New South Wales
Treasury Corporation

11 April 2013

The General Manager
Wakool Shire Council
Tualka Terrace,
Moulamein NSW 2733

Dear Sir/Madam,

Financial Assessment of NSW Councils

As part of TCorp's work for the Independent Review Panel chaired by Professor Graham Sansom, New South Wales Treasury Corporation (TCorp) has undertaken an assessment of the financial capacity and sustainability of all 152 Councils in New South Wales. Each Council has received, or is about to receive, a report prepared by TCorp that provides an assessment of the following key areas:

- 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

In addition, TCorp has also prepared a Financial Sustainability Rating (FSR) and Outlook for each Council. These FSRs and Outlooks have been developed by TCorp to provide an overall position of the sustainability of Councils when compared with each other Council within NSW.

The Appendix attached to this letter provides details of the seven FSR categories and the three Outlook categories that have been used in arriving at the assessed FSR and Outlook of each Council.

The Council has been assessed as:

FSR	Weak
Outlook	Negative

The FSR of each Council has been determined based on TCorp's review and consideration of the historical and forecast financial results and against a set of benchmark indicators. TCorp has categorised the 10 benchmark ratios into four broad categories and then considered the relative importance of each category in terms of a Council's financial capacity and sustainability. The category of financial flexibility has been assigned a greater weighting because it measures two key measures for sustainability, the Council's revenue raising capacity, and its ability to sustain financial

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shocks, which are important factors for sustainability. As a Council's core servicing function and main asset is its infrastructure, its asset renewal and capital works program is an important factor in its long term sustainability. Debt servicing has been given the least weighting because most Councils are lowly geared.

The Outlook is TCorp's assessment of the potential movement of a Council's FSR within the next three years. A Positive Outlook indicates that a Council's FSR is likely to improve in the short term, whilst a Neutral Outlook indicates that the FSR is likely to remain unchanged. A Negative Outlook indicates that a Council's FSR is more likely to deteriorate and is a sign of a general weakening in performance and sustainability.

For example, a Council with a FSR of Moderate and an Outlook of Negative, is assessed as being in a deteriorating position or at risk of being downgraded from Moderate to Weak. As TCorp considers a FSR of lower than Moderate to be at much greater risk of being unsustainable, Councils in this position need to be considering options for addressing the areas of poor performance that are contributing to Council's assessed FSR and Outlook.

The Outlook is TCorp's current assessment of the potential movement of a Council's FSR and will change as a Council undertakes actions to reduce perceived risks, such as completing Asset Management Plans, or obtaining approval for a special rate variation to increase investment in renewal capital expenditure.

TCorp's Report to the Independent Review Panel is expected to be released in mid-April and the FSR and Outlook for each Council will be included in TCorp's Report.

TCorp would be happy to discuss with you any questions that you may have in regard to the assessed FSR or Outlook for the Council.

Yours Sincerely
New South Wales Treasury Corporation

KPugh

Kevin Pugh
Senior Manager Corporate Finance

New South Wales Treasury Corporation

Wakool Shire Council

Financial Assessment, Sustainability and Benchmarking Report

13 March 2013

Prepared by NSW Treasury Corporation for Wakool 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 Wakool Shire Council, the DLG and the Independent Local Government Review Panel. TCorp shall not be liable to Wakool 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 Wakool 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 performance of Council has been satisfactory over the review period considering large flooding events in the LGA that have impacted operations. This is based on the following observations:

- Total revenue, excluding capital grants and contributions, increased by 5.3% p.a. to $15.2m on a compounded annual basis over the four year review period
- Council has maintained employee expense growth to satisfactory levels over the review period
- Council posted improving net operating results excluding capital grants and contributions for the past two years, albeit below benchmark

The Council reported $96.8m of Infrastructure Backlog in 2012 which represents 41.1% of its infrastructure asset value of $235.7m. During TCorp's review, Council advised that they had detected an error in their reported Backlog number. This error, relating to unsealed roads means that the Infrastructure Backlog was overstated by $28.9m and that the correct total Backlog number as at 30 June 2012 was $67.9m. We have used this corrected number in our report. Other observations include:

- 60.5% ($41.1m) of the backlog relates to public roads
- Council's backlog has grown since 2009, and increased by $33.1m in 2012 following the revision of their Asset Management Plan (AMP)

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

- Operating deficits are forecast in each year of the forecast when capital grants and contributions are excluded. These are projected to improve over the 10 year period but remain below the benchmark
- Council's liquidity is forecast to remain adequate over the 10 year period
- Council's cumulative capital expenditure is at a level to maintain the Net Asset position at the current level as indicated by the cumulative capital expenditure versus cumulative depreciation

With consecutive operating deficits projected over the LTFP we would not recommend any additional borrowings in addition to the $2.6m scheduled within the forecast. The uncertainties surrounding future service levels and the establishment of agreed standards for assets with the community also preclude us recommending further borrowings until Council completes its community consultation work in respect of service levels and fully integrates its AMP requirements into its LTFP.

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

- Council's long term Sustainability is at risk as based on current forecasts Council will not be able to provide the current service levels in the future
- In recent years, Council did not spend sufficient amounts on asset renewals
- The reported Infrastructure Backlog does not align with the AMPs stated service goals. The community engagement process has not as yet developed agreed service levels which may then be reflected in what constitutes the community's acceptable standards for the condition of council assets, particularly roads and bridges. Completing this work with the community should result in a more accurate Backlog calculation and determination of future maintenance requirements

TCorp believes Council is currently in a weak financial position. Council forecasts operating deficits in all 10 years of the LTFP when capital grants are excluded, with the limited size of the rate base making it difficult for Council to address the future operating deficits, manage unforseen financial shocks or any adverse changes in its business and to fund the Infrastructure Backlog.

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

- Council's financial flexibility as indicated by the Operating Ratio and Own Source Operating Revenue Ratio is generally below the group's average
- Council has less relative capacity to utilise further borrowings than the group average as it is closer to the DSCR and Interest Cover Ratio benchmarks
- Council was in a sufficient liquidity position but was below the group average liquidity level
- Council's Capital Expenditure Ratio is the highest performer however this is boosted by a strong 2009 result. It has performed below the group average in terms of asset maintenance and renewals and has a comparatively high level of Infrastructure Backlog

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Section 2 Introduction

2.1: Purpose of Report

This report provides the Council with an independent assessment of their financial capacity, Sustainability and performance measured against a peer group of councils. It will complement Council's internal due diligence, the IP&R system of the Council and the DLG, together with the work being undertaken by the Independent Local Government Review Panel.

The report is to be provided to the DLG and the Independent Local Government Review Panel.

The key areas focused on are:

- The financial capacity of the Council
- The long term Sustainability of the Council
- The financial performance of the Council in comparison to a range of similar councils and measured against prudent benchmarks

2.2: Scope and Methodology

TCorp's approach was to:

- Review the most recent four years of the Council's consolidated audited accounts using financial ratio analysis. In undertaking the ratio analysis TCorp has utilised ratio's substantially consistent with those used by Queensland Treasury Corporation (QTC) initially in its review of Queensland Local Government (2008), and subsequently updated in 2011
- Conduct a detailed review of the Council's 10 year financial forecasts including a review of the key assumptions that underpin the financial forecasts. The review of the financial forecasts focused on the Council's General Fund
- Identify significant changes to future financial forecasts from existing financial performance and highlight risks associated with such forecasts, including those that could impact Council's Sustainability
- Conduct a benchmark review of a Council's performance against its peer group
- Prepare a report that provides an overview of the Council's existing and forecast financial position and its capacity to meet increased debt commitments and achieve long term Sustainability
- Conduct a high level review of the Council's IP&R documents for factors which could impact the Council's financial capacity, performance and Sustainability

In undertaking its work, TCorp relied on:

- Council's audited financial statements (2008/09 to 2011/12)
- Council's financial forecast model
- Council's IP&R documents
- Discussions with Council officers
- Other publicly available information such as information published on the IPART website

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

- [Council agrees with the findings of the report and ... to be updated post council review]

Definition of Sustainability

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

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

Benchmark Ratios

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

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

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

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

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

2.3: Overview of the Local Government Area

Wakool Shire Council	
Locality and Size	
Locality	Murray
Area	7,549 km²
DLG Group No.	9
Demographics	
Population	4,362
% under 20	24.3%
% between 20 and 59	47.5%
% over 60	29.2%
Expected population in 2021	4,300
Operations	
Number of employees (FTE)	65
Annual revenue	$15.2m
Infrastructure	
Roads	1,668 km
Bridges	76
Infrastructure backlog value	$67.9m
Total infrastructure value	$235.7m

The Wakool Shire was founded in June 1906. It is a small rural Council located in the South Western area of the Riverina between the Murray and Murrumbidgee Rivers. The majority of the Shire is an extensive flood plain, with a large number of water courses, bridges and an extensive road network. The Edward, Wakool and Niemur Rivers flow through the Shire. There is diversified land use, vegetation and wildlife.

The Shire comprises the towns of Barham, Tooleybuc, Moulamein, Wakool, Koraleigh and Murray Downs. The Shire's headquarter and business centre are based in Moulamein with a branch office in Barham. Works depots are located in Moulamein and Barham.

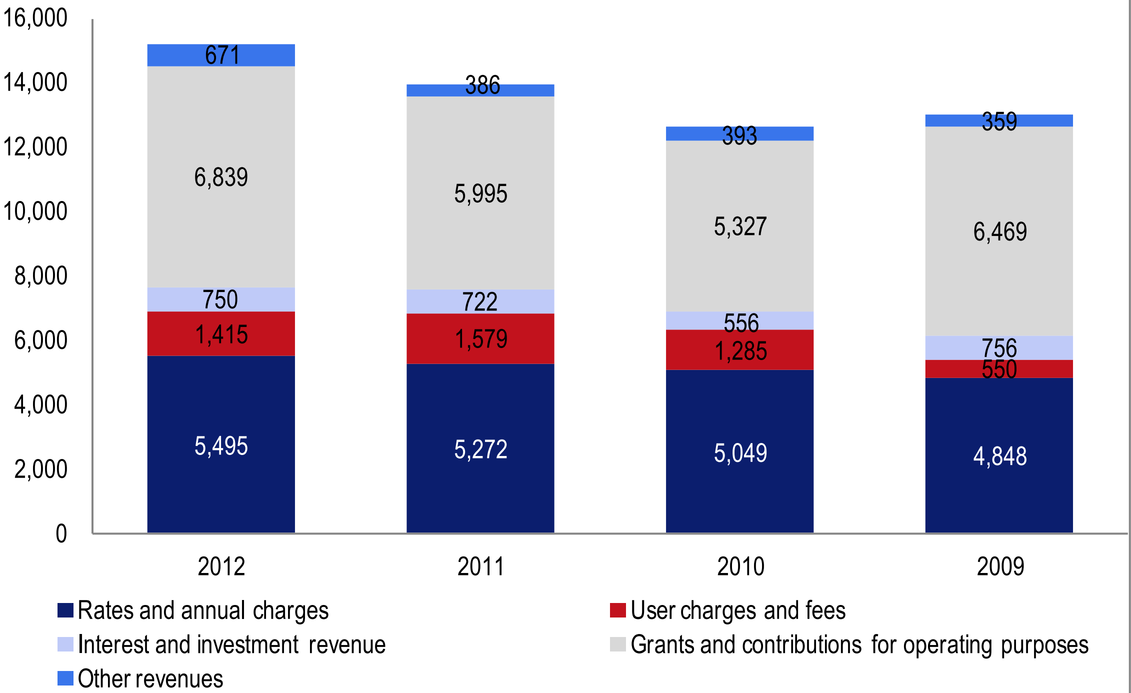
The LGA contains 42km of state highway, 310km of regional roads, 1,274km of shire roads, 17km of state road and, 42km of urban roads and streets. There are 25 bridges on regional roads and 51 bridges on shire roads. There are also an additional seven national bridges and one ferry, which are maintained by the RMS (the costs for funding are shared between the Victorian and NSW Governments as the ferry services both sides of the river).

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)

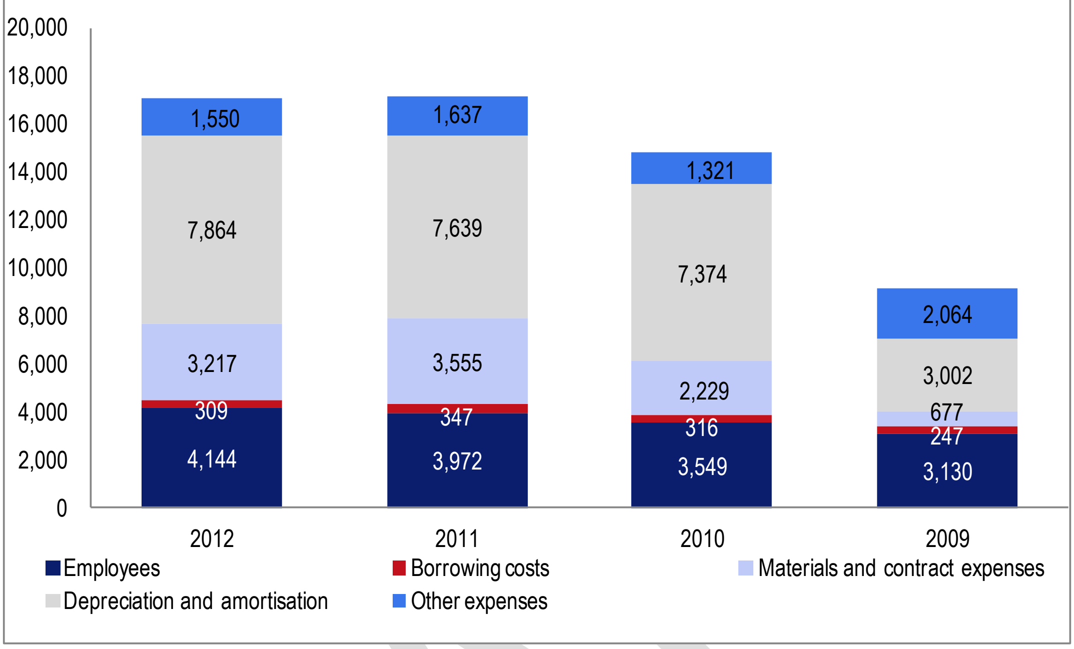


Key Observations

- Total revenue, excluding capital grants and contributions, increased by 16.9% to $15.2m over the four year period. On a compounded annual basis, this equates to a 5.3% p.a. increase.
- Rates and annual charges have increased by 13.4% ($0.6m) since 2009. Rates revenue growth of 4.2% p.a. is above the standard rate peg as a result of land revaluations and subdivisions in the LGA.
- In 2012, 22.2% ($0.3m) of user charges and fees were water charges. RMS fees were 44.8% ($0.6m in 2012) and represent the other large component of user charges and fees. These revenue streams can be volatile from year to year, depending on demand.
- The Federal Government brought forward one-half of the estimated 2013 local government Financial Assistance Grant (FAG) allocations for payment in the 2012 financial year. A similar arrangement applied in 2011 but only one quarter of the following year's grant allocations was paid in advance. As a result, Council's FAG paid in advance in 2012 was $1.7m and $0.8m in 2011.

3.2: Expenses

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



Key Observations

- Total expenses have grown by 87.3% ($8.0m) from 2009 to 2012, with increased depreciation being the major factor.
- Employee expenses have been on an upward trend over the review period increasing between 4.3% and 13.4% p.a. due to varying levels of capital works year to year which impact on the amount of employee costs capitalised. Average growth in salaries and wages was 2.8% p.a. and FTEs have grown from 62 to 69 over the review period.
- Materials and contract expenses have more than doubled since 2009 when the expenses were low due to a higher proportion of construction works which were capitalised. The significant increase since is primarily the result of increases in costs associated with RMS works and flood restoration works, however these costs are offset by fees and contributions received. Consultancy fees were higher in 2011 due to significant works associated with the AMPs.
- Depreciation and amortisation expenses increased from $3.0m to $7.4m in 2010 as a result of the Asset Revaluations process.
- Other expenses have declined by $0.5m over the review period.

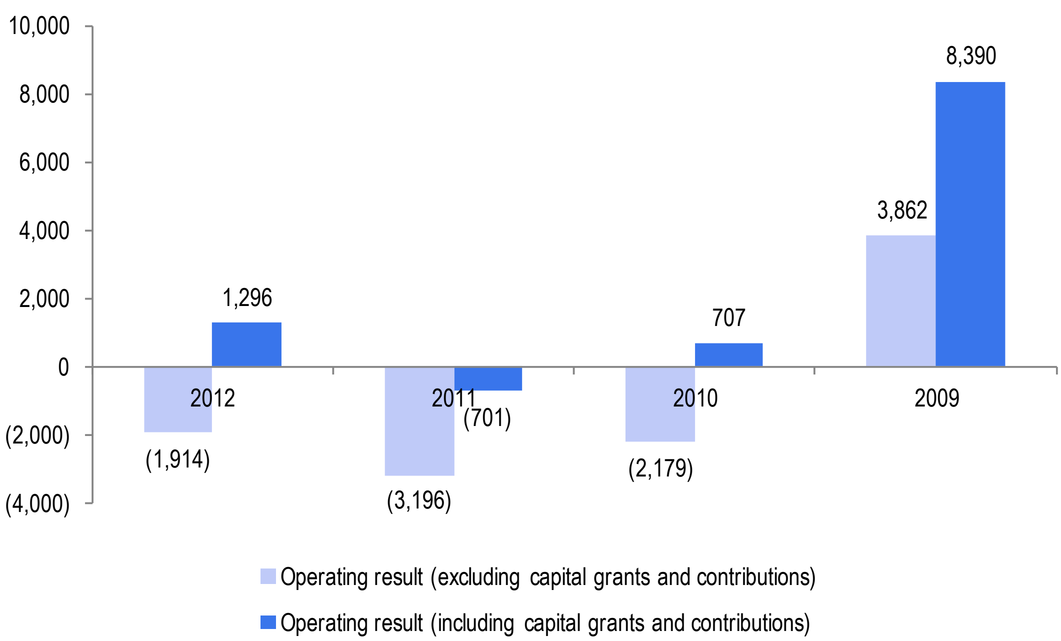
3.3: Operating Results

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 posted operating deficits in each of the last three years when excluding capital grants and contributions. The increase in depreciation from 2010 has been a major factor in the change in results. The operating result improved in 2012 mainly due to the advance payment of half the 2013 FAG.
- Council expenses include a large non-cash depreciation expense of $7.9m in 2012, which has increased substantially over the past three years following the Asset Revaluations. 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

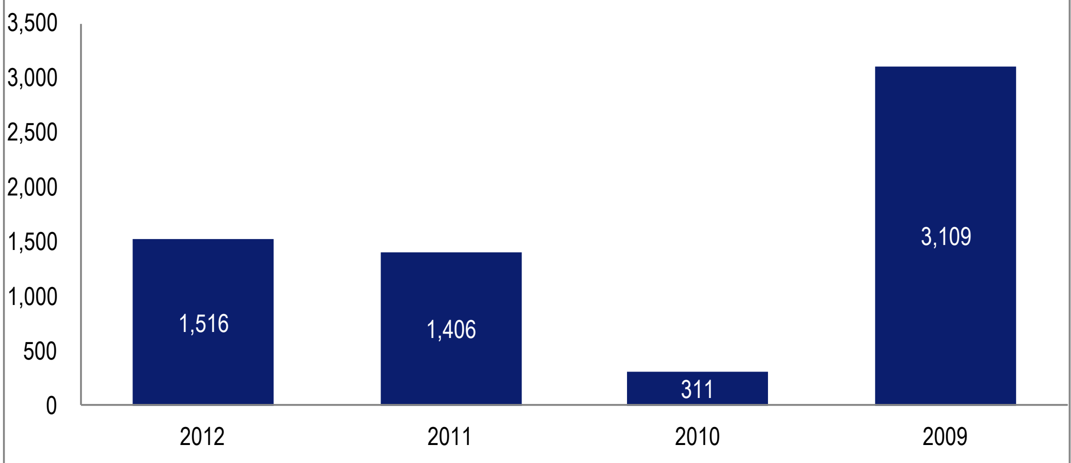
Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA ($'000s)	6,259	4,790	5,511	7,111
Operating Ratio	(12.6%)	(22.9%)	(17.3%)	29.7%
Interest Cover Ratio	20.26x	13.80x	17.44x	28.79x
Debt Service Cover Ratio	6.72x	4.45x	5.28x	7.97x
Unrestricted Current Ratio	4.41x	3.08x	3.19x	3.10x
Own Sourced Operating Revenue Ratio	37.6%	41.6%	40.9%	30.8%
Cash Expense Ratio	2.0 months	1.8 months	0.5 months	6.4 months
Net Assets ($'000s)	317,695	315,427	314,333	315,874

Key Observations

- EBITDA has fluctuated since 2009, largely as a result of varying levels of operating grants and contributions and increases in materials and contract expense.
- The Operating Ratio declined in 2010 mainly due to increase in depreciation expense and the increase in maintenance works for flood damaged assets.
- Council's Interest Cover Ratio and DSCR indicate that they had flexibility in regard to carrying more debt. Both ratios have been above their benchmarks over the review period.
- The Unrestricted Current Ratio has been well above the benchmark of 1.50x over the past four years, indicating Council has had sufficient liquidity.
- The Own Source Operating Revenue Ratio has been well below the benchmark in all four years, reflecting Council's dependence on grant revenue.
- The Cash Expense Ratio has not met the benchmark of 3.0 months since 2009 but has been improving. The low ratio in 2010 was the result of Council's investments in IPP&E and held to maturity investments.
- The underlying trend in the review period has been a marginal growth in the Net Asset base. The Infrastructure, Property, Plant and Equipment (IPP&E) asset base has increased with asset purchases being $1.0m greater than the combined value of disposed assets and annual depreciation, excluding revaluations.
- Council has total borrowings of $2.8m in 2012, being 0.9% 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 over the review period from $3.1m to $1.5m however hold-to-maturity investment securities have increased from $7.6m to $11.0m over the same period.
- The $11.0m within held to maturity investments were entirely invested in current term deposit accounts.
- The Unrestricted Current Ratio and the level of cash and investments indicated Council had sufficient liquidity.
- Within the $12.5m in total cash and investments, $4.1m was externally restricted, $7.5m was internally restricted and $0.9m was unrestricted.

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)

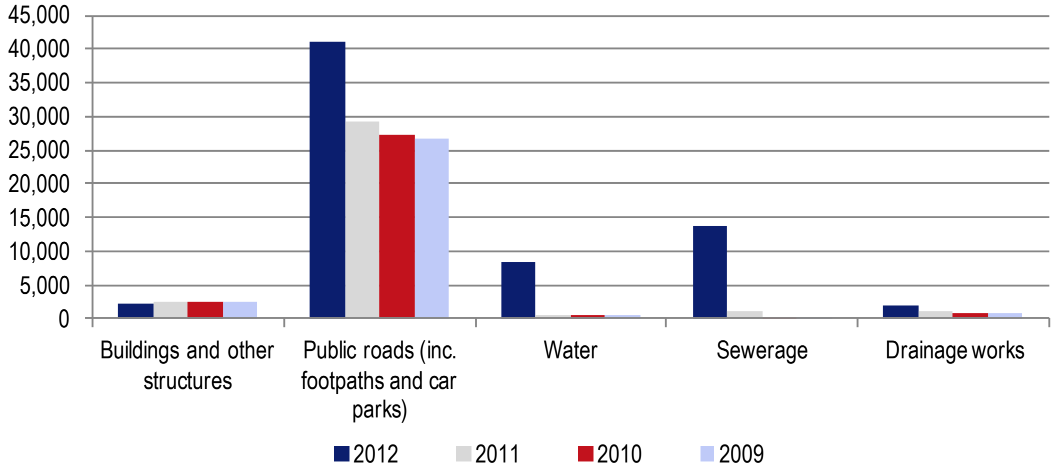
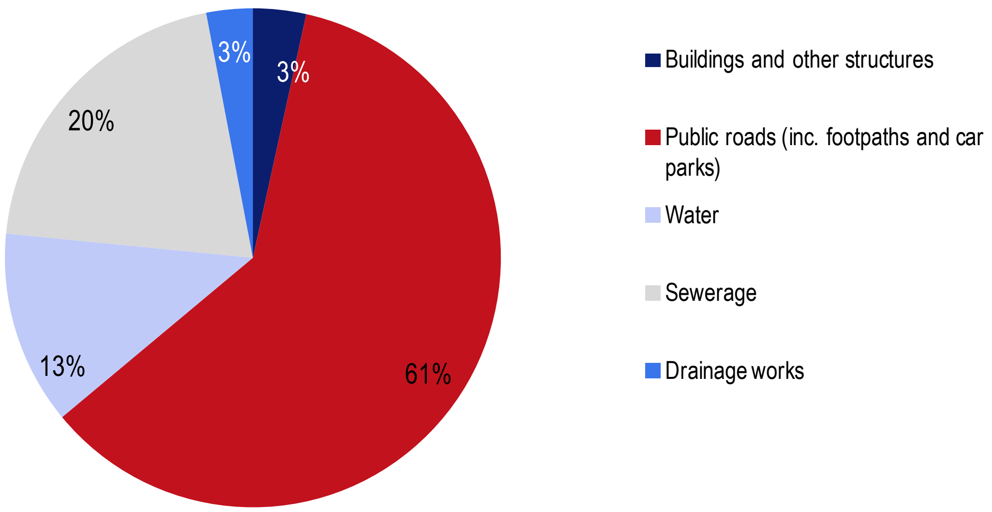


Figure 6 - Infrastructure Backlog Composition for 2011/12



Council reported a $67.9m Infrastructure Backlog in 2012, with 60.5% of the value relating to public roads. Council's Backlog has grown since 2009, and increased by $33.1m in 2012 due to the revision of the AMP, where a revision of the condition of roads resulted in sealed roads backlog increasing by $11.7m and unsealed roads backlog increasing by $3.0m. A significant increase was also seen in sewerage backlog, which increased by $23.8m.

Council has confirmed that the unsealed road backlog value of $31.8m stated within the 2012 special schedule 7 is incorrect and that the figure of $3.0m is an accurate figure for this asset class.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard ($'000s)	67,901	34,837	31,526	30,910
Required annual maintenance ($'000s)	4,377	5,466	5,448	5,344
Actual annual maintenance ($'000s)	4,072	3,248	3,622	3,095
Total value infrastructure assets ($'000s)	235,717	235,101	238,777	245,261
Total assets ($'000s)	324,168	323,534	321,807	322,591
Infrastructure Backlog Ratio	0.29x	0.15x	0.13x	0.13x
Asset Maintenance Ratio	0.93x	0.59x	0.66x	0.58x
Building and Infrastructure Asset Renewal ratio	0.52x	0.34x	0.70x	1.99x
Capital Expenditure Ratio	0.74x	0.66x	0.71x	4.54x

The total value of infrastructure assets decreased by $9.5m over the review period. This is due to a combination of low capital expenditure in 2011 and 2012, $7.8m of asset disposals in 2010 and a depreciating asset values, combined with some devaluations ($5.8m) of IPP&E in 2012.

The Asset Maintenance Ratio, the Building and Infrastructure Renewals Ratio and Capital Expenditure Ratio have been below benchmark over the majority of the review period.

The AMP was implemented in 2011 and Council reassessed the cost to bring assets to satisfactory standards. This more thorough assessment of assets resulted in the increased Backlog in 2012.Council is in the developing stages of Infrastructure Backlog reporting and is yet to finalise its methodology for the most appropriate way to assess infrastructure condition and agree service levels with the community.

The Capital Expenditure Ratio was high in 2009 due to a number of road upgrade projects which cost a total of $13.1m to Council while depreciation expense increased from 2010 which impacted the ratio with Council having to increase its capital expenditure to meet the benchmark from this year onwards. The 2010 figure has excluded a $3.45 road transfer to State Government that was classified as a disposal of an asset.

The infrastructure ratios are not meeting their respective benchmarks, indicating that Council has not been investing enough to keep their assets at their current standard.

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	1,000	1,000	2,013	10,000
Replacement/refurbishment of existing assets	5,000	5,000	7,759	5,000
Total	**6,000**	**6,000**	**9,772**	**15,000**

In 2012 Council replaced a bridge that was damaged by floods at a cost of $3.5m. Council also completed a number of main road and Shire road rehabilitation and reseals during 2012. Some Shire road improvements included but are not limited to;

- Rehabilitation and sealing of 2.5km of Noorong Road
- Restoration works associated with the rainfall and flood events in late 2010 and early 2011 continue with approximately 95km of unsealed road repair
- Resealing of 1.8km of Little Forest Road
- Final sealing of 3.8km of Speewa Road
- Resealing of 2.0km of Murray Downs Drive
- Resealing of 4.3km of Cunninyeuk Road

3.7: Specific Risks to Council

- Population. The LGA has a small and ageing population with a decreasing population size expected. Funding the increasing needs of an ageing population will require a changed focus from Council in future years. Council already promotes reaching out to elderly residents through social outings and grocery delivery.
- Freight on roads. There has been an increase in freight vehicles on the roads. Modern bigger trucks combined with wet weather can cause significant deterioration to the road network.
- Drought. The LGA suffered droughts for over 10 years leading to farming becoming more difficult to remain economically viable. This leads to social problems within the community such as depression. Council have tried to assist the community through various events and initiatives.
- Natural disasters. The LGA has been affected by flood events in recent years. As a result Council have had to prioritise repair work at the expense of other projects which are deferred in Council's delivery program. Council relies on grants and contributions from other levels of government particularly RMS, for repair works. Council has also opted to use its funds to improve assets to increase their useful life.
- Murray Darling Basin Plan. This plan proposes to return water from the irrigated farms in the Murray region to the river. Council feels that this will have a negative effect on the agriculture industry, and have a knock on effect on the community leading to Sustainability issues. Council have been lobbying against the plan through RAMROC.

Section 4 Review of Financial Forecasts

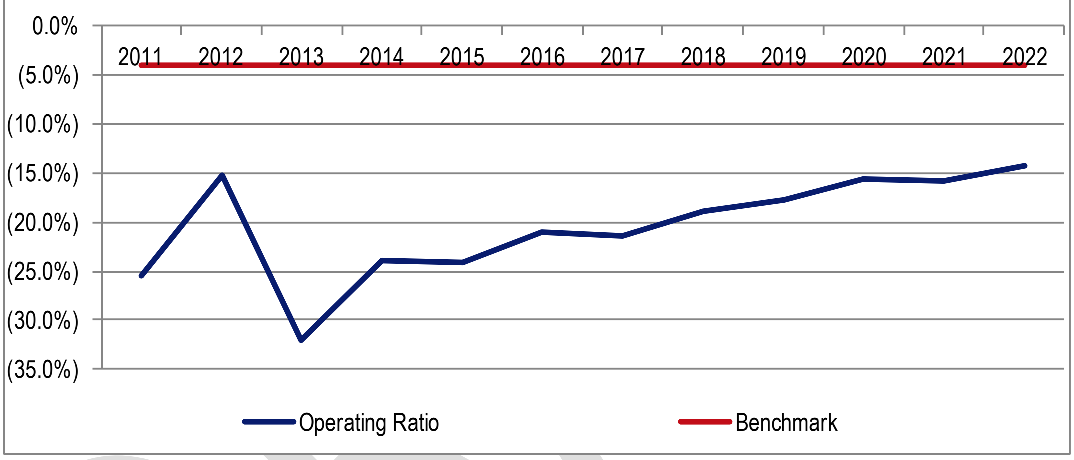
The financial forecast model shows the projected financial statements and assumptions for the next 10 years. We have focused our financial analysis upon the General Fund as although Council's consolidated position includes both a Water and Sewer Fund these are operated as independent entities, which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

Council's current LTFP does not have any supporting information to analyse the methodology of the forecast. TCorp has not received a balance sheet to analyse and has utilised the forecast income statement and statement of cashflows in order to analyse Council's projections.

At this time there has not been any scenario analysis completed and there is no detail of the underlying assumptions used to complete the LTFP.

4.1: Operating Results

Figure 7 - Operating Ratio for General Fund



Council has forecast that the Operating Ratio (excluding capital grants and contributions) will deteriorate from the 2012 historic result to a $3.7m deficit in 2013. The deficit is then forecast to marginally improve year on year to a deficit of $2.0m in 2022 however this is still below the negative 4% benchmark.

Total revenues are forecast to grow at an average rate of 2.4% p.a. from 2013 while total expenses are forecast to grow at rate of 0.7% p.a. leading to the marginal improvement.

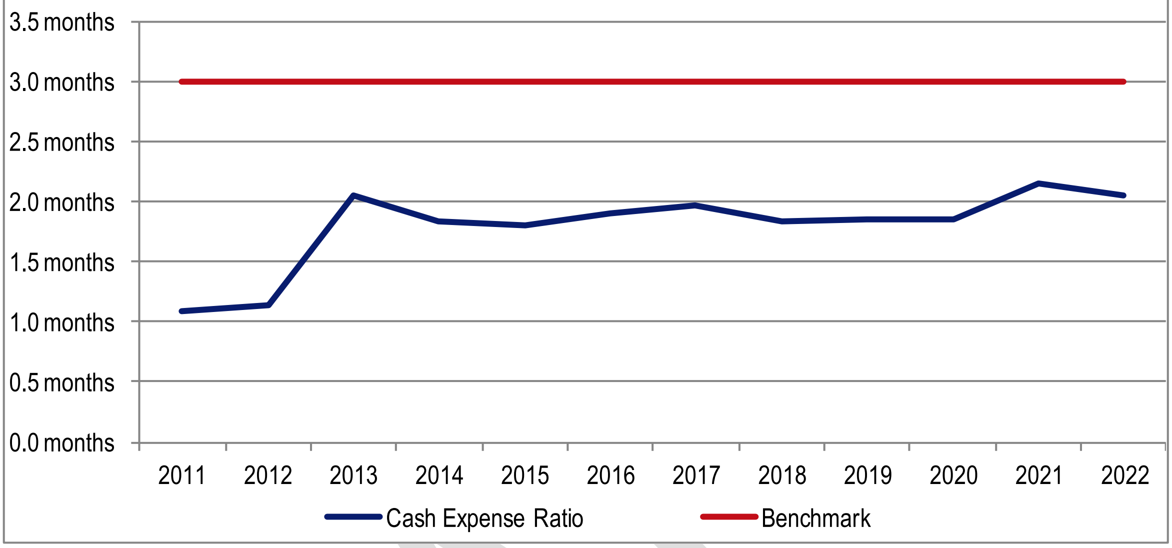
The decrease in 2013 is due to reduced forecast operating grants and contributions that reduce from $6.8m in 2012 to $5.1m in 2013. This reduction is due to the timing of the FAG with the advance payment of the first half of the 2013 FAG received in 2012.

This decrease leads to Council's total operating revenues reducing by 12.2% in 2013. Thereafter they are forecast to increase between 0.3% and 3.8% p.a.

4.2: Financial Management Indicators

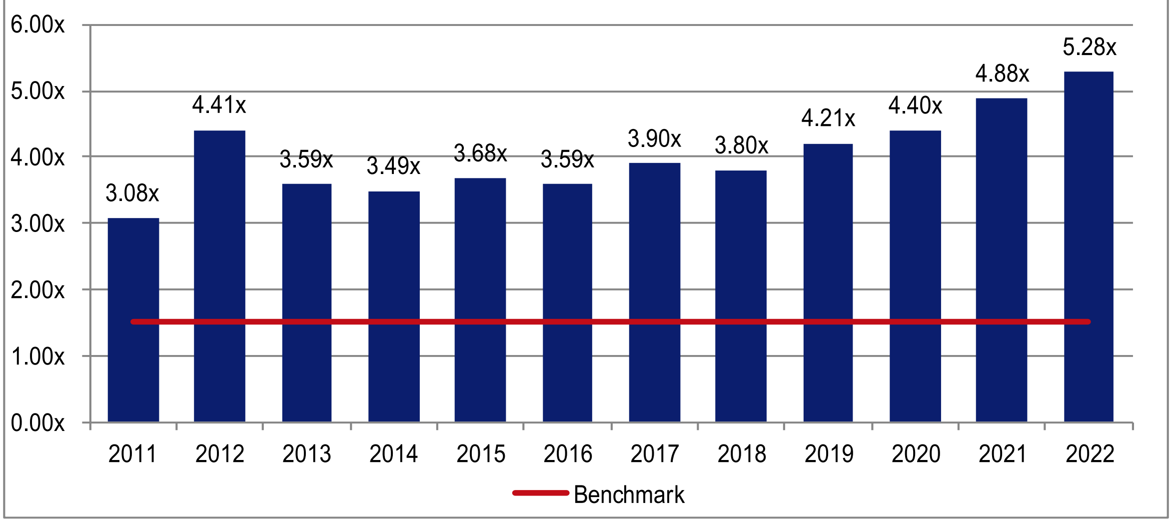
Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund



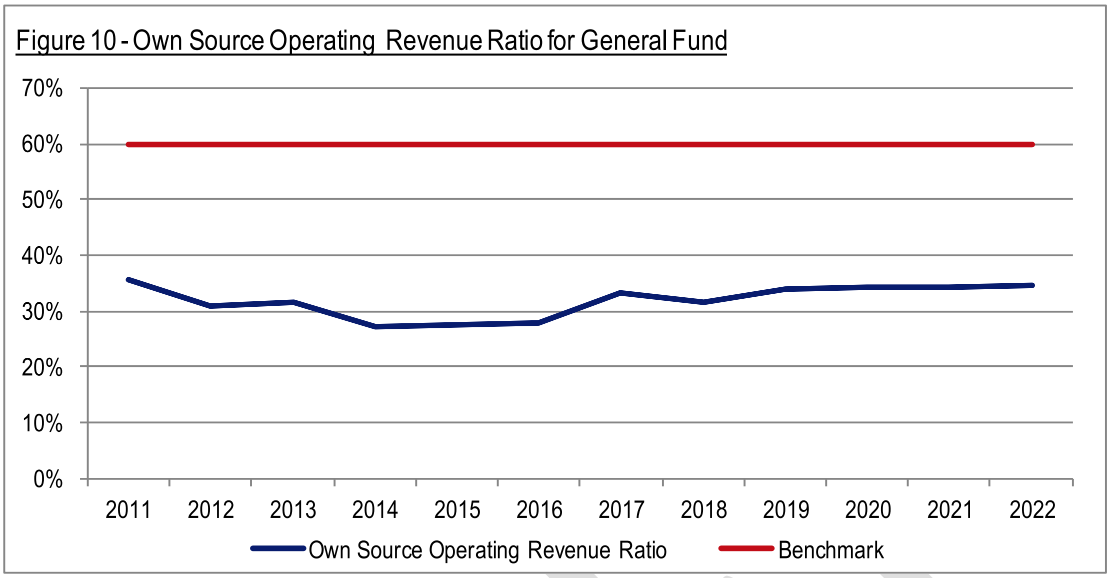
The Cash Expense Ratio graph indicates that Council expects to have cash reserves of between one and two and a half month's cash expenses during the LTFP. Council's projections include a decline in investments over the period.

Figure 9 - Unrestricted Current Ratio for General Fund

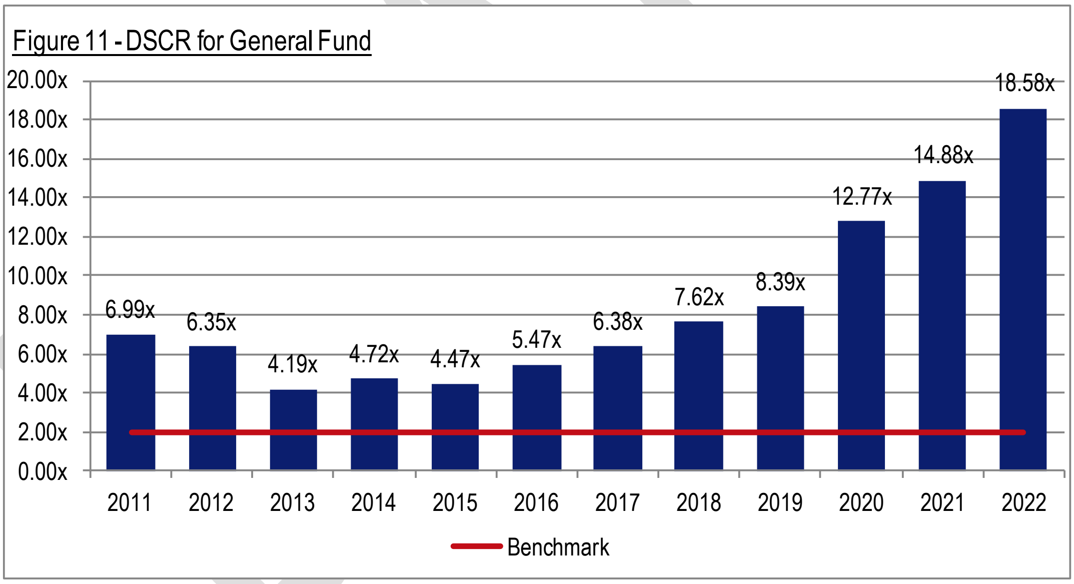


The Unrestricted Current Ratio remains above benchmark each year and gradually improves as Council expand their investments and reduce their level of borrowings.

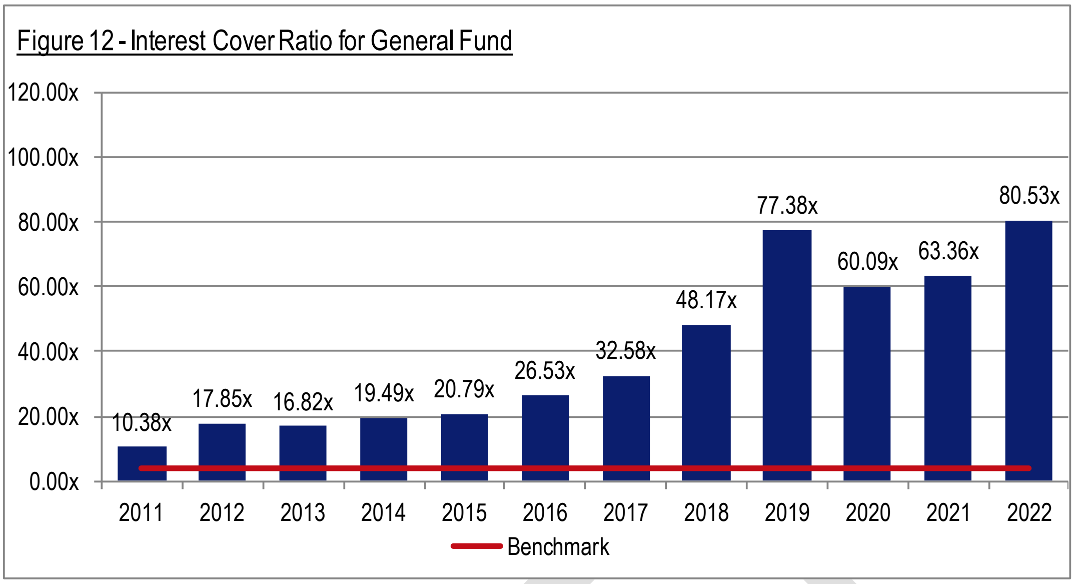
Fiscal Flexibility Ratios



The Own Source Operating Revenue Ratio is below benchmark reflecting Council's dependence on operating grants and contributions.



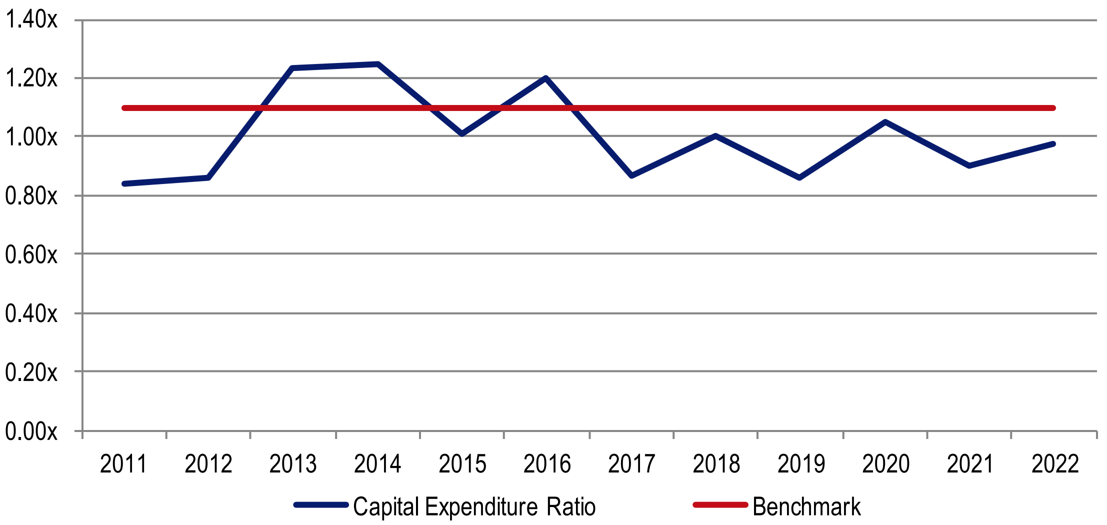
The General Fund DSCR remains above the benchmark figure of 2.00x for the full 10 years of the forecast.



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

4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund



Council forecasts a fluctuating Capital Expenditure Ratio for the General Fund. Forecast capital expenditure over the second five years of the LTFP is consistently below benchmark levels. Council does not have enough funding to provide all services at the current service levels or provide new services in the long term. Current service levels cannot be maintained in the long (10 year) term for unsealed roads and bridges. Council expects to be able to maintain current service levels for sealed roads. The current AMPs are reflected in the LTFP but further work is required to reflect community's expectations in the AMPs and LTFPs.

For a population that is likely to remain static or marginally decrease over the long term, a benchmark of 1.00x is more appropriate. The lowest forecast ratio is 0.86x in 2019, a similar level to 2012. Over the 10 year forecast Council is forecasting to spend $67.9m against the forecast depreciation expense of $65.5m therefore this would appear to be sufficient despite the AMP stating otherwise.

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%

Key Observations and Risks

- Total revenues are forecast to grow at an average rate of 2.4% p.a. from 2013 while total expenses are forecast to grow at rate of 0.7% p.a.
- Rates and annual charges are forecast to grow at an average rate of 3.0% p.a. in line with projected rate pegging and population decline forecasts.
- User charges and fees are forecast to fluctuate, with year to year variances according to expected RMS works. Materials and contracts costs also fluctuate according to expected RMS works.
- Operating grants and contributions are forecast to return to normal levels following the effects of the FAG in 2012 and 2013.
- Employee costs are forecast to grow at an average rate of 4.2% p.a.
- Depreciation is forecast to be static at $6.6m p.a. for the LTFP.
- Council have stated in their AMP that current service levels for the General Fund cannot be maintained in the long (10 year) term for unsealed roads and bridges. Council has proposed diminished service levels, restricted to areas where the impact will be less severe (such as load limits on certain bridges and unsealed roads)
- Despite this, the cumulative capital expenditure is $67.9m against the cumulative depreciation of $65.5m, suggesting that Council is projecting to maintain their asset base on a cumulative value basis.
- While TCorp has not received any information in relation to the underlying assumptions, the annual percentage changes appear to be reasonably realistic.

4.5: Borrowing Capacity

With consecutive operating deficits projected over the LTFP we would not recommend any additional borrowings in addition to the $2.6m scheduled within the forecast. The uncertainties surrounding future service levels and the establishment of agreed standards for assets with the community also preclude us recommending further borrowings until Council completes its community consultation work in respect of service levels and fully integrates its AMP requirements into its LTFP.

Once this work is completed by Council, further borrowing capacity may exist.

4.6: Sustainability

Financial

Based on the current LTFP, TCorp believes Council is in a weak financial position. Council forecasts operating deficits in all 10 years of the LTFP when capital grants are excluded, with the limited size of the rate base making it difficult for Council to address the future operating deficits, manage unforseen financial shocks or any adverse changes in its business and to fund the Infrastructure Backlog. In addition, Council has a very high reliance on the receipt of operating grants and contributions. Any material change in these grants could undermine Council's financial situation.

Council has stated that they classify some grant and contribution funding differently to other councils and this classifies some funding as capital rather than operating and this negatively impacts the operating performance of Council. Council plans to review the classifications to make sure that they are more in line with the majority of other councils.

Infrastructure

In respect to transport infrastructure, Council does not have enough funding to provide all services at the desired service levels or provide new services in the long term. Current service levels cannot be maintained in the long (10 year) term for unsealed roads and bridges, with service reductions required to restrict load limits and bridge closures. Council's AMP has identified suitable roads and bridges where these reductions will not have a substantial impact on the users of the infrastructure assets. Council expects to be able to maintain current service levels for sealed roads.

In respect to buildings and waste management services Council has enough funding to provide all services at the desired service levels in the long term under the current funding scenario.

Council has recently carried out a valuation of their water assets and a detailed condition audit of underground assets has also been carried out. The cost of asset replacement requirements is now more accurate.

The Infrastructure Backlog Ratio grew significantly in 2012 as a result of the revision of Council's asset conditions by its engineering department. Overall, Council appears to be in the developing stages of Asset Management and are yet to finalise the most appropriate way to fully assess infrastructure condition.

Council has confirmed that their engineering department is currently completing a revaluation of their roads, bridges and footpaths following the last revaluation in 2009. A review of the 2009 figures indicates that Council believe some asset classes were overvalued, specifically the unsealed road network. It is believed that a reduction in the valuation will possibly decrease the annual depreciation expense and reduce the Infrastructure Backlog total for this asset class.

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

- Council population has declined over the past decade. If this trend continues, it is unlikely that Council will manage to decrease its reliance on operating grants and contributions
- In recent years, Council did not spend sufficient amounts on asset renewals. Based on the current version of the LTFP, Council will be able to spend sufficient capital expenditure to maintain their asset base however the AMPs suggest that there is a marginal shortfall in each year of the LTFP that will eventually impact service levels in the medium to long term
- Council has maintained a moderate level of borrowings over time. In the long term, the forecast of consistent operating deficits may prevent Council from adding further borrowings
- Council do not appear to have reached a developed stage of the IP&R documentation, as demonstrated by the variability in Infrastructure Backlog reporting

As presented, Council's forecast position is declining with corrective action required to be taken in the short to medium term. As Council's funds are limited, service levels need to be reviewed and agreed with the community. This then needs to be incorporated into Council's LTFP. Once this occurs, a clearer picture of the long term Sustainability of Council will be available for consideration.

Section 5 Benchmarking and Comparisons with Other Councils

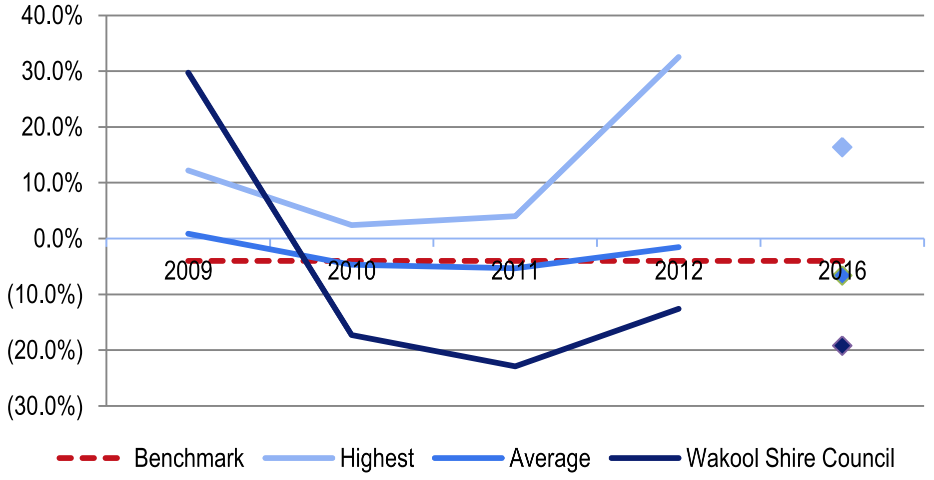
Each council's performance has been assessed against ten key benchmark ratios. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 9. There are 21 councils in this group and at the time of preparing this report, we have data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

In Figure 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.

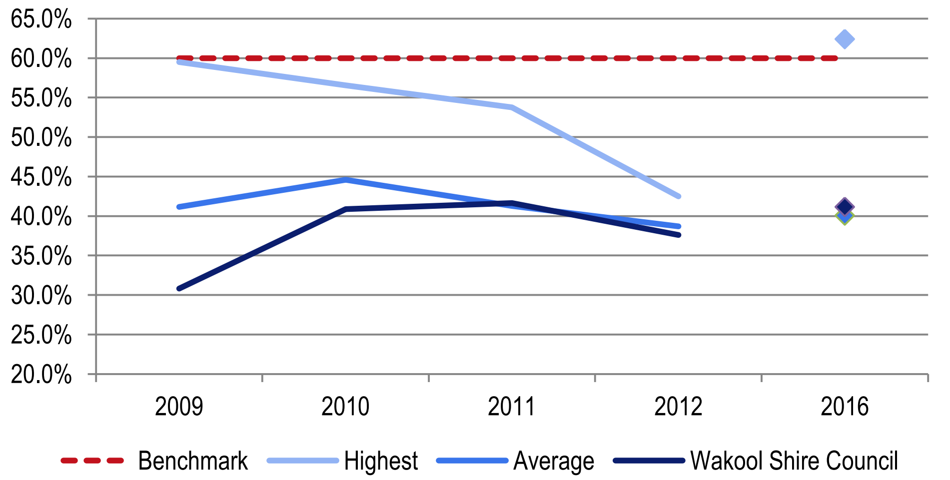
Financial Flexibility

Figure 14 - Operating Ratio Comparison



Council's Operating Ratio has been below the group average and benchmark since 2010 and this trend is projected to remain in 2016.

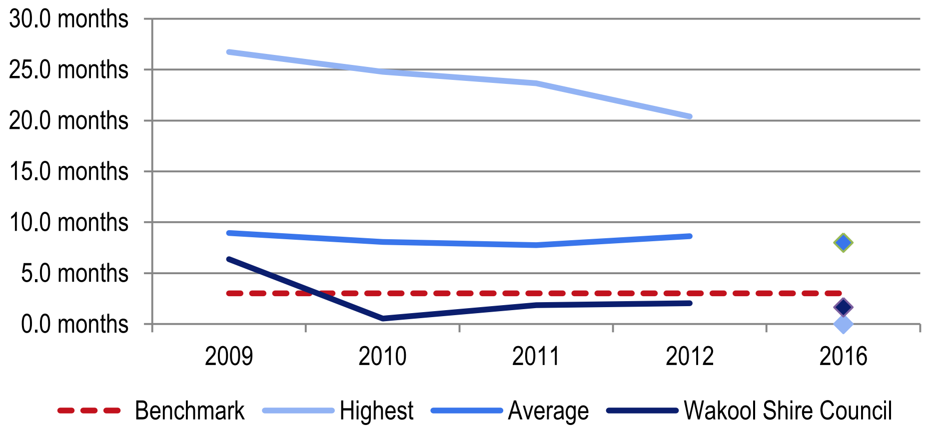
Figure 15 - Own Source Operating Revenue Ratio Comparison



Similar to the group average, Council is below the benchmark for the Own Source Operating Revenue Ratio and is forecast to remain in that position. With the highest performer also below the benchmark it highlights the reliance on councils within this group on external sources of funding such as grants and contributions.

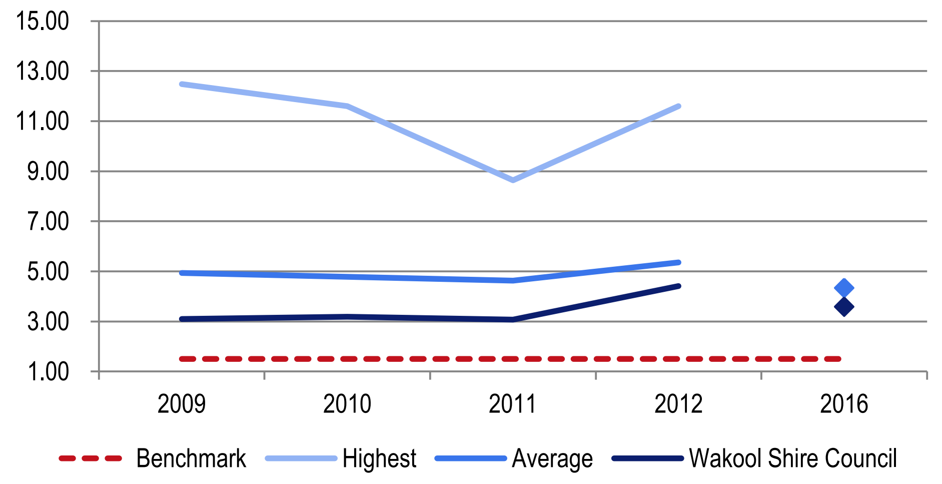
Liquidity

Figure 16 - Cash Expense Ratio Comparison



Council is below the group average and benchmark since 2010 and is forecast to remain in this position. Council has nearly 90% of funds allocated in term deposits to maximise returns and as these are classified as investments, they are not included within this ratio.

Figure 17 - Unrestricted Current Ratio Comparison



While Council's Unrestricted Current Ratio is below the group average, it is above the benchmark indicating an adequate level of liquidity that is forecast to remain.

Debt Servicing

Figure 18 - Debt Service Cover Ratio Comparison

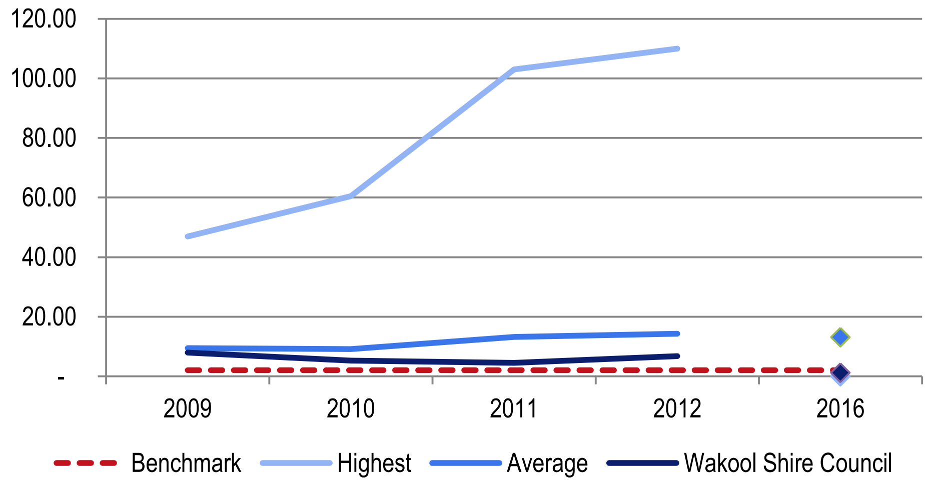
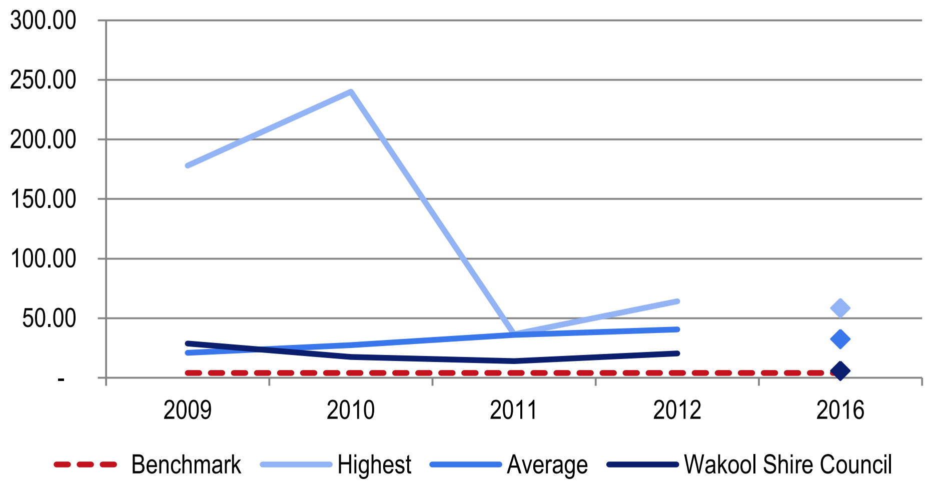


Figure 19 - Interest Cover Ratio Comparison



Council's DSCR and Interest Cover Ratio have been below the group average but above the benchmark in each review year. This indicates that proportionally Council had less capacity than its peers to utilise further borrowings and this is forecast to remain the position in 2016.

Asset Renewal and Capital Works

Figure 20 - Capital Expenditure Ratio Comparison

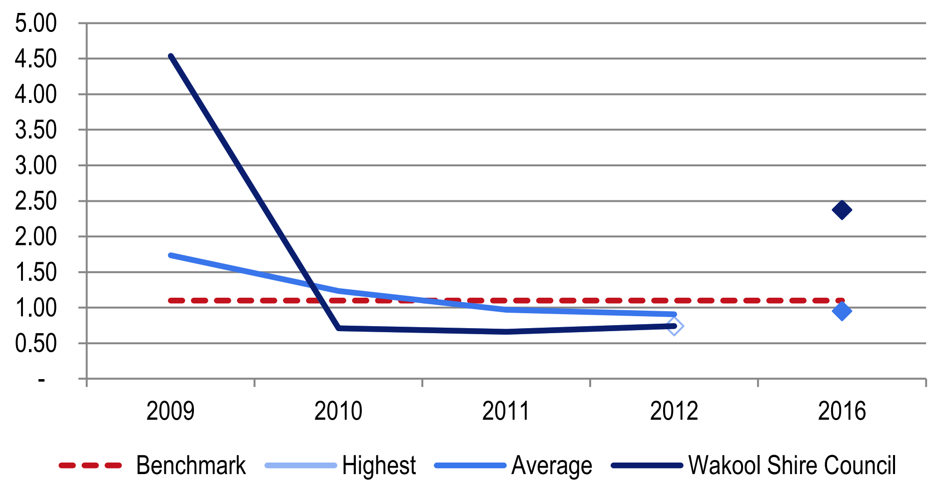


Figure 21 - Asset Maintenance Ratio Comparison

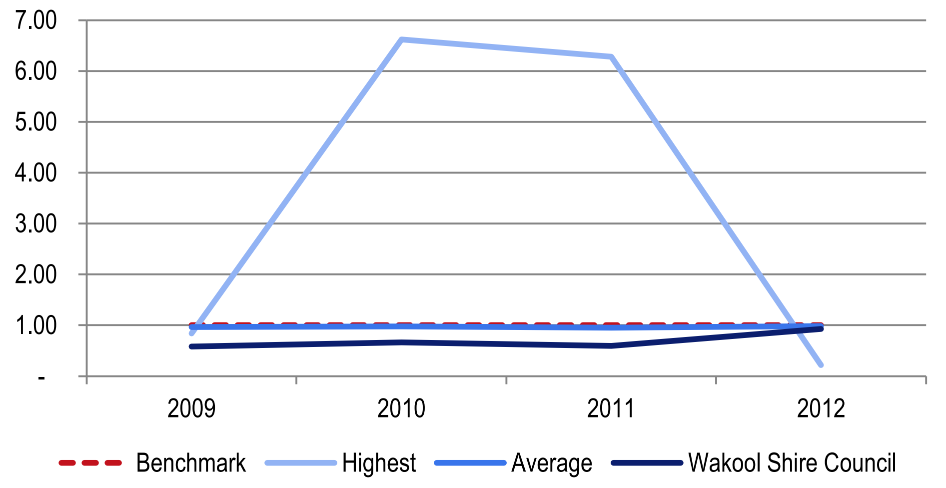


Figure 22 - Infrastructure Backlog Ratio Comparison

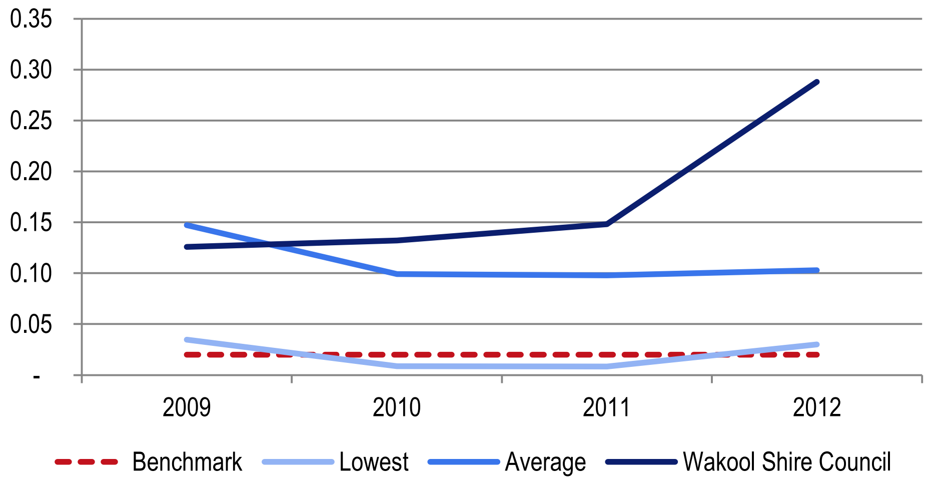
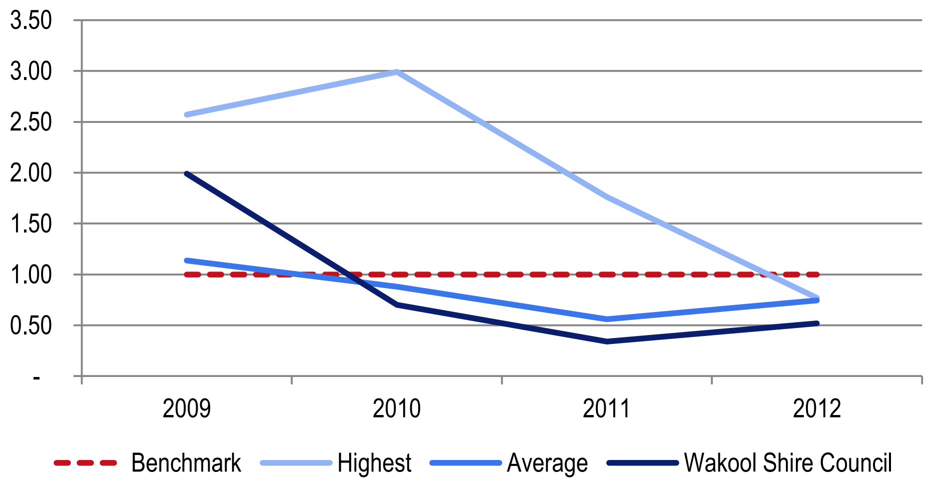


Figure 23 - Building and Infrastructure Asset Renewal Ratio



Despite being below the group average and benchmark for the Capital Expenditure Ratio since 2010, Council's average, due to the strong 2009 ratio and Council's strong projected ratio, Council is classified as the highest performer.

Council's Asset Maintenance Ratio has remained below the group average and benchmark but improved closer to both indicators in 2012.

Council's Infrastructure Backlog has been higher than the group average since 2010 and above the benchmark with the increase in 2012 taking it further away from both indicators.

Similar to the group average Council's asset renewals have decreased over the period albeit at a great rate so that they have been below the benchmark and average since 2010.

Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's LTFP we consider Council to be in a weak financial position. The current version of the AMPs detail that Council cannot maintain current service levels although the LTFP details that Council will be able to spend sufficient capital expenditure over the 10 year period in the General Fund to maintain the asset base on a consolidated value basis.

The LTFP details that Council will incur funding deficits in each year indicating Council may become unsustainable over the long term. Therefore further community consultation is needed to determine an agreed service level, and the AMPs and LTFP will need to be integrated to reflect this.

We base our recommendation on the following key points:

- Council's operating results have not met benchmark for the past three years.
- In recent years, Council did not spend sufficient amounts on asset renewals and asset additions.
- Council is highly dependent on external revenue sources such as State and Federal grants. Any material adverse change to the levels of grants receivable would severely weaken Council finances.
- Based on the current version of the LTFP, it appears that consecutive operating deficits will be experienced which will result in Council becoming unsustainable in the long term

We recognise that this is Council's first attempt at the IP&R documentation and that this will improve with each version that is completed. We recommend that future versions of the AMPs and LTFP are fully integrated and that the LTFP has scenario analysis completed with supporting documentation explaining Council's approach to completing the 10 year forecast figures.

Future versions may detail a more Sustainable future once Council is able to agree the suitable service levels 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	5,495	5,272	5,049	4,848	4.2%	4.4%	4.1%
User charges and fees	1,415	1,579	1,285	550	(10.4%)	22.9%	133.6%
Interest and investment revenue	750	722	556	756	3.9%	29.9%	(26.5%)
Grants and contributions for operating purposes	6,839	5,995	5,327	6,469	14.1%	12.5%	(17.7%)
Other revenues	671	386	393	359	73.8%	(1.8%)	9.5%
Total revenue	**15,170**	**13,954**	**12,610**	**12,982**	**8.7%**	**10.7%**	**(2.9%)**
Expenses							
Employees	4,144	3,972	3,549	3,130	4.3%	11.9%	13.4%
Borrowing costs	309	347	316	247	(11.0%)	9.8%	27.9%
Materials and contract expenses	3,217	3,555	2,229	677	(9.5%)	59.5%	229.2%
Depreciation and amortisation	7,864	7,639	7,374	3,002	2.9%	3.6%	145.6%
Other expenses	1,550	1,637	1,321	2,064	(5.3%)	23.9%	(36.0%)
Total expenses	**17,084**	**17,150**	**14,789**	**9,120**	**(0.4%)**	**16.0%**	**62.2%**
Operating result (excluding capital grants and contributions)	**(1,914)**	**(3,196)**	**(2,179)**	**3,862**	40.1%	(46.7%)	(156.4%)
Operating result (including capital grants and contributions)	**1,296**	**(701)**	**707**	**8,390**	284.9%	(199.2%)	(91.6%)

Table 2 - Items excluded from Income Statement

Excluded items	2012	2011	2010	2009
Grants and contributions for capital purposes	3,210	2,495	2,886	4,528
Net gain/(loss) from the disposal of assets	226	(382)	(7,562)	11

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	1,516	1,406	311	3,109	7.8%	352.1%	(90.0%)
Investments	11,023	9,399	10,013	7,626	17.3%	(6.1%)	31.3%
Receivables	2,837	3,287	1,630	1,642	(13.7%)	101.7%	(0.7%)
Inventories	94	126	121	223	(25.4%)	4.1%	(45.7%)
Other	12	6	10	11	100.0%	(40.0%)	(9.1%)
Non-current assets held for sale	0	403	68	68	(100.0%)	492.6%	0.0%
Total current assets	15,482	14,627	12,153	12,679	5.8%	20.4%	(4.1%)
Non-current assets							
Investments	2	2	2	2	0.0%	0.0%	0.0%
Receivables	449	95	85	166	372.6%	11.8%	(48.8%)
Inventories	241	204	170	89	18.1%	20.0%	91.0%
Infrastructure, property, plant & equipment	307,994	308,606	309,397	309,655	(0.2%)	(0.3%)	(0.1%)
Total non-current assets	308,686	308,907	309,654	309,912	(0.1%)	(0.2%)	(0.1%)
Total assets	**324,168**	**323,534**	**321,807**	**322,591**	**0.2%**	**0.5%**	**(0.2%)**
Current liabilities							
Payables	1,390	2,487	1,570	1,552	(44.1%)	58.4%	1.2%
Borrowings	597	618	699	672	(3.4%)	(11.6%)	4.0%
Provisions	1,322	1,390	1,295	1,442	(4.9%)	7.3%	(10.2%)
Total current liabilities	3,309	4,495	3,564	3,666	(26.4%)	26.1%	(2.8%)
Non-current liabilities							
Borrowings	2,230	2,819	3,127	2,382	(20.9%)	(9.8%)	31.3%
Provisions	934	793	783	669	17.8%	1.3%	17.0%
Total non-current liabilities	3,164	3,612	3,910	3,051	(12.4%)	(7.6%)	28.2%
Total liabilities	**6,473**	**8,107**	**7,474**	**6,717**	**(20.2%)**	**8.5%**	**11.3%**
Net assets	**317,695**	**315,427**	**314,333**	**315,874**	**0.7%**	**0.3%**	**(0.5%)**

Table 4-Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
Cash flows from operating activities	8,463	6,289	7,453	10,793
Cash flows from investing activities	(7,743)	(4,805)	(11,023)	(14,178)
Proceeds from borrowings and advances	0	340	1,500	500
Repayment of borrowings and advances	(622)	(729)	(728)	(645)
Cash flows from financing activities	(622)	(389)	772	(145)
Net increase/(decrease) in cash and equivalents	**98**	**1,095**	**(2,798)**	**(3,530)**
Cash and equivalents	1,516	1,406	311	3,109

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Sustainability

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

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

Building and Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

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

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

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

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

Operating Ratio

Benchmark = Better than negative 4%

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

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

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

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

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

<u>Unrestricted Current Ratio</u>

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.

Appendix 1 Ratings and Definitions

Table A1 - Financial Sustainability Ratings

Rating	Definition
Very Strong	• A local government with a very strong capacity to meet its financial commitments in the short, medium and long term. • It has a record of reporting operating surpluses. • It is highly likely to be able to manage unforseen financial shocks and any adverse changes in its business without revenue and/or expense adjustments. • Its capacity to manage core business risks is very strong.
Strong	• A local government with a strong capacity to meet its financial commitments in the short, medium and long term. • It generally has a record of operating surpluses and may occasionally report minor operating deficits. It is able to address its operating deficits, manage major unforseen financial shocks and any adverse changes in its business with minor revenue and/or expense adjustments. • The expense adjustments are likely to result in only minor changes to the range of and/or quality of services offered. • Its capacity to manage core business risks is strong.
Sound	• A local government with an adequate capacity to meet its financial commitments in the short, medium and long term. • While it is likely that it may have a record of minor to moderate operating deficits, the local government is expected to regularly report operating surpluses. It is likely able to address its operating deficits, manage major unforseen financial shocks and any adverse changes in its business with minor or moderate revenue and/or expense adjustments. • The expense adjustments are likely to result in some changes to the range of and/or quality of services offered. • Its capacity to manage core business risks is sound.

Moderate	• A local government with an adequate capacity to meet its financial commitments in the short to medium term and an acceptable capacity in the long term. • While it has some record of reporting minor to moderate operating deficits the local government may also have recently reported a significant operating deficit. • It is likely able to address its operating deficits, manage unforseen financial shocks and any adverse changes in its business, with moderate revenue and/or expense adjustments. The expense adjustments are likely to result in a number of changes to the range of and/or quality of services offered. • Its capacity to manage core business risks is moderate.
Weak	• A local government with an acceptable capacity to meet its financial commitments in the short to medium term and a limited capacity in the long term. • It has a record of reporting moderate to significant operating deficits with a recent operating deficit being significant. It is unlikely to be able to address its operating deficits, manage unforseen financial shocks and any adverse changes in its business, without the need for significant revenue and/or expense adjustments. • The expense adjustments would result in significant changes to the range of and/or quality of services offered. • It may experience difficulty in managing core business risks.
Very Weak	• A local government with a limited capacity to meet its financial commitments in the short to medium term and a very limited capacity long term. • It has a record of reporting significant operating deficits. It is highly unlikely to be able to address its operating deficits, manage unforseen financial shocks and any adverse changes in its business without the need for structural reform and major revenue and/or expense adjustments. • The expense adjustments are likely to result in significant changes to the range of and/or quality of services offered and it may need the assistance from higher levels of government. • It has difficulty in managing its core business risks.
Distressed	• A local government with a very limited capacity to meet its short term financial commitments and no capacity to meet its medium to long term financial commitments. • It has a record of reporting significant operating deficits. • To be able to address its operating deficits, meet its medium and long term obligations, manage unforseen financial shocks and any adverse changes in its business, major revenue and expense adjustments and structural reform will be required. • The local government is unlikely to have the capacity to manage core business risks and may need assistance from higher levels of government.

Table A2 – Outlook

Outlook	Definition
Positive	As a result of a foreseeable event or circumstance occurring, there is the potential for enhancement in the local government's capacity to meet its financial commitments (short and/or long term) and resulting change in its rating. However, it does not necessarily indicate that a rating change may be forthcoming.
Neutral	There are no known foreseeable events that would have a direct impact on the financial sustainability of the local government. It may be possible for a rating upgrade or downgrade to occur from a neutral outlook, if warranted by an event or circumstance.
Negative	As a result of a foreseeable event or circumstance occurring, there is the potential for deterioration in the local government's capacity to meet its financial commitments (short and/or long term) and resulting change in its rating. However, it does not necessarily indicate that a rating change may be forthcoming.