Richmond Valley Council

Financial Assessment and Sustainability Report

Date:	1 April 2015

Disclaimer

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1 Executive Summary

In April 2013 TCorp provided Richmond Valley Council (the Council) with a Financial Assessment, Sustainability and Benchmarking Report as part of the work undertaken for the Independent Local Government Review Panel.

In the report TCorp made the following observations:

- Council posted operating deficits consistently well below the Operating Ratio benchmark over the review period and these deficits were forecast to continue into the future.
- Council was unable to meet the benchmark for asset renewals or asset maintenance which indicates that the Infrastructure Backlog will increase over time.
- Council was undergoing an infrastructure audit by Morrison Low that was expected to amend the reported Infrastructure Backlog that was reported at $80.0m at 30 June 2012.
- Council had adequate liquidity throughout the review period.
- The LTFP incorporated the financial and operational impacts of delivering declining levels of service with current levels of funding
- A new management team had been appointed that was working towards improving the financial performance of Council.

Council achieved a Financial Sustainability Rating (FSR) of Weak with an Outlook of Negative due to the expected ongoing operating deficits and inability to fund their asset renewals.

In recent years, Council has initiated a number of measures to improve its financial sustainability and have contacted TCorp to complete a review of their financial position including reviewing their updated long term financial plan (LTFP). An updated FSR and Outlook has also been determined incorporating the 2013 and 2014 financial results. The main initiatives that Council has undertaken in the past two years are:

- Successfully applying for a permanent five year SRV that equates to a cumulative increase to rates revenue of 39% by 2019. The additional funding received via the SRV over the five years of $7.3m is to be utilised on a variety of projects to help reduce the Infrastructure Backlog from 2015.
- Following completion of the infrastructure audit, Council has upgraded to a more accurate asset condition based assessment model. This has contributed to the Infrastructure Backlog reducing significantly by $52.3m (65.4%) in 2013 although this rose to $30.8m in 2014. The new assessment model has also improved the lifecycle analysis of Council's assets resulting in reduced maintenance and depreciation expenses. Further work is being undertaken by Council to improve its methodology for calculating the Infrastructure Backlog.
- Council has also advised TCorp that it is in the process of revaluing its Land Improvements, Buildings and Other Structures. This will be completed as at 30 June 2015 and is expected to further reduce Council's depreciation expenses and have a positive impact on the Infrastructure Backlog for that category of assets, which currently represents nearly half of Council's reported Backlog. Once this work is completed, these improvements will be included in Council's future financial forecasts.

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

- The revised LTFP is based on maintaining current service levels with the five year SRV assisting with the scheduled capital works program and the long term sustainability of Council.
- Operating results are forecast to improve year on year from an operating deficit of $5.6m (20.3%) in 2014 to a deficit of $1.6m (3.9%) in 2024.
- Council's liquidity is forecast to remain at sufficient levels throughout the forecast period.
- Employee expenses are forecast to grow at levels below TCorp's expectations. If Council is not able to manage these expenses as forecast then the projected improvement in the operating result will be impacted.
- Depreciation expense is currently forecast to increase each year despite Council's forecast capital expenditure decreasing over the 10 year period. This results in Council's forecast I,P,P&E decreasing in value over the LTFP.
- There is a forecast increase in cash and cash equivalents while the capital expenditure ratio declines which appears to be counterintuitive. Council has confirmed that it is currently investigating how they can utilise this forecast increase in cash and cash equivalents to improve asset renewals within the General Fund as part of the 2016 budget process and their FFTF proposal.

In respect of the long term Sustainability of the Council our key observations are:

- Council's operating performance is forecast to improve year on year with the assistance of the additional SRV revenue beginning in 2015. These additional funds are to be permanently kept within the rates base which should assist Council to reach a break even position over the long term. Notwithstanding this, Council is forecasting operating deficits in each year of the LTFP.
- Council's Unrestricted Current Ratio is above benchmark and forecast to improve over the 10 year period.
- Council's Own Source Operating Revenue has historically fluctuated around the benchmark due to the inconsistent nature of the grants and contributions that it receives. The SRV should contribute to an improvement in this ratio going forward.
- Council has completed a review of its full asset base and has implemented an updated asset condition assessment model. This has resulted in a significantly reduced Infrastructure Backlog from $80.0m in 2012 to $30.8m in 2014. The capital works completed as part of the SRV should assist to reduce the backlog total.
- While the increase in the number of equivalent full time employees (FTEs) by 19 (10%) in 2014 may seem excessive in isolation, Council FTE numbers have only increased by 5 over the five year review period. The 2014 increase has occurred as Council has decided to permanently replace contractors that were completing ongoing roles. Council needs to continue to closely manage this as it is their largest expense at 34% in 2014.
- As stated above, Council has further work to do to allocate sufficient funding to its asset renewals and capital expenditure. This is highlighted by the deteriorating Capital Expenditure Ratio during the LTFP despite a forecast increase in cash and cash equivalents.

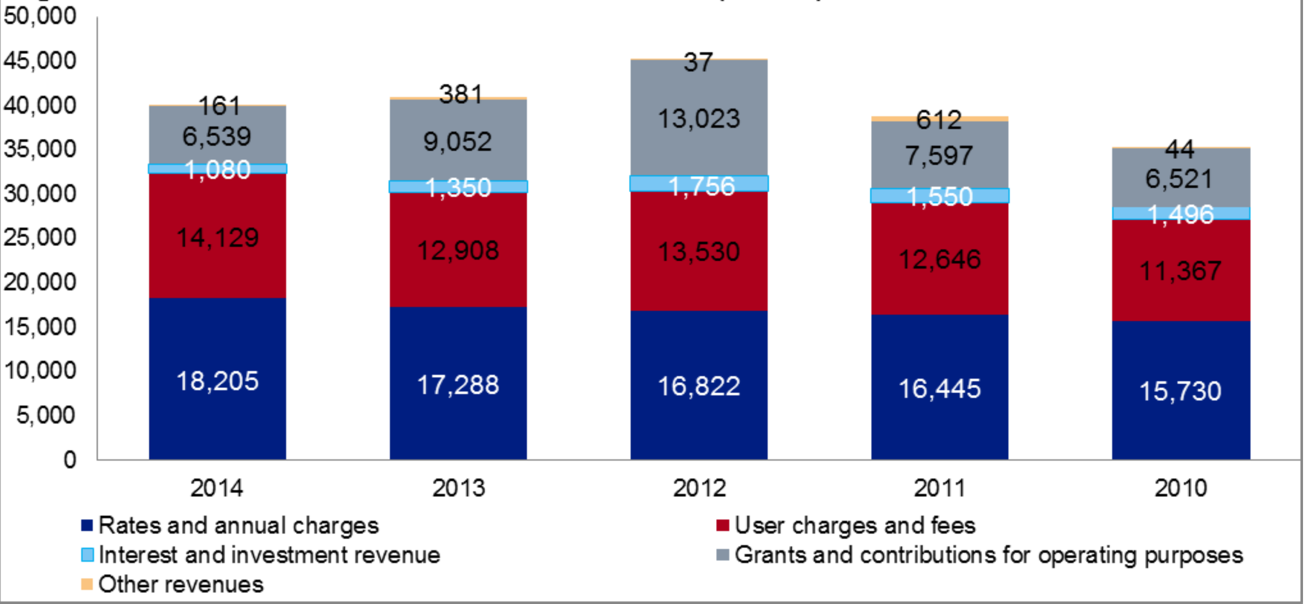
Based on the information received and the revised LTFP, TCorp believes Council to be currently in a Moderate Sustainability position. The Outlook for Council has also improved to Neutral.

2 Review of Financial Performance and Position

TCorp has updated its review based on the 2014 annual audited accounts of the Council which include both a General Fund, Water Fund and Sewerage Fund.

2.1 Revenue

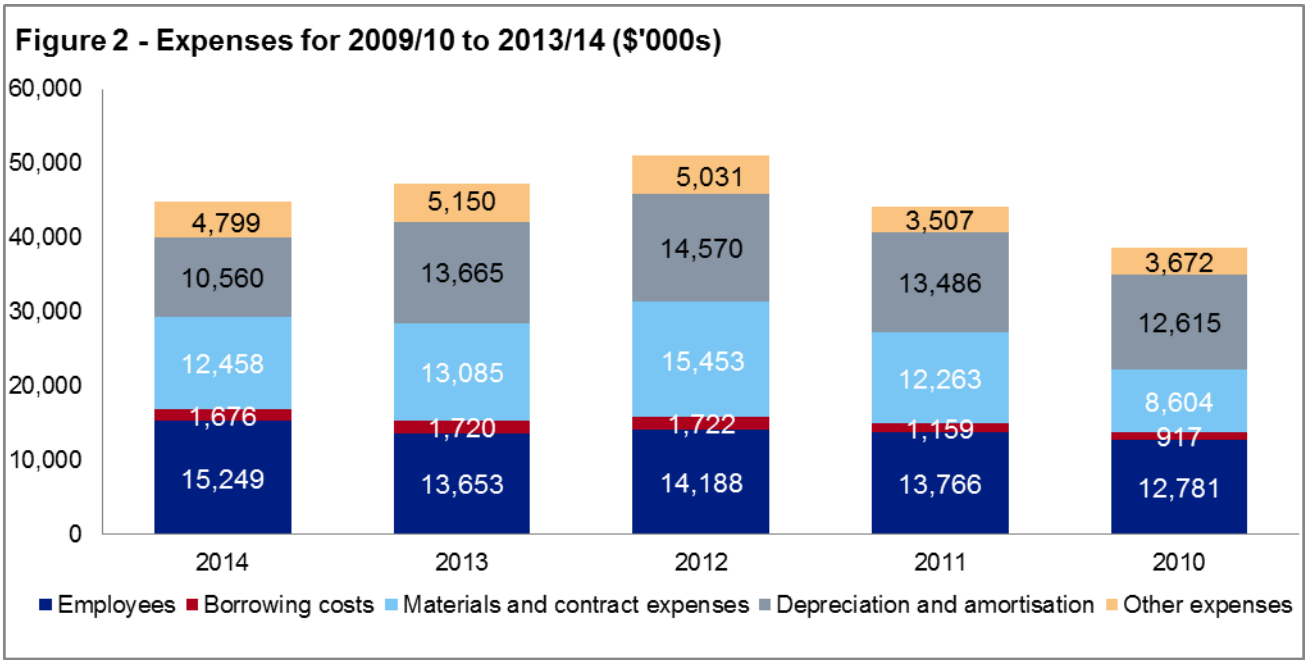
Figure 1 - Revenue Sources for 2009/10 to 2013/14 ($'000s)



Key Observations

- Total revenues have reduced year on year since 2012 from $45.2m to $40.1m in 2014.
- Rates and annual charges have continued to increase each year with a 5.3% increase in 2014 driven by a 28.4% increase in water supply services and a 4.6% increase in residential rates.
- User charges and fees reduced by 4.6% in 2013 before increasing 9.5% in 2014. The 2014 increase was driven by a $2.3m (72.5%) increase in RMS charges relating to additional works undertaken on state roads including the major re-sealing works throughout Casino. The RMS charges had reduced by $1.0m in 2013 from the 2012 total.
- Interest and investment revenue has decreased to its lowest level over the review period in 2014 driven by the low return environment and a reduced cash and investments total compared to 2013 and 2012.
- Changes in operating grants and contributions are the main reason for the reduction in total revenue between 2012 and 2014. The decrease of $3.0m (30.5%) in 2013 was caused by the re-scheduling of the Financial Assistance Grant (FAG) of $1.3m, a decrease in special purpose grants relating to the natural disaster funding of $1.8m, and the Evans Head Memorial Aerodrome Remediation of $0.7m. The 2014 decrease of $2.5m (27.8%) was mainly due to the re-scheduling in FAG with only 50% of the grant being received in that financial year due to payment timings being amended by the Commonwealth Government.

2.2 Expenses



Key Observations

- Total expenses have reduced year on year since 2012 from $52.7m to $44.7m in 2014.
- Employee expenses increased by 11.7% in 2014 following a 3.8% decrease in 2013. The variation coincided with a fluctuation in equivalent FTEs that increased to 210 in 2014 from 191 in 2013 and 198 in 2012. This increase occurred as Council increased the number of FTEs and reduced the number of contractors that it utilised. It also completed a staff restructure during the year.
- Materials and contract expenses have reduced year on year since 2012. The 2012 total was inflated by increased natural disaster remediation works, additional state roads maintenance and contamination remediation works at the Evans Heads Memorial Aerodrome. The $2.4m decrease in 2013 was mainly related to the reduced natural disaster works.
- Depreciation expense reduced in 2014 following a revaluation of Council's infrastructure assets and a change to the valuation and depreciation methodology. Council amended their transport asset depreciation methodology to a consumption based methodology from straight line from the beginning of the 2014 financial year.
- Other expenses reduced in 2014 due to the amount of waste levy paid to the State Government decreasing.

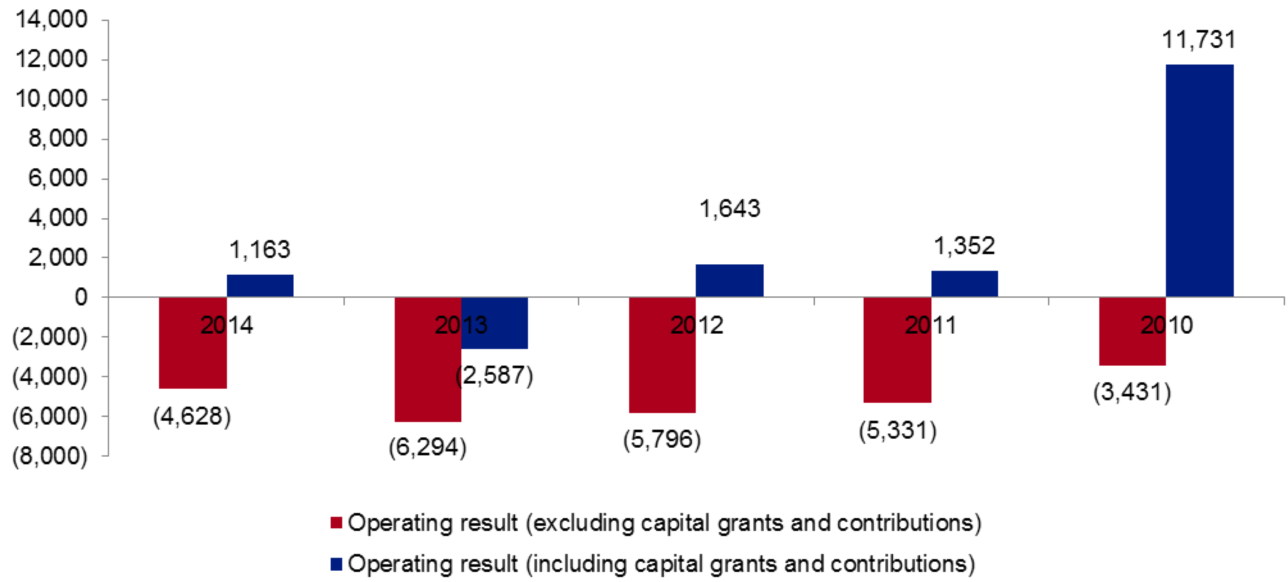
2.3 Operating Results

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 2009/10 to 2013/14 ($'000s)



Key Observations

- The 2012 results differ slightly from the original report as the User charges and fees and Materials and contract expenses were revised within the 2013 financial statements.
- When excluding capital grants and contributions, Council's performance deteriorated in 2013 but has improved in 2014 to post the best result since 2010. This improved result has predominantly occurred due to the reduction in the depreciation expense following the change in depreciation methodology for Council's transport assets.

2.4 Financial Management Indicators

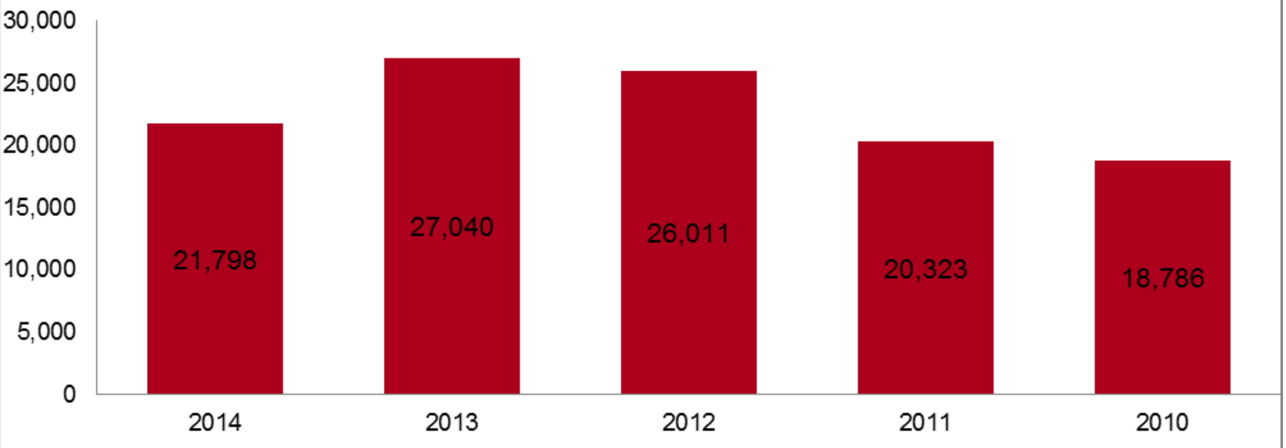
Performance Indicators	Year ended 30 June				
	2014	2013	2012	2011	2010
EBITDA ($'000s)	7,608	9,091	10,496	9,314	10,101
Operating Ratio	(11.5%)	(15.4%)	(12.8%)	(13.7%)	(9.8%)
Interest Cover Ratio	4.54x	5.29x	6.10x	8.04x	11.02x
Debt Service Cover Ratio	2.63x	2.99x	3.76x	4.64x	1.00x
Unrestricted Current Ratio	2.13x	2.06x	1.93x	1.73x	1.45x
Own Sourced Revenue Ratio	70.4%	67.6%	57.7%	63.9%	53.8%
Cash Expense Ratio	8.0 months	9.8 months	9.0 months	8.3 months	9.0 months
Net assets ($'000s)	624,949	603,314	569,146	524,184	503,342

Key Observations

- While Council's Operating Ratio has improved in 2014 it remains well below the benchmark or a breakeven position that councils should be aiming to achieve.
- Despite the improved Operating Ratio, EBITDA has reduced given the smaller depreciation expense in 2014.
- Council's Interest Cover Ratio has been on a downward trend over the review period due to the increased borrowings utilised in 2012 and the reducing EBITDA since 2012. The DSCR follows a similar trend with 2010 impacted by a one-off principal debt repayment. Despite the negative trends both indicators remain above their respective benchmarks.
- Council's Unrestricted Current Ratio has improved each year and remains above the 1.5x benchmark.
- The Own Source Revenue Ratio has improved above the benchmark in 2013 and 2014 more due to a reduction in the FAG grant received along with the one-off grants received in 2012 for natural disasters and remedial works rather than a significant increase in the own source revenue generated.
- Council invest the majority of its funds in term deposits with terms of 3 months with a smaller proportion invested for periods longer than this. Despite some of these term deposits mainly being 90 days or over, all of the funds are classified as deposits at call within cash and cash equivalents. This results in the strong Cash Expense Ratio results. This should be reviewed to ensure that these funds are classified accurately.
- Council's net assets have increased year-on-year following consecutive infrastructure Asset Revaluations from 2012. When the Asset Revaluations are excluded, the underlying trend has been a marginal reduction in asset value with a decrease of $11.2m across the five year period.

2.5 Statement of Cashflows

Figure 4 - Cash and Cash Equivalents for 2009/10 to 2013/14 ($'000s)



Key Observations

- Council's cash and cash equivalents reduced in 2014 with increased purchases of I, P, P & E and real estate assets and a reduction in net cash from operating activities due to the lower FAG payment received.
- Within Council's cash, cash equivalents, and investments totalling $23.7m in 2014, $18.4m was externally restricted, $5.3m was internally restricted and no unrestricted funds were held.
- Of the $1.9m in investments in 2014, $0.9m was held in Council's final CDO and $1.0m was held within listed equity securities. Council expects to redeem the full value of the CDO when it matures in June 2015.

2.6 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.

2.6.1 Infrastructure Backlog

Figure 5 - Infrastructure Backlog for 2009/10 to 2013/14($'000s)

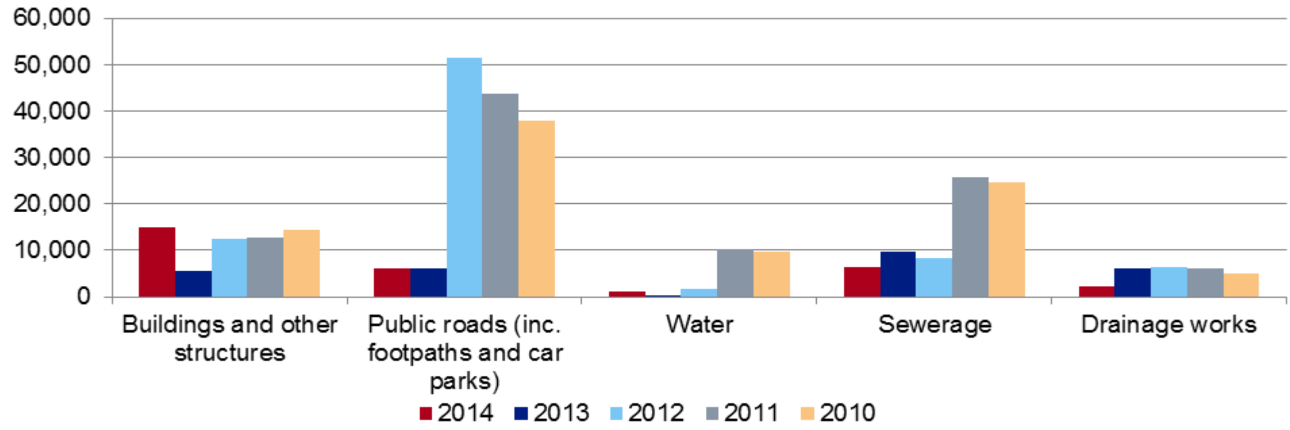
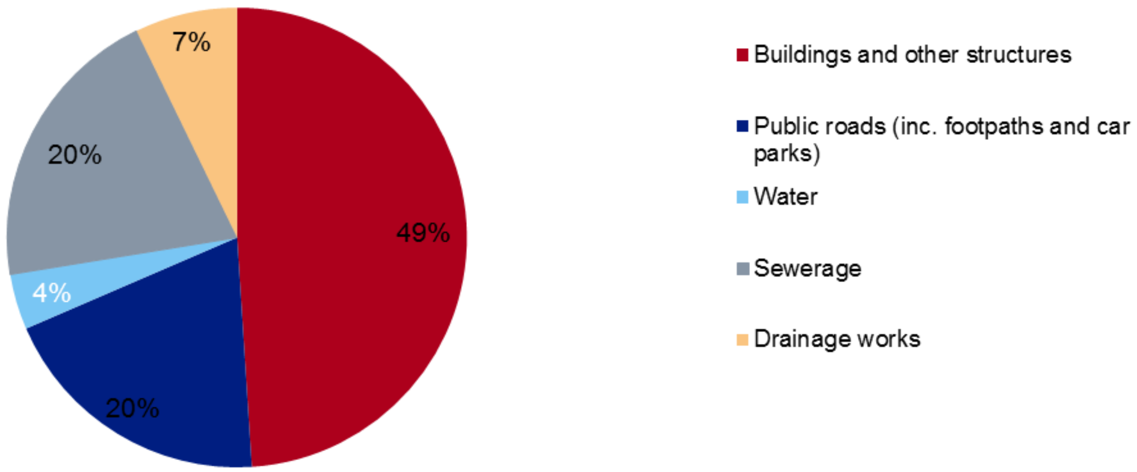


Figure 6 - Infrastructure Backlog Composition for 2013/14



Council's Infrastructure Backlog reduced dramatically in 2013 following the revaluation of their transport assets. The public roads backlog reduced 87.8% ($45.2m) to $6.2m following the valuation update.

In 2014 there was a total backlog of $30.8m, with buildings and other structures making up $15.1m, an increase from $5.5m in 2013. However $3.1m of this increase related to open space / recreational assets that had not previously been given a value.

2.6.2 Infrastructure Status

Infrastructure status	Year ended 30 June				
	2014	2013	2012	2011	2010
Bring to satisfactory standard ($'000s)	30,836	27,684	80,038	98,378	91,773
Required annual maintenance ($'000s)	4,569	4,214	12,565	11,990	11,815
Actual annual maintenance ($'000s)	4,766	5,107	6,732	4,646	4,074
Total value infrastructure assets ($'000s)	485,312	453,490	420,754	373,986	359,669
Total assets ($'000s)	659,642	637,804	604,666	554,691	531,056
Infrastructure Backlog Ratio	0.06x	0.06x	0.19x	0.26x	0.26x
Asset Maintenance Ratio	1.04x	1.21x	0.54x	0.39x	0.34x
Building and Infrastructure Asset Renewal Ratio	0.81x	0.61x	0.47x	0.37x	0.41x
Capital Expenditure Ratio	1.17x	0.67x	0.95x	0.02x	1.43x

The decrease in the Infrastructure Backlog has reduced the Infrastructure Backlog Ratio to 0.06x, considerably closer to the 0.02x benchmark. The approved SRV that has begun in 2015 will assist in further reducing the backlog over the next 5 years if Council is able to maintain their assets as they have been able to since 2012.

Following the Asset Revaluations in 2013 and 2014, the required annual maintenance significantly reduced which has immediately assisted Council's Asset Maintenance Ratio to meet the benchmark.

The Buildings and Infrastructure Asset Renewal Ratio has also improved since 2012 with the 2014 result particularly benefitting from the reduced depreciation in the denominator.

The Capital Expense Ratio has fluctuated over the five year period and the average over that period is 0.85x, below the benchmark. The ratio was low in 2011 and was impacted by Council disposal of a number of assets, with a total written down value of $18.2m.

Overall investment in renewals and new assets remains well below benchmark levels.

2.6.3 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				
	2014	2013	2012	2011	2010
New capital works	3,934	1,000	8,024	9,812	8,222
Replacement/refurbishment of existing assets	10,575	13,777	10,058	8,702	13,715
Total	14,509	14,777	18,082	18,514	21,937

The major capital expenditure for the past two years has been:

2013

- Waste – Plant 158 Organics Collection Truck $371,800
- Waste – Plant 316 Replace TANA Landfill Compactor $588,000
- Property Purchase – 153 Barker Street $444,800
- Reseals – Urban Local Roads $456,500
- Reseals – Rural Local Roads $628,988
- Evans Head Memorial Aerodrome Bellman Hangar Restoration $311,000
- Sewerage Services – Relining Works $828,800
- Sewer Pump Station Evans Head – Pump Station 4 Upgrade $484,000
- Broadwater Sewerage Construction $3,611,400

2014

- Nammoona Transfer Station $616,200
- Settlers Subdivision Construction – Site Establishment $687,500
- Reynolds Road Industrial Land Purchase $1,120,000
- Casino Community Centre First Floor Fit Out - Building works $470,400
- Reseals – Rural Local Roads $812,000
- Regional Road Repairs – MR145 S2340 Ranns Road $310,910
- Footpaths Woodburn - Cycleway to Evans Head $300,000
- Sewer Pump Station Evans Head- Pump Station 1 Upgrade $301,800

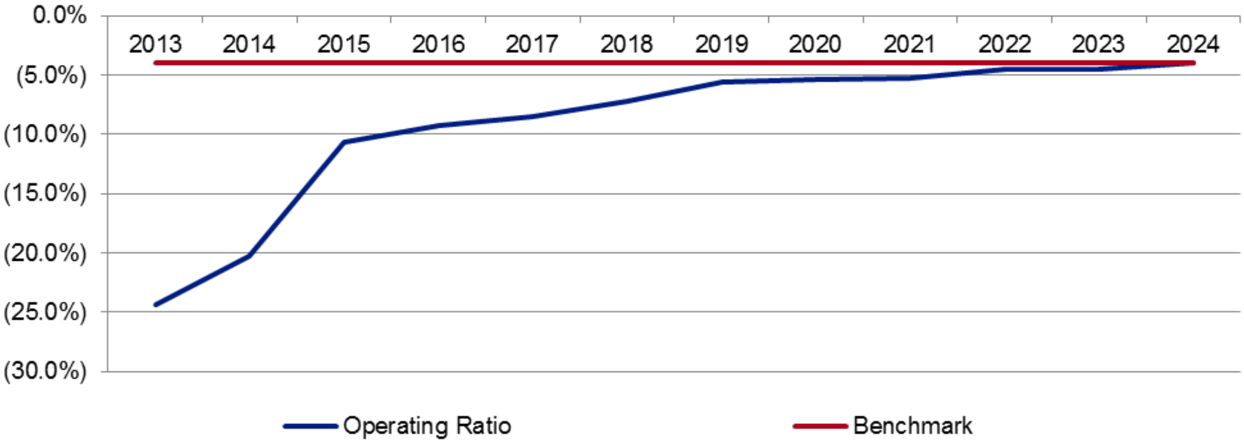
3 Review of Financial Forecasts

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

The LTFP has been based on maintaining the existing standard of services to the community and includes a Special Rate Variation (SRV) that was approved to begin in 2014/15 to assist with the reduction of Council's Infrastructure Backlog and improve long term sustainability. The SRV was approved for five years and is to be permanently included within the rate base. This SRV is projected to provide an additional $7.3m over these five years with the cumulative increase equating to 39%.

3.1 Operating Results

Figure 7- Operating Ratio for General Fund



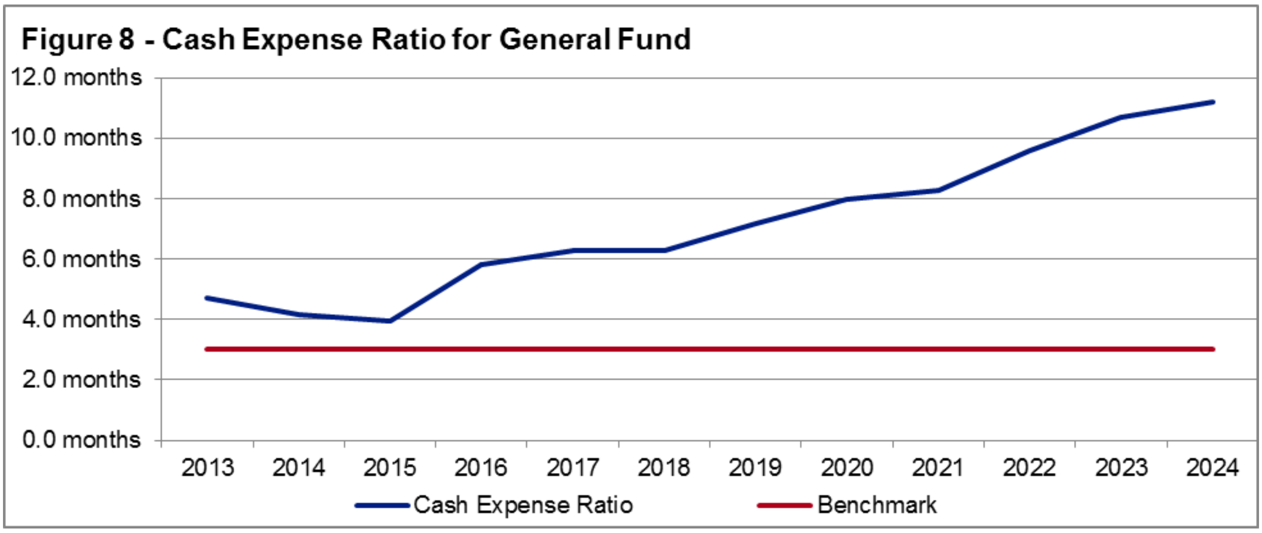
Council's historic operating deficits within the General Fund when capital grants and contributions are excluded have been over 20%. The 2014 result of a $5.6m deficit was an improvement from the $7.0m in 2013 primarily because of the reduced depreciation expense.

The 2015 result is expected to improve with the benefit of the additional SRV rates and a full years FAG being received as opposed to the 50% received in 2014. After 2015 Council is projecting that the operating performance will gradually improve, assisted by the SRV, to be a deficit of 3.9% by 2024. This projection is an improvement from Council's LTFP that was analysed as part of the 2013 TCorp report when operating deficits were projected to remain close to 15% for the duration of the forecast.

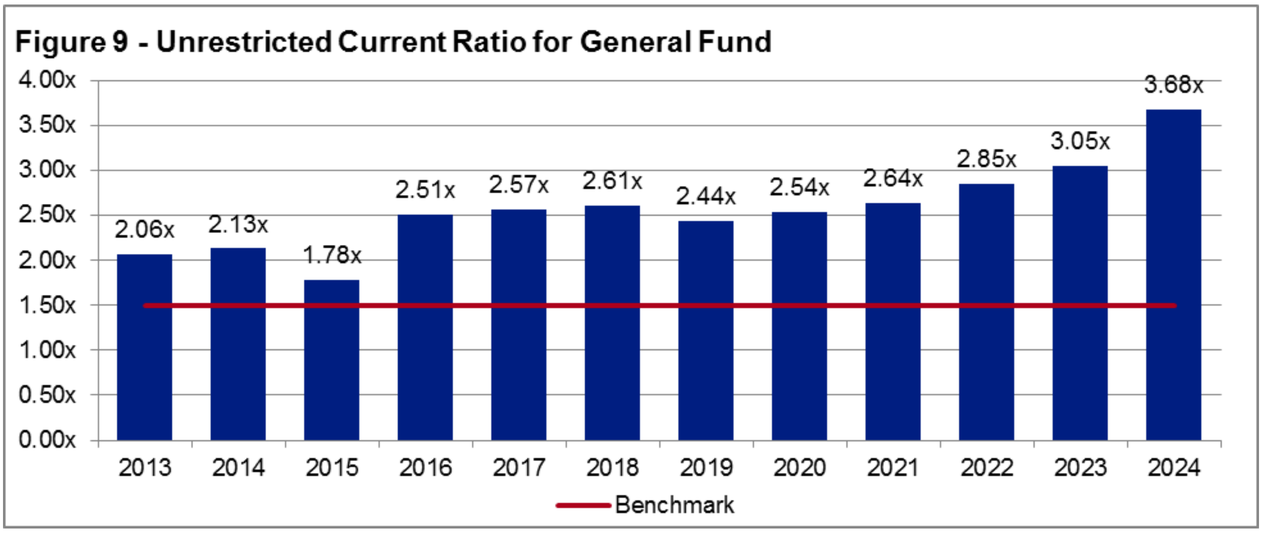
While the TCorp benchmark currently remains at negative 4%, it is important that Council aim to achieve a break-even position. The positive trend that is forecast will see Council gradually move towards break-even although further focus needs to be given to this task to achieve this in the medium term rather than long term, given that it is not immediately achievable in the short term.

3.2 Financial Management Indicators

Liquidity Ratios

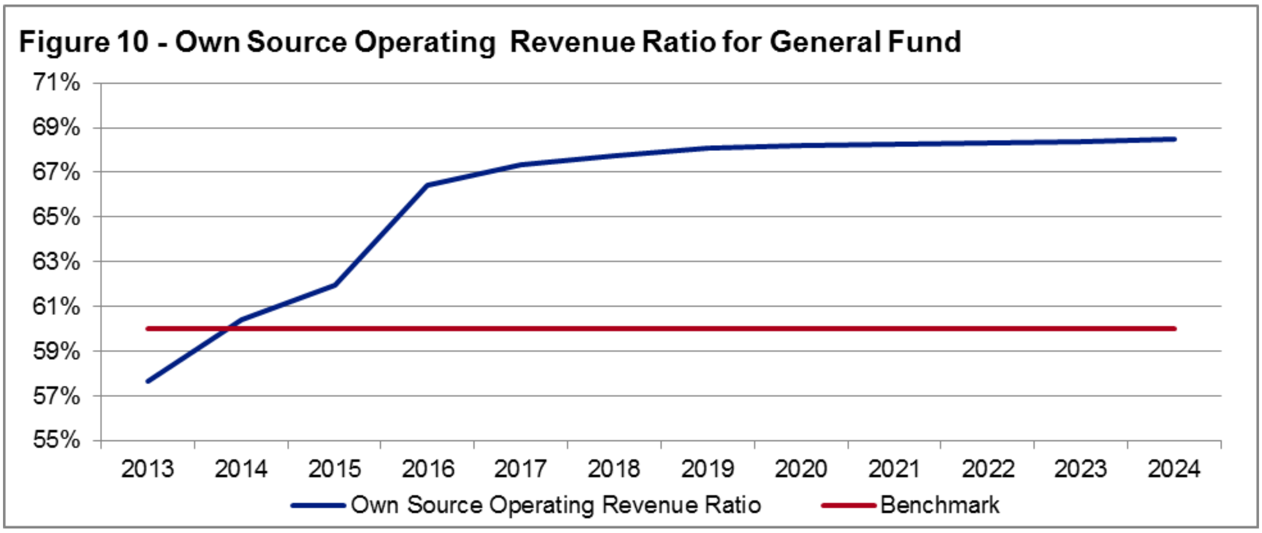


Council's Cash Expense Ratio is forecast to decrease slightly in 2015 before increasing over time. The increase in this ratio coincides with the receipt of additional funds via the SRV but also a decrease in the Capital Expenditure Ratio.

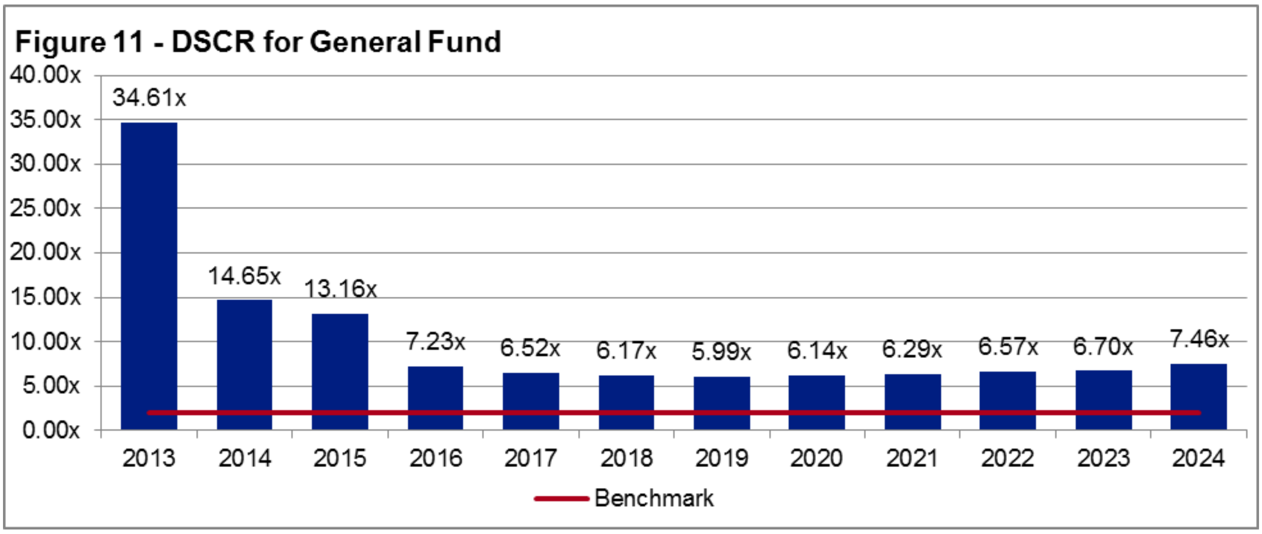


The Unrestricted Current Ratio is forecast to remain above the benchmark and increase over time in line with the increase in Council's cash and cash equivalents. As discussed earlier in the report, once the cash and capital expenditure forecasts are reviewed, we would expect the significant increases in this ratio in the second half of the LTFP to be amended.

Fiscal Flexibility Ratios



The Own Source Operating Revenue Ratio increased in 2014 to be marginally above the 60% benchmark after being below the benchmark for the previous three years. The increase in 2015 and beyond is a combination of the increased rates revenue from the SRV and a forecast reduction in capital grants and contributions. The capital grants and contributions are forecast marginally below $1.0m in each year from 2016 onwards compared to $5.6m in 2014. Council has highlighted that a number of the grants received historically were of a one-off nature such as natural disaster funding and subdivider developer contributions.

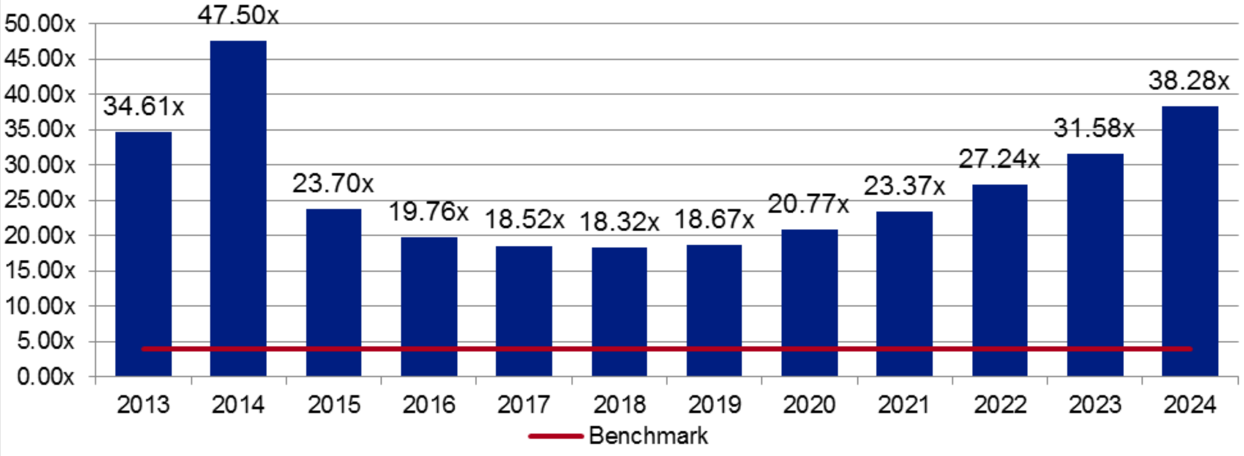


The General Fund DSCR has been strongly above the benchmark historically due to the low levels of debt that has been utilised. Council increased borrowings by $1.5m in 2014 for a loan that related to the Casino indoor sports stadium and there is $6.1m forecast to be drawn during the five years that the SRV increases occur. This results in the DSCR reducing to its lowest point in 2019 when total borrowings equate to $5.4m however it remains well above the benchmark before beginning to improve each year as the total borrowings begin to reduce.

The $3.0m LIRS approved loan was not within the model even though this was drawn down in February 2015. The loan was removed from the model at the time of developing this version of the LTFP as Council were uncertain as to whether the upgrade of the Casino Regional Livestock

Exchange was going to go ahead due to a lack of grant funding. Council subsequently resolved to proceed with part of the project to satisfy current work, health and safety requirements. This additional $3m has been manually added by TCorp within the above graph with the DSCR remaining strongly above the benchmark.

Figure 12 - Interest Cover Ratio for General Fund

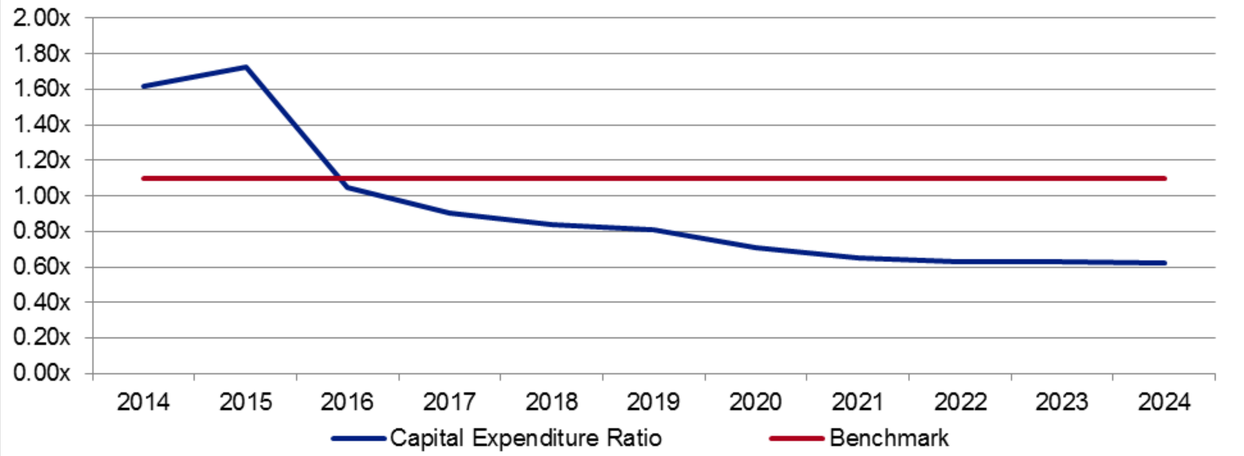


The Interest Cover Ratio follows a similar trend as the DSCR and remains comfortably above the benchmark in each year given the relatively low levels of borrowings.

The majority of Council's borrowings relate to their Sewer Fund where $19.1m of loans were held in 2014. These loans principally relate to the Evans Head and Broadwater Sewerage Augmentation projects and are being repaid over 20 year terms.

3.3 Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund



Council's Capital Expenditure Ratio is forecast to peak in 2015 before decreasing below the benchmark in 2016 and reducing to between 0.60x and 0.70x for the final four years of the forecast.

TCorp has queried this trend with Council, especially in light of the projected increase in cash and cash equivalents as shown in Section 3.2. Council has confirmed they are reviewing this as part of their 2016 budget and Fit for the Future (FFTF) proposal that are currently being completed.

TCorp would expect any build-up of cash reserves to be utilised on capital expenditure to assist with reducing the Infrastructure Backlog and improving this ratio.

3.4 Financial Model Assumption Review

Council has used its 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 Local Government Cost Index (LGCI) increased by 3.4% in the year to September 2011, 2.8% in 2012, 3.6% in 2013, 3.4% in 2014 and 2.3% in 2015. In December 2014 IPART announced that the rate peg to apply in the 2015/16 financial year will be 2.4%. Beyond 2016 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%.
- IPART developed the LGCI to use for setting the maximum allowable increase in general income for local government in NSW (rate peg). The LGCI is the measure of movement in the unit costs incurred by NSW council activities funded from the general rate base.
- Interest and investment revenue: annual return of 5%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

Key Observations and Risks

- The LTFP is based on maintaining current service levels with the five year SRV assisting with the scheduled capital works program and the long term sustainability of Council.
- Rates and annual charges are forecast to increase by 11.7% in 2015 and 5.1% p.a. for the following four years linked to the SRV increase of 12.3% in 2015 and 5.5% p.a. for the next four years.
- User charges and fees are forecast to decrease by 2.7% in 2015 before increasing by 2.9%-3.0% p.a. thereafter.
- Council has historically received one-off capital grants and contributions following natural disaster events as well as various development related contributions. Council does not forecast these payments therefore the forecast capital grants and contributions are below the historical amounts received at $0.9m p.a. from 2016 onwards. This $0.9m p.a. mainly comprises of the recurring Roads to Recovery grants.
- Employee expenses are forecast to increase by 2.5% p.a. following a 12.2% increase in 2014. This is lower than the historical annual increase that equated to 4.8% p.a. between 2010 and 2014 and TCorp's estimated annual increase of 3.5%. The actual annual CPI as at December

2014 was 1.7% therefore 1% above this would be 2.7% therefore Council's forecast is close to this figure + 1% however TCorp believes it prudent to keep CPI estimates at the higher level of 2.5% for the duration of the 10 year period given that the average inflation rate has been 2.75% over the 10 years to 2014.

- Depreciation expense is currently forecast to increase 5.5% in 2015 and 2.3% - 2.4% p.a. thereafter and is growing while Council's forecast capital expenditure is decreasing over the 10 year period. This results in Council's forecast I,P,P&E decreasing in value over the LTFP. Council is currently reviewing this as part of the 2016 budget and their FFTF proposal.
- The forecast increase in cash and cash equivalents, while the capital expenditure ratio declines appears to be counterintuitive. Council has confirmed that it is currently investigating how they can utilise this forecast increase in cash and cash equivalents to improve asset renewals within the General Fund.

3.5 Sustainability

Based on the information received and the revised LTFP, TCorp believes Council to be currently in a Moderate Sustainability position. The Outlook for Council is currently Neutral.

In considering the longer term financial Sustainability of the Council we make the following additional comments in respect of their General Fund:

- Council's operating performance is forecast to improve year on year with the assistance of the additional SRV revenue beginning in 2015. These additional funds are to be permanently kept within the rates base which should assist Council to reach a break even position over the long term. Notwithstanding this, Council is forecasting operating deficits in each year of the LTFP.
- Council's Unrestricted Current Ratio is above benchmark and forecast to improve over the 10 year period.
- Council's Own Source Operating Revenue has historically fluctuated around the benchmark due to the inconsistent nature of the grants and contributions that it receives. The SRV should contribute to an improvement in this ratio going forward.
- Council has completed a review of its full asset base and has implemented an updated asset condition assessment model. This has resulted in a significantly reduced Infrastructure Backlog from $80.0m in 2012 to $30.8m in 2014.
- While the increase in the number of equivalent FTEs by 19 (10%) in 2014 may seem high in isolation, Council FTE numbers have only increased by 5 over the five year review period. The 2014 increase has occurred as Council has decided to permanently replace contractors that were completing ongoing roles. Council needs to continue to manage this as it is their largest expense at 34% in 2014.
- Council has further work to do to allocate sufficient funding to its asset renewals and capital expenditure. This is highlighted by a deteriorating Capital Expenditure Ratio during the LTFP despite a forecast increase in cash and cash equivalents.

4 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's LTFP we consider Council to be Moderately Sustainable. Council is forecast to improve its operating position over the next 10 years however further work is required to ensure that adequate funding is allocated to asset renewals. Council's financial sustainability position has improved considerably since TCorp's initial review in 2013.

We base our recommendation on the following key points:

- Council has successfully applied for a five year SRV that will be permanently included within their rates base. Following completing their community consultation, the application was approved as presented and will assist Council to complete a number of capital works projects and help address Council's Infrastructure Backlog and their long term sustainability.
- To assist in completing the capital works projects Council is utilising a manageable level of borrowings.
- The SRV assists in improving the operating result however it is not going to achieve a break-even position immediately. The operating result is forecast to improve year on year however Council is still forecasting deficits in each of the 10 years.
- Council has re-assessed its asset base and improved its asset management system. This should improve Council's infrastructure management that was rated as very weak during a 2013 infrastructure audit.

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

- Within the General Fund, Council projects that they will not be able to achieve a break even operation result throughout the 10 years of the LTFP. It is critical that Council continue to focus on aiming for this result to ensure Council's long term sustainability can be achieved.
- Council recognises that further work is required to allocate additional funds to asset renewals during the LTFP period. The build-up of cash and cash equivalents that is expected to occur from the additional SRV rates revenue appears to be available to be utilised in this regard.
- Employee expenses increased by 10% in 2014. While this was due in part to a conversion in the use of EFT employees from contractors, as Council's largest expense this needs to be monitored closely so not to impact the forecast operating performance improvement.

Appendix A Historical Financial Information Tables

Table 1-Income Statement

Income statement	Year ended 30 June					% annual change			
	2014	2013	2012	2011	2010	2014	2013	2012	2011
Revenue									
Rates and annual charges	18,205	17,288	16,822	16,445	15,730	5.3%	2.8%	2.3%	4.5%
User charges and fees	14,129	12,908	13,530	12,646	11,367	9.5%	(4.6%)	7.0%	11.3%
Interest and investment revenue	1,080	1,350	1,756	1,550	1,496	(20.0%)	(23.1%)	13.3%	3.6%
Grants and contributions for operating purposes	6,539	9,052	13,023	7,597	6,521	(27.8%)	(30.5%)	71.4%	16.5%
Other revenues	161	381	37	612	44	(57.7%)	929.7%	(94.0%)	1290.9%
Total revenue	**40,114**	**40,979**	**45,168**	**38,850**	**35,158**	**(2.1%)**	**(9.3%)**	**16.3%**	**10.5%**
Expenses									
Employees	15,249	13,653	14,188	13,766	12,781	11.7%	(3.8%)	3.1%	7.7%
Borrowing costs	1,676	1,720	1,722	1,159	917	(2.6%)	(0.1%)	48.6%	26.4%
Materials and contract expenses	12,458	13,085	15,453	12,263	8,604	(4.8%)	(15.3%)	26.0%	42.5%
Depreciation and amortisation	10,560	13,665	14,570	13,486	12,615	(22.7%)	(6.2%)	8.0%	6.9%
Other expenses	4,799	5,150	5,031	3,507	3,672	(6.8%)	2.4%	43.5%	(4.5%)
Total expenses	**44,742**	**47,273**	**50,964**	**44,181**	**38,589**	**(5.4%)**	**(7.2%)**	**15.4%**	**14.5%**
Operating result (excluding capital grants and contributions)	**(4,628)**	**(6,294)**	**(5,796)**	**(5,331)**	**(3,431)**	26.5%	(8.6%)	(8.7%)	(55.4%)
Operating result (including capital grants and contributions)	**1,163**	**(2,587)**	**1,643**	**1,352**	**11,731**	145.0%	(257.5%)	21.5%	(88.5%)

Table 2 - Items excluded from Income Statement

Excluded items	2014	2013	2012	2011	2010
Grants and contributions for capital purposes	5,791	3,707	7,439	6,683	15,162
Fair Valuation Movements in Investments - unrealised capital gains/(losses)	62	841	640	640	530
Net Profit (Loss) from Discontinued Operations	0	(1,802)	(836)	(12,733)	422
Net gain (loss) from the disposal of assets	(1,301)	(1,327)	(3,232)	(4,810)	(1,018)

Table 3 – Employee Numbers

	2014	2013	2012	2011	2010
Full Time Equivalent Employees at year end	210	191	198	202	205

Table 4 – Balance Sheet

Balance sheet ($'000s)	Year ended 30 June					% annual change			
	2014	2013	2012	2011	2010	2014	2013	2012	2011
Current assets									
Cash and cash equivalents	21,798	27,040	26,011	20,323	18,786	(19.4%)	4.0%	28.0%	8.2%
Investments	1,457	1,722	1,972	4,775	4,424	(15.4%)	(12.7%)	(58.7%)	7.9%
Receivables	9,996	6,924	9,970	8,463	6,845	44.4%	(30.6%)	17.8%	23.6%
Inventories	1,877	2,485	2,067	1,977	2,613	(24.5%)	20.2%	4.6%	(24.3%)
Other	1,213	592	501	2,269	2,384	104.9%	18.2%	(77.9%)	(4.8%)
Total current assets	36,341	38,763	40,521	37,807	35,052	(6.2%)	(4.3%)	7.2%	7.9%
Non-current assets									
Investments	481	2,336	2,654	3,401	5,754	(79.4%)	(12.0%)	(22.0%)	(40.9%)
Receivables	2,437	2,330	2,193	1,923	2,020	4.6%	6.2%	14.0%	(4.8%)
Inventories	1,464	539	854	418	419	171.6%	(36.9%)	104.3%	(0.2%)
Infrastructure, property, plant & equipment	618,919	593,836	558,435	511,127	487,790	4.2%	6.3%	9.3%	4.8%
Investment property	0	0	9	15	21	N/A	(100.0%)	(40.0%)	(28.6%)
Total non-current assets	623,301	599,041	564,145	516,884	496,004	4.0%	6.2%	9.1%	4.2%
Total assets	**659,642**	**637,804**	**604,666**	**554,691**	**531,056**	**3.4%**	**5.5%**	**9.0%**	**4.5%**

Balance sheet ($'000s)	Year ended 30 June					% annual change			
	2014	2013	2012	2011	2010	2014	2013	2012	2011
Current liabilities									
Payables	5,378	4,269	5,338	5,916	7,618	26.0%	(20.0%)	(9.8%)	(22.3%)
Borrowings	1,111	1,218	1,048	767	785	(8.8%)	16.2%	36.6%	(2.3%)
Provisions	4,610	4,712	5,476	5,178	5,507	(2.2%)	(14.0%)	5.8%	(6.0%)
Total current liabilities	11,099	10,199	11,862	11,861	13,910	8.8%	(14.0%)	0.0%	(14.7%)
Non-current liabilities									
Borrowings	20,881	21,992	20,771	16,024	11,353	(5.1%)	5.9%	29.6%	41.1%
Payables	434	308	308	501	378	40.9%	0.0%	(38.5%)	32.5%
Provisions	2,279	1,991	2,579	2,121	2,073	14.5%	(22.8%)	21.6%	2.3%
Total non-current liabilities	23,594	24,291	23,658	18,646	13,804	(2.9%)	2.7%	26.9%	35.1%
Total liabilities	**34,693**	**34,490**	**35,520**	**30,507**	**27,714**	**0.6%**	**(2.9%)**	**16.4%**	**10.1%**
Net assets	**624,949**	**603,314**	**569,146**	**524,184**	**503,342**	**3.6%**	**6.0%**	**8.6%**	**4.1%**

Table 5 - Cashflow

Cash Flow Statement ($'000s)	Year ended 30 June				
	2014	2013	2012	2011	2010
Cash flows from operating activities	8,962	9,749	13,710	11,918	25,454
Cash flows from investing activities	(12,986)	(10,111)	(13,050)	(15,034)	(14,480)
Proceeds from borrowings and advances	0	2,706	6,100	5,500	756
Repayment of borrowings and advances	(1,218)	(1,317)	(1,072)	(847)	(9,142)
Cash flows from financing activities	(1,218)	1,389	5,028	4,653	(8,386)
Net increase/(decrease) in cash and equivalents	**(5,242)**	**1,027**	**5,688**	**1,537**	**2,588**

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 (now OLG) with representatives from the Department of Premier and Cabinet and NSW Treasury.

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

Office of Local Government (OLG)

OLG (previously DLG) is an Office in the Planning and Environment cluster and is responsible for local government across NSW. OLG’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 OLG has a policy, legislative, investigative and program focus in matters ranging from local government finance, infrastructure, governance, performance, collaboration and community engagement. OLG strives to work collaboratively with the local government sector and is the key adviser to the NSW Government on local government matters.

Depreciation of Infrastructure Assets

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

EBITDA

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

Financial Sustainability Rating (FSR)

[1] IPART “Revenue Framework for Local Government” December 2009 p.83
[2] DLG “Recognition of certain assets at fair value” March 2009

The FSR is an assessment of a council's capacity to meet its financial commitments in the short, medium and long term. The FSR for each Council has been determined based on the review and consideration of a Council's historical performance against a set of benchmark indicators. The rating methodology consists of seven FSR categories. The FSR is calculated using weighted benchmarks according to the relative importance of each benchmark in terms of a Council's financial capacity and sustainability.

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).

Outlook

The Outlook assigned to Council is TCorp's assessment of the potential movement of Council's FSR within the next three years. The outlook methodology consists of three categories. A positive Outlook indicates that a Council's FSR is likely to improve in the short term, whilst a Neutral Outlook indicates that the FSR is likely to remain unchanged. A Negative Outlook indicates that a Council's FSR is more likely to deteriorate and is a sign of a general weakening in performance and sustainability.

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 + current term deposits / (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.

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