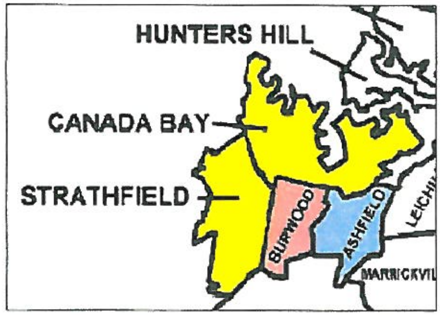
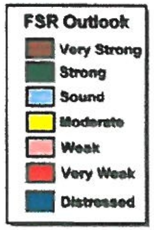
ANNEXURE D:
NSW TCORP REPORT

Inner West Sydney options

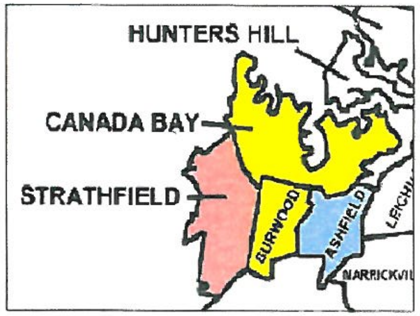
Regional outlook

Financial sustainability:
Current position

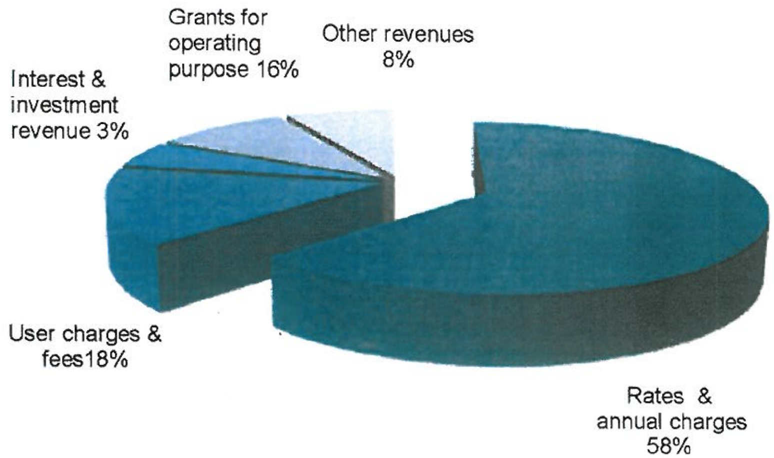




Financial sustainability:
Projected rating



Inner West income sources



Financial data

Based on 2011-2012 financial year.

Revenue Source	Inner West Sydney (000's)	Ashfield (000's)	Burwood (000's)	Canada Bay (000's)	Strathfield (000's)
Residential rates	$58,907	$14,241	$10,170	$25,118	$9,378
Business rates	$15,879	$3,605	$4,143	$4,237	$3,894
Farmland rates	$0	$0	$0	$0	$0
Mining rates	$0	$0	$0	$0	$0
Special rates	$1,255	$514	$0	$741	$0
Total rates	**$76,041**	**$18,360**	**$14,313**	**$30,096**	**$13,272**
Rates and annual charges	$101,495	$24,249	$18,321	$41,000	$17,925
User charges and fees	$23,972	$2,441	$6,497	$12,026	$3,009
Interest and investment revenue	$8,307	$834	$2,533	$3,049	$1,891
Grants and contributions for operating purposes	$15,355	$2,913	$3,654	$5,638	$3,150
Other revenue	$12,430	$1,749	$3,639	$5,748	$1,294
Total TCorp revenue	**$161,560**	**$32,186**	**$34,644**	**$67,461**	**$27,269**

TCorp revenue figures may exclude some revenue line items unique to the council or for the 2012 period

Current asset position

	Inner West Sydney	Ashfield	Burwood	Canada Bay	Strathfield
Total Roads (KMs)	445	91	82	186	86
Total Bridge Length (M)	156	22	12	85	37
Total Assets 2012 (Tcorp 000's)	$4,422,410	$262,728	$386,126	$3,481,317	$292,277
Assets Per Capita	$22,675	$6,014	$11,256	$43,568	$7,869
Total Infrastructure backlog (Tcorp 000's) 2012	$213,646	$250	$167,688	$35,339	$10,369
Infra. Backlog Per Capita	$1,095	$6	$4,888	$442	$279

Version 1: Prepared to support the deliberations of the Independent Review of Local Government Panel

New South Wales
Treasury Corporation

Burwood Council

Financial Assessment and Benchmarking Report

25 September 2012

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

Disclaimer

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

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

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

The report has been prepared for Burwood Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Burwood 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 Burwood 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 application for their road infrastructure backlog repair program for an amount of $1.0m to be repaid over 10 years.

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.

It is significant to note that the Council's General Manager was dismissed in April 2010, and has subsequently been found guilty of corruption following an investigation by ICAC. A new management team is now in place. Initiatives started by previous council management have been reviewed. An ambitious proposed civic centre redevelopment has been discontinued, with $7.0m in capital expenditure being written off. A less ambitious development that includes the relocation of the existing library and new community facilities is now planned.

Overall, the review has found that the Council has been managed in an inefficient manner over the three years of historical results from 2008/09 to 2010/11 based on the following observations:

- The Council has incurred operating deficits (excluding grants and contributions for capital purposes), and Council's underlying operating results (measured using EBITDA) have been negative in each of the last three years when proceeds from the sale of assets are excluded
- Operating expenses have been rising above the rate of CPI over the last three years, while rates and annual charges actually declined in the 2011 financial year
- Under the former management some areas of capital expenditure appears to have been poorly planned. $7.0m has been spent on a discontinued civic centre project. This amount is to be written off in the 2012 financial year

On the plus side, approximately 70% of the Council's revenue base is derived from own sourced revenue (annual charges, and user charges and fees). The Council can rely upon these revenue streams on an ongoing basis for financial flexibility.

The Council reported $168.5m of infrastructure backlog in 2011, with an infrastructure asset value of $254.8m. Other observations include:

- 69.2% of the backlog was drainage related, and 30.0% road related in 2011
- As the required maintenance amounts are not being spent to keep the assets in their current condition; it is likely that the backlog will grow
- Capital expenditure is currently not being targeted at reducing the backlog. Very little was spent in problematic areas such as drainage works compared to other capex projects
- Council have been proactive in measuring their backlog, and are committed to using up to date technology and experienced consultants to obtain an accurate valuation, particularly in respect of the drainage works where the majority of the backlog exists

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

- The forecast shows deficit positions are expected in all 10 years when capital grants and contributions are excluded. This is the weakest forecast ratio and highlights that over the longer term, Council could face financial sustainability issues. The deficit is forecast to improve throughout the forecast period from the worst ratio deficit in 2013 of 14.6%, to 5.5% in 2022. We have some reservations about the ability of Council to achieve these improved outcomes, particularly as the forecast capital expenditure program appears to be lower than what we would see as being required to maintain a sound asset base. Greater clarity is expected once the 2012 financial results are finalised and Council completes further investigative work in respect of the drainage works backlog
- Overall it appears that the Council will have sufficient liquidity throughout the next 10 year period to service all short term liabilities and currently scheduled capital expenditure and related long term liabilities
- Council's level of fiscal flexibility is sound as own source operating revenue is maintained at levels above 70%
- Current Council policy is to undertake capital investment and maintenance on all assets including community facilities, and not focus just on the infrastructure backlog

In our view, the Council does have the capacity to undertake the combined additional borrowings of $1.0m for the LIRS project. This is based on the following analysis:

- While the Council's operating performance in the last three years has been characterised by consistent operating deficits, and negative cash performance (measured using EBITDA), TCorp consider that the future financial results will improve to a more sustainable position
- Following the removal of the previous senior management team in 2010, a new management team has been in place since 2011. TCorp have met representatives of the new management team and discussed with them their plans to operate the Council more efficiently in the future. Management have identified key areas in which savings have been made immediately such as in overtime and other inefficient spending practices, and where more savings can be made in the future. Management also showed awareness of how key mistakes were previously made, in particular in regard to the asset sale process, and construction of new assets, and are putting in place practices to ensure improved outcomes are achieved in future
- Council's DSCR is below benchmark in 2013, and 2014, due to substantial principal repayments of $8.4m, and $4.5m respectively. While weakening the borrowings capacity

indicators, it is a positive that Council has the cash to repay the loans, and that Council are determined to consign some of the financial strategy decisions of the previous management to the past. From 2014 onwards the DSCR and Interest Cover Ratio are above the benchmarks

- Before analysing Council's capacity for further debt beyond the proposed LIRS borrowings, TCorp would need to analyse the full year 2012 audited accounts to see the initial financial impact of Council's new management team and the actions that they have taken

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios with other councils in DLG group 2. The key observations are:

- Council's financial flexibility as indicated by the Operating Ratio and Own Source Operating Revenue Ratio are generally below the group's average
- Council's EBITDA has been negative over recent years and this has caused its DSCR and Interest Cover Ratio to be below the group's average and benchmark. These ratios are expected to improve in the medium term to be above both the group average and the benchmark as profitability improves
- Council was in a sufficient liquidity position which is expected to improve to be above the group average in the medium term
- Council's performance in terms of its Asset Maintenance Ratio and Infrastructure Backlog are weaker than its peers.

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	> 1.5x
Own Source Operating Revenue Ratio	> 60.0%
Debt Service Cover Ratio (DSCR)	> 2.0x
Interest Cover Ratio	> 4.0x
Infrastructure Backlog Ratio	< 0.02x
Asset Maintenance Ratio	> 1.0x
Building and Infrastructure Asset Renewal ratio	> 1.0x
Capital Expenditure Ratio	> 1.1x

2.3: Overview of the Local Government Area

Burwood Council LGA	
Locality & Size	
Locality	Sydney Inner
Area	7 km²
DLG Group Number	2
Demographics	
Population	34,079
% under 18	23%
% between 18 and 59	51%
% over 60	26%
Expected population 2025	42,900
Operations	
Number of employees (FTE)	200
Annual revenue	$29.6m
Infrastructure	
Infrastructure backlog value	$168m
Total infrastructure value	$255m

Council's LGA is located in the inner west of Sydney. It is a mixed residential and commercial area with more than 1,800 businesses including two major shopping centres, and 12 schools.

The population of the LGA is a diverse mix of cultures, with 49% of the population being born overseas. The majority (56%) of people in Burwood speak languages other than English at home.

In 2011 the ICAC made 17 corrupt conduct findings against the former General Manager of Burwood Council, Pasquale (Pat) Romano. ICAC found that Mr Romano engaged in corrupt conduct involving the use of Council resources for personal purposes. Mr Romano was dismissed in April 2010, and the current General Manager was appointed in August 2010.

ICAC made 31 corruption prevention recommendations; some of these recommendations were to Burwood Council, while others were made to the NSW Government to help improve systems in local government across the state.

The Council had 200 equivalent full-time staff as at the end of the 2011 financial year, a decrease from 230 in 2010.

2.4: LIRS Application

Council has made one LIRS application.

Project: Road infrastructure backlog repair program

Description: Council has prepared a road infrastructure backlog repair program following a data capture and condition rating exercise undertaken in 2012 for its road, footpath, and kerb and gutter infrastructure assets. Council has identified a number of its local and collector roads that are in very poor condition and require an immediate injection of capital funding outside its normal roads capital funding program to fund this capital work. The project is targeted to commence in July 2012

Amount of loan facility: $1.0m

Term of loan facility: 10 years

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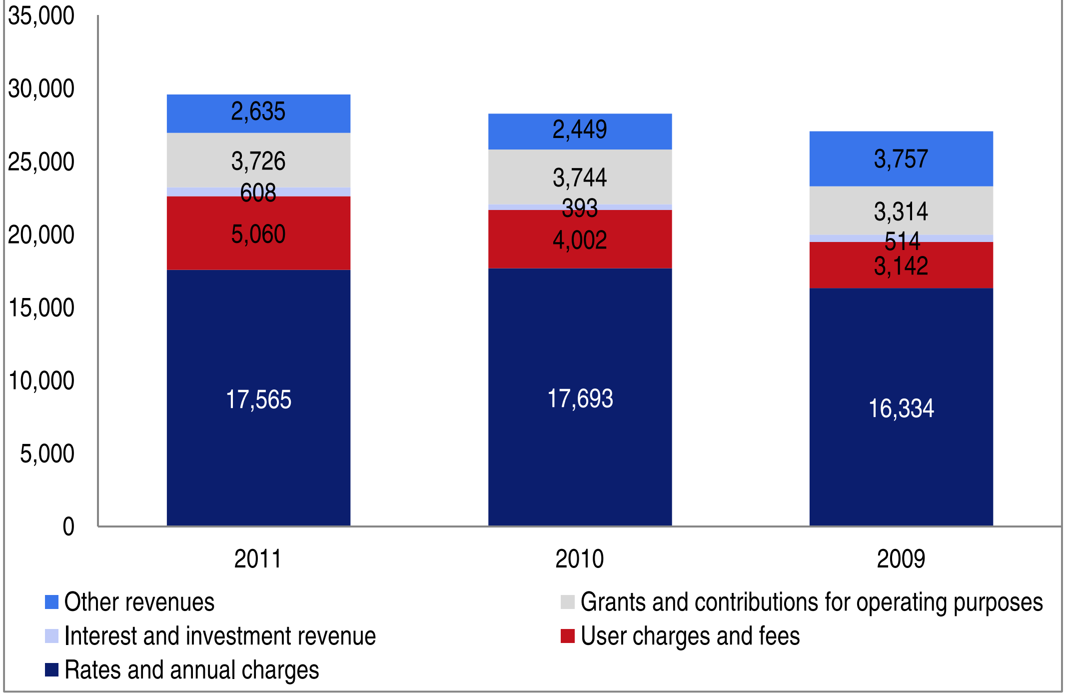
Section 3 Review of Financial Performance and Position

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

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

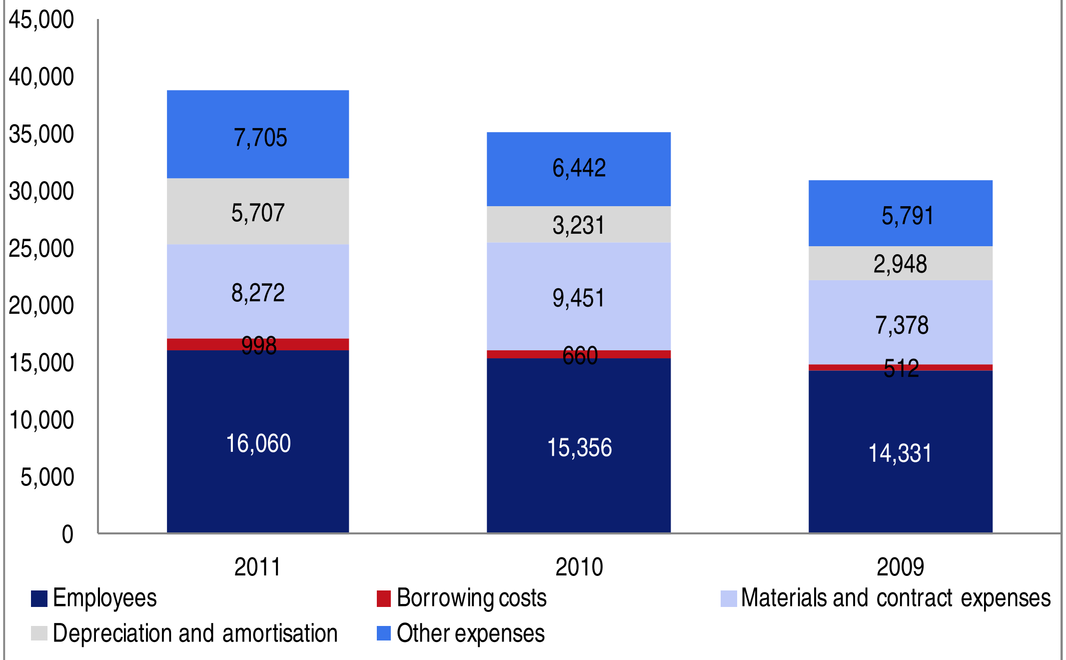


Key Observations

- Council's own source operating revenue from rates and user fees has been increasing steadily in the last three years.
- Rates and annual charges increased by 8.3% in 2010, driven by a 21.6% increase in domestic waste management charges to $3.8m.
- User fees and charges have been increasing by over 25% p.a. in the last two years to $5.1m in 2011. Increased revenue from car parking meters and street furniture advertising have been the main drivers of the increase.
- Other revenue consists mainly of parking fines of over $2.0m p.a. Parking fine revenue is volatile having fallen from $2.7m in 2009 to just over $2.0m in 2011.

3.2: Expenses

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



Key Observations

- Employee costs have been rising over the last three years despite a decrease in the number of full time equivalent staff, from 223 at year end 2009 to 200 at year end 2011. Despite the reduction in employee numbers, increased costs in areas such as superannuation and workers compensation hindered the ability of Council to constrain employee costs.
- Materials and contracts costs were reduced by 12.5% to $8.2m in 2011, after a 28.1% increase in 2010. The main expenses were contractor and consultancy fees, and legal expenses. Council, in discussions with TCorp, have indicated that they expect future contractor fees, and legal expenses to decline due to improved work practices, and improved management control over the structure of contractual relationships entered into.
- The Asset Revaluations process resulted in the annual depreciation charge increasing, from $2.9m in 2009 to $5.7m in 2011. Roads, bridges and footpaths were re-valued upwards, so the depreciation charges on these assets increased from $1.0m in 2009 to $2.1m in 2011. A substantial increase in the Council's asset values has directly correlated to a higher depreciation charge.
- Other expenses have risen due to increasing waste disposal fees, and rental fees. The increase in waste disposal fees has been offset by increases in waste disposal revenue. Due to the relocation of the library to the previous Council chambers, Council have been renting new premises since December 2009, but are considering purchasing new premises.

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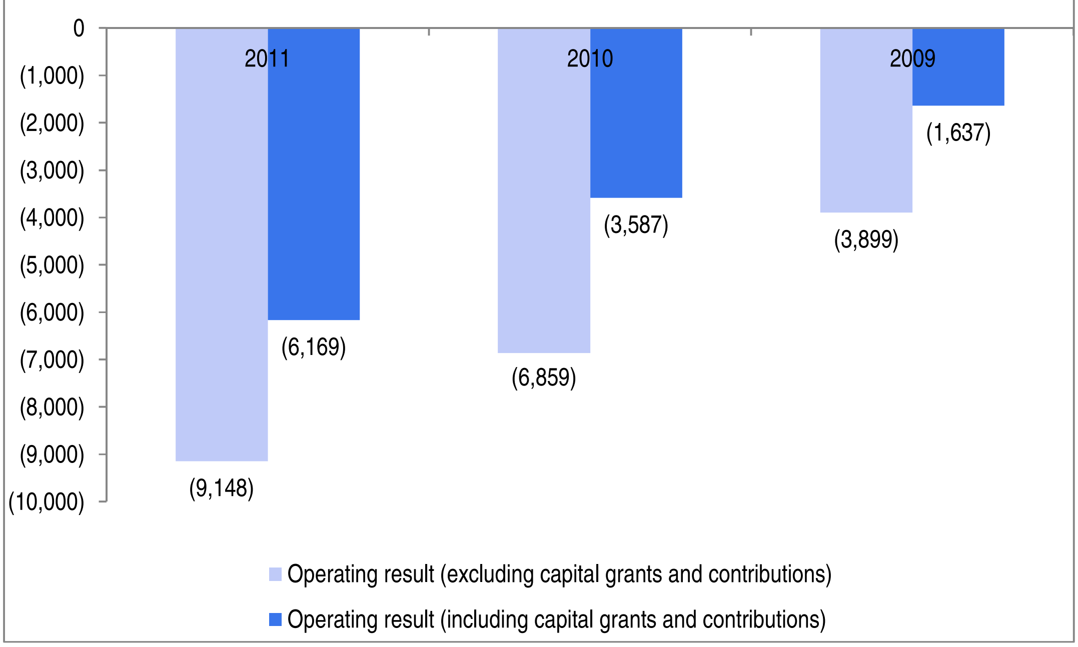
3.3: Operating Results

TCorp has made some standard adjustments to focus the analysis on core operating council results. Grants and contributions for capital purposes, realised and unrealised gains on investments are excluded, as well as one-off items which Council have no control over (e.g. impairments). For Burwood, excluding the profits from the sale of land and building has a major impact on the reported position of Council.

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 has consistently posted net operating deficits both including and excluding capital grants and contributions. The operating deficit increased in 2011 due to the increased depreciation charges.
- Council expenses include a non-cash depreciation expense, ($5.7m in 2011), which has increased by 93.6%over the past three years following the Asset Revaluations process. While the non cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.
- The above results have been normalised by removing the gains from the disposals of assets in the last three years. Property sales in the last three years include:

- Library building for $5.7m in October 2009 with a contingent deferred settlement amount $7.5m
- Car park for $15.5m in June 2011 with a deferred settlement amount of $8.0m 30 months after the date of sale
- Two properties for $16.9m in January 2012 (Conder and Belmore Streets)
- Wynne Avenue property for $14.5m in January 2012

- The overall strategy for the asset sales proceeds is to retire the current interest only loans in 2012 and 2013, and use the balance of the asset sale proceeds on the capital works program. The sale of these properties is to facilitate the redevelopment of Burwood town centre to create a mixed residential and commercial centre, based on a town centre local environment plan adopted in 2010. The civic precinct project does not form part of this plan and has been discontinued. This proposal is currently in the planning phase and needs to be carefully managed so that errors that occurred with the previous civic precinct development are not repeated.

3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA ($'000's)	(2,443)	(2,968)	(439)
Operating Ratio	(30.9%)	(24.3%)	(14.4%)
Interest Cover Ratio	N/A	N/A	N/A
Debt Service Cover Ratio	N/A	N/A	N/A
Unrestricted Current Ratio	1.10x	2.64x	3.25x
Net Assets ($'000's)	344,957	440,940	268,135

Key Observations

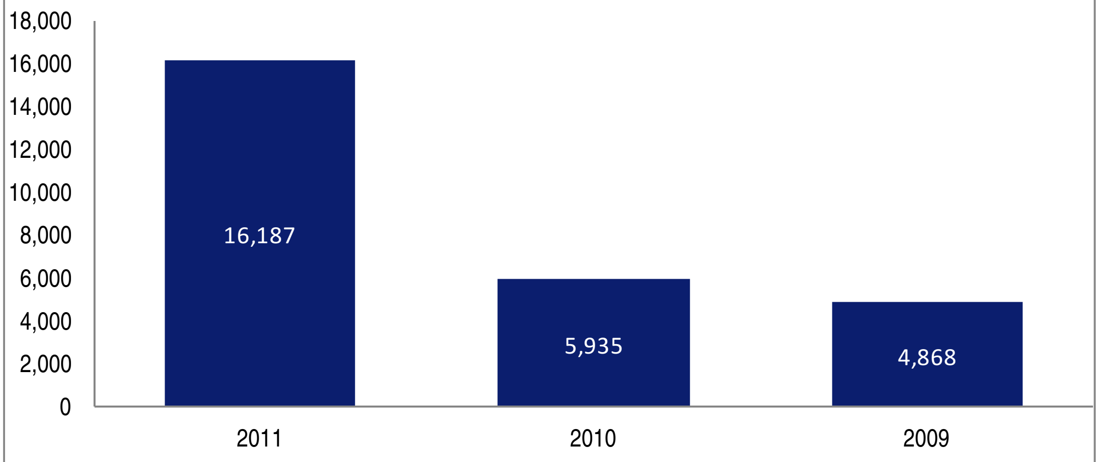
- Council's EBITDA was negative each year. Council also had a negative Interest Cover Ratio and DSCR indicating Council had no flexibility in regard to carrying more debt. The DSCR has been well below the benchmark of 2.00x over the past three years.
- The Unrestricted Current Ratio fell significantly below the benchmark of 1.50x in 2011, indicating liquidity is of concern.
- Net Assets have increased by over $76.8m between 2009 and 2011 due to the consecutive Asset Revaluations in 2010 and 2011 that increased the value of roads, bridges, and drainage infrastructure, and reduced the value of community land assets.
- The Asset Revaluations over the last three years have resulted in a high level of volatility in Net Assets over this period. Consequently, in the short term, the value of Net Assets is not necessarily an informative indicator of performance. In the medium to long term however, this is a key indicator of a Council's capacity to add value to its operations. Over time, Net Assets

should increase at least in line with inflation plus an allowance for increased population and/or improved or increased services. Declining Net Assets is a key indicator of the Council's assets not being able to sustain the ongoing operations of Council.

- When the Asset Revaluations are excluded, the underlying trend in all three years has been an expanding Infrastructure, property, Plant and Equipment (IPP&E) asset base with asset purchases being larger than the combined value of disposed assets and annual depreciation. Over the last three years this amounted to a $12.5m net increase in IPP&E.

3.5: Statement of Cashflows

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



Key Observations

- In total, the Council had cash and investments of $18.7m ($16.2m in cash) in 2011 of which $9.5m is externally restricted, $8.5m is internally restricted and $0.7m is unrestricted.
- Within the investments portfolio of $2.5m Council has non-current deposits, and floating rate notes amounting to $1.2m, and CDO's worth $1.3m. Note the CDO portfolio could not be accurately valued by the auditors, and Council do not expect to receive the full principal amount back. The CDO amount is not material in terms of the overall Council position.
- Despite the increase in cash balances, the Unrestricted Current Ratio suggests that liquidity is becoming more of a concern; however the ratio is forecast to be above the benchmark again in 2012.

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.

Capital Program ($'000's)	Year ended 30 June		
	2011	2010	2009
New capital works	0	0	6,267
Replacement/refurbishment of existing assets	3,204	8,479	7,084
Total	3,204	8,479	13,351

The majority of the capital budget was tied up in replacement and refurbishment of existing assets in the last two years. Any cut in grants and contributions would have an immediate effect on the capital works program and the infrastructure backlog.

The main focus of the capital works program in 2011 was footpath restoration, road resurfacing, kerb and gutter maintenance, and beautification projects. Previous to 2011 the development of a civic centre was a Council priority. Despite the gains from the disposals of assets in 2011, there was a low level of capital expenditure as Council put asset purchases on hold as it was going through an ICAC investigation, and forecast asset sales did not eventuate until 2012. For more detail please see section 3.6(c).

3.6(a): Infrastructure Backlog

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

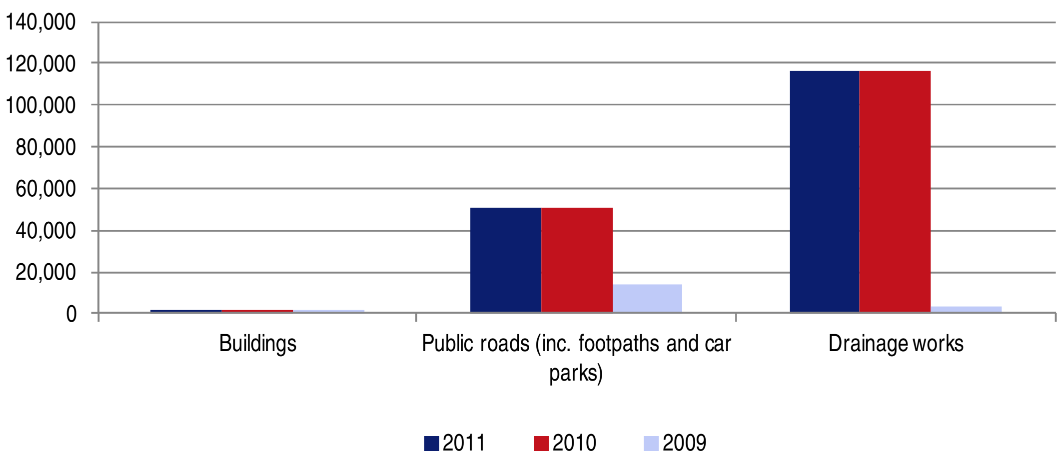
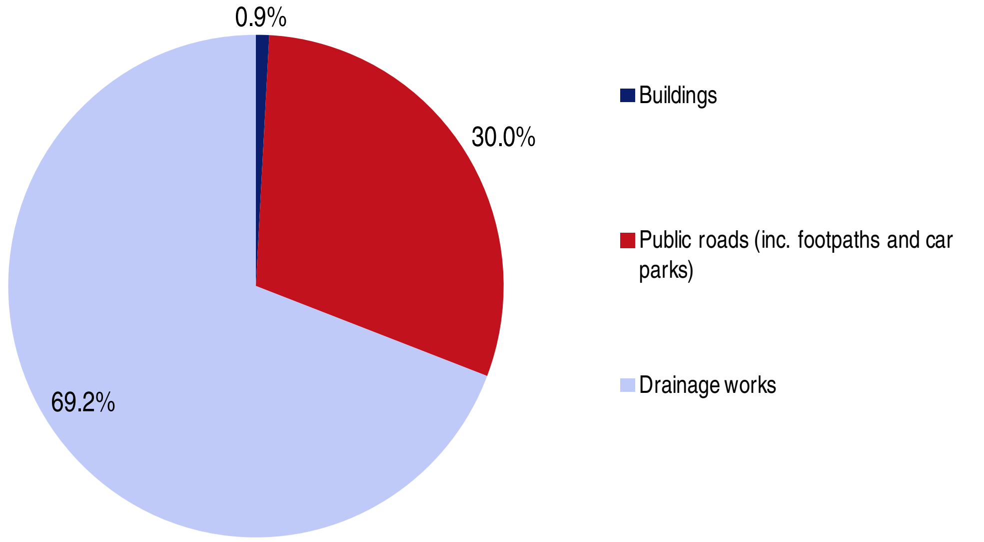


Figure 6 - Infrastructure Backlog Composition for 2010/11



The Council reported a $168.5m backlog in 2011 that was 69.2% drainage related, and 30.0% road related. The backlog has grown considerably since 2009 following the completion of the Asset Management Plan and the Asset Revaluation.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000's)	168,533	168,131	18,375
Required annual maintenance ($'000's)	4,426	4,226	3,632
Actual annual maintenance ($'000's)	1,813	2,131	2,298
Total value infrastructure assets ($'000's)	254,852	254,782	85,619
Total assets ($'000's)	374,524	467,227	290,674
Infrastructure Backlog Ratio	0.66x	0.66x	0.21x
Asset Maintenance Ratio	0.41x	0.50x	0.63x
Building and infrastructure asset renewal ratio	0.47x	0.95x	205.87x
Capital Expenditure Ratio	0.53x	2.53x	4.48x

Council has an Infrastructure Backlog Ratio of 0.66x. The Infrastructure Backlog Ratio increased in 2010 due to the Asset Revaluations process increasing the value of the backlog at a greater rate than the increase in the value of the infrastructure.

The Building and Infrastructure Asset Renewal Ratio, Asset Maintenance Ratio, and the Capital Expenditure Ratio did not meet the benchmarks in 2011 and indicate that Council did not spend sufficient amounts on asset renewal and asset maintenance.

Council is currently in the process of undertaking a CCTV assessment of 10% of the Council's drainage network per year which will provide Council with more accurate data on the condition of the drainage infrastructure. Once completed Council will have a better understanding of the nature and criticality of drainage issues, and be in a better position to plan and prioritise remedial works.

3.6(c): Capital Program

Council have utilised interest only loans in recent years to fund their capital works program. The proceeds from the sale of property assets are to repay these loans in 20112 and 2013. Despite the gains from the disposals of assets in recent years, the capital works program was reduced in 2011 due to an ongoing ICAC investigation, and asset sales which did not eventuate until 2012.

In 2011 the main focus of the Council's capital program has been road resurfacing, kerb and gutter maintenance and beautification projects. In 2011 the Council laid down:

- 4,800m^2 of footpath
- 800m^{2}of driveway
- 1700m of kerb and gutter
- 1.8km of asphalt roadway
- 280m^2 of pavement

Roads, bridges, and footpath infrastructure had additions of $5.5m over the past three years out of total capital expenditure of $25.0m. $5.2m was spent on a car park; however this addition was connected to a property sale. $2.2m was spent on the outfitting of a new commercial property leased by Council in 2010. Council now plan on buying this new office facility, for which negotiations are ongoing.

There was combined capital expenditure of $7.0m on the Burwood civic development. This development was to combine new council headquarters with residential, and community facilities. This development has now been discontinued by Council and its $7.0m cost is to be written off at the end of the 2012 financial year. The project was a priority for the former General Manager, but as the costs of design and construction increased, it has been decided it would be more prudent to scrap the development altogether.

3.7: Specific Risks to Council

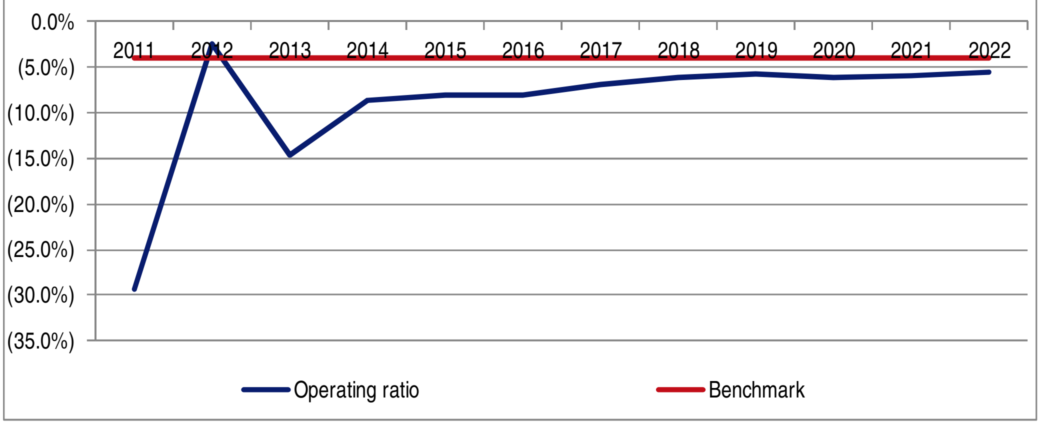
- Council maintains that the key risk they face is the failure of critical assets. This is associated with increases in costs of replacing infrastructure assets and hence the increase in public liability claims. Council tries to mitigate these risks by ensuring that its asset condition data is kept up to date, capital and maintenance works programs are prepared using this data, and that the Asset Management Plans are updated and reviewed on a regular basis.
- $1.3m of Council's CDO portfolio cannot be accurately valued by the auditors. The potential negative impact on the operating result and Net Assets is the carrying amount of these investments. These assets have a maturing range of between two and five years, and Council do not expect to receive the full principal amount back.
- Council's sale of assets has involved some contractual arrangements entered into by the former management that provide for the part payment of asset sales on a contingent basis with settlements of $7.5m and $8.0m respectively received up to 30 months after the sale. Despite selling the assets, Council have retained part of the risk. As property development is not part of core Council activities, future sales should not include any contingencies without greater consideration of the risks and benefits involved. The current management is well aware of the previous flawed contractual arrangements but is not in a position to amend these old contracts.

Section 4 Review of Financial Forecasts

The financial model shows the projected financial statements and assumptions for the next 10 years. The model includes the $1.0m road infrastructure backlog repair program loan without any LIRS subsidy. Council operate just one General Fund for all activities.

4.1: Operating Results

Figure 7 - Operating Ratio



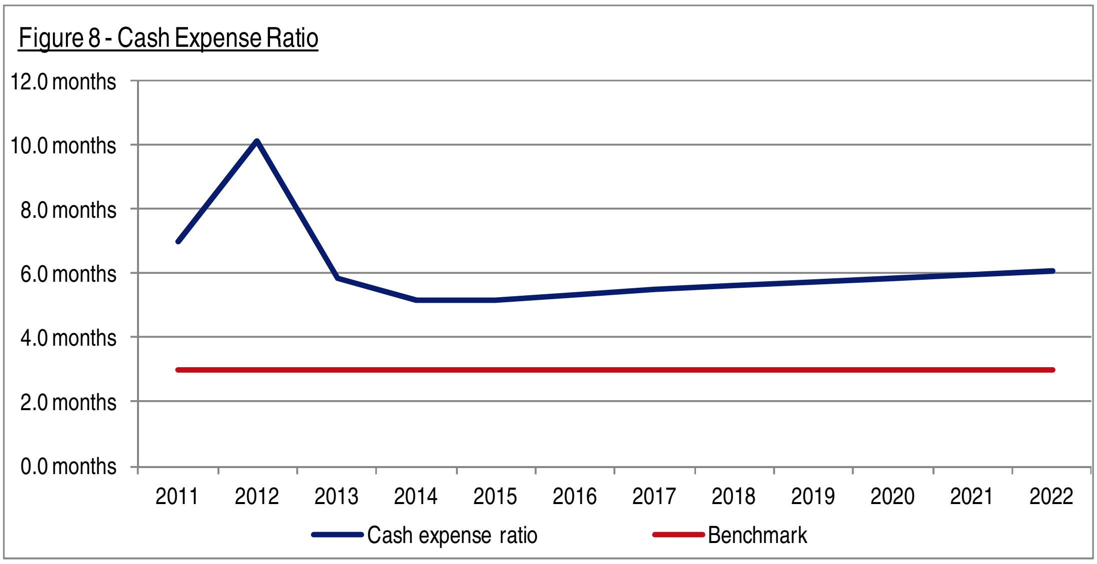
The forecast shows deficit positions are expected in all 10 years when capital grants and contributions are excluded. This is the weakest forecast ratio and highlights that over the longer term Council could face financial sustainability issues, although the figure is due to improve throughout the model from the worst ratio deficit in 2013 of 14.6% to 5.5% in 2022. The 2012 results are positively affected by exceptional earnings of $4.5m from two deposits retained after property sales failed. The properties have since sold. With the retained deposits and penalty interest, Council suffered no loss from the delay of the sale.

After 2012, the forecasted deficits are an improvement on historic results. This is due to increased revenues and decreased expenditure resulting from new efficiency initiatives.

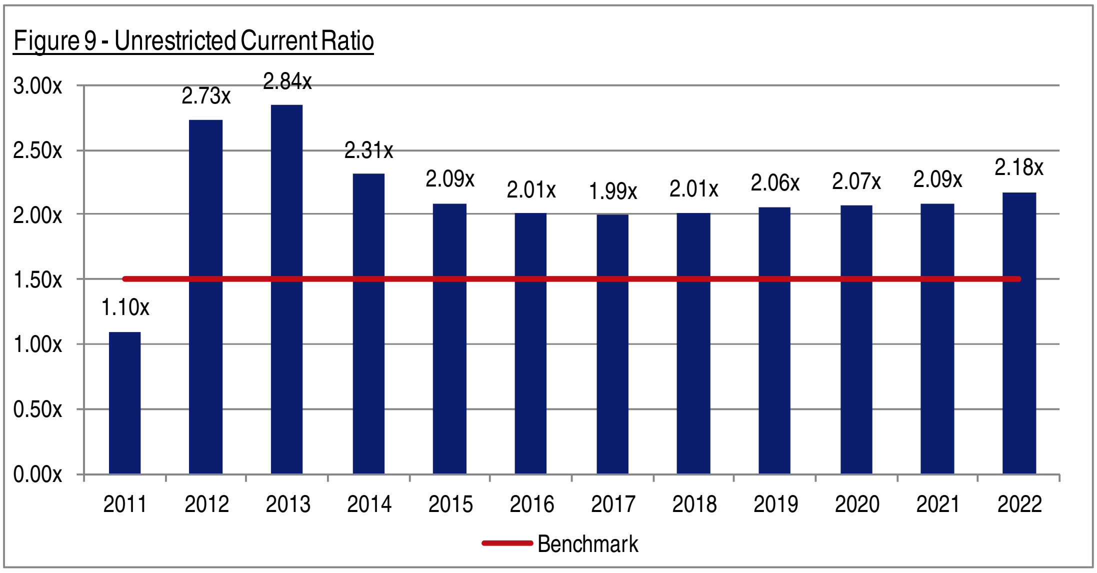
4.2: Financial Management Indicators

The financial indicators are linked to the utilisation of debt in early years and improve over time as the debt reduces and operating deficits also improve.

Liquidity Ratios



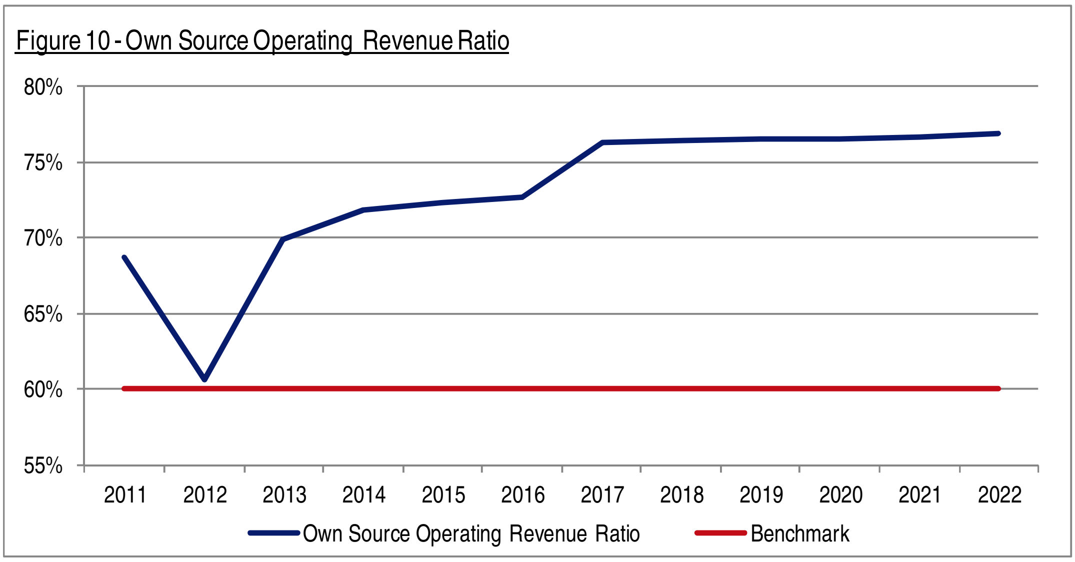
Council forecasts a Cash Expense Ratio well above the benchmark for each year of the forecast. Cash balances have been boosted by the sale of properties.



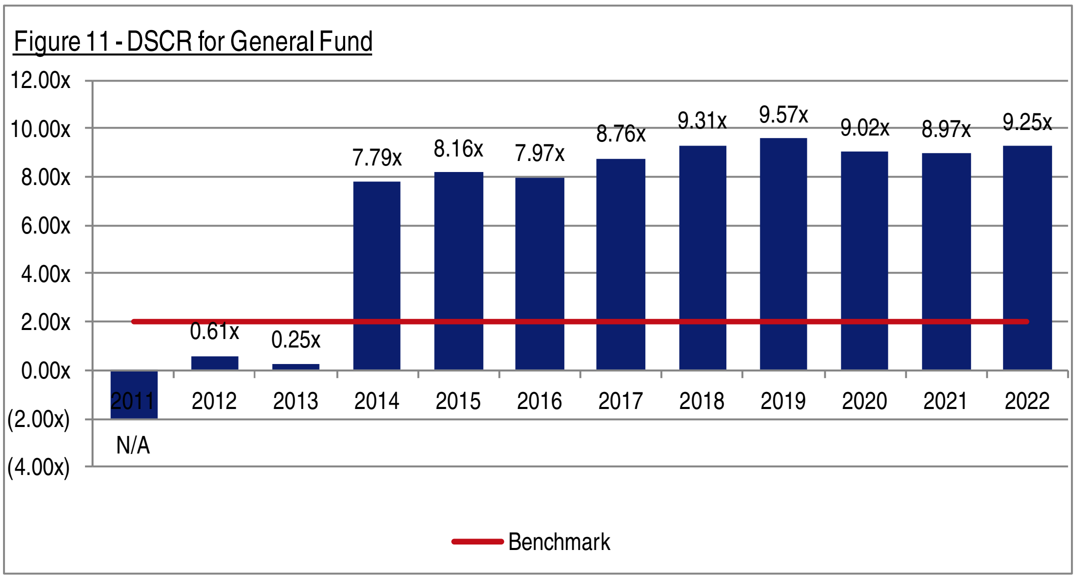
The Unrestricted Current Ratio is at the lowest position in 2017 however this is still above the IPART benchmark figure of 1.50x, and the historical results. The Council remains above the 1.50x benchmark for all 10 years.

Overall it appears that the Council will have sufficient liquidity throughout the next 10 year period to service all short term liabilities, currently scheduled capital expenditure and related long term liabilities.

Fiscal Flexibility Ratios

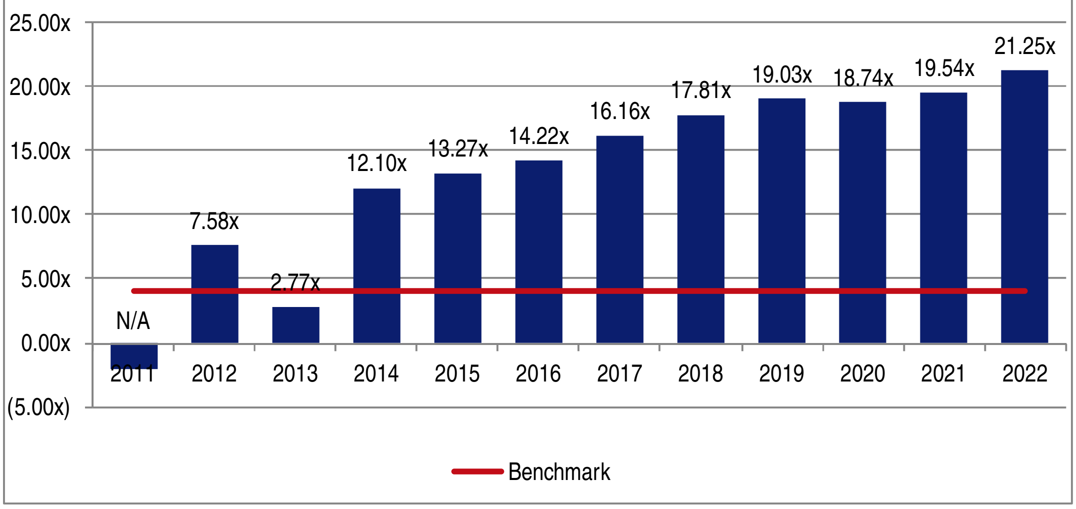


The Own Source Operating Revenue Ratio shows Council's net rates, utilities and charges remaining over 70.0% against the 60.0% benchmark figure of total revenue. This is higher than the historic results due to the fact that Council have forecast capital grants and contributions at a lower level than received historically. The ratio is at its lowest in 2012 due to higher than normal other revenue because of two deposits retained worth $4.5m from the failed sale of Council properties.



The DSCR increases above the benchmark 2.0x figure in 2014. Previous to this year, high principal repayments in 2012 and 2013 lowered the ratio. The improving ratio over time is due to increasing EBITDA and decrease in debt service costs as Council starts to pay down its debt.

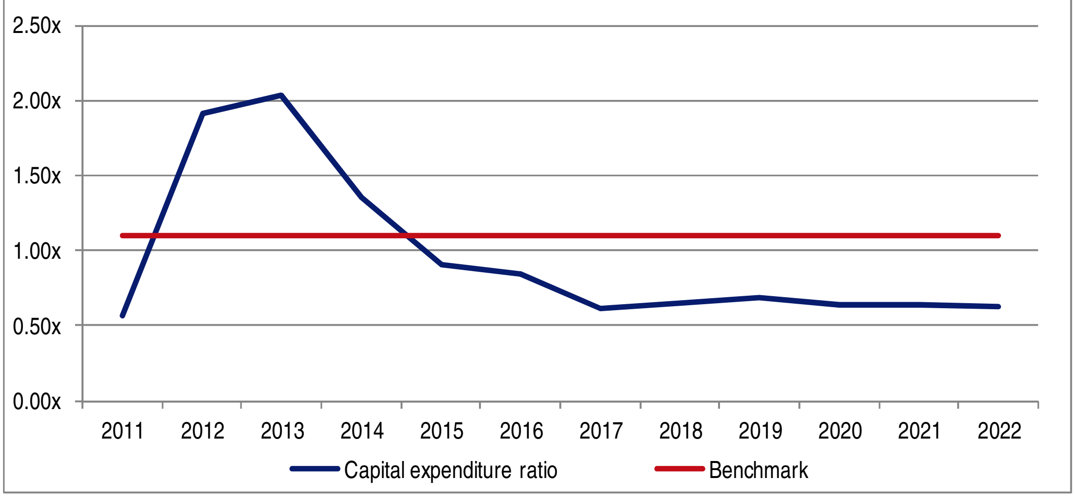
Figure 12 - Interest Cover Ratio for General Fund



The Interest Cover Ratio, similarly to the DSCR, shows the Council increases above the benchmark in 2014, when Council is no longer burdened by the high principal repayments.

4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio



The Capital Expenditure ratio shows a widely fluctuating performance across the 10 year period with Council forecasting a ratio above the benchmark of 1.1x in only three of the 10 years. As the Council is forecasting an increased population of 42,900 by 2025, the asset base should increase in line to meet demand. The forecast low levels of capital expenditure for the majority of the 10 years will increase pressure on existing assets. The total deficit for capital expenditure versus depreciation across the 10 year period amounts to $6.7m in nominal terms.

Capital expenditure peaks in 2013 with the focus being on road and footpath works, plus the library upgrade. Despite drainage works accounting for 69% of the infrastructure backlog, just $0.2m is allocated to its annual program that year, while projects such as the library, pool upgrades, and community centre expenditure taking greater priority. $1.8m is also budgeted for passenger vehicles in 2013, and 2014.

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 2013 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%
- 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 forecasts for rates and annual charges are forecast to be higher than historic IPART approved increases due to the introduction of a $0.3m p.a. special rate infrastructure levy in 2014. This levy has not yet been applied for. This revenue will be held in a reserve and used to fund specific road and footpath projects. The model also reflects that the underlying rate base will increase by 1.7% p.a. after 2015, due to an estimate of 7,500 new rateable properties over the next 20 years.
- User fees and charges have increased above the rate of CPI up to 2014 due to new parking meters installed in 2012, and increased DA fees and construction zone fees. These fees are forecast as part of the new Town Centre LEP adopted in 2010.
- Employee costs are forecast to increase at around 3.2% p.a. on average, and considering the increasing trend for the last three years may be considered optimistic. The new management team have reduced the number of departments from four to three and are hopeful this will contribute to reduced employee costs.
- After large increases between 2009 and 2011, materials and contracts costs are forecast to decrease in the short term, with low growth over the balance of the 10-year forecasting term. Council maintain that the review of a number of major contracts can result in efficiency gains. Council is aiming to put in place cost saving measures especially in the area of contracted agency staff and consulting.
- Overall, TCorp find the LTFP assumptions marginally optimistic. The forecast results are not consistent with the results from the past three years. Discussions with management have revealed strategies which will result in improved financial performance such as a reduction in

external legal advice, changes in work practices such as reducing overtime, and cutting contract staff. Council management are of the opinion that these cuts will have no effect on services provided but will produce reduced costs.

4.5: Borrowing Capacity

We believe the Council will be able to manage borrowings of $1.0m for the LIRS project.

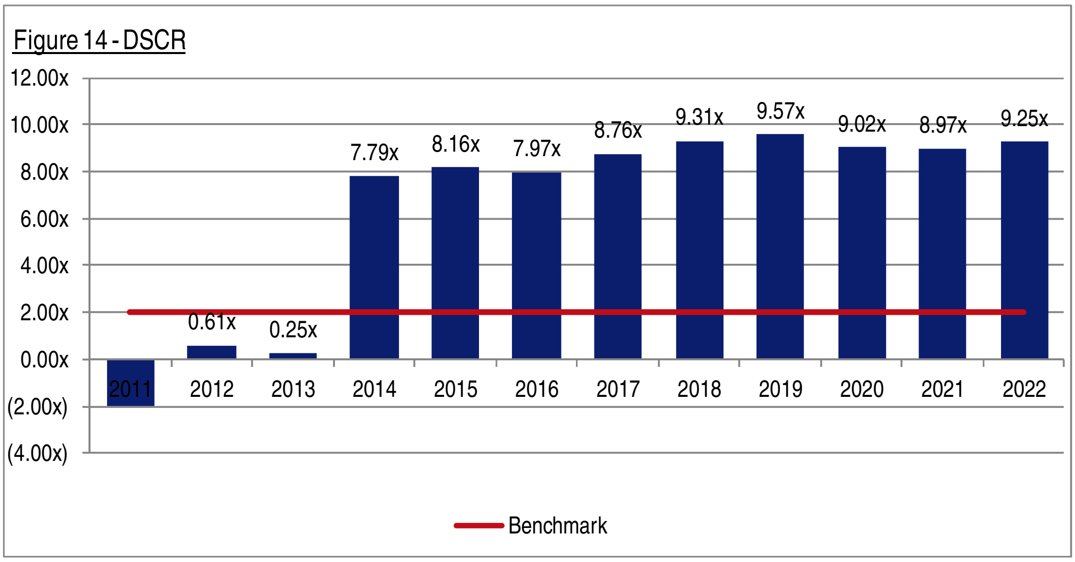


Figure 14 is the same as Figure 11.

The above ratios are based on a forecast scenario where overall revenues are forecast to grow at levels higher than CPI despite rates and annual charges, its main revenue source, being constrained by IPART. Councils forecast of 7,500 new rateable properties over the next 20 years is the key driver of the growth. Overall expenditure is forecast to be constrained by new efficiencies.

While the sale of assets in the last number of years has improved Council cash balances, Council operating performance and sustainability cannot be sustained this way indefinitely. TCorp considers that an analysis of the 2012 audited accounts is required before recommending further borrowing capacity in addition to the LIRS borrowings.

New South Wales
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Section 5 Benchmarking and Comparisons with Other Councils

Please refer to the Burwood Council Benchmarking Update from 12 March 2013.

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 weak financial operating position due to poor past operating performance and financial practices. Improved performance from the new Council management plus the proceeds from asset sales should put the Council in an acceptable operating position going forward, and we recommend Council receive the LIRS funding.

We base our recommendation on the following key points:

- Council has sufficient capacity to manage the additional $1.0m debt highlighted by a DSCR and Interest Cover Ratio above the benchmarks from 2014 onwards, plus cash balances boosted by asset sales
- Council has the financial capacity to service the principal repayments of $8.5m in 2012 and $4.6m in 2013. Repayments fall to negligible levels by 2014
- The new management have shown a clear understanding of the financial mistakes made in the recent past and are determined that they will not be repeated in areas such as asset sales and capital works

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

- Operating deficit results excluding capital grants and contributions are forecast to remain below the benchmark target of negative 4% for the 10 year forecast period. This is a significant issue that could impact the long term financial sustainability of the Council. We recommend Council considers its options for improving its performance in this area, either by further and on-going cost controls (particularly employee costs), or securing new or additional revenue
- Council should examine their capital expenditure priorities. The gains from the disposals of assets are likely to be one off, and may be best invested in addressing the infrastructure backlog
- As Council improves its asset data (particularly in the area of drainage) this data should be fed into Council capital expenditure forecasts and LTFP
- TCorp is unable to make any recommendation on the borrowing capacity of Council beyond LIRS until the audited 2012 results are published, to ascertain the impact of the new management team

New South Wales Treasury Corporation

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000's)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Revenue					
Rates and annual charges	17,565	17,693	16,334	(0.7%)	8.3%
User charges and fees	5,060	4,002	3,142	26.4%	27.4%
Interest and investment revenue	608	393	514	54.7%	(23.5%)
Grants and contributions for operating purposes	3,726	3,744	3,314	(0.5%)	13.0%
Other revenues	2,635	2,449	3,757	7.6%	(34.8%)
Total revenue	**29,594**	**28,281**	**27,061**	**4.6%**	**4.5%**
Expenses					
Employees	16,060	15,356	14,331	4.6%	7.2%
Borrowing costs	998	660	512	51.2%	28.9%
Materials and contract expenses	8,272	9,451	7,378	(12.5%)	28.1%
Depreciation and amortisation	5,707	3,231	2,948	76.6%	9.6%
Other expenses	7,705	6,442	5,791	19.6%	11.2%
Total expenses	**38,742**	**35,140**	**30,960**	**10.3%**	**13.5%**
Operating result (excluding capital grants and contributions)	**(9,148)**	**(6,859)**	**(3,899)**	**(33.4%)**	**(75.9%)**
Operating result (including capital grants and contributions)	**(6,169)**	**(3,587)**	**(1,637)**	**(72.0%)**	**(119.1%)**

Table 2 - Items excluded from Income Statement

Excluded items					
Grants and contributions for capital purposes	2,979	3,272	2,262	(9.0%)	44.7%
Interest revenue/ (losses)	2,233	258	(469)	765.5%	(155.0%)
Net gain from disposal of assets	13,941	6,599	5,291	111.3%	24.7%

Table 3 - Balance Sheet

Balance Sheet ($'000's)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and equivalents	16,187	5,935	4,868	172.7%	21.9%
Investments	2,541	3,264	3,006	(22.2%)	8.6%
Receivables	1,826	1,811	2,408	0.8%	(24.8%)
Inventories	3	4	3	(25.0%)	33.3%
Other	538	638	229	(15.7%)	178.6%
Non-current assets classified as held for sale	5,645	7,188	9,445	(21.5%)	(23.9%)
Total current assets	26,740	18,840	19,959	41.9%	(5.6%)
Non-current assets					
Infrastructure, property, plant & equipment	336,441	445,187	270,715	(24.4%)	64.4%
Investments accounted for using the equity method	3,343	3,200	0	4.5%	N/A
Intangible assets	8,000	0	0	N/A	N/A
Total non-current assets	347,784	448,387	270,715	(22.4%)	65.6%
Total assets	**374,524**	**467,227**	**290,674**	**(19.8%)**	**60.7%**
Current liabilities					
Payables	8,444	4,743	5,109	78.0%	(7.2%)
Borrowings	8,462	81	579	10346.9%	(86.0%)
Provisions	4,453	4,917	3,930	(9.4%)	25.1%
Total current liabilities	21,359	9,741	9,618	119.3%	1.3%
Non-current liabilities					
Payables	120	0	0	N/A	N/A
Borrowings	7,956	16,388	12,248	(51.5%)	33.8%
Provisions	132	158	673	(16.5%)	(76.5%)
Total non-current liabilities	8,208	16,546	12,921	(50.4%)	28.1%
Total liabilities	**29,567**	**26,287**	**22,539**	**12.5%**	**16.6%**
Net assets	**344,957**	**440,940**	**268,135**	**(21.8%)**	**64.4%**

Table 4-Cashflow

Cash Flow Statement ($'000's)	Year ended 30 June		
	2011	**2010**	**2009**
Cash flows from operating activities	5,246	(63)	1,678
Cash flows from investing activities	5,057	(2,512)	(8,232)
Proceeds from borrowings and advances	0	4,200	4,500
Repayment of borrowings and advances	(51)	(558)	(76)
Cash flows from financing activities	(51)	3,642	4,424
Net increase/(decrease) in cash and equivalents	**10,252**	**1,067**	**(2,130)**
Cash and equivalents	16,187	5,935	4,868

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Appendix B Glossary

<u>Asset Revaluations</u>

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.

<u>Collateralised Debt Obligation (CDO)</u>

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.

<u>Division of Local Government (DLG)</u>

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.

<u>Depreciation of Infrastructure Assets</u>

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

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

Infrastructure backlog is defined as the estimated cost to bring infrastructure 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 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.