New South Wales Treasury Corporation

Lithgow City Council

Financial Assessment, Sustainability and Benchmarking Report

22 April 2013

Prepared by NSW Treasury Corporation for Lithgow City Council, the Division of Local Government and the Independent Local Government Review Panel.

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 to assist the DLG and the Independent Local Government Review Panel in its consideration of the Sustainability of each local government area in NSW.

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, and Council's future Sustainability, within prudent risk parameters and the limits of its financial projections.

The report has been prepared for Lithgow City Council, the DLG and the Independent Local Government Review Panel. TCorp shall not be liable to Lithgow City 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 Lithgow City Council's (the Council) financial capacity, and its future Sustainability. 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.

TCorp's approach has been to:

- Review the most recent four years of Council's consolidated financial results
- Conduct a detailed review of the Council's 10 year financial forecasts, with a particular focus on a council's General Fund. Where a council operates a Water or other Fund the financial capacity of these other Funds may be reviewed where considered necessary.

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

- Council's underlying operating results, as measured by EBITDA has improved by 336.3% ($6.5m) over the review period. This is driven by an SRV to fund infrastructure improvements beginning in 2010 for a period of 10 years
- Annual depreciation expense increased substantially by 41.6% ($2.4m) from 2010 to 2011 due to Asset Revaluations
- Council had total borrowings of $18.9m in 2012 representing 5.3% of Net Assets
- Council's liquidity ratios and credit metrics were above or close to benchmark over the review period.

The Council reported $63.8m of Infrastructure Backlog in 2012 which represents 20.8% of its infrastructure asset value of $307.5m. Other observations include:

- Council's Capital Expenditure Ratio, and Building and Infrastructure Asset Renewal Ratio were above benchmark during the review period
- Asset Maintenance Ratio was close to benchmark for the last three years
- 54.5% of the Backlog value relates to public roads assets and 25.2% relates to sewerage assets

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

- The forecast shows that operating deficits are expected over the forecast period, when capital grants and contributions are excluded. The lowest forecast Operating Ratio is 18.3% in 2018
- Council is forecasting sound liquidity levels over the forecast period

- Council is forecasting improving debt servicing ratios as debt levels reduce
- Council is forecasting a drop in capital expenditure which is well below the benchmark over the forecast period

In our view, the Council has the capacity to undertake additional borrowings of up to $7.4m. This is based on the following analysis:

- The forecast DSCR remains at a level above the benchmark of 2.00x for all the forecast period

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

- Council is currently in a sound financial position with a focus on asset renewal but this is forecast to deteriorate
- Council forecasts continuous operating deficits (excluding capital grants and contributions) that will increase pressure to maintain existing services
- Council's current LTFP shows that the level of capital expenditure compared to depreciation expense is forecast to decrease over time to levels below what is required to maintain assets at an acceptable standard
- Council has the capacity to utilise further borrowings in the future

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

- Council's financial flexibility as indicated by the Operating Ratio is above the group average but below the benchmark
- Council's Own Source Operating Revenue Ratio is below the group average
- Council's DSCR and Interest Cover Ratio have been below the group averages but above the benchmarks. These ratios are expected to continue in the medium term to be above the benchmarks
- Council was in a sound liquidity position and this is expected to continue in the medium term
- Council's Infrastructure Backlog is higher than its peers.
- Council's Capital Expenditure Ratio and Asset Maintenance Ratio were at or above the group averages and close to or above the benchmarks. It had the highest Building and Infrastructure Asset Renewal Ratio in the peer group

Section 2 Introduction

2.1: Purpose of Report

This report provides the Council with an independent assessment of their financial capacity, Sustainability and performance measured against a peer group of councils. It will complement Council's internal due diligence, the IP&R system of the Council and the DLG, together with the work being undertaken by the Independent Local Government Review Panel.

The report is to be provided to the DLG and the Independent Local Government Review Panel.

The key areas focused on are:

- The financial capacity of the Council
- The long term Sustainability of the Council
- 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 four years of the Council's consolidated audited accounts using financial ratio analysis. In undertaking the ratio analysis TCorp has utilised ratios 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 Council's General Fund

- Identify significant changes to future financial forecasts from existing financial performance and highlight risks associated with such forecasts, including those that could impact Council's Sustainability

- 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 and achieve long term Sustainability

- Conduct a high level review of the Council's IP&R documents for factors which could impact the Council's financial capacity, performance and Sustainability

In undertaking its work, TCorp relied on:

- Council's audited financial statements (2008/09 to 2011/12)

- Council's financial forecast model

- Council's IP&R documents

- Discussions with Council officers

- Other publicly available information such as information published on the IPART website

In completing the report, TCorp worked closely with Council management to analyse and understand the information gathered. The Council was given a draft copy of the report for their review and comment. Based on our discussions with Council:

- Council provided feedback and TCorp subsequently updated the report

Definition of Sustainability

In conducting our reviews, TCorp has relied upon the following definition of sustainability to provide guidance:

"A local government will be financially sustainable over the long term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community."

Benchmark Ratios

In conducting our review of the Councils' financial performance, forecasts and Sustainability 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
Building and Infrastructure Backlog Ratio	< 0.02x
Asset Maintenance Ratio	> 1.00x
Building and Infrastructure Asset Renewal Ratio	> 1.00x
Capital Expenditure Ratio	> 1.10x

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2.3: Overview of the Local Government Area

Lithgow City Council LGA	
Locality and Size	
Locality	Central West
Area	4,514km²
DLG Group No.	4
Demographics	
Population	20,160
% under 20	25%
% between 20 and 59	50%
% over 60	25%
Expected population in 2021	22,150
Operations	
Number of employees (FTE)	182
Annual revenue	$34.8m
Infrastructure	
Roads	1,101km
Bridges	40
Infrastructure backlog value	$63.8m
Total infrastructure value	$307.5m

Lithgow City Council Local Government Area (LGA) is located approximately 140km west of the Sydney CBD.

The LGA consists of the Lithgow urban centre, two townships named Portland and Wallerawang, and a number of smaller rural localities. While Lithgow has traditionally been a mining town with heavy dependence on industry, it is diversifying its industries with two university campuses opening. The LGA also has a strong tourism industry with access to six national parks including Wollemi National Park.

According to Council's analysis, the population of the LGA is forecast to marginally increase from 20,160 in 2011 to 22,150 in 2021.

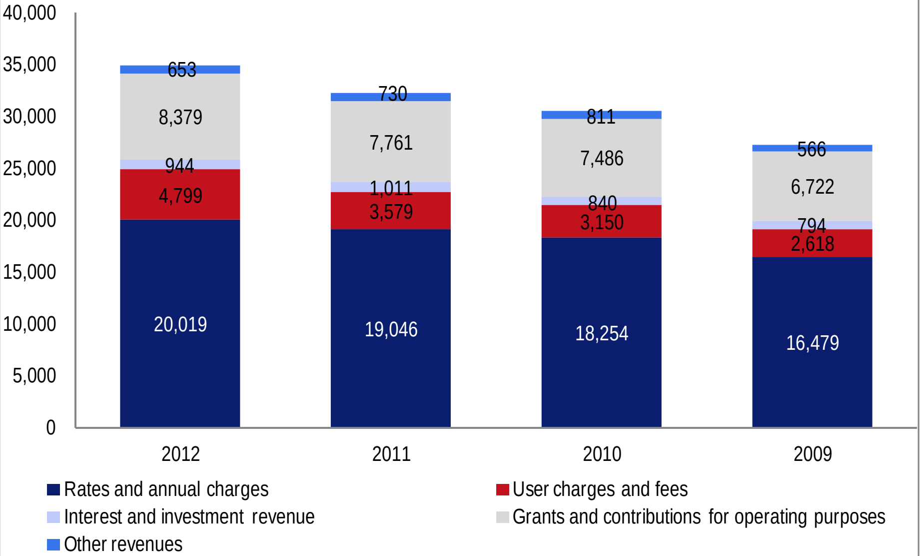
Council had 182 full time equivalent employees at 30 June 2012.

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 2011/12 ($'000s)



Key Observations

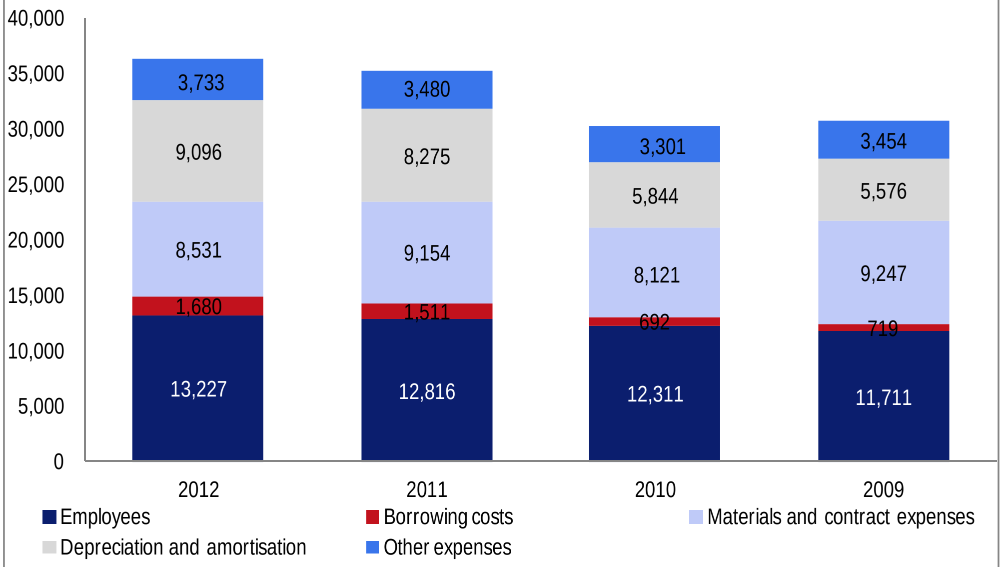
- Council's total revenue, excluding capital grants and contributions, increased by 28.0% ($7.6m) over the four year period to $34.8m in 2012.
- Rates and annual charges increased in line with the IPART approved rate peg over the past four years and the increase in rateable properties within the LGA due to subdivisions. There was also an increase in the sewerage special rate levied in 2012.
- Council has an existing SRV to fund infrastructure improvements on roads and buildings. The rate is 4.77% above the ordinary rates and lasts for 10 years beginning from the 2010 financial year.
- User fees and charges have increased by 83.3% ($2.2m) over the period, due mainly to a change in pricing for user pay water charges in compliance with grant conditions of the NSW Office of Water, Best Practice Guidelines. 2011 saw Council adjust its water supply fee structure to derive 75% of all residential income through user charges, in accordance with State Government Best Practice Guidelines.

- Grants and contributions for operating purposes have increased by $1.7m over the period with prepayments of Federal Financial Assistance Grants (FAG) taking place in 2009, 2011 and 2012.

- Other revenue is made up principally of rental income from Council's properties.

3.2: Expenses

Figure 2 - Expenses for 2008/09 to 2011/12 ($'000s)



Key Observations

- Council's expenses increased by 18.1% ($5.6m) from $30.7m in 2009 to $36.3m in 2012.

- Employee expenses saw an increase of 12.9% ($1.5m) over the review period, largely reflecting annual salary and wage increases in line with award increases. In 2010, Council's superannuation costs rose by $0.3m (32.6%) due to increased employer contributions required for the Local Government defined benefit superannuation funds.

- Borrowing expenses rose by 118.3% ($0.8m) in 2011 due to an increase in borrowed funds related to the Lithgow and Wallerawang sewerage treatment plants.

- While materials and contracts expenses fluctuated over the period, there was an overall reduction in costs ($0.7m) from 2009 to 2012. 2011 saw an increase of 12.7% ($1.0m) due to unscheduled works associated with flood damage following the December 2010 floods.

- Depreciation expense increased substantially in 2011 as a result of Council's Asset Revaluations process. Depreciation expense rose $2.4m from 2010 to 2011, of which $2.0m can be attributed to the Revaluations in 2010.

- Other expenses, consisting of items such as insurance and electricity, rose marginally over the review period.

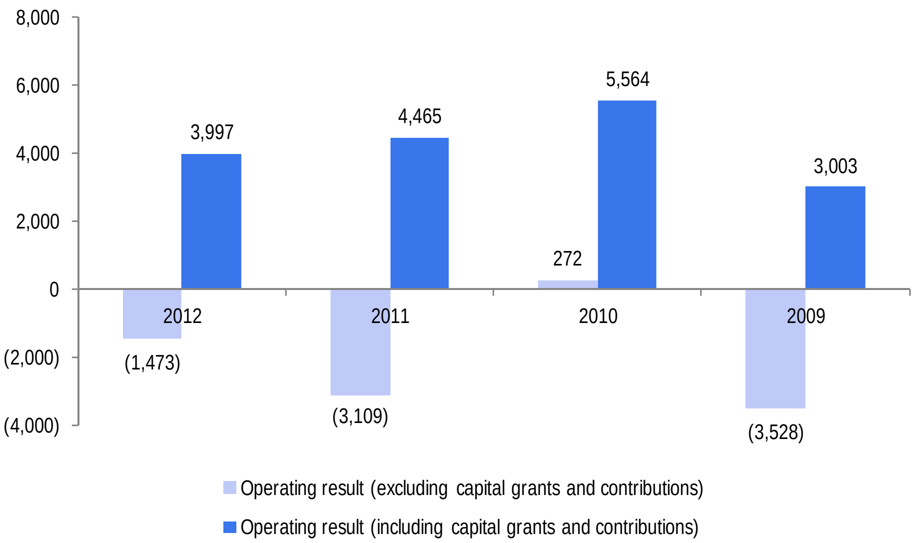
3.3: Operating Results

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 are detailed in Appendix A.

Figure 3 - Operating Results for 2008/09 to 2011/12 ($'000s)



Key Observations

- While Council has reported net operating deficits (excluding capital grants and contributions) in three of the past four years, Council's overall operating performance has improved over the review period although it is noted that the 2012 result was favourably impacted by the prepayment of the FAG of $1.7m.
- The 2011 results were adversely affected by increases in depreciation charges and unscheduled materials and contracts expenses. This included a non-cash depreciation expense of $8.3m in 2011 which was an increase of $2.4m from 2010 following the Asset Revaluations process. While the non-cash nature of depreciation can favourably impact on

ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA ($'000s)	9,303	6,677	6,808	2,767
Operating Ratio	(4.2%)	(9.7%)	0.9%	(13.0%)
Interest Cover Ratio	5.54x	4.42x	9.84x	3.85x
Debt Service Cover Ratio	3.11x	2.68x	5.97x	2.41x
Unrestricted Current Ratio	4.83x	2.07x	3.94x	2.48x
Own Source Operating Revenue Ratio	61.6%	57.0%	59.7%	56.7%
Cash Expense Ratio	5.0 months	6.3 months	10.7 months	7.7 months
Net assets ($'000s)	356,111	322,609	314,148	272,474

Key Observations

- Council's EBITDA has increased by $6.5m over the period to $9.3m in 2012.
- The Operating Ratio was below benchmark in three of the four years, reflecting the impact of the higher depreciation expense.
- Council's Interest Cover Ratio was above benchmark in three of the four years while Council's DSCR was above benchmark in all four years, indicating that Council has sufficient capacity to service its existing debt.
- The Unrestricted Current Ratio and Cash Expense Ratio were well above benchmark in all four years, demonstrating that Council's liquidity position is strong.
- While Council's Own Source Operating Revenue Ratio has improved over the review period, it was just below the 60% benchmark in three of the four years. This indicates that Council has moderate financial flexibility.
- Council's Net Assets have increased by $83.6m from 2009 to $356.1m in 2012 due largely to Asset Revaluations which increased the value of water and sewerage assets, stormwater drainage and other infrastructure assets including roads and bridges. When the Asset Revaluations are excluded, the underlying trend 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. This amounted to a $29.5m increase in IPP&E assets over the review period.
- Council had total borrowings of $18.9m in 2012 representing 5.3% of Net Assets.

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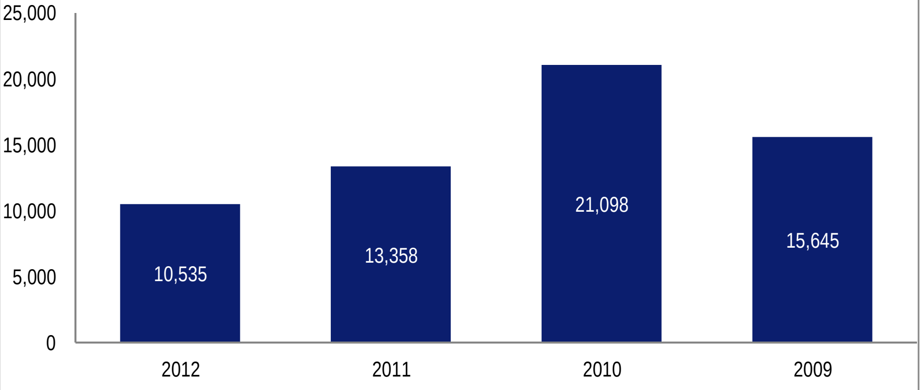
3.5: Statement of Cashflows

Key Observations

Figure 4 - Cash and Cash Equivalents for 2008/09 to 2011/12 ($'000s)



- Cash and cash equivalents have fluctuated over the period with an overall decrease of $5.1m (32.7%) since 2009. Increased expenditure on fixed assets in 2011 ($25.1m up from $16.2m in 2010), including capital expenditure on additions to Council's sewerage network totalling $17.1m, decreased the cash balance.

- Within Council's cash, cash equivalents and investments of $18.8m, $7.0m was externally restricted, $8.5m was internally restricted and $3.4m was unrestricted.

- Council's 2012 cash and cash equivalents comprised of $0.8m in cash, $1.2m in call deposits and $8.5m in short term deposits (where time to maturity from date of purchase is 3 months or less).

- Council's 2012 investment portfolio comprised of $8.3m in long term deposits.

- Council wrote down its 2009 valuation of its CBA Ethical Note (CDO asset) to Nil in 2010. The $500,000 Ethical Note was originally purchased in November 2006, but its value was adjusted to $220,000 in 2008 and then $57,000 in 2009 due to the asset's exposure to the CDO market.

3.6: Capital Expenditure

The following section predominantly relies on information obtained from Special Schedules 7 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 2011/12($'000s)

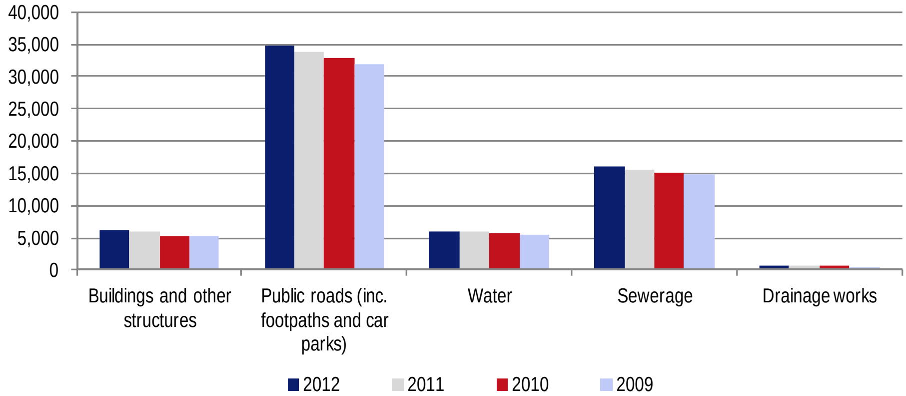
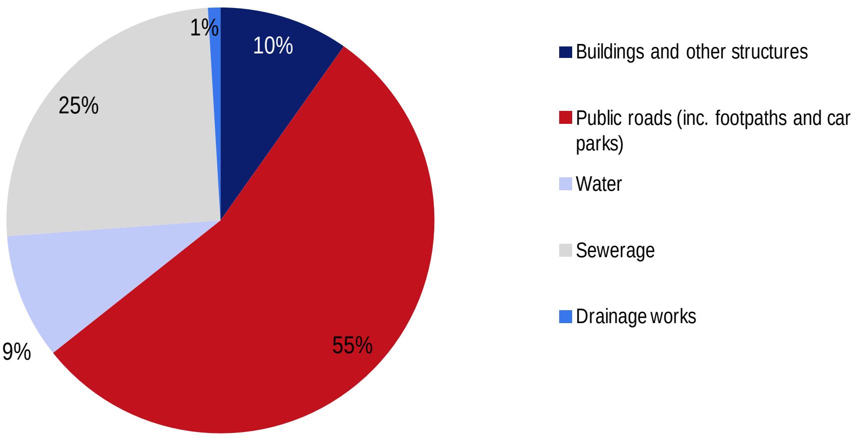


Figure 6 - Infrastructure Backlog Composition for 2011/12



Council reported $63.8m in Infrastructure Backlog in 2012, an increase of $5.9m since 2009. The backlog consists predominantly of road-related works at $34.8m in 2012. Council's Strategic Asset Management Plan 2012-2022 allocates $1.1m to road works capital expenditure in 2013, increasing annually to $1.7m in 2021. While this expenditure may stop the roads backlog from growing further, it is unlikely to reduce the backlog in a material way.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard ($'000s)	63,844	61,975	59,563	57,925
Required annual maintenance ($'000s)	10,770	10,458	9,998	9,707
Actual annual maintenance ($'000s)	10,269	9,972	9,682	6,796
Total value of infrastructure assets ($'000s)	307,529	276,446	265,799	182,119
Total assets ($'000s)	389,435	354,755	341,005	291,340
Building and Infrastructure Backlog Ratio	0.21x	0.22x	0.22x	0.32x
Asset Maintenance Ratio	0.95x	0.95x	0.97x	0.70x
Building and Infrastructure Renewals Ratio	1.32x	3.32x	3.08x	1.22x
Capital Expenditure Ratio	1.21x	2.93x	2.65x	1.13x

The Building and Infrastructure Backlog Ratio has improved over the review period mainly due to the Asset Revaluations increasing the value of the assets, however the Ratio remains well above benchmark in all four years.

The Asset Maintenance Ratio was close to benchmark in the last three years which indicates that Council has invested adequate funds to maintain the quality of its assets base.

The high Capital Expenditure Ratios and Building and Infrastructure Renewals Ratios over the review period suggest that Council has prioritised capital works and asset renewals. The particularly strong ratios in 2010 and 2011 are related to the Wallerawang and Lithgow sewerage treatment plant upgrades.

3.6(c): Capital Program

Significant Capital Works items include:

- Stage 1 Lithgow Aquatic Centre upgrade. Construction of the Lithgow Aquatic Centre in 2012 involved redevelopment of the old Lithgow War Memorial Olympic Pool site and repositioning of the entry, public amenities and kiosk. The new centre has improved disabled access and will open its amenities to other facilities in the Sporting Precinct, making it a multi-use facility. $2.1m was set aside for construction of Stage 1. Council's Long Term Financial Plan also provides for a Redevelopment Stage 2 in 2018 using loan borrowings of $1.3m.

- Road works under the Roads to Recovery Program. In 2012, Council completed $0.5m of bitumen upgrades to Cuthill Road, Glen Alice Road and Rydal Hampton Road under the Commonwealth funding program. Council's Roads to Recovery Allocation for 2013 is also $0.5m, and Council plans to continue to seek funding to upgrade state and regional roads within the LGA.

- Sewerage Treatment Plant Upgrades. Council has been undertaking significant work on upgrading of the Lithgow and Wallerawang Sewerage Treatment Plants during the last few years. The upgrades have increased capacity to service 23,000 and 3,300 "equivalent persons", respectively. Council funding for these projects was $3.6m in 2012. Over the medium term, Council is investigating sewerage collection and disposal of sewer waste in Cullen Bullen.

- Other significant capital projects included works to its sporting and recreational precincts (including the Tony Luchetti Sportsground, Civic Ballroom and Glanmire Oval Hockey Fields), and extensive Flood Mitigation work to Farmers Creek.

- Water assets. Improvements are being made to the water and sewer mains, the Clarence Colliery water transfer scheme and construction of a new reservoir.

3.7: Specific Risks to Council

- Ageing population. The LGA's population is ageing relatively quickly. Further, the LGA's population has not increased significantly in recent years and is forecast to remain flat over the next decade. The ageing population will place additional pressure on existing infrastructure, and additional services and facilities will be required to meet the added demand. Council has outlined strategies in its "Ageing Strategy" to address the needs of older people and implement an action plan.

- Economic growth. Currently, the LGA's economy is highly dependent upon coal mining, manufacturing and power generation, however structural changes in the broader economy are affecting jobs growth in the LGA's carbon-intensive industries. Jobs growth is central to attracting new workers and reducing the outward migration of people seeking opportunities elsewhere. Consequently, Council has identified skills development as key to promoting diverse employment opportunities for residents of the LGA. This is consistent with Council encouraging a university presence in Lithgow. The University of Notre Dame Sydney began construction of a clinical school at Lithgow District Hospital in 2012 and the University of Western Sydney will open a Lithgow campus in 2013.

- Natural disasters. The LGA has been declared a natural disaster area in recent years. Council is reliant on grants and contributions from other levels of government in the event of a natural disaster. Council is also planning a Floodplain Risk Management Plan to better prepare for future floods.

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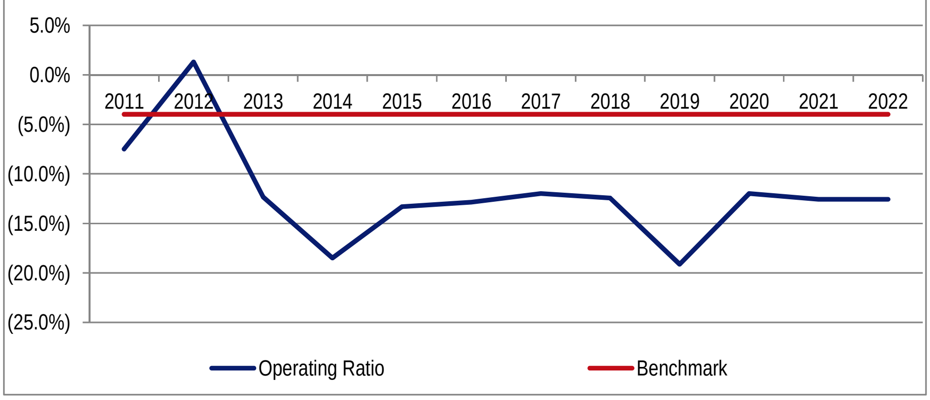
Section 4 Review of Financial Forecasts

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

4.1: Operating Results

Figure 7- Operating Ratio for General Fund



The overall trend in operating results is an initial deterioration and then relatively stable results over the forecast period that is well below the benchmark. The initial deterioration is due to the inclusion of the prepaid FAG in 2012, which improves the 2012 results and reduces the 2013 results.

The dip in 2014 is due to a 17.6% increase in depreciation which is reversed in 2015. The dip in 2019 is due to a 15.9% fall in operating grants and contributions that is reversed in 2020.

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4.2: Financial Management Indicators

Liquidity Ratios

Figure 8 - Cash Expense Ratio for General Fund

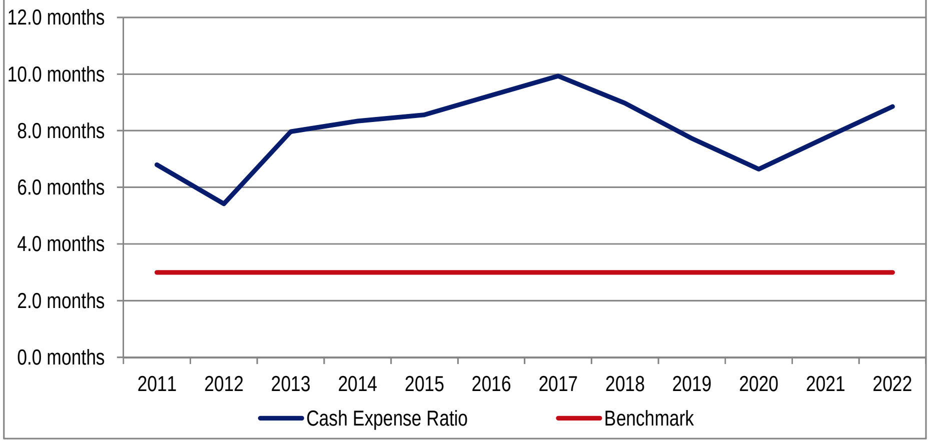
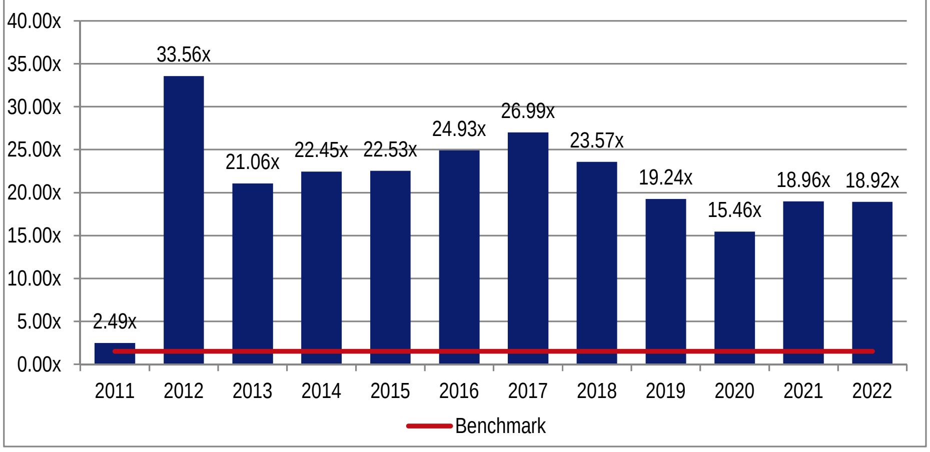


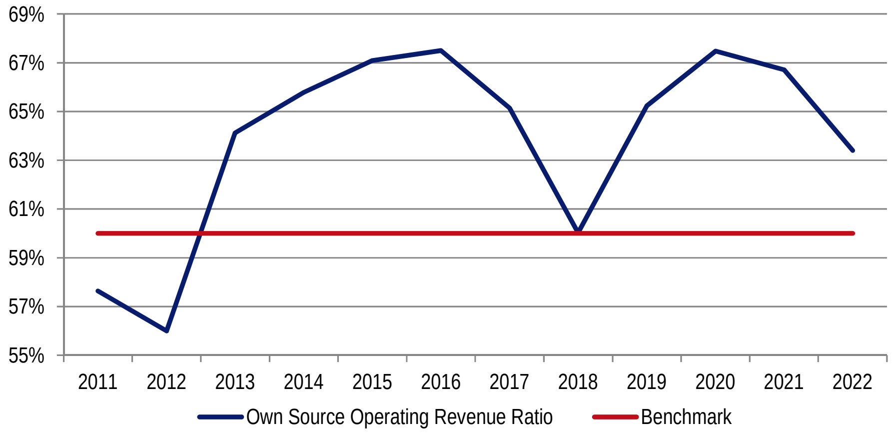
Figure 9 - Unrestricted Current Ratio for General Fund



Council's Cash Expense Ratio and Unrestricted Current Ratio are forecast to be strong over the forecast period, indicating that Council is forecasting a sound liquidity position.

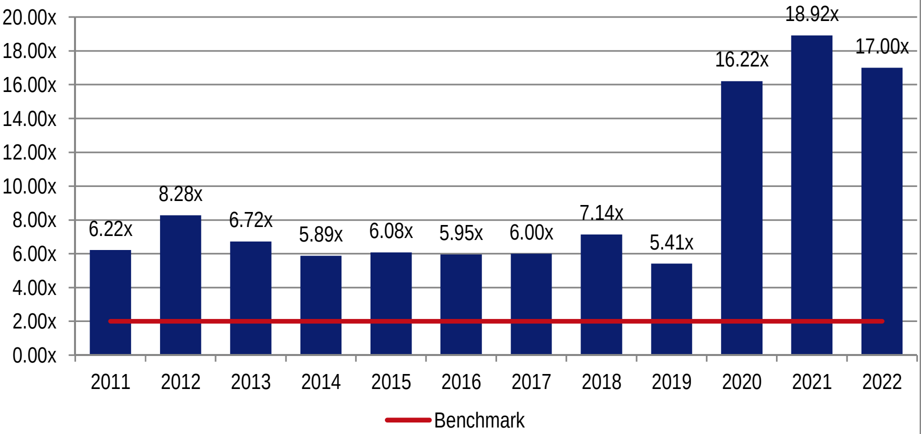
Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio for General Fund



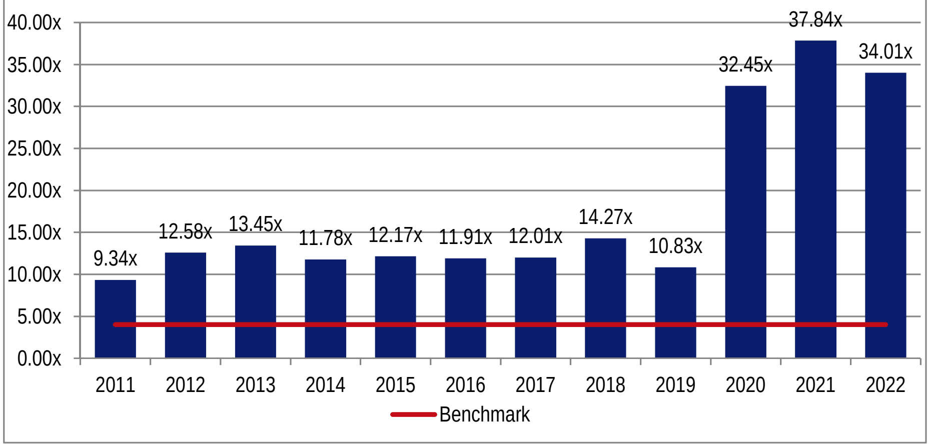
Council's forecast Own Source Operating Revenue Ratio remains above benchmark for the entire forecast period and increases due to more conservative forecasts of grants and contributions than historically received. The dip in 2018 is due to a one off increase in capital grants and contributions for roads and bridges funding.

Figure 11 - DSCR for General Fund



Council's DSCR is well above the benchmark over the forecast period and increases significantly from 2020 due to lower debt repayments as some loans are fully repaid. Council is proposing to borrow $0.5m in 2017 to fund the Lithgow Aquatic Centre Stage Three.

Figure 12 - Interest Cover Ratio for General Fund

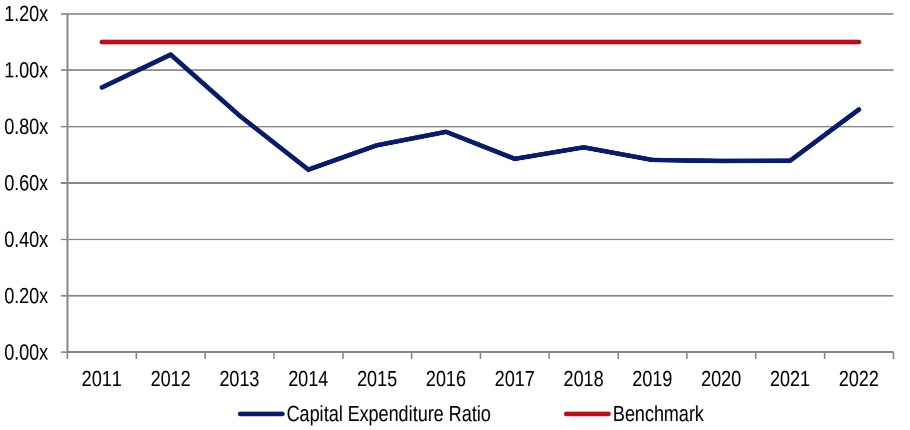


Council's Interest Cover Ratio is well above the benchmark over the forecast period and increases significantly from 2020 due to lower interest costs as some loans are fully repaid.

With both the DSCR and Interest Cover Ratios being very high and increasing, this suggests that the Council would be able to service more debt over the forecast period.

4.3: Capital Expenditure

Figure 13 - Capital Expenditure Ratio for General Fund



The Capital Expenditure Ratio is below the benchmark over the forecast period. This indicates that Council has not incorporated sufficient infrastructure asset investments into the forecast.

Council has completed its first iteration of the AMP with some asset condition assessments completed, community consultation undertaken and revised estimation for maintenance and operation of assets. This has enabled Council to determine the appropriate level of service expected by the community. Council is continuing to conduct asset condition assessments and refining their valuation methodologies.

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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

- Council has stated that consistent service levels are being maintained
- TCorp has based its analysis on the actual figures for 2011 and 2012 as well as the projections for the period between 2013 and 2022.
- Rates and annual charges increase by an average of 2.9% p.a.
- User fees and charges increase by an average of 3.5% p.a.
- Grants and contributions for operating purposes increase by an average of 3.5% p.a.
- Other revenue increases by an average of 3.0% p.a.
- Employee costs increase by an average of 2.9% p.a.
- Materials and contract expenses increase by 3.5% p.a.
- Depreciation and amortisation expenses increase by an average of 3.2% p.a. except for the abnormality noted in 2014 and 2015
- Other expenses increase by an average of 3.0% p.a.
- Other than our comments regarding underspending in capital expenditure compared to benchmark, the assumptions used by Council appear to be reasonable.

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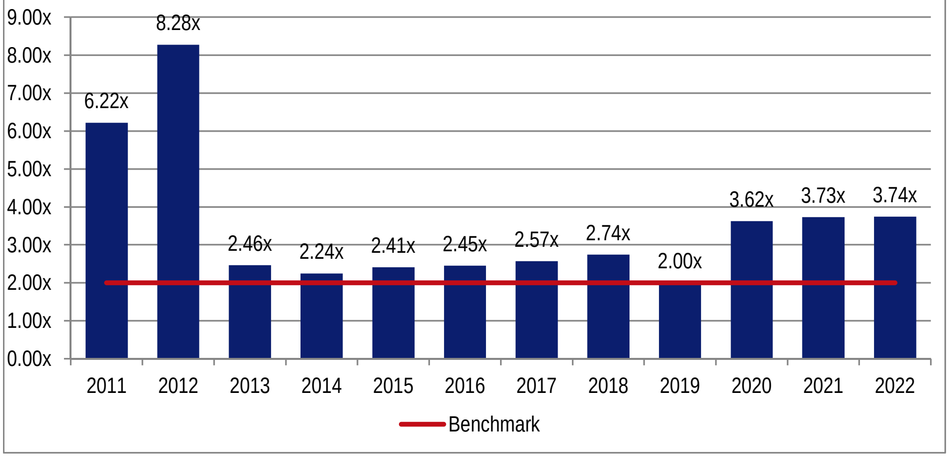
4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council will be able to incorporate additional loan funding in addition to its existing debt facilities (if any). Some comments and observations are:

- Based on a benchmark of DSCR>2x, up to $7.4m could be borrowed in addition to any existing borrowings
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at an interest rate of 8.0% p.a.

Figure 14 - DSCR for General Fund



4.6 Sustainability

TCorp believes that Council is currently in a sound but deteriorating financial position. The historical financial performance of Council has been moderate with operating deficits over most of the review period. Council's liquidity position was sound and credit metrics were sufficient to service current debt levels. Council has a relatively high Infrastructure Backlog but has an SRV in place till 2020 to fund infrastructure improvements, and their high capital and renewal ratios show that Council is focused on addressing the Backlog. Based on the current LTFP, Council is forecasting to be in a deteriorating operating position with significant operating deficits and insufficient capital spending over the forecast period.

In considering the long term Sustainability of the Council, we make the following comments:

- Council's operating performance has been satisfactory over recent years but is forecast to decrease as a result of slow revenue growth forecast being outpaced by expense growth. Council forecasts operating deficits (excluding capital grants and contributions) that will exert pressure to maintain existing service levels
- While Council has been spending enough on asset renewals in recent years compared to benchmark, their LTFP indicates that capital spending will be insufficient in the future which could lead to a reduction in the quality of the assets and ultimately service standards
- Council's liquidity position has been sound and is expected to remain sound over the forecast period
- Council has the capacity to utilise further borrowings that could assist for funding long term capital projects and reducing the Infrastructure Backlog

Section 5 Benchmarking and Comparisons with Other Councils

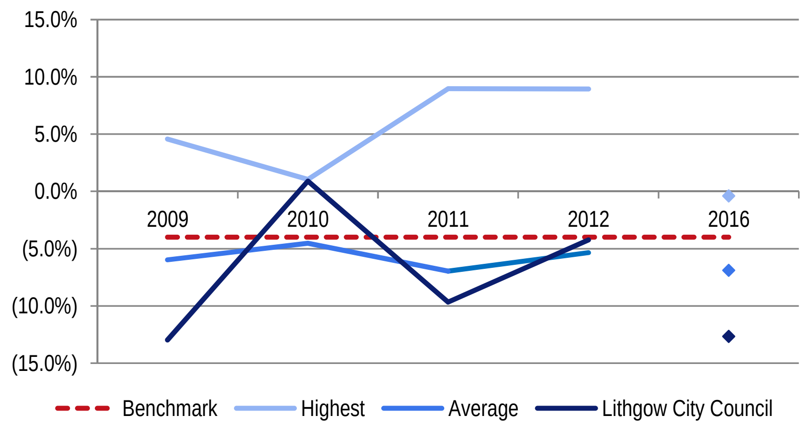
Each council's performance has been assessed against ten key benchmark ratios. . The benchmarking assessment has been conducted on a consolidated basis for councils operating more than one fund. This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 4. There are 31 councils in this group and at the time of preparing this report, we have data for all of these councils.

In Figure 15 to Figure 24, 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. For the Interest Cover Ratio and Debt Service Cover Ratio, we have excluded from the calculations, councils with very high ratios which are a result of low debt levels that skew the ratios.

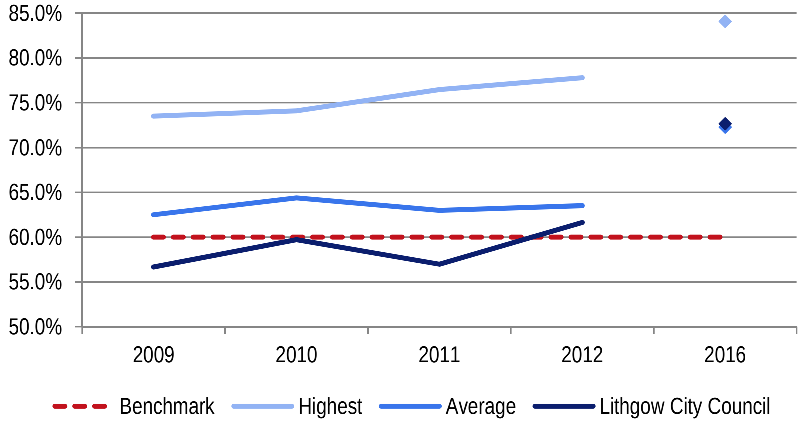
Financial Flexibility

Figure 15 - Operating Ratio Comparison



Council's Operating Ratio was above the group average in two of the last four years and above the benchmark once. Council's operating results are forecast to decline below the group average and benchmark over the medium term.

Figure 16 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio trended upwards over the review period, peaking above benchmark and slightly above the average council in the group. The upward trend is forecast to continue into the future, consistent with Council's peer group.

Liquidity

Figure 17 - Cash Expense Ratio Comparison

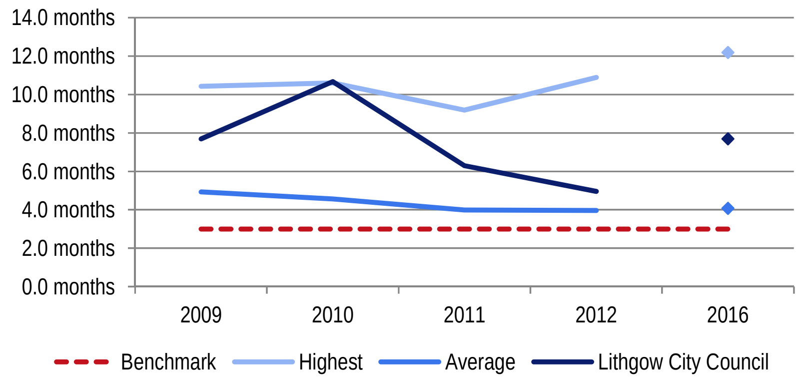
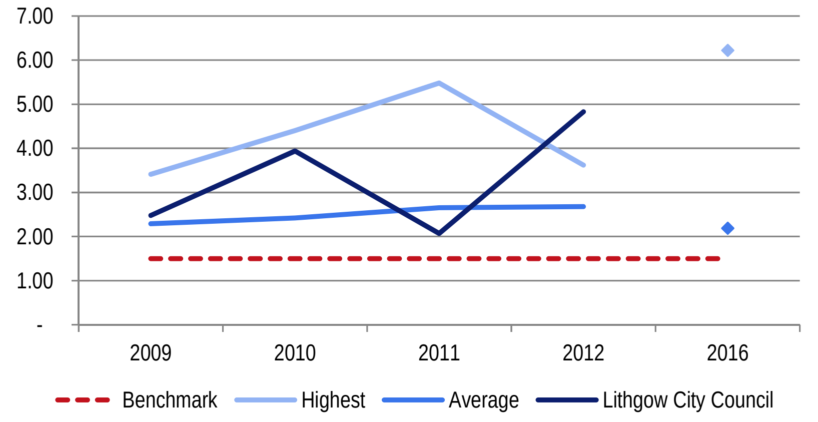


Figure 18- Unrestricted Current Ratio Comparison



On average over the last four years, the Council's liquidity position has been sound and this is forecast to continue in the medium term.

Debt Servicing

Figure 19 - Debt Service Cover Ratio Comparison

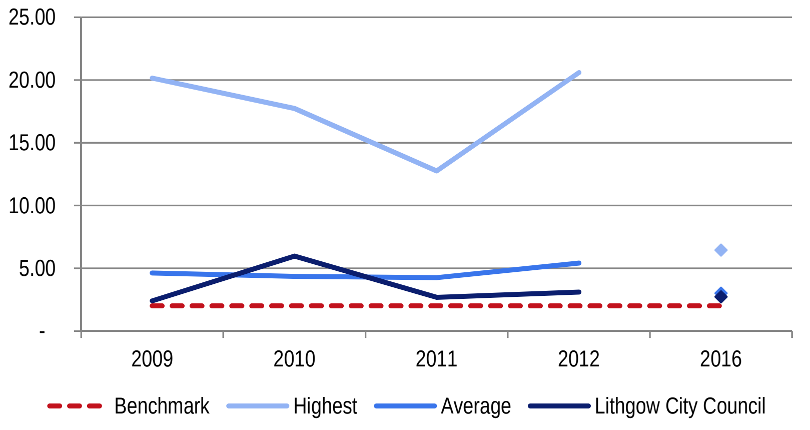
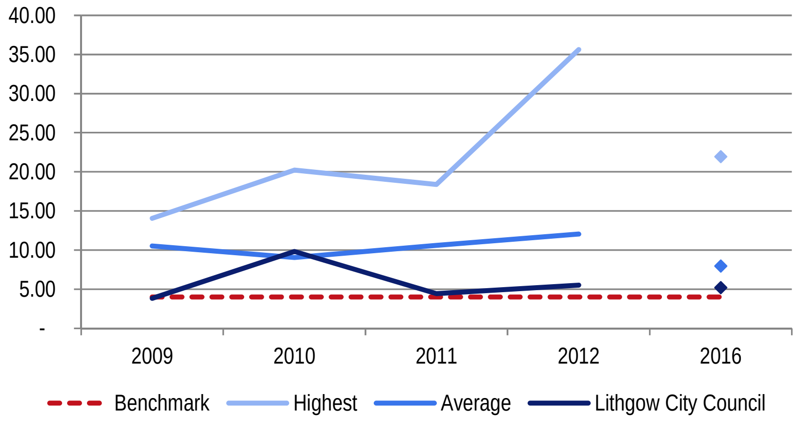


Figure 20 - Interest Cover Ratio Comparison



Over the review period, Council's credit ratios were above the benchmarks but below group averages. These ratios are forecast to marginally decline in the medium term but remain above the benchmarks.

Asset Renewal and Capital Works

Figure 21 - Capital Expenditure Ratio Comparison

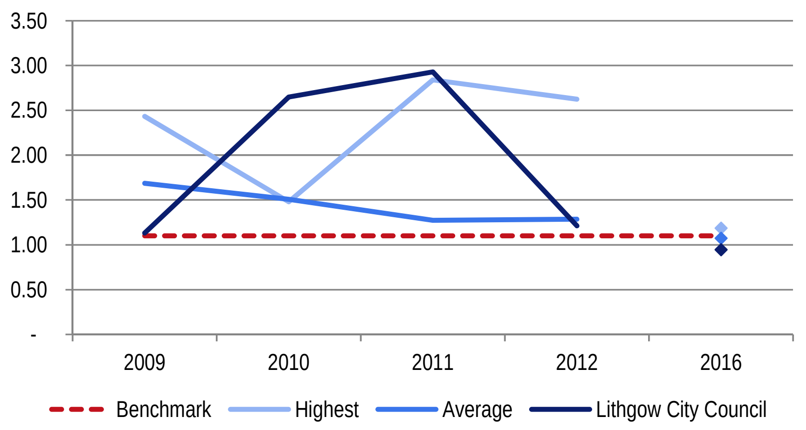


Figure 22 - Asset Maintenance Ratio Comparison

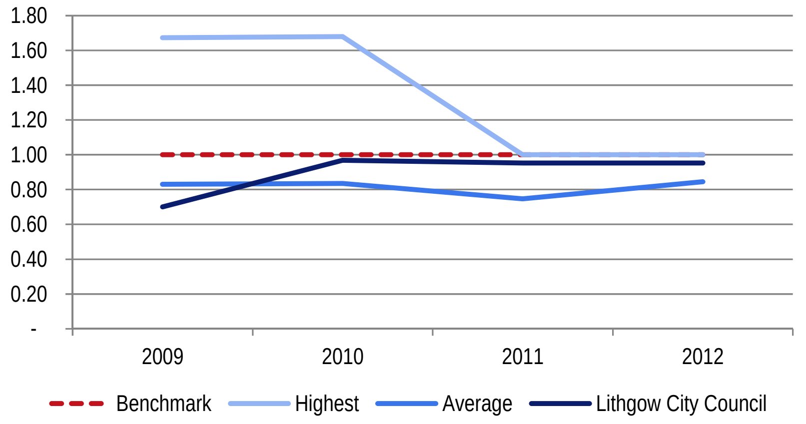


Figure 23 - Infrastructure Backlog Ratio Comparison

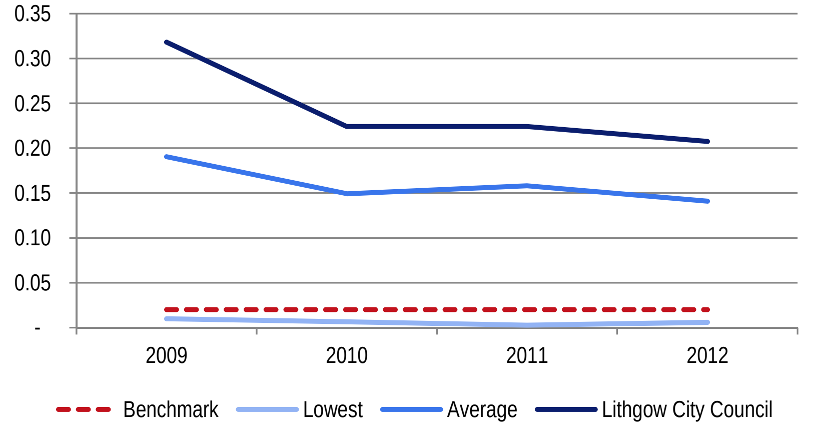
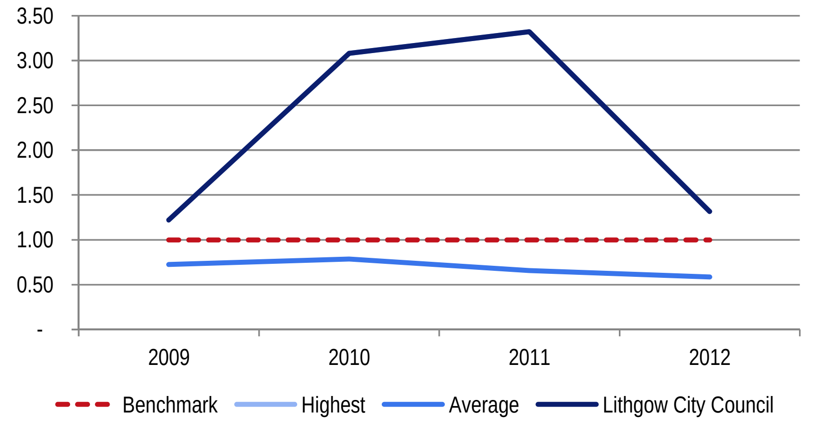


Figure 24 - Building and Infrastructure Asset Renewal Ratio



Council had a higher Infrastructure Backlog Ratio than other councils in the group and it was significantly higher than the benchmark. Council's Asset Maintenance Ratio was above the group average and close to the benchmark in 2010 to 2012. Council's Capital Expenditure Ratio, and Building and Infrastructure Asset Renewal Ratio were in line with or above the group averages and above the benchmarks.

Section 6 Conclusion and Recommendations

Based on our review of Council's historic financial information we consider Council to be in a sound financial position but this position is forecast to deteriorate.

We base our recommendation on the following key points:

- While Council had improving operating results over the review period, it is forecasting large operating deficits throughout the forecast period.
- Council had sound liquidity levels and this is forecast to continue.
- Council's Interest Cover and Debt Service Cover Ratios improved over the review period and continue to improve over the forecast period.
- Council has been dependent on external revenue sources such as State and Federal grants and any material adverse change to the levels of grants receivable could weaken Council finances.
- While the Infrastructure Backlog Ratio has declined over the review period and asset renewal and capital expenditure has been strong, Council is forecasting reducing levels of capital expenditure which may lead to a deteriorating quality of its infrastructure assets.

Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement ($'000s)	Year ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Revenue							
Rates and annual charges	20,019	19,046	18,254	16,479	5.1%	4.3%	10.8%
User charges and fees	4,799	3,579	3,150	2,618	34.1%	13.6%	20.3%
Interest and investment revenue	944	1,011	840	794	(6.6%)	20.4%	5.8%
Grants and contributions for operating purposes	8,379	7,761	7,486	6,722	8.0%	3.7%	11.4%
Other revenues	653	730	811	566	(10.5%)	(10.0%)	43.3%
Total revenue	34,794	32,127	30,541	27,179	8.3%	5.2%	12.4%
Expenses							
Employees	13,227	12,816	12,311	11,711	3.2%	4.1%	5.1%
Borrowing costs	1,680	1,511	692	719	11.2%	118.4%	(3.8%)
Materials and contract expenses	8,531	9,154	8,121	9,247	(6.8%)	12.7%	(12.2%)
Depreciation and amortisation	9,096	8,275	5,844	5,576	9.9%	41.6%	4.8%
Other expenses	3,733	3,480	3,301	3,454	7.3%	5.4%	(4.4%)
Total expenses	36,267	35,236	30,269	30,707	2.9%	16.4%	(1.4%)
Operating result	(1,473)	(3,109)	272	(3,528)	52.6%	(1243.0%)	107.7%

Table 2 - Items excluded from Income Statement

Excluded items ($'000s)				
	2012	2011	2010	2009
Grants and contributions for capital purposes	5,470	7,574	5,292	6,531
Interest revenue/(losses)	0	0	1,554	0
Net gain/(loss) on the disposal of assets	46	29	82	(38)

Table 3 - Balance Sheet

Balance Sheet ($'000s)	Year Ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Current assets							
Cash and equivalents	10,535	13,358	21,098	15,645	(21.1%)	(36.7%)	34.9%
Investments	8,310	2,409	1,805	2,807	245.0%	33.5%	(35.7%)
Receivables	3,707	3,606	3,485	3,082	2.8%	3.5%	13.1%
Inventories	691	743	706	695	(7.0%)	5.2%	1.6%
Other	175	97	164	74	80.4%	(40.9%)	121.6%
Total current assets	23,418	20,213	27,258	22,303	15.9%	(25.8%)	22.2%
Non-current assets							
Inventories	378	378	378	378	0.0%	0.0%	0.0%
Infrastructure, property, plant & equipment	365,639	334,164	313,369	268,659	9.4%	6.6%	16.6%
Total non-current assets	366,017	334,542	313,747	269,037	9.4%	6.6%	16.6%
Total assets	389,435	354,755	341,005	291,340	9.8%	4.0%	17.0%
Current liabilities							
Payables	3,998	5,345	3,128	4,168	(25.2%)	70.9%	(25.0%)
Borrowings	901	1,180	910	475	(23.6%)	29.7%	91.6%
Provisions	3,494	3,218	3,171	2,779	8.6%	1.5%	14.1%
Total current liabilities	8,393	9,743	7,209	7,422	(13.9%)	35.2%	(2.9%)
Non-current liabilities							
Payables	606	606	606	606	0.0%	0.0%	0.0%
Borrowings	18,010	15,823	13,390	5,490	13.8%	18.2%	143.9%
Provisions	6,315	5,974	5,652	5,348	5.7%	5.7%	5.7%
Total non-current liabilities	24,931	22,403	19,648	11,444	11.3%	14.0%	71.7%
Total liabilities	33,324	32,146	26,857	18,866	3.7%	19.7%	42.4%
Net assets	356,111	322,609	314,148	272,474	10.4%	2.7%	15.3%

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Table 4-Cashflow

Cashflow Statement ($'000s)	Year ended 30 June			
	2012	2011	2010	2009
Cashflows from operating activities	12,469	15,235	10,560	10,478
Cashflows from investing activities	(16,967)	(25,409)	(14,996)	(7,621)
Proceeds from borrowings and advances	3,131	3,277	10,347	0
Repayment of borrowings and advances	(1,314)	(985)	(448)	(431)
Cashflows from financing activities	1,817	2,292	9,899	(431)
Net increase/(decrease) in cash and equivalents	(2,681)	(7,882)	5,463	2,426
Cash and equivalents	10,535	13,358	21,098	15,645

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

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

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

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

EBITDA

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

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.

Sustainability

A local government will be financially sustainable over the long term when it is able to generate sufficient funds to provide the levels of service and infrastructure agreed with its community

Ratio Explanations

Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

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

Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

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

Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

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

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

Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

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

Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

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

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

Building and Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

Ratio = estimated cost to bring assets to a satisfactory condition (from Special Schedule 7) / total infrastructure assets (from Special Schedule 7)

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

Interest Cover Ratio

Benchmark = Greater than 4.0x

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

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

Operating Ratio

Benchmark = Better than negative 4%

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

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

<u>Own Source Operating Revenue Ratio</u>

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.

<u>Unrestricted Current Ratio</u>

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.