



New South Wales
Treasury Corporation

Hunters Hill Council

Financial Assessment, Sustainability and Benchmarking Report

05 March2013

**Prepared by NSW Treasury Corporation for Hunters Hill 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 Hunters Hill Council, the DLG and the Independent Local Government Review Panel. TCorp shall not be liable to Hunters Hill 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 Hunter's Hill Council's (the Council) financial capacity, its ability to undertake additional borrowings, 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.

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

- The majority of Council's performance indicators are above benchmark over the four years period
- 77.0% of the Council's revenue base is derived from own sourced revenue (annual charges and user charges and fees). They can rely on these revenue streams on an ongoing basis
- Council's underlying operating performance (measured using EBITDA) has been maintained at consistent levels over the past three years

The Council reported \$3.7m of infrastructure backlog in 2012 which represents 6.5% of its infrastructure asset value of \$56.8m. Other observations include:

- Council's infrastructure backlog has decreased by \$5.5m since 2011 due to road resealing and footpath upgrades
- The majority of Council's backlog is in drainage works
- Council are not spending sufficient on either asset maintenance or asset renewal

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

- The forecast shows deficit positions are expected, when capital grants and contributions are excluded, for the entire forecast period
- Council's own source revenue is above benchmark for the entire forecast period

Council has the capacity to undertake additional borrowings of \$0.9m. This is based on the following analysis:

- The DSCR remains above the benchmark of 2.00x before decreasing to 2.00x in 2022

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

- Council's operating result, excluding capital grants and contributions, has been in deficit position for the past four years and is deteriorating
- Council's current LTFP forecasts operating deficits for the entire period despite having multiple SRV's in place to provide additional funding
- Hunters Hill is a well established area with declining sales and building activity and therefore has little room to increase revenue through user fees and charges
- Council has forecast low levels of capital expenditure which are forecast to decrease further once the existing SRV expires. This will place additional pressure on existing infrastructure

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

- Council's financial flexibility is reasonably sound. While the Operating Ratio is below benchmark and the group average since 2010, Council's Own Source Operating Ratio is above benchmark and outperforms the group's average over the review period. Performance is forecast to remain at these levels in the medium term
- Council was in a sound liquidity position which is forecast to be above the group's average liquidity level over the medium term
- Council's DSCR was below the group's average but above benchmark over the review period. Council's Interest Cover Ratio generally tracked the group's average over the review period. Both ratios are forecast to be well above benchmark and to outperform the group average in the medium term
- Council has a comparatively low level of Infrastructure Backlog Ratio which fluctuates over the period and outperformed the group average in 2012. The Asset Maintenance Ratio is at benchmark levels generally tracking the average. Building and Infrastructure Asset Renewal and Capital Expenditure Ratios have been below the group's average in the past four years

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 which will complement their internal due diligence, and 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 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 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

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

2.3: Overview of the Local Government Area

Hunter's Hill Council LGA	
Locality & Size	
Locality	Sydney Inner
Area	6km ²
DLG Group	2
Demographics	
Population as at 2011	13,215
% under 18	28%
% between 18 and 59	47%
% over 60	25%
Expected population 2021	14,536
Operations	
Number of employees (FTE)	59
Annual revenue	\$12.6m
Infrastructure	
Roads	69km
Bridges	1
Infrastructure backlog value	\$3.7m
Total infrastructure value	\$56.8m

Hunter's Hill Council Local Government Area (LGA) serves a small area of 6km² situated 7km northwest of Sydney CBD.

Hunters Hill LGA is situated on a small peninsula that separates Lane Cove River and Parramatta River and encompasses the suburbs of Gladesville, Henley, Huntleys Cove, Huntleys Point, Hunters Hill and Woolwich. The LGA is a predominantly residential area with very little commercial or industrial land use and includes many parks and reserves.

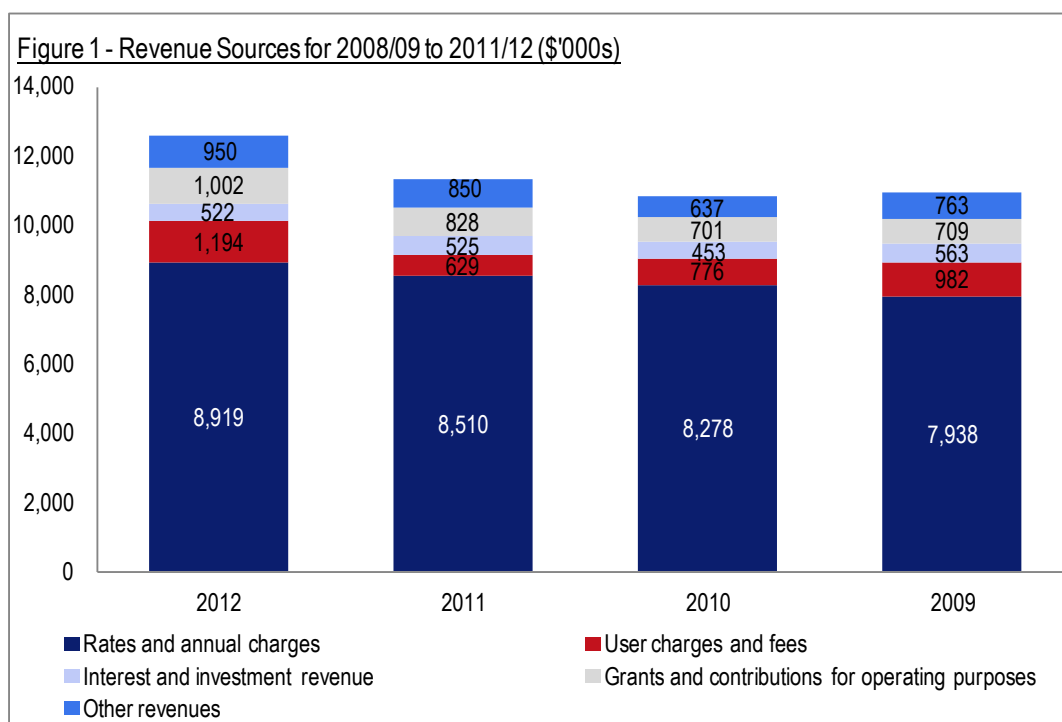
The current population of 13,215 is expected to grow by 10% to 14,536 in 2021.

Council had 59 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

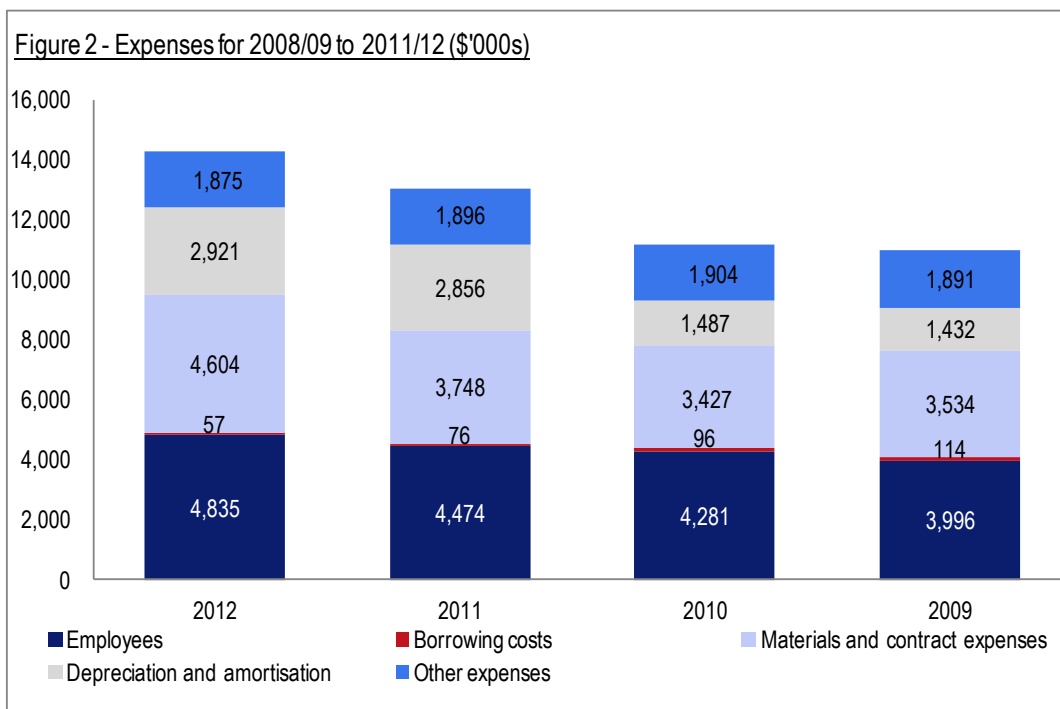


Key Observations

- Council's total revenue, excluding capital grants and contributions, increased by 14.9% (\$1.6m) over the four year period to \$12.6m in 2012.
- Rates and annual charges have increased by 12.3% (\$1.0m) since 2009. 2012 saw an increase of 4.8% (\$0.4m) primarily due to higher Domestic Waste charges.
- Council has had an SRV of 10.4% (including rate peg) approved for the 2012/13 financial year. The increase can be retained in Council's general income base for a period of 10 years. The income raised from the SRV is to be used for Council's capital expenditure works program. As a condition of this approval Council had to reduce their general income on July 1 2012 by \$0.3m which is the value of an expiring levy approved in 2002/03. Council also have two additional SRV's in place. In 2004 Council were approved an SRV of 5.9% (above rate peg) for a period of 10 years which was due to expire in 2013 however following consultation with IPART this SRV will remain in place until 2014. A new application must be submitted for the 2013/14 year. In 2008 Council were approved an SRV of 4.1% (above rate peg) also for 10 years which will expire in 2017.

- User fees and charges rose 89.6% (\$0.5m) in 2012 following decreases in 2010 and 2011. The rise in 2012 was due a \$0.6m increase in charges for restoration work for the Ausgrid Hunters Hill Substation project and is not of a recurring nature. Historically, user fees and charges make up only approximately 5.5% of Councils overall revenue due to limited capacity for Council to generate fees and charges. Hunters Hill is a well established area and the level of building activity and sales has been declining in recent years which is reflected in the low levels of income derived from user fees and charges.
- Grants and contributions increased by 18.1% (\$0.1m) in 2011 and 21.0% (\$0.2m) in 2012. 2011 saw slight increases in financial assistance grants, community care and environmental protection grants. 2012 also saw increases in the financial assistance grants and community care.
- Other Revenue increased by 33.4% (\$0.2m) in 2011 due to a \$0.2m increase in sundry rents and charges. During works on Ryde Road, Network Alliance hired a compound from council at Boronia Park to store equipment bringing in additional revenue in 2011. This revenue stream was not available in 2012 but was replaced by a \$0.2m increase in fines.

3.2: Expenses



Key Observations

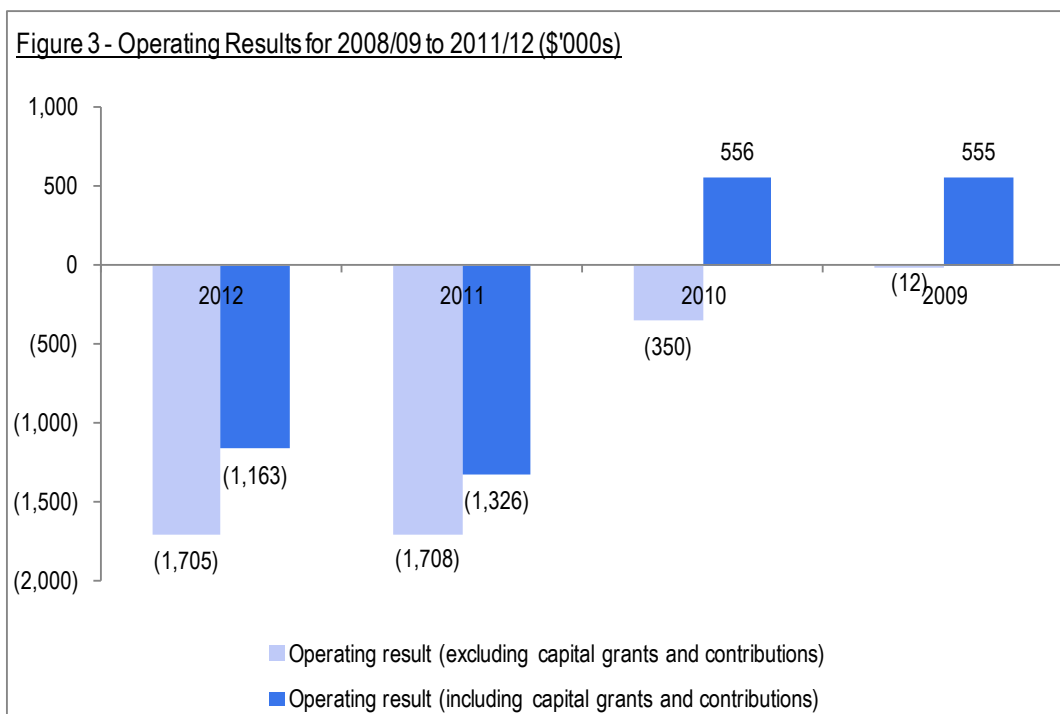
- Council's expenses have increased by 30.2% (\$3.3m) since 2009 to \$14.3m in 2012.
- Employee costs increased in 2012 by 8.1% (\$0.4m). Over the past number of years council has had difficulty in filling staff vacancies with suitably skilled staff which has led to an increase in the number of contractors used. As a result, in 2012 employee leave entitlements increased 53.2% (\$0.2m) and salaries and wages also increased by \$0.2m. Employee costs increased in by 7.1% (\$0.3m) in 2010 driven by increases in superannuation, employee leave entitlements and workers compensation insurance.
- Following a decrease in 2010, materials and contracts expenses increased by 9.4% (\$0.3m) in 2011 and 22.8% (\$0.9m) in 2012. The 2012 increase was due to contractors being used to fill staff vacancies until skilled replacements could be found as well as an increase in contractors used to carry out additional restoration funded works. 2011 saw increases in legal expenses, tipping fees and garbage contract costs.
- The Asset Revaluations process resulted in the value of Council's infrastructure assets increasing by \$34.5m since 2009 to \$56.8m in 2012. This resulted in the 2011 depreciation charge increasing by 92.1% (\$1.4m) to \$2.9m in 2012.
- Other expenses have been maintained at consistent levels over the past 4 years. The NSW Fire Brigade levy and library expenses remain Council's largest other expenses at \$0.4m and \$0.5m respectively.

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 has 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.



Key Observations

- Council has posted net operating deficits (excluding capital grants and contributions) for the past four years. The deficit increased in 2011 largely due to increased depreciation charges.
- Council expenses in 2012 include a non-cash depreciation expense of \$2.9m. Whilst the non-cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

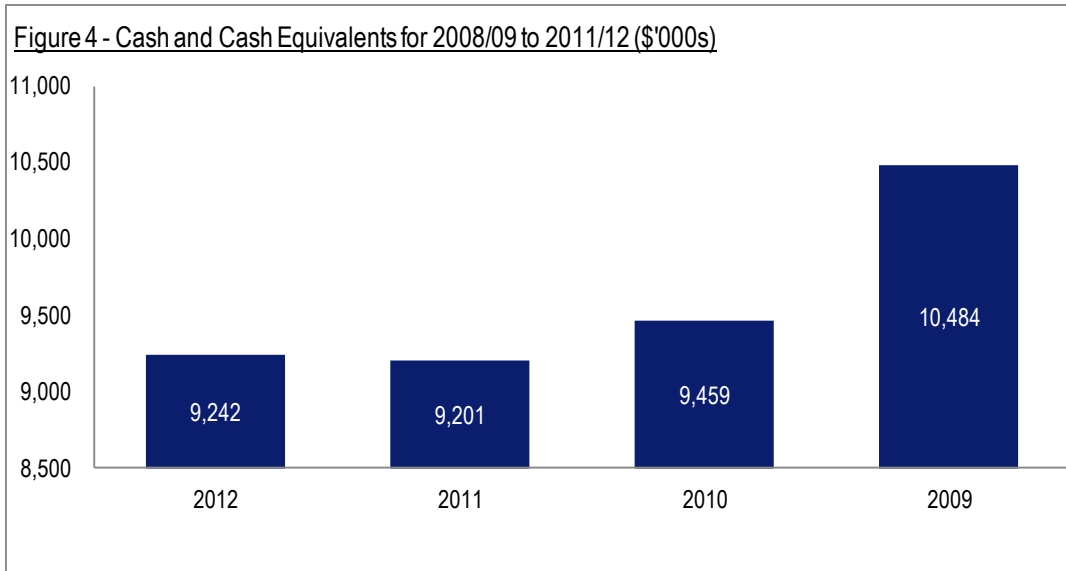
3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June			
	2012	2011	2010	2009
EBITDA (\$'000s)	1,273	1,224	1,233	1,534
Operating Ratio	(13.5%)	(15.1%)	(3.2%)	(0.1%)
Interest Cover Ratio	22.33x	16.11x	12.84x	13.46x
Debt Service Cover Ratio	2.93x	2.82x	2.83x	3.53x
Unrestricted Current Ratio	3.15x	3.49x	3.22x	3.92x
Own Source Operating Revenue Ratio	77.0%	78.0%	77.0%	77.4%
Cash Expense Ratio	9.8months	10.9months	11.8months	77.4months
Net assets (\$'000s)	482,222	483,343	304,718	288,317

Key Observations

- Councils underlying operating performance (measured using EBITDA) has been maintained at marginally positive albeit consistent levels over the review period.
- The Operating Ratio has been well below benchmark for the past two years due to increased depreciation expenses.
- Council's Interest Cover Ratio and DSCR has been above benchmark over the four year period.
- The Unrestricted Current Ratio has been well above the benchmark of >1.5x in all four years indicating Council had satisfactory liquidity.
- The Own Source Operating Ratio has been above benchmark in all four years indicating Council had sufficient financial flexibility.
- Council's Net Assets have increased by approximately \$194.0m since 2009 to \$482.2m in 2012. Asset Revaluations increased the value of Council's community land by \$170.0m since 2009 to \$399.0m in 2012. Asset revaluations also increased Council's infrastructure assets by \$34.5m since 2009 to \$56.8m in 2012 primarily due to an increase in the value of public roads over the period.
- When the Asset Revaluations are excluded, the underlying trend in all three years has been a decrease in the infrastructure, property, plant and equipment (IPP&E) asset base with asset purchases being less than the combined value of disposed assets and annual depreciation. Over the three years this amounted to a \$1.7m decrease in IPP&E assets.
- Council has existing borrowings of \$0.7m representing 0.1% of Council's Net Assets.

3.5: Statement of Cashflows



Key Observations

- Cash and cash equivalents have been maintained at consistent levels over the review period.
- The cash balances along with the Unrestricted Current Ratio indicate Council had satisfactory liquidity.
- Of the \$9.2m in cash and cash equivalents, \$3.1m is externally restricted, \$4.2m is internally restricted and \$1.9m is unrestricted.
- Council do not have any investments.

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 2011/12(\$'000s)

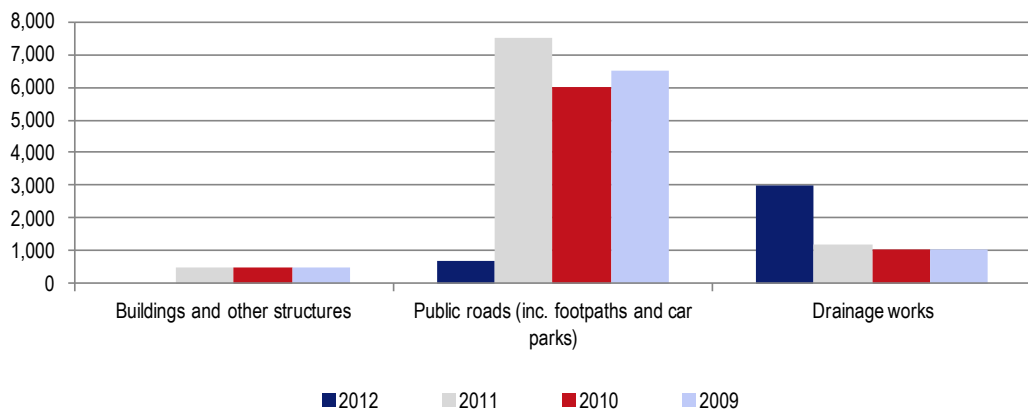
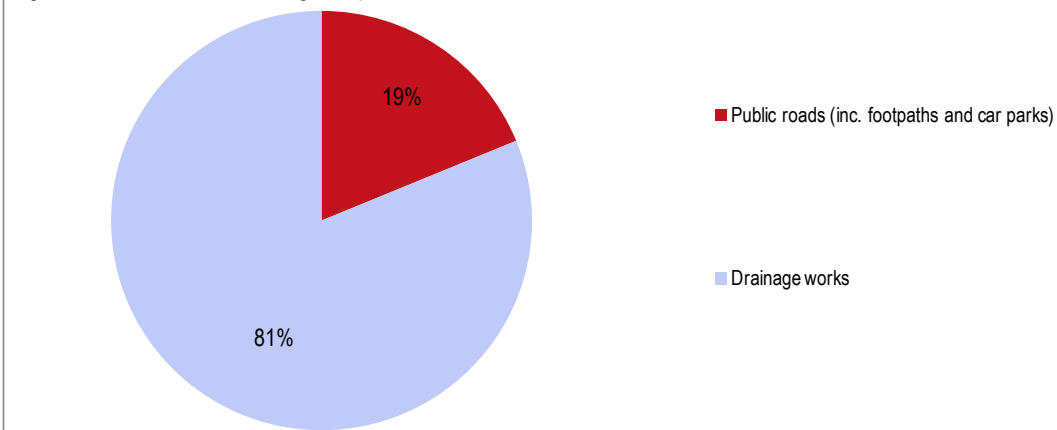


Figure 6 - Infrastructure Backlog Composition for 2011/12



Council reported a \$3.7m Infrastructure Backlog in 2012, of which 81.0% (\$3.0m) related to drainage. Council do not have any buildings backlog and do not have any water or sewer infrastructure assets.

3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June			
	2012	2011	2010	2009
Bring to satisfactory standard (\$'000s)	3,695	9,200	1,050	8,050
Required annual maintenance (\$'000s)	1,574	1,245	1,657	966
Actual annual maintenance (\$'000s)	1,452	919	1,590	1,533
Total value infrastructure assets (\$'000s)	56,803	55,400	57,404	22,301
Total assets (\$'000s)	487,831	488,909	310,576	294,366
Infrastructure Backlog Ratio	0.07x	0.17x	0.02x	0.36x
Asset Maintenance Ratio	0.92x	0.74x	0.96x	1.59x
Building and infrastructure asset renewal ratio	0.20x	0.18x	0.90x	0.68x
Capital Expenditure Ratio	0.56x	0.40x	1.88x	0.92x

The Infrastructure Backlog Ratio has been above the benchmark of <0.02x benchmark in three of the past four years.

The Asset Maintenance Ratio has decreased since 2009 and has been marginally below benchmark for the past three years which reflects Council are spending at levels just below the required amount to maintain their assets at the required levels.

Council's Building and Infrastructure Asset Renewals Ratio has been well below the benchmark of >1.0x which indicates Council is spending at levels below the required amount on asset renewal.

The Capital Expenditure Ratio, which takes into account assets which improve performance or capacity, was well below benchmark in 2011 and 2012.

Based on these figures, the quality of the existing asset base may decline and Council need to focus on improving this if current service levels are to be maintained.

On completion of a number of Council's IPP&R reporting documents including the Community Strategic Plan and the Asset Management Plan, Council has identified that its infrastructure assets are not being maintained at levels to support the provision of services that the community expects.

Unless Council is able to expand its revenue base, by increasing its income from general rates or from other fees and charges, it may not be able to continue to meet its commitments in respect of its infrastructure, asset maintenance and services.

3.6(c): Capital Program

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

Capital Program (\$'000s)	Year ended 30 June			
	2012	2011	2010	2009
New capital works	862	563	1,904	351
Replacement/refurbishment of existing assets	1,000	1,071	925	1,163
Total	1,862	1,634	2,829	1,514

Completed Capital Works Projects

Purchase of 40-48 Gladesville Road	\$1.2m
Margaret St Boat Ramp	\$0.2m
Riverglade Reserve	\$0.2m
The Priory Upgrade	\$0.1m
Riverglade Bikeway	\$0.1m

Future Proposed Capital Projects 2013-2021

Roads Improvement Program	\$8.9m
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Future Plans

A revised Local Environmental Plan and Development Plan has been completed to guide the future development of Gladesville Town Centre. This was undertaken in conjunction with Ryde City Council. Council owns a number of properties within the precinct that may present development or re-development opportunities to Council.

Council also owns commercially zoned vacant land at No. 4 and No. 6 Cowell Street and occupied land at No. 10. Council is currently investigating sale and/or development options that may arise from joint venture arrangements with adjoining property owners. Council hope the potential proceeds from sales or revenue earned could be returned to the Capital Works Reserve and used to fund future Capital Works programs. Such arrangements would also impose financial and commercial risks on Council.

Additional sites at Gladesville Road, Hunters Hill have been re-zoned within the Hunters Hill Village Masterplan for the purpose of using a potential redevelopment opportunity to construct new and significantly improved community facilities and car parking. A development strategy is completed and proceeds from sales or revenue earned could be returned to the Capital Works Reserve and used to fund future Capital Works programs.

3.7: Specific Risks to Council

Climate Change. Climate change is considered one Council's main risks. More extreme temperatures affecting the LGA's residents, more frequent and severe storms disrupting services and the increasing cost of carbon pollution increasing the cost of fuel and energy are some of the risks having a negative impact on the LGA. Council has implemented a High Risk Register which identifies both the risks in the LGA and the controls in place to counteract these risks. Council has also implemented a number of controls to mitigate these risks such as the domestic waste charge and adjusting some staff working hours to reduce exposure to the sun. While these measures have been very effective other controls have been only slightly effective such as repairs on footpaths due to damage caused by rainfall. The repairs are not sufficient and the footpaths need to be replaced. Council are continuing to monitor these risks and implement strategies to reduce risk in all areas of concern identified.

Ageing population. The LGA has a high proportion of aged persons, which is expected to increase significantly over the next 10 years. This will place additional pressure on existing infrastructure and services and also significantly increases Council's expenditure due to increased pension rebates as these costs will not be fully covered by grants.

Footpaths. Footpath works were clearly identified in the community survey as being of high priority. This is a reflection of Council's demographics and the high percentage of senior citizens in the area. A priority listing of required works has been developed as part of Council's Asset Management Plan.

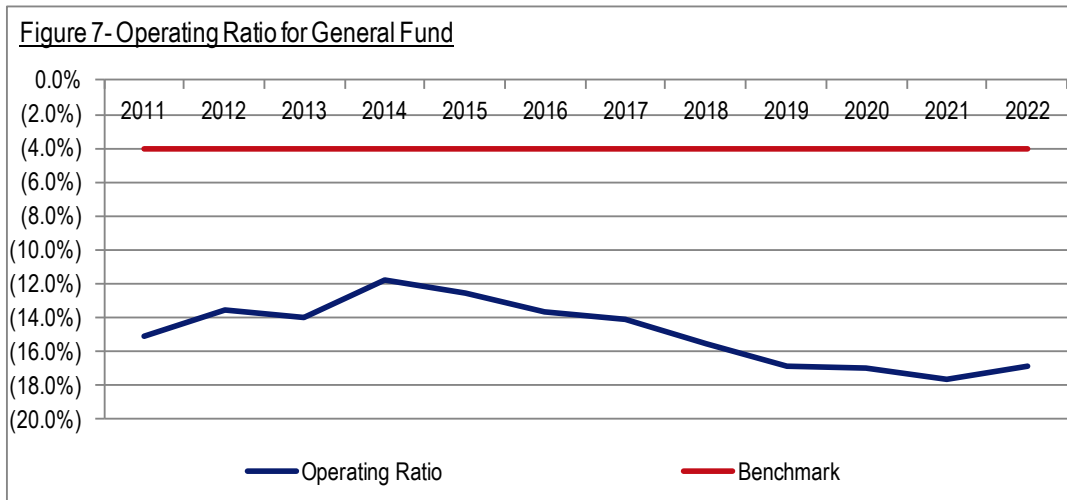
Skills shortage. Council's skills shortage is a critical issue that if left unaddressed may put at risk the Council achieving its objectives. Council compiled a skills audit in 2010 and the results showed there were gaps in knowledge across the organisation. The main reasons for the skills shortage were identified as being due to a reduction in the number of students entering the relevant fields of study, a reduction in the number of tertiary courses available and superior salary packages from other Councils and agencies. With half of Council's current workforce over the age of 50 and many considering retirement over the next 10 years the skills gap will grow unless they can be replaced with suitably skilled staff. Initiatives to address the skills shortage will need to be prioritised.

Revenue. Hunters Hill LGA is a well established area and as such the level of building activity and sales has been declining in recent years. As a result the income derived from user fees and charges in Hunters Hill makes up only 5.5% approximately of Council's overall revenue. Council has resolved to introduce paid parking for non residents at six sites which would increase income in this area. Negotiations and consultations are proceeding with a view to implementation as soon as possible.

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 which is the only Fund operated by Council.

4.1: Operating Results



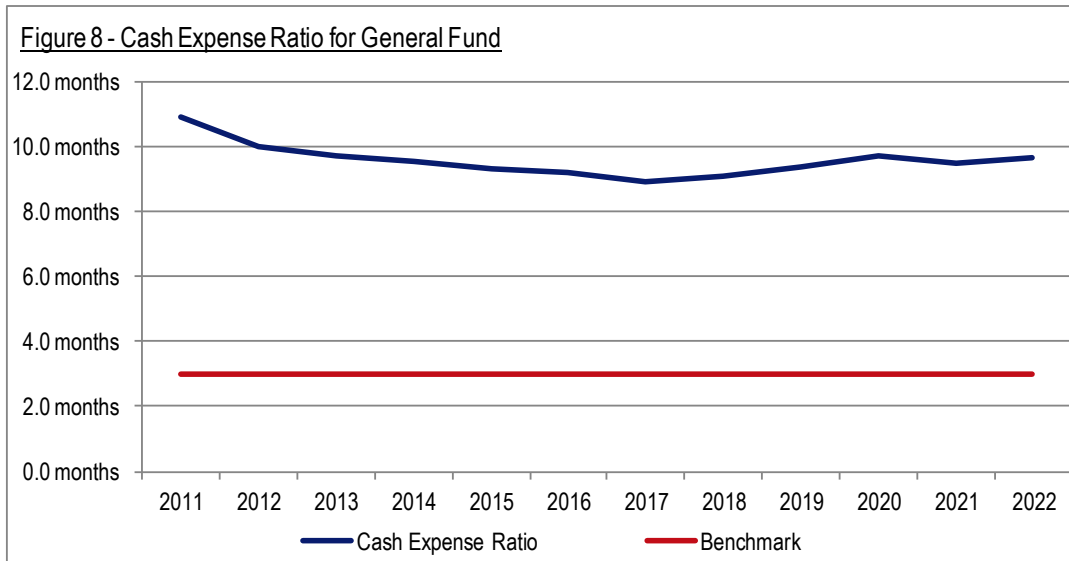
The Operating Ratio shows deficit positions are expected in all 10 years when capital grants and contributions are excluded. Low user fees and charges, high materials and expenses and the decrease in rates revenue in 2018 in accordance with the IPART SRV approval are all adversely affecting this ratio. The operating results are trending towards increasing deficits.

Council could face financial sustainability issues in the future unless additional revenue sources are found, services are amended and/or expenses reduced.

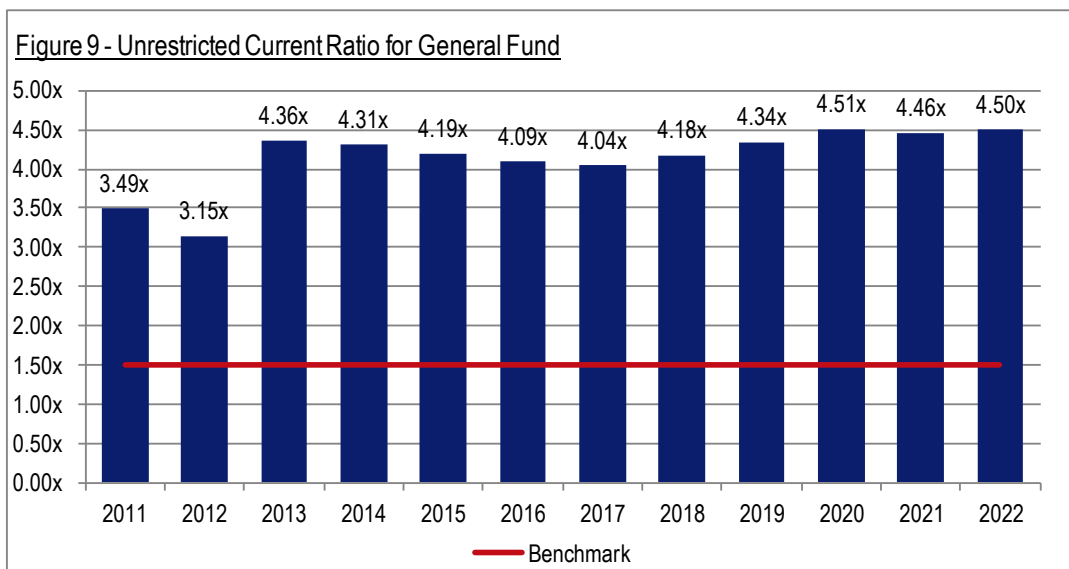
4.2: Financial Management Indicators

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

Liquidity Ratios



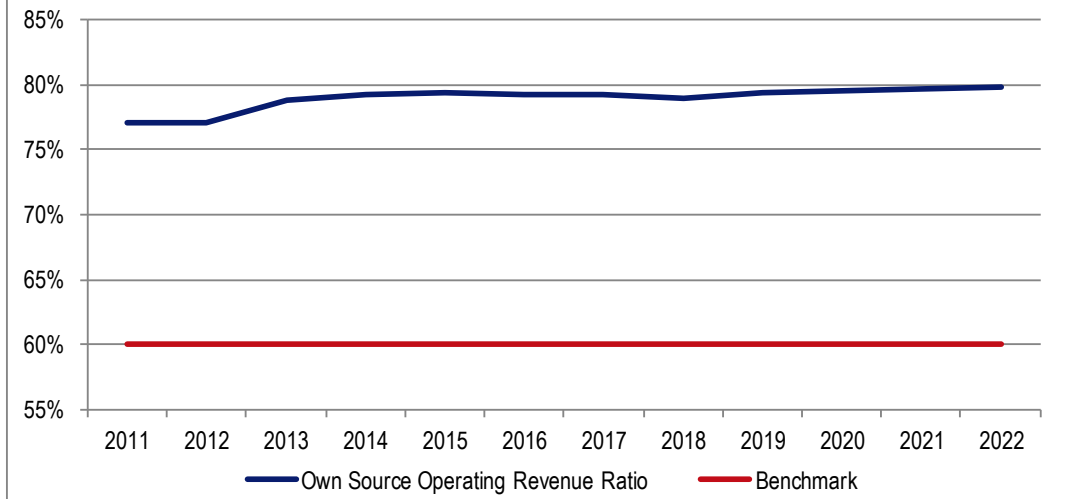
The Cash Expense Ratio is well above benchmark for the lifetime of the forecast which indicates Council will have sufficient liquidity.



Council's Unrestricted Current Ratio is also well above benchmark for the entire forecast period.

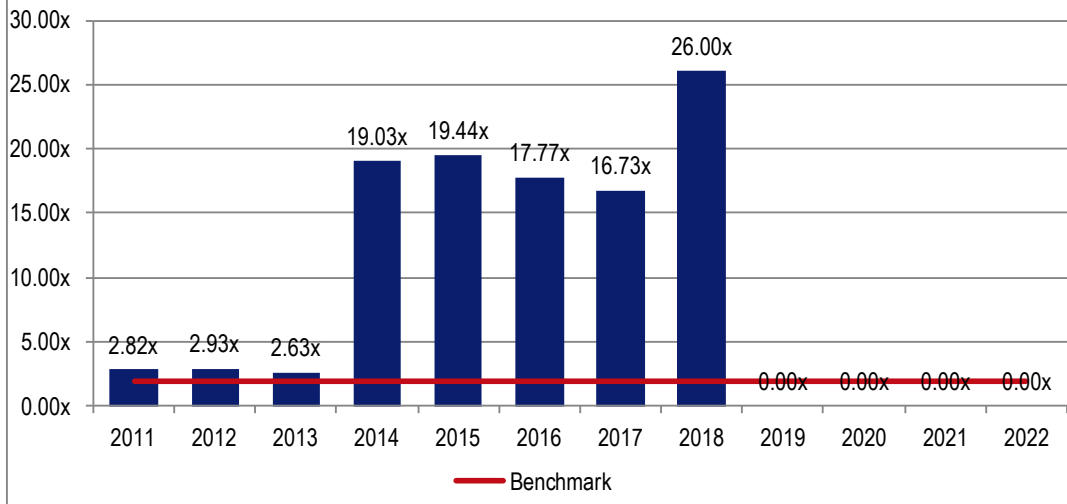
Fiscal Flexibility Ratios

Figure 10 - Own Source Operating Revenue Ratio for General Fund



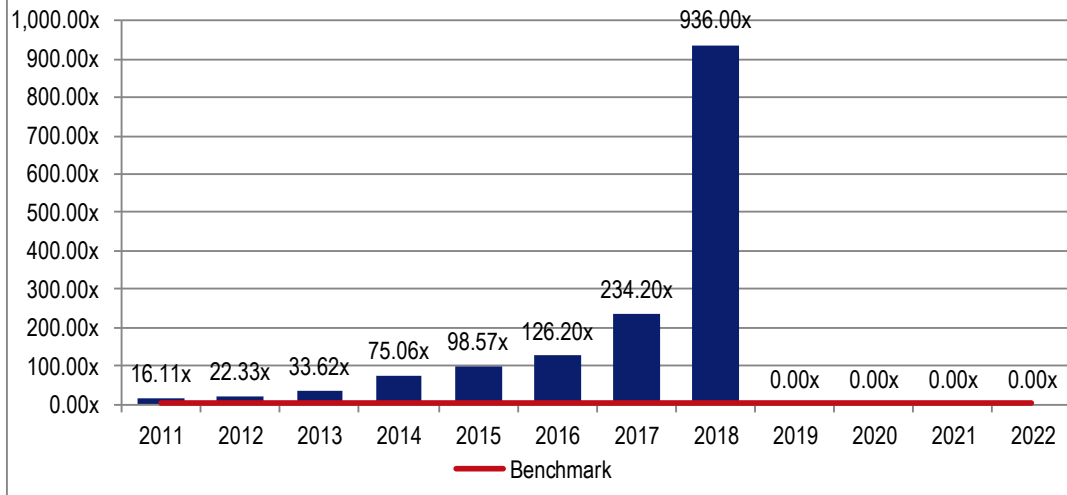
Council's Own Source Operating Revenue Ratio is above benchmark for the entire forecast period. This indicates the Council is not highly reliant on external revenue sources.

Figure 11 - DSCR for General Fund



The DSCR result is above the benchmark of 2.00x until 2018. From 2019 there is no result as Council will have paid down all their debt and have not forecast any additional borrowings. The DSCR increases significantly in 2014 as Council complete repayment of an infrastructure loan.

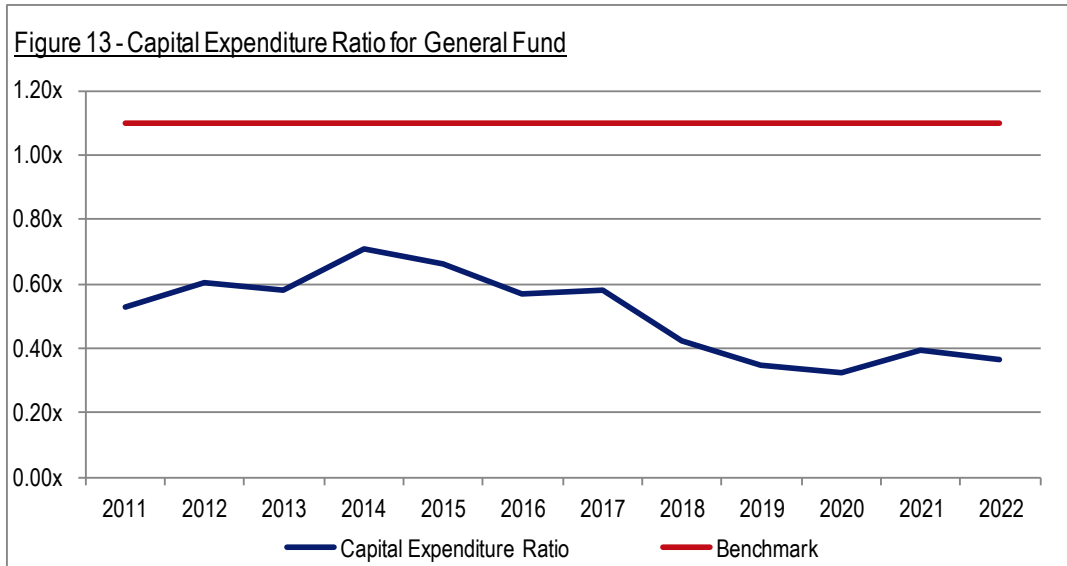
Figure 12 - Interest Cover Ratio for General Fund



The Interest Cover Ratio, similarly to the DSCR, shows the Council has sufficient capacity to service scheduled debt commitments with no ratio shown from 2019 as Council has forecast no additional borrowings.

With Council's current borrowings of \$0.7m, the DSCR and Interest Cover Ratio are not considered to be meaningful numbers when assessing Council's Sustainability.

4.3: Capital Expenditure



The Capital Expenditure Ratio is forecast to be below benchmark for the entire forecast period.

The ratio increases marginally between 2013 and 2016 as capital expenditure increases primarily due to the use of SRV funds for capital projects which were previously directed to loan repayments. Council can redirect these funds from the loan repayments however they must be used on infrastructure works outlined in the initial SRV application. The works progress must be reported in the annual report each year.

While depreciation is forecast to increase between 2012 and 2022, capital expenditure is decreasing resulting in a cumulative deficit for depreciation versus capital expenditure of \$18.7m.

The low levels of capital expenditure forecast will increase pressure on existing assets. Increasing capital expenditure to benchmark levels will adversely impact on Council's cash and overall liquidity position.

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%

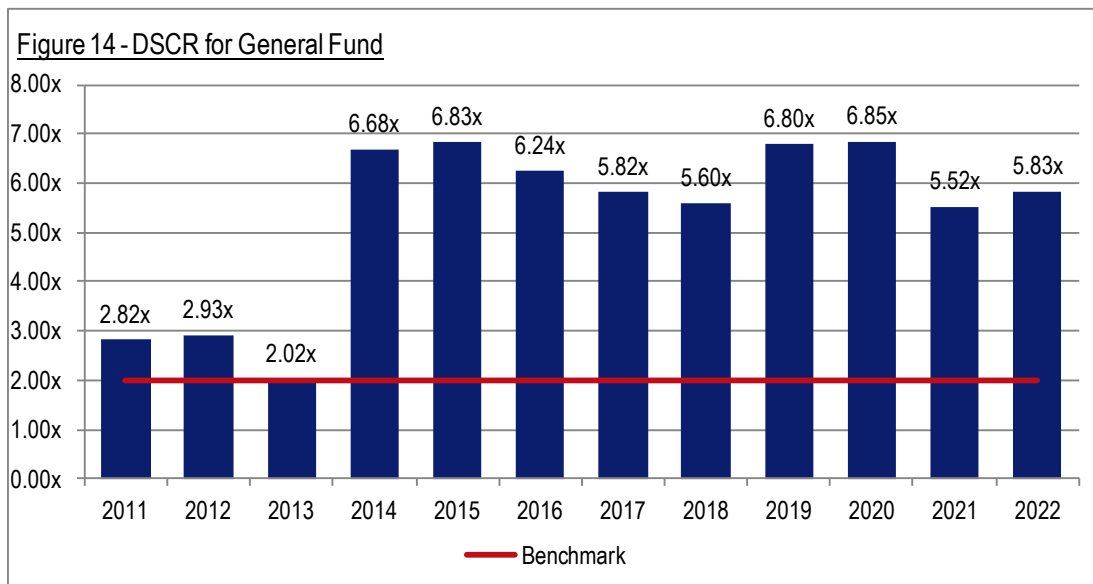
Key Observations and Risks

- Rates and annual charges are forecast to increase by approximately 2.9% p.a. for the majority of the forecast which is considered reasonable. They increase by 6.5% in 2013 and 4.4% in 2014 due to rate peg increases and the IPART approved SRV. In 2018 they decrease by 0.2% as per the conditions set for the 2008 SRV.
- User fees and charges decreased by 40.0% in 2013 following the completion of the Ausgrid Hunters Hill Substation project. From 2014 user fees and charges are forecast to increase up to 3.0% over the period which we consider conservative bearing in mind Council has introduced paid parking for non residents in some areas.
- Employee expenses are forecast to increase by 10.3% in 2013 and 5.2% in 2014. Council currently have a number of vacancies which need to be filled and over the past number of years have had difficulty in filling the vacancies with personnel with appropriate skills. This has led to contractors being used which are more expensive and Council has incorporated this expense into the LTFP for 2013 and 2014. Council has forecast to fill these vacancies but has not forecast to increase staff numbers unless they are grant funded i.e. Road safety officer. Given the reduced capital works program, Council hope they will be able to maintain employee cost increases from 2015 at below 4.5% for the remainder of the forecast period.
- Materials and contracts fluctuate until 2015 when they increase by 5.5% due to additional funds allocated for replacement vehicles and equipment. From 2016 they increase by approximately 2.5% p.a. which is considerably lower than historic increases.
- Capital expenditure forecasts are well below benchmark levels.
- Overall we consider most of these assumptions to be reasonable although we consider that the low levels of capital expenditure and above benchmark forecast increases for employee costs need to be reviewed.

4.5: Borrowing Capacity

When analysing the financial capacity of the Council we believe Council would be able to incorporate a small amount of additional loan funding in addition to its existing debt facilities. Some comments and observations are:

- Based on a benchmark of DSCR>2x, \$0.9m could be borrowed in addition to existing borrowings of \$0.7m
- This scenario has been calculated by basing borrowing capacity on a 10 year amortising loan at a rate of 7.50% p.a.



While the analysis indicates that \$0.9m could be borrowed in addition to Council's existing borrowings, given the low DSCR in 2013 we recommend that Council do not consider any additional borrowings until 2014 when the DSCR is in a stronger position.

4.6 Sustainability

General Sustainability

Council has made a commitment to work towards enhancing environmental sustainability and implemented their sustainability plan in 2008 to increase awareness and participation in local environmental issues and promote a sustainable future for their LGA.

As part of Council's economic development and sustainability Hunters Hill LGA are part of the Northern Sydney Regional Organisation of Councils (NSROC) which has been established to strengthen the role of Local Government in regional affairs and work together for the benefit of the Northern Sydney region.

Council has implemented Community initiatives such as the Bushcare Volunteer Program which allows residents to actively participate in environmental projects.

Council are also part of the Climate Clever Shop, an initiative with four other Councils to help residents install systems into their homes to reduce energy and potable water consumption. The Climate Clever Shop provides a link to local suppliers of heating solutions and green power products and residents receive a discount when they mention Climate Clever Shop.

Financial Sustainability

In considering the longer term financial sustainability of the Council we make the following comments:

- Historically, Council has been able to manage its financial affairs with the assistance of a number of SRV's
- Council's current LTFP shows the operating results deteriorating over the forecast period with capital expenditure well below the benchmark level of what is required to maintain or replace assets at an acceptable standard
- Council's DSCR and Interest Cover Ratio are well above benchmark from 2014 on for the remainder of the forecast period which indicates Council should have the capacity to take on additional borrowings which could be used to fund infrastructure projects and reduce the current backlog. However, Council's capacity to take on additional borrowings are limited due to the low levels of free cash (i.e. EBITDA) generated
- Council has forecast very conservative user fees and charges revenue. While this is based on historic performance it is considered very conservative. The introduction of paid parking to non-residents in a number of areas should improve this result
- Council also hope the development of a number of existing Council owned sites will generate revenue which could potentially be used to fund capital projects
- Council has limited financial reserves and does not have sufficient financial resources to withstand any significant unforeseen financial events.

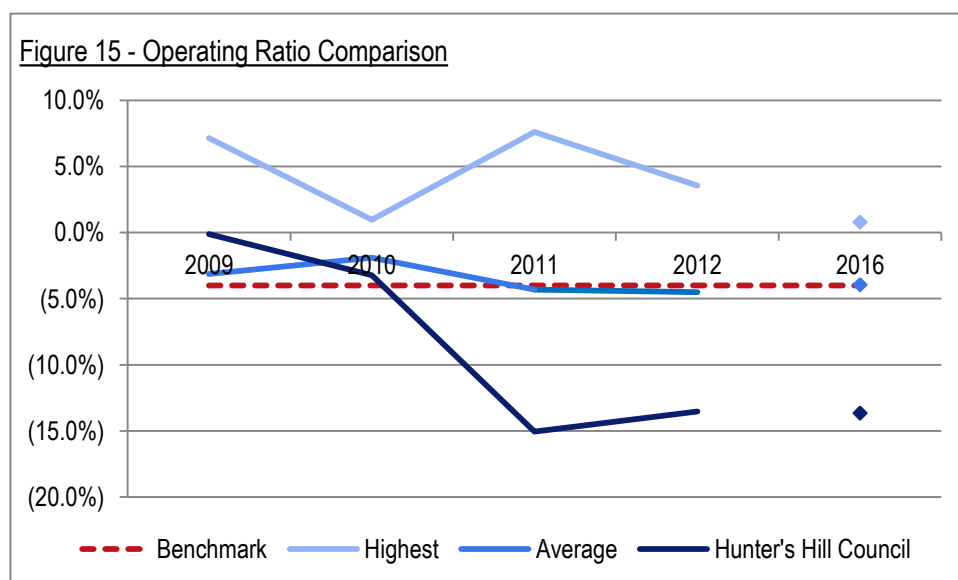
Section 5 Benchmarking and Comparisons with Other Councils

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 2. There are 14 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 21, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 22 to 24 do not include the 2016 forecast position as those numbers are not available.

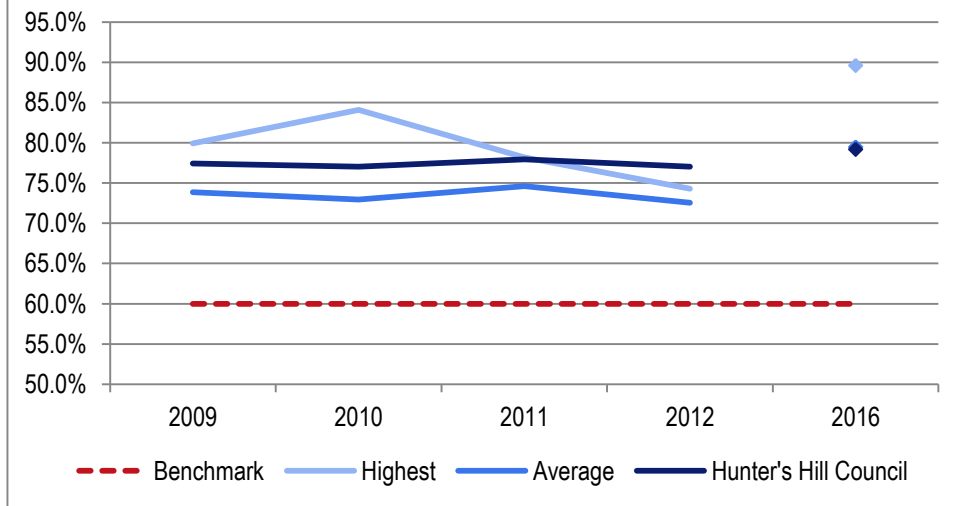
Where no highest line is shown on the graph, this means that Council is the best performer in its group for that Ratio. For the Interest Cover Ratio and Debt Service Cover Ratio, we have excluded the highest Councils because very low debt levels have resulted in very high ratios.

Financial Flexibility



Council's Operating Ratio decreases below the group average and benchmark in 2011. The ratio improves marginally in 2012 however Council is forecast to remain below the group average and benchmark in the medium term.

Figure 16 - Own Source Operating Revenue Ratio Comparison



Council's Own Source Operating Revenue Ratio outperformed benchmark and the group's average over the review period. The proportion of own sourced revenue is forecast to increase marginally over the medium term and continue to outperform other councils in the group.

Liquidity

Figure 17 - Cash Expense Ratio Comparison

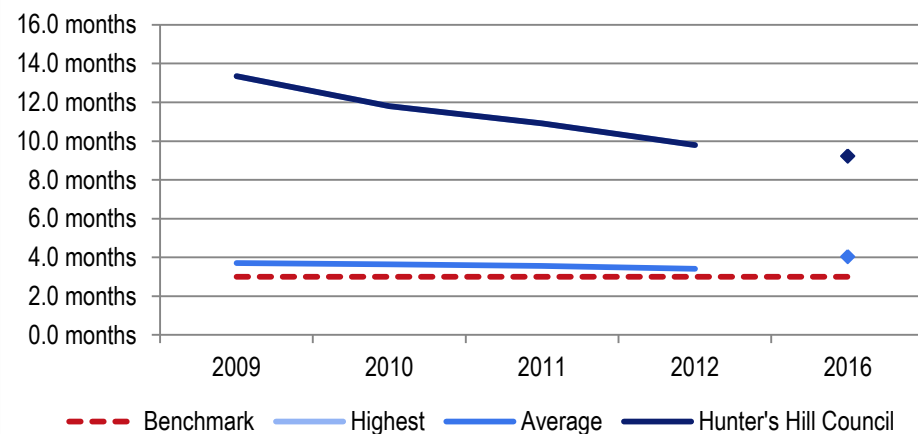
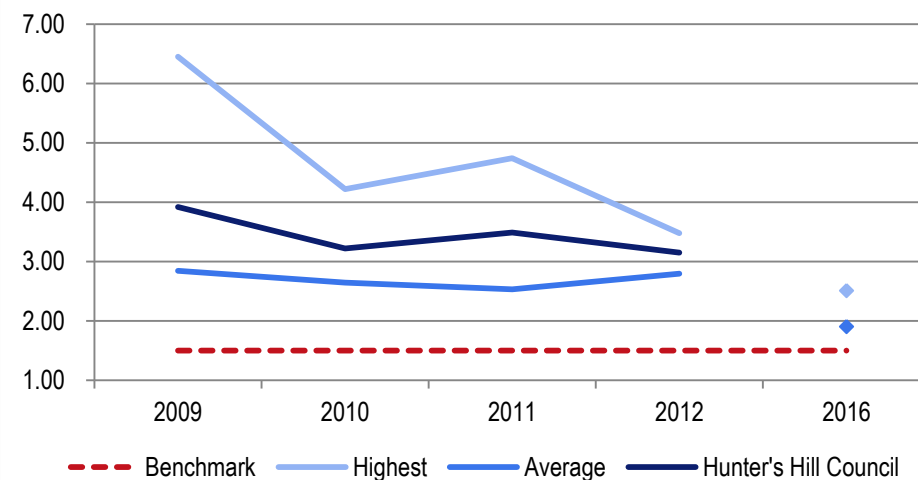


Figure 18 - Unrestricted Current Ratio Comparison



Council's Cash Expense Ratio was well above benchmark and the group average and is forecast to continue to outperform the group average in the medium term.

The Unrestricted Current Ratio was also above average and benchmark levels, indicating Council's ability to meet its payments is sufficient.

Overall, Council's liquidity position is sound.

Figure 19 - Debt Service Cover Ratio Comparison

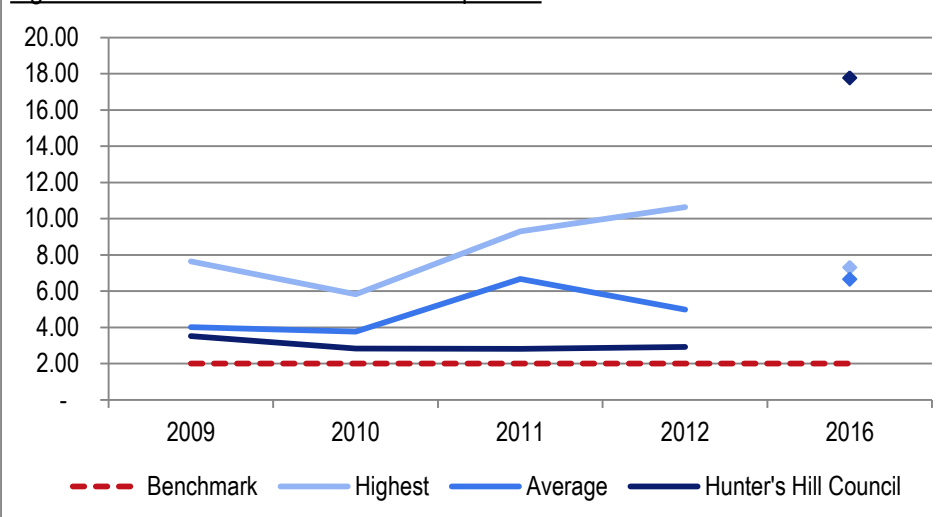
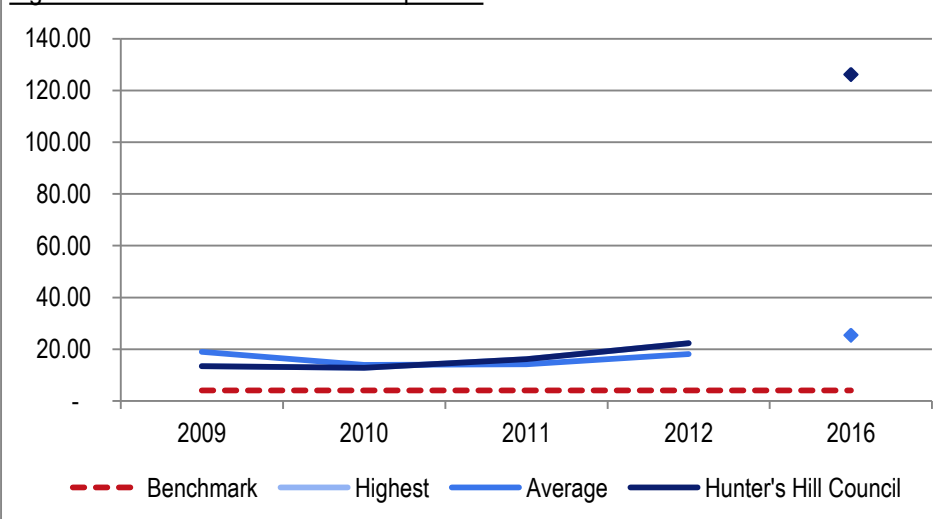


Figure 20 - Interest Cover Ratio Comparison



Council's debt servicing capacity was sound over the review period, as indicated by above benchmark DSCR and Interest Cover Ratios. Council's debt servicing ratios are forecast to increase well above benchmark and the group average in the medium term.

Figure 21 - Capital Expenditure Ratio Comparison

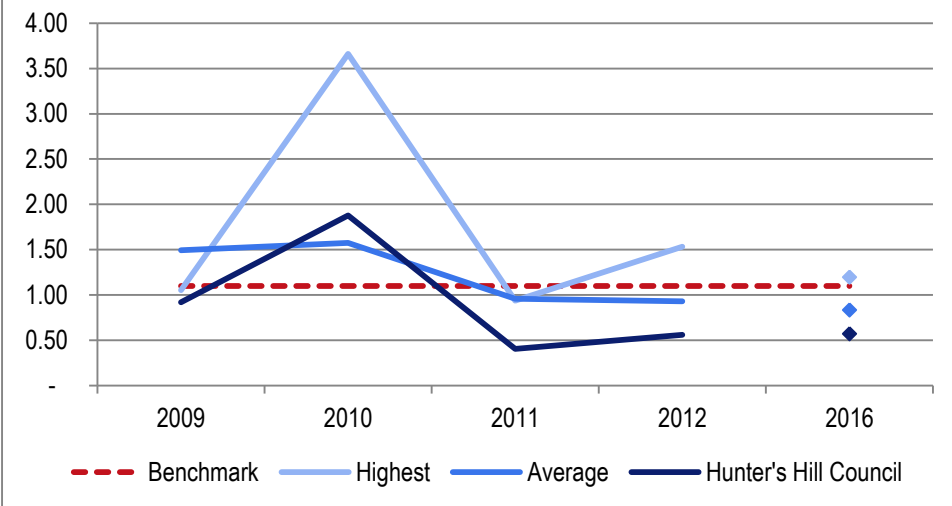


Figure 22 - Asset Maintenance Ratio Comparison

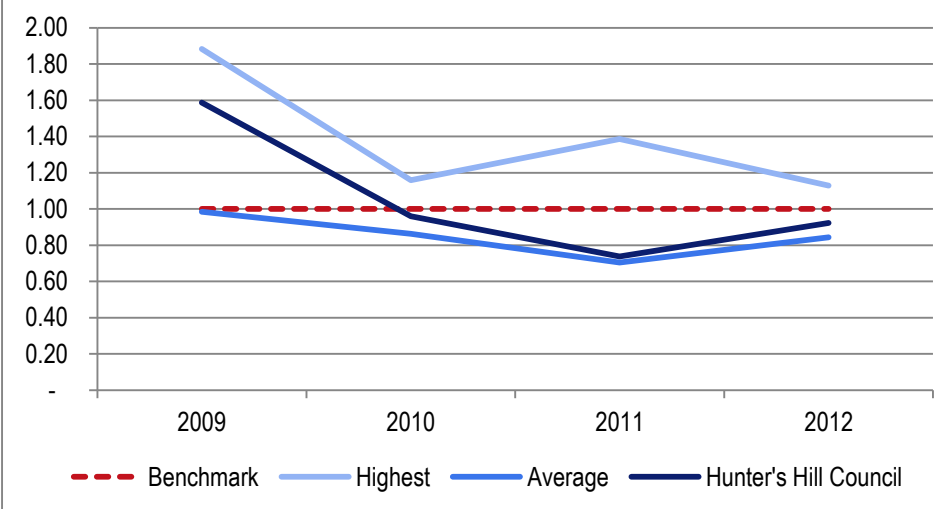


Figure 23- Infrastructure Backlog Ratio Comparison

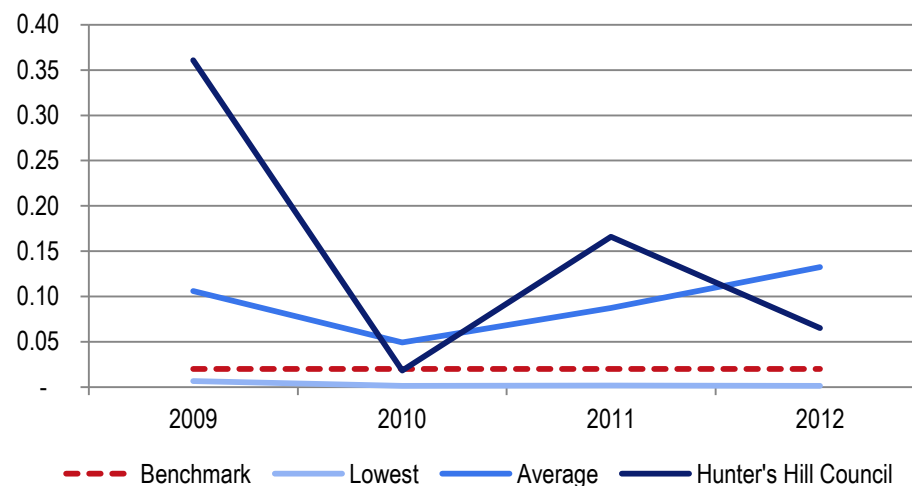
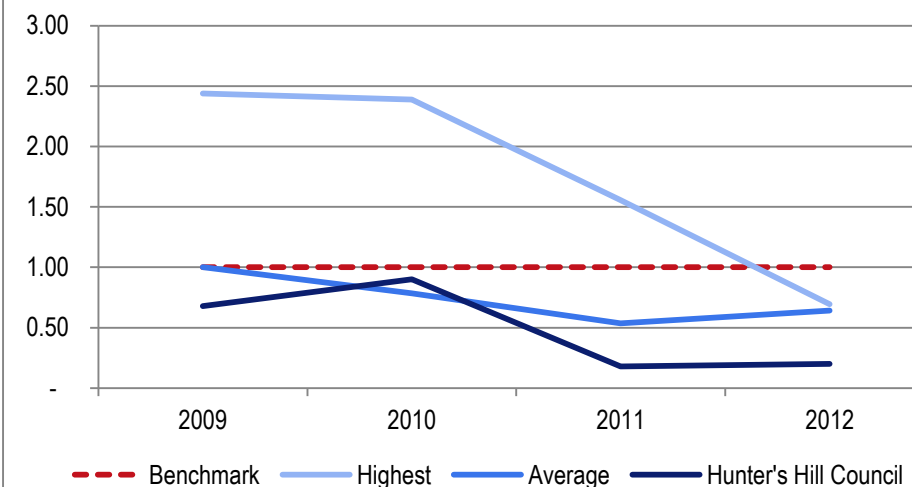


Figure 24 - Building and Infrastructure Asset Renewal Ratio



Council's Infrastructure Backlog has fluctuated over the period with the improved result in 2012 due to additional restoration works carried out which resulted in the Backlog falling below the group average. Council's Asset Maintenance Ratio has generally tracked and slightly outperformed the group average but has remained below benchmark since 2010. The Building and Infrastructure Asset Renewal Ratio has been below benchmark and the performance of other councils for the majority of the review period indicating that Council is underspending on asset renewals.

Council's Capital Expenditure has been below the group average since 2011. The ratio fell below benchmark in 2011 and is forecast to remain at these levels over the medium term.

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 moderately sustainable in the medium term, however they are likely to face financial difficulty in the longer term.

We base our recommendation on the following key points:

- With the exception of Councils Operating Ratio Council's performance indicators were above benchmark between 2009 and 2012
- Council's operating result, excluding capital grants and contributions, forecasts a deteriorating deficit position over the entire LTFP
- Council's capital expenditure ratio is below benchmark for the entire forecast period
- Council has limited financial reserves
- Council's Cash Expense Ratio and Own Source Operating Ratio is forecast above benchmark for the entire forecast period
- Council has the capacity to incorporate a low level of further debt in addition to their current borrowings

We would also recommend that the following points be considered:

- Council's current LTFP needs to be reviewed to include a capital program that highlights Council's total funding requirements to achieve a sustainable position in respect of its assets. This is expected to present a forecast financial position that is significantly weaker than the current forecast results
- While Council's current forecast own source revenue is in a strong position Council is very reliant on rates income and SRV income. Any decline in this revenue stream such as reduced SRV income, will have a negative impact on Council's operating result. Council need to consider alternative revenue streams in particular ways of increasing their user fee and charges revenue to boost their operating performance and reduce reliance on rates income. This need will be further highlighted if Council revisit their LTFP to include the additional capital expenditure as noted above

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	8,919	8,510	8,278	7,938	4.8%	2.8%	4.3%
User charges and fees	1,194	629	776	982	89.8%	(18.9%)	(21.0%)
Interest and investment revenue	522	525	453	563	(0.6%)	15.9%	(19.5%)
Grants and contributions for operating purposes	1,002	828	701	709	21.0%	18.1%	(1.1%)
Other revenues	950	850	637	763	11.8%	33.4%	(16.5%)
Total revenue	12,587	11,342	10,845	10,955	11.0%	4.6%	(1.0%)
Expenses							
Employees	4,835	4,474	4,281	3,996	8.1%	4.5%	7.1%
Borrowing costs	57	76	96	114	(25.0%)	(20.8%)	(15.8%)
Materials and contract expenses	4,604	3,748	3,427	3,534	22.8%	9.4%	(3.0%)
Depreciation and amortisation	2,921	2,856	1,487	1,432	2.3%	92.1%	3.8%
Other expenses	1,875	1,896	1,904	1,891	(1.1%)	(0.4%)	0.7%
Total expenses	14,292	13,050	11,195	10,967	9.5%	16.6%	2.1%
Operating result (excluding capital grants and contributions)	(1,705)	(1,708)	(350)	(12)	0.2%	(388.0%)	(2816.7%)
Operating result (including capital grants and contributions)	(1,163)	(1,326)	556	555	12.3%	(338.5%)	0.2%

Table 2 - Items excluded from Income Statement

Excluded items				
Grants and contributions for capital purposes	542	382	906	567
Net gains/(losses) from the disposal of assets	0	0	16	(4)

Table 3 - Balance Sheet

Balance Sheet (\$'000s)	Year Ended 30 June				% annual change		
	2012	2011	2010	2009	2012	2011	2010
Current assets							
Cash and cash equivalents	9,242	9,201	9,459	10,484	0.4%	(2.7%)	(9.8%)
Investments	0	0	0	0	N/A	N/A	N/A
Receivables	1,161	982	701	569	18.2%	40.1%	23.2%
Inventories	51	69	58	52	(26.1%)	19.0%	11.5%
Other	154	191	180	245	(19.4%)	6.1%	(26.5%)
Total current assets	10,608	10,443	10,398	11,350	1.6%	0.4%	(8.4%)
Non-current assets							
Investments	0	0	0	0	N/A	N/A	N/A
Receivables	27	31	36	42	(12.9%)	(13.9%)	(14.3%)
Inventories	0	0	0	0	N/A	N/A	N/A
Infrastructure, property, plant & equipment	476,856	478,139	299,952	282,816	(0.3%)	59.4%	6.1%
Other	340	296	190	158	14.9%	55.8%	20.3%
Total non-current assets	477,223	478,466	300,178	283,016	(0.3%)	59.4%	6.1%
Total assets	487,831	488,909	310,576	294,366	(0.2%)	57.4%	5.5%
Current liabilities							
Payables	3,369	3,183	3,197	3,238	5.8%	(0.4%)	(1.3%)
Borrowings	399	378	358	339	5.6%	5.6%	5.6%
Provisions	1,539	1,306	1,231	1,047	17.8%	6.1%	17.6%
Total current liabilities	5,307	4,867	4,786	4,624	9.0%	1.7%	3.5%
Non-current liabilities							
Borrowings	270	669	1,047	1,405	(59.6%)	(36.1%)	(25.5%)
Provisions	32	30	25	20	6.7%	20.0%	25.0%
Total non-current liabilities	302	699	1,072	1,425	(56.8%)	(34.8%)	(24.8%)
Total liabilities	5,609	5,566	5,858	6,049	0.8%	(5.0%)	(3.2%)
Net assets	482,222	483,343	304,718	288,317	(0.2%)	58.6%	5.7%

Table 4-Cashflow

Cashflow Statement (\$'000s)	Year ended 30 June			
	2012	2011	2010	2009
Cashflows from operating activities	2,052	1,327	2,061	2,233
Cashflows from investing activities	(1,633)	(1,226)	(2,747)	(1,163)
Proceeds from borrowings and advances	0	0	0	0
Repayment of borrowings and advances	(378)	(358)	(339)	(321)
Cashflows from financing activities	(378)	(358)	(339)	(321)
Net increase/(decrease) in cash and equivalents	41	(257)	(1,025)	749
Cash and equivalents	9,242	9,201	9,459	10,484

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 2009², 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.

¹IPART “Revenue Framework for Local Government” December 2009 p.83

² DLG “Recognition of certain assets at fair value” March 2009

Depreciation of Infrastructure Assets

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

EBITDA

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

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.

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.