Lockhart Shire Council

Financial Assessment, Sustainability and Benchmarking Report

21 March 2013

Prepared by NSW Treasury Corporation for Lockhart 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 Lockhart Shire Council, the DLG and the Independent Local Government Review Panel. TCorp shall not be liable to Lockhart 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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Index

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Section 1 Executive Summary

This report provides an independent assessment of Lockhart 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 well managed over the review period based on the following observations:

- Council reported operating surpluses each year over the review period
- Employee expenses decreased over the review period
- Council has had strong levels of liquidity throughout the review period
- Council works closely with surrounding councils to co-ordinate works and seek economies of scale where possible

The Council reported $1.8m of Infrastructure Backlog in 2012 which represents less than 1.0% of its infrastructure asset value of $179.2m. Other observations include:

- The Building and Infrastructure Renewals Ratio and Asset Maintenance Ratio both indicate that Council has been spending the required amounts on asset renewal and maintenance.
- Council's Infrastructure Backlog increased by $0.3m in 2012

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

- Council forecast operating surpluses each year
- Council's cash reserves remain static while Council maintains sufficient capital expenditure levels

In our view, the Council has the capacity to undertake borrowings of up to $11.9m in addition to existing borrowings, if required. This is based on the following analysis:

- Based on a benchmark of DSCR>2.00x, up to $11.9m could be borrowed in 2013
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at 7.5%

Based on our review, Council is in a sound Sustainability position. Our key observations are:

- Council has been spending sufficient amounts on asset renewal and is forecasting above benchmark levels of capital expenditure in the long term. This will assist Council to improve or maintain its quality of assets and better enable the provision of services
- Council's use of excess cash reserves to increase capital expenditure will support Council's long term Sustainability

- The long term Sustainability of the Council is dependent on Council continuing to receive operating grants and contributions from both the State and Federal government to support its operations

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

- Council's financial flexibility was mixed with above benchmark and group average Operating Ratio and below benchmark and group average Own Source Operating Revenue Ratio
- Council's liquidity position was sound with above group average Cash Expense Ratio and Unrestricted Current Ratio
- Council's debt servicing capacity was sound with above group average DSCR and Interest Cover Ratio
- Council generally outperformed the group average in terms of level of Infrastructure Backlog and Capital Expenditure. Council's spending on maintenance of assets was on par with the group average. Council's performance in terms of asset renewal was generally below the peer group.

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

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

- Council agrees with the findings of the report

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

Lockhart Shire Council LGA	
Locality & Size	
Locality	Murrumbidgee
Area	2,895.8 km²
DLG Group	9
Demographics	
Population as at August 2011	2,998
% under 20	27.5%
% between 20 and 59	45.0%
% over 60	27.5%
Expected population 2026	2,900
Operations	
Number of employees (FTE)	44
Annual revenue	$8.8m
Infrastructure	
Roads	??
Bridges	??
Infrastructure backlog value	$1.8m
Total infrastructure value	$179.2m

Lockhart Shire is a local government area in the Riverina region of New South Wales, Australia. The Shire was created in 1906 and is an agricultural and pastoral area.

The LGA is predominantly a rural shire with a variety of agricultural industries. These include stud sheep, stud cattle, wheat and rice crops, wool, lambs, dairying and market gardening. The LGA's population has been declining in the last five years and is forecast to marginally decline.

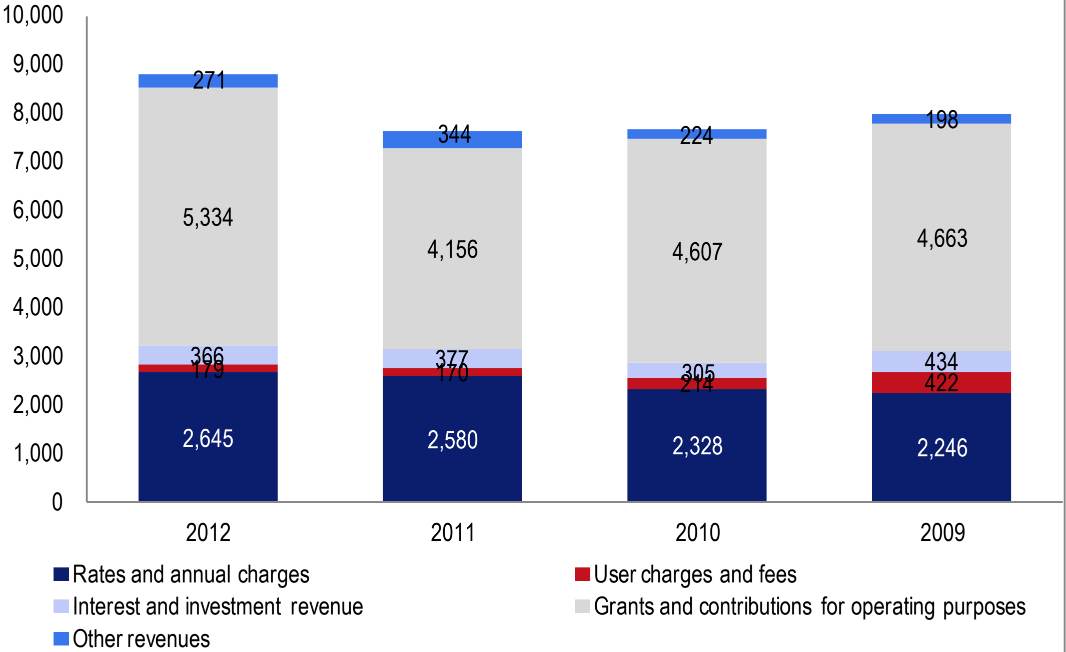
Council is a member of the Riverina Eastern Regional Organisation of Councils (REROC). REROC's mission is to work collaboratively to enhance the economic, social, economic and environmental capabilities of the communities so as to ensure the long term sustainability of the region.

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

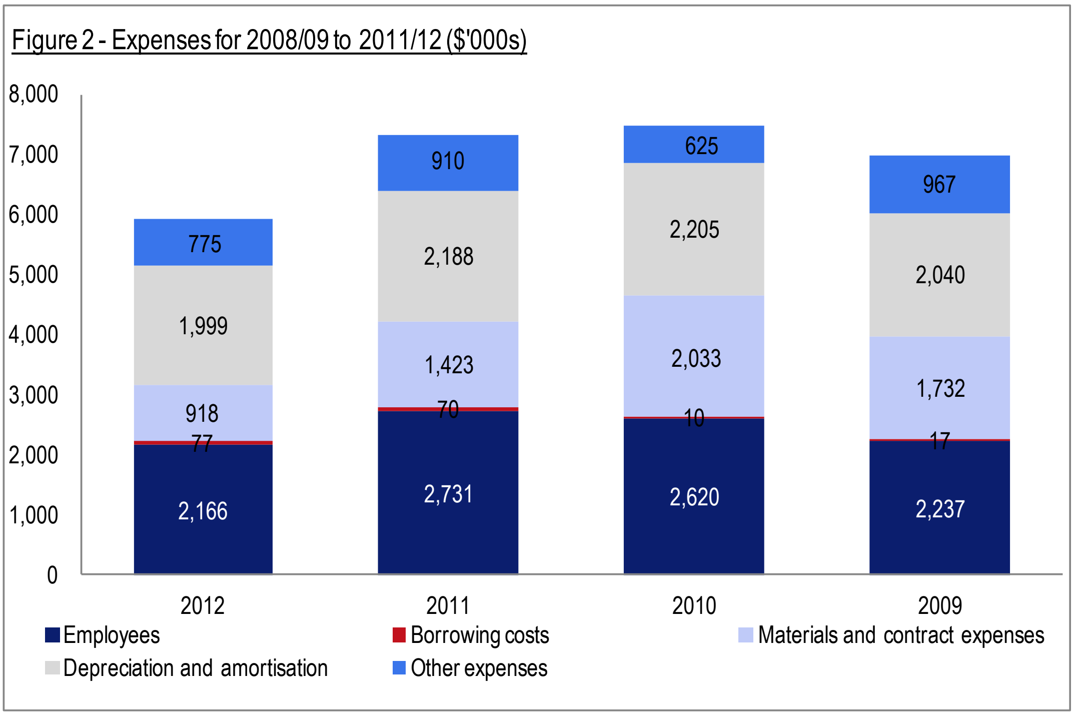
Figure 1 - Revenue Sources for 2008/09 to 2011/12 ($'000s)



Key Observations

- Rates and annual charges have been increasing in line with the IPART approved increases over the review period. Farmland rates contributed $1.5m (81.9%) of total rates in 2012. Annual charges increased by $0.2m in 2011 as a result of increased domestic and non domestic waste management service.
- User fees and charges mainly consist of statutory/ regulatory charges ($0.1m in 2012). Section 94 fees in 2009 were higher than other years at $0.2m. Council do not operate a water fund and is supplied by Riverina Water County Council.
- Grants and contributions for operating purposes have been volatile year on year. The Federal Government brought forward one-half of the estimated 2013 local government Financial Assistance Grant (FAG) allocations for payment in the 2012 financial year. A similar arrangement applied in 2011 but only one quarter of the following year's grant allocations were paid in advance. As a result the amount of Council's FAG paid in 2012 was $4.0m compared to $1.7m in 2011.

3.2: Expenses



Key Observations

- Total employee expenses decreased by 3.2% over the review period. FTEs decreased from 46 to 44 over the review period.
- Materials and contracts expenses decreased over the review period. Due to the floods, Council prioritised works on damage roads and asset repairs instead of maintenance costs.
- Depreciation charges remained static over the review period. Infrastructure asset values decreased by $15.9m to $179.2m over the review period due to impairments of $10.4m over the review period and Council's focus on reinstatements rather than capital additions. The increase in depreciation as a result of Asset Revaluation mainly occurred in 2009.
- Other expenses main components include NSW rural fire service levy and insurance.

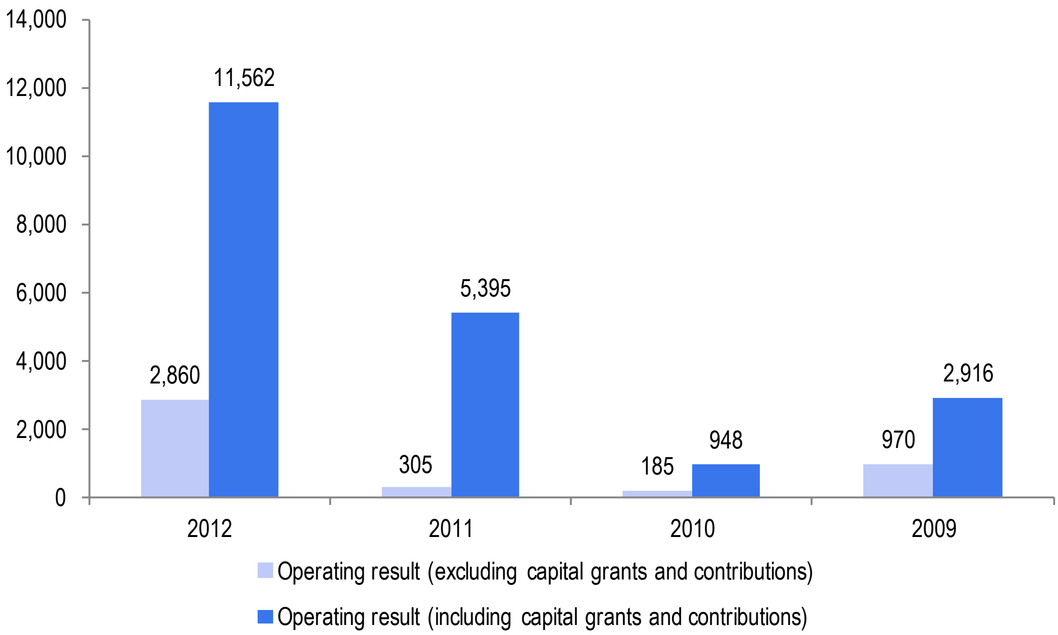
3.3: Operating Results

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 consistently recorded operating surpluses in each of the last four years. Council results were positively affected in 2012 through the early payment of 2013 FAG.
- Council expenses include a non-cash depreciation expense, ($2.0m 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

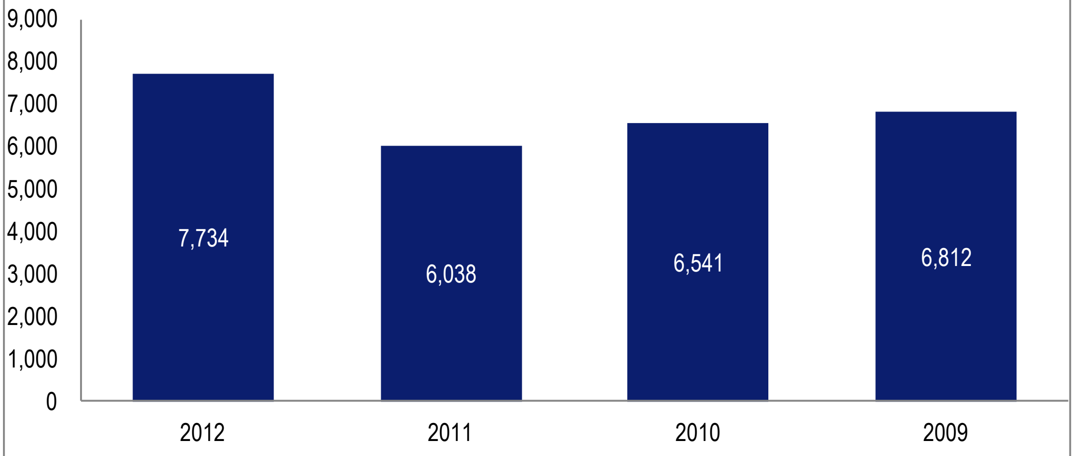
Performance Indicators	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
EBITDA ($'000s)	4,936	2,563	2,400	3,027
Operating Ratio	32.5%	4.0%	2.4%	12.2%
Interest Cover Ratio	64.10x	36.61x	240.00x	178.06x
Debt Service Cover Ratio	39.17x	17.20x	24.49x	21.32x
Unrestricted Current Ratio	8.07x	6.09x	7.43x	7.99x
Own sourced revenue	16.1%	21.6%	30.1%	26.9%
Cash expense ratio	24.0 months	14.3 months	14.9 months	16.6 months
Net assets ($'000s)	203,677	194,543	217,263	216,038

Key Observations

- Council's EBITDA has increased over the four year period. The 2012 result is higher due to the prepayment of half the 2013 FAG.
- The Unrestricted Current Ratio and Cash Expense Ratio are both at extremely high levels in comparison to the benchmarks in all four years indicating the liquidity position adopted by the Council is extremely conservative.
- The Own Source Operating Revenue Ratio has been well below the benchmark in all four years, reflecting Council's dependence on grant revenue.
- Net Assets have decreased by $12.4m between 2009 and 2012 mainly due to impairments from storm and flood damages which decreased the value of Council's infrastructure assets.
- The floods over the review period 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 population trends and/or increased or reduced 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, and the effects of impairments and reinstatements are excluded, the underlying trend in all four years has been an increasing 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 $5.0m 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

- Cash and cash equivalents have increased slightly over the review period. Council did not hold any other forms of investments over the review period.
- The Unrestricted Current Ratio and the cash balance indicated Council had sufficient liquidity
- Within the $7.7m in total cash balance, $2.8m was externally restricted, $4.5m was internally restricted and $0.5m was unrestricted.

3.6: Capital Expenditure

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

3.6(a): Infrastructure Backlog

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

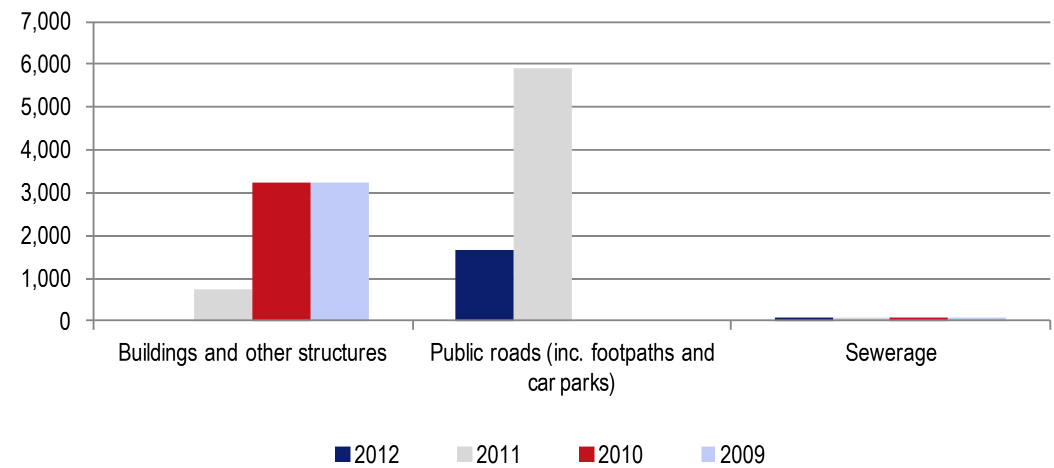
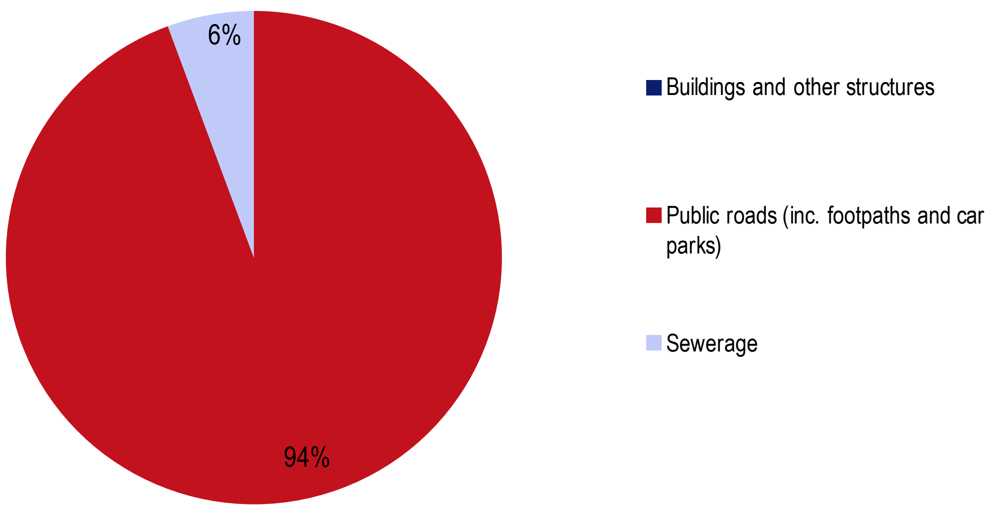


Figure 6 - Infrastructure Backlog Composition for 2011/12



Roads are the largest part of the Infrastructure Backlog (94.0%). The backlog decreased in 2012 due to further development of Asset Management Plans (AMP). In recent years Council adopted a new Asset Management system which better enables Council to allocate its resources towards maintaining and improving its assets with more confidence.

Council also share close working relationships with neighbouring councils in regards to asset maintenance and capital works. For example, when LGA's share roads, Council's keep their neighbours aware of when they plan to resheet or reseal. Council may then arrange to have one of the other Council's resheet their section of road also. Councils will also consult and sometimes work together when tendering for services.

Due to a new Director of Engineering commencing in June 2012, it is expected that an updated AMP will be prepared and incorporated into the LTFP in 2013.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard ($'000s)	1,766	6,741	3,350	3,350
Required annual maintenance ($'000s)	1,155	1,427	1,459	1,459
Actual annual maintenance ($'000s)	1,187	1,279	1,283	1,284
Total value infrastructure assets ($'000s)	179,239	173,987	195,971	195,114
Total assets ($'000s)	206,176	196,703	218,480	217,347
Infrastructure Backlog Ratio	0.01x	0.04x	0.02x	0.02x
Asset Maintenance Ratio	1.03x	0.90x	0.88x	0.88x
Building and infrastructure asset renewal ratio	1.98x	0.53x	0.78x	0.90x
Capital Expenditure Ratio	0.51x	2.21x	1.44x	2.16x

The Building and Infrastructure Renewals Ratio and Asset Maintenance Ratio both indicate that Council has been spending the required amounts on asset renewal and maintenance. A continuation of this level of spending will likely see the Infrastructure Backlog Ratio maintained at close to zero.

Council's Infrastructure Backlog and Building and Infrastructure Asset Renewal Ratio has been positively impacted in 2012 as Council repaired a number of roads and bridges following the flooding events of previous years.

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	0	0	0	500
Replacement/refurbishment of existing assets	0	0	0	4,048
Total	0	0	0	4,548

Council has not been reporting Special Schedule 8 over most of the review period.

3.7: Specific Risks to Council

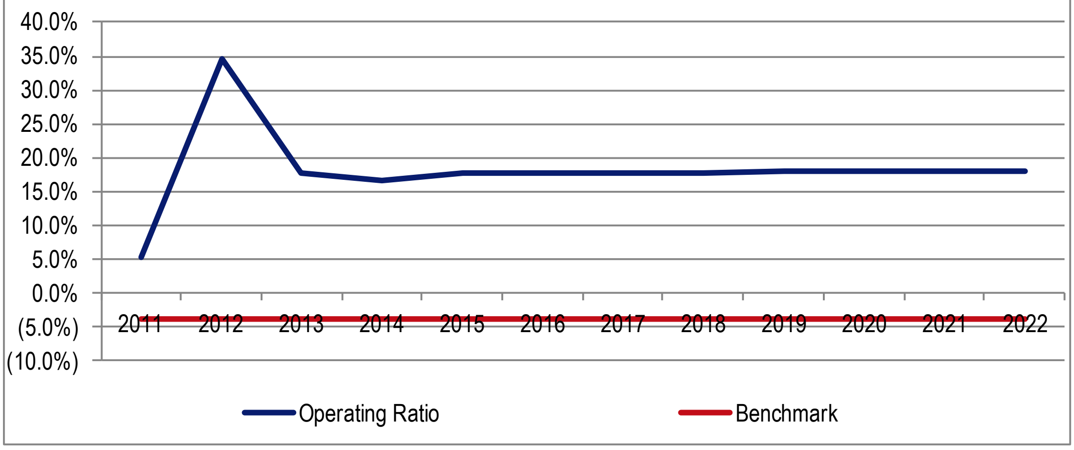
- Small population. The LGA has a small ageing population with little growth in population size expected. Funding the increasing needs of an ageing population will require a changed focus from Council in future years. Council already promotes reaching out to elderly residents through social outings and grocery delivery.
- Freight on roads. There has been an increase in freight vehicles on Council managed roads. Modern bigger trucks combined with wet weather can cause significant deterioration in the road network.
- Murray Darling Basin Plan. This plan proposes to return water from the irrigated farms in the Murray region to the river. Council feels that this will have a negative effect on the agriculture industry, and have a knock on effect on the community leading to Sustainability issues. Council have been lobbying against the plan through RAMROC.
- Drought. The LGA suffered droughts for over 10 years leading to farming becoming more difficult to remain economically viable. This leads to problems within the community such as depression. Council have tried to assist the community through various events and initiatives. Council ran the Biggest Ever Blokes Day Out in 2008 which was attended by over 3,000 men, and helped raise funds and awareness for some of the issues affecting residents.
- Natural disasters. The LGA has been affected by flood events in recent years. As a result Council have had to prioritise repair work at the expense of other projects which are deferred in Council's delivery program. Council relies on grants and contributions from other levels of government particularly RMS, for repair works.

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 a Sewer Fund this is operated as an independent entity, which unlike the General Fund is more able to adjust the appropriate fees and charges to meet all future operating and investing expenses.

4.1: Operating Results

Figure 7- Operating Ratio for General Fund



The Operating Ratio remains consistently above the benchmark indicating Council should be Sustainable. The spike in the Operating Ratio in 2012 and decline in 2013 is largely due to the significant prepayment of FAG by the Federal government in 2012 which is not forecast to re-occur in 2013. Thereafter grants are assumed to return to historical levels.

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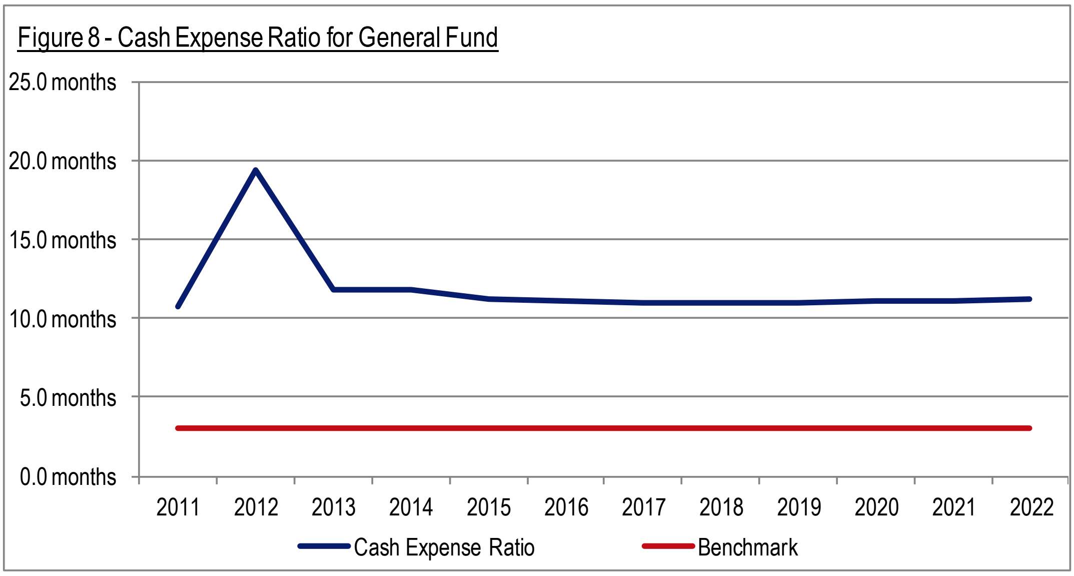
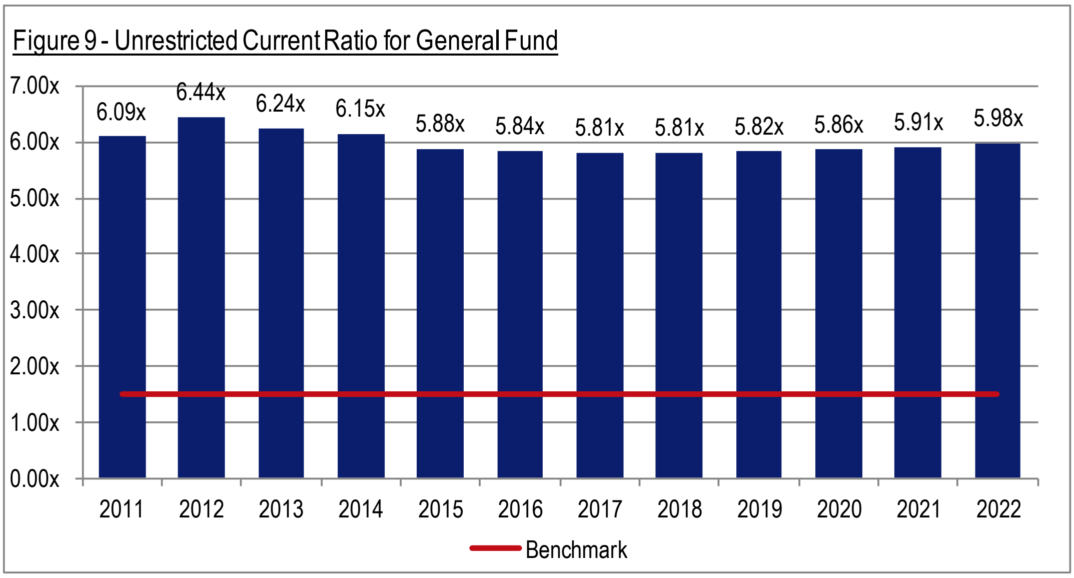
4.2: Financial Management Indicators

Liquidity Ratios



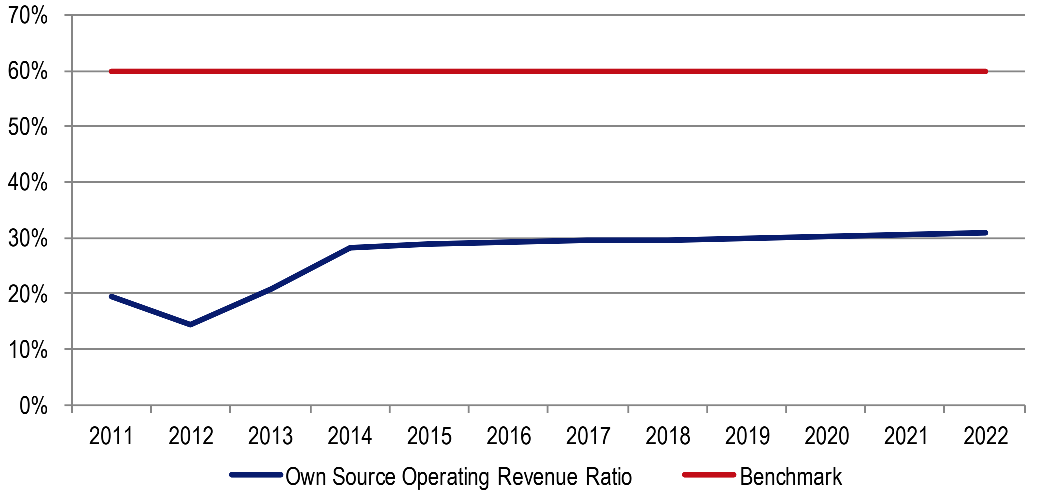
The Cash Expense Ratio remains above the benchmark each year of the forecast. It would also seem prudent for Council to increase investment in higher interest term deposits to generate increased investment income.



The Unrestricted Current Ratio remains above benchmark each year indicating that Council should have adequate liquidity.

Fiscal Flexibility Ratio

Figure 10 - Own Source Operating Revenue Ratio for General Fund



The Own Source Revenue Ratio is below benchmark reflecting Council's dependence on operating grants and contributions. The ratio increases marginally from 2012 levels over the forecast period due to both operating and capital grants and contributions forecast to be lower than historically received.

Being a large rural LGA with a sparse and dispersed population Council does not have many opportunities to improve this ratio significantly.

Figure 11 - DSCR for General Fund

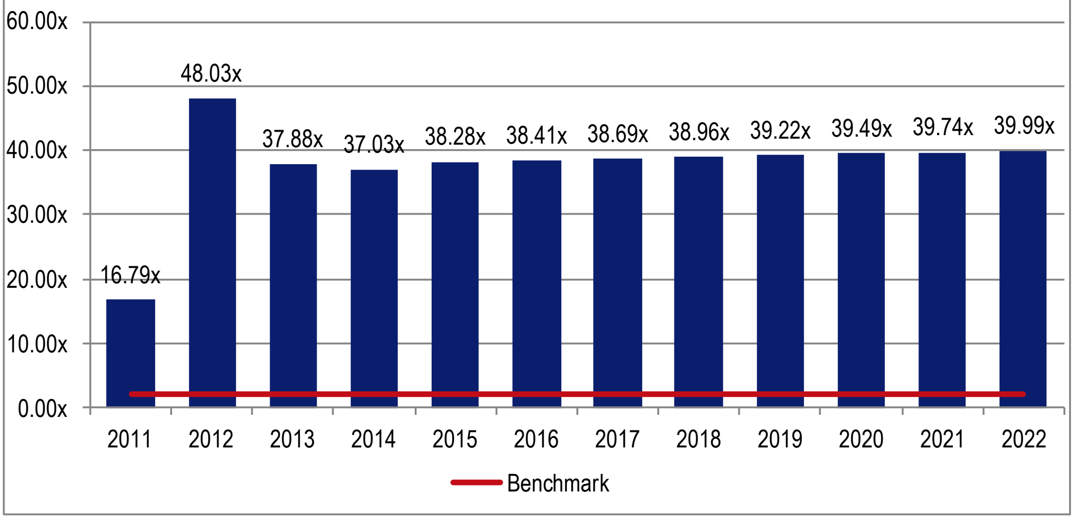
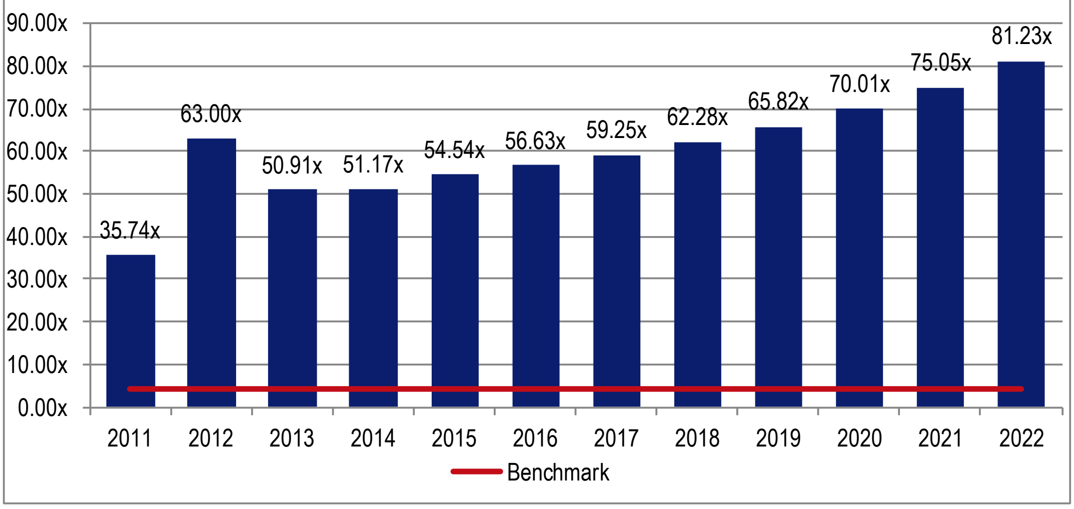
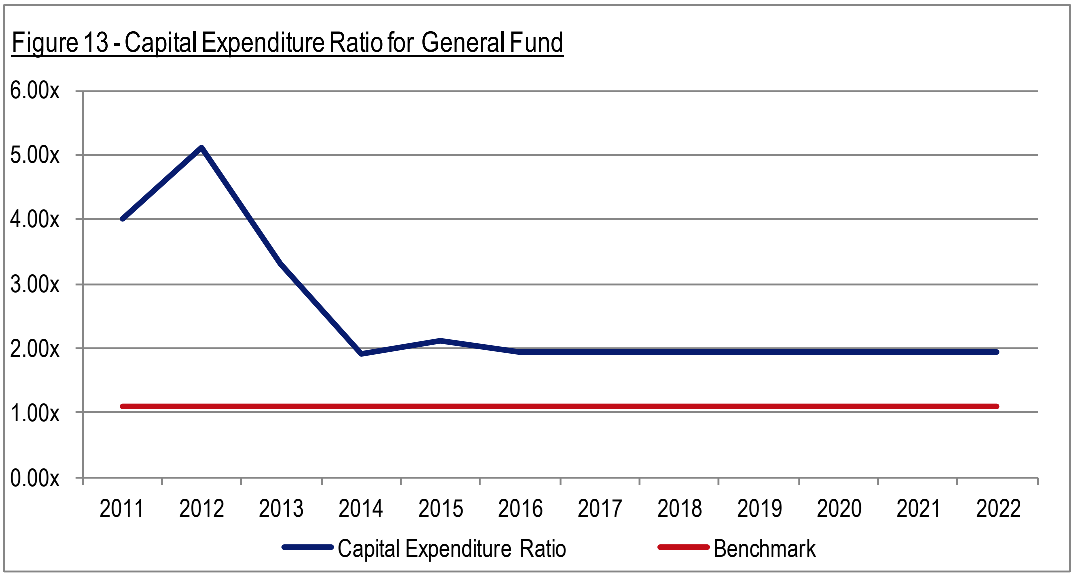


Figure 12 - Interest Cover Ratio for General Fund



The DSCR and Interest Coverage Ratio are both significantly above benchmark for the LTFP due to Council's low borrowing levels.

4.3: Capital Expenditure



Over the 10 years of the forecast Council's capital expenditure will exceed depreciation by $22.4m in nominal terms.

Due to a new Director of Engineering commencing in June 2012, it is expected that an updated AMP will be prepared and incorporated into the LTFP in 2013.

Any major expenditure in building assets would be influenced by the availability of grant funding.

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>

- Rates and annual charges are forecast to increase by 2.5% p.a.
- User fees and charges are forecast to increase by 2.2% p.a.
- Grants and contributions for operating purposes are forecast to decline from $5.2m in 2012 to $3.2m in 2013 before increasing by between 1.5% and 4.0% p.a. from 2015 onwards.
- Council do not forecast grants and contributions for capital purposes from 2014 onwards.
- Employee expenses are forecast to increase by 2.2% p.a.
- TCorp find the key assumptions underpinning the LTFP reasonable.
- The LTFP assumes current service levels are maintained.

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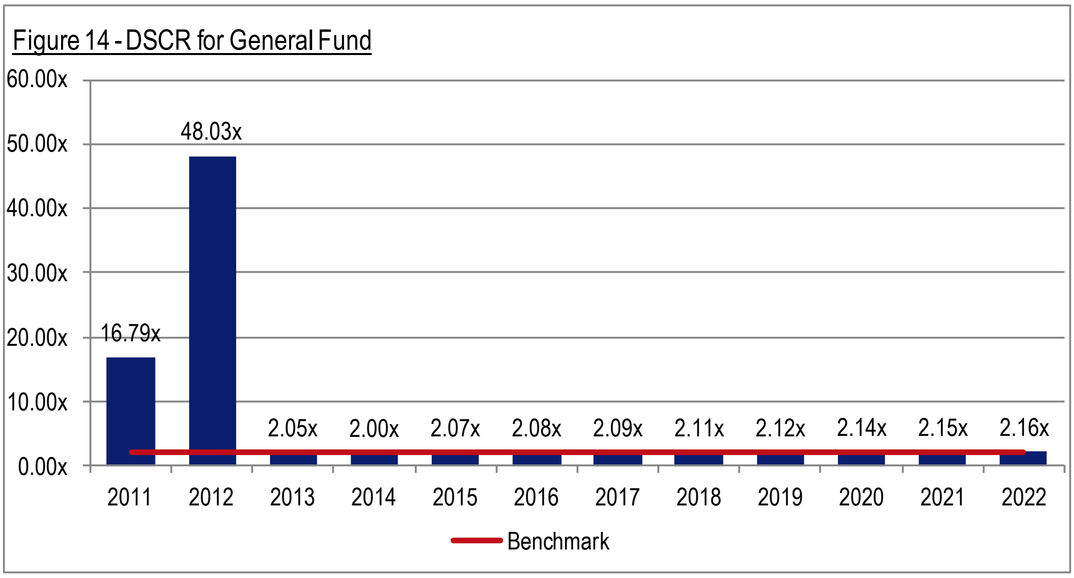
4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council would be able to incorporate additional loan funding if required. Some comments and observations are:



- Based on a benchmark of DSCR>2.00x, up to $11.9m could be borrowed in 2013 in addition to existing borrowings
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at 7.5% p.a.

4.6 Sustainability

Despite the significant challenges Council faces being a large rural LGA with a low population density, Council management have run a fiscally responsible operation which at this time appears to support a sound Sustainability position in the long term.

Council have provided agreed levels of service with the residents while building up significant cash reserves over the last number of years. The planned expenditure of these reserves over the next 10 years will enable sufficient capital expenditure to maintain infrastructure assets in an acceptable condition.

Other areas where management have shown foresight for longer term Sustainability include:

- Keeping staff numbers and salaries and wages static
- Regional cooperation through shared services and organisations such as REROC
- Joint tendering with neighbouring Councils
- Prudence in applying for capital grants, taking into account the longer term operational costs
- Infrastructure management has been sound with Council only having concrete bridges in the LGA
- Council's Infrastructure Backlog is close to zero after extensive flood repair works

In considering the longer term financial Sustainability of the Council we consider Council to be in a sound position. We make the following additional comments:

- Council's forecast capital expenditure program is sufficient to ensure the current service levels can be maintained
- Council's has built up good levels of cash reserves which can be used to fund its forecast capital expenditure program
- Council's LTFP takes a very conservative approach to forecasting its operating and capital grant revenue which may understate its forecast operating surpluses
- The long term Sustainability of the Council is dependent on Council continuing to receive operating grants and contributions from both the State and Federal government to support its operations

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Section 5 Benchmarking and Comparisons with Other Councils

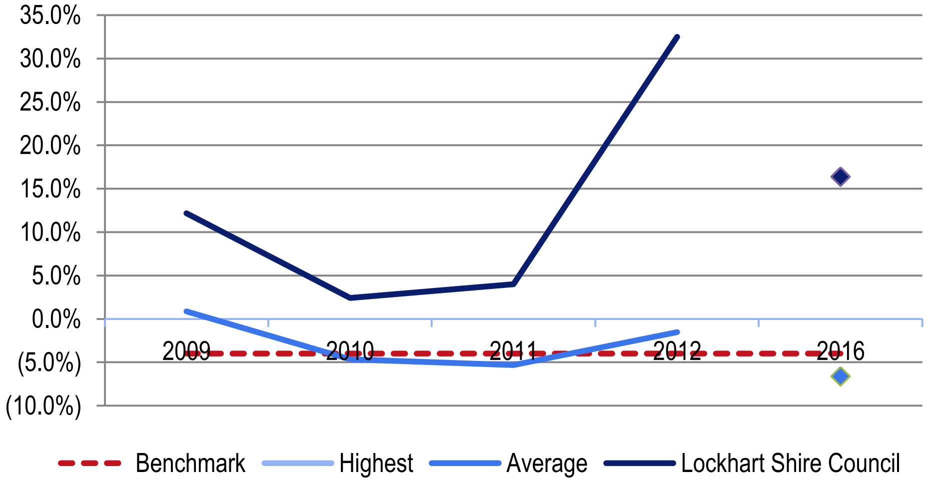
Each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis for councils operating more than one fund. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council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

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

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

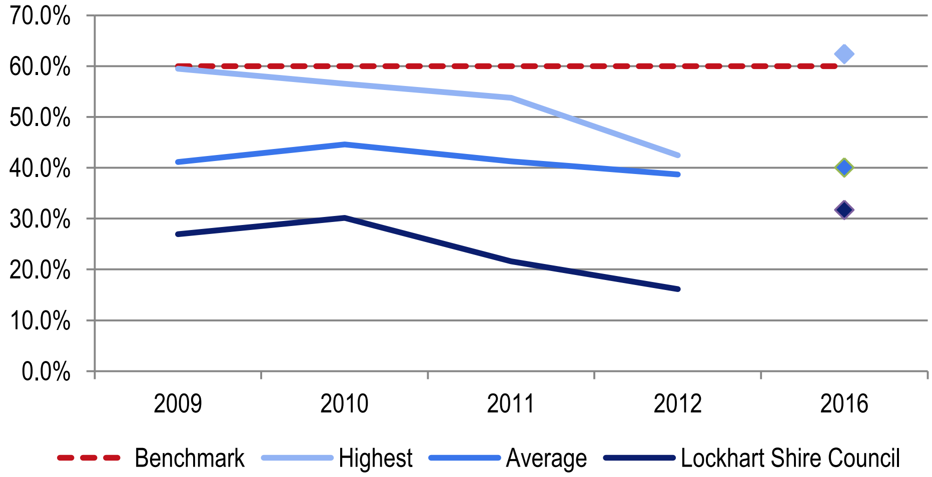
Financial Flexibility

Figure 15 - Operating Ratio Comparison



Council's Operating Ratio consistently outperformed the benchmark over the review period and was the highest ratio within the group. Over the medium term, this situation is forecast to remain unchanged.

Figure 16 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio was consistently well below the benchmark and the group average. Over the medium term, Council's ratio is forecast to improve but remain below the benchmark and the peer group.

Liquidity

Figure 17 - Cash Expense Ratio Comparison

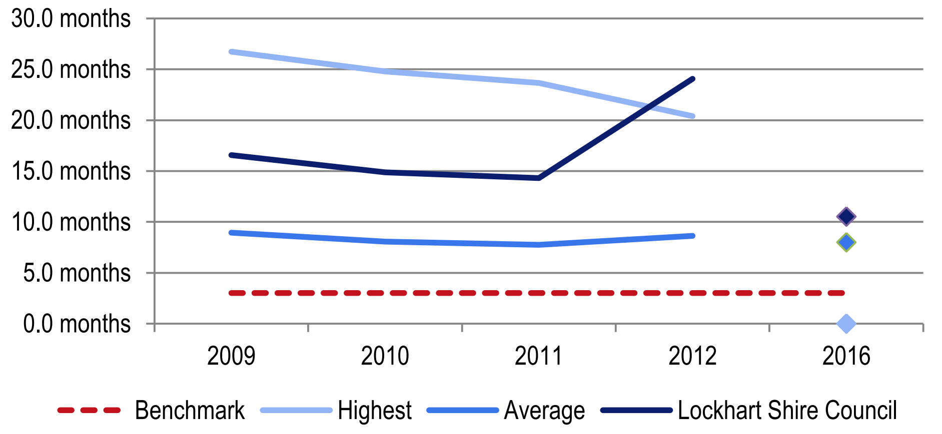
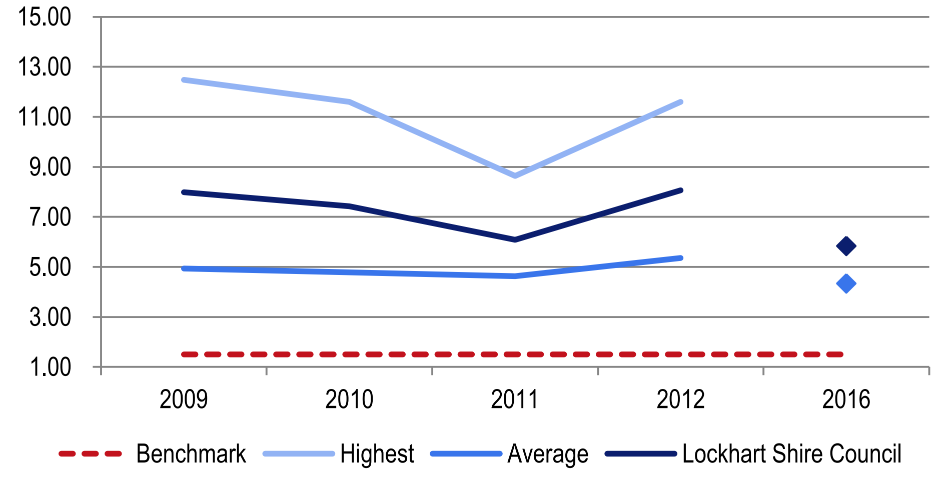
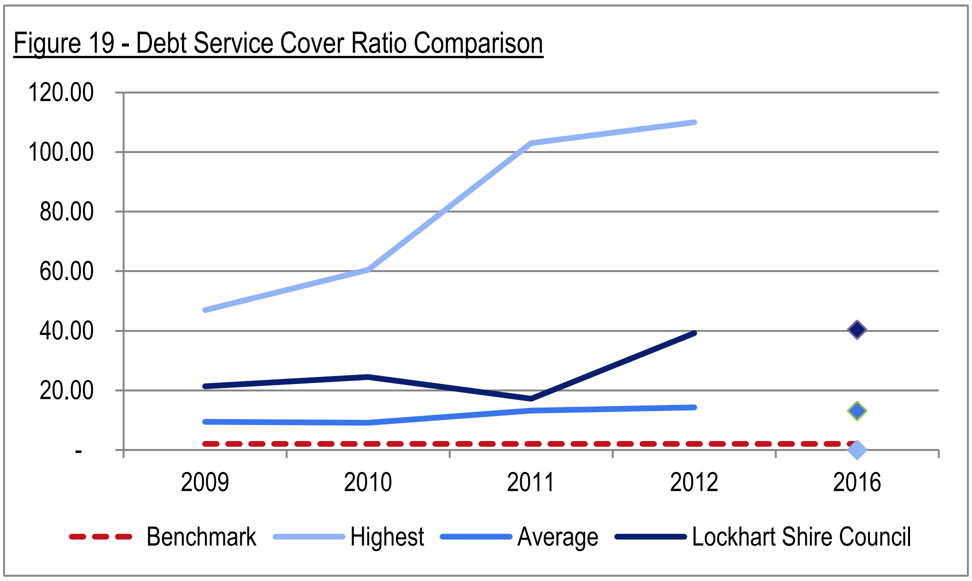


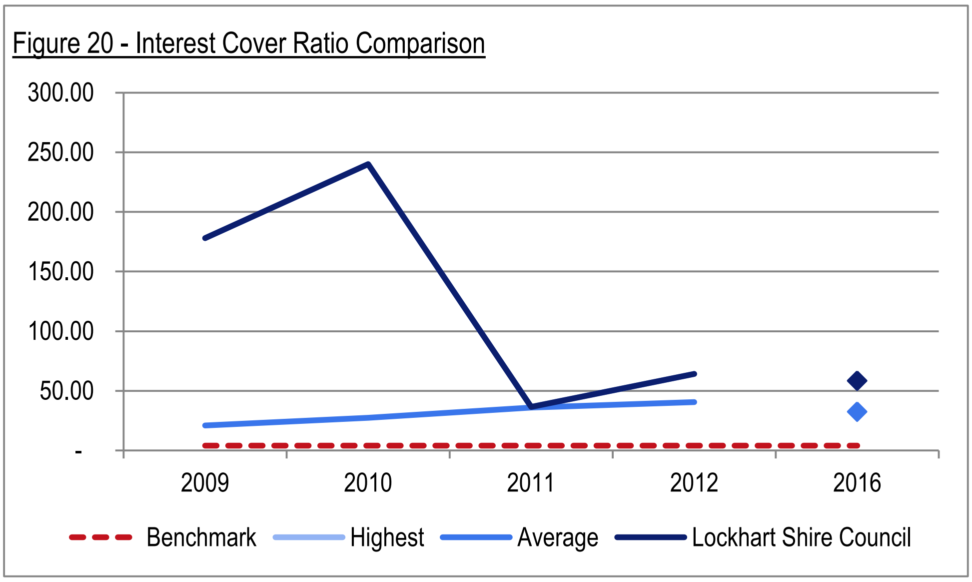
Figure 18 - Unrestricted Current Ratio Comparison



Council's liquidity position was sound with above benchmark and group average Cash Expense Ratio and Unrestricted Current Ratio. Over the medium term, Council's liquidity ratios are forecast to remain above the peer group.

Debt Servicing





Council's debt servicing capacity was sound with above benchmark and average DSCR and Interest Cover Ratio. Over the medium term, Council's debt servicing capacity is forecast to remain sound and outperform the group average.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

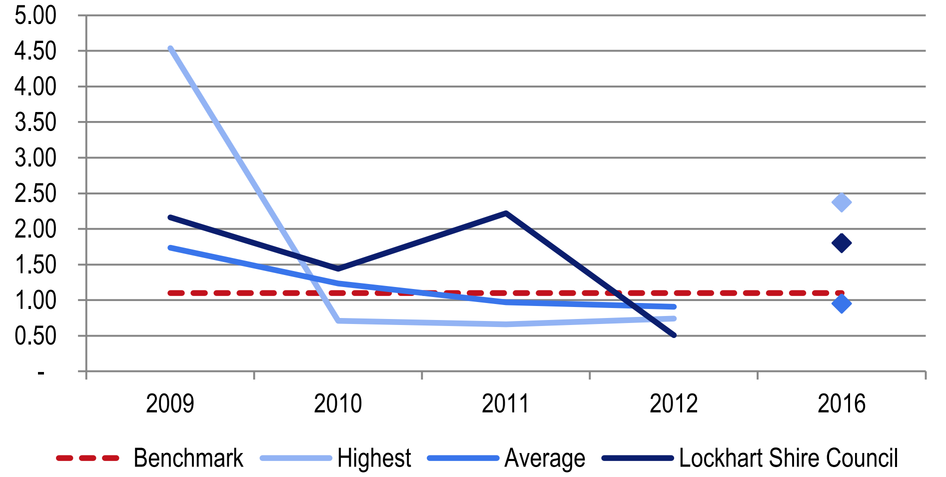


Figure 22 - Asset Maintenance Ratio Comparison

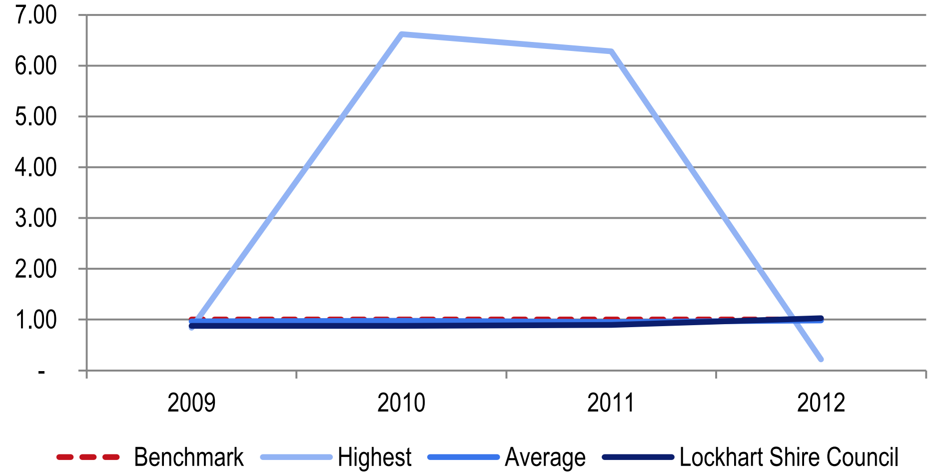


Figure 23 - Infrastructure Backlog Ratio Comparison

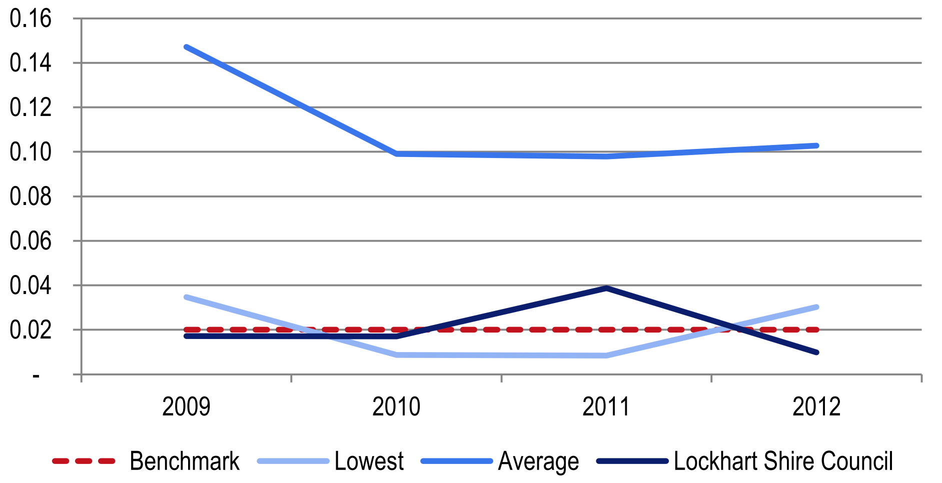
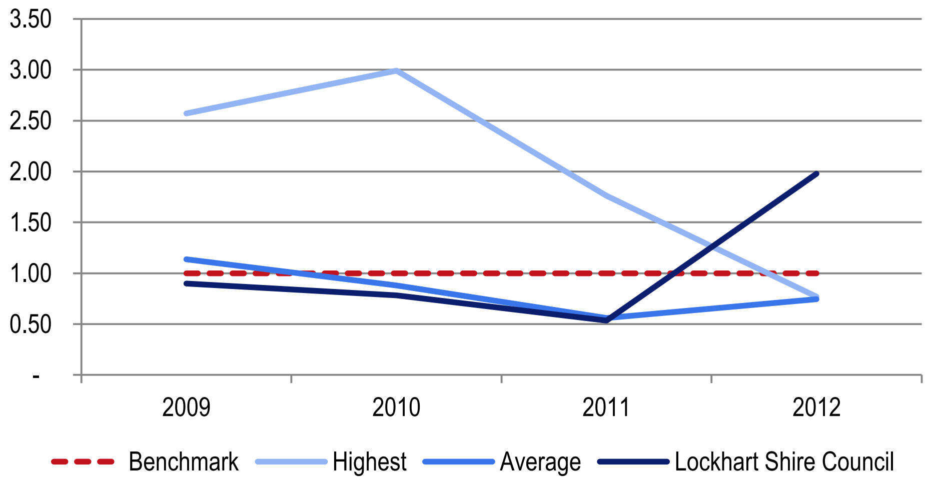


Figure 24 - Building and Infrastructure Asset Renewal Ratio



Council's Infrastructure Backlog Ratio was consistently well below the group average over the review period. Council's spending on maintenance of assets was generally below the benchmark but in line with the peer group.

Council's Capital Expenditure Ratio outperformed the benchmark and the group average in three of the past for years. Over the medium term, Council's ratio is forecast to improve and be above the benchmark and the peer group.

Council's Building and Infrastructure Asset Renewal Ratio outperformed the benchmark and the group average in one of the past four years (2012).

Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's long term financial plan we consider Council to be in a sound Sustainability position.

We base our recommendation on the following key points:

- Council reported operating surpluses each year over the review period and these are forecast to continue
- Employee expenses decreased over the review period
- Council has had very strong levels of liquidity throughout the period as indicated by its Unrestricted Current Ratio being well above the benchmark
- Council's forecast capital expenditure will be sufficient to keep infrastructure assets in their current satisfactory condition
- Council's cash reserves will fund required levels of asset renewal in the long term
- Council has close to zero Infrastructure Backlog, although the AMP is to be reviewed and this may have some financial implications for Council

New South Wales Treasury Corporation

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	2,645	2,580	2,328	2,246	2.5%	10.8%	3.7%
User charges and fees	179	170	214	422	5.3%	(20.6%)	(49.3%)
Interest and investment revenue	366	377	305	434	(2.9%)	23.6%	(29.7%)
Grants and contributions for operating purposes	5,334	4,156	4,607	4,663	28.3%	(9.8%)	(1.2%)
Other revenues	271	344	224	198	(21.2%)	53.6%	13.1%
Total revenue	**8,795**	**7,627**	**7,678**	**7,963**	**15.3%**	**(0.7%)**	**(3.6%)**
Expenses							
Employees	2,166	2,731	2,620	2,237	(20.7%)	4.2%	17.1%
Borrowing costs	77	70	10	17	10.0%	600.0%	(41.2%)
Materials and contract expenses	918	1,423	2,033	1,732	(35.5%)	(30.0%)	17.4%
Depreciation and amortisation	1,999	2,188	2,205	2,040	(8.6%)	(0.8%)	8.1%
Other expenses	775	910	625	967	(14.8%)	45.6%	(35.4%)
Total expenses	**5,935**	**7,322**	**7,493**	**6,993**	**(18.9%)**	**(2.3%)**	**7.2%**
Operating result (excluding capital grants and contributions)	**2,860**	**305**	**185**	**970**	837.7%	64.9%	(80.9%)
Operating result (including capital grants and contributions)	**11,562**	**5,395**	**948**	**2,916**	114.3%	469.1%	(67.5%)

Table 2 - Items excluded from Income Statement

Excluded items	2012	2011	2010	2009
Grants and contributions for capital purposes	8,702	5,090	763	1,946
Net Share of interests in Joint Ventures & Associated Entities using the equity method	19	5	2	5
Impairment	3,383	6,974	0	0
Net gain from the disposal of assets	60	87	97	(36)

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	7,734	6,038	6,541	6,812	28.1%	(7.7%)	(4.0%)
Receivables	3,802	1,465	571	476	159.5%	156.6%	20.0%
Inventories	1,435	984	896	543	45.8%	9.8%	65.0%
Other	16	16	58	56	0.0%	(72.4%)	3.6%
Total current assets	12,987	8,503	8,066	7,887	52.7%	5.4%	2.3%
Non-current assets							
Receivables	68	108	29	31	(37.0%)	272.4%	(6.5%)
Inventories	0	0	0	198	N/A	N/A	(100.0%)
Infrastructure, property, plant & equipment	193,021	188,011	210,309	209,157	2.7%	(10.6%)	0.6%
Investments accounted for using the equity method	100	81	76	74	23.5%	6.6%	2.7%
Total non-current assets	193,189	188,200	210,414	209,460	2.7%	(10.6%)	0.5%
Total assets	**206,176**	**196,703**	**218,480**	**217,347**	**4.8%**	**(10.0%)**	**0.5%**
Current liabilities							
Payables	849	534	468	442	59.0%	14.1%	5.9%
Borrowings	25	49	68	88	(49.0%)	(27.9%)	(22.7%)
Provisions	648	545	589	595	18.9%	(7.5%)	(1.0%)
Total current liabilities	1,522	1,128	1,125	1,125	34.9%	0.3%	0.0%
Non-current liabilities							
Borrowings	941	966	26	94	(2.6%)	3615.4%	(72.3%)
Payables	0	11	6	24	(100.0%)	83.3%	(75.0%)
Provisions	36	55	60	66	(34.5%)	(8.3%)	(9.1%)
Total non-current liabilities	977	1,032	92	184	(5.3%)	1021.7%	(50.0%)
Total liabilities	**2,499**	**2,160**	**1,217**	**1,309**	**15.7%**	**77.5%**	**(7.0%)**
Net assets	**203,677**	**194,543**	**217,263**	**216,038**	**4.7%**	**(10.5%)**	**0.6%**

Table 4-Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June			
	2012	**2011**	**2010**	**2009**
Cash flows from operating activities	11,595	6,775	3,243	4,827
Cash flows from investing activities	(9,850)	(8,199)	(3,426)	(4,865)
Proceeds from borrowings and advances	0	1,000	0	0
Repayment of borrowings and advances	(49)	(79)	(88)	(125)
Cash flows from financing activities	(49)	921	(88)	(125)
Net increase/(decrease) in cash and equivalents	**1,696**	**(503)**	**(271)**	**(163)**
Cash and equivalents	7,734	6,038	6,541	6,812

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.

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.