NSW TREASURY CORPORATION REPORT

SPECIAL RATE VARIATION APPLICATION APPENDIX

New South Wales
Treasury Corporation

Sutherland Shire Council

Financial Assessment and Benchmarking Report

14 March 2013

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

New South Wales
Treasury Corporation

Disclaimer

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

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

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

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

The report is primarily focused on the financial capacity of the Council to undertake additional borrowings as part of the Local Infrastructure Renewal Scheme (LIRS).

Council has made one LIRS application for $2.3m relating to the upgrade of the Cronulla Seawall and Esplanade.

TCorp's approach has been to:

- Review the most recent three years of Council's consolidated financial results
- Conduct a detailed review of the Council's 10 year financial forecasts. The review of the financial forecasts focused on the particular Council fund that was undertaking the proposed debt commitment. As the Council operates only one fund we focused our review on this General Fund.

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

- Council's underlying performance, measured by EBITDA, has improved in each year
- Council has adequate liquidity as indicated by an Unrestricted Current Ratio above the benchmark in each year
- Council's Own Source Operating Revenue Ratio is above 60% in all three years indicating Council has a sufficient level of fiscal flexibility
- Council has capacity to repay additional borrowings as indicated by a DSCR and Interest Cover Ratio above the benchmark in each year, even with an interest-free loan of $6.9m being repaid in full in 2011

Council's reported Infrastructure Backlog of $96.4m in 2011 represents 13.4% of its infrastructure asset value of $721.1m. Other observations include:

- The backlog figure has increased marginally from $91.9m in 2009
- 69.4% of the backlog relates to public roads
- Council's expenditure on asset maintenance has increased over the review period and since 2010, the asset maintenance ratio has been at the benchmark of 1.0x

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

- The LTFP 'Financial Model 1' base case has been analysed. It assumes existing service levels to the community are maintained
- The operating result is forecast to get progressively worse with a deficit forecast in each year as indicated by the Operating Ratio declining to negative 3.8% ($9.7m) in 2022. While this is above the benchmark of negative 4.0%, this trend could impact Council's financial sustainability in the long term

- Council's liquidity should remain adequate with a consistent Unrestricted Current Ratio forecast marginally below the benchmark in all 10 years
- The Cash Expense Ratio (when current investments are included) remains consistently above the benchmark
- Council is forecasting their capital expenditure compared to depreciation expense, will reduce over the 10 years as indicated by the decreasing Capital Expenditure Ratio. The Ratio will be at its lowest in 2022 at 0.77x. Over the 10 year period there is a shortfall against the benchmark of approximately $19m

In our view, the Council has the capacity to undertake the additional borrowings of $2.3m for the LIRS project. This is based on the following analysis:

- The forecast DSCR and forecast Interest Cover Ratio are above the benchmarks of 2.00x and 4.00x respectively, in each year with the result improving as Council's debt service costs reduce in line with total borrowings over time
- Based on Council's LTFP, Council would be able to utilise up to $34.8m in further borrowings (in addition to the loan to be used for the LIRS project and further $3.0m within the forecast) before their DSCR reduces to the 2.00x benchmark

In respect of our Benchmarking analysis we have compared the Council's key ratios with other councils in DLG Group 3. Our key observations are:

- Council's financial flexibility as indicated by the Operating Ratio and Own Source Operating Revenue Ratio is similar to the group average
- Council has less comparative capacity than the group average to manage additional borrowings as indicated by the DSCR and Interest Cover Ratio
- Council was in a sufficient liquidity position but was marginally below the group average liquidity level when measured using the Cash Expense ratio as they invest the majority of their funds within investments to increase interest revenue
- Council's Capital Expenditure Ratio has been above the group average since 2011 but they have a comparatively higher level of Infrastructure Backlog. Asset maintenance funding has been above the group average in each year and benchmark since 2010. Asset renewals have been above benchmark in three of the four years and remained above the group average in each year

Section 2 Introduction

2.1: Purpose of Report

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

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

The key areas focused on are:

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

2.2: Scope and Methodology

TCorp's approach was to:

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

In undertaking its work, TCorp relied on:

- Council's audited financial statements (2008/09 to 2010/11)
- Council's financial forecast model
- Council's IP&R documents
- Discussions with Council officers
- Council's submissions to the DLG as part of their LIRS application
- Other publicly available information such as information published on the IPART website

Benchmark Ratios

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

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

Therefore these benchmarks are intended as a guide to performance.

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

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

2.3: Overview of the Local Government Area

Sutherland Shire Council	
Locality and Size	
Locality	Sydney Outer
Area	334 km²
DLG Group No.	3
Demographics	
Population	210,863
% under 20	26%
% between 20 and 59	53%
% over 60	21%
Expected population in 2021	226,200
Operations	
Number of employees (FTE)	1,099
Annual revenue	$197.1m
Infrastructure	
Roads	804 km
Bridges	34
Infrastructure backlog value	$96.4m
Total infrastructure value	$721.1m

Sutherland Shire Council Local Government Area (LGA) is located at the southern coastal border of the Sydney metropolitan area, about 26 kilometres from the Sydney CBD. It encompasses a total land area of about 334 square kilometres, including beaches, waterways, bushlands, parklands and national parks. The LGA is predominantly a residential area, but also has industrial and commercial areas.

It is the second largest local government in NSW and is one of the biggest in Australia, as measured by the population it serves.

Council's infrastructure, property, plant and equipment (IPP&E) as at 30 June 2011, included:

- $306.8m of road, bridge and footpath infrastructure assets
- $155.1m of specialised buildings
- $143.7m of stormwater drainage infrastructure assets
- $73.0m of depreciable land improvements
- $42.5m of non specialised buildings

2.4: LIRS Application

Council has made one LIRS application.

Project: Cronulla Seawall and Esplanade Upgrade

Description: The seawall and esplanade were originally constructed in the 1920s and have suffered considerable deterioration in the last 15 years. The project consists of reconstruction of both the seawall and esplanade from the headland south of Cronulla Surf Life Saving Club to the southern-most extent of the grass in Cronulla Park.

Amount of loan facility: $2.3m

Total project cost $3.3m

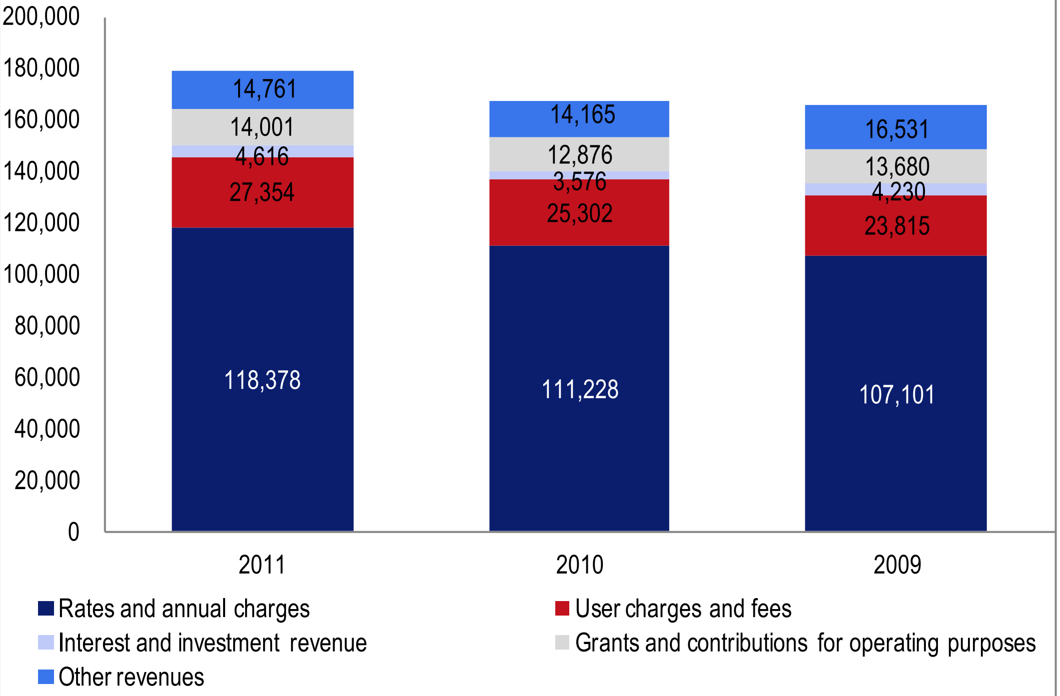
Term of loan facility: 10 years

Section 3 Review of Financial Performance and Position

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

3.1: Revenue

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

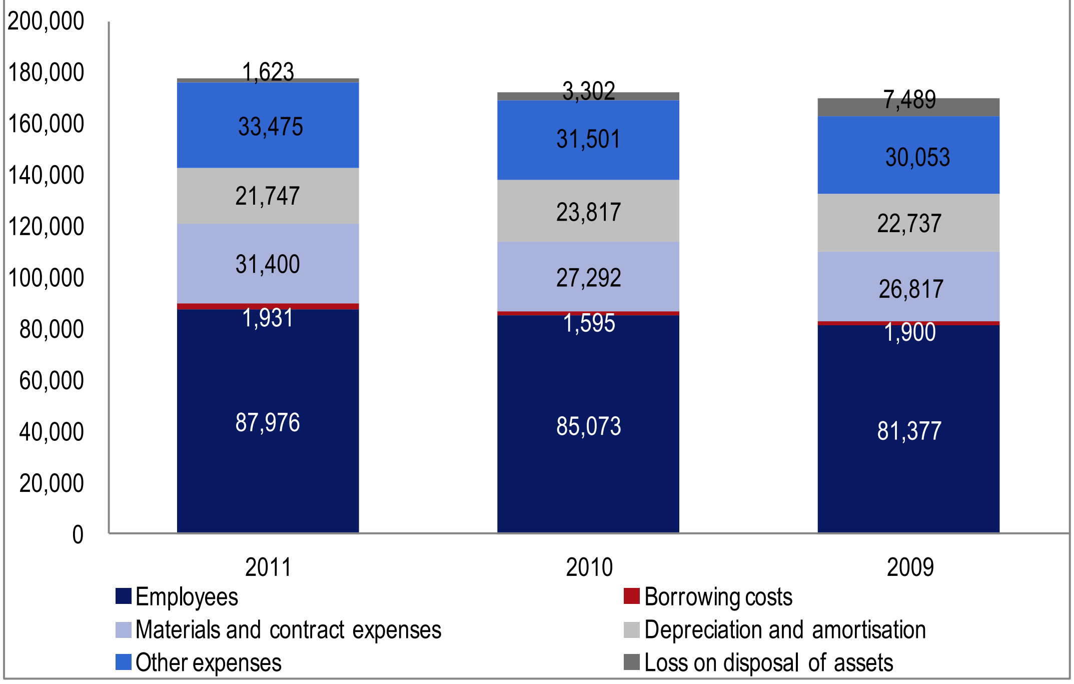


Key Observations

- Total operating revenues have increased by $13.8m (8.4%) over the period.
- Rates and annual charges are Council's main revenue source at 66.1% of the total in 2011. They have increased by 3.9% in 2010 and 6.4% in 2011. The 2010 increase was in line with the approved rate peg for general rates while the increase in 2011 was due to an additional 4.0% infrastructure levy SRV on general rates that began in 2011 for a three year period. The levy aims to raise $12m over three years for additional capital projects.
- User fees and charges have increased year on year with the largest contributors being child care fees, restoration charges and swimming pool fees which increased by $1.2m, $1.0m and $0.5m respectively over the period.
- In 2011 the largest categories of other revenues were fines of $4.4m, rental income from investment properties of $3.1m and lease rentals of $2.0m.
- The 2009 other revenues were boosted by one-off revenues of $0.5m for the City and Country Environmental Restoration Program and $0.7m from compensation relating to a Sydney Water property claim. The 2010 figure dipped as fines revenue was $0.5m below the 2009 total and $0.7m below the 2011 total.

3.2: Expenses

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



Key Observations

- Total expenses have increased by $7.8m over the period, representing an annual increase of 2.3% p.a.
- Employee costs have increased by 4.5% in 2010 and 3.4% in 2011. In 2010 superannuation costs increased by $2.0m and annual salaries and wages increased by $0.9m. The lower rate of increase in 2011 was in part due to the reduction in full time equivalent employee numbers by 22. The 2011 increase was predominantly due to the annual increase in salaries and wages that rose by $2.2m.
- Materials and contract expenses have increased year on year with the largest increase in 2011. This was due to a $4.1m increase in contractor and consultancy fees because of increased programmed works and increased outsourcing of certain operations. Outsourcing activities included $1.2m spent on road rehabilitation and maintenance work and $1.0m for tree contractors in the parks area.
- Depreciation has reduced over the period after increasing in 2010. The reduction in 2011 was because of the end of an annual $1.3m expense for non specialised buildings while the expense for specialised buildings decreased by $0.6m.
- Other expenses have increased each year with tipping fees increasing by $1.9m over the period to $10.4m in 2011 and electricity and heating increasing from $0.9m to $2.7m. Street lighting costs also increased by $1.1m to $2.8m, and contributions and levies to other levels of Government increased by $0.6m to $4.4m.
- Loss on disposal of assets related to properties that were demolished and replaced by a new structure. Examples of these building assets include a library, community centre, senior citizens

hall and bushfire station. Some of the accounting losses are attributed to the transfer of community land to land under road, and community land written off and classified as a licence due to a proposed freeway. Losses on plant and equipment relate to Council's fleet of vehicles.

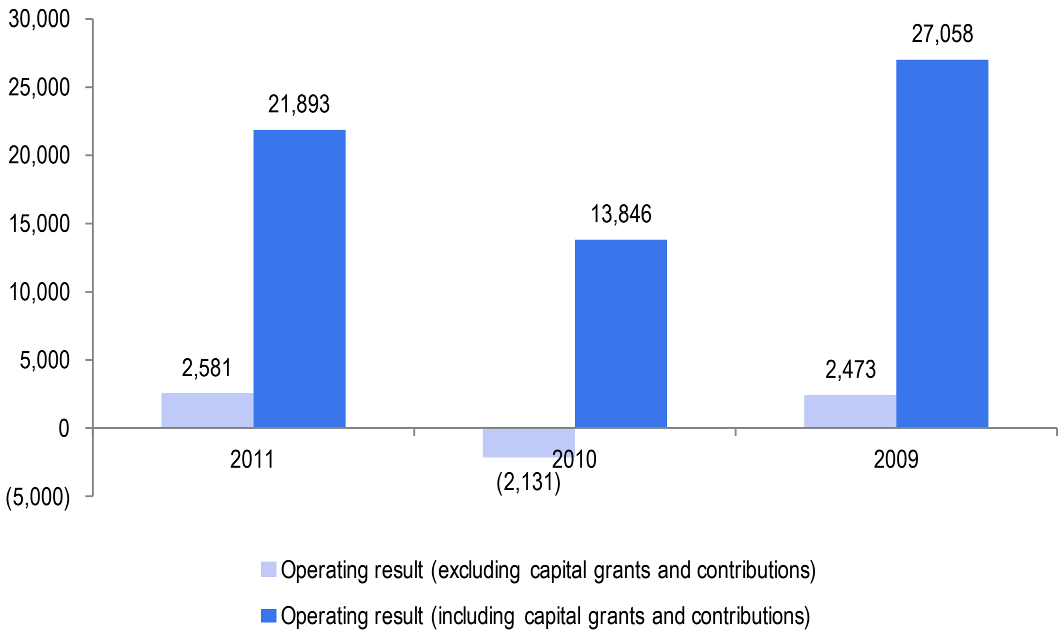
3.3: Operating Results

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

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

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

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



Key Observations

- Council's operating result excluding capital grants and contributions has improved over the period with Council recording surpluses in both 2009 and 2011 when the loss on the disposal of assets are excluded. The deficit in 2010 was experienced due to the four main expense categories increasing at a more rapid rate than Council's own source operating revenues. In 2011, the infrastructure levy SRV assisted in the improved result, while it also had the smallest loss on the disposal of assets of the three years.

3.4: Financial Management Indicators

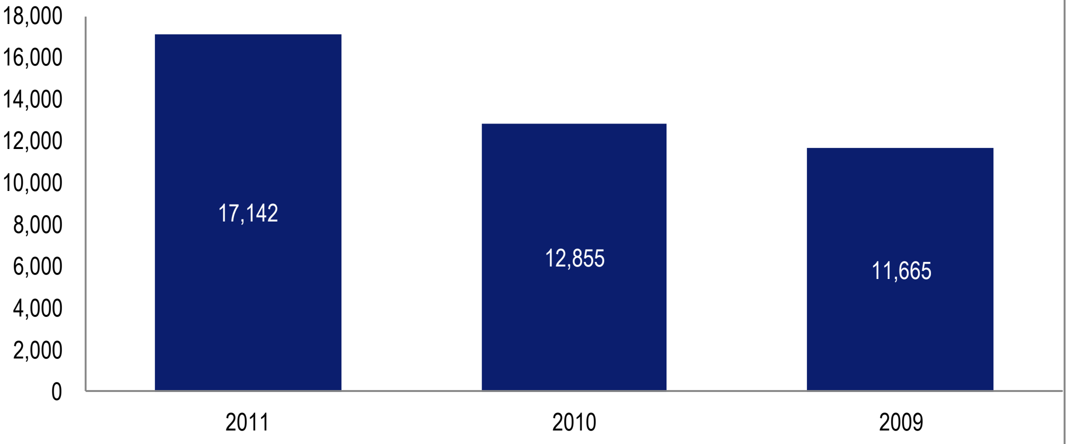
Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA ($'000s)	24,636	19,979	19,621
Operating Ratio	0.5%	(3.3%)	(3.0%)
Interest Cover Ratio	12.76x	12.53x	10.33x
Debt Service Cover Ratio (DSCR)	2.21x	4.64x	7.61x
Unrestricted Current Ratio	1.69x	1.53x	1.83x
Cash Expense Ratio	1.3 months	1.0 months	1.0 months
Own Source Operating Revenue Ratio	73.4%	74.6%	68.9%
Net assets ($'000s)	1,143,519	1,525,299	1,593,447

Key Observations

- EBITDA, a measure of Council's underlying performance, has improved over the period, mainly due to smaller losses on disposal of assets in 2011 compared to 2009 and 2010. This has resulted in an increased Interest Cover Ratio and the ratio remains sufficiently above the 4.00x benchmark in all three years. The DSCR has reduced over the period due to significant increases in the principal repayment of debt in each year. The increase of debt repayment to $9.2m in 2011 (from $0.7m in 2009) was because of an interest-only loan of $6.9m being repaid in this year. This loan related to the construction of the Cronulla community facilities.
- Council has total borrowings of $35.6m in 2011 compared to $36.2m in 2009. The 2011 figure represents 3.1% of Net Assets.
- The Unrestricted Current Ratio has remained above the 1.50x benchmark over the three years indicating Council have had sound liquidity over the period.
- The Cash Expense Ratio has improved marginally but remains below the benchmark however the majority of Council's funds are invested in term deposit accounts and equity linked notes as detailed in Section 3.5.
- The Own Source Operating Revenue Ratio has been above the benchmark in all three years and has trended upwards over the period. Council therefore have control over a sufficient level of their revenues indicating fiscal flexibility, enabling them to react more effectively in adverse financial situations.
- Net Assets have decreased in each year due to the Asset Revaluations process and changes in accounting policy. In 2010 there was an $85.0m decrease in infrastructure assets while in 2011 there was a $400.9m decrease in community land. Consequently, in the short term the value of Net Assets is not necessarily an informative indicator of performance. In the medium to long term however, this is a key indicator of a Council's capacity to add value to its operations. Over time, Net Assets should increase at least in line with inflation plus an allowance for increased population and/or improved or increased services. Declining Net Assets is a key indicator of the Council's assets not being able to sustain the ongoing operations of a Council.
- When excluding the Asset Revaluations, Council has increased the IPP&E asset base by $56.5m over the review period, with asset purchases being higher than the combined value of disposed assets and depreciation.

3.5: Statement of Cashflows

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



Key Observations

- Council's cash and cash equivalents have increased in each year however as stated in Section 3.4, Council holds the majority of its funds within term deposits which are classified as current investments instead of cash.
- Overall cash and cash equivalents, and investments have increased from $81.5m in 2009 to $103.1m in 2011. Of the $103.1m, $59.1m is externally restricted, $41.5m is internally restricted and $2.5m is unrestricted.
- Within the investments portfolio of $85.9m, $41.0m is invested in current term deposit accounts, $3.4m in non-current term deposits, $24.3m in equity linked notes, $5.0m in negotiable certificates of deposit / floating rate notes, $9.1m in CDOs and $3.2m of other long term financial assets.
- The $9.1m in CDOs related to three specific CDOs of which two have now been redeemed with Council receiving the full face value on maturity. One CDO remains, with a value of $2.0m that is due to mature in June 2015. Council has confirmed that this is capital guaranteed therefore they will also receive the full amount on maturity.
- The $3.2m of other long term financial assets also related to a Capital Protected Hedge Fund Note.
- The level of cash and investments combined along with the Unrestricted Current Ratio above the benchmark highlights an adequate liquidity position.

3.6: Capital Expenditure

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

3.6(a): Infrastructure Backlog

Figure 5 - Infrastructure Backlog for 2008/09 to 2010/11 ($'000s)

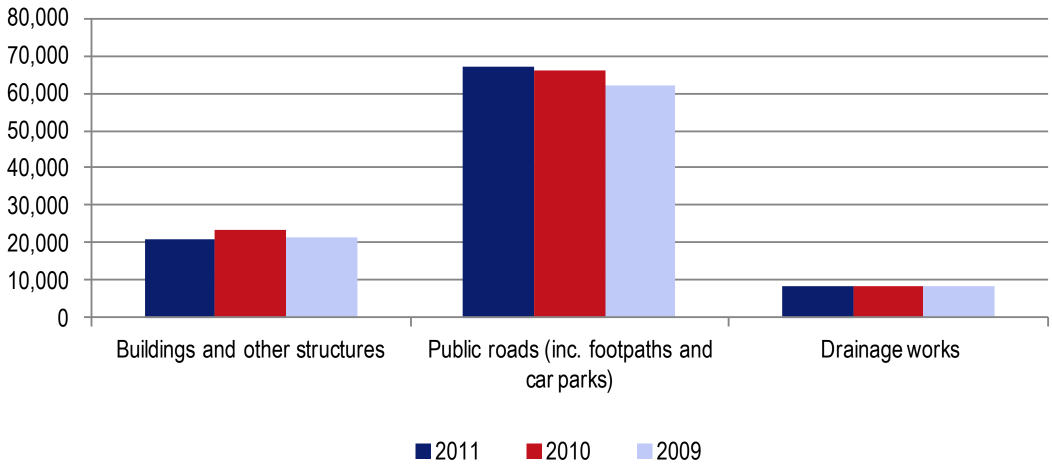
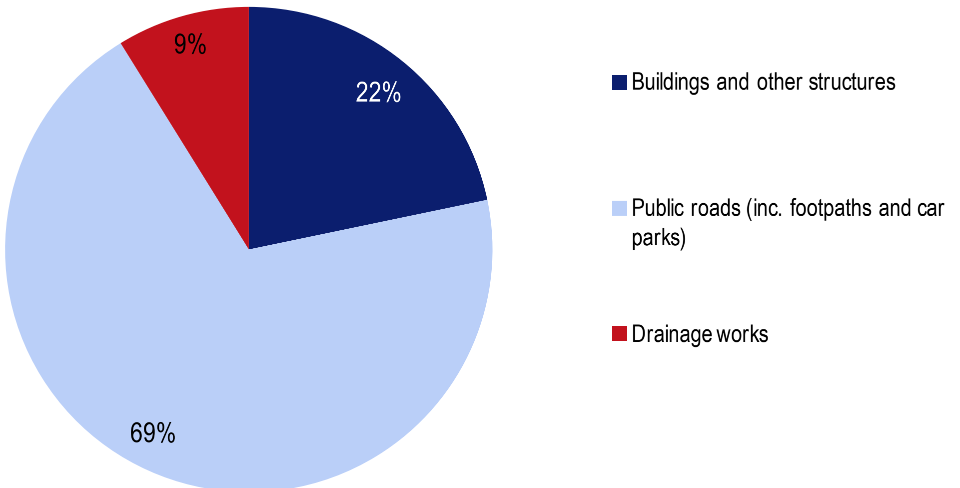


Figure 6 - Infrastructure Backlog Composition for 2010/11



Council's Infrastructure Backlog has increased from $91.9m in 2009 to $96.4m in 2011. All three categories of infrastructure asset have backlog figures that have remained relatively stable over the period.

The infrastructure levy that began in 2011 has been approved in order to assist reducing the backlog figure and was proposed for three years to 2013 to provide up to $12.0m in additional funds that were to be allocated for capital programs. The Council has now cancelled the third year of this levy for 2013 as they were wary of the financial strain that the community was under from the additional rates due.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000s)	96,373	97,702	91,913
Required annual maintenance ($'000s)	15,009	14,918	14,636
Actual annual maintenance ($'000s)	15,516	14,873	9,168
Total value of infrastructure assets ($'000s)	721,082	719,343	769,544
Total assets ($'000s)	1,233,792	1,614,654	1,680,041
Building and Infrastructure Backlog Ratio	0.13x	0.14x	0.12x
Asset Maintenance Ratio	1.03x	1.00x	0.63x
Building and Infrastructure Renewals Ratio	1.42x	0.89x	1.24x
Capital Expenditure Ratio	1.83x	1.26x	2.40x

The Building and Infrastructure Backlog Ratio has remained stable with the slight variations due to the change in the total value of infrastructure assets as opposed to a reduced backlog figure. Council has not been able to reduce the backlog towards the benchmark of 0.02x over the period.

The Asset Maintenance Ratio has improved over the period and was equal to the benchmark in 2010 and marginally above in 2011. This indicates that Council have increased their spending to maintain their assets at their current operating standard. The lower maintenance spend in 2009 is partly reflected in the increase in the infrastructure backlog from 2009 to 2010.

The Building and Infrastructure Renewals Ratio has been above the benchmark in 2009 and 2011 and overall it indicates that Council have also sufficiently invested in renewing their assets compared to that year's depreciation expense. This should help prevent the value of the Backlog from increasing further.

The Capital Expenditure Ratio has been above the benchmark in all three years although it has varied from year to year. Over the review period Council invested $144.5m in capital expenditure, $47.7m above the benchmark figure.

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		
	2011	**2010**	**2009**
New capital works	23,188	23,478	38,226
Replacement/refurbishment of existing assets	19,480	14,057	26,027
Total	**42,668**	**37,535**	**64,253**

Council's capital program in 2011 included:

- Approximately $25.0m spent on upgrading and maintaining infrastructure including 25 footpath construction, cycleways, playgrounds and parks projects
- Shopping centre upgrades at Sutherland, Gymea and Caringbah
- Completion of the new library and community facilities at Cronulla for a total cost of $19.7m
- Completion of the new community facilities at Engadine for a total cost of $9.7m

3.7: Specific Risks to Council

- Project management. Council has an upcoming list of capital projects which are subject to risks of delay and cost overrun. In 2011, Council set a Key Performance Indicator (KPI) to complete 90% of planned capital works supported by funding programs in that year. Council completed 65.4% of the projects which is short of its KPI. Council needs to continue to plan and manage its projects carefully to meet its KPIs.
- Ageing population. The proportion of over 50 year olds is increasing. This places additional demands on the physical and social infrastructure required, and services provided by Council to facilitate the wellbeing of the ageing community. Council was awarded the A.R. Bluett Memorial Award in 2011 that is awarded to only two councils each year. Council's CSP and its focus on people, place, nature and governance were the reasons for the award. This highlights Council's awareness of the demographic shift and its ability to meet this demand.
- Environmental disasters / climate change. Council will need to consider their land use near the coast if rising sea levels are predicted. Council is aware that they will need to be ready to respond to any such event and limiting the impact on the community.

Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $2.3m loan without any LIRS subsidy.

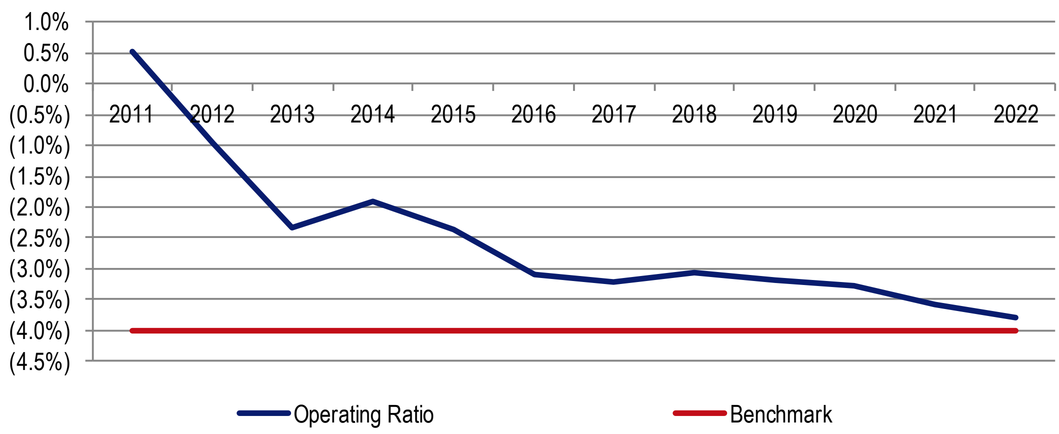
The LIRS loan relates to the General Fund, therefore we have focused our financial analysis solely upon this Fund.

Council's LTFP forecast figures from 2013 to 2022 have been extracted from the Resourcing Strategy document that are the most up to data figures available as at the date of this report. The 2012 figures have been taken from the budget completed in 2011 because Council is yet to finalise their 2012 audited accounts. As there is no Balance Sheet in the 2012 budget figures we have utilised estimated figures relating to cash and cash equivalents and current investments that are analysed in Section 4.2.

Council's LTFP contains three scenarios with 'Financial Model 1' being the base case that assumes current levels of service will be maintained. This is the scenario that our analysis focuses on.

4.1: Operating Results

Figure 7- Operating Ratio



After achieving an operating surplus in 2011, Council is forecasting to return to deficit in 2012 and for the results to gradually decline but for the Operating Ratio to remain above the benchmark in each year. The Operating Ratio is forecast to be at negative 3.8% in 2022 (a deficit of $9.2m). While above the benchmark, continuous deficits will impact on the financial sustainability of Council in the long term.

The deficits include $0.5m p.a. for the loss of disposal of assets representing both the demolition of buildings and sale of its fleet vehicles.

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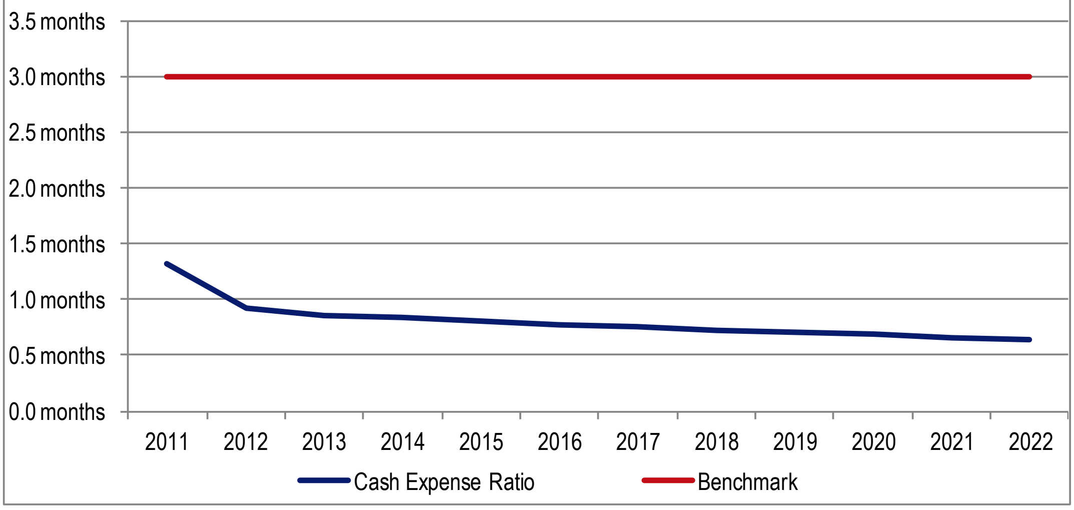
4.2: Financial Management Indicators

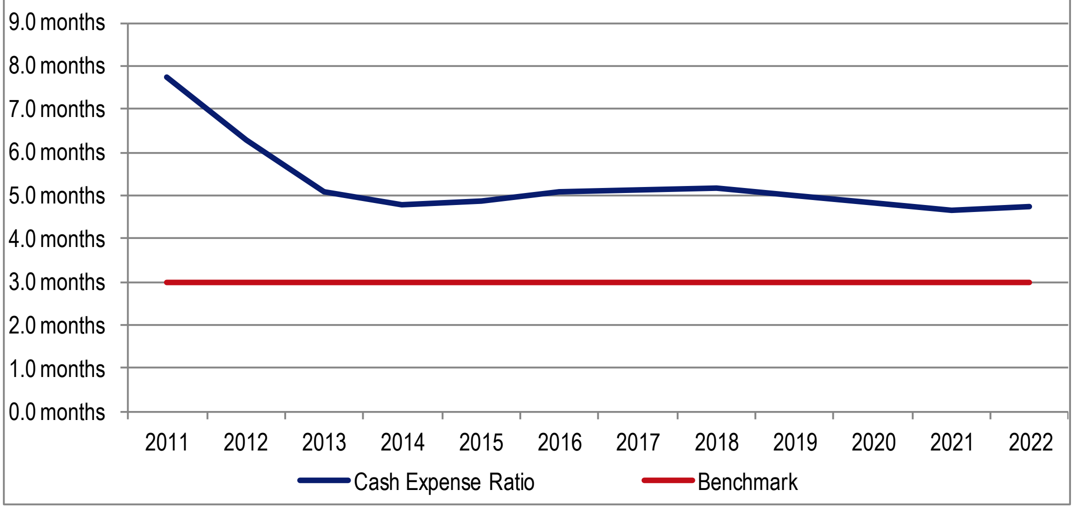
Liquidity Ratios

Figure 8 - Cash Expense Ratio

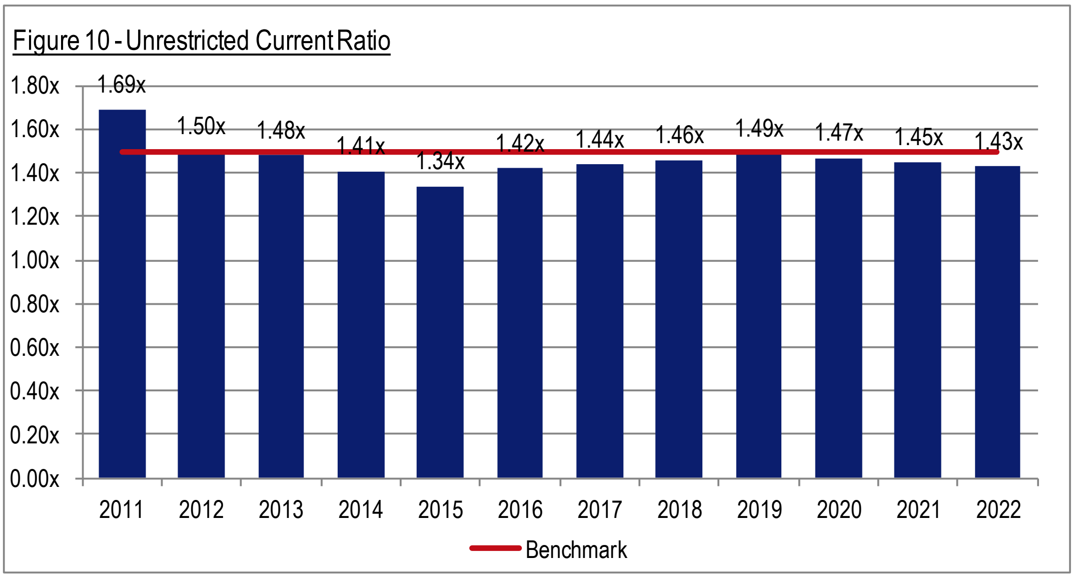


Council has forecast cash and cash equivalents to remain at $12.0m for the duration of the forecast period because they invest the majority of funds in term deposits which are classified as current investments. This results in the Cash Expense Ratio reducing gradually over time as the relevant expenses increase over the forecast period. We have combined both cash and investments to calculate the Cash Expense Ratio graph below.

Figure 9 - Cash Expense Ratio inc. Current Investments



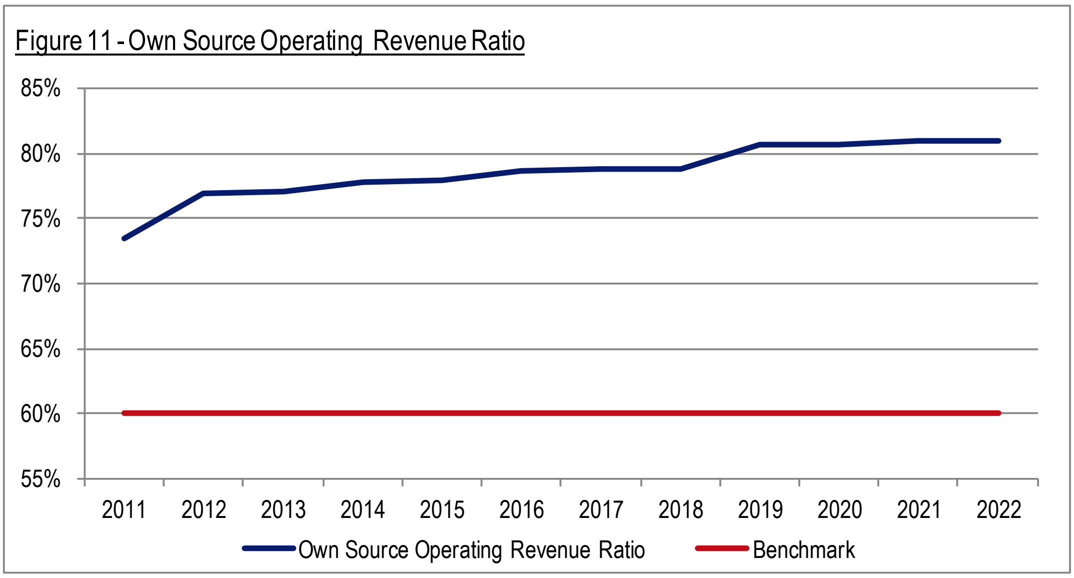
When cash and current investments are combined, Council's Cash Expense Ratio is above the benchmark but is again on a downward trend with the total cash and investments in 2011 of $99.7m reducing to $88.3m in 2022 while the relevant expenses increase as stated previously.



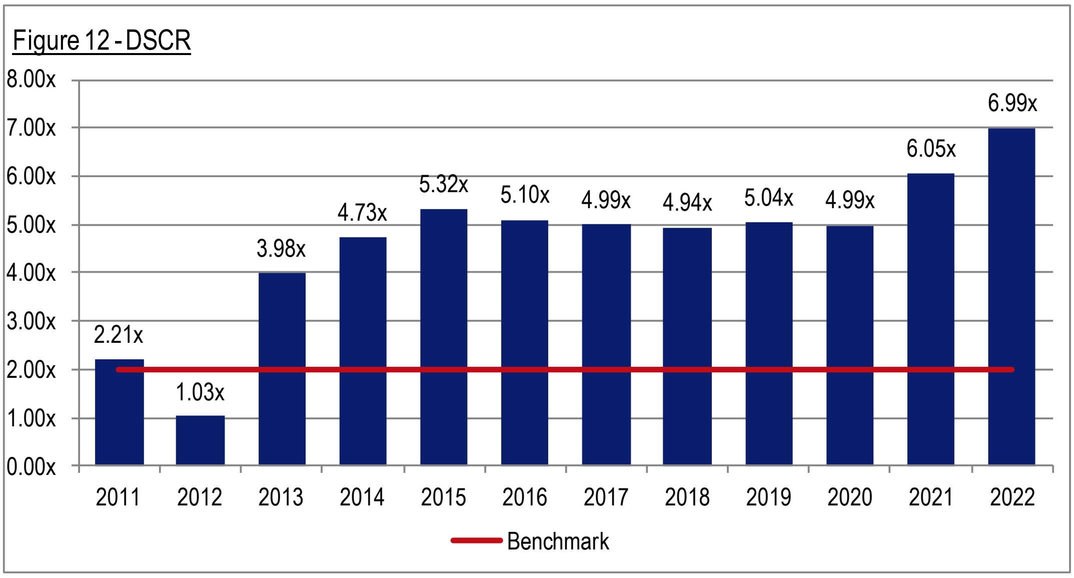
Council has historically been slightly above the benchmark for the Unrestricted Current Ratio. Council has forecast to be below the benchmark in each year but within 0.1x of the 1.50x benchmark in nine of the 10 years.

While being marginally below the benchmark, Council should be in an adequate position to meet all their short term liabilities and not experience major liquidity issues. For their internal purposes, Council use a benchmark of 1.00x as opposed to our 1.50x and keep a strong focus on this ratio so that it does not fall close to or below their 1.00x.

Fiscal Flexibility Ratios

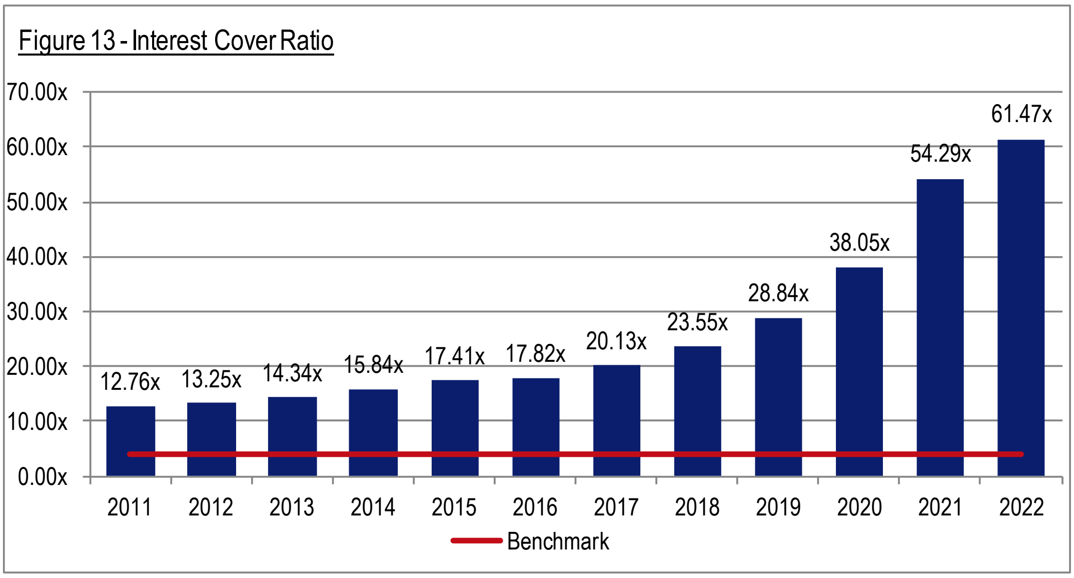


Council has historically been able to rely on over 70% of their revenues from rates and annual charges, and user fees and charges. This trend is forecast to continue and improves over time due to Council reducing the forecast capital grants and contributions. This skews the Own Source Operating Revenue Ratio upwards against historic results.



The DSCR is above the benchmark in each year excluding 2012 as the 2012 budget included the repayment of $22.7m of borrowings. This scheduled principal repayment strengthens the ratio for the remaining years, with the principal debt repayments from 2014 to 2022 being more evenly distributed between $2.5m to $3.7m p.a, while interest costs reduce over the forecast period.

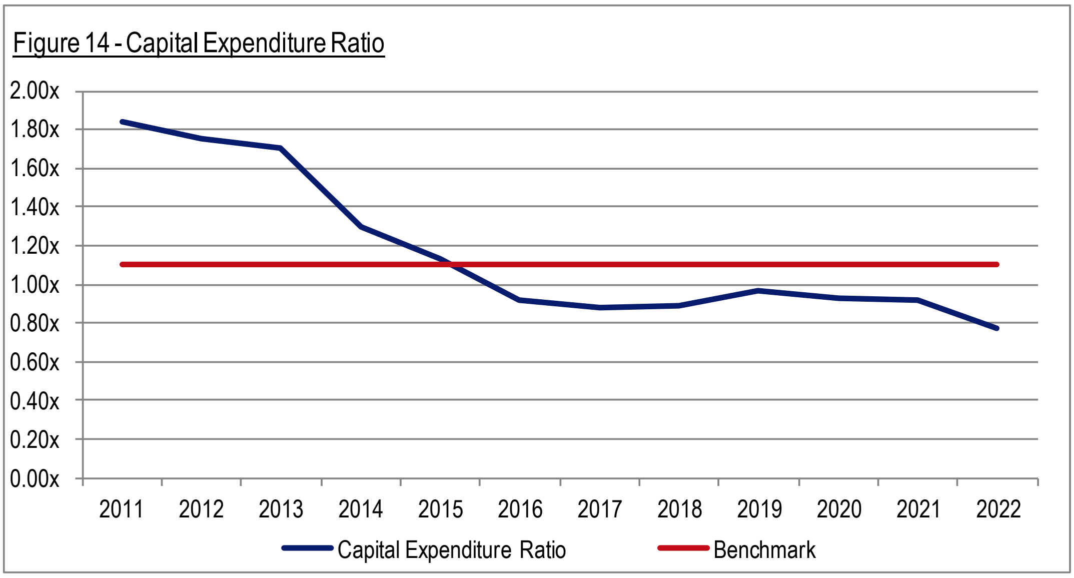
This indicates that Council has further capacity to manage additional borrowings if required.



Council has a strong Interest Cover Ratio historically and this is forecast to improve over the forecast period as interest cost reduces from $1.9m in 2011 to $0.3m in 2022 due to Council's total borrowings reducing during this period.

Again, the improving ratio indicates that Council has the capacity to utilise more borrowings.

4.3: Capital Expenditure



The Capital Expenditure Ratio has historically been well above the required benchmark and this is forecast to continue in 2013 before reducing to a low of 0.77x in 2022. Between 2013 and 2022 the cumulative capital expenditure equates to $268.3m against the cumulative benchmark figure of $287.4m, therefore over the 10 year period Council is forecasting to spend below the sufficient amount of capital expenditure for a growing LGA.

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>

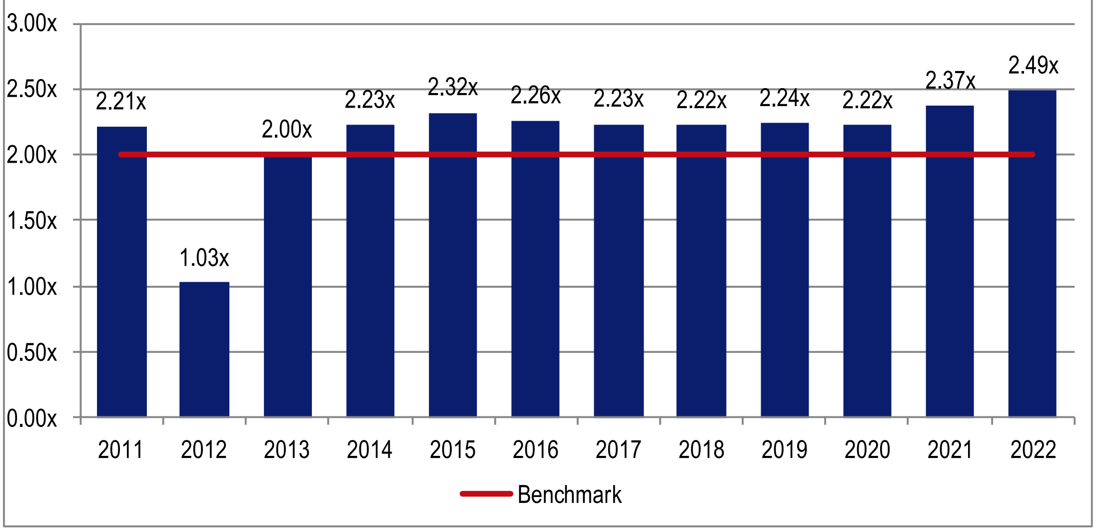
- The LTFP 'Financial Model 1' base case assumes existing service levels to the community are maintained and that any shortfalls reduce the capital asset program rather than service levels
- The additional two scenarios show possible improvements to the base case. Scenario two includes more optimistic revenue assumptions, operating expense reductions and a higher level of capital expenditure. Scenario three includes similar assumptions to scenario two but with borrowings to fund shortfalls
- Council has forecast a 3.0% p.a. increase in the majority of revenue categories unless specific information is already known
- Total employee costs are forecast to increase by 3.5% p.a. in the majority of years
- Depreciation varies between a zero percentage year on year increase in 2018 to a 5.6% increase from 2015 to 2016 in line with Council's depreciation calculation method
- Overall Council's assumptions appear reasonable and in line with TCorp's benchmarks

4.5: Borrowing Capacity

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

- Based on a benchmark of DSCR>2x, $34.8m could be borrowed, in addition to the $2.3m borrowings proposed under LIRS and the further $3.0m already included within the forecast in 2013
- The impact on Council's unrestricted cash position would require further analysis to observe whether this level of borrowings would impact Council's liquidity
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at a rate of 7.63% p.a.

Figure 15 - DSCR with additional borrowings of $34.8m



Section 5 Benchmarking and Comparisons with Other Councils

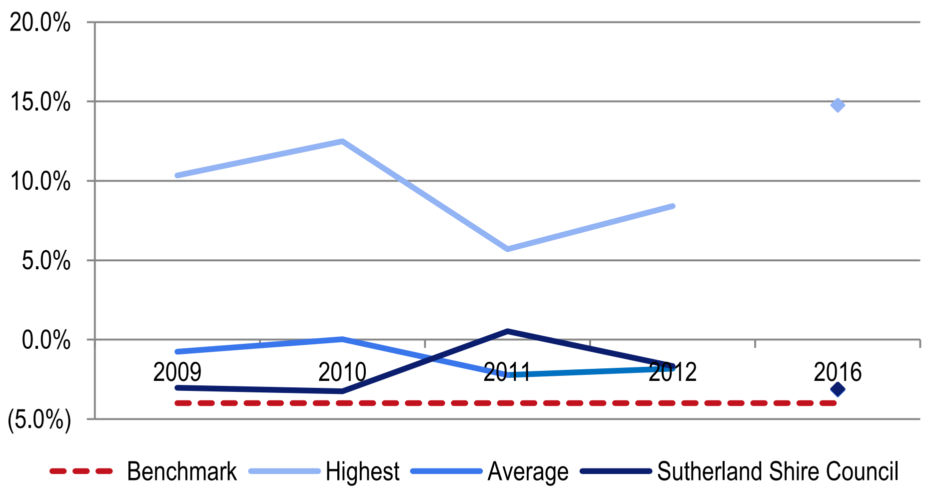
Each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis for councils operating more than one fund. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 3. There are 17 councils in this group and at the time of preparing this report, we have data for all of these councils.

In Figure 16 to Figure 25, 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 23 to 25 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 16 - Operating Ratio Comparison



Council's Operating Ratio has been above benchmark in each year and the group average since 2011 and is forecast to remain in that position in the medium term.

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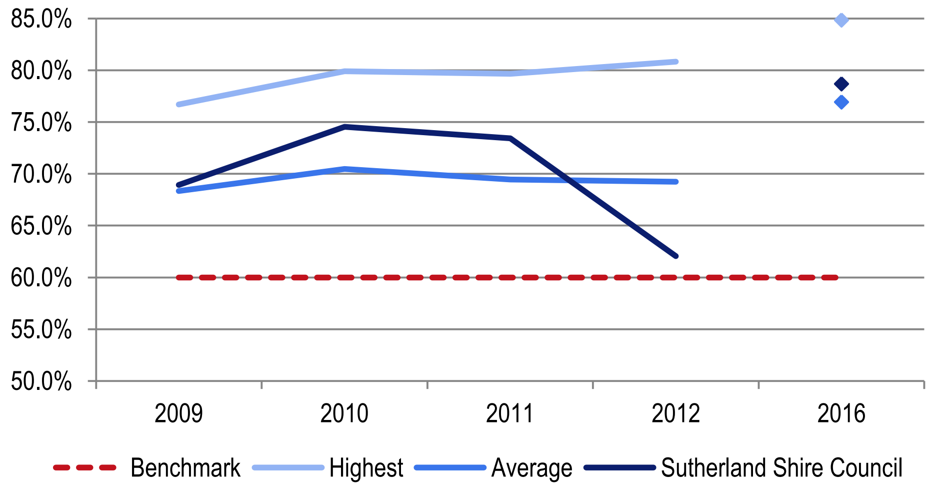
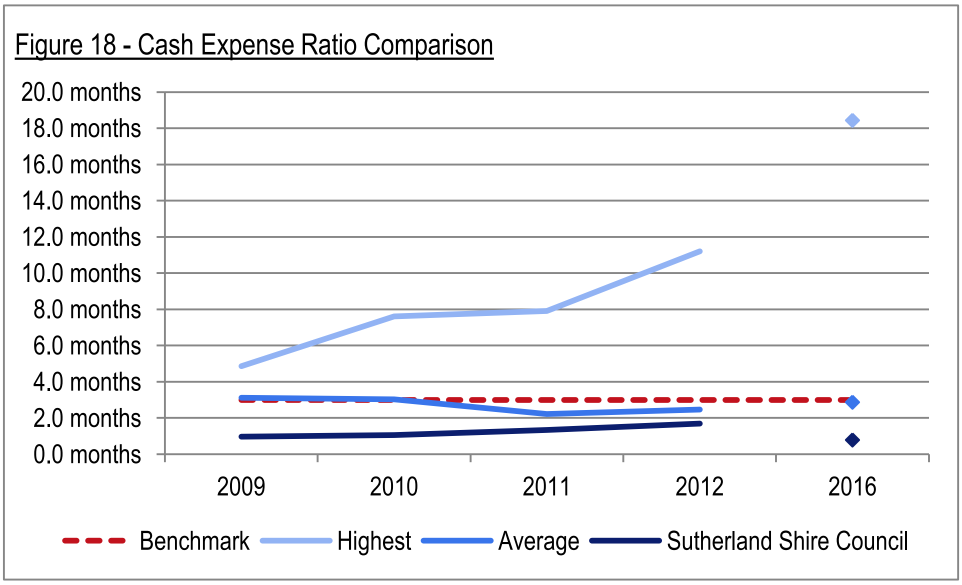
Figure 17 - Own Source Operating Revenue Ratio Comparison

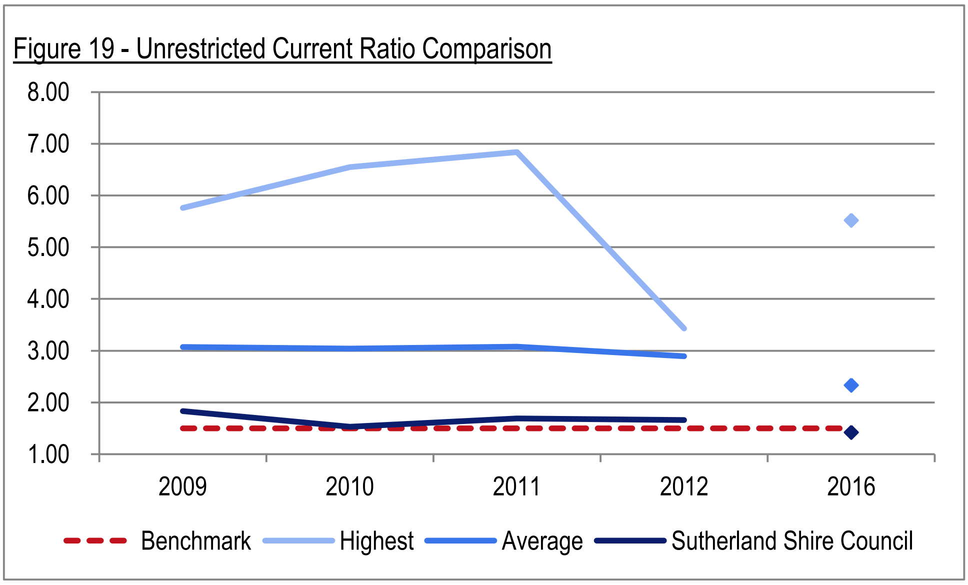


Council's Own Source Operating Revenue Ratio has remained above the benchmark in each year but decreased below the group average in 2012 following a large increase in capital grants and contributions received. It is forecast to increase further above the benchmark and be above the group average although the reduction in forecast grants and contributions skews the ratio upwards in 2016.

Liquidity



Council's Cash Expense Ratio has been below the group average and benchmark in each year and is forecast to remain below both indicators in the medium term. Council invests the majority of its funds within investments that are not captured within this ratio.



Council's Unrestricted Current Ratio has been below the group average but has remained above the benchmark in each year. It is forecast to decrease marginally below the benchmark in 2016.

Debt Servicing

Figure 20 - Debt Service Cover Ratio Comparison

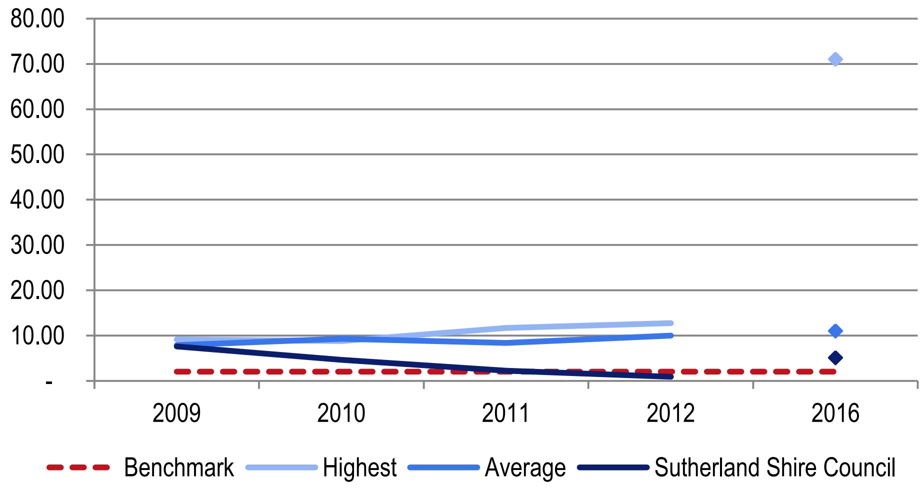
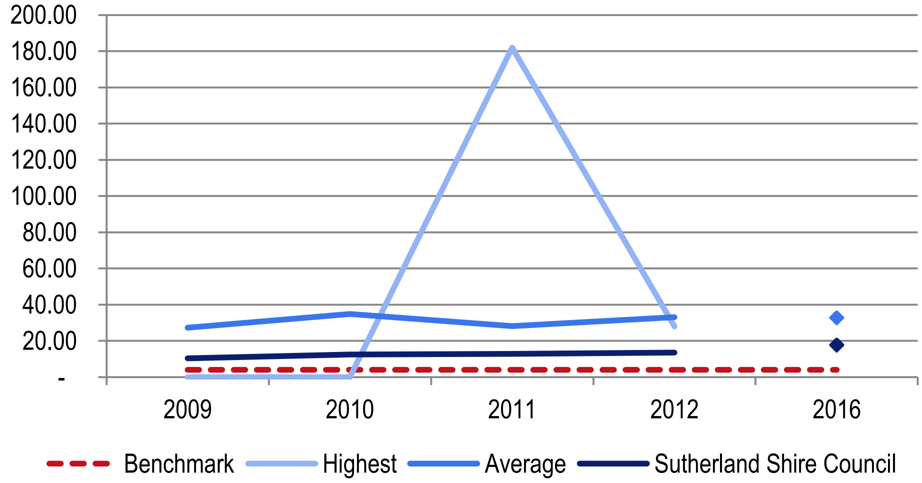


Figure 21 - Interest Cover Ratio Comparison



Council's DSCR and Interest Cover Ratio have been below the group average with the DSCR decreasing marginally below the benchmark in 2012. Over the medium term, Council is expecting to be above benchmark but remain below the group average.

Asset Renewal and Capital Works

Figure 22 - Capital Expenditure Ratio Comparison

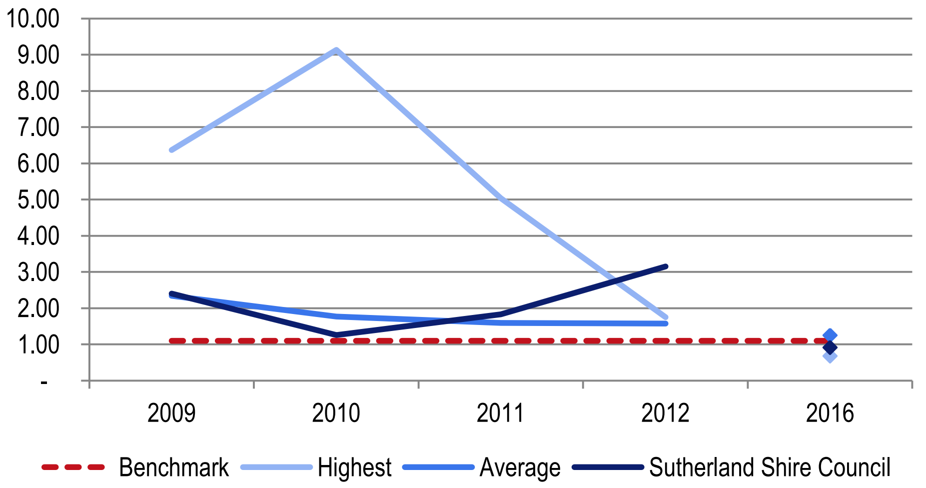
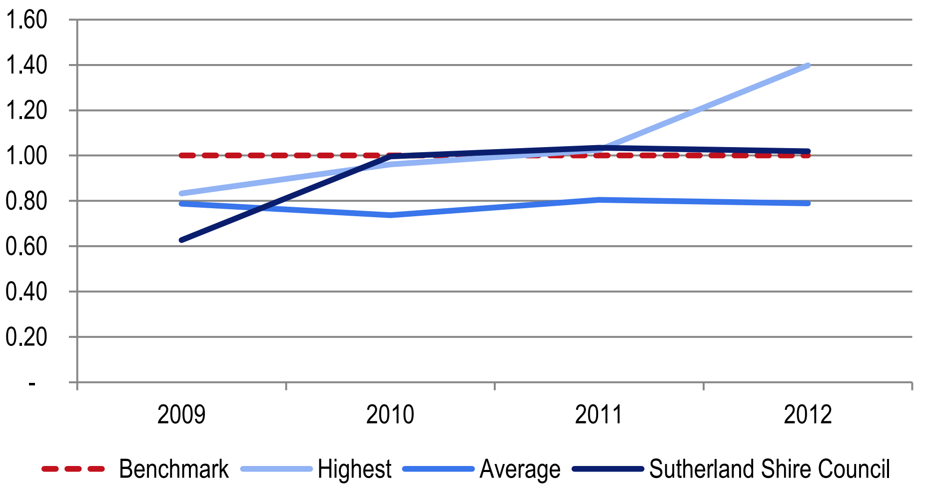


Figure 23 - Asset Maintenance Ratio Comparison



Council's Capital Expenditure Ratio has been above the benchmark in each year and on an upward trend since 2010, increasing above the group average from 2011. Over the medium term it is forecast to decrease below both indicators.

Council's Asset Maintenance Ratio has been above both the benchmark and group average since 2010.

Figure 24- Infrastructure Backlog Ratio Comparison

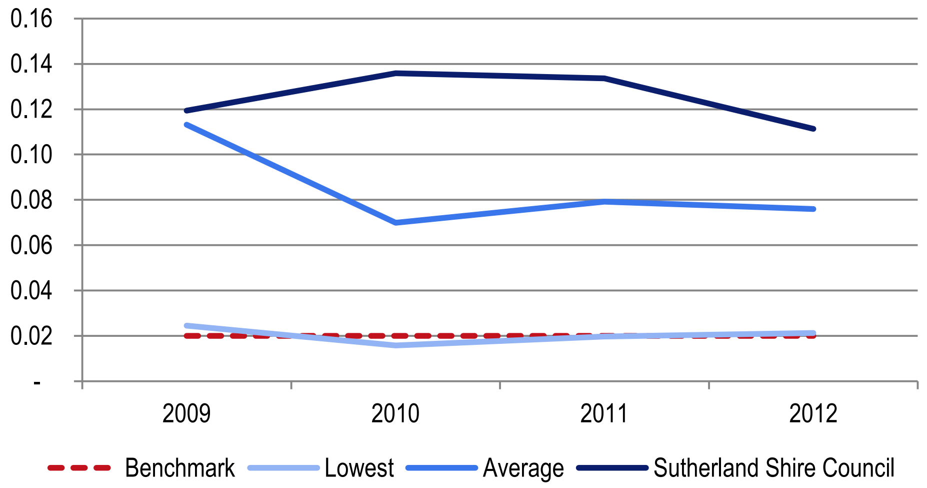
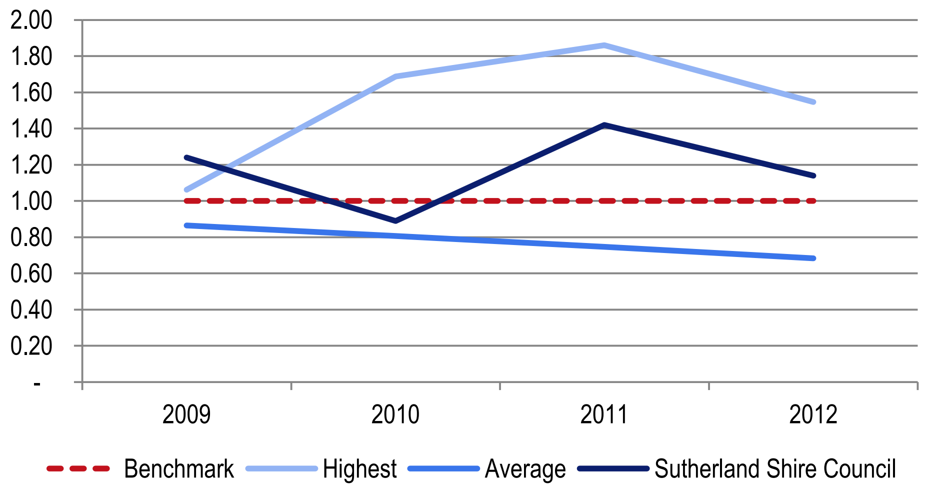


Figure 25 - Building and Infrastructure Asset Renewal Ratio



Council's Infrastructure Backlog has been above the benchmark and group average in each year but has been on a marginal downward trend since 2010.

Council's Building and Infrastructure Asset Renewal Ratio has been above the benchmark in three of the four years while remaining above the group average in each year.

New South Wales
Treasury Corporation

Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's long term financial plan we consider Council to be in a sound financial position. Council has completed a LTFP with three scenarios with the base case 'Financial Model 1' used in our analysis.

We base our recommendation on the following key points:

- Council has sufficient capacity to repay the additional $2.3m borrowings relating to the LIRS project highlighted by a DSCR and Interest Cover Ratio above the benchmarks for the full 10 years of the financial forecast
- Council Own Sourced Operating Revenue Ratio has consistently remained above the benchmark
- Council's operating result (measured using EBITDA) improved over the three year historical period
- Council has had adequate liquidity over the review period as indicated by the Unrestricted Current Ratio above benchmark

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

- Council uses an Unrestricted Current Ratio benchmark of 1.00x as opposed to TCorp's 1.50x. This is a reason why the forecast Unrestricted Current Ratio is marginally below 1.50x for the full 10 year forecast period. Council needs to continue to monitor this position closely so that liquidity issues do not occur
- Council has forecast net losses on the disposal of assets in each year of the forecast. This follows the historic trend and the depreciation policy of certain assets could require refining so that these losses are accounted for through the depreciation charge during the useful life of these assets
- Council is forecasting a decline in their capital expenditure that may impact on the sustainability of its assets in the long term
- Council should focus on the possible improvements to the base case scenario highlighted in the two additional scenarios. We suggest that Council seeks to achieve these variations so to reduce the impact of a reduced capital asset program and also the increasing operating deficits forecast

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000s)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Revenue					
Rates and annual charges	118,378	111,228	107,101	6.4%	3.9%
User charges and fees	27,354	25,302	23,815	8.1%	6.2%
Interest and investment revenue	4,616	3,576	4,230	29.1%	(15.5%)
Grants and contributions for operating purposes	14,001	12,876	13,680	8.7%	(5.9%)
Other revenues	14,761	14,165	16,531	4.2%	(14.3%)
Total revenue	**179,110**	**167,147**	**165,357**	**7.2%**	**1.1%**
Employees	87,976	85,073	81,377	3.4%	4.5%
Borrowing costs	1,931	1,595	1,900	21.1%	(16.1%)
Materials and contract expenses	31,400	27,292	26,817	15.1%	1.8%
Depreciation and amortisation	21,747	23,817	22,737	(8.7%)	4.7%
Other expenses	33,475	31,501	30,053	6.3%	4.8%
Total expenses	**176,529**	**169,278**	**162,884**	**4.3%**	**3.9%**
Operating result	**2,581**	**(2,131)**	**2,473**	**(221.1%)**	**(186.2%)**

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)			
	2011	2010	2009
Grants and contributions for capital purposes	19,312	15,977	24,585
Increase (Decrease) in the fair value of investments	2,783	6,349	(3,723)
Impairment (Losses)/Reversals	0	0	(3,744)
Increase (Decrease) in the fair value of investment properties	(4,145)	0	0
Loss on disposal of assets	(1,623)	(3,302)	(7,489)

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and equivalents	17,142	12,855	11,665	33.3%	10.2%
Investments	82,569	83,654	69,806	(1.3%)	19.8%
Receivables	11,496	12,120	13,712	(5.1%)	(11.6%)
Inventories	5,231	5,285	5,472	(1.0%)	(3.4%)
Other	1,457	1,403	1,144	3.8%	22.6%
Total current assets	117,895	115,317	101,799	2.2%	13.3%
Non-current assets					
Investments	3,368	0	0	N/A	N/A
Receivables	1,041	1,229	1,299	(15.3%)	(5.4%)
Infrastructure, property, plant & equipment	1,064,807	1,462,212	1,541,072	(27.2%)	(5.1%)
Investment property	46,312	35,527	35,527	30.4%	0.0%
Other	369	369	344	0.0%	7.3%
Total non-current assets	1,115,897	1,499,337	1,578,242	(25.6%)	(5.0%)
Total assets	**1,233,792**	**1,614,654**	**1,680,041**	**(23.6%)**	**(3.9%)**
Current liabilities					
Payables	16,554	13,927	15,299	18.9%	(9.0%)
Borrowings	24,656	11,015	3,524	123.8%	212.6%
Provisions	33,758	32,860	31,408	2.7%	4.6%
Total current liabilities	74,968	57,802	50,231	29.7%	15.1%
Non-current liabilities					
Borrowings	10,924	27,373	32,657	(60.1%)	(16.2%)
Provisions	4,381	4,180	3,706	4.8%	12.8%
Total non-current liabilities	15,305	31,553	36,363	(51.5%)	(13.2%)
Total liabilities	**90,273**	**89,355**	**86,594**	**1.0%**	**3.2%**
Net assets	**1,143,519**	**1,525,299**	**1,593,447**	**(25.0%)**	**(4.3%)**

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June		
	2011	**2010**	**2009**
Cashflows from operating activities	38,882	35,712	35,650
Cashflows from investing activities	(31,788)	(36,729)	(39,455)
Proceeds from borrowings and advances	6,128	4,905	4,902
Repayment of borrowings and advances	(9,199)	(2,714)	(677)
Cashflows from financing activities	(3,071)	2,191	4,225
Net increase/(decrease) in cash and equivalents	**4,023**	**1,174**	**420**
Cash and equivalents	17,142	12,855	11,665

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.

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

Ratio = estimated cost to bring assets to a satisfactory condition (from Special Schedule 7) / total infrastructure, building, other structures and depreciable land improvement assets (from note 9a)

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

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

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

Operating Ratio

Benchmark = Better than negative 4%

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

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

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

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

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

Unrestricted Current Ratio

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

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

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