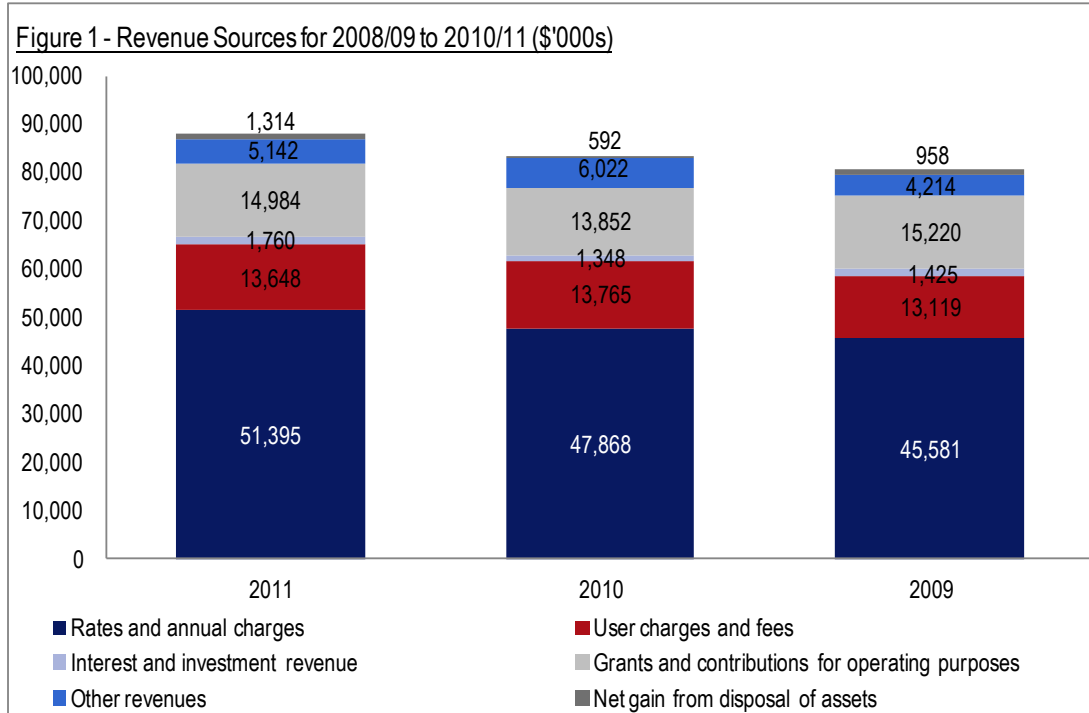
Amount of loan facility: \$6.0m

Term of loan facility: 10 years

Section 3 Review of Financial Performance and Position

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

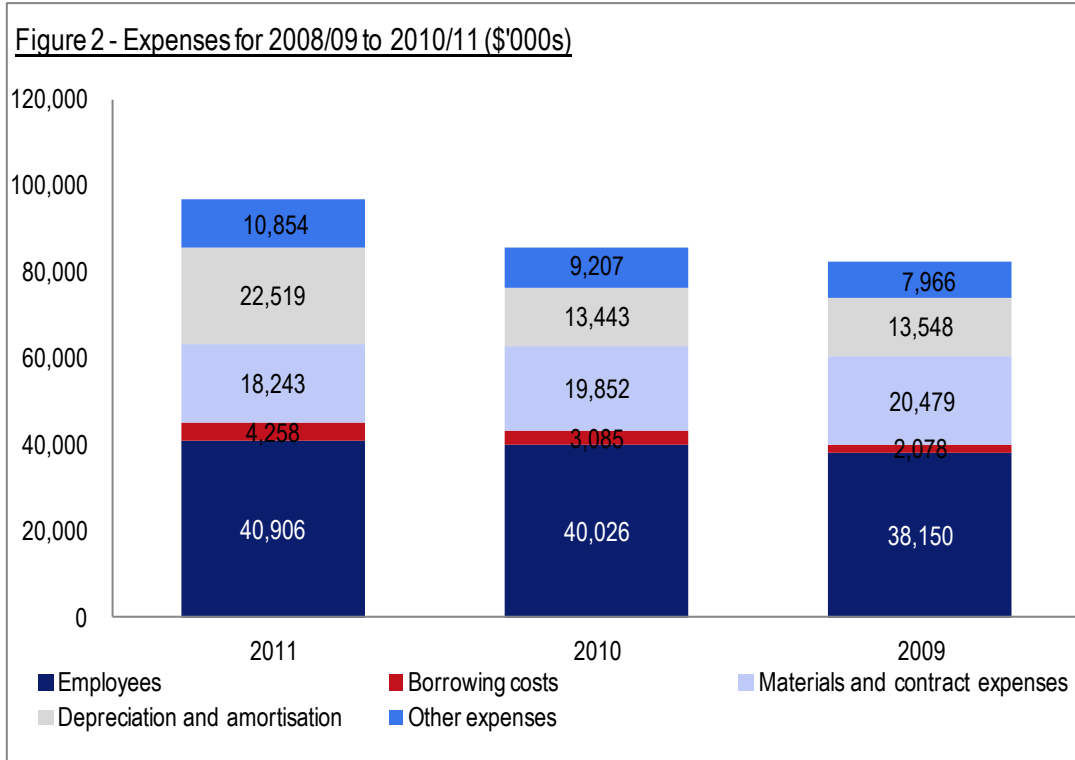
3.1: Revenue



Key Observations

- Over half of the Council's income is derived from rates and annual charges and this has been increasing steadily assisted by the SRV introduced in 2010. The Council also has an existing 10 year Environmental Levy which will expire in 2015.
- The Council is not heavily reliant on user charges and fees with only 15% of its income from this source. This category of income has been consistently generating around \$13m of revenue each year. It charges around \$3m p.a. for Domestic Waste Management Services, \$2m p.a. for its regulatory and statutory services, and around \$4m p.a. for its Swimming Centres.
- The Council earned a small surplus on its Caravan Parks of \$239,000 in 2011 but made deficits on its swimming pools and tourism activities.
- Overall, Council's revenue has been gradually increasing year to year at 4.1% in 2011 and 5.7% in 2010, mainly due to the consistent increase in rates revenue.

3.2: Expenses



Key Observations

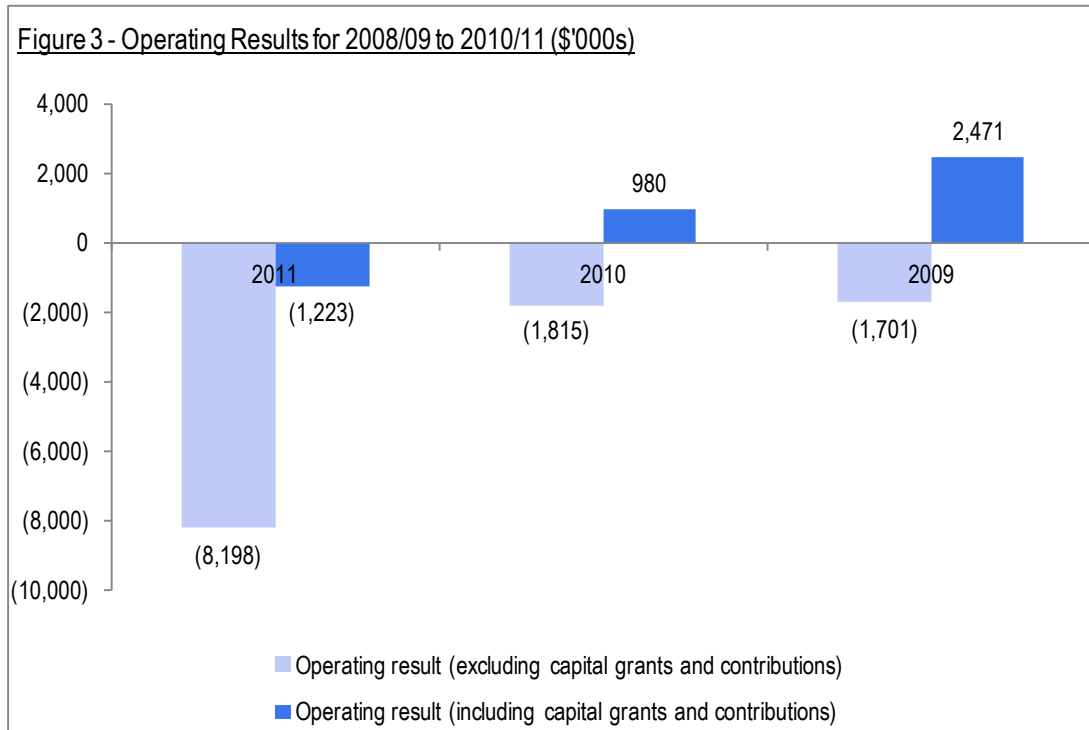
- Employee expenses have increased by 4.9% in 2010 and 2.2% in 2011. Superannuation expenses increased by 23.5% from 2009 to 2010 due to increased defined benefits employer contributions. The number of full time equivalent employees fluctuated over the period. It increased from 478 in 2010 to 490 in 2011 which led to some of the wages and salary cost increases in 2011. This is partly offset by a decrease in other employee on-costs. A key factor in the decrease in employee on-costs is a new workers compensation model which has delivered significant savings to Council.
- Materials and contracts expenses have decreased over the last three years which could be a sign of the Council's efforts to increase efficiencies and tighten expenditure.
- Depreciation expense has increased by \$9.1m from 2010 to 2011. This is mainly due to higher depreciation on roads, bridges, footpaths and stormwater drainage assets which underwent the Asset Revaluation process.
- Other expenses have increased by 15.6% in 2010 and 17.9% in 2011 mainly due to the introduction of the Waste Levy in 2010. The Levy expense was \$1.7m in 2011. This was partly offset by increases in the Council's revenue from domestic waste management services annual charges which increased by \$1.5m over the same period
- Overall, Council appears to manage its expenses well with no stand out increases noted when the non-cash item of depreciation is excluded.

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.



Key Observations

- Council has focused on balancing its working capital budget which is achieved each year but has not achieved balanced operating results when taking into account non cash items.
- 2011 was particularly impacted by the higher depreciation expense. 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.

Revenue increased by 10.0% over the two year period but expenses increased by 17.7% over the same period. This trend of a growing deficit needs to be addressed by Council and cannot be sustained into the future.

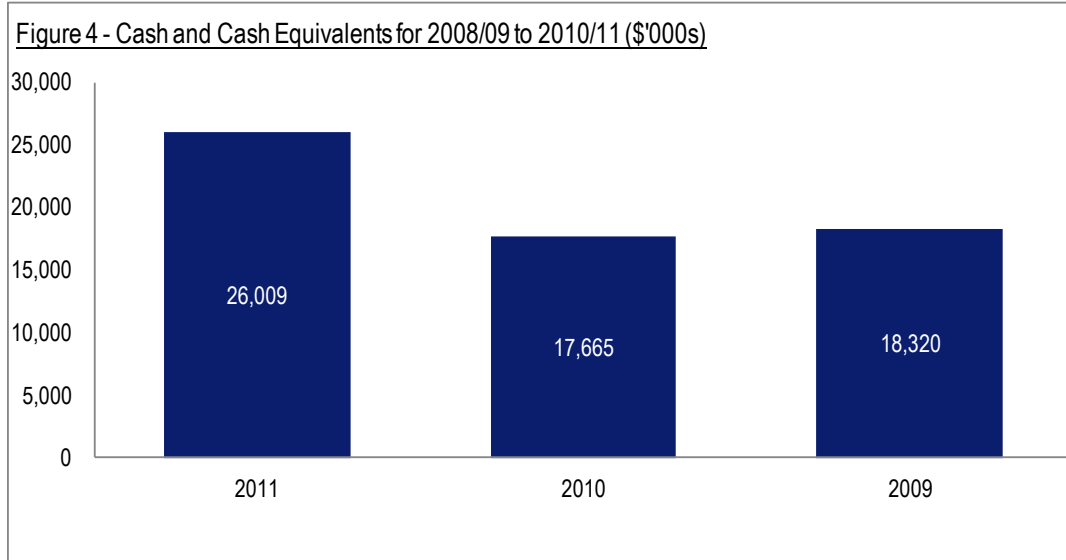
3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA (\$'000s)	18,579	14,713	13,925
Operating Ratio	(9.3%)	(2.2%)	(2.1%)
Interest Cover Ratio	4.36x	4.77x	6.70x
Debt Service Cover Ratio	2.49x	2.34x	2.73x
Unrestricted Current Ratio	2.01x	1.75x	1.57x
Own sourced operating revenue ratio	68.1%	71.2%	69.3%
Cash expense ratio	4.5 months	3.1 months	3.3 months
Net assets (\$'000s)	818,778	781,589	419,857

Key Observations

- EBITDA has been increasing consistently for the last two years reflecting its higher rates revenue with the SRV and controlled operating expenses excluding the non-cash depreciation expense.
- The Operating Ratio is deteriorating and falls below benchmark in 2011 largely as a result of increased depreciation expense.
- Both the Interest Cover Ratio and DSCR are above benchmark for all three years. These ratios indicate that the Council had sufficient funds to meet its debt requirements.
- The Council's liquidity ratios including the Unrestricted Current Ratio and Cash Expense Ratio are above benchmark in all three years. They have also improved throughout the period supporting the Council's ability to withstand short term shocks and servicing of its immediate commitments.
- The Council's Net Assets have increased by \$398.9m in the last two years mainly due to the consecutive Asset Revaluations in 2010 and 2011. This process increased the value of roads, bridges and footpaths, community land, and other structures.
- When the Asset Revaluations are excluded, the underlying trend has been an expanding infrastructure, property, plant & equipment asset base with asset purchases being larger than the combined value of disposed assets and annual depreciation. Over the two years this amounted to a \$6.1m increase in IPP&E assets. Most of these increases are related to planned major capital works.
- The Council has total borrowings of \$46.7m with total debt at 5.7% of Net Assets.

3.5: Statement of Cashflows



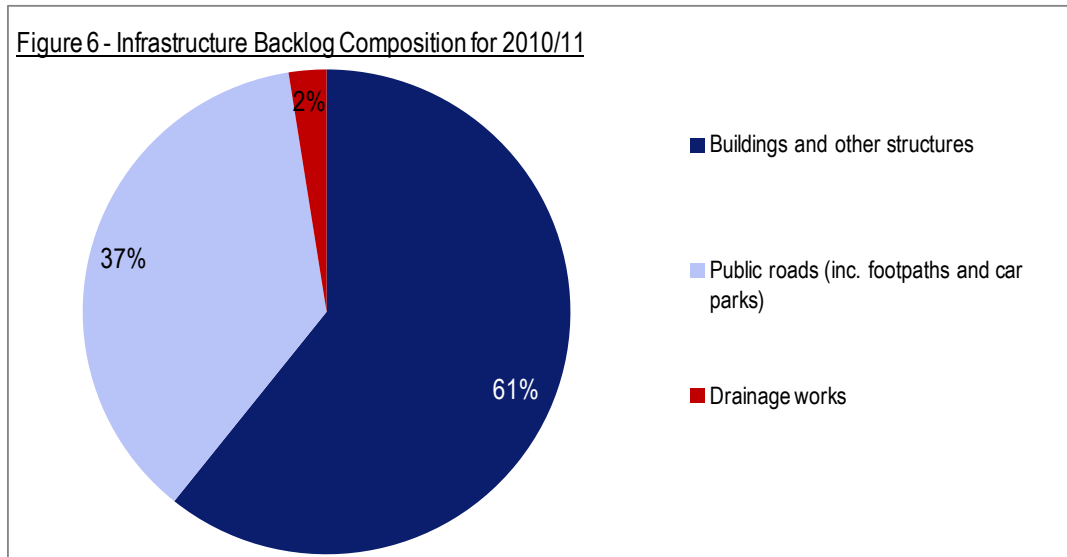
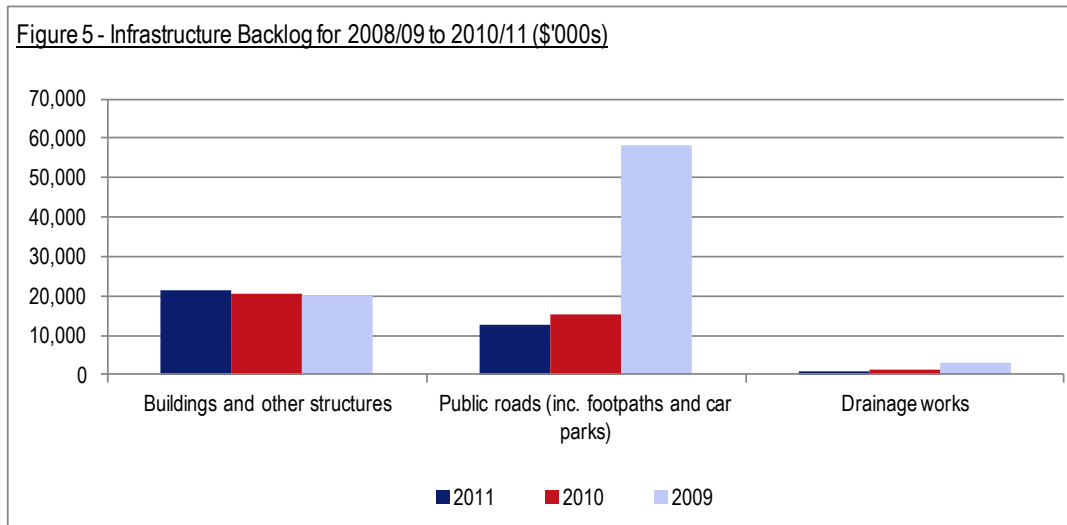
Key Observations

- Council's cash balance has increased over the review year period mainly due to increases in cash from operating activities. Particularly in 2011, cash payment for material and contracts cost is lower due to project work timing differences. The Council also received \$4.9m more cash in grants and contributions in 2011 compared to 2010. This is mainly attributed to a \$3.0m capital grant for the Lawson Clean Technology Park.
- Council had \$5.3m of investments at 30 June 2011. This includes \$2.9m in NCDs and FRNs, \$1.9m in CDOs and \$0.5m in other long term financial assets. Some of these investments are no longer prescribed by the ministerial investment order and will be disposed of when financially advantageous to the Council.
- The Council has created an investment default contingency reserve which at 30 June 2011 had a balance of \$1.6m invested in cash deposits (classified as cash and cash equivalents) and is within the Council's internal restricted funds.
- Of the Council's \$31.4m of cash and investments, \$10.4m is externally restricted, \$18.6m is internally restricted and the remaining \$2.3m is unrestricted.
- The Council's level of internally restricted and unrestricted assets, along with its liquidity ratios indicates that Council has sufficient liquidity to manage their short term liabilities.

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



Council's largest category of backlog is buildings which represents 60.8% of the backlog in 2011. This backlog has been gradually increasing year on year as actual maintenance has been lower than what is required.

The public roads backlog is the second largest category and this has significantly reduced since 2009. The Council has a road network repair and resurfacing program to continue to reduce the backlog.



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However, there is still a maintenance shortfall of \$3m to \$5m each year for road assets. Road assets, and in particular kerbs and gutters, were subject to a more systematic assessment process and more inspections which provided more accurate backlog figures from 2010 onwards. The Council is continually refining this process.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard (\$'000s)	34,893	37,309	81,342
Required annual maintenance (\$'000s)	14,554	14,759	13,579
Actual annual maintenance (\$'000s)	8,326	7,299	8,093
Total value of infrastructure assets (\$'000s)	605,037	594,120	228,088
Total assets (\$'000s)	886,315	848,722	479,494
Building and Infrastructure Backlog Ratio	0.06x	0.06x	0.36x
Asset Maintenance Ratio	0.57x	0.49x	0.60x
Building and Infrastructure Renewals Ratio	0.22x	0.36x	0.35x
Capital Expenditure Ratio	0.70x	1.66x	1.29x

The reduction in the Building and Infrastructure Backlog Ratio is partly related to the reduction in the backlog value following more detailed asset condition assessments and valuations but also the carrying value of infrastructure assets have increased due to Asset Revaluations. The Asset Maintenance Ratio and Building and Infrastructure Renewal Ratios are below benchmarks in all three years. Underspending in these areas could lead to an increasing backlog. The value of the backlog is volatile whilst Council continues to improve its asset condition assessment process and redraft its Asset Management Plan.

Although the Capital Expenditure Ratio was below benchmark in 2011, it was above benchmark in two of the three years which indicates the Council has spent a sufficient amount on capital expenditure and a substantial amount of the expenditure is on new assets. The 2011 Capital Expenditure Ratio is also lower because it reflects the increased depreciation expense following Asset Revaluation.

Council's expenditure on new assets particularly relate to major projects, such as the Cultural Centre, Katoomba Library & Civic Centre; Katoomba Waste Management Facility; and Lawson Town Centre redevelopment.

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 and the figures may include expenses which are not capitalised. These figures differ from the numbers used to calculate the Capital Expenditure Ratio in the Section 3.6 (b) table which are obtained from Note 9a of the financial statements.

Capital Program (\$'000s)	Year ended 30 June		
	2011	2010	2009
New capital works	12,092	6,256	7,758
Replacement/refurbishment of existing assets	23,553	25,297	36,367

Total	35,645	31,553	44,125
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The Council has spent a greater portion of its major capital program on replacement/refurbishment of existing assets. Some of the capital works undertaken by Council in the last three years have been:

- Blue Mountains Business Park incorporating \$3.5m of federal government funding
- Lawson Town Centre Development
- Blue Mountain Cultural Centre Precinct including the Blue Mountain Cultural Centre, the new Katoomba library, Katoomba Civic Centre and laneway connections
- Design work on Springwood Town Centre project. The project is funded by a \$9.5m federal grant
- \$7m Katoomba Waste Management Facility upgrade which included a new waste transfer station and upgraded resource recovery facilities

3.7: Specific Risks to Council

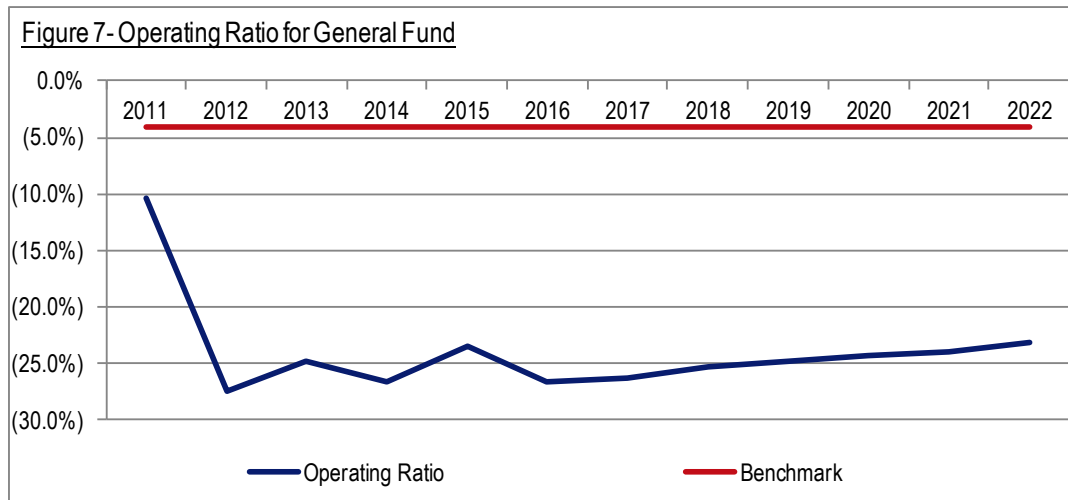
- Natural disasters. The LGA has had four Natural Disaster Declarations since 2009 due to two storm events and two bushfires. The Council is proactive in preventing the occurrence of bushfires including hazard inspection programs and approval of reduction burning. Meeting unexpected costs associated with the events are substantially reliant on being able to receive both State and Federal funding under various "natural disaster" funds.
- Low population growth. The LGA has historically low population growth levels and there is limited potential for land development. Some areas in the LGA are forecast to experience population decline. The Council is limited in its opportunities to grow its rate base and the location of infrastructure and services will need to be shifted to cater for the changing demands. This issue should be managed through the Council's Asset Management Planning and through the community consultation process to review changes in service and infrastructure levels.
- Ageing population and increase in service demand. The LGA's population age is higher than the state's average and the population is ageing as the area continues to attract retirees. This trend in demographics places heavier demand for certain infrastructure and services which cater for retirees. This issue should be managed through the Council's Asset Management Planning and through the community consultation process to review changes in service and infrastructure levels.
- CDO holdings. Council as at 30 June 2011 held CDOs valued at \$1.9m. The recovery of the investments is dependent on legal proceedings. A substantial amount of the holdings have been written off and the Council has created an investment default contingency reserve to mitigate the risk.
- Property investment. The Council has a portfolio of property investment worth \$17.6m at 30 June 2011 which generated \$0.5m of net rental return in 2011. Council has in place a Corporate Property Policy to manage the risks associated with the investment activities.

Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the \$4.9m and \$6.0m loans with LIRS subsidy.

The Council only operates one General Fund.

4.1: Operating Results



The Operating Ratio forecast is well below benchmark in all forecast years. This is expected to improve only marginally over the forecast period with the best Operating Ratio in the forecast in 2022 at negative 23.1%. The drop from 2011 to 2012 is mainly due to higher forecast depreciation expense (38.7%, \$8.7m increase from 2011) after Asset Revaluations, and changes in depreciation assumptions and valuation techniques. Employee expenses are forecast to increase (5.1%, \$2.1m increase from 2011) due to higher superannuation costs from anticipated changes in superannuation legislation.

The slight improvement in 2013 is due to higher forecast operating grants and contributions compared to a decline in 2012. The spike in 2015 is related to the \$2.7m expected profit from the planned disposal of non-strategic assets.

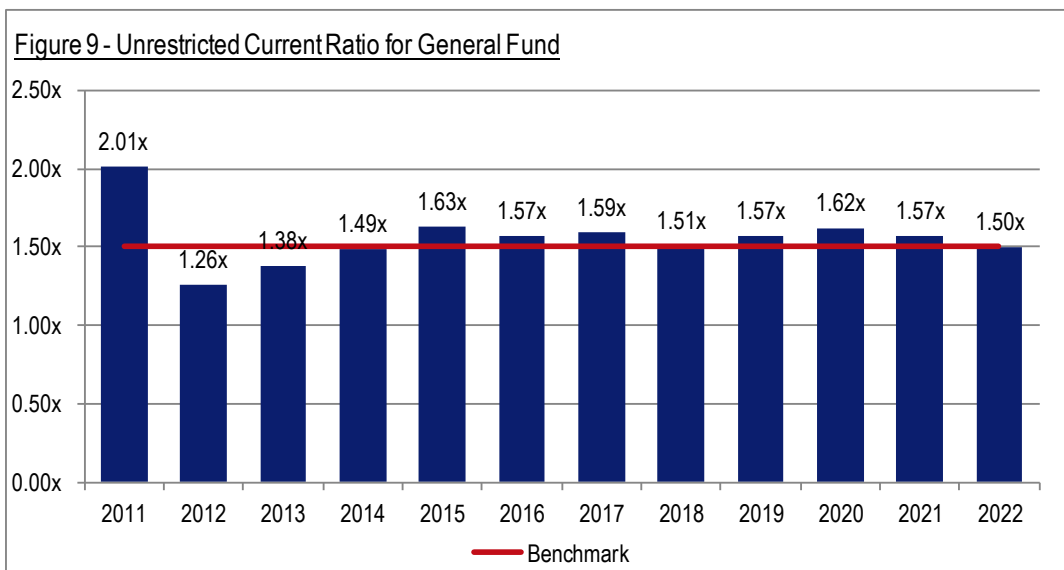
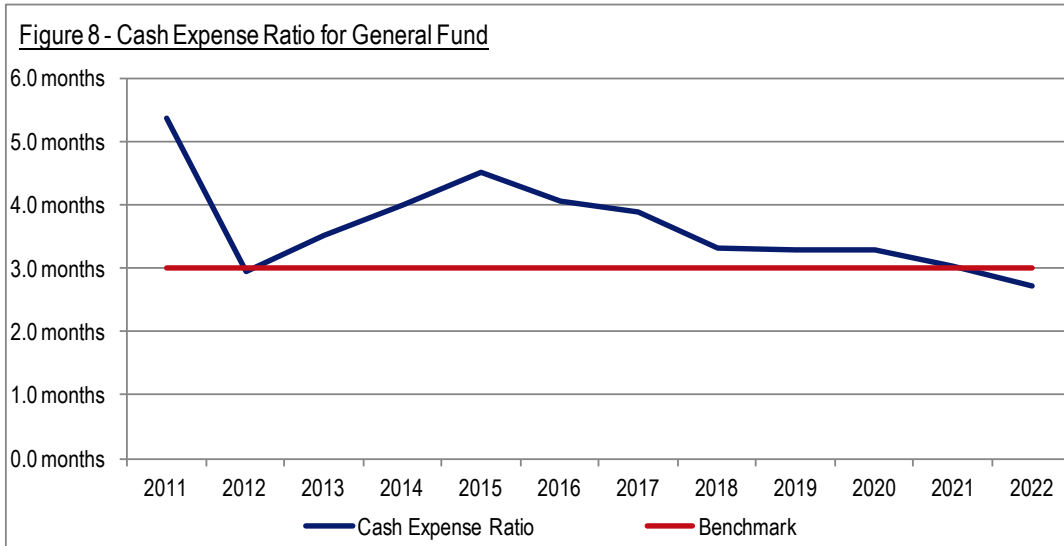
The Operating Ratio dips in 2014 and 2016 are linked to the expiration of the SRV and the Environmental Levy respectively.

Council is aware that the continuous level of deficits is not a sustainable position and has initiated a community engagement process to determine an acceptable and affordable level of services.

Council is also considering applications to extend its existing SRV and to extend the existing environmental levy. This will improve the Council's operating position and assist the funding of asset renewal but it is unlikely to shift the operating results to a surplus position.

4.2: Financial Management Indicators

Liquidity Ratios



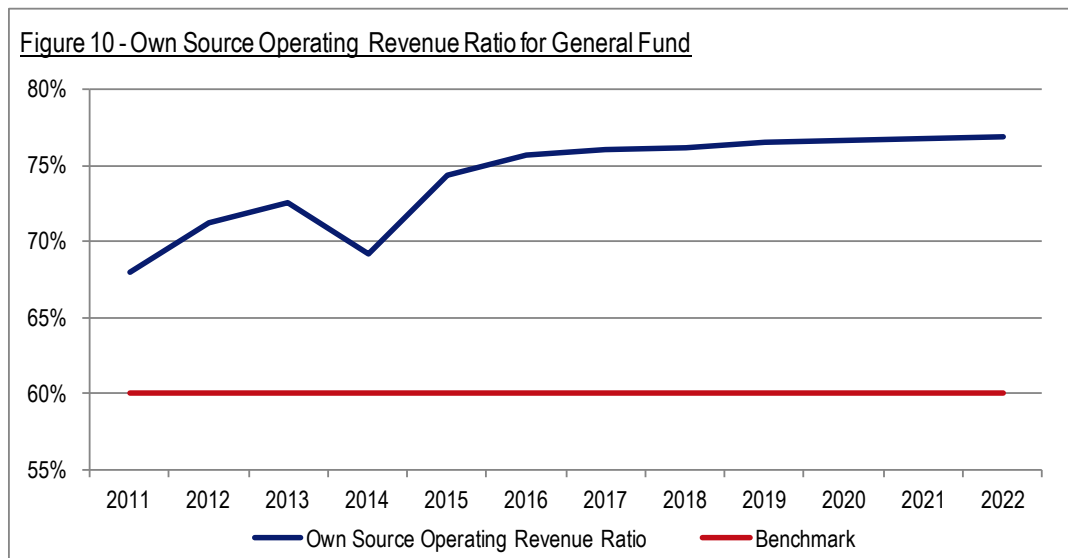
The Cash Expense Ratio has been calculated using both cash and cash equivalents, and current investments because the Council's financial model does not distinguish between these two categories. In 2011, Council's current investments of \$5.3m included \$2.9m of NCDs and FRNs, \$1.9m of CDOs, and \$0.5m of other investments. This Ratio calculation is overstated as not all current investments are liquid and readily redeemable.

Based on this analysis, the Council's Cash Expense Ratio is above benchmark in most forecast years. The highest point is at 2015 when the Ratio reaches 4.5 months where cash and investments is at the highest level in the forecast. This is related to the series of disposal of assets at \$1.3m profit in 2013, \$1.4m profit in 2014 and \$2.7m in 2015.

The Council's forecast Unrestricted Current Ratio is below benchmark in the short term to 2015. This is forecast to improve gradually and is above benchmark from 2015 onwards.

Overall, the Council's liquidity position is satisfactory but it should be aware of the weaknesses highlighted by the forecast in the short term.

Fiscal Flexibility Ratios



The Council's Own Source Operating Revenue Ratio is well above benchmark in all the forecast years. The Ratio is rising over the lifetime of the forecast due to capital grants and contributions forecast being lower than historically received. This skews the proportion of the Own Source Revenue Ratio upwards. The dip in the Ratio in 2014 is due to the expiration of the SRV and higher capital grants forecast.

Figure 11 - DSCR for General Fund

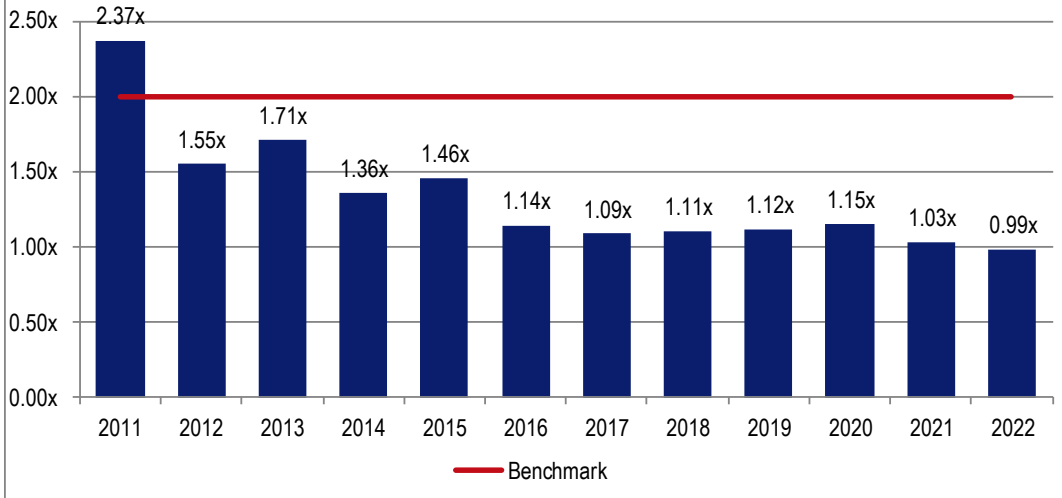
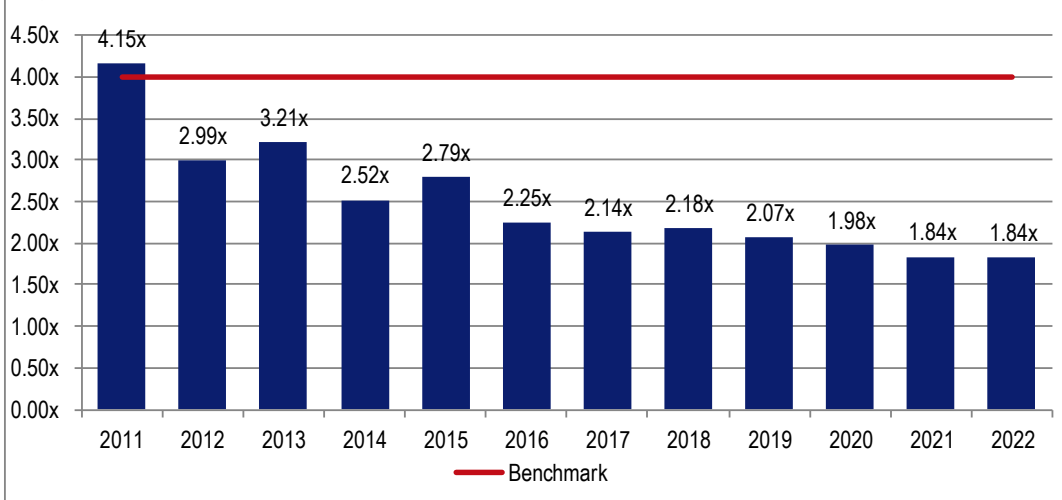
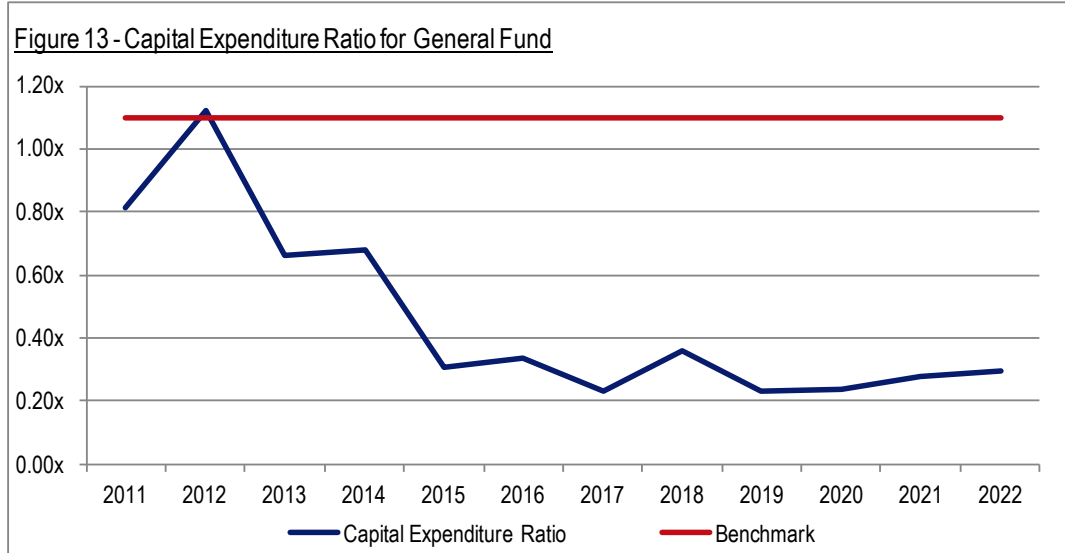


Figure 12 - Interest Cover Ratio for General Fund



The Council's debt servicing ratios are below benchmark in all the forecast years and decline over the forecast period. This is due to a forecast decline in EBITDA and a static level of debt repayment of \$3m to \$4m per year and interest cost of \$4m to \$5m per year. The borrowings level is forecast to gradually decline from a balance of \$57.0m in 2013 to \$48.8m in 2022. The total borrowings level was \$44.7m on 30 June 2011.

4.3: Capital Expenditure



Council's forecast capital expenditure level drops from 2013 onwards because the Council has not projected any major capital works projects. The major capital works proposed in 2013 and 2014 are the Blaxland Waste Management Facility, Springwood facilities upgrade and the Blue Mountains cultural centre.

\$3.9m p.a. to \$4.5m p.a. is forecast to be spent on renewal capital expenditure from 2014 onwards.

Based on the current model, Council will not be spending enough to renew its ageing infrastructure. The total deficit figure for capital expenditure versus depreciation from 2013 to 2022 amounts to \$201.6m in nominal terms.

The Strategic LTFP Case being developed by Council management begins to address the issue of Council not spending enough to renew its ageing infrastructure.

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 LGCI increased by 3.4% in the year to September 2011, and in December 2011, IPART announced that the rate peg to apply in the 2012/13 financial year will be 3.6%. Beyond 2013 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%
- Interest and investment revenue: annual return of 5%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

Key Observations and Risks

- Council has assumed that the same range of services will continue but the service level and quantity may be reduced accordingly to match Council's financial constraints.
- Rates and annual charges revenue is assumed to increase at 3.9% p.a. to 4.6% p.a. Any variations to this are linked to the expiration of the SRV and Environmental Levy. These assumptions seem optimistic given that population levels are forecast to remain stable and a shortage of land available for development [Check with Council that this model does not include an SRV assumption.]
- Operating grants and contributions increases by 3.3% p.a. to 3.6% p.a. which seems reasonable.
- Employee expenses are forecast to increase annually in the range of 4.2% p.a. to 4.9% p.a. This is driven by a 4.1% p.a. salary and wages cost, and a 4.2% p.a. to 9.5% p.a. superannuation cost increases. This appears consistent with historical increases.
- Materials and contracts cost fluctuates between the forecast years but is averaged to increase by 3.1% p.a. which is considered reasonable.
- The forecast capital expenditure is well below benchmark and appears to be insufficient to maintain assets. Council is working on different strategies to improve funding allocated to maintenance and renewal of assets.
- Net assets and in particular infrastructure, property, plant and equipment are forecast to decline over the forecast period.

4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will not be able to incorporate any further loan funding in addition to the already forecast loans. The Council has already incorporated \$57.0m of borrowings in its 2013 forecast which result in below benchmark forecast DSCR and Interest Cover Ratio.

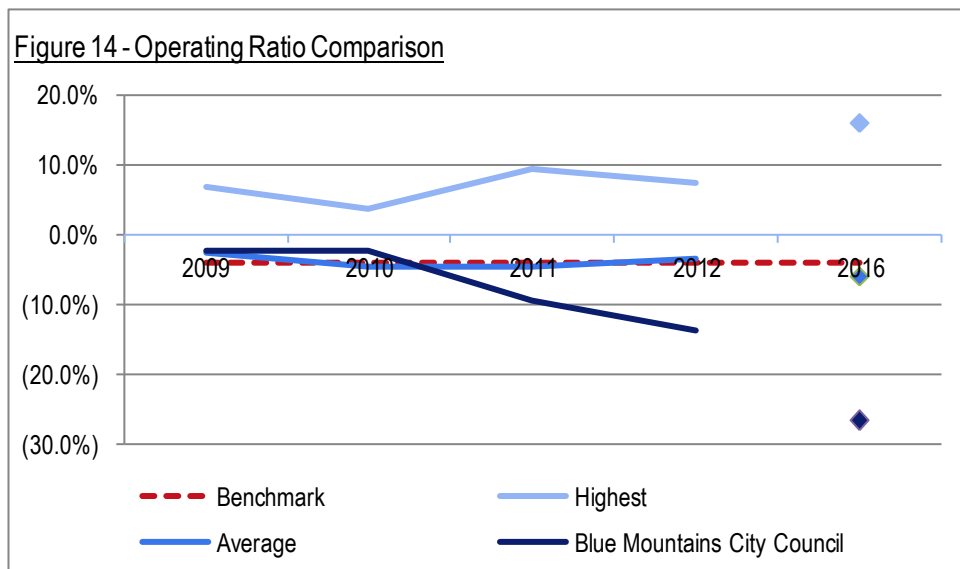
Section 5 Benchmarking and Comparisons with Other Councils

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 7. There are eight councils in this group and at the time of preparing this report, we have data for all eight of these councils. As the benchmarking assessment has been conducted subsequent to preparation of the reports, we have been able to include 2012 data for all councils in the group in this section.

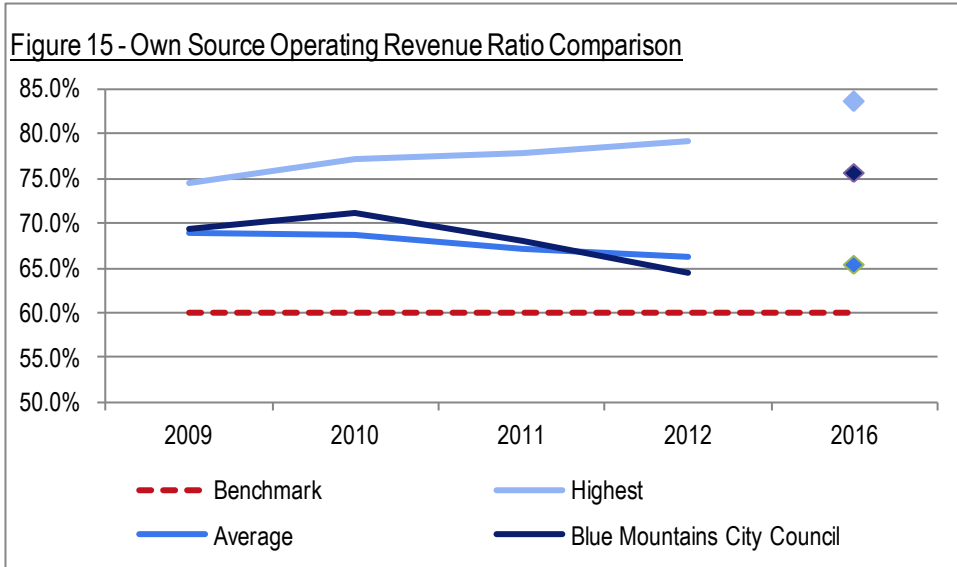
In Figure 14 to Figure 20, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 21 to 23 do not include the 2016 forecast position as those numbers are not available.

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



Council's Operating Ratio has deteriorated in the past two years to fall below the group's average and the benchmark. Council's operating results are forecast to deteriorate further over the medium term, in contrast to the average council in the group. This is due largely to increased depreciation expense.



Council's Own Source Operating Revenue Ratio was above benchmark and was at a similar level to the group's average in the past four years. The Ratio is forecast to improve over the medium term due to lower capital grants and contributions being forecast.

Liquidity

Figure 16 - Cash Expense Ratio Comparison

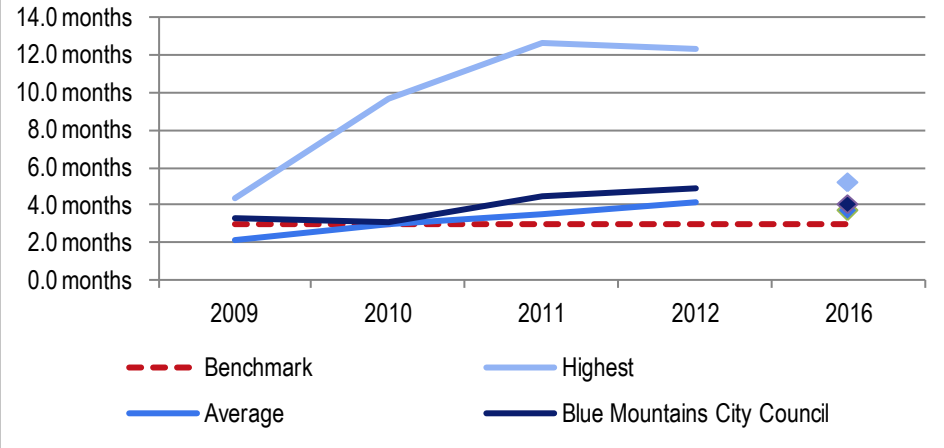
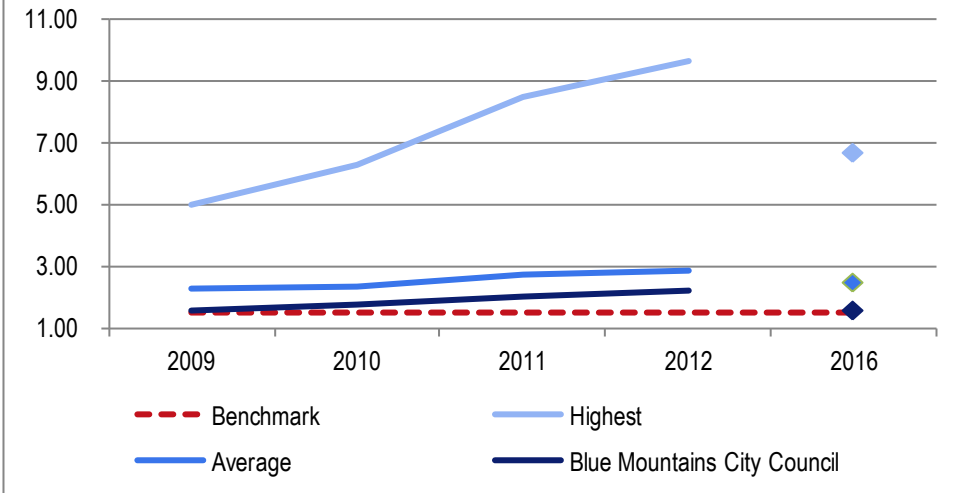
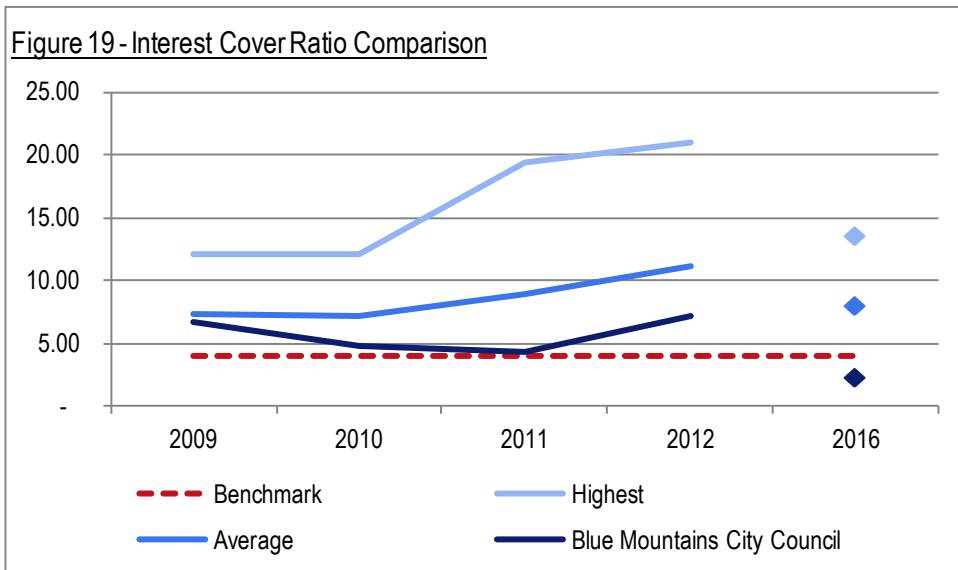
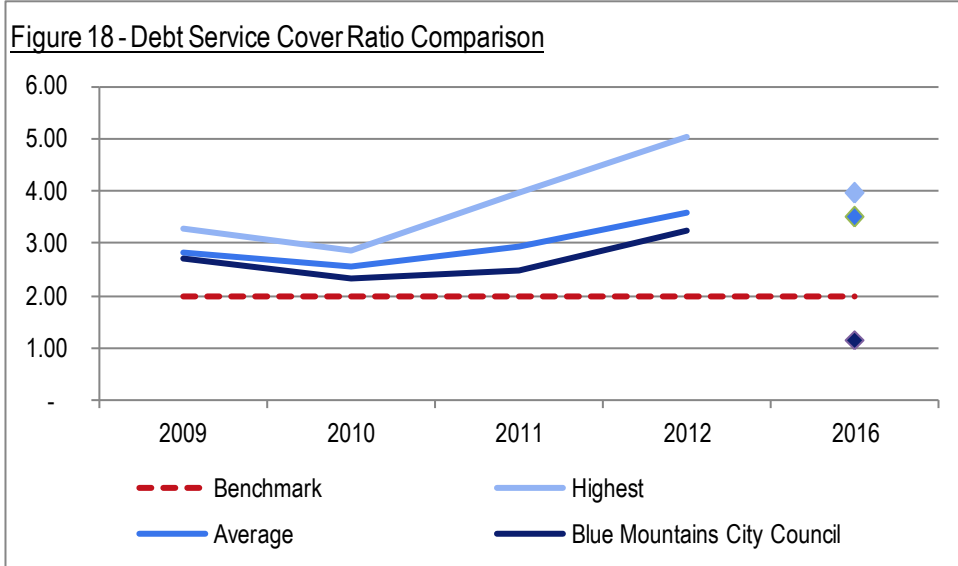


Figure 17 - Unrestricted Current Ratio Comparison



On average over the past four years, Council's liquidity position has been sound and tracking just close to the group average. This is forecast to be maintained over the medium term.

Debt Servicing



Council had above benchmark DSCR and Interest Cover Ratio over the review period however both Ratios dip below benchmark in the forecast. Overall, Council's debt servicing capacity is lower than the average council in the group.

Asset Renewal and Capital Works

Figure 20 - Capital Expenditure Ratio Comparison

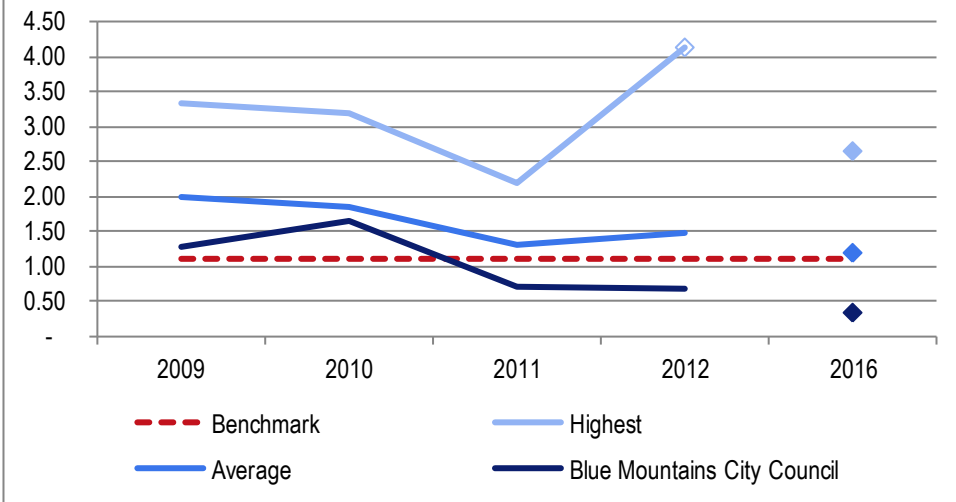


Figure 21 - Asset Maintenance Ratio Comparison

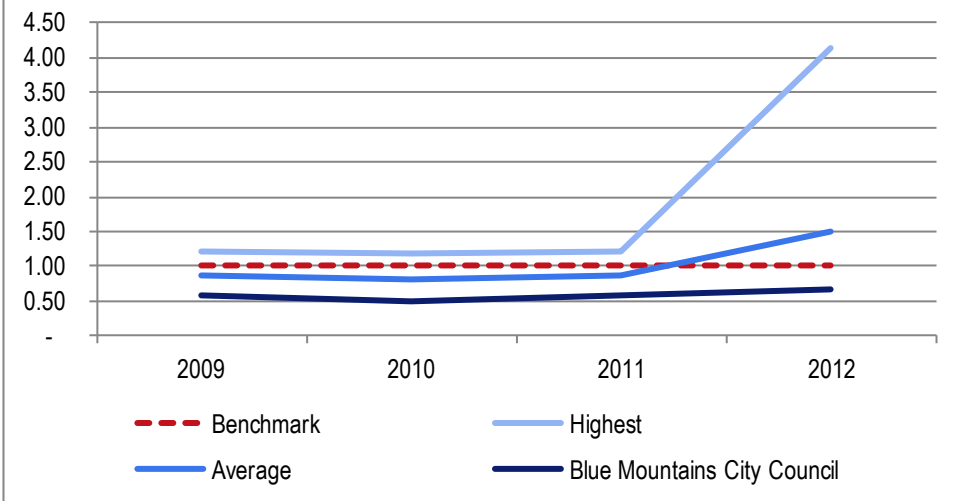


Figure 22 - Infrastructure Backlog Ratio Comparison

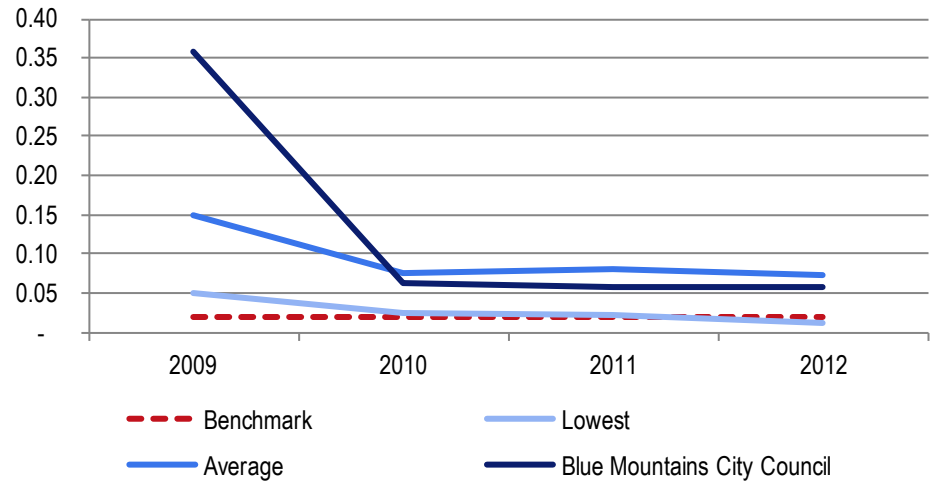
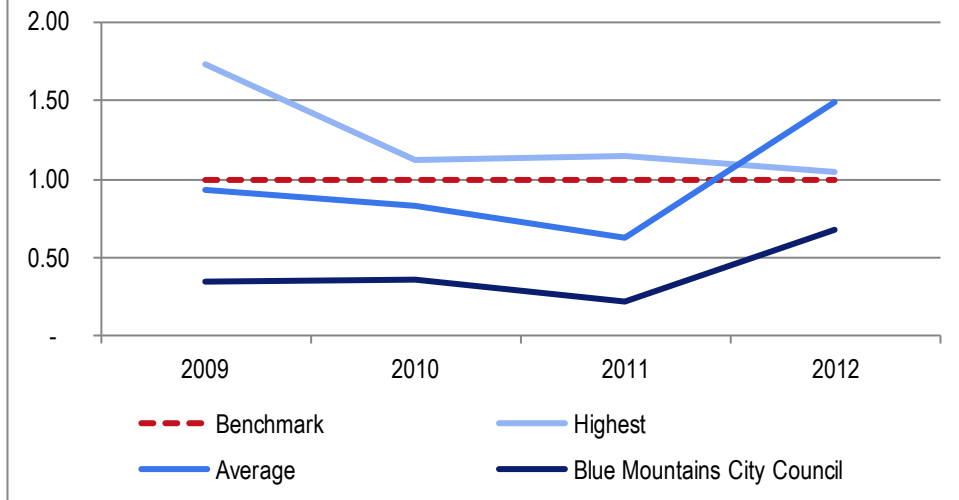


Figure 23 - Building and Infrastructure Asset Renewal Ratio



Council's Infrastructure Backlog was lower than the average council in the past three years, following a reduction in the Backlog value due to more detailed asset condition assessments in 2010.

However, Council underperforms the group in the Capital Expenditure, Asset Maintenance and Building and Infrastructure Asset Renewal Ratios. Council has also largely tracked below benchmark in these areas, indicating Council has not invested sufficient funds in capital expenditure compared to benchmark.

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 currently be in a satisfactory financial position but this position is forecast to deteriorate according to the current Long Term Financial Plan. The following observations were made:

- Council's forecast borrowings result in below benchmark DSCR and Interest Cover Ratios
- Council's overall historical performance is satisfactory but this position rapidly declines from 2011 and into the forecast years. This is mainly driven by increased depreciation expense. Although this is a non-cash expense it indicates that the Council cannot fund the renewal of its deteriorating assets and it is an unsustainable position
- Council is aware of its financial sustainability issues and have commenced a community consultation process to rationalise its service levels to generate expense reduction and/or revenue increases
- Council is considering an extension of its SRV and environmental levy to improve its forecast operating position. A successful SRV application in 2013 is critical to the Council's ability to fund the loan associated with the LIRS projects and its other scheduled debt repayments
- Changes in service levels to reduce expenses, and the SRV application will be subject to the support of the incoming councillors in September 2012
- Further refinement and integration of the Council's Asset Management Plan with its Long Term Financial Plan are required to provide a more realistic and sustainable forecast position

TCorp's approval for the LIRS subsidy is subject to the Council acknowledging that it is critical to improve its operating position. To help achieve this, they can seek to obtain the SRV and environmental levy extension, and reduce expenses through its service level review. The success of these events is critical to the Council's affordability of the additional \$10.9m loans and its other forecast debt repayments.

Council's Strategic LTFP Case proposes to replace ongoing loans with a Special Rate Variation. We are advised that the Strategic LTFP Case will be submitted to Council for adoption in 2012/13.

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement (\$'000s)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Revenue					
Rates and annual charges	51,395	47,868	45,581	7.4%	5.0%
User charges and fees	13,648	13,765	13,119	(0.8%)	4.9%
Interest and investment revenue	1,760	1,348	1,425	30.6%	(5.4%)
Grants and contributions for operating purposes	14,984	13,852	15,220	8.2%	(9.0%)
Other revenues	5,142	6,022	4,214	(14.6%)	42.9%
Net gain from disposal of assets	1,314	592	958	122.0%	(38.2%)
Net share of interests in JV and associated entities	339	350	3	(3.1%)	11566.7%
Total revenue	88,582	83,797	80,520	5.7%	4.1%
Expenses					
Employees	40,906	40,026	38,150	2.2%	4.9%
Borrowing costs	4,258	3,085	2,078	38.0%	48.4%
Materials and contract expenses	18,243	19,852	20,479	(8.1%)	(3.1%)
Depreciation and amortisation	22,519	13,443	13,548	67.5%	(0.8%)
Other expenses	10,854	9,207	7,966	17.9%	15.6%
Total expenses	96,780	85,612	82,221	13.0%	4.1%
Operating result	(8,198)	(1,815)	(1,701)	(351.7%)	(6.7%)

Table 2 - Items excluded from Income Statement

Excluded items (\$'000s)			
	2011	2010	2009
Grants and contributions for capital purposes	6,975	2,795	4,172
Interest revenue/ (losses)	0	1,242	(3,009)
Net gain from the disposal of non-current assets classified as "held for sale"	110	0	0

Table 3 - Balance Sheet

Balance Sheet (\$'000s)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and equivalents	26,009	17,665	18,320	47.2%	(3.6%)
Investments	5,348	6,974	8,901	(23.3%)	(21.6%)
Receivables	5,649	5,313	4,208	6.3%	26.3%
Inventories	444	487	422	(8.8%)	15.4%
Other	520	1,157	705	(55.1%)	64.1%
Total current assets	37,970	31,596	32,556	20.2%	(2.9%)
Non-current assets					
Receivables	346	359	427	(3.6%)	(15.9%)
Infrastructure, property, plant & equipment	828,731	799,715	431,348	3.6%	85.4%
Investments accounted for using the equity method	1,711	1,372	1,022	24.7%	34.2%
Investment property	17,557	14,190	14,141	23.7%	0.3%
Non-current assets classified as held for sale	0	1,490	0	N/A	N/A
Total non-current assets	848,345	817,126	446,938	3.8%	82.8%
Total assets	886,315	848,722	479,494	4.4%	77.0%
Current liabilities					
Payables	7,314	6,794	9,128	7.7%	(25.6%)
Borrowings	3,558	3,136	3,124	13.5%	0.4%
Provisions	10,143	9,741	8,671	4.1%	12.3%
Total current liabilities	21,015	19,671	20,923	6.8%	(6.0%)
Non-current liabilities					
Borrowings	43,128	43,434	33,068	(0.7%)	31.3%
Provisions	3,394	4,028	5,646	(15.7%)	(28.7%)
Total non-current liabilities	46,522	47,462	38,714	(2.0%)	22.6%
Total liabilities	67,537	67,133	59,637	0.6%	12.6%
Net assets	818,778	781,589	419,857	4.8%	86.2%

Table 4 - Cashflow

Cashflow Statement (\$'000s)	Year ended 30 June		
	2011	2010	2009
Cashflows from operating activities	20,288	7,505	17,348
Cashflows from investing activities	(12,060)	(18,538)	(15,195)
Proceeds from borrowings and advances	3,058	13,582	7,826
Repayment of borrowings and advances	(3,212)	(3,204)	(3,026)
Cashflows from financing activities	(154)	10,378	4,800
Net increase/(decrease) in cash and equivalents	8,074	(655)	6,953
Cash and equivalents (excluding bank overdraft)	26,009	17,665	18,320

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 2009², 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.

¹IPART “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 building, infrastructure and other structures to a satisfactory standard, measured at a particular point in time. It is unaudited and stated within Special Schedule 7 that accompanies the council's audited annual financial statements.

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

This ratio compares actual versus required annual asset maintenance, as detailed in Special Schedule 7. A ratio of above 1.0x indicates that the council is investing enough funds within the year to stop the infrastructure backlog from growing.

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

This ratio compares the proportion spent on infrastructure asset renewals and the asset's deterioration measured by its accounting depreciation. Asset renewal represents the replacement or refurbishment of existing assets to an equivalent capacity or performance as opposed to the acquisition of new assets or the refurbishment of old assets that increase capacity or performance.

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

Ratio = current year's cash and cash equivalents / (total expenses – depreciation – interest costs)*12

This liquidity ratio indicates the number of months a council can continue paying for its immediate expenses without additional cash inflow.

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

This indicates the extent to which a council is forecasting to expand its asset base with capital expenditure spent on both new assets, and replacement and renewal of existing assets.

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

Ratio = operating results before interest and depreciation (EBITDA) / principal repayments (from the statement of cash flows) + borrowing interest costs (from the income statement)

This ratio measures the availability of cash to service debt including interest, principal and lease payments

Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

Ratio = estimated cost to bring assets to a satisfactory condition (from Special Schedule 7) / total infrastructure assets (from Special Schedule 7)

This ratio shows what proportion the backlog is against total value of a council's infrastructure.

Interest Cover Ratio

Benchmark = Greater than 4.0x

Ratio = EBITDA / interest expense (from the income statement)

This ratio indicates the extent to which a council can service its interest bearing debt and take on additional borrowings. It measures the burden of the current interest expense upon a council's operating cash.

Operating Ratio

Benchmark = Better than negative 4%

Ratio = (operating revenue excluding capital grants and contributions – operating expenses) / operating revenue excluding capital grants and contributions

This ratio measures a council's ability to contain operating expenditure within operating revenue.

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

Ratio = rates, utilities and charges / total operating revenue (inclusive of capital grants and contributions)

This ratio measures the level of a council's fiscal flexibility. It is the degree of reliance on external funding sources such as operating grants and contributions. A council's financial flexibility improves the higher the level of its own source revenue.

Unrestricted Current Ratio

Benchmark = 1.5x (taken from the IPART December 2009 Revenue Framework for Local Government report)

Ratio = Current assets less all external restrictions / current liabilities less specific purpose liabilities

Restrictions placed on various funding sources (e.g. Section 94 developer contributions, RMS contributions) complicate the traditional current ratio because cash allocated to specific projects are restricted and cannot be used to meet a council's other operating and borrowing costs. The Unrestricted Current Ratio is specific to local government and is designed to represent a council's ability to meet debt payments as they fall due.