New South Wales
Treasury Corporation

Great Lakes Council

Financial Assessment and Benchmarking Report

4 October 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 Great Lakes Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Great Lakes 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 Great Lakes Council (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 $18.0m relating to Council's Road and Bridge Rehabilitation Program.

TCorp's approach has been to:

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

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

- The underlying operating performance (measured using EBITDA) has shown its strongest result in 2011
- The Unrestricted Current Ratio has remained above the benchmark in all three years indicating that Council had sound liquidity throughout the period.
- Council has been conducting an ongoing organisation-wide service level review that is identifying efficiencies and cost savings along with possible revenue generating opportunities
- Council has been granted an SRV of 8.0% p.a. including the rate peg for three years from 2011/12 that should assist the financial sustainability of Council by funding specific capital programs.
- Total borrowings have increased by $10.6m to $29.1m in 2011 indicating Council is utilising debt funding to manage their financial requirements

Council's reported Infrastructure Backlog of $38.5m in 2011 represents 6.6% of its infrastructure asset value of $586.3m. Other observations include:

- The Infrastructure Backlog has reduced from $59.1m in 2009, and then $73.2m in 2010 as a result of Council's improved asset management systems providing a more reliable information

- Capital expenditure has been adequate over the three years when measured by the Capital Expenditure Ratio
- Expenditure for asset maintenance and renewals has reduced over the period and has not been sufficient when compared to the Asset Maintenance Ratio and Buildings and Infrastructure Asset Renewal Ratio benchmarks.

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

- Operating deficits are forecast each year with the largest in 2013 of $7.3m (12.6%) followed by a gradual improvement through to 2022 when the deficit is $2.9m (3.6%)
- Council should not have liquidity issues as indicated by an Unrestricted Current Ratio above benchmark in every year
- Council has a cumulative shortfall of $26.9m when comparing the scheduled capital expenditure to depreciation expenses with the Capital Expenditure Ratio below benchmark from 2015 to 2022

In our view, the Council has the capacity to undertake the combined borrowings of $18.0m for the LIRS project. This is based on the following analysis:

- The DSCR is scheduled to fall below benchmark between 2013 and 2021 however the lowest ratio is 1.51x in 2016, indicating that Council will still be able to manage the associated debt commitments. The ratio also takes into account the non LIRS $20.1m additional borrowings scheduled within the forecast
- The Interest Cover Ratio remains above the benchmark in all 10 years

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

- Council's financial flexibility, as indicated by the Operating Ratio and Own Source Operating Revenue Ratio, is generally comparable to the group's average
- Council's liquidity position is adequate and it is generally similar to the group's average
- Council is more highly leveraged than its peers. Both the DSCR and Interest Cover Ratios were adequate over the review period
- Council had an overall lower level of Infrastructure Backlog than its peers; however did not achieve the benchmark throughout the review period. While Council's asset maintenance underperformed benchmark and the group's average, its capital expenditure outperformed benchmark and was generally comparable to the group's average

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 focused 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

Great Lakes Council	
Locality and Size	
Locality	Hunter
Area	3,373 km²
DLG Group No.	4
Demographics	
Population	34,430
% under 18	21%
% between 19 and 59	40%
% over 60	39%
Expected population 2021	42,900
Operations	
Number of employees	298
Annual revenue	$65m
Infrastructure	
Roads	1,282 km
Bridges	181
Infrastructure backlog value	$38.5m
Total infrastructure value	$586.3m

Great Lakes Council Local Government Area (LGA) is located about three hours drive north of Sydney on the Mid-North Coast between Port Stephens in the south, Taree in the north and west to the slopes of the Great Dividing Range.

The LGA is comprised of two main population centres - Forster/Tuncurry in the north and Tea Gardens/Hawks Nest to the south. In addition there are a number of towns and villages within the region, each with their own unique character, including Stroud, Bulahdelah, Coolongolook, Nabiac and Pacific Palms.

Economically the LGA has historically relied on agricultural related industry, however approximately 60% of the jobs in the LGA now relate to retail, accommodation and food services, health care and social assistance, education and training. This is due to increased retirees moving to the region and people migrating for a ‘sea’ or ‘tree’ change.

The LGA has an average growth rate of 1.1% p.a. across the five years between 2006 and 2011, below the 1.4% p.a. average for NSW LGA’s.

Within Council's total infrastructure, property, plant and equipment (IPP&E) of $673.3m at 30 June 2011 there are:

- $474.2m of roads, bridges and footpaths
- $69.2m of stormwater drainage
- $26.4m of specialised buildings
- $9.2m of other structures
- $5.1m of non specialised buildings

2.4: LIRS Application

Council has made one LIRS application.

Project: Great Lakes Council Road and Bridge Rehabilitation Program.

Description: The program provides for the replacement of approximately 12 timber bridges with concrete at a cost of $5.0m and the rehabilitation of $13.0m of urban and rural sealed road pavements which are classified as being in poor or very poor condition within Council's Asset Management Plan.

Amount of loan facility: $18.0m to be drawn down across a three year period from 2012 to 2015.

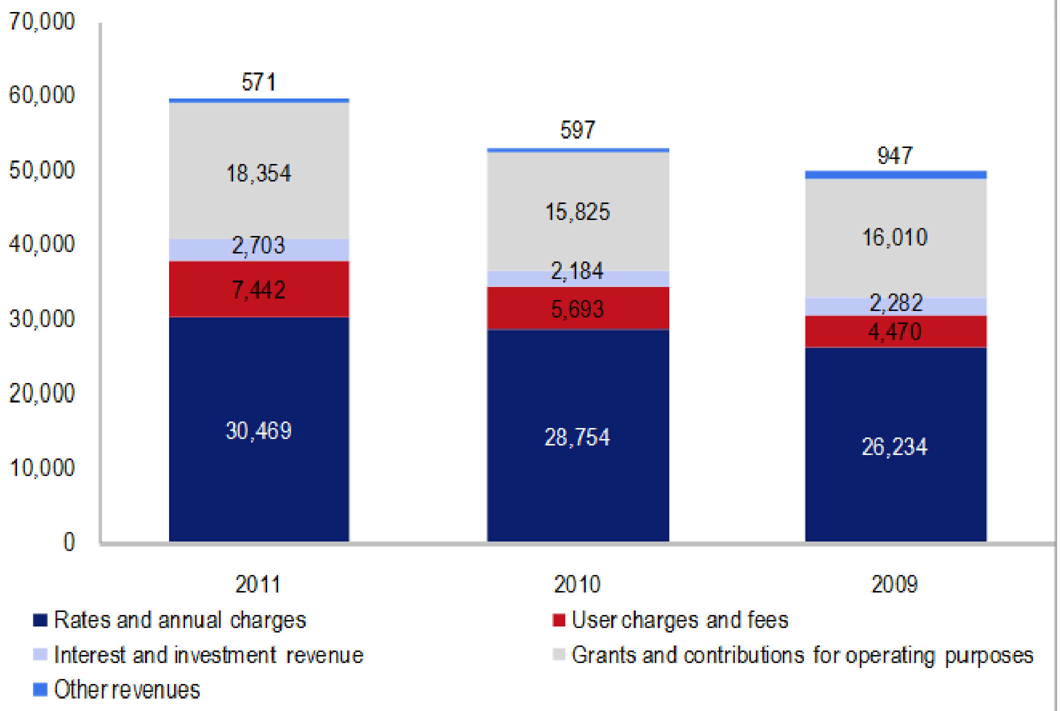
Term of loan facility: 10 years

Section 3 Review of Financial Performance and Position

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

3.1: Revenue

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



Key Observations

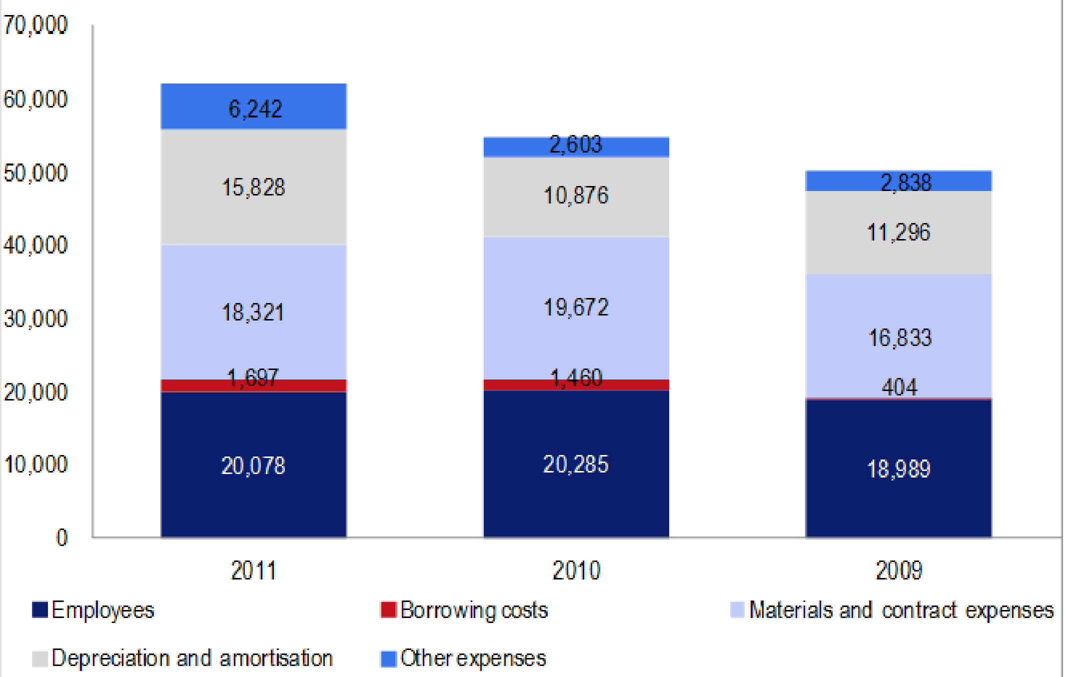
- Operating revenues have increased by $9.6m over the period, representing an average increase of 9.6% p.a.
- Rates and annual charges have increased in each year above the rate peg equating to 8.0% p.a. The introduction of a new non-domestic waste management services charge was the main driver in 2011, while a 6% environmental special rate in place until 2014 (included in general rate revenue) and increased domestic waste management charges were responsible in 2010.
- User fees and charges have grown by $3.0m over the period when the caravan park revenue has been excluded received in 2009 and 2010. The main drivers for the $3.0m increase were domestic waste management service charges in 2010 and private works in 2011.

  The caravan parks were transferred to the Land and Property Management Authority (LPMA) as part of an ongoing State Government directive.

- Operating grants and contributions varied over the period with the 2011 increases due to increased road contributions from the RTA (now RMS) and home and community care grants. They make up 30.8% of the total operating revenue in 2011, representing a significant source of funding for Council.

3.2: Expenses

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



Key Observations

- Operating expenses have increased by $11.8m over the period, representing an average 11.7% p.a.

- Employee expenses are the Council's largest expense and after an increase in 2010 it reduced marginally in 2011. The decrease in 2011 was due to lower workers compensation insurance premiums and Council not filling positions vacated during the year. The 2010 increase was due to higher superannuation payments of $0.5m relating to the defined benefit plan and employee leave entitlements of $0.5m. The overall increase was 5.7% across the period.

- Materials and contracts fluctuated over the period with the increase in 2010 due to additional contractor works for waste collection, road works and river environment studies. A reduction in these works in 2011 was the reason for the decrease in that year.

- Depreciation has seen the largest increase over the period of $4.5m, despite a decrease in 2010, representing a 40.0% increase from 2009. The increase relates to the Asset

Revaluations that increased the value of roads, bridges, footpaths and drainage infrastructure assets and their associated depreciation.

- The increase in borrowing costs relates to Council utilising increased borrowings over the period although the 2009 figure is deflated due to a $0.7m discount adjustment for remediation liabilities.

- The other expenses in 2009 and 2010 have been adjusted downwards as this is where TCorp deducted the caravan park expenses from for these years, as there is not one specific expense category where the cumulative expenses are stated.

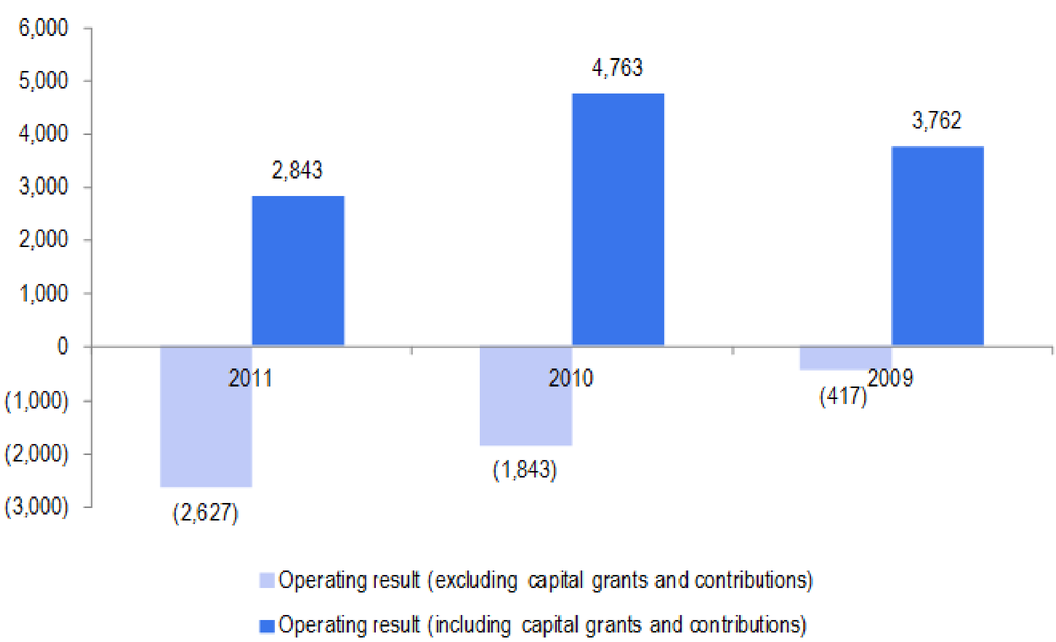
3.3: Operating Results

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

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

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

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



Key Observations

- Council has posted operating deficits in all three years when capital grants and contributions are excluded. The downward trend has been due to expenses growing at a faster rate than revenues over the period.

- The $2.8m increase in materials and contract expenses in 2010, and the $5.0m increase in depreciation in 2011 are the main expense items that have driven the expense growth.

- The depreciation amounted to $15.8m in 2011, which has increased substantially over the past three years following the Asset Revaluations process. Whilst the non cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June		
	2011	**2010**	**2009**
EBITDA ($'000s)	14,898	10,493	11,283
Operating Ratio	(4.4%)	(3.5%)	(0.8%)
Interest Cover Ratio	8.78x	7.19x	27.93x
Debt Service Cover Ratio	3.04x	2.54x	3.81x
Unrestricted Current Ratio	2.85x	2.84x	2.99x
Cash Expense Ratio	1.6 months	0.7 months	1.1 months
Own Source Operating Revenue Ratio	58.3%	57.7%	56.7%
Net assets ($'000s)	678,635	667,558	455,412

Key Observations

- The Operating Ratio has fallen below the benchmark in 2011 in line with the downward trend in the operating result.

- Council's underlying performance (measured using EBITDA) has also shown its strongest performance in 2011. This increase has improved the Interest Cover Ratio back over double the benchmark. The 2009 ratio was high due to the reduced interest expense in that year, relating to the $0.7m discount adjustment for remediation liabilities.

- The DSCR has remained above the benchmark for all three years, with the higher EBITDA contributing to the ratio climbing back above 3.0 times in 2011.

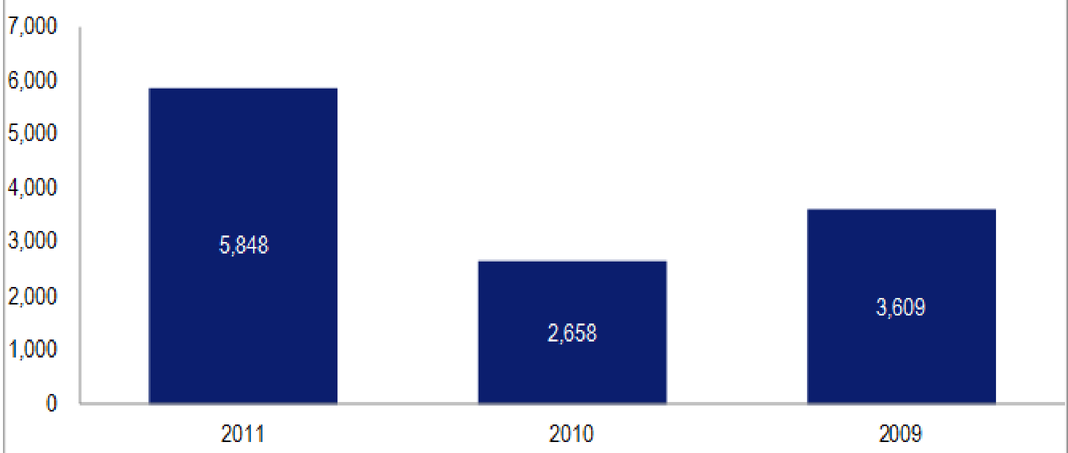
- Council's total debt stands at $29.1m in 2011, an increase from $18.5m in 2009. This equates to 4.3% of Net Assets in 2011. Over the three year period Council borrowed $8.1m in respect of a new land fill site and $7.0m for road infrastructure renewals and maintenance.

- The Unrestricted Current Ratio has remained above the benchmark indicating that the Council have had sufficient liquidity throughout the period.

- The Cash Expense Ratio has remained below the benchmark in all three years however Council have the majority of their current assets held in current investments. In 2011 the total of internally restricted and unrestricted cash and cash equivalents, and current investments totalled $25.4m, compared to cash and cash equivalents alone that totalled $5.8m.
- The Own Source Operating Revenue Ratio is slightly below the benchmark in all three years but is on an upward trend. This highlights that Council rely on grants and contributions to boost their total revenue.
- The increase in Net Assets relates to the Asset Revaluations with a $207.1m increase in 2010 relating to road, bridge, footpath and drainage infrastructure assets and $18.2m relating to community land and other structures in 2011.
- When the Asset Revaluations are excluded there has been a $15.6m increase in the IPP&E asset base over the three year period, compared to the written down value of disposed assets and depreciation.

3.5: Statement of Cashflows

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



Key Observations

- Council's cash and cash equivalents have fluctuated over the period and increased to their highest level in 2011. Overall the cash and cash equivalents, and investments combined have increased across the three year period by $8.4m to $48.8m.
- Of the $48.8m, $23.4m is externally restricted, $20.3m is internally restricted and $5.1m is unrestricted.

- Within the investments portfolio of $42.9m, $35.5m is held in current deposits, $4.0m in non-current deposits, $1.5m in CDOs due to mature in 2012, $0.9m in equity linked notes, and $1.0m in longer term Negotiable Certificates of Deposits and FRNs.

- The increase in both cash and cash equivalents, and investments, along with a strong Unrestricted Current Ratio indicates that Council had sufficient liquidity to manage their day to day liabilities.

3.6: Capital Expenditure

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

3.6(a): Infrastructure Backlog

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

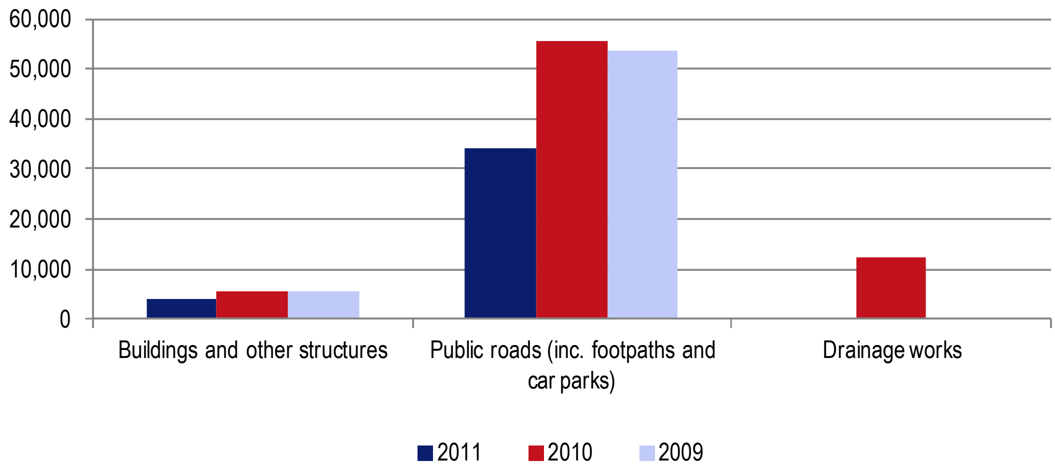
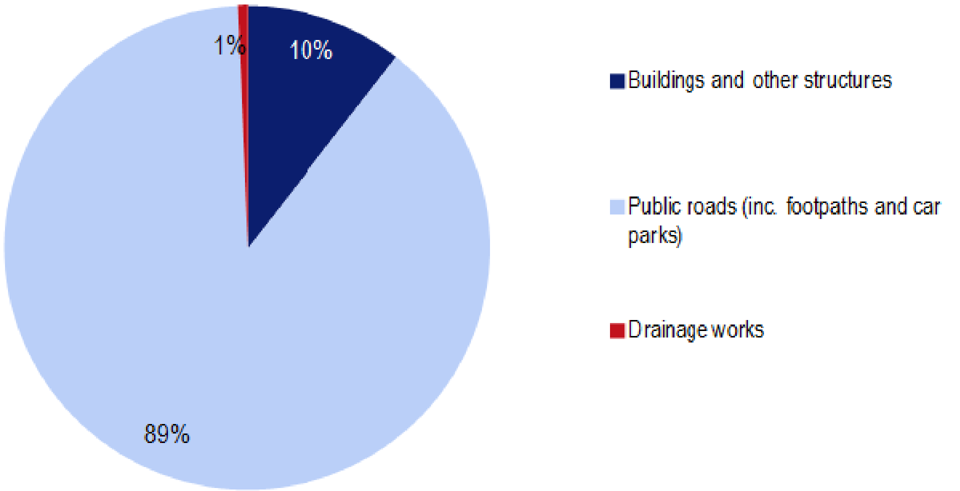


Figure 6 - Infrastructure Backlog Composition for 2010/11



The Infrastructure Backlog has fluctuated over the period and is stated at its lowest level in 2011 at $38.5m. This is a decrease from $73.2m in 2010 and is because Council have refined their revaluation process and their asset management plan.

The 2011 Infrastructure Backlog is heavily dominated by Public Roads which make up $34.2m of the total.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000s)	38,469	73,216	59,137
Required annual maintenance ($'000s)	12,569	17,741	0
Actual annual maintenance ($'000s)	7,138	10,243	0
Total value of infrastructure assets ($'000s)	586,316	596,410	342,633
Total assets ($'000s)	730,119	711,623	491,887
Building and Infrastructure Backlog Ratio	0.07x	0.12x	0.17x
Asset Maintenance Ratio	0.57x	0.58x	N/A
Building and Infrastructure Renewals Ratio	0.72x	1.02x	1.32x
Capital Expenditure Ratio	1.41x	1.54x	1.28x

The Infrastructure Backlog Ratio has been on a downward trend over the period. This positive trend is because of an increase in the value of the infrastructure assets from 2010 but also a reduction in the backlog amount in 2011.

The Asset Maintenance Ratio data was only available for 2010 and 2011 and the ratios for both years indicate that Council is not investing sufficient funds to maintain the asset base. This could impact negatively on the backlog figure in future years. The 2009 special schedules were not fully complete and is the reason for the absence of the 2009 ratio.

The Building and Infrastructure Renewals Ratio has been on a negative trend over the period and fell below the benchmark in 2011.

Council have invested adequate capital expenditure in all three years when analysing the Capital Expenditure Ratio. Over this period Council has invested $15.6m more in asset additions than the written down value of disposed assets and the depreciation of IPP&E combined.

3.6(c): Capital Program

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

Capital Program ($'000s)	Year ended 30 June		
	2011	**2010**	**2009**
New capital works	7,615	4,792	0
Replacement/refurbishment of existing assets	15,533	12,492	0
Total	**23,148**	**17,284**	**0**

Special Schedules 7 and 8 were not completed in 2009 as this was not a compulsory requirement.

Council's 2011 capital programs included:

- Myall Way upgrade - $1.2m
- Southern Parkway, Forster - $0.8m
- Bramble Parade Wetland refurbished
- Several sections of The Lakes Way reconstructed - $2.0m
- Sandy Creek Bridge on Booral Road reconstructed - $0.6m

- Lavinia Murray Bridge at Bunyah reconstructed - $0.8m
- Drainage piped past Bulahdelah Nursing Home - $0.3m

Other programs also listed in 2011 are:

- Palms Estate water treatment devices
- Smiths Lake Recreation Ground - netball court, picnic shelters and landscaping
- Dredging of Corrie Channel
- Upgrade to community halls - Bungwahl, Hawks Nest, Coolongolook and Pacific Palms
- Clarkson Street Nabiac cycleway construction
- Clarkson Street Nabiac road rehabilitation
- Near completion of a $2.2m addition to the Aquatic Centre in Forster
- Near completion of the access road to Council's landfill at Minimbah

3.7: Specific Risks to Council

- Inability to reduce Infrastructure Backlog. Council have historically funded a portion of their maintenance funding through loan borrowings as their operating revenues have been limited. This impacts their ability to finance their capital expenditure and reduce the backlog. The Infrastructure Backlog will increase over time unless this trend is addressed. Council is committed to reducing their reliance on borrowings for maintenance by 10%p.a. and has evidenced that this is being achieved.
- Climate change and sea level changes. Council has a large area of coastline and a number of areas very susceptible to sea level rise. One example relates to the beach at Winda Woppa where Council has to spend approximately $0.3m p.a. to replenish the sand but the total rates received by residents in the area only amounts to $0.33m. This cost has increased from $0.1m historically. Council has established a Climate Change Co-ordination Committee to identify the impacts and develop mitigation strategies and policies.

- Ageing population. The LGA is a popular place for the 'sea and tree' retirees and by 2021 the proportion of residents over 65 is expected to be over 30%. Council is mitigating the demographic shift by amending urban design and infrastructure provision within their town planning policies to service the ageing population.

- Ageing workforce. Council had 57% of employee's aged 45 or over in 2010 and 21% aged 55 or over. Council find it difficult to implement succession planning given the size of Council whereby a clear career path is not easily identifiable within the organisational structure. This makes it hard to transfer skill knowledge as employee's get towards retirement. Retaining skilled staff is also a challenge as Council battles against other industries such as mining. The development of Council's Workforce Management Plan is focusing Council's efforts to mitigate these issues.

- Natural Resources Management. The community rated the protection of waterways as their number one priority and protection of the natural environment as the number three priority in a 2008 survey of 38 separate priorities. The preservation of the natural environment and waterways is also vital to economic output with key industries of rock oyster production and fishing, along with tourism all relying on the natural resources. Council has developed a number of plans and strategies to preserve the quality of the LGA including the environmental levy that has been in place for 11 years. This levy is due to expire in 2015 and at present Council has not had approval for this to continue.

- Unemployment – especially amongst the young. The LGA has had an unemployment rate of 9% over the three year period, one of the highest in the Hunter Region. If unemployment remains high then younger people will most probably look outside the LGA for work and may end up having to move. This will compound the problem of an ageing population over the longer term. Council face the challenge of promoting and assisting economic development while respecting the community's wishes in relation to the natural environment preservation. Council's Community Strategic Plan is focusing on this issue within the 'planning for balance' key direction.

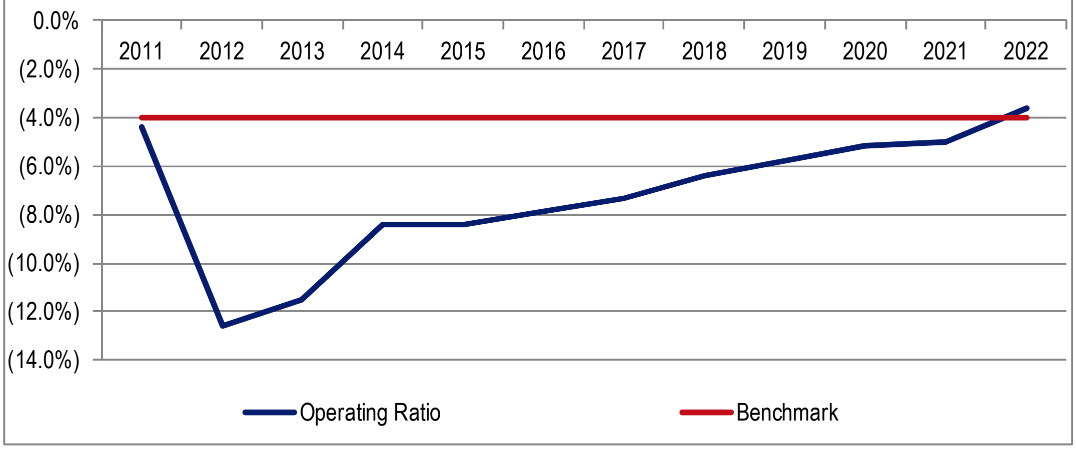
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $18.0m loan with the LIRS subsidy. We have therefore made a manual adjustment to the forecast to remove the subsidy after Council provided the relevant figures.

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

4.1: Operating Results

Figure 7- Operating Ratio



Council has forecast the weakest Operating Ratio in 2012 at negative 12.6%, equating to a deficit of $7.3m.

Council was granted an SRV of 8.0% p.a. including the rate peg for three years inclusive of 2012 that should assist the financial sustainability of Council by funding specific capital programs.

Despite the SRV in 2012, Council's operating revenues decreased by $1.6m due to reduced user charges and fees, and operating grants and contributions. At the same time operating expenses increased by $3.1m, leading to the weakest performance over the forecast.

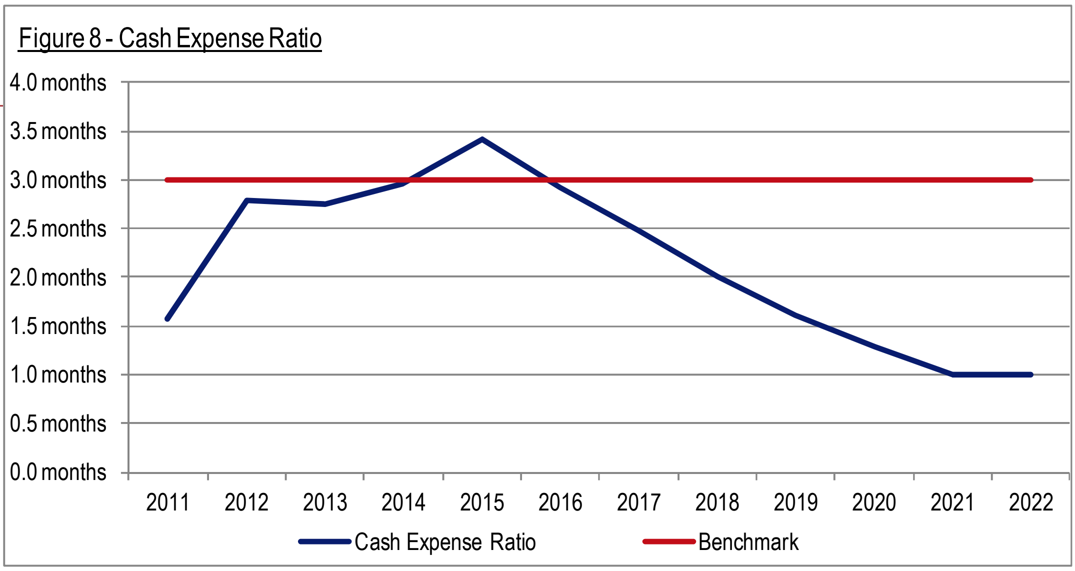
From 2012 Council is expecting the Operating Ratio to improve each year with the deficit in 2022 to be slightly better than the benchmark at negative 3.6%, or $2.9m.

The LIRS loan is scheduled to drawn down over a three year period with $4.9m utilised in 2013, $6.6m in 2014 and $6.5m in 2015.

4.2: Financial Management Indicators

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

Liquidity Ratios



Council is below the benchmark in all years excluding 2015 as they proactively utilise their cash reserves in short term deposits classified under current investments. Council is forecasting their cash and equivalents to reduce from $15.0m in 2015 to $5.6m in 2022.

When current investments are included the ratio is above the benchmark in all 10 years but is on a downward trend. The figure below includes all current investments however it is to be noted that in 2011 approximately 42% of cash and cash equivalents, and current investments were externally restricted.

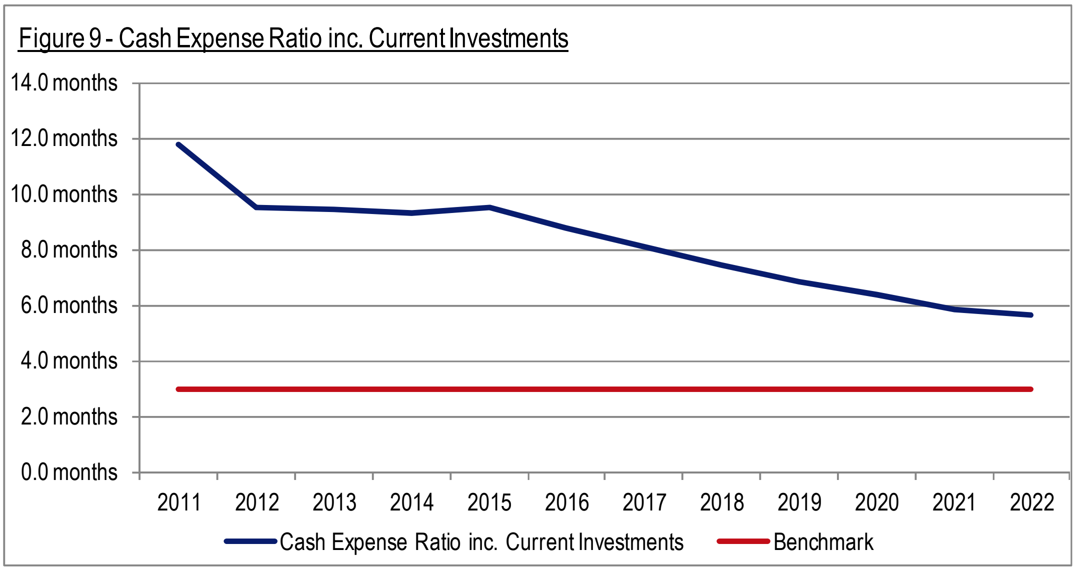


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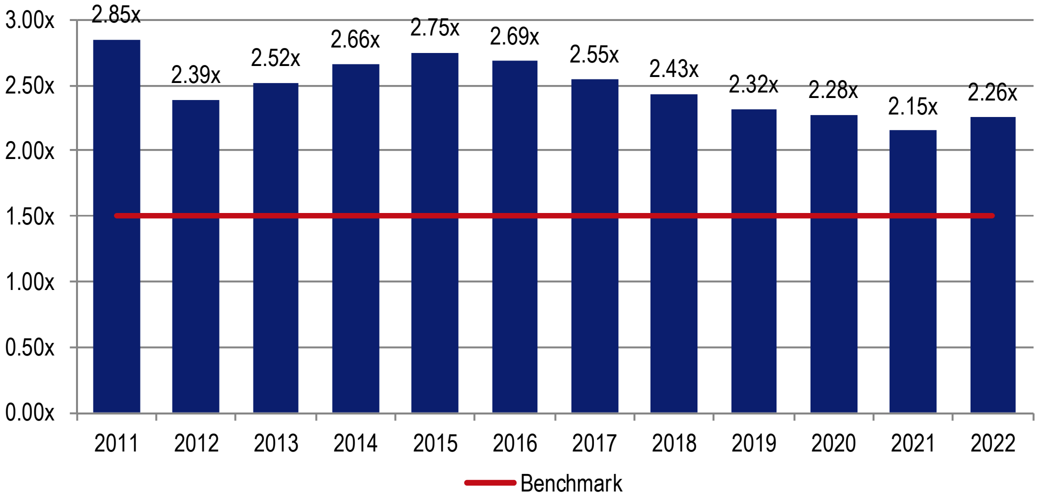
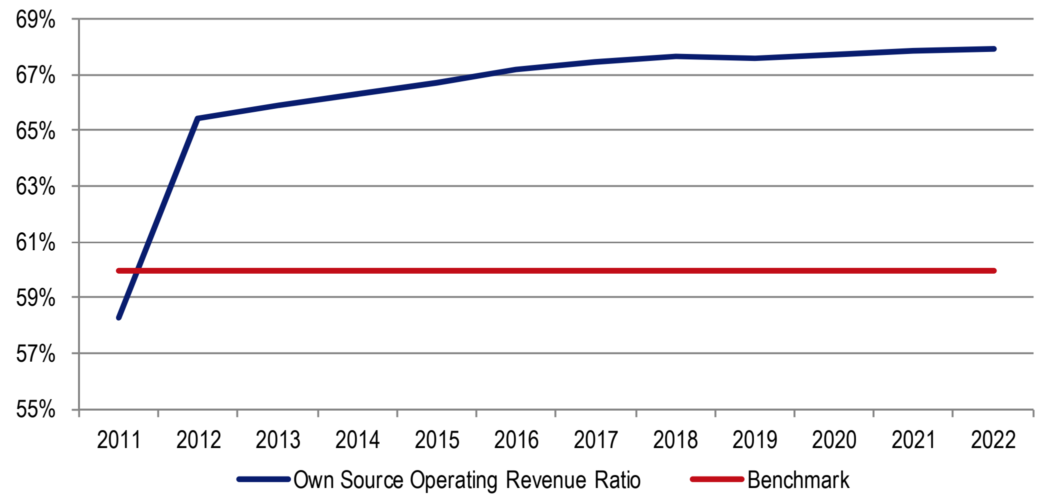
Figure 10 - Unrestricted Current Ratio



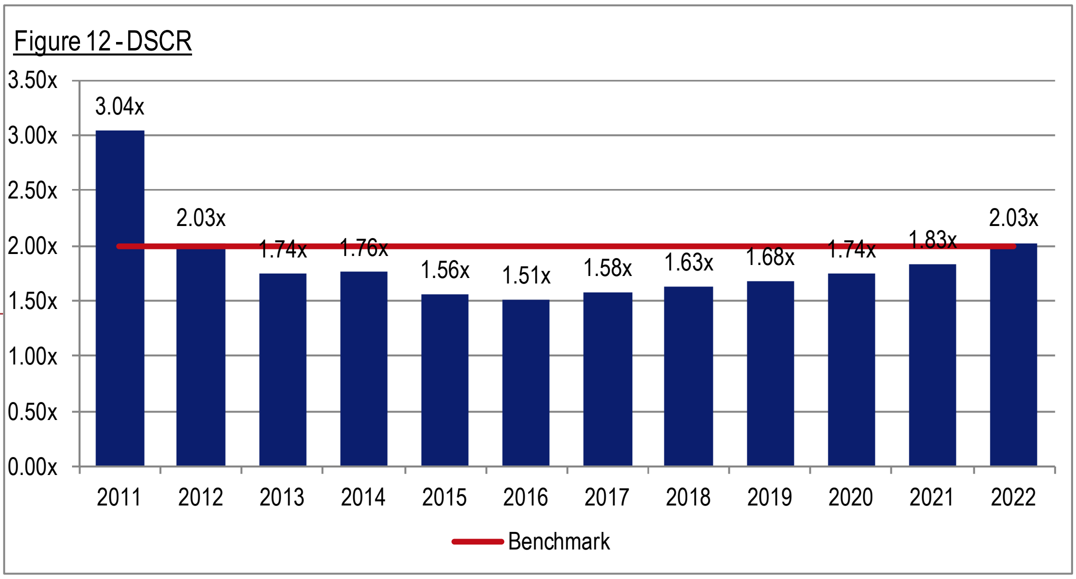
Council has forecast the Unrestricted Current Ratio to be below the historical results in all 10 years. The ratio still remains above the benchmark for every year indicating Council should not experience liquidity issues.

Fiscal Flexibility Ratios

Figure 11 - Own Source Operating Revenue Ratio

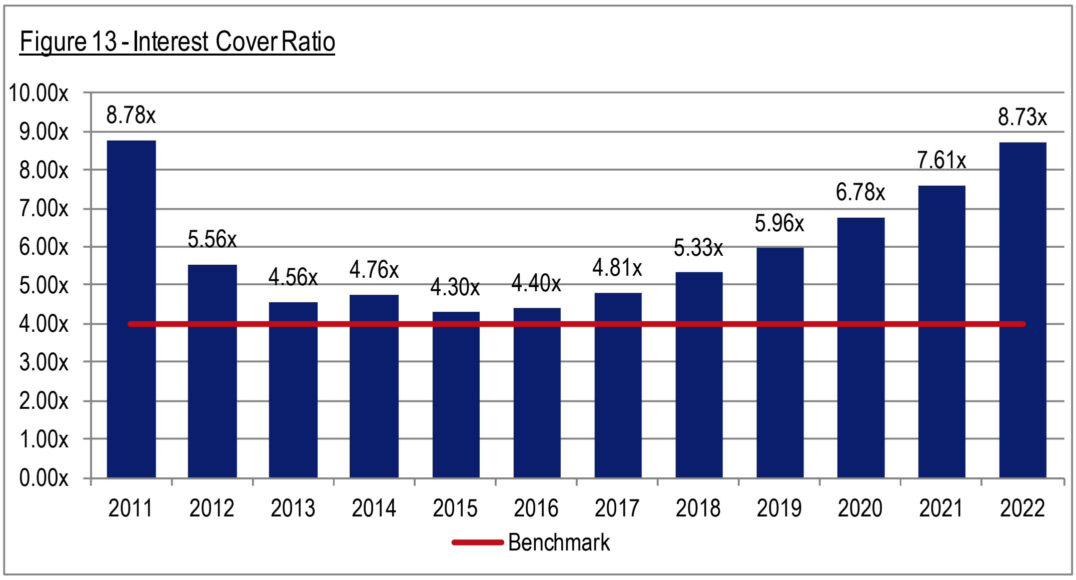


The Own Source Operating Revenue Ratio remains above the benchmark for each year of the forecast from 2012 onwards. This is in contrast the historic result being slightly below the benchmark. The ratio is rising marginally over the lifetime of the forecast due to capital grants and contributions forecast being lower than historically received. This skews the proportion of Own Source Revenue Ratio upwards.



The DSCR is forecast to be below benchmark in 2013, the first year of the LIRS project draw down, and to remain below the benchmark until 2022. In addition to the $18.0m LIRS borrowings, Council has scheduled further borrowings of $20.1m during the 10 year period.

Council's total borrowings peak at $48.7m in 2015. Council is scheduled to repay in excess of $5m in each year from 2015 therefore it appears that the majority of Council's borrowings have a 10 year term or less.

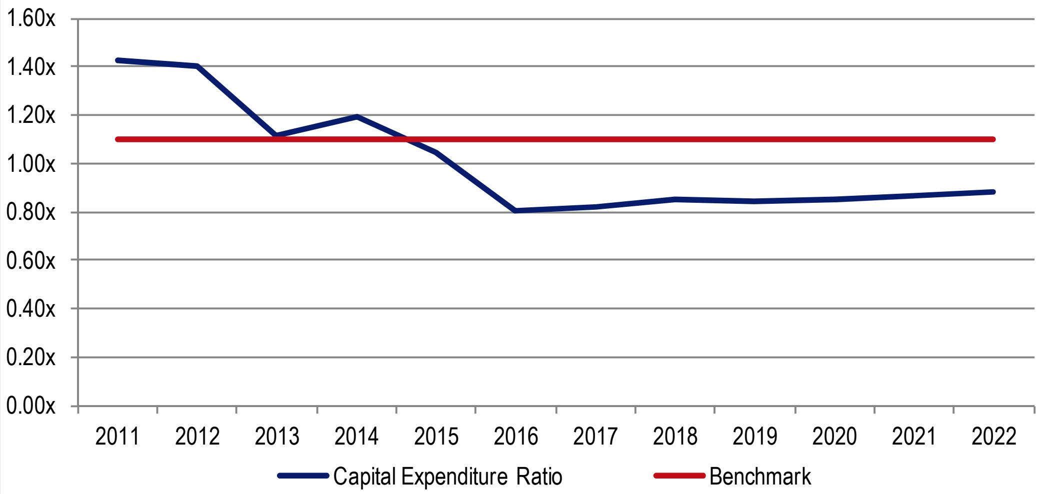


The Interest Cover Ratio decreases as the LIRS loans and the majority of the additional borrowings are utilised between 2013 and 2015 however unlike the DSCR, the ratio remains above the benchmark for the duration of the forecast and improves as the borrowings are repaid and the interest cost reduces from the high of $3.0m in 2015.

4.3: Capital Expenditure

New South Wales
Treasury Corporation

Figure 14 - Capital Expenditure Ratio



While Council has historically been above the benchmark for the Capital Expenditure Ratio, the ratio is forecast to be below the benchmark from 2015 onwards. Over the forecast period from 2013 to 2022, the cumulative shortfall of capital expenditure against depreciation is $26.9m.

This shortfall will likely have an impact on the quality of Council's assets and impact the Infrastructure Backlog figure.

4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

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

Key Observations and Risks

- As part of Council's on-going organisation-wide service level review it has already revised certain services in the past however the LTFP base case was completed on the assumption that services are maintained at the current service levels over the full 10 years
- The three year SRV that was partially approved by IPART for 2012 – 2014 was to provide an additional layer of funding to improve Council's financial sustainability through a number of capital works programs
- Other revenues are forecast to more than double in 2013 to $1.3m as this is the first year when rental income will be received from the supermarket development at Tuncurry. It is then forecast to increase in 2014 by a further 36.0% as this is the first full financial year of rental income being received
- Other expenses are forecast to increase by 19.1% in 2013 and between 8.8% to 5.8% from 2014 to 2017. These increases mainly relate to the State levies for the domestic waste management program along with higher than CPI increases for water and sewerage charges as well as electricity and other levies to State Government for the Rural Fire Service and State Emergency Services but we note that some of these increases are offset by corresponding revenue increases.
- TCorp considers the majority of the assumptions behind the LTFP reasonable

4.5: Borrowing Capacity

When analysing the financial capacity of the Council, we believe they will not be able to incorporate additional loan funding in addition to the LIRS loan facilities of $18.0m and the scheduled $20.1m additional borrowings already included within forecast. This observation is because as indicated in Section 4.2, Council will be below the DSCR benchmark of 2.00x from 2013 to 2021.

Section 5 Benchmarking and Comparisons with Other Councils

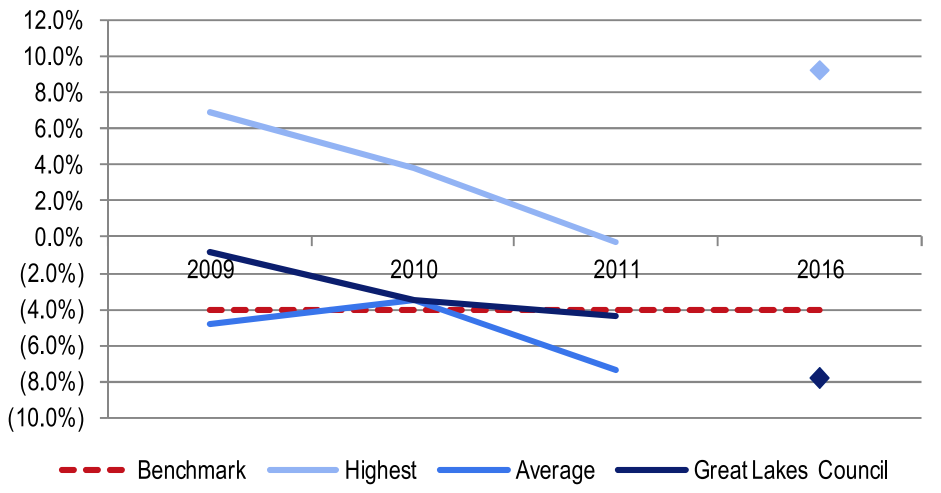
As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis (that is, for councils that operate more than one fund, the results of all funds are included). This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 4. There are 32 councils in this group and at the time of preparing this report, we have data for 19 of these councils.

In Figure 15 to Figure 21, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 22 to 24 do not include the 2016 forecast position as those numbers are not available.

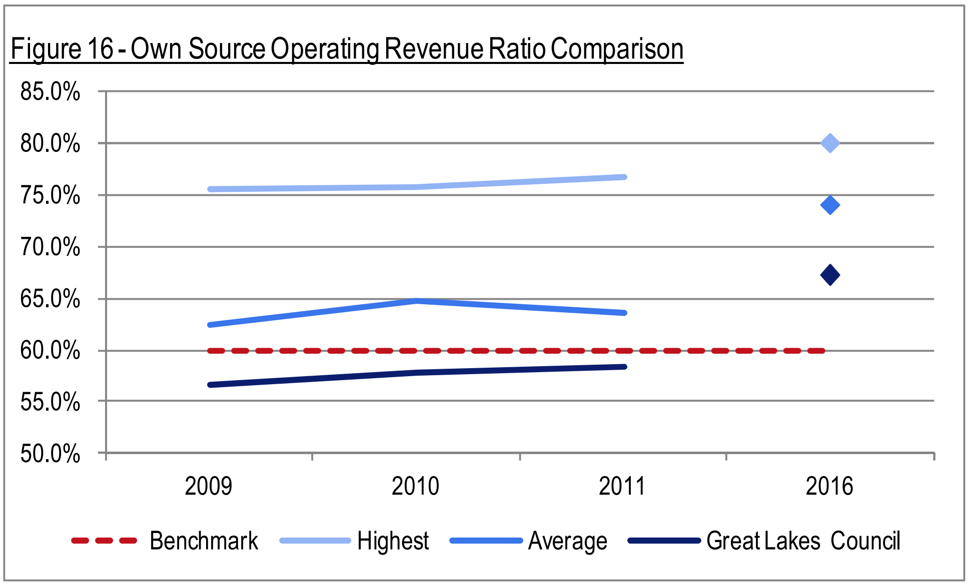
Where no highest line is shown on the graph, this means that Council is the best performer in its group for that Ratio.

Financial Flexibility

Figure 15 - Operating Ratio Comparison



Council's Operating Ratio generally tracked the benchmark and outperformed the group's average in the past three years. However, Council's operating results are forecast to fall below benchmark over the medium term to match the average of councils in the group.



Council's own sourced revenue was below benchmark and the group's average in the past three years. This indicates that fiscal flexibility was insufficient over the review period, with Council relying more heavily on external funding than its peers.

Council is forecast to improve its Own Source Operating Revenue Ratio over the medium term, due to expected reductions in capital grants and contributions.

Overall, Council's financial flexibility is comparable to the other councils in the group.

Liquidity

Figure 17 - Cash Expense Ratio Comparison

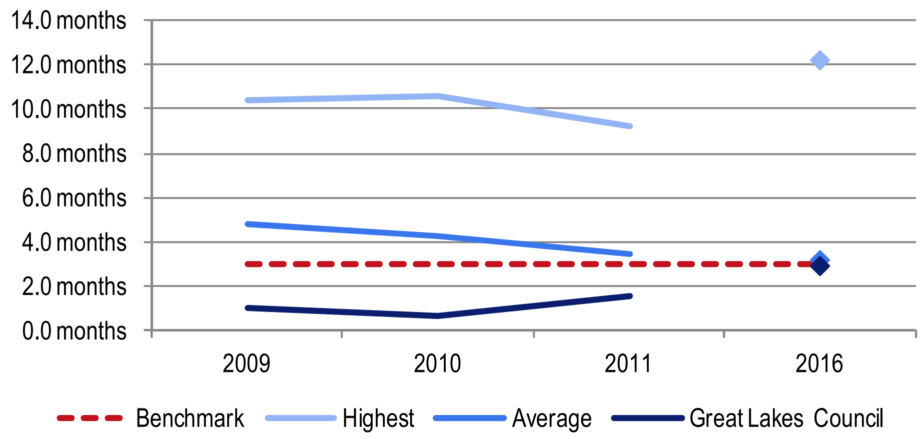
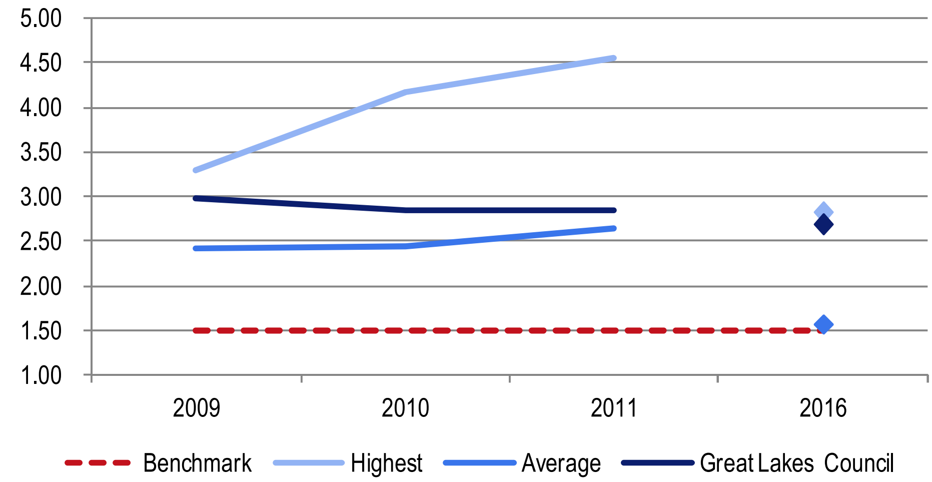


Figure 18 - Unrestricted Current Ratio Comparison



Council's Cash Expense Ratio was below benchmark and the group's average in the past three years, although it is on an upward trend and expected to improve to benchmark levels over the medium term.

Council's Unrestricted Current Ratio outperformed the average council in the group over the review period and is forecast to remain strong in future years.

On average over the past three years, Council's liquidity position has been adequate and comparable to the other councils in the group.

Debt Servicing

Figure 19 - Debt Service Cover Ratio Comparison

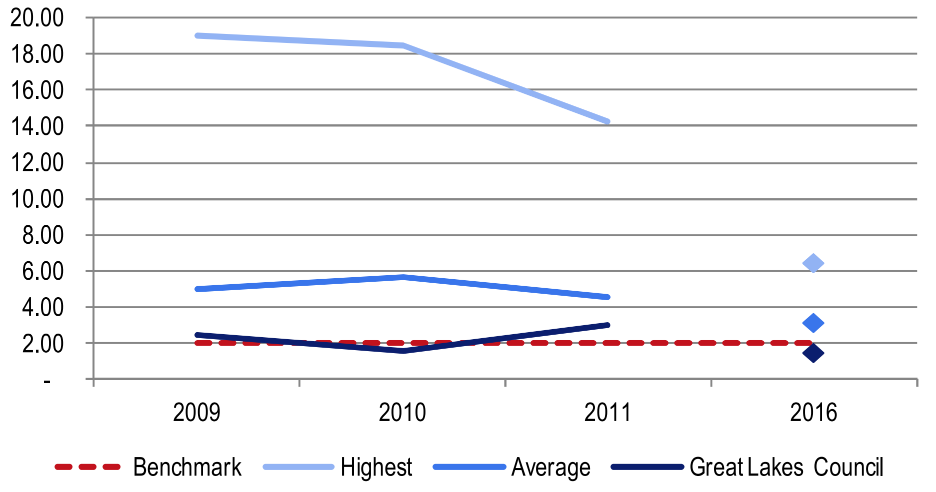
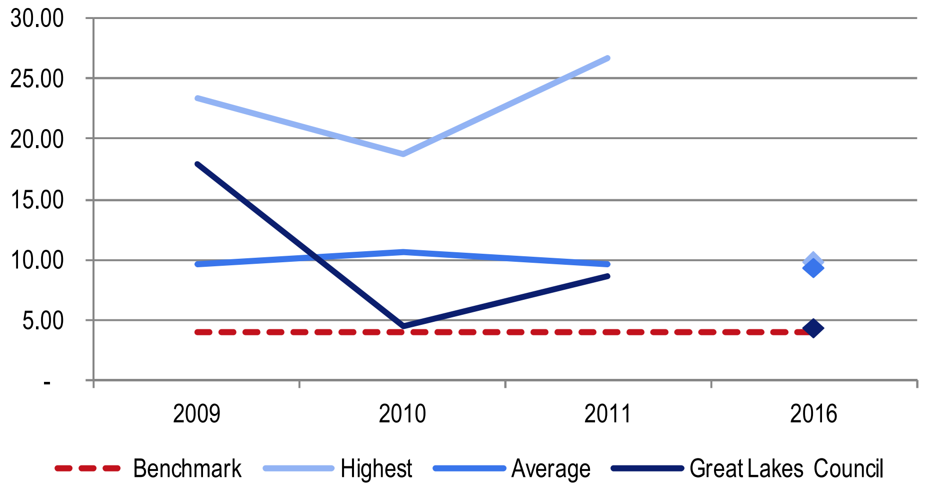


Figure 20 - Interest Cover Ratio Comparison



Council's debt servicing capacity has been sufficient in the past three years, being generally at or near benchmark, although it has generally tracked below the group's average. This indicates that whilst Council is more highly leveraged than its peers, it is still at acceptable levels.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

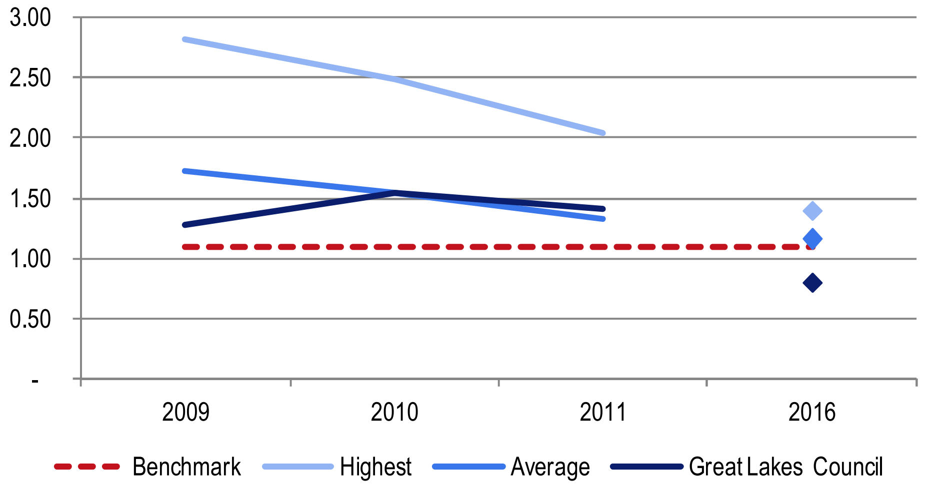
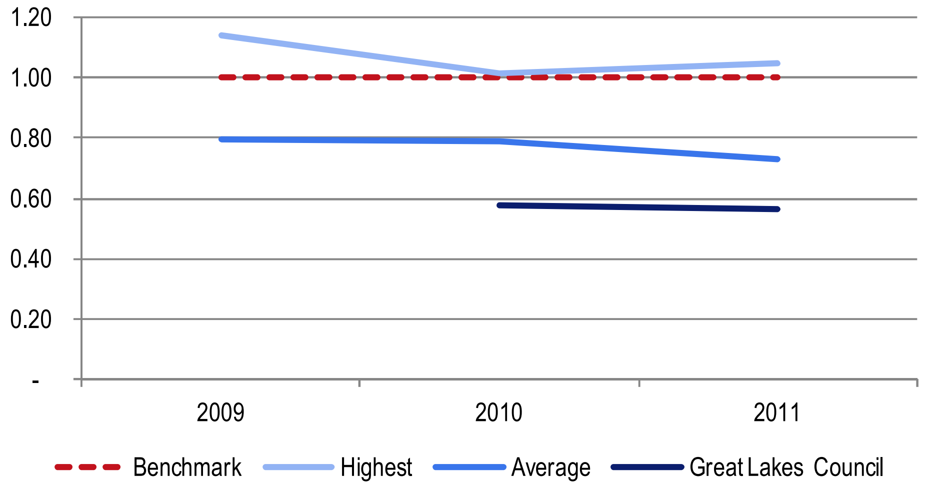
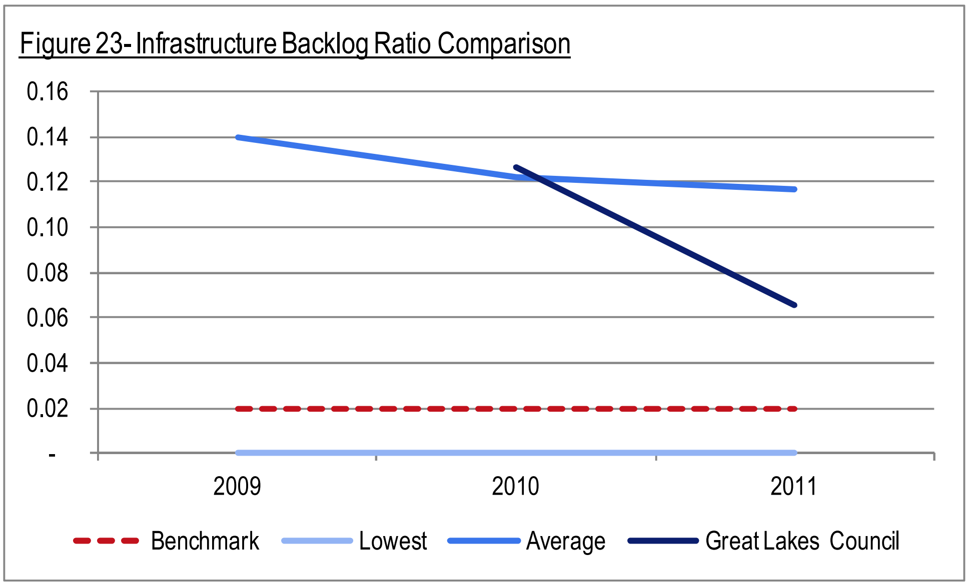
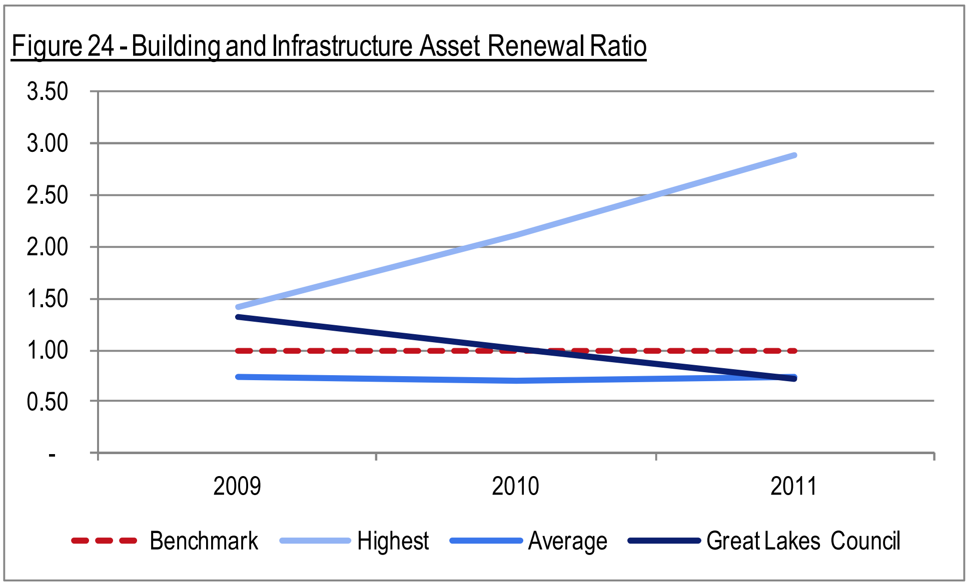


Figure 22 - Asset Maintenance Ratio Comparison







Council's Infrastructure Backlog declined in 2011 and compares favourably with the group's average, however the ratio remained above benchmark. Council did not provide data for a backlog ratio figure in 2009.

Council's Asset Maintenance was below benchmark and the group's average in the past two years (no figure was provided for 2009). Building and Infrastructure Asset Renewal trended downward over the review period to below benchmark levels.

Expenditure on capital works was above benchmark over the past three years and comparable to the other councils in the group, indicating that Council has been prioritising the purchase of new assets over maintenance and renewal work.

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 satisfactory financial position. We recommend that Council receive the LIRS facility, despite their DSCR falling below the benchmark for the majority of the forecast period.

We base our recommendation on the following key points:

- Council's underlying historical operating performance (measured using EBITDA) has improved over the three year period
- Council continues to review all service levels and expenditure with a view to continuing the efficiencies and cost savings that have been identified in the last few years. This is expected to save up to $0.6m p.a.
- Council has maintained sound liquidity and appears to have sufficient liquidity to manage their short term liabilities during the 10 year forecast period
- While the DSCR is below benchmark for the majority of the forecast, the lowest ratio of 1.51x indicates that Council will still be in a position to repay all scheduled borrowings - the $18.0m LIRS facility and $20.1m additional borrowings
- The Interest Cover Ratio remains above the benchmark in all 10 years

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

- Council need to be aware that they will have reduced fiscal flexibility with a DSCR below the benchmark of 2.00x. Therefore if they are faced with any unexpected events that have not been forecast, they may face liquidity issues. If the ratio is above the benchmark it offers a higher degree of comfort to manage any out of course events. Council may wish to review their borrowing projections to improve this position.
- Council is still reliant on borrowings to assist their asset renewals, although it is noted this is reducing by approximately 10% p.a. The sooner Council is able to fund all of this funding from recurring revenues, the sooner they will be able to work towards financial sustainability in the medium to long term

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000s)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Revenue					
Rates and annual charges	30,469	28,754	26,234	6.0%	9.6%
User charges and fees	7,442	5,693	4,470	30.7%	27.4%
Interest and investment revenue	2,703	2,184	2,282	23.8%	(4.3%)
Grants and contributions for operating purposes	18,354	15,825	16,010	16.0%	(1.2%)
Other revenues	571	597	947	(4.4%)	(37.0%)
Total revenue	**59,539**	**53,053**	**49,943**	**12.2%**	**6.2%**
Employees	20,078	20,285	18,989	(1.0%)	6.8%
Borrowing costs	1,697	1,460	404	16.2%	261.4%
Materials and contract expenses	18,321	19,672	16,833	(6.9%)	16.9%
Depreciation and amortisation	15,828	10,876	11,296	45.5%	(3.7%)
Other expenses	6,242	2,603	2,838	139.8%	(8.3%)
Total expenses	**62,166**	**54,896**	**50,360**	**13.2%**	**9.0%**
Operating result	**(2,627)**	**(1,843)**	**(417)**	**42.5%**	**342.0%**

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)			
	2011	2010	2009
Grants and contributions for capital purposes	5,470	6,606	4,179
Increase (Decrease) in the fair value of investments	151	(195)	(578)
Net share of interests in joint ventures and associates using equity method	9	7	1
Net gain from disposal of assets	0	13	0
Net losses from disposal of assets	231	0	497
Caravan Park user charges & fees	0	5,147	4,808
Caravan Park expenses (special schedule 1)	0	3,814	3,537
Net Loss from discontinued operations (caravan parks)	9,973	0	0

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and equivalents	5,848	2,658	3,609	120.0%	(26.4%)
Investments	37,907	37,622	30,788	0.8%	22.2%
Receivables	6,223	5,718	4,093	8.8%	39.7%
Inventories	947	901	926	5.1%	(2.7%)
Other	822	364	956	125.8%	(61.9%)
Total current assets	51,747	47,263	40,372	9.5%	17.1%
Non-current assets					
Investments	5,014	6,750	6,000	(25.7%)	12.5%
Infrastructure, property, plant & equipment	673,318	657,610	445,515	2.4%	47.6%
Investments accounted for using the equity method	40	0	0	N/A	N/A
Total non-current assets	678,372	664,360	451,515	2.1%	47.1%
Total assets	**730,119**	**711,623**	**491,887**	**2.6%**	**44.7%**
Current liabilities					
Payables	9,562	8,935	6,614	7.0%	35.1%
Borrowings	3,133	2,924	2,664	7.1%	9.8%
Provisions	7,938	7,575	6,919	4.8%	9.5%
Total current liabilities	20,633	19,434	16,197	6.2%	20.0%
Non-current liabilities					
Borrowings	25,940	19,945	15,847	30.1%	25.9%
Provisions	4,911	4,633	4,371	6.0%	6.0%
Investments accounted for using the equity method	0	53	60	(100.0%)	(11.7%)
Total non-current liabilities	30,851	24,631	20,278	25.3%	21.5%
Total liabilities	**51,484**	**44,065**	**36,475**	**16.8%**	**20.8%**
Net assets	**678,635**	**667,558**	**455,412**	**1.7%**	**46.6%**

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June		
	2011	**2010**	**2009**
Cashflows from operating activities	17,265	17,450	15,328
Cashflows from investing activities	(20,279)	(22,759)	(15,687)
Proceeds from borrowings and advances	9,413	7,022	3,493
Repayment of borrowings and advances	(3,209)	(2,664)	(2,561)
Cashflows from financing activities	6,204	4,358	932
Net increase/(decrease) in cash and equivalents	**3,190**	**(951)**	**573**
Cash and equivalents	5,848	2,658	3,609

Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

Linked to the asset revaluations process stated above, IPART's analysis of case study councils found that this revaluation process resulted in sharp increases in the value of some council's assets. In some

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

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

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.

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

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

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

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

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

Operating Ratio

Benchmark = Better than negative 4%

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

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

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

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

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

Unrestricted Current Ratio

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

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

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

New South Wales
Treasury Corporation

Great Lakes Council

Financial Assessment and Benchmarking Report

4 October 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 Great Lakes Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Great Lakes 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.

Index

Section 1 Executive Summary

This report provides an independent assessment of Great Lakes Council (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 $18.0m relating to Council's Road and Bridge Rehabilitation Program.

TCorp's approach has been to:

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

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

- The underlying operating performance (measured using EBITDA) has shown its strongest result in 2011
- The Unrestricted Current Ratio has remained above the benchmark in all three years indicating that Council had sound liquidity throughout the period.
- Council has been conducting an ongoing organisation-wide service level review that is identifying efficiencies and cost savings along with possible revenue generating opportunities
- Council has been granted an SRV of 8.0% p.a. including the rate peg for three years from 2011/12 that should assist the financial sustainability of Council by funding specific capital programs.
- Total borrowings have increased by $10.6m to $29.1m in 2011 indicating Council is utilising debt funding to manage their financial requirements

Council's reported Infrastructure Backlog of $38.5m in 2011 represents 6.6% of its infrastructure asset value of $586.3m. Other observations include:

- The Infrastructure Backlog has reduced from $59.1m in 2009, and then $73.2m in 2010 as a result of Council's improved asset management systems providing a more reliable information

- Capital expenditure has been adequate over the three years when measured by the Capital Expenditure Ratio

- Expenditure for asset maintenance and renewals has reduced over the period and has not been sufficient when compared to the Asset Maintenance Ratio and Buildings and Infrastructure Asset Renewal Ratio benchmarks.

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

- Operating deficits are forecast each year with the largest in 2013 of $7.3m (12.6%) followed by a gradual improvement through to 2022 when the deficit is $2.9m (3.6%)

- Council should not have liquidity issues as indicated by an Unrestricted Current Ratio above benchmark in every year

- Council has a cumulative shortfall of $26.9m when comparing the scheduled capital expenditure to depreciation expenses with the Capital Expenditure Ratio below benchmark from 2015 to 2022

In our view, the Council has the capacity to undertake the combined borrowings of $18.0m for the LIRS project. This is based on the following analysis:

- The DSCR is scheduled to fall below benchmark between 2013 and 2021 however the lowest ratio is 1.51x in 2016, indicating that Council will still be able to manage the associated debt commitments. The ratio also takes into account the non LIRS $20.1m additional borrowings scheduled within the forecast

- The Interest Cover Ratio remains above the benchmark in all 10 years

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

- Council's financial flexibility, as indicated by the Operating Ratio and Own Source Operating Revenue Ratio, is generally comparable to the group's average
- Council's liquidity position is adequate and it is generally similar to the group's average
- Council is more highly leveraged than its peers. Both the DSCR and Interest Cover Ratios were adequate over the review period
- Council had an overall lower level of Infrastructure Backlog than its peers; however did not achieve the benchmark throughout the review period. While Council's asset maintenance underperformed benchmark and the group's average, its capital expenditure outperformed benchmark and was generally comparable to the group's average

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 focused 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

Great Lakes Council	
Locality and Size	
Locality	Hunter
Area	3,373 km²
DLG Group No.	4
Demographics	
Population	34,430
% under 18	21%
% between 19 and 59	40%
% over 60	39%
Expected population 2021	42,900
Operations	
Number of employees	298
Annual revenue	$65m
Infrastructure	
Roads	1,282 km
Bridges	181
Infrastructure backlog value	$38.5m
Total infrastructure value	$586.3m

Great Lakes Council Local Government Area (LGA) is located about three hours drive north of Sydney on the Mid-North Coast between Port Stephens in the south, Taree in the north and west to the slopes of the Great Dividing Range.

The LGA is comprised of two main population centres - Forster/Tuncurry in the north and Tea Gardens/Hawks Nest to the south. In addition there are a number of towns and villages within the region, each with their own unique character, including Stroud, Bulahdelah, Coolongolook, Nabiac and Pacific Palms.

Economically the LGA has historically relied on agricultural related industry, however approximately 60% of the jobs in the LGA now relate to retail, accommodation and food services, health care and social assistance, education and training. This is due to increased retirees moving to the region and people migrating for a ‘sea’ or ‘tree’ change.

The LGA has an average growth rate of 1.1% p.a. across the five years between 2006 and 2011, below the 1.4% p.a. average for NSW LGA’s.

Within Council's total infrastructure, property, plant and equipment (IPP&E) of $673.3m at 30 June 2011 there are:

- $474.2m of roads, bridges and footpaths
- $69.2m of stormwater drainage
- $26.4m of specialised buildings
- $9.2m of other structures
- $5.1m of non specialised buildings

2.4: LIRS Application

Council has made one LIRS application.

Project: Great Lakes Council Road and Bridge Rehabilitation Program.

Description: The program provides for the replacement of approximately 12 timber bridges with concrete at a cost of $5.0m and the rehabilitation of $13.0m of urban and rural sealed road pavements which are classified as being in poor or very poor condition within Council's Asset Management Plan.

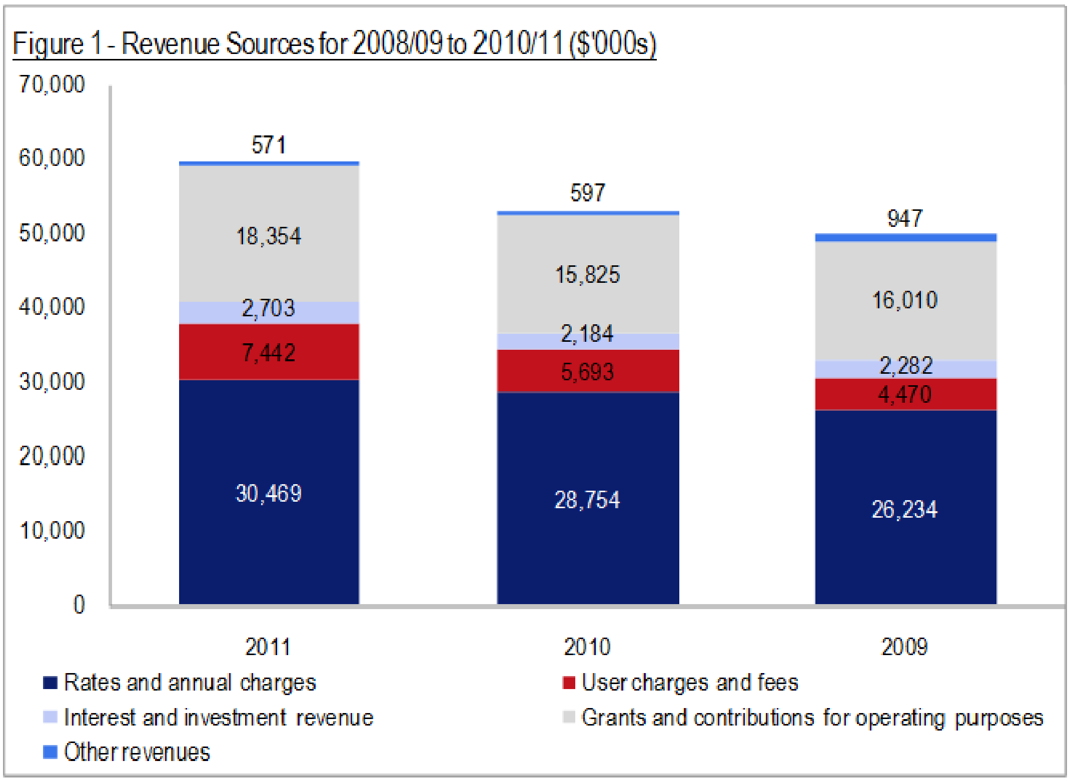
Amount of loan facility: $18.0m to be drawn down across a three year period from 2012 to 2015.

Term of loan facility: 10 years

Section 3 Review of Financial Performance and Position

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

3.1: Revenue



Key Observations

- Operating revenues have increased by $9.6m over the period, representing an average increase of 9.6% p.a.

- Rates and annual charges have increased in each year above the rate peg equating to 8.0% p.a. The introduction of a new non-domestic waste management services charge was the main driver in 2011, while a 6% environmental special rate in place until 2014 (included in general rate revenue) and increased domestic waste management charges were responsible in 2010.

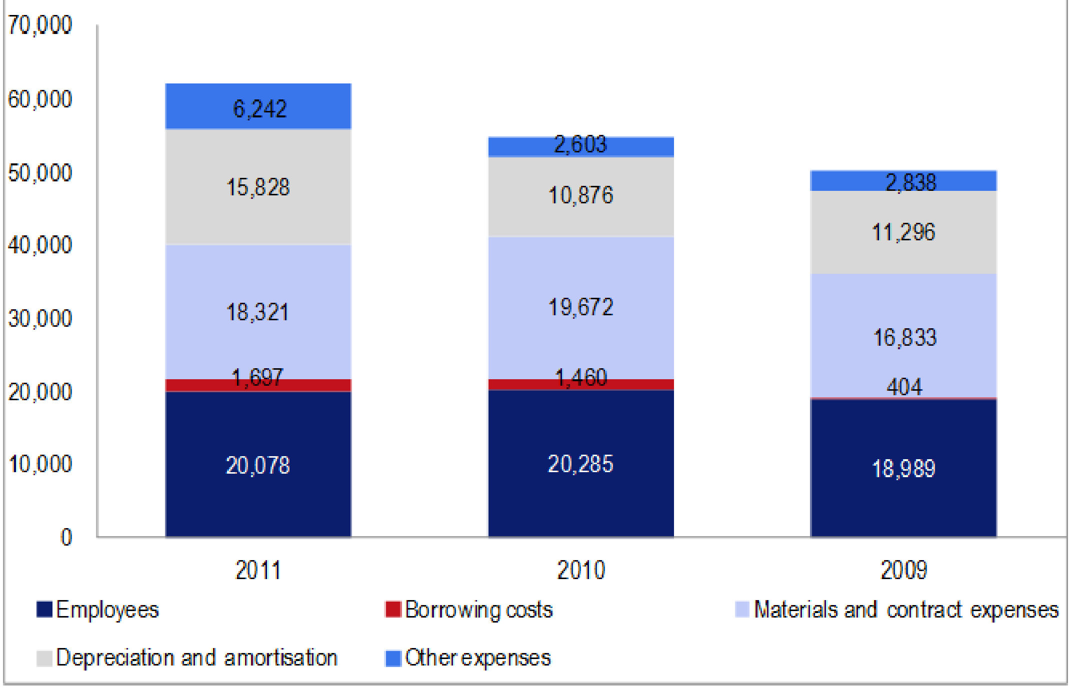
- User fees and charges have grown by $3.0m over the period when the caravan park revenue has been excluded received in 2009 and 2010. The main drivers for the $3.0m increase were domestic waste management service charges in 2010 and private works in 2011.

  The caravan parks were transferred to the Land and Property Management Authority (LPMA) as part of an ongoing State Government directive.

- Operating grants and contributions varied over the period with the 2011 increases due to increased road contributions from the RTA (now RMS) and home and community care grants. They make up 30.8% of the total operating revenue in 2011, representing a significant source of funding for Council.

3.2: Expenses

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



Key Observations

- Operating expenses have increased by $11.8m over the period, representing an average 11.7% p.a.

- Employee expenses are the Council's largest expense and after an increase in 2010 it reduced marginally in 2011. The decrease in 2011 was due to lower workers compensation insurance premiums and Council not filling positions vacated during the year. The 2010 increase was due to higher superannuation payments of $0.5m relating to the defined benefit plan and employee leave entitlements of $0.5m. The overall increase was 5.7% across the period.

- Materials and contracts fluctuated over the period with the increase in 2010 due to additional contractor works for waste collection, road works and river environment studies. A reduction in these works in 2011 was the reason for the decrease in that year.

- Depreciation has seen the largest increase over the period of $4.5m, despite a decrease in 2010, representing a 40.0% increase from 2009. The increase relates to the Asset

Revaluations that increased the value of roads, bridges, footpaths and drainage infrastructure assets and their associated depreciation.

- The increase in borrowing costs relates to Council utilising increased borrowings over the period although the 2009 figure is deflated due to a $0.7m discount adjustment for remediation liabilities.

- The other expenses in 2009 and 2010 have been adjusted downwards as this is where TCorp deducted the caravan park expenses from for these years, as there is not one specific expense category where the cumulative expenses are stated.

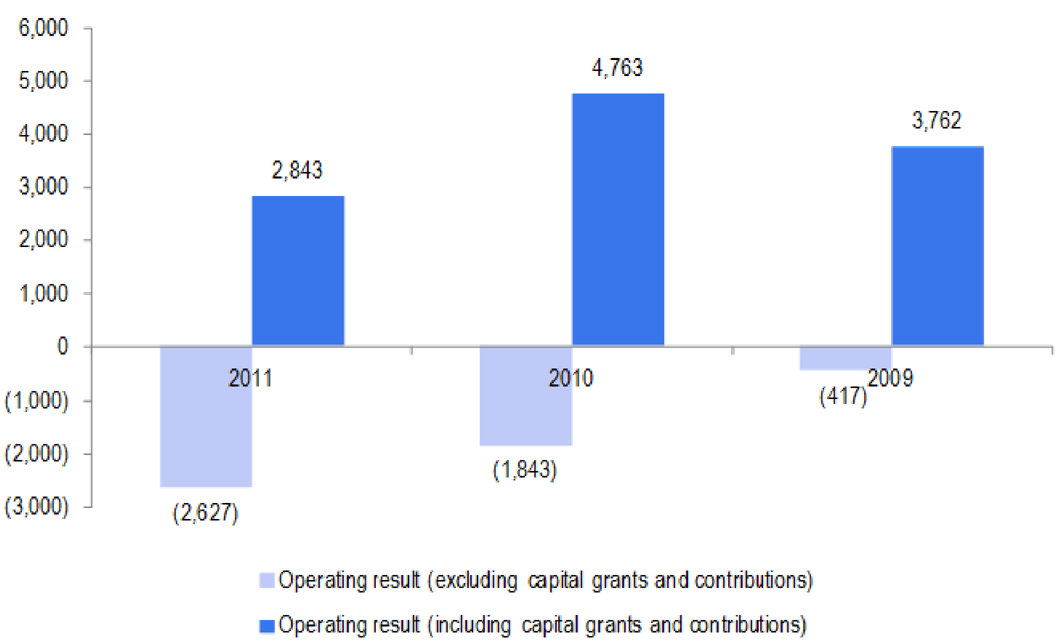
3.3: Operating Results

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

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

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

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



Key Observations

- Council has posted operating deficits in all three years when capital grants and contributions are excluded. The downward trend has been due to expenses growing at a faster rate than revenues over the period.

- The $2.8m increase in materials and contract expenses in 2010, and the $5.0m increase in depreciation in 2011 are the main expense items that have driven the expense growth.

- The depreciation amounted to $15.8m in 2011, which has increased substantially over the past three years following the Asset Revaluations process. Whilst the non cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June		
	2011	**2010**	**2009**
EBITDA ($'000s)	14,898	10,493	11,283
Operating Ratio	(4.4%)	(3.5%)	(0.8%)
Interest Cover Ratio	8.78x	7.19x	27.93x
Debt Service Cover Ratio	3.04x	2.54x	3.81x
Unrestricted Current Ratio	2.85x	2.84x	2.99x
Cash Expense Ratio	1.6 months	0.7 months	1.1 months
Own Source Operating Revenue Ratio	58.3%	57.7%	56.7%
Net assets ($'000s)	678,635	667,558	455,412

Key Observations

- The Operating Ratio has fallen below the benchmark in 2011 in line with the downward trend in the operating result.

- Council's underlying performance (measured using EBITDA) has also shown its strongest performance in 2011. This increase has improved the Interest Cover Ratio back over double the benchmark. The 2009 ratio was high due to the reduced interest expense in that year, relating to the $0.7m discount adjustment for remediation liabilities.

- The DSCR has remained above the benchmark for all three years, with the higher EBITDA contributing to the ratio climbing back above 3.0 times in 2011.

- Council's total debt stands at $29.1m in 2011, an increase from $18.5m in 2009. This equates to 4.3% of Net Assets in 2011. Over the three year period Council borrowed $8.1m in respect of a new land fill site and $7.0m for road infrastructure renewals and maintenance.

- The Unrestricted Current Ratio has remained above the benchmark indicating that the Council have had sufficient liquidity throughout the period.

- The Cash Expense Ratio has remained below the benchmark in all three years however Council have the majority of their current assets held in current investments. In 2011 the total of internally restricted and unrestricted cash and cash equivalents, and current investments totalled $25.4m, compared to cash and cash equivalents alone that totalled $5.8m.

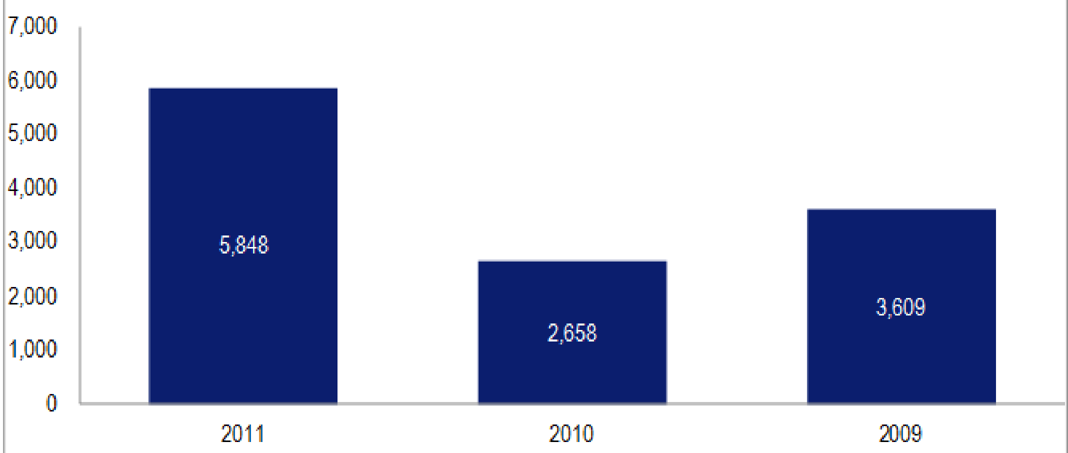
- The Own Source Operating Revenue Ratio is slightly below the benchmark in all three years but is on an upward trend. This highlights that Council rely on grants and contributions to boost their total revenue.

- The increase in Net Assets relates to the Asset Revaluations with a $207.1m increase in 2010 relating to road, bridge, footpath and drainage infrastructure assets and $18.2m relating to community land and other structures in 2011.

- When the Asset Revaluations are excluded there has been a $15.6m increase in the IPP&E asset base over the three year period, compared to the written down value of disposed assets and depreciation.

3.5: Statement of Cashflows

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



Key Observations

- Council's cash and cash equivalents have fluctuated over the period and increased to their highest level in 2011. Overall the cash and cash equivalents, and investments combined have increased across the three year period by $8.4m to $48.8m.

- Of the $48.8m, $23.4m is externally restricted, $20.3m is internally restricted and $5.1m is unrestricted.

- Within the investments portfolio of $42.9m, $35.5m is held in current deposits, $4.0m in non-current deposits, $1.5m in CDOs due to mature in 2012, $0.9m in equity linked notes, and $1.0m in longer term Negotiable Certificates of Deposits and FRNs.

- The increase in both cash and cash equivalents, and investments, along with a strong Unrestricted Current Ratio indicates that Council had sufficient liquidity to manage their day to day liabilities.

3.6: Capital Expenditure

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

3.6(a): Infrastructure Backlog

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

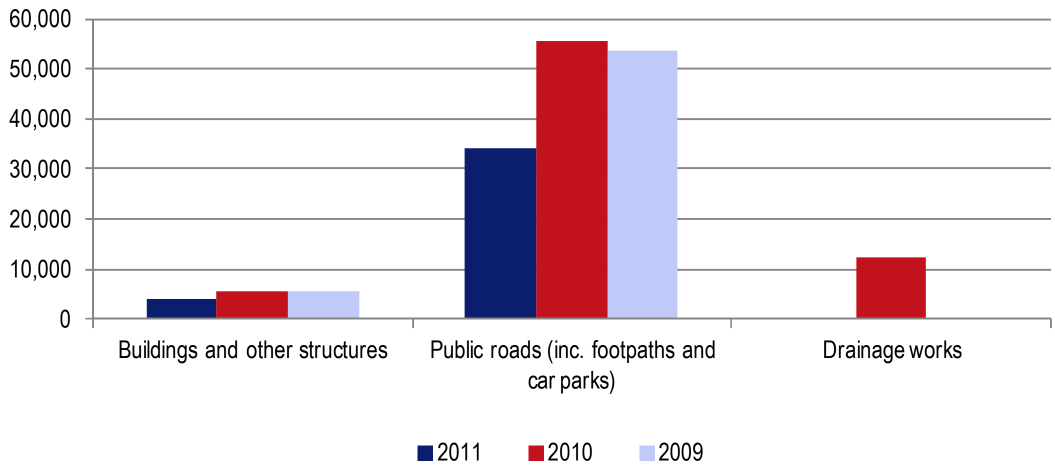
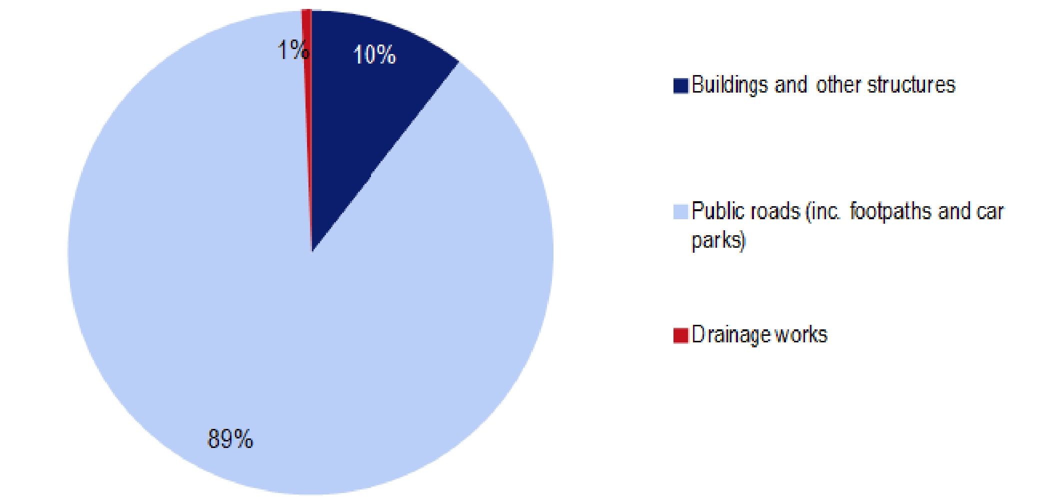


Figure 6 - Infrastructure Backlog Composition for 2010/11



The Infrastructure Backlog has fluctuated over the period and is stated at its lowest level in 2011 at $38.5m. This is a decrease from $73.2m in 2010 and is because Council have refined their revaluation process and their asset management plan.

The 2011 Infrastructure Backlog is heavily dominated by Public Roads which make up $34.2m of the total.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000s)	38,469	73,216	59,137
Required annual maintenance ($'000s)	12,569	17,741	0
Actual annual maintenance ($'000s)	7,138	10,243	0
Total value of infrastructure assets ($'000s)	586,316	596,410	342,633
Total assets ($'000s)	730,119	711,623	491,887
Building and Infrastructure Backlog Ratio	0.07x	0.12x	0.17x
Asset Maintenance Ratio	0.57x	0.58x	N/A
Building and Infrastructure Renewals Ratio	0.72x	1.02x	1.32x
Capital Expenditure Ratio	1.41x	1.54x	1.28x

The Infrastructure Backlog Ratio has been on a downward trend over the period. This positive trend is because of an increase in the value of the infrastructure assets from 2010 but also a reduction in the backlog amount in 2011.

The Asset Maintenance Ratio data was only available for 2010 and 2011 and the ratios for both years indicate that Council is not investing sufficient funds to maintain the asset base. This could impact negatively on the backlog figure in future years. The 2009 special schedules were not fully complete and is the reason for the absence of the 2009 ratio.

The Building and Infrastructure Renewals Ratio has been on a negative trend over the period and fell below the benchmark in 2011.

Council have invested adequate capital expenditure in all three years when analysing the Capital Expenditure Ratio. Over this period Council has invested $15.6m more in asset additions than the written down value of disposed assets and the depreciation of IPP&E combined.

3.6(c): Capital Program

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

Capital Program ($'000s)	Year ended 30 June		
	2011	**2010**	**2009**
New capital works	7,615	4,792	0
Replacement/refurbishment of existing assets	15,533	12,492	0
Total	**23,148**	**17,284**	**0**

Special Schedules 7 and 8 were not completed in 2009 as this was not a compulsory requirement.

Council's 2011 capital programs included:

- Myall Way upgrade - $1.2m
- Southern Parkway, Forster - $0.8m
- Bramble Parade Wetland refurbished
- Several sections of The Lakes Way reconstructed - $2.0m
- Sandy Creek Bridge on Booral Road reconstructed - $0.6m

- Lavinia Murray Bridge at Bunyah reconstructed - $0.8m
- Drainage piped past Bulahdelah Nursing Home - $0.3m

Other programs also listed in 2011 are:

- Palms Estate water treatment devices
- Smiths Lake Recreation Ground - netball court, picnic shelters and landscaping
- Dredging of Corrie Channel
- Upgrade to community halls - Bungwahl, Hawks Nest, Coolongolook and Pacific Palms
- Clarkson Street Nabiac cycleway construction
- Clarkson Street Nabiac road rehabilitation
- Near completion of a $2.2m addition to the Aquatic Centre in Forster
- Near completion of the access road to Council's landfill at Minimbah

3.7: Specific Risks to Council

- Inability to reduce Infrastructure Backlog. Council have historically funded a portion of their maintenance funding through loan borrowings as their operating revenues have been limited. This impacts their ability to finance their capital expenditure and reduce the backlog. The Infrastructure Backlog will increase over time unless this trend is addressed. Council is committed to reducing their reliance on borrowings for maintenance by 10%p.a. and has evidenced that this is being achieved.
- Climate change and sea level changes. Council has a large area of coastline and a number of areas very susceptible to sea level rise. One example relates to the beach at Winda Woppa where Council has to spend approximately $0.3m p.a. to replenish the sand but the total rates received by residents in the area only amounts to $0.33m. This cost has increased from $0.1m historically. Council has established a Climate Change Co-ordination Committee to identify the impacts and develop mitigation strategies and policies.

- Ageing population. The LGA is a popular place for the 'sea and tree' retirees and by 2021 the proportion of residents over 65 is expected to be over 30%. Council is mitigating the demographic shift by amending urban design and infrastructure provision within their town planning policies to service the ageing population.

- Ageing workforce. Council had 57% of employee's aged 45 or over in 2010 and 21% aged 55 or over. Council find it difficult to implement succession planning given the size of Council whereby a clear career path is not easily identifiable within the organisational structure. This makes it hard to transfer skill knowledge as employee's get towards retirement. Retaining skilled staff is also a challenge as Council battles against other industries such as mining. The development of Council's Workforce Management Plan is focusing Council's efforts to mitigate these issues.

- Natural Resources Management. The community rated the protection of waterways as their number one priority and protection of the natural environment as the number three priority in a 2008 survey of 38 separate priorities. The preservation of the natural environment and waterways is also vital to economic output with key industries of rock oyster production and fishing, along with tourism all relying on the natural resources. Council has developed a number of plans and strategies to preserve the quality of the LGA including the environmental levy that has been in place for 11 years. This levy is due to expire in 2015 and at present Council has not had approval for this to continue.

- Unemployment – especially amongst the young. The LGA has had an unemployment rate of 9% over the three year period, one of the highest in the Hunter Region. If unemployment remains high then younger people will most probably look outside the LGA for work and may end up having to move. This will compound the problem of an ageing population over the longer term. Council face the challenge of promoting and assisting economic development while respecting the community's wishes in relation to the natural environment preservation. Council's Community Strategic Plan is focusing on this issue within the 'planning for balance' key direction.

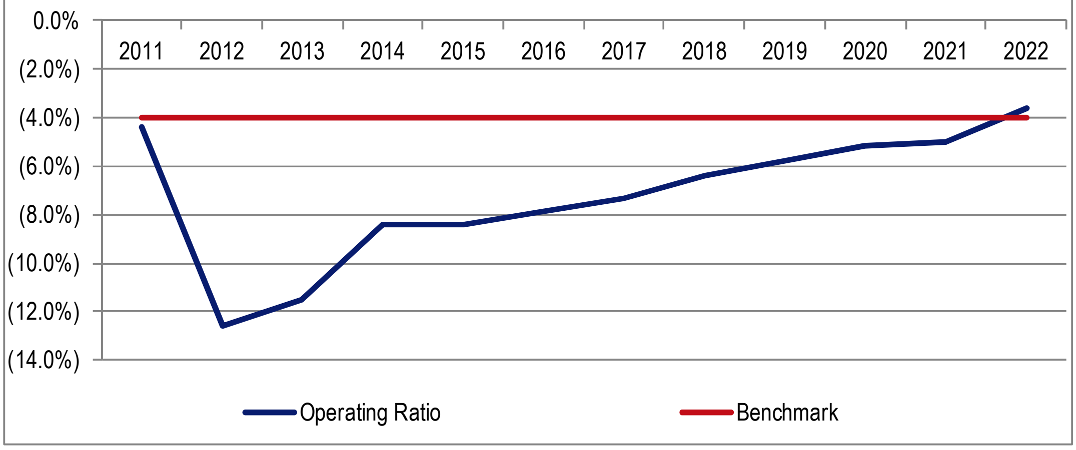
Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the $18.0m loan with the LIRS subsidy. We have therefore made a manual adjustment to the forecast to remove the subsidy after Council provided the relevant figures.

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

4.1: Operating Results

Figure 7- Operating Ratio



Council has forecast the weakest Operating Ratio in 2012 at negative 12.6%, equating to a deficit of $7.3m.

Council was granted an SRV of 8.0% p.a. including the rate peg for three years inclusive of 2012 that should assist the financial sustainability of Council by funding specific capital programs.

Despite the SRV in 2012, Council's operating revenues decreased by $1.6m due to reduced user charges and fees, and operating grants and contributions. At the same time operating expenses increased by $3.1m, leading to the weakest performance over the forecast.

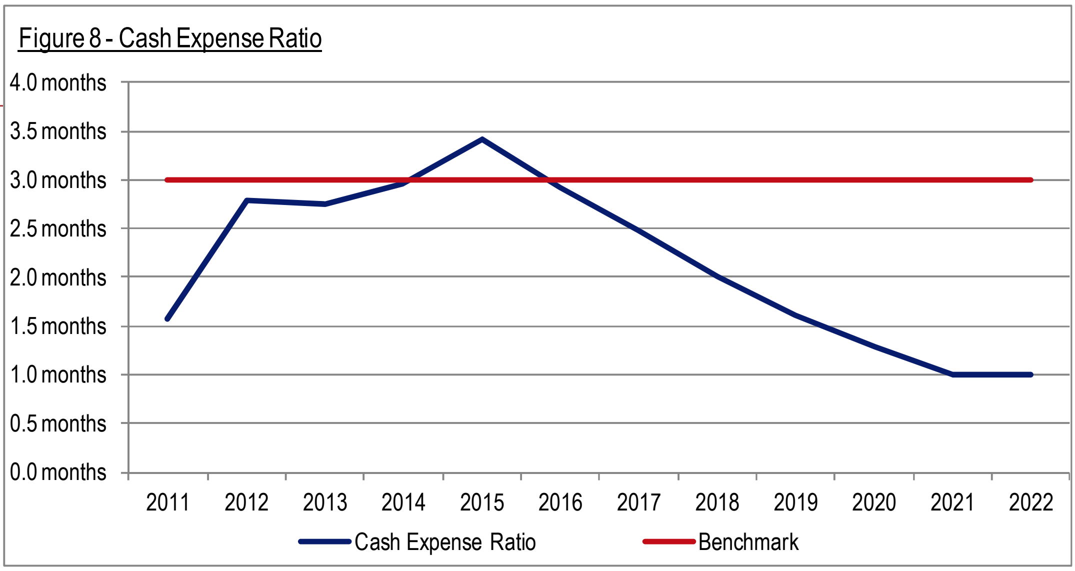
From 2012 Council is expecting the Operating Ratio to improve each year with the deficit in 2022 to be slightly better than the benchmark at negative 3.6%, or $2.9m.

The LIRS loan is scheduled to drawn down over a three year period with $4.9m utilised in 2013, $6.6m in 2014 and $6.5m in 2015.

4.2: Financial Management Indicators

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

Liquidity Ratios



Council is below the benchmark in all years excluding 2015 as they proactively utilise their cash reserves in short term deposits classified under current investments. Council is forecasting their cash and equivalents to reduce from $15.0m in 2015 to $5.6m in 2022.

When current investments are included the ratio is above the benchmark in all 10 years but is on a downward trend. The figure below includes all current investments however it is to be noted that in 2011 approximately 42% of cash and cash equivalents, and current investments were externally restricted.

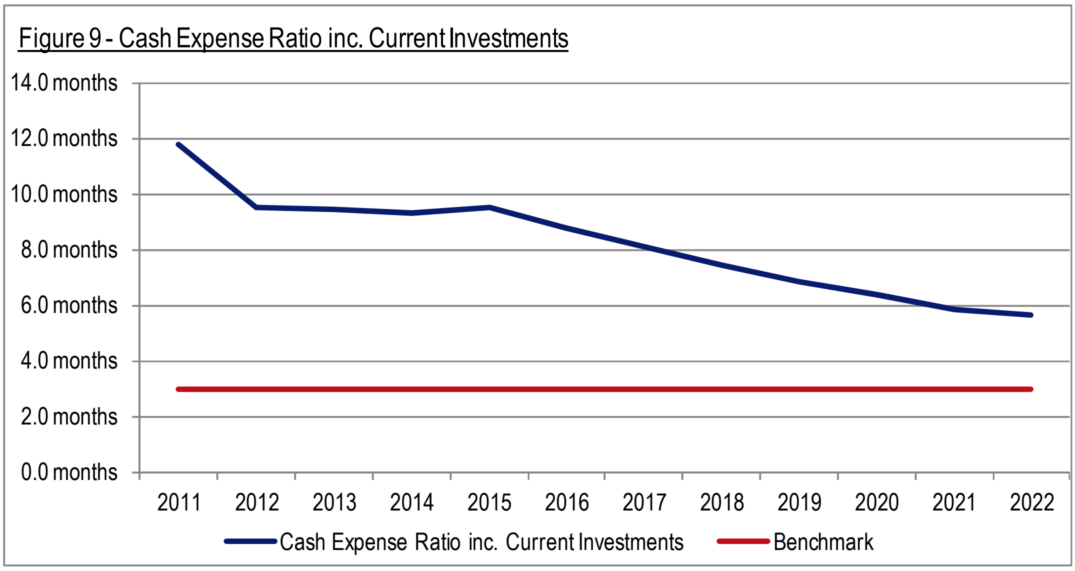
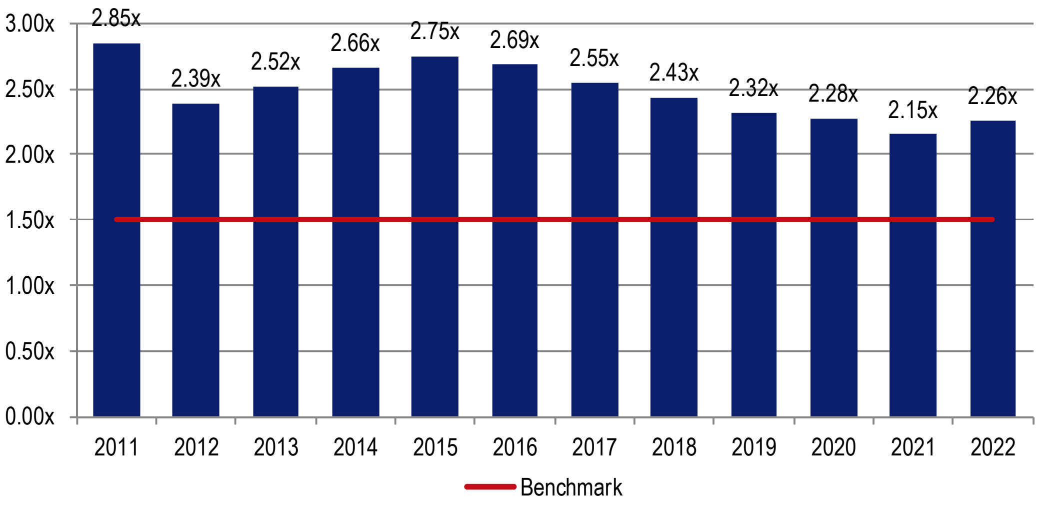


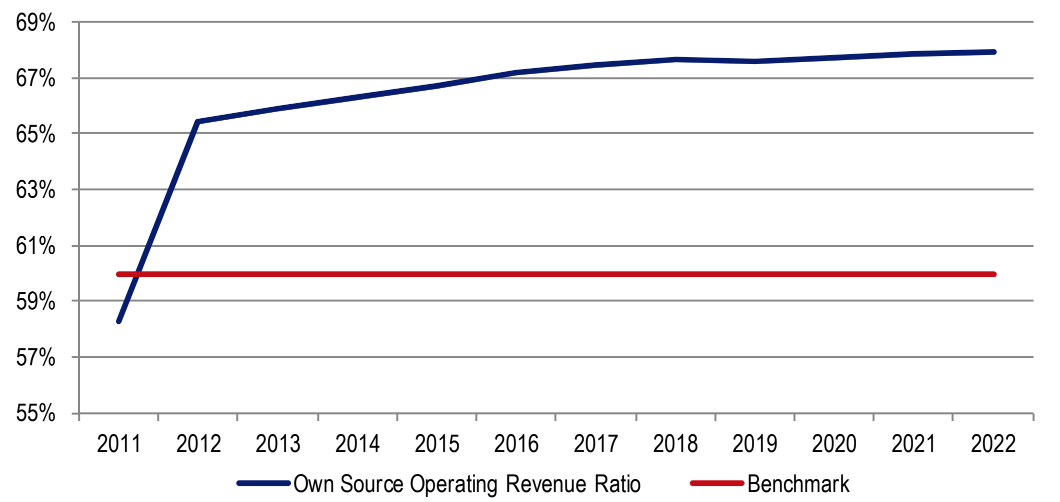
Figure 10 - Unrestricted Current Ratio



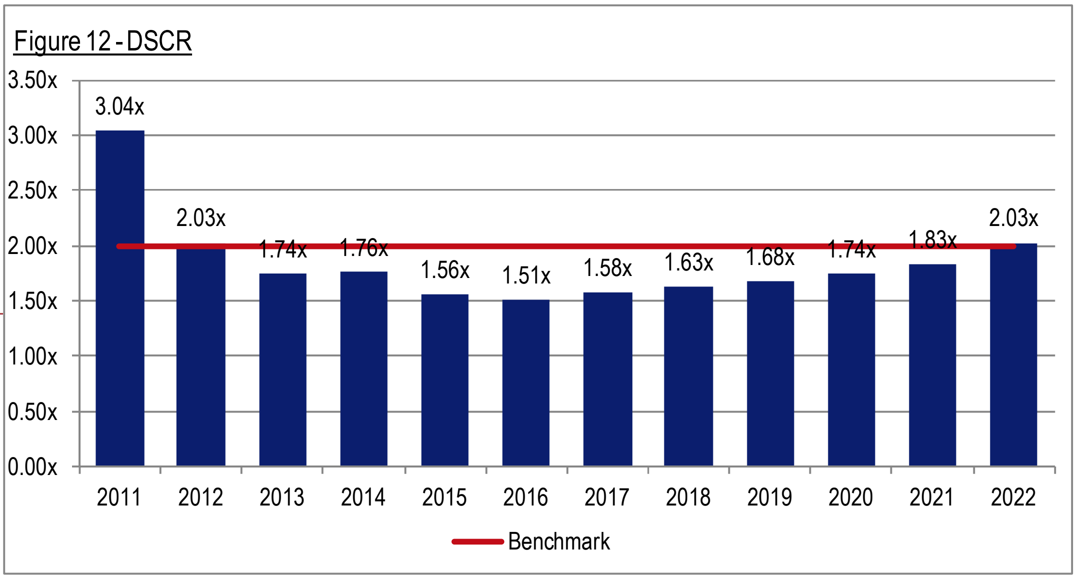
Council has forecast the Unrestricted Current Ratio to be below the historical results in all 10 years. The ratio still remains above the benchmark for every year indicating Council should not experience liquidity issues.

Fiscal Flexibility Ratios

Figure 11 - Own Source Operating Revenue Ratio

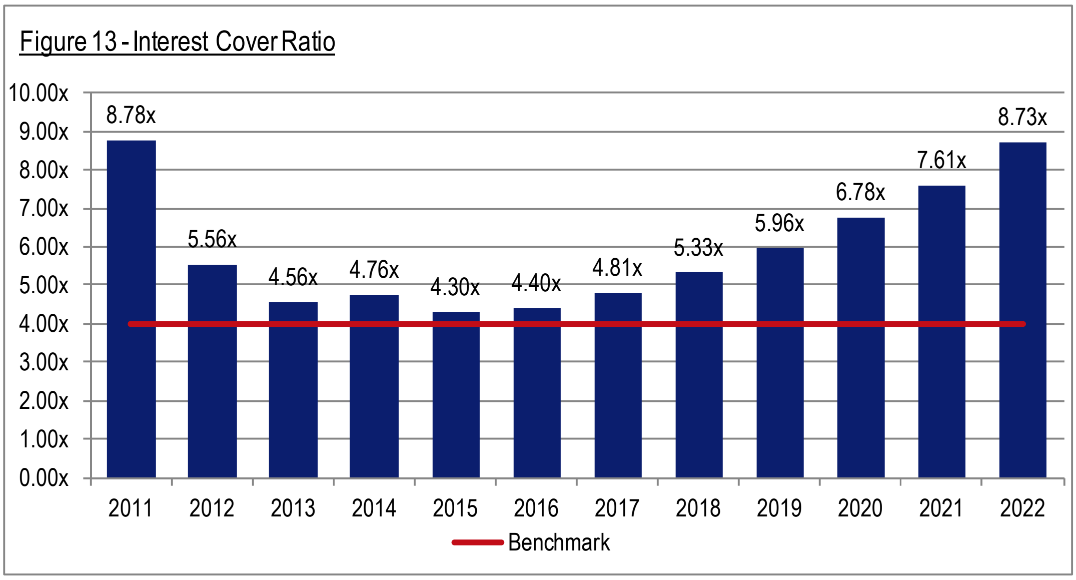


The Own Source Operating Revenue Ratio remains above the benchmark for each year of the forecast from 2012 onwards. This is in contrast the historic result being slightly below the benchmark. The ratio is rising marginally over the lifetime of the forecast due to capital grants and contributions forecast being lower than historically received. This skews the proportion of Own Source Revenue Ratio upwards.



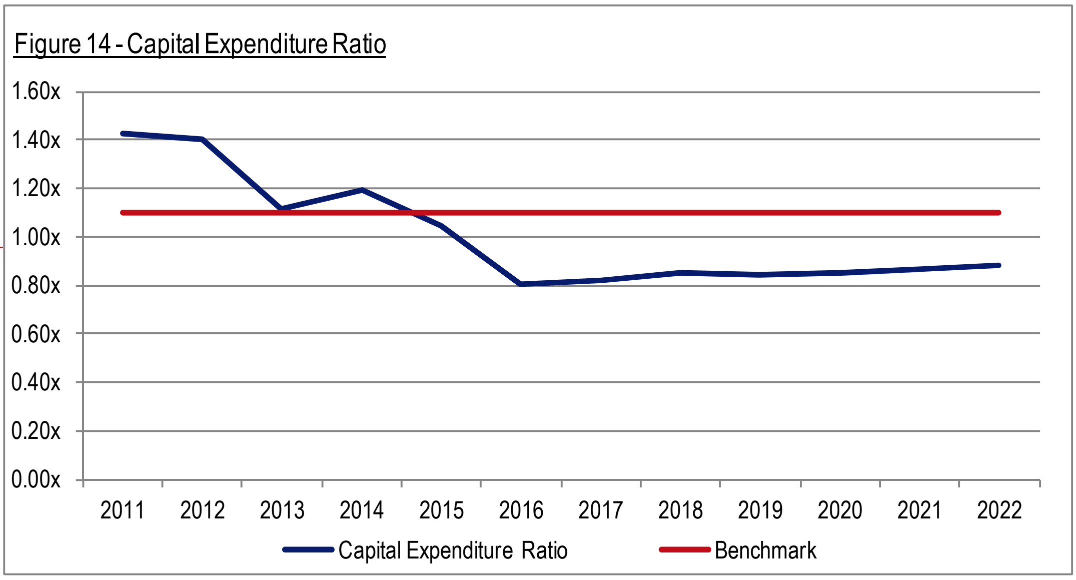
The DSCR is forecast to be below benchmark in 2013, the first year of the LIRS project draw down, and to remain below the benchmark until 2022. In addition to the $18.0m LIRS borrowings, Council has scheduled further borrowings of $20.1m during the 10 year period.

Council's total borrowings peak at $48.7m in 2015. Council is scheduled to repay in excess of $5m in each year from 2015 therefore it appears that the majority of Council's borrowings have a 10 year term or less.



The Interest Cover Ratio decreases as the LIRS loans and the majority of the additional borrowings are utilised between 2013 and 2015 however unlike the DSCR, the ratio remains above the benchmark for the duration of the forecast and improves as the borrowings are repaid and the interest cost reduces from the high of $3.0m in 2015.

4.3: Capital Expenditure



While Council has historically been above the benchmark for the Capital Expenditure Ratio, the ratio is forecast to be below the benchmark from 2015 onwards. Over the forecast period from 2013 to 2022, the cumulative shortfall of capital expenditure against depreciation is $26.9m.

This shortfall will likely have an impact on the quality of Council's assets and impact the Infrastructure Backlog figure.

4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

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

TCorp's benchmarks:

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

<u>Key Observations and Risks</u>

- As part of Council's on-going organisation-wide service level review it has already revised certain services in the past however the LTFP base case was completed on the assumption that services are maintained at the current service levels over the full 10 years
- The three year SRV that was partially approved by IPART for 2012 – 2014 was to provide an additional layer of funding to improve Council's financial sustainability through a number of capital works programs
- Other revenues are forecast to more than double in 2013 to $1.3m as this is the first year when rental income will be received from the supermarket development at Tuncurry. It is then forecast to increase in 2014 by a further 36.0% as this is the first full financial year of rental income being received
- Other expenses are forecast to increase by 19.1% in 2013 and between 8.8% to 5.8% from 2014 to 2017. These increases mainly relate to the State levies for the domestic waste management program along with higher than CPI increases for water and sewerage charges as well as electricity and other levies to State Government for the Rural Fire Service and State Emergency Services but we note that some of these increases are offset by corresponding revenue increases.
- TCorp considers the majority of the assumptions behind the LTFP reasonable

4.5: Borrowing Capacity

When analysing the financial capacity of the Council, we believe they will not be able to incorporate additional loan funding in addition to the LIRS loan facilities of $18.0m and the scheduled $20.1m additional borrowings already included within forecast. This observation is because as indicated in Section 4.2, Council will be below the DSCR benchmark of 2.00x from 2013 to 2021.

New South Wales
Treasury Corporation

Section 5 Benchmarking and Comparisons with Other Councils

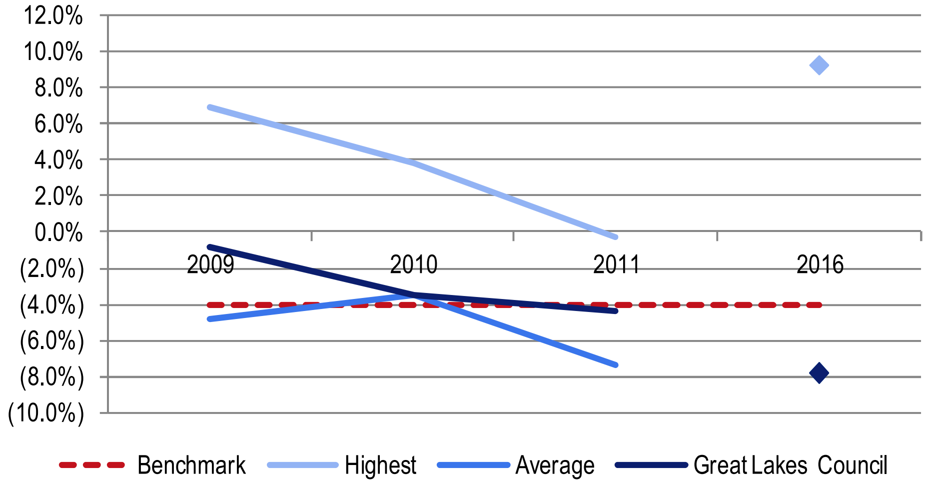
As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis (that is, for councils that operate more than one fund, the results of all funds are included). This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 4. There are 32 councils in this group and at the time of preparing this report, we have data for 19 of these councils.

In Figure 15 to Figure 21, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 22 to 24 do not include the 2016 forecast position as those numbers are not available.

Where no highest line is shown on the graph, this means that Council is the best performer in its group for that Ratio.

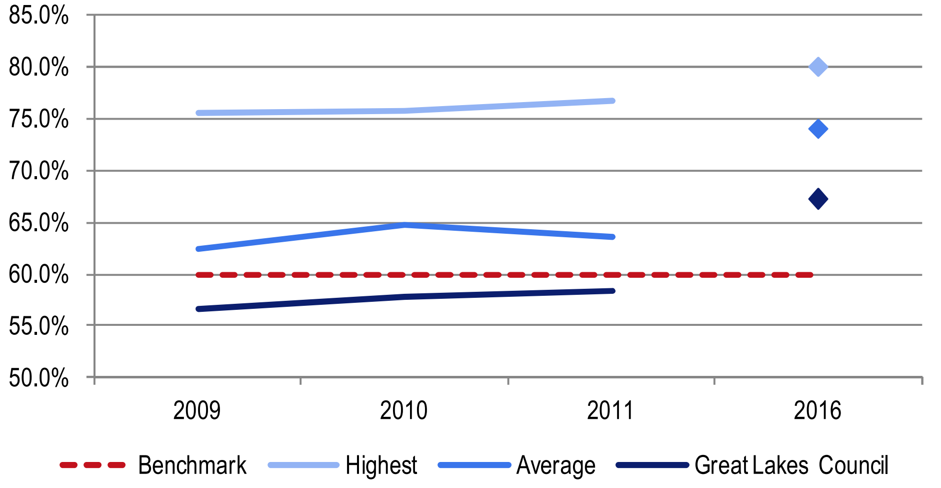
Financial Flexibility

Figure 15 - Operating Ratio Comparison



Council's Operating Ratio generally tracked the benchmark and outperformed the group's average in the past three years. However, Council's operating results are forecast to fall below benchmark over the medium term to match the average of councils in the group.

Figure 16 - Own Source Operating Revenue Ratio Comparison

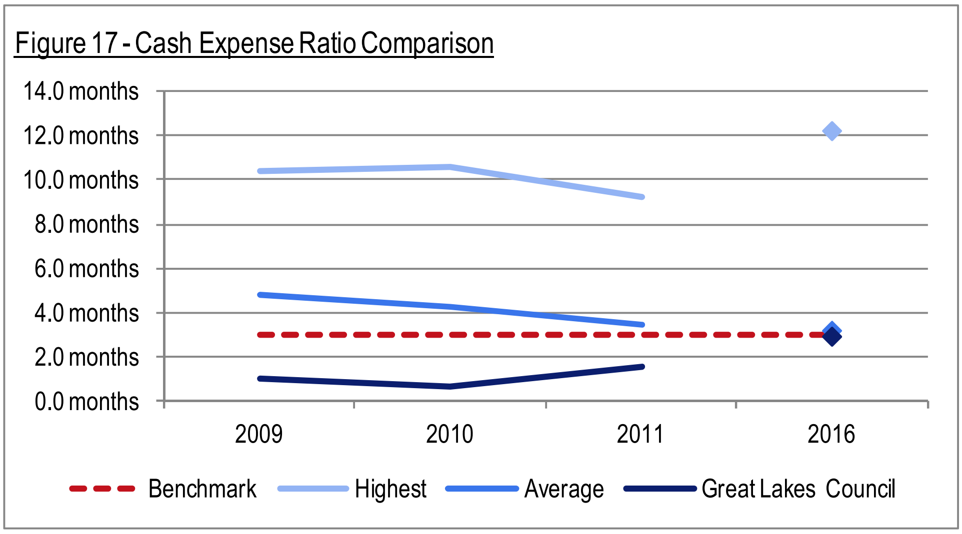


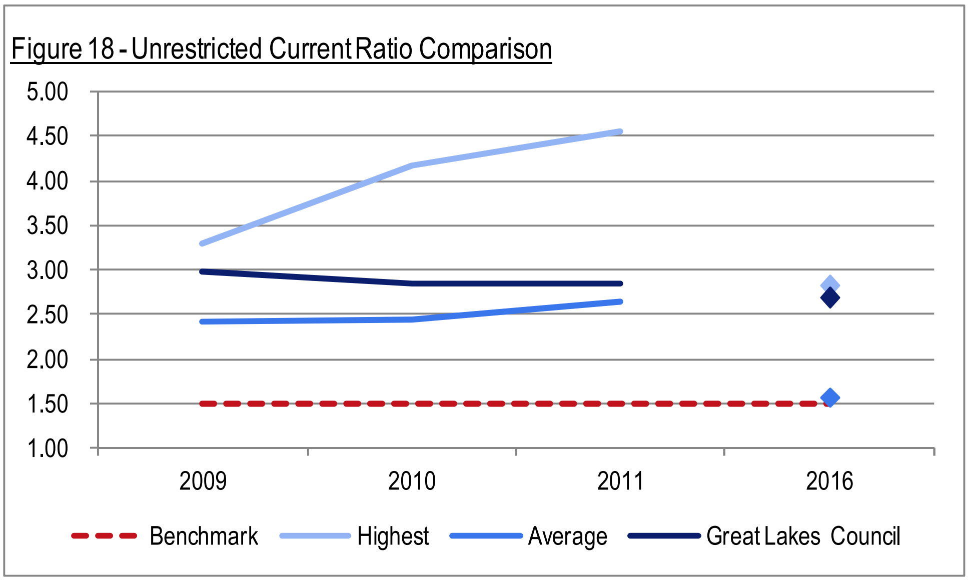
Council's own sourced revenue was below benchmark and the group's average in the past three years. This indicates that fiscal flexibility was insufficient over the review period, with Council relying more heavily on external funding than its peers.

Council is forecast to improve its Own Source Operating Revenue Ratio over the medium term, due to expected reductions in capital grants and contributions.

Overall, Council's financial flexibility is comparable to the other councils in the group.

Liquidity





Council's Cash Expense Ratio was below benchmark and the group's average in the past three years, although it is on an upward trend and expected to improve to benchmark levels over the medium term.

Council's Unrestricted Current Ratio outperformed the average council in the group over the review period and is forecast to remain strong in future years.

On average over the past three years, Council's liquidity position has been adequate and comparable to the other councils in the group.

Debt Servicing

Figure 19 - Debt Service Cover Ratio Comparison

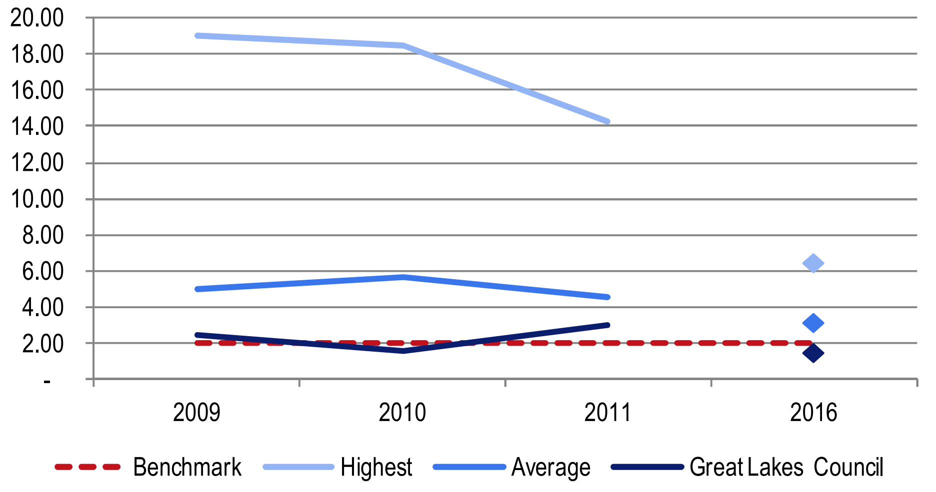
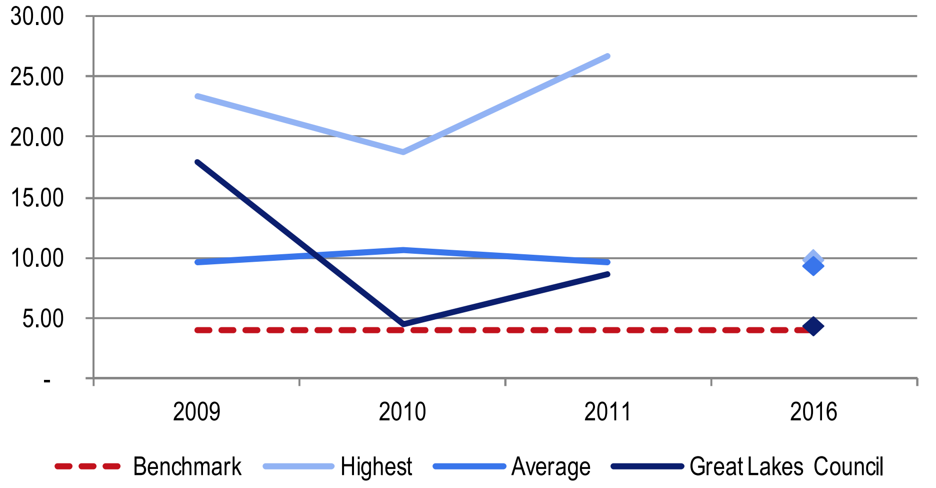


Figure 20 - Interest Cover Ratio Comparison



Council's debt servicing capacity has been sufficient in the past three years, being generally at or near benchmark, although it has generally tracked below the group's average. This indicates that whilst Council is more highly leveraged than its peers, it is still at acceptable levels.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

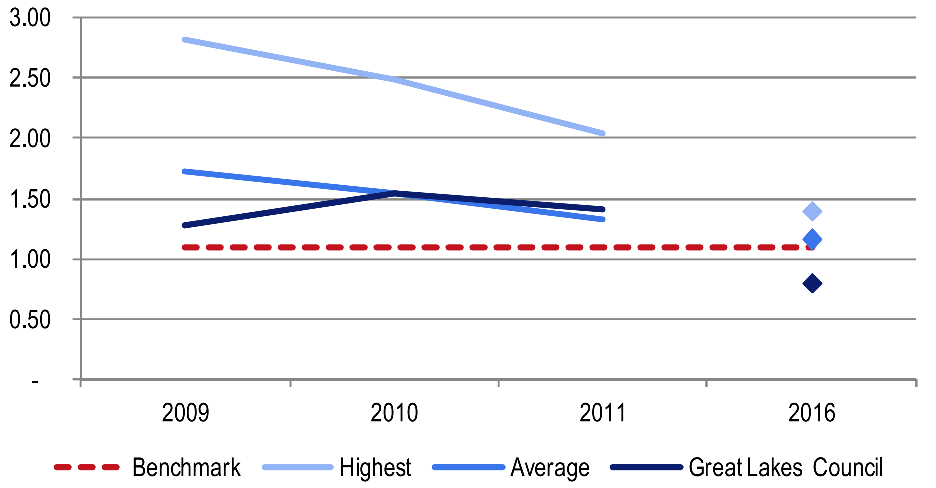
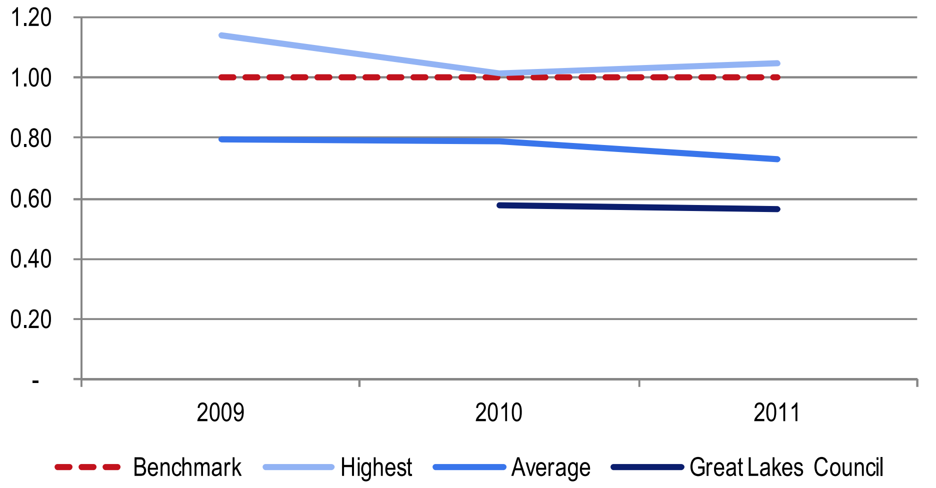
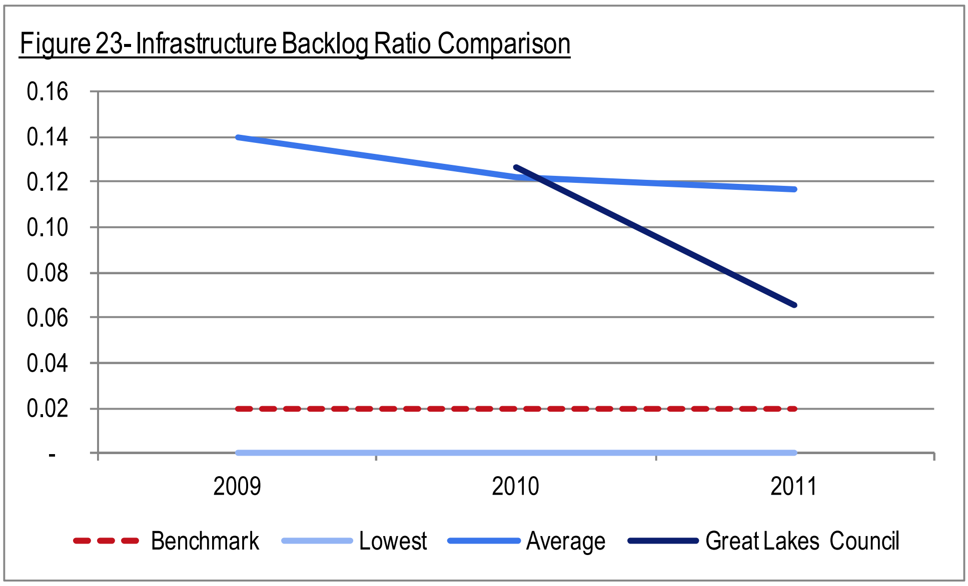
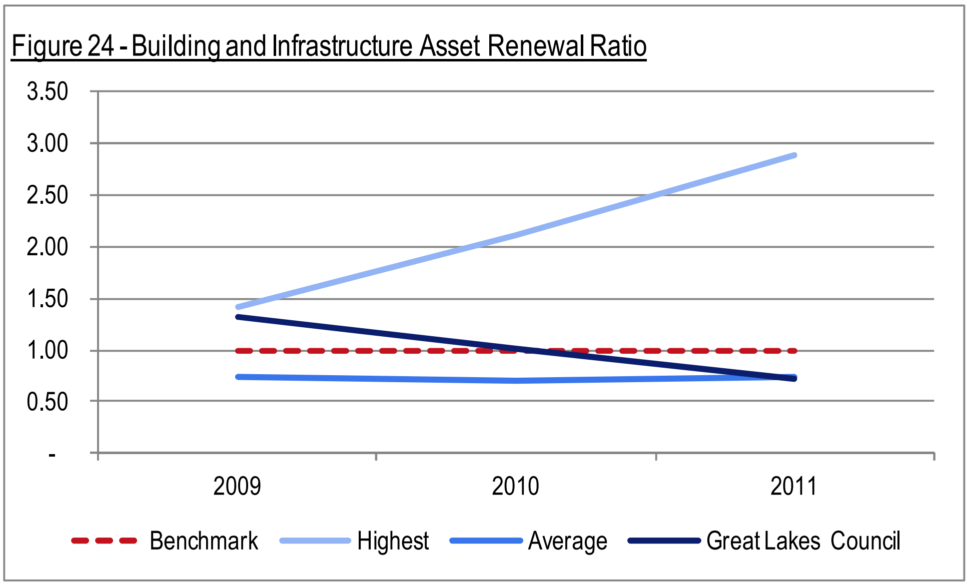


Figure 22 - Asset Maintenance Ratio Comparison







Council's Infrastructure Backlog declined in 2011 and compares favourably with the group's average, however the ratio remained above benchmark. Council did not provide data for a backlog ratio figure in 2009.

Council's Asset Maintenance was below benchmark and the group's average in the past two years (no figure was provided for 2009). Building and Infrastructure Asset Renewal trended downward over the review period to below benchmark levels.

Expenditure on capital works was above benchmark over the past three years and comparable to the other councils in the group, indicating that Council has been prioritising the purchase of new assets over maintenance and renewal work.

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 satisfactory financial position. We recommend that Council receive the LIRS facility, despite their DSCR falling below the benchmark for the majority of the forecast period.

We base our recommendation on the following key points:

- Council's underlying historical operating performance (measured using EBITDA) has improved over the three year period
- Council continues to review all service levels and expenditure with a view to continuing the efficiencies and cost savings that have been identified in the last few years. This is expected to save up to $0.6m p.a.
- Council has maintained sound liquidity and appears to have sufficient liquidity to manage their short term liabilities during the 10 year forecast period
- While the DSCR is below benchmark for the majority of the forecast, the lowest ratio of 1.51x indicates that Council will still be in a position to repay all scheduled borrowings - the $18.0m LIRS facility and $20.1m additional borrowings
- The Interest Cover Ratio remains above the benchmark in all 10 years

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

- Council need to be aware that they will have reduced fiscal flexibility with a DSCR below the benchmark of 2.00x. Therefore if they are faced with any unexpected events that have not been forecast, they may face liquidity issues. If the ratio is above the benchmark it offers a higher degree of comfort to manage any out of course events. Council may wish to review their borrowing projections to improve this position.
- Council is still reliant on borrowings to assist their asset renewals, although it is noted this is reducing by approximately 10% p.a. The sooner Council is able to fund all of this funding from recurring revenues, the sooner they will be able to work towards financial sustainability in the medium to long term

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000s)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Revenue					
Rates and annual charges	30,469	28,754	26,234	6.0%	9.6%
User charges and fees	7,442	5,693	4,470	30.7%	27.4%
Interest and investment revenue	2,703	2,184	2,282	23.8%	(4.3%)
Grants and contributions for operating purposes	18,354	15,825	16,010	16.0%	(1.2%)
Other revenues	571	597	947	(4.4%)	(37.0%)
Total revenue	**59,539**	**53,053**	**49,943**	**12.2%**	**6.2%**
Employees	20,078	20,285	18,989	(1.0%)	6.8%
Borrowing costs	1,697	1,460	404	16.2%	261.4%
Materials and contract expenses	18,321	19,672	16,833	(6.9%)	16.9%
Depreciation and amortisation	15,828	10,876	11,296	45.5%	(3.7%)
Other expenses	6,242	2,603	2,838	139.8%	(8.3%)
Total expenses	**62,166**	**54,896**	**50,360**	**13.2%**	**9.0%**
Operating result	**(2,627)**	**(1,843)**	**(417)**	**42.5%**	**342.0%**

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)			
	2011	2010	2009
Grants and contributions for capital purposes	5,470	6,606	4,179
Increase (Decrease) in the fair value of investments	151	(195)	(578)
Net share of interests in joint ventures and associates using equity method	9	7	1
Net gain from disposal of assets	0	13	0
Net losses from disposal of assets	231	0	497
Caravan Park user charges & fees	0	5,147	4,808
Caravan Park expenses (special schedule 1)	0	3,814	3,537
Net Loss from discontinued operations (caravan parks)	9,973	0	0

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and equivalents	5,848	2,658	3,609	120.0%	(26.4%)
Investments	37,907	37,622	30,788	0.8%	22.2%
Receivables	6,223	5,718	4,093	8.8%	39.7%
Inventories	947	901	926	5.1%	(2.7%)
Other	822	364	956	125.8%	(61.9%)
Total current assets	51,747	47,263	40,372	9.5%	17.1%
Non-current assets					
Investments	5,014	6,750	6,000	(25.7%)	12.5%
Infrastructure, property, plant & equipment	673,318	657,610	445,515	2.4%	47.6%
Investments accounted for using the equity method	40	0	0	N/A	N/A
Total non-current assets	678,372	664,360	451,515	2.1%	47.1%
Total assets	**730,119**	**711,623**	**491,887**	**2.6%**	**44.7%**
Current liabilities					
Payables	9,562	8,935	6,614	7.0%	35.1%
Borrowings	3,133	2,924	2,664	7.1%	9.8%
Provisions	7,938	7,575	6,919	4.8%	9.5%
Total current liabilities	20,633	19,434	16,197	6.2%	20.0%
Non-current liabilities					
Borrowings	25,940	19,945	15,847	30.1%	25.9%
Provisions	4,911	4,633	4,371	6.0%	6.0%
Investments accounted for using the equity method	0	53	60	(100.0%)	(11.7%)
Total non-current liabilities	30,851	24,631	20,278	25.3%	21.5%
Total liabilities	**51,484**	**44,065**	**36,475**	**16.8%**	**20.8%**
Net assets	**678,635**	**667,558**	**455,412**	**1.7%**	**46.6%**

Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June		
	2011	**2010**	**2009**
Cashflows from operating activities	17,265	17,450	15,328
Cashflows from investing activities	(20,279)	(22,759)	(15,687)
Proceeds from borrowings and advances	9,413	7,022	3,493
Repayment of borrowings and advances	(3,209)	(2,664)	(2,561)
Cashflows from financing activities	6,204	4,358	932
Net increase/(decrease) in cash and equivalents	**3,190**	**(951)**	**573**
Cash and equivalents	5,848	2,658	3,609

Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

Linked to the asset revaluations process stated above, IPART’s analysis of case study councils found that this revaluation process resulted in sharp increases in the value of some council’s assets. In some

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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

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.

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

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

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

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

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

Operating Ratio

Benchmark = Better than negative 4%

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

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

Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

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

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

Unrestricted Current Ratio

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

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

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