ATTACHMENT 4: FINANCIAL ASSESSMENTS AND LETTER OF SUPPORT

A4.1 NSW Treasury Corporation financial assessment

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Port Stephens Council

Financial Assessment and Benchmarking Report

8 October 2012

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

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Disclaimer

This report has been prepared by New South Wales Treasury Corporation (TCorp) in accordance with the appointment of TCorp by the Division of Local Government (DLG) as detailed in TCorp's letters of 22 December 2011 and 28 May 2012. The report has been prepared 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 Port Stephens Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Port Stephens 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 Port Stephens Council's (the Council) financial capacity and its ability to undertake additional borrowings. The analysis is based on a review of the historical performance, current financial position, and long term financial forecasts. It also benchmarks the Council against its peers using key ratios.

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

Council has made one application for a Road Reseal Program at a cost of $1.0m with the loan to be repaid over 10 years

TCorp's approach has been to:

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

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

- Council's underlying cash result (measured using EBITDA) has been improving over the three year period
- Council has developed a number of commercial operations such as the Newcastle Airport that provide reliable cash flows to support their activities
- Approximately 82.0% of the Council's revenue base is derived from own sourced revenue (annual charges, and user charges and fees). Council can rely upon these revenue streams for financial flexibility for the term of this facility

Council's reported infrastructure backlog of $26.8m in 2011 represents 5.2% of its infrastructure asset value of $512.8m. Council does not have any Water or Sewage Infrastructure.

Other observations include:

- Council's infrastructure backlog has decreased by $4.0m since 2009 following the Asset Revaluation process
- The most significant proportion of the backlog at 75.0% relates to roads. This is being addressed in the LIRS project
- Compared to benchmark ratios Council appears to be underspending on asset renewal and asset maintenance

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

- The forecast shows a surplus position is expected each year after 2012 when capital grants and contributions are excluded
- Council's level of fiscal flexibility is sound as Council's Own Source Operating Revenue Ratio is maintained at levels around 75.0%

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

- The DSCR remains above the benchmark of 2.00x for the 10 years forecast
- The Interest Cover Ratio is above the benchmark of 4.00x for the entire forecast period
- Based on a benchmark of DSCR>2x, we believe Council could borrow an additional $2.0m in addition to the $1.0m borrowings proposed under LIRS in 2013

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, was generally above the group's average
- Council's liquidity position was adequate but underperformed the group's average
- Whilst Council is more highly leveraged than its peers, its DSCR and Interest Cover Ratio were adequate over the review term
- Council had an overall lower level of Infrastructure Backlog than its peers; however it did not achieve the benchmark throughout the review period. Council's asset maintenance, asset renewal and capital expenditure were below the group's average in each of the past three years

Section 2 Introduction

2.1: Purpose of Report

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

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

The key areas focused on are:

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

2.2: Scope and Methodology

TCorp's approach was to:

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

In undertaking its work, TCorp relied on:

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

Benchmark Ratios

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

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

Therefore these benchmarks are intended as a guide to performance.

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

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

2.3: Overview of the Local Government Area

Port Stephens LGA	
Locality & Size	
Locality	Hunter
Area	859km²
DLG Group	4
Demographics	
Population	64,807
% under 19	26%
% between 20 and 59	48%
% over 60	26%
Expected population 2025	78,700
Operations	
Number of employees (FTE)	409
Annual revenue	$90.4m
Infrastructure	
Roads	5,327m m²
Bridges	15
Infrastructure backlog value	$27m
Total infrastructure value	$513m

Port Stephens Council Local Government Area (LGA) is located at the boundary of the Mid North and Central Coast of New South Wales. It covers an area of 859 km² and is approximately 55km from east to west and 30km form north to south. Known as the Blue Water Paradise it includes the suburbs of Nelson Bay, Anna Bay, Fingal Bay and Medowie.

The LGA has a substantial estuary system with a surface area of over 100 km² making it approximately three times the size of Sydney Harbour.

The current population is expected to grow by 21.4% to 78,700 in 2025.

Port Stephens Council had 409 full time equivalent employees at the end of June 2011.

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2.4: LIRS Application

Council has made one LIRS application:

Project: Road Reseal Injection Program

Description: To increase Council's road reseal program from $0.5m to $1.5m.

The proposed project is an extension of an existing program of works that Council already undertakes. Budget limitations have reduced Council's ability to undertake all the reseals identified. Increasing their funds will allow the usual program of works to expand and reseal more roads on the list. The list has expanded due to the high volume of rainfall over the last year.

Amount of loan facility: $1.0m

Term of loan facility: 10 years

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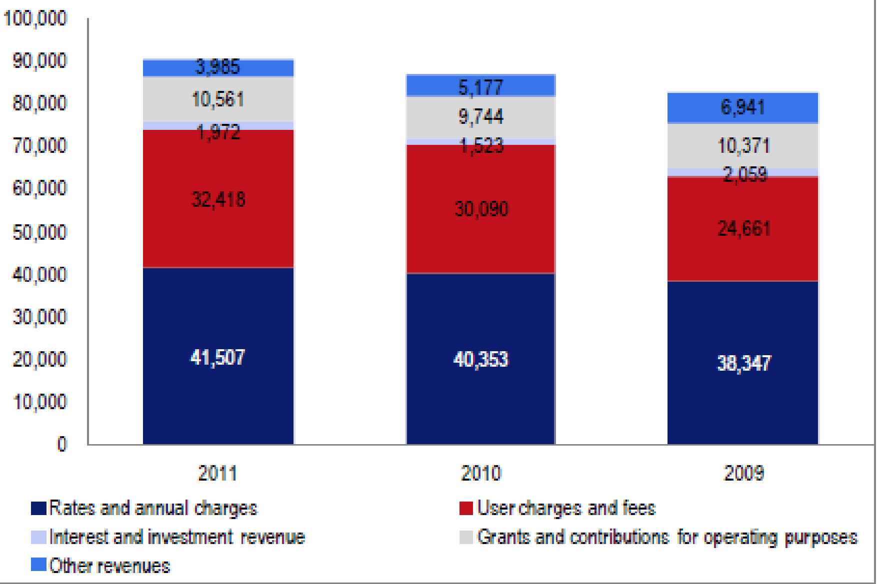
Section 3 Review of Financial Performance and Position

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

3.1: Revenue

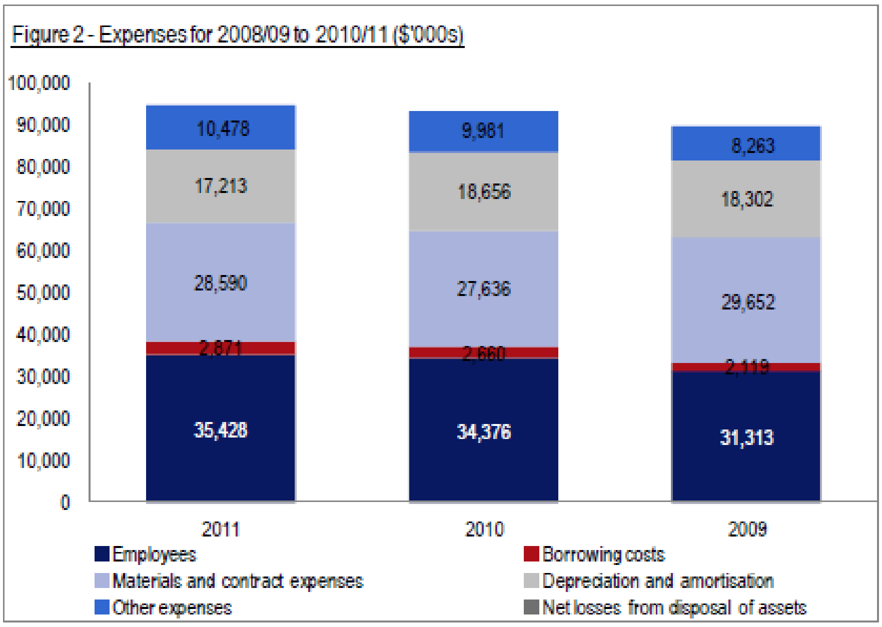
Figure 1 - Revenue Sources for 2008/09 to 2010/11 ($'000s)



Key Observations

- Rates and annual charges increased by 2.9% in 2011. This is compared to a 5.2% increase in 2010 which was due to an increase in domestic waste management services and an increase in the number of assessments.
- User fees and charges increased by 7.7% in 2011 driven by a $1.3m increase in revenue from Newcastle Airport (Council and Newcastle City Council each hold a 50% share of Newcastle Airport). In 2010 user fees and charges increased by 22.0% primarily due to a $1.2m increase in revenue from Newcastle Airport and a $2.3m increase in RMS charges. Council's holiday and caravan parks also generate significant revenue each year with $9.0m generated in 2011.
- In 2011 other revenue decreased by 23.0% due to a $1.2m decrease in insurance claim recoveries income. This was mainly due to the timing of invoices and outstanding claims in 2010 rather than increased claims in that year.
- Operating grants and contributions rose by 8.4% in 2011 compared to a 6.0% decrease in 2010. This was attributed to an increase of $0.9m in Roads to Recovery grants and $0.9m for bushfire and emergency services due to storms and floods in 2011.

3.2: Expenses



Key Observations

- Employee costs continue to be the largest expense at 37.4% ($35.4m) of overall expenses for 2011. While there was a slight decrease in salary costs in 2011, Workers' Compensation Insurance increased by $1.3m following an increase in claims history. Council's workers compensation figure has also historically included a component for the discount factor for employee leave entitlement (ELE) which increased by $0.2m in 2011. Following a recent audit this component will be separated from the workers compensation figure in the 2012 accounts. In 2010, employee expenses increased by 9.8% driven by a $2.2m increase in salaries and wages. This was driven by a new enterprise agreement which guaranteed staff a minimum salary increase of 4.0% p.a. for each of the three years of the agreement. Council also completed a market review of all positions in the organisation which resulted in a number of senior staff receiving pay increases in excess of the standard 4.0%. The 2010 financial year was the first year with the full impact of these pay increases.
- Materials and contracts increased by 3.5% in 2011 to $28.6m which was in line with general increases.
- The Asset Revaluation process in 2009 increased the value of Council's infrastructure assets by $114.0m. This resulted in the annual depreciation charge increasing from $13.4m in 2008 to $18.3m in 2009 with little movement since 2009.

- In 2011 other expenses increased by 5.0% to $10.5m. This is due to continued high costs at Newcastle Airport which amounted to $3.9m for 2011. This was partly offset by the increase in revenue.

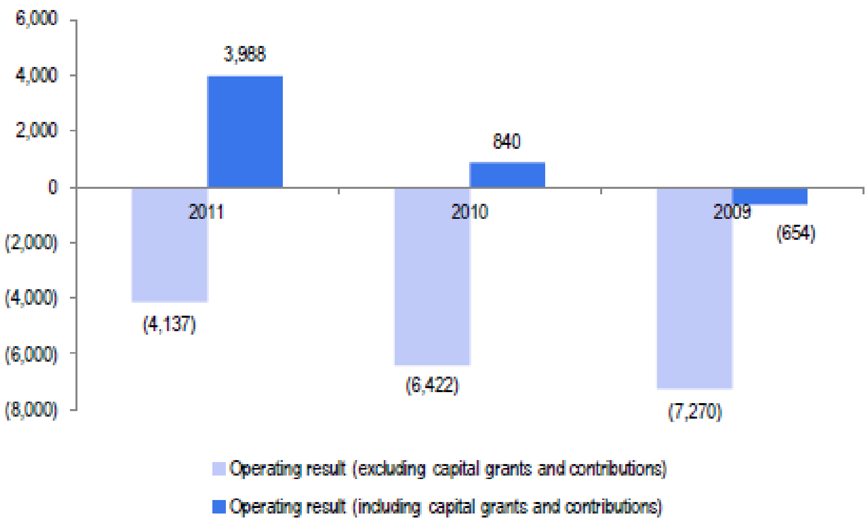
3.3: Operating Results

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 reported improving net operating deficits (excluding capital grants and contributions) for the last three years. 2011 improved due to decreased depreciation expense, and increases in user fees and charges revenue.
- Council expenses include a non-cash depreciation expense ($17.2m in 2011) which has increased by $5.0m since 2008 due to Asset Revaluations. Whilst the non cash nature of depreciation can favourably impact on such ratios as EBITDA that focus on cash, depreciation is an important expense that 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 ($'000's)	15,947	14,894	13,151
Operating Ratio	(4.6%)	(7.4%)	(8.8%)
Interest Cover Ratio	5.55x	5.60x	6.21x
Debt Service Cover Ratio	1.06x	1.60x	1.84x
Unrestricted Current Ratio	1.40x	1.16x	1.08x
Own Source Revenue	75.0%	75.0%	71.0%
Cash Expense Ratio	2.58 months	1.28 months	2.36 months
Net assets ($'000's)	721,128	681,820	511,138

Key Observations

- Council's underlying operating performance (measured using EBITDA) is on an upward trend.
- The Operating Ratio was below benchmark each year however has been improving primarily due to the increases in user fees and charges since 2009.
- Council's Interest Cover Ratio was well above benchmark in all three years.
- The DSCR was below benchmark and decreasing. This was driven by additional borrowings of $16.0m in 2009 for the Newcastle Airport Expansion and $10.5m in 2010
- The Unrestricted Current Ratio has been below benchmark for the past three years however it is increasing. The increase is due to a number of Council's long term investments reaching maturity within 12 months.
- When the Asset Revaluations are excluded, the underlying trend in all three years has been an increase in the infrastructure, property, plant and equipment (IPP&E) asset base with asset purchases being greater than the combined value of disposed assets and annual depreciation. Over the three years this amounted to an $11.4m increase in IPP&E assets.
- Council has borrowings of $38.8m with the total debt at 5.4% of the Net Assets.

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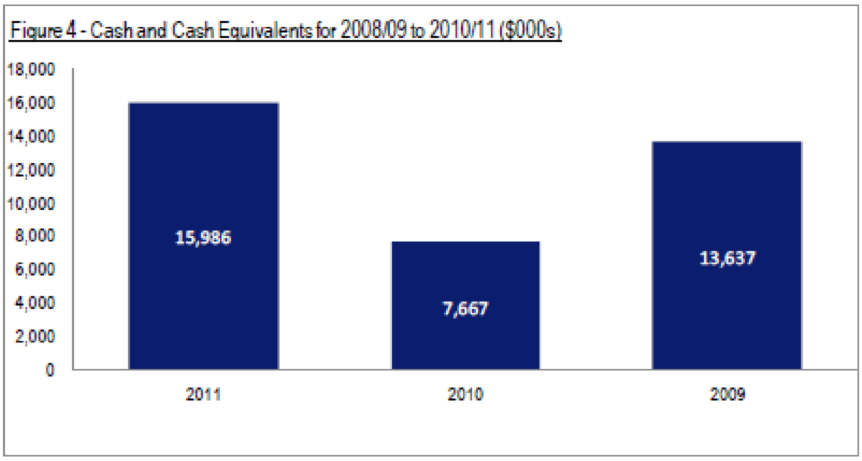
3.5: Statement of Cashflows



Key Observations

- Cash and cash equivalents decreased in 2010 due to increased capital expenditure.
- In 2011 Council added $6.9m to their cash flow from the sale of a block of land, at Heatherbrae, to a mining and manufacturing company.
- The cash balances indicate Council had sound liquidity.
- Of the $24.6m in cash and investments $12.2m is externally restricted and $12.4m is internally restricted. Council does not have any unrestricted cash or investments. In order to function without any unrestricted cash, Council has advised that they closely monitor their available cash and ongoing monthly expenditure. During the previous 12 months Council has managed to meet all financial commitments as and when they have fallen due.
- Within Council's investments $0.2m were held in long term deposits, $2.8m in equity linked notes, $3.9m in NCDs and FRNs, and $5.0m in CDOs. Council expect a return of $4.8m on their CDO, FRN and NCD investments.
- The management of both cash and equivalents, and investments, along with a continuing improvement in the Unrestricted Current Ratio indicates that Council has sufficient liquidity to manage their short term liabilities.

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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 20010/11 ($'000's)

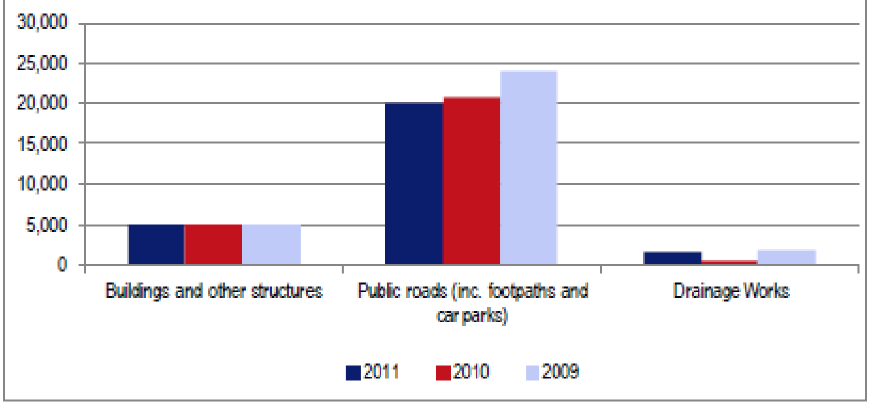
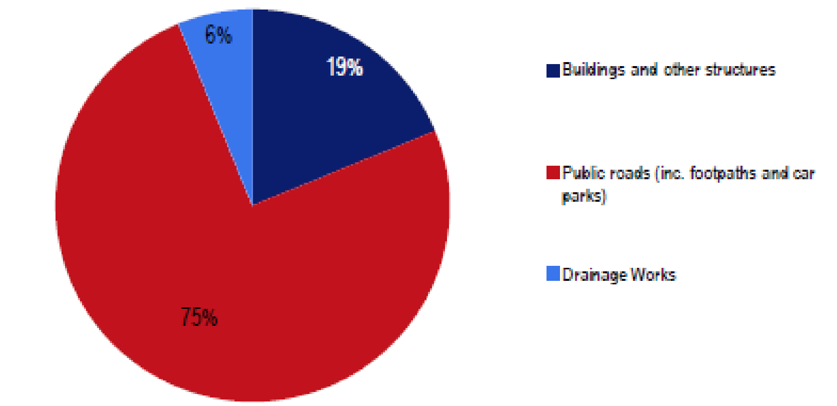


Figure 6 - Infrastructure Backlog Composition for 2010/11



Council reported a $26.8m infrastructure backlog in 2011 of which 75.0% ($20.1m) relates to Public Roads. Council is seeking to address part of their roads infrastructure backlog in their LIRS project.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard ($'000's)	26,819	24,498	30,854
Required annual maintenance ($'000's)	17,618	19,895	18,474
Actual annual maintenance ($'000's)	10,381	11,980	12,597
Total value of infrastructure assets ($'000's)	512,851	515,857	398,765
Total assets ($'000's)	781,069	752,602	580,928
Building and Infrastructure Backlog Ratio	0.05x	0.05x	0.08x
Asset Maintenance Ratio	0.59x	0.60x	0.68x
Building and Infrastructure Renewals Ratio	0.54x	0.63x	0.71x
Capital Expenditure Ratio	0.80x	1.33x	1.48x

The Infrastructure Backlog Ratio has improved since 2009. The total value of infrastructure assets has increased by $123.0m due to Asset Revaluations in 2009 while the value of the backlog decreased over the same period.

The Asset Maintenance Ratio, and Buildings and Infrastructure Asset Renewals Ratio indicate Council is spending at levels below benchmark on asset renewal and asset maintenance. This could cause the backlog to increase in the future.

The Capital Expenditure Ratio which takes into account assets which improve performance or capacity was above benchmark in two of the three years.

Based on these figures, Council is not spending sufficient amounts to maintain their existing assets at an acceptable level. The quality of the existing asset base may decline if this trend continues.

In their 2011 Asset Management Plan Council has recognised the fact that while they have the ability to sustain a considerable proportion of their assets, there is a significant shortfall in funds required to bring assets to the condition required by the community.

Council is addressing part of their backlog through the LIRS Scheme. They have also made a commitment to create an Operating Surplus from 2015 onwards, which is reflected in their Long Term Financial Plan. Once surplus funds become available Council plans to enhance their existing asset base and improve their asset maintenance.

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 ($'000's)	Year ended 30 June		
	2011	**2010**	**2009**
New capital works	6,461	17,015	N/A
Replacement/refurbishment of existing assets	7,833	8,844	N/A
Total	**14,294**	**25,859**	N/A

Capital Works Program 2009 and 2010:

Nelson Bay Foreshore Improvements	$1.1m
Pavement Rehabilitation Seaham Road - Nelsons Plains	$1.0m
President Poincare Parade Upgrade	$0.8m
Road Toll Response Bucketts Way	$0.6m
Karuah Community Hub Project	$0.5m

Major Capital Works Program 2011-2021:

Fingal Bay Surf Club Upgrade	$3.4m
Shoal Bay Foreshore Waterways Upgrade	$2.5m
Fingal Bay Amenities Upgrade	$1.5m

3.7: Specific Risks to Council

Environmental and Natural Disasters. Port Stephens LGA has very diverse ecosystems with a substantial estuarine system however population growth is putting pressure on the environment and natural resources of the LGA. Climate change and associated sea level rise, and frequency and severity of floods and storm events are risks to the LGA. The LGA has had three Natural Disaster Declarations since December 2002, two declarations were due to bushfires and the most recent in June 2011 was due to flooding. The Council must consider their exposure to the impacts associated with climate change when planning for the future as they will be reliant on both State and Federal grants and funding for various natural disaster funds.

Population Growth. With a population of 64,807, the LGA's population has grown over the past 15 years and this is expected to increase to 78,700 by 2021. The LGA has an increasing retiree population, with a growth rate of 50.0% in the aged over 60s demographics in the last 10 years. There have also been decline in the 20 to 34 years age group as people leave for higher education and employment. The increasing population and particularly the increasing retiree population will place additional pressure on existing infrastructure and services.

Shifts in LGA's economic activities. Economic activity in Port Stephens includes agribusiness, tourism and manufacturing, Port Stephens continues to experience growth in manufacturing however the tourism industry has declined, in line with national trends. The retail industry in the area is under pressure from competition from Newcastle and Maitland. Major constraints in the workforce include limited higher order knowledge base, current skills shortage in manufacturing and construction, and infrastructure gaps in roads, energy and services in industrial areas e.g. Newcastle Airport has limited public transport. These are all trends which will affect revenue growth in the future. In their 2012 Integrated Plan, Council has included plans to promote and develop education and training in their young people in order to retain them in the area.

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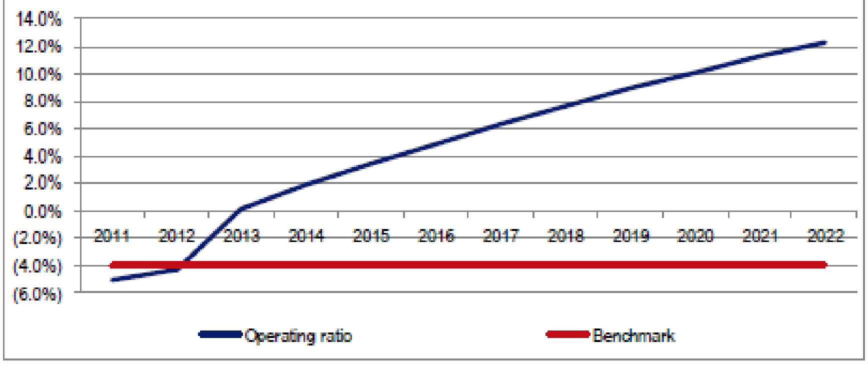
Section 4 Review of Financial Forecasts

The financial model shows the audited figures for 2011 and 2012, and projected financial statements and assumptions from 2013 until 2020. The model includes the $1.0m loan without any LIRS subsidy.

The LIRS loan relates to the Consolidated Fund therefore we have focused our financial analysis solely upon this Fund and Council does not operate Water or Sewer Funds.

4.1: Operating Results

Figure 7- Operating Ratio for General Fund



The Council's Operating Ratio is below benchmark until 2012 when capital grants and contributions are excluded. From 2013, Council forecasts a surplus each year with a total increase of 20.0% over the entire forecast period. A decrease in employee expenses in 2012 caused the ratio to increase sharply with Council forecasting operating revenue to increase at a faster rate than operating expenses from 2013.

Council are currently reviewing a number of potential low risk commercial projects for their LGA. While these have not been included in their LTFP they are expected to generate significant additional revenue streams for the LGA in the future.

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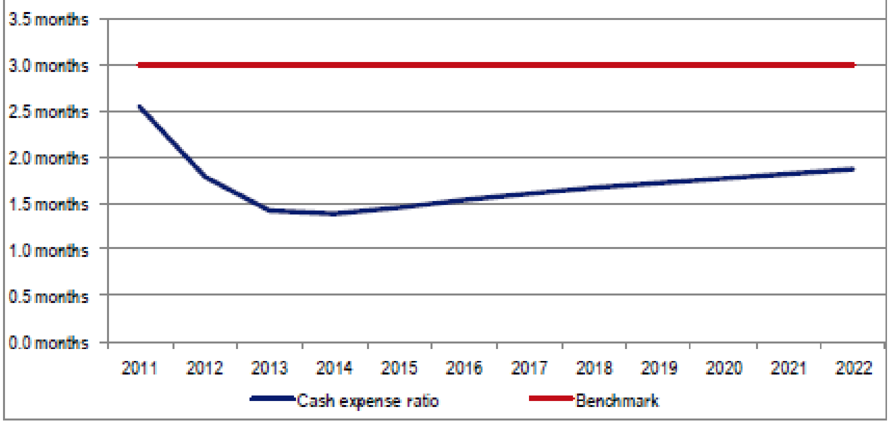
4.2: Financial Management Indicators

Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund

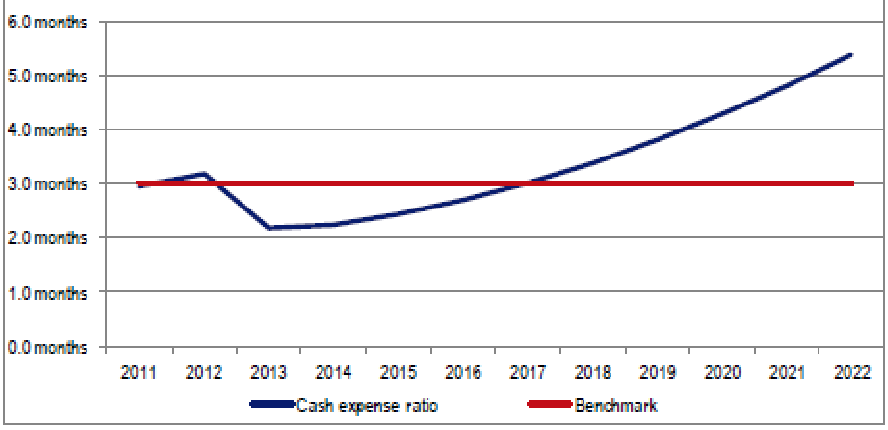


The Cash Expense Ratio is below benchmark and indicates that Council operates with little room for flexibility in regard to liquidity. The decrease in 2012 is due to increased IPP&E expenditure that year and the expenditure is maintained at these levels throughout the forecast period. We note that Council has a strong focus on cash management and actively monitors and manages its cash position.

This ratio does not take into account Council's level of investments. Council held $2.4m in current investments as at 30 June 2012.

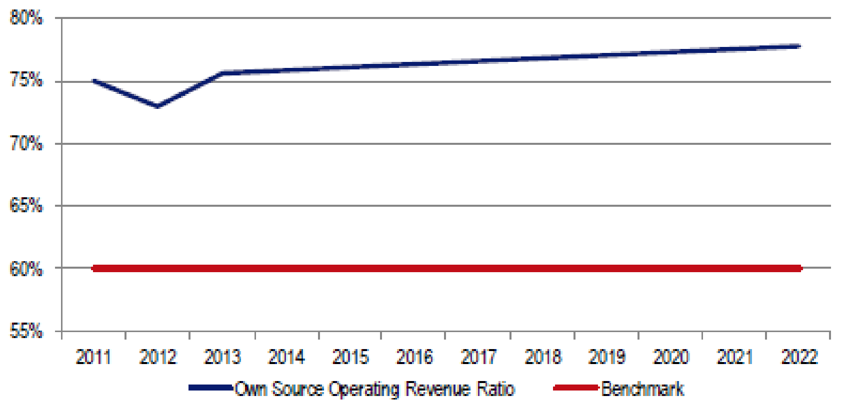
When Council's current investments are considered, the Cash Expense Ratio rises above benchmark in 6 of the 10 years, forecasting a more liquid position from 2017 onwards. Council have advised that since mid 2012 they invest in term deposits only.

Figure 8 (a) - Cash Expense Ratio for General Fund



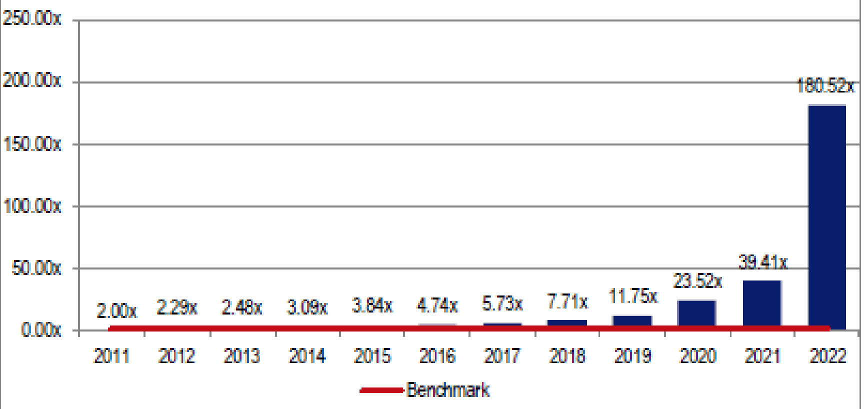
Fiscal Flexibility Ratios

Figure 9 - Own Source Operating Revenue Ratio for General Fund

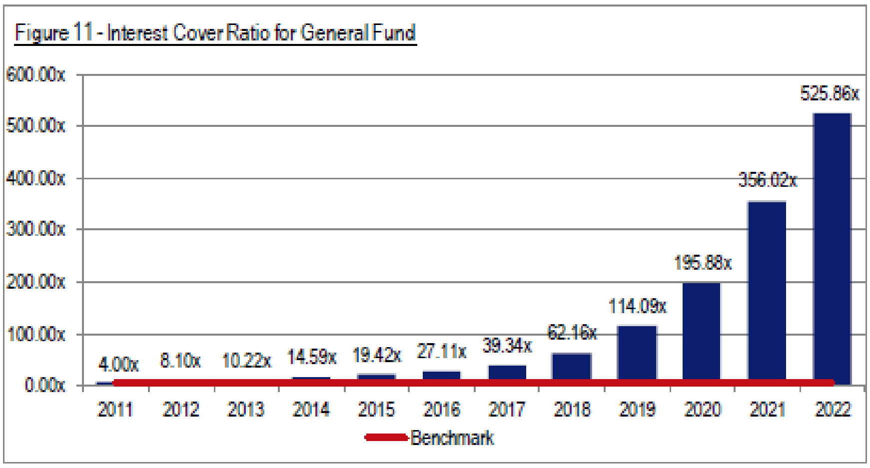


The Own Source Operating Revenue Ratio is above benchmark for the entire forecast period. This indicates the Council is not highly reliant on external revenue sources.

Figure 10 - DSCR for General Fund



The DSCR is at or above the benchmark of 2.00x for the entire forecast period. This indicates that Council has the ability to manage the additional debt cost that the LIRS application relates to.



The Interest Cover Ratio is well above benchmark for the entire forecast period and shows the Council has sufficient capacity to service scheduled debt commitments, including the LIRS loan with the forecast showing capability to service further debt interest cost in the future.

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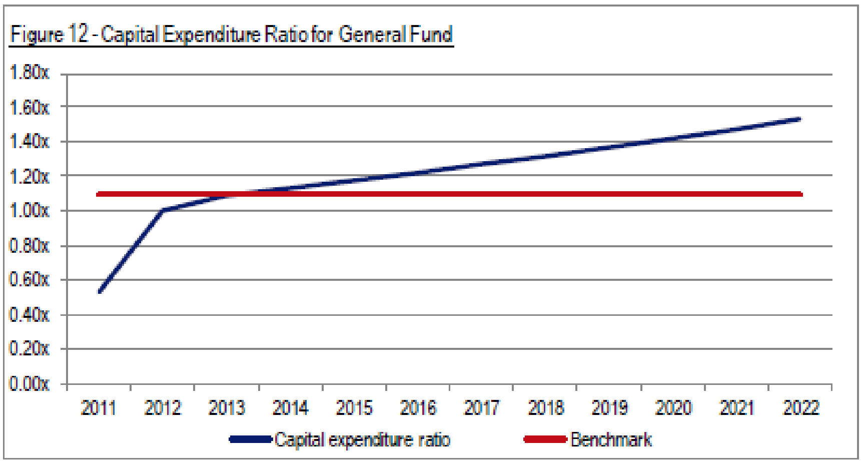
4.3: Capital Expenditure



The Capital Expenditure Ratio is forecast to increase over the next 10 years. The total surplus figure for capital expenditure versus depreciation over the 10 year period amounts to $44.5m. Council has forecast an increase in population over the next 10 years and the Increase in capital expenditure appears sufficient to meet that demand.

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 rates 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 rate and an annual charge to be an increase by mid-range LGCI annual increases of 3%
- Interest and investment revenue: annual return of 5%
- All other revenue items, the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

Key Observations and Risks

- Rates and annual charges are forecast to increase in 2013 by 3.6% p.a. for the remainder of the forecast period in line with IPART approved increases for 2013.
- User Fees and Charges are forecast to increase by 5.0% p.a. over the forecast period. This is high especially given the decreases in other revenues of 25.0% in 2010 and 23.0% in 2011. The forecast increase is driven by rental income for Council's investment and other rental properties which have increases built into the lease agreements.
- Employee costs are forecast to increase by 2.88% p.a. It is slightly optimistic compared to the 2011 increase of 3.1% however with Council now closely monitoring costs such as Workers Compensation we feel this is achievable.
- Council has not forecast any additional borrowings over the 10 year period. The model assumes that projects are funded from operational surpluses.
- Materials and contracts are forecast to increase by 3.6% p.a. This is in line with historical results of 3.5% increase in 2011.
- Grants and contributions for operating purposes are forecast to increase by 2.5% p.a. This is considered reasonable.
- Council in currently conducting an internal sustainability review which is due to be completed by December 2012. They have already begun to implement some efficiency initiatives identified during the review process which has resulted in savings in their 2013 budget.

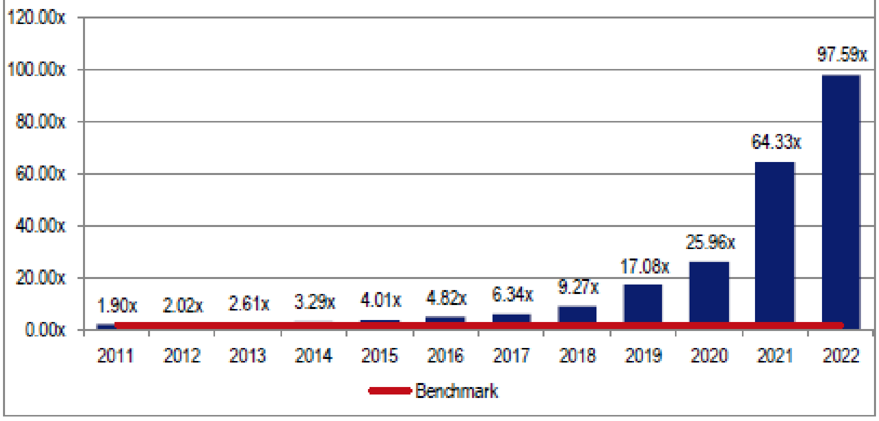
New South Wales Treasury Corporation

4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will be able to incorporate additional loan funding in addition to the LIRS loan facilities, subject to our comments in section in 4.4. Some comments and observations are:

- Based on a benchmark of DSCR>2x, $2m could be borrowed in addition to the $1.0m borrowings proposed under LIRS in 2013
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at a rate of 6.95% p.a.
- The Council's capacity to borrow additional funds increases each year as additional cashflow is forecast to become available for debt service

Figure 13 - DSCR for General Fund



New South Wales Treasury Corporation

Section 5 Benchmarking and Comparisons with Other Councils

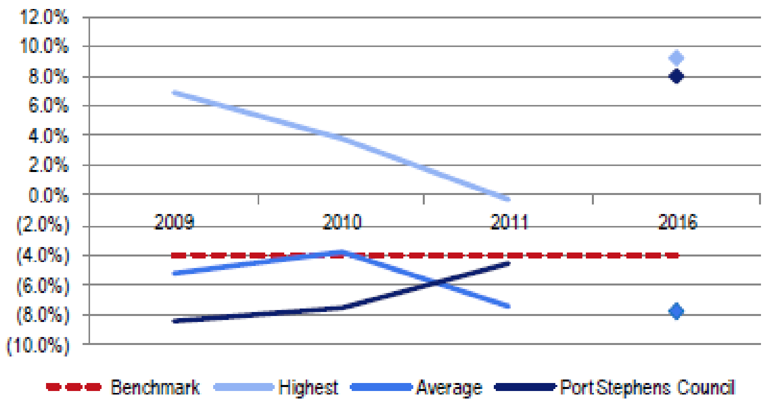
As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis (that is, for councils that operate more than one fund, the results of all funds are included). This section 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 14 to Figure 20, 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 21 to 23 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.

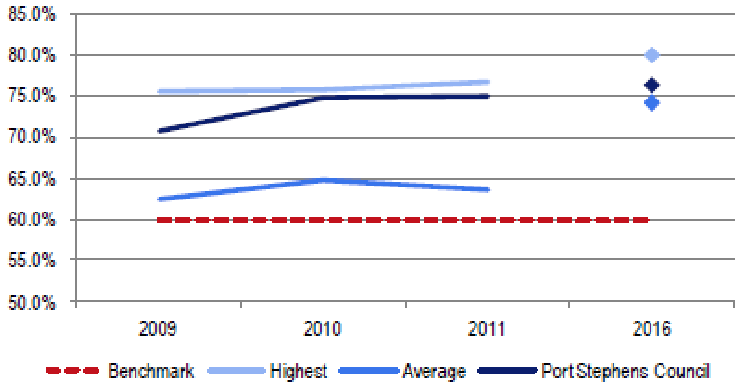
Financial Flexibility

Figure 14 - Operating Ratio Comparison



Council's Operating Ratio was below benchmark in the past three years and generally below the group's average. However, Council's operating results are forecast to improve substantially over the medium term, in contrast to most of the councils in the group.

Figure 15 - Own Source Operating Revenue Ratio Comparison



Council's Own Sourced Revenue Ratio was strong over the past three years, well above benchmark and the group's average. Council's sound fiscal flexibility is expected to continue over the medium term.

Overall, Council's financial flexibility has been adequate and is trending upwards to levels higher than most other councils in the group.

Liquidity

Figure 16 - Cash Expense Ratio Comparison

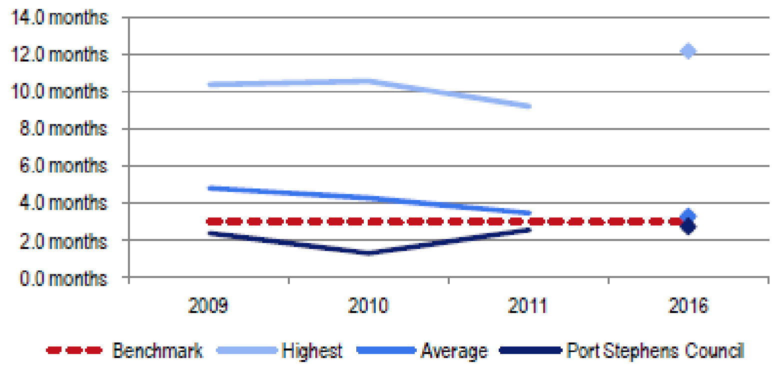
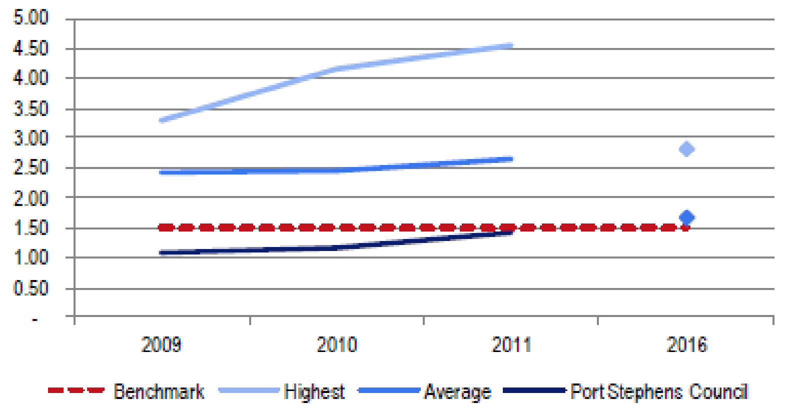


Figure 17 - Unrestricted Current Ratio Comparison



Council's Cash Expense Ratio was below benchmark and the group's average over the past three years, indicating that Council has been operating with limited cash reserves. It should be noted that Council's considerable investments were not taken into account when calculating the ratio.

Council's Unrestricted Current Ratio was also below benchmark and the group's average over the review period. Council did not provide sufficient data to calculate the ratio over the medium term.

Debt Servicing

Figure 18 - Debt Service Cover Ratio Comparison

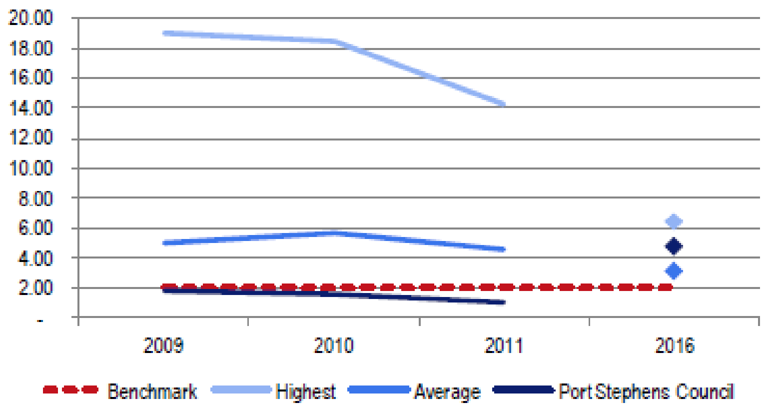
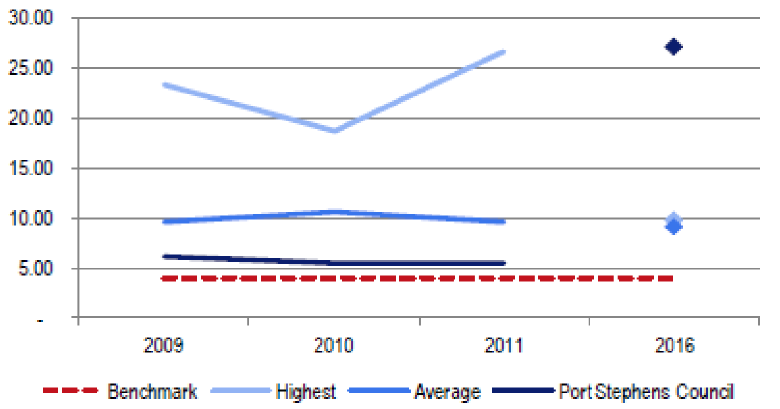


Figure 19 - Interest Cover Ratio Comparison



Council's debt servicing capacity was sufficient over the review period, with DSCR having tracked just below benchmark and Interest Cover Ratio having tracked just above benchmark.

In both ratios, Council underperformed the average council in the group. This indicates that it is more highly geared than its peers.

Figure 20 - Capital Expenditure Ratio Comparison

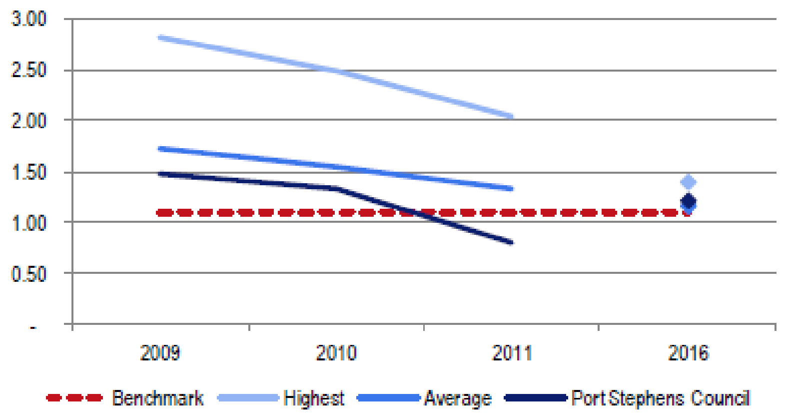
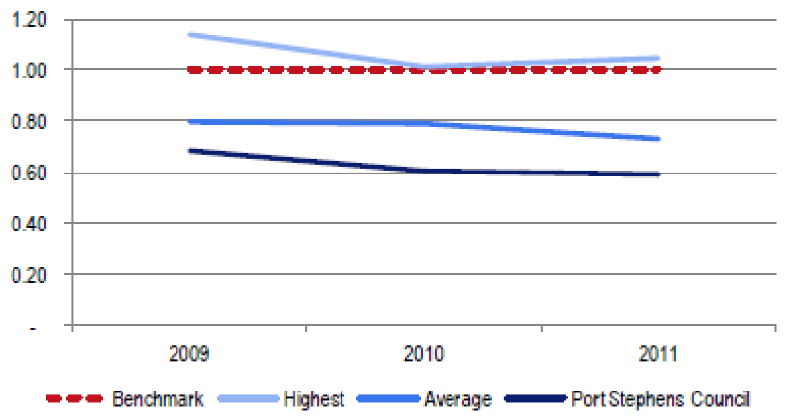
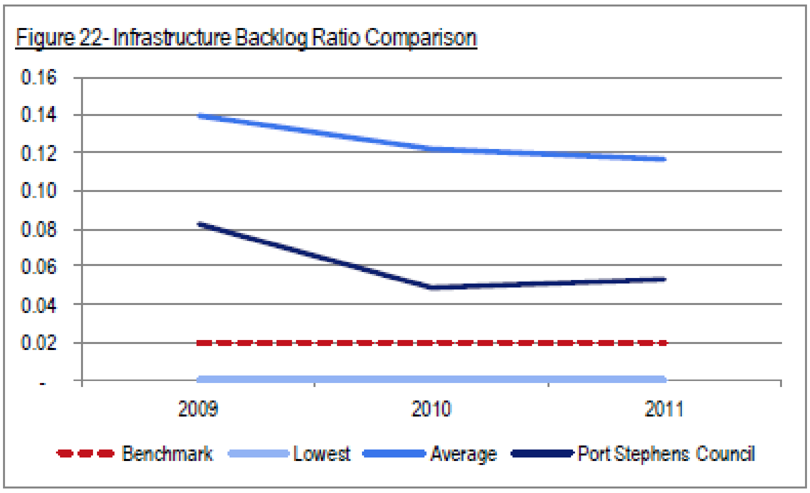
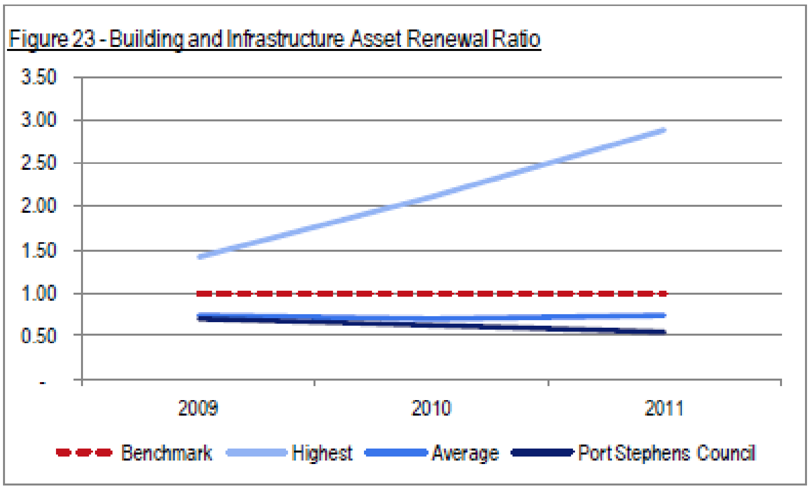


Figure 21 - Asset Maintenance Ratio Comparison







Council's Infrastructure Backlog was above benchmark but below the group's average over the review period, indicating that Council has managed its backlog better than its peers in recent years.

However, when compared with the other councils in the group and the benchmark levels, Council has underspent on asset renewal and asset maintenance. Council's Capital Expenditure Ratio was also below the group's average in the past three years, but above benchmark in two of the past three years.

Overall, the ratios suggest that Council needs to increase its investment in asset renewal and maintenance 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. Both past performance and the financial forecasts support our findings that Council has sufficient financial capacity to service the additional borrowings proposed under its LIRS application.

We base our recommendation on the following key points:

- Council has sufficient financial capacity to manage the additional $1.0m debt highlighted by a DSCR and Interest Cover Ratio above the benchmarks in all 10 years of its financial forecast
- Based on our analysis, Council could also incorporate an additional $2.0m of borrowings before it reaches the DSCR benchmark of 2.00x
- Council is currently reviewing a number of future low risk commercial projects for their LGA. While these have not been included in their LTFP they are expected to generate significant additional revenue for the LGA in the future

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

- Falling numbers in young people in the area is a concern and Council needs to continue to plan for the future and offer further opportunities to retain young people in the area
- Some of the assumptions used in Council's forecast are slightly more optimistic than what we expect. Council needs to carefully manage their expense increases and additional revenue sources to ensure the targeted operating results are reached

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Revenue					
Rates and annual charges	41,507	40,353	38,347	2.9%	5.2%
User charges and fees	32,418	30,090	24,661	7.7%	22.0%
Interest and investment revenue	1,972	1,523	2,059	29.5%	(26.0%)
Grants and contributions for operating purposes	10,561	9,744	10,371	8.4%	(6.0%)
Other revenues	3,985	5,177	6,941	(23.0%)	(25.4%)
Total revenue	**90,443**	**86,887**	**82,379**	**4.1%**	**5.5%**
Employees	35,428	34,376	31,313	3.1%	9.8%
Borrowing costs	2,871	2,660	2,119	7.9%	25.5%
Materials and contract expenses	28,590	27,636	29,652	3.5%	(6.8%)
Depreciation and amortisation	17,213	18,656	18,302	(7.7%)	1.9%
Other expenses	10,478	9,981	8,263	5.0%	20.8%
Total expenses	**94,580**	**93,309**	**89,649**	**1.4%**	**4.1%**
Operating result	**(4,137)**	**(6,422)**	**(7,270)**	**(35.6%)**	**(11.7%)**

Table 2 - Items excluded from Income Statement

Excluded items ($'000)			
	2011	2010	2009
Grants and contributions for capital purposes	8,125	7,262	6,616
Gain on recognition of interest-free loan	360	793	165
Increase (Decrease) in the fair value of investment properties	390	614	380
Impairment	316	0	3,933
Interest and Investment Losses	0	0	(1,709)
Fair Value adjustments borrowing costs	176	57	91
Gains/Loss on disposal of assets	5,854	(186)	(138)

Table 3 - Balance Sheet

Balance Sheet ($'000)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
Current assets					
Cash and equivalents	15,986	7,667	13,637	108.5%	(43.8%)
Investments	8,623	1,909	4,673	351.7%	(59.1%)
Receivables	8,891	8,958	7,349	(0.7%)	21.9%
Inventories	1,760	1,985	2,117	(11.3%)	(6.2%)
Total current assets	35,260	20,519	27,776	71.8%	(26.1%)
Non-current assets					
Investments	3,524	11,761	10,533	(70.0%)	11.7%
Receivables	6,003	8,019	9,152	(25.1%)	(12.4%)
Inventories	15,580	15,589	8,471	(0.1%)	84.0%
Infrastructure, property, plant & equipment	702,317	678,724	513,446	3.5%	32.2%
Investment property	18,385	17,990	11,550	2.2%	55.8%
Total non-current assets	745,809	732,083	553,152	1.9%	32.3%
Total assets	**781,069**	**752,602**	**580,928**	**3.8%**	**29.6%**
Current liabilities					
Payables	7,587	5,825	7,984	30.2%	(27.0%)
Borrowings	6,487	6,665	5,621	(2.7%)	18.6%
Provisions	13,034	12,678	13,299	2.8%	(4.7%)
Total current liabilities	27,108	25,168	26,904	7.7%	(6.5%)
Non-current liabilities					
Payables	47	36	60	30.6%	(40.0%)
Borrowings	32,305	43,866	40,704	(26.4%)	7.8%
Provisions	481	1,712	2,122	(71.9%)	(19.3%)
Total non-current liabilities	32,833	45,614	42,886	(28.0%)	6.4%
Total liabilities	**59,941**	**70,782**	**69,790**	**(15.3%)**	**1.4%**
Net assets	**721,128**	**681,820**	**511,138**	**5.8%**	**33.4%**

New South Wales
Treasury Corporation

Table 4-Cashflow

Cashflow Statement ($'000)	Year ended 30 June		
	2011	**2010**	**2009**
Cashflows from operating activities	22,419	14,202	11,365
Cashflows from investing activities	(2,185)	(24,321)	(22,324)
• Proceeds from borrowings and advances	201	10,779	17,693
• Repayment of borrowings and advances	(12,116)	(6,630)	(5,011)
Cashflows from financing activities	(11,915)	4,149	12,682
Net increase/(decrease) in cash and equivalents	**8,319**	**(5,970)**	**1,723**
Cash and equivalents	15,986	7,667	13,637

New South Wales Treasury Corporation

Appendix B Glossary

Asset Revaluations

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

Collateralised Debt Obligation (CDO)

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

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

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

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

Division of Local Government (DLG)

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

Depreciation of Infrastructure Assets

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

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

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

EBITDA

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

Grants and Contributions for Capital Purposes

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

Grants and Contributions for Operating Purposes

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

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

Independent Commission Against Corruption (ICAC)

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

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

Independent Pricing and Regulatory Tribunal (IPART)

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

Infrastructure Backlog

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

Integrated Planning and Reporting (IP&R) Framework

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

Local Government Cost Index (LGCI)

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

Net Assets

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

Roads and Maritime Services (RMS)

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

Section 64 Contribution

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

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

Section 94 Contribution

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

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

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

Special Rate Variation (SRV)

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

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

The applications are reviewed and approved by IPART.

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

New South Wales Treasury Corporation

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

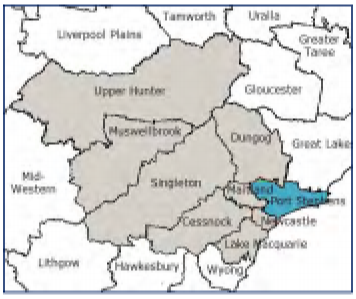
Benchmark = 1.5x (taken from the IPART December 2009 Revenue Framework for Local Government report)

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.

A4.2 Extract of summary assessment from IPART's *Fit for the Future* report 2015, p325

PORT STEPHENS COUNCIL – CIP



	FIT		
Area (km²)	979	Population 2011	67,200
OLG Group	4	(2031)	88,900
ILGRP Group	Hunter		
Operating revenue (2013-14)	$98.9m	TCorp assessment	Moderate FSR Neutral Outlook
ILGRP options	Council in JO (shaded area); further consideration of a possible transfer of some land to a merged Dungog Maitland LGA in the shorter term.		

Assessment summary

Scale and capacity	**Satisfies**
Financial criteria:	**Satisfies overall**
• Sustainability	Satisfies
• Infrastructure and service management	Satisfies
• Efficiency	Satisfies

Fit for the Future – FIT

- The council satisfies the scale and capacity criterion.
- The council satisfies the financial criteria overall. It satisfies the sustainability, infrastructure and service management and efficiency criteria.

Scale and capacity - satisfies

- The council's proposal is consistent with the ILGRP's option.
- Our analysis has not identified evidence for a better alternative to the council's proposal to stand alone.
- As the ILGRP did not identify another option for this council, it was not required to demonstrate how it met each of the elements of scale and capacity.
- The council has a robust revenue base and has demonstrated effective regional collaboration.

Sustainability – satisfies

- The council satisfies the criterion for sustainability based on its forecast to meet the benchmarks for the operating performance ratio, the own source revenue ratio and the building and infrastructure asset renewal ratio by 2019-20.

Infrastructure and service management - satisfies

- The council satisfies the criterion for infrastructure and service management based on its forecast to meet the benchmarks for the infrastructure backlog, asset maintenance and debt service ratios by 2019-20.
- The council states it has revised the methodology for calculating the backlog ratio from the 2014-15 year onwards, which we consider to be reasonable.

Efficiency - satisfies

- The council meets the criterion for efficiency based on its forecast for real operating expenditure per capita reducing over the period to 2019-20.

Other relevant factors	
Social and community context	The council's proposal does not address social or community concerns.
Community consultation	The council has not indicated it conducted community consultation for the FFTF proposal.
Water and/or sewer	The council does not have a water/sewer business.
Submissions	There were no submissions received in relation to Port Stephen's proposal.

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A4.3 Letter of Support (for loans) - Commonwealth Bank of Australia

Corporate Financial Services

Level 9
Darling Park, Tower 1
201 Sussex Street
SYDNEY NSW 2000

[redacted]

Tim Hazell
Finance Manager
Port Stephens Council
116 Adelaide St
RAYMOND TERRACE NSW 2324

21st January 2019

Dear Tim

Offer of Finance

Commonwealth Bank of Australia ('the Bank') is pleased to provide an Offer of Finance for a loan facility up to $80,000,000 to Port Stephens Council as proposed in Council's special rate variation proposal.

The Offer of Finance is based on multiple loan options for Council's consideration including:

- Proposed Option 1 : $80m x 20 years fixed/ variable, Principle and Interest repayments
- Proposed Option 2: $80m x 5 years Interest Only

Should you wish to proceed on the offer, Particulars of the Facility, including all fees and the interest rates and terms and conditions will be provided separately via a terms schedule.

In the meantime, should you have any queries on the attached, please do not hesitate to contact me on [redacted]

Yours sincerely

[redacted]