New South Wales
Treasury Corporation

# Marrickville Council

## Financial Assessment and Benchmarking Report

**12 March 2013**

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

## Disclaimer

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

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

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 Marrickville Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Marrickville 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.

New South Wales
Treasury Corporation

# Index

## Section 1 Executive Summary

This report provides an independent assessment of Marrickville Council (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, one for community facilities upgrades ($1.8m), and for the footpath and road renewal program ($1.2m). Both loans are to be repaid over 5 years.

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 operating result (measured using EBITDA) has been reasonably stable and was $9.6m in 2011
- Approximately 70% of the Council's revenue base is derived from own sourced revenue (annual charges, and user charges and fees). Council can rely upon these revenue streams on an ongoing basis for financial flexibility
- The Council was granted a 3.5% SRV in 2005 over 15 years to fund the refurbishment of its aquatic facilities. The repayment of the loans which funded the refurbishment is fully financed from the rate revenue set aside for this purpose
- Operating expenses are generally well managed, particularly employee costs that have been rising in line with historical NSW wage indexation rates over the last three years

The Council reported $32.5m of infrastructure backlog in 2011 with an infrastructure asset value of $521.3m. Other observations include:

- The Council's infrastructure backlog is on a downward trend
- The Council has spent less on maintenance than required over the last three years
- A significant portion of the backlog, 84.1%, is related to road assets. This is being addressed by a detailed list of capital programs including footpath and road renewal program

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

- The consolidated results show the Operating Ratio above the benchmark from 2014 onwards
- 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 75%
- 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 $3.0m for the two LIRS projects. This is based on the following analysis:

- The DSCR remains above a benchmark of 2.00x from 2014 onwards in the 10 year forecast
- The Interest Cover Ratio is well above the benchmark of 4.00x in the 10 year forecast
- We also believe Council has the capacity to undertake a further $2.2m in borrowings in 2014

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG group 3. 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 in three of the past four years
- Council's DSCR and Interest Cover Ratio are below the group average and above the benchmark. In the medium term Council's forecast credit ratios are expected to remain around the benchmarks
- Council was in a sound liquidity position though this is expected to decline in the medium term
- Council's Infrastructure Backlog Ratio has been lower than the group average. However, the Building and Infrastructure Asset Renewal Ratio and Asset Maintenance Ratio have been weaker than the benchmarks and weaker than or around the group averages. Council's Capital Expenditure Ratio has been in line with the group average and benchmark

# 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

New South Wales Treasury Corporation

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 | > 1.50x |
| Own Source Operating Revenue Ratio | > 60.0% |
| Debt Service Cover Ratio (DSCR) | > 2.00x |
| Interest Cover Ratio | > 4.00x |
| Infrastructure Backlog Ratio | < 0.02x |
| Asset Maintenance Ratio | > 1.00x |
| Building and Infrastructure Asset Renewal Ratio | > 1.00x |
| Capital Expenditure Ratio | > 1.10x |

## 2.3: Overview of the Local Government Area

| Marrickville Council LGA | |
|---|---|
| Locality & Size | |
| Locality | Sydney Inner |
| Area | 16.5 km² |
| DLG Group | 3 |
| Demographics | |
| Population | 79,478 |
| % under 18 | 16.2% |
| % between 18 and 64 | 73.2% |
| % over 64 | 10.5% |
| Expected population 2015 | 82,265 |
| Operations | |
| Number of employees (FTE) | 514 |
| Annual revenue | $83.7m |
| Infrastructure | |
| Parks and reserves | 106 |
| Infrastructure backlog value | $32.5m |
| Total infrastructure value | $529.4m |

The Marrickville Local Government Area (LGA) encompasses the suburbs of Dulwich Hill, Lewisham, Petersham, Marrickville, Stanmore, St Peters, Sydenham, Tempe, Enmore and parts of Newtown and Camperdown. It has a population of approximately 79,000 residents and is located in Sydney's inner west. The whole of the area lies between four and 10km from the centre of the city. The Council had 514 equivalent full-time staff as at the end of the 2011 financial year, an increase from 487 in 2009.

Between 2004 and 2009, the estimated population rose by 3,180, an annual rate of 0.8%. At this rate, it will be 82,265 by 2015. The age group which has been growing at the highest rate in that period has been the 80 to 84 year old group.

## 2.4: LIRS Application

Council has made two LIRS applications. Project 1 is part of a community facilities upgrade program which stems from a condition audit commissioned by the Council in 2004. The upgrade program was originally planned to be implemented over a 10 year period. The program is currently in its sixth year of implementation. The LIRS will expedite the program implementation.

Project 2 will allow the acceleration of the footpath reconstruction and roads resurfacing program reducing the Infrastructure Backlog.

Project 1: Community Facilities Upgrade

Amount of loan facility: $1.8 m

Term of loan facility: 5 years

Project 2: Footpath and road renewal program

Amount of loan facility: $1.2 m

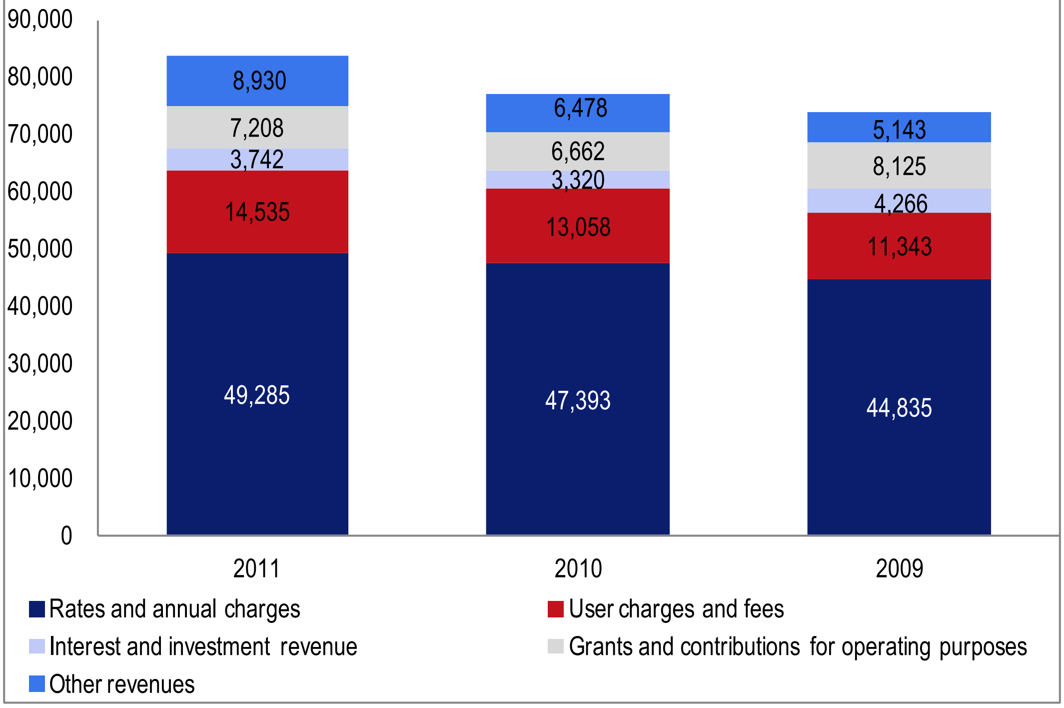
Term of loan facility: 5 years

# Section 3 Review of Financial Performance and Position

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

## 3.1: Revenue

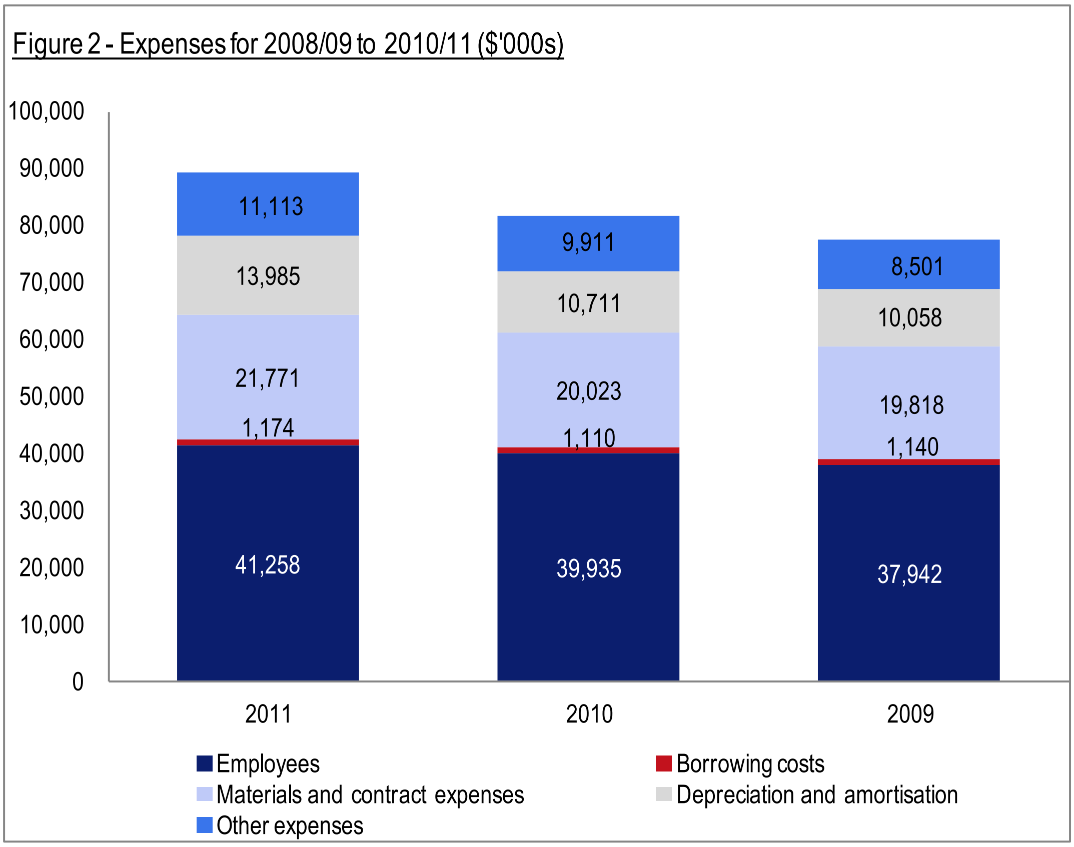
Figure 1 - Revenue Sources for 2008/09 to 2010/11 ($'000s)




Key Observations

- Total revenues have increased by 8.8% in 2011, and 4.3% in 2010, driven mainly by growth in Council's own sourced revenue in areas such as parking fines, child care facilities, rates, and restoration fees.
- Rates and annual charges have risen steadily over the last three years, driven by an increase in the number of rateable properties, and increases in domestic waste management charges. Council also benefited from a SRV of 3.5% introduced in 2006 to pay for aquatic facilities. The SRV expires in 2020. Council took out a loan of $10.0m to fund these projects and the 15 year SRV will repay the loan.
- The aquatic facilities recorded a deficit of $0.8m in 2011. 2012 will be the first full year the Annette Kellerman facility will be open. The facility has reached full membership and Council expect it to generate an operating surplus.
- User fees and charges have also grown each year mainly due to increased revenue from child care, and restoration fees. Child care centres contributed $7.9m in fees in 2011.
- Within other revenues, parking fines have increased from $1.8m in 2009 to $3.3m in 2011

## 3.2: Expenses




Key Observations

- Employee expenses have been rising in line with CPI and the increased number of employees. This suggests Council is managing employee costs efficiently even with rising full time employee numbers.
- Materials and contracts were the second largest expense category over the three years. This expense has been increasing due to the redevelopment of an aquatic centre, construction of another new aquatic centre, and redevelopment of sporting grounds and parks.
- In 2010, the Asset Revaluations process increased the value of Council's roads, bridges and footpaths. This resulted in the annual depreciation charge increasing by 30.6% in 2011 to $13.9m.
- Remediation expenses at the Tempe tip in 2010 and 2011 have increased other expenses year on year.
- Council appears to manage its expenses well with no stand out increases noted when the non-cash item of depreciation is excluded.

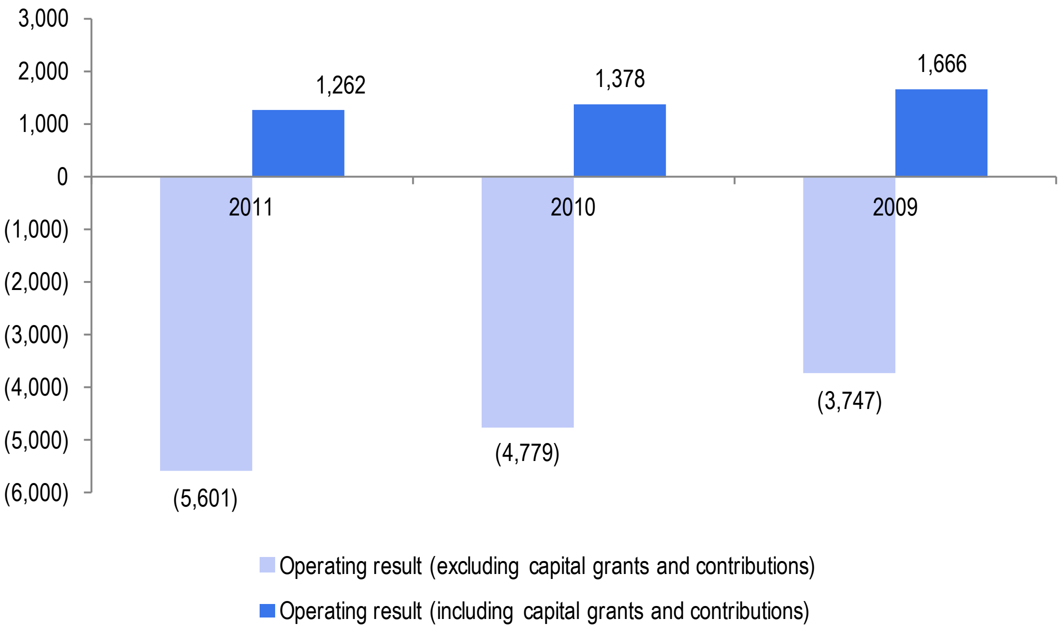
### 3.3: Operating Results

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

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

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

Figure 3 - Operating Results for 2008/09 to 2010/11 ($'000s)




Key Observations

- Council has consistently posted net operating deficits excluding capital grants and contributions. The deficits are increasing year on year. The deficit increased in 2011 due to increased depreciation charges
- Council expenses include a large non-cash depreciation expense, ($13.9m in 2011), which has increased substantially over the past three years following the Asset Revaluations process. Whilst the non cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

## 3.4: Financial Management Indicators

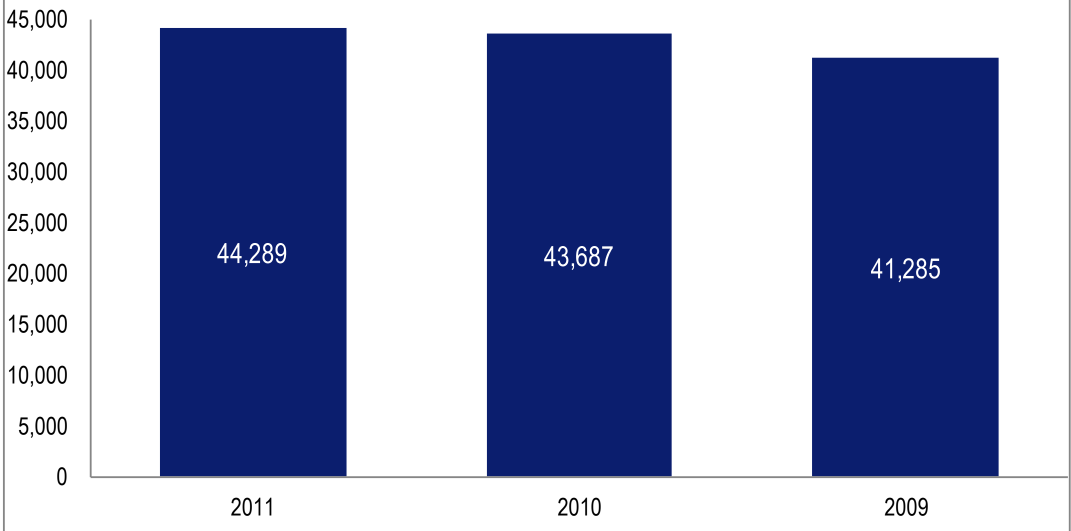
| Performance Indicators | Year ended 30 June | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| EBITDA ($'000's) | 9,558 | 7,042 | 7,451 |
| Operating Ratio | (6.7%) | (6.2%) | (5.1%) |
| Interest Cover Ratio | 8.14x | 6.34x | 6.54x |
| Debt Service Cover Ratio | 2.81x | 2.18x | 2.35x |
| Unrestricted Current Ratio | 3.67x | 3.69x | 3.68x |
| Net assets ($'000's) | 852,606 | 1,068,230 | 719,276 |

Key Observations

- Council's EBITDA increased over the three year period. Council's Interest Cover Ratio and DSCR indicated that they had flexibility in regard to carrying more debt. The DSCR has been above the benchmark of 2.00x over the past three years.
- The Unrestricted Current Ratio has been above the benchmark of 1.50x over the past three years, indicating that Council has sound liquidity.
- Net Assets have increased by over $133.3m between 2009 and 2011 due to the consecutive Asset Revaluations in 2010 and 2011 that increased the value of roads, bridges and footpaths, and reduced the value of community land assets. There was a decrement of $215.1m to community land assets in 2011 which reduced Net Assets.
- The Asset Revaluations over the last three years have resulted in a high level of volatility in Net Assets over this period. Consequently, in the short term the value of Net Assets is not necessarily an informative indicator of performance. In the medium to long term however, this is a key indicator of a Council's capacity to add value to its operations. Over time, Net Assets should increase at least in line with inflation plus an allowance for increased population and/or improved or increased services. Declining Net Assets is a key indicator of the Council's assets not being able to sustain the ongoing operations of a Council.
- When the Asset Revaluations are excluded, the underlying trend in all three years has been an expanding IPP&E asset base with asset purchases being larger than the combined value of disposed assets and annual depreciation. Over the three years this amounted to an $11.9m increase in IPP&E assets.
- Council has total borrowings of $19.4m, being 2.3% of Net Assets.

## 3.5: Statement of Cashflows

Figure 4 - Cash and Cash Equivalents for 2008/09 to 2010/11 ($000s)




Key Observations

- Overall, council's cash position has improved year to year.
- The cash balances, along with the Unrestricted Current Ratio being well above benchmark, provide the Council with a level of comfort in meeting their day to day obligations.
- Council had $15.5m in investment securities at 30June 2011 including $11.8m in NCDs and FRNs. Council also held $2.0m in corporate bond securities and $1.7m in mortgage backed securities. Some of these investments are no longer prescribed by the ministerial investment order and will be disposed of when financially advantageous to the Council.

New South Wales
Treasury Corporation

### 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)

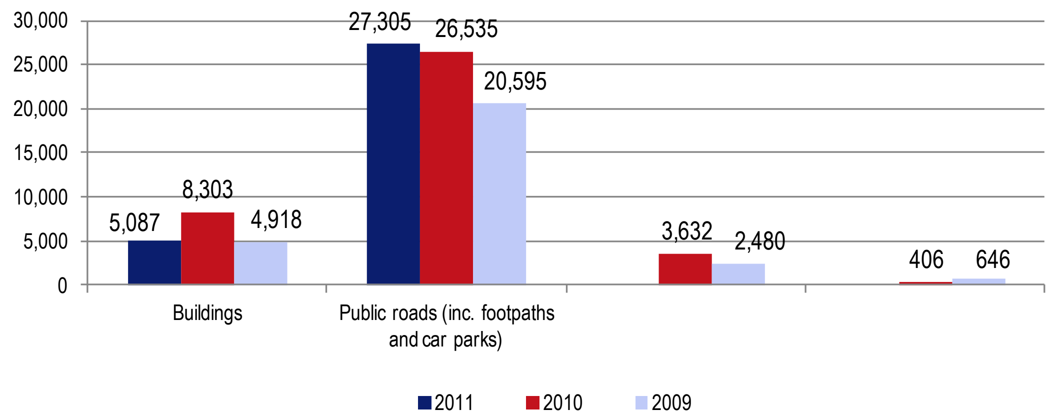
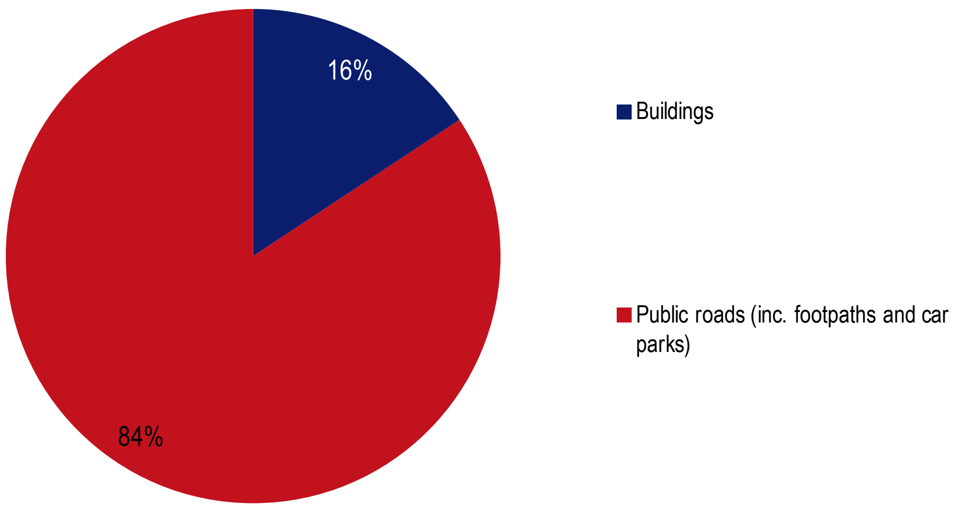



Figure 6 - Infrastructure Backlog Composition for 2010/11




The Council reported a $32.5m backlog in 2011. Typical of most councils, the backlog is mostly road related, however being an urban council, Council has less kilometres of roads to maintain compared to many rural councils. The backlog has increased between 2009 and 2011 by 13%.

### 3.6(b): Infrastructure Status

| Infrastructure Status | Year ended 30 June | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Bring to satisfactory standard ($'000's) | 32,467 | 38,876 | 28,639 |
| Required annual maintenance ($'000's) | 14,542 | 18,898 | 16,300 |
| Actual annual maintenance ($'000's) | 6,343 | 10,811 | 9,684 |
| Total value infrastructure assets ($'000's) | 521,268 | 508,839 | 259,965 |
| Total assets ($'000's) | 890,899 | 1,102,481 | 751,765 |
| Infrastructure Backlog Ratio | 0.06x | 0.08x | 0.11x |
| Asset Maintenance Ratio | 0.44x | 0.57x | 0.59x |
| Building and Infrastructure Asset Renewal Ratio | 0.55x | 0.75x | 0.74x |
| Capital Expenditure Ratio | 1.36x | 1.66x | 0.98x |

After the total backlog increased in 2010 due to the Asset Revaluations, the backlog fell again in 2011 due to building improvements, and the next stage of the Asset Revaluations process. The redevelopment of the Annette Kellerman pool, and the demolition of a building helped reduce the backlog in 2011. Also in 2011, Council undertook some major land improvement works at one of its sports facilities as part of a federal government grants program. Both the Building and Infrastructure Asset Renewal Ratio, and the Asset Maintenance Ratio are below the benchmarks for expenditure on asset renewal and asset maintenance.

However, the Capital Expenditure Ratio is above benchmark indicating that Council are investing in new assets that improve performance or capacity.

Council is currently reviewing the Asset Management Plans (AMP) which includes making improvements to the information which could affect the backlog valuation. The information improvements that will affect backlog valuation include:

- Review of asset useful lives. Asset management planning using updated useful lives based on historic performance and the remaining useful lives of current assets will provide more realistic forward works programs
- Implementing a more strategic integrated planning and reporting (IP&R) process. The maintenance and renewal of infrastructure assets will be strategically input from the AMPs into the long term financial planning and budget processes. The AMPs' 10 year programs will target decreasing the infrastructure backlog
- Introducing hierarchy of priorities. The hierarchies include footpaths (commercial areas, town centres, shopping areas), community areas (schools, churches, hospitals, clubs, community centres), transport nodes (Bus stops, train station), and residential areas (lane ways). The level of service and risk is different dependent on the hierarchy
- Improvement of data collection, and in particular, condition data. This may increase the backlog valuation. For example recent CCTV inspection of stormwater pipes showed an increase in estimated condition 5 (very poor condition) pipes from the assumed February 2010 AMP of 0.05% of all pipes to 2.79% (approximately valued at $3.6m)

- Introduction of improved treatment options. For example, changing the type of footpath materials used near trees will improve the asset condition and ensure the assets are fit for the right level of service

### 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 | 9,872 | 8,554 | 0 |
| Replacement/refurbishment of existing assets | 11,718 | 11,018 | 12,441 |
| **Total** | **21,590** | **19,572** | **12,441** |

The capital program has grown for the third consecutive year. Major projects completed or ongoing in the last number of years included:

- The redevelopment of the Annette Kellerman aquatic centre in Enmore Park was completed in 2011. Since opening, the centre has attracted on average over 1,000 visitors per day
- The Fanny Durack Aquatic Centre is currently being redeveloped in two stages. Stage two is due to commence in 2012
- The Mackey Park refurbishment was completed in 2010. The improved amenities include two full soccer fields and a cricket field. This refurbishment cost $3.1m and was made possible by a grant of $2.3m

### 3.7: Specific Risks to Council

- Population growth. This places pressure on existing infrastructure and services while increasing demand for new infrastructure and services.
- Ageing population. Demographic changes in the Marrickville community suggest that 12.5% of the population will be aged over 65 by 2022 and 22% by 2030; this compares with 10.4% in 2006. Increased demand for home and community care programs will be a likely result.
- Parking revenue and fines. These represent a sizeable proportion of Council's revenue ($3.3m in 2011). The level of individual fines for parking and traffic offences is determined by State Government. Any change in government policy could result in a loss of income.
- Rental revenues. These relate particularly to two sites in Tempe which are situated in a current road reserve. There is a risk that these sites may eventually be acquired by the State Government. There is also a risk that the lessees of Council owned sites may default on their financial obligations.

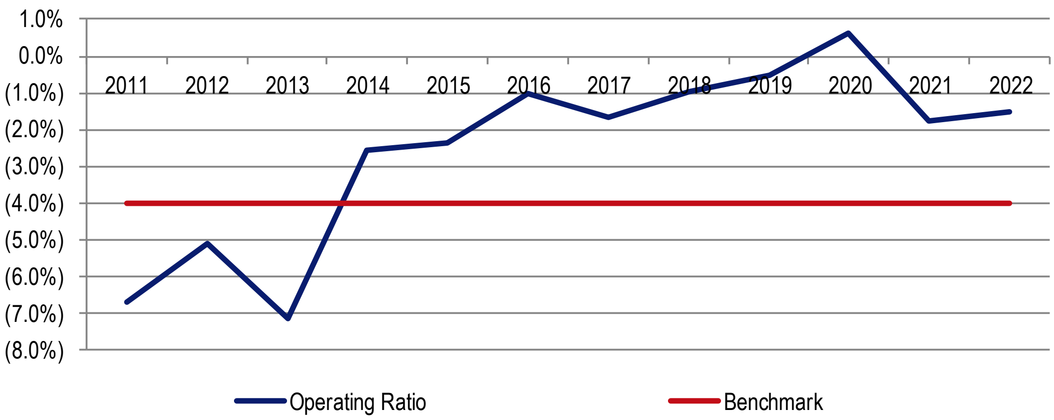
## Section 4 Review of Financial Forecasts

The financial model shows the projected financial statements and assumptions for the next 10 years. The model includes the proposed $1.8m community facilities upgrade loan and the proposed $1.2m road and footpath renewal loan without the LIRS subsidy included.

Council operate just one General fund covering all activities.

### 4.1: Operating Results

Figure 7 - Operating Ratio for General Fund

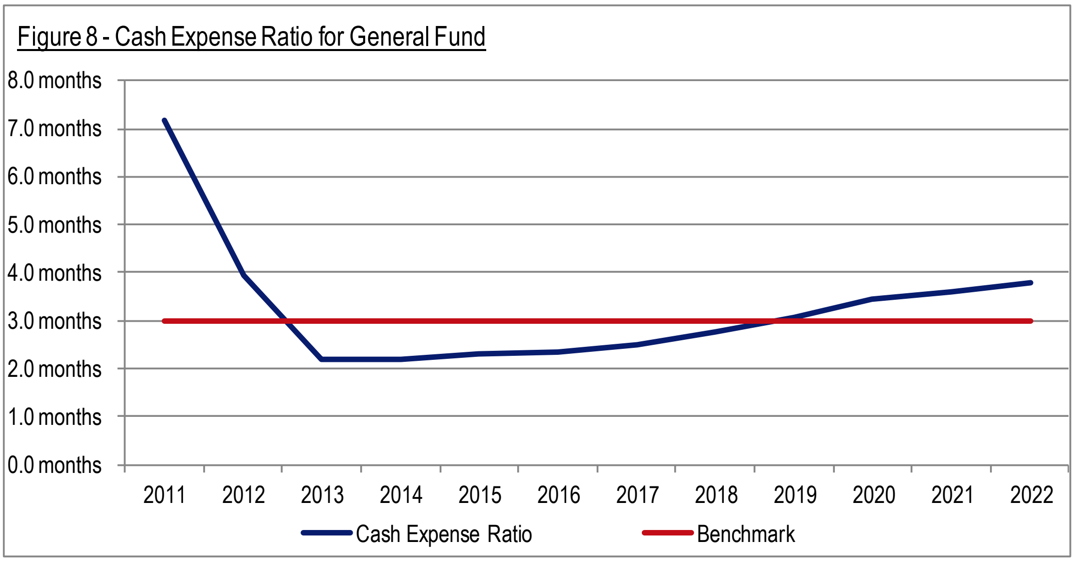



The Operating Ratio shows results are due to improve from 2013 onwards due to increased own sourced revenue both from rates and annual charges, and user fees and charges. The trend is improving over time due to revenue such as rates increasing at a higher rate than expenses including employee costs. The ratio declines in 2021 due to the expiration of the existing 3.5% SRV.

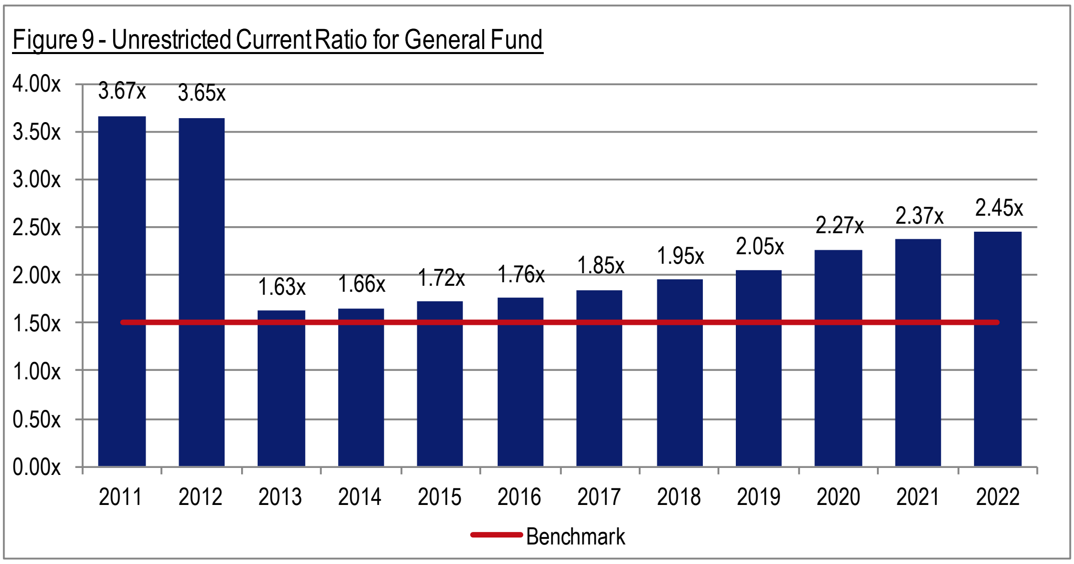
## 4.2: Financial Management Indicators

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

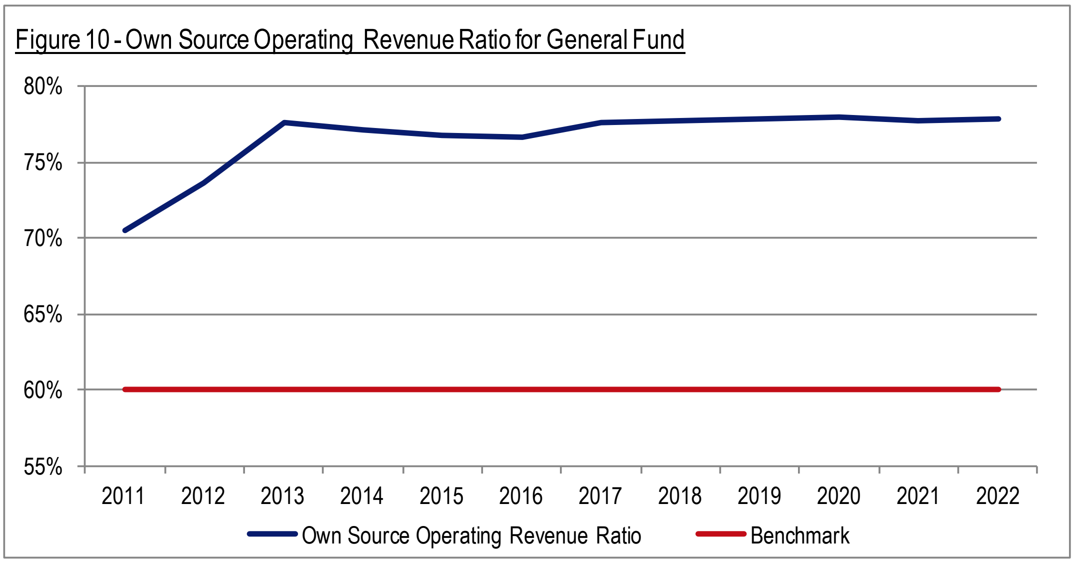



The Cash Expense Ratio indicates that Council's liquidity is below benchmark from 2013 to 2019, but is forecast to increase over the long term. This ratio does not take into account Council's level of investments. When current investments are considered, Council has a satisfactory liquidity position, and would be above the benchmark for the majority of the forecast. See section 3.5 for more on the composition of Council's current investments.

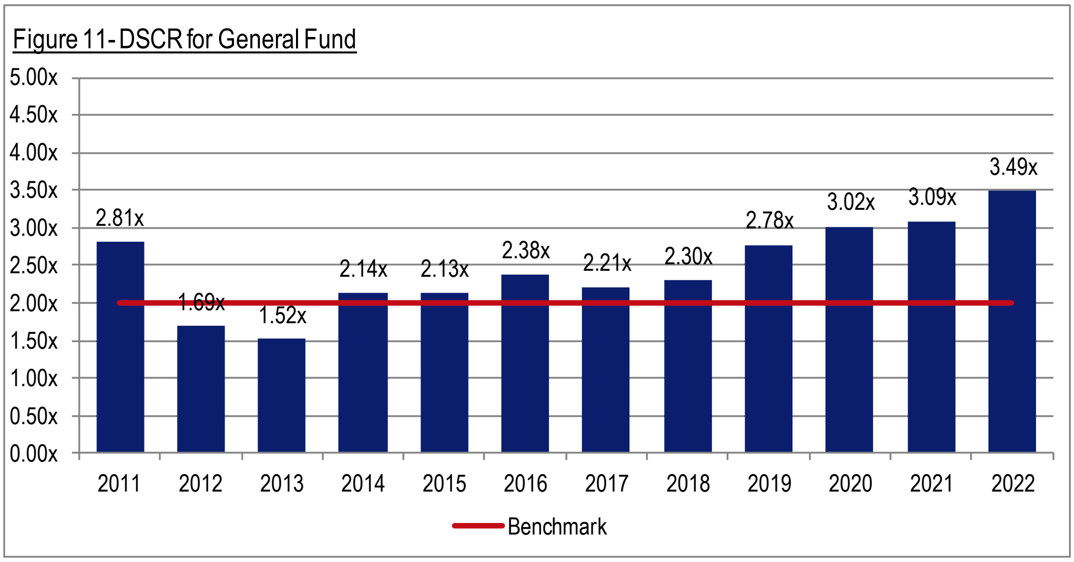


The Unrestricted Current Ratio along with the cash balances indicates that Council will have sound liquidity. Council should be able to service all short and long term liabilities and currently scheduled capital expenditure.

Fiscal Flexibility Ratios




The Own Source Operating Revenue Ratio remains above the benchmark for each year of the forecast. The ratio is rising over the lifetime of the forecast due to capital grants and contributions forecast being lower than historically received. This skews the proportion of Own Source Revenue Ratio upwards.

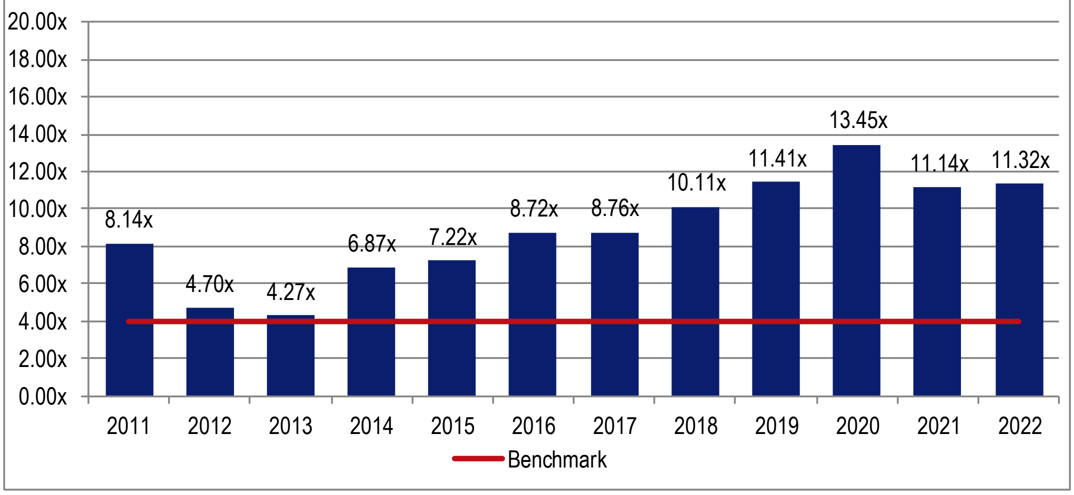



The DSCR is above the benchmark of 2.00x from 2014 onwards with the ratio showing an improved result over time. This indicates that the General Fund has the capacity to manage the additional debt costs that the LIRS applications relate to. The improving ratio over time results from an increasing

EBITDA, and reduced debt service costs. Outstanding borrowings peak at $21.4m in 2014 before gradually falling to $12.6m in 2022.

On occasions Council adopt a somewhat cyclical approach to major works and maintenance by increasing cash reserves then expending the cash on a combination of capital and non capital projects. For example, cash balances fall from $44.3m in 2011 to $14.8m in 2013. The impact of this strategy is that while the 2011 DSCR is above benchmark, as expenses increase in 2012 and 2013 the DSCR decreases before gradually rising again in line with the increasing cash reserves.

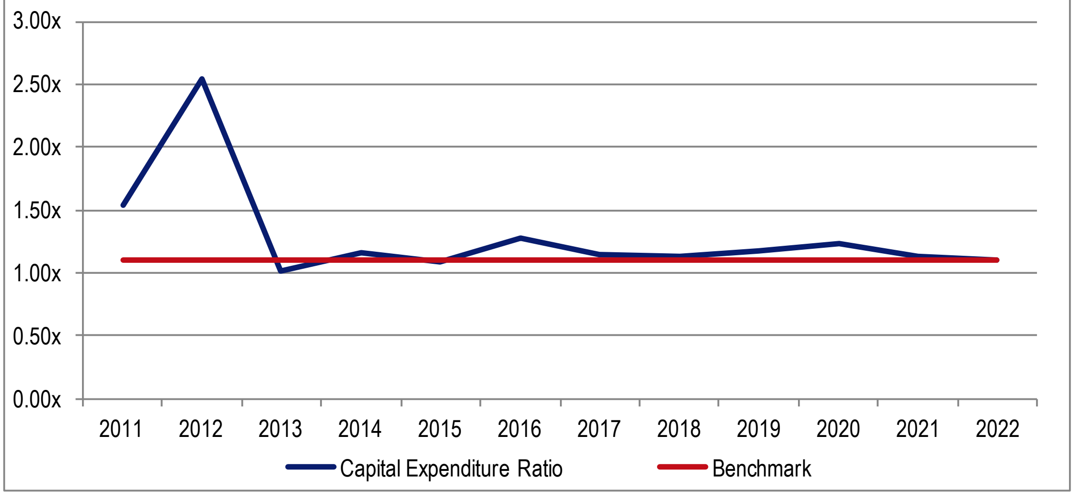
Figure 12 - Interest Cover Ratio for General Fund




The Interest Cover Ratio, similarly to the DSCR, shows the Council has sufficient capacity to service scheduled debt commitments, including the LIRS loans. 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



The Capital Expenditure ratio shows consistent performance across the 10 year period with Council forecasting to be on or around the benchmark figure every year. As Council is forecasting a population increase, the asset base may need to increase in line to meet demand. The total surplus for capital expenditure versus depreciation across the 10 year period amounts to $30.3m in nominal terms.

Council's capital investment in the local roads program is set at $0.8m in 2013 and is adjusted by the scope of works required and CPI for every year thereafter. Council's investment in its footpath upgrade program has been set at $0.5m in 2013 and is adjusted by CPI for every year thereafter. This accounts for about 4.0% of the capital program each year.

Besides capital expenditure on roads, systems, and infrastructure programs the LTFP incorporates expenditure on Council's major projects as follows:

| Project | Capex 2013 |
|---|---|
| Fanny Durack Aquatic Centre | $2.0m |
| SES Headquarters | $1.5m |
| Library - Preliminary Concept | $2.0m |
| Marrickville West Childcare Centre | $1.2m |
| Petersham Administrative centre Building | $2.0m |

Projects such as the Aquatic centre and the library are planned to take more than one year.

### 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 be increased 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%

Key Observations and Risks

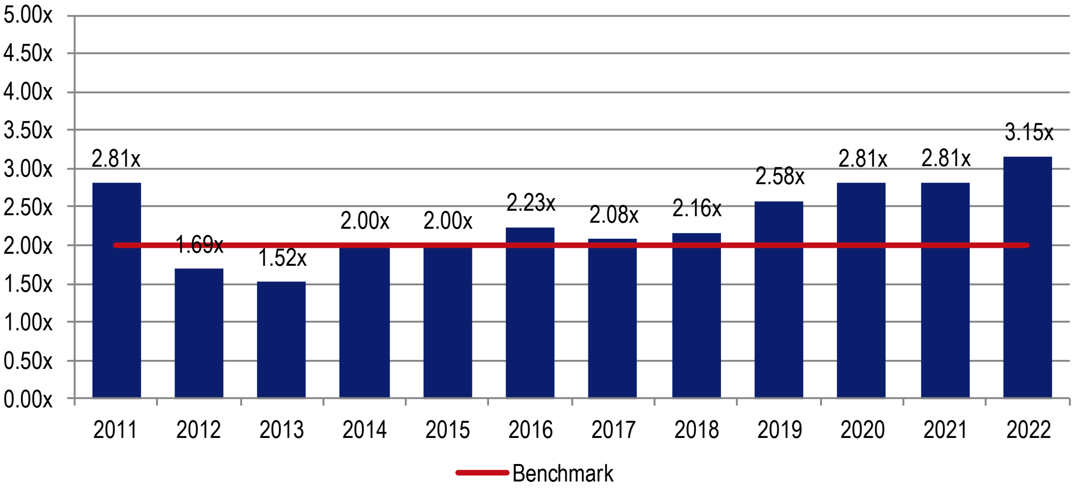
- The forecasts for rates and annual charges are linked to a rates model which provides for growth in the number of properties in accordance with Council's local environmental plan projections (295 additional properties per annum).
- The annual increases of user charges and fees, and materials and contracts expenses are considered reasonable.
- Employee costs are marginally optimistic, forecast to grow between 2.7% and 3.8% p.a., and will need careful management to achieve these levels
- Other expenses have been negatively affected by rising electricity and gas prices.
- This LTFP assumes, a continuation of existing services at current service levels, continuation of existing levels of investment in infrastructure maintenance and renewal, and continuation of existing income sources
- In general the LTFP assumptions are broadly consistent with TCorp's assumptions, and if varied, the LTFP goes into considerable detail as to how the assumptions were calculated.

New South Wales
Treasury Corporation

## 4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will be able to undertake increased loan funding in addition to the proposed LIRS loan facilities and the other existing borrowings incorporated into the LTFP. Some comments and observations are:

Figure 14 - DSCR for General Fund with additional $2.2m in borrowings




- Based on a benchmark of DSCR>2x, $2.2m could be borrowed in 2014 in addition to the $3.0m borrowings proposed under LIRS in 2013
- While the DSCR is below benchmark up to 2013, it increases above benchmark for the remainder of the forecast
- The Interest Cover Ratio will also remain above the benchmark for all years when the additional borrowings are incorporated into the model
- This scenario has been calculated by basing additional borrowing capacity on a 10 year amortising loan with an interest rate of 6.7%
- In this calculation, forecast gains from the disposal of assets each year of between $1.8m and $2.3m have been removed from EBITDA. These proceeds are from the sale of plant and motor vehicles.

# 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 3. There are 17 councils in this group and at the time of preparing this report, we have data for all of these councils.

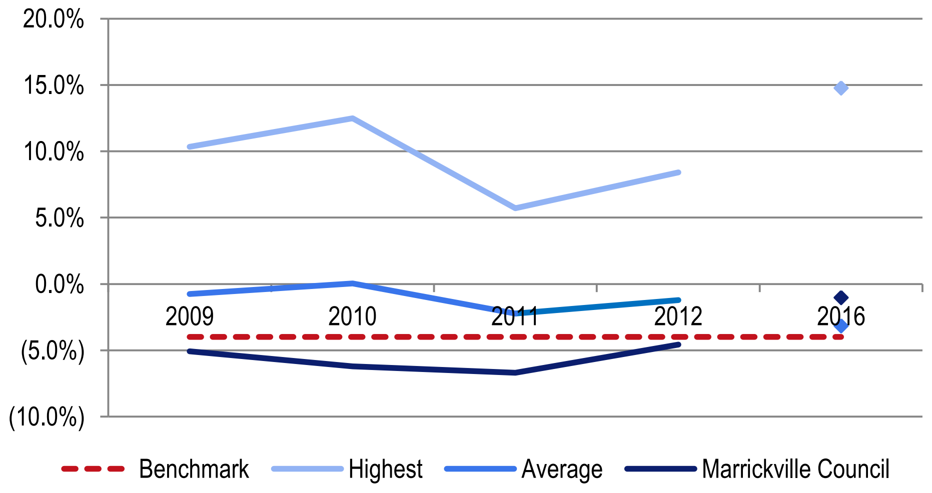
In Figure 15 to Figure 24, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), 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.

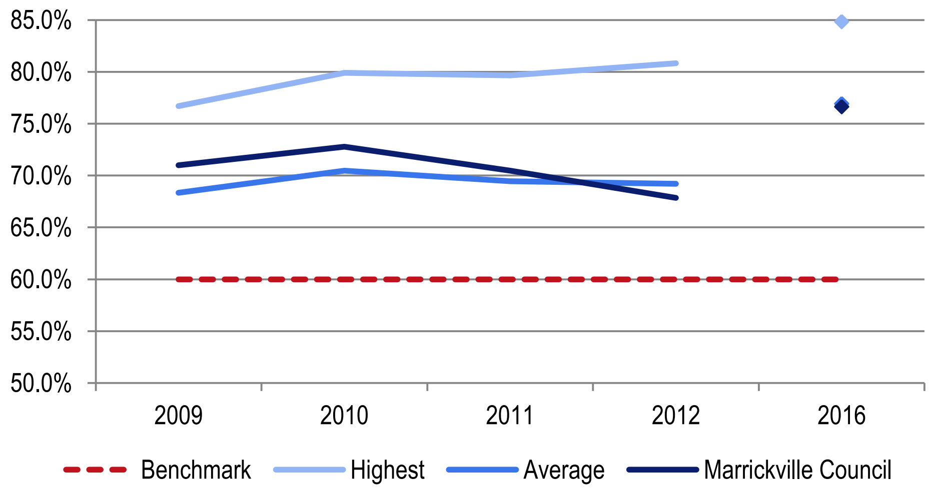
Financial Flexibility

Figure 15 - Operating Ratio Comparison



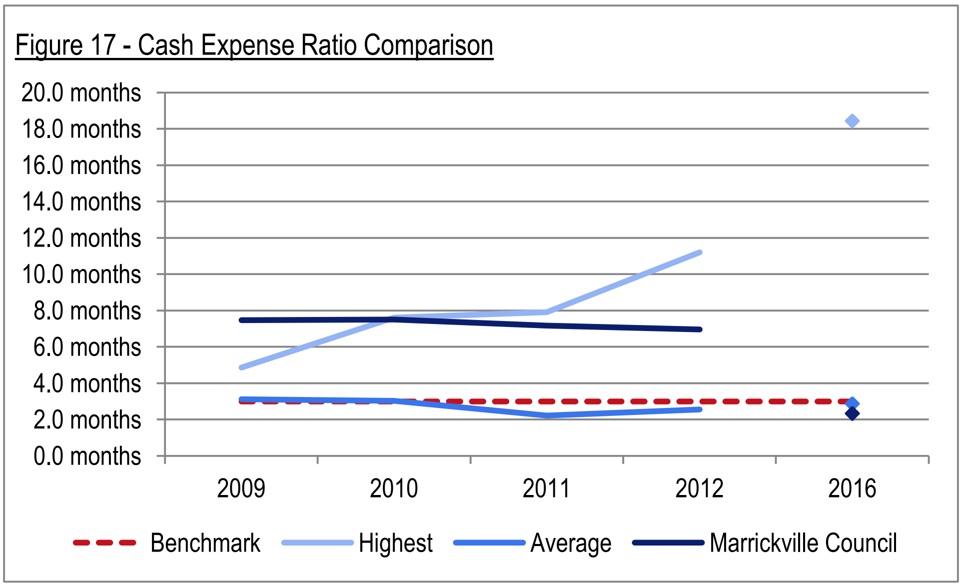

Council's Operating Ratio was below average and the benchmark in the past four years. The results are forecast to improve in the medium term to be above the group's average and benchmark.

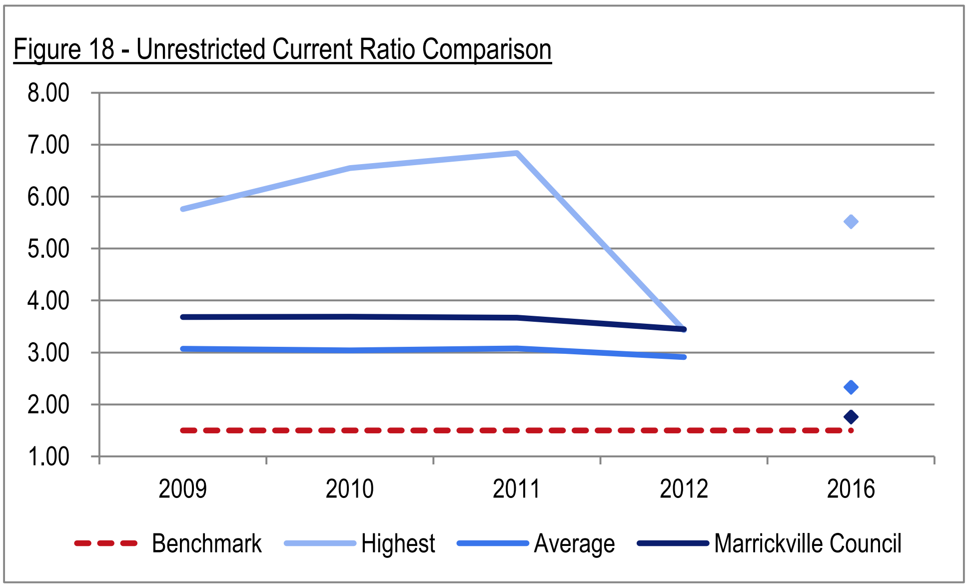
Figure 16 - Own Source Operating Revenue Ratio Comparison




Council's Own Source Operating Revenue Ratio was above the group average in three of the last four years and above the benchmark over the review period. The ratio is forecast to improve in the medium term in line with the group average.

Liquidity




On average over the past four years, the Council's liquidity position has been sound though this is forecast to decline in the medium term.

Debt Servicing

Figure 19 - Debt Service Cover Ratio Comparison

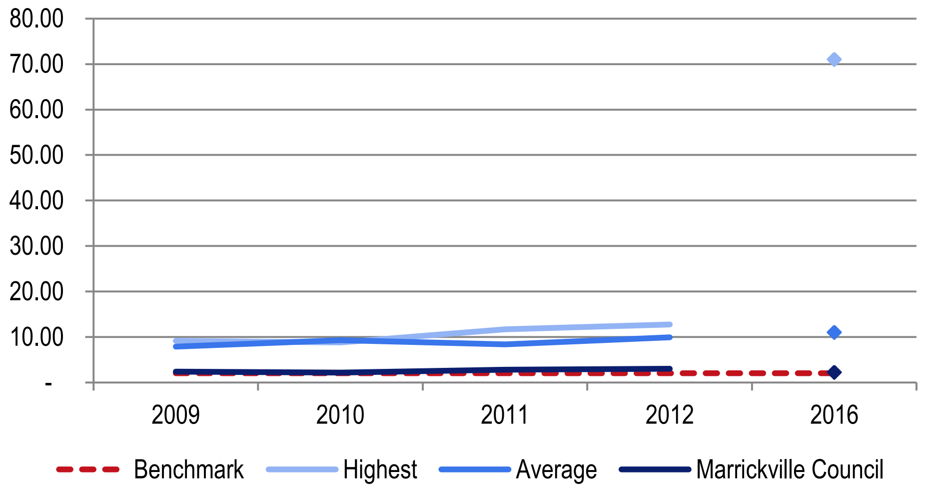
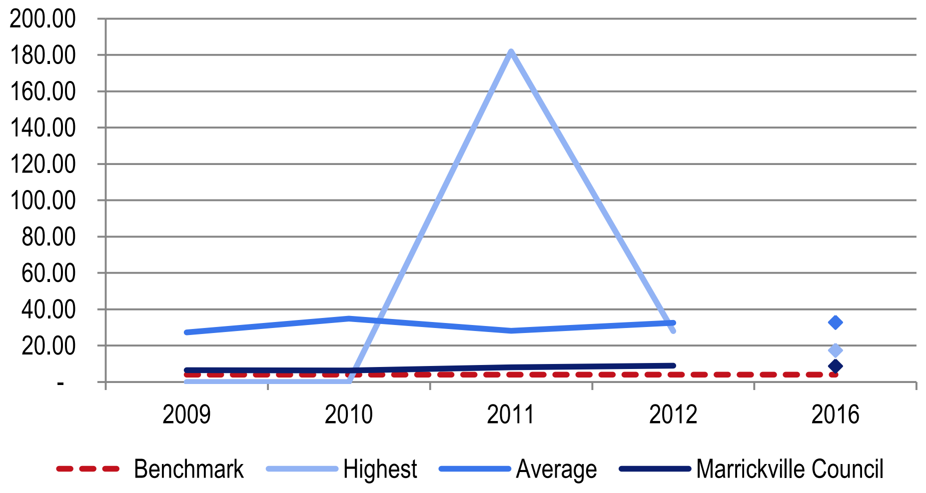



Figure 20 - Interest Cover Ratio Comparison




Council had above benchmark DSCR and Interest Cover Ratio in the past but this is below the group average. Both ratios are below the group average in the medium term indicating that it will be more highly leveraged than other councils in the group.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

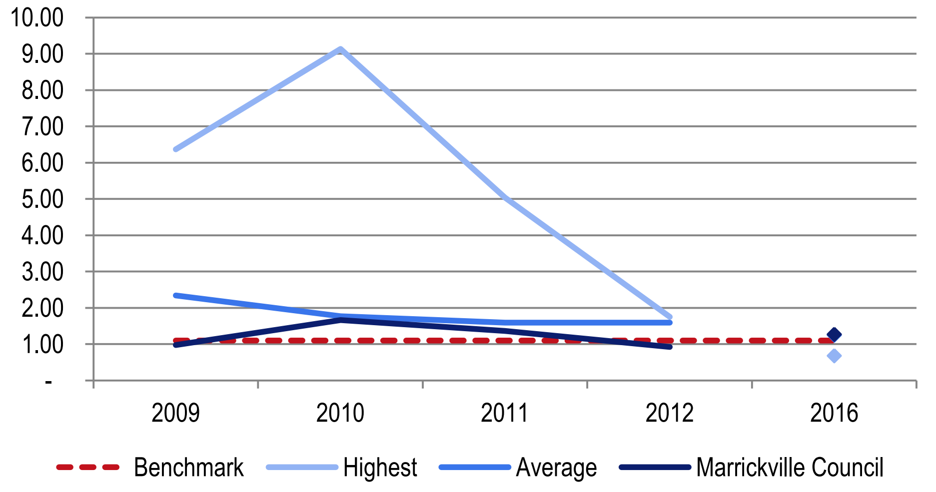



Figure 22 - Asset Maintenance Ratio Comparison

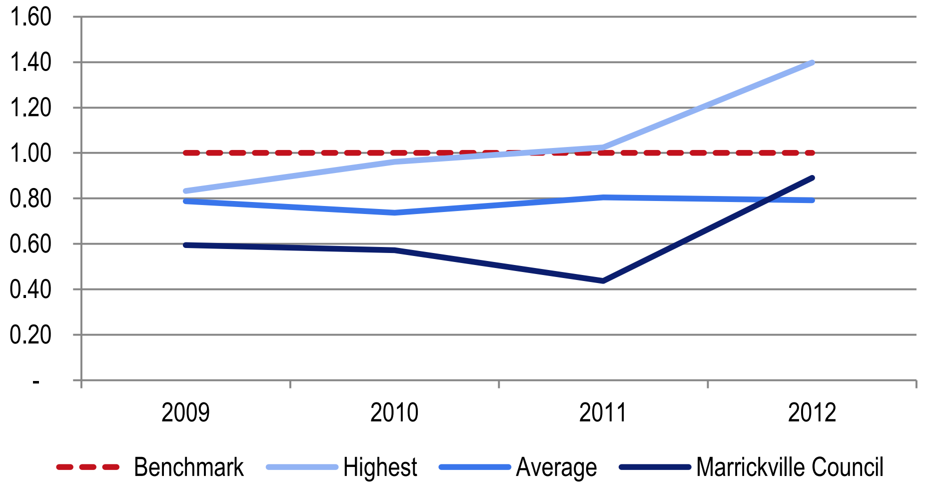


Figure 23- Infrastructure Backlog Ratio Comparison

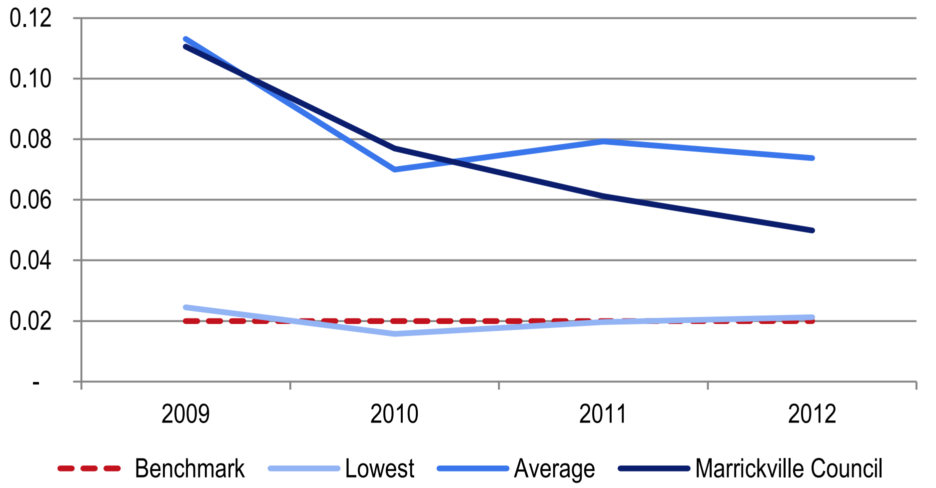
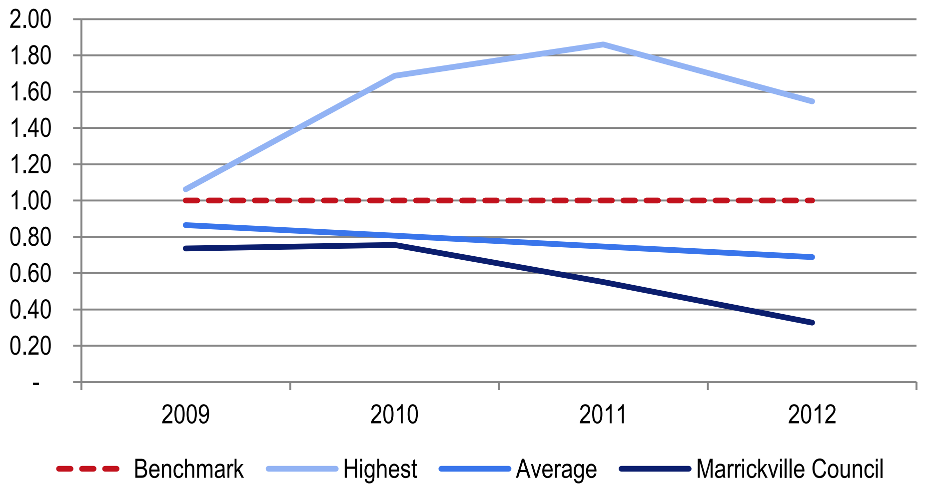



Figure 24 - Building and Infrastructure Asset Renewal Ratio




Overall, the Council has lower than the group average Infrastructure Backlog Ratio. Council's Capital Expenditure Ratio was generally above the benchmark and is forecast to remain around the benchmark in the medium term. However, Council's Asset Maintenance Ratio and Building and Infrastructure Asset Renewal Ratio were generally below the group average and 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 sound financial position.

We base our recommendation on the following key points:

- Council has sufficient financial capacity to repay the additional $3.0m debt highlighted by a DSCR and Interest Cover Ratio above the benchmarks in the majority of its financial forecast
- Council own sourced revenue has grown consistently over the last three years
- Council's cash result (measured using EBITDA) improved over the three year period
- Council have been proactive in measuring their Infrastructure Backlog and are using up to date valuation techniques to obtain the most accurate valuation

We would also recommend that the following points be considered:

- Council are forecasting consistent gains on the disposal of assets each year of the 10 year forecast. This would suggest that Council is undervaluing their assets or the depreciation charge is too high. Council should examine its valuation techniques. For example, we understand from Council that their rate of depreciation is too high on motor vehicles, but Council have acknowledged this and are looking at this issue
- Council's current investment strategy is to fund capital and non capital projects principally through cash reserves, and then to reduce expenditure when cash balances decrease. This leads to the below benchmark DSCR in 2012 and 2013. Council should consider the use of debt as a source of funding which would lead to a more stable and even investment profile and DSCR, and cash reserves could be retained for use in the event of unforseen events

# Appendix A Historical Financial Information Tables

Table 1- Income Statement

| Income Statement ($'000's) | Year ended 30 June | | | % annual change | |
|---|---|---|---|---|---|
| | 2011 | 2010 | 2009 | 2011 | 2010 |
| **Revenue** | | | | | |
| Rates and annual charges | 49,285 | 47,393 | 44,835 | 4.0% | 5.7% |
| User charges and fees | 14,535 | 13,058 | 11,343 | 11.3% | 15.1% |
| Interest and investment revenue | 3,742 | 3,320 | 4,266 | 12.7% | (22.2%) |
| Grants and contributions for operating purposes | 7,208 | 6,662 | 8,125 | 8.2% | (18.0%) |
| Other revenues | 8,930 | 6,478 | 5,143 | 37.9% | 26.0% |
| **Total revenue** | **83,700** | **76,911** | **73,712** | **8.8%** | **4.3%** |
| **Expenses** | | | | | |
| Employees | 41,258 | 39,935 | 37,942 | 3.3% | 5.3% |
| Borrowing costs | 1,174 | 1,110 | 1,140 | 5.8% | (2.6%) |
| Materials and contract expenses | 21,771 | 20,023 | 19,818 | 8.7% | 1.0% |
| Depreciation and amortisation | 13,985 | 10,711 | 10,058 | 30.6% | 6.5% |
| Other expenses | 11,113 | 9,911 | 8,501 | 12.1% | 16.6% |
| **Total expenses** | **89,301** | **81,690** | **77,459** | **9.3%** | **5.5%** |
| **Operating result (excluding capital grants and contributions)** | **(5,601)** | **(4,779)** | **(3,747)** | **(17.2%)** | **(27.5%)** |
| **Operating result (including capital grants and contributions)** | **1,262** | **1,378** | **1,666** | **(8.4%)** | **(17.3%)** |

Table 2 - Items excluded from Income Statement

| Excluded items ($'000) | | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| Grants and contributions for capital purposes | 6,863 | 6,157 | 5,413 |
| Increase (Decrease) in the fair value of investments | (47) | 650 | (263) |
| Net gain/(loss) from the disposal of assets | (1,771) | 91 | 218 |

Table 3 - Balance Sheet

| Balance Sheet ($'000's) | Year Ended 30 June | | | % annual change | |
|---|---|---|---|---|---|
| | 2011 | 2010 | 2009 | 2011 | 2010 |
| **Current assets** | | | | | |
| Cash and equivalents | 44,289 | 43,687 | 41,285 | 1.4% | 5.8% |
| Investments | 15,535 | 17,769 | 24,474 | (12.6%) | (27.4%) |
| Receivables | 4,979 | 5,260 | 4,531 | (5.3%) | 16.1% |
| Inventories | 232 | 234 | 197 | (0.9%) | 18.8% |
| Other | 228 | 443 | 152 | (48.5%) | 191.4% |
| Total current assets | 65,263 | 67,393 | 70,639 | (3.2%) | (4.6%) |
| **Non-current assets** | | | | | |
| Infrastructure, property, plant & equipment | 824,266 | 1,034,275 | 680,353 | (20.3%) | 52.0% |
| Investments held using equity method | 1,370 | 813 | 773 | 68.5% | 5.2% |
| Total non-current assets | 825,636 | 1,035,088 | 681,126 | (20.2%) | 52.0% |
| **Total assets** | **890,899** | **1,102,481** | **751,765** | **(19.2%)** | **46.7%** |
| **Current liabilities** | | | | | |
| Payables | 6,449 | 5,654 | 5,212 | 14.1% | 8.5% |
| Borrowings | 2,568 | 2,228 | 2,117 | 15.3% | 5.2% |
| Provisions | 10,874 | 10,477 | 10,052 | 3.8% | 4.2% |
| Total current liabilities | 19,891 | 18,359 | 17,381 | 8.3% | 5.6% |
| **Non-current liabilities** | | | | | |
| Borrowings | 16,859 | 14,830 | 14,168 | 13.7% | 4.7% |
| Payables | 600 | 0 | 0 | N/A | N/A |
| Provisions | 943 | 1,062 | 940 | (11.2%) | 13.0% |
| Total non-current liabilities | 18,402 | 15,892 | 15,108 | 15.8% | 5.2% |
| **Total liabilities** | **38,293** | **34,251** | **32,489** | **11.8%** | **5.4%** |
| **Net assets** | **852,606** | **1,068,230** | **719,276** | **(20.2%)** | **48.5%** |

Table 4-Cashflow

| Cash Flow Statement ($'000's) | Year ended 30 June | | |
|---|---|---|---|
| | **2011** | **2010** | **2009** |
| Cash flows from operating activities | 16,861 | 11,981 | 11,311 |
| Cash flows from investing activities | (18,628) | (10,352) | 23,709 |
| Proceeds from borrowings and advances | 4,598 | 2,890 | 1,628 |
| Repayment of borrowings and advances | (2,229) | (2,117) | (2,033) |
| Cash flows from financing activities | 2,369 | 773 | (405) |
| **Net increase/(decrease) in cash and equivalents** | **602** | **2,402** | **34,615** |
| Cash and equivalents | 44,289 | 43,687 | 41,285 |

## 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 to a satisfactory standard, measured at a particular point in time. It is unaudited and stated within Special Schedule 7 that accompanies the council's audited annual financial statements.

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

**Ratio Explanations**

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

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

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

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

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

Operating Ratio

Benchmark = Better than negative 4%

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

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

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

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

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

Unrestricted Current Ratio

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

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

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