New South Wales
Treasury Corporation

Byron Shire Council

Financial Assessment, Sustainability and Benchmarking Report

12 March 2013

Prepared by NSW Treasury Corporation for Byron Shire Council, the Division of Local Government and the Independent Local Government Review Panel.

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Disclaimer

This report has been prepared by New South Wales Treasury Corporation (TCorp) in accordance with the appointment of TCorp by the Division of Local Government (DLG) as detailed in TCorp's letters of 22 December 2011 and 28 May 2012. The report has been prepared to assist the DLG and the Independent Local Government Review Panel in its consideration of the Sustainability of each local government area in NSW.

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

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

The report has been prepared for Byron Shire Council, the DLG and the Independent Local Government Review Panel. TCorp shall not be liable to Byron Shire Council or have any liability to any third party under the law of contract, tort and the principles of restitution or unjust enrichment or otherwise for any loss, expense or damage which may arise from or be incurred or suffered as a result of reliance on anything contained in this report.

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Section 1 Executive Summary

This report provides an independent assessment of Byron Shire Council's (the Council) financial capacity and its future Sustainability. The analysis is based on a review of the historical performance, current financial position, and long term financial forecasts. It also benchmarks the Council against its peers using key ratios.

TCorp's approach has been to:

- Review the most recent four years of Council's consolidated financial results
- Conduct a detailed review of the Council's 10 year financial forecasts, with a particular focus on a council's General Fund. Where a council operates a Water or other Fund the financial capacity of these other Funds may be reviewed where considered necessary.

The Council has been satisfactorily managed in some areas over the review period based on the following observations:

- While Council has incurred operating deficits (excluding grants and contributions for capital purposes) in each of the past four years, Council's underlying operating results (measured using EBITDA) have improved from $8.7m in 2009 to $11.4m in 2012
- Council has had strong levels of liquidity throughout the review period

However, the Council reported $207.4m of Infrastructure Backlog in 2012 which represents 38.8% of its infrastructure asset value of $534.2m. Other observations include:

- The backlog is 100.0% road related
- The backlog has increased significantly following the Asset Revaluations process and further development of Asset Management Plans

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

- Council is forecast to consistently record operating deficits of over 10.0%
- The forecast capital expenditure is insufficient to meet the cost of forecast asset renewal requirements

In our view, the Council does not have the capacity to undertake any borrowings in addition to those already included in its LTFP for its General Fund.

We consider Council's financial position to be weak and in a deteriorating position in respect of its longer term Sustainability. Our key observations are:

- Council's LTFP for its General Fund forecasts consistent operating deficits of over 10.0% p.a.
- Council is not spending sufficient amounts on asset renewal and this will reduce the quality of assets and impact the provision of services
- Council has an increasing level of cash and investments reserves. The expenditure of part of the future unrestricted reserves would better enable asset renewal and maintenance

- With an increasing ageing population Council needs to address these issues and consider means of generating additional revenues or reducing operating expenses if it is to improve its prospects for Sustainability

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

- Council's financial flexibility as indicated by the Operating Ratio is below the group average and the benchmark
- Council's Own Source Operating Revenue Ratio is above average
- Council's DSCR and Interest Cover Ratio are below the group averages and benchmarks. In the medium term Council's forecast ratios are expected to marginally improve to be close to the benchmarks
- Council was in a sound liquidity position which is expected to marginally decline in the medium term
- Council's performance in terms of its Infrastructure Backlog Ratio was weaker than other councils in the group and the benchmark
- Council's Asset Maintenance Ratio, Building and Infrastructure Asset Renewal Ratio and Capital Expenditure Ratio have declined to be below the group averages and benchmarks

Section 2 Introduction

2.1: Purpose of Report

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

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

The key areas focused on are:

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

2.2: Scope and Methodology

TCorp's approach was to:

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

In undertaking its work, TCorp relied on:

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

Definition of Sustainability

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

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

Benchmark Ratios

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

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

Therefore these benchmarks are intended as a guide to performance.

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

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

2.3: Overview of the Local Government Area

Byron Shire Council LGA	
Locality & Size	
Locality	Richmond Tweed
Area	556 km^2
DLG Group	4
Demographics	
Population as at August 2011	29,029
% under 20	24.2%
% between 20 and 60	55.5%
% over 60	20.3%
Expected population 2025	33,898
Operations	
Number of employees (FTE)	244
Annual revenue	$61.4m
Infrastructure	
Roads	590 km
Footpaths	109 km
Infrastructure backlog value	$207.4m
Total infrastructure value	$534.2m

Byron Shire Council Local Government Area (LGA) is located on the north coast of NSW and shares its boundaries with the Tweed, Lismore, and Ballina LGAs. Brisbane is approximately 200 kilometres north and Sydney approximately 800 kilometres to the south.

The principal economic driver in the LGA is tourism, with an estimated value of $370.0m in 2006 from about 1.3m visitors. Tourism has a major impact on the retail, food, accommodation, construction and wholesale sectors. Agriculture and related value added products, and the creative industries also contribute substantially to the economy.

Similarly to many LGAs in the state, Council has an ageing population with over 25.0% of the population predicted to be over 60 by 2021.

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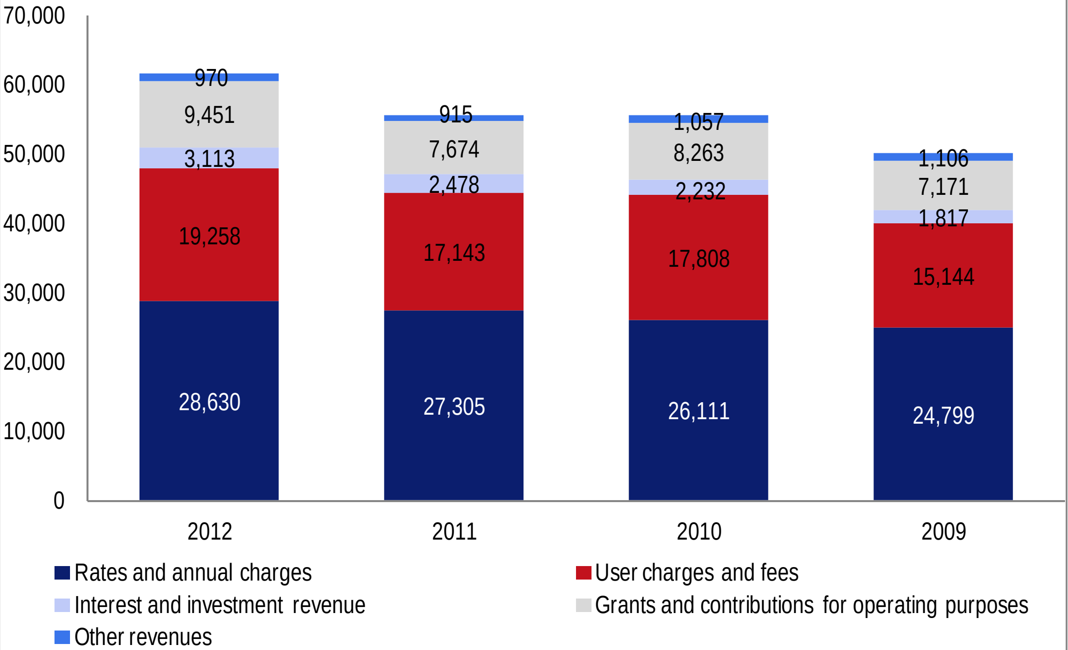
Section 3 Review of Financial Performance and Position

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

3.1: Revenue

Figure 1 - Revenue Sources for 2008/09 to 2011/12 ($'000s)

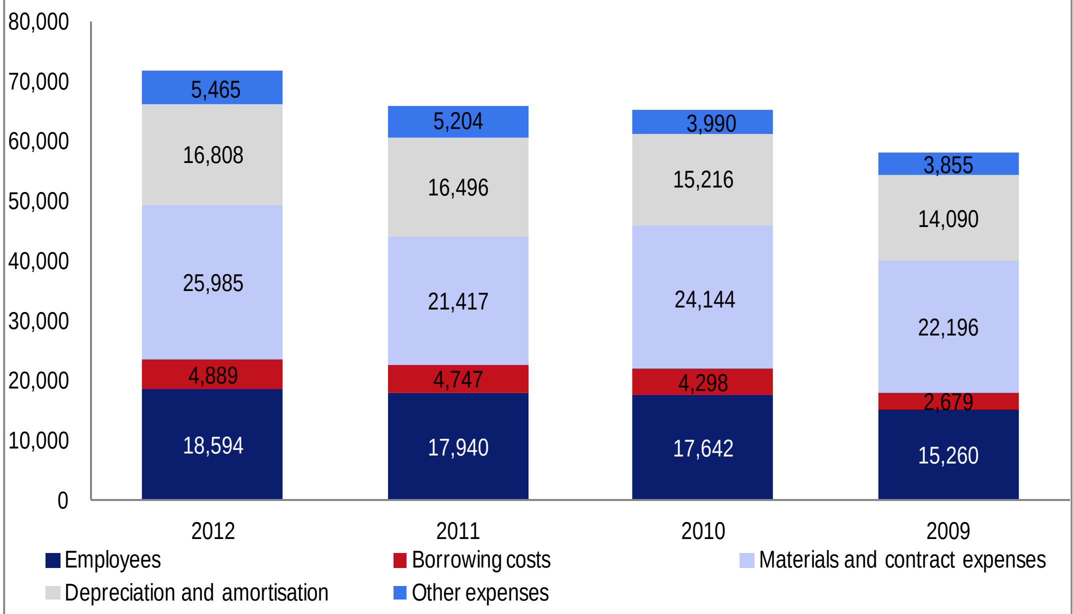


Key Observations

- Rates and annual charges increased in line with the IPART approved rate peg over the past four years along with an increase in the number of assessments.
- User fees and charges increased in 2012 due to increased water consumption, as well as increases in Council's fees and charges schedules. User fees and charges also had significant increases in 2010 due to increases in specific user water and sewerage charges.
- Within user fees and charges, Council also reported revenue from swimming pools, property rentals, quarries, parking, and holiday parks. Holiday parks reported an operating surplus of $0.5m in 2012.
- Grants and contributions for operating purposes increased in 2012 and 2011 due to the prepayment of Financial Assistance Grants.
- Other revenues are made up solely of fines.

3.2: Expenses

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



Key Observations

- Employee expenses increased by 21.8% over the review period. General wage escalations and decreased capitalisation of costs due to flood repairs contributed to the increase.
- Borrowings costs have been increasing since Council borrowed $28.6m in 2009 to fund the construction of the Brunswick Valley Sewerage Treatment Plant.
- Materials and contract expenses have increased as a result of significant natural disaster repairs costing approximately $3.0m in 2012.
- Depreciation charges increased over the review period from $14.0m in 2009 to $16.8m in 2012, following the Asset Revaluations process which increased the value of Council's infrastructure assets.
- Other expenses include electricity and heating, and contributions to the Richmond Tweed Regional Library.

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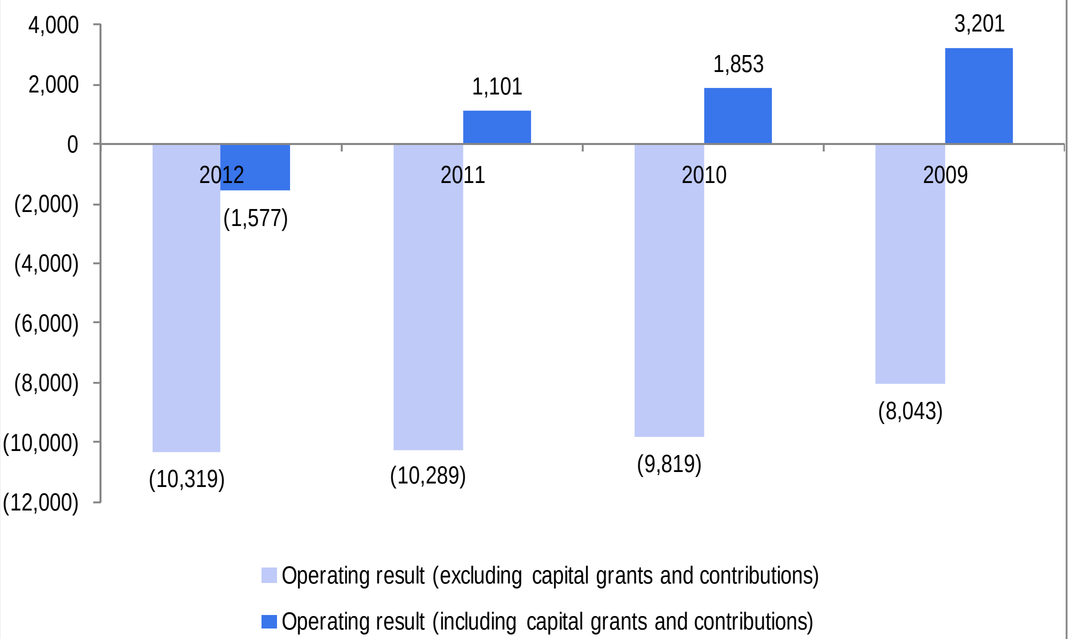
3.3: Operating Results

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

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

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

Figure 3 - Operating Results for 2008/09 to 2011/12 ($'000s)



Key Observations

- Council's operating performance has declined over the review period, mainly driven by increased employee and depreciation expenses. Council's operating performance in 2012 and 2011 was overstated due to the prepayment of $0.6m, and $0.3m respectively of Financial Assistance Grants.
- Council expenses include a non-cash depreciation expense, ($16.8m in 2012). Whilst the non cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

3.4: Financial Management Indicators

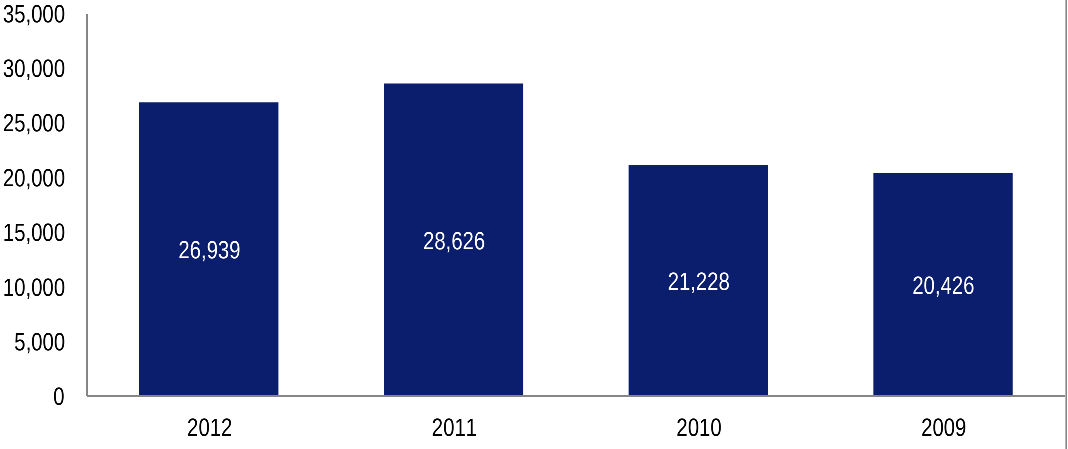
Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA ($'000s)	11,378	10,954	9,695	8,726
Operating Ratio	(16.8%)	(18.5%)	(17.7%)	(16.1%)
Interest Cover Ratio	2.33x	2.31x	2.26x	3.26x
Debt Service Cover Ratio	1.51x	1.51x	1.48x	1.93x
Unrestricted Current Ratio	2.89x	2.66x	2.19x	1.99x
Own Source Operating Revenue Ratio	68.3%	66.4%	65.4%	65.2%
Cash Expense Ratio	6.5 months	7.7 months	5.6 months	5.9 months
Net Assets ($'000s)	772,101	755,692	611,764	549,487

Key Observations

- Council's EBITDA increased marginally over the four year review period.
- Council borrowings have increased over the review period to fund the construction of the Brunswick Valley Sewerage Treatment Plant and Regional Sport and Cultural Complex. This has resulted in the DSCR and Interest Cover Ratio being lower than the benchmark indicating there is no further capacity to borrow.
- Council had total borrowings of $72.8m outstanding in 2012, being 9.4% of Net Assets.
- The Unrestricted Current Ratio and Cash Expense Ratio have been above the benchmarks in all four years indicating liquidity is sufficient.
- The Own Source Operating Revenue Ratio has been above the benchmark in all four years reflecting Council's fiscal flexibility.
- Net Assets have increased by $222.6m between 2009 and 2012 due to the Asset Revaluations which increased the value of Council's infrastructure assets.
- The Asset Revaluations over the last four years have resulted in some volatility in Net Assets. 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 Council.
- When the Asset Revaluations are excluded, the underlying trend in all four years has been an expanding Infrastructure, Property, Plant and Equipment (IPP&E) asset base with asset purchases being larger than the combined value of disposed assets and annual depreciation. Over the last four years this amounted to a $65.1m net increase in IPP&E.

3.5: Statement of Cashflows

Figure 4 - Cash and Cash Equivalents for 2008/09 to 2011/12 ($'000s)



Key Observations

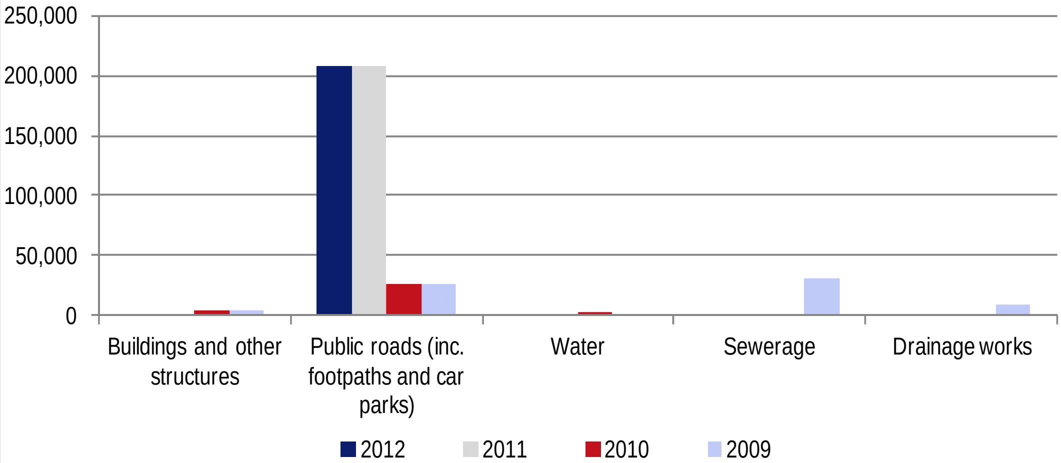
- In total, the Council had cash and investments of $58.8m ($26.9m in cash and equivalents) in 2012, up from $56.0m in 2009.
- Within total cash and investments, $43.2m is externally restricted, $15.6m is internally restricted and there are no unrestricted funds.
- The last of Council's CDO assets matured in 2012.
- As at October 2012, Council's investment portfolio was made up of $37.8m in term deposits, $3.0m in an online saver account, $3.3m in managed funds,$5.9m in credit, $8.6m in equity linked capital protected notes, and $0.5m in a building society bond.
- The values of the investment assets reflect current market valuations, and Council expects to receive the full amounts on maturity.
- As at October 2012, excluding credit union term deposits, all of Council's investments were rated at least BBB.

3.6: Capital Expenditure

The following section predominantly relies on information obtained from Special Schedules 7 and 8 that accompany the annual financial statements. These figures are unaudited and are therefore Council's estimated figures.

3.6(a): Infrastructure Backlog

Figure 5 - Infrastructure Backlog for 2008/09 to 2011/12($'000s)



Council's Infrastructure Backlog was 100.0% road related in 2012. The sewerage backlog has been eliminated following the completion of the Brunswick Valley Sewerage Treatment Plant. Council is better able to control the sewerage and water backlogs because of their ability to adjust the appropriate fees and charges to meet all future operating and investing expenses.

After the Asset Revaluations process, and further development of Asset Management Plans, the road backlog was refined upwards in 2011.

Council has advised that they are continuing to review their Asset Management Plans which may result in amendments to the level of the reported Infrastructure Backlog in future years.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard ($'000s)	207,429	207,429	35,677	72,877
Required annual maintenance ($'000s)	12,337	10,106	7,356	9,309
Actual annual maintenance ($'000s)	6,883	4,951	5,687	6,223
Total value of infrastructure assets ($'000s)	534,211	524,839	455,760	357,419
Total assets ($'000s)	858,163	844,624	699,171	607,709
Building and Infrastructure Backlog Ratio	0.39x	0.40x	0.08x	0.20x
Asset Maintenance Ratio	0.56x	0.49x	0.77x	0.67x
Building and Infrastructure Renewals Ratio	0.34x	0.68x	2.88x	1.09x
Capital Expenditure Ratio	0.73x	1.22x	2.74x	3.82x

The Building and Infrastructure Renewals Ratio and Asset Maintenance Ratio both indicate that Council has not been spending the required amounts on asset renewal and maintenance. A continuation of this level of spending will likely see deterioration in the quality of Council's assets and an increase in the Infrastructure Backlog. While the Capital Expenditure Ratio would indicate that Council has prioritised new assets ahead of asset renewal, the availability of grant funding influences Council's investment decisions. The high Capital Expenditure Ratio's in 2010 and 2009 are related to the construction of the Brunswick Valley Sewerage Treatment Plant.

3.6(c): Capital Program

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

Capital Program ($'000s)	Year ended 30 June			
	2012	2011	2010	2009
New capital works	3,967	16,960	43,324	19,606
Replacement/refurbishment of existing assets	9,252	4,454	7,445	0
Total	13,219	21,414	50,769	19,606

- Byron Regional Sport and Cultural Complex. The sporting and cultural complex was built at a cost of approximately $17.2 million and is being funded through Australian Government funding of $1.5m Better Regions Program, $8.0m Regional and Local Community Infrastructure Program and a Council contribution of $7.7m. The facility opened in February

2012, so full year operational costs are not known yet, although the complex is expected to operate at a loss. Total recreation and culture activities cost Council $3.9m in 2012.

- Brunswick Valley Sewerage Treatment Plant. The new plant completed in 2010 was designed to replace two older plants with modern technology designed to meet the population growth demands. It minimises energy and chemical consumption and provides high quality effluent for reuse in local farms or discharge to the river. Council borrowed $28.7m to fund this project.

3.7: Specific Risks to Council

- Expanding Infrastructure Backlog. The Council currently has a large road Backlog valuation that is expected to increase as the required asset maintenance and renewal amounts are not forecast to be spent. Council did apply for a SRV in 2011 which would have increased the funds available for asset renewal and maintenance but the application was rejected. IPART rejected the SRV request because *"the Council's financial planning to date has not been sufficiently rigorous to identify the underlying reasons why it continually requires special variations. It has also failed to identify any alternative options for addressing the prospective deterioration in its financial position".*
- Natural disasters. The LGA has been declared a natural disaster area in recent years. As a result Council have had to prioritise repair work at the expense of other projects which are deferred in Council's delivery program. Council relies on grants and contributions from other levels of government particularly RMS, for repair works.
- Ageing population. The LGA has an ageing population. Funding the increasing needs of an ageing population will require a changed focus from Council in future years. Council have outlined strategies designed to aid in a "Positive Ageing Strategy 2012 – 2016".

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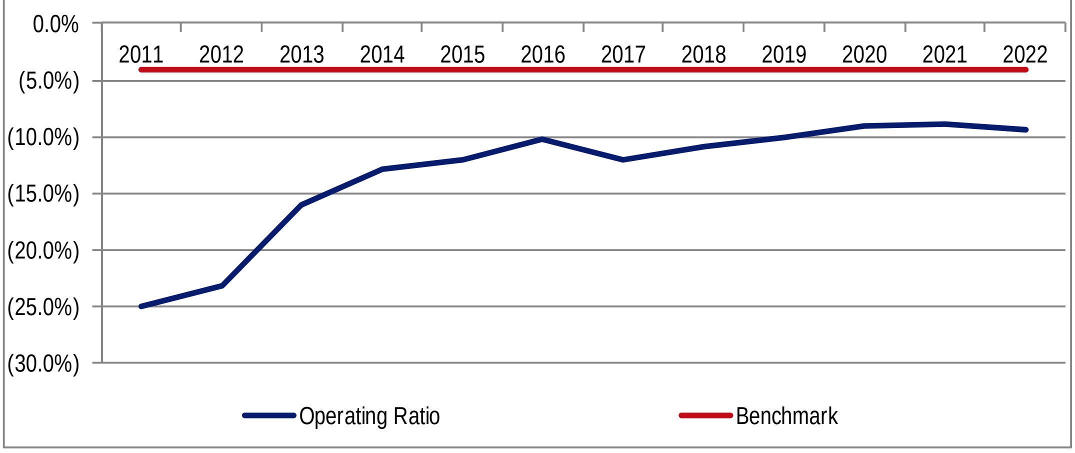
Section 4 Review of Financial Forecasts

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

4.1: Operating Results

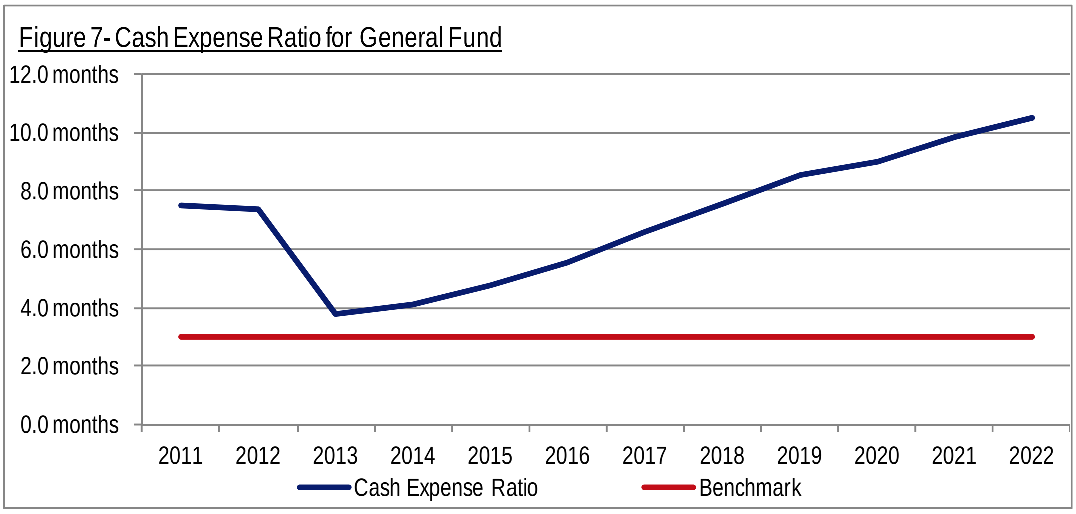
Figure 6 - Operating Ratio for General Fund



The Operating Ratio remains below the benchmark each year of the forecast. The Operating Ratio gradually improves due to revenue from rates and annual charges increasing at a higher rate than expenses such as employee expenses. Continuous deficits below the benchmark will lead to Sustainability issues in the long term.

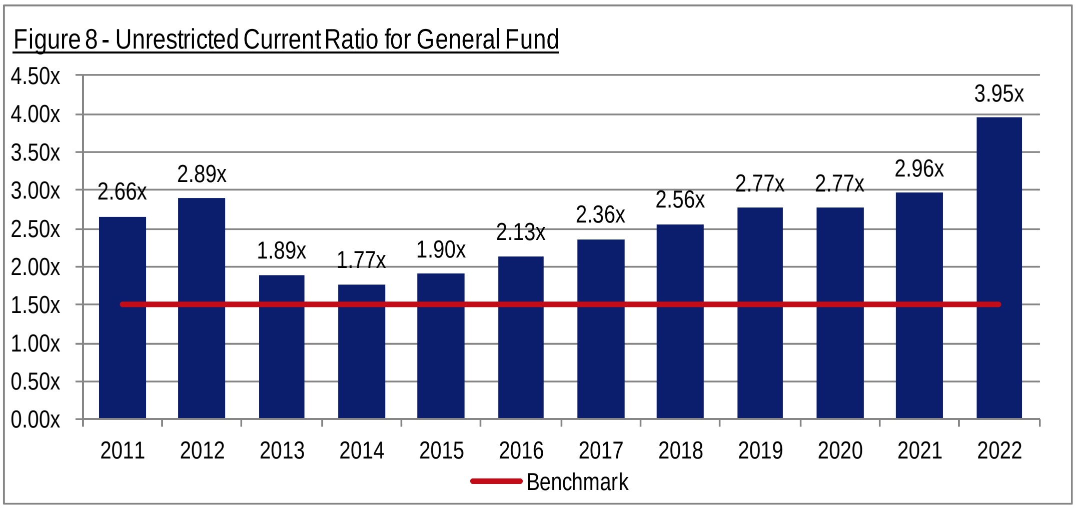
4.2: Financial Management Indicators

Liquidity Ratios



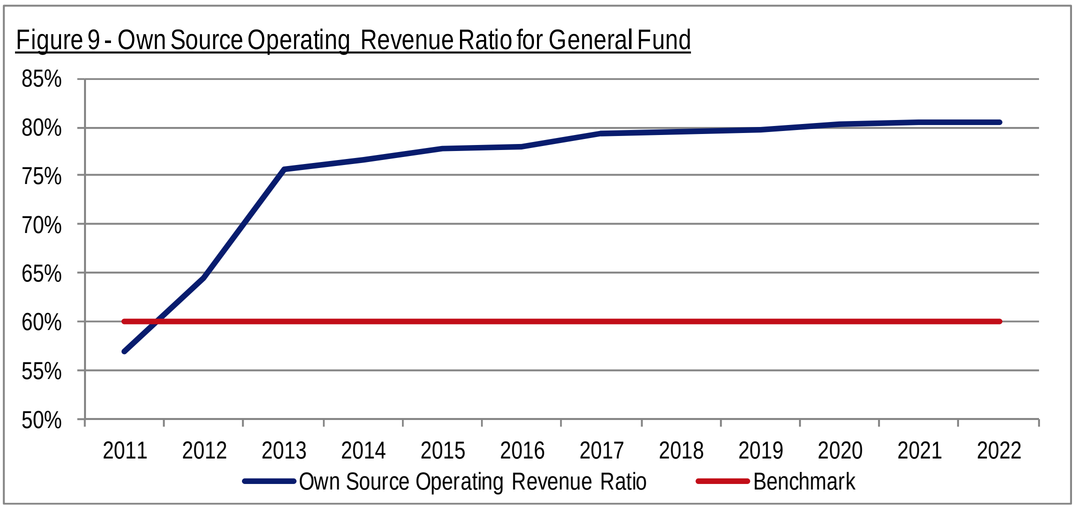
The Cash Expense Ratio remains above the benchmark each year of the forecast. Total cash and investment reserves are gradually increasing over the lifetime of the forecast, and Council could consider reducing the reserves to increase capital expenditure.

Total cash and investment reserves are forecast to increase to $62.2m in 2022.

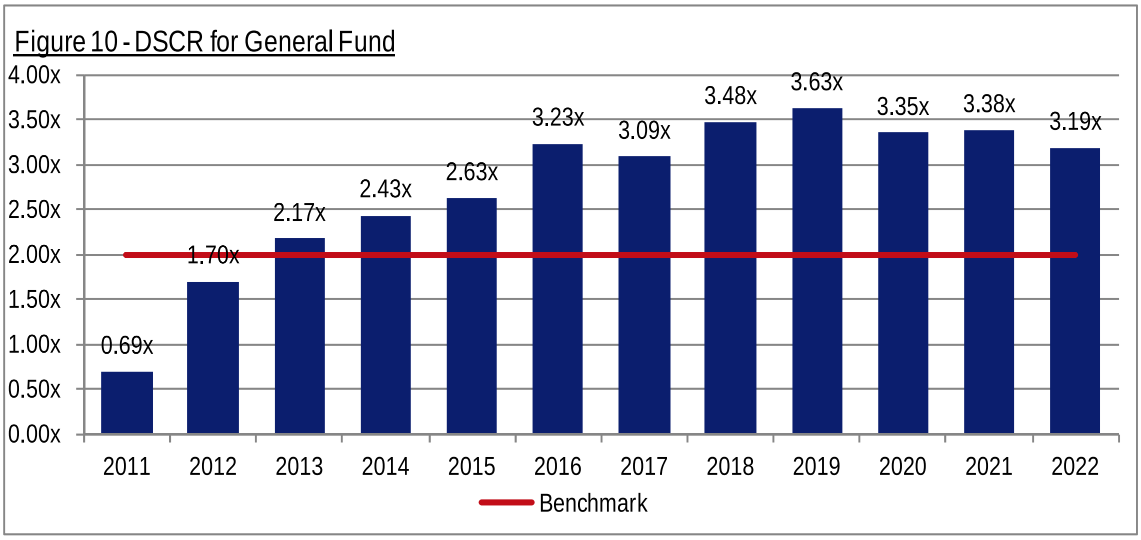


The Unrestricted Current Ratio remains above the benchmark each year of the forecast. This ratio indicates that Council will have sufficient liquidity to meet its short term obligations.

Fiscal Flexibility Ratios

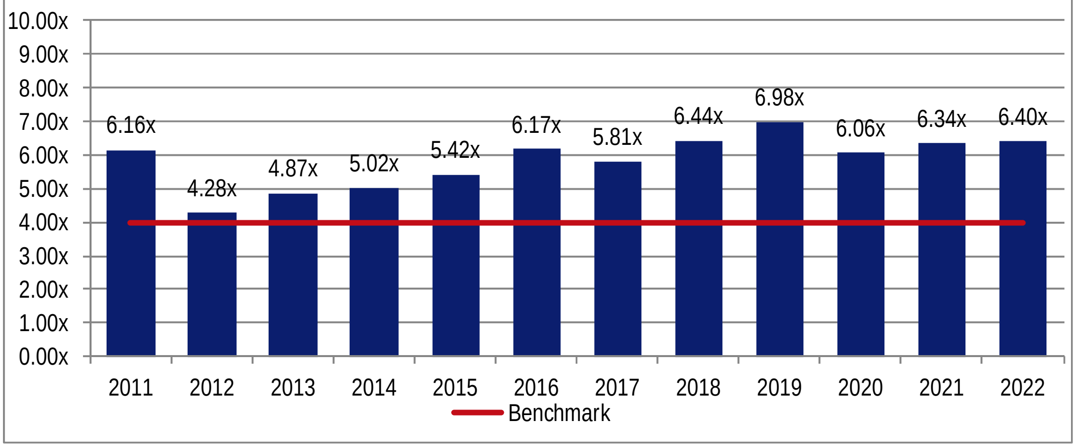


Historically, the Own Source Operating Revenue Ratio has been around the benchmark. The ratio is skewed upwards above the benchmark throughout the lifetime of the forecast due to both operating and capital grants and contributions being forecast to be lower than historically received. This conservative forecasting is potentially understating Council's forecast financial performance.



The DSCR shows that Council has the capacity to service all forecast borrowings. Outstanding borrowings in the General Fund will peak in 2014 at $19.1m reducing to a low of $13.9m in 2022. Council are forecast to borrow $3.5m in 2014 and 2020. Both loans are forecast to be for general purposes.

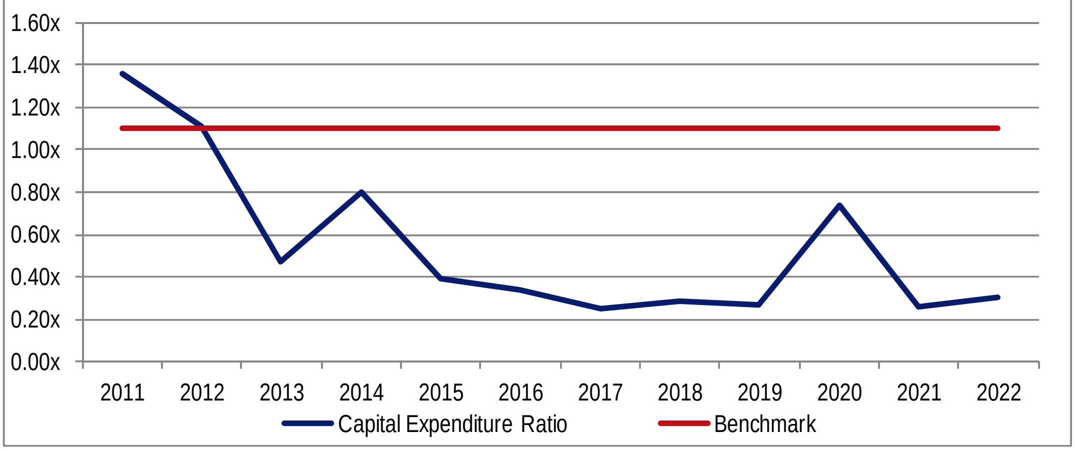
Figure 11 - Interest Cover Ratio for General Fund



The Interest Cover Ratio, similar to the DSCR, shows the Council has sufficient capacity to service scheduled debt commitments. According to this ratio, 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 12 - Capital Expenditure Ratio for General Fund



The forecast capital expenditure is insufficient to meet the cost of required asset renewals. The total deficit for capital expenditure versus depreciation across the 10 year period amounts to $67.6m in nominal terms. Council will need to revisit its Asset Management Plans and LTFP to reassess what capital expenditure is required and whether it can fund it. Council may need to amend service levels with community consultation, expend cash reserves, or find further efficiencies.

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4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

- Rates and annual charges: TCorp notes that the LGCI increased by 3.4% in the year to September 2011, and in December 2011, IPART announced that the rate peg to apply in the 2012/13 financial year will be 3.6%. Beyond 2013 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%
- Interest and investment revenue: annual return of 5.0%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1.0%)
- All other expenses: the estimated annual CPI increase of 2.5%

<u>Key Observations and Risks</u>

- The LTFP is assumed to have as its base case all of the outcomes identified by the other IP&R documents such as the Community Strategic Plan.
- Rates and annual charges are forecast to increase by between 3.0% and 5.2% p.a.
- User fees and charges to increase by between 3.0% and 7.7% p.a.
- Lower levels of grants and contributions than historically received have been included in the LTFP. Council do so as the sources of some grants and contributions do not give adequate advance notice and Council has a relatively fixed expenditure pattern based on permanent staff levels and operating costs.
- Employee expenses are forecast to increase by between 3.0% and 4.0% p.a.
- In line with the decreased operating grants and contributions, material and contacts costs also decrease due to the completion of flood repairs.
- Capital expenditure is forecast at levels well below the benchmark
- With the exception of our comments regarding the impacts of the forecast grant income and capital expenditure, TCorp finds the key assumptions underpinning the LTFP reasonable.

4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will not be able to incorporate further loan funding in addition to its existing debt facilities and those already included in its LTFP.

4.6 Sustainability

TCorp believes Council's financial position is currently weak and is deteriorating. Council has a record of reporting operating deficits and has a large Infrastructure Backlog.

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

- Council's current LTFP for its General Fund forecasts operating deficits of over 10.0% p.a. Deficits of this magnitude are not sustainable. The forecast annual revenue is lower than historic amounts due to conservative forecasting of operating grants and contributions. Should Council continue to receive operating grants at historical levels this would improve Council's prospects for achieving Sustainability
- Council has not been spending sufficient amounts on asset renewal and the current LTFP forecasts a relatively low level of capital expenditure. In the longer term this will reduce the quality of assets and diminish Council's capacity to provide services
- The Asset Management Plans forecast a maintenance and renewal funding gap of $9.9m p.a.

Section 5 Benchmarking and Comparisons with Other Councils

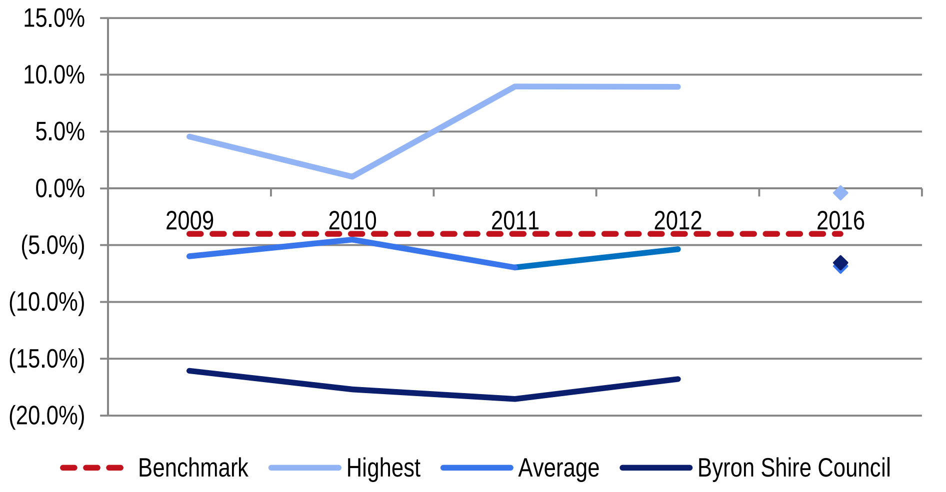
Each council's performance has been assessed against ten key benchmark ratios. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 4. There are 31 councils in this group and at the time of preparing this report, we have data for all of these councils.

In Figure 13 to Figure 22, 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 20 to 22 do not include the 2016 forecast position as those numbers are not available.

Where no highest line is shown on the graph, this means that Council is the best performer in its group for that ratio. For the Interest Cover Ratio and Debt Service Cover Ratio, we have excluded from the calculations, councils with very high ratios which are a result of low debt levels that skew the ratios.

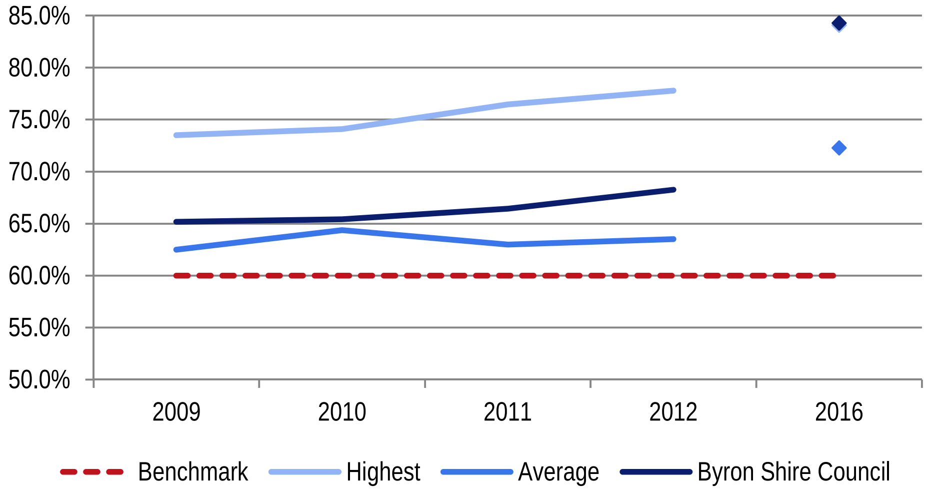
Financial Flexibility

Figure 13 - Operating Ratio Comparison



Council's Operating Ratio was below average in the past four years. The results are forecast to improve in the medium term to be in line with the group average though remain well below benchmark.

Figure 14 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio was above the group average and benchmark. The ratio is forecast to improve in the medium term and will remain above the group average and benchmark.

Liquidity

Figure 15 - Cash Expense Ratio Comparison

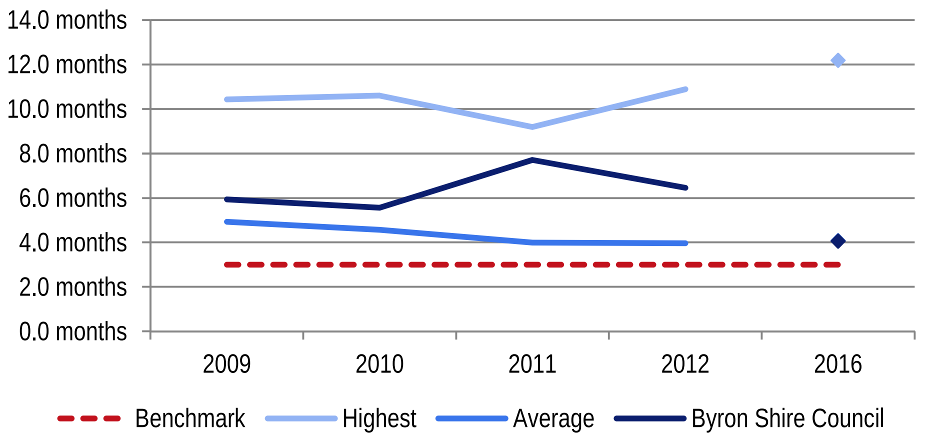
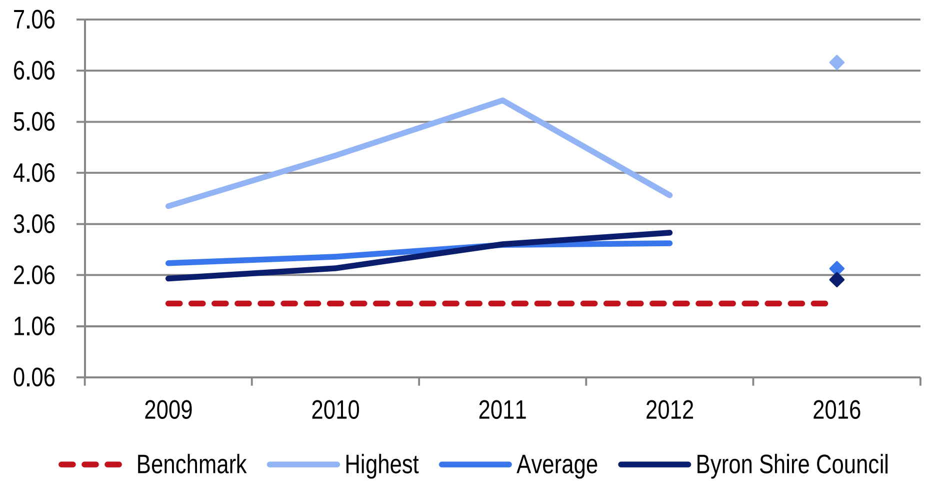


Figure 16 - Unrestricted Current Ratio Comparison



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

Debt Servicing

Figure 17 - Debt Service Cover Ratio Comparison

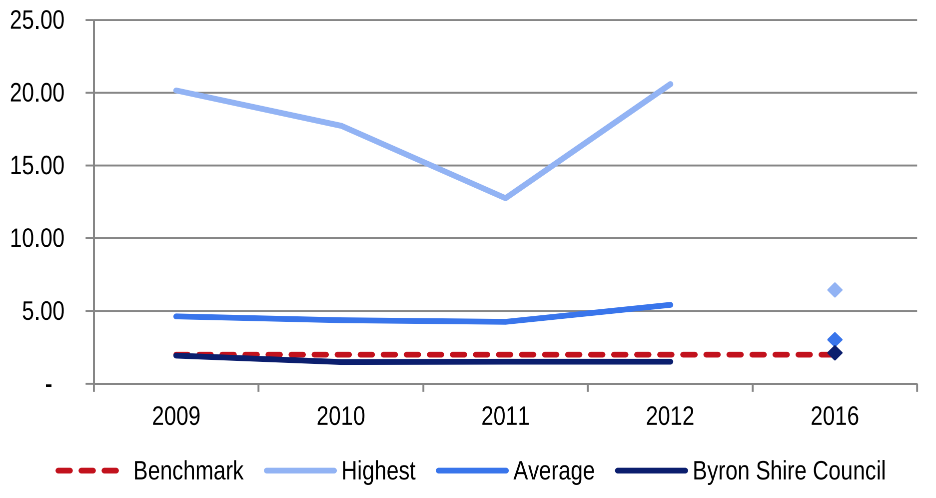
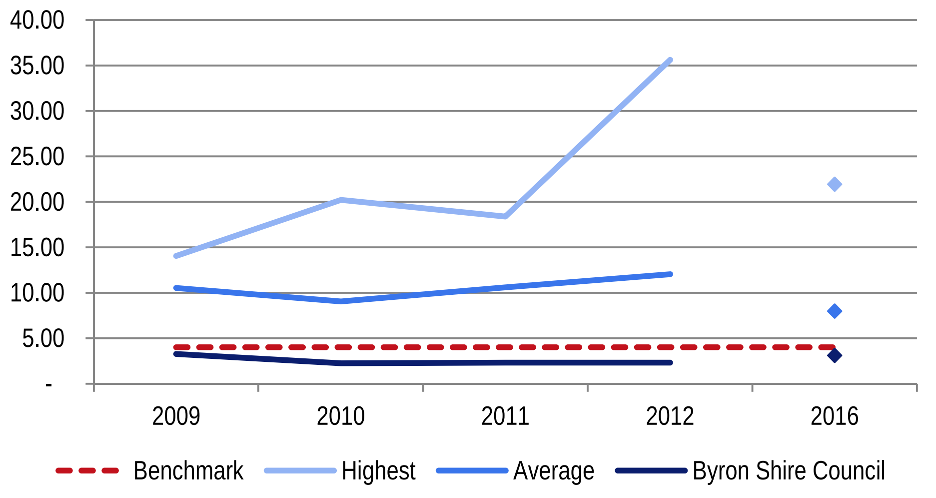


Figure 18 - Interest Cover Ratio Comparison



Over the review period, Council was below the benchmarks and group averages. These ratios are forecast to marginally improve in the medium term to be close to the benchmarks.

Asset Renewal and Capital Works

Figure 19 - Capital Expenditure Ratio Comparison

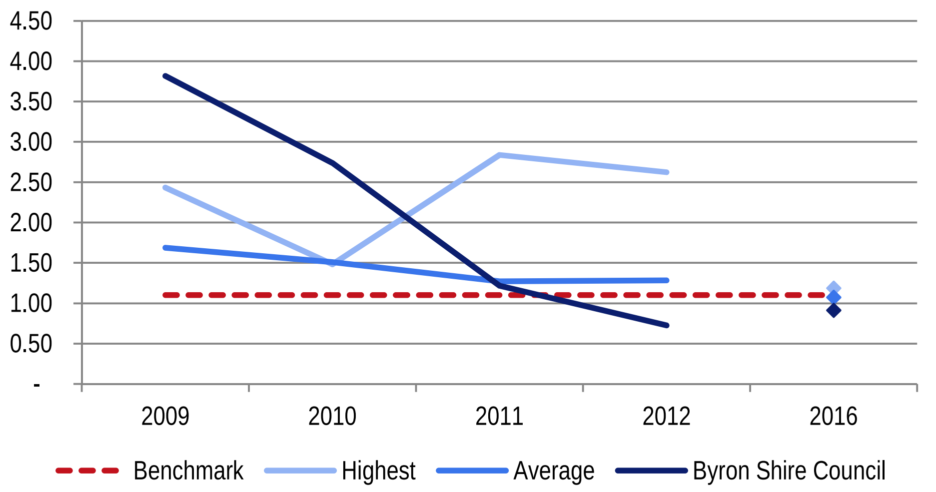


Figure 20 - Asset Maintenance Ratio Comparison

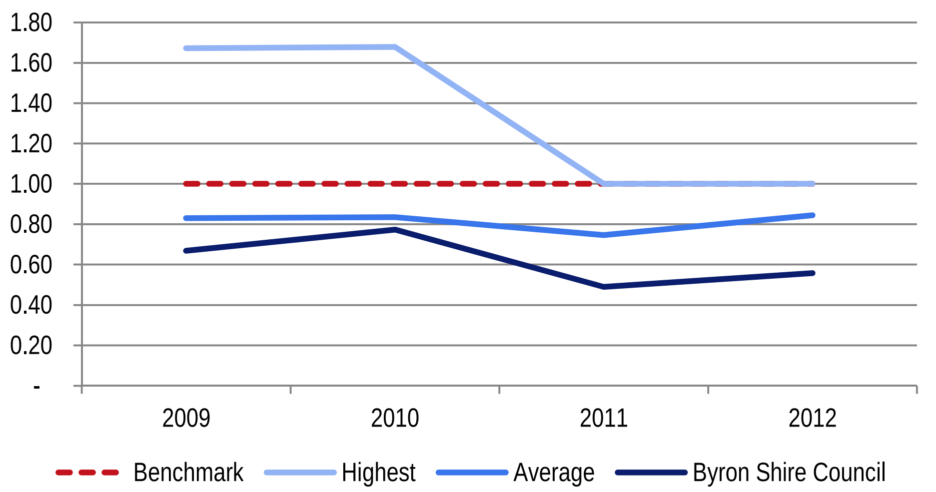


Figure 21 - Infrastructure Backlog Ratio Comparison

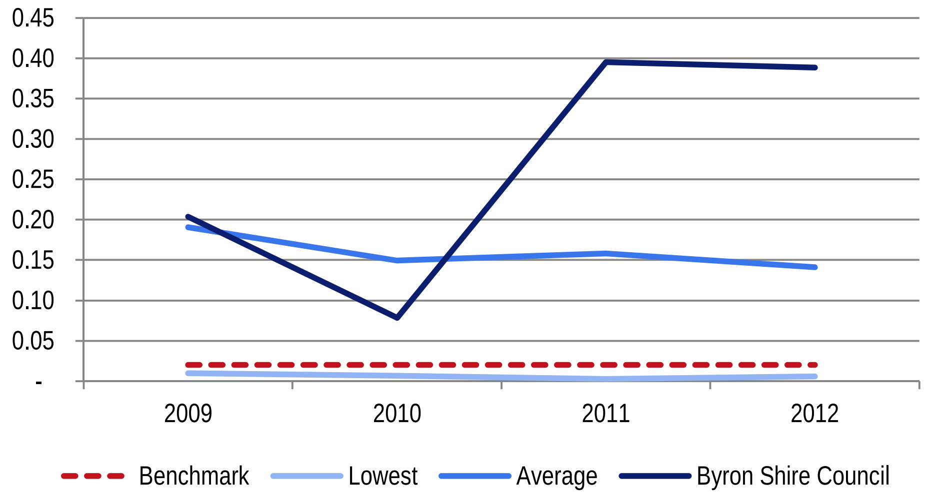
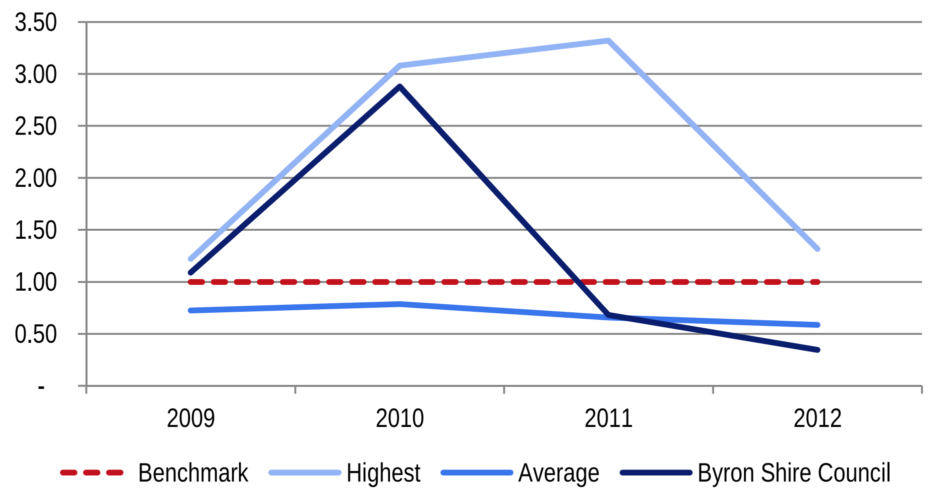


Figure 22 - Building and Infrastructure Asset Renewal Ratio



Council had a higher Infrastructure Backlog Ratio than other councils in the group in the last two years and it was significantly higher than the benchmark.

Council's Asset Maintenance Ratio, Building and Infrastructure Asset Renewal Ratio and Capital Expenditure Ratio declined over the review period to be below the group averages and benchmarks.

Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's LTFP we consider Council's financial position to be weak and it is deteriorating in respect of its longer term Sustainability.

We base our recommendation on the following key points:

- Council has incurred increasing operating deficits (excluding grants and contributions for capital purposes) in each of the past four years, and these deficits are forecast to continue over the forecast period.
- Council is not spending sufficient amounts on maintenance and asset renewal and in the long term this will reduce the quality of assets and potentially impact the provision of services
- The road Infrastructure Backlog is already at a critical level, and further under investment will impact on the quality of services offered to the community
- With an increasing ageing population Council needs to address these issues and consider means of generating additional revenues or reducing operating expenses
- Council has significant cash and investments reserves. The expenditure of part of these reserves would better enable asset renewal and maintenance.

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Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000s)	Year ended 30 June					% annual change	
	2012	2011	2010	2009	2012	2011	2010
Revenue							
Rates and annual charges	28,630	27,305	26,111	24,799	4.9%	4.6%	5.3%
User charges and fees	19,258	17,143	17,808	15,144	12.3%	(3.7%)	17.6%
Interest and investment revenue	3,113	2,478	2,232	1,817	25.6%	11.0%	22.8%
Grants and contributions for operating purposes	9,451	7,674	8,263	7,171	23.2%	(7.1%)	15.2%
Other revenues	970	915	1,057	1,106	6.0%	(13.4%)	(4.4%)
Total revenue	61,422	55,515	55,471	50,037	10.6%	0.1%	10.9%
Expenses							
Employees	18,594	17,940	17,642	15,260	3.6%	1.7%	15.6%
Borrowing costs	4,889	4,747	4,298	2,679	3.0%	10.4%	60.4%
Materials and contract expenses	25,985	21,417	24,144	22,196	21.3%	(11.3%)	8.8%
Depreciation and amortisation	16,808	16,496	15,216	14,090	1.9%	8.4%	8.0%
Other expenses	5,465	5,204	3,990	3,855	5.0%	30.4%	3.5%
Total expenses	71,741	65,804	65,290	58,080	9.0%	0.8%	12.4%
Operating result (excluding capital grants and contributions)	(10,319)	(10,289)	(9,819)	(8,043)	(0.3%)	(4.8%)	(22.1%)
Operating result (including capital grants and contributions)	(1,577)	1,101	1,853	3,201	(243.2%)	(40.6%)	(42.1%)

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)				
	2012	2011	2010	2009
Grants and contributions for capital purposes	8,742	11,390	11,672	11,244
Interest revenue/ (losses)	1,341	1,415	3,080	(3,021)
Impairment	(224)	0	0	0
Transfer of road assets from RMS	0	0	0	31,076
Revaluation decrements	0	(5,131)	0	0
Net gain/ (losses) from the disposal of assets	(2,987)	(856)	(589)	(963)

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Current assets							
Cash and cash equivalents	26,939	28,626	21,228	20,426	(5.9%)	34.9%	3.9%
Investments	16,267	5,696	6,988	0	185.6%	(18.5%)	N/A
Receivables	7,174	8,117	10,010	5,558	(11.6%)	(18.9%)	80.1%
Inventories	410	350	425	692	17.1%	(17.6%)	(38.6%)
Other	1,307	635	962	53	105.8%	(34.0%)	1715.1%
Total current assets	52,097	43,424	39,613	26,729	20.0%	9.6%	48.2%
Non-current assets							
Investments	15,640	25,234	29,527	35,556	(38.0%)	(14.5%)	(17.0%)
Receivables	572	540	470	266	5.9%	14.9%	76.7%
Inventories	0	596	596	596	(100.0%)	0.0%	0.0%
Infrastructure, property, plant & equipment	789,854	774,830	628,965	544,562	1.9%	23.2%	15.5%
Total non-current assets	806,066	801,200	659,558	580,980	0.6%	21.5%	13.5%
Total assets	858,163	844,624	699,171	607,709	1.6%	20.8%	15.1%
Current liabilities							
Payables	7,445	7,896	11,143	6,135	(5.7%)	(29.1%)	81.6%
Borrowings	2,661	5,405	2,503	2,270	(50.8%)	115.9%	10.3%
Provisions	4,608	4,500	4,066	4,016	2.4%	10.7%	1.2%
Total current liabilities	14,714	17,801	17,712	12,421	(17.3%)	0.5%	42.6%
Non-current liabilities							
Payables	0	0	0	2,469	N/A	N/A	(100.0%)
Borrowings	70,123	70,013	68,599	42,498	0.2%	2.1%	61.4%
Provisions	1,225	1,118	1,096	834	9.6%	2.0%	31.4%
Total non-current liabilities	71,348	71,131	69,695	45,801	0.3%	2.1%	52.2%
Total liabilities	86,062	88,932	87,407	58,222	(3.2%)	1.7%	50.1%
Net assets	772,101	755,692	611,764	549,487	2.2%	23.5%	11.3%

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June			
	2012	2011	2010	2009
Cashflows from operating activities	12,402	16,450	14,109	17,207
Cashflows from investing activities	(11,453)	(13,368)	(39,641)	(14,346)
Proceeds from borrowings and advances	0	6,836	28,575	7,950
Repayment of borrowings and advances	(2,635)	(2,520)	(2,241)	(1,848)
Cashflows from financing activities	(2,635)	4,316	26,334	6,102
Net increase/(decrease) in cash and equivalents	(1,686)	7,398	802	8,963
Cash and equivalents	26,939	28,626	21,228	20,426

Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Sustainability

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

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

Building and Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

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

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

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

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

New South Wales Treasury Corporation

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.