New South Wales
Treasury Corporation

Wagga Wagga City Council

Financial Assessment and Benchmarking Report

8 October 2012

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 Wagga Wagga City Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Wagga Wagga City 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 Wagga Wagga City Council's (the Council) financial capacity and its ability to undertake additional borrowings. The analysis is based on a review of the historical performance, current financial position, and long term financial forecasts. It also benchmarks the Council against its peers using key ratios.

The report is primarily focused on the financial capacity of the Council to undertake additional borrowings as part of the Local Infrastructure Renewal Scheme (LIRS). Council has made two LIRS applications. One application for $1.5m covers the resealing of roads identified as average/poor in condition. The second application for $1.14m involves the improvement of ageing soccer facilities including field improvements, amenities upgrades, lighting installation and drainage works.

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 is making both applications under the General Fund, we focused our review on this General Fund

Overall, the review has found that 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 results (measured using EBITDA) have improved from $6.6m in 2009 to $20.8m in 2011
- The increase in rates income was supported by an approved SRV from 2007 to 2012. In 2011, the SRV generated an additional $3.7m of revenue which was used to improve service standards on infrastructure and community facilities

Council's reported infrastructure backlog of $151.5m in 2011 represents 12.9% of its infrastructure asset value of $1,177.6m. Other observations include:

- Total infrastructure backlog has increased from $73.5m in 2009 to $151.5m in 2011. The increase has been due to a significant rise in sewerage asset backlog following more detailed asset management planning
- In 2011, the largest portion of the infrastructure backlog related to public roads at $69.6m followed by a sewerage asset backlog at $51.8m

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

- The Council sees initial deterioration in operating deficits once the current SRV expires at the end of 2012 and the Operating Ratio remains below benchmark in all the forecast years
- The Council's level of fiscal flexibility is moderate with Own Sourced Revenue Ratio above benchmark in most of the forecast years. However, this Ratio is partly skewed by understated capital grants in the long term forecast

- In respect of liquidity, Council's forecast Cash Expense Ratio remains below the benchmark for all 10 years. The Unrestricted Current Ratio which is currently above the 1.5x benchmark, falls below this level from 2015 onwards

In our view, Council has the capacity to undertake the additional borrowings of $2.64m for the LIRS projects based on the following comments:

- Council's financial results have been improving and whilst future operating deficits are forecast, Council is undertaking a review to identify cost saving initiatives. Achievement of savings is necessary to strengthen the Council's forecast position
- Whilst the forecast DSCR and Interest Cover Ratio are low for the medium term forecast years, this is mainly due to an extensive borrowing program already included in the forecast. This borrowing program is being undertaken to address backlog and asset renewal projects
- Council needs to closely monitor its debt servicing abilities and liquidity levels on an ongoing basis to ensure it is in a position to meet all of its obligations. Council should ensure that it retains flexibility over its capital expenditure schedule to allow Council to delay or defer projects and required borrowings to provide certainty over its levels of liquidity

In respect of the Benchmarking analysis, TCorp has compared the Council's key ratios, on a consolidated basis, with other councils in DLG group 4. The key observations are:

- Council's financial flexibility, as indicated by the Operating Ratio and Own Source Operating Revenue Ratio, is generally comparable to the group's average
- Council's liquidity position is adequate and generally similar to the group's average
- Council's level of gearing is comparable to that of its peers. Its DSCR and Interest Cover Ratio were above benchmark over the review period
- Council had an overall lower level of Infrastructure Backlog than its peers; however it did not achieve the benchmark throughout the review period. While Council's asset maintenance underperformed the group's average, its capital expenditure and asset renewal generally outperformed the group's average

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	> 1.50x
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

Wagga Wagga City Council LGA	
Locality & Size	
Locality	Murrumbidgee
Area	4,825 km^2
DLG Group	4
Demographics	
Population according to the 2011 census	59,458
% under 20	29.0%
% between 20 and 59	52.7%
% over 60	18.3%
Expected population 2021	66,600
Operations	
Number of employees (FTE)	467
Annual revenue	$158.5 m
Infrastructure	
Roads	2,277 km
Bridges	74
Infrastructure backlog value	$151.5 m
Total infrastructure value	$984.0 m

Wagga Wagga Local Government Area (LGA) is located midway between Sydney and Melbourne, just under 500km from each city. Wagga Wagga is Australia's largest regional city and the LGA has 21 suburbs, nine villages and large areas of rural land.

There is $1.2 billion of infrastructure, property, plant and equipment in the LGA ranging from roads and footpaths, levee banks, bridges, theatres, stormwater and sewer assets, and an airport. The population is forecast to increase by 1% p.a. The growing population and community expectations are requiring the Council to build new infrastructure whilst maintaining current infrastructure.

Council received a SRV for six years expiring at the end of the 2012 financial year to improve the service standard on Council infrastructure and community facilities. The application was made after the Council undertook a comprehensive review of its services and programs and found that the budget provisions for the maintenance of roads, public buildings and parks and sports grounds in particular were insufficient to maintain them at a satisfactory standard.

2.4: LIRS Application

Council has made two LIRS applications:

Project 1: - Local Road Renewal Program

Description: Resealing of roads identified as average/poor in condition before they require reconstruction. The project also includes stabilisation of failed pavement sections.

Amount of loan facility: $1.5m

Term of loan facility: 10 years

Project 2: - Implement Soccer Development Strategy Capital Works

Description: The project involves the improvement of ageing soccer facilities including field improvements, amenities upgrades, lighting installation and drainage works.

Amount of loan facility: $1.14m

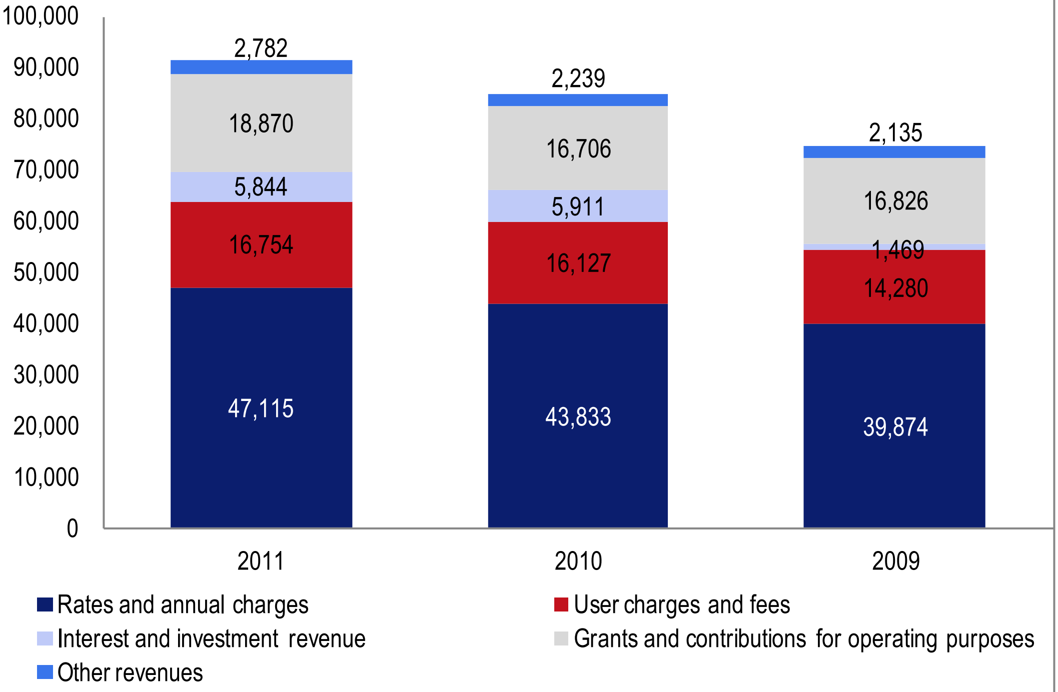
Term of loan facility: 10 years

Section 3 Review of Financial Performance and Position

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

3.1: Revenue

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



Key Observations

- Rates and annual charges are the main sources of income for the Council representing 52% of total income. They have increased by 9.9% and 7.5% in 2010 and 2011 respectively. The increase is partly as a result of the SRV which was at 4.18% above the rate peg for both 2010 and 2011.
- User charges and fees represent 18.3% of total revenue in 2011. They increased by 12.9% in 2010 and 3.9% in 2011. The main driver of this growth was sewerage services charges which increased from $1.5m to $2.5m in 2010.
- Grants and contributions for operating purposes represented 20.6% of total revenue in 2011. The increase of 13.0% in 2011 is mainly due to a $1.0m increase in financial assistance grants from the Grants Commission for road funding and $0.6m extra in specific purpose roads and bridges funding.
- The graph excludes an erroneous revaluation decrement of infrastructure, property, plant and equipment in 2009 and the subsequent reversal in 2011 to rectify the error.
- The graph also excludes impairments to storm damaged assets in 2010 because they were subsequently repaired and the value of the assets reinstated in 2011.

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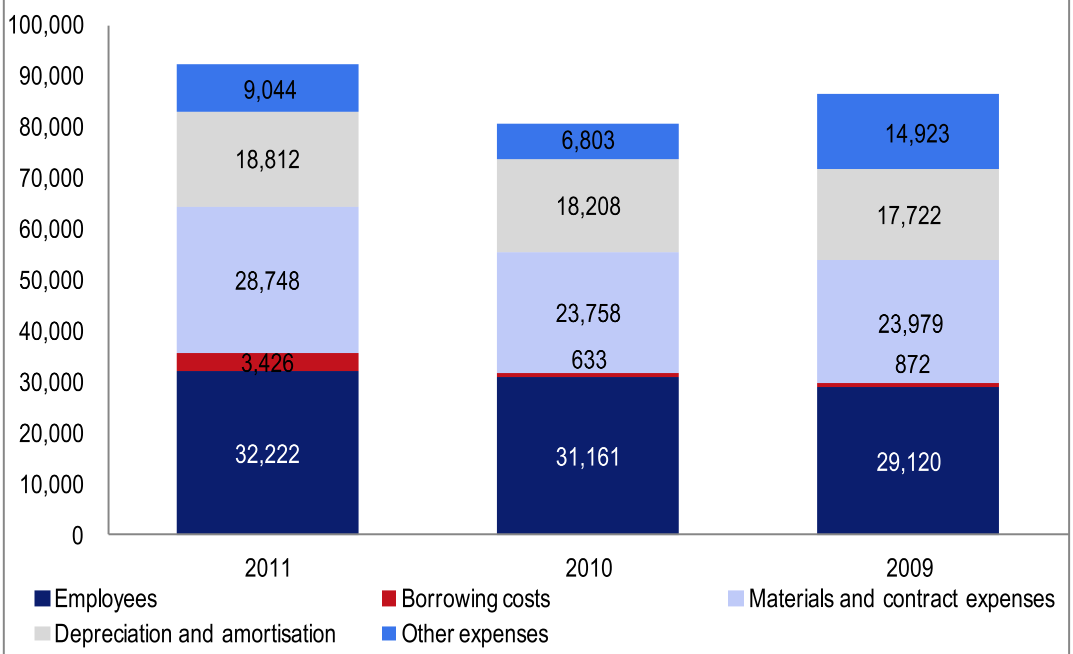
3.2: Expenses

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



Key Observations

- Employee costs are the largest category of expenses at 34.6% of total expenses. Employee costs increased by 7.0% in 2010 and 3.4% in 2011.
- Salaries and wages increased by 8.5% in 2010 and 13.0% in 2011 respectively. The strong growth in salaries and wages has been due to growth in equivalent full-time employees. The increase in 2011 in particular was due to additional overtime carried out by employees in the flood recovery efforts.
- Materials and contracts costs were 21% higher in 2011 mainly due to the increase in road repairs resulting from the storms and floods in 2010. The expenses are largely funded by the RMS in the form of specific purpose capital grants.
- Borrowing costs increased from $0.6m in 2010 to $3.4m in 2011. Though interest costs did not rise significantly, capital works completed by June 2010 previously allowed borrowing costs to be capitalised but had to be expensed in 2011. The capital works include the Sewer 2010 project and the airport runway upgrade.
- In 2011, other expenses grew by 32.9% with an additional $1.7m provision for land remediation. 2009 accounts also included a $7.3m provision for this remediation work. The provisions relate to the treatment of contaminated materials at a former gasworks site. The works are due for completion in the financial year 2013.

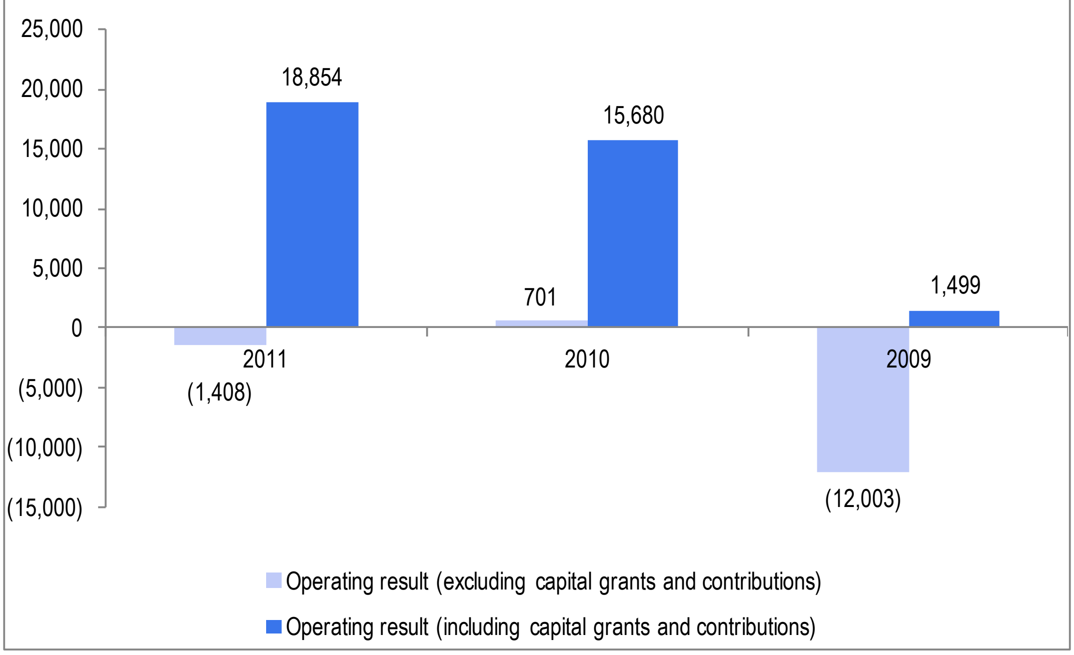
3.3: Operating Results

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

- The Council has seen operating results improve from 2009 to 2011 with the 2011 results showing a small operating deficit (excluding capital grants and contributions). Revenue increased by 22.9% over the three years compared to expenses which increased by 7.5% over the period.
- Strong revenue growth has been assisted by increases in rates (as a result of the SRV) in addition to increases in operating grants and contributions.
- Whilst low growth in expenses has resulted in an improvement in operating results, Council is not yet at a break-even position.

3.4: Financial Management Indicators

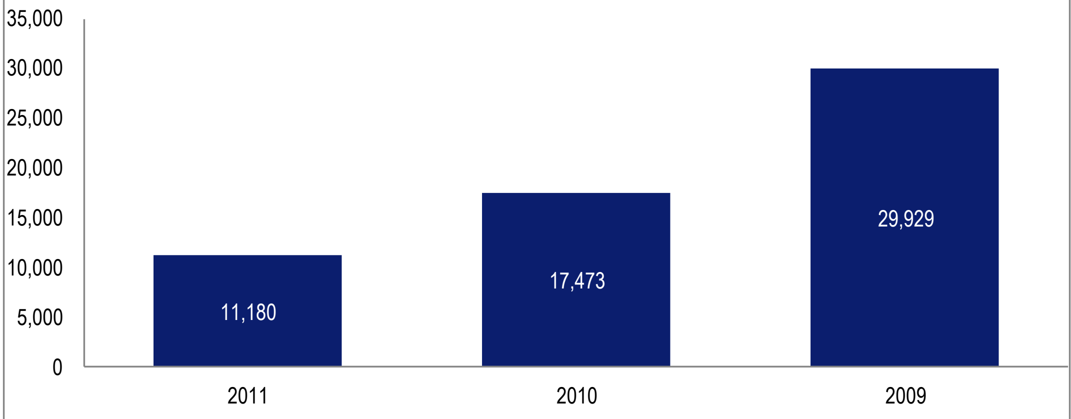
Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA ($'000's)	20,830	19,542	6,591
Operating Ratio	(1.5%)	0.8%	(16.1%)
Interest Cover Ratio	6.08x	30.87x	7.56x
Debt Service Cover Ratio	4.93x	18.99x	7.10x
Unrestricted Current Ratio	3.18x	4.33x	3.68x
Cash Expense Ratio	1.9 months	3.2 months	5.3 months
Own Sourced Operating Revenue Ratio	57.1%	60.0%	61.5%
Net assets ($'000's)	1,267,057	1,155,580	1,103,045

Key Observations

- As debt levels have increased, the Interest Cover and DSCR have deteriorated as a result but remain at levels well above the benchmarks.
- EBITDA has increased over the period along with the improvement in the net operating result
- Council's Unrestricted Current Ratio has reduced over the period to 3.18x in 2011. However the ratio still remains well above the 1.5x benchmark.
- Net Assets have increased by $164.0m between 2009 and 2011 partly due to Asset Revaluations. 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 a $59.6m increase in IPP&E assets.
- The Council has total borrowings of $39.9m with total debt at 3.1% of Net Assets.

3.5: Statement of Cashflows

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



Key Observations

- Council's position in cash and cash equivalents has declined from $29.9m in 2009 to $11.2m in 2011. This is due to more investment securities purchased in 2011 and less proceeds from borrowings with $32m drawn in 2009 compared to no drawdowns in 2011. The borrowings were used to fund the sewer project and airport runway upgrade.
- Total investments have increased from $48.0m in 2009 to $72.0m in 2011.
- Of the $48.6m of cash, cash equivalents and current investments held in 2011, $8.1m is externally restricted, $40.0m is internally restricted and the remainder is unrestricted.
- Of the Council's $31.9m investment portfolio in 2011, $4.3m was invested in managed funds, $25.9m in floating rate notes and $1.7m in capital protected asset linked notes.

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)

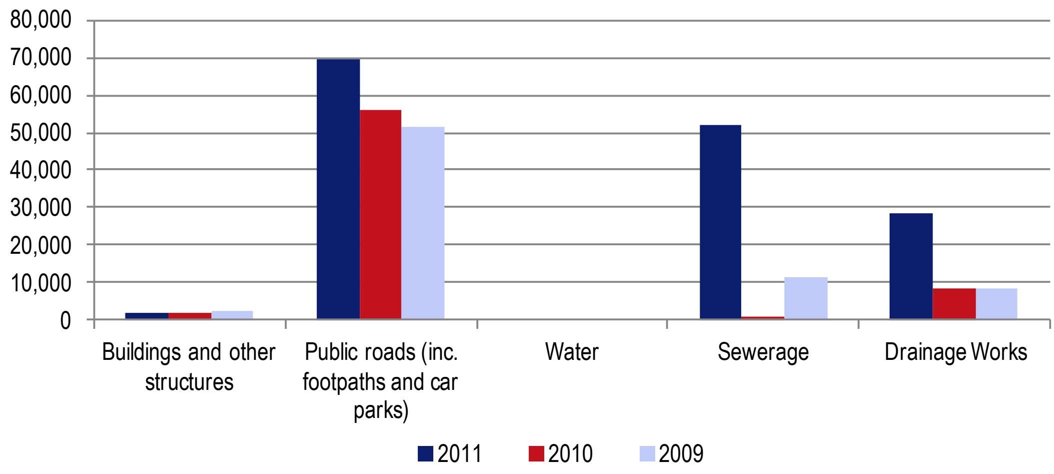
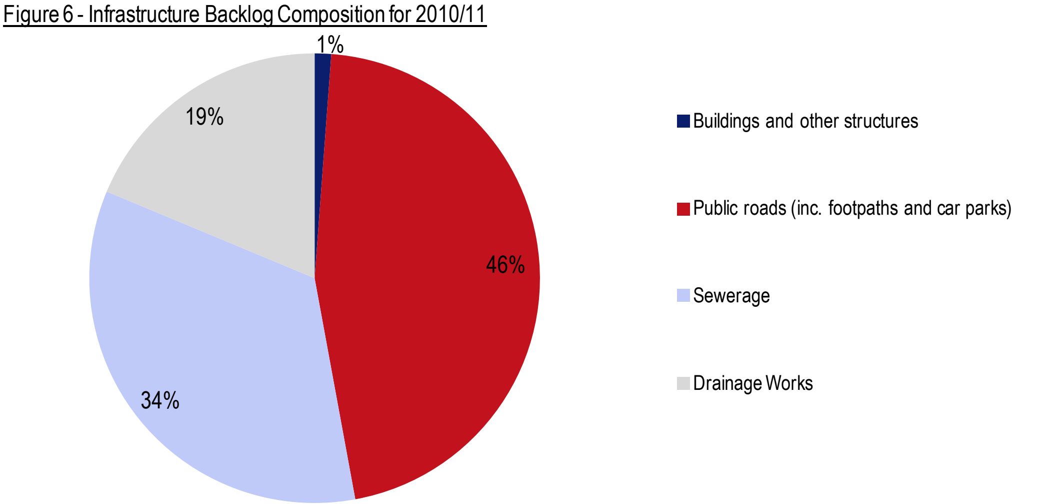


Figure 6 - Infrastructure Backlog Composition for 2010/11



The Council reported a $151.5m infrastructure backlog in 2011 with the largest category of backlog relating to public roads at $69.6m (45.9%). The overall backlog has more than doubled from 2009 to 2011, primarily attributed to increases in public roads and sewerage assets backlog following more detailed asset management planning particularly for the levee bank infrastructure. The Council has recently completed a sewerage upgrade project and should see the backlog figure decrease in the 2012 accounts.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000's)	151,520	67,213	73,521
Required annual maintenance ($'000's)	22,731	19,785	20,007
Actual annual maintenance ($'000's)	14,252	12,956	14,639
Total value of infrastructure assets ($'000's)	983,965	839,519	821,343
Total assets ($'000's)	1,341,700	1,228,633	1,166,964
Infrastructure Backlog Ratio	0.13x	0.07x	0.07x
Asset Maintenance Ratio	0.63x	0.65x	0.73x
Building and Infrastructure Renewals Ratio	0.94x	0.99x	2.58x
Capital Expenditure Ratio	2.05x	2.49x	2.82x

The Infrastructure Backlog Ratio has increased from 0.07x in 2009 to 0.13x in 2011 following more detailed asset condition assessments and valuations.

As indicated by the decreasing Asset Maintenance Ratio, the Council has been spending less than the required annual maintenance each year. Underspending in this area could lead to an increasing backlog.

The Capital Expenditure Ratio has declined to 2.05x in 2011 from 2.82x in 2009 but has been well above the benchmark of 1.1x in all three years. The Building and Infrastructure Renewals Ratio has declined from 2.58x in 2009 to 0.94x in 2011. This indicates that the Council has spent less on renewal capital expenditure compared to new assets.

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	12,092	6,256	7,758
Replacement/refurbishment of existing assets	23,553	25,297	36,367
Total	**35,645**	**31,553**	**44,125**

The capital program has seen a decline in the replacement/refurbishment of existing assets and an increase in new capital works.

Some of the capital works undertaken by Council in the last three years have been:

Airport Runway Upgrade

This $6.7m project included the completion of a major upgrade of the asphalt pavements including the runway.

Airport Instrument Landing System

The new $1.8m Instrument Landing System forms an important part of the aviation training centre strategy. The Airport provided a $1.1m surplus in 2011 which is transferred to a reserve for future capital improvements. The Airport site is owned by the Commonwealth Government and operated by Council under a long term lease.

Sewerage Asset Upgrades

$38.2m was spent on the Sewer 2010 project which included the upgrade of the Kooringakl and Narrung Street sewerage treatment plants. This project was largely completed in the 2010 financial year. A further $2.8m was spent in 2011 on the Flowerdale Pump Station Upgrade.

Reconstruction of Exhibition Centre Netball Courts

During 2011, funding in excess of $1m was allocated to the reconstruction of the Exhibition Centre netball courts where 17 new ‘Rebound Ace’ courts were constructed.

3.7: Specific Risks to Council

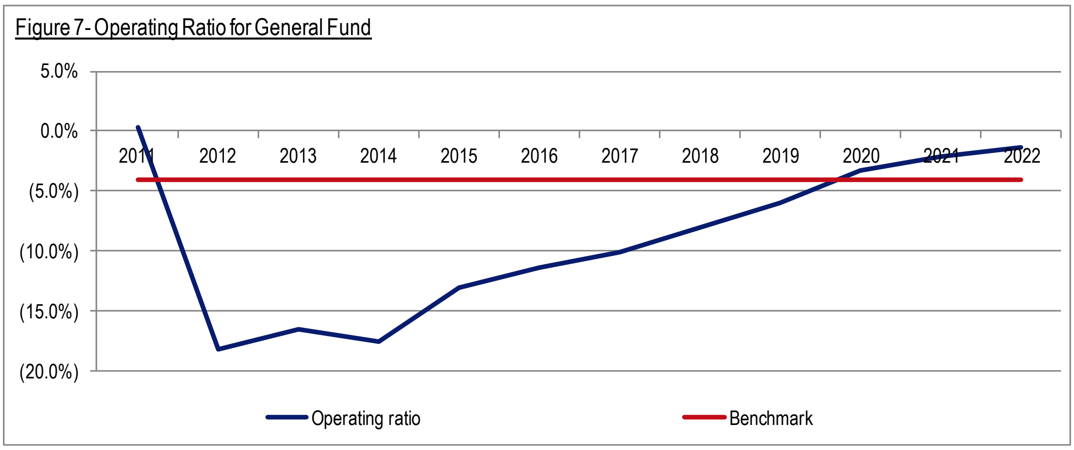
- Natural disaster. The risk of natural disasters remains high with three flood events in 2010 causing significant damage to community infrastructure across the LGA. As a result, the Council had to meet challenges of flood restoration works while delivering planned projects. Council’s management of this risk is substantially reliant on being able to receive both State and Federal funding under various “natural disaster” funds.
- Population growth. Population of the LGA is forecast to increase by 1.01% p.a. for the next decade. Council will need to consider this factor when drafting its IP&R documents as population growth creates higher demands for infrastructure and services.
- Shifts in demographic. The LGA’s population is relatively younger than the State average. This has been driven by growth in students to Charles Sturt University, TAFE, the RAAF base and the Army recruit training facilities. This creates shifts in demand for infrastructure and services such as an increase in demand for sporting and recreational facilities. The Council have considered this factor in its forecast capital works program.
- Commercial activities. Council operates the Livestock Marketing Centre and the Airport as commercial enterprises. Although both these activities have generated operating surpluses in the last three years, Council needs to continue to monitor the commercial risks involved.

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 capital costs of the two LIRS projects and $2.6m of loans without any LIRS subsidy.

The LIRS loans relate to the General Fund, therefore we have focused our financial analysis solely upon this Fund. The Council's consolidated position includes both the General Fund and the Sewer Fund. The Sewer Fund operates as an independent entity, which unlike the General Fund is able to adjust the appropriate fees and charges to meet all future operating and investing expenses.

4.1: Operating Results



The General Fund shows deficit positions are expected in all 10 years when capital grants and contributions are excluded. The weakest forecast ratio occurs in 2012 with a deficit of 18.1% and thereafter gradually improving to a deficit of 1.4% by 2022. With the Council forecast to be in operating deficit for the next 10 years, the Council could face sustainability issues in the future unless additional revenue sources are found or expenses are reduced.

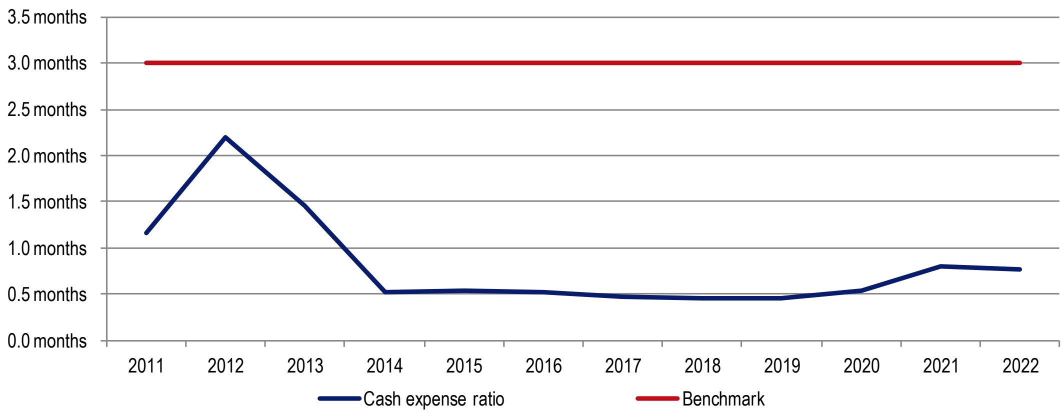
The Council is aware of this issue and has, according to its latest Long Term Financial Plan, formed an internal committee to identify initiatives which could improve the Council's sustainability.

The Operating Ratio is higher in 2011 compared to 2012 due to a $6.3m forecast increase in materials and contracts costs and $4.2m forecast increase in employee costs in the 2012 year.

4.2: Financial Management Indicators

Liquidity Ratios

Figure 8 (a) - Cash Expense Ratio for General Fund



The Council is forecasting a Cash Expense Ratio below the benchmark for all 10 years up to 2022. This indicates the Council will have very low levels of liquidity as it will utilise a majority of its cash reserves by 2014 in order to meet the capital expenditure spending program set by the Council. Major capital works include the $17.5m Riverina Freight & Logistics Hub and $10m PCYC & Bolton Park Stadium Upgrade, both due to complete in 2014.

However this ratio does not take into account Council's level of investments. When total investments are considered, the Ratio improves marginally but remains below benchmark for most of the forecast besides 2013 when reserves remain to fund major capital works in 2014. As at 30 June 2011, 55% of the Council's investments were in deposits, 36% in floating rate notes and the rest in either managed funds or capital protected asset linked notes.

Figure 8 (b) - Cash Expense Ratio with Investments for General Fund

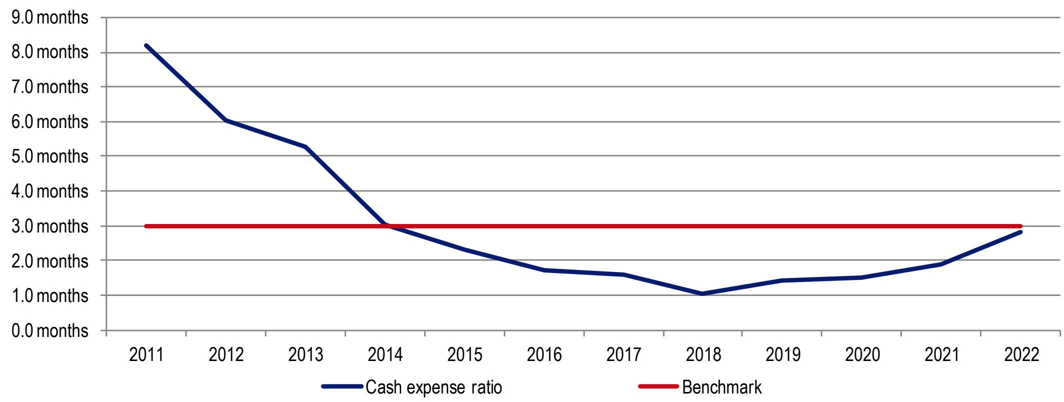
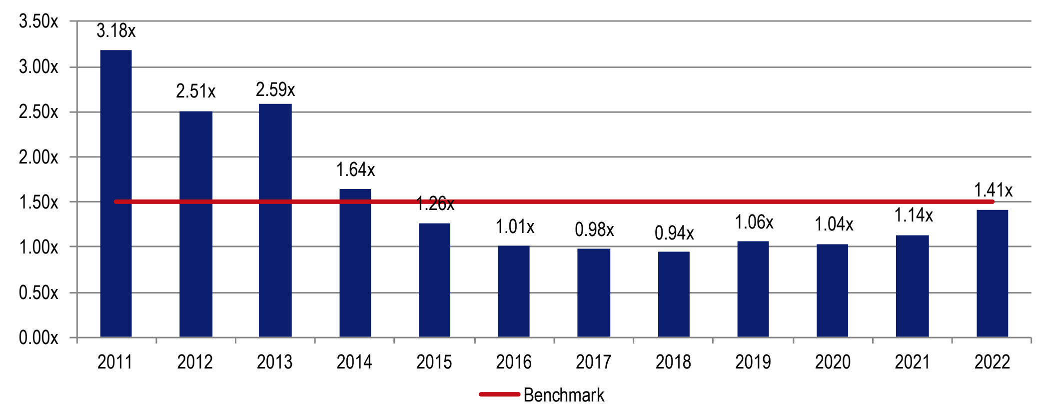


Figure 9 - Unrestricted Current Ratio for General Fund

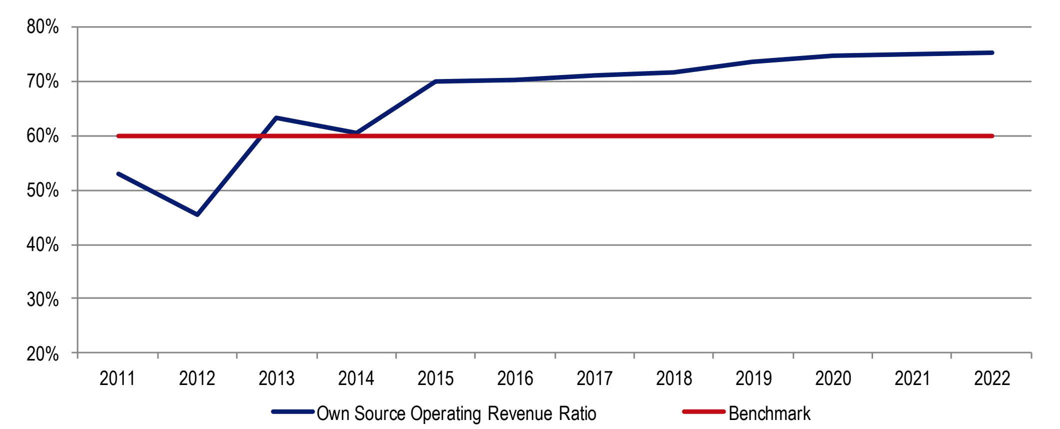


The Unrestricted Current Ratio starts above benchmark but falls below it in 2015 and progressively declines until 2018. After 2018, the Ratio is expected to improve progressively to 1.41x by 2022, which is still below benchmark. The decline from 2015 is due to reserves being used up for capital works spending in 2013 and 2014.

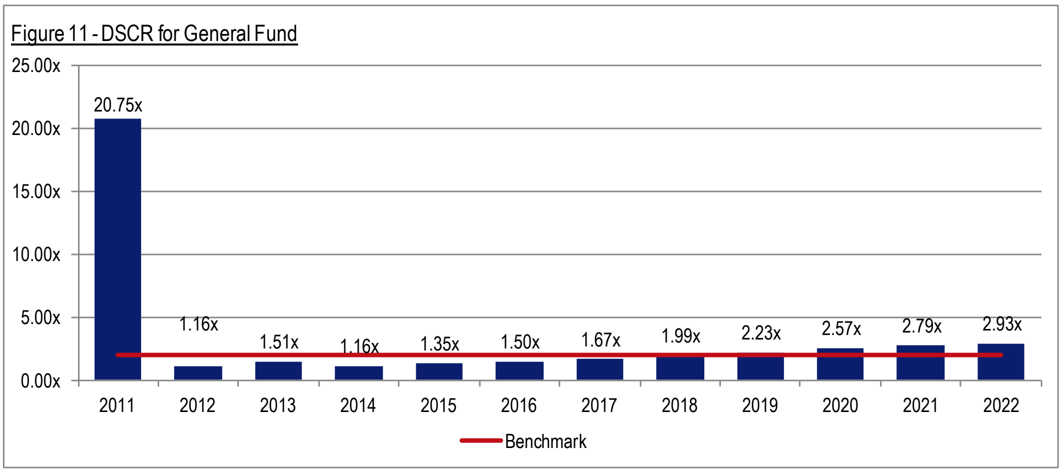
Overall, it appears that the Council will have to closely monitor its liquidity position with the forecast ratios well below benchmark during much of the forecast period.

Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio for General Fund



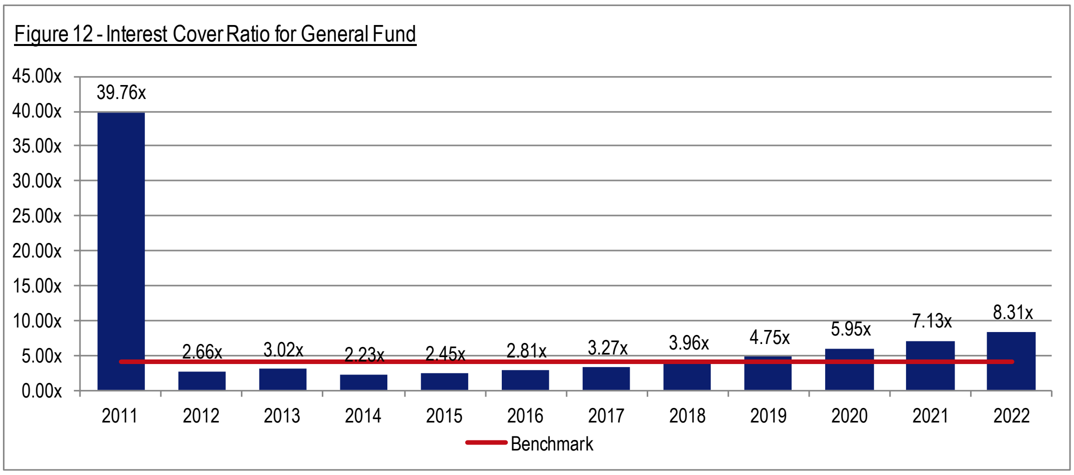
The Own Source Operating Revenue Ratio shows a strong result from 2015 onwards. The dip in 2014 is due to forecast capital grants peaking in that year at $18.7m which skews the proportion of revenue. After 2014, capital grants forecast begin to decline and along with increases in annual rates and charges and user fees, the ratio of Own Source Operating Revenue increases to a high of 75% by 2022. This ratio is higher than the historic result mainly due to forecast capital grants and contributions at lower levels than received historically.



The General Fund DSCR is above the benchmark 2.0x only from 2019 onwards. The ratio begins to improve with increasing EBITDA year on year. The decrease from 2011 is due to an increase in borrowings of $17.9m.

The Council has also forecast an extensive loan program with forecast drawdowns of $8.9m in 2013, $10.5m in 2014, $12.7m in 2015, $5.3m in 2016 and $2.8m in 2017. The new soccer project loan begins interest and principal repayments in 2015.

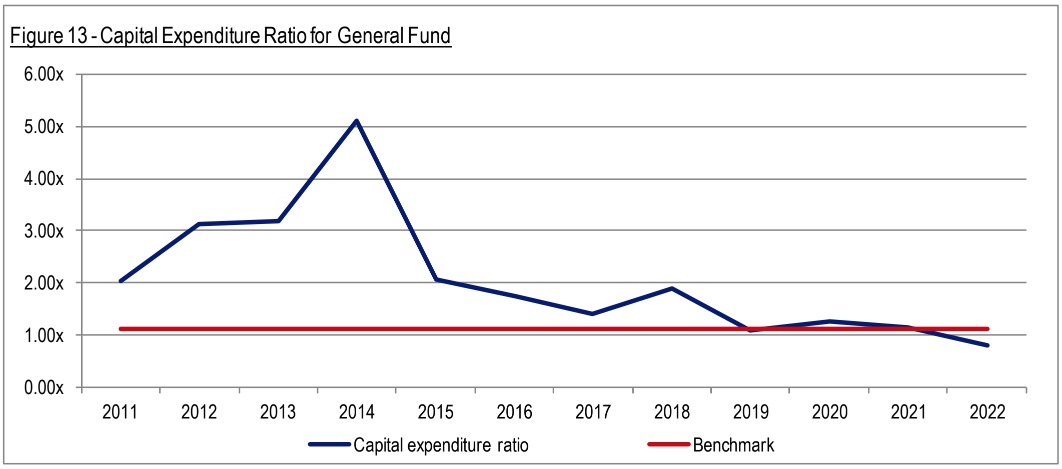
As the DSCR is below benchmark in the medium term, this indicates that the Council's financial forecasts include a significant level of additional debt compared to its forecast EBITDA. Whilst this below benchmark forecast position imposes a level of risk on Council and reduces their flexibility to take on further debt, the progressive drawdown of the debt over a number of years would allow Council to defer some of these debt drawdowns should they need to reduce expenditure.



The Interest Cover Ratio, similarly to the DSCR, shows the Council is forecasting a below benchmark position for the short to medium term. The Interest Cover Ratio is at its lowest in 2014, before progressively increasing to an above benchmark position by 2019 and a high of 8.31x by 2022 with increasing EBITDA.

New South Wales Treasury Corporation

4.3: Capital Expenditure



The Capital Expenditure Ratio is above benchmark in most of the forecast years. The ratio is at its highest level in 2014 as a result of capital expenditure spending of $77.0m. Two major projects in 2014 include the development of the Riverina Freight & Logistics Hub and the Bolton Park Stadium Upgrade. $13.1m is forecast to be spent on asset renewals in 2014. The projection is for the capital expenditure to come down to $32.9m in 2015 where $13.2m is forecast to be spent on asset renewals.

The forecast levels of capital expenditure for the majority of the 10 years are in excess of the required level to maintain the existing level of infrastructure assets and to support forecast population growth. These forecast levels are consistent with Council's policy to improve its assets and service quality.

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 2013 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

- Council has advised the forecast is based on a continuation of existing services, a detailed 10 year capital expenditure plan and continuation of the high level of funding for infrastructure maintenance & renewal, parks and recreation expenditure and additional resourcing for the planning directorate.
- Rates and annual charges are forecast to increase by 4.0% p.a. comprising of forecast rate peg increases and a 1% p.a. growth of rateable properties. This appears marginally optimistic as forecast population growth is 1.01% p.a. It is expected that rateable property increases at a lower rate than population growth.
- Fees and user charges are projected to increase between 1.3% p.a. to 11.8% p.a. Some of the high year on year increase has been explained in the LTFP.
- Employee costs are generally forecast to increase by 3.6% annually, in line with the TCorp benchmark.
- Material and contracts expenses are forecast to remain flat which is an optimistic assumption and will rely on Council's current initiative to seek cost savings to be achieved.
- An extensive 10 year capital expenditure program has been included in the forecast.

4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will not be able to incorporate any further loan funding in addition to the already forecast loans.

This is due to its low forecast DSCR, Interest Cover Ratio and low liquidity levels as measured by the Cash Expense Ratio and Unrestricted Ratio. Council could reconsider its capital expenditure programs and the situation could improve as capital grants, matching the capital expenditure programs, are approved and received. However, based on current estimates excluding capital grants, additional borrowings are not recommended.

We would recommend a further review of this position in two years once greater clarity in respect of forecast capital grants and Council has identified cost saving initiatives.

New South Wales
Treasury Corporation

Section 5 Benchmarking and Comparisons with Other Councils

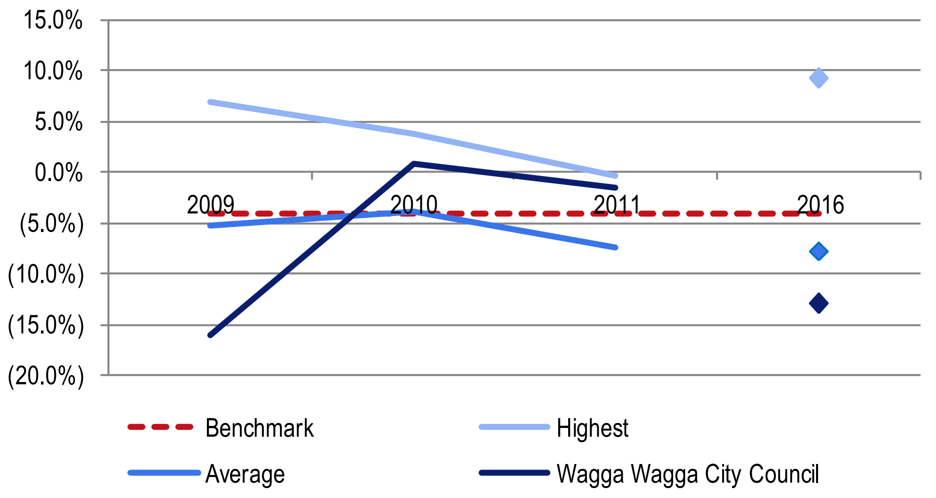
As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis (that is, for councils that operate more than one fund, the results of all funds are included). This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 4. There are 32 councils in this group and at the time of preparing this report, we have data for 19 of these councils.

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

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

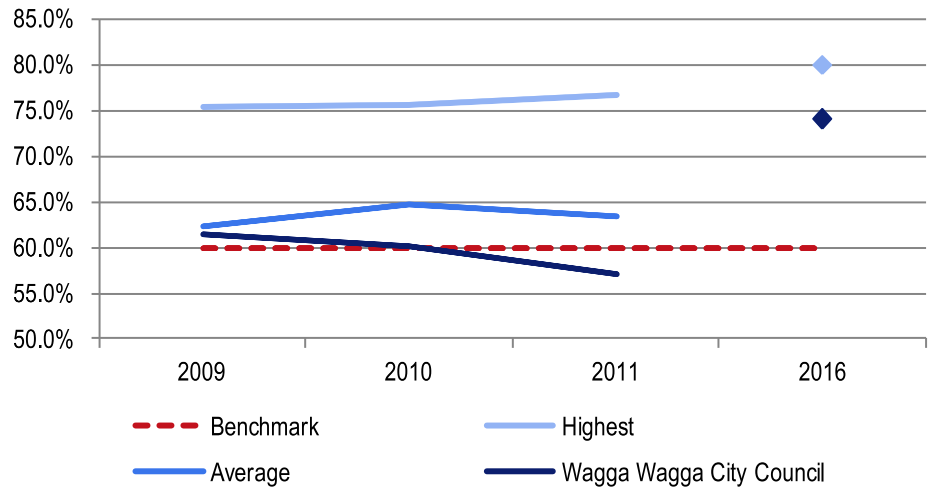
Financial Flexibility

Figure 14 - Operating Ratio Comparison



Council's Operating Ratio improved significantly in 2010 to be above benchmark and the group's average. However, Council's operating results are forecast to decline over the medium term to levels below benchmark and below the average council in the group.

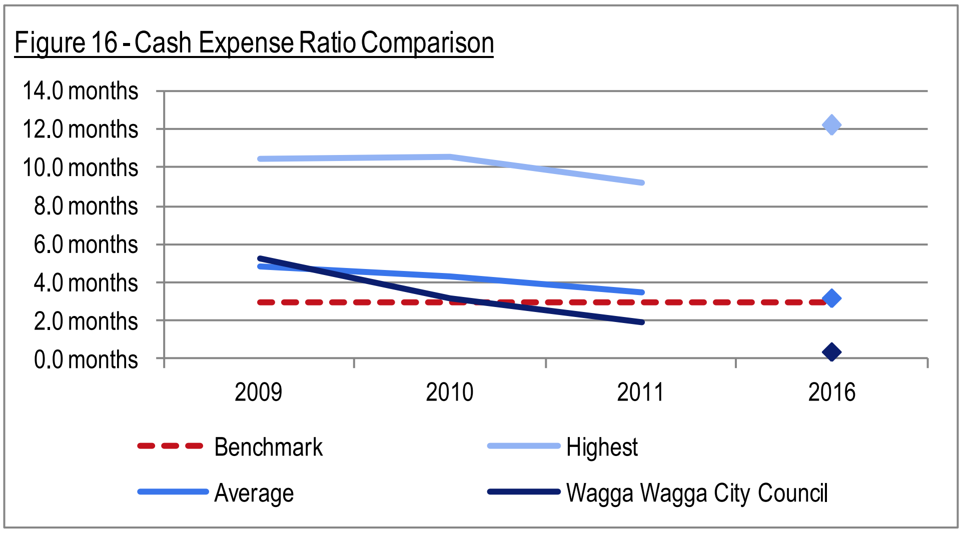
Figure 15 - Own Source Operating Revenue Ratio Comparison

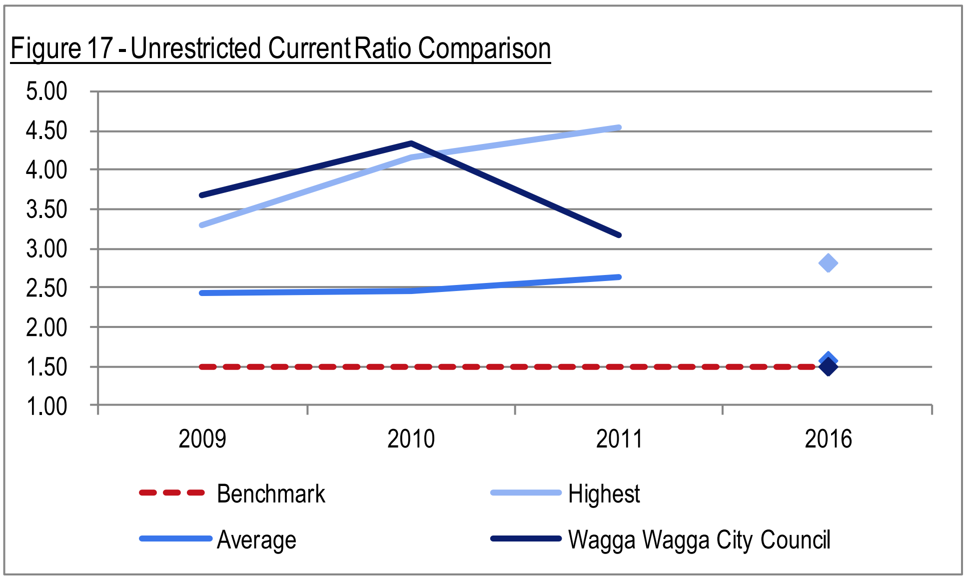


Council's own sourced revenue was near benchmark over the past three years. This ratio is forecast to improve over the medium term to 74% in 2016, exactly in line with the average council in the group and well above benchmark levels.

Overall, Council's level of financial flexibility is sufficient and comparable to the other councils in the group.

Liquidity



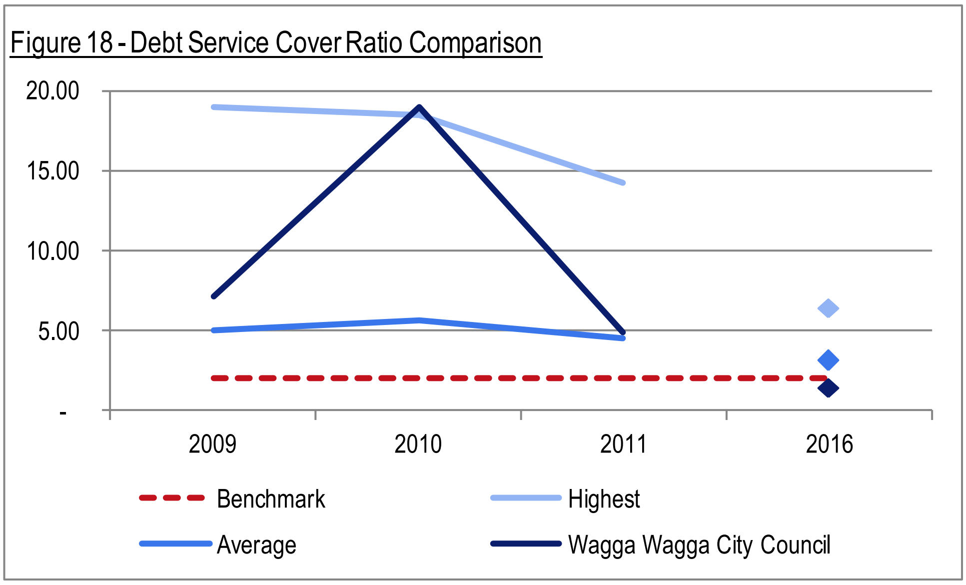


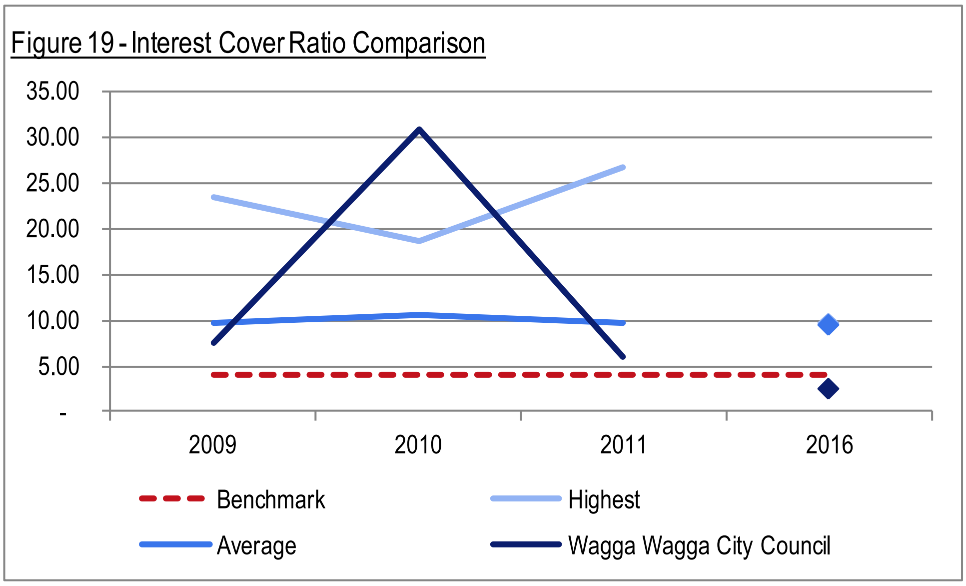
Council's Cash Expense Ratio fell below the group's average in 2010 and below benchmark in 2011. The ratio is forecast to remain below benchmark over the medium term, in contrast to the other councils in the group. This indicates that Council will hold low levels of cash in future years.

Council's Unrestricted Current Ratio was above benchmark and the group's average in the past three years. However, the ratio is forecast to decline over the medium term to benchmark levels, due to Council using up reserves for capital works spending.

Overall, Council's liquidity position is generally comparable to other councils in the group.

Debt Servicing





Over the review period, Council was above benchmark DSCR and Interest Cover Ratio, peaking in 2010 at very high levels of debt servicing, well above benchmark and the group's average in both ratios. However, Council is forecast to slip below benchmark over the medium term in both ratios.

Overall, Council's gearing levels are comparable with the other councils in the group.

Asset Renewal and Capital Works

Figure 20 - Capital Expenditure Ratio Comparison

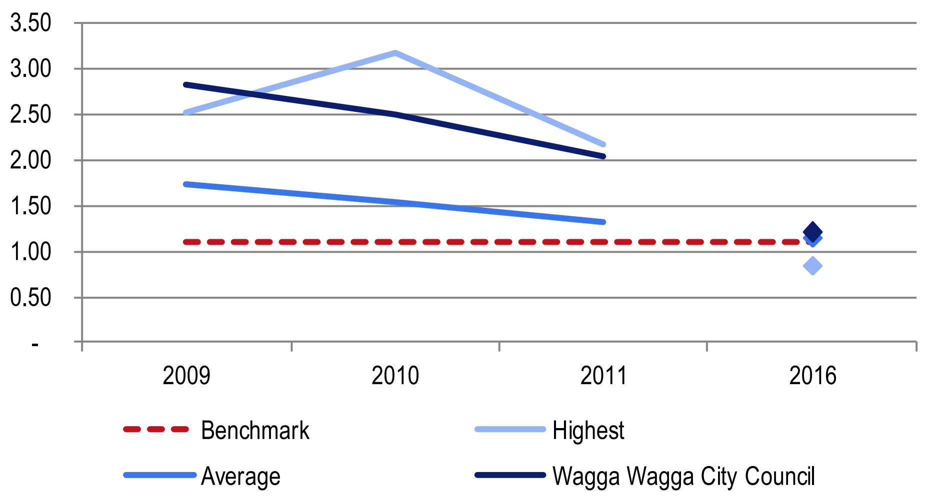


Figure 21 - Asset Maintenance Ratio Comparison

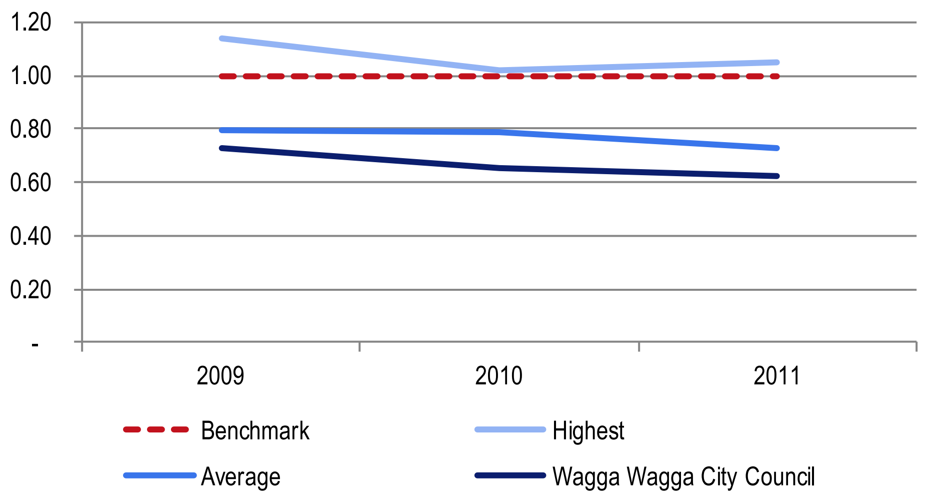


Figure 22- Infrastructure Backlog Ratio Comparison

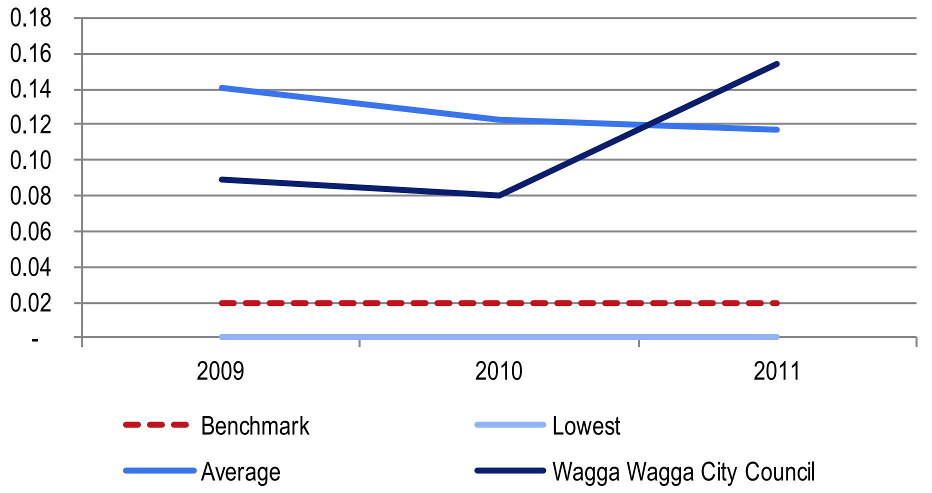
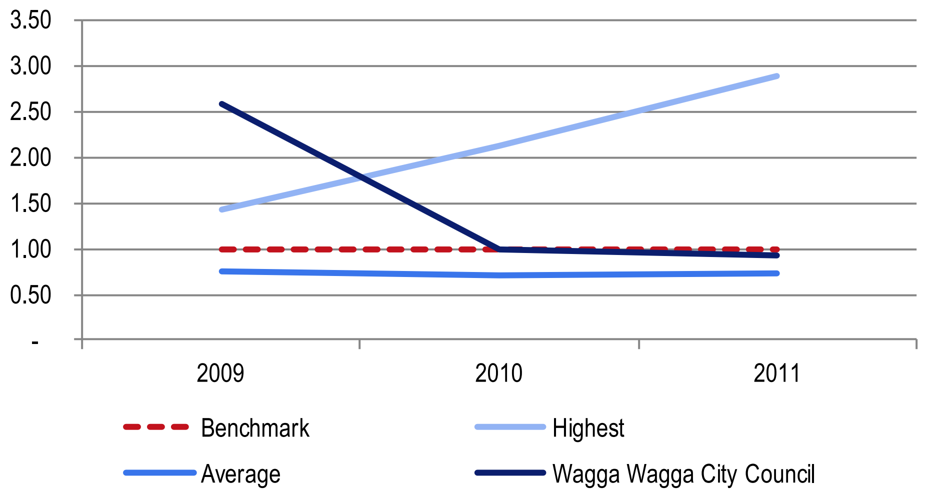


Figure 23 - Building and Infrastructure Asset Renewal Ratio



Council's Infrastructure Backlog was above benchmark in the past three years, and above the group's average in the past year. The backlog spiked in 2011 due to increases in the Council's public roads and sewerage assets backlog. Council's Asset Maintenance Ratio was below benchmark and the group's average in the past three years, indicating that expenditure on asset maintenance each year has been insufficient to contain the backlog.

Spending on capital works was above benchmark over the review period but is forecast to fall to benchmark levels over the medium term, similar to the other councils in the group. Asset renewals declined in 2010 to benchmark levels and remained flat in 2011, suggesting that Council is prioritising new assets over asset maintenance.

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. The quality of management plans, asset management plans, and the long term financial plan suggests that Council is well managed and resourced. However, this position is forecast to deteriorate according to the current Long Term Financial Plan. The Council can undertake the borrowings for the LIRS projects however, its debt servicing capacity and its ability to undertake further major capital works should be carefully considered.

We base our recommendation on the following key points:

- Based on the planned borrowing and capital works schedule, Council's forecast DSCR and Interest Cover Ratio are below benchmark in the short to medium term. Council could consider delaying or cancelling some capital works projects to ensure it can continue to service its existing debt and maintain a reasonable liquidity level
- Council is aware of the financial issues it will face and have established an internal committee to identify initiatives which could improve the Council's sustainability
- Revenue has been increasing at a faster rate than expenses in the last three years
- The Council's debt servicing capacity and liquidity levels have all been well above the benchmarks for the last three years

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

- Council has included an extensive borrowing program in its forecast which results in low forecast liquidity and debt servicing capacity. It should closely monitor these issues and if necessary, reconsider its capital expenditure program
- The Council will need to continue to consider revenue increasing and expenditure reduction initiatives to improve its financial capacity in the medium to long term
- Borrowings in addition to the LIRS related loans and other current forecast borrowings are not recommended based on the current forecasts until the issues noted above are considered and potential improvements identified and implemented

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	47,115	43,833	39,874	7.5%	9.9%
User charges and fees	16,754	16,127	14,280	3.9%	12.9%
Interest and investment revenue	5,844	5,911	1,469	(1.1%)	302.4%
Grants and contributions for operating purposes	18,870	16,706	16,826	13.0%	(0.7%)
Other revenues	2,782	2,239	2,135	N/A	4.9%
Net share of interest in Joint Ventures & Associated Entities	318	82	29	287.8%	182.8%
Total revenue	**91,683**	**84,898**	**74,613**	**8.0%**	**13.8%**
Expenses					
Employees costs	32,222	31,161	29,120	3.4%	7.0%
Borrowing costs	3,426	633	872	441.2%	(27.4%)
Materials and contract expenses	28,748	23,758	23,979	21.0%	(0.9%)
Depreciation and amortisation	18,812	18,208	17,722	3.3%	2.7%
Other expenses	9,044	6,803	14,923	32.9%	(54.4%)
Net losses from disposal of assets	839	3,634	0	(76.9%)	N/A
Total expenses	**93,091**	**84,197**	**86,616**	**10.6%**	**(2.8%)**
Operating result	**(1,408)**	**701**	**(12,003)**	**N/A**	**N/A**

Table 2 - Items excluded from Income Statement

Excluded items ($'000)			
	2011	2010	2009
Grants and contributions for capital purposes	20,262	14,979	13,502
Reversal of prior period revaluation decrements	46,595	0	0
Net gain from the disposal of assets	0	0	1,211
Revaluation decrement	0	0	42,425
Impairment	0	4,171	0

Table 3 - Balance Sheet

Balance Sheet ($'000's)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and equivalents	11,180	17,473	29,929	(36.0%)	(41.6%)
Investments	37,384	30,372	9,767	23.1%	211.0%
Receivables	15,550	9,505	6,822	63.6%	39.3%
Inventories	2,813	2,318	2,428	21.4%	(4.5%)
Other	365	331	237	10.3%	39.7%
Total current assets	67,292	59,999	49,183	12.2%	22.0%
Non-current assets					
Investments	34,657	34,878	38,241	(0.6%)	(8.8%)
Receivables	348	212	1,212	64.2%	(82.5%)
Infrastructure, property, plant & equipment	1,233,035	1,126,850	1,071,585	9.4%	5.2%
Investment property	4,685	5,335	5,500	(12.2%)	(3.0%)
Other assets	1,683	1,359	1,243	23.8%	9.3%
Total non-current assets	1,274,408	1,168,634	1,117,781	9.1%	4.5%
Total assets	**1,341,700**	**1,228,633**	**1,166,964**	**9.2%**	**5.3%**
Current liabilities					
Payables	11,974	10,914	11,335	9.7%	(3.7%)
Borrowings	993	735	318	35.1%	131.1%
Provisions	15,644	9,659	8,554	62.0%	12.9%
Total current liabilities	28,611	21,308	20,207	34.3%	5.4%
Non-current liabilities					
Borrowings	38,879	39,691	31,804	(2.0%)	24.8%
Provisions	7,153	12,054	11,908	(40.7%)	1.2%
Total non-current liabilities	46,032	51,745	43,712	(11.0%)	18.4%
Total liabilities	**74,643**	**73,053**	**63,919**	**2.2%**	**14.3%**
Net assets	**1,267,057**	**1,155,580**	**1,103,045**	**9.6%**	**4.8%**

Table 4-Cashflow

Cash Flow Statement ($'000's)	Year ended 30 June		
	2011	**2010**	**2009**
Cash flows from operating activities	32,872	28,989	26,202
Cash flows from investing activities	(38,611)	(49,749)	(49,389)
Proceeds from borrowings and advances	0	8,700	32,000
Repayment of borrowings and advances	(802)	(396)	(56)
Cash flows from financing activities	(802)	8,304	31,944
Net increase/(decrease) in cash and equivalents	**(6,541)**	**(12,456)**	**8,757**
Cash and equivalents	11,180	17,473	29,929

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.

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.

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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

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.