Attachment 4: TCorp report on financial sustainability

New South Wales Treasury Corporation

Wollondilly Shire Council

Financial Assessment and Benchmarking Report

7 March 2013

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

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Disclaimer

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

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

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

The report has been prepared for Wollondilly Shire Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Wollondilly 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 Wollondilly Shire 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 under LIRS with the first being for the Bridges/Culverts replacement program for $1.75m and the second being for the Kerb and Gutter program for $1.14m with borrowings of $1.0m.

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

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

- While the Council has incurred operating deficits (excluding grants and contributions for capital purposes), Council's underlying cash result (measured using EBITDA) has improved to $7.5m in 2011
- Approximately 64% of the Council's revenue base is derived from own sourced revenue (rates and annual charges, and user charges and fees). They can rely upon these revenue streams on an ongoing basis for financial flexibility
- The Council was granted an SRV of 6% increase over each of three years, starting from 2012. These funds will be used to fund infrastructure maintenance
- Operating expenses are generally well managed. It is noted that depreciation and amortisation increased rapidly due to changes in accounting policies

Council's reported infrastructure backlog of $51.3m in 2011 represents 19.3% of its infrastructure asset value of $266.4m. Other observations include:

- The infrastructure backlog has been increasing over the period by an average of 10.8%p.a. when the total value of infrastructure assets has increased 62.6% since 2009
- Council has spent less than required on maintenance in the last three years
- Council is forecasting to spend more on capital expenditure than required in the first year of its financial forecast and then substantially less than required over the remaining years of the forecast

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

- The forecast shows operating deficits that improve over the forecast period though they remain well below benchmark when capital grants and contributions are excluded
- The 10 year financial forecasts include a capital expenditure program that reduces over time and appears to be lower than what may be required to maintain a sound asset base. The impact of this lower level of capital investment is that other areas such as cash and investment balances continue to improve over time as investments are not used to fund new assets or the renewal of existing assets
- Overall it appears that the Council will have sufficient liquidity throughout the next 10 year period to service all short term liabilities and currently scheduled capital expenditure and related long term liabilities
- Council's level of fiscal flexibility is sound as own source revenue is maintained at levels around 67% for most of the forecast period
- With the exception of our comments regarding the future capital program, other key assumptions within the financial forecasts are considered to be reasonable

In our view, the Council has the capacity to undertake the combined additional borrowings of $2.75m for the LIRS project. This is based on the following analysis:

- The DSCR remains well above a benchmark of 2.0x in the 10 year forecast
- The Interest Cover Ratio is well above the benchmark of 4.0x in the 10 year forecast
- Council's liquidity is adequate

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG group 6 and at the request of Council with a number of other similar councils. Council made this request as they consider that these other councils were also directly comparable with them. The key observations are:

- Council's financial flexibility as indicated by the Operating Ratio is below the group average
- Council's Own Source Operating Revenue Ratio is above average
- Council's DSCR and Interest Cover Ratio are above the benchmarks but below the group averages. In the medium term Council's forecast ratios are expected to remain above the benchmarks
- Council was in an acceptable liquidity position which is expected to continue in the medium term
- Council's performance in terms of its Infrastructure Backlog Ratio is weaker than the group average and benchmark. Council's Asset Maintenance Ratio improved to be above the group average though it remains below the benchmark. Council's Building and Infrastructure Asset Renewal Ratio was around or above the group average and below benchmark. Council's Capital Expenditure Ratio was below the group average and close to the benchmarks

Section 2 Introduction

2.1: Purpose of Report

This report provides the Council with an independent assessment of their financial capacity and performance measured against a peer group of councils which will complement their internal due diligence, and the IP&R system of the Council and the DLG.

The report is to be provided to the LIRS Assessment Panel for its use in considering applications received under the LIRS.

The key areas focused on are:

- The financial capacity of the Council to undertake additional borrowings
- The financial performance of the Council in comparison to a range of similar councils and measured against prudent benchmarks

2.2: Scope and Methodology

TCorp's approach was to:

- Review the most recent 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
- Conduct a benchmark review of a Council's performance against its peer group
- Prepare a report that provides an overview of the Council's existing and forecast financial position and its capacity to meet increased debt commitments
- Conduct a high level review of the Council's IP&R documents for factors which could impact the Council's financial capacity and performance

In undertaking its work, TCorp relied on:

- Council's audited financial statements (2008/09 to 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 and forecasts we have measured performance against a set of benchmarks. These benchmarks are listed below. Benchmarks do not necessarily represent a pass or fail in respect of any particular area. One-off projects or events can impact a council's performance against a benchmark for a short period. Other factors such as the trends in results against the benchmarks are critical as well as the overall performance against all the benchmarks. As councils can have significant differences in their size and population densities, it is important to note that one benchmark does not fit all.

For example, the Cash Expense Ratio should be greater for smaller councils than larger councils as a protection against variation in performance and financial shocks.

Therefore these benchmarks are intended as a guide to performance.

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

Ratio	Benchmark
Operating Ratio	> (4.0%)
Cash Expense Ratio	> 3.0 months
Unrestricted Current Ratio	> 1.5x
Own Source Operating Revenue Ratio	> 60.0%
Debt Service Cover Ratio (DSCR)	> 2.0x
Interest Cover Ratio	> 4.0x
Infrastructure Backlog Ratio	< 0.02x
Asset Maintenance Ratio	> 1.0x
Building and Infrastructure Asset Renewal Ratio	> 1.0x
Capital Expenditure Ratio	> 1.1x

2.3: Overview of the Local Government Area

Wollondilly Shire Council LGA	
Locality & Size	
Locality	Sydney Surrounds
Area	2556.6km^2
DLG Group	6
Demographics	
Population	44,790
% under 18	30%
% between 18 and 59	55%
% over 60	15%
Expected population 2025	53,000
Operations	
Number of employees (FTE)	201
Annual revenue	$43.1m
Infrastructure	
Roads	800km
Bridges	78
Infrastructure backlog value	$51.3m
Total infrastructure value	$266.4m

Wollondilly Shire Council Local Government Area (LGA) is located 75km south west of Sydney CBD. The Shire has 16 small towns and villages including Tahmoor, Picton, Silverdale, Warragamba, Appin, Menangle, The Oaks and Bargo.

Wollondilly has a population that is dispersed across a large area of separate towns and villages linked by more than 800km of roads. Historically, public transport has been limited, making residents heavily reliant on road transport and private vehicle use.

Unemployment in the area is low but local employment opportunities are limited and 60% to 70% of workers travel to employment outside Wollondilly, generally to adjoining LGAs.

Wollondilly is rich in natural resources. The Shire is custodian of Sydney's water supply, vast stretches of bushland and productive agricultural lands. The landscape varies between river gorges, vast paddocks, thick bushland, villages and mountain ranges.

2.4: LIRS Application

Council has made two LIRS applications.

Project: Bridges/Culverts Replacement Program

Description: This program includes the replacement of three timber bridges and the insitu concrete relining of two steel culverts.

Project Cost: $1.75m

Amount of loan facility: $1.75m

Term of loan facility: four years

Project: Kerb and Gutter Program

Description: This project involves accelerating the existing kerb and gutter program with an injection of an additional $1m in loan funds to undertake a substantially expanded program of works in 2013.

Project Cost: $1.14m

Amount of loan facility: $1.0m

Term of loan facility: seven years

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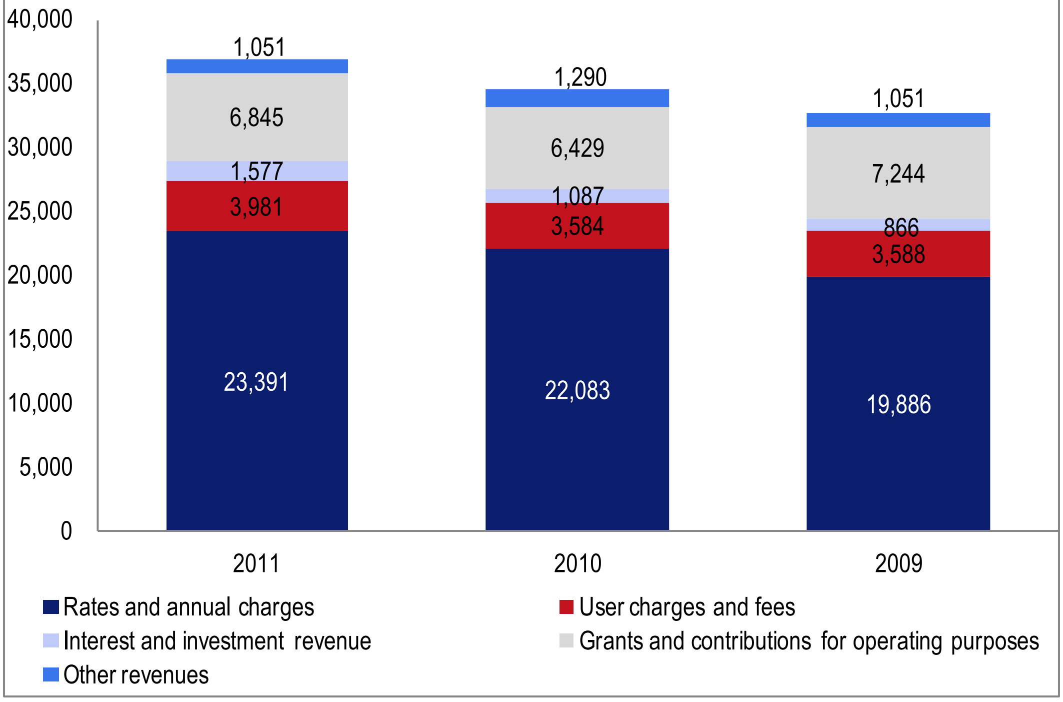
Section 3 Review of Financial Performance and Position

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

3.1: Revenue

Figure 1 - Revenue Sources for 2008/09 to 2010/11 ($'000s)



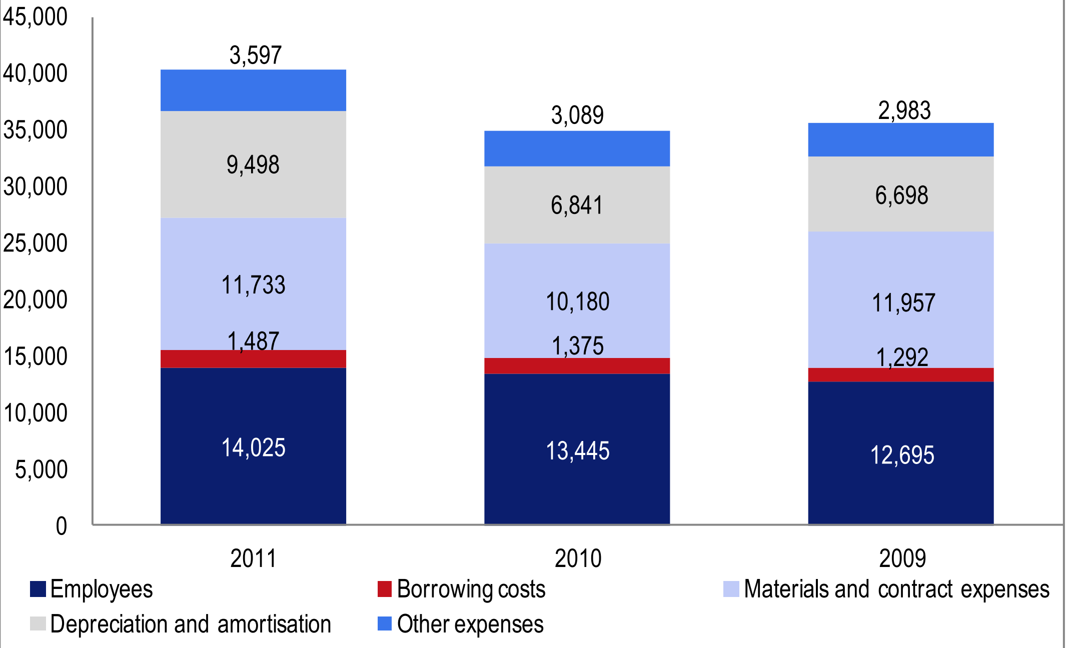
Key Observations

- Rates and annual charges increased 11% in 2010 due to an SRV from 2006 to 2010 for 10% annual increases which remain a permanent part of the revenue base. In 2011 rates and annual charges increased 5.9% due to an adjustment in levies. In June 2011 Council was granted a permanent SRV for an increase of 6% each year from 2012 to 2014. Council applied for a 6.7% pa SRV to continue for seven years but only received a partial approval. The SRV will be used to fund backlogs in its infrastructure maintenance and other asset maintenance and improvements.
- User fees and charges increased by an average of 5.5% p.a. over the period mainly due to increases in Development Management fees and Plan Checking fees.
- Council's own sourced revenue of 64% has been above the benchmark of 60% over the period.
- Interest and investment revenue has been increasing over the period in line with increasing cash and investment balances.

- Operating grants and contributions have fallen over the period due to falls in both general purpose and specific purpose grants. Operating contributions have remained relatively flat over the period.

3.2: Expenses

Figure 2 - Expenses for 2008/09 to 2010/11 ($'000s)



Key Observations

- Employee costs have been rising by an average of 5.1% p.a. over the period. The increases were due to reduced capitalisation of employee costs. Excluding the capitalisation of costs, employee costs increased by an average of 2.8% over the period. The number of FTEs has remained stable over the period.
- Materials and contract expenses dipped in 2010 due to a $2.6m fall in road maintenance and construction and increased in 2011 due to a $1.3m increase in raw materials and consumables.
- Depreciation and amortisation increased by 38.8% in 2011 after a 2.1% increase in 2010. These increases were due to a $2.4m increase in roads, bridges and footpaths infrastructure depreciation following a $75.4m increase in the value of roads, bridges and footpaths infrastructure due to adjustments and revaluation increments.
- Other expenses increased 16.4% in 2011 following a 3.6% increase in 2010 following increases in electricity and heating costs and computer software charges.

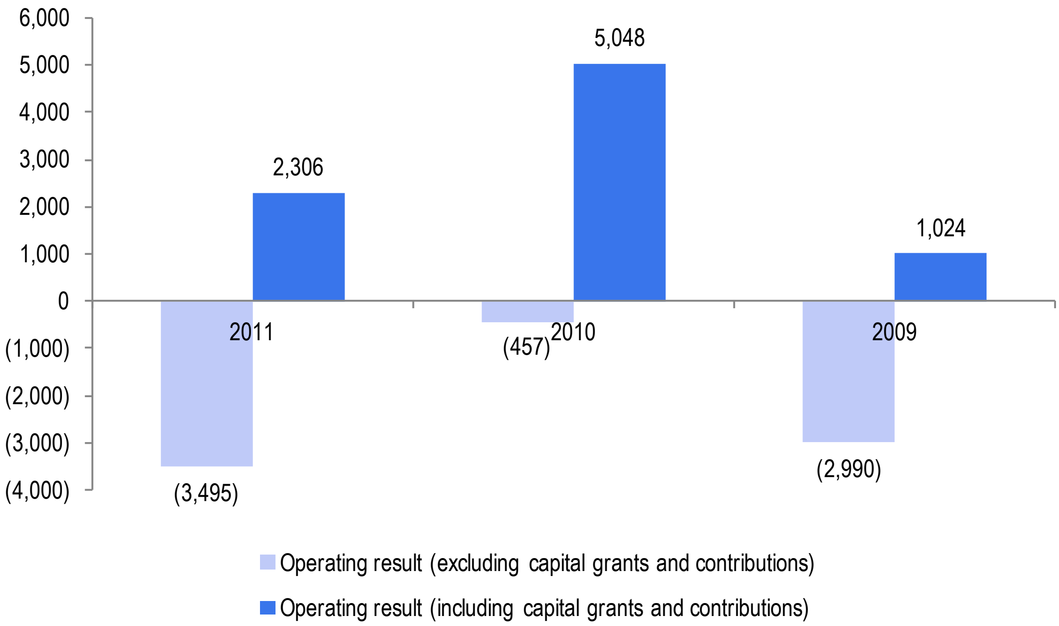
3.3: Operating Results

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.

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 2010/11 ($'000s)



Key Observations

- Results have varied over the period with 2011 having the greatest deficit. The improved result in 2010 is primarily due to the $2.6m fall in road maintenance and construction contractor and consultancy costs.
- While revenue growth has been reasonably strong over the period, expenses have grown at a higher rate.

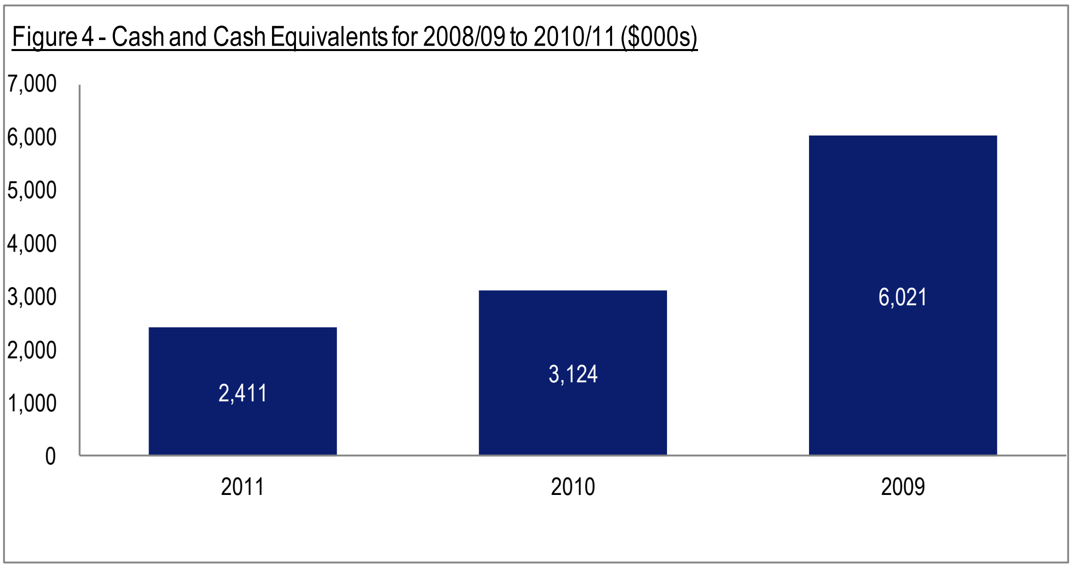
3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA ($'000's)	7,490	7,759	5,000
Operating Ratio	(9.5%)	(1.3%)	(9.2%)
Interest Cover Ratio	5.04x	5.64x	3.87x
Debt Service Cover Ratio	3.86x	4.16x	2.85x
Unrestricted Current Ratio	2.91x	2.65x	2.13x
Own Source Operating Revenue Ratio	64.2%	64.2%	64.1%
Cash Expense Ratio	1.0 months	1.4 months	2.6 months
Net assets ($'000's)	333,229	316,820	209,859

Key Observations

- The Council's EBITDA has trended higher over the period as the deteriorating operating result is largely due to non cash items.
- Both the Interest Cover Ratio and Debt Service Cover Ratio have been improving over the period.
- The Operating Ratio has been below the benchmark of negative 4.0% in two of the three years and has marginally deteriorated since 2009.
- The Unrestricted Current Ratio has been above the benchmark of 1.50x over the last three years and has been increasing, indicating that Council has sound liquidity.
- The Cash Expense Ratio is below benchmark as Council invests excess cash. Cash and Investments have been increasing over the period.
- Net assets increased significantly in 2010 and 2011 due to Revaluations and adjustments to Infrastructure, Property, Plant and Equipment of $101.7m and $9.9m respectively.
- When asset revaluations and adjustments are excluded, Infrastructure, Property, Plant and Equipment have been marginally increasing with asset purchases being more than the combined value of disposed assets and annual depreciation. Since 2009 this amounts to a $4.4m increase in Infrastructure, Property, Plant and Equipment assets.
- Council has total borrowings of $9.1m. This represents a total debt level of 2.7% of net assets.

3.5: Statement of Cashflows



Key Observations

- Council's cash and cash equivalents has been decreasing each year primarily due to the purchase of investment securities. The majority of investments are in term deposits and Council has small amounts of investments in other financial assets.
- In total, the Council has cash and investments of $26.4m in 2011 of which $14.6m is externally restricted, $11.1m is internally restricted and $0.7m is unrestricted. The majority of the external restrictions relate to developer contributions, domestic waste management and unexpended specific purpose grants.
- Within the investments portfolio of $24.0m, Council has current deposits of $15.5m and non-current deposits of $3.0m, other long term financial assets of $2.0m, mortgage backed securities of $2.0m,negotiable certificates of deposits and floating rate notes of $1.0m and CDOs of $0.5m.
- Overall the cash balances along with the Unrestricted Current Ratio suggest the Council was able to meet their day to day obligations.

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 2010/11 ($'000's)

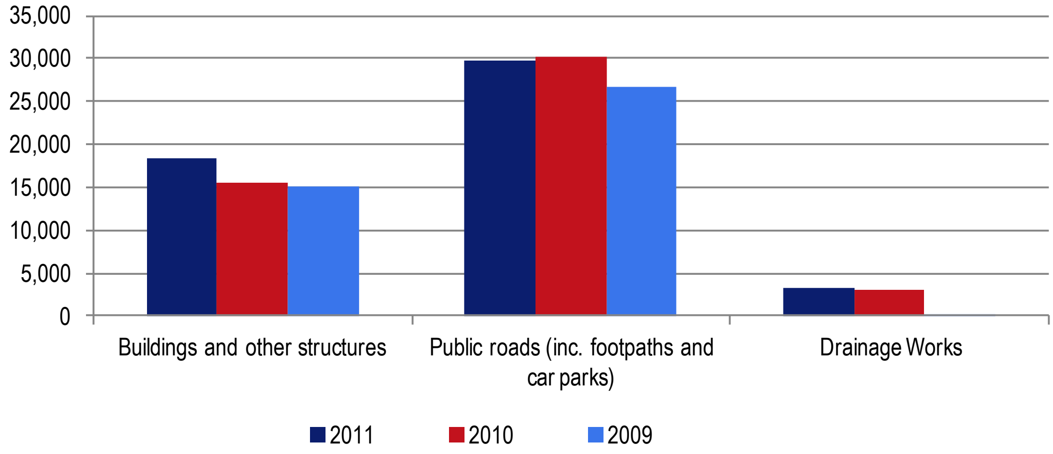
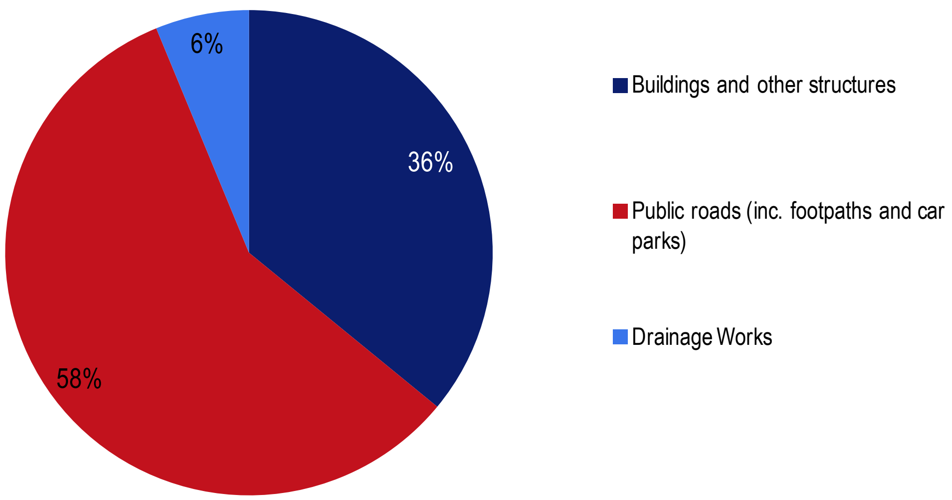


Figure 6 - Infrastructure Backlog Composition for 2010/11



The Council reported a $51.3m backlog in 2011 that is mainly related to roads and buildings and other structures at 58% and 36% respectively.

The infrastructure backlog has been trending marginally higher over the period mainly due to increases in the roads and buildings and other structures backlogs.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000's)	51,281	48,772	41,893
Required annual maintenance ($'000's)	12,813	11,750	10,226
Actual annual maintenance ($'000's)	7,109	5,207	5,630
Total value of infrastructure assets ($'000's)	266,362	255,978	163,814
Total assets ($'000's)	361,344	344,485	237,318
Infrastructure Backlog Ratio	0.19x	0.19x	0.26x
Asset Maintenance Ratio	0.55x	0.44x	0.55x
Building and Infrastructure Renewals Ratio	0.78x	1.08x	0.63x
Capital Expenditure Ratio	0.94x	1.18x	1.33x

Council's infrastructure backlog ratio has reduced over the period even though the estimated cost to bring to satisfactory standard has increased because of the revaluations and adjustments to infrastructure values of over $111m over the period.

Council's asset maintenance ratio has been well below the benchmark of 1.0x over the period though this is expected to improve from 2012 as the SRV funding will be used to address infrastructure maintenance and other asset maintenance and improvements.

The Building and Infrastructure Renewals Ratio has trended higher over the period and was above the benchmark of 1.0x in 2010.

The Capital Expenditure Ratio has trended lower over the period due to increases in depreciation expenses and reduced asset additions.

3.6(c): Capital Program

The following figures are sourced from the Council's Annual Financial Statements at Special Schedule No. 8 and are not audited. New capital works are major non-recurrent projects.

Capital Program ($'000's)	Year ended 30 June		
	2011	2010	2009
New capital works	2,929	2,539	3,985
Replacement/refurbishment of existing assets	6,009	6,093	5,221
Total	8,938	8,632	9,206

Council's overall capital program has trended a little lower over the period with the proportion of replacement and refurbishment works increasing and new capital works decreasing.

Major capital works over the period include:

- Blackspot program $1.1m
- Pavement Reconstruction program $0.9m
- Road toll response program $0.5m
- Traffic and parking improvement program $0.4m
- Building repair projects $0.4m

3.7: Specific Risks to Council

- Deterioration of Council infrastructure assets. Council applied for a seven year SRV in 2011 to fund infrastructure maintenance and it was partially accepted at a reduced % level and for only three years. Council has demonstrated that they require further funding for infrastructure maintenance and would like to apply for another SRV when the current one expires in 2014, though they expect this will require significant consultation and discussion with both Councillors and the community. Over the last three years the infrastructure backlog has increased and actual maintenance has been around half of required maintenance. If this trend continues the Council's infrastructure backlog will continue to grow and may be reflected in lower quality infrastructure assets.
- Community Service provisions. Wollondilly is in between a metropolitan area and a rural area. Their issue is that they are classified differently in different areas that often provide less funding. Council is advocating a new classification which would allow a better distribution of funding.
- New Developments. The state government initiated a project requesting landowners to nominate sites for new dwellings and a number are within the LGA. They are potentially large developments and could significantly change the demographics.

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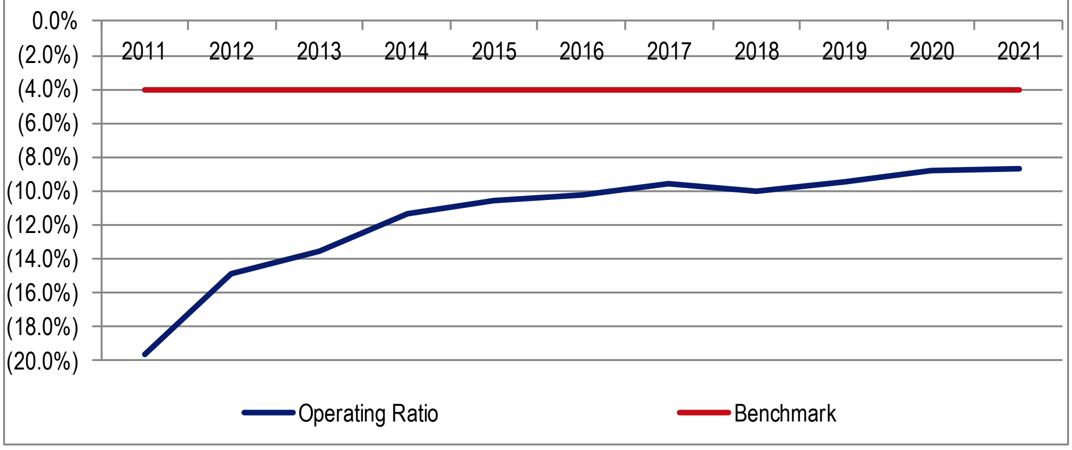
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $2.75m loans without any LIRS subsidy.

The LIRS loan relates to the General Fund, therefore we have focused our financial analysis solely upon this Fund.

4.1: Operating Results

Figure 7- Operating Ratio for General Fund



The overall trend in operating results is improving over the forecast period, though results remain well below benchmark. The improving operating results are due to revenue increases being higher than expense increases. Revenue increases are driven by the SRV from 2012 to 2014. Expense growth is slowing due to reducing borrowing costs and unchanged depreciation expenses. Council expects little change in its asset base over the forecast period so has kept depreciation constant. Council is still developing capability in this area and expects to produce a more robust depreciation calculation in the next LTFP.

4.2: Financial Management Indicators

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

Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund

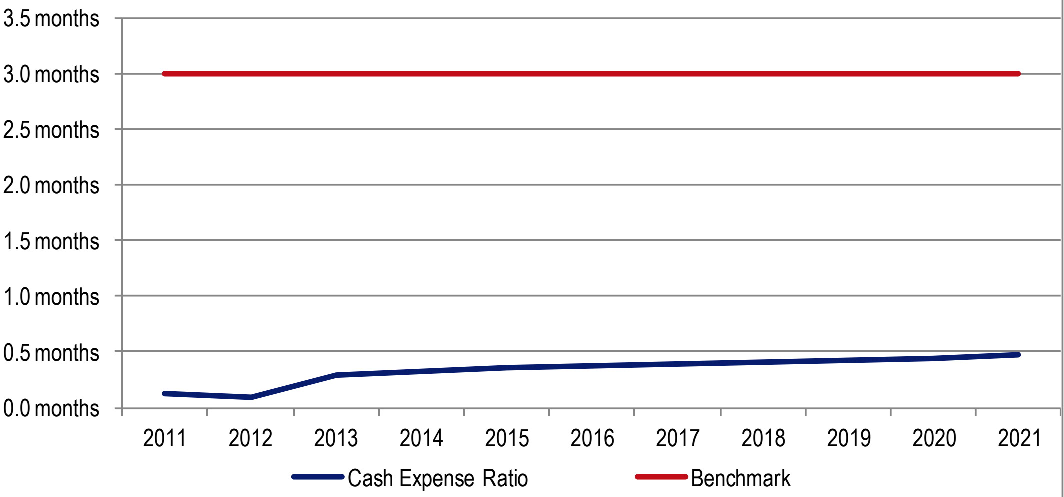
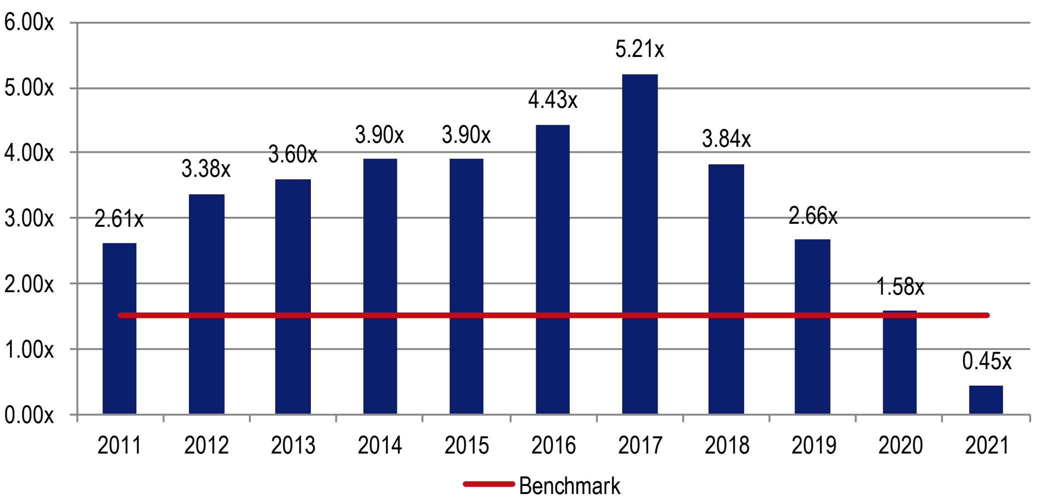


Figure 9 - Unrestricted Current Ratio for General Fund



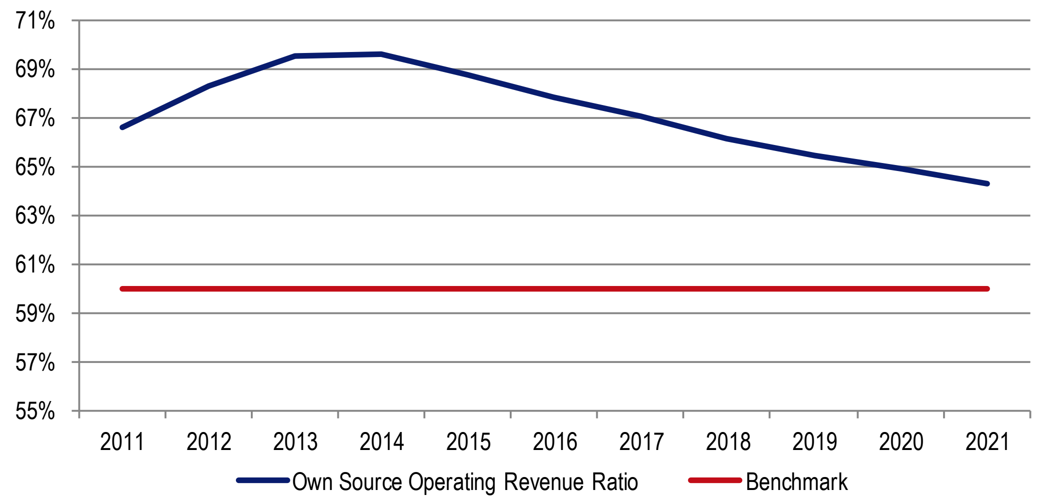
Council's Cash Expense Ratio is low as Council invests excess cash. Council's cash and investments balances increase over the forecast period.

The reducing Unrestricted Current Ratio is due to a mismatch in the projections between the capital works program and contributions plans. Council is currently reviewing their projections and this issue will be corrected.

This indicates that Council is forecasting sufficient liquidity levels over the period except for 2021.

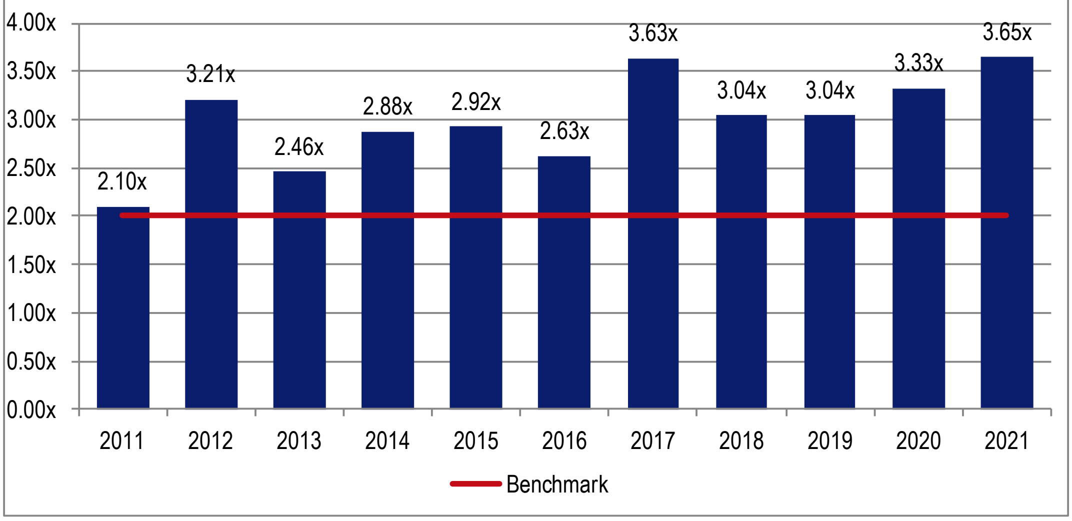
Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio for General Fund



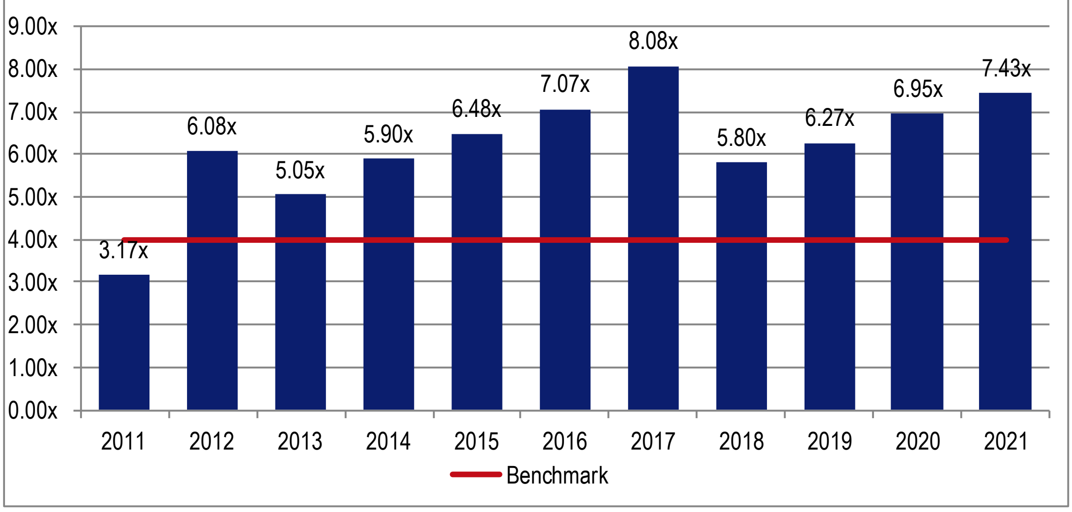
Council's Own Source Operating Revenue Ratio is well above benchmark over the forecast period though it does fall over the period due to increases in capital grants and contributions. Council is currently reviewing their projections.

Figure 11 - DSCR for General Fund



The Debt Service Cover Ratio remains above the benchmark over the forecast period. The variability is due to changes in debt servicing levels each year.

Figure 12 - Interest Cover Ratio for General Fund

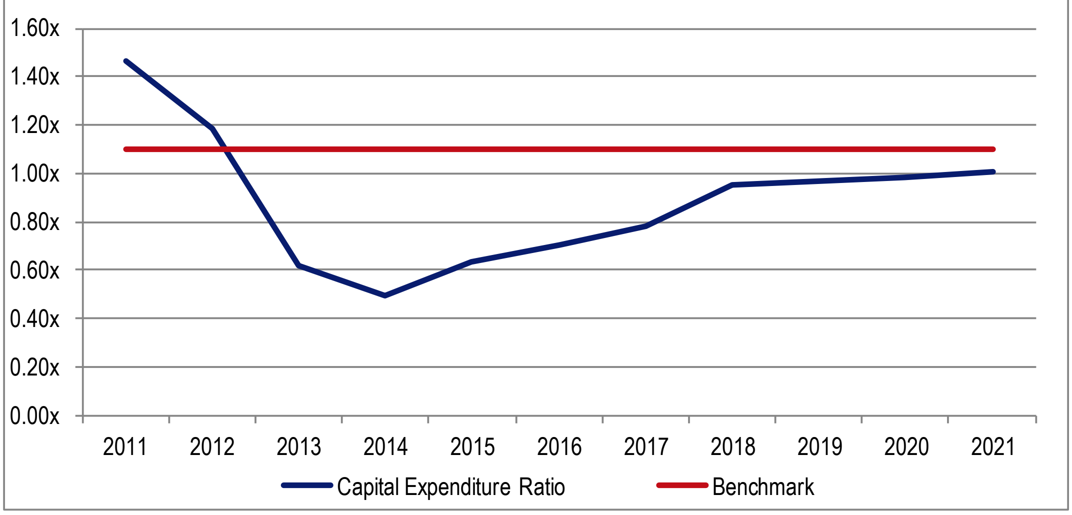


Council's Interest Cover Ratio remains above the benchmark over the forecast period.

With both the DSCR and Interest Cover Ratios being above benchmark and trending higher, this suggests that the Council would be able to service more debt over the forecast period.

4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund



The capital expenditure ratio deteriorates over the initial years of the forecast period and is below the benchmark for most of the period due to lower than benchmark capital expenditure. This suggests that the infrastructure backlog may continue to increase. This issue may be compounded if service level demands increase over the forecast period, which is likely to happen with forecast increases in population over the period.

The total deficit figure for capital expenditure versus depreciation across the forecast period amounts to $15.5m in nominal terms.

4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

- Rates and annual charges: TCorp notes that rates 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%
- Interest and investment revenue: annual return of 5%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

<u>Key Observations and Risks</u>

- Council has a 6% p.a. SRV from 2012 to 2014 and then assumes annual increases in rates and annual charges of 3% p.a. for the rest of the forecast period.
- Council has forecast a 15.6% fall in user fees and charges in 2012 due to a five yearly increase in 2011 from septic tank licence renewals, reduced DA fees from anticipated legislation changes and reduced contract works. User fees and charges increase by an average of 2.7% p.a. from 2013.
- Interest and investment revenue generally moves in line with cash and investment balances.
- Other revenue falls by 17.6% in 2012 due to the stripping out of internal charges that were included in the 2011 figures. From 2013 other revenue increases by an average of 3.2% p.a.
- Operating grants and contributions increase by an average of 3.0% p.a.
- Capital grants and contributions increase by an average of 7.3% p.a.
- Employee cost increases average 3.4% p.a.
- Borrowing costs move in line with debt balances and decrease over the forecast period.
- Materials and contract expenses fall by 10.1% in 2012 due to the stripping out of internal charges that were included in the 2011 figures. From 2013 materials and contract expenses increase by an average of 3.0% p.a.
- Depreciation and amortisation stays flat over the forecast period because Council expects the asset base to remain stable over the forecast period.
- Other expenses increase by an average of 4.4% p.a.

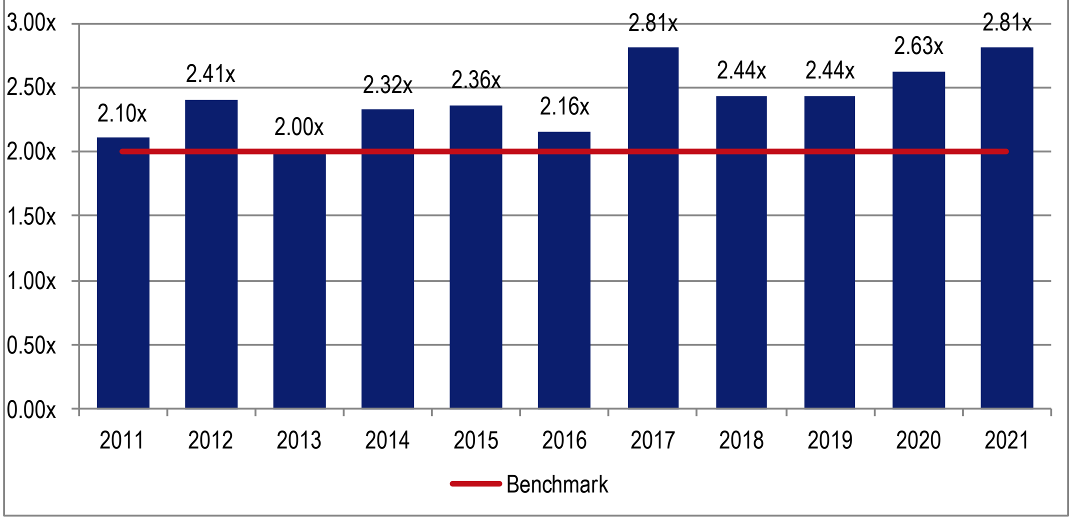
- Apart from the comments on the capital expenditure program overall, the assumptions used by Council appear to be reasonable

4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will be able to incorporate additional loan funding in addition to the LIRS loan facilities. Some comments and observations are:

- Based on a benchmark of DSCR>2x, $3.1m could be borrowed in addition to the $2.75m borrowings proposed under LIRS in 2013 and the $6.5m borrowings included in the LTFP
- As the DSCR ratio improves from 2017 onwards there could be further capacity to take on increased borrowings from that point however we would recommend a subsequent review of the Council's financial position nearer the time to confirm if this remains the case. This is particularly related to the potential understatement of the required capital expenditure program
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at an interest rate of 8.6%

Figure 14 - DSCR for General Fund including additional borrowings



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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 6. There are three councils in this group and at the time of preparing this report, we have data for all of these councils. Additionally, Council has requested that we also use an expanded group so we have added six similar Councils for comparison purposes. The additional councils are Cessnock City Council, Great Lakes Council, Greater Taree City Council, Maitland City Council, Port Stephens Council and Blue Mountains City Council.

Part a is the benchmarking comparison for DLG Group 6 and Part b is the benchmarking comparison for the expanded group (including the Group 6 councils).

In Figure 15 to Figure 24, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 22 to 24 do not include the 2016 forecast position as those numbers are not available.

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

Please note that this section of the report has been prepared separately to the LIRS financial assessment and includes the latest information at the time of preparation which includes data from the 2012 financial year.

Financial Flexibility

Figure 15a - Operating Ratio Comparison

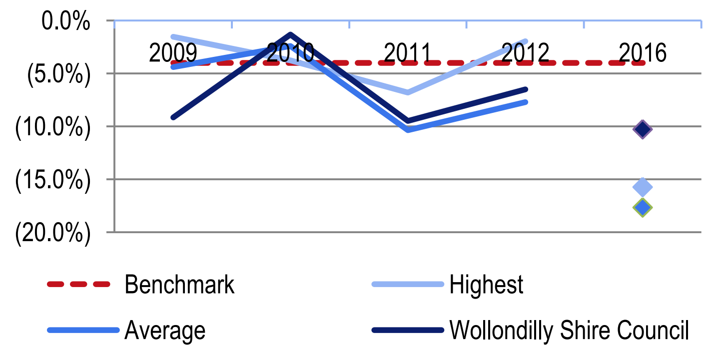
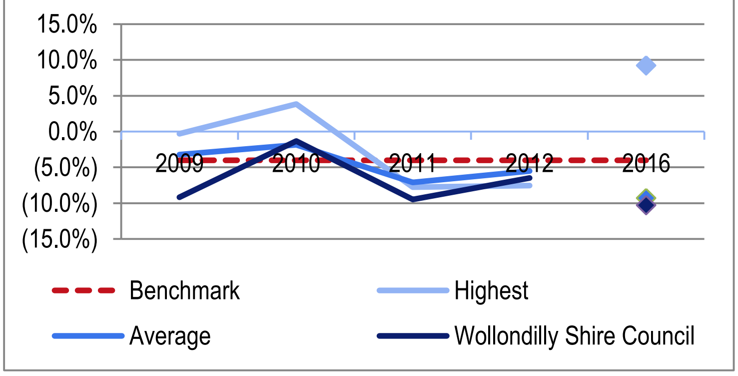


Figure 15b - Operating Ratio Comparison



Council's Operating Ratio was below the benchmark in three of the last four years and close to the group averages. The results are forecast to decline in the medium term.

Figure 16a - Own Source Operating Revenue Ratio Comparison

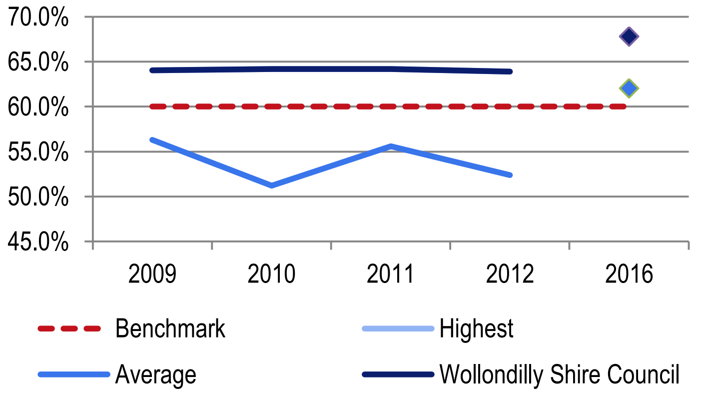
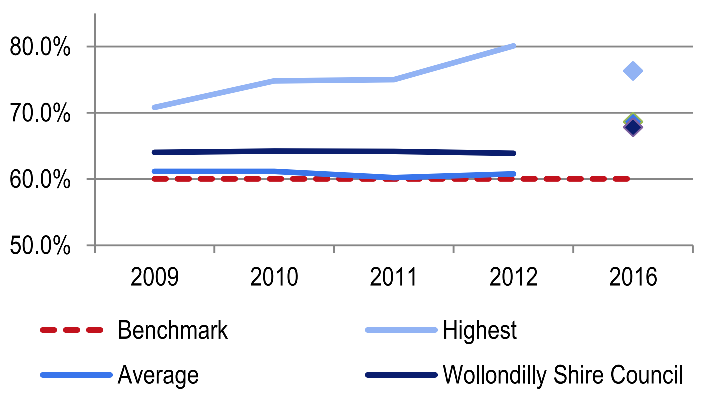


Figure 16b - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio was above the benchmark and group averages over the last four years. The ratio is expected to improve in the medium term to be at or above the group averages and above benchmark.

Liquidity

Figure 17a - Cash Expense Ratio Comparison

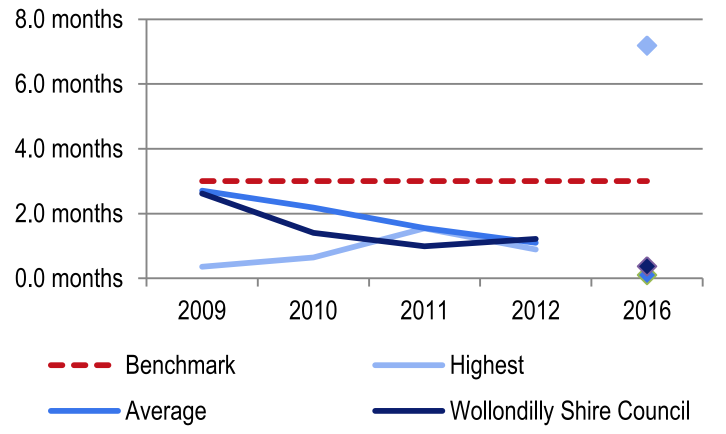


Figure 17b - Cash Expense Ratio Comparison

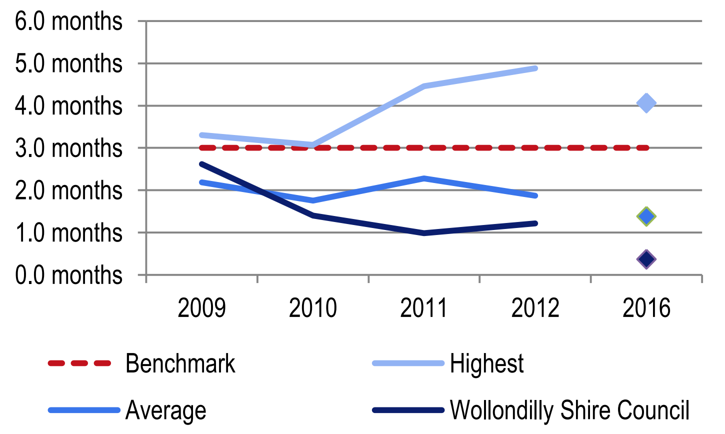


Figure 18a - Unrestricted Current Ratio Comparison

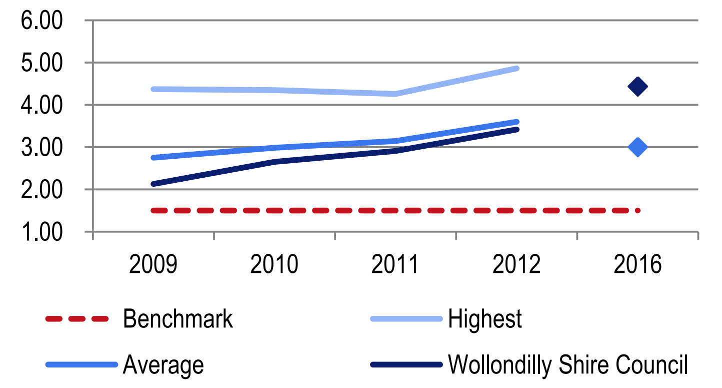
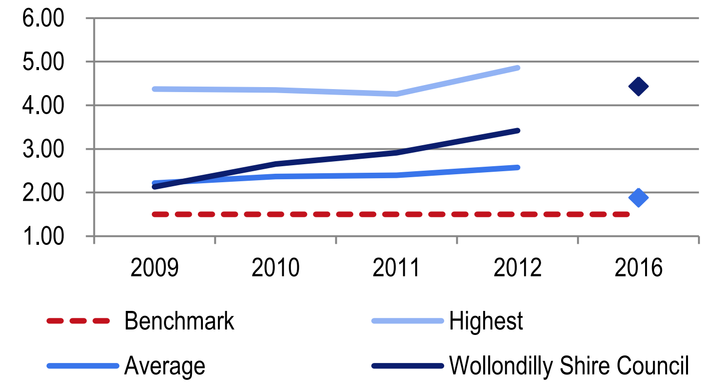


Figure 18b - Unrestricted Current Ratio Comparison



On average over the last four years Council's liquidity position has been broadly acceptable and this is expected to continue in the medium term.

Figure 19a - Debt Service Cover Ratio Comparison

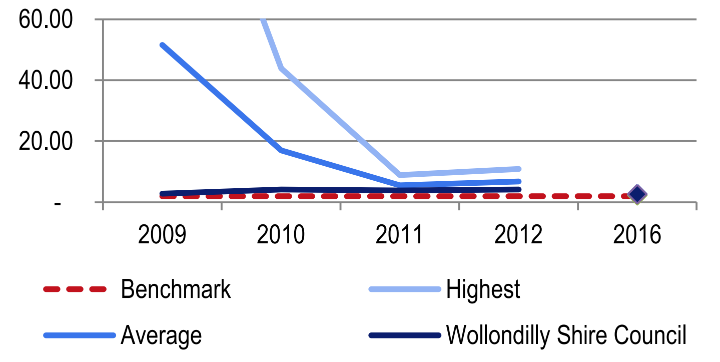


Figure 19b - Debt Service Cover Ratio Comparison

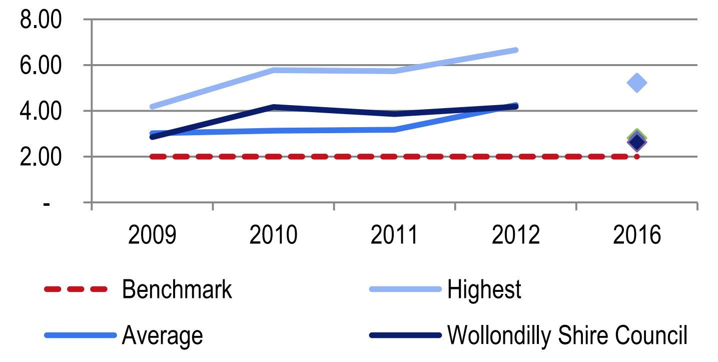


Figure 20a - Interest Cover Ratio Comparison

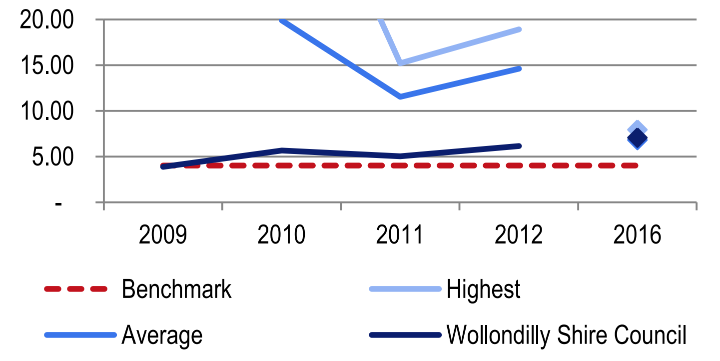
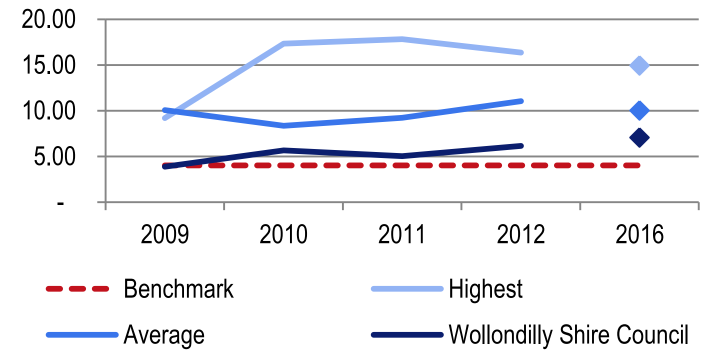


Figure 20b - Interest Cover Ratio Comparison



Over the review period, Council was above the benchmarks and around or below the group averages. The ratios are forecast to remain above the benchmarks in the medium term.

Figure 21a - Capital Expenditure Ratio Comparison

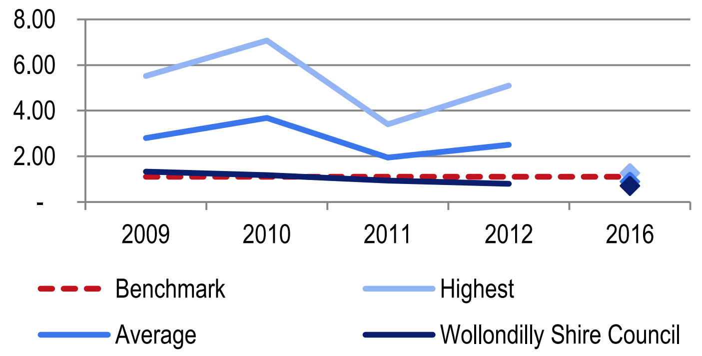


Figure 21b - Capital Expenditure Ratio Comparison

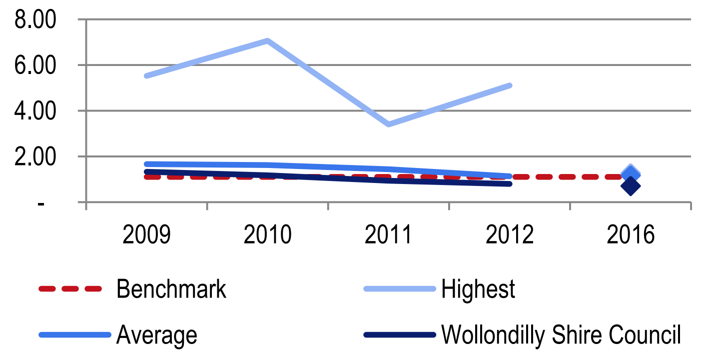


Figure 22a - Asset Maintenance Ratio Comparison

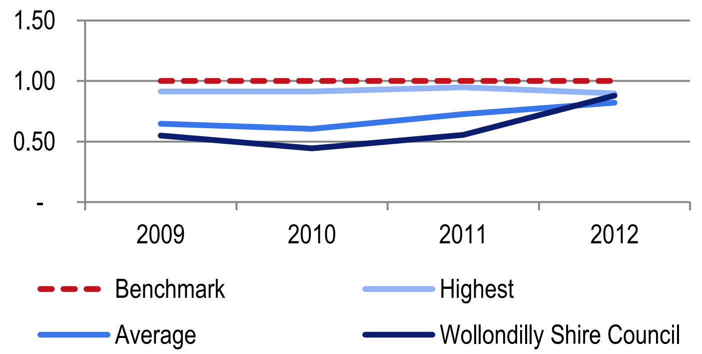


Figure 22b - Asset Maintenance Ratio Comparison

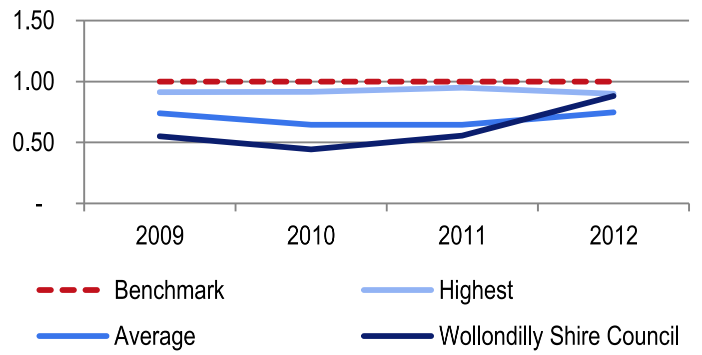


Figure 23a - Infrastructure Backlog Ratio Comparison

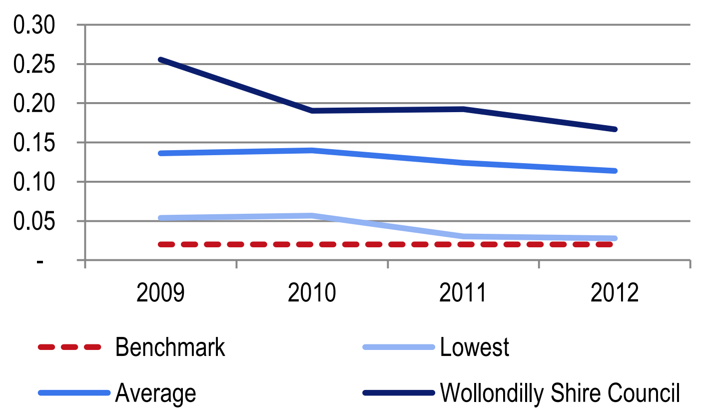
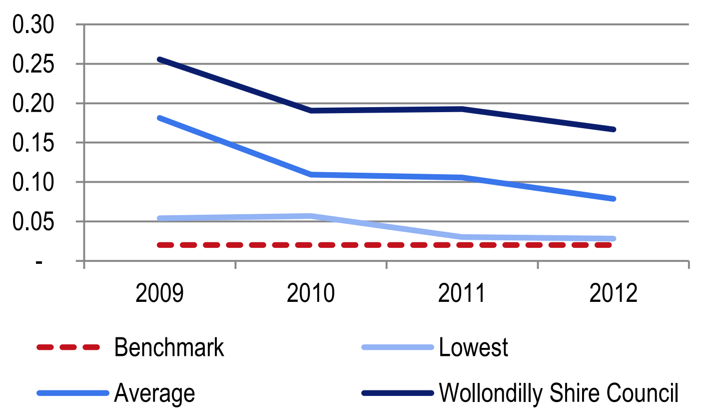
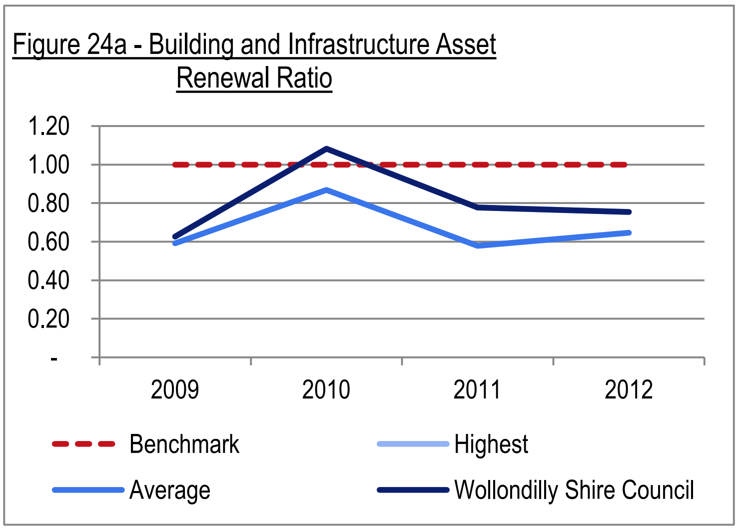
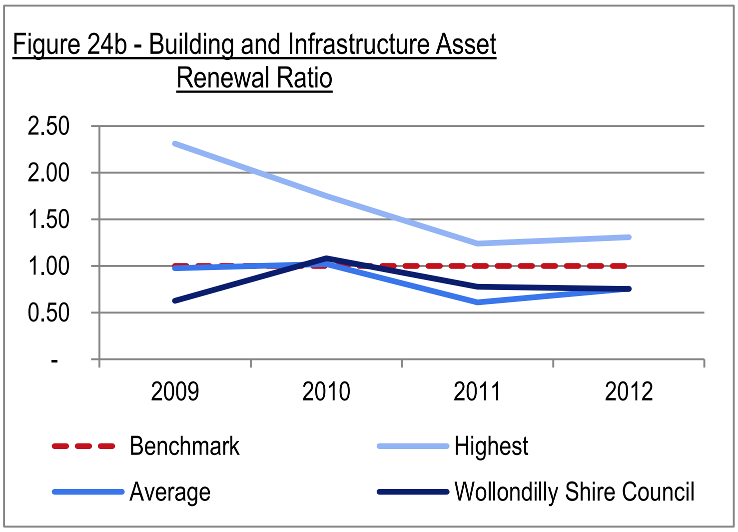


Figure 23b - Infrastructure Backlog Ratio Comparison







Overall, Council had a higher Infrastructure Backlog than other councils in the groups and the benchmark in the last four years.

Council has improved to be above the group average though it remains below benchmark in terms of spending on asset maintenance. Council's Capital Expenditure Ratio was below the group average and close to the benchmark. Council's Building and Infrastructure Asset Renewal Ratio was above the group average but below the 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 be in a satisfactory financial position.

Both past performance and the financial forecasts support our findings that Council has sufficient financial capacity to service the additional borrowings proposed under its LIRS applications.

We base our recommendation on the following key points:

- Council has sufficient capacity to manage the additional $2.75m debt supported by a DSCR and Interest Cover Ratio above the benchmarks in all 10 years of its financial forecast and has the capacity to service additional debt of $3.1m
- Council has adequate liquidity to manage their short term liabilities during the forecast period
- Council has maintained control of expenses in the past three years, noting the comments on the depreciation expenses
- Council has a relatively low level of borrowings at $9.1m, being 2.7% of net assets

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

- Operating deficit results excluding capital grants and contributions are forecast over the entire forecast period. These operating deficit results improve over the forecast period though they remain well below benchmark. This is a significant issue that could impact the long term financial sustainability of the Council. We recommend Council considers its options for improving its performance in this area, either by further and on-going cost controls, or securing new or additional revenue in future years
- Whilst depreciation is fully funded by sufficient capital expenditure in the first year of the financial forecasts, it appears that for the remaining years of the forecast a much lower level of capital expenditure has been forecast. We would therefore recommend these figures be reviewed by Council and would recommend ongoing analysis to verify them in the future

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Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Revenue					
Rates and annual charges	23,391	22,083	19,886	5.9%	11.0%
User charges and fees	3,981	3,584	3,588	11.1%	(0.1%)
Interest and investment revenue	1,577	1,087	866	45.1%	25.5%
Grants and contributions for operating purposes	6,845	6,429	7,244	6.5%	(11.3%)
Other revenues	1,051	1,290	1,051	(18.5%)	22.7%
Total revenue	**36,845**	**34,473**	**32,635**	**6.9%**	**5.6%**
Employees	14,025	13,445	12,695	4.3%	5.9%
Borrowing costs	1,487	1,375	1,292	8.1%	6.4%
Materials and contract expenses	11,733	10,180	11,957	15.3%	(14.9%)
Depreciation and amortisation	9,498	6,841	6,698	38.8%	2.1%
Other expenses	3,597	3,089	2,983	16.4%	3.6%
Total expenses	**40,340**	**34,930**	**35,625**	**15.5%**	**(2.0%)**
Operating result	**(3,495)**	**(457)**	**(2,990)**	**(664.8%)**	**84.7%**

Table 2 - Items excluded from Income Statement

Excluded items ($'000)			
	2011	2010	2009
Grants and contributions for capital purposes	5,801	5,505	4,014
Net gain/(loss) on disposal of assets	435	83	(416)

Table 3 - Balance Sheet

Balance Sheet ($'000)	Year Ended 30 June			% annual change	
	2011	**2010**	**2009**	**2011**	**2010**
Current assets					
Cash and equivalents	2,411	3,124	6,021	(22.8%)	(48.1%)
Investments	17,000	14,500	7,000	17.2%	107.1%
Receivables	5,156	3,754	3,720	37.3%	0.9%
Inventories	1,517	1,968	1,628	(22.9%)	20.9%
Other	387	362	526	6.9%	(31.2%)
Total current assets	26,471	23,708	18,895	11.7%	25.5%
Non-current assets					
Investments	6,956	5,928	6,472	17.3%	(8.4%)
Infrastructure, property, plant & equipment	327,917	314,849	211,951	4.2%	48.5%
Total non-current assets	334,873	320,777	218,423	4.4%	46.9%
Total assets	**361,344**	**344,485**	**237,318**	**4.9%**	**45.2%**
Current liabilities					
Payables	4,036	3,639	3,794	10.9%	(4.1%)
Borrowings	666	547	497	21.8%	10.1%
Provisions	3,465	3,590	3,336	(3.5%)	7.6%
Total current liabilities	8,167	7,776	7,627	5.0%	2.0%
Non-current liabilities					
Borrowings	8,448	9,020	9,560	(6.3%)	(5.6%)
Provisions	11,500	10,869	10,272	5.8%	5.8%
Total non-current liabilities	19,948	19,889	19,832	0.3%	0.3%
Total liabilities	**28,115**	**27,665**	**27,459**	**1.6%**	**0.8%**
Net assets	**333,229**	**316,820**	**209,859**	**5.2%**	**51.0%**

Table 4-Cashflow

Cashflow Statement ($'000)	Year ended 30 June		
	2011	**2010**	**2009**
Cashflows from operating activities	11,298	11,978	8,090
Cashflows from investing activities	(11,558)	(14,385)	(11,612)
• Proceeds from borrowings and advances	0	0	1,200
• Repayment of borrowings and advances	(453)	(490)	(461)
Cashflows from financing activities	(453)	(490)	739
Net increase/(decrease) in cash and equivalents	**(713)**	**(2,897)**	**(2,783)**
Cash and equivalents	2,411	3,124	6,021

Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

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, building, other structures and depreciable land improvement assets (from note 9a)

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.